British American Tobacco

Delivering today Investing in tomorrow

Annual Report 2015

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British American Tobacco p.l.c. (No. 3407696)
Annual Report 2015

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 2015. 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.

More available online

www.bat.com/review2015 www.bat.com/investors BAT IR app

Overview

Our year in numbers

British American Tobacco is a global company with over 200 brands sold in more than 200 markets. With more than 50,000 people employed across the globe, we make the cigarettes chosen by around one in eight of the world's one billion adult smokers.

The foundations of our continuing success are built on the Group's diverse strengths – our strong brands, our innovation in new products and product categories, the geographic spread of the markets in which we operate and our talented people.

We are an innovative company with a proven strategy that continues to deliver value for our shareholders today whilst investing in tomorrow.

Group cigarette volume

663bn
-0.5%
2014: 667bn

Group share of Key Markets

+40 bps
bps = basis points
KPI

Global Drive Brands' (GDBs) cigarette volume

301bn
+8.5%

Global Drive and Strategic Brands' (GDSBs) total volume

323bn
+8.0%
KPI

Revenue

£13,104m
-6.2%
2014: £13,971m

Revenue at constant rates[1]

£14,720m
+5.4%
2014: £13,971m
KPI

Profit from operations

£4,557m
+0.2%
2014: £4,546m

Adjusted profit from operations[2] at constant rates[1]

£5,620m
+4.0% (+10% excl trans FX[3])
2014: £5,403m
KPI

Adjusted diluted earnings per share[2]

208.4p
+0.1%
2014: 208.1p
KPI

Adjusted diluted earnings per share[2] at constant rates[1]

229.1p
+10.1%
2014: 208.1p

Basic earnings per share

230.9p
+38.2%
2014: 167.1p

Total dividends per share

154.0p
+4.0%
2014: 148.1p

Cash generated from operations at constant rates[1]

£3,656m
+37%
2014: £2,660m
KPI

Free cash flow as a percentage of adjusted earnings

90%
2014: 64%

Total shareholder return (TSR) (compound annual growth rate)

10.2%
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. Constant currency provides the information based on a re-translation, at prior year exchange rates, of the current year information.
2. 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 35).
3. Estimate to exclude transactional foreign exchange.

We are a global business with a proud history

Our heritage

British American Tobacco was founded in 1902 and was first listed in 1912. Today, we are one of the top 10 companies on the London Stock Exchange. We also have a secondary listing on the Johannesburg Stock Exchange.

We make the cigarettes chosen by around one in eight of the world's one billion adult smokers and are market leaders in more than 55 countries.

We continue to deliver value to shareholders today while investing in our markets, our brands, our new product categories and our people to ensure a sustainable future for our business.

Our products

Traditional tobacco range

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

Next Generation Products

Investment in building a portfolio of innovative new tobacco and nicotine-based products continues alongside our traditional tobacco business. These Next Generation Products include: Vapour Products (e-cigarettes), battery-powered electronic devices which heat a solution to create a vapour which can be inhaled; Tobacco Heating Products, devices designed to work with specifically engineered cartridges, containing tobacco, to deliver a real tobacco taste and aroma; and Licensed Medicinal Products, licensed nicotine products to help smokers reduce, replace or stop.

see pages 13–15 to learn more

Our cigarette portfolio

Our Global Drive Brands comprise Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans. These famous brands continued to drive volume and share growth in our markets worldwide in 2015.

Our portfolio also comprises other popular international brands with strong market positions in many countries. It includes Vogue, Viceroy, Kool, Peter Stuyvesant, Craven A, Benson & Hedges, John Player Gold Leaf, State Express 555 and Shuang Xi.

32bn
Cigarette volume

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

59bn
Cigarette volume

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

92bn
Cigarette volume

Pall Mall
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.

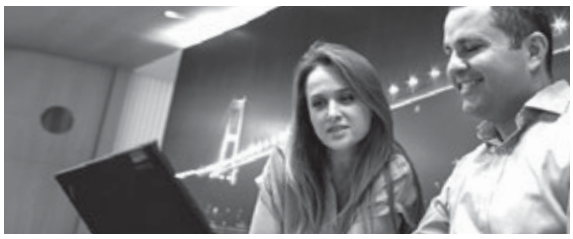
66bn
Cigarette volume

Kent
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.

52bn
Cigarette volume

Rothmans
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



We employ more than 50,000 people worldwide who work in an array of environments, from city offices to factories, from remote farms to research laboratories.

The international nature of our business is reflected in the diverse range of nationalities of our people – in 2015, for example, 69 nationalities were represented at our London head office.

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

see pages 18–21 to learn more

Our sustainable approach

Our Sustainability Agenda is about creating shared value for both our shareholders and our stakeholders in wider society, focusing on the three key areas which have the greatest significance to our business and our stakeholders:

- Harm reduction: We are committed to researching, developing and commercialising potentially 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 20–21 to learn more

Our geographic diversity

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

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

55+
countries where we are market leader

44
factories in 41 countries producing cigarettes and Other Tobacco Products

Americas
Argentina
Brazil
Canada
Chile
Colombia
Mexico

see page 25 to learn more

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

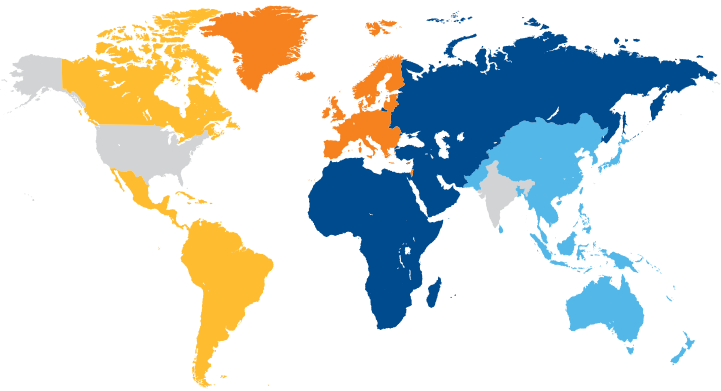
see page 26 to learn more

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

see page 27 to learn more

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

see page 24 to learn more



Overview

Chairman's introduction

Excellent underlying performance

"Your Company continued to perform very strongly in 2015, despite challenging conditions persisting across many markets"

Richard Burrows
Chairman

Welcome to our Annual Report for 2015. Your Company continued to perform very strongly in 2015, despite challenging conditions persisting across many markets.

At constant rates of exchange, the Group delivered adjusted diluted earnings of 229.1p per share, an increase of 10.1% on 2014.

Reported adjusted diluted earnings were 208.4p per share, an increase of 0.1% on 2014 as our excellent underlying performance was offset by the impact of currency fluctuations on our reported results.

We also delivered outstanding overall market share growth of over 40 bps across our Key Markets, driven by the excellent performance of our Global Drive Brands which grew by 8.5% and increased adjusted operating profit, at constant rates of exchange, by 4%.

We aim to consistently deliver shareholder value

We remain very confident in our future. As such we are proposing a 4% increase in the final dividend to 104.6p per share. This takes the total dividend for 2015 to 154.0p.

If approved at our Annual General Meeting (AGM), the final dividend will be paid on 5 May 2016 to shareholders on the register on 18 March 2016.

Sustainable growth

For us, sustainability is not a choice or something that is nice to have, it is crucial to securing the future of our business by creating shared value for consumers, our customers and our shareholders.

That is why, in addition to our continued investment in our traditional brands, our high growth markets, our systems and our people, we developed our Sustainability Agenda, focusing on tobacco harm reduction, sustainable agriculture and farmer livelihoods, and corporate behaviour. This ensures we have an ongoing focus on the matters which have the most relevance for our stakeholders and consequently the future health of our business.

Our 2015 activities in these areas are covered in greater depth within our Sustainability Summary report, which can be read separately. You can download this report from our corporate website at www.bat.com/sustainability.

Strategic investments in tobacco and beyond

Our commitment to delivering long-term value to our shareholders extends beyond investments in existing businesses and driving operational efficiencies. In 2015, we also completed a number of investments and strategic partnerships which enhance our opportunities for future growth.

We completed the acquisition of TDR in Croatia, the leading independent cigarette manufacturer in Central Europe. We acquired the rest of the shares in our Brazilian subsidiary, Souza Cruz, not currently owned by the Group and de-listed the company. We also concluded the investment of US$4.7 billion to maintain our 42% stake in the enlarged, and substantially stronger, Reynolds American Inc., following its purchase of Lorillard Inc.

In addition, further signalling our commitment to leading in Next Generation Products, we signed a vapour products technology-sharing agreement with R.J. Reynolds Tobacco Company and completed the acquisition of the CHIC Group, the market-leading Vapour Product (e-cigarette) business in Poland.

Board changes

I am pleased to report that we maintain our strong record on Board diversity, both in terms of gender and in the wide range of relevant backgrounds and nationalities represented among our Directors.

There are two proposed changes to the Board which will take effect from the conclusion of the forthcoming AGM. Karen de Segundo has indicated that she will be retiring from the Board at the end of this year's AGM on 27 April 2016, having served for eight years on the Board, nearly seven of which as Chairman of the Corporate and Social Responsibility Committee. Dr Richard Tubb will also retire from the Board at the conclusion of the AGM, having served as a Non-Executive Director since January 2013.

The right strategy for a sustainable future

Reflecting on the success of 2015, let me express my thanks and appreciation to my fellow Directors on the Board, to our Chief Executive, Nicandro Durante, to management and to all our colleagues across the globe.

Looking to the future, I am confident that we have the right strategic focus, people and resources to deliver continued growth in the years ahead.

Richard Burrows
Chairman

Download our Sustainability Summary report at www.bat.com/sustainability

Strategic management

Chief Executive's review

A strategy that consistently delivers

"We delivered outstanding results in 2015, against a very challenging external environment"

Nicandro Durante
Chief Executive

2015 was further proof that our strategy remains the right one to consistently deliver for shareholders.

We delivered outstanding results in 2015, against a very challenging external environment and with significant adverse transactional foreign exchange rate movements.

Driven by a very strong second half of the year, with cigarette volume higher by 1.7%, total Group cigarette volume for the full year was down only 0.5%, to 663 billion. This was significantly better than the overall estimated industry decline of 2.3%. After excluding the impact of the TDR acquisition, organic cigarette volume decline was still ahead of the market at 0.8%.

Market share in our Key Markets increased by over 40 bps. This was driven by an excellent performance from our Global Drive Brands, which grew volume by an exceptional 8.5% and increased market share by 120 bps.

At constant rates of exchange, we grew revenue by 5.4%, adjusted profit from operations by 4.0% and adjusted diluted earnings per share by 10.1%. Excluding the significant transactional effect of foreign exchange on the cost of raw materials and leaf, adjusted profit from operations would have grown by approximately 10%.

Price mix of 5.9% was up from 4.2% in 2014. Underlying operating margin grew by around 160 bps, although on a reported basis it was down by 60 bps to 38.1%. This was largely due to the adverse transactional impact of unfavourable foreign exchange described above.

These excellent results in 2015 are once again proof of the strength of our strategy. They were achieved despite unprecedented adverse exchange rate movements and continuing pressure on consumers' disposable income.

Continuing progress in Next Generation Products

We are confident that Next Generation Products can deliver a substantial and sustainable commercial return to shareholders over the long term.

In 2015, we continued to grow market share of Vype, our e-cigarette brand, in the UK where we launched three new products and a range of new e-liquid flavours. We also expanded the geographical footprint of our Next Generation Product business beyond the UK, with launches of Vype in France, Germany, Italy, Poland and Colombia. Additionally, our first Tobacco Heating Product, the 'glo iFuse', was launched in Romania, with excellent initial levels of consumer acceptance.

We also continued our R&D focus on building a high quality pipeline of products across three distinct Next Generation Product categories – Vapour Products (e-cigarettes), Tobacco Heating Products and Licensed Medicinal Products.

Progress is encouraging and our ambition is to lead the category worldwide.

Our approach to better regulation

We have always been clear that we 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.

That is why, on issues such as the regulation of Next Generation Products, we have been working with governments and regulators to ensure appropriate frameworks are in place to protect consumers whilst ensuring proper marketing freedoms exist. This will help grow the category and meet the demand for less risky alternatives to smoking. An example of this work is our collaborative approach with the national standards bodies in France and in the UK to establish voluntary standards for Vapour Products (e-cigarettes).

With respect to plain packaging, we have always believed that the policy is not proportionate, will not deliver the intended results and will significantly erode our Intellectual Property Rights. Consequently, we have reluctantly taken legal action to protect shareholders' interests.

Our strategy continues to deliver

Since we updated the Group Strategy in 2011, we have seen the business continue to perform strongly. We have increased our share of the global cigarette market and significantly grown share in key market segments. Our Global Drive Brands have grown year on year, accounting now for 45% of all Group cigarettes sold (up from 34% in 2011) and they continue to be a key pillar for future growth.

In 2016 we expect the trading environment to remain challenging but our resilient business model has shown the Group is well placed to face future challenges. As such, I am confident that we have the right brands, people and focus on efficiency to enable the continued delivery of value to shareholders.

Nicandro Durante
Chief Executive

Strategic management

Our vision and strategy

Our strategy enables our business to deliver growth today, while ensuring we generate the funds to invest in our future. Tobacco remains at the core of our business and will continue to provide us with opportunities for growth. We are also committed to leading the Next Generation Product category globally.

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 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 13
Developing brands, innovations and new products to meet consumers' evolving needs.

Productivity page 16
Effectively deploying resources to increase profits and generate funds for investment.

Winning organisation page 18
Ensuring we have great people, great teams and a great place to work.

Sustainability page 20
Ensuring a sustainable business that meets stakeholders' expectations.

Read about our industry page 12

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 approximately 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

Our business model

What we do

At the heart of our business is the manufacturing and marketing of superior cigarettes, Other 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 more than 50,000 people worldwide, engaged in securing our leaf supply through production and distribution, as well as our efforts to develop new products.

Our workforce is diverse, multicultural and we have a devolved structure, with each local company having responsibility for its operations.

We encourage a culture of personal ownership and value our employees' talents and abilities. Their diverse perspectives help enable 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 whilst recognising unintended consequences.

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

see pages 13–21 for more information

Source

What we do

Whilst the Group does not own tobacco farms or directly employ farmers, we buy more than 400,000 tonnes of tobacco each year from some 90,000 contracted farmers and third-party suppliers, mainly in developing countries and emerging economies in Africa, Asia and Latin America.

What makes us different

- We provide on-the-ground support and advice to our 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.
- Our Social Responsibility in Tobacco Production programme encourages continual improvement of suppliers' social and environmental performance.

see pages 37–44

Market

What we do

We offer adult consumers a range of products, including: cigarettes and cigars, 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 45% 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 (e-cigarettes), Tobacco Heating Products and Licensed Medicinal Products, enables us to meet varied consumer needs in this emerging product category.

see pages 37–44

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 while addressing expectations about how we should market our products.

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. 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 2015 we had 44 factories across the globe producing cigarettes and Other Tobacco Products. 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.

see pages 37–44

Distribute

What we do

We distribute our products around the globe effectively and efficiently. Around half of our global volume is sold by retailers, supplied through our direct distribution capability or exclusive distributors. We continuously review our route to market, 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 37–44

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, tube filters and Reloc, our resealable pack technology. We also look outside the traditional cigarette market and research, develop and test innovative products such as Vapour Products (e-cigarettes), Tobacco Heating Products and Licensed Medicinal Products.

World-class science

We have an extensive scientific research programme. We have spent more than £460 million on research and development over the past three years. 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 13–21 for more information

Strategic management

Industry insight

The global tobacco industry sells around 5,600 billion cigarettes each year and generates an estimated £450-£500 billion in net sales. The market is also one of the most highly regulated in the world, with tobacco subject to extensive, and often differing product, and taxation requirements in different markets.

Global economic uncertainty

The global economic recovery remains fragile, with the pace of growth slower than anticipated.

In some major markets across the globe, unemployment has levelled off to around pre-recession levels but real disposable income is yet to do so. Such economic weakness is attributable to a number of factors, including mounting debt levels in some emerging economies and continuing weak import demand, particularly among higher-income countries. Short-term pressures in some countries, including volatile foreign exchange movements, are likely to continue.

Resilience of tobacco continues

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

While cigarette sales in developed countries continue to decline year on year, sustained volume growth is widely predicted in emerging markets.

Notwithstanding the prevailing macro-economic fragility, the overall value of the tobacco industry is expected to continue growing in the future, with the ability to drive profits through good pricing remaining.

The resilience of the industry is underlined by the continued year-on-year net revenue growth, at constant rates of exchange.

Industry-specific risks

There remain a number of industry-specific risks which the industry continues to monitor, manage and mitigate.

Excise, which remains a significant source of revenue to the majority of governments worldwide, leads many to view the industry as a potential source of extra funds during difficult economic times. It is estimated that those governments collect an estimated £150 billion in excise on the sale of tobacco each year.

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 tobacco market remains a concern globally, with increases seen across many markets. Whilst there is evidence that the increase in government enforcement in some countries is beginning to yield results, the global illegal market still accounts for some 600 billion cigarettes and deprives national treasuries of around £30 billion in legitimate taxes.

Regulatory challenges continue to 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.

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 which 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.

Growth in tobacco and beyond

The combustible market is likely to be the mainstay of the industry's profits for some years to come, but Next Generation Products, such as Vapour Products (e-cigarettes) and Tobacco Heating Products, are constantly advancing, both in terms of technology and market growth.

Growth in these products continues to be strong. In 2015, globally, sales of Vapour Products are expected to have grown to US$6.1 billion, up from US$3.9 billion in 2014, according to data from Euromonitor International. That growth trend is expected to continue through to 2020. Vapour Products are expected to account for the majority of that growth.

There remains a lack of consensus on the best way to regulate these products. However, the industry is working to help ensure that sensible and consistent regulatory frameworks exist to foster further growth in this emerging product category.

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 38–44 to learn more about the Principal Group risk factors

Strategic management

Delivering our strategy

Growth

Our brands delivered further growth in 2015 as we continued to invest in opportunities in Key Markets and Next Generation Products.

Highlights during the year

- Group revenue grew by 5.4% at constant rates of exchange.
- Volume growth achieved across all Global Drive Brands – up 8.5% on 2014.
- Price mix of 5.9% up from 4.2% in 2014.
- Market share in Key Markets up by over 40 bps.
- Absolute volume growth achieved in three of our four regions.
- Launched Vype, our Vapour Products (e-cigarette) brand in Italy, France, Poland, Germany and Colombia.
- Completed €550 million acquisition of TDR in Croatia, the leading independent cigarette manufacturer in Central Europe.

Winning in combustibles

The Group grew revenue by 5.4% at constant rates of exchange, driven by a price mix of 5.9%. Revenue decreased by 6.2% at current rates of exchange, impacted substantially by adverse exchange rate movements.

Our combustible brands delivered significant further share growth in 2015, with another strong performance from all of our Global Drive Brands (GDBs) – Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans – which grew volume by 8.5% overall and market share by 120 bps.

Dunhill

Dunhill volume increased by 6.0% to 59 billion, with market share higher by 30 bps, driven mainly by strong performances in Indonesia, Brazil and South Africa, offsetting lower volume in South Korea, Malaysia and Russia.

Key performance indicators

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

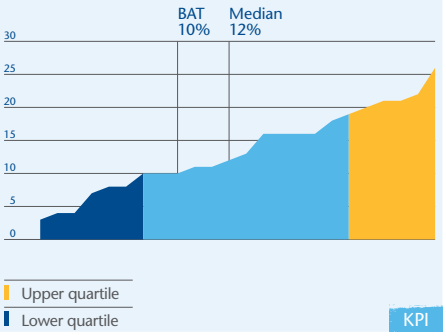
10.2%

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 80 for details). The FMCG comparator group is reviewed annually to ensure it remains both relevant and representative.

KPI

FMCG group – 1 January 2013 to 31 December 2015
The FMCG group comparison is based on three months' average values



KPI

Revenue at constant exchange rates

£14,720m
+5.4%

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.

KPI

Group share of Key Markets
(increase in % share)

+40 bps

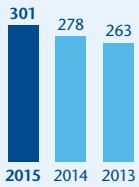
Definition: This is our retail market share in the Group's Key Markets, which cover around 80% of the volumes of subsidiaries.

Target: To continue to grow market share.

KPI

Global Drive Brands' (GDBs) cigarette volume
(bn)

301bn
+8.5%

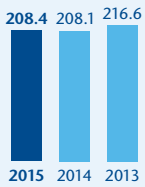


Definition: GDB volume is calculated as the total volumes of the five GDBs sold by our subsidiaries.

Target: To increase our GDBs' share faster than the rest of our portfolio. 2013 figures have been re-stated to include Rothmans' volume.

Adjusted diluted earnings per share at current rates
(pence)

208.4p
+0.1%



Definition: This is our adjusted diluted earnings per share (EPS) – the detail of the calculation and adjustments are explained in 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

Strategic management

Delivering our strategy continued

Growth continued

Winning in combustibles cont'd

Kent

Kent's volume in 2015 was 66 billion, up by 3.3% as volume growth in Iran, Turkey, Japan and Chile was partly offset by lower volume in Russia and Ukraine. Market share was flat.

Lucky Strike

Lucky Strike's market share grew 10 bps, with volume of 32 billion, up 3.7%, with increases in Belgium, France and Chile more than offsetting decreases in Russia and Argentina.

Pall Mall

Pall Mall's volume in 2015 was 92 billion, up 0.4% as growth in Pakistan, Venezuela, Poland and Mexico was partly offset by the effect of the brand migration to Rothmans in Italy. Market share was up 10 bps.

Rothmans

Rothmans had exceptional growth of 46.5%, with volume of 52 billion, led by strong performances in Russia, Ukraine, Turkey, Italy, Kazakhstan, Australia, Algeria and the UK. Market share was up 70 bps.

Premium products

The Group's share of the premium segment was up 120 bps. Volume was marginally down on 2014, by 0.1% to 180 billion, largely due to declines in Russia, Malaysia and Brazil. Despite this overall decline, good growth was seen in Indonesia, Vietnam and South Korea.

Local and international brands

Our other international brands (down 6.8%) include Vogue, Viceroy, Kool, Peter Stuyvesant, Benson & Hedges, State Express 555, Shuang Xi and John Player Gold Leaf. These, in conjunction with our local brands (down 8.8%), continue to play an important role in a number of our Key Markets, including South Africa, Vietnam, Pakistan, Bangladesh and Japan.

Innovations

Innovations grew by 14% in 2015, mainly driven by Tubes and Slimmer products, and now account for 26% of the Group's total reported cigarettes volume. Innovations' share of Global Drive Brand volume was 51.3%.

Other Tobacco Products

Other Tobacco Products volume fell by 4.1% to 26 billion sticks equivalent due to a reduction in Fine Cut volume in Western Europe. Pall Mall remains the number one Fine Cut brand in Western Europe.

Enhancing our position in high growth markets and through strategic investments

High growth markets

Market share in our Key Markets was higher by over 40 bps in 2015, driven by further brand investment and the roll-out of new and innovative products in markets such as South Korea, Mexico, Indonesia, Japan, Malaysia, France, Ukraine, Turkey, UK, Bangladesh and Pakistan.

Acquisitions

During 2015, we completed the acquisition of TDR in Croatia, the leading independent cigarette manufacturer in Central Europe. See case study below for further details.

The Group also acquired the rest of the shares in our Brazilian subsidiary, Souza Cruz S.A., not currently owned by the Group and de-listed the company.

Additionally, the Group concluded the investment of US$4.7 billion to maintain our 42% stake in the enlarged, and substantially stronger, Reynolds American Inc. following its purchase of Lorillard Inc.

Case study

Winning in combustibles – Innovation in Japan

Challenge

To increase sales and market share in Japan, a Key Market for the Group, where innovations remain a key competitive lever.

What we did

With even greater focus on the consumer, we delivered transformational innovations including tube filters, novel flavour capsules in super slim and double flavour capsules.

Outcome

The market delivered consistent market share growth over a number of months, with Kent becoming the fastest growing brand in Japan for two consecutive years. Refined brand strategies for Kent and Kool were also implemented, with a robust innovation pipeline and new consumer activation.

Case study

Enhancing our position in high growth markets – Acquisition of TDR

Challenge

To provide immediate scale and establish a sustainable platform to grow our business in the Balkans, where we have previously had limited market share.

What we did

The Group acquired TDR and other tobacco and retail assets from Adris Grupa for €550 million.

Outcome

By combining its existing business in the region together with TDR, the Group acquired immediate scale in the core markets of Croatia, Bosnia and Serbia – adding 1.8 billion cigarettes to Group volumes in 2015. The Group expects to further benefit from highly skilled people, well established brands, enhanced regional leaf processing capabilities, a local high quality factory and print facility, and strong relationships with distributors and retailers in these markets.

Next Generation Products

We are confident that Next Generation Products can deliver a substantial and sustainable commercial return to shareholders over the long term. Our ambition is to lead the Next Generation Product category worldwide.

Our approach to this emerging product category encompasses a number of key drivers. The Group continues to invest in a sustainable pipeline of high-quality Next Generation Products to give consumers a choice of potentially less risky alternatives to smoking. We are also continuing our efforts, through robust science, to set the bar on product safety and quality. Additionally, we are supporting the development of suitable regulations, sharing our own research and approach, implementing globally responsible marketing practices, and collaborating with regulators and standards authorities.

Investing in a sustainable pipeline of products

In the Vapour Products (e-cigarettes) segment, since the launch, in 2013, of our Vype brand in the UK, we have developed the range, adding new flavours and devices, such as the eTank, a refillable device.

In 2015, we launched Vype in five further markets – Italy, France, Poland, Germany and Colombia.

We also launched our first Tobacco Heating Product, 'glo iFuse', in Romania, in 2015. This is an electronic device that heats a nicotine-containing liquid into an inhalable vapour, which then passes through a tobacco section, releasing tobacco flavour to the consumer.

In the Licensed Medicinal Products segment, we were the first tobacco company to have a nicotine product licensed as a medicine. This was following receipt of the relevant licences from the UK medicines regulator for our innovative nicotine inhaler, Voke.

We expect Voke will be launched in 2016.

Setting the bar on product safety and quality

Given concerns regarding consumer safety and uncertainty about how new products should be regulated, we think it is crucial for consistent product standards and marketing rules to be implemented.

Case study

Leading Next Generation Products – Responsibly meeting consumer needs in the online world

Challenge

Online sales form an important component of the Vapour Products (e-cigarettes) business. Currently there are no universally agreed standards for online age verification for access to age-restricted products and services and we believe these need to exist.

What we did

The Group worked with a global provider of online age-verification solutions and implemented them through our govype.com websites in the UK and subsequent launch markets. We also became members of the Digital Policy Alliance (DPA) – a Westminster-based industry and policymakers group, to support the creation of credible standards for online age verification.

Outcome

In 2015, the UK Department of Health acknowledged the need for businesses selling into the UK to demonstrate an electronic age-verification scheme that unambiguously confirms the consumer's age. Technical and policy experts from the Group have been invited to sit on the steering committee with the UK national standards body, the British Standards Institution, to establish standards for an online age-verification process which will help prevent youth access to Vapour Products. The work the Group has carried out in this area, through its work on govype.com, and working with relevant stakeholders, positions the business for responsible future growth in online sales of our Vapour Products.

We have robust product assessment procedures in place, facilitated by cutting-edge science and peer-reviewed research. This includes our research published in 2015 on toxicological risk assessments of e-liquid flavours and ingredients, and tests to investigate the effects of vapour in Next Generation Products compared with cigarette smoke.

Supporting the development of regulation

The Group would like to see high product standards across the whole industry, so we continue to advocate for, and collaboratively develop, consistent national and international standards and regulation.

In 2015, we worked with the British Standards Institution, and AFNOR, the French standards association, to develop new voluntary standards for Vapour Products.

We are also looking carefully at the responsible sale and marketing of Vapour Products online. Further information on these activities can be found in the case study above.

Acquisitions and partnerships

Reinforcing the Group's commitment to leading in Next Generation Products, we signed a technology-sharing agreement with R.J. Reynolds Tobacco Company in 2015.

The agreement provides a framework for collaboration and mutual cross-licensing of the parties' vapour product technologies up to 31 December 2022.

Additionally in 2015, the Group completed its acquisition of the CHIC Group, the market-leading Vapour Product business in Poland.

The CHIC Group has 800 points of sale in Poland. Additionally, it has a dedicated e-liquids production facility, a modern research and development centre and leading Polish e-cigarette brands including VOLISH, P1, Provog, Cottien, LiQueen and Aromativ. As such, we have gained access to Europe's largest Vapour Products (e-cigarettes) retailing network.

Further information on our work in all these areas can be found in our Sustainability Summary report, available at www.bat.com/sustainability.

Strategic management

Delivering our strategy continued

Productivity

We are driving a more efficient and effective globally integrated organisation, with global systems and ways of working, a responsive supply chain and a long-established approach to securing the highest quality leaf for our products.

Highlights during the year

- Continued optimisation of our manufacturing operations, with 80% of our tobacco coming from our strategic sources in 2015, up from 65% in 2011.
- TaO operating model, supported by a global SAP template, so far implemented in 180 markets, 40 factories and 25,000 users within a period of two years and three months.
- Accelerated roll-out of innovations, including capsules, double capsules and novel flavours, now deployed in over 100 markets across the globe.

Key performance indicators

Adjusted profit from operations at constant exchange rates

£5,620m
+4.0%
(+10% excluding transactional FX)

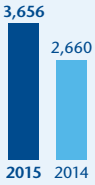
Definition: This is the adjusted profit from operations of the Group's subsidiaries – profit from operations at constant rates adjusted for the items shown as memorandum information on the Group Income Statement.

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

£3,656m
+37%



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 33.

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

KPI

Business measures

Operating margin

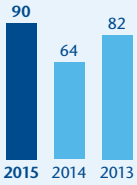
38.1%
-60 bps

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.

Free cash flow as a percentage of adjusted earnings

90%



Definition: This measures our free cash flow (see page 33) per share as a ratio of the adjusted diluted earnings per share.

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

Enhancing and streamlining our supply chain

The Group operates a globally integrated supply chain delivering market-leading products and innovations to our markets to satisfy consumers, drive share growth and create value for our business partners.

2015 has seen an accelerated global roll-out of tube filter innovations along with the continued roll-out of capsules, including novel flavours and double capsules products, along with excellent growth of demi-slims products in a number of Key Markets.

Continued strategic investment in new machinery in 2015 supported by our global planning systems and integrated business model has ensured we deliver 'on time in full' in all our Key Markets at optimal cost, with speed and scale.

Having a clear global view of our plans means we can allocate resources in the right areas. It also improves our ability to react quickly in situations when speed to market will give us a competitive advantage.

We continued to optimise our manufacturing operations in 2015 and at the end of the year had 44 factories producing cigarettes and Other Tobacco Products.

We are continually looking to improve the efficiency of our supply chain. Last year we launched Integrated Work Systems, a new programme designed to maximise productivity and flexibility in our factories while ensuring we maintain high standards of product quality.

In 2015, we also continued to drive cost savings in our supply chain in areas such as leaf and blends, wrapping materials, logistics, manufacturing and indirect procurement.

Savings such as these not only enhance our profitability, but also release funds to invest in activities that will deliver sustainable growth.

Integrated efficiencies

In order to become a more globally integrated enterprise, the Group decided to bring all its entities onto the same SAP-based enterprise resource planning system. The aim of 'Programme TaO' was to create a standard operating model, harmonise business processes and instil common ways of working across the Group. This will enable the Group to extend its use of shared services, drive cost efficiencies, increase its business agility and exploit further transformation opportunities across the Group. For an example of this, please see the Group Treasury case study on the right of this page.

TaO is a complex programme involving all functions across the business. In just two years and three months, the new Global platform has been implemented in over 180 markets and 40 factories. More than 25,000 employees use the new systems and global processes.

By harnessing the expertise of the IT function and business users across every region and market, this ambitious global transformation programme has been implemented successfully on time and on budget.

Working with farmers to secure access to high-quality leaf

It is crucial to our business to ensure we have secure and sustainable sources of high-quality leaf. This helps enable delivery of the Group's strategic focus on delivering superior products to our consumers.

The Group operates a fully integrated tobacco model encompassing research, growing, buying, processing, sourcing and deployment. This ensures the business is effective in the way it manages the overall asset base, sustainable sourcing footprint, farmers and key suppliers while ensuring we are able to deliver a robust leaf innovation pipeline.

Whilst the Group does not own tobacco farms or directly employ farmers, we buy more than 400,000 tonnes of tobacco each year from some 90,000 contracted farmers and third-party suppliers mainly in developing countries and emerging economies in Africa, Asia and Latin America.

We invest more than £60 million each year to support farmers with more than 1,000 leaf technicians providing advice and training for farmers worldwide, who also benefit from our cutting-edge research into tobacco plants and agronomic practices.

This integrated approach not only benefits farmers today but helps to encourage future generations whilst ensuring the quality and integrity of the tobacco we buy.

Working together to strengthen industry-wide supplier standards

Our Social Responsibility in Tobacco Production (SRTP) programme sets out the minimum requirements we expect of our suppliers. We first developed it over 15 years ago and have shared it with a number of other tobacco companies.

Over the years, we have worked to continually strengthen and evolve the programme. As part of this, in 2015, we worked as part of an industry initiative to collaborate on the development of a new Sustainable Tobacco Programme, which will replace SRTP later in 2016.

The new programme will apply to all the major global tobacco manufacturers and 100% of their suppliers. It draws on best practice from across the industry and external standards, such as those of the International Labor Organization (ILO) and the UN Guiding Principles on Business and Human Rights. It also includes additional enhancements to deal with future challenges and stronger processes, such as more frequent on-site reviews and a defined approach to risk assessment.

Continuing to focus on improving our productivity

While transactional foreign exchange rates had a material impact on our cost base in 2015, by continuing to improve our productivity in all areas of our supply chain, we can increase our profitability and continue to deliver returns to our shareholders today.

But it is not just about today; it also underpins our future. The more efficient and effective we become, the more we are able to generate funds to invest in the things that will fuel future growth: our products, our innovations, our people, our markets and our Next Generation Products.

Case study

Programme TaO – Group Treasury

Challenge

To ensure access to consolidated and accurate information and to drive further efficiencies within the Treasury function, the role of which is to raise finance for the Group, manage its cash resources and the financial risks arising from underlying operations.

What we did

Central Treasury was part of the Programme TaO pilot that went live in September 2012. Since then, TaO has enabled Treasury to implement a centralised operation with global reach; operating across three time zones in partnership with the Marketing and Finance Shared Services Centres.

Outcome

The new global system replaced a standalone system with notable improvements. The change will bring substantial direct benefits, driven from enhanced analytics capabilities and more accurate and timely information. Additional benefits will continue to be realised, with a better and faster view of cash meaning we can use cheaper sources of funding. For example, the Group was able to triple the use of cheaper short-term borrowings in 2015.

Strategic management

Delivering our strategy continued

Winning organisation

A winning organisation is one with high-performing leaders inspiring diverse teams of committed and engaged people in a fulfilling, rewarding and responsible work environment.

Highlights during the year

- Accelerated the capability enhancement of our senior leaders through new development programmes in conjunction with leading business schools.
- Enhanced the content and scale of our graduate intake programme.
- Increased the digital reach and reputation of our employer brand 'Bring your Difference'.

Business measures

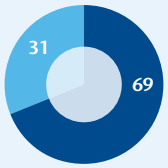
Group diversity

	Total	Male	Female
Main Board	**13**	9	4
Senior managers*	**212**	183	29
Total Group employees	**50,599**	37,132	13,467

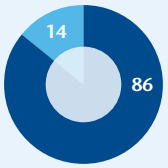
Nationalities represented

	Total
Main Board level	**8**
Global headquarters	**69**
Management level globally	**138**

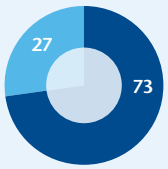
Main Board



Senior managers



Total Group employees



% Male
% Female

Employee engagement index

72%

BAT	72%
FMCG Comparator group	69%

Definition: Results from our biennial '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 2015.

Investing in leaders

The quality of our people is a major reason why the Group continues to perform well. In return, we commit to invest as much time and energy in our people as we do our brands.

The way our people operate is embodied in our four Guiding Principles: Enterprising Spirit, Freedom Through Responsibility, Open Minded and Strength from Diversity. These principles underpin our culture and guide how we deliver our strategy.

The culture of the Group is about developing talent from within, stretching and supporting the high-performing managers who will lead the delivery of our strategy. This year over 80% 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 2015, we invested in two core areas: accelerating the capability enhancement of our senior leaders through new development programmes in conjunction with leading business schools; and enhancing the content and scale of our graduate intake programme to strengthen the commercial experience and acumen of tomorrow's leaders.

Attracting the best talent

When we do recruit externally, we seek to bring in people who will provide additional knowledge and skills that will strengthen our teams and ultimately make us a stronger business. In 2015, we championed a talent culture shift, increasing the digital reach and reputation of our employer brand 'Bring your Difference' across core social media channels, achieving industry leadership of our talent brand on LinkedIn.

We continue to raise our engagement with key talent pools about the opportunities within our business. With a view to the future, we have run targeted campaigns and searches focusing on future capabilities to strengthen our expertise and representation in growth markets.

Safe place to work

The Group sets a goal of zero accidents and is committed to providing a safe working environment for all our employees and contractors.

Our people work in a diverse range of environments and conditions, from city offices to remote farms. Thousands also work in distribution and sales, often spending long periods on the road when they are vulnerable to road traffic accidents, particularly in developing countries where the transport infrastructure can be poor.

To reduce the main causes of accidents and serious injuries, we focus on risk management and assessments, and in 2015 we further rolled out our enhanced driver safety programme. As a result, while total accidents across the Group have remained relatively steady with a small 1.7% reduction, we have achieved a 15% reduction in road traffic accidents. Sadly, however, six members of the public lost their lives in accidents involving our vehicles, and one contractor died in a road accident. In addition, six contractors died as a result of armed attacks.

We deeply regret this loss of life and the suffering caused. We carry out reviews of all reported accidents and fatalities to learn lessons and identify actions to reduce the chances of similar events happening again.

Diversity for growth

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 consumers in more than 200 markets.

We are proud to have joined the 30% Club – an organisation focused on enabling growth through diversity. Recruitment searches have been directed where we see mismatches in our employee profile compared with our consumer profile – ensuring that we are addressing both current need and the talent pipeline for future opportunities.

The tables on page 18 set out the nationality representation and gender breakdown within the Group as at 31 December 2015, comparing numbers for all employees, our most senior managers and the Main Board. Our specific diversity ambition is to achieve by 2020 a sustainable improvement in senior representation of women and nationalities which is key to our success.

The Group's broad geographic presence means we are well placed to attract talented people from many different countries and diverse nationalities are widely represented across the business, including at Board level.

Case study

Women in Leadership programme

Challenge

To better support career progression of female talent within the Group, to unlock their full potential and develop inclusive leadership further whilst better representing a core adult consumer base.

What we did

We established a coaching programme delivered in three phases over a period of six to nine months for high potential female employees. It involves line managers who work with the delegates throughout the programme. The programme is facilitated by an external executive coaching consultancy that specialises in developing and optimising female talent.

Outcome

The programme has enabled the acceleration of performance of female talent. Since 2013 we have had five waves of the programme, with 144 female managers attending in total. Delegates from major Group locations have been involved, representing all functions within the company. In 2015 alone, the Group ran two waves of the programme, with 50 women identified as high-potential managers taking part. In establishing this programme, we have: engaged female talent sooner in their careers to unlock their full potential; helped them navigate towards more inclusive leadership; strengthened networking; and continued to address gender diversity at senior levels across the Group.

We commit to provide 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

We believe strongly in the need to recognise excellence and, whilst we have a number of recognition schemes globally, 2015 saw the launch across Western Europe of a recognition platform to enable managers and peers to recognise colleagues. This platform will continue to be rolled out across the Group in 2016 as part of our commitment to ensuring our people feel valued.

Additionally, we regularly review our remuneration policy to reward our employees to drive the strategic fundamentals of the business. Further information on the Group's Remuneration Policy for the Executive Directors and the Non-Executive Directors can be found on pages 67–112.

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

Engagement for change

To win we must evolve, and as our organisation evolves we focus on our culture of passionate owners, having people who lead and inspire each other for the journey ahead.

Our most recent employee survey in 2014 had a response rate of 93% – 11 percentage points higher than the average response rate for this type of survey of FMCG peers and one percentage point up on our previous survey in 2012. Our Employee Engagement Index score of 72% was ahead of a FMCG comparator norm of 69%. Broadly, this index combines employee satisfaction with their attitudes towards recommending us as a place to work, their desire to stay and their pride in working for us.

Our High Performance Index score of 72% indicates our continued focus on leadership and talent development is supporting our high-performance culture.

Strategic management

Delivering our strategy continued

Sustainability

Sustainability is a key pillar of our Group strategy and has always played a fundamental role within our business.

Our Sustainability Agenda focuses on the three key areas which have the greatest significance to our business and our stakeholders, in addition to adhering to good environmental practices.

Highlights during the year

- Included for the 14th consecutive year in the Dow Jones Sustainability Indices, maintaining our position as industry leader.
- Worked as part of an industry-wide initiative to strengthen standards for tobacco leaf suppliers.
- Developed our new Supplier Code of Conduct which clearly defines the minimum human rights standards we expect of all our suppliers worldwide.
- Made significant progress against our environmental targets, with a 48% reduction in CO_2e emissions from our 2000 baseline.

Business measures

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

0.79

48% lower than 2000 baseline

Definition: We track Group CO_2e in tonnes per million cigarettes equivalent produced.

Target: To reduce Group CO_2e (see above) by 50% by 2030 from our 2000 baseline of 1.52 and by 80% by 2050.

Group energy use
(gigajoules per million cigarettes equivalent produced)

9.75

17.5% lower than 2007 baseline

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

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

Water use
(cubic metres per million cigarettes equivalent produced)

3.56

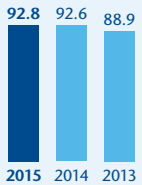
26.6% lower than 2007 baseline

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

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

Recycling
(percentage of waste recycled)

92.8%



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

Objective: To recycle more than 85% of waste generated (see above) in each year.

Sustainability reporting

Find out more about our focus on sustainability in our Sustainability Summary report 2015.

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

Harm reduction

Our approach

- Investing in a sustainable pipeline of high-quality Next Generation Products that consumers can trust.
- Setting the bar on high product standards, based on robust science and implementing globally responsible marketing practices.
- Supporting the development of regulation for Next Generation Products by sharing our own research and approach, and collaborating with regulators and standards authorities.

We are committed to researching, developing and commercialising potentially less risky alternatives to regular cigarettes as a fundamental part of our vision to satisfy consumers in tobacco and beyond.

In 2015, the Group made significant progress in the development of Vapour Products (e-cigarettes), Tobacco Heating Products and Licensed Medicinal Products.

You can read more about these products and our approach to them in the Growth section of this Strategic Report (page 15).

Sustainable agriculture and farmer livelihoods

Our approach

- Supporting farmers' livelihoods across five focus areas of: farm income; natural resources; skills knowledge and labour; infrastructure and resources; and community networks.
- Strengthening industry-wide supplier standards and driving best practice and continuous improvement.
- Tackling agriculture's social and environmental challenges through global and local initiatives and stakeholder partnerships.

We are committed to working to enable prosperous livelihoods for all farmers who supply our tobacco leaf.

The farmers we work with are valued business partners and crucial to the success of our business – if they do well, we do well.

Our specialist leaf technicians provide on-the-ground advice and support for some 90,000 contracted farmers worldwide. We also work in collaboration with governments, the industry and NGOs on programmes to tackle social and environmental challenges in farming communities.

Exploitative child labour is an important issue for any industry with an agricultural supply chain. Our Social Responsibility in Tobacco Production (SRTP) programme, against which all our first-tier leaf suppliers are reviewed, has a specific focus on child labour. In 2015, we worked as part of an industry-wide initiative to develop a new Sustainable Tobacco Programme, which has a strengthened process and more frequent on-site reviews. It will replace SRTP later in 2016.

We also co-founded the Eliminating Child Labour in Tobacco Growing (ECLT) Foundation and remain active members along with others in the industry, the ILO and Save the Children. ECLT focuses on research and advocacy and runs long-term community projects to address the root causes of child labour.

Corporate behaviour

Our approach

- Engaging openly on regulation.
- Responsible marketing of tobacco products and working with retailers to prevent youth smoking.
- Collaborating with governments, law enforcement agencies, international organisations and the industry to tackle the illegal tobacco trade.
- Safeguarding human rights across our own operations and our supply chain.

Conducting our affairs with honesty, integrity and transparency is key if we are to continue to develop as a responsible, successful and sustainable business.

This is why we have clear principles and policies in place that set out the way we operate. Integral to this are the Group Standards of Business Conduct (SoBC), which cover our policies and procedures on areas such as sanctions, and bribery and corruption compliance.

The action being taken in relation to the recent allegations of misconduct in East Africa is described on page 65.

Our Regional Audit and CSR Committees monitor the performance of our companies in managing human rights in the workplace and supply chain. This includes reviews of operations in countries of concern as identified by independent human rights risks analytics.

Our approach to human rights is based on our core belief that universally recognised fundamental human rights should be respected. Our Human Rights Policy details our commitments to eliminating child labour and the exploitation of labour, as well as to respect freedom of association.

In 2015, to help suppliers meet our Policy commitments, we developed a new Supplier Code of Conduct defining the minimum standards we expect. This was published at bat.com/principles in early 2016.

Good environmental management

As a global business, we have a responsibility to reduce our impact on local communities and the environment. We do this through a mixture of performance management, risk assessments and, where appropriate, strengthening our processes and procedures.

We continue to make good progress towards our long-term target to cut carbon dioxide equivalent (CO_2e) by 80% by 2050 from our year 2000 baseline. 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.

To address indirect impacts, environmental criteria are included in supplier assessments and programmes, and we support wider multi-stakeholder projects and afforestation programmes. In 2015, 98.2% of the wood our farmers used for curing did not come from natural forest.

Emissions	2015	2014
Scope 1 CO_2e emissions (tonnes)	**330,495**	342,385
Scope 2 CO_2e emissions (tonnes)	**363,501**	370,724
Scope 3 CO_2e emissions (tonnes)	**182,343**	212,018
Total (tonnes)	**876,339**	925,127
Intensity (per million cigarettes equivalent)	**0.79**	0.83

Case study

Sustainable agriculture and farmer livelihoods in Brazil

Challenge

People working in agriculture represent around 30% of global employment. Over the past few decades this has been in steady decline, driven by negative perceptions of working in this area and high levels of migration among young adults. We recognised the need to ensure a genuinely sustainable livelihood for our farmers to secure a sustainable supply of leaf for the business.

What we did

Our company in Brazil has been working for over ten years on an holistic approach to demonstrate how farming in general, and tobacco-growing specifically, can be a desirable, profitable and sustainable business.

This has included a range of activities to increase farm productivity and crop yields, and incentives such as advance payments of crop inputs to reduce debt and long-term, strategic contracts with over 60% of contracted farmers. This is complemented with: training and capacity building for over 20,000 farmers; multi-stakeholder projects focused on rural youth development; enhancing farm safety and labour practices; women's leadership; and eliminating child labour.

Outcome

While the general trend in the country has been for farmers' average age to increase, the average age of our contracted farmers has remained steady. The number of farmers aged 18–30 has also increased from 17.5% to 20% since 2009.

We are now working to build upon this approach in our other leaf operations.

Strategic management

Our Global Drive Brands in 2015

Our five Global Drive Brands (GDBs) had another successful year in 2015, growing volume and share in Key Markets.

Share and volume

2015 GDB overall market share growth

+120 bps

bps = basis points

2015 GDB cigarette volume growth

+8.5%

Dunhill

Volume
59bn
+6.0%
2014: 55bn

Market share
+30 bps

Markets
110+
Number of markets where Dunhill is sold

Kent

Volume
66bn
+3.3%
2014: 64bn

Market share
Flat

Markets
80+
Number of markets where Kent is sold

Lucky Strike

Volume
32bn
+3.7%
2014: 31bn

Market share
+10 bps

Markets
70+
Number of markets where Lucky Strike is sold

Pall Mall

Volume
92bn
+0.4%
2014: 92bn

Market share
+10 bps

Markets
100+
Number of markets where Pall Mall is sold

Rothmans

Volume
52bn
+46.5%
2014: 36bn

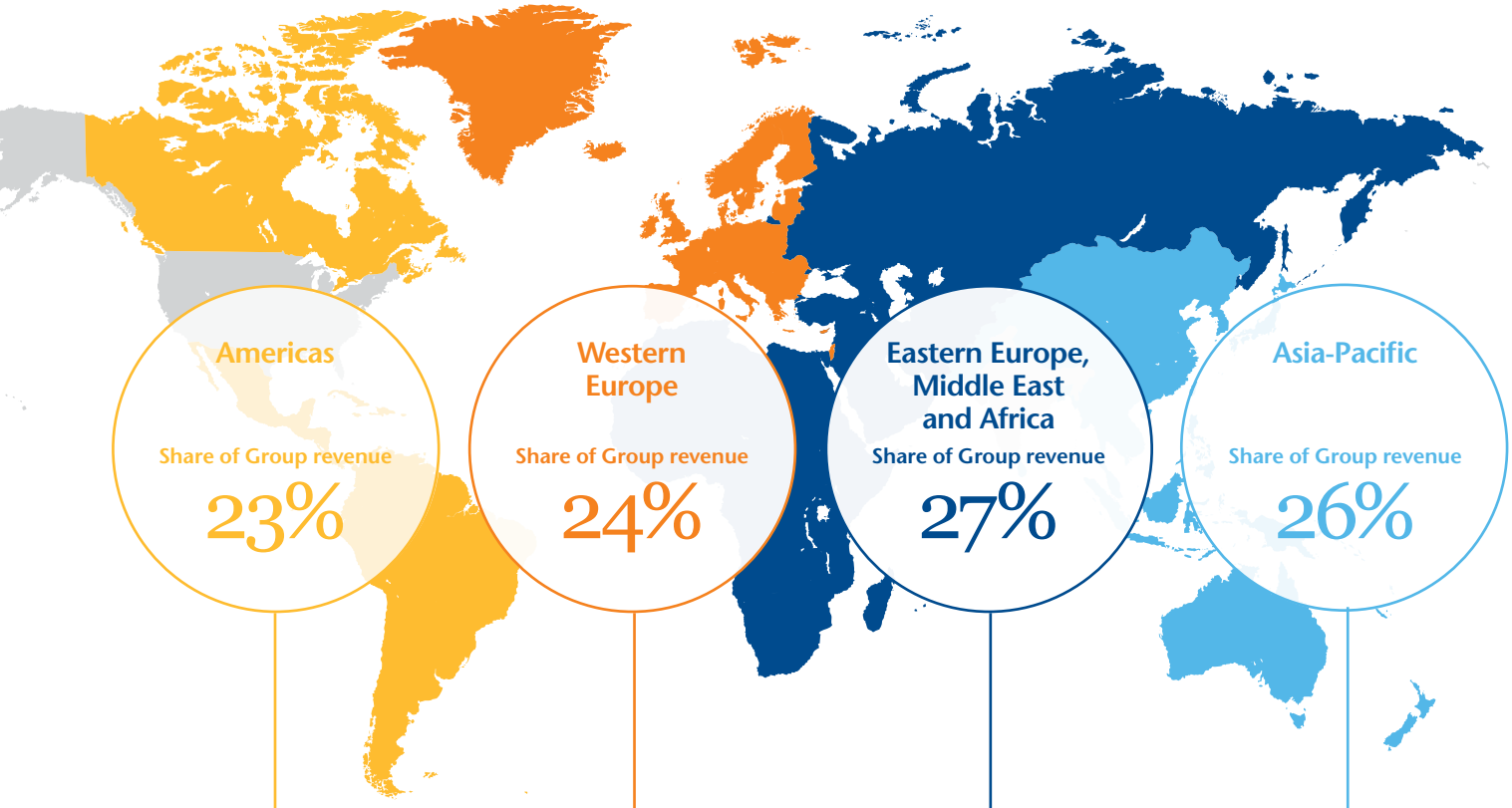
Market share
+70 bps

Markets
60+
Number of markets where Rothmans is sold

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.



	Americas	Western Europe	Eastern Europe, Middle East and Africa	Asia-Pacific
Volume	124bn -5.2% 2014: 131bn	112bn +0.5% 2014: 112bn	229bn +1.1% 2014: 227bn	198bn +0.1% 2014: 197bn
Revenue at CC[2]	£3,340m +11.7% 2014: £2,990m	£3,476m +3.5% 2014: £3,359m	£4,030m +7.5% 2014: £3,749m	£3,874m 0.0% 2014: £3,873m
Profit[1]	£1,169m -9.1% 2014: £1,286m	£1,146m -3.6% 2014: £1,189m	£1,208m -12.5% 2014: £1,380m	£1,469m -5.2% 2014: £1,548m
Profit[1] at CC[2]	£1,426m +10.9% 2014: £1,286m	£1,249m +5.1% 2014: £1,189m	£1,399m +1.3% 2014: £1,380m	£1,546m -0.1% 2014: £1,548m
	see page 25 to learn more	see page 26 to learn more	see page 27 to learn more	see page 24 to learn more

Notes:

1. Profit refers to adjusted profit from operations and 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 35).
2. Constant currency (CC) provides the information based on a re-translation, at prior year exchange rates, of the current year information.

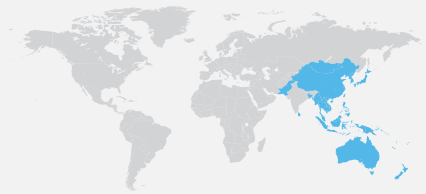
Strategic management

Regional review

Asia-Pacific

Jack Bowles
Director, Asia-Pacific

"The region increased market share in 9 of our 11 Key Markets, with excellent growth in GDB volume. I am extremely proud of the progress we have made in an environment that I expect to remain challenging in 2016."



Share of Group revenue	Adjusted profit from operations at CC
26%	£1,546m
2014: 27%	-0.1%
	2014: £1,548m

Adjusted profit, at current rates of exchange, was down by £79 million to £1,469 million as strong profit performances in Pakistan, Bangladesh, New Zealand, Sri Lanka and Vietnam were offset by a challenging environment in Australia and adverse foreign exchange rates in a number of markets. At constant rates of exchange, adjusted profit was in line with 2014. Volume was marginally ahead of 2014 at 198 billion, as increases in Bangladesh, Vietnam, Indonesia and Japan were offset by Pakistan, Malaysia and South Korea, where lower volume was due to market decline.

Performance at constant rates of exchange

Australia

Volume fell due to market contraction. Excise-led price increases, a challenging environment and continued high prevalence of illicit trade led to down-trading and a significant reduction in profit. Market share was flat.

Malaysia

Profit was stable, as the introduction of sales tax (GST) and large ad hoc excise-led price increases were offset by a reduction in industry volume, which was partly due to an increase in illicit trade. Market share was up, driven by Peter Stuyvesant.

Japan

Excellent growth in market share was driven by a strong performance by Kent, supported by innovations. Profit was down mainly due to the adverse exchange rate impact on cost of sales, which was partly mitigated by productivity savings.

New Zealand

Profit was higher as pricing offset lower volume. Rothmans performed strongly leading to an increase in market share.

Bangladesh

Profit continued to increase strongly, driven by higher volume, significant market share growth and higher pricing.

Pakistan

High excise-driven pricing led to market contraction and an increase in illicit trade. Volume decline was lower than the market, leading to an increase in market share, particularly in Pall Mall. The roll-over of prior year pricing and cost efficiencies drove profit significantly higher.

Vietnam

Volume was up, in line with the industry. Profit was higher due to increased volume, pricing and an improvement in mix.

South Korea

Market share grew strongly, driven by Dunhill and Vogue. Volume declined as a result of significant industry contraction following high excise-driven price increases, leading to lower profit.

Indonesia

Volume and market share were up and profitability improved as Dunhill continued to grow, driving an improvement in mix and offsetting the decline in local brands.

Taiwan

Market share was higher driven by Pall Mall. Good pricing was offset by marketing investment, leading to a small decline in profit.

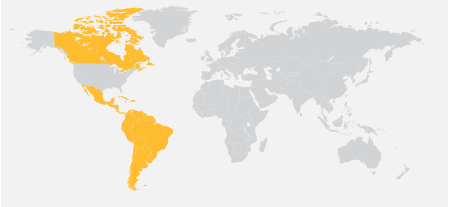
Philippines

Market share increased driven by Pall Mall, leading to an improvement in profitability.

Americas

Ricardo Oberlander
Director, Americas

"Market share and GDB volume both grew, with revenue and profit up strongly, at constant rates of exchange. There are a number of economic challenges across the region, but I am confident that we will continue to win in the coming years."



Share of Group revenue

23%

2014: 22%

Adjusted profit from operations
at CC

£1,426m

+10.9%
2014: £1,286m

Adjusted profit, at current rates of exchange, declined by £117 million to £1,169 million, mainly due to exchange rate movements in Brazil, Canada and Venezuela. At constant rates, adjusted profit rose by £140 million, or 10.9%, driven by good performances from Canada, Mexico, Venezuela and Chile. Volume was lower by 5.2% at 124 billion, mainly due to Brazil, Argentina, Chile and Canada, partially offset by higher volume in Mexico.

Performance at constant rates of exchange

Brazil

Dunhill and Minister performed well with higher market share, but were more than offset by the rest of the portfolio. Market contraction due to the effects of illicit trade and the deterioration in the economic environment led to lower volume and a reduction in profit.

Canada

Profit grew strongly driven by good pricing and cost reductions, offsetting lower volume. Market share fell, despite growth in Pall Mall.

Chile

Strong profit growth was due to good pricing and up-trading to capsule offers, offsetting lower volume and the effect of adverse exchange rates on cost of sales. Kent, Lucky Strike and Pall Mall all grew market share.

Venezuela

Profit was higher as significant pricing was required to offset the combined effects of local inflation and the devaluation of the bolivar following the introduction of the SIMADI exchange rate mechanism. Volume was marginally lower.

Mexico

Market share was up, driven by the continued growth in Pall Mall and Lucky Strike. Profit was higher driven by pricing and higher volume.

Colombia

Market share growth was partly driven by Kool and Lucky Strike, with volume flat despite industry decline. Profit was up as pricing offset the impact of adverse foreign exchange on cost of sales.

Argentina

Pricing more than offset the impact of lower volume and led to higher profit. Lucky Strike grew market share, continuing to perform well in the premium segment.

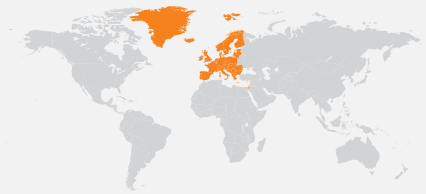
Strategic management

Regional review continued

Western Europe

Naresh Sethi
Director, Western Europe

"Western Europe performed very well, increasing profit and revenue at constant rates of exchange. Good share growth in a number of markets reflects the continued investment behind our GDB portfolio. From these strong foundations I am confident we will continue to deliver another good performance in 2016."



Share of Group revenue	Adjusted profit from operations at CC
24%	£1,249m
2014: 23%	+5.1%
	2014: £1,189m

Adjusted profit, at current rates of exchange, declined by £43 million to £1,146 million, largely reflecting the devaluation of the euro. At constant rates, adjusted profit was higher by £60 million or 5.1% with good performances in a number of markets including Denmark, Germany and Romania. This was partly offset by the effect of lower volume in Italy and Netherlands. Total cigarette volume was up by 0.5% to 112 billion but, excluding the acquisition of TDR, would have declined by 1.1%. Fine Cut volume was lower by 3.9% at 20 billion sticks equivalent.

Performance at constant rates of exchange

Germany

Volume and market share were higher, driven by Lucky Strike and Pall Mall, which, coupled with pricing, led to an increase in profit. Fine Cut volume was lower.

Switzerland

Profit was up as pricing offset lower volume and a decline in market share.

Italy

The migration of Pall Mall to Rothmans progressed very well, with an increase in the brands' combined market share. Total volume fell, with profit down partly due to increased marketing investment.

Romania

Market share grew, driven by Pall Mall and Dunhill, consolidating the Group's leadership position. Good pricing and a marginal increase in volume drove profit higher.

France

Volume was higher as Lucky Strike continued to perform very well, driving an increase in total market share. Profit fell, partly due to down-trading and increased marketing investment.

Denmark

Volume and profit were higher following the trade de-stocking in 2014. Market share declined driven by competitive pricing activity at the low end of the market.

Netherlands

Market share was higher due to the good performance of Lucky Strike and Pall Mall. Industry decline led to lower volume and a reduction in profit.

Belgium

Profit was stable as pricing offset lower volume. Market share declined as growth in Lucky Strike was more than offset by the rest of the local portfolio.

United Kingdom

Rothmans drove an increase in market share, with profit higher as good pricing offset marginally lower volume, due to industry decline.

Spain

Profit was flat as pricing was offset by lower volume and reduction in market share.

Poland

Profitability improved as pricing more than offset a fall in volume, which was in part due to further industry contraction. Pall Mall continued to demonstrate excellent momentum, with an increase in market share.

Eastern Europe, Middle East and Africa (EEMEA)

Johan Vandermeulen
Director, Eastern Europe, Middle East and Africa

"At constant rates of exchange, EEMEA delivered very good growth in revenue and profit, despite significant transactional foreign exchange headwinds, which I anticipate will continue to impact our performance in 2016. Our GDBs had an exceptional year and we are well placed for 2016, despite the continued instability in a number of markets."

Share of Group revenue	Adjusted profit from operations at CC
27%	£1,399m
2014: 28%	+1.3%
	2014: £1,380m

Adjusted profit, at current rates of exchange, decreased by £172 million to £1,208 million. Good pricing across the region and strong profit growth in a number of markets was offset by the effect of currency devaluation, notably in Russia, Nigeria and Ukraine. At constant rates of exchange, profit would have increased by £19 million or 1.3%. Volume was 1.1% higher at 229 billion, with growth in a number of markets including Turkey, Iran, Kazakhstan and Ukraine offsetting lower volume in Egypt, Russia, Nigeria and South Africa.

Performance at constant rates of exchange

Russia

Market share continued to grow, driven by a strong performance by Rothmans. Industry volume decline was due to excise-led price increases, with the Group's volume falling at a lower rate than the market. Pricing partially offset the significant adverse effect of devaluation on cost of sales, leading to a decrease in profit.

South Africa

Market share was down despite good growth from Benson & Hedges, following the launch in 2014, and Pall Mall. Lower volume and down-trading were offset by pricing and cost savings, with profit flat on prior year.

GCC

Higher volume, driven by JPGL and Rothmans, and the full-year effect of pricing taken in 2014, more than offset negative mix to deliver an increase in profit. Total market share declined.

Nigeria

Profit was down, partly due to the effect of adverse exchange rates on cost of sales and a reduction in volume, which was driven by market contraction. Market share was up.

Iran

Kent continued to perform extremely well, with higher volume driving an increase in profit despite a change in excise that was partly borne by the industry.

Ukraine

Geopolitical instability continued to impact performance, with a significant deterioration in currency and intense price competition leading to a decline in profit. Volume was up, driven by Rothmans. Market share grew strongly.

Turkey

Higher volume and excellent market share growth were driven by Kent and Rothmans. Profit fell due to the continued part absorption of excise.

Egypt

Volume, market share and profitability declined, due to down-trading following the change in the excise regime in 2014.

Kazakhstan

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

Algeria

Excellent market share growth drove an increase in volume and profit.

Financial Review

Income Statement

Ben Stevens
Finance Director

Highlights

- Group revenue was down as exchange rate movements and volume offset the impact of pricing. Revenue was 5.4% higher at constant rates of exchange.
- Adjusted profit from operations at constant rates of exchange increased by 4.0%.
- Adjusted diluted earnings per share grew by 0.1% to 208.4p per share.
- At constant rates, adjusted diluted earnings per share were 10.1% higher at 229.1p.
- Dividends for 2015 up by 4.0% to 154.0p per share.
- Free cash flow of £3,481 million with free cash flow per share equal to 90% of adjusted diluted earnings per share. Excluding adjusting cash, this was 80%.
- The Group invested US$4.7 billion in cash to maintain its shareholding in Reynolds American Inc. (RAI), after RAI's acquisition of Lorillard Inc., and invested £1.7 billion to acquire the shares not already owned by the Group in Souza Cruz.
- The Group completed the acquisition of TDR in Croatia (€550 million) and CHIC in Poland.

Another strong performance despite unprecedented adverse exchange rate movements.

Revenue and profit from operations

A very good financial performance was offset by continued adverse exchange rate movements, with an adverse translational impact of 12%. Reported revenue was down by 6.2% from £13,971 million to £13,104 million. Reported profit from operations was 0.2% higher at £4,557 million, reflecting the impact of foreign exchange movements on the reported results, being partly offset by the charge in 2014 related to non-tobacco litigation that does not repeat.

To better evaluate the underlying performance of the business, management reviews the results by adjusting for a number of items relating to restructuring and integration costs and one-off charges, provisions and income (see page 35). We call the underlying profit after adjusting for these items, which are described further below, adjusted profit from operations. Adjusted profit from operations was £4,992 million, 7.6% lower than in 2014. In order to assess the underlying performance, we also have to view the business results at constant rates of exchange, excluding the translational impact of exchange rate movements. This does not adjust for the transactional effects of currency fluctuations on the cost of items such as leaf, filter tow and wrapping materials.

The Group's strong underlying performance for the year is demonstrated by the growth of 5.4% in revenue and 4.0% in adjusted profit from operations, at constant rates. Excluding the above transactional exchange effect, adjusted operating profit would have increased by approximately 10%.

More details of the Group's adjusted operating performance can be found in the regional review (see pages 24–27).

Operating margin

The Group has increased its operating margin by 460 bps since 2010. This has been achieved through pricing, portfolio development through GDBs, tight cost control, factory rationalisation, the implementation of the new operating model, systems standardisation and productivity savings. In 2015, adjusted profit from operations, as a percentage of net revenue, grew on an underlying basis by around 160 bps. On a reported basis, it fell by 60 bps to 38.1%, mainly as a result of the impact of exchange rates on the Group's cost of sales.

Adjusting items

During 2015, the Group continued to incur costs that do not relate to the day-to-day operations of the business. The adjustments made to profit from operations are separately disclosed as memorandum information either on the face of the Income Statement or within the segmental analysis.

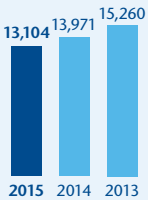
The Group incurred restructuring and integration costs of £367 million in 2015 mainly in respect of the restructuring initiatives directly related to the implementation of the new operating model, the continuation of the factory closure in Australia, certain costs related to the acquisitions undertaken (including TDR in Croatia), and restructurings in Indonesia, Canada, Switzerland and Germany. These were offset by gains on the sale of land and buildings in Australia. The items also cover cost of initiatives in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

Revenue at constant rates of exchange
(£m)

+5%
2015
+3%
2014
+4%
2013

Revenue at current rates of exchange
(£m)

-6%
2015
-8%
2014
0%
2013



Operating margin
(%)

-60 bps
2015
+54 bps
2014
+100 bps
2013

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

Revenue			2015	2014
	Reported revenue £m	Impact of exchange £m	Revenue at CC[1] £m	Reported revenue £m
Asia-Pacific	3,773	101	3,874	3,873
Americas	2,720	620	3,340	2,990
Western Europe	3,203	273	3,476	3,359
EEMEA	3,408	622	4,030	3,749
Total	13,104	1,616	14,720	13,971

Profit from operations/Diluted earnings per share					2015			2014
	Reported profit £m	Adjusting items £m	Adjusted profit £m	Impact of exchange £m	Adjusted profit at CC[1] £m	Reported profit £m	Adjusting items £m	Adjusted profit £m
Asia-Pacific	1,361	108	1,469	77	1,546	1,360	188	1,548
Americas	1,082	87	1,169	257	1,426	1,197	89	1,286
Western Europe	990	156	1,146	103	1,249	1,018	171	1,189
EEMEA	1,127	81	1,208	191	1,399	1,318	62	1,380
Total regions	4,560	432	4,992	628	5,620	4,893	510	5,403
Fox River[2]	–	–	–	–	–	27	(27)	–
Flintkote[2]	(3)	3	–	–	–	(374)	374	–
Profit from operations	4,557	435	4,992	628	5,620	4,546	857	5,403
Net finance income/(costs)	62	(489)	(427)	(37)	(464)	(417)	–	(417)
Associates and joint ventures	1,236	(293)	943	(54)	889	719	(7)	712
Profit before tax	5,855	(347)	5,508	537	6,045	4,848	850	5,698
Taxation	(1,333)	(58)	(1,391)	(126)	(1,517)	(1,455)	(69)	(1,524)
Non-controlling interest	(232)	(3)	(235)	(26)	(261)	(278)	(5)	(283)
Profit attributable to shareholders	4,290	(408)	3,882	385	4,267	3,115	776	3,891
Diluted number of shares	1,863		1,863		1,863	1,870		1,870
Diluted earnings per share (pence)	230.3		208.4		229.1	166.6		208.1

Notes

1. CC: profit translated at constant currencies. No adjustment is made for the transactional impact of currency movements on cost of sales.
2. The Fox River credit in 2014 and the Flintkote charges in 2015 and 2014 have not been allocated to any segment as they do not relate to current operations, nor to the tobacco business. They are presented separately from the segment reporting which is used to evaluate segment performance and to allocate resources.

Adjusted profit from operations at constant rates of exchange (£m)

+4% 2015

+4% 2014

+7% 2013

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

	2015		2014	
	Revenue growth	Profit growth	Revenue growth	Profit growth
As reported	-6.2	+0.2	-8.4	-17.7
Adjusted		-7.6		-7.2
Adjusted at constant rates	+5.4	+4.0	+2.8	+4.4
Adjusted excluding all currency (est.)		+10.0		+5.9

Financial Review

Income Statement continued

The £452 million restructuring and integration charge in 2014 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 the factory closure and downsizing activities in Australia, Colombia and the Democratic Republic of Congo and restructurings in Argentina, Indonesia, Canada, Switzerland and Germany.

Recent acquisitions, including TDR, Bentoel, Tekel, ST, Protabaco and CN Creative Limited, as well as the creation of CTBAT International Ltd, resulted in the capitalisation of trademarks and similar intangible assets, which are amortised over their expected useful lives, which do not exceed 20 years. The 2015 amortisation charge is £65 million, compared to £58 million in 2014.

Subsequent to the 2014 Funding Agreement between a Group subsidiary and the parties in respect of the clean-up cost of the Fox River, there was no release in 2015 to the provision set up in 2011 other than related to costs incurred. In 2014, a Group subsidiary agreed the settlement of the Flintkote asbestos-related claim and paid the settlement sum into an escrow account. Legal fees, in respect of the claim, which was finalised during the year, were £3 million in 2015, with the total cost, including legal fees, of £374 million in 2014. More detail of these two settlements are provided in note 30 to the accounts.

Net finance income/(costs)

Net finance income was £62 million in 2015 (2014: £417 million cost). The movement reflects a £601 million deemed gain in relation to the investment in Reynolds American Inc., as described on page 143, partly offset by £104 million option costs in relation to the funding of the acquisition of the shares not already owned by the Group in Souza Cruz and investment in RAI. Interest cost of £8 million related to the FII GLO case was accrued following the receipt in 2015 of £963 million from HMRC, as described on page 143. Net adjusted finance costs were £427 million, £10 million higher than last year, as the increased level of borrowing was partly offset by lower costs to service the debt.

Associates

The Group's share of the post-tax results of associates, included at the pre-tax profit level under International Financial Reporting Standards (IFRS), grew by £517 million or 72% to £1,236 million.

In 2015, the Group's share of the adjusted post-tax results of associates increased by 32% to £943 million (2014: £712 million), being an increase of 25% at constant rates. The adjusting items for associates amounted to a net gain of £293 million, primarily related to the Group's share of the gain earned on the divestiture of brands by RAI to ITG Brands. In 2014, the adjusted net gain was £7 million.

The adjusted contribution from RAI increased by 53% to £652 million. At constant rates of exchange, this would have been an increase of 42%. The adjusted contribution from our associate in India, ITC, was £280 million, up 3.6%. At constant rates of exchange, the contribution would have been 1.1% higher than last year.

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

Tax

Profit before tax was up £1,007 million at £5,855 million, reflecting the impact of higher adjusted profit from operations at constant rates of exchange, the deemed gain related to the investment in RAI, the gain in RAI related to the disposal of certain assets as part of the acquisition of Lorillard Inc. and the impact of the Flintkote charge in 2014, which were partially offset by adverse exchange rate movements on the translation of the Group's results.

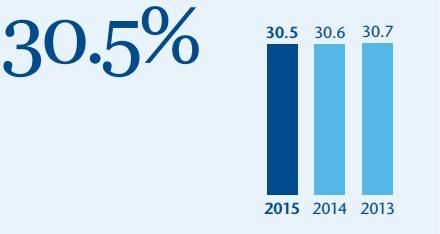
The tax rates in the Income Statement of 22.8% in 2015 and 30.0% in 2014 are affected by the inclusion of the shares of associates' post-tax profit in the Group's pre-tax results and by adjusting items. Excluding these, the underlying tax rate for subsidiaries was 30.5% in 2015 and 30.6% in 2014. The slight decrease is the result of a change in the mix of profits.

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

- comply with all applicable laws and regulations in the countries where we operate;
- be open and transparent with tax authorities and operate 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;
- 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 tax strategy is reviewed regularly by the Board. The operation of the strategy is managed by the Finance Director and the Head of Corporate Tax who report the Group's tax position to the Audit Committee on a regular basis. The Group Risk Management Committee considers tax risks that may arise as a result of our business operations.

Underlying tax rate
(%)



Major taxes paid 2015
(£bn)

	2015
Tobacco excise (collected)	22.7
Net VAT and other sales taxes (collected)	4.8
Corporation tax (borne)	1.3
Customs and import duties (borne)	0.3
Taxes paid by employee (collected)	0.3
Employment taxes (borne)	0.2

Financial Review

EPS, dividends and financing

In accordance with our tax strategy, the transfer of goods and services between companies within the Group is conducted on an arm's length basis. The pricing of such transactions between Group companies is based on fair market terms and reflects the commercial nature of the transactions.

Our tax footprint extends beyond corporation tax and we are obliged to pay other significant taxes such as employment taxes and customs and import duties. Apart from the taxes borne, the Group also collects taxes on behalf of governments, for example, tobacco excise, employee taxes, VAT and other sales taxes. The total tax contribution therefore consists of both taxes borne and taxes collected. In 2015, the total tax cash contribution by the Group amounted to £29.6 billion (2014: £29.7 billion), with the 2015 contribution by each category as shown in the chart (left).

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.

The corporate tax charge (current tax) for 2015 was £1.33 billion (2014: £1.45 billion), which differs from the tax paid of £1.27 billion (2014: £1.43 billion) due to the timing of corporation tax instalment payments which often straddle different financial years.

Earnings per share

Basic earnings per share for 2015 were 230.9p, up 38.2% (2014: 167.1p). With the impact that adjusting items can cause in profit, as well as the potential dilutive effect of employee share schemes, earnings per share are best viewed on the basis of adjusted diluted earnings per share. The calculation of this measure is explained in note 7 on the Financial Statements.

On this basis, adjusted diluted earnings per share was marginally ahead of prior year at 208.4p, up 0.1% against 2014, as the strong operating performance of the Group, its associates and a reduced non-controlling interest charge was offset by adverse movement in exchange rates. When the translational impact of exchange rate movements on our reported results are excluded, the adjusted diluted earnings per share (at constant rates) would have increased by 10.1% to 229.1p.

Dividends

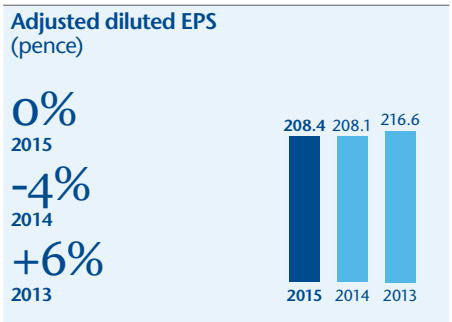
The Group's policy is to pay dividends of 65% of long-term sustainable earnings, calculated with reference to the adjusted diluted earnings per share. However, despite adverse exchange rate movements, where possible we like to reward shareholders with an increase in the dividends in sterling terms. Interim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

With the recommended final dividend of 104.6p, the total dividends per share for 2015 are 154.0p, compared to the total dividend of 148.1p for 2014. This leads to a total dividend growth of 4% and a pay-out ratio of 74%.

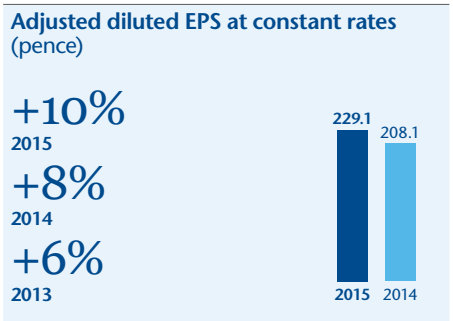
Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2015 accounts reflect the 2014 final dividend and the 2015 interim dividend amounting to 150.0p (£2,770 million in total (2014: 144.9p – £2,712 million)).

The table below shows the dividends declared in respect of 2015 and 2014. 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=21.32780 as at 23 February 2016, the closing rate for that day as quoted by Bloomberg, results in an equivalent final dividend of 2,230.88788 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 113.

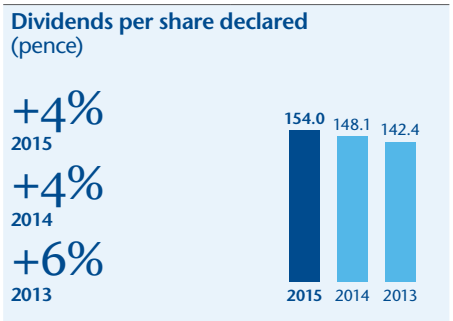
Adjusted diluted EPS
(pence)



Adjusted diluted EPS at constant rates
(pence)



Dividends per share declared
(pence)



Dividends declared/proposed	2015		2014	
Ordinary shares	Pence per share	£m	Pence per share	£m
Interim	49.4	908	47.5	881
Final	104.6	1,943	100.6	1,862
	154.0	2,851	148.1	2,743

EPS, dividends and financing continued

Treasury operations

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

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

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

The Group continues to maintain investment-grade credit ratings. As at 31 December 2015, the ratings from Moody's/S&P were A3 (stable outlook)/A- (stable outlook) respectively. 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.

Liquidity

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group targets an average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. As at 31 December 2015, the average centrally managed debt maturity was 7.9 years (2014: 6.8 years) and the highest proportion of centrally managed debt maturing in a single rolling 12-month period was 15.0% (2014: 18.7%).

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 2015, £505 million of commercial paper was outstanding (2014: £160 million).

In February 2015, the Group signed a one-year bridge facility of £2.5 billion with an extension option of up to one year for its possible public tender offer to acquire up to all of the 24.7% of Souza Cruz shares which were not owned by BAT. This was cancelled in December 2015.

In March 2015, the Group issued €3 billion of bonds in four tranches as follows: €800 million maturing in 2019, €800 million maturing in 2023, €800 million maturing in 2027 and €600 million maturing in 2045. A €1.25 billion bond was repaid.

In March 2015, a one-year extension option was exercised for the £3 billion central banking facility, extending the final maturity to May 2020. The facility was undrawn as at 31 December 2015. The US$2 billion US commercial paper programme was increased in size to US$3 billion.

In June 2015, the Group issued US$4.5 billion of bonds in five tranches as follows: US$750 million maturing in 2018, US$1,250 million maturing in 2020, US$500 million maturing in 2022, US$1,500 million maturing in 2025 and US$500 million of floating rate notes maturing in 2018. A US$500 million bond was repaid. The US$4.7 billion bridge facility in respect of the RAI transaction was cancelled following the issue of the bonds.

In July 2015, the Group received £620 million from HM Revenue & Customs in connection with the Franked Investment Income Group Litigation Order, as described on page 145. The Group received a further £343 million in November 2015 from HM Revenue & Customs.

In November 2015, the Group issued a €600 million bond maturing in 2022 and a £350 million bond maturing in 2055.

In March 2014, the Group issued €1 billion of bonds in two tranches as follows: €600 million maturing in 2029 and €400 million of floating rate notes maturing in 2018.

In May 2014, the Group negotiated a new central banking facility of £3 billion with a final maturity of May 2019 (with two additional one-year extensions at the option of the banks). This facility is provided by 22 banks. The new facility is on significantly improved terms compared to the previous central banking facility of £2 billion, with a maturity of December 2015, which was cancelled at the same time.

In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029; this purchase was financed from Group cash balances.

In August 2014, the Group repaid a maturing MYR250 million note, financed from Group cash balances.

In September 2014, the Group issued SFr1 billion of bonds in three tranches as follows: SFr350 million maturing in 2016, SFr400 million maturing in 2021 and SFr250 million maturing in 2026. A €600 million bond was repaid, financed from Group cash balances.

The Group has drawn US$225 million in 2015 and 2014 against a US$240 million Chilean peso facility maturing in 2016.

Capital structure

The Group defines capital as net debt and equity. The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5 times. The Group targets a gross interest cover, as calculated under its key central banking facilities, of greater than 5. For 2015 it is 11.6 times (2014: 12.0 times). The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital structure is managed and, in particular, the policies on dividends and share buy-backs are decided.

Financial Review

Alternative cash flow

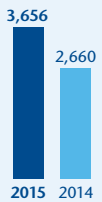
Cash flow and net debt movements (at current rates, unless specifically stated)

	2015 £m	2014 £m
Adjusted profit from operations	**4,992**	5,403
Depreciation, amortisation and impairment	**338**	396
Other non-cash items in operating profit	**(1)**	45
Profit from operations before depreciation and impairment	**5,329**	5,844
Increase in working capital	**(263)**	(309)
Net capital expenditure	**(483)**	(627)
Gross capital expenditure	**(591)**	(689)
Sale of fixed assets	**108**	62
Operating cash flow	**4,583**	4,908
Pension funds' shortfall funding	**(148)**	(140)
Net interest paid	**(522)**	(426)
Tax paid	**(1,273)**	(1,433)
Franked Investment Income Group Litigation Order (FII GLO)	**963**	–
Dividends paid to non-controlling interests	**(235)**	(249)
Cash generated from operations	**3,368**	2,660
Memo – Cash generated from operations at constant rates of exchange	**3,656**	2,660
Restructuring costs	**(405)**	(325)
Non-tobacco litigation: Flintkote and Fox River (settlement)	**(20)**	(437)
Tobacco litigation: Quebec (deposit)	**(55)**	–
Dividends and other appropriations from associates	**593**	609
Free cash flow	**3,481**	2,507
Dividends paid to shareholders	**(2,770)**	(2,712)
Share buy-back (including transaction costs)	**–**	(800)
Net investment activities	**(5,192)**	(6)
Net flow from share schemes and other	**(52)**	108
Net cash outflow	**(4,533)**	(903)
Movements on net debt		
Exchange rate effects*	**(112)**	270
Change in accrued interest and other	**16**	(17)
Change in net debt	**(4,629)**	(650)
Opening net debt	**(10,165)**	(9,515)
Closing net debt	**(14,794)**	(10,165)

* Including movements in respect of debt-related derivatives.

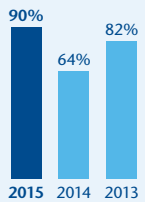
Cash generated from operations at constant rates
(£m)

£3,656m
+37%



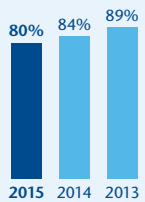
Free cash flow as a percentage of adjusted earnings
(%)

90%



Adjusted free cash flow as a percentage of adjusted earnings
(%)

80%



Alternative cash flow continued

Return on capital employed

The Group's return on capital employed has increased from 27% in 2009 to 33% in 2015. This is calculated as the adjusted profit from operations, divided by the average total assets (less investment in associates and joint ventures) net of average current liabilities.

Cash flow

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

Operating cash flow decreased by £325 million, or 7%, to £4,583 million, reflecting the growth in underlying operating performance at constant currency being more than offset by adverse exchange movements. Free cash flow was higher by £974 million, or 39%, at £3,481 million as the receipt related to the FII GLO case, as described on page 185 and lower cash paid in the year in respect of Flintkote and Fox River which, combined with a reduction in tax paid, offset higher net interest paid, higher outflows for restructuring costs and the deposit in relation to the Quebec Class Action (£55 million, or CAD $108 million).

The conversion of adjusted operating profit to operating cash flow remained strong at 92% (2014: 91%). Due to the receipt in relation to FII GLO and lower cash costs related to non-tobacco related litigation (Flintkote and Fox River) the ratio of free cash flow per share to adjusted diluted earnings per share increased to 90% (2014: 64%).

Below free cash flow, the principal cash outflows for 2015 comprise the payment of the prior year final dividend and the 2015 interim dividend, which was £58 million higher at £2,770 million, as well as a £5,192 million outflow related to net investment activities. This was principally due to the investment in Reynolds American Inc. (RAI), the buy-out of the minorities in Souza Cruz and the acquisition of TDR in Croatia. During 2014, the cash outflow from net investing activities was £6 million relating to various entities in which the Group already has an interest.

The other net flows in 2015 principally relate to shares purchased by the employee share ownership trusts and cash flows in respect of certain derivative financial instruments.

These flows resulted in a net cash outflow of £4,533 million (2014: £903 million outflow).

After taking account of other changes, especially exchange rate movements, total net debt was £4,629 million higher at £14,794 million at 31 December 2015 (2014: £10,165 million).

Net debt

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

	2015 £m	2014 £m
Net debt due within one year		
Borrowings	**(2,195)**	(2,479)
Related derivatives	**46**	79
Cash and cash equivalents	**1,963**	1,818
Current available-for-sale investments	**35**	50
	(151)	(532)
Net debt due beyond one year		
Borrowings	**(14,806)**	(9,779)
Related derivatives	**163**	146
	(14,643)	(9,633)
Total net debt	**(14,794)**	(10,165)

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 2015 was £5,956 million (2014: £6,609 million), while unfunded scheme liabilities amounted to £364 million (2014: £385 million). The schemes' assets decreased from £6,266 million in 2014 to £6,086 million in 2015.

After excluding unrecognised scheme surpluses of £11 million (2014: £13 million), the overall net liability for all pension and health care schemes in Group subsidiaries amounted to £245 million at the end of 2015, compared to £741 million at the end of 2014.

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.

Share buy-back programme

The Group suspended, with effect from 30 July 2014, the £1.5 billion buy-back programme. This was as a result of the Group's announcement of 15 July 2014 that it planned to invest US$4.7 billion as part of RAI's proposed acquisition of Lorillard. This investment was completed in 2015. During 2014, 23 million shares were bought at a value of £795 million, excluding transaction costs of £5 million.

Changes in the Group

In June 2015, the Group invested US$4.7 billion (£3.0 billion) in cash in RAI to maintain its 42% shareholding in the enlarged business, following the acquisition of Lorillard Inc. by RAI.

During 2015, the Group invested £1.7 billion to acquire the shares not already owned by the Group in its subsidiary Souza Cruz. At 31 December 2015 the Group had acquired, following the public auction on 15 October 2014, sufficient shares to cancel Souza Cruz's registration as a publicly listed company, with a total shareholding of 99.1%. The compulsory acquisition of the remaining minority shares was approved on 5 February 2016, with Souza Cruz becoming a wholly-owned subsidiary at that date.

In June 2015 the Group subsidiary in Hungary and Taban Trafik, the distribution company of local manufacturer Continental, announced a joint venture that would be granted the exclusive distribution concession for tobacco products in Hungary, for a period of 20 years. This became effective from 17 November 2015.

The Group also acquired TDR in Croatia (€550 million) in September 2015 and CHIC in Poland in December 2015.

Non-GAAP measures and other information

Non-GAAP measures

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

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

The Management Board, as the chief operating decision maker, reviews current and prior year segmental adjusted profit from operations of subsidiaries and joint operations, and adjusted post-tax results of associates and joint ventures, at constant rates of exchange. This allows comparison of the Group's results had they been translated at the previous year's average rates of exchange. The Group does not adjust for the 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 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 2015 from that applied in 2014.

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 21 and 24 in the Notes on the Accounts provide further detail on the Group's borrowings and management of financial risks.

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

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

Non-GAAP measures and other information continued

Foreign currencies

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

	Average		Closing	
	2015	2014	**2015**	2014
Australian dollar	**2.036**	1.827	**2.026**	1.905
Brazilian real	**5.101**	3.874	**5.831**	4.145
Canadian dollar	**1.954**	1.819	**2.047**	1.806
Euro	**1.378**	1.241	**1.357**	1.289
Indian rupee	**98.070**	100.529	**97.508**	98.424
Japanese yen	**185.012**	174.223	**177.303**	186.946
Russian rouble	**93.591**	63.412	**107.646**	93.555
South African rand	**19.522**	17.861	**22.839**	18.039
US dollar	**1.528**	1.648	**1.474**	1.559

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 pages 8 and 9. Following a description of each risk, its causes and potential impact on the Group are summarised. We also explain the activities we are undertaking to mitigate each risk.

The Group has identified, actively monitors and is taking action to mitigate many different risks. This section does not include them all, but focuses on those risks that the Directors believe to be the most important 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. Others, currently regarded as immaterial, could become material risks in the future.

The risk factors listed in this section and the activities being undertaken to mitigate them should be considered in the context of the Group's internal control framework. This is described in the section on risk management and internal control in the corporate governance statement on page 61. This section should also be read in the context of the cautionary statement set out on the right.

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 of the risk has increased to reflect the challenge posed by negative perceptions of the sustainability and corporate reputation of a tobacco business and is now listed as a principal risk facing the business.

In addition, the Board has considered the foreign exchange rate exposure risk. An assessment of the current exposure to transactional foreign exchange rate risk has resulted in an increase to the risk rating.

A solvency and liquidity risk has also been disclosed as its assessment underpins our Viability Statement on page 38, although the mitigation plans reduce the likelihood of the risk occurring.

With regard to the Group's revised operating model and single IT operating system, another key risk factor reported in 2014, in view of the good progress on deployment, the Board considers that a combined risk, focusing on sustainability and benefits realisation, describes more accurately the context of the current risk. As such, the risks have been merged into a new combined risk, which is the failure to achieve sustainability of the operating model and its benefits. This is not considered to be a principal risk and as a result it is not reported again this year.

The risk of failure to lead the development of the Next Generation Products category has also been removed from the principal risk factors as progress has been made in several areas which mitigates the risk.

Details of the principal risks are set out in the following tables.

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.

Business environment

Principal Group risk factors continued

Principal risks at a glance

	Description	Time frame	Link to Strategy	Movement in year Risk
01	Competition from illicit trade	Short term, Medium term, Long term	Growth	No change
02	Market size reduction and consumer down-trading	Short term, Medium term	Growth	No change
03	Inability to obtain price increases and impact of increases on consumer affordability	Short term, Medium term	Growth	No change
04	Significant excise increases or structure changes	Short term, Medium term, Long term	Growth	No change
05	Disputed taxes, interest and penalties	Short term, Medium term	Productivity	No change
06	Foreign exchange rate exposures	Short term, Medium term	Productivity	Increased
07	Solvency and liquidity	Short term, Medium term	Productivity	No change
08	Geopolitical tensions	Short term, Medium term, Long term	Growth	No change
09	Injury, illness or death in the workplace	Short term, Medium term, Long term	Sustainability	No change
10	Tobacco regulation inhibits growth strategy	Short term, Medium term, Long term	Growth, Sustainability	No change
11	Litigation	Short term, Medium term, Long term	Growth	No change
12	Inability to recruit or retain talent	Short term, Medium term, Long term	Growth, Winning Organisation	Increased

Time frame: Short term, Medium term, Long term

Link to Strategy: Growth, Productivity, Winning Organisation, Sustainability

Movement in year: Decreased, No change, Increased

Viability Statement

The Directors have assessed, in accordance with the requirements of the 2014 revision of the UK Corporate Governance Code, the viability of the Group. The Directors have considered a number of factors that affect the resilience of the Group, including the principal risks (as described on pages 39–44) which are reviewed, 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. This includes a sensitivity analysis regarding core drivers to ensure the business is able to continue in operation and can continue to meet the liabilities as they fall due.

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 30 "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, appeals will usually 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.

Marketplace risk factors

Competition from illicit trade

Time frame

Long term

Strategic impact

Growth (organic revenue growth)

Risk owner

Director, Legal and External Affairs

Definition

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

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

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

Principal causes

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

Potential impact

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

Mitigation activities

- Dedicated Anti-Illicit Trade (AIT) teams operating at global and country levels and internal cross-functional coordination.
- Active engagement with key external stakeholders.
- Cross-industry and multi-sector cooperation on a range of AIT issues.
- Global AIT strategy supported by a research programme to further the understanding of the size and scope of the problem.
- AIT Engagement Team (including a dedicated analytical laboratory) works with enforcement agencies in pursuit of priority targets.

Market size reduction and consumer down-trading

Time frame

Short/Medium term

Strategic impact

Growth (organic revenue growth)

Risk owner

Regional Directors

Definition

As a consequence of steep excise-led price increases and the continuing difficult economic and regulatory environment in many countries, market contraction and consumer down-trading are expected to remain principal risks facing the Group. A number of instances of market contraction have arisen, particularly in Europe, Australia, Brazil and Russia.

Principal causes

- Downturn in the economic climate impacting consumers' disposable incomes.
- Changes in the regulatory environment.
- Continued above-inflation price rises.
- Targeted growth of low-priced brands through aggressive pricing.

Potential impact

- Volume decline and portfolio mix erosion.
- Funds to invest in growth opportunities are reduced.

Mitigation activities

- Geographic spread mitigates impact at Group level.
- Quarterly brand reviews are presented to the Global Marketing Leadership Team as well as to the Management Board.
- Economic outlook embedded into quarterly performance reviews in markets.
- Key market reviews at Management Board meetings.
- Close monitoring of sales volume by segment to detect changes in consumer purchasing patterns in markets.
- Clear 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.

Business environment

Principal Group risk factors continued

Marketplace risk factors continued

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

Time frame
Short/Medium term

Strategic impact
Growth (organic revenue growth)

Risk owner
Regional Directors

Definition
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.

Principal causes
- Increased regulation reduces the ability to build brand equity and enhance the value proposition to the consumer.
- Stretched consumer affordability arising from deteriorating economic conditions and rising prices.
- Sharp increase or change in excise structure reduces opportunities for manufacturer-led pricing.
- Competitor pricing activities.

Potential 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.
- Down-trading and growth of illicit trade.

Mitigation activities
- Key market and pricing reviews at Management Board meetings.
- Pricing, 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.

Excise and tax risk factors

Significant excise increases or structure changes

Time frame
Long term

Strategic impact
Growth (organic revenue growth)

Risk owner
Regional Directors

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

A number of significant excise increases have taken place over the past three years, for example in Australia, Russia, Brazil, South Korea, Turkey, Ukraine and the Philippines. To date, the Group has been able to balance these increases with its geographic spread and continues to develop effective measures to address the risk.

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

Potential 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.
- Central team in place to define the excise management framework, develop training materials, monitor and engage with international financial institutions on excise and anti-illicit trade matters.

Excise and tax risk factors continued

Disputed taxes, interest and penalties

Time frame

Short/Medium term

Strategic impact

Productivity (capital effectiveness)

Risk owner

Finance Director

Definition

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

Principal causes

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

Potential impact

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

Mitigation activities

– 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.

Finance risk factors

Foreign exchange rate exposures

Time frame

Short/Medium term

Strategic impact

Productivity (capital effectiveness)

Risk owner

Finance Director

Definition

The Group faces transactional and translational foreign exchange (FX) rate exposures for earnings/cash flows from its global business. During periods of sterling strength and FX rate volatility, as seen in 2015, the adverse impact on the Group's results can be significant.

Principal causes

– FX rate exposures arise from exchange rate movement against the functional currency and against sterling, the Group's reporting currency.

Potential impact

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

Business environment

Principal Group risk factors continued

Finance risk factors continued

Solvency and liquidity

Time frame

Short/Medium term

Strategic impact

Productivity (capital effectiveness)

Risk owner

Finance Director

Definition

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).

Principal causes

- The external environment (foreign exchange and interest rates) and the availability of financing and business conditions are subject to variability which may lead to stress in the capital structure, liquidity and solvency of the Group.

Potential 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 2020 (an additional one-year extension is available at the option of the banks) 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.

Operations risk factors

Geopolitical tensions

Time frame

Long term

Strategic impact

Growth (organic revenue growth)

Risk owner

Director, Legal and External Affairs

Definition

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

Principal causes

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

Potential impact

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

Mitigation activities

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

Operations risk factors continued

Injury, illness or death in the workplace

Time frame

Long term

Strategic impact

Sustainability

Risk owner

Director, Operations

Definition

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

Principal causes

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

Potential impact

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

Mitigation activities

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

Regulation risk factors

Tobacco regulation inhibits growth strategy

Time frame

Long term

Strategic impact

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

Risk owner

Director, Legal and External Affairs

Definition

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

Principal causes

- Pressure from some international health organisations, governments and the tobacco control community to pursue regulation and policy that: is not evidence-based; is designed to eradicate tobacco and nicotine use; excludes the industry from the manufacture and sale of Next Generation Products or regulates them in a way that fails to incentivise their commercialisation; and fails to deliver legitimate public health objectives.

Potential 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.
- Constriction of the retail universe and limitations on product visibility.

Potential impact continued

- 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.
- Prioritisation of key current and emerging regulatory issues.
- 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.

Business environment

Principal Group risk factors continued

Litigation risk factors

Litigation

Time frame

Long term

Strategic impact

Growth (revenue impact)

Risk owner

Director, Legal and External Affairs

Definition

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.

Principal causes

- Case lost by either a non-Group or Group company may set a precedent for the filing of future claims against the Group.
- Cases are brought on the basis of the reversal of the burden of proof which places the Group, as a defendant, at a disadvantage e.g. health care recoupment cases.
- Aggressive court timeline or approach that undermines defence preparation.

Potential 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.

People risk factors

Inability to recruit or retain talent

Time frame

Long term

Strategic impact

Growth (revenue impact) and Winning Organisation

Risk owner

Director, Group Human Resources

Definition

The Group faces a risk of an inability to attract and retain the right people who have the ability and personal leadership to drive and deliver competitive advantage and superior performance.

Principal causes

- Negative perception of the sustainability and corporate reputation of a tobacco company.
- Perceived uncompetitive remuneration packages compared to the marketplace.

Potential impact

- Undesirable voluntary turnover reducing organisational performance and productivity.
- Critical positions left vacant unbalances skills and capabilities and reduces sustainable leadership to drive the Group strategy.

Mitigation activities

- Group employee communication campaign 'The BAT Way' and leadership team interaction to strengthen employee engagement.
- Employee engagement 'Your Voice' analysis and global exit interviews to understand employee satisfaction and drive targeted action.
- Elevating our employer brand and communication digitally through targeted social media channels.
- Active talent agenda and talent management globally, providing succession planning and stretch development opportunities to enhance the quality of our people and the strength of our talent pipelines.
- Investment in our leadership development portfolio to challenge and inspire, enabling career development.
- Benchmarking of reward in line with a global FMCG comparator group.

Ben Stevens
Finance Director

Governance

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Governance

Directors' Report

Chairman's introduction

Richard Burrows
Chairman

Dear Shareholder

One of the key objectives of our Board is establishing and driving clear, transparent and rigorous systems of Corporate Governance. We aim to meet the best of international standards and regulatory requirements and review our ways of working regularly each year.

During 2015, both regulatory requirements and international standards were in sharp focus. The Board worked closely with the Audit Committee to consider the broader assessment of long-term solvency, liquidity and viability now required under the revised provisions of the UK Corporate Governance Code on risk management and internal control. These, together with our principal Group risk factors, are reported upon in detail in our Strategic Report on pages 37–44.

Our Standards of Business Conduct came under the spotlight in late 2015, as a result of media interest in allegations of bribes being paid in East Africa in 2012.

We take these allegations extremely seriously. Although we were aware of and had looked into some of the allegations in the past, given the high standards to which we hold ourselves and the number and nature of the allegations of which we are now aware, the Group has appointed an external law firm to conduct a full investigation.

We have also informed the Serious Fraud Office of our approach and we are liaising with them.

All our employees are required to understand and abide by our Standards of Business Conduct. We will not tolerate corruption in our business anywhere in the world.

The Group's Statement of Business Principles is another policy that underpins the Group's commitment to high standards of corporate behaviour and human rights. We demand high standards from our suppliers and in early 2016 we formalised this through a Supplier Code of Conduct which details the minimum standards we expect our suppliers to meet in these areas.

As reported in the 2014 Annual Report, the Audit Committee agreed to conduct a competitive audit tender ahead of the AGM on 29 April 2015. As a result of proposed litigation by a Group subsidiary against PricewaterhouseCoopers LLP (PwC), PwC had notified us that it would not seek reappointment as the Group's auditors at the AGM in April 2015. This situation arose from potential claims against PwC in respect of work carried out by PwC in relation to the audit of the accounts of a third party. These claims do not concern the audit of any Group Company. KPMG LLP was appointed as the Group Auditors in March 2015 and their appointment was confirmed by shareholders at our 2015 AGM. Further details of the audit tender can be found on page 60.

We continue to evaluate our own performance on an annual basis. The evaluation includes a 360-degree review of all Board members, including myself, and we receive individual feedback. The key outcomes from this year's evaluation are set out in this section, including our proposed actions for 2016.

We aim to have a Board that is as diverse as our geographic reach and our consumer profiles. Sue Farr, Pedro Malan and Dimitri Panayotopoulos, who joined the Board in February 2015, have added to the Board's diverse composition, bringing valuable business and geopolitical skills to the Board.

We also refreshed our Committee composition during 2015. As a result Christine Morin-Postel replaced Kieran Poynter as Chair of the Audit Committee and Kieran Poynter replaced Gerry Murphy as Chair of the Remuneration Committee.

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. The Board remains committed to ensuring that our governance processes and the culture throughout the Group continue to reflect the standards that you expect. Many of you share your thinking with me on this topic and I welcome this open and ongoing dialogue.

Richard Burrows
Chairman

Compliance statement

Throughout the year ended 31 December 2015 and to the date of this document, we applied the Main Principles of the UK Corporate Governance Code as revised in September 2014 (the Code). 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 Rules and Transparency Rules requirements for corporate governance statements by virtue of the information included in this section, together with the information contained in the other corporate disclosures section.

Governance

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 four principal Board Committees, listed below, 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 2015.

Audit Committee page 58
CSR Committee page 64
Nominations Committee page 66
Remuneration Committee page 92

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. The key activities of the Board in 2015, grouped under the Group's four strategy pillars of Growth, Productivity, Sustainability and Winning Organisation, are detailed on pages 52–53. The Board's strategic priorities for 2016 are identified within the key performance indicators set out in our Strategic Report on page 13.

The Board devotes considerable attention to Group Corporate Governance, including internal control and compliance issues. It receives verbal updates from the Chairmen of the Audit, Remuneration and CSR Committees following each Committee meeting and updates from the Nominations Committee on a periodic basis, where appropriate. Copies of the minutes of the Audit and CSR Committees are circulated to all members of the Board. With effect from 1 January 2016, copies of the minutes of all Committees (redacted where necessary) will be made available to all Directors.

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 biographies are detailed on pages 50–51. Neil Withington, General Counsel, retired from the Management Board with effect from 30 April 2015. Jerome Abelman was appointed to the combined role of Director, Legal & External Affairs and General Counsel with effect from 1 May 2015.

Principal Management Board role:

- Developing 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.

Next Generation Products Governance

Until September 2015, the Board of British American Tobacco (NGP) Limited, a Group subsidiary, was exclusively responsible for the strategic oversight and governance of the Next Generation Products business. This facilitated a flexible and proactive approach to the early stages of building this new category. As the Next Generation Products business has developed and as non-combustible tobacco product development has progressed and become more integrated with the rest of the Group, the separation of its management and strategic oversight from that of the combustible tobacco business is no longer required. With effect from October 2015, all matters relating to the Next Generation Products business now also fall within the remit of the Management Board. The corporate structure of the Next Generation Products business is not affected by this change.

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.

Governance

Board of Directors

Richard Burrows
Chairman (70)

Nationality: Irish

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

Key appointments: NED and member of the Remuneration and Nominations Committees of Rentokil Initial plc; Supervisory Board member, member of the Audit Committee 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.

Christine Morin-Postel
Senior Independent Director (69)

Nationality: French

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

Key appointments: NED and member of the Nomination and Remuneration Committee of Groupe Bruxelles Lambert S.A.; NED and Chair of the Nomination and Remuneration Committee of Hightech Payment Systems S.A.; Member of the Investment Committee of Capmezzanine 2 private equity fund.

Skills and experience: Christine has extensive international board experience and has held a number of senior management positions, including Chief Executive of Société Générale de Belgique, Executive Vice-President and member of the Executive Committee of Suez and Chairman and CEO of Crédisuez S.A.

Nicandro Durante
Chief Executive (59)

Nationality: Brazilian/Italian

Position: Chief Executive since 2011.

Key appointments: Non-Executive Director and member of the Nomination and Remuneration Committees 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 (56)

Nationality: British

Position: Finance Director since 2008.

Key appointments: No external appointments.

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 (59)

Nationality: British

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

Key appointments: Special Advisor, Chime Group; NED, member of the Audit, Nomination and Remuneration Committees and Chair of the Corporate Social Responsibility Committee of Dairy Crest Group plc; NED and member of the Remuneration and Nominations Committees of Millennium & Copthorne Hotels plc; NED and member of the Audit and Nominations & Remuneration Committees of Accsys Technologies PLC.

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 (60)

Nationality: Canadian/British

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

Key appointments: NED, member of the Nominations Committee and Chair of the Audit Committee of Rio Tinto plc and Rio Tinto Limited; NED, member of the Audit Committee and Chair of the Compensation Committee of UBS Group AG and UBS AG; NED, member of the Nomination and Risk Committees 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 of Canada and a Fellow of the Chartered Professional Accountants.

Savio Kwan
Non-Executive Director (67)

Nationality: British

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

Key appointments: Co-Founder and CEO of A&K Consulting Co Ltd, advising entrepreneurs and their start-up businesses in China; Visiting Professor at Henley Business School; Member of APAC Advisory Board of UBS Wealth Management, UBS AG Hong Kong Branch; Non-Executive Director of The 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 (73)

Nationality: Brazilian

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

Key appointments: Chairman of the International Advisory Board of Itaú Unibanco; member of the Advisory Board of EDP – Energias do Brasil SA; NED of Mills Estruturas e Servicos de Engenharia 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 Gerard Murphy
Non-Executive Director (60)

Nationality: Irish

Position: Non-Executive Director since 2009; member of the Audit and Nominations Committees.

Key appointments: Chairman of the Executive Committee of The Blackstone Group International Partners LLP; Chairman of Ideal Shopping Direct; and Supervisory Board member of Intertrust N.V. and Jack Wolfskin.

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 (64)

Nationality: Greek/Tanzanian

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

Key appointments: Senior Advisor at The Boston Consulting Group; NED and member of the Compensation Committee 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 2015

Name	Director since	Attended/ Eligible to attend
Richard Burrows	2009	9/9
Christine Morin-Postel	2007	9/9
Nicandro Durante	2008	9/9
Ben Stevens	2008	9/9
Sue Farr	2015	9/9
Ann Godbehere[1]	2011	8/9
Savio Kwan[2]	2014	8/9
Dr Pedro Malan[3]	2015	8/9
Dr Gerry Murphy	2009	9/9
Dimitri Panayotopoulos[1]	2015	8/9
Kieran Poynter	2010	9/9
Karen de Segundo[4]	2007	8/9
Dr Richard Tubb[5]	2013	8/9

Notes:

1. Ann Godbehere and Dimitri Panayotopoulos missed the March ad hoc Board meeting, arranged at short notice, due to prior engagements.
2. Savio Kwan missed the January ad hoc Board meeting, arranged at short notice, due to a prior engagement.
3. Pedro Malan, missed the July ad hoc Board meeting, arranged at short notice, due to a prior engagement.
4. Karen de Segundo missed the October Board meeting due to illness.
5. Dr Richard Tubb missed the September Board meeting due to a family bereavement.
6. The Board held nine meetings in 2015. Six of these were scheduled. One meeting was held off site, in Brazil, to review the Group's strategy and the Group's Americas regional businesses. Six Board meetings are scheduled for 2016.
7. The Board of Directors is shown as at the date of this Annual Report.

Kieran Poynter
Non-Executive Director (65)

Nationality: British

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

Key appointments: NED and member of the Audit and Compliance and Safety Committees 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.

Karen de Segundo
Non-Executive Director (69)

Nationality: Dutch

Position: Non-Executive Director since 2007; Chair of the Corporate Social Responsibility Committee; member of the Nominations Committee. Will retire at the conclusion of the 2016 AGM.

Key appointments: Supervisory Board Member and member of the Finance & Investment and Nomination Committees at E.ON SE; member of the Board and member of the Audit Committee of Pöyry Oyj; NED of Cubico Sustainable Investments Holdings Limited.

Skills and experience: Karen has considerable leadership experience of global business. Karen spent more than 30 years with Shell, holding various senior executive roles before retiring as CEO Shell International Renewables and President Shell Hydrogen in 2005. Karen is a Council Member of the Anglo Netherlands Society.

Dr Richard Tubb
Non-Executive Director (56)

Nationality: US

Position: Non-Executive Director since 2013; member of the Corporate Social Responsibility and Nominations Committees. Will retire at the conclusion of the 2016 AGM.

Key appointments: White House Physician Emeritus; member of the Board of Reference for Project Rescue; Senior Managing Director, Shoreland, Inc; advisory position at Lonsdale.

Skills and experience: Richard is a leading public health figure actively involved in the science and policy development of tobacco harm reduction and alternative nicotine products. He was White House Physician from 1995 to 2009, including Physician to the President of the United States from 2002 until his retirement in 2009. Prior to that, Richard was Clinical Assistant Professor at the Uniformed Services University (retired) and Brigadier General (retired) in the US Air Force.

Governance

Management Board

Jerome Abelman

Director, Legal & External Affairs and General Counsel (52)

Nationality: US

Jerry was appointed Director, Legal & External Affairs and General Counsel on 1 May 2015, having joined the Management Board as Group Corporate & Regulatory Affairs Director in January 2015. He has been with the Group for 13 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 Inc., on 4 February 2016.

Jack Bowles

Regional Director, Asia-Pacific (52)

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 (52)

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 (50)

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 (51)

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

Director, Business Development (49)

Nationality: Brazilian

Tadeu joined the Management Board as Business Development Director in September 2014. In addition to his role leading Strategy and M&A, Tadeu is responsible for IT, including the roll-out of the Group's revised operating model and single IT operating system. 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 (49)

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 (52)

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 Inc., in December 2014 and was appointed to the Chief Marketing Officer (CMO) Council Latin America Advisory Board on 3 February 2016.

Naresh Sethi
Regional Director, Western Europe (49)

Nationality: Australian/Indian

Naresh was appointed Regional Director for Western Europe in January 2013. 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 and was appointed Director, Group Business Development in 2012.

Johan Vandermeulen
Regional Director, Eastern Europe, Middle East and Africa (48)

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 (43)

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.

Governance

Board activities in 2015

Growth

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

Activities in 2015

Consideration of industry trends and the competitor environment for Tobacco Products and Next Generation Products;

Reviewing the implementation of the Group's Strategy in light of evolving global trends, in particular the slower economic recovery and its impact on emerging markets and changing consumer preferences. Agreeing key strategic imperatives to ensure that the Group Strategy remains relevant and appropriately targets key growth segments;

Receiving and agreeing to pursue M&A strategic and tactical opportunities for growth. In the tobacco sector this included the maintenance of the Group's shareholding of 42% in the enlarged Reynolds American Inc. following its purchase of Lorillard Inc.; the acquisition by the Group of the minority interest shareholding in Souza Cruz S.A.; the acquisition of TDR d.o.o., which has strong distribution networks for tobacco products in Croatia, Bosnia and Serbia; and the acquisition of the Blue Nile Cigarette Company Limited in Sudan, enhancing the Group's manufacturing and distribution capabilities in this market. In the Next Generation Products sector, this included the acquisition of the CHIC e-cigarette manufacturing business in Poland and the conclusion of a vapour products technology-sharing agreement with R.J. Reynolds Tobacco Company, a subsidiary of Reynolds American Inc. which provides a framework for collaboration and mutual cross-licensing of the parties' vapour product technologies until the end of 2022;

Reviewing 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;

Reviewing the quarterly financial performance of the Group's associate companies, Reynolds American Inc. and Imperial Tobacco Canada (ITCAN).

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 2015

Monitoring the final stages 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;

Working through the Audit Committee to establish and conduct a compressed audit tender process to appoint new Group Auditors and appointing KPMG LLP as Group Auditors in March 2015;

Reviewing the Group's trade marketing and distribution resources, including the proposal to leverage the Group's Direct to Store Distribution (DSD) networks in the Americas by partnering with other FMCG companies to distribute their products, to achieve further efficiencies and cost savings;

Regularly reviewing the Group's liquidity, confirming that the Company was conforming with its financing principles, and noting planned refinancing activities for the year ahead;

Monitoring the Group's IT security threat assessment process;

Reviewing progress on the merger of the Group Legal and the Corporate and Regulatory Affairs functions to form a combined Legal and External Affairs function.

Strategy deep dives

Delivering growth

In October 2015, the Board held a week of meetings in Brazil led by senior management from the Americas region. The Board participated in a comprehensive review of the Group's Product and Leaf Strategy, including the Must Win sources for high-quality leaf and issues of farmer sustainability and reviewed the Americas regional strategy and its implementation.

It also reviewed the Group's combustible product and innovation pipeline at the Regional Product Centre in Porto Alegre, in particular its process for innovation.

The Board spent a day visiting a contractor farmer, reviewing all aspects of the leaf growing and curing business and conducted a market visit in Rio de Janeiro.

For more information on our Group Strategy see pages 8–9 of our Strategic Report.

Sustainability

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

Activities in 2015

Receiving updates on the Group's Next Generation Products business, including a new organisational structure and strategy for the Vapour Products and Tobacco Heating Products business. Reviewing performance following the launch of the Vype e-stick and Vype e-pen including the innovation pipeline in this area and proposed timelines and markets for future launches, including the 'glo iFuse' Tobacco Heating Product;

Monitoring progress made by the Group in securing regulatory approval for its nicotine inhalation product, Voke, for which a Medicines and Healthcare Products Regulatory Agency licence was received in February 2015;

Approving Group-wide Vapour Marketing Principles to govern the Group's advertising and promotion of Vapour Products;

Monitoring the status of the Group's litigation proceedings. This included receiving updates on the class actions in Quebec, Canada against the Group's subsidiary Imperial Tobacco Canada (ITCAN) and two other Canadian manufacturers, and the Plaintiffs' unsuccessful claim for a Provisional Execution order in July; the Plaintiffs' successful application for security for costs in October and preparations for ITCAN's appeal of the substantive judgment. Receiving updates on legacy litigation in relation to pollution in the US (Fox River and Kalamazoo River) and the settlement of asbestos-related claims made against a former US subsidiary of the Group's Canadian business (Flintkote);

Reviewing the Group's regulatory strategy in the context of the current regulatory landscape, including plain packaging proposals within the EU and their potential implications for the business, including the Group's legal challenge to the UK Government's proposed new packaging rules;

Reviewing the new risk management related requirements set out in the revised UK Corporate Governance Code; reviewing Group-wide and regional risks in the context of identified growth opportunities. 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;

Reviewing future sustainability reporting plans to ensure continued focus on priority topics, namely sustainable agriculture, corporate conduct and harm reduction. Reviewing progress on the Group's activities to improve its relationships with its contracted farmers in key markets;

Monitoring compliance with the Group's Standards of Business Conduct and internal controls. A number of allegations were made towards the end of 2015 regarding historic misconduct in Africa. Although the Group was aware of and had looked into some of the allegations in the past, given the high standards to which we hold ourselves and the number and nature of the allegations of which the Group is now aware, the Board approved the appointment of an external law firm to conduct a full investigation and instructed that it be kept updated on the progress and findings of this investigation.

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 2015

Reviewing the results of the Group-wide survey of employee engagement undertaken in late 2014, where all categories had improved compared to the 2012 survey and where, in the majority of categories the Group scores were higher than the average for comparable companies;

Receiving updates on the difficulties of attracting and retaining talent and factoring this into consideration of revised talent and remuneration policies;

Reviewing the application and continuing impact of the Remuneration Policy during 2015; agreeing proposals for a revised Policy and consulting with key shareholders in both early and late 2015 in relation to those proposals;

Reviewing the development of leaders in the Group, in particular activities to drive a high-performance leadership culture, including a revised performance management system to develop diverse leaders at all levels and a focus on external recruitment utilising social media;

Receiving updates on the Group's diversity ambitions with particular focus on gender and nationality diversity at senior grades;

Reviewing detailed succession planning at Board level, including Executive Director and Management Board succession planning and monitoring the progress of Management Board development plans;

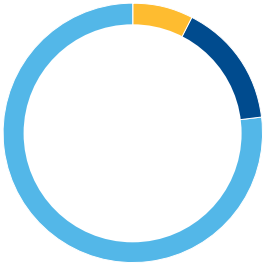
Reviewing the performance of the Executive Directors and Management Board members;

Considering Non-Executive Director appointments proposed by the Nominations Committee and appointing three new Non-Executive Directors and reviewing and refreshing the composition of Board Committees.

Governance

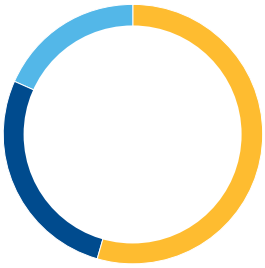
Board effectiveness

Balance of Non-Executive Directors and Executive Directors



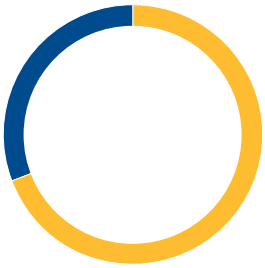
Chairman	1
Executive Directors	2
Independent Non-Executive Directors	10

Length of tenure of Non-Executive Directors



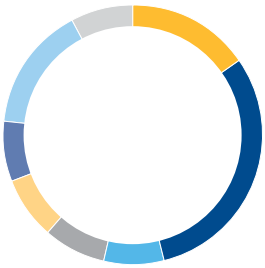
1–5 years	6
5–7 years	3
7–9 years	2

Gender split of Directors



Male	9
Female	4

Nationality of Directors



Brazilian	2	Dutch	1	Irish	2
British	4	French	1	US	1
Canadian	1	Greek	1		

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 48–49. In 2015 over 30% 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. The Board promotes diversity and encourages initiatives to improve gender diversity in senior management roles. Our Strategic Report contains details of our diversity policy, including the proportion of women in our total workforce and in senior management, on pages 18–19.

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.

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.

Sue Farr, Pedro Malan and Dimitri Panayotopoulos received a comprehensive induction in 2015 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. They, along with the rest of the Board, also had the opportunity to visit the Group's Regional Product Centre in Brazil. A visit to a factory is planned for 2016 to complete their induction.

Conflicts of interest in 2015

Two particular issues of potential conflicts of interest were considered in 2015 in connection with the decision to bring proceedings against PwC and the resulting tender process for new auditors. The Board reconsidered whether or not it should re-authorise any situational conflict which had already arisen or which could arise for each of Kieran Poynter and Christine Morin-Postel, both of whom had previously advised of separate circumstances which could be considered to have impacted their independence. The issue arose in relation to discussions on whether or not to pursue proceedings against PwC in relation to potential claims the Group has against the French company Sequana SA, in respect of the Group's exposure to clean-up costs for pollution in the Lower Fox River, Wisconsin. Christine Morin-Postel was a non-executive director of a shareholder in Sequana SA from 15 April 2009 until 29 May 2012, a time when the issues in dispute may have taken place. In addition, Kieran Poynter was Senior Partner at PwC during the period in which it was auditing the accounts of the third party connected with the proceedings. Neither Christine Morin-Postel nor Kieran Poynter had any personal involvement in or knowledge of the matters underlying the dispute.

After careful consideration, the Board authorised both potential situational conflicts. Both Kieran Poynter and Christine Morin-Postel recused themselves from the Board discussion as to whether or not proceedings would be pursued against PwC. The Board also decided that neither Director was required to recuse him or herself from any subsequent discussions relating to the consequences of the Board's decision to bring proceedings against PwC. As a consequence, both Kieran Poynter and Christine Morin-Postel, both members of the Audit Committee, played a full role in the audit tender process which led to the appointment of KPMG LLP as the Group's Auditors.

Training and development

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 the Group's regional and central functions and are also invited to attend a market visit alongside a Regional Director to see the Group's business on the ground. In 2015, a number of Non-Executive Directors visited Turkey where they discussed the local challenges being faced by the Group. In addition, in April 2015 a number of Non-Executive Directors attended a training session on the new approach to brand development being applied across the Group's Global Drive Brands.

The Board and its Committees receive regular briefings on legal and regulatory developments. In 2015, the Board reviewed the revised requirements for audit tenders and the appointment of auditors and the new regulatory requirements for assessing risk appetite and for developing a viability statement.

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

Shareholder engagement

The Chairman and the Executive Directors are committed to open and transparent dialogue with shareholders. In early 2015, both the Chairman and the Chairman of the Remuneration Committee met a number of key shareholders to engage further in relation to the Group's Remuneration Policy. The Board decided, following engagement, that it would not submit changes to the Remuneration Policy at the 2015 AGM. That feedback has, however, led to revised proposals and subsequent further consultation with shareholders in late 2015. Input from shareholders has been reflected in the final Policy proposals being submitted to the AGM in 2016.

The Chairman also meets significant shareholders and, during the year, held eight personal meetings with major investors. He also met with the Investment Association, to discuss the introduction of their Board Confidence index.

The Senior Independent Director and other Non-Executive Directors are also available to meet with major shareholders on request.

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 attended the AGM in 2015. Details of our 2016 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. Every two years, combined investor meetings are held over two days with the Management Board also in attendance. This year's investor roadshow was held in Bucharest, Romania, and all members of the Management Board gave detailed presentations covering the current status and issues in Marketing, Regulation, Operations, and Research and Development, as well as providing regional updates.

In 2015, as part of the annual investors relations programme, meetings were also held with institutional shareholders in 17 countries, spanning five continents. In terms of percentage shareholding, the Company engaged with the owners of the majority of its shares. Regular investor presentations were also given and these together with the roadshow and results presentations are all published on www.bat.com. All results presentations are also available to shareholders by webcast.

In addition, there is a micro site 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

Twice a year, the Head of Investor Relations reports to the Board, identifying key issues raised by institutional shareholders as well as a commentary on share price performance. Many of the same issues have been raised by shareholders this year, including the impact of foreign exchange rates, industry volume declines, industry pricing, the rise of the value-for-money segment, and the slowing down of emerging market economies. In addition, the regulatory challenges facing the Group such as plain packaging in Australia and the UK as well as the Group's significant M&A activity have also been areas of interest.

The Board also receives reports at each meeting on any changes to the holdings of the Company's main institutional shareholders. The Chairman also comments on any meetings he has had with shareholders allowing the Board to discuss the key points they have raised.

Board evaluation

Evaluation process

The performance and effectiveness of the Board, its Committees, the Executive and Non-Executive Directors and the Chairman have again been assessed internally, using questionnaires produced with the assistance of the online governance assessment service, Thinking Board. For each question, Directors were requested to rank the Board against a number of questions. They also had the opportunity to provide specific comments.

Constructive feedback

Reports were prepared by the Company Secretary for the Board and each Board Committee on the results of the evaluation. In addition, the Chairman received reports from the Company Secretary 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 very well and each of its Committees continue to be efficient and effective. All Board members are considered to be making an effective contribution to the Board and Board discussions.

A summary of the key points arising from the evaluation, our progress against 2015 action points and proposed actions for 2016, is set out on pages 56–57.

For disclosures required by paragraph 7.2.6 of the Disclosure and Transparency rules and the Companies Act 2006 see the other corporate disclosures section on pages 113–119.

Board effectiveness continued

Board evaluation 2015

Leadership

"Good discussion about the Company's performance with the right degree of challenge on the performance of the business"

Findings

The Board continues to have a clear understanding of the Group's business and the environment in which it operates.

Strategy is continually reviewed with management and its focus refined as necessary. "There is an excellent balance between the long and short-term views in a very dynamic global market."

There is a good understanding of the risks to the business, including reputational risks.

The continuing importance and the value of the market visits, particularly for the Non-Executive Directors, was rated highly although as a global organisation it is recognised that not all Regions can be covered each year.

The Executive Directors and senior management are well regarded.

Action for 2016

Continue to ensure that the Board receives timely briefings on the development and progress of strategy and on the challenges and opportunities facing the sector.

Earlier involvement in strategy development could allow more input from the Board, in particular around different scenarios and alternative strategic proposals.

Progress against 2015 actions

To assist the Non-Executive Directors in understanding fully the challenges and opportunities facing the Group, the annual Strategy meeting was held in Brazil where the Board received presentations on leaf and product issues, discussed regional issues with senior management and visited a tobacco farm and the Regional Product Centre.

Additional Board training sessions were held on the Group's Brand Building activity and the Next Generation Products businesses which provided further opportunities for Board interaction with senior managers in the Marketing and Next Generation Products functions.

Oversight

NEDs demonstrate "a willingness to understand the business in depth"

Findings

The Board has effective oversight of the business and a good understanding of the business drivers.

The Group's Audit and Corporate and Social Responsibility Committee framework, and risks monitored by the Board in this context, continues to work well.

Group performance against a range of measures was reported to the Board by the Chief Executive and the Finance Director in regular Board updates.

Action for 2016

To provide further context for Board discussions, more regular 'deep dives' into the performance and published strategies of the Group's key competitors will be scheduled.

More regular reviews of shareholder and media views of the Company will be sought directly by the Board to help challenge the Board's assumptions.

Progress against 2015 actions

The Board reviewed detailed proposals on defining and setting the Group's risk appetite and considered the viability of its business model relative to its principal risks.

Market visits conducted during the year allow senior managers greater access to Non-Executive Directors and vice versa, increasing the Board's confidence that effective oversight and a detailed line of sight is prevalent throughout the organisation.

Meetings

"Well managed in terms of scope, complexity, efficiency and time management"

"Thorough documentation"

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.

Meetings enable good discussion about the Company's results with the right degree of challenge on performance issues.

Views are presented clearly. Meeting times may be extended and discussions often continue over dinner, without management being present, to allow full and frank discussion.

Action for 2016

Committee memberships and the scheduling of Committee meetings will be 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.

Non-Executive Director-only discussions have been particularly valuable during 2015 and these will continue to be scheduled during 2016.

Progress against 2015 actions

Non-Executive Directors received regular functional briefings on the Next Generation Products business, M&A and litigation matters during 2015, and briefings on operational and regional issues during the market visit to Turkey and the Strategy meeting in Brazil.

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 2015.

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, in order to discuss the Chairman's performance.

Support

"The administrative and secretariat support is first class and much appreciated"

Findings

The Board continues to receive good support from management and the secretariat. All Non-Executive Directors appreciate the level of training and support they receive in performing their duties.

As mentioned on page 55, the Chairman meets each Non-Executive Director individually, each year, to discuss their training and development needs.

Action for 2016

Regular, relevant training on legal duties and corporate governance will continue to be provided, for example on the new Market Abuse Regulations.

Progress against 2015 actions

All new Non-Executive Directors completed a detailed induction covering all aspects of the business where they have been able to meet all of the Management Board members and Heads of Function. The final element, a factory visit, is planned for 2016.

Training sessions for the Board have been held on brand building activity and on the development of the Next Generation Products business.

Composition

"The approach to succession planning and the oversight exercised by the Board represents very best practice"

Findings

The addition of new Non-Executive Directors with branding and marketing experience is seen as "a real plus" given the Group's operations in the FMCG sector.

The Board has broad and diverse skills, experience and talent. The Board mix meets current and future needs and benefits from the right mix of personalities and styles.

The Board also deals with transition and long-term planning well.

Action for 2016

The succession needs of specific Committees, as opposed to the Board as a whole, will be a focus area in 2016.

The appointment of Non-Executive Directors with diverse skills, nationalities and gender will continue to support the Group's diversity and strategy ambitions, particularly in light of the retirement of one female Non-Executive Director in 2016.

Succession contingency plans will be kept under regular review.

Progress against 2015 actions

The Board refreshment exercise undertaken in 2014 and early 2015 culminated in the appointment of three new Non-Executive Directors in February 2015. Each of the new appointees brings identified skills to the Board, whether consumer goods marketing experience or business and geopolitical skills.

Working together

"Working well together as a group"

"Cohesion and active participation of all"

Findings

The Chairman creates a culture of openness, respect and trust and creates opportunities for discussions with the Non-Executive Directors, individually and collectively. Difficult discussions with regards to the impact of the current Remuneration Policy on recruitment and employee relations were handled sensitively.

The Chief Executive and the Chairman have a good working relationship; in addition, the Board works within a consensus position, once established.

The change of auditor was noted as being an example of a united Board working well and being effective to achieve a desired outcome in a very tight timeframe.

The Directors scored each other highly on teamwork and relationships in the Director 360-degree review.

Action for 2016

Ensure that market visits and opportunities to engage with senior management continue as these not only give confidence to the Board that strategy implementation is aligned, it also provides context for succession planning discussions.

Progress against 2015 actions

In addition to the opportunities to meet senior managers provided by the market visit to Turkey and the Strategy meeting in Brazil, the Board budget meeting in December was also attended by all members of the Management Board.

Governance

Audit Committee

Christine Morin-Postel
Chairman of the Audit Committee

Audit Committee current members
Christine Morin-Postel (Chairman)
Ann Godbehere
Gerry Murphy
Kieran Poynter

Attendance at meetings in 2015

Name	Member since	Attendance/Eligible to attend
Ann Godbehere[1]	2012	6/6
Christine Morin-Postel[2]	2014	6/6
Gerry Murphy[3]	2015	3/3
Kieran Poynter[1]	2012	6/6

Notes:

1. Ann Godbehere and Kieran Poynter have recent and relevant financial experience.
2. Christine Morin-Postel became Chairman of the Committee, replacing Kieran Poynter, with effect from 5 May 2015. She re-joined the Committee on 6 January 2014 having previously served as a member of the Committee from 2007 to 2012.
3. Gerry Murphy joined the Committee with effect from 5 May 2015.
4. The Finance Director attends all meetings of the Committee but is not a member. Other Directors may attend by invitation. The Group Head of Audit and Business Risk, the Director, Legal & External Affairs, and the external auditors also attend meetings on a regular basis.
5. The Committee held six meetings in 2015. Five of these were scheduled. One ad hoc meeting was held in March regarding the tender process to appoint new Group Auditors.
6. The Committee meets alone with the external auditors and, separately, with the Group Head of Audit and Business Risk, at the end of most meetings.

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;
- the consistency of the Group's accounting policies;
- the effectiveness of, and makes recommendations to the Board on, the Group's accounting, risk and internal control systems;
- the effectiveness of the Company's internal audit function; and
- the performance, independence and objectivity of the Company's external auditors, making recommendations as to their reappointment (or for a tender of audit services), and approving their terms of engagement and the level of audit fees.

Key activities in 2015

Regular work programme:

- reviewing the application of accounting standards, the Group's 2014 results, 2015 half-year results, the interim management statements and the external auditors' reports where results are audited;
- reviewing the Group's liquidity position, current facilities and financing needs through 2015;
- reviewing the steps taken to validate the Group's 'Going Concern' assessment at half-year and year-end and the discussions and agreeing of the process steps taken to determine the Group's viability statement at year-end;
- reviewing the 2016 Internal Audit Plan;
- reviewing periodic reports from the Group's regional Audit and CSR Committees and Corporate Audit Committee;
- reviewing the Group's Risk Register, including the categorisation of, and mitigating factors in respect of, Group risks;
- reviewing regular reports from the Group Head of Audit and Business Risk on international audits and the management responses and action plans being put in place to address any concerns raised;
- reviewing in-depth reviews of specific risk topics (see page 59);
- reviewing the annual assessment of goodwill impairment;
- reviewing the annual report from the Head of Group Security on security risks and frauds and losses arising during the preceding year; and
- reviewing quarterly reports on compliance with the Group's Standards of Business Conduct and biannual reports on political contributions.

Further specific matters considered by the Committee:

- receiving a report on the threat to independence arising from the proposal to bring legal proceedings against the Group's then auditors, PricewaterhouseCoopers LLP (PwC) and accepting their resignation following the Board's decision to bring proceedings;
- reviewing the audit tender process and conducting the tender for the appointment of new Group Auditors and agreeing the audit strategy and transition plan following the appointment of KPMG LLP as the Group's auditors following the resignation of PwC;
- reviewing the Group's tax position including the progress made in tax litigation cases in various jurisdictions;
- reviewing accounting issues and policies relating to M&A activity;
- reviewing and agreeing a revised Group Treasury Policy; and
- receiving an update on Base Erosion and Profit Shifting and country by country tax reporting.

Risk topics considered by the Committee:

- the continued roll-out of the Group's revised operating model and single IT operating system programme, including reviewing the programme costs, its timeframe, and the risks and mitigation plans;
- the review of projects which will leverage the capabilities of the single IT operating system and its global scale to increase standardisation, automation, scale and service orientation in the areas of HR shared services and business information capabilities; and
- the Group's position and progress made with regard to various smoking and health litigation brought in Canada.

Significant accounting judgements considered by the Committee in relation to the 2015 accounts:

- **the continuing roll-out of the Group's revised operating model and single IT operating system:** given the level of investment, complexity and strategic importance to the Group, the Committee received regular updates from management, internal audit and the external auditors on progress with the roll-out throughout the year (including programme governance, risk and compliance activities). The Committee examined the capitalisation of the IT template as an intangible asset on the Group balance sheet (see note 9 in the Notes on the Accounts), amortisation of IT assets generated as part of the programme, and adjusting items in relation to implementation costs (see note 3(e) in the Notes on the Accounts), and was satisfied that the accounting treatment and disclosure of these matters adopted previously remains appropriate;
- **the Group's significant corporate tax exposures and related provisions:** 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, Turkey and the Netherlands and a favourable outcome in Canada. The Committee agreed with management's proposed provisions and extended disclosures in respect of them (see note 30 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, there has been no release of this provision in 2015 (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);
- **changes in the Group:** the Committee reviewed and approved the accounting treatment in relation the US$4.7 billion cash investment by the Group to maintain its 42% shareholding in RAI, as part of the RAI's acquisition of Lorillard Inc., including the recognition by the Group of a deemed gain of US$931 million (£601 million) in compliance with IAS 39 (see note 4(b) in the Notes on the Accounts). The Committee also agreed the Group's treatment in relation to the acquisition of the shares it does not already own in its subsidiary Souza Cruz; and
- **foreign exchange and restricted cash:** as the Group has operations in certain territories with severe currency restrictions, where foreign currency is not readily available, the Committee satisfied itself that the methodologies used to determine relevant exchange rates for accounting purposes remained appropriate (for restricted cash, see note 19 in the Notes on the Accounts).

Audit Committee continued

External auditors

As reported in the 2014 Annual Report, PricewaterhouseCoopers LLP (PwC) notified the Group that it would not seek reappointment as the Group's auditors at the 2015 AGM. This situation arose from potential claims against PwC, which had been assigned to the Group, in relation to the audit of the accounts of a third party. These claims do not concern the audit of any Group company (see below for further details of the tender process). KPMG LLP (KPMG) was appointed as Group Auditors on 27 March 2015 and their appointment was approved by shareholders at the AGM on 29 April 2015. The Committee considers that the relationship with the auditors is working well and is satisfied with their effectiveness.

Group auditor tender process

Process and selection criteria

The tender process was carried out in compliance with the provisions of the Competition and Markets Authority Audit Order 2014 (the CMA Order). The selection criteria adopted by the Committee also closely followed those detailed in the Audit Tender notes of best practice set out by the FRC as at July 2013 (namely, quality and clarity of approach, understanding of the business and risks, appropriate geographic breadth, appropriate team structure and experience, cultural fit and approach to independence and conflict issues). Due to the global nature of the Group's business, it was deemed not practicable to invite a mid-tier accountancy firm to tender, nor, given the short timescale, were investors views sought on the list of tender participants.

Process summary from 24 February to 27 March 2015

Request for Proposal (RFP) issued by the Chairman of the Audit Committee to RFP Vendors.

A data room was set up and introduction and engagement meetings were held between RFP Vendors and the Chairman of the Audit Committee, the Chairman, the Chief Executive, the Finance Director and the Director responsible for corporate and regulatory affairs.

Knowledge and information meetings were then held between RFP Vendors and senior management from key functions and functional teams submitted their evaluation on the selection criteria to the Head of Audit.

RFP Vendors submitted their final written tenders.

An ad hoc Audit Committee was convened to consider the tender responses. Each of the firms presented to the Audit Committee on their sector and global experience and the Committee questioned each firm in relation to its audit approach, on issues of independence and on the terms of their proposed engagement letters. A Board meeting followed on the same day. On the recommendation of the Audit Committee, and following receipt of PwC's letter of resignation, the Board appointed KPMG as the Group's new auditors.

A resolution to appoint KPMG as the Group's auditors was included in the Notice of AGM.

KPMG was confirmed by shareholders (99.76% voted in favour) as Group Auditors at the 2015 AGM.

There are no contractual obligations restricting the Company's choice of auditors. The Group's external auditors are required to rotate the audit partner responsible for the Group audit at least every five years, and those responsible for the subsidiary audits at least every seven years.

Auditor independence policy

The Committee has an established policy to safeguard and support the independence and objectivity of the Group's external auditors, which complies with the provisions of the CMA Order. 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, and provided that the total annual fees for non-audit services are below the sum of annual fees for audit and audit-related services.

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

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

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

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

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

Subject to the above, the external auditors may provide certain tax and other non-audit services. The Committee recognises that using the external auditors to provide such services is often of benefit 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 2015 is provided in note 3(d) in the Notes on the Accounts and is summarised as follows:

Services provided by KPMG firms and associates 2015 and by PwC and associates in 2014

	2015 (KPMG) £m	2014 (PwC) £m
Audit services	**8.7**	9.3
Audit-related assurance services	**0.2**	0.3
Total audit and audit-related services	**8.9**	9.6
Other assurance services	**0.1**	0.1
Tax advisory services	**0.6**	3.8
Tax compliance	**0.4**	0.8
Other non-audit services	**2.0**	0.2
Total non-audit services	**3.1**	4.9

Note:
In 2015 non-audit fees paid to KPMG amounted to 35% of the audit and audit-related assurance fees paid to them (2014 Auditors, PwC: 51%).

Annual assessment

In the ordinary course of business, each year, the Committee will normally separately assess the qualification, expertise and resources, and independence of the Group's external auditors and the effectiveness of the audit process. This year, given the change of auditors, KPMG's suitability was assessed by the Committee as part of the audit tender process, taking due consideration of the FRC guidance for Audit Committees on the evaluation of external auditor quality, including culture, skills, character, knowledge, quality control and judgement. The Committee were also particularly interested in understanding KPMG's proposed approach to the Group audit and questioned them carefully to ensure its effectiveness given the scope and geographic spread of the organisation and their links with, and the competence of, non UK-based component auditors.

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 37–44. 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 will review and monitor its risk appetite on an annual basis 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 and reports to shareholders that it has done so. This review covers all material controls including financial, operational and compliance controls and risk management systems.

Audit and CSR Committee framework

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

The Group's regional Audit and CSR Committees are all chaired by an Executive Director and attended by one or more Non-Executive Directors. 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 a number of markets in EEMEA and in other Regions where the complexity of the business requires it.

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 responsible Management Board member is identified in relation to each of the principal Group risk factors set out in our Strategic Report. The Group Risk Register is reviewed regularly by a committee of senior managers, chaired by the Finance Director. 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 2015, the Board noted that despite a number of changes to the Group Risk Register, which demonstrated its dynamic nature, the Group's risk profile remained stable.

This year the Board also considered the development of the Group Viability Statement see page 38 of the Strategic Report.

For more information on risk factors see the principal Group risk factors section in our Strategic Report on pages 37–44.

Audit Committee continued

Internal control

Group companies and other business units are required, on an annual basis, 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 and other business units, and does so against an audit plan presented annually to the Audit Committee, which focuses in particular on higher risk areas of the Group's business. Throughout much of 2015 there has been a significant focus by internal audit on the roll-out of the Group's revised operating model and single IT system, reviewing the Group's planning process for roll-out, its testing and business readiness, as well as reviewing the success of implementation. Once the roll-out completes in 2016, the focus of internal audit during the year will revert to both global process reviews as well as entity audits on a business-as-usual basis.

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 in order 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 attended an internal Annual Report drafting meeting and engaged separately with the Finance Director during the drafting process in 2015. 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 2015 (including established breaches), is available at www.bat.com/sobc.

In the year to 31 December 2015, 94 instances of suspected improper conduct contrary to the Standards (excluding non-material employee fraud and theft against Group companies) were reported to the Committee (2014: 56). In mid-2014, a new category under the Standards was included which encompassed Respect in the Workplace. In 2015, the first full year of reporting in this category, Respect in the Workplace matters accounted for 30 of the reported instances, following training in this area.

Of the 94 instances reported, 29 were established as breaches and appropriate action taken (2014: 20). In 43 cases, an investigation found no wrongdoing (2014: 31). In 22 cases, the investigation continued at the year-end (2014: 5).

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. It remains satisfied that the Group's policy and procedures enable proportionate and independent investigation of matters raised and ensure appropriate follow-up action is taken.

Of the total number of business conduct incidents reported in 2015, set out on the previous page, 73 were brought to management's attention through whistleblowing reports from employees, ex-employees, third parties or unknown individuals reporting anonymously (2014: 42). The increase is also considered to be a result of reporting relating to the new Standards of Business Conduct category which encompasses Respect in the Workplace, as well as continued awareness training delivered during 2015.

Political contributions

The Committee is responsible for reviewing donations made for political purposes throughout the Group. The total amount of political donations paid in 2015 was £25,804 (2014: £3,214), as follows:

British American Tobacco Japan Limited reported contributions totalling Japanese yen ¥1,910,000, (£10,324) for the full year 2015. 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.

British American Tobacco Colombia S.A.S. reported contributions totalling Colombian peso $65,000,000 (£15,480) for the period covering 1 July to 31 December 2015. This expenditure relates specifically to donations made to five different political parties in Colombia in order to contribute to public and democratic debates on issues affecting that company.

No other political donations were reported.

Annual review

The Financial Reporting Council's 'Guidance on Risk Management and Internal Control and Related Business Reporting' published in September 2014 (the Guidance) replaces the Turnbull Guidance on these matters and reflects the recent changes to 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 2015.

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.

Governance

Corporate Social Responsibility (CSR) Committee

Karen de Segundo
Chairman of the CSR Committee

CSR Committee current members	
Karen de Segundo (Chairman)	Dr Pedro Malan
Sue Farr	Dr Richard Tubb
Savio Kwan	

Attendance at meetings in 2015

Name	Member since	Attendance/Eligible to attend
Sue Farr	2015	2/2
Savio Kwan	2014	2/2
Dr Pedro Malan	2015	2/2
Karen de Segundo	2008	2/2
Dr Richard Tubb	2013	2/2

Notes:
1. The Committee held two meetings in 2015. Both were scheduled.
2. The Chairman, Chief Executive and the Director, Operations, regularly attend meetings by invitation but are not members. Senior managers responsible for Corporate Affairs and, on occasion, the Director, Legal & External Affairs, also attend the meetings but are not members.

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

Role

The CSR Committee monitors and reviews:

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

Key activities in 2015

CSR governance and compliance

- considering Group risks in the countries that are of potential concern from a human rights perspective, and reviewing the measures and controls in place to mitigate those risks;
- reviewing the Group's EHS strategy, measures, targets and performance data;
- reviewing the progress of the Group's leaf strategy, aimed at enhancing farmers' livelihoods and sustainable agriculture;
- reviewing the potential reputational impact arising from incidents of non-compliance with the Standards of Business Conduct;
- monitoring adherence to the Group's International Marketing Principles (IMP);
- reviewing the Group's Youth Smoking Prevention (YSP) activities and analysis of their global reach and impact; and
- reviewing the Group's Corporate Social Investment strategy, plans and activities.

Sustainability planning and reporting

- considering the Sustainability reporting plan for 2015 and 2016;
- reviewing the Group's Focus report for publication in early 2016; and
- assessing progress against the Group's sustainability goals and commitments.

Group Sustainability Agenda

Our Sustainability Agenda is an integral part of delivering the Group strategy. The Sustainability Agenda aims to build shared value for our consumers, our shareholders and our stakeholders. This concept of shared value underpins our whole approach.

The Group's Sustainability Agenda covers the three key areas that have the greatest significance to our business and our stakeholders. These are:

- harm reduction: we are committed to researching, developing and commercialising a range of innovative tobacco and nicotine products to enable adult consumers to have a choice of 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, benefiting rural communities and the environment; and
- corporate behaviour: we are committed to operating to the highest standards of corporate conduct and transparency, benefiting government, consumers, the environment and our people.

For information on our greenhouse gas emissions see
the sustainability section of our Strategic Report on pages 20–21.

Upholding high standards and supporting human rights

A central part of being a sustainable business is operating with integrity and responsibility. Effective governance is critical to ensuring that we live up to our principles and standards and also that we deliver on our Sustainability Agenda. We have clear policies and standards in place that set the standard for the way we do business and how we behave.

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

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

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

Our Standards of Business Conduct are an integral part of the Group's governance and, together with our Business Principles, underpin our commitment to high standards of corporate responsibility. While the Statement of Business Principles sets out our beliefs and values as an organisation, the Standards of Business Conduct apply those values and principles to specific situations that may arise in day-to-day business life.

We have a long-standing commitment to human rights, and it is our core belief that fundamental human rights, as recognised by the Universal Declaration on Human Rights, should be respected. We are now strengthening our approach in line with the UN Guiding Principles on Business and Human Rights. The first step was the publication, in 2014, of a new Human Rights Policy as part of our revised Standards of Business Conduct, which covers areas such as child labour, freedom of association and forced or bonded labour.

We are also committed to promoting human rights in our supply chain and to support this we are developing an integrated and systematic management approach to human rights due diligence. This includes our recent publication of a new Supplier Code of Conduct, which defines the minimum standards we expect, including those covering human rights.

Towards the end of 2015, a number of allegations were made regarding historic misconduct in Africa. Although the Group was aware of and had looked into some of the allegations in the past, given the high standards to which we hold ourselves and the number and nature of the allegations of which the Group is now aware, the Board approved the appointment of an external law firm to conduct a full investigation and instructed that it be kept updated on the progress and findings of this investigation.

For information on our approach to human rights see
the sustainability section of our Strategic Report on pages 20–21.

Sustainability reporting

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

Our sustainability reporting aims to provide focused and integrated sustainability communications for our stakeholders across different formats. This includes an annual Sustainability Summary, regular Focus Reports and a dedicated online performance centre – all independently assured by Ernst & Young LLP.

The Sustainability Summary is published at the same time as the Company's Annual Report and covers our performance for the year across the key focus areas of our Sustainability Agenda. This is complemented by our online Sustainability Performance Centre covering progress against our goals, data charts and our reporting against the Global Reporting Initiative (GRI) G4 indicators.

Our Sustainability Focus Reports each cover specific topics and provide stakeholders with more in-depth information on the areas that interest them most.

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

External recognition

As a result of the Group's progress in embedding sustainability practices into its day-to-day business, the Group received notable external recognition in 2015. It maintained its industry leadership position in the Dow Jones Sustainability Indices (DJSI) and was included for the 14th consecutive year. The Company's overall score was 83%, consolidating our position as industry leader. We achieved industry leadership in nine of the 20 categories.

The Indices track the economic, environmental and social performance of leading sustainability-driven companies worldwide and are based on the cooperation between Dow Jones Indices and RobecoSAM, a sustainability investment specialist.

In RobecoSAM's Sustainability Yearbook we were named industry leader and placed in the highest Gold Class category. The Yearbook lists the world's most sustainable companies in each industry as determined by their score in the DJSI Assessment.

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

In addition, the Company was rated the 12th most empathetic company in the world in a global survey and was also shortlisted for three Building Public Trust Awards, a UK-wide recognition award.

Governance

Nominations Committee

Richard Burrows
Chairman of the Nominations Committee

Nominations Committee current members	
Richard Burrows (Chairman)	Dr Gerry Murphy
Sue Farr	Dimitri Panayotopoulos
Ann Godbehere	Kieran Poynter
Savio Kwan	Karen de Segundo
Dr Pedro Malan	Dr Richard Tubb
Christine Morin-Postel	

Attendance at meetings in 2015

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

Notes:
1. Savio Kwan missed the January ad hoc meeting, arranged at short notice, due to a prior engagement.
2. The Committee held three meetings, one of which was convened at short notice.
3. The Chief Executive and Group Human Resources Director regularly attend meetings by invitation but are not members.

For the Committee's terms of reference visit
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 2015

– considering Non-Executive Director appointments, interviewing candidates and recommending appointments to the Board;

– considering the Group Talent Strategy and talent development priorities for 2015, including the promotion of diversity;

– reviewing succession planning for the Executive Directors and for the Management Board; and

– reviewing 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).

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 in the Annual Report 2013 on www.bat.com. A new Policy is being submitted to shareholders for consideration at the AGM on 27 April 2016. Details of this revised Policy, which if approved will apply to Executive Directors with effect from 28 April 2016, are set out on pages 74–90. 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 takes into account 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.

In 2015, the Board underwent a significant refreshment process. In order to provide continuity and stability throughout this period of change, it is considered prudent that Christine Morin-Postel should remain on the Board and she is considered to remain independent notwithstanding her length of service. 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. An explanation of the Group's diversity policy appears on page 19 of this report.

Annual General Meeting 2016

Karen de Segundo has indicated that she will be retiring from the Board at the end of this year's AGM on 27 April 2016, having served for eight years on the Board, nearly seven of which as Chairman of the Corporate and Social Responsibility Committee. Dr Richard Tubb will also retire from the Board at the conclusion of the AGM, having served as a Non-Executive Director since January 2013.

The Company will be submitting all other Directors for re-election at this year's AGM. 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

Kieran Poynter
Chairman of the Remuneration Committee

Dear Shareholder

It is essential that we attract and retain top international talent in order to deliver the high levels of performance that the Board and shareholders want and expect.

In order to do this, our remuneration structure must be competitive in that global talent market. We also need to ensure there is a strong and clear relationship between delivery on key strategic metrics with stretching performance targets and reward outcomes.

In other words, management needs to be rewarded appropriately, based on competitive opportunity for delivering long-term sustainable shareholder value.

We believe that the interests of shareholders and senior management should be strongly aligned over the long term.

Last year my predecessor highlighted the issues affecting the existing Remuneration Policy which had prompted dialogue with shareholders at the end of 2014. Given the diversity of feedback received during that consultation, the Committee decided not to proceed with any Policy changes at that time and to evaluate the proposals in the light of the investor responses. Nevertheless, his 2014 Statement also noted that the underlying issues that had prompted engagement remained unresolved.

Shareholder consultation – proposals

Consequently, in 2015, the Committee's agenda has been focused on its review of proposals to address and eliminate these persistent issues and to re-engage with shareholders. Over the last few months I have consulted with shareholders representing about 60% of our shares. During this most recent dialogue, I am pleased to say that the response has been encouraging, with shareholders recognising the degree to which our redesigned proposals reflected earlier concerns whilst at the same time addressing the underlying issues compromising the effectiveness of the existing Policy.

In summary those issues were, and remain:

– a disconnect, in the design of the current long-term incentive plan, between management's performance in delivering against its long-term strategic objectives and compensation outcomes to reward that performance. In particular, sterling's persistent strength, against the currencies in a number of countries where the Group operates, adversely impacts the financial results on translation from their local currencies into sterling. The Group's objective is to deliver high single figure growth rates for earnings per share measured at constant rates of exchange. Management has continued to deliver on that objective but our current long-term incentive plan (LTIP) vesting outcomes have not recognised and rewarded that performance.

– a lack of competitiveness in the design of our Executive Directors' compensation. We need to increase the amount of incentive opportunity to bring it more into line with the marketplace. Actual earnings will, of course, continue to be driven by the levels of performance delivered.

The proposed changes to our current Policy, as set out in the accompanying report, reflect key elements of the investor feedback we have received and which the Committee believes will address the two issues highlighted above.

First, we propose the introduction of a new LTIP, replacing our existing plan, with a re-configured set of balanced metrics. We believe this will both reward management for strong delivery against key strategic objectives and align them with the interests of our shareholders. Those metrics, their respective weights and performance ranges are set out in the table below.

Secondly, we propose increases in the maximum potential award levels of variable pay for the 2016 and future awards as follows:

(a) Chief Executive maximum LTIP award increases from 400% of salary to 500%;

(b) Finance Director maximum LTIP award increases from 300% of salary to 350%;

(c) Chief Executive target and maximum short-term incentive (STI) opportunity will increase from 100% and 200% of salary respectively to 125% and 250%;

(d) Finance Director target and maximum STI opportunity will increase from 90% and 180% to 95% and 190% respectively.

In order to instil greater alignment between the Group's management and its shareholders, the Committee has determined that the new LTIP will include an additional two-year vesting period which will follow the three-year performance period for LTIP awards made in 2016 and subsequent years. Directors will be unable to exercise any LTIP awards, following the completion of the performance period, for a further two years.

Measure	% of award	Performance range	Threshold vesting %
Growth in earnings per share (EPS) at current exchange rates	20	5%–10% compound annual growth rate (CAGR) over performance period	3
Growth in EPS at constant exchange rates	20	5%–10% CAGR over performance period	3
Total shareholder return (TSR) relative to global FMCG peers	20	Median performance vs. peer group to upper quartile	3
Growth in Net Turnover	20	3%–5% CAGR over performance period	3
Operating cash flow as a % of adjusted operating profit (AOP)	20	Cash flow is 85%–95% of AOP over performance period	3
Total	**100**		**15**

Annual Statement continued

Furthermore the minimum shareholding requirements of our Executive Directors will be increased to match the maximum annual award under the LTIP: Chief Executive to 500% of salary (previously 400%) and the Finance Director to 350% of salary (previously 250%).

We will also make the following additional changes to the current Policy:

– we will revise the performance range for the NTO metric in the new LTIP scheme from the current 2–5% to a new 3–5%. The Committee is of the view that the new range introduces an appropriate increase in the degree of stretch represented by the metric.

– several investors provided feedback that a combined level of LTIP vesting at threshold performance generating a value equivalent to the annual salary of the Chief Executive was excessive. In recognition of this, the Committee has decided to reduce the level of vesting at threshold performance from 20% to 15% of the new award levels for the Chief Executive and the Finance Director. This lower level of threshold vesting will represent 75% and 52.5% of the respective annual salaries of the Chief Executive and the Finance Director.

– the Committee has decided to introduce retrospective disclosure of threshold and maximum performance points within its short-term incentive scheme. Given the commercial sensitivity that this entails, disclosure will be on a two-year retrospective basis. In other words, in this 2015 report we will provide disclosures in respect of the 2014 short-term incentive scheme and on this basis in future years.

Shareholder consultation – principal themes

Given the importance the Committee attaches to its dialogue with shareholders, I would like to highlight some of the principal themes on which discussion centred:

– **an LTIP that does not function effectively to incentivise and reward management to drive the strategic fundamentals is not in the interests of its shareholders.** There was considerable diversity of opinion amongst our shareholders on preferred metrics – with, in particular, TSR and some form of potential 'Returns' measure attracting polarised opinions of like and dislike. There was, however, widespread acknowledgement that an LTIP which was not reflecting strong underlying performance needed to be addressed and that the metrics being proposed would deliver a stronger and more transparent linkage between performance on key strategic objectives and reward outcomes.

– **measured over several years, the Company's underlying performance, when analysed on a consistent basis, has remained extremely strong.** In past years, when EPS growth in percentage terms on an actual currency basis achieved in a number of years the 'high teens', benefiting its shareholders, underlying EPS growth on a constant currency basis was at or near high single-digit growth. In more recent years of currency headwinds, caused by sterling's appreciation, management has continued to deliver high single-digit EPS growth on a constant basis. In other words, management's performance has been consistently strong, irrespective of positive or negative translational currency impacts. The Committee believes that reward outcomes should continue to reflect that strong underlying performance.

– **increasing the award potential for the Executive Directors to ensure competitiveness in the market.** The Committee is acutely conscious of shareholders' general unease with the potential for 'ratcheting-up' executive compensation. However, in proposing the variable award increases, we looked at the external market – where we saw, for a company of British American Tobacco's size and complexity when compared to its most relevant peers, a gap in potential earnings. Our proposals, which have been tempered in response to dialogue with shareholders, restores a measure of competitiveness vis-à-vis the external market for our Executive Directors.

We believe that the results of our discussions have resulted in a Policy which will reward management fairly for strong performance on key strategic deliverables.

Incentive outcomes

The 2015 outcomes for both of our incentive schemes reflects not only the Group's strong underlying performance – especially evident in respect of the STI – but illustrates in stark terms, in respect of the LTIP outcome, the logic for introducing a new LTIP based on a re-configured set of performance metrics.

As the Chief Executive's statement highlights, in spite of the continued challenging global economic environment, the Group has delivered a strong all-round performance on the key financial and marketing fundamentals.

In terms of the STI outcomes, Global Drive Brands and Key Strategic Brands grew by 8% during 2015 while our volume share in the Group's Top 40 markets increased by over 40 bps over the same period, reflecting growth across the majority of the largest cigarette markets. This strong share and volume delivery, together with a 4% growth in adjusted operating profit (at constant rates) which has translated into a very satisfying 'cash generated from operations' performance, has combined to result in the overall achievement of a maximum award for 2015 under the IEIS. This strong all-round performance will result in IEIS awards for 2015 for the Chief Executive and the Finance Director of 200% and 180%, respectively.

Following on from a 0% vesting of the 2012 LTIP award last year, the 2013 LTIP award has vested at 8.7% with performance against its metrics materially impacted by translational currency headwinds as a result of sterling's strength versus key operational currencies over the three-year period.

On a constant currency basis, adjusting only for translational impacts, CAGR EPS of 9.2% was achieved over the 2013 LTIP award performance period, delivering against our commitment of high single-digit EPS growth. However, as a result of translational currency headwinds and inflation adjustment of 10.5%, actual real CAGR EPS growth has registered a decline of 1.3% leading to a nil vesting for the EPS element of the 2013 LTIP award. It is, of course, much harder to isolate the impact of translational currency headwinds on the relative TSR measure, suffice it to say it will be significant and similarly negative in its impact on vesting.

This continued disconnect between management performance and reward outcomes has undermined the LTIP's role, in its present form, as an effective incentive mechanism and has prompted us to make the changes that I have discussed at length earlier.

Remuneration Report

Index to key elements

Directors' personal performance

Under the rules of the IEIS scheme the Remuneration Committee has discretion to award an individual performance uplift for outstanding performance in any year up to the overall maximum opportunity under the STI. In 2015 the STI corporate result reached the maximum and so no individual performance adjustment could be made.

Nevertheless the Board has evaluated the individual performance of the Executive Directors and concluded they have both made a big contribution to the achievement of our short-term goals reflected in the IEIS and to the progress we have made towards the delivery of an ambitious transformational strategic long-term agenda.

Notwithstanding this strong performance, in view of the proposed increases in variable pay opportunities, we propose no increase this year in the fixed pay of our Executive Directors.

Shareholder support

In summary, the Committee believes that the changes to our existing Remuneration Policy which it proposes to make are in the interests of our shareholders as the revisions will ensure that the Company's ability to attract and retain top talent in a globally competitive marketplace continues and is therefore in the interests of our shareholders. Consequently, I hope we can count on our shareholders to support not only those changes but also our Annual Report on Remuneration at the forthcoming AGM.

Kieran Poynter
Chairman of the Remuneration Committee

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At a glance

Our Remuneration Policy in 2015

The Remuneration Policy for the Executive Directors and the Non-Executive Directors applicable in 2015 was approved by shareholders at the 2014 AGM. It is set out in the Annual Report 2013 on www.bat.com. A summary of the key elements is set out below.

Remuneration element YE 31 Dec 2015	Nicandro Durante Chief Executive	Ben Stevens Finance Director
Base salary	Year-on-year increases will not exceed 10% per annum. Increases will generally be in the range of the increases in the base pay of other UK-based employees in the Group.	
Short-term incentives: **IEIS bonus opportunity** **50% cash** **50% deferred shares (DSBS)**	Maximum opportunity: **200%** of base salary. On-target opportunity: **100%** of base salary.	Maximum opportunity: **180%** of base salary. On-target opportunity: **90%** of base salary.
Short-term incentives: **performance adjustment** **clawback and malus**	Up to **20% uplift** possible if individual performance is assessed as outstanding (up to the maximum opportunity of 200% or 180%). A **50% reduction** possible if individual performance is assessed as poor. Clawback and malus provisions are in place.	
Short-term incentives: **IEIS – performance measures and weightings (%)**	– Adjusted profit from operations **(40%)** – Group's share of Key Markets **(20%)** – Global Drive Brands and Key Strategic Brands volumes **(20%)** – Cash generated from operations **(20%)**	
Long-term incentives: **LTIP awards 2015 opportunity**	Maximum vesting: shares to a value of **400%** of base salary at time of award. Threshold vesting: 20% of maximum (80% of base salary).	Maximum vesting shares to a value of **300%** of base salary at time of award. Threshold vesting: 20% of maximum (60% of base salary).
Long-term incentives: **dividend equivalent payment** **clawback and malus**	Dividend equivalent payment on all vesting shares. Clawback and malus provisions are in place.	
Long-term incentives **LTIP awards 2015 – performance measures and weightings (%)**	**TSR** Performance versus international FMCG companies comparator group **(25%)**. **EPS** Adjusted diluted EPS growth at current rates of exchange **(50%)**. **NTO** CAGR of net turnover at constant rates of exchange **(25%)**. **Underpin:** no NTO element payable unless the corresponding three-year constant currency CAGR of underlying profit exceeds the CAGR of the threshold performance level for underlying operating profit (as defined annually in the IEIS).	
Pension	**UURBS (UK):** accrual of 0.65% per annum for each year of service on a sterling salary comparable to that of a General Manager of Souza Cruz S.A.; and 2.5% per annum for each year of service on his salary in excess thereof.	(1) **Pension Fund (UK):** retains a scheme-specific salary cap (currently £150,000 effective 1 April 2015). Benefits in excess of the cap are accrued in the UURBS. Further to the changes to the UK regulated allowances, as his lifetime allowance has been reached, accrual in the Pension Fund has ceased and all future benefits are provided through the UURBS. (2) **UURBS (UK):** pension accrual in the UURBS is at the same rate as in the Pension Fund (1/40th per annum).
Shareholding requirements	**400%** of salary	**250%** of salary
Changes in policy from 2014	**Short-term incentives:** the introduction of a clawback provision which may be applied at the Committee's discretion: (1) within two years after the payment of a bonus cash amount and/or (2) within three years of the date of grant of an award of shares under the DSBS. Clawback is applicable from 2016 IEIS cash awards and DSBS awards for performance ended 2015. **Long-term incentives:** the introduction of a clawback provision which may be applied at the Committee's discretion at any time during the two-year period from the vesting date; applicable in respect of 2015 awards and those made after that date.	

Remuneration Report

At a glance

Our remuneration outcomes 2015

These key outcomes for the year-end 2015 relate to the implementation of the Remuneration Policy for the Executive Directors and the Non-Executive Directors as approved by shareholders at the 2014 AGM. It is set out in the Annual Report 2013 on www.bat.com.

KPIs performance year-ended December 2015

The performance measures (KPIs) for the management incentive schemes reflect the alignment of management's strategic focus areas with the interests of our shareholders. IEIS targets for the year-ended December 2015 remain commercially sensitive and are not disclosed below. For the year-ended 2014, the IEIS targets at Threshold and Maximum are disclosed retrospectively on page 99 of this report. The equivalent target levels for the year-ended 2015 will be disclosed in the Annual Report on Remuneration for the year-ending 2016 to be published in March 2017.

Measure	Strategic focus area	Strategic target or objective	Management incentive	Weighting %	Actual performance 2015
Group share of Key Markets	Growth	To grow market share.	IEIS	20	+40 bps
Global Drive Brands (GDB) and Key Strategic Brands (KSB) volumes	Growth	To increase GDB and KSB volumes faster than the rest of our portfolio.	IEIS	20	+8%
Adjusted profit from operations	Productivity	To grow adjusted profit from operations on average by 5-7% per year over the medium to long term.	IEIS	40	+4%
Cash generated from operations	Productivity	To generate optimal cash flow compared to budget while continuing to support business requirements.	IEIS	20	+12%
Adjusted earnings per share (EPS)	Growth	To grow EPS by high single-figure percentages per year, on average, over the medium to long term.	LTIP (2013 awards)	50	(1.3)%
Total shareholder return (TSR) – FTSE 100 Index **Median performance: 9.1%**	Growth	To secure median (or above) performance in shareholder value relative to peer group.	LTIP (2013 awards)	25	10.2%
Total shareholder return (TSR) – FMCG group **Median performance: 12.5%**	Growth	To secure median (or above) performance in shareholder value relative to peer group.	LTIP (2013 awards)	25	10.2%

Policy implementation YE 2015: Executive Directors	Nicandro Durante Chief Executive	Ben Stevens Finance Director
Base salary: from 1 April 2015	£1,190,000 (+3%)	£867,000 (+3%)
Short-term incentives: IEIS	200% on the corporate result; maximum award – no individual performance uplift	180% on the corporate result; maximum award – no individual performance uplift
Long-term incentives: LTIP – 2013 awards	8.7%	8.7%
'Single figure'	£4,523,000	£3,319,000
Shareholding requirements	598.8% of salary (400% required)	313.8% of salary (250% required)

Policy implementation YE 2015: Richard Burrows (Chairman)	Fee from 1 April 2015	
	£645,000 (+2%)	
Non-Executive Directors	**Fees from 1 January 2015**	
Base fee	£92,700 (+3%)	
Supplements:	Senior Independent Director £30,000 (no change)	
Committee membership fees:		
Audit Committee	Chairman: £30,000 (no change)	Member: £6,000 (no change)
CSR Committee	Chairman: £25,000 (no change)	Member: £6,000 (no change)
Nominations Committee	Chairman: £ – (no change)	Member: £6,000 (no change)
Remuneration Committee	Chairman: £30,000 (no change)	Member: £6,000 (no change)

At a glance

Our proposed Remuneration Policy from 2016

A new Remuneration Policy will be the subject of a binding vote by shareholders at the AGM on 27 April 2016 and, if approved, will apply with effect from 28 April 2016. A summary of the key elements of the new Remuneration Policy showing how it will be applied in 2016 and the key changes and differences from the current Policy is set out below.

Fixed remuneration	Executive Directors	
	Nicandro Durante Chief Executive	Ben Stevens Finance Director
Base salary from 1 April 2016	£1,190,000 (no change from 2015)	£867,000 (no change from 2015)

Variable Remuneration	Executive Directors							
	Nicandro Durante Chief Executive				Ben Stevens Finance Director			
Short-term incentives: IEIS opportunity 50% cash; 50% deferred shares (DSBS) Percentage of base salary	Proposed Policy 2016		Current Policy 2015		Proposed Policy 2016		Current Policy 2015	
	Maximum	On-target	Maximum	On-target	Maximum	On-target	Maximum	On-target
	250%	125%	200%	100%	190%	95%	180%	90%
Short-term incentives: performance adjustment clawback and malus	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. The performance adjustment factor and the clawback and malus provisions are included unchanged in the Proposed Policy for 2016.							
Short-term incentives: IEIS – performance measures and weighting (%)	The IEIS performance measures and weightings from 2016 apply equally to the Executive Directors and are unchanged in the Proposed Policy. – Adjusted profit from operations **(40%)** – Group's share of Key Markets **(20%)** – Global Drive Brands and Key Strategic Brands volumes **(20%)** – Cash generated from operations **(20%)**							

Long-term incentives: renewal of LTIP 2016	The current long-term incentive plan (LTIP 2007) will expire in 2017. The Proposed Policy for 2016 includes a renewed LTIP (LTIP 2016), subject to approval by shareholders at the AGM on 27 April 2016.			
	Nicandro Durante Chief Executive		Ben Stevens Finance Director	
Long-term incentives: LTIP awards vesting opportunity; shares to a percentage value of base salary at time of award	Proposed Policy 2016	Current Policy 2015	Proposed Policy 2016	Current Policy 2015
	Maximum	Maximum	Maximum	Maximum
	500%	400%	350%	300%
Long-term incentives: dividend equivalent payment clawback and malus	Dividend equivalent payment on all vesting shares – included unchanged in the Proposed Policy for 2016. Clawback and malus provisions are in place – included unchanged in the Proposed Policy for 2016.			
Long-term incentives: the LTIP Extended Vesting Period	**Proposed Policy 2016** **Introduction of an additional vesting period of two years from the third anniversary of the date of grant. LTIP awards to vest only to the extent that: (1) the performance conditions or measures are satisfied at the end of the three-year performance period; and (2) an additional vesting period of two years from the date of the third anniversary of the date of grant has been completed – the LTIP Extended Vesting Period. LTIP awards are therefore only exercisable once the total period of five years from the date of grant has been completed.**		Current Policy 2015 No additional vesting period after completion of three-year performance period.	

Long-term incentives: performance measures and weightings (%); reduction in vesting at threshold performance from 20% to 15% of award	Proposed Policy 2016	Current Policy 2015
	TSR: performance versus international FMCG companies comparator group **(20%)**. Measure unchanged from Current Policy; weighting reduced by 5 ppts.	**TSR:** performance versus international FMCG companies comparator group **(25%)**.
	EPS: (1) CAGR of adjusted diluted EPS at current rates of exchange **(20%)**. Measure unchanged from Current Policy; weighting reduced by 30 ppts. **EPS:** (2) CAGR of adjusted diluted EPS at constant rates of exchange **(20%)**. New measure from 2016.	**EPS:** CAGR of adjusted diluted EPS at current rates of exchange **(50%)**.
	NTO: CAGR of net turnover at constant rates of exchange **(20%). Underpin:** no NTO element payable unless the corresponding three-year constant currency CAGR of underlying profit exceeds the CAGR of the threshold performance level for underlying operating profit (as defined annually in the IEIS). Measure amended – threshold vesting now at 3% (2015: 2%); weighting reduced by 5 ppts.	**NTO:** CAGR of net turnover at constant rates of exchange **(25%). Underpin:** no NTO element payable unless the corresponding three-year constant currency CAGR of underlying profit exceeds the CAGR of the threshold performance level for underlying operating profit (as defined annually in the IEIS).
	Operating cash flow conversion ratio: operating cash flow as a percentage of adjusted operating profit with currency at actual rates of exchange **(20%)**. New measure from 2016.	
	Threshold vesting across five measures: 15%.	Threshold vesting across three measures: 20%.

	Executive Directors	
	Nicandro Durante **Chief Executive**	**Ben Stevens** **Finance Director**
Pension	**UURBS (UK):** accrual of 0.65% per annum for each year of service on a sterling salary comparable to that of a General Manager of Souza Cruz S.A.; and 2.5% per annum for each year of service on his salary in excess thereof. This element of remuneration is included unchanged in the Proposed Policy for 2016.	(1) **Pension Fund (UK):** retains a scheme-specific salary cap (currently £150,000 effective 1 April 2015). Benefits in excess of the cap are accrued in the UURBS. Further to the changes to the UK-regulated allowances, as his lifetime allowance has been reached, accrual in the Pension Fund has ceased and all future benefits are provided through the UURBS. (2) **UURBS (UK):** pension accrual in the UURBS is at the same rate as in the Pension Fund (1⁄40th per annum). These elements of remuneration are included unchanged in the Proposed Policy for 2016.
Shareholding requirements	500% of salary (2015: 400%)	350% of salary (2015: 250%)
	Changes 2016: (1) increased level of shareholding required; (2) shares awarded but not yet vested under the DSBS element of the IEIS; and (3) the estimated notional net number of shares held by an Executive Director in the LTIP Extended Vesting Period (see above) will each count towards the respective shareholding requirements for the Executive Directors.	
Sharesave Scheme	The Company's current Sharesave Scheme will expire in 2017 and the Proposed Policy 2016 includes a new Sharesave Scheme, subject to separate approval by shareholders at the AGM on 27 April 2016. This will remain an all-employee share scheme in which Executive Directors are eligible to participate.	

Chairman (Richard Burrows):	**Fee from 1 Apr 2016 (no change from 2015)**	
	£645,000	
Non-Executive Directors:	**Fees from 1 Jan 2016 (no change from 2015)**	
Base fee	£92,700	
Supplements:	Senior Independent Director: £30,000	
Committee Membership Fees:		
Audit Committee	Chairman: £30,000	Member: £6,000
CSR Committee	Chairman: £25,000	Member: £6,000
Nominations Committee	Chairman: £–	Member: £6,000
Remuneration Committee	Chairman: £30,000	Member: £6,000

Remuneration Report

Policy Report

Introduction

This policy section of the Remuneration Report (the 'Policy Report') sets out a proposed new Remuneration Policy for the Executive Directors and the Non-Executive Directors – the Executive Directors principally in the Future Policy Table and the Chairman and the Non-Executive Directors in the Remuneration Table.

This new Remuneration Policy, which is intended to replace the Policy approved by shareholders at the 2014 AGM, is subject to a binding vote by shareholders at the AGM on 27 April 2016 and, if approved, will come into effect from 28 April 2016. A Remuneration Policy will be put to shareholders again no later than the 2019 AGM. The new Remuneration Policy is set out in full on the following pages with changes from the Current Policy identified for reference.

Principles of remuneration

The Committee's remuneration principles are to:

- reward, as an overriding objective, the delivery of the Group's strategy in a manner which is simple, straightforward and understandable and which is aligned with shareholders' long-term interests;
- structure a remuneration package that is appropriately positioned relative to the market and comprises core fixed elements and performance-based variable elements;
- the fixed elements comprise base salary, pension and other benefits and these are designed to recognise the skills and experience of our Executive Directors and to ensure current and future market competitiveness in attracting talent;
- 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)) which are designed to be both transparent and stretching and to motivate and reward the delivery of the Group's strategy and of growth to shareholders on a long-term sustainable basis;
- maintain an appropriate balance between fixed pay and the opportunity to earn performance-related remuneration with immediate and deferred elements: the performance-based elements form, at maximum opportunity, between 75% and 85% of the Executive Directors' total remuneration packages; and
- conduct an annual review to ensure that the Policy is both rigorously applied and remains aligned with business needs to promote the long-term success of the Company.

Summary of key changes

The background and explanation of the proposed key changes from the current Remuneration Policy are given in the Annual Statement from the Chairman of the Remuneration Committee starting on page 67 of this Remuneration Report. In addition a summary of these changes is set out in the 'At a glance' tables on pages 72 and 73.

Future Policy Table – Executive Directors

Base salary	
How the element supports the Company's strategic objectives	To attract and retain high calibre individuals to deliver the Company's strategic plans by offering market competitive levels of guaranteed cash to reflect an individual's skills, experience and role within the Company.
Operation of the element	**Base salary** is normally paid in 12 equal monthly instalments during the year. Salaries are normally reviewed annually in February (with salary changes effective from April) or subject to an ad hoc review on a significant change of responsibilities. Salaries are reviewed against 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 2016 are as follows:

Revisions to Pay Comparator Group made in 2015:
for 2016, non-UK based multinational and FMCG companies have been included as these are key competitors for talent.

AstraZeneca	GlaxoSmithKline	Mondelēz International	Royal Dutch Shell
BP	Heineken	Nestlé	SABMiller
BT	Imperial Brands	PepsiCo	Unilever
Coca-Cola	Japan Tobacco International	Pernod Ricard	Vodafone
Colgate-Palmolive	Johnson & Johnson	Philip Morris International	
Danone	L'Oréal	Procter & Gamble	
Diageo	LVMH	Reckitt Benckiser	

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

Base salary is pensionable.

There are no contractual provisions for clawback or malus.

Maximum potential value	Current levels stated in the Annual Report on Remuneration will be increased in line with the Policy following the 2016 salary review. Increases will generally be in the range of the increases in the base pay of other UK-based employees in the Group. The salary of a recently appointed Executive Director as he or she progresses in a role may exceed the top of the range of the salary increases for UK-based employees where the Committee considers it appropriate to reflect the accrual of experience. 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.
Performance metrics used, weighting and time period applicable	None.

Policy Report continued

Benefits	
How the element supports the Company's strategic objectives	To provide market competitive benefits consistent with role which: – help to facilitate the attraction and retention of high calibre, senior individuals to deliver the Company's strategic plans; and – recognise that such talent is global in source and that the availability of certain benefits (e.g. relocation, repatriation, taxation compliance advice) will from time to time be necessary to avoid such factors being an inhibitor to accepting the role.
Operation of the element	The Company currently offers the following contractual benefits to Executive Directors: **a car or car allowance;** the **use of a driver; tax advice** (in instances where multi-jurisdictional tax authorities are involved); **tax equalisation payments** (where appropriate); **private medical insurance**, including **general practitioner 'walk-in' medical services; personal life and accident insurance;** and **relocation** and shipment of effects and associated expenses on appointment and at the end of tenure, and **housing** and **education** allowances or similar arrangements as appropriate to family circumstances. Other benefits not identified above may be offered if, in the Committee's view, these are necessary in order to remain aligned with market practice. The cost of legal fees spent in reviewing a settlement agreement on departure may also be provided where appropriate. With the exception of the car or car allowance, 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. In addition the partners of the 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. HM Revenue & Customs may classify this and the provision of certain other services and payments as taxable benefits. Services or payments classified in this way include: the provision of home and personal security and the reimbursement of certain travel and related expenses. It is also part of the Remuneration Policy to pay the tax that may be due on these types of benefits.
Maximum potential value	The maximum potential values are based on market practice for individuals of this level of seniority. Any tax due on these benefits paid by the Company is in addition to the maximum amounts specified below. The maximum annual value (subject to periodic inflation-related increases where applicable) that can be offered for each benefit is: – **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. Relocation and shipment expenses are subject to applicable clawback provisions.
Performance metrics used, weighting and time period applicable	None.

Pensions	
How the element supports the Company's strategic objectives	To provide competitive post-retirement benefit arrangements 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.
Operation of the element	**British American Tobacco UK Pension Fund (the 'Pension Fund') – non-contributory defined benefit section** The early retirement rules in the Pension Fund permit a member to draw the accrued retirement pension within five years of Fund normal retirement age without actuarial reduction, subject to the employing company's agreement. Alternatively, an Executive Director (who was a member of the Pension Fund before 6 April 2006) may choose to leave and take a pension at any time on or after his or her 50th birthday without the employing company's agreement, subject to a reduction as determined by the Pension Fund trustee in conjunction with the Pension Fund actuary. Accrual rates differ according to individual circumstances but do not exceed one-fortieth of pensionable salary for each year of pensionable service. Although the defined benefit section is 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 employer. The Pension Fund includes provision for spouses' and children's benefits on death in service or after retirement. In the event of death in service, a spouse's pension equal to half of the member's prospective pension at normal retirement age would be payable together with, where there are dependent eligible children, a pension equal to half of the member's prospective pension at normal retirement age, shared equally between any eligible children. A spouse's pension payable in the event of death after retirement is equal to half of the member's pension, irrespective of any previous decision to exchange part of the benefit for a lump sum at retirement. Eligible children share equally a pension equal to half of the member's full pension. **British American Tobacco UK Pension Fund – defined contribution section** A defined contribution pension arrangement has been in place since April 2005 where an annual contribution of up to the equivalent of 35% of base salary would be made. The actual level of contribution paid to the Pension Fund is restricted to take into account the annual allowance and lifetime allowance with any balance payable as a gross cash allowance or accumulated in the UURBS – see below. **Unfunded unapproved retirement benefit scheme (UURBS)** The Pension Fund retains a scheme-specific salary cap, currently £150,000 effective 1 April 2015, which is adjusted in April each year in line with the Retail Prices Index as at September of the previous year. Where an individual is entitled to benefits calculated on a base salary that exceeds the scheme-specific cap, these are accrued in the Company's UURBS. Pension accrual in the UURBS will not exceed the accrual rate applicable to the individual in respect of their Pension Fund entitlement (maximum one-fortieth per annum). Under UK regulations, there are annual allowance and lifetime allowance limits on pension accrual in the defined benefit section of the Pension Fund and on contributions to the defined contribution section of the Pension Fund. In order to ensure that these limits are not breached, benefits and contributions respectively are adjusted. In the defined contribution section, the individual may elect to accumulate the balance of the contributions in the UURBS or receive the balance as a gross cash allowance. From April 2016, the Pension Fund will have an automatic limit of £10,000 on the value of any member's defined benefit accrual or defined contributions. Upon retirement, Executive Directors who have accrued defined benefits in the UURBS will have the opportunity to receive this element of their overall entitlement either in the form of a single lump sum or as an ongoing pension payment. Lump sums in lieu of a pension entitlement in the UURBS are subject to a decrement of between 19% and 21%, depending on age. In addition, a further reduction that recognises the Company's liability to employer's national insurance will also be made. For Executive Directors with defined contribution benefits in the UURBS, a lump sum payment will be made on leaving the Group with a credit adjustment based on the Company's average weighted cost of debt in respect of each year that benefit has accrued. Pensionable pay covers base salary only.
Maximum potential value	The pension accrual rate in the Pension Fund and the UURBS will not exceed the maximum one-fortieth of salary per annum. 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. Pension benefits and entitlements will continue to be calculated with reference to an individual's base salary. Pension entitlements for external appointees as Executive Directors will be subject to negotiation taking into account the relevant annual and lifetime allowances. In most cases the pension arrangements will fall within the scope of the Policy as outlined in this section.
Performance metrics used, weighting and time period applicable	There are no performance metrics. Pensions in payment are paid monthly or quarterly in accordance with the rules of the relevant section of the Pension Fund.

Policy Report continued

Short-term incentives: International Executive Incentive Scheme (IEIS)	
How the element supports the Company's strategic objectives	To incentivise the attainment of corporate targets aligned to the strategic objectives of the Company on an annual basis. Performance-based award in the form of cash and deferred shares, so that the latter element ensures alignment with shareholders' long-term interests. Strong alignment and linkage between individual and corporate annual objectives via the application of an individual performance adjustment factor to the corporate result. To ensure, overall, a market competitive package to attract and retain high calibre individuals to deliver the Group's strategy.
Operation of the element: key points	IEIS comprises an annual award referenced to base salary, which is normally paid approximately three months after the end of the financial year to which it relates: **50%** is paid immediately in **cash** and **50%** of the total bonus amount is awarded in **shares** through the **Deferred Share Bonus Scheme (DSBS)**. The free deferred shares 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. Deferred shares attract a **cash payment equivalent** to the dividend on the after-tax position on all of a participant's unvested ordinary shares held in the DSBS at each dividend record date.
Operation of the element: the process cycle	The Remuneration Committee sets the performance targets each year at the beginning of the performance period and is able to vary the exact measures and the weighting of them from year to year. The Committee then reviews performance for the prior year in February each year and the Group's external auditors perform certain specified procedures to assist the Committee's assessment of the calculations used to determine the IEIS corporate bonus outcomes and future targets. The total payout of the **corporate result** is determined by the Company's performance under each measure relative to that measure's performance target. The Committee may use its **discretion** to adjust the payout in circumstances where, it considers, the overall performance of the Company warrants a different outcome, whether higher or lower, than that determined by the application of the bonus formula. An **individual performance element** for outstanding performance may be awarded (being an adjustment factor of up to 20% of the annual corporate result) up to the overall maximum and is paid in cash. In cases of identified poor individual performance, the corporate result will be reduced by 50%.
Operation of the element: other aspects	**Malus (for 2014 DSBS share awards onwards):** provisions apply so that the number of shares subject to an unvested DSBS share award may be reduced where the Committee determines that there has been a material misrepresentation or misstatement of the performance of the Company and/or the participant on the basis of which that or any prior DSBS share award was granted. **Clawback (from 2016 IEIS cash awards and DSBS awards for performance ended 2015):** provisions operate under which all or a part of the value of an award may be recovered if the Committee determines that there has been: (1) a material misrepresentation or misstatement in relation to the performance of the Company and/or the participant; or (2) an erroneous calculation in the assessment of the extent to which the award was made, and in either case which caused the award to be granted with a greater value than would otherwise have been the case. This provision may be applied in respect of an IEIS cash award within the two-year period from payment and in respect of a DSBS share award within the three-year period from grant. Clawback may also be applied at any time where the Committee determines that a participant committed, at any time prior to the payment/vesting, an act or omission which justified dismissal for misconduct. Where the Committee determines that these provisions are to be applied, the number of shares subject to an unvested DSBS share award may be reduced or the participant can be required to repay the excess value received (and this repayment may be effected by reducing other cash or share-based awards held by the participant). For IEIS participants determined by the Committee as 'good leavers': (1) a cash bonus is subject to a clawback period of two years from the payment date; and (2) a DSBS share award will vest or transfer to a participant upon termination of their contract, subject to a clawback period of up to three years referenced to the original award date. The details of the policy on payment for loss of office which includes the scope for determination of 'good leaver' status applied by the Committee is set out on page 89 of this Policy Report. Awards under the annual incentive scheme are not pensionable and no element of the bonus is guaranteed.

Short-term incentives: International Executive Incentive Scheme (IEIS)	
Maximum potential value **2016 Policy – change proposed:** to increase the maximum bonus opportunity for Executive Directors. See 'At a glance' on page 72.	The **maximum annual bonus** opportunity for the Chief Executive (including any individual performance element) is 250% of base salary. The equivalent bonus opportunity for other Executive Directors (including any individual performance element) is 190% of base salary. No bonus is paid for threshold performance of any metric, which must be exceeded for that element of the bonus to be paid. The annual **'on-target' bonus opportunity** for the Chief Executive is 125% of base salary (increasing up to 150% if the Committee assesses individual performance as outstanding and applies the individual performance element at 20% to an 'on-target' corporate result). For the other Executive Directors, the 'on-target' bonus opportunity is 95% (increasing up to 114% if the individual performance element is awarded at a 20% level, based on an 'on-target' corporate result).
Performance metrics used, weighting and time period applicable **KPIs:** see summary on page 1 of the Strategic Report.	The IEIS contains four corporate performance measures (KPIs) and weightings measured over the financial year. These KPIs are the same as those KPIs used to measure the Company's performance against its strategy as outlined and explained from page 13 of the Strategic Report. (1) **Adjusted profit from operations (40%)** – this is the profit from operations of the Group's subsidiaries at constant rates of exchange adjusted for the items shown as memorandum information in the Group Income Statement. It is the Group's medium- to long-term aim to grow adjusted profit from operations on average by 5-7% annually. (2) **Group's share of key markets (20%)** – this is the Group's retail market share in its key markets, which accounts for around 80% of the volumes of the Group's subsidiaries. The aim is to increase the Group's share year-on-year. The information used in this calculation is based on information (available on subscription) on retail audit share. The process is subject to rebasing as and when the Group's Key Markets change. When rebasing occurs to reflect changes in the sample or estimated market size, the Company will also restate history and provide fresh comparative data on the markets. (3) **Global Drive Brands (GDBs) and Key Strategic Brands (KSBs) volumes (20%)** – this comprises: (1) the cigarette volumes of the following GDBs sold by the Group's subsidiaries: 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. The aim is to improve the quality of the Group's portfolio by increasing the volume of GDBs and KSBs faster than the rest of the brands in the Group's portfolio. (4) **Cash generated from operations (20%)** – is defined as the free cash flow excluding restructuring costs, dividends and other appropriations from associate undertakings measured at constant rates of exchange. The aim is to generate the optimal level cash flow while continuing to invest to support the short-medium and long-term requirements of the business. A specific target is set each year. Two levels of award attainment relative to the measures are defined under the IEIS: (1) **Threshold** (which must be exceeded to attract any bonus pay-out in respect of that measure); and (2) **Maximum** (a level of performance exceeding budget and at which the bonus pay-out for that measure is capped). An **individual performance element** may also be awarded by the Remuneration Committee based on its assessment of an outstanding level of Executive Director performance against key strategic and commercial objectives set at the beginning of the year. This element is applied to the corporate result but is subject to the maximum award limit as explained above.

Policy Report continued

Long-term incentives: Long-Term Incentive Plan (LTIP 2016)

How the element supports the Company's strategic objectives

2016 Policy – change proposed:

the Company's current Long-Term Incentive Plan expires in 2017. The proposed LTIP 2016 will be subject to approval by shareholders at the 2016 AGM. See 'At a glance' on pages 72 and 73.

To 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.

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.

Operation of the element for awards – from 2016

2016 Policy – changes proposed:

(1) a new performance measure (EPS at constant rates of exchange);

(2) a new performance measure (cash flow conversion);

(3) an increased maximum award level;

(4) value of vesting award for threshold performance reduced from 20% to 15% of the award; and

(5) 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.

See 'At a glance' on page 73.

Discretionary annual awards of shares with vesting levels based on the achievement of defined and appropriately stretching targets that are relative TSR, EPS growth and NTO growth, together with a consistently high measure of operating cash flow to operating profit conversion ratio, aligned to Group's strategic objectives over a three-year performance period with a five-year vesting period.

TSR – performance is measured against a **peer group of international FMCG companies** using the return index calculated by Datastream and reviewed by the Company's remuneration consultants. The current constituents of the FMCG peer group as at the date of this report are as follows:

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	SABMiller
Colgate-Palmolive	Johnson & Johnson	PepsiCo	Unilever
Danone	Kellogg	Pernod Ricard	

TSR is measured on the basis that all companies' dividends are reinvested in the shares of those companies. The return is the percentage increase in each company's index over the three-year performance period. The opening and closing indices for this calculation are respectively: (1) the average of the index numbers for the last quarter of the year prior to the start of the performance period; and (2) the average of the last quarter of the final year of that performance period – this methodology is employed to reflect movements of the indices over that time as accurately as possible.

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

EPS – growth in adjusted diluted EPS for these purposes incorporates an increase in adjusted diluted EPS between the base year and the final year of the performance period, expressed as a compound annual growth rate over the period. The EPS measure is split into two separate and equal components: 50% is measured using current rates of exchange and 50% is measured on constant rates of exchange adjusted for the impact of translational foreign exchange only.

NTO – growth in gross turnover less excise, duties and rebates. No vesting will occur for NTO unless the corresponding three-year constant currency compound annual growth rate (CAGR) of underlying operating profit exceeds the CAGR of the threshold performance level for underlying operating profit as approved by the Board, as defined annually in the IEIS.

Operating cash flow conversion ratio – operating cash flow measured at actual rates expressed as a percentage of adjusted operating profit (as defined for the purposes of the IEIS, except as for actual rates of exchange) over a three-year period.

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 date of the third anniversary of the date of grant has been completed – **the LTIP Extended Vesting Period.**

LTIP awards are therefore only exercisable once the total period of five years from the date of grant has elapsed.

Long-term incentives: Long-Term Incentive Plan (LTIP 2016)	
Operation of the element for awards – from 2016 continued	The Remuneration Committee may apply its discretion to vary the outcome (either positively or negatively) of the formulaic performance to ensure a fair result for both the Executive Directors and shareholders. The Remuneration Committee is able to vary the exact measures and the weighting of them from year to year, but will generally only seek to make amendments to them following consultation with shareholders. Participants may receive a dividend equivalent payment to the value of the actual dividends that they would have received on the gross number of shares as shareholders on their vesting awards at the end of the LTIP Extended Vesting Period as no actual dividends will be paid during the LTIP Extended Vesting Period. Any proportion of an award that lapses does not attract the payment of the LTIP dividend equivalent payment. **Clawback and malus (for 2016 awards onwards)**: provisions operate under which all or a part of the value of an award may be recovered if, at any time within a period of five years from the date of grant, the Committee determines that: (1) there has been a material misrepresentation in relation to the performance of any Group Company, relevant business unit and/or the participant; or (2) an erroneous calculation was made in assessing the extent to which an award is capable of vesting or vested, which in either case resulted in the number of shares in respect of which an award vested or became capable of vesting being more than it should have been. The material misrepresentation may include (but is not limited to); (1) a misstatement of the financial results and/or health of any Group Company; or (2) an erroneous calculation in relation to any Group Company's results or other performance benchmark. Clawback may also be applied at any time where the Committee determines that a participant committed, at any time prior to the vesting of an award at the end of the LTIP Extended Vesting Period (including prior to grant), an act or omission which justified dismissal for misconduct. Where the Committee determines that these provisions are to be applied, the participant may be required to repay the excess value which vested and this repayment may be effected so that the number of shares subject to the award may be reduced and/or by reducing other cash held by or share-based awards granted to the participant. For LTIP participants determined by the Committee as 'good leavers', the number of shares vesting is dependent on the performance at the end of the three-year performance period (pro-rated for the period employed) and shares vesting are subject to clawback at any time prior to the vesting of an award at the end of the LTIP Extended Vesting Period. The detailed policy on payment for loss of office which includes the scope for determination of 'good leaver' status applied by the Committee is set out on page 89 of this Policy Report. **Clawback (for 2015 awards) and malus (for 2013, 2014 and 2015 awards)**: the equivalent provisions for the 2016 awards apply save for the absence of the LTIP Extended Vesting Period which did not apply to those awards.
Maximum potential value and payment at threshold **2016 Policy – change proposed:** an increase in the maximum LTIP award level with a reduction in the value of threshold vesting from 20% to 15% of the award. See 'At a glance' on pages 72 and 73.	**Maximum award of shares** permitted is 500% of salary for the Chief Executive and 350% for other Executive Directors. Proportion of vesting is determined by reference to achievement of defined measures over a three-year period as set out in the performance metrics section below: A **maximum vesting** of 100% will result in the vesting of shares to a value equivalent to 500% of the Chief Executive's salary as at the time of award, plus the appropriate dividend equivalent payment. For other Executive Directors, a maximum vesting of 100% will result in the vesting of shares to a value to 350% of salary as at the time of award, plus the applicable dividend equivalent payment. If the **threshold performanc**e level is attained in respect of all five measures, 15% of the original award level will vest: (1) for the Chief Executive with shares to the value equivalent of 75% of salary at the time of the award; and (2) for the other Executive Directors with shares to the value equivalent of 52.5% of salary at the time of the award. The appropriate dividend equivalent payment will attach to the shares vesting in each case. Between threshold and maximum, the balance of an award vests on a straight-line basis. Executive Directors departing as 'good leavers' will receive vesting shares only at the end of the LTIP Extended Vesting Period based on the vesting percentage applicable on the satisfaction of the performance conditions at the end of the three-year performance period and pro-rated for the period of employment during that performance period.

Policy Report continued

Long-term incentives: Long-Term Incentive Plan (LTIP 2016)

Performance metrics used, weighting and time period applicable

2016 Policy – changes proposed:

(1) two additional performance measures (EPS at constant rates of exchange and an operating cash flow to operating profit conversion ratio) and re-weighting of measures;

(2) an amendment to the NTO threshold vesting; and

(3) value of vesting award for threshold performance reduced from 20% to 15% of the award.

See 'At a glance' on page 73.

Performance will be measured over a three-year period and compared with the target range for each of five conditions. In each case no award will vest for performance below the threshold of the range and the maximum award will vest for performance at or above the top of the range. The performance conditions which each account for 20% of any award and the relevant ranges are as follows:

(1) **20% of an award based on the Company's relative TSR compared with a peer group of international FMCG companies**: the threshold of the range is the median and the top of the range is at upper quartile versus the peer group. In the event of a top quartile performance by the Company relative to this comparator group, this element of the award vests in full; 3% will vest for median performance. The TSR portion of an LTIP award will not vest for below median performance.

(2) **20% of an award is based on the percentage growth in adjusted diluted EPS measured in sterling at current rates**: the range is 5% to 10% CAGR. If the Company achieves a CAGR of 10%, this element of the award will vest in full. If 5% CAGR is achieved, then 3% of the award will vest. If CAGR over the period is less than 5%, none of this EPS portion of an award will vest.

(3) **20% of an award is based on the percentage growth in adjusted diluted EPS measured at constant rates**: the range is 5% to 10% CAGR. If the Company achieves a CAGR of 10%, this element of the award will vest in full. If 5% CAGR is achieved, then 3% of the award will vest. If CAGR over the period is less than 5%, none of this EPS portion of an award will vest.

(4) **20% of an award is based on the percentage organic growth in net turnover (NTO) measured at constant rates**: the range is 3% to 5% CAGR. If the Company achieves a growth rate of 5% this element of the award relating to NTO will vest in full. If the Company achieves a CAGR over the three-year period of 3%, then 3% of the award will vest. The NTO portion of the award will not vest for CAGR below 3%.

There is an underpin to the NTO measure: no vesting will occur for NTO unless the corresponding three-year constant CAGR of underlying operating profit exceeds the CAGR of the threshold performance level for underlying operating profit as approved by the Board, as defined annually in the IEIS.

(5) **20% of an award is based on operating cash flow, measured at actual rates, expressed as a percentage of adjusted operating profit (as defined for the purposes of the IEIS, except as for actual rates of exchange)**: the performance range is 85% to 95%. If the Company achieves a ratio of operating cash flow to adjusted operating profit of 95% or more on average over a three-year period, this element of the award will vest in full. If the Company achieves a ratio of operating cash flow to adjusted operating profit of 85% on average over a three-year period, 3% of the award will vest. This measure will not vest if the ratio is below 85%.

The Remuneration Committee will also assess the performance of the **current outstanding LTIP awards** against the performance conditions applicable to those awards as follows:

Measures applying for March 2013 LTIP awards (vesting 22 March 2016)

EPS: adjusted diluted compound annual growth rate (CAGR) of 3% (measured at current rates of exchange) in excess of UK inflation triggers threshold performance. CAGR of 8% in excess of inflation would trigger maximum vesting under this measure. For performance between these two points, a pro-rated award will vest. None of the EPS portion of the award will vest if CAGR for the period is less than 3%.

Component weighting: 50%.

TSR: relative to and measured against two groups of companies:

(1) a group of international FMCG companies (weighting 25%); and

(2) the constituents of the London Stock Exchange's FTSE 100 Index (weighting 25%).

Upper quartile performance by the Company relative to both the TSR comparator groups triggers 50% of the total award to vest in full; 6% of the total award vests for median performance. For performance between these two points, a pro-rated award will vest. The TSR portions of the LTIP award do not vest for below median performance.

The actual performance against these measures is set out on page 102. Application of an early vesting percentage can apply. Three-year performance period; no application of a two-year post-performance extended period to vesting.

Long-term incentives: Long-Term Incentive Plan (LTIP 2016)	
Performance metrics used, weighting and time period applicable continued	**Measures applying for March 2014 LTIP awards (vesting 28 March 2017) and March 2015 LTIP awards (vesting 27 March 2018)** **EPS:** adjusted diluted compound annual growth rate (CAGR) of 5% (measured at current rates of exchange) triggers threshold performance and 8% of the award will vest. CAGR of 10% would trigger maximum vesting under this measure. For performance between these two points, a pro-rated award will vest. None of the EPS portion of the award will vest if CAGR for the period is less than 5%. Component weighting: 50%. **TSR:** relative to and measured against a group of international FMCG companies. Upper quartile performance by the Company relative to the TSR comparator group triggers 25% of the total award to vest in full; 6% of the total award vests for median performance. For performance between these two points, a pro-rated award will vest. The TSR portion of the LTIP award does not vest for below median performance. Component weighting: 25%. **NTO:** compound annual growth measured at constant rates of exchange. If the Company achieves a compound annual growth rate (CAGR) of 5%, this element of the award relating to NTO will vest in full. If the Company achieves a CAGR over the three-year period of 2%, then 6% of the award will vest. There is a pro-rata vesting between these points. The NTO portion of the LTIP award will not vest for a CAGR below 2%. Component weighting: 25%. There is an **underpin to the NTO measure** whereby the corresponding three-year constant currency CAGR of underlying operating profit must exceed the CAGR of the threshold performance level for underlying operating profit (as defined annually in the IEIS and approved by the Board) in order for an LTIP vesting payment in respect of the NTO measure to become payable. No application of an early vesting percentage. Three-year performance period; no application of a two-year post-performance extended period to vesting.

All-employee share schemes	
How the element supports the Company's strategic objectives	Executive Directors are eligible to participate in the Company's all-employee share schemes which are designed to incentivise employees by giving them an opportunity to build shareholdings in the Company.
Operation of the element and performance metrics used **Proposed new Sharesave Scheme 2016:** the Company's current Sharesave Scheme for all employees expires in 2017. The proposed new Sharesave Scheme 2016 is in all material respects unchanged from the current scheme and will be subject to approval by shareholders at the 2016 AGM.	**Sharesave Scheme** – an HM Revenue & Customs (HMRC) approved scheme where eligible employees are granted savings-related share options to subscribe for ordinary shares in the Company. Options are granted to be exercisable in conjunction with either a three-year or five-year savings contract with a monthly savings limit of currently £500. Options are normally granted at a discount of 20% to market price at the time of invitation. **Share Incentive Plan (SIP)** – an HMRC-approved plan incorporating: (1) **Partnership Scheme** – eligible employees can allocate part of their pre-tax salary to purchase shares in the Company. Shares purchased are held in a UK-based trust, normally capable of transfer to participants tax-free after a five-year holding period. The annual value of partnership shares that can be purchased is currently £1,800. (2) **Share Reward Scheme** – eligible employees receive an award of shares in April of each year in which the Scheme operates which may be based on performance in the previous financial year. The performance conditions are aligned to those set for the IEIS in respect of the same performance period. The plan shares are held in a UK-based trust for three years and during that time the trust will exercise its voting rights as directed by the plan's participants. For awards made from 2016 onwards, the maximum individual award is currently £3,600 (previously £3,000).
Maximum potential value	**Sharesave Scheme:** the market value of the shares under option at the date of maturity of the Sharesave savings contract, less the grant price of the option at the contract start date. **SIP – Partnership Scheme:** the value of the shares purchased out of the potential maximum annual purchase value of currently £1,800 at the end of the five-year holding period. **SIP – Share Reward Scheme:** the value of the shares awarded out of the potential maximum annual award value of currently £3,600 at the end of the three-year holding period in the employee trust.

Policy Report continued

Shareholding guidelines	
How the element supports the Company's strategic objectives	To strengthen the alignment between the interests of the Executive Directors and those of the shareholders by requiring Executive Directors to build up a high level of personal shareholding in the Company.
Operation of the element and performance metrics used **2016 Policy – changes proposed:** (1) increase to the minimum shareholding requirement; and (2) DSBS shares and shares in the LTIP Extended Vesting Period count towards the shareholding requirements.	Executive Directors are required to hold shares in the Company equal to the value of a multiple of salary. Those Executive Directors who do not, at any point, meet the requirements of the shareholding guidelines, may generally sell a maximum of up to 50% of any shares vesting (after tax) under the Company's share plans until the threshold for the shareholding guidelines has been met. Shares 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. Further, the estimated notional net number of shares held by an Executive Director in the LTIP Extended Vesting Period (see page 80) will also count towards the respective shareholding requirements. A waiver of compliance with the shareholding guidelines is permitted at the discretion of the Remuneration Committee in circumstances where a restriction on a requested share sale could cause undue hardship.
Shareholding requirements	Chief Executive: 500% of salary. Other Executive Directors: 350% of salary.

External Board appointments	
How the element supports the Company's strategic objectives	The Company recognises the opportunities and benefits that accrue to both the Company and its Executive Directors who serve as Non-Executive Directors on the Boards of comparable companies.
Operation of the element and performance metrics used	Each Executive Director is limited to one external appointment, with the permission of the Board. There are no performance metrics.
Maximum potential value	Any fees from such appointments are retained by the individual in recognition of the increased level of personal commitment required. Executive Directors may also serve as nominated directors on the Boards of the Company's associate undertakings. In such instances, the fees will be paid to the Group and are not for the individual's account.

Additional notes to the Future Policy Table

1. The Remuneration Committee reserves the right to make any remuneration payments where the terms were agreed prior to an individual being appointed an Executive Director of the Company or prior to the approval and implementation of the Remuneration Policy (including, for the avoidance of doubt, pursuant to the previous Remuneration Policy). This includes the achievement of the applicable performance conditions, for Executive Directors who are eligible to receive payment from any award made prior to the approval and implementation of the Remuneration Policy.

2(a) This policy applies in a similar form, with appropriate eligibility criteria and gradations of salary, benefits and incentive awards to the members of the Management Board and senior management. Award levels vary with seniority up to the appropriate maxima expressed within the relevant scheme rules.

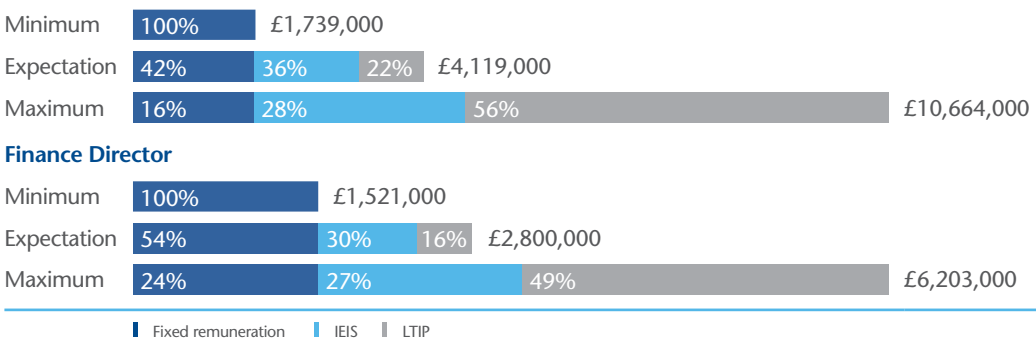
2(b) For other UK employees of the Group, remuneration will cover annual base salary, retirement plus other benefits and participation in the Company's annual short-term incentive scheme, including eligibility to participate in all-employee share plans.

2(c) For employees employed outside of the UK, remuneration policy is set in accordance with conditions in the local marketplace. Local policy is established with reference to Group guidelines concerning: annual base salary relative to the local market, the provision of retirement and other benefits (where locally relevant) and participation in short-term incentive plans where the incentive opportunity is established with reference to the local market conditions and locally relevant targets.

Illustrations of the application of the Remuneration Policy

The levels of remuneration received by Nicandro Durante and Ben Stevens as Executive Directors for the first complete year in which the Policy applies are shown as the hypothetical values of their remuneration packages under different performance scenarios in the charts below. No share price growth has been assumed and benefits from all-employee share schemes (Sharesave Scheme and Share Incentive Plan) have been excluded.

Remuneration outcomes for varying levels of performance



The following assumptions have been applied in the table above.

Maximum award opportunities (% of salary)		Chief Executive	Finance Director
IEIS		250%	190%
LTIP		500%	350%
Minimum	Fixed pay only:	No bonus payout; no vesting under LTIP	
Expectation	Fixed pay plus:	50% of the maximum IEIS award; threshold vesting under the LTIP	
Maximum	Fixed pay plus:	100% payout of the IEIS; 100% vesting under the LTIP	

	Salary effective 1 April 2016 £'000	Benefits value for 2015 £'000	Pension value for 2015 £'000	Total fixed pay £'000
Chief Executive (Nicandro Durante)	1,190	157	392	1,739
Finance Director (Ben Stevens)	867	110	544	1,521

Note:
Benefits value for 2015: (1) excludes any expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events; and (2) includes 'Other emoluments' – life insurance.

Policy Report continued

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 has built in a degree of flexibility to enable the practical implementation of the policy over that prospective lifetime. This is outlined in the table below under the categories of flexibility, judgement and discretion.

Flexibility Areas of the Policy which include a degree of flexibility.	– pay, benefits and pension arrangements allowing the Committee to set these either on appointment or following an annual salary review, and to review and change the pay comparator groups to ensure they remain appropriate. The degree of flexibility to operate is constrained by the policy maximum. – the IEIS bonus plan, for example, allowing the Committee to design performance measures, agree their relative weighting and set annual targets to incentivise business outcomes aligned to the Group's short-term strategic objectives. This is to ensure that these remain relevant and aligned to the Group Strategy. – the LTIP, allowing the Committee to make revisions to the performance measures, their respective weightings, threshold and target levels as permitted under the LTIP scheme rules.
Judgement The Committee will be required to exercise its judgement over the life of the Policy. For example when:	– considering an individual's remuneration award or the specific benefits or pension arrangements applying to an appointment. – varying the measures and their weightings, as well as setting specific targets, for example, in the IEIS in any year to ensure that all elements continue to remain aligned to Group Strategy and drive the right behaviours. – determining the percentage of salary which can be earned as a bonus in excess of threshold, target and up to the maximum, or the percentage salary level in respect of an LTIP award in each case up to the relevant maximum set out in the Policy Table. – assessing the performance of each individual Executive Director in delivering against his or her personal performance objectives.
Discretion 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. For example:	**Short-term incentives (IEIS)** – to assess whether an individual performance element should be applied to an Executive Director's bonus outcome and at what level (+ up to 20% for outstanding personal performance or -50% for poor personal performance), subject to the overall cap as provided in the Policy. – to assess and override a payout in circumstances where the overall performance of the Company justifies a different outcome whether higher or lower than that determined by the bonus formula. – in relation to leavers (other than automatic 'good leavers' under the DSBS) as to whether deferred shares will be released and whether any bonus (in whole or in part) is payable during the year of departure. – whether circumstances have arisen that should result in the application of the clawback and/or malus provisions to deferred shares held by an Executive Director. **Long-term incentives (LTIP)** – to assess and override the formulaic outcomes of the LTIP performance outcome (either positively or negatively) to ensure that the resulting LTIP payout reflects fairly the underlying performance of the business and serves the interest of shareholders. – in relation to leavers (other than automatic 'good leavers' under the LTIP) as to whether shares will vest, the terms on which such shares will vest and the percentage level of the award which vests as well as whether any LTIP (in whole or in part) is payable during the year of departure. – whether circumstances have arisen which should result in the application of the clawback and/or malus provisions to unvested LTIP awards. **Other** – on appointment of a new Executive Director, to agree a contract, for an initial period only, longer than the normal one-year rolling contract. – where the shareholding requirements are not yet met and where a waiver of compliance with the guidelines is agreed by the Committee. In each case above, wherever the Committee exercises its discretion in relation to an Executive Director, it will disclose the rationale for doing so in its Annual Report on Remuneration the following year.

Approach to remuneration of Directors on recruitment

Principles In making an Executive Director appointment (whether an internal or external appointee) the Remuneration Committee will follow these principles.	– British American Tobacco seeks to appoint senior, high calibre managers and many of its competitors for talent are based outside the UK. – to offer a package (both fixed salary, pension and performance-related remuneration) which is sufficiently competitive (but not excessively so) so that senior, high calibre candidates can be appointed which are designed to promote the long-term success of the Company. The Remuneration Committee will consider the market, including the Pay Comparator Group, and by reference to other companies of equivalent size and complexity to ensure that it does not overpay. – consideration will be given to relevant factors, such as the candidate's skills, knowledge and experience and his or her current package and current location in determining the overall package. – internal pay relativities and the terms and conditions of employment of the new and existing Executive Directors will be considered to ensure fairness between Executive Directors.
External appointment to role of Executive Director – additional considerations Individual has variable remuneration arrangements with his or her previous employer that will be lost on joining British American Tobacco.	– the Committee will consider matching up to the maximum of the expected value of the lost awards in order to facilitate the recruitment of that individual. – this may take the form of a one-off long-term incentive award with performance conditions and vesting period similar to the awards given up. – in addition, a sign-on award may be made on a like-for-like basis to compensate for any short-term incentives which may be forgone. – any cash-based awards will normally only be used to replace a bonus for which the remaining performance period is less than three months and where the outcome is reasonably foreseeable. – where appropriate, such awards will also be made subject to clawback and malus provisions.
Relocation – to the UK from overseas and return on retirement or departure from the Group British American Tobacco may provide appropriate relocation support.	Includes: – the shipment of personal goods to/from the Director's home to his/her permanent office location. – the provision of temporary accommodation. – the provision of relocation support to find accommodation. – the provision of tax support services to be provided by the Company's advisers. – the payment by the Company of the cost of spouse or partner career counselling. – the provision of housing and schooling support for up to four years as appropriate for the individual's family circumstances.

Policy Report continued

Service contracts – Executive Directors

Current Executive Directors Employed on a one-year rolling contract, executed at the time of the original appointment.	– contracts are governed by English law. – may be varied from time to time to take account of changes in terms and conditions as well as to incorporate best practice. – includes a provision for a termination or compensation payment in lieu of notice. 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 the 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 this summary and in the Policy.	– to provide pay, contributions to applicable pension arrangements and benefits (whether in cash or in kind) as specified in the contract, and to reimburse expenses incurred by the Executive Director in performing their duties. – to give the Executive Director eligibility to participate in: (1) short-term (IEIS) and long-term (LTIP) incentive plans; and (2) all-employee share plans, subject to the rules of those schemes. – to provide for the use of: (1) a company car for private and business use, subject to the terms of the Company's car policy or to provide a monthly car allowance; and (2) the personal use of a car and driver. – to provide 25 working days' (plus public holidays) paid holiday per annum and to provide pay in lieu of any accrued but untaken holiday. – to provide sick pay as specified in the contract. – to give the Executive Director eligibility to participate in the following benefit schemes: private medical expenses scheme; personal accident scheme; and life assurance scheme, subject to the terms and conditions of such schemes from time to time in force. – subject to the termination, garden leave and suspension provisions of the service contract, to provide continued employment in the role to which the Executive Director has been appointed. – to terminate the contract only on the expiry of twelve months' written notice or to make a payment in lieu of notice equal to the value of: (1) twelve months' salary at his or her then current base pay; and (2) a cash payment in respect of benefits under the contract, such as medical insurance, or the Company may, at its option, continue those benefits for a twelve month period – see below for the treatment of short-term and long-term incentive awards on termination. – in addition to the contractual rights to a payment on loss of office, Executive Directors will have statutory and/or common law rights to certain additional payments (for example, in a redundancy situation covering the review of settlement agreements and the provision of legal fees relating thereto), available to all employees.
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

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

Policy on payment for loss of office

Principles The principles on which the Remuneration Committee will approach the determination for payments on termination.	The service contracts of the current 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. – compensation for loss of office in service contracts is limited to no more than twelve months' salary and benefits excluding pension. This amount would be payable where the requisite twelve months' notice is not given to the Executive Director or when the Executive Director terminates by giving twelve months' notice and the Company does not wish the Executive Director to serve notice. – if an Executive Director is required to serve a period of notice, the compensation payment is reduced pro rata. In the event that the contract is terminated for cause (such as gross misconduct), the Company may terminate the contract with immediate effect and no compensation would be payable. – in cases of underperformance, termination payments will not exceed twelve months' salary and benefits.

Policy on payment for loss of office continued

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.

Plan	'Good leaver'	'Other' leaver scenarios
IEIS	In accordance with the IEIS rules, 'good leavers' are eligible for a bonus pro-rated to the period of service during the year; payments are cash only. Awards made under the DSBS component of the IEIS will vest or transfer to an individual upon termination of their contract in accordance with the specific circumstances set out in the rules of the scheme.	No entitlement to a bonus but the Committee has the discretion to treat other leavers in the same manner as 'good leavers'; this discretion is not exercisable in the case of summary dismissal.
LTIP	For awards made in 2014 and 2015, 'good leavers' vesting on the normal vesting date is dependent on performance over the full performance period and pro-rated for the part of the performance period employed. For awards made from 2016, vesting occurs at the end of, and is subject to malus/clawback reductions during, the LTIP Extended Vesting Period. For the awards made in 2013, 'good leavers' vesting is dependent on performance to date of leaving and pro-rated for the part of the performance period employed.	In all other circumstances, the awards will lapse immediately including any awards made from 2016 onwards and which are still subject to the LTIP Extended Vesting Period unless the Committee, in its absolute discretion, decides otherwise.
SRS	The award is not forfeited. If an individual ceases to be employed within three years of the allocation date, the shares and the dividend shares will be withdrawn from trust and transferred to the individual.	

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.

Guidelines

Individual event	Indicative status
Resignation intending to cease work altogether.	'Good leaver' and discretion to release awards.
Resignation intending to take up a different occupation, such as a portfolio career.	'Good leaver' and discretion to release awards.
Delays resignation from the Company to accommodate the Company's plans or the demands of their current workload.	'Good leaver' and discretion to release awards.
Departure at the request of and/or with the agreement of the Company.	'Good leaver' and discretion to release awards.
Resignation from the Company to work for a competitor or to undertake a role or otherwise acting in conflict with the interests of the Company.	Discretion not to release awards.
Resignation from the Company notwithstanding the Company's plans and role demands.	Discretion not to release awards.
Dismissal for any reason such as misconduct or poor performance.	Discretion not to release awards.

In exercising its discretion, the Committee will also take into account the individual's overall performance as well as their contribution to the Company during their total period of employment.

Other discretionary powers

The Remuneration Committee retains discretion to settle any other amounts reasonably due to an individual Executive Director as set out here.

- payment of legal fees incurred by an individual in connection with reviewing a settlement agreement on termination of employment where the Company wishes to enter into a settlement agreement and the individual must obtain independent legal advice.
- reimbursement of reasonable relocation costs where an Executive Director had originally relocated to take up the appointment; these will relate to returning the individual (and where relevant their family) to their country of origin, the shipment of personal goods and winding up their affairs in the UK and the incidental costs incurred in doing so.

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.

Policy Report continued

Statement of consideration of employment conditions elsewhere in the Company

Process	– the Committee considers the budgeted salary increases for the UK-based employee population, the guidance given to managers on the range of salary increases and other remuneration arrangements and employment conditions for all UK-based employees, when determining the remuneration policy for Executive Directors. – it is expected that future salary increases for Executive Directors will be in line with the range set out in the salary review guidelines for the general UK employee population, except in exceptional circumstances, such as where a recently appointed Executive Director's salary is increased to reflect his or her growth in the role over time or where significant additional responsibilities are added to the role. – annual bonus metrics and related targets for Executive Directors are aligned with those of senior management and are cascaded to lower tier bonus plans adjusted in some cases for local market context, in order to maintain alignment and line of sight.
Employee opinion survey/ consultation	– an employee opinion survey is conducted every two years and the Company includes general questions on its pay arrangements in the survey, the outcomes of which are reviewed by the Board.

Remuneration Table – Chairman and Non-Executive Directors

Chairman and Non-Executive Directors	
Fees – Chairman	The Remuneration Committee considers annually the fee payable to the Chairman. Given that the role of a chairman can vary considerably between companies and sectors, this process (using data from the FTSE 30 companies) takes into account the breadth of that role coupled with its associated levels of personal commitment and expertise in the overall context of international reach and the 'ambassadorial' aspect of the role. The Chairman is currently expected to make an annual time commitment of about 100 days to cover the responsibilities of the role. The Chairman does not participate in any discussions on his level of remuneration.
Fees – Non-Executive Directors	The quantum and structure of Non-Executive Directors' remuneration will primarily be 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. The fees for the Non-Executive Directors are reviewed annually, although the review does not always result in an increase in the Board fees or Committee fees. The Board as a whole considers the policy and structure for the Non-Executive Directors' fees on the recommendation of the Chairman and the Chief Executive. The Non-Executive Directors do not participate in discussions on their specific levels of remuneration.
General	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[1].
Benefits, travel and related expenses – Chairman	Richard Burrows is reimbursed for the cost of travel and related expenses incurred by him in respect of attendance at Board, Committee and General meetings including the cost of return airline tickets to London from his home in Ireland in connection with his duties as Chairman. He is also entitled to the use of a Company driver; private medical insurance and personal accident insurance benefits; 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. In addition, 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. In appointing a new Chairman, the Committee will offer the components set out in respect of the current Chairman, as appropriate, and may also offer housing allowances for a limited period and other relocation benefits.
Travel and related expenses – Non-Executive Directors	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. In addition, it is the policy of the Board 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. 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.
General	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.
Shareholding requirements	The remuneration of the Chairman and the Non-Executive Directors is paid in cash. There are 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.

Note:

1. **Aggregate fees limit:** the total annual fees of the Chairman and the Non-Executive Directors are limited to the overall aggregate annual limit of £2,500,000 authorised by shareholders with reference to the Company's Articles of Association.

Remuneration Report

Annual Report on Remuneration

Kieran Poynter
Chairman of the Remuneration Committee

Remuneration Committee current members
Kieran Poynter (Chairman)[2(d)]
Ann Godbehere
Christine Morin-Postel
Dimitri Panayotopoulos[2(b)]

Attendance at meetings in 2015

Name	Member since	Attendance/Eligible to attend
Kieran Poynter	2011	5/5
Ann Godbehere	2011	5/5
Christine Morin-Postel	2007	5/5
Gerry Murphy[2(c)]	2009	1/1
Dimitri Panayotopoulos	2015	5/5

Notes:

1. **Number of meetings 2015:** four scheduled meetings were held; an additional further meeting was held in early October 2015 to review, in outline, executive compensation proposals for 2016.
2. **Membership:** (a) all of the members of the Remuneration Committee are independent Non-Executive Directors of the Company; (b) **Dimitri Panayotopoulos** was appointed a member on 2 February 2015; (c) **Gerry Murphy** stood down as Chairman and ceased to be a member on 5 May 2015; and (d) **Kieran Poynter** became Chairman on 5 May 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 his 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.
5. **Secretary to the Remuneration Committee:** this is the Company Secretary.

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 2015.

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 British American Tobacco Group.

Remuneration Committee – advisers 2015

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.	2015: £178,750 2014: £285,650	Tax, corporate finance and consulting services to Group companies worldwide.
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.
PricewaterhouseCoopers LLP	Specified procedures to assist in the assessment of the calculations of the IEIS bonus outcomes and future targets. This service is provided by KPMG LLP from February 2016 onwards.	2015: £10,870 2014: £10,870	External auditor to 23 March 2015; audit and tax services and other non-audit services.

Note:
The Remuneration Committee has not expressly considered the objectivity and independence of the advice received from these professional firms, although it regularly reflects upon the quality of advice received. The Committee is confident that none of the cross-relationships generate an unmanageable conflict of interest and that the fees paid in respect of each service do not compromise the objectivity and impartiality of the provision of the other services.

Remuneration Committee – activities in 2015

Regular work programme

- reviewed and set salaries for the Executive Directors from 1 April 2015 taking into account both the pay comparator group positioning and the pay and employment conditions elsewhere in the Group, particularly in the UK;
- reviewed and set the Chairman's fee from 1 April 2015;
- assessed the achievement against the targets for the 2014 IEIS award and set the IEIS targets for 2015;
- assessed and agreed the application of an individual performance element for the Executive Directors;
- assessed the achievement against the performance conditions for the vesting of the LTIP 2012 award, determined the level of LTIP awards for March 2015 and confirmed the associated performance conditions;
- assessed the achievement against the targets for the 2014 Share Reward Scheme and set the targets for the 2015 award;
- monitored the continued application of the Company's shareholding guidelines for the Executive Directors;
- reviewed the Annual Statement, the summary Policy Report and the Annual Report on Remuneration for the year ended 31 December 2014 prior to its approval by the Board and subsequent shareholder submission to the AGM on 29 April 2015;
- analysed the AGM results on remuneration voting and reviewed market trends in the context of the 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 2015 for the IEIS 2015 and the outstanding LTIP awards;
- previewed the positioning of the salaries for Executive Directors for 2016; and
- reviewed the report on the effectiveness of the Remuneration Committee.

Annual Report on Remuneration continued

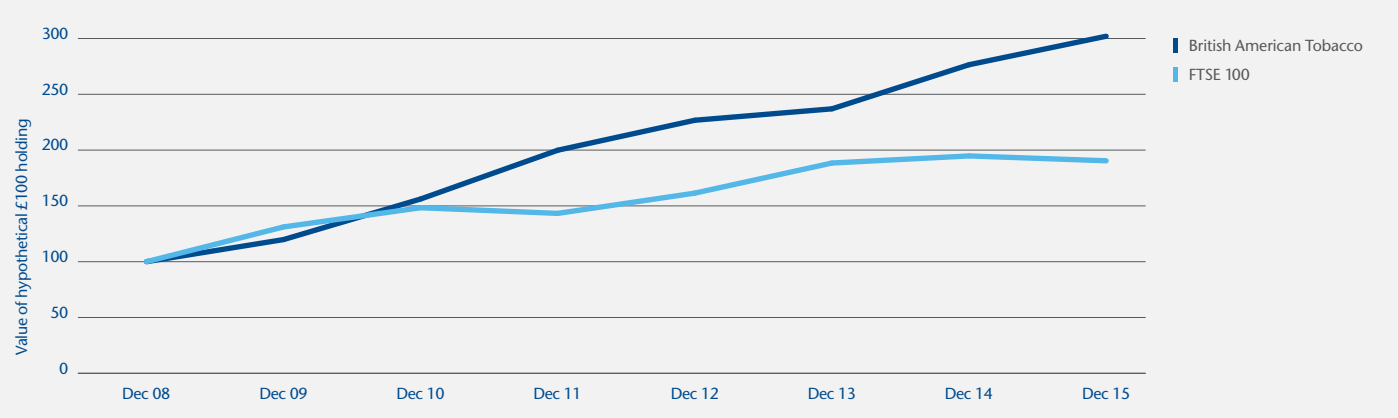
Remuneration policy matters

- introduced a clawback facility in respect of both the short-term incentive (IEIS and DSBS) and long-term incentive (LTIP) variable pay plans which enable post-vesting clawback of share or cash bonus awards in accordance with the provisions of the UK Corporate Governance Code;
- initiated a review of all aspects of the current remuneration offer in the context of the impact on employee retention and recruitment and the consequent need for remedial action of the Group's current incentive schemes;
- considered and reviewed an outline of executive compensation proposals for 2016 including: (1) a new LTIP ahead of the expiry of the current LTIP in April 2017 linking to a review of remuneration policy; and (2) an increase in the maximum LTIP award level to 500% of salary and an increase in the maximum IEIS award level to 250% of salary;
- reviewed the outcomes of the review of the Remuneration Policy and agreed that shareholders be consulted with regard to a new Policy to be put to the AGM in April 2016;
- considered and agreed a revised approach to the disclosure of IEIS bonus outcomes, balancing shareholder concerns with considerations of commercial sensitivity;
- discussed the preliminary results of the consultation with shareholders on a Revised Remuneration Policy; and
- approved an amendment to the shareholding guidelines to enable a dispensation for Executive Directors and members of the Management Board from the obligation to build up or maintain a shareholding to the required threshold in circumstances where such a restriction on a potential share sale could cause undue hardship; any application for a waiver by an Executive Director must be considered by the Remuneration Committee and, if agreed, such an application would be included in the relevant Annual Report on Remuneration.

Other incentive matters

- excluded the contribution of the South Korea market from the IEIS volume share metrics for 2015 and 2016 in order to remove the distorting effect of a significant increase in that market share earlier in 2015, in anticipation of an announced significant excise increase planned in that market; and
- excluded funds received from HMRC from the calculation of cash flow performance measure for the purposes of the 2015 outcomes for the IEIS.

Total shareholder return (TSR) performance – 2008 to 2015



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 seven financial years starting from 1 January 2009 through to 31 December 2015 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 seven-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 2015

Year	2009	2010	2011	2012	2013	2014	**2015**
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**
Nicandro Durante[2] (from 1 March 2011)	n/a	n/a	5,589	6,340	6,674	3,617	**4,523**
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**
Nicandro Durante[2] (from 1 March 2011)	n/a	n/a	100	85.0	81.3	73.2	**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**
Nicandro Durante[2] (from 1 March 2011)	n/a	n/a	100	87.1	49.2	00.0	**8.7**

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.

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	**2015 £m**	2014 £m	% change
Remuneration of Group employees[1]	**2,039**	2,194	(7)
Remuneration of Executive Directors	**8**	7	14
Remuneration of Chairman and Non-Executive Directors	**2**	2	–
Dividends paid in the year	**2,770**	2,712	2
Share buy-back programme[2]	**–**	795	(100)
Adjusted profit from operations[3]	**5,620**	5,403	4

Notes:

1. **Total remuneration of Group employees:** this has changed in the year mainly as a result of the impact of exchange rate movements, local remuneration agreements, varying employment costs and a reduction in headcount across end markets and regions.
2. **Share buy-back programme:** this was suspended with effect from 30 July 2014.
3. **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 2015

'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 2015 together with comparative figures for 2014. The aggregate Directors' emoluments are shown on page 106. 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 £'000		Total £'000	
	2015	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014
Nicandro Durante	**1,181**	1,141	**155**	132	**2,380**	1,690	**394**	293	**392**	323	**21**	38	**4,523**	3,617
Ben Stevens	**861**	835	**104**	99	**1,560**	1,108	**220**	158	**544**	521	**30**	28	**3,319**	2,749
John Daly (retired 6 April 2014)	**n/a**	191	**n/a**	59	**n/a**	171	**n/a**	143	**n/a**	109	**n/a**	2	**n/a**	675
Total remuneration	**2,042**	2,167	**259**	290	**3,940**	2,969	**614**	594[2]	**936**	953	**51**	68	**7,842**	7,041

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.

Annual Report on Remuneration continued

Analysis by individual Director – audited
Nicandro Durante

	2015 £'000	2014 £'000
Salary[1]	**1,181**	1,141
Taxable benefits		
Cash		
– car allowance	**16**	16
Non-cash		
– health insurance/provision of 'walk-in' health services	**8**	8
– tax advice	**20**	22
– the use of a company driver	**59**	62
– home and personal security in the UK and Brazil	**35**	17
– other expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**17**	7
Total taxable benefits[2]	**155**	132
Short-term incentives		
IEIS: annual performance related bonus – cash receivable March 2016 (YE 2015); cash received March 2015 (YE 2014)	**1,190**	704
DSBS: annual performance-related bonus – award of deferred shares at full market value March 2016 (YE 2015) and March 2015 (YE 2014)[3]	**1,190**	704
IEIS: individual performance uplift of 20% of total annual performance-related bonus – no cash receivable March 2016 (YE 2015) as no award of individual performance uplift; cash received March 2015 (YE 2014)	**–**	282
Total short-term incentives	**2,380**	1,690
Long-term incentives		
LTIP: award 22 March 2013 of 119,828 shares; performance period 2013/2015; award will vest 22 March 2016 at 8.7% resulting in 10,425 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 2015 of 3,782.11p	**394**	
LTIP: award 28 March 2012 of 124,688 shares; performance period 2012/2014; award vested on 28 March 2015; none of the performance conditions were met which resulted in the lapse of the full award		–
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; 2015: (LTIP award 28 March 2012; vested at 00.0% on 28 March 2015); 2014: (LTIP award 13 May 2011; vested at 49.2% on 13 May 2014)	**–**	293
Total long-term incentives	**394**	293
Pension-related benefits		
Unfunded unapproved retirement benefit scheme (UURBS – UK)[4]	**392**	323
Total pension-related benefits	**392**	323
Other emoluments		
Life insurance	**19**	17
Share Reward Scheme: value of shares received during the year	**2**	2
Sharesave Scheme: grant of options on 26 August 2014 over 543 shares at an option price of 2,787.0p per share; options were awarded at a discount of 20% of the market value (3,483.0p per share) in accordance with the rules of the Sharesave Scheme	**–**	19
Total other emoluments	**21**	38
Total remuneration	**4,523**	3,617

Notes:

1. **Salary:** base salary from 1 April 2015: £1,190,000 (+3%) (from 1 April 2014: £1,155,000); UK-based employees received salary increases averaging around 3% and within a range of 0% to 8% with effect from 1 April 2015.
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. **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 2014 (adjusted for inflation) and as at 31 December 2015, multiplied by 20 in accordance with the Regulations.
5. **External directorship:** Nicandro Durante is a non-executive director of Reckitt Benckiser Group. He retains the fees for this appointment, 2015: £102,500 (2014: £91,250).

Analysis by individual Director – audited

Ben Stevens

	2015 £'000	2014 £'000
Salary[1]	**861**	835
Taxable benefits[2]		
Cash		
– car allowance	**14**	14
Non-cash		
– health insurance/provision of 'walk-in' health services	**8**	4
– the use of a company driver	**76**	73
– 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	**3**	5
Total taxable benefits	**104**	99
Short-term incentives		
IEIS: annual performance related bonus – cash receivable March 2016 (YE 2015); cash received March 2015 (YE 2014)	**780**	462
DSBS: annual performance-related bonus – award of deferred shares at full market value March 2016 (YE 2015) and March 2015 (YE 2014)[3]	**780**	462
IEIS: individual performance uplift of 20% of total annual performance-related bonus – no cash receivable March 2016 (YE 2015) as no award of individual performance uplift; cash received March 2015 (YE 2014)	**–**	184
Total short-term incentives	**1,560**	1,108
Long-term incentives		
LTIP: award 22 March 2013 of 66,932 shares; performance period 2013/2015; award will vest 22 March 2016 at 8.7% resulting in 5,823 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 2015 of 3,782.11p	**220**	
LTIP: award 28 March 2012 of 70,137 shares; performance period 2012/2014; award vested on 28 March 2015; none of the performance conditions were met which resulted in the lapse of the full award		–
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; 2015: (LTIP award 28 March 2012; vested at 0.00% on 28 March 2015); 2014: (LTIP award 13 May 2011; vested at 49.2% on 13 May 2014)	**–**	158
Total long-term incentives	**220**	158
Pension-related benefits[4]		
British American Tobacco UK Pension Fund	**9**	6
Unfunded unapproved retirement benefit scheme (UURBS – UK)	**535**	515
Total pension-related benefits	**544**	521
Other emoluments		
Life insurance	**9**	7
Share Reward Scheme: value of shares received during the year	**2**	2
Sharesave Scheme: grant of options on 23 March 2015 over 495 shares at an option price of 3,026.0p per share; grant of options on 26 August 2014 over 543 shares at an option price of 2,787.0p per share; options were awarded at a discount of 20% of the market value (2015:3,782.0p per share; 2014:3,483.0p per share) in accordance with the rules of the Sharesave Scheme	**19**	19
Total other emoluments	**30**	28
Total remuneration	**3,319**	2,749

Notes:

1. **Salary:** base salary from 1 April 2015: £867,000 (+3%) (from 1 April 2014: £841,500); UK-based employees received salary increases averaging around 3% and within a range of 0% to 8% with effect from 1 April 2015.
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. **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 2014 (adjusted for inflation) and as at 31 December 2015, multiplied by 20 in accordance with the Regulations.

Annual Report on Remuneration continued

Base salary

The Executive Directors' salary review in February 2015 agreed the following changes effective from 1 April 2015. UK-based employees received salary increases averaging around 3% and within a range of 0% to 8%, depending on time in grade, performance and position relative to the market with effect from 1 April 2015.

Executive Directors – salaries	Base salary from 1 Apr 2015 £	Percentage change %	Base salary from 1 Apr 2014 £
Nicandro Durante	**1,190,000**	3	1,155,000
Ben Stevens	**867,000**	3	841,500

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 2015
Performance period	Financial year ended 31 December 2015.
Payment	March 2016; 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 2016 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 his or her 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 2014 and 2015
The Remuneration Committee considers annually the question of commercial confidentiality and the sensitivity of bonus targets and results.
Specific performance measures, their weightings and actual performance/results achieved in 2015 are disclosed.
The specific performance targets for each measure are considered to be commercially sensitive and will only be disclosed retrospectively, at the earliest, in the Annual Report on Remuneration which relates to the period of twelve 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 2014. These are shown in the table below.
It is expected that the specific Threshold and Maximum targets for the IEIS performance period ended 31 December 2015 will be published in March 2017 in the Annual Report for 2016.

IEIS: performance measures and targets year ended 31 December 2014

IEIS: performance measure	Description of measure and target 2014
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 2014** Threshold: 4.0% growth over 2013 Maximum: 6.0% growth over 2013
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 2014** Threshold: 0.0 ppt growth over 2013 Maximum: 0.2 ppt growth over 2013
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 2014** Threshold: 2.0% growth over 2013 Maximum: 4.0% growth over 2013
Cash generated from operations (as against 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 2014** Threshold: 5% less than 2014 budget Maximum: 5% above 2014 budget

Annual Report on Remuneration continued

IEIS: performance measures, weightings and results year ended 31 December 2015		
IEIS: performance measure	**Description of measure 2015**	**Actual performance 2015**
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 over 40 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 8% **Strategic Report: Delivering our strategy – Growth**
Cash generated from operations (as against 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 12%. **Strategic Report: Delivering our strategy – Productivity**

Nicandro Durante – IEIS outcomes 2015

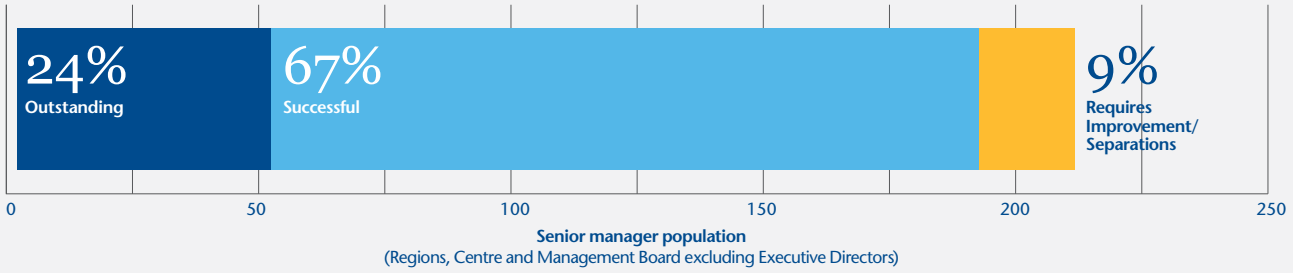
	2015 % of base salary	2015 £'000	2014 % of base salary	2014 £'000
Corporate result 50% in cash; 50% in deferred shares (DSBS)	**200.0**	**2,380**	121.9	1,408
Individual performance element up to 20% performance uplift on the corporate result (cash)	**00.0**	**–**	20.0	282
2015 assessment: no individual performance uplift.				
Total IEIS result	**200.0**	**2,380**	146.3	1,690
Maximum opportunity	**200.0**		200.0	

Ben Stevens – IEIS outcomes 2015

	2015 % of base salary	2015 £'000	2014 % of base salary	2014 £'000
Corporate result 50% in cash; 50% in deferred shares (DSBS)	**180.0**	**1,560**	109.7	924
Individual performance element up to 20% performance uplift on the corporate result (cash)	**00.0**	**–**	20.0	184
2015 assessment: no individual performance uplift.				
Total IEIS result	**180.0**	**1,560**	131.6	1,108
Maximum opportunity	**180.0**		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 96 and 97.
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.
3. **Senior managers:** a performance-related uplift is available for all senior managers whose performance is rated as 'Outstanding'. The outcomes of the performance assessment for these senior managers in 2015 is set out below.

Senior managers: individual performance ratings 2015



Annual Report on Remuneration continued

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

Vesting of the 2013 LTIP awards in 2016: outcomes against performance measures

2013 LTIP awards	Performance measures		
Award date: 22 March 2013 Vesting date: 22 March 2016	Total shareholder return (TSR) FTSE 100 Index 25% of award	Total shareholder return (TSR) 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
Performance period: 1 January 2013 – 31 December 2015 In the event of upper quartile performance by the Company relative to both the TSR comparator groups, 25% of each element of this measure of the total award vests in full; 6% of the total award vests for median performance. There is a pro rata vesting between these two points. The TSR portions of an LTIP award do not vest for below median performance. None of the EPS portion of an award vests if EPS growth is less than 3% per annum in excess of UK inflation.	Ranked 45/96 At median: 6% vests At upper quartile: 25% vests	Ranked 16/24 At median: 6% vests At upper quartile: 25% vests	(1.3)% From 3% EPS to 8% EPS: 8–50% vests pro rata between these two points
Percentage maximum achieved at end of performance period 31 December 2015: total vesting of 8.7% Additional information describing the key elements supporting the performance measures and the management of LTIP awards are set out on the Policy Report section of this Remuneration Report.	8.7%	00.0%	00.0%

Vesting of 2013 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	119,828	10,425 8.7%	109,403 91.3%	**394**
Ben Stevens	66,932	5,823 8.7%	61,109 91.3%	**220**

Notes:

1. **2013 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 2013 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 2015 was 3,782.11p.

Current position on outstanding LTIP awards

The table below shows the current position against the performance targets for the outstanding LTIP awards for 2014 and 2015 for Executive Directors as at 31 December 2015. The key elements supporting the performance measures and the management of LTIP awards are set out on the Policy Report section of this Remuneration Report.

2014 and 2015 LTIP awards: performance measures	Threshold	Maximum	Actual to 31 Dec 2015 2014 Award	% achieved at 31 Dec 2015 2014 Award	Actual to 31 Dec 2015 2015 Award	% achieved at 31 Dec 2015 2015 Award
Total shareholder return (TSR) ranking – a peer group of international FMCG companies at the beginning of the three-year performance period: **25% of award. 2014 Award:** (1 January 2014 to 31 December 2016) **2015 Award:** (1 January 2015 to 31 December 2017)	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 – **2014 Award:** a below-median annualised TSR of 11.9%; and **2015 Award:** a below-median annualised TSR of 11.1%. No company in the comparator group has delisted during the performance period to date, 31 December 2015.			**Ranked 13/24**	**00.0%**	**Ranked 16/24**	**00.0%**
Earnings per share (EPS) – compound annual growth relative to UK inflation measured at current rates of exchange: **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 an average of 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.			**(0.7)%**	**00.0%**	**2.9%**	**00.0%**
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: 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.			**4.3%**	**20.9%**	**4.8%**	**23.5%**
Total				**20.9%**		**23.5%**

Annual Report on Remuneration continued

Vesting of past LTIP awards for the years ended 2011 to 2015

The following table shows the historical vesting of awards over the five-year period for the years ended 31 December 2011 to 31 December 2015, inclusive.

LTIP award date	22 Mar 2013	28 Mar 2012	13 May 2011	25 Mar 2010	27 Mar 2009
Year ended	31 Dec 2015	31 Dec 2014	31 Dec 2013	31 Dec 2012	31 Dec 2011
Performance period	2013/2015	2012/2014	2011/2013	2010/2012	2009/2011
Vesting date	22 Mar 2016	28 Mar 2015	13 May 2014	25 Mar 2013	27 Mar 2012
TSR – FTSE 100 group of companies:					
Ranking	45/96	53/96	34/97	15/97	21/96
Percentage of vesting award	8.7	00.0	17.9	25	25
TSR – FMCG peer group:					
Ranking	16/24	19/24	10/24	5/25	5/25
Percentage of award vesting	00.0	00.0	14.2	25	25
Earnings per share growth:					
Percentage per annum above inflation	(1.3)	0.2	4.1	6.5	10.8
Percentage of vesting award	00.0	00.0	17.1	37.1	50
Total vesting percentage	8.7	00.0	49.2	87.1	100

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 2015.

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 (2015: 1,972 individuals; 2014: 1,979 individuals). 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		
	2015 £'000	2014 £'000	Change %	2015 £'000	2014 £'000	Change %	2015 £'000	2014 £'000	Change %
Nicandro Durante (Chief Executive)	1,181	1,141	3.5	155	132	17.4	2,380	1,690	40.8
UK-based employees	71	67	6.0	4	4	0.0	24	22	9.1

Notes:

UK-based employees:

1. The data for this comparator group is made up as follows as at 31 December 2015: (a) the weighted average base salaries; (b) the average taxable benefits per grade; and (c) an estimated weighted average bonus based on that population as at that date.
2. 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 2015 together with comparative figures for 2014. The aggregate Directors' emoluments are shown on page 106.

Non-Executive Directors[1]	Base fee £'000		Chair/Committee membership fees £'000		Taxable benefits[2] £'000		Total remuneration £'000	
	2015	2014	**2015**	2014	**2015**	2014	**2015**	2014
Karen de Segundo CSR: Chair; Nominations: Member	**93**	90	**31**	31	**–**	–	**124**	121
Sue Farr (from 2 February 2015) CSR and Nominations: Member	**85**	–	**11**	–	**2**	–	**98**	–
Ann Godbehere Audit, Remuneration and Nominations: Member	**93**	90	**18**	18	**2**	1	**113**	109
Savio Kwan (from 6 January 2014) CSR and Nominations: Member	**93**	89	**12**	12	**42**	39	**147**	140
Pedro Malan (from 2 February 2015) CSR and Nominations: Member	**85**	–	**11**	–	**42**	–	**138**	–
Christine Morin-Postel SID; Audit: Chair; Remuneration and Nominations: Member	**93**	90	**64**	48	**16**	8	**173**	146
Gerry Murphy Audit and Nominations: Member	**93**	90	**20**	36	**1**	1	**114**	127
Dimitri Panayotpoulos (from 2 February 2015) Remuneration and Nominations: Member	**85**	–	**11**	–	**13**	–	**109**	–
Kieran Poynter Remuneration: Chair; Audit and Nominations: Member	**93**	90	**42**	42	**–**	–	**135**	132
Richard Tubb CSR and Nominations: Member	**93**	90	**12**	12	**35**	36	**140**	138
Retired Non-Executive Director Anthony Ruys (to 30 April 2014)	**n/a**	30	**n/a**	4	**n/a**	5	**n/a**	39
Total	**906**	659	**232**	203	**153**	90	**1,291**	952

Notes:

1. **2015 fee structure:** Base fee: £92,700; Senior Independent Director: £30,000; Audit – Chair: £30,000; Member: £6,000; CSR – Chair: £25,000; Member: £6,000; Nominations – Chair: £ –; Member: £6,000; Remuneration – Chair: £30,000; Member: £6,000.
2. **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 2015 to the value of £255 each (2014: £255).

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'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 2015 together with comparative figures for 2014. The aggregate Directors' emoluments are shown below.

Chairman – Richard Burrows	2015 £'000	2014 £'000
Fees		
£645,000 (from 1 April 2015)	**642**	629
Taxable benefits		
– health insurance and 'walk-in' medical services[2]	**13**	14
– use of a company driver	**55**	59
– home and personal security in the UK and Ireland	**4**	7
– hotel accommodation and related expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events	**4**	16
– commuting flights to London[3]	**9**	5
Total remuneration	**727**	730

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 2015 to the value of £255 (2014: £255).
3. **Commuting flights to London:** treated as a taxable benefit from 6 April 2015.

Aggregate Directors' emoluments – audited

The following table shows the aggregate emoluments of the Directors of the Company.

	Executive Directors		Chairman		Non-Executive Directors		Total	
	2015 £'000	2014 £'000	2015 £'000	2014 £'000	2015 £'000	2014 £'000	2015 £'000	2014 £'000
Salary; fees; benefits; incentives								
Salary	**2,042**	2,167					**2,042**	2,167
Fees			**642**	629	**1,138**	862	**1,780**	1,491
Taxable benefits	**259**	290	**85**	96	**153**	90	**497**	476
Short-term incentives	**3,940**	2,969					**3,940**	2,969
Long-term incentives	**614**	594					**614**	594
Sub-total	**6,855**	6,020	**727**	725	**1,291**	952	**8,873**	7,697
Pension; other emoluments								
Pension	**936**	953					**936**	953
Other emoluments	**51**	68		5			**51**	73
Sub-total	**987**	1,021		5			**987**	1,026
Total emoluments	**7,842**	7,041	**727**	730	**1,291**	952	**9,860**	8,723

Total pension entitlements

Executive Directors' pension entitlements – audited

Pension values	Accrued pension at year end 31 Dec 2015 £'000	Additional value of pension on early retirement
Nicandro Durante (normal retirement age: 60)		
UURBS (UK)	102	–
Total	102	–

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 2014 (adjusted for inflation) and as at 31 December 2015, 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 entity in which the Group had a 75% interest. During 2015, the Group undertook the acquisition and delisting of the Souza Cruz shares that it did not own. This process was completed on 5 February 2016 when Souza Cruz became a wholly-owned subsidiary. This pension benefit has been in payment since April 2012 and currently amounts to approximately £305,000 per annum (after adjusting for currency exchange) reflecting his 31 years' service at Souza Cruz.

Pension values	Accrued pension at year end 31 Dec 2015 £'000	Additional value of pension on early retirement
Ben Stevens (normal retirement age: 60)		
British American Tobacco UK Pension Fund	99	–
UURBS (UK)	255	–
Total	354	–

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 £150,000 for the tax year 2015/16). 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 2014 (adjusted for inflation) and as at 31 December 2015, 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.

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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 2015)	No. of eligible[1] ordinary shares held at 31 Dec 2015	Value of eligible ordinary shares held at 31 Dec 2015[2] £m	Actual percentage (%) of base salary at 31 Dec 2015
Nicandro Durante	400	188,959	7.1	598.8
Ben Stevens	250	72,136	2.7	313.8

Notes:

1. **Eligibility of shares:** shares earned but not yet vested under the Company's short-term (DSBS) and long-term (LTIP) incentive plans as well as those held in trust under the all-employee share ownership plan (SIP) are not eligible and do not count towards the shareholding requirement.
2. **Closing mid-market price:** at 31 December 2015 was 3,771.0p.
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 2015.
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 2015 in the ordinary shares of the Company (beneficial, family and any connected persons) are as follows:

	At 1 Jan 2015	Awarded on 27 Mar 2015	Released 30 Mar 2015[2]	At 31 Dec 2015	Changes from 31 Dec 2015
Nicandro Durante					
Shares held[1]	171,297			188,959	
SIP shares[3] – held in employee benefit trust	1,556			1,724	8[5]
DSBS: deferred shares – unvested, subject to continued employment	84,116	19,419	(31,172)	72,363	
Total share interests	256,969			263,046	
Ben Stevens					
Shares held[1]	59,349			72,136	
SIP shares[3] – held in employee benefit trust	532			535	8[5]
DSBS: deferred shares – unvested, subject to continued employment	56,476	12,732	(21,041)	48,167	
Total share interests	116,357			120,838	

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 (30 March 2015) was 3,594.5p.
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 2015, the Executive Directors will each be awarded a number of ordinary shares to the value of £3,600 on 1 April 2016.
5. **Changes from 31 December 2015:** these relate to purchases by Nicandro Durante and Ben Stevens of a total of eight ordinary shares each under the Partnership Share Scheme on 6 January 2016 and 3 February 2016.
6. **BATGET:** on 31 December 2015, the Group's employee share ownership trust, referred later in this Remuneration Report, held a total of 5,356,084 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 2015 in the ordinary shares of the Company (beneficial, family and any connected persons) are as follows:

	At 1 Jan 2015	At 31 Dec 2015
Chairman		
Shares held[1]		
Richard Burrows	15,000	**15,000**
Non-Executive Directors		
Shares held[1]		
Karen de Segundo	2,000	**2,000**
Sue Farr (from 2 February 2015)	n/a	**–**
Ann Godbehere[2]	3,100	**3,100**
Savio Kwan	–	**3,040**
Pedro Malan (from 2 February 2015)	n/a	**–**
Christine Morin-Postel	3,000	**3,000**
Gerry Murphy	5,000	**5,000**
Dimitri Panayotopoulos (from 2 February 2015)	n/a	**3,300**
Kieran Poynter	5,000	**5,000**
Richard Tubb	–	**–**

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 represents 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 2015 in the shares of the Company under the Long-Term Incentive Plan (LTIP) and who received LTIP awards during the year ended 31 December 2015 are as follows:

LTIP awards	Nicandro Durante	Ben Stevens
Balance 1 January 2015 comprising:	379,568	212,299
28 March 2012 Performance period: 1 January 2012 – 31 December 2014 Exercisable: 28 March 2015 – 27 March 2022	124,688	70,137
22 March 2013 Performance period: 1 January 2013 – 31 December 2015 Exercisable: 22 March 2016 – 21 March 2023	119,828	66,932
28 March 2014 Performance period: 1 January 2014 – 31 December 2016 Exercisable: 28 March 2017 – 27 March 2024	135,052	75,230
Awarded: 27 March 2015 Performance period: 1 January 2015 – 31 December 2017 Exercisable: 27 March 2018 – 26 March 2025	127,448[3]	69,641[4]
Award 28 March 2012: vested at 0.00% and lapsed on 30 March 2015	(124,688)	(70,137)
Balance 31 December 2015	**382,328**	**211,803**

Notes:
1. **LTIP interests:** (a) awards of shares made under the LTIP are for nil consideration; (b) the changes to the performance conditions for the LTIP awards made from 2014 onwards are described above; there have been no subsequent variations in the terms and conditions of the LTIP interests during 2015.
2. **Aggregate gains of LTIP shares exercised in the year:** no LTIP shares were exercised during the year following the lapse of the 2012 LTIP awards on 30 March 2015 when none of the performance conditions were met.
3. **Nicandro Durante – award of 127,448 shares on 27 March 2015:** (a) the basis of the award was 400% multiple of base salary; (b) the face value of the award was £4,619,990 calculated by reference to the closing mid-market price of the Company's ordinary shares of 3,625.0p, being an average over three dealing days preceding the date of grant of the award; and (c) the percentage of the award vesting at threshold performance is 20%.
4. **Ben Stevens – award of 69,641 shares on 27 March 2015:** (a) the basis of the award was 300% multiple of base salary; (b) the face value of the award was £2,524,486 calculated by reference to the closing mid-market price of the Company's ordinary shares of 3,625.0p, being an average over three dealing days preceding the date of grant of the award; and (c) the percentage of the award vesting at threshold performance is 20%.

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Scheme interests – share options – audited

The scheme interests of the Executive Directors who served during the year ended 31 December 2015 in the shares of the Company under the Sharesave Scheme are as follows:

Sharesave options	Nicandro Durante	Ben Stevens
Balance 1 January 2015 comprising:	1,134	1,543
Grant: 25 November 2009 Grant price: 1,555.0p Exercisable: January 2015 – June 2015		1,000
Grant: 28 March 2012 Grant price: 2,536.0p Exercisable: May 2017 – October 2017	591	
Grant: 26 August 2014 Grant price: 2,787.0p Exercisable: October 2019 – March 2020	543	543
Grant: 25 November 2009 Exercised in full on 28 January 2015 Aggregate gain of £22,235 on a closing mid-market price of 3,778.5p; the shares were retained		(1,000)
Grant: 23 March 2015 Grant price: 3,026.0p Exercisable: May 2020 – October 2020		495
Balance 31 December 2015	**1,134**	**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) the total aggregate gains on the exercise of share options was £22,235 (2014: £nil); (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 (2009: 1,943.0p; 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	New ordinary shares issued by the Company during the year ended 31 December 2015
– 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.	– 173,695 ordinary shares issued by the Company in relation to the Sharesave Scheme; – a total of 840,099 Sharesave Scheme options over ordinary shares in the Company were outstanding at 31 December 2015, representing 0.05% of the Company's issued share capital (excluding shares held in treasury) – options outstanding under the Sharesave Scheme are exercisable until end October 2020 at option prices ranging from 1,974.0p to 3,026.0p.

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: £313 million at 31 December 2015 (2014: £272 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	

	1 Jan 2015	31 Dec 2015
Number of ordinary shares	6,357,513	**5,356,084**
Market value of ordinary shares[2]	£222.5m	**£202.0m**
% of issued share capital of Company	0.31	**0.26**

Dividends	– BATGET currently waives dividends on the ordinary shares held by it; – final dividend 2014: £6.1 million in May 2015; and – interim dividend 2015: £2.7 million in September 2015.
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.

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 27 on the accounts.
2. **Closing mid-market price** at 31 December 2015 was 3,771.0p (31 December 2014: 3,500.0p).

Other required disclosures

Payments to former Directors and payments for loss of office – audited

The Company did not make: (1) any payment of money or other assets to former Directors; or (2) any payments to Directors for loss of office during the year ended 31 December 2015.

Voting on the Remuneration Report at the 2015 AGM and engagement with shareholders

At the AGM on 29 April 2015, 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]		Approval of Directors' Remuneration Report[2]	
	2015	2014	**2015**	2014
Percentage for	**n/a**	90.54	**93.39**	95.30
Votes for (including discretionary)	**n/a**	1,251,092,549	**1,257,729,382**	1,316,656,333
Percentage against	**n/a**	9.46	**6.61**	4.70
Votes against	**n/a**	130,764,082	**89,047,657**	64,934,172
Total votes cast excluding votes withheld	**n/a**	1,381,856,631	**1,346,777,039**	1,381,590,505
Votes withheld[3]	**n/a**	4,014,169	**35,469,417**	4,280,179
Total votes cast including votes withheld	**n/a**	1,385,870,800	**1,382,246,456**	1,385,870,684

Notes:
1. **Directors' Remuneration Policy:** was approved by shareholders at the AGM on 30 April 2014 and is set out in full in the Annual Report 2013. There was no requirement for the Directors' Remuneration Policy to be put to the vote at the 2015 AGM.
2. **Directors' Remuneration Report:** does not include the part containing the Remuneration Policy (2014 AGM) or a summary of the key elements of that policy (2015 AGM).
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 2014, the Remuneration Committee identified a number of factors which prompted a new round of engagement with major shareholders on possible revisions to the Remuneration Policy. The impact of the relatively severe movements in sterling exchange rates was seen as de-linking long-term rewards for management from the underlying strong performance of the business and the impact of those exchange rate movements on actual LTIP outcomes highlighted the emergence of a gap between the Company and its relevant peers in the terms of the Chief Executive's earnings potential. The Company undertook a further short programme of engagement with over thirty of its largest shareholders in late 2014 and early 2015 in order to gauge their opinions on proposed revisions to the Policy. A diversity of views and feedback was received and in order to reflect the views of investors in the Remuneration Committee decisions, the Company decided not to propose any policy changes at that time other than the introduction of clawback provisions for both the IEIS and LTIP. It was with this background that the Committee noted the Company's AGM results of voting as part of its annual analysis of AGM remuneration voting outcomes and trends.

As described elsewhere in this report, the Company subsequently engaged with shareholders representing about 60% of our shares before putting forward the proposals to be considered for approval by shareholders at the 2016 AGM.

Directors' remuneration in the year ending 31 December 2016

Proposed implementation of Remuneration Policy in 2016

The proposed Remuneration Policy for the Executive Directors and the Non-Executive Directors is set out in full as the Policy Report – the Executive Directors principally in the Future Policy Table and the Chairman and the Non-Executive Directors in the Remuneration Table. This new Remuneration Policy, which is intended to replace the Policy approved by shareholders at the 2014 AGM, is subject to a binding vote by shareholders at the AGM on 27 April 2016 and, if approved, will come into effect from 28 April 2016. In accordance with the regulations, a Remuneration Policy will be put to shareholders again no later than the 2019 AGM.

A summary of the key changes from the current Remuneration Policy, together with the basic elements of the proposed Remuneration Policy from 2016, are set out in the 'At a glance' tables on pages 72 and 73 at the beginning of this Remuneration Report.

On behalf of the Board

Kieran Poynter
Chairman, Remuneration Committee
24 February 2016

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	Delivering our strategy: Sustainability
A statement describing the Group's policy regarding the hiring, continuing employment and training, career development and promotion of disabled persons	Delivering our strategy: Winning organisation
Details of employee engagement: information, consultation, share scheme participation and the achievement of a common awareness of the financial and economic factors affecting the performance of the Group	Delivering our strategy: Winning organisation
Disclosures concerning greenhouse gas emissions	Delivering our strategy: Sustainability

Listing Rules (LRs) disclosures

For the purpose of LR 9.8.4C R, the applicable information required to be disclosed in accordance with LR 9.8.4 R can be found in the sections set out below.

Applicable information required by LR 9.8.4 R	Section in this Annual Report
Section (12) – Shareholder waivers of dividends	Remuneration Report, page 111 and other corporate disclosures, page 114
Section (13) – Shareholder waivers of future dividends	Remuneration Report, page 111 and other corporate disclosures, page 114

Dividends

Final dividend – recommendation

The Board recommends to shareholders for approval at the Annual General Meeting on 27 April 2016, a final dividend of 104.6p per ordinary share of 25p for the year ended 31 December 2015.

Final dividend – key dates and South Africa branch register

In compliance with the requirements of the London Stock Exchange (LSE) and Strate, the electronic settlement and custody system used by the JSE Limited (JSE), the following are the salient dates for the payment of the final dividend:

Event	Date 2016
Last day to trade (LDT) cum-dividend (JSE)	11 March
Shares commence trading ex-dividend (JSE)	14 March
Shares commence trading ex-dividend (LSE)	17 March
Record date (JSE and LSE)	18 March
Payment date	5 May

As the Group reports in sterling, dividends are declared and payable in sterling except for shareholders on the branch register in South Africa whose dividends are payable in rand. A rate of exchange of £:R = 21.32780 as at 23 February 2016 (the closing rate for that date as quoted on Bloomberg), results in an equivalent final dividend of 2,230.88788 SA cents per ordinary share. From the commencement of trading on 25 February 2016 (the date of the preliminary announcement) until the close of business on 18 March 2016, no removal requests between the UK main register and the South Africa branch register (in either direction) are permitted. Further, from the close of business on 11 March 2016 until the close of business on 18 March 2016, no transfers between the UK main register and the South Africa branch register are permitted and no shares may be dematerialised or rematerialised between 14 March and 18 March 2016, both days inclusive.

South Africa branch register: Dividends Tax information

South Africa Dividends Tax of 334.63318 SA cents per ordinary share will be withheld from the gross final dividend paid to shareholders on the South Africa branch register at the rate of 15% unless a shareholder qualifies for an exemption. After Dividends Tax has been withheld, the net dividend will be 1,896.25470 SA cents per ordinary share. The final dividend is regarded as a 'foreign dividend' for the purposes of the South Africa Dividends Tax.

British American Tobacco p.l.c. is registered with the South African Revenue Service (SARS) with tax reference number 9378193172.

Dividends Tax and the information provided above is only of direct application to shareholders on the South Africa branch register. Shareholders on the South Africa branch register should refer to 'Shareholder and contact information' for the contact details of Computershare Investor Services Proprietary Limited, the Company's registrar for the branch register.

Dividend information

Further details of the total amounts of dividends paid in 2015 (with 2014 comparatives) are given in note 8 on the accounts.

Annual General Meeting (AGM)

The AGM will be held at Milton Court Concert Hall, Silk Street, London EC2Y 9BH at 11.30am on 27 April 2016. 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 published on www.bat.com.

The Company provides for the vote on each resolution to be by poll rather than by show of hands. This provides for greater transparency and allows the votes of all shareholders to be counted, including those cast by proxy. The voting results are announced on the same day through the Regulatory News Service (RNS) and on www.bat.com.

Other corporate disclosures continued

Share capital

As at 31 December 2015, the Company had an allotted and fully paid share capital of 2,026,866,724 ordinary shares of 25p each with an aggregate nominal value of £506.7 million (including treasury shares and shares owned by the employee share trusts).

At the close of business on 23 February 2016 (the latest practicable date prior to the recommendation of the final dividend for the year ended 31 December 2015), the Company had a total of 1,864,228,895 ordinary shares in issue (excluding treasury shares). The Company held 162,645,590 ordinary shares in treasury giving a total issued share capital of 2,026,874,485 ordinary shares.

Significant shareholders

At 31 December 2015, the following substantial interests (3% or more) in the Company's ordinary share capital (voting securities) had been notified to the Company in accordance with Section 5.1.2 of the Disclosure Rules and Transparency Rules. As at 24 February 2016, the Company had not received notification either of any change in the interests below or that any other person holds 3% or more of its ordinary shares.

Name	Number of ordinary shares	% of issued share capital
BlackRock, Inc.	132,891,526	7.13
Reinet Investments S.C.A.	76,518,264	4.10
The Capital Group Companies, Inc.	75,240,878	4.04

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

Stock market listings

Premium listing

The ordinary shares of the Company (as British American Tobacco p.l.c.) have been listed on the Official List and traded on the main market of the London Stock Exchange for listed securities since 8 September 1998 (Share Code: BATS and ISIN: GB0002875804). This is classified as a premium listing. The share registrar is Computershare Investor Services plc.

Secondary listing

The Company's ordinary shares have a secondary listing on the JSE Limited in South Africa (JSE), under the abbreviated name BATS and the trading code BTI. As at 31 December 2015, 290,914,691 ordinary shares of the Company (being 15.61% of the Company's issued ordinary share capital – excluding treasury shares) were on its South Africa branch register for which Computershare Investor Services Proprietary Limited are share registrars.

American Depositary Receipts

The Company's ordinary shares are also traded on NYSE MKT in the form of American Depositary Receipts (ADRs) under the symbol BTI with a CUSIP number 110448107. Each ADR represents two of the Company's ordinary shares and at 31 December 2015, 37,785,964 ADRs were outstanding, representing 75,571,928 ordinary shares. Citibank, N.A. continues to act as depositary for the ADR programme.

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

Renewal of authority to purchase shares

The Company's share buy-back programme was suspended with effect from 30 July 2014 and the present authority for the Company to purchase its own shares (granted at the 2015 AGM) will expire at the 2016 AGM. The Directors are seeking a fresh authority for the Company to purchase its ordinary shares in order that the appropriate mechanisms are in place to enable the share buy-back programme to be reinstated at any time 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.

Under the proposed authority, 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. In accordance with the Company's policy, any repurchased shares are expected to be held as treasury shares and as at 31 December 2015 the number of treasury shares was 162,645,590 (2014: 162,645,590). While treasury shares are held, no dividends are paid on them and they have no voting rights. Treasury shares may be resold at a later date.

Further details are contained in the Notice of Annual General Meeting which is made available to all shareholders and is also published on www.bat.com.

Significant agreements – change of control

The following significant agreement contains certain termination and other rights for our counterparties upon a change of control of the Company.

On 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) entered into a revolving credit facility agreement with HSBC Bank plc (as agent) and certain financial institutions (as lenders) pursuant to which the lenders agreed to make available to the borrowers £3 billion for general corporate purposes (the 'Facility'). Pursuant to the Facility, should a borrower (other than the Company) cease to be a direct or indirect subsidiary of the Company, such borrower shall immediately repay any outstanding advances made to it. Where there is a change of control in respect of the Company, the lenders can require all amounts outstanding under the Facility to be repaid.

LTIP – change of control

The rules of the LTIP provide that in the event of a change of control of the Company as a result of a takeover, reconstruction or winding-up of the Company (not being an internal reorganisation), LTIP awards will become exercisable for a limited period based on the period of time 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. In addition, the LTIP allows (as an alternative to early release) that participants may, if permitted, exchange their LTIP awards for new awards of shares in the acquiring company on a comparable basis.

The rules of the proposed LTIP 2016 contain equivalent provisions in respect of the vesting of awards and the exercise of options in the event of a change of control as a result of a corporate action.

Directors' interests and indemnities

Further details of Directors' contracts and letters of appointment, remuneration and emoluments, and their interests in the Company's shares (including share options and deferred shares) as at 31 December 2015 are given in the Remuneration Report. No Director had any material interest in a contract of significance (other than a service contract) with the Company or any subsidiary company during the year.

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

Information and advice

The Board and its Committees receive papers for review in good time ahead of each meeting. The Company Secretary ensures good information flow within the Board and its Committees, and between the Non-Executive Directors and senior management. She also advises the Board on all governance matters.

All Directors have access to the advice and services of the Company Secretary, and a procedure is in place for them to take independent professional advice at the Company's expense if required. Each of the four principal Committees of the Board may obtain independent legal or other professional advice, at the Company's expense, and secure attendance at meetings of outsiders if needed.

Articles of Association

The following description summarises certain provisions of the Company's current Articles of Association (as adopted by special resolution at the AGM on 28 April 2010), applicable English law and the Companies Act 2006 (the 'Companies Act'). This summary is qualified in its entirety by reference to the Companies Act and the Company's Articles of Association, available on www.bat.com.

Share capital

All of the Company's ordinary shares are fully paid and, accordingly, no further contribution of capital may be required by the Company from the holders of such shares.

Objects and purposes

The Company is incorporated under the name of British American Tobacco p.l.c. and is registered in England and Wales under registered number 3407696. Under the Companies Act 2006, the Company's objects are unrestricted.

Directors: appointment and retirement

The Company's Articles of Association provide for a Board of Directors, consisting (unless otherwise determined by ordinary resolution of the shareholders) of not fewer than five Directors, and not subject to any maximum.

The Directors and the Company (by ordinary resolution) may appoint a person who is willing to act as a Director, either to fill a vacancy or as an additional Director. A Director appointed by the Directors shall retire at the next AGM and will put himself/herself forward to be reappointed by the shareholders. Such a Director shall not be taken into account in determining the number or identity of the Directors to retire by rotation at that next AGM.

At each AGM, all Directors shall retire from office by rotation who: (1) held office at the time of each of the two preceding AGMs and who did not retire at either of them; and (2) if the number of Directors retiring in (1) above is less than one-third of the Directors who are subject to retirement by rotation (or, if their number is not three or a multiple of three, is less than the number which is nearest to but does not exceed one-third of the Directors), such additional number of Directors as shall, together with the Directors retiring under (1) above, equal one-third of the Directors (or, if their number is not three or a multiple of three, the number which is nearest to but does not exceed one-third of the Directors).

Subject to the provisions of the Companies Act and the Articles of Association, the Directors to retire at an AGM under (2) above will be those who have been in office the longest since their appointment or last reappointment.

Notwithstanding these provisions contained in the Articles of Association, the Company is not restricted to the number of Directors who may retire and seek re-election each year. The Articles of Association merely set a minimum number of Directors who must be subject to retirement by rotation each year. As a result, since the introduction of the provision in the UK Corporate Governance Code in 2011 that all Directors of FTSE 350 companies should be subject to annual re-election by shareholders, all of the Directors of the Company will be subject to re-election at the forthcoming AGM to be held on 27 April 2016.

A Director who retires at an AGM and is not reappointed shall retain office until the meeting elects someone in his place or, if it does not do so, until the conclusion of the meeting. In addition to any power of removal under the Companies Act, the Company may, by special resolution, remove a Director before the expiration of his period of office and, subject to the Articles of Association, may by ordinary resolution, appoint another person who is willing to act as a Director, and is permitted by law to do so, to be a Director instead of him. A person so appointed shall be subject to retirement as if he had become a Director on the day on which the Director in whose place he is appointed was last appointed or reappointed a Director.

Fees for Non-Executive Directors and the Chairman shall be determined by the Directors but shall not exceed in aggregate an annual sum of £2,500,000, unless determined otherwise by ordinary resolution of the shareholders. The remuneration of the Executive Directors is determined by the Remuneration Committee, which comprises independent Non-Executive Directors.

Other corporate disclosures continued

Directors: meetings and voting

The quorum for meetings of Directors is two Directors. The Directors may delegate any of their powers that are conferred upon them under the Articles of Association to such person or committee as they consider appropriate.

The Articles of Association place a general prohibition on a Director voting at a meeting of the Directors on any resolution concerning a matter in which he has an interest other than by virtue of his interest in shares in the Company. However, in the absence of some other interest not indicated below, a Director is entitled to vote and to be counted in a quorum for the purpose of any vote relating to a resolution concerning the following matters:

1. the giving to him of a guarantee, security or indemnity in respect of money lent to, or an obligation incurred by him for the benefit of, the Company or any of its subsidiaries;
2. the giving to a third party of a guarantee, security or indemnity in respect of an obligation of the Company or any of its subsidiaries for which the Director has assumed responsibility (in whole or part and whether alone or jointly with others) under a guarantee or indemnity or by the giving of security;
3. the giving to him of any other indemnity which is on substantially the same terms as indemnities given, or to be given, to all of the other Directors and/or to the funding by the Company of his expenditure on defending proceedings of the doing by the Company of anything to enable him to avoid incurring such expenditure where all other Directors have been given, or are to be given, substantially the same arrangements;
4. any proposal concerning the purchase of Directors' and officers' liability insurance;
5. any proposal concerning his being, or intending to become, a participant in the underwriting or sub-underwriting of an offer of any such shares, debentures or other securities for subscription, purchase or exchange;
6. any arrangements which relate in any way to a retirement benefits scheme or any arrangement for the benefit of the employees of the Company or any of its subsidiaries including but without being limited to an employees' share scheme, which does not accord to any Director any privilege or advantage not generally accorded to the employees and/or former employees to whom the arrangement relates; and
7. any transaction or arrangement with any other company, being a company in which the Director is interested only as an officer, creditor or shareholder, provided that he is not the holder of or beneficially interested in 1% or more of the equity share capital of that company (or of any other company through which his interest is derived) and not entitled to exercise 1% or more of the voting rights available to members of the relevant company (disregarding, for the purposes of this proviso: (i) any shares held by a Director as bare or custodian trustee and in which he has no beneficial interest; (ii) any shares comprised in an authorised unit trust scheme in which the Director is interested only as a unit holder; and (iii) any shares of that class held as treasury shares).

The Company may by ordinary resolution suspend or relax to any extent, either generally or in respect of any particular matter, any provision of the Articles prohibiting a Director from voting at a meeting of the Directors or of a committee of the Directors.

Directors: borrowing powers

Without prejudice to their general powers, the Directors may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property, assets (present and future) and uncalled capital or any part thereof, and (subject to the provisions of the Articles of Association) to issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the Company or a third party.

Directors: interests

Provided that the Director has disclosed to the other Directors the nature and extent of any material interest of his, a Director, notwithstanding his office:

1. may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise interested;
2. may be a Director or other officer of, or employed by or may be a party to, or otherwise interested in, any transaction or arrangement with anybody corporate promoted by the Company or in which the Company is otherwise interested;
3. shall not, by reason of his office, be accountable to the Company for any benefit which he derives from any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate;
4. shall not infringe his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or may possibly conflict, with the interests of the Company as a result of any such office or employment or from any such transaction or arrangement or from any interest in any such body corporate;
5. shall not be required to disclose to the Company, or use in performing his duties as a Director of the Company, any confidential information relating to such office or employment if to make such a disclosure or use would result in a breach of duty or obligation of confidence owed by him in relation to or in connection with that office or employment;
6. may absent himself from discussions and exclude himself from information, which will or may relate to that office, employment, transaction, arrangement or interest; and
7. no such transaction or arrangement will be liable to be avoided because of any such interest or benefit.

For the purposes of the Articles, a general notice given to the Directors that he is to be regarded as having an interest of the nature and extent specified in the notice in any transaction or arrangement in which a specified person or class of persons is interested is deemed to be a disclosure that the Director has an interest in any such transaction of the nature and extent so specified.

An interest of which a Director has no knowledge and of which it is unreasonable to expect him to have knowledge is not treated as an interest; an interest which consists of a Director being a Director or other officer of, or employed by any subsidiary of the Company is not deemed to be a material interest; a Director need not disclose an interest if it cannot be reasonably regarded as likely to give rise to a conflict of interest; and a Director need not disclose an interest if, or to the extent that, the other Directors are already aware of it.

A Director will no longer be regarded as having an interest in a transaction by virtue of a person connected to the Director having a relevant interest. However, the Director and the Company must still take a view each time a matter is being considered as to whether the interests of the Director's connected persons mean that a Director should be treated as interested in a transaction.

The Directors may (subject to such terms and conditions, if any, as they may think fit to impose from time to time, and subject always to their right to vary or terminate such authorisation) authorise, to the fullest extent permitted by law:

1. any matter which would otherwise result in a Director infringing his duty to avoid a situation in which he has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the Company and which may reasonably be regarded as likely to give rise to a conflict of interest (including a conflict of interest and duty or conflict of duties); and
2. a Director to accept or continue in any office, employment or position in addition to his office as a Director of the Company and may authorise the manner in which a conflict of interest arising out of such office, employment or position may be dealt with, either before or at the time that such a conflict of interest arises, provided that the authorisation is only effective if: (a) any requirement as to the quorum at the meeting at which the matter is considered is met without counting the Director in question or any other interested Director; and (b) the matter was agreed to without their voting or would have been agreed to if their votes had not been counted.

If a matter, or office, employment or position, has been authorised by the Directors then (subject to such terms and conditions, if any, as the Directors think fit to impose, and subject to their right to vary or terminate such authorisation or the permissions set out below):

1. the Director shall not be required to disclose any confidential information relating to such matter, or such office, employment or position, to the Company if to make such a disclosure would result in a breach of a duty or obligation of confidence owed by him in relation to or in connection with that matter, or that office, employment or position;
2. the Director may absent himself from discussions, whether in meetings of the Directors or otherwise, and exclude himself from information which will or may relate to that matter, or that office, employment or position; and
3. a Director shall not, by reason of his office as a Director of the Company, be accountable to the Company for any benefit which he derives from such matter, office, employment or position.

Dividend rights

Holders of the Company's ordinary shares may, by ordinary resolution, declare dividends but may not declare dividends in excess of the amount recommended by the Directors. The Directors may also pay interim dividends if it appears that such dividends are justified by the profits available for distribution. No dividend shall be paid otherwise than out of profits available as specified under the provisions of the Companies Act.

The Directors may, with the sanction of an ordinary resolution of the shareholders, offer any holders of ordinary shares the right to elect to receive ordinary shares credited as fully paid instead of cash in respect of the whole or part of all such dividends as may be specified by the resolution. Any general meeting declaring a dividend may, upon the recommendation of the Directors, direct payment or satisfaction of such dividend to be wholly or partly by the distribution of specific assets. Where difficulty arises in regard to distribution, the Directors may ignore fractions or issue fractional certificates, fix the value for distribution of any assets and may determine that cash shall be paid to any shareholder in order to adjust the rights of such members.

Any dividend which has been unclaimed for 12 years from the date it became due for payment shall, if the Directors so resolve, be forfeited and cease to be owed by the Company. The Company can cease sending dividend warrants and cheques by post or otherwise if these have been returned undelivered to, or left uncashed by, the shareholder on at least two consecutive occasions, or, if following one such occasion, reasonable enquiries have failed to establish the member's new address. No dividend shall bear interest against the Company, unless provided by the rights attached to the share.

The Directors may elect to pay dividends to shareholders by bank or electronic transfer only. Amounts due to shareholders who provide no, or invalid, account details may be held in an account in the Company's name until such shareholders nominate a valid account. The Company shall not be a trustee of any such monies, shall be deemed to have discharged its payment obligations by paying the relevant monies into such account and interest will not accrue for shareholders on any such monies pending payment to such persons.

Voting rights

Voting at any general meeting of shareholders is by a show of hands unless a poll is demanded. On a show of hands, every shareholder who is present in person at a general meeting has one vote regardless of the number of shares held by the shareholder.

Every proxy appointed by a shareholder and present at a general meeting has one vote, except that if the proxy has been duly appointed by more than one shareholder entitled to vote on the resolution and is instructed by one or more of those shareholders to vote for the resolution and by one or more others to vote against it, or is instructed by one or more of those shareholders to vote in one way and is given discretion as to how to vote by one or more others (and wishes to use that discretion to vote in the other way) he has one vote for and one vote against the resolution.

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

Other corporate disclosures continued

5. a shareholder or shareholders holding shares which confer a right to vote on the resolution at the meeting being shares on which an aggregate sum has been paid up equal to not less than one-tenth of the total sum paid up on all shares conferring that right (excluding any voting rights attached to treasury shares).

Matters are transacted at general meetings of the Company by the proposing and passing of two kinds of resolutions:

1. ordinary resolutions, which can include resolutions for the appointment, reappointment and removal of Directors, the receiving of the Annual Report, the declaration of final dividends, the appointment and reappointment of the external auditor, the authority for the Company to purchase its own shares and the grant of authority to allot shares; and
2. special resolutions, which can include resolutions amending the Company's Articles of Association and resolutions relating to certain matters concerning a winding-up of the Company.

An ordinary resolution requires the affirmative vote of a simple majority of the votes cast at a meeting at which there is a quorum in order to be passed. Special resolutions require the affirmative vote of not less than three-quarters of the votes cast at a meeting at which there is a quorum in order to be passed. The necessary quorum for a meeting of the Company is a minimum of two shareholders present in person or by proxy or by a duly authorised representative(s) of a corporation which is a shareholder and entitled to vote.

When convening a meeting the Company may specify a time not more than 48 hours before the time of the meeting (excluding any part of a day that is not a working day) by which a person must be entered on the register of members in order to have the right to attend or vote at the meeting.

Winding-up

If the Company is wound up, the liquidator may, with the sanction of a special resolution and any other sanction required by law, subject to the provisions of the Companies Act, divide among the shareholders the whole or any part of the assets of the Company, and may, for that purpose, value any assets and determine how the division is to take place as between the shareholders or different classes of shareholders. Alternatively, with the same sanction, the liquidator may vest the whole or any part of the assets in trustees upon trusts for the benefit of the shareholders, but no shareholder will be compelled to accept any asset upon which there is a liability.

Transfer of shares

Shares may be transferred by an instrument of transfer in any usual form or in any other form which the Directors may approve and shall be executed by or on behalf of the transferor and, where the share is not fully paid, by or on behalf of the transferee. The Directors can, in their absolute discretion, refuse to register the transfer of a share in certificated form which is not fully paid, provided that such a refusal would not prevent dealings in shares in certificated form which are not fully paid from taking place on a proper basis. The Directors may also refuse to register a transfer of a share in certificated form (whether fully paid or not) unless the instrument of transfer:

1. is lodged, duly stamped, and is deposited at the registered office of the Company or such other place as the Directors may appoint and is accompanied by a certificate for the shares to which it relates and such other evidence as the Directors may reasonably require to show the right of the transferor to make the transfer;
2. is in respect of only one class of share; and
3. is in favour of not more than four transferees.

For uncertificated shares, transfers shall be registered only in accordance with the terms of the Uncertificated Securities Regulations 2001 so that Directors may refuse to register a transfer which would require shares to be held jointly by more than four persons.

If the Directors refuse to register a share transfer, they must give the transferee notice of this refusal as soon as practicable and in any event within two months of the instrument of transfer being lodged with the Company. No fees may be charged for registering a transfer.

Pre-emptive rights and new issues of shares

While holders of ordinary shares have no pre-emptive rights under the Articles of Association, the ability of the Directors to cause the Company to issue shares, securities convertible into shares or rights to shares, otherwise than pursuant to an employee share scheme, is restricted. Under the Companies Act, the Directors of a company are, with certain exceptions, unable to allot any equity securities without express authorisation, which may be contained in a company's Articles of Association or given by its shareholders in a general meeting, but which in either event cannot last for more than five years. Under the Companies Act, a company may also not allot shares for cash (otherwise than pursuant to an employee share scheme) without first making an offer to existing shareholders to allot such shares to them on the same or more favourable terms in proportion to their respective shareholdings, unless this requirement is waived by a special resolution of the shareholders.

Alteration of share capital

The Company may, from time to time, by ordinary resolution:

1. consolidate and divide all or any of its shares into shares of a larger amount than its existing shares;
2. sub-divide any of its shares into shares of smaller amount than its existing shares; and
3. determine that, as between the shares resulting from such a sub-division, any of them may have any preference or advantage as compared with the others.

Subject to the provisions of the Companies Act:

1. the Company may reduce its share capital, its capital redemption reserve and any share premium account in any way; and
2. the Company may purchase its own shares, including redeemable shares, and may hold such shares as treasury shares or cancel them.

Disclosure of interests in the Company's shares

There are no provisions in the Articles of Association whereby persons acquiring, holding or disposing of a certain percentage of the Company's shares are required to make disclosure of their ownership percentage, although there are such requirements under statute and regulation. The basic disclosure requirement under Part 6 of the Financial Services and Markets Act 2000 and Rule 5 of the Disclosure Rules and the Transparency Rules made by the Financial Conduct Authority imposes a statutory obligation on a person to notify the Company and the Financial Conduct Authority of the percentage of the voting rights in the Company he directly or indirectly holds or controls, or has rights over, through his direct or indirect holding of certain financial instruments, if the percentage of those voting rights:

1. reaches, exceeds or falls below 3% and/or any subsequent whole percentage figure as a result of an acquisition or disposal of shares or financial instruments; or
2. reaches, exceeds or falls below any such threshold as a result of any change in the number of voting rights attached to shares in the Company.

The Disclosure Rules and the Transparency Rules set out in detail the circumstances in which an obligation of disclosure will arise, as well as certain exemptions from those obligations for specified persons.

Under Section 793 of the Companies Act, the Company may, by notice in writing, require a person that the Company knows or has reasonable cause to believe is or was during the three years preceding the date of notice interested in the Company's shares, to indicate whether or not that is the case and, if that person does or did hold an interest in the Company's shares, to provide certain information as set out in that Act. The Disclosure Rules and the Transparency Rules further deal with the disclosure by persons of interests in shares or debentures of the companies of which they are Directors and certain associated companies.

The City Code on Takeovers and Mergers also imposes strict disclosure requirements with regard to dealings in the securities of an offeror or offeree company on all parties to a takeover and also on their respective associates during the course of an offer period.

General meetings and notices

An AGM and all other general meetings of the Company must be called by at least 21 clear days' written notice. However, the Companies Act allows for this period of notice for meetings other than AGMs to be reduced to 14 clear days' notice provided that two conditions are met: (1) a company must allow shareholders to make proxy appointments via a website (such as that hosted by its share registrars); and (2) shareholders must pass a special resolution at the AGM every year approving that shortening of the notice period to 14 days. A special resolution enabling the Company to hold general meetings (other than AGMs) on 14 days' notice will be proposed at the AGM to be held on 27 April 2016.

Subject to the resolution being passed, the approval of the shortening of the notice period will be effective until the Company's next AGM, when it is intended that the approval be renewed. The shorter notice period would not be used as a matter of routine. Rather the Directors will consider on a case-by-case basis whether the use of the flexibility offered by the shorter notice period is merited, taking into account the circumstances, including whether the business of the meeting is time sensitive, and is thought to be to the advantage of shareholders as a whole. Further, the shorter notice period would not be used unless both of the conditions as stated above are met.

Variation of rights

If the capital of the Company is divided into different classes of shares, the rights attached to any class of shares may only be varied, either in such a manner as provided by those rights or in the absence of any provision, with the consent in writing of three-quarters in nominal value of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of holders of such shares. At any separate meeting, the necessary quorum is two persons together holding or representing by proxy at least one-third in nominal amount of the issued shares of the class (but at an adjourned meeting shall be any one person holding shares of the class or his proxy). Unless otherwise expressly provided by the rights attached to any shares, those rights shall be deemed to be varied by the reduction of the capital paid up on those shares and by the creation or issue of further shares ranking in priority for payment of a dividend or in respect of capital or which confer on the holders voting rights more favourable than those conferred by the first-mentioned shares, but shall not otherwise be deemed to be varied by the creation or issue of further shares ranking pari passu with them or subsequent to them.

Repurchase of shares

Subject to authorisation by shareholder resolution, the Company may purchase its own shares in accordance with the Companies Act. Any shares which have been bought back may be held as treasury shares or, if not so held, must be cancelled immediately upon completion of the purchase, thereby reducing the amount of the Company's issued share capital. There is no longer a requirement for public companies to have specific authorisations in their articles of association to undertake these actions.

The Strategic Report and the Directors' Report comprised in this Annual Report have been approved and are signed by order of the Board by:

Nicola Snook
Secretary
24 February 2016

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 prepare financial statements that 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 ensuring that the Company keeps adequate accounting records that are sufficient to show and explain the Group and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that their 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 was approved by the Board of Directors on 24 February 2016 and signed on its behalf by:

Richard Burrows
Chairman

Ben Stevens
Finance Director

British American Tobacco p.l.c.
Registered in England and Wales No. 3407696

Financial Statements

Independent auditor's report

To the members of British American Tobacco p.l.c. only

Opinions and conclusions arising from our audit

1 Our opinion on the Group financial statements is unmodified

We have audited the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2015 which comprise the Group Income Statement, the Group Statement of Comprehensive Income, the Group Statement of Changes in Equity, the Group Balance Sheet, the Group Cash Flow Statement and the related notes. In our opinion the Group financial statements:

– give a true and fair view of the state of the Group's affairs as at 31 December 2015 and of its profit for the year then ended;

– have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and

– have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the accounts. These are cross-referenced from the Group financial statements and identified as audited.

2 Our assessment of risks of material misstatement

In arriving at our audit opinion above on the Group financial statements, the risks of material misstatement that had the greatest effect on our audit were as follows:

Provisions and contingent liabilities in respect of litigations

Refer to page 59 (Audit Committee Report), page 135 (accounting policy note) and pages 178, 192–201 (financial disclosures)

The risk: The Group is subject to claims and class actions, which could have a significant impact on the Group's results if the potential exposures were to materialise. Management applies significant judgement when considering whether, and how much, to provide for the potential exposure of each litigation. We focused on this area given the number and magnitude of potential exposures across the Group, and the complexity and judgement necessary to determine whether to provide for or disclose certain exposures.

Our response: Our procedures included an assessment of the processes and controls over litigations operated by Management at a Group, regional and local level. We met quarterly with the Group's in-house legal counsel including after the year end to discuss the nature of ongoing claims, and to validate the latest status and accounting and disclosure implications. Our in-scope component audit teams reported to us on the status of open claims, and helped us to validate completeness of the matters discussed by us at a Group level. We also obtained formal confirmations from the Group's external counsel for significant litigation matters to ensure completeness of provisioning and disclosure. We assessed relevant historical and recent judgments passed by the court authorities alongside legal opinion from external lawyers to challenge the basis used for the provisions recorded or disclosures made by Management. Where provisions were not required, we also considered the adequacy and completeness of the Group's disclosures in note 30 made in relation to contingent liabilities.

IT system change (TaO)

Refer to page 59 (Audit Committee Report)

The risk: The Group has continued to implement its revised Operating Model and single IT operating system in a number of end markets over the course of the year. An IT migration project of this type presents inherent risks including the loss of integrity of key financial data being migrated, and the breakdown in operation or monitoring of IT dependent controls within critical business processes (purchase to pay, order to cash, and record to report), which could lead to financial errors or misstatements and inaccurate financial reporting.

Our response: Our procedures included use of our IT specialists to assess and test the General IT control environment of the single IT operating system, including IT access and segregation of duties, as well as IT dependent controls within critical business processes. In relation to the system migration itself, our IT specialists assessed and tested the controls specifically established over the implementation process and migration of key financial data from the legacy to the new single operating system, and reviewed the work of Internal Audit and other external specialists to corroborate our findings. Additionally, where system migration occurred during 2015, our end market component audit teams performed independent validation of the data migration and reconciliation between legacy systems and the single IT operating system.

Global taxation exposures

Refer to page 59 (Audit Committee Report), page 133 (accounting policy note) and pages 145–146, 160–161, 201–202 (financial disclosures)

The risk: The Group operates in multiple jurisdictions governed by national tax laws and regulations and is required to estimate the tax effect of cross-border transactions including transfer pricing arrangements. Where the precise impact of these laws and regulations on indirect taxes and the tax payable on profits is unclear, the Group seeks to make reasonable estimates to determine the tax charge arising. The calculation of the amount of tax receivable or payable, in addition to any specific taxation provisions that are required, is often complex, and requires a significant level of expertise and judgement.

Our response: Our audit procedures included the use of our own international and local tax specialists to assess the Group's tax positions, its correspondence with the relevant tax authorities, and to analyse and challenge the assumptions used to determine tax provisions based on our knowledge and experience of the application of the international and local legislation by the relevant authorities and courts. We also considered the adequacy of the Group's disclosures in respect of tax and uncertain tax positions.

Independent auditor's report continued

Goodwill and intangible asset impairment

Refer to page 133 (accounting policy note) and pages 149–150 (financial disclosures)

The risk: As at 31 December 2015, the Group had £9,324 million of goodwill and £583 million of trademarks and similar intangibles, principally relating to the acquisitions of, among others, Rothmans, Imperial Tobacco Canada, ETI (Italy), ST (Scandinavia) and Bentoel (Indonesia). There is significant judgement involved in forecasting and discounting of future cash flows, which is the basis of the assessment of the recoverability of goodwill balances.

Our response: In this area our audit procedures included testing of the Group's budgeting procedures upon which the forecasts are based and the integrity of the Group's discounted cash flow model. We used our own valuation specialists to assist us in evaluating the assumptions and methodologies used by the Group, in particular those relating to the Group and cash-generating unit level discount rates. Where required, we compared the Group's assumptions to externally derived data as well as our own assessments in relation to key inputs such as projected growth, volumes, market share and competition, cost inflation and discount rates, as well as performing break-even analysis on the assumptions. We also assessed whether the Group's disclosures about the sensitivity of the outcome of the impairment assessment to changes in key assumptions reflected the risks inherent in the valuation of goodwill.

3 Our application of materiality and an overview of the scope of our audit

Materiality

The materiality for the Group financial statements as a whole was set at £245 million, determined with reference to a benchmark of Group profit before taxation adjusted to exclude:

- a current year one-off gain in relation to the investment to maintain a 42% shareholding in Reynolds American Inc. (RAI) of £601 million as disclosed in note 4; and
- a current year one-off gain in relation to the Group's share of divestiture of assets recorded in RAI following the Lorillard acquisition of £371 million as disclosed in note 5.

This represents 5.0% of the Group's reported profit before taxation as adjusted.

We report to the Audit Committee any corrected or uncorrected identified misstatements exceeding £12 million, in addition to other identified misstatements that warranted reporting on qualitative grounds.

Scope of our audit

In establishing the overall approach to our audit, we considered the centralised nature of the Group's operations, the risk profile of countries where the Group operates, and changes taking place within the business. We also considered the financial significance of each business unit together with any local statutory audit requirements.

The Group financial statements are a consolidation of over 300 end market and corporate reporting components, primarily structured across four geographic regions, being Asia-Pacific; Americas; Western Europe; and Eastern Europe, Middle East and Africa. The Group has four centralised shared service centres that perform accounting and reporting activities, and together these shared service centres process a substantial portion of the Group's transactions. The outputs from the centralised shared service centres are included in the financial information of the end market entities they serve.

Each of the shared service centres was subject to specified audit procedures, primarily to test the effectiveness of the financial controls that they operate.

For Group reporting purposes, we determined that 42 end market components required audits performed under our instruction. Audits of these components were performed using materiality levels assigned by the Group audit team, which were lower than the materiality level for the Group as a whole, ranging from £2 million to £70 million, and determined by reference to the size and risk profile of the components. Specified risk-focused audit procedures were performed by Group and component auditors on certain balances and transactions in respect of a further three end market components, one of which is an associate.

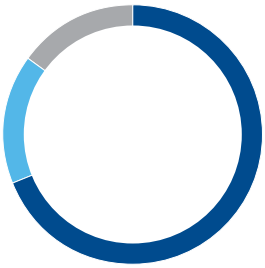
The Group consolidation, financial statement disclosures and a number of complex items were audited by the Group engagement team centrally in London. These included general IT controls, taxation, pensions, litigation, treasury, goodwill and intangible asset impairment, and earnings per share.

Detailed audit instructions were sent to all auditors of in-scope components. These instructions covered the significant audit areas that we required to be covered by these audits (which included the relevant risks of material misstatement detailed above) and set out the information required to be reported back to the Group audit team.

The Group audit team visited component locations subject to audit in Brazil, Canada, Russia, South Africa, Turkey, UAE, Australia, Indonesia, Japan, Malaysia, Denmark, Germany, Italy and Romania, as well as shared service centres in Romania, Malaysia and Costa Rica. The Group team also held regional meetings with component teams subject to both audit and specified risk-focused audit procedures as part of the audit planning phase to explain our audit instructions and discuss the component auditors' audit plans. In addition to these visits, telephone and/or online meetings were held with component auditors. The findings reported to the Group audit team were discussed in more detail with component auditors as necessary, and any further work required by the Group audit team was then performed by the component auditor.

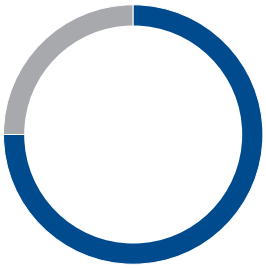
Taken together, the end market components and Group functions in the scope of our work accounted for the following percentages of the Group's results:

Group Profit before taxation



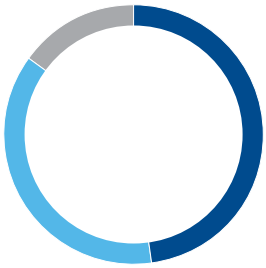
Audit for Group reporting purposes (42 components)	69
Specified risk-focused audit procedures (3 components) and centrally audited items	16
Out of scope	15

Group Revenue



Audit for Group reporting purposes (42 components)	75
Out of scope	25

Group Total assets



Audit for Group reporting purposes (42 components)	48
Specified risk-focused audit procedures (3 components) and centrally audited items	37
Out of scope	15

For the remaining components, we performed analysis at an aggregated Group level to re-examine our assessment that there were no significant risks of material misstatement within these.

4 Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the Group financial statements.

5 We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

– the Directors' statement of viability on page 38, concerning the principal risks, their management and, based on that, the Directors' assessment and expectations of the Group's continuing in operation over the three years to 2018; or

– the disclosures in page 35 of the financial statements concerning the use of the going concern basis of accounting.

6 We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the Annual Report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

– we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the Annual Report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy; or

– the section of the Annual Report on page 58 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

Under the Companies Act 2006 we are required to report to you if, in our opinion:

– certain disclosures of Directors' remuneration specified by law are not made; or

– we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

– the Directors' statements, set out on pages 35 and 38, in relation to going concern and longer-term viability; and

– the part of the Corporate Governance Statement on page 46 relating to the company's compliance with the 11 provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

Independent auditor's report continued

7 Other matter – we have reported separately on the parent company financial statements

We have reported separately on the parent company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2015 and on the information in the Directors' Remuneration Report that is described as having been audited.

Scope and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 120, the Directors are responsible for the preparation of the Group financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate. This report is made solely to the company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Mark Baillache (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London, E14 5GL
24 February 2016

Financial Statements

Group Income Statement

For the year ended 31 December

	Notes	2015 £m	2014 £m
Gross turnover (including duty, excise and other taxes of £27,896 million (2014: £28,535 million))		**41,000**	42,506
Revenue	2	**13,104**	13,971
Raw materials and consumables used		**(3,217)**	(3,088)
Changes in inventories of finished goods and work in progress		**184**	58
Employee benefit costs	3(a)	**(2,039)**	(2,194)
Depreciation, amortisation and impairment costs	3(b)	**(428)**	(523)
Other operating income	3(c)	**225**	178
Other operating expenses	3(d)	**(3,272)**	(3,856)
Profit from operations	2	**4,557**	4,546
Analysed as:			
– adjusted profit from operations	2	**4,992**	5,403
– restructuring and integration costs	3(e)	**(367)**	(452)
– amortisation of trademarks and similar intangibles	3(f)	**(65)**	(58)
– Fox River	3(g)	**–**	27
– Flintkote	3(h)	**(3)**	(374)
		4,557	4,546
Net finance income/(costs)	4	**62**	(417)
Finance income		**646**	67
Finance costs		**(584)**	(484)
Share of post-tax results of associates and joint ventures	5	**1,236**	719
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	2	**943**	712
– issue of shares and change in shareholding	5	**22**	14
– gain on disposal of assets	5	**371**	–
– other	5	**(100)**	(7)
		1,236	719
Profit before taxation		**5,855**	4,848
Taxation on ordinary activities	6	**(1,333)**	(1,455)
Profit for the year		**4,522**	3,393
Attributable to:			
Owners of the parent		**4,290**	3,115
Non-controlling interests		**232**	278
		4,522	3,393
Earnings per share			
Basic	7	**230.9p**	167.1p
Diluted	7	**230.3p**	166.6p

All of the activities during both years are in respect of continuing operations.

The accompanying notes are an integral part of the Group financial statements.

Financial Statements

Group Statement of Comprehensive Income

For the year ended 31 December

	Notes	2015 £m	2014 £m
Profit for the year (page 125)		**4,522**	3,393
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss:		**(849)**	(327)
Differences on exchange			
– subsidiaries		**(1,006)**	(539)
– associates		**336**	113
Cash flow hedges			
– net fair value (losses)/gains		**(99)**	57
– reclassified and reported in profit for the year		**15**	(67)
– reclassified and reported in net assets		**(45)**	8
Available-for-sale investments			
– net fair value gains		**15**	15
– reclassified and reported in profit for the year		**(10)**	–
Net investment hedges			
– net fair value (losses)/gains		**(118)**	2
– differences on exchange on borrowings		**42**	60
Tax on items that may be reclassified	6(f)	**21**	24
Items that will not be reclassified subsequently to profit or loss:		**263**	(458)
Retirement benefit schemes			
– net actuarial gains/(losses) in respect of subsidiaries	12	**283**	(428)
– surplus recognition and minimum funding obligations in respect of subsidiaries	12	**–**	7
– actuarial gains/(losses) in respect of associates net of tax	5	**3**	(124)
Tax on items that will not be reclassified	6(f)	**(23)**	87
Total other comprehensive income for the year, net of tax		**(586)**	(785)
Total comprehensive income for the year, net of tax		**3,936**	2,608
Attributable to:			
Owners of the parent		**3,757**	2,349
Non-controlling interests		**179**	259
		3,936	2,608

The accompanying notes are an integral part of the Group financial statements.

Financial Statements

Group Statement of Changes in Equity

At 31 December

	Notes	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 parent £m	Non-controlling interests £m	Total equity £m
Balance at 1 January 2015		**507**	**3,923**	**(498)**	**1,578**	**5,510**	**304**	**5,814**
Total comprehensive income for the year (page 126)		**–**	**–**	**(796)**	**4,553**	**3,757**	**179**	**3,936**
Profit for the year		**–**	**–**	**–**	**4,290**	**4,290**	**232**	**4,522**
Other comprehensive income for the year		**–**	**–**	**(796)**	**263**	**(533)**	**(53)**	**(586)**
Employee share options								
– value of employee services		**–**	**–**	**–**	**50**	**50**	**–**	**50**
– proceeds from shares issued		**–**	**4**	**–**	**–**	**4**	**–**	**4**
Dividends and other appropriations								
– ordinary shares		**–**	**–**	**–**	**(2,770)**	**(2,770)**	**–**	**(2,770)**
– to non-controlling interests		**–**	**–**	**–**	**–**	**–**	**(238)**	**(238)**
Purchase of own shares								
– held in employee share ownership trusts		**–**	**–**	**–**	**(46)**	**(46)**	**–**	**(46)**
Non-controlling interests – acquisitions	26(c)	**–**	**–**	**–**	**(1,642)**	**(1,642)**	**(107)**	**(1,749)**
Other movements		**–**	**–**	**–**	**31**	**31**	**–**	**31**
Balance at 31 December 2015		**507**	**3,927**	**(1,294)**	**1,754**	**4,894**	**138**	**5,032**

	Notes	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 parent £m	Non-controlling interests £m	Total equity £m
Balance at 1 January 2014		507	3,919	(190)	2,398	6,634	301	6,935
Total comprehensive income for the year (page 126)		–	–	(308)	2,657	2,349	259	2,608
Profit for the year		–	–	–	3,115	3,115	278	3,393
Other comprehensive income for the year		–	–	(308)	(458)	(766)	(19)	(785)
Employee share options								
– value of employee services		–	–	–	66	66	–	66
– proceeds from shares issued		–	4	–	1	5	–	5
Dividends and other appropriations								
– ordinary shares		–	–	–	(2,712)	(2,712)	–	(2,712)
– to non-controlling interests		–	–	–	–	–	(260)	(260)
Purchase of own shares								
– held in employee share ownership trusts		–	–	–	(49)	(49)	–	(49)
– share buy-back programme		–	–	–	(800)	(800)	–	(800)
Non-controlling interests – acquisitions	26(c)	–	–	–	(4)	(4)	–	(4)
Non-controlling interests – capital injection	26(c)	–	–	–	–	–	4	4
Other movements		–	–	–	21	21	–	21
Balance at 31 December 2014		507	3,923	(498)	1,578	5,510	304	5,814

The accompanying notes are an integral part of the Group financial statements.

Financial Statements

Group Balance Sheet

At 31 December

	Notes	2015 £m	2014 £m
Assets			
Non-current assets			
Intangible assets	9	**10,436**	10,804
Property, plant and equipment	10	**3,021**	3,004
Investments in associates and joint ventures	11	**6,938**	2,400
Retirement benefit assets	12	**408**	40
Deferred tax assets	13	**326**	311
Trade and other receivables	14	**248**	153
Available-for-sale investments	15	**37**	36
Derivative financial instruments	16	**287**	287
Total non-current assets		**21,701**	17,035
Current assets			
Inventories	17	**4,247**	4,133
Income tax receivable	18	**74**	57
Trade and other receivables	14	**3,266**	2,768
Available-for-sale investments	15	**35**	50
Derivative financial instruments	16	**209**	274
Cash and cash equivalents	19	**1,963**	1,818
		9,794	9,100
Assets classified as held-for-sale	26(e)	**20**	32
Total current assets		**9,814**	9,132
Total assets		**31,515**	26,167

	Notes	2015 £m	2014 £m
Equity			
Capital and reserves			
Share capital		**507**	507
Share premium, capital redemption and merger reserves		**3,927**	3,923
Other reserves		**(1,294)**	(498)
Retained earnings		**1,754**	1,578
Owners of the parent		**4,894**	5,510
after deducting			
– cost of treasury shares		**(5,049)**	(5,073)
Non-controlling interests		**138**	304
Total equity	20	**5,032**	5,814
Liabilities			
Non-current liabilities			
Borrowings	21	**14,806**	9,779
Retirement benefit liabilities	12	**653**	781
Deferred tax liabilities	13	**563**	495
Other provisions for liabilities and charges	22	**296**	278
Trade and other payables	23	**1,029**	128
Derivative financial instruments	16	**130**	123
Total non-current liabilities		**17,477**	11,584
Current liabilities			
Borrowings	21	**2,195**	2,479
Income tax payable	18	**414**	430
Other provisions for liabilities and charges	22	**273**	210
Trade and other payables	23	**5,937**	5,524
Derivative financial instruments	16	**187**	126
Total current liabilities		**9,006**	8,769
Total equity and liabilities		**31,515**	26,167

The accompanying notes are an integral part of the Group financial statements.

On behalf of the Board

Richard Burrows
Chairman
24 February 2016

Financial Statements

Group Cash Flow Statement

For the year ended 31 December

	Notes	2015 £m	2014 £m
Cash flows from operating activities			
Cash generated from operations	25	**5,400**	4,634
Dividends received from associates		**593**	515
Tax paid		**(1,273)**	(1,433)
Net cash generated from operating activities		**4,720**	3,716
Cash flows from investing activities			
Interest received		**64**	61
Dividends received from investments		**–**	2
Purchases of property, plant and equipment		**(483)**	(529)
Proceeds on disposal of property, plant and equipment	25	**108**	62
Purchases of intangibles		**(118)**	(163)
Purchases of investments	25	**(99)**	(31)
Proceeds on disposals of investments	25	**45**	34
Proceeds from associates' share buy-backs	25	**–**	94
Investment in associates	25	**(3,015)**	–
Acquisition of subsidiaries	25	**(493)**	–
Net cash used in investing activities		**(3,991)**	(470)
Cash flows from financing activities			
Interest paid		**(596)**	(571)
Interest element of finance lease rental payments		**(1)**	–
Capital element of finance lease rental payments		**(2)**	(2)
Proceeds from issue of shares to owners of the parent		**4**	4
Proceeds from the exercise of options over own shares held in employee share ownership trusts		**–**	1
Proceeds from increases in and new borrowings	25	**6,931**	1,967
Proceeds relating to derivative financial instruments	25	**201**	244
Purchases of own shares		**–**	(800)
Purchases of own shares held in employee share ownership trusts		**(46)**	(49)
Reductions in and repayments of borrowings	25	**(2,028)**	(1,300)
Dividends paid to owners of the parent	8	**(2,770)**	(2,712)
Purchases of non-controlling interests	25	**(1,677)**	(4)
Non-controlling interests – capital injection	25	**–**	4
Dividends paid to non-controlling interests		**(235)**	(249)
Net cash used in financing activities		**(219)**	(3,467)
Net cash flows generated from/(used in) operating, investing and financing activities		**510**	(221)
Differences on exchange		**(272)**	(63)
Increase/(decrease) in net cash and cash equivalents in the year		**238**	(284)
Net cash and cash equivalents at 1 January		**1,492**	1,776
Net cash and cash equivalents at 31 December	19	**1,730**	1,492

The accompanying notes are an integral part of the Group financial statements.

The net cash outflows relating to adjusting items, including £97 million of interest, are £577 million (2014: £750 million). The FII GLO receipt in 2015 from HMRC was £963 million (see note 6(b)) and has been included in 'Cash generated from operations' above (see note 25).

Notes on the Accounts

1 Accounting policies

Basis of accounting

The Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The Group financial statements are prepared on a going concern basis, as set out in the Financial Review on page 35.

The financial statements have been prepared under the historical cost convention except as described in the accounting policy below on financial instruments.

The preparation of the Group financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the financial statements. The key estimates and assumptions are set out in the accounting policies below, together with the related notes to the accounts.

The most significant items include:

- the review of asset values, especially goodwill and impairment testing. The key assumptions used in respect of goodwill and impairment testing are the determination of cash-generating units, the budgeted cash flows of these units, the long-term growth rate for cash flow projections and the rate used to discount the cash flow projections. These are described in note 9;
- the estimation of and accounting for retirement benefit costs. The determination of the carrying value of assets and liabilities, as well as the charge for the year, and amounts recognised in other comprehensive income, involves judgements made in conjunction with independent actuaries. These involve estimates about uncertain future events based on the environment in different countries, including life expectancy of scheme members, salary and pension increases, inflation, as well as discount rates and asset values at the year end. The assumptions used by the Group and sensitivity analysis are described in note 12;
- the estimation of amounts to be recognised in respect of taxation and legal matters, and the estimation of other provisions for liabilities and charges are subject to uncertain future events, may extend over several years and so the amount and/or timing may differ from current assumptions. The accounting policy for taxation is explained below. The recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 13, and a contingent tax asset is explained in note 6(b). Other provisions for liabilities and charges are as set out in note 22. The accounting policy on contingent liabilities, which are not provided for, is set out below and the contingent liabilities of the Group are explained in note 30. The application of these accounting policies to the payments made and credits recognised under the Master Settlement Agreement by Reynolds American Inc. is described in note 5;
- the definition of adjusting items, which are separately disclosed as memorandum information, is explained below and the impact of these on the calculation of adjusted earnings is described in note 7;
- the estimation of the fair values of acquired net assets arising in a business combination and the allocation of the purchase consideration between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair values. These estimates are prepared in conjunction with the advice of independent valuation experts where appropriate. The relevant transactions for 2015 are described in note 26 and in note 11;
- the determination as to whether control (subsidiaries), joint control (joint arrangements), or significant influence (associates) exists in relation to the investments held by the Group. This is assessed after taking into account the Group's ability to appoint directors to the entity's board, its relative shareholding compared with other shareholders, any significant contracts or arrangements with the entity or its other shareholders and other relevant facts and circumstances. The application of this judgement in respect of the Group's investment in Reynolds American Inc. is explained in note 11;
- the review of applicable exchange rates for transactions with and translation of entities in territories where there are restrictions on the free access to foreign currency, or multiple exchange rates; and
- the exemptions taken under IFRS 1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to goodwill on business combinations which are explained in the accounting policies below.

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

Basis of consolidation

The consolidated financial information includes the financial statements of British American Tobacco p.l.c. and its subsidiary undertakings, together with the Group's share of the results of its associates and joint arrangements.

A subsidiary is an entity controlled by the Group. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Associates comprise investments in undertakings, which are not subsidiary undertakings or joint arrangements, where the Group's interest in the equity capital is long term and over whose operating and financial policies the Group exercises a significant influence. They are accounted for using the equity method.

Joint arrangements comprise contractual arrangements where two or more parties have joint control and where decisions regarding the relevant activities of the entity require unanimous consent. Joint operations are jointly-controlled arrangements where the parties to the arrangement have rights to the underlying assets and obligations for the underlying liabilities relating to the arrangement. The Group accounts for its share of the assets, liabilities, income and expenses of any such arrangement. Joint ventures comprise arrangements where the parties to the arrangement have rights to the net assets of the arrangement. They are accounted for using the equity method.

The results of subsidiary undertakings acquired during the period are included from the date of acquisition of a controlling interest at which date, for the purposes of consolidation, the purchase consideration is allocated between the underlying net assets acquired, including intangible assets other than goodwill, on the basis of their fair value. Acquisition-related costs are expensed as incurred. Similarly, the results of associates and joint arrangements are included from the date of acquiring significant influence or joint control respectively.

Notes on the Accounts continued

1 Accounting policies continued

The results of subsidiary undertakings, associates and joint arrangements which have been sold during the year are included up to the date of disposal. The profit or loss on sale is calculated by reference to the net asset value at the date of disposal, adjusted for purchased goodwill previously consolidated in the balance sheet.

Inter-company balances and transactions, and any unrealised gains arising from inter-company transactions, are eliminated in preparing the consolidated financial statements.

Foreign currencies

The functional currency of the parent company is sterling and this is also the presentation currency of the Group. The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling using exchange rates applicable to the dates of the underlying transactions. Average rates of exchange in each year are used where the average rate approximates the relevant exchange rate at the date of the underlying transactions. Assets and liabilities of Group undertakings are translated at the applicable rates of exchange at the end of each year. In territories where there are restrictions on the free access to foreign currency or multiple exchange rates, the applicable rates of exchange are regularly reviewed.

For hyperinflationary countries, the financial statements in local currency are adjusted to reflect the impact of local inflation prior to translation into sterling.

The differences between retained profits of overseas subsidiary undertakings, associates and joint arrangements translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of overseas net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component of equity. As permitted under IFRS 1, any differences prior to that date are not included in this separate component of equity.

Where a disposal of an investment in a Group undertaking results in a loss of control of a subsidiary undertaking, the loss of significant influence over an associated company or the loss of joint control over a joint arrangement, the cumulative amount of the related foreign exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised. These related exchange differences comprise the exchange differences on all amounts deemed to be part of the net investment in the undertaking, which are recycled to the income statement when a disposal occurs. For partial disposals of subsidiary undertakings the related exchange differences are reclassified within equity. For all other partial disposals the proportional share of the related exchange differences is recycled to the income statement.

Foreign currency transactions are initially recognised in the functional currency of each entity in the Group using the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of foreign currency assets and liabilities at year end rates of exchange are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges, on inter-company net investment loans and qualifying net investment hedges. Foreign exchange gains or losses recognised in the income statement are included in profit from operations or net finance costs depending on the underlying transactions that gave rise to these exchange differences.

Revenue

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

Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. The net deficit or surplus for each defined benefit pension scheme is calculated in accordance with IAS 19 *Employee Benefits*, based on the present value of the defined benefit obligation at the balance sheet date less the fair value of the scheme assets adjusted, where appropriate, for any surplus restrictions or the effect of minimum funding requirements.

Actuarial gains and losses, changes in unrecognised scheme surpluses and minimum funding requirements are recognised in full through other comprehensive income. Past service costs or credits resulting from amendments to benefits are recognised immediately.

The Group also has certain post-retirement healthcare schemes and they are accounted for on a similar basis to the defined benefit pension schemes.

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, net interest on the net defined benefit liability or asset, past service cost and the impact of any settlements.

Some benefits are provided through defined contribution schemes and payments to these are charged as an expense as they fall due.

Share-based payments

The Group has equity-settled and cash-settled share-based compensation plans.

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed over the vesting period, based on the Group's estimate of awards that will eventually vest. For plans where vesting conditions are based on total shareholder returns, the fair value at date of grant reflects these conditions, whereas earnings per share vesting conditions are reflected in the calculation of awards that will eventually vest over the vesting period. For cash-settled share-based payments, a liability equal to the portion of the services received is recognised at its current fair value determined at each balance sheet date. Fair value is measured by the use of the Black-Scholes option pricing model, except where vesting is dependent on market conditions when the Monte-Carlo option pricing model is used. The expected life used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Research and development

Research expenditure is charged to income in the year in which it is incurred. Development expenditure is charged to income in the year it is incurred, unless it meets the recognition criteria of IAS 38 *Intangible Assets*.

1 Accounting policies continued

Taxation

Taxation is that chargeable on the profits for the period, together with deferred taxation.

The current income tax charge is calculated on the basis of tax laws enacted or substantively enacted at the balance sheet date in the countries where the Group's subsidiaries, associates and joint arrangements operate and generate taxable income.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS 12 *Income Taxes*, deferred tax assets and liabilities are not discounted.

Deferred tax is determined using the tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or deferred tax liability is settled.

Tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in other comprehensive income or changes in equity.

The Group has exposures in respect of the payment or recovery of a number of taxes. Liabilities or assets for these payments or recoveries are recognised at such time as an outcome becomes probable and when the amount can reasonably be estimated.

Goodwill

Goodwill arising on acquisitions is capitalised and is considered to have an indefinite life subject to impairment reviews. Any impairment of goodwill is recognised immediately in the income statement and is not subsequently reversed.

Goodwill represents the excess of the cost of acquisition of a subsidiary, associate or joint venture over the Group's share of the fair value of identifiable net assets acquired. Goodwill is stated at cost net of accumulated impairment losses and recognised amortisation prior to 1 January 2004.

The Group's policy up to and including 1997 was to eliminate goodwill against reserves. Goodwill acquired from 1998 to 31 December 2003 was capitalised and amortised over its useful economic life.

As permitted under IFRS 1, in respect of acquisitions prior to 1 January 2004, the classification and accounting treatment of business combinations was not amended on transition to IFRS. Goodwill previously written off direct to reserves is not recycled to the income statement on the disposal of the subsidiary, associate or joint venture to which it relates.

Goodwill in respect of subsidiaries is included in intangible assets. In respect of associates and joint ventures, goodwill is included in the carrying value of the investment in the associated company or joint venture. On disposal of a subsidiary, associate or joint venture, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Intangible assets other than goodwill

The intangible assets shown on the Group balance sheet consist mainly of trademarks and similar intangibles, including certain intellectual property, acquired by the Group's subsidiary undertakings and computer software.

Acquired trademarks and similar assets are carried at cost less accumulated amortisation and impairment. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment. Intangible assets other than goodwill classified as held-for-sale are not amortised. Other trademarks and similar assets are amortised on a straight-line basis over their remaining useful lives, consistent with the pattern of economic benefits expected to be received, which do not exceed 20 years. Any impairments of trademarks are recognised in the income statement but increases in trademark values are not recognised.

Computer software is carried at cost less accumulated amortisation and impairment, and, with the exception of global software solutions, is amortised on a straight-line basis over periods ranging from three years to five years. Global software solutions are software assets designed to be implemented on a global basis and used as a standard solution by all of the operating companies in the Group. These assets are amortised on a straight-line basis over periods not exceeding 10 years.

The investments in associates and joint ventures shown in the Group balance sheet include trademarks arising from the combination of Brown & Williamson (B&W) and R.J. Reynolds (RJR) in 2004 to form Reynolds American Inc. (RAI), as well as those arising on the acquisition by RAI of Conwood in 2006 and Lorillard in 2015. Most of the carrying value of these assets relates to intangibles which are deemed to have indefinite lives and each trademark is subject to an annual impairment test. Certain minor trademarks are being amortised over their remaining lives.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and impairment. Depreciation is calculated on a straight-line basis to write off the assets over their useful economic life. No depreciation is provided on freehold land or assets classified as held-for-sale. Freehold and leasehold property are depreciated at rates between 2.5% and 4% per annum, and plant and equipment at rates between 7% and 25% per annum.

Capitalised interest

Borrowing costs which are directly attributable to the acquisition, construction or production of intangible assets or plant, property and equipment that takes a substantial period of time to get ready for its intended use or sale, and for which the commencement date for capitalisation was on or after 1 January 2009, are capitalised as part of the cost of the asset, in accordance with IAS 23 *Borrowing Costs*. The Group's previous policy was to expense such borrowing costs as they were incurred.

Leased assets

Assets where the Group has substantially all the risks and rewards of ownership of the leased asset are classified as finance leases and are included as part of property, plant and equipment. Finance lease assets are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, then depreciated over the shorter of the lease term and their estimated useful lives. Leasing payments consist of capital and finance charge elements and the finance element is charged to the income statement.

Notes on the Accounts continued

1 Accounting policies continued

Rental payments under operating leases are charged to the income statement on a straight-line basis over the lease term.

Where arrangements are entered into which, while they are not in the legal form of a lease, are in substance a lease under IFRIC 4, then they are recognised on the same basis as the leased assets above.

Impairment of non-financial assets

Assets are reviewed for impairment whenever events indicate that the carrying amount of a cash-generating unit may not be recoverable. In addition, assets that have indefinite useful lives are tested annually for impairment. An impairment loss is recognised to the extent that the carrying value exceeds the higher of the asset's fair value less costs to sell and its value in use.

A cash-generating unit is the smallest identifiable group of assets that generates cash flows which are largely independent of the cash flows from other assets or groups of assets. At the acquisition date, any goodwill acquired is allocated to the relevant cash-generating unit or group of cash-generating units expected to benefit from the acquisition for the purpose of impairment testing of goodwill.

Impairment of financial assets

Financial assets are reviewed at each balance sheet date, or whenever events indicate that the carrying amount may not be recoverable. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the investment below its cost is considered as an indicator that the investment is impaired.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is based on the weighted average cost incurred in acquiring inventories and bringing them to their existing location and condition, which will include raw materials, direct labour and overheads, where appropriate. Net realisable value is the estimated selling price less costs to completion and sale. Tobacco inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognised industry practice.

Financial instruments

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the relevant instrument and derecognised when it ceases to be a party to such provisions. Such assets and liabilities are classified as current if they are expected to be realised or settled within 12 months after the balance sheet date. If not, they are classified as non-current.

Financial assets and financial liabilities are initially recognised at fair value, plus directly attributable transaction costs where applicable, with subsequent measurement as set out below.

Non-derivative financial assets are classified on initial recognition as available-for-sale investments, loans and receivables or cash and cash equivalents as follows:

Available-for-sale investments

Available-for-sale investments are those non-derivative financial assets that cannot be classified as loans and receivables or cash and cash equivalents.

Loans and receivables

These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments including investments in certain money market funds. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts, which are included as current borrowings in the liabilities section on the balance sheet.

Apart from available-for-sale investments, non-derivative financial assets are stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. These estimates for irrecoverable amounts are recognised when there is objective evidence that the full amount receivable will not be collected according to the original terms of the asset. Such evidence might include financial difficulties of the debtor, defaults of payment or significant overdue balances. For interest-bearing assets, their carrying value includes accrued interest receivable. Available-for-sale investments are stated at fair value, with changes in fair value being recognised directly in other comprehensive income. When such investments are derecognised (e.g. through disposal) or become impaired, the accumulated gains and losses, previously recognised in other comprehensive income, are reclassified to the income statement within finance income. Dividend and interest income on available-for-sale investments are included within finance income when the Group's right to receive payments is established.

Fair values for quoted investments are based on observable market prices. If there is no active market for a financial asset, the fair value is established by using valuation techniques principally involving discounted cash flow analysis.

Non-derivative financial liabilities are stated at amortised cost using the effective interest method. For borrowings, their carrying value includes accrued interest payable, as well as unamortised issue costs.

Derivative financial assets and liabilities are initially recognised, and subsequently measured, at fair value, which includes accrued interest receivable and payable where relevant. Changes in their fair values are recognised as follows:

- for derivatives that are designated as cash flow hedges, the changes in their fair values are recognised directly in other comprehensive income, to the extent that they are effective, with the ineffective portion being recognised in the income statement. Where the hedged item results in a non-financial asset, the accumulated gains and losses, previously recognised in other comprehensive income, are included in the initial carrying value of the asset (basis adjustment) and recognised in the income statement in the same periods as the hedged item. Where the underlying transaction does not result in such an asset, the accumulated gains and losses are reclassified to the income statement in the same periods as the hedged item;
- for derivatives that are designated as fair value hedges, the carrying value of the hedged item is adjusted for the fair value changes attributable to the risk being hedged, with the corresponding entry being made in the income statement. The changes in fair value of these derivatives are also recognised in the income statement;

1 Accounting policies continued

– for derivatives that are designated as hedges of net investments in foreign operations, the changes in their fair values are recognised directly in other comprehensive income, to the extent that they are effective, with the ineffective portion being recognised in the income statement. Where non-derivatives such as foreign currency borrowings are designated as net investment hedges, the relevant exchange differences are similarly recognised. The accumulated gains and losses are reclassified to the income statement when the foreign operation is disposed of; and

– for derivatives that do not qualify for hedge accounting or are not designated as hedges, the changes in their fair values are recognised in the income statement in the period in which they arise.

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed periodically to ensure that the hedge has remained, and is expected to remain, highly effective.

Hedge accounting is discontinued when a hedging instrument is derecognised (e.g. through expiry or disposal), or no longer qualifies for hedge accounting. Where the hedged item is a highly probable forecast transaction, the related gains and losses remain in equity until the transaction takes place, when they are reclassified to the income statement in the same manner as for cash flow hedges as described above. When a hedged future transaction is no longer expected to occur, any related gains and losses, previously recognised in other comprehensive income, are immediately reclassified to the income statement.

Derivative fair value changes recognised in the income statement are either reflected in arriving at profit from operations (if the hedged item is similarly reflected) or in finance costs.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders at the Annual General Meeting, while interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Segmental analysis

The Group is organised and managed on the basis of its geographic regions. These are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the chief operating decision maker, identified as the Management Board, for assessing performance and allocating resources.

The Group is primarily a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information. The results of Next Generation Products are not currently material to the Group.

The prices agreed between Group companies for intra-group sales of materials, manufactured goods, charges for royalties, commissions, services and fees, are based on normal commercial practices which would apply between independent businesses. Royalty income, less related expenditure, is included in the region in which the licensor is based.

Adjusting items

Adjusting items are significant items in the profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. While the disclosure of adjusting items is not required by IFRS, these items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes to the accounts as appropriate.

The Group believes that these items are useful to users of the Group financial statements in helping them to understand the underlying business performance and are used to derive the Group's principal non-GAAP measures of adjusted profit from operations and adjusted diluted earnings per share.

Provisions

Provisions are recognised when either a legal or constructive obligation as a result of a past event exists at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and a reasonable estimate can be made of the amount of the obligation.

Contingent liabilities and contingent assets

Subsidiaries and associates companies are defendants in tobacco-related and other litigation. Provision for this litigation (including legal costs) would be made at such time as an unfavourable outcome became probable and the amount could be reasonably estimated.

Contingent assets are possible assets whose existence will only be confirmed by future events not wholly within the control of the entity and are not recognised as assets until the realisation of income is virtually certain.

Where a provision has not been recognised, the Group records its external legal fees and other external defence costs for tobacco-related and other litigation as these costs are incurred.

Repurchase of share capital

When share capital is repurchased the amount of consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares which are not cancelled, or shares purchased for the employee share ownership trusts, are classified as treasury shares and presented as a deduction from total equity.

Notes on the Accounts continued

1 Accounting policies continued

Future changes to accounting policies

Certain changes to IFRS will be applicable to the Group financial statements in future years. Set out below are those which are considered to be most relevant to the Group.

IFRS 9 *Financial Instruments*. This standard was finalised and published in July 2014 as the replacement for IAS 39 *Financial Instruments: Recognition and Measurement*. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's reported profit and equity for 2015 and 2014 is not expected to be material. The Standard is largely retrospective in application. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2018.

IFRS 15 *Revenue from Contracts with Customers*. This standard was finalised and published in May 2014 with the intention to harmonise IFRS and US GAAP through a single revenue recognition standard. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's operating profit for 2015 and 2014 is not expected to be material. However, this standard may require changes to the allocation of costs between operating expenses and deductions from revenue, for example, payments to customers currently classed as expenses. The Standard is retrospective in application. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2018.

IFRS 16 *Leases*. This standard was finalised and published in January 2016 and is a major revision to the way that entities will account for leases. The distinction between operating leases and finance leases enshrined in current accounting requirements (IAS 17) is removed with the effect that virtually all leasing arrangements will be brought on to the balance sheet as financial obligations and 'right-to-use' assets. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's operating profit and net assets for 2015 and 2014 is not expected to be material, although assets and liabilities would have been grossed up by approximately £220 million in both years based on current leasing commitments as disclosed in note 30. The Standard is retrospective in application, but allows for implementation either as a single cumulative amount at the date of initial application or as an adjustment to each prior reporting period. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2019.

In addition, a number of other interpretations and revisions to existing standards have been issued which will be applicable to the Group's financial statements in future years, but will not have a material effect on reported profit or equity or on the disclosures in the financial statements.

2 Segmental analyses

As the chief operating decision maker, the Management Board reviews external revenues and adjusted profit from operations to evaluate segment performance and allocate resources to the overall business. The results of Next Generation Products as a separate segment are currently not material to the Group and therefore it is not considered a reportable segment that requires separate disclosure under the requirements of IFRS 8 *Operating Segments*. Interest income, interest expense and taxation are centrally managed and accordingly such items are not presented by segment as they are excluded from the measure of segment profitability.

The four geographic regions are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the Management Board for assessing performance and allocating resources.

The Management Board reviews current and prior year segmental revenue, adjusted profit from operations of subsidiaries and joint operations, and adjusted post-tax results of associates and joint ventures at constant rates of exchange. The constant rate comparison provided for reporting segment information is based on a retranslation, at prior year exchange rates, of the current year results of the Group, including inter-company royalties payable in foreign currency to UK entities. However, the Group does not adjust for the normal transactional gains and losses in operations which are generated by movements in exchange rates. As a result, the 2015 segmental results were translated using the 2014 rates of exchange. The 2014 figures are stated at the 2014 rates of exchange and are, therefore, unadjusted from those published for 2014.

The analyses of revenue for the 12 months to 31 December 2015 and 31 December 2014, based on location of sales, are as follows:

	2015			2014
	Revenue Constant rates £m	Translation exchange £m	Revenue Current rates £m	Revenue £m
Asia-Pacific	3,874	(101)	3,773	3,873
Americas	3,340	(620)	2,720	2,990
Western Europe	3,476	(273)	3,203	3,359
EEMEA	4,030	(622)	3,408	3,749
Revenue	14,720	(1,616)	13,104	13,971

The analyses of profit from operations and the Group's share of the post-tax results of associates and joint ventures, reconciled to profit before taxation, are as follows:

	2015					2014		
	Adjusted* segment result Constant rates £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	1,546	(77)	1,469	(108)	1,361	1,548	(188)	1,360
Americas	1,426	(257)	1,169	(87)	1,082	1,286	(89)	1,197
Western Europe	1,249	(103)	1,146	(156)	990	1,189	(171)	1,018
EEMEA	1,399	(191)	1,208	(81)	1,127	1,380	(62)	1,318
	5,620	(628)	4,992	(432)	4,560	5,403	(510)	4,893
Fox River**				–	–		27	27
Flintkote**				(3)	(3)		(374)	(374)
Profit from operations	5,620	(628)	4,992	(435)	4,557	5,403	(857)	4,546
Net finance income/(costs)	(464)	37	(427)	489	62	(417)	–	(417)
Asia-Pacific	278	8	286	16	302	277	14	291
Americas	610	46	656	277	933	431	(7)	424
EEMEA	1	–	1	–	1	4	–	4
Share of post-tax results of associates and joint ventures	889	54	943	293	1,236	712	7	719
Profit before taxation	6,045	(537)	5,508	347	5,855	5,698	(850)	4,848

* The adjustments to profit from operations, net finance income/(costs) and the Group's share of the post-tax results of associates and joint ventures are explained in notes 3(e) to 3(h), note 4(b) and note 5, respectively.

** The Fox River credit in 2014 (see note 3(g) and note 30) and the Flintkote charge in 2014 and 2015 (see note 3(h) and note 30) have not been allocated to any segment as they neither relate to current operations nor the tobacco business. They are presented separately from the segmental reporting which is used to evaluate segment performance and to allocate resources, and is reported to the chief operating decision maker on this basis.

Notes on the Accounts continued

2 Segmental analyses continued

Adjusted profit from operations at constant rates of £5,620 million (2014: £5,403 million) excludes certain depreciation, amortisation and impairment charges as explained in notes 3(b), 3(e) and 3(f). These are excluded from segmental profit from operations at constant rates as follows:

	2015					2014		
	Adjusted depreciation, amortisation and impairment Constant rates £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	95	–	95	33	128	96	52	148
Americas	96	(12)	84	9	93	106	17	123
Western Europe	81	(6)	75	39	114	96	50	146
EEMEA	97	(14)	83	10	93	98	8	106
	369	(32)	337	91	428	396	127	523

External revenue and non-current assets other than financial instruments, deferred tax assets and retirement benefit assets are analysed between the UK and all foreign countries at current rates of exchange as follows:

	United Kingdom		All foreign countries		Group	
Revenue is based on location of sale	2015 £m	2014 £m	2015 £m	2014 £m	2015 £m	2014 £m
External revenue	190	143	12,914	13,828	13,104	13,971

	United Kingdom		All foreign countries		Group	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 £m	2014 £m
Intangible assets	580	499	9,856	10,305	10,436	10,804
Property, plant and equipment	378	343	2,643	2,661	3,021	3,004
Investments in associates and joint ventures	–	–	6,938	2,400	6,938	2,400

In 2014, Souza Cruz S.A. operating in Brazil met the criteria for separate disclosure under the requirements of IFRS 8 *Operating Segments*. Revenue and non-current assets for Souza Cruz operations in 2014 amounted to £1,602 million and £399 million, respectively. In 2015, there is no foreign operation that requires separate disclosure under the requirements of IFRS 8 *Operating Segments*.

The main acquisitions comprising the goodwill balance of £9,324 million (2014: £9,842 million), included in intangible assets, are provided in note 9. Included in investments in associates and joint ventures are amounts of £5,749 million (2014: £1,361 million) attributable to the investment in Reynolds American Inc. and £1,136 million (2014: £991 million) attributable to the investment in ITC Ltd. Further information is provided in note 11.

3 Profit from operations

(a) Employee benefit costs

	2015 £m	2014 £m
Wages and salaries	1,667	1,776
Social security costs	174	212
Other pension and retirement benefit costs (note 12)	138	132
Share-based payments – equity-settled (note 27)	50	66
Share-based payments – cash-settled (note 27)	10	8
	2,039	2,194

3 Profit from operations continued

(b) Depreciation, amortisation and impairment costs

		2015 £m	2014 £m
Intangibles	– amortisation of trademarks and similar intangibles (note 3(f))	**65**	58
	– amortisation of other intangibles	**74**	58
	– impairment	**15**	11
Property, plant and equipment	– depreciation	**265**	307
	– impairment	**9**	89
		428	523

Impairment in respect of certain intangibles, and property, plant and equipment is included in restructuring costs (see note 3(e)).

(c) Other operating income

This represents operating income arising from the Group's activities which falls outside the definition of revenue and includes gains as a result of property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

(d) Other operating expenses include:

	2015 £m	2014 £m
Research and development expenses (excluding employee benefit costs and depreciation)	**60**	74
Exchange differences	**10**	7
Rent of plant and equipment (operating leases)		
– minimum lease payments	**20**	28
Rent of property (operating leases)		
– minimum lease payments	**52**	69
Fees payable for audit services pursuant to legislation:		
– fees payable to KPMG LLP for parent company and Group audit	**2.0**	0.3
– fees payable to PricewaterhouseCoopers LLP for parent company and Group audit	**–**	2.0
– fees payable to other KPMG LLP firms and associates for local statutory and Group reporting audits	**6.7**	–
– fees payable to other PricewaterhouseCoopers LLP firms and associates for local statutory and Group reporting audits	**0.6**	7.3
Audit fees payable to KPMG LLP firms and associates	**8.7**	0.3
Audit fees payable to PricewaterhouseCoopers LLP firms and associates	**0.6**	9.3
Audit fees payable to other firms	**–**	0.1
Total audit fees payable	**9.3**	9.7
Fees payable to KPMG LLP (2015)/PricewaterhouseCoopers LLP (2014) firms and associates for other services:		
– audit-related assurance services	**0.2**	0.3
– other assurance services	**0.1**	0.1
– tax advisory services	**0.6**	3.8
– tax compliance	**0.4**	0.8
– other non-audit services	**2.0**	0.2
	3.3	5.2

The total fees payable to PricewaterhouseCoopers firms and associates included above are £0.6 million (2014: £14.5 million). The total fees payable to KPMG firms and associates included above are £12.0 million (2014: £0.3 million).

Total research and development costs including employee benefit costs and depreciation are £148 million (2014: £154 million).

Notes on the Accounts continued

3 Profit from operations continued

(e) Restructuring and integration costs

Restructuring costs reflect the costs incurred as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise, including the relevant operating costs of implementing the new operating model. These costs represent additional expenses incurred, which are not related to the normal business and day-to-day activities. The new operating model includes revised organisation structures, standardised processes and shared back office services underpinned by a global single instance of SAP. The new organisation structures and processes are currently being implemented and the deployment of the new SAP system started in the third quarter of 2012 and will take at least four years to fully roll-out. These initiatives also include a review of the Group's manufacturing operations, supply chain, overheads and indirect costs, organisational structure and systems and software used. The costs of these initiatives together with the costs of integrating acquired businesses into existing operations, including acquisition costs, are included in profit from operations under the following headings:

	2015 £m	2014 £m
Employee benefit costs	**159**	223
Depreciation, amortisation and impairment costs	**26**	69
Other operating expenses	**228**	180
Other operating income	**(46)**	(20)
	367	452

Restructuring and integration costs in 2015 principally relate to the restructuring initiatives directly related to implementation of a new operating model and the cost of initiatives in respect of permanent headcount reductions and permanent employee benefit reductions in the Group. The costs also cover factory closure and downsizing activities in Australia, certain costs related to the acquisitions undertaken (including TDR in Croatia) and restructurings in Indonesia, Canada, Switzerland and Germany.

Restructuring and integration costs in 2014 principally related to the restructuring initiatives directly related to implementation of a new operating model and the cost of packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group. The costs also covered factory closure and downsizing activities in Australia, Colombia and the Democratic Republic of Congo, and restructurings in Argentina, Indonesia, Canada, Switzerland and Germany.

Other operating income in 2015 includes gains from the sale of land and buildings in Australia. In 2014, other operating income included gains from the sale of land and buildings in Turkey, Uganda and the Democratic Republic of Congo.

(f) Amortisation of trademarks and similar intangibles

The acquisitions of TDR (see note 26), Protabaco, Bentoel, Tekel, ST, CN Creative and the creation of CTBAT International Limited resulted in the capitalisation of trademarks and similar intangibles which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £65 million (2014: £58 million) is included in depreciation, amortisation and impairment costs in profit from operations.

(g) Fox River

As explained in note 30, a Group subsidiary has certain liabilities in respect of indemnities given on the purchase and disposal of former businesses in the US and in 2011, the subsidiary provided £274 million in respect of claims in relation to environmental clean-up costs of the Fox River.

On 30 September 2014, a Group subsidiary, NCR, Appvion and Windward Prospects entered into a Funding Agreement with regard to the costs for the clean-up of Fox River. Based on this Funding Agreement, £17 million has been paid in 2015, which includes legal costs of £8 million (2014: £56 million, including legal costs of £7 million). The Fox River provision has been reviewed with no further change required in 2015, following a release in 2014 of £27 million. The remaining provision is £160 million (2014: £177 million).

(h) Flintkote

As explained in note 30, in December 2014, a Group subsidiary entered into a settlement agreement in connection with various legal cases related to a former non-tobacco business in Canada. Under the terms of the settlement, the subsidiary will obtain protection from current and potential future Flintkote-related asbestos liability claims in the US. The settlement was finalised in 2015 when approvals of certain courts in the US were obtained. This agreement has led to a charge of £3 million in 2015 (2014: £374 million).

4 Net finance (income)/costs

(a) Net finance (income)/costs

	2015 £m	2014 £m
Finance costs		
– interest payable		
– bonds and notes	**484**	501
– other loans and commercial paper	**36**	22
– bank loans and overdrafts	**53**	56
– facility fees	**9**	9
– interest and fees related to the funding of the acquisition of non-controlling interests in Souza Cruz and the investment in RAI (see note 4(b)(i))	**16**	–
– interest related to Franked Investment Income Global Litigation Order (see note 4(b)(iii))	**8**	–
	606	588
– fair value changes on derivative financial instruments and hedged items	**(245)**	(154)
– derivatives costs related to the funding of the acquisition of non-controlling interests in Souza Cruz (see note 4(b)(i))	**88**	–
– exchange differences on financial liabilities	**135**	50
	584	484
Finance income		
– interest and dividend income		
– gains in respect of available-for-sale investments	**(10)**	–
– dividend income in respect of available-for-sale investments	**–**	(2)
– other interest income	**(69)**	(65)
	(79)	(67)
– deemed gain related to the investment in RAI (see note 4(b)(ii))	**(601)**	–
– exchange differences on financial assets	**34**	–
	(646)	(67)
Net finance (income)/costs	**(62)**	417

The Group manages foreign exchange gains and losses and fair value changes on a net basis excluding adjusting items, as shown below. Adjusting items are explained separately in note 4(b). The derivatives that generate the fair value changes are detailed in note 16.

Fair value changes		
– cash flow hedges transferred from equity	**(18)**	(31)
– fair value hedging instruments – exchange-related movements	**(27)**	12
– fair value hedging instruments – net interest income	**(75)**	(83)
– fair value hedging instruments – interest-related movements *(note (i))*	**(27)**	(174)
– fair value changes on hedged items – interest-related movements *(note (i))*	**22**	158
– instruments held-for-trading *(note (ii))*	**(120)**	(36)
	(245)	(154)
Finance costs – exchange differences on financial liabilities	**135**	50
Finance income – exchange differences on financial assets	**34**	–
	(76)	(104)

Notes:

(i) Hedge ineffectiveness in respect of fair value hedges is a £5 million gain (2014: £16 million gain) being the difference between the two items above.

(ii) IFRS requires derivatives which do not meet the tests for hedge accounting under IAS 39 to be classified as instruments held-for-trading with fair value changes included in the income statement. These derivatives principally consist of forward foreign currency contracts which have not been designated as hedges due to their fair value changes offsetting with other components of net finance costs relating to financial assets and liabilities.

Facility fees principally relate to the Group's central undrawn banking facilities of £3 billion and US$150 million (2014: £3 billion and US$150 million).

Exchange differences in respect of hedged items subject to fair value hedges and cash flow hedges were a loss of £27 million (2014: £12 million gain) and a loss of £18 million (2014: £36 million loss) respectively and are included in 'Finance costs – exchange differences' in the table above.

Notes on the Accounts continued

4 Net finance (income)/costs continued

(b) Adjusting items included in net finance (income)/costs

Adjusting items are significant items in net finance costs which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. Refer to note 1 for details on the Group adjusting items policy.

In 2015, the following adjusting items have been recognised:

(i) costs of £104 million in relation to financing activities, which includes costs on the acquisition of the non-controlling interests in the Group's Brazilian subsidiary, Souza Cruz S.A. and the Group's activities to maintain the current ownership in RAI following its acquisition of Lorillard, Inc.;

(ii) the Group's investment of US$4.7 billion in cash in RAI has realised a deemed gain of US$931 million (£601 million). This has arisen as the contract to acquire shares is deemed to be a financial instrument and has been fair valued through profit and loss, in compliance with IAS 39 *Financial Instruments: Recognition and Measurement*. The deemed gain reflects the difference between the fixed price paid by the Group to RAI and the market value of RAI shares on the day of the transaction (see note 11); and

(iii) as described in note 6, the Group received £963 million from HM Revenue & Customs in relation to the Franked Investment Income Group Litigation Order (FII GLO). The payment was received subject to an ongoing appeals process and was made with no admission of liability. This amount is included in deferred income (see note 23). Any future repayment by the Group is subject to interest and, as any recognition of income will be deemed to be adjusting (due to size), interest of £8 million has been accrued and treated as an adjusting item.

5 Associates and joint ventures

	2015		2014	
	Total £m	Group's share £m	Total £m	Group's share £m
Revenue	**11,186**	**4,215**	9,201	3,402
Profit from operations	**6,117**	**2,391**	3,166	1,163
Net finance costs	**(335)**	**(139)**	(169)	(70)
Profit on ordinary activities before taxation	**5,782**	**2,252**	2,997	1,093
Taxation on ordinary activities	**(2,545)**	**(1,013)**	(1,006)	(370)
Profit on ordinary activities after taxation	**3,237**	**1,239**	1,991	723
Non-controlling interests	**(12)**	**(3)**	(11)	(4)
Post-tax results of associates and joint ventures	**3,225**	**1,236**	1,980	719
Analysed as:				
– adjusted share of post-tax results of associates and joint ventures	**2,501**	**943**	1,951	712
– issue of shares and change in shareholding	**74**	**22**	46	14
– gain on disposal of assets	**879**	**371**	–	–
– other	**(229)**	**(100)**	(17)	(7)
	3,225	**1,236**	1,980	719

5 Associates and joint ventures continued

(a) Adjusting items

The share of post-tax results of associates and joint ventures is after the following adjusting items which are excluded from the calculation of adjusted earnings per share as set out in note 7:

2015

In 2015, the Group's interest in ITC Ltd. (ITC) decreased from 30.26% to 30.06% as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. The issue of these shares and change in the Group's share of ITC resulted in a gain of £22 million, which is treated as a deemed partial disposal and included in the Group Income Statement.

Reynolds American Inc. (RAI) recognised a gain on the related divestiture of assets, following the Lorillard, Inc. (Lorillard) acquisition, of US$3,288 million. The Group's share of this net gain amounted to £371 million (net of tax).

RAI has also recognised amounts that have been combined in the table of adjusting items in the Group Income Statement and are included within "other". This includes restructuring charges of US$223 million, the Group's share of which is £39 million (net of tax) and costs in respect of a number of Engle progeny lawsuits and other tobacco litigation charges that amounted to US$152 million, the Group's share of which is £26 million (net of tax). Also included are transaction costs of US$54 million and financing costs of US$60 million connected with the acquisition of Lorillard, the Group's share of which is £12 million (net of tax) and £10 million (net of tax), respectively. Additionally, there is income of US$108 million related to the Non-Participating Manufacturer (NPM) Adjustment claims of the states no longer challenging the findings of non-diligence entered against them by an Arbitration Panel, the Group's share of which is £18 million (net of tax). The remaining costs of US$99 million are primarily in respect of asset impairment and exit charges, the Group's share of which is £25 million (net of tax).

2014

In 2014, the Group's interest in ITC decreased from 30.47% to 30.26% as a result of ITC issuing ordinary shares under the company's Employee Share Option Scheme. This resulted in a gain of £14 million, which was treated as a deemed partial disposal and included in the Group Income Statement.

RAI also recognised amounts that have been combined in the table of adjusting items in the Group Income Statement and are shown as "other". These are costs in respect of a number of Engle progeny lawsuits and other tobacco litigation charges that amount to US$102 million, the Group's share of which is £16 million (net of tax). RAI recognised income of US$34 million related to the 2013 MSA liability as an adjusting item. The Group's share of this income amounted to £5 million (net of tax). RAI recognised a net gain from discontinued activities of US$25 million, reduced by restructuring activities of US$16 million, resulting in a net gain of US$9 million. The Group's share of this net gain amounted to £4 million (net of tax).

(b) Master Settlement Agreement

In 1998, the major US cigarette manufacturers (including R.J. Reynolds and Brown & Williamson) entered into the Master Settlement Agreement (MSA) with attorney generals representing most US states and territories. The MSA imposes a perpetual stream of future payment obligations on the major US cigarette manufacturers. The amounts of money that the participating manufacturers are required to annually contribute are based upon, among other things, the volume of cigarettes sold and market share (based on cigarette shipments in that year). Given these facts, the Group's accounting for the MSA payments is to accrue for them in the cost of products sold as the products are shipped and no provision is made in respect of potential payments relating to future years. The event which gives rise to the obligation is the actual sale of products shipped and the MSA payments are therefore recognised as part of the costs of those business operations.

During 2013, RAI, various other tobacco manufacturers, 19 states, the District of Columbia and Puerto Rico reached a final agreement related to RAI's 2003 MSA activities. Under this agreement RAI will receive credits, currently estimated to be more than US$1 billion, in respect of its NPM Adjustment claims related to the period from 2003 to 2012. These credits will be applied against the company's MSA payments over a period of five years from 2013, subject to, and dependent upon, meeting the various ongoing performance obligations.

During 2014, two additional states agreed to settle NPM disputes related to claims for the period 2003 to 2012. It is estimated that RAI will receive US$170 million in credits, which will be applied over a five-year period from 2014.

During 2015, another state agreed to settle NPM disputes related to claims for the period 2004 to 2014. It is estimated that RAI will receive US$285 million in credits, which will be applied over a four-year period from 2015.

Credits in respect of future years' payments and the NPM Adjustment claims would be accounted for in the applicable year and will not be treated as adjusting items. Only credits in respect of prior year payments are included as adjusting items.

Notes on the Accounts continued

5 Associates and joint ventures continued

(c) Other financial information

	2015 Group's share £m	2014 Group's share £m
Profit on ordinary activities after taxation		
– attributable to owners of the Parent	**1,236**	719
Other comprehensive income:		
Differences on exchange	**336**	113
Net fair value gains on available-for-sale investments	**1**	15
Actuarial gains/(losses) relating to pensions and other post-retirement benefits (note 20)	**3**	(124)
Total comprehensive income (note 11)	**1,576**	723

	2015 Group's share £m	2014 Group's share £m
Dividends received		
– listed investments	**635**	510
– unlisted investments	**5**	8
Total dividends received from associates	**640**	518

Summarised financial information of the Group's associates and joint ventures:

	2015				2014			
	RAI £m	ITC £m	Others £m	Total £m	RAI £m	ITC £m	Others £m	Total £m
Revenue	**6,986**	**3,839**	**361**	**11,186**	5,132	3,777	292	9,201
Profit on ordinary activities before taxation	**4,250**	**1,505**	**27**	**5,782**	1,551	1,389	57	2,997
Post-tax results of associates and joint ventures	**2,203**	**1,005**	**17**	**3,225**	1,000	938	42	1,980
Other comprehensive income	**684**	**43**	**(24)**	**703**	(166)	184	(29)	(11)
Total comprehensive income	**2,887**	**1,048**	**(7)**	**3,928**	834	1,122	13	1,969

6 Taxation on ordinary activities

(a) Summary of taxation on ordinary activities

	2015 £m	2014 £m
UK corporation tax	**5**	–
Overseas tax	**1,324**	1,450
Comprising:		
– current year tax expense	**1,317**	1,439
– adjustments in respect of prior periods	**7**	11
Total current tax	**1,329**	1,450
Deferred tax	**4**	5
Comprising:		
– deferred tax relating to origination and reversal of temporary differences	**(11)**	7
– deferred tax relating to changes in tax rates	**15**	(2)
	1,333	1,455

(b) Franked Investment Income Group Litigation Order

British American Tobacco is the principal test claimant in an action in the UK against HM Revenue and Customs (HMRC) in the Franked Investment Income Group Litigation Order (FII GLO). There are 25 corporate groups in the FII GLO. The case concerns the treatment for UK corporation tax purposes of profits earned overseas and distributed to the UK. The claim was filed in 2003 and the case was heard in the European Court of Justice (ECJ) in 2005 and a decision of the ECJ received in December 2006. In July 2008, the case reverted to a trial in the UK High Court for the UK Court to determine how the principles of the ECJ decision should be applied in a UK context.

The High Court judgment in November 2008 concluded, among other things, that the corporation tax provisions relating to dividend income from EU subsidiaries breached EU law. It also concluded that certain dividends received before 5 April 1999 from the EU and, in some limited circumstances after 1993 from outside the EU, should have been creditable against advance corporation tax (ACT) liabilities with the consequence that ACT need not have been paid. Claims for the repayment of UK tax incurred where the dividends were from the EU were allowed back to 1973.

The case was heard by the Court of Appeal in October 2009 and the judgment handed down on 23 February 2010. The Court of Appeal determined that various questions, including which companies in the corporate tree can be included in a claim, should be referred back to the ECJ for further clarification. In addition, the Court determined that the claim should be restricted to six years and not cover claims dating back to 1973.

The issue of time limits was heard by the Supreme Court in February 2012 and in May 2012 the Supreme Court decided in British American Tobacco Group's favour, that claims submitted before 8 September 2003 can go back to 1973. A hearing took place in February 2012 at the ECJ on the questions referred from the Court of Appeal.

The ECJ judgment of 13 November 2012 confirms that the UK treatment of EU dividends was discriminatory and produces the same outcome for third country dividends from 1994 in certain circumstances. The judgment also confirms that the claim can cover dividends from all indirect as well as direct EU subsidiaries and also ACT paid by a superior holding company.

The detailed technical issues of the quantification mechanics of the claim were heard by the High Court during May and June 2014 and the judgment handed down on 18 December 2014. The High Court determined that in respect of issues concerning the calculation of unlawfully charged corporation tax and ACT, the law of restitution including the defence on change of position and questions concerning the calculation of overpaid interest, the approach of the British American Tobacco Group was broadly preferred. The conclusion reached by the High Court would, if upheld, produce an estimated receivable of £1.2 billion for British American Tobacco. Appeals on a majority of the issues have been made to the Court of Appeal, which is likely to hear the case in 2016.

During 2015, HMRC paid to the Group a gross amount of £1,224 million in two separate payments. The payments made by HMRC have been made without any admission of liability and are subject to refund were HMRC to succeed on appeal. The second payment in November 2015 followed the introduction of a new 45% tax on the interest component of restitution claims against HMRC. HMRC held back £261 million from the second payment contending that it represents the new 45% tax on that payment, leading to total cash received by the Group of £963 million. Actions challenging the legality of the 45% tax have been lodged by both the Group and other participants in the FII GLO.

Due to the uncertainty of the amounts and eventual outcome the Group has not recognised any impact in the Group Income Statement in the current or prior period. The receipt, net of the deduction by HMRC, is held as deferred income as disclosed in note 23. Any future recognition as income will be treated as an adjusting item, due to the size of the order, with interest accruing on the balance (£8 million in 2015) also treated as an adjusting item.

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% (2014: 21%) rate of corporation tax in the UK. The major causes of this difference are listed below:

	2015		2014	
	£m	%	£m	%
Profit before tax	5,855		4,848	
Less: share of post-tax results of associates and joint ventures	(1,236)		(719)	
	4,619		4,129	
Tax at 20% (2014: 21%) on the above	924	20.0	867	21.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	231	5.0	236	5.7
Other national tax charges	77	1.7	69	1.7
Permanent differences	(119)	(2.6)	29	0.7
Overseas withholding taxes	145	3.1	157	3.8
Double taxation relief on UK profits	(6)	(0.1)	(9)	(0.2)
Unutilised tax losses	32	0.7	45	1.1
Adjustments in respect of prior periods	7	0.2	11	0.2
Deferred tax relating to changes in tax rates	15	0.3	(2)	–
Additional net deferred tax charges	27	0.6	52	1.2
	1,333	28.9	1,455	35.2

(d) Adjusting items included in taxation

IFRS requires entities to provide deferred taxation on the undistributed earnings of associates and joint ventures. The Group's share of the gain on the divestiture of intangibles and other assets by RAI to ITG Brands LLC, a subsidiary of Imperial Tobacco Group PLC, is £371 million. Given that the profit on this item is recognised as an adjusting item by the Group, the additional deferred tax charge of £22 million on the potential distribution of these undistributed earnings has also been treated as adjusting.

(e) Tax on adjusting items

In addition, the tax on adjusting items, separated between the different categories, as per note 7, amounted to £80 million (2014: £69 million). As described in note 4(b) the Group's investment of US$4.7 billion in cash in RAI has realised a deemed gain of US$931 million (£601 million). This gain is reflected as a permanent difference in note 6(c). The adjustment to the adjusted earnings per share (see note 7) also includes £3 million (2014: £5 million) in respect of the non-controlling interests' share of the adjusting items net of tax.

(f) Tax on items recognised directly in other comprehensive income

	2015 £m	2014 £m
Current tax	7	17
Deferred tax	(9)	94
(Charged)/credited to other comprehensive income	(2)	111

The tax relating to each component of other comprehensive income is disclosed in note 20.

7 Earnings per share

Basic earnings per share are based on profit for the year attributable to ordinary shareholders of £4,290 million (2014: £3,115 million) and 1,858 million (2014: 1,864 million) ordinary shares of 25p each, being the weighted average number of shares in issue during the year (excluding shares held as treasury shares).

For the calculation of diluted earnings per share, the weighted average number of shares in issue is increased to 1,863 million (2014: 1,870 million) to reflect the potential dilutive effect of employee share schemes.

	2015			2014		
	Earnings £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	4,290	1,858	230.9	3,115	1,864	167.1
Share options	–	5	(0.6)	–	6	(0.5)
Diluted earnings per share	4,290	1,863	230.3	3,115	1,870	166.6

Earnings have been affected by a number of adjusting items, which are described in notes 3 to 6. To illustrate the impact of these items, an adjusted earnings per share calculation is shown below.

Adjusted earnings per share calculation

		Diluted				Basic			
		2015		2014		2015		2014	
	Notes	Earnings £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		4,290	230.3	3,115	166.6	4,290	230.9	3,115	167.1
Effect of restructuring and integration costs	3(e)	367	19.7	452	24.2	367	19.7	452	24.2
Tax and non-controlling interests on restructuring and integration costs		(74)	(4.0)	(67)	(3.6)	(74)	(4.0)	(67)	(3.6)
Effect of amortisation of trademarks and similar intangibles	3(f)	65	3.5	58	3.1	65	3.5	58	3.1
Tax on amortisation of trademarks and similar intangibles		(9)	(0.5)	(7)	(0.4)	(9)	(0.5)	(7)	(0.4)
Effect of Fox River	3(g)	–	–	(27)	(1.4)	–	–	(27)	(1.4)
Effect of Flintkote	3(h)	3	0.2	374	20.0	3	0.2	374	20.1
Effect of deemed gain related to investment in RAI	4(b)	(601)	(32.3)	–	–	(601)	(32.3)	–	–
Effect of additional deferred tax charge from gain on divestiture of assets by RAI to ITG	6(d)	22	1.2	–	–	22	1.2	–	–
Effect of interest on FII GLO settlement	4(b)	8	0.4	–	–	8	0.4	–	–
Effect of certain costs and fees related to the acquisition of non-controlling interests in Souza Cruz and investment in RAI	4(b)	104	5.6	–	–	104	5.6	–	–
Effect of associates' adjusting items net of tax	5(a)	(293)	(15.7)	(7)	(0.4)	(293)	(15.8)	(7)	(0.4)
Adjusted earnings per share		3,882	208.4	3,891	208.1	3,882	208.9	3,891	208.7

Headline earnings per share as required by the JSE Limited

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 2/2015 'Headline Earnings', as issued by the South African Institute of Chartered Accountants. There is no impact of the new circular on the prior year headline earnings per share.

Notes on the Accounts continued

7 Earnings per share continued

	Diluted				Basic			
	2015		2014		2015		2014	
	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	4,290	230.3	3,115	166.6	4,290	230.9	3,115	167.1
Effect of impairment of intangibles, property, plant and equipment, and assets held-for-sale	27	1.4	107	5.7	27	1.4	107	5.7
Tax and non-controlling interests on impairment of intangibles, and property, plant and equipment	(6)	(0.3)	(20)	(1.0)	(6)	(0.3)	(20)	(1.0)
Effect of gains on disposal of property, plant and equipment and held-for-sale assets	(60)	(3.2)	(34)	(1.9)	(60)	(3.2)	(34)	(1.8)
Tax and non-controlling interests on disposal of property, plant and equipment and held-for-sale assets	19	1.0	9	0.5	19	1.0	9	0.5
Effect of gains reclassified from the available-for-sale reserve	(10)	(0.6)	–	–	(10)	(0.6)	–	–
Tax and non-controlling interests on losses/(gains) reclassified from the available-for-sale reserve	3	0.2	–	–	3	0.2	–	–
Share of associates' impairment losses and non-current investments	17	0.9	–	–	17	0.9	–	–
Share of associates' gains on disposal of assets held-for-sale	(371)	(19.9)	–	–	(371)	(19.9)	–	–
Tax effect of associates' disposal of assets held-for-sale	22	1.2	–	–	22	1.2	–	–
Issue of shares and change in shareholding in associate	(22)	(1.2)	(14)	(0.8)	(22)	(1.2)	(14)	(0.8)
Headline earnings per share	3,909	209.8	3,163	169.1	3,909	210.4	3,163	169.7

An alternative measure of headline earnings per share has been presented below to take account of the effects of Fox River (note 3(g)), Flintkote (note 3(h)) and adjusting items in net finance (income)/costs (note 4(b)); this measure is in addition to and not mandated by the JSE Listing Requirements:

Headline earnings per share amended for adjusting items in net finance (income)/costs, Fox River and Flintkote	3,415	183.3	3,510	187.7	3,415	183.9	3,510	188.4

8 Dividends and other appropriations

	2015		2014	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim				
2015 paid 30 September 2015	49.4	908		
2014 paid 30 September 2014			47.5	881
Final				
2014 paid 7 May 2015	100.6	1,862		
2013 paid 8 May 2014			97.4	1,831
	150.0	2,770	144.9	2,712

The Directors have recommended to shareholders a final dividend of 104.6 pence per share for the year ended 31 December 2015. If approved, this dividend will be paid to shareholders on 5 May 2016. This dividend is subject to approval by shareholders at the Annual General Meeting and therefore, in accordance with IAS 10 *Events After the Reporting Period*, it has not been included as a liability in these financial statements. The total estimated dividend to be paid is £1,943 million, which takes the total dividends declared in respect of 2015 to £2,851 million (2014: £2,747 million) representing 154.0 pence per share (2014: 148.1 pence per share).

9 Intangible assets

	Goodwill* £m	Computer software £m	Trademarks and similar intangibles £m	Assets in the course of development £m	Total £m
1 January 2015					
Cost	**9,842**	**735**	**844**	**305**	**11,726**
Accumulated amortisation and impairment		**(530)**	**(392)**		**(922)**
Net book value at 1 January 2015	**9,842**	**205**	**452**	**305**	**10,804**
Differences on exchange	**(681)**	**(3)**	**(36)**	**–**	**(720)**
Additions					
– internal development	**–**	**1**	**–**	**102**	**103**
– acquisitions (note 26)	**163**	**–**	**237**	**–**	**400**
– separately acquired	**–**	**2**	**–**	**–**	**2**
Reallocations	**–**	**225**	**2**	**(227)**	**–**
Amortisation charge	**–**	**(66)**	**(68)**	**–**	**(134)**
Impairment	**–**	**(10)**	**(4)**	**–**	**(14)**
Disposals	**–**	**(5)**	**–**	**–**	**(5)**
31 December 2015					
Cost	**9,324**	**918**	**1,015**	**180**	**11,437**
Accumulated amortisation and impairment		**(569)**	**(432)**		**(1,001)**
Net book value at 31 December 2015	**9,324**	**349**	**583**	**180**	**10,436**
1 January 2014					
Cost	10,249	631	891	283	12,054
Accumulated amortisation and impairment		(496)	(353)		(849)
Net book value at 1 January 2014	10,249	135	538	283	11,205
Differences on exchange	(407)	(3)	(31)	–	(441)
Additions					
– internal development	–	16	–	143	159
– separately acquired	–	4	3	–	7
Reallocations	–	121	–	(121)	–
Amortisation charge	–	(56)	(58)	–	(114)
Impairment	–	(12)	–	–	(12)
31 December 2014					
Cost	9,842	735	844	305	11,726
Accumulated amortisation and impairment		(530)	(392)		(922)
Net book value at 31 December 2014	9,842	205	452	305	10,804

* The cost of goodwill is shown net of impairment charges made in prior years.

Included in computer software and assets in the course of development are internally developed assets with a carrying value of £517 million (2014: £493 million). The costs of internally developed assets include capitalised expenses of employees working full time on software development projects, third party consultants, as well as software licence fees from third party suppliers.

Included in the net book value of trademarks and similar intangibles are trademarks relating to the acquisition of TDR d.o.o. £144 million, Sudan £34 million, Chic Group £45 million, Skandinavisk Tobakskompagni (ST) £229 million (2014: £262 million), Tekel £19 million (2014: £25 million), Bentoel £19 million (2014: £30 million) and Protabaco £54 million (2014: £72 million) and intellectual property of £nil (2014: £13 million) relating to the acquisition of CN Creative Limited in 2012.

The Group has future contractual commitments of £15 million (2014: £10 million) related to intangible assets.

Notes on the Accounts continued

9 Intangible assets continued

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £9,324 million (2014: £9,842 million) is included in intangible assets in the Group Balance Sheet of which the following are the significant acquisitions: Rothmans Group £4,131 million (2014: £4,384 million); Imperial Tobacco Canada £1,964 million (2014: £2,223 million); ETI (Italy) £1,216 million (2014: £1,280 million) and ST (principally Scandinavia) £913 million (2014: £963 million). The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of Eastern Europe, Western Europe and South Africa, with the remainder mainly relating to operations in the domestic and export markets in the UK and operations in Asia-Pacific.

In 2015 and 2014, goodwill was allocated for impairment testing purposes to 14 individual cash-generating units – five in Asia-Pacific, five in the Americas, two in Western Europe and two in EEMEA.

The carrying amounts of goodwill allocated to the cash-generating units of Canada £1,964 million (2014: £2,223 million), Western Europe (includes Rothmans and other acquisitions) £3,249 million (2014: £3,388 million), Eastern Europe (includes Rothmans and other acquisitions) £832 million (2014: £851 million), South Africa £485 million (2014: £614 million), Australia (includes Rothmans and other acquisitions) £661 million (2014: £703 million), Singapore £511 million (2014: £517 million) and Malaysia £372 million (2014: £432 million) are considered significant in comparison with the total carrying amount of goodwill.

The recoverable amounts of all cash-generating units have been determined on a value-in-use basis. The key assumptions for the recoverable amounts of all units are the budgeted volumes, operating margins and long-term growth rates, which directly impact the cash flows, and the discount rates used in the calculation. The long-term growth rate used is purely for the impairment testing of goodwill under IAS 36 *Impairment of Assets* and does not reflect long-term planning assumptions used by the Group for investment proposals or for any other assessments. The discount rate is based on the Group's weighted average cost of capital, taking into account the cost of capital and borrowings, to which specific market-related premium adjustments are made. These adjustments are derived from external sources and are based on the spread between bonds (or credit default swaps, or similar indicators) issued by the US or comparable governments and by the local government, adjusted for the Group's own credit market risk. For ease of use and consistency in application, these results are periodically calibrated into bands based on internationally recognised credit ratings. The long-term growth rates and discount rates have been applied to the budgeted cash flows of each cash-generating unit. These cash flows have been determined by local management based on experience, specific market and brand trends, pricing expectations and costs, and have been endorsed by Group management as part of the consolidated Group budget.

The valuations use cash flows based on detailed financial budgets prepared by management covering a one-year period, with growth in year 2 of 5% (2014: 5%). Cash flows for the years 3 to 10 are extrapolated from year 2 cash flows of each relevant operating unit at 4% (2014: 4%) per annum, including 1% (2014: 1%) inflation, where after a total growth rate of 2% (2014: 2%) per annum (including 2% (2014: 2%) inflation) has been assumed. The extrapolated growth rates are considered conservative given the Group's history of profit and cash growth, its well balanced portfolio of brands and the industry in which it operates. The long-term real growth does not exceed the expected long-term average growth rate for the combined markets in which the cash-generating units operate. In some instances, such as recent acquisitions, start-up ventures or in other specific cases, the valuation is expanded to reflect the medium-term plan of the country or market management, spanning five years or beyond.

Pre-tax discount rates of between 7.2% and 14.7% (2014: 7.2% to 15.0%) were used, based on the Group's weighted average cost of capital, together with any premium applicable for economic and political risks.

The pre-tax discount rates used for the cash-generating units which are significant in comparison with the total carrying amount of goodwill are 8.5% for Canada (2014: 8.5%), 8.6% for Western Europe (2014: 8.6%), 8.5% for Eastern Europe (2014: 8.5%), 9.6% for South Africa (2014: 9.6%), 8.6% for Australia (2014: 8.6%), 7.2% for Singapore (2014: 7.2%) and 8.7% for Malaysia (2014: 8.7%).

If discounted cash flows for cash-generating units should fall by 10%, or the discount rate was increased at a post-tax rate of 1%, there would be no impairment.

10 Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £m
1 January 2015					
Cost	998	260	4,109	570	5,937
Accumulated depreciation and impairment	(343)	(132)	(2,439)	(19)	(2,933)
Net book value at 1 January 2015	655	128	1,670	551	3,004
Differences on exchange	(62)	–	(125)	(62)	(249)
Additions					
– acquisitions (note 26)	76	–	23	4	103
– separately acquired	6	7	129	353	495
Reallocations	23	9	211	(243)	–
Depreciation	(19)	(10)	(242)	–	(271)
Impairment	–	(2)	(17)	7	(12)
Disposals	(15)	(2)	(15)	(8)	(40)
Net reclassifications as held-for-sale	(8)	–	(1)	–	(9)
31 December 2015					
Cost	944	256	3,976	617	5,793
Accumulated depreciation and impairment	(288)	(126)	(2,343)	(15)	(2,772)
Net book value at 31 December 2015	656	130	1,633	602	3,021
1 January 2014					
Cost	1,034	258	4,257	527	6,076
Accumulated depreciation and impairment	(325)	(123)	(2,460)	(12)	(2,920)
Net book value at 1 January 2014	709	135	1,797	515	3,156
Differences on exchange	(45)	(1)	(138)	(33)	(217)
Additions	9	1	74	414	498
Reallocations	55	12	274	(341)	–
Depreciation	(20)	(9)	(278)	–	(307)
Impairment	(40)	(8)	(36)	(3)	(87)
Disposals	(13)	(2)	(12)	(1)	(28)
Net reclassifications as held-for-sale	–	–	(11)	–	(11)
31 December 2014					
Cost	998	260	4,109	570	5,937
Accumulated depreciation and impairment	(343)	(132)	(2,439)	(19)	(2,933)
Net book value at 31 December 2014	655	128	1,670	551	3,004
Assets held under finance leases					
31 December 2015					
Cost		4	29	1	34
Accumulated depreciation and impairment		–	(10)	–	(10)
Net book value at 31 December 2015		4	19	1	24
31 December 2014					
Cost		–	17	–	17
Accumulated depreciation and impairment		–	(8)	–	(8)
Net book value at 31 December 2014		–	9	–	9

The Group's finance lease arrangements relate principally to the lease of vehicles and tobacco vending machines by the Group's subsidiaries in Canada and Japan respectively. In 2014, the Group's finance lease arrangements related principally to the lease of vehicles and tobacco vending machines by the Group's subsidiaries in Pakistan and Japan respectively. Assets held under finance leases are secured under finance lease obligations included in note 21.

Notes on the Accounts continued

10 Property, plant and equipment continued

As explained in note 12, contributions to the British American Tobacco UK Pension Fund are secured by a charge over the Group's Head Office (Globe House). Globe House is included in freehold property above with a carrying value of £189 million (2014: £191 million).

	2015 £m	2014 £m
Cost of freehold land within freehold property on which no depreciation is provided	**193**	200
Leasehold property comprises		
– net book value of long leasehold	**119**	113
– net book value of short leasehold	**11**	15
	130	128
Contracts placed for future expenditure	**71**	121

11 Investments in associates and joint ventures

	2015 £m	2014 £m
1 January	**2,400**	2,299
Total comprehensive income (note 5)	**1,576**	723
Dividends (note 5)	**(640)**	(518)
Share buy-backs (note 25(d))	**–**	(94)
Additions	**3,628**	–
Other equity movements	**(26)**	(10)
31 December	**6,938**	2,400
Non-current assets	**14,800**	4,070
Current assets	**2,818**	1,798
Non-current liabilities	**(8,692)**	(2,099)
Current liabilities	**(1,988)**	(1,369)
	6,938	2,400
Reynolds American Inc. (Group's share of the market value is £18,850 million (2014: £9,205 million))	**5,749**	1,361
ITC Ltd. (Group's share of the market value is £8,112 million (2014: £9,001 million))	**1,136**	991
Other listed associates (Group's share of the market value is £86 million (2014: £98 million))	**14**	13
Unlisted associates	**39**	35
	6,938	2,400

The principal associate undertakings of the Group are Reynolds American Inc. (RAI) and ITC Ltd. (ITC) as shown under principal associate undertakings.

Reynolds American Inc.

	2015 £m	2014 £m
Non-current assets	**28,666**	4,481
Current assets	**4,242**	2,193
Non-current liabilities	**(20,430)**	(4,838)
Current liabilities	**(3,459)**	(2,162)
	9,019	(326)
Group's share of Reynolds American Inc. (42.2%)	**3,804**	(137)
Goodwill	**1,945**	1,498
Total Group's share of Reynolds American Inc.	**5,749**	1,361

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 & Williamson (B&W), one of its subsidiaries, with R.J. Reynolds. This combination resulted in the formation of RAI, which was 58% owned by R.J. Reynolds' shareholders and 42% owned by the Group. The Group has concluded that it does not have de facto control of RAI because of the operation of the governance agreement between the Group and RAI which ensures that the Group does not have the practical ability to direct the relevant activities of RAI; in particular, the Group cannot nominate more than five of the Directors (out of 13 or proportionally less if there are less than 13 Directors) unless it owns 100% of RAI or some other party owns more than 50%. In addition, there are no other contractual arrangements which would give the Group the ability to direct RAI's operations. Manufacturing and cooperation agreements between RAI and the Group have been agreed on an arm's length basis (see note 29).

On 12 June 2015, RAI completed its acquisition of Lorillard, Inc. (Lorillard) and related divestiture transactions to ITG Brands LLC, a subsidiary of Imperial Tobacco Group PLC, after receiving the required regulatory approval. At the same time, the intention of which was announced on 15 July 2014, the Group invested US$4.7 billion (£3.0 billion) of cash in RAI to maintain its 42% equity position in the enlarged business.

The Group has recognised a deemed gain of US$931 million (£601 million), as part of the cost of investment. This has arisen as the contract to acquire shares is deemed to be a financial instrument and was fair valued through the profit and loss, in compliance with IAS 39 *Financial Instruments: Recognition and Measurement*. This has been treated as an adjusting item, in line with the Group's policy as described in note 4. Goodwill of US$529 million (£336 million) has also been recognised, being the difference between the Group's share of the net assets acquired by RAI, and the deemed fair value of the consideration paid.

RAI recognised a gain on divestiture of assets of US$3,288 million. The Group's share of this net gain amounted to £371 million (net of tax). This has been treated as an adjusting item, in line with the Group's policy, as described in note 5.

The Group's share of RAI includes £427 million (2014: £472 million) of trademarks arising from the RAI transaction in 2004. The Group's share of non-current assets also includes £708 million (2014: £667 million) of goodwill and £327 million (2014: £308 million) of trademarks arising from the acquisition of Conwood by RAI in 2006. In addition, the Group's share of non-current assets includes £7,784 million of trademarks arising from the acquisition of Lorillard by RAI in 2015.

The Group's share of the RAI results for the year to 31 December 2015 includes £55 million (2014: £46 million) in respect of external legal fees and other external product liability defence costs.

Details of the Group's contingent liabilities are set out in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, RAI group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

ITC Ltd.

ITC prepares accounts on a quarterly basis with a 31 March year-end. As permitted by IAS 28 *Investments in Associates and Joint Ventures*, results up to 30 September 2015 have been used in applying the equity method. This is driven by the availability of information at the half year, to be consistent with the treatment in the Group's interim accounts. Any further information available after the date used for reporting purposes is reviewed and any material items adjusted for in the final results. The latest published information available is at 31 December 2015.

	2015 £m	2014 £m
Non-current assets	**2,432**	2,201
Current assets	**3,044**	2,713
Non-current liabilities	**(250)**	(212)
Current liabilities	**(1,447)**	(1,428)
	3,779	3,274
Group's share of ITC Ltd. (2015: 30.06% (2014: 30.26%))	**1,136**	991

Additional information on associates is provided in the 'Group Companies and Undertakings' section to the Annual Report on pages 206 to 212.

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. As a result of regulatory changes, with effect from 1 January 2015, the schemes in the Netherlands now accrue benefits based on lifetime average salaries.

In addition, the Group operates several healthcare benefit schemes, of which the most significant are in Canada. The liabilities in respect of healthcare benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

All of these arrangements, including funded schemes where formal trusts or equivalents are required, have been developed and are operated in accordance with local practices and regulations where applicable in the countries concerned. For example, in the UK, the main pension scheme is the British American Tobacco UK Pension Fund, which is established under trust law and has a corporate trustee that is required to run the scheme in accordance with the Scheme's Trust Deed and Rules and to comply with the Pension Scheme Act 1993, Pensions Act 1995, Pension Act 2004 and all the relevant legislation.

Responsibility for the governance of the schemes, including investment decisions and contribution schedules, lies with the trustees. The trustees for each arrangement will usually consist of representatives appointed by both the sponsoring company and the beneficiaries.

The majority of schemes are subject to local regulation regarding funding deficits. Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes and after taking into account regulatory requirements.

Contributions to the British American Tobacco UK Pension Fund have been agreed with the Trustee as part of a recovery plan to include £30 million a year to cover ongoing service costs and additional contributions to eliminate a funding shortfall. Additional contributions were £148 million in 2015 and £140 million in 2014 and are planned to be £78 million in each of 2016, 2017 and 2018. These contributions will be used to achieve the statutory funding objective and thereafter to support attaining a lower risk investment strategy (noted below) and may be subject to renegotiation, dependent on funding levels. Total contributions payable are secured by a charge over the Group's Head Office (Globe House) up to a maximum of £150 million. The charge would be triggered in the event that the Group defaults on agreed contributions due to the Fund or if an insolvency event occurs with respect to the UK entity responsible for making the payments. The charge is due to be released in 2039 but may be released earlier by negotiation or if the assets of the Fund are sufficient to achieve certain funding levels. Under the rules of the scheme, any future surplus would be returnable to the Group by refund at the end of the life of the scheme. The funding commitment is therefore not considered onerous and in accordance with IFRIC 14 no additional liabilities have been recognised in respect of this commitment.

Payments made to pensioners by the operating companies in Germany, net of income on scheme assets, are deemed to be company contributions to the Contractual Trust Arrangements and are anticipated to be around £33 million in 2016 and then £31 million per annum for the next following four years. Contributions to pension schemes in Canada, the Netherlands and Switzerland in total are anticipated to be around £19 million in 2016 and then £11 million per annum for the next following four years. Group contributions to pension schemes in 2016 are expected to be £173 million in total compared to £262 million in 2015.

The majority of benefit payments are from trustee administered funds; however, there are also a number of unfunded schemes where the sponsoring company meets the benefit payment obligation as it falls due. For unfunded schemes in the UK and Canada, 33% of the liabilities reported at year-end are expected to be settled by the Group within 10 years, 28% between 10 and 20 years, 20% between 20 and 30 years, and 19% thereafter.

The funded arrangements in the Group have policies on investment management, including strategies over a preferred long-term investment profile, and schemes in certain territories including Canada and the Netherlands manage their bond portfolios to match the weighted average duration of scheme liabilities. In addition, the main scheme in the UK has a target investment strategy such that, by 31 December 2018, the scheme will have moved to 20% return-seeking assets and 80% risk-reducing assets. Investments are diversified by type of investment, by investment sector, and where appropriate by country.

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 Group Balance Sheet are determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2015 £m	2014 £m	**2015 £m**	2014 £m	**2015 £m**	2014 £m
Present value of funded scheme liabilities	**(5,944)**	(6,594)	**(12)**	(15)	**(5,956)**	(6,609)
Fair value of funded scheme assets	**6,076**	6,253	**10**	13	**6,086**	6,266
	132	(341)	**(2)**	(2)	**130**	(343)
Unrecognised funded scheme surpluses	**(11)**	(13)	**–**	–	**(11)**	(13)
	121	(354)	**(2)**	(2)	**119**	(356)
Present value of unfunded scheme liabilities	**(276)**	(287)	**(88)**	(98)	**(364)**	(385)
	(155)	(641)	**(90)**	(100)	**(245)**	(741)

The above net liability is recognised in the Group Balance Sheet as follows:

– retirement benefit scheme liabilities	**(563)**	(681)	**(90)**	(100)	**(653)**	(781)
– retirement benefit scheme assets	**408**	40	**–**	–	**408**	40
	(155)	(641)	**(90)**	(100)	**(245)**	(741)

The net liabilities of funded pension schemes by territory are as follows:

	Liabilities		Assets		Total	
	2015 £m	2014 £m	**2015 £m**	2014 £m	**2015 £m**	2014 £m
– UK	**(2,995)**	(3,217)	**3,291**	3,198	**296**	(19)
– Germany	**(822)**	(929)	**704**	733	**(118)**	(196)
– Canada	**(654)**	(753)	**661**	762	**7**	9
– Netherlands	**(588)**	(704)	**641**	685	**53**	(19)
– Switzerland	**(347)**	(349)	**278**	272	**(69)**	(77)
– Rest of Group	**(538)**	(642)	**501**	603	**(37)**	(39)
Funded schemes	**(5,944)**	(6,594)	**6,076**	6,253	**132**	(341)

Of the Group's unfunded pension schemes 62% (2014: 57%) relate to arrangements in the UK, while 79% (2014: 81%) of the Group's unfunded healthcare arrangements relate to arrangements in Canada.

Notes on the Accounts continued

12 Retirement benefit schemes continued

The amounts recognised in the Group Income Statement are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015 £m	2014 £m	**2015 £m**	2014 £m	**2015 £m**	2014 £m
Defined benefit schemes						
Service cost						
– current service cost	**85**	81	**1**	1	**86**	82
– past service cost	**(10)**	(2)	**–**	(3)	**(10)**	(5)
Net interest on the net defined benefit liability						
– interest on scheme liabilities	**215**	261	**5**	6	**220**	267
– interest on scheme assets	**(201)**	(252)	**(1)**	(1)	**(202)**	(253)
– interest on unrecognised funded scheme surpluses	**1**	1	**–**	–	**1**	1
	90	89	**5**	3	**95**	92
Defined contribution schemes	**43**	40	**–**	–	**43**	40
Total amount recognised in the Income Statement (note 3(a))	**133**	129	**5**	3	**138**	132

The above charges are recognised within employee benefit costs in note 3(a) and include a charge of £16 million in 2015 (2014: £4 million charge) in respect of settlements, past service costs and defined contribution costs reported as part of the restructuring costs charged in arriving at profit from operations (see note 3(e)).

The amounts recognised in other comprehensive income in respect of actuarial gains and losses of subsidiaries are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015 £m	2014 £m	**2015 £m**	2014 £m	**2015 £m**	2014 £m
Actuarial gains/(losses) on scheme liabilities	**378**	(878)	**(1)**	(6)	**377**	(884)
Actuarial (losses)/gains on scheme assets	**(94)**	456	**–**	–	**(94)**	456
Net actuarial gains/(losses) in other comprehensive income (note 20)	**284**	(422)	**(1)**	(6)	**283**	(428)

The amounts recognised in other comprehensive income in respect of surplus restrictions of subsidiaries are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015 £m	2014 £m	**2015 £m**	2014 £m	**2015 £m**	2014 £m
Movements in the year (note 20)	**–**	7	**–**	–	**–**	7

12 Retirement benefit schemes continued

The movements in scheme liabilities are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 £m	2014 £m
Present value at 1 January	**6,881**	6,144	**113**	114	**6,994**	6,258
Differences on exchange	**(215)**	(142)	**(13)**	(4)	**(228)**	(146)
Current service cost	**86**	80	**1**	1	**87**	81
Past service cost	**(9)**	(2)	**–**	(3)	**(9)**	(5)
Settlements	**(20)**	–	**–**	–	**(20)**	–
Interest on scheme liabilities	**211**	258	**4**	6	**215**	264
Contributions by scheme members	**3**	4	**–**	–	**3**	4
Benefits paid	**(339)**	(339)	**(6)**	(7)	**(345)**	(346)
Actuarial (gains)/losses	**(378)**	878	**1**	6	**(377)**	884
Present value at 31 December	**6,220**	6,881	**100**	113	**6,320**	6,994
Scheme liabilities by scheme membership:						
Active members	**1,139**	1,354	**20**	23	**1,159**	1,377
Deferred members	**900**	1,080	**2**	8	**902**	1,088
Retired members	**4,181**	4,447	**78**	82	**4,259**	4,529
Present value at 31 December	**6,220**	6,881	**100**	113	**6,320**	6,994

Approximately 95% of scheme liabilities in both years relate to guaranteed benefits.

Actuarial (gains)/losses shown above can be analysed as follows:

	Pension schemes		Healthcare schemes		Total	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 £m	2014 £m
Actuarial (gains)/losses:						
– arising from changes in demographic assumptions	**13**	120	**–**	3	**13**	123
– arising from changes in financial assumptions	**(335)**	766	**1**	6	**(334)**	772
Experience gains	**(56)**	(8)	**–**	(3)	**(56)**	(11)
Total	**(378)**	878	**1**	6	**(377)**	884

Changes in financial assumptions principally relate to discount rate movements in both years.

The movements in funded scheme assets are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 £m	2014 £m
Fair value of scheme assets at 1 January	**6,253**	5,767	**13**	13	**6,266**	5,780
Differences on exchange	**(209)**	(141)	**(3)**	(1)	**(212)**	(142)
Settlements	**(19)**	–	**–**	–	**(19)**	–
Interest on scheme assets	**197**	249	**1**	1	**198**	250
Company contributions	**262**	241	**–**	–	**262**	241
Contributions by scheme members	**4**	4	**–**	–	**4**	4
Benefits paid	**(318)**	(323)	**(1)**	–	**(319)**	(323)
Actuarial (losses)/gains	**(94)**	456	**–**	–	**(94)**	456
Fair value of scheme assets at 31 December	**6,076**	6,253	**10**	13	**6,086**	6,266

Notes on the Accounts continued

12 Retirement benefit schemes continued

Fair value of scheme assets by category:

	Pension schemes		Healthcare schemes		Total	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 £m	2014 £m
Equities – listed	1,559	1,759	4	5	1,563	1,764
Equities – unlisted	557	533	–	–	557	533
Bonds – listed	3,092	2,812	3	4	3,095	2,816
Bonds – unlisted	43	34	–	–	43	34
Other assets – listed	94	84	3	4	97	88
Other assets – unlisted	731	1,031	–	–	731	1,031
Fair value of scheme assets at 31 December	**6,076**	6,253	**10**	13	**6,086**	6,266

Scheme assets have been diversified into equities, bonds and other assets and are typically invested via fund investment managers into both pooled and segregated mandates of listed and unlisted equities and bonds. In addition certain scheme assets, including a portion of the assets held in the main UK pension scheme, are further diversified by investing in equities listed on foreign stock exchanges via investment funds. In the above analysis investments via equity-based investment funds are shown under listed equities, and investments via bond-based investment funds are shown under listed bonds.

In Jamaica, a pension scheme holds shares in Carreras Limited (a Group subsidiary) with a fair value of £1 million (2014: £1 million). The shares are listed on the Jamaica stock exchange.

Other assets include cash and other deposits, derivatives and other hedges (including liability driven investments funds and inflation opportunity funds), recoverable taxes, reinsurance contracts, infrastructure investments and investment property.

The actuarial gains and losses in both years principally relate to movements in the fair values of scheme assets and actual returns are stated net of applicable taxes and fund management fees.

	Pension schemes		Healthcare schemes		Total	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 £m	2014 £m
Actual return on scheme assets	**103**	705	**1**	1	**104**	706

The movements in the unrecognised scheme surpluses, recognised in other comprehensive income, are as follows:

	Pension schemes		Healthcare schemes		Total	
	2015 £m	2014 £m	2015 £m	2014 £m	2015 £m	2014 £m
Unrecognised funded scheme surpluses at 1 January	**(13)**	(19)	–	–	**(13)**	(19)
Differences on exchange	3	–	–	–	3	–
Interest on unrecognised funded scheme surpluses	(1)	(1)	–	–	(1)	(1)
Movement in year (note 20)	–	7	–	–	–	7
Unrecognised funded scheme surpluses at 31 December	**(11)**	(13)	–	–	**(11)**	(13)

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are shown below. In both years, discount rates are determined by reference to normal yields on high quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds, the yield on government bonds is used.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2015					
Rate of increase in salaries	4.6	2.3	3.3	2.0	1.3
Rate of increase in pensions in payment	3.1	1.5	Nil	1.1	Nil
Rate of increase in deferred pensions	2.3	Nil	Nil	1.1	–
Discount rate	3.8	2.3	3.8	2.5	0.7
General inflation	3.1	1.5	2.3	2.0	0.9

12 Retirement benefit schemes continued

	UK years	Germany years	Canada years	Netherlands years	Switzerland years
31 December 2015					
Weighted average duration of liabilities	**16.9**	**13.0**	**11.1**	**17.9**	**14.6**

For healthcare inflation in Canada, the assumption is 4.5%. For the remaining pension schemes, typical assumptions are that real salary increases will be from 0% to 6.5% per annum and discount rates will be from 0% to 7.7% above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2014					
Rate of increase in salaries	4.5	2.5	3.3	2.0	1.5
Rate of increase in pensions in payment	3.0	1.8	Nil	1.6	Nil
Rate of increase in deferred pensions	2.5	Nil	Nil	1.6	–
Discount rate	3.4	1.9	3.8	2.0	1.1
General inflation	3.0	1.8	2.3	2.0	Nil

	UK years	Germany years	Canada years	Netherlands years	Switzerland years
31 December 2014					
Weighted average duration of liabilities	17.2	14.0	11.2	19.4	14.8

For healthcare inflation in Canada, the assumption was 4.0%. For the remaining pension schemes, typical assumptions were that real salary increases would be from 0% to 4.5% per annum and discount rates would be from 0% to 5.9% above inflation. Pension increases, where allowed for, were generally assumed to be in line with inflation.

Mortality assumptions are subject to regular review. The principal schemes used the following tables for both years:

UK	91.5% S1NA (year of birth) table with the Continuous Mortality Investigation (2013) model with a 1.75% long-term improvement rate
Germany	Heubeck tables 2005G
Canada	CPM-2014 Private Table
Netherlands	AG Prognosetafel 2014
Switzerland	LPP 2010 tables

Based on the above, the weighted average life expectancy, in years, for mortality tables used to determine benefit obligations is as follows:

	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
31 December 2015										
Member age 65 (current life expectancy)	**23.7**	**26.3**	**19.0**	**23.1**	**21.2**	**23.7**	**20.9**	**24.8**	**21.5**	**24.0**
Member age 45 (life expectancy at age 65)	**26.4**	**29.1**	**21.7**	**25.6**	**22.3**	**24.7**	**23.4**	**26.8**	**23.3**	**25.7**
31 December 2014										
Member age 65 (current life expectancy)	23.6	26.1	18.9	23.0	20.8	23.3	20.8	24.7	21.4	23.9
Member age 45 (life expectancy at age 65)	26.3	28.9	21.6	25.5	22.0	24.3	23.3	26.7	23.2	25.6

Valuation of retirement benefit schemes involves judgements about uncertain future events. Sensitivities in respect of the key assumptions used to measure the principal pension schemes as at 31 December 2015 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation, while asset values also change, and the impacts may offset to some extent.

Notes on the Accounts continued

12 Retirement benefit schemes continued

	1 year increase £m	1 year decrease £m	0.25 percentage point increase £m	0.25 percentage point decrease £m
Average life expectancy – increase/(decrease) of scheme liabilities	170	(171)		
Rate of inflation – increase/(decrease) of scheme liabilities			182	(171)
Discount rate – (decrease)/increase of scheme liabilities			(198)	210

A one percentage point increase in healthcare inflation would increase healthcare scheme liabilities by £14 million, and a one percentage point decrease would decrease liabilities by £11 million. The income statement effect of this change in assumption is not material.

13 Deferred tax

Deferred tax assets comprise:

	Stock relief £m	Excess of depreciation over capital allowances £m	Tax losses £m	Retirement benefits £m	Fair value losses/ (gains) £m	Other temporary differences £m	Total £m
At 1 January 2015	31	34	46	155	62	138	466
Differences on exchange	(1)	1	(9)	(8)	3	(22)	(36)
Credited/(charged) to the Income Statement	3	(2)	16	(46)	(6)	39	4
(Charged)/credited to other comprehensive income	–	–	–	(4)	1	–	(3)
Subsidiaries acquired (note 26)	–	–	–	–	–	3	3
At 31 December 2015	33	33	53	97	60	158	434
At 1 January 2014	46	34	67	104	–	157	408
Differences on exchange	(5)	(2)	(4)	(7)	–	(5)	(23)
(Charged)/credited to the Income Statement	(10)	2	(17)	(7)	62	(14)	16
Credited to other comprehensive income	–	–	–	65	–	–	65
At 31 December 2014	31	34	46	155	62	138	466

Deferred tax liabilities comprise:

	Stock relief £m	Excess of capital allowances over depreciation £m	Undistributed earnings of associates and subsidiaries £m	Retirement benefits £m	Fair value (losses)/ gains £m	Other temporary differences £m	Total £m
At 1 January 2015	8	176	204	76	23	163	650
Differences on exchange	2	(11)	(4)	(6)	–	(13)	(32)
(Credited)/charged to the Income Statement	(7)	–	55	(40)	7	(7)	8
Charged/(credited) to other comprehensive income	–	–	–	19	(13)	–	6
Subsidiaries acquired (note 26)	–	–	–	–	–	39	39
At 31 December 2015	3	165	255	49	17	182	671
At 1 January 2014	11	164	181	105	37	176	674
Differences on exchange	2	(5)	6	(8)	–	(11)	(16)
(Credited)/charged to the Income Statement	(5)	17	12	2	–	(5)	21
Charged/(credited) to other comprehensive income	–	–	5	(23)	(14)	3	(29)
At 31 December 2014	8	176	204	76	23	163	650

	2015 £m	2014 £m
Net deferred tax liabilities	237	184

13 Deferred tax continued

The net deferred tax liabilities are reflected in the Group Balance Sheet as follows, after offsetting assets and liabilities where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred income taxes relate to the same fiscal authority.

	2015 £m	2014 £m
Deferred tax assets	**(326)**	(311)
Deferred tax liabilities	**563**	495
	237	184

Deferred tax expected to be recovered within 12 months:

	2015 £m	2014 £m
Deferred tax assets	**(133)**	(112)
Deferred tax liabilities	**348**	364
	215	252

At the balance sheet date, the Group has unused tax losses of £804 million (2014: £704 million) which have no expiry date and unused tax losses of £698 million (2014: £642 million) which will expire within the next 10 years. No amount of deferred tax has been recognised in respect of these unused losses.

At the balance sheet date, the Group has not recognised a deferred tax asset in respect of deductible temporary differences of £737 million (2014: £971 million), which have no expiry date and £173 million (2014: £193 million), which will expire within the next 10 years.

At the balance sheet date, the Group has unused tax credits of £80 million (2014: £80 million) which have no expiry date. No amount of deferred tax has been recognised in respect of these unused tax credits.

At the balance sheet date, the aggregate amount of undistributed earnings of subsidiaries which would be subject to dividend withholding tax was £2 billion (2014: £2 billion). No liability has been recognised in respect of this withholding tax because the Group is in a position to control the timing of these distributions and it is probable that these distributions will not be made in the foreseeable future.

14 Trade and other receivables

	2015 £m	2014 £m
Trade receivables	**2,355**	2,071
Loans and other receivables	**984**	697
Prepayments and accrued income	**175**	153
	3,514	2,921
Current	**3,266**	2,768
Non-current	**248**	153
	3,514	2,921

Included in loans and other receivables, is £55 million in respect of payments made by a Group subsidiary in relation to the Quebec Class Action, as detailed in note 30. The Group has determined that these payments are recoverable on conclusion of the ongoing appeal and the deposit has not been discounted. While there is uncertainty over the timeframe of the appeal process, it is estimated that had discounting been applied the carrying value of the asset would have been reduced by approximately £4 million.

Amounts receivable from related parties including associated undertakings are shown in note 29.

Trade and other receivables have been reported in the Group Balance Sheet net of allowances as follows:

	2015 £m	2014 £m
Gross trade and other receivables	**3,565**	2,975
Allowance account	**(51)**	(54)
Net trade and other receivables per Balance Sheet	**3,514**	2,921

Notes on the Accounts continued

14 Trade and other receivables continued

The movements in the allowance account are as follows:

	2015 £m	2014 £m
1 January	**54**	56
Differences on exchange	**(9)**	(3)
Provided in the year	**8**	11
Amounts reversed during the year	**(2)**	(10)
31 December	**51**	54

Impairment of trade receivables, including write-offs and allowances, charged during the year is included as part of other operating expenses. For 2015, the net impairment charge was £19 million (2014: £4 million) of which £6 million (2014: £1 million) is reflected in the above table.

As at 31 December 2015, trade and other receivables of £75 million (2014: £39 million) were past their contractual payment date but not impaired. These relate to a number of external parties where there is no expectation of default. The aged analysis of these trade receivables is as follows:

	2015 £m	2014 £m
Less than three months	**64**	31
Between three and six months	**5**	2
Between six months and one year	**4**	3
Greater than one year	**2**	3

The Group holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

Trade and other receivables are predominantly denominated in the functional currencies of subsidiary undertakings apart from the following:

	2015 £m	2014 £m
US dollar	**158**	141
UK sterling	**209**	195
Euro	**65**	62
Other currencies	**174**	185

Trade and other receivables also include certain interest bearing amounts and their effective interest rates are as follows:

	2015 £m	2014 £m	2015 %	2014 %
UK sterling	**5**	5	**10.0**	10.0
Euro	**3**	3	**5.2**	4.0
Other currencies	**1**	2	**5.7**	5.5

There is no material difference between the above amounts for trade and other receivables and their fair value due to the short-term duration of the majority of trade and other receivables as determined using discounted cash flow analysis. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of internationally dispersed customers.

15 Available-for-sale investments

	2015 £m	2014 £m
1 January	**86**	90
Differences on exchange	**–**	(4)
Additions and advances	**17**	32
Revaluations	**14**	–
Disposals and repayments	**(45)**	(32)
31 December	**72**	86
Current	**35**	50
Non-current	**37**	36
	72	86

The classification of these investments under the IFRS 13 fair value hierarchy is given in note 24.

Investments have the following maturities:

	As per Balance Sheet	
	2015 £m	2014 £m
Equity investments	**37**	36
Non-equity investments		
– within one year	**34**	49
– beyond one year and within two years	**1**	–
– beyond two years and within three years	**–**	1
	72	86

There is no material difference between the maturity profile of investments in the table above and the maturity profile on a gross contractual basis where the values in each year include the investments maturing in that year together with forecast interest receipts on all investments which are due for all or part of that year.

Included within non-equity investments are cash deposits of £17 million (2014: £32 million) which do not meet the definition of cash and cash equivalents.

Investments are all denominated in the functional currency of the subsidiary undertaking holding the investments.

Notes on the Accounts continued

16 Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives. The classification of these derivative assets and liabilities under the IFRS 13 fair value hierarchy is given in note 24.

	2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges				
– interest rate swaps	217	23	300	102
– cross-currency swaps	40	38	6	18
Cash flow hedges				
– cross-currency swaps	9	–	30	5
– forward foreign currency contracts	77	70	139	38
Net investment hedges				
– forward foreign currency contracts	40	75	55	52
Held-for-trading*				
– interest rate swaps	52	70	–	–
– cross-currency swaps	4	11	–	–
– forward foreign currency contracts	57	30	31	34
Total	496	317	561	249
Current	209	187	274	126
Non-current	287	130	287	123
	496	317	561	249
Derivatives				
– in respect of net debt	373	164	362	137
– other	123	153	199	112
	496	317	561	249

* As explained in note 4, some derivative financial instruments are not designated as hedges and so are required to be classified as held-for-trading. The Group does not use derivatives for speculative purposes. All derivatives are undertaken for risk management purposes.

For cash flow hedges, the timing of expected cash flows is as follows:

	2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	73	65	150	38
Between one and two years	4	5	17	5
Between two and three years	–	–	2	–
Beyond five years	9	–	–	–
	86	70	169	43

The Group's cash flow hedges are principally in respect of sales or purchases of inventory and certain debt instruments. The timing of expected cash flows in respect of derivatives designated as cash flow hedges is broadly expected to be comparable to the time periods when the hedged item will affect profit or loss.

16 Derivative financial instruments continued

The tables below set out the maturities of the Group's derivative financial instruments on an undiscounted contractual basis, based on spot rates.

The maturity dates of all gross-settled derivative financial instruments are as follows:

	2015				2014			
	Assets		Liabilities		Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year								
– forward foreign currency contracts	5,294	(5,133)	4,358	(4,491)	4,993	(4,803)	2,960	(2,935)
– cross-currency swaps	9	(21)	359	(362)	186	(149)	18	(4)
Between one and two years								
– forward foreign currency contracts	107	(103)	323	(332)	398	(377)	112	(115)
– cross-currency swaps	368	(373)	361	(368)	19	(16)	343	(370)
Between two and three years								
– forward foreign currency contracts	–	–	28	(28)	49	(46)	–	–
– cross-currency swaps	15	(32)	16	(16)	19	(20)	–	–
Between three and four years								
– cross-currency swaps	29	(47)	30	(32)	19	(22)	–	–
Between four and five years								
– cross-currency swaps	14	(35)	16	(18)	34	(23)	–	(14)
Beyond five years								
– cross-currency swaps	1,465	(1,500)	458	(537)	709	(774)	–	–
	7,301	(7,244)	5,949	(6,184)	6,426	(6,230)	3,433	(3,438)

The maturity dates of net-settled derivative financial instruments are as follows:

	2015		2014	
	Assets Inflow/ (Outflow) £m	Liabilities (Inflow)/ Outflow £m	Assets Inflow/ (Outflow) £m	Liabilities (Inflow)/ Outflow £m
Within one year	82	46	62	(61)
Between one and two years	62	25	59	25
Between two and three years	49	11	49	24
Between three and four years	37	9	41	10
Between four and five years	20	8	35	9
Beyond five years	28	19	55	30
	278	118	301	37

The above analysis of derivatives settled on a net basis primarily relates to the Group's interest rate swaps.

The fair value of derivative financial instruments is summarised as follows:

	2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps	269	93	300	102
Cross-currency swaps	53	49	36	23
Forward foreign currency contracts	174	175	225	124
	496	317	561	249

Notes on the Accounts continued

16 Derivative financial instruments continued

(a) Interest rate swaps

								2015
					Interest rate %			
	Maturity date	Principal currency	m	£m	Original	Swapped	Assets £m	Liabilities £m
Fixed to floating	2017	USD	600	407	2.1	note (a)	–	1
	2018	USD	750	509	1.9	note (a)	1	–
	2019	GBP	250	250	6.4	note (a)	38	–
	2020	EUR	600	442	4.0	note (a)	59	–
	2020	GBP	650	650	4.0	note (a)	23	–
	2020	USD	1,250	848	2.8	note (a)	9	–
	2021	EUR	600	442	3.1	note (a)	31	–
	2022	USD	900	611	3.3	note (a)	7	–
	2023	EUR	750	553	2.4	note (a)	52	–
	2025	EUR	650	479	2.8	note (a)	49	–
Floating to fixed	2017	EUR	600	442	note (a)	3.7	–	22
	2023	EUR	750	553	note (a)	2.8	–	70
							269	93

								2014
					Interest rate %			
	Maturity date	Principal currency	m	£m	Original	Swapped	Assets £m	Liabilities £m
Fixed to floating	2017	USD	600	385	2.1	note (a)	–	1
	2019	GBP	250	250	6.4	note (a)	47	–
	2020	EUR	600	466	4.0	note (a)	70	–
	2020	GBP	650	650	4.0	note (a)	27	–
	2021	EUR	600	466	3.1	note (a)	34	–
	2022	USD	900	577	3.3	note (a)	2	–
	2023	EUR	750	582	2.4	note (a)	60	–
	2025	EUR	650	504	2.8	note (a)	60	–
Floating to fixed	2017	EUR	600	466	note (a)	3.7	–	33
	2023	EUR	750	582	note (a)	2.8	–	68
							300	102

Note (a): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 49 and 176 basis points (2014: between 67 and 176 basis points).

These swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 21.

16 Derivative financial instruments continued

(b) Cross-currency swaps

											2015
	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to floating	2016	GBP	5.5	325	325	EUR	note (b)	473	349	–	10
	2019	EUR	4.6	20	15	USD	note (b)	22	15	2	–
	2021	EUR	3.6	600	442	GBP	note (b)	518	518	–	28
	2021	CHF	0.6	320	217	GBP	note (b)	210	210	18	–
	2023	EUR	0.9	800	590	GBP	note (b)	566	566	20	–
	2017	BRL	16.7	2,008	344	GBP	note (b)	354	354	4	–
Fixed to fixed	2027	EUR	12.5	800	590	GBP	2.6	572	572	9	–
Floating to fixed	2017	GBP	note (b)	354	354	BRL	16.7	2,008	344	–	11
										53	49

											2014
	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to floating	2016	GBP	5.5	325	325	EUR	note (b)	473	367	–	17
	2019	EUR	4.6	20	16	USD	note (b)	22	14	5	–
	2021	EUR	3.6	600	466	GBP	note (b)	518	518	1	–
	2021	CHF	0.6	320	207	GBP	note (b)	210	210	–	1
Floating to fixed	2015	BRL	note (b)	150	36	USD	1.0	68	44	–	5
	2015	USD	note (b)	261	167	COP	6.8	502,692	136	30	–
										36	23

Note (b): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between 64 and 350 basis points (2014: between 65 and 250 basis points).

Notes on the Accounts continued

16 Derivative financial instruments continued

(c) Forward foreign currency contracts

Forward foreign currency contracts have been used to hedge both internal and external forecast transactions as well as the hedging of internal and external assets and liabilities.

	2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Purchase/Sell				
GBP/EUR	7	12	32	–
GBP/AUD	8	13	18	–
GBP/CHF	5	2	6	–
GBP/USD	–	58	–	49
GBP/JPY	8	13	22	–
EUR/GBP	14	1	–	–
USD/EUR	18	1	38	–
USD/GBP	26	–	15	–
USD/JPY	–	–	43	–
BRL/USD	–	32	–	35
CHF/GBP	8	–	–	–
AUD/GBP	13	1	–	–
NZD/GBP	6	–	–	–
Other	61	42	51	40
	174	175	225	124

A certain number of these contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 21. The nominal values of these contracts are as follows:

	2015		2014	
	Purchase £m	Sell £m	Purchase £m	Sell £m
Purchase/Sell				
GBP/CAD	(181)	178	(204)	202
GBP/USD	(529)	541	(192)	192
GBP/EUR	(70)	71	(76)	75
EUR/DKK	(321)	321	(339)	339
EUR/SEK	(111)	112	(116)	114
EUR/NOK	(120)	115	(137)	128
EUR/GBP	(116)	115	–	–
NOK/EUR	(115)	116	–	–
CHF/GBP	(272)	264	(223)	228

17 Inventories

	2015 £m	2014 £m
Raw materials and consumables	**1,635**	1,732
Finished goods and work in progress	**2,359**	2,211
Goods purchased for resale	**253**	190
	4,247	4,133

Inventories pledged as security for liabilities amount to £8 million (2014: £4 million). Write-offs taken to other operating expenses in the Group Income Statement comprise £73 million (2014: £47 million), including amounts relating to restructuring costs.

18 Income tax receivable and payable

Income tax balances shown on the Group Balance Sheet as current assets and current liabilities, while subject to some uncertainty as to the extent and timing of cash flows, are largely expected to be received or paid within 12 months at the balance sheet date for both 2015 and 2014.

19 Cash and cash equivalents

	2015 £m	2014 £m
Cash and bank balances	**1,325**	1,199
Cash equivalents	**638**	619
	1,963	1,818

Cash equivalents mainly comprise short-term deposits and investments in money market funds with an original maturity of three months or less. The carrying value of cash and cash equivalents approximates their fair value.

Cash and cash equivalents are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2015 £m	2014 £m
Functional currency	**1,679**	1,559
US dollar	**167**	115
UK sterling	**8**	13
Euro	**50**	47
Other currency	**59**	84
	1,963	1,818

In the Group Cash Flow Statement, net cash and cash equivalents are shown after deducting bank overdrafts and accrued interest where applicable, as follows:

	2015 £m	2014 £m
Cash and cash equivalents as above	**1,963**	1,818
Less accrued interest	**(1)**	(1)
Less overdrafts	**(232)**	(325)
Net cash and cash equivalents	**1,730**	1,492

Cash and cash equivalents include restricted amounts of £169 million (2014: £190 million), principally due to exchange control regulations in certain countries.

Notes on the Accounts continued

20 Capital and reserves – reconciliation of movement in total equity

	Attributable to owners of the parent						
	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of the parent £m	Non-controlling interests £m	Total equity £m
1 January 2015	507	3,923	(498)	1,578	5,510	304	5,814
Comprehensive income and expense							
Profit for the year	–	–	–	4,290	4,290	232	4,522
Differences on exchange							
– subsidiaries	–	–	(953)	–	(953)	(53)	(1,006)
– associates	–	–	336	–	336	–	336
Cash flow hedges							
– net fair value losses	–	–	(98)	–	(98)	(1)	(99)
– reclassified and reported in profit for the year	–	–	14	–	14	1	15
– reclassified and reported in net assets	–	–	(45)	–	(45)	–	(45)
Available-for-sale investments							
– net fair value gains	–	–	15	–	15	–	15
– reclassified and reported in profit for the year	–	–	(10)	–	(10)	–	(10)
Net investment hedges							
– net fair value losses	–	–	(118)	–	(118)	–	(118)
– differences on exchange on borrowings	–	–	42	–	42	–	42
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(f))	–	–	21	–	21	–	21
Retirement benefit schemes							
– net actuarial gains in respect of subsidiaries (note 12)	–	–	–	283	283	–	283
– actuarial gains in respect of associates net of tax (note 5)	–	–	–	3	3	–	3
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(f))	–	–	–	(23)	(23)	–	(23)
Other changes in equity							
Employee share options							
– value of employee services	–	–	–	50	50	–	50
– proceeds from shares issued	–	4	–	–	4	–	4
Dividends and other appropriations							
– ordinary shares	–	–	–	(2,770)	(2,770)	–	(2,770)
– to non-controlling interests	–	–	–	–	–	(238)	(238)
Purchase of own shares							
– held in employee share ownership trusts	–	–	–	(46)	(46)	–	(46)
Non-controlling interests – acquisitions (note 29)	–	–	–	(1,642)	(1,642)	(107)	(1,749)
Other movements	–	–	–	31	31	–	31
31 December 2015	507	3,927	(1,294)	1,754	4,894	138	5,032

20 Capital and reserves – reconciliation of movement in total equity continued

	Attributable to owners of the parent						
	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of the parent £m	Non-controlling interests £m	Total equity £m
1 January 2014	507	3,919	(190)	2,398	6,634	301	6,935
Comprehensive income and expense							
Profit for the year	–	–	–	3,115	3,115	278	3,393
Differences on exchange							
– subsidiaries	–	–	(526)	–	(526)	(13)	(539)
– associates	–	–	113	–	113	–	113
Cash flow hedges							
– net fair value gains	–	–	75	–	75	(18)	57
– reclassified and reported in profit for the year	–	–	(76)	–	(76)	9	(67)
– reclassified and reported in net assets	–	–	8	–	8	–	8
Available-for-sale investments of associates							
– net fair value gains	–	–	15	–	15	–	15
Net investment hedges							
– net fair value gains	–	–	2	–	2	–	2
– differences on exchange on borrowings	–	–	60	–	60	–	60
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss (note 6(f))	–	–	21	–	21	3	24
Retirement benefit schemes							
– net actuarial losses in respect of subsidiaries (note 12)	–	–	–	(428)	(428)	–	(428)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	–	–	–	7	7	–	7
– actuarial losses in respect of associates net of tax (note 5)	–	–	–	(124)	(124)	–	(124)
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss (note 6(f))	–	–	–	87	87	–	87
Other changes in equity							
Employee share options							
– value of employee services	–	–	–	66	66	–	66
– proceeds from shares issued	–	4	–	1	5	–	5
Dividends and other appropriations							
– ordinary shares	–	–	–	(2,712)	(2,712)	–	(2,712)
– to non-controlling interests	–	–	–	–	–	(260)	(260)
Purchase of own shares							
– held in employee share ownership trusts	–	–	–	(49)	(49)	–	(49)
– share buy-back programme	–	–	–	(800)	(800)	–	(800)
Non-controlling interests – acquisitions (note 29)	–	–	–	(4)	(4)	–	(4)
Non-controlling interests – capital injection (note 26(c))	–	–	–	–	–	4	4
Other movements	–	–	–	21	21	–	21
31 December 2014	507	3,923	(498)	1,578	5,510	304	5,814

Details relating to the allotted share capital, and movements therein, are included in note 4 of the Parent Company financial statements.

Notes on the Accounts continued

20 Capital and reserves – reconciliation of movement in total equity continued

(a) Share premium account, capital redemption reserves and merger reserves comprise:

	Share premium account £m	Capital redemption reserves £m	Merger reserves £m	Total £m
1 January 2014	70	101	3,748	3,919
31 December 2014	74	101	3,748	3,923
31 December 2015	**78**	**101**	**3,748**	**3,927**

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £4 million (2014: £4 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report.

On the purchase of own shares as part of the share buy-back programme for shares which are cancelled, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. Purchased shares which are not cancelled are classified as treasury shares and presented as a deduction from total equity.

Total equity attributable to owners of the parent is stated after deducting the cost of treasury shares which include £4,845 million (2014: £4,845 million) for shares repurchased and not cancelled and £204 million (2014: £228 million) in respect of the cost of own shares held in employee share ownership trusts.

The share buy-back programme was suspended from 30 July 2014 and did not recommence in the current year. During 2014, 23 million shares were bought back at a cost of £795 million excluding transaction costs of £5 million.

In 1999, shares were issued for the acquisition of the Rothmans International B.V. Group, and the difference between the fair value of shares issued and their nominal value was credited to merger reserves.

(b) Information on the principal components of non-controlling interests is provided in note 31.

20 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:

							Retained earnings	
	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Treasury shares £m	Other £m
1 January 2015	(1,369)	75	44	179	573	(498)	(5,073)	6,651
Comprehensive income and expense								
Profit for the year	–	–	–	–	–	–	–	4,290
Differences on exchange								
– subsidiaries	(953)	–	–	–	–	(953)	–	–
– associates	336	–	–	–	–	336	–	–
Cash flow hedges								
– net fair value losses	–	(98)	–	–	–	(98)	–	–
– reclassified and reported in profit for the year	–	14	–	–	–	14	–	–
– reclassified and reported in net assets	–	(45)	–	–	–	(45)	–	–
Available-for-sale investments								
– net fair value gains	–	–	15	–	–	15	–	–
– reclassified and reported in profit for the year	–	–	(10)	–	–	(10)	–	–
Net investment hedges								
– net fair value losses	(118)	–	–	–	–	(118)	–	–
– differences on exchange on borrowings	42	–	–	–	–	42	–	–
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss	–	21	–	–	–	21	–	–
Retirement benefit schemes								
– net actuarial gains in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	283
– actuarial gains in respect of associates net of tax (note 5)	–	–	–	–	–	–	–	3
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss	–	–	–	–	–	–	–	(23)
Other changes in equity								
Employee share options								
– value of employee services	–	–	–	–	–	–	–	50
Dividends and other appropriations								
– ordinary shares	–	–	–	–	–	–	–	(2,770)
Purchase of own shares								
– held in employee share ownership trusts	–	–	–	–	–	–	(46)	–
Non-controlling interests – acquisitions (note 29)	–	–	–	–	–	–	–	(1,642)
Other movements	–	–	–	–	–	–	70	(39)
31 December 2015	(2,062)	(33)	49	179	573	(1,294)	(5,049)	6,803

Notes on the Accounts continued

20 Capital and reserves – reconciliation of movement in total equity continued

	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Revaluation reserve £m	Other £m	Total other reserves £m	Retained earnings: Treasury shares £m	Retained earnings: Other £m
1 January 2014	(1,015)	44	29	179	573	(190)	(4,325)	6,723
Comprehensive income and expense								
Profit for the year	–	–	–	–	–	–	–	3,115
Differences on exchange								
– subsidiaries	(526)	–	–	–	–	(526)	–	–
– associates	113	–	–	–	–	113	–	–
Cash flow hedges								
– net fair value gains	–	75	–	–	–	75	–	–
– reclassified and reported in profit for the year	–	(76)	–	–	–	(76)	–	–
– reclassified and reported in net assets	–	8	–	–	–	8	–	–
Available-for-sale investments of associates								
– net fair value gains	–	–	15	–	–	15	–	–
Net investment hedges								
– net fair value gains	2	–	–	–	–	2	–	–
– differences on exchange on borrowings	60	–	–	–	–	60	–	–
Tax on items recognised directly in other comprehensive income that may be reclassified subsequently to profit or loss	(3)	24	–	–	–	21	–	–
Retirement benefit schemes								
– net actuarial losses in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	(428)
– surplus recognition and minimum funding obligations in respect of subsidiaries (note 12)	–	–	–	–	–	–	–	7
– actuarial losses in respect of associates net of tax (note 5)	–	–	–	–	–	–	–	(124)
Tax on items recognised directly in other comprehensive income that will not be reclassified subsequently to profit or loss	–	–	–	–	–	–	–	87
Other changes in equity								
Employee share options								
– value of employee services	–	–	–	–	–	–	–	66
– proceeds from shares issued	–	–	–	–	–	–	1	–
Dividends and other appropriations								
– ordinary shares	–	–	–	–	–	–	–	(2,712)
Purchase of own shares								
– held in employee share ownership trusts	–	–	–	–	–	–	(49)	–
– share buy-back programme	–	–	–	–	–	–	(800)	–
Non-controlling interests – acquisitions (note 29)	–	–	–	–	–	–	–	(4)
Other movements	–	–	–	–	–	–	100	(79)
31 December 2014	(1,369)	75	44	179	573	(498)	(5,073)	6,651

The translation reserve is as explained in the accounting policy on foreign currencies in note 1.

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments in note 1.

The revaluation reserve relates to the acquisition of the cigarette and snus business of ST in 2008.

Of the amounts released from the hedging reserve during the year, losses of £50 million (2014: £21 million gain) and gains of £22 million (2014: £27 million gain) were reported within revenue and raw materials and consumables respectively, together with a loss of £8 million (2014: £13 million loss) reported in other operating expenses and a gain of £18 million (2014: £31 million gain) reported within net finance costs.

20 Capital and reserves – reconciliation of movement in total equity continued

Other reserves comprise:

(a) £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries was distributed, so effectively demerging them; and

(b) In the Rothmans transaction, convertible redeemable preference shares were issued as part of the consideration. The discount on these shares was amortised by crediting other reserves and charging retained earnings. The £90 million balance in other reserves comprises the accumulated balance in respect of the preference shares converted during 2004.

The tax attributable to components of other comprehensive income is as follows:

	2015 £m	2014 £m
Translation reserve		
Net investment hedges		
– difference on exchange on borrowings	–	(3)
	–	(3)
Hedging reserve		
Cash flow hedges		
– net fair value losses/(gains)	38	(3)
– reclassified and reported in profit for the year	(17)	27
	21	24
Retained earnings		
– actuarial (gains)/losses in respect of subsidiaries	(23)	89
– surplus recognition and minimum funding obligations in respect of subsidiaries	–	(2)
	(23)	87
Owners of the parent	(2)	108
Non-controlling interests	–	3
Total tax recognised in other comprehensive income for the year (note 6(f))	(2)	111

21 Borrowings

	Currency	Maturity dates	Interest rates	2015 £m	2014 £m
Eurobonds	Euro	2017 to 2045	0.4% to 5.4%	6,603	5,211
	Euro	2018	3m EURIBOR + 50bps	294	309
	UK sterling	2016 to 2055	4.0% to 7.3%	3,413	3,083
	US dollar	2016	1.1%	203	192
	Swiss franc	2016	CHF 3m LIBOR + 16bps	238	226
	Swiss franc	2021 to 2026	0.7% to 1.4%	446	419
Bonds issued pursuant to Rule 144A and RegS under the US Securities Act (as amended)	US dollar	2017 to 2025	1.9% to 9.5%	4,208	1,726
	US dollar	2018	USD 3m LIBOR + 51bps	339	–
Bonds and notes				15,744	11,166
Commercial paper				505	160
Other loans				236	223
Bank loans				258	374
Bank overdrafts				232	325
Finance leases				26	10
				17,001	12,258

The interest on the commercial paper referred to in the table above is based on USD LIBOR plus a margin ranging between 25 and 43 basis points (2014: 10 and 43 basis points).

Notes on the Accounts continued

21 Borrowings continued

	2015 £m	2014 £m
Current	**2,195**	2,479
Non-current	**14,806**	9,779
	17,001	12,258

Current borrowings include interest payable of £210 million at 31 December 2015 (2014: £240 million). Included within borrowings are £7,394 million (2014: £4,522 million) of borrowings subject to fair value hedges where their amortised cost has been increased by £201 million (2014: £228 million) in the table above.

The fair value of borrowings is estimated to be £20,448 million (2014: £13,606 million). £19,059 million (2014: £12,533 million) has been calculated using quoted market prices and is within level 1 of the fair value hierarchy. £1,389 million (2014: £1,073 million) has been calculated based on discounted cash flow analysis and is within level 2 of the fair value hierarchy.

	2015 £m	2014 £m
Amounts secured on Group assets	**34**	14

In both years amounts secured on Group assets include finance leases of £26 million (2014: £10 million) and amounts secured on certain inventory of the Group (see note 17).

Borrowings are repayable as follows:

	Per Balance Sheet		Contractual gross maturities	
	2015 £m	2014 £m	2015 £m	2014 £m
Within one year	**2,195**	2,479	**2,451**	2,656
Between one and two years	**1,337**	877	**1,905**	1,262
Between two and three years	**1,619**	1,349	**2,110**	1,756
Between three and four years	**1,141**	758	**1,519**	1,085
Between four and five years	**1,325**	560	**1,665**	799
Beyond five years	**9,384**	6,235	**11,902**	7,814
	17,001	12,258	**21,552**	15,372

The contractual gross maturities in each year include the borrowings maturing in that year together with forecast interest payments on all borrowings which are outstanding for all or part of that year.

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	Functional currency £m	US dollar £m	UK sterling £m	Euro £m	Canadian dollar £m	Other currencies £m	Total £m
31 December 2015							
Total borrowings	**5,858**	**4,872**	**330**	**4,974**	**–**	**967**	**17,001**
Effect of derivative financial instruments							
– cross-currency swaps	**2,215**	**15**	**(325)**	**(1,637)**	**–**	**(217)**	**51**
– forward foreign currency contracts	**(401)**	**541**	**–**	**(481)**	**178**	**161**	**(2)**
	7,672	**5,428**	**5**	**2,856**	**178**	**911**	**17,050**
31 December 2014							
Total borrowings	5,419	2,240	330	3,478	–	791	12,258
Effect of derivative financial instruments							
– cross-currency swaps	1,195	(109)	(325)	(482)	–	(207)	72
– forward foreign currency contracts	(244)	192	–	(517)	202	358	(9)
	6,370	2,323	5	2,479	202	942	12,321

Details of the derivative financial instruments included in these tables are given in note 16.

21 Borrowings continued

The exposure to interest rate changes when borrowings are repriced is as follows:

	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	Beyond 5 years £m	Total £m
31 December 2015							
Total borrowings	**2,988**	**1,337**	**986**	**1,140**	**1,324**	**9,226**	**17,001**
Effect of derivative financial instruments							
– interest rate swaps	**4,196**	**35**	**(509)**	**(250)**	**(1,940)**	**(1,532)**	**–**
– cross-currency swaps	**1,333**	**–**	**–**	**(15)**	**–**	**(1,267)**	**51**
	8,517	**1,372**	**477**	**875**	**(616)**	**6,427**	**17,052**
31 December 2014							
Total borrowings	2,492	879	1,347	758	559	6,223	12,258
Effect of derivative financial instruments							
– interest rate swaps	2,832	–	81	–	(250)	(2,663)	–
– cross-currency swaps	1,086	(325)	–	–	(16)	(673)	72
	6,410	554	1,428	758	293	2,887	12,330

Details of the derivative financial instruments included in these tables are given in note 16.

Finance lease liabilities per the Group Balance Sheet and on a contractual gross maturity basis are payable as follows:

	2015 £m	2014 £m
Within one year	**7**	3
Between one and two years	**6**	2
Between two and three years	**5**	2
Between three and four years	**5**	1
Between four and five years	**2**	1
Beyond five years	**1**	1
	26	10

There is no material difference between the repayable principal and the total gross cash flows shown above.

Borrowings facilities – undrawn committed facilities (see note 24) expire as follows:

	2015 £m	2014 £m
Within one year	**158**	3,165
Between one and two years	**102**	–
Between two and three years	**–**	96
Between four and five years	**3,000**	3,000
	3,260	6,261

The Group defines net debt as follows:

	2015 £m	2014 £m
Borrowings (note 21)	**17,001**	12,258
Derivatives in respect of net debt:		
– assets (note 16)	**(373)**	(362)
– liabilities (note 16)	**164**	137
Cash and cash equivalents (note 19)	**(1,963)**	(1,818)
Current available-for-sale investments (note 15)	**(35)**	(50)
	14,794	10,165

Notes on the Accounts continued

22 Other provisions for liabilities and charges

	Restructuring of existing businesses £m	Employee related benefits £m	Fox River £m	Other provisions £m	Total £m
1 January 2015	**104**	**40**	**177**	**167**	**488**
Differences on exchange	**(6)**	**(3)**	**–**	**(22)**	**(31)**
Subsidiaries acquired	**30**	**1**	**–**	**1**	**32**
Provided in respect of the year	**15**	**9**	**–**	**167**	**191**
Utilised during the year	**(54)**	**(9)**	**(17)**	**(31)**	**(111)**
31 December 2015	**89**	**38**	**160**	**282**	**569**
Analysed on the Group Balance Sheet as					
– current	**54**	**17**	**22**	**180**	**273**
– non-current	**35**	**21**	**138**	**102**	**296**
	89	**38**	**160**	**282**	**569**
1 January 2014	88	42	267	184	581
Differences on exchange	(4)	(1)	–	(7)	(12)
Provided/(reversed) in respect of the year	56	8	(27)	47	84
Utilised during the year	(36)	(9)	(63)	(57)	(165)
31 December 2014	104	40	177	167	488
Analysed on the Group Balance Sheet as					
– current	49	13	36	112	210
– non-current	55	27	141	55	278
	104	40	177	167	488

The restructuring provisions relate to the restructuring and integration costs incurred and reported as adjusting items in the Group Income Statement. The principal restructuring activities in 2015 and 2014 are as described in note 3(e). While some elements of the non-current provisions of £35 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that approximately 58% will unwind in 2017 and over 93% within five years.

Employee related benefits mainly relate to long-term employee benefits other than post-employment benefits. As the principal components of these provisions are long service awards and 'jubilee' payments due after a certain service period, they will unwind over several years. It is estimated that approximately 13% of the non-current provisions of £21 million will unwind within five years.

A provision of £274 million was made in 2011 for a potential claim under a 1998 settlement agreement entered into by a Group subsidiary in respect of the clean-up of sediment in the Fox River. On 30 September 2014, the Group, NCR, Appvion and Windward Prospects entered into the Funding Agreement. The details of this agreement are explained in note 30. This agreement led to payments of £9 million in 2015 (2014: £56 million). In addition, the Group incurred legal costs of £8 million (2014: £7 million) which were also charged against the provision. In light of the conclusion of the Funding Agreement, the sums that the Group agreed to pay thereunder, as well as the available information in relation to the extent of the clean-up related costs, the Group reviewed the Fox River provision and £27 million was released from the provision in 2014. It is expected that the non-current provision will unwind within five years.

Other provisions comprise balances set up in the ordinary course of general business that cannot be classified within the other categories, such as sales returns, onerous contracts, together with amounts in respect of supplier, excise and other disputes. The nature of the amounts provided in respect of disputes is such that the extent and timing of cash flows is difficult to estimate and the ultimate liability may vary from the amounts provided.

Amounts provided above are shown net of reversals of unused provisions which include reversals of £18 million (2014: £18 million) for restructuring of existing businesses, £nil (2014: £nil) for employee benefits and £6 million (2014: £17 million) for other provisions.

23 Trade and other payables

	2015 £m	2014 £m
Trade payables	**1,056**	764
Duty, excise and other taxes	**3,481**	3,539
Accrued charges and deferred income	**931**	1,033
FII GLO deferred income (note 6(b))	**963**	–
Social security and other taxation	**15**	7
Sundry payables	**520**	309
	6,966	5,652
Current	**5,937**	5,524
Non-current	**1,029**	128
	6,966	5,652

Accrued charges and deferred income include £14 million of deferred income (2014: £67 million) and £10 million (2014: £6 million) in respect of interest payable. In 2014, deferred income related primarily to government grants for property acquired in Brazil. An amount of £70 million has been accrued in respect of the remaining balance due to be paid for the buy-out of non-controlling interests in Souza Cruz S.A. (see note 26(c)). In 2015, FII GLO deferred income of £963 million relates to receipts in respect of the Franked Investment Income Government Litigation Order (see notes 6(b) and 25). Amounts payable to related parties including associated undertakings are shown in note 29.

There is no material difference between the above amounts for trade and other payables and their fair value due to the short-term duration of the majority of trade and other payables, as determined using discounted cash flow analysis.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 7% in other currencies (2014: less than 5%).

24 Financial instruments and risk management

Management of financial risks

One of the principal responsibilities of Treasury is to manage the financial risks arising from the Group's underlying operations. Specifically Treasury manages, within an overall policy framework set by the Group's Main Board and Corporate Finance Committee (CFC), the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. The Group's treasury position is monitored by the CFC which meets regularly throughout the year and is chaired by the Group Finance Director. The approach is one of risk reduction within an overall framework of delivering total shareholder return.

The Group defines capital as net debt (see note 21) and equity (see note 20). The only externally imposed capital requirement for the Group is interest cover as described under interest rate risk below. The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed and, in particular, the policies on dividends (as a percentage of long-term sustainable earnings) and share buy-back are decided. The key objective of the financing principles is to appropriately balance the interests of equity and debt holders in driving an efficient financing mix for the Group. The Group's average cost of debt is 3.1% in 2015.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group Balance Sheet and related notes.

Notes on the Accounts continued

24 Financial instruments and risk management continued

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group has a target average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. As at 31 December 2015, the average centrally managed debt maturity was 7.9 years (2014: 6.8 years) and the highest proportion of centrally managed debt maturing in a single rolling year was 15.0% (2014: 18.7%).

It is Group policy that short-term sources of funds (including drawings under both the Group US$3 billion US commercial paper programme, and the Group £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. Commercial paper is issued by B.A.T. International Finance p.l.c. and guaranteed by British American Tobacco p.l.c. At 31 December 2015, commercial paper of £505 million was outstanding (2014: £160 million).

In February 2015, the Group signed a one-year bridge facility of £2.5 billion with an extension option of up to one year for its public tender offer to acquire up to all of the 24.7% of Souza Cruz shares which were not owned by the Group. The facility was partially cancelled in September, October and November 2015. The facility was cancelled in December 2015.

In March 2015, the Group issued €3 billion of bonds in four tranches as follows: €800 million maturing in 2019, €800 million maturing in 2023, €800 million maturing in 2027 and €600 million maturing in 2045. A €1.25 billion bond was repaid.

In March 2015, a one-year extension option was exercised for the £3 billion main bank facility, extending the final maturity to May 2020. The facility was undrawn as at 31 December 2015 (2014: undrawn). The US$2 billion US commercial paper programme was increased in size to US$3 billion.

In June 2015, the Group issued US$4.5 billion of bonds in five tranches as follows: US$750 million maturing in 2018, US$1,250 million maturing in 2020, US$500 million maturing in 2022, US$1,500 million maturing in 2025 and US$500 million of floating rate notes maturing in 2018. A US$500 million bond was repaid. The US$4.7 billion bridge facility in respect of the RAI transaction was cancelled following the issue of the bonds.

In July 2015, as previously described in note 6(b), the Group received £620 million from HM Revenue & Customs in connection with the Franked Investment Income Group Litigation Order. The Group received a further £343 million in November 2015 from HM Revenue & Customs.

In November 2015, the Group issued a €600 million bond maturing in 2022 and a £350 million bond maturing in 2055.

In March 2014, the Group issued €1 billion of bonds in two tranches as follows: €600 million maturing in 2029 and €400 million of floating rate notes maturing in 2018.

In May 2014, the Group through B.A.T. International Finance p.l.c. negotiated a new main bank facility of £3 billion with a final maturity of May 2019 (with two additional one-year extensions at the option of the banks). This facility is provided by 22 banks. The new facility is on significantly improved terms compared to the previous facility of £2 billion, with a maturity of December 2015, which was cancelled at the same time.

In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029 financed from Group cash balances.

In August 2014, the Group repaid a maturing MYR250 million note, financed from Group cash balances.

In September 2014, the Group issued SFr1 billion of bonds in three tranches as follows: SFr350 million maturing in 2016, SFr400 million maturing in 2021 and SFr250 million maturing in 2026. A one-year bridge facility of US$4.7 billion with an extension option of up to one year for the Group's investment in RAI was signed. A €600 million bond was repaid, financed from Group cash balances.

During the year, the Group's subsidiary in Brazil received proceeds of £255 million (2014: £411 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £250 million (2014: £271 million).

The Group has a US$240 million facility, maturing in 2016. This facility is drawable in Chilean peso and was drawn to the value of US$225 million at 31 December 2015 (2014: US$225 million).

The Group utilises cash pooling and zero balancing bank account structures in addition to inter-company loans and borrowings to mobilise cash efficiently within the Group. The key objectives of Treasury in respect of cash and cash equivalents are to protect their principal value, to concentrate cash at the centre to minimise the required long-term debt issuance and to optimise the yield earned. The amount of debt issued by the Group is determined by forecasting the net debt requirement after the mobilisation of cash.

The Group continues to target investment-grade credit ratings; as at 31 December 2015 the ratings from Moody's and S&P were A3 (stable outlook)/A- (stable outlook) (2014: A3/A-). The Moody's rating was upgraded from Baa1 to A3 on 12 March 2013. The strength of the ratings has underpinned debt issuance in 2015 and 2014 and, despite the impact of the turbulence in financial markets, the Group is confident of its ability to successfully access the debt capital markets, as demonstrated by the issue of bonds in the Swiss franc, euro, US dollar and sterling markets in 2015 and 2014.

24 Financial instruments and risk management continued

As part of its short-term cash management, the Group invests in a range of cash and cash equivalents, including money market funds, which are regarded as highly liquid and are not exposed to significant changes in fair value. These are kept under continuous review as described in the credit risk section below. At 31 December 2015, cash and cash equivalents include £334 million invested in money market funds (2014: £nil).

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

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro, Danish krone, Swiss franc, South African rand, Russian rouble, Brazilian real, Australian dollar, Malaysian ringgit and Singaporean dollar. These exposures are kept under continuous review. The Group's policy on borrowings is to broadly match the currency of these borrowings with the currency of cash flows arising from the Group's underlying operations. Within this overall policy, the Group aims to minimise all balance sheet translation exposure where it is practicable and cost-effective to do so through matching currency assets with currency borrowings. The main objective of these policies is to protect shareholder value by increasing certainty and minimising volatility in earnings per share. At 31 December 2015, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 32% (2014: 19%) US dollar, 30% (2014: 40%) euro, 1% (2014: 2%) Canadian dollar, 30% (2014: 26%) sterling, and 7% (2014: 13%) other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates and joint arrangements; these exposures are not normally hedged. Exposures also arise from:

(i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and

(ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group enters into forward foreign exchange contracts which are designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

IFRS 7 *Financial Instruments: Disclosures* requires a sensitivity analysis that shows the impact on the Income Statement and on items recognised directly in other comprehensive income of hypothetical changes of exchange rates in respect of non-functional currency financial assets and liabilities held across the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. Financial assets and liabilities held in the functional currency of the Group's subsidiaries, as well as non-financial assets and liabilities and translation risk, are not included in the analysis. The Group considers a 10% strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year-end, unless this is unrepresentative of the position during the year.

A 10% strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £3 million lower (2014: £2 million higher) and items recognised directly in other comprehensive income being £326 million higher (2014: £49 million higher). A 10% weakening of functional currencies against non-functional currencies would result in pre-tax profit being £2 million higher (2014: £3 million lower) and items recognised directly in other comprehensive income being £398 million lower (2014: £59 million lower).

The exchange sensitivities on items recognised directly in other comprehensive income relate to hedging of certain net asset currency positions in the Group as well as on cash flow hedges in respect of future transactions, but does not include sensitivities in respect of exchange on non-financial assets or liabilities.

Interest rate risk

The objectives of the Group's interest rate risk management policy are to lessen the impact of adverse interest rate movements on the earnings, cash flow and economic value of the Group and to safeguard against any possible breach of its financial covenants. Additional objectives are to minimise the cost of hedging and the associated counterparty risk.

The Group targets an interest cover ratio, as calculated under its key central banking facilities, of greater than 5 and for 2015 it is 11.6 times (2014: 12.0 times). The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of at least 4.5 times.

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The Group sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on both a gross and net basis (at least 50% fixed on a net basis in the short to the medium-term) as a result of regular reviews of market conditions and strategy by the CFC and the board of the main central finance company. At 31 December 2015, the relevant ratios of floating to fixed rate borrowings were 44:56 (2014: 45:55) on a gross basis and 33:67 (2014: 30:70) on a net basis. Underlying borrowings are arranged on both a fixed rate and a floating rate basis and, where appropriate, the Group uses derivatives, primarily interest rate swaps, to vary the fixed and floating mix. The interest rate profile of liquid assets is taken into account in determining the net interest rate exposure.

Notes on the Accounts continued

24 Financial instruments and risk management continued

IFRS 7 *Financial Instruments: Disclosures* requires a sensitivity analysis that shows the impact on the Income Statement and on items recognised directly in other comprehensive income of hypothetical changes of interest rates in respect of financial assets and liabilities of the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. For the purposes of this sensitivity analysis, financial assets and liabilities with fixed interest rates are not included. The Group considers a 100 basis point change in interest rates a reasonably possible change except where rates are less than 100 basis points. In these instances it is assumed that the interest rates increase by 100 basis points and decrease to zero for the purpose of performing the sensitivity analysis. The impact is calculated with reference to the financial asset or liability held as at the year-end, unless this is unrepresentative of the position during the year.

A 100 basis point increase in interest rates would result in pre-tax profit being £65 million lower (2014: £35 million lower). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being £40 million higher (2014: £20 million higher). The effect of these interest rate changes on items recognised directly in other comprehensive income is not material in either year.

Credit risk

The Group has no significant concentrations of customer credit risk. Subsidiaries have policies in place requiring appropriate credit checks on potential customers before sales commence. The process for monitoring and managing credit risk once sales to customers have been made varies depending on local practice in the countries concerned.

Certain territories have bank guarantees, other guarantees and credit insurance provided in the Group's favour in respect of Group trade receivables, the issuance and terms of which are dependent on local practices in the countries concerned.

All derivatives are subject to ISDA agreements or equivalent documentation.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from the related counterparties. Generally the Group aims to transact with counterparties with strong investment grade credit ratings. However, the Group recognises that due to the need to operate over a large geographic footprint, this will not always be possible. Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint, while at the same time ensuring that there is no geographic concentration in the location of counterparties.

With the following exceptions, the maximum exposure to the credit risk of financial assets at the balance sheet date is reflected by the carrying values included in the Group Balance Sheet. The Group has issued guarantees to third parties, part of which has been recognised on the Balance Sheet in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. The unrecognised portion of these guaranteed amounts was £nil (2014: £28 million). During 2014, the Group entered into a guarantee arrangement in respect of the borrowings of the non-controlling interest in relation to the capital injection made to the Group's Algerian business (see note 26(c)). The maximum exposure under the arrangement would be £3 million (2014: £4 million). In addition, the Group has entered into short-term risk participation agreements in relation to certain leaf supply arrangements and the maximum exposure under these would be £105 million (2014: £106 million).

The impact of own credit risk on the fair value of derivatives and other obligations held at fair value is not material.

Price risk

The Group is exposed to equity price risk on equity investments held by the Group, which are included in available-for-sale investments on the Group Balance Sheet, but the quantum of such is not material.

Hedge accounting

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is repeated periodically to ensure that the hedge has remained, and is expected to remain highly effective.

Fair value estimation

The fair values of financial assets and liabilities with maturities of less than one year, other than derivatives, are assumed to approximate their book values. For other financial instruments which are measured at fair value in the Balance Sheet, the basis for fair values is described below.

24 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:

				2015
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets at fair value				
Available-for-sale investments (note 15)	35	–	37	72
Derivatives relating to				
– interest rate swaps (note 16)	–	269	–	269
– cross-currency swaps (note 16)	–	53	–	53
– forward foreign currency contracts (note 16)	–	174	–	174
Assets at fair value	35	496	37	568
Liabilities at fair value				
Derivatives relating to				
– interest rate swaps (note 16)	–	93	–	93
– cross-currency swaps (note 16)	–	49	–	49
– forward foreign currency contracts (note 16)	–	175	–	175
Liabilities at fair value	–	317	–	317

				2014
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets at fair value				
Available-for-sale investments (note 15)	50	–	36	86
Derivatives relating to				
– interest rate swaps (note 16)	–	300	–	300
– cross-currency swaps (note 16)	–	36	–	36
– forward foreign currency contracts (note 16)	–	225	–	225
Assets at fair value	50	561	36	647
Liabilities at fair value				
Derivatives relating to				
– interest rate swaps (note 16)	–	102	–	102
– cross-currency swaps (note 16)	–	23	–	23
– forward foreign currency contracts (note 16)	–	124	–	124
Liabilities at fair value	–	249	–	249

Level 1 financial instruments are traded in an active market and fair value is based on quoted prices at the year-end.

Level 2 financial instruments are not traded in an active market, but the fair values are based on quoted market prices, broker/dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The Group's level 2 financial instruments include OTC derivatives.

The fair values of level 3 financial instruments have been determined using a valuation technique where at least one input (which could have a significant effect on the instrument's valuation) is not based on observable market data. The Group's level 3 financial instruments primarily consist of an equity investment in an unquoted entity which is valued using the discounted cash flows of estimated future dividends. The valuation assumes the following:

- future dividends grow by 3.5% (2014: 2.0%) and a 100 basis points decrease in the growth rate would result in the valuation being £1 million lower (2014: £6 million lower); and
- discount rate of 8.3% (2014: 6.5%) and a 100 basis points decrease in the discount rate would result in the valuation being £14 million higher (2014: £10 million higher).

Notes on the Accounts continued

24 Financial instruments and risk management continued

The following table presents the changes in level 3 financial instruments:

	2015	2014
	Available-for-sale investments £m	Available-for-sale investments £m
1 January	**36**	36
Differences on exchange	**(3)**	–
Revaluation	**14**	–
Disposal	**(10)**	–
31 December	**37**	36

Netting arrangements of derivative financial instruments

The gross fair value of derivative financial instruments as presented in the Group Balance Sheet, together with the Group's rights of offset associated with recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements, is summarised as follows:

	2015			2014		
	Amount presented in the Group Balance Sheet* £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)	**496**	**(272)**	**224**	561	(227)	334
Financial liabilities						
– Derivative financial instruments (note 16)	**(317)**	**272**	**(45)**	(249)	227	(22)
	179	**–**	**179**	312	–	312

* No financial instruments have been offset in the Group Balance Sheet.

The Group is subject to master netting arrangements in force with financial counterparties with whom the Group trades derivatives.

The master netting arrangements determine the proceedings should either party default on their obligations. In case of any event of default: the non-defaulting party will calculate the sum of the replacement cost of outstanding transactions and amounts owed to it by the defaulting party. If that sum exceeds the amounts owed to the defaulting party, the defaulting party will pay the balance to the non-defaulting party. If the sum is less than the amounts owed to the defaulting party, the non-defaulting party will pay the balance to the defaulting party.

25 Cash flow

Cash generated from operations

	2015 £m	2014 £m
Profit from operations	**4,557**	4,546
Adjustments for		
– depreciation, amortisation and impairment costs	**428**	523
– increase in inventories	**(520)**	(405)
– increase in trade and other receivables	**(508)**	(36)
– increase in amounts receivable in respect of the Quebec Class Action	**(55)**	–
– increase in trade and other payables	**732**	203
– FII GLO receipts (note 6(b))	**963**	–
– decrease in net retirement benefit liabilities	**(191)**	(170)
– increase/(decrease) in provisions for liabilities and charges	**48**	(76)
– other non-cash items	**(54)**	49
Cash generated from operations	**5,400**	4,634

25 Cash flow continued

Profit from operations includes charges in respect of Group restructuring and integration costs referred to in note 3(e). These are also reflected in the movements in depreciation, amortisation, impairment, inventories, receivables, payables and provisions above and in the proceeds on disposal of property, plant and equipment shown in the Group Cash Flow Statement. The cash outflow in respect of the Group's restructuring costs was £405 million (2014: £325 million).

The cash outflow in respect of the Fox River provision was £17 million (2014: £63 million), as reflected in the movement in provisions in note 22.

Profit from operations includes a charge in respect of Flintkote referred to in note 3(h) and this corresponds with the cash outflow of £3 million (2014: £374 million). The FII GLO cash receipt in 2015 of £963 million is referred to in more detail in note 6(b). The cash outflow in respect of the Quebec Class Action represents the first instalment of the deposit required by the state of Quebec in order for Imperial Tobacco Canada Limited to appeal the class action (see note 30).

Cash flows from investing activities

(a) Property, plant and equipment

In 2015, proceeds on disposal of property, plant and equipment include receipts in respect of Brazil and Australia. The gains related to Australia have been included in restructuring and integration costs (note 3(e)).

In 2014, proceeds on disposal of property, plant and equipment include receipts in respect of Turkey, Uganda and the Democratic Republic of Congo, the gains on which have been included in restructuring and integration costs (note 3(e)).

(b) Purchases of investments

The purchases of investments (which comprise available-for-sale investments and loans and receivables) comprise cash outflows in respect of current investments of £99 million (2014: £31 million outflow).

(c) Proceeds from disposals of investments

The disposals of investments (which comprise available-for-sale investments and loans and receivables) comprise cash inflows in respect of current investments of £45 million (2014: £34 million inflow).

(d) Proceeds from associates' share buy-backs

There were no associate buy-backs in the year (2014: £94 million inflow); as Reynolds American Inc. suspended its buy-back programme due its acquisition of Lorillard, Inc. in 2015.

(e) Purchase of subsidiaries

In October 2015, the Group acquired TDR d.o.o. for cash consideration of £404 million. In December 2015, the Group acquired CHIC, an e-cigarette business based in Poland for £52 million and Blue Nile Cigarette Company Limited, a cigarette business based in the Republic of Sudan for £37 million. See note 26 for further details on the acquisitions in the year.

(f) Investment in associates

In June 2015, in order to maintain its percentage holding of 42%, the Group invested £3,015 million into Reynolds American Inc., an existing associate. The funds were used (among other funds generated by Reynolds American Inc.) to acquire 100% of the equity capital of Lorillard, Inc., which was completed on 12 June 2015.

Cash flows from financing activities

(a) Cash flows from borrowings

In March 2015, the Group issued €3 billion of bonds in four tranches as follows: €800 million maturing in 2019, €800 million maturing in 2023, €800 million maturing in 2027 and €600 million maturing in 2045. A €1.25 billion bond was repaid.

In June 2015, the Group issued US$4.5 billion of bonds in five tranches as follows: US$750 million maturing in 2018, US$1,250 million maturing in 2020, US$500 million maturing in 2022, US$1,500 million maturing in 2025 and US$500 million of floating rate notes maturing in 2018. A US$500 million bond was repaid. The US$4.7 billion bridge facility in respect of the RAI transaction was cancelled following the issue of the bonds.

In November 2015, the Group issued a €600 million bond maturing in 2022 and a £350 million bond maturing in 2055.

In March 2014, the Group issued €1 billion of bonds in two tranches as follows: €600 million maturing in 2029 and €400 million of floating rate notes maturing in 2018.

In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029 financed from Group cash balances.

In August 2014, the Group repaid a maturing MYR250 million note, financed from Group cash balances.

In September 2014, the Group issued SFr1 billion of bonds in three tranches as follows: SFr350 million maturing in 2016, SFr400 million maturing in 2021 and SFr250 million maturing in 2026. A €600 million bond was repaid, financed from Group cash balances.

During 2015, the Group's subsidiary in Brazil received proceeds of £255 million (2014: £411 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £250 million (2014: £271 million).

Notes on the Accounts continued

25 Cash flow continued

(b) Movements relating to derivative financial instruments

The movement relating to derivative financial instruments is in respect of derivatives taken out to hedge cash and cash equivalents and external borrowings, derivatives taken out to hedge inter-company loans and borrowings and derivatives treated as net investment hedges. Derivatives taken out as cash flow hedges in respect of financing activities are also included in the movement relating to derivative financial instruments, while other such derivatives in respect of operating and investing activities are reflected along with the underlying transactions.

(c) Purchases of non-controlling interests

In 2015, the purchases of non-controlling interests of £1,677 million related to the acquisition of the non-controlling interest in Souza Cruz S.A. (£1,660 million), part of the non-controlling interest in BAT Chile Operaciones S.A. (£1 million) and part of the non-controlling interests in BAT Central America S.A. (£16 million) (see note 26(c)).

(d) Non-controlling interests – capital injection

There were no capital injections into non-controlling interests in 2015 (2014: £4 million) (see note 26(c)).

26 Business combinations, disposals and other changes in the Group

(a) TDR d.o.o. (TDR)

On 30 May 2015, the Group signed an agreement to acquire TDR and other tobacco and retail assets from Adris Grupa d.d. for a total enterprise value of €550 million. The transaction was completed on 30 September 2015. The purchase price is subject to the final agreement of adjustments for certain liabilities, and part of the consideration is contingent upon certain targets being met post-acquisition.

TDR is the leading independent cigarette manufacturer in Central Europe with a market leading position in Croatia and a position of scale in Bosnia and Serbia which will provide the Group with the opportunity to significantly grow its business in the region.

By combining its existing business in South East Europe together with TDR, the Group expects to benefit from highly skilled people, well established brands, local high quality operations and strong relationships with distributors and retailers in these markets. As part of the transaction, the Group has committed to keeping TDR's manufacturing facility in Kanfanar, Croatia operational for at least five years following completion of the acquisition.

The provisional goodwill of £116 million on the acquisition of TDR, stated at the exchange rates ruling at the date of the transaction, arises as follows:

Provisional values

	Book value £m	Fair value adjustments £m	Fair value £m
Intangible assets	2	159	161
Property, plant and equipment	69	26	95
Investments in associates	8	5	13
Deferred tax assets	3	–	3
Inventories	53	8	61
Trade and other receivables	101	–	101
Cash and cash equivalents	4	–	4
Borrowings	(27)	–	(27)
Deferred tax liabilities	–	(32)	(32)
Provisions	(8)	(22)	(30)
Trade and other payables	(50)	–	(50)
Net assets	155	144	299
Less: Non-controlling interests	2	–	2
Net assets acquired			297
Goodwill			116
Total consideration			413

Included in the fair value of consideration above is £9 million of contingent consideration.

Acquisition costs of £2 million have been expensed as part of other operating expenses within restructuring and integration costs (note 3(e)).

The provisional goodwill of £116 million on the acquisition of the business represents a strategic premium to strengthen the Group's position in South East Europe, as well as synergies and cost savings that are anticipated to be realised post-acquisition.

The contribution of this business to the Group's results in 2015 was not material. If the acquisition had occurred on 1 January 2015, the Group's results for the year would not have been materially different.

26 Business combinations, disposals and other changes in the Group continued

(b) Other acquisitions

On 22 September 2015, the Group announced the conditional agreement to acquire 100% of the CHIC Group from private shareholders, and the transaction concluded on 30 December 2015. The fair value of the consideration payable was £82 million of which £30 million is contingent on achievement of certain post-acquisition targets. The fair value and book values of net assets acquired were not materially different except for the recognition of trademarks and similar intangibles of £45 million and the recognition of a deferred tax liability of £8 million. Provisional goodwill of £40 million arising on this transaction represents a strategic premium to enter the non-tobacco market. The acquisition of CHIC provides the Group with scale and market reach, with around 800 points of sale in Poland, a number of leading Polish e-cigarette brands, a dedicated e-liquids production facility and a modern research and development centre.

In addition, on 17 November 2015, the Group acquired 100% of Blue Nile Cigarette Company Limited, the number two tobacco manufacturing and distribution company in the Republic of Sudan, from a private shareholder. The fair value of the consideration payable was £45 million of which £8 million is contingent on achievement of certain post-acquisition targets. The fair value and book values of net assets acquired were not materially different except for the recognition of trademarks and similar intangibles of £34 million. Provisional goodwill of £7 million arising on this transaction represents a strategic premium to enter this market, acquire a manufacturing base in the Republic of Sudan, and benefit from future growth prospects in an emerging market, enhancing the Group's competitive position in the North Africa Area.

The contribution of these businesses to the Group's results in 2015 was not material. If the acquisitions had occurred on 1 January 2015, the Group's results for the year would not have been materially different.

(c) Non-controlling interests

Souza Cruz S.A.

On 16 October 2015, the Group announced that it had concluded the auction related to its public tender offer in Brazil to acquire up to all of the 24.7% of Souza Cruz shares not currently owned by the Group and to delist the company. As a result of the auction, the Group acquired 342,956,819 shares at a price of R$27.20 per share (the Offer Price), representing 22.4% of Souza Cruz. The Group's total ownership of Souza Cruz increased to 97.7% following the auction. Given the level of acceptances at the auction, Souza Cruz cancelled its registration as a publicly listed company. Subsequent to the auction the Group continued to acquire outstanding minority shares at the Offer Price (plus interest) and as at 31 December 2015 the Group owned 99.1% of Souza Cruz. The cost of acquiring these shares up to the end of December 2015 was £1,660 million.

The compulsory acquisition of the remaining minority shares was approved on 5 February 2016, with Souza Cruz becoming a wholly-owned subsidiary as at that date. The cost of acquiring the remaining shares was £70 million.

BAT Chile Operaciones S.A.

During 2015, the Group acquired a further 0.2% interest in BAT Chile Operaciones S.A. at a cost of £1 million. This increased the Group's shareholding to 99%. This transaction is shown as a £1 million reduction to reserves attributable to the owners of the parent in note 20. During 2014, the Group acquired a 1% interest in BAT Chile Operaciones S.A. at a cost of £3 million.

BAT Central America S.A.

During 2015, the Group acquired a further 9% interest in BAT Central America S.A. at a cost of £16 million. This increased the Group's shareholding to approximately 88%. This transaction is shown as a £14 million reduction to reserves attributable to the owners of the parent and a £2 million reduction in reserves attributable to non-controlling interests in note 20. On 15 December 2014, the Group acquired a 1% interest in BAT Central America S.A. at a cost of £1 million.

BAT Algérie S.P.A.

On 8 June 2014, the Group made a capital injection to BAT Algérie S.P.A. at a cost of £4 million. This injection was in proportion to a capital injection made by the non-controlling interest to the Group company and as such, the Group's shareholding remains unchanged.

(d) Other changes in the Group

On 15 December 2014, the Hungarian Government voted in new legislation whereby the distribution of tobacco products to retail would move to a single authorised concession holder. On 11 June 2015 it was announced that a joint venture between Taban Trafik and the Group would be granted a concession for the exclusive distribution of tobacco products, for a period of 20 years. This was effective from 17 November 2015. The Group owns 49% of the issued capital and has an effective economic interest under a profit sharing agreement of 25% in the new entity, which is reported as a joint venture. The investment in the new entity and share of results and net assets at the end of the year is not material to the Group. Transactions between the Group and the entity are classified as related party transactions.

(e) Items classified as held-for-sale

At 31 December 2015, held-for-sale assets comprise land and buildings in Denmark which are being actively marketed for sale.

At 31 December 2014, held-for-sale assets comprised mainly plant and equipment in Souza Cruz and land and buildings in Denmark which were being actively marketed for sale.

Notes on the Accounts continued

27 Share-based payments

The Group operates a number of share-based payment arrangements of which the two principal ones are:

Long-Term Incentive Plan (LTIP)

Nil-cost options exercisable after three years from date of grant with a contractual life of 10 years. Payout is subject to performance conditions based on earnings per share (50% of grant), total shareholder return (25% of grant) and net turnover (25% of grant). Total shareholder return combines the share price and dividend performance of the Company by reference to one comparator group. Participants are not entitled to dividends prior to the exercise of the options. A cash equivalent dividend accrues through the vesting period and is paid on vesting. Both equity and cash-settled LTIPs are granted in March each year.

Deferred Share Bonus Scheme (DSBS)

Free ordinary shares released three years from date of grant and may be subject to forfeit if a participant leaves employment before the end of the three-year holding period. Participants receive a separate payment equivalent to a proportion of the dividend payment during the holding period. Both equity and cash-settled deferred shares are granted in March each year.

The Group also has a number of other arrangements which are not material for the Group and these are as follows:

Sharesave Scheme (SAYE)

Options granted in March each year from 2011 onwards (previously November until 2009 and no options were granted during 2010) by invitation at a 20% discount to the market price. Options to this equity-settled scheme are exercisable at the end of a three-year or five-year savings contract. Participants are not entitled to dividends prior to the exercise of the options. The maximum amount that can be saved by a participant in this way is £6,000 in any tax year.

Share Reward Scheme (SRS) and International Share Reward Scheme (ISRS)

Free shares granted in April each year (maximum £3,000 in any year) under the equity-settled scheme are subject to a three-year holding period. Participants receive dividends during the holding period which are reinvested to buy further shares.

Partnership Share Scheme

Open to all eligible employees, where employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco p.l.c. The maximum amount that can be allocated in this way to any individual is £1,800 in any tax year. The shares purchased are held in a UK-based trust and are normally capable of transfer to participants tax-free after a five-year holding period.

Further details on the operation of share-based payment arrangements can be found in the Remuneration Report.

Share-based payment expense

The amounts recognised in the Group Income Statement in respect of share-based payments were as follows:

	2015		2014	
	Equity-settled £m	Cash-settled £m	Equity-settled £m	Cash-settled £m
LTIP (note (a))	1	3	6	1
DSBS (note (b))	44	7	54	7
SAYE (note (c))	1	–	1	–
SRS (note (c))	4	–	5	–
Total recognised in the Income Statement (note 3(a))	**50**	**10**	66	8

Share-based payment liability

The Group issues to certain employees cash-settled share-based payments that require the Group to pay the intrinsic value of these share-based payments to the employee at the date of exercise. The Group has recorded liabilities in respect of vested and unvested grants at the end of 2015 and 2014:

	2015		2014	
	Vested £m	Unvested £m	Vested £m	Unvested £m
LTIP	1.3	3.5	2.1	3.4
DSBS	0.1	10.4	0.3	17.4
Total liability	**1.4**	**13.9**	2.4	20.8

27 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 2015 and 31 December 2014, were as follows:

	2015		2014	
	Equity-settled Number of options in thousands	**Cash-settled Number of options in thousands**	Equity-settled Number of options in thousands	Cash-settled Number of options in thousands
Outstanding at start of year	**5,198**	**485**	5,592	709
Granted during the period	**2,141**	**160**	2,477	112
Exercised during the period	**(255)**	**(92)**	(1,278)	(281)
Forfeited during the period	**(1,859)**	**(139)**	(1,593)	(55)
Outstanding at end of year	**5,225**	**414**	5,198	485
Exercisable at end of year	**189**	**34**	376	56

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £35.39 (2014: £34.40) for equity-settled and £35.52 (2014: £34.57) for cash-settled options.

The outstanding shares for the year ended 31 December 2015 had a weighted average remaining contractual life of 8.2 years (2014: 8.4 years) for the equity-settled scheme and 7.9 years (2014: 8.0 years) for the cash-settled share-based payment arrangements.

(b) Deferred Share Bonus Scheme

Details of the movements for the equity and cash-settled DSBS scheme during the years ended 31 December 2015 and 31 December 2014, were as follows:

	2015		2014	
	Equity-settled Number of options in thousands	**Cash-settled Number of options in thousands**	Equity-settled Number of options in thousands	Cash-settled Number of options in thousands
Outstanding at start of year	**4,262**	**555**	5,105	754
Granted during the period	**1,072**	**172**	1,695	175
Exercised during the period	**(1,874)**	**(260)**	(2,486)	(367)
Forfeited during the period	**(65)**	**(16)**	(52)	(7)
Outstanding at end of year	**3,395**	**451**	4,262	555
Exercisable at end of year	**22**	**1**	18	4

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the financial year was £35.05 (2014: £33.70) for equity-settled and £34.42 (2014: £33.43) for cash-settled options.

The outstanding shares for the year ended 31 December 2015 had a weighted average remaining contractual life of 1.2 years (2014: 1.1 years) for the equity-settled scheme and 1.3 years (2014: 1.0 year) for the cash-settled scheme.

(c) Other schemes

SAYE

The number of outstanding options at the end of the year for the three-year scheme was 345,001 (2014: 352,504) and for the five-year scheme was 495,098 (2014: 558,756).

SRS and ISRS

The number of outstanding shares at the end of the year for the Share Reward Scheme was 412,332 (2014: 456,057) and for the International Share Reward Scheme was 25,332 (2014: 34,748).

Notes on the Accounts continued

27 Share-based payments continued

Valuation assumptions

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2015		2014	
	LTIP	DSBS	LTIP	DSBS
Expected volatility (%)	**17**	**17**	18	18
Average expected term to exercise (years)	**3.5**	**3.0**	3.5	3.0
Risk-free rate (%)	**0.8**	**0.7**	1.4	1.1
Expected dividend yield (%)	**4.0**	**4.0**	4.2	4.2
Share price at date of grant (£)	**36.25**	**36.25**	32.60	32.60
Fair value at grant date (£)	**14.29**	**32.15**	17.72	19.55

Market condition features were incorporated into the Monte-Carlo models for the total shareholder return elements of the LTIP, in determining fair value at grant date. Assumptions used in these models were as follows:

	2015 %	2014 %
Average share price volatility FMCG comparator group	**19**	20
Average correlation FMCG comparator group	**33**	31

Fair values determined from the Black-Scholes and Monte-Carlo models use assumptions revised at the end of each reporting period for cash-settled share-based payment arrangements.

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the return index (the share price index plus the dividend reinvested) over a five-year period. The FMCG share price volatility and correlation was also determined over the same periods. The average expected term to exercise used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural conditions, forfeiture and historical experience.

The risk-free rate has been determined from market yield curves for government gilts with outstanding terms equal to the average expected term to exercise for each relevant grant. The expected dividend yield was determined by calculating the yield from the last two declared dividends divided by the grant share price.

In addition to these valuation assumptions, LTIP awards contain earnings per share performance conditions. As these are non-market performance conditions they are not included in the determination of fair value of share options at the grant date, however they are used to estimate the number of awards expected to vest. This pay-out calculation is based on expectations published in analysts' forecasts.

28 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 87,577 (2014: 90,118).

	2015 Number	2014 Number
Asia-Pacific	**14,671**	17,108
Americas	**15,662**	16,011
Western Europe	**12,645**	12,355
EEMEA	**11,691**	12,488
Subsidiary undertakings	**54,669**	57,962
Associates	**32,908**	32,156
	87,577	90,118

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration Report.

Included within the employee numbers for Western Europe are certain employees in the UK in respect of central functions. Some of the costs of these employees are allocated or charged to the various regions and markets in the Group.

29 Related party disclosures

The Group has a number of transactions and relationships with related parties, as defined in IAS 24 *Related Party Disclosures*, all of which are undertaken in the normal course of business. Transactions with CTBAT International Limited are not included in these disclosures as it is a joint operation.

Transactions and balances with associates relate mainly to the sale and purchase of cigarettes and tobacco leaf. Amounts receivable from associates in respect of dividends included in the table below were £145 million (2014: £96 million). The Group's share of dividends from associates, included in other net income in the table below, was £640 million (2014: £518 million).

29 Related party disclosures continued

As mentioned in note 26(d), the below table includes amounts related to the new joint venture in 2015 in Hungary.

	2015 £m	2014 £m
Transactions		
– revenue	**38**	38
– purchases	**(270)**	(279)
– other net income	**639**	512
Amounts receivable at 31 December	**190**	98
Amounts payable at 31 December	**(20)**	(25)

On 17 December 2012, a wholly-owned subsidiary of the Group, BATUS Japan Inc. (BATUSJ), entered into an Amendment and Extension Agreement (referred to as the Amendment) with a wholly-owned subsidiary of Reynolds American Inc. (RAI), R.J. Reynolds Tobacco Company (referred to as RJRT). The Amendment modifies the American blend Cigarette Manufacturing Agreement (referred to as the 2010 Agreement), effective as of 1 January 2010.

Prior to the Amendment, the term of the 2010 Agreement was scheduled to expire on 31 December 2014, subject to early termination and extension provisions. Pursuant to the Amendment, the Manufacturing Agreement will remain in effect beyond 31 December 2014, provided that either RJRT or BATUSJ may terminate the Manufacturing Agreement by furnishing three years' notice to the other party; such notice was given in January 2016.

During 2014, the Group received proceeds of £94 million in respect of its participation in the share buy-back programme conducted by RAI. This programme ceased in the second quarter of 2014.

On 12 June 2015, RAI completed its acquisition of Lorillard, Inc. and related divestiture transactions to ITG Brands LLC, a subsidiary of Imperial Tobacco Group PLC, after receiving the required regulatory approval. At the same time, the intention of which was announced on 15 July 2014, the Group invested US$4.7 billion (£3.0 billion) of cash in RAI to maintain its 42% equity position in the enlarged business.

In addition, on 1 December 2015, the Group and RAI announced an agreement providing a framework for collaboration and mutual cross-licensing of vapour product technologies through 2022.

During 2015, the Group acquired a further 24% interest in Souza Cruz S.A. at a cost of £1,660 million. This increased the Group's shareholding to 99%. This transaction is shown as a £1,555 million reduction to reserves attributable to the owners of the parent and a £105 million reduction in reserves attributable to non-controlling interests in note 20. The compulsory acquisition of the remaining shares was approved on 5 February 2016, with Souza Cruz S.A. becoming a wholly-owned subsidiary at that date. The cost of acquiring the remaining shares was £70 million.

During 2015, the Group acquired a further 0.2% interest in BAT Chile Operaciones S.A. at a cost of £1 million. This increased the Group's shareholding to 99%. This transaction is shown as a £1 million reduction to reserves attributable to the owners of the parent in note 20.

During 2015, the Group acquired a further 9% interest in BAT Central America S.A. at a cost of £16 million. This increased the Group's shareholding to 88%. This transaction is shown as a £14 million reduction to reserves attributable to the owners of the parent and a £2 million reduction in reserves attributable to non-controlling interests in note 20.

For comparative purposes, prior year's acquisitions are disclosed in note 26.

As explained in note 12, contributions to the British American Tobacco UK Pension Fund are secured by a charge over the Group's Head Office (Globe House) up to a maximum of £150 million.

The key management personnel of British American Tobacco consist of the members of the Board of Directors of British American Tobacco p.l.c. and the members of the Management Board. No such person had any material interest during the year in a contract of significance (other than a service contract) with the Company or any subsidiary company. The term key management personnel in this context includes the respective members of their households.

	2015 £m	2014 £m
The total compensation for key management personnel, including Directors, was:		
– salaries and other short-term employee benefits	**20**	20
– post-employment benefits	**4**	3
– share-based payments	**11**	13
	35	36

There were no other long-term benefits applicable in respect of key personnel other than those disclosed in the Remuneration Report.

Notes on the Accounts continued

30 Contingent liabilities and financial commitments

1. The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards.

2. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, interest charges, reputational damage or other sanctions. These matters are inherently difficult to quantify. In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and if the amount of the obligation can be reliably estimated, a provision will be recognised based on best estimates and management judgement.

3. There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions have been made.

General litigation

Product liability litigation

4. Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) (B&W) as well as other leading cigarette manufacturers, are defendants in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

5. On 30 July 2004, B&W completed the combination of the assets, liabilities and operations of its US tobacco business with R.J. Reynolds Tobacco Company (RJRT), a wholly-owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., pursuant to which Reynolds American Inc. was formed (the "Business Combination"). As part of the Business Combination, B&W contributed to RJRT all of the assets and liabilities of its US cigarette and tobacco business, subject to specified exceptions, in exchange for a 42%. equity ownership interest in Reynolds American Inc.

6. As a result of the Business Combination, RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the US on or prior to 30 July 2004. In addition, RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American Inc. and its subsidiaries) against, among other matters, all losses (including those arising from Environmental Tobacco Smoke (ETS) claims), liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the "RJRT Indemnification").

7. The scope of the RJRT Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's US tobacco business as conducted on or prior to 30 July 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after 30 July 2004 (the "Tobacco Litigation").

8. Pursuant to the terms of the RJRT Indemnification, RJRT is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defence of the Tobacco Litigation. RJRT has assumed control of the defence of the Tobacco Litigation involving B&W, to which RJRT is also a party in most (but not all) of the same cases.

9. Included in the US Litigation section below are all significant cases where B&W and/or a UK company is named as a defendant and all cases where RJRT is named as a defendant as a successor to B&W (the "RJRT Successor Cases"). The RJRT Successor Cases are covered by the RJRT Indemnification.

US litigation

10. The total number of US product liability cases pending at 31 December 2015 involving B&W was approximately 5,237 (compared to approximately 6,057 in 2014). Of these, 2,236 cases are RJRT Successor Cases. For all of the 5,237 cases involving B&W, British American Tobacco Group companies have the protection of the RJRT Indemnification. As at 31 December 2015, British American Tobacco (Investments) Limited (Investments) has been served as a co-defendant in one of those cases (compared to one in 2014). No other UK-based Group company has been served as a co-defendant in any US product liability case pending as at 31 December 2015. Since many of these pending cases seek unspecified damages, it is not possible to quantify the total amounts being claimed, but the aggregate amounts involved in such litigation are significant, possibly totalling billions of US dollars. The cases fall into four broad categories: medical reimbursement cases; class actions; individual cases and other claims.

(a) Medical reimbursement cases

11. These civil actions seek to recover amounts spent by government entities and other third-party providers on healthcare and welfare costs claimed to result from illnesses associated with smoking.

12. At 31 December 2015, one US medical reimbursement suit was pending against B&W by an Indian tribe in an Indian tribal court in South Dakota. No other suits are pending against B&W by county or other political subdivisions of the states.

(b) Class actions

13. At 31 December 2015, B&W was named as a defendant in five separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. If the classes are or remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will be necessary to resolve any claims by individual plaintiffs. Class action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices:

    (a) Black is a 'lights' class action filed in November 2000, which in 2008, the Circuit Court, City of St. Louis, Missouri stayed pending US Supreme Court review in Good v Altria Group, Inc. A status conference is scheduled for 22 February 2016.

    (b) Howard is a 'lights' class action filed in February 2000 in the Circuit Court, Madison County, Illinois, currently stayed pending resolution of Price v Philip Morris, Inc.

    (c) Jones is a case filed in December 1998 in the Circuit Court, Jackson County, Missouri; the action was brought by tobacco product users and purchasers on behalf of all similarly situated Missouri consumers alleging that the plaintiffs' use of the defendants' tobacco products has caused them to become addicted to nicotine, and seek an unspecified amount of compensatory and punitive damages. There has been limited activity in this case.

30 Contingent liabilities and financial commitments continued

(d) Parsons is a case filed in February 1998 in the Circuit Court, Ohio County, West Virginia currently stayed pending final resolution of a motion brought by the plaintiffs, and because three defendants filed bankruptcy petitions.

(e) Young is a case filed in November 1997 in the Circuit Court, Orleans Parish, Louisiana. This Environmental Tobacco Smoke (ETS) class action on behalf of all residents of Louisiana who, though not themselves cigarette smokers, have been exposed to second-hand smoke from cigarettes manufactured by the defendants, and who allegedly suffered injury as a result of that exposure, seeks an unspecified amount of compensatory and punitive damages, and has been stayed since 2004.

14. In Engle (a case in Florida), a jury awarded a total of US$12.7 million to three class representatives, and in a later stage of the three-phase trial procedure adopted in this case, a jury assessed US$17.6 billion in punitive damages against B&W. On 21 May 2003, the intermediate appellate court reversed the trial court's judgment and remanded the case to the trial court with instructions to de-certify the class; this was upheld on 6 July 2006. Further, the Florida Supreme Court permitted the judgments entered for two of the three Engle class representatives to stand, but dismissed the judgment entered in favour of the third Engle class representative. Finally, the Florida Supreme Court permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the Court's decision (subsequently extended to 11 January 2008).

15. Engle progeny cases, as at 31 December 2015:

	Engle progeny cases in which B&W has been served (both state and federal courts in Florida)	Engle progeny cases in which RJRT is named as a successor to B&W
Number of cases	38	2,224
Number of plaintiffs	94	2,902

16. Phase three trials of individual Engle class members, as at 31 December 2015:

	Additional Phase three Engle Trials naming RJRT as successor to B&W proceeding to verdict
Total number of trials	95
Number of trials resulting in plaintiffs' verdicts	55
Total damages awarded in final judgments against RJRT as successor to B&W (approximately)	US$262,199,662
Amount of overall damages comprising 'compensatory damages' (approximately)	US$141,294,246 (of overall US$262,199,662)
Amount of overall damages comprising 'punitive damages' (approximately)	US$120,905,416 (of overall US$262,199,662)
Number of adverse judgments appealed by RJRT	40*
Number of adverse judgments (not yet appealed), in which RJRT still has time to file an appeal	11

* Of the 40 adverse judgments appealed by RJRT, 25 were decided and/or closed, and 15 appeals remain undecided (including three that have petitions for review pending in the Florida Supreme Court). In three of the appeals that were decided, the Florida intermediate appellate court affirmed the liability finding but vacated the damages award and remanded the matter to the trial court. In three of the appeals that were decided, the Florida intermediate appellate courts reversed the final judgment and remanded the matter to the trial court for a new trial on all issues. In another 18 appeals that were decided, the Florida intermediate appellate courts affirmed final judgments in favour of plaintiffs. One appeal was voluntarily dismissed. RJRT has paid damages to plaintiffs in 15 cases that are now closed.

17. In June 2009, the Florida legislature amended its existing bond cap statute by adding a US$200 million bond cap that applies to all phase three Engle progeny cases in the aggregate and establishing individual bond caps for individual cases in amounts that vary depending on the number of judgments in effect at a given time. In May 2011, Florida removed the provision in this legislation that would have permitted this bond cap to expire on 31 December 2012. Plaintiffs in several Engle progeny cases have unsuccessfully challenged the constitutionality of the bond cap. One of these appellate courts has since certified to the Florida Supreme Court the question of whether the bond cap violates the Florida Constitution. The Florida Supreme Court accepted jurisdiction over the issue of the constitutionality of the bond cap on 23 January 2012. On 31 August 2012, the Florida Supreme Court entered an order dismissing this case based on RJRT's mootness argument. Plaintiff subsequently moved for a rehearing. On 12 October 2012, the Florida Supreme Court denied plaintiff's motion. Plaintiff did not file a petition for writ of certiorari to the United States Supreme Court.

Notes on the Accounts continued

30 Contingent liabilities and financial commitments continued

(c) Individual cases

	As at:	Total number of cases		
Cases pending against B&W which were filed by or on behalf of individuals and in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to ETS	31 December 2014	3,052		
	31 December 2015	2,995	2,499	ETS cases brought by flight attendants who were members of a class action (Broin) that was settled on terms that allow compensatory but not punitive damages claims by class members
			394	Cases brought in consolidated proceedings in West Virginia, where the first phase of the trial began on 15 April 2013 and on 15 May 2013 the jury returned a verdict for defendants on all but one of plaintiffs' claims; the verdict is currently on appeal
			38	Engle progeny cases that have been filed directly against B&W (please see earlier table in paragraph 15)
			64	Cases filed by other individuals

In addition to the 2,224 Engle progeny cases which name RJRT as successor to B&W, there are 12 cases filed by other individuals naming RJRT as successor to B&W. These cases are subject to the RJRT Indemnification and are not detailed here.

(d) Conduct-based claims

18. In the Daric Smith case, purchasers of cigarettes in the state of Kansas brought a conspiracy/price fixing class action in the Kansas State Court against B&W, Investments and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. On 26 March 2012, the Court dismissed the plaintiff's first amended petition with prejudice. On appeal, the Court of Appeals of Kansas, on 18 July 2014, affirmed the trial court's order. On 29 June 2015, the Supreme Court of Kansas denied plaintiff's petition for review. The case is now closed and will be removed from future reports.

UK-based Group companies

19. As at 31 December 2015, Investments has been served in one dormant individual action in the US (Perry) in which there has been no activity since 1998 following the plaintiff's death in 1997.

Product liability outside the United States

20. As at 31 December 2015, active product liability claims against the Group's companies existed in 14 markets outside the US (2014: 15) but the only markets with more than five claims were Argentina, Brazil, Canada, Chile, Italy and Nigeria. As at 31 December 2015, medical reimbursement actions are being brought in Argentina, Brazil, Canada, Nigeria and South Korea.

(a) Medical reimbursement cases

Argentina

21. In 2007, the non-governmental organisation the Argentina Tort Law Association (ATLA) and Emma Mendoza Voguet brought a reimbursement action against Nobleza Piccardo S.A.I.C.y F. (Nobleza) and Massalín Particulares. The case is being heard in the Contentious Administrative Court and is currently at the evidentiary stage.

Brazil

22. In August 2007, the São Paulo Public Prosecutor's Office filed a medical reimbursement claim against Souza Cruz S.A. (Souza Cruz). A similar claim was lodged against Philip Morris. On 4 October 2011, the Court dismissed the action against Souza Cruz, with a judgment on the merits. The plaintiff filed an appeal on 9 January 2012 and Souza Cruz filed its counter arguments on 17 February 2012. On 23 April 2013, the Justices of the 2nd Civil Chamber of the Court of Appeals of the State of São Paulo, by unanimous vote (3 to 0), denied the appeal of the Prosecution Office, thereby confirming the favourable Lower Court ruling. The Public Prosecutor's Office has filed a Special Appeal.

Canada

23. In Canada there are 10 active statutory actions for recovery of healthcare costs arising from the treatment of smoking and health-related diseases. These proceedings name various Group companies as defendants, including the Company, Investments, B.A.T Industries p.l.c. (Industries), Carreras Rothmans Limited (collectively the "UK Companies") and Imperial Tobacco Canada Limited (Imperial), the Group's operating company in Canada. Legislation enabling provincial governments to recover the healthcare costs has been enacted in all 10 provinces and two of three territories in Canada and has been proclaimed in force in 10 provinces. The Acts have received Royal Assent in Northwest Territories and Nunavut but have yet to be proclaimed into force. Actions have begun against various Group companies, including Imperial, in British Columbia, New Brunswick, Newfoundland and Labrador, Ontario, Quebec, Manitoba, Alberta, Saskatchewan, Nova Scotia and Prince Edward Island (PEI). In Quebec, three Canadian manufacturers, including Imperial, challenged the enabling legislation. This challenge was dismissed. One other manufacturer is seeking leave to appeal to the Supreme Court of Canada.

30 Contingent liabilities and financial commitments continued

24.

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
British Columbia	Tobacco Damages and Health Care Costs Recovery Act 2000	Imperial. Investments. Industries. Other former Rothmans Group companies.	The underlying medical reimbursement action remains at a preliminary case management stage. Damages have not been quantified by the province. The federal government has commenced a cost assessment in connection with the motion and appeals relating to the federal government claim, seeking CAD$5 million jointly from all the defendants and an additional CAD$5 million from Imperial. No hearing date has been set.
New Brunswick	Tobacco Damages and Health Care Costs Recovery Act 2006	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	Both Imperial and the UK Companies have now filed their defences and document production by the defendants is substantially complete. A first round of oral discoveries of the province began in September 2014 and a second round will continue at least through the end of Q2 of 2016. Damages have been quantified at CAD$19 billion. No trial date has been set.
Ontario	Tobacco Damages and Health Care Costs Recovery Act 2009	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	Following the Supreme Court of Canada's dismissal of the jurisdiction leave application, the case is under case management. Third-party notices against the federal government have been discontinued. Claims against several native manufacturers were filed but are in abeyance. The province has stated its claim to be worth CAD$50 billion. No trial date has been set.
Newfoundland and Labrador	Tobacco Health Care Costs Recovery Act 2006	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	Particulars and other preliminary motions were filed on 16 January 2015, and a case management conference took place on 22 January 2015. The hearing on the preliminary motions took place on 4–6 March 2015. On 22 December 2015, the Court ordered some particulars to be provided but did not set a date for compliance. Damages have not been quantified by the province. No trial date has been set.
Saskatchewan	Tobacco Damages and Health Care Costs Recovery Act 2012	The UK Companies have all been named as defendants. Imperial and the UK Companies have all been served.	This case is at an early case management stage. A standstill agreement was negotiated under which defences were filed by 27 February 2015 and the matter will remain in abeyance until document production begins in September 2017. Damages have not been quantified by the province.
Manitoba	Tobacco Damages Health Care Costs Recovery Act 2006	Imperial. Investments. Industries. Other former Rothmans Group companies.	This case is at an early case management stage. A standstill agreement has been negotiated, under which defences were filed and the matter will remain in abeyance until document production begins in January 2017. Damages have not been quantified by the province. No trial date has been set.
Alberta	Crown's Right of Recovery Act 2009	Imperial and the UK Companies have all been named as defendants and served.	This case is at an early case management stage. Following particulars motions in January 2015, the province provided certain particulars in October 2015. Defences are to be filed by March 2016 and replies and document production are to follow. The next case management hearing is set for 12 April 2016. The province has stated its claim to be worth CAD$10 billion. No trial date has been set.
Quebec	Tobacco Related Damages and Health Care Costs Recovery Act 2005	Investments, Industries, and Carreras Rothmans Limited have been named as defendants. Imperial and the UK Companies have been served.	On 25 August 2009, Imperial and the other Canadian manufacturers filed a constitutional challenge to the Quebec Medicaid Legislation. This claim was dismissed and a further appeal (heard on 18 June 2015) was also dismissed. Another manufacturer has sought leave to appeal to the Supreme Court of Canada. This case is at an early case management stage. Defences have been filed. Motions over admissibility of documents and damages discovery have been filed but not heard. The province is seeking CAD$60 billion. No trial date has been set.

Notes on the Accounts continued

30 Contingent liabilities and financial commitments continued

24. continued

Canadian province	Act pursuant to which claim was brought	Companies named as defendants and date served	Current stage
Prince Edward Island	Tobacco Damages and Health Care Costs Recovery Act 2009	Imperial and the UK Companies.	This case is at an early case management stage. A standstill agreement has been negotiated. Defences were filed in February 2015 and the next step will be document production, which will commence in September 2017. Damages have not been quantified by the province. No trial date has been set.
Nova Scotia	Tobacco Health Care Costs Recovery Act 2005	Imperial and the UK Companies.	On 22 January 2015, Imperial and the UK Companies were served with the Nova Scotia Medicaid suit. This case is at an early case management stage. A standstill agreement has been negotiated. Defences were filed in July 2015 and the next step will be document production, which will commence on or before 1 September 2017. Damages have not been quantified by the province. No trial date has been set.

Nigeria

25. As at 31 December 2015, six medical reimbursement actions filed by the federal government and five Nigerian states (Lagos, Kano, Gombe, Oyo, Ogun) were pending in the Nigerian courts. British American Tobacco (Nigeria) Limited (BAT Nigeria), the Company and Investments have been named as defendants in each of the cases. The plaintiffs in the six cases seek a total of approximately £38 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief.

26. The Company and Investments have made a number of challenges to the jurisdiction of the Nigerian courts. Such challenges are still pending (on appeal) against the federal government and the states of Lagos, Kano, Gombe and Ogun. In the state of Oyo, on 13 November 2015, the Company's jurisdictional challenge was successful in the Court of Appeal and the issuance of the writ of summons was set aside. The underlying cases are stayed or adjourned pending the final outcome of these jurisdictional challenges.

South Korea

27. In April 2014, Korea's National Health Insurance Service (NHIS) filed a healthcare recoupment action against KT&G (the state-owned former monopoly), PM Korea and BAT Korea (including BAT Korea Manufacturing). The lawsuit relates to healthcare costs allegedly incurred by the NHIS treating patients with lung (small cell and squamous cell) and laryngeal cancer between 2003 and 2012. The claim is based on allegations of defective design, failure to warn, fraud/misrepresentation, marketing to youth, use of additives and causing addiction. The NHIS is seeking damages of roughly £32 million from the defendants. Court hearings in the case, which constitute the trial, commenced in September 2014 and remain ongoing.

(b) Class actions

Brazil

28. There are currently two class actions being brought in Brazil. One is also a medical reimbursement claim (São Paulo Public Prosecutor's Office), and is therefore discussed above.

29. In 1995, the Associação de Defesa da Saúde do Fumante (ADESF) class action was filed against Souza Cruz and Philip Morris in the São Paulo Lower Civil Court alleging that the defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. The case was stayed in 2004 pending the defendants' appeal from a decision issued by the Lower Civil Court that held that the defendants had not met their burden of proving that cigarette smoking was not addictive or harmful to health, notwithstanding an earlier interlocutory order that the São Paulo Court of Appeals had issued, which directed the trial court to allow more evidence to be taken before rendering its decision.

30. On 12 November 2008, the São Paulo Court of Appeals overturned the lower court's unfavourable decision of 2004, returning the case to the lower court for production of evidence and a new judgment. Following production of evidence, on 16 May 2011, the lower court granted Souza Cruz's motion to dismiss the action in its entirety on the merits. Plaintiffs filed an appeal of the dismissal on 22 July 2011. Souza Cruz filed its response on 5 October 2011. On 6 September 2012, the case was assigned to a new temporary Reporting Justice in the 7th Chamber of Private Law of the São Paulo Court of Appeals, pending reference to a permanent Reporting Justice of the case. On 10 October 2013, a Reporting Justice of the case was designated. The São Paulo Court of Appeals ruled in favour of defendants in February 2015. Plaintiff has filed a special appeal to the Superior Court of Justice. On 27 November 2015, Souza Cruz filed its response to the appeal, which remains pending.

Canada

31. There are 10 class actions being brought in Canada against Group companies.

32. Knight is a 'lights' class action in which the plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Although the claim arises from health concerns, it does not seek compensation for personal injury. Instead it seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial.

30 Contingent liabilities and financial commitments continued

33. The Supreme Court of British Columbia certified a class of all consumers who purchased in British Columbia Imperial cigarettes bearing 'light' or 'mild' descriptors since 1974. Whilst the appellate court confirmed the certification of the class, on appeal it limited any financial liability, if proven, to 1997 onward. Imperial's third-party claim against the federal government was dismissed by the Supreme Court of Canada. The federal government is seeking a parallel cost order in this action as it is in the British Columbia government recoupment case. Knight has otherwise been dormant for several years.

34. On 9 December 2009, Imperial was served with a class action filed by Ontario tobacco farmers and the Ontario Flue-Cured Tobacco Growers' Marketing Board (Growers' claim). The plaintiffs allege that, during a specific timeframe, Imperial and two other domestic defendants improperly paid lower prices for tobacco leaf destined for duty-free products and then were smuggled back into Canada and sold in the domestic market. As a preliminary challenge Imperial, and the other domestic defendants, alleged that the Growers' claim is time barred. By decision dated 30 June 2014, the Court dismissed the preliminary challenge. Imperial and the domestic defendants sought leave to appeal that decision, and leave was granted on 14 January 2015. The appeal is scheduled to be heard in April 2016. If Imperial is ultimately successful, the Growers' claim will be dismissed; if not successful, the action will proceed to a class action certification hearing.

35. There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification in two class actions against Imperial and two other domestic manufacturers, which have a combined value of CAD$21 billion plus interest and costs. The Court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema as of November 1998 or developed these diseases thereafter and who smoked a minimum of 15 cigarettes a day for at least five years, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. The trial in this matter commenced on 12 March 2012 and was completed in December 2014. Judgment was rendered on 27 May 2015. It awarded moral and punitive damages and interest against Imperial and the Canadian subsidiaries of Philip Morris International and Japan Tobacco International in the amount of CAD$15.6 billion, of which Imperial's share is CAD$10.4 billion. An appeal of the judgment was filed on 26 June 2015. It also awarded provisional execution pending appeal of CAD$1.131 billion, of which Imperial's share was approximately CAD$742 million, which order was subsequently overturned by the Court of Appeal. Following the cancellation of the order for provisional execution, the Plaintiffs filed a motion against Imperial and one other manufacturer seeking security in the amount of CAD$5 billion to guarantee, in whole or in part, the payment of costs of the appeal and the judgment. On 27 October 2015, the Court of Appeal ordered the parties to post security in the amount of CAD$984 million, of which Imperial's share is CAD$758 million to be paid in 7 equal quarterly instalments. The first instalment, of just over CAD$108 million, was paid on 30 December 2015. Imperial filed its Factum on Appeal on 11 December 2015 and the appeal is scheduled for November 2016.

36. In June 2009, four new smoking and health class actions were filed in Nova Scotia, Manitoba, Saskatchewan and Alberta, against Canadian and foreign manufacturers and foreign companies, including the UK Companies and Imperial. In Saskatchewan, the Company and Carreras Rothmans Limited have been released from the action. No date has been set for the certification motion hearing. There are service issues in relation to the UK Companies in Alberta and Manitoba.

37. In July 2010, two further smoking and health class actions in British Columbia were served on Imperial and the UK Companies. The Bourassa claim is allegedly on behalf of all individuals who have suffered chronic respiratory disease and the McDermid claim proposes a class based on heart disease. Both claims state that they have been brought on behalf of those who have "smoked a minimum of 25,000 cigarettes". The UK Companies objected to jurisdiction. Subsequently, the Company was released from Bourassa and McDermid. Industries and Investments remain as defendants in both actions. No certification motion hearing date has been set. Plaintiffs were due to deliver certification motion materials by 31 January 2015, but have not yet done so. Once the materials are delivered, the motions regarding abuse of process will be dealt with.

38. In June 2012, a new smoking and health class action was filed in Ontario against the domestic manufacturers and foreign companies, including Imperial and the UK Companies. Imperial was served on 20 November 2012, and the UK Companies were served on 30 November 2012. The claim is presently in abeyance.

Italy

39. In or about June 2010, BAT Italia was served with a class action filed in the Civil Court of Rome by the consumer association, Codacons, and three class representatives. Plaintiffs primarily asserted addiction-related claims. The class action lawsuit was rejected at the first instance (Civil Court of Rome) and appellate (Rome Court of Appeal) court levels. In July 2012, Codacons filed an appeal before the Italian Supreme Court. At a hearing on 21 January 2015, the Public Prosecutor's Office agreed that the appeal should be rejected, and the Supreme Court reserved its decision with no firm date for issuing judgment. A hearing of procedural issues took place on 26 January 2016 and a decision on these issues is pending.

Venezuela

40. In April 2008, the Venezuelan Federation of Associations of Users and Consumers (FEVACU) and Wolfang Cardozo Espinel and Giorgio Di Muro Di Nunno, acting as individuals, filed a class action against the Venezuelan government. The class action seeks regulatory controls on tobacco and recovery of medical expenses for future expenses of treating smoking-related illnesses in Venezuela. On 5 December 2012, C.A Cigarrera Bigott Sucs. (Cigarrera Bigott) was admitted as an opposing third-party by the Constitutional Chamber of the Supreme Court of Justice and presented its defences and evidence on 26 February 2013. In February 2015, the Constitutional Chamber also admitted ASUELECTRIC, represented by its president Giorgio Di Muro Di Nunno (who had previously filed as an individual), as a third-party. ASUELECTRIC has petitioned the Constitutional Chamber on a number of occasions, requesting that it set a date for a hearing; however, a hearing date is yet to be scheduled.

Notes on the Accounts continued

30 Contingent liabilities and financial commitments continued

(c) Individual personal injury claims

41. As at 31 December 2015, the jurisdictions with the most number of active individual cases against Group companies were, in descending order: Brazil (101), Italy (22), Argentina (19), Chile (11), Canada (5) and Ireland (2). There were a further four jurisdictions with one active case only.

Non-tobacco related litigation

Flintkote

42. The Flintkote Company (Flintkote), a US company formerly engaged in the production and sale of asbestos-containing products, was included in the acquisition of Genstar Corporation by Imasco Limited in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited (Imperial), the Group's operating company in Canada) in 2000. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy Court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos plaintiffs (collectively, the "Flintkote Plaintiffs"), and certain individual asbestos plaintiffs (the "Hopkins Plaintiffs") were permitted by the Bankruptcy Court to file a complaint in the California State Court against Imperial and numerous other defendants, for the recovery of certain dividends declared by Flintkote in 1986 and 1987, and other compensation under various legal and equitable theories.

43. Following extensive discovery and a series of bench trials over a multi-year period, the Court narrowed the claims that might ultimately go to trial, but Flintkote and the Hopkins Plaintiffs continued to pursue substantial claims against Imperial. On 17 December 2014, following a series of formal mediation sessions and other negotiations, Imperial and the Flintkote Plaintiffs executed a settlement agreement. In furtherance of this settlement, Imperial placed into escrow the required settlement payment of US$575 million. The settlement was contingent upon further documentation and approval of the United States Bankruptcy Court for the District of Delaware, where Flintkote's bankruptcy case remains pending, and the United States District Court for the District of Delaware. On 10 August 2015 and 13 August 2015, respectively, the Bankruptcy Court and the District Court entered orders approving the settlement and confirming Flintkote's plan of reorganisation, which implements the settlement. The settlement finally and completely resolves the existing Flintkote litigation, including the claims of the Hopkins Plaintiffs, and Imperial and its corporate affiliates obtained protections from any potential future litigation related to Flintkote. The proceedings in the California State Court litigation, and all claims asserted therein, were dismissed on 14 December 2015. The case is now closed and will be removed from future reports.

Reynolds American, Inc./Lorillard, Inc. Shareholder Litigation

44. On 15 July 2014, Reynolds American, Inc. (Reynolds) announced that it had entered into a definitive merger agreement with Lorillard, Inc. (Lorillard), whereby Reynolds would acquire Lorillard in exchange for a combination of cash and Reynolds' stock (the "Lorillard Transaction"). As part of this transaction, the Company executed a Share Purchase Agreement to acquire a sufficient number of Reynolds' shares to maintain its 42% equity stake in Reynolds after the merger.

45. On 8 August 2014, the Company was named as a defendant in an action in state court in North Carolina stemming from the announcement of the Lorillard Transaction. The action was brought on behalf of a putative class of Reynolds' shareholders alleging that the Company is a controlling shareholder of Reynolds and breached its fiduciary duty to the other Reynolds' shareholders.

46. On 8 December 2014, the Company moved to dismiss the Amended Complaint. On 28 August 2015, the court issued an order dismissing all claims against the Company. Among other things, the court found that the plaintiff had not properly alleged that the Company was a controlling shareholder of Reynolds and therefore that the Company did not owe a fiduciary duty to Reynolds' other shareholders. On 3 September 2015, the plaintiff filed a notice of appeal. On 11 January 2016, the plaintiff filed its opening brief. The appeal remains pending, and briefing is scheduled to be complete by February 2016.

Khosravi

47. In January 2014, an individual named Mehdi Khosravi issued a claim in the English High Court against the Company, as well as Al Aqili Trading LLC, Mohammed Saleh Al Aqili and Mohammed Saeed Mohamed Al Aqili (the "Al Aqili Defendants"). After obtaining multiple extensions of time for service, in September 2015, the claimant amended his claim to join B.A.T (U.K. and Export) Limited and B.A.T. Pars Company as defendants and served the claim on the Company and B.A.T (U.K. and Export) Limited (the "BAT UK Defendants"). B.A.T. Pars Company has not been served with the claim and therefore is currently not an active party to the proceedings.

48. The claimant sought damages of up to £1.5 billion for alleged personal injuries and economic loss which, he alleged, were caused by the Al Aqili Defendants acting as agents for BAT and/or for which BAT was vicariously liable. The BAT UK Defendants applied for the orders granting extensions of time for service to be set aside, as well as for the claim to be struck out or dismissed on summary judgment. These applications were heard by a judge on 8 and 11 December 2015. On 28 January 2016, the judge dismissed the case against the BAT UK Defendants and ordered that the claimant should pay their legal costs. The claimant was not given permission to appeal by the High Court but has until 11 March 2016 to seek such permission from the Court of Appeal.

Fox River

Background to environmental liabilities arising out of contamination of the Fox River

49. In Wisconsin, the authorities have identified potentially responsible parties (PRPs) to fund the clean-up of river sediments in the lower Fox River. The pollution was caused by discharges of Polychlorinated Biphenyls (PCBs) from paper mills and other facilities operating close to the river. Among the PRPs is NCR Corporation (NCR).

50. There has been a substantial amount of litigation in the US regarding the responsibility for the costs of the clean-up operations. This can be summarised as follows:

    (a) As regards the mid and lower portions of the Fox River:

        i. NCR was initially made subject to an injunction filed by the US Government against it and Appvion Inc. (Appvion) in the courts of Wisconsin in 2012.

        ii. A subsequent ruling by the same Court in April 2012 found that Appvion was not a PRP, and the injunction was accordingly granted against NCR alone. NCR sought to appeal this decision, but it was affirmed on 3 August 2012.

30 Contingent liabilities and financial commitments continued

iii. A full trial of the merits of the US Government's application for a permanent injunction took place in December 2012 and the Court entered a permanent injunction against NCR.

iv. On 1 May 2013, the Wisconsin Court ruled that the pollution in the Fox River is not divisible. In a series of rulings, the Wisconsin Court also held that NCR was not entitled to recover any amounts in contribution from other PRPs and that the other PRPs were entitled to recover Fox River clean-up costs from NCR. Cross-claims by Appvion against other PRPs to recover its own Fox River related expenditures were rejected by the Wisconsin Court on 25 June 2013. As a result of these decisions NCR was found wholly responsible for the clean-up of those portions of the river. NCR and Appvion appealed against these decisions.

v. On 25 September 2014, the US Court of Appeals for the Seventh Circuit:

1. vacated the decisions finding NCR wholly liable. The Court remanded the case to the district court for further consideration of defence of divisibility available to NCR. The Court also vacated the permanent injunction against NCR, reasoning that such relief is unnecessary;

2. remanded the issue of contribution to the district court for reconsideration. The trial is currently set to commence in January 2017; and

3. found that Appvion is entitled to bring actions against other PRPs to recover its expenses, thereby reversing the trial court's finding in relation to this.

vi. As a result therefore of the US Court of Appeals for the Seventh Circuit's decision, the district court initially held that harm in Operable Unit 4 of the lower part of the Fox River was divisible and hence that NCR should bear responsibility for a 28% share. However, the district court later reversed that decision on 19 October 2015 and has rejected a further attempt by NCR to reconsider that ruling. On 25 January 2016, the district court denied NCR's motion for an interlocutory appeal of its decision on divisibility. As a consequence, NCR cannot appeal that decision until later in the proceedings. Thus, the present position is that NCR is wholly responsible for the costs of cleaning-up of the mid and lower portions of the river.

(b) As regards the upper portion of the Fox River:

i. In July 2012, the Wisconsin Court ruled that NCR was not liable for the clean-up costs in the upper portion of the Fox River. This judgment considered whether NCR was liable as a result of the sale, by a predecessor of NCR's Appleton Papers Division, of scrap paper, or "broke", to other PRPs which, in turn, discharged PCBs into the upper portion of the river in the course of recycling the broke. This order was made final on 27 June 2013.

ii. On 25 September 2014, the US Court of Appeals for the Seventh Circuit dismissed the other PRPs' appeal against this order.

iii. As a result, however, of the appellate court decision, the district court reconsidered its previous position and on 3 March 2015 ruled that NCR was liable for the upper portion of the Fox River. That notwithstanding, the district court has since indicated that NCR had no liability for that portion of the river because it did not discharge PCBs there.

51. In NCR's Form 10-K Annual Report for the year ended 31 December 2014, the total clean-up costs for the Fox River are estimated at US$825 million. This estimate is subject to uncertainties and does not include natural resource damages (NRDs). In connection with a settlement entered by certain PRPs, the district court ceded to the Government's request to allow it to withdraw the NRD claims it has prosecuted on behalf of NRD trustees, including those asserted against NCR. NCR retains residual exposure to NRDs in the form of claims by other PRPs. Previously, NCR had estimated that NRDs may range from US$0 to US$246 million (albeit the US Government in one court filing in 2009 indicated that natural resource damages could be as high as US$382 million).

Industries' involvement with environmental liabilities arising out of the contamination of the Fox River

52. Industries' involvement with the environmental liabilities arises out of indemnity arrangements which it became party to due to a series of transactions that took place from the late-1970s onwards. US authorities have never identified Industries or BATUS as PRPs.

53. In 1978, a subsidiary of Industries, later known as Appleton Papers Inc. and now known as Appvion, purchased what was then NCR's Appleton Papers Division from NCR. Under the terms of the agreement, Industries and Appvion both provided indemnities to NCR concerning certain environmental liabilities. In 1978, Industries also incorporated a US entity by the name of BATUS, Inc. (BATUS), which in 1980 became the holding company for all of Industries' US subsidiaries, including Appvion. As the holding company, BATUS obtained insurance policies for itself and its subsidiaries that included coverage for certain environmental liabilities. Industries/BATUS spun off the Appvion business in 1990 via a Demerger Agreement with Wiggins Teape Appleton p.l.c., now known as Windward Prospects Ltd (Windward), and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins US Holdings Ltd (collectively, the "AWA Entities"), obtaining what Industries believes were full indemnities from the AWA Entities and Appvion for past and future environmental claims.

54. Disputes between NCR, Appvion, and Industries as to the indemnities given and received under the original purchase agreement in 1978 have been the subject of litigation that was commenced in 1995, a settlement agreement effective from 1998 (the "Settlement Agreement"), and an arbitration award in 2005. NCR took the position that, under the terms of the Settlement Agreement and the arbitration award, Industries and Appvion generally had a joint and several obligation to bear 60% of the Fox River environmental remediation costs imposed on NCR. Until May 2012, Appvion and the AWA Entities paid the 60% share of the clean-up costs and Industries was never required to contribute.

Notes on the Accounts continued

30 Contingent liabilities and financial commitments continued

Litigation surrounding Windward's indemnities to Appvion and to Industries

55. The refusal of Appvion and Windward to continue to pay clean-up costs after May 2012 led to NCR making the demands on Industries referenced above. Industries commenced proceedings against Windward and Appvion in the High Court of England & Wales (the "High Court") in December 2011 concerning the indemnity obligations under the 1990 Demerger Agreement and Settlement Agreement. These proceedings were discontinued pursuant to the Funding Agreement, described below.

Funding Agreement of 30 September 2014

56. On 30 September 2014, Industries entered into the Funding Agreement with Windward, Appvion, NCR and BTI 2014 LLC (a wholly-owned subsidiary of Industries). Pursuant to the Funding Agreement, the English Indemnity Proceedings and a counterclaim Appvion had brought in those proceedings, as well as an NCR-Appvion arbitration concerning Appvion's indemnity to NCR, were discontinued as part of an overall agreement between the parties providing a framework through which they would together fund the ongoing costs of the Fox River clean-up. Under the agreement, NCR has agreed to accept funding by BAT at the lower level of 50% of the ongoing clean-up related costs of the Fox River (rather than the 60% referenced above; this remains subject to an ability to litigate the extent to which a further 10% of the costs ought to be allocated at a later stage). In addition Windward and Appvion each committed to contribute to the funding – Windward has contributed US$10 million and Appvion will contribute up to a maximum of US$25 million respectively for each of Fox River and Kalamazoo River (see further below). The parties have also agreed to cooperate in order to maximise recoveries from certain claims that exist against third parties, including those claims which exist against Windward's former shareholder, Sequana S.A. (Sequana), Windward's former directors and Windward's former advisors in relation to dividend payments made by Windward to Sequana totalling over US$800 million in 2008 and 2009. Any proceeds resulting from third-party claims will be applied to meet river clean-up costs first, thereby reducing Industries' obligations under the Funding Agreement and Industries then ranks first in the agreed repayment waterfall should surplus remain. Windward has provided Industries with an agreed direct indemnity to potentially cover shortfalls in recoveries by Industries against the amounts paid out. The Funding Agreement also assigned the claims which Windward has against Sequana, as well as certain claims against former advisers to Windward, to BTI 2014 LLC.

57. Previously, Sequana sought to challenge Windward's ability to enter into the Funding Agreement on the basis of certain restrictions contained in Windward's articles of association. As a consequence, Sequana also challenged the validity of the assignment by Windward to BTI 2014 LLC of certain claims belonging to Windward, including Windward's claim against Sequana and Windward's former directors. Sequana ultimately dropped its challenge on 19 June 2015 meaning BTI 2014 LLC is now free to progress the various assigned claims.

58. Windward commenced a claim against Sequana and the former Windward directors in the High Court of England & Wales (High Court) on 9 May 2014 concerning the dividend payments. Industries filed its own direct claims seeking to recover the dividend payments from Sequana in December 2013. Industries' and Windward's dividend payment claims (the latter were assigned to an Industries subsidiary, BTI 2014 LLC, as part of the Funding Agreement) are set down for trial before the High Court in February 2016.

59. BTI 2014 LLC has brought claims against certain of Windward's former advisors, including Windward's auditors at the time of the dividend payments, PricewaterhouseCoopers LLP.

60. The sums Industries has agreed to pay under the Funding Agreement are subject to ongoing adjustment, as clean-up costs can only be estimated in advance of the work being carried out and as certain sums payable are the subject of ongoing US litigation. In 2014 and 2015, Industries paid £65 million in respect of clean-up costs and is potentially liable for a further £144 million in future clean-up costs. Industries has retained a provision of £160 million which represents the current best estimate of its exposure – see note 22 "Provisions".

Kalamazoo

61. Industries is aware that NCR is also being pursued by Georgia-Pacific, as the owner of a facility on the Kalamazoo River in Michigan which released PCBs into that river. Georgia-Pacific has been designated as a PRP in respect of the river.

62. Georgia-Pacific contends that NCR is responsible for, or should contribute to, the clean-up costs, because:

    (a) a predecessor to NCR's Appleton Papers Division sold "broke" containing PCBs to Georgia-Pacific or others for recycling;

    (b) NCR itself sold paper containing PCBs to Georgia-Pacific or others for recycling; and/or

    (c) NCR is liable for sales to Georgia-Pacific or others of PCB-containing broke by Mead Corporation, which, like the predecessor to NCR's Appleton Papers Division, coated paper with the PCB containing emulsion manufactured by NCR.

63. A full trial on liability took place in February 2013. On 26 September 2013, the Michigan Court held that NCR was liable as a PRP on the basis that broke sales constituted an arrangement for the disposal of hazardous material for the purposes of CERCLA. The decision was based on NCR's knowledge of the hazards of PCBs from at least 1969, but the Court did not specify directly the entity(ies) whose broke sales form the basis of NCR's liability. NCR will have the ability to appeal the ruling once a final judgment has been entered or it has been otherwise certified for appeal.

30 Contingent liabilities and financial commitments continued

64. The second phase of the Kalamazoo trial to determine the apportionment of liability amongst NCR, Georgia-Pacific and the other PRPs (International Paper Company and Weyerhaeuser Company) took place between September and December 2015. Post-briefing submissions will run to 25 March 2016 and a judgment is not expected until some time thereafter. The court may or may not also rule on the allocation of future costs. Industries anticipates that NCR may seek to recover from Appvion (subject to a cap of US$25 million for "Future Sites" under the Funding Agreement as described above) and/or Industries 60% of any Kalamazoo clean-up costs for which it is found liable on the basis, it would be asserted, that the river constitutes a "Future Site" for the purposes of the Settlement Agreement. Industries believes it may have defences to any such claim by NCR. The Funding Agreement described above does not resolve any such claims, but does provide an agreed mechanism pursuant to which any surplus from the valuable recoveries of any third-party claims that remains after all Fox River related clean-up costs have been paid and Industries and NCR have been made whole may be applied towards Kalamazoo clean-up costs, in the event that NCR were to be successful in any claim for a portion of them from Industries or Appvion (subject to Appvion's cap). The quantum of the clean-up costs for the Kalamazoo River is presently unclear (as is the extent of NCR's liability in respect of such costs), but could run into hundreds of millions of dollars. A witness on behalf of Georgia-Pacific testified in the trial concerning the apportionment of liability that the cost of performing future remediation in Operable Unit 5 of the Kalamazoo River was in the order of US$670 million. Operable Unit 5 is the Kalamazoo River itself, as distinct from the other Operable Units which are landfills or other facilities adjoining the Kalamazoo River. Remediation of these other Operable Units has largely been completed except for monitoring.

65. As detailed above, Industries is taking active steps to protect its interests, including seeking to procure the repayment of the Windward dividends, pursuing the other valuable claims that are now within its control, and working with the other parties to the Funding Agreement to maximise recoveries from third parties with a view to ensuring that amounts funded towards clean-up related costs are later recouped under the agreed repayment mechanisms.

General litigation conclusion

66. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Group believes that the defences of the Group's companies to all these various claims are meritorious on both the law and the facts, and a vigorous defence is being made everywhere. An adverse judgment was entered against one Group company, Imperial, in the Quebec class actions and an appeal has been made. If further adverse judgments are entered against any of the Group's companies in any case, appeals will be made. Such appeals could require the appellants to post appeal bonds or substitute security (as has been necessary in Quebec) in amounts which could in some cases equal or exceed the amount of the judgment. In any event, the Group has the benefit of the RJRT Indemnification with regard to US litigation, excluding the litigation brought by the shareholders of Reynolds. At least in the aggregate, and despite the quality of defences available to the Group, it is not impossible that the Group's results of operations or cash flows in particular quarterly or annual periods could be materially affected by this and by the final outcome of any particular litigation.

67. Having regard to all these matters, with the exception of Fox River, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation; and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

Tax disputes

The Group has exposures in respect of the payment or recovery of a number of taxes. The Group is and has been subject to a number of tax audits covering, among others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with the Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense.

The following matters may proceed to litigation:

Brazil

The Brazilian Federal Tax Authority has filed claims against Souza Cruz seeking to reassess the profits of overseas subsidiaries to corporate income tax and social contribution tax. The first reassessment was for the years 2004-2006 in the sum of R$518 million (£89 million) to cover tax, interest and penalties. The second reassessment was for the years 2007 and 2008 in the amount of R$271 million (£46 million) to cover tax, interest and penalties.

Souza Cruz appealed both reassessments. Regarding the first assessment the Souza Cruz appeal was rejected in 2013 although the written judgment of that tribunal is still awaited. The appeal against the second assessment was upheld at the second tier tribunal and was closed. In 2015 a further reassessment for the same period was raised after the five-year statute of limitation. This has been appealed and awaits review at the first tier tribunal.

Souza Cruz received further reassessments in 2014 for the 2009 calendar year in the sum of R$231 million (£40 million), and in 2015 an assessment for the 2010 calendar year in the sum of R$152 million (£26 million) both covering tax, interest and penalties. Souza Cruz appealed both the reassessments in full. Regarding the 2009 assessment the Souza Cruz appeal was rejected and awaits review by the second tier tribunal.

South Africa

In 2011 the South African Revenue Service (SARS) challenged the debt financing of British American Tobacco South Africa (BATSA) and reassessed the years 2006 to 2008. BATSA has objected to and appealed this reassessment. In 2014, SARS also reassessed the years 2009 and 2010. In 2015, BATSA has filed formal Notices of Appeal against the 2009 and 2010 assessments and has reserved its right to challenge the constitutionality of the assessment at a later date. BATSA have filed a detailed objection letter to the 2009/10 reassessments. Across the period from 2006 to 2010 the reassessments are for R1.79 billion (£78 million) covering both tax and interest.

Netherlands

External bonds of British American Tobacco Holdings (The Netherlands) B.V. are guaranteed by British American Tobacco p.l.c. In 2013, a new Dutch transfer pricing decree was introduced. The authorities are seeking to deny all deductions for guarantee fees going back to 2008, and have issued assessments for the years 2008, 2009 and 2011 in the sum of €31 million (£23 million) to cover tax and interest. The appropriate objection correspondence against these assessments has been filed.

Notes on the Accounts continued

30 Contingent liabilities and financial commitments continued

The Group believes that the Group's companies have meritorious defences in law and fact in each of the above matters and intends to pursue each dispute through the judicial system as necessary. The Group does not consider it appropriate to make provision for these amounts assessed nor for any potential further amounts which may be assessed in subsequent years.

While the amounts that may be payable or receivable in relation to tax disputes could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

VAT and duty disputes

Bangladesh

The operating company is in receipt of a retrospective notice of imposition and realisation of VAT and supplementary duty on low price category brands from the National Board of Revenue (NBR) for approximately £162 million. The company is alleged to have evaded tax by selling the products in the low price segments rather than the mid-tier price segments. Management believe that the claims are unfounded.

Litigation has proceeded during 2015. The issue is currently awaiting outcome from the High Court, and a 10% deposit may have to be paid during 2016 in order to pursue any appeal.

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2015 £m	2014 £m
Property		
Within one year	**51**	52
Between one and five years	**102**	117
Beyond five years	**48**	25
	201	194
Plant and equipment		
Within one year	**19**	24
Between one and five years	**26**	40
	45	64

Performance guarantees

As shown in note 26(a) as part of the acquisition of TDR, the Group has committed to keeping the manufacturing facility in Kanfanar, Croatia operational for at least five years following completion of the acquisition. A similar commitment has been given in respect of the packaging plant in Rovinj, Croatia. The maximum exposure under these guarantees is £38 million.

31 Interests in subsidiaries

Subsidiaries with material non-controlling interests

Non-controlling interests principally arise from the Group's listed investment in Malaysia (British American Tobacco (Malaysia) Berhad) (where the Group held 50% of the listed holding company in both 2015 and 2014). The Group has assessed that it exercises de facto control over Malaysia as it has the practical ability to direct the business through effective control of the company's board as a result of the Group controlling the largest shareholding block in comparison to other shareholdings which are widely dispersed. Summarised financial information for Malaysia is shown below as required by IFRS 12 *Disclosure of Interests in Other Entities*. As part of the Group's reporting processes, Malaysia report consolidated financial information for the Malaysia group which has been adjusted to comply with Group accounting policies which may differ to local accounting practice. Goodwill in respect of Malaysia, which arose as a result of the acquisition of the Rothmans group referred to in note 9, has not been included as part of the net assets below. No adjustments have been made to the information below for the elimination of inter-company transactions and balances with the rest of the Group.

The Group also held 75% of the listed investment in Brazil (Souza Cruz) in 2014 but acquired substantially all of the non-controlling interests in 2015 (see note 26). Financial information for the Souza Cruz Group is not presented as it no longer has a material non-controlling interest.

31 Interests in subsidiaries continued

Summarised financial information	Malaysia Group 2015 £m	2014 £m
Revenue	**422**	485
Profit for the year	**152**	167
– Attributable to non-controlling interests	***76***	*84*
Total comprehensive income	**136**	167
– Attributable to non-controlling interests	***68***	*83*
Dividends paid to non-controlling interests	**(75)**	(82)
Summary net assets:		
Non-current assets	**43**	55
Current assets	**74**	93
Non-current liabilities	**(8)**	(8)
Current liabilities	**(99)**	(131)
Total equity at the end of the year	**10**	9
– Attributable to non-controlling interests	***5***	*4*
Net cash generated from operating activities	**164**	182
Net cash generated from investing activities	**1**	2
Net cash used in financing activities	**(161)**	(195)
Differences on exchange	**–**	1
Increase/(decrease) in net cash and cash equivalents	**4**	(10)
Net cash and cash equivalents at 1 January	**1**	11
Net cash and cash equivalents at 31 December	**5**	1

Other shareholdings

In the section 'Group Companies and Undertakings' on pages 206 to 212, the Group discloses that it holds 85% (2014: 85%) of the equity shares of PT Bentoel Internasional Investama Tbk (Bentoel). In 2011, the Group sold 984 million shares, representing approximately 14% of Bentoel's share capital, for the purposes of fulfilling certain obligations pursuant to Bapepam LK (Indonesia) takeover regulations. The Group simultaneously entered into a total return swap on 971 million of the shares. As a consequence of this and for the duration of the swap, while the Group does not have legal ownership of these shares, it retains the risks and rewards which results in the Group continuing to recognise an effective interest in 99% of Bentoel's net assets and results.

32 Post balance sheet date announcement

The compulsory acquisition of the remaining minority shares of Souza Cruz S.A. was approved on 5 February 2016, with Souza Cruz S.A. becoming a wholly-owned subsidiary at that date. The cost of acquiring the remaining shares was £70 million.

Financial Statements

Unaudited financial information

Five-Year Summary

For the years ended 31 December	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Income Statement					
Gross turnover (including duty, excise and other taxes)	**41,000**	42,506	46,185	45,872	46,123
Revenue (after deducting duty, excise and other taxes)	**13,104**	13,971	15,260	15,190	15,399
Profit from operations	**4,557**	4,546	5,526	5,372	4,675
Adjusted profit from operations	**4,992**	5,403	5,820	5,641	5,473
Profit before taxation	**5,855**	4,848	5,799	5,592	4,870
Profit for the year	**4,522**	3,393	4,199	4,076	3,321

	2015 pence	2014 pence	2013 pence	2012 pence	2011 pence
Earnings per share					
– basic unadjusted	**230.9**	167.1	205.4	195.8	154.4
– diluted unadjusted	**230.3**	166.6	204.6	194.8	153.5
– diluted adjusted	**208.4**	208.1	216.6	205.2	191.9
Dividends declared per share	**154.0**	148.1	142.4	134.9	126.5

At 31 December	2015 £m	2014 £m	2013 £m	2012 £m	2011 £m
Balance Sheet					
Non-current assets	**21,701**	17,035	17,363	18,141	18,624
Current assets	**9,814**	9,132	9,518	9,186	8,495
Total assets	**31,515**	26,167	26,881	27,327	27,119
Owners of the parent	**4,894**	5,510	6,634	7,472	8,167
Non-controlling interests	**138**	304	301	307	307
Total equity	**5,032**	5,814	6,935	7,779	8,474
Non-current liabilities	**17,477**	11,584	11,510	11,406	10,798
Current liabilities	**9,006**	8,769	8,436	8,142	7,847
Total liabilities	**26,483**	20,353	19,946	19,548	18,645
Total equity and liabilities	**31,515**	26,167	26,881	27,327	27,119

Unaudited financial information

Half-Yearly Analysis of Profit

The figures shown below have been produced using average rates of exchange on a half-yearly basis since the beginning of the year. Thus the discrete half year to 30 June has not been restated for subsequent movements in foreign exchange rates during the year, which are reflected in the results for the subsequent half year to 31 December.

	6 months to		Year to
	30 Jun 2015 £m	31 Dec 2015 £m	31 Dec 2015 £m
Profit from operations	**2,347**	**2,210**	**4,557**
Analysed as:			
– adjusted profit from operations	**2,507**	**2,485**	**4,992**
– restructuring and integration costs	**(133)**	**(234)**	**(367)**
– amortisation of trademarks and similar intangibles	**(26)**	**(39)**	**(65)**
– Flintkote	**(1)**	**(2)**	**(3)**
	2,347	**2,210**	**4,557**
Net finance income/(costs)	**351**	**(289)**	**62**
Share of post-tax results of associates and joint ventures	**799**	**437**	**1,236**
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	**419**	**524**	**943**
– issue of shares and change in shareholding	**25**	**(3)**	**22**
– gain on disposal of assets	**406**	**(35)**	**371**
– other	**(51)**	**(49)**	**(100)**
	799	**437**	**1,236**
Profit before taxation	**3,497**	**2,358**	**5,855**
Earnings per share			
Basic	**142.4p**	**88.5p**	**230.9p**
Diluted	**142.1p**	**88.2p**	**230.3p**
Adjusted diluted	**100.2p**	**108.2p**	**208.4p**

	6 months to		Year to
	30 Jun 2014 £m	31 Dec 2014 £m	31 Dec 2014 £m
Profit from operations	2,458	2,088	4,546
Analysed as:			
– adjusted profit from operations	2,665	2,738	5,403
– restructuring and integration costs	(179)	(273)	(452)
– amortisation of trademarks and similar intangibles	(28)	(30)	(58)
– Fox River	–	27	27
– Flintkote	–	(374)	(374)
	2,458	2,088	4,546
Net finance costs	(208)	(209)	(417)
Share of post-tax results of associates and joint ventures	364	355	719
Analysed as:			
– adjusted share of post-tax results of associates and joint ventures	349	363	712
– issue of shares and change in shareholding	16	(2)	14
– other	(1)	(6)	(7)
	364	355	719
Profit before taxation	2,614	2,234	4,848
Earnings per share			
Basic	93.3p	73.8p	167.1p
Diluted	93.1p	73.5p	166.6p
Adjusted diluted	101.8p	106.3p	208.1p

Financial Statements

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, associate undertakings and joint operations (showing the country of incorporation and effective percentage of equity shares held) as at 31 December 2015 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
British American Tobacco – Albania SH.P.K.

Algeria
British American Tobacco (Algérie) S.P.A. (50.99%)

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
Nobleza-Piccardo S.A.I.C.y F. (99.95%)

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
British American Tobacco (Austria) GmbH

Bahrain
British American Tobacco Middle East S.P.C.

Bangladesh
British American Tobacco Bangladesh Company Limited (72.91%)

Barbados
B.C.O., Inc.
Southward Insurance Ltd.

Belarus
British-American Tobacco Trading Company Foreign Private Trading Unitary Enterprise

Belgium
British American Tobacco Belgium N.V.
British American Tobacco Co-ordination Centre/L.P. Co-ordination Centre VOF
British American Tobacco Holdings Belgium N.V.
Tabacofina-Vander Elst N.V.

Benin
British American Tobacco Benin SA

Bosnia and Herzegovina
Adista BH d.o.o.
British American Tobacco – BAT – BL d.o.o.
iNovine BH d.o.o. (100%) (97.44%)^
IPRESS d.o.o. (51%)
Opresa d.d. (97.44%)
TDR d.o.o. Sarajeva

Botswana
British American Tobacco Botswana (Pty) Limited
Business Venture Investments Botswana 6773 (Pty) Ltd.

Brazil
British American Tobacco Americas Prestação de Serviços Limitada
Souza Cruz S.A. (99.1%)
Yolanda Participacoes S.A. (100%) (99.1%)^

Brunei Darussalam
Commercial Marketers and Distributors Sdn. Bhd. (100%) (50%)^

Bulgaria
British American Tobacco Trading EOOD
Rovita Bugarska d.o.o.

Cambodia
British American Tobacco (Cambodia) Limited (71%)
British American Tobacco (Cambodge) International Limited

Cameroon
British American Tobacco Cameroun S.A. (99.75%)

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 Services Inc.
Imperial Tobacco Products Limited
John Player & Sons Ltd
Liggett & Myers Tobacco Company of Canada Limited[iii]
Marlboro Canada Limited
Medaillon Inc.
2004969 Ontario Inc.

Chile
BAT Chile S.A. (100%) (99.41%)^
British American Tobacco Chile Operaciones S.A. (99.41%)
Inversiones Casablanca S.A.

China
British American Consulting (Beijing) Ltd

Colombia
British American Tobacco Colombia S.A.S.
Samkas International SAS
Vype Colombia S.A.S.

Congo
BAT Distribution SPRL
British American Tobacco Congo SARL
BAT Services Congo SARL

Costa Rica
BATCCA Park Inversiones Inmobiliarias, S.A.
BATCCA Servicios S.A.
BASS Americas S.A.

Croatia
Adiste d.o.o.
BAT HRVATSKA d.o.o.
Bonaster d.o.o.
Hrvatski Duhani d.d. Tobacco Leaf Processing (89.55%)
Inovine d.d. (88.80%)
Istagratika d.d. Cardboard packaging production
TDR d.o.o.

Cuba
Brascuba Cigarrillos S.A. (50%) (37.63%)^

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
British American Tobacco (Czech Republic), s.r.o.

Denmark
British American Tobacco Denmark A/S (House of Prince A/S)
British American Tobacco Denmark Investments ApS
Precis (1789) Denmark A/S

Djibouti
British American Tobacco Djibouti SARL
Tobacco Exporters International (Mer Rouge) SARL

Egypt
BETCO for General Services and Marketing LLC
BETCO for Trade and Distribution LLC
British American Tobacco Egypt LLC
British American Tobacco North Africa LLC
English American Company for Importation and Trade LLC

Eritrea
British American Tobacco (Eritrea) Share Company#

Estonia
British American Tobacco Estonia AS

Fiji
British American Tobacco (Fiji) Marketing Limited
Central Manufacturing Company Limited
Rothmans of Pall Mall (Fiji) Limited

Finland
British American Tobacco Finland Oy

France
British American Tobacco France SAS
Carreras France SAS
Chic France Sarl
Nicoventures France S.A.S.

Germany
Batberg Cigarettenfabrik GmbH
BATIG Gesellschaft fur Beteiligungen m.b.H.
British American Tobacco (Germany) GmbH
British American Tobacco (Hamburg International) GmbH
British American Tobacco (Industrie) GmbH
Chic Deutschland GmbH
TDR Germany GmbH Hamburg

Ghana
British American Tobacco Ghana Limited (97.09%)

Greece
British American Tobacco Hellas S.A.

Guernsey
Belaire Insurance Company Limited

Guyana
Demerara Tobacco Company Limited (70.25%)

Financial Statements

Group Companies and Undertakings continued

Honduras
Tabacalera Hondureña S.A. (80.64%)

Hong Kong
American Cigarette Company Limited
British American Tobacco Asia-Pacific Region Limited
British American Tobacco China Investments Limited
British Cigarette Company (1964) Limited
British-American Tobacco Company (Hong Kong) Limited

Hungary
BAT Pécsi Dohánygyár Kft.

Indonesia
PT Amiseta (100%) (85.50%)^
PT Bentoel Distribusi Utama (100%) (85.50%)^
PT Bentoel Internasional Investama, Tbk (85.50%)
PT Bentoel Prima[iv] (100%) (85.50%)^
PT Bintang Boladunia (100%) (85.50%)^
PT Bintang Jagat Sejati (100%) (85.50%)^
PT Bintang Pesona Jagat (100%) (85.50%)^
PT Cipta Pesona Bintang (100%) (85.50%)^
PT Java Tobacco (100%) (85.50%)^
PT Lestariaputra Wirasejati (100%) (85.50%)^
PT Pantura Tobacco (100%) (85.50%)^
PT Perusahaan Dagang dan Industri Tresno (100%) (85.50%)^
PT Perusahaan Dagang Suburaman (100%) (85.50%)^

Iran, Islamic Republic of
B.A.T. Pars Company (Private Joint Stock)
TDR Parisian Co

Iraq
B.A.T. Iraqia Company for Tobacco Trading Limited

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
Abbey Investment Company Limited
The Raleigh Investment Company Limited
Tobacco Investments Limited
Tobacco Manufacturers (India) Limited

Israel
Overseas Tobacco Limited

Italy
British American Tobacco Italia S.p.A.

Jamaica
Carreras Limited (50.40%)[x]
Cigarette Company of Jamaica Limited (100%) (50.40%)^
Sans Souci Development Limited (100%) (50.40%)^
Sans Souci Limited (100%) (50.40%)^

Japan
British American Tobacco Japan, Ltd.

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 3 (Jersey) Limited#
Pathway 4 (Jersey) Limited
Pathway 5 (Jersey) Limited

Jordan
British American Tobacco – Jordan Private Shareholding Company Limited[xii]

Kazakhstan
British American Tobacco Kazakhstan Trading LLP

Kenya
African Cigarette Company (Overseas) Limited (100%) (60%)^
BAT Kenya Tobacco Company Limited (100%) (60%)^
British American Tobacco Area Limited
British American Tobacco Kenya Limited (60%)
East African Tobacco Company (Kenya) Limited (100%) (60%)^

Korea, Republic of
British American Tobacco Korea Limited
British American Tobacco Korea Manufacturing Limited

Kosovo
TDR shp.p.k. Pristina

Latvia
British American Tobacco Latvia SIA

Lithuania
UAB British American Tobacco Lietuva

Luxembourg
British American Tobacco Brands (Switzerland) Limited

Macedonia, Former Yugoslav Republic of
TDR Skopje d.o.o.e.i. Skopje

Malawi
British American Tobacco (Malawi) Limited

Malaysia
BAT Aspac Service Centre Sdn Bhd
British American Tobacco (Malaysia) Berhad (50%)
British American Tobacco Malaysia Foundation[viii]
British American Tobacco GSD (Kuala Lumpur) Sdn Bhd
Commercial Importers and Distributors Sdn. Bhd. (100%) (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
British American Tobacco (Mali) sarl

Malta
British American Tobacco (Malta) Limited
Central Cigarette Company Limited
Rothmans of Pall Mall (Malta) Limited

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.
Procesadora de Tabacos de Mexico, S.A. de C.V. (93%)

Moldova, Republic of
British American Tobacco-Moldova S.R.L.

Montenegro
TDR d.o.o. Podgorica

Mozambique
British American Tobacco Mozambique Limitada (95%)
Sociedade Agricola de Tabacos Limitada (95%)

Myanmar
British American Tobacco Myanmar Limited (51%)[x]
British American Tobacco Myanmar Services Limited[x]

Namibia
British American Tobacco Namibia (Pty) Limited

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 Finance RUB B.V.
British American Tobacco Finance ZAR 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
British American Tobacco (New Zealand) Limited
British American Tobacco Holdings (New Zealand) Limited
New Zealand (UK Finance) Limited[#]
Nicovations New Zealand Limited

Niger
British American Tobacco Niger

Nigeria
British American Tobacco (Nigeria) Limited
British American Tobacco Exports (Nigeria) Limited
British American Tobacco Marketing Nigeria Limited

Norway
British American Tobacco Norway AS
British American Tobacco Norway Holding AS

Pakistan
British American Tobacco SAA Services (Private) Ltd
Pakistan Tobacco Company Limited (94.66%)
Phoenix (Private) Limited (100%) (94.66%)^

Panama
BAT Caribbean, S.A.
British American Tobacco Central America S.A. (87.76%)
British American Tobacco Panama, S.A. (100%) (87.76%)^
Tabacalera Istmena S.A.

Papua New Guinea
British American Tobacco (PNG) Limited
Papua New Guinea Tobacco Company Limited
Paradise Tobacco Company Pty. Limited[iv]
Rothmans of Pall Mall (P.N.G.) Limited[iv]

Paraguay
British American Tobacco Productora de Cigarrillos S.A.

Peru
British American Tobacco del Peru Holdings S.A.A.[vi]
British American Tobacco Del Peru, S.A.C.

Philippines
Alhambra Industries Inc.[#]

Poland
British-American Tobacco Polska S.A.
British American Tobacco Polska Trading sp. zo.o.
Chic Holding sp.zo.o
Chic Investments sp.zo.o.
CHIC SP. ZO.O.
CHIC sp.zo.osp.k.
Dziurlaj, Urban I Wspolnicy Sp. Z.o.o.

Financial Statements

Group Companies and Undertakings continued

eSMOKING INSITUTE sp.zo
eSMOKING Liquids sp.zo.o
eSMOKING Liquids sp.zo.o.sp.k.
Nicoventures Poland Sp. Z.o.o.

Portugal

COTAPO Empreendimentos Commerciais e Industriais S.A.
Sociedade Unificada de Tabacos Limitada (76.40%)

Réunion

B.A.T. La Reunion SAS

Romania

British American Shared Services (Europe) S.R.L.
British-American Tobacco Romania Investment S.R.L.
British-American Tobacco (Romania) Trading SRL

Russia

CJSC 'British American Tobacco-SPb'[#]
CJSC 'International Tobacco Marketing Services'

Rwanda

British American Tobacco Rwanda Limited

Saint Lucia

Carisma Marketing Services Ltd.
Rothmans Holdings (Caricom) Limited

Samoa

British American Tobacco (Samoa) Limited

Senegal

Tobacco Marketing Consultant TMC S.A.R.L

Serbia

British American Tobacco South – East Europe d.o.o.
British American Tobacco Vranje a.d.[(vii)]
TDR d.o.o. Beograd

Singapore

Agrega Asia Pacific Pte. Ltd.
British American Tobacco Asia Pacific Treasury Private Limited
British American Tobacco International Services Pte Ltd
British American Tobacco Sales & Marketing Singapore Pte. Ltd.
British-American Tobacco (Singapore) Private Limited
British-American Tobacco Marketing (Singapore) Private Limited
RHL Investments Pte Limited[#]
Rothmans Industries Private Limited

Slovenia

British American Tobacco d.o.o.
TDR Rovita d.o.o. Liubliana

Solomon Islands

Solomon Islands Tobacco Company Limited

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) Ltd.
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

British American Tobacco España, S.A.

Sri Lanka

Ceylon Tobacco Company Plc (84.13%)

Sudan

Blue Nile Cigarette Company Limited

Swaziland

British American Tobacco Swaziland (Pty) Limited

Sweden

British American Tobacco Sweden AB
British American Tobacco Sweden Holding AB
Fiedler & Lundgren AB

Switzerland

AD Tabacs International S.A.
American-Cigarette Company (Overseas) Limited
British American Tobacco International Limited
British American Tobacco Switzerland S.A.
British American Tobacco Switzerland Vending SA
Intertab S.A. (50%)
Rothmans of Pall Mall Limited

Tanzania

BAT Distribution Tanzania Limited
British American Tobacco (Tanzania) Limited
International Cigarette Distributors Limited (99%)
Zanzibar Distribution Company Limited (99%)

Thailand

British American Tobacco (Thailand) Limited

Trinidad and Tobago

The West Indian Tobacco Company Limited (50.13%)

Turkey

British American Tobacco Tutun Mamulleri Sanayi ve Ticaret Anonim Sirketi

Uganda

British American Tobacco Uganda Limited (90%)

Ukraine

A/T B.A.T. – Prilucky Tobacco Company (99.98%)

British American Tobacco Sales and Marketing Ukraine LLC

United Arab Emirates

British American Tobacco FZ-LLC

British American Tobacco GCC DMCC

British American Tobacco ME DMCC

United Kingdom (England & Wales)

Advanced Technologies (Cambridge) Limited

Agrega Limited

Allen & Ginter (UK) Limited

Amalgamated Tobacco Company Limited

American Cigarette Company (Overseas) Limited

Ardath Tobacco Company Limited

B.A.T (U.K. and Export) Limited

B.A.T Additional Retirement Benefit Scheme Trustee 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 Industries p.l.c.

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

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

BAT Finance COP Limited

BATIF Dollar Limited

BATLaw Limited

BATMark Limited*

BATUS Limited

Benson & Hedges (Overseas) Limited

Big Ben Tobacco Company Limited

British American Global Shared Services Limited

British American Shared Services (GSD) Limited

British American 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 (AIT) Limited

British American Tobacco (AME) Exports Limited

British American Tobacco (AME) Limited

British American Tobacco (Brands) Limited

British American Tobacco (Corby) Limited

British American Tobacco (GLP) Limited

British American Tobacco (Investments) Limited

British American Tobacco (NGP) Limited

British American Tobacco (Philippines) Limited

British American Tobacco (Serbia) Limited

British American Tobacco (South America) Limited

British American Tobacco China Holdings Limited

British American Tobacco Georgia Limited

British American Tobacco Global Retail Travel 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 Taiwan Logistics Limited

British American Tobacco UK Limited

British American Tobacco UK Pension Fund Trustee Limited[(x)]

British American Ventures Limited

British American Tobacco Western Europe Commercial Trading Limited

British-American Tobacco (Holdings) Limited

British-American Tobacco (Mauritius) p.l.c.

Brown & Williamson Tobacco Corporation (Export) Limited

Carreras Limited

Carreras Rothmans Limited[#]

CG Ventures Limited

Chelwood Trading & Investment Company Limited

Courtleigh of London Limited

Dunhill Tobacco of London Limited

East African Tobacco Company (U.K.) Limited

John Sinclair Limited

Lord Extra Limited

Louisville Securities Limited

Moorgate Tobacco Co. Limited

Murray, Sons & Company, Limited

Myddleton Investment Company Limited

Nicovations Limited

Nicoventures Holdings Limited

Nicoventures Trading Limited

Peter Jackson (Overseas) Limited

Powhattan Limited

Precis (1789) Limited

Precis (1790) Limited

Precis (1814) Limited

Precis (2396) Limited

Ridirectors Limited

Financial Statements

Group Companies and Undertakings continued

Rothmans (UK) Trading Limited
Rothmans Exports Limited
Rothmans International Enterprises Limited
Rothmans International Limited
Rothmans International Tobacco (UK) Limited
Rothmans International Services Limited
Rothmans of Pall Mall (Overseas) Limited
Rothmans of Pall Mall Limited
Rothmans Trading Limited
Ryesekks p.l.c. (50%)
Ryservs (1995) Limited
Ryservs (No.3) Limited
Senior Service (Overseas) Limited
South Western Nominees Limited
The London Tobacco Company Limited
Tobacco Exporters International Limited
Tobacco Insurance Company Limited
Tobacco Marketing Consultants Limited
Venezuela Property Company Limited
Westanley Trading & Investment Company Limited
Westminster Tobacco Company Limited
Weston (2009) Limited
Weston Investment Company Limited
World Investment Company Limited

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.
BTI 2014 LLC
Genstar Pacific Corporation
Imasco Holdings Group, Inc.
Imasco Holdings, Inc.
ITL (USA) Limited
Louisville Corporate Services, Inc.
Nicoventures U.S. Limited

Uruguay

Kellian S.A.

Uzbekistan

UZBAT A.O. (97.38%)

Venezuela

Agrega de Venezuela, Agreven, C.A. (50%)
Agrobigott, C.A.
Compania Anonima Cigarrera Bigott Sucs.
Distribuidora Bigott, C.A.
Proyectos de Inversion BAT 1902

Vietnam

British American Tobacco East Asia Area Services Company Limited
British American Tobacco – Vinataba Limited (70%)
VINA-BAT Joint Venture Company (49%)

Zambia

British American Tobacco (Zambia) plc (78.08%)

Zimbabwe

American-Cigarette Company (Overseas) (Private) Ltd
British American Tobacco Zimbabwe (Holdings) Limited (43.13%)
Rothmans Limited
Rothmans of Pall Mall (Malawi) Limited (100%) (43.13%)^(x)

Associate Undertakings

Angola

Agrodande Limitada (32.50%)
Soc. Filtros Angola Sarl (39.14%)

Argentina

Agrega S.A. (75%) (43.74%)^

Bosnia and Herzegovina

POS d.o.o. (100%) (22.24%)^
Satelit Plus d.o.o. (25%) (22.24%)^
Uncro Team d.o.o. (100%) (22.24%)^

Croatia

Tisak d.d. (25.86%)

Hungary

Országos Dohányboltellátó Korlátolt Felelosségu Társaság (49%)

India

ITC Limited (30.03%)(x)
VST Industries Limited (32.16%)(x)

Nepal

Surya Nepal Pvt. Limited (51%) (17.28%)^(xi)

Nigeria

BATN Foundation (40%)(viii)
Nigerpak Limited (26%)(ix)

Serbia

Veletabak d.o.o. (25%)

United States

Reynolds American Inc. (42.17%)

Yemen

Kamaran Industry and Investment Company (31%)
United Industries Company Limited (26.40%)

Joint Operations

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.

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 parent company financial statements is unmodified

We have audited the parent company financial statements of British American Tobacco p.l.c. for the year ended 31 December 2015 which comprise the parent company Balance Sheet, the parent company Statement of Changes in Equity and the related notes. In our opinion the parent company financial statements:

– give a true and fair view of the state of the company's affairs as at 31 December 2015;

– have been properly prepared in accordance with UK Accounting Standards, including FRS 101 *Reduced Disclosure Framework;* and

– have been prepared in accordance with the requirements of the Companies Act 2006.

Certain required disclosures have been presented elsewhere in the Annual Report, rather than in the notes to the accounts. These are cross-referenced from the Group financial statements and identified as audited.

2 Our 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 for which the financial statements are prepared is consistent with the parent company financial statements.

3 We have nothing to report in respect of the matters on which we are required to report by exception

The Companies Act 2006 requires us to report to you if, in our opinion:

– adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or

– the parent company financial statements and the part of the 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.

We have nothing to report in respect of the above responsibilities.

4 Other matter – we have reported separately on the Group financial statements

We have reported separately on the Group financial statements of British American Tobacco p.l.c. for the year ended 31 December 2015.

Scope and responsibilities

As explained more fully in the Directors' Responsibilities Statement set out on page 120, the Directors are responsible for the preparation of the parent company 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 www.kpmg.com/uk/auditscopeukco2014a, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

Mark Baillache (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London, E14 5GL
24 February 2016

Financial Statements

Balance Sheet

British American Tobacco p.l.c. – at 31 December

	Notes	2015 £m	2014 £m
Assets			
Fixed assets			
Investments in Group companies	2	**4,415**	4,356
		4,415	4,356
Current assets			
Debtors	3	**7,371**	9,116
Cash at bank and in hand		**3**	4
Total current assets		**7,374**	9,120
Total assets		**11,789**	13,476
Equity			
Capital and reserves			
Called up share capital		**507**	507
Share premium account		**78**	74
Capital redemption reserves		**101**	101
Other reserves		**90**	90
Profit and loss account		**7,116**	8,902
after deducting			
– cost of treasury shares		**(5,032)**	(5,057)
Shareholders' funds	4	**7,892**	9,674
Liabilities			
Creditors	5	**3,897**	3,802
Total equity and liabilities		**11,789**	13,476

The accompanying notes are an integral part of the Parent Company financial statements.

On behalf of the Board

Richard Burrows
Chairman
24 February 2016

Financial Statements

Statement of Changes in Equity

British American Tobacco p.l.c. – at 31 December

	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

As set out in note 8, 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 *Share-based Payment* related to Group-settled share-based payments.

In the transition from UK Generally Accepted Accounting Principles to FRS 101, the Company has applied IFRS 1 *First-time Adoption of International Financial Reporting Standards*, whilst ensuring that its assets and liabilities are measured in compliance with FRS 101. There were no material measurement or recognition adjustments to previously reported amounts as a result of applying FRS 101. 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 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 is 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., B.A.T Capital Corporation 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 206 to 212 of the Group financial statements.

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.

	2015 £m	2014 £m
1 January	**4,356**	4,350
Additions	**59**	6
31 December	**4,415**	4,356

3 Debtors

	2015 £m	2014 £m
Amounts due from Group undertakings	**7,371**	9,116
Current	**7,327**	9,056
Non-current	**44**	60
31 December	**7,371**	9,116

Included within amounts due from Group undertakings is an amount of £7,309 million (2014: £9,036 million) which is unsecured, interest bearing and repayable on demand. The interest rate is based on LIBOR.

Amounts totalling £18 million (2014: £20 million) due from Group undertakings are unsecured, interest-free and repayable on demand.

Included in the above are amounts of £44 million (2014: £60 million) falling due after one year, all of which is unsecured and interest-free. The Directors do not consider the difference between book value and fair value to be material.

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 2015 is shown in note 8 to the Group financial statements and will be recognised in the financial statements for the year ended 31 December 2016.

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 2015 was £961 million (2014: £4,561 million).

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration Report. Details of key management compensation are included in note 29 of the Group financial statements. The Company had two employees at 31 December 2015 (2014: two). These two employees are Nicandro Durante and Ben Stevens. The details of their remuneration are shown on pages 96 and 97 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 (2014: £4,845 million) for shares repurchased and not cancelled and £187 million (2014: £212 million) in respect of the cost of own shares held in employee share ownership trusts.

During 2014, 23 million shares were bought back at a cost of £795 million, excluding transaction costs of £5 million. The share buy-back programme was suspended from 30 July 2014. As at 31 December 2015, treasury shares include 5,356,084 of shares held in trust and 162,645,590 of shares repurchased and not cancelled as part of the Company's share buy-back programme.

Financial Statements

Notes on the Accounts continued

4 Shareholders' funds continued

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 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**

Called-up share capital	Ordinary shares of 25p each Number of shares	£m
Allotted and fully paid		
1 January 2014	2,026,456,406	506.61
Changes during the year		
– share option schemes	236,623	0.06
31 December 2014	2,026,693,029	506.67

Share premium

The increase of £4 million (2014: £4 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report.

5 Creditors

	2015 £m	2014 £m
Amounts due to Group undertakings	**64**	9
Loans due to Group undertakings	**3,617**	3,617
Other creditors	**208**	176
Deferred income	**8**	–
	3,897	3,802
Current	**108**	56
Non-current	**3,789**	3,746
31 December	**3,897**	3,802

Amounts due to Group undertakings of £64 million (2014: £9 million) are unsecured, interest-free and repayable on demand.

Loans due to Group undertakings of £3,617 million (2014: £3,617 million) are unsecured, bear interest at rates between 1.92% and 1.94% (2014: 1.87% and 1.92%) and are repayable in 2017.

Other creditors include financial guarantees of £191 million (2014: £160 million) of which £164 million (2014: £129 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 an ongoing appeals process and was made with no admission of liability.

6 Audit fees

	2015	2014
Fees payable to PricewaterhouseCoopers LLP		
– Audit fees	**£nil**	£30,000
– Fees paid for other services	**£nil**	£nil
Fees payable to KPMG LLP		
– Audit fees	**£30,000**	£nil
– 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 £15.8 billion (2014: £11.1 billion) and total borrowing facilities of £21.5 billion (2014: £25.3 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 2015 of £311 million (2014: deficit of £0.3 million). In addition, there are contingent liabilities in respect of litigation in various countries (note 30 to the Group financial statements).

8 FRS 101 *Reduced Disclosure Framework*

The Financial Reporting Council has issued FRS 100 *Application of Financial Reporting Requirements,* FRS 101 *Reduced Disclosure Framework* and FRS 102 *The Financial Reporting Standard applicable in the UK and Ireland*. These standards are applicable to all companies and entities in the UK and Republic of Ireland, other than listed groups which continue to report under IFRS, for accounting periods beginning on or after 1 January 2015.

FRS 100 sets out the overall financial reporting framework for companies in the UK and Ireland. FRS 101 applies to the individual financial statements of subsidiaries and ultimate parents, allowing them to apply the same accounting policies as in their listed group accounts, but with fewer disclosures. FRS 102 is a single financial reporting standard that applies to the financial statements of entities that are not applying IFRS, FRS 101 or the FRSSE. The primary statements of entities applying FRS 101 or FRS 102 would continue to follow the requirements of the Companies Act 2006.

The Company has adopted the accounting requirements of the reduced disclosure framework under FRS 101 in these financial statements, with a transition date of 1 January 2014. Given that the Company previously applied the fair value provisions of historic UK GAAP, the adoption of FRS 101 had no material impact to previously reported amounts in profit or equity.

The Company's financial statements still meet the requirements of the Companies Act 2006 including giving a true and fair view of the Company's assets, liabilities, financial position and profit or loss. This means the Company will therefore always be required to include in its accounts all information relevant to shareholders and necessary to show a true and fair view.

The Company is required to inform its shareholders and to provide a reasonable opportunity for its shareholders to object to the use of FRS 101. A shareholder or shareholders holding in aggregate 5% or more of the total allotted shares in British American Tobacco p.l.c. may object to the Company applying the FRS 101 *Reduced Disclosure Framework* to its individual financial statements by notifying the Company Secretary in writing at the address of the Company given on page 222 of the Annual Report and Accounts by the close of business on Friday, 22 April 2016.

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 100 925; +27 11 870 8222
email enquiries: web.queries@computershare.co.za

American Depositary Receipts

NYSE MKT (Symbol: BTI; CUSIP No. 110448107)

British American Tobacco sponsors an American Depositary Receipt (ADR) programme in the United States. Each ADR represents two of the Company's ordinary shares.

Enquiries regarding ADR holder accounts and payment of dividends should be directed to:

Citibank Shareholder Services
PO Box 43077, Providence, Rhode Island 02940-3077, USA
tel: 1-888 985-2055 (toll-free) or +1 781 575 4555
email enquiries: citibank@shareholders-online.com
website: www.citi.com/dr

Publications

Copies of current and past Annual Reports are available on request. Copies of the Group corporate brochure, 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

Final dividend 2015 – dates in 2016

Please see 'Other corporate disclosures' (page 113) for further details.

25 February	Dividend announced (including amount of dividend per share in both sterling and rand, applicable exchange rate and conversion date – 23 February 2016; plus additional applicable information as required in respect of South Africa Dividends Tax)
25 February to 18 March	From the commencement of trading on 25 February to 18 March 2016 (inclusive), no removal requests in either direction between the UK main register and the South Africa branch register will be permitted
11 March	Last day to trade (JSE)
14 March to 18 March	From the commencement of trading on 14 March to 18 March 2016 (inclusive), no transfers between the UK main register and the South Africa branch register; no shares may be dematerialised or rematerialised
14 March	Ex-dividend date (JSE)
17 March	Ex-dividend date (LSE)
18 March	Record date (LSE and JSE)
13 April	Last date for receipt of Dividend Reinvestment Plan (DRIP) elections (UK main register only)
5 May	Payment date (sterling and rand)

Financial calendar 2016

26 April	Interim Management Statement *(This represents a change to the previously reported date due to the closure of the JSE on a national holiday in South Africa on 27 April 2016)*
27 April	Annual General Meeting Milton Court Concert Hall, Silk Street, London EC2Y 9BH
28 July	Half-Yearly Report
26 October	Interim Management Statement

Analyses of shareholders

The high and low prices at which the Company's shares are recorded as having traded during the year on each of the LSE and the JSE are as follows:

	High	Low
LSE	£38.985	£33.555
JSE	R873.14	R609.47

At 31 December 2015 there was a total of 2,026,866,724 ordinary shares in issue held by 118,963 shareholders. These shareholdings are analysed as follows:

(a) by listing as at 31 December 2015:

Register	Total number of shares	Percentage of issued share capital	Number of holders
UK	1,735,952,033	85.65	45,807
South Africa	290,914,691	14.35	73,156

b) by category of shareholder and size of shareholding as at 31 December 2015 (UK register) and 24 December 2015 (South Africa register), being the latest practicable dates on which equivalent information was available on both registers:

UK Register

Category of UK shareholder	Number of UK holders	Percentage of total UK holders	Number of UK ordinary shares	Percentage of UK ordinary share capital
Individuals	36,972	80.71	39,599,843	2.28
Financial institutions/ Pension funds	250	0.55	2,576,882	0.15
Nominee companies	8,351	18.23	1,465,880,757	84.44
Other corporate holders	233	0.51	65,248,961	3.76
Treasury shares (UK)	1	<0.01	162,645,590	9.37

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	53,817	73.56	26,371,900	9.07
Financial institutions/ Pension funds	2,566	3.51	188,812,826	64.90
Nominee companies	14,375	19.65	63,830,593	21.94
Other corporate holders	2,398	3.28	11,899,372	4.09

Financial Statements

Shareholder and contact information continued

Combined Registers

Category of shareholder	Number of holders	Percentage of total holders	Number of ordinary shares	Percentage of issued ordinary share capital
Individuals	90,789	76.32	65,971,743	3.26
Financial institutions/ Pension funds	2,816	2.37	191,389,708	9.44
Nominee companies	22,726	19.10	1,529,711,350	75.47
Other corporate holders	2,631	2.21	77,148,333	3.81
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	38,663	1.03
2,000 – 9,999	5,363	1.17
10,000 – 199,999	1,279	3.62
200,000 – 499,999	219	4.00
500,000 and over	282	80.81
Treasury shares (UK)	1	9.37

South Africa Register

	Number of holders	Percentage of SA ordinary share capital
1 – 1,999	66,808	6.83
2,000 – 9,999	4,540	6.26
10,000 – 199,999	1,639	21.85
200,000 – 499,999	97	10.15
500,000 and over	72	54.91

Combined Registers

	Number of holders	Percentage of issued ordinary share capital
1 – 1,999	105,471	1.86
2,000 – 9,999	9,903	1.90
10,000 – 199,999	2,918	6.24
200,000 – 499,999	316	4.88
500,000 and over	354	77.10
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

34 Alexander Street, Stellenbosch 7600, South Africa
PO Box 631, Cape Town 8000, South Africa
tel: +27 21 888 3194

Secretary

Nicola Snook

General Counsel

Jerome Abelman

Investor relations

Enquiries should be directed to Mike Nightingale, Rachael Brierley or Sabina Marshman
tel: +44 20 7845 1180

Press office

Enquiries should be directed to Will Hill or 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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Printed in the UK by Pureprint Group on Amadeus 100 Offset and Amadeus 50 Offset. Amadeus 100 Offset is made from 100% recycled post-consumer waste, Amadeus 50 Offset is made from 50% recycled post-consumer waste and 50% virgin wood fibre sourced from sustainable forests. Both papers are independently certified according to the rules of the Forest Stewardship Council®. All pulps used are Elemental Chlorine Free (ECF). The manufacturing mill holds the ISO 14001 and EU Ecolabel (EMAS) certificates for environmental management.

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