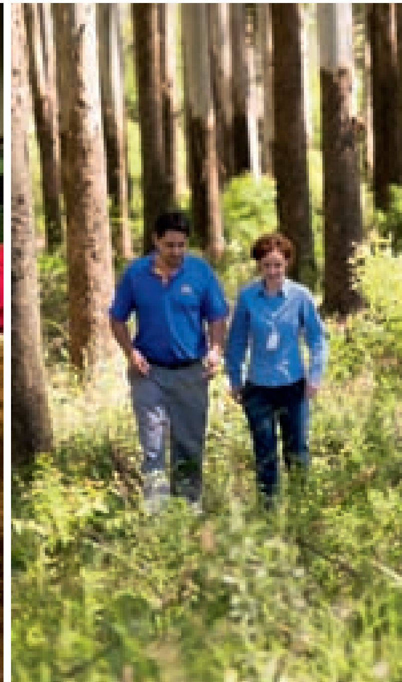
BRITISH AMERICAN TOBACCO



British American Tobacco

Annual Report and Accounts 2007

What you'll find online

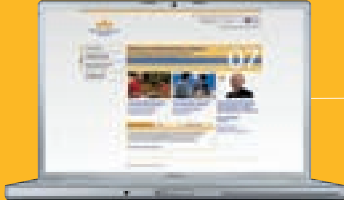
Usability
Clear and easy to use navigation, including choice of a summarised Quick Read or the Full Report.

Accessibility
Following international guidelines to make content generally user-friendly and accessible for people with disabilities.

Portability
All the main parts of the Report can be viewed on handhelds.

Videos
Clips of the Chairman and Chief Executive delivering their statements.

Downloads
Sections of the Report, or the whole document, available in PDFs for quick and easy download.



The way we report is changing

At the 2007 Annual General Meeting, shareholders approved changes to the Articles of Association of British American Tobacco p.l.c. enabling us to make greater use of electronic communications with shareholders.

Moving from printed to online reporting will not only bring about reduced print and distribution costs, but also help our environment by saving on paper.

We have further enhanced our online Annual Report this year, making it more accessible and engaging for our shareholders.

To opt out of receiving printed copies, shareholders should register with www.computershare.com/investor/uk/ecomms.

www.bat.com/annualreport2007

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

Quick Read

02 At a glance
04 Vision and strategy
06 Our Global Drive Brands

Operating and Financial Review

Chairman's overview

08 Chairman's statement

Business review

10 Chief Executive's review
12 Measuring our performance
14 Our strategy
- 16 Growth
- 20 Productivity
- 22 Responsibility
- 26 Winning Organisation

Risk factors

28 Key Group risk factors

Regional and financial review

32 Regional review
- 34 Europe
- 36 Asia-Pacific
- 37 Latin America
- 38 Africa and Middle East
- 39 America-Pacific
- 40 Associates

41 Financial review
- 41 Profit from operations
- 41 Exceptional items
- 42 Net finance costs
- 42 Interest cover
- 42 Associates
- 42 Profit before tax
- 42 Effective tax rate
- 42 Earnings per share
- 43 Dividends
- 43 Total equity
- 43 Cash flow
- 44 Treasury operations
- 45 Changes in the Group
- 45 Share buy-back programme
- 45 Accounting developments

Directors' Report and Accounts

Management

46 Board of Directors
47 Management Board
48 Directors' report
58 Remuneration report
76 Corporate governance statement

British American Tobacco Group

84 Report of the independent auditors
86 Group income statement
87 Group statement of changes in total equity
88 Group balance sheet
90 Group cash flow statement
91 Notes on the accounts
162 Five year summary
164 Quarterly analyses of profit
166 Principal subsidiary undertakings
168 Principal associate undertakings

British American Tobacco p.l.c.

169 Report of the independent auditors
170 Balance sheet
171 Notes on the accounts

Shareholder information

175 Shareholder information
176 Contact information

AT A GLANCE

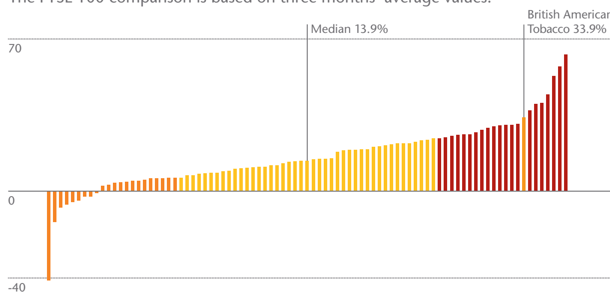
2007 results

British American Tobacco has had another very good year, with increased profit and share growth in many markets. At current rates of exchange, revenue was ahead by 3 per cent and profit from operations, excluding exceptionals, by 7 per cent, despite the £106 million adverse impact of exchange rates. At comparable rates of exchange, revenue was up 5 per cent and profit from operations, excluding exceptionals, up 11 per cent.

Total shareholder return (annual %)
(1 January 2005 – 31 December 2007) FTSE 100

■ Upper quartile ■ Lower quartile

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



Group results 2007

Gross turnover (including duty, excise and other taxes)
+4% **£26,234 million**

Revenue
+3% **£10,018 million**

Profit from operations
+11% **£2,905 million**

Profit from operations, excluding exceptional items
+7% **£3,003 million**

Basic earnings per share
+14% **105.19 pence**

Adjusted diluted earnings per share
+11% **108.53 pence**

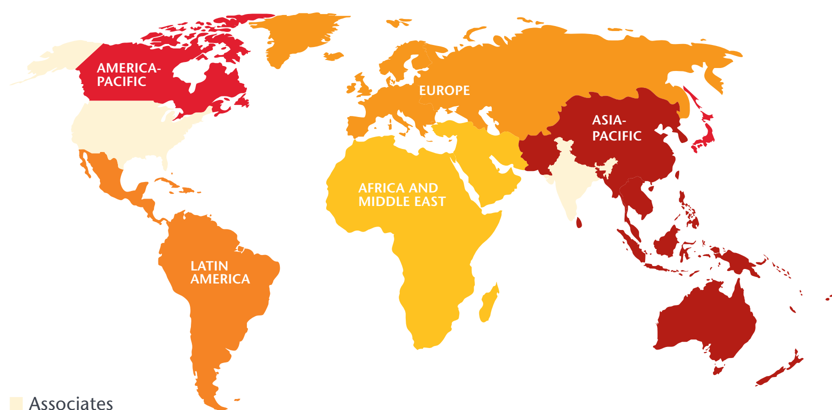
Dividend per share declared
+18% **66.20 pence**

Group cigarette volumes, excluding associates
-1% **684 billion**

Our regions

	Volume (billions)	Revenue (£ million)	Profit (£ million)*
Europe The region covers over 50 countries and extends from Portugal to Russia.	-1% 245	+3% 3,655	+8% 842
Asia-Pacific The region covers South Korea, China and the countries of South Asia, South-East Asia and Australasia.	+2% 145	+2% 1,876	+9% 672
Latin America The region covers the countries of South America, Mexico, Central America and the Caribbean.	-1% 151	+11% 1,983	+11% 680
Africa and Middle East The region covers Africa, the Middle East, the Caucasus and Turkey.	-4% 101	-3% 1,445	+0% 470
America-Pacific The region covers Canada and Japan.	-3% 42	-4% 1,059	+5% 446

*Profit from operations, excluding exceptional items.



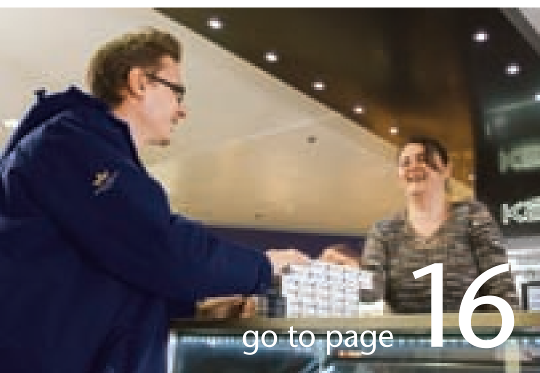
VISION AND STRATEGY

Our vision is to achieve leadership of the global tobacco industry in order to create shareholder value.

Quantitatively, we seek volume leadership among our international competitors. Qualitatively, we aim to lead our industry as the preferred partner of key stakeholders and in demonstrating responsibility.

Our strategy to deliver our vision is based on Growth, Productivity, Responsibility and building a Winning Organisation.

We use a range of indicators to assess our performance against our strategy. They include our Key Performance Indicators, described on pages 12 and 13, together with some of our other Business Measures, described on pages 16 to 27.

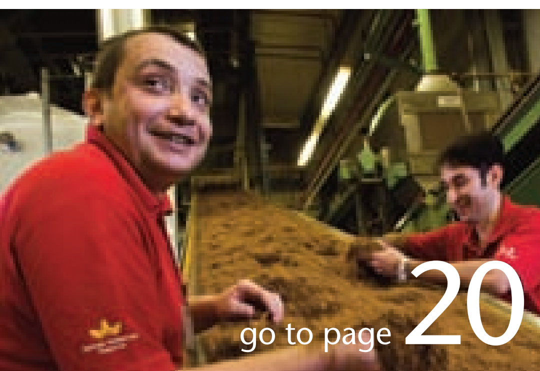


Growth

We focus on increasing our volume and value share of the global tobacco market through organic growth and mergers and acquisitions.

In this section

• Our approach to marketing
• Our marketing strategy
• Delivering innovations
• Global Drive Brands
• Other International Brands
• Trade Marketing and Distribution

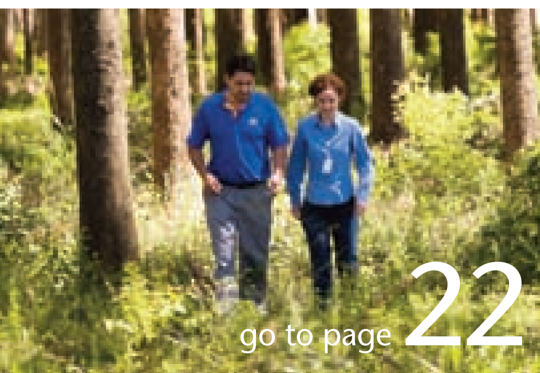


Productivity

We focus on effectively and efficiently deploying our global resources to increase profits and generate funds to reinvest in our business.

In this section

• Supply chain
• Overheads and indirects



Responsibility

We focus on continuing to balance our commercial objectives with the expectations of a broad range of stakeholders, thus ensuring a sustainable business.

In this section

• Dow Jones Sustainability Indexes
• Environmental performance
• Harm reduction

Winning Organisation

We focus on ensuring we have the right people and the right work environment to deliver our vision.

In this section

• Talent management
• Employee share ownership
• Employee engagement
• Your Voice
• Work environment

OUR GLOBAL DRIVE BRANDS

Our four Global Drive Brands – Dunhill, Kent, Lucky Strike and Pall Mall – are well represented across the key market segments. Since 2002, they have together grown volumes by 62 per cent. They represent 24 per cent of our volume, and give us a truly global approach.

Innovation is central to our approach to building brands that evolve and offer consumers relevant products to meet their changing needs.

Dunhill celebrated its centenary in 2007. It is a strong Premium Brand which sells in more than 120 countries. It offers a diverse range of Premium and Super Premium cigars and cigarettes. 35 billion Dunhill cigarettes were sold in 2007, up 6 per cent on 2006. Key markets include South Korea, Malaysia, Taiwan, South Africa and Australia.

Kent was introduced in America in 1952. It is now sold in more than 70 countries. Kent is a modern freestanding Premium Brand, consistently perceived as delivering 'the modern way to smoke'. 54 billion cigarettes were sold in 2007, the brand's fifth year of double-digit volume growth. Kent grew 19 per cent on 2006. Key markets include Russia, Eastern Europe and Chile.

Lucky Strike was launched in 1871 and remains one of the world's most iconic trademarks. It is among our leading Premium Brands and sold in more than 90 countries. It continues to bring creativity to consumers through product and packaging initiatives. Its volumes rose 1 per cent to 23 billion cigarettes. Key markets include Germany, Spain, Japan, France and Indonesia.

Pall Mall is our leading global Value-for-Money Brand, positioned to exceed consumer expectations. Introduced in 1899, it now sells in more than 60 countries, offering a range of cigarette and make-your-own products. It delivered outstanding growth in 2007, with volumes up 10 per cent on 2006 to 51 billion cigarettes. Key markets include Germany, Italy, Russia and Uzbekistan.

CHAIRMAN'S STATEMENT

"Over the past five years, our strategy for building shareholder value has delivered compound growth of 10 per cent in adjusted diluted earnings per share and 13 per cent in dividends."

Jan du Plessis Chairman

British American Tobacco has had another very good year, with increased profit and share growth in many markets. At current rates of exchange, revenue was ahead by 3 per cent and profit from operations, excluding exceptionals, by 7 per cent, despite the £106 million adverse impact of exchange rates. At comparable rates of exchange, revenue was up 5 per cent and profit from operations, excluding exceptionals, up 11 per cent.

Adjusted diluted earnings per share increased by 11 per cent to 108.53p. Over the past five years, our earnings per share have grown by 10 per cent compound, clearly demonstrating our ability to meet our goal of delivering high single-figure growth in earnings, on average, over the medium to long term.

Sales of the Group's Global Drive Brands improved by 10 per cent, as both Kent and Pall Mall broke through the 50 billion sticks volume level for the first time. Kent grew by 19 per cent, driven by the innovative Kent Nanotek in Russia, as well as by growth in Chile, Romania and Ukraine. Dunhill was up 6 per cent, benefiting from new products and packaging, while Lucky Strike grew slightly. Our premium volume grew by 3 per cent, in contrast to the 1 per cent decline in overall volumes, demonstrating the benefit of our continuing investment in innovation.

2007 saw the completion of our initial five year programmes of cost savings from the supply chain and from overheads and indirects. Over the period, we have saved over £1 billion in annual costs. The annualised supply chain savings in 2007 reached £177 million, bringing the total to £551 million and the overheads and indirects annualised savings were £100 million, making the total for that programme £455 million.

+11%

Increase in adjusted diluted earnings per share

Over the next five years, our target is to achieve further annualised savings of £800 million by 2012, in areas such as supply chain efficiencies, back office integration and management structures. Some of the savings will be reinvested in the business, so that we can maintain our investment in innovation, distribution and research and development, driving sustainable revenue growth and improving the quality of our business.

Our share of our associate companies' post-tax results rose by 3 per cent to £442 million, reflecting higher profits from Reynolds American and ITC, partly offset by adverse exchange movements.

We have announced an agreement to acquire 100 per cent of Skandinavisk Tobakskompagni's (ST) cigarette and snus business in exchange for our 32.35 per cent holding in ST and the payment of DKK11,384 million (£1,151 million) in cash. ST accounts for more than 60 per cent of cigarette sales in Scandinavia.

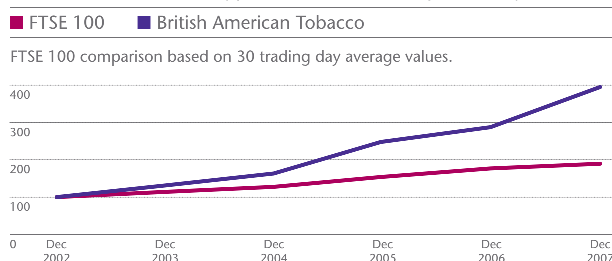
By turning our minority stake in a diversified group into full control of a very profitable cigarette business, we will strengthen our market positions in Denmark, Norway, Sweden and Poland and achieve significant synergy benefits. The transaction, which is subject to competition approvals, will be funded from a committed bank facility and, excluding one-off costs, is expected to be immediately earnings enhancing.

We are also delighted to have won the public tender for the cigarette assets of Tekel, the Turkish state-owned tobacco company, with a bid of US$1,720 million (£860 million). On completion, which is expected later this year and is subject to regulatory approvals, the acquisition will raise our market share in Turkey, the eighth largest cigarette market in the world, to some 36 per cent from just over 7 per cent today.

The addition of Tekel's portfolio will provide a stronger platform for the growth of our International Brands such as Kent, Pall Mall and Vogue

Historical total shareholder return performance

Growth in the value of a hypothetical £100 holding over five years



in the Turkish market. We expect to achieve significant one-off benefits in addition to the expected cost savings and the transaction, which will also be financed with a committed bank facility, should be earnings enhancing from 2009.

During the year, we repurchased some 45 million shares at a cost of £750 million and at an average price of £16.57. Over the past five years, we have returned almost £3 billion to shareholders in share buy-backs. However, in view of our refinancing plans following the Tekel and ST transactions, we have decided to scale back the 2008 share buy-back to some £400 million with a view to maintaining our credit rating. We will keep the level under review, as we intend to return to the higher level of £750 million announced last year in due course.

Once again, following discussions with the Takeover Panel, the Company will be asking independent shareholders at the Annual General Meeting (AGM) to waive the requirement for R&R Holdings S.A. (R&R) to make a bid for the remaining shares in British American Tobacco, should their combined interest, which currently stands at 29.95 per cent, reach or exceed 30 per cent as a result of our share buy-back programme.

In November 2007, Richemont and Remgro made preliminary announcements that they were considering restructurings that might entail providing their respective shareholders with the option of becoming direct shareholders in British American Tobacco. We have agreed, if requested, to obtain a secondary listing for our ordinary shares on the Johannesburg Stock Exchange with a view to facilitating any such restructurings.

+18%

Increase in dividend per share declared

Shareholders may remember that last year the Board announced a phased increase in the dividend payout ratio, which is planned to reach 65 per cent of long term sustainable earnings in 2008. The Board is therefore proposing a final dividend for 2007 of 47.60p, taking the total for the year to 66.20p, an increase of 18 per cent, representing a payout ratio of 61 per cent. Over the past five years, we have achieved compound dividend growth of 13 per cent.

There have been a number of changes to the Board during 2007. Antonio Monteiro de Castro retired following an outstandingly successful period as Chief Operating Officer and was replaced by Nicandro Durante. We have also announced that Paul Rayner will be retiring as Finance Director at the AGM, as he needs to return to Australia for family reasons. Our thoughts are very much with Paul and his family at this difficult time. I would like to thank him for his tremendous contribution to the Group over many years. Paul will be succeeded by Ben Stevens, currently Regional Director, Europe.

Amongst the Non-Executive Directors, Piet Beyers retired in June and Karen de Segundo and Christine Morin-Postel were appointed in October. Ken Clarke will be retiring from the Board at the AGM, having served since 1998. We will miss his wise counsel very much indeed. Ken will be succeeded as Senior Independent Director by Sir Nick Scheele.

At a time of considerable economic and financial uncertainty around the world, British American Tobacco is in good shape. Over the past five years, we have delivered significant shareholder value with a total return of 294 per cent, compared to 89 per cent for the FTSE 100 as a whole.

CHIEF EXECUTIVE'S REVIEW

"We are confident we can continue to meet the expectations of our shareholders."

Paul Adams Chief Executive

Group numbers 2007

£26,234 million
Gross turnover (including duty, excise and other taxes)

£10,018 million
Revenue

£3,003 million
Profit from operations, excluding exceptional items

108.53 pence
Adjusted diluted earnings per share

£86 million
Research and development expenditure

53,907
Employees

684 billion
Group cigarette volumes, excluding associates

2007 was another very good year for British American Tobacco. We maintained the strong momentum of the past five years as we made progress in all areas of our Group strategy – Growth, Productivity, Responsibility and building a Winning Organisation.

Since 2002, our organic growth has been driven by our Global Drive Brands (GDBs), which have been rising by an average of over 10 per cent per annum, resulting in a 62 per cent increase over the last five years. This is partly due to successful innovations, that have real appeal to our consumers, and the roll-out of our GDBs into new markets.

We have achieved volume growth in developing markets, such as Russia, Nigeria and Pakistan. We have also entered new markets, such as Turkey, Bulgaria and Kazakhstan.

While our growth has been boosted by previous merger and acquisition activities, including the purchase of Ente Tabacchi Italiani, the Reynolds American transaction and the acquisition in Peru, there has also been steady and notable organic growth. This will be the basis for achieving our future targets, supported by further acquisitions as opportunities arise.

For example, we have recently announced the acquisition of both the cigarette assets of Tekel, the Turkish state-owned tobacco company, and 100 per cent of the cigarette and snus business belonging to Skandinavisk Tobakskompagni, our associate company in Scandinavia. As a result, our market positions will be significantly strengthened in Turkey, Denmark, Sweden, Norway and Poland.

+62%
Increase in GDB volumes over five years

As detailed on pages 20 and 21, we have delivered over £1 billion of productivity savings over the last five years. More than half of our worldwide manufacturing capacity has been restructured to achieve greater efficiencies. Additionally, we are conducting extensive reorganisations to enhance our market effectiveness and achieve above-market synergies.

Margins have improved over the last five years. Profit from operations, excluding exceptional items, has risen from 24 per cent of revenue in 2002, to 30 per cent in 2007. Not content with that, we have announced our target to achieve a further £800 million savings over the next five years.

We have been pursuing our Responsibility strategy with the same rigour as Growth and Productivity targets.

Our increased investment in research and development really kicked off in 2005. Developing new products which meet consumer needs and are recognised by scientific and regulatory authorities as reduced-risk, remains top of our agenda.

In 2007, we test-marketed snus in Canada and ran a limited consumer test in Japan, in addition to our existing presence in Sweden, Norway and South Africa.

>£1 billion

Productivity savings over five years

I believe we are becoming a truly global enterprise – our people are aligned with our strategy and are relentless in executing it. We are rigorous with our recruitment policies, performance management and succession planning. We will continue to ensure we have the right people on board to tackle the challenges ahead with confidence.

Industry outlook

The world market has consistently exceeded five trillion cigarettes over the last two decades.

This is predominantly propelled by year-on-year growth in China which has offset the softening of volumes from the rest of the world, especially in higher-value markets such as America-Pacific and Western Europe. This trend is expected to continue into the next decade.

Tobacco regulation has been on the rise in recent years. This will continue with, for example, further restrictions on smoking in public places and workplaces.

As national regulations increasingly reflect global influences, the scope of areas regulated will further expand, particularly in the design features of cigarettes, such as setting ceilings for tar and nicotine content and increasing restrictions on advertising and promotions.

Illicit trade remains a key challenge and is fuelled by many factors including tax-driven price increases, poor enforcement of borders, weak laws, loosely regulated Free Trade Zones, a lack of intellectual property rights protection and the growth of the internet as a trading medium. We estimate that 330 billion cigarettes a year are smuggled, manufactured illegally or counterfeited.

We remain fully committed to tackling the problem, and are liaising with governments, customs and law enforcement agencies around the world. We also support the World Health Organisation's development of a global treaty specifically to address the problem of the growing global trade in illicit tobacco products.

Where does this leave us?

Despite these challenges, we expect the profitability of the global industry to increase over the next five years.

Some of this increase will be due to consumers up-trading, leading to higher volumes of premium-priced brands. We expect this trend to be most marked in developing markets, where we expect most of the future profit growth of the industry to come from.

British American Tobacco's market positions, in both developed and developing economies, mean we are strongly positioned to benefit from increases in industry profits.

Competitive landscape

The recent round of consolidation means that our competition has got stronger. However, we have the geographic spread, brand portfolio, innovation pipeline and global scale to continue to compete and win.

In 2008, we will continue to sharpen our focus on growing our GDBs, achieving stretching productivity targets and practising high standards of corporate responsibility, underpinned by continuing efforts to build a winning organisation. These combined efforts will place us in a strong position to keep winning in the marketplace.

>5 trillion

Cigarettes sold in the world

Conclusion

In an industry confronted with challenges, British American Tobacco will continue to grow. We are seeing positive trends in share growth and margins through improved product mix and lower costs across our key markets.

We are confident we can continue to meet the expectations of our shareholders. Our strategy and business model are clear. We have been consistently effective in executing them and this success will continue.

MEASURING OUR PERFORMANCE

We have a wide range of measures and indicators by which the Board assesses performance compared to the Group's strategy.

To ensure management's focus is aligned with the interests of our shareholders, the Key Performance Indicators form the basis upon which the levels of incentives for the global organisation are decided.

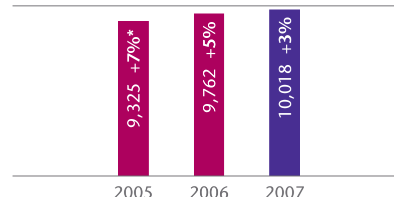
1. Revenue growth

Revenue for 2007 grew by 3 per cent, compared to the long term target of growing revenue, on average over the medium to long term, by 3 to 3.5 per cent per annum.

This figure is calculated as the revenue of the Group after the deduction of any duties, excise and other taxes, as published in the Group Income Statement on page 86.

Revenue
£ million

+3% in 2007



3-3.5%
Long term target, on average

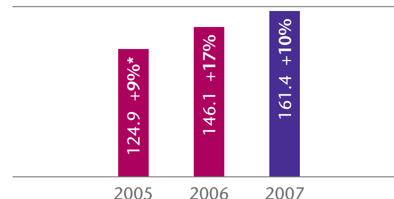
2. Global Drive Brand volume

A key strength of the Group is its diversified Global Drive Brands (GDBs) portfolio. The growth of the four GDBs – Dunhill, Kent, Lucky Strike and Pall Mall – is therefore a key driver of the Group strategy. In 2007, GDB overall volumes grew by 10 per cent to 161 billion, compared to 17 per cent growth in 2006. Our target is to achieve high single-figure growth.

GDB volumes are calculated as the total volumes of the four brands sold by our subsidiaries. More information about the GDBs and their individual performances, is provided on pages 16 to 19.

Global Drive Brand volume
billions

+10% in 2007



Long term target, on average, high single-figure growth

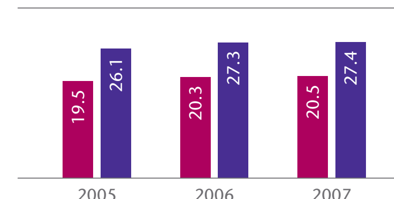
3. Share of global volume amongst key players

The share of the Group subsidiaries amongst key players of global volumes, excluding China, grew by 0.2 per cent to 20.5 per cent. When the volumes of associate companies are included, the share grew by 0.1 per cent to 27.4 per cent. The target is to continue our growth of the share of global volume as compared to other global players.

Share of global volume is calculated as the volumes sold by all international players, namely Altria, Japan Tobacco, Imperial Group, Gallaher and Altadis. The information used in this calculation is based on publicly available information and internal company analysis.

Share of global volume, excluding China
%

■ Subs ■ Subs and associates



Continue to grow share

*This percentage has been calculated after adjusting for the distortions caused by the inclusion in 2004 of seven months' results of Brown & Williamson, prior to the company's merger with R.J. Reynolds to form Reynolds American, since then an associate of the Group. It is also adjusted to remove the distortion caused by the disposal of Etinera in December 2004.

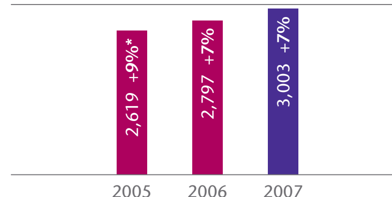
4. Profit from operations excluding exceptional items

The Group's long term target is to grow, on average, operating profit by 6 per cent per annum. For 2007, it was 7 per cent, the same as the growth for 2006.

Profit used in this assessment is the profit from operations of the Group's subsidiaries, excluding any exceptional items – the items shown as memorandum information on the Group Income Statement on page 86.

Profit from operations excluding exceptional items
£ million

+7% in 2007



6%
Long term target, on average

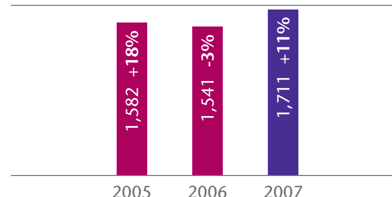
5. Cash flow

The Group's free cash flow in 2007 was £1,711 million, up £170 million from 2006. The change in free cash flow for the year is described on pages 43 and 44.

Free cash flow is defined as net cash from operating activities (including dividends from associates, restructuring costs and taxation) less net interest, net capital expenditure and dividends to minorities. A specific target is set each year for free cash flow.

Free cash flow
£ million

+11% in 2007



Specific target set for each year

6. Earnings per share

Adjusted diluted earnings per share (adjusted diluted EPS) grew at an average of 10 per cent per annum since the beginning of 2002. This compared favourably to the target of growing at the rate of high single-figures per annum, on average, over the medium to long term. Adjusted diluted EPS grew by 11 per cent in 2007 (2006: 10 per cent).

Adjusted diluted EPS is the best measure to assess the underlying performance of the business as it excludes all significant distortions (one-off and exceptional items that occur). The detail of the calculation and the adjustments made are explained in note 7 on page 107.

Adjusted diluted EPS
pence

+11% in 2007

Long term target, on average, high single-figure growth

7. Total shareholder return

The Group's strategy is focused on increasing shareholder value, which is measured using total shareholder return (TSR) compared to the FTSE 100 Index and also to the Fast Moving Consumer Goods (FMCG) peer group. The target is to show an above average performance in the long term, compared to the two comparator groups, based on a three year average.

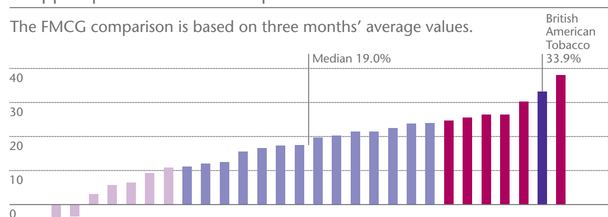
TSR performance combines both the share price and dividend performance of the Company during the performance period, as set against the two comparator groups. The FMCG comparator group is reviewed annually to ensure that it remains both relevant and representative and to, as far as possible, reflect the Group's financial and business trading environment.

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. On the TSR measure, the Company ranked eighth out of the FTSE 100 group of companies while it ranked second in the peer group of International FMCG companies. The Group has achieved a top quartile performance in both of these categories since 1999. See page 62 of the Remuneration Report for more information.

Total shareholder return (annual %)
(1 January 2005 – 31 December 2007) FMCG group

■ Upper quartile ■ Lower quartile

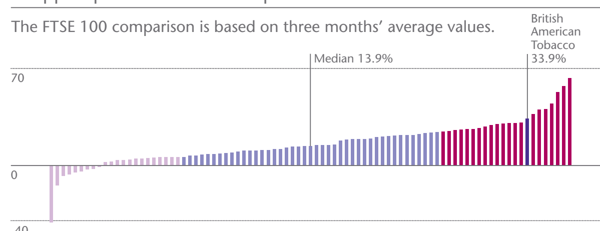
The FMCG comparison is based on three months' average values.



Total shareholder return (annual %)
(1 January 2005 – 31 December 2007) FTSE 100

■ Upper quartile ■ Lower quartile

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



OUR STRATEGY

Our vision is to achieve leadership of the global tobacco industry in order to create shareholder value.

Quantitatively, we seek volume leadership among our international competitors. Qualitatively, we aim to lead our industry as the preferred partner of key stakeholders and in demonstrating responsibility.

Our strategy to deliver our vision is based on Growth, Productivity, Responsibility and building a Winning Organisation.

1. Growth

To increase our volume and value share of the global tobacco market through organic growth and mergers and acquisitions (M&A).

Organic growth means increasing our market share in existing markets and through entering new markets. To achieve organic growth, we focus on key market segments that offer the best long term prospects, including Premium and International Brands.

We also aim to optimise the performance of our Global Drive Brands and seek opportunities for profitable volume growth in the Value-for-Money and Low Price segments. We see innovative products that offer consumers meaningful, value-added differentiation as key to organic growth.

Strategically important and financially attractive M&A may also provide us with growth opportunities.

2. Productivity

To effectively and efficiently deploy our global resources to increase profits and generate funds to reinvest in our business.

Our focus is on smart cost management, marketing efficiency and capital effectiveness. This includes ensuring that we use our marketing resources and capabilities in the most efficient way, reducing unnecessary complexity and using our cash and other assets effectively.

We are saving money by turning a multinational business operating in over 180 markets into an integrated global enterprise that can take advantage of its scale. Greater integration across our supply chain is helping us to reduce costs, increase speed to market and improve effectiveness. We are also reducing our overheads and indirect costs (anything other than leaf, wrapping materials, cigarette making machinery and labour).

3. Responsibility

To continue balancing our commercial objectives with the expectations of a broad range of stakeholders, thus ensuring a sustainable business.

Because we manage a product that poses real risks to health, we strongly believe that our business must demonstrate responsibility in everything it does.

Our Business Principles and our Standards of Business Conduct set out what we require of our companies and employees in terms of responsible corporate behaviour and personal integrity.

We support tobacco regulation that balances the preferences of consumers with the interests of society, establishes an open-minded approach to harm reduction as a policy, and enables our businesses to continue to compete and prosper. Harm reduction is an important element of our strategy.

4. Winning Organisation

To ensure we have the right people and the right work environment to deliver our vision.

We aim to develop leaders at all levels, who have a clear vision for the business and will energise those around them. Fostering a confident culture that embraces change and innovation is also central to our strategy, together with attracting, growing and retaining talent and ensuring continuous improvement throughout the Group.

A number of other Business Measures, financial and non-financial, are monitored and assessed frequently to ensure that all the Group's strategies are delivered. Although these are not included in management's incentives, we believe that these Business Measures contribute to the success of the Group, particularly over the long term.

We have therefore included, in the following pages, the performance of some of these Business Measures relating to the four elements of our strategy.

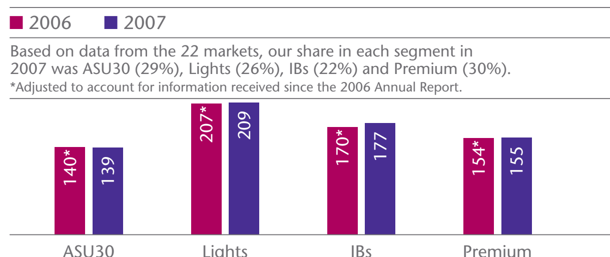
GROWTH

In 2007, our Global Drive Brands grew by 10 per cent, and other International Brands by over 5 per cent. In Trade Marketing and Distribution, we continue to focus on Direct Store Sales, and our 'Win Win Win' approach brings benefits for customers, consumers and ourselves. There are more details on the following pages and news of the success of our Vogue brand.

Strategic segment volume in 22 key markets
billions

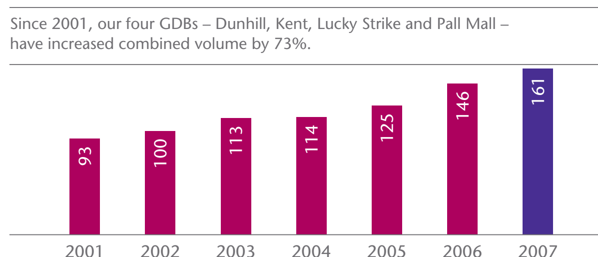
■ 2006 ■ 2007

Based on data from the 22 markets, our share in each segment in 2007 was ASU30 (29%), Lights (26%), IBs (22%) and Premium (30%).
*Adjusted to account for information received since the 2006 Annual Report.



Global Drive Brand volume growth
billions

Since 2001, our four GDBs – Dunhill, Kent, Lucky Strike and Pall Mall – have increased combined volume by 73%.



Our approach to marketing

We believe there should be marketing restrictions for risky products, such as tobacco. In 2007, we revised our International Marketing Standards, which apply to all our companies and govern our tobacco marketing across print, billboards, electronic media, promotional events and sponsorship. They now include, for example, further procedures for adult verification and for the responsible use of new and emerging channels of consumer communication.

In some countries, they are stricter than local laws. Our Group companies have until 30 June 2008 to apply the updated standards in full. We aim to 'raise the bar' by establishing a benchmark for the industry.

Our marketing is based on understanding consumers and giving them relevant choices. We gather insights into smokers' preferences and buying behaviour, before investing in developments across the marketing mix to deliver relevant choices for our consumers.

Our marketing strategy

We are focused on delivering quality tobacco products to consumers. Our marketing strategy is driven by three principles:

- a portfolio of strong Global Drive Brands (GDBs);
- innovation; and
- world class trade marketing.

We have a diversified GDB portfolio, rather than a 'one size fits all' model. Using insights into consumer lifestyles and values, the GDBs – Dunhill, Kent, Lucky Strike and Pall Mall – deliver perceived consumer benefits through quality in product, blend, taste and price.

+10%

GDB volume growth in 2007

The GDB approach offers consumers brand, format and style choices – driving the expansion of each brand's geographic footprint and improved margins for our business.

We focus resources to develop these brands in the International, Premium, Lights and Adult Smokers Under 30 (ASU30) marketing segments, where we expect both current and long term growth opportunities. We also invest in local and regional brands in areas where they play a strategic role in a particular market.

Delivering innovations

Innovation is central to our continuous growth. Our growth strategy aims to generate greater consumer relevance measured by:

- consumer demand;
- a reconsidered brand image;
- brand loyalty; and
- willingness to pay a premium.

We continue to improve our trade marketing capabilities. We have actively restructured the secondary supply chain in many markets to take advantage of Direct Store Sales to improve our competitive position and serve our retail partners better.

Global Drive Brands

+10% volume growth

We achieved organic volume growth in the higher margin Premium and Value-for-Money (VFM) segments in 2007. Our Premium volume grew by 3 per cent or 7 billion sticks, while VFM grew by 3 per cent or 6 billion sticks. Our GDBs grew by 10 per cent or 15 billion sticks for the year, leading our growth in the Premium segment.

Brand migrations played a key role in the successful launch of our GDBs across several markets in 2007, including Kent in Western Europe and South Africa, and Pall Mall in several markets.

GROWTH continued

DUNHILL

KENT

Dunhill
35 bn cigarettes sold in 2007
+6% volume growth

It was another good year for Dunhill, with strong margins in the Premium Plus arena.

Dunhill Fine Cut continued to perform well in existing markets and saw strong positive indications in new markets. The recent entries into Russia, Romania and other markets are strengthening Dunhill's share of the Premium segment. Dunhill Fine Cut was launched in the Super Slim format in South Korea in 2007.

The strong performance of Tribute – Dunhill's Centenary offer – showed that consumers are willing to up-trade. Tribute delivered significant share growth in Global Travel Retail. It was named 'Star Product of the Year' by the Tax Free World Symposium in Cannes, beating competitors from first-tier Fast Moving Consumer Goods brands.

Dunhill Signed Range cigars were rated 88-92 in Cigar Aficionado's 'Top 25 Cigars of 2007'. Dunhill Signed Range Toro finished in the top 10 with a score of 92. Sales of total Dunhill cigars increased by 67 per cent on 2006.

2007 saw Dunhill moving towards its vision of being the number one Premium Plus Brand.

Kent
54 bn cigarettes sold in 2007
+19% volume growth

Kent delivered double-digit growth for the fifth consecutive year – our first Premium GDB to surpass 50 billion sticks in annual sales. We have increased the brand's global footprint with growth in existing markets, new market entries and migrations. Kent is now available in Western and Eastern Europe, Africa, Latin America and Asia.

54 billion

Kent cigarettes sold

Innovations in 2007 included:

- Nanotek: King Size Super Slim format with Activated Charcoal, in the Super Premium segment. First of its kind in this category, it was developed and deployed across 10 major markets in just 18 months, paving the way for further global roll-out in 2008.
- Mintek: King Size format with Menthol Thread Technology. The introduction in Japan and Hong Kong helped increase our share of the menthol segment within six months of launch.

Lucky Strike
23 bn cigarettes sold in 2007
+1% volume growth

Lucky Strike delivered stable global volume performance compared to 2006. It has achieved significant share and volume growth in France, Spain and Italy. It had double-digit volume growth in five of its top 10 markets, offset by industry decline in the well-established German and Japanese markets.

ASU30s account for more than 60 per cent of the brand's franchise. We focus on maintaining its relevance to this segment.

This year has seen the launch of the limited edition Window Pack, X-Pack and Fresh Pack to complement the global roll-out of a pack upgrade that began in 2006.

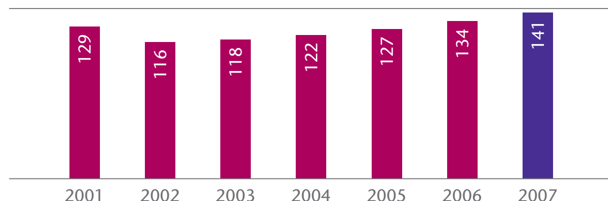
2007 also saw Lucky Strike tackle the menthol segment with the launch of 'Nites' in Peru, 'Piperita' in France and 'Piperita Balance' in Hong Kong.

Pall Mall
51 bn cigarettes sold in 2007
+10% volume growth

Pall Mall delivered solid performance in 2007, driven by good organic volume and share growth in established markets such as Germany, Russia, Italy and Turkey, as well as successful launches across most regions.

Other International Brands volume growth
billions

Since 2001, other International Brands – excluding the four GDBs – rose by 9%.



Its success is driven by a strong, consistent brand mix and consumer-relevant innovations, including the Russian launch of two aromatic Superslims.

Pall Mall is the global number two brand in Roll Your Own (RYO), driven mainly by volume and share growth in Germany and the Benelux. On a total tobacco basis (including RYO), Pall Mall sold 55 billion cigarettes equivalent in 2007, an increase of 14 per cent on 2006.

Other International Brands

+5% volume growth

We focus on our GDBs, but other International Brands are also growing, especially Vogue and Viceroy, achieving 11 per cent and 21 per cent growth respectively in 2007.

In Japan, a new cigarette product, Kool Boost, was introduced with positive response from consumers. It uses menthol capsules, allowing consumers to choose when to enhance the menthol experience.

Trade Marketing and Distribution

Direct Store Sales (DSS)

Retail outlets are focal points for the implementation of our marketing activities. This makes developing excellent and commercially based relationships with our strategic customers an essential element of our Trade Marketing and Distribution strategy.

Where appropriate and possible, we believe that direct and exclusive distribution, or DSS, is the most effective way of serving these outlets.

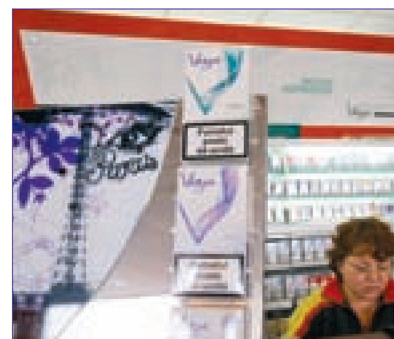
In 2007, we had several DSS projects around the Group, including Canada, Nigeria, Malaysia, Vietnam, Turkey and New Zealand. We believe that increasing our direct sales footprint in those markets will give us the impetus to achieve new growth.

The ‘Win Win Win’ Strategy

For our strategy to succeed there must be a benefit for all three participants – our customers, ourselves and, above all, our consumers. This ‘Win Win Win’ approach has continued to reap dividends with our global trade partners, such as Shell and Exxon Mobil, for whom we are now the long term chosen partner internationally.

These two accounts give us priority access to over 10,500 outlets selling over 13 billion cigarettes in over 45 countries – outlets whose customers largely match the profile of our GDB consumers.

Our ability to forge partnerships with global, strategic customers on this scale will give us a significant competitive advantage in the future.



Vogue

9 bn cigarettes sold in 2007

Volume and brand margin doubled in three years (+27 per cent CAGR 2004 to 2007).

Although our focus is on our GDBs, Vogue – our international Premium Superslim brand – has become important in our global portfolio, responding to the needs of female consumers.

Vogue has seen successful innovations, such as the new Vogue Arome range in 2007.

We expect further product mix improvements to help maintain strong, consistent growth. Vogue is already an important player in Eastern Europe, with impressive growth in Russia, Romania and Ukraine, and leading positions in France and Poland.

PRODUCTIVITY

We have made some notable achievements in Productivity, exceeding our five year targets set in 2002, and have now set further targets for the next five years. In this section, we look at some examples of how we have achieved efficiencies and savings in our supply chain, overheads and indirects. The savings have been a significant driver of operating profit growth, with some dropping through to the bottom line and the balance being reinvested in the business.

We will continue our cost-saving momentum into the next five years. We aim to achieve further savings in supply chain, overheads and indirects of £800 million by 2012.

Supply chain

Our focus on primary supply chain efficiencies has delivered benefits of £177 million in 2007, bringing total savings of the five year programme to £551 million.

>£1 billion

Productivity savings over five years

In the past five years, we have moved or removed over 400 billion sticks of capacity as we optimised our factory footprint and delivered efficiencies. We closed five factories in 2007, and several others are pending, including Zevenaar in the Netherlands and Paarl in South Africa.

Our 'Bullseye' initiative, which focuses on sharing best practice in manufacturing, continued to deliver excellent improvements in productivity, alongside innovative and more flexible packaging and filter machines. Our drive to reduce irrelevant complexity has similarly made strong progress.

Where jobs are affected by factory closures, we act responsibly by supporting our employees and addressing any impact on the community.

The business continues to benefit from optimising 'above-market' ways of working. The transfer to Mexico of production for the Canadian market continues to deliver cost efficiencies. Our Global Leaf Pooling organisation started trading in December. It will reduce the need to hold multiple leaf stocks to cover local or regional contingencies, and is expected to deliver significant savings.

Overheads and indirects

The current programme of cost reduction in overheads and indirects ended its fifth year in 2007 and delivered savings of £100 million. Since it began in 2003, annualised savings have reached £455 million, above the £400 million target set for 2007.

We see more opportunities for savings through back office integration and more efficient management structures.

We will continue to focus on leveraging our global purchasing power to drive down the costs of indirects purchases, just as we do with direct materials.

Product Complexity Reduction

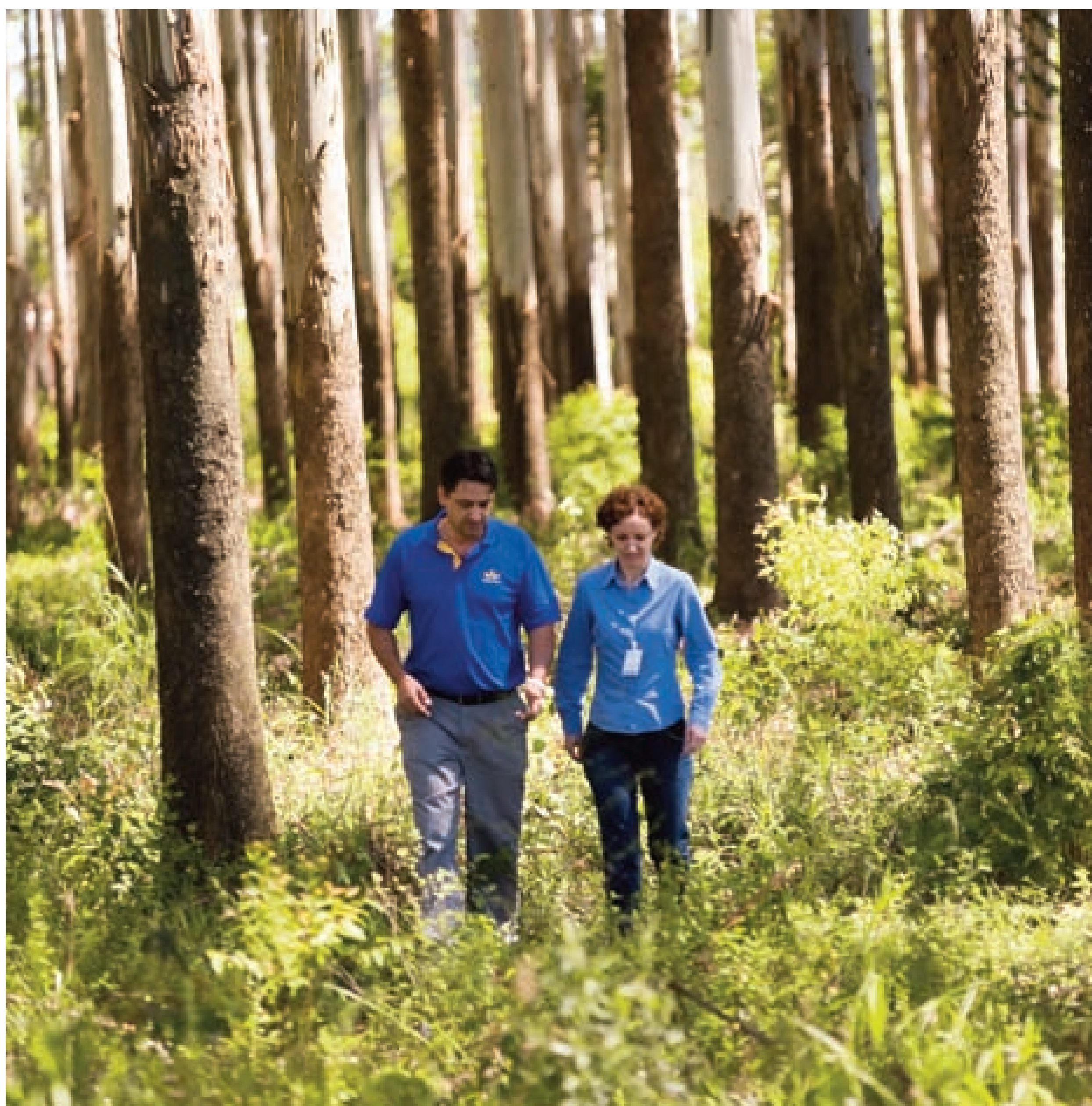
This programme, centred on ensuring the efficient use of resources, has successfully eliminated, streamlined and optimised various specifications and practices in the business.

Some key achievements include:

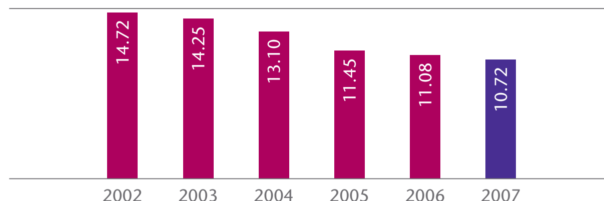
- **452 specifications for different cigarettes manufactured around the world were streamlined to 159, increasing sourcing opportunities and allowing hub planning at reduced cost.**
- **Naked wrap, a type of cellophane material, is now the standard packaging globally. It has replaced cardboard cartons, delivering environmental and cost benefits.**
- **The number of stock-keeping units has been reduced by 35 per cent and the number of input materials by 40 per cent, leaving a more focused, consumer-relevant portfolio.**

RESPONSIBILITY

We use the Dow Jones Sustainability Indexes (DJSI), an external benchmark, as our primary Business Measure to assess our performance in terms of responsibility. We have also included some environmental data on the following pages. This section also features an update on harm reduction, which is a key element of our business strategy.



Group energy use
gigajoules per million cigarettes equivalent



Carbon dioxide
tonnes CO_2 per million cigarettes equivalent

Dow Jones Sustainability Indexes

In 2007, we were, for the sixth year running, the only tobacco company included in the DJSI. These indexes track the economic, environmental and social performance of leading companies, and examine how well they integrate sustainability strategies into their businesses.

In 2007, our overall score increased from 79 per cent to 83 per cent, while the sector average decreased from 66 per cent to 44 per cent. We achieved a higher score than the average in all 19 categories, the top score in 14, and an improved score in eight. We aim to maintain our position in the Indexes. Because inclusion is determined by a third party, we do not regard inclusion in itself as a Business Measure.

Environmental performance

We believe that good environmental practice is good business practice; that businesses can enhance efficiency through environmentally sound technologies, optimising products and processes and conserving energy and natural resources. We work to control and reduce our impacts through reduction, re-use and recycling and have established a strong record over time.

Areas of focus for our efforts include energy consumption, the concerns about climate change and biodiversity

Dow Jones Sustainability Indexes

Dow Jones Criteria	Was 2007 score same or better than 2006?	Was score higher than sector average?
Economic Dimension	✔	✔
Environmental Dimension	✘	✔
Social Dimension	✔	✔
Economic Dimension		
Corporate Governance	✔	✔
Risk & Crisis Management	✔	✔
Codes of Conduct/Compliance/ Corruption & Bribery	✔	✔
Customer Relationship Management	✔	✔
Combat Smuggling	✔	✔
Environmental Dimension		
Environmental Policy/Management	✔	✔
Environmental Performance (Eco-efficiency)	✔	✔
Environmental Reporting*	✘	✔
Management of Genetically Modified Organism	✔	✔
Fuels for Tobacco Curing	✔	✔
Raw Material Sourcing	✘	✔
Social Dimension		
Labour Practice Indicators	✔	✔
Human Capital Development	✔	✔
Talent Attraction & Retention	✔	✔
Social Standards for Suppliers	✔	✔
Corporate Citizenship/Philanthropy	✔	✔
Social Reporting*	✘	✔
Responsible Marketing Policies	✔	✔
Occupational Health & Safety	✔	✔
TARGET reached**		✔

*We were previously sector leaders in this category, but a change in the scoring system resulted in a significant fall in our score in 2007.

**Our target is to record a higher score than the sector average in a minimum of 15 out of 19 categories.

RESPONSIBILITY continued

Waste to landfill
tonnes per million cigarettes equivalent

Recycling
percentage of waste recycled

conservation. We also work to support and spread good environmental practices in our supply chains.

In recent years, we have achieved significant reductions in water use, and in energy use and waste sent to landfill and the carbon dioxide equivalent resulting from these. As a result, large reductions over short timeframes in future will be harder to achieve.

Energy use

We define Group energy use as the total energy used in our own operations plus energy used in Group business travel and freight. We do not include energy used to produce and deliver purchased energy, which in effect tracks the performance of energy suppliers.

In 2007, we continued with energy conservation programmes, which include measuring, reducing and replacing energy and using renewable fuels and fuels with a lower carbon footprint. We reduced Group energy use in the year by 3.3 per cent.

See chart on page 23.

Carbon dioxide (CO_2)

In 2000, we set a target to cut Group CO_2 equivalent by 5.2 per cent by 2008. We achieved this in 2004 and met a further, lower 2008 target in 2005. We have now set long term targets to reduce CO_2 from our 2000 baseline by 50 per cent by 2030 and by 80 per cent by 2050.

In 2007, we limited CO_2 equivalent to a small increase, making a cumulative reduction of 36 per cent so far from our 2000 baseline.

See chart on page 23.

80%

CO_2 reduction target by 2050

Landfill and recycling

We work to reduce the amount of waste we generate and to re-use or recycle to avoid sending waste to landfill wherever possible. Waste in landfill creates methane which, like CO_2, is associated with global warming.

In 2007, the amount of waste we sent to landfill increased by 8.7 per cent, as our recycling rate fell slightly to 78.8 per cent of total waste generated. This resulted from manufacturing relocations requiring new production start-ups, which increase waste. We continue to target reductions over time.

Water use

Areas where we operate include arid and developing countries where water may be a scarce resource. We seek to control our water consumption and to reduce it across the Group.

In 2007, we reduced our water use by 6.4 per cent.

See chart on page 25.

Supply chain

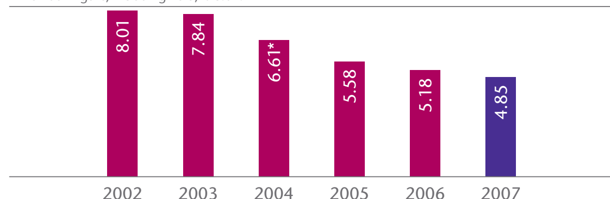
Our supply chain programmes include evaluation of suppliers' environmental and social performance and supporting them in achieving high standards.

In 2007, some 280,000 growers supplying our tobacco leaf continued to be reached by our Social Responsibility in Tobacco Production (SRTP) programme, which addresses the social and environmental issues associated with leaf growing and processing. Environmental dimensions of SRTP include soil and water conservation, appropriate use of agrochemicals, managing biodiversity and promoting afforestation initiatives for farmers who require wood for curing to obtain it from sustainable sources.

We continued to use our Business Enabler Survey Tool to set and monitor the standards we expect from suppliers of raw materials such as packaging, cigarette paper, filter materials, glues and inks. 102 criteria are used to assess suppliers' performance.

Water use
cubic metres per million cigarettes equivalent

*For comparison purposes, the 2004 figure excludes data from Peru relating to the use of irrigation water by farms owned by a company we acquired in late 2003. It is unusual for the Group to own farms. The 2004 figure, including Peru, is 8.01.



Biodiversity conservation

For seven years, we have worked with conservation NGOs in the British American Tobacco Biodiversity Partnership to understand our impacts on biodiversity and to avoid or minimise biodiversity loss. The Partnership works to protect and restore habitats and species, to ensure sustainable use of natural resources and to integrate biodiversity into British American Tobacco's business.

Harm reduction

Harm reduction is a key element of our business strategy. In 2007, we increased our investment in research and development, which is heavily focused on work towards products that may help to reduce tobacco-related harm to health. We also continued to seek common ground on harm reduction with health policymakers, seeking to achieve a reduction in the net public health impact of tobacco use.

Regulatory policies based on prevention and cessation – discouraging people from starting to smoke and encouraging them to quit – have been and continue to be effective. However, the strongly increasing global population suggests that, although the proportion of adults who smoke is likely to continue declining, in 10 years' time there will still be as many or more tobacco consumers globally as there are today.

We believe there could be further public health gains if tobacco regulatory policies also included harm reduction, for the millions of adults globally who will continue to consume tobacco products.

Snus test markets extended

In 2007, we extended to Canada our test marketing of Swedish-style snus, a smokeless form of tobacco recognised as much less harmful than smoking by a growing number of health experts, such as the UK's Royal College of Physicians. We continued our snus test market in South Africa, ran a limited consumer trial in Japan and increased our snus sales in Sweden and Norway.

We also lobbied for an amendment to the EU regulations that ban sales of snus in the EU except for Sweden. We believe that smokers should not be barred from choosing a less hazardous alternative to cigarettes.

We are still learning about the smokeless tobacco category, and it presents consumer and regulatory challenges. However, we intend to continue our efforts, to share our learnings with regulators and public health groups and to extend initiatives elsewhere in due course.

Combustible products

In 2007, we continued our research and development work towards reduced harm products that are smoked. The science is not simple and we still cannot be certain about what might constitute a reduced-harm cigarette. We are addressing three scientific challenges that will take time to resolve:

- determining which toxicants in smoke are significant for disease and how to measure smokers' exposure to them;
- developing products that may reduce exposure to these significant toxicants and demonstrating that they do; and
- assessing whether this reduced exposure can be predicted to reduce the risk of tobacco-related disease.

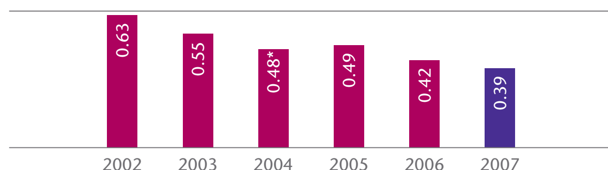
We continue to publish research findings in peer-reviewed journals, to present our findings and views at scientific conferences and to seek constructive discussions about harm reduction with scientific and public health stakeholders.

WINNING ORGANISATION

British American Tobacco employs over 53,000 employees worldwide. We are proud to have a diversity of cultures, perspectives and skills in our workplaces, as well as the ability to share knowledge globally and stay ahead of changing trends. This section reports on some of our efforts to provide a good working environment and to retain and develop our people.

Lost Workday Case Incident Rate (LWCIR)
LWCIR = Number of lost workday cases through injury x 200,000 ÷ total hours worked

*For comparison purposes, the 2004 figure excludes new companies acquired. If these acquisitions are included, the 2004 figure is 0.64.



Talent management

Robust recruitment, performance management and remuneration processes are in place to attract and retain the right talent.

Graduate recruitment and development ensure a sustainable pool of high-calibre managers. In 2007, we recruited 356 graduates into our Management Trainee programme globally. Accelerated development programmes enable many of them to go on quickly to senior leadership roles.

Additionally, more than 1,000 delegates attended our international management development programmes in 2007.

Succession planning and talent review processes track employee progress and development. In 2007, we rolled out Systems Application and Products (SAP) HR globally, providing easier access and greater flexibility for employees.

Employee share ownership

We continue to encourage employee ownership through the provision of employee share plans, including the Partnership Share Scheme and the Share Reward Scheme. Our Employment Principles are available to all staff. They are on our corporate website and the Group's intranet.

Employee engagement

We encourage open, two-way communications to stimulate innovative thinking, leverage our diversity and promote creative collaboration across the Group. We encourage employee engagement through individual discussions, team briefings, publications, internal blogs and local surveys.

We place a premium on leadership communication, and in 2007 introduced a twice-yearly global communications cascade to promote and support timely and relevant business conversations between leaders and teams.

We continue to monitor the effectiveness of our employee engagement through global surveys such as Your Voice.

Your Voice

In last year's report, we presented the results of Your Voice, which we conduct every two years. The results showed that 90 per cent of the respondents were proud to be associated with our organisation, while 92 per cent responded that they understood how their role contributed to the achievement of the Company's strategy. We reported that we were committed to building on these strengths and to addressing areas which required attention. Since then, actions have been taken around the Group.

The next Your Voice survey is due to be conducted in 2008. The results will be published in next year's annual report.

-7.1%

Lost Workday Case Incident Rate on 2006

Work environment

We track and measure how well we create a safe place to work by using the Lost Workday Case Incident Rate (LWCIR).

In 2007, the rate was 0.39, a decrease of 7.1 per cent on 2006. A global awareness campaign was conducted to address vehicle-related and machinery entrapment incidents. They constitute about 26 per cent and 24 per cent of the overall cases respectively. We will focus on these again in 2008, and aim for a rate of 0.1 to 0.2 – a best practice standard for comparable multinational organisations.

We are committed to a work environment free from harassment, bullying and discrimination. We do not discriminate against people with disabilities who apply for jobs, and they get the same opportunities for promotion, training and career development as other staff.

KEY GROUP RISK FACTORS

Risk	Description	Management Processes
Illicit trade and intellectual property	Illicit trade in the form of counterfeit products, smuggled genuine products and locally manufactured products on which applicable taxes are evaded, may have an adverse effect on Group volumes, restrict the ability to increase selling prices and damage brand equity.	Group companies are required to assess the illicit trade risk in their operating environment, to report significant issues centrally, and to develop appropriate anti-illicit trade policies, practices and procedures which are consistent with the Group's overall strategy on illicit trade.
Excise and sales tax	Increases in tobacco taxes, changes in relative tax rates, or adjustments to excise structures, may impact upon volume sales or alter the Group's sales mix. Increases in tobacco taxes could also lead to consumers rejecting the Group's legitimate tax-paid products for products from illicit sources.	Group companies are required to have in place a formalised pricing and excise strategy, with clearly defined roles and responsibilities, to ensure a coordinated approach to strategy execution and regular monitoring. Contingency plans must be in place to manage significant excise changes.
Regulation	Increasingly stringent regulation regimes worldwide affecting the manufacture and sale of the Group's products may potentially impact on volumes and profits.	Major regulatory trends are monitored centrally. Group companies are required to have in place a regulatory strategy to identify regulatory issues material to their operating environment and develop plans to address them in a manner consistent with local law and Group policy.
Marketplace	Disruption or change in the economic, regulatory or political situations in the countries and regions in which the Group operates may have an adverse impact on its investments and businesses or on its consolidated results of operations. The actions of competitors, for example, branding changes, new product launches, or price repositioning, could potentially affect the results of the Group's operations or impact on its volumes or profits.	Group companies are required to develop and implement a business continuity plan covering their key risks, to include business relocation capacity, and to develop a programme for testing those plans to measure their effectiveness and relevance. To maintain a competitive advantage, the Group seeks to anticipate and respond to new consumer trends through continuous innovation, and to develop and market new products, packaging and technologies, including products with potentially reduced harm. Scenario planning for price war situations is also undertaken, where appropriate.
Financial	Funding and liquidity risks may expose the Group to shortages of cash and cash equivalents needed in the Group's operations and for refinancing of existing debt. Changes in currency values and interest rates may have an adverse impact on the financial condition or operations of the Group. Cash deposits and other financial instruments give rise to credit risk on the amounts due from counterparties. Changes in asset returns, salary increases, inflation, long term interest rates and other actuarial assumptions could affect the retirement benefit arrangements operated by the Group, and so have an adverse impact on the Group.	The Group operates within a set of conservative financing principles which target a minimum level of liquidity, a minimum average maturity for the total debt portfolio and a maximum allowable proportion of total debt maturing in any one year. The Group maintains a substantial, medium term committed bank facility which may be drawn at short notice. The Group operates within a conservative cash flow hedging policy which sets out minimum levels of foreign exchange cover against known currency exposures. The Group maintains both floating and fixed rate debt. Where appropriate, the Group also uses derivatives, primarily interest rate swaps, to lock in interest rates. Exposure to each financial counterparty is monitored on a global basis and risk is limited according to the counterparty's credit rating. The Group centrally monitors its most significant retirement benefit schemes. In three of the five most significant operations with defined benefit schemes, the main schemes have been closed to new entrants in line with the Group's policy to make this change where possible. The value of funding deficits remains modest when compared with the Group's market capitalisation and operating cash flow.
Litigation	The outcomes of legal and regulatory court proceedings in various jurisdictions, including claims for personal injury, claims for economic loss arising from the treatment of smoking and health-related diseases and claims for unpaid excise tax, could potentially impact on the results of operations or cash flows of the Group.	Any litigation which has the potential to impact upon the Group's operations or financial position is monitored centrally. Group companies are required to assess their exposure to such litigation and liaise centrally in connection with specific claims.
Information technology	A significant disruption to the Group's information technology systems due to computer viruses, malicious intrusions, the setting up of shared services centres or the installation of new systems could affect the Group's communications and operations.	The Group has in place processes to ensure robust anti-virus coverage and to protect information security. Secure back-ups are required to be maintained for all business-critical applications, data and supporting systems.

Introduction

This section identifies the main risk factors that may affect the British American Tobacco Group's finances and operations. The table opposite provides a brief description of the key risks to which the Group's operations are exposed and identifies, in each case, the principal processes in place to manage those risks. The factors listed all have the potential to have an adverse impact on the Group's business, its revenues, profits, assets, liquidity and capital resources, and their potential impact is described in greater detail below.

It is not the intention to provide an extensive analysis of all risks affecting the Group. Not all of the factors listed are within the control of British American Tobacco and other factors besides those listed may affect the performance of its business. Some risks may be unknown at present and other risks, currently regarded as immaterial, could turn out to be material in the future.

This section should be read in the context of the cautionary statement regarding forward-looking statements on page 31.

Risk management in summary

The risk factors listed in this section and the specific processes in place to manage them should be considered with reference to the Group's internal control framework. The main aspects of this are summarised below, and it is addressed in greater detail in the statement on internal control (see pages 81 to 82).

The Group maintains a sound system of internal control with a view to safeguarding shareholders' investment and the Group's assets. It is designed to manage risks that may impede the achievement of the Group's business objectives rather than to eliminate these risks and can therefore provide only reasonable, not absolute, assurance against material misstatement or loss.

The Group uses audit committees at central, regional, area and individual market levels to support the Audit Committee (see pages 79 and 81) in monitoring risks and control. This framework provides a continuing process for identifying, evaluating and managing the significant risks faced by the Company and its subsidiaries. The Group's regional audit committees focus on risks and the control environment within each region and are in turn supported by end market or area audit committees. The corporate Audit Committee addresses risks and the control environment within the Group's operations which do not fall under the responsibility of the regional, area and local audit committees, for example, central functions, global programmes and above-region projects. Their reviews include consideration of the effectiveness of the process for identifying, evaluating and managing the risks of the business and the assessments of internal control and business risks completed by operating companies.

In addition, the Corporate Social Responsibility (CSR) Committee (see pages 82 and 83) is responsible for identifying and assessing, in conjunction with management, the significant social, environmental and reputational risks facing the Group's business and for evaluating management's handling of such risks. In this, it is similarly supported by a framework of regional and end market CSR committees.

Illicit trade and intellectual property

Illicit trade in the form of counterfeit products, smuggled genuine products and locally manufactured product on which applicable taxes are evaded, represents a significant and growing threat to the legitimate tobacco industry. Increasing excise rates are encouraging more consumers to switch to illegal cheaper tobacco products and providing greater rewards for smugglers. Illicit trade can have an adverse effect on Group volumes, restrict the ability to increase selling prices and damage brand equity.

The brand names under which the Group's products are sold are key assets. Investments over a period of time have led to many of the Group's brands having significant brand equity and global appeal to consumers, essential for delivering sustainable profit growth into the future. The protection and maintenance of the reputation of these brands is important to the success of the Group. In a number of countries around the world, the risk of intellectual property rights infringement remains high as a result of limitations in judicial protection and/or inadequate enforceability. Any substantial erosion in the value of the brands could have an adverse effect on the Group.

Excise and sales tax

Tobacco products are subject to substantial excise and sales taxes in most countries in which the Group operates. In many of these countries, taxes are generally increasing but the rate of increase varies between countries and between different types of tobacco products. Increased tobacco taxes, or changes in relative tax rates for different tobacco products, or adjustments to excise structures, may result in a decline in overall sales

KEY GROUP RISK FACTORS continued

volume for the Group's products or may alter the Group's sales mix in favour of Value-for-Money Brands. Increases in tobacco taxes can also lead to consumers rejecting the Group's legitimate tax-paid products for products from illicit sources.

Regulation

The Group's businesses operate under increasingly stringent regulatory regimes around the world. Further regulation is expected, particularly as a result of the World Health Organisation's Framework Convention on Tobacco Control (FCTC) and increasingly active tobacco control activities outside the FCTC. It is not possible to predict where, when and in what form regulations will be enacted, but regulation of the tobacco industry generally covers:

Product: Product design and attributes (e.g. 'low ignition propensity paper') as well as product disclosures (e.g. ingredients, additives, emissions);

Packaging: Pictorial warnings, rotating warnings, use of colours and size;

Promotion: Communications regarding the Group's products at both retail and trade levels;

Purchase: The manner in which cigarettes are sold, such as type of outlet (e.g. supermarkets, vending machines) and how they are sold (e.g. above the counter versus beneath the counter);

Place: Regulations as to the places where adults can and cannot smoke tobacco products; and

Price: Regulations as to the price the Group can charge for its products (e.g. by excise or minimum prices).

These regulations may have an impact on volumes (e.g. as a result of restrictions on where cigarettes may be smoked) and profits (e.g. as a result of diminution of brand equity leading consumers away from premium brands, through excise increases and/or through increased cost of complying with product design, disclosure or packaging requirements).

Marketplace

The Group has substantial operations in over 180 countries. Its results are influenced by the economic, regulatory and political situations in the countries and regions in which it has operations. Some countries in which the Group operates face the threat of increasing civil unrest and can be subject to frequent changes in regime. In others, terrorism, conflict and the threat of war may have a significant impact on the business environment. Some countries maintain trade barriers or adopt policies that favour domestic producers, preventing or restricting sales by the Group. There can be no assurance that political, social, legal, economic, trade or other developments, as well as theft and fraud, will not have an adverse impact on the Group's investments and businesses or on the Group's consolidated results of operations.

Severe disruption to any aspect of the Group's supply chain or suppliers' operations could have an adverse impact on the Group's ability to produce and deliver to customer demands. In certain markets, the distribution of Group products is through channels managed by third parties, and often licensed by governments. In these instances, loss of distribution, and therefore a reduction in sales volumes and revenues, is a possibility.

The raw materials used in the Group's business are commodities that are subject to price volatility caused by factors such as weather conditions, growing conditions, local planting decisions, market fluctuations and changes in agricultural regulations. Commodity price changes that are beyond the Group's control may result in unexpected increases in raw materials and packaging costs for the Group's products.

The Group operates in highly competitive business and geographical markets. To maintain a competitive advantage, it must anticipate and respond to new consumer trends through continuous innovation. The Group also seeks to develop and market new products, packaging and technologies, including products with potentially reduced harm. Development of these products is an expensive and lengthy process, but there are anticipated advantages for any manufacturer who introduces these products to the market first. Competitors' speed to market in branding changes, new product launches, or changes in product mix, could have an adverse effect on the Group's operations.

In tough competitive environments, where the price burden on consumers is high because of taxation or limited purchasing power, the Group is vulnerable to competitors aggressively taking market share through price repositioning, which generally has the impact of reducing the overall profit pool of the market and, ultimately, Group profits. To mitigate such risks, scenario planning for price war scenarios is undertaken, where appropriate.

Financial

The Group's subsidiary undertakings operate over 160 retirement benefit arrangements worldwide. These arrangements have been developed in accordance with local practices in the countries concerned. The majority of employees belong to defined benefit schemes, most of which are funded externally, although the Group operates a number of defined contribution schemes. The contributions to the Group's defined benefit schemes and their valuations are determined in accordance with the advice of independent, professionally qualified actuaries. Changes in asset returns, salary increases, inflation, long term interest rates and other actuarial assumptions could have an adverse impact on the Group.

Funding and liquidity risks expose the Group to shortages of cash and cash equivalents needed in the Group's operations and for refinancing of existing debt. The Group cannot be certain that it will at all times have access to the bank and capital markets and that the failure to achieve such access will not have an adverse effect on the Group's funding and liquidity position and on its credit ratings.

The Group is exposed to changes in currency rates on the translation of the net assets of overseas subsidiaries into the Group's reporting currency, sterling. The Group is also exposed to currency changes from the translation of profits earned in overseas subsidiaries; these exposures are not normally hedged. Exposures also arise from the foreign currency denominated trading transactions undertaken by subsidiaries and dividend flows. The Group maintains both floating and fixed rate debt. Where appropriate, the Group also uses derivatives, primarily interest rate swaps, to vary the fixed to floating mix. Changes in currency values and interest rates could have an adverse impact on the financial condition or operations of the Group.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from counterparties. The failure of any counterparty to meet its obligations to the Group could have an adverse effect on the financial condition or operations of the Group.

Further details on the Group's financial management and treasury operations are on pages 44 and 45.

Litigation

Group companies are involved in a number of legal and regulatory court proceedings in a number of countries. These proceedings may be characterised as covering smoking and health issues and include claims for personal injury and claims for economic loss arising from the treatment of smoking and health-related diseases. Regulatory proceedings may result in a challenge to new regulations. In addition, there are legal proceedings and a governmental investigation in Canada arising from alleged past smuggling activities with consequent claims for unpaid excise tax. A fuller analysis of current legal proceedings to which the Group is subject is set out on pages 153 to 161.

While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Company believes that the defences of the Group companies to all these various claims are meritorious both on the law and the facts. Nevertheless, it is not impossible that the results of operations or cash flows of the Group could be materially affected by the final outcome of any particular litigation.

Information technology

The Group is increasingly reliant on information technology systems for its internal communications, controls, reporting and relations with customers and suppliers. A significant disruption due to computer viruses, malicious intrusions, the setting up of shared services centres or the installation of new systems could affect the Group's communications and operations.

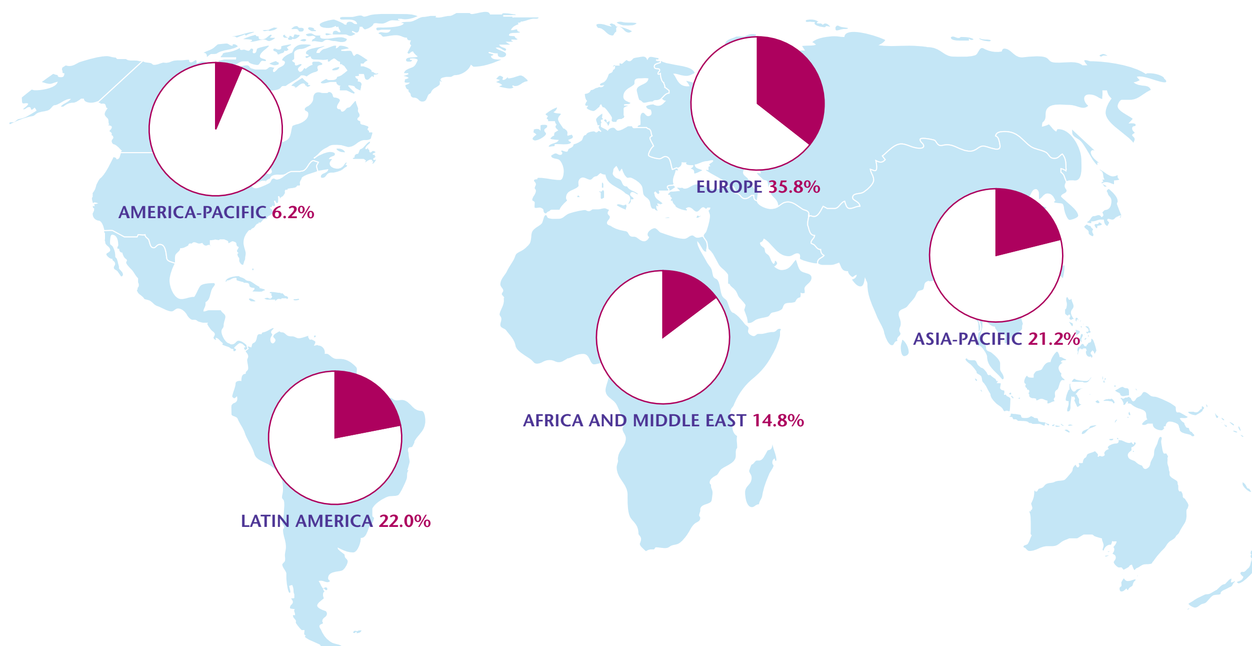
Cautionary statement

The Operating and Financial Review and certain other sections of this document contain forward-looking statements which are subject to risk factors associated with, among other things, the economic and business circumstances occurring from time to time in the countries and markets in which the Group operates.

It is believed that the expectations reflected in these statements are reasonable but they may be affected by a wide range of variables which could cause actual results to differ materially from those currently anticipated.

REGIONAL REVIEW

Percentage of Group volumes per region



Regional data

	Volumes		Revenue		Profit from operations	
	2007 bns	2006 bns	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Europe	**245.0**	247.7	**3,655**	3,545	**842**	781
Asia-Pacific	**145.2**	141.9	**1,876**	1,839	**672**	616
Latin America	**150.5**	152.6	**1,983**	1,791	**680**	611
Africa and Middle East	**101.0**	104.8	**1,445**	1,489	**470**	468
America-Pacific	**42.3**	43.8	**1,059**	1,098	**446**	424
	684.0	690.8	**10,018**	9,762	**3,110**	2,900
Unallocated costs					**(107)**	(103)
Profit from operations before exceptional items					**3,003**	2,797
Revenue and profit from operations, before exceptional items, restated at comparable rates of exchange			**10,297**	9,762	**3,109**	2,797

The profits discussed in the Regional Review exclude the impact of restructuring costs and gains/losses on disposal of businesses and brands, as explained on page 41 and 42.

"The very good performance of our Global Drive Brands in many markets, together with improved pricing and cost savings, led to strong growth in profit from operations."

Nicandro Durante
Chief Operating Officer and Director, America-Pacific

Summary

The reported Group profit from operations was 11 per cent higher at £2,905 million or 7 per cent higher if exceptional items, as explained on pages 41 and 42, are excluded. However, profit from operations at comparable rates of exchange and excluding exceptional items, would have been 11 per cent higher, with all regions contributing to this strong result.

Group volumes from subsidiaries were 684 billion, a decrease of 1 per cent, mainly as a result of the high level of trade buying in some markets at the end of 2006, supply chain disruptions in the Middle East and the loss of StiX in Germany.

Group revenue increased by 3 per cent to £10,018 million but, at comparable rates of exchange, would have increased by 5 per cent as a result of favourable pricing and improved product mix.

The four Global Drive Brands continued their good performance and achieved an overall volume growth of 10 per cent, with a particularly strong performance in the second half of the year. The good performance of the Global Drive Brands led to share improvements in many markets.

Kent grew by 19 per cent, with excellent growth in Russia, Romania, Ukraine and Chile, while volumes were maintained in a reduced Japanese market. It also benefited from significant volume increases from the brand migrations in Western Europe and new markets in Azerbaijan and Kazakhstan.

Dunhill rose by 6 per cent, driven by strong performances in South Korea, Russia, Italy, South Africa and Saudi Arabia, although volumes were in line with last year in Malaysia and lower in Taiwan and Australia.

Lucky Strike volumes were slightly up as the growth in Spain, Italy, France, Argentina and Brazil was almost offset by declines as a result of lower industry volumes in Germany and Japan.

Despite the absence of Pall Mall StiX in Germany during 2007, Pall Mall continued its growth with an increase of 10 per cent, driven by Italy, Hungary, Russia, Uzbekistan, Turkey and Taiwan, partly offset by lower volumes in Germany, Romania, Spain, Greece and Malaysia.

EUROPE

"Another strong year with Global Drive Brand growth of 15 per cent. These brands plus Vogue and Viceroy are now 47 per cent of regional volumes. Profits grew strongly, driven by productivity savings and an improved mix assisted by a better pricing environment."

Ben Stevens Director, Europe

In **Europe**, profit at £842 million was up £61 million or 8 per cent, at both current and comparable rates of exchange, mainly as a result of higher margins in Russia, Romania, Hungary and Spain, which more than offset the impact of reduced volumes in a number of markets. Volumes were down 1 per cent at 245 billion, with reductions in Russia, Ukraine, Germany, Italy and Spain partly offset by increases in Romania.

In Italy, volumes and market share were lower although Lucky Strike, Dunhill and Pall Mall grew share. While margins improved following industry price increases, profit was lower due to the reduced volumes, higher marketing expenses and the disposal of the Toscano cigar business in 2006.

In addition, the Group incurred a penalty of €20 million in the 'cartel case' related to cigarette prices in Italy, where the infringement had been committed prior to the Group's acquisition of Ente Tabacchi Italiani.

The productivity programme was completed through the consolidation of production into one factory and a further reduction in the cost base.

Although cigarette market share rose in Germany, driven by Pall Mall, volumes declined as industry sales were affected by the continued growth of illicit trade, the end of StiX sales, changes in vending regulations and consumer down-trading to other tobacco products. This, together with the lower margins of other tobacco products, led to lower profit.

Sales volumes in France were lower, mainly as a result of the overall industry decline after public place smoking restrictions and a price increase. Lucky Strike and Pall Mall showed strong growth in market share, with Dunhill and Vogue performing well in the Premium segment. Profit was up as margins improved through the price increase and cost reductions.

The excise increase in Switzerland at the beginning of the year stimulated down-trading and growth in the trade brand sector, resulting in weaker volumes and lower profits. However, Parisienne and Pall Mall grew market share.

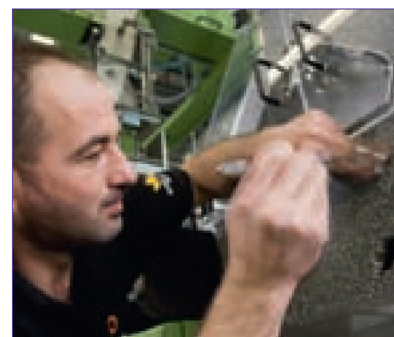
Volumes and profit in the Netherlands increased, benefiting from the growth of Lucky Strike, Kent and Pall Mall and the May 2007 price increase, partially offset by consumer down-trading. In Belgium, a significant excise-driven price increase led to lower volumes and market down-trading. Profit was lower as the impact of these more than offset higher margins and overhead savings.

Results in Spain improved, benefiting from price increases at the beginning of 2007 and, although volumes were lower, Lucky Strike showed impressive market share growth.

Sales volumes in Russia were influenced by trade buying at the end of 2006 in anticipation of the new excise system and price increases in December. However, most of the shortfall was recovered with strong performances by Kent, Vogue and Viceroy, leading to an increased market share. Profit grew significantly, benefiting from higher margins, an improved product mix and productivity savings.

In Romania, the excellent performance of Kent, the leading brand in this market, supported by the growth of Dunhill, Vogue and Pall Mall, resulted in a higher market share. Profit increased impressively with volume growth, higher prices and an improved product mix.

Results in Ukraine improved as better pricing, effective cost control and an improved mix, following a good performance by Kent, was partly offset by the impact of reduced local brand volumes. In Hungary, profit grew substantially, benefiting from improved margins and efficiency programmes. Overall volumes were stable with Viceroy and Pall Mall growing strongly and Vogue strengthening its position in the Premium segment. Results in Poland improved significantly as prices increased and volume and market share grew with good performances from Viceroy, Pall Mall and Vogue.



The European Productivity Programme

The programme governs a range of projects to reduce product complexity, drive continuous improvement and deliver synergies above and within markets.

The programme has delivered significant savings, contributing over 40 per cent of the Group's total productivity gains, ahead of schedule, through:

- **the elimination of overcapacity with 11 factories closed or sold whilst maintaining the Group's corporate reputation;**
- **reduced packaging material costs;**
- **80 per cent fewer cigarette specifications;**
- **30 per cent fewer tobacco blends; and**
- **800 fewer stock-keeping units.**

ASIA-PACIFIC

"2007 was a strong year with good Global Drive Brand and overall volume growth, productivity savings, improved distribution effectiveness to the retail trade and a strengthened talent pipeline."

John Daly Director, Asia-Pacific

Share gains for Dunhill across Asia-Pacific

For the second year in a row, Dunhill delivered an additional one billion sticks with over 4 per cent volume growth in 2007.

There were strong performances in the key markets of South Korea, Malaysia and Australia.

The roll-out of the global strategy across Asia-Pacific is led by Dunhill Fine Cut, launched in South Korea and Malaysia. In South Korea, it was successfully introduced as a Super Slim product.

Both launches enhanced the image of the House of Dunhill and strengthened the brand's premium qualities and attributes.

In **Asia-Pacific**, profit rose by £56 million to £672 million, mainly attributable to strong performances from Australasia, Vietnam, Pakistan and Bangladesh, despite the adverse impact of exchange. At comparable rates of exchange, profit would have increased by £66 million or 11 per cent. Volumes at 145 billion were 2 per cent higher as a result of strong growth in Pakistan, South Korea and Vietnam, partially offset by declines in Malaysia and Bangladesh.

In Australia, profit growth was achieved with improved margins from product cost reductions and price increases. Market share grew with good performances from Dunhill, Pall Mall and Winfield. In New Zealand, strong competition affected market share and profit but Pall Mall and Dunhill showed good growth.

In Malaysia, the strong performance of Dunhill and, more recently, Pall Mall, resulted in growth in their respective price segments with Dunhill increasing overall share. However, the large excise increase in July 2007 impacted industry volumes which were already declining due to high levels of illicit trade and total market share was lower. Profit was slightly lower as a result of increased marketing expenditure and lower volumes which more than offset the benefits of higher pricing and an improved product mix.

In Vietnam, profit increased significantly benefiting from better pricing, productivity initiatives and volume growth. Market share was higher, driven by a good performance from Craven 'A'.

Volumes and market share rose in South Korea, with Dunhill continuing to grow strongly. However, the positive impact of higher volumes, margins and supply chain savings were offset by increased marketing investment and a weaker local currency. In Taiwan, volume and profit rose due to a strong performance from Pall Mall, increased prices and cost reductions.

Pakistan continued its strong volume growth with Gold Flake the major contributor. Overall market share increased confirming our market leadership. Higher volumes, price increases and effective cost management led to an impressive profit performance. In Bangladesh, despite lower volumes due to the growth of the Value-for-Money segment, profit increased as a result of improved pricing and product mix.

In Sri Lanka, profit and market share continued to grow although overall volumes declined due to the security situation and price increases.

LATIN AMERICA

"Another year of truly exceptional results with double-digit profit growth despite some volume contraction due to excise and pricing dynamics. Product mix improved with a strong growth in Global Drive Brands."

Mark Cobben Director, Latin America

Development of strategic brand portfolio in Chiletabacos

Chiletabacos has an excellent track record of delivering strong financial results. Yet more recently it has also demonstrated sterling progress in the development of a strategic brand portfolio where Global Drive Brands now deliver nearly 15 per cent of its sales volume, with total sales of Kent, Pall Mall and Lucky Strike surpassing the 2 billion mark in 2007.

Led by Kent, which alone has a market share of 8 per cent, the company has enriched its sales mix, with Premium-priced products now representing over 15 per cent of its sales volume. Notwithstanding tightening regulation and competition, Chiletabacos has, as a result, been very successful in benefiting from up-trading to these brands, all of which contributes to its sustainable future and continued success.

Profit in **Latin America** increased by £69 million to £680 million due to good performances in key markets such as Brazil and Venezuela, partly offset by lower profit in Mexico and the adverse impact of some weaker local currencies. At comparable rates of exchange, profit would have increased by £86 million or 14 per cent. Volumes were 1 per cent down at 151 billion as the increases in Brazil, Venezuela and Chile were more than offset by declines in Mexico, Argentina and Central America.

In Brazil, profit grew strongly, benefiting from higher volumes, price rises in anticipation of the excise increase in July, some improvement in product mix and a stronger local currency. Market share was higher as volumes increased due to strong brand and trade marketing efforts and the effective anti-illicit trade enforcement actions by the government.

Industry volume in Mexico suffered following a large excise-driven price increase at the beginning of 2007 and this, together with a lower market share and a weaker currency, resulted in lower profit. In Argentina, profit grew as prices increased after the severe price competition of the prior year, as well as a better product mix and cost saving initiatives. Volumes and market share, however, were both down.

In Chile, volumes were higher than last year and, despite an unfavourable exchange rate, profit grew due to higher margins and strong up-trading to Kent and Lucky Strike. Volumes in Peru were stable although profit declined due to competitive pricing.

In Venezuela, profit increased strongly, despite the impact of exchange, due to price rises and higher volumes, partially offset by increased costs. Market share grew through good performances by Consul and Belmont.

The Central America and Caribbean area benefited from higher margins and more efficient product sourcing, but this was more than offset by the impact of exchange and lower industry volumes, as a result of excise-driven price increases.

AFRICA AND MIDDLE EAST

"In line with our vision 'to strengthen our position as the leading tobacco company in the region', Africa and Middle East had a good year in 2007 with strong underlying results."

Andrew Gray Director, Africa and Middle East

Supporting the global strategy

Global Drive Brands grew strongly across the region. Major milestones achieved include Dunhill selling in excess of 1 billion cigarettes in South Africa, Pall Mall having been launched in 15 markets and Kent remaining the leading brand in the Caucasus.

The productivity programme continued to drive unnecessary cost and complexity out of the business. It included rationalising the factory footprint, changing management structures and obtaining economies of scale through consolidation of spend and implementation of shared services. Effective stakeholder engagement continued, with increased dialogue on industry issues including anti-illicit trade and smokeless tobacco.

Profit in the **Africa and Middle East** region was £2 million higher at £470 million due to exchange rate movements. However, at comparable rates of exchange, profit would have increased by £53 million or 11 per cent with strong performances from South Africa and Nigeria. Volumes were 4 per cent lower at 101 billion, resulting from supply chain disruption in the Middle East and a change in distribution model in Turkey.

In South Africa, despite the weaker average exchange rate, good profit growth was achieved as a result of reductions in illicit trade, an improved product mix and higher margins. The margin improvements were the result of pricing and productivity improvements across the business. Dunhill recorded its highest ever market share and Peter Stuyvesant continued its growth.

Strong profit growth in Nigeria was the result of higher margins, the benefits of productivity initiatives and an improved product mix. Share performance was particularly strong for Benson & Hedges and was supported by Dunhill and Pall Mall. Volumes were marginally lower as a result of trade de-stocking following the country's elections.

In Sub-Saharan Africa, supply difficulties in West Africa at the beginning of the year impacted volume and profit, while a number of markets in East Africa delivered productivity savings and grew volumes reflecting lower levels of illicit trade.

In the Middle East, the brand portfolio mix improved across the area through the growth of premium brands, although profit was adversely affected by lower volumes as a result of supply chain disruptions and weaker currencies. Dunhill continued its growth in Saudi Arabia and the Arabian Gulf and grew market share. North Africa showed improved volume and profit performance, with market share in Egypt growing as a result of strong performances by Kent and Rothmans.

Volumes, market share and profit in the Caucasus were all well ahead of last year. The higher volumes reflected significant increases in Dunhill and Vogue, while Kent remained the leading brand. In Turkey, volumes and market share were higher but operating losses increased due to the one-off costs associated with the change in the distribution model in January and higher brand support with the launch of new brands.

AMERICA-PACIFIC

"In Japan, we are the only tobacco company which grew volumes and share. In Canada, major structural improvements have improved our cost base and benefited distribution. We expect to build on these strengths in 2008."

Nicandro Durante Director, America-Pacific

Innovation in Japan

In 2006, we recognised that Japan was rapidly becoming one of the world's most demanding and innovative consumer markets. We resolved to gear our consumer offerings around highly innovative and contemporary ideas to meet consumers' expectations.

To achieve this, a dedicated innovation group was established at our headquarters in Tokyo, with the task of creating and delivering a step change in innovation. In 2007, almost 14 per cent of our business came from new innovations.

Perhaps the most noteworthy of these is Kool Boost, a highly original product that employs a crushable capsule in the filter to deliver an extra boost of menthol. Such has been the consumer reaction to Boost, that Kool is today the fastest growing brand in the market.

The profit from the **America-Pacific** region increased by £22 million to £446 million as a result of higher profit in local currency in Japan and Canada, partly offset by the impact of weaker exchange rates. At comparable rates of exchange, profit would have increased by £45 million or 11 per cent. Volumes decreased by 3 per cent to 42 billion, mainly as a result of the decline in industry volumes in Canada, partly offset by the increase in Japan.

In Canada, profit of £276 million was down £4 million from last year. However, profit would have been £4 million higher at comparable rates of exchange, due to higher margins and lower production costs following the transfer of manufacturing to Mexico. The impact of these more than offset the reduction in volumes driven by the increased prevalence of illicit product and loss of market share. The continued growth of Peter Jackson resulted in share growth in the Value-for-Money segment, but, as this was more than offset by the decline in the Premium segment, the overall market share was lower.

In Japan, where there was a significant decline in industry volumes, the growth of market share, profit and volumes continued, driven by the strong performances of Kent and Kool. Profit grew through higher volumes, increased margins, improved product mix and effective cost management, partly offset by the impact of unfavourable exchange rates.

ASSOCIATES

Results of associates

Associates principally comprise Reynolds American, ITC and Skandinavisk Tobakskompagni (ST).

The Group's share of the post-tax results of associates increased by £11 million, or 3 per cent to £442 million, after taxation of £246 million (2006: £216 million).

Excluding the exceptional items explained on pages 41 and 42, the Group's share of the post-tax results of associates at £449 million rose by 5 per cent. However, the Group's share of these results was particularly affected by the weakening of the average US dollar rate against sterling from 1.844 to 2.001 and, at comparable rates of exchange, the increase would have been 11 per cent.

The contribution from Reynolds American, excluding exceptional items, was only £4 million higher due to the impact of the weaker US dollar. At comparable rates of exchange, the contribution from Reynolds American would have been £28 million higher at £313 million. The impact of increased pricing, moist-snuff volumes and productivity more than offset lower cigarette volumes and higher settlement expenses.

The results of Reynolds American also reflect the inclusion of the first full year of Conwood's results and that company's continued growth. As explained on page 45, Reynolds American acquired Conwood on 31 May 2006 and reported that on a pro forma US GAAP basis, as if it had been owned since the beginning of 2006, Conwood increased volume, margins and profit.

The Group's associate in India, ITC, continued its strong revenue growth and its contribution to the Group rose by £17 million to £108 million, with the growth helped by one-off costs in 2006.

The contribution from the Group's associate in Denmark, ST, rose by 4 per cent to £48 million.

Associates' volumes decreased by 4 per cent to 230 billion and, with the inclusion of these, total Group volumes were 914 billion (2006: 930 billion).

FINANCIAL REVIEW

"British American Tobacco has delivered average adjusted earnings per share growth of 10 per cent over the last five years. This is in line with our commitment to high single-digit growth in earnings on average over the medium to long term."

Paul Rayner Finance Director

- **Growth in revenue of 5 per cent and profit from operations, excluding exceptional items of 11 per cent, at comparable rates of exchange.**
- **Adjusted diluted earnings per share growth of 11 per cent.**
- **Total dividends per share for 2007 of 66.2p, up 18 per cent on the prior year.**
- **Strong cash flow, with free cash flow up 11 per cent at £1,711 million and free cash flow per share up 13 per cent.**
- **Interest cover remains strong with interest payable covered 9.4x (2006: 8.1x).**
- **Committed long term facilities of £1.75 billion, unused at 31 December 2007.**
- **The 2002 five year cost saving programme reached over £1 billion in annual savings, with a new target set for annual savings of £800 million by 2012.**

Profit from operations

The reported Group revenue at £10,018 million grew by 3 per cent and profit from operations at £2,905 million grew by 11 per cent. However, at comparable rates of exchange, the growth rates would have been 5 per cent and 15 per cent respectively. The adverse impact of exchange resulted from the weakening in the average rates against sterling of a number of currencies.

In addition, reported profit can be distorted by exceptional items, as described below. Excluding the exceptional items, profit from operations grew by 7 per cent or 11 per cent at comparable rates of exchange.

During 2007, revenue grew and costs were lower, with profit from operations, excluding exceptional items, as a percentage of revenue at 30.0 per cent compared to 28.7 per cent in 2006.

During 2007, the last year of our five year programme of cost savings, we achieved annual savings of £1,006 million in total for supply chain and overheads and indirects. A new five year target has been set to achieve annual savings of £800 million by 2012, in areas such as supply chain efficiencies, back office integration and management structures.

Details of the Group's operating performance excluding exceptional items and unallocated costs can be found on pages 32 to 40. Unallocated costs, which are net corporate costs not directly attributable to regional segments of the businesses, were £107 million (2006: £103 million).

Exceptional items

The exceptional items below are separately disclosed as memorandum information on the face of the Income Statement on page 86 and in the segmental analysis on pages 98 and 99, to help provide a better understanding of the Group's financial performance.

The Group continued its review of manufacturing operations and organisational structure, including the initiative to reduce overheads and indirect costs. In 2007, costs were incurred for restructuring the operations in Italy and the reorganisation of the business across the Europe and Africa and Middle East regions, as well as further costs related to restructurings announced in prior years. The total restructuring costs were £173 million for 2007 compared to £216 million for 2006.

On 20 February 2007, the Group announced that it had agreed to sell its pipe tobacco trademarks to the Danish company, Orlik Tobacco Company A/S, for €24 million. The sale was completed during the second quarter and resulted in a gain of £11 million included in other

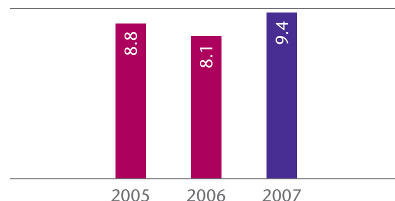
FINANCIAL REVIEW continued

Profit from operations excluding exceptional items £ million

+7% in 2007

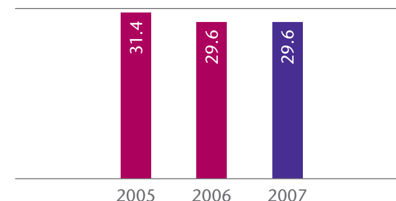
Interest cover times

9.4 times in 2007



Underlying tax rate percentage

29.6% in 2007



operating income in the profit from operations. However, the Group has retained the Dunhill and Captain Black pipe tobacco brands.

On 23 May 2007, the Group announced that it had agreed to sell its Belgian cigar factory and associated brands to the cigars division of Skandinavisk Tobakskompagni AS. The sale includes a factory in Leuven as well as trademarks including Corps Diplomatique, Schimmelpennick, Don Pablo and Mercator. The transaction was completed on 3 September 2007, and a gain on disposal of £45 million is included in other operating income for the twelve months to 31 December 2007.

On 1 October 2007, the Group agreed the termination of its license agreement with Philip Morris for the rights to the Chesterfield trademark in a number of countries in Southern Africa. This transaction resulted in a gain of £19 million included in other operating income in the profit from operations.

Profit from operations in 2006 benefited from a £41 million gain, comprising a £60 million gain on a trademark transfer agreement for certain brands in Far East and African markets, partly offset by a loss of £19 million on the disposal of the Italian cigar business.

Net finance costs

Below profit from operations, net finance costs at £269 million were £20 million lower than last year, principally reflecting the impact of lower average net debt, as well as one-off items.

Interest cover

The Group assesses its financial capacity by reference to cash flow and interest cover. Interest cover is distorted by the pre-tax impact of the exceptional items reflected in the adjusted earnings per share as explained below. The chart shows the cover, adjusting for these items, on the basis of profit before interest payable over interest payable. The interest cover remains strong at 9.4x (2006: 8.1x), with the higher cover reflecting both higher profit and lower interest costs.

Net interest cover, on the basis of profit before net finance costs over net finance costs, was 12.8x (2006: 11.2x).

At 31 December 2007, the ratio of floating to fixed rate financial liabilities was 53:47 (2006: 58:42).

Associates

As explained on page 40, the Group's share of the post-tax results of associates, included at the pre-tax level under IFRS, increased by £11 million to £442 million, after an exceptional charge of £7 million (2006: £4 million net income). The exceptional items include impairment charges in Reynolds American due to modified levels of support between certain brands and the resultant projected net sales of certain brands. The Group's share of these charges was £7 million (2006: £13 million). In addition, 2006 included a benefit from the favourable resolution of tax matters of which the Group's share was £17 million.

Profit before tax

Profit before tax was up £314 million at £3,078 million, principally reflecting the higher profit from operations.

Effective tax rate

The tax rates in the Income Statement of 25.7 per cent in 2007 and 25.9 per cent in 2006 are affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results.

The underlying tax rate for subsidiaries, adjusted to remove the distortions as reflected in the adjusted earnings per share below, was 29.6 per cent in 2007 and 29.6 per cent in 2006.

Earnings per share

Basic earnings per share for 2007 were 105.19p (2006: 92.08p).

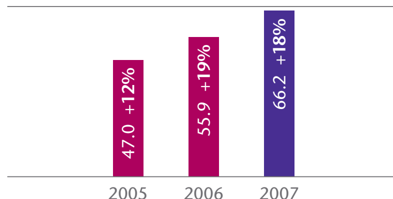
With the distortions that can occur in profit over the years, as well as the potential dilutive effect of employee share schemes, earnings per share is best viewed on the basis of adjusted

Adjusted diluted EPS
pence

+11% in 2007

Dividend per share declared
pence

+18% in 2007



diluted earnings per share. This measure removes the impact of exceptional items and the calculation is explained in note 7 on page 107. The adjustments relate to restructuring costs and the disposal of businesses and brands. In addition, the calculation adjusts for the impact of the potential conversion of shares.

On this basis, the earnings per share were 108.53p, an 11 per cent increase over 2006, as a result of the strong operating performance, partly offset by the adverse impact of foreign exchange movements.

Dividends

With the recommended final dividend of 47.6p, the total dividends per share declared for 2007 are 66.2p, up 18 per cent on the prior year. Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2007 accounts reflect the 2006 final dividend and the 2007 interim dividend amounting to 58.8p (£1,198 million) in total (2006: 48.7p – £1,008 million). The table below shows the dividends declared in respect of 2007 and 2006.

As we announced last year, the Board decided to raise the ratio of dividends paid as a percentage of long term sustainable earnings from the previous policy of at least 50 per cent to 65 per cent by 2008 in progressive steps. Dividends per share declared for 2007 of 66.2p represent 61 per cent of adjusted diluted earnings per share (2006: 57 per cent).

Total equity

Total equity was £410 million higher at £7,098 million. The profit retained after payment of dividends exceeded the impact of the share buy-back by £182 million. In addition, exchange movements had a £312 million positive impact on shareholders' funds, reflecting the general weakness of sterling at the end of 2007 compared to 2006.

Cash flow

The IFRS cash flow includes all transactions affecting cash and cash equivalents, including financing. The alternative cash flow on page 44 is presented to illustrate the cash flows before transactions relating to borrowings. The growth in underlying operating performance, as well as the timing of working capital movements and higher dividends from associates, resulted in a £361 million increase in cash flow before restructuring costs and taxation to £3,656 million.

Although there was a £153 million increase in tax outflows reflecting higher profits and the timing of payments, with the above operating cash flows and lower restructuring costs, the Group's net cash flow from operating activities was £238 million higher at £2,600 million.

With higher net interest flows, net capital expenditure and dividends to minority interests, the free cash flow was £170 million higher than 2006 at £1,711 million. However, with the step up in dividends and share buy-back in 2007, the total cash outlay on dividends to shareholders and share buy-back exceeds the free cash flow by £237 million.

Free cash flow is the Group's cash flow before dividends, share buy-back and investing activities. The ratio of free cash flow per share to adjusted diluted earnings per share was 77 per cent (2006: 76 per cent), with free cash flow per share increasing by 13 per cent.

Dividends declared

	2007		2006	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim	18.6	377	15.7	323
Final	47.6	954	40.2	821
	66.2	1,331	55.9	1,144

REGIONAL AND FINANCIAL REVIEW

The other net flows in 2007 principally reflect the sale of the Belgian cigar factory and associated brands, as well as the disposal of pipe tobacco business as described on pages 41 and 42. The comparative figure for 2006 largely relates to the purchase of minority interests in Chile and shares for the Group's share-based compensation plans, largely offset by the sale of Toscano in Italy and the disposal of brands.

The above flows resulted in net cash outflow of £85 million compared to an inflow of £28 million in 2006. After taking account of transactions related to borrowings, the above flows resulted in a net decrease of cash and cash equivalents of £143 million compared to a net decrease of £292 million in 2006, as shown in the IFRS cash flow on page 90.

These cash flows, after a positive exchange impact of £47 million, resulted in cash and cash equivalents, net of overdrafts, decreasing by £96 million to £1,180 million in 2007 (2006: £388 million decrease).

Borrowings, excluding overdrafts but taking into account derivatives relating to borrowings, were £6,836 million compared to £6,401 million as at 31 December 2006. The increase principally reflected the impact of exchange movements.

Current available-for-sale investments at 31 December 2007 were £75 million (2006: £128 million).

As a result of the above net debt, comprising borrowings, cash, cash equivalents and current available-for-sale investments, was £5,581 million (2006: £4,996 million).

Cash flow

	2007 £m	2006 £m
Net cash from operating activities before restructuring costs and taxation	**3,656**	3,295
Restructuring costs	**(190)**	(220)
Taxation	**(866)**	(713)
Net cash from operating activities	**2,600**	2,362
Net interest	**(280)**	(263)
Net capital expenditure	**(436)**	(419)
Dividends to minority interests	**(173)**	(139)
Free cash flow	**1,711**	1,541
Dividends paid to shareholders	**(1,198)**	(1,008)
Share buy-back	**(750)**	(500)
Other net flows	**152**	(5)
Net cash flows	**(85)**	28
IFRS cash flow		
Net cash from operating activities	**2,600**	2,362
Net cash from investing activities	**(122)**	(315)
Net cash from financing activities	**(2,621)**	(2,339)
Net cash flows	**(143)**	(292)

Treasury operations

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

The Board reviews and agrees the overall treasury policies and procedures, delegating appropriate authority to the Finance Director, the Treasury function and the Boards of the central finance companies. The policies include a set of financing principles 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 and share buy-back are decided. The Finance Director chairs the Boards of the major central finance companies. Any significant departure from agreed policies is subject to the prior approval of the Board.

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 the Group Treasury Committee, which meets regularly throughout the year and is chaired by the Finance Director. Regular reports are provided to senior management, and treasury operations are subject to periodic independent reviews and audits, both internal and external.

One of the principal responsibilities of Treasury is to manage the financial risk arising from the Group's underlying operations. Specifically, Treasury manages, within an overall policy framework, the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. Derivative contracts are only entered into to facilitate the management of these risks.

During 2006, the Group issued three bonds (€525 million maturing in 2010, €600 million maturing in 2014 and £325 million maturing in 2016) and the proceeds were used to refinance maturing bond issues. In 2007, €800 million of €1.7 billion bonds with a maturity of February 2009 were replaced by €1 billion bonds with a maturity of 2017. In March 2007, the Group's central banking facility of £1.75 billion was extended on existing terms under a one year extension option, with final maturity dates between March 2011 and March 2012, and remains undrawn as at 31 December 2007.

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 5 years with no more than 20 per cent of centrally managed debt maturing in a single year. As at 31 December 2007, the average centrally managed debt maturity was 5.4 years and the highest proportion of centrally managed debt maturing in a single year was under 17 per cent.

The Group utilises cash pooling and zero balancing bank account structures in addition to inter-company loans and borrowings to ensure that there is the maximum mobilisation of cash within the Group. The 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 2007 the ratings from Moody's and S&P were Baa1/BBB+ (2006: Baa1/BBB+). The strength of the ratings has underpinned the debt issuance during 2006 and 2007 and, despite the impact of the turbulence in financial markets, the Group is confident of its ability to successfully access the debt capital markets.

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.

Changes in the Group

There were a number of changes in the Group in 2007 and 2006 as described under exceptional items on pages 41 and 42, while developments since 31 December 2007 are described in note 31 on page 161.

In addition, on 31 May 2006, the Group's associate, Reynolds American, completed the acquisition of Conwood, the second largest manufacturer of smokeless tobacco products in the US, for US$3.5 billion. The acquisition was funded principally with debt, and the fair value of assets acquired and liabilities assumed was US$4.1 billion and US$0.6 billion respectively.

From August 2006, the Group purchased minority interests in its subsidiary in Chile for a cost of £91 million, raising the Group shareholding from 70.4 per cent to 96.6 per cent. In the year ended 31 December 2006, the goodwill arising on this transaction was £80 million and the minority interests in Group equity were reduced by £11 million.

Share buy-back programme

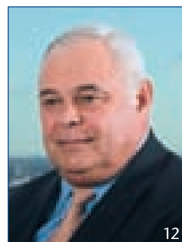
The Group initiated an on-market share buy-back programme at the end of February 2003. During the year to 31 December 2007, 45 million shares were bought back at a cost of £750 million (2006: 35 million shares at a cost of £500 million). This brought the total of the share buy-back programme to 291 million shares at a cost of £2,942 million and an average share price of £10.11.

Accounting developments

From 1 January 2005, the Group has reported under International Financial Reporting Standards (IFRS) and, generally, the move to IFRS has made the reporting of performance more complex.

As regards 2007, the changes in IFRS have not had a material impact on the Group's results. The main change in 2007 was the implementation of IFRS7 on disclosures for financial instruments. This did not affect the measurement of the Group's results but has required some changes and additions to the financial statements in describing the financial instruments we have in our business. However, the next few years are likely to see more changes in our financial statements following the relatively small changes in 2006 and 2007.

BOARD OF DIRECTORS



1. Jan du Plessis (British/South African)
Chairman ▲
Appointed Chairman in July 2004, having been a Non-Executive Director since his appointment to the Board in 1999. He was previously Group Finance Director of Richemont. He is Chairman of the Nominations Committee. He is a Non-Executive Director of Lloyds TSB Group plc. (54)

2. The Rt. Hon. Kenneth Clarke QC MP (British)
Deputy Chairman and Senior Independent Non-Executive Director ▲■●◆
Appointed a Director in 1998 and will retire at the conclusion of this year's AGM on 30 April 2008. He is Chairman of the Remuneration and Corporate Social Responsibility Committees. He is Non-Executive Director of Independent News & Media (UK) Limited and Independent News and Media p.l.c. (Republic of Ireland). (67)

3. Paul Adams (British)
Chief Executive
Appointed a Director in March 2001 and Chief Executive in January 2004. He joined British American Tobacco in July 1991 and held senior appointments as Regional Director, Asia-Pacific and Regional Director, Europe prior to becoming Deputy Managing Director in June 2001 and Managing Director in January 2002. (54)

4. Paul Rayner (Australian)
Finance Director
Joined Rothmans Holdings Limited in Australia in 1991. He held senior executive positions with Rothmans before becoming Chief Operating Officer of British American Tobacco Australasia Limited in September 1999. He became Finance Director in January 2002. He has been a Non-Executive Director of Centrica plc since September 2004. Paul Rayner will retire as Finance Director at the conclusion of the AGM on 30 April 2008. (53)

5. Nicandro Durante (Brazilian/Italian)
Chief Operating Officer and Director, America-Pacific
Appointed a Director and Chief Operating Officer on 1 January 2008 having previously been Regional Director for Africa and Middle East and a member of the Management Board since March 2006. He previously held senior general management roles in Brazil (including President of Souza Cruz) and also in the UK and Hong Kong. (51)

6. Robert Lerwill (British)
Non-Executive Director ▲■●◆
Appointed a Director in 2005, he is Chairman of the Audit Committee. He has been Chief Executive of Aegis Group plc since 2005 and was formerly a Director of Cable & Wireless plc and WPP Group PLC. He is a Non-Executive Director of Synergy Healthcare plc. (56)

7. Karen de Segundo (Dutch)
Non-Executive Director ▲■●◆
Appointed a Director on 1 October 2007, she has been appointed Chair of the Corporate Social Responsibility Committee with effect from 1 May 2008. Karen retired as CEO Renewables and President Hydrogen of Shell International in 2005. She is currently a Non-Executive Director of Lonmin plc, Merrill Lynch New Energy Technology plc, Ensus Ltd, Pöyry Oyj and Ahold NV. (61)

8. Dr Ana Maria Llopis (Spanish)
Non-Executive Director ▲■●◆
Appointed a Director in 2003. She is Executive Deputy Chairman of the J F Llopis Foundation and a member of the Good Governance Working Group for Spanish listed companies. Ana Maria was appointed a Non-Executive Director of ABN AMRO Bank in April 2007. (57)

9. Christine Morin-Postel (French)
Non-Executive Director ▲■●◆
Appointed a Director on 1 October 2007. Christine is currently a Non-Executive Director of Royal Dutch Shell PLC and 3i Group plc. She previously held a number of executive 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 plc before her retirement in 2003. (61)

10. Anthony Ruys (Dutch)
Non-Executive Director ▲■●◆
A Director from March 2006, he has been appointed Chairman of the Remuneration Committee with effect from 1 May 2008. He was previously Chairman of Heineken N.V. He is a member of the Supervisory Boards of ABN AMRO Bank and Schiphol Airport N.V. and a director of Lottomatica S.p.A. (Italy). (60)

11. Sir Nicholas Scheele (British/US)
Non-Executive Director ▲■●◆
Appointed a Director in 2005, he has been appointed Senior Independent Director with effect from 1 May 2008. He is Chancellor of the University of Warwick. He is Chairman of The Cambridge-MIT Institute and Key Safety Systems, Inc. (USA) and a Director of Caparo plc. (64)

12. Thys Visser (South African)
Non-Executive Director ▲◆
A Director since 2001. He is CEO of Remgro Limited, having held senior management positions with Rembrandt Group since 1980. He is Chairman of Rainbow Chicken Ltd and is a Non-Executive Director of Medi-Clinic Corporation Limited, Nampak Limited and Distell Group Limited. (53)

Board Committees
Committee membership is indicated by the following symbols:
▲ Nominations Committee
■ Audit Committee
● Remuneration Committee
◆ Corporate Social Responsibility Committee

MANAGEMENT BOARD

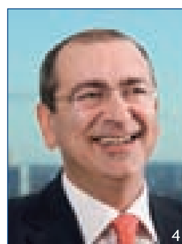
The role of the Management Board

The Management Board, chaired by the Chief Executive, comprises the Executive Directors of British American Tobacco p.l.c. together with the executives shown on this page. The Management Board has delegated responsibility for overseeing the implementation by the Group's operating subsidiaries of the policies and strategy set by the Board of Directors, and for creating the conditions for their successful day-to-day operation.

1

2

3


4

5

6

7

8

9

1. Mark Cobben (Dutch)
Director, Latin America and Caribbean
Joined British American Tobacco in 1993. He has held a number of senior roles across the Group (including General Manager in Switzerland, Argentina, Russia and, most recently, Germany). He has been Director, Latin America and Caribbean since October 2007. (51)

2. John Daly (Irish)
Director, Asia-Pacific
Joined the Management Board as Regional Director for Asia-Pacific in October 2004. He held a number of senior management roles for Rothmans International in Europe and the Far East before becoming Area Director for the Middle East and North Africa in 2001. (51)

3. Andrew Gray (Brazilian/British)
Director, Africa and Middle East
Appointed Director, Africa and Middle East in January 2008. He joined British American Tobacco 21 years ago and has held a variety of senior marketing and general management roles in South America (including President of Souza Cruz) and also in Central America, the Caribbean and Malaysia. (43)

4. Rudi Kindts (Belgian)
Director, Human Resources
Joined British American Tobacco in 1988. He has held a number of senior human resources roles in the Group and his responsibilities have covered Europe, Africa, the Middle East and Central and South Asia. He has been Director, Human Resources since July 2004. (50)

5. Michael Prideaux (British)
Director, Corporate and Regulatory Affairs
Appointed Director, Corporate and Regulatory Affairs in 1998 following the demerger of B.A.T Industries. He joined B.A.T Industries in 1989 from Charles Barker, a leading financial and corporate public relations, advertising and design agency, where he was Chief Executive. (57)

6. Jimmi Rembiszewski (German)
Group Marketing Director
Joined the Group as a Marketing Director and as a Territorial Director in 1991, having had various senior marketing and business appointments in Procter & Gamble and Jacobs Suchard. He has been a member of the Management Board since 1996. (57)

7. Ben Stevens (British)
Director, Europe
Appointed Director, Europe in January 2004 having previously joined the Management Board in 2001 as Development Director. Since joining British American Tobacco in 1989, he has covered a number of senior marketing, finance and management roles particularly in Europe, South Asia and Russia. He has been appointed Executive Director with effect from 3 March 2008 and will succeed Paul Rayner as Finance Director on 30 April 2008. (48)

8. Peter Taylor (British)
Global Operations Director
Joined British American Tobacco in 1980 and worked in a variety of operational and general management roles across the Group. He was appointed Global Operations Director in 2003. (55)

9. Neil Withington (British)
Director, Legal and Security and General Counsel
Appointed Director, Legal and Security and General Counsel of British American Tobacco in 2000, having previously been the Group's Deputy General Counsel. He joined the Group in 1993 after a career at the Bar and in the chemical and pharmaceutical industries. He has been a Director of Reynolds American Inc. since July 2004. (51)

DIRECTORS' REPORT

Introduction

The Directors present their report and the audited financial statements for the Group and the Company for the year ended 31 December 2007. A report from the Directors on corporate governance is set out on pages 76 to 83 and the Remuneration Committee report is on pages 58 to 75.

Business review

Section 234ZZB of the Companies Act 1985 requires British American Tobacco p.l.c. (the Company) to produce a business review. The information that has been prepared to a standard which fulfils the requirements of that business review can be found in the Operating and Financial Review (OFR) on pages 8 to 45, those pages being incorporated by reference into this Directors' Report. The preparation of the OFR has also taken into account, where considered appropriate, the best practice set out in the UK Accounting Standards Board's 'Reporting Statement: Operating and Financial Review'. The OFR reports on the Group's development and performance during the past year together with its strategy and prospects, with particular reference to the business measures on pages 12 and 13. The OFR also includes information in respect of financial and other risks under the heading of 'Key Group Risk Factors' (pages 28 to 31) and employee involvement and employment practices (pages 26 and 27).

The Annual Report and Accounts is published on bat.com. It is issued only to those shareholders who have elected to receive it. Otherwise, shareholders are notified that the Annual Report and Accounts is available on the website and will, at the time of that notification, receive a 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) together with a Proxy Form and Notice of Annual General Meeting and Circular to Shareholders.

Principal activities

British American Tobacco p.l.c. is a holding company which owns, directly or indirectly, investments in the numerous companies constituting the British American Tobacco Group of companies. The principal subsidiaries and associates are listed on pages 166 to 168. All subsidiary undertakings are involved in activities related to the manufacture, distribution or sale of tobacco products.

Group results and dividends

The Group results are addressed fully in the financial statements (pages 86 to 165) and in the OFR (pages 8 to 45). The Board has recommended to shareholders a final dividend of 47.60p per ordinary share for the year ended 31 December 2007. If approved, this dividend will be paid on 7 May 2008 to shareholders on the register at the close of business on 7 March 2008. Full details of dividends in respect of 2007 are given on page 108 in note 8.

Annual General Meeting

The Annual General Meeting will be held at The Mermaid Conference & Events Centre, Puddle Dock, Blackfriars, London EC4V 3DB at 11.30am on 30 April 2008. Details of the business to be proposed at the meeting are contained in the Notice of Annual General Meeting which is sent to all shareholders and is also published on bat.com.

Directors

The following persons are the current Directors of the Company:

Chairman
Jan du Plessis

Deputy Chairman and Senior Independent Non-Executive Director
Kenneth Clarke

Executive Directors
Paul Adams (Chief Executive)
Paul Rayner (Finance Director)
Nicandro Durante (Chief Operating Officer)

Non-Executive Directors
Karen de Segundo
Robert Lerwill
Ana Maria Llopis
Christine Morin-Postel
Anthony Ruys
Sir Nicholas Scheele
Thys Visser

Rupert Pennant-Rea and Piet Beyers retired as Non-Executive Directors on 26 April 2007 and 30 June 2007 respectively, Christine Morin-Postel and Karen de Segundo were appointed as Non-Executive Directors on 1 October 2007, and Antonio Monteiro de Castro retired as Chief Operating Officer on 31 December 2007. Nicandro Durante was appointed to the Board as Chief Operating Officer on 1 January 2008.

Paul Rayner will retire as Finance Director at the conclusion of the Annual General Meeting on 30 April 2008. Ben Stevens has been appointed to the Board with effect from 3 March 2008 and will succeed Paul Rayner as Finance Director on 30 April 2008.

In accordance with the Articles of Association, the Directors named below retire from the Board at the forthcoming Annual General Meeting and, being eligible, offer themselves for reappointment:

Jan du Plessis
Ana Maria Llopis
Anthony Ruys
Karen de Segundo
Nicandro Durante
Christine Morin-Postel
Ben Stevens

Biographical and related information about the Directors is given on pages 46 and 47 and will also be given in the Secretary's letter in the Notice of Annual General Meeting for those Directors who are offering themselves for reappointment.

Directors' interests and indemnities

The interests of the Directors of the Company in the issued share capital of the Company (including interests in share options and deferred shares) are shown in the Remuneration Report on pages 58 to 75.

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. Details of the Executive Directors' service contracts and the letters of appointment for the Non-Executive Directors, their emoluments and share interests (including interests in share-based payments) are given in the Remuneration Report on pages 58 to 75.

The Company's practice has always been to indemnify 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, indemnities are in force under which the Company has agreed to indemnify the Directors, in accordance with the Company's Articles of Association and to the maximum extent permitted by law, in respect of all costs, charges, expenses or liabilities, which they may incur in or about the execution of their duties to the Company, or any entity which is an associated company (as defined in Section 256 of the Companies Act 2006), or as a result of duties performed by the Directors on behalf of the Company or any such associated company.

Directors' responsibilities in relation to the financial statements

The following statement sets out the responsibilities of the Directors in relation to the financial statements of both the Group and the Company. The reports of the independent auditors shown on pages 84 and 85 and 169 set out their responsibilities in relation to those financial statements.

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss of the Group for the financial year. In preparing those financial statements, the Directors are required to:

(1) select appropriate accounting policies and apply them consistently;

(2) make judgements and estimates that are reasonable and prudent;

(3) state whether applicable accounting standards have been followed, subject to any material departures being disclosed and explained; and

(4) prepare the financial statements on the going concern basis, unless they consider that to be inappropriate.

The applicable accounting standards referred to in (3) above are: (a) United Kingdom Generally Accepted Accounting Principles (UK GAAP) for the Company; and (b) International Financial Reporting Standards (IFRS) as adopted by the European Union for the Group.

The Directors are responsible for ensuring that the Company keeps proper accounting records to disclose with reasonable accuracy at any time the financial position of the Group and the Company and to enable them to ensure that the Group financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation and the Company financial statements and the Directors' Remuneration Report comply with the Companies Act 1985. They are also responsible for taking reasonable steps to safeguard the assets of the Company and the Group and, in that context, having proper regard to the establishment of appropriate systems of internal control with a view to the prevention and detection of fraud and other irregularities.

The Directors are required to prepare financial statements and to provide the auditors with every opportunity to take whatever steps and undertake whatever inspections the auditors consider to be appropriate for the purpose of enabling them to give their audit report.

The Directors are responsible for the maintenance and integrity of the Annual Report and Accounts on bat.com in accordance with the UK legislation governing the preparation and dissemination of financial statements. Access to the website is available from outside the UK, where comparable legislation may be different.

The Directors consider that they have pursued the actions necessary to meet their responsibilities as set out in this Statement.

Directors' declaration in relation to relevant audit information

Having made enquiries of fellow Directors and of the Company's auditors, each of the Directors confirms that:

(1) 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

(2) 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.

Going concern

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

Auditors

Resolutions will be proposed at the Annual General Meeting to reappoint PricewaterhouseCoopers LLP as the Company's auditors and to authorise the Directors to agree their remuneration. The Audit Committee will recommend the appropriate level of fees to the Board.

Interim dividend 2006 and related party transaction

In the Company's Annual Report and Accounts for the year ended 31 December 2006, it was reported that, in December 2006, the Company had become aware of a technical issue concerning: (i) the payment of certain historical dividends by B.A.T Industries p.l.c. (a wholly owned subsidiary of the Company); (ii) the payment of the Company's interim dividend in September 2006; and (iii) the repurchase by the Company (pursuant to its on-market share buy-back programme) of 6,927,790 ordinary shares of 25p each for an aggregate consideration of £100 million between 22 September 2006 and 4 December 2006 which caused such dividends and share repurchases to be unlawful and invalid.

These matters were drawn to shareholders' attention at the Annual General Meeting in April 2007 and were ratified by way of a shareholders' resolution. At the same general meeting, shareholders also approved entering into deeds of release in favour of Directors and certain former Directors of both the Company and B.A.T Industries p.l.c. Following that meeting the Company and B.A.T Industries p.l.c. entered into these deeds of release for no consideration in favour of the present and certain former Directors of both companies releasing them from liability arising from the aforementioned unlawful dividends and share repurchases. The invalidly repurchased shares were subsequently repurchased on 1 March 2007 from their holders, the Company's brokers, at the same prices agreed between 22 September 2006 and 4 December 2006.

Share capital

As at 31 December 2007, the Company had:

(1) an authorised share capital comprising 2,858,265,349 ordinary shares of 25p each with an aggregate nominal value of £714.57 million and 241,734,651 convertible redeemable preference shares of 25p each (CRPS) with an aggregate nominal value of £60.43 million; and

(2) an allotted and fully paid share capital of 2,024,504,341 ordinary shares of 25p each with an aggregate nominal value of £506.13 million (including treasury shares and shares owned by the employee share trusts). The CRPS are no longer in issue with 50 per cent being redeemed for cash in June 2000 and 50 per cent converted into the same number of ordinary shares in June 2004, in accordance with the terms of their issue.

Stock market listings

The Company's ordinary shares are listed on the London Stock Exchange. They are also traded on the American Stock Exchange, New York, in the form of American Depositary Receipts (ADRs) under the symbol BTI with a CUSIP number 110448107. ADRs represent two of the Company's ordinary shares and at 31 December 2007, 26,501,452 ADRs were outstanding, represented by 53,002,904 ordinary shares. The Company has unlisted trading privileges for its 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.

Major shareholder

At 27 February 2008, the following substantial interest (3 per cent or more) in the Company's ordinary share capital (voting securities) had been notified to the Company.

	Number of ordinary shares	Percentage of issued share capital
R&R Holdings S.A. (direct holding)	604,336,627	29.95

Note:
The percentage of issued share capital shown excludes treasury shares.

Pursuant to the Standstill Agreement dated 11 January 1999 (the Standstill Agreement) entered into between the Company and R&R Holdings S.A. (then named Rothmans International Holdings S.A.), Compagnie Financière Richemont SA (then called Compagnie Financière Richemont AG) and Rembrandt Group Limited (together the R and R Parties), the R and R Parties gave certain undertakings to the Company including the following: (a) that the R and R Parties and persons acting in concert with any of them will not exercise at any general meeting of the Company more than 25 per cent of the voting rights attached to shares of a class carrying rights to vote in all circumstances at general meetings of the Company; (b) the interests of the R and R Parties and persons acting in concert with any of them in the issued ordinary share capital of the Company will not exceed 27.8 per cent except in certain specified circumstances e.g. the Company making a purchase of its own shares or otherwise having reduced its issued share capital; and (c) if the R and R Parties have already disposed of 5 per cent or more of the Company's issued shares within the preceding six month period, no further shares of the Company may be disposed of by them unless at least five business days' notice has been given prior to the proposed additional disposal and the Company and its brokers have been consulted regarding the marketing of the shares. During the year ended 31 December 2007, the interests of the R and R Parties changed as a result of the Company continuing its share buy-back programme (see below). Further to a reorganisation of the Rembrandt Group in August 2000, the interest of Rembrandt Group Limited in R&R Holdings S.A. is now held by Remgro Limited, which company has become a party to the Standstill Agreement.

Purchase of own shares

From March 2007, the Board continued its on-market programme of buying back the Company's ordinary shares of 25p each in order to enhance its earnings under the authority granted by shareholders in 2006. At the 2007 Annual General Meeting, the Company was given authority to purchase up to 206,200,000 of its ordinary shares. The minimum price which must be paid for such shares is 25 pence and the maximum price is an amount equal to 105 per cent of the average of the middle market prices shown in the quotation for an ordinary share as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which the ordinary share is contracted to be purchased.

During the year ended 31 December 2007, the Company made on-market repurchases totalling 45,268,285 of its own ordinary shares, representing 2.24 per cent of the issued share capital (excluding treasury shares) as at 31 December 2007 and for an aggregate consideration of £750 million. Of these repurchased shares, 38,379,505 were cancelled and the share capital was reduced accordingly. Since 1 October 2007, the Company's policy has been to hold any repurchased shares as treasury shares and as at 31 December 2007 the number of treasury shares was 6,888,780. Whilst treasury shares are held no dividends are paid on them and they have no voting rights; treasury shares may be re-sold at a later date.

The present authority for the Company to purchase its own shares will expire at the 2008 Annual General Meeting. The Directors will be seeking fresh authority for the Company to purchase its ordinary shares as part of the planned continuation of the share buy-back programme.

Continuation of the Company's share buy-back programme may result in the shareholding of R&R Holdings S.A. (the Company's largest shareholder – see above) increasing to 30 per cent or more. This would trigger an obligation on the part of R&R Holdings S.A. to make a general offer for the remainder of the entire issued share capital of the Company under the City Code on Takeovers and Mergers. With the approval of the shareholders, given at the Annual General Meeting held on 26 April 2007, this requirement was waived by the Panel on Takeovers and Mergers in 2007 until the end of the AGM in 2008. The Company has requested the Panel to consider a further waiver of the requirement and approval of the independent shareholders will be sought by means of an ordinary resolution at the 2008 Annual General Meeting. Full details of the waiver will be sent out in a circular to shareholders which will accompany the Notice of Annual General Meeting.

In November 2007, the R and R Parties made preliminary announcements that they were considering restructurings that might entail providing their respective shareholders with the option of becoming direct shareholders in the Company. The Company has agreed, if requested, to obtain a secondary listing for its ordinary shares on the Johannesburg Stock Exchange with a view to facilitating any such restructurings.

Significant agreements – change of control

The following significant agreements contain certain termination and other rights for our counterparties upon a change of control of the Company.

The provisions of the Standstill Agreement referred to above will terminate if:

(1) a general offer, made by a person being independent of the R and R Parties (as defined above), becomes wholly unconditional; or

(2) the date on which a court scheme, having the effect of giving control of the Company to such a person, becomes effective.

On 8 March 2005, the Company, B.A.T. International Finance p.l.c., B.A.T Capital Corporation and British American Tobacco Holdings (The Netherlands) B.V. (as Borrowers and, in the case of the Company, as a Borrower and guarantor) entered into a revolving credit facility agreement with HSBC Bank plc (as agent) and certain financial institutions (as Lenders) pursuant to which the Lenders agreed to make available to the Borrowers £1.75 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 prepay 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.

On 7 August 2007, British American Tobacco Mexico, S.A. de C.V. (as Borrower) and the Company, B.A.T. International Finance p.l.c. and B.A.T Capital Corporation (as guarantors) entered into a term credit facility arrangement with Barclays Capital (as mandated lead arranger), HSBC Bank plc (as agent) and certain financial institutions (as Lenders) pursuant to which the Lenders agreed to make available to the Borrower US$690 million to refinance existing facilities and for general corporate purposes (the Facility). Pursuant to the Facility, should the Borrower cease to be a direct or indirect subsidiary of the Company, the Borrower shall immediately prepay any outstanding amounts. Where there is a change of control in respect of the Company, the Lenders can require all amounts outstanding under the Facility to be repaid.

On 19 December 2007, B.A.T. International Finance p.l.c. (as Borrower) and the Company (as guarantor) entered into a revolving credit facility agreement with Barclays Bank PLC (as agent) and certain financial institutions (as Lenders) pursuant to which the Lenders agreed to make available to the Borrower €1.8 billion to finance certain acquisition activities and refinance existing debt (the Facility). Pursuant to the Facility, should the Borrower cease to be a direct or indirect subsidiary of the Company, the Borrower shall immediately prepay any outstanding advances. Where there is a change of control in respect of the Company, the Lenders can require all amounts outstanding under the Facility to be repaid.

Details of the change of control provisions contained in the Company's long term incentive plans are given in the Remuneration Report on page 64.

Memorandum and Articles of Association

The following description summarises certain provisons of the Company's current Memorandum of Association and its Articles of Association (as adopted by special resolution at the Annual General Meeting on 26 April 2007) and applicable English law, the Companies Act 1985 and the Companies Act 2006 (the Companies Acts). This summary is qualified in its entirety by reference to the Companies Acts and the Company Memorandum and Articles of Association, a copy of which is available on bat.com.

A resolution will be put to the Annual General Meeting to be held on 30 April 2008 to adopt new articles of association to reflect the provisions of the 2006 Act which came into effect in 2007 (after the adoption of the most recent Articles of Association at the Company's 2007 AGM) as well as those which will take effect during 2008. As the 2006 Act will not be fully in force until October 2009, it is not yet possible to incorporate entirely all of the 2006 Act changes, and so it is anticipated that shareholders will be asked to approve further changes to the Articles of Association at the 2009 AGM. If adopted, the substance of the new Articles of Association will be reflected in the summary of the articles which will appear in the 2008 Annual Report and Accounts.

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. The Company's objects and purposes are set out in the fourth clause of its Memorandum of Association and cover a wide range of activities, including the principal objective of carrying on the business of a holding company. The Memorandum of Association grants the Company a broad range of general powers to effect that objective.

Directors

The Company's Articles of Association provide for a Board of Directors, consisting (unless otherwise determined by ordinary resolution of the shareholders) of not fewer than five Directors, not subject to any maximum, who shall manage the business of the Company. The quorum for meetings of Directors is two Directors. The Directors may delegate any of their powers to a committee which must consist of one or more Directors and (if thought fit) one or more other persons. The quorum at a meeting of a committee may be decided upon by the Directors at the meeting provided that any committee with two or more members shall have a quorum of two Directors.

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) 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;

(4) 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;

(5) any transaction or arrangement with any other company, being a company in which the Director is interested only as an officer, creditor or shareholder, provided that he is not the holder of or beneficially interested in one per cent or more of the equity share capital of that company (or of any other company through which his interest is derived) and not entitled to exercise one per cent or more of the voting rights available to members of the relevant company (disregarding, for the purposes of this proviso: (i) any shares held by a Director as bare or custodian trustee and in which he has no beneficial interest; (ii) any shares comprised in an authorised unit trust scheme in which the director is interested only as a unit holder; and (iii) any shares of that class held as treasury shares); and

(6) any proposal concerning the purchase of Directors' and officers' liability insurance.

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.

Fees for Non-Executive Directors and the Chairman shall be determined by the Directors but shall not exceed in aggregate an annual sum of £2,000,000, unless determined otherwise by ordinary resolution of the shareholders. The remuneration of the Executive Directors is determined by the Remuneration Committee which is comprised of independent Non-Executive Directors.

Directors' appointment and removal

The Directors and the Company (by ordinary resolution) may appoint a person who is willing to act as a Director, either to fill a vacancy or as an additional Director. A Director appointed by the Directors shall retire at the next Annual General Meeting and will put himself/herself forward to be reappointed by the shareholders.

At each Annual General Meeting, at least one-third of the Directors who are subject to retirement by rotation or, if their number is not three or a multiple of three, the number constituting at least one-third, shall retire from office. Notwithstanding this, at the Annual General Meeting every Director who was not appointed at either of the two previous Annual General Meetings and who has served as a Director for more than two years since his appointment shall retire. Subject to the provisions of the Companies Acts and the Articles of Association, the Directors to retire by rotation will be those who have been in office the longest since their appointment or last reappointment. If a Director retires at an Annual General Meeting and is not reappointed he shall retain

office until at the meeting someone is appointed in his place. If no one is appointed in his place he shall retain office until the end of the meeting.

Without prejudice to the provisions of the Companies Acts or any claim to damages for breach of any contract the Director may have with the Company or a subsidiary, the shareholders may, by ordinary resolution, remove any Director from office before the expiration of his period of office and may, by ordinary resolution, appoint another person in his place. A Director so appointed shall be subject to retirement at the same time as if he had become a Director on the day on which the director in whose place he is appointed was last appointed.

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 Memorandum and Articles of Association) to issue debentures, debenture stock and other securities whether outright or as security for any debt, liability or obligation of the Company or of any third party.

Interested Director transactions

Notwithstanding his office, a Director:

- may be a party to, or otherwise interested in, any transaction or arrangement with the Company or in which the Company is otherwise interested;
- 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 any body corporate promoted by the Company or in which the Company is otherwise interested; and
- will 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 and 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; and an interest of which a Director has knowledge and of which it is unreasonable to expect him to have knowledge is not treated as his interest.

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 Acts.

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 twelve years from the date when it became due for payment shall, if the Directors so resolve, be forfeited and shall cease to be owing 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.

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 (and every proxy appointed by a shareholder and present at a general meeting) has one vote regardless of the number of shares held by the shareholder (or represented by the proxy). On a poll, every shareholder who is present in person or by proxy has one vote for every share held by the shareholder.

A poll may be demanded by any of the following:

- the chairman of the meeting;
- not less than five shareholders having the right to vote at the meeting;
- 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
- 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 one-tenth of the total sum paid up on all shares conferring that right (excluding any voting rights attached to treasury shares).

Matters are transacted at general meetings of the Company by proposing and passing of two kinds of resolutions:

- ordinary resolutions, which can include resolutions for the appointment, re-appointment and removal of Directors, the receiving of the Annual Report and Accounts, the declaration of final dividends, the appointment and re-appointment of the external auditor, the increase of authorised share capital and the grant of authority to allot shares; and
- special resolutions, which can include resolutions amending the Company's Memorandum or 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 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 of a corporation which is a shareholder and entitled to vote.

In the case of an equality of votes, whether on a show of hands or on a poll, the chairman of the meeting is entitled to a casting vote in addition to any other votes he may have.

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 Acts, 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. The instrument of transfer 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 and without giving any reason, refuse to register the transfer of a share 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 unless the instrument of transfer:

- 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;
- is in respect of only one class of shares; and
- is in favour of not more than four transferees.

In the case of uncertificated shares transfers shall be registered only in accordance with the terms of the Uncertificated Securities Regulations 2001 so that Directors may refuse to register a transfer which would require shares to be held jointly by more than four persons. If the Directors refuse to register a transfer of shares, they must give the transferee notice of this refusal within two months of the instrument of transfer being lodged with the Company. No fees may be charged for the registration of a transfer of shares. Subject to the Uncertificated Securities Regulations 2001, the registration of transfer of shares or of any class of shares may be suspended for such periods, not exceeding thirty days in any year, as the Directors may determine.

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 Acts, the directors of a company are, with certain exceptions, unable to allot any equity securities without express authorisation, which may be contained in a company's articles of association or given by its shareholders in general meeting, but which in either event cannot last for more than five years. Under the Companies Acts, the 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) increase its share capital by such amount as the resolution prescribes;

(2) consolidate and divide all or any of its shares into shares of a larger amount than its existing shares;

(3) sub-divide any of its shares into shares of smaller amount than is fixed by the Company's Memorandum of Association;

(4) 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; and

(5) cancel shares which, at the date of the passing of the resolution, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the share so cancelled.

The Company may, by special resolution, reduce its share capital, its capital redemption reserve and any share premium account in any way. Subject to the provisions of the Companies Acts, 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 the Companies Acts. The basic disclosure requirement under Part 6 of the Financial Services and Markets Act 2000 and Rule 5 of the Disclosure and Transparency Rules made by the Financial Services Authority imposes a statutory obligation on a person to notify the Company and the Financial Services Authority of the percentage of the voting rights in the Company he directly or indirectly holds or controls, or has rights over, through his direct or indirect holding of certain financial instruments, if the percentage of those voting rights:

- reaches, exceeds or falls below 3 per cent and/or any subsequent whole percentage figure as a result of an acquisition or disposal of shares or financial instruments; or
- 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 and 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 2006, 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 and 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

At least 21 clear days' written notice of an Annual General Meeting is required. Any general meeting which is not an Annual General Meeting is called an 'Extraordinary General Meeting'. At least 14 clear days' written notice of any Extraordinary General Meeting is required, unless a special resolution or a resolution on which special notice has been given to the Company is proposed, in which case 21 clear days' written notice is required.

Variation of rights

If the capital of the Company is divided into different classes of shares then the rights attached to any class of shares may only be varied and abrogated, 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 an extraordinary 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 Acts. 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.

Charitable and political contributions

Payments for charitable purposes in 2007 amounted to £16.1 million (2006: £17.6 million), £2.2 million of which was paid in the UK (2006: £3 million). No donation was made to any political party registered in the UK under the Political Parties, Elections and Referendums Act 2000. Subsidiaries of the Company in Australia and Jamaica made contributions to non-EU political parties in their respective countries of incorporation totalling £85,183 (2006: £87,570).

Research and development

The Group's research and development activities are focused on developing new products and new processes, as well as maintaining and improving the quality of existing products. Research is also carried out on risk characterisation, building a framework to assess the relative risk of novel and conventional products and a better understanding of how consumers use them. Risk reduction, such as developing technologies that have the potential to lower exposure to toxicants in smoke, is also a central part of the research and development programme.

Research is also undertaken into aspects of the science and behavioural science related to smoking and we continued to provide funding for independent studies.

Creditor payment policy

Given the international nature of the Group's operations, there is not a global standard code for the Group in respect of payments to suppliers. In the UK, the operating subsidiaries have signed up to the Better Payment Practice Code under which each company undertakes to:

(1) seek agreement on payment terms with its suppliers at the outset of each transaction;

(2) explain its payment procedures to its suppliers;

(3) pay bills in accordance with the agreed terms and all legal requirements; and

(4) inform suppliers without delay when contesting an invoice and settle disputes quickly. Details of the Code are available on the website, payontime.co.uk.

Non-UK operating subsidiaries are responsible for agreeing terms and conditions for their business transactions when orders for goods and services are placed, ensuring that suppliers are aware of the terms of payment and including the relevant terms in contracts where appropriate. These arrangements are adhered to provided that suppliers meet their contractual commitments.

Creditor days have not been calculated for the Company as it is an investment holding Company and had no trade creditors at 31 December 2007.

OECD Guidelines

The Group recognises its responsibilities to the countries in which it operates and, in this context, notes the OECD Guidelines for Multinational Enterprises in their current form.

Intra-group pricing

The prices agreed between Group companies for intra-group sales of materials, manufactured goods, charges for royalties, commissions, services and fees are based on the normal commercial practices which would apply between independent businesses.

On behalf of the Board

Nicola Snook
Secretary

27 February 2008

REMUNERATION REPORT

Remuneration strategy and policy: overview

British American Tobacco's remuneration policy continues to seek to reward the achievement of corporate and individual goals by linking success in those areas to the Group strategy. This includes taking a balanced approach to achieving growth, improving productivity, managing the business in a responsible manner and developing a winning organisation, all of which help to build a sustainable business. The delivery of strategy is measured by the specific Key Performance Indicators (KPIs) and comprehensive business measures set out and described on pages 12 and 13 of this Annual Report and Accounts.

The Remuneration Committee considers executive reward in the context of these measures of corporate performance and the methodology is supported by a competitively positioned and integrated pay and benefits structure which reflects the nature of the Group's worldwide operations and the need to attract, motivate and retain high quality executives.

The alignment of executive remuneration to the generation of shareholder value has been a strong and consistent theme for British American Tobacco for some time and its success is illustrated by the sustained performance of the Company. The total shareholder return elements of the Company's long term incentive plan (LTIP), in particular the total shareholder return measure which compares the Company against a peer group of International FMCG companies, shows that British American Tobacco has achieved a position of third, second and second against that comparator group in respect of LTIP awards which vested (or will vest) in 2006, 2007 and 2008 respectively. This emphasis on performance and the alignment of reward with returns to shareholders will continue to apply during 2008.

Variable and fixed remuneration

The role of the Remuneration Committee is to determine the framework and policy that apply to the terms of engagement (including remuneration) of the Chairman, the Executive Directors and the members of the Management Board. It also determines the specific remuneration of each of them (including awards under share incentive schemes and pension scheme participation) and any compensation payments. In determining and applying the framework and policy, the Committee has a guideline that approximately 50 per cent of the remuneration (assuming 'on target' performance) should be performance-related or variable in nature. The remuneration package comprises both performance-based variable rewards (cash and share incentive annual bonus plans; and the LTIP) and core fixed elements (base salary, pension and other benefits).

The composition in the case of the Executive Directors for 2007 is illustrated in the bar chart on page 75.

Remuneration strategy and policy: 2007 in focus

The remuneration package for the senior executive team is built on a simple, straightforward model in which there are only two elements of variable pay, in contrast to a number of FTSE 100 companies which may operate two or, in a few cases, three different long term incentive plans, in addition to an annual incentive plan. The long term element is delivered through the long term incentive plan adopted last year (2007 LTIP) which replaced the LTIP adopted in 1998 (1998 LTIP) which has now expired. The Remuneration Committee believes that the Company's approach provides a clear message to participants of what is required and is transparent to shareholders.

The Committee continues to take a responsible approach to benchmarking and aims to set the reward opportunity for Executive Directors within the market competitive range, but with a balanced overall positioning.

During 2007, the Committee confirmed the use, for benchmarking purposes, of an established peer group of selected FTSE 100 companies (the Pay Comparator Group). The Pay Comparator Group is reviewed annually and a company is included on the basis of its consumer goods focus, its international spread of operations and if it is considered as a competitor for top management talent. The Pay Comparator Group has been in use for a number of years to ensure that base salaries and executive reward continue to be market competitive. The constituent companies in the Pay Comparator Group as at 31 December 2007 are set out on page 74 in Table 6.

In December 2007, as part of the preparatory work for the Committee's annual review of the salaries of the Executive Directors and the members of the Management Board, the Committee agreed that, whilst the principles of the remuneration policy remained unchanged, additional reference points would also be considered in order to

provide a robust decision-making framework for pay. On this basis, market data for companies in the FTSE 350 will also be considered when setting base salaries for 2008, taking into account the relative size and complexity of the company, as well as practice in the FTSE 30 for the purposes of evaluating total compensation.

Salary

The summary table on page 60 sets out the key policy elements for the salaries for the Executive Directors and the members of the Management Board.

Similar principles are applied to the salaries of senior managers. Below this level in the organisation, salary scales are graded with reference to market conditions, whilst individual salary increases are linked to performance.

During 2007, the Committee continued to recognise that the requirements of recruitment or retention may on occasion justify the payment of a salary outside the range regarded as appropriate for a particular position.

In addition to basic salary, the Executive Directors and members of the Management Board receive certain benefits in kind, principally a car or car allowance as well as private medical and personal accident insurance. The Executive Directors also receive the benefit of the use of a driver.

Executive Directors' performance-related bonus plans

Details of the International Executive Incentive Scheme (IEIS) are shown in the summary table on page 60. The IEIS aims to reward short term performance within the context of longer term sustainability and comprises both a cash and a deferred shares element. The bonus entitlements and awards to the Executive Directors and members of the Management Board under the IEIS depend upon the performance of the business. Demanding targets are set by the Remuneration Committee at the beginning of each year and are measured in terms of both financial and business performance. The targets reflect the five common measures referred to in the summary table below. These are identified as being key to sustained performance and have an equal weighting of 20 per cent. Payouts for each target are determined on a sliding scale with three performance points: threshold (which must be exceeded to attract a bonus); target; and maximum amount (the level at which the bonus is capped). The specific targets are not disclosed as they are considered to be commercially sensitive.

The performance points are calculated at the start of the year by reference to the type of target and projected performance in the context of the Group's annual budget. The Committee receives reports from internal functions to allow it to determine the extent to which performance measures have been achieved. No elements of the bonuses are guaranteed. Bonuses are equally delivered in cash and shares.

Awards made under the Deferred Share Bonus Scheme (the Deferred Scheme) are in the form of free ordinary shares in the Company which are normally held in trust for three years and no further performance conditions apply in that period. In certain circumstances, participants may forfeit the shares if they resign before the end of the three year period. The Remuneration Committee is keen to encourage a culture of 'ownership' of these awarded shares and, since April 2004, participants have received a cash sum equivalent to the dividend on the after-tax position of all unvested ordinary shares held in the Deferred Scheme at the dividend record date.

The Committee, following its usual procedures, reviewed the performance targets for the year ended 31 December 2007 and details of the performance-related bonus payments resulting from that review are included on page 69 in Table 1, in the year to which they relate.

As part of the year end review, the Committee considered the current annual bonus opportunity for the Executive Directors and Management Board against market practice, taking into account the total compensation opportunity for comparable roles in the Pay Comparator Group and the FTSE 30. As a result of this review, the Committee agreed to increase the maximum bonus opportunity for these roles for 2008 as set out below. (The equivalent percentages for 2007 are shown in the table in brackets.)

Role	On-target bonus %	Maximum bonus %
Chief Executive	100 (100)	200 (150)
Finance Director	90 (100)	180 (150)
Chief Operating Officer	90 (100)	180 (150)
Management Board	67.5 (67)	135 (100)

MANAGEMENT

Summary remuneration policy for Executive Directors and the Management Board

Remuneration constituents	Purpose	Delivery	Policy
Base salary	– competitively reward individual performance – reflect skills and experience	– cash – monthly – pensionable	– annual review (or on a significant change of responsibilities) with salary changes effective from April – benchmarked for appropriate salary levels using a company size and complexity model coupled with: (1) the Pay Comparator Group with a mainly international consumer goods focus chosen from the FTSE 100 Index; and (2) published salary data for FTSE 350 companies – Management Board members are reviewed on the Pay Comparator Group and salary data for FTSE 30 companies
Performance-related bonus	– incentivise the attainment of corporate targets on an annual basis	– International Executive Incentive Scheme (IEIS) – annual, non-pensionable payments and awards – 50 per cent cash – 50 per cent shares (Deferred Share Bonus Scheme – DSBS) – DSBS shares held in trust for three years and participants receive cash sum equivalent to the dividend on the after-tax position of all unvested shares held in the DSBS at the dividend record date	– five common measures: underlying operating profit, market share of key players, Global Drive Brand volume, net revenue and cash flow – for 2007, the 'on target' bonus opportunity for Executive Directors was 100 per cent of the base salary with a maximum award of 150 per cent of salary – for the Management Board the 'on target' bonus opportunity was 67 per cent of the base salary with a maximum award of 100 per cent of salary – following a review of market practice, the structure of the bonus has been adjusted for 2008 as set out on page 59, with an increase to the maximum bonus opportunity for Executive Director and Management Board roles
Long term incentives (2007 LTIP)	– incentivise growth in earnings per share and total shareholder return (TSR) over a three year period	– awards of shares – variable due to performance over three year period – discretionary annual award – LTIP dividend equivalent – the proportion of shares awarded under an LTIP award which later lapse upon the vesting of an award do not attract the LTIP dividend equivalent	– maximum annual award of 300 per cent of salary – during 2007, an award of 250 per cent of salary was made to the Chief Executive and 200 per cent of salary to the Finance Director and the Chief Operating Officer – members of the Management Board received awards of 150 per cent of salary – cash LTIP Dividend Equivalent to the dividends that participants would have received as shareholders from the date of the LTIP award to the award's vesting date – the value of the LTIP Dividend Equivalent is taken into account when considering awards – three year performance period – TSR performance (50 per cent of the total award) combines both the share price and dividend performance during the three year performance period as against two comparator groups (25 per cent for each measure): (1) the constituents of the FTSE 100 Index; and (2) a peer group of FMCG companies – earnings per share measure (50 per cent of the total award) relates to earnings per share growth (on an adjusted diluted basis) relative to inflation
Pension	– provision of competitive post-retirement benefits	– British American Tobacco UK Pension Fund; defined benefit plan (up to April 2005) – benefit paid as on-going pension	– pension accrues at 1⁄40 of annual basic salary – normal pensionable age of 60 – maximum pension payable will not exceed 2⁄3 of base salary averaged over the preceding 12 months – UK Pension Fund retains a scheme-specific cap following the introduction of the new UK pension regime in April 2006 – excess benefits continue to be accrued within an unfunded unapproved retirement benefits scheme

Shareholding guidelines

The Remuneration Committee continues to promote its shareholding guidelines under which Executive Directors and members of the Management Board are encouraged to work towards holding ordinary shares in the Company. Since 2003, the guidelines were set at one times base salary for Executive Directors and 0.75 times base salary for the Management Board.

As part of the annual review, the Committee decided that the share holding guidelines should be made more demanding by excluding shares earned but not yet vested under Company share plans. In addition, the Committee increased the shareholding guidelines to two times base salary for the Chief Executive, one and a half times base salary for the Finance Director and Chief Operating Officer and one times base salary for the Management Board.

The interests of the Directors of the Company in the ordinary shares of the Company are shown on page 70 in Table 2.

Share incentive schemes and share options

The Executive Directors are eligible to participate in the following employee share schemes which are designed to incentivise employees of the Group by giving them opportunities to build a shareholding in the Company: the British American Tobacco Sharesave Scheme (Sharesave Scheme), the Employee Share Ownership Plan and the 2007 LTIP. Executive Directors have also participated in the British American Tobacco Share Option Scheme (Share Option Scheme) and in line with current policy, no options have been granted to Executive Directors or other participants under the Share Option Scheme since March 2004. The Share Option Scheme will expire in April 2008 and there is no intention to renew it.

All benefits under the employee share schemes are non-transferable and non-pensionable.

Sharesave Scheme

Eligible employees, including the Executive Directors, have been granted employee savings-related share options to subscribe for ordinary shares in the Company. In November 2007, the Company made a further grant of options under the Sharesave Scheme which allows for options granted to be exercisable in conjunction with either a three year or five year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme. At 31 December 2007, all the Executive Directors participated in the Sharesave Scheme, each saving the maximum monthly amount.

The Sharesave Scheme was renewed for a further 10 years following the requisite approval of the shareholders at the 2007 Annual General Meeting. The rules of the renewed Sharesave Scheme are substantially unchanged. The Sharesave Scheme, in its renewed and amended form, has been approved by HM Revenue & Customs.

Employee Share Ownership Plan

The Employee Share Ownership Plan is an HM Revenue & Customs approved share incentive plan. The Company continues to operate its Partnership Share Scheme as a part of this plan. The Partnership Share Scheme is open to all eligible employees, including Executive Directors. Employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco. The maximum amount that can be allocated in this way is £1,500 in any year. Shares purchased are held in a UK-based trust, normally capable of transfer to participants tax-free after a five year holding period. At 31 December 2007, all the Executive Directors participated in the Partnership Share Scheme, each investing the maximum monthly contribution.

The Company also operates the Free Shares element of the plan, known as the Share Reward Scheme. Under this Scheme, eligible employees (including Executive Directors) receive an appropriation of shares in April of each year in which the Scheme operates in respect of performance in the previous financial year. In this way, an award will be made on 1 April 2008 in respect of the year ended 31 December 2007, subject to the performance conditions being met. The performance conditions are aligned to those set for the IEIS in respect of the same performance period. The plan shares are held in a UK-based trust for a minimum period of three years and during that time the trust will exercise its voting rights as directed by the plan's participants. The maximum individual award under the Share Reward Scheme is £3,000. The former forfeiture restrictions applicable during the holding period for Free Shares were removed by the Company from April 2007.

Share Option Scheme

No options have been granted under the Share Option Scheme since March 2004 and no options have been granted to the current Executive Directors since September 1999. The Share Option Scheme expires in April 2008 and will not be renewed. During the year ended 31 December 2007, the one Executive Director (Paul Rayner) who held outstanding options under the Share Option Scheme exercised in full those options which had been granted to him prior to his appointment as a Director in 2002. As at 31 December 2007, no Executive Directors hold outstanding options under the Share Option Scheme.

During the life of the Share Option Scheme, options granted were not issued at a discount to the market price at the time of grant, with the value of options for that grant being limited to 50 per cent of a participant's base salary. All outstanding options have matured and are exercisable up to March 2014.

2007 LTIP

The 2007 LTIP is the current share incentive plan in which all the Executive Directors, members of the Management Board and senior employees participate. This plan provides for awards of free ordinary shares, provided certain demanding and stretching performance conditions are met over a three year period. The first award under the 2007 LTIP was made in May 2007.

The summary table above on page 60, sets out the key parameters of the plan.

Award levels

During 2007, awards were increased from previous levels to 250 per cent of base salary for the Chief Executive, 200 per cent of base salary for the Finance Director and the Chief Operating Officer and 150 per cent of base salary for members of the Management Board, in order to position the total packages appropriately against the market.

The maximum annual award under the rules of the 2007 LTIP is 300 per cent of base salary.

The Committee continues to review the application of this limit in the context of its policy overall.

For awards made since 2005 (initially under the 1998 LTIP and from May 2007 under the 2007 LTIP), participants have been entitled to receive a cash payment equivalent to the value of the dividends that they would have received as shareholders on their vesting awards (the LTIP Dividend Equivalent). The value of the LTIP Dividend Equivalent is taken into account when considering awards under an LTIP and continues to be important in aligning further the interests of senior management with those of shareholders. This is illustrated by the release of the first LTIP Dividend Equivalent payments in tandem with the vesting of the 2005 LTIP award in May 2008. The expected values of those payments for the Executive Directors are shown in note 5 to Table 5 on page 74.

To the extent that the performance conditions have been satisfied following assessment by the Remuneration Committee, awards are normally exercisable between three and 10 years after they have been made. An award of shares lapses to the extent that the performance conditions are not satisfied in accordance with the measures set out above at the end of the three year performance period.

Performance

Awards are based on a combination of total shareholder return (TSR) and earnings per share (EPS) performance conditions measured over three years. The Remuneration Committee considers that both of these measures are widely accepted and understood benchmarks of a company's performance. Together they provide a good spread of measures relevant to the Group's business and market conditions as well as giving a balance between the aspirations of the Executive Directors, the members of the Management Board and shareholders. These performance conditions are stated in the summary table above and considered in more detail below.

TSR performance condition

A total of 50 per cent of the total award is based on the Company's TSR performance against two comparator groups (25 per cent for each measure): (1) the constituents of the London Stock Exchange's FTSE 100 Index at the beginning of the performance period; and (2) a peer group of International Fast Moving Consumer Goods (FMCG) companies. 25 per cent of the total award vests in full in the event of upper quartile performance by the Company relative to one of the comparator groups above, not more than 7.5 per cent of the total award will vest in the event of median performance and with pro rata

vesting between these two points. The TSR portions of an LTIP award would not vest for below median performance.

These comparator groups, which are kept under review to ensure that they will remain both relevant and representative, are chosen to reflect, as far as possible, the Company's financial and business trading environments.

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

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

EPS performance condition
50 per cent of an award is based on earnings per share growth relative to inflation. This element of the award will vest fully if EPS growth over the three year performance period is an average of at least 8 per cent per annum in excess of inflation; not more than 10 per cent of this element will vest if the same figure is at least 3 per cent in excess of inflation and an award will vest on a pro rata basis between these two points. The EPS portion of an award would not vest below these points.

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

These targets are in line with and support British American Tobacco's strategy to deliver high single-digit EPS growth (on average) over the medium to long term. The maximum target would require 8 per cent per annum growth in earnings ahead of inflation and is considered to be very demanding. The Remuneration Committee will keep these targets under review to ensure that they continue to be appropriately stretching.

1998 LTIP
Following the adoption of the 2007 LTIP, no further awards will be made under the 1998 LTIP. However, it is necessary to report on the vesting of the award made in 2005.

Vesting of 2005 LTIP award
As reported last year, 100 per cent of the 2004 LTIP award vested on 17 March 2007. The seventh LTIP award was made in 2005, with the performance period being completed at 31 December 2007. The Remuneration Committee has assessed the performance of British American Tobacco against the two performance conditions outlined above and has determined that 100 per cent of the award will vest. On the TSR measure, the Company ranked eighth out of the FTSE 100 group of companies, giving a vesting of 25 per cent for performance at the upper quartile. A vesting of 25 per cent was achieved for ranking second out of the peer group of International FMCG companies, this being upper quartile. EPS growth was 9.92 per cent per annum in excess of inflation resulting in a vesting of 50 per cent. Members of the FMCG group for the 2005 award vesting in May 2008 are set out on page 74 in Table 7.

Performance graph
Schedule 7A to the Companies Act 1985 requires that the Company must provide a graph comparing the TSR performance of a hypothetical holding of shares in the Company with a broad equity market index over a five year period. In this context, the Directors have again chosen to illustrate the performance of TSR against the FTSE 100 Index over a five year period, commencing on 1 January 2003. In the opinion of the Directors, the FTSE 100 Index is the most appropriate index against which TSR should be measured because it is a widely used and understood index of broadly similar sized UK companies to the Company. The performance graph is shown on page 75.

In addition to the performance graph, illustrative graphs that show the relative position on the TSR measures for the LTIP award vesting in May 2008 are shown on page 75.

LTIPs – change of control

The rules of the 1998 LTIP and the 2007 LTIP both provide that in the event of a change of control of the Company as a result of a takeover, reconstruction or winding up of the Company (not being an internal reorganisation), LTIP awards will become exercisable for a limited period based on the period of time which has elapsed since the date of the award and the achievement of the performance conditions at that date, unless the Remuneration Committee determines this not to be appropriate in the circumstances. In addition, the 2007 LTIP allows (as an alternative to early release) that participants may, if permitted, exchange their LTIP awards for new awards of shares in the acquiring company on a comparable basis.

Options and awards outstanding: Employee Share Ownership Trust

To satisfy the future exercise of options or awards under the Group's employee share schemes, ordinary shares are acquired in the market by an existing employee share ownership trust – the British American Tobacco Group Employee Trust (BATGET). During the year, new ordinary shares were issued by the Company in relation to the Sharesave Scheme and to certain participants in the Share Option Scheme resident outside the UK.

Under the Sharesave Scheme, a total of 1,608,514 options over ordinary shares in the Company were outstanding at 31 December 2007. The options outstanding under the Sharesave Scheme are exercisable until June 2013 at option prices ranging from 510p to 1435p.

BATGET is used to satisfy the future exercise of options under the Share Option Scheme and the vesting and exercise of awards of ordinary shares made under the Deferred Scheme, and the 1998 LTIP and the 2007 LTIP respectively. The number of shares held in BATGET to satisfy outstanding awards is consistently monitored by a committee of senior management that reports to a committee of the Board. BATGET is funded by interest-free loan facilities from the Company totalling £300 million, enabling the trust to facilitate the purchase of ordinary shares to satisfy the future vesting or exercise of options and awards. The loan to BATGET amounted to £263 million at 31 December 2007 (2006: £248 million). The loan will be repaid from the proceeds of the exercise of options. If the options lapse, ordinary shares may be sold by BATGET to cover the loan repayment or, in the case of ordinary shares acquired by BATGET to satisfy the vesting and exercise of awards, the Company will subsequently waive the loan provided over the life of the awards.

BATGET currently waives dividends on the ordinary shares held by it. As at 31 December 2007, BATGET held 13,987,584 ordinary shares with a market value of £274.9 million (1 January 2007: 19,252,345 ordinary shares; £275.1 million). BATGET waived payment of the final dividend for 2006 of £7.5 million in May 2007 and the interim dividend for 2007 of £2.7 million in September 2007.

Where shares held in BATGET have been transferred out to share scheme participants, the participants may exercise their voting rights. Where shares are held by BATGET and have not been transferred out to the participants, the trustee of BATGET does not exercise any voting rights.

Details of the Company's material share-based payment arrangements, reflecting both equity share-based and cash-settled share-based arrangements, are set out in note 27 on pages 146 to 151.

Executive Directors' pension benefits

Details of the basic pension entitlements are shown in the summary table on page 60. The Executive Directors (with the exception of Antonio Monteiro de Castro up to 31 December 2007 and Nicandro Durante from 1 January 2008) are, like other employees, eligible for membership of the British American Tobacco UK Pension Fund (Pension Fund).

The Pension Fund, for members who joined before 1 April 2005, is a non-contributory defined benefit scheme and includes provision for spouses' benefits on death in service or after retirement. In the event of death in service, a spouse's pension equal to half of the member's prospective pension at normal retirement age

would be payable. A spouse's pension payable in the event of death after retirement is equal to half of the member's full pension, irrespective of any decision to exchange part of the benefit for a lump sum. The early retirement rules in the Pension Fund permit a member to draw the accrued retirement pension within five years of normal retirement age without actuarial reduction, subject to the employing company's agreement. Alternatively, an Executive Director may choose to retire at any time on or after his or her 50th birthday without the employing company's agreement, subject to a reduction as determined by the Pension Fund trustee in conjunction with the Pension Fund actuary. Accrual rates differ according to individual circumstances but do not exceed one-fortieth of pensionable salary for each year of pensionable service.

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

Paul Adams and Paul Rayner both joined the Pension Fund after 1989. As a result, prior to 6 April 2006, both individuals were subject to the HM Revenue & Customs cap on pensionable earnings (notionally £112,800 for the tax year 2007/08). In addition, each has an unfunded pension promise from the Company in respect of earnings above the cap on an equivalent basis to the benefits provided by the Pension Fund. This is provided through membership of an unfunded unapproved retirement benefit scheme.

However, following the changes in pensions legislation in 2006, it was agreed that benefits up to £75,000 per annum (targeting the Lifetime Allowance) would be provided through the Pension Fund with the remainder of benefits being provided through the unfunded arrangement. As a result, the Company paid an additional amount to the Pension Fund in 2006 to fund the additional benefits up to a maximum of £75,000 per annum. The overall pension entitlement for each of the Executive Directors remained unchanged. Paul Adams and Paul Rayner, being members of the Pension Fund, are entitled to receive increases in their pensions in line with price inflation up to 6 per cent per annum.

These unfunded commitments are included in the provisions referred to on page 113 note 12 to the accounts.

Paul Rayner has an accumulated defined contribution entitlement from Division A of the British American Tobacco Australia Superannuation Fund. No contributions were paid to this arrangement on behalf of Paul Rayner during 2007.

Antonio Monteiro de Castro retired as an Executive Director on 31 December 2007. Details of his pension entitlements are set out in note 5 to Table 4 on page 72.

Nicandro Durante, who was appointed an Executive Director with effect from 1 January 2008, is a member of the Fundacao Albino Souza Cruz in Brazil. This is a non-contributory defined benefit scheme and includes a spouse's death in service benefit equal to 37.5 per cent of the member's prospective pension at normal retirement age. Accrual rates do not exceed 1.85 per cent of basic salary (excluding bonus) averaged over the last 12 months to normal retirement age, for each year of pensionable service. Nicandro Durante's pension will be reviewed by the Company annually with reference to the salary of that of a General Manager of Souza Cruz SA which will increase annually in line with local practice. In addition, Nicandro Durante accrues a pension of 0.65 per cent for each year of service based on his 12-month average UK basic salary (excluding bonus) with effect from 1 March 2006, that being the date of his appointment as a member of the Management Board. This benefit is provided through the unfunded unapproved retirement benefit scheme.

Executive Directors' service contracts

The Remuneration Committee continues to operate a policy of one year rolling contracts for Executive Directors. Each Executive Director has such a contract, executed at the time of his original appointment. The contract may be re-executed during the term of his employment to take account of variations in terms and conditions as well as changes in best practice; the contractual term will continue to be of a one year rolling period. Most recently, in February 2007, the service contracts for each of Paul Adams, Paul Rayner and Antonio Monteiro de Castro, were revised to principally take account of the new age discrimination legislation.

In addition, the Remuneration Committee maintains discretion in respect of this policy for those future Executive Directors who may be recruited externally or from overseas, when it may be appropriate to offer a contract with an initial period of longer than one year, reducing to a one year rolling contract after the expiry of the initial period. It is the policy that an Executive Director's one year rolling contract incorporates a provision for a termination or compensation payment in lieu of notice.

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

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

Nicandro Durante, who was appointed Chief Operating Officer with effect from 1 January 2008, has a service contract with the Company in the form outlined above. In addition, as a result of the application of local labour laws in Brazil, Nicandro Durante retains certain termination or compensation rights in respect of his former employment with Souza Cruz SA. In the event of any compensation being payable to Nicandro Durante pursuant to his service contract with the Company, these Souza Cruz rights will be taken into account first in arriving at a final compensation amount.

External appointments

Executive Directors and members of the Management Board are able to accept one substantive external Board appointment provided that permission is respectively sought from the Board or Chairman. Since 1 January 2006, the fees from such appointments have been retained for a Director's own account, thereby recognising the increasing level of personal commitment and expertise required for non-executive roles. Paul Rayner is currently a Non-Executive Director of Centrica plc and the fees from this appointment for the year ended 31 December 2007 totalled £74,500.

Antonio Monteiro de Castro has been a British American Tobacco designated Non-Executive Director of Reynolds American Inc. (RAI) since 30 July 2004. In that time, RAI has paid British American Tobacco an annual fee in respect of Antonio Monteiro de Castro's services to RAI (a BAT Designee). For the year ended 31 December 2007, the annual fee paid to the Company by RAI was US$237,000. Following his retirement as an Executive Director on 31 December 2007, Antonio Monteiro de Castro will remain a BAT Designee from 1 January 2008 and will receive an annual fee of US$237,000 from RAI, payable in equal quarterly instalments.

Non-Executive Directors' terms of appointment

The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. For Non-Executive Directors appointed before 1 October 2007, the terms of appointment of each such Director provide that he or she is appointed for a specified term, being an initial period to the next Annual General Meeting after appointment and, subject to reappointment at that meeting, for a further period ending at the Annual General Meeting held three years thereafter. Subsequent reappointment is subject to endorsement by the Board and the approval of shareholders.

Following the implementation of the relevant provisions of the Companies Act 2006, an appointment of a Non-Executive Director made by the Company from 1 October 2007 is made on the basis of a two year term; such appointment being subject to approval by shareholders in accordance with the terms of the provisions of the Company's Articles of Association relating to the rotation of Directors.

The date of appointment and most recent reappointment is shown below for each Non-Executive Director:

	Date of appointment	Date of last reappointment at Annual General Meeting
K H Clarke[1]	28 April 1998	28 April 2005
R E Lerwill	1 January 2005	26 April 2007
A M Llopis	24 February 2003	27 April 2006
C J M Morin-Postel	1 October 2007	–
A Ruys	1 March 2006	27 April 2006
Sir Nicholas Scheele	28 February 2005	26 April 2007
K M A de Segundo	1 October 2007	–
M H Visser	1 April 2001	26 April 2007

Note:
1 Kenneth Clarke is scheduled to retire at the conclusion of the 2008 Annual General Meeting.

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

Non-Executive Directors' remuneration policy

The fees for the Non-Executive Directors are determined by the Board, on the recommendation of the Chairman and the Chief Executive, within the overall aggregate annual limit of £2,000,000 authorised by shareholders with reference to the Company's Articles of Association. In order to retain flexibility, as well as recognising the increased demands made upon Non-Executive Directors in terms of time and commitment, it is proposed that this overall aggregate annual limit is increased to £2,500,000 as part of the proposed revision of the Company's Articles of Association at the forthcoming Annual General Meeting. The Non-Executive Directors do not participate in discussions with the Board about their own remuneration.

The fees paid to the Non-Executive Directors are determined in light of market best practice and with reference to the time commitment and responsibilities associated with the roles. In order to recognise the increased focus on the roles and responsibilities of the Non-Executive Directors and the need to ensure that the Company is able to continue to attract and retain high calibre individuals to such non-executive roles, the fees for the Non-Executive Directors were revised by the Board with effect from 1 January 2007 as follows: Deputy Chairman (also the Senior Independent Director) £165,000; Non-Executive Directors £75,000 with an additional £20,000 being payable to the Chairman of the Audit Committee.

Ken Clarke will retire from the Board at the conclusion of the Company's Annual General Meeting on 30 April 2008 and will therefore cease to be the Deputy Chairman and Chairman of the Corporate Social Responsibility and the Remuneration Committees. In light of these changes, the Board has agreed that the annual fees for the Non-Executive Directors will be as follows (with effect from 1 May 2008): Senior Independent Director £100,000; Non-Executive Directors £75,000 with an additional £25,000 being payable to the Chairman of the Audit Committee (an increase of £5,000) and additional fees of £20,000 being payable to each of the respective Chairs of the Corporate Social Responsibility Committee and the Remuneration Committee.

Non-Executive Directors receive no other material pay or benefits (with the exception of reimbursement of expenses incurred in respect of their duties as Directors of the Company). It is the policy of the Board that the spouses of the Executive Directors and Non-Executive Directors may accompany the Directors for business purposes on designated trips and functions during the year.

Chairman's terms of appointment and remuneration

The Remuneration Committee is responsible for determining the terms of engagement and fees payable to the Chairman. This process takes into account the breadth of that role coupled with its associated levels of commitment and expertise. Jan du Plessis' terms of appointment provide that he holds the office of Chairman of the Company with effect from 1 July 2007 for a period of three years unless terminated earlier by: (1) the Company giving three months' notice or a discretionary compensation payment in lieu of notice; or (2) by the Chairman giving one month's written notice with the Company having discretion to make a compensation payment in lieu of such notice. The compensation payment is limited to any fees which are payable for such part of the relevant notice period as the Board does not require the Chairman to perform his duties.

As a Director of the Company, the Chairman is subject to the reappointment of Directors provisions contained in the Company's Articles of Association. The date of his last reappointment as a Director was at the Annual General Meeting held on 27 April 2006. The terms of Jan du Plessis' appointment provide for: (1) an annual

fee of £570,000; (2) the use of a driver; and (3) private medical insurance and personal accident insurance. In common with the Non-Executive Directors, the Chairman does not participate in the British American Tobacco share schemes, bonus schemes or incentive plans and is not a member of any Group pension plan.

Following the end of the year, the Committee reviewed the fees for the Chairman against practice in the FTSE 30 and agreed to increase his fees to £600,000 with effect from 1 April 2008.

Copies of the Executive Directors' service contracts and the details of the terms of appointment of each Non-Executive Director and the Chairman are available for inspection during normal business hours at the Company's registered office and will also be available for inspection at the Annual General Meeting on 30 April 2008.

Appendices to the Remuneration Report

The Remuneration Committee

Terms of reference

The terms of reference of the Remuneration Committee, together with an explanation of its role and the authorities delegated to it by the Board, are available from the Company Secretary on request and can be accessed on the corporate governance section of bat.com. The terms of reference of the Remuneration Committee do not currently provide for the Committee to consider corporate performance on environmental, social and governance (ESG) issues when setting the reward structure for Executive Directors and the members of the Management Board. However, the Board continues to recognise the importance of ESG issues. Governance is embedded in the organisation as evidenced by our strong governance structure – see pages 76 to 83. In addition, the delivery of our strategic vision encompasses the Key Performance Indicator of Responsibility (see pages 22 to 25) for which we have used the Dow Jones Sustainability Indexes (an external benchmark) as our primary business measure to assess our successful performance to date.

Membership

At the date of this report, the Committee comprises the following independent Non-Executive Directors of the Company: Ken Clarke (Chairman of the Remuneration Committee); Robert Lerwill; Ana Maria Llopis; Christine Morin-Postel (appointed 1 October 2007); Anthony Ruys; Sir Nicholas Scheele and Karen de Segundo (appointed 1 October 2007). Anthony Ruys will succeed Ken Clarke as Chairman of the Remuneration Committee following Ken Clarke's retirement as a Non-Executive Director of the Company at the conclusion of the Annual General Meeting of the Company on 30 April 2008.

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

No Executive Director or other member of the Management Board plays any part in determining his or her remuneration. During the year ended 31 December 2007, the Chief Executive was consulted and invited to attend meetings of the Committee, except when his own remuneration was under consideration. In determining remuneration for the year, the Committee consulted the Chief Executive, and the Director, Human Resources and the Head of Reward. The Chairman, Jan du Plessis, was also consulted and invited to attend meetings of the Committee. Further information on meetings held and Directors' attendance is disclosed in the corporate governance statement on page 77.

The Committee appointed Towers Perrin as remuneration consultants, to provide remuneration services and advice to the Company for 2007 with specific reference to the needs of the Remuneration Committee. Towers Perrin is a leading international firm of remuneration and benefits consultants who also provide general consultancy services and advice to British American Tobacco Group companies around the world on pay, pensions and other human resources related issues.

With effect from 1 January 2008, Deloitte were appointed to provide remuneration services and advice to the Company for 2008 with specific reference to the needs of the Remuneration Committee. Deloitte is an international accountancy firm who provide remuneration and benefits and general consultancy services and advice to British American Tobacco Group companies around the world on pay, pensions and other human resources related issues.

Herbert Smith LLP has also been retained by the Company to provide legal advice in respect of the Company's share schemes, as well as providing other legal services to British American Tobacco as a whole. In addition, Ernst & Young LLP provides tax advice to international assignees and in respect of the Company's share schemes.

Table 1. Directors' remuneration – audited

	Salary/fees £	Performance-related pay: annual cash bonus £	Performance-related pay: deferred share bonus[2] £	Benefits in kind[3] £	2007 Total £	2006 Total £
J P du Plessis	561,250	–	–	85,224	646,474	588,524
K H Clarke	165,000	–	–	8,909	173,909	150,593
P N Adams	1,076,641	487,230	528,386	137,016	2,229,273	2,572,718
P A Rayner[4]	652,810	295,020	322,790	173,637	1,444,257	1,738,450
A Monteiro de Castro[1, 5]	1,003,890	652,620	26,994	195,373	1,878,877	2,036,711
K M A de Segundo[1]	18,750	–	–	46	18,796	–
R E Lerwill	95,000	–	–	515	95,515	75,403
A M Llopis	75,000	–	–	–	75,000	60,000
C J M Morin-Postel[1]	18,750	–	–	–	18,750	–
A Ruys	75,000	–	–	562	75,562	50,831
Sir Nicholas Scheele	75,000	–	–	887	75,887	68,739
M H Visser	75,000	–	–	6,879	81,879	66,584
Former Directors						
P E Beyers[1]	37,500	–	–	–	37,500	69,735
R L Pennant-Rea[1]	25,000	–	–	–	25,000	60,000
Total remuneration	3,954,591	1,434,870	878,170	609,048	6,876,679	7,538,288

Notes:

1 Rupert Pennant-Rea retired on 26 April 2007; Piet Beyers retired on 30 June 2007. Karen de Segundo and Christine Morin-Postel were appointed on 1 October 2007. Antonio Monteiro de Castro retired on 31 December 2007.

2 The deferred share bonus payments include cash sums equivalent to the dividend on the after-tax position on all unvested ordinary shares comprised in the awards held by participants (including Executive Directors) in the Deferred Share Bonus Scheme at each dividend record date. For the year ended 31 December 2007, these payments for Executive Directors were as follows: Paul Adams £41,156 (2006: £35,425); Paul Rayner £27,770 (2006: £23,862); and Antonio Monteiro de Castro £26,994 (2006: £21,979). Antonio Monteiro de Castro received a cash award in respect of the performance of the Company in 2007 rather than an award of shares under the Deferred Share Bonus Scheme as he ceased to be an employee before the date of the award in 2008.

3 Benefits in kind include: (a) a car or a car allowance; (b) use of a driver; (c) travel and other expenses incurred in connection with accompanied attendance at business functions. Non-Executive Directors receive benefits under (c) only.

4 Paul Rayner's benefits in kind included payments in respect of family education (£56,344) which followed his relocation to the UK from Australia.

5 Antonio Monteiro de Castro's benefits in kind included tax advice of £43,051 in respect of his former contractual arrangements up to 1 January 2004, prior to which date he derived his emoluments in both the UK and Brazil.

6 The Directors' remuneration shown above does not include the illustrative value (as at 25 February 2008) of the Executive Directors' Long Term Incentive Plan awards made in May 2005 which will vest on 17 May 2008. Reference should be made to note 4 to Table 5 on page 74.

Table 2. Directors' interests in British American Tobacco p.l.c. ordinary shares of 25p

	At 1 Jan 2007 or date of appointment	At 31 Dec 2007	Changes from 31 Dec 2007[1, 2]	At 27 Feb 2008
J P du Plessis	50,000	50,000	–	50,000
K H Clarke	4,611	4,779	–	4,779
P N Adams	143,394	143,743	13	143,756
P A Rayner	83,558	92,948	13	92,961
A Monteiro de Castro[1, 3]	179,844	180,127	–	–
K M A de Segundo[1]	5,000	5,000	–	5,000
R E Lerwill	3,000	3,000	–	3,000
A M Llopis	2,200	2,200	–	2,200
C J M Morin-Postel[1]	–	4,700	–	4,700
A Ruys	3,000	3,000	–	3,000
Sir Nicholas Scheele	–	–	–	–
M H Visser	–	–	–	–

Notes:

1 Karen de Segundo and Christine Morin-Postel were appointed Directors on 1 October 2007. Antonio Monteiro de Castro retired on 31 December 2007.

2 The changes in Directors' interests since 31 December 2007 relate to the purchase of shares pursuant to the Company's Partnership Share Scheme. No Director had a non-beneficial interest in the shares of the Company at the dates stated in Table 2 above.

3 At 31 December 2007, Antonio Monteiro de Castro also had an interest in 40,000 shares of no par value in the Common Stock of Souza Cruz SA of Brazil, the listed company in which British American Tobacco has a 75 per cent interest (1 January 2007: 100,000 shares).

4 In addition to the shares shown above, the Executive Directors have the following interests in the ordinary shares of the Company which are held in trust pursuant to the British American Tobacco Deferred Share Bonus Scheme:

	At 1 Jan 2007	Awarded 13 Mar 2007[6]	Released 20 Mar 2007	At 31 Dec 2007
P N Adams	118,611	46,083	46,011	118,683
P A Rayner	82,821	28,341	37,105	74,057
A Monteiro de Castro[5]	75,889	31,337	25,260	81,966

5 In the case of the unvested awards made to Antonio Monteiro de Castro under the Deferred Share Bonus Scheme, the Remuneration Committee agreed that these awards would vest in full immediately upon his retirement on 31 December 2007. The shares comprised in these awards will transfer to Antonio Monteiro de Castro no later than 31 March 2008.

6 The cost of these shares has been included as Directors' emoluments in the prior year. Details of the Deferred Share Bonus Scheme are given on page 60.

7 Based on the performance for 2007, the Executive Directors will each be awarded a number of ordinary shares to the value of £1,788 pursuant to an appropriation of shares under the Share Reward Scheme on 1 April 2008.

8 On 31 December 2007, the Group's employee share ownership trust referred to on page 64 held a total of 13,987,584 ordinary shares in the Company. All participating employees, including the Executive Directors, are deemed to have a beneficial interest in these shares.

Table 3. Executive Directors' share options over British American Tobacco p.l.c. ordinary shares of 25p – audited

	At 1 Jan 2007 number of shares	Exercise price	Granted in 2007 number of shares	Exercised in 2007[3] number of shares	At 31 Dec 2007 number of shares	Dates from which exercisable	Latest expiry date
P N Adams							
Sharesave Scheme[1]	2,492	663.0p	–	–	2,492	Jan 2010	Jun 2010
P A Rayner							
Sharesave Scheme[1]	3,447	480.0p	–	3,447	–	Jan 2007	Jun 2007
	1,421	1,152.0p	–	–	1,421	Jan 2012	Jun 2012
Total	4,868		–	3,447	1,421		
Share Option Scheme[2]	1,398	500.0p	–	1,398	–	Sep 2002	Sep 2009
A Monteiro de Castro							
Sharesave Scheme[1]	957	977.0p	–	–	957	Jan 2009	Jun 2009

Notes:

1 Sharesave Scheme: in respect of the Executive Directors, no options lapsed during the year ended 31 December 2007. There have been no variations in the terms and conditions of these interests in share options during the year. Options granted under the Sharesave Scheme are exercisable in conjunction with a three year or five year savings contract up to a monthly limit of £250. Options are normally granted at a discount of 20 per cent to the market price at the time of the invitation, as permitted under the rules of the Sharesave Scheme. Antonio Monteiro de Castro retired on 31 December 2007 and his options lapsed in accordance with the rules of the Sharesave Scheme.

2 Share Option Scheme: in respect of the Executive Directors, no options lapsed or were granted during the year ended 31 December 2007. There have been no variations in the terms and conditions of these interests in share options during the year. No consideration is payable for the grant of an option.

3 Aggregate gains on share options exercised by Executive Directors during the year ended 31 December 2007 were as follows:

	Date of exercise	Exercise price	Market price[5]	Number of options exercised	Gain £
P A Rayner					
Sharesave Scheme	5 March 2007	480.0p	1,570.0p	3,447	37,572
Share Option Scheme[4]	8 May 2007	500.0p	1,579.0p	1,398	15,084
Aggregate gains on the exercise of share options 2007					52,656
Aggregate gains on the exercise of share options 2006					17,562

4 Performance conditions were applicable in respect of the options granted under the Share Option Scheme. For options to be exercisable, the Company's published adjusted diluted earnings per share growth had to exceed inflation by 3 per cent per annum over any consecutive three year period during the 10 year life of the options.

5 The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 31 December 2007 was 1,965p and the range during the year was 1,434p to 1,996p. The market price on 31 December 2007 exceeded the grant price of all the options detailed in Table 3 above.

Table 4. Executive Directors' pension entitlements – audited

The following Directors were members of defined benefit schemes provided by the Group during the year. Pension entitlements and corresponding transfer values increased as follows during the year:

	Normal retirement age	Total accrued pension at 31 Dec 2007[1] £	Gross increase in accrued pension £	Increase in accrued pension net of inflation[2] £	Transfer value of net increase in accrual over period[3] £	Transfer value of accrued pension at 31 Dec 2006[3] £	Transfer value of accrued pension at 31 Dec 2007[3] £	Total change in transfer value during period £
P N Adams	60	438,325	59,447	44,120	849,678	7,345,334	8,441,347	1,096,013
P A Rayner	60	97,246	21,517	18,453	345,110	1,424,481	1,818,705	394,224
A Monteiro de Castro[5]	60	336,328	42,103	30,200	650,356	6,472,957	7,242,753	769,796

Notes:

1 The amount of total accrued pension is the pension that would be paid annually on retirement based on service to the end of the year, excluding any increases granted under statute before retirement.

2 The value of net increase in accrued pension represents the incremental value to the Executive Director of his service during the year, calculated on the assumption service terminated at the year end.

3 Changes in the transfer values reflect both individual Executive Director's circumstances such as the date of joining the Pension Fund and changes in salary during the year together with the application of market value adjustments in accordance with actuarial and legislative requirements. During 2006, the Trustee of the Pension Fund revised the method and assumptions used to calculate transfer values. Previously, transfer values were calculated in accordance with section 1.5 of version 9.2 of Actuarial Guidance Note GN11 issued by the actuarial profession. Following a review of the transfer value basis, the Trustee agreed to increase the transfer value offered to members and these are now provided on the same basis used for the ongoing funding of the Pension Fund. The transfer values of the accrued entitlement represent the value of assets that the Pension Fund would need to transfer to another pension provider on transferring the Pension Fund's liability in respect of Executive Directors' pension benefits. They do not represent sums payable to individual Executive Directors and, therefore, cannot be added meaningfully to annual remuneration. Further, although Antonio Monteiro de Castro is not a member of the Pension Fund, the transfer values calculated above have been calculated in accordance with the method used for the Pension Fund.

Although Paul Adams and Paul Rayner receive a significant element of their overall entitlement from an unfunded unapproved retirement benefit scheme, the transfer values calculated above have been calculated in accordance with the method used for the Pension Fund.

4 The Pension Fund is non-contributory; voluntary contributions paid by Executive Directors and resulting benefits are not shown. No excess retirement benefits have been paid to or are receivable by any Executive Director or past Executive Director of the Company.

5 Antonio Monteiro de Castro retired from the Company on 31 December 2007 and became entitled to an overall pension based on an accrual rate of 2.5 per cent per annum in respect of years and completed months of service for the period 1 April 1989 to 31 December 2007 using a 12 month average salary. In addition, 15 days' leave paid in lieu were taken into account when assessing the pensionable salary. This amounts to an additional £1,044 per annum. The overall pension takes into account benefits paid and payable from a number of sources.

Antonio Monteiro de Castro retired from the Fundacao Albino Souza Cruz pension scheme (the Souza Cruz Pension Scheme) in May 2005 and commenced receipt of his pension in accordance with the rules of that scheme. For calculation purposes, the level of ongoing pension has been converted into sterling and amounts to £99,535 per annum. Antonio Monteiro de Castro's accrual rate in the Souza Cruz Pension Scheme was 1.85 per cent per annum. The value of benefits received by Antonio Monteiro de Castro from the Souza Cruz Pension Scheme for the period May 2007 to December 2007 have, for calculation purposes, been converted into sterling and an equivalent pension and amount to £13,450 per annum.

Antonio Monteiro de Castro became entitled to a pension in respect of his top-up benefit from the Souza Cruz Pension Scheme for the period January 1989 to May 2005 equivalent to 0.65 per cent of his pensionable salary. The value of this benefit amounts to US$3.7 million and has been retained by Souza Cruz whilst Antonio Monteiro de Castro continued to be employed by the Group. This sum is now payable and for calculation purposes has been converted into sterling and an equivalent pension and amounts to £89,762 per annum.

In order to deliver the overall pension entitlement of £337,372 per annum, a top-up benefit amounting to £133,581 per annum is now payable which has been provided through an unfunded unapproved retirement scheme. Antonio Monteiro de Castro has been provided with the option of receiving a cost-neutral lump sum in lieu of the annual pension amounting to £2,124,400.

Table 5. Executive Directors' Long Term Incentive Plan awards over British American Tobacco p.l.c. ordinary shares of 25p – audited

	Performance period ending	Award date	At 1 Jan 2007 number of shares	Awarded in 2007 number of shares	Vested in 2007 number of shares	Lapsed in 2007 number of shares	At 31 Dec 2007 number of shares	Value vested 2006[2] £	Value vested 2007[2] £	Vesting date
P N Adams	2006	17 Mar 2004	105,132	–	105,132	–	–	–	1,670,547	17 Mar 2007
	2007	17 May 2005	143,442	–	–	–	143,442	–	–	17 May 2008
	2008	15 Mar 2006	113,493	–	–	–	113,493	–	–	15 Mar 2009
	2009	15 May 2007	–	159,337	–	–	159,337	–	–	15 May 2010
Total			362,067				416,272			
P A Rayner	2006	17 Mar 2004	61,842	–	61,842	–	–	–	982,669	17 Mar 2007
	2007	17 May 2005	65,091	–	–	–	65,091	–	–	17 May 2008
	2008	15 Mar 2006	50,557	–	–	–	50,557	–	–	15 Mar 2009
	2009	15 May 2007	–	78,393	–	–	78,393	–	–	15 May 2010
Total			177,490				194,041			
A Monteiro	2005	19 Mar 2003	63,950	–	–	–	63,950[2]	925,996	–	19 Mar 2006
de Castro[3]	2006	17 Mar 2004	74,211	–	74,211	–	–	–	1,179,213	17 Mar 2007
	2007	17 May 2005	72,324	–	–	–	72,324	–	–	17 May 2008
	2008	15 Mar 2006	55,788	–	–	–	55,788	–	–	15 Mar 2009
	2009	15 May 2007	–	86,679	–	–	86,679	–	–	15 May 2010
Total			266,273				278,741			
Total of awards vested in 2006 and 2007					241,185			925,996	3,832,429	

Notes:

1 The closing mid-market price of ordinary shares in British American Tobacco p.l.c. on 17 March 2004 was 810.5p, 17 May 2005 was 1,030p, 15 March 2006 was 1,435p, 20 March 2006 was 1,448p (the vesting date of 19 March 2006 not being a business day) and 19 March 2007 was 1,589p (the vesting date of 17 March 2007 not being a business day).

2 The vesting of the awards on 17 March 2007 was reported in the Company's Directors' Report and Accounts 2006 showing illustrative vesting values based on the mid-market price of ordinary shares of 1,584p at 23 February 2007, being the latest practicable date prior to publication of that Report. Antonio Monteiro de Castro did not exercise the award made to him in March 2003 during 2007.

3 In respect of the awards outstanding for Antonio Monteiro de Castro at the date of his retirement, the Remuneration Committee agreed that, in accordance with the rules of the 1998 LTIP and the 2007 LTIP, he would receive: (1) 100 per cent of the award made in May 2005; (2) 57.6 per cent of the March 2006 award (32,133 shares); and (3) 31.9 per cent of the May 2007 award (27,650 shares). The vested awards may be exercised by Antonio Monteiro de Castro no later than 30 June 2008.

4 The May 2005 award will vest on 17 May 2008 at 100 per cent in the manner described on page 63. For illustrative purposes only, the share price on 25 February 2008, being the latest practicable date prior to publication, was 1,874.0p, valuing the vesting awards as follows:

	Award granted number of shares	Award vesting number of shares	Award vesting illustrative value £
P N Adams	143,442	143,442	2,688,103
P A Rayner	65,091	65,091	1,219,805
A Monteiro de Castro	72,324	72,324	1,355,352
Total	280,857	280,857	5,263,260

5 For awards made since 2005, participants have been entitled to receive a cash payment equivalent to the value of the dividends that they would have received as shareholders on their vesting awards (the LTIP Dividend Equivalent). The value of the LTIP Dividend Equivalent to be paid to Paul Adams and Paul Rayner, subject to the performance conditions being met, on the May 2005 awards shown above on the date of the payment of the final dividend (7 May 2008) are £242,560 and £110,069 respectively. Antonio Monteiro de Castro retired on 31 December 2007 and he will receive an LTIP Dividend Equivalent payment of £87,874.

6 The performance conditions applicable to the awards that vested on 17 March 2007 and will vest on 17 May 2008 relate to an apportionment between measures relating to total shareholder return (TSR) and earnings per share based criteria with reference to a three year performance period. TSR combines both the share price and dividend performance of the Company as set against two comparator groups: (a) the FTSE 100 Index at the beginning of the performance period; and (b) a peer group of FMCG companies. A total of 50 per cent of the total award is based upon each of two separate measures (25 per cent for each measure). 25 per cent of the total award vests in full in the event of upper quartile performance by the Company relative to one of the comparator groups, 7.5 per cent of the total award will vest in the event of median performance and then pro rata between these two points. The earnings per share measure applies to 50 per cent of the award. 50 per cent of the award will vest if earnings per share growth over the three year performance period is an average of at least 8 per cent per annum in excess of inflation; 10 per cent will vest if the same figure is at least 3 per cent in excess of inflation and an award will vest pro rata between these two points. Similar criteria attach to the awards made on 17 May 2005, 15 March 2006 and 15 May 2007.

7 There have been no variations in the terms and conditions of the LTIP interests during the year.

8 The awards made in March 2006 and May 2007 are due to vest in March 2009 and May 2010 respectively. At 31 December 2007, the performance percentage reflecting performance to date, was 86.4 per cent for the March 2006 award and 95.7 per cent for the May 2007 award.

Table 6. Pay comparator group

AstraZeneca	Diageo	Reckitt Benckiser	Tesco
BP	GlaxoSmithKline	Reed Elsevier	Unilever
BT Group	Imperial Tobacco Group	Royal Dutch Shell	Vodafone
British Sky Broadcasting	Marks & Spencer	SABMiller	WPP Group
Cadbury Schweppes	Pearson	Scottish & Newcastle	

Table 7. FMCG group

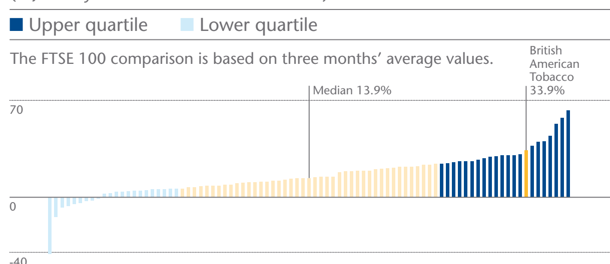
For the 2005 award vesting in May 2008

Altadis	Colgate-Palmolive	InBev	Procter & Gamble
Altria Group	Danone	Johnson & Johnson	Reckitt Benckiser
Anheuser-Busch	Diageo	Kellogg	SABMiller
Cadbury Schweppes	Heineken	Kimberly-Clark	Sara Lee
Campbell Soup	HJ Heinz	LVMH Moët Hennessy	Scottish & Newcastle
Carlsberg	The Hershey Company	Nestlé	Unilever
Coca-Cola	Imperial Tobacco Group	Pepsico	

go online at www.bat.com/annualreport2007

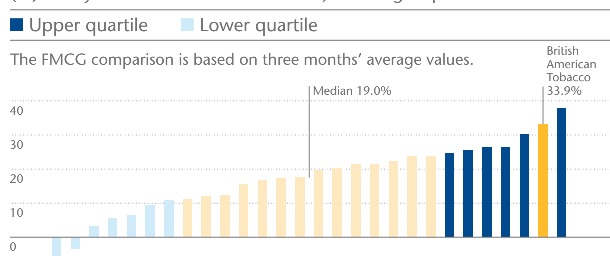
Total shareholder return (annual %)

(1 January 2005 – 31 December 2007) FTSE 100



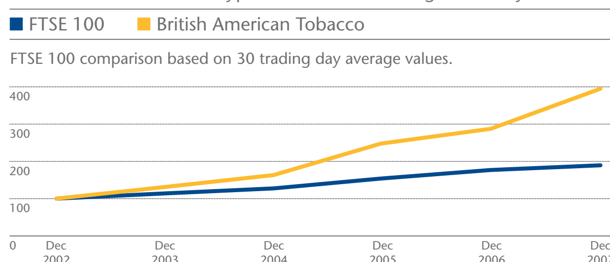
Total shareholder return (annual %)

(1 January 2005 – 31 December 2007) FMCG group

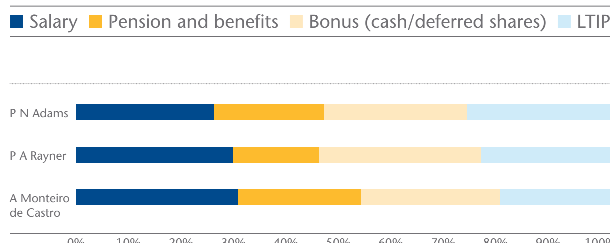


Historical total shareholder return performance

Growth in the value of a hypothetical £100 holding over five years



Executive Directors' percentage of fixed and variable remuneration



Notes:

1 The above illustration of the Executive Directors' percentage of fixed and variable remuneration for 2007 is based on a number of assumptions: (1) base salary represents annual salary; (2) pension represents the transfer value of net increase in pension in the UK Pension Fund as disclosed in Table 4 on page 72; it does not include transfer values accruing in other Group pension funds; (3) benefits are core benefits such as car/car allowance, private medical and personal accident insurance; (4) bonus is the amount expected for delivery of 'on target' performance delivered in cash and deferred shares; and (5) LTIP represents the target annualised expected value of long term incentives expressed as a percentage of base salary.

2 Fixed remuneration comprises: salary, pension and benefits. Variable remuneration comprises: bonus (cash and deferred shares) and LTIP.

Status of Remuneration Report

This report has been prepared in accordance with Schedule 7A to the Companies Act 1985. The report also meets the relevant requirements of the Listing Rules of the UK Listing Authority and describes how the Board has applied the Principles of Good Governance relating to Directors' remuneration as set out in the Combined Code on Corporate Governance referred to in the Corporate Governance Statement on page 76. As required by the Companies Act 1985, a resolution to approve the Directors' Remuneration Report (the Report) will be proposed at the Annual General Meeting of the Company on 30 April 2008, at which the Financial Statements will be presented for approval. The vote will have advisory status, will be in respect of the remuneration policy and overall remuneration packages and will not be specific to individual levels of remuneration. The Companies Act 1985 requires the auditors to report to the Company's shareholders on the 'audited information' within the Report and to state whether, in their opinion, those parts of the Report have been prepared in accordance with the Companies Act 1985. The Auditors' Report is set out on pages 84 and 85 and those aspects of the Report which have been subject to audit have been clearly marked: Table 1, Table 3, Table 4 and Table 5 on pages 69 to 74.

On behalf of the Board

Kenneth Clarke
Chairman of the Remuneration Committee

27 February 2008

CORPORATE GOVERNANCE STATEMENT

British American Tobacco has long been committed to maintaining high standards of corporate governance. Our corporate governance framework is directed towards achieving our business objectives in a manner which is responsible and in accordance with high standards of honesty, transparency and accountability. These principles are reflected in our Standards of Business Conduct, which have been in place for many years and have recently been updated in order to ensure that they remain at the forefront of best business practice. Every Group company and every employee worldwide is expected to live up to them. In addition, the principles set out within our Statement of Business Principles are designed to help meet the expectations placed on us by our various stakeholders. Both documents are available from the Company Secretary and on bat.com.

The principal governance rules applying to UK companies listed on the London Stock Exchange are contained in the Combined Code on Corporate Governance adopted by the Financial Reporting Council in June 2006 (the Code). As required by the Code, this Statement reports on how the Code's principles are applied by the Company and provides our formal report on compliance with the Code's provisions.

The Board

The Board is responsible to the Company's shareholders for the success of the Group and for its overall strategic direction, its values and its governance. It provides the leadership necessary to enable the Group's business objectives to be met within the framework of the internal controls described below, while also ensuring that the Company's obligations to its shareholders and others are met.

Directors

The Company currently has a Board of 12 Directors: the Chairman, three Executive Directors – the Chief Executive, the Chief Operating Officer and the Finance Director – and eight Non-Executive Directors. They are listed in the Directors' Report on page 48 and their details appear on page 46.

Rupert Pennant-Rea and Piet Beyers retired as Non-Executive Directors on 26 April 2007 and 30 June 2007 respectively, Christine Morin-Postel and Karen de Segundo were appointed as Non-Executive Directors on 1 October 2007, and Antonio Monteiro de Castro retired as Chief Operating Officer on 31 December 2007. Nicandro Durante was appointed to the Board as Chief Operating Officer on 1 January 2008. Paul Rayner will retire as Finance Director at the conclusion of the Annual General Meeting on 30 April 2008. Ben Stevens has been appointed to the Board with effect from 3 March 2008 and will succeed Paul Rayner as Finance Director on 30 April 2008.

Meetings of the Board

The Board held eight meetings in 2007 and is scheduled to hold seven meetings in 2008.

Among the key matters on which the Board alone may make decisions are the Group's business strategy, its annual budget, dividends and major corporate activities. It is also responsible for reviewing the Company's internal controls and governance system and for approving our Standards of Business Conduct. In addition, the Board annually:

- approves the Annual Report and Accounts, recommends the final dividend and agrees the agenda for the Annual General Meeting;
- reviews the quarterly and interim results and declares an interim dividend;
- agrees succession plans and evaluates the Board's performance over the preceding year; and
- agrees the two year Company budget.

The agenda for Board meetings is set by the Chairman in consultation with the Deputy Chairman, the Chief Executive and the Company Secretary. In addition to the Company Secretary, the General Counsel to the Company ordinarily attends all meetings of the Board.

Non-Executive Directors, led by the Chairman, meet, if required, prior to meetings of the Board without the Executive Directors present and also meet annually, led by the Deputy Chairman, without the Chairman present.

All Directors are aware of their responsibility to take decisions objectively in the interests of the Company. The Chairman will always seek to obtain consensus at Board meetings but, in exceptional circumstances, decisions will be taken by majority. If any Director has concerns about the running of the Company or a proposed action which cannot be resolved, such concerns will be recorded in the Board minutes. No such concerns arose in 2007.

Management Board

The Board delegates to the Management Board responsibility for overseeing the implementation by the Group's operating subsidiaries of the policies and strategy which it sets, and for creating the conditions for their successful day-to-day operation. The Management Board

is chaired by the Chief Executive and its other members are the Finance Director, the Chief Operating Officer and nine senior Group executives, whose names appear on page 47. It held nine scheduled meetings in 2007 and is scheduled to hold the same number of meetings in 2008. Members of the Management Board are also invited to attend meetings of the Board from time to time, in particular when the Group's future strategy and annual budgets are under discussion.

Board Committees

The Board has established four principal Board Committees, to which it has delegated certain of its responsibilities. They are the Audit Committee, the Nominations Committee, the Remuneration Committee and the Corporate Social Responsibility Committee. Each has its own clear terms of reference, which are available from the Company Secretary and on bat.com. The roles and membership of these Committees are described in more detail where appropriate below.

Board and Committee meetings held in 2007

The following table shows the total number of Board and Committee meetings held in 2007 and the number attended by their respective members.

	Board	Audit	Nominations	Remuneration	CSR
Number held	8	5	6	6	2
Number attended					
J P du Plessis	8	–	6	–	–
K H Clarke	7	5	5	5	2
P N Adams	8	–	–	–	–
P A Rayner	8	–	–	–	–
A Monteiro de Castro	8	–	–	–	–
P E Beyers[1]	3	–	2	–	0
R E Lerwill	7	5	5	5	2
A M Llopis	7	4	5	4	2
C Morin-Postel[1]	3	2	1	2	1
R L Pennant-Rea[1]	2	2	2	2	1
A Ruys	7	5	6	6	2
Sir Nicholas Scheele	8	5	6	6	2
K de Segundo[1]	2	2	0	1	1
M H Visser	7	–	4	–	1

– Indicates not a member of that Committee.

Notes:

1 Rupert Pennant-Rea retired from the Board on 26 April 2007; Piet Beyers retired from the Board on 30 June 2007. Christine Morin-Postel and Karen de Segundo were appointed to the Board and its four Committees with effect from 1 October 2007.

2 Every Director withdrew from any meeting at which his or her own position was being considered.

3 All Directors attended the Annual General Meeting in April 2007 with the exception of Anthony Ruys, who was unable to attend due to a conflicting engagement.

Chairman and Chief Executive

The roles of Chairman and Chief Executive are separate, with each having distinct and clearly defined responsibilities.

The Chairman is responsible for leadership of the Board, ensuring its effectiveness and setting its agenda, and for ensuring that a clear business and financial strategy for the Group is formulated for recommendation to the Board. An important aspect of this function is to ensure effective communication with the Company's shareholders, and facilitate the productive contribution of the Non-Executive Directors in particular.

Once agreed by the Board as a whole, it is the Chief Executive's responsibility to ensure delivery of the strategic and financial objectives. He is also responsible for stewardship of the Group's assets and, jointly with the Chairman, representation of the Group externally.

Board balance and independence

The Board considers that seven of the eight Non-Executive Directors are independent. Thys Visser is presumed not to be independent because of the shareholding that he represents. Accordingly, he does not sit on the Audit or Remuneration Committees, both of which comprise solely independent Non-Executive Directors.

Kenneth Clarke was appointed to the Board on 28 April 1998 and so has served on the Board for over nine years. The Board recognises that length of service can impact on the independence of a Non-Executive Director and has therefore kept his position under careful review. It is satisfied, in light of his continuing valuable contributions to the Board and its Committees, that he has remained independent throughout the period under review. He will retire from the Board at the conclusion of the Company's Annual General Meeting on 30 April 2008.

In addition to being the Non-Executive Deputy Chairman, Kenneth Clarke is the Senior Independent Director. He is available should occasion arise where there is a need to convey concerns to the Main Board other than through the Chairman or Chief Executive. He and the other Non-Executive Directors remain available to meet with major investors in order to understand their views and concerns. On his retirement, Sir Nicholas Scheele will assume the role of Senior Independent Director and the position of Deputy Chairman will cease.

Appointments to the Board

The Board has established the Nominations Committee to make recommendations on suitable candidates for appointment to the Board and for promotion to the Management Board, ensuring that both Boards have the appropriate balance of expertise and ability. It is chaired by Jan du Plessis and its remaining membership comprises all of the Non-Executive Directors. The Chief Executive and Management Board Director responsible for Human Resources regularly attend meetings by invitation but are not members.

The Nominations Committee is responsible for ensuring that the procedure for appointing new Directors is rigorous and transparent and that appointments are made on merit and against objective criteria for the purpose. The selection process will generally involve benchmarking and interviews with a selection of candidates, using where appropriate the services of executive search firms specialising in board level recruitment. This process was followed in connection with the appointments to the Board of Christine Morin-Postel and Karen de Segundo in October 2007 and Nicandro Durante in January 2008.

Directors are submitted for reappointment at regular intervals by application of the Company's Articles of Association. These require that at each Annual General Meeting: (1) not less than one-third of the Directors who are subject to retirement by rotation must retire; and (2) any Director has to retire who was not appointed at either of the two previous Annual General Meetings and who has served as a Director for more than two years since appointment or last reappointment.

Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. For Non-Executive Directors appointed before 1 October 2007, the terms of appointment of each such Director provide that he or she is appointed for a specified term, being an initial period to the next Annual General Meeting after appointment and, subject to reappointment at that meeting, for a further period ending at the Annual General Meeting held three years thereafter. Subsequent reappointment is subject to endorsement by the Board and the approval of shareholders. Following the implementation of the relevant provisions of the Companies Act 2006 during 2007, an appointment of a Non-Executive Director made by the Company from 1 October 2007 is made on the basis of a two year term, such appointment being subject to approval by shareholders in accordance with the terms of the provisions of the Company's Articles of Association relating to the rotation of Directors.

There is a general assumption on the part of the Board that Non-Executive Directors will not normally be invited to stand for reappointment after serving nine years. The Committee reviews forthcoming retirements at least once a year and considers the need to identify candidates to fill vacancies for non-executive positions on the Board. This process includes an evaluation of the skills and experience to be looked for in those candidates to ensure continuing Board balance.

The Nominations Committee has made recommendations to the Board as to the Directors who are retiring and being put forward for reappointment at the Annual General Meeting on 30 April 2008.

Information and professional development

Directors receive induction on joining the Board, which consists of at least two days' briefings on all areas of the Company's business. After a period on the Board, they are given an opportunity to review the induction programme and raise questions on any areas in respect of which they would like further information. In addition, they have the opportunity to update their skills and knowledge on a regular basis, for example through further briefings on the business and by visits to Company sites. They also make use of the opportunity to attend meetings of the Group's regional audit committees.

The Board and its Committees receive high quality, up-to-date information for review in good time ahead of each meeting, and the Company Secretary, under the direction of the Chairman, ensures good information flows within the Board and its Committees and between the Non-Executive Directors and senior management. She is also responsible for advising the Board, through the Chairman, on all governance matters. The appointment and removal of the Company Secretary is a matter for the Board.

During 2007, the Board was fully briefed on the practical implications for directors of the Companies Act 2006,

including in particular the codification of directors' duties which came into effect in October 2007. This included a dedicated presentation covering relevant aspects of the legislation, together with a briefing pack and supporting materials.

All Directors have access to the advice and services of the Company Secretary, and a procedure is in place for them to take independent professional advice at the Company's expense should this be required. The Company has arranged appropriate insurance to provide cover in the event of legal action against its Directors.

Evaluation of Board performance

The Board conducts a critical evaluation of its activities on an annual basis. A questionnaire-based peer review of the performance of the Chairman, the Executive Directors, the Non-Executive Directors, the Board and its committees is conducted by the Company Secretary. The results of the review of the Committees and the Board are discussed with the Chairman and presented to the Board. The results of the review of individual performance are raised by the Chairman with each individual Director, as appropriate. The results of the review of the Chairman's performance are discussed by the Non-Executive Directors without the Chairman present and feedback is given by the Senior Independent Director on a one-to-one basis. The Chairman also discusses the effectiveness and performance of Directors immediately before they make themselves available for reappointment. The Remuneration Committee evaluates the effectiveness of the Chairman and the Chief Executive annually.

The process in 2007 confirmed that all Directors continue to make an effective contribution to the Board and that the Board and its Committees continue to operate effectively in discharging their obligations and meeting defined objectives. The Committees were rated highly and the Board expressed particular appreciation for the regional audit committee framework which allows broad access to the business. It was commented that the balance of expertise on the Board should continue to be kept under review, taking into account the geographical spread of the Group's business.

The Notice for this year's Annual General Meeting confirms that the performance of the Directors being proposed for reappointment continues to be effective and that they continue to show commitment to their role.

Remuneration

It is the role of the Remuneration Committee to determine the framework and policy on terms of engagement (including remuneration) of the Chairman, Executive Directors and members of the Management Board, and the specific remuneration of each Executive Director and Management Board member (including entitlements under share incentive schemes and pension schemes) and any compensation payments. Fees payable to Non-Executive Directors are determined by the Board on the recommendation of the Chairman and Chief Executive.

The Remuneration Committee is chaired by Kenneth Clarke and its members are Robert Lerwill, Ana Maria Llopis, Christine Morin-Postel, Anthony Ruys, Sir Nicholas Scheele and Karen de Segundo. On Kenneth Clarke's retirement from the Board, Anthony Ruys will assume Chairmanship of the Committee. The Chairman, Chief Executive and Management Board Director responsible for Human Resources regularly attend meetings by invitation but are not members.

Details of the Directors' remuneration are set out in the Remuneration Report on page 69.

Accountability and audit

Financial reporting

The Board is satisfied that it has met its obligation to present a balanced and understandable assessment of the Company's position and prospects in the Directors' Report and Accounts and the Operating and Financial Review and in interim reports, reports to regulators and price-sensitive announcements. A summary of the Directors' responsibilities for the financial statements and their statement concerning relevant audit information is included in the Directors' Report on pages 49 and 50. The Directors' statement that it is appropriate to continue to adopt the going concern basis in preparing the accounts is set out in the Directors' Report on page 50.

Audit Committee

The Board's obligation to establish formal and transparent arrangements for considering how it should apply financial reporting and internal control principles, and

for maintaining an appropriate relationship with the Company's external auditors, PricewaterhouseCoopers LLP, is met through the Audit Committee.

The Audit Committee is chaired by Robert Lerwill and comprises six other independent Non-Executive Directors – Kenneth Clarke, Ana Maria Llopis, Christine Morin-Postel, Anthony Ruys, Sir Nicholas Scheele and Karen de Segundo. Robert Lerwill has recent and relevant financial experience. The Chairman and the Executive Directors regularly attend meetings of the Committee by invitation but are not members. The Committee's meetings are also regularly attended by the Head of Audit and Business Risk, the General Counsel to the Company and a representative of the external auditors. As a matter of best practice, the Committee meets alone with the external auditors at the end of its meetings.

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

Activities of the Audit Committee in 2007

The Audit Committee met five times during 2007, including immediately before the Company's full year results were published. It continued to monitor the integrity of the Company's financial statements and all formal announcements concerning the Company's financial performance, to review significant financial reporting judgements contained in them, and to keep under review the consistency of accounting policies applied across the Group.

During the course of the year, the Committee met regularly with management and with the internal and external auditors to review the effectiveness of internal controls and business risk management, and received reports from the Head of Audit and Business Risk, the Head of Group Security and the Group's regional audit committees and corporate audit committee. The specific items considered by the Audit Committee during 2007 included:

- compliance with the Standards of Business Conduct;
- compliance with records management procedures;
- a revised audit committee framework;
- the updated Standards of Business Conduct;
- the main risks and controls of the Group's treasury operations; and
- the threat to the Group's business posed by illicit trade and the specific controls in place to address such risks.

It has satisfied itself by means of these steps that proper and satisfactory internal controls remain in place to identify and contain business risks, and that the Company's business, and that of its subsidiaries, is being conducted in a proper and economically sound manner.

The Audit Committee made recommendations to the Board on the reappointment, for approval by shareholders, of the Company's external auditors and approved their fees and terms of engagement. The Committee has an established policy on the appointment of the auditors to perform non-audit services for the Group over and above the external audit (as further detailed in its terms of reference, available on bat.com) and keeps this issue under continual review. It remains confident that the objectivity and independence of the auditors are not in any way impaired by reason of this further work. Moreover, the Committee is satisfied that such work is best handled by them, either because of their knowledge of the Group or because they have been awarded it through a competitive tendering process. A breakdown of non-audit fees charged by the auditors is disclosed on page 102 in note 3(d).

The Group's whistleblowing policy and procedures enable staff, in confidence, to raise concerns about possible improprieties in financial and other matters and to do so without fear of reprisal, provided that such concerns are not raised in bad faith. Details of this policy are set out in the Company's Standards of Business Conduct. The policy is supplemented by local procedures throughout the Group and at the Group's London

headquarters, which provide staff with additional guidance and enable them to report matters in a language with which they are comfortable. The Audit Committee remains satisfied that the policy and the procedures in place incorporate arrangements for the proportionate and independent investigation of matters raised and for the appropriate follow-up action.

Internal control

The Board is responsible for the overall system of internal control for the Company and its subsidiaries and for reviewing the effectiveness of the system. It carries out such a review annually, covering all material controls including financial, operational and compliance controls and risk management systems, and reports to shareholders that it has done so.

Overview

The Company maintains a sound system of internal control with a view to safeguarding shareholders' investment and the Company's assets. It is designed to identify, evaluate and manage risks that may impede the achievement of the Company's business objectives rather than to eliminate these risks and can therefore provide only reasonable, not absolute, assurance against material misstatement or loss. A description of the key risk factors that may affect the Group's business is provided in the Operating and Financial Review on pages 28 to 31.

The main features of the risk management processes and system of internal control operated within the Group are identified below. They do not cover the Group's associate undertakings. Save to the extent indicated (in relation to developments which occurred during the year), they have been in place throughout the year under review and up to date.

Audit committee framework

The Group uses audit committees at central, regional, area and individual market levels to support the Audit Committee in monitoring risks and control. This framework provides a continuing process for identifying, evaluating and managing the significant risks faced by the Company and its subsidiaries. It is designed to capture and evaluate failings and weaknesses and to ensure that appropriate remedial action is taken where necessary.

The audit committee framework is regularly reviewed by the Board and was revised during the course of 2007 to ensure that it remains aligned with the Group's business structure. The revised framework reflects the continuing migration of many of the processes and supporting control systems above the Group's individual markets and is directed towards ensuring that these processes and control systems remain subject to adequate review from an internal control and business risk perspective. In relation to each level of audit committee, the Group's requirements on constitution, membership and procedures have been developed to reflect both existing practice within the Group and best practice generally in the field of corporate governance.

The Group's regional audit committees (which are all chaired by an Executive Director) focus on risks and the control environment within each region and are in turn supported by end market or area audit committees. The corporate audit committee comprises members of the Management Board and it focuses on the risks and the control environment within the Group's operations which do not fall under the responsibility of the regional, area and local audit committees, for example central functions, global programmes and above-region projects. The reviews conducted by the regional audit committees and the corporate audit committee include consideration of the effectiveness of the process for identifying, evaluating and managing the risks of the business and the assessments of internal control and business risks completed by operating companies. The relevant external and internal auditors regularly attend meetings of all audit committees and have private audiences with members of the audit committees at least once each year. In addition, central, regional and individual market management, along with internal audit, supports the Board in its role of ensuring a sound control environment.

Risk management and internal control processes

It is the responsibility of each Group company to manage its risks (both financial and non-financial) and they must maintain a business risk register to identify, assess and monitor the key risks which they face. They are required regularly to review and update the register. The Group's internal audit function provides advice and guidance

to the Group's businesses on best practice in risk management and control systems.

Group companies and other business units are required at least annually to complete a checklist of the key controls which they are expected to have in place. Its purpose is to enable them to self-assess their internal control environment, assist them in identifying any controls which may require strengthening and support them in implementing and monitoring action plans to address control weaknesses.

The Group's internal audit function is 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.

Annual processes

Annually, at the year end, each operating company within the Group and each department within the Group's UK headquarters is required to:

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

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

Review

The Turnbull Guidance sets out best practice on internal control for UK-listed companies to assist them in assessing the application of the Code's principles and compliance with the Code's provisions with regard to internal control. The current version of the Turnbull Guidance (the Guidance) applies to listed companies for financial years beginning on or after 1 January 2006.

The processes described above, and the reports that they give rise to, enable the Board and the Audit Committee to monitor the internal control framework on a continuing basis throughout the year and to review its effectiveness at the year end. The Board, with advice from its Audit Committee, has completed its annual review of the effectiveness of the system of internal control for the period since 1 January 2007. No significant failings or weaknesses were identified and the Board is satisfied that, where specific areas for improvement have been identified, processes are in place to ensure that the necessary remedial action is taken and that progress is monitored. The Board is satisfied that the system of internal control is in accordance with the Guidance.

Relations with shareholders

The Board maintains a dialogue with shareholders directed towards ensuring a mutual understanding of objectives. Its primary contact with shareholders is through the Chief Executive and Finance Director, but the Chairman and Chief Operating Officer also maintain contact with major shareholders in order to understand their issues and concerns. Where appropriate, major institutional shareholders are consulted on significant changes to the structure of the Directors' remuneration.

At least twice a year, the Head of Investor Relations presents a report to the Board on the issues considered at meetings between the Company and institutional shareholders. In addition, the Board receives regular reports on developments concerning the holdings of the Company's main institutional shareholders.

The Annual General Meeting is the principal opportunity for the Board to meet a wide range of investors and for the Chairman to explain the Company's progress and receive questions from its owners, the shareholders. At the Annual General Meeting on 30 April 2008, the Company will provide for the vote on each resolution to be by poll, using its Registrar's electronic voting system, rather than by show of hands. This provides for greater transparency and allows the votes of all shareholders to be counted, including those cast by proxy. The Chairman announces the provisional voting results at the Meeting, and the final results are announced on the same day through the Regulatory News Service and on bat.com.

Corporate Social Responsibility

The Corporate Social Responsibility (CSR) Committee supports the Company's commitment to social and environmental issues. It is chaired by Kenneth Clarke, its other members being all of the Non-Executive Directors,

and Karen de Segundo will chair the Committee following Kenneth Clarke's retirement from the Board. The Chairman, the Executive Directors and the Management Board Director responsible for Corporate and Regulatory Affairs regularly attend meetings by invitation but are not members. The Committee's role is to help identify and assess, with management, those significant social, environmental and reputational risks that might impair the Company's strategic objective to be recognised as a responsible company in a controversial industry. The Committee also evaluates the adequacy of the Company's policies in this area and makes recommendations for change.

The Company's Social Reports have detailed the Company's social, ethical and environmental performance and performance against commitments each year since the first Social Report in 2002. In 2006, the Company issued a performance summary (Social Reporting: 2006 progress and review), rather than publishing a full Social Report, in anticipation of the transition to a Sustainability Report later this year. Details of the Company's performance on social, ethical and environmental issues can be found on bat.com.

Group companies in 32 countries are engaged in social reporting and others covering 10 countries are holding dialogue and reporting on a key issue. British American Tobacco's first EU Social Report was published in 2007 and reflects dialogues with senior EU-level stakeholders in 2006/7. All of the Group's Social Reports continue to be measured, through rigorous independent review, against the AA1000 Standard and the latest AA1000 Assurance Standard is being applied. Engagement with key stakeholders is a major requirement of the AA1000 Standard, and Group companies continue to be very active in this area.

The principles of CSR continue to be strongly embedded in the Group, with the governance dimension being provided by local and regional CSR committees, overseen by the CSR Committee. The focus for CSR governance this year will be to review and improve the governance process, including a review of the CSR key control checklist, first used in 2006.

The Company has been included in both the Dow Jones Sustainability World Index (DJSI World) and the Dow Jones STOXX Sustainability Index for the sixth year running. British American Tobacco (Malaysia) Berhad was also included in the 2007 DJSI World. British American Tobacco was placed in the second highest (Gold) Band in the Corporate Responsibility Index 2006 run by Business in the Community, the 700 member organisation established in the UK to help business improve its positive impact on society. The Company was rated first in its sector and included in the highest (Platinum) Band for environmental performance in the Business in the Environment Index for 2006.

American Depositary Receipts

The Company has unlisted trading privileges for its American Depositary Receipts (ADRs) on the American Stock Exchange. 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 American Stock Exchange 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 (as explained above) and those that would be required if the Company were subject to those rules. The updated statement will be available on the corporate governance section of bat.com from the date of publication of the Directors' Report and Accounts.

Compliance

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

In the interests of further transparency, we have again prepared a report which summarises the matters addressed in this Statement, as appropriate, by reference to each Principle and Provision of the Code. The updated report will be available on the corporate governance section of bat.com from the date of publication of the Directors' Report and Accounts.

REPORT OF THE INDEPENDENT AUDITORS

TO THE MEMBERS OF BRITISH AMERICAN TOBACCO P.L.C.

We have audited the Group Financial Statements of British American Tobacco p.l.c. for the year ended 31 December 2007 which comprise the Group income statement, the Group statement of changes in total equity, the Group balance sheet, the Group cash flow statement, and the related notes including the Principal subsidiary undertakings and the Principal associate undertakings. These Group Financial Statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company Financial Statements of British American Tobacco p.l.c. for the year ended 31 December 2007 and on the information in the Remuneration report that is described as having been audited.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and Accounts, including the Group Financial Statements, in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, are set out in the Statement of directors' responsibilities in relation to the Financial Statements, included in the Directors' report.

Our responsibility is to audit the Group Financial Statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the Group Financial Statements give a true and fair view and whether the Group Financial Statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the Directors' report is consistent with the Group Financial Statements. The information given in the Directors' report includes that specific information presented in the Operating and financial review that is cross referred from the Business review section of the Directors' report.

In addition, we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate governance statement reflects the Company's compliance with the nine provisions of the Combined Code (2006) specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and Accounts and consider whether it is consistent with the audited Group Financial Statements. The other information comprises only the Quick read, the Operating and financial review, the Board of Directors, the Management Board, the Directors' report, the Remuneration report, the Corporate governance statement, the Five year summary, the Quarterly analyses of profit, the parent company Financial Statements and the Shareholder information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group Financial Statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group Financial Statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group Financial Statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group Financial Statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the Group Financial Statements.

Opinion

In our opinion

- the Group Financial Statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2007 and of its profit and cash flows for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' report is consistent with the Group Financial Statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
1 Embankment Place, London

27 February 2008

GROUP INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER

	Notes	2007 £m	2006 £m
Gross turnover (including duty, excise and other taxes of £16,216 million (2006: £15,427 million))		**26,234**	25,189
Revenue	2	**10,018**	9,762
Raw materials and consumables used		**(2,802)**	(2,861)
Changes in inventories of finished goods and work in progress		**30**	(11)
Employee benefit costs	3a	**(1,586)**	(1,554)
Depreciation and amortisation costs	3b	**(336)**	(401)
Other operating income	3c	**205**	181
Other operating expenses	3d	**(2,624)**	(2,494)
Profit from operations	2	**2,905**	2,622
after (charging)/crediting			
– restructuring costs	3e	**(173)**	(216)
– net gains/(losses) on disposal of businesses and brands	3f	**75**	41
Finance income		**136**	110
Finance costs		**(405)**	(399)
Net finance costs	4	**(269)**	(289)
Share of post-tax results of associates and joint ventures	5	**442**	431
after (charging)/crediting			
– brand impairments	5	**(7)**	(13)
– exceptional tax credits	5		17
Profit before taxation		**3,078**	2,764
Taxation on ordinary activities	6	**(791)**	(716)
Profit for the year		**2,287**	2,048
Attributable to:			
Shareholders' equity		**2,130**	1,896
Minority interests		**157**	152
Earnings per share			
Basic	7	**105.19p**	92.08p
Diluted	7	**104.46p**	91.33p

All of the activities during both years are in respect of continuing operations.

Notes are shown on pages 91 to 161 and pages 166 to 168.

GROUP STATEMENT OF CHANGES IN TOTAL EQUITY
FOR THE YEAR ENDED 31 DECEMBER

	Notes	2007 £m	2006 £m
Differences on exchange		**312**	(685)
Cash flow hedges			
– net fair value gains		**15**	13
– reclassified and reported in profit for the year		**(42)**	(15)
Available-for-sale investments			
– net fair value gains/(losses)		**1**	(2)
– reclassified and reported in profit for the year		**1**	
Net investment hedges			
– net fair value (losses)/gains		**(35)**	117
Tax on items recognised directly in equity	6c	**(19)**	(12)
Net gains/(losses) recognised directly in equity		**233**	(584)
Profit for the year *page 86*		**2,287**	2,048
Total recognised income for the year		**2,520**	1,464
– shareholders' equity		**2,348**	1,334
– minority interests		**172**	130
Employee share options			
– value of employee services	27	**37**	41
– proceeds from shares issued		**27**	28
Dividends and other appropriations			
– ordinary shares	8	**(1,198)**	(1,008)
– to minority interests		**(173)**	(137)
Purchase of own shares			
– held in employee share ownership trusts		**(41)**	(77)
– share buy-back programme		**(750)**	(500)
Acquisition of minority interests		**(9)**	(13)
Other movements		**(3)**	13
		410	(189)
Balance 1 January	20	**6,688**	6,877
Balance 31 December	20	**7,098**	6,688

The increase in total equity of £410 million (2006: £189 million decrease) comprised £419 million increase (2006: £169 million decrease) in respect of shareholders' funds and £9 million decrease (2006: £20 million decrease) in respect of minority interests.

Notes are shown on pages 91 to 161 and pages 166 to 168.

GROUP BALANCE SHEET
AT 31 DECEMBER

	Notes	2007 £m	2006 £m
Assets			
Non-current assets			
Intangible assets	9	**8,105**	7,476
Property, plant and equipment	10	**2,378**	2,207
Investments in associates and joint ventures	11	**2,269**	2,108
Retirement benefit assets	12	**50**	29
Deferred tax assets	13	**262**	273
Trade and other receivables	14	**123**	192
Available-for-sale investments	15	**22**	24
Derivative financial instruments	16	**153**	76
Total non-current assets		**13,362**	12,385
Current assets			
Inventories	17	**1,985**	2,056
Income tax receivable	18	**85**	59
Trade and other receivables	14	**1,845**	1,568
Available-for-sale investments	15	**75**	128
Derivative financial instruments	16	**82**	124
Cash and cash equivalents	19	**1,258**	1,456
		5,330	5,391
Assets classified as held for sale	26	**36**	
Total current assets		**5,366**	5,391
Total assets		**18,728**	17,776

	Notes	2007 £m	2006 £m
Equity			
Capital and reserves			
Share capital		**506**	517
Share premium, capital redemption and merger reserves		**3,902**	3,886
Other reserves		**637**	419
Retained earnings		**1,835**	1,639
Shareholders' funds		**6,880**	6,461
after deducting			
– cost of treasury shares		**(296)**	(197)
Minority interests		**218**	227
Total equity	20	**7,098**	6,688
Liabilities			
Non-current liabilities			
Borrowings	21	**6,062**	5,568
Retirement benefit liabilities	12	**357**	435
Deferred tax liabilities	13	**294**	296
Other provisions for liabilities and charges	22	**165**	161
Trade and other payables	23	**149**	146
Derivative financial instruments	16	**49**	29
Total non-current liabilities		**7,076**	6,635
Current liabilities			
Borrowings	21	**861**	1,058
Income tax payable	18	**227**	292
Other provisions for liabilities and charges	22	**263**	253
Trade and other payables	23	**2,976**	2,766
Derivative financial instruments	16	**225**	84
		4,552	4,453
Liabilities directly associated with assets classified as held for sale	26	**2**	
Total current liabilities		**4,554**	4,453
Total equity and liabilities		**18,728**	17,776

Notes are shown on pages 91 to 161 and pages 166 to 168.

On behalf of the Board

Jan du Plessis
Chairman

27 February 2008

GROUP CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER

	Notes	2007 £m	2006 £m
Cash flows from operating activities			
Cash generated from operations	25	**3,181**	2,816
Dividends received from associates		**285**	259
Tax paid		**(866)**	(713)
Net cash from operating activities		**2,600**	2,362
Cash flows from investing activities			
Interest received		**114**	119
Dividends received from investments		**2**	2
Purchases of property, plant and equipment		**(416)**	(425)
Proceeds on disposal of property, plant and equipment		**46**	64
Purchases of intangibles		**(66)**	(58)
Proceeds on disposal of intangibles	25	**16**	60
Purchases and disposals of investments	25	**71**	(37)
Purchases of subsidiaries and minority interests	25	**(15)**	(101)
Proceeds on disposal of subsidiaries	25	**126**	62
Purchases of associates			(1)
Net cash from investing activities		**(122)**	(315)
Cash flows from financing activities			
Interest paid		**(384)**	(389)
Interest element of finance lease rental payments		**(3)**	(3)
Capital element of finance lease rental payments		**(21)**	(19)
Proceeds from issue of shares to Group shareholders		**5**	5
Proceeds from the exercise of options over own shares held in employee share ownership trusts		**22**	23
Proceeds from increases in and new borrowings	25	**438**	1,365
Movements relating to derivative financial instruments	25	**(89)**	142
Purchases of own shares		**(750)**	(500)
Purchases of own shares to be held in employee share ownership trusts		**(41)**	(77)
Reductions in and repayments of borrowings	25	**(427)**	(1,739)
Dividends paid to shareholders	8	**(1,198)**	(1,008)
Dividends paid to minority interests		**(173)**	(139)
Net cash from financing activities		**(2,621)**	(2,339)
Net cash flows from operating, investing and financing activities		**(143)**	(292)
Differences on exchange		**47**	(96)
Decrease in net cash and cash equivalents in the year		**(96)**	(388)
Net cash and cash equivalents at 1 January		**1,276**	1,664
Net cash and cash equivalents at 31 December	19	**1,180**	1,276

Notes are shown on pages 91 to 161 and pages 166 to 168.

NOTES ON THE ACCOUNTS

1 Accounting policies

Basis of Accounting

The Group accounts 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 1985 applicable to companies reporting under IFRS.

The 2005 Financial Statements were the Group's first consolidated Financial Statements prepared under IFRS, with a transition date of 1 January 2004. However, as permitted under IFRS, IAS32 and IAS39 on financial instruments were applied from 1 January 2005.

The Financial Statements have been prepared under the historical cost convention except as described in the accounting policy below on financial instruments.

In 2007, the Group adopted IFRS7 (Financial Instruments: Disclosures) and amendments to IAS1 (Capital Disclosures). As these only required amended disclosures, including comparatives, they have had no effect on the Group's reported profit and equity.

The preparation of the Group accounts 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 exemptions taken under IFRS1 on the first time adoption of IFRS at 1 January 2004 and, in particular, those relating to goodwill on business combinations and retirement benefit costs which are explained in the accounting policies on pages 92 and 93 respectively. The main adjustments made in the transition to IFRS are summarised on page 163.
- The review of asset values, especially goodwill and impairment testing. The key assumptions used in respect of goodwill and impairment testing are the determination of cash generating units, the long term growth rate for cash flow projections and the rate used to discount the cash flow projections. These are described in note 9 on page 108.
- 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, 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 and expected returns on assets, as well as discount rates and asset values at the year end. The resultant volatility is moderated in the accounts by the deferral of some actuarial gains and losses as explained in the accounting policy on page 93. The assumptions used by the Group and sensitivity analysis are described in note 12 on page 113.
- The estimation of other provisions including taxation. Provisions and liabilities, which 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 on page 94 and the recognised deferred tax assets and liabilities, together with a note of unrecognised amounts, are shown in note 13 on page 120. Other provisions are as set out in note 22 on page 140. The accounting policy on contingent liabilities, which are not provided for, is set out on page 97 and the contingent liabilities of the Group are explained in note 30 on page 153.
- The definition of exceptional items, which are separately disclosed as memorandum information, is explained in the accounting policy on page 97 and the impact of these on the calculation of adjusted earnings is described in note 7 on page 107.

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 accounts 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 ventures.

1 Accounting policies continued

A subsidiary is an entity controlled by the Group, where control is the power to govern the financial and operating policies of the entity so as to obtain benefit from its activities.

Associates and joint ventures comprise investments in undertakings, which are not subsidiary undertakings, where the Group's interest in the equity capital is long term and over whose operating and financial policies the Group exercises a significant influence and, in the case of joint ventures, has joint control. They are accounted for using the equity method.

The results of Group 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.

The results of Group undertakings 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.

Where accumulated losses applicable to a minority exceed the minority's interest in the equity of a subsidiary, the excess is allocated to the Group's interest in the subsidiary, except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

Inter-company balances and transactions, and any unrealised gains arising from inter-company transactions, are eliminated in preparing the consolidated Financial Statements.

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 less accumulated impairment losses and 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 IFRS1, 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 or associate to which it relates.

Goodwill in respect of subsidiaries is included in intangible assets. In respect of associates, goodwill is included in the carrying value of the investment in the associated company. On disposal of a subsidiary or associate, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Foreign currencies

The Income and Cash Flow Statements of Group undertakings expressed in currencies other than sterling are translated to sterling at average rates of exchange in each year provided that the average rate approximates the exchange rate at the date of the underlying transactions. Assets and liabilities of these undertakings are translated at rates of exchange at the end of each year. For high inflation countries, the translation from local currencies to sterling makes allowance for the impact of inflation on the local currency results.

The differences between retained profits of overseas subsidiary and associated undertakings 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 IFRS1, any differences prior to that date are not included in this separate component of equity. On the disposal of an overseas undertaking, the cumulative amount of the related exchange differences deferred in the separate

component of equity are recognised in the income statement when the gain or loss on disposal is recognised.

Foreign currency transactions are initially recorded at 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, qualifying net investment hedges and on inter-company quasi-equity loans. Foreign exchange gains or losses recognised in the Income Statement are included in profit from operations or net finance costs depending on the underlying transactions that gave rise to these exchange differences.

Revenue

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

Retirement benefit costs

The Group operates both defined benefit and defined contribution schemes. The net deficit or surplus for each defined benefit pension scheme is calculated in accordance with IAS19, based on the present value of the defined benefit obligation at the balance sheet date less the fair value of the scheme assets.

As permitted under IFRS1, all actuarial gains and losses as at 1 January 2004, the date of transition to IFRS, were recognised. In respect of actuarial gains and losses that arise subsequent to that date, to the extent that cumulatively they exceed 10 per cent of the greater of the present value of the defined benefit obligation and the fair value of the scheme assets, that portion is recognised in the income statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the accumulated actuarial gains and losses are not recognised, except where there are unrecognised scheme surpluses. In such instances, the actuarial gains and losses are recognised as they occur.

Where the actuarial valuation of the scheme demonstrates that the scheme is in surplus, the recognised asset is limited to that for which the Group expects to benefit in future, by refunds or a reduction in contributions.

Past service costs resulting from enhanced benefits are expensed over the period to vesting and if they vest immediately, then they are recognised at that time in the Income Statement.

The Group also has certain post-retirement healthcare schemes and they are accounted for on a similar basis to the defined benefit pension schemes.

For defined benefit schemes, the actuarial cost charged to profit from operations consists of current service cost, interest cost, expected return on plan assets, past service cost and the impact of any settlements or curtailments, as well as actuarial gains or losses to the extent they are recognised, and changes in unrecognised scheme surpluses.

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.

1 Accounting policies continued

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 IAS38 Intangible Assets.

Taxation

Taxation is that chargeable on the profits for the period, together with deferred taxation.

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 IAS12, 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 directly in equity, in which case it is recognised in equity.

Intangible assets other than goodwill

These intangible assets shown on the Group Balance Sheet consist mainly of computer software which is carried at cost less accumulated amortisation and impairment, and is amortised on a straight-line basis over a period ranging from three to five years.

The investments in associates shown in the Group Balance Sheet include brand names arising from the combination of Brown & Williamson (B&W) and R.J. Reynolds (RJR) in 2004 to form Reynolds American Inc. (RAI), as well as those arising on the acquisition of Conwood by RAI in 2006. As the combination of B&W and RJR for the Group involved the partial disposal of B&W and an investment in RAI, fair values were assigned to brands formerly owned by RJR but not to those formerly owned by B&W. Most of the carrying value of the brands relates to brands which are deemed to have indefinite lives and each brand is subject to an annual impairment test. Certain minor brands are being amortised over their remaining lives consistent with the pattern of economic benefits expected to be received. Any impairments of brands are recognised in the Income Statement but increases in brand values are not recognised.

Property, plant and equipment

Property, plant and equipment is 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. Freehold and long leasehold property are depreciated at rates between 2.5 per cent and 4 per cent per annum, and plant and equipment at rates between 7 per cent and 25 per cent per annum. In accordance with the benchmark treatment under IAS23, borrowing costs associated with expenditure on property, plant and equipment are not capitalised.

Leased assets

Assets held under finance leases are included as part of property, plant and equipment. Finance lease assets are initially recognised at an amount equal to the lower of their fair value and the present value of the minimum lease payments at inception of the lease, then depreciated over the shorter of the lease term and their estimated useful lives. Leasing payments consist of capital and finance charge elements and the finance element is charged to the Income Statement.

Rental payments under operating leases are charged to the Income Statement on a straight-line basis over the lease term.

Where arrangements are entered into which, while they are not in the legal form of a lease, are in substance a lease under IFRIC Interpretation 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 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 or if they are derivative financial instruments not designated as hedges in accordance with IAS39. If not, they are classified as non-current.

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. 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 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 equity. When such investments are derecognised (e.g. through disposal) or become impaired, the accumulated gains and losses, previously recognised in equity, are recognised in 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.

1 Accounting policies continued

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 equity, 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 equity, 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 recognised in the Income Statement;
- For derivatives that are designated as fair value hedges, the carrying value of the hedged item is adjusted for the fair value changes attributable to the risk being hedged, with the corresponding entry being made in the Income Statement. The changes in fair value of these derivatives are also recognised in the Income Statement;
- For derivatives that are designated as hedges of net investments in foreign operations, the changes in their fair values are recognised directly in equity, 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 recognised in 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 removed from equity 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 equity, are immediately recognised in 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

A segment is a distinguishable component of the Group that is engaged in providing products or services within a particular economic environment, and the Group's geographical segments form the focus of the Group's internal reporting systems. The Group is a single product business providing cigarettes and other tobacco products. While the Group has clearly differentiated brands, global segmentation between a wide portfolio of brands is not part of the regular internally reported financial information. It is not feasible to segment global results by brand without a high degree of estimation, especially given that geographically the same operations are used to produce the different brands, and brand results are managed in the context of the geographic markets in which they are sold.

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.

Exceptional items

Exceptional items are items in the profit from operations and the Group share of the post-tax results of associates which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's financial performance. These items are separately disclosed as memorandum information on the face of the Income Statement and in the segmental analyses.

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

Subsidiaries and associate companies are defendants in tobacco-related litigation. Provision for this litigation would be made at such time as an unfavourable outcome became probable and the amount could be reasonably estimated.

The Group records its external legal fees and other external defence costs for tobacco-related litigation as these costs fall due.

Repurchase of share capital

When share capital is repurchased the amount of consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares which are not cancelled, or shares purchased for the employee share ownership trusts, are classified as treasury shares and presented as a deduction from total equity.

Future changes to accounting policies

Certain changes to IFRS will be applicable for the Group accounts in future years and set out below are those which are considered to affect the Group.

- IFRIC14 (IAS19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction) will be effective from 1 January 2008, once it has been endorsed by the EU. The interpretation clarifies the conditions under which a surplus in a post-retirement benefit scheme can be recognised in the financial statements, as well as setting out the accounting implications where minimum funding requirements exist. It is not expected that this change would materially alter the Group's reported profit and equity for 1 January 2007 or 31 December 2007.

There are other changes which are effective from 1 January 2009 but can be adopted before 2009.

- IFRS8 (Operating Segments) has been endorsed by the EU. This standard requires segmental reporting in the financial statements to be on the same basis as is used for internal management reporting. This will not require any change to the segments currently reported by the Group but there will be some additional disclosures.
- The revised IAS1 (Presentation of Financial Statements) is awaiting EU endorsement. This standard will require some changes in the format of the financial statements and permit some changes in terminology, but it will not affect the measurement of reported profit or equity.
- The revised IAS23 (Borrowing costs) is also awaiting endorsement by the EU. This standard requires borrowings directly attributable to the acquisition, construction or production of an asset that takes a substantial period of time to get ready for its intended use or sale, to be capitalised as part of the cost of the asset. The Group's current policy is to expense such borrowing costs as they are incurred. It is not expected that this change would materially affect the Group's reported profit or equity.

In addition, the revised IFRS3 (Business Combinations) and IAS27 (Consolidated and Separate Financial Statements) have been issued and change the accounting for business combinations and transactions with minorities. While these revised standards are applicable for periods beginning on or after 1 July 2009, with early adoption permitted from on or after 30 June 2007, these are only to be applied prospectively and so there is no restatement of transactions prior to the effective date. Moreover, these standards have not yet been endorsed by the EU and will only be applicable once that endorsement has occurred.

2 Segmental analyses

Segmental analyses of revenue, profit, assets and liabilities for the year ended 31 December:

	Europe		Asia-Pacific	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Revenue				
External sales	**3,621**	3,495	**1,874**	1,755
Inter-segment sales	**225**	526	**22**	27
Revenue	**3,846**	4,021	**1,896**	1,782
Results				
Segment result before restructuring costs and net gains/(losses) on disposal of businesses and brands	**842**	781	**672**	616
Restructuring costs	**(116)**	(132)	**(5)**	(7)
Net gains/(losses) on disposal of businesses and brands	**56**	27		
Segmental result	**782**	676	**667**	609
Unallocated costs				
Profit from operations				
Net finance costs				
Share of post-tax results of associates and joint ventures				
Profit on ordinary activities before taxation				
Taxation on ordinary activities				
Profit for the year				
Attributable to:				
Shareholders' equity				
Minority interests				

Unallocated costs represent net corporate costs not directly attributable to individual segments.

	Europe 2007 £m	Europe 2006 £m	Asia-Pacific 2007 £m	Asia-Pacific 2006 £m
Other segment items				
Capital expenditure	**245**	232	**70**	59
Depreciation and amortisation	**138**	126	**45**	48
Impairment, accelerated depreciation and amounts written off	**4**	49	**3**	
Assets				
Segment assets before goodwill	**2,586**	2,653	**1,047**	1,056
Goodwill	**3,508**	3,295	**1,329**	1,244
Segment assets including goodwill *page 100*	**6,094**	5,948	**2,376**	2,300
Investments in associates and joint ventures	**203**	203	**508**	394
Assets classified as held for sale	**5**		**27**	
Unallocated assets				
Total assets *page 88*				
Liabilities				
Segment liabilities *page 100*	**1,846**	1,797	**526**	532
Liabilities directly associated with assets classified as held for sale			**2**	
Unallocated liabilities				
Total liabilities *page 89*				

The restructuring costs and net gains/(losses) on disposal of businesses and brands are explained on page 103 in note 3. The 2006 analysis of revenue above has been restated to reflect changes in manufacturing operations.

Latin America		Africa and Middle East		America-Pacific		Elimination		Consolidated	
2007	2006 restated	**2007**	2006	**2007**	2006 restated	**2007**	2006	**2007**	2006
£m	£m	**£m**	£m	**£m**	£m	**£m**	£m	**£m**	£m
1,979	1,780	**1,224**	1,063	**473**	760			**9,171**	8,853
585	332	**15**	24					**847**	909
2,564	2,112	**1,239**	1,087	**473**	760			**10,018**	9,762
680	611	**470**	468	**446**	424			**3,110**	2,900
		(42)	(24)	**(10)**	(53)			**(173)**	(216)
		19			14			**75**	41
680	611	**447**	444	**436**	385			**3,012**	2,725
								(107)	(103)
								2,905	2,622
								(269)	(289)
								442	431
								3,078	2,764
								(791)	(716)
								2,287	2,048
								2,130	1,896
								157	152
110	102	**72**	69	**32**	51			**529**	513
63	64	**37**	39	**31**	35			**314**	312
		11	3	**4**	37			**22**	89
1,305	1,191	**897**	1,004	**459**	560	**(412)**	(439)	**5,882**	6,025
188	186	**815**	803	**2,102**	1,822			**7,942**	7,350
1,493	1,377	**1,712**	1,807	**2,561**	2,382	**(412)**	(439)	**13,824**	13,375
3	2	**11**	10	**1,544**	1,499			**2,269**	2,108
1		**1**		**2**				**36**	
								2,599	2,293
								18,728	17,776
678	564	**584**	546	**568**	580	**(657)**	(625)	**3,545**	3,394
								2	
								8,083	7,694
								11,630	11,088

Segment assets and segment liabilities include inter-company balances with entities reported as corporate liabilities and corporate assets on page 100.

2 Segmental analyses continued

(a) Segment revenue

The segmental analysis of revenue is based on location of manufacture. Figures based on external sales by subsidiaries in each segment are as follows:

	2007 £m	2006 £m
Europe	**3,655**	3,545
Asia-Pacific	**1,876**	1,839
Latin America	**1,983**	1,791
Africa and Middle East	**1,445**	1,489
America-Pacific	**1,059**	1,098
Segment revenue *pages 98 and 99*	**10,018**	9,762

(b) Segment assets

	2007 £m	2006 £m
Total assets *page 88*	**18,728**	17,776
Less		
– investments in associates and joint ventures	**2,269**	2,108
– available-for-sale investments *note 15*	**97**	152
– deferred tax assets	**262**	273
– interest receivable *note 14*	**11**	1
– income tax receivable	**85**	59
– dividends receivable from associates *note 14*	**53**	48
– derivatives in respect of net debt *note 16*	**188**	125
– loans	**77**	85
– interest bearing cash and cash equivalents	**1,063**	972
– assets classified as held for sale	**36**	
– corporate assets	**763**	578
Segment assets *pages 98 and 99*	**13,824**	13,375

(c) Segment liabilities

	2007 £m	2006 £m
Total current and non-current liabilities *page 89*	**11,630**	11,088
Less		
– borrowings *note 21*	**6,923**	6,626
– deferred tax liabilities	**294**	296
– derivatives in respect of net debt *note 16*	**179**	79
– dividends payable	**5**	4
– income tax payable	**227**	292
– interest payable *note 23*	**4**	12
– liabilities directly associated with assets classified as held for sale	**2**	
– corporate liabilities	**451**	385
Segment liabilities *pages 98 and 99*	**3,545**	3,394

2 Segmental analyses continued

(d) Segmental analysis of the Group's share of the revenue and post-tax results of associates and joint ventures

External revenue

	2007 £m	2006 £m
Europe	**763**	771
Asia-Pacific	**547**	456
Latin America	**1**	1
Africa and Middle East	**9**	20
America-Pacific	**1,888**	1,942
	3,208	3,190

Post-tax results

	Segment result		Adjusted segment result*	
	2007 £m	2006 £m	2007 £m	2006 £m
Europe	**48**	46	**48**	46
Asia-Pacific	**110**	92	**110**	92
Latin America	**1**		**1**	
Africa and Middle East	**1**	4	**1**	4
America-Pacific	**282**	289	**289**	285
	442	431	**449**	427

*Excluding brand impairments and exceptional tax credits (page 105 note 5).

3 Profit from operations

(a) Employee benefit costs

	2007 £m	2006 £m
Wages and salaries	**1,301**	1,233
Social security costs	**164**	159
Other pension and retirement benefit costs *page 113 note 12*	**60**	112
Share-based payments *page 146 note 27*	**61**	50
	1,586	1,554

(b) Depreciation and amortisation costs

	2007 £m	2006 £m
Intangibles including goodwill – amortisation	**37**	34
– amounts written off	**6**	
Property, plant and equipment – depreciation	**277**	278
– impairment and accelerated depreciation	**16**	89
	336	401

Impairment and accelerated depreciation in respect of property, plant and equipment arose in relation to the restructuring costs (see note (e) below) and, for 2006, in respect of the impairment of a business (see note (f) below). Goodwill arising on the acquisition of minority interests in Africa and Middle East in 2007 has been expensed as part of restructuring costs of that region.

3 Profit from operations continued

(c) Other operating income

This represents income arising from the Group's activities which falls outside the definition of revenue and includes gains on the disposal of businesses and brands, property disposals, service fees and other shared costs charged to third parties, manufacturing fees and trademark income.

(d) Other operating expenses include:

	2007 £m	2006 £m
Research and development expenses (excluding employee benefit costs and depreciation)	**43**	36
Exchange differences	**(18)**	7
Rent of plant and equipment (operating leases)		
– minimum lease payments	**25**	25
– contingent rents	**2**	1
Rent of property (operating leases)		
– minimum lease payments	**64**	61
– sublease payments	**2**	2
Fees payable for audit services pursuant to legislation:		
– fees payable to PricewaterhouseCoopers LLP for parent company and Group audit	**1.5**	1.3
– fees payable to other PricewaterhouseCoopers firms and associates for local statutory and Group reporting audits	**6.7**	6.1
Audit fees payable to PricewaterhouseCoopers firms and associates	**8.2**	7.4
Audit fees payable to other firms	**0.5**	0.6
Total audit fees payable	**8.7**	8.0
Fees payable to PricewaterhouseCoopers firms and associates for other services:		
– other services pursuant to statutory legislation	**0.3**	0.2
– tax advisory services	**3.7**	4.3
– tax compliance	**0.5**	0.4
– services relating to information technology	**0.3**	0.1
– other non-audit services	**0.8**	0.3
	5.6	5.3

The total fees payable to PricewaterhouseCoopers firms and associates included above are £13.8 million (2006: £12.7 million).

Total research and development costs including employee benefit costs and depreciation were £91 million (2006: £76 million).

3 Profit from operations continued

(e) Restructuring costs

These were the costs incurred as a result of a review of the Group's manufacturing operations and organisational structure, including the initiative to reduce overheads and indirect costs, and are included in the profit from operations under the following headings:

	2007 £m	2006 £m
Employee benefit costs	**84**	100
Depreciation and amortisation costs	**22**	74
Other operating expenses	**73**	62
Other operating income	**(6)**	(20)
	173	216

Restructuring costs in 2007 principally relate to costs associated with restructuring the operations in Italy and with the reorganisation of the business across the Europe and Africa and Middle East regions, as well as further costs related to restructurings announced in prior years. The restructuring costs in 2006 principally relate to manufacturing rationalisation in the Netherlands, with further costs for the earlier restructurings in the UK and in Canada.

Other operating income relates to gains on property disposals arising from the restructuring exercises.

(f) Net gains/(losses) on disposal of businesses and brands

On 10 March 2006, the Group's Italian subsidiary signed an agreement to sell its cigar business, Toscano, to Maccaferri for €95 million. The sale was subject to regulatory and governmental approval and was completed on 19 July 2006. The sale resulted in the recognition of a loss of £19 million, reflecting an impairment charge of £15 million included in depreciation and amortisation costs in the profit from operations and £4 million of other costs included in other operating expenses in the profit from operations.

On 29 November 2006, the Group completed a trademark transfer agreement with Philip Morris International. Under this arrangement the Group sold its Muratti Ambassador brand in certain markets, as well as the L&M and Chesterfield trademarks in Hong Kong and Macao, while acquiring the Benson & Hedges trademark in certain African countries. These transactions resulted in a gain of £60 million included in other operating income in the profit from operations.

On 20 February 2007, the Group announced that it had agreed to sell its pipe tobacco trademarks to the Danish company, Orlik Tobacco Company A/S, for €24 million. The sale was completed during the second quarter and resulted in a gain of £11 million included in other operating income in the profit from operations. However, the Group has retained the Dunhill and Captain Black pipe tobacco brands.

On 23 May 2007, the Group announced that it had agreed to sell its Belgian cigar factory and associated brands to the cigars division of Skandinavisk Tobakskompagni AS. The sale includes a factory in Leuven as well as trademarks including Corps Diplomatique, Schimmelpennick, Don Pablo and Mercator. The transaction was completed on 3 September 2007 and a gain on disposal of £45 million is included in other operating income in the profit from operations.

On 1 October 2007, the Group agreed the termination of its license agreement with Philip Morris for the rights to the Chesterfield trademark in a number of countries in Southern Africa. This transaction resulted in a gain of £19 million included in other operating income in the profit from operations.

4 Net finance costs

	2007		2006	
	£m	£m	£m	£m
Finance costs				
– interest payable		**382**		410
– fair value changes		**143**		(212)
– exchange differences		**(120)**		197
– loss on net monetary position				4
		405		399
Finance income				
– interest and dividend income		**(111)**		(122)
– exchange differences		**(25)**		12
		(136)		(110)
Net finance costs		**269**		289
Net finance costs comprise:				
Interest payable				
– bank borrowings	**67**		94	
– finance leases	**3**		3	
– other	**312**		313	
		382		410
Interest receivable	**(109)**		(120)	
Dividend income	**(2)**		(2)	
		(111)		(122)
Fair value changes				
– cash flow hedges transferred from equity	**(26)**		4	
– fair value changes on hedged items	**(6)**		(113)	
– fair value hedges	**(14)**		39	
– ineffective portion of fair value hedges	**8**		2	
– instruments not designated as hedges	**181**		(144)	
	143		(212)	
Exchange differences	**(145)**		209	
Loss on net monetary position			4	
		(2)		1
		269		289

Other interest payable includes interest on the bonds and notes detailed in note 21.

Included within the interest receivable above is £3 million (2006: £6 million) in respect of available-for-sale investments. Included within dividend income above is £1 million (2006: £2 million) in respect of available-for-sale investments.

Included within exchange differences above is a loss of £35 million (2006: £71 million loss) in respect of items subject to fair value hedges.

5 Associates and joint ventures

	2007		2006	
	Total £m	**Group's share £m**	Total £m	Group's share £m
Gross turnover (including duty, excise and other taxes)	**12,089**	**4,436**	11,831	4,384
Duty, excise and other taxes	**(3,503)**	**(1,228)**	(3,349)	(1,194)
Revenue	**8,586**	**3,208**	8,482	3,190
Profit from operations	**1,926**	**735**	1,765	677
Net finance costs	**(99)**	**(42)**	(61)	(26)
Profit on ordinary activities before taxation	**1,827**	**693**	1,704	651
Taxation on ordinary activities	**(646)**	**(246)**	(564)	(216)
Profit on ordinary activities after taxation	**1,181**	**447**	1,140	435
after (charging)/crediting				
– brand impairments	**(16)**	**(7)**	(30)	(13)
– exceptional tax credits			40	17
Attributable to British American Tobacco's shareholders *page 86*		**442**		431
Minority interests		**5**		4
Dividends				
– listed investments		**(245)**		(222)
– unlisted investments		**(45)**		(45)
		(290)		(267)

The share of post-tax results of associates and joint ventures is after brand impairments and exceptional tax credits.

In the year ended 31 December 2007, Reynolds American modified the previously anticipated level of support between certain brands and the projected net sales of certain brands, resulting in a brand impairment charge of which the Group's share amounted to £7 million (net of tax) (2006: £13 million).

In the year ended 31 December 2006, Reynolds American also benefited from the favourable resolution of tax matters of which the Group's share was £17 million.

6 Taxation on ordinary activities

(a) Summary of tax on ordinary activities

	2007 £m	2006 £m
UK corporation tax		14
comprising		
– current year tax expense	977	768
– double taxation relief	(977)	(754)
Overseas tax	765	681
comprising		
– current year tax expense	816	743
– adjustments in respect of prior periods	(51)	(62)
Total current tax	765	695
Deferred tax	26	21
comprising		
– deferred tax relating to origination and reversal of temporary differences	38	16
– deferred tax relating to a previously unrecognised tax loss		(14)
– deferred tax relating to changes in tax rates	(12)	19
	791	716

(b) Factors affecting the tax charge

The taxation charge differs from the standard 30 per cent rate of corporation tax in the UK. The major causes of this difference are listed below:

	2007		2006	
	£m	%	£m	%
Profit before tax	3,078		2,764	
Less: share of associates post-tax profit	(442)		(431)	
	2,636		2,333	
Tax at 30% (2006: 30%) on the above	791	30.0	700	30.0
Factors affecting the tax rate:				
Tax at standard rates other than UK corporation tax rate	(72)	(2.7)	(56)	(2.4)
National tax rate relief	18	0.7	(15)	(0.6)
State and local taxes	52	2.0	50	2.1
Permanent differences	(51)	(1.9)	9	0.5
Overseas withholding taxes	63	2.4	50	2.1
Double taxation relief on UK profits	(8)	(0.3)	(13)	(0.6)
Unutilised tax losses	28	1.0	13	0.6
Adjustments in respect of previous periods	(51)	(1.9)	(62)	(2.7)
Deferred tax charges at other tax rates	33	1.2	21	0.9
Deferred tax attributable to a (decrease)/increase in the rate of domestic income tax	(12)	(0.5)	19	0.8
	791	30.0	716	30.7

6 Taxation on ordinary activities continued

(c) Tax on items recognised directly in equity

	2007 £m	2006 £m
Current tax	**25**	14
Deferred tax	**(6)**	(2)
Charged to equity	**19**	12

7 Earnings per share

Basic earnings per share are based on equity earnings of £2,130 million (2006: £1,896 million) and 2,025 million (2006: 2,059 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 2,039 million (2006: 2,076 million) to reflect the potential dilutive effect of employee share schemes.

	2007			2006		
	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	**2,130**	**2,025**	**105.19**	1,896	2,059	92.08
Share options		**14**	**(0.73)**		17	(0.75)
Diluted earnings per share	**2,130**	**2,039**	**104.46**	1,896	2,076	91.33

Earnings have been affected by a number of exceptional items. To illustrate the impact of these, an alternative earnings per share is shown below:

Alternative earnings per share calculation

	Diluted				Basic			
	2007		2006		**2007**		2006	
	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	**2,130**	**104.46**	1,896	91.33	**2,130**	**105.19**	1,896	92.08
Restructuring costs per Income Statement	**173**	**8.49**	216	10.40	**173**	**8.54**	216	10.49
Tax and minority interests on restructuring costs	**(41)**	**(2.01)**	(48)	(2.31)	**(41)**	**(2.02)**	(48)	(2.33)
Net (gains)/losses on disposal of businesses and brands per Income Statement	**(75)**	**(3.68)**	(41)	(1.98)	**(75)**	**(3.70)**	(41)	(1.99)
Tax on net (gains)/losses on disposal of businesses and brands	**19**	**0.93**	18	0.87	**19**	**0.94**	18	0.87
Associates: brand impairments and exceptional tax credits per Income Statement	**7**	**0.34**	(4)	(0.19)	**7**	**0.34**	(4)	(0.19)
Adjusted earnings per share	**2,213**	**108.53**	2,037	98.12	**2,213**	**109.29**	2,037	98.93

8 Dividends and other appropriations

	2007		2006	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim				
2007 paid 12 September 2007	**18.60**	**377**		
2006 paid 13 September 2006			15.70	323
Final				
2006 paid 3 May 2007	**40.20**	**821**		
2005 paid 4 May 2006			33.00	685
	58.80	**1,198**	48.70	1,008

The Directors have recommended to shareholders a final dividend of 47.60 pence per share for the year ended 31 December 2007. If approved, this dividend will be paid to shareholders on 7 May 2008. This dividend is subject to approval by shareholders at the Annual General Meeting and therefore, in accordance with IAS10, it has not been included as a liability in these Financial Statements. The total estimated dividend to be paid is £954 million which takes the total dividends declared in respect of 2007 to £1,331 million (2006: £1,144 million) representing 66.20 pence per share (2006: 55.90 pence per share).

As described on page 172 in note 4, while the 2006 interim dividend did not comply with the technical requirements of the Companies Act 1985, the payment has been presented as a dividend payment above.

9 Intangible assets

	Goodwill £m	Computer software £m	Trademarks, brands and licences £m	Assets in the course of development £m	Total £m
1 January 2007					
Cost	**7,350**	**258**	**23**	**39**	**7,670**
Accumulated amortisation		**(180)**	**(14)**		**(194)**
Net book value at 1 January 2007	**7,350**	**78**	**9**	**39**	**7,476**
Differences on exchange	**612**	**6**		**1**	**619**
Additions					
– internal development		**2**		**26**	**28**
– acquisitions of subsidiaries and minority interests	**7**				**7**
– separately acquired		**21**	**3**	**17**	**41**
Reallocations		**35**		**(35)**	
Amortisation charge		**(38)**	**(1)**		**(39)**
Amounts written off	**(6)**				**(6)**
Disposals	**(21)**				**(21)**
31 December 2007					
Cost	**7,942**	**305**	**29**	**48**	**8,324**
Accumulated amortisation		**(201)**	**(18)**		**(219)**
Net book value at 31 December 2007	**7,942**	**104**	**11**	**48**	**8,105**

9 Intangible assets continued

	Goodwill £m	Computer software £m	Trademarks, brands and licences £m	Assets in the course of development £m	Total £m
1 January 2006					
Cost	7,887	228	16	31	8,162
Accumulated amortisation		(162)	(13)		(175)
Net book value at 1 January 2006	7,887	66	3	31	7,987
Differences on exchange	(617)	(4)		(1)	(622)
Additions					
– internal development		9		12	21
– acquisitions of subsidiaries and minority interests	80		5		85
– separately acquired		23	2	14	39
Reallocations		17		(17)	
Amortisation charge		(33)	(1)		(34)
31 December 2006					
Cost	7,350	258	23	39	7,670
Accumulated amortisation		(180)	(14)		(194)
Net book value at 31 December 2006	7,350	78	9	39	7,476

Included in computer software and assets in the course of development above are internally developed assets with a carrying value of £104 million (2006: £80 million). The costs of internally developed assets include capitalised expenses of third party consultants as well as software licence fees from third party suppliers.

From August 2006, the Group purchased minority interests in its subsidiary in Chile for a cost of £91 million, raising the Group shareholding from 70.4 per cent to 96.6 per cent. The goodwill arising on this transaction was £80 million and the minority interests in Group equity were reduced by £11 million. In addition, a number of smaller acquisitions of minority interests were made during 2007 in Africa and Middle East, Europe, and Asia-Pacific.

Impairment testing for intangible assets with indefinite lives including goodwill

Goodwill of £7,942 million (2006: £7,350 million) included in intangible assets in the balance sheet is mainly the result of the following acquisitions: Rothmans Group £4,067 million (2006: £3,889 million); Imperial Tobacco Canada £2,046 million (2006: £1,768 million); and ETI (Italy) £1,212 million (2006: £1,113 million). The principal allocations of goodwill in the Rothmans' acquisition are to the cash-generating units of Continental Europe and South Africa, with the remainder mainly relating to operations in the domestic and export market in the United Kingdom and operations in Asia-Pacific.

Goodwill has been allocated for impairment testing purposes to 13 (2006: 13) individual cash-generating units – four in Europe, one in Africa and Middle East, three in Asia-Pacific, three in Latin America and two in America-Pacific. The carrying amounts of goodwill allocated to the cash-generating units of South Africa (£814 million, 2006: £803 million), Continental Europe (£1,112 million, 2006: £1,020 million), Canada (£2,046 million, 2006: £1,768 million) and Italy (£1,218 million, 2006: £1,119 million) are considered significant in comparison with the total carrying amount of goodwill.

9 Intangible assets continued

The recoverable amount of all cash-generating units has been determined on a value-in-use basis. The key assumptions for the recoverable amount of all units are the long term growth rate and the discount rate. The long term growth rate is a nominal rate used purely for the impairment testing of goodwill under IAS36 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 weighted average cost of capital, taking into account the cost of capital and borrowings, to which specific market-related premium adjustments are made. These assumptions have been applied to the individual cash flows of each unit as compiled by local management in the different markets.

The valuation uses cash flow projections based on detailed financial budgets approved by management covering a two year period, with cash flow beyond two years extrapolated by a nominal growth rate of 3 per cent per annum for the years 3 to 10, whereafter a zero per cent growth rate has been assumed. This long term growth rate used does not exceed the expected long term average growth rate for the markets in which the cash-generating units operate. In some instances, such as recent acquisitions or start-up ventures, the valuation is expanded to reflect the medium term plan of management, spanning five years or beyond, with the cash flow beyond these years to year 10, extrapolated by the growth rate of 3 per cent, as above.

Pre-tax discount rates of between 7.9 per cent and 18.7 per cent (2006: 8.1 per cent to 17.9 per cent) were used, based on the Group's weighted average cost of capital, together with any premium applicable for country/area inflation and economical 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 12.1 per cent for South Africa (2006: 12.1 per cent), 9.3 per cent for Continental Europe (2006: 9.8 per cent), 10.0 per cent for Canada (2006: 10.0 per cent) and 10.7 per cent for Italy (2006: 10.7 per cent).

Aside from the amounts written off and shown as part of restructuring costs (see page 101 note 3(b)), no impairment charges were recognised in 2007 (2006: £nil). If discounted cash flows per cash-generating unit should fall by 10 per cent, or the discount rate was increased at an after-tax rate of 1 per cent, 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 2007					
Cost	**833**	**202**	**3,348**	**222**	**4,605**
Accumulated depreciation and impairment	**(317)**	**(64)**	**(2,017)**		**(2,398)**
Net book value at 1 January 2007	**516**	**138**	**1,331**	**222**	**2,207**
Differences on exchange	**33**	**7**	**78**	**17**	**135**
Additions	**15**	**3**	**197**	**245**	**460**
Reallocations	**19**	**7**	**219**	**(245)**	
Depreciation	**(16)**	**(13)**	**(269)**		**(298)**
Impairment			**(12)**		**(12)**
Disposals	**(21)**		**(28)**		**(49)**
Disposal of subsidiaries	**(23)**		**(12)**		**(35)**
Reclassification as held for sale	**(11)**	**(1)**	**(18)**		**(30)**
31 December 2007					
Cost	**810**	**212**	**3,573**	**239**	**4,834**
Accumulated depreciation and impairment	**(298)**	**(71)**	**(2,087)**		**(2,456)**
Net book value at 31 December 2007	**512**	**141**	**1,486**	**239**	**2,378**

10 Property, plant and equipment continued

	Freehold property £m	Leasehold property £m	Plant and equipment £m	Assets in the course of construction £m	Total £m
1 January 2006					
Cost	909	212	3,602	194	4,917
Accumulated depreciation and impairment	(321)	(59)	(2,206)		(2,586)
Net book value at 1 January 2006	588	153	1,396	194	2,331
Differences on exchange	(35)	(8)	(100)	(15)	(158)
Additions	15	2	181	255	453
Reallocations	19		193	(212)	
Depreciation	(22)	(9)	(274)		(305)
Impairment	(8)		(40)		(48)
Disposals	(16)		(24)		(40)
Disposal of subsidiaries	(25)		(1)		(26)
31 December 2006					
Cost	833	202	3,348	222	4,605
Accumulated depreciation and impairment	(317)	(64)	(2,017)		(2,398)
Net book value at 31 December 2006	516	138	1,331	222	2,207
Assets held under finance leases					
31 December 2007					
Cost		**3**	**106**		**109**
Accumulated depreciation and impairment		**(1)**	**(47)**		**(48)**
Net book value at 31 December 2007		**2**	**59**		**61**
31 December 2006					
Cost		3	94		97
Accumulated depreciation and impairment		(1)	(37)		(38)
Net book value at 31 December 2006		2	57		59

Assets held under finance leases are secured under finance lease obligations on page 137 in note 21.

	2007 £m	2006 £m
Cost of freehold land within freehold property on which no depreciation is provided	**63**	70
Leasehold property comprises		
– net book value of long leasehold	**98**	95
– net book value of short leasehold	**43**	43
	141	138
Contracts placed for future expenditure	**34**	31

Bank borrowings are secured by property, plant and equipment to the value of £8 million (2006: £15 million).

11 Investments in associates and joint ventures

	2007 £m	2006 £m
1 January	**2,108**	2,193
Differences on exchange	**38**	(254)
Share of profit after taxation *page 105 note 5*	**442**	431
Dividends *page 105 note 5*	**(290)**	(267)
Acquisitions		1
Other equity movements	**(29)**	4
31 December	**2,269**	2,108
Non-current assets	**3,551**	3,386
Current assets	**1,733**	1,603
Non-current liabilities	**(1,697)**	(1,635)
Current liabilities	**(1,318)**	(1,246)
	2,269	2,108
Reynolds American Inc. (market value £4,121 million (2006: £4,145 million))	**1,544**	1,499
Other listed associates (market value £3,245 million (2006: £2,473 million))	**502**	394
Unlisted	**223**	215
	2,269	2,108

On 25 April 2006, Reynolds American Inc. announced an agreement to acquire Conwood, the second largest manufacturer of smokeless tobacco products in the US, for US$3.5 billion, and the acquisition was completed on 31 May 2006. The acquisition was funded principally with debt, and the fair value of the assets acquired and liabilities assumed were US$4.1 billion and US$0.6 billion respectively. Included in the assets were US$2.5 billion in respect of goodwill and US$1.4 billion in respect of brands.

The Group's share of non-current assets above includes £529 million (2006: £540 million) of goodwill and £290 million (2006: £300 million) of brands arising from the Conwood acquisition. In addition, the non-current assets above include £1,187 million (2006: £1,207 million) of goodwill and £463 million (2006: £479 million) of brands arising from the Reynolds American transaction in 2004.

Details of the Group's contingent liabilities are set out on page 153 in note 30. In addition to US litigation involving Group companies, which is covered by the R.J. Reynolds Tobacco Company (RJRT) indemnity referred to in note 30, Reynolds American Inc. (RAI) group companies are named in litigation which does not involve Group companies. While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, it is not impossible that the results of operations or cash flows of RAI, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. However, having regard to the contingent liability disclosures on litigation made by RAI in its public financial reports, the Directors are satisfied with the carrying value included above for RAI.

The Group's share of the RAI results for the year to 31 December 2007 includes £18 million (2006: £24 million) in respect of external legal fees and other external product liability defence costs.

12 Retirement benefit schemes

The Group's subsidiary undertakings operate around 160 retirement benefit arrangements worldwide. These arrangements have been developed in accordance with local practices in the countries concerned. The majority of scheme members belong to defined benefit schemes, most of which are funded externally, although the Group also operates a number of defined contribution schemes.

The liabilities arising in the defined benefit schemes are determined in accordance with the advice of independent, professionally qualified actuaries, using the projected unit credit method. All schemes are formally valued at least every three years.

The principal pension schemes are in the UK, Germany, Canada, the Netherlands and Switzerland. Together these schemes account for over 88 per cent of the total obligations of the Group's defined benefit schemes.

In addition, the Group operates significant schemes in Canada which provide employees with certain other retirement benefits such as healthcare. The liabilities in respect of these benefits are also assessed by qualified independent actuaries, applying the projected unit credit method.

The amounts recognised in the Balance Sheet are determined as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Present value of funded scheme liabilities	**(4,248)**	(4,189)	**(17)**	(10)	**(4,265)**	(4,199)
Fair value of funded scheme assets	**4,209**	3,938	**14**	12	**4,223**	3,950
	(39)	(251)	**(3)**	2	**(42)**	(249)
Unrecognised funded scheme surpluses	**(44)**	(61)			**(44)**	(61)
	(83)	(312)	**(3)**	2	**(86)**	(310)
Present value of unfunded scheme liabilities	**(111)**	(107)	**(121)**	(115)	**(232)**	(222)
Net unrecognised actuarial (gains)/losses	**(4)**	111	**14**	14	**10**	125
Unrecognised past service cost	**1**	1			**1**	1
	(197)	(307)	**(110)**	(99)	**(307)**	(406)
The above net liability is recognised in the Balance Sheet as follows						
– retirement benefit scheme liabilities	**(247)**	(335)	**(110)**	(100)	**(357)**	(435)
– retirement benefit scheme assets	**50**	28		1	**50**	29
	(197)	(307)	**(110)**	(99)	**(307)**	(406)

In Jamaica, the pension scheme holds shares in Carreras Group Ltd. with a fair value of £7 million (2006: £6 million). In Switzerland, a pension scheme owns a property with a fair value of £11 million (2006: £10 million), part of which is occupied by British American Tobacco Switzerland SA.

12 Retirement benefit schemes continued

The amounts recognised in the Income Statement are as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Defined benefit schemes						
– current service cost	**73**	90	**1**	3	**74**	93
– interest cost	**216**	207	**7**	7	**223**	214
– expected return on scheme assets	**(264)**	(237)	**(1)**	(1)	**(265)**	(238)
– net actuarial losses recognised	**13**	6			**13**	6
– past service cost	**9**	9			**9**	9
– settlements and curtailments	**1**	9			**1**	9
– surplus recognition movement	**(14)**	4			**(14)**	4
	34	88	**7**	9	**41**	97
Defined contribution schemes	**19**	15			**19**	15
	53	103	**7**	9	**60**	112

The above charges are recognised within employee benefit costs in 2007 and 2006 (page 101 note 3(a)) and include £13 million in 2006 in respect of pension schemes reported as part of the restructuring costs charged in arriving at profit from operations (page 103 note 3(e)).

The reduction in the amounts recognised in the Income Statement in 2007 is principally due to the change in the impact of costs related to the restructurings noted above and the effect on pension costs of restructurings in recent years, along with the recognition of previously restricted funded scheme surpluses and higher investment returns.

The movements in scheme liabilities are as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Present value at 1 January	**4,296**	4,494	**125**	136	**4,421**	4,630
Exchange differences	**230**	(162)	**15**	(18)	**245**	(180)
Current service cost	**75**	89	**1**	2	**76**	91
Interest cost	**225**	202	**7**	6	**232**	208
Past service costs – vested	**9**	8			**9**	8
Contributions by scheme members	**4**	4			**4**	4
Benefits paid	**(281)**	(253)	**(9)**	(7)	**(290)**	(260)
Settlements and curtailments	**(5)**	4			**(5)**	4
Disposals of subsidiaries	**(5)**	(1)			**(5)**	(1)
Scheme changes	**(1)**	(6)			**(1)**	(6)
Actuarial (gains)/losses	**(188)**	(83)	**(1)**	6	**(189)**	(77)
Present value at 31 December	**4,359**	4,296	**138**	125	**4,497**	4,421
Funded schemes	**4,248**	4,189	**17**	10	**4,265**	4,199
Unfunded schemes	**111**	107	**121**	115	**232**	222
	4,359	4,296	**138**	125	**4,497**	4,421

The actuarial gains in both years principally relate to increases in discount rates.

12 Retirement benefit schemes continued

The movements in funded scheme assets are as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Fair value of scheme assets at 1 January	**3,938**	3,824	**12**	12	**3,950**	3,836
Exchange differences	**224**	(152)	**(1)**	(3)	**223**	(155)
Expected return on scheme assets	**275**	231	**1**	1	**276**	232
Company contributions	**138**	144	**7**	5	**145**	149
Contributions by scheme members	**4**	4			**4**	4
Benefits paid	**(272)**	(246)	**(7)**	(5)	**(279)**	(251)
Disposals of subsidiaries	**(4)**				**(4)**	
Scheme changes	**2**	(6)			**2**	(6)
Actuarial (losses)/gains	**(96)**	139	**2**	2	**(94)**	141
Fair value of scheme assets at 31 December	**4,209**	3,938	**14**	12	**4,223**	3,950

Contributions to defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes, taking into account regulatory requirements. Contributions in 2008 are expected to be £124 million for pension schemes and £8 million for healthcare schemes, compared to £138 million and £7 million respectively in 2007.

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Actual return on scheme assets	**179**	370	**3**	3	**182**	373

The movements in the unrecognised funded scheme surpluses are as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Unrecognised funded scheme surpluses at 1 January	**(61)**	(70)			**(61)**	(70)
Exchange differences	**2**	13			**2**	13
Movement in year	**15**	(4)			**15**	(4)
Unrecognised funded scheme surpluses at 31 December	**(44)**	(61)			**(44)**	(61)

In 2007, a surplus apportionment scheme in South Africa was approved by the relevant regulatory authority, resulting in the recognition of a previously restricted surplus.

The movements in the net unrecognised actuarial (gains)/losses are as follows:

	Pension schemes		Healthcare schemes		Total	
	2007 £m	2006 £m	**2007 £m**	2006 £m	**2007 £m**	2006 £m
Net actuarial losses at 1 January	**111**	342	**14**	13	**125**	355
Exchange differences	**(10)**	(3)	**3**	(3)	**(7)**	(6)
Actuarial losses/(gains): scheme assets	**96**	(139)	**(2)**	(2)	**94**	(141)
Actuarial (gains)/losses: scheme liabilities	**(188)**	(83)	**(1)**	6	**(189)**	(77)
Actuarial (losses) recognised	**(13)**	(6)			**(13)**	(6)
Net actuarial (gains)/losses at 31 December	**(4)**	111	**14**	14	**10**	125

12 Retirement benefit schemes continued

The principal actuarial assumptions (weighted to reflect individual scheme differences) used in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2007					
Rate of increase in salaries	**5.4**	**3.0**	**4.0**	**2.7**	**1.6**
Rate of increase in pensions in payment	**3.4**	**2.0**	**Nil**	**2.4**	**1.0**
Rate of increase in deferred pensions	**3.4**	**Nil**	**Nil**	**2.4**	
Discount rate	**5.8**	**5.5**	**4.9**	**5.5**	**3.3**
General inflation	**3.4**	**2.0**	**3.0**	**2.4**	**1.0**

For healthcare inflation in Canada, the assumption is 10 per cent reducing to 5 per cent by 2013.

For the remaining pension schemes, typical assumptions are that real salary increases will be from 1 per cent to 4 per cent per annum and discount rates will be from 2 per cent to 5 per cent above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2006					
Rate of increase in salaries	5.1	2.5	4.0	2.4	1.6
Rate of increase in pensions in payment	3.1	2.0	Nil	2.0	1.0
Rate of increase in deferred pensions	3.1	Nil	Nil	2.0	
Discount rate	5.1	4.5	4.7	4.6	3.2
General inflation	3.1	2.0	3.0	2.0	1.0

For healthcare inflation in Canada, the assumption is 10 per cent reducing to 5 per cent by 2012.

For the remaining pension schemes, typical assumptions are that real salary increases will be from 2 per cent to 4 per cent per annum and discount rates will be from 2 per cent to 5 per cent above inflation. Pension increases, where allowed for, are generally assumed to be in line with inflation.

Discount rates are determined by reference to normal yields on high quality corporate bonds at the balance sheet date. For countries where there is not a deep market in such corporate bonds then the yield on government bonds is used.

Mortality assumptions are subject to regular review. In Canada, Germany and Switzerland the same tables were used for both years. In the UK, for post-retirement mortality assumptions at 31 December 2007 the table PXA92 (B=1965) rated up one year for active and deferred members and PXA92 (B=1935) table rated up three years for current pensioners, all with the medium cohort effect, have been used. At 31 December 2006, the same tables are used, along with the medium cohort effect, however active and deferred members are rated up two years and current pensioners are rated up four years. In the Netherlands at 31 December 2007 GBM/V 2006-2050 tables with an age setback of one year for both males and females have been used. In the Netherlands at 31 December 2006 GBM/V 1995-2000 tables with an age setback of two years for males and one year for females have been used. In Canada UP94 tables, in Germany Heubeck tables 2005G, and EVK 2000 mortality tables in Switzerland, have been used.

12 Retirement benefit schemes continued

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 2007										
Member age 65 (current life expectancy)	**18.9**	**21.7**	**17.9**	**22.0**	**19.0**	**21.6**	**17.7**	**20.9**	**17.8**	**20.6**
Member age 45 (life expectancy at age 65)	**22.2**	**25.0**	**20.6**	**24.6**	**19.0**	**21.6**	**19.5**	**21.7**	**20.6**	**23.3**

	UK		Germany		Canada		Netherlands		Switzerland	
	Male	Female	Male	Female	Male	Female	Male	Female	Male	Female
31 December 2006										
Member age 65 (current life expectancy)	18.5	21.3	17.6	21.7	19.0	21.6	17.3	20.9	17.6	20.4
Member age 45 (life expectancy at age 65)	21.2	24.0	20.4	24.4	19.0	21.6	17.3	20.9	20.6	23.3

The expected rates of return on scheme assets in the following principal countries are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2007					
Equities	**7.5**	**8.0**	**8.8**	**8.5**	**7.3**
Bonds	**5.2**	**5.5**	**5.5**	**4.6**	**3.5**
Property	**7.5**	**4.5**		**7.3**	**4.4**
Other assets	**8.0**		**Nil**	**3.6**	**5.2**

For the remaining pension schemes, typical expected long term real rates of return ranged from 2 per cent to 8 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2006					
Equities	7.5	8.0	8.2	8.2	7.0
Bonds	4.8	5.5	5.5	4.1	4.5
Property	7.5	4.5		6.9	5.0
Other assets	8.1		Nil	3.2	2.0

For the remaining pension schemes, typical expected long term real rates of return ranged from 2 per cent to 7 per cent.

	UK %	Germany %	Canada %	Netherlands %	Switzerland %
31 December 2005					
Equities	7.1	8.0	7.5	7.6	7.0
Bonds	4.3	5.5	6.5	3.8	4.5
Property	7.1	4.5		6.3	5.0
Other assets	7.0		Nil	2.0	2.0

For the remaining pension schemes, typical expected long term real rates of return ranged from 2 per cent to 7 per cent.

12 Retirement benefit schemes continued

Expected rates of return are determined taking into account the current level of expected returns on risk-free investments, the historical level of risk premium associated with other invested assets, and the expectations for future returns on such assets.

The major categories of assets as a percentage of the total fair value of scheme assets are as follows:

	UK %	Germany %	Canada %	Netherlands %	Switzerland %	Others %	Total %
31 December 2007							
Equities	**53.8**	**38.8**	**47.9**	**37.0**	**31.9**	**25.0**	**44.1**
Bonds	**36.0**	**33.0**	**47.1**	**45.0**	**46.7**	**54.2**	**41.1**
Property	**4.8**	**28.2**		**8.3**	**9.9**	**1.5**	**7.8**
Other assets	**5.4**		**5.0**	**9.7**	**11.5**	**19.3**	**7.0**
31 December 2006							
Equities	53.4	43.6	60.2	36.4	35.9	23.4	46.8
Bonds	36.5	28.8	34.7	44.9	48.7	54.4	38.7
Property	5.1	27.6		8.7	9.2	1.7	7.8
Other assets	5.0		5.1	10.0	6.2	20.5	6.7

Other assets principally comprise hedge funds, cash and reinsurance contracts.

Valuation of post-retirement 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 2007 are set out below. These sensitivities show the hypothetical impact of a change in each of the listed assumptions in isolation, with the exception of the sensitivity to inflation which incorporates the impact of certain correlating assumptions such as salary increases. While each of these sensitivities holds all other assumptions constant, in practice such assumptions rarely change in isolation and the impacts may offset to some extent.

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
Rate of mortality				
– (decrease)/increase in profit before taxation	(8)	7		
– increase/(decrease) of scheme liabilities	115	(115)		
Rate of inflation				
– (decrease)/increase in profit before taxation			(9)	8
– increase/(decrease) of scheme liabilities			107	(99)
Discount rate				
– increase/(decrease) in profit before taxation			1	(2)
– (decrease)/increase of scheme liabilities			(120)	130
Expected return on scheme assets				
– increase/(decrease) in profit before taxation			8	(8)

	2.5 percentage point increase £m	2.5 percentage point decrease £m
Market value of scheme assets		
– increase/(decrease) in profit before taxation	6	(6)
– increase/(decrease) of scheme assets	93	(93)

The effect on the profit before taxation reflects the impact on current service cost, interest cost and expected return on scheme assets where relevant, for 2008. The effect on scheme assets and liabilities is as at 31 December 2007.

A one percentage point change in healthcare inflation would have the following effects, which were similar in 2006:

	1 percentage point increase £m	1 percentage point decrease £m
31 December 2007		
Effect on total of current service cost and interest cost	1	(1)
Effect on healthcare scheme liabilities	17	(14)

The history of the present value of the scheme liabilities, fair value of the scheme assets, the scheme net deficits and experience gains and losses are as follows:

	2007 £m	2006 £m	2005 £m	2004 £m
Historical information				
Scheme liabilities	4,497	4,421	4,630	3,852
Scheme assets	4,223	3,950	3,836	3,339
Scheme net deficits	(274)	(471)	(794)	(513)
Experience losses/(gains) on scheme liabilities	6	35	(6)	68
Experience losses/(gains) on scheme assets	94	(141)	(253)	(64)

GROUP ACCOUNTS

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 £m	Other temporary differences £m	Total £m
At 1 January 2007	**43**	**13**	**32**	**112**		**188**	**388**
Exchange differences	**4**	**(1)**	**3**	**11**		**10**	**27**
(Charged)/credited to the Income Statement	**(13)**		**(20)**	**(22)**		**9**	**(46)**
Other	**1**	**(4)**	**7**	**(1)**		**(3)**	
At 31 December 2007	**35**	**8**	**22**	**100**		**204**	**369**
At 1 January 2006	40	9	18	137		221	425
Exchange differences	(3)	(1)	(1)	(10)		(21)	(36)
Credited/(charged) to the Income Statement	1	(4)	34	(16)		(8)	7
Other	5	9	(19)	1		(4)	(8)
At 31 December 2006	43	13	32	112		188	388

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 gains £m	Other temporary differences £m	Total £m
At 1 January 2007	**27**	**140**	**87**	**114**	**8**	**35**	**411**
Exchange differences	**2**	**3**	**1**	**11**		**1**	**18**
(Credited)/charged to the Income Statement	**(15)**		**20**	**(25)**		**1**	**(19)**
Credited to equity					**(6)**		**(6)**
Other		**(4)**	**1**	**(1)**	**(2)**	**3**	**(3)**
At 31 December 2007	**14**	**139**	**109**	**99**		**40**	**401**
At 1 January 2006	30	154	73	98	15	42	412
Exchange differences	(1)	(12)	(3)	(2)	(2)	(9)	(29)
Charged/(credited) to the Income Statement	(4)	(8)	17	20	(2)	4	27
Credited to equity					(2)		(2)
Other	2	6		(2)	(1)	(2)	3
At 31 December 2006	27	140	87	114	8	35	411

13 Deferred tax continued

	2007 £m	2006 £m
Net deferred tax liabilities	**32**	23

The net deferred tax liabilities are reflected in the 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.

	2007 £m	2006 £m
Deferred tax assets	**(262)**	(273)
Deferred tax liabilities	**294**	296
	32	23

Deferred tax expected to be recovered within 12 months:

	2007 £m	2006 £m
Deferred tax assets	**(116)**	(86)
Deferred tax liabilities	**132**	105
	16	19

At the balance sheet date, the Group has recognised and unrecognised deferred tax assets in respect of unused tax losses of £191 million (2006: £144 million) available for offset against future profits. A deferred tax asset has been recognised in respect of £22 million (2006: £32 million) of such losses, as realisation of the related tax benefit is probable.

Unrecognised deferred tax assets in respect of unused income tax losses of £101 million (2006: £67 million) have no expiry date and unused income tax losses of £64 million (2006: £35 million) expire after five years. Unrecognised deferred tax assets in respect of unused capital tax losses of £4 million (2006: £10 million) have no expiry date.

At the balance sheet date, the Group has unrecognised deferred tax assets in respect of deductible temporary differences of £158 million (2006: £183 million) and unused tax credits of £206 million (2006: £136 million). These unrecognised deferred tax assets have no expiry period.

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £5 billion in both years. No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences, and it is probable that such differences will not reverse in the foreseeable future.

14 Trade and other receivables

	2007 £m	2006 £m
Trade receivables	**1,272**	1,083
Loans and other receivables	**498**	530
Prepayments and accrued income	**198**	147
	1,968	1,760
Analysed on the Balance Sheet as		
– current	**1,845**	1,568
– non-current	**123**	192
	1,968	1,760

Prepayments and accrued income include £53 million (2006: £48 million) in respect of dividends from associates and £11 million (2006: £1 million) in respect of interest.

Trade and other receivables have been reported in the Balance Sheet net of allowances as follows:

	2007 £m	2006 £m
Gross trade and other receivables	**2,019**	1,803
Allowance account	**(51)**	(43)
Net trade and other receivables per Balance Sheet	**1,968**	1,760

The movements in the allowance account are as follows:

	2007 £m	2006 £m
1 January	**43**	33
Differences on exchange	**5**	(2)
Provided in respect of the year	**22**	17
Amounts reversed during the year	**(3)**	
Amounts in respect of receivables written off	**(16)**	(5)
31 December	**51**	43

Impairment of trade receivables charged during the year is included as part of other operating expenses. For 2007, the net impairment charged was £37 million (2006: £17 million) of which £19 million (2006: £17 million), is reflected in the above table.

As at 31 December 2007, trade and other receivables of £63 million (2006: £42 million) were past due but not impaired. These relate to a number of external parties where there is no expectation of default. The age analysis of these trade receivables is as follows:

	2007 £m	2006 £m
Less than three months	**38**	25
Between three and six months	**5**	2
Between six months and one year	**11**	13
Greater than one year	**9**	2

The Group holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

14 Trade and other receivables continued

Trade and other receivables are predominantly denominated in the functional currencies of subsidiary undertakings apart from the following:

	2007 £m	2006 £m
US dollar	**144**	106
UK sterling	**12**	4
Euro	**25**	22
Other currencies	**33**	24

Trade and other receivables also include certain interest bearing amounts and their effective interest rates are as follows:

	2007 £m	2006 £m	2007 %	2006 %
US dollar*	**13**	64	**5.5**	4.6
Euro	**1**	1	**4.0**	3.6
Other currencies	**21**	36	**12.0**	10.6

*2006 includes US$100 million (£51 million) collateral pledged representing a bond posted in connection with the Engle class action in the US (page 153 note 30).

There is no material difference between the above amounts for trade and other receivables and their fair value, due to the short term duration of the majority of trade and other receivables. There is no concentration of credit risk with respect to trade receivables as the Group has a large number of customers, internationally dispersed.

15 Available-for-sale investments

	2007 £m	2006 £m
1 January	**152**	123
Differences on exchange	**9**	(1)
Additions and advances	**99**	85
Revaluations	**1**	(2)
Disposals and repayments	**(164)**	(54)
Other movements		1
31 December	**97**	152
Current	**75**	128
Non-current	**22**	24
	97	152

15 Available-for-sale investments continued

Investments have the following maturities:

	As per Balance Sheet		Contractual gross maturities	
	2007 £m	2006 £m	**2007 £m**	2006 £m
Equity investments	**24**	25	**24**	25
Non-equity investments				
– within one year	**67**	73	**67**	75
– beyond one year and within two years	**3**	4	**3**	7
– beyond two years and within three years	**1**	21	**1**	23
– beyond three years and within four years	**1**	12	**1**	13
– beyond four years and within five years				1
– beyond five years	**1**	17	**1**	20
	97	152	**97**	164

The contractual gross maturities in each year include the investments maturing in that year together with forecast interest receipts on all investments which are due for all or part of that year.

Investments are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2007 £m	2006 £m
Functional currencies	**91**	92
US dollar	**3**	56
Other currencies	**3**	4
	97	152

Non-equity investments are denominated in the following currencies:

	2007 £m	2006 £m
US dollar	**1**	56
UK sterling	**72**	71
	73	127

Effective interest rates applicable to non-equity investments are as follows:

	2007 %	2006 %
On US dollar	**4.6**	4.8
On UK sterling	**6.1**	5.3

The fair values of available-for-sale investments are principally based on readily observable market data with the exception of an equity investment in an unquoted entity which is valued at £18 million (2006: £17 million) using the discounted cash flows of estimated future dividends.

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.

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges				
– interest rate swaps	14	14	25	19
– cross-currency swaps	85	31	24	4
Cash flow hedges				
– cross-currency swaps	29			
– forward foreign currency contracts	6	6	20	1
Net investment hedges				
– cross-currency swaps	57		53	
– forward foreign currency contracts	5	50	31	10
Trading				
– cross-currency swaps		53		43
– forward foreign currency contracts	7	85	29	13
– others	32	35	18	23
	235	274	200	113
Current	82	225	124	84
Non-current	153	49	76	29
	235	274	200	113
Current assets and liabilities include				
– trading derivatives that mature beyond one year	1	10		37
Derivatives				
– in respect of net debt	188	179	125	79
– other	47	95	75	34
	235	274	200	113

Some derivative financial instruments are not designated as hedges and have been classified as trading derivatives.

16 Derivative financial instruments continued

The maturity dates of all derivative financial instruments as recognised in the Balance Sheet are as follows:

	2007		2006 restated	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	**81**	**215**	124	47
Between one and two years	**81**	**3**	5	29
Between two and three years			46	3
Between three and four years	**5**			
Between four and five years	**64**		4	
Beyond five years	**4**	**56**	21	34
	235	**274**	200	113

The above maturity analysis for 2006 has been restated to enhance consistency of presentation with other financial instrument maturity analyses.

For cash flow hedges, the timing of expected cash flows is as follows:

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	**3**	**6**	11	1
Between one and two years	**32**		2	
Between two and three years			7	
	35	**6**	20	1

The Group's cash flow hedges are 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 timing of when the hedged item will affect profit or loss.

The tables below set out the maturities of the Group's derivative financial instruments on an undiscounted contractual basis, based on spot rates.

16 Derivative financial instruments continued

The maturity dates of all gross settled derivative financial instruments are as follows:

	2007				2006			
	Assets		Liabilities		Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year								
– forward contracts	**1,108**	**(1,095)**	**4,266**	**(4,394)**	3,293	(3,212)	1,943	(1,969)
– cross-currency swaps	**66**	**(70)**	**249**	**(310)**	59	(71)	73	(88)
– other	**1,450**	**(1,396)**	**1,395**	**(1,451)**	1,320	(1,281)	1,280	(1,321)
Between one and two years								
– forward contracts	**62**	**(61)**	**70**	**(73)**	66	(57)	17	(17)
– cross-currency swaps	**876**	**(774)**	**18**	**(18)**	59	(69)	254	(285)
Between two and three years								
– forward contracts							3	(3)
– cross-currency swaps	**21**	**(22)**	**21**	**(22)**	736	(688)	124	(122)
Between three and four years								
– forward contracts							3	(3)
– cross-currency swaps	**21**	**(24)**	**18**	**(18)**	19	(27)	18	(16)
Between four and five years								
– cross-currency swaps	**572**	**(468)**	**18**	**(19)**	19	(27)	18	(16)
Beyond five years								
– cross-currency swaps	**19**	**(15)**	**397**	**(421)**	542	(493)	414	(396)
	4,195	**(3,925)**	**6,452**	**(6,726)**	6,113	(5,925)	4,147	(4,236)

The maturity dates of net settled derivative financial instruments are as follows:

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	**(4)**	**6**	3	5
Between one and two years	**14**	**3**		5
Between two and three years	**1**	**3**	13	5
Between three and four years	**6**	**4**	1	4
Between four and five years		**3**	5	3
Beyond five years	**11**	**3**	18	6
	28	**22**	40	28

The above analysis of derivatives settled on a net basis primarily relates to the Group's interest rate swaps.

16 Derivative financial instruments continued

In summary by type, the fair value of derivative financial instruments is as follows:

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Interest rate swaps	**14**	**14**	25	19
Cross-currency swaps	**171**	**84**	77	47
Forward foreign currency contracts	**18**	**141**	80	24
Others	**32**	**35**	18	23
	235	**274**	200	113

(a) Interest rate swaps

	Maturity date	Principal currency	m	£m	Interest rate % Original	Interest rate % Swapped	2007 Assets £m	2007 Liabilities £m
Fixed to floating	**2009**	**EUR**	**550**	**404**	**4.9**	**note (a)**	**7**	
	2009	**EUR**	**250**	**184**	**4.1**	**note (a)**	**2**	
	2013	**EUR**	**400**	**294**	**5.1**	**note (a)**		
	2013	**GBP**	**350**	**350**	**5.8**	**note (a)**		**14**
	2019	**GBP**	**250**	**250**	**6.4**	**note (a)**	**5**	
							14	**14**

	Maturity date	Principal currency	m	£m	Interest rate % Original	Interest rate % Swapped	2006 Assets £m	2006 Liabilities £m
Fixed to floating	2009	EUR	550	371	4.9	note (a)	10	
	2009	EUR	250	168	4.1	note (a)	4	
	2013	EUR	400	270	5.1	note (a)	7	
	2013	GBP	350	350	5.8	note (a)		19
	2019	GBP	250	250	6.4	note (a)	4	
Floating to fixed	2007	AUD	50	20	note (a)	5.5		
							25	19

Note (a): The floating rate interest rates are based on LIBOR (or local equivalent) plus a margin ranging between nil and 137 basis points.

The fixed to floating swaps have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table on page 138 in note 21. The floating to fixed swaps have been used to manage the interest rate profile of both internal and external financing arrangements, and those relating to external borrowings are also reflected in the repricing table on page 138 in note 21.

(b) Cross-currency swaps

2007

	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to fixed	**2009**	**EUR**	**4.9**	**500**	**367**	**USD**	**6.5**	**564**	**283**	**86**	
Fixed to floating	**2008**	**GBP**	**6.5**	**217**	**217**	**AUD**	**note (b)**	**607**	**268**		**53**
	2009	**EUR**	**4.9**	**150**	**110**	**GBP**	**note (b)**	**104**	**104**	**8**	
	2012	**EUR**	**3.6**	**750**	**551**	**USD**	**note (b)**	**907**	**456**	**74**	
	2016	**GBP**	**5.5**	**325**	**325**	**EUR**	**note (b)**	**473**	**347**		**31**
	2019	**EUR**	**4.6**	**20**	**15**	**USD**	**note (b)**	**22**	**11**	**3**	
										171	**84**

2006

	Maturity date	Original currency	Interest rate %	Principal original currency m	£m	Swapped currency	Interest rate %	Principal swapped currency m	£m	Assets £m	Liabilities £m
Fixed to fixed	2007	USD	5.8	70	36	KRW	7.5	85,876	47		13
	2009	EUR	4.9	500	337	USD	6.5	564	288	53	
Fixed to floating	2008	GBP	6.5	217	217	AUD	note (b)	607	244		30
	2009	EUR	4.9	150	101	GBP	note (b)	104	104		1
	2012	EUR	3.6	750	505	USD	note (b)	907	463	22	
	2016	GBP	5.5	325	325	EUR	note (b)	473	319		3
	2019	EUR	4.6	20	13	USD	note (b)	22	11	2	
										77	47

Note (b): The floating rate interest rates are based on LIBOR plus a margin ranging between 66 and 127 basis points.

In 2006, the US dollar/South Korean won swaps were used to manage internal financing arrangements. The remaining swaps were used to manage the currency profile of external borrowings and are reflected in the currency table on page 138 in note 21. The fixed to floating swaps are also reflected in the repricing table on page 138 in note 21.

16 Derivative financial instruments continued

(c) Forward foreign currency contracts

Forward foreign currency contracts are denominated in the following currencies:

Fair values of assets

	2007 Currencies purchased forward							2006 Currencies purchased forward						
	EUR £m	GBP £m	USD £m	CHF £m	SGD £m	PLN £m	Total £m	EUR £m	GBP £m	USD £m	CHF £m	CAD £m	AUD £m	Total £m
Currencies sold forward														
AUD		1					1		1					1
CAD									15					15
CHF	1						1		5					5
CYP									1					1
EUR									19					19
GBP	2			2		1	5							
KRW	2						2							
JPY			4				4			20				20
USD		3			1		4		18					18
RUR	1						1							
ZAR									1					1
	6	4	4	2	1	1	18		60	20				80

Fair values of liabilities

	2007 Currencies purchased forward							2006 Currencies purchased forward						
	EUR £m	GBP £m	USD £m	CHF £m	SGD £m	PLN £m	Total £m	EUR £m	GBP £m	USD £m	CHF £m	CAD £m	AUD £m	Total £m
Currencies sold forward														
AUD		17					17		3	1				4
CAD		25	1				26							
CHF		14					14							
EUR		43	5				48		1	2				3
CZK		1					1							
DKK		1					1							
GBP											2	6		8
HKD		6					6							
HUF		1					1							
PLN		2					2							
NZD													2	2
SGD		1					1							
JPY			4				4							
USD	1	11					12		1					1
RUR			2				2			1				1
ZAR		6					6	1	4					5
	1	128	12				141	1	9	4	2	6	2	24

16 Derivative financial instruments continued

Forward foreign currency contracts have been used to hedge both internal and external forecast transactions as well as the hedging of internal and external assets and liabilities. Certain contracts were used to manage the currency profile of external borrowings and are reflected in the currency table on page 138 in note 21, and their nominal values are as follows:

	2007		2006	
	£m	£m	£m	£m
Forward contracts to purchase GBP, sell CHF	**(115)**	**122**	(74)	73
Forward contracts to purchase GBP, sell CAD	**(338)**	**356**	(308)	307
Forward contracts to purchase GBP, sell AUD	**(569)**	**579**	(525)	529

(d) Others

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Others: Bund forwards *note i*	**27**	**28**	15	16
Interest derivative *note ii*		**7**		7
Sinking fund policy *note iii*	**5**		3	
	32	**35**	18	23

Notes:
(i) Forward contracts to purchase and sell German government securities with a nominal value of €1.91 billion (2006: €1.86 billion) taken out to manage internal financing arrangements and maturing within one year.

(ii) Remaining impact of an interest derivative with a nominal value of €1 billion maturing in 2013.

(iii) Investment in sinking fund policy with a nominal value of ZAR73 million (2006: ZAR51 million).

17 Inventories

	2007 £m	2006 £m
Raw materials and consumables	**1,103**	1,182
Finished goods and work in progress	**707**	721
Goods purchased for resale	**175**	153
	1,985	2,056

Inventories pledged as security for liabilities amount to £8 million (2006: £11 million). Write-offs taken to other operating expenses in the Income Statement comprise £46 million (2006: £26 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 of the balance sheet date for both 2007 and 2006.

19 Cash and cash equivalents

	2007 £m	2006 restated £m
Cash and bank balances	**651**	717
Cash equivalents	**607**	739
	1,258	1,456

Cash equivalents mainly comprise short term deposits with an original maturity of three months or less. The carrying value of cash and cash equivalents approximates their fair value. The analysis of cash and cash equivalents has been restated so that all amounts accessible on demand or within one day are classified as cash and bank balances. Consequently, the 2006 amounts above for cash and bank balances have been restated from £484 million to £717 million, with a corresponding reduction in cash equivalents.

Cash and cash equivalents are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	2007 £m	2006 £m
Functional currency	**968**	896
US dollar	**159**	352
UK sterling	**5**	7
Euro	**104**	179
Other currencies	**22**	22
	1,258	1,456

The currency in which cash and cash equivalents are held, together with the effective interest rates applicable to cash and cash equivalents are as follows:

	Values		Rates	
	2007 £m	2006 £m	2007 %	2006 %
US dollar	**231**	354	**3.6**	4.5
UK sterling	**146**	153	**5.1**	4.9
Euro	**158**	222	**3.2**	3.0
Canadian dollar	**32**	17	**4.2**	4.2
Australian dollar	**10**	2	**6.3**	5.8
Other currencies	**681**	708	**6.8**	5.1
	1,258	1,456		

At 31 December 2007, cash and cash equivalents of £nil (2006: £4 million) were pledged as collateral principally in respect of excise creditors.

In the Group Cash Flow Statement, net cash and cash equivalents are shown after deducting bank overdrafts, as follows:

	2007 £m	2006 £m
Cash and cash equivalents as above	**1,258**	1,456
Less		
– accrued interest		(1)
– overdrafts	**(78)**	(179)
Net cash and cash equivalents	**1,180**	1,276

Cash and cash equivalents include restricted amounts of £54 million (2006: £65 million).

20 Capital and reserves – reconciliation of movement in total equity

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Shareholders' funds £m	Minority interests £m	Total equity £m
1 January 2007	517	3,886	419	1,639	6,461	227	6,688
Differences on exchange			292		292	20	312
Cash flow hedges							
– net fair value gains			15		15		15
– reclassified and reported in profit for the year			(42)		(42)		(42)
Available-for-sale investments							
– net fair value gains			1		1		1
– reclassified and reported in profit for the year			2		2	(1)	1
Net investment hedges							
– net fair value losses			(35)		(35)		(35)
Tax on items recognised directly in equity *page 107 note 6(c)*			(15)		(15)	(4)	(19)
Profit for the year				2,130	2,130	157	2,287
Employee share options							
– value of employee services				37	37		37
– proceeds from shares issued		5		22	27		27
Dividends and other appropriations							
– ordinary shares				(1,198)	(1,198)		(1,198)
– to minority interests						(173)	(173)
Purchase of own shares							
– held in employee share ownership trusts				(41)	(41)		(41)
– share buy-back programme	(11)	11		(750)	(750)		(750)
Acquisition of minority interests						(9)	(9)
Other movements				(4)	(4)	1	(3)
31 December 2007	506	3,902	637	1,835	6,880	218	7,098

20 Capital and reserves – reconciliation of movement in total equity continued

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Shareholders' funds £m	Minority interests £m	Total equity £m
1 January 2006	524	3,874	981	1,251	6,630	247	6,877
Differences on exchange			(665)		(665)	(20)	(685)
Cash flow hedges							
– net fair value gains			13		13		13
– reclassified and reported in profit for the year			(15)		(15)		(15)
Available-for-sale investments							
– net fair value losses			(2)		(2)		(2)
Net investment hedges							
– net fair value gains			117		117		117
Tax on items recognised directly in equity *page 107 note 6(c)*			(10)		(10)	(2)	(12)
Profit for the year				1,896	1,896	152	2,048
Employee share options							
– value of employee services				41	41		41
– proceeds from shares issued		5		23	28		28
Dividends and other appropriations							
– ordinary shares				(1,008)	(1,008)		(1,008)
– to minority interests						(137)	(137)
Purchase of own shares							
– held in employee share ownership trusts				(77)	(77)		(77)
– share buy-back programme	(7)	7		(500)	(500)		(500)
Acquisition of minority interests						(13)	(13)
Other movements				13	13		13
31 December 2006	517	3,886	419	1,639	6,461	227	6,688

Details relating to the authorised and allotted share capital, and movements therein, are included on page 173 in note 4.

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 2006	43	83	3,748	3,874
31 December 2006	48	90	3,748	3,886
31 December 2007	53	101	3,748	3,902

The share premium account includes the difference between the value of shares issued and their nominal value. The increase of £5 million (2006: £5 million) relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report on pages 58 to 75.

20 Capital and reserves – reconciliation of movement in total equity continued

On the purchase of own shares as part of the buy-back programme, a transfer is made from retained earnings to the capital redemption reserve equivalent to the nominal value of shares purchased. As described on page 173 in note 4, in 2006 a technical infringement of the Companies Act 1985 occurred in relation to £100 million of the £500 million shares purchased under the buy-back programme in the table on page 134, which remained in the share capital as at 31 December 2006 shown on page 134 and were excluded from the transfer to the capital redemption reserve in that year. As these payments were ratified by the shareholders in 2007, in the table on page 133 the share capital is adjusted with a consequent transfer to the capital redemption reserve.

Shareholders' funds are stated after deducting the cost of treasury shares which include £123 million (2006: £nil) for shares repurchased and not cancelled and £173 million (2006: £197 million) in respect of the cost of own shares held in employee share ownership trusts.

In 1999, shares were issued for the acquisition of the Rothmans International B.V. Group, and the difference between the fair value of shares issued and their nominal value was credited to merger reserves.

Movements in other reserves and retained earnings (which is after deducting treasury shares) shown above comprise:

						Retained earnings	
	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Other reserves £m	Total other reserves £m	Treasury shares £m	Other £m
1 January 2007	**(177)**	**10**	**13**	**573**	**419**	**(197)**	**1,836**
Differences on exchange	292				292		
Cash flow hedges							
– net fair value gains		15			15		
– reclassified and reported in profit for the year		(42)			(42)		
Available-for-sale investments							
– net fair value gains			1		1		
– reclassified and reported in profit for the year			2		2		
Net investment hedges							
– net fair value losses	(35)				(35)		
Tax on items recognised directly in equity *page 107 note 6(c)*	(21)	6			(15)		
Profit for the year							2,130
Employee share options							
– value of employee services							37
– proceeds from shares issued						22	
Dividends and other appropriations							
– ordinary shares							(1,198)
Purchase of own shares							
– held in employee share ownership trusts						(41)	
– share buy-back programme						(123)	(627)
Other movements						43	(47)
31 December 2007	**59**	**(11)**	**16**	**573**	**637**	**(296)**	**2,131**

GROUP ACCOUNTS

20 Capital and reserves – reconciliation of movement in total equity continued

	Translation reserve £m	Hedging reserve £m	Available-for-sale reserve £m	Other reserves £m	Total other reserves £m	Retained earnings	
						Treasury shares £m	Other £m
1 January 2006	383	10	15	573	981	(182)	1,433
Differences on exchange	(665)				(665)		
Cash flow hedges							
– net fair value gains		13			13		
– reclassified and reported in profit for the year		(15)			(15)		
Available-for-sale investments							
– net fair value losses			(2)		(2)		
Net investment hedges							
– net fair value gains	117				117		
Tax on items recognised directly in equity *page 107 note 6(c)*	(12)	2			(10)		
Profit for the year							1,896
Employee share options							
– value of employee services							41
– proceeds from shares issued						23	
Dividends and other appropriations							
– ordinary shares							(1,008)
Purchase of own shares							
– held in employee share ownership trusts						(77)	
– share buy-back programme							(500)
Other movements						39	(26)
31 December 2006	(177)	10	13	573	419	(197)	1,836

The translation reserve is as explained in the accounting policy on foreign currencies on pages 92 and 93.

The hedging reserve and the available-for-sale reserve are as explained in the accounting policy on financial instruments on page 95.

Of the amounts released from the hedging reserve during the year, gains of £5 million (2006: £5 million) and £9 million (2006: £15 million) were reported within revenue and raw materials and consumables respectively, together with a gain of £2 million reported in other operating expenses (2006: £1 million loss) and a gain of £26 million (2006: £4 million loss) reported within net finance costs.

Other reserves comprise:

(a) £483 million which arose in 1998 from merger accounting in a Scheme of Arrangement and Reconstruction whereby British American Tobacco p.l.c. acquired the entire share capital of B.A.T Industries p.l.c. and the share capital of that company's principal financial services subsidiaries were distributed, so effectively demerging them; and

(b) in the Rothmans transaction noted on page 135, 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.

21 Borrowings

	Currency	Maturity dates	Interest rates	2007 £m	2006 £m
Eurobonds	Euro	2009 to 2019	3.6% to 5.4%	**3,920**	3,465
	UK sterling	2008 to 2019	5.5% to 6.5%	**1,376**	1,364
Floating rate notes	Euro	2010	floating rate	**388**	355
Other notes	Malaysian ringgit	2007 to 2012	3.7% to 7.9%	**115**	103
	US dollar	2008	6.9%	**173**	176
	Other currencies			**97**	93
Syndicated bank loans	US dollar	2012	floating rate	**346**	358
Bank loans				**352**	460
Other loans				**13**	11
Finance leases				**65**	62
Overdrafts				**78**	179
				6,923	6,626

The floating rate interest rates are based on EURIBOR or US LIBOR plus a margin ranging between 36 and 200 basis points.

	2007 £m	2006 £m
Current	**861**	1,058
Non-current	**6,062**	5,568
	6,923	6,626

Current borrowings include interest payable of £136 million at 31 December 2007 (2006: £133 million). Included within non-current borrowings are £2,466 million (2006: £2,340 million) of borrowings subject to fair value hedges where this amortised cost has been decreased by £49 million (2006: decreased £52 million) in the table above.

The fair value of borrowings is estimated to be £6,862 million (2006: £6,772 million) and has been determined using quoted market prices or discounted cash flow analysis.

	2007 £m	2006 £m
Amounts secured on Group assets	**81**	88

Amounts secured include finance leases of £65 million (2006: £62 million) and the remaining amounts are secured on certain property and inventory of the Group (page 111 note 10 and page 131 note 17).

Borrowings are repayable as follows:

	Per Balance Sheet		Contractual gross maturities	
	2007 £m	2006 £m	2007 £m	2006 £m
Within one year	**861**	1,058	**1,029**	1,240
Between one and two years	**765**	419	**1,047**	712
Between two and three years	**397**	1,240	**636**	1,504
Between three and four years	**898**	361	**1,134**	553
Between four and five years	**927**	828	**1,151**	1,013
Beyond five years	**3,075**	2,720	**3,749**	3,350
	6,923	6,626	**8,746**	8,372

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.

21 Borrowings continued

Borrowings are denominated in the functional currency of the subsidiary undertaking or other currencies as shown below:

	Functional currency £m	US dollar £m	UK sterling £m	Euro £m	Canadian dollar £m	Australian dollar £m	Other currencies £m	Total £m
31 December 2007								
Total borrowings	**3,275**	**599**	**327**	**2,722**				**6,923**
Effect of derivative financial instruments								
– cross-currency swaps	**(113)**	**750**	**(325)**	**(696)**		**268**		**(116)**
– forward foreign currency contracts	**(1,022)**				**356**	**579**	**122**	**35**
	2,140	**1,349**	**2**	**2,026**	**356**	**847**	**122**	**6,842**
31 December 2006								
Total borrowings	3,128	809	327	2,362				6,626
Effect of derivative financial instruments								
– cross-currency swaps	(113)	762	(325)	(637)		244		(69)
– forward foreign currency contracts	(907)				307	529	73	2
	2,108	1,571	2	1,725	307	773	73	6,559

Details of the derivative financial instruments included in these tables are given in note 16 on page 125.

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 2007							
Total borrowings	**1,593**	**765**	**12**	**898**	**582**	**3,073**	**6,923**
Effect of derivative financial instruments							
– interest rate swaps	**1,482**	**(588)**				**(894)**	
– cross-currency swaps	**918**	**(110)**			**(551)**	**(340)**	**(83)**
	3,993	**67**	**12**	**898**	**31**	**1,839**	**6,840**
31 December 2006							
Total borrowings	1,505	419	1,240	8	735	2,719	6,626
Effect of derivative financial instruments							
– interest rate swaps	1,409		(539)			(870)	
– cross-currency swaps	1,141	(217)	(101)			(843)	(20)
	4,055	202	600	8	735	1,006	6,606

Details of the derivative financial instruments included in these tables are given in note 16 on page 125.

21 Borrowings continued

Effective interest rates are as follows:

	2007 £m	2006 £m	2007 %	2006 %
US dollar	**653**	866	**6.8**	6.6
UK sterling	**1,393**	1,382	**6.1**	5.4
Euro	**4,305**	3,814	**4.5**	4.5
Canadian dollar	**22**	13	**5.8**	5.8
Australian dollar		7		6.5
Other currencies	**550**	544	**6.0**	6.8
	6,923	6,626		

The values and rates shown above do not reflect the effect of the interest rate and cross-currency swaps detailed in note 16 on page 125.

Finance lease liabilities per the Balance Sheet and on a contractual gross maturity basis are payable as follows:

	2007			2006		
	Principal £m	Interest £m	Total £m	Principal £m	Interest £m	Total £m
Within one year	**24**	**3**	**27**	18	3	21
Between one and two years	**20**	**2**	**22**	17	2	19
Between two and three years	**12**	**1**	**13**	13	1	14
Between three and four years	**5**		**5**	8	1	9
Between four and five years	**2**		**2**	3		3
Beyond five years	**2**		**2**	3	1	4
	65	**6**	**71**	62	8	70

Borrowings facilities

	2007 £m	2006 £m
Undrawn committed facilities expiring		
– within one year	**1,416**	85
– between one and two years		57
– between three and four years	**99**	
– between four and five years	**1,651**	1,750
	3,166	1,892

The facilities include undrawn amounts in respect of the Group's central banking facility of £1.75 billion (2006: £1.75 billion). In March 2007, a one year option was exercised with final maturity dates between March 2011 and March 2012.

As explained in the Director's Report on page 52, a new central banking facility of €1.8 billion was entered into in 2007.

Facility fees of £2 million were charged to the Income Statement in 2007 (2006: £2 million) in respect of undrawn committed borrowing facilities.

22 Other provisions for liabilities and charges

	Restructuring of existing businesses £m	Acquired businesses £m	Employee-related benefits £m	Other provisions £m	Total £m
1 January 2007	**191**	**41**	**14**	**168**	**414**
Differences on exchange	**16**	**3**	**1**	**13**	**33**
Provided in respect of the year	**108**		**9**	**67**	**184**
Utilised during the year	**(132)**	**(21)**	**(4)**	**(44)**	**(201)**
Other movements	**(1)**			**(1)**	**(2)**
31 December 2007	**182**	**23**	**20**	**203**	**428**
Analysed on the Balance Sheet as					
– current	**106**	**14**	**5**	**138**	**263**
– non-current	**76**	**9**	**15**	**65**	**165**
	182	**23**	**20**	**203**	**428**
1 January 2006	222	76	25	172	495
Differences on exchange	(15)	(4)	(2)	(13)	(34)
Provided in respect of the year	99	(12)	1	38	126
Utilised during the year	(111)	(19)	(4)	(31)	(165)
Other movements	(4)		(6)	2	(8)
31 December 2006	191	41	14	168	414
Analysed on the Balance Sheet as					
– current	120	24	5	104	253
– non-current	71	17	9	64	161
	191	41	14	168	414

The restructuring provisions relate to the restructuring costs incurred and reported as exceptional items in the Income Statement. The principal restructurings provided in 2007 and 2006 are as described on page 103 in note 3(e). While some elements of the non-current provisions of £76 million will unwind over several years, as termination payments are made over extended periods in some countries, it is estimated that over 50 per cent will unwind in 2009 and approximately 80 per cent within five years.

Provisions in respect of acquired businesses mostly relate to those which were part of the integration of the Rothmans businesses in 1999, the transition of Imperial Tobacco Canada Ltd. to a subsidiary in 2000 and the reorganisation of the Italian business acquired in 2003. While some elements of the non-current provisions of £9 million will unwind over several years, it is estimated that around 50 per cent will unwind within five years.

Employee-related benefits mainly relate to long term employee benefits other than post-retirement benefits. As the principal components of these provisions are long service awards and 'Jubilee' payments due after a certain service period, they will unwind over several years. It is estimated that approximately 50 per cent of the non-current provisions of £15 million will unwind within five years.

22 Other provisions for liabilities and charges continued

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 and the age verification scheme in Japan, together with amounts in respect of supplier, excise and other disputes. The nature of the amounts provided in respect of disputes is such that the extent and timing of cash flows is difficult to estimate and the ultimate liability may vary from the amounts provided.

Amounts provided above are shown net of reversals of unused provisions which include £10 million (2006: £15 million) for restructuring of existing businesses, £3 million (2006: £12 million) for acquired businesses, £nil (2006: £2 million) for employee-related benefits and £24 million (2006: £12 million) for other provisions.

23 Trade and other payables

	2007 £m	2006 £m
Trade payables	**633**	611
Duty, excise and other taxes	**1,605**	1,467
Accrued charges and deferred income	**610**	553
Social security and other taxation	**24**	9
Sundry payables	**253**	272
	3,125	2,912
Analysed on the Balance Sheet as		
– current	**2,976**	2,766
– non-current	**149**	146
	3,125	2,912

Accrued charges and deferred income include £4 million (2006: £12 million) in respect of interest payable.

There is no material difference between the above amounts for trade and other payables and their fair value, due to the short term duration of the majority of trade and other payables.

Trade and other payables are predominantly denominated in the functional currencies of subsidiary undertakings with less than 6 per cent in other currencies.

24 Financial instruments

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, the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks.

Derivative contracts are only entered into to facilitate the management of these risks. The Board reviews and agrees the overall treasury policies and procedures, delegating appropriate authority to the Finance Director, the Treasury function and the Boards of the central finance companies. The policies include a set of financing principles 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 and share buy-back are decided.

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's Balance Sheet and related notes.

The Group's management of specific risks is dealt with as follows:

24 Financial instruments continued

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 5 years with no more than 20 per cent of centrally managed debt maturing in a single year. As at 31 December 2007, the average centrally managed debt maturity was 5.4 years and the highest proportion of centrally managed debt maturing in a single year was 16.7 per cent. It is Group policy that short term sources of funds (including drawings under US dollar and euro commercial paper programmes) are backed by undrawn committed lines of credit and cash.

During 2007, the Group's central banking facility at £1.75 billion was extended on existing terms under a one year extension option with final maturity dates between March 2011 and March 2012.

As explained in the Director's Report on page 52, a new central banking facility of €1.8 billion was entered into in 2007.

The Group utilises cash pooling and zero balancing bank account structures in addition to inter-company loans and borrowings to ensure that there is the maximum mobilisation of cash within the Group. The 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 2007, the ratings from Moody's and S&P were Baa1/BBB+ (2006: Baa1/BBB+). The strength of the ratings has underpinned the debt issuance during 2006 and 2007 and, despite the impact of the turbulence in the financial markets, the Group is confident of its ability to successfully access the debt capital markets.

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

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries and associates into its reporting currency, sterling. The Group's primary balance sheet translation exposures are to the US dollar, Canadian dollar, euro and South African rand. 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. At 31 December 2007, the currency profile of the Group's gross debt, after taking into account derivative contracts, was 20 (2006: 25) per cent US dollar, 53 (2006: 48) per cent euro, 5 (2006: 5) per cent Canadian dollar, nil (2006: 1) per cent sterling, 12 (2006: 12) per cent Australian dollar and 10 (2006: 9) per cent other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries and associates; these exposures are not normally hedged. Exposures also arise from:

(i) foreign currency denominated trading transactions undertaken by subsidiaries. These exposures comprise committed and highly probable forecast sales and purchases, which are offset wherever possible. The remaining exposures are hedged within the Treasury policies and procedures with forward foreign exchange contracts and options, which are designated as hedges of the foreign exchange risk of the identified future transactions; and

(ii) forecast dividend flows from subsidiaries to the centre. To ensure cash flow certainty, the Group hedges such flows using forward foreign exchange contracts designated as net investment hedges of the foreign exchange risk arising from the investments in these subsidiaries.

24 Financial instruments continued

IFRS7 requires a sensitivity analysis that shows the impact on the Income Statement and on items recognised directly in equity 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. All 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 analyses. The Group considers a 10 per cent strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year end, unless this is unrepresentative of the position during the year.

A 10 per cent strengthening of functional currencies against non-functional currencies would result in pre-tax profit being £21 million higher (2006: £9 million lower) and items recognised directly in equity being £211 million higher (2006: £168 million higher). A 10 per cent weakening of functional currencies against non-functional currencies would result in pre-tax profit being £21 million lower (2006: £12 million higher) and items recognised directly in equity being £243 million lower (2006: £204 million lower).

The exchange sensitivities on items recognised directly in equity relates to hedging of certain net asset currency positions in the Group, where the compensating effect is not included above as it arises on non-financial assets, as well as cash flow hedges in respect of future transactions and debt.

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 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. The Group targets gross interest cover to be between 5 and 9.

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 (50:50 +/- 10) and net (at least 50 per cent fixed in the short to medium term) basis as a result of regular reviews of market conditions and strategy by Treasury and the Board of the main central finance company. At 31 December 2007, the relevant ratios of floating to fixed rate borrowings were 53:47 (2006: 58:42) on a gross basis and 33:67 (2006: 34:66) 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.

IFRS7 requires a sensitivity analysis that shows the impact on the Income Statement and on items recognised directly in equity 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 these sensitivity analyses, 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. 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 £28 million lower (2006: £26 million lower) and items recognised directly in equity being £1 million higher (2006: £1 million lower). A 100 basis point decrease in interest rates would result in pre-tax profit being £28 million higher (2006: £26 million higher) and items recognised directly in equity being £1 million lower (2006: £1 million higher).

24 Financial instruments continued

Credit risk

The Group has no significant concentrations of customer credit risk. Subsidiaries have policies in place requiring appropriate credit checks on potential customers before sales commence. The process for monitoring and managing credit risk once sales to customers have been made varies depending on local practice in the countries concerned.

Certain territories have bank guarantees, other guarantees and credit insurance provided in the Group's favour in respect of Group trade receivables, the issuance and terms of which are dependent on local practices in the countries concerned.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from the related counterparties. Generally the Group targets a long term counterparty credit rating of at least A/A2 however the Group recognises that due to the need to operate over a large geographic footprint, sovereign risk can be the determining factor on the suitability of a counterparty. From time to time the Group may invest in short dated corporate commercial paper; for this the Group has identified specific counterparties with a minimum short term rating of A1/P1.

Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly.

The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions throughout its geographic footprint while at the same time ensuring that there is no geographic concentration in the location of counterparties.

The maximum exposure to the credit risk of financial assets at the balance sheet date is reflected by the carrying values included in the Group's Balance Sheet. In addition, the Group has issued guarantees to third parties, part of which has been recognised on the Balance Sheet in accordance with IAS39. The unrecognised portion of these guarantees amounts to £61 million (2006: £61 million).

Price risk

The Group is exposed to equity price risk on equity investments held by the Group, which are included in available-for-sale investments on the consolidated Balance Sheet, but the quantum of such is not material.

Hedge accounting

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed periodically to ensure that the hedge has remained, and is expected to remain highly effective.

Fair value estimation

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.

Other financial instruments

The fair values of financial assets and liabilities with maturities of less than one year are assumed to approximate to their book values. For financial assets and liabilities with maturities of more than one year, fair values are based on quoted market prices, market prices of comparable instruments at the balance sheet date or discounted cash flow analysis.

25 Cash flow

Cash generated from operations

	2007 £m	2006 £m
Profit before taxation	**3,078**	2,764
Adjustments for		
– share of post-tax results of associates and joint ventures	**(442)**	(431)
– net finance costs	**269**	289
– gains on disposal of businesses and brands	**(75)**	(60)
– depreciation and impairment of property, plant and equipment	**293**	367
– amortisation and write off of intangible assets	**43**	34
– decrease in inventories	**170**	21
– increase in trade and other receivables	**(83)**	(105)
– increase in trade and other payables	**61**	57
– decrease in net retirement benefit liabilities	**(120)**	(69)
– decrease in provisions for liabilities and charges	**(16)**	(68)
– other	**3**	17
Cash generated from operations	**3,181**	2,816

Profit before taxation includes charges in respect of Group restructuring costs referred to on page 103 in note 3(e). These are also reflected in the movements in depreciation, amortisation, inventories, receivables, payables and provisions above, and in the proceeds on disposal of property, plant and equipment shown on page 90. The cash outflow in respect of the Group restructuring costs was £170 million (2006: £177 million), of which £190 million (2006: £220 million) is included in cash generated from operations above.

Cash flows from investing activities

(a) Proceeds on disposals of intangibles

The cash inflow in 2007 reflects the sale of the pipe tobacco trademarks, while the cash inflow in 2006 reflects the trademark transfer agreements with Philip Morris (page 103 note 3(f)).

(b) Purchases and disposals of investments

Purchases and disposals of investments (which comprise available-for-sale investments and loans and receivables) include an inflow in respect of current investments of £65 million for the year to 31 December 2007 (2006: £41 million outflow) and £6 million sales proceeds from non-current investments for the year to 31 December 2007 (2006: £4 million).

(c) Purchases of subsidiaries and minority interests

In 2007, the cash outflow reflects the acquisition of minority interests in the Group's subsidiaries in Africa and Middle East, Europe and Asia-Pacific. In 2006, the cash outflow principally reflects the cost of acquiring minority interests in the Group's Chilean subsidiary (page 109 note 9).

(d) Proceeds on disposal of subsidiaries

In 2007, the cash inflow principally reflects the proceeds on the Group's disposal of its Belgian cigar factory and associated brands. In 2006, the proceeds principally reflect the sale of Toscano in Italy (page 103 note 3(f)).

Cash flows from financing activities

(a) In 2007, reductions in borrowings principally reflect the repayment of MYR450 million medium term notes along with repayment of bank loans, whilst new borrowings principally reflect MYR400 million medium term notes and MYR100 million commercial papers. In addition, €800 million of €1.7 billion bonds with a maturity of 2009 were replaced by €1 billion bonds with a maturity of 2017.

In 2006, reductions in borrowing principally reflect repayment of €1 billion floating rate notes, a deutschmark1 billion Eurobond and a €500 million Eurobond, whilst new borrowings principally reflected €600 million Eurobonds with a 2014 maturity, £325 million Eurobonds with a 2016 maturity and €525 million floating rate notes with a 2010 maturity.

(b) 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 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.

26 Disposals of businesses and assets

(a) As described on page 103 in note 3(f), the Group agreed to sell its pipe tobacco trademarks on 20 February 2007, sold its Belgian cigar factory and associated brands on 3 September 2007, and on 1 October 2007 agreed to terminate its Chesterfield license agreement with Philip Morris in a number of countries in Southern Africa. During 2006, the Group's Italian subsidiary sold its cigar business on 19 July, while a cigarette trademark transfer agreement with Philip Morris for some brands in certain countries was completed on 29 November.

(b) At 31 December 2007, the Group had non-core assets in various locations being actively marketed for sale, comprising plant, property and equipment of £30 million, inventories of £3 million and other assets of £3 million. These assets are expected to be sold during 2008. Trade and other payables of £2 million have been shown as liabilities directly associated with assets held for sale. The effect of the reclassification of these assets and liabilities on reported segments is shown on page 98 note 2.

27 Share-based payments

During the period ended 31 December 2007, the following material share-based payment arrangements existed, which are described below:

Type of arrangement	Long Term Incentive Plan	Deferred Share Bonus Scheme	Sharesave Scheme	Share Option Scheme	Share Reward Scheme
Timing of grant	2007 – March and May (2006: March)	Annually in March	Annually in November	See note (a)	Annually in April
Number of options/ shares granted in 2007	March – 2,123,478 May – 658,054	2,315,410	3 year – 108,351 5 year – 142,511	n/a	240,641
Number of options/ shares granted in 2006	2,712,841	1,835,223	3 year – 126,844 5 year – 154,664	n/a	334,738
Fair value per share for 2007 grant	March – £10.47 May – £10.72	£13.82	3 year – £4.25 5 year – £4.57	n/a	£15.76
Fair value per share for 2006 grant	£10.10	£13.00	3 year – £3.65 5 year – £3.91	n/a	£13.85
Method of settlement	Both equity and cash-settled grants	Both equity and cash-settled grants	Equity	Both equity and cash-settled grants	Equity
Contractual life	10 years	3 years	3.5 or 5.5 years	10 years	3 years
Vesting conditions	See note (b)	See note (c)	See note (d)	See note (e)	See note (f)

Notes:

(a) The granting of options under this scheme ceased with the last grant made in March 2004. Eligible individuals are entitled to participate in the Long Term Incentive Plan and Deferred Share Bonus Scheme.

(b) Nil-cost options exercisable three years from date of grant, with payout subject to performance conditions based on earnings per share relative to inflation (50 per cent of grant) and total shareholder return, combining the share price and dividend performance of the Company by reference to two comparator groups (50 per cent of grant). Participants are not entitled to dividends prior to the exercise of the options. For grants made in 2005 and thereafter, a cash equivalent dividend will accrue through the vesting period and will be paid on vesting.

(c) Free shares released three years from date of grant and may be subject to forfeit if participant leaves employment before the end of the three year holding period. Participants receive a separate payment equivalent to a proportion of the dividend during the holding period.

(d) Options granted by invitation at a 20 per cent discount to the market price. Options 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.

(e) Options exercisable three years from date of grant and subject to earnings per share performance condition relative to inflation. Participants are not entitled to receive dividends in the period prior to the exercise of the options.

(f) Free shares granted (maximum £3,000 in any year) subject to a three year holding period and may be subject to forfeit if the employee leaves within this period. Participants are entitled to receive dividends during the holding period which are reinvested to buy further shares.

27 Share-based payments continued

During the period, the Company operated a Partnership Share Scheme, which was open to all eligible employees, where employees can allocate part of their pre-tax salary to purchase shares in British American Tobacco p.l.c. The maximum amount that can be allocated in this way to any individual is £1,500 in any tax year. The shares purchased are held in a UK-based trust and are normally capable of transfer to participants tax free after a five year holding period.

Further details on the operation of share-based payment arrangements can be found in the Remuneration Report.

Share option schemes

Details of the movements for equity-settled share option schemes during the years ended 31 December 2007 and 31 December 2006 covering the Share Option and Sharesave Schemes were as follows:

	2007		2006	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	**8,449,681**	**6.86**	12,648,695	6.39
Granted during the period	**250,862**	**14.35**	281,508	11.52
Exercised during the period	**(3,806,566)**	**6.73**	(4,234,650)	5.75
Forfeited during the period	**(297,967)**	**7.85**	(245,872)	7.01
Outstanding at end of year	**4,596,010**	**7.32**	8,449,681	6.86
Exercisable at end of year	**3,440,746**	**6.44**	3,626,882	5.55

In addition to the above options, the movement in nil-cost equity-settled options from the Long Term Incentive Plan was as follows:

	2007 Number of options	2006 Number of options
Outstanding at start of year	**8,108,255**	9,403,252
Granted during the period	**2,324,409**	2,224,313
Exercised during the period	**(2,439,044)**	(2,478,316)
Forfeited during the period	**(316,591)**	(1,040,994)
Changed to cash-settled share-based payment arrangement*	**(354,984)**	
Outstanding at end of year	**7,322,045**	8,108,255
Exercisable at end of year	**921,841**	922,014

*During 2007, equity-settled awards in respect of 300,107 options were modified to a cash-settled basis, while a further 54,877 options were replaced by cash-settled awards.

27 Share-based payments continued

The weighted average British American Tobacco p.l.c. share price at the date of exercise for share options exercised during the period was £16.03 (2006: £13.94). A detailed breakdown of the range of exercise prices for options outstanding for the years ended 31 December 2007 and 31 December 2006 is shown in the table below:

	2007			2006		
Range of exercise prices	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £
Nil-cost	**7,322,045**	**7.8**	**n/a**	8,108,255	7.8	n/a
£2.53 to £4.99	**287,606**	**2.0**	**3.16**	389,805	2.0	3.19
£5.00 to £6.99	**1,960,056**	**3.6**	**5.84**	3,908,880	4.1	5.74
£7.00 to £8.99	**1,588,218**	**5.0**	**7.72**	3,488,622	6.4	7.83
£9.00 to £12.49	**509,268**	**3.0**	**10.61**	662,374	3.9	10.51
£12.50 to £14.49	**250,862**	**4.6**	**14.35**			
	11,918,055	**6.2**	**2.82**	16,557,936	6.4	3.50

The weighted average fair value of equity-settled share option schemes' shares granted during 2007 was £9.94 (2006: £9.39).

Assumptions used in the Black-Scholes models to determine the fair value of share options at grant date were as follows:

	2007		2006	
	Long Term Incentive Plan*	Sharesave Schemes**	Long Term Incentive Plan	Sharesave Schemes**
Share price at date of grant (£)	**15.41/15.69**	**17.94**	14.34	14.40
Exercise price (£)	**nil-cost**	**14.35**	nil-cost	11.52
Expected volatility (%)	**21/20**	**18**	23	21
Average expected term to exercise (years)	**3.5**	**3.2/5.2**	3.5	3.2/5.2
Risk-free rate (%)	**5.1/5.5**	**4.4/4.5**	4.4	4.9/4.8
Expected dividend yield (%)	**4.1/4.0**	**3.5**	3.3	3.4

*Where two figures have been quoted for the Long Term Incentive Plan, the first number represents the March 2007 award and the second number the May 2007 award.

**Where two figures have been quoted for the Sharesave Schemes, the first number represents the assumptions for the three year savings contract and the second number for the five year savings contract.

Market condition features were incorporated into the Monte-Carlo models for the total shareholder return elements of the Long Term Incentive Plan, in determining fair value at grant date. Assumptions used in these models were as follows:

	2007 %	2006 %
Average share price volatility FTSE 100 comparator group	**28**	31
Average share price volatility FMCG comparator group	**21**	23
Average correlation FTSE 100 comparator group*	**27/28**	26
Average correlation FMCG comparator group	**18**	18

*Where two figures have been quoted for the Long Term Incentive Plan, the first number represents the March 2007 award and the second number the May 2007 award.

27 Share-based payments continued

The expected British American Tobacco p.l.c. share price volatility was determined taking account of the daily share price movements over a five year period. The respective FMCG and FTSE 100 share price volatility and correlations were also determined over the same periods. The average expected term to exercise used in the models has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural conditions, forfeiture and historical experience.

The risk-free rate has been determined from market yield curves for government gilts with outstanding terms equal to the average expected term to exercise for each relevant grant. The expected dividend yield was determined by calculating the yield from the last two declared dividends divided by the grant share price, adjusted for the Group's announced change in dividend policy.

For grants containing earnings per share performance conditions, the payout calculation is based on the expectations published in analysts' forecasts.

Other equity share-based payment arrangements (other than share options)

Details of the movements of other equity share-based payment arrangements during the years ended 31 December 2007 and 31 December 2006, covering the Deferred Share Bonus and Share Reward Schemes, were as follows:

	2007 Number of shares	2006 Number of shares
Outstanding at start of year	**5,833,871**	7,001,271
Granted during the period	**2,302,001**	1,959,868
Exercised during the period	**(2,162,432)**	(3,037,981)
Forfeited during the period	**(68,004)**	(89,287)
Changed to cash-settled share-based payment arrangement*	**(292,276)**	
Outstanding at end of year	**5,613,160**	5,833,871
Exercisable at end of year	**437,703**	383,294

*During 2007, equity-settled awards in respect of 235,819 shares were modified to a cash-settled basis, while a further 56,457 shares were replaced by cash-settled awards.

The shares outstanding for the year ended 31 December 2007 had a weighted average contractual life of 1.2 years (2006: 1.1 years).

The fair value for other equity share-based payment arrangements granted during the period was determined using the Black-Scholes model with the following input assumptions at their grant date:

	2007		2006	
	Deferred Share Bonus Scheme	**Share Reward Scheme**	Deferred Share Bonus Scheme	Share Reward Scheme
Grant price (£)	**15.41**	**15.76**	14.34	13.85
Expected volatility (%)	**21**	**21**	23	23
Average expected term to exercise (years)	**3.0**	**5.0**	3.0	5.0
Risk-free rate (%)	**5.1**	**5.0**	4.4	4.5
Expected dividend yield (%)	**4.1**	**4.0**	3.3	3.4

The weighted average fair value of other equity share-based payment arrangements granted during 2007 was £14.02 (2006: £13.14).

27 Share-based payments continued

Cash-settled share-based payment arrangements

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 at the end of 2007 of £28 million (2006: £14.3 million) of which £6.3 million (2006: £3.5 million) was in respect of vested grants. Fair value was determined from the Black-Scholes and Monte-Carlo models, using assumptions revised at the balance sheet date for cash-settled share-based payment arrangements. The Group recorded total expenses of £23.9 million in 2007 (2006: £9.3 million).

Details of movements for cash-settled arrangements in respect of the Share Option Scheme during the years ended 31 December 2007 and 31 December 2006, were as follows:

	2007		2006	
	Number of options	Weighted average exercise price per share £	Number of options	Weighted average exercise price per share £
Outstanding at start of year	431,280	6.69	1,057,496	6.40
Granted during the period	n/a	n/a	n/a	n/a
Exercised during the period	(129,317)	6.86	(605,634)	6.19
Forfeited during the period	(6,632)	6.39	(20,582)	6.69
Outstanding at end of year	295,331	6.63	431,280	6.69
Exercisable at end of year	295,331	6.63	313,101	6.17

In addition to the above, the movement in other nil-cost cash-settled arrangements during the years ended 31 December 2007 and 31 December 2006, covering the Long Term Incentive Plan and Deferred Share Bonus Scheme, were as follows:

	2007 Number of shares	2006 Number of shares
Outstanding at start of year	1,614,706	1,215,861
Granted during the period	711,173	698,621
Exercised during the period	(591,471)	(239,513)
Forfeited during the period	(102,840)	(60,263)
Changed from equity-settled share-based arrangement*	647,260	
Outstanding at end of year	2,278,828	1,614,706
Exercisable at end of year	125,406	63,934

* As explained in the sections for share option schemes and other equity share-based payment arrangements above, during 2007 awards in respect of 647,260 shares were changed from an equity-settled to a cash-settled basis.

27 Share-based payments continued

Assumptions used to determine the fair value of cash-settled share-based payment arrangements at date of grant, can be found in the sections relating to share option schemes and other equity share-based payment arrangements.

The weighted average British American Tobacco p.l.c. share price at the date of exercise for cash-settled share-based arrangements exercised during the period was £16.37 (2006: £14.05). A detailed breakdown of the range of exercise prices for cash-settled share-based payment arrangements outstanding for the years ended 31 December 2007 and 31 December 2006 are shown in the table below:

	2007			2006		
Range of exercise prices	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £	Number outstanding at end of year	Weighted average remaining contractual life in years	Weighted average exercise price per share £
Nil-cost	**2,278,828**	**5.6**	**n/a**	1,614,706	6.1	n/a
£5.60 to £5.98	**120,844**	**5.0**	**5.96**	163,481	6.1	5.97
£6.39 to £8.09	**174,487**	**5.0**	**7.09**	267,799	6.0	7.14
	2,574,159	**5.5**	**0.76**	2,045,986	6.1	1.41

Share-based payment expense

The amounts recognised in the Income Statement in respect of share-based payments were as follows:

	2007 £m	2006 £m
Equity-settled share-based payments	**37**	41
Cash-settled share-based payments	**24**	9
Total amount recognised in the Income Statement *page 101 note 3(a)*	**61**	50

As explained in the sections for share option schemes and other equity share-based payment arrangements, during 2007 certain awards were changed from an equity-settled to a cash-settled basis. The fair value of the old and new awards were calculated using the valuation basis set out in the relevant sections of this note and the British American Tobacco p.l.c. share price at the date of the change. This resulted in a net incremental charge of £3.2 million, which was reflected in a £6.4 million increase in the expense for cash-settled payments and a £3.2 million decrease in the expense for equity-settled payments. The other main cause of the higher charge for cash-settled payments in 2007 is the increase in the British American Tobacco p.l.c. share price over the year.

28 Group employees

The average number of persons employed by the Group and its associates during the year, including Directors, was 97,696 (2006: 97,431).

	2007 Number	2006 Number
Europe	**18,913**	18,953
Asia-Pacific	**10,334**	10,128
Latin America	**15,009**	14,941
Africa and Middle East	**7,807**	8,993
America-Pacific	**1,844**	2,130
Subsidiary undertakings	**53,907**	55,145
Associates	**43,789**	42,286
	97,696	97,431

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration Report on pages 58 to 75.

Included within the employee numbers for 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 IAS24 on related party disclosures, all of which are undertaken in the normal course of trading. Details of these are set out below.

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 £53 million (2006: £48 million). The Group's share of dividends from associates included in other net income in the table below, was £290 million (2006: £267 million). Legal fees recovered from Reynolds American Inc. included in other net income amounted to £1 million (2006: £2 million).

	2007 £m	2006 £m
Transactions		
– revenue	**32**	35
– purchases	**(275)**	(292)
– other net income	**292**	272
Amounts receivable at 31 December	**67**	58
Amounts payable at 31 December	**(37)**	(24)

As discussed on page 103 in note 3(f), the Group completed the sale of its Belgian cigar factory and associated brands to the cigars division of Skandinavisk Tobakskompagni AS on 3 September 2007. The gain on disposal is not included in the above table.

29 Related party disclosures continued

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.

	2007 £m	2006 £m
The total compensation for key management personnel, including Directors, was		
– salaries and other short term employee benefits	**14**	14
– post-employment benefits	**4**	3
– share-based payments	**7**	6
	25	23

There were no other long term benefits applicable in respect of key personnel. The above table includes termination benefits paid during the year of £1.2 million (2006: £0.9 million).

Other than in their capacity as shareholders, there have been no material transactions with Compagnie Financière Richemont SA and Remgro Limited, who together indirectly own 29.95 per cent (2006: 29.2 per cent) of the ordinary share capital of British American Tobacco p.l.c. at 31 December 2007.

30 Contingent liabilities and financial commitments

The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, reputational damage, or other sanctions. These matters are inherently difficult to quantify.

In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and the amount of the obligation can be reliably estimated, a provision would be recognised based on best estimates and management judgement.

There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions were made.

The Group has exposures in respect of the payment or recovery of a number of taxes. The Group is and has been subject to a number of tax audits covering amongst others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with the Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense. In some cases disputes are proceeding to litigation.

While the amounts that may be payable or receivable could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

Product liability litigation

Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) (B&W), as well as other leading cigarette manufacturers, are defendants, principally in the US, in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

30 Contingent liabilities and financial commitments continued

Indemnity

On 30 July 2004, B&W completed transactions combining its US tobacco business assets, liabilities and operations with R.J. Reynolds Tobacco Company. A new company called R.J. Reynolds Tobacco Company (RJRT) was created as a result of the combination transactions. These transactions (the Business Combination) were accomplished through Reynolds American Inc. (RAI), which is a publicly traded holding company and the indirect parent corporation of RJRT. As a result of the Business Combination: (a) B&W discontinued the active conduct of any tobacco business in the US; (b) B&W contributed to RJRT all of its assets other than the capital stock of certain subsidiaries engaged in non-US businesses and other limited categories of assets; (c) 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; and, (d) RJRT agreed to indemnify B&W and each of its affiliates (other than RAI and its subsidiaries) against, among other matters, all losses, liabilities, damages, expenses, judgments, attorneys' fees, etc, to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the RJRT Indemnification). The scope of the RJRT Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's US tobacco business as conducted on or prior to 30 July 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after 30 July 2004 (the tobacco litigation).

Pursuant to the terms of the RJRT Indemnification, RJRT is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defence of the tobacco litigation. RJRT has assumed control of the defence of the tobacco litigation involving B&W and RJRT is also a party in most (but not all) of the same cases. Accordingly, RJRT uses or plans to use the same law firm or firms to represent both B&W and RJRT in any single or similar case (except in certain limited circumstances) as RJRT's interests are typically aligned with B&W's interests, and RJRT has substantial experience in managing recognised external legal counsel in defending the tobacco litigation, and external counsel have independent professional responsibilities to represent the interests of B&W. In addition, in accordance with the terms of the RJRT Indemnification, affiliates of B&W have retained control of the defence in certain tobacco litigation cases with respect to which such affiliates are entitled to indemnification.

US litigation

The total number of US product liability cases pending at 31 December 2007 involving B&W and/or other Group companies was approximately 3,323 (2006: 3,492). At 31 December 2007, UK-based Group companies have been named as co-defendants in six of those cases (2006: seven). In 2007, only one case was tried against B&W, and it resulted in a defence verdict. That case, Menchinini, was an individual case brought by a flight attendant who was a member of the Broin class action (see below). No US cases involving the UK-based Group companies were tried in 2007. Approximately six cases where B&W is a defendant are currently scheduled for trial in 2008, some involving amounts ranging possibly into the hundreds of millions and even billions of dollars. No case in which a UK-based Group company is a defendant is currently scheduled for trial in 2008.

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. The cases fall into four broad categories:

(a) Medical reimbursement cases

These civil actions seek to recover amounts spent by government entities and other third party providers on healthcare and welfare costs claimed to result from illnesses associated with smoking. Although B&W continues to be a defendant in healthcare cost recovery cases involving plaintiffs such as hospitals and Native American tribes, the vast majority of such cases have been dismissed on legal grounds. At 31 December 2007, one reimbursement suit was pending against B&W by an Indian tribe in Indian tribal court in South Dakota, and no suits were pending against B&W by county or other political subdivisions of the states. The Master Settlement Agreement (MSA) with the 46 states includes a credit for any amounts paid in suits brought by the states' political subdivisions; nevertheless, RJRT intends to defend and is defending these cases vigorously. Based on somewhat different theories of claim are two non-governmental medical reimbursement cases and health insurers' claims. One third party reimbursement case (City of St. Louis),

consists of more than 60 public and non-profit hospitals in Missouri seeking reimbursement of past and future alleged smoking related healthcare costs. A trial date for this case has been set for 11 January 2010.

B&W was named as a defendant in two cases brought by foreign government entities in a single US court (Republic of Panama and State of São Paulo) seeking reimbursement of medical costs which they incurred for treatment for persons in their own countries who are alleged to have smoked imported cigarettes, including those manufactured by B&W. These two cases, originally filed in state court in Louisiana, were consolidated and then dismissed by the trial court on the basis that Louisiana was the inappropriate forum. These plaintiffs filed new cases in the Superior Court for the State of Delaware on 19 July 2005. On 13 July 2006, the Delaware Superior Court granted defendants' motion to dismiss. Plaintiffs filed notices of appeal to the Supreme Court of Delaware on 19 July 2006, and that Court affirmed the dismissal of plaintiffs' claims on 23 February 2007.

(b) Class actions

At 31 December 2007, B&W was named as a defendant in some 12 (2006: 15) 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. Even if the classes remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will still be necessary to resolve any actual claims. 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 class action complaint (Schwab) was filed in the US District Court for the Eastern District of New York on 11 May 2004 against several defendants, including B&W and certain UK-based Group companies. The complaint challenges the defendants' practices with respect to the marketing, advertising, promotion and sale of 'light' cigarettes. The court granted plaintiffs' motion for class certification on 25 September 2006. By order dated 17 November 2006, the Second Circuit Court of Appeals granted defendants' motion to stay the district court proceedings in this case, and further granted defendants' petition for leave to appeal the district court's class certification order. Briefing on the appeal was completed on 31 January 2007, and oral argument was heard on 10 July 2007. A decision on the appeal remains pending. Other types of class-action suits assert claims on behalf of classes of individuals who claim to be addicted, injured, or at greater risk of injury by the use of tobacco or exposure to environmental tobacco smoke, or the legal survivors of such persons.

In Engle (Florida), one jury awarded a total of US$12.7 million to three class representatives, and in a later stage of this three phase trial process, a jury assessed US$17.6 billion in punitive damages against B&W. In November 2000, B&W posted a surety bond in the amount of US$100 million (the amount required by Florida law) to stay execution of this punitive damages award. 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 decertify the class. On 16 July 2003, plaintiffs filed a motion for rehearing which was denied on 22 September 2003. On 12 May 2004, the Florida Supreme Court agreed to review this case and, on 6 July 2006, it upheld the intermediate appellate court's decision to decertify the class, and vacated the jury's punitive damages award. By an order dated 17 April 2007, the surety bond for the punitive damages was released and the US$100 million collateral securing that bond was returned to B&W. 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 Court has permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the Court's decision (subsequently extended to 11 January 2008). The Court's order precludes defendants from litigating certain issues of liability against the putative Engle class members in these individual actions. On 7 August 2006, defendants filed a motion for rehearing before the Florida Supreme Court, which was granted in part, and denied in part, on 21 December 2006. The Florida Supreme Court's 21 December 2006 ruling did not amend any of the earlier decisions' major holdings, which included decertifying the class, vacating the punitive damages judgment, and permitting individual members of the former class to file separate suits. Instead, the ruling addressed the claims on which the Engle jury's phase one verdict will be applicable to the individual lawsuits that were permitted to stand. On 1 October 2007, the United States Supreme Court denied defendants' request for certiorari review of the Florida Supreme Court's decision. At 31 December 2007, more than

30 Contingent liabilities and financial commitments continued

1,700 plaintiffs had filed lawsuits as purported Engle class members, and 43 of these suits name B&W as a defendant. All 43 suits against B&W, however, are individual smoker lawsuits that were pending in Florida before the Florida Supreme Court's 6 July 2006 decision, which have been re-classified as individual Engle lawsuits. No lawsuits by purported Engle class members have been filed against B&W after the Florida Supreme Court's 6 July 2006 decision. However, at 31 December 2007, approximately 360 suits named RJRT individually and as successor in interest to B&W, four suits named RJRT only as successor in interest to B&W, and approximately 197 suits named RJRT only in its individual capacity.

In the first 'phase three' trial of an individual Engle class member (Lukacs), the jury awarded the plaintiff US$37.5 million in compensatory damages (B&W's share: US$8.4 million). On 1 April 2003, the jury award was reduced to US$25.125 million (B&W's share: US$5.65 million) but no final judgment has been entered to date because the Court postponed the entry of final judgment until the Engle appeal was fully resolved. On 12 October 2007, plaintiff filed notice of completion of all appellate review to the trial court. Once final judgment is entered, defendants intend to pursue an appeal.

In a Louisiana medical monitoring case brought on behalf of Louisiana smokers (Scott), on 28 July 2003, the jury returned a verdict in defendants' favour on the medical monitoring claim but made findings against defendants with respect to claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On 21 May 2004, the jury returned a verdict in the amount of US$591 million on the class's claim for a smoking cessation programme. On 1 July 2004, the court upheld the jury's verdict and entered final judgment. On 29 September 2004, defendants posted a US$50 million bond (legislation in Louisiana limits the amount of a bond to prevent execution upon such a judgment to US$50 million collectively for signatories to the MSA). RJRT posted US$25 million (i.e. the portions for RJRT and B&W) towards the bond. On 12 April 2006, the Louisiana Fourth Circuit Court of Appeal heard argument on defendants' appeal. The appellate court issued a decision on 7 February 2007 that affirmed class certification and upheld the smoking cessation programme for certain smokers who began smoking before 1988, but reduced the US$591 million jury award by US$312 million and rejected any award of prejudgement interest. The decision also remanded the case to re-determine damages in light of its holding that no class members who started smoking before 1988 were entitled to any monetary damages. All further proceedings in the trial court have been stayed, however, pending further appellate review. Defendants (on 2 April 2007) and plaintiffs (on 13 April 2007) both filed petitions for review by the Louisiana Supreme Court, which the Court denied on 7 January 2008.

(c) Individual cases

Approximately 3,307 cases were pending against B&W at 31 December 2007 (2006: 3,471) filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to environmental tobacco smoke (ETS). Of these cases: (a) approximately 75 per cent are ETS cases brought by flight attendants who were members of a class action (Broin) that was settled on terms that allow compensatory but not punitive damages claims by class members; (b) approximately 20 per cent of the individual cases against B&W are cases brought in consolidated proceedings in West Virginia, where the first phase of trial is scheduled to begin on 17 March 2008; and (c) only about 5 per cent are cases filed by other individuals.

Of the individual cases that were decided or remained on appeal during 2007, 3 resulted in verdicts against B&W:

In December 2003, a New York jury (Frankson) awarded US$350,000 compensatory damages against B&W and two industry organisations. In January 2004, the same jury awarded US$20 million punitive damages. On 22 June 2004, the trial judge granted a new trial unless the parties agreed to an increase in compensatory damages to US$500,000 and a decrease in punitive damages to US$5 million, of which US$4 million would be assigned to B&W. Plaintiffs agreed to a decrease in punitive damages, but B&W has not agreed to an increase in compensatory damages. On 25 January 2005, B&W appealed to an intermediate New York State appellate court. Oral argument was heard on 8 May 2006. The appellate court affirmed the judgment on 5 July 2006. B&W filed a motion for leave to reargue, or in the alternative, for leave to appeal to the New York Court of Appeals, on 3 August 2006. The intermediate appellate court denied this motion on 5 October 2006. On 8 December 2006, the trial judge granted plaintiff's application for entry of judgment, and granted plaintiff's motion to vacate that part of the 2004 order granting a new trial unless the parties agreed to an increase in compensatory damages to US$500,000. RJRT posted a bond in the approximate amount of US$8,018,000 on 3 July

2007. B&W appealed from final judgment on 3 July 2007 to an intermediate New York State appellate court, and its initial appellate brief was submitted on 3 January 2008.

On 1 February 2005, a Missouri jury (Smith) awarded US$500,000 in compensatory damages against B&W and then, on 2 February 2005, awarded US$20 million in punitive damages, also against B&W. On 1 June 2005, B&W filed its notice of appeal. B&W filed its opening appellate brief on 28 April 2006. Oral argument was heard on 31 August 2006. On 31 July 2007, an intermediate Missouri appellate court affirmed the compensatory damages award, but it reversed the punitive damages award, reasoning that plaintiff failed to produce sufficient evidence to justify the verdict. The court remanded the case for a second trial, limited to punitive damages.

On 18 March 2005, a New York jury (Rose) awarded US$1.7 million in compensatory damages against B&W. On 18 August 2005, B&W filed its notice of appeal. RJRT posted a bond in the approximate amount of US$2.058 million on 7 February 2006. Oral argument on this appeal was heard on 12 December 2006 by an intermediate New York appellate court, which has not yet rendered a decision.

(d) Other claims

The Flintkote Company (Flintkote), a US asbestos production and sales company, was included in the acquisition of Genstar Corporation by Imasco in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited (Imperial)) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar began to sell most of its assets, including the non-asbestos related operations and subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice that sufficient assets would remain to satisfy liabilities, Flintkote and Imasco authorised the payment of two dividends. 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, certain representatives of both the present and future asbestos claimants as well as certain individual asbestos claimants were permitted by the bankruptcy court to file a complaint against Imperial and numerous other defendants for the recovery of the dividends and other compensation under various legal theories. The parties are presently engaged in case management discussions to establish the scope and manner of discovery in this case. This litigation is at a preliminary stage and is expected to take a number of years to proceed to trial.

In Wisconsin, the authorities have identified potentially responsible parties to fund the clean up of the Fox River, Wisconsin. The pollution was caused by discharges of toxic material from paper mills operating close to the river. The cost of the clean up work has been estimated to be in the order of US$600 million. Among the potentially responsible parties are NCR Corporation (NCR) and Appleton Papers Inc. (Appleton) who may be liable for a proportion of the clean up costs. B.A.T Industries p.l.c. (Industries) purchased what was then NCR's Appleton Papers Division from NCR in 1978 and spun off this business in 1990, obtaining full indemnities from Appleton for past and future environmental claims. Disputes between NCR, Appleton and Industries as to the indemnities given and received under the purchase agreement in 1978 have been the subject of arbitration in 1998 and 2006. Under the terms of the arbitration awards, Industries and Appleton have an obligation to share the costs of environmental claims with NCR, but Industries has never been required to pay any sums in this regard because Appleton has paid any sums demanded to date. It is believed that all future environmental liabilities will continue to be met directly by Appleton by self-funding or insurance cover and no demand will be made upon Industries.

Settlement of State Health Care Reimbursement Cases

During 2003, agreement was reached on certain disputed MSA payments relating to MSA calculations based on 1999 and 2000 sales. This agreement resulted in a benefit of £27 million which is excluded from the 2003 costs shown in the consolidated audited annual accounts of the Company for the financial year ended 31 December 2004. In other developments, after an Independent Auditor found that the terms of the MSA were a 'significant factor' in market share losses experienced by signatories to the MSA in 2003, several US tobacco companies, including B&W, asserted their rights under the NPM (or Non-Participating Manufacturer) Adjustment provision of the MSA to recover a payment credit or offset – against their April 2006 payment obligations – for MSA payments made in April 2004 in respect of cigarettes shipped or sold in the US in 2003. The amount at stake exceeds US$1 billion. The settling states oppose these MSA payment reduction claims and, in late April 2006, began filing motions in MSA courts across the country seeking enforcement of certain MSA provisions and a declaration of the parties' rights under the NPM Adjustment provision of the MSA. Defendants have opposed these motions, arguing that their NPM Adjustment claims must go instead to arbitration. To date, the overwhelming majority of MSA courts to decide these motions have ruled in defendants' favour.

30 Contingent liabilities and financial commitments continued

UK-based Group companies

At 31 December 2007, Industries was a defendant in the US in one class action, the Schwab case mentioned previously. In that case, Industries was substituted for the Company as a defendant. British American Tobacco (Investments) Limited (Investments) had been served in one reimbursement case (City of St. Louis), the Department of Justice case (see below), one anti-trust case (Smith, see below), two class actions (Cleary and Schwab) and two individual actions (Eiser and Perry).

Conduct-based claims

On 22 September 1999, the US Department of Justice brought an action in the US District Court for the District of Columbia against various industry members, including RJRT, B&W, Industries and Investments. Industries was dismissed for lack of personal jurisdiction on 28 September 2000. The government sought to recover federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related, and, in addition, sought, pursuant to the federal Racketeer Influenced and Corrupt Organizations Act (RICO), disgorgement of profits the government contends were earned as a consequence of a RICO 'enterprise'. On 28 September 2000, the portion of the claim which sought recovery of federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related was dismissed. The bench (non-jury) trial of the RICO portion of the claim began on 21 September 2004, and ended on 9 June 2005. On 17 November 2004, the Washington DC Circuit Court of Appeals heard an appeal by the defendants against an earlier district court decision that disgorgement of profits is an appropriate remedy to the RICO violations alleged by the government. On 4 February 2005, the Court of Appeals allowed the appeal, ruling that the government could not claim disgorgement of profits. On 17 October 2005, the US Supreme Court declined to hear the government's appeal in respect of the claim for disgorgement of US$280 billion of past profits from the US tobacco industry. The disgorgement claim was a centrepiece of the government's claim.

On 17 August 2006, the district court issued its final judgment, consisting of some 1,600 pages of factual findings and legal conclusions. The court found in favour of the government, and against certain defendants, including B&W and Investments. The court also ordered a wide array of injunctive relief, including a ban on the use of 'lights' and other similar descriptors beginning 1 January 2007. Compliance with the court-ordered remedies may cost RJRT and Investments millions of dollars. In addition, the government is seeking the recovery of roughly US$1.9 million in litigation costs. Defendants filed a motion to stay enforcement of the judgment shortly after the judgment was issued. The court denied defendants' stay motion on 28 September 2006. Defendants, including B&W and Investments, filed their notices of appeal to the Washington DC Circuit Court of Appeals on 11 September 2006, and filed an emergency motion to stay the judgment before the same court on 29 September 2006. On 31 October 2006, the Court of Appeals granted defendants' motion to stay enforcement of the judgment pending the outcome of the appeal. On 10 August 2007, defendants filed their initial appellate briefs to the Court of Appeals. All defendants filed a joint appellate brief, and Investments also filed its own brief which raised the issue of whether Congress intended for RICO to apply to extraterritorial conduct by a foreign defendant. On 19 November 2007, the government filed its opposition/cross-appeal brief. Appellate briefing will be completed in May 2008, but a date for oral argument has not yet been scheduled.

In the Daric Smith case, purchasers of cigarettes in the State of Kansas brought a class action in the Kansas State Court against B&W, Investments and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. The allegations are that the defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including the State of Kansas, in violation of the Kansas Restraint of Trade Act. The matter will be defended vigorously.

Product liability outside the United States

At 31 December 2007, active claims against Group companies existed in 18 (2006: 18) countries outside the US but the only countries with more than five active claims were Argentina, Australia, Brazil, Canada, Chile, Italy, and the Republic of Ireland. Recoupment actions are being brought in Argentina, Brazil, Israel, Nigeria, Spain and Saudi Arabia, and there are also three class actions being brought in Brazil.

At 31 December 2007, there were some 3,478 (2006: 1,113) filed individual 'lights' cases in Italy. This is a significant increase from last year due to the filing of 2,230 cases by a single plaintiffs' counsel in one jurisdiction (Pescopagano). Of the 2,230 Pescopagano cases, plaintiffs' lawyer

has withdrawn 472 claims currently before the Court, although the Court has not yet confirmed the withdrawal of those cases. Plaintiffs' lawyer has also stated his intention to withdraw the remaining 1,758 cases not yet formally registered. Almost all of the individual 'lights' cases filed in Italy, including Pescopagano, are pending before Justices of the Peace courts. Because of the type of court involved, the most that any individual plaintiff can recover is €1,033. To date, more than 950 (2006: 678) of these cases (not including Pescopagano cases) have been suspended or resulted in decisions given in favour of British American Tobacco Italia S.p.A. There are around 33 (2006: 27) smoking and health cases pending before Italian Civil Courts, filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking. There are two (2006: two) labour cases for alleged occupational exposure pending in Italy.

In Canada, the government of the Province of British Columbia brought a claim pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 against domestic and foreign 'manufacturers' seeking to recover the plaintiff's costs of health care benefits. The constitutionality of the 2000 Act was challenged by certain defendants and, on 5 June 2003, the British Columbia Supreme Court found the Act to be beyond the competence of the British Columbia legislature and, accordingly, dismissed the government's claim. The government appealed that decision to the British Columbia Court of Appeal which, on 20 May 2004, overturned the lower court's decision and declared the Act to be constitutionally valid. Defendants appealed to the Supreme Court of Canada in June 2004 and that court gave its judgment in September 2005 dismissing the appeals and declaring the Act to be constitutionally valid. The action is now set down for trial in September 2010. The federal government has been enjoined by a Third Party Notice, and has presented a Motion to Strike the claim. The hearing will take place during the week of 3 March 2008. Non-Canadian defendants challenged the personal jurisdiction of the British Columbia Court and those motions were heard in the Supreme Court of British Columbia. On 23 June 2006, the court dismissed all defendants' motions, finding that there is a 'real and substantial connection' between British Columbia and the foreign defendants. Subsequently, defendants were granted leave to appeal. The appeal was dismissed on 15 September 2006. Defendants have filed leave to appeal to the Supreme Court on 10 November 2006. Similar legislation has been enacted, but not yet brought into force, in some other Canadian provinces, and is also being considered by other Canadian provinces. In June 2006, the government of New Brunswick passed the Tobacco Damages and Health Care Costs Recovery Act. It has recently announced that it has hired a consortium of law firms from Canada and the US to represent the Province and file suit.

In addition, there are five class actions and four individual cases in Canada. In the Knight class action, the Supreme Court of British Columbia certified a class of all consumers of cigarettes bearing 'light' or 'mild' descriptors since 1974 manufactured in British Columbia by Imperial. Imperial filed an appeal against the certification which was heard in February 2006. The Appeal Court confirmed the certification of the class but has limited any financial liability, if proved, to the period from 1997. This is a 'lights' class action in which plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Although the claim arises from health concerns, it does not seek compensation for personal injury. Instead it seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial. The motion of the federal government to strike out the third party notice issued against them by Imperial was heard in February 2006 and was granted but is currently under appeal by Imperial. A similar 'lights' and 'mild' class action claim has been filed in Newfoundland. Imperial has filed a third party notice against the federal government. The certification hearing took place in September 2007 and is now under advisement.

There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification. The court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. In Quebec, there is no right of appeal for a defendant upon certification. Plaintiffs have served a Statement of Claim. This litigation is expected to take several years to proceed to trial. The other class action is an attempt to establish a class claiming for personal injury or damage to property from fires caused by cigarettes that did not automatically extinguish on being dropped or left unattended. Certification of such a class was denied in October 2005. Plaintiffs' appeal was heard on 28/29 January 2008 and judgment is awaited.

In 2007, four Nigerian states (Lagos, Kano, Gombe, and Oyo) and the federal government of Nigeria filed separate health care recoupment actions, each seeking the equivalent of billions of US dollars for costs allegedly incurred by the

30 Contingent liabilities and financial commitments continued

state and federal governments in treating smoking-related illnesses. The actions are still in the preliminary stages. British American Tobacco (Nigeria) Limited, the Company, and Investments have all been named as defendants in these suits. At 31 December 2007, the British American Tobacco defendants had filed preliminary objections in each of the state cases. British American Tobacco (Nigeria) Limited raised preliminary objections based on, inter alia, lack of standing by plaintiffs, lack of jurisdiction of the courts over plaintiffs' claims, a failure by plaintiffs to prove that defendants' purported misconduct was the proximate cause of plaintiffs' damages and constitutional arguments relating to separation of powers and federalism. Both the Company and Investments raised preliminary objections to personal jurisdiction and service. The courts in Kano and Gombe are scheduled to hear oral argument on defendants' jurisdiction and service objections in early 2008. It is possible that other Nigerian states will file similar lawsuits in the near future.

In Saudi Arabia, there are reports that the Ministry of Health is pursuing a health-care recoupment action in the Riyadh General Court against Saudi tobacco distributors, seeking damages of billions of Saudi Riyals. The identity of the defendants is unclear at this time. At 31 December 2007, no Group company had been served with process. In addition, a separate recoupment action was reportedly filed by the King Faisal Hospital on 30 September 2007 in the Riyadh General Court, naming 'BAT Company Limited' as a defendant. At 31 December 2007, no Group company had been served with process in the action.

Other litigation outside the US

In November 2004, the Royal Canadian Mounted Police (the RCMP) obtained a warrant to search and seize business records and documents at the head office of Imperial in Montreal. The affidavit filed by the RCMP to obtain the search warrant made allegations in relation to the smuggling of cigarettes in Canada between 1989 and 1994, naming Imperial, the Company, Industries and certain former directors and employees. No charges have yet been laid. Imperial believes that it has conducted itself appropriately at all times, but cannot predict the outcome of any such investigation, or whether additional investigations will occur.

Two actions were started in Russia by a minority shareholder in OJSC Company British American Tobacco-Yava (BAT-Yava), a Russian incorporated subsidiary of British American Tobacco Holdings (Russia) B.V. The minority shareholder, Branston Holdings (Branston), issued a claim in Moscow seeking to have a contract between BAT-Yava and its sister company invalidated, and issued another claim in the Stavropol region alleging that certain of the directors of BAT-Yava, and other parties, took various unlawful steps. At first instance, the Moscow Court dismissed the claim and the Stavropol Court ordered the transfer of the case filed there to Moscow. The Stavropol case was duly transferred and after a hearing on the merits on 3 October 2007, the Court dismissed all Branston's claims in full. Branston has now appealed the first instance judgment and there is a hearing scheduled before the Moscow Court of Appeal on 9 April 2008. The Group considers the claim to be without merit and will continue to defend it strenuously.

Conclusion

While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Company believes that the defences of the Group companies to all these various claims are meritorious both on the law and the facts, and a vigorous defence is being made everywhere. If an adverse judgment is entered against any of the Group companies in any case, an appeal will be made. Such appeals could require the appellants to post appeal bonds or substitute security in amounts which could in some cases equal or exceed the amount of the judgment. In any event, with regard to US litigation, the Group has the benefit of the RJRT Indemnification. At least in the aggregate, and despite the quality of defences available to the Group, it is not impossible that the results of operations or cash flows of the Group in particular quarterly or annual periods could be materially affected by this and by the final outcome of any particular litigation.

Having regard to all these matters, the Directors (i) do not consider it appropriate to make any provision in respect of any pending litigation and (ii) do not believe that the ultimate outcome of this litigation will significantly impair the financial condition of the Group.

Guarantees

Performance guarantees given to third parties in respect of Group companies were £1 million (2006: £157 million).

Operating leases

Total future minimum lease payments under non-cancellable operating leases comprise leases where payments fall due:

	2007 £m	2006 £m
Property		
Within one year	**55**	50
Between one and five years	**100**	112
Beyond five years	**147**	167
	302	329
Plant and equipment		
Within one year	**21**	17
Between one and five years	**29**	19
	50	36

31 Post balance sheet events

(a) On 22 February 2008, the Group announced that it had won the public tender for Tekel, the Turkish state-owned tobacco company, with a bid of US$1,720 million. The transaction, financed with a committed bank facility, is subject to regulatory approvals and is expected to be completed later this year. The privatisation only relates to the cigarette assets of Tekel, which principally comprise brands, six factories and tobacco leaf stocks. The privatisation does not include employees and an announcement on employment by the Group is planned nearer to the completion of the transaction, after dialogue with employees and unions.

(b) On 27 February 2008, the Group agreed to acquire 100 per cent of Skandinavisk Tobakskompagni's (ST) cigarette and snus business in exchange for its 32.35 per cent holding in ST and payment of DKK11,384 million in cash. This transaction, which is subject to approval by the European Commission, is being financed through a committed bank facility and completion is anticipated later this year.

(c) On 21 February 2008, the Group's associated company Reynolds American announced that it would receive a payment from Gallaher Limited resulting from the termination of a joint venture agreement. While the payment will be received over a number of years, in the first quarter of 2008 Reynolds American will recognise a pre-tax gain of US$300 million.

FIVE YEAR SUMMARY

For the years ended 31 December	2007 IFRS £m	2006 IFRS £m	2005 IFRS £m	2004 IFRS £m	2003 UK GAAP £m
Income statement					
Gross turnover (including duty, excise and other taxes)	**26,234**	25,189	23,984	31,833	25,622
Revenue (after deducting duty, excise and other taxes)	**10,018**	9,762	9,325	10,768	10,570
Profit from operations*	**2,905**	2,622	2,420	3,760	1,852
Profit before taxation	**3,078**	2,764	2,584	3,637	1,567
Profit for the year (before minority interest)	**2,287**	2,048	1,894	2,964	788
*after (charging)/crediting					
– restructuring costs	**(173)**	(216)	(271)	(206)	(437)
– investment costs written off				(50)	
– net gains/(losses) on disposal of businesses non-current investments and brands	**75**	41	72	1,427	
– goodwill amortisation					(405)

	2007 IFRS pence	2006 IFRS pence	2005 IFRS pence	2004 IFRS pence	2003 UK GAAP pence
Earnings per share					
– basic unadjusted	**105.19**	92.08	84.34	133.76	26.93
– diluted unadjusted	**104.46**	91.33	83.66	131.45	26.69
– diluted adjusted	**108.53**	98.12	89.34	76.62	69.21
Dividends declared per share	**66.20**	55.90	47.00	41.90	38.80

At 31 December	2007 IFRS £m	2006 IFRS £m	2005 IFRS £m	2004 IFRS £m	2003 UK GAAP £m
Balance sheet					
Non-current assets	**13,362**	12,385	13,147	12,095	
Fixed assets					11,313
Current assets	**5,366**	5,391	5,904	5,680	7,544
Total assets	**18,728**	**17,776**	**19,051**	**17,775**	**18,857**
Shareholders' funds	**6,880**	6,461	6,630	5,919	4,361
Minority interests	**218**	227	247	198	225
Total equity	**7,098**	6,688	6,877	6,117	4,586
Non-current liabilities	**7,076**	6,635	6,338	7,218	
Current liabilities	**4,554**	4,453	5,836	4,440	
Borrowings					7,610
Provisions and other creditors					6,661
Total liabilities	**11,630**	11,088	12,174	11,658	14,271
Total equity and liabilities	**18,728**	**17,776**	**19,051**	**17,775**	**18,857**

The information included in the five year summary for the year ended 31 December 2003 is as published under UK GAAP and has not been restated to IFRS.

The main adjustments in changing to IFRS were as follows:

	UK GAAP £m	Post-retirement benefits (a) £m	Goodwill (b) £m	Dividends (c) £m	Reallocations (d) £m	Other (e) £m	IFRS £m
Shareholders' funds:							
– 1 January 2004	4,361	(493)		585		(66)	4,387
– 31 December 2004	5,220	(237)	473	617		(154)	5,919
Year ended 31 December 2004							
Profit from operations	1,794	59	454		1,323	130	3,760
Profit for the year (before minority interests)	1,224	29	491		1,132	88	2,964
Earnings per share							
Basic	55.20p						133.76p
Adjusted diluted	75.83p						76.62p

(a) All cumulative actuarial gains and losses were recognised at 1 January 2004.

(b) Under UK GAAP, goodwill was amortised over its useful economic life, while from 1 January 2004 goodwill is not amortised under IFRS.

(c) Under UK GAAP, the final dividend for the year was provided in the results for that year while under IFRS it is provided in the year that it is declared.

(d) In respect of the Reynolds American transaction in 2004, which combined the Group's US domestic business (B&W) with R.J. Reynolds:

– a £918 million unrecognised gain, included in the statement of total recognised gains and losses in UK GAAP, is included in profit from operations under IFRS; and

– a write-back of £216 million under UK GAAP for goodwill previously written off to reserves, is not required under IFRS, which results in an additional gain on the partial disposal of B&W.

In addition, the gains and losses on the disposal of subsidiaries and fixed asset investments were shown below profit from operations under UK GAAP (£185 million).

(e) The other adjustments principally reflect:

– provisions for deferred tax on the unremitted profit of associates and part of the unremitted profit of subsidiaries required under IFRS but not UK GAAP;

– the application of IFRS to the results of associates; and

– an additional gain on the partial disposal of B&W in 2004 of £128 million, as a result of the IFRS adjustments for B&W in respect of post-retirement benefits.

IAS32 and IAS39, which deal with financial instruments, were applied from 1 January 2005 and consequently the figures for 2004 and 2003 do not reflect the impact of those standards.

QUARTERLY ANALYSES OF PROFIT

The figures shown below have been produced using average rates of exchange on a quarterly basis since the beginning of the year. Thus the discrete quarters have not been restated for subsequent movements in foreign exchange rates during the year, which are reflected in the results for subsequent quarters.

				3 months to	Year to
	31 Mar 2007 £m	30 Jun 2007 £m	30 Sept 2007 £m	31 Dec 2007 £m	31 Dec 2007 £m
Profit from operations	**684**	**808**	**812**	**601**	**2,905**
after (charging)/crediting					
– restructuring costs	(8)	(32)	(10)	(123)	(173)
– net gains/(losses) on disposal of businesses and brands		11	45	19	75
Net finance costs	(58)	(68)	(78)	(65)	(269)
Share of post-tax results of associates and joint ventures	111	111	113	107	442
after charging					
– brand impairments				(7)	(7)
Profit before taxation	**737**	**851**	**847**	**643**	**3,078**
Earnings per share					
Basic	24.24p	28.70p	29.73p	22.52p	105.19p
Adjusted diluted	24.31p	29.20p	28.49p	26.53p	108.53p

	3 months to				Year to
	31 Mar 2006 £m	30 Jun 2006 £m	30 Sept 2006 £m	31 Dec 2006 £m	31 Dec 2006 £m
Profit from operations	616	709	619	678	2,622
after (charging)/crediting					
– restructuring costs	(21)	(27)	(116)	(52)	(216)
– net gains/(losses) on disposal of businesses and brands	(15)	(1)		57	41
Net finance costs	(68)	(56)	(85)	(80)	(289)
Share of post-tax results of associates and joint ventures	120	123	105	83	431
after (charging)/crediting					
– brand impairments				(13)	(13)
– exceptional tax credits	16	1			17
Profit before taxation	668	776	639	681	2,764
Earnings per share					
Basic	21.81p	26.57p	21.73p	21.97p	92.08p
Adjusted diluted	22.05p	27.06p	25.89p	23.12p	98.12p

PRINCIPAL SUBSIDIARY UNDERTAKINGS

	% equity shares held
Europe	
Great Britain	
B.A.T Industries p.l.c.	100
B.A.T (U.K. and Export) Ltd.	100
B.A.T. International Finance p.l.c.	100*
BATMark Ltd.	100*
British-American Tobacco (Holdings) Ltd.	100
British American Tobacco International (Holdings) B.V. (incorporated in the Netherlands) ■	100
British American Tobacco (1998) Ltd.	100*
British American Tobacco (Brands) Ltd.	100
British American Tobacco (Investments) Ltd.	100
British American Tobacco UK Ltd.	100
Tobacco Insurance Company Ltd.	100
Weston Investment Company Ltd.	100
Belgium	
British American Tobacco Belgium S.A.	100
Tabacofina-Vander Elst N.V.	100
Cyprus	
B.A.T (Cyprus) Ltd.	100
Czech Republic	
British American Tobacco (Czech Republic), s.r.o.	100
Finland	
British American Tobacco Nordic Oy	100
France	
British American Tobacco France SAS	100
Germany	
British-American Tobacco (Germany) GmbH	100
British American Tobacco (Industrie) GmbH ●	100
Greece	
British American Tobacco Hellas S.A.	100
Hungary	
BAT Pécsi Dohánygyár Kft.	100
Italy	
British American Tobacco Italia S.p.A.	100
Netherlands	
British American Tobacco The Netherlands B.V.	100
British American Tobacco Holdings (The Netherlands) B.V.	100
Poland	
British-American Tobacco Polska S.A.	96
Republic of Ireland	
P.J. Carroll & Company Ltd.	100
Romania	
British-American Tobacco (Romania) Trading SRL	100

	% equity shares held
Russia	
OJSC British American Tobacco – STF	99
OJSC British American Tobacco – Yava	99†
CJSC British American Tobacco – SPb	100†
Serbia	
Duvanska Industrija 'Vranje' A.D.	88
Spain	
British American Tobacco España, S.A.	100
Switzerland	
British American Tobacco International Ltd.	100
British American Tobacco Switzerland S.A.	100
Ukraine	
A/T B.A.T. – Prilucky Tobacco Co.	99
Uzbekistan	
UZBAT A.O.	97
America-Pacific	
Canada	
Imperial Tobacco Canada Ltd.	100
Japan	
BAT Pacific, Inc (incorporated in the US)	100
BAT Pacific Corporation	100
British American Tobacco Japan K.K. (Ltd.)	100
United States of America	
B.A.T Capital Corporation	100*
BATUS Japan, Inc	100
Brown & Williamson Holdings, Inc.	100
British American Tobacco (Brands) Inc.	100
Asia-Pacific	
Australia	
British American Tobacco Australia Ltd.	100
Bangladesh	
British American Tobacco Bangladesh Co. Ltd.	65
Cambodia	
British American Tobacco (Cambodia) Ltd.	71
China	
B.A.T. China Ltd. (incorporated in Great Britain)	100
British-American Tobacco Co. (Hong Kong) Ltd. (incorporated in Hong Kong)	100
Indonesia	
PT BAT Indonesia Tbk	78
Malaysia	
British American Tobacco (Malaysia) Berhad	50
New Zealand	
British American Tobacco (New Zealand) Ltd.	100

	% equity shares held
Pakistan	
Pakistan Tobacco Co. Ltd.	94
Papua New Guinea	
British American Tobacco (PNG) Ltd.	100
Singapore	
British-American Tobacco (Singapore) Pte Ltd.	100
British-American Tobacco Marketing (Singapore) Pte Ltd.	100
South Korea	
British American Tobacco Korea Ltd.	100
British American Tobacco Korea Manufacturing Ltd.	100
Sri Lanka	
Ceylon Tobacco Co. Ltd.	84
Vietnam	
B.A.T Vietnam Ltd. (incorporated in Great Britain)	100
British American Tobacco-Vinataba (JV) Ltd.	70
Latin America	
Argentina	
Nobleza-Piccardo S.A.I.C.y F.	96
Brazil	
Souza Cruz S.A.	75
Chile	
Compania Chilena de Tabacos S.A.	96
Guyana	
Demerara Tobacco Co. Ltd.	70
Honduras	
Tabacalera Hondureña S.A.	80
Jamaica	
Carreras Group Ltd. ▲	50
Mexico	
British American Tobacco Mexico, S.A. de C.V.	100
Panama	
British American Tobacco Central America S.A.	78
Tabacalera Istmeña S.A.	100
Peru	
Tabacalera Nacional S.A.A.	96^
Trinidad & Tobago	
The West Indian Tobacco Company Ltd.	50

	% equity shares held
St Lucia	
CARISMA Marketing Services Ltd.	100
Venezuela	
C.A. Cigarrera Bigott Sucs.	100
Africa and Middle East	
Cameroon	
British American Tobacco Cameroun S.A.	99
Congo	
British American Tobacco Congo SARL	100
Egypt	
British American Tobacco Egypt LLC	100
Ghana	
British American Tobacco Ghana Ltd.	97
Kenya	
British American Tobacco Kenya Ltd.	60
La Reunion	
B.A.T. La Reunion SAS	100
Malawi	
British American Tobacco (Malawi) Ltd.	100
Mauritius	
British-American Tobacco (Mauritius) p.l.c. (incorporated in Great Britain)	100
Mozambique	
Sociedade Agricola de Tabacos Lda.	95
Nigeria	
British American Tobacco (Nigeria) Ltd.	100
South Africa	
British American Tobacco Holdings South Africa (Pty) Ltd.	100
Turkey	
British American Tobacco Sigara ve Tütüncülük Sanayi ve Ticaret A.S.	92
Uganda	
British American Tobacco Uganda Ltd.	90
Zambia	
British American Tobacco (Zambia) plc	78

Subsidiary undertakings held directly by British American Tobacco p.l.c. are indicated thus *; all others are held by sub-holding companies. Unless otherwise stated, the country of incorporation and operation is that under which the company is listed. All subsidiary undertakings are involved in activities related to the manufacture, distribution or sale of tobacco products.

All companies' shares are ordinary shares or common stock except for those indicated thus †, which include preference shares, and that indicated thus ^, which includes investment stock (non-voting).

● Financial year end is 30 November. ■ Financial year end is 14 January. ▲ Financial year end is 31 March.

A complete list of subsidiary and associated undertakings will be attached to the next British American Tobacco p.l.c. annual return to the Registrar of Companies.

The Company has taken advantage of the exemption under Section 231(5) of the Companies Act 1985 by providing information only in relation to subsidiary and associate undertakings whose results or financial position, in the opinion of the Directors, principally affected the Financial Statements.

PRINCIPAL ASSOCIATE UNDERTAKINGS

		Latest published information	Total issued capital £m	% shares held
Europe				
Denmark				
Skandinavisk Tobakskompagni AS	Class I Ordinary	30 Sep 2007	1	
tobacco	Class II Ordinary		36	32
America-Pacific				
United States of America				
Reynolds American Inc.	▼ Common Stock	31 Dec 2007	*	42
tobacco	▼ Preferred Stock		**	
Asia-Pacific				
India				
ITC Ltd.	▼ Ordinary	31 Dec 2007	48	32
tobacco				
paper and packaging				
hotels				

▼ Listed overseas.

* As at 31 December 2007, Reynolds American Inc. had issued 295,007,327 shares (US$0.0001 Common Stock), of which the Group held 123,905,524.

** As at 31 December 2007, Reynolds American Inc. had issued 1,000,000 shares (US$0.01 Preferred Stock), in which the Group held no interest.

REPORT OF THE INDEPENDENT AUDITORS

TO THE MEMBERS OF BRITISH AMERICAN TOBACCO P.L.C.

We have audited the parent company Financial Statements of British American Tobacco p.l.c. for the year ended 31 December 2007 which comprise the Balance Sheet and the related notes. These parent company Financial Statements have been prepared under the accounting policies set out therein. We have also audited the information in the Remuneration report that is described as having been audited.

We have reported separately on the Group Financial Statements of British American Tobacco p.l.c. for the year ended 31 December 2007.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and Accounts, including the Remuneration report and the parent company Financial Statements, in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of directors' responsibility in relation to the Financial Statements, included in the Directors' report.

Our responsibility is to audit the parent company Financial Statements and the part of the Remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the parent company Financial Statements give a true and fair view and whether the parent company Financial Statements and the part of the Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether, in our opinion, the information given in the Directors' report is consistent with the parent company Financial Statements. The information given in the Directors' report includes that specific information presented in the Operating and financial review that is cross referred from the Business review section of the Directors' report.

In addition, we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and Accounts and consider whether it is consistent with the audited parent company Financial Statements. The other information comprises only the Quick read, the Operating and financial review, the Board of directors, the Management Board, the Directors' report, the unaudited part of the Remuneration report, the Corporate governance statement, the Five year summary, the Quarterly analyses of profit, the Group Financial Statements and the Shareholder information. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company Financial Statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company Financial Statements and the part of the Remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the parent company Financial Statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent company Financial Statements and the part of the Remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the parent company Financial Statements and the part of the Remuneration report to be audited.

Opinion

In our opinion:

- the parent company Financial Statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2007;
- the parent company Financial Statements and the part of the Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the parent company Financial Statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
1 Embankment Place, London

27 February 2008

PLC ACCOUNTS

BALANCE SHEET – BRITISH AMERICAN TOBACCO p.l.c.

AT 31 DECEMBER

	Notes	2007 £m	2006 £m
Assets			
Fixed assets			
Investments in Group companies	2	**4,047**	4,047
		4,047	4,047
Current assets			
Debtors	3	**4,110**	2,246
		4,110	2,246
Total assets		**8,157**	6,293
Equity			
Capital and reserves			
Share capital		**506**	517
Share premium account		**53**	48
Capital redemption reserves		**101**	90
Other reserves		**90**	90
Profit and loss account		**2,951**	1,356
after deducting			
– cost of treasury shares		**(294)**	(197)
Shareholders' funds	4	**3,701**	2,101
Liabilities			
Creditors	5	**4,456**	4,192
Total equity and liabilities		**8,157**	6,293

Notes are shown on pages 171 to 174.

On behalf of the Board

Jan du Plessis

Chairman

27 February 2008

NOTES ON THE ACCOUNTS

1 Accounting policies

Basis of Accounting

The Financial Statements have been prepared on the going concern basis under the historical cost convention and in accordance with the Companies Act 1985 and UK Generally Accepted Accounting Principles.

Cash flow statement

The cash flows of the Company are included in the consolidated Cash Flow Statement of British American Tobacco p.l.c. which is included in this Directors' Report and Accounts. Consequently the Company is exempt under the terms of FRS1 (Revised) from publishing a cash flow statement.

Foreign currencies

Transactions arising in currencies other than sterling are translated at the rate of exchange ruling on the date of the transaction. Assets and liabilities expressed in currencies other than sterling are translated at rates of exchange ruling at the end of the financial year. All exchange differences are taken to the profit and loss account in the year.

Accounting for income

Income is included in the profit and loss account when all contractual or other applicable conditions for recognition have been met. Provisions are made for bad and doubtful debts, including where delays are anticipated in the receipt of monies from overseas.

Taxation

Taxation provided is that chargeable on the profits of the period, together with deferred taxation. Deferred taxation is provided in full on timing differences between the recognition of gains and losses in the Financial Statements and their recognition in tax computations. However, the Company does not discount deferred tax assets and liabilities.

Fixed asset investments

Fixed asset investments are stated at cost, together with subsequent capital contributions, less provisions for any impairment in value.

Dividends

Final dividend distributions to the Company's shareholders are recognised as a liability in the Financial Statements in the period in which the dividends are approved by the Company's shareholders, while interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Repurchase of share capital

When share capital is repurchased the amount of consideration paid, including directly attributable costs, is recognised as a deduction from equity. Repurchased shares which are not cancelled, or shares purchased for the employee share ownership trusts, are classified as treasury shares and presented as a deduction from total equity.

Related parties

The Company has taken advantage of the exemption under paragraph 3(b) FRS8 from disclosing transactions with related parties that are part of the British American Tobacco p.l.c. Group.

Financial instruments

The financial instrument disclosures of the Company are included in the Consolidated Group Accounts which are included in this Directors' Report and Accounts. Consequently, the Company is exempt under paragraph 3C (b) of FRS25 from publishing these financial instrument disclosures.

Financial guarantees are recorded at fair value less accumulated amortisation.

2 Investments in Group companies

The Company's directly owned subsidiaries are British American Tobacco (1998) Limited, B.A.T. International Finance p.l.c., B.A.T Capital Corporation, BATMark Limited, British American Ventures Limited and British American Tobacco QUEST Limited.

The Directors are of the opinion that the individual investments in the subsidiary undertakings have a value not less than the amount at which they are shown in the Balance Sheet.

	2007 £m	2006 £m
	4,047	4,047

3 Debtors

	2007 £m	2006 £m
Amounts due from Group undertakings	**4,110**	2,246

Included in debtors are amounts of £95 million (2006: £99 million) falling due after one year.

4 Shareholders' funds

	Share capital £m	Share premium account £m	Capital redemption reserves £m	Other reserves £m	Profit and loss account £m	Total £m
1 January 2007	**517**	**48**	**90**	**90**	**1,356**	**2,101**
Increase in share capital – share options		**5**				**5**
Transfer from profit and loss account					**3,517**	**3,517**
Dividends and other appropriations ordinary shares *page 108 note 8*					**(1,198)**	**(1,198)**
Purchase of own shares	**(11)**		**11**		**(750)**	**(750)**
Consideration paid for purchase of own shares held in employee share ownership trusts					**(39)**	**(39)**
Consideration received on the exercise of options over own shares held in employee share ownership trusts					**22**	**22**
Other movements					**43**	**43**
31 December 2007	**506**	**53**	**101**	**90**	**2,951**	**3,701**

Dividends paid are recognised in the year in which they are declared, 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 2007 is shown on page 108 in note 8 and will be recognised in the Financial Statements for the year ended 31 December 2008.

In 2006, for the first time, the Company needed to file interim accounts which were prepared to recognise additional dividend income in 2006. As a result of the Company not doing so, the interim dividend of £323 million paid on 13 September 2006 did not comply with the technical requirements of the Companies Act 1985. The appropriation of distributable profits to the payment of the interim dividend was ratified by shareholders by way of special resolution at the 2007 Annual General Meeting.

As permitted by Section 230 of the Companies Act 1985, the profit and loss account of the Company has not been presented in these Financial Statements. The profit for the year ended 31 December 2007 was £3,517 million (2006: £1,809 million).

4 Shareholders' funds continued

Details of Directors' remuneration, share options and retirement benefits are given in the Remuneration Report on pages 58 to 75.

Shareholders' funds are stated after deducting the cost of treasury shares which include £123 million (2006: £nil) for shares repurchased and not cancelled and £171 million (2006: £197 million) in respect of the cost of own shares held in employee share ownership trusts.

Share capital	**Ordinary shares of 25p each Number of shares**	**Convertible redeemable preference shares of 25p each Number of shares**	**£m**
Authorised			
1 January 2007 and 31 December 2007	**2,858,265,349**	**241,734,651**	**775.00**
Allotted, called up and fully paid			
1 January 2007	**2,068,803,944**		**517.20**
Changes during the year			
– share option schemes	**1,007,692**		**0.25**
– purchase of own shares	**(45,307,295)**		**(11.32)**
31 December 2007	**2,024,504,341**		**506.13**

Share capital	Ordinary shares of 25p each Number of shares	Convertible redeemable preference shares of 25p each Number of shares	£m
Authorised			
1 January 2006 and 31 December 2006	2,858,265,349	241,734,651	775.00
Allotted, called up and fully paid			
1 January 2006	2,096,139,187		524.03
Changes during the year			
– share option schemes	994,757		0.25
– purchase of own shares	(28,330,000)		(7.08)
31 December 2006	2,068,803,944		517.20

Between 22 September 2006 and 4 December 2006, the Company sought to repurchase 6,927,790 shares for an aggregate consideration of £100 million, which were included in the purchases of own shares of £500 million for the year ended 31 December 2006. However, as a result of the technical infringement of the Companies Act 1985, the repurchase and cancellation of these shares was invalid and, accordingly, their nominal value is included within the Company's allotted, called up and fully paid share capital as at 31 December 2006 shown above. These shares were repurchased on 1 March 2007 from the holders, the Company's brokers, at the same prices agreed between 22 September 2006 and 4 December 2006. Consequently, the above table for the year ended 31 December 2006 includes 28 million shares purchased for cancellation at a cost of £400 million. During the year ended 31 December 2007, 45 million shares were also purchased at a cost of £750 million, of which 7 million shares at a cost of £123 million are held in treasury, the remainder being cancelled. The above table for the year ended 31 December 2007 therefore includes 45 million shares purchased for cancellation, at a cost of £727 million.

Share premium

The increase of £5 million relates solely to ordinary shares issued under the Company's share option schemes. These schemes are described in the Remuneration Report on pages 58 to 75.

5 Creditors

	2007 £m	2006 £m
Amounts due to Group undertakings	**692**	2,003
Loans due to Group undertakings	**3,617**	2,046
Sundry creditors	**147**	143
	4,456	4,192

Included in creditors are amounts of £108 million (2006: £106 million) falling due after one year.

Loans due to Group undertakings are unsecured and bear interest at rates between 6.85 per cent and 6.94 per cent.

6 Audit fees

	2007	2006
Auditors' fees	**£30,000**	£30,000
Fees paid to PricewaterhouseCoopers LLP for advisory and accountancy services – UK	**£nil**	£nil

7 Contingent liabilities and financial commitments

British American Tobacco p.l.c. has guaranteed borrowings by subsidiary undertakings of £6,383 million (2006: £5,907 million) and total borrowing facilities of £15,905 million (2006: £13,009 million).

Performance guarantees given to third parties in respect of Group companies were £1 million (2006: £157 million).

There are contingent liabilities in respect of litigation in various countries (page 153 note 30).

SHAREHOLDER INFORMATION

Registrar

Enquiries concerning your shareholding, mandating your dividends (including consolidated dividend tax vouchers) and notifying changes in your personal details should be directed to Computershare Investor Services PLC, The Pavilions, Bridgwater Road, Bristol BS99 6ZY
tel: 0800 408 0094 (UK); +44 870 889 3159

Online

bat.com
Access comprehensive information about British American Tobacco and download shareholder publications at the corporate website; visit the Investor Centre for valuation and charting tools and dividend and share price data; and subscribe to the e-mail and SMS alert services for key financial events in the British American Tobacco financial calendar

computershare.com/uk/investor/bri
Access the web-based enquiry service for shareholders operated by Computershare Investor Services; view details of your British American Tobacco shareholding and recent dividend payments and register for electronic shareholder communications to receive notification of British American Tobacco shareholder mailings by e-mail, including your dividend tax vouchers

computershare.com/dealing/uk
Go online or telephone 0870 703 0084 (UK) to buy or sell British American Tobacco shares

web.queries@computershare.co.uk
Contact Computershare Investor Services by e-mail

Publications

Copies of Annual Report and Accounts and the Performance Summary are available on request. Copies of the Group corporate descriptive booklet About Us and past Quarterly Reports 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 (0)20 7511 7797, facsimile: +44 (0)20 7540 4326
e-mail: bat@team365.co.uk

Dividend Reinvestment Plan

A straightforward and economic way of utilising your dividends to build up your shareholding in British American Tobacco; contact Computershare Investor Services for details

American Depositary Receipts

British American Tobacco sponsors an American Depositary Receipt (ADR) programme in the United States. Enquiries regarding ADR holder accounts and payment of dividends should be directed to Shareholder Relations, The Bank of New York Mellon, PO Box 11258, Church Street Station, New York, NY 10286-1258, USA
tel: +1 888 BNY ADRS (toll-free) or +1 212 815 3700
e-mail: shareowners@bankofny.com
website: adrbny.com

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 (UK); +44 (0)1296 414 141
e-mail: service@share.co.uk; website: share.co.uk

Capital gains tax

Fact sheet for British American Tobacco historical capital gains tax information; contact the British American Tobacco Company Secretarial Department tel: +44 (0)20 7845 1000 or access the Investor Centre at bat.com/investorcentre/cgt

Final dividend 2007

Ex-dividend date – 5 March 2008
Record date – 7 March 2008
Payment date – 7 May 2008

Annual General Meeting

Wednesday, 30 April 2008 at 11.30am, The Mermaid Conference & Events Centre, Puddle Dock, Blackfriars London EC4V 3DB

Financial results 2008

First quarter – 7 May
Interim – 31 July
Third quarter – 30 October

Analyses of shareholders

At 31 December 2007, there were 2,024,504,341 ordinary shares in issue held by 58,030 shareholders. These shareholdings are analysed as follows by category of shareholder and size of shareholding:

Category of shareholder	Number of holders	% of total holders	Number of ordinary shares	% of issued share capital
Individuals	50,541	87.09	68,107,907	3.37
Financial institutions/ pension funds	243	0.42	3,297,138	0.16
Nominee companies	6,744	11.62	1,323,258,967	65.36
Other corporate holders	500	0.86	18,614,922	0.92
Treasury	1	<0.01	6,888,780	0.34
R&R Holdings S.A.	1	<0.01	604,336,627	29.85*
	58,030	100.00	2,024,504,341	100.00

*The interest of R&R Holdings S.A. in the issued share capital (excluding treasury shares) is 29.95 per cent (see page 50).

Size of shareholding	Number of holders	% of issued share capital
1 – 1,999	46,714	1.22
2,000 – 9,999	9,258	1.71
10,000 – 199,999	1,548	3.28
200,000 – 499,999	214	3.41
500,000 and over	296	90.38
	58,030	100.00

SHAREHOLDER INFORMATION

CONTACT INFORMATION

Registered office
Globe House, 4 Temple Place, London WC2R 2PG
tel: +44 (0)20 7845 1000, facsimile: +44 (0)20 7240 0555

Incorporated in England and Wales No. 3407696

Secretary
Nicola Snook

General Counsel
Neil Withington

Investor relations
Enquiries should be directed to Ralph Edmondson or Sharon Woodcock, tel: +44 (0)20 7845 1180

Press office
Enquiries should be directed to Fran Morrison or David Betteridge, tel: +44 (0)20 7845 2888
e-mail: press_office@bat.com

Auditors
PricewaterhouseCoopers LLP, 1 Embankment Place, London WC2N 6RH

Registrar
Enquiries concerning your shareholding, mandating your dividends (including consolidated dividend tax vouchers) and notifying changes in your personal details, contact Computershare Investor Services PLC, The Pavilions, Bridgwater Road, Bristol BS99 6ZY
tel: 0800 408 0094 (UK); +44 870 889 3159 (International)

www.bat.com

Photography by Matthew Ford. Printed in the UK by St Ives Westerham Press Ltd. ISO14001:2004, FSC certified and Carbon Neutral. The paper used for this report is Revive 50:50 silk, comprising 25% post-consumer and 25% pre-consumer waste, and 50% virgin wood fibre sourced from sustainable forests independently certified according to the rules of the Forest Stewardship Council. This document is recyclable.