FINANCIAL REVIEW

Income Statement

2014 Highlights

- Group revenue was down as exchange rate movements and volume offset the impact of pricing. Revenue was 2.8% higher at constant rates of exchange.
- Adjusted profit from operations at constant rates of exchange increased by 4.4%.
- Adjusted diluted earnings per share fell by 3.9% to 208.1p per share.
- At constant rates, adjusted diluted earnings per share were 7.9% higher at 233.7p.
- Dividends for 2014 up by 4.0% to 148.1p per share.
- Free cash flow of £2,507 million with free cash flow per share equal to 64% of adjusted diluted earnings per share. Excluding non-tobacco litigation payments this was 76%.
- The Group will contribute US$4.7 billion to maintain its shareholding in Reynolds American Inc., after its acquisition of Lorillard. As a result the share buy-back was suspended in July 2014.

A strong Group performance despite adverse exchange rate movements and a difficult environment.

Revenue and profit from operations

The results of the Group were impacted by the adverse movement of a number of key currencies and this is reflected in an adverse translational exchange rate movement of 11%. As a result, reported revenue was down by 8% from £15,260 million to £13,971 million. Exchange rate movements and one-off charges, mainly the cost in respect of the settlement of the Flintkote claims, resulted in profit from operations declining by 18% to £4,546 million.

To better understand the underlying performance of the business, management reviews the results by adjusting for a number of items relating to restructuring and integration costs and one-off charges, provisions and income (see page 44). We call the underlying profit after adjusting for these items, which are described further below, adjusted profit from operations. Adjusted profit from operations was £5,403 million, 7% lower than in 2013. In order to assess the underlying performance, we also have to view the business results at constant rates of exchange, excluding the translational impact of exchange rate movements. This does not adjust for the transactional effects of currency fluctuations on the cost of items such as leaf, filter tow and wrapping materials, which are estimated to be an additional £90 million negative.

The Group's strong underlying performance for the year is demonstrated by the growth of 2.8% in revenue and 4.4% in adjusted profit from operations, at constant rates. Excluding the above transactional exchange effect, adjusted operating profit would have increased by a further 1.5%.

Operating margin

The Group continues to improve its operating margin through pricing, portfolio development through GDBs, tight cost control, factory rationalisation, the implementation of the new operating model, systems standardisation and productivity savings. In 2014, adjusted profit from operations, as a percentage of net revenue, improved to 38.7% compared to 38.1% in 2013. More details of the Group's adjusted operating performance can be found in the Regional review.

Adjusting items

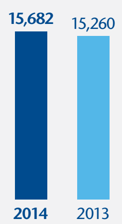
During 2014, the Group continued to incur costs that do not relate to the day-to-day operations of the business. The adjustments made to profit from operations are separately disclosed as memorandum information on the face of the Income Statement and in the segmental analysis.

The Group incurred restructuring and integration costs of £452 million in 2014 mainly in respect of the restructuring initiatives directly related to the implementation of the new operating model, the continuation of factory closures in Australia, Colombia and in the Democratic Republic of Congo, and restructurings in Argentina, Indonesia, Canada, Switzerland and Germany, offset by profits on the sale of land and buildings in Turkey and Congo. The costs also cover packages in respect of permanent headcount reductions and permanent employee benefit reductions in the Group.

The £246 million restructuring and integration charge in 2013 principally related to the implementation of the new operating model, the continuation of factory closures in Australia and Russia, and restructurings in the Democratic Republic of the Congo, Switzerland and Germany, offset by profits on the sale of land and buildings in Australia, Russia and Denmark. In addition, it also includes packages in respect of permanent headcount reductions in the Group.

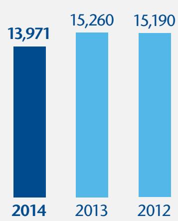
Net turnover at constant rates of exchange
(£ million)

+3%
2014
+4%
2013
+4%
2012



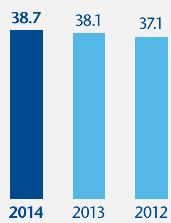
Net turnover at current rates of exchange
(£ million)

-8%
2014
0%
2013
-1%
2012



Operating margin
(%)

+54bpts
2014
+100bpts
2013
+160bpts
2012



FINANCIAL REVIEW

Income Statement continued

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

Revenue	2014			2013
	Reported revenue £m	Impact of exchange £m	Revenue at CC[1] £m	Reported revenue £m
Asia-Pacific	3,873	380	4,253	4,203
Americas	2,990	516	3,506	3,317
Western Europe	3,359	187	3,546	3,635
EEMEA	3,749	628	4,377	4,105
Total	13,971	1,711	15,682	15,260

Profit from operations/Diluted earnings per share	2014					2013		
	Reported profit[2] £m	Adjusting items £m	Adjusted profit[2] £m	Impact of exchange £m	Adjusted profit[2] at CC[1] £m	Reported profit[2] £m	Adjusting items £m	Adjusted profit[2] £m
Asia-Pacific	1,360	188	1,548	165	1,713	1,672	21	1,693
Americas	1,197	89	1,286	189	1,475	1,303	61	1,364
Western Europe	1,018	171	1,189	73	1,262	1,133	140	1,273
EEMEA	1,318	62	1,380	245	1,625	1,418	72	1,490
Total regions	4,893	510	5,403	672	6,075	5,526	294	5,820
Fox River[3]	27	(27)						
Flintkote[3]	(374)	374						
Profit from operations	4,546	857	5,403	672	6,075	5,526	294	5,820
Net finance costs	(417)	–	(417)	(39)	(456)	(466)	–	(466)
Associates and joint ventures	719	(7)	712	50	762	739	(16)	723
Profit before tax	4,848	850	5,698	683	6,381	5,799	278	6,077
Taxation	(1,455)	(69)	(1,524)	(174)	(1,698)	(1,600)	(46)	(1,646)
Non-controlling interest	(278)	(5)	(283)	(29)	(312)	(295)	(3)	(298)
Profit attributable to shareholders	3,115	776	3,891	480	4,371	3,904	229	4,133
Diluted number of shares	1,870		1,870		1,870	1,908		1,908
Diluted earnings per share (pence)	166.6		208.1		233.7	204.6		216.6

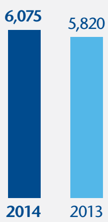
Notes
1. CC: constant currencies.
2. Profit: profit from operations.
3. The Fox River credit in 2014 and the Flintkote charge in 2014 have not been allocated to any segment as they do not relate to current operations. They are presented separately from the segment reporting which is used to evaluate segment performance and to allocate resources.

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

+4%
2014

+7%
2013

+8%
2012



Percentage changes in revenue and in profit from operations

	Revenue growth	Profit growth
As reported	-8.4%	-17.7%
Adjusted		-7.2%
Adjusted at constant rates	+2.8%	+4.4%

The acquisitions of Bentoel, Tekel, ST, Protabaco and CN Creative Limited, as well as the creation of CTBAT International Ltd, resulted in the capitalisation of trademarks and similar intangible assets, which are amortised over their expected useful lives, which do not exceed 20 years. The 2014 amortisation charge is £58 million, compared to £74 million in 2013.

The 2013 contribution of the State Express 555 brand to CTBAT International Ltd is accounted for at fair value in the arrangement resulting in a £26 million gain on deemed partial disposal of a trademark.

Subsequent to the 2014 Funding Agreement between a Group subsidiary and the parties in respect of the clean-up cost of the Fox River, a partial release of £27 million was made from the provision set up in 2011. A Group subsidiary agreed the settlement of the Flintkote asbestos related claims in 2014, and paid the settlement sum into an escrow account. The total cost, including legal fees, amounted to £374 million. More detail of these two settlements are provided in note 30 to the accounts.

Net finance costs

Net finance costs at £417 million were £49 million lower than last year, principally reflecting the lower interest paid as a result of lower borrowing costs, the increased net fair value gains in the Group, and the impact of exchange rate movements.

Associates

The Group's share of the post-tax results of associates, included at the pre-tax profit level under International Financial Reporting Standards (IFRS), fell by £20 million or 2.7% to £719 million.

In 2014, the Group's share of the adjusted post-tax results of associates decreased by 1.5% to £712 million (2013: £723 million), this was an increase of 5.4% at constant rates. The adjusting items for associates amounted to a net gain of £7 million (2013: £16 million).

The adjusted contribution from Reynolds American Inc. decreased by 3.1% to £427 million. At constant rates of exchange this would have been an increase of 2.0%. The adjusted contribution from our associate in India, ITC, was £270 million, up 2.1%. At constant rates of exchange, the contribution would have been 11.9% higher than last year.

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

Tax

Profit before tax was down £951 million at £4,848 million, reflecting the impact of higher adjusted profit from operations at constant rates of exchange and lower net finance costs, more than offset by one-off charges and the adverse exchange rate movements.

The tax rates in the Income Statement of 30.0% in 2014 and 27.6% in 2013 are affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results and by adjusting items. Excluding these, the underlying tax rate for subsidiaries was 30.6% in 2014 and 30.7% in 2013. The slight decrease is the result of a change in the mix of profits.

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

– comply with all applicable laws and regulations in the countries where we operate;

– be open and transparent with tax authorities and operate with mature, professional relationships;

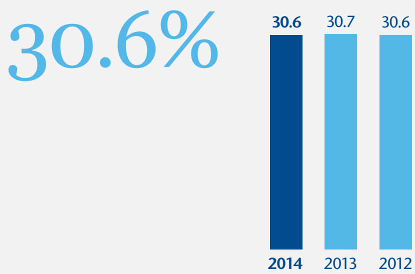
– seek to optimise shareholder return by structuring the business in a tax efficient manner;

– transact on an arm's length basis for all exchanges of goods and services between companies within the Group. Transfer pricing between Group companies is based on fair market terms and reflects the commercial nature of the transaction; and

– to engage in proactive discussions with tax authorities on occasions of differing legal interpretation to bring matters to as quick a resolution as possible. Where resolution is not possible, tax disputes may proceed to litigation.

Our tax footprint extends beyond corporation tax and we are obliged to pay other significant taxes such as employment taxes and customs and import duties. Apart from the taxes borne, the Group also collects taxes on behalf of governments, such as tobacco excise, employee taxes, VAT and other sales taxes. The total tax contribution therefore consists of both taxes borne and taxes collected. In 2014, the total cash tax contribution by the Group amounted to £29.7 billion (2013: £33.6 billion), with the contribution by each category as shown in the chart (right). The reduction is largely due to adverse movements in foreign exchange.

Underlying tax rate
(%)



Major taxes paid 2014
(£bn)

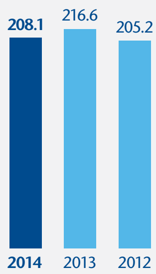
Tobacco excise (collected)	22.2
Net VAT and other sales taxes (collected)	5.2
Corporation tax (borne)	1.4
Customs and import duties (borne)	0.3
Taxes paid by employee (collected)	0.4
Employment taxes (borne)	0.2

FINANCIAL REVIEW

EPS, dividends and financing

Adjusted diluted EPS
(pence)

-4%
2014
+6%
2013
+7%
2012

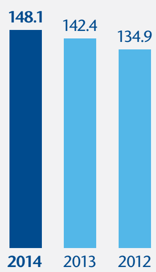


Adjusted diluted EPS at constant rates
(pence)

+8%
2014
+6%
2013
+12%
2012

Dividends per share declared
(pence)

+4%
2014: 148.1
+6%
2013: 142.4
+7%
2012: 134.9



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

The corporate tax charge (current tax) for 2014 was £1.45 billion (2013: £1.57 billion), which differs from the tax paid of £1.43 billion (2013: £1.44 billion) due to the timing of corporation tax instalment payments which often straddle different financial years.

Earnings per share

Basic earnings per share for 2014 were 167.1p, down 19% (2013: 205.4p). With the impact that adjusting items can cause in profit, as well as the potential dilutive effect of employee share schemes, earnings per share are best viewed on the basis of adjusted diluted earnings per share. The calculation of this measure is explained in note 7 on the Financial Statements.

On this basis, the adjusted diluted earnings per share were 208.1p, a 3.9% decrease over 2013, as the strong operating performance of the Group and the impact of the share buy-back programme, were more than offset by adverse movement in exchange rates. When the impact of exchange rate movements are excluded, the adjusted diluted earnings per share (at constant rates) would have been 233.7p, a 7.9% increase on 2013.

Dividends

The Group's policy is to pay dividends of 65% of long-term sustainable earnings, calculated with reference to the adjusted diluted earnings per share. Interim dividends are calculated as one-third of the total dividends declared for the previous year. In 2013, as a result of the restatement of the 2012 numbers after a change in accounting policy, the increase in dividends was kept at the same rate as the increase in earnings, leading to a dividend growth of 6% and a pay-out ratio of 65.7%.

With the recommended final dividend of 100.6p, the total dividends per share for 2014 are 148.1p, compared to the total dividend of 142.4p for 2013. This leads to a total dividend growth of 4% and a pay-out ratio of 71.2%.

Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2014 accounts reflect the 2013 final dividend and the 2014 interim dividend amounting to 144.9p (£2,712 million in total (2013: 137.7p – £2,611 million)). The table below shows the dividends declared in respect of 2014 and 2013.

Dividends are declared/proposed and payable in sterling except for those shareholders on the branch register in South Africa, whose dividends are payable in rand. A rate of exchange of £:R=17.76480 as at 24 February 2015, the closing rate for that day as quoted by Bloomberg, results in an equivalent final dividend of 1,787.13888 SA cents per ordinary share. Further details of the final dividend and key dates (and the South Africa branch register key dates) are set out in the other statutory and regulatory information section.

Dividends declared/proposed

	2014		2013	
Ordinary shares	Pence per share	£m	Pence per share	£m
Interim	**47.5**	**881**	45.0	846
Final	**100.6**	**1,866**	97.4	1,831
	148.1	**2,747**	142.4	2,677

Treasury operations

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

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

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

The Group continues to maintain investment-grade credit ratings and was upgraded during 2013 by Moody's. Since then, and as at 31 December 2014, the ratings from Moody's/S&P were A3 (stable outlook)/A- (stable outlook). The strength of the ratings has underpinned debt issuance and the Group is confident of its ability to successfully access the debt capital markets.

All contractual borrowing covenants have been met and none are expected to inhibit the Group's operations or funding plans.

Liquidity

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group targets an average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. As at 31 December 2014, the average centrally managed debt maturity was 6.8 years (2013: 7.2 years) and the highest proportion of centrally managed debt maturing in a single rolling 12-month period was 18.7% (2013: 18.3%).

It is Group policy that short-term sources of funds (including drawings under both the US$2 billion commercial paper programme and the £1 billion euro commercial paper programme) are backed by undrawn committed lines of credit and cash. At 31 December 2014, £160 million of commercial paper was outstanding (2013: £521 million).

In May 2014, the Group through B.A.T. International Finance p.l.c. negotiated a new central banking facility of £3 billion with a final maturity of May 2019 (with two additional one-year extensions at the option of the banks). This facility is provided by 22 banks. The new facility is on significantly improved terms compared to the previous central banking facility of £2 billion, with a maturity of December 2015, which was cancelled at the same time. The new facility was undrawn as at 31 December 2014 (2013: undrawn).

In September 2014, the Group signed a one-year bridge facility of US$4.7 billion with an extension option of up to one year for its proposed investment in Reynolds American Inc.

In the year ended 31 December 2014, the Group continued with transactions in the capital markets. In September 2014 the Group repaid a maturing €600 million bond, this repayment was financed from Group cash balances. In September 2014, the Group issued a new CHF 350 million bond with a maturity of 2016; a new CHF 400 million bond with a maturity of 2021 and a new CHF 250 million bond with a maturity of 2026.

In August 2014 the Group repaid a maturing MYR 250 million note, this repayment was financed from Group cash balances. In June 2014, the Group purchased and cancelled an existing US$40 million bond with a maturity of 2029; this purchase was financed from Group cash balances. In March 2014, the Group issued a new €400 million bond with a maturity of 2018 and a new €600 million bond with a maturity of 2029.

In March 2013, the Group issued a US$300 million bond with a maturity of March 2016 and €650 million bond with a maturity of March 2025. In July 2013, the Group repaid a €519 million bond from the Group's cash balances. In September 2013, the Group issued a new £650 million bond with a maturity of 2026. In November 2013, a maturing US$300 million bond was repaid and in December 2013, a maturing £152 million bond was repaid. These repayments were financed from Group cash balances.

The Group has drawn US$225 million in 2013 and 2014 against a Chilean peso facility, maturing in 2016.

Capital structure

The Group defines capital as net debt and equity. The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5 times. The Group targets a gross interest cover, as calculated under its key central banking facilities, of greater than five. For 2014 it is 12.0 times (2013: 12.3 times). The Group assesses its financial capacity by reference to cash flow, net debt and interest cover. Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital structure is managed and, in particular, the policies on dividends and share buy-backs are decided.

FINANCIAL REVIEW

Alternative cash flow

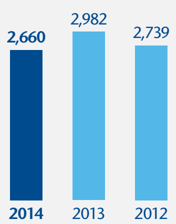
Cash flow and net debt movements

	2014 £m	2013 £m
Adjusted profit from operations	5,403	5,820
Depreciation, amortisation and impairment	396	392
Other non-cash items in operating profit	45	30
Profit from operations before depreciation and impairment	5,844	6,242
Increase in working capital	(309)	(375)
Net capital expenditure	(627)	(547)
Gross capital expenditure	(689)	(720)
Sale of fixed assets	62	173
Operating cash flow	4,908	5,320
Pension funds' shortfall funding	(140)	(190)
Net interest paid	(426)	(443)
Tax paid	(1,433)	(1,440)
Dividends paid to non-controlling interests	(249)	(265)
Cash generated from operations	2,660	2,982
Restructuring costs	(325)	(310)
Non-tobacco litigation: Flintkote and Fox River	(437)	–
Dividends and other appropriations from associates	609	699
Free cash flow	2,507	3,371
Dividends paid to shareholders	(2,712)	(2,611)
Share buy-back (including transaction costs)	(800)	(1,509)
Net investment activities	(6)	(19)
Net flow from share schemes and other	108	(79)
Net cash outflow	(903)	(847)
Movements on net debt		
Exchange rate effects*	270	(163)
Change in accrued interest and other	(17)	(32)
Change in net debt	(650)	(1,042)
Opening net debt	(9,515)	(8,473)
Closing net debt	(10,165)	(9,515)

* Including movements in respect of debt-related derivatives.

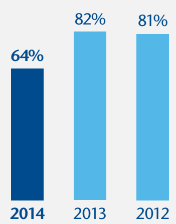
Cash generated from operations at current rates

£2,660m
-11%



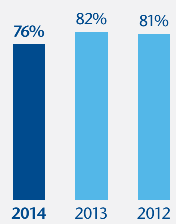
Free cash flow as a percentage of adjusted earnings

64%



Free cash flow as a percentage of adjusted earnings (excluding non-tobacco litigation)

76%



Return on capital employed

The Group's return on capital employed has increased from 23% in 2009 to 30% in 2014. This is calculated as the adjusted profit from operations, divided by the average total assets net of average current liabilities.

Cash flow

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

Operating cash flow decreased by £412 million, or 8%, to £4,908 million, reflecting the growth in underlying operating performance at constant currency being more than offset by adverse exchange movements. Lower payments relating to pension funds, net interest paid, dividends to non-controlling interests and taxation offset the fall in appropriations from associates following the completion of the Reynolds American share buy-back programme (£94 million in 2014 and £189 million in 2013). These, combined with the increase in restructuring costs and payments for Flintkote and Fox River, led to the Group's free cash flow decreasing by £864 million or 26% to £2,507 million.

The conversion of adjusted operating profit to operating cash flow remained strong at 91% (2013: 91%). However due to payments in relation to Flintkote and Fox River, the ratio of free cash flow per share to adjusted diluted earnings per share fell to 64% (2013: 82%).

Below free cash flow, the principal cash outflows for 2014 comprise the payment of the prior year final dividend and the 2014 interim dividend, which was £101 million higher at £2,712 million, as well as a £800 million outflow due to the on-market share buy-back programme. This was down £709 million on 2013 as the buy-back was suspended from 30 July 2014 due to the proposed investment in Reynolds American.

During 2014, the cash outflow from net investing activities was £6 million relating to various entities in which the Group already has an interest. In 2013, the cash outflow was mainly for the acquisition of CN Creative and amounted to £19 million.

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

These flows resulted in a net cash outflow of £903 million (2013: £847 million outflow). After taking account of other changes, especially exchange rate movements, total net debt was £650 million higher at £10,165 million at 31 December 2014 (2013: £9,515 million).

Net debt

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

	2014 £m	2013 £m
Net debt due within one year		
Borrowings	**(2,479)**	(1,980)
Related derivatives	**79**	55
Cash and cash equivalents	**1,818**	2,106
Current available-for-sale investments	**50**	54
	(532)	235
Net debt due beyond one year		
Borrowings	**(9,779)**	(9,716)
Related derivatives	**146**	(34)
	(9,633)	(9,750)
Total net debt	**(10,165)**	(9,515)

Retirement benefit schemes

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

The present total value of funded scheme liabilities as at 31 December 2014 was £6,609 million (2013: £5,921 million), while unfunded scheme liabilities amounted to £385 million (2013: £337 million). The schemes' assets increased from £5,780 million in 2013 to £6,266 million in 2014.

After excluding unrecognised scheme surpluses of £13 million (2013: £19 million), the overall net liability for all pension and health care schemes in Group subsidiaries amounted to £741 million at the end of 2014, compared to £497 million at the end of 2013.

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

Share buy-back programme

The Board had approved the continuation of the on-market share buy-back programme in 2014 with a value of up to £1.50 billion, excluding transaction costs. However, the Group suspended, with effect from 30 July 2014, the buy-back programme. This was as a result of the Group's announcement of 15 July 2014 that it planned to invest US$4.7 billion as part of Reynolds American Inc.'s proposed acquisition of Lorillard. During 2014, 23 million shares were bought at a value of £795 million, excluding transaction costs of £5 million.

Changes in the Group

On 30 August 2013 the Group announced that CTBAT International Ltd (CTBAT), a joint investment incorporated in Hong Kong between subsidiaries of China National Tobacco Corporation (CNTC) and British American Tobacco, had commenced official business operations. It owns and manages the worldwide international cigarette trademark State Express 555, and also owns the worldwide right outside China to the leading CNTC brand Shuang Xi.

CTBAT is reported as part of the Asia-Pacific Region with the majority of its international sales (non-China domestic sales) made through existing Group end markets in that region. The Group recognises its share (50%) of the assets, liabilities, income and expenses of the arrangement on a line-by-line basis in the consolidated financial statements.

The impact of the arrangement on operating results for 2014 and 2013 is not material.

On 8 July 2013, the Group announced a joint venture in Myanmar with I.M.U. Enterprise Limited to manufacture, distribute and market the Group's brands. Under the terms of the agreement, the Group has contributed plant and machinery and cash to the venture in return for a controlling stake.

FINANCIAL REVIEW

Non-GAAP measures and other information

Non-GAAP measures

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

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

Management reviews current and prior year segmental adjusted profit from operations of subsidiaries and joint operations and adjusted post-tax results of associates and joint ventures at constant rates of exchange. This allows comparison of the Group's results had they been translated at the previous year's average rates of exchange. Other than in exceptional circumstances, this does not adjust for the normal transactional gains and losses in operations which are generated by exchange movements. As an additional measure to indicate the impact of exchange rate movements on the Group results, adjusted diluted earnings per share is also shown at constant rates of exchange.

The Group also prepares an alternative cash flow, which includes a measure of 'free cash flow', to illustrate the cash flows before transactions relating to borrowings. A net debt summary is also provided. The Group publishes gross turnover as an additional disclosure to indicate the impact of duty, excise and other taxes.

Due to the secondary listing of the ordinary shares of British American Tobacco p.l.c. on the JSE Limited (JSE) in South Africa, the Group is required to present headline earnings per share and headline diluted earnings per share.

Post balance sheet date announcement

On 23 February 2015, the Group announced that it was evaluating a possible public tender offer to acquire up to all of the 24.7% of Souza Cruz shares which are not currently owned by British American Tobacco and to delist the company.

An offer for Souza Cruz's shares would be at a price per share of R$26.75, to be paid in cash, in Brazilian reais, and to be reduced by any dividend paid by Souza Cruz. A price of R$26.75 per share would represent a premium of 30.0% to Souza Cruz's volume weighted average closing price over the three months to Friday 20 February 2015.

Accounting policies

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

Accounting developments

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

There were no material changes to the accounting standards applied in 2014 from that applied in 2013.

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

Going concern

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

The key Group risk factors include analyses of financial risk and the Group's approach to financial risk management. Notes 21 and 24 in the notes on the accounts provide further detail on the Group's borrowings and management of financial risks.

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

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

Foreign currencies

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

	Average		Closing	
	2014	2013	2014	2013
US dollar	**1.648**	1.564	**1.559**	1.656
Canadian dollar	**1.819**	1.612	**1.806**	1.760
Euro	**1.241**	1.178	**1.289**	1.202
South African rand	**17.861**	15.099	**18.039**	17.347
Brazilian real	**3.874**	3.381	**4.145**	3.908
Australian dollar	**1.827**	1.623	**1.905**	1.851
Russian rouble	**63.412**	49.853	**93.555**	54.424
Japanese yen	**174.223**	152.715	**186.946**	174.080
Indian rupee	**100.529**	91.707	**98.424**	102.447

Ben Stevens
Finance Director