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British American Tobacco p.l.c. (No. 3407696)

Annual Report 2019

This document constitutes the Annual Report and Accounts of British American Tobacco p.l.c. (the 'Company') and the British American Tobacco Group prepared in accordance with UK requirements and the Annual Report on Form 20-F prepared in accordance with the US Securities Exchange Act of 1934 (the 'Exchange Act') for the year ended 31 December 2019, except that certain phrases, paragraphs or similar sections denoted with a [@] symbol do not form part of the Annual Report on Form 20-F as filed with the US Securities and Exchange Commission (the 'SEC') and certain phrases, paragraphs or similar sections denoted with a [»] symbol do not form part of the Annual Report and Accounts. In addition, the Report of Independent Registered Public Accounting Firm on pages 122-123 will only be included in the Annual Report on Form 20-F. Moreover, the information in this document may be updated or supplemented only for purposes of the Annual Report on Form 20-F at the time of filing with the SEC or later amended if necessary. Any such updates, supplements or amendments will also be denoted with a [»] symbol. Insofar as this document constitutes the Annual Report and Accounts, it has been drawn up and is presented in accordance with, and reliance upon, applicable English company law and the liabilities of the Directors in connection with this report shall be subject to the limitations and restrictions provided by such law.

This document is made up of the Strategic Report, the Governance Report, the Financial Statements and Notes, and certain other information. Our Strategic Report, pages 2 to 62, includes our purpose and strategy, global market overview, business model, global performance, as well as our financial performance and principal group risks. The Strategic Report has been approved by the Board of Directors and signed on its behalf by Paul McCrory, Company Secretary. Our Governance Report on pages 63 to 114 contains detailed corporate governance information, our Committee reports[@] and our Responsibility of Directors[@]. The Directors' Report on pages 63 to 89 (the Governance pages)[@], page 114 (Responsibility of Directors)[@] and 254 to 323 (the Additional disclosure and Shareholder information pages) has been approved by the Board of Directors and signed on its behalf by Paul McCrory, Company Secretary. Our Financial Statements and Notes are on pages 115 to 253. The Other Information section commences on page 254.

This document provides alternative performance measures (APMs) which are not defined or specified under the requirements of International Financial Reporting Standards (IFRS). We believe these APMs provide readers with important additional information on our business. We have included a Non-GAAP measures section on pages 258 to 268 which provides a comprehensive list of the APMs that we use, an explanation of how they are calculated, why we use them and a reconciliation to the most directly comparable IFRS measure where relevant.

British American Tobacco p.l.c. has shares listed on the London Stock Exchange (BATS) and the Johannesburg Stock Exchange (BTJ), and, as American Depositary Shares, on the New York Stock Exchange (BTI).

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

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

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

The material in this Annual Report is provided for the purpose of giving information about the Company to investors only and is not intended for general consumers. The Company, its directors, employees, agents or advisers do not accept or assume responsibility to any other person to whom this material is shown or into whose hands it may come and any such responsibility or liability is expressly disclaimed. The material in this Annual Report is not provided for product advertising, promotional or marketing purposes. This material does not constitute and should not be construed as constituting an offer to sell, or a solicitation of an offer to buy, any of our products. Our products are sold only in compliance with the laws of the particular jurisdictions in which they are sold.

References in this document to information on websites, including the web address of BAT, have been included as inactive textual references only. These websites and the information contained therein or connected thereto are not intended to be incorporated into or to form part of the Annual Report and Form 20-F.

Cautionary statement

This document contains forward-looking statements. For our full cautionary statement, please see page 298.

CHAIRMAN'S INTRODUCTION



A STRONG OPERATIONAL PERFORMANCE



Welcome to our combined Annual Report and Form 20-F for 2019. I'm pleased to report a strong operational performance with growth in revenue, as well as both value and volume share. Notwithstanding a number of one-off charges that led to a decline in reported profit from operations, performance was strong on an adjusted basis, growing on the back of our combustibles business and our continued progress in New Categories.

It has also been a busy year as we accelerate our ambition to transform our business. The Board and I are confident in the vision and focus of our new CEO, Jack Bowles, and his drive to satisfy evolving consumer preferences with new and innovative products.

Jack has already made great progress in his stated aim to simplify the Group and he and his management team have spent significant time looking at how we can accelerate the progress already made in our New Categories business. This has been instrumental in the Board's endorsement of an evolution of our strategy and I am excited and energised about the possibilities for the future.

A sustainable and well-governed business

Our sustainability agenda is at the heart of our strategic plans to build a long-term sustainable business. We have made a clear commitment to providing consumers with a range of potentially less harmful products, which is central to our corporate purpose around which long-term growth is planned. I am proud to see that the continuing growth in our New Categories business reflects the significant success we have already made in this vital area.

However, we are also clear that long-term sustainability, as well as our ability to meet short-term financial and other targets, will be underpinned by successful delivery against other environmental, social and governance measures.

Last year, our newly-revised environmental targets gained the approval of the Science-Based Target initiative, and I'm very pleased to report that we are performing well against our goals. The Group's direct carbon dioxide equivalent emissions are already 10% lower than its 2017 baseline, and we have also been honoured to have been named on the Carbon Disclosure Project's prestigious 'A List' for climate change. This recognises our actions to cut emissions, mitigate climate risks and develop the low-carbon economy.

The Group's commitment to improving social conditions, from respecting Human Rights in every country in which we operate to our own workforce diversity, remains central to the business. Human rights commitments, in particular involving issues such as child labour, sit at the heart of both our Standards of Business Conduct and Supplier Code of Conduct, and we have an array of due diligence procedures to monitor our entire supply chain. Our management comprises 141 different nationalities, while women made up 51% of senior recruits in 2019.

The Group's governance practices promote transparent and responsible corporate behaviour. All our staff worldwide must comply with our Standards of Business Conduct, and we have continued to expand compliance training, which complements our internal 'Speak Up' channels.

Overall, the quality and success of our Sustainability Agenda continues to be recognised externally, and I am proud to report that we are once again the only company in the industry to have been included in the Dow Jones Sustainability Indices' prestigious World Index in 2019. This is our 18th consecutive year of inclusion in the Index series, which reflects BAT's long-standing commitment to delivering against ESG measures.

Dividends

The Board has declared a dividend of 210.4p per ordinary share, payable in four equal instalments of 52.6p per ordinary share, to shareholders registered on the UK main register or the South Africa branch register and to American Depositary Shares (ADS) holders, each on the applicable record dates. The dividends receivable by ADS holders in US dollars will be calculated based on the exchange rate on the applicable payment dates. Further information on dividends can be found on page 47 of the Financial Review and page 300 in the Shareholder information section.

Board composition and outlook

I am very pleased to welcome Jerry Fowden to the Board this year. He brings with him a wealth of executive experience relating to operations, transformation and marketing, which will complement the expertise of the other two North American members of our Board, and we look forward to the insights he will provide as we grow our business.

Kieran Poynter will retire from the Board with effect from the conclusion of the Annual General Meeting on 30 April 2020. Mr Poynter has served as a Non-Executive Director since July 2010, as Senior Independent Director since October 2016, and is currently a member of the Audit and Nominations Committees.

As we enter 2020, I feel strongly that the business is in excellent shape. As I write this opening statement, the Group is closely monitoring the development of Covid 19 (Coronavirus). We believe that our business continuity plans will ensure the business is prepared to manage the challenges as and when they may develop. Notwithstanding Covid 19, with our new management team and strategy, I am confident that we are well placed to deliver sustainable growth for many years to come.

Richard Burrows
Chairman

CHIEF EXECUTIVE'S REVIEW

“ DELIVERING TODAY AND BUILDING A BETTER TOMORROW ”



Dear shareholders and stakeholders,

I write this reflecting on my first year as Chief Executive of BAT. It is a privilege to lead the Group, with its record of achievements both past and present.

Since taking the helm in early 2019, I have focused the business on three clear priorities: driving value from combustibles, ensuring a step change in New Categories performance and simplifying the business. Stronger, simpler, faster.

My new management team has fully embraced these priorities and is already delivering against them.

In my first Annual Report as Chief Executive, I want to take this opportunity to set out my vision for BAT's future.

CHIEF EXECUTIVE'S REVIEW

CONTINUED



I HAVE FOCUSED THE BUSINESS ON THREE CLEAR PRIORITIES:

- **DRIVING VALUE FROM COMBUSTIBLES**
- **ENSURING A STEP CHANGE IN NEW CATEGORIES PERFORMANCE**
- **AND SIMPLIFYING THE BUSINESS**

STRONGER, SIMPLER, FASTER.



OUR PURPOSE IS TO BUILD A BETTER TOMORROW BY REDUCING THE HEALTH IMPACT OF OUR BUSINESS THROUGH OFFERING A GREATER CHOICE OF ENJOYABLE AND LESS RISKY PRODUCTS FOR OUR CONSUMERS.



WE ARE ON A JOURNEY TO BECOME A BUSINESS THAT DEFINES ITSELF NOT BY THE PRODUCTS IT SELLS BUT BY THE CONSUMER NEEDS IT MEETS.



Delivering today

In 2019, building on our foundations, we delivered strong operational results and cash generation, creating a solid base for delivering today and building a better tomorrow.

I am especially pleased to report 6% revenue growth (at current rates of exchange) of £1.4 billion to £25.9 billion. This growth was achieved while also increasing investment in the business, growing our New Categories business by 37%, and increasing our value and volume share by 30bps and 20bps respectively. [@]Operating cash conversion of 97% demonstrates our commitment to maximising cash to reduce leverage and invest in the business[@].

Of course, we live in an age of relentless change. Consumers' desires and tastes evolve, while societal attitudes are changing. These changes are providing us with growth opportunities we could not previously have imagined.

A clear corporate purpose

Our purpose is to build a better tomorrow by reducing the health impact of our business through offering a greater choice of enjoyable and less risky products for our consumers.

We will evolve our growth model through the development of our portfolio in tobacco, nicotine and beyond, meeting our consumers' evolving need for enjoyment and satisfaction.

By building on our strong foundations, we will build a better tomorrow for consumers, employees, shareholders and society.

Our ambition is to increasingly transition our revenues from cigarettes to non-combustible products over time. We aim to achieve at least £5 billion in New Categories revenues in 2023/2024.

To achieve that, we need to continue to drive value from our combustible business and accelerate the growth of our New Categories.

Supporting this is our new 'ethos', which I am delighted to launch in 2020. Our ethos is about being bold, fast, empowered, responsible and diverse. This annual report is a showcase of our new ethos in action.

Acting responsibly

As a leading multinational business we understand our global impact, the importance of high standards of integrity, and our evolving societal responsibilities. As a result, we are moving from a business where sustainability has always been important, to one where it is front and centre in all that we do.

For our consumers, we want to offer a range of enjoyable and responsibly-marketed products in tobacco, nicotine and beyond.

For society, we aim to reduce the health and environmental impacts of our business.

For our suppliers and customers, we want to raise standards for everyone across our value chain.

For our employees, we want to create a dynamic, inspiring and purposeful place for them to work.

And for our shareholders, we want to deliver superior and sustainable returns.

Meeting consumer needs

Today, we see new opportunities to capture consumer moments which have, over time, become limited by societal and regulatory shifts, and to satisfy evolving consumer needs and preferences.

Consequently, we have evolved our strategy to put a sharper focus on delivering a step change in New Categories performance, fuelled by investment from the continued delivery of our combustible business.

Our evolved strategy is about anticipating and satisfying the ever-evolving consumer: providing pleasure, reducing risk, offering and increasing choice, and stimulating the senses of adult consumers worldwide.

BAT will satisfy consumer needs through a focused portfolio of products that offer sensorial enjoyment for a variety of moods and moments. We will build fewer but stronger global brands.

This strategy is underpinned by a unique view of the consumer across four categories, which is increasingly driven by powerful consumer data and analytics and we are accelerating our investment further.

Our business will be further enabled by simplifying our management structure, truly embracing digital transformation, rigorously managing our cost base, and enhancing our internal culture.

[@] Denotes phrase, paragraph or similar that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.



WE BELIEVE IN A MULTI-CATEGORY STRATEGY TO BETTER MEET CONSUMER NEEDS AND LEVERAGE OUR SCALE.



OUR FOCUS ON OPERATING CASH CONVERSION DEMONSTRATES OUR COMMITMENT TO REDUCE LEVERAGE AND INVEST.



WE WILL FOCUS OUR PORTFOLIO DEVELOPMENT ON CONSUMER OFFERS THAT WILL CAPITALISE ON OUR CORE BUSINESS CAPABILITIES.



OUR FUTURE IS ABOUT BEING BOLD, FAST, EMPOWERED, RESPONSIBLE AND DIVERSE.



WE HAVE A STRATEGY FOR GROWTH AND SUSTAINABILITY.



Parameters of our developing portfolio

We will focus our developing portfolio on consumer offers that will capitalise on our core business capabilities.

Specifically, we consider there to be four key parameters that create the boundaries of our portfolio development.

First, we will leverage our unique global marketing reach and scale.

Second, we will build on our existing delivery platforms in vapour and modern oral where we have hard-earned technological expertise.

Third, given our well-developed regulatory and scientific expertise, we will operate in product categories that require those capabilities.

Finally, any portfolio investment will be judged by stringent strategic and financial metrics.

As we explore these portfolio development opportunities, our new corporate ventures team will accelerate the creation, development and commercialisation of new-to-world innovation on a test-and-learn basis.

Strong foundations

As the world's largest international tobacco company by revenue, we are exceptionally well-placed for future growth. Our deep understanding of consumers, significant geographic spread, supply chain proficiency and experience engaging with diverse stakeholders are essential capabilities.

Few consumer goods companies can claim over 150 million consumer interactions every day; distribution in 11 million points of sale across a well-balanced, developed and emerging market footprint; and approaching 11 million consumers of non-combustible tobacco and nicotine products.

This year we have grown the New Categories revenue to £1.3 billion – a growth rate of 37% in 2019 (both at current rates of exchange) and more than double our revenues from two years ago. This provides us with a vital platform for the future.

Maximising efficiencies

I have been clear that we need to simplify the business and I have been dedicated to that end in my first year as Chief Executive.

During 2019, we launched both a fundamental re-evaluation of how we are organised and a redesign of management layers that eliminated duplication and entrenched accountability. We called this Project Quantum and it is the first, not the last, step, as we will constantly need to refine our business as the Group evolves.

Project Quantum created new capabilities in the organisation, and will help us release valuable funds for further reinvestment in our growth ambition.

Empowered and diverse

Our 53,000 plus people remain our most important asset. As we recast our structure, we are clarifying accountability and empowering real ownership to our teams.

As our business evolves, so too does our employee value proposition. Today, we are attracting a different and wider range of people and skillsets than we did before, injecting exciting new capability into the business. This is exemplified by our over 300 new specialist hires in 2019, who are bringing with them new capabilities in digital, product development and design.

For both our long-time BAT employees and those who have more recently joined, we are inspiring an ethos that is responsive to constant change and embodies a learning culture dedicated to continuous improvement.

Sustainable future

I am honoured to be at the helm of an exceptional business with such a successful history. My responsibility is to ensure that it is faster, bolder and stronger in the years to come.

We now have a business with a new corporate identity that reflects our company today and our journey ahead. We are becoming a business that defines itself not by the products it sells but by the consumer needs it meets.

Our total commitment to a multi-category business powered by investment from our combustibles category will drive sustainable growth and underpin continued delivery of high single-digit earnings growth on an adjusted constant currency basis.

I am confident that we have a strategy for growth and sustainability which will deliver a better tomorrow.

Yours

Jack Bowles
Chief Executive



OUR TOTAL COMMITMENT TO A MULTICATEGORY BUSINESS POWERED BY INVESTMENT FROM OUR COMBUSTIBLES CATEGORY WILL DRIVE SUSTAINABLE GROWTH AND UNDERPIN CONTINUED DELIVERY OF HIGH SINGLE-DIGIT EARNINGS GROWTH.



THE FOUNDATIONS OF OUR EVOLVED STRATEGY

We are committed to providing a better tomorrow for all our stakeholders. Our ambition is to deliver long-term sustainable growth with a range of innovative and less harmful products that stimulate the senses of new adult generations.

STRONG FOUNDATIONS



>180
markets in which
we operate



>150m
daily consumer
interactions



>11m
points of sale across
over 180 markets

Our wide range of capabilities make us exceptionally well-placed for future growth:

- our unique global marketing and distribution reach;
- our track record of R&D strength and innovation;
- our decades' worth of consumer insights, and brand building expertise; and
- our £1.3 billion New Categories business built in just a few years.

SATISFYING CONSUMER MOMENTS

20 years ago

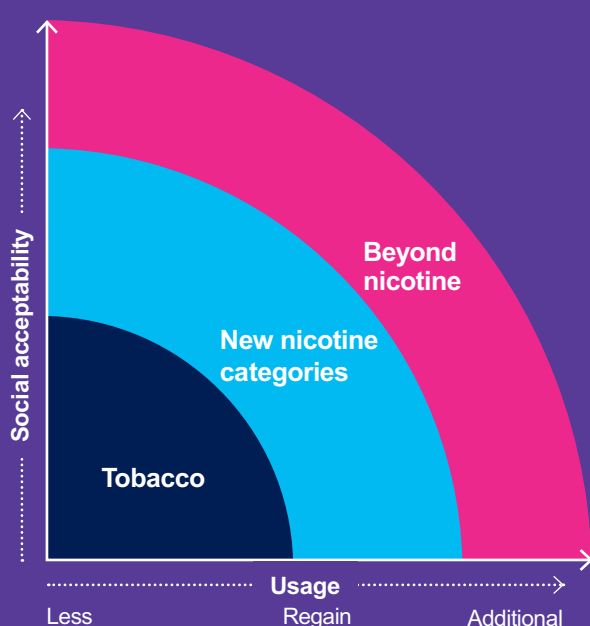
Traditional cigarettes fulfilled a multitude of consumer moments



For decades, cigarettes satisfied a need for sensorial enjoyment for many individuals. While occasions for tobacco consumption are now reduced, new opportunities have arisen:

- new products provide us with an opportunity to capture in a focused way the lost consumer moments previously associated with tobacco.
- evolving and fragmenting consumer needs provide us with opportunities for additional growth in a variety of new categories.

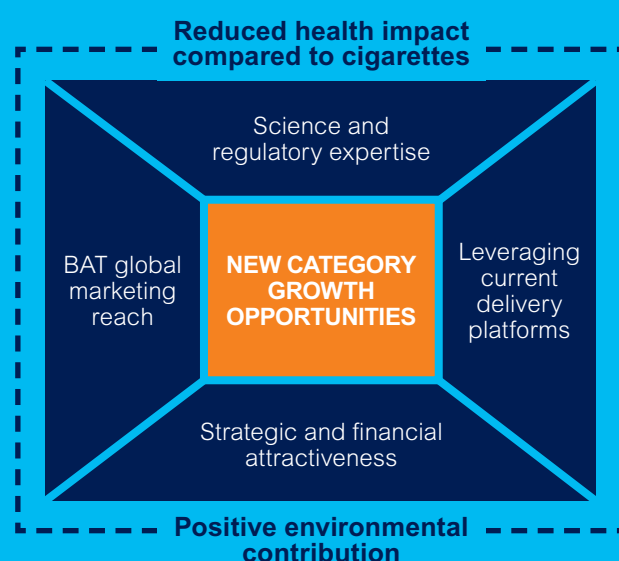
A DEVELOPING PORTFOLIO



A wider portfolio of products that offer sensorial enjoyment for different moods and moments will allow us to capture the consumer moments previously associated with tobacco use, as well as satisfy new evolving consumer needs, through:

- traditional tobacco and nicotine products;
- new nicotine products; and
- ultimately, a portfolio of products beyond tobacco and nicotine that leverages our proven delivery technologies.

PARAMETERS TO GUIDE GROWTH OPPORTUNITIES



Our new growth opportunities will capitalise on our core business strengths, creating clear boundaries for our portfolio development:

- reducing the health and environmental impacts of our business;
- leveraging our global marketing reach and scale;
- building on existing delivery platforms and technological expertise;
- relying on our experience in managing complex regulatory and scientific matters; and
- meeting stringent strategic and financial metrics.

A STRATEGY FOR ACCELERATED GROWTH

While combustible tobacco will be at the core of our business for some time to come, we aim to generate an increasingly greater proportion of our revenues from products other than cigarettes, thereby reducing the health impact of our business.

This will deliver a better tomorrow for our consumers who will have a range of enjoyable and potentially less risky choices for every mood and moment; for society through reducing the overall health and environmental impacts of our business; for our employees by creating a dynamic and purposeful place to work; and for our shareholders by delivering sustainable superior returns.



OUR MISSION

Stimulating the senses of new adult generations

Today, we see opportunities to capture consumer moments which have, over time, become limited by societal and regulatory shifts, and to satisfy evolving consumer needs and preferences.

Our mission is to anticipate and satisfy this ever-evolving consumer: provide pleasure, reduce risk, increase choice and stimulate the senses of adult consumers worldwide.

MUST WINS

High Growth Segments

Driven by our unique and data-driven consumer insight platform (PRISM), we will focus on product categories and consumer segments across our global business that have the best potential for long-term sustainable growth.

Priority Markets

By relying on a rigorous market prioritisation system (MAPS), we will focus the strengths of our unparalleled retail and marketing reach, as well as our regulatory and scientific expertise, on those markets and marketplaces with the greatest opportunities for growth.

HOW WE WIN

Inspirational foresights

As one of the most long-standing and established consumer goods businesses in the world, we have a unique view of the consumer across four product categories, which is increasingly driven by powerful data and analytics. These insights ensure that the development and responsible marketing of our products is fit to satisfy consumer needs.

Remarkable innovation

As consumer preferences and technology evolve rapidly, we rely on our growing global network of digital hubs, innovation super centres, world-class R&D laboratories, external partnerships and an upcoming corporate venturing initiative to stay ahead of the curve.



OUR STRATEGY PUTS THE **CONSUMER FIRST**, FOCUSING ON UNDERSTANDING ADULT CONSUMER CHOICE AND ENJOYMENT. WE WILL **CAPTURE LOST CONSUMER MOMENTS** WITH A PORTFOLIO IN TOBACCO, NICOTINE AND BEYOND. THIS WILL ENABLE SUSTAINABLE, LONG-TERM GROWTH WITH A CLEAR FOCUS ON FORESIGHTS, INNOVATION, BRANDS, ACTIVATION, TEAMS AND TECHNOLOGY. WE WILL BECOME A BUSINESS THAT DEFINES ITSELF NOT BY THE PRODUCTS IT SELLS BUT BY THE CONSUMER NEEDS IT MEETS.

Kingsley Wheaton
Chief Marketing Officer



OUR PURPOSE



KEY STAKEHOLDER OUTCOMES

Consumers



enjoyable choices for every mood and moment, today and tomorrow

Society



reduced overall health & environmental impact

Employees



a dynamic, inspiring and purposeful place to work

Shareholders



sustainable and superior returns

ETHOS

Empowered

Bold

Fast

Diverse

Responsible

Powerful brands

For over a century, we have built trusted and powerful brands that satisfy our consumers and serve as a promise for quality and enjoyment. We will focus on fewer, stronger and global brands across all our product categories, delivered through our deep understanding and segmenting of our consumers.

Connected

Few companies can claim over 150 million daily consumers, over 11 million retail points of sale, as well as a network of expert and skilled employees around the world. Staying connected to all of them, especially through digital means (including e-commerce), ensures better consumer connections, access to markets and innovations that offer sensorial enjoyment and satisfy consumer needs.

People and partnerships

Our highly-motivated people are being empowered through a new ethos that is responsive to constant change, embodies a learning culture and is dedicated to continuous improvement. But we cannot succeed on our own, and our partnerships with farmers, suppliers and customers are also key for ensuring sustainable future growth.

US focus

The United States comprises nearly half of our global business. It is also the single largest economy in the world, the largest single centre for technology and the key driver of global consumer trends, and is where we have the deep consumer understanding and financial strength to support the delivery of our mission to stimulate consumer senses around the rest of the world.

OUR PURPOSE

By stimulating the senses of new adult generations, our purpose is to create A Better Tomorrow for all our stakeholders.

We will create A Better Tomorrow for:

Consumers



By responsibly offering enjoyable and stimulating choices for every mood and every moment, today and tomorrow;

Society



By reducing the health impact of our business by offering a range of alternative products, as well as by reducing our environmental and social impacts;

Employees



By creating a dynamic, inspiring and purposeful place to work; and

Shareholders



By delivering sustainable and superior returns.

PUTTING SUSTAINABILITY FRONT AND CENTRE

As we evolve our Group strategy, we are also evolving our Sustainability Agenda. We are moving ourselves from a business where sustainability has always been important, to one where it is front and centre in all that we do.

Our commitment to reduce the health impacts of our cigarette business – by providing a range of potentially less risky products – is central to our corporate purpose. This is underpinned by excellence in all other environmental, social and governance (ESG) measures.

Each year we engage with a wide range of stakeholders to understand the issues that are most important to them. 2019 was a significant year, with many stakeholders re-emphasising the importance of addressing the health impacts of our cigarette business and with governments and cities around the world declaring a climate emergency.

Consequently, we refreshed our Sustainability Agenda (as an integral part of our evolved Group Strategy) to reflect the prominence of tobacco harm reduction and also to place a greater emphasis on the importance of addressing climate change and environmental management. At the same time, we remain committed to delivering a positive social impact and ensuring robust corporate governance across the Group.

New Sustainability Targets

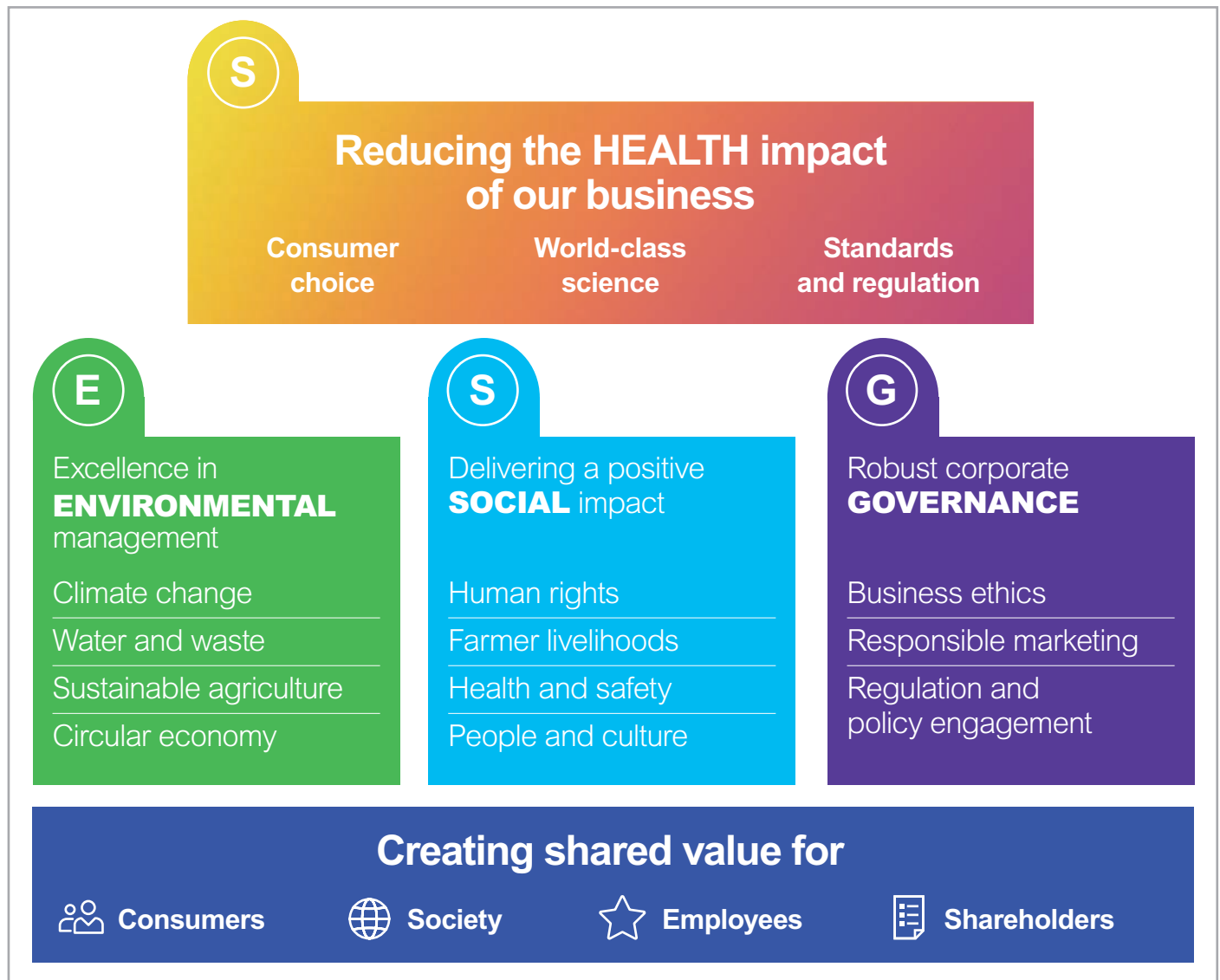
We are committed to making a step-change in our sustainability ambition. As a result, we have announced a number of stretching targets that we are confident will deliver A Better Tomorrow for all our stakeholders.

These include:

- increasing our number of non-combustible product consumers from 11 million to 50 million by 2030;
- achieving carbon neutrality by 2030*;
and
- bringing forward our existing 2030 environmental targets to 2025.

* Based on Scope 1 and 2 carbon dioxide equivalent (CO₂e) emissions.

OUR SUSTAINABILITY AGENDA



ETHOS

Our purpose is to build a better tomorrow by reducing the health impact of our business through offering a greater choice of enjoyable and less-risky products for our consumers.



A KEY DRIVER TO DELIVER THIS WILL BE OUR ETHOS – AN EVOLUTION OF OUR GUIDING PRINCIPLES – WHICH GUIDES OUR CULTURE AND BEHAVIOURS ACROSS THE ENTIRE GROUP. IT HAS BEEN DEVELOPED WITH SIGNIFICANT INPUT FROM OUR EMPLOYEES, AND ENSURES AN ORGANISATION THAT IS FUTURE FIT FOR SUSTAINABLE GROWTH.

Hae In Kim
Director, Talent and Culture



We are **BOLD**



Dream big – with innovative ideas

Make tough decisions quickly and proudly stand accountable for them

Resilient and fearless to compete

We are **FAST**



Speed matters. Set clear direction and move fast

Keep it simple. Focus on outcomes

Learn quickly and share learnings

We are **EMPOWERED**



Set the context for our teams and trust their expertise

Challenge each other. Once in agreement, we commit collectively

Collaborate and hold each other accountable to deliver

We are **DIVERSE**



Value different perspectives

Build on each others' ideas, knowledge and experiences

Challenge ourselves to be open-minded recognising unconscious bias

We are **RESPONSIBLE**



Take action to reduce the health impact of our business

Ensure the best quality products for our consumers, the best place to work for our people, and the best results for shareholders

Act with integrity, never compromising our standards and ethics

OUR PEOPLE

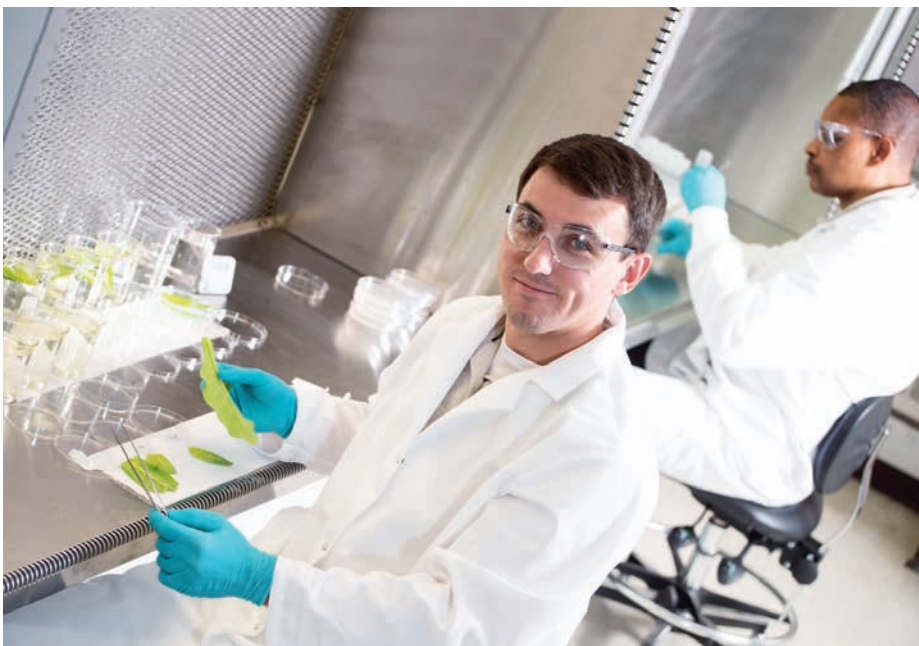
As our business evolves, so too does our employee value proposition. Today, as we have expanded our portfolio across a number of new categories, we are attracting a different and wider range of people and skillsets than we did before, injecting exciting new capabilities into the business.



THERE ARE **141 NATIONALITIES** REPRESENTED AT MANAGEMENT LEVEL WITHIN OUR GROUP



OUR GLOBAL EMPLOYEE SURVEY RESULTS DEMONSTRATE THAT **WE OUTPERFORM** OUR FMCG COMPARATOR GROUP





LAST YEAR WE RECEIVED OVER **60,000 APPLICATIONS** TO OUR GLOBAL GRADUATE PROGRAMME



WE WERE AWARDED **'BEST PLACE TO WORK FOR LGBTQ EQUALITY'** BY THE HUMAN RIGHTS CAMPAIGN FOUNDATION IN THE US, AND HAD SEVEN FINALISTS IN THE GLOBAL **WOMEN IN I.T. AWARDS**



DIVERSITY MATTERS TO THE GROUP BECAUSE IT MAKES GOOD COMMERCIAL SENSE



BUILDING WORLD-CLASS CAPABILITIES FOR INNOVATION

To achieve a step-change in New Categories, we are building new capabilities around the world focused on science, innovation, and digital information.

Consumer preferences and technology are evolving rapidly, and we are staying ahead of the curve with our digital hubs, the creation of innovation super centres, and further development of our world-class R&D laboratories. We are also leveraging the expertise of our external partners, and are looking forward to exciting results from our upcoming venturing initiative.

Key

-  Innovation
-  R&D
-  Science
-  Digital



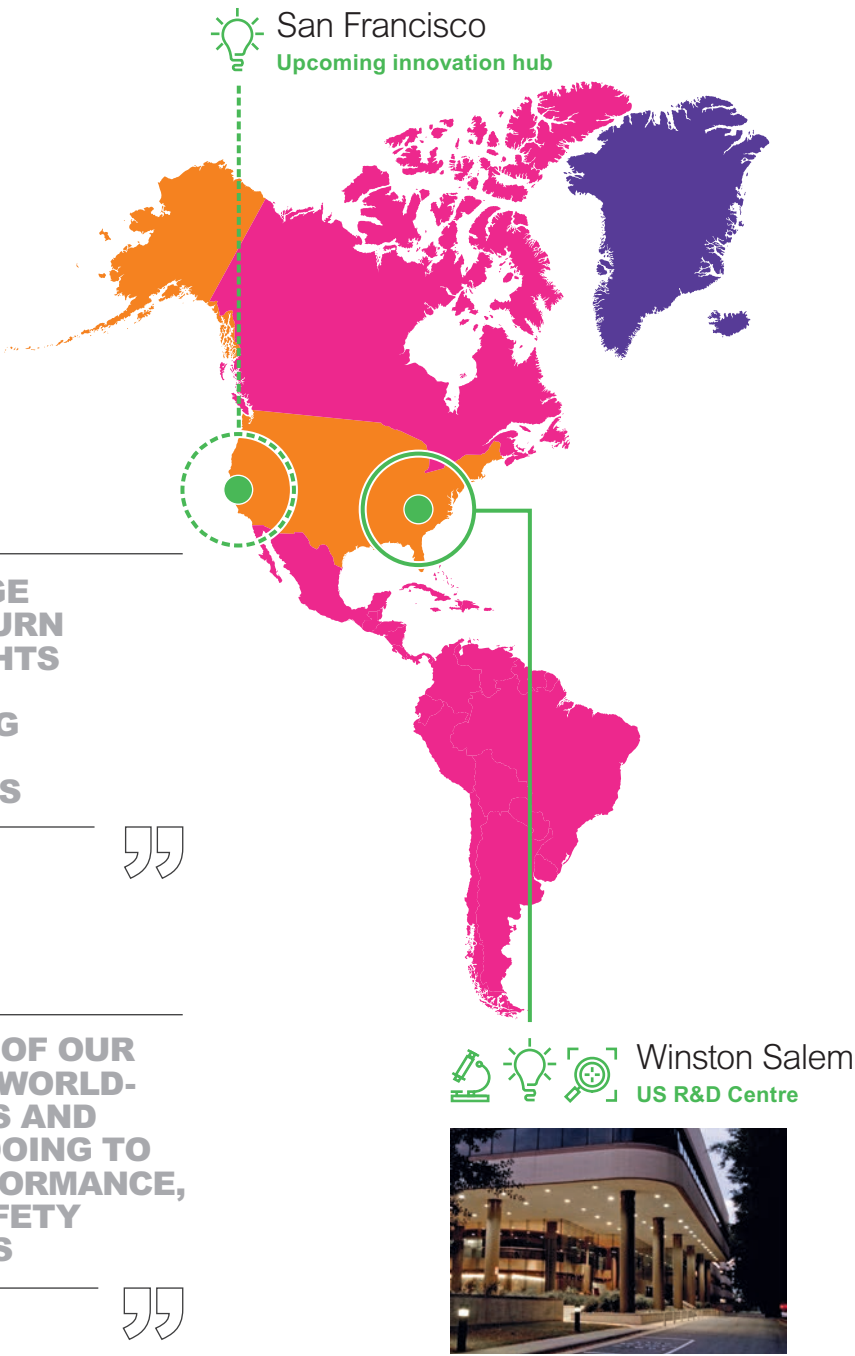
“OUR CUTTING EDGE TECHNOLOGIES TURN CONSUMER INSIGHTS INTO INNOVATIVE AND OUTSTANDING PRODUCTS THAT MEET THEIR NEEDS”

Paul Lageweg
Director, New Categories



“I AM VERY PROUD OF OUR GLOBAL TEAM OF WORLD-CLASS SCIENTISTS AND WHAT THEY ARE DOING TO ENSURE THE PERFORMANCE, EFFICACY AND SAFETY OF OUR PRODUCTS”

David O'Reilly
Director, Research and Science



San Francisco
Upcoming innovation hub

Winston Salem
US R&D Centre



WE ARE EMBEDDING DIGITAL CAPABILITIES ACROSS BAT. THROUGH DATA AND E-LEARNING, THIS IS DELIVERING MORE EFFICIENT WAYS OF WORKING, AGILE SUPPLY CHAINS AND ENHANCED CONSUMER CONNECTIONS



Marina Bellini
Director, Digital and Information



Four

New and upcoming tech hubs

50+

toxicologists

1,500+

R&D specialists

600+

scientists and engineers

300+

new specialist hires in 2019

330

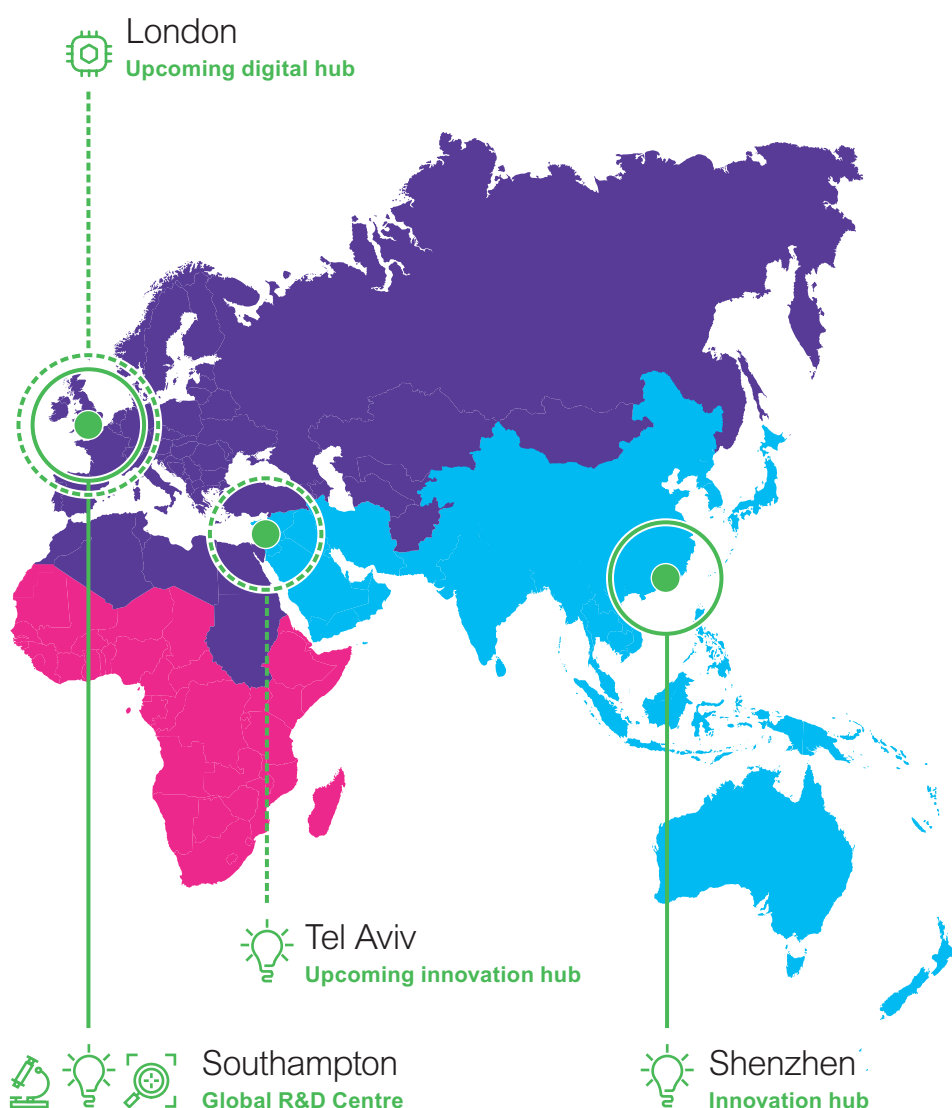
Global Graduate hires in 2019

200+

external partners

150+

PhDs





@ IN 2019, BUILDING ON OUR FOUNDATIONS, WE HAVE DELIVERED STRONG OPERATIONAL RESULTS, CREATING A SOLID BASE FOR DELIVERING TODAY WHILE BUILDING A BETTER TOMORROW

EXCLUDING CURRENCY, WE GREW OUR ADJUSTED REVENUE 5.6%, ADJUSTED PROFIT 6.6%

ADJUSTED OPERATING MARGIN GREW 50 BPS TO 43%

OPERATING CASH FLOW CONVERSION RATIO OF 97% GENERATED £1.9BN OF FREE CASH FLOW AFTER DIVIDENDS FUELLING DELEVERAGING OF 0.5X

Tadeu Marroco
Finance Director



FINANCE DIRECTOR'S OVERVIEW



CASH GENERATION FUELS DIVIDENDS, DELEVERAGING AND INVESTMENT



Our financial ambitions as fundamentals improve

As we build A Better Tomorrow, we will be focused on three key priorities: releasing funds to support our growth agenda, maximising our marketing spend effectiveness and generating cash to continue to deleverage the balance sheet.

Our combustible portfolio and operational efficiencies will fuel our financial performance by providing the fire-power to invest in New Categories, both inorganically, mainly through our new corporate venturing initiative, and organically, in products that meet our consumers' changing needs.

We remain committed to consistent and sustainable long-term 3-5% revenue growth which will deliver high single figure earnings growth, on a constant currency basis, whilst targeting a minimum of 95% cash conversion and a dividend pay-out ratio of 65% of adjusted diluted EPS over the medium to long-term.

Pricing and New Categories drive revenue growth

Revenue grew by 5.7% in 2019 to £25,877 million driven by pricing across the cigarettes portfolio (with price/mix of 9%) and an increase in revenue from Traditional Oral (up 15%, with 2018 up 127%) and New Categories (up 37%, 2018 up 138%), which more than offset a 4.7% reduction in cigarette volume. In 2018, revenue grew 25.2% at £24,492 million largely due to the full year effect of the RAI acquisition. Adjusting for the impact of acquisitions, excise on bought-in goods and the impact of currency, constant currency adjusted revenue grew 5.6% in 2019 (2018: up 3.5% on a representative constant rate basis).

Increased focus on operational efficiency

Profit from operations was down 3.2% (2018: up 45.2%), as the improvement in revenue and operational efficiencies were more than offset by the charges related to Canada, Russia, other smoking and health litigation (including Engle in

the US) and Indonesia (as discussed on page 154), the impact of the restructuring programmes (including Quantum), the ongoing investment in New Categories and the impact of amortisation of acquired brands. 2018 was positively skewed by the inclusion of 12 months of results from RAI. Our operating margin declined in 2019 by 320 bps to 34.8% on a reported basis.

Adjusted profit from operations grew by 6.6% on a constant currency basis (2018: up 4.0% on a representative, constant rate basis). On an adjusted basis, operating margin increased by 50 bps to 43.1% (2018: 42.6%).

Focus on dividends

Dividends per share for 2019 will be 210.4p, an increase of 3.6% (2018: 203.0p, up 4.0%), in line with our commitment of a 65% payout ratio on adjusted diluted earnings per share (2018: 68.4%).

Net finance costs increased 16% to £1,602 million partly due to a foreign exchange headwind and interest on leases recognised under IFRS16 (*Leases*). 2018 was up 26.2% to £1,381 million due to higher borrowings following the acquisition of RAI. Our banking facilities require a gross interest cover of at least 4.5 times. In 2019, our gross interest cover was 7.1 times (2018: 7.2 times).

On a reported basis, basic EPS was 5.4% lower than 2018 at 249.7p largely due to the reduction in profit from operations. EPS in 2018 declined 86% as 2017 was materially affected by a deemed gain (£23.3 billion) arising on the acquisition of RAI. Excluding the adjusting items and the effect of foreign exchange on the Group's results, adjusted diluted earnings per share, at constant rates, increased by 8.4% to 321.6p, with 2018 ahead of 2017 by 11.8%.

Cash delivery leads to deleveraging and investment

In 2019, net cash generated from operating activities fell 12.6% to £8,996 million (2018: up 93% to £10,295 million), with 2018 positively impacted by the timing of payments related to the Master Settlement Agreement (MSA) in the US.

Adjusted cash generated from operations (as defined on page 265) was £6,831 million, a decline of 15% on 2018, or 16% on a constant rate basis. Normalising for the timing of the MSA liability, adjusted cash generated from operations would have been 1.2% higher than 2018.®

Based upon net cash generated from operating activities, the Group's cash conversion ratio reduced from 111% in 2018 to 100% in 2019.

Excluding the MSA timing impact (affecting 2018), operating cash flow conversion ratio (as defined on page 264) was 97% (2018: 100%).

Free cash flow is a measure the Group uses to assess total cash generated by the Group's operations, prior to the payment of dividends, repayment of borrowings or undertaking of investing activities. In 2019, free cash flow was £6,519 million. After paying the dividend in the year, free cash flow was £1,921 million demonstrating the Group's ability to service and repay borrowings which reduced in 2019 to £45,366 million from £47,509 million, whilst continuing to pay dividends to shareholders.®

Adjusted net debt to adjusted EBITDA, as defined on page 267 provides a measure to assess the Group's ability to meet its borrowing obligations. The Group continues to focus on a balanced approach of deleveraging, while investing for the future and providing a return via dividends to shareholders. This measure will be a key performance indicator in 2020 (replacing adjusted cash generated from operations)®, demonstrating our commitment to the deleveraging agenda. In 2019, the adjusted net debt to adjusted EBITDA ratio improved from 4.0 times to 3.5 times.

The Group continues to deliver against the financial objectives, which allows for growth in dividends while deleveraging and investing in A Better Tomorrow.

Tadeu Marroco
Finance Director

The term 'representative' is used to compare the 2018 results against an equivalent 2017 if that year included results from RAI for the whole of that period, including certain additional adjusting items related to the acquired companies.

® Denotes phrase, paragraph or similar that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.

OUR YEAR IN NUMBERS

Group cigarette (and tobacco heating products – THP) volume

+677bn
-4.4%

2018: +3.3% (-3.5% representative^a)
2017: +3.2% (-2.6% organic^a)

KPI

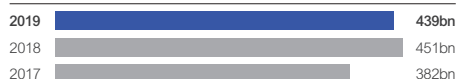
Group volume share of Key Markets

+20 bps

2018: +40 bps
2017: +40 bps

Strategic Cigarette and THP volume

439bn
-2.5%



2018: +17.9% (+5.8% representative^a)
2017: +17.9% (+7.6% organic^a)

Modern Oral (no. pouches)

1.2bn
+188%



2018: +108%
2017: n/a – no sales of modern oral in 2016

Vapour (units)

226m
+19%



2018: +100% (+35% representative^a)
2017: +120%

Notes: To supplement our results of operations presented in accordance with IFRS, the information presented also includes several non-GAAP measures used by management to monitor the Group's performance. See the section non-GAAP measures beginning on page 258 for information on these non-GAAP measures, including their definitions and reconciliations from the most directly comparable IFRS measure, where applicable. Certain of our measures are presented based on constant rates of exchange, on an adjusted basis, and on a representative basis and on an organic basis.

IFRS-GAAP

Revenue (£m)

£25,877m
+5.7%



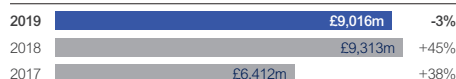
Definition: Revenue recognised, net of duty, excise and other taxes.

In 2019, revenue includes £18,793 million of revenue from the Strategic Portfolio, an increase of 9% (2018: £17,257 million). Within the Strategic Portfolio, revenue from New Categories was £1,255 million (2018: £917 million).

IFRS-GAAP

Profit from operations (£m)

£9,016m
-3.2%



Definition: Profit for the year before the impact of net finance costs/income, share of post-tax results of associates and joint ventures and taxation on ordinary activities.

IFRS-GAAP

Net cash generated from operating activities (£m)

£8,996m
-12.6%



Definition: Movement in net cash and cash equivalents before the impact of net cash used in financing activities, net cash used in investing activities and differences on exchange.

IFRS-GAAP

Diluted earnings per share (EPS) (p)

249.0p
-5.4%



Definition: Profit attributable to owners of BAT p.l.c. over weighted average number of shares outstanding, including the effects of all dilutive potential ordinary shares.

The information presented also includes several non-financial key performance indicators ("KPIs") used by management to monitor the Group's performance. The Group's Management Board believes that these KPIs provide information that enables investors to better understand the Group's performance across periods. See the section "Non-Financial KPIs" on page 257 for more information on these non-financial KPIs.

KPI Non-GAAP

Change in adjusted² revenue at constant rates¹ (%)

+5.6%

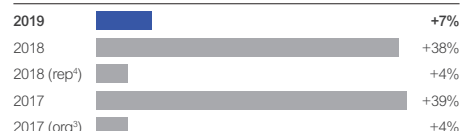


Definition: Change in revenue before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

KPI Non-GAAP

Change in adjusted² profit from operations at constant rates¹ (%)

+6.6%



Definition: Change in profit from operations before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

KPI Non-GAAP

@Change in adjusted² cash generated from operations at constant rates¹ (%)

-16.3%



Definition: Change in adjusted cash generated from operations, as defined on page 265, before the impact of fluctuations in foreign exchange rates.[@]

KPI Non-GAAP

Change in adjusted² diluted EPS (%)

+9.1%



Definition: Change in diluted earnings per share before the impact of adjusting items.

- Where measures are presented 'at constant rates', the measures are calculated based on a re-translation, at the prior year's exchange rates, of the current year results of the Group and, where applicable, its segments. See page 51 for the major foreign exchange rates used for Group reporting.
- Where measures are presented as 'adjusted', they are presented before the impact of adjusting items. Adjusting items represent certain items of income and expense which the Group considers distinctive based on their size, nature or incidence.

KPI Non-GAAP

Change in adjusted² revenue from the Strategic Portfolio at constant rates¹ (%)**+7.3%**

Definition: Change in revenue from the strategic portfolio before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

This measure was introduced in 2018, with no comparators provided.

KPI Non-GAAP

Change in adjusted² revenue from New Categories at constant rates¹ (%)**+32.4%**

Definition: Change in revenue from New Categories before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

IFRS-GAAP

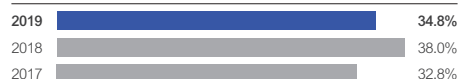
Denotes IFRS-GAAP financial measure

KPI

Denotes key performance indicator (KPI) measure

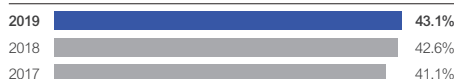
Non-GAAP

Denotes non-GAAP financial measure, see Non-GAAP measures on pages 258 to 268

Operating margin (%)**34.8%**

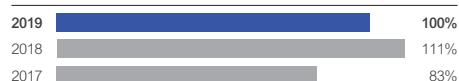
Definition: Profit from operations as a percentage of revenue.

Non-GAAP

Adjusted² operating margin (%)**43.1%**

Definition: Adjusted profit from operations as a percentage of adjusted revenue.

KPI Non-GAAP

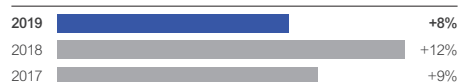
Cash conversion (%)**100%**

Definition: Net cash generated from operating activities as a percentage of profit from operations.

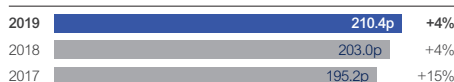
Operating cash flow conversion ratio² (%)**97%**

Definition: Operating cash flow, as defined on page 264 as a percentage of adjusted profit from operations.

KPI Non-GAAP

Change in adjusted² diluted EPS at constant rates¹ (%)**+8.4%**

Definition: Change in diluted earnings per share before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

Total dividends per share (p)**210.4p**
+3.6%

Definition: Dividends per share in respect of the financial year.

Target: To increase dividend in sterling terms, based upon the Group's policy to pay dividends of 65% of long-term sustainable earnings.

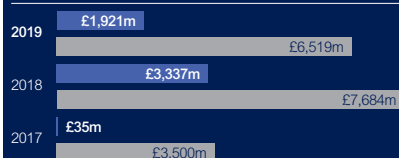
@Changes in 2019

In 2019, the Group introduced the measure 'free cash flow before and after payment of dividends to shareholders'. This measure supplements the existing measures related to cash flow. It is used to demonstrate the level of net cash generated by the Group, in any one year, after payment of all operating expenses, interest, tax, capital expenditure and payments to non-controlling interests and inclusive of dividends received from associates. This provides users of the financial statements with the available cash generation from which dividends to shareholders are paid, with the remaining cash being available for other activities such as investment or repayment of debt.

@ Denotes table and accompanying text that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.

● After dividends paid
● Before dividends paid

Non-GAAP

Free cash flow before and after dividends paid to shareholders (£m)

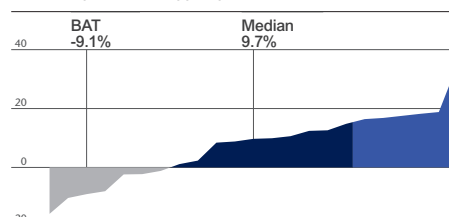
Definition: The level of free cash flow, as defined on page 266, earned by the business in the year, before and after the payment of dividends to shareholders.

KPI

@Total shareholder return (TSR) of the FMCG group – 1 January 2017 to 31 December 2019 (%)

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

● Lower quartile ● Upper quartile



Definition: Relative TSR to a peer group of international FMCG companies, with the constituent FMCG peer group listed on page 104.

3. Where measures are presented as 'organic' or 'org', they are presented before the impact of the contribution of brands and businesses acquired during the comparator period, including Reynolds American, Bulgartabac, Winnington and Fabrika Duhana Sarajevo in 2017. There were no material acquisitions or disposals in 2018 or 2019.

4. Where measures are presented as 'representative', 'rep' or 'on a representative basis', they are presented inclusive of the acquired businesses in the 2017 comparator period as though those businesses had been included in the consolidated results for the whole of that comparator period and including certain additional adjusting items related to the acquired companies.

GLOBAL INDUSTRY OVERVIEW*

While the total tobacco and nicotine market comprises a growing user pool of over one billion individual adult consumers, global trends are shifting and our industry is experiencing a period of ongoing change.

Generational differences, as well as shifting attitudes towards health and wellness, are expected to increase the growth of new categories of products including and beyond tobacco and nicotine, which are able to provide stimulation and pleasure for consumers in ways previously associated with cigarettes. This is expected to play a role in off-setting the predicted steady decline in cigarette consumption.

Global combustible market

While combustible cigarettes remain the largest global tobacco category, their volumes have seen a gradual fall over many years driven by increased regulation and changing societal attitudes. Total tobacco consumption, including illicit, declined 2% from 2018 to 2019; this decline rate is forecasted to remain between 2%-3% over the next three years, while the retail value of tobacco sales is expected to increase by between 2%-4% each year, driven principally by pricing.

The most recent estimates for the legal global tobacco market (2018) indicate that sales are worth approximately US\$814 billion. More than US\$700 billion of this comes from the sale of conventional cigarettes, with over 5,300 billion cigarettes consumed per year by over 19% of the world's population.

A contributing factor to the decline of legal tobacco volumes is the continued rise in the consumption of illicit products. Cigarettes are a reliable source of tax revenue for governments worldwide, and price differentials between markets, regulatory changes and broader macroeconomic pressures have driven the establishment of a significant and growing illicit cigarette trade, now estimated to account for 11.2% of the global tobacco market.

It is generally accepted that there is a direct correlation between steep and ad hoc increases in taxes and an increase in illicit sales, with the current sanctions in many countries doing little to deter criminals for whom profits from the illegal sale of tobacco remain an appealing prospect. For example, following successive excise increases, the Australasia region has seen legal volumes decline substantially. However, in markets such as South Africa, where effective action has reduced the prevalence of illegal tobacco, legal volumes have been restored.

See pages 58 to 62 to read more about our Principal Group risks

For further discussion regarding the regulation of our business, please see pages 287 to 290

Global combustible regulation

Tobacco is one of the world's most regulated and most taxed industries, contributing in excess of \$200 billion to government treasuries each year. Manufacturers are required to comply with a swath of regulations that vary considerably across markets.

Legislation and subsequent regulation has been focused mainly on the introduction of plain packaging, product-specific regulation, graphic health warnings on packs, tougher restrictions on smoking in enclosed public places and bans on shops displaying tobacco products at the point of sale.

In more recent years, governments have begun considering and adopting regulations aimed at menthol flavourings, as well as environmental concerns resulting from the litter associated with cigarette consumption.



THE RETAIL VALUE OF TOBACCO SALES IS EXPECTED TO INCREASE BY BETWEEN 2% AND 4% EACH YEAR



Global New Categories market

The last five years have seen the global tobacco and nicotine market diversify beyond traditional combustible tobacco with the growth of vapour and tobacco heating products (THPs), and modern oral tobacco.

The success of these new categories is the result of their ability to offer consumer satisfaction in circumstances where the consumption of combustible tobacco is no longer permitted or socially acceptable, as well as to offer potentially reduced risk compared to traditional cigarettes. With new adult generations increasingly focused on health and lifestyle considerations, technological innovation, and personalised consumer experiences, it is expected that the growth of new categories will continue to accelerate as they can better meet consumer preferences and demands.

New category nicotine products have grown quickly across the world, with an estimated 54 million vapour consumers and 15 million THP consumers.

The latest global figures (2018) suggest that global vapour sales are worth \$15.7 billion, while global THP revenues stand at \$11.9 billion.

While traditional oral products show steady incremental growth, new modern oral products (which comprise tobacco-free nicotine pouches) are showing accelerated volume expansion in both Europe and the US.

There has also been growth in the market for wellbeing and 'new active' products. This growth is expected to continue as consumer tastes fragment and evolve.

Within this space, cannabidiol (CBD) oil is expected to gain wider use, as already evidenced by its recent growth in market size.

* All data sources on this page are from Euromonitor International unless otherwise stated.

New Categories regulation

The THP and vapour markets are relatively nascent. Regulation is in its early stages in many countries and, while many governments are considering regulation specific to this category, it has often not been enacted. Globally, there is a mix of attitudes between regulators who aim to encourage THPs and vapour as products that are potentially lower risk for smokers and those who view them with greater scepticism – including some countries where they are banned.

Although many jurisdictions have yet to implement clear regulations concerning new category products, an increasing number of governments are passing laws that allow and encourage the growth of these categories, while also balancing concerns regarding increased youth usage.

The UK is an example of what can happen with the support of regulators and public health bodies. Driven by influential reports from Public Health England and the Royal College of Physicians on the reduced risk potential of vapour products, the UK Government has implemented a balanced regulatory regime that discourages youth uptake while also encouraging adult smokers to migrate to potentially less harmful products.



IT IS EXPECTED THAT THE GROWTH OF NEW CATEGORIES WILL CONTINUE TO ACCELERATE AS THEY CAN BETTER MEET CONSUMER PREFERENCES AND DEMANDS



Litigation

Legal and regulatory court proceedings continue in a number of forms against the tobacco industry, and more recently the vaping industry, with the most common being third-party reimbursement cases, class actions and individual lawsuits.

Special factors that led to product liability litigation in the US and Canada are not typically replicated in other countries, which is why large volume and high-value litigation has not generally spread to other parts of the globe. The industry has a proven track record of defending its rights and managing risks such as these.



THE LAST FIVE YEARS HAVE SEEN THE GLOBAL TOBACCO AND NICOTINE MARKET DIVERSIFY BEYOND TRADITIONAL COMBUSTIBLE TOBACCO WITH THE GROWTH OF VAPOUR AND TOBACCO HEATING PRODUCTS, AS WELL AS MODERN ORAL TOBACCO

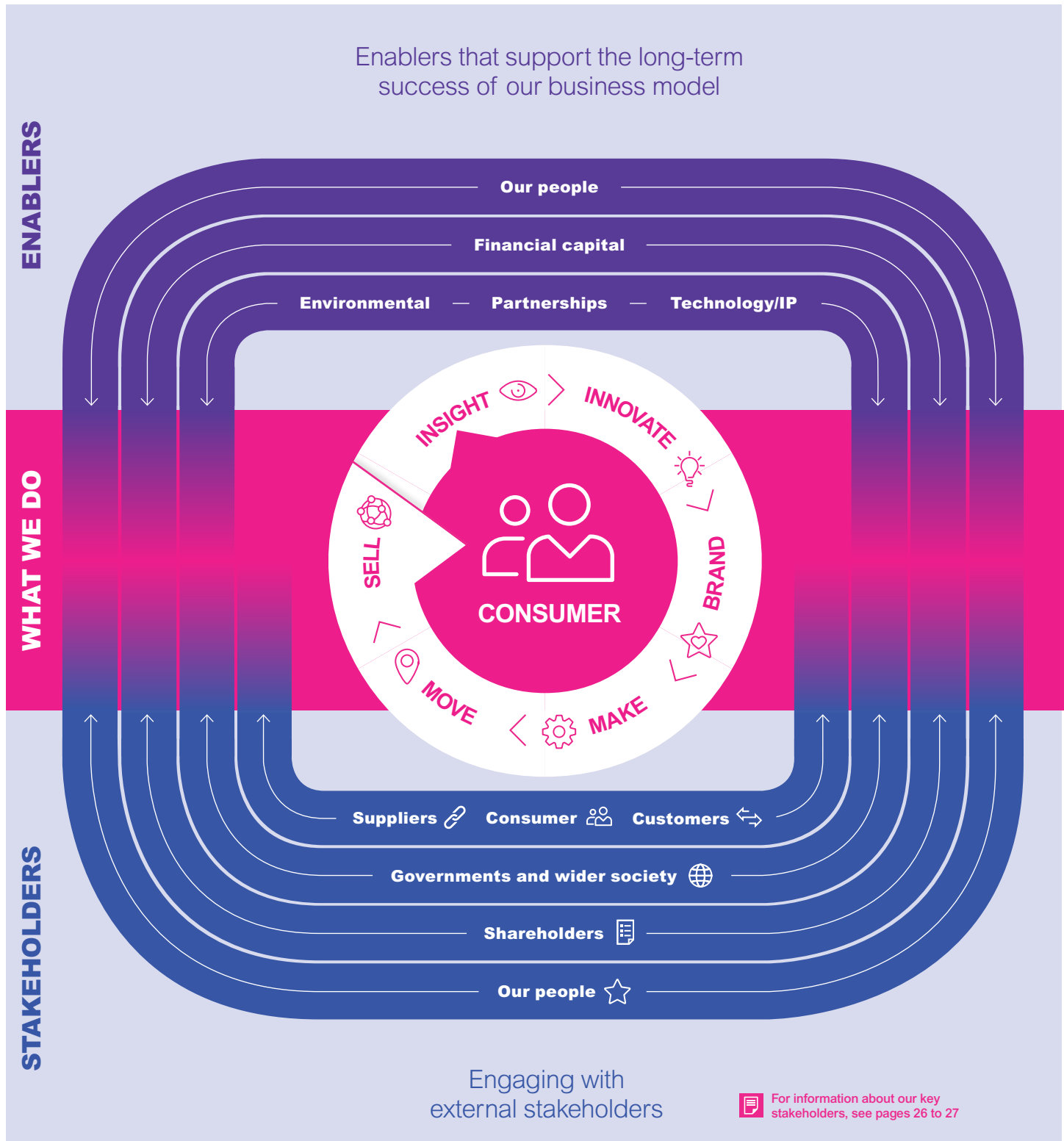


THE TOBACCO INDUSTRY CONTRIBUTES IN EXCESS OF US\$200 BILLION IN TAXES TO GOVERNMENT TREASURIES EACH YEAR



OUR BUSINESS MODEL

Our global business understands our diverse consumers, develops products to satisfy their preferences, and ultimately distributes them across over 200 markets. Five key enablers support us in turning powerful insights into products that provide enjoyment to our consumers, while engagement helps our key stakeholders benefit from our sustainable growth.





CONSUMER

Consumers sit in the centre of our business model. BAT strives to first identify consumer needs and desires, and ultimately provide satisfaction through the development and delivery of innovative products. With societal attitudes and regulatory restrictions narrowing the opportunities for tobacco-related consumer moments, we are committed to providing alternative products that consumers can enjoy in a variety of moods and moments.



INSIGHT

Our global community of consumers is diverse and has differing needs. We have a deep understanding of our 150 million daily consumers and anticipate trends with powerful data and analytics. We reject a 'one size fits all' approach, and satisfy their evolving preferences with a broad portfolio that takes into account geographic and market differences, while leveraging our own strengths.



INNOVATE

From combustibles to New Categories, exciting new products are the key to success. We make significant investments in research and development to deliver innovations that satisfy consumer tastes and generate growth for the business. Our new corporate ventures team will set a new benchmark for innovation by allowing us to assess, test and invest in new ideas, concepts and portfolio offers.



BRAND

Our global brands communicate quality and value, and establish trust in our products. They are essential to our credibility around the world, and their scale provides far-reaching awareness of our products, while our diverse portfolio allows us to meet the needs of different consumer segments. We have a proven track record of building and managing some of the most iconic brands in history, and will continue to leverage this expertise to grow our business across all categories.



MAKE

We manufacture high-quality cigarettes, THP consumables and oral tobacco products in facilities all over the world, and ensure that these products and the tobacco leaf we purchase are in the right place at the right time. Our vapour and tobacco heating product devices and liquids are manufactured in a mix of our own and third-party factories, and we work to ensure that our costs are globally competitive and that we use our resources as effectively as possible.



MOVE

We distribute our products around the globe effectively and efficiently using a variety of different distribution models suited to local circumstances and conditions. Around half of our global cigarette volume is sold by retailers, supplied through our direct distribution capability or exclusive distributors. We continuously review our route to market for both combustibles and New Categories, including our relationships with wholesalers, distributors and logistics providers.



SELL

We offer adult consumers a range of products including cigarettes, vapour, tobacco heating products, and oral products in markets around the world. Our range of high-quality products covers all segments, from value-for-money to premium, while also offering choices based on levels of potentially reduced risk. We are governed by our International Marketing Principles, which ensure that all of our products are marketed responsibly.

Key performance indicators

Group volume share of Key Markets

Change in adjusted revenue at constant rates (%)

Change in adjusted revenue from the Strategic Portfolio at constant rates (%)

Change in adjusted revenue from New Categories at constant rates (%)

Change in adjusted profit from operations at constant rates (%)

@Change in adjusted cash generated from operations at constant rates (%)

Operating cash flow conversion ratio (%)@

Change in adjusted diluted EPS (%)

Change in adjusted diluted EPS at constant rates

Total shareholder return of the FMCG group

For more key detail on our key performance indicators, see pages 18-19

DELIVERING MEASURABLE LONG-TERM SUSTAINABLE GROWTH

Non-financial information statement

Non-financial information reporting required under the UK Companies Act is included in the Strategic Report as referenced below:

Our business model is set out on these pages. Pages 58 to 62 for Principal Group Risks

Our reporting in the following areas includes information about the policies and principles that govern our approach, due diligence processes, outcomes and non-financial performance indicators.

Environmental matters pages 28 to 30

Social matters pages 28 to 31

Employees pages 40 to 42

Respect for human rights pages 30 to 31

Anti-bribery and anti-corruption matters pages 31 to 32

Further details of our Group policies and principles can be found at www.bat.com

OUR GLOBAL BUSINESS

BAT is a leading, multi-category consumer goods business dedicated to stimulating the senses of adult consumers worldwide.

Our Strategic Portfolio comprises our key brands in both the combustible and new categories. This drives focus and investment on the brands and categories that will underpin the Group's future growth.

We also have a portfolio of international and local brands which, while not the focus of our investment, contribute valuable returns across several key markets.*

STRATEGIC PORTFOLIO

Non-Combustible

New Categories

.....

Vapour

 **VUSE**

 **vype**

.....

Tobacco Heating

 **glo™**

.....

Modern Oral

 **VELO**

Traditional Oral

 **GRIZZLY**

 **CAMEL SNUS**

Combustible

Combustible Tobacco

 **Newport**

 **NATURAL AMERICAN SPIRIT**

 **CAMEL**

 **PALL MALL**

 **LUCKY STRIKE**

 **KENT**

 **DUNHILL TOBACCO**
of LONDON LIMITED

 **Rothmans**

* These combustible brands include Vogue, Viceroy, 555, Benson and Hedges, Peter Stuyvesant, Double Happiness, Kool, and Craven A, while oral brands include Granit, Mocca, and Kodiak.

Our portfolio reflects our commitment to meeting the evolving and varied needs of today's consumer who seeks sensorial enjoyment for different moods and moments.

BAT's marketplace analysis delivers insights regarding consumer trends and segmentation, which ultimately facilitates our geographic brand prioritisation across over 180 markets. Our business is divided into four regions, and covers over 150 million consumers and 11 million retail points of sale, with a balanced presence in both high-growth emerging markets and highly profitable developed markets.

**United States
of America**

**Americas and
Sub-Saharan
Africa**

**Europe and
North Africa**

**Asia-Pacific
and Middle East**



 for more key detail on our Regional performance, see pages 52 to 57

Map is representative of general geographic regions and does not suggest that the Group operates in each country of every region.

ENGAGING WITH OUR STAKEHOLDERS



CIVIC PARTICIPATION IS A FUNDAMENTAL ASPECT OF RESPONSIBLE BUSINESS AND POLICY MAKING, AND BRITISH AMERICAN TOBACCO EMPLOYEES WILL PARTICIPATE IN THE POLICY PROCESS IN A **TRANSPARENT AND OPEN MANNER, IN COMPLIANCE WITH ALL LAWS AND REGULATIONS OF THE MARKETS IN WHICH IT OPERATES**

Jerry Abelman Director, Legal & External Affairs and General Counsel



Consumers



**Shareholders/
Bondholders**



Our people

Why this stakeholder is important to us

As preferences and attitudes change in an evolving industry, understanding our consumers is essential to both successful portfolio and business growth.

It is essential that we maintain the support of our shareholders and bondholders to maintain access to capital. This allows us to implement our strategy and achieve our business objectives.

A winning organisation is a core pillar of the Group's strategy. We understand the value of listening and responding to feedback from our people to maintain a fulfilling, rewarding and responsible work environment.

Examples of how we engaged in 2019

- Consumer panels and focus groups
- Consumer product testing
- Consumer care helplines
- Responsible advertising and marketing
- Pack inserts / product leaflets
- Consumer feedback channels
- Real-time feedback via digital platforms



Read more
pages 29, 32 and 72

- Annual General Meeting
- Investor relations programme
- Institutional shareholder meetings
- Capital Markets Days
- Investor roadshows
- Results announcements
- Annual Report & Form 20-F
- Sustainability Report
- Stock exchange announcements
- Shareholder information on website



Read more
pages 71

- Director market and site visits
- Employee town halls
- Global and regional webcasts
- 2019 'Your Voice' employee survey
- Works councils and European Employee Council meetings
- Graduate and management trainee events
- Individual performance reviews
- Speak Up channels



Read more
pages 41 to 42 and 72

What matters to our stakeholders

- Product quality and innovation
- Affordability, value and price
- Product anxiety (addiction, harm, social considerations)
- Responsible marketing

- Business performance
- Corporate governance
- Strength of Group leadership
- Board succession planning
- ESG considerations

- Reward
- Career development
- Diversity and inclusion
- Corporate responsibility
- Health and safety
- Business ethics

How we respond

- Development of innovative products taking into account consumer feedback
- Product quality and safety standards
- Product stewardship
- Clear and accurate product information
- International Marketing Principles

- Regular dialogue with shareholders
- Robust corporate governance
- Enhanced ESG reporting
- Continual improvement of our Delivery with Integrity programme
- Our range of enjoyable and innovative products
- Product quality and safety standards
- Clear and accurate product information
- International Marketing Principles

- Introduction of BAT Ethos, taking into account employee feedback
- Board review of and feedback on workforce engagement
- Training and development programme
- Introduction of revised management incentive schemes (below Executive Director level)
- Diversity & Inclusion Strategy
- Delivery with Integrity Programme

Strategic impact*



Growth



Sustainability



Productivity



Growth



Sustainability



Sustainability



Winning organisation

Principal risk impact

- Market size reduction/consumer downtrading
- Inability to develop, commercialise and deliver New Categories strategy

- Solvency and liquidity

- Work place safety

* These engagement examples took place in 2019 and the strategic impact of engagement is measured against the strategic pillars in place for 2019. Reporting for FY2020 will measure against our evolved strategy discussed on pages 8 to 9.



**OUR 2019 ‘YOUR VOICE’ GLOBAL EMPLOYEE
OPINION SURVEY RESULTS SHOW WE CONTINUE
TO OUTPERFORM OUR GLOBAL FMCG COMPARATOR
GROUPS IN ALL CATEGORIES, INCLUDING
THE SUSTAINABLE ENGAGEMENT AND HIGH
PERFORMANCE INDICES**



Suppliers

Effective relationships with farmers, and suppliers of leaf, direct materials and services are essential to an efficient, productive and secure supply chain.

- Ongoing farmer support, training and monitoring by our extension services
- Sustainable Tobacco Programme assessments, reviews and meetings
- Supplier reviews and audits
- Supplier Voice survey and dialogue
- Strategic partnerships
- Eliminating Child Labour in Tobacco Growing (ECLT) Foundation engagement

[Read more](#)
pages 29 to 31 and 38 to 39

- Costs and payment practices
- Efficiencies and forecasting
- Quality and crop yields
- Sustainable agriculture and farmer livelihoods
- Human rights

- Supplier Code of Conduct
- ‘Thrive’ sustainable agriculture and farmer livelihoods programme
- Operational standards for child labour prevention
- Supplier and farmer training and capacity building



Productivity



Growth



Sustainability

- Inability to develop, commercialise and deliver New Categories strategy
- Geopolitical tensions



Customers

Our customers include distributors, wholesalers, and retailers.

Engagement with our customers is essential for driving growth and embedding responsible marketing practices.

- Ongoing dialogue, contract discussions and account management
- Customer Voice programme
- Audits and performance reviews
- Sales calls and visits by trade representatives
- Business-to-business programmes
- Performance tracking
- Participating in industry Digital Code and Tracking Association

- Route-to-market planning
- Contingency planning
- Cost, price and quality
- Availability and stock levels
- Consumer buying behaviour
- Youth access prevention

- Customer loyalty programmes and incentives
- Youth Access Prevention Guidelines



Productivity



Growth



Sustainability

- Inability to develop, commercialise and deliver New Categories strategy
- Geopolitical tensions



Governments and wider society

We engage transparently with governments and regulators to share our views on regulation that impact our business whilst respecting the WHO’s FCTC Article 5.3 provision. We actively cooperate with law enforcement and customs authorities, governments and regulators to combat the rise of illicit trade.

We also engage with scientific and public health communities.

- Face-to-face meetings and ongoing dialogue
- Presentations and submissions to government committees
- Participation in business, industry and multi-stakeholder groups
- Presentations and participation at conferences
- Submissions to peer-reviewed journals
- BAT External Scientific Panel
- Submissions to sustainability indices
- Stakeholder Sustainability Panel

- Public health impacts
- Tax, excise and illicit trade
- Corporate behaviour
- Youth access prevention
- Human rights, sustainable agriculture and economic development

- Standards of Business Conduct (SoBC)
- International Marketing Principles
- Youth Access Prevention Guidelines
- Science-based carbon reduction targets
- Community investment projects



Productivity



Growth



Sustainability

- Geopolitical tensions
- Competition from illicit trade
- Significant excise increases
- Regulation that inhibits growth

UK Companies Act: Section 172(1) Statement

Our Directors have a duty, individually and collectively as the Board, to act as they consider most likely to promote the success of the Company for the benefit of our members as a whole. As part of this duty, our Directors must have regard for likely long-term consequences of decisions and the desirability of maintaining a reputation for high standards of business conduct. Our Directors must also have regard for our employees’ interests, business relationships with our wider stakeholders, the impact of our operations on the environment and communities in which we operate and the need to act fairly between shareholders.

Consideration of these factors and other relevant matters is embedded into all Board decision-making, strategy development and risk assessment throughout the year.

Our key stakeholders and primary ways in which we engage with them are set out in the table to the left. Pages 71 to 73 provide further explanation of our Board’s approach to understanding stakeholder interests to enable relevant considerations to be drawn on in Board discussion and decision-making. Where the Board delegates authority for decision-making to management, our Group governance framework discussed on pages 69 to 70 mandates consideration of these factors and other relevant matters as a critical part of delegated authorities.

Just some of the ways that these factors have shaped Group strategy and initiatives during the year are illustrated in the table to the left. Examples of how these factors have been taken into account in Board decision-making and strategy development during the year are highlighted on pages 74 to 75.

DELIVERING OUR STRATEGY*



SUSTAINABILITY

Our Sustainability Agenda is at the heart of our strategic plans to build a long-term sustainable business.

Within it, our clear commitment to providing our consumers with a range of potentially less risky products addresses the principal health impacts of our business.

We also know that our long-term sustainability will be driven by ensuring best-in-class delivery against all our other environmental, social and governance (ESG) measures.

In 2019, we refreshed our Sustainability Agenda to reflect the prominence of the health risks of smoking as our principal focus and to place greater emphasis on the importance of addressing climate change and environmental management.

Our priority areas are:

A commitment to reducing the health impact of our business

Excellence in environmental management

Delivering a positive societal impact

Robust corporate governance

Highlights during the year

- growth of our New Categories revenues by 37% to £1.3 billion.
- a 9.5% reduction of our direct Scope 1 and 2 carbon dioxide equivalent (CO₂e) emissions from our 2017 baseline.
- revised Group Standards of Business Conduct to strengthen controls around human rights and incorporate a new Lobbying and Engagement Policy.
- new independent research published into the impacts of tobacco growing and the role it plays in rural livelihoods.



Read more about our sustainability performance in each area at www.bat.com/sustainabilityreport

Emissions**	2019	2018	2017
Scope 1 CO ₂ e emissions ('000 tonnes)	396	415	427
Scope 2 CO ₂ e emissions ('000 tonnes)	386	426	438
Scope 3*** CO ₂ e emissions ('000 tonnes)	n/a	7,547	8,254
Total statutory emissions (Scope 1 and 2 in '000 tonnes)	782	841	864
Intensity (tonnes per £ million of revenue)	30.4	32.6	34.7

All data is calculated on the basis of the Greenhouse Gas (GHG) Protocol Corporate Standard.

** Scope 1 reporting includes: energy consumed at our factories and offices (coal, natural gas, wood, diesel and LPG), emissions from our dry ice expanded tobacco plants, and fuel consumed by our fleet vehicles.

Scope 2 reporting includes: electricity purchased and consumed at our factories and offices, purchased steam and hot water.

Scope 3 reporting includes: all 15 categories of the GHG Protocol.

*** Consolidation and verification of our 2019 Scope 3 data is ongoing to fully align with the GHG Protocol. 2019 data will be reported in the 2020 Annual Report and Form 20-F.

New Sustainability Targets

We are committed to making a step-change in our sustainability ambition. As a result, we have announced a number of stretching targets that we are confident will deliver A Better Tomorrow for all our stakeholders.

These include:

- increasing our number of non-combustible product consumers from 11 million to 50 million by 2030;
- achieving carbon neutrality by 2030*; and
- bringing forward our existing 2030 environmental targets to 2025.

* Based on Scope 1 and 2 carbon dioxide equivalent (CO₂e) emissions.

CO₂e emissions

(in '000 tonnes)

782

9.5% lower than 2017 baseline



Definition: Group Scope 1 and Scope 2 carbon dioxide equivalent (CO₂e) emissions.

Target: To reduce our Scope 1 and Scope 2 CO₂e emissions by 30% by 2025 compared to our 2017 baseline.

Water use

(total water withdrawn in mn metres³)

4.51

13.1% lower than 2017 baseline



Definition: Group water use in million cubic metres.

Target: To reduce water use to 3.38 mn metres³ by 2025, 35% lower than our 2017 baseline.

Recycling

(percentage of waste recycled)

90.5%



Definition: Total percentage of Group waste re-used or recycled against total waste generated.

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

* This year's Annual Report and Accounts measures all backward-looking reporting against the strategy, which includes the four strategic pillars and KPIs, that was in place until March 2020. Next year's Annual Report and Accounts will measure our delivery against our evolved strategy, which is detailed on pages 8 to 9.

A commitment to reducing the health impact of our business

As harm reduction is our most material ESG issue, we have long been committed to reducing the public health impact of smoking.

Satisfying consumer moments

Smokers are more likely to switch to new products if they can find satisfying alternatives that offer sensorial enjoyment and recapture consumer moments long-associated with tobacco that have been lost to shifting trends. We have a deep understanding of our consumers and we use these insights to develop an exciting product portfolio across a range of categories, including Vapour, Tobacco Heating Products (THPs) and Modern Oral products.

World-class science

The reduced-risk potential of new category products needs to be supported by sound science. We conduct cutting-edge research to evaluate our new category products and apply the highest standards for product safety and quality. Globally, we have over 1,500 scientists focused on researching and developing new category products and we openly share our science on bat-science.com. To date, we have published 59 peer-reviewed research papers on our new category products and the results indicate they have the potential to be significantly less risky than cigarettes. We are continuing to establish more evidence to support this.

Standards and regulation

New category products can only meet their potential if they are widely available with the right regulatory and market conditions in place, alongside high standards and responsible practices across the industry.

To support the success of our new product categories, we advocate for regulation that enables market availability, applies the highest product quality and safety standards, allows communication of the potential benefits and risks, and ensures affordability for consumers by taxing them appropriately, while preventing youth appeal and access.

Other ESG focus areas

In addition to our commitment to address the health impacts of smoking, we also continue to focus on a wide range of other important ESG issues.

 [Read more about our ESG reporting on page 10](#)

Excellence in environmental management

We are committed to reducing our environmental impact across our operations and supply chain. Our Environment Policy is supported by a comprehensive Environmental, Health and Safety (EHS) management system which has been in place for many years and is based on international standards including ISO14001.

Addressing the impacts of climate change

Climate change is one of the most important global issues facing the world today. We recognise that addressing the impacts of climate change is not only the right thing to do, but also makes sound business sense given how much we depend on natural resources for our products.

In 2019, our targets for reducing our CO₂e emissions by 2030 were given formal approval by the Science-Based Targets initiative (SBTi) and we have now brought forward our Scope 1 and 2 targets to 2025. Building on this, we are now setting ourselves an even more ambitious target: to be carbon neutral by 2030.

We are also committed to align our reporting with the Taskforce on Climate-related Financial Disclosures (TCFD) framework by 2022. We are also proud to have been named on the Carbon Disclosure Project's prestigious 2019 'A List' for our leading approach to climate change.

We have achieved a 7.0% year-on-year reduction in our Scope 1 and 2 carbon emissions in 2019. In total, these equalled 782,394 tonnes, 9.5% lower than 2017, our baseline year. Drivers include a 6.5% reduction in direct energy consumption and an increase in renewable energy use which now stands at 10.8%, an 1.6% increase over 2018.

Supporting our continued drive to reduce our emissions, we have developed a new Climate Change and Energy Standard which requires our subsidiaries to include renewables in their energy purchase agreements and we are also identifying opportunities to increase on-site energy generation and purchase more renewable energy certificates.

Meeting our ambitious climate targets will require collective effort across the Group and, given our Scope 3 emissions represent around 90% of our total carbon footprint, addressing impacts in our supply chain is also crucial. We are engaging with our largest suppliers to raise awareness of carbon reduction in our supply chain and we continue to make progress in the tobacco leaf supply chain, where more efficient curing technologies, smarter use of fertilisers and increases in yields are all contributing to reduced emissions.

In 2018, our Scope 3 emissions decreased by 3.3% compared to our 2017 baseline, driven by a reduction in purchase volume, changes to emissions factors and decreases in fertiliser and fossil fuel use for tobacco leaf curing.

Water and waste

As well as a priority focus on carbon and energy, our approach to environmental management also addresses a wide range of issues, including water use and waste management.

We have been steadily decreasing our water use and increasing water recycling for several years and 2019 saw a 5.3% year-on-year reduction in total water withdrawn.

Additionally, our increased focus on environmental management has resulted in us bringing forward our existing 2030 target for water and waste to 2025.

We are committed to recycling at least 95% of our total waste generated, which is more challenging in locations with limited recycling and waste management facilities. Nevertheless, 28% of our manufacturing sites have already achieved zero waste to landfill and another 24% are recycling at least 95% of their waste.

Sustainable agriculture

We have a long and proud history of working directly with farmers around the world to advance agriculture. We provide farmers with best practice environmental information and introduce them to new sustainable farming practices. For example, we have been successful in introducing drip irrigation technology to farmers in Brazil and Mexico, which has been shown to increase water usage efficiency by up to 90%, as well as reducing soil erosion and salination, and ultimately boosting yields.

We have an ongoing commitment to eliminate the use of unsustainable sources of wood by our contracted farmers for curing fuels. Monitoring of the last three years of our contracted farmers' wood use for curing has shown 99% was from sustainable sources.

We also support community-based afforestation programmes in a number of countries. For example, our afforestation programmes in Bangladesh and Pakistan date back to the early 1980s and have planted over 185 million tree saplings combined. Both are recognised to be among the largest private sector-driven programmes in these countries.

DELIVERING OUR STRATEGY CONTINUED

Circular economy

Globally, there is growing concern around the use and disposal of plastics and other materials and increased pressure on businesses to address post-consumption waste. Adopting circular economy principles will deliver better products for our consumers, create efficiencies in our operations and reduce our overall impacts.

This is a new focus area for us and, in 2019, we established a cross functional project team, led by our Management Board, to develop a Group-wide circular economy strategy and oversee its implementation across all product categories. Initially, this is focusing on the recovery of post-consumption waste, reducing plastic waste in packaging and exploring opportunities to improve the recyclability of our products. Already, we have established new electronic device return and recycling schemes in France, Japan, Korea and Mexico.

Delivering a positive societal impact

Reducing the harm associated with smoking and the opportunity to have a positive impact on public health is the most material issue for our business, but as one of the world's most international businesses, we also have a larger role to play in delivering a positive societal impact.

Human Rights

Our integrated human rights strategy is aligned to the UN Guiding Principles and includes policies, due diligence, grievance channels and remediation procedures for our own business operations and supply chain, as well as working to understand and address the root causes. Our Human Rights policy forms part of our Group Standards of Business Conduct and is reflected in our Supplier Code of Conduct.

The most significant challenges for human rights are in our tobacco leaf supply chain and this has been a priority area for us for many years. The industry-wide Sustainable Tobacco Programme focuses on leaf supplier due diligence and compliance with international standards, and our own Thrive programme is focused at farm-level and seeks to identify and address the root causes and long-term challenges around human rights, including rural poverty.

To further enhance our understanding and ability to address human right issues in the tobacco supply chain, in 2019 we commissioned human rights impact assessments in tobacco growing areas in Indonesia and India, with two more planned for 2020 in Mozambique and Mexico. We will report on the results in a Human Rights Focus Report, to be published later in 2020.

All our other products materials and goods and services suppliers are subject to annual human rights risk assessments. Further independent audits are conducted on the highest risk by Intertek, our audit partner. In 2019, a total of 94 supplier audits in 31 countries were conducted, including 65 audits of tier 1 materials suppliers, 20 audits of tier 2 materials suppliers and nine audits of indirect goods and services suppliers.

The vast majority of issues identified in these audits were categorised by Intertek as 'moderate', relating to hours and wages, poor record keeping, and health and safety procedures. Eleven suppliers had issues identified that were categorised as 'major' by Intertek. These related to preventing worker interviews, excessive working hours, wages below the legal minimum, fire and emergency preparedness, lack of required permits or licences, poor record keeping and, in one case, retention of workers' original documents.

By the end of the year, 71% of corrective actions had been fully completed and verified by Intertek, in desktop reviews for the moderate issues and 11 on-site follow-up audits for the major issues. All outstanding actions are in progress and being closely monitored.

 Further details of our approach to human rights and our Modern Slavery Act statement are available at bat.com/msa

Sustainability: Our policies*	Summary of areas covered	Key stakeholder groups	
Standards of Business Conduct (SoBC)	Speak Up, conflicts of interest, anti-bribery and anti-corruption, gifts and entertainment, respect in the work place, human rights, lobbying and engagement, political and charitable contributions, corporate assets and financial integrity, competition and anti-trust, anti-money laundering and tax evasion, anti-illicit trade, data privacy and information security.	☆ Our People	🌐 Governments and Wider Society
Environmental Policy	Our commitments to following high standards of environmental protection, adhering to the principles of sustainable development and protecting biodiversity covering our direct operations and supply chain, including agricultural, manufacturing and distribution operations.	☆ Our People 👤 Consumers ↔ Customers	🔗 Suppliers 🌐 Governments and Wider Society
Health and Safety Policy	Our commitments to applying the highest standards of health and safety.	☆ Our People	
Supplier Code of Conduct	Standards required of our suppliers worldwide, including business integrity, anti-bribery and anti-corruption, environmental sustainability, anti-illicit trade and respect for human rights (covering equal opportunities and fair treatment, health and safety, prevention of harassment and bullying, child labour and modern slavery, conflict minerals and freedom of association).	☆ Our People ↔ Customers	🔗 Suppliers 🌐 Governments and Wider Society
Strategic Framework for Corporate Social Investment (CSI)	Sets out our Group CSI strategy and how we expect our local operating companies to develop, deliver and monitor community investment programmes within two themes: Sustainable Agriculture and Rural Communities; and Empowerment.	🌐 Governments and Wider Society	
International Marketing Principles	The standards that govern marketing across all our product categories and including the requirement for all our marketing to be targeted at adult consumers only.	👤 Consumers ↔ Customers	🔗 Suppliers ☆ Our People

These policies and procedures are endorsed by our Board, apply to all Group companies and support the effective identification, management and mitigation of risks and issues for our business in these and other areas.

* Further details of our Group policies and principles can be found at www.bat.com/principles

Further details of our Strategic Framework for Corporate Social Investment can be found at bat.com/csi

With the majority of our employees working in business areas where we have direct oversight and control, human rights challenges in our own operations are substantially avoided.

The challenges that do exist are mitigated by our robust policies and procedures in place across all Group companies. However, we recognise that we need to continually work to ensure these are effectively applied and that we carefully monitor the situation, particularly in countries assessed as higher risk, such as where regulation or enforcement regimes are limited, or there are higher levels of corruption, criminality or unrest. Our due diligence includes conducting an annual review of compliance with applicable Group policies and additional measures in place for operations in higher risk countries.

Farmer livelihoods

Rural poverty is recognised as a root cause for wider issues in agriculture, such as child labour, poor safety standards and urban migration. If we can support tobacco farmers to have prosperous livelihoods, we can help address these issues while also securing our tobacco leaf supply chain. We support our 90,000+ directly-contracted farmers through our Extension Services of expert field technicians. We develop new tobacco seed varieties that offer greater yields and higher quality and so help boost farmers' profits, as well as introducing them to more efficient farming technologies that save farmers time and money. Our Extension Services also provide training and advice and help our farmers to grow other crops to enhance food security and generate additional sources of income. For instance, in 2019 our leaf operations and strategic third-party suppliers reported that 92% of their contracted farmers grew other crops, including fruit, vegetables, wheat, maize, cotton and soy.

To further increase our understanding of the role tobacco plays in rural livelihoods, we commissioned IMC Worldwide, one of the world's leading international development consultancies, to conduct independent research in Bangladesh, Brazil and Kenya to identify if tobacco growing reduces resilience and prevents farmers and rural communities from prospering. Overall, IMC found no evidence of this: IMC concluded that tobacco growing plays an important and positive role in the livelihoods of tobacco farmers and labourers interviewed, while no evidence supporting a causal link between tobacco cultivation and poverty was found.

 Read more about the IMC Report at bat.com/farmers/research

 Read more about our Group risk factors related to tobacco leaf supply on page 275

Culture and workplace health and safety

The health and safety of our employees and creating a great place to work are also key components of our Sustainability Agenda. We focus on building an inclusive and supportive culture that attracts, engages and retains diverse and talented people, develops the next generation of leaders, and creates a fulfilling, rewarding and responsible work environment.

We also have a comprehensive workplace health and safety approach based on risk management and assessment, employee training and awareness, and tailored initiatives for specific issues and higher-risk areas. You can read more about our culture on pages 40 to 42 and page 70. More information on our approach to workplace health and safety is set out on page 42.

Community investment and social initiatives

As an international business, we play an important role in countries around the world and have built close ties with local communities. We encourage our employees to play an active role both in their local and business communities. Our charitable contributions policy in our SoBC is supported by the Group Strategic Framework for CSI, which sets out our Group CSI strategy and how we expect our local operating companies to develop, deliver and monitor community investment programmes within two themes: Sustainable Agriculture and Rural Communities, and Empowerment.

Our Group Head of Sustainability has oversight of the Group CSI strategy, and Board-level governance is managed through our Audit Committee, which reviews the strategy and an analysis of activities (including investment and alignment to the Group's priorities) annually.

Our performance indicator in this area relates to the total amount of money contributed to charitable giving and CSI projects. In 2019, the Group contributed over £13 million in cash for charitable contributions and CSI projects, including £1.1 million given for charitable purposes in the UK. Much of this contribution is delivered through partnerships with external stakeholders including communities, NGOs, governments, development agencies, academic institutions, industry associations and peer companies.

Corporate governance

Robust corporate governance is key to our sustainable long-term growth. We are committed to achieving our business objectives in an honest, transparent and accountable way, and sustaining a culture of integrity in everything we do.

Our actions and behaviours impact all areas of our business, which is why corporate governance is such an important focus for us.

Our commitment to responsible corporate behaviour is underpinned by our SoBC which mandate high standards of integrity and require every Group company, joint venture which the Group controls and all staff worldwide, including senior management and the Board, to act with a high degree of business integrity, comply with applicable laws and regulations and ensure our standards are not compromised for the sake of results. We expect our contractors, secondees, trainees, agents and consultants to act in a way consistent with our SoBC and to apply similar standards within their own organisations.

Our SoBC comprise our global policies referenced on page 30 and are available in 12 languages. SoBC awareness and understanding is promoted through regular training and communications. Our SoBC are fully aligned with the provisions of applicable laws including the UK Bribery Act, the US Foreign Corrupt Practices Act and the UK Criminal Finances Act.

Corrupt practices are illegal, cause distortion in markets and harm economic, social and political development, particularly in developing countries. Our SoBC make it clear that it is wholly unacceptable for Group companies, our employees or our business partners to be involved or implicated in any way in corrupt practices. We keep our SoBC under regular review to maintain best practice and to take employee and stakeholder feedback into account. Our Board approved a revised version of the SoBC in 2019, which came into effect on 1 January 2020, supported by a global awareness campaign across the Group.

Delivery with integrity

Our Delivery with Integrity programme is focused on driving a globally consistent approach to compliance across the Group. This programme is led by our Business Conduct & Compliance Department reporting directly to the Director, Legal & External Affairs and General Counsel. This programme provides employees with ways to raise concerns without fear of retaliation and assurance that investigations will be fair and thorough. It drives a consistent approach to the mitigation of key compliance risk areas such as bribery and corruption, money laundering, tax evasion, competition law, sanctions, and data protection through tools and guidance for Group company employees and business units.

 Read more about our Group risk factors related to corporate behaviour and compliance with sanctions regimes and competition laws on pages 279 and 281

DELIVERING OUR STRATEGY CONTINUED

We monitor regulatory developments to ensure the continued evolution of our Delivery with Integrity programme.

Mitigating third-party risk is a key component of our compliance programme. We do this through a Third-Party Anti-Bribery and Corruption Procedure (the ABAC Procedure) which assists business units in identifying and mitigating bribery and corruption risks. The ABAC Procedure mandates a consistent methodology for due diligence of third parties, complemented by mandatory mitigation packages for third parties assessed as medium and high risk. In 2019, this due diligence procedure was applied retrospectively to over 4,500 existing third parties engaged by Group companies. In addition, given the challenges associated with intermediaries engaged to interface with public officials on the Group's behalf, detailed due diligence and mitigation measures were completed for 903 service providers with external input and oversight. In 2019 we also launched an ABAC risk assessment tool to assist our markets to identify, assess and evaluate bribery and corruption risks.

In 2019, over 25,000 Group company employees completed our annual SoBC sign-off and e-learning through the online SoBC portal. Other Group company employees (over 30,000) who do not have easy online access completed the SoBC sign-off in face-to-face sessions which included training. In 2019, our SoBC e-learning through the online portal resulted in 10,800 training hours and it included scenarios covering product diversion, money laundering and bribery and corruption risks. To further increase awareness and accessibility, in 2019 we launched a new SoBC app, which provides easy access to our SoBC, Speak Up channels, procedures and guidance.

Information on compliance with our SoBC is gathered at a regional and global level and reported to the Regional Audit and CSR Committees, Corporate Audit Committee and to the Audit Committee.

Speak Up channels

We encourage anyone working for, or with, any Group company to raise concerns, including regarding accounting or auditing matters, through our Speak Up channels, which are independently managed and available 24 hours a day online, by text or telephone. The channels can be used in confidence, and anonymously where preferred, and are available in multiple local languages. Speak Up channels contact information is promoted through staff training and communications and through our SoBC app and Supplier Code of Conduct. Our Speak Up policy makes it clear no one will suffer any direct or indirect reprisal for speaking up about actual or suspected wrongdoing, even if they are mistaken.

Our Speak Up policy is supplemented by local procedures throughout the Group, providing staff with further guidance on reporting matters and raising concerns, and the channels through which they can do so. We do not tolerate the harassment or victimisation of anyone raising concerns or anyone who assists them. Such conduct is itself a breach of our SoBC and a serious disciplinary matter. In 2019, our global 'Your Voice' employee survey, completed by 90% of Group company employees, found that 79% strongly agreed they "can report concerns about actual or suspected wrongdoing at work without fear of reprisal", 8% higher than the FMCG comparator norm.

Not all contacts made via our SoBC Portal involve SoBC allegations; some contacts relate to questions regarding the SoBC or other matters. There were 497 SoBC contacts in 2019, representing a 40% increase on the total number of SoBC contacts in 2018 (355 contacts).

In the year ended 31 December 2019, 359 of the 497 SoBC contacts were assessed as SoBC allegations and reported to the Audit Committee, representing a 35% increase on 2018 SoBC allegations (266). Of the 359 SoBC allegations reported, 130 were established as breaches and appropriate action taken (2018: 126). In 179 cases, an investigation found no wrongdoing (2018: 140). In 50 cases, the investigation continued at year-end (2018: 69), including investigation through external legal advisers of allegations of misconduct. Disciplinary action taken as a result of the 130 established SoBC breaches resulted in 80 dismissals (2018: 92). In 184 of the 359 SoBC allegations (51%), the person raising the allegation chose to remain anonymous.

Please refer to the Governance Report for more information about Board and Audit Committee oversight and monitoring of compliance with our SoBC. Our SoBC, and information on the total number of incidents reported under it, are available at bat.com/sobc.

Responsible marketing

Our International Marketing Principles (IMP) govern marketing across all our product categories and require all our marketing to be responsible, accurate and not misleading, targeted at adult consumers, transparent and compliant with all applicable laws.

Our IMP are applied consistently everywhere we operate, even when more stringent than applicable local laws. Through our long-standing IMP, responsible marketing is well embedded in the culture of our organisation and inherent to the way we operate. We continually evolve our IMP to reflect developments in marketing, our product portfolio, technology, changing regulations and stakeholder expectations, and the Board approved a revised version of the IMP in 2019.

To support our strict requirement to only direct marketing at adult consumers, all Group companies are required to adhere to our global Youth Access Prevention (YAP) Guidelines. These apply to all markets where our products are sold, including where distributed through third parties and include a mandatory requirement to provide retailers with point-of-sale materials with YAP messaging (unless prohibited by local laws). In 2019, 100% of Group companies to which our YAP Guidelines apply reported compliance.

Regulatory engagement

Truly effective regulation needs cooperation between governments and industry, and we have a legitimate role to play in policy-related debate that affects our business. We also respect the World Health Organization's FCTC 5.3 provision, which calls for transparent and accountable interaction between governments and the tobacco industry.

By conducting all our engagement with politicians, policy makers and regulators transparently and with high regard for accuracy and integrity, we can make a valuable contribution to policy development and help enable the best information to be used as a foundation for decisions in policy making.

Our Principles for Engagement have long provided clear guidance for our external engagement with regulators, politicians and other third parties. In 2019, these were incorporated into a new Lobbying and Engagement Policy in our SoBC. The revised SoBC took effect from January 2020 and all lobbying and engagement activities across the Group are now subject to our SoBC compliance procedures.

Our sustainability efforts and commitment to high standards have received notable independent recognition over the years, including the following.



CDP Climate A List

These recognise our actions to cut emissions, mitigate climate risks and develop the low-carbon economy, as well as engaging with our suppliers to manage climate risk and reduce Scope 3 carbon emissions in our supply chain.



In collaboration with

Dow Jones Sustainability Indices

BAT is the only company in our industry listed in the prestigious World Index, representing the world's top 10% ESG performers. We have achieved inclusion in the DJSI for 18 consecutive years.



Global Top Employer

We have been accredited as a Global Top Employer for three consecutive years, acknowledging our commitment to providing best-in-class working environments and career opportunities.



SEAL Awards

BAT has been awarded with the SEAL Organizational Impact Award, which recognises overall corporate sustainability performance and represents the 50 most sustainable companies globally.



Top 5 FTSE ranking for our Modern Slavery Statement

The Business and Human Rights Resource Centre and Development International ranked BAT as being among the top five highest scoring companies in the FTSE for the detailed disclosure and action reflected in our Modern Slavery Statement.



Diversity leader in the Financial Times Diversity Leaders report

BAT was ranked in the top 10% of the total of 8,000 organisations covered by this inaugural report. It was compiled from extensive research, with 80,000 people surveyed across 10 European countries.



Leader status in the Global Child Forum's benchmark study

In the Global Child Forum's 2019 benchmarking study of children's rights across the work place and supply chain, we were awarded 'leader' status with a score of 9.2 out of 10, compared to 'industry' and 'all companies' averages of just 5.6.



International Women's Day Best Practice Winner

Our global campaigns for International Women's Day have been recognised for two consecutive years as examples of best practice and featured as case studies by the International Women's Day Association.

DELIVERING OUR STRATEGY CONTINUED



GROWTH

Our multi-category portfolio of brands continued to deliver strong growth in 2019, driven by our Strategic Portfolio.

Growth remains a key focus of our evolved strategy, and will be delivered by our inspirational foresights, remarkable innovation and powerful brands.

Highlights during the year:

- group revenue grew by 6%, driven by price mix and growth in New Categories;
- New Categories revenue grew 37%; and
- Strategic Portfolio revenue grew 9%, driven by robust cigarette pricing and growth from New Categories and Traditional Oral.

New Categories

Vapour



THP



Modern oral



KPI Non-GAAP

**Change in adjusted revenue
from New Categories,
at constant rates (%)**

+32.4%



Definition: Change in revenue from New Categories before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

Traditional Oral



Non-GAAP

**Change in adjusted revenue from
Traditional Oral, at
constant rates (%)**

+10.2%



Definition: Change in revenue from Traditional Oral before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

Combustibles



Non-GAAP

**Change in adjusted revenue
from combustibles
at constant rates (%)**

+4.6%



Definition: Change in adjusted revenue from Combustibles before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

Volume by product category

	Units	2019 units	vs 2018 %	2018 units	vs 2017 (rep) %	2017 (rep) units
Cigarette	Sticks (bn)	668	-5%	701	-4%	732
Other (incl RYO/MYO)	Sticks (bn)	21	-7%	22	-8%	24
Combustibles	Sticks (bn)	689	-5%	723	-4%	756
New categories:						
Vapour	10ml units/pods (mn)	226	+19%	189	+35%	140
THP	Sticks (bn)	9	+32%	7	+217%	2
Modern oral	Pouches (mn)	1,194	+188%	414	+108%	199
Traditional oral	Stick equivalent (bn)	8	-1%	8	-0.4%	9

Revenue by product category

	2019 £m	vs 2018 %	Adjusting items £m	Impact of exchange £m	2019 adjusted at constant rates £m	vs 2018 (adjusted) %	2018 £m	vs 2017 %	vs 2017 adjusted repres at constant rates %
Combustibles	23,001	+4%	(50)	(59)	22,892	+5%	22,072	+22%	+2%
New Categories:									
Vapour	401	+26%	–	(9)	392	+23%	318	+89%	+26%
THP	728	+29%	–	(35)	693	+23%	565	+180%	+184%
Modern oral	126	+267%	–	3	129	+273%	34	+127%	+140%
Total New Categories	1,255	+37%	–	(41)	1,214	+32%	917	+140%	+98%
Traditional oral	1,081	+15%	–	(45)	1,036	+10%	941	+127%	+8%
Other	540	-4%	–	1	541	-4%	562	-5%	-10%
Revenue	25,877	+6%	(50)	(144)	25,683	+6%	24,492	+25%	+4%

Combustibles

Group cigarette volume declined 4.7% in 2019 to 668 billion sticks (2018: up 2.6% to 701 billion, or a 4.1% decrease on a representative basis). In 2019, growth in Japan, the Middle East, South Africa, Romania and Poland was more than offset by Russia (partly due to the one-off stock reduction), Egypt (largely due to the change in local taxes impacting Pall Mall), Venezuela (due to the ongoing macro-economic challenges) and the impact of market decline in the US, Indonesia, Pakistan and Ukraine.

2018 volume was positively impacted by the full year effect of the RAI acquisition. The decline in 2018, on a representative basis, was despite growth in a number of markets, including Pakistan (as the market recovered following the revision to excise), Turkey, Poland, Romania and Egypt. This growth was more than offset by lower volume in Saudi Arabia (due to down-trading and market contraction following the 2017 excise-led price increase), the US (partly due to the impact of fuel price rises on disposable income, the change in excise in California and the growth of vapour), Brazil (primarily due to down-trading to illicit trade) and Russia (largely due to both market contraction and inventory movements in the supply chain).

Group cigarette value share increased 20 bps, with volume share up 20 bps in 2019, maintaining the momentum of 8 successive years of growth, and building on the 40 bps increase in 2018.

Cigarette volume share in 2019 was higher in Japan (driven by Lucky Strike and Kool), Pakistan (as Pall Mall outperformed the declining market), Bangladesh (as the Group's portfolio outperformed the declining market), Mexico (driven by Pall Mall), Ukraine (driven by Kent and Rothmans) and Russia (driven by Rothmans which outperformed the declining market).

Volume of the strategic cigarette brands collectively declined 3.0% (2018: up 16.7%, or an increase of 4.8% on a representative basis). Volume share of the strategic cigarette portfolio grew 70 bps in 2019, benefiting from migrations in Brazil and Colombia. Excluding migrations, the increase in strategic cigarette volume share was 30 bps (2018: up 40 bps) with growth in all regions:

- Dunhill's overall volume share was stable (2018: stable) as growth in Bulgaria, Netherlands and Romania was offset by down-trading in Malaysia, South Africa, South Korea and Saudi Arabia. Volume was 5.5% lower (2018: down 6.1%) as growth in Bulgaria and Netherlands was more than offset by the effect of the down-trading noted above and industry contraction in Indonesia, Malaysia and South Korea;

- Kent's volume share grew 10 bps, (2018: up 40 bps) with volume down 1.3% (2018: down 2.2%), as growth in the Middle East, Turkey, Uzbekistan, Romania and Peru was more than offset by lower volume in Russia, due to the one-off stock reduction;

- Lucky Strike's volume share was in line with 2018 (2018: up 20 bps), as growth in Colombia, Japan, Spain, Bulgaria and Argentina was offset by Chile, Belgium and Indonesia. Volume was 3.5% down (2018: 1.0% down) as growth in Japan was more than offset by the impact of industry contraction in Indonesia;

- Rothmans' volume share continued to grow, increasing 50 bps (2018: up 110 bps) with volume 2.5% higher (2018: up 19.7%), driven by Pakistan, Colombia, Bulgaria and the full year effect of migrations in Brazil and Poland, which more than offset lower volume in Russia and Ukraine which were impacted by competitive pricing and higher illicit trade;

- Pall Mall volume share was up 10 bps, as higher share in Pakistan, Australia, Chile, South Africa and Mexico was offset by reductions in the US and Turkey. Volume declined 6.7% as growth in Kenya, South Africa, Australia and Romania was more than offset by lower volume in Egypt (largely due to the change in local taxes), Pakistan (following the excise-led price increases), Venezuela (partly due to market contraction driven by the macroeconomic climate) and in the US (partly due to the competitive pricing in the low-price segment).

DELIVERING OUR STRATEGY CONTINUED

In 2018, Pall Mall volume increased 20.4% due to the full year impact of the US acquisition, with volume up 9.9% on a representative basis partly due to the strong volume and market share growth in the Middle East following a period of down-trading arising from the excise-led price increases in 2017.

The Group's US strategic combustible portfolio performed well in a market that was estimated to be down 5.3% in volume:

- Newport volume share increased 40 bps (2018: up 10 bps), while volume declined 3.9% (2018: down 4.6% representative);
- Natural American Spirit performed well with volume share, including premium volume share, up 10 bps (2018: up 20 bps). Volume was up 0.5% against 2018, (2018: 3.5% increase on a representative basis); and
- Camel's volume share declined 10 bps in the US (2018: flat) with volume lower by 6.0% (2018: down 4.4% representative), as the capsule and menthol variants performed well but were more than offset by a decline in the remainder of the Camel portfolio.

Volume of other tobacco products (OTP) declined 7.1% to 20.6 billion sticks equivalent (2018: 6.6% decline, or 7.5% on a representative basis), being 3% of the Group portfolio (2018: 3%).

Revenue from combustibles grew 4.2% to £23,001 million driven by higher pricing across the Group notably in the US (including a reduction in discounting), Canada, Kenya, Mexico, Nigeria, Saudi Arabia, Japan, Pakistan, Australia, New Zealand, Germany, France, Turkey and Ukraine. An improved performance in high value markets such as Japan, South Africa, Romania and Australia which, combined with reduced volumes in lower value markets such as Pakistan and Egypt, led to an enhanced geographic mix. These were offset by an unfavourable portfolio mix due to the relative growth of lower value products such as Rothmans and Pall Mall.

In 2018, revenue from combustibles increased by 21.5% to £22,072 million largely due to the full year inclusion of RAI and pricing in a number of markets, which more than offset a translational foreign exchange headwind of 6%.

After adjusting for the short-term impact of excise on bought-in goods and the translational foreign exchange tailwind of 0.6%, adjusted revenue from combustibles at constant rates of exchange was up 4.6% to £22,892 million. In 2018, this was an increase of 30% or 1.8% on an adjusted, representative constant currency basis.

2019 is the last year where the Group will adjust for the excise on bought-in goods as short-term contract manufacturing agreements in ENA, to which such adjustments relate, have either ended in 2019 or will be immaterial in 2020.

Tobacco heating products

The Group's THP portfolio continued to grow, with consumable volume up 32% to 9.0 billion sticks (2018: up 217% to 6.8 billion sticks) while revenue increased 28.9% to £728 million (2018: up 180% to £565 million). Excluding the impact of the relative movements in sterling, at constant rates of exchange, this was an increase of 22.7% in 2019 and 184% in 2018.

- In Japan, the Group's volume share grew to 5.0% in December 2019, an increase of 60 bps on 2018, while the Group's THP category volume share reached 19.6%. Consumable volume grew 21% against 2018 driven by the launch of new device upgrades, 'glo pro', 'glo nano' and 'glo sens' together with a new range of consumables which achieved national distribution by the end of 2019. After an encouraging launch of 'glo sens', the Group will be reviewing the in-market execution, broadening device penetration and driving increased consumer uptake in 2020. The Group's integrated, cross category approach to marketing has seen the Group's volume share of total nicotine increase to 18.9% in December 2019 (up 210 bps from December 2018).
- In other markets, the Group continued to grow volume and glo is above 1% volume share in key cities in Eastern Europe, including Moscow. The Group's THP products are now available in 17 markets with further expansion planned for 2020.

Vapour

By December 2019, the Group's vapour products were present in a total of 27 markets as the Group continued to expand its geographic footprint during 2019, with the Group the leading vapour company in the key European markets.

The Group's vapour portfolio continues to perform strongly despite a slowdown in the category growth rate in the US and in a number of other markets in the second half of 2019, partly impacted by the US regulatory environment. The Group welcomes the US FDA's recent actions to clarify regulations in the US vapour market.

Total volume of vapour consumables was up 19% to 226 million units in 2019, driving vapour revenue up 26.1% to £401 million. In 2018, revenue was £318 million (up 89%) with volume 100% higher to 189 million units partly due to the full year impact of RAI. Excluding the movement of foreign exchange and adjusting for the impact of RAI (on 2018's growth rate), this was an increase, at constant rates of exchange, of 23% in 2019 and 26% in 2018 (on a representative basis).

In the US, total revenue from vapour was £207 million, an increase of 12% on 2018, (2018: up 149% at £184 million). On a constant currency basis, this was an increase of 7% in 2019, with the US up 20% in 2018 after adjusting for currency and on a representative basis. Alto increased vapour value share to 15.4% in December 2019, driving total Vuse vapour value share higher to 21.2% in December 2019 (December 2018: 12.5%), despite a 6.2% decline in consumable volume.

On 2 January 2020, the US FDA announced that all flavoured cartridges/pods (excluding menthol and tobacco flavours) must be withdrawn until they have cleared through the Premarket Tobacco Application (PMTA) process. A Group subsidiary in the US has submitted a PMTA for Vuse Solo and the Group believes it is well positioned to submit applications for the remaining Vuse portfolio and a range of flavours by 12 May 2020. It is expected that, as required by the PMTA process to remain on the market, all these will be shown to be appropriate for the protection of public health. There is no intention to submit a PMTA for the Vapewild portfolio and consequently the Group has recognised an impairment charge in respect of the trademarks of £37 million.

Vype continued to perform strongly, largely driven by the success of ePen3 and ePod.

In the UK, the Group maintained value leadership of the category with 38% vapour value share driven by Vype which performed well, with vapour value share increasing 290 bps to 12% (December 2019), due to the success of ePen3 (launched in 2018) with 10% vapour value share in December 2019.

In France, vapour value share reached 23% (December 2019), an increase of 1,210 bps (versus December 2018), driven by ePen3 and ePod, which was launched during the year.

In Germany, Vype continues to grow with an increase in Vype's total share of vapour consumers to 17%.

In South Africa, Twisp, a leading vaping products company, was acquired in 2019. Twisp has close to 70 dedicated stores nationally, nationwide retailer distribution and a modern e-commerce platform.

In Canada, following a period of value share decline as competitors reacted to the legalisation of the market, Vype returned to growth and is the fastest growing vapour brand in Canada in the second half of the year, with value share in December 2019 of 28.2% (34.7% December 2018).

Following the announcement on 28 November 2019 regarding the intention to simplify the New Categories product portfolio, the Group expects to migrate certain vapour brands (including Vype, Chic, Highendsmoke and ViP) to Vuse during 2020, where possible, and has recognised an impairment charge of £29 million, as discussed on page 153.

Modern Oral

The Group is the leader in Modern Oral (on a pouch basis), with volume of 1.2 billion pouches in 2019. This was an increase of 188% on 2018, when volume was 0.4 billion pouches, itself an increase of 108% on 2017. Revenue increased 267% to £126 million (2018: up 127% to £34 million). Excluding the impact of foreign exchange, this was an increase of 273% in 2019 and 140% in 2018, on a representative, constant rates basis. This was driven by:

- The expansion, in 2019, in the US of Velo to over 100,000 retail outlets, achieving a category volume share of 10.1% in December 2019;
- Norway, where volume share (of the total oral category) grew, in 2019, to 14%, building on the growth in 2018 to 8%;
- Switzerland, where volume share of the total oral category reached 41% in 2019, having reached 17% in 2018;
- Denmark, where the Group continues to lead the development of the oral category with 75% volume share of the total oral category; and
- Russia where, following the launch in 2019, the Group achieved 27% volume share (December 2019) within the total oral category, in tracked channels. In December 2019, following concerns in Russia regarding irresponsible marketing by our competitors, all sales of modern oral have been temporarily suspended. There is no indication of a concern regarding the Group's products or practices and we expect a regulatory framework will be implemented in 2020.

In line with the simplification agenda, the Group expects to migrate the majority of its modern oral portfolio to Velo during 2020.

Traditional Oral

In 2019, volume was marginally lower than the prior year (down 0.6% to 8.4 bn stick equivalents), with 2018 0.4% lower than 2017. Total revenue grew by 15% to £1,081 million (2018: up 127% to £941 million), driven by pricing in 2019, with the movement in 2018 due to the acquisition of RAI. On a constant rates basis, this was an increase in 2019 of 10% and 8% in 2018 (driven by pricing), after also adjusting for the RAI acquisition uplift effect in that year.

In the US, moist value share grew 80 bps in 2019, largely due to the performance of Grizzly with total volume share of moist up 10 bps. Total volume declined 1.5%. In 2018, volume in the US declined 2.3% on a representative basis.

The Modified Risk Tobacco Products (MRTP) application for Camel Snus was discussed by the Tobacco Products Scientific Advisory Committee (TPSAC) in September 2018. A response is expected soon.

Outside the US, volume was higher in Sweden in 2019 with volume share increasing 50 bps to 10.9% of the total oral category, driven by growth in Lundgrens.

DELIVERING OUR STRATEGY CONTINUED



PRODUCTIVITY

We have continued our drive towards a more effective and efficient globally-integrated organisation, in large part through the consolidation of our Global Supply Chain Service Centre. This global integration allows for the lowest possible overheads cost, and has resulted in a more agile and responsive supply chain.

This increased flexibility and agility will play an important role in delivering our new strategy, which we look forward to reporting on next year.

Highlights during the year

- another year of substantial productivity savings and RAI acquisition savings delivered ahead of schedule;
- consolidation of our Global Supply Chain Service Centre; and
- challenges of Track and Trace and plain packaging regulations successfully overcome.

Agile global operations model

The 2018 completion of our Global Supply Chain Service Centre resulted in the synchronisation of our end-to-end supply network, with Leaf supply chain, procurement, manufacturing, planning, logistics, and the introduction of new products all consolidated. In 2019, we built on these strong existing capabilities to leverage cross-functional synergies.

Our fast-paced geographic expansion of our New Categories business has necessitated a prioritisation of flexibility and agility. As a result, we have developed a more responsive supply chain, which involved developing different supply chain models to meet the different demand models that arise in our increasingly multicategory business.

This has improved response to markets, which has supported NTO growth in New Categories.

In 2019, supply chain flexibility and agility were also proven in response to both plain packaging regulation in Canada, as well as Tobacco Products Directive (TPD) regulations in the EU. In response to TPD regulations that mandated the traceability of all products and packs from manufacture to retail outlet, our supply chain was successfully adapted to ensure full compliance across 14 factories, 6,400 external warehouses, and 900,000 retailers. Similar successful flexibility was demonstrated by significant changes to ensure compliance while protecting revenue following strict new packaging regulations in Canada.



OUR FAST-PACED GEOGRAPHIC EXPANSION OF OUR NEW CATEGORIES BUSINESS HAS NECESSITATED A PRIORITISATION OF FLEXIBILITY AND AGILITY



Alan Davy
Director, Operations



IFRS-GAAP

Profit from operations

(£m)

£9,016m
-3.2%

2019	£9,016m	-3%
2018	£9,313m	+45%
2017	£6,412m	+38%

Definition: Profit for the year before the impact of net finance costs/income, share of post-tax results of associates and joint ventures and taxation on ordinary activities.

KPI Non-GAAP

Change in adjusted profit from operations at constant rates (%)

+6.6%

2019	+7%
2018	+38%
2018 (rep)	+4%
2017	+39%
2017 (org)	+4%

Definition: Change in profit from operations before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

KPI Non-GAAP

Operating cash flow conversion ratio[®]

(%)

97%

2019	97%
2018	113%
2017	79%

Definition: Operating cash flow, as defined on page 264 as a percentage of adjusted profit from operations.

IFRS-GAAP

Net cash generated from operating activities (£m)

£8,996m
-12.6%

2019	£8,996m	-13%
2018	£10,295m	+93%
2017	£5,347m	+16%

Definition: Movement in net cash and cash equivalents before the impact of net cash used in financing activities, net cash used in investing activities and differences on exchange.

[®] Denotes phrase, paragraph or similar that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.

KPI Non-GAAP

Change in adjusted cash generated from operations at constant rates[®] (%)**-16.3%**

Definition: Change in adjusted cash generated from operations, as defined on page 265, before the impact of fluctuations in foreign exchange rates.

Operating margin (%)**34.8%**

Definition: Profit from operations as a percentage of revenue.

Non-GAAP

Adjusted operating margin (%)**43.1%**

Definition: Adjusted profit from operations as a percentage of adjusted revenue.

Continued optimisation of manufacturing and leaf footprint

In 2019, we continued to optimise our manufacturing footprint and at the end of the year had 45 cigarette factories in 43 countries. The Group also has facilities that are manufacturing New Categories products and are co-located with the cigarette factories. In ENA, the Group also has two facilities manufacturing Modern Oral and one facility producing vapour liquids.

Cigarette factories were closed in Saratov, Russia and Phonm Penh, Cambodia.

While the Group does not own tobacco farms or directly employ farmers, it sources over 400,000 tonnes of tobacco leaf each year directly from over 90,000 contracted farmers and through third-party suppliers mainly in developing countries and emerging markets.

We continually strive to improve farmer sustainability and viability with a focus on improved quality, reduced costs of production and increased yield. As a result, we review our contracts on an annual basis to ensure that production is aligned to the needs of both the farmer and the Group.

The Group also purchases a small amount of tobacco leaf from India where the tobacco is bought over an auction floor. The price of tobacco in US dollars varies from year-to-year driven by domestic inflationary pressures, supply, demand and quality. The Group believes there is an adequate supply of tobacco leaf in the world markets to satisfy its current and anticipated production requirements.

Increasing productivity savings

By operating globally, exploiting our systems and striving for results, the Group delivered substantial productivity savings in 2019, supported in large part by the acquisition of Reynolds American Inc. with annualised savings of over US\$400 million delivered by the end of 2019, a year ahead of schedule.

These savings are returned to the business for re-investment and to increase shareholder return. The Group considers all opportunities for productivity savings in the supply chain, including procurement, international logistics and leaf operations:

Procurement

Global visibility of forward demand and product specifications in one system has delivered significant benefits with the tender at a global level of print materials and tow being notable examples. In addition to the benefits of lower product cost, the development of long-term supplier relationships with key suppliers has improved security of supply and enabled higher flexibility in the supply chain.

International logistics

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

Leaf operations

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

In 2019, we continued to improve our productivity in all areas of our supply chain and elsewhere in the Group. As a result, we have increased our profitability and continue to deliver returns to our shareholders today and invest in the future.

[®] Denotes phrase, paragraph or similar that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.

DELIVERING OUR STRATEGY CONTINUED



WINNING ORGANISATION

We enable growth by having a winning and agile organisation. We inspire diverse teams of committed and engaged people by:

- investing in our people;
- attracting the best;
- developing high-performing leaders; and
- offering a fulfilling, rewarding and responsible work environment.

Highlights during the year

- accelerated talent development and attraction in growth markets and growth categories including tobacco heating products, vapour and modern oral;
- celebrated our first year anniversary of B United, a network for our LGBT+ employees;
- top Employer recognition in Europe, Africa, and Asia-Pacific; and
- recognised as a Diversity Leader in 2019 by the UK Financial Times in its inaugural Diversity Leaders report, highlighting progress in promoting diversity across our organisation.

Investing in leaders

As our industry continues to transform, the way we attract and develop talent continues to evolve to meet these new challenges. Our increasingly data-led and digitally-enabled approach focuses on bringing new skills and capabilities to our teams.

We continue to reshape our employer brand to attract and retain capabilities needed to deliver our strategy, supported by our strong social media position that grew followership by over 20% in 2019. Our employee value proposition remains strong and the Group was awarded Global Top Employer recognition for the third consecutive year with special recognition in 35 countries, as well as the National Undergraduate Employability Award in the UK.

Developing critical capabilities is at the highest of the Group's priorities and we are focused on personalised digital opportunities for upskilling employees.

 You can read about our Group risk factor related to talent on page 274

To support our people, in 2019 we launched a new Digital Learning platform called The Grid, which consolidates our internal and external learning content together in one place for ease of access. Additionally, we launched the micro-learning mobile app Ed, which is available to all our Group company employees in marketing and provides mobile access to our New Category products learning portfolio. As a result, more than 6,700 marketeers and trade marketing representatives regularly use the app to support their daily sales visits to retail outlets and wholesalers.

Growth through diversity

Diversity matters to the Group because it makes good commercial sense. Having a diverse workforce means we are better able to understand and meet the varied preferences of our global consumers. We are proud of our Diversity and Inclusion Strategy, which is built on the three pillars of:

1. driving ownership and accountability;
2. building diverse talent pools; and
3. creating enablers;

all of which are underpinned by an inclusive culture.

1. Driving ownership and accountability

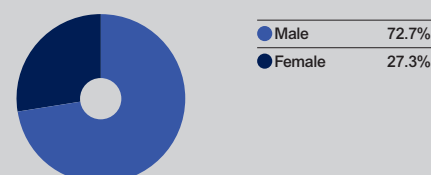
Ensuring ownership of and accountability for our Diversity and Inclusion Strategy across the Group is key to driving progress. Our regions, markets and business units have specific diversity action plans and initiatives in place to support diversity across the Group and to develop a pipeline of diverse talent at all levels of our organisation.

Our Director, Talent and Culture, has overall responsibility for all employee and human resources matters, while our Management Board oversees the development and management of talent within the Group's regions and functions, and monitors progress against our key objectives and performance indicators. Our Board reviews progress on our Diversity and Inclusion Strategy and initiatives and diversity reporting forms a key part of all Functional and Regional Leadership Team meetings, with quarterly reviews.

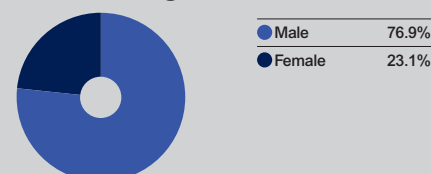
Group diversity as at 31 December 2019

	Total	Male	Female
Main Board	11	8	3
Senior management	576	443	133
Total Group employees	53,185	38,402	14,783

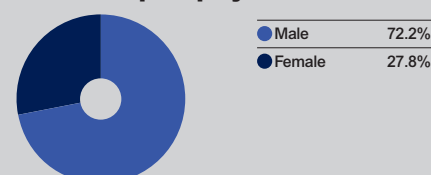
Main Board



Senior management



Total Group employees



Nationalities represented

	Total
Main Board	8
Global headquarters	83
Management level globally	141

Senior managers: Companies Act 2006

For the purposes of disclosure under Section 414C(8) of the Companies Act 2006, the Group had 190 male and 30 female senior managers as at 31 December 2019. Senior managers are defined here as the members of the Management Board (excluding the Executive Directors) and the Directors of the Group's principal subsidiary undertakings. The principal subsidiary undertakings, as set out in the Financial Statements, represented approximately 70% of the Group's employees and contributed over 76% of Group revenue and 78% of profit from operations in 2019.

2. Building diverse talent pools

We are a diverse employer. There are 141 nationalities represented at management level within our Group, and we are pleased with the continuous progress we are making and the sustainable pipeline we are building in terms of nationality diversity.

We are also continuing to work hard to improve gender diversity within the Group. Women represent 27% of our Board and 15% of our Management Board, and comprised 24% of our senior recruits and 23% of our internal promotions in 2019. We support women's development into senior roles through a variety of initiatives, including our Women in Leadership programme and participation in the 30% Club mentoring programme. We have female executives on all our senior functional and geographical leadership teams, and 49% of our 2019 graduate intake were women, supporting the development of a sustainable pipeline of women for senior management roles.

 Read about our Global Graduate Programme at www.bat-careers.com/graduates

3. Creating enablers

To realise our diversity ambitions, we know we must develop enablers to provide a supportive environment for people to thrive. One of the ways we do this is by maintaining networks to share experiences. We currently support 13 women's networks across all levels of our organisation, including Women in BAT UK network. We also partnered with the International Women's Day Association for the second year on the #BalanceforBetter campaign.

'B United' celebrated its first anniversary in 2019. 'B United' is a Group network that provides our LGBT+ employees with a safe forum to share experiences, mentoring opportunities and help with overcoming hurdles, such as those relating to adoption or travelling abroad with same sex partners.

Employee engagement index

82%

FMCG comparator group 75%

Definition: Results from our 'Your Voice' employee opinion survey, carried out in 2019, enabled us to calculate our employee engagement index – a measure that reflects employees' level of commitment, energy and connection towards the organisation.

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

Our other key metrics in this area include:

- Employee retention: In 2019, total voluntary turnover of management-grade employees was 1,085, representing 8.1% of the total management population.
- Diversity: Representation of women in senior management roles increased from 16% in 2016, and 21% in 2017, to 23% in 2019.

Inclusive culture

We can only truly harness the benefits of a diverse workforce if we have an inclusive culture that enables all our employees to flourish regardless of their gender, ethnicity, culture or other differences.

We were proud to be recognised as a Diversity Leader by the Financial Times in its inaugural Diversity Leaders report. The report, which lists the top 700 companies across 10 European countries, recognises organisations that have achieved a diverse and inclusive workforce across a number of criteria.

Workforce engagement

The Group has a range of well-established engagement channels worldwide covering the Group's global workforce. We define the Group's workforce as comprising all Group company employees and individuals contracted on a fixed term basis to undertake permanent roles.

Our workforce engagement channels include market and site visits by our Directors and Management Board members to meet local employees, town hall sessions, works councils, European Employee Council meetings, our 'Your Voice' global employee survey, global, functional and regional webcasts and webcasts with the Chief Executive.

These engagement channels are implemented as appropriate for the composition of local workforce populations, at market, business unit, functional or regional levels. Our Speak Up channels are also available to our workforce worldwide and are discussed further on page 32.

The Board has taken account of the requirements of the UK Corporate Governance Code in its approach to engagement with the Group's workforce. Given the spread, scale and diversity of the Group's workforce, the Board considers it effective to use the established channels referred to above, and has augmented these from January 2019 by introducing Group-wide reporting structures to capture feedback from engagement channels at market, business unit, functional and regional levels.

To ensure the Board understands the views of our workforce, the Board now reviews consolidated feedback from these engagement channels annually. Feedback from the Board, with associated action planning, is cascaded back across our workforce and the Board is kept updated on progress against identified actions during the year. This approach supplements the Directors' direct engagement, including through market and site visits, discussed further at page 72.

Our policies and principles*	Summary of areas covered	Key stakeholder groups
Employment Principles	Employment practices, including commitments to diversity, reasonable working hours, family-friendly policies, employee wellbeing, talent, performance and equal opportunities, and fair, clear and competitive remuneration and benefits.	☆ Our People
Health and Safety Policy	Health, safety and welfare of all employees, other members of our workforce and third-party personnel.	☆ Our People 🔗 Suppliers ↔ Customers
Standards of Business Conduct (SoBC)	Respect in the work place, including promoting equality and diversity, preventing harassment and bullying, and safeguarding employee wellbeing.	☆ Our People
Group Data Privacy Policy	The manner in which BAT processes personal data about all individuals, including consumers, employees, contractors and employees of suppliers.	☆ Our People 👤 Consumers 🔗 Suppliers ↔ Customers

These policies and procedures are endorsed by our Board, apply to all Group companies and support the effective identification, management and mitigation of risks and issues for our business in these and other areas.

* Further details of our Group policies and principles can be found at www.bat.com/principles

DELIVERING OUR STRATEGY CONTINUED

Our global 'Your Voice' employee survey is conducted across the Group every two years, most recently in 2019. The results from 2019 demonstrate that we continue to outperform our global FMCG comparator group in all areas surveyed, including our employee engagement index at 7% higher than our FMCG comparator group and our high performance index at 13% above our FMCG comparator group. Our Group results are also significantly ahead of our FMCG comparator group in the categories of corporate responsibility, diversity & inclusion and talent development.

Our Employment Principles

Our Employment Principles set out a common approach for our Group companies' policies and procedures, recognising that each Group company must take account of local labour law and practice, and the local political, economic and cultural context.

In developing our Employment Principles, we have sought the views of a cross-section of internal and external stakeholders, and have consulted with employee representatives and (where relevant) with our works councils. All Group companies have adopted our Employment Principles and, through our internal audit processes, are required to demonstrate how these are embedded into the work place.

In addition to our Employment Principles, our Board Diversity Policy specifically applies to our Board and Management Board and is discussed further at pages 81 to 82.

Equal opportunities for all

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

Rewarding people

Reward is a key pillar in ensuring that we have the right people to drive the business forward. Reward is necessarily local and we strongly support this through global frameworks to ensure leading edge policies, processes and technology are available to all markets.

Base pay rewards core competence relative to skills, experience and contribution to the Group, while annual bonuses, long-term incentives, recognition schemes and ad hoc incentives provide the right mix to ensure that sustained high performance is recognised and rewarded. We also offer our UK employees the chance to share in our success via our Sharesave Scheme, Partnership Share Scheme and Share Reward Scheme, and operate several similar schemes for senior management in our Group companies.

Our approach to rewarding Group company employees is set out further on pages 95 to 96. Further information on the Company's Remuneration Policy for Directors can be found on pages 93 to 113.

Gender pay

Since 2018, we have published data relating to UK gender pay in accordance with statutory requirements.



You can learn more about our published data relating to UK gender pay in line with statutory requirements at www.bat.com/genderpayreport

Safe place to work

Operating in challenging environments

Providing a safe working environment for all our employees and contractors is paramount. As a global business, operating in diverse markets including some of the world's most volatile regions, this can also be challenging.

Safety risks vary across our business. For example, our manufacturing sites carry lower risks, while the vast majority of all Group accidents are in Trade Marketing & Distribution (TM&D), which involves the distribution and sale of our products. We have close to 30,000 vehicles and motorcycles out on the road every day, often in environments with difficult social or economic conditions. Our goods have a high street value, and in a small number of markets this carries high risk of armed robbery and assault. Poor road infrastructure and wide variations in driving standards and behaviour provide further challenges.

Although these challenges will always exist, our goal is zero accidents across the Group. To help achieve this, we have a comprehensive approach based on risk management and assessments, employee training and awareness, and tailored initiatives for specific issues.

Since 2017, we have implemented a range of additional initiatives, such as ensuring drivers carry less stock, together with extra security measures for route planning and vehicle tracking. We use in-vehicle 'telematics' monitoring systems to analyse driver behaviour data, and use the insights to tailor our training programmes and improve driving skills and hazard perception.

In markets where we have introduced distribution by motorcycle, we provide training programmes to reduce risk. These provide practical techniques for different road conditions and types of traffic, safe speeds and distances, and how to spot a potential problem and take action to deal with it safely.

We are pleased to report that our actions are producing improvements. While vehicle-related incidents remained flat in 2019, we saw an 18% reduction in injuries reported across TM&D, driven by a 40% decrease in the number of assaults on our people.

Relatedly, the number of fatalities fell significantly from 12 in 2018 to one across the Group in 2019. This was primarily a result of our concerted effort to address the rise in attacks on our field-force. However, we recognise that changing local conditions, such as increased levels of violence and civil unrest, continue in certain markets and that this requires continuous assessments to ensure the learnings from other markets are rapidly deployed to mitigate any rising trends in potential threats to our people.

We are making every effort to further address these challenges in 2020, notably through sharing best-practice examples across our regions.



You can read about our Principal Group risk relating to workplace health & safety on page 62

Health and Safety Policy

Our Health and Safety Policy recognises the importance of the health, safety and welfare of all our employees and third-party personnel in the conduct of our business operations. We are committed to the prevention of injury and ill-health, and strive for continual improvement in health and safety management and performance. This policy is supported by our Environmental, Health and Safety (EHS) management system, outlined on page 29.

Overall responsibility for Group health and safety is held by the Director, Operations. The Director, Group Talent and Culture, has overall responsibility for all employee and human resources matters.

Our key metrics* in this area include:

- Lost Workday Case Incident Rate (LWCIR): There was a decrease in our LWCIR from 0.29 in 2018 to 0.27 in 2019.
- Lost workday cases (LWC): The number of work-related accidents (including assaults) resulting in injury to employees and to contractors under our direct supervision, causing absence of one shift or more, decreased from 213 in 2018 to 186 in 2019.
- Serious injuries and fatalities: The total number of serious injuries and fatalities to employees and contractors decreased from 54 in 2018 to 38 in 2019.

* 2018 LWC data has been restated to include Health and Safety data from our recent acquisitions.

FINANCIAL PERFORMANCE SUMMARY



STRONG OPERATIONAL PERFORMANCE DRIVES DELEVERAGING

Tadeu Marroco
Finance Director



Highlights

- Group revenue was up 5.7% with profit from operations 3.2% lower than 2018;
- At constant rates of exchange, adjusted revenue grew 5.6% with adjusted profit from operations up 6.6%;
- Diluted earnings per share decreased 5.4%. Adjusted diluted earnings per share was up 9.1%, or 8.4% at constant rates;
- Dividend per share was up 3.6% at 210.4p;
- Net cash generated from operating activities declined 12.6%, [@]with adjusted cash generated from operations at constant rates down 16.3%; and
- Cash conversion at 100%, [@]with operating cash flow conversion ratio at 97%[@].

Non-GAAP measures

In the reporting of financial information, the Group uses certain measures that are not defined by IFRS, the Generally Accepted Accounting Principles (GAAP) under which the Group reports. The Group believes that these additional measures, which are used internally, are useful to users of the financial information in helping them understand the underlying business performance.

The principal non-GAAP measures which the Group uses are adjusted revenue, adjusted revenue from New Categories, adjusted revenue from the Strategic Portfolio, adjusted profit from operations, adjusted diluted earnings per share, [@]operating cash flow conversion ratio and adjusted cash generated from operations[@]. Adjusting items are significant items in revenue, profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. As an additional measure to indicate the results of the Group before the impact of exchange rates on the Group's results, the movement in adjusted revenue, adjusted revenue from the Strategic Portfolio, adjusted profit from operations and adjusted diluted earnings per share are shown at constant rates of exchange. The Group also includes, where appropriate, measures termed 'representative' or 'organic' to provide the user with the Group's performance without the potentially distorting effects of acquisitions, particularly RAI. These non-GAAP measures are explained on pages 258 to 268.

Revenue

In 2019, revenue grew 5.7% to £25,877 million (2018: £24,492 million, up 25.2% on 2017). The higher revenue in 2019 was due to pricing across the cigarettes portfolio (with price mix of 9%) and an increase in revenue from Traditional Oral (up 15%, 2018 up 127%) and New Categories (up 37%, 2018 up 138%), which more than offset a 4.7% decline in cigarette volume (2018: increase of 2.6%). The growth in 2018 was mainly due to the inclusion of RAI as a wholly-owned subsidiary from the acquisition date as 2017 only included approximately five months of revenue from RAI. 2018 revenue was also driven by price mix of 6% (on the combustible brands) and the growth of the New Categories portfolio. Revenue was also affected by the movements of foreign exchange on our reported results which was a tailwind of 0.6% in 2019, compared to a headwind in 2018 of approximately 6%.

After adjusting for the short-term uplift to revenue due to the treatment of excise on bought-in goods and the effect of exchange on the reported result, on a constant currency basis, in 2019 adjusted revenue was up 5.6% as combustibles pricing and the growth of New Categories more than offset a decline in cigarette volume of 4.7%. Excluding the variance created to the Group's results from the acquisition of RAI and other businesses in 2017, in 2018 adjusted revenue grew 3.5% on an adjusted, constant currency, representative basis as pricing and the growth in New Categories more than offset the decline in combustibles volume on a representative basis.

Revenue

(£m)

£25,877m
+5.7%

2019	£25,877m	+6%
2018	£24,492m	+25%
2017	£19,564m	+39%

Definition: Revenue recognised, net of duty, excise and other taxes.

In 2019, revenue includes £18,793 million of revenue from the Strategic Portfolio, an increase of 9% (2018: £17,257 million). Within the Strategic Portfolio, revenue from New Categories was £1,255 million (2018: £917 million).

Change in adjusted revenue at constant rates (%)

+5.6%

2019	+6%
2018	+33%
2018 (rep)	+4%
2017	+32%
2017 (org)	+3%

Definition: Change in revenue before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

[@] Denotes phrase, paragraph or similar that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.

Reconciliation of revenue to adjusted revenue at constant rates

	2019	2018	2018	2017
	£m	Change % (vs 2018)	£m	Change % (vs 2017)
Revenue	25,877	+5.7%	24,492	+25%
Adjusting items	(50)	–	(180)	–
Add impact of acquisition (for representative calculation)	–	–	–	–
Adjusted revenue (2017 shown on a representative basis)	25,827	+6.2%	24,312	-2.3%
Impact of exchange	(144)	–	1,448	–
Adjusted revenue at constant rates	25,683	+5.6%	25,760	+3.5%

INCOME STATEMENT

Profit from operations

Profit from operations fell by 3.2% to £9,016 million, compared to an increase of 45% to £9,313 million in 2018. This was driven by the recognition of charges related to Quebec Class Action in Canada (£436 million), the settlement of an excise dispute in Russia (£202 million), amortisation and impairment of trademarks and similar intangibles (£481 million), the impairment of Indonesian goodwill (£172 million), other smoking and health litigation costs of £236 million (which included *Engle* progeny in the US) and costs related to the restructuring programmes, which includes Quantum (£264 million). The growth in 2018 was driven by the inclusion of RAI mid-way through 2017.

Raw materials and other consumables costs declined 1.4% to £4,599 million in 2019 mainly due to the end of the contract manufacturing agreement which, due to excise recognition, led to an increase in revenue and in raw materials and other consumables costs. In 2018, this was an increase of 3.2% to £4,664 million due to the higher volume following the acquisition in 2017 of RAI as well as an increase in THP volume, and a year-on-year movement benefiting from a charge of £465 million recognised in 2017 related to the purchase price allocation adjustment to inventory which did not repeat in 2018.

Employee benefit costs increased by 7.2% to £3,221 million in 2019, which includes charges in relation to Quantum of £264 million. In 2018, this was an increase of 12.2% to £3,005 million, due to the acquisition of RAI in 2017.

Depreciation, amortisation and impairment costs increased by £474 million to £1,512 million in 2019 and by £136 million to £1,038 million in 2018. This includes the amortisation and impairment charges of £481 million (2018: £377 million) largely related to the trademarks and similar intangibles capitalised following acquisitions (including RAI, TDR, Skandinavisk Tobakskompagni A/S (ST) and VapeWild).

Profit from operations (£m)

£9,016m
-3.2%

2019	£9,016m	-3%
2018	£9,313m	+45%
2017	£6,412m	+38%

Definition: Profit for the year before the impact of net finance costs/income, share of post-tax results of associates and joint ventures and taxation on ordinary activities.

Also included in 2019 are goodwill impairment charges in relation to Bentoel in Indonesia (£172 million) recognised in the year following a change in excise rates impacting forecast future performance. The increase in 2018 reflects the full year effect of RAI, with depreciation increasing in 2017 due to the higher depreciation charges following the consolidation of RAI in that year.

Other operating expenses increased by £1,183 million to £7,851 million in 2019 mainly due to the recognition of the charges in respect of Quebec Class Action in Canada (£436 million), Russia excise dispute (£202 million) and other litigation (including *Engle* progeny in the US) of £236 million. 2018 was up £1,986 million to £6,668 million, largely due to the consolidation of RAI, including charges in relation to the MSA.

Expenditure on research and development was £376 million in 2019 (2018: £258 million) with a focus on products that could potentially reduce the risk associated with smoking conventional cigarettes.

Adjusted profit from operations is the Group's profit from operations before adjusting items. Adjusting items were £2,114 million in 2019 (2018: £1,034 million), including the charges related to trademark amortisation and impairment (discussed above), and restructuring and integration costs of

Change in adjusted profit from operations at constant rates (%)

+6.6%

2019	+7%
2018	+38%
2018 (rep)	+4%
2017	+39%
2017 (org)	+4%

Definition: Change in profit from operations before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

£565 million (2018: £363 million), of which Quantum incurred £264 million (2018: £nil). Quantum will simplify the business and create a more efficient and agile organisation to support the growth of New Categories. The charge in 2018 included costs related to the implementation of the operating model, integration costs associated with the acquisition of RAI and factory rationalisations (in Germany, Russia and APME).

In 2019, the Group also incurred a £436 million charge in respect of the Quebec Class Action in Canada, amortisation and impairment of trademarks and similar intangibles (£481 million), a charge of £202 million related to an excise dispute in Russia, impairment of goodwill in Indonesia (£172 million) and other smoking and health litigation costs of £236 million, including *Engle* progeny in the US.

In 2018, the Group incurred an impairment of assets in Venezuela due to the accounting revaluation (related to hyperinflationary accounting) of £110 million and £178 million charge due to *Engle* progeny cases in the US.

In 2019, adjusted profit from operations grew by 7.6% to £11,130 million or 6.6% to £11,032 million on a constant currency basis. This compared to an increase of 38% in 2018 which was largely driven by the full year effect of the acquisition of RAI in 2017. On a representative basis, adjusted profit from operations at constant rates increased by 4.0% in 2018.

Analysis of profit from operations, net finance costs and results from associates and joint ventures

	2019					2018		
	Reported £m	Adjusting items £m	Adjusted £m	Impact of exchange £m	Adjusted at CC £m	Reported £m	Adjusting items £m	Adjusted £m
Profit from operations								
US	4,410	626	5,036	(238)	4,798	4,006	505	4,511
APME	1,753	306	2,059	43	2,102	1,858	90	1,948
AmSSA	1,204	638	1,842	70	1,912	1,544	194	1,738
ENA	1,649	544	2,193	27	2,220	1,905	245	2,150
Total regions	9,016	2,114	11,130	(98)	11,032	9,313	1,034	10,347
Net finance (costs)/income	(1,602)	80	(1,522)	56	(1,466)	(1,381)	(4)	(1,385)
Associates and joint ventures	498	(25)	473	(7)	466	419	(32)	387
Profit before tax	7,912	2,169	10,081	49	10,032	8,351	998	9,349

Operating margin

Operating margin in 2019 declined by 320 bps to 34.8% as the growth in revenue was more than offset by continued investment in the development of New Categories and the impact of the charges related to Quebec, Russia, Indonesia, amortisation of trademarks, other litigation and Quantum as described in note 3 in the Notes on the Accounts.

In 2018, operating margin was ahead of 2017 by over 500 bps to 38.0%, as the Group's performance and the full year impact of RAI more than offset the increased spend related to the New Category portfolio and restructuring and integration costs incurred.

In 2019, adjusted operating margin grew by 50 bps driven by combustibles pricing and cost management initiatives, fuelling the investment into New Categories.

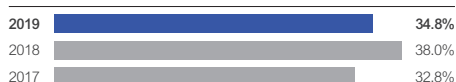
In 2018, adjusted operating margin grew by 150 bps largely due to the full year effect of RAI. On a representative basis, this was an increase of 40 bps as the impact of pricing more than offset the investment into New Categories and inflation on the cost base.

Net finance costs

In 2019, net finance costs increased £221 million to £1,602 million, largely driven by higher short-term borrowings required to fund the timing of payments, interest on leases recognised under IFRS 16, working capital movements in the period and the impact of the translational headwind on costs due to the relative weakness of sterling against the US dollar. In 2018, net finance costs increased by £287 million to £1,381 million, largely due to the full year effect of servicing higher level of debt following the acquisition of RAI.

Operating margin (%)

34.8%



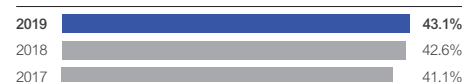
Definition: Profit from operations as a percentage of revenue.

In 2018, the Group recognised a monetary gain arising from the revaluation of the Group's operations in Venezuela in line with hyperinflation (£45 million), which has been treated as an adjusting item. Before the impact of adjusting charges related to the Franked Investment Income Group Litigation Order (FIIGLO), as discussed on page 147, (£28 million in 2019 and £25 million in 2018), interest in relation to the Russia excise dispute (2019: £50 million), a £12 million charge in 2018 in relation to retrospective guidance by a tax authority on overseas withholding tax, the monetary gain in Venezuela in 2018 and the translation impact of foreign exchange, adjusted net finance costs were 5.8% higher in 2019 and 59.2% higher in 2018. The movement in 2018 reflected the full year's interest charges following the acquisition of RAI, including the increased borrowings to finance the acquisition and the consolidation into the Group's accounts of RAI's borrowings.

The Group's average cost of debt in 2019 was 3.3%, compared to 3.0% in 2018.

Adjusted operating margin (%)

43.1%



Definition: Adjusted profit from operations as a percentage of adjusted revenue.

Associates and joint ventures

Associates in 2019 largely comprised the Group's shareholding in its Indian associate, ITC. The Group's share of post-tax results of associates and joint ventures, included at the pre-tax level under IFRS, increased 19% to £498 million largely due to improved operational performance of ITC and the benefit from lower corporate tax following the change in rates in India. In 2018, this was a decline of 98% to £419 million, as 2017 included the results of RAI prior to the acquisition, after which it was consolidated as a wholly-owned subsidiary, with 2017 also including the recognition of a gain of £23.3 billion, which arose as the Group was deemed, under IFRS, to have disposed of RAI as an associate in that period.

Excluding the effect of adjusting items, including a gain arising on the deemed disposal of part of the Group's shareholding in ITC (due to issuances to employee trusts), the Group's share of associates and joint ventures on an adjusted, constant currency basis was 20% higher in 2019, at £466 million. In 2018, this was a decline of 58.5% to £420 million as the Group ceased to recognise the results of RAI as an associate.

Analysis of profit from operations, net finance costs and results from associates and joint ventures

	2018					2017				
	Reported £m	Adjusting items £m	Adjusted £m	Impact of exchange £m	Adjusted at CC £m	Reported £m	Adjusting items £m	Adjusted £m	Uplift due to acq £m	Adjusted repres £m
Profit from operations										
US	4,006	505	4,511	175	4,686	1,165	763	1,928	2,502	4,430
APME	1,858	90	1,948	151	2,099	1,902	147	2,049	25	2,074
AmSSA	1,544	194	1,738	184	1,922	1,648	134	1,782	22	1,804
ENA	1,905	245	2,150	67	2,217	1,697	473	2,170	29	2,199
Total regions	9,313	1,034	10,347	577	10,924	6,412	1,517	7,929	2,578	10,507
Net finance (costs)/income	(1,381)	(4)	(1,385)	(30)	(1,415)	(1,094)	205	(889)		
Associates and joint ventures	419	(32)	387	33	420	24,209	(23,197)	1,012		
Profit before tax	8,351	998	9,349	580	9,929	29,527	(21,475)	8,052		

INCOME STATEMENT

CONTINUED

Tax

In 2019, the tax charge in the Income Statement was £2,063 million, compared to £2,141 million in 2018 and a credit of £8,129 million in 2017. The 2017 credit was largely due to the impact of the change in tax rates in the US which led to a credit of £9.6 billion related to the revaluation of deferred tax liabilities arising on the acquired net assets of RAI, and described below. The tax rates in the Income Statement are therefore a charge of 26.1% in 2019, a charge of 25.6% in 2018 and a credit of 27.5% in 2017. These are also affected by the inclusion of adjusting items described earlier and the associates and joint ventures' post-tax profit in the Group's pre-tax results. Excluding these items and the deferred tax credit in 2017, the underlying tax rate for subsidiaries was 26.0% in 2019, 26.4% in 2018 and 29.7% in 2017. See the section Non-GAAP measures on page 263 for the computation of underlying tax rates for the periods presented.

Tax strategy

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

- complying with all applicable laws and regulations in countries in which we operate;
- being open and transparent with tax authorities and operating to build mature professional relationships;
- supporting the business strategy of the Group by undertaking efficient management of our tax affairs in line with the Group's commercial activity;
- transacting on an arm's-length basis for exchanges of goods and services between companies within the Group; and
- engaging in pro-active discussions with tax authorities on occasions of differing legal interpretation.

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

The tax strategy outlined above is applicable to all Group companies, including the UK Group companies. Reference to tax authorities includes HMRC.

The publication of this strategy is considered to constitute compliance with the duty under paragraph 16(2) Schedule 19 Part 2 of the UK Finance Act 2016.

The taxation on ordinary activities for 2019 was a charge of £2.1 billion, compared to a charge of £2.1 billion in 2018 and a credit of £8.1 billion in 2017. Corporation tax paid (due to the timing of corporation tax instalment payments which straddle different financial years) was £2.2 billion in 2019 (2018: £1.9 billion, 2017: £1.7 billion).

Our tax footprint extends beyond corporation tax, including significant payment of employment taxes and other indirect taxes including customs and import duties. The Group also collects taxes on behalf of governments (including tobacco excise, employee taxes, VAT and other sales taxes). The total tax paid in 2019 of £41.4 billion (2018: £39.9 billion, 2017: £37.4 billion) therefore consists of both taxes borne and taxes collected as shown in the table provided.

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

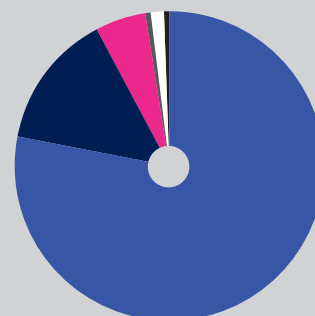
In 2017, as part of the acquisition of RAI, the Group acquired the assets and liabilities of the RAI Companies. These are required to be fair valued at the date of acquisition. The fair value of the net assets acquired created a deferred tax liability, valued at the prevailing rate of corporation tax at the date of acquisition, being 25 July 2017. Subsequently, on 22 December 2017, the US federal corporate tax rate was changed to 21%, effective from 1 January 2018. This revised rate was used to revalue the deferred tax liability at the balance sheet date, reducing the liability and providing a credit to the income statement in 2017 of £9.6 billion. Due to the scale of the impact, this credit was treated as an adjusting item in that period.

Deferred tax asset/(liability)

	2019 £m	2018 £m	2017 £m
Opening balance	(17,432)	(16,796)	(216)
Difference on exchange	680	(1,011)	852
Recognised on acquisition of RAI	–	–	(27,065)
Impact of US tax reforms	–	–	9,620
Changes in tax rates	47	70	–
Other (charges)/credits to the income statement	(55)	304	152
Other credits/(charges) to other comprehensive income	138	(7)	(133)
Other movements	(4)	8	(6)
Closing balance	(16,626)	(17,432)	(16,796)

Major taxes paid 2019 (£bn)

£41.4bn



Major taxes paid

	2019 £bn	2018 £bn
● Tobacco excise (collected)	32.4	31.1
● Net VAT and other sales taxes (collected)	5.8	5.9
● Corporation tax (borne)	2.2	1.9
● Customs and import duties (borne)	0.3	0.3
● Taxes paid by employees (collected)	0.5	0.5
● Employment taxes (borne)	0.2	0.2
	41.4	39.9

The movements in deferred tax, taken through other comprehensive income, mainly relate to the change in the valuation of retirement benefits in the year, as disclosed in note 12 in the Notes on the Accounts.

Earnings per share

Profit for the year was £5,849 million, a 5.8% decline compared to £6,210 million in 2018 (itself a decline of 84% on 2017). The movement in 2019 was driven by the recognition of charges in relation to Quebec, Russia, Indonesia, the impairment of acquired brands, other litigation charges, Quantum and higher net finance costs, as previously discussed, which more than offset an increase in revenue across all product categories. The movement in 2018 was largely due to accounting gains in 2017 related to the acquisition of RAI and the deferred tax credit arising from the US tax reform, which both arose in the prior year.

Consequently, and after accounting for the movement in non-controlling interests in the year, basic earnings per share were 5.4% lower at 249.7p (2018: 264.0p, 2017: 1,833.9p). After accounting for the dilutive effect of employee share schemes, diluted earnings per share were 249.0p, 5.4% lower than 2018 (2018: 263.2p, 2017: 1,827.6p).

Earnings per share are impacted by the adjusting items discussed above. Adjusted diluted EPS, as calculated in note 7 in the Notes on the Accounts, was up against the prior year by 9.1% at 323.8p, with 2018 ahead of 2017 by 5.2% at 296.7p. Adjusted diluted EPS at constant rates would have been 8.4% ahead of 2018 at 321.6p, with 2018 up 11.8% against 2017.

Dividends

The Group pays its dividends to shareholders over four quarterly interim dividends. Quarterly dividends provide shareholders with a more regular flow of dividend income and allow the Company to spread its substantial dividend payments more evenly over the year. The dividends align better with the cash flow generation of the Group and so enable the Company to fund the payments more efficiently.

The Board has declared an interim dividend of 210.4p per ordinary share of 25p, payable in four equal quarterly instalments of 52.6p per ordinary share in May 2020, August 2020, November 2020 and February 2021. This represents an increase of 3.6% on 2018, (2018: 203.0p per share), and a payout ratio, on 2019 adjusted diluted earnings per share, of 65.0% (2018: 68.4%).

The quarterly dividends will be paid to shareholders registered on either the UK main register or the South Africa branch register and to ADS holders, each on the applicable record dates.

Under IFRS, the dividend is recognised in the year that it is approved by shareholders or, if declared as an interim dividend by directors, in the period that it is paid. Following a review of the Group's 2018 Annual Report and Accounts conducted by the Financial Reporting Council (FRC), an error was identified whereby the Group had previously recognised the interim dividend that would be paid in the subsequent period as a liability on the balance sheet. The effect was to overstate liabilities and reduce equity by £1.0 billion in 2017 and £1.1 billion in 2018. Assessing the nature of the error, it was considered to be immaterial by the Directors as it did not affect the primary users of the financial statements (see page 130) as there was no impact to the amount or timing of the dividends received.

In 2019, the Group revised the recognition of the dividend in the accounts to be in accordance with IFRS. The 2019 Statement of Changes in Equity reflects the remaining three quarterly dividends that were paid in the period, which, in total amount to £3,476 million (2018: £4,463 million). The cash flow, prepared in accordance with IFRS, reflects the total cash paid in the period. Further details of the total amounts of dividends paid in 2019 (with 2018 comparatives) are given in note 18 in the Notes on the Accounts.

Dividends are declared and payable in sterling except for those shareholders on the branch register in South Africa, where dividends are payable in rand. The equivalent dividends receivable by holders of ADSs in US dollars are calculated based on the exchange rate on the applicable payment date.

Further details of the quarterly dividends and key dates are set out under 'Shareholder information' on pages 300 and 301.

IFRS-GAAP

Diluted earnings per share (EPS) (p)

249.0p
-5.4%

2019	249.0p	-5%
2018	263.2p	-86%
2017	1827.60p	+633%

Definition: Profit attributable to owners of BAT p.l.c. over weighted average number of shares outstanding, including the effects of all dilutive potential ordinary shares.

KPI Non-GAAP

Change in adjusted diluted EPS (%)

+9.1%

2019	+9%
2018	+5%
2017	+14%

Definition: Change in diluted earnings per share before the impact of adjusting items.

KPI Non-GAAP

Change in adjusted diluted EPS at constant rates (%)

+8.4%

2019	+8%
2018	+12%
2017	+9%

Definition: Change in diluted earnings per share before the impact of adjusting items and the impact of fluctuations in foreign exchange rates.

The discussion of 2017 results that are not necessary to an understanding of the Group's financial condition, changes in financial condition and results of operations is excluded from this Financial Review in accordance with applicable US Securities laws. Discussion of such 2017 metrics is contained in the Group's Annual Report on Form 20-F 2018, which is available at bat.com/annualreport and has been filed with the SEC. Information contained in pages 33 to 47 of the Annual Report on Form 20-F 2018 are accordingly incorporated by reference into this Annual Report on Form 20-F 2019 only to the extent such information pertains to the Group's financial condition and results of operations for the fiscal year ended 31 December 2017.

TREASURY AND CASH FLOW

Treasury, liquidity and capital structure

The Treasury Function is responsible for raising finance for the Group and managing the Group's cash resources and the financial risks arising from underlying operations. Clear parameters have been established, including levels of authority, on the type and use of financial instruments to manage the financial risks facing the Group. Such instruments are only used if they relate to an underlying exposure; speculative transactions are expressly forbidden under the Group's treasury policy. All these activities are carried out under defined policies, procedures and limits, reviewed and approved by the Board, delegating oversight to the Finance Director and Treasury Function. See note 22 in the Notes on the Accounts for further detail.

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 sources. 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 2019, the average centrally managed debt maturity was 9.1 years (2018: 8.8 years) and the highest proportion of centrally managed debt maturing in a single rolling 12-month period was 18.6% (2018: 18.4%).

The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5 times. The Group targets a gross interest cover, as calculated under its key central banking facilities, of greater than 5 times. For 2019, it was 7.1 times (2018: 7.2 times).

In order to manage its interest rate risk, the Group maintains both floating rate and fixed rate debt. The Group sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on a net basis (at least 50% fixed on a net basis in the short to medium term). At 31 December 2019, the relevant ratios of floating to fixed rate borrowings were 18:82 (2018: 21:79) on a net basis.

As part of the management of liquidity, funding and interest rate risk, the Group regularly evaluates market conditions and may enter into transactions, from time to time, to repurchase outstanding debt, pursuant to open market purchases, tender offers or other means.

The Group has early adopted the Amendments to IFRS 9 *Financial Instruments* in respect of the Interest Rate Benchmark Reform as a result of the UK Financial Conduct Authority's announcement on 27 July 2017.

Considering the relevant hedge relationships impacted by these amendments, as at 31 December 2019, the Group has floating rate borrowings with nominal value £1,929 million and US\$750 million (£566 million) that are due to mature in January 2022 and August 2022, respectively.

In relation to the Group's floating rate borrowings and hedge instruments, there is exposure to uncertainty arising from changes in the USD LIBOR, EURIBOR and GBP LIBOR benchmarks. The Group believes that its contracts with interest rates based on these benchmarks adequately provide for alternate calculations of interest in the event that they are unavailable. The Group believes that any resulting ineffectiveness consequent to the Interest Rate Benchmark Reform is likely to be immaterial. Although these calculations may cause an administrative burden, the Group does not believe that these would materially adversely affect the Group or its ability to manage its interest rate risk.

The Group continues to maintain investment-grade credit ratings*, with ratings from Moody's/S&P at Baa2 (stable outlook)/BBB+ (stable outlook), respectively, with a medium-term rating target of Baa1/BBB+. 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 these covenants are not expected to inhibit the Group's operations or funding plans.

The Group maintains a two-tranche £6 billion revolving credit facility. This consists of a £3 billion 364-day revolving credit facility (which, in July 2019, was extended to mature in July 2020) and a £3 billion revolving credit facility maturing in 2021. On 12 March 2020, the Group refinanced the existing two-tranche £6 billion revolving credit facility with a new two-tranche £6 billion revolving credit facility. This consists of a £3 billion 364-day tranche (with two one-year extension options and a one-year term-out option), and a £3 billion five-year tranche (with two one-year extension options).

In July 2019, the Group also arranged short-term bilateral facilities with some of its core banks for a total amount of £745 million.

The Group also maintains a £25 billion EMTN programme, and US (US\$4 billion) and European (£3 billion) commercial paper programmes to accommodate the liquidity needs of the Group.

At 31 December 2019, the revolving credit facility was undrawn (2018: undrawn) with £1,056 million of commercial paper outstanding (2018: £536 million).

In July 2019, the Group filed a shelf registration statement on Form F-3 with the SEC pursuant to which B.A.T Capital Corporation and B.A.T. International Finance p.l.c. may issue debt securities guaranteed by certain members of the Group from time to time. This forms part of the Group's strategy to ensure flexible and agile access to capital markets and the registration statement is initially valid for three years.

Management believes that the Group has sufficient working capital for present requirements, taking into account the amounts of undrawn borrowing facilities and levels of cash and cash equivalents, and the ongoing ability to generate cash.

Cash flow

Net cash generated from operating activities

In 2019, net cash generated from operating activities declined by £1,299 million (or 12.6%) largely due to the timing of part of the 2018 MSA payment (£1.4 billion) which was paid in 2017 and due to working capital movements, particularly in Australia where the payment terms related to excise were changed in the year, removing bonded warehousing and increasing inventory values.

In 2018, net cash generated from operating activities increased by £4,948 million to £10,295 million, principally due to the full year effect from RAI, compared to approximately five months' contribution to 2017, the timing of payments related to the MSA in the US and an increase in debtor factoring by approximately £300 million. These more than offset a reduction in dividends from associates following the acquisition of RAI. Other movements include:

- the increase in inventory in 2018 was predominantly related to the timing of leaf purchases and inventory movements in Romania, Turkey and Russia;
- the increase in trade and other payables was driven by higher excise payables which are impacted by the timing of inventory movements in the supply chain; and
- the final quarterly payments in relation to the Quebec Class Action in 2017.

Net cash used in investing activities

In 2019, net cash used in investing activities declined by £382 million to £639 million (2018: £1,021 million), largely due to a net inflow of £148 million from short-term investment products, including treasury bills (2018: £153 million net outflow) and a reduction in purchases of property, plant and equipment of £94 million.

* A credit rating is not a recommendation to buy, sell or hold securities. A credit rating may be subject to withdrawal or revision at any time. Each rating should be evaluated separately of any other rating.

Included within investing activities is gross capital expenditure which includes purchases of property, plant and equipment and certain intangibles. This includes the investment in the Group's global operational infrastructure (including, but not limited to, the manufacturing network, trade marketing software and IT systems). In 2019, the Group invested £807 million, a decrease of 8.6% on the prior year (2018: £883 million). The Group expects gross capital expenditure in 2020 of £650 million, mainly related to the ongoing investment in the Group's operational infrastructure including the expansion of our New Categories portfolio.

Net cash used in financing activities

Net cash used in financing activities was an outflow of £8,593 million in 2019 (2018: £9,630 million outflow).

The 2019 outflow was mainly due to the repayment (at maturity) or early redemption (as part of the Group's liquidity management strategy) of bonds in the year totalling £5.1 billion, discussed below. This more than offset the inflow from the four bonds issued (totalling US\$3.5 billion or £2.7 billion) in September 2019, following the shelf registration in the US referred to on page 48. The 2019 outflow also included the increased dividend payment of £4,598 million (2018: £4,347 million) due to the higher dividend per share and interest paid in the year of £1,601 million (2018: £1,557 million).

In March and June 2019, the Group repaid €820 million and US\$750 million of bonds at maturity, respectively.

As part of the liquidity management strategy, the Group redeemed, prior to their maturity in 2020, US\$2.25 billion and US\$1.25 billion of bonds in September 2019 and November 2019, respectively. The Group also repaid US\$650 million of bonds (in September 2019) and £500 million of bonds (in December 2019) at maturity.

The 2018 outflow was also due to the payment of a €0.4 billion bond (in March 2018) and three bonds totalling US\$2.5 billion (in June 2018) at maturity, the repayment of £0.6 billion, under the revolving credit facility and £1.2 billion of commercial paper outstanding in each case at 31 December 2017.

Eight series of US\$ denominated bonds totalling US\$17.25 billion were issued in August 2017 pursuant to Rule 144A with registration rights, whereby the Group committed to investors that the bonds would be exchangeable for registered notes. In October 2018, investors were offered to exchange their unregistered bonds for registered bonds in line with the registration rights. The exchange offer was completed in November 2018 with 99.7% of the bonds exchanged.

Free cash flow (before and after dividends paid to shareholders)[@]

Free cash flow (before dividends paid to shareholders), as defined on page 266, was £6,519 million, a decrease of 15% on the prior year (2018: £7,684 million; 2017: £3,500 million). This movement was driven by the timing of the 2018 MSA payment (brought forward to 2017) which impacts the comparator periods and more than offsets the enhanced delivery across the remainder of the Group.

After payment of dividends to shareholders, free cash flow was £1,921 million (2018: £3,337 million; 2017: £35 million).

2018 was also impacted by the full year inclusion of results from RAI, which led to higher interest payments and a reduction in dividends from associates (due to the change in accounting recognition of RAI in 2017).

Adjusted cash generated from operations (Adjusted CGFO)[@]

Adjusted CGFO is defined on page 265. Adjusted CGFO was £6,831 million, a decrease of 15% (2018: £8,071 million, 2017: £3,282 million), or 16% at constant rates of exchange. The decrease in 2019 was driven by the timing of the 2018 MSA payment, paid in 2017 as it was tax deductible at 2017 tax rates.

Excluding the timing impact of this payment, adjusted cash generated from operations would have increased by 1.2% in 2019 and 43%, in 2018. See page 265 for further information on this measure.

Cash flow conversion

The conversion of profit from operations to net cash generated from operating activities may indicate the Group's ability to generate cash from the profits earned. Based upon net cash generated from operating activities, the Group's conversion rate decreased from 111% to 100% in 2019. This was largely due to the timing of the payment for the MSA in December 2017 (positively impacting 2018 conversion).

[@]Operating cash flow conversion ratio (based upon adjusted profit from operations) decreased in 2019 to 97% from 113% in 2018, as 2018 was positively impacted by the timing of the MSA payment which was brought forward to December 2017. Normalising for this timing difference in both 2018 and 2017, the operating cash flow conversion ratio would have been 97% in 2019 and 100% in 2018, reflecting the Group's ability to deliver cash from the operating performance of the business. See page 264 for further information on this measure.

[@] Denotes phrase, paragraph or similar that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.

Summary cash flow

	2019 £m	2018 £m	2017 £m
Cash generated from operations	10,948	11,972	6,119
Dividends received from associates	252	214	903
Tax paid	(2,204)	(1,891)	(1,675)
Net cash generated from operating activities	8,996	10,295	5,347
Net cash used in investing activities	(639)	(1,021)	(18,544)
Net cash (used in)/from financing activities	(8,593)	(9,630)	14,759
Differences on exchange	(57)	(138)	(391)
(Decrease)/increase in net cash and cash equivalents	(293)	(494)	1,171

[@]Reconciliation of net cash generated from operating activities to free cash flow and adjusted cash generated from operations[@]

	2019 £m	2018 £m	2017 £m
Net cash generated from operating activities	8,996	10,295	5,347
Dividends paid to non-controlling interests	(157)	(142)	(167)
Net interest paid	(1,550)	(1,533)	(1,004)
Net capital expenditure	(774)	(845)	(767)
Trading loans to third party	4	(93)	101
Other	–	2	(10)
Free cash flow	6,519	7,684	3,500
Net cash impact of adjusting items	564	601	685
Dividends and other appropriations from associates	(252)	(214)	(903)
Adjusted cash generated from operations	6,831	8,071	3,282

TREASURY AND CASH FLOW

CONTINUED

Borrowings and net debt

Total borrowings decreased to £45,366 million in 2019 (2018: £47,509 million) largely due to the repayment of borrowings in the year, driven by the cash flow generated by the business and a foreign exchange tailwind of £1,566 million, partly offset by the recognition of lease liabilities under IFRS 16 (£607 million), which are included in 'borrowings' and the payment of dividends to shareholders in the period. The 4% decrease in 2018 was largely due to the repayment, on maturity, of a €400 million bond in March 2018 and three bonds totalling US\$2,500 million in June 2018.

Total borrowings includes £848 million (31 December 2018: £944 million) in respect of the purchase price adjustments related to the acquisition of RAI.

As discussed on page 48, the Group remains confident about its ability to access the debt capital markets successfully and reviews its options on a continuing basis.

Net debt is a non-GAAP measure and is defined as total borrowings, including related derivatives, less cash and cash equivalents and current investments held at fair value.

Net debt, at 31 December 2019, was £42,574 million (2018: £44,351 million; 2017: £45,571 million), with the movement in net debt largely due to the repayment of the outstanding bonds and a foreign exchange benefit of £873 million largely due to the movement of US\$ to sterling (2018: £1,963 million headwind).

@The movement in net debt also includes the free cash flow before dividends earned in the year (2019: £6,519 million; 2018: £7,684 million) as described on page 49. This is partly offset by dividends paid to owners of the parent of £4,598 million (2018: £4,347 million).@

Adjusted net debt to adjusted EBITDA

The Group uses adjusted net debt to adjusted EBITDA, as defined on page 267, to assess its level of adjusted net debt in comparison to the earnings generated by the Group. This is deemed by management to reflect the Group's ability to service and repay borrowings. In 2019, the ratio of adjusted net debt to adjusted EBITDA was 3.5 times, representing an improvement from 4.0 times at the end of 2018. The improvement in 2018 from 5.3 times in 2017 was due to the additional adjusted net debt arising as part of the acquisition of RAI in 2017, with only five months of RAI contribution to adjusted EBITDA recognised in that year.

The Group's adjusted net debt to adjusted EBITDA ratio is subject to the fluctuations in the foreign exchange market by virtue of the Group's foreign currency denominated earnings and the exposure of the debt portfolio to, predominantly, the US dollar. In 2019, due to the relative movement in the US dollar against sterling, the sterling value of adjusted net debt declined by £873 million. Excluding the impact of foreign exchange on the Group's reported results, adjusted net debt to adjusted EBITDA declined 0.4x in 2019 (2018: decline 0.4x) on a constant rate basis.

Refer to page 267 for a full reconciliation from borrowings to adjusted net debt, profit for the year to adjusted EBITDA and the ratio of adjusted net debt to adjusted EBITDA, at both current and constant rates of exchange.

@Return on capital employed (ROCE)

The Group's ROCE, calculated in accordance with our reported numbers was 7.1% (2018: 7.3%) with the reduction partly due to the lower profit from operations, discussed earlier.

On an adjusted basis, as defined on page 268, including dividends from associates and joint ventures (as a proxy to a return in the period, given the inclusion of the investment in associates and joint ventures in the Group's calculation of capital employed), adjusted ROCE grew from 8.3% in 2018 to 9.0% in 2019. This was partly due to the higher adjusted profit from operations in the year and foreign exchange tailwind reducing average capital employed largely due to the relative value of US\$ to sterling. In 2018, adjusted ROCE declined from 11.5% in 2017 to 8.3%, largely due to higher average capital employed in 2018 following the acquisition of RAI in 2017 and translational foreign currency headwinds.®

Retirement benefit schemes

The Group's subsidiaries operate over 190 retirement benefit arrangements worldwide. The majority of the scheme members belong to defined benefit schemes, most of which are funded externally and many of which are closed to new entrants. The Group also operates a number of defined contribution schemes.

The present total value of funded scheme liabilities as at 31 December 2019 was £11,726 million (2018: £11,317 million), while unfunded scheme liabilities amounted to £1,135 million (2018: £1,106 million). The schemes' assets declined to £11,925 million in 2018 (largely due to actuarial losses of £531 million) and declined to £11,860 million in 2019, partly due to the pension buy-in in the UK (discussed on page 159). After excluding unrecognised scheme surpluses of £28 million (2018: £20 million), the overall net liability for all pension and healthcare schemes in Group subsidiaries amounted to £1,029 million at the end of 2019, compared to £518 million at the end of 2018. Contributions to the defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes, taking into account regulatory environments.

Litigation and settlements

As discussed in note 27 in the Notes on the Accounts, various legal proceedings or claims are pending or may be instituted against the Group.

Government activity

The marketing, sale, taxation and use of tobacco products have been subject to substantial regulation by government and health officials for many years. For information about the risks related to regulation, see page 59 and pages 276 to 281.

Reconciliation of total borrowings to adjusted net debt

	2019 £m	2018 £m	2017 £m
Total borrowings	45,366	47,509	49,450
Derivatives in respect of net debt:			
– assets	(527)	(647)	(640)
– liabilities	384	269	117
Cash and cash equivalents	(2,526)	(2,602)	(3,291)
Current investments held at fair value	(123)	(178)	(65)
Net debt	42,574	44,351	45,571
Purchase price adjustment (PPA) to RAI debt	(848)	(944)	(947)
Adjusted net debt	41,726	43,407	44,624

@ Denotes phrase, paragraph or similar that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.

OTHER

Off-balance sheet arrangements and contractual obligations

Except for certain indemnities, the Group has no significant off-balance sheet arrangements. The Group has contractual obligations to make future payments on debt guarantees. In the normal course of business, it enters into contractual arrangements where the Group commits to future purchases of goods and services from unaffiliated and related parties. See page 270 for a summary of the contractual obligations as at 31 December 2019.

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 include 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 are also performed to ensure and confirm adherence.

In order to prepare the Group's consolidated financial information in accordance with IFRS, management has used estimates and assumptions that affect the reported amounts of revenue, expenses, assets and the disclosure of contingent liabilities at the date of the financial statements.

The critical accounting estimates are described in note 1 in the Notes on the Accounts and include:

- review of asset values, including goodwill and impairment testing;
- estimation and accounting for retirement benefit costs; and
- estimation of provisions, including as related to taxation and legal matters.

Foreign exchange rates

	Average			Closing		
	2019	2018	2017	2019	2018	2017
Australian dollar	1.836	1.786	1.681	1.885	1.809	1.730
Brazilian real	5.035	4.868	4.116	5.329	4.936	4.487
Canadian dollar	1.694	1.730	1.672	1.718	1.739	1.695
Euro	1.140	1.130	1.142	1.180	1.114	1.127
Indian rupee	89.898	91.227	83.895	94.558	88.916	86.343
Japanese yen	139.234	147.376	144.521	143.967	139.733	152.387
Russian rouble	82.623	83.677	75.170	82.282	88.353	77.880
South African rand	18.437	17.643	17.150	18.525	18.321	16.747
US dollar	1.277	1.335	1.289	1.325	1.274	1.353

The critical accounting judgements are described in note 1 in the Notes on the Accounts and include:

- identification and quantification of adjusting items;
- determination as to whether to recognise provisions and the exposures to contingent liabilities related to pending litigation or other outstanding claims;
- determination that an error, identified following a review by the FRC (and discussed on page 175) was immaterial and did not require restatement of the prior periods as, whilst the effect was to overstate liabilities and reduce equity by £1.0 billion in 2017 and £1.1 billion in 2018, it did not affect the primary users of the financial statements (see page 175) as there was no impact to the amount or timing of the dividends received;
- determination as to whether control (subsidiaries), joint control (joint arrangements), or significant influence (associates) exist in relation to investments held by the Group; and
- review of applicable exchange rates for transactions with and translation of entities in territories where there are restrictions on the free access to foreign currency or multiple exchange rates.

Accounting developments

Other than as stated below, there were no further material changes to the accounting standards applied in 2019 from those applied in 2018.

IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* became effective from 1 January 2018, and the impact of these changes is also disclosed in note 1 in the Notes on the Accounts.

IFRS 16 *Leases* was published in January 2016 with a mandatory effective date of 1 January 2019. The effect is that virtually all leasing arrangements are brought on to the balance sheet as financial obligations and 'right-of-use' assets. The impact of applying the Standard to the Group's reported profit in 2019, 2018 or 2017 would not have been material.

Foreign exchange rates

The principal exchange rates used to convert the results of the Group's foreign operations to sterling, for the purposes of inclusion and consolidation within the Group's financial statements, are indicated in the table below.

Where the Group has provided results at constant rates of exchange this refers to the translation of the results from the foreign operations at rates of exchange prevailing in the prior period – thereby eliminating the potentially distorting impact of the movement in foreign exchange on the reported 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 and Form 20-F.

The key Group risks include analyses of financial risk and the Group's approach to financial risk management. Notes 19 and 22 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 ability to generate cash from trading activities, the performance of the Group's Strategic Portfolio, 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 for the next three years, the Directors consider that the Group has adequate resources to continue operating and that it is therefore appropriate to continue to adopt the going concern basis in preparing the Annual Report and Form 20-F.

REGIONAL REVIEW

Operational growth demonstrates inherent business model strength in all regions – offset by short-term headwinds

UNITED STATES



Volume

	2019 units	vs 2018 %	2018 units	vs 2017 %	2017 units
Cigarettes (bn sticks)	73	-6.0%	77	-5.3%	82
Other (bn sticks eq)*	–	–	–	–	–
Combustibles (bn sticks)	73	-6.0%	77	-5.3%	82
New Categories:					
Vapour (10ml/pods)	103	-6.2%	109	+36.0%	80
THP (bn sticks)	–	–	–	–	–
Modern Oral (mn pouches)	112	–	–	–	–
Traditional Oral (bn sticks eq)	8	-1.5%	8	-2.3%	8

* Other combustibles includes MYO/RYO

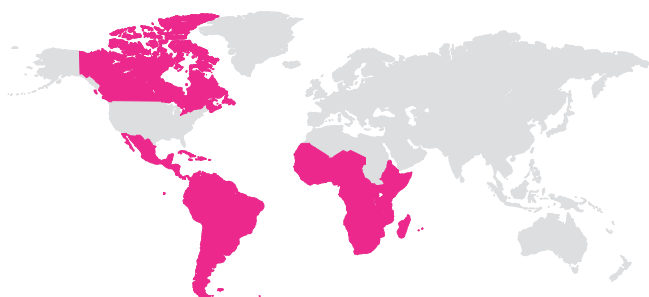
Revenue

	2019 £m	vs 2018 %	vs 2018 (adj at cc) %	2018 £m	vs 2017 %	vs 2017 (adj repres at cc) %
Combustibles	9,078	+8.6%	+3.8%	8,358	+128%	+0.8%
New Categories:						
Vapour	207	+12.4%	+7.4%	184	+149%	+20%
THP	1	-7.7%	-11.7%	1	–	–
Modern Oral	9	n/m	n/m	–	–	–
Total New Categories	217	+17.1%	+11.9%	185	+149%	+20%
Traditional Oral	1,052	+14.5%	+9.5%	919	+129%	+7.1%
Other	26	-21.2%	-27.1%	34	+88%	-28%
Revenue	10,373	+9.2%	+4.4%	9,495	+128%	+1.5%

Profit from operations/Operating margin

	2019 £m	vs 2018 %	vs 2018 (adj at cc) %	2018 £m	vs 2017 %	vs 2017 (adj repres at cc) %
Profit from operations	4,410	+10.1%	+6.4%	4,006	+244%	+5.8%
Operating margin (%)	42.5%	+30 bps		42.2%	+1,420 bps	

AMERICAS AND SUB-SAHARAN AFRICA



Volume

	2019 units	vs 2018 %	2018 units	vs 2017 %	2017 units
Cigarettes (bn sticks)	152	-3.1%	157	-5.4%	166
Other (bn sticks eq)*	2	-8.2%	2	-17.4%	3
Combustibles (bn sticks)	154	-3.1%	159	-5.6%	169
New Categories:					
Vapour (10ml/pods)	14	+191%	5	n/m	–
THP (bn sticks)	–	n/m	–	n/m	–
Modern Oral (mn pouches)	8	n/m	–	n/m	–
Traditional Oral (bn sticks eq)	–	n/m	–	n/m	–

* Other combustibles includes MYO/RYO

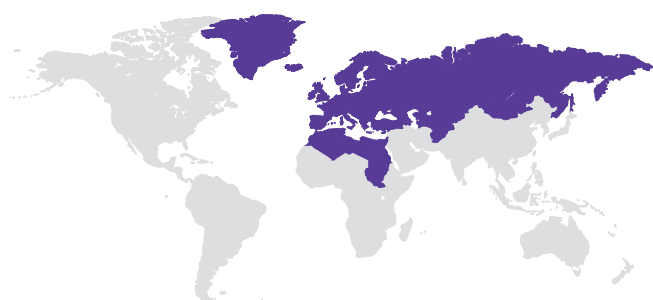
Revenue

	2019 £m	vs 2018 %	vs 2018 (adj at cc) %	2018 £m	vs 2017 %	vs 2017 (adj repres at cc) %
Combustibles	3,992	+2.7%	+8.5%	3,886	-4.9%	+5.3%
New Categories:						
Vapour	43	+120%	+117%	20	n/m	n/m
THP	–	n/m	n/m	–	n/m	n/m
Modern Oral	1	n/m	n/m	–	n/m	n/m
Total New Categories	44	+119%	+116%	20	n/m	n/m
Traditional Oral	–	n/m	n/m	–	n/m	n/m
Other	225	+10.2%	+13.1%	205	-14%	+1.0%
Revenue	4,261	+3.6%	+9.2%	4,111	-4.9%	+5.6%

Profit from operations/Operating margin

	2019 £m	vs 2018 %	vs 2018 (adj at cc) %	2018 £m	vs 2017 %	vs 2017 (adj repres at cc) %
Profit from operations	1,204	-22.0%	+10.0%	1,544	-6.3%	+6.5%
Operating margin (%)	28.3%	-930 bps		37.6%	-60 bps	

EUROPE AND NORTH AFRICA



Volume

	2019 units	vs 2018 %	2018 units	vs 2017 %	2017 units
Cigarettes (bn sticks)	230	-6.3%	246	-5.3%	260
Other (bn sticks eq)*	17	-7.9%	18	-8.2%	19
Combustibles (bn sticks)	247	-6.4%	264	-5.6%	279
New Categories:					
Vapour (10ml/pods)	108	+44%	75	+26.3%	59
THP (bn sticks)	1.1	+334%	–	n/m	–
Modern Oral (mn pouches)	1,071	+157%	414	+108%	199
Traditional Oral (bn sticks eq)	1	+8.3%	1	+23.3%	1

* Other combustibles includes MYO/RYO

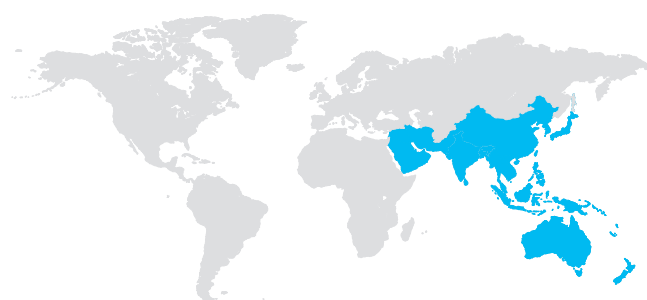
Revenue

	2019 £m	vs 2018 %	vs 2018 (adj at cc) %	2018 £m	vs 2017 %	vs 2017 (adj repres at cc) %
Combustibles	5,544	-0.7%	+3.0%	5,585	-3.1%	+3.3%
New Categories:						
Vapour	147	+29.2%	+30.1%	114	+22%	+15%
THP	56	+200%	+200%	19	n/m	n/m
Modern Oral	116	+234%	+246%	34	+139%	+146%
Total New Categories	319	+91.0%	+93.6%	167	+55%	+48%
Traditional Oral	29	+33.4%	+38.5%	22	+51%	+58%
Other	198	-14.2%	-14.3%	230	+4.3%	-14.1%
Revenue	6,090	+1.4%	+5.0%	6,004	-1.7%	+3.5%

Profit from operations/Operating margin

	2019 £m	vs 2018 %	vs 2018 (adj at cc) %	2018 £m	vs 2017 %	vs 2017 (adj repres at cc) %
Profit from operations	1,649	-13.4%	+3.3%	1,905	+12.3%	+0.8%
Operating margin (%)	27.1%	-460 bps		31.7%	+390 bps	

ASIA-PACIFIC AND MIDDLE EAST



Volume

	2019 units	vs 2018 %	2018 units	vs 2017 %	2017 units
Cigarettes (bn sticks)	213	-3.7%	221	-1.3%	224
Other (bn sticks eq)*	2	+1.5%	2	+10.4%	2
Combustibles (bn sticks)	215	-3.7%	223	-1.2%	226
New Categories:					
Vapour (10ml/pods)	1	n/m	–	n/m	–
THP (bn sticks)	8	+20.1%	7	+208%	2
Modern Oral (mn pouches)	3	n/m	–	n/m	–
Traditional Oral (bn sticks eq)	–	n/m	–	n/m	–

* Other combustibles includes MYO/RYO

Revenue

	2019 £m	vs 2018 %	vs 2018 (adj at cc) %	2018 £m	vs 2017 %	vs 2017 (adj repres at cc) %
Combustibles	4,387	+3.4%	+4.4%	4,243	-8.9%	-1.2%
New Categories:						
Vapour	4	+906%	+902%	–	n/m	n/m
THP	671	+23.2%	+16.8%	545	+170%	+175%
Modern Oral	–	–	–	–	n/m	n/m
Total New Categories	675	+23.9%	+17.5%	545	+170%	+175%
Traditional Oral	–	–	–	–	–	–
Other	91	-3.5%	-6.9%	94	-20%	-14%
Revenue	5,153	+5.6%	+5.6%	4,882	-1.8%	+5.7%

Profit from operations/Operating margin

	2019 £m	vs 2018 %	vs 2018 (adj at cc) %	2018 £m	vs 2017 %	vs 2017 (adj repres at cc) %
Profit from operations	1,753	-5.7%	+7.9%	1,858	-2.3%	+1.2%
Operating margin (%)	34.0%	-410 bps		38.1%	-20 bps	

REGIONAL REVIEW CONTINUED

UNITED STATES



COMBUSTIBLES PRICING DRIVES STRONG REVENUE GROWTH

Ricardo Oberlander
President and CEO (RAI)



Volume and share

The cigarette industry volume was estimated to be 5.3% lower than 2018, with 2018 down 4.5% on 2017. In 2019, this was largely due to the growth of vapour and the timing and frequency of pricing in the year. In 2018, the decline was largely driven by the impact of higher fuel prices on disposable income, the growth of the vapour category and the full year effect of the change in excise in 2017 in California.

Total cigarette value share increased 30 bps (2018: up 25 bps) with volume share from the strategic cigarette portfolio up 20 bps (2018: up 10 bps) driven by Newport and Natural American Spirit (which combined to drive premium volume share up 50 bps; 2018: up 30 bps). This was partly offset by Pall Mall. Total cigarette volume share was down 10 bps as the strategic cigarette portfolio performance was more than offset by declines across the remainder of the portfolio.

In 2019, cigarette volume from the US business was 73 billion sticks, a decline of 6.0% on 2018, largely driven by the market contraction. In 2018, cigarette volume was 77 billion sticks, an increase of 118% due to the recognition of a full year's volume from RAI. On a representative basis, this was 5.3% lower than in 2017.

In vapour, the Vuse portfolio performed well as the category faced a number of challenges in the US. Alto vapour value share increased to 15.4% in December 2019. This drove an increase in the total Vuse value share to 21.2% in December 2019 (December 2018: 12.5%), despite a 6.2% decline in consumable volume, which had grown 36% in 2018 (due to the impact of a product recall on the Vibe variant due to an isolated issue with batteries in 2018).

Value share of Traditional Moist Oral increased 80 bps, largely due to the performance of Grizzly, with total volume share of moist up 10 bps. Total volume of Traditional Oral declined 1.5% (2018: down 2.3% on a representative basis). 2018 volume was down on a representative basis as 2017 benefited from a competitor's product recall in 2017.

In the Modern Oral category, Velo was rolled out to over 100,000 retail outlets, achieving a category volume share of 10.1% in December 2019.

Revenue

Reported revenue increased 9.2% to £10,373 million (2018: £9,495 million, an increase on 2017 of 128%), with growth across all categories (discussed below) and a favourable currency tailwind due to the relative strength of the US dollar against sterling of approximately 5%. The 2018 movement was largely due to the 12-month inclusion of results from RAI, compared to approximately five months in 2017.

Excluding the impact of currency on the reported results, adjusted revenue on a constant currency basis was up 4.4% on 2018, with 2018 up 1.5% on 2017 on a constant currency, representative basis.

In 2019, revenue from combustibles grew 8.6% as pricing led to an increase in price/mix on cigarettes of 10%. This more than offset a decline in cigarette volume. In 2018, this was a growth of 128%, due to the full year effect of the RAI acquisition. On a constant currency and, in 2018, representative basis, combustibles grew 3.8% in 2019 and 0.8% in 2018.

In 2019, revenue from vapour grew by 12.4% to £207 million, driven by the success of Alto. In 2018, this was an increase of 149% to £184 million. On a constant currency and, in 2018, representative basis, vapour revenue grew 7.4% in 2019 and 20% in 2018.

In 2019, revenue from Traditional Oral grew 14.5% to £1,052 million, or 9.5% on a constant currency basis, as pricing more than offset a decline in volume. In 2018, revenue from Traditional Oral was up 129% on 2017, driven by the full year effect of the RAI acquisition. On a constant currency, representative basis, this was an increase of 7.1%.

In 2019, following the national roll-out of Velo, revenue from Modern Oral reached £9 million. There was no equivalent revenue in 2018 or 2017.

Profit from operations

Reported profit from operations was £4,410 million, an increase of 10.1% on 2018. This was due to the growth in revenue and lower MSA charges in the year which more than offset an increase in marketing investment behind New Categories.

The performance also benefited from efficiencies delivered since the acquisition of RAI, with total annualised savings of over US\$400 million fully realised by the end of 2019, a year ahead of the Group's initial schedule. In 2018, revenue was £4,006 million, an increase of 244% on 2017, largely due to the full year's inclusion in the Group's results.

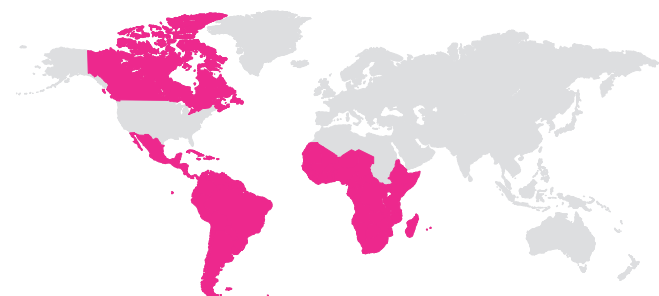
Excluding adjusting items related to litigation (including *Engle*), the impairment of certain acquired brands including VapeWild, Quantum and the impact of currency on the Group's results, adjusted profit from operations grew 6.4% to £4,798 million on a constant currency basis. In 2018, this was an increase, after adjusting for the impact of the acquisition in 2017, of 5.8%. These increases reflect the growth in revenue from the portfolio and cost reductions since the acquisition of RAI.

Regulatory environment

The Group continues to welcome reasonable regulation that supports the use of our products by adults. In December 2019, an amendment to the Federal Food, Drug, and Cosmetic Act (as enforced by the FDA) was signed into law that increased the federal minimum legal age to purchase tobacco products from 18 to 21. It is our understanding that approximately 40% of industry cigarette volume is sold in states where the legal age to acquire tobacco was already over 21 prior to the beginning of 2019.

On 2 January 2020, the US FDA announced that all flavoured cartridges/pods (excluding menthol and tobacco flavours) must be withdrawn until they have cleared through the Premarket Tobacco Application (PMTA) process. A Group subsidiary in the US has submitted a PMTA covering 15 products. On 2 November, a letter from the US FDA was received, accepting the Vuse SOLO PMTAs for substantive scientific review. The Group believes it is well positioned to submit applications for the remaining Vuse portfolio and a range of flavours by 12 May 2020. It is expected that, as required by the PMTA process to remain on the market, these will be shown to be appropriate for the protection of public health. There is no intention to submit a PMTA for the VapeWild products.

AMERICAS AND SUB-SAHARAN AFRICA



STRATEGIC CIGARETTE BRANDS PERFORM VERY WELL

Luciano Comin
Regional Director

Key markets: Argentina, Brazil, Canada, Chile, Colombia, Mexico, Nigeria, South Africa



Volume and share

In 2019, cigarette value share was up 20 bps, driven by growth in the strategic cigarette brands volume share of 465 bps largely driven by the migrations in Brazil and Colombia. Excluding migrations, the increase was 50 bps. Total cigarette volume share was down 10 bps, as growth in Colombia (driven by Lucky Strike and Rothmans), Mexico (driven by Pall Mall) and Canada (driven by Pall Mall) was more than offset by Brazil and South Africa, where growth in Rothmans and Pall Mall, respectively, was outweighed by lower volume share in the remainder of the portfolio.

In 2018, the cigarette volume share decline was 20 bps despite growth in Kent (migration from Free) in Brazil, Dunhill in South Africa, Rothmans in Colombia, Argentina and Brazil (following the migration from Mustang and Minister, respectively, to strengthen the consumer proposition), and from Pall Mall in Mexico, which were more than offset by declines in the local portfolio in South Africa and Brazil (largely due to the growth in illicit trade during 2018).

In 2019, cigarette volume was 3.1% lower at 152 billion sticks as higher volume in South Africa (due to lower illicit trade) was more than offset by the continued difficult macroeconomic environment in Venezuela, continued growth in illicit trade (albeit at a reduced rate) in Brazil and the impact of market contraction in Canada.

The annual decline rate moderated versus 2018 (5.4% decline on 2017 to 157 billion sticks) as 2018 was largely driven by the growth of illicit trade in Brazil and South Africa in that year, the termination of a third-party licence agreement in Mexico and market contraction in Canada, Colombia and Venezuela. South African volumes stabilised in the second half of 2018 after a period of decline.

In vapour, following a period of value share decline in Canada as the competition reacted to the legalisation of the category, Vype returned to growth and was the fastest growing vapour brand in the second half of the year, with value share in December 2019 of 28.2% (34.7% in December 2018).

Twisp, a South African vaping products company, was acquired by the Group in 2019. Twisp has close to 70 dedicated stores nationally, nationwide retailer distribution and a modern e-commerce platform. Modern oral was launched in Kenya, in Nairobi and other key cities, with full national expansion planned in early 2020.

Revenue

In 2019, revenue grew 3.6% to £4,261 million, led by pricing in combustibles across the region (notably in Canada, Kenya, Chile, Mexico and Nigeria) and the growth of revenue from New Categories, particularly from vapour which was up 120% to £43 million (2018: £20 million) driven by Canada and Mexico. These more than offset the lower total cigarette volume and the translational foreign exchange headwind of 6%. On a constant currency basis, revenue grew by 9.2% to £4,491 million.

In 2018, revenue declined 4.9% to £4,111 million, due to the translational foreign exchange headwind of approximately 10%. On a constant currency, representative basis, adjusted revenue grew by 5.6% to £4,560 million, as pricing across the region (notably in Mexico, Brazil, Chile and Nigeria) more than offset the lower total volume and the negative impact of mix due to the growth of lower-priced products following the significant excise-led price increases in a number of markets.

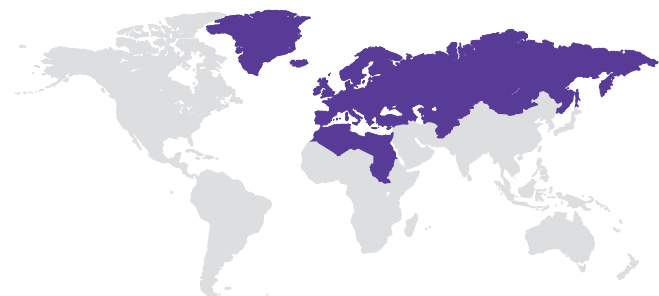
Profit from Operations

In 2019, reported profit from operations was down 22% to £1,204 million, mainly due to the £436 million charge in relation to Quebec (as described on page 165), charges related to Quantum and the translational foreign exchange headwinds. Excluding these effects, adjusted profit from operations on a constant currency basis grew 10.0% to £1,912 million, driven by increases in Brazil, Canada, Chile, Nigeria and Mexico, despite the investment in New Categories, specifically related to ePod.

In 2018, profit from operations was down 6.3% to £1,544 million, as the effect of currency headwinds more than offset growth across the region. Excluding adjusting items (mainly related to a £110 million asset impairment to recoverable value in Venezuela arising from hyperinflationary accounting and costs related to the Group's ongoing restructuring programme) and the effect of currency, adjusted profit from operations on a representative, constant currency basis grew by 6.5% to £1,922 million, driven by Nigeria, Mexico and Chile, partly offset by the effect of the lower duty paid market and down-trading in South Africa.

REGIONAL REVIEW CONTINUED

EUROPE AND NORTH AFRICA



MODERN ORAL AND VAPOUR PERFORMANCE DRIVES GROWTH

Johan Vandermeulen
Regional Director

Key markets: Algeria, Belgium, Bulgaria, Egypt, Czech Republic, Denmark, France, Germany, Italy, Kazakhstan, Morocco, Netherlands, Poland, Romania, Russia, Spain, Sweden, Switzerland, Turkey, Ukraine, UK



Volume and share

In 2019, cigarette value share was marginally higher with strategic cigarette volume share up 50 bps. Total cigarette volume share was up 10 bps as growth in Rothmans (which outperformed the market in Ukraine and Russia), Kent (in Ukraine) and higher total cigarette volume share in Italy, Poland, Romania and Spain was partially offset by a reduction in Kazakhstan and the UK. This compares to 2018 when volume share was flat against 2017 as increases in Kent (led by Ukraine, Turkey, Kazakhstan and regaining premium segment leadership in Russia), and Rothmans (Ukraine, Russia, Poland, Spain, Bulgaria and Italy) were offset by both the continued reduction in Pall Mall (Poland, Germany and Belgium) and a decline in the low-price portfolio in Russia.

In 2019, cigarette volume declined 6.3% to 230 billion sticks as growth in Poland, Romania, Denmark and Spain was more than offset by lower volume in Russia (partly due to a one-off reduction in stock), Ukraine (largely due to the growth of illicit trade and competition in the low-price segment) and Egypt (driven by excise-led price increases in the low-price segment particularly affecting Pall Mall).

In 2018, volume declined 4.7% to 246 billion sticks, which was a reduction of 5.3% on a representative basis, as volume from assets acquired (from Bulgartabac and FDS) in 2017 combined with growth in Turkey, Egypt, Poland and Romania was more than offset by Russia (partly due to inventory movements and the growth of illicit trade), Ukraine (due to market contraction following the excise-led price increase, leading to an increase in illicit trade), Italy (partly due to impact of higher prices) and France (following the excise-led price increase).

In 2019, THP volume was up over 330%, with growth in Russia, Ukraine and Kazakhstan while also developing in the other launch markets of Romania, Italy, Czech Republic, Bulgaria and Poland.

Vapour volume was 44% higher in 2019 than in 2018. Vapour in both years was driven by the success of Vype (particularly ePen3) in the UK (where the Group's portfolio of products maintained value leadership in 2019 with 38% vapour value share in December 2019), France (where ePen3 and ePod combined reached 20% vapour value share in December 2019) and in Germany (where Vype reached 17% share of total vapour consumers).

The Group's Modern Oral portfolio increased volume by 157% to 1.1 billion pouches in 2019 (2018: 0.4 billion pouches, an increase of 44% on 2017), largely due to higher volume in Denmark and Norway, reaching 75% and 14% volume share of the total oral category, respectively. In Russia, Lyft achieved 27% volume share of the total oral category (in tracked channels) in December 2019.

In December 2019 following concerns in Russia regarding the irresponsible marketing by our competitors, all sales of modern oral have been temporarily suspended in Russia. There is no indication of a concern regarding the Group's products or practices and we expect a regulatory framework will be implemented in 2020.

In Sweden, the Group's total oral portfolio performed well, increasing total volume share of the oral category to 13.2%. This was driven by the Traditional Oral brands, up 50 bps to 10.9%, principally due to the success of Lundgrens, and the Modern Oral products (Lyft) which increased to 2.3% volume share of the total oral category following the launch in 2018.

Revenue

In 2019, reported revenue increased 1.4% to £6,090 million (2018: decline of 1.7% to £6,004 million) as strong combustibles pricing in 2019 across the region (notably in Germany, Turkey and Ukraine) and an increase in revenue from New Categories by 91% (to £319 million) were partly offset by the end of a contract manufacturing arrangement (which led to a short-term increase in revenue due to the recognition by the Group of excise within revenue in prior periods), lower regional volume and translational foreign exchange headwinds of 1.3% (2018: translational foreign exchange headwind of 5%).

Adjusted revenue, at constant rates, increased 5.0% to £6,118 million in 2019 (2018: up 3.5% on a representative basis). This was driven by pricing across the combustible portfolio as noted earlier, as well as the 94% growth in revenue from New Categories to £324 million (2018: £167 million) driven by:

- vapour revenue increasing 30% to £148 million (2018: £114 million) due to the performance of Vype in the UK, France and Germany;
- THP revenue growing 200% driven by Russia, Ukraine and Kazakhstan; and
- modern oral revenue increasing 246% to £120 million (2018: £34 million) following the increase in volume in Norway and Denmark, and the launch in Russia.

Profit from operations

In 2019, reported profit from operations fell 13.4% to £1,649 million, as the Group increased investment behind New Categories, recognised a charge of £202 million in respect of the Russian excise dispute as discussed on page 143, recognised additional impairment charges of £29 million related to the Group's brand consolidation programme to simplify the New Categories portfolio and incurred charges in relation to Quantum. Profit from operations was up in Germany, Turkey, Romania, Denmark and Poland, which more than offset declines in Russia and the UK. Excluding adjusting items (referred to above) and the impact of the foreign currency headwind, adjusted profit from operations at constant rates was up 3.3% at £2,220 million.

In 2018, profit from operations grew 12.3% to £1,905 million. This was due to an improvement in the operating performance in Germany, Romania and Ukraine and a one-off charge of £69 million in 2017 in relation to a third party in Croatia that does not repeat in 2018. Excluding adjusting items (related to the factory closure in Germany, amortisation of acquired brands, other costs related to the Group's ongoing restructuring programme and the 2017 impairment in Croatia) and the impact of the foreign currency headwind, adjusted profit from operations at constant rates, on a representative basis was up 0.8%, at £2,217 million.

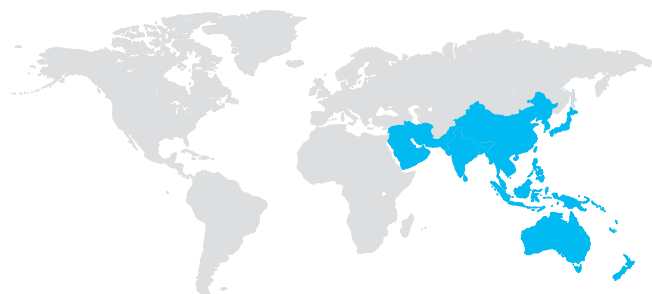
ASIA-PACIFIC AND MIDDLE EAST



COMBUSTIBLES AND THP COMBINE TO ACCELERATE GROWTH

Guy Meldrum
Regional Director

Key markets: Australia, Bangladesh, Indonesia, Japan, Malaysia, Middle East (incl KSA), New Zealand, Pakistan, South Korea, Taiwan, Vietnam



Volume and share

In 2019, cigarette and THP value share increased 30 bps, driven by the strategic cigarette and THP portfolio, which increased volume share by 20 bps. Total cigarette and THP volume share was up 50 bps (2018: up 90 bps), led by Japan (driven by Kool, Lucky Strike and glo), Vietnam (driven by Craven A) and Pakistan (driven by Pall Mall). This more than offset lower Lucky Strike volume share in Indonesia and Dunhill volume share in Malaysia and South Korea.

The movement in 2018 was driven by Japan, an increase in Dunhill and Lucky Strike in Indonesia, growth of Pall Mall in Pakistan, Australia and particularly in Saudi Arabia and Rothmans in Malaysia. Total market share increased in Bangladesh. This combined growth was partially offset by lower volume share in South Korea, due to a reduction in Dunhill and a reduction in Taiwan driven by Dunhill and Pall Mall.

In 2019, cigarette volume declined 3.7% as growth in Japan (due to the success of Lucky Strike and Kool), Vietnam (driven by the growth of Craven A) and the Middle East (driven by Kent) was more than offset by the impact of industry contraction (following excise-led price increases) in Bangladesh and Pakistan, and macroeconomic pressures impacting consumer disposable income in Indonesia.

In 2018, cigarette volume was down 1.3% at 221 billion sticks as the recovery in the combustibles volume in Pakistan (following the revision to the excise structure that negatively impacted the equivalent period in 2017) was more than offset by lower volume in the Middle East, largely due to the impact of a 2017 excise-led price increase in Saudi Arabia and the difficult trading environment in a number of countries in the Middle East. Volume was lower in Bangladesh due to higher illicit trade following an increase in excise, with Indonesia lower due to market contraction. Volume decreases slowed in Malaysia in 2018 after a period of accelerated decline following the excise changes in prior years.

THP volume increased 20% to 7.9 billion sticks (2018: 6.5 billion) driven by the continued growth of glo neo in Japan following the launch of glo 'pro', glo 'nano' and glo 'sens', with volume share increasing 60 bps to 5.0% in December 2019. 'glo pro' introduced a new induction heating technology, improving consumer satisfaction and their sensorial experience. With regards to 'glo sens', after an encouraging launch, the Group will be reviewing the in-market execution and seeking to broaden device penetration and drive increased consumer uptake in 2020. The Group's share of nicotine in Japan increased from 17% (December 2018) to 19% (December 2019).

Revenue

In 2019, reported revenue grew 5.6% to £5,153 million. This was partly driven by pricing in a number of markets, including Saudi Arabia, Japan, Australia, Pakistan and New Zealand. New Categories revenue grew by 23.9% driven by the higher THP volume, notably in Japan, which, combined with combustibles pricing, more than offset the impact of lower cigarette volume. On a constant currency basis, revenue grew 5.6%.

In 2018, revenue declined 1.8% to £4,882 million, as pricing, higher THP volume (discussed earlier) and the positive mix effect, was offset by the impact of lower cigarette volume, down-trading in Saudi Arabia and by the foreign exchange headwinds related to the relative strength of sterling. Excluding the translational foreign exchange headwind and at constant currency rates, adjusted revenue on a representative basis grew 5.7%.

Profit from operations

In 2019, profit from operations decreased 5.7% to £1,753 million. Growth in Japan (driven by an increase in combustibles revenue and higher THP volume which more than offset an increase in marketing related to the launch of the new THP products) and Middle East (driven by pricing and volume) was more than offset by lower volume in Bangladesh and Malaysia, and the impact of the impairment to Indonesian goodwill (£172 million) following the substantial change in excise which is applicable from 2020 and is anticipated to affect the total market. Excluding adjusting items, which primarily relate to Indonesia goodwill, Quantum, the ongoing factory rationalisation programme (principally in South East Asia) and the impact of foreign exchange on the regional results, adjusted profit from operations grew 7.9% to £2,102 million, at constant rates of exchange.

In 2018, profit from operations declined 2.3% to £1,858 million, as the performance was negatively affected by foreign exchange headwinds and adjusting items related to the ongoing costs of the Group's restructuring programme. Adjusted profit from operations on a representative constant currency basis grew 1.2% to £2,099 million driven by an improvement in Japan, where the performance of both combustibles and THP more than offset the higher marketing investment, and increases in Australia, Pakistan and Bangladesh. These were partly offset by Saudi Arabia which was negatively impacted by down-trading, described above, and South Korea.



PRINCIPAL GROUP RISKS

Overview

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

Each risk is considered in the context of the Group's strategy and business model, as set out in this Strategic Report on pages 8 to 9, and 22 to 23. Following a description of each risk, its potential impact and management by the Group is summarised. Clear accountability is attached to each risk through the risk owner.

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

The risks listed in this section and the activities being undertaken to manage them should be considered in the context of the Group's internal control framework. This is described in the section on risk management and internal control in the corporate governance statement on pages 87 to 88. This section should also be read in the context of the cautionary statement on page 298.

A summary of all the risk factors (including the principal risks) which are monitored by the Board through the Group's risk register is set out in the Additional disclosures section on pages 272 to 286.

Assessment of Group risk[@]

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

The principal risks facing the Group have remained broadly unaltered over the past year with regards to marketplace, excise and tax, operations, regulation and litigation risks.

The viability statement below provides a broader assessment of long-term solvency and liquidity. The Directors have considered a number of factors that may affect the resilience of the Group. Except for the risk 'injury, illness or death in the work place' the Directors have also assessed the potential impact of the principal risks that may impact the Group's viability.

Time frame

Short term

Medium term

Long term

Strategic impact

Growth

Productivity

Winning organisation

Sustainability

Considered in viability statement[@]

Yes

No



[@] Denotes phrase, paragraph or similar that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.

Viability statement[@]

The Board has assessed the viability of the Group taking into account the current position and principal risks, in accordance with provision 31 of the 2018 UK Corporate Governance Code. While the Board believes the Group will be viable over a longer period, owing to the inherent uncertainty arising due to ongoing litigation and regulation, the period over which the Board has formed the reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due is three years.

In making its assessment of the Group's prospects, the Board has considered the Group's continued strong cash generation from operating activities. This assessment included a robust review of the principal risks that may impact the Group's viability (as indicated on pages 59 to 62) which are considered, with the mitigating actions, at least once a year. The Board also took account of the Group's operational and financial processes, which cover both short-term (1-2 year financial forecasts, 2-3 year capacity plans) and longer-term strategic planning. The assessment included reverse stress testing core drivers that underpin the specific risks to ensure the business is able to continue in operation, while not breaching the required gross interest cover of 4.5 times (see page 48). Each impact would, individually, have to be between 5 times and 10 times worse than a prudent annual forecast, or would all have to arise simultaneously with no mitigating or corrective actions to affect the Group's ability to meet the liabilities as they fall due.

Due to the level of borrowings carried on the balance sheet, the Group may be exposed to movements in interest rates. The Board noted that, as stated in note 22 in the Notes on the Accounts, the Group sets a minimum of 50% of interest rate as fixed on short- to medium-term borrowings, minimising the risk of interest rate fluctuation impacting viability over the period. At 31 December 2019, the ratio of floating to fixed rate borrowings was 18:82 (2018: 21:79).

The Board noted that the Group would be able to adjust certain capital requirements, including but not limited to the investment in the Group's manufacturing infrastructure in the short term and access the £6 billion credit facility (2019 undrawn), to mitigate the impact of the effect of the above principal risks, each of which have specific mitigation activities as disclosed on pages 59 to 62.

The Group is subject to inherent uncertainties with regards to regulatory change and litigation, the outcome of which may have a bearing on the Group's viability. The Group maintains, as referred to in note 27 in the Notes on the Accounts 'Contingent Liabilities and Financial Commitments', that, while it is impossible to be certain of the outcome of any particular case, the defences of the Group's companies to all the various claims are meritorious on both law and the facts. If an adverse judgment is entered against any of the Group's companies in any case, an appeal may be made, the duration of which can be reasonably expected to last for a number of years.

Risks

Competition from illicit trade

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

Time frame	Strategic impact	Considered in viability statement [@]
 Long term	 Growth	 Yes
Impact Erosion of brand equity, with lower volumes and reduced profits. Reduced ability to take price increases. Investment in trade marketing and distribution is undermined.		
Mitigation activities[@] Dedicated Anti-Illicit Trade (AIT) teams operating at global and country levels; internal cross-functional levels; compliance procedures and best practice shared. Active engagement with key external stakeholders. Cross-industry and multi-sector cooperation on a range of AIT issues. Global AIT strategy supported by a research programme to further the understanding of the size and scope of the problem. AIT Engagement Teams (including a dedicated analytical laboratory) works with enforcement agencies in pursuit of priority targets.		

Tobacco, New Categories and other regulation interrupts growth strategy

The enactment of regulation that significantly impairs the Group's ability to communicate, differentiate, market or launch its products.

Time frame	Strategic impact	Considered in viability statement [@]
 Medium term	 Growth and Sustainability	 Yes
Impact Erosion of brand value through commoditisation, the inability to launch innovations, differentiate products, maintain or build brand equity and leverage price. Regulation in respect of menthol, nicotine levels and New Categories may adversely impact individual brand portfolios. Adverse impact on ability to compete within the legitimate tobacco, nicotine or New Categories industry and with illicit traders. Reduced consumer acceptability of new product specifications, leading to consumers seeking alternatives in illicit markets. Shocks to share price on the announcement or enactment of restrictive regulation. Reduced ability to compete in future product categories and make new market entries. Increased scope and severity of compliance regimes in new regulation leading to higher costs, greater complexity and potential reputational damage or fines for inadvertent breach. Proposed EU Directive on single-use plastics could result in increased operational costs and/or a decline in sales volume.		
Mitigation activities[@] Engagement and litigation strategy coordinated and aligned across the Group to drive a balanced global policy framework for the nicotine category. Stakeholder mapping and prioritisation, developing robust compelling advocacy materials (with supporting evidence and data) and regulatory engagement programmes. Regulatory risk assessment of marketing plans to ensure decisions are informed by an understanding of the potential regulatory environments. Advocating the application of integrated regulatory proposals to governments and public health practitioners based on the harm reduction principles. Development of an integrated regulatory strategy that spans conventional combustibles and New Categories.		

 Please refer to pages 287 to 290 for details of tobacco and nicotine regulatory regimes under which the Group's businesses operate

Disputed taxes, interest and penalties

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

Time frame	Strategic impact	Considered in viability statement [@]
 Short/Medium term	 Productivity	 Yes
Impact Significant fines and potential legal penalties. Disruption and loss of focus on the business due to diversion of management time. Impact on profit and dividend.		
Mitigation activities[@] End market tax committees. Internal tax function provides dedicated advice and guidance, and external advice sought where needed. Engagement with tax authorities at Group, regional and individual market level.		

 Please refer to note 27 in the Notes on the Accounts for details of contingent liabilities applicable to the Group

[@] Denotes phrase, paragraph or similar that does not form part of BAT's Annual Report on Form 20-F as filed with the SEC.

PRINCIPAL GROUP RISKS

CONTINUED

Risks continued

Inability to develop, commercialise and deliver the New Categories strategy

Risk of not capitalising on the opportunities in developing and commercialising successful, safe and consumer-appealing innovations.

Time frame	Strategic impact	Considered in viability statement [@]
 Long term	 Growth and Sustainability	 Yes
Impact Failure to deliver Group strategic imperative and 2024 growth ambition. Potentially missed opportunities, unrecoverable costs and/or erosion of brand. Reputational damage and recall costs may arise in the event of defective product design or manufacture. Loss of market share due to non-compliance of product portfolio with regulatory requirements.		Mitigation activities[@] Focus on product stewardship to ensure high-quality standards across portfolio. Collaboration between internal legal, external affairs and R&D in order to identify current and future regulations and align the innovation pipeline. Retail transformation strategy embedded. Investment on consumer insights and foresight.

Market size reduction and consumer down-trading

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

Time frame	Strategic impact	Considered in viability statement [@]
 Short/Medium term	 Growth	 Yes
Impact Volume decline and portfolio mix erosion. Funds to invest in growth opportunities are reduced.		Mitigation activities[@] Geographic spread mitigates impact at Group level. Close monitoring of portfolio and pricing strategies, ensuring balanced portfolio of strong brands across key segments. Overlap with many mitigation activities undertaken for other principal risks facing the Group, such as competition from illicit tobacco trade and significant excise increases or structure changes. New Category growth and multi category approach.

Litigation

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

Time frame	Strategic impact	Considered in viability statement [@]
 Long term	 Growth	 Yes
Impact Damages and fines, negative impact on reputation, disruption and loss of focus on the business. Consolidated results of operations, cash flows and financial position could be materially affected, in a particular fiscal quarter or fiscal year, by region or country, by an unfavourable outcome or settlement of pending or future litigation. Inability to sell products as a result of patent infringement action may restrict growth plans and competitiveness.		Mitigation activities[@] Consistent litigation and patent management strategy across the Group. Expertise and legal talent maintained both within the Group and external partners. Ongoing monitoring of key legislative and case law developments related to our business. Delivery with Integrity compliance programme.

 Please refer to note 27 in the Notes on the Accounts for details of contingent liabilities applicable to the Group

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Significant increases or structural changes in tobacco, nicotine and New Categories related taxes

The Group is exposed to unexpected and/or significant increases or structural changes in tobacco, nicotine and New Categories related taxes in key markets.

Time frame	Strategic impact	Considered in viability statement [@]
 Long term	 Growth	 Yes
Impact Consumers reject the Group's legitimate tax-paid products for products from illicit sources or cheaper alternatives. Reduced legal industry volumes. Reduced sales volume and/or portfolio erosion. Partial absorption of excise increases.		Mitigation activities[@] Requirement for Group companies to have in place formal pricing and excise strategies, including contingency plans, with annual risk assessments. Pricing, excise and trade margin committees in markets, with regional and global support. Engagement with local tax, customs authorities, IMF and WHO where appropriate, in particular in relation to the increased risk to excise revenues from higher illicit trade. Portfolio reviews to ensure appropriate balance and coverage across price segments. Monitoring of economic indicators, government revenues and the political situation.

Foreign exchange rate exposures

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

Time frame	Strategic impact	Considered in viability statement [@]
 Short/Medium term	 Productivity	 Yes
Impact Fluctuations in FX rates of key currencies against sterling introduce volatility in reported earnings per share (EPS), cash flow and the balance sheet driven by translation into sterling of our financial results and these exposures are not normally hedged. The dividend may be impacted if the payout ratio is not adjusted. Differences in translation between earnings and net debt may affect key ratios used by credit rating agencies. Volatility and/or increased costs in our business, due to transactional FX, may adversely impact financial performance.		Mitigation activities[@] While translational FX exposure is not hedged, its impact is identified in results presentations and financial disclosures; earnings are re-stated at constant rates for comparability. Debt and interest are matched to assets and cash flows to mitigate volatility where possible and economic to do so. Hedging strategy for transactional FX and framework is defined in the treasury policy, a global policy approved by the Board. Illiquid currencies of many markets where hedging is either not possible or uneconomic are reviewed on a regular basis.

Geopolitical tensions

Geopolitical tensions, civil unrest, economic policy changes, global health crises, terrorism and organised crime have the potential to disrupt the Group's business in multiple markets.

Time frame	Strategic impact	Considered in viability statement [@]
 Medium term	 Growth and Productivity	 Yes
Impact Potential loss of life, loss of assets and disruption to supply chains and normal business processes. Increased costs due to more complex supply chain arrangements and/or the cost of building new facilities or maintaining inefficient facilities. Lower volumes as a result of not being able to trade in a country. Higher taxes or other costs of doing business as a foreign company or the loss of assets as a result of nationalisation.		Mitigation activities[@] Physical and procedural security controls are in place, and constantly reviewed in accordance with our Security Risk Management process, for all field force and supply chain operations, with an emphasis on the protection of Group employees. Globally integrated sourcing strategy and contingency sourcing arrangements. Security risk modelling, including external risk assessments and the monitoring of geopolitical and economic policy developments worldwide. Insurance cover and business continuity planning, including scenario planning and testing, and risk awareness training.

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PRINCIPAL GROUP RISKS

CONTINUED

Risks continued

Solvency and liquidity

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

Time frame	Strategic impact	Considered in viability statement [@]
 Short/Medium term	 Productivity and Sustainability	 Yes
Impact Inability to fund the business under the current capital structure resulting in missed strategic opportunities or inability to respond to threats. Decline in our creditworthiness and increased funding costs for the Group. Requirement to issue equity or seek new sources of capital. Reputational risk of failure to manage the financial risk profile of the business, resulting in an erosion of shareholder value reflected in an underperforming share price.		
Mitigation activities[@] Group policies include a set of financing principles and key performance indicators including the monitoring of credit ratings, interest cover, solvency and liquidity with regular reporting to the Corporate Finance Committee and the Board. The Group targets an average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. The Group holds a two-tranche revolving credit facility of £6 billion syndicated across a wide banking group, consisting of a 364-day tranche (with two one-year extension options and a one-year term-out option) and a £3bn five year tranche (with two one-year extension options). Liquidity pooling structures are in place to ensure that there is maximum mobilisation of cash liquidity within the Group. Going concern and viability support papers are presented to the Board on a regular basis.		

Injury, illness or death in the work place

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

Time frame	Strategic impact	Considered in viability statement [@]
 Short term	 Sustainability	 No
Impact Serious injuries, ill health, disability or loss of life suffered by employees and the people who work with the Group. Exposure to civil and criminal liability and the risk of prosecution from enforcement bodies and the cost of associated fines and/or penalties. Interruption of Group operations if issues are not addressed immediately. High staff turnover or difficulty recruiting employees if perceived to have a poor Environment, Health and Safety (EHS) record. Reputational damage to the Group.		
Mitigation activities[@] Risk control systems in place to ensure equipment and infrastructure are provided and maintained. EHS strategy aims to ensure that employees at all levels receive appropriate EHS training and information. Behavioural-based safety programme to drive operations' safety performance, culture and closer to zero accidents. Analysis of incidents undertaken regionally and globally by a dedicated team to identify increasing incident trends or high potential risks that require coordinated action.		

The Strategic Report was approved by the Board of Directors on 17 March 2020 and signed on its behalf by Paul McCrory, Company Secretary.

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