



BRITISH AMERICAN
TOBACCO

A FOCUS ON INTEGRITY

Why it matters

SUSTAINABILITY FOCUS REPORT 2013:
How we engage on regulation, market our products and fight tobacco trafficking



Our Chief Executive on why acting with integrity matters

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You talk about acting with integrity. Why should we trust you?

It's an indisputable fact that smoking has very serious health risks. Given these risks, it's all the more important for us to uphold high standards of corporate conduct and demonstrate responsibility in the way we make and sell our products.

We trust that our actions will speak for themselves: engaging openly on regulatory issues, marketing our products responsibly and working with global partners to fight the illegal tobacco trade. And we're committed to leading the way in our industry – by working to reduce the risks of our products and being consistently transparent in what we do. That's what acting with integrity means to me.

But can you really be responsible when you need to make a profit?

Yes, I believe we can. Like any business we want to grow and create value for our shareholders.

That is not about 'selling smoking' but it is about growing our market share by encouraging existing adult smokers to choose our products instead of competitor brands.

And fighting the black market in tobacco addresses a threat to our business, while also helping to fight organised crime and preventing smokers from getting access to unregulated tobacco products.

In short, it makes good business sense for us to act responsibly.

You say that you act responsibly, but don't you fight all new tobacco regulation on principle?

No. Smoking poses serious risks to health so tobacco products should be regulated. It's actually in our interest to have effective regulation of the tobacco market. Not all our competitors follow the same high standards as us, so where local laws are not as strict as our International Marketing Principles, we lobby to have similar standards put into legislation – it creates a more level playing field and helps ensure that all tobacco products are marketed responsibly.

We support sound regulation that is consultative, evidence based, delivers its policy aims and recognises unintended consequences. Given that people choose to continue to smoke and are likely to do so in the future, we think it's far better to have a regulated, legal industry that takes its responsibilities seriously, than an unregulated and criminal black market.

Nicandro Durante

Nicandro Durante, Chief Executive, December 2013

A balanced approach

The global picture

Today, most countries have some form of tobacco control regulation. Since the World Health Organisation's (WHO) Framework Convention on Tobacco Control (FCTC) came into force in 2005, the pace of regulation has increased. Yet over a billion adults still smoke today and the WHO estimates¹ that many more will do so in the future.

Black market sales of tobacco products are rapidly increasing, with some 12% of global tobacco sales² estimated to be illegal and, in some countries, as much as 40%. It is not a victimless crime. Interpol³, the international police organisation, says gangs that traffic drugs, arms and people are also behind the illicit cigarette and alcohol trade. The International Tax and Investment Centre⁴ says some also have ties to terrorist organisations.

A legitimate business operating to high standards

Given the serious health risks associated with using tobacco products, it is essential that companies such as ours who make, distribute and market tobacco products operate to very high standards.

We are proud of the high standards we apply to the way we do business and we aim always to be open and honest about our views and activities. For example, we have voluntary International Marketing Principles that provide a consistent and responsible approach to marketing tobacco products across the Group, often going above and beyond local laws. Around the world, our companies work constructively with governments and retailers to address underage smoking.

For many years, we have been in the front line in the battle against the black market trade in tobacco products – from working with law enforcers, customs officials and international organisations, to working with others to develop industry-wide systems to make our packs easier to trace and harder to counterfeit.

Our Group at a glance

- ▶ **£30+ billion**
paid each year to governments in excise and other taxes – more than seven times the Group's net profit
- ▶ **Top 10**
company in the FTSE 100
- ▶ **180+ markets**
where we operate
- ▶ **55,000+**
employees worldwide
- ▶ **100,000+**
tobacco farmers directly contracted

1 Foreword by the Director-General of the World Health Organisation to *The Tobacco Atlas*, Fourth Ed. Eriksen M, Mackay J, Ross H. American Cancer Society, 2012.
2 Industry estimate given by the Digital Coding and Tracking Association.
3 *Trafficking in illicit goods and counterfeiting*, Interpol, www.interpol.int
4 *The Illicit Trade in Tobacco Products and How to Tackle It*, International Tax and Investment Centre, Second Ed.

Contributing over 100 years' expertise

Having operated as a leading global tobacco business for over 100 years, our experience and expertise can make a valuable contribution to developing regulatory solutions. And because we understand what works and have a genuine interest in seeing evidence-based and enforceable tobacco regulation introduced, we are in a position to offer constructive views, information and practical solutions.

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A clear view on engagement

Some people have concerns that the views we publish externally and those we advocate to regulators 'behind closed doors' are not the same. I can assure you this is not the case. I think it goes without saying that views advocated in policy formation – whether from businesses, NGOs or any other parties – should be able to be communicated transparently.

We follow high standards and processes to help ensure our behaviour is exemplary, including having our regional audit and CSR committees monitor regulatory engagement activities across the Group, and our Standards of Business Conduct set out clear policy and compliance procedures on political donations.

We always work to be consistently open about our views on regulation, including the areas we support, such as those that help to eliminate the black market in tobacco or address youth smoking. For the regulatory proposals that we don't agree with, we make our positions clear and offer practical alternatives that we believe will help deliver public health objectives and not lead to unintended consequences.

To me, this approach demonstrates our commitment to transparency and I hope it helps to reassure stakeholders about any concerns they may have.



Kingsley Wheaton
Group Corporate and Regulatory Affairs Director

HEALTH WARNINGS ON PACKS

THE REGULATION

The FCTC requires that governments put in place regulation requiring tobacco products to carry health warnings.

OUR RESPONSE

We support the inclusion of appropriate health warnings on packs and other primary packaging that don't undermine our ability to use our brands. Our International Marketing Principles require all our advertising and packaging to carry clearly visible and legible health warnings, even in those markets where there is no legal requirement to do so.

CONTENTS AND EMISSIONS OF TOBACCO PRODUCTS

THE REGULATION

The FCTC requires the testing, measuring, regulation and reporting to governments of contents and emissions along with requirements to publicly disclose constituents and emissions.

OUR RESPONSE

We agree with the testing, measuring and publishing of emissions using internationally validated methods and with their regulation based on scientific evidence and a sound public health rationale.

BLACK MARKET IN TOBACCO PRODUCTS

THE REGULATION

The WHO Protocol to Eliminate Illicit Trade in Tobacco Products, adopted at the fifth Conference of Parties to the FCTC in November 2012.

OUR RESPONSE

We publicly support the WHO Protocol and have done since it was first proposed in 2007. We work closely with others to tackle the black market and our track and trace technology helps governments to meet the requirements of the Protocol.



Regulation we support

THE REGULATION

The FCTC's development of recommendations for governments to promote, as appropriate, economically sustainable alternatives to tobacco growing.

OUR RESPONSE

We support governments looking at the impacts tobacco growing may have on the environment or society in the same way as with any other commercial crop. However, we don't think tobacco should be looked at in isolation.

We believe more independent research is needed to compare tobacco with other crops, so we commissioned independent research on this subject in 2011¹ and have also supported the UN Food & Agriculture's pilot of its guidelines, 'Sustainability Assessment of Food & Agriculture Systems'.

ALTERNATIVE CROPS



THE REGULATION

Minimum age laws of 18 for tobacco sales.

OUR RESPONSE

Our marketing is aimed only at adult smokers. Our companies actively engage with governments to adopt minimum age laws of 18 for tobacco sales where none exist and, where they do, to effectively enforce them. We encourage governments to make it illegal for adults to buy cigarettes for children.

Given that we don't sell directly to consumers, we also work with retailers to raise awareness of minimum age laws and provide training and advice on age verification.

YOUTH SMOKING PREVENTION

THE REGULATION

Many governments are still considering how to regulate the new e-cigarette category. In the interim, some regulate them as consumer products, some as tobacco products, some as medicinal products and a small number have banned them.

OUR RESPONSE

We support regulation of nicotine products, including e-cigarettes. We want to see a regulatory approach that puts consumer safety and product quality first, while allowing the appropriate level of innovation, marketing and distribution freedoms so as not to hamper the growth of a product category that could help smokers to cut down or quit. You can read more about this in our Focus on Harm Reduction Report.

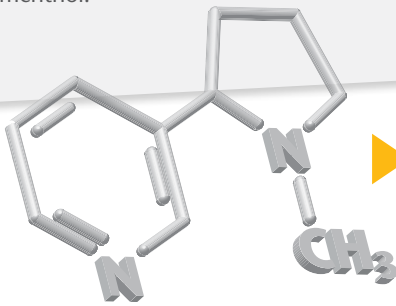
E-CIGARETTES

¹ *The Role of Tobacco Growing in Rural Livelihoods*, DD International, commissioned by British American Tobacco, 2011.

Ingredients: the issue

For centuries, ingredients have been added to tobacco to control moisture, maintain quality and balance the natural tobacco taste.

Some regulatory bodies have stated that flavours added to cigarettes can mask the taste of tobacco and reduce the harshness of tobacco smoke – making them more attractive to children. Some governments have implemented regulations to restrict or ban the use of some flavours, or the sale of certain overtly flavoured products. Canada was the first country, in 2009, to prohibit the use of all flavours except menthol. Other governments are currently considering similar measures, some of which may include a ban on menthol.



A nicotine molecule

▶ **Nicotine**
is never added to cigarettes
– it is a natural component
of the tobacco leaf.

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The research we have done indicates that menthol use is actually declining. It is not something that youth view as attractive.

Health Canada, 2009¹

The evidence

There is no reliable or convincing scientific evidence that shows that a greater toxicological effect results from the use of cigarettes containing ingredients when compared with those without. As the WHO has stated, “cigarettes claimed to be without additives... have never been demonstrated to be less dangerous or addictive than conventional cigarettes”².



▶ **Menthol**
cigarettes accounted for
around 5% of the global
cigarette market in 2012.

“

We support restrictions and prohibitions on certain ingredients if the science proves that they either increase the toxicological effect of tobacco products, enhance the pharmacological effects of nicotine or encourage underage smoking.

But science has shown us that the ingredients used in our products don't increase the health risks associated with smoking, they don't affect a smoker's ability to quit and they don't encourage people to smoke. We never add anything to make our tobacco products more appealing to children either, such as overt candy or fruit flavouring.

For me, transparency is key, and I'm not alone in this belief. As a Group we voluntarily publish the ingredients used in our cigarettes at www.bat-ingredients.com.



David O'Reilly
Group Scientific Director

1 Evidence given by Health Canada (the Canadian federal health department) at the Standing Committee on Health reviewing bill C-32 *Cracking Down on Tobacco Marketing Aimed at Youth Act*.
2 *Tobacco: deadly in any form or disguise*, World Health Organisation, 2006.

Plain packaging: the issue

Some people believe that the colours, designs and trademarks used on tobacco packaging make cigarettes more attractive, particularly to children. Australia is the only country to have introduced plain packaging in December 2012.

There are concerns that by introducing plain packaging governments risk breaching intellectual property rights and international trade agreements. As such, the governments of Ukraine, Cuba, Honduras, the Dominican Republic and Indonesia are challenging Australia's plain packaging laws at the World Trade Organisation (WTO).

The evidence

Research suggests that there are more important factors than packaging that influence young people's behaviour. For example, a 2012 study commissioned by the EU Health Department found that seeing friends smoke was the most significant influence over people starting to smoke¹.

A 2011 report that we commissioned from Deloitte on packaging regulation also shows that neither increasing the size of health warnings on packs nor introducing graphic images had reduced tobacco consumption².

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Plain packaging makes it easier for packaging to be copied by counterfeiters, exposing consumers to products of unknown and potentially dangerous ingredients.

International Chamber of Commerce
Business Action to Stop Counterfeiting and Piracy group, 2011

“

Plain packaging legislation ignores the crucial role that branding plays in providing consumers with high-quality, consistent products they can trust.

The British Brands Group, 2011

There are a number of alternatives to plain packaging that we believe to be more effective at achieving public health objectives including reducing smoking rates and addressing youth smoking. These include:

- Youth smoking prevention programmes and consumer education campaigns
- Strengthening laws and enforcement on the minimum age for purchasing tobacco products
- Making it illegal for adults to buy cigarettes for children
- Increasing measures to tackle the black market
- Consistent tax policy that avoids 'shock' excise and duty increases of tobacco products.



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We support appropriate health warnings on packs but we're strongly against plain packaging. We think governments need to think very carefully about this, and conduct much more robust research before introducing it as a policy.

We think that a policy intended to make tobacco less accessible to children could actually have the opposite effect. After all, if products are easier to copy it's difficult to tell the difference between legitimate and illegal packs. This, coupled with the availability of branded smuggled products, could fuel the black market.

Yes, we do openly campaign against plain packaging. We also respond to government consultations and we're assisting the Ukrainian and Honduran governments with legal support for their WTO challenges.

Like other companies, it's important that we can distinguish our products from our competitors', and for retailers and consumers to be able to tell the difference too. Our brands are our intellectual property. We've invested in them over many years and they're key to our business.



Jean-Marc Levy
Group Marketing Director

¹ *Attitudes of Europeans towards Tobacco*. A report commissioned by the European Commission, Directorate-General Health and Consumers, 2012.

² *Tobacco Packaging Regulation: An international assessment of the intended and unintended impacts*, Deloitte. A report commissioned by British American Tobacco, 2011.

Tax and excise: the issue

Tobacco taxes provide a source of funds for many governments and can account for an important part of their revenue. Unsurprisingly, when difficult economic times reduce a country's national budget, taxes on tobacco products are often viewed as a strong potential source of income.

High taxation rates can be used to support specific policy objectives. Some governments seek to cover the costs considered to be associated with tobacco use, such as healthcare costs. Health advocates might also put pressure on governments to increase tobacco taxes in an effort to reduce consumption. However, 'shock' increases in tobacco taxes often fail in both of these goals as consumers increasingly look towards the black market.

The evidence

While some smokers may choose to quit, or smoke less, evidence shows that large and sudden tax rises do not always result in reduced overall tobacco consumption. In some developed countries we have seen tax rates raised to such a high level that tax revenue begins to fall, as smokers seek out cheaper, black market alternatives.

Hikes in excise tax may also lead to greater price differences between nearby countries, encouraging tobacco smuggling across borders. In fact, in some countries, such as Singapore, Malaysia and Ireland, government officials have publicly stated that the principal cause of tobacco trafficking is the high level of tax.

It is clear that unusually high taxes on tobacco can create opportunities for criminals and ultimately undermine governments' revenue and health objectives.



Image from a Mexican advertising campaign against the sale of illegal cigarettes. "I only sell legal cigarettes in my shop."

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If there is a sharp increase in the price of cigarettes, the percentage of those who smoke illegal cigarettes will continue to rise.

The Honourable Dato' Sri Mohd Najib, Malaysian Prime Minister, speaking on TV3, October 2011

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We're not against excise increases if they're considered in the context of the wider economic environment and are implemented in a gradual and predictable way. But care needs to be taken, since large and sudden excise increases may actually lead to lower revenues for governments and could fuel sales within the black market.

One example of this happening was in Mexico in October 2010, when a sudden and significant increase in excise led to a price increase of 30% for the most popular cigarette brand. This had a direct impact on the illegal trade. Before the excise hike, black market sales represented about 3% of the market, but within the first 12 months, they went up to approximately 11%. In Mexico today, the illegal trade is estimated to be at around 15%. That's a five-fold increase since the excise shock.





Retail display bans: the issue

Some countries have banned the display of tobacco products in shops. Instead of being on display, the products are hidden under the counter, or behind curtains or screens, making it hard for customers to know what is available. This is based on claims that displays encourage people to smoke, especially children, and demotivate them from quitting.

The evidence

In our view, there's no clear evidence that display bans have any significant effect on smoking rates – either among children or adults. In Ireland, the first studies conducted after the introduction of the 2009 display ban suggested there was no observable change in adult smoking prevalence¹.

“

I think governments have to be careful in terms of framing regulation. We have seen no proper evidence that full retail display bans have any impact on smoking rates: instead I think there is a very real possibility that such bans could have unintended consequences.

With tobacco products hidden from view, consumers may struggle to tell whether their purchases are legitimate or black market products. Display bans would also affect competition among tobacco companies, inhibiting new product launches and new market entrants, and preventing companies from communicating information about legal products. Not only could smaller retailers be hit with potential refitting costs, but they could potentially lose out to larger competitors, as consumers might assume larger stores are more likely to stock their favourite brand.

Instead of display bans, we'd like to see stronger enforcement of minimum age laws, harsher penalties for retailers caught selling tobacco products to underage smokers, and legislation that makes it illegal for adults to buy cigarettes for children.

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Bans may work well in principle, but when in place, they do not produce the intended effect.

Dave Bryans, President of the Canadian Convenience Stores Association, 2008



Kingsley Wheaton
Group Corporate and Regulatory Affairs Director

¹ Evaluation of the removal of point-of-sale tobacco displays in Ireland, Ann McNeill, Sarah Lewis, Casey Quinn, et al., 2010.

Marketing our products responsibly

Like any business, we want to grow our market share. That doesn't mean we want to increase the number of smokers or how much they smoke. Our marketing is aimed at encouraging existing adult smokers to choose our products over those of our competitors.

We have voluntary International Marketing Principles, which provide a consistent and responsible approach to marketing tobacco products across the Group, often going above and beyond local laws. These core Principles are supported by a set of standards which show how they must be applied in our communications with consumers. For example, we require all advertising to carry appropriate health warnings, even when not required by law. It is also a requirement that no advertising or trade communication portrays smoking as something that makes people appear more popular, appealing or successful, and must not feature or contain an endorsement by a celebrity. Where local laws or voluntary codes are stricter than, or override, our Principles, we will at all times abide by those laws or codes.

International Marketing Principles: our commitments

- 1 Our marketing will not mislead about the risks of smoking.
- 2 We will only market our products to adult smokers.
- 3 We will not seek to influence the consumer's decision about whether or not to smoke, nor how much to smoke.
- 4 It will always be clear to our consumers that our advertising originates from a tobacco company and that it is intended to promote the sale of our tobacco brands.

We are committed to 100% compliance with these Principles and monitor compliance through market audits and annual self-assessments – immediate action is taken in response to any breaches identified and we report on our performance.

The Principles framework states that “in very exceptional circumstances the use of other activities that may not be wholly aligned with the Principles may be justifiable.” This is the case in Indonesia, where we took control of our company in 2010. Taking into account Indonesia's light regulation, implementing our Principles without other industry players following similar standards would have placed our relatively new and small business there at an exceptional disadvantage. We are engaging with other tobacco companies and the Indonesian Government on implementing stricter legislation to ensure a level playing field and a better regulated marketplace.

Our global approach to youth smoking prevention focuses on encouraging governments to adopt minimum age laws of 18 for tobacco sales where none exist and, where they do, to effectively enforce them. We also work with retailers around the world to raise awareness and provide advice and training, such as on age verification, as well as supplying in-store posters and materials.



Q Do you focus on developing markets that have less tobacco regulation?

A “Just because a country is an emerging economy doesn't mean it will have fewer marketing restrictions. For example, Mauritius, Kenya and Ghana have marketing regulations as strict as you find in Europe. All countries have laws and we abide by them. And where they are stricter than local law, we follow our International Marketing Principles as the minimum standard – this is the case for some 30% of our markets in the Eastern Europe, Middle East and Africa region.”

Q But surely it's harder to stick to your Principles where laws aren't as strict?

A “For me, upholding our high standards and marketing our products responsibly is not just a ‘nice to have’ – it's fundamental to the way we do business.

“Every market has its differences, in terms of the type of regulation that's in place and the nature of the local environment – and these can, of course, present challenges. For example, in Nigeria there is no minimum age law for purchasing tobacco products; it's still culturally acceptable for children to buy their parents cigarettes, and retailers often split cigarettes from their packaging and sell them separately.

“It's in these kinds of circumstances that you really get to see our Principles in action. So, not only does BAT Nigeria actively lobby for the introduction of a minimum age law of 18, but it also runs campaigns to educate retailers to sell tobacco products only to adults. We also have a strict Group policy to never supply loose or single cigarettes to retailers.”



Q&A

Andrew Gray

Director, Eastern Europe, Middle East and Africa region

Tackling the black market

The issue

The black market in tobacco is a global problem. It involves criminal gangs producing counterfeit cigarettes, cross-border smuggling and large-scale tax evasion. With weak penalties for criminals, poor border controls, low arrest rates and tobacco taxes creating disparity between neighbouring countries, it's a problem that is set to grow.

How we fight it

Keeping our own house in order

Our companies and employees must only support legitimate trade in our products and we stop doing business with customers or suppliers who are found to be complicit in tobacco trafficking. Our *Know Your Customer* guidelines and procedures require that the volume of tobacco products we supply is consistent with legitimate demand.

Global tracking for the supply chain

With other international tobacco companies, we're developing industry-wide supply chain security systems, including digital coding technology, to help governments ensure taxes and duties are paid, and track and trace technology to monitor product movements. We plan to implement track and trace in 42 markets by the end of 2016.

Committed to cooperation

We work with many international organisations to help tackle the illegal tobacco trade, such as the World Customs Organisation, the International Chamber of Commerce, the Organisation for

Economic Cooperation and Development and the International Trademark Association, for which a BAT employee was elected President in 2013. We have a cooperation agreement with the European Commission for its member states and have committed €134 million over the next 20 years to fund areas including training for border staff in new security systems and the acquisition of new detection technology.

Fighting alongside law enforcement agencies

Our Anti-Illicit Trade Intelligence Unit works hand in hand with global law enforcement agencies around the world, such as Interpol and the World Customs Organisation, to gather and share intelligence. Regionally, we also work with the European Anti-Fraud Office, Europol and many national customs and police agencies. We assist in monitoring the destruction of seized goods, provide training, help authenticate seized products and carry out forensic analysis on illegal goods.

The world of the criminal black market



Our world



Neil Withington
Group Legal Director and General Counsel



We've supported the development of the WHO Protocol to Eliminate Illicit Trade in Tobacco Products since the early days. Its formal adoption in 2012 was a real milestone. As an international treaty, it provides a framework for over 170 of the world's governments to combat the illegal trade in tobacco products. I'm hopeful that the resulting stronger international coordination and enforcement will lead to some big wins in tackling these criminals, and we're keen to play an important part.

▶ **The black market** is estimated to be equivalent in size to the world's third largest multinational tobacco company by volume¹.

▶ **Up to 12%** of global tobacco sales are estimated to be illegal².

▶ **660 billion** cigarettes are sold every year on the black market².

▶ **Between US\$40–50 billion** in worldwide taxes estimated to be evaded every year due to tobacco trafficking³.

▶ **At 40%** market share, Malaysia suffers one of the highest rates of illegal tobacco sales in the world³.



Spotlight on Canada

It's a startling fact that in the last five years up to an estimated one third of tobacco sold in Canada has been illegal. It's a trade that robs Canadian governments of up to C\$2 billion a year in lost tax revenue, funds criminal gangs and organisations, provides cheap unregulated tobacco products to youth, and deprives legitimate retailers of significant revenue.

Among the groups concerned with this illegal trade, one association in particular, the National Coalition Against Contraband Tobacco (NCACT), has taken a lead role. Our subsidiary, Imperial Tobacco Canada, through the Canadian Tobacco Manufacturers Council, is a member of the NCACT along with 14 other concerned business groups and associations.



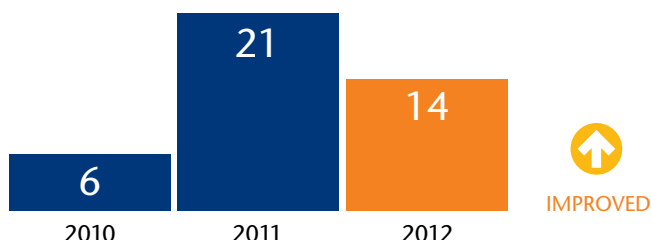
The Coalition's main objectives are to increase public awareness of the social and economic consequences illegal tobacco sales have on the Canadian population while ensuring their governments devote the necessary attention to eliminate this problem once and for all. It's a campaign that has already won the support of many political, business and community leaders.

1 Calculation based on industry estimates given by the Digital Coding and Tracking Association.
2 Industry estimate given by the Digital Coding and Tracking Association.
3 *Illicit Trade in Tobacco Products 2012*, Euromonitor International.

Performance highlights

International Marketing Standards

Number of instances of partial or non-compliance to International Marketing Standards identified through market audits and annual self-assessments

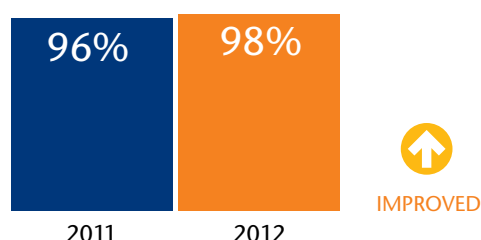


Our International Marketing Standards (IMS) have been in place throughout the Group since 2001. They were replaced with International Marketing Principles in 2013 to reflect developments in marketing, technology, regulation and stakeholder expectations.

In 2012, there were 14 instances of partial or non-compliance to our IMS in nine markets. These included instances where health warnings were not clearly visible; the display of cigarettes in close proximity to products that may appeal to children; and the use of video in a non-age-verified environment. Immediate actions were put in place in every one of these cases and we are committed to 100% compliance.

Youth smoking prevention

Percentage of markets required to undertake youth smoking prevention activities that reported adherence to our global approach



Minimum requirements for youth smoking prevention (YSP) activities were introduced in 2010 and compliance monitored since 2011. Prior to this, YSP activities were measured based on the number and type of programmes.

In some markets, political instability or regulation stops our activities, and we are also limited where we only operate through a distributor. In 2012, this was the case for markets representing 14% of our total sales volumes. In the remaining markets, three reported non-compliance. These are being closely monitored by our Board CSR Committee and we remain committed to achieving 100% compliance.

Get in touch

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Ernst & Young LLP has been engaged by British American Tobacco to provide limited external assurance of this focus report. A full assurance statement, including the scope of work and conclusions, can be found at www.bat.com/assurance.



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