



**BRITISH AMERICAN
TOBACCO**

news release

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23 February 2012

**BRITISH AMERICAN TOBACCO p.l.c.
PRELIMINARY ANNOUNCEMENT – YEAR ENDED 31 DECEMBER 2011**

SUMMARY

	2011	2010	Change
Revenue	£15,399m	£14,883m	+3%
Adjusted profit from operations	£5,519m	£4,984m	+11%
Profit from operations	£4,721m	£4,318m	+9%
Adjusted diluted earnings per share	194.6p	175.7p	+11%
Basic earnings per share	157.1p	145.2p	+8%
Dividends per share	126.5p	114.2p	+11%

- The Group's organic revenue at constant rates of exchange grew by 7 per cent with continued good pricing momentum. Reported Group revenue was up 3 per cent.
- Adjusted Group profit from operations increased by 11 per cent. All the regions contributed to this good profit result. The reported profit from operations was 9 per cent higher at £4,721 million. The adjusting items are set out on page 11 and detailed on pages 22 to 23.
- Group volumes were 705 billion, down 0.4 per cent as the overall market share of the Group increased and industry volume decline moderated.
- The four Global Drive Brands achieved excellent volume growth of 9 per cent. Dunhill volumes were slightly higher, Kent was up 10 per cent, Lucky Strike 14 per cent and Pall Mall grew by 11 per cent.
- Adjusted diluted earnings per share rose by 11 per cent, principally as a result of the growth in profit from operations. Basic earnings per share were up 8 per cent at 157.1p (2010: 145.2p).
- The Board is recommending a final dividend of 88.4p, payable on 3 May 2012. The total dividend in respect of 2011 is 126.5p, an increase of 11 per cent.
- Free cash flow increased by 3 per cent to £3,326 million, 86 per cent of adjusted earnings.
- 28 million shares were bought back at a cost of £750 million, excluding transaction costs. A continuation of the share buy-back to a value of £1.25 billion has been agreed by the Board.
- The Chairman, Richard Burrows, commented "2011 has been a very successful year for your Company and we carry momentum in market share growth and margin improvement into 2012. The economic climate around the world is far from settled but we remain confident that our strategy should continue to generate growth for our shareholders in the years ahead."

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BRITISH AMERICAN TOBACCO p.l.c.

PRELIMINARY ANNOUNCEMENT – YEAR ENDED 31 DECEMBER 2011

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*Non-GAAP measures referred to and used in the preliminary announcement, such as adjusted profit from operations, organic growth and adjusted diluted earnings per share, are explained on page 17.

CHAIRMAN'S STATEMENT

2011 has been a very successful year for your Company. While economic uncertainty continues, our operating environment improved during 2011. Our results for the year are driven by revenue growth, an improved operating margin, and growth in market share due to our successful brands, enhanced by the roll-out of product and packaging innovations.

Market share growth

Overall, industry volumes continued to decline in 2011 but there are signs that the rate of decline has moderated. Our own volumes were down marginally by 0.4 per cent and we grew market share during the year. These positive results were spread across many markets around the world.

The expansion of illicit trade is a continuing and growing threat to the business. Sharp increases in excise duty, pressure on consumers' disposable income, and ill-considered regulation of our industry, are all making life easier and more lucrative for traders of illicit products, both contraband and counterfeit.

Increasing returns to shareholders

Using constant currency exchange rates, revenue rose by 7 per cent on an organic basis. Adjusted profit from operations grew by 11 per cent to £5,519 million, or by 10 per cent at constant currency exchange rates.

This is reflected in the adjusted diluted earnings per share for 2011 improving by 11 per cent to 194.6p.

The Board has recommended a final dividend of 88.4p per share, which will be paid on 3 May 2012 to shareholders on the register at 9 March 2012. This takes the total dividend for the year to 126.5p, an increase of 11 per cent on last year, and maintains our target of paying out 65 per cent of earnings in dividends.

In addition, following the suspension of our share buy-back programme in 2009, the Board approved the resumption of the programme in 2011. Between the beginning of March and the end of December 2011, some 28 million shares were repurchased at a value of £750 million, excluding transaction costs.

A continuation of the share buy-back to a value of £1.25 billion has been agreed by the Board.

Board and Audit Committee changes

Ana Maria Llopis retired from the board after the AGM in April 2011. Ann Godbehere, a Canadian, joined the Board as a Non-Executive Director on 3 October 2011. Paul Adams, former Chief Executive, retired at the end of February 2011 and was succeeded by Nicandro Durante who was introduced to shareholders in his new role at the AGM.

Christine Morin-Postel has resigned as a member of the Audit Committee with effect from 21 February 2012 due to a personal conflict of interest, details of which are set out at the end of this Preliminary Announcement.

Sustainability

Over the years we have built a strong reputation for corporate social responsibility and sustainability and have been recognised as leaders in our industry. For example, we were the first tobacco company to be included in the Dow Jones Sustainability World Index and were included again in 2011. This focus on running our business responsibly helps us create value for our shareholders as well as being in the best interests of our other stakeholders.

Continued success

I express my thanks and appreciation to my fellow Directors on the Board; to management; to our Chief Executive, Nicandro Durante; and, in particular, to all our 56,000 colleagues around the world.

2011 has been a very successful year for your Company and we carry momentum in market share growth and margin improvement into 2012. The economic climate around the world is far from settled but we remain confident that our strategy should continue to generate growth for our shareholders in the years ahead.

Richard Burrows
22 February 2012

EXTRACT FROM CHIEF EXECUTIVE'S REVIEW

Our proven strategy continues to deliver

The strength of our brands, our consumer-centric innovative products and the quality of our people have delivered another year of very good earnings growth. The Group increased overall market share in 2010 and this continued in 2011 despite challenging economic conditions in some markets.

There are signs that the industry volume decline seen in recent years is moderating but substantial excise-driven price increases in a few markets continue to affect overall volumes. While industry volume declined again in 2011, our share improvement ensured that Group volumes were virtually unchanged, down just 0.4 per cent year on year.

Our Global Drive Brands and other international brands once again achieved good growth in 2011, driven by the launch of product innovations such as Click & Roll, Reloc and Convertibles in key markets, better retailer relationships and by improving our speed to market.

Group revenue grew by 7 per cent on an organic basis and at constant rates of exchange, driven by continued good pricing. The resulting increase in adjusted profit from operations of 11 per cent has helped us to deliver superior returns to shareholders once again, with adjusted diluted earnings per share up by 11 per cent on last year.

Our productivity continued to improve in 2011 as we further addressed our cost base through factory rationalisation, systems standardisation and productivity savings. This helped us achieve a substantial increase in operating margin from 33.5 to 35.8 per cent. This is well ahead of our target of improving overall margin by 50-100 basis points per annum.

For the foreseeable future, the world market is likely to remain fairly stable at around five and a half trillion cigarettes, more than 40 per cent of which are sold in China. We expect overall market values to grow due to changes in the product mix and we believe the value of emerging markets will grow more quickly. Because of this, our geographic diversity and strong positions in emerging markets remain a key strength.

The tobacco industry remained fairly stable during 2011, with little M&A activity among the leading industry players. On 26 May 2011, the Group announced that it had agreed to acquire 100 per cent of privately-owned Protobaco, the second largest cigarette company in Colombia. The transaction was completed on 11 October 2011 and the deal was financed from internal resources.

We continue to monitor acquisition opportunities around the world and will participate where it makes financial and strategic sense to do so.

The expansion of illicit trade remains a threat globally, driven by sharp excise increases and pressure on consumers' disposable income. We support the development of the World Health Organisation's Framework Convention on Tobacco Control (FCTC) protocol aimed at creating an international regulatory framework for addressing illicit trade. However, we remain critical of other measures proposed by the FCTC that may drive significant excise increases, retail display bans and plain packaging – all of these measures could play into the hands of organised crime by creating ideal conditions for further increases in illicit trade.

Substantial opportunities

The last year has seen considerable success for the Group and I am excited when I look to our strengths. We have some great brands and our marketing is based on powerful consumer insights, supported by differentiated and superior products. We have market-leading innovations – and we are getting better at deploying them. We have a great business mix, with a strong presence in emerging markets and a balanced product portfolio across all segments. We have a fully integrated supply chain and our systems are becoming more efficient. We have an industry-leading approach to science and harm reduction and, importantly, we have the people capable of tackling the challenges ahead.

I am confident that we are well placed to take advantage of the substantial opportunities ahead for our business and that we can continue to deliver superior shareholder returns.

Nicandro Durante
22 February 2012

REGIONAL REVIEW

Against the backdrop of global financial uncertainty, generally lower disposable incomes and political upheaval in some parts of the world, the Group delivered a strong performance in 2011, achieving all the goals set as part of its long-term strategy. Reported revenue grew by over 3 per cent as a result of continued good pricing momentum and stable volumes. At constant rates of exchange, revenue was up 4 per cent, while on an organic basis at constant rates of exchange, it increased by 7 per cent.

The reported profit from operations was 9 per cent higher at £4,721 million with an 11 per cent increase in adjusted profit from operations, as explained on pages 22 to 23. At constant rates of exchange, the adjusted profit increase was 10 per cent. All the regions contributed to this good profit result. Organic adjusted Group profit from operations, at constant rates of exchange, also increased by 10 per cent.

Group volumes from subsidiaries were 705 billion, down by 3 billion or 0.4 per cent. Organic volumes were also 0.4 per cent lower. The Group again grew overall market share in its Top 40 markets.

The four Global Drive Brands achieved excellent overall volume growth of 9 per cent following the successful launches of innovations, resulting in the continued improvement in market share. Dunhill volumes increased slightly as strong growth in Brazil, Romania and the GCC, and good performances by Malaysia and Russia, were offset by a decline in South Korea which was affected by competitor pricing. Excluding the volumes in South Korea, Dunhill volumes were up 8 per cent. Kent was 10 per cent higher with increased volumes in Romania, Ukraine, Russia, Egypt and Japan.

Lucky Strike increased volumes by 14 per cent with growth in Spain, Germany, France, Italy, Japan, Chile and Brazil. Pall Mall volumes rose by 11 per cent with strong growth in Pakistan, Turkey, Russia and Canada, partially offset by lower volumes in Mexico and Spain.

The Group announced at the end of 2010 that as part of the plans to reduce complexity, drive efficiency in management structures and achieve a better balance in the scale of our regions, it had decided to reduce the management structure from five to four regions from 1 January 2011. Markets which comprised the Eastern Europe region, were merged into the Africa and Middle East region and the Western Europe region. Russia, Ukraine, Moldova, Belarus, Caucasus and Central Asia form part of the new Eastern Europe, Middle East and Africa region (EEMEA), while Romania, Bulgaria, Serbia, Montenegro, Albania and Kosovo form part of the Western Europe region. The 2010 information has been reallocated on the basis of the new regional structure.

Adjusted profit from operations* at constant and current rates of exchange is as follows:

	2011		2010
	Adjusted profit from operations*		Adjusted profit from operations*
	Constant rates	Current rates	
	£m	£m	£m
Asia-Pacific	1,480	1,539	1,332
Americas	1,440	1,441	1,382
Western Europe	1,204	1,228	1,103
EEMEA	1,362	1,311	1,167
	<u>5,486</u>	<u>5,519</u>	<u>4,984</u>

*Adjusted profit from operations (page 11) is derived after excluding adjusting items from profit from operations. Adjusting items include restructuring and integration costs, amortisation of trademarks, goodwill impairments and the Fox River provision as explained on pages 22 and 23.

Regional review cont...

In **Asia-Pacific**, profit was up £207 million to £1,539 million as a result of strong performances in Japan, Bangladesh and Taiwan and favourable exchange rates in Australia, Japan and New Zealand. At constant rates of exchange, profit increased by £148 million or 11 per cent. Volumes at 191 billion were up 2 per cent, with increases in Japan, Pakistan and Indonesia partially offset by lower volumes in South Korea, Australia and New Zealand.

In Australia, the steep excise increase during 2010 impacted industry volumes. Profit was up as a result of cost saving initiatives, favourable exchange movements and higher pricing, partially offset by additional costs associated with the campaign against plain packaging. Market share was slightly lower although Pall Mall performed well. In New Zealand, volumes decreased following an ad-hoc excise increase in January 2011. Profit was lower as pricing and favourable exchange rate movements were more than offset by lower volumes.

Market share grew in Malaysia, driven by the strong performances of Dunhill and Peter Stuyvesant, although total industry volumes were lower following the excise led price increases in 2010. Profit was higher, mainly as a result of exchange rate movements.

In Japan, industry volumes were down sharply following a significant excise increase in October 2010. However, as a result of the disruption to domestic production following the tragic events in March 2011, the Group delivered an exceptionally strong growth in profit and volumes for the year, with underlying market share higher.

In Vietnam, volumes and market share grew but profit was adversely impacted by high inflation and an exchange rate devaluation, partially offset by higher pricing and cost saving initiatives.

Profit in South Korea was impacted by competitor pricing and significant marketing investment, following a price increase by the Group's business at the end of April 2011, the first in the industry in over six years. Lower volumes also led to a reduction in market share.

In Taiwan, significant profit growth was driven by higher volumes and improved industry pricing. Good performances by Dunhill and Pall Mall achieved higher market share.

Volume growth in Pakistan led to a strong increase in market share as Pall Mall performed well, more than doubling its volumes. Profit was stable, adversely impacted by higher special excise duties, high inflation and severe price competition in the low-priced segment. In Bangladesh, both market share and volumes grew due to the strong performance of Benson & Hedges. Profit increased as a result of higher volumes, price increases and tight control of costs.

Profit grew in Indonesia following higher volumes, price increases and synergies resulting from the integration of the business units during 2010 which were partially offset by higher clove prices and marketing investment. Market share was marginally lower as the growth of the mild kretek brands was more than offset by the rationalisation of the brand portfolio.

In **Americas**, profit rose by £59 million to £1,441 million, mainly attributable to a strong performance from Brazil, Venezuela and Mexico and an improved product mix across the region. At constant rates of exchange, profit rose by £58 million or 4 per cent. Volumes were down 4 per cent at 143 billion, mainly as a result of decreases in Mexico, Brazil, Chile and Venezuela.

In Brazil, strong profit growth was driven by an improved product mix and higher pricing. Market share and volumes were slightly lower due to the growth of local duty evaded product. However, volume, share in the premium segment and share compared to international competitors continued to grow as a result of the solid performances of Lucky Strike, Dunhill and Free.

Industry volumes were lower in Canada as a result of increased illicit trade, with aggressive price competition in the low-priced segment fuelling down-trading. These factors adversely impacted volumes, market share and profit, although du Maurier and Vogue maintained their share in the premium segment and John Player Standard remained the number one brand in Canada.

In Mexico, industry volumes declined sharply as a result of excise-led price increases at the beginning of 2011, as well as increased purchases by the trade during December 2010 in anticipation of the price increase. Market share was marginally down on last year, while profit was higher, benefiting from increased pricing and lower costs.

Regional review cont...

In Argentina, market share was lower despite the growth of Lucky Strike and the successful launch of Dunhill. Marketing investment was higher with the launch of new brands and competitors' pricing activities, impacting profitability. Lucky Strike performed well in Chile, and the very strong market share was maintained. Volumes were lower, following the steep excise-driven price increases, adversely impacting profit.

Profit in Venezuela grew strongly as a result of higher pricing, partially offset by increased costs and lower volumes, although market share rose. Volumes were down due to industry declines and growth in illicit product. The Group acquired Protabaco, the second largest cigarette company in Colombia, on 11 October 2011. Protabaco and British American Tobacco Colombia are operating from January 2012 as one entity with a market share of almost 50 per cent.

Profit in **Western Europe** increased by £125 million to £1,228 million, mainly as a result of strong performances in Germany, Switzerland, Italy, France and Romania, partially offset by declines in Spain, the Netherlands and Greece. At constant rates of exchange, profit increased by £101 million or 9 per cent. Regional volumes were marginally lower at 135 billion as a result of declines in Germany, Switzerland, Italy, Greece and Spain, partially offset by an increase in Romania.

In Italy, volumes and market share were slightly lower although the Global Drive Brands performed well. Good profit growth was the result of the improved product mix, price increases and lower costs, partially offset by the effect of the volume decline.

Profit increased in Germany as a result of higher pricing and lower costs. The higher organic market share was driven by excellent performances by Pall Mall and Lucky Strike although volumes decreased.

In France, volumes were higher and market share increased which, together with improved pricing and lower product costs, led to an increase in profit. Lucky Strike and Vogue performed well. Market share in Spain was up strongly, driven by Pall Mall and Lucky Strike. Industry volumes were lower as a result of the tough economic conditions, unemployment and an excise-driven price increase at the end of 2010. Profit was impacted by a price war during the middle of the year and lower volumes.

Profit in Switzerland grew strongly as a result of reduced costs and increased pricing. Volumes were lower but market share grew through the performance of Kent and Pall Mall. Volumes and profit in Belgium and the Netherlands were lower but market share increased in Belgium with Pall Mall and Lucky Strike performing well.

In Romania, excellent increases in profit and volumes were achieved as the industry benefited from the significant reduction in the level of illicit trade following the strong action taken by the Government. Market share was higher, led by Dunhill, Kent and Vogue.

In Poland, despite an industry volume decline, profit, volumes and market share increased with the growth of Viceroy and Vogue. Market share in Greece was higher and Peter Stuyvesant achieved leadership in the low-priced segment. The partial absorption of excise increases by the industry over the last two years contributed to a drop in profit. In the United Kingdom, Pall Mall performed well, resulting in market share growth, which, coupled with price increases, cost management and higher volumes, led to higher profit.

Profit was maintained in Denmark where industry volumes were adversely affected by the impact of two significant excise-driven price increases. Market share was recovering by the year end. In Sweden, profit improved as a result of lower costs, improved pricing and volumes. Market share was also higher.

Regional review cont...

Profit from the **Eastern Europe, Middle East and Africa** region increased by £144 million to £1,311 million. This was principally due to stable volumes and price increases, partly offset by the adverse impact of exchange rate movements. At constant rates of exchange, profit increased by £195 million or 17 per cent. Volumes at 236 billion were marginally higher than last year with the increases in Egypt, GCC and Nigeria partially offset by the decline in Turkey.

In Russia, market share grew, driven by Kent, supported by Dunhill, Pall Mall and Vogue. Total volumes were in line with last year. Strong profit growth was the result of price increases, an improved product mix and lower costs.

Market share in Ukraine was higher as volumes increased in a declining total market, resulting in an increase in profit. Volumes, profit and market share improved in Kazakhstan due to the strong performance of Pall Mall.

In Turkey, the 2010 excise-driven contraction of the market continued with the government announcing an unexpected excise rise in October 2011, with a further increase from January 2013. This, coupled with an increase in illicit trade, resulted in a steep drop in volumes. Market share declined as a result of competitor pricing activities. Kent and Pall Mall grew strongly and Lucky Strike was launched, partially offsetting the volume losses of tail brands. Profit reduced despite the improved product mix and significant savings initiatives.

In the GCC markets, volumes and market share increased and profit grew strongly, mainly due to Dunhill's excellent performance in all the markets. In Egypt, volumes and market share continued to grow strongly despite the political instability and a significant excise increase in June. Profit was impacted by the absorption by manufacturers of some of the excise increases of 2010 and 2011. Rothmans expanded its leadership position amongst International Brands.

In Nigeria, volumes were up and market share continued to grow. Premium brands posted impressive rises with Dunhill, Benson & Hedges and Rothmans the main contributors. The improved product mix and higher volumes led to a strong increase in profit. Growth in market share was primarily driven by marketing investment. Improved government control saw a reduction in illicit trade.

In South Africa, market share strengthened due to the good performance of the portfolio. There was a significant increase in the incidence of illicit trade and down-trading to the low-priced segment. As a result, profit was in line with last year.

The Group continued its investment in new markets, with the launch of Dunhill in Morocco after an import and distribution licence was approved, while it continued to build the business in Algeria.

Cigarette volumes

The segmental analysis of the volumes of subsidiaries is as follows:

6 months to			12 months to	
30.6.11	30.6.10		31.12.11	31.12.10
bns	bns		bns	bns
95	95	Asia-Pacific	191	188
70	73	Americas	143	149
65	66	Western Europe	135	136
114	114	EEMEA	236	235
344	348		705	708

RESULTS OF ASSOCIATES

Associates principally comprise Reynolds American and ITC.

The Group's share of post-tax results of associates increased by £120 million, or 22 per cent, to £670 million. The Group's share of the adjusted post-tax results of associates increased by 6 per cent to £659 million, with a rise of 11 per cent at constant rates of exchange.

The segmental analyses of the Group's share of the adjusted* post-tax results of associates and joint ventures are as follows:

	2011		2010
	Adjusted share of post-tax results*		Adjusted share of post-tax results*
	Constant rates £m	Current rates £m	£m
Asia-Pacific	238	225	208
Americas	448	432	412
EEMEA	2	2	2
	<u>688</u>	<u>659</u>	<u>622</u>

*Adjusted share of post-tax results of associates and joint ventures is after the adjusting items, as shown on page 20 and explained on pages 25 and 26.

The adjusted contribution from Reynolds American increased by 5 per cent to £429 million. At constant rates of exchange the increase was 9 per cent.

The Group's contribution from its associate in India, ITC, was £218 million, up 7 per cent. At constant rates of exchange, the contribution would have been 13 per cent higher than last year.

DIVIDENDS

The Board recommends a final dividend of 88.4 pence per ordinary share of 25p for the year ended 31 December 2011. If approved by shareholders at the Annual General Meeting to be held on 26 April 2012, the dividend will be payable on 3 May 2012 to shareholders registered on either the UK main register or the South African branch register on 9 March 2012 (the record date).

In compliance with the requirements of Strate, the electronic settlement and custody system used by the JSE Limited (JSE), the following salient dates for the payment of the final dividend are applicable:

	2012
Last Day to Trade (LDT) cum-dividend (JSE):	2 March (Friday)
Shares commence trading ex-dividend (JSE):	5 March (Monday)
Last Day to Trade (LDT) cum-dividend (LSE):	6 March (Tuesday)
Shares commence trading ex-dividend (LSE):	7 March (Wednesday)
Record date (JSE and LSE):	9 March (Friday)
Payment date:	3 May (Thursday)

As the Group reports in sterling, dividends are declared and payable in sterling except for shareholders on the branch register in South Africa whose dividends are payable in rand. A rate of exchange of £:R = 12.19960 as at 21 February 2012 (the closing rate on that date as quoted by Bloomberg), results in an equivalent final dividend of 1078.44464 SA cents per ordinary share. From the commencement of trading on 23 February 2012 until the close of business on 9 March 2012 (both days inclusive), no removal requests between the UK main register and the South African branch register will be permitted. Further, no transfers between the UK main register and the South African branch register will be permitted and no shares may be dematerialised or rematerialised between 5 March 2012 and 9 March 2012, both days inclusive.

The following is a summary of the dividends declared for the years ended 31 December 2011 and 2010:

	2011		2010	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim				
- 2011 paid 28 September 2011	38.1	738		
- 2010 paid 29 September 2010			33.2	662
Final				
- 2011 payable 3 May 2012	88.4	1,741		
- 2010 paid 5 May 2011			81.0	1,620
	126.5	2,479	114.2	2,282

In accordance with IFRS, the proposed final dividend amounting to £1,741 million (2010: £1,620 million), payable on 3 May 2012, will be recognised in the Group accounts for the year ending 31 December 2012. For the year ended 31 December 2011, the accounts include the final dividend paid in respect of the year ended 31 December 2010, amounting to £1,620 million and the interim dividend amounting to £738 million, paid on 28 September 2011. For the year ended 31 December 2010, the accounts include the final dividend paid in respect of the year ended 31 December 2009, amounting to £1,431 million and the 2010 interim dividend, amounting to £662 million.

RISKS AND UNCERTAINTIES

The principal risks and uncertainties affecting the business activities of the Group were reviewed and updated and are summarised in a table that is attached as appendix 2 to this announcement. The table provides a brief description of the key risks to which the Group's operations are exposed and it identifies, in each case, their potential impact on the Group and the principal processes in place to manage the risk.

- Illicit trade;
- Excise and tax;
- Financial;
- Marketplace; and
- Regulation.

The key Group risks should be read in the context of the cautionary statement regarding forward looking statements on page 55.

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 announcement. Further information will be provided in the Business Review and Financial Review and in the notes to the financial statements, all of which will be included in the 2011 Annual Report that will be available on the Group's website, www.bat.com on 26 March 2012.

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

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

DIRECTORS' RESPONSIBILITY STATEMENT

The responsibility statement below has been prepared in connection with the company's full Annual Report for the year ended 31 December 2011. Certain parts thereof are not included within this announcement.

We confirm to the best of our knowledge:

- the financial statements, prepared in accordance with IFRS as adopted by the European Union, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the Group; and
- the Directors' report (which incorporates the business review), includes a fair review of the development and performance of the business and the position of the Group and the Company, together with a description of the principal risks and uncertainties that they face.

This responsibility statement was approved by the Board of Directors on 22 February 2012 and is signed on its behalf by:

For and on behalf of the Board of Directors:

Richard Burrows
Chairman

Ben Stevens
Finance Director and Chief Information Officer

22 February 2012

GROUP INCOME STATEMENT

For the year ended 31 December

	2011 £m	2010 £m
Gross turnover (including duty, excise and other taxes of £30,724 million (2010: £28,972 million))	46,123	43,855
Revenue	15,399	14,883
Raw materials and consumables used	(3,507)	(3,695)
Changes in inventories of finished goods and work in progress	81	(12)
Employee benefit costs	(2,501)	(2,550)
Depreciation, amortisation and impairment costs	(817)	(897)
Other operating income	233	207
Other operating expenses	(4,167)	(3,618)
Profit from operations	4,721	4,318
Analysed as:		
– adjusted profit from operations	5,519	4,984
– restructuring and integration costs	(193)	(311)
– amortisation of trademarks	(58)	(62)
– impairment of trademarks		(44)
– goodwill impairment	(273)	(249)
– Fox River	(274)	
	4,721	4,318
Finance income	117	27
Finance costs	(577)	(507)
Net finance costs	(460)	(480)
Share of post-tax results of associates and joint ventures	670	550
Analysed as:		
– adjusted share of post-tax results of associates and joint ventures	659	622
– issue of shares and change in shareholding	28	(9)
– smoking cessation programme	(23)	
– gain on disposal of business	22	
– Canadian settlements		(59)
– other (see page 25)	(16)	(4)
	670	550
Profit before taxation	4,931	4,388
Taxation on ordinary activities	(1,556)	(1,248)
Profit for the year	3,375	3,140
Attributable to:		
Owners of the parent	3,095	2,879
Non-controlling interests	280	261
	3,375	3,140
Earnings per share		
Basic	157.1p	145.2p
Diluted	156.2p	144.4p
Adjusted diluted earnings per share	194.6p	175.7p

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

The accompanying notes on pages 17 to 52 form an integral part of this condensed consolidated financial information.

GROUP STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December

	2011 £m	2010 £m
Profit for the year (page 11)	3,375	3,140
Other comprehensive income		
Differences on exchange		
– subsidiaries	(411)	502
– associates	(109)	105
Differences on exchange reclassified and reported in profit for the year	(4)	(3)
Cash flow hedges		
– net fair value losses	(21)	(106)
– reclassified and reported in profit for the year	38	55
– reclassified and reported in net assets	(5)	3
Available-for-sale investments		
– net fair value gains	26	4
– reclassified and reported in profit for the year	(1)	
Net investment hedges		
– net fair value gains/(losses)	62	(31)
– differences on exchange on borrowings	(104)	74
Retirement benefit schemes		
– net actuarial (losses)/gains in respect of subsidiaries	(462)	193
– surplus recognition and minimum funding obligations in respect of subsidiaries	2	58
– actuarial losses in respect of associates net of tax	(67)	(54)
Tax on items recognised directly in other comprehensive income	20	1
Total other comprehensive income for the year, net of tax	(1,036)	801
Total comprehensive income for the year, net of tax	2,339	3,941
Attributable to:		
Owners of the parent	2,094	3,664
Non-controlling interests	245	277
	2,339	3,941

The accompanying notes on pages 17 to 52 form an integral part of this condensed consolidated financial information.

GROUP STATEMENT OF CHANGES IN EQUITY

At 31 December

2011

Attributable to owners of the parent

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of parent £m	Non- controlling interests £m	Total equity £m
Balance at 1 January 2011	506	3,910	1,600	3,190	9,206	342	9,548
Total comprehensive income for the year			(488)	2,582	2,094	245	2,339
Profit for the year (page 11)				3,095	3,095	280	3,375
Other comprehensive income for the year (page 12)			(488)	(513)	(1,001)	(35)	(1,036)
Employee share options							
– value of employee services				76	76		76
– proceeds from shares issued		3		2	5		5
Dividends and other appropriations							
– ordinary shares				(2,358)	(2,358)		(2,358)
– to non-controlling interests						(279)	(279)
Purchase of own shares							
– held in employee share ownership trusts				(123)	(123)		(123)
– share buy-back programme				(755)	(755)		(755)
Non-controlling interests - acquisitions				(10)	(10)		(10)
Other movements				32	32	(1)	31
Balance at 31 December 2011	506	3,913	1,112	2,636	8,167	307	8,474

2010

Attributable to owners of the parent

	Share capital £m	Share premium, capital redemption and merger reserves £m	Other reserves £m	Retained earnings £m	Total attributable to owners of parent £m	Non- controlling interests £m	Total equity £m
Balance at 1 January 2010	506	3,907	1,032	2,168	7,613	299	7,912
Total comprehensive income for the year			568	3,096	3,664	277	3,941
Profit for the year (page 11)				2,879	2,879	261	3,140
Other comprehensive income for the year (page 12)			568	217	785	16	801
Employee share options							
– value of employee services				67	67		67
– proceeds from shares issued		3		4	7		7
Dividends and other appropriations							
– ordinary shares				(2,093)	(2,093)		(2,093)
– to non-controlling interests						(234)	(234)
Purchase of own shares							
– held in employee share ownership trusts				(66)	(66)		(66)
Non-controlling interests - acquisitions				(12)	(12)		(12)
Other movements				26	26		26
Balance at 31 December 2010	506	3,910	1,600	3,190	9,206	342	9,548

The accompanying notes on pages 17 to 52 form an integral part of this condensed consolidated financial information.

GROUP BALANCE SHEET

At 31 December

	2011 £m	2010 £m
Assets		
Non-current assets		
Intangible assets	11,992	12,458
Property, plant and equipment	3,047	3,117
Investments in associates and joint ventures	2,613	2,666
Retirement benefit assets	105	122
Deferred tax assets	343	411
Trade and other receivables	305	272
Available-for-sale investments	40	29
Derivative financial instruments	179	128
Total non-current assets	18,624	19,203
Current assets		
Inventories	3,498	3,608
Income tax receivable	127	73
Trade and other receivables	2,423	2,409
Available-for-sale investments	57	58
Derivative financial instruments	159	145
Cash and cash equivalents	2,194	2,329
	8,458	8,622
Assets classified as held-for-sale	37	35
Total current assets	8,495	8,657
Total assets	27,119	27,860

The accompanying notes on pages 17 to 52 form an integral part of this condensed consolidated financial information.

GROUP BALANCE SHEET

At December 31

	2011 £m	2010 £m
Equity		
Capital and reserves		
Share capital	506	506
Share premium, capital redemption and merger reserves	3,913	3,910
Other reserves	1,112	1,600
Retained earnings	2,636	3,190
Owners of the parent	8,167	9,206
after deducting		
– cost of treasury shares	(1,539)	(750)
Non-controlling interests	307	342
Total equity	8,474	9,548
Liabilities		
Non-current liabilities		
Borrowings	8,510	8,916
Retirement benefit liabilities	1,003	770
Deferred tax liabilities	556	509
Other provisions for liabilities and charges	458	187
Trade and other payables	184	193
Derivative financial instruments	87	92
Total non-current liabilities	10,798	10,667
Current liabilities		
Borrowings	1,766	1,334
Income tax payable	494	467
Other provisions for liabilities and charges	236	282
Trade and other payables	5,174	5,335
Derivative financial instruments	177	227
Total current liabilities	7,847	7,645
Total equity and liabilities	27,119	27,860

The accompanying notes on pages 17 to 52 form an integral part of this condensed consolidated financial information.

GROUP CASH FLOW STATEMENT

For the year ended 31 December

	2011 £m	2010 £m
Cash flows from operating activities		
Cash generated from operations	5,537	5,207
Dividends received from associates	476	461
Tax paid	(1,447)	(1,178)
Net cash from operating activities	4,566	4,490
Cash flows from investing activities		
Interest received	79	59
Dividends received from investments	2	2
Purchases of property, plant and equipment	(510)	(497)
Proceeds on disposal of property, plant and equipment	45	61
Purchases of intangibles	(107)	(87)
Purchases and proceeds on disposals of investments	3	(1)
Proceeds from associates' share buy-backs	71	
Purchase of Protabaco	(295)	
Proceeds on disposal of subsidiaries		12
Net cash used in investing activities	(712)	(451)
Cash flows from financing activities		
Interest paid	(580)	(578)
Interest element of finance lease rental payments		(2)
Capital element of finance lease rental payments	(13)	(17)
Proceeds from issue of shares to owners of the parent	3	3
Proceeds from the exercise of options over own shares held in employee share ownership trusts	2	4
Proceeds from increases in and new borrowings	1,361	892
Movements relating to derivative financial instruments	5	(179)
Purchases of own shares	(755)	
Purchases of own shares held in employee share ownership trusts	(123)	(66)
Purchases of non-controlling interests	(10)	(12)
Reductions in and repayments of borrowings	(1,304)	(1,582)
Dividends paid to owners of the parent	(2,358)	(2,093)
Dividends paid to non-controlling interests	(275)	(234)
Net cash used in financing activities	(4,047)	(3,864)
Net cash flows (used in)/from operating, investing and financing activities	(193)	175
Differences on exchange	(48)	29
(Decrease)/increase in net cash and cash equivalents in the year	(241)	204
Net cash and cash equivalents at 1 January	2,183	1,979
Net cash and cash equivalents at 31 December	1,942	2,183

The accompanying notes on pages 17 to 52 form an integral part of this condensed consolidated financial information.

ACCOUNTING POLICIES AND BASIS OF PREPARATION

The financial information has been extracted from the Annual Report, including the audited financial statements for the year ended 31 December 2011. This financial information does not constitute statutory accounts within the meaning of Section 434 of the Companies Act 2006.

The Group has prepared its annual consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and implemented in the UK.

These financial statements have been prepared under the historical cost convention, except in respect of certain financial instruments, and on a basis consistent with the IFRS accounting policies as set out in the Annual Report for the year ended 31 December 2010.

The Group has not adopted any new and amended IFRSs and IFRIC interpretations with any significant effect on reported profit or equity or on the disclosures in the financial statements with effect from 1 January 2011.

The preparation of these condensed consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities and the disclosure of contingent liabilities at the date of these condensed consolidated financial statements. Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgement at the date of the condensed consolidated financial statements. In the future, actual experience may deviate from these estimates and assumptions, which could affect these condensed consolidated financial statements as the original estimates and assumptions are modified, as appropriate, in the period in which the circumstances change.

NON-GAAP MEASURES

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

The principal non-GAAP measure which the Group uses is adjusted diluted earnings per share, which is reconciled to diluted earnings per share. The adjusting items that mainly drive the reconciling items are separately disclosed, as memorandum information, on the face of the income statement and are used to calculate the additional non-GAAP measures of adjusted profit from operations and adjusted share of post-tax results of associates and joint ventures. All adjustments to profit from operations and diluted earnings per share are explained in this announcement.

The Management Board, as the chief operating decision maker, reviews current and prior year adjusted segmental income statement information of subsidiaries and associates and joint ventures at constant rates of exchange which provides an approximate guide to performance in the current year had they been translated at last year's rate of exchange. The constant rate comparison provided for reporting segment information is based on a retranslation, at prior year exchange rates, of the current year results of the Group's overseas entities but other than in exceptional circumstances, does not adjust for the normal transactional gains and losses in operations which are generated by exchange movements.

In the presentation of financial information, the Group also uses another measure, organic growth, to analyse underlying business performance. Organic growth is the growth after adjusting for mergers and acquisitions and discontinued activities. Adjustments are made to current and prior year numbers, based on the 2011 Group position.

Non-GAAP measures cont...

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

Due to the secondary listing of the ordinary shares of British American Tobacco p.l.c. on the main board of the JSE Limited (JSE) in South Africa, the Group is required to present headline earnings per share and diluted headline earnings per share, as alternative measures of earnings per share, calculated in accordance with Circular 3/2009 'Headline Earnings' issued by the South African Institute of Chartered Accountants. These are shown on pages 27 and 28.

FOREIGN CURRENCIES

The income and cash flow statements of overseas subsidiaries and associates and joint ventures have been translated at the average rates for the respective periods. Assets and liabilities have been translated at the relevant period end rates. For hyperinflation countries, the local currency results are adjusted for the impact of inflation prior to translation to sterling at closing exchange rates.

The principal exchange rates used were as follows:

	Average		Closing	
	2011	2010	2011	2010
US dollar	1.604	1.546	1.554	1.566
Canadian dollar	1.586	1.592	1.583	1.556
Euro	1.153	1.166	1.197	1.167
South African rand	11.632	11.300	12.547	10.358
Brazilian real	2.683	2.719	2.899	2.599
Australian dollar	1.554	1.682	1.516	1.527
Russian rouble	47.116	46.945	49.922	47.795
Japanese yen	127.826	135.518	119.572	126.982

SEGMENTAL ANALYSES OF REVENUE AND PROFIT

As part of the plans to reduce complexity and drive efficiency in management structures and achieve a better balance in the scale of our regions, it was decided to reduce the management structure from five regions to four regions from 1 January 2011. Markets which comprised the Eastern Europe region were merged into the Africa and Middle East region and the Western Europe region. Russia, Ukraine, Moldova, Belarus, Caucasus and Central Asia form part of the new Eastern Europe, Middle East and Africa region (EEMEA) while Romania, Bulgaria, Serbia, Montenegro, Albania and Kosovo have become part of the Western Europe region. The comparatives have been restated according to the new management structure.

The four geographic regions are the reportable segments for the Group as they form the focus of the Group's internal reporting systems and are the basis used by the chief operating decision maker, identified as the Management Board, for assessing performance and allocating resources.

Segmental analysis of revenue and profit cont...

The Management Board reviews current and prior year segmental revenue, adjusted profit from operations of subsidiaries and adjusted post-tax results of associates and joint ventures at constant rates of exchange. As a result, the 2011 segmental results are translated using the 2010 average rates of exchange. The 2010 comparative figures are also stated at the 2010 actual average rates of exchange.

The analyses of **revenue** for the 12 months to 31 December 2011, and 31 December 2010, based on location of sales, are as follows:

	2011			2010
	Revenue Constant rates £m	Translation exchange £m	Revenue Current rates £m	Revenue Restated £m
Asia-Pacific	4,150	101	4,251	3,759
Americas	3,574	(16)	3,558	3,498
Western Europe	3,532	68	3,600	3,695
EEMEA	4,206	(216)	3,990	3,931
Total	<u>15,462</u>	<u>(63)</u>	<u>15,399</u>	<u>14,883</u>

The analyses of profit from operations and the Group's share of the post-tax results of associates and joint ventures for the year ended 31 December 2011, reconciled to profit before tax, are as follows:

	2011				
	Adjusted* segment result Constant rates £m	Translation exchange £m	Adjusted* segment result Current rates £m	Adjusting items £m	Segment result Current rates £m
Asia-Pacific	1,480	59	1,539	(58)	1,481
Americas	1,440	1	1,441	(15)	1,426
Western Europe	1,204	24	1,228	(153)	1,075
EEMEA	1,362	(51)	1,311	(298)	1,013
	<u>5,486</u>	<u>33</u>	<u>5,519</u>	<u>(524)</u>	<u>4,995</u>
Fox River**				(274)	(274)
Profit from operations	<u>5,486</u>	<u>33</u>	<u>5,519</u>	<u>(798)</u>	<u>4,721</u>
Net finance costs					<u>(460)</u>
Asia-Pacific	238	(13)	225	28	253
Americas	448	(16)	432	(17)	415
EEMEA	<u>2</u>		<u>2</u>		<u>2</u>
Share of post-tax results of associates and joint ventures	<u>688</u>	<u>(29)</u>	<u>659</u>	<u>11</u>	<u>670</u>
Profit before taxation					<u>4,931</u>

*The adjustments to profit from operations and the Group's share of the post-tax results of associates and joint ventures are explained on pages 22 and 25.

**The Fox River provision made in 2011 (see page 23), has not been allocated to a segment or segments as it relates to a 1998 settlement agreement. It is presented separately from the segmental reporting which is used to evaluate segment performance and to allocate resources.

Segmental analysis of revenue and profit cont...

The analyses of profit from operations and the Group's share of the post-tax results of associates and joint ventures for the year ended 31 December 2010 are as follows:

	2010 Restated		
	Adjusted* Segment result Current rates £m	Adjusting items £m	Segment result Current rates £m
Asia-Pacific	1,332	(56)	1,276
Americas	1,382	(36)	1,346
Western Europe	1,103	(236)	867
EEMEA	1,167	(338)	829
Profit from operations	<u>4,984</u>	<u>(666)</u>	<u>4,318</u>
Net finance costs			<u>(480)</u>
Asia-Pacific	208	(9)	199
Americas	412	(63)	349
EEMEA	<u>2</u>	<u>-</u>	<u>2</u>
Share of post-tax results of associates and joint ventures	<u>622</u>	<u>(72)</u>	<u>550</u>
Profit before taxation			<u><u>4,388</u></u>

*The adjustments to profit from operations and the Group's share of the post-tax results of associates and joint ventures are explained on pages 22 and 25.

ADJUSTING ITEMS INCLUDED IN PROFIT FROM OPERATIONS

Adjusting items are significant items in the profit from operations which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance. These items are separately disclosed either as memorandum information on the face of the income statement and in the segmental analyses, or in the notes as appropriate. The Group believes that these items are useful to the users of the Group condensed financial statements in helping them understand the underlying business performance and are used to derive the Group's principal non-GAAP measure which is adjusted diluted earnings per share.

(a) Restructuring and integration costs

Restructuring costs reflect the costs incurred as a result of initiatives to improve the effectiveness and the efficiency of the Group as a globally integrated enterprise. These initiatives include a review of the Group's manufacturing operations, overheads and indirect costs, organisational structure and systems and software used. The costs of these initiatives together with the costs of integrating acquired businesses into existing operations, including acquisition costs, are included in profit from operations under the following headings:

	2011	2010
	£m	£m
Employee benefit costs	100	163
Depreciation, amortisation and impairment costs	39	100
Other operating expenses	72	68
Other operating income	(18)	(20)
Total	193	311

Restructuring and integration costs in 2011 principally relate to the continuation of: factory closure and downsizing activities in Denmark and Australia respectively; a voluntary separation scheme and closure of the printing unit in Argentina; the closure of the Jawornik factory in Poland; the Lecce factory in Italy and Tire factory in Turkey. The costs also cover the social plan and other closure activities relating to the Bremen factory closure in Germany, integration of Productora Tabacalera de Colombia, S.A.S. (Protabaco) into existing operations, including acquisition costs, as well as other restructuring initiatives directly related to improving the efficiency and effectiveness of the Group as a globally integrated enterprise. In addition, they also include separation packages in respect of permanent headcount reductions in the Group.

Restructuring and integration costs in 2010 principally relate to: the continuation of factory closure and downsizing activities in Denmark and Australia respectively; the closure of the Jawornik factory in Poland and the Tire Factory in Turkey; the planned closure of the Lecce factory in Italy; a voluntary separation scheme and closure of the printing unit in Argentina and the continued integration of Bentoel into existing operations, as well as other restructuring initiatives directly related to improving the efficiency and effectiveness of the Group as a globally integrated enterprise. These include the combining of the Group's businesses in Belgium, Luxembourg and the Netherlands and some other activities to reduce the overheads of the Group. The Group also recognised impairment charges as a result of the continued review of its software assets in light of the development of global software solutions.

Restructuring and integration costs in 2010 also include a payment of US\$21 million to Reynolds American relating to the early termination and settlement of all disputes at issue in respect of the Contract Manufacturing Agreement dated 30 July 2004.

Other operating income in 2011 includes gains on sale of surplus land and buildings in Argentina as well as the release of deferred income from a disposal in 2007. In 2010, other operating income also includes gains on property disposals and the release of deferred income from a disposal in 2007.

Adjusting items included in profit from operations cont...

(b) Amortisation of trademarks

The acquisitions of Protabaco, Bentoel, Tekel and ST resulted in the capitalisation of trademarks which are amortised over their expected useful lives, which do not exceed 20 years. The amortisation charge of £58 million (2010: £62 million) is included in depreciation, amortisation and impairment costs in the profit from operations.

(c) Impairment of goodwill and trademarks

During 2011, the Group impaired the remaining balance of the goodwill in respect of the Tekel acquisition in 2008, amounting to £273 million. This followed a goodwill and trademark impairment of £249 million and £44 million respectively for the year to 31 December 2010. Although cost savings initiatives in the acquisition plan have been delivered successfully, the impairment recognised in 2010 was calculated on the basis of no further significant excise increases. However, the Turkish government announced a further excise increase effective from October 2011 and an additional increase effective from January 2013. The excise increases to date have resulted in the growth of illicit trade and a loss of volumes on market share and this is expected to continue. Turkey remains an important strategic market for the Group.

(d) Fox River

A provision of £274 million has been made for a potential claim under a 1998 settlement agreement entered into by a Group subsidiary in respect of the clean up of sediment in the lower Fox River. See contingent liabilities on page 40 for full details.

OTHER CHANGES IN THE GROUP

(a) Productora Tabacalera de Colombia, S.A.S. (Protabaco)

On 11 October 2011, the Group acquired from Flentex Holdings Limited and Trioumvir Enterprises Limited, both private investor shareholders, a 100 per cent stake in Productora Tabacalera de Colombia, S.A.S. (Protabaco), for US\$461 million (£298 million). The purchase price is subject to the final agreement of adjustments for working capital and net debt with the vendors. The completion follows earlier approval by Colombia's competition authority, the Superintendence of Industry and Commerce, on 2 August 2011.

The goodwill of £134 million on the acquisition of the cigarette business of Protabaco, stated at the exchange rates ruling at the date of the transaction, arises as follows:

Provisional values:

	Book value	Fair value adjustments	Fair value
	£m	£m	£m
Intangible assets		121	121
Property, plant and equipment	37	17	54
Deferred tax asset	1	(1)	
Inventories	42	(4)	38
Trade and other receivables	19		19
Cash and cash equivalents	3		3
Retirement benefit liabilities	(1)		(1)
Deferred tax liabilities		(42)	(42)
Provisions	(5)	(9)	(14)
Trade and other payables	(11)	(3)	(14)
Net assets acquired	85	79	164
Goodwill			134
Total consideration			298

The goodwill of £134 million on the acquisition of the business represents a strategic premium to strengthen the Group's position in Latin America's fourth largest market, building on British American Tobacco's existing business and anticipated synergies, that will arise from combining the businesses in Colombia, post-acquisition.

Other changes in the Group cont...

In the period from 11 October 2011 to 31 December 2011, the acquired business contributed revenue of £9 million and a loss from operations of £13 million after charging £2 million for amortisation of acquired intangibles and £10 million in respect of restructuring and integration costs.

If the acquisition had occurred on 1 January 2011, before accounting for anticipated synergies and restructuring benefits, it is currently estimated that Group revenue would have been £15,452 million and Group profit from operations would have been £4,714 million for the 12 months to 31 December 2011. These amounts have been estimated based on Protabaco's results for the period prior to acquisition, adjusted to reflect changes arising from differences in accounting policies and the anticipated effect of fair value adjustments. The amounts estimated for profit from operations are after charging £9 million for the amortisation of acquired intangibles for the period to 11 October 2011.

Acquisition costs of £3 million have been expensed as part of other operating expenses within restructuring and integration costs (see page 22).

(b) Lyfra NV

On 7 April 2010, the Group announced that it had agreed to sell its Belgium distribution business, Lyfra NV, to Landewyck Group S.a.r.l. The transaction was completed on 25 June 2010 for a consideration of €16 million and resulted in a gain of £5 million. Lyfra contributed £215 million to revenue and £1 million to profit from operations to 25 June 2010 in the Western Europe region.

(c) Gauloises licence agreement termination

With effect from the end of the first quarter in 2010, the Gauloises licence agreement applicable in Germany, was terminated. The agreement resulted in a revenue contribution of £37 million and a profit contribution of £5 million to the 2010 results in the Western Europe region.

(d) Phone card distribution business in Brazil

During 2010, the Group made the decision to withdraw from distributing phone cards in Brazil. The phone card distribution business contributed £134 million to revenue and £3 million to profit from operations to the 2010 results in the Americas region.

(e) Termination of distributor arrangement

With effect from 1 July 2011, the arrangement by which the Group acted as a distributor for a third party in Norway, was terminated. This arrangement contributed £57 million to revenue and less than a £1 million to profit from operations in the Western Europe region in 2010, and £30 million and £nil, respectively, for the six months ended 31 December 2010.

NET FINANCE COSTS

Net finance costs comprise:

	2011	2010
	£m	£m
Finance costs	(577)	(507)
Finance income	117	27
	(460)	(480)
Comprising:		
Interest payable	(567)	(583)
Interest and dividend income	82	60
Net impact of fair value and exchange	25	43
- fair value changes - derivatives	(12)	(209)
- exchange differences	37	252
	(460)	(480)

Net finance costs cont...

Net finance costs at £460 million were £20 million lower than last year, reflecting the strong cash generation of the business.

The net £25 million gain (2010: £43 million) of fair value changes and exchange differences reflects a £9 million loss position (2010: £nil position) from the net impact of exchange rate movements and a gain of £34 million (2010: gain of £43 million), principally due to the interest related changes in the fair value of derivatives.

The Group targets interest cover, as calculated under its key central banking facilities, of greater than five times. For 2011 it was 12.5 times (2010: 11.2 times) with the higher cover reflecting improved adjusted profits before tax.

ASSOCIATES AND JOINT VENTURES

The Group's share of the post-tax results of associates and joint ventures was £670 million (2010: £550 million) after net adjusting income of £11 million (2010: £72 million charge) and after tax of £331 million (2010: £322 million). Excluding the adjusting items, the Group's share of the post-tax results increased by 6 per cent to £659 million (2010: £622 million). The following adjusting items are excluded from the calculation of adjusted diluted earnings per share (page 28).

In 2011, the Group's interest in ITC decreased from 31.43 per cent to 31.04 per cent as a result of ITC issuing ordinary shares under the company's employee stock option scheme. The issue of shares and change in the Group's share of ITC resulted in a gain of £28 million, which is treated as a partial deemed disposal and included in the income statement.

During the year, Reynolds American, along with other tobacco companies, was refused by the US Supreme Court a request to revoke a 2009 order requiring them to finance a US\$278 million smoking cessation programme in Louisiana (Scott case). The Group's share of this charge amounts to £23 million (net of tax).

In March 2011, Reynolds American sold Lane Limited for US\$205 million in cash. The Group's share of the gain on disposal of this business amounts to £22 million (net of tax).

Reynolds American has also recognised the following amounts which have been combined in adjusting items and reported as other: Reynolds American reported a charge of US\$64 million in respect of four Engle progeny lawsuits that have proceeded through the appellate process in the state of Florida. The amount includes compensatory and punitive damages as well as attorneys' fees and statutory interest. The Group's share of this charge amounts to £10 million (net of tax). Reynolds American recognised trademark amortisation and impairment of US\$47 million and the Group's share of these charges amounted to £8 million (net of tax). Reynolds American reported US\$16 million and US\$11 million of tax credits and interest respectively. The Group's share of these credits amounts to £6 million (net of tax). Reynolds American recognised restructuring costs of US\$23 million. The Group's share of these charges amounts to £4 million (net of tax).

During 2010, the Group's interest in ITC decreased from 31.92 per cent to 31.43 per cent as a result of ITC issuing ordinary shares under the Company's Employee Stock Option Scheme. This resulted in a charge of £9 million.

In the year ended 31 December 2010, a subsidiary of Reynolds American, R.J. Reynolds Tobacco Company Inc. (RJRTC), entered into a comprehensive settlement agreement with the Canadian federal, provincial and territorial governments to resolve all the governments' civil claims related to smuggling in Canada during the 1980s and 1990s. As part of the civil settlement, RJRTC agreed to pay the governments C\$325 million. In a separate matter, a subsidiary of R.J. Reynolds Tobacco Holdings Inc., Northern Brands International Inc., entered into a plea agreement with the Ministry of the Attorney General of Ontario. As a result of its plea to one count of conspiracy to aid others in the sale and possession of contraband cigarettes in the early 1990s, Northern Brands paid a fine of C\$75 million. The Group's share of these charges amounted to £59 million (net of tax).

Associates and joint ventures cont...

In the year ended 31 December 2010, Reynolds American recognised the following amounts which have been combined in adjusting items and reported as other: Reynolds American also recognised restructuring charges in the year ended 31 December 2010 from the closure of one factory in August 2010 and the planned closure of another in mid 2011. As a result of these actions, Reynolds American has recorded charges mostly relating to asset impairment and to a lesser extent, severance costs. The Group's share of these charges amounted to £6 million (net of tax). RJRTC received a payment of US\$21m as a result of the agreement to terminate early the Contract Manufacturing Agreement dated 30 July 2004 between RJRTC and BATUS Japan Inc., a wholly owned Group subsidiary, and settle all disputes at issue between the parties as explained on page 64. The Group's share of this receipt amounted to £3 million (net of tax) and is treated as an adjusting item. Reynolds American recognised a trademark impairment charge of US\$6 million as well as trademark amortisation of US\$4 million. The Group's share of these charges amounted to £1 million (net of tax).

TAXATION

	2011 £m	2010 £m
UK		
- adjustment in respect of prior periods		(16)
Overseas		
- overseas tax	1,449	1,270
- adjustment in respect of prior periods	21	24
Current tax	1,470	1,278
Deferred tax	86	(30)
	<u>1,556</u>	<u>1,248</u>

The tax rates in the income statement of 31.6 per cent in 2011 and 28.4 per cent in 2010 are affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results and by adjusting items. The underlying tax rate for subsidiaries reflected in the adjusted earnings per share below was 31.2 per cent in 2011 and 30.2 per cent in 2010. The increase is mainly due to a change in the mix of profits. The charge relates to taxes payable overseas.

EARNINGS PER SHARE

	2011 pence	2010 pence
Earnings per share		
- basic	157.1	145.2
- diluted	156.2	144.4
Adjusted earnings per share		
- basic	195.8	176.7
- diluted	194.6	175.7
Headline earnings per share		
- basic	168.7	160.9
- diluted	167.7	160.0

Basic earnings per share are based on the profit for the year attributable to ordinary shareholders and the weighted average number of ordinary shares in issue during the period (excluding treasury shares).

For the calculation of the diluted earnings per share, the weighted average number of shares reflects the potential dilutive effect of employee share schemes.

The presentation of headline earnings per share, as an alternative measure of earnings per share, is mandated under the JSE Listing Requirements. It is calculated in accordance with Circular 3/2009 'Headline Earnings', as issued by the South African Institute of Chartered Accountants.

Earnings have been affected by a number of adjusting items which impact profit from operations (see pages 22 and 23) and share of post-tax results of associates and joint ventures (see pages 25 and 26). For the years to 31 December 2011 and 2010, it was also affected by the write-off of deferred tax assets of £33 million and £35 million respectively, which have also been treated as adjusting items. In order to illustrate the impact of these items, the adjusted diluted earnings per share are shown below:

	2011 pence	2010 pence
Unadjusted earnings per share	156.2	144.4
Effect of restructuring and integration costs	7.4	11.8
Effect of impairment of goodwill and trademarks	13.3	11.8
Effect of deferred tax asset written off	2.2	1.8
Effect of amortisation of trademarks	2.2	2.3
Effect of Fox River	13.8	
Effect of associates' adjusting items	(0.5)	3.6
Adjusted diluted earnings per share	<u>194.6</u>	<u>175.7</u>

Similar types of adjustments would apply to basic earnings per share.

Earnings per share cont...

The earnings per share are based on:

	2011		2010	
	Earnings	Shares	Earnings	Shares
	£m	m	£m	m
Earnings per share				
- basic	3,095	1,970	2,879	1,983
- diluted	3,095	1,982	2,879	1,994
Adjusted earnings per share				
- basic	3,857	1,970	3,504	1,983
- diluted	3,857	1,982	3,504	1,994
Headline earnings per share				
- basic	3,323	1,970	3,191	1,983
- diluted	3,323	1,982	3,191	1,994

Headline earnings per share are calculated by taking the following adjustments into account:

	2011	2010
	pence	pence
Unadjusted earnings per share	156.2	144.4
Effect of impairment of intangibles and property, plant and equipment	14.4	15.6
Effect of gains on disposal of non-current assets held-for-sale	(0.5)	(0.7)
Effect of gains on disposal of businesses and trademarks		(0.2)
Effect of gains reclassified from the available-for-sale reserve	(0.1)	
Effect of share of associates' trademark and other asset impairments and termination of joint venture	0.4	0.4
Effect of share of associates' gains on disposal of assets held-for-sale	(1.3)	-
Effect of issue of shares and change in shareholding in associate	(1.4)	0.5
Headline earnings per share	167.7	160.0

An alternative measure of headline earnings per share has been presented below to take account of the effect of Fox River (see page 23); this measure is in addition to that mandated by the JSE Listing Requirements.

Headline earnings per share amended for Fox River	181.5	160.0
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CASH FLOW AND NET DEBT MOVEMENTS

a) Alternative cash flow

The IFRS cash flow statement on page 16 includes all transactions affecting cash and cash equivalents, including financing. The alternative cash flow statement below is presented to illustrate the cash flows before transactions relating to borrowings.

	2011 £m	2010 £m
Adjusted profit from operations (page 11)	5,519	4,984
Depreciation, amortisation and impairment	447	442
Other non-cash items in operating profit	68	59
Profit from operations before depreciation and impairment	6,034	5,485
Increase in working capital	(281)	(61)
Net capital expenditure	(566)	(523)
Gross capital expenditure	(611)	(584)
Sale of fixed assets	45	61
Operating cash flow	5,187	4,901
Net interest paid	(469)	(491)
Tax paid	(1,447)	(1,178)
Dividends paid to non-controlling interests	(275)	(234)
Restructuring costs	(217)	(219)
Dividends and other appropriations from associates	547	461
Free cash flow	3,326	3,240
Dividends paid to shareholders	(2,358)	(2,093)
Share buy-back (including transaction costs)	(755)	
Net investment activities	(311)	
Purchases of subsidiaries, non-controlling interests and trademarks	(311)	(12)
Disposal of subsidiaries		12
Net flow from share schemes and other	(93)	(77)
Net cash flow	(191)	1,070
External movements on net debt		
Exchange rate effects*	123	(41)
Net debt disposed		11
Change in accrued interest and other	(19)	(39)
Change in net debt	(87)	1,001
Opening net debt	(7,841)	(8,842)
Closing net debt	(7,928)	(7,841)

* Including movements in respect of debt related derivatives.

Free cash flow is the Group's cash flow before dividends, share buy-back and investing activities. Operating cash flow increased by £286 million or 6 per cent to £5,187 million, reflecting growth in underlying operating performance partially offset by working capital movements. Taking into account outflows relating to taxation, which were £269 million higher than last year due to higher taxable profits and an increase in dividends to non-controlling interests offset by higher dividends and other appropriations from associates due to the Reynolds share buy-back, the Group's free cash flow was £86 million or 3 per cent higher at £3,326 million.

Cash flow cont...

The ratio of free cash flow per share to adjusted diluted earnings per share was 86 per cent (2010: 92 per cent), with free cash flow per share increasing by 3 per cent (2010: increasing by 23 per cent).

Below free cash flow, the principal cash outflows for 2011 comprise the payment of the prior year final dividend and the 2011 interim dividend which was £265 million higher at £2,358 million as well as a £755 million outflow due to the resumption of the on-market share buy-back programme in 2011. Also reflected below free cash flow are cash flows in respect of investing activities. During 2011, there was a net cash outflow of £295 million relating to the purchase of Protabaco comprising the purchase price less acquired net cash and cash equivalents as explained on page 23. In addition, there was a cash outflow of £10 million for the acquisition of non-controlling interests in Chile and £6 million in respect of the purchase of trademarks. The year ended 31 December 2010 included proceeds on disposal of subsidiaries of £12 million which arose from the sale of the Group's Belgian distribution business, Lyfra NV as explained on page 24, offset by a cash outflow of £12 million arising from the acquisition of non-controlling interests in Bentoel and subsidiaries in the EEMEA region.

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

The above flows resulted in net cash outflows of £191 million (2010: £1,070 million inflow). After taking account of other changes, especially exchange rate movements, total net debt was £87 million higher at £7,928 million at 31 December 2011 (2010: £7,841 million).

b) Net debt

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

	2011	2010
	£m	£m
Net debt due within one year:		
Borrowings	(1,766)	(1,334)
Related derivatives	5	(29)
Cash and cash equivalents	2,194	2,329
Current available-for-sale investments	57	58
	<u>490</u>	<u>1,024</u>
Net debt due beyond one year:		
Borrowings	(8,510)	(8,916)
Related derivatives	92	51
	<u>(8,418)</u>	<u>(8,865)</u>
Total net debt	<u>(7,928)</u>	<u>(7,841)</u>

The Group remains confident about its ability to access the debt capital markets successfully and reviews its options on a continuing basis.

Cash flow cont...

c) IFRS cash generated from operations

The cash generated from operating activities in the IFRS cash flows on page 16 includes the following items:

	2011	2010
	£m	£m
Profit from operations	4,721	4,318
Adjustments for:		
Amortisation and impairment of trademarks	58	106
Amortisation and impairment of intangible assets	365	322
Gains on disposal of businesses		(5)
Depreciation and impairment of property, plant and equipment	394	469
Increase in inventories	(47)	(280)
Increase in trade and other receivables	(87)	(127)
Increase in trade and other payables	46	497
Decrease in net retirement benefit liabilities	(208)	(153)
Increase in provisions for liabilities and charges	232	17
Other non-cash items	63	43
Cash generated from operations	<u>5,537</u>	<u>5,207</u>

d) IFRS Investing and financing activities

The investing and financing activities in the IFRS cash flows on page 16 include the following items:

The purchases and proceeds on disposals of investments (which comprise available-for-sale investments and loans and receivables) comprises a net cash inflow in respect of current investments of £3 million (2010: £1 million outflow).

In 2011, the proceeds from associates' share buy-backs reflects proceeds of £71 million in respect of the Group's participation in the share buy-back programme conducted by Reynolds American Inc.

In 2011, the cash outflow of £295 million arising on the purchase of Protabaco reflects the settlement of the purchase consideration of £298 million less acquired net cash and cash equivalents of £3 million.

In the year ended 31 December 2010, the proceeds of disposal of subsidiaries in 2010 reflects the consideration received, less cash and cash equivalents disposed of, from the sale of the Group's Belgium distribution business, Lyfra NV, as explained on page 24.

The purchase of non-controlling interests of £10 million in 2011 relates to the acquisition of non-controlling interests in Chile. The cash outflow of £12 million in 2010 arises from the acquisition of non-controlling interests in Bentoel and subsidiaries in the EEMEA region.

The movement relating to derivative financial instruments is in respect of derivatives taken out to hedge cash and cash equivalents and external borrowings, derivatives taken out to hedge inter company loans and derivatives treated as net investment hedges. Derivatives taken out as cash flow hedges in respect of financing activities are also included in the movement relating to derivative financial instruments, while other such derivatives in respect of operating and investing activities are reflected along with the underlying transactions.

Cash flow cont...

e) IFRS net cash and cash equivalents

The net cash and cash equivalents in the IFRS Group cash flow statement on page 16 comprise:

	2011	2010
	£m	£m
Cash and cash equivalents per balance sheet	2,194	2,329
Accrued interest		(1)
Overdrafts	(252)	(145)
Net cash and cash equivalents	<u>1,942</u>	<u>2,183</u>

f) Liquidity

The Central Treasury Department is responsible for managing, within an overall policy framework, the Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risk arising from the Group's underlying operations.

The Group has a target average centrally managed debt maturity of at least 5 years with no more than 20 per cent of centrally managed debt maturing in a single rolling year. As at 31 December 2011, the average centrally managed debt maturity was 7.0 years (2010: 7.4 years) and the highest proportion of centrally managed debt maturing in a single rolling year was 18.3 per cent (2010: 12.5 per cent).

In June 2011, the Group established a US\$2 billion commercial paper programme. It is Group policy that short-term sources of funds (including drawings under both the US\$ programme and the existing Group £1 billion euro commercial paper (ECP) programme) are backed by undrawn committed lines of credit and cash. At 31 December 2011 £85 million of commercial paper was outstanding, while at 31 December 2010 the programme was undrawn.

In November 2011, the Group issued a new €600 million bond with a maturity of November 2021.

In September 2011, the Group repaid a Mexican Peso 1,444 million borrowing which was due in September 2011 with a new Mexican Peso 1,444 million borrowing due 2014.

In August 2011, the Group extended the maturity date of a US\$200 million facility from 2011 to 2016, and simultaneously increased the size of the facility to US\$240 million. This facility is drawable in Chilean pesos and was drawn to the value of US\$225 million at 31 December 2011. The undrawn element is available for drawing until February 2013.

In June 2011, the Group repaid a €530 million bond. The repayment was financed from Group cash balances.

During the period, the Group's subsidiary in Brazil received proceeds of £401 million (2010: £410 million) from short-term borrowings in respect of advance payments on leaf export contracts and repaid £519 million (2010: £297 million).

In May 2010, the Group repaid a €525 million bond. The repayment was financed from debt issued in November 2009. On 25 June 2010, the terms of €470 million of the €1 billion bond maturing in 2011 were modified by extending the maturity to 2020; at the same time, the Group issued an additional €130 million bond with a maturity of 2020. In addition, €413 million of the Group's €750 million bond maturing in 2012 was purchased and cancelled. At the same time, the Group issued a new £275 million bond with a maturity of 2040.

In December 2010, the Group negotiated a new central banking facility of £2 billion with a final maturity date of December 2015. The existing central banking facility of £1.75 billion, with a final maturity date of March 2012 was cancelled at the same time. The facility was undrawn at 31 December 2011 and 2010.

RETIREMENT BENEFIT SCHEMES

The Group's subsidiaries operate around 175 retirement benefit arrangements worldwide. The majority of the scheme members belong to defined benefit schemes, most of which are funded externally and many are closed to new entrants. The Group also operates a number of defined contribution schemes.

The present total value of funded scheme liabilities was £5,675 million (2010: £5,365 million), while unfunded scheme liabilities amounted to £346 million (2010: £337 million). The scheme assets increased from £5,134 million in 2010 to £5,200 million in 2011.

After accounting for minimum funding obligations of £2 million (2010: £29 million) and excluding unrecognised scheme surpluses of £75 million (2010: £51 million), the overall net liability for all pension schemes and healthcare schemes amounted to £898 million at the end of 2011, an increase from £648 million at the end of 2010.

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

LITIGATION: FRANKED INVESTMENT INCOME GROUP LITIGATION ORDER

British American Tobacco is the principal test claimant in an action in the United Kingdom against HM Revenue and Customs in the Franked Investment Income Group Litigation Order (FII GLO). There are 25 corporate groups in the FII GLO. The case concerns the treatment for UK corporate tax purposes of profits earned overseas and distributed to the UK. The claim was filed in 2003 and the case was heard in the European Court of Justice (ECJ) in 2005 and a decision of the ECJ received in December 2006. In July 2008, the case reverted to a trial in the UK High Court for the UK Court to determine how the principles of the ECJ decision should be applied in a UK context.

The High Court judgment in November 2008 concluded, amongst many other things, that dividends received from EU subsidiaries should be, and should have been, exempt from UK taxation. It also concluded that certain dividends received before 5 April 1999 from the EU and, in some limited circumstances after 1993 from outside the EU, should have been treated as franked investment income with the consequence that advance corporation tax need not have been paid. Claims for the repayment of UK tax incurred where the dividends were from the EU can be made back to 1973. The tentative conclusion reached by the High Court would, if upheld, produce an estimated receivable of about £1.2 billion for British American Tobacco.

The case was heard by the Court of Appeal in October 2009 and the judgment handed down on 23 February 2010. The Court of Appeal has determined that various questions should be referred back to the ECJ for further clarification. In addition, the Court determined that the claim should be restricted to six years and not cover claims dating back to 1973. This time restriction would, if upheld, reduce the value of the claim to between zero and £10 million. Based on advice received, the Company believes it has realistic prospects of success on further appeal. The Company sought leave to appeal from the Supreme Court in the UK and the Supreme Court has agreed to hear the appeal on time limits in February 2012. Several questions were referred back to the ECJ for further clarification and a hearing took place in February 2012 at the ECJ. The Courts' decisions are awaited.

No potential receipt has been recognised in the current year or the prior year, in the results of the Group, due to the uncertainty of the amounts and eventual outcome.

CONTINGENT LIABILITIES AND FINANCIAL COMMITMENTS

The Group is subject to contingencies pursuant to requirements that it complies with relevant laws, regulations and standards. Failure to comply could result in restrictions in operations, damages, fines, increased tax, increased cost of compliance, interest charges, reputational damage or other sanctions. These matters are inherently difficult to quantify.

In cases where the Group has an obligation as a result of a past event existing at the balance sheet date, it is probable that an outflow of economic resources will be required to settle the obligation and the amount of the obligation can be reliably estimated, a provision will be recognised based on best estimates and management judgment.

Contingent liabilities and financial commitments cont...

There are, however, contingent liabilities in respect of litigation, taxes in some countries and guarantees for which no provisions have been made.

The Group has exposures in respect of the payment or recovery of a number of taxes. The Group is and has been subject to a number of tax audits covering, amongst others, excise tax, value added taxes, sales taxes, corporate taxes, withholding taxes and payroll taxes.

The estimated costs of known tax obligations have been provided in these accounts in accordance with the Group's accounting policies. In some countries, tax law requires that full or part payment of disputed tax assessments be made pending resolution of the dispute. To the extent that such payments exceed the estimated obligation, they would not be recognised as an expense. In some cases disputes are proceeding to litigation.

While the amounts that may be payable or receivable could be material to the results or cash flows of the Group in the period in which they are recognised, the Board does not expect these amounts to have a material effect on the Group's financial condition.

Product liability litigation

Group companies, notably Brown & Williamson Holdings, Inc. (formerly Brown & Williamson Tobacco Corporation) (B&W) as well as other leading cigarette manufacturers, are defendants, principally in the United States, in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant.

Indemnity

In 2004, B&W completed the combination of the assets, liabilities and operations of its US tobacco business with R.J. Reynolds Tobacco Company (RJRT), a wholly-owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., pursuant to which Reynolds American Inc. was formed (the Business Combination). As part of the Business Combination, B&W contributed to RJRT all of the assets and liabilities of its US cigarette and tobacco business, subject to specified exceptions, in exchange for a 42 per cent equity ownership interest in Reynolds American Inc. As a result of the Business Combination:

- B&W discontinued the active conduct of any tobacco business in the United States;
- B&W contributed to RJRT all of its assets other than the capital stock of certain subsidiaries engaged in non-US businesses and other limited categories of assets;
- RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the United States on or prior to 30 July 2004; and
- RJRT agreed to indemnify B&W and each of its associates (other than Reynolds American Inc. and its subsidiaries) against, among other matters, all losses, liabilities, damages, expenses, judgments, attorneys' fees, etc., to the extent relating to or arising from such assumed liabilities or the assets contributed by B&W to RJRT (the RJRT Indemnification).

The scope of the RJRT Indemnification includes all expenses and contingent liabilities in connection with litigation to the extent relating to or arising from B&W's US tobacco business as conducted on or prior to 30 July 2004, including smoking and health tobacco litigation, whether the litigation is commenced before or after 30 July 2004 (the Tobacco Litigation).

Pursuant to the terms of the RJRT Indemnification, RJRT is liable for any possible judgments, the posting of appeal bonds or security, and all other expenses of and responsibility for managing the defence of the Tobacco Litigation. RJRT has assumed control of the defence of the Tobacco Litigation involving B&W, to which RJRT is also a party in most (but not all) of the same cases. Accordingly, RJRT uses or plans to use the same law firm or firms to represent both B&W and RJRT in any single or similar case (except in certain limited circumstances) as RJRT's interests are typically aligned with B&W's interests, as RJRT has substantial experience in managing recognised external legal counsel in defending the Tobacco Litigation and external counsel have independent professional responsibilities to represent the interests of B&W. In addition, in accordance with the terms of the RJRT Indemnification, associates of B&W have retained control of the defence in certain Tobacco Litigation cases with respect to which such associates are entitled to indemnification.

Included in the US litigation section below are all significant cases where B&W and/or a UK company is named as a defendant and all cases where RJRT is named as a defendant as a successor to B&W (the RJRT Successor Cases). The RJRT Successor Cases are covered by the RJRT Indemnification. Of the RJRT Successor Cases, the section below includes details of all cases where there has been an adverse judgment and also notes favourable judgments.

US litigation

The total number of US product liability cases pending at 31 December 2011 naming B&W was approximately 8,688 (2010: approximately 9,458). Of these, 5,588 cases are RJRT Successor Cases. For all of these cases, British American Tobacco Group companies have the protection of the RJRT Indemnification. British American Tobacco (Investments) Limited (Investments) has been served as a co-defendant in three of those cases (2010: five). No other UK based Group company has been served as a co-defendant in any US product liability case pending as at 31 December 2011. In 2011, there was one US product liability case tried to verdict against B&W and Investments (City of St. Louis - see below). There is one case (Daric Smith – see below) against B&W and Investments scheduled for trial on 16 July 2012. Since many of these pending cases seek unspecified damages, it is not possible to quantify the total amounts being claimed, but the aggregate amounts involved in such litigation are significant, possibly totalling billions of US dollars. The cases fall into four broad categories: medical reimbursement cases; class actions; individual cases and other claims.

(a) Medical reimbursement cases

These civil actions seek to recover amounts spent by government entities and other third party providers on healthcare and welfare costs claimed to result from illnesses associated with smoking. Although B&W continues to be a defendant in one healthcare cost recovery case involving a Native American tribe (see below), the vast majority of such cases have been dismissed on legal grounds.

Further, on 23 November 1998, the major US cigarette manufacturers (including B&W and RJRT) and the attorneys general of 46 US states and five US territories executed the Master Settlement Agreement (MSA), which settled medical reimbursement lawsuits that had been brought by these states and territories. Under the terms of the MSA, the settling cigarette manufacturers agreed, among other things, to pay approximately US\$246 billion to the settling states and territories (and to four states that reached separate settlements of their medical reimbursement actions) over 25 years, and agreed to various restrictions on US tobacco advertising and marketing. The MSA includes a credit for any amounts paid by participating manufacturers in subsequent suits brought by the states' political subdivisions.

At 31 December 2011, one US medical reimbursement suit was pending against B&W (2010: three). This suit has been brought by an Indian tribe in the Indian Tribal Court in South Dakota.

Two additional reimbursement cases pending against Group companies as at 31 December 2010 have recently been dismissed. The Nat'l Committee to Preserve Social Security & Medicare case against B&W and other defendants was dismissed by the district court on 22 December 2010 and judgment was entered in defendants' favour on 23 December 2010. The City of St. Louis case against B&W, Investments and several other defendants was dismissed following a jury verdict in defendants' favour on 29 April 2011. Final judgment was entered in defendants' favour on 10 June 2011 and the plaintiffs waived all rights to appeal this judgment.

(b) Class actions

At 31 December 2011, B&W was named as a defendant in some eight (2010: eight) separate actions attempting to assert claims on behalf of classes of persons allegedly injured or financially impacted through smoking or where classes of tobacco claimants have been certified. If the classes are or remain certified and the possibility of class-based liability is eventually established, it is likely that individual trials will be necessary to resolve any claims by individual plaintiffs. Class action suits have been filed in a number of states against individual cigarette manufacturers and their parent corporations, alleging that the use of the terms 'lights' and 'ultralights' constitutes unfair and deceptive trade practices.

The Cleary putative class action complaint was filed in state court in Chicago, Illinois on 3 June 1998 against several defendants, including B&W, B.A.T Industries p.l.c. (Industries) and Investments. Industries was dismissed on jurisdictional grounds by an intermediate appellate court on 17 March 2000. The case was removed to the federal district court on 13 March 2009. After certain discovery and motion practice, the plaintiffs' motion for leave to file a Fourth Amended Complaint was granted on 22 April 2010. The Fourth Amended Complaint alleged that all defendants fraudulently concealed facts regarding the addictive nature of nicotine and that defendant Philip Morris fraudulently marketed Marlboro Lights cigarettes, and sought disgorgement of profits. The defendants' motion to dismiss the Fourth Amended Complaint was granted on 22 June 2010. The plaintiffs filed a notice of appeal in the US Court of Appeals for the Seventh Circuit on 20 August 2010. In an order entered on 25 August 2011, the Seventh Circuit affirmed the federal district court's order dismissing the case. The plaintiffs' petition for rehearing with suggestion for rehearing en banc was denied by the Seventh Circuit on 15 November 2011. The plaintiffs have not sought further review of this decision.

In a medical monitoring class action brought on behalf of Louisiana smokers (Scott) the jury returned a verdict on 28 July 2003 in favour of the defendants on the plaintiffs' claim for medical monitoring and found that cigarettes were not defectively designed. However, the jury also made certain findings against the defendants on claims relating to fraud, conspiracy, marketing to minors and smoking cessation. Notwithstanding these findings, this portion of the trial did not determine liability as to any individual class member or class representative. On 21 May 2004, the jury returned a verdict in the amount of US\$591 million, requiring the defendants to fund a cessation programme to help eligible class members stop smoking. On 29 September 2004, the defendants posted a US\$50 million bond, pursuant to legislation that limits the amount of the bond to US\$50 million collectively for MSA signatories, and noticed their appeal. RJRT posted US\$25 million (the portions for RJRT and B&W) towards the bond. On 7 February 2007, the Louisiana Court of Appeals upheld the class certification and found the defendants responsible for funding smoking cessation for eligible class members. The appellate court also ruled, however, that no class member who began smoking after 1 September 1988 could receive any relief and that only those smokers whose claims accrued on or before 1 September 1988 would be eligible for the smoking cessation programme. In addition, the appellate court rejected the award of prejudgment interest, and struck eight of the twelve components of the smoking cessation programme. The defendants' application to the Louisiana Supreme Court for a writ of certiorari was denied on 7 January 2008. The defendants' petition to the US Supreme Court for a writ of certiorari was denied on 10 June 2008. On 21 July 2008, the trial court entered an amended judgment in the case. The court found that the defendants are jointly and severally liable for funding the cost of a court-supervised smoking cessation programme and ordered the defendants to deposit approximately US\$263 million together with interest from 30 June 2004, into a trust for the funding of the programme. On 23 April 2010, the Louisiana Court of Appeals amended but largely affirmed the trial court's amended judgment. Pursuant to the judgment, the defendants are required to deposit US\$242 million with the court, with interest from 21 July 2008 until paid. In September 2010, the defendants' application for writ of certiorari or review by the Supreme Court of Louisiana along with the defendants' motion to stay execution of the judgment was denied. On 24 September 2010, the US Supreme Court granted the defendants' motion to stay the judgment pending the US Supreme Court's disposition of the defendants' petition for a writ of certiorari. The defendants' petition for writ of certiorari in the US Supreme Court was denied on 27 June 2011. In August 2011, RJRT paid US\$139 million (the portion of the judgment allocated to RJRT and B&W) into the trust. On 31 October 2011, the plaintiffs requested that defendants pay attorneys' fees and litigation costs to plaintiffs' counsel. The defendants filed their opposition to the plaintiffs' request for attorney's fees on 6 January 2012. Discovery on this issue is currently continuing.

Black is a 'lights' class action filed in November 2000 in the Circuit Court, City of St. Louis, Missouri. B&W removed the case to the US District Court for the Eastern District of Missouri on 23 September 2005. On 25 October 2005, the plaintiffs filed a motion to remand, which was granted on 17 March 2006. On 16 April 2008, the court stayed the case pending US Supreme Court review in *Good v. Altria Group, Inc.* On 28 June 2011, the court issued a memorandum removing the case from the trial docket. A status conference is currently scheduled for 4 February 2013.

Brown is a case filed in June 1997 in the Superior Court, San Diego County, California. On 11 April 2001, the court granted in part the plaintiffs' motion for certification of a class composed of residents of California who smoked at least one of the defendants' cigarettes from 10 June 1993 through 23 April 2001, and who were exposed to the defendants' marketing and advertising activities in California. The plaintiffs seek to recover restitution, disgorgement of profits and other equitable relief under the California Business and Professions Code. Certification was granted as to the plaintiffs' claims that the defendants violated the section of the California Business and Professions Code pertaining to unfair competition. The court, however, refused to certify the class under the California Legal Remedies Act and on the plaintiffs' common law claims. On 7 March 2005, the court granted the defendants' motion to decertify the class. On 5 September 2006, the California Court of Appeal affirmed the judge's order decertifying the class. On 1 November 2006, the plaintiffs' petition for review with the California Supreme Court was granted. On 18 May 2009, the California Supreme Court reversed the decision issued by the trial court and affirmed by the California Court of Appeal that decertified the class to the extent that it was based upon the conclusion that all class members were required to demonstrate standing, and remanded the case to the trial court for further proceedings regarding whether the class representatives have, or can demonstrate, standing. On 10 March 2010, the California Superior Court found that the plaintiffs' 'lights' claims were not pre-empted by the Federal Cigarette Labelling and Advertising Act, held the court's 30 September 2004 ruling on the issue no longer viable and denied the defendants' second motion for summary judgment. The defendants filed a motion on 9 January 2012 requesting that the class be decertified because the class representatives do not meet the requisites of standing, adequacy, or typicality needed to represent the class. Trial is scheduled to begin on 5 October 2012.

Howard is a 'lights' class action filed in February 2000 in the Circuit Court, Madison County, Illinois. A judge certified a class on 18 December 2001. On 6 June 2003, the trial judge issued an order staying all proceedings pending resolution of *Price v. Philip Morris, Inc.*, a 'lights' class action against Philip Morris, Inc. in the Illinois state court. The plaintiffs appealed this stay order to the Illinois Fifth District Court of Appeals, which affirmed the Circuit Court's stay order on 19 August 2005. There is currently no activity in the case.

Jones is a case filed in December 1998 in the Circuit Court, Jackson County, Missouri. The defendants removed the case to the US District Court for the Western District of Missouri on 16 February 1999. The action was brought by tobacco product users and purchasers on behalf of all similarly situated Missouri consumers. The plaintiffs allege that their use of the defendants' tobacco products has caused them to become addicted to nicotine. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. The case was remanded to the Circuit Court on 17 February 1999. There has been limited activity in this case.

Parsons is a case filed in February 1998 in the Circuit Court, Ohio County, West Virginia. The plaintiff sued asbestos manufacturers, US cigarette manufacturers, including B&W, among other defendants, seeking to recover US\$1 million in compensatory and punitive damages individually and an unspecified amount for the class in both compensatory and punitive damages. The action was brought on behalf of a class of persons who allegedly have personal injury claims arising from their exposure to respirable asbestos fibres and cigarette smoke. The case has been stayed pending a final resolution of the plaintiffs' motion to refer tobacco litigation to the judicial panel on multidistrict litigation filed in *In Re: Tobacco Litigation* in the Supreme Court of Appeals of West Virginia. On 26 December 2000, three defendants, Nitral Liquidators, Inc., Desseaux Corporation of North American and Armstrong World Industries, filed bankruptcy petitions in the US Bankruptcy Court for the District of Delaware. Pursuant to the Bankruptcy Code, Parsons is automatically stayed with respect to all defendants.

Young is a case filed in November 1997 in the Circuit Court, Orleans Parish, Louisiana. The plaintiffs brought an Environmental Tobacco Smoke (ETS) class action on behalf of all residents of Louisiana who, though not themselves cigarette smokers, have been exposed to second-hand smoke from cigarettes which were manufactured by the defendants, and who allegedly suffered injury as a result of that exposure. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. On 13 October 2004, the trial court stayed this case pending the outcome of appellate review in the Scott class action in Louisiana (discussed above).

In Engle (a case in Florida), a jury awarded a total of US\$12.7 million to three class representatives, and in a later stage of the three-phase trial procedure adopted in this case, a jury assessed US\$17.6 billion in punitive damages against B&W. On 21 May 2003, the intermediate appellate court reversed the trial court's judgment and remanded the case to the trial court with instructions to decertify the class. On 16 July 2003, the plaintiffs filed a motion for rehearing which was denied on 22 September 2003. On 12 May 2004, the Florida Supreme Court agreed to review this case and, on 6 July 2006, it upheld the intermediate appellate court's decision to decertify the class and vacated the jury's punitive damages verdict. Further, the Florida Supreme Court permitted the judgments entered for two of the three Engle class representatives to stand, but dismissed the judgment entered in favour of the third Engle class representative. Finally, the Florida Supreme Court has permitted putative Engle class members to file individual lawsuits against the Engle defendants within one year of the court's decision (subsequently extended to 11 January 2008). The court's order precludes defendants from litigating certain issues of liability against the putative Engle class members in these individual actions. On 7 August 2006, the defendants filed a motion for rehearing before the Florida Supreme Court, which was granted in part and denied in part, on 21 December 2006. The Florida Supreme Court's 21 December 2006 ruling did not amend any of the earlier decisions' major holdings, which included decertifying the class, vacating the punitive damages judgment, and permitting individual members of the former class to file separate suits. Instead, the ruling addressed the claims on which the Engle jury's phase one verdict will be applicable to the individual lawsuits that were permitted to stand. On 1 October 2007, the United States Supreme Court denied the defendants' request for certiorari review of the Florida Supreme Court's decision.

As at 31 December 2011, B&W has been served in approximately 47 Engle progeny cases in both state and federal courts in Florida. These cases include approximately 103 plaintiffs. RJRT as a successor to B&W is named in approximately 5,572 Engle progeny cases. These 47 B&W cases and 5,572 RJRT have the benefit of the RJRT Indemnification.

In the first 'phase three' trial of an individual Engle class member (Lukacs), the jury awarded the plaintiff US\$37.5 million in compensatory damages (B&W's share: US\$8.4 million) on 11 June 2002. On 1 April 2003, the jury award was reduced to US\$25.1 million (B&W's share: US\$5.6 million) but no final judgment was entered into because the trial court postponed the entry of final judgment until the Engle appeal was fully resolved. The trial court, on 14 August 2008, issued an order entering judgment for the plaintiff that awarded US\$24.8 million to the plaintiff (plus interest), for which the defendants would be jointly and severally liable. On 17 October 2008, the plaintiff withdrew her request for punitive damages. On 12 November 2008, the trial court entered final judgment. On 1 December 2008, the defendants filed a notice of appeal. On 17 March 2010, the Third District Court of Appeal affirmed the ruling of the trial court. The defendants' motion for rehearing and petition for rehearing en banc was denied on 18 May 2010. RJRT expensed and paid the final judgment in the amount of approximately US\$15.2 million on 18 June 2010. On 21 June 2010, the court entered an order discharging the supersedeas bonds posted by the defendants.

As at 31 December 2011, approximately 22 additional phase three Engle trials naming RJRT as successor to B&W have proceeded to verdict. There have been no additional phase three Engle progeny trials naming B&W individually. Of these 22 trials, approximately 11 resulted in plaintiffs' verdicts. Total damages awarded against RJRT as successor to B&W in final judgments in these cases are approximately US\$21,493,351. This number is comprised of approximately US\$10,593,351 in compensatory damages and approximately US\$10,900,000 in punitive damages. As of 31 December 2011, RJRT had appealed 10 of these adverse judgments and all of these appeals remained pending. As of 31 December 2011, RJRT's time to file a notice of appeal from the eleventh of these final judgments had not expired.

In June 2009, the Florida legislature amended its existing bond cap statute by adding a US\$200 million bond cap that applies to all phase three Engle progeny cases in the aggregate and establishing individual bond caps for individual cases in amounts that vary depending on the number of judgments in effect at a given time. In May 2011, Florida removed the provision in this legislation that would have permitted this bond cap to expire on 31 December 2012. Plaintiffs in several Engle progeny cases have challenged the constitutionality of the bond cap. The Florida appellate courts upheld the constitutionality of the bond cap in each of these cases. One of these appellate courts has since certified to the Florida Supreme Court the question of whether the bond cap violates the Florida Constitution. The Florida Supreme Court accepted jurisdiction over the issue of the constitutionality of the bond cap on 23 January 2012.

(c) Individual cases

Approximately 3,091 cases were pending against B&W at 31 December 2011 (2010: 3,161), which were filed by or on behalf of individuals and in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to ETS. Of these cases, approximately: (a) 2,586 are ETS cases brought by flight attendants who were members of a class action (Broin) that was settled on terms that allow compensatory but not punitive damages claims by class members; (b) 411 are cases brought in consolidated proceedings in West Virginia, where the first phase of the trial began on 19 October 2011 but ended in a mistrial on 8 November 2011; (c) 47 are Engle progeny cases that have been filed directly against B&W; and (d) 47 are cases filed by other individuals.

As mentioned above there are a further 5,572 Engle progeny cases which name RJRT as successor to B&W. In addition, there are 16 cases filed by other individuals naming RJRT as successor to B&W. These cases are subject to the RJRT Indemnification and are not detailed here.

Of the individual cases that remain pending as of 31 December 2011, two resulted in verdicts against B&W:

In December 2003, a New York jury (Frankson) awarded US\$350,000 in compensatory damages against B&W and two industry organisations. In January 2004, the same jury awarded US\$20 million in punitive damages. On 22 June 2004, the trial judge granted a new trial unless the parties agreed to an increase in compensatory damages to US\$500,000 and a decrease in punitive damages to US\$5 million, of which US\$4 million would be awarded against B&W. The plaintiff agreed to a decrease in punitive damages but B&W has not agreed to an increase in compensatory damages. On 25 January 2005, B&W appealed to an intermediate New York State appellate court. Oral argument was heard on 8 May 2006. The appellate court affirmed the judgment on 5 July 2006, except insofar as it dismissed the plaintiff's design defect claims. The intermediate appellate court denied B&W's motion for leave to reargue, or in the alternative, for leave to appeal to the New York Court of Appeals on 5 October 2006. On 8 December 2006, the trial judge granted the plaintiff's application for entry of judgment in the amounts of US\$5 million in punitive damages and US\$175,000 in compensatory damages. The trial court also granted the plaintiff's motion to vacate that part of the 2004 order granting a new trial unless the parties agreed to an increase in compensatory damages to US\$500,000. RJRT posted a bond in the approximate amount of US\$8.018 million on 3 July 2007. B&W appealed from final judgment on 3 July 2007 to an intermediate New York State appellate court. Oral argument was heard on 28 January 2009. On 29 September 2009, the appellate court issued a decision modifying the final judgment by deleting the award of punitive damages, and remanding the case to the trial court for a new trial on the issue of punitive damages. On 15 January 2010, the appellate court denied the plaintiff's motion for additional time to seek leave to appeal to the New York Court of Appeals, but granted the plaintiff more time to file a motion for leave to reargue to the appellate court. The plaintiff's motion for leave to reargue was denied by the appellate court on 12 March 2010. As at 31 December 2011, no date has been set for a new trial on the issue of punitive damages.

On 1 February 2005, a Missouri jury (Lincoln Smith) awarded US\$500,000 in compensatory damages against B&W and then, on 2 February 2005, awarded US\$20 million in punitive damages, also against B&W. On 1 June 2005, B&W filed its notice of appeal. Oral argument was heard on 31 August 2006. On 31 July 2007, an intermediate Missouri appellate court affirmed the compensatory damages award but it reversed the punitive damages award, reasoning that the plaintiffs failed to produce sufficient evidence to justify the verdict. The majority of the court would have remanded the case for a second trial, limited to punitive damages, but a dissenting judge transferred the case to the Missouri Supreme Court, as permitted by Missouri law. Oral argument was heard by the Missouri Supreme Court on 13 February 2008. On 31 July 2008, the Missouri Supreme Court transferred the case back to the intermediate appellate court for further proceedings. In a decision entered on 16 December 2008, the intermediate appellate court again upheld the award of compensatory damages and reversed the jury's award of US\$20 million in punitive damages, sending the case back to the trial court for a new trial on punitive damages. Following a new trial, on 20 August 2009, a Missouri jury returned a verdict awarding US\$1.5 million in punitive damages against B&W. On 24 September 2009, B&W filed a motion for a new trial and a motion for judgment notwithstanding the verdict. On the same date, the plaintiffs filed a motion for additur, asking the court to increase the amount of punitive damages from US\$1.5 million to US\$20 million, and a motion to vacate, modify or set aside judgment, or in the alternative, for a new trial. On 21 December 2009, the court denied the plaintiffs' and B&W's post-trial motions. On 30 December 2009, B&W filed a notice of appeal. On 31 December 2009, the plaintiffs

filed a notice of appeal. The appeals were consolidated and oral argument was held with respect to both appeals on 28 September 2011. A decision remains pending.

(d) Other claims

The Flintkote Company (Flintkote), a US asbestos production and sales company, was included in the acquisition of Genstar Corporation by Imasco Limited in 1986 and became a Group subsidiary following the restructuring of Imasco Limited (now Imperial Tobacco Canada Limited (Imperial), the Group's operating company in Canada) in 2000. Soon after this acquisition, and as part of the acquisition plan, Genstar Corporation began to sell most of its assets, including the non-asbestos related operations and subsidiaries of Flintkote. The liquidation of Flintkote assets produced cash proceeds and, having obtained advice from the law firm of Sullivan & Cromwell LLP (S&C) and other advice that sufficient assets would remain to satisfy liabilities, Flintkote and Imasco Limited authorized the payment of a dividend of US\$170.2 million in 1986 and a further dividend of US\$355 million in 1987. In 2003, Imperial divested Flintkote and then, in 2004, Flintkote filed for bankruptcy in the United States Bankruptcy court for the District of Delaware. In 2006, Flintkote, representatives of both the present and future asbestos claimants, and individual asbestos claimants were permitted by the bankruptcy court to file a complaint against Imperial and numerous other defendants including S&C, for the recovery of the dividends and other compensation under various legal and equitable theories. S&C and Imperial filed cross complaints against each other. The case remains in the discovery phase, but over the last 18 months the court has resolved multiple issues that will narrow the case. Firstly, following a multi-day bench trial, the court issued a preliminary decision dismissing S&C. Flintkote settled with S&C for a nominal sum before the decision was made final. The settlement is subject to bankruptcy court approval but is expected to become final. Secondly, after a series of bench trials, on 5 October 2011, the court issued orders deciding multiple preliminary issues regarding Flintkote's claims to recover the dividends and Flintkote's claim that Imperial is its 'alter ego' for purposes of asbestos liabilities. Among other things, the court's rulings largely remove Flintkote's claim to the US\$355 million 1987 dividend. The court also concluded that Flintkote cannot pursue its alter ego claim (such claims must instead be pursued by individual asbestos plaintiffs). These rulings were made final on 6 January 2012. The remaining preliminary issue pending is whether Flintkote is stopped from pursuing certain fraudulent conveyance remedies as a result of contrary statements it made early in the litigation. Discovery is ongoing and is likely to continue throughout 2012. Flintkote intends to press the court to set a trial date in mid-2012 but it appears unlikely that a trial could be held before late 2012 or early 2013.

In Wisconsin, the authorities have identified potentially responsible parties (PRPs) to fund the clean up of river sediments in the lower Fox River. The pollution was caused by discharges of Polychlorinated Biphenyls (PCBs) from paper mills and other facilities operating close to the river. The cost of the clean up work has been estimated to be in excess of US\$900 million. Among the potentially responsible parties is NCR Corporation (NCR) which is liable for the clean up costs in a large portion of the river under the terms of a consent decree and a unilateral administrative order issued by the United States Environmental Protection Agency.

In 1978, a subsidiary of Industries, later known as Appleton Papers Inc. (Appleton), purchased what was then NCR's Appleton Papers Division from NCR. In 1978, Industries also incorporated a US entity by the name of BATUS, Inc. (BATUS), which in 1980 became the holding company for all of Industries' US subsidiaries, including Appleton. As the holding company, BATUS obtained insurance policies for itself and its subsidiaries that included coverage for certain environmental liabilities. Industries/BATUS spun off the Appleton business in 1990 via a Demerger Agreement with Wiggins Teape Appleton p.l.c., now known as Windward Prospects Ltd (Windward), and Wiggins Teape Appleton (Holdings) p.l.c., now known as Arjo Wiggins US Holdings Ltd (together, the AWA Entities), obtaining what Industries believes were full indemnities from the AWA Entities and Appleton for past and future environmental claims.

Disputes between NCR, Appleton, and Industries as to the indemnities given and received under the original purchase agreement in 1978 have been the subject of litigation that was commenced in 1995, a settlement agreement executed in 1998 (the Settlement Agreement), and an arbitration award in 2005. Under the terms of the Settlement Agreement and the arbitration award, Industries and Appleton generally have an obligation to share the costs of Fox River environmental claims with NCR (60:40), but Industries has never been required to pay any sums in this regard because Appleton and the AWA Entities have paid the non NCR (60 per cent) share of the clean up costs to date, and the governmental authorities have not identified Industries or BATUS as PRPs. Windward also separately, and indirectly, indemnified Appleton in respect of the clean up costs.

A trial is currently scheduled to begin in Wisconsin on 21 February 2012 to determine whether NCR/Appleton is liable for the clean-up costs in the upper portion of the Fox River. This trial is expected to address issues as to whether NCR/Appleton is liable as a result of the sale, by a predecessor of NCR's Appleton Papers Division, of scrap paper, or "broke", to other paper companies which in turn discharged PCBs into the river in the course of recycling the broke.

Industries has become aware that Windward settled the majority of Appleton's insurance claims (over which it had control) at what Industries believes constituted a significant discount, and has made dividend payments to its former and current shareholders of approximately US\$810 million, leaving it holding, according to its latest accounts, approximately US\$100 million of net assets. Accordingly, there may be a greater risk that the assets of Windward are insufficient to meet its obligations under the indemnities Industries believes it has been granted. Appleton's own accounts indicate limited financial resources.

In December 2011, Windward asserted that it did not indemnify Industries pursuant to the terms of the 1990 Demerger Agreement in respect of Industries' obligations under the Settlement Agreement. Industries disputes Windward's position and has commenced proceedings.

While Industries believes it may have defences to claims by NCR against it under the Settlement Agreement and arbitration award and remains hopeful that Appleton and the AWA Entities will satisfy their obligations with respect to the Fox River cleanup, taking into account court decisions, sums paid to date on the clean-up and other available information, Industries believes it may have an exposure of some US\$426 million (equivalent to £274 million) in clean up related costs. Accordingly, Industries has made a provision of £274 million, which has been treated as an adjusting item in the income statement. This figure is necessarily subject to uncertainty.

Industries has become aware that NCR is also being pursued by Georgia-Pacific LLC (Georgia-Pacific), the owner of a facility on the Kalamazoo River in South-West Michigan which released PCBs into that river. Georgia-Pacific has been designated as a PRP in respect of that river. Georgia-Pacific contends that NCR is responsible for, or should contribute to, the clean up costs, because (i) a predecessor to NCR's Appleton Paper Division sold "broke" containing PCBs to Georgia Pacific or others for recycling; (ii) NCR itself sold paper containing PCBs to Georgia Pacific or others for recycling; and/or (iii) NCR is liable for sales to Georgia Pacific or others of PCB containing broke by Mead Corporation, which, like the predecessor to NCR's Appleton Papers Division, coated paper with the PCB-containing emulsion manufactured by NCR. Industries understands that NCR does not believe that NCR has any liability in relation to the Kalamazoo River and that it will vigorously contest Georgia-Pacific's claim. Industries itself believes that Industries only has potential exposure under the Settlement Agreement or arbitration award if NCR is unsuccessful in its defence of the claim and it is found that PCB contamination in the Kalamazoo River is due to "broke" supplied by a predecessor of NCR's Appleton Papers Division.

Industries is taking active steps to protect its interests, including seeking to confirm its indemnities and to procure the repayment of the Windward dividends, with a view to restoring value to Windward and, accordingly, the indemnities it believes were granted to Industries.

UK-based Group companies

Investments has been served in the following US cases pending at 31 December 2011: one smoking and health class action (Cleary - see above); one class action alleging violations of Kansas antitrust and consumer protection laws (Daric Smith - see below); and two individual actions (Eiser and Perry). Two other cases which had been pending against Investments as at 31 December 2010 were no longer pending as at 31 December 2011 (City of St. Louis - see above, and the US Department of Justice case - see below). The Company and Investments have been served in one individual action alleging misappropriation of novel ideas and breach of contract (Gero), although on 7 November 2011, the trial court dismissed the Company and Investments from the case, which order the plaintiff appealed on 7 December 2011.

Conduct-based claims

On 22 September 1999, the US Department of Justice brought an action in the US District Court for the District of Columbia against various industry members, including RJRT, B&W, Industries and Investments. Industries was dismissed for lack of personal jurisdiction on 28 September 2000. The government sought to recover federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related, and, in addition, sought, pursuant to the Racketeer Influenced and Corrupt Organisations Act (RICO), disgorgement of profits the government contends were earned as a consequence of a RICO 'enterprise'. On 28 September 2000, the federal district court dismissed the portion of the claim which sought recovery of federal funds expended in providing healthcare to smokers who have developed diseases and injuries alleged to be smoking-related. The non-jury trial of the RICO portion of the claim began on 21 September 2004, and ended on 9 June 2005. On 17 November 2004, the US Court of Appeals for the DC Circuit heard an appeal by the defendants against an earlier district court decision that disgorgement of profits is an appropriate remedy for the RICO violations alleged by the government. On 4 February 2005, the DC Circuit allowed the appeal, ruling that the government could not claim disgorgement of profits. On 17 October 2005, the US Supreme Court declined to hear the appeal by the US government in respect of the claim for disgorgement of US\$280 billion of past profits from the defendants.

On 17 August 2006, the federal district court issued its Final Judgment and Remedial Order, consisting of some 1,600 pages of factual findings and legal conclusions. The court found in favour of the government, and against certain defendants, including RJRT, B&W and Investments. The court also ordered a wide array of injunctive relief, including a ban on the use of 'lights' and other similar descriptors. In addition, the Final Judgment and Remedial Order ordered the defendants to pay the government's costs, which were US\$1.9 million plus interest.

On 10 August 2007, the defendants filed their initial appellate briefs to the Court of Appeals for the DC Circuit. All defendants filed a joint appellate brief, and Investments also filed its own brief which raised the issue of whether Congress intended for RICO to apply to extraterritorial conduct by a foreign defendant. On 19 November 2007, the government filed its opposition and cross-appeal brief, seeking to reinstate certain remedial relief, including its disgorgement claims. On 22 May 2009, a three-judge appellate panel unanimously affirmed the federal district court's RICO liability judgment against Investments, Altria, Philip Morris, RJRT and Lorillard, ordered the dismissal of Counsel for Tobacco Research (CTR) and Tobacco Institute (TI) (two defunct US trade associations that were not covered by the district court's injunctive remedies), and remanded for further factual findings and clarification as to whether liability should be imposed against B&W, based on changes in the nature of B&W's business operations. The panel also remanded on four discrete issues relating to the injunctive remedies, including for the district court "to reformulate" the injunction on the use of low-tar descriptors "to exempt foreign activities that have no substantial, direct, and foreseeable domestic effects". The government's cross-appeal seeking disgorgement of past profits and the funding of smoking education and cessation programmes was denied. Investments' petition for panel rehearing and rehearing en banc was filed on 31 July 2009 and was denied on 22 September 2009 by the DC Circuit.

On 19 February 2010, the defendants and the government filed certiorari petitions with the US Supreme Court. On 28 June 2010, the US Supreme Court declined to grant certiorari on all petitions. On 23 July 2010, Investments filed a petition for rehearing of its certiorari petition before the US Supreme Court, on the basis of an intervening decision by the US Supreme Court that invalidated the "effects" test the federal district court and DC Circuit both used in concluding that the RICO statute applied to Investments' foreign conduct. The US Supreme Court denied Investments' rehearing petition on 3 September 2010.

On 7 July 2010, the DC Circuit issued its remand returning the case to the federal district court for further proceedings. At a status conference on 20 December 2010, the CTR and the TI were dismissed by consent of the parties and B&W was deemed "not to be a defendant" and was therefore not subject to the Final Judgment and Remedial Order.

On 28 December 2010, the government filed a motion to compel Investments to comply with injunctive remedies being sought in the case. On 21 January 2011, Investments filed its brief in opposition and its motion for reconsideration of the liability judgment and remedial relief against it based on intervening change in controlling law governing the extraterritorial application of US statutes. The government filed its reply in support of its motion to compel and its opposition to Investments' motion for reconsideration on 7 February 2011. Investments filed its reply in further support of its motion for reconsideration on 21 February 2011.

On 28 March 2011, the federal district court issued an opinion granting Investments' motion for reconsideration in part and denying it in part and granting the government's motion to compel in part and denying it in part. The district court determined that a decision by the US Supreme Court in an unrelated case issued several years after the district court's 2006 Final Judgment and Remedial Order, "rejected the 'effects' test for extraterritorial application", and therefore "invalidated the sole basis for [Investment's] liability" in this litigation". As a result, the district court held that the Final Judgment and Remedial Order no longer applied to Investments prospectively, and for this reason, Investments would not have to comply with any of the remaining injunctive remedies being sought by the government. The district court determined, however, that there was no basis for it to retrospectively modify Investments' obligation to pay the government's costs as a prevailing party under the Final Judgment and Remedial Order, and therefore ordered Investments to contribute its one-sixth share of the government's costs. Investments paid its share of the government's costs (a total of US\$404,243.88 inclusive of interest) on 25 May 2011. (RJRT paid approximately US\$782,000 in costs on behalf of itself and B&W on 28 September 2010.)

The government did not appeal the 28 March 2011 opinion. This means that Investments is no longer in the case and will not be subject to any injunctive relief that the court is expected to order against the remaining US defendants.

In the Daric Smith case, purchasers of cigarettes in the state of Kansas brought a class action in the Kansas State Court against B&W, Investments and certain other tobacco companies seeking injunctive relief, treble damages, interest and costs. The allegations are that the defendants participated in a conspiracy to fix or maintain the price of cigarettes sold in the US, including in the state of Kansas, in violation of the Kansas Restraint of Trade Act.

Prior discovery disputes involving Investments have now been resolved by motion and fact discovery is now closed. In late October 2010, the parties participated in a court-ordered mediation but the case was not resolved. In late October and early November 2010, all defendants, including Investments, moved for summary judgment. On 13 May 2011, Investments supplemented its summary judgment motion on the basis of its de minimis market share and the inapplicability of the Kansas Restraint of Trade Act to a nonresident (such as Investments) that did not purchase, sell or manufacture goods in the state of Kansas. The defendants' summary judgment motions were heard on 18 January 2012 and the Court reserved ruling.

On 22 July 2011, the plaintiff filed his own summary judgment motions. These will be briefed and argued, if necessary, after a decision on the defendants' summary judgment motions is issued. If the case is not dismissed on summary judgment, trial of the matter is scheduled to begin on 16 July 2012. In December 2011, the plaintiff filed a motion to file a second amended petition. The defendants' arguments in opposition to this motion were heard on 18 January 2012 and the Court reserved ruling.

Product liability outside the United States

At 31 December 2011, active claims against the Group's companies existed in 17 markets outside the US (2010: 22) but the only markets with more than five claims were Argentina, Brazil, Canada, Italy, Nigeria, and the Republic of Ireland (2010: seven). Medical reimbursement actions are being brought in Canada, Argentina, Brazil, Israel, Nigeria, Saudi Arabia and Spain.

(a) Medical reimbursement cases

Argentina

In 2007, the non-governmental organisation the Argentina Tort Law Association (ATLA) brought a reimbursement action against Nobleza Piccardo S.A.I.C.y.F. (Nobleza) and Massalín Particulares. A defence was filed by Nobleza on 1 October 2009. Nobleza and the federal government's preliminary objections were considered by the Civil Court in late 2009 and, on 23 December 2009, the Civil Court declared its lack of jurisdiction to hear the claim. On 11 March 2010, the case was sent to the Contentious-Administrative Court, which determined that it had jurisdiction over the case. On 24 June 2011, the Contentious-Administrative Court issued an Order stating that it would decide defendants' outstanding procedural objections together with the merits of the case. The case will now enter the evidentiary stage.

Brazil

In August 2007, the São Paulo Public Prosecutors office filed a medical reimbursement claim against Souza Cruz S.A. (Souza Cruz). A similar claim was lodged against Philip Morris. Souza Cruz's motion to consolidate the two claims was rejected and instead this case was removed to a different lower court. Souza Cruz filed a motion to reconsider the refusal for consolidation and an interlocutory appeal against assignment to the lower court. At the same time, the Public Prosecutor filed a motion challenging the connection between the two cases, which argument the State Court of Appeals accepted in August 2010 and ordered the two cases to progress independently. On 4 October 2011, the court dismissed the action against Souza Cruz, with a judgment on the merits. The plaintiff filed an appeal on 9 January 2012.

Canada

In Canada there are four pending statutory actions for recovery of healthcare costs arising from the treatment of smoking and health related diseases. These proceedings name various group companies. Legislation enabling provincial governments to recover the healthcare costs has been enacted in all 10 provinces and two of three territories in Canada but has only been proclaimed into force in British Columbia, New Brunswick, Newfoundland and Labrador, Ontario and Quebec. Actions have begun against various Group companies, including Imperial, in British Columbia, New Brunswick, Newfoundland and Labrador, and Ontario. In Quebec, three Canadian manufacturers, including Imperial, are challenging the legislation and the Quebec government has yet to issue a statement of claim.

The government of British Columbia brought a claim pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2000 (the Recovery Act) against domestic and foreign 'manufacturers' seeking to recover the plaintiff's costs of healthcare benefits. Imperial, Investments, Industries and other former Rothmans Group companies are named as defendants. The constitutionality of the Recovery Act was challenged by certain defendants and, on 5 June 2003, the British Columbia Supreme Court found the Recovery Act to be beyond the competence of the British Columbia legislature and, accordingly, dismissed the government's claim. The government appealed the decision to the British Columbia Court of Appeal which, on 20 May 2004, overturned the lower court's decision and declared the Recovery Act to be constitutionally valid. The defendants appealed to the Supreme Court of Canada in June 2005 and the court gave its judgment in September 2005 dismissing the appeals and declaring the Act to be constitutionally valid.

The federal government was enjoined by a Third Party Notice and presented a motion to strike out the claim. The hearing took place during the week of 3 March 2008 and the court found in favour of the federal government. The defendants appealed that decision and the hearing was held during the week of 1 June 2009. On 8 December 2009, the British Columbia Court of Appeal handed down its decision in both this case and the Knight class action (see below). This appeal was granted in part. The Court of Appeal held that it was not "plain and obvious" that the federal government did not owe a duty of care to tobacco manufacturers or consumers when it implemented its tobacco control strategy.

On 8 February 2010, the federal government sought leave to appeal this decision to the Supreme Court of Canada. On 10 March 2010, the defendant filed response materials and a cross appeal. The government of British Columbia sought leave to oppose the defendants' cross appeal in part. On 20 May 2010, the Supreme Court of Canada granted leave to appeal both in respect of the federal government's application and the defendants' conditional cross applications. The appeal was heard on 24 February 2011. On 29 July 2011, the Supreme Court of Canada delivered its opinion, which struck out the third party claims against the federal government.

The underlying medical reimbursement action remains at a preliminary case management stage. Damages have not yet been quantified by the plaintiff. Given the prior pendency of the Supreme Court application, and a number of other factors including delay on the part of the plaintiff in producing damages modelling materials, the trial date has been postponed and no trial date is currently set.

Non-Canadian defendants challenged the personal jurisdiction of the British Columbia Court and those motions were heard in the Supreme Court of British Columbia. On 23 June 2006, the court dismissed all defendants' motions, finding that there is a "real and substantial connection" between British Columbia and the foreign defendants. Subsequently, the defendants were granted leave to appeal that ruling to the Court of Appeal of British Columbia. The appeal was dismissed on 15 September 2006. The defendants filed leave to appeal to the Supreme Court on 10 November 2006, and that application was denied on 5 April 2007.

The government of New Brunswick has brought a medical reimbursement claim against domestic and foreign tobacco 'manufacturers', pursuant to the provisions of the Recovery Act passed in that Province in June 2006. The Company, Investments, Industries, Carreras Rothmans Limited (the UK Companies) and Imperial have all been named as defendants. The government filed a statement of claim on 13 March 2008. The Group defendants were served with the Notice of Action and Statement of Claim on 2 June 2008. A case management conference was held on 8 January 2009 so that other defendants could challenge the use of a contingent fee arrangement (CFA) for the plaintiff's lawyer. This challenge was refused at first instance. Leave to appeal was granted on limited grounds. These grounds, upon which leave was denied, were appealed directly to the Supreme Court of Canada. On 13 May, 2010, the New Brunswick Court of Appeal dismissed Imperial's appeal. The Supreme Court of Canada subsequently denied leave on all aspects of the CFA challenge, thus ending this preliminary challenge. The appeal was dismissed and an application to appeal to the Supreme Court was denied on 21 October 2010.

The UK Companies' challenge to the New Brunswick court's jurisdiction was heard in June 2010. The court of Queen's Bench dismissed the UK Companies' jurisdictional motions on 15 November 2010. The UK Companies sought leave to appeal this decision in the Court of Appeal of New Brunswick, which leave was denied 11 April 2011 by a single judge of the Court of Appeal. The UK Companies' applications for leave to appeal the 11 April 2011 decision of the Court of Appeal of New Brunswick were dismissed by the Supreme Court of Canada on 13 October 2011. No damages have yet been quantified by the plaintiff. The UK Companies filed demands for particulars on 15 November 2011.

The government of the Province of Ontario has also filed a C\$50 billion medical reimbursement claim against domestic and foreign tobacco 'manufacturers', pursuant to the provisions of the Tobacco Damages and Health Care Costs Recovery Act 2009. The UK Companies have all been named as defendants. Imperial was served on 30 September 2009 and the UK Companies were served on 8 October 2009. A case management judge has been appointed and the hearing on the UK Companies' jurisdiction motions commenced on 23 November 2011. The jurisdiction motion was heard in November 2011. Judgment was handed down on 4 January 2012 in favour of the plaintiff in respect of all the UK Companies. The effect of this order is that the court has determined that it has jurisdiction to hear the claim against the UK Companies. There is however an automatic right to appeal the judgment to the Court of Appeals.

The government of the Province of Newfoundland and Labrador filed a health care reimbursement claim in February 2011 against domestic and foreign tobacco 'manufacturers', pursuant to the provisions of the Tobacco Health Care Costs Recovery Act enacted in that Province. The UK Companies have all been named as defendants. Imperial was served on 1 April 2011, and the UK Companies were served on 22 March 2011. A case management judge has been appointed. The UK Companies have challenged the personal jurisdiction of the Newfoundland and Labrador court. These jurisdictional challenges are currently scheduled for hearing in May 2012.

Colombia

A medical reimbursement action pending as at 31 December 2010 against British American Tobacco (South America) Limited in Colombia was dismissed on 10 June 2011.

Israel

In Israel, a medical reimbursement claim was brought against Industries, B&W, Investments and B.A.T (U.K. and Export) Limited (BATUKE), amongst others, by Clalit Health Services. The plaintiff claimed damages of NIS7.6 billion and sought injunctive relief. On 13 July 2011, the Israeli Supreme Court reversed the trial court's ruling and dismissed the lawsuit on the grounds of remoteness. On 28 August 2011, the plaintiff filed a petition for the holding of an additional hearing before an expanded bench of the Supreme Court. A response on behalf of the Group company defendants was filed by 27 November 2011. The Supreme Court denied the plaintiff's petition for an additional hearing on 28 January 2012. The case is now closed.

Nigeria

Medical reimbursement actions have also been brought by eight Nigerian states (Lagos, Kano, Gombe, Oyo, Akwa Ibom, Ogun, Ondo and Ekiti) and by the federal government of Nigeria, each seeking the equivalent of billions of pounds sterling for costs allegedly incurred by the state and federal governments in treating smoking-related illnesses. British American Tobacco (Nigeria) Limited (BAT Nigeria) has been named as a defendant in each of the cases; the Company and Investments have been named as defendants in seven of the cases.

On 9 October 2009, the actions that had been filed by the Attorneys General of Ondo State and of Ekiti State were voluntarily discontinued by the plaintiffs without prejudice to refile by notices dated 5 October 2009 and 18 June 2009, respectively. The action filed by the Attorney General of Akwa Ibom was struck out without prejudice on 19 October 2009 for lack of prosecution.

On 21 February 2008, the Lagos action was voluntarily discontinued by the plaintiffs. On 13 March 2008, the Lagos Attorney General filed a substantially similar action which was marked as “qualified” under Lagos State’s “Fast-Track” system, seeking approximately £10.9 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. The “Fast-Track” system provides for resolution of the dispute within an eight-month time-period after filing. BAT Nigeria, the Company and Investments have all been served in the new action, and have filed preliminary objections. At a hearing on 16 September 2008, the court directed that the case no longer qualified to be heard on the “Fast Track” because service was yet to be completed on other non-BAT defendants. On 18 September 2009, the court issued a ruling denying the preliminary objections filed by the Company and Investments on the basis that the court was competent to hear the case as it related to the Company and Investments, that the Company and Investments are necessary parties to the action and that the suit therefore was not liable to be struck out as against the Company and Investments. On 2 October 2009, the Company and Investments filed notices of appeal from the entirety of the court’s ruling as it related to their respective objections. The Company and Investments filed their appeal briefs and, on 8 February and 6 July 2011, respectively, the plaintiff filed responding briefs in these appeals with motions for extensions of time. As at 31 December 2011, the appeals and plaintiff’s motions for extensions of time remain pending before the Court of Appeal. On 15 October and 19 October 2009, respectively, the Company and Investments filed motions to stay all proceedings pending the resolution of their appeals, which motion was granted by the High Court on 20 September 2010. On 15 June 2011, the Lagos Attorney General filed a notice of appeal from the High Court’s order granting a stay of proceedings, which remains pending as at 31 December 2011.

On 8 July 2008, the High Court of Gombe State issued a ruling on the preliminary objections filed by the Company, Investments and other defendants in the case, setting aside the service on all defendants and striking out the Gombe suit. In its decision, the court held that the writs served on the defendants were invalid, the plaintiff had failed to pay the requisite filing fees, and based on these filing defects, the court was not competent to assume jurisdiction. The court also stated, however, that the plaintiff, through its statement of claim and affidavit evidence filed in support of its ex parte motion for leave to serve outside the jurisdiction, had satisfied the requirements for service outside the jurisdiction. Although the plaintiff has not appealed from the court’s decision, the plaintiff has filed a renewed action in the High Court of Gombe State. The plaintiff seeks approximately £2.4 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. BAT Nigeria, the Company and Investments filed notices of preliminary objection in the renewed action. On 10 February 2011, the High Court denied the preliminary objections filed by the Company and Investments and the companies appealed the court’s ruling on 24 February 2011. The companies also filed motions to stay proceedings in the High Court pending the appeals, and on 19 December 2011 the High Court adjourned sine die pending resolution of the defendants’ appeals. On 8 July 2011, the Company and Investments filed their respective appeal briefs and their appeals remain pending as at 31 December 2011.

Oyo State seeks approximately £1.5 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. The High Court partially granted the preliminary objections filed by the Company and Investments on 22 June 2010 and set aside the service of the writ of summons. The Company and Investments appealed the court’s order insofar as it denied the remainder of the relief requested, including the High Court’s decision not to set aside the issuance of the writ. As at 31 December 2011, the Court of Appeal has yet to set a date for hearing of the appeals.

In Kano, the plaintiff seeks approximately £7.6 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. Preliminary objections filed by the Company and Investments were dismissed on 16 April 2010. The Company and Investments have appealed the decision and sought a stay of proceedings in the High Court pending appeal. On 13 May 2010, the plaintiff filed a motion in the High Court for preliminary injunctive relief, seeking, inter alia, orders to restrain the defendants from various alleged marketing and distribution practices in Kano State including the sale of tobacco products within 1000 meters of any public places that are predominately a location for minors. On 3 February 2011, the Company and Investments filed motions in the Court of Appeal to stay further proceedings in the High Court. On 14 February 2011, the plaintiff moved to dismiss the stay motions filed by the Company and Investments before the Court of Appeal. The Court of Appeal hearing on the stay motions filed by the Company and Investments and the plaintiff's motions to dismiss was adjourned on 26 January 2012. No new hearing date has been set. As at 31 December 2011, no date has been set for continuation of proceedings in the High Court.

In Ogun, the preliminary objections filed by BAT Nigeria, the Company and Investments were denied by the court on 20 May 2010. All three BAT defendants have filed appeals and the Company and Investments have sought a stay of proceedings pending their appeals. On 24 May 2010, the plaintiff filed a motion for preliminary injunctive relief in the High Court, seeking, inter alia, orders to restrain the defendants from committing various alleged marketing and distribution practices in Ogun State, including the sale of tobacco products within 1000 meters of any public places that are predominately a location for minors. On 21 October 2010, the High Court adjourned proceedings sine die pending resolution of the defendants' stay motions before the Court of Appeal. On 18 October 2011, the Court of Appeal set 8 May 2012 for hearing of the Company's appeal and reserved hearing of the Company's stay motion. BAT Nigeria's and Investments' appeals stand adjourned to 30 May 2012 for hearing of the Ogun Attorney General's motions for extensions of time to file responding briefs on appeal.

The Attorney General of the Federation filed suit on 6 November 2007 against the Company, Investments, BAT Nigeria and two other defendants, seeking approximately £21.3 billion in damages, including special, anticipatory and punitive damages, restitution and disgorgement of profits, as well as declaratory and injunctive relief. The Company, BAT Nigeria, and Investments, respectively, were served on 16, 18, and 19 December 2007, and filed preliminary objections. On 27 January 2010, the Attorney General of the Federation filed a notice of discontinuance of the action as against another defendant, and the court struck out the action as against that defendant.

Saudi Arabia

In Saudi Arabia, in 2007 there were reports that the Ministry of Health was pursuing a medical reimbursement action in the Riyadh General Court against a number of distributors and agents. According to these reports, the Ministry of Health would reportedly seek damages of at least 127 billion Saudi Riyals. As at 31 December 2011, no Group company has been served with process. A separate medical reimbursement action was reportedly filed by the King Faisal Specialist Hospital in the Riyadh General Court, naming 'BAT Company Limited' as a defendant. As at 31 December 2011, no Group company had been served with process in the action.

Spain

In early 2006, the Junta de Andalucia, in Spain, filed a medical reimbursement action against the State and tobacco companies (including BAT España S.A.) before the contentious-administrative courts. The State filed preliminary objections to the Junta's claim, with tobacco companies filing supporting briefs. The court upheld these preliminary objections and dismissed the claim in November 2007. The Junta's appeal of this ruling to the Supreme Court was dismissed in September 2009. However, in May 2009, the Junta filed a new contentious-administrative claim with similar allegations. The defendants filed procedural objections, which were rejected by the court. The next procedural step is for the Junta to file its exhibits to the claim which were not attached to the Writ.

(b) Class actions

Brazil

There are currently four class actions being brought in Brazil. One class action recently ended in a final defence judgment (see below). One is also a medical reimbursement (São Paulo), and is therefore discussed above.

In 1995, the Associação de Defesa da Saúde do Fumante (ADESF) class action was filed against Souza Cruz and Philip Morris in the São Paulo Lower Civil Court alleging that the defendants are liable to a class of smokers and former smokers for failing to warn of cigarette addiction. The case was stayed in 2004 pending the defendants' appeal from a decision issued by the lower civil court on 7 April 2004. That lower court decision held that the defendants had not met their burden of proving that cigarette smoking was not addictive or harmful to health, notwithstanding an earlier interlocutory order that the São Paulo Court of Appeals had issued, which directed the trial court to allow more evidence to be taken before rendering its decision. On 12 November 2008, the São Paulo Court of Appeals overturned the lower court's unfavourable decision of 2004, finding that the lower court had failed to provide the defendants with an opportunity to produce evidence. The case was returned to the lower court for production of evidence and a new judgment. On 19 March 2009, the Lower Civil Court ordered designation of court-appointed medical and advertising experts. The parties submitted questions to these court-appointed experts who subsequently delivered their reports. Each party also provided expert reports commenting on the court-appointed experts' conclusions. On 16 May 2011, the court granted Souza Cruz's motion to dismiss the action in its entirety on the merits. Plaintiffs filed an appeal of the dismissal on 22 July 2011. Souza Cruz filed its response on 5 October 2011. On 10 November 2011, the case records were sent to the Public Prosecutor Office. On 20 December 2011, the Public Prosecutor Office presented a non-binding, advisory opinion that rejected most of Souza Cruz's legal defence arguments. The case records were sent to the São Paulo State Court of Appeals. The appellate court has not yet issued a ruling.

The Brazilian Association for the Defense of Consumers' Health (Saudecon) filed a class action against Souza Cruz in the City of Porto Alegre, Brazil on 3 November 2008. The plaintiff purports to represent all Brazilian smokers whom, it alleges, are unable to quit smoking and lack access to cessation treatments. The plaintiff is seeking an order requiring the named defendants to fund, according to their market share, the purchase of cessation treatments for these smokers over a minimum period of two years. Souza Cruz was served with this complaint on 19 November 2008. On 18 May 2009, the case was dismissed with judgment on the merits. The plaintiffs appealed in August 2009 and Souza Cruz and Philip Morris both responded. On 22 July 2011, the Public Prosecution Office issued a non-binding opinion saying that the favourable first instance ruling should be vacated based on procedural issues. On 25 August 2011, the reporting justice of the appellate court rejected the Public Prosecution Office's opinion, finding that the trial court ruling should not be nullified. On 1 November 2011, the 9th Chamber of the Rio Grande do Sul State Court of Appeals granted the Public Prosecution Office special appeal, ordering the remittance of the case records in the first instance to complete proper notification to the Public Prosecutor Office of the sentence. On 14 December 2011, the Public Prosecution Office filed a special appeal. Souza Cruz's counter-arguments were submitted on 10 February 2012.

A class action was filed against Souza Cruz by the Association of Exploited Consumers of the federal District, requesting a court order to prevent Souza Cruz selling cigarettes in Brazil. In December 2006, the federal District Court of Appeals confirmed a favourable lower court decision which had found the claim groundless and unlawful. The plaintiff appealed that ruling, but on 12 March 2009 the Superior Court affirmed the ruling and rejected the plaintiff's appeal. The plaintiff appealed again, but on 23 March 2009, in a unanimous decision, the Superior Court rejected the plaintiff's appeal. On 25 November 2011, the Reporting Justice confirmed the Superior Court of Justice and the Federal District State Court of Appeals favourable decisions. The case is now closed.

In 2004, the State of Sergipe instigated a class action seeking compensation for smokers in Sergipe State who purportedly tried to quit smoking. The lower court denied the plaintiffs' request for early relief and determined ANVISA (a federal government health agency) be ordered to join the case as co-defendants. As ANVISA is a federal agency, the case was removed to the federal court where ANVISA successfully argued that it lacked standing to be sued. The claim against ANVISA was dismissed and the federal court sent the case back to the lower state court for proceedings to continue. However, the action was stayed on 18 December 2009 pending a decision by the Superior Court on which court has jurisdiction. On 26 March 2010 the Superior Court determined that the civil court had jurisdiction of the matter. On 19 October 2011, the court dismissed the action with judgment on the merits. The plaintiff filed an appeal on 9 January 2012.

Bulgaria

In March 2008, Mr Nikolay Benchev Yochkolovski filed a smoking-related consumer fraud class action in the Sofia City Court of Bulgaria against 21 defendants, including the following British American Tobacco-affiliated companies: British-American Tobacco Polska S.A., British-American Tobacco (Romania) Investments SRL, House of Prince A/S, and Scandinavian Tobacco S.A. On 24 September 2008, the claim was dismissed on procedural grounds and the plaintiff appealed this ruling. On 11 November 2008, the Court of Appeal granted the plaintiff's appeal. On 2 December 2008, the Sofia City Court ordered the plaintiff to meet various evidentiary and procedural conditions before proceeding further with this claim. The Sofia Court of Appeal upheld this decision. Following a hearing before the Sofia City Court, the court denied the plaintiff's request to allow a class action to proceed on 26 November 2010. The plaintiff appealed that decision and on 20 January 2011, the Sofia Court of Appeal, rejected plaintiff's appeal and affirmed termination of the proceedings. Thereafter, the plaintiff appealed the decision to the Bulgarian Supreme Court of Cassation. The Court rejected this appeal on 3 May 2011.

Canada

There are 10 class actions being brought in Canada against Group companies.

Knight is a 'lights' class action in which the plaintiff alleges that the marketing of light and mild cigarettes is deceptive because it conveys a false and misleading message that those cigarettes are less harmful than regular cigarettes. Although the claim arises from health concerns, it does not seek compensation for personal injury. Instead it seeks compensation for amounts spent on 'light and mild' products and a disgorgement of profits from Imperial.

The Supreme Court of British Columbia certified a class of all consumers of cigarettes bearing 'light' or 'mild' descriptors since 1974 manufactured in British Columbia by Imperial. Imperial filed an appeal against the certification which was heard in February 2006. The appellate court confirmed the certification of the class but has limited any financial liability, if proven, to the period from 1997.

The motion of the federal government to strike out the third party notice issued against them by Imperial was heard in February 2006 and was granted but was appealed by Imperial. The appeal was heard in June 2009 in conjunction with the British Columbia health care reimbursement claim. The Court of Appeal went so far as to say that it was not "plain and obvious" that the federal government did not owe a duty of care to manufacturers or indeed to the class itself and, therefore, the federal government could face potential liability to claims of product liability or misrepresentation. The federal government appealed the Court of Appeal's decision. On 29 July 2011, the Supreme Court unanimously granted the federal government's appeal and dismissed the third party claim on the basis that the federal government's impugned conduct constituted valid policy benefiting public health and is therefore not subject to civil liability.

On 9 December 2009, Imperial was served with a class action filed by Ontario tobacco farmers and the Ontario Flue-Cured Tobacco Growers' Marketing Board (the Growers' Claim). The plaintiffs allege that, during the timeframe, Imperial improperly paid lower prices for tobacco leaf destined for duty-free products that was smuggled back into Canada and sold in the domestic market, as opposed to the higher domestic leaf price. Imperial deposited the amount owing to the government of Ontario pursuant to the Comprehensive Agreement into an escrow account, alleging that the Comprehensive Agreement permitted Imperial to set-off that amount against costs incurred as a result of the claim (including damages, if any). In response, the Ontario government commenced an application against Imperial, seeking the release of the funds (the Ontario Claim). No monetary damages are being claimed against Imperial by the government of Ontario.

On 26 July 2010, Imperial argued its preliminary motion in the Ontario claim. Imperial was successful in its application and the court ordered that the Ontario claim be stayed in favour of the arbitration provisions stipulated in the Comprehensive Agreement and raised by Imperial in its Notice of Arbitration. The Ontario government appealed this decision and the hearing date originally scheduled for 4 January 2011 was heard by the Ontario Court of Appeal on 17 February 2011. The Canadian government intervened in the appeal to support Ontario government's position.

Contingent liabilities and financial commitments cont...

On 20 July 2011, the Court of Appeal gave judgment in Imperial's favour and held that the funds would remain in escrow pending a decision by an arbitrator on the issue pursuant to the Comprehensive Agreement. The court also ruled that the question of whether the Growers' Claim constitutes a 'Released Claim' under the Comprehensive Agreement must be determined by the courts, thereby splitting the issues. In the meantime, Imperial will proceed with the arbitration. As yet, no hearing date has been set.

Imperial was recently served with certification materials in the underlying Growers' Claim. This case remains at a very preliminary stage and no hearing date has been set.

There are currently two class actions in Quebec. On 21 February 2005, the Quebec Superior Court granted certification in two class actions against Imperial and two domestic manufacturers, which have a combined value of C\$23 billion plus interest and costs. The court certified two classes, which include residents of Quebec who suffered from lung, throat and laryngeal cancer or emphysema as at November 1998 or developed these diseases thereafter and who smoked a minimum of fifteen cigarettes a day for at least five years, and residents who were addicted to nicotine at the time the proceedings were filed and who have since remained addicted. In Quebec, there is no right of appeal for a defendant upon certification. The plaintiffs have served a Statement of Claim. The trial in this matter has been set for 5 March 2012.

In June 2009, four new smoking and health class actions were filed in Nova Scotia, Manitoba, Saskatchewan and Alberta, against Canadian manufacturers and foreign companies, including the UK Companies and Imperial. In Saskatchewan, a number of UK companies have been released from the action. In Nova Scotia the proceedings have not progressed. There are service issues in relation to the UK Companies for Alberta and Manitoba.

In June 2010, two further suits were filed in British Columbia. Imperial was served with the British Columbia suits on 16 July 2010. The Bourassa claim is allegedly on behalf of all individuals who have suffered chronic respiratory disease and the McDermid claim proposes a class based on heart disease. Both claims state that they have been brought on behalf of those who have "smoked a minimum of 25,000 cigarettes". The UK companies were served on 20 July 2010. The UK Companies and Imperial proceeded to challenge jurisdiction.

Italy

In 2010, British American Tobacco Italia S.p.A (BAT Italia) was served with notice of a class action suit filed by an Italian consumer association (Codacons) and three representative individuals. The main allegations made in the class action relate to addiction claims and failure to warn. In April 2011, the class action suit was declared inadmissible by the First Instance Civil Court of Rome. The Court of Rome considered the action to be manifestly without merit and held that it was inadmissible on that basis as well as others. Plaintiffs filed an appeal against the decision issued by the Court of Rome, challenging the grounds of inadmissibility. The parties presented their final arguments to the Court of Appeal on 25 January 2012. On 27 January 2012, the Court of Appeal upheld the lower court's decision confirming the inadmissibility of the case.

Venezuela

The Venezuelan Federation of Associations of Users and Consumers filed a class action against the Venezuelan government seeking regulatory controls on tobacco and recovery of medical expenses for future expenses of treating smoking-related illnesses in Venezuela. On 19 January 2009, C.A Cigarrera Bigott Sucs. (Cigarrera Bigott) notified the court of its intention to appear as a third party. The court adjourned a public hearing, initially scheduled for 28 July 2009, where Cigarrera Bigott's status as a third party would be determined and parties would present evidence and make arguments. On 16 September 2009, the Venezuelan Republic ordered the court to continue the judicial process. A new date has yet to be scheduled by the court.

On 12 April 2011, however, the Constitutional Chamber of the Supreme Court of Justice issued decision number 494, which established the rules for class action procedures. The court must therefore decide whether Cigarrera Bigott's intervention may be admitted under the new procedure prior to the public hearing. This decision has not yet been issued.

(c) Individual personal injury claims

Aside from the US there are approximately 353 individual smoking cases pending world-wide as at 31 December 2011 against Group companies that are not detailed here. Over three-quarters of these cases are in Brazil.

At 31 December 2011, there were only three (compared to approximately 1,000 cases in July 2008, which decreased to 634 in July 2009) individual 'lights' cases in Italy pending against BAT Italia before the justice of the peace courts and 43 'lights' cases on appeal. In addition, in 2007, 2,230 cases were filed by a single plaintiffs' counsel in one jurisdiction (Pescopagano). The court has confirmed the withdrawal of all of these claims. Because of the type of court involved, the most that any individual plaintiff can recover in damages is €1,033, plus €1,000 in costs and an additional €3,000 for enforcement proceedings. As at 31 December 2011, more than 4,000 cases (including 2,230 Pescopagano cases) had been withdrawn, suspended or resulted in decisions given in favour of BAT Italia.

As at 31 December 2011, there are 27 smoking and health cases pending before Italian first instance civil courts, filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking. There are two labour cases for alleged occupational exposure pending in Italy. In addition, there are 12 cases on appeal, including two appeals that relate to the same labour court decision (Serafini) but based on different grounds.

On 23 June 2003, an individual action was brought in the Danish High Court against House of Prince A/S and Skandinavisk Tobakskompagni A/S seeking DKK485,450 (currently approximately €65,215) for alleged smoking-related diseases and loss of earnings. On 8 December 2011, the Court issued Judgment in favour of the defendants and ordered costs against the plaintiff. On 31 January 2012, the plaintiff filed an appeal.

On 14 September 2011, an individual action was brought in the Zheleznodorozhny District Court of Khabarovsk, Russia against British American Tobacco-STF (BAT-STF) and British American Tobacco-Yava (BAT-Yava) among others. The plaintiff seeks to compel defendants, including BAT-STF and BAT-Yava, to cease production and sale of tobacco products and to remove their tobacco products from circulation within the Russian Federation. On 20 October 2011, a statement of defence was filed for BAT-STF and BAT-Yava. The plaintiff filed to withdraw his claim and the court accepted the withdrawal of the claim on 22 November 2011. The plaintiff did not file an appeal within the time permitted. However, the plaintiff may still be allowed to file an appeal if he can show that there was a valid reason for missing the appeal deadline.

Conclusion

While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Group believes that the defences of the Group's companies to all these various claims are meritorious on both the law and the facts, and a vigorous defence is being made everywhere. If an adverse judgment is entered against any of the Group's companies in any case, an appeal will be made. Such appeals could require the appellants to post appeal bonds or substitute security in amounts which could in some cases equal or exceed the amount of the judgment. In any event, with regard to US litigation, the Group has the benefit of the RJRT Indemnification. At least in the aggregate, and despite the quality of defences available to the Group, it is not impossible that the Group's results of operations or cash flows in particular quarterly or annual periods could be materially affected by this and by the final outcome of any particular litigation.

Having regard to all these matters, the Group (i) does not consider it appropriate to make any provision in respect of any pending litigation, save insofar as stated above and (ii) does not believe that the ultimate outcome of this litigation will significantly impair the Group's financial condition.

RELATED PARTY DISCLOSURES

The Group's related party transactions and relationships for 2011 and 2010 are disclosed as Appendix 3 to this announcement.

SHARE BUY-BACK PROGRAMME

In 2011, the Board approved the resumption of the on-market share buy-back programme with a value of up to £750 million, excluding costs. During the year ended 31 December 2011, 28 million shares were bought at a cost of £ 750 million, excluding transaction costs of £5 million. (2010: £nil).

The Board has approved the continuation of the on-market share buy-back programme in 2012 with a value of up to £1.25 billion, excluding costs.

NON-EXECUTIVE DIRECTOR: CONFLICT OF INTEREST AND AUDIT COMMITTEE MEMBERSHIP

During 2011, a potential conflict of interest arose for Christine Morin-Postel, a Non-Executive Director of British American Tobacco p.l.c. (the "Company") and a member of the Company's Audit Committee, in respect of the British American Tobacco Group's (the "Group") exposure to the clean-up costs for pollution in the Lower Fox River in Wisconsin, USA (the "Fox River Matter"). Further details of the Fox River Matter are set out in the section on Contingent Liabilities and Financial Commitments. Group companies have potential direct or indirect causes of action against the French company, Sequana SA, in relation to a former subsidiary of it, which subsidiary the Group believes provides an indemnity to it in relation to the clean-up costs. Ms Morin-Postel is a non-executive director of a shareholder in Sequana SA.

To date, Ms Morin-Postel has absented herself from any Board or Audit Committee meetings of the Company when the Fox River Matter has been discussed. She will continue to do so in future meetings and to facilitate this process further, she has decided to resign as a member of the Audit Committee with effect from 21 February 2012.

Christine Morin-Postel remains a Non-Executive Director of the Company.

ANNUAL REPORT

The financial information set out above does not constitute the Company's statutory accounts for the years ended 31 December 2011 or 2010. Statutory accounts for 2010 have been delivered to the Registrar of Companies and those for 2011 will be delivered following the Company's Annual General Meeting. The auditors' reports on both the 2010 and 2011 accounts were unqualified, did not draw attention to any matters by way of emphasis and did not contain statements under s498(2) or (3) of Companies Act 2006 or equivalent preceding legislation.

The Annual Report will be published on bat.com on 26 March 2012. At that time, a printed copy will be mailed to shareholders on the UK main register who have elected to receive it. Otherwise, such shareholders will be notified that the Annual Report is available on the website and will, at the time of that notification, receive a Performance Summary (which sets out an overview of the Group's performance, headline facts and figures and key dates in the Company's financial calendar) together with a Proxy Form and Notice of Annual General Meeting. Specific local mailing and/or notification requirements will apply to shareholders on the South African branch register.

SHAREHOLDER INFORMATION

FINANCIAL CALENDAR 2012

Thursday 26 April	Interim Management Statement
Thursday 26 April	Annual General Meeting The Banqueting House, Whitehall, London SW1A 2ER
Wednesday 25 July	Half-yearly Report
Wednesday 24 October	Interim Management Statement

CALENDAR FOR THE FINAL DIVIDEND 2011

2012

Thursday 23 February	Dividend announced (including amount of dividend per share in both sterling and rand; applicable exchange rate and conversion date – Tuesday 21 February 2012)
Thursday 23 February to Friday 9 March	From the commencement of trading on Thursday 23 February 2012 to Friday 9 March 2012, no removal requests in either direction between the UK main register and the South African branch register will be permitted
Friday 2 March	Last Day to Trade (JSE)
Monday 5 March to Friday 9 March	No transfers between the UK main register and the South African branch register will be permitted; no shares may be dematerialised or rematerialised between these inclusive dates
Monday 5 March	Ex-dividend date (JSE)
Tuesday 6 March	Last Day to Trade (LSE)
Wednesday 7 March	Ex-dividend date (LSE)
Friday 9 March	Record date (LSE and JSE)
Thursday 3 May	Payment date (sterling and rand)

Note: details of the applicable exchange rate can be found under the heading 'Dividends' above.

For holders of American Depositary Receipts (ADRs), the record date for ADRs is also Friday 9 March 2012 with an ADR payment date of Tuesday 8 May 2012.

CORPORATE INFORMATION

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Secondary listing

JSE (Share Code: BTI)

Shares are traded in electronic form only and transactions settled electronically through Strate.

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American Depositary Receipts (ADRs)

NYSE Amex Equities (Symbol: BTI; CUSIP Number: 110448107)

Sponsored ADR programme; each ADR represents two ordinary shares of British American Tobacco p.l.c.

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British American Tobacco p.l.c. is a public limited company which is listed on the London Stock Exchange and the JSE Limited in South Africa. British American Tobacco p.l.c. is incorporated in England and Wales (No. 3407696) and domiciled in the UK.

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DISCLAIMERS

This announcement does not constitute an invitation to underwrite, subscribe for, or otherwise acquire or dispose of any British American Tobacco p.l.c. shares or other securities.

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

Past performance is no guide to future performance and persons needing advice should consult an independent financial adviser.

DISTRIBUTION OF REPORT

This announcement is released to the London Stock Exchange and the JSE Limited. It may be viewed and downloaded from our website www.bat.com.

Copies of the announcement may also be obtained during normal business hours from: (1) the Company's registered office; (2) the Company's representative office in South Africa; and (3) British American Tobacco Publications, as above.

Nicola Snook
Secretary
22 February 2012

ANALYSIS OF REVENUE AND PROFIT FROM OPERATIONS

REVENUE

	2011					2010		
	Reported revenue £m	Impact of exchange £m	Revenue at CC ⁽¹⁾ £m	Organic adjustment ⁽³⁾ £m	Organic revenue at CC ⁽¹⁾ £m	Reported revenue £m	Organic adjustment ⁽³⁾ £m	Organic revenue £m
Asia-Pacific	4,251	(101)	4,150		4,150	3,759		3,759
Americas	3,558	16	3,574	(9)	3,565	3,498	(134)	3,364
Western Europe	3,600	(68)	3,532		3,532	3,695	(282)	3,413
EEMEA	3,990	216	4,206		4,206	3,931		3,931
Total	15,399	63	15,462	(9)	15,453	14,883	(416)	14,467

PROFIT FROM OPERATIONS

	2011							2010		
	Reported Profit ⁽²⁾ £m	Adjusting items £m	Adjusted Profit ⁽²⁾ £m	Impact of exchange £m	Adjusted Profit ⁽²⁾ at CC ⁽¹⁾ £m	Organic adjustment ⁽³⁾ £m	Adjusted Profit ⁽²⁾ at CC ⁽¹⁾ £m	Adjusted Profit ⁽²⁾ £m	Organic adjustment ⁽³⁾ £m	Adjusted Profit ⁽²⁾ £m
Asia-Pacific	1,481	58	1,539	(59)	1,480		1,480	1,332		1,332
Americas	1,426	15	1,441	(1)	1,440	1	1,441	1,382	(3)	1,379
Western Europe	1,075	153	1,228	(24)	1,204		1,204	1,103	(6)	1,097
EEMEA	1,013	298	1,311	51	1,362		1,362	1,167		1,167
	4,995	524	5,519	(33)	5,486	1	5,487	4,984	(9)	4,975
Fox River ⁽⁴⁾	(274)	274								
Total	4,721	798	5,519	(33)	5,486	1	5,487	4,984	(9)	4,975

Notes:

(1) CC: Constant currencies

(2) Profit: Profit from operations

(3) Organic adjustments: Mergers and acquisitions and discontinued activities - adjustments are made to the 2010 and 2011 numbers, based on the 2011 Group position

(4) The Fox River provision made in 2011 (see page 23), has not been allocated to a segment or segments as it relates to a 1998 settlement agreement. It is presented separately from the segmental reporting which is used to evaluate segment performance and to allocate resources.

KEY GROUP RISK FACTORS

This section identifies the main risk factors that may affect the British American Tobacco Group.

The following provides a brief description of the key risks to which the Group's operations are exposed and identify, in each case, their potential impact on the Group and the principal activities in place to manage the risk. Each risk is considered in the context of the Group strategy by identifying the principal strategic element to which it relates, although other elements may also be relevant.

It is not the intention to provide an extensive analysis of all risks affecting the Group but rather to identify only those risks and uncertainties which the Directors believe to be the principal ones facing the business. Not all of the factors listed are within the control of the Group and other factors besides those listed may affect the performance of its businesses. Some risks may be unknown at present and other risks, currently regarded as immaterial, could turn out to be material in the future.

The risk factors listed in this section and the specific activities in place to manage them should be considered in the context of the Group's internal control framework. This section should also be read in the context of the cautionary statement regarding forward-looking statements on page 55.

Risk registers, based on a standardised methodology, are used at Group, regional, area and individual market level to identify, assess and monitor the key risks (both financial and non-financial) faced by the business at each level. Information on prevailing trends, for example whether a risk is considered to be increasing or decreasing over time, is provided in relation to each risk and all identified risks are assessed at three levels (high/medium/low) by reference to their impact and likelihood. Mitigation plans are required to be in place to manage the risks identified and the risk registers and mitigation plans are reviewed on a regular basis. At Group level, specific responsibility for managing each identified risk is allocated to a member of the Management Board. The Group risk register provides the basis for the assessment of the key Group risk factors identified below. It is reviewed regularly by a committee of senior managers chaired by the Finance Director and twice yearly by the Corporate Committee. In addition, it is reviewed annually by the Board and twice yearly by the Audit Committee. The Board and each such Committee reviews changes in the status of identified risks, assessing changes in impact and likelihood, and the Audit Committee also spends time focusing on selected key risks in detail.

Developments in the assessment of Group risk

The Board's assessment of the key risks and uncertainties facing the Group has remained broadly unchanged over the past year, particularly with regard to illicit trade, excise and tax and financial risk. However, as a consequence of the Board's continuing reappraisal of Group risks and the activities in place to address them, some risks which have in previous years been considered as key Group risks are no longer assessed as such in terms of their impact and likelihood and so are not addressed in the tables below. They are nevertheless still addressed as Group risks, remain on the Group risk register and continue to be reviewed in accordance with the Group's risk management procedures. This applies, for example, to the loss of confidential information or malicious manipulation of data, which was included in last year's table but is no longer included this year.

Climate change, which has previously been identified as a Group risk, is no longer considered to be a risk factor itself, but is treated as a potential cause of more specific risks, such as the inability to obtain adequate supplies of leaf. It therefore continues to be taken into account in the assessment of Group risk. Non-compliance with environmental, health and safety measures is now assessed as a key Group risk, having been identified as a significant compliance issue facing the Group given the complexity and global nature of its operations and in light of a number of recent incidents involving workplace accidents. In addition, increased focus on the regulatory risks facing the Group has highlighted key areas of risk, now set out separately below. This reflects their importance in the context of the future development of the Group's business and the need to ensure that they are each effectively addressed.

Illicit trade

Competition from Illicit trade

Illicit trade in the form of counterfeit products, smuggled genuine products and locally manufactured products on which applicable taxes are evaded, continues to represent a significant and growing threat to the legitimate tobacco industry. The majority of such illicit products are sold at the bottom end of the market and in contravention of applicable regulatory requirements. Increasing excise rates can encourage more consumers to switch to illegal cheaper tobacco products and provide greater rewards for smugglers. The risk is exacerbated where current economic conditions have resulted in high unemployment and/or reduced disposable incomes. Global volume of illicit trade is currently estimated to be up to 12 per cent of consumption. In the next 10 years, we believe that the problem is likely to increase, driven by the increased regulatory and compliance burden for legitimate manufacturers and fuelled by further significant excise increases.

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Time frame: Long term

Principal potential causes

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

Potential impact on Group

- Erosion of brand equity.
- Reduced ability to take price increases.
- Investment in trade marketing and distribution is undermined.
- Product is commoditised.
- Lower volumes and reduced profits.

Principal activities in place to address risk

- Dedicated Anti-Illicit Trade (AIT) teams operating at global, regional, area and key market levels and internal cross-functional coordination.
- Active engagement with key external stakeholders.
- Cross-industry and multi-sector cooperation on a wide range of AIT issues.
- Global AIT strategy development supported by a research programme to further the understanding of the size and scope of the problem.
- AIT Intelligence Unit (including a dedicated analytical laboratory) cooperates with law enforcement agencies in pursuit of priority targets and capacity building.
- Strong internal business conduct and customer approval policies

Excise and tax

Excise shocks from tax rate increases or structure changes

Tobacco products are subject to substantial excise and sales taxes in most countries in which the Group operates. In many of these countries, taxes are generally increasing, but the rate of increase varies between countries and between different types of tobacco products. A number of significant excise shocks have taken place over the past two years, for example in Romania, Turkey, Malaysia, Mexico and Japan. To date, the Group has been able to balance these shocks with its geographic spread, and it continues to develop effective measures to address the risk.

Key Group risk factors cont...

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Time frame: Long term

Principal potential causes

- Government initiatives to raise revenues.
- Increases advocated within context of national health policies.
- Insufficient capacity to engage with stakeholders in meaningful dialogue.

Potential impact on Group

- Consumers reject the Group's legitimate tax-paid products for products from illicit sources.
- Reduced legal industry volumes.
- Reduced sales volume or alteration of sales mix.

Principal activities in place to address risk

- Requirement for Group companies to have in place formal pricing and excise strategies including contingency plans.
- Pricing and excise committees at regional, area and individual market levels.
- Engagement with local tax and customs authorities, where appropriate.
- Annual management review of brand portfolio, brand health and equity.

Onerous disputed taxes, interest and penalties

The Group may face significant financial penalties, including the payment of interest, if it fails to meet its obligations with regard to the filing of tax returns and the payment of applicable taxes or in the event of an unfavourable ruling by a tax authority in a disputed area.

Principal relevance to Group strategy: Potential impact on **Productivity** (capital effectiveness)

Time frame: Short term

Principal potential causes

- Non-filing or late filing of tax returns or incorrect filings.
- Non-payment or late payments of taxes.
- Unfavourable ruling by tax authorities in disputed areas and aggressive auditing and/or pursuit of tax claims.

Potential impact on Group

- 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.

Principal activities in place to address risk

- Tax committees.
- Specialist resources available internally to provide advice and guidance and external advice sought where appropriate.
- Engagement with tax authorities at Group, regional and individual market level.

Financial

The Group's underlying operations give rise to certain financial risks. The principal risks in this regard, and the controls in place to address them, are identified below.

Management of cost base

The Group continues to implement measures to reduce its overall cost base. There is a risk that targeted reductions will fail to be achieved and/or that productivity programmes do not achieve their objectives.

Key Group risk factors cont...

Principal relevance to Group strategy: Potential impact on **Productivity** (cost management)

Time frame: Short term

Principal potential causes

- Insufficient resources devoted to productivity programmes due to other priorities.
- Low prioritisation or resistance to change.

Potential impact on Group

- Inability to manage cost savings leads to lower profits and reduced funds for investment in long-term growth.
- Reduced shareholder confidence.

Principal controls in place to address risk

- Targeted improvements in operating margin through factory rationalisation, systems standardisation and productivity savings.
- Development of a formal structure to integrate, drive and orchestrate the delivery of productivity programmes by providing visibility and enabling benefits tracking.
- Regular tracking of actual productivity savings and forecast improvements in operating margin and supply chain, overheads and indirects projects.
- Aggregation of planned productivity savings in the annual budget.

Translational foreign exchange rate exposures

The Group faces translational foreign exchange (FX) rate exposures for earnings/cash flows from its global business.

Principal relevance to Group strategy: Potential impact on **Productivity** (capital effectiveness)

Time frame: Short term

Principal potential causes

- FX rate exposures arise from exchange rate movements against sterling, the Group's reporting currency.

Potential impact on Group

- Fluctuations in translational FX rates of key currencies against sterling introduce volatility in reported results.

Principal activities in place to address risk

- While translational FX exposure is not hedged, its impact is identified in results presentations and financial disclosures; earnings are restated at constant rates for comparability.
- Debt and interest are matched to assets and cash flows to mitigate volatility where possible.

Marketplace

The Group has substantial operations in over 180 countries. Its results are influenced by the economic, regulatory and political situations in the countries and regions in which it has operations, as well as by the actions of competitors.

Inability to obtain required price increases

To the extent that price increases are required to cover cost rises and deliver profit growth, there is a risk that the Group will be unable to achieve these.

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Time frame: Short term

Principal potential causes

- Changes in the global economy reduce consumers' disposable income.
- Consumer down-trading.
- Competitors seek volume growth by price discounts or by not taking full price increases.

Key Group risk factors cont...

Potential impact on Group

- Inability to capture value generated by innovative products.
- Reduction in volumes.
- Profit growth in the short term falls below shareholders' expectations.
- Reduction in funds for investment in long-term growth.

Principal activities in place to address risk

- Strong alignment between pricing and brand portfolio.
- Regular regional and management reviews of budgeted pricing scenarios.
- Pricing and excise committees at regional, area and individual market levels.
- Routine brand price trade-off exercises conducted in key markets.
- Competitor analysis and price war simulations.

Geopolitical tensions

Geopolitical tensions, including terrorism, have the potential to disrupt the Group's business operations.

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Time frame: Short term

Principal potential causes

- Regional and/or global conflicts.
- Terrorism and political violence.
- Violent organised crime.
- The implementation of trade sanctions.
- Economic policy changes, including nationalisation of assets and withdrawal from international and bilateral trade agreements.

Potential impact on Group

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

Principal activities in place to address risk

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

Non-compliance with environmental, operational and health & safety measures

The Group is subject to environmental, health & safety (EHS) laws and regulations across its operations worldwide. A failure to ensure compliance with such measures could have a significant impact on the Group's business.

Principal relevance to Group strategy: Potential impact on **Responsibility** (responsible corporate behaviour)

Time frame: Short term

Principal potential causes

- Failure to obtain new or renew existing permits and/or licences required for lawful operations.
- Non-compliance with applicable EHS standards and requirements.
- Failure to discharge duty of care in operational activities.
- Insufficient qualified expertise to ensure compliance with applicable law and regulations.

Potential impact on Group

- Potential civil and/or criminal liability for loss of life or injury.
- Potential liability for clean-up costs.
- Financial impact of damages awards and/or fines and penalties imposed.
- Damage to corporate reputation.
- Possible impairment of assets and/or closure of operations, resulting in additional costs and potential loss of volume and market share.

Principal activities in place to address risk

- Management accountability to ensure appropriate compliance mechanisms are in place, including a registry of applicable licences and permits and the tracking of local legislative requirements and developments.
- EHS governance and committees in place at individual market level, monitored at regional level, to oversee compliance.
- Provision of appropriate EHS training, information and communications at all levels.
- Dedicated global team to provide support in the management of EHS risks.
- Key issues and incidents monitored regionally and reported globally.

Regulation

The Group's businesses operate under increasingly stringent regulatory regimes around the world. Further regulation is expected, particularly as a result of the World Health Organisation's Framework Convention on Tobacco Control (FCTC) and, increasingly, active tobacco control activities outside the FCTC.

Regulation inhibits Growth strategy

There is a risk that the enactment of regulation that is not evidence based will put the Group at a competitive disadvantage, interfere with its ability to differentiate its products and increase costs and complexity.

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Time frame: Long term

Principal potential causes

- Adoption of FCTC guidelines and adoption of more stringent national regulations.
- Adoption of differing regulatory regimes in different countries/groups of countries and/or lack of consensus on interpretation/application.
- Exclusion of the industry from participating in engagement with regulators and policy makers.
- Product regulation which increases complexity and cost.

Potential impact on Group

- Contribution to the denormalisation of smoking.
- Erosion of brand value and adverse impact on ability to communicate and build brand equity.
- Increased cost of business for legitimate industry, lower turnover and reduced profits.
- Reduced ability to communicate brand portfolio and innovations contributing to an increase in illicit trade.

Principal activities in place to address risk

- Group companies have regulatory strategies in place in order to identify issues material to their operating environment and develop plans to address them in a manner consistent with local law and Group policy.
- Engagement is sought with scientific and regulatory communities within the context of the FCTC process, and stakeholder engagement takes place at global, regional and individual market levels.
- Establishment of a dedicated Regulatory Futures team to monitor regulatory trends and developments, analyse regulatory proposals to determine impacts, if any, on business and develop initiatives in response.
- Development of dedicated technical and advocacy capabilities, corporate positions and best practice examples, supported by training, for markets to address regulation.

Reduced ability to meet consumer expectations and increased compliance costs

Restrictive regulation, in particular in relation to the content and design of tobacco products, may impair the Group's ability to meet consumer expectations and may also lead to increased operating costs and reduced sales.

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth)

Time frame: Long term

Principal potential causes

- Adoption of FCTC guidelines on product design, contents and emissions and testing and measuring.
- Product regulation aimed at reducing the appeal of cigarettes through severe restrictions on ingredients and design.
- Regulation on the content and design of tobacco products which increases complexity and cost.

Potential impact on Group

- Reduced consumer acceptability of new product specifications, leading to loss of volume and contributing to an increase in illicit trade.
- Loss of volume due to regulation in individual markets impacting on established portfolio.
- Cost complexity of meeting regulations.
- Loss of reputation, penalties and closure of production as a result of non-compliance.

Principal activities in place to address risk

- Establishment of Leaf Blending Innovation Centre in Brazil to explore and develop product solutions that are consumer relevant within the developing regulatory context.
- Development of standardised product platforms and a rationalised brand/product portfolio to reduce the compliance testing and reporting costs.
- Effective and globally integrated processes for sales and operations planning processes, product specification and new product initiatives.
- Programme of engagement with scientific and regulatory authorities within the context of the FCTC process.

Loss of ability directly to communicate with consumer

Strict and restrictive regulation may reduce the Group's ability to communicate with adult smokers and may also impact on its ability to communicate with its corporate stakeholders.

Principal relevance to Group strategy: Potential impact on **Growth** (organic revenue growth) and **Responsibility** (balanced regulation)

Time frame: Long term

Principal potential causes

- Adoption of FCTC guidelines on packaging and labelling, advertising and promotion.
- Adoption of more stringent national regulations, such as point of sale display bans and plain packaging.

Potential impact on Group

- Generic or plain packaging leads to loss of brand equity.
- Lower margins through reduced ability to build brand equity and leverage price.
- Reduced ability to compete and make new market entries.
- Reduced volumes and impact on profits.

Principal activities in place to address risk

- Development of comprehensive plans to support markets to prepare for the implications of an increasingly strict regulatory environment and to address key regulatory issues.
- Development of innovative solutions to evolve brand portfolio, product and design and product differentiation within the context of regulatory developments and consistent with Group policy and local law.
- Programme of engagement with stakeholders at global, regional and individual market levels to address key regulatory issues, including plain packaging and product display initiatives, and identify potential unintended consequences, such as a contribution to increased illicit trade.

RELATED PARTY DISCLOSURES

The Group has a number of transactions and relationships with related parties, as defined in IAS 24 (Related Party Disclosures), all of which are undertaken in the normal course of business.

Transactions and balances with associates relate mainly to the sale and purchase of cigarettes and tobacco leaf. Amounts receivable from associates in respect of dividends included in the table below were £87 million (2010: £77 million). The Group's share of dividends from associates, included in other net income in the table below, was £486 million (2010: £466 million). Legal fees recovered from Reynolds American Inc. included in other net income amounted to £nil million (2010: £1 million).

	2011	2010
	£m	£m
Transactions		
- revenue	28	38
- purchases	(342)	(442)
- other net income	487	460
Amounts receivable at 31 December	97	99
Amounts payable at 31 December	(40)	(21)

On 26 May 2010, a wholly-owned subsidiary of the Group, BATUS Japan Inc., entered into an American blend Cigarette Manufacturing Agreement (referred to as the 2010 Agreement) with a wholly-owned subsidiary of Reynolds American, R.J. Reynolds Tobacco Company (referred to as RJRTC), with an effective date of 1 January 2010. Under this Agreement, RJRTC has been appointed as BATUS Japan's exclusive manufacturer of all BATUS Japan's requirements for certain American-blend cigarettes intended to be distributed and sold in Japan for the five year period expiring on 31 December 2014, subject to the early termination and extension provisions set out in the agreement. The 2010 Agreement is based on arm's length terms and conditions.

On the same date, RJRTC and BATUS Japan entered into a letter agreement terminating the existing Contract Manufacturing Agreement dated 30 July 2004 (referred to as the 2004 Agreement), as amended between the parties, with effect from midnight on 31 December 2009. The 2004 Agreement was scheduled to expire on 31 December 2014, subject to early termination and extension provisions. Under the terms of the letter agreement, certain sections and sub-sections of the 2004 Agreement will survive the termination, and, in consideration for RJRTC agreeing to terminate the agreement and in settlement of all disputes at issue between the parties, BATUS Japan agreed to pay RJRTC US\$21 million. The payment has been presented as an adjusting item and is included within the Group's restructuring and integration costs (see page 22). The Group's share of the income net of tax included within the post-tax results of Reynolds American is also presented as an adjusting item and is credited against other (see page 25).

In 2011, the Group acquired non-controlling interests of shareholders in Chile for £10 million. This transaction is shown as a £10 million reduction to reserves. In 2010, the Group acquired non-controlling interests of shareholders in Indonesia and Eastern Europe for £3 million and £9 million respectively. These transaction are shown as a £12 million reduction to reserves.

The Group sold its Belgium distribution business, Lyfra NV, to Landewyck Group S.a.r.l in 2010 for a consideration of €16 million. The Group's German subsidiary has an available-for-sale investment in Landewyck Group S.a.r.l.

Related party disclosures cont...

The key management personnel of British American Tobacco consist of the members of the Board of Directors of British American Tobacco p.l.c. and the members of the Management Board. No such person had any material interest during the year in a contract of significance (other than a service contract) with the Company or any subsidiary company. The term key management personnel in this context includes the respective members of their households.

	2011 £m	2010 £m
The total compensation for key management personnel, including Directors, was:		
- salaries and other short term employee benefits	21	22
- post-employment benefits	3	3
- share based payments	8	12
	<u>32</u>	<u>37</u>

There were no other long term benefits applicable in respect of key personnel other than those disclosed in the Remuneration Report in the Annual Report.