British American Tobacco

Review 05

Annual Review and Summary Financial Statement 2005

Inside this review

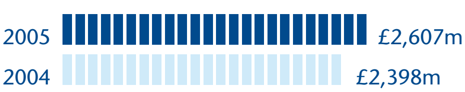
OPERATIONAL AND FINANCIAL HIGHLIGHTS

"The outstanding results for 2005 demonstrate that British American Tobacco's strategy is working well and I am confident that we can continue to deliver quality earnings growth and good cash flow over the long term."

Jan du Plessis, Chairman

Like-for-like profit from operations

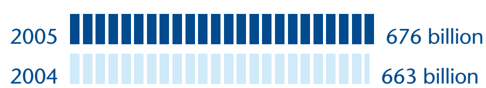
+9%



Growth of 9 per cent, or 5 per cent at constant rates of exchange, reflected higher profit in all regions, except America-Pacific. Reported profit from operations was down 36 per cent due principally to the impact of a gain on disposal of subsidiaries in the 2004 comparative. An explanation of the like-for-like basis is given on page 20.

Like-for-like Group volumes

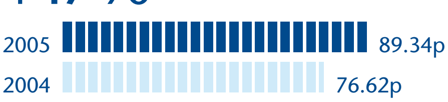
+2%



Like-for-like Group volumes grew by 2 per cent to 676 billion, with the four Global Drive Brands achieving overall growth of 9 per cent. Reported volumes were 1 per cent lower reflecting the disposal of subsidiaries in 2004.

Adjusted diluted earnings per share

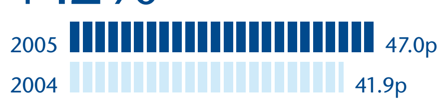
+17%



Earnings per share are 89.34p, up 17 per cent, reflecting the improved underlying operating performance and reduced net finance costs, as well as the impact of the Reynolds American transaction and the share buy-back programme.

Dividends per share declared

+12%



With the recommended final dividend of 33.0p, the total dividends per share declared in respect of 2005 are 47.0p, an increase of 12 per cent on last year.

This Annual Review and Summary Financial Statement does not contain sufficient information to allow for a full understanding of the results of the Group and the state of affairs of the Company or of the Group. For further information, refer to the Directors' Report and Accounts, which incorporates the full annual accounts, the Report of the independent auditors on those accounts, the Directors' Report and the Remuneration Report (see page 26).

CHAIRMAN'S STATEMENT

"These outstanding results have been achieved in a year when the management team has also been able to take significant steps to improve the quality of our business."

2005 has been a vintage year for British American Tobacco. The Group has achieved good underlying growth in profit and a 17 per cent increase in adjusted diluted earnings per share. Profit from operations in subsidiary companies was ahead by 9 per cent on a like-for-like basis, or 5 per cent at comparable rates of exchange, driven by underlying volume growth of 2 per cent.

These outstanding results have been achieved in a year when the management team has also been able to take significant steps to improve the quality of our business. Our strategic focus on Growth, Productivity, Responsibility and developing a Winning Organisation is positioning the Group well for the future.

The 9 per cent growth in our Global Drive Brands is particularly encouraging. Kent, at almost 39 billion, was 18 per cent ahead with excellent performances in its major markets of Russia and Romania, as well as an increase in share in Japan. With volumes of close to 33 billion, Pall Mall continued its exceptional growth of 25 per cent, performing well in all its key markets. Dunhill, at over 30 billion, was 4 per cent down because of substantially reduced industry volumes in Malaysia and South Korea. Lucky Strike, with sales of 22 billion, was 2 per cent lower, mainly as a result of a decline in total market volumes in Germany.

The overall growth in our Global Drive Brands illustrates the improvement in the quality of our business. This is further underlined by the growth in our revenue on a like-for-like basis of 7 per cent at current rates of exchange, or 3.4 per cent at comparable rates.

Productivity

The £271 million restructuring charge for 2005 is mainly because of the factory closures announced in the UK, Canada, New Zealand and Ireland, together with redundancy costs associated with our overheads reduction programme in a number of countries. A £68 million exceptional gain reflects the profit on the sale of some brands to Gallaher in April 2005, as a result of the enlargement of the European Union.

In 2005, the savings achieved from our supply chain programme, which includes the factory footprint review, were £106 million, bringing the total over the three years since we started the programme to £226 million per year. We expect to deliver further supply chain savings in the years ahead.

In addition, £103 million was saved from our overheads and indirect costs programme in 2005, bringing the annualised total since 2003 to £256 million, well on the way to our target of £320 million per year by 2007. As a result, we are increasing this target to annual savings of £400 million by 2007.

British American Tobacco's associate companies, Reynolds American, ITC and STK achieved volume of 232 billion and our share of their post-tax results was £392 million. Reynolds American, which accounts for £244 million of the total, continues to perform ahead of our expectations, reflecting a truly successful merger.

Exceeding our long term goal

In addition to the improved like-for-like operating performance, the Group benefited from reduced net finance costs, the Reynolds American transaction and the share buy-back programme. As a result, adjusted diluted earnings per share rose 17 per cent to 89.34p, an increase that significantly exceeds our long term goal of delivering, on average, high single figure growth in earnings.

Under the share buy-back programme, we bought some 45 million shares in 2005, at a cost of £501 million and at an average price of £11.08 per share. The programme will continue during 2006.

The Board has proposed a final dividend of 33.0p per share, taking the total for the year to 47.0p, an overall increase of 12 per cent. The dividend will be paid on 4 May 2006 to shareholders on the Register at 10 March 2006.

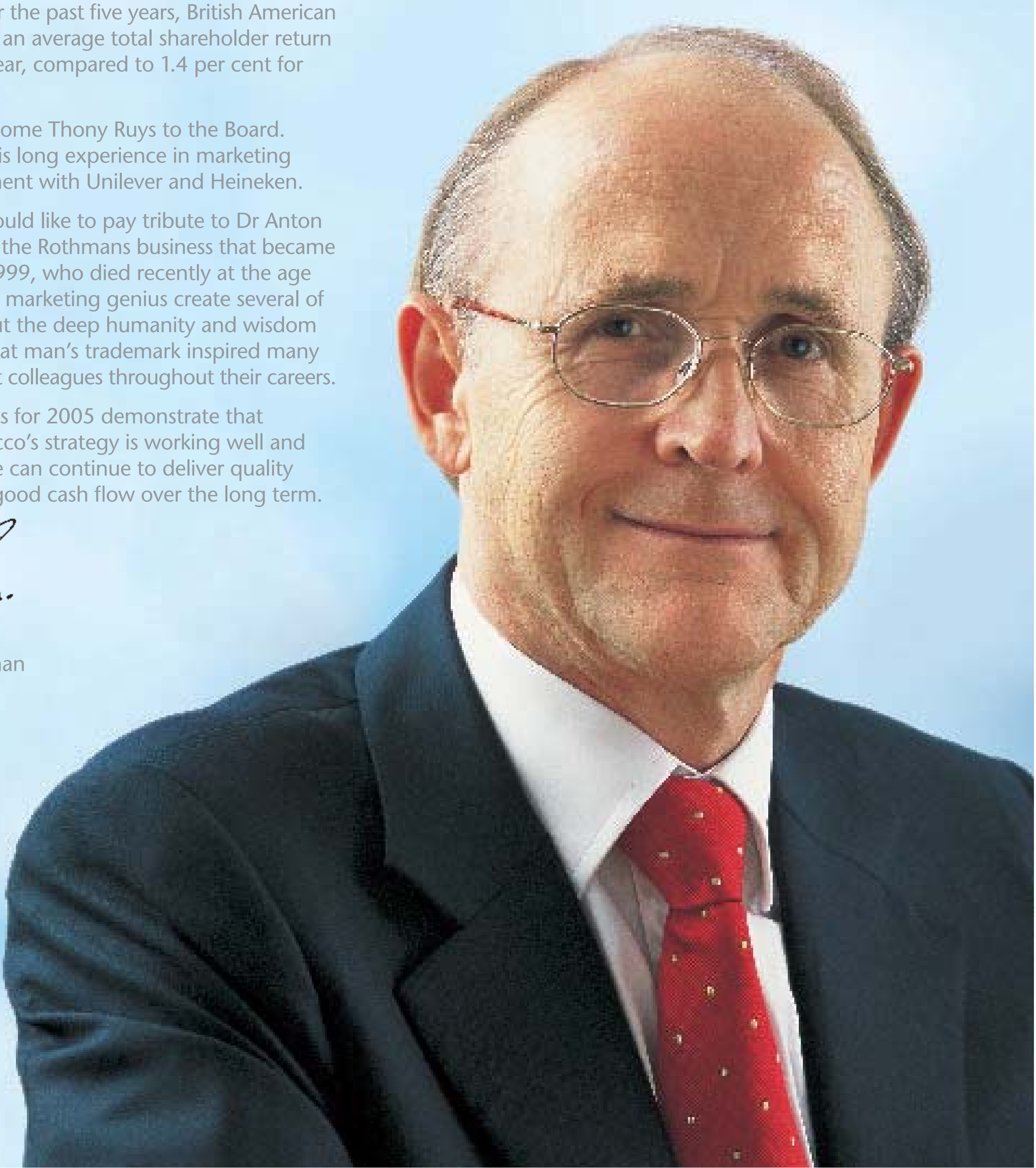
The savings referred to earlier are the result of our focus on turning a multinational business operating in 180 markets into an integrated global enterprise that can take advantage of its scale. We are working hard to reduce our costs but we are also investing in the business to build long term value and sustainability. Over the past five years, British American Tobacco has delivered an average total shareholder return of 26.7 per cent per year, compared to 1.4 per cent for the FTSE 100.

I am delighted to welcome Thony Ruys to the Board. We will benefit from his long experience in marketing and general management with Unilever and Heineken.

Before I conclude, I would like to pay tribute to Dr Anton Rupert, the founder of the Rothmans business that became part of the Group in 1999, who died recently at the age of 89. Not only did his marketing genius create several of our leading brands, but the deep humanity and wisdom which became the great man's trademark inspired many of our past and present colleagues throughout their careers.

The outstanding results for 2005 demonstrate that British American Tobacco's strategy is working well and I am confident that we can continue to deliver quality earnings growth and good cash flow over the long term.

Jan du Plessis, Chairman



MANAGEMENT REVIEW **CHIEF EXECUTIVE'S INTRODUCTION**

"We have confidence in our strategy, we believe that our business is sustainable and we expect that British American Tobacco will continue to grow."

British American Tobacco is well positioned and ready for the future. While the global adult population is expected to grow, keeping the industry's volumes above five trillion units over the next 10 years, we also have the advantages of a broad geographic spread and a focused brand portfolio. We have confidence in our strategy, we believe that our business is sustainable and we expect that British American Tobacco will continue to grow. The evidence of our performance over recent years and our own analysis of future prospects support this view.

Industry challenges

Hikes in excise rates will mean consumers facing price rises above inflation. As a result, in many markets there will be some consumer switching to cheaper brands. Varying excise levels applied by governments have created wide tax differentials across national borders and are a major factor in driving an increase in contraband and counterfeit activity. We now view smuggling and counterfeit as a major 'competitor', a stark indication of the scale of the problem that illicit trade poses for the industry and governments.

We support balanced and evidence-based regulation of the tobacco industry, but the pace and scope of disproportionate regulatory initiatives are increasing. Recent examples include graphic health warnings on packs and excessive restrictions, or even bans, on smoking in public places like bars and restaurants.

Despite these apparent threats, we continue to expect the industry to remain sizeable in the future and we believe that we can increase our share of its profit pool.

British American Tobacco is well positioned

The global tobacco industry currently produces nearly five and a half trillion cigarettes a year, with sales from the six biggest international manufacturers accounting for half of the global market. With a market share, including our associates, of 17 per cent, we are the second largest international tobacco group.

Global volumes, excluding China, have been declining slowly for some years and this trend is expected to continue. Volumes are expected to fall faster in higher-margin markets, such as the US and Japan, than they will grow in certain lower-margin markets, such as Pakistan, Bangladesh and Turkey.

Based on evidence from 24 of the major markets, representing over three-quarters of global industry volumes, the adult population (20+) will grow, but the incidence of adult smoking will decline over the next decade. Our general conclusion is that the total smoking population is likely to remain stable at around one billion people. Global cigarette consumption is likely to remain above five trillion units, despite cigarette volumes declining slowly, over the next 10 years. In our view, an industry of this size makes suggestions of a 'tobacco-free' world and the 'quit or die' approach to regulation, extremely unrealistic. A more constructive view would see regulators and others working with us on a reduced harm approach.

We like to say we were 'born international' over 100 years ago, and our broad geographic base means we are already well represented in many of the emerging markets, which we expect to grow in terms of profit as well as volume over the next 10 years. Additionally, we are not over-reliant on one or two high-margin markets which are declining faster than the global average.

Our future growth

Our future growth is not dependent on the overall world market expanding. It will come from adult population growth, higher prices in the more mature markets and increased market share in the developing world. As disposable income grows, particularly in the emerging markets, smokers want to upgrade to international brands. Our Global Drive Brands, already demonstrating strong growth, are well positioned to benefit from this trend. In short, we are confident of growing our share of a five trillion unit industry and improving our profitability.

We remain clear and focused on providing leadership for our industry and creating long term shareholder value. Our strategy for achieving this is straightforward. Most importantly, we can see the strategic focus on Growth, Productivity, Responsibility and Winning Organisation being translated into action around the Group with consistency and energy.

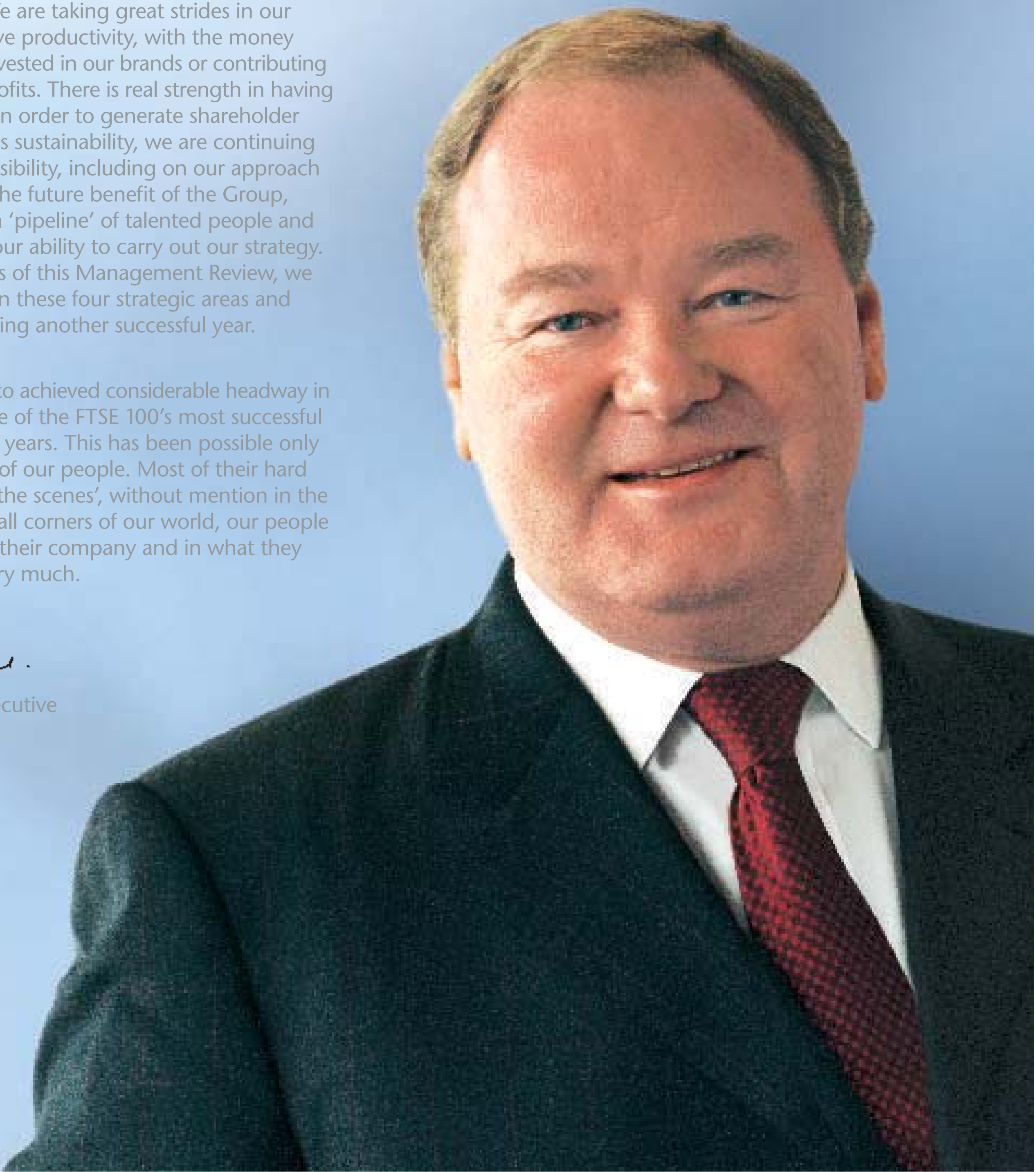
Our Global Drive Brands have increased volumes by 47 per cent over the last five years, producing much of our organic growth. We are taking great strides in our programmes to improve productivity, with the money from these savings reinvested in our brands or contributing directly to increased profits. There is real strength in having a sustainable business in order to generate shareholder value. To help build this sustainability, we are continuing to demonstrate responsibility, including on our approach to reduced harm. For the future benefit of the Group, we are strengthening a 'pipeline' of talented people and this work is central to our ability to carry out our strategy. On the following pages of this Management Review, we report in more detail on these four strategic areas and the progress made during another successful year.

Our people

British American Tobacco achieved considerable headway in 2005 and has been one of the FTSE 100's most successful companies over recent years. This has been possible only with the commitment of our people. Most of their hard work goes on 'behind the scenes', without mention in the Annual Review. Yet, in all corners of our world, our people are displaying pride in their company and in what they do. I thank them all very much.

Paul Adams.

Paul Adams, Chief Executive



MANAGEMENT REVIEW **GROWTH**

"Volumes were 2 per cent higher, a very good level of organic growth in the context of the industry environment and ahead of our goal."

We continue to seek increases in our volumes and share of the global tobacco industry in two ways. Always looking out for interesting opportunities, we will pursue mergers or acquisitions but only if they make strategic and financial sense. This means that our day-to-day focus is set on delivering organic growth.

Organic growth

At 676 billion, the volumes from our subsidiary companies were 2 per cent higher on a like-for-like basis, a very good level of organic growth in the context of the industry environment and ahead of our goal. The overall performance from around the Group was very good too, with four of our five regions well ahead. Within the regions there were some particularly impressive results, including Australia, Brazil, Germany, Pakistan, Russia and South Africa. America-Pacific is the one region lower than 2004, as the difficulties in Canada continue. The durability to withstand a significant regional downturn highlights the strategic benefit that geographic spread brings to the Group.

Our subsidiaries can also demonstrate durability and fortitude in the face of extremely challenging market conditions. For example, in Germany, economic uncertainties and a series of massive excise increases are just two of the influences on a tobacco sector characterised by down-trading to cheaper brands, an increase in cross-border and illicit trade and an overall decline in industry volumes. Yet a combination of price and product mix changes, a significant reduction in the overall cost base and higher cigarette market share driven by strong growth from Pall Mall have enabled us to increase the profit substantially from this key high-margin market.

One market that continues to exceed expectations is Russia. In the space of little more than 10 years, Russia has grown to become our second largest market in terms of volumes and it continues to go from strength to strength. Now we are the second largest player, with 20 per cent of the market. During 2005, the continued focus on our Global Drive Brands and a national expansion led to a better product mix and strong volume and market share growth, resulting in a significantly higher profit contribution.

Building key relationships

Building strong relationships with trade customers can be a source of competitive advantage. We aim to be the benchmark supplier in every market and channel where we do business. While our Trade Marketing and Distribution teams are in continual dialogue with key customers and trade partners, we also commission independent annual customer satisfaction surveys, to assess the effectiveness of these relationships. The results from surveys to date indicate favourable scores against those from other tobacco companies and consumer goods companies.

Innovation

A critical factor setting us apart from our competitors is the innovation we have brought to well established brands, an integral part of our growth strategy. The impact of innovations valued by consumers can be measured in terms of consumer demand, a reconsidered image of the brand, brand loyalty and the willingness to pay a premium. The result for British American Tobacco is increased net turnover and an enhanced competitive position in the market. We are offering more and more innovations to consumers covering all aspects of our products – filters, flavours (including menthol), cigarette formats, packaging and other tobacco products (including snus). A few of these are mentioned in other sections of this Review.

AUSTRALASIA – GROWTH IN A CHALLENGING ENVIRONMENT

CASE STUDY – AUSTRALASIA

"We are meeting the challenge of creating and maintaining growth in Australasia by continual innovation in our brands."

David Fell, General Manager
British American Tobacco, Australasia

Impact of regulation

Increasing regulation in the form of public smoking bans and product display restrictions in New Zealand, and the removal of product descriptors such as Lights, from all tobacco products in Australia, were some of the obstacles to growth in Australasia in 2005. In spite of industry declines, growth was led by Dunhill, Winfield and Holiday.

Meeting customer and consumer preferences

Product and packaging innovation drove much of this success. Dunhill's growth resulted from the full year effect of the Dunhill 'Button' packaging, while the 'Signed Range' of cigars also grew through a greater focus on distribution and increased efficiency within the primary supply chain.

At a customer level in Australia, we gained leadership of the strategic grocery channel for the first time and share increased in every channel. This focus on customer satisfaction was recognised by a number of key accounts naming British American Tobacco as the best supplier in the tobacco category, and by winning the best indirect supplier award from the Australasian Association of Convenience Stores for the third consecutive year.

Revitalising Pall Mall

In New Zealand, Pall Mall 25s were launched, revitalising the brand, creating market share at year end of 7.6 per cent and contributing significantly to Global Drive Brand growth. Pall Mall was also launched in eight variants in Australia in February 2006.

Kent

Kent achieved its third consecutive year of double-digit growth, with outstanding performances in markets including Russia, Romania and Iran, combined with further global expansion.

39 billion cigarettes sold in 2005
18 per cent increase on 2004

Dunhill

In spite of volume declines in 2005, mainly due to price increases driven by excise in Dunhill's two biggest markets, Korea and Malaysia, the new Dunhill mix continued to be rolled-out with positive results in all regions.

31 billion cigarettes sold in 2005
4 per cent decrease on 2004

Lucky Strike

Lucky Strike achieved record market share and share of the Adult Smokers Under 30 (ASU30) category in many major markets in 2005, including Germany, France, Italy, Argentina, Serbia, Brazil and Indonesia.

22 billion cigarettes sold in 2005
2 per cent decrease on 2004

Pall Mall

Pall Mall delivered accelerated growth in 2005, driven by organic growth in existing markets, innovation, geographic expansion and growth in other tobacco products including StiX.

33 billion cigarettes sold in 2005
25 per cent increase on 2004

"In 2005, the four Global Drive Brands performed well once again, showing overall growth of 9 per cent."

Global Drive Brands (GDBs)

In all regions, we are concentrating our efforts on the international, premium, lights and Adult Smokers Under 30 (ASU30) segments, because they represent the best opportunities for growing our business. Our four GDBs and other brands within our portfolio are well represented in these segments. We are rolling-out our GDBs consistently around the world. They are crucial as they drive around a third of our growth in net turnover.

In 2005, the four GDBs performed well once again, showing overall growth of 9 per cent.

Kent

A commitment to innovation led to another strong year for Kent, based around the launch of the 3-Tek (triple part charcoal filter) in Japan, Russia and Romania in late 2004 and in markets including Chile and Ukraine in 2005. In Russia, Kent became the leading premium lights brand, while in Romania, Kent was the leading premium brand with a share of over 11 per cent. In Japan, Kent Mintek was upgraded, using new technology to deliver an enhanced menthol taste, and in Romania, Kent Senso-Tek, using menthol with three different flavour combinations, was introduced as a limited edition offer.

Dunhill

In 2005, total Dunhill volumes were down following excise increases in its key markets, South Korea and Malaysia. However, Dunhill grew market share by 2.6 per cent to 14.7 per cent in South Korea, with positive initial results from Dunhill Balance and an improved performance in the ASU30 category. Malaysia continued to be Dunhill's biggest market in 2005, with 45 per cent market share and a strong position in ASU30. Taiwan became Dunhill's third largest market with total shipments up 47 per cent compared to 2004, strong organic growth and the successful launch of Dunhill Fine Cut. In the Africa and Middle East region, the Dunhill 'Button' range performed strongly in South Africa and the continued roll-out of the Dunhill mix in Europe has good potential in Germany and Russia, where share in Moscow grew to 7 per cent.

Lucky Strike

Overall, Lucky Strike volumes in 2005 were slightly down in the face of declining markets in Western Europe and Japan. Following the global roll-out of the new 'Original Smoke' campaign, packs and blends, significant volume growth was achieved in emerging markets. Sales in Indonesia exceeded one billion sticks in a calendar year for the first time and sales in Latin America topped 1.5 billion, with a strong upward trend. The brand also entered the roll-your-own market with test launches in the UK and Spain. Lucky Strike was the first international brand to launch snus in Sweden, achieving success in the Stockholm test market, and was one of two brands selected for the test launch of the product in South Africa.

Pall Mall

Pall Mall delivered its strongest ever organic growth in 2005, with outstanding volume and share performances in most key markets, including Russia and Malaysia. Innovation drove much of this success, with the introduction of bevelled edge 'Pallm Pacs' and Pall Mall Superslims. The brand also entered other tobacco categories, resulting in the significant growth of StiX in Germany. The new brand mix is enabling markets to launch Pall Mall with a portfolio that is flexible enough to adapt to local needs while maintaining global consistency.

Other key brands – Vogue and Viceroy

Although the progress of our GDBs remains central to our brand portfolio and our Group strategy, we have increased the profile of Vogue and Viceroy as brands that are performing strongly in their respective segments.

Vogue's success reflects the growing importance of the super premium segment and, in 2005, volumes increased over 25 per cent compared to 2004. Viceroy made significant volume progress for the third year running, becoming the leading low price international brand in four out of its top five markets.

"We are increasing our annual savings target for overheads and indirects to £400 million by 2007."

By using our global resources as effectively as possible, we aim to increase profits and generate funds to reinvest in the business. Last year saw us take more significant steps to improve our productivity, both in terms of our supply chain and overheads and indirects.

Supply chain

The drive to reduce complexity and costs throughout the primary supply chain continues to accelerate, achieve results and produce above target savings. Total supply chain benefits of £106 million in 2005 have brought annual savings for the first three years of the programme up to £226 million. These savings include benefits achieved from streamlining manufacturing operations and other efficiencies across areas such as logistics, and the direct procurement of packaging materials and leaf. We expect to deliver further supply chain savings in the years ahead.

Savings resulting from the factory closures in 2003 and 2004 continue to come through. Initiatives to reduce excess capacity continued in 2005, as a further five factories closed and an additional eight closure programmes were announced, including Guelph and Aylmer in Canada and Southampton in the UK. In total, Group subsidiaries are transferring the manufacture of more than 300 billion cigarettes to more economic centres of production. This is a major exercise and involves the transformation of the Group's manufacturing footprint. There have also been significant downsizings in several factories, including Bayreuth in Germany and Zevenaar in Holland. In addition, some major productivity gains have been achieved in eight other facilities.

Manufacturing overcapacity has undoubtedly required some difficult decisions. Job losses of some 4,100 have resulted from closures and downsizings over the past three years. Our subsidiaries work hard to ensure adequate measures are in place to mitigate the impact on employees and local communities, and help those made redundant. For example, measures taken in Darlington, UK, resulted in more than 96 per cent of employees being able to retire, find re-employment, opt for self-employment or choose retraining. A legacy fund was established to help attract new employment to the town.

The Product Complexity Reduction programme, targeting the elimination of consumer irrelevant, historic complexity across the brand portfolio is well under way and already providing significant savings. Progress has also been made in resourcing leaf requirements from fewer locations and towards global pooling of strategic leaf stocks, reducing inventory and costs and facilitating blending.

Overheads and indirects

In 2005, £103 million was saved from our overheads and indirect costs (those that are not involved in cigarette production) programme, bringing the annualised total since 2003 to £256 million, well on the way to our target of £320 million per year by 2007. As a result, we are increasing this target to annual savings of £400 million by 2007.

The savings are being accumulated as we continue to adopt smarter procurement planning around the Group, led by teams of procurement specialists. Big inroads are being made into a range of cost areas, including IT and transportation. We are also benefiting from both an increased use of shared services and a restructuring of businesses to better support our strategy. For example, the integration of our Smoking Tobacco and Cigars business into markets in the European region has had a positive impact.

BRAZIL – INCREASING EFFICIENCY ACROSS SOUZA CRUZ

CASE STUDY – BRAZIL

"At Souza Cruz, we continue to look for new ways to increase our productivity and improve our business performance."

Nicandro Durante, Souza Cruz President in 2005 (Director, Africa and Middle East from March 2006)

Sharing best practice

In working towards greater productivity, Souza Cruz is also increasing its synergy with other British American Tobacco companies. Examples include the relocation of its Research & Development Centre and printing facilities to the site of its factory in Rio Grande do Sul State, and establishing its R&D facility as a Regional Product Centre, providing expertise and equipment under one roof for Group companies.

Working through partnerships

Souza Cruz continues to work closely with external companies through innovative partnerships that cut costs and deliver competitive advantage. Created in January 2001 as a joint venture between AmBev and Souza Cruz for optimising indirect purchases, AGREGA has expanded over the past two years to include other customers in Brazil, generating annual savings of US$19 million in costs. The AGREGA business model has been rolled-out to Argentina and, more recently, to Venezuela. Using its nationwide distribution network, Souza Cruz has also entered into a new relationship with Telemar, Brazil's largest telecoms company, for distributing phone cards to retailers, resulting in savings of US$7 million.

"Harm reduction is not only an integral part of our responsibility strategy but also a key component of long term business sustainability."

We are determined to continue demonstrating that it is possible to be a responsible tobacco company. It is the best way to build a sustainable business which, in turn, generates shareholder value. We hope that governments and regulators will eventually understand that their public policy goals can best be achieved by working with us.

Dow Jones Sustainability Indexes

For the fourth successive year, British American Tobacco continues to be the only tobacco company included in both the DJSI World and DJSI STOXX Indexes. These independent indices are an important assessment of the corporate sustainability of an organisation, measuring economic, environmental and social criteria. British American Tobacco achieved the best scores across 73 per cent of the categories, including all the environmental criteria for the sector.

Social reporting and environmental performance

During recent years, our financial reporting has been augmented by comprehensive social reporting by many Group companies. Our fifth social report will be published on bat.com in late July and it will contain a detailed review of our environmental performance during 2005. In summary, we have continued to lower the environmental impacts of our factories and operations, with reductions in energy, water usage and carbon dioxide emissions, as well as an increase in recycling.

Harm reduction

Harm reduction is not only an integral part of our responsibility strategy but also a key component of long term business sustainability. Consumers have also told us in social reporting dialogue that developing less harmful products is one of the most important things that a tobacco company can do.

Our approach currently focuses on exploring ways to reduce human exposure to tar and toxins across our current brand portfolio and how to achieve accepted and accurate measures of exposure. We are also developing and testing technologies that we believe have the potential to reduce exposure to harmful toxins and test-marketing smokeless products.

'Smokeless' tobacco does not mean 'harmless' tobacco. However, snus has been reported by independent researchers to be much less harmful than cigarettes, and our trials are in response to a number of public health stakeholders who have told us that they believe snus, properly regulated, can contribute to reducing the health impact of tobacco.

Our testing of snus is the first launch of a smokeless product under major cigarette brands. By marketing snus under Lucky Strike and Peter Stuyvesant, we aim to find out if we can extend the appeal of snus to more adult smokers and encourage smokers who have not heard of snus to try it.

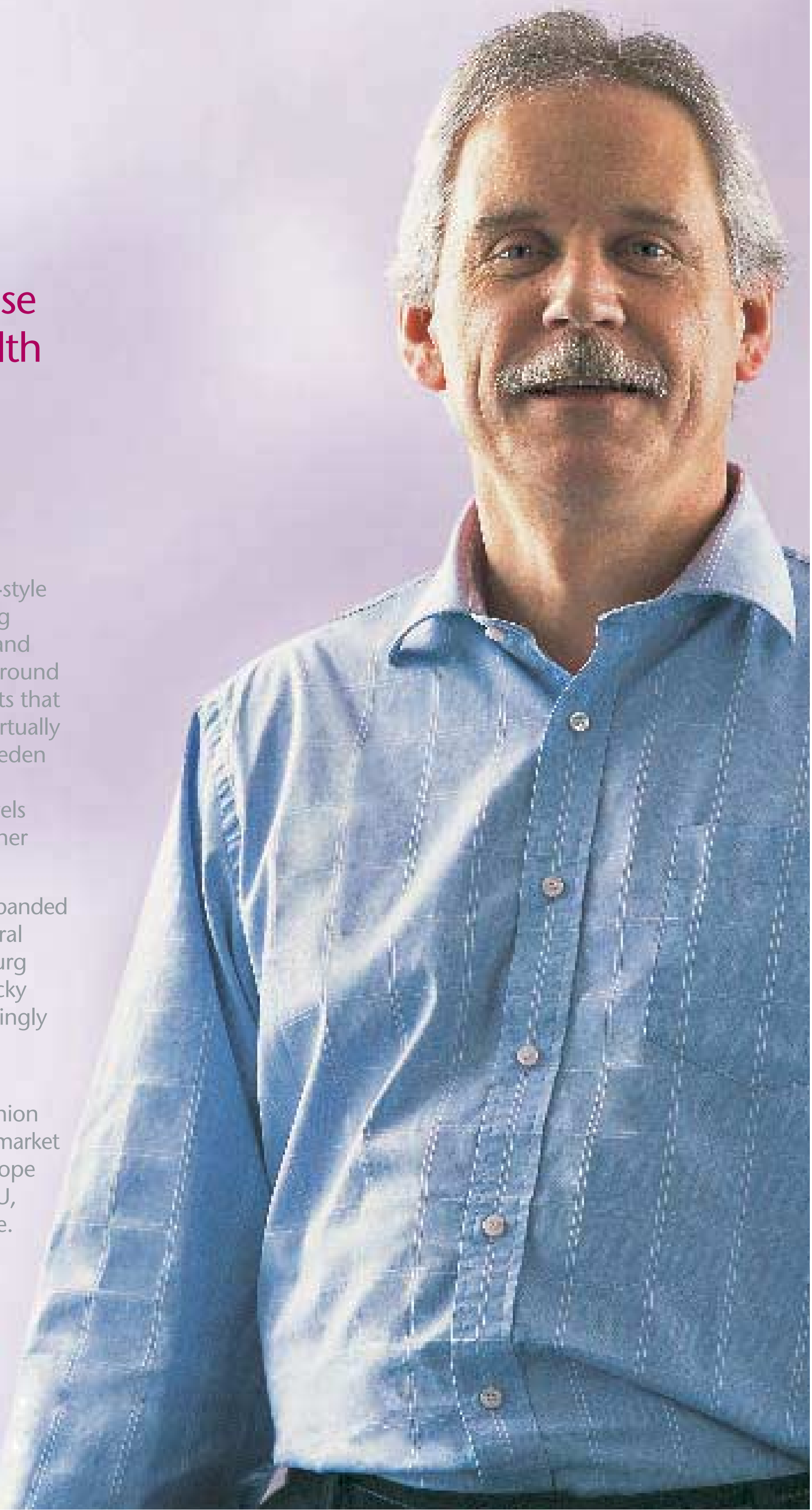
We recognise that no tobacco product is completely free from risk but we believe that some product categories, such as snus, are much less hazardous than others. We are committed to trying to develop and bring to market a new generation of tobacco products that both meet consumer appeal and will, over time, be recognised by scientific and regulatory authorities as posing substantially reduced risks to health.

Some regulators and anti-tobacco groups reject the concept of reduced harm products, suggesting that the approach is ineffective. Some express concern that such products may discourage smokers from quitting, or may lead people to become tobacco consumers who would not otherwise do so.

We believe that, although there will certainly be smokers who quit and people who choose not to smoke, many informed adults will also continue choosing to smoke or to consume tobacco in other ways. We want our consumers to know about the products that could be developed from a reduced harm approach, so that they can make up their own minds.

We seek to work constructively with regulators, scientists and public health groups to establish standards for evaluating how new developments might contribute to a reduced harm approach, as well as to agree the appropriate messages for consumers about novel products and technologies.

TEST-MARKETING OF SMOKELESS TOBACCO



CASE STUDY – SNUS

"We are testing snus in response to consumers and public health stakeholders as part of our continuing efforts in harm reduction."

Peter Taylor, Director, Operations and IT

In May 2005, we began year-long trials of Swedish-style snus in test markets in Stockholm and Johannesburg under two of our best known brands, Lucky Strike and Peter Stuyvesant. Snus is not smoked but is finely-ground pasteurised moist tobacco that comes in tiny sachets that are placed under the upper lip. While it has been virtually unknown in South Africa, snus is widely used in Sweden and has overtaken smoking amongst adult tobacco consumers. Swedish snus has significantly lower levels of potentially carcinogenic chemicals than some other types of smokeless tobacco.

The early signs in Sweden are very promising. We expanded distribution from the pilot area to throughout Central Stockholm and to two other major cities, Gothenburg and Malmo. Consumer and retail interest in the Lucky Strike product is high and sales steady in an increasingly competitive environment.

Taking the results forward

Sweden, which has an exemption to a European Union ban on most forms of smokeless tobacco, is the only market within the EU where snus could be launched. We hope to engage with regulators, including those in the EU, to discuss our learnings from the trials in due course.

MANAGEMENT REVIEW **WINNING ORGANISATION**

"Developing talented leaders at all levels with a clear vision for the business remains central to our Winning Organisation strategy."

Creating a Winning Organisation

We know that in order to deliver our strategy, it is essential to create a Winning Organisation with talented people working in a culture that encourages dialogue, shares knowledge, learns from its mistakes and replicates successful formulas quickly.

It is also important that our Group strategy and vision are clearly understood by everyone. This enables employees to work towards a common goal in which every department, market and function plays an important part.

Developing talented leaders at all levels with a clear vision for the business remains central to our Winning Organisation strategy and to the Group strategy as a whole. Given the challenges and opportunities presented by the external environment, coupled with the speed of change in the market place, it is essential to grow and nurture the next generation of leaders. To that end, we remain committed to attracting, recruiting and retaining the best people, whether they join us as graduates or in mid-career. In 2005, 115 graduates joined our Management Trainee scheme and since 1996, the programme has recruited 1,150 graduates.

Employee opinion research

We are committed to creating an environment where employees feel that they can speak honestly about the Company and issues of importance to them. We run annual employee surveys with International Survey Research (ISR) and, in October 2005, we conducted our most comprehensive survey to date.

The survey, Your Voice 2005, obtained opinions from over 35,000 employees based in over 60 markets across our five regions, with an overall response rate of 80 per cent. The 16 categories in the survey included those which relate directly to our vision of a Winning Organisation – Leadership, Alignment, Learning, Culture and Talent – as well as categories relating to our Core Beliefs and Guiding Principles.

To establish how employee opinion within British American Tobacco compares with other organisations, the Your Voice survey data was compared with ISR's 2005 benchmark of high performing companies. This comprises data from a range of organisations globally who are considered high performers in financial performance and in general levels of employee satisfaction.

In terms of global results, British American Tobacco scored significantly above or the same as the ISR benchmark in over half of the categories. 91 per cent of employees expressed a strong sense of pride in working for the Company and over 85 per cent believed that individuals and teams continually aimed to improve their performance.

The Your Voice results are enabling us to analyse and address areas of concern among employees both globally and on a local level. Around the world, management teams will be turning the results into tangible change management plans in order to make British American Tobacco an even more successful company.

USING LEADERSHIP TO DRIVE CHANGE IN EQUATORIAL AFRICA

CASE STUDY – EQUATORIAL AFRICA

"Our leadership initiative has made a real difference to performance across all areas of our business."

Brian Finch, Area Marketing Manager in 2005
(Marketing Director, South Africa from March 2006)

In 2004, the senior management of the Equatorial Africa (EquatA) area launched Safari Yetu (Our Journey), a leadership initiative that built on the merger earlier that year of our former Eastern and Southern Africa areas, totalling 22 countries. Spanning 16 project initiatives covering the four elements of the global strategy, Safari Yetu has helped EquatA to deliver outstanding results as well as generate an entrepreneurial spirit among employees.

Building success

EquatA's performance has been underpinned by a high level of development, training and mentoring. Senior management each mentor a minimum of two high-achieving employees and there has been a significant increase in emphasis on developing local talent. There are now around 50 EquatA employees who are working in markets other than in their home market. The Safari Yetu awards, which recognise the exceptional achievements of teams, individuals, markets and projects within EquatA, have also helped to create a huge sense of enthusiasm and pride across the area.

Making a difference

In 2005, the area achieved underlying growth of over 11 per cent and has also delivered incremental cost savings in excess of £3 million.

“South Africa is making a major contribution to the Group through the successful implementation of our strategy.”

Tobacco in South Africa has a long history. Tobacco was first cultivated over 350 years ago and the first factory opened in the 1880s. Today, the industry provides a living for more than 100,000 people and contributes over R7 billion to the Government in excise and VAT. In the last 10 years, excise on cigarettes has increased nearly five-fold and has contributed to the dramatic rise in illicit trade in tobacco products. Despite this challenge, British American Tobacco South Africa is winning in an industry of approximately 29 billion cigarettes. It is one of the Group’s most important and top performing companies.

Our origins in South Africa can be traced back to the creation of the United Tobacco Company in 1904. With the global merger of British American Tobacco with Rothmans International in 1999, we became South Africa’s largest manufacturer of cigarettes.

British American Tobacco South Africa has over 90 per cent of the legitimate cigarette market and more than 70 per cent share of the total legitimate tobacco market, in a country where one out of every four adults chooses to smoke or use tobacco products. The Company employs some 2,400 people, sells 27 brands and produces about 22 billion cigarettes annually for the local market and 7 billion for export. It also purchases up to 60 per cent of the annual South African tobacco leaf crop for local and export production.

Our strategy in action

In the following pages, you can find out how British American Tobacco South Africa is making a major contribution to the Group through the successful implementation of our strategy based around Growth, Productivity, Responsibility and Winning Organisation.

This success is driven by a combination of initiatives that show our Group strategy working at market level. These include rejuvenating brands to accelerate growth, achieving cost savings, engaging with stakeholders on key issues including illicit trade, and maintaining a strong commitment to corporate social investment. Underpinning everything is the development of a Winning Organisation culture.

None of the elements of our strategy can work in isolation for it to succeed at market, regional or Group level. An integrated approach is enabling British American Tobacco South Africa to achieve the impressive quantitative and qualitative results that consistently make it one of our outstanding companies.

Consumers at a bar near Cape Town
Front cover: A tobacco grader at a farm in the Mpumalanga province

Growth through brand strength

In South Africa, our four key brands – Peter Stuyvesant, Lucky Strike, Dunhill and Rothmans – have achieved consistent growth in recent years, increasing their combined market share from 51.9 per cent in 2000 to 57.8 per cent in 2005.

Of these brands, Dunhill is the leader in the Premium segment with a growing share of the Adult Smokers Under 30 (ASU30) segment, chiefly as a result of a pack change to the 'Button' range, positive performance in the Lights and Menthol segments and the launch of Dunhill Fine Cut.

Peter Stuyvesant, however, is South Africa's most popular cigarette and the primary source of profit for the Company. The successful launch of a new pack in August 2004 helped to increase market share to 44.5 per cent in 2005 and the brand continues to have a leading share (63.8 per cent) of the ASU30 segment. The new pack also features a number of enhancements that have helped to reduce counterfeit product.

Peter Stuyvesant was also selected, together with Lucky Strike, for a 12 month trial of snus from May 2005. Snus, a much less harmful, smokeless tobacco product, is sold at 241 tobacco outlets in the province of Gauteng.

"Peter Stuyvesant, South Africa's most popular cigarette and the primary source of profit for the Company."

Productivity: Creating greater efficiency across the business

In line with our global programme to reduce complexity and indirect costs across our operations, South Africa has delivered cumulative savings 30 per cent over its initial target for 2005. This was achieved through strategic sourcing of goods and materials by a team of indirect procurement professionals working closely with other functions.

Improvements in supply chain efficiency have also led to better utilisation of resources and greater productivity in a variety of areas, with exports of metallised paper (the silver paper found inside cigarette packets), cigarettes and cutrag tobacco (processed tobacco leaf before manufacture into cigarettes) to other markets in the Africa and Middle East region significantly increasing.

The massive growth in exports has demanded a similar increase in logistics efficiency across despatch, container handling and storage. Both air and sea freight are now used to deliver cigarettes to other markets and a new storage facility was opened at the Heidelberg factory in May 2005 to provide greater capacity for cutrag tobacco.

Expansion of Heidelberg's manufacturing capacity has led to a subsequent downscaling of facilities at our Paarl factory, located in the Western Cape.

A tobacconist in Johannesburg


Now Available
DANGER: SMOKING CAN KILL YOU
WE CANNOT, BY LAW, SELL TOBACCO PRODUCTS TO ANYONE UNDER THE AGE OF 16 YEARS
SNUS
CAUSES CANCER
OLD CHARLIE'S


Peter Stuyvesant
Peter Stuyvesant

Responsibility: A multiple approach

British American Tobacco South Africa spends over R30 million annually on corporate social investment and focuses its work on four core areas: HIV/AIDS, black economic empowerment, sustainable agriculture and civic life.

Projects supported include the Manenberg People's Centre in Cape Town, which gives unemployed women from the ages of 18 to 34 the opportunity to learn new skills such as gardening, IT and hairdressing. The Centre trains around 70 women every year, with several intakes of trainees to maximise the number of people who can benefit. All training is part-time to allow mothers to spend time with their families. Produce grown in the Manenberg garden is available for the local community to buy and dedicated support is given to trainees as they look for their first jobs.

"British American Tobacco South Africa recognises that a well-run business can and should help local communities to achieve economic, social and environmental development."

The British American Tobacco South Africa Scholarship Fund assists university students from previously disadvantaged communities to read for degrees in commerce, engineering, business science and IT. More than 500 students from 14 universities around the country are currently receiving full scholarships or other educational support.

The threat of HIV/AIDS is addressed through the Company's Signature Trust, launched in 2003 to raise awareness of HIV/AIDS and address its impact on South Africa's disadvantaged communities. Among other activities, the Trust is currently involved in a three-year partnership with Siyaya, an innovative music group based in the Western Cape, which uses songs and performance to convey health messages and encourage responsible behaviour.

In the last six months of 2005, Siyaya reached more than 70,000 people and the group will continue touring rural communities during 2006.

South Africa was also among the first of our markets to produce a Social Report in 2002 and has received three awards for social reporting since then, most recently the 2004 'Best Sustainability Report in South Africa' award from the national Association of Chartered Certified Accountants.

Previous photo: Employees at the Heidelberg factory
Women attending an induction session at the Manenberg People's Centre

Creating a Winning Organisation

With around 6 per cent of its payroll allocated to development and training, British American Tobacco is currently regarded as one of the top three investors in people in South Africa. The Company's programmes are specifically designed to enable it to build on its success, supported by excellence across functions and departments. All 2,400 employees have been included in at least one of its initiatives, which aim to create a Winning Organisation through building a culture of leadership at all levels.

The employees on the opposite page represent the diversity and talent that is found throughout the business. The Company enjoys a high staff retention level and over 50 per cent of employees have been with the Company for over 10 years. They include Jacob Nkosi, a Training Foreman, who has worked at the Heidelberg factory in various roles for 30 years. Others come mid-career to find new opportunities, such as Fay Kajee, who joined five years ago and, in 2005, was promoted to Head of Corporate and Regulatory Affairs, becoming the first woman to join the Management Board of British American Tobacco South Africa.

Attracting, developing and retaining talented people lies at the heart of the approach to creating a Winning Organisation. Former Management Trainee Gabeba Gaidien, who works in internal audit, was sponsored by our Scholarship Fund at the University of Stellenbosch and joined the Company two years ago.

Our OneLeader initiative aims to develop leadership style, emotional intelligence, a team climate and coaching skills. It focuses on the formation of coaching circles, providing opportunities for teams to coach each other. By the end of 2005, 320 managers had participated in the programme, 45 coaching circles were active across the organisation and 195 coaching relationships existed across all functions. John Feller, responsible for marketing development, is one of those managers providing the energy and commitment to make the programme successful.

Through accelerated development, 70 non-managers have participated in the Growth Academy Programme that aims to develop employees from within and create a future pool of leaders, with over half already promoted into management roles.

The investment in people, training and development is enabling British American Tobacco South Africa to reap rewards in terms of business performance across all of its operations.

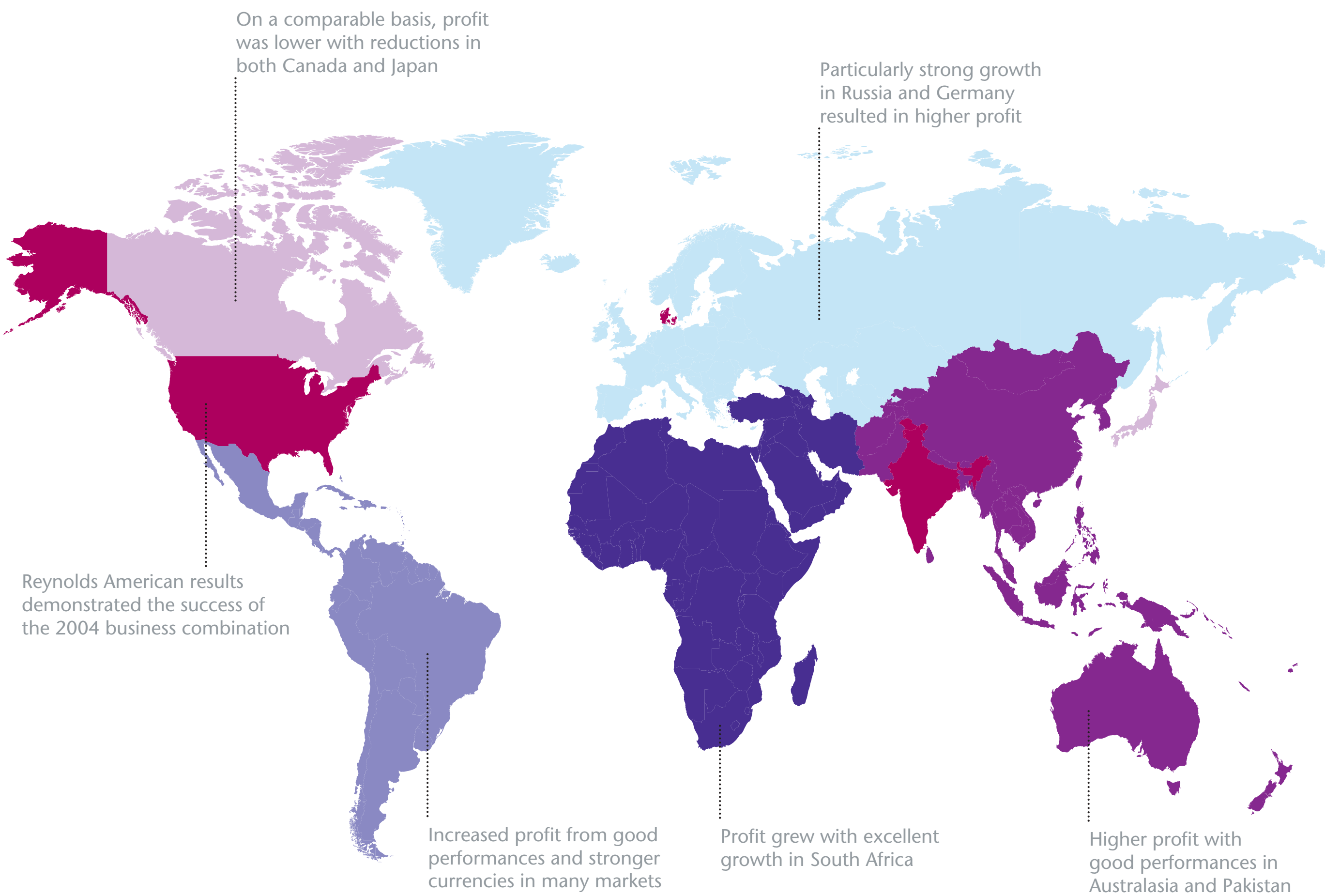
To find out more information about British American Tobacco in South Africa, please visit www.batsa.co.za

Clockwise from top left: Jacob Nkosi, Fay Kajee, John Feller, Gabeba Gaidien
Back cover: Siyaya, working in partnership with the Signature Trust to promote HIV/AIDS awareness



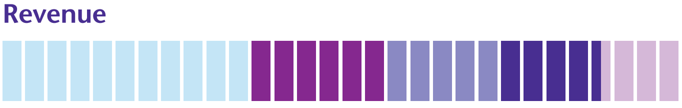

MANAGEMENT REVIEW **REGIONAL SUMMARY**

Profit by region



Cigarette volumes

Revenue



Operating profit

- Europe
- Asia-Pacific
- Latin America
- Africa and Middle East
- America-Pacific
- Associates

To find out more information about our performance please visit www.bat.com/investorcentre

"On a like-for-like basis, profit from operations would have been 9 per cent higher."

The reported Group profit from operations was 36 per cent lower at £2,420 million, mainly due to the impact in 2004 of a significant £1,389 million gain on the Reynolds American transaction. As explained on page 20, on a like-for-like basis profit from operations would have been 9 per cent higher, or 5 per cent at constant rates of exchange. This like-for-like information provides a better understanding of the subsidiaries' trading results. The strong profit performance reflected higher profit in all regions, except America-Pacific.

On a reported basis, Group volumes from subsidiaries were affected by the transactions noted on page 20, resulting in a decrease of 1 per cent to 678 billion. Excluding the impact of these transactions, there was good organic volume growth from subsidiaries, with many markets contributing to the overall growth of 2 per cent, growing from 663 billion to 676 billion. The Group continues to include make-your-own cigarette 'stix' in volumes.

The four Global Drive Brands performed well with an overall growth of 9 per cent on a like-for-like basis. Kent grew by 18 per cent with outstanding performances in its major markets of Russia and Romania, as well as a higher share in Japan. Dunhill was down 4 per cent, affected by the substantially reduced industry volumes in South Korea earlier this year, as well as in Malaysia. Lucky Strike was 2 per cent lower mainly as a result of reduced market volumes in Germany. Pall Mall continued its exceptional growth of 25 per cent as it performed well in all its key markets.

Europe
In Europe, profit increased by £34 million to £784 million, with particularly strong growth from Russia and Germany. The integration of the Smoking Tobacco and Cigars business in 2005, other cost savings and the positive impact of the change in trade terms in Italy, also contributed to the result. Excluding a net £30 million gain as a result of the sale of Etinera at the end of 2004, partly offset by the consequent change in terms of trade, profit on a like-for-like basis would have increased by £64 million or 9 per cent. Volumes were 2 per cent higher at 244 billion with growth in Russia, Romania and Poland, partly offset by declines in Italy, Germany, Switzerland and Ukraine.

In Italy, an excise increase at the end of 2004 and the virtual ban on indoor public smoking effective from the beginning of 2005, resulted in a total market decline of around 6 per cent, with aggressive competition mainly in the low-price segment. Despite lower volumes and market share, like-for-like profit rose, benefiting from higher prices.

Germany grew market share and substantially increased profit, despite lower volumes in a reduced overall market due to excise increases. Profit growth was driven by pricing, improved product mix and significant reductions in the overall cost base. Increased market share resulted from gains by Lucky Strike and Pall Mall.

In France, profit grew impressively with higher volumes and market share growth through Lucky Strike and Pall Mall. Profits benefited from the improved mix, better pricing and lower costs. In Switzerland, industry volumes declined after an excise increase at the end of 2004 but the key brands, Lucky Strike, Pall Mall, Vogue and Parisienne, all grew market share. However, the tough trading conditions affected profit. In the Netherlands and Belgium, the very successful integration of the Smoking Tobacco and Cigars business, as well as other cost savings, more than offset the effect of lower volumes on profit.

Russia continued its excellent performance with strong profit and volume growth. Market share was up and product mix improved with further growth from the premium brands, Kent and Vogue. The focus on international brands continued with the launch of Viceroy, the introduction of the new Pall Mall range and the roll-out of Dunhill to the top 30 cities. In Romania, good Global Drive Brand growth, especially from Kent and Pall Mall, and higher total market share, reinforced the Group's market leadership position. Strong profit growth was achieved by an improved mix, higher volumes and margins.

Profit in Ukraine was lower due to reduced volumes, although there were good performances from Kent and Vogue. In Hungary, profit was higher as a result of higher margins and reduced costs. Pall Mall grew but volumes were adversely impacted by a continuing total market decline and down-trading. In Poland, volumes and profits grew with good results from Vogue and Viceroy.

Asia-Pacific

In Asia-Pacific, profit rose by £36 million to £531 million as good performances in Australasia and Pakistan, a benefit in the first quarter from the timing of an excise payment in South Korea and good results from many of its other markets, more than covered the reductions in Malaysia and Vietnam. Volumes at 137 billion were 4 per cent higher as strong increases in Pakistan and Bangladesh were partially offset by declines in South Korea, Vietnam and Malaysia.

Profit grew strongly in Australia, with higher margins and market share due to good performances from Dunhill and Winfield, and despite increased competitor activity and lower volumes in a reduced total market. In New Zealand, profit increased as margins were higher, although market share was slightly down as a result of the growth of the low-price segment.

In Malaysia, a further excise tax increase depressed industry volumes. Market share was only marginally lower but profit was impacted by the lower volumes, adverse product mix, price competition and the contribution to a government sponsored leaf programme. In Vietnam, volumes were lower as a result of inventory adjustments leading to a decline in volumes and profit, although the market share of State Express 555 and Craven 'A' continued to grow.

South Korea's higher profit reflected the first quarter excise benefit and productivity gains. Volumes were only slightly down while the market was significantly lower, due to stocking by the trade before the excise increase. Dunhill continued to grow market share, while Vogue grew strongly after it was relaunched in August.

In Pakistan, profit was well ahead with lower costs and excellent volume growth by Gold Flake and John Player Gold Leaf, resulting in a higher market share and industry volume leadership. Volumes rose in Bangladesh but profit fell as down-trading continued and higher excise and the inflationary impact on costs were not recovered through higher prices. In Sri Lanka, good profit growth was achieved through lower costs, an improved product mix and higher volumes, with strong performances by John Player Gold Leaf and Benson & Hedges.

Latin America

In Latin America, profit increased by £82 million to £530 million as good performances across the region reflected higher volumes and margins, further helped by stronger currencies in many of the markets. Volumes at 149 billion increased slightly as growth in many markets was partly offset by declines in Mexico and Argentina.

In Brazil, profit increased strongly with improved margins and product mix, higher volumes and the strengthening of the real, partly offset by higher marketing investment and lower export leaf margins impacted by the currency appreciation. Volumes grew impressively, while anti-illicit trade initiatives reduced both counterfeit and contraband volumes.

Good profit growth in Mexico was driven by price increases, an improved product mix, lower costs and a stronger local currency, partly offset by lower volumes as the total market declined and market share fell in the low-price segment. In Argentina, profit was down as the benefit from price increases was offset by marketing investment, coupled with lower volumes due to a temporary excise tax advantage for local ultra low-price manufacturers. The volume loss has now been reversed with the launch of Viceroy.

In Chile, profit rose substantially with volumes and market share up, higher margins and a stronger currency. Venezuela's excellent profit growth was the result of increased margins and good market share gains, following a general recovery in consumer purchasing power and a reduction in illicit trade. An impressive profit increase in Peru was achieved through new marketing initiatives and a lower cost base, following the closure of manufacturing facilities. The Central America and Caribbean area showed strong profit growth as volumes and market shares increased, with margins benefiting from factory rationalisation.

Africa and Middle East

Profit in the Africa and Middle East region grew by £74 million to £434 million, mainly driven by South Africa and reduced losses from Turkey. Volumes grew by 5 per cent to 103 billion with strong growth from the Middle East markets and Turkey.

In South Africa, good profit growth was achieved with higher margins, as well as a stronger currency. In addition, the product mix improved as Peter Stuyvesant continued its growth. These benefits were partially offset by lower volumes as the total legal market declined following further inroads from illicit trade. Market share in Nigeria increased strongly, as the Benson & Hedges and London brands maintained share growth while the authorities continued to address illicit trade.

Strong volume growth in Iran, mainly from Kent and Montana, resulted in increased profit. The Arabian Gulf markets increased profit as costs were reduced and volumes were higher.

Geographical expansion continued with investment in new markets but this had some adverse effect on profit. Turkey continued to progress despite further excise changes and price volatility. Volumes almost doubled, principally driven by the strong performance of Viceroy, while Pall Mall was relaunched. Tight cost control continued and combined with the strong volume gains, resulted in significantly reduced losses.

America-Pacific

On a like-for-like basis, the America-Pacific regional profit declined by £54 million to £436 million, with lower contributions from both Canada and Japan. Increased volumes in Japan were more than offset by a decrease in Canada, leading to an overall decline of 2 per cent. As the comparative period included the US tobacco businesses now merged with R.J. Reynolds and included in associates (see page 20), the reported regional volumes were 34 per cent lower at 45 billion and reported profit was £203 million down.

Profit from Canada was £24 million lower at £319 million. The volume decline, due to significant industry contraction and the continuing shift to low-price products, more than offset lower operating costs, as a result of restructuring, and the impact of the stronger Canadian dollar. The decline in total market share slowed and was down two share points at 56 per cent, as Imperial increased its share of the low-price segment. Premium segment share was only slightly down but this segment shrank nine share points to 59 per cent of the total market.

In Japan, market share and volumes were up, with particularly strong growth by Kool and Kent, and there was a better product mix and lower costs. Profit, however, was affected by the non-recurrence of a benefit from a business reorganisation included in the prior year and costs associated with an age verification project for vending machines.

Unallocated costs

Corporate costs not directly attributable to individual segments were down £7 million to £96 million, due to lower costs and higher income.

The above regional profits were achieved before accounting for restructuring costs, investment costs written off and gains on the disposal of subsidiaries, joint ventures, non-current investments and brands (see page 20).

Results of associates

The Group's share of the post-tax results of associates increased by £266 million to £392 million, reflecting the inclusion of £244 million for Reynolds American following the transaction described on page 20. On a pro forma US GAAP basis, as if the combination with Brown & Williamson had been completed as of 1 January 2004, Reynolds American reported that operating profit for the year increased by 35 per cent and net income rose by 29 per cent. These results demonstrate the success of the business combination. The higher income principally reflected improved pricing and merger synergies.

The Group's associate company in India, ITC, continued its strong volume growth, leading to an increased profit, assisted further by one-off items.

Associates' volumes increased from 167 billion to 232 billion and, with the inclusion of these, total Group volumes would be 910 billion (2004: 853 billion).

With effect from 1 January 2005, the Group has changed its **regional structure**, with South Korea included in Asia-Pacific rather than the America-Pacific region. The regional analyses below have been restated for this change.

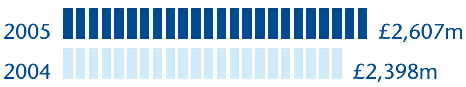
Regional data

	Volumes		Revenue		Operating profit	
	2005 bns	2004 bns	2005 £m	2004 £m	2005 £m	2004 £m
Europe	244.0	240.2	3,497	4,452	784	750
Asia-Pacific	137.1	131.7	1,758	1,629	531	495
Latin America	149.3	147.6	1,555	1,273	530	448
Africa and Middle East	102.6	97.6	1,405	1,339	434	360
America-Pacific	45.0	68.4	1,110	2,075	436	639
	678.0	685.5	9,325	10,768	2,715	2,692
Unallocated costs					(96)	(103)
Operating profit before exceptional items *page 20*					2,619	2,589
Revenue and operating profit, before exceptional items, restated at comparable rates of exchange *page 20*			9,014	10,768	2,515	2,589

FINANCIAL REVIEW

As explained on page 26, from 1 January 2005 the Group is reporting under International Financial Reporting Standards (IFRS). The changes in presentation required by IFRS have made the reporting of performance more complex and have been complicated still further by important changes in the Group that took place in 2004.

Profit from operations like-for-like



The reported Group profit from operations was 36 per cent lower at £2,420 million, due to a number of distorting factors but principally the gain on the Reynolds American transaction in 2004. The table below shows like-for-like operating profit after excluding restructuring costs, investment costs written off and gains on disposal of subsidiaries, joint ventures, non-current investments and brands, as well as the Brown & Williamson (B&W), Lane and Etinera operating profit, and the resultant change in terms of trade in Italy.

	2005 £m	2004 £m
Profit from operations *page 24*	2,420	3,760
Exceptional items *page 24*	199	(1,171)
B&W and Lane		(149)
Etinera	(12)	(42)
	2,607	2,398

On this basis, the operating profit for 2005 of £2,607 million would represent growth of 9 per cent. The results benefited from the weakness of sterling against many currencies and profit at constant rates of exchange would have risen by 5 per cent.

Details of the Group's operating performance can be found on pages 16 to 19.

The principal distortion in the headline profit from operations was due to the agreement to combine the Group's US domestic businesses with R.J. Reynolds at the end of July 2004, which resulted in a gain of £1,389 million on the partial disposal of the US business and was included in the profit from operations. The 2004 profit from operations also included a contribution from the US businesses of £149 million for the period to July 2004.

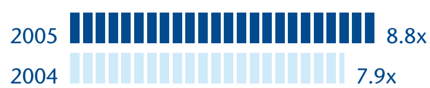
In December 2004, the Group sold Etinera, the distribution business of the Italian subsidiary. Although there was no gain on the disposal, the Group profit from operations in 2004 is estimated to include £42 million from the Etinera operations.

The Group continued its review of manufacturing operations and organisational structure, including the initiative to reduce overheads and indirect costs. Major announcements in 2005 covered the cessation of production in the UK, Ireland and Canada, with production to be transferred elsewhere. Restructuring charges in total for 2005 were £271 million compared to £206 million in 2004.

Profit from operations in 2005 also benefited from a £72 million gain, principally in respect of the disposal of certain trademarks in Malta, Cyprus and Lithuania. In 2004, there was a gain of £38 million on the disposal of non-current investments and a £50 million cost for writing off costs previously capitalised on a project to establish a major strategic investment in China.

Below profit from operations, net finance costs at £224 million were £32 million lower than last year, principally reflecting the impact of derivatives and exchange differences under IFRS, together with the benefit of the Group's improved cash flow.

Interest cover



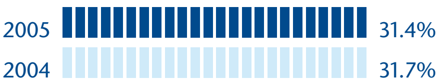
The Group assesses its financial capacity by reference to cash flow and interest cover. Interest cover is distorted by the pre-tax impact of the exceptional items and net finance cost distortions reflected in the adjusted earnings per share as explained on page 21. The chart above shows the cover, adjusting for these items, on the basis of profit before interest payable over interest payable. The interest cover remains strong at 8.8x (2004: 7.9x), with the higher cover reflecting the increase in underlying profit.

At 31 December 2005, the ratio of floating to fixed rate financial liabilities was 55:45 (2004: 52:48).

As explained on page 19, the Group's share of post-tax results of associates, included at the pre-tax level under IFRS, increased by £266 million to £392 million, after exceptional net income of £3 million (2004: £63 million expense). The exceptional items are shown as memorandum information on the Group income statement (page 24).

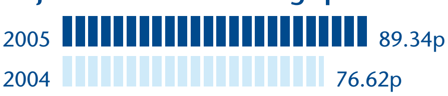
Despite the good underlying performance, profit before tax was down £1,042 million at £2,588 million, principally reflecting the gain on the disposal of subsidiaries in the 2004 comparative.

Effective tax rate – subsidiaries



The tax rates in the income statement of 26.7 per cent in 2005 and 18.5 per cent in 2004 are affected by the inclusion of the share of associates' post-tax profit in the Group's pre-tax results and the significant gain on the Reynolds American transaction in 2004. The underlying tax rate for subsidiaries, adjusted to remove the distortions as reflected in the adjusted earnings per share below, was 31.4 per cent in 2005 and 31.7 per cent in 2004, and the decrease reflects changes in the mix of profits.

Adjusted diluted earnings per share

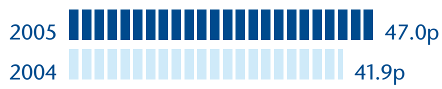


Basic earnings per share for 2005 were 84.53p (2004: 133.43p).

With the distortions that can occur in profit over the years, as well as the potential dilutive effect of employee share schemes and the convertible redeemable preference shares (in 2004), earnings per share is best viewed on the basis of adjusted diluted earnings per share. This removes the impact of exceptional items which are shown as memorandum information in the Group income statement on page 24. The main items are gains in respect of disposals of subsidiaries and brands, partly offset by restructuring costs. In addition, the calculation adjusts for certain distortions in net finance costs arising under IFRS, as well as reflecting the impact of the potential conversion of shares.

On this basis, the earnings per share are 89.34p, a 17 per cent increase over 2004, benefiting from the improved underlying operating profit and reduced net finance costs, as well as the impact of the Reynolds American transaction and the share buy-back programme.

Dividends per share declared



With the recommended final dividend of 33.0p, the total dividends per share declared for 2005 are 47.0p, up 12 per cent on the prior year. Under IFRS, the recommended final dividend in respect of a year is only provided in the accounts of the following year. Therefore, the 2005 accounts reflect the 2004 final dividend and the 2005 interim dividend amounting to 43.2p (£910 million) in total (2004: 39.7p – £856 million). The table below shows the dividends declared in respect of 2005 and 2004.

Our policy is to pay out as dividends at least 50 per cent of long term sustainable earnings. Dividends per share declared for 2005 represent 52.6 per cent of adjusted fully-diluted earnings per share (2004: 54.7 per cent).

Total equity was £760 million higher at £6,877 million. This reflected the profit retained after payment of dividends, which more than offset the impact of the share buy-back programme. In addition, exchange movements had a £421 million positive impact on shareholders' funds, reflecting the general weakness of sterling. The adoption of IFRS for financial instruments from 1 January 2005 reduced the total equity at that date by £42 million.

Dividends declared

	2005		2004	
	Pence per share	£m	Pence per share	£m
Ordinary shares				
Interim 2005 paid 14 September 2005	14.0	293	12.7	271
Final 2005 payable 4 May 2006	33.0	684	29.2	617
	47.0	977	41.9	888
Convertible redeemable preference shares				
Amortisation of discount				8
				8

FINANCIAL REVIEW continued

Cash flow

	2005 £m	2004 £m
Net cash from operating activities before restructuring costs	2,467	2,194
Restructuring costs	(143)	(214)
Net cash from operating activities	2,324	1,980
Net interest	(231)	(215)
Net capital expenditure	(378)	(306)
Dividends to minority interests	(133)	(123)
Free cash flow	1,582	1,336
Dividends paid to shareholders	(910)	(856)
Share buy-back	(501)	(492)
Other net flows	(49)	109
Net cash flows	122	97
IFRS cash flow		
Net cash from operating activities	2,324	1,980
Net cash from investing activities	(292)	(29)
Net cash from financing activities	(2,147)	(2,193)
Net cash flows	(115)	(242)

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

The Group's net cash flow from operating activities at £2,324 million was £344 million higher, with the growth in underlying operating performance. Cash flows also benefited from timing of working capital while, with £112 million additional dividends from associates following the Reynolds American transaction, the disposal of subsidiaries in 2004 did not materially affect operating flows. The reduced restructuring flows were offset by a £59 million rise in tax outflows reflecting higher profits and the timing of payments. After higher net interest, net capital expenditure and dividends paid to minorities, the free cash flow is £1,582 million, up £246 million on 2004. This inflow exceeds the total cash outlay on dividends to shareholders and share buy-back by £171 million.

The other net flows in 2005 mainly arise from the acquisition of further shares in the Group's Danish associate and the acquisition of Restomat AG in Switzerland, partly offset by the proceeds of the brand sale to Gallaher. The other net flows in 2004 principally reflect the sale of Etinera in Italy and the disposal of non-current investments, partly offset by the outflow in respect of the Reynolds American transaction.

The above flows resulted in net cash flows of £122 million compared to £97 million in 2004. After taking account of transactions related to borrowings, especially the net repayment of borrowings, the above flows resulted in a net decrease of cash and cash equivalents of £115 million, compared to a net decrease of £242 million in 2004.

These cash flows, after an exchange benefit of £49 million, resulted in cash and cash equivalents, net of overdrafts, decreasing by £66 million in 2005.

Borrowings, excluding overdrafts but taking into account derivatives relating to borrowings, were £6,985 million at 31 December 2004. The adoption of IAS32 and IAS39 on financial instruments from 1 January 2005 resulted in a £121 million increase in this figure to £7,106 million, principally due to the reclassification of interest accruals to borrowings from elsewhere in the balance sheet. The marginal increase in this figure during the year to £7,113 million at 31 December 2005 principally reflected a net repayment of borrowings of £136 million offset by the impact of exchange.

Current available-for-sale investments at 31 December 2005 were £96 million (31 December 2004: £86 million).

Treasury operations

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

The Board reviews and agrees the overall treasury policies and procedures, delegating appropriate authority to the

Finance Director, the Treasury function and the boards of the central finance companies. The Finance Director chairs the boards of the major central finance companies. Any significant departure from agreed policies is subject to the prior approval of the Board.

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

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

In 2004, the Group issued one bond maturing in 2011, which raised €1 billion; the proceeds were used to refinance maturing bond issues. In addition, the Group's central banking facility was renewed for an increased amount of £1.5 billion and on improved terms. In particular, £1.0 billion of the facility was renewed for an extended term of five years, with £500 million continuing with a one year term.

During 2005, the Group issued one further bond maturing in 2012, which raised €750 million; the proceeds were used to refinance maturing bond issues. In addition, the Group's central banking facility was renewed for an increased amount of £1.75 billion for a term of five years (with two additional one year extension options) and on significantly improved terms.

The Group continues to target investment-grade credit ratings; as at the end of 2005, the ratings from Moody's and S&P were Baa 1/BBB+ (end 2004: Baa 1/BBB+). The strength of the ratings has underpinned the success of the debt issuance during 2004 and 2005 and the Group continues to enjoy full access to the debt capital markets.

Changes in the Group

The Group ceased to be the controlling company of British American Racing (Holdings) Ltd. (BAR) on 8 December 2004, when BAR went into administration. The Group consequently ceased to consolidate BAR from that date. On 7 January 2005, a joint venture (BARH) between British American Tobacco and Honda Motor Co. Ltd., acquired the BAR business. On 4 October 2005, the Group announced that it had agreed the sale of its 55 per cent shareholding in BARH to Honda and the sale was completed on 20 December 2005. For the period 7 January 2005 to 20 December 2005, BARH has been equity accounted, reflecting shared control with Honda.

On 21 October 2005, the Group announced the exercise of its pre-emption rights over shares in STK, its Danish associated company, and the transaction was completed on 12 December 2005. This increased the Group's holding from 26.6 per cent to 32.3 per cent at a cost of £95 million, resulting in goodwill of £69 million.

On 25 November 2005, the Group acquired Restomat AG, the largest operator of cigarette vending machines in Switzerland, at a cost of £25 million, resulting in goodwill of £7 million.

Share buy-back programme

The Group initiated an on-market share buy-back programme at the end of February 2003. During 2005, 45 million shares were bought at a cost of £501 million (2004: 59 million shares at a cost of £492 million).

International Financial Reporting Standards (IFRS)

As noted on page 26, with the transition to IFRS the comparative figures for 2004 have been restated to IFRS. In the Report and Accounts for 2004 the impact of this change to IFRS on the 2004 results was explained. This explanation was based on IFRS expected, at that date, to apply for Group reporting in 2005. Subsequent IFRS changes have only had a minor impact on the restatement of the 2004 figures.

The effect on the profit for the year to 31 December 2004 was an increase of £1,733 million to £2,957 million. This was principally due to £1,262 million in respect of disposal of subsidiaries, £918 million of which was recognised outside of the income statement under UK GAAP and £344 million of which arose from applying IFRS to the transactions. In addition, goodwill is not amortised under IFRS, which added £491 million to the profit.

The effect on shareholders' funds as at 31 December 2004 was an increase of £699 million. This principally arose from the non-accrual of the final dividend (£617 million) and non-amortisation of goodwill (£473 million), partly offset by the recognition of post-retirement benefit liabilities (£237 million), the impact of IFRS on associates (£84 million) and higher deferred tax (£65 million).

SUMMARY FINANCIAL STATEMENT AND NOTES

Group income statement for the year ended 31 December

	2005 £m	2004 £m
Gross turnover (including duty, excise and other taxes of £14,659m (2004: £21,065m))	23,984	31,833
Revenue	9,325	10,768
Raw materials and consumables used	(2,760)	(2,670)
Purchase of finished goods by distribution business		(1,086)
Changes in inventories of finished goods and work in progress	(2)	4
Employee benefit costs	(1,557)	(1,686)
Depreciation and amortisation costs	(383)	(375)
Other operating income	179	1,595
Other operating expenses	(2,382)	(2,790)
Profit from operations	2,420	3,760
after (charging)/crediting		
– restructuring costs	(271)	(206)
– investment costs written off		(50)
– gains on disposal of subsidiaries, joint ventures, non-current investments and brands	72	1,427
Finance income	118	112
Finance costs	(342)	(368)
Net finance costs	(224)	(256)
Share of post-tax results of associates and joint ventures	392	126
after (charging)/crediting		
– restructuring costs	(13)	(63)
– US Federal tobacco buy-out	(12)	
– brand impairments	(29)	(49)
– exceptional tax credits and other impairments	57	49
Profit before taxation	2,588	3,630
Taxation on ordinary activities	(690)	(673)
Profit for the year	1,898	2,957
Attributable to:		
Shareholders' equity	1,771	2,827
Minority interests	127	130
Earnings per share:		
Basic	84.53p	133.43p
Diluted	83.85p	131.12p

Group balance sheet at 31 December

	2005 £m	2004 £m
Assets		
Non-current assets		
Intangible assets	7,987	7,700
Property, plant and equipment	2,327	2,162
Investments in associates and joint ventures	2,193	1,717
Retirement benefit assets	35	16
Deferred tax assets	290	246
Trade and other receivables	197	188
Available-for-sale investments	27	14
Derivative financial instruments	87	52
Total non-current assets	13,143	12,095
Current assets		
Inventories	2,274	2,143
Income tax receivable	81	51
Trade and other receivables	1,577	1,422
Available-for-sale investments	96	86
Derivative financial instruments	86	127
Cash and cash equivalents	1,790	1,851
Total current assets	5,904	5,680
Total assets	19,047	17,775
Equity		
Total equity	6,877	6,117
Liabilities		
Non-current liabilities		
Borrowings	5,054	6,049
Retirement benefit liabilities	543	548
Deferred tax liabilities	277	233
Other provisions for liabilities and charges	261	213
Trade and other payables	180	144
Derivative financial instruments	19	31
Total non-current liabilities	6,334	7,218
Current liabilities		
Borrowings	2,202	1,139
Income tax payable	374	352
Other provisions for liabilities and charges	234	228
Trade and other payables	2,883	2,682
Derivative financial instruments	143	39
Total current liabilities	5,836	4,440
Total equity and liabilities	19,047	17,775

This summary financial statement was approved by the Board of Directors on 28 February 2006 and signed on its behalf by Jan du Plessis, Chairman.

Group statement of changes in total equity for the year ended 31 December

	2005 £m	2004 £m
Differences on exchange	421	54
Cash flow hedges	58	
Net investment hedges	(52)	
Tax on items recognised directly in equity	(41)	(12)
Net gains recognised directly in equity	386	42
Profit for the year *page 24*	1,898	2,957
Total recognised income for the year	2,284	2,999
– shareholders' equity	2,128	2,879
– minority interests	156	120
Employee share options	72	68
Dividends and other appropriations		
– to British American Tobacco shareholders	(910)	(864)
– to minority interests	(112)	(145)
Purchase of own shares		
– held in Employee Share Ownership Trusts	(48)	(76)
– share buy-back programme	(501)	(492)
Other movements	17	8
	802	1,498
Balance 1 January *page 25*	6,117	4,619
Change in accounting policy *page 21*	(42)	
Balance 31 December	6,877	6,117

Total equity comprised £6,630 million of shareholders' funds (2004: £5,919 million), after deducting cost of own shares held in Employee Share Ownership Trusts of £182 million (2004: £190 million), and minority interests of £247 million (2004: £198 million).

Summary financial statement and notes

The summary financial statement on pages 24 to 29 is a summary of information in the Directors' Report and Accounts and should be read with the reviews on pages 2 to 23. Reference should also be made to the summary remuneration report on pages 32 to 36.

The Annual Review and Summary Financial Statement does not contain sufficient information to allow for as full an understanding of the results of the Group and the state of affairs of the Company, or of the Group, and their policies and arrangements concerning Directors' remuneration, as would be provided by the full annual Directors' Report and Accounts. Shareholders requiring more detailed information have the right to obtain, free of charge, a copy of the full annual Directors' Report and Accounts for 2005, or for future years, by contacting British American Tobacco Publications as set out on the inside back cover.

Report of the auditors

The auditors' report on the full annual accounts of the Group for the year ended 31 December 2005 is unqualified and does not contain any statement concerning accounting records or failure to obtain necessary information and explanations.

Going concern

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

Accounting policies

From 1 January 2005, the Group is required to prepare its financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and implemented in the UK. Prior to that date the results were prepared under UK Generally Accepted Accounting Principles. As the 2005 Financial

Statements include comparatives for 2004, the Group's date of transition to IFRS is 1 January 2004 and the 2004 comparatives are restated to IFRS. However, in preparing the comparative figures for 2004, the Group has chosen to utilise the IFRS1 exemption from the requirement to restate comparative information for IAS32 and IAS39 on financial instruments.

Contingent liabilities

There are contingent liabilities in respect of litigation, overseas taxes and guarantees in various countries.

Product liability litigation

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

Indemnity

On 30 July 2004, B&W completed transactions combining its US tobacco business assets, liabilities and operations with R.J. Reynolds Tobacco Company. A new company called R.J. Reynolds Tobacco Company (RJRT) was created as a result of the combination transactions. These transactions (the Business Combination) were accomplished through a publicly traded holding company Reynolds American Inc. (RAI), which is the indirect parent corporation of RJRT. The Group, through B&W, owns approximately 42 per cent of the outstanding common stock of RAI. As a result of the Business Combination: (a) B&W discontinued the active conduct of any tobacco business in the US; (b) B&W contributed to RJRT all of its assets other than the capital stock of certain subsidiaries engaged in non-US businesses and other limited categories of assets; (c) RJRT assumed all liabilities of B&W (except liabilities to the extent relating to businesses and assets not contributed by B&W to RJRT and other limited categories of liabilities) and contributed subsidiaries or otherwise to the extent related to B&W's tobacco business as conducted in the US on or prior to 30 July 2004; and (d) RJRT agreed to indemnify B&W and each of its affiliates (other than RAI and its subsidiaries) against, among other matters, all losses, liabilities, damages, expenses, judgements, 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 judgements, 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. Affiliates of B&W have retained control of the defence in certain tobacco litigation cases with respect to which such affiliates are entitled to indemnification.

US litigation

1. 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. As at 31 December 2005, a reimbursement suit was pending against B&W and other Group companies by an Indian tribe. The vast majority of other such claims have been dismissed on legal grounds.

2. Class actions

As at 31 December 2005, B&W was named as a defendant in some 15 separate actions attempting to assert claims on behalf of classes of persons allegedly injured by smoking. In the Engle case (Florida), one jury awarded compensatory damages totalling US$12.7 million and assessed US$17.6 billion in punitive damages against B&W. The intermediate appellate court reversed the trial court's judgement. A decision following review by the Florida Supreme Court is now awaited. In Scott, the jury returned a verdict of US$591 million. The defendants appealed this verdict. Oral argument has not yet been scheduled. In a class action complaint (Schwab), the judge issued an order in favour of the plaintiffs allowing them to prove the defendants' liability on an aggregate basis. The defendants are seeking an immediate appeal of this matter. If allowed, this will considerably delay any trial.

3. Individual cases

Approximately 3,767 cases were pending against B&W at 31 December 2005, filed by or on behalf of individuals in which it is contended that diseases or deaths have been caused by cigarette smoking or by exposure to environmental tobacco smoke (ETS).

4. 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 R.J. Reynolds Tobacco Company and B&W. British American Tobacco (Investments) Limited (formerly called British-American Tobacco Company Limited) is also now a co-defendant in the action. The trial of this claim began on 21 September 2004 and was completed in June 2005. After an appeal by the defendants, the Court of Appeals ruled on 4 February 2005 that the Government could not claim disgorgement of profits. On 17 October 2005, the US Supreme Court declined to hear an appeal by the US Government in respect of the claim for disgorgement of US$280 billion of past profits from the US tobacco industry. Judgement is awaited in the case and is not expected before Spring 2006.

5. Other claims

As at 31 December 2005, one case was pending on behalf of asbestos companies, seeking reimbursement for costs and judgements paid in litigation brought by third parties against them. Based on different theories of claim there are two non-government medical reimbursement cases. As at 31 December 2005, B&W was named as defendant in two US cases brought by foreign government entities seeking reimbursement of medical costs which they incurred for treatment for persons in their own countries who are alleged to have smoked imported cigarettes, including those manufactured by B&W.

Other foreign litigation

At year end, active claims against Group companies existed in 19 other countries but the only countries with more than five active claims were Argentina, Brazil, Canada, Italy, the Netherlands and the Republic of Ireland. As at 31 December 2005, there were some 1,097 pending individual cases in Italy. 1,077 relate to 'light' cigarettes in cases before the Justice of the Peace Courts and the most an individual plaintiff can recover is €1,033. There are around 20 smoking and health cases filed by or on behalf of individuals. There are pending healthcare cost recoupment cases in France, Spain and Israel. All of these cases are at the appellate stage of the process. In Israel, the industry is seeking an appeal at the Israeli Supreme Court to reverse the decision at first instance that permits Clalit, a healthcare fund, to pursue their healthcare costs recoupment claim seeking approximately US$1.6 billion in damages and injunctive relief.

The Supreme Court of Canada has upheld the constitutionality of the British Columbian Tobacco Damages and Health Care Costs Recovery Act. Whilst the case will now proceed against the Canadian defendants, including Imperial Tobacco Canada Limited (Imperial), the claims against the non-resident defendants are stayed pending the outcome of their challenge to jurisdiction. Similar legislation has been enacted in other Canadian provinces.

In addition, there are six class actions and four individual cases in Canada. In the Knight Class Action, the Supreme Court of British Columbia certified a class of all consumers of Imperial manufactured cigarettes in British Columbia, not just British Columbia residents. Imperial filed their appeal against the certification on 23 June 2005. An appeal is being pursued.

In Quebec, in February 2005, two smoking and health class actions were certified. There is no right of appeal against class certification.

Imperial is currently being investigated by the Royal Canadian Mounted Police relating to its business records and sales of products exported from Canada between 1989 and 1994. No action has been commenced against Imperial and Imperial believes that it has conducted itself appropriately at all times.

The Flintkote Company (Flintkote), a US company that was engaged in the production and distribution of asbestos and asbestos-containing products, was one of many subsidiaries of Genstar Corporation at the time that Imasco Limited (now Imperial) acquired Genstar Corporation in 1986. Flintkote became a Group subsidiary following the restructuring of Imasco in 2000. In 2003, the shares of Flintkote were divested to a trust. Flintkote had been named, along with a large number of defendants, in numerous actions by individuals who seek damages based upon alleged exposure to asbestos products, or alleged damage to their buildings due to the presence in the buildings of certain materials containing asbestos, allegedly manufactured and/or sold by such defendants. Certain of these claims and suits allege significant damage. Flintkote filed for protection under Chapter 11 of the US Bankruptcy Code in May of 2004. In December of 2005, Flintkote filed a status report in the bankruptcy proceedings alleging that Flintkote's estate has substantial claims against various parties that participated in certain transactions that allegedly left Flintkote with insufficient assets to satisfy foreseeable asbestos-related liabilities, including two dividends totalling US$525.2 million received ultimately by Imasco in 1986 and 1987, which dividends were paid by Flintkote from the proceeds generated through the sale of its operating assets. As of 1984, Flintkote had ceased all production and distribution of asbestos-containing materials. In connection with the 1986 and 1987 dividends, Imasco entered into certain contractual undertakings and indemnities with Flintkote and its directors. Flintkote stated in the December 2005 status report that it intends to jointly prosecute with the Official Committee of Asbestos Personal Injury Claimants and the Legal Representative for Future Asbestos Personal Injury Claimants, various causes of action against Imasco and other former direct and indirect parent companies of Flintkote. These include a cause of action to recover the US$525.2 million in dividends plus interest under the terms of the contractual undertakings and indemnities and, following further evaluation, possibly other causes of action against various parties that participated in dividend transactions and certain sale transactions that left Flintkote with insufficient assets to satisfy its asbestos-related liabilities.

Conclusion

While it is impossible to be certain of the outcome of any particular case or of the amount of any possible adverse verdict, the Company believes that the defences of the Group companies to all these various claims are meritorious both on the law and the facts, and a vigorous defence is being made everywhere. If an adverse judgement were entered against any of the Group companies in any case, an appeal would 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 judgement. In any event, with regard to US litigation, the Group has the benefit of the RJRT Indemnification. At least in the aggregate and despite the quality of defences available to the Group, it is not impossible that the results of operations or cash flows of the Group, in particular quarterly or annual periods, could be materially affected by this and by the final outcome of any particular litigation. Having regard to these matters, the Directors (i) do not consider it appropriate to make any provision in respect of any pending litigation and (ii) do not believe that the ultimate outcome of all this litigation will significantly impair the financial condition of the Group.

INDEPENDENT AUDITORS' STATEMENT to the members of British American Tobacco p.l.c.

We have examined the summary financial statement, including the summary remuneration report of British American Tobacco p.l.c. for the year ended 31 December 2005.

Respective responsibilities of Directors and auditors

The Directors are responsible for preparing the Annual Review and Summary Financial Statement in accordance with applicable law. Our responsibility is to report to you our opinion on the consistency of the summary financial statement within the Annual Review and Summary Financial Statement with the Annual Report and Accounts, the Directors' report and the Remuneration report and its compliance with the relevant requirements of Section 251 of the Companies Act 1985 and the regulations made thereunder. We also read the other information contained in the Annual Review and Summary Financial Statement and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the summary financial statement.

This statement, including the opinion, has been prepared for and only for the Company's members as a body in accordance with Section 251 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this statement is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Basis of opinion

We conducted our work in accordance with Bulletin 1999/6, 'The auditors' statement on the summary financial statement' issued by the Auditing Practices Board for use in the United Kingdom.

Opinion

In our opinion the summary financial statement is consistent with the Annual Report and Accounts, the Directors' report and the Remuneration report of British American Tobacco p.l.c. for the year ended 31 December 2005 and complies with the applicable requirements of Section 251 of the Companies Act 1985, and the regulations made thereunder.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

28 February 2006

CORPORATE GOVERNANCE **BOARD OF DIRECTORS**

Jan du Plessis (British/South African)
Chairman
Jan du Plessis became Chairman on 1 July 2004, having been a Non-Executive Director since his appointment to the Board following the merger with Rothmans in June 1999. Prior to taking on the Chairmanship, he was Group Finance Director of Richemont, a position he held since 1988. He is Chairman of the Nominations Committee. He has been Chairman of RHM plc since June 2005 and a Non-Executive Director of Lloyds TSB Group plc from October 2005. (52) ▲

The Rt. Hon. Kenneth Clarke QC MP (British)
Deputy Chairman and Senior Independent Non-Executive Director
Appointed a Director in 1998. He is Chairman of the Remuneration and Corporate Social Responsibility Committees. From 1993 until May 1997, he was Chancellor of the Exchequer. He is Non-Executive Chairman of Savoy Asset Management plc, Deputy Chairman of Alliance UniChem Plc and a Non-Executive Director of Foreign & Colonial Investment Trust PLC and Independent News & Media (UK) Limited. (65) ▲■●◆

Paul Adams (British)
Chief Executive
Appointed a Director in March 2001 and Chief Executive in January 2004. He joined British American Tobacco from Pepsi International in July 1991 and held senior appointments as Regional Director, Asia-Pacific and Regional Director, Europe prior to becoming Deputy Managing Director in June 2001 and Managing Director in January 2002. (52)

Paul Rayner (Australian)
Finance Director
Joined Rothmans Holdings Limited in Australia in 1991 as General Manager, Group Finance and Corporate Services. He held senior executive positions with Rothmans before becoming Chief Operating Officer of British American Tobacco Australasia Limited in September 1999. He became Finance Director in January 2002. He has been a Non-Executive Director of Centrica plc since September 2004. (51)

Antonio Monteiro de Castro (Brazilian)
Chief Operating Officer and Director, America-Pacific
Appointed a Director in March 2002 and Chief Operating Officer in January 2004. He was previously President and CEO of Souza Cruz SA and Regional Director, Latin America and Caribbean. He is President of the Administrative Council of Souza Cruz SA and a member of the board of the Getulio Vargas Foundation. He has been a Director of Reynolds American Inc. since July 2004. (60)

Piet Beyers (South African)
Non-Executive Director
Appointed a Director in June 2004. He is an Executive Director of Richemont and a Non-Executive Director of Distell Group Limited, VenFin Limited and Remgro Limited where he was previously Marketing Strategy Director. (56) ▲◆

Robert Lerwill (British)
Non-Executive Director
A Director since 1 January 2005. He was appointed Chief Executive of Aegis Group plc in February 2005, having been a Non-Executive Director since 2000. He was formerly a Director of Cable & Wireless plc where he served as Finance Director between 1997 and 2002 and as Chief Executive of Cable & Wireless Regional between 2000 and 2003. He is a Non-Executive Director of Synergy Healthcare plc and a Director of The Anthony Nolan Trust. He has been Chairman of the Audit Committee since August 2005. (54) ▲■●◆

Dr Ana Maria Llopis (Spanish)
Non-Executive Director
Appointed a Director in 2003. In 2005 she was appointed Executive Deputy Chairman of the J F Llopis Foundation and a member of the Good Governance Working Group for Spanish listed companies. Previously she was Executive Vice-President at Indra, the leading Spanish IT firm, and Chief Executive of Openbank, the Santander Group online bank. (55) ▲■●◆

Rupert Pennant-Rea (British)
Non-Executive Director
Formerly Editor of The Economist and Deputy Governor of the Bank of England. He is Chairman of Henderson Group plc, PGI Group plc and Electra Kingsway VCT plc. He was appointed a Non-Executive Director of B.A.T Industries p.l.c. in 1995, becoming a Director of British American Tobacco in 1998. He retired as Chairman of the Audit Committee in August 2005. (58) ▲■●◆

Anthony Ruys (Dutch)
Non-Executive Director
A Director from 1 March 2006. He joined Heineken N.V. in 1993 as a member of its Executive Board, became Vice Chairman in 1996 and Chairman in 2002, from which position he retired in October 2005. Prior to his career at Heineken, he held various marketing and general management positions with Unilever in the Netherlands, Colombia and Italy. He is currently a member of the Supervisory Boards of ABN AMRO Bank, Gtech Holdings Corporation (USA) and Sara Lee International B.V. He was appointed an Officer in the Order of Orange-Nassau in September 2005. (58) ▲■●◆

Sir Nicholas Scheele (British/US)
Non-Executive Director
Appointed a Director on 28 February 2005. He is a former President and Chief Operating Officer of Ford Motor Company where he held several senior management positions including Chairman of Ford Europe, Chairman and CEO of Jaguar Cars Limited and President of Ford Mexico. He is Chancellor of the University of Warwick. He is also Chairman of The Cambridge-MIT Institute and is a Director of Pegasus Holdings Group (USA) and Grupo Proeza (Mexico). (62) ▲■●◆

Thys Visser (South African)
Non-Executive Director
A Director since 2001. He is CEO of Remgro Limited, having held senior management positions with Rembrandt Group since 1980. He is Chairman of Rainbow Chicken Ltd and is a Non-Executive Director of Medi-Clinic Corporation Limited, Nampak Limited and Distell Group Limited. (51) ▲◆

MANAGEMENT BOARD

Flavio de Andrade (Brazilian)
Director, Latin America and Caribbean
Joined the Management Board as Regional Director for Latin America and Caribbean in January 2004, following a long career in Brazil with Souza Cruz SA, assuming a variety of senior management roles (including President of Souza Cruz) before being appointed to his current position. He also worked in Chile as General Manager from 1986 to 1988. (57)

John Daly (Irish)
Director, Asia-Pacific
Joined the Management Board as Regional Director for Asia-Pacific in October 2004. Since 1994, he held a number of senior management roles for Rothmans International in Europe and the Far East before becoming Area Director for the Middle East and North Africa in 2001. (49)

Nicandro Durante (Italian)
(from March 2006)
Director, Africa and Middle East
Appointed Director, Africa & Middle East in succession to Jacques Kruger, he will join the Management Board with effect from 1 March 2006. He previously held senior financial and general management roles in Brazil (including President of Souza Cruz) and also in the UK and Hong Kong. (49)

Rudi Kindts (Belgian)
Director, Human Resources
Joined British American Tobacco in 1988. He has held a number of senior human resources roles across the Group (including Europe, Africa, the Middle East and Central and South Asia). He has been Director, Human Resources since July 2004. (48)

Jacques Kruger (South African)
Director, Africa and Middle East
(until 31 March 2006)
Joined the Management Board as Regional Director for Africa and the Middle East in August 2002. He was previously Managing Director of British American Tobacco South Africa Limited. He will retire from British American Tobacco on 31 March 2006. (55)

Michael Prideaux (British)
Director, Corporate and Regulatory Affairs
Appointed Director, Corporate and Regulatory Affairs in 1998 following the demerger of B.A.T Industries. He had previously joined B.A.T Industries in 1989 from Charles Barker, a leading financial and corporate public relations, advertising and design agency, where he was Chief Executive. (55)

Jimmi Rembiszewski (German)
Director, Marketing
Joined the Group as a Marketing Director and as a Territorial Director in 1991, having held various senior marketing and business appointments in Procter & Gamble and Jacobs Suchard. He has been a member of the Management Board since 1996. (55)

Ben Stevens (British)
Director, Europe
Appointed Director, Europe in January 2004 having previously joined the Management Board in 2001 as Development Director. Since joining British American Tobacco in 1990, he has covered a number of senior marketing, finance and management roles particularly in Europe, Pakistan and Russia. (46)

Peter Taylor (British)
Director, Operations and IT
Joined British American Tobacco in 1980 and worked in a variety of operational and general management roles across the Group. He was appointed Global Operations Director in 2003. (53)

Neil Withington (British)
Director, Legal and General Counsel
Appointed Legal Director and General Counsel of British American Tobacco in 2000, having previously been the Group's Deputy General Counsel. He joined the Group in 1993 after a career at the Bar and in the chemical and pharmaceutical industries with ICI. He has been a Director of Reynolds American Inc. since July 2004. (49)

The role of the Management Board

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

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

Corporate governance

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

The principal governance rules applying to UK companies listed on the London Stock Exchange are contained in the Combined Code on Corporate Governance adopted by the Financial Reporting Council in July 2003 (the Code). The Company has either complied with the Provisions of the Code throughout the year or else a full explanation has been provided in the Corporate Governance Statement on pages 17 to 23 of the Report and Accounts where it has not. The Board therefore considers that the Company has satisfied its obligations under the Code.

The Board and its Committees

The Board is responsible to the Company's shareholders for the success of the Group and for its overall strategic direction, its values and its governance. Among the key matters on which the Board alone may make decisions are the Group's business strategy, its annual budget, dividends and major corporate activities. It is also responsible for reviewing the Company's internal controls and governance system and for approving the Standards of Business Conduct. It held seven scheduled meetings in 2005. Responsibility for implementing the Group's strategy and for creating the conditions for the Group's successful day-to-day operation is delegated to the Management Board, which met eight times in 2005.

The Board is responsible for the overall system of internal control for the Company and its subsidiaries and for reviewing the effectiveness of the system. It carries out such a review at least annually, covering all material controls including financial, operational and compliance controls and risk management systems, and reports to shareholders that it has done so. The system is designed to manage risk that may impede the achievement of the Company's business objectives rather than to eliminate these risks. The internal control system can therefore only provide reasonable, not absolute, assurance against material misstatement or loss.

The Audit Committee is chaired by Robert Lerwill. Its role is to monitor the integrity of the financial statements of the Company and review and, where appropriate, make representations to the Board on business risks, internal controls and compliance.

The Corporate Social Responsibility Committee is chaired by Kenneth Clarke and its role is to help identify and assess, with management, those significant social, environmental and reputational risks that might impair the Company's strategic objective to be recognised as a responsible company in a controversial industry. The Committee also evaluates the adequacy of the Company's policies on these issues and makes recommendations for change.

The Nominations Committee is chaired by Jan du Plessis. Its role is to make recommendations to the Board on suitable candidates for appointment to the Board and Management Board, ensuring that both boards have an appropriate balance of expertise and ability. In addition, it is responsible for reviewing the succession plans for the Executive Directors and members of the Management Board.

The Remuneration Committee is chaired by Kenneth Clarke and the summary remuneration report below sets out its role, responsibilities and policies during 2005.

Summary Remuneration Report

This report is extracted from the full Remuneration Report set out in the Directors' Report and Accounts 2005 (a copy of which is available on request and can be found on our website, bat.com).

The role of the Remuneration Committee and Executive remuneration policy

The Remuneration Committee determines the framework and policy on the terms of engagement (including remuneration) for the Chairman, the Executive Directors and the members of the Management Board. The Remuneration Committee also decides their specific remuneration, including awards under the share incentive schemes and pension schemes.

The remuneration strategy for the British American Tobacco Group is to pay competitively, and, through the use of an integrated pay and benefits structure, to reward corporate and individual performance and so contribute to the

Table 1. Executive Directors' remuneration policy summary

Remuneration key components	Rationale	Delivery	Policy summary
Base salary	– competitively reward corporate and individual performance – reflect skills and experience	– cash – monthly	– annual review with changes effective from April – benchmarked against a mid-market level of main board directors from a UK comparator group with a mainly international consumer goods focus chosen from the FTSE 100 Index – additional reference to published salary data with reference to companies in the UK comparator group
Benefits in kind		– car or car allowance – private medical and personal accident insurance	– UK management level benefit – Executive Directors receive the benefit of the use of a chauffeur
Performance-related bonus	– incentivise the attainment of corporate targets on an annual basis	– 50% cash (Executive Incentive Bonus Scheme – EIS) – 50% shares (Deferred Share Bonus Scheme – DSBS) – DSBS shares held in trust for three years and participants receive cash sum equivalent to the dividend on the after tax position of all unvested ordinary shares held in the DSBS at the dividend record date	– cash bonus targets in four areas: operating profit, cash flow, market share and corporate activity – shares bonus targets: business sustainability measures such as growth and productivity – for 2006, five common measures for EIS and DSBS: underlying operating profit, market share volume of key players, Global Drive Brand volume, net turnover/revenue and cash flow – for an 'on target' performance, the EIS and DSBS together carry a value of 100 per cent of the base salary with an overall maximum of 150 per cent
Long term incentives (Long Term Incentive Plan – LTIP)	– alignment of executive remuneration with the generation of shareholder value – incentivise growth in earnings per share and three year total shareholder return	– shares – discretionary annual award – LTIP dividend equivalent as cash at time of vesting – the proportion of shares awarded under an LTIP grant which later lapse upon the vesting of an award do not attract the LTIP dividend equivalent	– maximum annual award of 125 per cent of salary (175 per cent for the Chief Executive) – cash LTIP dividend equivalent to the dividends that participants would have received as shareholders from the date of the LTIP award to the award's vesting date – with inclusion of the LTIP dividend equivalent, the applied percentage level of salary applicable to annual awards is a maximum of 200 per cent for the Chief Executive and 150 per cent for the other Executive Directors – three year performance period – Total Shareholder Return (TSR) performance (50 per cent of the total award) combines both the share price and dividend performance (25 per cent for each measure) during the three year performance period as against two comparator groups: (1) the constituents of the FTSE 100 Index; and (2) a peer group of FMCG companies – earnings per share measure (50 per cent of the total award) relates to earnings per share growth (on an adjusted diluted basis) relative to inflation
Pension	– provision of post-retirement benefits	– British American Tobacco UK Pension Fund; defined benefit plan – benefit paid as on-going pension	– pension accrues at 1/40 of annual basic salary – normal retirement age of 60 – maximum pension payable will not exceed 2/3 of base salary averaged over the preceding 12 months – Paul Adams and Paul Rayner are both members of the UK Pension Fund – UK Pension Fund will retain a scheme-specific cap on the introduction of the new UK pension regime in April 2006 – excess benefits continue to be accrued within an unfunded unapproved retirement benefit scheme (UURBS) – benefits for Antonio Monteiro de Castro are all accrued in the UURBS, offset by his entitlements under the defined benefit plan of Souza Cruz of Brazil

CORPORATE GOVERNANCE continued

development of a Winning Organisation. This strategy underpins the remuneration policy for the Executive Directors of British American Tobacco and the members of its Management Board. A balance between the short and long term elements rewards and strengthens the alignment of executive remuneration to the generation of shareholder value. The pay and benefits structure reflects the competitive nature of the Group's worldwide operations, recognising the need to attract, motivate and retain high-quality executives. It is anticipated that this remuneration policy will continue to be applied throughout 2006. Performance-based variable rewards (cash and share-based performance related annual bonus plans; and LTIP) comprise about 53 per cent of total remuneration with the balance of core fixed elements covering base salary, pension and other benefits.

Long Term Incentive Plan: vesting of 2003 award

As reported last year, 66 per cent of the 2002 LTIP award vested on 20 March 2005. The fifth LTIP award was made in 2003, with the performance period being completed at 31 December 2005. The Remuneration Committee has assessed the performance of British American Tobacco against the two performance conditions outlined in Table 1 and has determined that 77.1 per cent of the award will vest. On the TSR measure, the Company ranked ninth out of the FTSE 100 group of companies, giving a vesting of 25 per cent for performance at the upper quartile. A vesting of 25 per cent was achieved for ranking third out of the peer group of international FMCG companies, this being upper quartile. Earnings per share growth was 5.14 per cent per annum in excess of inflation, resulting in a vesting of 27.1 per cent.

Table 2. Directors' remuneration

	Salary/fees £	Performance-related pay: annual cash bonus £	Performance-related pay: deferred share bonus[2] £	Benefits in kind[3] £	2005 Total £	2004 Total £
J P du Plessis[1]	468,750	–	–	64,993	533,743	295,555
K H Clarke	150,000	–	–	4,237	154,237	171,307
P N Adams	911,433	581,250	529,609	96,165	2,118,457	1,708,358
P A Rayner[4]	571,433	362,500	331,320	178,547	1,443,800	1,253,563
A Monteiro de Castro[5]	794,993	400,000	362,376	245,754	1,803,123	1,392,858
P E Beyers[1]	60,000	–	–	–	60,000	26,346
R E Lerwill[1]	66,250	–	–	13,414	79,664	–
A M Llopis	60,000	–	–	–	60,000	56,659
R L Pennant-Rea	68,750	–	–	–	68,750	56,036
Sir Nicholas Scheele[1]	50,231	–	–	629	50,860	–
M H Visser	60,000	–	–	22,588	82,588	66,530
Former Directors[1]						
M F Broughton[6]	–	–	–	–	–	1,225,910
H Einsmann	–	–	–	–	–	15,385
W A Owens	–	–	–	–	–	37,455
K S Wong (deceased)	10,000	–	–	–	10,000	68,421
Total remuneration	3,271,840	1,343,750	1,223,305	626,327	6,465,222	6,374,383

Notes:

1 The Directors' appointment and retirement dates are as follows: Harald Einsmann retired 21 April 2004; Piet Beyers appointed 22 June 2004; Martin Broughton retired 30 June 2004; Jan du Plessis, Non-Executive Director to 30 June 2004 and Chairman from 1 July 2004; William Owens retired 31 August 2004; Robert Lerwill appointed 1 January 2005; K S Wong died 16 February 2005; and Sir Nicholas Scheele appointed 28 February 2005.

2 The deferred share bonus payments include cash sums equivalent to the dividend on the after tax position on all unvested ordinary shares comprised in the awards held by participants (including Executive Directors) in the Deferred Share Bonus Scheme at each dividend record date. For the year ended 31 December 2005, these payments for Executive Directors were as follows: Paul Adams £29,734 (2004: £22,457); Paul Rayner £19,570 (2004: £12,552); and Antonio Monteiro de Castro £18,376 (2004: £16,451).

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

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

5 Antonio Monteiro de Castro's benefits in kind included tax advice of £103,390 in respect of his former contractual arrangements up to 1 January 2004, prior to which date he derived his emoluments in both the UK and Brazil.

6 In 2005, £29,347 was paid to Martin Broughton in respect of the reimbursement to him by the Company of tax paid on business related spouse travel expenses incurred by him in tax years prior to him ceasing to be a Director in 2004.

7 The Directors' remuneration shown above does not include the illustrative value (as at 23 February 2006) of the Executive Directors' Long Term Incentive Plan awards made in March 2003 which will vest on 19 March 2006. Reference should be made to Table 3 on page 35 note 5.

Members of the FMCG group for the 2003 award vesting in March 2006:

Altadis	InBev
Altria Group	Johnson & Johnson
Anheuser-Busch	Kellogg
Cadbury Schweppes	Kimberly-Clark
Campbell Soup	LVMH Moët Hennessy
Carlsberg	Nestlé
Coca-Cola	Pepsico
Colgate-Palmolive	Procter & Gamble
Danone	Reckitt Benckiser
Diageo	RJ Reynolds (up to 30 July 2004)
Gallaher Group	SABMiller
Heineken	Sara Lee
HJ Heinz	Scottish & Newcastle
The Hershey Company	Unilever
Imperial Tobacco Group	

Performance graph

Schedule 7A to the Companies Act 1985 requires that the Company provide a graph comparing the TSR performance of a hypothetical holding of shares in the Company with a broad equity market index over a five year period – the performance graph. This illustrates the performance of TSR against the FTSE 100 Index over a five year period commencing on 1 January 2001. In the opinion of the Directors, the FTSE 100 Index is the most appropriate index against which TSR should be measured because it is a widely used and understood index of broadly similar-sized UK companies to the Company. In addition to the performance graph, illustrative graphs show the relative position on the TSR measures for the LTIP award vesting in March 2006 (see page 36).

Table 3. Summary of share interests including long term incentives

	Ordinary shares at 1 Jan 2005 or date of appointment	Ordinary shares at 31 Dec 2005	Ordinary shares (Deferred Scheme) at 1 Jan 2005	Ordinary shares (Deferred Scheme) at 31 Dec 2005	Options and awards over ordinary shares at 1 Jan 2005	Options and awards over ordinary shares at 31 Dec 2005	Share options exercisable from/to LTIP awards initial vesting date
P N Adams	122,815	143,051	112,411	125,517	–	–	–
Share Option and Sharesave Schemes	–	–	–	–	71,159	2,492	Jan 10-Jun 10
LTIP	–	–	–	–	280,062	341,383	Mar 06-May 08
P A Rayner	82,868	83,228	73,725	83,155	–	–	–
Share Option and Sharesave Schemes	–	–	–	–	10,071	6,777	Sep 02-Sep 09
LTIP	–	–	–	–	201,116	200,511	Mar 06-May 08
A Monteiro de Castro	179,390	179,564	69,850	76,784	–	–	–
Sharesave Scheme	–	–	–	–	–	957	Jan 09-Jun 09
LTIP	–	–	–	–	222,846	229,480	Mar 06-May 08
J P du Plessis	50,000	50,000	–	–	–	–	–
K H Clarke	4,283	4,459	–	–	–	–	–
P E Beyers	–	–	–	–	–	–	–
R E Lerwill[1]	3,000	3,000	–	–	–	–	–
A M Llopis	–	2,200	–	–	–	–	–
R L Pennant-Rea	3,165	3,295	–	–	–	–	–
Sir Nicholas Scheele[1]	–	–	–	–	–	–	–
M H Visser	–	–	–	–	–	–	–

Notes:

1 Reference should be made to Table 2 on page 34 note 1.

2 No Director had a non-beneficial interest in the shares of the Company at the dates stated above.

3 Share options granted under the Share Option Scheme are not normally granted in any year to Executive Directors who receive an award under the LTIP; no options were granted in the year ended 31 December 2005. The aggregate gains on share options exercised by Executive Directors during the year ended 31 December 2005 were £423,516 (2004: £738,113). Options granted under the Share Option Scheme are exercisable subject to a performance condition based on earnings per share growth; the Company's published adjusted earnings per share growth has to exceed inflation by an average of 3 per cent per annum over any consecutive three year period during the 10 year life of the options.

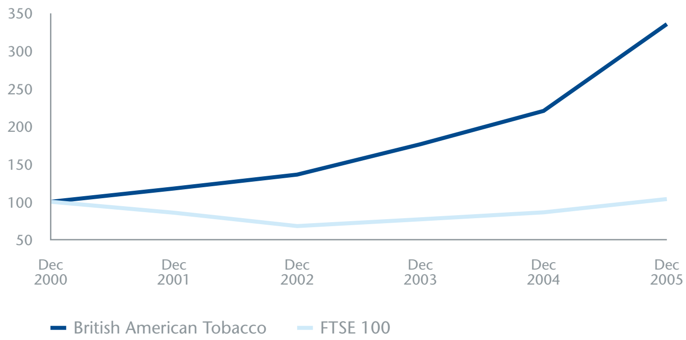
4 The value of LTIP awards which vested to Executive Directors during the year ended 31 December 2005 was £1,300,628 (2004: £1,097,452).

5 The March 2003 LTIP award will vest on 19 March 2006 at 77.1 per cent in the manner described on page 34. For illustrative purposes only, the aggregate value of the vesting awards for the Executive Directors was £2,552,854 based on a share price on 23 February 2006 (being the latest practicable date prior to publication) of 1,328p per ordinary share.

CORPORATE GOVERNANCE continued

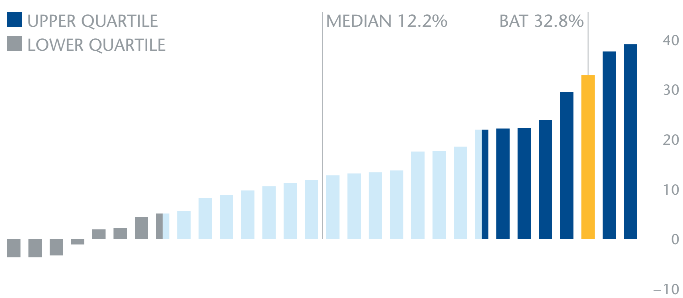
Performance graph – historical TSR performance

Five year growth in the value of a hypothetical £100 holding
FTSE 100 comparison based on 30 trading day average values



Total shareholder return (annual %)

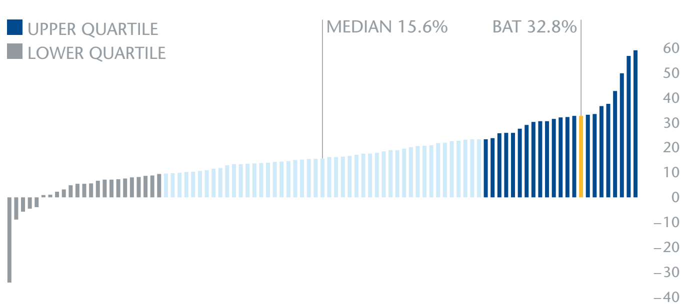
(1 January 2003 – 31 December 2005) FMCG group



The FMCG comparison is based on three months' average values

Total shareholder return (annual %)

(1 January 2003 – 31 December 2005) FTSE 100



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

Executive Directors' service contracts

The Remuneration Committee continues to operate a policy of one year rolling contracts for Executive Directors; these contracts incorporate a provision for a termination or compensation payment in lieu of notice. This will comprise: (1) 12 months' salary at his then current base pay; and (2) a cash payment in respect of other benefits under the contract such as medical insurance, or the Company may at its option continue those benefits for a 12 month period. In addition, the Committee also maintains discretion in respect of this policy for those Executive Directors who may be recruited externally or from overseas, when it may be appropriate to offer a contract with an initial period of longer than one year, reducing to a one year rolling contract after the expiry of the initial period.

Non-Executive Directors' terms of appointment and remuneration policy

The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment. The terms of appointment provide that a new Director is appointed for a specified term, being an initial period to the next Annual General Meeting after appointment and, subject to reappointment at that meeting, for a further period ending at the Annual General Meeting held three years thereafter. Subsequent reappointment is subject to endorsement by the Board and the approval of shareholders. Fees for Non-Executive Directors are determined by the Board with reference to the time commitment and responsibilities associated with the roles. Under the terms of their letters of appointment, on termination (at any time), a Non-Executive Director is entitled to any accrued but unpaid Director's fees but not to any other compensation.

Chairman's terms of appointment

Jan du Plessis's terms of appointment provide that he holds the office of Chairman with effect from 1 July 2004 for a period of three years unless terminated earlier by: (1) the Company giving three months' notice or a discretionary compensation payment in lieu of notice; or (2) by the Chairman giving one month's written notice with the Company having discretion to make a compensation payment in lieu of such notice. This is limited to any fees which are payable for such part of the relevant notice period as the Board does not require the Chairman to perform his duties. The Chairman is subject to the reappointment of Directors' provisions contained in the Company's articles of association and accordingly he retires from the Board and offers himself for reappointment at the Annual General Meeting on 27 April 2006. The date of his last reappointment as a Director was at the Annual General Meeting held on 21 April 2004. In common with the Non-Executive Directors, he does not participate in the Company's share schemes, bonus schemes or incentive plans and is not a member of any Group pension plan.

Registered office
Globe House, 4 Temple Place, London WC2R 2PG
tel: +44 (0)20 7845 1000, facsimile: +44 (0)20 7240 0555

Incorporated in England and Wales No. 3407696

Secretary
Alan Porter

General Counsel
Neil Withington

Investor relations
Enquiries should be directed to Ralph Edmondson or Rachael Cummins, tel: +44 (0)20 7845 1180

Press office
Enquiries should be directed to Fran Morrison or David Betteridge, tel: +44 (0)20 7845 2888, e-mail: press_office@bat.com

Auditors
PricewaterhouseCoopers LLP, 1 Embankment Place, London WC2N 6RH

Final dividend 2005

Ex dividend date	– 8 March 2006
Record date	– 10 March 2006
Payment date	– 4 May 2006

Annual General Meeting
Thursday, 27 April 2006 at 11.30am, The Mermaid Conference & Events Centre, Puddle Dock, Blackfriars, London EC4V 3DB

Financial results 2006

First quarter	– 3 May
Interim	– 27 July
Third quarter	– 26 October

Registrar
Enquiries concerning your shareholding, mandating your dividends (including consolidated dividend tax vouchers) and notifying changes in your personal details should be directed to Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA tel: 0870 600 3983 (UK); +44 (0)121 415 7059

Online
www.bat.com
Access comprehensive information about British American Tobacco and download shareholder publications at the corporate website

Visit the Investor Centre for valuation and charting tools and share price data to help you track the performance of your British American Tobacco ordinary shares

Subscribe to the e-mail and SMS alert services for key financial events in the British American Tobacco financial calendar

www.shareview.co.uk
Register for the web-based enquiry and portfolio management service for shareholders operated by Lloyds TSB Registrars

Define a portfolio of investments; view details of your recent dividend payments; access dividend tax vouchers (mandated dividends only); and register a preference for receiving notification of British American Tobacco shareholder mailings by e-mail

www.shareview.co.uk/dealing
Go online or telephone 0870 850 0852 (UK) to buy or sell British American Tobacco ordinary shares

Publications
Copies of current and past Directors' Report and Accounts and Annual Reviews are available on request. Copies of the Group corporate descriptive booklet *About Us* and past Quarterly Reports are also available

Highlights from these publications can be produced in alternative formats such as Braille, audio tape and large print

Contact British American Tobacco Publications, Unit 84, London Industrial Park, Roding Road, London E6 6LS
tel: +44 (0)20 7511 7797, facsimile: +44 (0)20 7540 4326
e-mail: bat@team365.co.uk

Dividend Reinvestment Plan
A straightforward and economic way of utilising your dividends to build up your shareholding in British American Tobacco; contact Lloyds TSB Registrars for details

American Depositary Receipts
British American Tobacco sponsors an American Depositary Receipt (ADR) programme in the United States

Enquiries regarding ADR holder accounts and payment of dividends should be directed to Shareholder Relations, The Bank of New York, PO Box 11258, Church Street Station, New York, NY 10286-1258, USA
tel: +1 888 BNY ADRS (toll-free) or +1 212 815 3700,
e-mail: shareowners@bankofny.com,
website: www.adrbny.com

Individual Savings Accounts (ISAs)
A British American Tobacco sponsored ISA

Contact The Share Centre, PO Box 2000, Aylesbury, Bucks HP21 8ZB tel: 0800 800 008 (UK); +44 (0)1296 414 141, e-mail: service@share.co.uk, website: www.share.co.uk

Capital gains tax
Fact sheet for British American Tobacco historical capital gains tax information

Contact the British American Tobacco Company Secretarial Department, tel: +44 (0)20 7845 1000 or access the Investor Centre at www.bat.com/investorcentre www.bat.com

Mixed Sources
Product group from well-managed forests, controlled sources and recycled wood or fibre
www.fsc.org Cert no. SGS-COC-1732
© 1996 Forest Stewardship Council
FSC

Designed and produced by CGI London +44 (0)20 7467 9300. Photography by Matthew Ford. Printed in the UK by St Ives Westerham Press, Environmental Management System ISO 14001 accredited and Forest Stewardship Council (FSC) chain of custody certified. Covers and full size text pages printed on Revive Special Silk containing fibre from well managed forests independently certified according to the rules of the Forest Stewardship Council and recovered fibre. The paper is also totally chlorine free (TCF) and produced at an ISO 14001 accredited mill. The gloss paper used in the Special feature is Revive Gloss. It uses 75% de-inked post consumer waste and is totally chlorine free (TCF).