# Chairman's introduction on Governance

**Richard Burrows**
Chairman

## Index to key elements



## Dear Shareholder

A key focus of the Board during 2017 was the oversight of the acquisition of RAI. In addition to our scheduled Board programme, during the months leading up to the acquisition, the Board convened several additional meetings during which it received detailed briefings from senior management and external advisers on the RAI business and the legal and governance implications of the acquisition.

As a result of the acquisition, we are subject to additional US compliance obligations as a 'foreign private issuer', including certain requirements of the NYSE Rules and US Securities laws including the Exchange Act and SOx. We carried out a full review of our key policies and governance frameworks to ensure that they would meet all required governance requirements post acquisition.

Our Audit Committee was instrumental in reviewing our internal control processes to ensure alignment with US and SOx requirements, particularly in the areas of Audit Committee responsibilities, financial disclosures, and conflicts of interest. The review resulted in changes to our Audit Committee Terms of Reference and our Auditor Independence Policy; the creation of a SOx Steering Committee and Disclosure Committee composed of senior management to provide day to day oversight of SOx issues; and the approval of a Code of Ethics for the Chief Executive and Senior Financial Officers. Please see our Audit Committee report on pages 65 to 70 for further details.

Our Nominations Committee carried out an externally facilitated review of the composition, independence, diversity and skills set of our Board, and following the acquisition of RAI we made three new appointments to the Board. A full report on the activities of our Nominations Committee can be found on pages 71 and 72.

We continue to pay close attention to business conduct issues. As previously reported, we are investigating, through external legal advisers, allegations of misconduct and have been liaising with the UK's Serious Fraud Office (SFO) and other relevant authorities. It was announced in August 2017 that the SFO had opened an investigation in relation to the Company, its subsidiaries and associated persons. We are cooperating with the SFO's investigation and a sub-Committee of the Board continues to have oversight of these matters.

We have improved our global business conduct governance framework, implementing the Group's new global compliance programme, known as 'Delivery with Integrity'. Driven by our Business Conduct & Compliance (BC&C) department, the programme focuses on driving a globally consistent approach to compliance, and strengthening our existing processes, across the Group. Further information on the work of the BC&C department can be found on page 28.

It is important that the Board is equipped with the right balance of skills and expertise and has a deep understanding of the business. I led the internal evaluation of the Board's performance during the year, which found that the Board continues to perform effectively. Market visits and engagement with our senior management remain key to the Board's understanding of our business, and our meetings held in the US provided an excellent insight into the US business, its strategy and future challenges. Further details on the Board performance evaluation can be found on pages 63 and 64.

Corporate governance requirements continue to evolve, with the possibility of significant UK corporate governance reforms during 2018. I look forward to continuing the Board's engagement with our shareholders and corporate governance stakeholders on governance issues.

On behalf of the Board, I confirm that we believe that this Annual Report presents a fair, balanced and understandable assessment of the Company's position, its performance and prospects, as well as its business model and strategy.

**Richard Burrows**
Chairman

# Board of Directors

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## Richard Burrows
Chairman (72)

**Nationality:** Irish

**Position:** Chairman since November 2009; Non-Executive Director since September 2009; Chairman of the Nominations Committee.

**Other appointments:** Chairman of the Board and Chair of the Nomination, Remuneration and Compliance Committees of Craven House Capital plc; Senior Independent Director and Chairman of the Remuneration Committee of Rentokil Initial plc; Supervisory Board member and Chairman of the Remuneration Committee at Carlsberg A/S.

**Skills and experience:** Richard brings considerable consumer goods and international business experience to the Board, having been Chief Executive of Irish Distillers and Co-Chief Executive of Pernod Ricard. Prior to joining the Board, Richard was Governor of the Bank of Ireland. Richard is a Fellow of the Institute of Chartered Accountants of Ireland.

A N

## Kieran Poynter
Senior Independent Director (67)

**Nationality:** British

**Position:** Senior Independent Director since October 2016; Non-Executive Director since 2010; Chairman of the Audit Committee since October 2016 and member of the Nominations Committee.

**Other appointments:** NED and Chair of the Audit and Compliance Committee of International Consolidated Airlines Group S.A.; Chairman and Chair of the Nominations, Audit and Compliance and Risk and Remuneration Committees of F&C Asset Management plc.

**Skills and experience:** Kieran brings a wealth of financial and international experience to the Board. He was Chairman and Senior Partner of PricewaterhouseCoopers from 2000 to his retirement in 2008, having started as a graduate trainee in 1971; and is a former Chairman of Nomura International PLC. Kieran served on the President's Committee of the Confederation of British Industry and as member of an advisory committee for the Chancellor of the Exchequer. Kieran is a Chartered Accountant.

## Nicandro Durante
Chief Executive (61)

**Nationality:** Brazilian/Italian

**Position:** Chief Executive since 2011.

**Other appointments:** Non-Executive Director of Reckitt Benckiser Group plc.

**Skills and experience:** Nicandro has extensive leadership skills developed in various senior international roles within the Group. He joined Souza Cruz in Brazil in 1981, rising to become President of that company. Nicandro joined the Management Board in 2006 as Regional Director for the Africa and Middle East region. He joined the Board in 2008 as Chief Operating Officer, before being appointed as Chief Executive in 2011.

## Ben Stevens
Finance Director (58)

**Nationality:** British

**Position:** Finance Director since 2008.

**Other appointments:** Non-Executive Director of ISS A/S.

**Skills and experience:** Ben joined the Group in 1990 and has broad international experience spanning both senior finance and general management roles. He was Head of Merger Integration following the merger with Rothmans and Chairman and Managing Director of both Pakistan Tobacco Company and British American Tobacco Russia. Ben was appointed to the Management Board in 2001 as Development Director and became Director, Europe, in 2004. He joined the Board in 2008 as Finance Director.

N R

## Sue Farr
Non-Executive Director (61)

**Nationality:** British

**Position:** Non-Executive Director since 2015; member of the Nominations and Remuneration Committees.

**Other appointments:** Special Adviser, Chime Group; NED and Chair of the Corporate Responsibility Committee of Dairy Crest Group plc; NED and Chair of the Remuneration Committee of Millennium & Copthorne Hotels plc; NED and Chair of the Nominations & Remuneration Committee of Accsys Technologies PLC.

**Skills and experience:** Sue brings considerable expertise in marketing, branding and consumer issues to the Board. Sue is a former Chairwoman of both the Marketing Society and the Marketing Group of Great Britain. Prior to joining the Chime Group in 2003, where she was Director, Strategic and Business Development until 2015, Sue's career in corporate communications included roles with the BBC and Vauxhall Motors.

N R

## Ann Godbehere
Non-Executive Director (62)

**Nationality:** Canadian/British

**Position:** Non-Executive Director since 2011; member of the Nominations and Remuneration Committees. Ann will retire at the conclusion of the AGM on 25 April 2018.

**Other appointments:** Senior Independent Director and Chair of the Audit Committee of Rio Tinto plc and Rio Tinto Limited; NED and Chair of the Compensation Committee of UBS Group AG and UBS AG.

**Skills and experience:** Ann has more than 25 years' experience in the financial services industry. She spent 10 years at Swiss Re Group, latterly as Chief Financial Officer from 2003 to 2007. From 2008 until 2009 she was CFO of Northern Rock during the initial phase of its public ownership. Ann was a NED and Chair of the Audit Committee of Prudential plc until May 2017. Ann is a Fellow of the Certified General Accountants Association of Canada and a Fellow of the Institute of Chartered Professional Accountants.

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## Dr Marion Helmes
Non-Executive Director (52)

**Nationality:** German

**Position:** Non-Executive Director since August 2016; member of the Audit and Nominations Committees.

**Other appointments:** Supervisory Board member and Chair of Audit Committee of Bilfinger SE; NED of NXP Semiconductors N.V.; Vice Chairwoman of the Supervisory Board of ProSiebenSat.1 Media SE; Supervisory Board member of Uniper SE.

**Skills and experience:** Marion brings significant financial expertise and operational experience gained at an international level having spent her working life managing businesses across Europe, the Americas and Asia. Her extensive career includes Chief Financial Officer positions at Celesio, Q-Cells and ThyssenKrupp Elevator Technology.

N R

## Luc Jobin
Non-Executive Director (58)

**Nationality:** Canadian

**Position:** Non-Executive Director since 25 July 2017; member of the Nominations and Remuneration Committees.

**Other appointments:** President and Chief Executive Officer of Canadian National Railway Company.

**Skills and experience:** Luc brings with him extensive financial and strategic experience, including in the US tobacco sector as an independent director of RAI from 2008 until the acquisition in 2017. Before being appointed to his current role at the Canadian National Railway Company, Luc had served as Executive Vice President and Chief Financial Officer since 2009. He was Executive Vice President of Power Corporation of Canada from 2005 to 2009 and was Chief Executive Officer of Imperial Tobacco Canada, a subsidiary of the Company from 2003 to 2005 and Executive Vice President and Chief Financial Officer from 1998 to 2003.

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**Holly Keller Koeppel**
Non-Executive Director (59)

**Nationality:** American

**Position:** Non-Executive Director since 25 July 2017; member of the Audit and Nominations Committees.

**Other appointments:** NED of Vesuvius and AES Corporation; Senior Adviser to Corsair Capital LLC.

**Skills and experience:** Holly has extensive operational and financial management experience in the US business environment and served as an independent director on the Board of RAI from 2008 until the acquisition in 2017. Prior to her role as Senior Adviser to Corsair Capital LLC, she served as Managing Partner and Co-Head of Corsair Infrastructure Management L.P. from 2015 until her retirement in 2017. From 2010 to 2015, she served as Co-Head of Citi Infrastructure Investors and prior to 2010 she held financial and executive management roles with American Electric Power Company, Inc. and Consolidated Natural Gas Company.

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**Savio Kwan**
Non-Executive Director (69)

**Nationality:** British

**Position:** Non-Executive Director since 2014; member of the Nominations and Remuneration Committees.

**Other appointments:** Co-Founder and CEO of A&K Consulting Co Ltd, advising entrepreneurs and their start-up businesses in China; Visiting Professor at Henley Business School; Non-Executive Director of the Alibaba Hong Kong Entrepreneur Fund.

**Skills and experience:** Savio brings significant business leadership experience of Greater China and Asia to the Board. During his extensive career he has worked broadly in technology for General Electric, BTR plc and Alibaba Group, China's largest internet business, where he was both Chief Operating Officer and, later, a Non-Executive Director.

## Attendance at Board meetings in 2017

| Name | Director since | Attended/Eligible to attend – Scheduled | Attended/Eligible to attend – Ad hoc |
|---|---|---|---|
| Richard Burrows | 2009 | 6/6 | 6/6 |
| Nicandro Durante | 2008 | 6/6 | 6/6 |
| Ben Stevens | 2008 | 6/6 | 6/6 |
| Sue Farr [2(a), 2(c), 2(e)] | 2015 | 6/6 | 3/6 |
| Ann Godbehere [4(d)] | 2011 | 6/6 | 6/6 |
| Dr Marion Helmes [2(b), 2(e)] | 2016 | 5/6 | 6/6 |
| Luc Jobin [4(c)] | 2017 | 3/3 | 1/1 |
| Holly Keller Koeppel [4(c)] | 2017 | 3/3 | 1/1 |
| Savio Kwan | 2014 | 6/6 | 6/6 |
| Dr Pedro Malan [2(e), 4(d)] | 2015 | 6/6 | 5/6 |
| Dr Gerry Murphy [2(a), 2(d), 4(b)] | 2009–2017 | 2/2 | 1/2 |
| Lionel Nowell, III [4(c)] | 2017 | 3/3 | 1/1 |
| Dimitri Panayotopoulos [2(e)] | 2015 | 6/6 | 6/6 |
| Kieran Poynter | 2010 | 6/6 | 6/6 |

**Notes:**

1. Number of meetings in 2017: (a) the Board held 12 meetings in 2017, six of which were held at short notice, five to discuss the proposed acquisition of RAI and one to discuss proposed Management Board changes. One meeting was held off-site, in the United States, to review the Group's strategy and the Group's US business.
2. (a) Sue Farr and Dr Gerry Murphy did not attend the January ad hoc Board meeting due to prior commitments; (b) Dr Marion Helmes did not attend the February Board meeting due to prior commitments; (c) Sue Farr did not attend the March and May ad hoc Board meetings due to prior commitments; (d) Dr Gerry Murphy did not attend the 2017 AGM due to prior commitments; and (e) Sue Farr, Dr Marion Helmes, Dr Pedro Malan and Dimitri Panayotopoulos did not attend the July general meeting, arranged to approve the RAI acquisition, due to prior commitments.
3. Number of meetings in 2018: six Board meetings are scheduled for 2018.
4. Composition: (a) the Board of Directors is shown as at the date of this Annual Report and Form 20-F; (b) Dr Gerry Murphy retired as NED at the AGM on 26 April 2017; (c) Luc Jobin, Holly Keller Koeppel and Lionel Nowell, III were appointed as Non-Executive Directors with effect from 25 July 2017; and (d) Ann Godbehere and Pedro Malan will retire as NEDs at the AGM on 25 April 2018.

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**Dr Pedro Malan**
Non-Executive Director (75)

**Nationality:** Brazilian

**Position:** Non-Executive Director since 2015; member of the Audit and Nominations Committees. Pedro will retire at the conclusion of the AGM on 25 April 2018.

**Other appointments:** Chairman of the International Advisory Board of Itaú Unibanco; member of the Board of EDP – Energias do Brasil SA; Trustee of the Thomson Reuters Trust Principles; member of the Temasek International Panel.

**Skills and experience:** Pedro has extensive experience of Brazilian trade and industry and an in-depth knowledge of the international economy. Pedro was Minister of Finance for Brazil from 1995 to 2002, having been President of the Central Bank of Brazil from 1993 to 1994, and before that Chief External Debt Negotiator for Brazil from mid-1991 to 1993. He is a former Chairman of Unibanco and was a NED of Souza Cruz S.A. from 2010 to 2015.

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**Lionel Nowell, III**
Non-Executive Director (63)

**Nationality:** American

**Position:** Non-Executive Director since 25 July 2017; member of the Audit and Nominations Committees.

**Other appointments:** NED of Bank of America Corporation and NED and Chair of the Audit Committee of American Electric Power Company, Inc.

**Skills and experience:** Lionel brings a wealth of operational and financial management experience in the consumer products industry having served as Lead Independent Director of the Board of RAI from January 2017 until the acquisition in 2017 and as a director since 2007. Lionel retired as Senior Vice President and Treasurer of PepsiCo in 2009, where he held senior financial executive roles since 1999. Prior to PepsiCo, Lionel was Senior Vice President, Strategy and Business Development at RJR Nabisco, Inc. from 1998 to 1999 and held a variety of senior financial roles at the Pillsbury division of Diageo PLC from 1991 to 1998.

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**Dimitri Panayotopoulos**
Non-Executive Director (66)

**Nationality:** Greek/Tanzanian

**Position:** Non-Executive Director since 2015; Chairman of the Remuneration Committee since October 2016 and member of the Nominations Committee.

**Other appointments:** Senior Adviser at The Boston Consulting Group; NED of Logitech International S.A.; Advisory Board member of JBS USA; Chairman of Coveris Holdings S.A.

**Skills and experience:** Dimitri has extensive general management and international sales and brand building expertise. He was Vice Chairman and Adviser to the Chairman and CEO of Procter & Gamble (P&G), where he started his career in 1977. During his time at P&G, Dimitri led on significant breakthrough innovations and continued to focus on this, speed to market and scale across all of P&G's businesses while Vice Chairman of all the Global Business Units.

A Audit Committee
N Nomination Committee
R Remuneration Committee
Committee Chairman
Executive Director
Non-Executive Director

# Management Board

**Jerome Abelman**
Director, Legal & External Affairs and General Counsel (54)

**Nationality:** American

Jerry was appointed Director, Legal & External Affairs and General Counsel in May 2015, having joined the Management Board as Group Corporate & Regulatory Affairs Director in January 2015. Jerry was Regional General Counsel, Asia-Pacific from 2010 to 2014, before becoming Assistant General Counsel – Corporate & Commercial. He was a member of the Board of RAI from February 2016 until the RAI acquisition in July 2017.

**Jack Bowles**
Chief Operating Officer (54)

**Nationality:** French

Jack became Chief Operating Officer for the International Business in October 2017. Joining the Group in 2004, he was Chairman of British American Tobacco France in 2005, before becoming Managing Director of British American Tobacco Malaysia in 2007. He joined the Management Board as Regional Director for Western Europe in October 2009 and then Regional Director for the Americas in October 2011. He was Regional Director for Asia-Pacific from January 2013 to the end of 2017.

**Alan Davy**
Director, Operations (54)

**Nationality:** British

Alan was appointed to the Management Board as Group Operations Director in March 2013. He joined the Group in 1988 and has held various roles in manufacturing, supply chain and general management. Alan previously held the position of Group Head of Supply Chain.

**Giovanni Giordano**
Director, Group Human Resources (52)

**Nationality:** Italian/American

Giovanni joined the Management Board of British American Tobacco in June 2011. He is an international human resources executive with wide experience from senior roles at Procter & Gamble and Ferrero, where he was Chief Corporate Officer.

**Andrew Gray**
Chief Marketing Officer (53)

**Nationality:** Brazilian/British

Andrew was appointed Chief Marketing Officer in October 2017. He joined the Management Board as Regional Director for Africa and the Middle East in January 2008 before being appointed Regional Director for Eastern Europe, Middle East and Africa (EEMEA) in January 2011 and Marketing Director in September 2014. Joining Souza Cruz in 1986, he held a number of senior management positions in South America and the Caribbean (including President of Souza Cruz) and also in Malaysia.

**Tadeu Marroco**
Regional Director, Europe and North Africa (51)

**Nationality:** Brazilian

Tadeu was appointed Regional Director, Europe and North Africa in January 2018. He joined the Management Board as Director, Business Development in September 2014 and was appointed Regional Director, Western Europe in December 2016. Tadeu joined British American Tobacco in Brazil over 20 years ago. He has held various senior finance positions, including Regional Finance Controller, EEMEA, and Group Finance Controller.

**Dr David O'Reilly**
Group Scientific and R&D Director (51)

**Nationality:** British

David was appointed Group Scientific Director in January 2012. He has been with British American Tobacco for over 20 years and has held various positions in Group Research and Development. He has led the Group's R&D efforts to develop reduced toxicant products and has also been Head of International Public Health & Scientific Affairs, responsible for engagement with the scientific, medical and public health communities.

**Ricardo Oberlander**
President and CEO, Reynolds American Inc. (54)

**Nationality:** Brazilian

Ricardo was appointed President and CEO of Reynolds American Inc. in January 2018. Appointed to the Management Board as Regional Director for the Americas in 2013, previous roles include Marketing Director of the Malaysian business, Regional Marketing Manager for the Americas, General Manager in France and Global Consumer Director. He was an RAI Board member from 2014 until the acquisition and is a member of the Chief Marketing Officer Council North America Advisory Board.

**Naresh Sethi**
Director, Business Development (51)

**Nationality:** Australian/Indian

Naresh was appointed Director, Business Development in December 2016. He has over 20 years of experience in the tobacco industry, holding various marketing roles in India, Indonesia, West Africa and Australasia. He was Marketing Director in Japan and then the Group's General Manager. He became Group Head of Strategy and Planning, and was appointed to the Management Board as Director, Group Business Development in 2012 before being appointed Regional Director for Western Europe in January 2013.

**Johan Vandermeulen**
Regional Director, Asia-Pacific and Middle East (50)

**Nationality:** Belgian

Johan was appointed Regional Director, Asia-Pacific and Middle East in January 2018. He joined the Management Board as Regional Director for Eastern Europe, Middle East and Africa in September 2014. He has been with British American Tobacco for more than 25 years and was previously General Manager in Russia, General Manager in Turkey and in the marketing function he was Global Brand Director for the Kent brand.

**Kingsley Wheaton**
Regional Director, Americas and Sub-Saharan Africa (45)

**Nationality:** British

Kingsley was appointed Regional Director, Americas and Sub Saharan Africa in January 2018. He was Marketing Director in Nigeria and Russia, prior to being General Manager in Russia and then the Global Brand Director for the Kent and Vogue brands. He joined the Management Board in January 2012 as Deputy Corporate and Regulatory Affairs Director and appointed Director, Corporate and Regulatory Affairs in June 2012. In 2015 he was appointed Managing Director, Next Generation Products.

# Leadership and effectiveness

## Governance framework

### The Board

The Board is collectively responsible to shareholders of the Company for its performance and for the Group's strategic direction, its values and its governance. It provides the leadership necessary for the Group to meet its performance objectives within a robust framework of internal controls.

**Board responsibilities:**

- Group strategy.
- Significant corporate activities.
- Group policies.
- Corporate governance.
- Board succession plans.
- Group budget.
- Risk management and internal control.
- Annual Report approval.
- Periodic financial reporting.
- Dividend policy.

**Board Committees**

The Board has three principal Board Committees to which it has delegated certain responsibilities. The roles, memberships and activities of these Committees are described in their individual reports in this section. Each Committee has its own terms of reference, available at www.bat.com/governance, which are reviewed and updated regularly, most recently with effect from July 2017 to reflect US governance requirements following the acquisition of RAI, which resulted in a number of changes to the terms of reference of the Audit Committee.

**Board programme**

The Board has a comprehensive annual programme of meetings to monitor and review the Group's strategy across all the elements of the Group's business model. The key activities of the Board in 2017, grouped under the Group's four strategy pillars of Growth, Productivity, Sustainability and Winning Organisation, are detailed on pages 60 and 61. The Board's strategic priorities for 2017 are identified within the key performance indicators set out in our Strategic Report on pages 10 and 11.

The Board devotes considerable attention to Group Corporate Governance, including internal control and compliance issues. It receives verbal updates from the Chairmen of all Committees following each Committee meeting. Copies of the minutes of all Committees are circulated to all members of the Board.

Audit Committee page 65
Nominations Committee page 71
Remuneration Committee page 73

**Management Board**

The Management Board, chaired by the Chief Executive, is responsible for overseeing the implementation of the Group's strategy and policies set by the Board, and for creating the framework for the day-to-day operation of the Group's operating subsidiaries. Its other members comprise the Finance Director and 11 senior Group executives whose names and roles are described on page 58.

An organisational restructuring, from four to three regions, has resulted in the following changes to the Management Board:

Jack Bowles, Regional Director, ASPAC, was appointed to the newly created role of Chief Operating Officer for the International Business (excluding the United States) with effect from 1 October 2017.

Andrew Gray, Director, Marketing, was appointed to the newly created role of Chief Marketing Officer with effect from 1 October 2017.

Ricardo Oberlander, Regional Director, Americas, was appointed to the role of President and CEO, RAI, with effect from 1 January 2018, following the departure of Debra Crew, the previous incumbent.

All of the above roles report directly to the Chief Executive.

Regional Director responsibilities were reorganised as follows, with effect from 1 January 2018:

Kingsley Wheaton, Managing Director, Next Generation Products, was appointed Regional Director, Americas and Sub-Saharan Africa.

Tadeu Marroco, Regional Director, Western Europe, was appointed Regional Director, Europe and North Africa.

Johan Vandermeulen, Regional Director, EEMEA, was appointed Regional Director, Asia-Pacific and Middle East.

All of the above roles report directly to the Chief Operating Officer.

The new structure enables more integrated resource allocation and decision making across geographies and categories.

## Leadership roles and responsibilities

### Leadership

**Chairman**
- Leadership of the Board.
- Ensures Board effectiveness.
- Sets Board agenda.
- Interfaces with shareholders.
- Ensures effective shareholder engagement.

**Chief Executive**
- Overall responsibility for Group performance.
- Leadership of the Group.
- Enables planning and execution of objectives and strategies.
- Stewardship of Group assets.

### Oversight

**Non-Executive Directors (NEDs)**
- Oversee Group strategy.
- Review management proposals.
- Monitor Group performance.
- Bring an external perspective and effective challenge to the Board.

**Senior Independent Director (SID)**
- Leads review of Chairman's performance.
- Presides at Board in Chairman's absence.
- Intermediary for other Directors.
- Available to meet with major shareholders.

### Management Board

- Develops Group strategy for Tobacco Products and NGPs for approval by the Board.
- Monitors Group operating performance.
- Ensures Group, regional and functional strategies and resources are effective and aligned.
- Manages the central functions.
- Oversees the management and development of talent.

# Board activities in 2017

## Growth

**Growth remains our key strategic focus. Continued investment in, and development of, our strategic focus areas is central to the Board's annual agenda.**

### Activities in 2017

Reviewing:

- NGP strategy and updates on the Group's NGP performance, including the acquisition of ViP e-cigarette company in the UK; the launch of glo in Japan; and the Group's approach to, and future plans in respect of, the NGP portfolio;
- the Group's acquisition of RAI;
- the RAI business strategy and performance following its acquisition by the Group;
- acquisition opportunities, including the acquisition of Winnington, the maker of the market leading white snus product, Epok, in Sweden;
- the acquisition of certain tobacco assets from Bulgartabac Holding AD;
- operating performance and the continued significant impact of foreign exchange rates on the Group's financial performance, including measures taken by management to mitigate foreign exchange risks;
- the quarterly financial performance of the associates of the Group; and
- the Group's results and current outlook throughout the year.

### Strategy review highlights: Growth

NGPs: The Board received regular updates on the Group's approach to its NGP business during 2017 from senior management, covering the evolution of the Group's NGP business, current NGP performance highlights, NGP strategy and objectives in the short and long term, and challenges, together with an overview of the competitor landscape in the sector.

Acquisition of RAI: The Board convened five additional Board meetings to oversee all material matters relating to the acquisition of RAI, which constituted a Class I transaction for the Company for the purposes of the UK Listing Rules. The key conditions to completing the transaction were obtaining the approval of the shareholders of the Company and RAI; obtaining anti-trust approvals in the US and Japan; registration of the Company's shares with the Securities and Exchange Commission (SEC) in the US; approval of the Company's shares for listing on the UK London Stock Exchange; and approval of the Company's American Depository Shares for listing on the New York Stock Exchange. The Board also approved the creation of a sub-committee of the Board to ensure ongoing oversight of all matters relating to the transaction between full meetings of the Board.

## Productivity

**The Board pays close attention to the Group's operational efficiency and our programmes are aimed at delivering a globally integrated enterprise with cost and capital effectiveness.**

### Activities in 2017

Reviewing:

- organisational design changes following the successful completion of the acquisition of RAI, including proposals to simplify the Group's regional structure to fully integrate the NGP business into the core operations of the Group;
- business transformation programmes to implement operational efficiencies;
- proposed changes to the Group's delegated authorities framework to reflect organisational changes;
- the operating performance of the Group;
- proposals to issue multiple series of guaranteed bonds in the US; and
- Group liquidity, confirming that the Company was conforming with its financing principles and noting planned refinancing activities for the year ahead.

### Strategy review highlights: Productivity

Oversight of operating model changes: During 2017, the Group established a Global Business Services (GBS) organisation which will deliver all transactional activities, efficiently manage non-core transactional activity, and deliver value-adding analytics services to the Group. The establishment of GBS is a natural next step to maximise the benefits from the Group's TaO programme.

Organisational design changes: Following the successful completion of the acquisition of RAI, the Board approved organisational design changes to simplify the Group's regional structure and to fully integrate the NGPs business into the core operations of the Group, reflecting the outstanding growth of this part of the business to date and its long-term importance to the Group's future. Three new regions have been created, effective 1 January 2018: Americas and Sub-Saharan Africa, Europe and North Africa and Asia-Pacific and Middle East. These replace the previous four-region structure.

## Sustainability

**The Board places considerable emphasis on the need for our business to be sustainable for the long term, to meet the expectations of our stakeholders and inform our commitments to society.**

### Activities in 2017

Reviewing:

- the Group's Global Product Stewardship Policy Framework in light of the new product stewardship challenges for the Group arising from its NGP activities;
- the status of the Group's litigation proceedings, including updates on the class actions in Quebec, Canada, against the Group's subsidiary Imperial Tobacco Canada and two other Canadian manufacturers; the Sequana dividend trial; the trial in Georgia brought by Tiblisi Tobacco; and key RAI litigation matters;
- updates on compliance matters including allegations of misconduct and the activities of the newly created Business Conduct and Compliance department;
- approving changes to the Group's Standards of Business Conduct to reflect US legislative and regulatory requirements following the acquisition of RAI;
- Environment, Health and Safety performance and long-term targets;
- the Group's Risk Register, considering the Group's risk appetite and determining the Group's viability for Financial Reporting Council reporting purposes, taking account of the Company's current position and principal risks; and
- the Group's director and officer insurance cover and agreeing revised provisions to take into account the change in requirements in this area following the acquisition of RAI.

### Strategy review highlights: Sustainability

During its strategy meeting in the US, the Board received a comprehensive briefing on the FDA regulation of Tobacco Products and the strategies which have been adopted to minimise the impact on RAI's operating performance. The evolution of the FDA's role and the key regulatory risks and challenges, including the numerous types of submissions and time frames, were explained in some detail. RAI's mitigation strategies were also discussed, together with recent developments from the FDA and their likely impact on the US market.

In 2017, the Group launched a new compliance programme, known as 'Delivery with Integrity'. See page 28 for details of this programme.

## Winning organisation

**Setting the 'tone from the top' is an important part of the Board's role, helping to foster a culture centred on our Guiding Principles and which harnesses diversity.**

### Activities in 2017

Reviewing:

- succession planning at Board level, including Executive Director and Management Board succession planning and monitoring the progress of Management Board development plans;
- the performance of Executive Directors and Management Board members;
- Non-Executive Director appointments in light of requirements following the acquisition of RAI, including approving the appointment of three new Non-Executive Directors from the RAI board of directors as proposed by the Nominations Committee;
- the composition of Board Committees and approving changes to the Committees;
- proposed changes to the roles and responsibilities of the Management Board and approving changes including the creation of the roles of Chief Operating Officer and Chief Marketing Officer; and
- RAI integration plans, including proposals for ensuring integration and retention of talent in the enlarged Group.

### Strategy review highlights: Winning organisation

Talent development: The approach to talent development and attraction was comprehensively reviewed to ensure it remains fit for purpose, particularly in the areas of brand-building and NGPs. A number of new initiatives were implemented, including the introduction of a new Global Graduate Academy, together with revised functional leadership programmes. See page 25 for further details.

Your Voice survey: The Group's global employee survey 'Your Voice' achieved exceptional results with a key Engagement Index score of 83%. See pages 25 and 26 for more details.

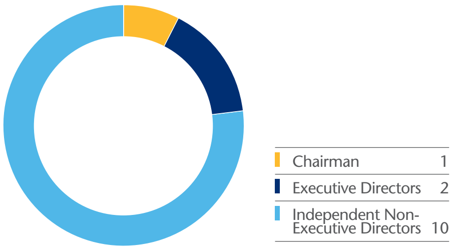
Diversity: Initiatives during 2017 included the development of two new diversity training modules, Inclusive Leadership and Cross-Cultural Awareness, the continued roll-out of the Group's 'Women in Leadership' programme, and the confirmation of the diversity principles applicable to the Board and Management Board in a Board Diversity Policy. See pages 25, 26 and 62 for further details.

## Directors: information and advice

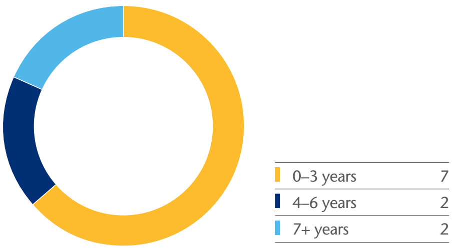
| | |
|---|---|
| **Information: Board and Committees** | – Directors receive papers for review in good time ahead of each meeting;<br>– the Company Secretary ensures good information flow within the Board and its Committees, and between the Non-Executive Directors and senior management; and<br>– the Company Secretary, in conjunction with external advisers where appropriate, advises the Board on all governance matters. |
| **Advice** | – all Directors have access to the advice and services of the Company Secretary;<br>– a procedure is in place for all Directors to take independent professional advice at the Company's expense if required; and<br>– each of the three principal Committees of the Board may obtain independent legal or other professional advice, at the Company's expense, and secure attendance at meetings of outsiders if needed. |

# Board effectiveness

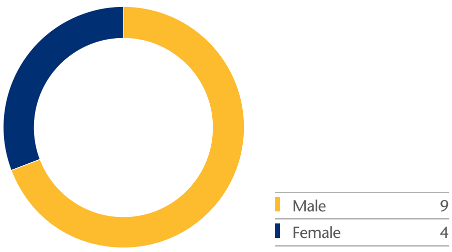
### Balance of Non-Executive Directors and Executive Directors



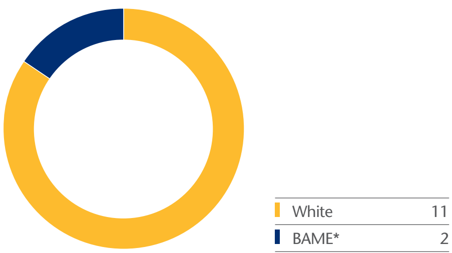

### Length of tenure of Non-Executive Directors




### Gender split of Directors

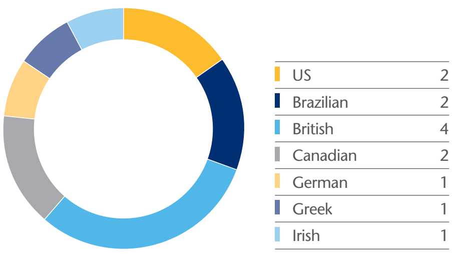



### Ethnicity split of Directors




* applying the Parker Report guidance.

### Nationality of Directors




## Balance and diversity

Our Non-Executive Directors come from broad industry and professional backgrounds, with varied experience and expertise aligned to the needs of our business. Short biographies of the Directors are set out in this section on pages 56 and 57. In 2017, as at 31 December, 31% of our Board was female.

The Parker Review Committee published its final report on ethnic diversity in UK boards on 12 October 2017 (the 'Parker Report'). The Parker Report recommends that there be at least one Director from a Black, Asian and Minority Ethnic (BAME) background on each FTSE 100 board by 2021, and more generally that UK companies increase ethnic diversity on boards, develop BAME employees to ensure a pipeline of capable candidates, and enhance transparency and disclosure regarding diversity. As at 31 December 2017, applying the assessment guidance set out in the Parker Report, 15% of our Board (two directors) are from a BAME background.

The Board appreciates the benefit of diversity in all its forms, within its own membership and at all levels of the Group. Our Strategic Report contains details of our Group diversity initiatives, including the proportion of women in our total workforce and in senior management, on pages 25 and 26.

## Board Diversity Policy

We believe that great talent and an engaging culture are key to our success, and diversity is a critical component of both.

'Strength from Diversity' is one of our Group's long-standing four Guiding Principles. This principle is applicable to all Group employees, as reflected in our Group Employment Principles discussed further on pages 30 and 31, and applies to the composition of our Board and Management Board.

We think of diversity in its widest sense, as those attributes that make each of us unique. These include our race, ethnicity, cultural background, geographical origin, gender, age, any disability, sexual orientation, religion, skills, experience, education and professional background, perspectives and thinking styles.

The Nominations Committee is responsible for regularly reviewing the composition of the Board and Management Board to ensure both boards have an appropriate balance of skills, expertise, and knowledge, and ensuring that all appointments are made on merit against objective criteria and with due regard for the benefits of diversity. These principles were rigorously applied by the Nominations Committee in identifying and recommending Luc Jobin, Holly Keller Koeppel and Lionel Nowell, III for appointment to the Board.

With effect from 1 March 2018, the diversity principles applied in relation to our Board and Management Board are now confirmed in our Board Diversity Policy, which sets out the Board's commitment to the following objectives:

- considering all aspects of diversity when reviewing the composition of, and succession planning for, the Board and Management Board;
- considering a wide pool of candidates of both genders for appointment to the Board;
- maintaining at least 30% representation of females on our Board, with the ambition of progressing towards further gender balance;
- giving preference, where appropriate, to engagement of executive search firms that are accredited under the Standard and Enhanced Codes of Conduct for Executive Search Firms, which include gender diversity; and
- supporting the oversight of the development of internal senior managers to create a diverse pipeline of high-performing potential Executive Directors and Management Board members, supported by the activities of the Nominations Committee.

Please refer to pages 71 and 72 for further discussion of the Nomination Committee's activities in support of these objectives.

## Training and development:

### NGPs

The Board attended a training session on the NGP business and long-term strategic objectives.

### US governance requirements

The Directors completed a comprehensive training programme, facilitated by external advisers, to ensure that they understood the significant changes to the Group's procedures and policies as well as their own individual obligations resulting from the acquisition of RAI.

### RAI business and strategy

At its Board meeting held in Washington, D.C. following the acquisition of RAI, the Board received detailed briefings from senior RAI management on the US business, its strategy and future challenges and participated in a market visit.

## Independence and conflicts of interest

### Independence

The Board considers all Non-Executive Directors to be independent, as they are free from any business or other relationships that could interfere materially with, or appear to affect, their judgement.

The Board has also considered the independence requirements outlined in the NYSE's listing standards and has determined that these are met by all of its Non-Executive Directors.

### Conflicts of interest

The Board has formal procedures for managing conflicts of interest. Directors are required to give advance notice of any conflict issues to the Company Secretary. These are considered either at the next Board meeting or, if the timing requires it, at a meeting of the Board's Conflicts Committee. Each year, the Board also considers afresh all previously authorised situational conflicts. Directors are excluded from the quorum and vote in respect of any matters in which they have an interest.

During 2017, the Board convened a Conflicts Committee at which the interests of Luc Jobin, Holly Keller Koeppel and Lionel Nowell, III were noted. In relation to Mr Jobin and Ms Koeppel's interests, no reasonable likelihood of conflict was identified. The same applied to Mr Nowell, other than in relation to his Non-Executive Directorship of, and shareholding interest in, Bank of America Corporation. In this case a situational conflict was authorised by the Conflicts Committee. Mr Nowell will be regarded as having an interest in any transactional agreement between the Company and Bank of America Corporation without any requirement to give further disclosure.

The Board also convened a Conflicts Committee to consider the appointment of Mr Panayotopoulos as a member of the Advisory Board of JBS USA Food Company and Chairman and interim CEO of Coveris Holdings SA. The appointment of Mr Panayotopoulos as a member of the Advisory Board of JBS USA Food Company was deemed to be a situational conflict, as its parent company JBS SA is a supplier to the Group's businesses in Brazil and Poland. In this case, a situational conflict was authorised by the Conflicts Committee. It was agreed, in relation to Coveris Holdings SA, that there was no reasonable likelihood of a conflict arising in relation to this interest. The Board, in accordance with the Company's procedures confirmed the Conflicts Committee's decisions in these matters.

The Board also noted the appointment of Mr Burrows as Chairman of the Remuneration Committee and as the new Senior Independent Director of Rentokil Initial PLC with effect from 21 September 2017.

The Board does not consider the change in the Chairman's commitments to have any impact on his responsibilities to the Company.

## Information and professional development

### Board induction

On joining the Board, all Directors receive a full induction. Non-Executive Directors also receive a full programme of briefings on all areas of the Company's business from the Executive Directors, members of the Management Board, the Company Secretary and other senior executives.

Luc Jobin, Holly Keller Koeppel and Lionel Nowell, III attended our Director induction programme in 2017, which included briefings covering the Group's Strategy, its functions (including Marketing and NGPs), the statutory reporting cycle, Group Treasury, IT strategy, and legal and regulatory issues. They, along with the rest of the Board, also had the opportunity to conduct a market visit at the off-site Board meeting held in Washington, D.C. in October to review the Group's strategy following the acquisition of RAI and engage with RAI senior management.

Non-Executive Directors are encouraged to attend meetings of the Group's regional Audit and Corporate and Social Responsibility Committees to gain a better understanding of issues in the Group's regions.

The Chairman meets with each Non-Executive Director individually, in the latter part of each year, to discuss their individual training and development plans.

### Shareholder engagement

The Chairman and the Executive Directors are committed to open and transparent dialogue with shareholders.

The Senior Independent Director and other Non-Executive Directors are also available to meet with major shareholders on request.

The AGM is an opportunity for further shareholder engagement and for the Chairman to explain the Company's progress and, along with other members of the Board, to answer any questions. All Directors attend, unless illness or pressing commitments prevent them. All Directors, except for Dr Gerry Murphy, attended the AGM in 2017.

An additional shareholder meeting was held on 19 July 2017, to consider the acquisition of RAI.

Details of our 2018 AGM are set out in the Other information section.

### Annual investor relations programme

A full programme of engagement with shareholders, potential investors and analysts, in the UK and overseas, is undertaken each year by the Head of Investor Relations, often accompanied by one or both Executive Directors.

Every two years, combined investor meetings are held over two days with the Management Board also in attendance. This year's investor event took place in London and members of the Management Board gave detailed presentations that included our NGP objectives and strategy, our new US subsidiary RAI, regulation, marketing and an update on the performance of our International business. In 2017, as part of the annual investors relations programme, meetings were held with institutional shareholders in 24 countries, engaging with the owners of the majority of the Group's shares. Regular investor presentations were also given and these together with the results presentations are published on www.bat.com. All results presentations are also available to shareholders by webcast.

In addition, there is a microsite on www.bat.com for debt investors, with comprehensive bondholder information on credit ratings, debt facilities, outstanding bonds and maturity profiles.

### Board reporting on shareholder views

In 2017, the Head of Investor Relations updated the Board on key issues raised by institutional shareholders as well as providing a commentary on share price performance. The Chairman also regularly reports on any meetings he has had with shareholders in between Board meetings and the Board discusses the key points investors may have raised.

## Board evaluation

### Evaluation outcomes

The results of the annual Board evaluation show that the Board and each of its Committees continues to function efficiently and the Directors work well together and contribute effectively to the Board and their designated Committees.

The Board scored highly in the areas of leadership and oversight of the Group's activities, particularly with regard to the work of the Board on the RAI acquisition.

The Board's regular opportunities for interaction with senior management and opportunities to further understand the business are highly valued by the Non-Executive Directors, with examples cited including regular management briefings on strategy matters such as the RAI acquisition and the NGP business; the market visit to the US; and the opportunity to participate in the Audit Committee framework.

The Board continues to have a good mix of broad and diverse skills, gender balance, nationalities, experience and talent, which is used effectively and promotes debate. These have been further enhanced with the appointment of the three new Non-Executive Directors from the RAI board.

# Board effectiveness continued

The Executive Directors are highly regarded and add significant value and insight to the Board.

The Chairman ensures that sufficient time is allocated to Board meetings, as evidenced by the additional Board meetings convened during 2017 to ensure that matters such as the acquisition of RAI could be fully discussed.

As a result of the conclusions of the Board evaluation, there are a number of areas of focus for the Board during 2018. These include continuing to provide opportunities for the Board to engage with senior management and understand the business, particularly following the restructuring of the Group's regional operating structure; overseeing a review of the Group's remuneration policies and their alignment to Group strategy in consultation with shareholders; ensuring that sufficient time is allocated to risk monitoring and oversight of compliance issues; and reviewing Board size and composition to ensure that the Board continues to operate effectively.

### Evaluation process

The performance and effectiveness of the Board, its Committees, the Executive and Non-Executive Directors and the Chairman were evaluated internally during 2017, following an externally facilitated evaluation in 2016.

The Chairman is responsible for the overall evaluation process and each Committee Chair is responsible for Committee effectiveness evaluation.

The evaluation was carried out by the Company Secretarial team using detailed bespoke, objective, written questionnaires.

All Non-Executive Directors and Executive Directors participated in the evaluation process. They were requested to rank the Board, its Committees and each other against several outcomes. They also had the opportunity to elaborate their replies by providing specific comments.

Anonymised reports were prepared by the Company Secretary for the Board and each Board Committee on the results of the evaluation. In addition, the Chairman received reports on the performance of each of the Executive and Non-Executive Directors. A report on the Chairman's own performance was prepared for the Senior Independent Director. Individual feedback was given by the Chairman to all Board members, and by the Senior Independent Director to the Chairman.

## Collective Board effectiveness

### Collective decision-making

The Chairman seeks a consensus at Board meetings but, if necessary, decisions are taken by majority. If any Director has concerns on any issues that cannot be resolved, such concerns are noted in the Board minutes. No such concerns arose in 2017.

When required, the Non-Executive Directors, led by the Chairman, meet prior to Board meetings and regular meetings are scheduled in the Board calendar without the Executive Directors present. The Executive and the Non-Executive Directors also meet annually, led by the Senior Independent Director and without the Chairman present, to discuss the Chairman's performance.

**For disclosures required by paragraph 7.2.6 of the Disclosure Guidance and Transparency Rules and the Companies Act 2006 see the Other Information section.**

### Compliance statement

Throughout the year ended 31 December 2017 and to the date of this document, we applied the Main Principles of the April 2016 version of the UK Corporate Governance Code (the 'Code') as it applies to the year ended 31 December 2017. The Company was compliant with all provisions.

The Board considers that this Annual Report, and notably this section, provides the information shareholders need to evaluate how we have complied with our current obligations under the Code.

For ease of reference, we prepare a separate voluntary annual compliance report by reference to each provision of the Code. This report is available at www.bat.com/governance.

We comply with the Disclosure Guidance and Transparency Rules requirements for corporate governance statements by virtue of the information included in this section, together with the information contained in the Other information section. As a result of the listing of the Company's American Depositary Shares (ADSs) on the NYSE, the Company is required to meet certain NYSE requirements relating to corporate governance matters. Certain exceptions to these requirements apply to the Company as a foreign private issuer. For a discussion of the significant differences between the NYSE requirements and the Company's practices, please see page 236.

# Audit Committee

**Kieran Poynter**
Chairman of the Audit Committee

| Audit Committee current members |
|---|
| Kieran Poynter (Chairman) |
| Dr Marion Helmes |
| Holly Keller Koeppel |
| Dr Pedro Malan |
| Lionel Nowell, III |

### Attendance at meetings in 2017

| | | Attended/Eligible to attend | |
|---|---|---|---|
| Name | Member since | Scheduled | Ad hoc |
| Dr Marion Helmes | 2016 | 5/5 | 2/2 |
| Holly Keller Koeppel[3(b)] | 2017 | 2/2 | 0/0 |
| Dr Pedro Malan | 2016 | 5/5 | 2/2 |
| Dr Gerry Murphy[3(c)] | 2015–2017 | 2/2 | 1/1 |
| Lionel Nowell, III[1,2(b),3(d)] | 2017 | 1/2 | 0/0 |
| Kieran Poynter[1] | 2012 | 5/5 | 2/2 |

**Notes:**

1. Kieran Poynter, Marion Helmes and Lionel Nowell, III have recent and relevant financial experience, and Lionel Nowell, III has been designated as the audit committee financial expert, in accordance with applicable US federal securities laws and NYSE listing standards. The members of the Committee as a whole have competence relevant to the sectors in which the Group operates.
2. Number of meetings in 2017: (a) The Committee held seven meetings in 2017, two of which were convened at short notice in connection with the acquisition of RAI; and (b) Lionel Nowell, III did not attend the meeting held in December due to commitments already in place prior to his appointment to the Committee.
3. Membership: (a) all members of the Committee are independent Non-Executive Directors in accordance with the UK Corporate Governance Code Provision C.3.1., applicable US federal securities laws and NYSE listing standards; (b) Holly Keller Koeppel became a member of the Committee on 2 October 2017 following her appointment as a Non-Executive Director; (c) Dr Gerry Murphy ceased to be a member of the Committee upon his retirement as a Non-Executive Director on 26 April 2017; and (d) Lionel Nowell, III became a member of the Committee on 2 October 2017 following his appointment as a Non-Executive Director.
4. The Finance Director attends all meetings of the Committee but is not a member. Other Directors may attend by invitation. The Director, Legal & External Affairs, the Group Head of Audit, and the external auditors also attend meetings on a regular basis.
5. The Committee meets alone with the external auditors and, separately, with the Group Head of Audit, at the end of every meeting.

**For the Committee's terms of reference see www.bat.com/governance**

## Role

### The Audit Committee monitors and reviews the:

- integrity of the Group's financial statements and any formal announcements relating to the Company's performance, considering any significant issues and judgements reflected in them, before their submission to the Board;
- consistency of the Group's accounting policies;
- effectiveness of, and makes recommendations to the Board on, the Group's accounting, internal accounting controls, auditing matters and business risk systems;
- effectiveness of the Company's internal audit function; and
- performance, independence and objectivity of the Company's external auditors, making recommendations as to their reappointment (or for a tender of audit services where appropriate), and approving their terms of engagement and the level of audit fees.

### Audit Committee Terms of Reference

Revised Audit Committee Terms of Reference were adopted by the Board with effect from 25 July 2017, to incorporate provisions required by US securities laws and the NYSE listing standards. These revisions include:

- enhancements to the specific criteria that Committee members must meet to be considered independent under US securities laws, which must be assessed and confirmed by the Board;
- details of the procedures established for receipt, retention and treatment of complaints relating to the Group's accounting, internal accounting controls or auditing matters, on a confidential and anonymous basis;
- confirmation of the Committee's authorisation to incur ordinary and administrative expenses, at the Company's expense, as necessary for the Committee to carry out its duties;
- reference to the new requirement in the Group Auditor Independence Policy (discussed below) for the concurring external audit partner to rotate off the Group audit engagement at least every five years, and not to recommence provision of audit or audit-related services to the Group for a further five years; and
- the requirement for the Board to consider designating one or more Committee members as an audit committee financial expert, in accordance with US securities laws.

## Key activities in 2017

### Regular work programme – reviewing:

- the application of accounting standards, the Group's 2016 results, 2017 half-year results and the external auditors' reports where results are audited;
- the Basis of Preparation and Accounting Judgements;
- the internal processes that have been followed for the preparation of the 2017 Annual Report and Form 20-F, and confirming that the processes appropriately facilitated the preparation of an Annual Report and Form 20-F that is 'fair, balanced and understandable';
- the review on the year-end audit from the Group's external auditors, including the key audit risks, the Group's control environment and the final materiality assessment, and confirming the independence of the external Group auditors;
- the Group's liquidity position, current facilities and financing needs through 2017;
- the steps taken to validate the Group's 'going concern' assessment at half-year and year-end and agreeing the process steps taken to determine the Group's viability statement at year-end;

# Audit Committee continued

– the 2018 Internal Audit Plan;

– the Group's sustainability performance, including the Group's corporate social investment in empowerment, sustainable agriculture and environment initiatives in countries and communities in which the Group operates;

– periodic reports from the Group's Regional Audit and CSR Committees and Corporate Audit Committee;

– the Group's Risk Register, including the categorisation of, and mitigating factors in respect of, Group risks;

– regular reports from the Group Head of Audit on international and global process audits and the management responses and action plans being put in place to address any concerns raised;

– the annual assessment of goodwill impairment;

– the annual report from the Group Head of Security on security risks, losses and fraud arising during the preceding year;

– quarterly and annual reports on compliance with the Group's SoBC and biannual reports on political contributions; and

– the Committee's effectiveness following the Board evaluation process, discussed further on pages 63 and 64.

### Further specific matters considered by the Committee:

### Acquisition of RAI

– a key focus of the Committee during 2017 was the oversight of financial, accounting and compliance matters associated with the acquisition of RAI (together with the Board), including review of documentation to be submitted to the SEC and UKLA in connection with the acquisition, the Company's obligations as a foreign private issuer under US securities laws and the NYSE listing standards, progress of implementation of the associated compliance programme, and steps required to establish, maintain and demonstrate the effectiveness of internal controls over financial reporting; and

– amendments to the Audit Committee Terms of Reference and the Group's Global Policy on Auditor Independence to incorporate provisions required by US securities laws and the NYSE listing standards, and recommending them for adoption by the Board with effect from 25 July 2017.

### Other specific matters

– application of IFRS 9 (relating to financial instruments) and IFRS 15 (relating to revenue recognition), and the Group's approach to the implementation of these standards, discussed further on page 116;

– progress on the implementation of the Group's 'Delivery with Integrity' compliance programme (discussed further on page 28), reviewing appropriate materiality thresholds for reporting, and approving an enhanced format for the future reporting of instances of suspected and established non-compliance with the SoBC, drawing on more detailed reporting capabilities enabled by the analytical functionality of the new online SoBC portal;

– following successful implementation of the core TaO programme over the past five years, latest status on the progress of implementation of the template in additional markets; and

– enhancements to the Group's approach to assessing and monitoring key countries of concern to the Group from a human rights perspective, to take into account changes to the United Nation's Guiding Principles on business and human rights, and the introduction of the UK Modern Slavery Act.

### Risk topics considered by the Committee included:

– the impact of FDA tobacco regulation on the US business, and risks associated with non-compliance with tobacco and related legislation applicable to the Group's business;

– risks associated with increased exposure to interest rate changes on net finance costs, arising from existing and future refinanced debt;

– an update on risks to the Group posed by cyber-attacks and on the Group's priorities for ensuring continuing protection;

– an update on the risks associated with the UK's decision to exit the EU (Brexit), including potential risks relating to supply chain continuity, taxation, changes in customs duty, foreign exchange rate exposures and talent acquisition;

– revisions to the Group's risk appetite framework as it relates to the Group's strategic objectives; and

– the report on the effectiveness of the Company's risk management system.

Please refer to pages 48 to 54 for information about the principal Group risk factors.

### Significant accounting judgements considered by the Committee in relation to the 2017 accounts:

– **the Group's significant corporate tax exposures:** the Committee was updated periodically on corporate tax matters and considered reports from the Group Head of Tax on the current status of the FII GLO matter and the status of issues in various markets. These included significant tax disputes in Brazil, South Africa and The Netherlands, and Bangladesh (in respect of VAT). The Committee agreed with management's positions and extended disclosures in respect of them (see note 28 in the Notes on the Accounts);

– **contingent liabilities, provisions and deposits in connection with ongoing litigation:** the Committee reassessed the provision in respect of the Fox River clean-up costs and related legal expenses subsequent to a funding agreement in relation to the sharing of the costs. As a result, the provision was retained at the prior year level (see note 3 in the Notes on the Accounts). However, inherent uncertainties remain (see note 28 in the Notes on the Accounts). The Committee agreed that no provision should be recognised at this point in respect of the Kalamazoo River claim. The Committee also agreed that the quarterly deposits in relation to security for costs in relation to the Quebec Class Action, made by the Group's subsidiary Imperial Tobacco Canada, would continue to be treated as an asset to be recovered upon a successful appeal of the original judgment (see note 14 in the Notes on the Accounts);

– **foreign exchange:** as the Group has operations in certain territories with severe currency restrictions, where foreign currency is not readily available, the Committee satisfied itself that the methodologies used to determine relevant exchange rates for accounting purposes remained appropriate; and

– **changes in the Group:** the Committee reviewed and approved the accounting treatment in relation to the acquisitions undertaken in the year, including the acquisition of the remaining shares in RAI not already owned. This included the recognition of a gain of £23,288 million related to the deemed disposal of the Group's investment in RAI as an associate. The Committee also reviewed the purchase price allocation of all the acquisitions in the year and the related assessment of the carrying value of the intangibles, including goodwill.

## External auditors

KPMG LLP (KPMG) were appointed as the Company's auditors on 27 March 2015, following a formal tender process carried out in 2015. The Committee considers the relationship with the auditors to be working well and is satisfied with their effectiveness.

### Group Auditor Independence Policy (AIP)

The Group has an established AIP to safeguard the independence and objectivity of the Group's external auditors, and to specify the approval processes for the engagement of the Group's external auditors to provide audit and non-audit services.

The key principle of the AIP is that the Group's external auditors may be engaged to provide services only in cases where those services do not impair their independence and objectivity. The Committee recognises that using the external auditors to provide such services is often of benefit where they have detailed knowledge of our business, although the external auditors may not be engaged to provide services if the provision of such services would result in the external auditors:

– having a mutual or conflicting interest with any Group company;

– being placed in the position of auditing their own work;

– acting as a manager or employee of any Group company; or

– being placed in the position of being an advocate for any Group company.

Audit services are approved in advance by the Committee on the basis of the annual engagement letter and the scope of audit services is agreed by the Committee with the external auditors.

Subject to the above requirements, the external auditors may also provide certain non-audit services with the prior approval of the Committee. The requirement for the Committee's pre-approval of non-audit services may be waived only if the aggregate amount of all non-audit services provided is less than five per cent. of the total amount paid to the external auditors during the reporting year, where those services were not recognised to be non-audit services at the time of engagement, and provided those services are promptly brought to the attention of the Committee and their provision is approved prior to completion of the audit in the relevant reporting year.

The provision of permitted non-audit services must be put to tender if expected spend exceeds limits specified in the AIP, unless a waiver of this requirement is agreed by the Finance Director and notified to the Committee.

The Group's AIP was revised with effect from 25 July 2017 to support compliance with US and EU securities laws, and includes:

– enhanced limitations on the provision of non-audit services, such as express prohibitions on the provision of services with contingent fee arrangements, expert services unrelated to audit and other services prohibited by US securities laws;

– clarifications in respect of requirements for the Committee to pre-approve all audit and non-audit services, except in respect of non-audit services falling within the exceptions described above;

– additional requirements in respect of audit partner rotation, including for the concurring external audit partner to rotate off the Group audit engagement at least every five years, and not to recommence provision of audit or audit-related services to the Group for a further five years;

– express prohibition on the Chief Executive, Finance Director, Group Financial Controller and Group Chief Accountant having been employed by the external auditors in any capacity in connection with the Group audit for two years before initiation of an audit; and

– authority for the Committee to oversee any allegations of improper influence, coercion, manipulation or purposeful misleading in connection with any external audit, and to review any issues arising in the course of engagement with the external auditors.

The Committee also reviews a schedule identifying the total fees for all audit-related services, tax services and other non-audit services expected to be undertaken by the external auditors in the following year. Tax services and other non-audit services in excess of the tender thresholds referred to above must be itemised. Updated schedules are also submitted to the Committee at the mid-year and year-end, so that it has full visibility of the Group spend on non-audit services.

A breakdown of audit, audit-related, tax and non-audit fees paid to KPMG firms and associates in 2017 is provided in Note 3(c) on the Accounts and is summarised as follows:

### Services provided by KPMG firms and associates 2017

| | 2017 £m | 2016 £m |
|---|---|---|
| Audit services | **17.6** | 9.2 |
| Audit-related assurance services | **8.0** | 0.2 |
| **Total audit and audit-related services** | **25.6** | 9.4 |
| Other assurance services | **4.1** | 0.1 |
| Tax advisory services | **–** | 0.2 |
| Tax compliance | **0.2** | 0.3 |
| Other non-audit services | **–** | 1.4 |
| **Total non-audit services** | **4.3** | 2.0 |

**Notes:**
In 2017, non-audit fees paid to KPMG amounted to 16.8% of the audit and audit-related assurance fees paid to them (2016: 21.3%).

All audit and non-audit services provided by the external auditors in 2017 were pre-approved by the Committee, except for £3,500 of tax fees (2% of tax fees) approved subsequently.

### Annual assessment

The Committee carries out an annual assessment of the Group's external auditors, covering qualification, expertise and resources, and objectivity and independence, as well as the effectiveness of the audit process. This assessment is informed by an external audit satisfaction survey completed by members of senior management. No material issues were identified during 2017. The Committee is satisfied with the qualification, expertise and resources of its external auditors and that the objectivity and independence of its external auditors is not in any way impaired by the non-audit services which they provide.

The Finance Director, Director, Legal & External Affairs, Group Head of Audit, Company Secretary and the Committee Chairman all meet with the external auditors throughout the year to discuss relevant issues as well as the progress of the audit. Any significant issues are included on the Committee's agenda.

### Competition and Markets Authority Audit Order

The Company has complied with the Statutory Audit Services Order issued by the Competition and Markets Authority for the financial year ended 31 December 2017.

# Audit Committee continued

## Risk management and internal control

### Overview

The Company maintains its system of risk management and internal control with a view to safeguarding shareholders' investment and the Company's assets. It is designed to identify, evaluate and manage risks that may impede the Company's objectives. It cannot, and is not designed to, eliminate them entirely. The system therefore provides a reasonable, not absolute, assurance against material misstatement or loss. A description of the principal risk factors that may affect the Group's business is provided in our Strategic Report on pages 48 to 54.

The main features of the risk management processes and system of internal control operated within the Group are described below, and have been in place throughout the year under review and remain in place to date. They do not cover associates of the Group.

### Board oversight

During the year, the Board considered the nature and extent of the principal risks that the Group is willing to take to achieve its strategic objectives (its 'risk appetite') and for maintaining sound risk management and internal control systems. It keeps its risk appetite under review to ensure that it is appropriate and consistent with internal policies.

With the support of the Committee, the Board conducts a review of the effectiveness of the Group's risk management and internal control systems annually. This review covers all material controls including financial, operational and compliance controls and risk management systems.

### Audit and CSR Committee framework

The Group's Regional Audit and CSR Committee framework underpins the Board's Audit Committee. It provides a flexible channel for the structured flow of information through the Group, with committees covering locally listed Group entities or complex markets where considered appropriate in certain markets, and each of the Group's regions. In the EEMEA region, given the size of the region and the number of countries it includes, the regional Audit and CSR Committee is supported by an area Audit and CSR Committee. Local Audit and CSR Committees also operate in several markets in EEMEA.

Following the acquisition of RAI, the RAI Regional Audit and CSR Committee was appointed by the Committee to extend the Group's Regional Audit and CSR Committee framework to cover the US business.

The Group's Regional Audit and CSR Committees are all chaired by a member of the Management Board and attended by one or more Non-Executive Directors. The Corporate Audit Committee focuses on the Group's risks and control environment that fall outside the regional committees' remit, for example head office central functions, global programmes and projects. It comprises members of the Management Board, is chaired by a Regional Director and is also attended by one or more of the Non-Executive Directors.

External and internal auditors attend meetings of these committees and regularly have private audiences with members of the committees after meetings. Additionally, central, regional and individual market management, along with internal audit, support the Board in its role of ensuring a sound control environment.

This framework ensures that significant financial, social, environmental and reputational risks faced by the Group are appropriately managed and that any failings or weaknesses are identified so that remedial action may be taken.

The Group's Regional Audit and CSR Committee framework structure will be revised in 2018 to reflect the Group's new international business model, and to establish a Regional Audit and CSR Committee for each of the three Group regions, in addition to the RAI Regional Audit and CSR Committee.

### Risk management

Risk registers, based on a standardised methodology, are used at Group, regional, area and individual market level to identify, assess and monitor the principal risks (both financial and non-financial) faced by the business at each level. Information on prevailing trends, for example whether a risk is considered to be increasing or decreasing over time, is provided in relation to each risk and all identified risks are assessed at three levels (high/medium/low) by reference to their impact and likelihood. Mitigation plans are required to be in place to manage the risks identified and their progress is also monitored. The risk registers and mitigation plans are reviewed on a regular basis. Regional and above-market risk registers are reviewed regularly by the relevant regional Audit and CSR Committee or the Corporate Audit Committee, as appropriate.

At Group level, specific responsibility for managing each identified risk is allocated to a member of the Management Board. The Group Risk Register is reviewed regularly by a committee of senior managers, chaired by the Finance Director. In addition, it is reviewed annually by the Board and twice yearly by the Committee. The Board and the Committee review changes in the status of identified risks, assessing the changes in impact and likelihood. The Committee also conducts deep dives into selected risks, meeting senior managers responsible for managing and mitigating them, so that it can consider those risks in detail.

The Board noted that the Group's risk profile remained stable during 2017.

**The Board also considered the Group Viability Statement see page 48 of the Strategic Report.@**

**For more information on risk factors see the Principal Group risk factors section in our Strategic Report on pages 48 to 54.**

### Internal control

Group companies and other business units are annually required to complete a checklist, called Control Navigator, of the key controls that they are expected to have in place. Its purpose is to enable them to self-assess their internal control environment, assist them in identifying any controls that may need strengthening and support them in implementing and monitoring action plans to address control weaknesses. The Control Navigator checklist is reviewed annually to ensure that it remains relevant to the business and covers all applicable key controls. In addition, at each year-end, Group companies and other business units are required to:

- review their system of internal control, confirm whether it remains effective and report on any material weaknesses and the action being taken to address them; and
- review and confirm policies and procedures to promote compliance with the SoBC are fully embedded within the Group company or business unit and identify any material instances of non-compliance.

The results of these reviews are reported to the relevant Regional Audit and CSR Committees or to the Corporate Audit Committee and, where appropriate, to the Committee to ensure that appropriate remedial action has been, or will be, taken where necessary.

### SOx compliance oversight

Following the registration of Company securities under the US Securities Act of 1933, as amended (the Securities Act), the Company is subject to certain rules and regulations of US securities laws, including the Exchange Act and SOx. The Committee reviewed existing internal control processes to ensure compliance with the requirements of US securities laws which were immediately applicable upon completion of the acquisition of RAI. Outcomes following this review included amendments to the Audit Committee Terms of Reference and the Group AIP as detailed on page 67.

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

The Committee also has oversight of processes which are being put in place to ensure ongoing compliance with applicable US securities laws. SOx places specific responsibility on the Chief Executive and the Finance Director to certify or disclose information applicable to the financial statements, disclosure controls and procedures (DCP) and the internal control over financial reporting (ICFR).

Two committees have been established during 2017 to provide assurance with regard to applicable SOx certifications. A Disclosure Committee has been established for the purposes of reviewing the Company's financial statements for appropriate disclosure and designing and maintaining DCP. A sub-committee of the Disclosure Committee, the SOx Steering Committee, has also been established to provide assurance that ICFR has been designed, and is being implemented, evaluated and disclosed appropriately in accordance with applicable requirements. The activities of this sub-committee are directly reported to the Disclosure Committee. The output from the Disclosure Committee and SOx Steering Committee are presented to and reviewed by the Committee.

### Code of Ethics for the Chief Executive and Senior Financial Officers

In addition to the SoBC described further below, which applies to all staff of the Group, including senior management and the Board, the Company has adopted a Code of Ethics applicable to the Chief Executive, the Finance Director, and other senior financial officers performing similar functions, with effect from 25 July 2017, as required by US securities laws. The Code of Ethics includes obligations for those senior financial officers to act with honesty and integrity in the performance of their duties and to promote full, fair, accurate, timely and understandable disclosures in all reports and other documents submitted to the US Securities and Exchange Commission, the UK Financial Conduct Authority, and any other regulatory agency.

No waivers or exceptions to the Code of Ethics were granted in 2017.

### Internal audit function

The Group's internal audit function provides advice and guidance to the Group's businesses on best practices in risk management and control systems. It is also responsible for carrying out audit checks on Group companies, other business units, and in relation to key global processes and does so against an audit plan presented annually to the Committee, which focuses on higher risk areas or processes in relation to the Group's business. Following the acquisition of RAI, the internal audit function of RAI was integrated into the Group's internal audit function and its existing ways of working with effect from 1 January 2018, reporting directly into the Group Head of Audit.

### Financial reporting controls

The Group has in place a series of policies, practices and controls in relation to the financial reporting and consolidation process, which are designed to address key financial reporting risks, including risks arising from changes in the business or accounting standards and to provide assurance of the completeness and accuracy of the content of the Annual Report and Form 20-F.

A key area of focus is to assess whether the Annual Report and Form 20-F and financial statements are 'fair, balanced and understandable' in accordance with regulatory requirements, with particular regard to:

- Fair: Consistency of reporting between the financial statements and narrative reporting of Group performance and coverage of an overall picture of the Group's performance;
- Balanced: Consistency of narrative reporting of significant accounting judgements and key matters considered by the Committee with disclosures of material judgements and uncertainties noted in the financial statements; appropriate prominence and explanation of primary and adjusted measures; and
- Understandable: Clarity and structure of the Annual Report and Form 20-F and financial statements, appropriate emphasis of key messages, and use of succinct and focused narrative with strong linkage throughout the report, to provide shareholders with the information needed to assess the Group's business, performance, strategy and financial position.

The Group Manual of Accounting Policies and Procedures sets out the Group accounting policies, its treatment of transactions and its internal reporting requirements. The internal reporting of financial information to prepare the Group's half-yearly and year-end financial statements is signed off by the heads of finance responsible for the Group's markets and business units. The heads of finance responsible for the Group's markets and all senior managers must also confirm annually that all information relevant to the Group audit has been provided to the Directors and that reasonable steps have been taken to ensure full disclosure in response to requests for information from the external auditors.

The Chairman of the Committee participated in several internal Annual Report and Form 20-F drafting and review meetings, and engaged separately with the Finance Director during the drafting process.

The effectiveness of the Group's financial reporting controls are assessed as part of the Control Navigator exercise described on page 68 and evaluated by internal audit in the context of the annual audit plan.

### Group Standards of Business Conduct (SoBC)

The Committee is responsible for monitoring compliance with the SoBC, which underpins the Group's commitment to good corporate behaviour. The SoBC requires all staff to act with a high degree of business integrity, comply with applicable laws and regulations, and ensure that standards are never compromised for the sake of results. Every Group company and all staff worldwide, including senior management and the Board, are expected to live up to the SoBC. Guidance on the SoBC is provided across the Group, including through training and awareness programmes, described further on pages 28 and 32.

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

All Group companies have adopted the SoBC or local equivalent, with the exception of RAI Companies until 31 December 2017. The RAI Code of Conduct, adopted prior to acquisition and substantially in alignment with the SoBC, applied to RAI Companies for the full year 2017.

In the year to 31 December 2017, 183 instances of suspected improper conduct contrary to the SoBC were reported to the Committee (2016: 174) (excluding RAI Companies).

Of the instances reported (excluding RAI Companies), 78 were established as breaches and appropriate action taken (2016: 77). In 75 cases, an investigation found no wrongdoing (2016: 65). In 30 cases, the investigation continued at the year-end (2016: 32), including investigation, through external legal advisers, of allegations of misconduct.

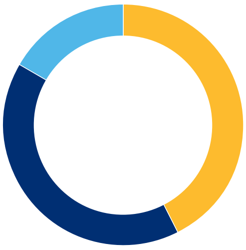
The SoBC and information on the total number of incidents reported under it in 2017 (including established breaches), is available at www.bat.com/sobc.

In respect of RAI Companies, in the year to 31 December 2017, 123 instances of suspected improper conduct contrary to the RAI Code of Conduct were reported (2016: 157). Of the instances reported, 65 were established as breaches and appropriate action taken (2016: 73). In 57 cases, an investigation found no wrongdoing (2016: 84). In one case, the investigation continued at the year-end (2016: none).

# Audit Committee continued

## SoBC

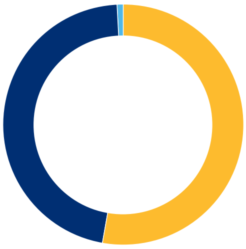
**BAT Group (excl. RAI Companies)**
Year to 31 December 2017



| | |
|---|---|
| Established breach of SoBC | 78 |
| No breach of SoBC | 75 |
| Ongoing investigation | 30 |
| **Total** | **183** |

## RAI Code of Conduct

**RAI Companies**
Year to 31 December 2017



| | |
|---|---|
| Established breach of Code of Conduct | 65 |
| No breach of Code of Conduct | 57 |
| Ongoing | 1 |
| **Total** | **123** |

The RAI Code of Conduct (applicable to RAI Companies until 31 December 2017), and information on the total number of incidents reported under it in 2017 (including established breaches), is available at http://www.reynoldsamerican.com/transforming-tobacco/ethics-and-compliance-resources.

RAI Companies adopted their localised version of the SoBC with effect from 1 January 2018, and any instances of suspected improper conduct contrary to their localised SoBC, and established breaches, will be reported on an aggregated Group basis from 2018 onwards.

## Whistleblowing

The SoBC also sets out the Group's whistleblowing policy, enabling staff, in confidence (and anonymously where they wish), to raise concerns without fear of reprisal, including concerns regarding accounting or auditing matters. The Group's whistleblowing policy is supplemented by local procedures throughout the Group (including RAI Companies) and at the Group's London headquarters, providing staff with further guidance on reporting matters and raising concerns, and the channels through which they can do so.

Following establishment of the Business Conduct & Compliance Department (discussed further at page 28), an extensive review of the Group's whistleblowing procedures was conducted and a new global whistleblowing hotline was deployed across the Group from January 2018, to offer staff additional channels through which any concerns can be raised or matters reported, in a language with which they are comfortable and anonymously where they wish.

Of the total number of business conduct incidents reported in 2017 set out above (excluding RAI Companies), 131 were brought to management's attention through whistleblowing reports from employees, ex-employees, third parties or unknown individuals reporting anonymously (2016: 115).

In respect of RAI Companies, of the total number of incidents reported under the RAI Code of Conduct in 2017 set out above, six were brought to the RAI board's attention under the RAI whistleblowing policy from employees, ex-employees, third parties or unknown individuals reporting anonymously (2016: 5).

The Committee is satisfied that the Group's policy and procedures enable proportionate and independent investigation of matters raised, and ensure that appropriate follow-up action is taken.

## Political contributions

The Group does not make contributions to European Union (EU) political organisations or incur EU political expenditure. The total amount of political contributions made to non-EU political parties in 2017 was £4,832,321 (2016: £20,208) as follows:

RAI Companies reported political contributions totalling £4,826,416 (US$6,221,250) for the full year 2017 to US political organisations, non-federal-level political party committees and to campaign committees of various non-federal candidates, in accordance with their contributions programme established prior to the acquisition of RAI by the Group. No corporate contributions were made to federal candidates or political party committees and all contributions were made in accordance with applicable laws.

All political contributions made by RAI Companies are assessed and approved in accordance with RAI's policies and procedures to ensure appropriate oversight and compliance with applicable laws.

In accordance with the US Federal Election Campaign Act, RAI Companies continue to support an employee-operated Political Action Committee (PAC), a non-partisan committee registered with the US Federal Election Commission that facilitates voluntary political donations by eligible employees of RAI Companies. According to US federal finance laws, the PAC is a separate segregated fund and is controlled by a governing board of individual employee-members of the PAC. In 2017, RAI Companies incurred expenses, as authorised by US law, in providing administrative support to the PAC.

Carreras Limited reported a contribution to the Jamaica Labour Party of £5,905 in 2017.

No other political contributions were reported.

## Annual review

The Financial Reporting Council's 'Guidance on Risk Management and Internal Control and Related Business Reporting' reflects the requirements of the Code regarding the applicability of, and compliance with, the Code's provisions with regard to issues of risk and internal control management and related financial and business reporting.

The processes described above, and the reports that they give rise to, enable the Board and the Committee to monitor the issue of risk and internal control management on a continuing basis throughout the year and to review its effectiveness at the year-end. The Board, with advice from the Committee, has completed its annual review of the effectiveness of that system for 2017.

No significant failings or weaknesses were identified and the Board is satisfied that, where areas for improvement were identified, processes are in place to ensure that remedial action is taken and progress is monitored. The Board is satisfied that the system of risk and internal control management accords with the Code.

# Nominations Committee

**Richard Burrows**
Chairman of the Nominations Committee

### Nominations Committee current members

| | |
|---|---|
| Richard Burrows (Chairman) | Savio Kwan |
| Sue Farr | Dr Pedro Malan |
| Ann Godbehere | Lionel Nowell, III |
| Dr Marion Helmes | Dimitri Panayotopoulos |
| Luc Jobin | Kieran Poynter |
| Holly Keller Koeppel | |

### Attendance at meetings in 2017

| | | Attended/Eligible to attend | |
|---|---|---|---|
| Name | Member since | Scheduled | Ad hoc |
| Richard Burrows | 2009 | 2/2 | 5/5 |
| Sue Farr[1(b)] | 2015 | 2/2 | 4/5 |
| Ann Godbehere | 2011 | 2/2 | 5/5 |
| Dr Marion Helmes | 2016 | 2/2 | 5/5 |
| Luc Jobin[2(b)] | 2017 | 0/0 | 2/2 |
| Holly Keller Koeppel[2(b)] | 2017 | 0/0 | 2/2 |
| Savio Kwan | 2014 | 2/2 | 5/5 |
| Dr Pedro Malan[1(c)] | 2015 | 2/2 | 3/5 |
| Dr Gerry Murphy[2(c)] | 2009–2017 | 1/1 | 2/2 |
| Lionel Nowell, III[2(b)] | 2017 | 0/0 | 2/2 |
| Dimitri Panayotopoulos | 2015 | 2/2 | 5/5 |
| Kieran Poynter | 2010 | 2/2 | 5/5 |

Notes:
1. Number of meetings in 2017: (a) the Committee held seven meetings, five of which were convened at short notice; (b) Sue Farr did not attend the November ad hoc meeting, convened at short notice, due to other commitments; and (c) Dr Pedro Malan did not attend the ad hoc meetings in July and November, convened at short notice, due to other commitments.
2. Membership: (a) all members of the Committee are independent in accordance with Code Provision B.2.1.; (b) Luc Jobin, Holly Keller Koeppel and Lionel Nowell, III became members of the Committee on 2 October 2017 following their appointment as Non-Executive Directors; and (c) Dr Gerry Murphy ceased to be a member of the Committee upon his retirement as a Non-Executive Director on 26 April 2017.
3. Other attendees: the Chief Executive, Group Human Resources Director and Group Head of Talent & Organisation Effectiveness regularly attend meetings by invitation but are not members.

**For the Committee's terms of reference see www.bat.com/governance**

## Role

### The Nominations Committee is responsible for:

– reviewing the structure, size and composition of the Board and Management Board to ensure both have an appropriate balance of skills, expertise, knowledge and (for the Board) independence;

– reviewing the succession plans for appointments to the Board and the Management Board, to maintain an appropriate balance of skills and experience;

– ensuring that the procedure for appointing Directors is rigorous, transparent, objective and merit-based, and has regard for diversity;

– making recommendations to the Board on suitable candidates for appointments to the Board and Management Board; and

– assessing the time needed to fulfil the roles of Chairman, Senior Independent Director and Non-Executive Director, and ensuring Non-Executive Directors have sufficient time to fulfil their duties.

### Key activities in 2017 – reviewing:

– Executive Directors' 2017 performance assessment;

– Non-Executive Director appointments of Luc Jobin, Holly Keller Koeppel and Lionel Nowell, III, discussed further below;

– Board Committee appointments, including recommending to the Board the appointment of Holly Keller Koeppel and Lionel Nowell, III to the Audit Committee, the appointment of Luc Jobin to the Remuneration Committee, and the appointment of each of them to the Nominations Committee, with effect from 2 October 2017 following their appointment as Non-Executive Directors;

– Directors' annual appointment and re-election at the AGM, discussed below;

– organisational changes to deliver the Group's strategic agenda, and making recommendations to the Board to:

  – appoint a new Chief Operating Officer for the Group's international business (excluding the United States), a new Chief Marketing Officer, and to make the other Management Board appointments discussed on page 59; and

  – reduce the number of Group Regions from four to three, and for each new Regional Director for the Group's international business to report to the Chief Operating Officer, with effect from 1 January 2018;

– the Nominations Committee effectiveness following the Board evaluation process, discussed further on pages 63 and 64;

– the Group Talent Strategy, talent development priorities and the key programmes underpinning the Group's commitment to investment in engaging, developing and retaining talent, including graduate recruitment initiatives;

– diversity initiatives to further develop a diverse and gender-balanced workplace, progress made in engaging, developing and retaining a diverse talent pool, and consideration of the findings and recommendations of the Parker Review Committee's Report into Ethnic Diversity of UK Boards;

– the results of the 2017 global 'Your Voice' survey of employee opinion across the Group;

– succession planning for the Board and for the Management Board, including to take account of the integration of RAI Companies and the Group's commitment to investing in the NGP portfolio; and

– the progress of bespoke development plans for candidates for Executive Director and Management Board roles (covering the key experience required for further progression, mentoring and education opportunities).

# Nominations Committee continued

## Board appointments

The Committee is responsible for identifying candidates for positions on the Board. This process includes an evaluation of the skills and experience to be looked for in candidates to ensure continuing Board balance and relevant experience. The selection process generally involves interviews with several candidates, using the services of independent, specialist external search firms to identify and shortlist appropriate candidates. The Committee is also responsible for implementing the Board Diversity Policy and monitoring progress towards achievement of its objectives, discussed further on page 62.

Following the acquisition of RAI, and pursuant to the Agreement and Plan of Merger with RAI, the Board appointed three new Non-Executive Directors, selected from a pool of Directors on the Board of RAI prior to acquisition.

The Committee identified Luc Jobin, Holly Keller Koeppel and Lionel Nowell, III for appointment as Non-Executive Directors following a rigorous assessment of the potential candidates' skills, expertise, experience, independence and consumer focus. The Committee also considered the candidates' diversity of ethnicity, nationality, gender and thinking styles, taking into account the principles now reflected in the Board Diversity Policy, and undertook an assessment of the Board's composition against peer company boards to identify areas for specific focus. The Committee considered each of the candidates in detail, and the Committee then proposed the recommended appointments to the Board.

This selection process was supported by Egon Zehnder, an independent executive search firm accredited under the Enhanced Code of Conduct for Executive Search Firms, including on gender diversity.

## Board retirements in 2017

Dr Gerry Murphy retired as a Non-Executive Director of the Company with effect from the conclusion of the Annual General Meeting on 26 April 2017.

## Terms of appointment to the Board

Details of the Directors' terms of appointment to the Board are contained in the Directors' Remuneration Policy, which is set out in full in the Remuneration Report 2015, contained in the Annual Report for the year ended 2015 available at www.bat.com.

The Executive Directors have rolling contracts of one year. The Non-Executive Directors do not have service contracts with the Company but instead have letters of appointment for one year. Their expected time commitment is 25–30 days per year.

The Board considers the need for it to refresh its membership progressively over time. Non-Executive Directors are normally expected to serve for up to six years, and any additional service beyond six years would be subject to rigorous review. Further details of Director appointments and the Company's policy on payments for loss of office are outlined in the Summary of our Directors' Remuneration Policy in the Remuneration Report.

## Annual General Meeting 2018

Ann Godbehere and Dr Pedro Malan will be retiring from the Board at the conclusion of this year's AGM on 25 April 2018. Ms Godbehere has served as a Non-Executive Director since October 2011, and Dr Malan has served as a Non-Executive Director since February 2015.

The Company will be submitting all other eligible Directors for re-election and, in the case of Luc Jobin, Holly Keller Koeppel and Lionel Nowell, III, election for the first time.

Prior to making recommendations to the Board in respect of Directors' submission for election or re-election (as applicable), the Committee carried out an assessment of each Non-Executive Director, including their continued independence.

In respect of the reappointment of Kieran Poynter, who will have served as a Non-Executive Director for just over seven years at the time of the 2018 AGM, the Committee conducted a particularly rigorous review, taking into account his performance as the Senior Independent Director and Chairman of the Audit Committee, his annual performance review, and his record of full attendance at meetings of the Board and Committees to which he is appointed. The performance review conducted as part of the Board evaluation process is discussed on page 64.

The Committee concluded that Mr Poynter contributed strongly to Board and Board Committee debate, offered valuable insight and constructive challenge, and continued to demonstrate his independence of thought and approach. Accordingly, the Committee considered it appropriate to recommend Mr Poynter's submission for re-election to the Board.

The Chairman's letter accompanying the AGM Notice confirms that all Directors being proposed for election or re-election (as applicable) are effective and that they continue to demonstrate commitment to their roles as Non-Executive Directors.

# Annual Statement on Remuneration

**Dimitri Panayotopoulos**
Chairman of the Remuneration Committee

## Index to our Remuneration Report



The following Annual Report on Remuneration has been prepared in accordance with the relevant provisions of the Companies Act 2006 and as prescribed in The Large and Medium-sized Companies and Group (Accounts and Reports) (Amendment) Regulations 2013 (the UK Directors' Remuneration Report Regulations). Where required and for the purpose of the audit conducted in accordance with International Standards on Auditing (ISA) data has been audited by KPMG LLP and this is indicated appropriately.

## Dear Shareholder

### Business context

2017 was a significant year for BAT with the acquisition of the remaining 57.8% of Reynolds American Inc. (RAI) the Group did not already own.

The acquisition creates a stronger, global tobacco and Next Generation Products company committed to delivering sustained long-term profit growth and returns. Work on integration is underway and the Remuneration Committee is provided with regular updates on remuneration related matters for the enlarged group.

### How remuneration aligns with Strategy

The Remuneration Committee believes that the Remuneration Policy adopted by our shareholders in April 2016 has continued to work effectively, as evidenced by a clear link between the performance of the Company and the reward outcomes generated.

The acquisition has however led the Remuneration Committee to determine to exercise its judgement, provided under our Policy, in respect of the impact of the RAI acquisition on incentives and the choice of performance metrics going forward. Both are articulated in full in the body of the Remuneration Report and are summarised below:

- The acquisition of the remaining shares in RAI on 25 July 2017 has an impact on the operation of the Company's in-progress short-term and long-term incentive schemes. As the transaction occurred in the second part of the year the Remuneration Committee has determined that:
  - RAI results will be stripped out entirely from the BAT 2017 short-term incentive (STI) performance scheme metrics. Consequently, the 2017 STI result will be based on BAT performance only.
  - RAI results will be stripped out entirely from the calculation of the adjusted revenue growth metric relating to the 2017 performance year within the 2015, 2016 and 2017 long-term incentive plan (LTIP) awards, and from the operating cash flow conversion metric relating to the 2017 performance year within the 2016 and 2017 LTIP awards. The 2017 performance of these two metrics will be based solely on BAT performance. No adjustments will be made in respect of the two EPS metrics or to the TSR metric for 2017 since the Remuneration Committee has concluded that they are neither necessary nor possible.
  - RAI results will be wholly reflected within the 2018 short-term incentive scheme and also within the 2018 performance year attaching to the 2016, 2017 and 2018 LTIP awards. In order to ensure that 2018 performance is compared on an appropriate like-for-like basis, the 2017 base period will be restated, where required, to include RAI results for the full year.
- The Remuneration Committee seeks to ensure that the performance metrics within the short and long-term incentive schemes continue to be aligned to objectives integral to the Company's long-term strategic vision. To that end it has decided to make some important changes to performance metrics for the 2018 short-term incentive scheme:
  - The introduction of a new value-creation metric measuring adjusted revenue growth of our Strategic Portfolio, with a 30% weighting attached to it. The Strategic Portfolio comprises our existing Global Drive Brands, combined with RAI's Strategic Brands – Camel, Natural American Spirit and Newport. Importantly, our Strategic Portfolio also includes our potentially reduced-risk products, including our key oral tobacco brands and NGP brands in vapour and THP, which are the focus of significant investment activity and therefore merit inclusion.
  - The new metric will replace the Global Drive Brand (GDB) & Key Strategic Brand (KSB) volume growth metric. The Group share of Key Markets metric is retained with a weighting reduced from 20% to 10%.
  - The adjusted profit from operations (APFO) and adjusted cash generated from operations (Adjusted CGFO) metrics retain their combined 60% weighting. However, the weight of Adjusted CGFO has increased to 30% (from 20%), with a compensatory reduction in APFO (weighting reduced from 40% to 30%), reflecting the importance attaching to cash generation in light of the RAI acquisition.

### The external environment

The Remuneration Committee is very aware of the continued debate on executive remuneration and corporate governance. This is placing increased focus on long-term alignment with shareholders and is emphasising the importance of taking account of executive compensation within a broader context, particularly in relation to a business' employees. The Board takes its corporate responsibilities very seriously. We are pleased to note that BAT has ranked in the upper quartile of the Institute of Directors' Good Governance Report. Our Sustainability Report provides further information on how we engage with stakeholders and on our corporate behaviour. Our People section highlights some of the actions we are taking to improve diversity in our business.

Our long-term incentive arrangements already provide for a five-year time horizon and our Executive Directors' shareholding requirements rank amongst the highest in the FTSE 100 with the Chief Executive required to hold five times his base salary in shares and our Finance Director three and a half times. Actual shareholdings far exceed these requirements with the Chief Executive owning over 13 times his base salary in BAT shares and the Finance Director over seven times.

# Annual Statement on Remuneration continued

The Remuneration Committee has followed and discussed the various contributions to the debate on executive pay and will continue to do so. As a broad principle we remain supportive of those initiatives that add transparency and focus on simplicity and internal consistency.

Taking these themes on board, we have taken the opportunity to review our Remuneration Report and have shortened it where possible and restructured the report which we hope readers will find helpful.

In March 2018, we will be publishing data relating to UK Gender Pay in line with statutory requirements. Upon reviewing the data prior to publication, the Committee noted that men and women are rewarded equally for similar roles, the Group does have a "gender pay gap" as defined by the UK legislation. This is largely a reflection of having more men than women in senior roles and the Group has a comprehensive set of diversity initiatives in place by way of which we will to continue to prioritise progress on this issue.

## How pay outcomes align with Group results

As highlighted earlier, our incentive arrangements are closely linked to our strategy and our performance metrics align with the key performance indicators stated in the Strategic Report.

The Group has once again delivered a strong set of results in 2017, building on the long-term strategic growth agenda across all key business metrics. Group revenue was up by 37.6%, or 2.9% on an adjusted organic basis at constant rates of exchange, driven by excellent volume performance and good pricing. Profit from operations increased by 39.1%. On an organic basis at constant rates of exchange APFO grew by 4%. Please refer to page 218 to 219 for definitions of these measures and a reconciliation of these measures to the most appropriate IFRS measure where applicable.

These results are reflected positively in the outcomes of the respective measures for both the STI and the LTIP. The corporate result for the STI across the four measures (Group share of Key Markets; GDB and KSB volumes; APFO; and Adjusted CGFO) was 81%. The 2015 LTIP award with KPIs representing EPS, TSR and adjusted revenue growth will vest in March 2017 at 96.1%. This vesting result is an accurate reflection of the sustained outstanding performance of the Company and bears testimony to the importance the Remuneration Committee attaches to maintaining a strong link between underlying performance and the outcomes of managerial incentive schemes. More details of these STI and LTIP outcomes are given in the short-term incentives and long-term incentives sections of this report.

## Individual performance adjustment factor

As part of the Remuneration Committee's discussions on the STI outcomes, in accordance with our Remuneration Policy consideration was given to the appropriate individual performance adjustment factor to the STI outcome based on Group performance.

The Remuneration Committee has concluded that both the Chief Executive and the Finance Director have both shown exceptional leadership during 2017. In particular the Remuneration Committee identified the following key achievements against challenging personal objectives in the year:

– The successful completion of the RAI acquisition, the biggest tobacco acquisition in history, and the major progress made integrating the RAI business into the BAT Group. This will deliver the benefits of this major strategic acquisition to shareholders over the medium to long term.

– Delivering strong results on an organic basis while continuing to invest in NGP brands over and above what was forecast. The management team have therefore delivered short-term success while positioning BAT's product offering to ensure long-term shareholder value growth.

Consequently, in the Committee's judgement, these outstanding personal performances merited the application of an individual adjustment factor of 20%. The impact of the performance adjustment factors are as follows:

– for the Chief Executive, an award of 202.6% of salary based on corporate performance is adjusted upwards by 20% based on our assessment of his individual performance, to 243.1% of base salary; and

– for the Finance Director, an award of 154.0% of salary based on corporate performance is adjusted upwards by 20% based on our assessment of his individual performance, to 184.8% of base salary.

## 2018 salaries

The Remuneration Committee considered salary increases for Executive Directors in the context of the level of pay increases for UK employees. These ranged between 0% and 7.3% based on performance in the prior year, with an average increase of 3%.

The Remuneration Committee also recognised the fact that the Group is now a significantly more complex organisation as a result of both the acquisition and organic growth, with increased profit from operations (up 39.1%), revenue (up 37.6%) and volumes (up 3.2%) from 2016, and noted the exceptional individual performance shown during the year.

In this context, the Remuneration Committee decided that the Executive Directors should receive salary increases within the range of those for our high performing UK employees. With effect from 1 April 2018 the Chief Executive's salary will be increased to £1,310,000 (+4.8%); and the Finance Director's salary will be increased to £924,000 (+3.5%).

## Our focus for 2018

During 2018 the Remuneration Committee will undertake a full review of our existing Remuneration Policy – taking into account the updated UK Corporate Governance Code and any further changes to regulations and guidance – in anticipation of presenting a new Policy for our shareholders to consider at our 2019 AGM.

**Dimitri Panayotopoulos**
Chairman, Remuneration Committee

21 February 2018

# Annual Report on Remuneration

## 1: Overview of what our Executive Directors earned in 2017 and why

### What our Executive Directors earned in 2017 – audited

| Single figure for Executive Directors | Salary £'000 | | Taxable benefits £'000 | | Short-term incentives £'000 | | Long-term incentives £'000 | | Pension £'000 | | Other emoluments £'000 | | Total £'000 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 | **2017** | 2016[1] | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 |
| Nicandro Durante | **1,235** | 1,190 | **218** | 235 | **3,039** | 2,975 | **6,590** | 3,535 | **307** | 352 | **34** | 26 | **11,423** | 8,313 |
| Ben Stevens | **887** | 867 | **167** | 100 | **1,650** | 1,647 | **3,602** | 1,969 | **305** | 309 | **16** | 18 | **6,627** | 4,910 |
| **Total** | **2,122** | 2,057 | **385** | 335 | **4,689** | 4,622 | **10,192** | 5,504 | **612** | 661 | **50** | 44 | **18,050** | 13,223 |

Note:
1. **Long-term incentives shown for 2016:** in accordance with the UK Directors' Remuneration Report Regulations, estimates for the values of the vesting 2014 LTIP awards were given in the Annual Report on Remuneration 2016; these amounts have been re-presented to show the actual market value on the date of vesting in 2017.

Further information in respect of this remuneration can be found in Section 2 on page 76.

### How this aligns to performance

**Short-term incentives for the performance period ended in 2017**

**Vesting at:**
**Chief Executive:** corporate performance – 202.6% of salary; individual performance – 40.5% of salary; total – 243.1% of salary
**Finance Director:** corporate performance – 154.0% of salary; individual performance – 30.8% of salary; total – 184.8% of salary

**Adjusted profit from operations (APFO)**
at constant rates of exchange
+4% organic growth[1]

**Global Drive Brands (GDBs) and Key Strategic Brands (KSBs)**
total volume
+7.5% organic growth

**Group share of Key Markets**
+40 bps

**Adjusted cash generated from operations (Adjusted CGFO)**
at constant rates of exchange
Exceeded the maximum performance level set by the Remuneration Committee

**Long-term incentives for the three year performance period ended in 2017**

**Vesting at 96.1%**

| | |
|---|---|
| **Total shareholder return (TSR)**<br>3 out of 23 in FMCG comparator group 2015–2017 | 100% achievement<br>(25% of award vesting out of possible 25%) |
| **Adjusted diluted earnings per share (EPS) growth**<br>11.0% CAGR at current rates of exchange | 100% achievement<br>(50% of award vesting out of possible 50%) |
| **Adjusted revenue growth[2]**<br>4.4% CAGR at constant rates of exchange | 84.4% achievement<br>(21.1% of award vesting out of possible 25%) |

Notes:
1. **Adjusted profit from operations:** performance is rounded to the nearest 1%.
2. **Adjusted revenue growth:** this measure was referred to as growth in net turnover in previous annual reports and has been updated to align with Group reporting practices. This change to the name of the measure has no impact on the performance measured or the targets used.

### Non-GAAP measures

Adjusted profit from operations (APFO), adjusted cash generated from operations (Adjusted CGFO), adjusted diluted EPS, adjusted revenue and operating cash flow conversion ratio are non-GAAP measures used by the Remuneration Committee to assess performance. Please refer to pages 218 to 222 for definitions of these measures and a reconciliation of these measures to the most directly comparable IFRS measure where applicable.

For the purposes of the Remuneration Report in relation to STI and LTIP performance measures, APFO, Adjusted CGFO, adjusted revenue and operating cash flow conversion ratio for 2017 are measured on an organic basis to exclude the impact of 2017 acquisitions and, in the case of APFO, Adjusted CGFO and operating cash flow conversion ratio, are further adjusted to exclude one-off payments related to the integration of RAI.

# Annual Report on Remuneration continued

## 2: Executive Directors' remuneration for the year ended 31 December 2017

### Total remuneration for the year ended 31 December 2017 – audited

| | Nicandro Durante | | Ben Stevens | | For further information |
|---|---|---|---|---|---|
| | 2017 £'000 | 2016 £'000 | 2017 £'000 | 2016 £'000 | |
| **Salary** | **1,235** | 1,190 | **887** | 867 | |
| **Taxable benefits**[1] | | | | | |
| – car allowance | **16** | 16 | **14** | 14 | |
| – health insurance | **6** | 8 | **9** | 8 | |
| – tax advice | **6** | 28 | **–** | – | |
| – use of company driver | **64** | 68 | **80** | 73 | |
| – home and personal security | **115** | 109 | **44** | 3 | |
| – other expenses related to individual and/or accompanied attendance at company functions/events | **11** | 6 | **20** | 2 | |
| **Total taxable benefits** | **218** | 235 | **167** | 100 | |
| **Short-term incentives** | | | | | |
| STI vesting percentage (% of maximum) | **97.2%** | 100% | **97.2%** | 100% | |
| STI: cash – Group performance element | **1,266** | 1,487.5 | **687.5** | 823.5 | |
| STI: cash – Individual performance adjustment factor | **507** | – | **275** | – | |
| STI: DSBS – Group performance deferred element | **1,266** | 1,487.5 | **687.5** | 823.5 | |
| **Total short-term incentives** | **3,039** | 2,975 | **1,650** | 1,647 | Page 77 |
| **Long-term incentives** | | | | | |
| LTIP vesting percentage (% of maximum) | **96.1%** | 46% | **96.1%** | 46% | |
| LTIP value to vest | **6,018**[2] | 3,242[3] | **3,289**[2] | 1,806[3] | |
| Dividend equivalent | **572** | 293[4] | **313** | 163[4] | |
| **Total long-term incentives** | **6,590** | 3,535 | **3,602** | 1,969 | Page 79 |
| **Total pension-related benefits** | **307** | 352[5] | **305** | 309 | Page 80 |
| **Other emoluments** | | | | | |
| Life insurance | **26** | 22 | **12** | 14 | |
| Share Reward Scheme (value of ordinary shares awarded) | **4** | 4 | **4** | 4 | |
| Sharesave Scheme (face value of discount on options granted) | **4**[6] | – | **–** | – | |
| **Total other emoluments** | **34** | 26 | **16** | 18 | |
| **Total remuneration** | **11,423** | 8,313 | **6,627** | 4,910 | |

Notes:

1. **Taxable benefits:** the figures shown are gross amounts as in line with the UK market; it is the normal practice of the Company to pay the tax which may be due on any benefits, with the exception of the car or car allowance. Ben Stevens' home and personal security benefit in 2017 includes costs associated with installation of a new home security system.
2. **LTIP award shown for 2017:** the 2015 LTIP award is due to vest on 27 March 2018 based on performance to 31 December 2017. The value shown is based on the average share price for the three-month period ended 31 December 2017 of 4,913.85p.
3. **LTIP award shown for 2016:** the values disclosed in the Annual Report on Remuneration for the year ended 31 December 2016 were estimated values as the award had not vested by the date of that report; these amounts have been re-presented based on the actual market value on the date of vesting of 28 March 2017 of 5,219p.
4. **LTIP dividend equivalent payments:** in prior years the values disclosed have been the dividend equivalent amount paid during the year being reported on. However, to improve this disclosure we now report the dividend equivalent payment that will attach to the LTIP award that is included in the Single Figure Table. The values for the year ended 31 December 2016 have been restated on this basis.
5. **Total pension-related benefits:** Nicandro Durante's pension-related benefits for the year ended 31 December 2016 have been re-presented in accordance with the UK Directors' Remuneration Report Regulations.
6. **Sharesave Scheme:** the value disclosed for the year ended 31 December 2017 represents the difference between the closing share price on the working day prior to the start of the invitation period (24 February 2017) of 5,070p, and the option price of 4,056p.

## Short-term incentives for the year ended 31 December 2017

### Timing of disclosures

The Remuneration Committee considers annually the question of commercial confidentiality and the sensitivity of bonus targets and results. This review is considered against a background of the Group operating in a highly consolidated industry and being the largest tobacco and potentially reduced-risk products business in the world outside China, with its two key competitors not subject to the same regulatory disclosures.

Specific performance measures, their weightings and actual performance/results achieved in 2017 are disclosed. The specific performance targets for each measure are considered to be commercially sensitive. The Remuneration Committee considers that its competitors would gain significant commercial insights into the Group's specific objectives and key priorities for its brands and markets if actual targets were disclosed year-on-year; such disclosure would be prejudicial to the interests of the Company and its shareholders.

The specific performance targets for each measure will only be disclosed retrospectively, at the earliest, in the Annual Report on Remuneration which relates to the period of 12 months after the end of the relevant STI performance period. It is expected that the specific Threshold and Maximum targets for the STI performance period ended 31 December 2017 will be published in March 2019 in the Annual Report on Remuneration for 2018.

**Disclosure of the specific targets for the STI in the year ended 31 December 2016, and the outcomes against those targets, are included on page 89.**

### STI performance measures, weightings and results for year ended 31 December 2017

| STI: performance measure | Description of measure 2017 | Actual performance 2017 |
|---|---|---|
| **Adjusted profit from operations (APFO)** (growth over prior year)<br>Weighting: 40%<br>**Strategic target or objective**<br>The medium- to long-term target is to grow adjusted profit from operations on average by 5–7% per year. | APFO is the adjusted profit from operations at constant rates of exchange for the year ended 31 December 2017. | APFO growth over the prior year of 4% on an organic basis.*<br>**Strategic Report: Delivering our strategy – Productivity**<br>* Performance is rounded to the nearest 1%. |
| **Group's share of Key Markets** (growth over prior year)<br>Weighting: 20%<br>**Strategic target or objective**<br>To continue to grow market share. | The Group's retail market share in its Key Markets accounts for around 80% of the volumes of the Group's subsidiaries. The Group's share is calculated from data supplied by retail audit service providers and is rebased as and when the Group's Key Markets change. When rebasing does occur, the Company will also restate history and provide fresh comparative data on the markets. | Global market share in key markets grew by 40bps.<br>**Strategic Report: Delivering our strategy – Growth** |
| **Global Drive Brands (GDB) and Key Strategic Brands (KSB) volumes** (growth over prior year)<br>Weighting: 20%<br>**Strategic target or objective**<br>To increase our GDB and KSB volumes faster than the rest of the portfolio. | GDB volumes comprise the cigarette volumes of Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans, and include volumes of the Fine Cut variants of those brands sold in Western Europe.<br>KSB volumes comprise the cigarette volumes of State Express 555 and Shuang Xi associated with the joint venture with China National Tobacco Corporation in China.<br>GDB and KSB volumes are assessed on an organic basis. | GDB and KSB volumes grew by 7.5% on an organic basis.<br>**Strategic Report: Delivering our strategy – Growth** |
| **Adjusted cash generated from operations (Adjusted CGFO)** (as against adjusted budget)<br>Weighting: 20%<br>**Strategic target or objective**<br>A specific target is set at each year for this measure with the aim to generate the optimal level cash flow while continuing to invest to support the short-, medium- and long-term requirements of the business. | Adjusted CGFO is defined as the net cash generated from operating activities, before the impact of adjusting items, dividends paid to non-controlling interests and received from associates, net interest paid and net capital expenditure.<br>Adjusted CGFO is measured at constant rates of exchange. | Adjusted CGFO exceeded the maximum performance level set by the Remuneration Committee.<br>**Strategic Report: Delivering our strategy – Productivity** |

# Annual Report on Remuneration continued

### Impact of the RAI acquisition on short-term incentives in 2017

Following the acquisition of the remaining shares of RAI the Group did not already own on 25 July 2017 the Committee has taken time to consider how the impact of this major acquisition should be treated for the purposes of the 2017 short-term incentive scheme. As a result of this review, the following treatments have been applied in respect of the RAI acquisition.

For all measures 2017 performance is based on organic BAT performance, excluding share, profit, cash and volumes from RAI (and other acquisitions). Further to this, consistent application dictates that all non-adjusting acquisition-related costs (such as capital expenditure and net financing costs) are also removed.

The Remuneration Committee believe this is the correct, fair and appropriate way to treat the acquisition of RAI.

### Consideration of individual performance adjustment factor

In addition to the Company-based STI corporate performance measures, the Remuneration Committee has also reviewed each Executive Director's personal performance against a weighted set of operational and strategic measures. These were agreed as their specific individual objectives at the beginning of the year and depend on the priorities for each Director's area of responsibility in the context of the delivery of Group strategy. Personal performance rated as 'Outstanding' can result in an adjustment factor of up to 20% to the corporate STI result but is subject to the applicable maximum award limit. Personal performance rated as 'Requires Improvement' results in any corporate STI result being reduced by 50%.

The Remuneration Committee exercised its discretion to rate the Executive Directors as follows: Chief Executive 'Outstanding' and Finance Director 'Outstanding'. These ratings resulted in the STI outcomes for both Executive Directors being increased by 20% to give a total short-term incentive result of 243.1% and 184.8% respectively. The Remuneration Committee has concluded that both the Chief Executive and the Finance Director have shown exceptional leadership during 2017. In particular the Remuneration Committee identified the following key achievements against challenging personal objectives in the year:

– The successful completion of the RAI acquisition, the biggest tobacco acquisition in history, and the major progress made integrating the RAI business into the BAT Group. This will deliver the benefits of this major strategic acquisition to shareholders over the medium to long-term.

– Delivering strong results on an organic basis while continuing to invest in NGP brands over and above what was forecast. The management team have therefore delivered short term success while positioning BAT's product offering to ensure long-term shareholder value growth.

### STI outcome for year ended 31 December 2017

| | Available STI award as % of base salary | Group % result | Individual performance adjustment factor % | STI award achieved % of base salary | **STI award achieved £'000 (Value shown in Single Figure Table)** |
|---|---|---|---|---|---|
| Nicandro Durante | 250% | 81% | 20% | 243.1% | **3,039** |
| Ben Stevens | 190% | 81% | 20% | 184.8% | **1,650** |

50% of the award in respect of the Group result will be paid in cash and 50% as an award of deferred ordinary shares under the DSBS. The award in respect of the individual performance adjustment factor will be paid in cash.

Note:
1. **DSBS:** awards made under the DSBS are in the form of free ordinary shares in the Company that normally vest after three years and no further performance conditions apply in that period. In certain circumstances, such as resigning before the end of the three-year period, participants may forfeit all of the shares. Malus-only provisions apply for DSBS share awards made from 2014 and clawback provisions operate from 2016 STI cash awards.

## Long-term incentives (LTIP) for the year ended 31 December 2017

### LTIP performance measures, weightings and results for the year ended 31 December 2017 – audited

| LTIP: performance measure | Description of measure and target for 2015 LTIP Performance period 1 January 2015 – 31 December 2017 | | Result achieved | Vesting percentage |
|---|---|---|---|---|
| **Relative TSR**[1] Relative to a peer group of international FMCG companies Weighting: 25% | 2015–2017 LTIP target | | Ranked 3 out of 23 (above upper quartile) | 25% (out of maximum of 25%) |
| | Threshold | At median, 6% vests | | |
| | Maximum | At upper quartile, 25% vests | | |
| **EPS growth** Compound annual growth in adjusted diluted EPS measured at current rates of exchange Weighting: 50% | 2015–2017 LTIP target | | 11.0% CAGR | 50% (out of maximum of 50%) |
| | Threshold | At CAGR of 5%, 8% vests | | |
| | Maximum | At CAGR of 10%, 50% vests | | |
| **Adjusted revenue growth**[2] Compound annual growth measured at constant rates of exchange Weighting: 25% | 2015–2017 LTIP target | | 4.4% CAGR | 21.1% (out of maximum of 25%) |
| | Threshold | At CAGR of 2%, 6% vests | | |
| | Maximum | At CAGR of 5%, 25% vests | | |
| **Underpin for adjusted revenue growth measure**[2] Measured at constant rates of exchange | The adjusted revenue growth measure can only vest provided the corresponding three-year CAGR of APFO exceeds the CAGR of the threshold performance level for APFO as approved annually in the STI and approved by the Board. | | The underpin was exceeded with reference to the APFO STI outcomes for 2015, 2016 and 2017. | |
| **Total vesting level** | | | | **96.1% vesting** |

Notes:
1. **Relative TSR:** the constituents of the FMCG peer group are listed on page 84.
2. **Adjusted revenue growth: this measure was referred to as growth in net turnover in previous annual reports and has been updated to align with Group reporting practices.** This change to the name of the measure has no impact on the performance measured or the targets used.

### Impact of the RAI acquisition on 2015 LTIP awards

Following the acquisition of the remaining shares of RAI the Group did not already own on 25 July 2017 the Committee has taken time to consider how the impact of this major acquisition should be treated for the purposes of the 2017 performance year within the 2015 LTIP award. As a result of this review, the following treatments have been applied in respect of the RAI acquisition.

- Relative TSR and EPS growth – no further adjustments were needed as the incremental costs and benefits associated with the acquisition are already factored into performance.
- Adjusted revenue growth and underpin – the 2017 performance year was measured based on organic BAT performance (excluding the impact of RAI and other 2017 acquisitions) to allow for a like-for-like comparison.

The Remuneration Committee believe this is the correct, fair and appropriate way to treat the acquisition of RAI.

### LTIP outcome for year ended 31 December 2017

| | Number of ordinary shares subject to award | Vesting % achieved (based on 2015–2017 performance period) | Number of ordinary shares to vest | Value of ordinary shares to vest[1] £'000 | Dividend equivalent payment on vesting[2] £'000 | **Total value to vest £'000 (Value shown in Single Figure Table)** |
|---|---|---|---|---|---|---|
| Nicandro Durante | 127,448 | 96.1% | 122,477 | 6,018 | 572 | **6,590** |
| Ben Stevens | 69,641 | 96.1% | 66,925 | 3,289 | 313 | **3,602** |

These LTIP awards are due to vest on 27 March 2018, and will become exercisable on that same date.

Notes:
1. The value of ordinary shares to vest shown above is based on the average share price for the three-month period ended 31 December 2017 of 4,913.85p.
2. The dividend equivalent amount shown above that will become payable on vesting is the value of the dividend equivalents accrued on the proportion of the award that is due to vest.

# Annual Report on Remuneration continued

## Executive Directors' pension entitlements and accruals for the year ended 31 December 2017 – audited

### Nicandro Durante

| Pension values | Accrued pension at year end 31 Dec 2017 £'000 | Additional value of pension on early retirement |
|---|---|---|
| UURBS (UK) | 142 | – |
| Total | 142 | – |

Nicandro Durante's **UURBS** pension entitlements are derived as follows:

(1) Effective from 1 March 2006 (being the date of his appointment as a member of the Management Board), an accrual of 0.65% for each year of service on a basic sterling salary comparable to that of a General Manager of Souza Cruz S.A. At retirement the pension will be based on a 12 months' average and will be provided through the UURBS.

(2) With effect from 1 January 2011 (being the date of his appointment as Chief Executive Designate), Nicandro Durante commenced an accrual of 2.5% for each year of service on a basic salary in excess of that stated in (1) above. At retirement the pension is based on a 12 months' average and will be provided through the UURBS.

Total accrued pension is the amount of pension that would be paid annually on retirement based on service to the end of the year.

**The pension-related benefits disclosed in the single figures for Executive Directors' remuneration represent Nicandro Durante's net accrual for the period, being the differential between his total pension entitlements as at 31 December 2016 (adjusted for inflation) and as at 31 December 2017, multiplied by 20 in accordance with the UK Directors' Remuneration Report Regulations.**

Nicandro Durante receives a pension in payment from the Fundação Albino Souza Cruz (FASC) from Souza Cruz S.A., a Brazilian registered wholly owned subsidiary of the Group. This pension benefit has been in payment since April 2012 and currently amounts to approximately £420,280 per annum (after adjusting for currency exchange) reflecting his 31 years' service at Souza Cruz.

### Ben Stevens

| Pension values | Accrued pension at year end 31 Dec 2017 £'000 | Additional value of pension on early retirement |
|---|---|---|
| British American Tobacco UK Pension Fund | 98 | – |
| UURBS (UK) | 311 | – |
| Total | 409 | – |

Ben Stevens joined the **UK Pension Fund** after 1989 and before the closure of its non-contributory defined benefit section to new members in April 2005. As a result, prior to 6 April 2006, he was subject to the HM Revenue & Customs cap on pensionable earnings (notionally £154,800 for the tax year 2017/8). In addition, he has an unfunded pension promise from the Company in respect of earnings above the cap on an equivalent basis to the benefits provided by the UK Pension Fund. This is provided through the UURBS. Further to the changes to the applicable tax regulations, Ben Stevens has reached his lifetime allowance of £1.8 million and therefore has ceased accrual in the Pension Fund with all future benefits being provided through membership of the UURBS. During the year, there has been no change to the overall pension entitlement of Ben Stevens.

**Total accrued pension** is the amount of pension that would be paid annually on retirement based on service to the end of the year.

**The pension-related benefits disclosed in the single figures for Executive Directors' remuneration represent Ben Stevens' net accrual for the period, being the differential between his total pension entitlements as at 31 December 2016 (adjusted for inflation) and as at 31 December 2017, multiplied by 20 in accordance with the UK Directors' Remuneration Report Regulations.**

These commitments are included in note 12 on the Accounts. UK Pension Fund members are entitled to receive increases in their pensions once in payment, in line with price inflation (as measured by the Retail Prices Index) up to 6% per annum.

**Note:**
1. **UK Pension Fund:** this is non-contributory. Voluntary contributions paid by an Executive Director and resulting benefits are not shown. No excess retirement benefits have been paid to or are receivable by an Executive Director or past Executive Director.

## Other information relating to our Chief Executive's remuneration for the year ended 31 December 2017

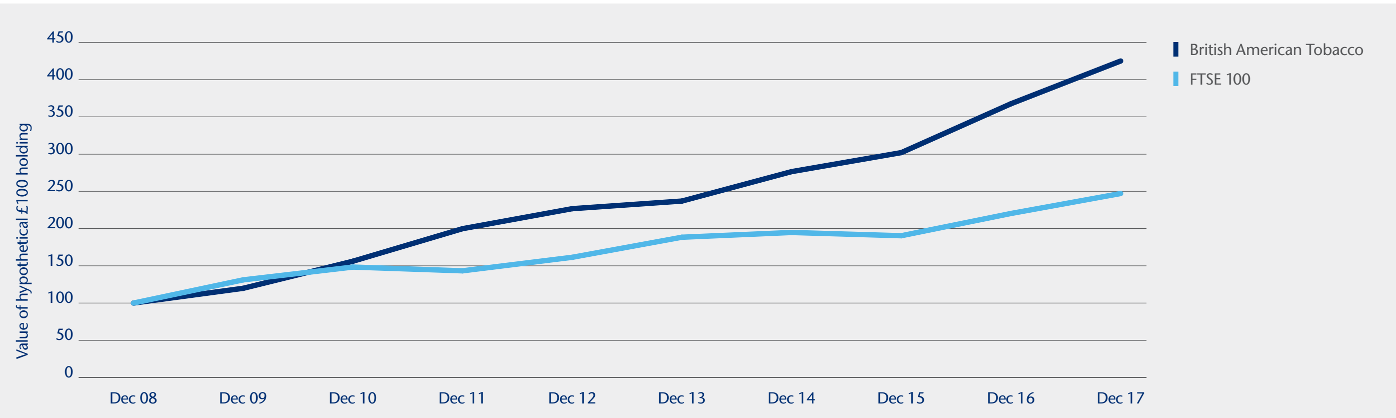
### Chief Executive's pay – comparative figures 2009 to 2017

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|
| **Chief Executive's 'single figure' of total remuneration (£'000)** | | | | | | | | | |
| Paul Adams[1] (to 28 February 2011) | 7,713 | 8,858 | 5,961 | n/a | n/a | n/a | n/a | n/a | **n/a** |
| Nicandro Durante[2] (from 1 March 2011) | n/a | n/a | 5,589 | 6,340 | 6,674 | 3,617 | 4,543 | 8,313[3] | **11,423** |
| **Annual bonus (STI) paid against maximum opportunity (%)** | | | | | | | | | |
| Paul Adams[1] (to 28 February 2011) | 67.7 | 87.0 | 100 | n/a | n/a | n/a | n/a | n/a | **n/a** |
| Nicandro Durante[2] (from 1 March 2011) | n/a | n/a | 100 | 85.0 | 81.3 | 73.2 | 100 | 100 | **97.2** |
| **Long-term incentive (LTIP) paid against maximum opportunity (%)** | | | | | | | | | |
| Paul Adams[1] (to 28 February 2011) | 100 | 100 | 100 | n/a | n/a | n/a | n/a | n/a | **n/a** |
| Nicandro Durante[2] (from 1 March 2011) | n/a | n/a | 100 | 87.1 | 49.2 | 0.0 | 8.7 | 46.0 | **96.1** |

**Notes:**

1. **Paul Adams:** (a) historic data is taken from the Remuneration Reports for the relevant years and is recast (as appropriate) on the basis of the 'single figure' calculation as prescribed in the UK Directors' Remuneration Report Regulations; (b) he retired as Chief Executive on 28 February 2011 which affected his STI and LTIP as follows in accordance with the rules of those schemes: (i) his STI for the year ended 31 December 2010 was paid as a 100% cash bonus instead of 50% in cash and 50% in deferred ordinary shares; (ii) the outstanding LTIP awards of ordinary shares vested immediately on his retirement either in full (2008 Award) or on a time-apportioned basis (2009 Award and 2010 Award); and (iii) the LTIP dividend equivalent payments for the LTIP awards which vested at his retirement were also paid in full and/or on a pro-rated time and performance basis.
2. **Nicandro Durante:** (a) historic data is taken from the Remuneration Reports for the relevant years and is recast (as appropriate) on the basis of the 'single figure' calculation as prescribed in the UK Directors' Remuneration Report Regulations; (b) he became Chief Executive on 1 March 2011 and his 'single figure' remuneration for the year ended 31 December 2011 has accordingly been time-apportioned.
3. **Long-term incentives 2016:** in accordance with the UK Directors' Remuneration Report Regulations, estimates for the values of the vesting 2014 LTIP awards were given in the Annual Report on Remuneration 2016; these amounts have been re-presented to show the actual market value on the date of vesting in 2017.

### Total shareholder return (TSR) performance: 1 January 2009 to 31 December 2017




**Note:**

1. **Performance and pay chart:** this shows the performance of a hypothetical investment of £100 in ordinary shares (as measured by the TSR for the Company) against a broad equity market index (the FTSE 100 Index) over a period of nine financial years starting from 1 January 2009 through to 31 December 2017 based on 30-trading-day average values. A local currency basis is used for the purposes of the TSR calculation making it consistent with the approach to TSR measurement for the LTIP.

# Annual Report on Remuneration continued

### Percentage change in the Chief Executive's remuneration

The following table shows the percentage change in the Chief Executive's remuneration measured against a comparator group comprising the UK employee population on UK employment contracts (2017: 2,202; 2016: 2,022 individuals[1]). This comparator group is considered to be the most appropriate group as Executive Directors are employed on UK contracts. Using a more widely drawn group encompassing the worldwide nature of the Group's business would also present practical difficulties in collation as well as presenting a less relevant comparator given the significant variations in employee pay across the Group and the differing economic conditions and wide variations in gross domestic product per capita.

| | Base salary | | | Taxable benefits | | | Short-term incentives | | |
|---|---|---|---|---|---|---|---|---|---|
| | **2017 £'000** | 2016 £'000 | Percentage change % | **2017 £'000** | 2016 £'000 | Percentage change % | **2017 £'000** | 2016 £'000 | Percentage change % |
| Nicandro Durante (Chief Executive) | 1,235 | 1,190 | 3.8 | 218 | 235 | -7.2 | 3,039 | 2,975 | 2.2 |
| UK-based employees | 70 | 70 | 1.0 | 4 | 4 | -5.2 | 23 | 25 | -7.9 |

**Notes:**
**UK-based employees:**
1. The 1.0% increase to average base salary and the decrease in average taxable benefits and short-term incentive awards for UK-based employees is due to an increase in the proportion of more junior staff within the population. UK-based employees were awarded performance-based pay increases in 2017 in the range 0% to 8% with an average of around 3%.
2. The data for this comparator group is made up as follows as at 31 December 2017: (1) the weighted average base salaries; (2) the average taxable benefits per grade; and (3) an estimated weighted average target bonus based on that population as at that date.

## 3: Executive Directors' Remuneration for the upcoming year

### Base salary for 2018

The Remuneration Committee has determined the following salaries for the Executive Directors

| Executive Directors – salaries | **Base salary from 1 Apr 2018 £** | Percentage change % | Base salary from 1 Apr 2017 £ |
|---|---|---|---|
| Nicandro Durante | **1,310,000** | 4.8 | 1,250,000 |
| Ben Stevens | **924,000** | 3.5 | 893,000 |

The Remuneration Committee considered salary increases for Executive Directors in the context of the level of pay increases for UK employees. These ranged between 0% and 7.3% based on performance in the prior year, with an average increase of 3%.

The Remuneration Committee also recognised the fact that the Group is now a significantly more complex organisation as a result of both the RAI acquisition and organic growth, with increased profit from operations (up 39.1%), revenue (up 37.6%) and volumes (up 3.2%) from 2016, and noted the exceptional individual performance shown during the year.

### Benefits and pension

No changes to the provision of benefits or pension are proposed for 2018.

### Short-term incentives for 2018 onwards, including the impact of the RAI acquisition

Under the provisions of flexibility afforded to it in order to enable the practical implementation of our Remuneration Policy, the Remuneration Committee has undertaken a review of the current STI performance metrics in conjunction with management.

Following this exercise, it has decided to make a number of changes to the metrics and their weightings applicable for the forthcoming 2018 STI performance year. In so doing, the Remuneration Committee has concluded that such changes will improve incentivisation of business outcomes that are aligned to the Group's immediate and longer-term strategic objectives.

In addition, the Committee has taken time to consider how the impact of the RAI acquisition should be treated for the purposes of the short-term incentive scheme for 2018 and beyond.

Further to the new metric design outlined on below, RAI will be an operationally fully integrated unit within the Group for the whole of 2018. Management will be fully accountable for RAI performance in 2018 and consequently we are of the view that the performance ranges for 2018 metrics will fully reflect that all-inclusive basis.

The table below sets out the current metric design and weightings alongside the design that will apply for 2018, together with the key reasons driving change:

| From | | To | |
|---|---|---|---|
| **Current STI metrics & weightings** | | **2018 STI metrics & weightings** | |
| Group share of key markets | 20% | Group share of key markets | 10% |
| Global Drive Brands (GDB) & Key Strategic Brands (KSB) volumes | 20% | Adjusted revenue growth of Strategic Portfolio[1] | 30% |
| Adjusted profit from operations (APFO) | 40% | APFO[2] | 30% |
| Adjusted cash generated from operations (Adjusted CGFO) | 20% | Adjusted CGFO[2] | 30% |
| **Total** | **100%** | **Total** | **100%** |

Notes:

1. The most significant change is in respect of the introduction of a new metric, adjusted revenue growth of our Strategic Portfolio. This Strategic Portfolio is comprised of the following core strategic categories – both cigarette brands and potentially reduced-risk brands – in our portfolio:

| Strategic Portfolio Definition for STI from 2018<br>Cigarette brands: | Potentially reduced-risk product brands: |
|---|---|
| 1. GDBs: Dunhill, Kent, Lucky Strike, Pall Mall, Rothmans | 1. Vapour Brands |
| 2. RAI Strategic Brands: Camel, Natural American Spirit, Newport | 2. THP Brands |
| | 3. Moist Snuff Brands (Grizzly and Kodiak) |
| | 4. Snus Brands (including Epok) |

Adjusted revenue growth for this portfolio is a central value driver for the business from both current and longer-term strategic perspectives and its inclusion within the 2018 STI award, with what we consider to be a very significant weighting attached, acknowledges the need for this objective form part of our incentive design.

The GDB and KSB volume objective, which has served to concentrate focus on the key brands and drive value as well as volume growth in our brand portfolio, makes way for our new objective. Adjusted revenue growth in this Strategic Portfolio will enable a simultaneous focus on growth in both the core cigarette GDB categories (including new key strategic brands at RAI) and in our fast-growing potentially reduced-risk portfolio.

In order to attach what the Remuneration Committee considers to be the appropriate weight to this new metric, it has decided to reduce the weighting of the Group share of key markets metric, from 20% to 10% for 2018.

2. The overall weight attached to the financial metrics – adjusted profit from operations and cash generated from operations – within the STI remains constant at 60%. However, in light of the acquisition during the year of the remaining shares in RAI, the Remuneration Committee concluded that a marginal uplift in the weight attached to the Adjusted CGFO metric, from 20% to 30% was both appropriate and desirable.

Further detail is included in the description of the STI measures for the year ended 31 December 2017 on page 77.

# Annual Report on Remuneration continued

## Long-term incentives for 2018 onwards, including the impact of the RAI acquisition on 2018 LTIP awards

The performance measures and weightings for the LTIP award to be granted in 2018 will remain unchanged from those for 2017 awards.

The Committee remains satisfied that the current EPS growth targets remain appropriately challenging given the increasing future investment in Next Generation Products.

The Committee has taken time to consider how the impact of the RAI acquisition should be treated for the purposes of the long-term incentive scheme for 2018 awards and beyond.

– Relative TSR, EPS growth and operating cash flow conversion ratio – no adjustment to performance measurement of 2018 is required. Performance will include the impact of RAI (and other 2017 acquisitions).

– Adjusted revenue growth – performance for 2018 will include the contribution of RAI (and other 2017 acquisitions) as management are wholly responsible for that performance. To allow for a like-for-like comparison with 2018, the 2017 base year will also include the full year of revenue from RAI (and other 2017 acquisitions).

The measures and targets for 2018 LTIP awards are set out below:

| LTIP measures and performance ranges | | | | | % of award vesting at maximum | % of award vesting at threshold |
|---|---|---|---|---|---|---|
| **Relative TSR**<br>Median performance vs. FMCG peer group to upper quartile.<br>The current constituents of the FMCG peer group as at the date of this report are: | | | | | 20 | 3 |
| Anheuser-Busch InBev | Danone | Johnson & Johnson | Nestlé | Reckitt Benckiser | | |
| Campbell Soup | Diageo | Kellogg | PepsiCo | Unilever | | |
| Carlsberg | Heineken | Kimberly Clark | Pernod Ricard | | | |
| Coca-Cola | Imperial Brands | LVMH | Philip Morris International | | | |
| Colgate-Palmolive | Japan Tobacco | Mondelēz International | Procter & Gamble | | | |
| **EPS growth at current exchange rates**<br>5%–10% compound annual growth in adjusted diluted EPS over the performance period | | | | | 20 | 3 |
| **EPS growth at constant exchange rates**<br>5%–10% compound annual growth in adjusted diluted EPS over the performance period | | | | | 20 | 3 |
| **Adjusted revenue growth**<br>3%–5% compound annual growth over the performance period | | | | | 20 | 3 |
| **Operating cash flow conversion ratio**<br>Ratio of 85%–95% over the performance period at current exchange rates | | | | | 20 | 3 |
| **Total** | | | | | **100** | **15** |

## 4: Chairman and Non-Executive Directors' remuneration for the year ended 31 December 2017– audited

The following table shows a single figure of remuneration for the Chairman and Non-Executive Directors in respect of qualifying services for the year ended 31 December 2017 together with comparative figures for 2016.

| | Base fee[3] £'000 | | Chair/Committee membership fees[3] £'000 | | Taxable benefits[1] £'000 | | Total remuneration £'000 | |
|---|---|---|---|---|---|---|---|---|
| | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 | **2017** | 2016 |
| Chairman | | | | | | | | |
| **Richard Burrows** | **660** | 645 | **–** | – | **129** | 106 | **789** | **751** |
| Non-Executive Directors | | | | | | | | |
| **Sue Farr** | **93** | 93 | **19** | 13 | **1** | 1 | **113** | **107** |
| **Ann Godbehere** | **93** | 93 | **19** | 18 | **1** | 1 | **113** | **112** |
| **Marion Helmes** (from 1 August 2016) | **93** | 39 | **19** | 5 | **12** | 5 | **124** | **49** |
| **Luc Jobin** (from 25 July 2017) | **40** | – | **6** | – | **18** | – | **64** | **–** |
| **Holly Keller Koeppel**[2] (from 25 July 2017) | **40** | – | **6** | – | **20** | – | **66** | **–** |
| **Savio Kwan** | **93** | 93 | **19** | 13 | **51** | 37 | **163** | **143** |
| **Pedro Malan** | **93** | 93 | **19** | 13 | **49** | 44 | **161** | **150** |
| **Lionel Nowell, III**[2] (from 25 July 2017) | **40** | – | **6** | – | **5** | – | **51** | **–** |
| **Dimitri Panayotopoulos** | **93** | 93 | **44** | 19 | **24** | 4 | **161** | **116** |
| **Kieran Poynter** | **93** | 93 | **79** | 48 | **14** | – | **186** | **141** |
| Retired Non-Executive Directors | | | | | | | | |
| **Karen de Segundo** (to 27 April 2016) | **–** | 30 | **–** | 10 | **–** | – | **–** | **40** |
| **Christine Morin-Postel** (to 6 December 2016) | **–** | 86 | **–** | 59 | **–** | 11 | **–** | **156** |
| **Gerry Murphy** (to 26 April 2017) | **31** | 93 | **4** | 13 | **–** | 1 | **35** | **107** |
| **Richard Tubb** (to 27 April 2016) | **–** | 30 | **–** | 4 | **–** | 20 | **–** | **54** |
| **Total** | **1,462** | 1,481 | **240** | 215 | **324** | 230 | **2,026** | **1,926** |

**Notes:**

1. **Benefits:** the Chairman's benefits in 2017 comprised: health insurance and 'walk-in' medical services £17,000 (2016: £14,000); the use of a company driver £63,000 (2016: £69,000); home and personal security in the UK and Ireland, including installation costs £13,000; (2016: £6,000); hotel accommodation and related expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or corporate events £29,000 (2016: £9,000); and commuting flights to London £7,000 (2016: £8,000). The benefits for the other Non-Executive Directors principally comprised travel-related expenses incurred in connection with individual and/or accompanied attendance at certain business functions and/or events and 'walk-in' medical services. The figures shown are grossed-up amounts (as appropriate) as, in line with the UK market, it is the normal practice of the Company to pay the tax that may be due on any benefits. Christine Morin-Postel's benefits in 2016 have been restated to include £2,000 travel-related expenses that were incurred in 2016.
2. **Deferred Compensation Plan for Directors of RAI (DCP):** as former outside directors of RAI, Holly Keller Koeppel and Lionel Nowell, III each participated in the DCP under which they could elect to defer payment of a portion of their RAI retainers and meeting attendance fees to an RAI stock account, a cash account, or a combination of both. Following the acquisition of RAI by BAT, amounts deferred to a stock account (Deferred Stock Units or DSUs) mirror the performance of, and receive dividend equivalents based on, BAT ADSs. Amounts deferred to a cash account earn quarterly interest at the prime rate as set by JPMorgan Chase Bank. The respective DSUs of Holly Keller Koeppel and Lionel Nowell, III are disclosed as a note to 'Summary of Directors' share interests' below. The deferred cash account for Lionel Nowell, III showed a balance of US$119,824 at 31 December 2017 (25 July 2017: US$117,597). DSUs and cash deferred under the DCP will be paid to the two Directors in accordance with the terms of the DCP, section 409A of the US Internal Revenue Code of 1986 and each Director's existing deferral elections.
3. **Committee memberships:** are shown, together with changes during the year, in the reports of the respective committees in the Governance sections of the Directors' Report.
4. **Non-Executive Directors' fees structure 2017:** are set out in the table below.

| | Fees from 1 May 2017 £ | Fees to 30 April 2017 £ |
|---|---|---|
| Base fee | **92,700** | 92,700 |
| Senior Independent Director – supplement | **36,000** | 32,000 |
| Audit Committee: Chairman | **36,000** | 32,000 |
| Audit Committee: Member | **11,000** | 7,000 |
| Nominations Committee: Chairman | **–** | – |
| Nominations Committee: Member | **11,000** | 7,000 |
| Remuneration Committee: Chairman | **36,000** | 32,000 |
| Remuneration Committee: Member | **11,000** | 7,000 |

## Chairman and Non-Executive Directors' fees and remuneration for the upcoming year

As described in the Annual Report on Remuneration for the year ended 31 December 2016, the Chairman's fee was increased from £645,000 to £665,000 from 1 April 2017. In keeping with the level of pay awards granted to UK employees based on a 3% increase in budget, the Remuneration Committee determined the Chairman's fee will be £685,000 with effect from 1 April 2018 (+3%).

The fees for Non-Executive Directors' fees are scheduled to be reviewed in April 2018 with any changes being effective from 1 May 2018.

# Annual Report on Remuneration continued

## 5: Directors' share interests

### Summary of Directors' share interests – audited

| | Ordinary shares held at 31 Dec 2017[1] | Outstanding scheme interests 31 Dec 2017: Unvested awards subject to performance measures and continued employment (LTIP) | Unvested awards subject to continued employment only (DSBS) | Unvested interests (Sharesave) | Total ordinary shares subject to outstanding scheme interests | Total of all interests in ordinary shares at 31 Dec 2017 |
|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | |
| Nicandro Durante[1,3] | **255,982** | 382,158 | 77,654 | 912 | 460,724 | **716,706** |
| Ben Stevens[2,3] | **84,363** | 199,542 | 48,005 | 1,038 | 248,585 | **332,948** |
| **Chairman** | | | | | | |
| Richard Burrows | 15,000 | | | | | **15,000** |
| **Non-Executive Directors** | | | | | | |
| Sue Farr | – | | | | | **–** |
| Ann Godbehere[4] | 3,100 | | | | | **3,100** |
| Marion Helmes | 4,500 | | | | | **4,500** |
| Luc Jobin[4,6] | 45,236 | | | | | **45,236** |
| Holly Keller Koeppel[4,5,6] | 8,416 | | | | | **8,416** |
| Savio Kwan[3] | 6,292 | | | | | **6,292** |
| Pedro Malan | – | | | | | **–** |
| Lionel Nowell, III[4,5,6] | 17,436 | | | | | **17,436** |
| Dimitri Panayotopoulos | 3,300 | | | | | **3,300** |
| Kieran Poynter | 5,000 | | | | | **5,000** |

Notes:
1. **Nicandro Durante:** ordinary shares held include 2,088 held by the trustees of the BAT Share Incentive Plan (SIP).
2. **Ben Stevens:** ordinary shares held include 547 held by the trustees of the SIP.
3. **Changes from 31 December 2017:** (a) Nicandro Durante – purchases of 3 ordinary shares on 3 January 2018 and 3 ordinary shares on 7 February 2018 under the SIP; acquisition of 995 ordinary shares on 8 February 2018 as a result of reinvestment of dividend income in the Vested Share Account; acquisition of 20 ordinary shares on 8 February 2018 as a result of reinvestment of dividend income under the SIP and acquisition of 1,410 ordinary shares on 13 February 2018 as a result of reinvestment of dividend income by Mrs Durante; (b) Ben Stevens – purchases of 3 ordinary shares on 3 January 2018 and 3 ordinary shares on 7 February 2018 under the SIP; acquisition of 5 shares on 8 February 2018 as a result of reinvestment of dividend income under the SIP; and (c) Savio Kwan – purchase of 60 ordinary shares as a result of the reinvestment of dividend income on 14 February 2018. There were no changes in the interests of the Chairman and the other Non-Executive Directors.
4. **American Depositary Shares (ADSs):** each of the interests in ordinary shares held by Ann Godbehere, Luc Jobin, Holly Keller Koeppel and Lionel Nowell, III consist of an equivalent number of BAT ADSs each of which represents one ordinary share in the Company.
5. **Deferred Stock Units (DSUs):** at the date of this report the following Non-Executive Directors, each being a former director of RAI and a participant in the Deferred Compensation Plan for Directors of RAI (DCP), hold DSUs which were granted prior to becoming a Director of the Company – (a) Holly Keller Koeppel 20,568.87 DSUs (31 December 2017: 20,392.01 DSUs); and (b) Lionel Nowell, III 37,330.63 DSUs (31 December 2017: 37,009.65 DSUs). Each DSU entitles the holder to receive a cash payment following ceasing to be a Director equal to the value of one BAT ADS. The number of DSUs will increase on each dividend date by reference to the value of dividends declared on the ADSs underlying the DSUs.
6. **Director changes during 2017:** Gerry Murphy retired on 26 April 2017; Luc Jobin, Holly Keller Koeppel and Lionel Nowell, III each appointed on 25 July 2017.

### Executive Directors' shareholding guidelines

Executive Directors are encouraged to build up a high level of personal shareholding to ensure a continuing alignment of interests with shareholders. The shareholding guidelines require Executive Directors to hold ordinary shares equal to the value of a percentage of salary as set out in the table below.

| | Shareholding requirements (% of base salary 31 Dec 2017) | No. of eligible ordinary shares held at 31 Dec 2017 | Value of eligible ordinary shares held at 31 Dec 2017[1] £m | Actual percentage (%) of base salary at 31 Dec 2017 |
|---|---|---|---|---|
| Nicandro Durante | 500 | **331,548** | **16.6** | **1,331.0** |
| Ben Stevens | 350 | **131,821** | **6.6** | **740.7** |

Eligibility of shares: (a) unvested ordinary shares under the DSBS, which represent deferral of earned bonus, are eligible and count towards the requirement; (b) unvested ordinary shares under the LTIP are not eligible and do not count towards the requirement during the performance period, but the estimated notional net number of ordinary shares held during the LTIP Extended Vesting Period are eligible and will count towards the requirement; and (c) ordinary shares held in trust under the all-employee share ownership plan (SIP) are not eligible and do not count towards the shareholding requirement.

Notes:
1. **Value of ordinary shares shown above:** this is based on the closing mid-market share price on 29 December 2017 (being the last trading day of the year) of 5,018p.
2. **Meeting the guidelines:** if an Executive Director does not, at any time, meet the requirements of the shareholding guidelines, the individual may, generally, only sell a maximum of up to 50% of any ordinary shares vesting (after tax) under the Company share plans until the threshold required under the shareholding guidelines has been met.
3. **Waiver of compliance with guidelines:** this is permitted with the approval of the Remuneration Committee in circumstances where a restriction on a requested share sale could cause undue hardship. No such applications were received from the Executive Directors during 2017.

Non-Executive Directors are not subject to any formal shareholding requirements although they are encouraged to build a small interest in ordinary shares during the term of their appointment.

## Executive Directors' outstanding scheme interests – audited

| | Plan | At 1 Jan 2017 | Awarded in 2017 | Lapsed in 2017 | Exercised/ released in 2017 | At 31 Dec 2017 | Exercise price (p) | End of performance period | Date from which exercisable or shares released |
|---|---|---|---|---|---|---|---|---|---|
| **Nicandro Durante** | LTIP[1] | 135,052 | | 72,929 | 62,123 | – | | 31 Dec 16 | 28 Mar 17 |
| | LTIP[2] | 127,448 | | | | 127,448 | | 31 Dec 17 | 27 Mar 18 |
| | LTIP[3] | 140,529 | | | | 140,529 | | 31 Dec 18 | 12 May 21 |
| | LTIP[3] | | 114,181 | | | 114,181 | | 31 Dec 19 | 27 Mar 22 |
| | DSBS | 27,466 | | | 27,466 | – | | | 28 Mar 17 |
| | DSBS | 19,419 | | | | 19,419 | | | 27 Mar 18 |
| | DSBS | 29,690 | | | | 29,690 | | | 29 Mar 19 |
| | DSBS | | 28,545 | | | 28,545 | | | 27 Mar 20 |
| | Sharesave | 591 | | | 591 | – | 2,536 | | 1 May 17 |
| | Sharesave | 543 | | | | 543 | 2,787 | | 1 Oct 19 |
| | Sharesave | | 369 | | | 369 | 4,056 | | 1 May 22 |
| **Ben Stevens** | LTIP[1] | 75,230 | | 40,625 | 34,605 | – | | 31 Dec 16 | 28 Mar 17 |
| | LTIP[2] | 69,641 | | | | 69,641 | | 31 Dec 17 | 27 Mar 18 |
| | LTIP[3] | 71,669 | | | | 71,669 | | 31 Dec 18 | 12 May 21 |
| | LTIP[3] | | 58,232 | | | 58,232 | | 31 Dec 19 | 27 Mar 22 |
| | DSBS | 18,356 | | | 18,356 | – | | | 28 Mar 17 |
| | DSBS | 12,732 | | | | 12,732 | | | 27 Mar 18 |
| | DSBS | 19,468 | | | | 19,468 | | | 29 Mar 19 |
| | DSBS | | 15,805 | | | 15,805 | | | 27 Mar 20 |
| | Sharesave | 543 | | | | 543 | 2,787 | | 1 Oct 19 |
| | Sharesave | 495 | | | | 495 | 3,026 | | 1 May 20 |

**Notes:**
1. Details of the performance condition for the LTIP award granted in 2014 (which vested during 2017), and of achievement against that condition in the period to 31 December 2016, was set out in the Annual Report on Remuneration for the year ended 31 December 2016.
2. Details of the performance condition attached to 2015 LTIP awards, and of achievement against that condition in the period to 31 December 2017, are set out on page 79.
3. Details of the performance condition attached to 2016 and 2017 LTIP awards are set out on page 88.

## Further details in relation to scheme interests granted during the year ended 31 December 2017

| | Plan | Ordinary shares awarded | Price per ordinary share at award[1] | Face value of award £'000 | Exercise price | Proportion of award vesting for threshold performance (%) | Performance period | Date from which exercisable or shares released |
|---|---|---|---|---|---|---|---|---|
| **Nicandro Durante** | LTIP[2] | 114,181 | 5,211p | 5,950 | n/a | 15 | 2017–2019 | 27 Mar 22 |
| | DSBS[3] | 28,545 | 5,211p | 1,487.5 | n/a | n/a | n/a | 27 Mar 20 |
| **Ben Stevens** | LTIP[2] | 58,232 | 5,211p | 3,034 | n/a | 15 | 2017–2019 | 27 Mar 22 |
| | DSBS[3] | 15,805 | 5,211p | 823.5 | n/a | n/a | n/a | 27 Mar 20 |

**Notes:**
1. The price per ordinary share is the price used to determine the number of ordinary shares subject to the awards, which is calculated as the average of the closing mid-market price of an ordinary share over the three dealing days preceding the date of grant.
2. Details of the performance condition attached to these LTIP awards are set out on page 88.
3. These DSBS awards were granted to deliver 50% of the annual bonus earned for the year ended 31 December 2016, details of which are set out on page 89.

# Annual Report on Remuneration continued

## Further details in relation to performance conditions attaching to outstanding scheme interests

| | LTIP award granted in 2016 | | | LTIP award granted in 2017 | | |
|---|---|---|---|---|---|---|
| | 1 January 2016–31 December 2018 | | | 1 January 2017–31 December 2019 | | |
| | Weighting | Threshold | Maximum | Weighting | Threshold | Maximum |
| **Relative TSR**<br>Ranking against a peer group of international FMCG companies | 20% | At median, 3% of award vests | At upper quartile, 20% of award vests | **20%** | **At median, 3% of award vests** | **At upper quartile, 20% of award vests** |
| **EPS growth at current exchange rates**<br>Compound annual growth in adjusted diluted EPS measured at current rates of exchange | 20% | At 5% CAGR, 3% of award vests | At 10% CAGR, 20% of award vests | **20%** | **At 5% CAGR, 3% of award vests** | **At 10% CAGR, 20% of award vests** |
| **EPS growth at constant exchange rates**<br>Compound annual growth in adjusted diluted EPS measured at constant rates of exchange | 20% | At 5% CAGR, 3% of award vests | At 10% CAGR, 20% of award vests | **20%** | **At 5% CAGR, 3% of award vests** | **At 10% CAGR, 20% of award vests** |
| **Adjusted revenue growth**<br>Compound annual growth measured at constant rates of exchange | 20% | At 3% CAGR, 3% of award vests | At 5% CAGR, 20% of award vests | **20%** | **At 3% CAGR, 3% of award vests** | **At 5% CAGR, 20% of award vests** |
| **Operating cash flow conversion ratio**<br>Measured at current rates of exchange, as a percentage of APFO | 20% | At 85%, 3% of award vests | At 95%, 20% of award vests | **20%** | **At 85%, 3% of award vests** | **At 95%, 20% of award vests** |

References to growth in net turnover have been updated to adjusted revenue consistent with Group reporting practices. This change to the name of the measure has no impact on the performance measured or the targets used.

For LTIP awards granted from 2016 onwards, an additional vesting period of two years applies from the third anniversary of the date of grant.

### Impact of the RAI acquisition on 2016 and 2017 LTIP awards

The Committee has taken time to consider how the impact of the RAI acquisition should be treated for the purposes of the 2017 performance year within the 2016 and 2017 long-term incentive awards. As a result of this review, the following treatments will apply.

– Relative TSR and EPS growth – no further adjustments are needed as the incremental costs and benefits associated with the acquisition are already factored into performance.

– Adjusted revenue growth – the 2017 performance year will be measured based on organic BAT performance versus the 2016 base year to allow for a like-for-like comparison. The contribution of RAI (and other 2017 acquisitions) will be included from the 2018 performance year onwards.

– Operating cash flow conversation ratio – the 2017 performance year will be measured based on organic BAT performance, excluding RAI profit and cash, and any additional costs related to the acquisition. The contribution of RAI (and other 2017 acquisitions) will be included from the 2018 performance year onwards.

The Remuneration Committee believe this is the correct, fair and appropriate way to treat the acquisition of RAI.

## 6: Other disclosures

### STI targets and outcome for the year ended 31 December 2016

As explained on page 77, the specific performance targets under the STI are considered to be commercially sensitive. Consequently, the specific performance targets for each measure will only be disclosed retrospectively, at the earliest, in the Annual Report on Remuneration which relates to the period of 12 months after the end of the relevant STI performance period. The following sets out the specific targets and the outcomes against those targets for the year ended 31 December 2016. For ease of reference we have also repeated the information disclosed last year, showing the total vesting outcome achieved and the resulting bonus achieved.

| STI: performance measure | Description of measure and target 2016 | | Result achieved | Vesting percentage |
|---|---|---|---|---|
| Adjusted profit from operations (APFO) (growth over prior year)<br>**Weighting: 40%** | APFO is the adjusted profit from operations at constant rates of exchange for the year ended 31 December 2016. | | Growth over 2015 of 4% | 40% (out of maximum of 40%) |
| | **STI target 2016** | | | |
| | Threshold | 1% growth over 2015 | | |
| | Maximum | 4% growth over 2015 | | |
| Group's share of Key Markets (growth over prior year)<br>**Weighting: 20%** | The Group's retail market share in its Key Markets accounts for around 80% of the volumes of the Group's subsidiaries. The Group's share is calculated from data supplied by retail audit service providers and is rebased as and when the Group's Key Markets change. When rebasing does occur, the Company will also restate history and provide fresh comparative data on the markets. | | Global market share in key markets grew over 2015 by 52bps | 20% (out of maximum of 20%) |
| | **STI target 2016** | | | |
| | Threshold | 5bps growth over 2015 | | |
| | Maximum | 15bps growth over 2015 | | |
| Global Drive Brands (GDB) and Key Strategic Brands (KSB) volumes (growth over prior year)<br>**Weighting: 20%** | GDB volumes comprise the cigarette volumes of Dunhill, Kent, Lucky Strike, Pall Mall and Rothmans, and include volumes of the Fine Cut variants of those brands sold in Western Europe.<br>KSB volumes comprise the cigarette volumes of State Express 555 and Shuang Xi associated with the joint venture with China National Tobacco Corporation in China. | | GDB and KSB volumes grew over 2015 by 7.2% | 20% (out of maximum of 20%) |
| | **STI target 2016** | | | |
| | Threshold | 1% growth over 2015 | | |
| | Maximum | 3% growth over 2015 | | |
| Adjusted cash generated from operations (Adjusted CGFO) (as against adjusted budget)<br>**Weighting: 20%** | Adjusted CGFO is defined as net cash generated from operating activities, before the impact of adjusting items, dividends paid to non-controlling interests and received from associates, net interest paid and net capital expenditure. Adjusted CGFO is measured at constant rates of exchange. | | Adjusted CGFO exceeded 2016 budget by 29.7%. | 20% (out of maximum of 20%) |
| | **STI target 2016** | | | |
| | Threshold | 5% less than 2016 budget | | |
| | Maximum | 5% above than 2016 budget | | |

| | Available STI award as % of base salary | Corporate result % | Individual performance adjustment factor % | STI award achieved % of base salary | STI award achieved £'000 (Value shown in Single Figure Table for 2016) |
|---|---|---|---|---|---|
| Nicandro Durante | 250 | 100% | – | 250% | **2,975** |
| Ben Stevens | 190 | 100% | – | 190% | **1,647** |

The STI awards shown above were paid as to 50% in cash and 50% as an award of deferred ordinary shares under the DSBS granted in March 2017, the details of which are set out on page 87 above.

**Payments to former Directors and payments for loss of office** The Company did not make: (1) any payments of money or other assets to former Directors; or (2) any payments to Directors for loss of office during the year ended 31 December 2017.

**External directorships** Nicandro Durante is a non-executive director of Reckitt Benckiser Group and he retains the fees for this appointment, 2017: £120,000 (2016: £110,000). Ben Stevens is a non-executive director of ISS A/S and he retains the fees for this appointment, 2017: DKK892,500 (£105,080) (2016: DKK525,000 (£58,833)).

# Annual Report on Remuneration continued

## Relative importance of spend on pay

To illustrate the relative importance of the remuneration of the Directors in the context of the Group's finances overall, the Remuneration Committee makes the following disclosure:

| Item | 2017 £m | 2016 £m | % change |
|---|---|---|---|
| Remuneration of Group employees[1] | **2,679** | 2,274 | 17.8 |
| Remuneration of Executive Directors | **18** | 13 | 36.5 |
| Remuneration of Chairman and Non-Executive Directors | **2** | 2 | 5.2 |
| Total dividends[2] | **4,465** | 2,910 | 53.4 |

**Notes:**

1. **Total remuneration of Group employees:** This represents the total employee benefit costs for the Group, set out on page 121 within note 3 in the Notes on the Accounts.
2. **Total dividends:** This represents the total dividends paid in 2017, set out on page 132 within note 8 in the Notes on the Accounts..
3. **Adjusted profit from operations:** this was included as a comparator for the year ended 31 December 2016. It has been removed as a comparator for the year ended 31 December 2017 as it is a non-IFRS measure of performance.

## Shareholder dilution – options and awards outstanding

| Satisfaction of Company share plan awards in accordance with the Investment Association's Principles of Remuneration | New ordinary shares issued by the Company during the year ended 31 December 2017 |
|---|---|
| – by the issue of new ordinary shares; or<br>– ordinary shares issued from treasury only up to a maximum of 10% of the Company's issued share capital in a rolling 10-year period;<br>– within this 10% limit, the Company can only issue (as newly issued ordinary shares or from treasury) 5% of its issued share capital to satisfy awards under discretionary or executive plans; and<br>– the rules of the Company's Deferred Share Bonus Scheme (DSBS) do not allow for the satisfaction of awards by the issue of new ordinary shares. | – 180,245 ordinary shares issued by the Company in relation to the Sharesave Scheme;<br>– a total of 747,570 Sharesave Scheme options over ordinary shares in the Company were outstanding at 29 December 2017 (being the last trading day of the year), representing 0.03% of the Company's issued share capital (excluding shares held in treasury); and<br>– options outstanding under the Sharesave Scheme are exercisable until end October 2022 at option prices ranging from 2,536p to 4,056p. |

## 7: The Remuneration Committee and shareholder engagement

**Remuneration Committee current members**

Dimitri Panayotopoulos (Chairman)
Sue Farr
Ann Godbehere
Luc Jobin
Savio Kwan

### Role

The Remuneration Committee is responsible for:

- agreeing and proposing the Directors' Remuneration Policy (covering salary, benefits, performance-based variable rewards and pensions) for shareholder approval;
- determining, within the terms of the agreed Directors' Remuneration Policy, the specific remuneration packages for the Chairman and the Executive Directors, both on appointment and on review and, if appropriate, any compensation payment due on termination of appointment;
- the setting of targets applicable for the Company's performance-based variable reward scheme and determining achievement against those targets, exercising discretion where appropriate and as provided by the applicable scheme rules and the Directors' Remuneration Policy; and
- monitoring and advising the Board on any major changes to the policy on employee benefit structures for the Group.

### Attendance at meetings in 2017

| Name | Member since | Attendance/ Eligible to attend Scheduled | Attendance/ Eligible to attend Ad Hoc |
|---|---|---|---|
| Dimitri Panayotopoulos (Chairman) | 2015 | 4/4 | 2/2 |
| Sue Farr[1(a)] | 2016 | 4/4 | 1/2 |
| Ann Godbehere | 2011 | 4/4 | 2/2 |
| Luc Jobin[1(b),2(b)] | 2017 | 1/2 | 1/1 |
| Savio Kwan | 2016 | 4/4 | 2/2 |

**Notes:**

1. **Meetings in 2017:** (a) Sue Farr did not attend the short notice meeting in November 2017 due to a prior commitment; and (b) Luc Jobin did not attend the scheduled meeting in October 2017 due to a commitment scheduled prior to his appointment as a Director.
2. **Membership:** (a) all members of the Committee are independent Non-Executive Directors in accordance with the UK Corporate Governance Code Provision D.2.1.; (b) Luc Jobin became a member of the Committee on 2 October 2017 following his appointment as a Non-Executive Director.
3. **Other attendees:** the Chairman, the Chief Executive, the Group Human Resources Director, the Group Head of Reward and other senior management, including the Company Secretary, may be consulted and provide advice, guidance and assistance to the Remuneration Committee. They may also attend Committee meetings (or parts thereof) by invitation; neither the Chairman nor any Executive Director plays any part in determining their own remuneration.
4. **Deloitte LLP:** as the Remuneration Committee's remuneration consultants, they may attend meetings of the Remuneration Committee. As a member of the Remuneration Consultants Group (RCG), Deloitte agrees to the RCG Code of Conduct which seeks to clarify the scope and conduct of the role of executive remuneration consultants when advising UK-listed companies.

**For the Remuneration Committee's terms of reference see: www.bat.com/governance**

# Annual Report on Remuneration continued

### Remuneration Committee advisers during 2017

| Independent external advisers | Services provided to the Remuneration Committee | Fees | Other services provided to the Company |
|---|---|---|---|
| **Deloitte LLP** | General advice on remuneration matters including: market trends and comparator group analysis; policy review and shareholder engagement perspectives; and independent measurement of the relative TSR performance conditions. | 2017: £86,000<br>2016 £89,050 | Tax, corporate finance and consulting services to Group companies worldwide. |
| **Herbert Smith Freehills LLP** | Advice in respect of share plan regulations is provided to the Company and is available to the Remuneration Committee. | Fees relate to advice given to the Company | General corporate legal and tax advice principally in the UK. |
| **Ernst & Young LLP** | Provision of personal tax advice regarding Executive Directors' international pension planning. | Fees relate to advice given to the Company | Tax, corporate finance and consulting services to Group companies worldwide. |
| **KPMG LLP** | Specified procedures to assist in the assessment of the calculations of the STI bonus outcomes and future targets. | 2017: £15,000<br>2016: £15,000 | Audit and tax services and other non-audit services. |

### Regular work programme 2017

– reviewed salaries for the Executive Directors from 1 April 2017 taking into account both the Pay Comparator Group positioning and the pay and employment conditions elsewhere in the Group, particularly in the UK;

– reviewed the Chairman's fee from 1 April 2017 with specific reference to the level of pay awards granted to UK employees;

– assessed the achievement against the targets for the 2016 STI award and set the STI targets for 2017;

– assessed and agreed that no award of an individual performance element for the Executive Directors was appropriate for 2016 as the STI payout was at the maximum level;

– assessed the achievement against the performance conditions for the vesting of the LTIP 2014 award, determined the contingent level of LTIP awards for May 2017 and confirmed the associated performance conditions;

– assessed the achievement against the targets for the 2016 Share Reward Scheme and set the targets for the 2017 award;

– monitored the continued application of the Company's shareholding guidelines for the Executive Directors;

– reviewed the Annual Statement and the Annual Report on Remuneration for the year ended 31 December 2016 prior to its approval by the Board and subsequent shareholder submission to the 2017 AGM on 26 April;

– analysed the 2017 AGM results on remuneration voting and reviewed market trends in the context of that annual general meeting season together with on-going corporate governance trends;

– reviewed the achievement against the performance measures for the six months to 30 June 2017 for the STI 2017 and the outstanding LTIP awards;

– previewed the positioning of the salaries for the Executive Directors for 2018 with particular reference to amending the Pay Comparator Group post the acquisition of RAI to increase the US peer proportion and industry split by the deletion of BT and Pernod Ricard and the addition of Altria, Estee Lauder and Pfizer. Following these changes the weighting of US peers has increased from 33% to 40% of the total Pay Comparator Group. The Pay Comparator Group now comprises: Altria, Anheuser-Busch InBev, AstraZeneca, Bayer, BP, Coca-Cola, Colgate Palmolive, Danone, Estee Lauder, GlaxoSmithKline, Heineken, Imperial Brands, Japan Tobacco International, Johnson & Johnson, Kellog, Kraft-Heinz, L'Oreal, Mondelēz International, Nestlé, PepsiCo, Pfizer, Philip Morris International, Procter & Gamble, Reckitt Benckiser, Royal Dutch Shell, Unilever and Vodafone; and

– reviewing the Remuneration Committee's effectiveness following the Board evaluation process.

### Other incentive matters 2017

– reviewed the key elements of the executive and senior management compensation at RAI focusing on the immediate and short-to-medium term considerations in the context of the proposed completion of the acquisition;

– reviewed the impact of the acquisition of RAI on the treatment of the performance metrics for the STI for the year ended 31 December 2017 and the year ending 2018 and LTIP awards (2015 to 2018 awards inclusive);

– approved changes to the constituents for the STI volume share metrics based on market changes and reporting capabilities;

– reviewed and approved a proposal to revise the STI metrics for the year ending 31 December 2018 to better reflect the measures of the Group's performance in the context of the NGP business and the impact of the acquisition of RAI;

– reviewed the terms of appointment and remuneration and termination in connection with Management Board changes during the year; and

– noted the preliminary insights on the UK gender pay gap reporting.

### Voting on the Remuneration Report at the 2017 AGM and engagement with shareholders

At the 2017 AGM on 26 April, the shareholders considered and voted on the Directors' Remuneration Report as set out on the table below. No other resolutions in respect of Directors' remuneration and incentives were considered at the 2017 AGM. The Directors' Remuneration Policy was approved by shareholders at the AGM on 27 April 2016. A summary of this Policy is on pages 94 to 98.

| | Approval of Directors' Remuneration Policy 2016 | Approval of Directors' Remuneration Report 2017 |
|---|---|---|
| Percentage for | 90.32 | 92.05 |
| Votes for (including discretionary) | 1,191,242,495 | 1,346,502,332 |
| Percentage against | 9.68 | 7.95 |
| Votes against | 127,646,481 | 116,220,156 |
| **Total votes cast excluding votes withheld** | 1,318,888,976 | 1,462,722,488 |
| Votes withheld[1] | 103,597,686 | 13,100,905 |
| **Total votes cast including votes withheld** | 1,422,486,662 | 1,475,823,393 |

**Note:**
1. Votes withheld: these are not included in the final proxy figures as they are not recognised as a vote in law.

The Company offered its regular programme of engagement with key investors in late March/early April before the Annual General Meeting on 26 April 2017. Shareholders' comments and views were discussed in the context of performance and outcomes in the twelve months since the approval of the Remuneration Policy and the new LTIP at the AGM in 2016.

# Annual Report on Remuneration continued

## 8: Summary of our Directors' Remuneration Policy

The Remuneration Policy for the Executive Directors and the Non-Executive Directors was approved by shareholders at the Annual General Meeting on 27 April 2016.

The full Directors' Remuneration Policy is set out in the Remuneration Report 2015 contained in the Annual Report for the year ended 2015, which is available at www.bat.com.

To assist in reviewing our Annual Report on Remuneration, we have summarised the key elements of the Directors' Remuneration Policy as it principally applies to remuneration paid during 2017.

### Directors' Remuneration Policy summary: our remuneration strategy

#### Our principles of remuneration – summary

The Remuneration Committee's remuneration principles seek to reward the delivery of the Group's strategy in a simple and straightforward manner which is aligned to shareholders' long-term sustainable interests.

The remuneration structure comprises fixed and variable elements. These rewards are structured and designed to be both transparent and stretching while recognising the skills and experience of the Executive Directors and ensuring a market competitiveness for talent. The fixed elements comprise base salary, pension and other benefits; the variable elements are provided via two performance-based incentive schemes (a single cash and share incentive annual bonus plan (STI), and a single long-term incentive scheme (LTIP)).

In applying these principles, the Remuneration Committee maintains an appropriate balance between fixed pay and the opportunity to earn performance-related remuneration with the performance-based elements forming, at maximum opportunity, between 75% and 85% of the Executive Directors' total remuneration. An annual review is conducted to ensure application and alignment of the Directors' Remuneration Policy with the business needs to promote the long-term success of the Company.

| How each key element of our remuneration supports the strategic priorities | |
|---|---|
| **Fixed remuneration:**<br>base salary pension benefits | – attract and retain high calibre individuals to deliver the Company's strategic plans by offering market competitive levels of guaranteed cash to reflect an individual's skills, experience and role within the Company;<br>– provide competitive post-retirement benefit arrangements which recognise both the individual's length of tenure with the Group and the external environment in the context of attracting and retaining senior high calibre individuals to deliver the Group's strategy; and<br>– provide market competitive benefits consistent with the role which: (1) help to facilitate the attraction and retention of high calibre, senior individuals to deliver the Company's strategic plans; and (2) recognise that such talent is global in source and that the availability of certain benefits (e.g. relocation, repatriation, taxation compliance advice) will from time to time be necessary to avoid such factors being an inhibitor to accepting the role. |
| **Variable remuneration:**<br>short-term incentives | – incentivise the attainment of corporate targets aligned to the strategic objectives of the Company on an annual basis;<br>– performance-based award in the form of cash and deferred ordinary shares, so that the latter element ensures alignment with shareholders' long-term interests;<br>– strong alignment and linkage between individual and corporate annual objectives via the application of an individual performance adjustment factor to the corporate result; and<br>– ensure, overall, a market-competitive package to attract and retain high calibre individuals to deliver the Group's strategy. |
| **Variable remuneration:**<br>long-term incentives | – incentivise long-term sustainable growth in total shareholder return (TSR), adjusted diluted earnings per share (EPS) and adjusted revenue growth, together with the achievement of a consistently high measure of operating profit conversion ratio over a three-year period; to facilitate the appointment of high calibre, senior individuals required to deliver the Company's strategic plans; and to promote the long-term success of the Company.<br>– to put in place a combination of measures with appropriately stretching targets around the long-term plan that provides a balance relevant to the Group's business and market conditions, as well as providing alignment between Executive Directors and shareholders. In setting performance criteria and thresholds/targets, the Remuneration Committee takes account of the Group's long-term plans and market expectations. |

## Directors' Remuneration Policy summary: elements of pay for the current Executive Directors

### Base salary

Normally paid in 12 equal monthly instalments during the year and is pensionable.

Normally reviewed annually in February (with salary changes effective from April) or subject to an ad hoc review on a significant change of responsibilities.

Salaries are reviewed against appropriate market data, including general UK pay trends and a company size and complexity model based on UK companies, as well as a Pay Comparator Group.

Increases in salary will generally be in the range of the increases in the base pay of other UK-based employees in the Group.

Year-on-year increases for Executive Directors, currently in role, will not exceed 10% per annum during the policy period.

A significant change in responsibilities may be reflected in an above-average increase (which may exceed 10%) of salary.

### Pensions

**Pension Fund: non contributory defined benefit section**

Accrual rates differ according to individual circumstances but do not exceed 1/40th of pensionable salary for each year of pensionable service.

Retains a scheme-specific salary cap (currently £154,800 effective 1 April 2017).

Benefits in excess of the cap are accrued in the UURBS.

**Pension Fund: defined contribution section**

In place since April 2005.

Annual contribution up to the equivalent of 35% of base salary would be made.

Actual level of contribution paid to the Pension Fund is restricted to take account of the annual allowance and lifetime allowance.

Balance of contribution payable as a gross cash allowance or accumulated in the UURBS.

**UURBS**

Accrued defined benefits in the UURBS may be received on retirement either as a single lump sum or as an ongoing pension payment.

Pension accrual in the UURBS is at the same rate as in the Pension Fund (1/40th per annum).

### Benefits

The Company currently offers the following range of contractual benefits to Executive Directors (on an individually specific basis) with maximum annual values (subject to periodic inflation related increases where applicable):

- **car or car allowance:** £20,000.
- **use of a company driver:** variable maxima as the actual cost is dependent on the miles driven in any year.
- variable maxima will apply to the cost of **private medical insurance** which is dependent on an individual's circumstances and is provided on a family basis.
- **GP 'walk-in' medical services located close to the Group's headquarters in London:** £5,000 per annum.
- **personal life and accident insurance** designed to pay out at a multiple of four and five times base salary respectively.
- **international tax advice** as required, but not exceeding £30,000 per annum and tax equalisation payments as agreed by the Remuneration Committee from time to time.
- **relocation and shipment expenses** at the beginning and end of service as an Executive Director up to £200,000 and, in addition, **housing and education allowances** or other similar arrangements, as appropriate to the individual's family circumstances.

With the exception of the car or car allowance, in line with the UK market and the practice followed for all the Group's other UK employees, it is also practice to pay the tax that may be due on these benefits.

### Short-term incentives – STI

| | Chief Executive | | Finance Director | |
|---|---|---|---|---|
| | Maximum | On-target | Maximum | On-target |
| **STI opportunity** (Group outcome delivered 50% cash; 50% deferred ordinary shares, individual performance adjustment factor delivered in cash) | 250% | 125% | 190% | 95% |

| | |
|---|---|
| **Performance adjustment and clawback and malus** | **Individual performance adjustment factor:** up to 20% uplift possible if individual performance is assessed as outstanding (up to the maximum opportunity) and paid in cash. Up to 50% reduction possible if individual performance is assessed as poor.<br>**Clawback and malus:** provisions are in place. |
| **Performance measures and weightings** | The Remuneration Committee sets the performance targets each year at the beginning of the performance period and is able to vary the exact measures and the weighting of them from year to year.<br>The **performance measures** are detailed for 2017 on page 77 and for 2018 and on page 83. |

# Annual Report on Remuneration continued

## Long-term incentives – LTIP

| | Chief Executive | | Finance Director | |
|---|---|---|---|---|
| **LTIP opportunity** | Maximum | 500% | Maximum | 350% |
| **Performance measures and weightings** | The Remuneration Committee may make revisions to the performance measures, their weightings, thresholds and target levels as permitted under the LTIP rules.<br>The performance measures are detailed for the 2015 – 2017 performance period on page 79 and for the award to be granted in 2018 on page 84. | | | |
| **Dividend equivalent payment and clawback and malus** | **Dividend equivalent payment:** on all vesting ordinary shares. **Clawback and malus:** provisions are in place. | | | |
| **LTIP extended vesting period** | For awards granted in 2016 and subsequently, an additional vesting period of two years applies from the third anniversary of the date of grant. Where this applies, LTIP awards vest only to the extent that: (1) the performance conditions are satisfied at the end of the three-year performance period; and (2) an additional vesting period of two years from the third anniversary of grant is completed. | | | |

## Other elements of remuneration for the Executive Directors

### All-employee share plans

Executive Directors are eligible to participate in the Company's all-employee share schemes:

- **Sharesave Scheme** – a UK tax-advantaged approved scheme where eligible employees are granted savings-related share options to subscribe for ordinary shares in the Company.
- **Share Incentive Plan (SIP)** – a UK tax-advantaged plan incorporating: (1) Partnership Scheme and (2) Share Reward Scheme.

### Shareholding requirements

| Chief Executive<br>% of salary | Finance Director<br>% of salary |
|---|---|
| 500% | 350% |

Ordinary shares awarded but not yet vested and for which performance conditions have already been met under the DSBS element of the STI are included in the calculation of the threshold for the shareholding guidelines for the Executive Directors.

The estimated notional net number of ordinary shares held by an Executive Director in the LTIP Extended Vesting Period will also count towards the respective shareholding requirements.

### External Board appointments

Each Executive Director is limited to one external appointment, with the permission of the Board. Any fees from such appointments are retained by the individual in recognition of the increased level of personal commitment required.

## Directors' Remuneration Policy summary: other policy provisions in relation to Executive Directors

### Service contracts

The current Executive Directors are employed on a one-year rolling contract, executed at the time of the original appointment.

The Remuneration Committee may exercise its discretion to award two- or three-year contracts in the event that the Executive Director is recruited externally or from overseas.

Contracts with an initial period of longer than one year will then reduce to a one-year rolling contract after the expiry of the initial period.

### Policy on payment for loss of office

#### Principles

The principles on which the Remuneration Committee will approach the determination for payments on termination are as follows:

- compensation for loss of office in service contracts is limited to no more than 12 months' salary and benefits excluding pension;
- in the event that the contract is terminated for cause (such as gross misconduct), the Company may terminate the contract with immediate effect and no compensation would be payable; and
- the service contracts of the Executive Directors are terminable on the expiry of 12 months' notice from either the Director or the Company – which means that, where an internal successor has not been identified, the Company would have sufficient time to replace the Executive Director through an orderly external recruitment process and ideally have a period of handover.

#### Treatment of awards under the share incentive schemes: STI/DSBS and LTIP; All-employee scheme: SRS

Executive Directors do not have contractual rights to the value inherent in any awards held under the share incentive schemes. The release of awards is dependent on 'leaver' status and is at the discretion of the Remuneration Committee.

The Remuneration Committee retains discretion in deciding 'good leaver' status other than in cases of automatic 'good leavers' as set out in the applicable provisions of the DSBS and LTIP rules. The discretionary powers are intended to provide flexibility as Executive Directors may leave employment for a broad variety of reasons which may not necessarily fall within the prescribed category of 'good leaver'. The Remuneration Committee exercises its discretion by reference to guidelines which set out its agreed relevant factors to assist in the determination of a leaver's status.

In exercising its discretion, the Remuneration Committee will also take into account the individual's overall performance as well as their contribution to the Company during their total period of employment.

Details of how leavers are assessed as 'good leavers' are set out in the Remuneration Policy.

# Annual Report on Remuneration continued

## Directors' Remuneration Policy summary: elements of pay for the current Chairman and Non-Executive Directors

### Fees – Chairman

Considered annually by the Remuneration Committee using data from the FTSE 30 companies and taking into account the breadth of that role, coupled with its associated levels of personal commitment and expertise in the overall context of international reach and the 'ambassadorial' aspect of the role. The Chairman does not participate in discussions on his level of remuneration.

It is anticipated that any future aggregate increase to any of the fees for the Chairman and Non-Executive Directors will be within the salary range which governs the Company's annual salary reviews for UK-based staff and will not exceed the equivalent of 10% per annum in aggregate.

### Benefits, travel and related expenses – Chairman

Reimbursed for the cost of travel and related expenses incurred by him in respect of attendance at Board, Committee and General Meetings including the cost of return airline tickets to London from his home in Ireland in connection with his duties as Chairman.

Entitled to the use of a Company driver; private medical insurance and personal accident insurance benefits; the provision of home and personal security; and general practitioner 'walk-in' medical services based a short distance from the Company's Group headquarters in London.

Richard Burrows' spouse may, from time to time, accompany him to participate in a partners' programme occasionally organised in conjunction with overseas or UK-based Board meetings and otherwise at hospitality functions during the year.

In instances where any reimbursements or expenses are classified by HM Revenue & Customs as a benefit to the Chairman, it is also the practice of the Company to pay any tax due on any such benefits.

### Fees – Non-Executive Directors

Non-Executive Directors receive a base fee and an appropriate Board Committee Membership Fee.

The Chairs of the Audit and Remuneration Committees receive an additional supplement and an additional supplement is also paid to the Senior Independent Director.

The quantum and structure of Non-Executive Directors' remuneration primarily assessed against the same Pay Comparator Group of companies used for setting the remuneration of Executive Directors. The Board may also make reference to and take account of relevant research and analysis on Non-Executive Directors' fees in FTSE 100 companies published by remuneration consultants from time to time.

Fees for the Non-Executive Directors are reviewed annually, usually in April. The review does not always result in an increase in the Board fees or Committee fees.

The Board as a whole considers the policy and structure for the Non-Executive Directors' fees on the recommendation of the Chairman and the Chief Executive. Non-Executive Directors do not participate in discussions on their specific levels of remuneration.

It is anticipated that any future aggregate increase to any of the fees for the Chairman and Non-Executive Directors will be within the salary range which governs the Company's annual salary reviews for UK-based staff and will not exceed the equivalent of 10% per annum in aggregate.

### Benefits, travel and related expenses – Non-Executive Directors

Non-Executive Directors are generally reimbursed for the cost of travel and related expenses incurred by them in respect of attendance at Board, Committee and General Meetings.

It is Board policy that the partners of the Non-Executive Directors may, from time to time, accompany the Directors to participate in a partners' programme occasionally organised in conjunction with overseas or UK-based Board meetings and otherwise at hospitality functions during the year.

Non-Executive Directors are also eligible for general practitioner 'walk-in' medical services based a short distance from the Company's Group headquarters in London; Non-Executive Directors receive no other benefits.

In instances where any reimbursements or expenses are classified by HM Revenue & Customs as a benefit to the Director, it is also the practice of the Company to pay any tax due on any such benefits.

The Directors' Remuneration Report has been approved by the Board on 21 February 2018 and signed on its behalf by:

**Dimitri Panayotopoulos**
Chairman, Remuneration Committee

21 February 2018

# Responsibility of Directors

## Statement of Directors' responsibilities in respect of the Annual Report and the financial statements@

The Directors are responsible for preparing the Annual Report and the Group and Company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS as adopted by the EU) and applicable law and have elected to prepare the Company financial statements in accordance with UK Accounting Standards, including FRS 101 Reduced Disclosure Framework. In preparing these Group financial statements, the Directors have also elected to comply with IFRS as issued by the International Accounting Standards Board (IASB).

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the Company and of their profit or loss for that period. In preparing each of the Group and Company financial statements, the Directors are required to:

– select suitable accounting policies and then apply them consistently;

– make judgements and estimates that are reasonable, relevant and reliable;

– for the Group financial statements, state whether they have been prepared in accordance with IFRS as adopted by the EU and IFRS as issued by the IASB;

– for the Company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Company financial statements;

– assess the Group and Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and

– use the going concern basis of accounting unless they either intend to liquidate the Group or the Company or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the Annual Report included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## Directors' declaration in relation to relevant audit information@

Having made appropriate enquiries, each of the Directors who held office at the date of approval of this Annual Report confirms that:

– to the best of his or her knowledge and belief, there is no relevant audit information of which the Company's auditors are unaware; and

– he or she has taken all steps that a Director might reasonably be expected to have taken in order to make himself or herself aware of relevant audit information and to establish that the Company's auditors are aware of that information.

## Responsibility statement of the Directors in respect of the annual financial report@

We confirm that to the best of our knowledge:

– the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and

– the Strategic Report and the Directors' Report include a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

We consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides information necessary for shareholders to assess the Company's position and performance, business model and strategy.

This responsibility statement has been approved and is signed by order of the Board by:

**Richard Burrows**
Chairman

**Ben Stevens**
Finance Director

21 February 2018

British American Tobacco p.l.c.
Registered in England and Wales No. 3407696

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