Financial performance summary

"The Group **continues to deliver** across all key financial metrics"

Ben Stevens
Finance Director

Highlights

- Group revenue was up 37.6% or 2.9% on an adjusted, organic basis at constant rates of exchange.
- Profit from operations increased by 39.1%, or 3.7% on an adjusted, organic basis at constant rates of exchange.
- Diluted earnings per share up 634%. Adjusted diluted earnings per share up 14.9% or 9.9% at constant rates.
- Dividend per share up 15.2% at 195.2p.
- Net cash generated from operating activities up 16.0%, with adjusted cash generated from operations® at constant rates up 0.3%.
- Cash conversion at 83%, with operating cash flow conversion ratio at 79%®.

Non-GAAP measures

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

The principal non-GAAP measures which the Group uses are adjusted revenue, adjusted profit from operations, adjusted diluted earnings per share, operating cash flow conversion ratio® and adjusted cash generated from operations®. Adjusting items are significant items in revenue, profit from operations, net finance costs, taxation and the Group's share of the post-tax results of associates and joint ventures which individually or, if of a similar type, in aggregate, are relevant to an understanding of the Group's underlying financial performance.

As an additional measure to indicate the results of the Group before the impact of exchange rate movements on the Group's results the movement in adjusted revenue, adjusted profit from operations and adjusted diluted earnings per share are shown at constant rates of exchange.

The Group also includes organic measures of volume, revenue, profit from operations and operating margin to ensure a full understanding of the underlying performance of the Group, before the impact of acquisitions.

These non-GAAP measures are explained on pages 218 to 222.

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

Revenue

Revenue (£m)

£20,292m
+37.6%

Year	Revenue	Change
2017	£20,292m	+38%
2016	£14,751m	+13%
2015	£13,104m	-6%

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

Change in adjusted revenue at constant rates (%)

+30.7%

KPI
Non-GAAP

Year	Change
2017	+31%
2017(org)	+3%
2016	+7%
2015	+5%

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

In 2017, revenue was 37.6% higher at £20,292 million. This was driven by the inclusion of RAI since the acquisition date, pricing, the growth of the NGP portfolio and the translational foreign exchange tailwind on the reported results, partially offset by negative geographic and portfolio mix of 1%. Revenue also grew due to the sale of products bought-in on short-term contract manufacturing arrangements inclusive of excise. After adjusting for the revenue from acquisitions, including RAI, the short-term uplift to revenue due to the treatment of excise on bought-in goods and the effect of exchange on the reported result, on an organic, adjusted constant currency basis, revenue was up by 2.9%.

Revenue from our NGP portfolio was £397 million, which includes the contribution from RAI brands since the acquisition date. On a 12-month basis, including the full year's revenue from RAI, revenue from NGPs was approximately £500 million.

In 2016, revenue increased by 12.6%, to £14,751 million driven by price mix of over 6%, and reflecting the positive currency effects resulting from the relative weakness of pound sterling. At constant rates of exchange, revenue would have increased by 6.9% or by 5.3% on an organic basis.

Reconciliation of revenue to adjusted organic revenue at constant rates

	2017 £m	Change %	2016 £m	Change %	2015 £m
Revenue	**20,292**	**+38%**	14,751	+13%	13,104
Adjusting items	**(258)**		–		–
Adjusted revenue	**20,034**	**+36%**	14,751	+13%	13,104
Impact of exchange	**(750)**		(743)		
2016 adjusted revenue at 2015 exchange rates			14,008	+7%	
2017 adjusted revenue at 2016 exchange rates	**19,284**	**+31%**			
Impact of acquisitions	**(4,111)**		(207)		
Adjusted organic revenue at constant rates	**15,173**	**+3%**	13,801	+5%	

Income statement

Profit from operations

(£m)

£6,476m
+39.1%

2017	£6,476m	+39%
2016	£4,655m	+2%
2015	£4,557m	+0%

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

Profit from operations grew by 39.1% to £6,476 million and by 2.2% to £4,655 million in 2016. This was driven by the inclusion of RAI during 2017, the improved organic revenue in 2017 and 2016 as described earlier, and the favourable foreign exchange movements, partly offset by the following:

Raw materials and other consumables increased by 19.7% to £4,520 million in 2017, and by 17.4% to £3,777 million in 2016, mainly due to the higher volume and the continued transactional foreign exchange headwinds in both years. This negatively impacted the cost of hard currency denominated items such as leaf and wrapping materials in the operating currencies of our local companies.

Employee benefit costs increased by £405 million to £2,679 million in 2017 and by £235 million to £2,274 million in 2016. The movement was mainly due to the acquisition of RAI in 2017 and the translational foreign exchange movements in 2017 and 2016.

Depreciation, amortisation and impairment costs increased by £295 million to £902 million in 2017 and by £179 million in 2016. This was due to the amortisation and impairment charges of £393 million (2016: £166 million, 2015: £72 million) largely related to the trademarks and similar intangibles capitalised following the acquisitions (including RAI, Ten Motives, CHIC Group, TDR, Bentoel, Tekel and Skandinavisk Tobakskompagni A/S (ST)). The increase in 2017 was also driven by higher depreciation charges due to the consolidation of RAI, with depreciation higher in 2016 due to the investment in the Group's manufacturing infrastructure.

Other operating expenses increased by £1,688 million to £5,346 million in 2017 (2016 up by £386 million) due to the impact of higher overhead costs, foreign exchange in 2017 and 2016 and the acquisition of RAI in 2017.

Expenditure on research and development was approximately £191 million in 2017 (2016: £144 million, 2015: £148 million) with a focus on products that could potentially reduce the risk associated with smoking conventional cigarettes.

Included in profit from operations are a number of adjusting items related to restructuring and integration costs and one-off charges, provisions and income. Adjusted items are defined in note 1 in the Notes on the Accounts.

Total adjusting items were £1,517 million in 2017 (2016: £825 million, 2015: £435 million), including the charges related to trademark amortisation and impairment (discussed above), and £600 million (2016: £603 million, 2015: £367 million) of restructuring and integration costs being mainly in respect of the implementation of the new operating model, integration costs associated with the acquisition of RAI and factory rationalisations. The release of fair value adjustment to inventory (£465 million) and the impairment of certain assets related to Agrokor in Croatia have also been treated as adjusting items.

We call the underlying profit before these items 'adjusted profit from operations'.

In 2017, adjusted profit from operations at constant rates grew by 39.9% to £7,665 million, driven by the acquisition of RAI. On an organic basis, adjusted profit from operations at constant rates increased by 3.7% (2016: 4.1%). The increase was due to the movement in profit from operations before the impact of adjusting items discussed earlier.

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

+39.9%

KPI
Non-GAAP

2017	+40%
2017(org)	+4%
2016	+4%
2015	+4%

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

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

	2017							2016		
	Reported £m	Adjusting items £m	Adjusted £m	Impact of exchange £m	Adjusted at CC £m	Impact of acquisitions £m	Adjusted organic at CC £m	Reported £m	Adjusting items £m	Adjusted £m
Profit from operations										
United States	**1,318**	**763**	**2,081**	**(101)**	**1,980**	**(1,980)**	**–**	–	–	–
Asia-Pacific	**1,638**	**117**	**1,755**	**(81)**	**1,674**	**–**	**1,674**	1,432	198	1,630
Americas	**1,147**	**109**	**1,256**	**32**	**1,288**	**–**	**1,288**	1,017	155	1,172
Western Europe	**1,127**	**435**	**1,562**	**(104)**	**1,458**	**(2)**	**1,456**	1,044	345	1,389
EEMEA	**1,246**	**93**	**1,339**	**(74)**	**1,265**	**–**	**1,265**	1,182	107	1,289
Total region	**6,476**	**1,517**	**7,993**	**(328)**	**7,665**	**(1,982)**	**5,683**	4,675	805	5,480
Non-tobacco litigation:										
Fox River	**–**	**–**	**–**	**–**	**–**			(20)	20	–
Profit from operations	**6,476**	**1,517**	**7,993**	**(328)**	**7,665**			4,655	825	5,480
Net finance (costs)	**(1,094)**	**205**	**(899)**	**56**	**(833)**			(637)	108	(529)
Associates and joint ventures	**24,209**	**(23,197)**	**1,012**	**(61)**	**951**			2,227	(900)	1,327
Profit before tax	**29,591**	**(21,475)**	**8,116**	**(333)**	**7,783**			6,245	33	6,278

Operating margin

(%)

31.9%

2017		**31.9%**
2016		31.6%
2015		34.8%

Definition: Profit from operations as a percentage of revenue.

Adjusted operating margin (%)

39.9%

Non-GAAP

2017		**39.9%**
2016		37.2%
2015		38.1%

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

Operating margin in 2017 was ahead of 2016 by 30 bps at 31.9%, as the organic performance and inclusion of RAI more than offset the impact of the RAI purchase accounting (mainly on inventory), increased spend related to the NGP portfolio and restructuring and integration costs incurred. The decrease in 2016 was driven by higher restructuring and impairment charges, and transactional foreign exchange headwinds, impacting the Group's cost of sales.

In 2017, adjusted operating margin increased by 270 bps as the inclusion of RAI, the growth in adjusted organic revenue, driven in part by pricing, and ongoing cost savings (including the US$70 million of synergies achieved), more than offset the impact of inflation and transactional foreign exchange. Adjusted organic operating margin increased by 40 bps. At constant rates, adjusted organic operating margin increased by 30 bps.

In 2016, adjusted operating margin fell by 90 bps as the impact of transactional foreign exchange on cost of sales more than offset the impact of pricing and cost savings across the Group.

Net finance costs

In 2017, net finance costs increased by £457 million to £1,094 million, largely due to the additional finance, including pre-financing charges of £153 million, required to acquire RAI and the finance costs associated with the RAI debt now consolidated within the Group. In 2016, net finance costs were £637 million compared to net finance income of £62 million in 2015. This was principally due to the impact of adjusting items in net finance costs, including one-off costs of £101 million related to the early settlement of a bond (described on page 39), while 2015 included a deemed gain (£601 million) related to the investment in that year in RAI associated with RAI's acquisition of Lorillard. In 2017 and 2016 the Group recognised interest of £25 million and £25 million respectively in related to FII GLO. 2016 also benefited from an £18 million hedge ineffectiveness gain, which partially reversed in 2017 (£9 million charge), following the market volatility due to Brexit, which is not in the normal course of business.

Net finance costs before the impact of the adjusting items described above, and at constant rates of exchange, were £833 million an increase of 57.5% on 2016, which were 15.7% higher than 2015 at £427 million. The Group's average cost of debt in 2017 was 3.3%, ahead of 3.1% achieved in both 2016 and 2015.

Associates and joint ventures

Associates in 2017 principally comprised RAI (for the period prior to the acquisition in July 2017 of the shares in RAI not already owned by the Group) and ITC. The Group's share of the post-tax results of associates and joint ventures, included at the pre-tax profit level under IFRS, increased by £21,982 million to £24,209 million, due to a gain of £23,288 million arising on the deemed disposal of RAI as an associate as, following the acquisition, RAI is consolidated as a wholly owned subsidiary.

In 2016, the Group's share of post-tax results from associates and joint ventures increased by £991 million, to £2,227 million, largely due to a gain of £900 million recognised in 2016 which mainly related to the sale by RAI of the international rights to Natural American Spirit.

Excluding the effect of the gain noted above and other adjusting items, the Group's share of associates and joint ventures on an adjusted, constant currency basis fell in 2017 by £951 million or 28.3% due to RAI's contribution as an associate for only part of the year, while the Group's share of ITC's post-tax results grew by 16.7%. In 2016, the Group's share of results of associates and joint ventures on an adjusted constant currency basis increased by 26.2%, driven by RAI, up 35% partly due to a full year's contribution from Lorillard and ITC, higher by 7%.

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

	2016							2015		
	Reported £m	Adjusting items £m	Adjusted £m	Impact of exchange £m	Adjusted at CC £m	Impact of acquisitions £m	Adjusted organic at CC £m	Reported £m	Adjusting items £m	Adjusted £m
Profit from operations										
Asia-Pacific	1,432	198	1,630	(142)	1,488	–	1,488	1,361	108	1,469
Americas	1,017	155	1,172	30	1,202	–	1,202	1,082	87	1,169
Western Europe	1,044	345	1,389	(153)	1,236	(11)	1,225	990	156	1,146
EEMEA	1,182	107	1,289	(18)	1,271	(12)	1,259	1,127	81	1,208
Total region	4,675	805	5,480	(283)	5,197	(23)	5,174	4,560	432	4,992
Non-tobacco litigation:										
Fox River / Flintkote	(20)	20	–	–	–			(3)	3	–
Profit from operations	4,655	825	5,480	(283)	5,197			4,557	435	4,992
Net finance (costs) / income	(637)	108	(529)	35	(494)			62	(489)	(427)
Associates and joint ventures	2,227	(900)	1,327	(137)	1,190			1,236	(293)	943
Profit before tax	6,245	33	6,278	(385)	5,893			5,855	(347)	5,508

Income statement continued

Tax

In 2017, the tax charge in the Income Statement was a credit of £8,113 million, against a charge of £1,406 million in 2016 and £1,333 million in 2015. The 2017 credit was largely due to the impact of the change in tax rates in the United States which led to a credit of £9.6 billion related to the revaluation of deferred tax liabilities arising on the acquired net assets of RAI, and described below. The tax rates in the Income Statement are therefore a credit of 27.4% in 2017, against a charge of 22.5% in 2016 and 22.8% in 2015. These are also affected by the inclusion of adjusting items described earlier and the associates and joint ventures' post-tax profit in the Group's pre-tax results. Excluding these items and the deferred tax credit in 2017, the underlying tax rate for subsidiaries was 29.7% in 2017 (2016: 29.8% and 2015: 30.5%). See the section Non-GAAP measures on page 220 for the computation of underlying tax rate for the periods presented.

Tax strategy

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

– complying with all applicable laws and regulations in countries in which we operate;

– being open and transparent with tax authorities and operate to build mature professional relationships;

– supporting the business strategy of the Group by undertaking efficient management of our tax affairs in line with the Group's commercial activity;

– transacting on an arm's length basis for exchanges of goods and services between companies within the Group; and

– engaging in proactive discussions with tax authorities on occasions of differing legal interpretation.

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

The tax strategy outlined above is applicable to all Group companies, including the UK Group; reference to tax authorities includes HMRC. The publication of this strategy is considered to constitute compliance with the duty under paragraph 16(c) Schedule 19 Part 2 of the UK Finance Act 2016.

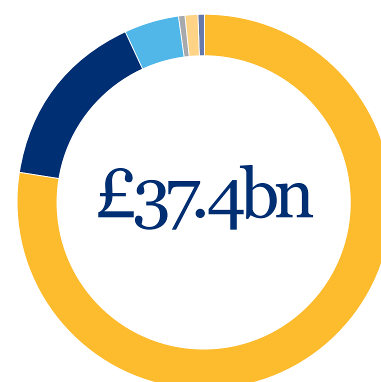
The taxation on ordinary activities for 2017 was a credit of £8.1 billion against a charge of £1.4 billion in 2016 and £1.3 billion in 2015, with tax paid (due to the timing of corporation tax instalment payments which straddle different financial years) of £1.7 billion (2016: £1.2 billion, 2015: £1.3 billion).

Our tax footprint extends beyond corporation tax, including significant payment of employment taxes and other indirect taxes including customs and import duties. The Group also collects taxes on behalf of governments (including tobacco excise, employee taxes, VAT and other sales taxes). The total tax contribution in 2017 of £37.4 billion (2016: £33.2 billion, 2015: £29.6 billion) therefore consists of both taxes borne and taxes collected as shown in the table provided.

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

As part of the acquisition of RAI, the Group acquired the assets and liabilities of the RAI Companies. These are required to be fair valued at the date of acquisition, as disclosed in note 24 on the accounts, on page 165. The value of the net assets acquired created a deferred tax liability, valued within the purchase price allocation process at the prevailing rate of corporation tax at the date of acquisition, being 25 July 2017. Subsequently, on 22 December 2017, the US federal corporate tax rate was changed to 21%, effective from 1 January 2018. This revised rate has been used to value the deferred tax liability at the balance sheet date, reducing the liability and providing a credit to the income statement in 2017 of £9.6 billion. Due to the scale of the impact, this credit has been treated as an adjusting item.

Major taxes paid 2017 (£bn)



Major taxes paid

	2017 £bn	2016 £bn
Tobacco excise (collected)	**29.0**	25.9
Net VAT and other sales taxes (collected)	**5.9**	5.2
Corporation tax (borne)	**1.7**	1.2
Customs and import duties (borne)	**0.2**	0.4
Taxes paid by employee (collected)	**0.4**	0.3
Employment taxes (borne)	**0.2**	0.2
	37.4	33.2

The movements in deferred tax, taken through other comprehensive income, mainly relate to the change in the valuation of pensions in the year, as disclosed in note 13 in the Notes on the Accounts.

Deferred tax asset / (liability)

	2017 £m	2016 £m	2015 £m
Opening balance	**(216)**	(237)	(184)
Difference on exchange	**852**	(39)	(4)
Recognised on acquisition of RAI	**(27,065)**	–	–
Impact of US tax reforms	**9,620**	–	–
Other (charges) / credits to the income statement	**136**	(4)	(4)
Other (charges) / credits to other comprehensive income	**(133)**	70	(9)
Other movements	**(6)**	(6)	(36)
Closing balance	**(16,812)**	(216)	(237)

Diluted earnings per share (EPS) (p)

1,830.0p
+634%

Year	Value	Change
2017	1,830.0p	+634%
2016	249.2p	+8%
2015	230.3p	+38%

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

Change in adjusted diluted EPS (%)

+14.9%

KPI
Non-GAAP

Year	Change
2017	+15%
2016	+19%
2015	0%

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

Change in adjusted diluted EPS at constant rates (%)

+9.9%

KPI
Non-GAAP

Year	Change
2017	+10%
2016	+10%
2015	+10%

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

Earnings per share

Basic earnings per share were 634% higher at 1,836.3p (2016: 250.2p, up 8.4%, 2015: 230.9p) with the growth in 2017 benefiting from the movements related to the acquisition of RAI in the year and the impact of the US tax reform. 2016 was higher than 2015 due to growth in profit from operations and an increased contribution from RAI following the acquisition of Lorillard. After accounting for the dilutive effect of employee share schemes, diluted earnings per share were 634% higher than 2016 at 1,830.0p (2016: 249.2p, 2015: 230.3p).

Earnings per share are impacted by the adjusting items discussed earlier. Adjusted diluted EPS, as calculated in note 7 in the Notes on the Accounts, was up against the prior year by 14.9%, with 2016 ahead of 2015 by 18.8% at 247.5p. Adjusted diluted EPS at constant rates would have been 9.9% ahead of 2016 at 272.1p, with 2016 up 10.4% against 2015.

Dividends

On 26 April 2017, the Group announced its move to quarterly dividends with effect from 1 January 2018. Quarterly dividends will provide shareholders with a more regular flow of dividend income and will allow the Company to spread its substantial dividend payments more evenly over the year. The dividends will align better with the cash flow generation of the Group and so enable the Company to fund the payments more efficiently.

The Board has declared an interim dividend of 195.2p per ordinary share of 25p, payable in four equal quarterly instalments of 48.8p per ordinary share in May 2018, August 2018, November 2018 and February 2019. This represents an increase of 15.2% on 2016, (2016: 169.4p per share), and a payout ratio, on 2017 adjusted diluted earnings per share, of 69%.

As part of the transition to quarterly dividend payments, the Group committed that shareholders would receive the equivalent amount of total cash payment in 2018 as they would have under the previous payment policy.

Based upon 65% of 2017 earnings, under the previous calculation methodology, shareholders would have expected to receive a final dividend of 128.4p in May 2018 and an interim dividend of 61.6p in September 2018, being equivalent to one third of the dividend in respect of 2017, with total dividend expected to be received in 2018 of 190.0p.

A second interim dividend of 43.6p (equivalent to 25% of the cash dividend paid in 2017) was announced on 5 December 2017 and was paid on 8 February 2018. This second interim dividend and the three quarterly dividend amounts payable in the calendar year 2018 (May, August and November), ensure that shareholders receive the equivalent cash amount during the year as they would have under the previous payment policy.

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

Under IFRS, the dividend is recognised in the year that it is declared or, if required, approved by shareholders. Therefore, the 2017 accounts reflect the 2016 final dividend (approved in April 2017), the 2017 interim dividend (approved in July 2017) and the second 2017 interim dividend (approved in December 2017), in total amounting to 218.2p (£4,465 million), against 155.9p (£2,910 million) in 2016. Further details of the total amounts of dividends paid in 2017 (with 2016 comparatives) are given in note 8 in the Notes on the Accounts.

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

Further details of the quarterly dividends and key dates are set out under 'Shareholder information' on page 242.

Treasury and cash flow

Treasury, liquidity and capital structure

The Treasury function is responsible for raising finance for the Group, managing the Group's cash resources and managing the financial risks arising from underlying operations. Clear parameters have been established, including levels of authority, on the type and use of financial instruments to manage the financial risks facing the Group. Such instruments are only used if they relate to an underlying exposure; speculative transactions are expressly forbidden under the Group's treasury policy. All these activities are carried out under defined policies, procedures and limits, reviewed and approved by the Board, delegating oversight to the Finance Director and Treasury function. See note 23 in the Notes on the Accounts for further detail.

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the Group and obtaining this financing from a wide range of providers. The Group targets an average centrally managed debt maturity of at least five years with no more than 20% of centrally managed debt maturing in a single rolling year. As at 31 December 2017, the average centrally managed debt maturity was 9.2 years (2016: 8.2 years, 2015: 7.9 years) and the highest proportion of centrally managed debt maturing in a single rolling 12-month period was 13.2% (2016: 18.1%, 2015: 15.0%).

The only externally imposed capital requirement the Group has is in respect of its centrally managed banking facilities, which require a gross interest cover of 4.5 times. The Group targets a gross interest cover, as calculated under its key central banking facilities, of greater than 5 times. For 2017, it is 7.8 times (2016: 12.2 times, 2015: 11.6 times).

The Group continues to maintain investment-grade credit ratings, with ratings from Moody's/S&P at Baa2 (stable outlook)/BBB+ (stable outlook), respectively. The strength of the ratings has underpinned debt issuance and the Group is confident of its ability to successfully access the debt capital markets. All contractual borrowing covenants have been met and none are expected to inhibit the Group's operations or funding plans.

The Group replaced the existing £3 billion revolving credit facility maturing in 2021 with a new two-tranche £6 billion revolving credit facility. This consists of a 364-day revolving credit facility of £3 billion (with a one-year extension and a one-year term out option), and a £3 billion revolving credit facility maturing in 2021. The Group also increased the EMTN programme from £15 billion to £25 billion and increased its US and European commercial paper programmes from US$3 billion to US$4 billion and from £1 billion to £3 billion, respectively, to accommodate the liquidity needs of the enlarged Group. At 31 December 2017, £600 million was drawn within the revolving credit facility (2016: undrawn) with £1.2 billion of commercial paper outstanding (2016: £254 million, 2015: £505 million), due to short term funding of the payment of the 2017 MSA liability.

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

On 25 July 2017, British American Tobacco p.l.c. acceded as guarantor under the indentures of its indirect wholly owned subsidiaries RAI and R.J. Reynolds Tobacco Company. The securities issued under these indentures include approximately US$12.2 billion aggregate principal amount of unsecured RAI debt securities and approximately US$231 million aggregate principal amount of unsecured R.J. Reynolds Tobacco Company securities.

Cash flow

Net cash generated from operating activities

Net cash generated from operating activities increased in 2017 by £737 million (or 16.0%) largely due to the cash generated by RAI from 25 July 2017, the profit from operations earned in the period from the rest of the Group (as discussed on pages 44 to 47) and a reduction in inventories. This more than offset an increase in receivables, reduction in trade and other payables, the payment of the 2017 liability related to the MSA in the US and the final quarterly payments in relation to the Quebec Class Action.

In 2016, net cash generated from operating activities decreased by £110 million to £4,610 million, principally due to the Franked Investment Income Group Litigation Order receipts (FII GLO) of £963 million in 2015 that did not recur in 2016 and the continued payments on the Quebec Class Action.

Net cash used in investing activities

In 2017, net cash used in investing activities increased by £17,904 million to £18,544 million (2016: £640 million, 2015: £3,991 million) principally due to the acquisition of the shares in RAI not already owned by the Group. In 2016, cash outflows from investing activities mainly related to the acquisition of Ten Motives, and were lower than 2015, during which year the Group invested to maintain its shareholding in RAI during RAI's acquisition of Lorillard and completed a number of other acquisitions including TDR.

Included within investing activities is gross capital expenditure which includes purchases of property, plant and equipment and purchases of intangibles. This includes the investment in the Group's global operational infrastructure (including, but not limited to, the manufacturing network, trade marketing and IT systems). In 2017, the Group invested £862 million, an increase of 32.2% on the prior year (2016: £652 million, 2015: £591 million). The Group expects gross capital expenditure in 2018 of £1,075 million, mainly related to the ongoing investment in the Group's operational infrastructure including the expansion of NGP.

Summary cash flow

	2017 £m	2016 £m	2015 £m
Cash generated from operations	**6,119**	4,893	5,400
Dividends received from associates	**903**	962	593
Tax paid	**(1,675)**	(1,245)	(1,273)
Net cash generated from operating activities	**5,347**	4,610	4,720
Net cash used in investing activities	**(18,544)**	(640)	(3,991)
Net cash used in financing activities	**14,759**	(4,229)	(219)
Differences on exchange	**(391)**	180	(272)
Increase / (Decrease) in net cash and cash equivalents	**1,171**	(79)	238

Net cash used in financing activities

In 2017, net cash used in financing activities was an inflow of £14,759 million, against an outflow of £4,229 million in 2016 and £219 million in 2015. The increase in cash flows in 2017 were mainly due to the debt movements below, largely the result of the financing undertaken in respect of the acquisition of RAI, partly offset by the payment of the dividend. The increase in outflows in 2016 was largely attributable to a reduction in cash inflows from borrowings of £3,445 million in 2016.

Dividends paid in 2017 increased to £3,465 million compared to £2,910 million in 2016 and £2,770 million in 2015. The increase in 2017 was due to the increased dividend per share and the higher number of shares in issue following the acquisition of RAI.

In March 2016, a US$300 million bond was repaid on maturity. In July 2016, the Group issued a £500 million bond maturing in 2021, and issued two bonds in September 2016 (a US$650 million bond maturing in 2019 and a £650 million bond maturing in 2052). The Group repaid on maturity a CHF 350 million bond in August 2016 and a £325 million bond in September 2016. On 19 July 2016, the Group exercised the make-whole provision for its US$700 million bond originally issued in 2008 pursuant to Rule 144A. The bond was redeemed on 18 August 2016, prior to its original maturity date of 15 November 2018.

In March and April 2017, the Group arranged short term bilateral facilities with some of its core banks for a total of approximately £1.6 billion equivalent. In June 2017, a €1,250 million bond and a US$600 million bond were repaid at maturity. In August 2017, the Group paid on maturity a US$500 million bond.

In July 2017, following the shareholder approvals of the acquisition of RAI, the Group used its US$25 billion acquisition facility provided by a syndicate of relationship banks comprising US$15 billion and US$5 billion bridge facilities with one-and two-year maturities, respectively. In addition, the acquisition facility included two $2.5 billion term loans with maturity in 2020 and 2022. In August 2017, the bridge facilities were refinanced in the US and European capital markets.

Eight US dollar denominated bonds were issued pursuant to Rule 144A with registration rights totalling US$17.25 billion. The issue comprised two bonds totalling US$3.25 billion maturing in August 2020, two bonds totalling US$3 billion maturing in August 2022, one US$2.5 billion bond maturing in August 2024, one US$3.5 billion bond maturing in August 2027, one US$2.5 billion bond maturing in August 2037 and one US$2.5 billion bond maturing in August 2047.

During 2017, four series of bonds were issued pursuant to the EMTN programme and comprised a £450 million bond maturing in August 2025 and three euro denominated bonds totalling €3.1 billion comprising a €1.1 billion bond maturing in August 2021, a €750 million bond maturing in November 2023 and a €1.25 billion bond maturing in January 2030.

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

Adjusted CGFO is a non-GAAP measure and is defined as net cash generated from operating activities, adjusted for the cash impact of adjusting items, net interest paid, net capital expenditure, dividends received from associates and dividends paid to non-controlling interests. Adjusted CGFO was £3,282 million, an increase of 5.4%, and in line with 2016 on a constant rate basis (2016: £3,115 million, 2015: £3,368 million). The increase in 2017 was after the early payment of the 2017 MSA liability, which was tax deductible at 2017 tax rates. Excluding the timing impact of this payment, adjusted cash generated from operations would have increased by approximately 45%. The decrease in 2016 was due to the receipt of £963 million in 2015 related to FII GLO, which did not recur. See page 222 for further information on this measure.

Cash flow conversion

The conversion of profit from operations to net cash generated from operating activities may indicate the Group's ability to generate cash from the profits earned. Based upon net cash generated from operating activities, the Group's conversion rate decreased from 99% to 83% in 2017. This was largely due to the timing of the payment in relation to the 2017 liability for the MSA in December 2017, the costs associated with the acquisition of RAI and other adjusting items.

[@]Operating cash flow conversion ratio (based upon adjusted profit from operations) fell from 92% in 2015 and 93% in 2016 to 79% in 2017. Excluding the timing of the payment of the 2017 MSA liability, operating cash flow conversion ratio would have been 96%, reflecting the Group's ability to deliver cash from the operating performance of the business. Operating cash flow conversion ratio is not an IFRS measure. See page 221 for further information on this measure.

Reconciliation of net cash generated from operating activities to Adjusted CGFO[@]

	2017 £m	2016 £m	2015 £m
Net cash generated from operating activities	**5,347**	4,610	4,720
Net cash impact of adjusting items	**685**	711	480
Dividends paid to non-controlling interests	**(167)**	(147)	(235)
Net interest paid	**(1,004)**	(537)	(522)
Net capital expenditure	**(767)**	(559)	(483)
Dividends from associates	**(903)**	(962)	(593)
Trading loans to third party	**101**	–	–
Other	**(10)**	(1)	1
Adjusted cash generated from operations	**3,282**	3,115	3,368

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

Cash flow continued

Borrowings and net debt

Total borrowings increased to £49,450 million in 2017 (2016: £19,495 million; 2015: £17,001 million), largely due to the US$25 billion debt raised in connection with the acquisition of the remaining 57.8% of shares in RAI not previously owned by the Group and the consolidation of RAI's debt on acquisition (US$13 billion). Borrowings increased in 2016 partly due to the issuance of GBP and US dollar bonds and the impact of devaluation of sterling on the year end balances.

Net debt is a non-GAAP measure and is defined as total borrowings, including related derivatives, less cash and cash equivalents and current available-for-sale investments. Net debt at 31 December 2017 was £45,571 million (2016: £16,767 million; 2015: £14,794 million), with the movement in net debt in 2017 and 2016 largely due to the movement in borrowings, described above.

Retirement benefit schemes

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

The Group also operates a number of defined contribution schemes. The present total value of funded scheme liabilities as at 31 December 2017 was £11,868 million (2016: £7,155 million; 2015: £5,956 million), while unfunded scheme liabilities amounted to £1,157 million (2016: £476 million; 2015: £364 million). The schemes' assets increased from £6,086 million in 2015 to £7,278 million in 2016 and to £12,350 million in 2017. After excluding unrecognised scheme surpluses of £23 million (2016: £18 million; 2015: £11 million), the overall net liability for all pension and health care schemes in Group subsidiaries amounted to £698 million at the end of 2017, compared to £371 million at the end of 2016 (2015: £245 million). Contributions to the defined benefit schemes are determined after consultation with the respective trustees and actuaries of the individual externally funded schemes, taking into account regulatory environments.

Accounting policies

The application of the accounting standards and the accounting policies adopted by the Group are set out in the Group Manual of Accounting Policies and Procedures (GMAPP).

GMAPP includes the Group instructions in respect of the accounting and reporting of business activities, such as revenue recognition, asset valuations and impairment testing, adjusting items, the accrual of obligations and the appraisal of contingent liabilities, which include taxes and litigation. Formal processes are in place whereby central management and end-market management confirm adherence to the principles and the procedures and to the completeness of reporting. Central analyses and revision of information are also performed to ensure and confirm adherence.

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

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

- review of asset values, including goodwill and impairment testing;
- estimation and accounting for retirement benefit costs;
- estimation of provisions, including as related to taxation and legal matters; and
- estimation of the fair values of acquired net assets arising in a business combination.

The critical accounting judgements are described in note 1 on the financial statements and include;

- identification and quantification of adjusting items; and
- review of applicable exchange rates for transactions with and translation of entities in territories where there are restrictions on the free access to foreign currency or multiple exchange rates.

Reconciliation of total borrowings to net debt

	2017 £m	2016 £m	2015 £m
Total borrowings*	**49,450**	19,495	17,001
Derivatives in respect of net debt:			
– assets	**(640)**	(809)	(373)
– liabilities	**117**	300	164
Cash and cash equivalents	**(3,291)**	(2,204)	(1,963)
Current available for sale investments	**(65)**	(15)	(35)
Net debt	**45,571**	16,767	14,794

* borrowings as at 31 December 2017 include £947 million in respect of the purchase price adjustments relating to the acquisition of Reynolds.

Other

Accounting developments

The Group has prepared its annual consolidated financial statements in accordance with IFRS. There were no material changes to the accounting standards applied in 2017 from those applied in 2016.

Future changes applicable on the accounting standards that will be applied by the Group are set out in the Notes on the Accounts (note 1 – Accounting Policies).

IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers will apply to the Group Financial Statements with effect from 1 January 2018, and the expected impact of these changes is also disclosed in note 1.

Under IFRS 9, the recognition of potential impairment of receivables under the expected loss model, and changes in the carrying value of debt modified in historic liability management exercises, are expected to reduce reserves by £37 million at 1 January 2018.

Under IFRS 15, certain trade related expenditure is reclassified from operating costs, reducing reported revenue in 2017 by £664 million (2016: £618 million). In addition, in 2017, an adjustment for the timing of payments to indirect customers would have reduced revenue and profit from operations by £64 million.

Foreign exchange rates

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

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

Litigation and settlements

As discussed in note 28 in the Notes on the Accounts, various legal proceedings or claims are pending or may be instituted against the Group.

Government activity

The marketing, sale, taxation and use of tobacco products have been subject to substantial regulation by government and health officials for many years. For information about the risks related to regulation, see page 49 and pages 226 to 231.

Off-balance sheet arrangements and contractual obligations

Except for operating leases, the Group has no significant off-balance sheet arrangements. The Group has contractual obligations to make future payments on debt guarantees. In the normal course of business, it enters into contractual arrangements where the Group commits to future purchases of services from unaffiliated and related parties. See page 224 for a summary of the contractual obligations as at 31 December 2017.

Going concern

A description of the Group's business activities, its financial position, cash flows, liquidity position, facilities and borrowings position, together with the factors likely to affect its future development, performance and position, are set out in this Annual Report and Form 20-F.

The key Group risk factors include analyses of financial risk and the Group's approach to financial risk management. Notes 20 and 23 in the Notes on the Accounts provide further detail on the Group's borrowings and management of financial risks.

The Group has, at the date of this report, sufficient existing financing available for its estimated requirements for at least the next 12 months. This, together with the proven ability to generate cash from trading activities, the performance of the Group's Global Drive Brands, its leading market positions in a number of countries and its broad geographical spread, as well as numerous contracts with established customers and suppliers across different geographical areas and industries, provides the Directors with the confidence that the Group is well placed to manage its business risks successfully in the context of current financial conditions and the general outlook in the global economy.

After reviewing the Group's annual budget, plans and financing arrangements for the next three years, the Directors consider that the Group has adequate resources to continue operating and that it is therefore appropriate to continue to adopt the going concern basis in preparing the Annual Report and Form 20-F.

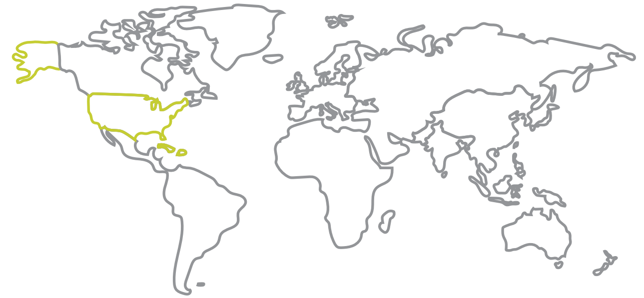
Foreign exchange rates

	Average			Closing		
	2017	2016	2015	**2017**	2016	2015
Australian dollar	**1.681**	1.824	2.036	**1.730**	1.707	2.026
Brazilian real	**4.116**	4.740	5.101	**4.487**	4.022	5.831
Canadian dollar	**1.672**	1.795	1.954	**1.695**	1.657	2.047
Euro	**1.142**	1.224	1.378	**1.127**	1.172	1.357
Indian rupee	**83.895**	91.022	98.070	**86.343**	83.864	97.508
Japanese yen	**144.521**	147.466	185.012	**152.387**	144.120	177.303
Russian rouble	**75.170**	91.026	93.591	**77.880**	75.429	107.646
South African rand	**17.150**	19.962	19.522	**16.747**	16.898	22.839
US dollar	**1.289**	1.355	1.528	**1.353**	1.236	1.474

Regional review
United States

"These are exciting times as Reynolds American Inc. is integrated with BAT – the integration is going well, with the business continuing to deliver"

Ricardo Oberlander
President and CEO (RAI)



Our US business (Reynolds American) includes:

– the second largest tobacco company in the United States, R.J. Reynolds Tobacco Company;

– Santa Fe Natural Tobacco Company, Inc. (manufacturing Natural American Spirit);

– American Snuff Company LLC, the second largest smokeless tobacco company in the United States; and

– Other business units of R.J. Reynolds Vapor, Niconovum USA, Inc. and Niconovum AB, principally managing the development and commercialisation of NGP.

RAI's largest operating unit is R.J. Reynolds Tobacco Company with a brand portfolio which includes three of the top four best-selling cigarettes in the United States: Newport, Camel and Pall Mall. These, and other brands including Doral, Misty and Capri, are manufactured in a variety of styles and marketed throughout the United States.

R.J. Reynolds Tobacco Company owns a manufacturing facility near Winston-Salem, North Carolina – a facility capable of producing approximately 115 billion cigarettes a year. Cigarettes are distributed primarily through a combination of direct wholesale deliveries from two distribution centres and public warehouses located throughout the United States.

R.J. Reynolds Tobacco Company also offers a smokeless tobacco product called Camel Snus – a heat-treated tobacco product sold in individual pouches.

The second largest operating unit is Santa Fe Natural Tobacco Company, Inc. – which manufactures and markets premium cigarettes and other tobacco products under the Natural American Spirit brand in the United States. Natural American Spirit is one of the top ten brands in the United States.

Santa Fe Natural Tobacco Company, Inc. owns a manufacturing facility in Oxford, North Carolina.

The RAI Companies also include the United States' second largest smokeless tobacco manufacturer, American Snuff Company, LLC, which offers consumers a range of differentiated smokeless tobacco products, primarily moist snuff. The main brands are Grizzly and Kodiak.

American Snuff Company, LLC owns manufacturing facilities in Memphis, Tennessee; Clarksville, Tennessee and Winston-Salem, North Carolina.

Also included within the US business are a number of other products including:

– Vuse "Digital" vapour cigarette products, one of the top-selling vapour products in convenience/gas stores, and available in more than 110,000 retail outlets across the United States; and

– Zonnic, a nicotine replacement therapy gum, available in approximately 40,000 retail outlets across the United States.

All financial statements and financial information provided by the US business or RAI (and/or the RAI Group) are prepared on the basis of US GAAP and constitute the primary financial statements or financial records of the US business or RAI (and/or the RAI Group). For the purpose of consolidation within the results of BAT p.l.c. and the BAT Group, this financial information is then converted to IFRS. To the extent any such financial information provided in this Annual Report and Form 20-F relates to the US business or RAI (and/or the RAI Group) it is provided as an explanation of the US business's or RAI's (and/or the RAI Group's) primary US GAAP based financial statements and information.

Volume and Market Share

In the period since acquisition, cigarette volume was 36 billion, outperforming the industry with total cigarette market share at 34.7%, up 20 bps on 2016. Newport and Natural American Spirit continued to grow market share driven by the investment into the trade and, together, they are the fastest growing premium brands on the market. Camel market share increased due to the performance of the menthol range. Pall Mall market share was lower due to the price competition in the value for money category. Combined, the US drive brands grew market share by 40 bps in 2017.

Volume of moist snuff was equivalent to 3.2 billion sticks in the period since acquisition. Total moist market share was up 100 bps on 2016 to 34.4%, primarily due to the performance of Grizzly in the moist snuff category, benefiting from its strength in the pouch and wintergreen categories, as well as the recent national expansion of its Dark Select style and the limited edition packs.

Volume

36 bn

Market share

+20 bps

Revenue

Revenue was £4,211 million in the period since acquisition.

Revenue (£m)

£4,211m

Profit from operations

Profit from operations was £1,318 million in the period since acquisition. Profit from operations was impacted by the FDA user fees of £62 million and product liability defence costs of £59 million. Additionally, £865 million was incurred as part of the State Settlement Agreements, with £109 million credits recognised as part of the non-participating manufacturers (NPM) adjustment claims.

The United States business also incurred other costs that relate to adjusting items, including the Engle progeny cases, tobacco related or other litigation and other costs associated with the integration with the rest of the Group. Adjusted profit from operations at constant rates was £1,980 million for the period since acquisition.

Profit from operations

£1,318m

Adjusted profit from operations at constant rates

£1,980m

Non-GAAP

Operating margin

31.3%

Adjusted operating margin

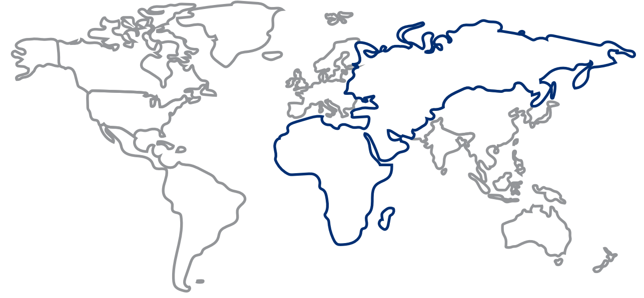
49.4%

Non-GAAP

Regional review continued
Eastern Europe, Middle East and Africa (EEMEA)

"Growing market share driven by the GDBs, underpins a resolute performance in challenging circumstances"

Johan Vandermeulen
Regional Director



Key markets

Algeria, Egypt, GCC, Iran, Iraq, Kazakhstan, Morocco, Nigeria, Russia, South Africa, Turkey, Ukraine

Volumes and market share

Volume in 2017 was 228 billion, a decline of 3.4% on the prior year, as higher volume in Nigeria, GCC, Turkey and Algeria was more than offset by reductions in Ukraine, South Africa, Russia and Iran. Market share was up 30 bps as growth in Russia and Turkey, driven by Rothmans and Kent, and GCC, more than offset a lower market share in South Africa.

In 2016, volume was 236 billion, up 3.0% (2015: 229 billion) as growth in a number of markets including Ukraine, Russia, Turkey and Algeria were partly offset by lower volume in South Africa and GCC. Market share grew in Russia and Turkey, which was driven by Kent and Rothmans, and in Ukraine.

Volume

228 bn

2016: 236 bn
2015: 229 bn

Market share

+30 bps

GDB as % of volume

59%

2016: 52%
2015: 48%

Revenue

Revenue was up 4.4% at £3,915 million as pricing in a number of markets, including Ukraine, Turkey and Iran, and the impact of the devaluation in sterling, more than offset the decline in volume in the region and down-trading in both Russia (due to competitive pricing in the low segment) and GCC (following the increase in excise). On a constant currency basis, adjusted revenue was up 0.6% at £3,773 million.

In 2016, revenue was up 10.0% at £3,750 million (2015: £3,408 million). This growth was driven by the higher regional volume and pricing, notably in Russia, GCC, Nigeria, Turkey and Egypt, more than offsetting the down-trading in South Africa and GCC. On a constant currency basis, adjusted revenue was up 10.1% at £3,753 million.

Revenue (£m)

£3,915m

2016: £3,750m (+10.0%)
2015: £3,408m (-9.1%)

Change in adjusted revenue at constant rates (%)

+0.6%

2016: +10.1%
2015: +7.5%

Non-GAAP

Profit from operations

Profit from operations was 5.4% higher in 2017, at £1,246 million, driven by the growth in revenue and the foreign exchange tail wind due to the devaluation of sterling. Before adjusting items and the impact of exchange on the regional performance, adjusted profit from operations at constant rates of exchange fell by 1.9%, to £1,265 million, as the impact of the excise change in GCC, down-trading in Russia and continued transactional foreign exchange headwinds on cost of sales more than offset the growth in Ukraine, Iran and Algeria.

In 2016, profit from operations grew by 4.9% to £1,182 million (2015: £1,127 million) as growth in Russia, Turkey and Algeria, more than offset a decline in Ukraine (impacted by geopolitical volatility and competitive pricing), Iran (largely due to the retrospective application of an increase in excise) and South Africa, driven by down-trading and higher illicit trade. Excluding adjusting items and the impact of exchange on the regional results, adjusted profit from operations was up 5.3% at constant rates at £1,271 million (2015: £1,208 million).

Profit from operations (£m)

£1,246m

2016: £1,182m (+4.9%)
2015: £1,127m (-14.5%)

Change in adjusted profit from operations at constant rates

-1.9%

2016: +5.3%
2015: +1.3%

Non-GAAP

Operating margin

31.8%

2016: 31.5%
2015: 33.1%

Adjusted operating margin

34.2%

2016: 34.4%
2015: 35.4%

Non-GAAP

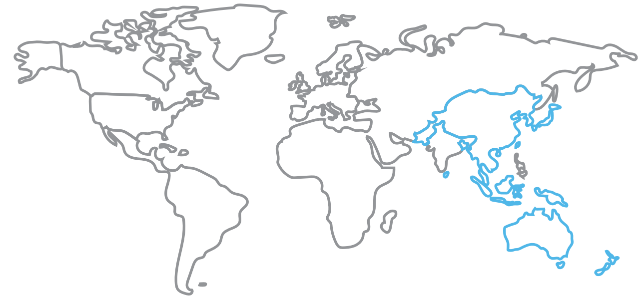
Asia-Pacific

"glo provides a platform for further success as the business continues to perform well"

Johan Vandermeulen
Regional Director

Key markets

Australia, Bangladesh, Indonesia, Japan, Malaysia, New Zealand, Pakistan, South Korea, Taiwan, Vietnam



Volumes and market share

Volume was lower in 2017 (down 1.3% at 193 billion). glo was launched nationally in Japan and South Korea, performing well with national market share in Japan reaching 3.6% in December 2017. Volume from glo and cigarette volume growth in Bangladesh was more than offset by the lower combustible volume in Japan and industry volume decline in Malaysia, Pakistan and South Korea. Market share was higher, up 60 bps, with growth in Bangladesh, Japan, Pakistan and Australia, driven by Lucky Strike, Pall Mall and Rothmans, more than offsetting lower market share in Malaysia and Indonesia, which was due to down-trading.

In 2016, volume was 196 billion, 0.9% down on 2015, as higher volume in Bangladesh, Vietnam, South Korea and Indonesia, was more than offset by industry declines in Pakistan and Malaysia. Market share was down as down-trading in Malaysia and South Korea more than offset increases in Australia, Japan and Indonesia.

Volume

193 bn

2016: 196 bn
2015: 198 bn

Market share

+60 bps

GDB as % of volume

44%

2016: 43%
2015: 42%

Revenue

In 2017, revenue was up by 5.7% at £4,509 million due to the combination of volume and pricing, notably in Bangladesh, Australia and New Zealand, revenue from glo following the roll-out and subsequent growth in Japan and South Korea, and the positive impact of the devaluation in sterling on the reported results. This more than offset the impact of down-trading in Malaysia, and the industry contraction combined with growth in illicit trade in Pakistan.

Excluding the positive currency effect, on a constant exchange rate basis, adjusted revenue increased by 1.3% to £4,320 million.

In 2016, revenue grew 13.1% to £4,266 million, as volume movements and pricing led to higher revenue in Bangladesh, Pakistan, Indonesia and Sri Lanka, combined with the currency tailwind following the devaluation of sterling. On a constant currency basis, adjusted revenue fell by 0.1%.

Revenue (£m)

£4,509m

2016: £4,266m (+13.1%)
2015: £3,773m (-2.6%)

Change in adjusted revenue at constant rates (%)

+1.3%

2016: -0.1%
2015: +0.0%

Non-GAAP

Profit from operations

Profit from operations was 14.4% higher in 2017 at £1,638 million, as the growth in revenue, and transactional foreign exchange tailwinds notably due to the relative movements in the US dollar and euro against the Japanese yen, were partly offset by the investment behind glo in Japan and South Korea and negative mix effects from down-trading in Malaysia.

Before adjusting items, which mainly related to the Malaysian factory closure and the amortisation of trademarks, and the impact of exchange rate movements on the reported results, adjusted profit from operations on a constant currency basis was up 2.7% at £1,674 million.

In 2016, profit from operations was up 5.2% at £1,432 million (2015: £1,361 million), driven by revenue growth noted above and productivity initiatives in South Korea. Before the impact of the South Korea sales tax, restructuring in Japan and Australia and the factory closure in Malaysia, adjusted profit from operations, at constant rates increased by 1.3% to £1,488 million (2015: £1,469 million).

Profit from operations (£m)

£1,638m

2016: £1,432m (+5.2%)
2015: £1,361m (+0.0%)

Change in adjusted profit from operations at constant rates

+2.7%

2016: +1.3%
2015: -0.1%

Non-GAAP

Operating margin

36.3%

2016: 33.6%
2015: 36.1%

Adjusted operating margin

38.9%

2016: 38.2%
2015: 38.9%

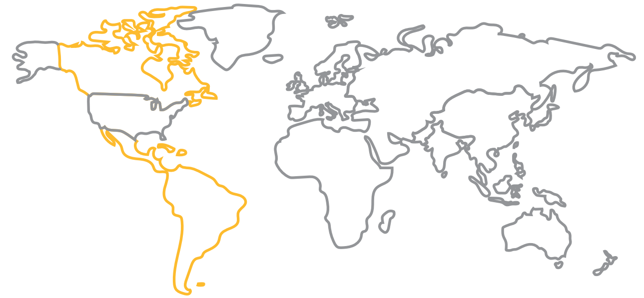
Non-GAAP

Regional review continued
Americas

"Pricing more than offset volume declines in a difficult environment, with profit from operations increasing"

Kingsley Wheaton
Regional Director

Key markets
Argentina, Brazil, Canada, Chile, Colombia, Mexico



Volume and market share

Volume was 5.0% lower in 2017 at 107 billion, as growth in Mexico was more than offset by the difficult economic conditions which led to continued down-trading and industry contraction in Brazil and Argentina, and the growth of illicit trade in Chile. Market share was flat as the combined growth in Mexico, Argentina, Colombia and Chile offset Brazil, which was lower despite the continued success of Minister and Kent (following the migration from Free).

In 2016, volume was down 8.8% at 113 billion (2015: 124 billion) as higher volume in Mexico and Colombia was more than offset by declines in Brazil (due to the VAT and excise-led price increase) and Venezuela, where price increases impacted consumer affordability and disposable income.

Volume
107 bn
2016: 113 bn
2015: 124 bn

Market share
Flat

GDB as % of volume
43%
2016: 36%
2015: 31%

Revenue

Revenue grew by 9.0% in 2017, to £3,125 million. This was driven by pricing across the region, with revenue higher in Canada, Mexico, Chile and Colombia, more than offsetting a decline in Brazil and in Venezuela, where the deterioration in the exchange rate more than offset higher pricing due to local inflation. On a constant rate basis adjusted revenue was up 10.8% at £3,178 million.

In 2016, revenue was up by 5.4% at £2,868 million (2015: £2,720 million), driven by pricing in Canada, Chile, Venezuela, and Colombia more than offsetting the volume decline and delay in pricing in Mexico. The reported results were also impacted by the volatility on the currency markets. On a constant rate basis, adjusted revenue increased by 10.8%.

Revenue (£m)
£3,125m
2016: £2,868m (+5.4%)
2015: £2,720m (-9.0%)

Change in adjusted revenue at constant rates (%)
+10.8%
2016: +10.8%
2015: +11.7%
Non-GAAP

Profit from operations

In 2017, profit from operations increased by 12.8%, to £1,147 million. This was mainly due to the growth in revenue noted above. Excluding adjusting items, that largely relate to the amortisation of acquired trademarks, and the impact of currency, adjusted profit from operations at constant rates increased by 9.9% to £1,288 million.

Profit from operations fell by 6.0% in 2016 to £1,017 million (2015: £1,082 million). Growth in profit from operations in Canada, Chile and Colombia, driven by the increase in revenue and the positive impact of the weakness of sterling, was more than offset by lower profit in Brazil, which was due to the lower revenue and costs associated with the factory down-sizing. After adjusting for such restructuring costs, the amortisation of acquired trademarks and the impact of exchange rate movements, adjusted profit from operations at constant rates increased by 2.8% to £1,202 million (2015: £1,169 million).

Profit from operations (£m)
£1,147m
2016: £1,017m (-6.0%)
2015: £1,082m (-9.6%)

Change in adjusted profit from operations at constant rates
+9.9%
2016: +2.8%
2015: +10.9%
Non-GAAP

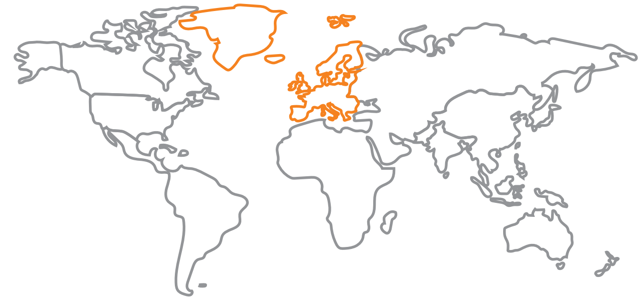
Operating margin
36.7%
2016: 35.5%
2015: 39.8%

Adjusted operating margin
40.2%
2016: 40.9%
2015: 42.9%
Non-GAAP

Western Europe

"Growth driven by strong fundamentals, acquisitions and the increasing contribution from Vype"

Tadeu Marroco
Regional Director



Key markets

Belgium, Czech Republic, Denmark, France, Germany, Italy, Netherlands, Poland, Romania, Spain, Switzerland, United Kingdom

Volume and market share

In 2017, volume was 122 billion, an increase on 2016 of 1.7%. This was driven by the contribution from the tobacco assets of Bulgartac and FDS acquired in the year, and higher volume in Spain, Romania, Portugal, Poland and Hungary, which more than offset lower volume in Italy and Greece. On an organic basis, volume fell 0.8%.

Market share was up 30 bps, driven by Germany, Spain, Romania and Poland largely due to the performance of Rothmans, Pall Mall and Lucky Strike.

Volume was up in 2016 by 6.7%, benefiting from the acquisition of TDR (in Croatia) and higher volume in Poland and Romania, more than offsetting declines in the UK, Denmark and Germany. Excluding the acquisition of TDR, on an organic basis volume was up 2.4% on 2015 (2015: 112 billion). Market share was lower despite growth in Romania through Pall Mall and Dunhill, which was more than offset by lower market share in Switzerland, Italy and Denmark.

Volume

122 bn (organic -0.8%)

2016: 120 bn
2015: 112 bn

Market share

+30 bps

GDB as % of volume

67%

2016: 63%
2015: 62%

Revenue

Revenue, in 2017, grew by 17.2% to £4,532 million, as the positive effect of acquisitions in the year and higher revenue in Germany, Romania, and Spain, offset a decline in the UK due to aggressive pricing in the market and lower revenue in Italy and France. Excluding excise on goods acquired under short-term contract manufacturing arrangements, on an adjusted, constant rate basis, revenue was up 3.6%, or 0.9% excluding acquisitions.

In 2016, revenue grew by 20.7% to £3,867 million (2015: £3,203 million). This was due to the contribution from TDR, and pricing, notably in Germany, Romania, Italy and Poland, and the weakness of sterling in the period. Excluding the impact of currency and the contribution from TDR in the period, on an adjusted organic constant rate basis revenue increased by 3.6% to £3,317 million.

Revenue (£m)

£4,532m

2016: £3,867m (+20.7%)
2015: £3,203m (-4.6%)

Change in adjusted revenue at constant rates (%)

+3.6% (organic +0.9%)

2016: +8.4% (organic +3.6%)
2015: +3.5%
Non-GAAP

Profit from operations

Profit from operations grew 8.0% in 2017 to £1,127 million, due to improved revenue and devaluation in sterling, with profit from operations up in Germany, Romania, Denmark and Spain. This was partly offset by the costs of the ongoing closure of the factory in Germany and impairment of certain assets related to a third-party distributor (Agrokor) in Croatia, the partial absorption of excise in France, investment behind NGP in the UK and lower profit from operations in Belgium and Netherlands. Excluding the acquisitions, adjusting items (including Agrokor, factory closure costs and trademark amortisation) and the impact of foreign exchange, adjusted organic profit from operations at constant rates of exchange increased by 4.9% to £1,456 million.

In 2016, profit from operations increased by 5.5% to £1,044 million, driven by increases in Germany, Romania, Italy and France and the devaluation in sterling. Excluding adjusting items, largely related to the factory closure in Germany and the amortisation of acquired trademarks, and the impact of foreign exchange, adjusted profit from operations at constant rates of exchange grew by 7.8% to £1,236 million.

Profit from operations (£m)

£1,127m

2016: £1,044m (+5.5%)
2015: £990m (-2.8%)

Change in adjusted profit from operations at constant rates

+5.0% (organic +4.9%)

2016: +7.8%
2015: +5.1%
Non-GAAP

Operating margin

24.9%

2016: 27.0%
2015: 30.9%

Adjusted operating margin

36.5%

2016: 35.9%
2015: 35.8%
Non-GAAP