

RESPONDING TO A CHANGING WORLD

Sustainability Report 2016



BRITISH AMERICAN
TOBACCO

INTRODUCTION

Our Group vision is to be the world's best at satisfying consumer moments in tobacco and beyond, based on the key strategic focus areas of growth, productivity, a winning organisation and sustainability.

This enables our business to deliver growth today, while ensuring we generate the funds to invest in our future. Tobacco remains at the core of our business and will continue to provide us with opportunities for growth. However, we also see substantial growth opportunities in new types of tobacco and nicotine alternatives, which we call Next Generation Products, and are making significant progress in the commercialisation and development of a range of products which offer consumers potentially less risky alternatives to conventional cigarettes.

As a key strategic focus area, sustainability is crucial to the delivery of our Group strategy and is integrated across all areas of our business. In particular, three key areas have been identified through a detailed materiality process as having the greatest significance to our business and our stakeholders: Harm Reduction, Sustainable Agriculture and Farmer Livelihoods, and Corporate Behaviour.

This Report covers these areas and how we are responding to the challenges and opportunities they create. As with any business, we need to deliver value for our shareholders, but this should not be at a 'cost' to society. So the concept of shared value and mutual benefit is central to our whole approach – by taking action to address our impacts today, we can create value for the future of our business and for stakeholders across our value chain.

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Q&A with

What is the biggest change that BAT has had to respond to over recent years?

I think it has to be the evolution of technology and innovation that has enabled the development of a whole range of smoking alternatives, which can perform to consumers' expectations and be scaled commercially.

We've embraced this change and, over the last five years, have built a whole new area of our business focused on researching, developing and commercialising this new generation of tobacco and nicotine products.

Does this change everything? In reality, I don't think all smokers will switch to these alternative products over the medium term. But I do believe that through the creation of inspiring products, we can drive change for the good. At the heart of this is our desire to reduce the health impact of smoking on the world.

How is BAT responding to the increasing focus on human rights in supply chains?

Our global agricultural supply chain is a vital part of our business and we've long been aware of the importance of protecting human rights in this area. That's why we welcome the UN Guiding Principles on Business and Human Rights, and legislation such as the UK Modern Slavery Act, as they provide a much clearer roadmap for companies to follow.

From an industry-wide perspective, the new Sustainable Tobacco Programme is bringing together best practice to strengthen standards for suppliers across the tobacco leaf supply chain. I believe it's an excellent example of collaboration, and shows how different parties can come together to make a difference for the common good.

However, human rights remain an incredibly challenging area and one which we are constantly working to improve. For example, in 2016, we rolled out our new Supplier Code of Conduct which sets out the minimum standards we expect all our suppliers to adhere to, including specific human rights criteria.

We've also been working over the last year to strengthen due diligence for all our suppliers outside of our agricultural supply chain. This includes a new integrated system focused on assessing suppliers' human rights risk exposure and then prioritising the highest risk for self-assessments and on-site audits. We are now conducting a phased roll out to all our suppliers worldwide.

our Chief Executive

How are the growing number of allegations against businesses impacting upon BAT?

We have always done our utmost to uphold high standards, openly engage with our stakeholders and work to strengthen our approach to align to their expectations.

Multinational businesses have long been subject to stakeholder scrutiny and allegations – especially one like ours in a controversial sector and with global operations and supply chains in challenging and diverse environments.

So if we do receive any reports of unethical behaviour, such as two recent allegations of human rights abuses in our tobacco leaf supply chains in Indonesia and Bangladesh, we conduct detailed investigations, take appropriate action to address any issues identified, and report transparently on the progress and outcomes.

What role do you see BAT taking in supporting the UN Sustainable Development Goals (SDGs)?

I see a clear alignment between the SDGs and our own sustainability priorities. This is especially true of our global Sustainable Agriculture and Farmer Livelihoods (SAFL) programme, which will enable us to measure our contribution to the SDGs in a tangible way, especially the goals relating to poverty, life on the land, gender equality, clean water and sanitation, and decent work and economic growth.

Goal 17, with its focus on partnerships, is also particularly relevant. Working collaboratively as part of multi-stakeholder partnerships has always been central to our approach to sustainability. Only by working together can some of the biggest challenges we face, such as child labour in agriculture or the global illegal tobacco trade, be addressed effectively.

This is BAT's 15th year of sustainability reporting – what are you most proud of and where do you see the next 15 years taking the business?

I'm incredibly proud of how we've continually developed our strategy to meet evolving stakeholder expectations and the needs of the business.

We conducted our first detailed materiality assessment 10 years ago, which was instrumental in sharpening our agenda and taking us from a broad approach that included numerous socially responsible and philanthropic projects, to focusing-in on the core issues and embedding the principle of shared value across our day-to-day business practices.

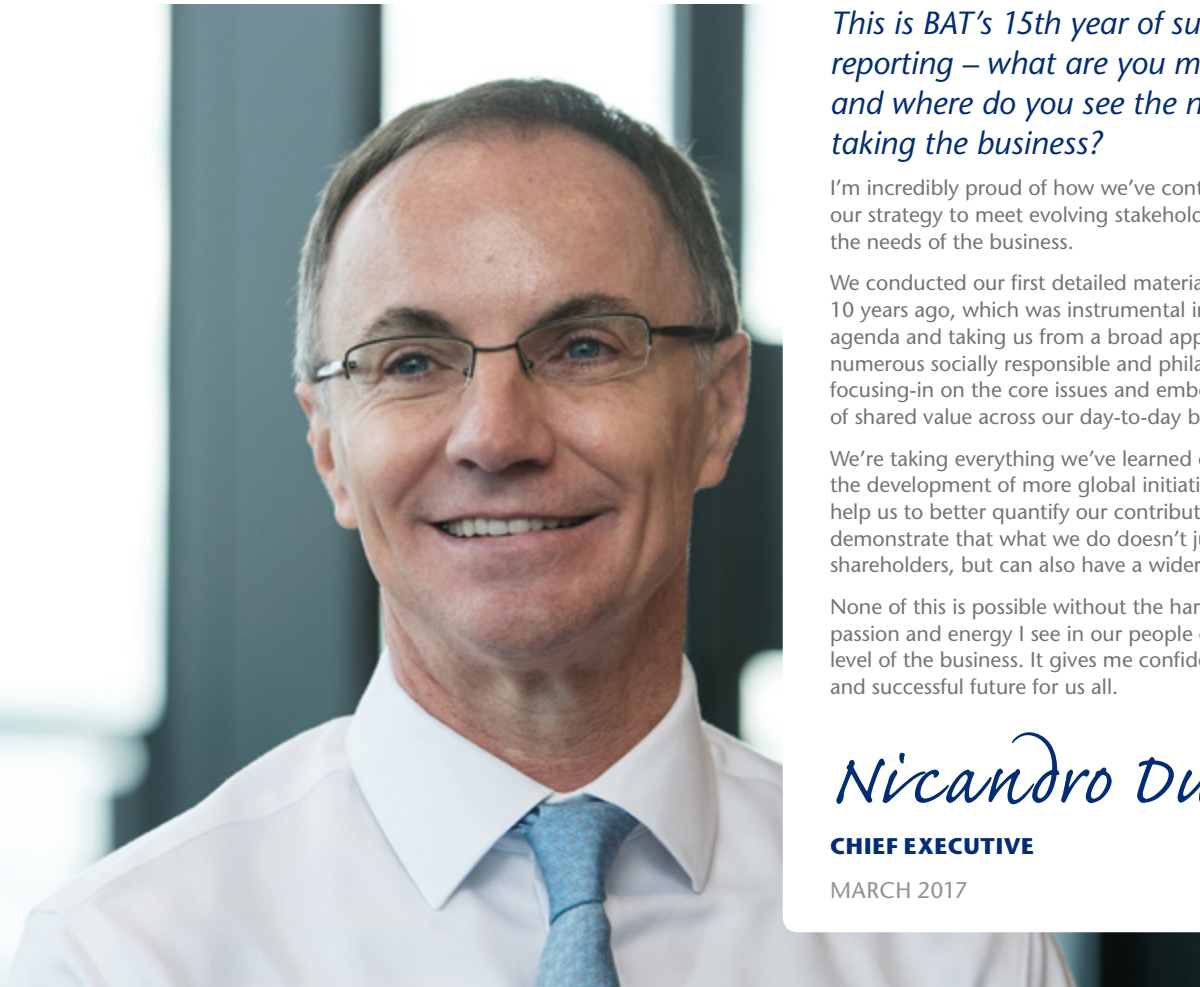
We're taking everything we've learned over the years into the development of more global initiatives, which will help us to better quantify our contribution and ultimately demonstrate that what we do doesn't just benefit our shareholders, but can also have a wider, positive impact.

None of this is possible without the hard work, dedication, passion and energy I see in our people every day, at every level of the business. It gives me confidence in a sustainable and successful future for us all.

Nicandro Durante

CHIEF EXECUTIVE

MARCH 2017



OUR BUSINESS AND VALUE CHAIN

British American Tobacco is one of the world's leading multinational companies, with brands sold in over 200 markets.

We are also one of the world's most successful businesses – we are consistently among the top 10 companies on the London Stock Exchange and are market leaders in more than 55 countries.

Founded in 1902, our continuing success is built on the Group's diverse strengths – our strong brands, our innovation in new products and our research into less risky alternatives, the geographic spread of the markets in which we operate, and our talented people.

We are an innovative company with a proven strategy focused on delivering mutual benefit across our value chain, while investing in a sustainable future for our business and society.

Our long-standing focus on sustainability and commitment to high standards has received notable independent recognition, including:



Industry leader in the 2016 Thomson Reuters Diversity & Inclusion Index



Number one ranking in the Institute of Directors' 2016 Good Governance Report



Inclusion in RobecoSAM's 2017 Sustainability Yearbook, with a Silver Class distinction for excellent sustainability performance



Inclusion in the Dow Jones Sustainability Indices (DJSI) for 15 consecutive years



Our people and relationships feed into everything we do, at every stage

We employ around 50,000 people worldwide, to whom we pay over £2.4 billion each year in wages and benefits.

Our workforce is diverse and multicultural, with 144 nationalities and 33% female representation in management roles globally. We also have 27% female representation on our Board of Directors and are ranked in the top 20 of the FTSE for Ethnic Diversity of UK Boards.

Our business also supports thousands of people across our value chain, including farmers, suppliers, contractors, distributors and retailers, with whom we have excellent relationships as valued business partners.

Our companies have always been closely identified with the communities where they operate and over the past five years we have invested around £60 million in projects to support them.

We engage with a wide variety of stakeholders at local, regional and global levels, to understand their views and concerns, gain valuable feedback and respond appropriately. We also actively share our experience and expertise, and collaborate with others to develop joint solutions to common challenges.

SOURCE



We source over 400,000 tonnes of tobacco leaf each year from a small number of first-tier suppliers, including our own in-house tobacco leaf operations, which directly contract and support over 90,000 contracted farmers; as well as third-party suppliers, which contract their own farmers.

We also source direct materials that go into our products, such as paper, filter tips and packaging, and indirect goods and services, such as machinery, IT and consultancy, from approximately 70,000 suppliers worldwide.

The e-liquids used in our Vapour Products (e-cigarettes) are made from medical-grade nicotine sourced from high-quality third-party manufacturers.

How we create value

- We invest over £60 million each year in providing on-the-ground support for our contracted farmers and have a dedicated programme focused on ensuring that we are meeting the real needs of rural communities.
- Our Supplier Code of Conduct defines the minimum standards we expect, such as in relation to human rights, helping to improve the lives of people in countries where legal requirements or enforcement aren't as high.

MARKET



We offer adult consumers a range of products including: cigarettes, Fine Cut tobacco, Swedish-style snus and Next Generation Products in a number of markets.

How we create value

- Our range of Next Generation Products, including Vapour Products and Tobacco Heating Products, enables us to meet varied consumer preferences for alternatives, which could help to reduce the public health impact of smoking.
- Our marketing is aimed at adult consumers only and we work with retailers to prevent underage access.
- We provide clear and meaningful information about the risk profiles of our different product categories, enabling consumers to make an informed choice.
- In 2016, we collected over £30 billion in taxes on behalf of governments, including tobacco excise, employee taxes, VAT and other sales taxes.



PRODUCE

We manufacture high-quality tobacco products in our own state-of-the-art facilities all over the world and our Next Generation Products are manufactured in third-party factories. We continue to work to ensure that we use natural resources as efficiently as possible to reduce our impact on the environment.

How we create value

- In 2016, we had 44 factories across the globe producing cigarettes. These strategically placed factories enable us to maximise efficiency and ensure products are where they need to be at the right time.
- Environmental factors are a key consideration in the design of new factories and in making our existing factories more efficient, with a particular focus on reducing energy and water use.
- For our Next Generation Products, we expect our contract manufacturers to comply with the same high standards that exist on our own sites.



Innovation feeds into everything we do, at every stage

We make significant investments in research and development to deliver innovations that satisfy or anticipate consumer needs and generate growth for the business.

This includes cigarette innovations, such as capsule products, as well as researching and working to develop innovative, less risky alternatives, including Vapour Products and Tobacco Heating Products.

World-class science

We have an extensive scientific research programme and 2016 marked the 60th anniversary of the opening of our first R&D centre in the UK.

Over recent years, we've transformed our R&D to ensure we have an innovation pipeline of Next Generation Products for the future, as well as developing the science we need to evaluate them.

We have invested more than US\$1 billion on R&D over the past five years – the majority of which is focused on harm reduction research and developing Next Generation Products.

We follow high standards and codes of conduct for all our research, collaborations, funding and clinical studies.

We are transparent about our science and publish details of our research programmes on bat-science.com, and the results of our studies in peer-reviewed journals. Since 2008, over 200 of our research papers have been published.

We open the doors of our research facilities in the UK to visiting regulators and scientists and you can take a video tour inside our labs and meet some of our scientists at bat.com/labtour.

CONSUMERS

We place adult consumers at the heart of our business.

We invest in world-class research to understand changing consumer needs and buying behaviour. This drives our sourcing, product development, innovations, brands and trade activities.

We aim to satisfy consumers with a range of inspiring products across the risk spectrum, providing clear information about the health risks and marketing them responsibly to adults only.



DISTRIBUTE

We distribute our products around the globe effectively and efficiently. Around half of our global volume is sold by retailers, supplied through our direct distribution capability or exclusive distributors. We continuously review our route to market for traditional tobacco and Next Generation Products, including our relationships with wholesalers, distributors and logistics providers.

How we create value

- Our global footprint and direct distribution capability enables our products and new innovations to be distributed to markets quickly and efficiently.
- We have a dedicated programme focused on the safety of our 26,000 drivers, which won the International Fleet Safety Award in 2016.
- We're working to address the environmental impact of our fleet through optimum standards for fuel efficiency, engine size and emissions, as well as increasing load capacity to reduce the number of journeys.



HARM REDUCTION**INSPIRING PRODUCTS****THE ISSUE**

Harm reduction is a well-established public health concept that seeks pragmatic ways to minimise the impact of an inherently risky activity or behaviour without stopping it entirely.

So, in terms of tobacco, this means giving the millions of people worldwide who continue to smoke, the choice of switching to alternative products with lower health risks.

**DRIVING CHANGE****THE OPPORTUNITY**

The evolution of new, game-changing technology has enabled the development of a whole new generation of alternatives to smoking, including Vapour Products (e-cigarettes), which contain no tobacco at all, and Tobacco Heating Products, which heat rather than burn tobacco.

These products have the potential to offer a triple win: a win for society in reducing the public health impact of smoking; a win for consumers in offering a choice of exciting, less risky products; and a win for our business and our shareholders in generating sustainable value.

THE CHALLENGE

There is no 'one-size-fits-all' alternative product, as consumers are complex with different preferences that change and evolve over time. So, we need to develop a range of inspirational products that meet all their varying demands and expectations.

To achieve this, it is critical that governments and regulators create a fertile ground in which growth and innovation are encouraged, while ensuring consumer safety and driving product quality.



"I see our role in tobacco harm reduction very clearly. It's to help reduce the public health burden of smoking and, to do so, ensure that we have the resources, skills and ambition to develop and market a compelling range of products which will deliver to consumers' needs.

Over the last five years, we've invested over US\$1 billion in building our Next Generation Product business, and supporting the growth of these new products with industry-leading standards, world-class science, responsible marketing and regulatory engagement."

**KINGSLEY WHEATON,
MANAGING DIRECTOR OF NEXT GENERATION PRODUCTS**



Next Generation Products is the term we use to describe new types of alternatives to smoking, including Vapour Products (e-cigarettes) and Tobacco Heating Products.



Find more detailed information in our Harm Reduction Focus Report

WWW.BAT.COM/SUSTAINABILITYFOCUS

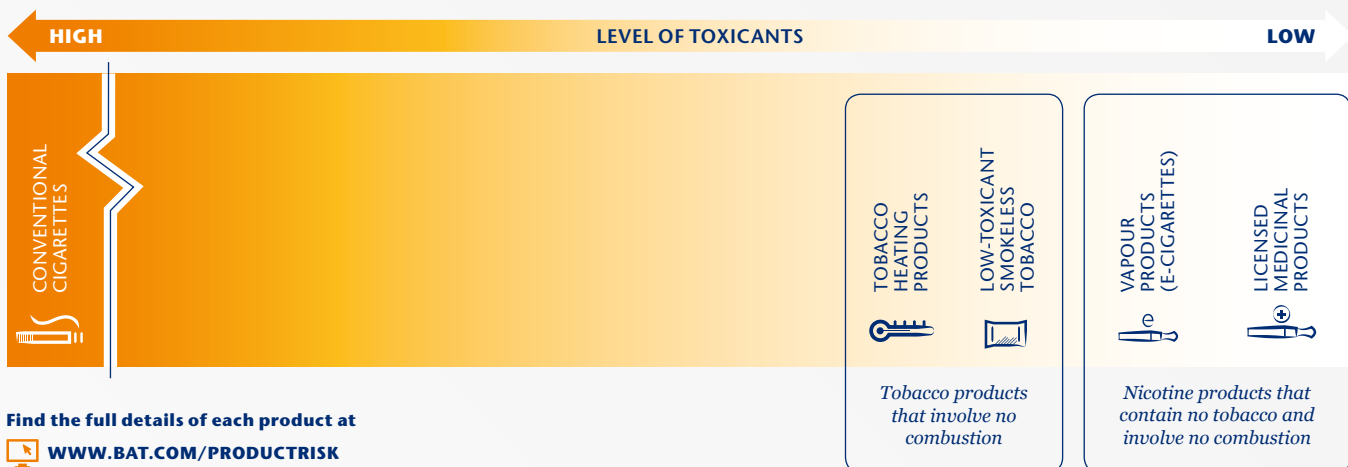
UNDERSTANDING THE RELATIVE RISKS OF DIFFERENT PRODUCTS

Scientists widely agree that it's largely the toxicants found in cigarette smoke that cause smoking-related diseases – not the nicotine itself. Products that involve no combustion are likely to emit far fewer and lower levels of toxicants compared to conventional cigarettes and have the potential to be significantly less harmful to health.

The independent evidence for Swedish-style snus – a type of low-toxicant smokeless tobacco – and licensed medicinal products, such as nicotine patches or gum, is well-established from decades of use. The same long-term evidence is not yet available for new

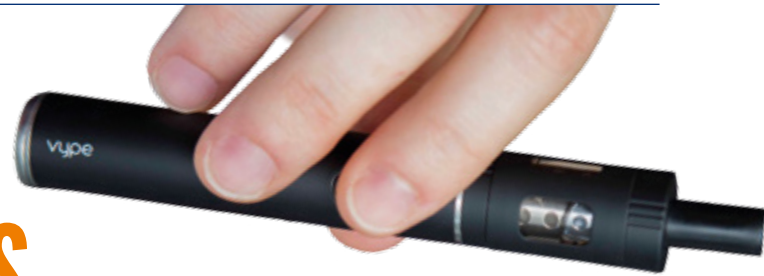
types of Tobacco Heating and Vapour Products. However, our research has shown they emit far lower levels of toxicants compared to conventional cigarettes and have the potential, that needs to be confirmed by further research, to be associated with significantly lower health risks than continued cigarette smoking. We therefore believe tax and regulation for these different products should be appropriate to their relative risks.

The level of toxicants different products emit, based on current evidence, is modelled on the graphic below:



INNOVATIVE AND INSPIRING PRODUCTS

Our strategy is to offer consumers a range of quality products from Vapour to Tobacco Heating Products. This means developing innovative, new products to give our consumers more choice and help ensure their various preferences are met. It also means expanding to new markets.



Our Vapour Products and Tobacco Heating Products are available to consumers across

12 MARKETS WORLDWIDE

VAPOUR PRODUCTS

In 2016, we continued to develop our range with the launch of the Vype Pebble. Pebble is truly original with a striking, minimalist design for those that want the convenience of a small, highly portable device.

We also launched the eBox and eTank Pro devices, which give consumers more control of their vaping experience with open, refillable e-liquid reservoirs.

By the end of 2016, our Vype range was available across 10 markets worldwide and we became the leading Vapour Products business in Europe, covering the UK, France, Germany, Italy and Poland. Vype is also available in Colombia, Guatemala, Kuwait, Bahrain and the Philippines.

In consumer tests, Vype is outperforming its nearest competitor and is seen as a trusted and superior brand. In the UK, according to the market researcher Nielsen, Vype is the fastest-growing brand by retail market share and the number one brand in pharmacy stores.

In the next year, we plan to launch our new Vype platform using a radical new vaping technology developed in partnership with an external inventor. This replaces the current 'coil and wick' system and will give better product performance and satisfaction to consumers.



TOBACCO HEATING PRODUCTS

In December 2016, we launched a new-to-world product, called glo, in Japan.

This was developed following an extensive R&D programme that brought together more than 100 professionals, including world-leading industrial designers, micro-engineers and manufacturers, across five continents.

We are already seeing positive results from the initial launch in the north-eastern city of Sendai, including strong consumer awareness and trial. This test market is informing our plans for further expansion nationwide.

Our innovative product which blends vaping technology with tobacco, iFuse, has also been performing well in our test market in Romania.



SUPPORTING RESPONSIBLE GROWTH

We continue to invest in a number of areas to support the growth of our Next Generation Products and help to realise their potential benefits for public health.

INDUSTRY-LEADING PRODUCT STANDARDS

We use a wide range of analytical techniques and toxicological risk assessments to first develop and then conduct detailed tests of our products – from the flavours and e-liquids we formulate, to the devices we manufacture and the combinations in which they are sold.

We use only pharmaceutical-grade ingredients and food-grade flavourings in our e-liquids, all our devices are CE certified for EU safety, health and environmental requirements and assessed by an independent third party, and we operate and maintain a quality management system based on the requirements of ISO9001:2008. Only when we are fully satisfied that a product meets our high standards for quality and safety do we allow it to go on the market.

These robust assessments and standards for safety and quality give consumers confidence in our products and ensure they are of the highest quality. We would like the approaches we've developed to become the benchmark for the industry and for future regulation. That's why we've been openly sharing our knowledge, expertise and scientific research results, as well as participating, as part of a broad consultation, in the development of industry-wide standards with independent organisations.

Having worked on the development of the first national standards for Vapour Products in the UK and France, we are now participating in working groups of the EU Standards Body (CEN) for Europe-wide standards. We are also providing technical input to the International Organisation for Standardisation (ISO) for developing global specifications.

WORLD-CLASS SCIENCE

We've transformed our R&D over recent years to ensure we have an innovations pipeline of commercially scalable and consumer satisfying products for the future.

This includes using cutting-edge consumer research and feedback, monitoring wider market trends, recruiting new scientists and experts, scouting for innovative technologies, and partnering with inventors and small companies.

We're also at the cutting-edge of science in developing new studies to evaluate these products and publishing the results in peer-reviewed scientific journals.

In 2016, we completed the most comprehensive chemical comparison to date between cigarette smoke and e-cigarette vapour emissions. It found substantial reductions in Vype ePen emissions for all toxicant groups measured¹. While this does not necessarily confirm that Vapour Products produce less adverse health effects than conventional cigarettes, it is very encouraging.

Also in 2016, we published the results of the largest study of its kind conducted to examine vaping behaviour². We are now using the results to help ensure our studies and tests in the lab mimic 'real world' consumer use.

To better understand the effects on the human body, we undertook a number of lab-based studies³ on human cells that compared the biological effect of cigarette smoke with that of vapour from our Vype ePen. The results concluded that smoke is highly toxic to these cells, but vapour is significantly less so. In addition, we found that cigarette smoke causes DNA damage, but the vapour does not, even when the cells are subjected to doses much higher than for the smoke. So, in general, cells exposed to vapour did not exhibit the same disease-relevant responses as smoke. These results support our belief that Vapour Products have the potential to be substantially reduced risk compared to conventional cigarettes.

We openly share our scientific research and, in 2016, participated in a number of international conferences, including the Global Forum on Nicotine, EuroScience Open Forum and the US Food and Drug Administration (FDA) Workshop on Biomarkers of Potential Harm.

Find details of our latest research at

 WWW.BAT-SCIENCE.COM



The current expert estimate is that

USING E-CIGARETTES IS AROUND 95% SAFER THAN SMOKING

according to a report by Public Health England

1 *Chemical Composition of Aerosol from an E-Cigarette: A Quantitative Comparison with Cigarette Smoke*, Margham, J., McAdam, K., Forster, M., Liu, C., Wright, C., Mariner, D. and Proctor, C., *Chemical Research in Toxicology*, September 2016. Please note, this is a comparison between the smoke from combusted tobacco in a standard 3R4F reference cigarette (approximately 9mg tar) and the vapour from Vype ePen, in terms of the nine types of harmful components which the World Health Organisation recommends to reduce in cigarette smoke.

2 *Development, validation and application of a device to measure e-cigarette users' puffing topography*, Cunningham, A., Slayford, S., Vas, C., Gee, J., Costigan, S. and Prasad, K., *Scientific Reports*, October 2016.

3 (a) *E-cigarette aerosols induce lower oxidative stress in vitro when compared to tobacco smoke*, Taylor, M., Carr, T., Oke, O., Jaunky, T., Breheny, D., Lowe, F. and Gaça, M., *Toxicology Mechanisms and Methods*, September 2016; (b) *Electronic cigarette aerosol induces significantly less cytotoxicity than tobacco smoke*, Azzopardi, D., Patel, K., Jaunky, T., Santopietro, S., Camacho, O., McAughy, J. and Gaça, M., *Toxicology Mechanisms and Methods*, September 2016; (c) *The mutagenic assessment of an electronic-cigarette and reference cigarette using the Ames assay in strains TA98 and TA100*, Thorne, D., Crooks, I., Hollings, M., Seymour, A., Meredith, C. and Gaça, M., *Mutation Research*, October 2016; (d) *The comparative in vitro assessment of e-cigarette and cigarette smoke aerosols using the yH2AX assay and applied dose measurements*, Thorne, D., Larard, S., Baxter, A., Meredith, C. and Gaça, M., *Toxicology Letters*, January 2017.

Spotlight on Italy

In 2015, Italy became one of the first markets to sell Vype outside the UK.

Following a successful pilot in the city of Florence, Vype products have now been rolled out to 10 new cities, reaching over 2,000 retailers, as well as being available nationally online.

In November 2016, our first ever Vype flagship store in Milan opened to coincide with the international launch of our Pebble device.

Luca Angiolillo, Head of Next Generation Products at BAT Italy, explains: "The store is not only a place for consumers to buy Vype products, but also to learn more about the category and explore the range, including exciting new innovations, like Pebble.

"It was a fantastic culmination of over two years of work in building our Vype business in Italy, from developing new supply chain and distribution channels, to training our marketing agencies in our Vapour Products Marketing Principles to ensure full compliance.

"As such a new category, there is still a lot of debate and misunderstanding among both regulators and the general public, so we're particularly proud of our successes in building a constructive and transparent dialogue on regulation and product standards with the Ministry of Health and the National Institute of Health, based on expertise and scientific evidence.

"It's been no easy undertaking and we've still much more to do, including further expansion across the country and introducing new devices and flavours in 2017.

"For me, it's been a very challenging, yet incredibly fulfilling time and I'm excited to see where the future will take us."



OVER US\$1 BILLION

invested in our Next Generation Product business over the last five years

EVIDENCE-BASED REGULATION

Proportionate regulation for Next Generation Products is essential for creating a fertile ground for responsible growth and adult consumer access, to support take-up by more smokers which can ultimately help to realise the potential benefits for public health. To achieve this and ensure growth isn't stymied, it is critical for governments to introduce policies that are thoroughly informed by robust evidence.

This is a challenging area where there has been much debate and confusion about how these new products should be regulated. We believe that collaboration between all relevant stakeholders is needed to ensure new regulation protects consumer safety and product quality, while also taking account of the relative risks and not treating them in the same way as conventional cigarettes.

In 2016, we continued to engage with governments and regulators to advocate for our preferred regulatory approach outlined in the adjacent graphic.

Following the November 2016 Conference of the Parties to the World Health Organisation (WHO) Framework Convention on Tobacco Control (FCTC), we welcome the WHO's recognition of the potential role of what they refer to as Electronic Nicotine Delivery Systems (ENDS) in helping to reduce the public health impact of tobacco use, as well as the need for product safety standards.

We hope that our work as part of multi-stakeholder initiatives to develop industry-wide product standards will contribute to this vital area.

RESPONSIBLE MARKETING

Nicotine is addictive and no product is 100% safe, so it's important our marketing of Next Generation Products is done in a responsible way and they do not get into the hands of under-18s.

2016 was the first year in which our Vapour Product Marketing Principles were in operation. Aligned to the UK Committee of Advertising Practice Codes, they are based on four core principles:

 <p>We will target our Vapour Product marketing at adults (18+).</p>	<p>We will be clear and factual about our Vapour Products and their potential risks.</p>
 <p>We will market our Vapour Products to smokers and consumers of vapour and nicotine products.</p>	<p>We will not promote combustible tobacco products through our Vapour Product marketing.</p> 

We are now working on the development of new Marketing Principles for Tobacco Heating Products. This will ensure we have specific principles in place for each of our different product categories worldwide, which are appropriate to their risk profiles.

OUR PREFERRED APPROACH TO REGULATION



QUALITY AND SAFETY STANDARDS

Based on robust science, to ensure consumer safety and confidence.



RESPONSIBLE MARKETING TO ADULTS ONLY

Controlled marketing and advertising rules aimed at adult consumers only.



FREEDOM TO INNOVATE

To give consumers more choice and satisfy their evolving needs and preferences.



FREEDOM TO COLLABORATE AND COMMUNICATE

So the public and private sectors can work together and provide meaningful information to consumers.



APPROPRIATE TAXES AND EXCISE

Reflecting the relative product risks and not artificially driving up prices, which can discourage take-up by more smokers.

"With careful management and proportionate regulation, harm reduction provides an opportunity to improve the lives of millions of people."

UK ROYAL COLLEGE OF PHYSICIANS

Spotlight on Japan

In December 2016, our innovative Tobacco Heating Product, glo, was launched in Japan.

This unique product provides a new-to-world experience, similar to that of a cigarette, but by heating, rather than burning, tobacco. This delivers a cleaner experience with around 90% less toxicants than a standard cigarette⁴.

It works by heating 'Neostiks', under the Kent brand, which contain tobacco and are available in different flavours – from bright tobacco to fresh mint. The device itself is advanced, yet simple and intuitive to use, and has excellent battery life, with one single charge lasting more than 30 sessions based on back-to-back usage.

"Japan is a great market for testing this type of new product as consumers are so open to new technologies, and the country is seen as a unique market and well suited for this type of product," explains Brett Mather, Head of Next Generation Products at BAT Japan. "The Kent brand is also one that Japanese consumers already know and trust.

"It's a real game changer for consumers – a genuine advancement in Tobacco Heating Products for the Japanese market," continues Brett.

"Yet, when you have a product this new and different, it's important you thoroughly prepare for the launch to get the best possible results. We spent over a year preparing for the launch – engaging with the Government and public officials, gaining deep consumer insights through research and focus groups, and educating retailers so they understand and can explain the product to their customers.

"We are proud of the first flagship store in the north-eastern city of Sendai, where consumers can learn more about the innovative Tobacco Heating Product and experience the new glo brand.

"Next Generation Products is a very exciting and fast-moving area of the business to work in. I really enjoy seeing how we're continuously innovating and offering consumers fantastic choices," Brett concludes.

"The interests of consumers are better advanced by the provision of accurate information and choice, than by prohibitions and restrictions on innovative products under the 'precautionary principle'."

JEFF STIER, NATIONAL CENTER FOR PUBLIC POLICY RESEARCH IN WASHINGTON, D.C.

⁴ This is a comparison between the smoke from combusted tobacco in a standard 3R4F reference cigarette (approximately 9mg tar), and the vapour from heated tobacco in glo, in terms of the nine types of harmful components that the World Health Organisation recommends to reduce. It does not necessarily mean that this product produces less adverse health effects than other tobacco products.

ADDRESSING KEY CONCERNS ABOUT NEXT GENERATION PRODUCTS



KEY CONCERNS

They are just as harmful as conventional cigarettes



VIEWS FROM SELECTED INDEPENDENT EXPERTS

While these products haven't been around long enough to generate epidemiological data, which looks at health impacts after decades of use, the current expert estimate from respected bodies, such as Public Health England and the UK Royal College of Physicians, is that e-cigarettes are around 95% safer than smoking⁵. However, some organisations, such as the British Medical Association, continue to raise concerns regarding long-term health risks and so are calling for a precautionary approach through regulatory restrictions, like bans on vaping in public places.



OUR VIEW

The results of our most recent peer-reviewed research show significant reductions in toxicant emissions from Next Generation Products compared with cigarette smoke. This indicates that the health risks are highly likely to be much lower than conventional cigarettes, while recognising that further research is needed. The body of research to date also indicates that Vapour Products emit lower levels of toxicants than Tobacco Heating Products, however more research is needed to assess the significance of this difference in terms of the relative risk.

Second-hand vapour can cause harm to others

A number of studies and evidence reviews have noted that passive exposure to vapour is unlikely to have any significant health impact. Cancer Research UK has stated: "There is no evidence that second-hand vapour is dangerous to others."⁶

All of the robust evidence to date does not justify an indoor ban on Next Generation Products on the basis of potential harm to bystanders from second-hand vapour.

They will act as a gateway into smoking for young people

The UK Royal College of Physicians has stated: "All the UK evidence, and almost all the international evidence, on the use of e-cigarettes by children and young people to date indicates that concerns about e-cigarettes helping to recruit a new generation of tobacco smokers through a gateway effect are, at least to date, unfounded."⁷

We support the UK Royal College of Physicians' view that the current evidence does not indicate a notable gateway effect for young people. We agree that these products should not be used by anyone under the age of 18, which is why we have a strict requirement for our marketing to be directed at adults only.

Not enough is known yet about the long-term health risks

A joint statement by UK public health organisations stated: "We all agree that e-cigarettes are significantly less harmful than smoking... All the evidence suggests that the health risks posed by e-cigarettes are relatively small by comparison but we must continue to study the long-term effects."⁸

We agree that further research and continued monitoring of consumer use is needed to determine long-term risks. Nevertheless, we believe adults, who otherwise would continue smoking, should have the choice to switch to alternative products now. To restrict or ban products under the 'precautionary principle' would be a huge wasted opportunity.

The tobacco industry's involvement in harm reduction is not credible

The tobacco industry is seen as controversial and some organisations, such as the WHO, are sceptical about our motivations. However, some prominent figures in public health have acknowledged the important role tobacco companies can play in being part of the solution.

If the ultimate public health aim is for less risky products to be as widespread, successful and easily available as possible in order to reduce the number of people who smoke, then companies such as BAT are best placed to help achieve this through deep consumer insights, global resources, skills, capabilities and ambition.



OUR COMMITMENTS FOR THE FUTURE

We are committed to researching, developing and commercialising less risky alternatives to regular cigarettes.

Our ambition is to have the world's leading Next Generation Product business by end 2020.

- Launch our new Vype platform using our **game-changing new vaping technology** by end 2017;
- Expand the reach of our Next Generation Products with **launches in 10 new markets** by end 2017;
- **100% adherence to our Vapour Products Marketing Principles** each year;
- Develop and publish **new Marketing Principles for Tobacco Heating Products** by end 2017;
- Continue to take a lead in **advocating for regulation that has high product standards and appropriate commercial freedoms**, including contributing to the working groups of CEN for Europe-wide and ISO for global standards;
- Continue to **present the results of our peer-reviewed scientific research into Next Generation Products** to regulators and other relevant bodies; and
- Continue to work with scientists, public health professionals, regulators and governments around the world to **build support for innovative, less risky products.**

5 (a) *E-cigarettes: an evidence update*, Public Health England, August 2015; (b) *Nicotine without smoke: Tobacco harm reduction*, a report by the Tobacco Advisory Group of the UK Royal College of Physicians, April 2016.

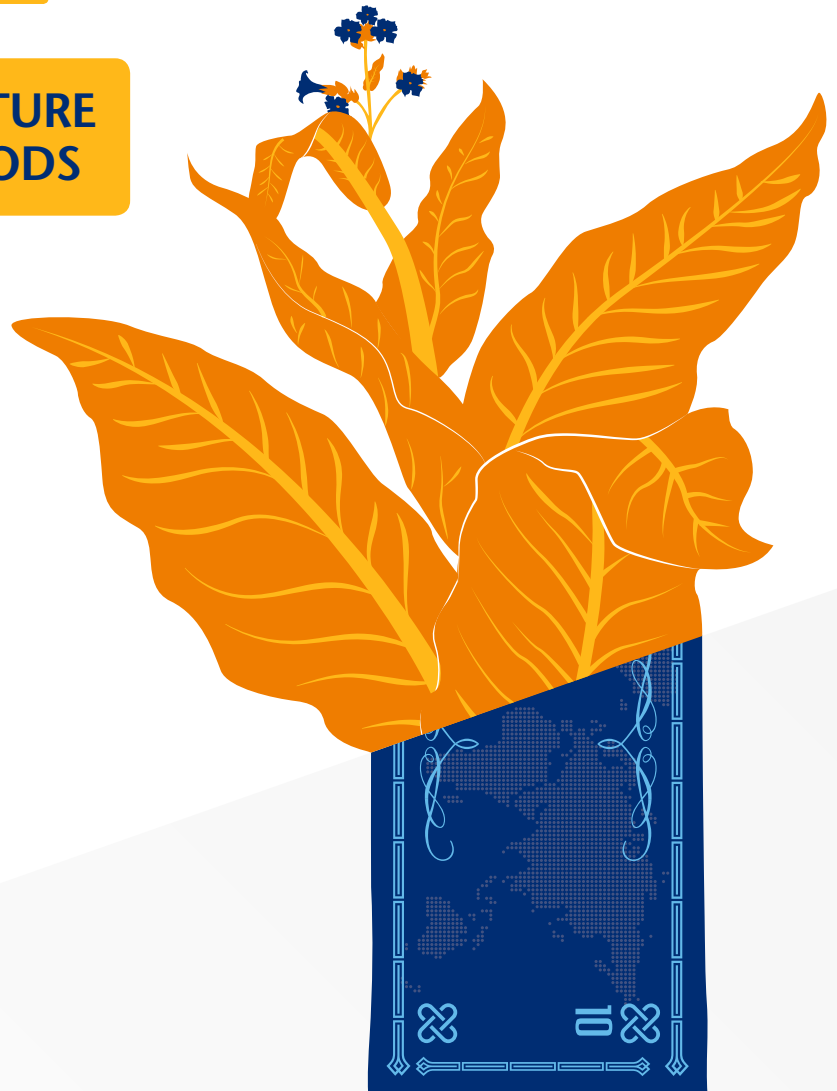
6 *10 common questions about e-cigarettes answered*, Cancer Research UK, May 2016 (accessed in March 2017).

7 *Nicotine without smoke: Tobacco harm reduction*, a report by the Tobacco Advisory Group of the UK Royal College of Physicians, April 2016.

8 *E-cigarettes: a developing public health consensus*, Joint statement on e-cigarettes by Public Health England and other UK public health organisations, July 2016.

SUSTAINABLE AGRICULTURE AND FARMER LIVELIHOODS

THEY GROW, WE GROW: HELPING FARMERS TO THRIVE



THE ISSUE

Tobacco leaf is the most essential part of cigarettes, so the farmers who grow it are absolutely crucial to the success of our business.

We do not own tobacco farms or directly employ farmers – we source from over 90,000 directly contracted farmers, as well as third-party suppliers, mainly in developing countries in Africa, Asia and Latin America.

THE OPPORTUNITY

At BAT, we have a long and proud history of working directly with farmers around the world and advancing agricultural practices.

This benefits our farmers by giving them the resources and support they need to be successful, as well as helping to secure our long-term supply of tobacco leaf and ensure the integrity and quality of our products to satisfy our consumers.

We see an opportunity for us to build on this long-standing approach, to work with others to develop multi-stakeholder solutions to increasing challenges and expectations, and to further enhance the livelihoods of farmers and their communities.

THE CHALLENGE

Agricultural supply chains are particularly vulnerable to a range of challenges, including climate change and water scarcity, increasing demand for land and natural resources, rural poverty, social inequality, child labour and ageing farmer populations. Tobacco is no exception.

OUR TOBACCO LEAF SUPPLY CHAIN

We buy more than **400,000 TONNES** of tobacco each year from first-tier suppliers, which include:



– BAT-owned companies, which directly contract and support over 90,000 farmers



– Third-party suppliers, which contract their own farmers

We also purchase a small amount of tobacco sourced from auction floors

THE DIFFERENT TYPES OF FARMS WE SOURCE FROM



59% are one hectare or less

– Unmechanised and no hired labour
– Grow food crops for their own consumption and for sale in local markets



11% are between 1.1 and four hectares

– Some mechanisation and hired labour
– Grow other crops, such as wheat and maize for commercial sale



30% are over four hectares

– Fully mechanised and use hired labour
– Grow multiple crops for commercial sale, including cotton and soy bean

Over **£60 MILLION** invested each year in farmer support



Extension services

– Our contracted farmers receive on-the-ground support and advice from over 1,000 expert field technicians worldwide
– This covers areas such as improving productivity, preserving soil, water and forests, crop rotation, and tackling child labour



Training and capacity building

– Through farmer clubs, field days, workshops and manuals for our farmers and their communities



Community projects and partnerships

– More than 60 projects and partnerships in 19 countries. Focused on long-term objectives such as eliminating child labour, developing the next generation of farmers and women's empowerment



Global leaf research centre

– Developing comprehensive agri-support packages for our farmers, including new seed varieties and sustainable technologies

“The farmers we work with are valued business partners, so we want them to feel secure and confident about their future, and to be self-sufficient and prosperous.

To achieve this, we know we must respond to the growing number of challenges that are facing agriculture, as well as meeting the increased expectations of the role of businesses in supporting the UN Sustainable Development Goals and protecting human rights across global supply chains.”

ALAN DAVY, GROUP OPERATIONS DIRECTOR



A STRATEGIC APPROACH

We focus on two key programmes to ensure the long-term sustainability of our tobacco leaf supply chain and to enhance farmer livelihoods.

ALL MAJOR GLOBAL TOBACCO MANUFACTURERS

SUSTAINABLE TOBACCO PROGRAMME (STP)



First-tier supplier-level



Global industry-wide standards on pre-competitive areas



Formal assessment and monitoring of suppliers' performance



Compliance to industry-wide standards
Driving continuous improvement across the global tobacco leaf supply chain



BAT-ONLY



SUSTAINABLE AGRICULTURE AND FARMER LIVELIHOODS (SAFL) PROGRAMME



Farm and community-level



Identifying the most pressing issues and risks impacting upon the sustainability of farming communities



Developing effective local actions and long-term multi-stakeholder partnerships



Meeting the needs of rural communities where we source tobacco leaf
Creating long-term value and mutual benefit

SUPPLIER STANDARDS

SUSTAINABLE TOBACCO PROGRAMME

We conduct due diligence on our tobacco leaf supply chain through the Sustainable Tobacco Programme (STP), which assesses and monitors suppliers' performance in meeting industry-wide standards.

The programme assesses first-tier suppliers we buy tobacco leaf from, some of which are BAT-owned companies. It checks if they have the appropriate systems, governance and procedures in place to ensure high environmental and human rights standards on the farms they source from, and provide the best quality tobacco leaf.

STP was developed in 2015 in collaboration with five other tobacco manufacturers to bring together best practice from across the industry. Implementation began in June 2016, replacing our Social Responsibility in Tobacco Production programme, which ran for more than 15 years.

The programme is aligned to important external standards, such as those of the International Labour Organisation (ILO), and includes strengthened processes and more frequent on-site reviews.

Suppliers complete a comprehensive annual self-assessment covering 178 different criteria under the key areas of: crop, environment, people and facilities. They must also show that they have good governance underpinning all four areas and are required to assess, identify and mitigate any significant risks that may affect their ability to meet the criteria.

As well as the self-assessments, independent on-site reviews will be carried out every three years, including in-depth analyses of suppliers' policies, processes and practices, and visits to the tobacco farms they source from.

We will use the results of the self-assessments and on-site reviews to work collaboratively with suppliers to drive corrective action and improvements. In the event of any serious and/or persistent issues, or where suppliers fail to demonstrate a willingness to improve performance, we reserve the right to terminate the business relationship.



ENHANCING FARMER LIVELIHOODS

SAFL PROGRAMME

While STP helps ensure high environmental, social and agronomy standards on a day-to-day basis, many of the challenges impacting upon the livelihoods of our farmers and sustainability of agriculture require a long-term, holistic approach.

For example, in many parts of the world farming isn't seen as an aspirational career choice for young people, so they move away from rural communities to find jobs in the cities. This is leading to ageing farmer populations and is a threat to the long-term sustainability of agriculture.

We need to ensure we have access to high-quality tobacco leaf now and in the future, so it's critical that we work to address this and other supply chain risks and challenges.

These challenges aren't something we can address alone – but we do have a role to play. So, in 2016, we launched our SAFL programme to all our BAT-owned and strategic third-party suppliers worldwide.

Unlike STP, which is a standards-based compliance programme for first-tier tobacco leaf suppliers, SAFL is focused on the farm and community-level and aims to ensure:

- That all our contracted farmers have a viable livelihood;
- That farming is seen as a preferred profession, particularly for rural youth; and
- That within farming, tobacco is seen as a valuable crop to grow.

The programme is based on an internationally recognised framework covering five Capitals

for financial, natural, human, physical and social factors, which are key to sustainable and thriving agricultural communities.

We first piloted it between 2014 and 2015, and used the result to further refine the strategy in consultation with external consultants with expertise in livelihoods programmes. This has included the development of a focused set of key indicators under each of the Capitals, as detailed in the graphic below.

In 2016, we conducted a comprehensive assessment of our farmers' current circumstances for each of these indicators. We are now using the results to identify the most pressing risks and issues on the ground, for which we will develop effective local actions to address them.



WORKING TOGETHER TO IMPLEMENT LONG-TERM SOLUTIONS

We know that many agricultural challenges and their root causes will take years to address and cannot be tackled alone. So implementing long-term community-based projects and multi-stakeholder partnerships are central to the SAFL programme.

Over the next year, we will work to identify appropriate partners, including NGOs, governments, the tobacco industry and other companies with agricultural supply chains, and then support the design and implementation of new projects where they are most needed. This will include integrating the learnings from

our previous and existing collaborative projects, such as the BAT Biodiversity Partnership, and sharing best practices to address common challenges in different countries.

As well as meeting our own objectives around the long-term sustainability of tobacco growing and our responsibility to provide viable livelihoods for our farmers, we believe SAFL will help support wider global objectives, such as the UN Sustainable Development Goals relating to poverty, life on the land, gender equality, clean water and sanitation, and decent work and economic growth.



Tackling rural poverty in Sri Lanka

Our SAFL programme builds upon the many examples of best practice we have across our leaf supply chain to enhance farmer livelihoods.

For example, for over 10 years our business in Sri Lanka has worked to empower poor rural families through a programme of training and support.

Focusing on food cultivation and animal husbandry, our expert field technicians work with the families, teaching them agricultural skills, enhancing their knowledge and providing resources such as seeds, plants and poultry, as well as training in beekeeping, mushroom cultivation and goat-rearing.

The programme is designed to help the families become more self-sufficient and economically independent, while also maximising their land use, empowering women and providing them with a more nutritional diet. It is independently audited against the project objectives, which the programme continues to exceed each year.

In the last 10 years, the programme has benefited over 75,000 people from 19,000 families and has played an important role in helping the Sri Lankan Government to alleviate poverty.

It has also been acknowledged as one of the most comprehensive and effective programmes of its type in the world, winning recognition at the Asia Responsible Entrepreneurship Awards in 2015 and 2016.



CHILD LABOUR AND HUMAN RIGHTS

Agricultural supply chains are particularly susceptible to human rights violations, with the ILO, for example, reporting that 60% of global child labour occurs in agriculture⁹.

We have always made it clear to all our contracted farmers and suppliers that exploitative child labour and other human rights abuses will not be tolerated. Compliance was previously monitored through our Social Responsibility in Tobacco Growing programme and now through the new industry-wide STP.

Our SAFL programme complements STP by working to address some of the root causes of human rights issues. For example, if our farmers have a viable income and livelihood, they are less likely to use their children as farm labour and more likely to send them to school. SAFL also includes a key indicator on child labour and we expect to see further farmer training and focused on-the-ground projects that build on our existing approaches.

For example, in Brazil we support the Tobacco Industry Interstate Union's *Growing Up Right* programme, which uses farmer training to address child labour and has been recognised as an example of best practice by the ILO. Also in Brazil, our *Extended School Day* programme helps provide after-school activities for children in tobacco growing regions.

In Mexico, our company has been working for over 15 years with the Government on the *Blossom* programme, helping to build centres that support the children of indigenous migrant farmworkers through providing education, health checks, better nutrition and somewhere to play.

RESPONDING TO ALLEGATIONS

While we do our utmost to ensure high standards, there have been incidents where it has been alleged we failed to protect the human rights of people in our supply chain, including two reports published by NGOs in 2016 on Bangladesh¹⁰ and Indonesia¹¹.

We take such allegations extremely seriously and openly engaged with the NGOs prior to the reports being published, providing detailed responses to the issues raised and, where possible, also providing supporting evidence, including independent studies, where we felt allegations were unfounded.

We conducted our own internal review in Bangladesh and remain of the view that the report¹⁰ as a whole is not representative of the reality on the ground. However, we recognise the serious nature of the allegations and so have also commissioned an independent assessment of the human rights-related impacts of tobacco growing in the country. We will report on the key findings and, if any issues are identified, we will of course address them as soon as is practically possible.

The report into tobacco growing in Indonesia¹¹ highlighted a number of issues that result from the way in which certain types of tobacco are traditionally grown and sold in the country. We are pleased that it acknowledges the collective responsibilities of the Government, the tobacco industry and NGOs, and we support many of the recommendations on how these groups can tackle this issue. The report findings have been fed into an existing review of our practices in Indonesia and have contributed to our ongoing plans.

These plans include our work with an ECLT-led (see below), multi-stakeholder project to address child labour in Indonesian tobacco growing, as well as further developing our own internal processes to ensure that all aspects of the supply chain are meeting our expected standards. You can read more about this in the case study on page 18.

Also, in 2016, the International Union of Food (IUF) workers made a complaint to the UK National Contact Point (NCP) of the Organisation for Economic Cooperation and Development (OECD), alleging human rights abuses of migrant farmworkers in our US supply chain.

An initial assessment by the UK NCP¹² found that the complaint that we had directly caused or contributed to abuses could not be substantiated and, as a result, they will not examine this further. However, the complaint that we may not have taken adequate steps to leverage a business relationship in order to prevent abuses will be examined further by the NCP. We vigorously disagree with this secondary complaint and are actively and constructively engaging with the NCP to contest it. We will report on the findings once the NCP's investigation has concluded.

THE ECLT FOUNDATION

We were founding Board members of the Eliminating Child Labour in Tobacco Growing (ECLT) Foundation in 2000 and remain active members today, along with all the major tobacco companies, leaf suppliers and the International Tobacco Growers' Association. The ILO and Save the Children Switzerland also serve as advisors to the Board.



ECLT strengthens communities, improves policies, advances research and brings together key stakeholders to develop and implement innovative projects. Since 2000, it has funded 26 long-term projects, reaching over half-a-million families.

Its independent status also means it can call upon governments to take action. For example, over the last year, the ECLT has worked with over 400 key stakeholders to renew national commitments and action plans on child labour.

In December 2014, all ECLT members signed a shared Pledge of Commitment and Minimum Requirements on combatting child labour. The Pledge is consistent with the UN Guiding Principles on Business and Human Rights and signing it is a pre-requisite of membership.

It provides a framework for members to align, reinforce and, where necessary, expand current policies and practices in addressing child labour in tobacco growing. The ECLT publishes results of an annual self-assessment of progress towards full implementation.

Find the Pledge dashboard and more details of the ECLT's approach and achievements at

 WWW.ECLT.ORG

⁹ www.ilo.org/ipec/areas/Agriculture (accessed in March 2017).

¹⁰ *Smokescreens in the supply chain: The impacts of the tobacco industry on human rights and the environment in Bangladesh*, Swedwatch, June 2016.

¹¹ *The Harvest is in My Blood: Hazardous Child Labor in Tobacco Farming in Indonesia*, Human Rights Watch, May 2016.

¹² *Initial Assessment By The UK National Contact Point For The OECD Guidelines For Multinational Enterprises*, Complaint from IUF against BAT, August 2016.

Spotlight on Indonesia

Our business in Indonesia has a long history of supporting tobacco farmers and working as part of multi-stakeholder partnerships to implement joint solutions to common challenges.

For example, a long-term project to address water scarcity on the island of Lombok, involving NGOs, government agencies, the local university and farming communities, resulted in a 15-year Integrated Watershed Management Plan for the area.

TACKLING CHILD LABOUR

Child labour is another challenging issue that cannot be addressed by one group working in isolation – as highlighted by the recent Human Rights Watch report into Indonesian tobacco growing¹³.

As in many developing countries, it's traditional in Indonesia for the children on family farms to learn agricultural techniques and skills from their elders. The ILO acknowledges this is a normal part of growing-up in a rural community – it's only considered to be child labour when activities hinder the children's education, or can be harmful to their health, such as when handling green tobacco or agro-chemicals.

"Since the 1970s, we've worked in partnership with over 1,600 contracted farmers," explains Emmanuel Cosmas-Silalahi, BAT's Head of Leaf in Indonesia. "Working to address child labour has always been a fundamental part of the support, advice and training we give them.

"It's a complex area which cuts across the whole industry and, following our acquisition of the Bentoel Group, another Indonesian tobacco business, in 2010, we've also had the challenge of bringing its farmers and third-party buying agents up to the same standard."

COLLABORATIVE SOLUTIONS

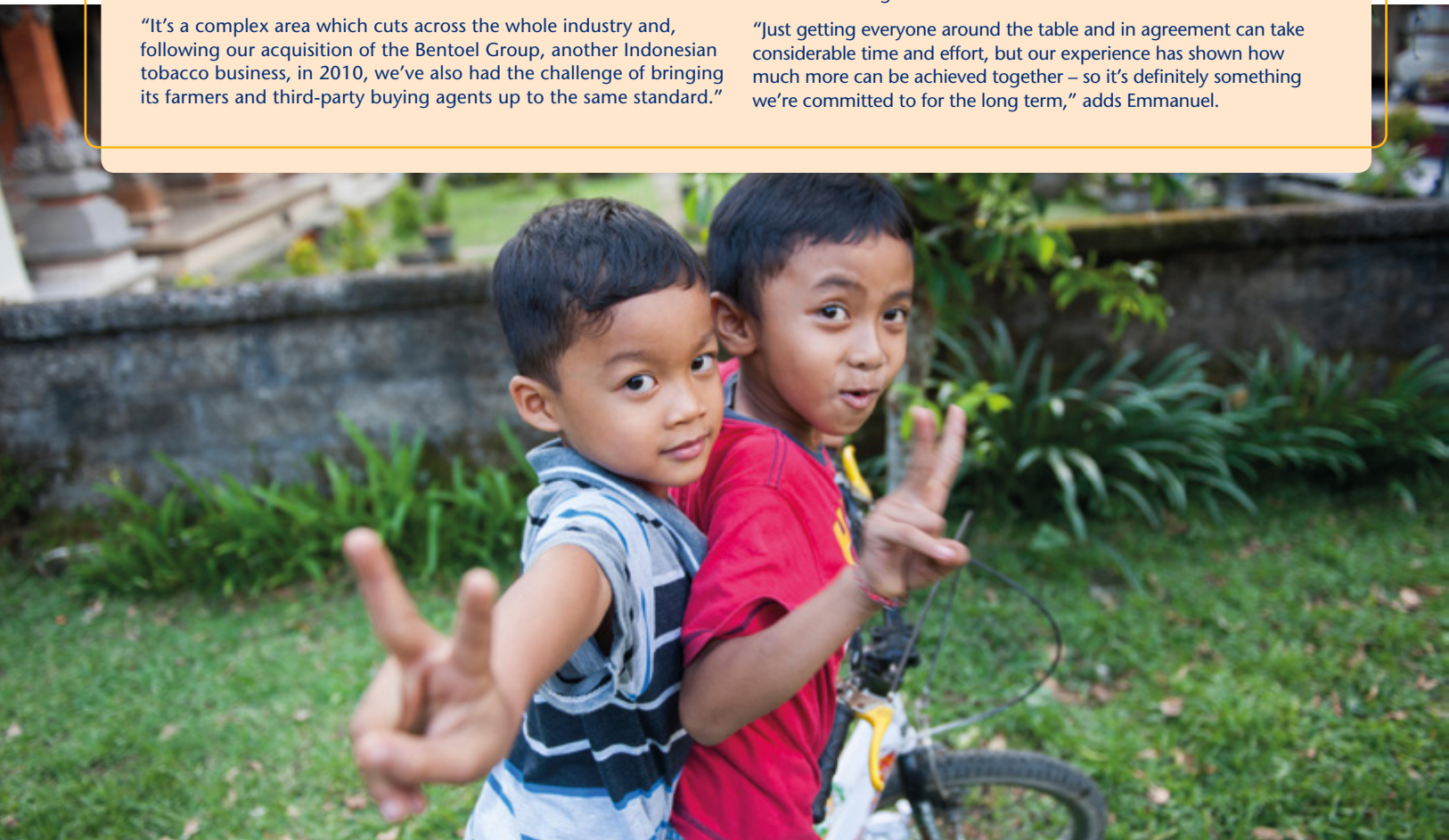
"The introduction of the Sustainable Tobacco Programme (STP) has been a great opportunity for us to work together as an industry to strengthen our approach," Emmanuel continues. "For example, we've run training workshops with all the third-party buying agents so they can effectively apply the programme, drawing on best practice and practical examples, such as adding a 'no child labour' clause to farmer contracts."

We are also working with the ECLT Foundation, and other key stakeholders, to conduct research and engagement into the root causes of child labour, and examine its use in the production of other crops – which it is hoped will ultimately serve as a blueprint for data collection by other agricultural sectors.

The insights will be used to inform ECLT plans for a new project to support national and local government plans, along with strategic partnerships and interventions.

Our business is also collaborating with four state universities on a programme to raise awareness of child labour and conduct farm-level monitoring of children's ages, verifying these against school attendance records and promoting access to schools. In 2017, a focus group of key stakeholders, including Government, schools and farmers, will be established to develop an action plan for priority areas identified through the research.

"Just getting everyone around the table and in agreement can take considerable time and effort, but our experience has shown how much more can be achieved together – so it's definitely something we're committed to for the long term," adds Emmanuel.



¹³ *The Harvest is in My Blood: Hazardous Child Labor in Tobacco Farming in Indonesia*, Human Rights Watch, May 2016.

100% SCORE AND INDUSTRY LEADER

in the Raw Material Sourcing category of the 2016 Dow Jones Sustainability Index

99%

of our contracted farmers' wood fuel for curing in 2016 was from

SUSTAINABLE SOURCES



OUR COMMITMENTS FOR THE FUTURE

We are committed to working to enable prosperous livelihoods for all farmers who supply our tobacco leaf.

- Following the first full year of implementation, **publish our suppliers' aggregated STP scores** from 2018;
- Aim for at least 70% of our spending on **community investment activities in tobacco growing countries to be focused on sustainable agriculture** each year;
- **Eliminate use of unsustainable wood sources** by our contracted farmers;
- Develop **action plans for the most pressing issues identified against our global SAFL indicators** by end 2017; and
- Report on **performance of our SAFL programme** by end 2018.

CORPORATE BEHAVIOUR**GLOBAL REACH,
RESPONSIBLE ACTIONS****THE ISSUE**

Operating to high standards of corporate conduct and transparency is crucial for any company and can be a key determining factor for its ability to operate and its long-term sustainability.

For BAT, as a major multinational in a controversial sector, we have long been aware of our responsibilities in this area.

THE OPPORTUNITY

Multinational businesses can make a difference at a global scale and make a valuable contribution to society: from the economic benefits of trade, investment and employment; to following international frameworks, such as the UN Sustainable Development Goals (SDGs) and Guiding Principles on Business and Human Rights, which can help to improve the lives of people in countries where legal requirements or enforcement aren't as high.

Leveraging influence through supply chains, setting stretching targets and working as part of multi-stakeholder partnerships and collaborations can also help to support and deliver wider international goals.

THE CHALLENGE

In the face of increasing scrutiny and negative perceptions of corporate behaviour, including tax avoidance, executive pay and bonuses, and allegations of unethical behaviour, nearly 50% of the general population globally do not trust businesses¹⁴.

There are also increased expectations of the role of business in helping to address complex global challenges, particularly in relation to areas such as bribery and corruption, climate change, human rights, poverty and sustainable development.

¹⁴ 2016 Edelman Trust Barometer, Annual Global Study.

OUR POLICIES, PRINCIPLES AND STANDARDS

We have clear policies, principles and standards that detail the way we do business and how we behave.

These are regularly reviewed to ensure they remain at the forefront of business practice and continue to meet the expectations of our stakeholders.



Statement of Business Principles

Sets out our core beliefs and values.



Standards of Business Conduct

Apply our values to day-to-day situations and cover policy commitments on issues such as bribery and corruption and human rights, as well as our whistleblowing procedures.



Supplier Code of Conduct

Introduced in 2016, it complements our Standards of Business Conduct by defining the minimum standards we expect of all our suppliers.



International Marketing Principles

Governs the marketing of our tobacco products wherever they are sold around the world.



Principles for Engagement

Provides clear guidance for our external engagement with regulators, politicians and other third parties.

We also have a number of other policies, principles and standards covering areas such as environment, health and safety, employment and youth smoking prevention.

Find details of these, and all our other policies, principles and standards, at

WWW.BAT.COM/PRINCIPLES

“Our actions and behaviour impact all areas of our business – which is why corporate behaviour is such an important area for our long-term sustainability strategy.

We’re proud of the many long-standing and industry-leading practices we have in place, which continue to form the foundation of our culture and values.

Yet, we’re always striving to build upon our approach, addressing tough issues and challenges head-on, while embracing opportunities to continuously improve.”

JERRY ABELMAN, GROUP LEGAL AND EXTERNAL AFFAIRS DIRECTOR



BUILDING TRUST

UPHOLDING HIGH STANDARDS

Transparent and effective governance is critical for ensuring a company acts in a responsible way and is accountable for its behaviour.

In 2016, our commitment to high standards of corporate governance was recognised with the number one ranking among FTSE 100 companies in the Institute of Directors' 2016 Good Governance Report. This index is the only one of its kind to combine measurable factors with the views of investors, business leaders and governance professionals.

"From a reputational standpoint, [BAT] is a tobacco company so is always going to struggle from that aspect, but if you scrutinise the factors, they are really well run."

OLIVER PARRY, HEAD OF CORPORATE GOVERNANCE POLICY AT THE INSTITUTE OF DIRECTORS

OVERSIGHT AND MONITORING

Our governance structure starts at the Main Board of Directors, of which nine of the 11 members are independent Non-Executive Directors. It is collectively responsible to the 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.

In April 2016, following a review of the structure of our Board Committees, we made important changes to sustainability governance. Responsibility for the oversight of strategic issues was moved from a stand-alone Board CSR Committee to the Main Board, and responsibility for regular monitoring of performance was moved to the Board Audit Committee.

This reflects the considerable progress we've made integrating and embedding sustainability into business practices, and demonstrates how key sustainability issues and risks now have the same level of oversight as all other financial, operational and compliance controls.

Full details of our governance and principal Group risk factors can be found in our Annual Report at

 WWW.BAT.COM/ANNUALREPORT

Our whistleblowing procedures enable anyone working for, or with, the Group to raise concerns or grievances in confidence and without fear of reprisal. In 2016, 174 instances of suspected improper conduct contrary to our Standards of Business Conduct (SoBC) were reported (2015: 94). In 65 cases, an investigation found no wrongdoing and in 32 cases the investigation continued at year-end. 77 cases were established as breaches (2015: 29) and the appropriate action was taken which, depending on the circumstances, will include dismissal or disciplinary action. Where criminal activity is believed to be involved, the matter will generally be reported to the relevant authorities and where any weakness in internal controls is identified, appropriate measures are taken to strengthen them.

In 2016, we conducted a review of our ethics and compliance procedures, including peer benchmarking of over 20 multinational companies. A new Business Conduct and Compliance Department, covering our SoBC, including anti-bribery, sanctions and competition law, has now been established to drive forward and embed key recommendations from the review. This will include strengthening our whistleblowing procedures and increasing their accessibility through implementing a new third-party managed 'speak up' hotline and website in 2017.

ANTI-BRIBERY AND CORRUPTION

Our SoBC make it abundantly clear that we do not tolerate corruption in our business, no matter where it takes place. Our Standards, and associated anti-corruption training materials, are fully aligned with the provisions of the UK Bribery Act 2010, and also help support the UN SDGs target, under goal 16, to substantially reduce corruption and bribery in all their forms.

As part of our commitment to continuous improvement, in 2016, we developed new training and communications materials for our employees worldwide to clarify what they should do if they discover actions that conflict with our SoBC.

Despite this, any company can fall victim to an employee acting inappropriately, but what is most important is how it responds. With around 50,000 employees, BAT is no different and we are rightly proud that any alleged breach of our very high expectations of transparency and honesty is swiftly investigated. Any proven transgression results in disciplinary action and may lead to dismissal.

Our investigation into allegations of bribes being paid in our African business is ongoing. We also informed the Serious Fraud Office of our approach to investigating the allegations and are continuing to liaise with them.



OUR STANDARDS OF BUSINESS CONDUCT (SOBC) UNDERPIN OUR COMMITMENT TO HIGH STANDARDS OF CORPORATE BEHAVIOUR

Every Group company and every employee worldwide is expected to live up to the Standards, and guidance on them is provided across the Group through training and awareness programmes and a dedicated site on our intranet.

OVERSIGHT AND MONITORING

MAIN BOARD AUDIT COMMITTEE



REGIONAL AUDIT AND CSR COMMITTEES

COMPLIANCE PROCEDURES



KEY AUDIT CONTROLS

All business units worldwide complete an annual self-assessment against our key audit controls, in which they confirm they have adequate procedures in place to support SoBC compliance.



ANNUAL SIGN-OFF

All staff working across the Group are required to complete an annual sign-off, confirming their commitment and adherence to the SoBC, and re-declare any personal conflicts of interest.



WHISTLEBLOWING PROCEDURES

Anyone working for, or with, the Group can raise concerns or grievances in confidence and without fear of reprisal. We investigate all reported incidents and take appropriate action.

INDUSTRY LEADER

in the Corporate Governance category of the 2016 Dow Jones Sustainability Index

Find out more at

 WWW.BAT.COM/SOBC



TACKLING THE ILLEGAL TOBACCO TRADE

The black market in tobacco involves criminal gangs selling counterfeit cigarettes, cross-border smuggling and engaging in large-scale tax evasion. Some people think we are complicit in this illegal trade – we are not. It harms our business, deprives governments of taxes and funds terrorism. We are determined to do as much as we can to tackle it.

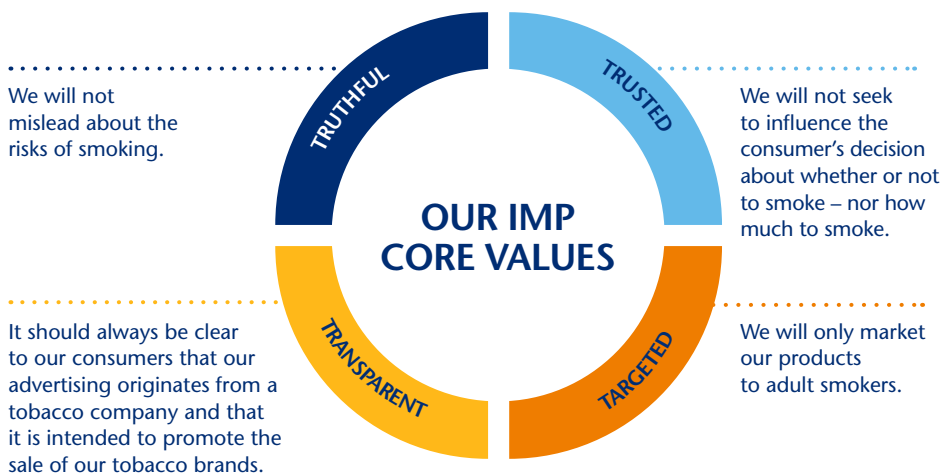
To prevent our products becoming part of this criminal trade, we have robust ‘know your supplier and customer’ procedures to make sure we don’t do business with anyone found to be complicit in tobacco trafficking. We have also introduced an automated system for tracking and tracing our products as they move through the supply chain, as part of our agreement with the European Commission’s Anti-Fraud Office. By the end of 2016, we successfully completed our commitment in the agreement to have this implemented in 18 markets and 11 factories.

We also work to ensure business is joined up with governments and other organisations to make our combined efforts more effective. This includes working collaboratively with law enforcement and working closely with international bodies, such as the World Customs Organisation, Europol and the OECD Task Force on Countering Illicit Trade.

MARKETING RESPONSIBLY

Conventional tobacco products pose serious health risks, so it's vital that they are marketed responsibly wherever they are sold and do not get into the hands of under-18s.

All our marketing of tobacco products complies with local legislation and is governed by our International Marketing Principles (IMP) wherever they are sold, which comprise four core values detailed in the graphic below. These values commit us to always be truthful about the risks of smoking and to never seek to influence the consumer's decision whether to smoke or not. They make it clear that we will only market cigarettes to adult smokers and that we will always be clear that our marketing originates from a tobacco company.



Some have suggested that we take the easy option and ignore our IMP in developing countries, or where tobacco regulation is less strict or the market is more challenging. This is not the case. The Principles are our minimum standard and are applied even when they are stricter than local laws.

We are committed to 100% IMP compliance worldwide. All our marketing materials have to be formally reviewed and approved by our Legal and External Affairs function and we provide training to our marketing employees and trade representatives, as well as any external agencies we work with, to ensure they are effectively applied.



In 2016, no incidents of IMP non-compliance were identified through our internal procedures. There were, however, four external allegations made about our marketing practices in relation to local tobacco control and advertising laws. We conducted detailed investigations and found no evidence of any wrongdoing. Where any instances of non-compliance are identified, immediate action plans are put in place to address them.

» Find out about our approach to responsible marketing for Next Generation Products on page 09.

PREVENTING YOUTH SMOKING

In addition to our strict requirement to only market our tobacco products to adult smokers, we expect youth smoking prevention activities to be conducted in all our markets where we directly distribute our products and where permitted by local legislation. In 2016, we achieved 100% compliance.

Activities include working with retailers to prevent underage access, such as through supporting proof-of-age schemes, and providing training and awareness raising to shop staff. We also engage with governments to establish a minimum age law of 18 or to enforce tougher penalties for those that breach existing age-18 laws.

We are currently reviewing our approach to strengthen it further, including developing new Youth Access Prevention Principles to cover all our different product categories – from conventional cigarettes, to Vapour and Tobacco Heating Products. We are also looking to broaden the scope to include markets where our products are distributed through third parties. This will be rolled out globally in 2017.



Responsible cigarette marketing in a digital world

The pace of change in the digital world is quick, with an expanding range of digital media and devices. As such, people are spending more time online, with the expectation that not only can they buy products but they can also learn about them, explore them and speak with whoever is selling them.

We need to embrace these changes, but are aware that the health risks of smoking mean that we need to do this responsibly – particularly in making sure that we apply our IMP effectively so that tobacco products don't get into the hands of children, or that no one under the age of 18 is exposed to the marketing of them.

In 2016, we developed a digital toolkit that includes in-depth guidance to help our markets apply IMP online. The guidelines cover all aspects of online activity for conventional tobacco products, including content standards and strong restrictions on the use of social media and search engines. There is also extensive guidance on ensuring robust age verification, including requirements for:

- Online content to only be accessible to adult smokers who have had their age verified;
- Robust and dependable proof of age to be provided – simply asking smokers to tick a box or self-declare is not sufficient; and
- Age-verification to take place *before* any branded content is visible.

In implementing this, we recognise there is no 'one-size-fits-all' approach, so consider local variations in literacy, social and cultural factors, and technological understanding.

Acceptable methods include credit cards, government-approved ID, new technologies such as iris recognition, webcam images of users with their ID, and compliance checks with official government and credit bureau databases.

The digital space is continuously changing, so we will regularly be updating the toolkit based on new developments and feedback from our markets.



"Like any business, we want to grow our market share. But we do this responsibly through competitive and innovative product offers that encourage existing adult smokers to choose our products over those of our competitors."

ANDREW GRAY, GROUP MARKETING DIRECTOR

ENGAGING OPENLY ON REGULATION

Our experience and expertise mean that we have much to offer governments and regulators when it comes to developing policies around tobacco.

Some people may think that we try to subvert the regulatory process for our own gain. This is not the case.

We have long supported the OECD Principles for Transparency and Integrity in Lobbying, and the views and positions we advocate on key issues are openly available on our website at bat.com/regulation.

We are always clear about the regulation we support and where we disagree – such as plain packaging, for which we are reluctantly taking legal action to protect our business and commercial rights.

Our Principles for Engagement provide clear guidance for our external engagement with regulators, politicians and other third parties. In 2016, we rolled out new internal guidelines on the Principles to provide further clarity and to ensure that they are interpreted consistently across the Group.

TAX TRANSPARENCY

We operate in 200 markets around the world and pay taxes wherever we make money, in accordance with local laws and following a policy of full disclosure with all tax authorities.

Our tax footprint extends beyond corporation tax and we pay other significant taxes, such as employment taxes, as well as customs and import duties. The Group also collects taxes on behalf of governments, for example, tobacco excise, employee taxes, VAT and other sales taxes.

In 2016, our total Group tax contribution, including both taxes borne and collected, amounted to over £33 billion.

We are committed to being open and transparent with tax authorities, and we contribute to government consultations on new tax measures at both the national and international level.

£33 BILLION

our total tax and excise contribution worldwide

Read our full Group tax strategy in our Annual Report at

 WWW.BAT.COM/ANNUALREPORT

WE WOULD LIKE TO SEE REGULATION THAT IS:



Inclusive: takes a consultative approach, is shaped in collaboration with all stakeholders and respects legal rights and livelihoods, such as those of farmers or retailers.

Evidence-based: derived from robust evidence and thorough research.



Effective: delivers its policy aims and public health objectives, while recognising unintended consequences, such as fuelling the illegal tobacco trade.

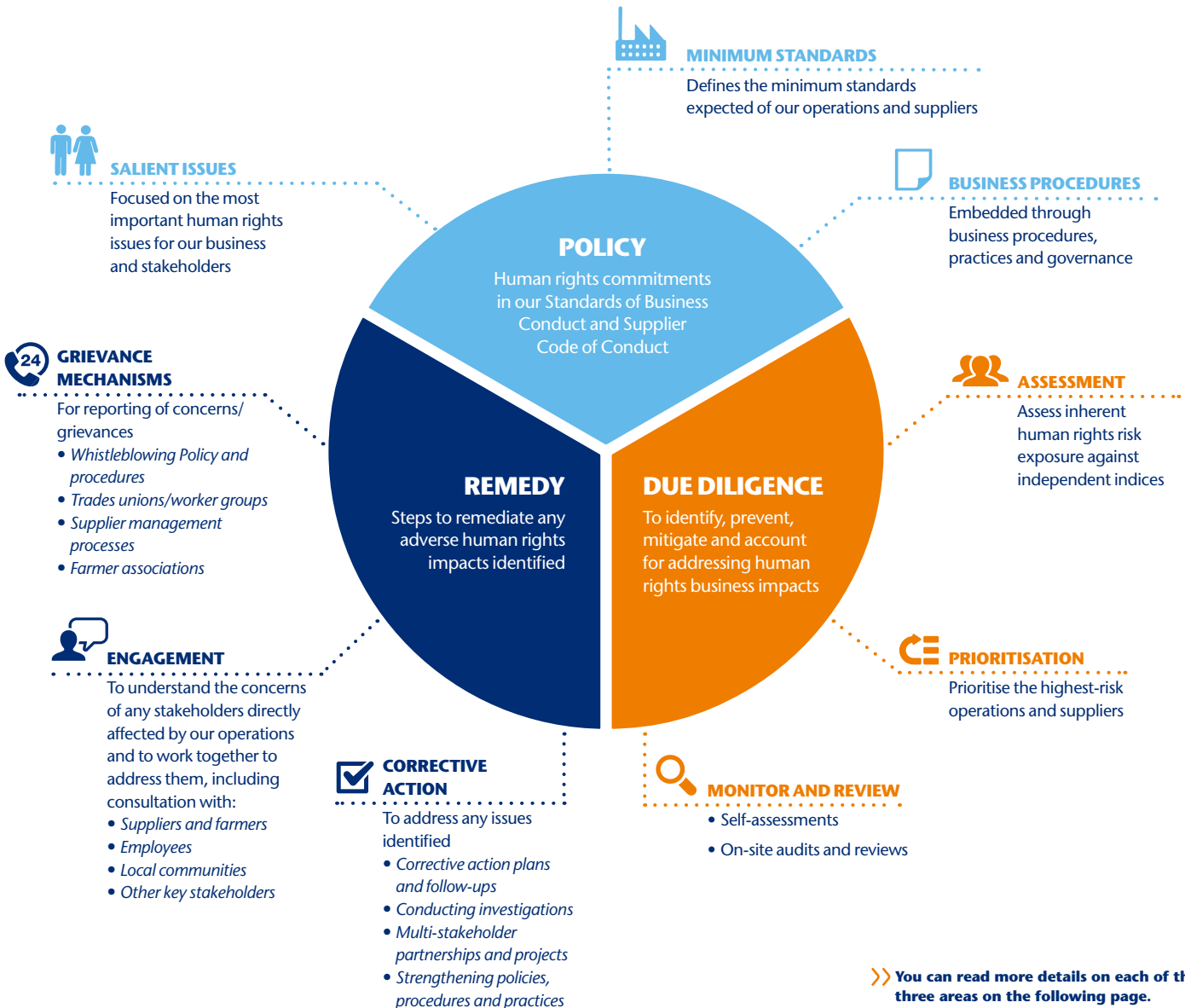


PEOPLE

SAFEGUARDING HUMAN RIGHTS

We have had a long-standing commitment to respect fundamental human rights, as affirmed by the Universal Declaration of Human Rights, and support the UN Guiding Principles on Business and Human Rights.

Our approach to human rights management, covering the three key areas of policy, due diligence and remedy, is summarised in the graphic below.





POLICY

Our Human Rights Policy forms part of our Standards of Business Conduct (SoBC) and details our commitments for our most salient human rights issues, including no child labour or exploitation of labour, and respect for freedom of association, as well as covering our management of human rights risks.

We have always expected our suppliers to follow the same high standards, but to clarify this further and to complement the SoBC, in 2016, we rolled out our new Supplier Code of Conduct. This sets out the minimum standards we expect all our suppliers to adhere to, including specific human rights criteria, and is incorporated into our contractual arrangements with suppliers.



DUE DILIGENCE

Our due diligence processes enable us to monitor the effectiveness of, and compliance to, our Policy commitments, as well as to identify, prevent and mitigate human rights risks and impacts.

With the highest risks for human rights abuses in our tobacco leaf supply chain, due diligence is conducted on 100% of our first-tier suppliers through the industry-wide Sustainable Tobacco Programme (see page 14).

For our 70,000+ other first-tier suppliers, we have been strengthening our approach to be better aligned to the UN Guiding Principles. In 2016, we worked with experts from a respected independent consultancy to pilot a new integrated system focused on assessing suppliers' human rights risk exposure and then prioritising the highest risk for self-assessments and on-site audits. We are now conducting a phased roll out to all our suppliers worldwide.

We are also currently reviewing our due diligence processes for our own subsidiary companies and plan to implement a strengthened approach, with more focused monitoring of high-risk operations, later in 2017.



REMEDY

In the event of any adverse human rights impacts occurring, we take steps to remediate them through:

- Effective grievance mechanisms, such as our whistleblowing procedures and relationships with worker groups, trades unions and supplier associations;
- Engagement and consultation with suppliers, farmers, local communities and other key stakeholders; and
- Taking action to address any issues identified, such as strengthening policies, procedures and practices, conducting investigations, and implementing corrective action plans and follow-ups with suppliers.

For example, in 2016, there was a fire at the factory of one of our third-party packaging suppliers in Bangladesh, in which 39 people tragically lost their lives. The Government awarded compensation to the victims and their families through the existing Workers Welfare Fund. All large companies who operate in Bangladesh contribute to this fund and we have contributed more than £2.21 million since 2011. In addition, as a reflection of our long-standing relationship with the supplier and our commitment to supporting human rights throughout our supply chain, we donated additional funds to further enhance each individual compensation package.

We also brought forward audits of all our direct materials and strategic indirect suppliers in the country to ensure our health and safety standards are being met. We are now supporting them in implementing improvement plans where required.

BUILDING A LEGACY OF LEADERS

We believe a winning organisation is one where high-performing leaders can inspire diverse teams of committed and engaged people in a fulfilling, rewarding and responsible environment.

As competition for talented employees intensifies, people increasingly want to work for businesses with a good corporate reputation, so we are proud to have been ranked among the top five employers in Europe by the Top Employers Institute in 2016.

Our focus is on driving high performance and developing leadership capabilities from within. In 2016, over 93% of our senior appointments were drawn from our own people.

Having a diverse workforce means we are better able to understand and meet the needs of our consumers, customers and stakeholders, who themselves will be from a diverse mix of backgrounds, and helps create a positive corporate culture and build stronger leaders. Our commitment to increasing the representation of women in senior leadership also supports the UN SDG for gender equality.

While we are proud to have achieved 27% female representation on our Main Board, we recognise that we still have more to do, particularly in increasing the number of women in senior leadership positions and at the executive Management Board level.

We have made good progress over the last five years, with a 25% increase in the number of women on leadership teams and a 38% increase in the number of women recruited to senior management roles. We have also filled 29% of senior roles with focus nationalities from Asia, the Middle East, Africa and Eastern Europe.

In 2016, the Thomson Reuters Diversity & Inclusion Index ranked us as the industry leader and one of the most diverse and inclusive companies to work for. We were also recognised by a review into Ethnic Diversity of UK Boards, which ranked BAT in the top 20 of the FTSE.



Modern Slavery Act

Forced labour, servitude, slavery and human trafficking (modern slavery) is a growing global issue and businesses have a clear role to play in eliminating them from their operations and supply chains. Our first Modern Slavery Act statement details the steps we are taking to tackle it.

 WWW.BAT.COM/MSA

Diversity in action

Our ambition is to significantly increase representation of women and focus nationalities in senior management roles by 2020.

We're making good progress, but we know we can do better, so are focused on initiatives throughout our organisation to drive ownership and accountability, build diverse talent pools and create enablers, supported by an inclusive culture.

Our Women in Leadership programme helps support and accelerate career progression of female talent within the Group. Since 2013, the programme has reached 130 high-potential female managers representing all functions and major locations across the Group. We have also developed new 'unconscious bias' training, which is being rolled out to all management employees globally.

Our regions and markets work to progress the global diversity strategy through on-the-ground initiatives relevant for the local culture and circumstances.

ASIA-PACIFIC

Initiatives, such as childcare and flexible working options, extended maternity leave, and training and coaching programmes in the region, have helped increase female representation in senior management from just 10% in 2014 to 20% by the end of 2016.

The region has also achieved 64% representation of focus nationalities in senior management through initiatives such

as on-the-job and immersive English language lessons, and providing opportunities for above-market projects and short-term international assignments.

In BAT Japan, women represent 44% of employees, well above the market norm of 17%, and we were named Best Employer for Women in 2016. We were also named in 2016 as the 'Most Female-Friendly Organisation' in Pakistan and Bangladesh, and three senior female managers in Bangladesh won individual Inspiring Women Awards.

One of the winners, Sanjana Zerín, Territory Officer in Trade Marketing & Distribution, explains: "It's considered unconventional for women to work in Trade Marketing. But we've come a long way in challenging the status quo and we hope to see this result in an increase in female representation in this area."

EASTERN EUROPE, AFRICA AND MIDDLE EAST

The region has implemented mentoring programmes, dual-career support and flexible working arrangements. In 2016, a regional Diversity Forum was launched to help women manage their career development through peer coaching and networking.

Connie Anyika, Senior Commercial Counsel, who volunteered to lead the initiative explains: "The women in the forum boost each other's potential by sharing knowledge, experience and insights, as well as challenging one another."



27%

of our Board of Directors are women

16%

*of women and **19%** of focus nationalities in senior management roles globally*

98%

score in the Talent Attraction and Retention category of the 2016 Dow Jones Sustainability Index

Sanjana Zerín, Territory Officer in Trade Marketing & Distribution at BAT Bangladesh, collects her Inspiring Women Award from the respected Bangladesh Brand Forum in 2016

OPERATIONS

PROTECTING THE HEALTH AND SAFETY OF OUR WORKFORCE

We are committed to a safe working environment for all our employees and contractors worldwide and have a Group-wide goal of zero accidents.

We focus on risk management and assessments, employee training and awareness, and specific initiatives for high-risk areas of our business. For example, to further integrate health and safety into manufacturing practices and procedures, we're implementing an internationally recognised management system.

In 2016, total reported accidents remained steady. However, we were pleased to achieve an 8% improvement in our Lost Workday Case Incident Rate – from 0.26 in 2015 to 0.24 in 2016.

Nearly 70% of total accidents are in Trade Marketing & Distribution (TM&D), where we have over 26,000 drivers out on the road every day who are particularly vulnerable to road traffic accidents (RTAs) and robberies.

Our fleet and driver safety programme focuses on addressing these risks through: enhanced global vehicle specifications and safety controls; driver training to improve skills and hazard perception; toolkits and practical guidance for management; security protocols and escorts in high-risk locations; efficient route-to-market planning; and tracking progress through quarterly business reviews. As a result, in 2016, we achieved a 14% reduction in accidents in the TM&D area of the business.

Sadly, however, four contractors lost their lives – three in armed robberies and one in a fall from height, and two employees died – one in an RTA and one in a train accident. In addition, two members of the public lost their lives in accidents involving our vehicles.

While this is a reduction in fatalities compared to 2015, any loss of life is completely unacceptable and is a matter of enormous concern to us. We deeply regret this loss of life and the suffering caused to family, friends and colleagues.

We want to reduce the chances of similar events happening again. So we carry out detailed reviews of all reported accidents and fatalities to learn lessons and identify where we can improve our approach to ensure the health and safety of all our employees and contractors.

WINNER

of the 2016
International Fleet
Safety Award


71%

of our sites
achieved zero
accidents in 2016

ENVIRONMENTAL PERFORMANCE

Based on our intensity measure per million cigarettes equivalent

CO₂E EMISSIONS (AGAINST YEAR 2000 BASELINE)

	Achieved by end 2016	-47%	Target	-55% by 2025 -80% by 2050
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ENERGY USE (AGAINST YEAR 2007 BASELINE)

	Achieved by end 2016	-16%	Target	-25% by 2025
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WATER WITHDRAWN (AGAINST YEAR 2007 BASELINE)

	Achieved by end 2016	-29%	Target	-35% by 2025
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WASTE TO LANDFILL (AGAINST YEAR 2007 BASELINE)

	Achieved by end 2016	-67%	Target	-80% by 2025
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REDUCING OUR ENVIRONMENTAL IMPACT

As a major multinational, we have a responsibility to minimise our impact on the environment.

We welcome the Paris Agreement on climate change and, through our operations in over 200 markets, believe we have an opportunity to make a significant contribution towards this, as well as the UN SDG to combat climate change and its impacts.

In 2016, we developed a new set of targets to achieve by 2025. We also continue to work towards our long-term target to cut carbon dioxide equivalent (CO₂e) emissions by 80% by 2050 and have so far achieved a 47% reduction from our 2000 baseline.

With 44 cigarette factories and a further 28 other manufacturing sites worldwide, over 60% of our direct impacts are in these operations, and so we have a number of initiatives in this area.

Examples include investing in energy-efficient technologies, switching to less carbon-intensive fuels or renewable energy sourcing. Currently, 8% of our Group energy use is from renewable sources. We're also optimising our logistics and fleet with standards for fuel efficiency, engine size and emissions, as well as increasing load capacity to reduce the number of journeys.

Our manufacturing processes don't use as much water as other industries but, with the realities of water scarcity increasingly being felt in many parts of the world, we have conducted water risk assessments at all our strategic, high-risk sites. Action plans are in place and we are now rolling this out to all our factories worldwide.

WORKING WITH OTHERS

Environmental problems cannot be solved by one company acting alone, so we also work in collaboration with others.

In Kenya, for instance, we are members of the Nairobi Water Roundtable, working alongside local government, NGOs and other major companies, including Diageo and Coca-Cola, to find solutions to water scarcity in the area.

Spotlight on Pakistan

BAT has been operating in Pakistan for nearly 70 years, helping to develop both the country's industrial sector, with our manufacturing operations, and agriculture, through tobacco growing.

Today, the country is facing a growing energy and water crisis, which has made the role of the private sector, in reducing its impacts and supporting national objectives, more crucial than ever.

In 2015, we signed an agreement with the Ministry of Climate Change to plant trees on 641 acres of Government-owned land. This builds on our global afforestation programme, which has seen more than two million trees planted each year since 1981.

Our two factories in Pakistan were among the first in the Group to undertake a water risk assessment in 2014. This led to the development of a detailed action plan that has helped achieve an 11% reduction in the amount of water withdrawn and an 8% increase in water recycling in 2016 compared to the previous year.

We supported this in 2016 with the introduction of a new management system to provide a more consistent approach to recording, measuring and analysing energy and water use. By operating in real time, it also helps to prioritise improvement plans and investment in new infrastructure.

"The new system has been a real game-changer," explains Engineering Manager Zain Ul Abideen Mughal. "It's helped us to identify priority areas and drive continuous improvements.

"This year we've already achieved a 17% reduction in the total amount of energy we use in the factories, as well as a 16% reduction in absolute CO₂e emissions from 2015 – but we're not complacent and although we're on the right path, we know plenty more challenges lie ahead."



OUR COMMITMENTS FOR THE FUTURE

We are committed to operating to the highest standards of corporate conduct and transparency.

TRUST

- Implement a new **third-party managed 'speak up' hotline and website** by end 2017;
- **100% adherence to our International Marketing Principles** each year; and
- **Roll out our updated Youth Access Prevention Principles to include our Next Generation Product categories** by end 2017 and aim for 100% adherence each year.

PEOPLE

- **Develop and roll out new human rights e-learning** by end 2017;
- **Develop and implement a strengthened approach to monitoring human rights for our own subsidiary companies** by end 2017;
- **Complete the phased roll out of our due diligence process** for all non-agricultural suppliers by the end of 2018; and
- **Significantly increase the representation of women and focus nationalities** in senior management by 2020.

OPERATIONS

- Aim to achieve **zero accidents** Group-wide.

Based on our intensity measure per million cigarettes equivalent:

- **Reduce our CO₂e emissions by 55%** by 2025 and **by 80%** by 2050 (against year 2000 baseline);
- **Reduce our energy use by 25%** by 2025 (against year 2007 baseline);
- **Increase the amount of renewable energy we source to 25%** by 2025 (against year 2007 baseline);
- **Reduce the total amount of water withdrawn by 35%** by 2025 (against year 2007 baseline);
- **Increase the total amount of water we recycle to 15%** by 2025 (against year 2007 baseline);
- **Reduce our waste to landfill by 80%** by 2025 (against year 2007 baseline);
- **Reduce the total volume of waste generated by 10%** by 2025 (against year 2007 baseline); and
- **Recycle at least 95%** of our total waste generated each year.

PROGRESS AGAINST OUR GOALS AND COMMITMENTS

All our new and ongoing goals and commitments can be found at the end of each section in this Report. The status of our previously published goals and commitments can be found below.

- On track
- ✓ Completed
- Partially met
- ✗ Not met

HARM REDUCTION

- Continue to build our range of Next Generation Products, including launching Voke in the UK and test marketing an innovative Tobacco Heating Product in 2016.
 - In early 2017, we reached an agreement for our partner, Kind Consumer, to take ownership of the commercialisation of Voke.
- ✓ 100% adherence to our Vapour Products Marketing Principles each year. If any cases of non-adherence are identified, ensure immediate actions are put in place.
- ✓ Continue to take a lead in advocating for regulation that has high product standards and appropriate commercial freedoms.
- ✓ Present the results of our scientific research into Next Generation Products to regulators and other relevant bodies.
- ✓ Work with scientists, public health professionals, regulators and governments around the world to build support for innovative, less risky products.

SUSTAINABLE AGRICULTURE AND FARMER LIVELIHOODS

- Aim for at least 70% of our spending on community investment activities in tobacco growing countries to be focused on sustainable agriculture each year.
 - This goal was successfully met in all but two tobacco growing countries which have valid reasons for continuing to focus the majority of community investment in other areas – one where our business focuses on a government-mandated development fund, and one where our business has a long-term programme supporting the indigenous cultural heritage.
- Eliminate use of unsustainable wood sources by our contracted farmers.
- ✗ Not to exceed the Group's long-term standard for our BAT-owned leaf suppliers to use no more than an average of 1.5kg of active chemicals per hectare of tobacco per year.
 - In 2016, the average use of active chemicals per hectare of tobacco was 2.16kg. However, this is a global average which does not accurately represent the varying usage rates dependent on the country, its use of technologies and the introduction of more efficient and newer products. We will therefore no longer have a global average target, but will continue to work with our leaf suppliers to better understand how improvements in best practice can be applied in this area.
- As part of our membership of the ECLT Foundation, develop new global guidance on hazardous child labour and occupational health and safety in tobacco growing based on ILO research.

CORPORATE BEHAVIOUR

- ✓ As part of our cooperation agreement with the European Commission, implement track-and-trace technology in all markets covered by the agreement where we annually supply 25 million cigarettes or more to multiple customers, by end 2016.
- ✓ 100% adherence to our International Marketing Principles each year. If any cases of non-adherence are identified, ensure immediate actions are put in place.
- ✓ 100% adherence to our global approach to youth smoking prevention in all markets where feasible and allowed each year.
- Reduce our carbon dioxide equivalent (CO₂e) emissions by 55% by 2025 and 80% by 2050 against our 2000 baseline of 1.52 tonnes per million cigarettes equivalent.
- ✓ Reduce our CO₂e emissions by 46% by 2017 against our 2000 baseline.
- ✓ Reduce our energy use towards our 2017 target of 9.82 gigajoules per million cigarettes equivalent produced, 17% lower than our 2007 baseline.
- ✓ Reduce our water use towards our 2017 target of 3.6 cubic metres per million cigarettes equivalent produced, 26% lower than our 2007 baseline.
- ✓ Sustain our waste to landfill at no more than 0.016 tonnes per million cigarettes equivalent produced, 36% lower than our 2007 baseline, and recycle at least 85% of our waste.
- Ensure the right policies, governance and practices are in place to enable us to get closer to our goal of zero accidents.
- ✓ Pilot our strengthened, integrated and systematic management approach to human rights due diligence on our non-leaf suppliers by end 2016.

Full details of our performance for each goal can be found online at

[WWW.BAT.COM/SUSTAINABILITY/DATA](http://www.bat.com/sustainability/data)

MATERIALITY

IDENTIFYING OUR SUSTAINABILITY PRIORITIES

Our Group Sustainability Agenda is developed through a detailed materiality process, which we conduct every three years, to identify the issues that have the greatest significance to our business and our stakeholders.

Our last detailed materiality assessment took place in 2014 and involved a three-stage process:

The first stage involved inputs from a wide variety of external stakeholders, utilising a number of different sources, including interviews with key opinion leaders in different geographies, stakeholder perception research, stakeholder dialogue, peer benchmarking, a global media review and consumer focus groups. The external insights sought were complemented by an extensive period of internal consultation with senior management.

In the second stage, all the different issues raised through the external stakeholder and internal consultation were refined by mapping them onto the matrix below, with each one positioned according to its level of concern to stakeholders and its current or potential impact on the Group.

In the third stage, this refined issues matrix was presented for comment at a stakeholder dialogue session with sustainability opinion leaders, NGOs and civil society, academic and research bodies, peer companies in challenging sectors, and specialist consultancies.

The result was the identification of the three strategic focus areas of our Sustainability Agenda: Harm Reduction, Sustainable Agriculture and Farmer Livelihoods, and Corporate Behaviour. Other issues continue to be important business priorities and are covered in our Annual Report and on our **bat.com** website.

We conduct a review of these issues each year to ensure they continue to remain relevant. In 2016, this was conducted by a specialist sustainability consultancy and included a media review, peer benchmarking and horizon scanning of emerging issues. No new issues, that are not currently captured within our Sustainability Agenda, were identified.

We plan to undertake a new, detailed materiality assessment on our Sustainability Agenda in 2017.



OPEN AND RESPONSIVE STAKEHOLDER ENGAGEMENT

We engage with a wide range of stakeholders at local, regional and global levels on the key sustainability issues covered in this Report.

This long-standing approach has seen many positive impacts and outcomes over the years, including the development of our Statement of Business Principles and first International Marketing Standards in 2001.

Listening to our stakeholders helps us better understand their views and concerns and so respond to them appropriately. It gives us valuable feedback on our policies, procedures and ways of working, so that we can continually improve and strengthen them. It provides us with opportunities to put our views across, helping our stakeholders understand our positions.

We also actively share our experience and expertise with others, which can help to raise standards across the industry and make a valuable contribution to wider society. For example, openly sharing our scientific research and approach to product stewardship helped result in the first national standards for Vapour Products in the UK and France.

WHO WE ENGAGE WITH...

-  Shareholders and investors
-  Employees and contractors
-  Suppliers, business partners and farmers
-  Customers – retailers, wholesalers and distributors
-  Adult consumers and smokers
-  Governments and regulators
-  Scientific and public health communities
-  Industry and other peer companies
-  Key opinion leaders, experts and academics
-  International organisations, such as the UN and ILO
-  Standards bodies and organisations, such as ISO, the British Standards Institution (BSI) and the European Standards Body (CEN)
-  Law enforcement agencies and customs bodies
-  Trades unions, employee and supplier groups
-  NGOs and development agencies
-  Media and journalists
-  Local communities and the general public

HOW WE ENGAGE WITH THEM...

PARTNERSHIPS, COLLABORATIONS AND MEMBERSHIPS

For example:

- Stakeholder panels of leading experts to provide opinions on, and inform, our programmes, such as our External Scientific Panel and our new Sustainability Stakeholder Panel (see page 36)
- Formal partnerships, such as the Eliminating Child Labour in Tobacco Growing (ECLT) Foundation
- Sustainability groups, such as Business in the Community, the Institute of Business Ethics, the Institute of Corporate Responsibility and Sustainability, the All-Party Parliamentary Corporate Responsibility Group, and the EU Business and Biodiversity Platform
- Local partnership projects with the industry, NGOs, governments and peer companies, to support local communities and the environment
- Industry groups, such as the Digital Coding & Tracking Association and Tobacco Manufacturers' Associations
- Cooperation agreements to tackle the illegal tobacco trade, such as with the European Commission, the United Nations Conference on Trade and Development, and with local governments, customs and law enforcement
- Collaborations and studies with scientific research partners and inventors, such as on less risky tobacco and nicotine products





CONTRIBUTING OUR EXPERTISE AND SHARING INFORMATION

For example:

- Working groups, such as with the BSI, CEN and ISO on Vapour Product standards, and the UK Digital Policy Alliance on online age-verification
- Submissions to government consultations, such as on the development of new regulation
- Corporate publications, websites and social media channels
- Investor meetings and roadshows, and submissions to the Dow Jones Sustainability Indices
- We openly share our scientific research on bat-science.com, through publications in peer-reviewed journals and by participating in international conferences and workshops, such as those of the US Food and Drug Administration

ONGOING DIALOGUE AND ENGAGEMENT

For example:

- Support for farmers through our Leaf Extension Services, farmer clubs and capacity building
- Engagement with retailers via our Trade Representatives on preventing underage access to our products
- Customer Voice programme to measure our retail customers' satisfaction
- Supplier forums and working groups, such as on the development of the Sustainable Tobacco Programme
- Regulatory engagement and advocacy
- Independently facilitated dialogue sessions on specific issues, such as human rights and climate change
- Relationships, negotiations and consultations with trades unions and employee/worker groups
- Consumer research and focus groups
- Employee opinion surveys and focus groups
- Consumer information and campaigns, such as on the health risks of our products and youth smoking prevention

EXAMPLES OF THE IMPACT AND OUTCOMES...

- Sustainability Agenda focused on the most material issues for our business and our stakeholders
- Offering consumers a choice of a new generation of tobacco and nicotine products
- The first industry-wide safety standards for Vapour Products published in the UK and France – which could set a benchmark for best practice globally
- More effective regulatory and tax policies, based on robust evidence and thorough research
- Industry-wide standards for tobacco leaf suppliers through the new Sustainable Tobacco Programme
- Our Human Rights Policy and Supplier Code of Conduct aligned to the UN Guiding Principles
- Strengthening of our human rights due diligence processes
- The signing of a shared Pledge of Commitment and Minimum Requirements on combatting child labour by members of the ECLT Foundation
- More effective strategies and enforcement to tackle the illegal tobacco trade
- Preventing underage access to our products through the introduction of minimum age laws, better enforcement and retailer compliance



INDEPENDENT ASSURANCE

An independent review of our sustainability reporting is an important element of helping stakeholders place trust in our processes and in what we report, and supports our commitment to openness and transparency.

In 2016, we continued to engage Ernst & Young LLP to provide limited assurance of selected environment, health and safety data. In addition, to build on our long history of open engagement with our stakeholders, we invited key opinion leaders to offer comment on the materiality of our Sustainability Report and a collective opinion on BAT's performance.



THE STAKEHOLDER PANEL'S INDEPENDENT STATEMENT

PANEL MEMBERS

Philippa Foster Back CBE, Director of the Institute of Business Ethics (Panel chair) – an education charity whose purpose is to promote high standards of business behaviour based on ethical values.

Scott Ballin, Health Policy Adviser – Scott has spent more than 40 years involved in issues related to tobacco and health and is a key opinion leader on tobacco harm reduction.

Marco Ferroni, Director of the Syngenta Foundation for Sustainable Agriculture – a non-profit organisation focused on improving the livelihoods of smallholder farmers.

Peder Michael Pruzan-Jorgensen, Senior VP of Business for Social Responsibility – a global network dedicated to addressing business sustainability issues.

PROCESS

This is the first year of the Panel's existence. Its aim is to understand the context BAT's business operates within, identify how it is meeting the various sustainability challenges, and offer comment on the materiality of the Report and a collective opinion on reporting performance.

To achieve this, the Panel reviewed a draft of the Report, asked questions of BAT and received additional information in response, and made suggestions as to how this year's Report could be improved. A number of these comments were incorporated prior to publication. Throughout the process BAT's

willingness to share information and enter into an open discussion of the issues and challenges arising from its operations and products was impressive.

The Panel's comments on the Report, together with recommendations as to how future reports could be improved to meet the needs of BAT's stakeholders, are summarised below.

MATERIALITY AND PERFORMANCE

Overall, the Report reads well, captures the sustainability issues most material to BAT and its stakeholders, and usefully guides the reader to more comprehensive qualitative and quantitative data on BAT's website. We believe openness and transparency would be improved if there was a clearer rationale for the selection of material issues and accompanying objectives together with a single, consolidated data table that sets out performance.

Moreover, the Report would be greatly enhanced by providing more detail on BAT's corporate strategy and operations, in particular the significance of Next Generation Products (NGPs), to enable readers to contextualise its sustainability performance. We recommend that the Report focus more on the outcomes of BAT's strategy and policies than on the scale of its inputs.

Given the importance BAT attaches to its most material issues, the Panel felt it important to comment on how each is addressed in the Report.

HARM REDUCTION

The health implications of BAT's products are considerable both in terms of scale and seriousness. Thus, its commitment to develop lower risk alternatives is a positive step. The Report conveys important information about these products and how their understood risks compare to those of combustible cigarettes.

While we welcome the inclusion of stakeholder views in the Report, it would benefit from greater detail on BAT's engagement with its stakeholders, such as the academic and public health communities, regulators, policy makers and consumers. Similarly, BAT should explain how its research increases understanding of the health risks of conventional cigarettes and NGPs. Greater clarity is also needed on how BAT's research into NGPs in general and their health impacts in particular compares to its total investment in these areas.

Finally, future Reports should emphasise BAT's commitment to and detail what it regards as an appropriate and workable regulatory framework. Among other things, this should include an explicit prohibition on the use of tobacco or nicotine products by children and adolescents.

SUSTAINABLE AGRICULTURE AND FARMER LIVELIHOODS (SAFL)

The significance of SAFL to BAT and how its operations affect the environment and well-being of farming communities is reflected by the Report's comprehensive coverage of the



Company's impacts in its leaf supply chain. This insight will be enhanced by the planned inclusion of SAFL and Sustainable Tobacco Programme key indicators in future Reports.

The Report could be improved by more clearly identifying the principal risks and opportunities that affect the resilience of BAT's supply chain. As the Company increases investments in NGPs, the Panel would welcome more detail on how this would impact both the NGP and BAT's traditional supply chains.

CORPORATE BEHAVIOUR

The Panel was concerned that this section lacked focus given the variety of topics covered. To address this, BAT could make the following changes:

- Include more detail on how BAT's policies in this area are delivering tangible benefits;
- Highlight the role employees play in implementing the Company's strategy; and
- More radically, BAT could include a stand-alone section on marketing, covering both combustible and NGPs. In conjunction with our comment above, about what BAT regards as a workable regulatory framework, this would clarify how it is preventing young people accessing the full range of tobacco and nicotine products.



ASSURANCE OF OUR PERFORMANCE DATA

Ernst & Young LLP has performed a limited assurance engagement on selected environment, health and safety data presented in this Report and at our Sustainability Performance Centre at

[WWW.BAT.COM/SUSTAINABILITY/DATA](http://www.bat.com/sustainability/data)

Read Ernst & Young's full statement, including the scope of work and conclusions, at

[WWW.BAT.COM/ASSURANCE](http://www.bat.com/assurance)

OUR RESPONSE TO THE PANEL'S STATEMENT

The Panel's insights and constructive feedback are invaluable in helping to ensure our reporting meets stakeholder expectations and identifying areas for improvement.

We would like to thank the Panel members for their time and thorough review of our Report and performance. We were pleased to have the opportunity to apply many of their comments prior to publication, including providing greater clarity on our R&D investment into NGPs and harm reduction, as well as more detail on what we regard as an appropriate regulatory framework for NGPs.

We are committed to acting upon their additional suggestions in future reports:

PROCESS, MATERIALITY AND PERFORMANCE

We believe the process for the first year of the Panel's review worked well and found the open discussion of the issues and challenges incredibly beneficial. Such was the value of the Panel's input, we have invited them to engage at an earlier stage of the reporting process in the future.

In 2017, we plan to undertake a new, comprehensive materiality assessment, including detailed stakeholder input. We will work to include more detail and clarity on this process in our next Report.

While our performance data is comprehensively covered online at bat.com/sustainability/data, we recognise, and are committed to including, the Panel's suggestion for more data transparency in the main Report in the future.

HARM REDUCTION

We appreciate the Panel's suggestions for more detail on our extensive stakeholder engagement for this important area, as well as further clarity on our research and regulatory views. In February 2017, we published a Harm Reduction Focus Report, which we hope will help address some of the comments by providing more in-depth information on these complex issues.

SUSTAINABLE AGRICULTURE AND FARMER LIVELIHOODS

We are committed to include key indicators for STP and SAFL in future reports. We also plan to undertake a detailed mapping exercise of our new NGP supply chain in 2017 and will openly report on the results of this. In addition, we plan to publish a new Focus Report on Sustainable Agriculture and Farmer Livelihoods later in 2017, which will include more detail on the programmes and our supply chain risks and opportunities.

CORPORATE BEHAVIOUR

We note the Panel's concern that this section lacked focus due to the variety of topics covered and the need for more clarity on marketing and youth access prevention. As detailed on page 24, we are currently working on the development of new Youth Access Prevention Principles for all our product categories – from conventional cigarettes to NGPs – which we will cover in our next Report. The Panel's suggestions for potential changes will form valuable inputs into our 2017 materiality assessment, as well as our planning for next year's Report.

www.bat.com/sustainability

More detailed information on our Sustainability Agenda and initiatives.



PERFORMANCE CENTRE

Progress against our goals, performance charts, Global Reporting Initiative (GRI) G4 reporting, independent assurance statement and our response to assurance.

 www.bat.com/sustainability/data



GET IN TOUCH

Jennie Galbraith and
Verity Lawson

British American Tobacco
Globe House, 4 Temple Place
London WC2R 2PG

 sustainability@bat.com

 +44 (0)20 7845 1000



SUSTAINABILITY REPORT

Our sustainability strategy and the three key areas of Harm Reduction, Sustainable Agriculture and Farmer Livelihoods, and Corporate Behaviour.

 www.bat.com/sustainabilityreport



FOCUS REPORTS

More in-depth information on a specific area of our Group Sustainability Agenda.

 www.bat.com/sustainabilityfocus



ANNUAL REPORT

Our Group vision, strategy, business model, governance, principal risk factors and financial reporting.

 www.bat.com/annualreport

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 www.youtube.com/welcometobat

 www.flickr.com/welcometobat

About this Report

This is a report by British American Tobacco p.l.c. Associate companies are excluded. All Group data relates to the calendar year 2016. References to 'British American Tobacco', 'BAT', 'we', 'us' and 'our' when denoting opinion refer to British American Tobacco p.l.c. (the Company), and when denoting tobacco business activity refer to Group operating companies, collectively or individually as the case may be. This Report contains forward-looking statements that are subject to risk factors associated with, among other things, the economic and business circumstances occurring in the countries in which the Group operates. It is believed that the expectations reflected in these statements are reasonable, but they may be affected by a wide range of variables that could cause actual results to differ materially from those currently anticipated.

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