BRITISH AMERICAN TOBACCO

news release

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QUARTERLY REPORT TO 30 SEPTEMBER 2005

SUMMARY

NINE MONTHS RESULTS		2005	2004	Change
Profit from operations	- as reported	£1,901m	£3,321m	-43%
	- 'like for like'	£1,961m	£1,800m	+9%
Adjusted diluted earnings per share		67.91p	55.07p	+23%

- The reported Group profit from operations was 43 per cent lower at £1,901 million, mainly due to the impact in 2004 of a significant £1,392 million gain on the Reynolds American transaction. However, profit from operations would have been 9 per cent higher, or 6 per cent at comparable rates of exchange, if exceptional items and the changes in the Group resulting from the merger of the Group's US businesses with R.J. Reynolds and the sale of Etinera, with the resulting change in terms of trade, are excluded. This 'like for like' information provides a better understanding of the subsidiaries' trading results than the 'headline' change in profit from operations.

- On a reported basis, Group volumes from subsidiaries were affected by the changes in the Group noted above, resulting in a 2 per cent decrease to 505 billion. Excluding the impact of these transactions, there was good organic volume growth from subsidiaries of 2 per cent. The four global drive brands showed overall growth of 9 per cent on a 'like for like' basis.

- Adjusted diluted earnings per share rose by 23 per cent, benefiting from the improved underlying operating performance, reduced net finance costs, a lower effective tax rate and minority interests, as well as the impact of the Reynolds American transaction and the share buy-back programme. While these factors also benefited the basic earnings per share, they were offset by the inclusion of the gain on the Reynolds American transaction in the 2004 comparatives and the basic earnings per share was lower at 65.73p (2004: 121.23p).

- The Chairman, Jan du Plessis, commented: "The results as a whole continue to point to a highly satisfactory year, although the comparisons with 2004 will become more demanding, as the final quarter of last year contained significant one-off tax and interest benefits, while the uncertainties inherent in forecasting net finance costs under IFRS remain. However, based on good quality organic volume growth, British American Tobacco has real momentum."

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British American Tobacco has maintained its momentum during the first nine months of 2005 with good 'like for like' growth in profit from operations of 9 per cent at current rates of exchange and 6 per cent at comparable rates. The exceptional growth in adjusted diluted earnings per share has also continued, rising by 23 per cent.

I expect that shareholders understand by now that changes in the presentation of the Group's results arising from the move to International Financial Reporting Standards (IFRS) are further complicated by the merger of our US businesses with R.J. Reynolds in July 2004 and the sale of Etinera in December 2004. Investors are probably also aware that, in 2005, the results include restructuring charges and the profit arising from a disposal of brands.

The 'like for like' information provided, by adjusting for these factors, gives a much better guide to the Group's performance than the 43 per cent 'headline' decline in profit from operations as reported on a statutory basis, mainly as a result of the impact of the £1.4 billion gain from the Reynolds American transaction in 2004.

Adjusted volume from our subsidiary companies was 2 per cent ahead at 503 billion cigarettes, a good level of organic volume growth. Strong performances in Russia, Turkey, Pakistan and Bangladesh more than offset declines in Canada, South Korea, Argentina and Mexico.

Our global drive brands continued to improve their growth rate, increasing by 9 per cent as a whole. On a 'like for like' basis, the star performers continued to be Kent in Russia and Romania, along with Pall Mall in Germany and Hungary. Lucky Strike was marginally down, due to industry declines in some of its key markets, despite particular success in France, Serbia, Indonesia and Argentina. Dunhill continued to improve in South Korea and Taiwan.

Moving to the regions, Europe, Asia-Pacific, Latin America and Africa and Middle East were all well ahead, while the difficulties in Canada and Japan remained. Although our market share in Japan is growing, conditions in Canada continue to concern us.

The Group's associated companies achieved combined volumes of 171 billion cigarettes and our share of their post tax results was £277 million, of which £165 million related to Reynolds American.

Adjusted diluted earnings per share rose to 67.9p, an increase of 23 per cent. The drivers of this growth are the same as they were at the half year: a better 'like for like' operating performance, reduced net finance costs, a lower effective tax rate, lower minority interests, the Reynolds American transaction and the share buy-back programme.

In the first nine months, we have bought back around 37 million shares at a cost of some £394 million and at an average price of £10.65 per share. We will be back in the market following the publication of these results.

In terms of productivity, negotiations about the proposed factory closure at Southampton in the UK have now been concluded and the restructuring costs of £142 million for the nine months principally relate to this closure. In addition, Imperial Tobacco Canada has recently announced that it is to close its manufacturing facilities in Canada and transfer production to the Group's plant in Mexico. Restructuring charges of approximately £200 million will be taken over the next three years, with the largest portion to be taken before the end of 2005. The annual savings from the Canadian closure should be approximately £40 million, once the full benefits have been realised.

On 21 October, we announced the exercise of our pre-emption rights over part of Andresen Holdings' shareholding in STK, our Danish associated company. As a result, the Group's shareholding in STK will increase from 26.6 per cent to 32.3 per cent, at a purchase price of £95 million. We have also recently agreed the sale of our remaining holding in British American Racing to Honda and confirmed that we will withdraw from sponsorship of the team at the end of 2006.

Our commitment to Corporate Social Responsibility has been endorsed by our inclusion, for the fourth year running, in the Dow Jones Sustainability Indices. The Group achieved the best scores in 11 out of the 22 areas covered, including all the environmental criteria.

It seems appropriate to make a comment on the Supreme Court of Canada's ruling that the British Columbian government can pursue its claim against the Canadian tobacco industry under the provisions of that Province's Tobacco Damages and Healthcare Costs Recovery Act. The decision does not find any company to be liable and the case will take years to bring forward to trial.

The results as a whole continue to point to a highly satisfactory year, although the comparisons with 2004 will become more demanding, as the final quarter of last year contained significant one-off tax and interest benefits, while the uncertainties inherent in forecasting net finance costs under IFRS remain. However, based on good quality organic volume growth, British American Tobacco has real momentum.

Jan du Plessis
27 October 2005

The reported Group profit from operations was 43 per cent lower at £1,901 million, mainly due to the impact in 2004 of a significant £1,392 million gain on the Reynolds American transaction. However, profit from operations would have been 9 per cent higher, or 6 per cent at constant rates of exchange, if exceptional items and the changes in the Group resulting from the merger of the Group's US businesses with R.J. Reynolds and the sale of Etinera, together with the resulting beneficial changes in terms of trade in Italy, are excluded (see page 16). This 'like for like' information provides a better understanding of the subsidiaries' trading results, with the strong profit performance a reflection of the higher profit in all regions, except America-Pacific.

On a reported basis, Group volumes from subsidiaries were affected by the transactions noted above, resulting in a 2 per cent decrease to 505 billion. Excluding the impact of these transactions, there was good organic volume growth from subsidiaries, with many markets contributing to the growth of 2 per cent. The Group continues to include make-your-own cigarette 'stix' in volumes.

The four global drive brands performed very well and showed overall growth of 9 per cent. Kent grew by 17 per cent with outstanding performances in its major markets of Russia and Romania. Dunhill grew 7 per cent for the quarter but, as a result of the substantially reduced industry volumes earlier this year in South Korea, it declined by 4 per cent for the nine months to September. Lucky Strike volumes were marginally lower following industry led volume declines in its key markets of Germany, Japan and Spain. These declines were largely offset by strong performances in France and many of Lucky Strike's smaller markets. Pall Mall showed exceptional growth of 23 per cent on a 'like for like' basis, as it excelled in all its key markets.

In **Europe**, profit, excluding restructuring costs and the gain on disposal of brands, increased by £42 million to £616 million, with strong growth from Russia, Germany, France and Romania. The integration of the Smoking Tobacco and Cigars business into the respective markets, together with cost savings across the region, also contributed to the positive result. Regional volumes were up by around 1 per cent to 184 billion as growth in Russia, France and Poland was offset by declines in Italy and Germany.

In Italy, the virtual ban on indoor public smoking effective from the beginning of this year and an excise increase at the end of last year resulted in a total market decline of 6 per cent leading to lower profit and volumes. Market share was slightly down as a result of increased competition in the low-price segment. Profit was affected by a £16 million reduction as a result of the sale of Etinera at the end of 2004 (see page 16).

Germany continued its excellent profit performance. In a reduced market size, profit increased substantially, driven by price and mix changes, a significant reduction in the overall cost base and higher cigarette market share, with strong growth from Pall Mall. Volumes in France were up in a total market that has shown signs of stabilising, although consumer off-take share softened slightly. Profit increased impressively due to the higher volumes, driven by the global drive brands, and lower costs.

Russia continued its excellent performance with strong volume and market share growth, principally from the premium brands Kent and Vogue. The continued focus on our global drive brands and national expansion led to a better product mix and strong volume growth, resulting in significantly higher profit. In Romania, market share grew as Kent and Pall Mall recorded excellent share and volume performances resulting in a strengthening of the Group's market leadership position and higher profits.

In Switzerland, although costs were lower, profit and volumes were adversely affected by an excise increase at the end of last year. Overall market share was slightly down due to increased price competition but Lucky Strike and Pall Mall remained stable with Parisienne growing share. In the Netherlands and Belgium, the integration of the Smoking Tobacco and Cigars business, as well as other cost savings, contributed to improved profit although volumes were lower. In Poland, profit was higher as volumes rose in an increased market. Volumes in Ukraine were slightly down but profit grew strongly as a result of product mix improvements through Kent and Pall Mall. In Hungary, profit and volume were adversely affected by a continuing decline in the total market and down-trading.

In **Asia-Pacific**, regional profit rose by £41 million to £418 million as good performances in Australasia and Pakistan, a benefit in the first quarter from the timing of an excise payment in South Korea and the good results from a number of the other markets more than covered the reductions in Malaysia and Vietnam. Regional volumes at 103 billion were 4 per cent higher as strong increases in Pakistan and Bangladesh were partially offset by volume declines in South Korea, Vietnam and Malaysia.

Although industry volumes remained under pressure, Australia continued its profit growth with stable volumes, higher margins and overall market share up due to strong performances from Dunhill and Winfield. In New Zealand, higher margins and volumes led to increased profit.

In Malaysia, excise taxes increased by a further 13 per cent after last year's severe increase and industry volumes continued to be under pressure. Market share was in line with last year but profit was impacted by the lower volumes, adverse product mix, price competition and the contribution to a government sponsored leaf programme. Although Pall Mall increased share, this was offset by reductions in Dunhill and non-drive brands. In Vietnam, market share rose but lower industry volumes led to a decline in profit. Consumer off-take and market share reached an all time high as State Express 555 and Craven 'A' continued to grow.

South Korea's profit reflected the first quarter excise benefit, although shipments declined significantly due to stocking by the trade before the excise increase. The strong profit growth in the nine months also reflected productivity gains. Dunhill continued to deliver good share growth, while Vogue was relaunched in August.

In Pakistan, higher margins and excellent volume growth by Gold Flake and John Player Gold Leaf resulted in higher profit and market share. Volumes rose in Bangladesh but profit was lower as down-trading continued and prices were maintained despite an excise increase. In Sri Lanka, strong profit and share growth was achieved through John Player Gold Leaf and Benson & Hedges.

In **Latin America**, profit at £378 million, increased by £53 million, as good performances were delivered in Brazil, Chile, Venezuela and Peru. Volume at 110 billion increased slightly as growth in many markets was offset by declines in Mexico and Argentina.

In Brazil, profit was higher as the benefits of a stronger local currency, price increases, an improved product mix and higher volumes more than offset increased brand and trade marketing investment and lower export leaf margins. Volumes were higher as a result of major anti-illicit trade operations by various Government bodies.

Good profit growth in Mexico was the result of higher margins, improved product mix and a stronger local currency, partly offset by lower volumes as the total market declined and market share fell in the low-price segment. In Argentina, profit rose as price increases offset the impact of lower volumes and higher marketing investment. Premium brands, mainly Lucky Strike, continued to grow but overall volumes were affected as price increases benefited the ultra low-price local manufacturers.

In Chile, the good profit increase was the result of a stronger currency, higher volumes and market share as Belmont significantly improved its market position. Excellent profit growth in Venezuela was the result of a general recovery in consumer purchasing power, higher margins and strong volume growth, mainly from Viceroy, leading to a higher market share. Profit in Peru increased due to a better mix and lower expenses, as well as higher volumes. Strong profit performance in the Central America and Caribbean area was driven by higher volumes and increased margins.

Profit in the **Africa and Middle East** region grew by £49 million to £308 million with good performances mainly from South Africa, Turkey and Iran. Volumes grew by 8 per cent to 76 billion as a result of the strong growth in Turkey and the markets in the Middle East.

In South Africa, profit grew, benefiting from an improved product mix as Peter Stuyvesant continued its impressive growth to reach a record market share, together with the stronger rand and higher pricing. These improvements were partially offset by lower volumes as industry volumes declined due to illicit trade. Market share in Nigeria increased in a stable overall market, as a result of the Benson & Hedges and London brands gaining share after the authorities continued to address the illicit trade.

Strong volume growth in Iran, from Kent and Montana, resulted in a higher profit. The Arabian Gulf markets increased volumes but not sufficiently to cover the higher marketing investment, leading to lower profit.

Turkey continued to make good progress despite further excise changes throughout the year, with strong volume growth driven by Viceroy which increased market share significantly, while Pall Mall share was stable. Losses were significantly reduced by the volume gains and lower costs.

On a comparable basis, the **America-Pacific** regional profit was £43 million lower at £327 million, and volumes were 4 per cent lower. Profit was down in both Canada and Japan while volumes were also lower in Canada. As the comparative period included the US tobacco businesses now merged with R.J. Reynolds and included in associates (see page 16), reported regional volumes were down by 42 per cent to 33 billion and reported profit was £192 million lower.

The profit contribution from Canada was down £16 million to £236 million as a result of a decline in volumes and a continuing shift in sales mix to low-price products which more than offset lower operating costs and the impact of the stronger Canadian dollar. The low-price segment continued to grow slowly and represented 41 per cent of the market in the third quarter. Within the low-price segment, a budget segment has developed, further widening the price gap between premium brands and low-price products. For the nine months Imperial Tobacco's market share declined by 3 percentage points to 56 per cent.

In Japan, volumes were up resulting in an increased market share in a declining total market with Kool and Kent increasing share, while Lucky Strike was stable. Profit was adversely affected by the impact of exchange and the non-recurrence of a benefit from a business reorganisation included in prior years. This was partly offset by increases in volumes and lower costs.

Unallocated costs, which are net corporate costs not directly attributable to individual segments, were down £3 million at £72 million.

The above regional profits were achieved before accounting for **restructuring costs and gains on the disposal of subsidiaries and brands** (see pages 17 and 18).

Results of associates

The Group's share of the post tax results of associates increased by £180 million to £277 million, reflecting the inclusion of £165 million for Reynolds American following the transaction described on page 16. On a proforma US GAAP basis, as if the combination with Brown & Williamson had been completed as of 1 January 2004, Reynolds American reported that operating profit for the nine months to September 2005 increased by 24 per cent and net income rose 4 per cent. The growth in operating profit was due primarily to improved pricing, net merger related synergies and other cost reductions. These factors were partially offset by lower volumes, higher net costs related to settlements and tobacco grower legislation and charges related to the sale of the R.J. Reynolds packaging business. The growth in net income was adversely affected by the resolution of certain prior year tax matters in 2004.

The Group's associated company in India, ITC, continued its strong volume growth, leading to an increased profit, assisted further by one-off items (see page 20).

Cigarette volumes of subsidiaries

3 months to 30.9.05 bns	3 months to 30.9.04 Restated bns		9 months to 30.9.05 bns	9 months to 30.9.04 Restated bns	Year to 31.12.04 Restated bns
65.6	64.0	Europe	183.9	181.1	240.2
34.8	32.9	Asia-Pacific	102.6	98.3	131.7
37.0	36.7	Latin America	109.7	108.9	147.6
25.9	25.4	Africa and Middle East	75.5	69.8	97.6
12.0	15.3	America-Pacific	33.0	56.7	68.4
175.3	174.3		504.7	514.8	685.5

The above segmental analysis has been restated for the change in regional structure as described on page 12.

In addition, associates' volumes for the nine months were 171.2 billion (2004: 105.2 billion) and, with the inclusion of these, total Group volumes would be 675.9 billion (2004: 620.0 billion).

3 months to 30.9.05 £m	3 months to 30.9.04 £m		9 months to 30.9.05 £m	9 months to 30.9.04 £m	Year to 31.12.04 £m
2,485	2,662	**Revenue**	6,884	8,201	10,768
(819)	(632)	Raw materials and consumables used	(2,072)	(1,964)	(2,670)
	(285)	Purchase of finished goods by distribution business		(808)	(1,086)
7	(30)	Changes in inventories of finished goods and work in progress	19	29	4
(422)	(364)	Employee benefit costs	(1,069)	(1,187)	(1,686)
(78)	(71)	Depreciation and amortisation costs	(267)	(236)	(375)
27	1,434	Other operating income	138	1,513	1,595
(552)	(639)	Other operating expenses	(1,732)	(2,227)	(2,790)
648	2,075	**Profit from operations**	1,901	3,321	3,760
		after:			
(100)	(9)	Restructuring costs	(142)	(50)	(206)
		Investment costs written off			(50)
	1,392	Gains on disposal of subsidiaries, non-current investments and brands	68	1,392	1,427
(58)	(65)	Net finance costs	(154)	(204)	(254)
81	45	Share of post tax results of associates	277	97	126
		after:			
(5)	(60)	Restructuring costs	(12)	(60)	(63)
(11)		US Federal Tobacco buy-out	(11)		
1	41	Exceptional tax credits and impairments	27	41	
671	2,055	**Profit before taxation**	2,024	3,214	3,632
(194)	(195)	Taxation	(547)	(580)	(673)
477	1,860	**Profit for the period**	1,477	2,634	2,959
		Attributable to:			
443	1,822	**Shareholders' equity**	1,381	2,526	2,829
34	38	**Minority interests**	96	108	130
		Earnings per share:			
21.25p	87.25p	Basic	65.73p	121.23p	135.11p
21.03p	84.40p	Diluted	65.17p	116.89p	131.22p

See notes on pages 13 to 23.

	9 months to 30.9.05 £m	9 months to 30.9.04 £m	Year to 31.12.04 £m
Differences on exchange	290	(12)	40
Available-for-sale investments	(2)		
Cash flow hedges	41		
Net investment hedges	(34)		
Net gains/(losses) recognised directly in equity	295	(12)	40
Profit for the period *page 9*	1,477	2,634	2,959
Total recognised income for the period	1,772	2,622	2,999
- shareholders' equity	1,647	2,521	2,879
- minority interests	125	101	120
Employee share options			
- value of employee services	31	26	32
- proceeds from shares issued	27	32	36
Dividends and other appropriations			
- ordinary shares	(910)	(823)	(823)
- convertible redeemable preference shares		(33)	(33)
- amortisation of discount on preference shares		(8)	(8)
- to minority shareholders	(99)	(114)	(145)
Purchase of own shares			
- held in Employee Share Ownership Trusts	(47)	(74)	(76)
- share buy-back programme	(394)	(368)	(492)
Other movements	13	7	8
	393	1,267	1,498
Balance 1 January	6,117	4,619	4,619
Change in accounting policy *page 13*	(42)		
Balance at period end	6,468	5,886	6,117

See notes on pages 13 to 23.

Revenue

	30.9.05 External £m	30.9.05 Inter segment £m	30.9.05 Revenue £m	30.9.04 External £m	30.9.04 Inter segment £m	30.9.04 Revenue £m
Europe	2,595	410	3,005	3,266	489	3,755
Asia-Pacific	1,216	12	1,228	1,097		1,097
Latin America	1,106	1	1,107	922	7	929
Africa and Middle East	708	25	733	601	15	616
America-Pacific	811		811	1,772	32	1,804
Revenue	6,436	448	6,884	7,658	543	8,201

The analysis for revenue is based on location of manufacture and figures based on location of sales would be as follows:

	30.9.05 £m	30.9.04 £m
Europe	2,633	3,319
Asia-Pacific	1,299	1,201
Latin America	1,116	931
Africa and Middle East	1,024	958
America-Pacific	812	1,792
	6,884	8,201

Profit from operations

	30.9.05 Segment result £m	30.9.05 Adjusted segment result* £m	30.9.04 Segment result £m	30.9.04 Adjusted segment result* £m
Europe	559	616	532	574
Asia-Pacific	410	418	377	377
Latin America	373	378	323	325
Africa and Middle East	307	308	257	259
America-Pacific	324	327	1,907	519
	1,973	2,047	3,396	2,054
Unallocated costs	(72)	(72)	(75)	(75)
	1,901	1,975	3,321	1,979

*Excluding restructuring costs and gains on disposal of subsidiaries and brands.

With effect from 1 January 2005, the Group has changed its regional structure, with South Korea included in Asia-Pacific rather than the America-Pacific region. The 2004 analyses on page 11 reflect this change as do the IFRS analyses for the year ended 31 December 2004 below:

Revenue	Location of manufacture			Location of sales
	External	Inter segment	Revenue	Revenue
	£m	£m	£m	£m
Europe	4,410	637	5,047	4,452
Asia-Pacific	1,489	1	1,490	1,629
Latin America	1,260	9	1,269	1,273
Africa and Middle East	853	2	855	1,339
America-Pacific	2,072	35	2,107	2,075
	10,084	684	10,768	10,768

Profit from operations	Segment result	Adjusted segment result*
	£m	£m
Europe	591	750
Asia-Pacific	467	495
Latin America	438	448
Africa and Middle East	357	360
America-Pacific	2,010	639
	3,863	2,692
Unallocated costs	(103)	(103)
	3,760	2,589

* Excluding restructuring costs, investment costs written off and gains on disposal of subsidiaries and non-current investments.

The segmental analysis of the **Group's share of post tax results of associates** is as follows:

	30.9.05	30.9.04	31.12.04
	£m	£m	£m
Europe	27	28	38
Asia-Pacific	84	49	67
Africa and Middle East	1	1	1
America-Pacific	165	19	20
	277	97	126

The financial information comprises the unaudited results for the nine months to 30 September 2005 and 30 September 2004, together with the unaudited results for the twelve months ended 31 December 2004.

Prior to 2005, the Group prepared its audited annual financial statements and unaudited quarterly results under UK Generally Accepted Accounting Principles (UK GAAP). The audited UK GAAP annual financial statements for 2004, which represent the statutory accounts for that year, and on which the auditors gave an unqualified opinion, have been filed with the Registrar of Companies. From 1 January 2005, the Group is required to prepare its annual consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) and implemented in the UK. As the annual 2005 financial statements will include comparatives for 2004, the Group's date of transition to IFRS under IFRS1 (First time adoption of IFRS) is 1 January 2004 and the 2004 comparatives will be restated to IFRS. However, in preparing the comparative figures for 2004, the Group has chosen to utilise the IFRS1 exemption from the requirement to restate comparative information for IAS32 and IAS39 on financial instruments.

To explain how the Group's reported performance and financial position are affected by this change, the Report and Accounts for the year ended 31 December 2004 set out on pages 75 to 84 a comparison of key figures under UK GAAP for 2004, with unaudited restated IFRS results and an explanation of the principal differences between UK GAAP and IFRS, together with the accounting policies which are to be used under IFRS.

These unaudited Group results for the nine months to 30 September 2005 have been prepared on a basis consistent with the IFRS accounting policies as set out on pages 81 to 84 of the Report and Accounts for the year ended 31 December 2004. These interim financial statements have been prepared under the historical cost convention, except in respect of certain financial instruments. In addition, these interim financial statements do not comply with all the disclosures in IAS34 on interim financial reporting and are therefore not in full compliance with IFRS.

As noted above, IAS32 and IAS39 on financial instruments are being applied from 1 January 2005 and the changes to the balance sheet as at 1 January 2005 principally reflect:

(a) The measurement of available-for-sale investments at fair value.
(b) The reclassification of interest accruals to form part of the carrying value of the related asset or liability.
(c) The measurement of all derivative financial instruments at fair value.
(d) Derecognition of deferred losses on derivatives.

At 1 January 2005, these changes resulted in increases in total assets of £71 million (derivatives £113 million, trade and other receivables £(71) million, available-for-sale investments £16 million, deferred tax £10 million and cash and cash equivalents £3 million) and total liabilities of £113 million (borrowings £188 million, trade and other payables £(170) million, derivatives £92 million and deferred tax £3 million). The increase in borrowings reflects the inclusion of interest accruals, previously shown as creditors under UK GAAP, and adjustments to the carrying value of borrowings where there is a fair value hedge.

Consequently, total equity on 1 January 2005 was £42 million lower, comprising £58 million for recognition of derivative financial instruments and derecognition of deferred losses on derivatives less £16 million in respect of revaluing available-for-sale investments. The £58 million change is reflected in equity through a £44 million reduction in the profit and loss reserves and a cash flow hedging reserve of £26 million, partly offset by a £12 million increase in currency translation reserves. The impact on the results for the first nine months of 2005 is set out in net finance costs on page 19. The Group has adopted the amendment to IAS39 on cash flow hedge accounting of forecast intra group transactions from 1 January 2005, as endorsement by the European Union is expected later this year.

The effect of the change to IFRS on the profit for the three months and nine months to 30 September 2004 and the total equity at 30 September 2004 is as follows:

	Profit for the period		Total equity
	3 months to 30.9.04	9 months to 30.9.04	30.9.04
	£m	£m	£m
UK GAAP	460	994	5,919
Post retirement benefits	6	16	(254)
Deferred taxation	(7)	(10)	(69)
Share schemes	(2)	(3)	(6)
Goodwill	132	368	368
Disposal of subsidiaries	1,265	1,265	
Other	6	4	(72)
IFRS	1,860	2,634	5,886

The total equity under UK GAAP of £5,919 million comprises shareholders' funds of £5,720 million, as disclosed in the Third Quarter Report for 2004, and minority interests of £199 million.

The basis for the adjustments above, together with the implications for the balance sheets as at 1 January 2004 and 31 December 2004 and the profit for the quarterly results in 2004 and the year ended 31 December 2004, are as explained on pages 75 to 80 of the Report and Accounts for the year ended 31 December 2004. The 'Other' adjustments to the total equity above mainly reflect the application of IFRS to the Group's carrying value of associated companies as described on page 77 of the Report and Accounts. The 'Other' adjustments to the profit for the three and nine months to 30 September 2004 include the impact of not restating previously reported quarterly figures for subsequent exchange rate changes as described on page 16.

Under UK GAAP, operating profit, net finance costs, taxation and minority interests included the Group's share of the associates' results, whereas the income statement under IFRS only includes the Group's share of the post tax and minority results of the associates as one line before the Group's pre-tax profit.

These results are based on the IFRS expected to be applicable as at 31 December 2005 and the interpretation of those standards. IFRS are subject to possible amendment by and interpretative guidance from the International Accounting Standards Board, as well as the ongoing review and endorsement by the EU, and are therefore still subject to change. These figures may therefore require amendment, to change the basis of accounting and/or presentation of certain financial information, before their inclusion in the IFRS financial statements for the year to 31 December 2005, when the Group prepares its first complete set of IFRS financial statements.

CONVERTIBLE REDEEMABLE PREFERENCE SHARES

On 7 June 1999, the Company issued 241,734,651 convertible redeemable preference shares (CRPS) of 25p each to R&R Holdings SA as part consideration for the acquisition of the issued share capital of Rothmans International B.V. Subsequently, in accordance with the terms of the CRPS, 50 per cent of the CRPS was redeemed for cash on 7 June 2000 and the remaining 50 per cent was converted into the same number of ordinary shares on 3 June 2004.

The amortisation of discount on preference shares referred to on page 10 reflects the difference between the share price at the date of the Rothmans transaction and the redemption price, which was being amortised over the period to the redemption date.

FOREIGN CURRENCIES

The results of overseas subsidiaries and associated companies have been translated to sterling as follows:

The income statement has been translated at the average rates for the respective periods. The total equity has been translated at the relevant period end rates. For high inflation countries, the local currency results are adjusted for the impact of inflation prior to translation to sterling at closing exchange rates.

The principal exchange rates used were as follows:

	Average			Closing		
	30.9.05	30.9.04	31.12.04	30.9.05	30.9.04	31.12.04
US dollar	1.843	1.820	1.830	1.769	1.810	1.920
Canadian dollar	2.256	2.418	2.384	2.053	2.290	2.300
Euro	1.460	1.486	1.475	1.467	1.457	1.413
South African rand	11.626	11.979	11.821	11.247	11.717	10.816

Under UK GAAP previously reported quarterly figures were restated to the average rates for the year to date. Under IFRS, each quarter is not restated for subsequent movements in foreign exchange during the year and so the figures remain translated to sterling at the average rates for the relevant periods. The comparative 2004 figures in these results reflect this change, as well as the other adjustments to IFRS.

CHANGES IN THE GROUP

On 23 December 2003, the Group completed the acquisition of Ente Tabacchi Italiani S.p.A. (ETI), Italy's state tobacco company. On 29 December 2004 the Group sold Etinera S.p.A., the distribution business of the Italian subsidiary, for €590 million. After allocating the relevant portion of the goodwill on the ETI acquisition to Etinera there was no gain on the disposal. It is estimated that Etinera contributed £823 million of revenue and £30 million of operating profit to the Group results for the nine months to 30 September 2004.

In the first nine months of 2005, following the sale of Etinera, volumes and profits in Italy benefited by 2 billion and £14 million respectively from a change in the terms of trade with Etinera, but around 60 per cent of this is expected to reverse over time.

The Group announced on 27 October 2003, and completed on 30 July 2004, the agreement to combine Brown & Williamson's (B&W) US domestic businesses with R.J. Reynolds (RJR) under Reynolds American Inc., a new holding company 58 per cent owned by RJR shareholders and 42 per cent by the Group, through B&W. The Group also sold Lane to Reynolds American for US$400 million in cash. This transaction gave rise to goodwill relating to the Group's investment in Reynolds American Inc. and a gain on the partial disposal of the US domestic businesses. The goodwill on the transaction is £1,285 million, with a gain on the partial disposal of £1,392 million and £1,389 million included in the profit from operations for the nine months to 30 September 2004 and the year ended 31 December 2004 respectively.

The Group consolidated the results of B&W and Lane for the seven months to the end of July 2004, and from that date Reynolds American Inc. is accounted for as an associated company. In the nine months to 30 September 2005, the Group's share of Reynolds American post tax profit was £165 million (£188 million excluding exceptional items). In the nine months to 30 September 2004 B&W and Lane contributed £965 million of revenue and £149 million of operating profit through to the end of July, while the Group's share of Reynolds American post tax profit was £19 million (£38 million after excluding exceptional items) for the subsequent two months.

Excluding the Etinera, B&W and Lane operating profits, as well as restructuring costs and the gain on disposal of subsidiaries, from the first nine months of 2004 would result in an operating profit for 2004 of £1,800 million. On this basis, the operating profit for the first nine months of 2005 of £1,961 million, after excluding restructuring costs and the benefit from the change in terms of trade in Italy and from the disposal of brands, would represent growth of 9 per cent.

The Group ceased to be the controlling company of British American Racing (Holdings) Ltd. (BAR) on 7 December 2004 when BAR went into administration. The Group consequently ceased to consolidate BAR from that date. In January 2005, a joint venture between British American Tobacco and Honda Motor Co. Ltd. acquired the BAR business. As there is now shared control with Honda, BAR is equity accounted from January 2005. On 4 October 2005, the Group announced that it had agreed the sale of its shares in BAR to Honda and the sale is expected to take effect by 31 December 2005. The gross assets of BAR Honda GP were £24 million at 30 September 2005.

On 21 October 2005, the Group announced the exercise of its pre-emption rights over shares in STK, its Danish associated company, for £95 million which will increase the Group's holding from 26.6 per cent to 32.3 per cent.

RESTRUCTURING COSTS

During 2003, the Group commenced a detailed review of its manufacturing operations and organisational structure, including the initiative to reduce overheads and indirect costs. During 2004, announcements were made principally in respect of a reorganisation of the Group's business in Germany, the closing and downsizing of some factories and the integration of the Smoking Tobacco and Cigars operations with the cigarette businesses in Europe and the UK. The profit from operations for the year ended 31 December 2004 included a charge for restructurings of £206 million and for the nine months to 30 September 2004 included £50 million.

Manufacturing rationalisation continued in 2005. Following the announcement in June that part of the UK production would be transferred overseas, in July the Group announced that its operating companies in the UK and Ireland were initiating consultations on proposals to cease manufacture and transfer production elsewhere. The restructuring costs of £142 million for the nine months to 30 September 2005 principally comprise fixed asset impairment charges and staff costs in respect of the UK operations.

On 20 October 2005, Imperial Tobacco Canada announced that it had decided to close its cigarette factory in Guelph, Ontario, and its fine cut/roll-your-own and leaf processing operations in Aylmer, Ontario. This will create restructuring charges of approximately £200 million over the next few years, with the largest portion to be taken before the end of 2005.

INVESTMENT COSTS WRITTEN OFF

Considering the uncertainty of the timetable and the significant hurdles in establishing a major strategic investment in China, in 2004 the Group decided to write off £50 million reflecting all costs previously capitalised in reaching that stage of the project.

GAINS ON DISPOSAL OF SUBSIDIARIES, NON-CURRENT INVESTMENTS AND BRANDS

In the year ended 31 December 2004, a gain on partial disposal of £1,389 million (nine months to 30 September 2004: £1,392 million) arose from the agreement to combine Brown & Williamson with R.J. Reynolds, with no gain on the disposal of Etinera, as described on page 16.

In 2004, the Group sold two non-current asset investments, its 20 per cent stake in Lakson Tobacco Company in Pakistan and Bolloré Investissement S.A. in France. The total proceeds were £66 million, resulting in a gain on disposal of £38 million included in other operating income in the profit from operations.

In April 2005, the Group sold to Gallaher Group plc its Benson & Hedges and Silk Cut trademarks in Malta and Cyprus, together with the Silk Cut trademark in Lithuania, resulting in a gain on disposal of £68 million included in other operating income in the profit from operations. The transactions are in accordance with contracts of 1993 and 1994 in which Gallaher agreed to acquire these trademarks in European Union states and the recent accession of Malta, Cyprus and Lithuania necessitated the sale.

NET FINANCE COSTS

Net finance costs comprise:

		9 months to 30.9.05 £m		30.9.04 £m
Finance costs		(234)		(273)
Finance income		80		69
		(154)		(204)
Comprising:				
Interest payable		(277)		(278)
Interest and dividend income		80		68
Fair value changes - derivatives	(151)			
Exchange differences	194		6	
		43		6
		(154)		(204)

Net finance costs at £154 million were £50 million lower than last year principally reflecting the impact of derivatives and exchange differences under IFRS as described in (a) and (c) below, together with the benefit of the Group's cash flow since 30 September 2004 and interest rates.

The £43 million net gain (2004: £6 million) of fair value changes and exchange differences reflects:

(a) IAS39 requires all derivatives to be recognised at fair value in the accounts. This results in a £14 million benefit in the nine months on applying fair values to derivatives which do not qualify for hedge accounting under IAS39. However, this is principally in respect of long term structural swaps as part of the Group's treasury management. While valuations under IAS39 will be subject to volatility over time, the intention is to hold the swaps to maturity.

(b) £10 million related to swaps which in 2004 would have been included in interest payable.

(c) £19 million (2004: £6 million) principally reflecting exchange differences which were included in reserve movements under UK GAAP.

Net finance costs under IFRS, especially with the implementation of IAS39, are potentially more volatile than under UK GAAP. As described on page 22, the Group will review the appropriate treatment of this volatility for the adjusted earnings per share calculations prior to publishing the first annual IFRS results for 2005.

ASSOCIATES

The share of post tax results of associates is after restructuring costs, the US Federal Tobacco buy-out, exceptional tax credits and impairments of brands and non-current investments.

Following the combination of Brown & Williamson with R.J. Reynolds as described on page 16, the new company Reynolds American incurred restructuring costs in integrating the two businesses. For the period to 31 December 2004 the Group's share of these amounted to £63 million net of tax (30 September 2004: £60 million), mainly in relation to asset write downs and staff costs. The contribution from Reynolds American also included a £49 million (net of tax) impairment charge following the implementation of a review of brand strategies resulting from the combination of R.J. Reynolds and Brown & Williamson offset by a £49 million (30 September 2004: £41 million)exceptional tax credit arising from tax recoveries. In the nine months to 30 September 2005, Reynolds American incurred further restructuring costs and a one-off charge related to the stabilisation inventory pool losses associated with the US tobacco quota buy-out programme. The Group's share of these amounted to £12 million and £11 million respectively.

In the nine months to 30 September 2005, the contribution from ITC in India included a benefit of £27 million (net of tax), principally related to the write back of provisions for taxes partly offset by the impairment of a non-current investment.

The tax rate for associates, adjusted to remove exceptional items and as reflected in the adjusted earnings per share shown below, was 37.4 per cent in 2005 (30 September 2004: 36.0 per cent). The increase reflects the inclusion of the US tobacco business in associated companies following the Reynolds American transaction.

TAXATION

The tax rates in the income statement of 27.0 per cent in 2005 and 18.0 per cent in 2004 are affected by the inclusion of the share of associates post tax profit in the Group's pre-tax results and the significant gain on the Reynolds American transaction in 2004. The underlying tax rate for subsidiaries, adjusted to remove exceptional items as reflected in the adjusted earnings per share shown below, was 30.6 per cent in 2005 and 33.4 per cent in 2004, and the decrease reflects changes in the mix of profits. The charge relates to taxes payable overseas.

EARNINGS PER SHARE

Basic earnings per share are based on the profit for the period attributable to ordinary shareholders, after deducting the amortisation of discount on the convertible redeemable preference shares, and the average number of ordinary shares in issue during the period (excluding shares held to satisfy the Group's Employee Share Schemes).

For the calculation of the diluted earnings per share the average number of shares reflects the potential dilutive effect of employee share schemes and, up to their redemption on 3 June 2004, the convertible redeemable preference shares. The earnings are correspondingly adjusted to the amount of earnings prior to deducting the amortisation of discount on the convertible redeemable preference shares.

The earnings per share are based on:

	30.9.05		30.9.04		31.12.04	
	Earnings	Shares	Earnings	Shares	Earnings	Shares
	£m	m	£m	m	£m	m
Basic	1,381	2,101	2,518	2,077	2,821	2,088
Diluted	1,381	2,119	2,526	2,161	2,829	2,156

The earnings have been impacted by exceptional items and to illustrate the impact of these, the adjusted diluted earnings per share are shown below:

	Diluted earnings per share		
	9 months to		Year to
	30.9.05	30.9.04	31.12.04
	pence	pence	pence
Unadjusted earnings per share	65.17	116.89	131.22
Effect of restructuring costs	6.71	4.49	9.32
Investment costs written off			2.32
Effect of disposal of subsidiaries, non-current investments and brands	(3.21)	(64.41)	(66.33)
Effect of exceptional tax credits, impairments and US Federal Tobacco buy-out in associated companies	(0.76)	(1.90)	
Adjusted earnings per share	67.91	55.07	76.53
Adjusted earnings per share are based on			
- adjusted earnings (£m)	1,439	1,190	1,650
- shares (m)	2,119	2,161	2,156

Similar types of adjustments would apply to basic earnings per share. For the nine months to 30 September 2005, basic earnings per share on an adjusted basis would be 68.49p (2004: 56.90p) compared to unadjusted amounts of 65.73p (2004: 121.23p).

IFRS requires fair value changes for derivatives, which do not meet the tests for hedge accounting under IAS39, to be included in the income statement. In addition, certain exchange differences included in reserve movements under UK GAAP, are required to be included in the income statement under current IFRS. As both these items are particularly subject to exchange rate movements in a period, they can be a volatile element of reported income, and especially of net finance costs, and one which does not always reflect an economic gain or loss for the Group. Subject to further developments in IFRS during 2005, including interpretations of IFRS and best practice in reporting IFRS results, the Group will review the appropriate treatment of these in the adjusted earnings per share calculations prior to publishing the first annual IFRS results for 2005.

DIVIDENDS

In accordance with IFRS the interim dividend amounting to £293 million (30 September 2004: £271 million), paid on 14 September 2005, is charged in the Group results for the third quarter. The results for the nine months to 30 September 2005 also include the final dividend paid in respect of the year ended 31 December 2004 amounting to £617 million (30 September 2004: £585 million).

CONTINGENT LIABILITIES

As noted in the Report and Accounts for the year ended 31 December 2004, there are contingent liabilities in respect of litigation, overseas taxes and guarantees in various countries.

Group companies, as well as other leading cigarette manufacturers, are defendants in a number of product liability cases. In a number of these cases, the amounts of compensatory and punitive damages sought are significant. At least in the aggregate and despite the quality of defences available to the Group, it is not impossible that the results of operations or cash flows of the Group in particular quarterly or annual periods could be materially affected by this.

Having regard to these matters, the Directors (i) do not consider it appropriate to make any provision in respect of any pending litigation and (ii) do not believe that the ultimate outcome of this litigation will significantly impair the financial condition of the Group.

SHARE BUY-BACK PROGRAMME

The Group initiated an on-market share buy-back programme at the end of February 2003. During the nine months to 30 September 2005, 37 million shares were bought at a cost of £394 million (30 September 2004: £368 million).

During the year to 31 December 2004, 59 million shares were bought at a cost of £492 million.

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Copies of this Report will be posted to shareholders and may also be obtained during normal business hours from the Company's Registered Office at Globe House, 4 Temple Place, London WC2R 2PG.

Alan F Porter
Secretary
27 October 2005