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REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

OPINION

In our opinion:

- Imperial Brands PLC's Group financial statements and Parent Company financial statements (the "financial statements") give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 30 September 2018 and of the Group's profit and cash flows for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the Parent Company financial statements have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 101 "Reduced Disclosure Framework", and applicable law); and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements, included within the Annual Report and Accounts (the "Annual Report"), which comprise: the Consolidated and Imperial Brands PLC Balance Sheets as at 30 September 2018; the Consolidated Income Statement and the Consolidated Statement of Comprehensive Income, the Consolidated Cash Flow Statement, and the Consolidated and Imperial Brands PLC Statements of Changes in Equity for the year then ended; and the notes to the financial statements, which include a description of the significant accounting policies.

Our opinion is consistent with our reporting to the Audit Committee.

BASIS FOR OPINION

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

INDEPENDENCE

We remained independent of the Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, which includes the FRC's Ethical Standard, as applicable to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided to the Group or the Parent Company.

Other than those disclosed in the Directors' Report and in note 4, we have provided no non-audit services to the Group or the Parent Company in the period from 1 October 2017 to 30 September 2018.

OUR AUDIT APPROACH

OVERVIEW

- Overall Group materiality: £130 million (2017: £130 million), based on approximately 4 per cent of adjusted profit before tax, as defined in note 1 to the Group financial statements.
- Overall Parent Company materiality: £160 million (2017: £160 million), based on 1 per cent of total assets. For the purposes of the Group audit we applied a lower materiality of £10m (2017: £10 million).

- Following our assessment of the risk of material misstatement we selected 19 reporting entities for full scope audits which represent the principal business units. We conducted full scope audit work in the UK, USA, Germany and Logista in addition to a further 13 locations in which the Group has significant operations. Our work also covered the Group shared service centre, central treasury function and the Parent Company.
- In addition, we performed specified procedures over certain balances and transactions in Russia and Fontem Ventures in the Netherlands.
- During the year, the Group engagement team visited five locations outside of the UK where full scope audits were performed, the shared service centre in Poland and both locations where specified procedures took place.

- Goodwill and intangible asset impairment assessment (Group).
- Uncertain tax positions in respect of direct and indirect taxes (Group).
- Viability of key distributors and customers and impact on recoverability of receivables (Group).
- Tobacco-related litigation (Group).

THE SCOPE OF OUR AUDIT

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we looked at where the Directors made subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain.

We gained an understanding of the legal and regulatory framework applicable to the Group and the industries in which it operates, and considered the risk of acts by the Group which were contrary to applicable laws and regulations, including fraud. We designed audit procedures at Group and significant component level to respond to the risk, recognising that the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion. We focused on laws and regulations that could give rise to a material misstatement in the Group and Parent Company financial statements, including, but not limited to, the Companies Act 2006, the Listing Rules, UK tax legislation and equivalent local laws and regulations applicable to significant component teams. Our tests included, but were not limited to, review of the financial statement disclosures to underlying supporting documentation, inspection of correspondence with legal advisors, enquiries of management, review of significant component auditors' work and review of internal audit reports in so far as they related to the financial statements. There are inherent limitations in the audit procedures described above and the further removed non-compliance with laws and regulations is from the events and transactions reflected in the financial statements, the less likely we would become aware of it.

We did not identify any key audit matters relating to irregularities, including fraud. As in all of our audits we also addressed the risk of management override of internal controls including system segregation of duties, including testing journals and evaluating whether there was evidence of bias by the Directors that represented a risk of material misstatement due to fraud.

KEY AUDIT MATTERS

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by the auditors, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters, and any comments we make on the results of our procedures thereon, were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. This is not a complete list of all risks identified by our audit.

KEY AUDIT MATTER

GOODWILL AND INTANGIBLE ASSET IMPAIRMENT ASSESSMENT (GROUP)

Refer to the Report of the Audit Committee and note 11 – Intangible Assets.

We focused on this area because the determination of whether elements of goodwill and intangible assets are impaired involves complex and subjective judgements by the Directors about the future results of the relevant parts of the business.

At 30 September 2018 the Group had £12,463 million of goodwill and £607 million of intangible assets with indefinite lives and clear headroom in the majority of the Group's cash generating unit (CGU) Groupings.

We focused on the valuation of the Growth Markets reporting segment (£2,411 million of goodwill and intangible assets with indefinite lives). Growth Markets is made up of a number of operating segments and individual CGU's, mainly the Drive Growth CGU Grouping. We note that while headroom has increased in this division to £164 million (2017: £33 million) it remains relatively low and is sensitive to key assumptions.

For the Drive Growth CGU Grouping we focused on both the valuation of the Russian business, which represents the most material part of this CGU Grouping, and to a lesser extent on Japan where significant growth is anticipated in the medium term. In particular we considered the robustness of short-term growth included in the impairment models, together with discount rates and long-term growth rates.

HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER

We challenged the Directors' analysis around the key drivers of the Drive Growth cash flow forecasts including the ability to achieve sustained price increases, market size and market share. We evaluated the appropriateness of the key assumptions including discount rates, short-term and long-term growth rates and performed sensitivities across the reporting segments. We also tested the integrity of the model, checking key formulae and logic of the calculations used.

For the Russian business we assessed the credibility of the model by testing the accuracy of prior year estimates and considered the forecast growth trajectory in the context of historical levels of profitability. We also considered the impact of current and expected legislative and duty changes on the business and utilised recent market information of acquisitions and disposals within the Russian tobacco sector to calculate valuation multiples and compared these to Management's model.

In assessing the Japanese cash flows we considered the Group's brand investment strategy to target the value-end of this market against a backdrop of increased regulation and taxes driving more consumers towards the value-end of the tobacco product range. Given there is little historical Group precedent to support these forecasts in Japan, we challenged Management to ensure the discount rate reflected this risk, and compared their rate to other growing businesses facing similar situations in similar environments. On balance we are comfortable that the discount rate used reflects relevant risks and is therefore appropriate.

As a result of our work we concluded that Management's judgement that no impairment was required to Drive Growth was reasonable. We note that goodwill and intangibles held by these businesses remain sensitive to changes in key assumptions. In particular, for Drive Growth, this conclusion is dependent on a sustained recovery in the Russian market from the difficult trading conditions encountered last year, and if this does not occur an impairment could arise. Given this, Management has appropriately disclosed relevant sensitivities.

We highlight however that Management's analysis was performed on a 'value in use' basis under IAS 36 which currently excluded 'Next Generation Product' (NGP) cash flows due to these products only recently having been launched in the Drive Growth markets. We held discussions with Management in relation to these NGP cash flows and are comfortable with Management's disclosure that these cash flows can be incorporated into a 'Fair value less costs to sell' model for the Drive Growth CGU and that this would increase headroom by at least £200 million.

KEY AUDIT MATTER

UNCERTAIN TAX POSITIONS IN RESPECT OF DIRECT AND INDIRECT TAXES (GROUP)

Refer to the Report of the Audit Committee and note 8 – Tax

The Group operates across a large number of jurisdictions and is subject to periodic challenges by local tax authorities on a range of tax matters during the normal course of business, including transfer pricing, direct and indirect taxes and transaction related tax matters.

Where the amount of tax payable is uncertain, the Group establishes provisions based on Management's judgement of the likelihood of settlement being required.

We focused on the judgements made by Management in assessing the likelihood of potentially material exposures and the estimates used to determine such provisions where required. In particular we focused on the impact of changes in local tax regulations and ongoing inspections by local tax authorities and international bodies, which could materially impact the amounts recorded in the Group financial statements.

Given the nature of judgements involved, the complexities of dealing with tax rules and regulations in numerous jurisdictions, accounting for this risk is primarily managed by the Imperial Brands head office tax team in Bristol. As such, this was a key area of focus for the Group engagement team.

HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER

We evaluated the design and implementation of controls in respect of identifying uncertain tax positions, which we found to be satisfactory for the purposes of our audit. We also evaluated the related accounting policy for provisioning for tax exposures and found it to be appropriate.

We used our UK and overseas tax specialists to gain an understanding of the current status of tax assessments and investigations and to monitor developments in ongoing disputes.

Our focus was on uncertain tax positions in relation to the challenge from the French Tax Authority in respect of the disposal of the Altadis Distribution France business, the EU Commission's challenge of the UK Controlled Foreign Company regime, and a number of other State Aid and transfer pricing risks. We read recent rulings and correspondence with local tax authorities, challenged key assumptions and inspected external advice provided by the Group's tax experts and legal advisors where relevant, to satisfy ourselves that the provisions had been appropriately recorded or adjusted to reflect any latest developments.

We determined that the position adopted in the Group financial statements was reasonable based on our consideration of the risks.

We also considered significant findings from recent tax audits, including the Russian Tax Authority's preliminary audit report seeking additional taxes of up to approximately £132 million, as disclosed in note 8 to the Group financial statements. We engaged our Russian audit and tax specialists to perform some specified procedures in relation to this matter and have discussed the status and expected Group responses with Management and their external tax and legal experts.

We challenged the overall sufficiency and clarity of disclosures in relation to uncertain tax provisions and tax related contingent liabilities. We highlighted where further disclosure was considered appropriate and ensured this has been included in the Annual Report.

KEY AUDIT MATTER

VIABILITY OF KEY DISTRIBUTORS AND CUSTOMERS AND IMPACT ON RECOVERABILITY OF RECEIVABLES (GROUP)

Refer to the Report of the Audit Committee

Due to the nature of the tobacco sector, the Group is reliant on a number of key distributors and customers in certain markets.

In late November 2017, a key distributor for the UK market, 'Palmer and Harvey', entered administration. This led to a reported £160 million charge to the interim results.

Given the significance of the administration, our work has focused on the charges recognised in respect of Palmer & Harvey and consideration of the viability of other key distributors and customers as part of assessing the recoverability of receivables at year end.

In relation to the Palmer & Harvey administration, subsequent to the interim results, certain cost estimates have been revised by Management based on actual costs incurred and a more accurate understanding of further costs, and some cash recovery has also been received from the Administrator, reducing the overall charge recognised in the Group financial statements to £110 million.

HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER

Our audit of this charge included validating total receivables and loans with Palmer & Harvey at the time of administration, inspection of correspondence with the Administrators, and testing subsequent recovery of cash receipts.

We also considered the suitability of presentation of the £110 million charge as an 'adjusting' item and was comfortable with this treatment given its size and non-recurring nature.

We have considered the viability of other significant distributors and customers, through looking at recent payment history, analysing aged receivables and challenging provisions for any doubtful debts.

Based on our procedures, we noted no material exceptions and considered Management's key assumptions regarding recoverability of receivables to be reasonable.

KEY AUDIT MATTER

TOBACCO-RELATED LITIGATION (GROUP)

Refer to the Report of the Audit Committee and note 28 – Contingent Liabilities

The Group is currently involved in a number of legal cases in which claimants are seeking damages for alleged smoking and health-related effects.

The Group's view is that it has meritorious defences to all these cases and therefore no provisions have been made.

In the US, tobacco-related litigation is managed separately by the Master Settlement Agreement ("MSA"). Four states are not parties to this agreement and claims have been raised against the Group's US business, ITG Brands, in connection with its acquisition of certain US brands in June 2015.

The Group continues to receive legal advice in relation to these claims that supports Management's assessment that at present it is remote that the Group will incur any outflow of resources and therefore no provision is necessary.

HOW OUR AUDIT ADDRESSED THE KEY AUDIT MATTER

In respect of these matters, we have held meetings with the Group legal team and reviewed board meeting minutes to understand the matters and current progress. We have also assessed available historic precedent.

We have written to and received responses from the Group's external lawyers in all these cases and validated responses to Management's position.

As a result of our work we consider Management's position, that no provision is required, to be reasonable. We also discussed the level of disclosure in relation to these matters and highlighted where further disclosure was considered appropriate, and ensured this has been included in the Group financial statements.

We determined that there were no key audit matters applicable to the Parent Company to communicate in our report.

HOW WE TAILORED THE AUDIT SCOPE

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the Group and the Parent Company, the accounting processes and controls, and the industry in which they operate.

The Group is structured along two business lines being 'Tobacco and NGP' and 'Distribution'. The Tobacco and NGP business operates across 160 markets, with 21 main markets, which are then managed through segments: Returns North; Returns South; and Growth, which includes the USA. A number of these markets are supported by the Group's shared service centres in Poland and the Philippines. The output of these shared service centres are included in the financial information of the reporting components they service and they are therefore not separate reporting components. The Group's accounting process is structured around a local or regional finance function for each of the markets in which the Group operates. These functions maintain their own accounting records and controls and report to the head office finance team in Bristol through an integrated consolidation system.

In establishing the overall approach to the Group audit we determined the type of work that needed to be performed at reporting components, by either the Group engagement team or through directing component auditors from PwC network firms. This included consideration of the work required to be performed by our audit teams at shared service centres to support component auditors.

We identified 19 reporting entities (including the Distribution sub group), which due to their significance and/or risk characteristics required an audit of their complete financial information. We also conducted specified procedures in Russia based on our assessment of the risk of misstatement and the scale of operations at this market, and we performed specified audit procedures over Fontem Ventures in the Netherlands due to the increasing importance of NGP to the Group.

Certain specific audit procedures over central corporate functions and areas of significant judgement, including goodwill and intangible assets, taxation, material provisions and contingent liabilities, were performed at the Group's head office. We also performed work centrally on systems and IT general controls, consolidation journals and the one-off transactions undertaken by the Group during the year.

Taken together, the reporting entities and Group functions where we performed audit work accounted for approximately 79 per cent of Group revenues and in excess of 90 per cent of both Group profit before tax and Group adjusted profit before tax. At the Group level, we also carried out analytical and other procedures on the reporting components not covered by the procedures above.

Where the work was performed by component auditors, we determined the level of involvement we needed to have in the audit work at those functions to be able to conclude whether sufficient and appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole. We issued formal, written instructions to component auditors setting out the work to be performed by each of them and maintained regular communication throughout the audit cycle. These interactions included attending component clearance meetings and holding regular conference calls, as well as reviewing and assessing matters reported.

Senior members of the Group engagement team visit the component teams on a rotational basis. In the current year the Group team visited the USA, Morocco, Germany, Spain, Logista, Russia and Fontem Ventures B.V., as well as in-scope UK reporting locations. These visits included meetings with local management and with the component auditors, as well as certain operating site tours. The Group engagement partner also took part in the year-end clearance meetings for the UK, USA, Germany and Logista businesses, and the Group engagement team reviewed the audit working papers for these components and certain other components.

MATERIALITY

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent Company financial statements
Overall materiality	£130 million (2017: £130 million).	£10 million (2017: £10 million).
How we determined it	Approximately 4 per cent of adjusted profit before tax.	1 per cent of total assets.
Rationale for benchmark applied	We believe that adjusted profit before tax is the primary measure used by shareholders and other users in assessing the performance of the Group, and that by excluding adjusting items it provides a clearer view on the performance of the underlying business.	The parent entity is principally an investment holding company and therefore it is not appropriate to use profit before tax or revenues to calculate materiality, rather materiality is considered with reference to total assets. Overall materiality applied is limited to £10 million, lower than 1 per cent of total assets, due to being restricted for Group reporting for the purposes of the audit of the consolidated financial statements of the Group.

For each component in the scope of our Group audit we allocated a materiality that is less than our overall Group materiality. The range of materiality allocated across components was between £10 million and £40 million for the trading entities and £80 million for the financing and treasury entity. Certain components were audited to a local statutory audit materiality that was also less than our overall Group materiality.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £10 million (Group audit) (2017: £10 million) and £10 million (Parent Company audit) (2017: £10 million) as well as misstatements below those amounts that, in our view, warranted reporting for qualitative reasons.

GOING CONCERN

In accordance with ISAs (UK) we report as follows:

Reporting obligation	Outcome
We are required to report if we have anything material to add or draw attention to in respect of the Directors' statement in the financial statements about whether the Directors considered it appropriate to adopt the going concern basis of accounting in preparing the financial statements and the Directors' identification of any material uncertainties to the Group's and the Parent Company's ability to continue as a going concern over a period of at least twelve months from the date of approval of the financial statements.	We have nothing material to add or to draw attention to. However, because not all future events or conditions can be predicted, this statement is not a guarantee as to the Group's and Parent Company's ability to continue as a going concern.
We are required to report if the Directors' statement relating to going concern in accordance with Listing Rule 9.8.6R(3) is materially inconsistent with our knowledge obtained in the audit.	We have nothing to report.

REPORTING ON OTHER INFORMATION

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The Directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except to the extent otherwise explicitly stated in this report, any form of assurance thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If we identify an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report based on these responsibilities.

With respect to the Strategic Report and Directors' Report, we also considered whether the disclosures required by the UK Companies Act 2006 have been included.

Based on the responsibilities described above and our work undertaken in the course of the audit, the Companies Act 2006, (CA06), ISAs (UK) and the Listing Rules of the Financial Conduct Authority (FCA) require us also to report certain opinions and matters as described below (required by ISAs (UK) unless otherwise stated).

Strategic Report and Directors' Report

In our opinion, based on the work undertaken in the course of the audit, the information given in the Strategic Report and Directors' Report for the year ended 30 September 2018 is consistent with the financial statements and has been prepared in accordance with applicable legal requirements. (CA06)

In light of the knowledge and understanding of the Group and Parent Company and their environment obtained in the course of the audit, we did not identify any material misstatements in the Strategic Report and Directors' Report. (CA06)

The Directors' assessment of the prospects of the Group and of the principal risks that would threaten the solvency or liquidity of the Group

We have nothing material to add or draw attention to regarding:
- The Directors' confirmation on page 29 of the Annual Report that they have carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity.
- The disclosures in the Annual Report that describe those risks and explain how they are being managed or mitigated.
- The Directors' explanation on page 29 of the Annual Report as to how they have assessed the prospects of the Group, over what period they have done so and why they consider that period to be appropriate, and their statement as to whether they have a reasonable expectation that the Group will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, including any related disclosures drawing attention to any necessary qualifications or assumptions.

We have nothing to report having performed a review of the Directors' statement that they have carried out a robust assessment of the principal risks facing the Group and statement in relation to the longer-term viability of the Group. Our review was substantially less in scope than an audit and only consisted of making inquiries and considering the Directors' process supporting their statements; checking that the statements are in alignment with the relevant provisions of the UK Corporate Governance Code (the "Code"); and considering whether the statements are consistent with the knowledge and understanding of the Group and Parent Company and their environment obtained in the course of the audit. (Listing Rules)

Other Code Provisions

We have nothing to report in respect of our responsibility to report when:
- The statement given by the Directors, on page 35, that they consider the Annual Report taken as a whole to be fair, balanced and understandable, and provides the information necessary for the members to assess the Group's and Parent Company's position and performance, business model and strategy is materially inconsistent with our knowledge of the Group and Parent Company obtained in the course of performing our audit.
- The section of the Annual Report on pages 41-47 describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.
- The Directors' statement relating to the Parent Company's compliance with the Code does not properly disclose a departure from a relevant provision of the Code specified, under the Listing Rules, for review by the auditors.

Directors' Remuneration

In our opinion, the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006. (CA06)

RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS AND THE AUDIT

RESPONSIBILITIES OF THE DIRECTORS FOR THE FINANCIAL STATEMENTS

As explained more fully in the Statement of Directors' Responsibilities set out on page 55, the Directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The Directors are also responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Group's and the Parent Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or the Parent Company or to cease operations, or have no realistic alternative but to do so.

AUDITORS' RESPONSIBILITIES FOR THE AUDIT OF THE FINANCIAL STATEMENTS

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditors' report.

USE OF THIS REPORT

This report, including the opinions, has been prepared for and only for the Parent Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

OTHER REQUIRED REPORTING

COMPANIES ACT 2006 EXCEPTION REPORTING

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Parent Company, or returns adequate for our audit have not been received from branches not visited by us; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- the Parent Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

APPOINTMENT

Following the recommendation of the Audit Committee, we were appointed by the Directors on 6 August 1996 to audit the financial statements for the year ended 27 September 1997 and subsequent financial periods. The period of total uninterrupted engagement is 22 years, covering the years ended 27 September 1997 to 30 September 2018.

RICHARD FRENCH (SENIOR STATUTORY AUDITOR)
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors

Bristol

6 November 2018

CONSOLIDATED INCOME STATEMENT
for the year ended 30 September

£ million unless otherwise indicated	Notes	2018	2017
Revenue	3	**30,524**	30,247
Duty and similar items		**(15,125)**	(14,967)
Other cost of sales		**(8,949)**	(8,853)
Cost of sales		**(24,074)**	(23,820)
Gross profit		**6,450**	6,427
Distribution, advertising and selling costs		**(2,441)**	(2,434)
Amortisation of acquired intangibles	11	**(1,053)**	(1,092)
Administration of UK distributor	3	**(110)**	–
Restructuring costs	5	**(196)**	(391)
Other expenses		**(243)**	(232)
Administrative and other expenses		**(1,602)**	(1,715)
Operating profit	3	**2,407**	2,278
Investment income		**631**	910
Finance costs		**(1,257)**	(1,360)
Net finance costs	7	**(626)**	(450)
Share of profit of investments accounted for using the equity method	13	**42**	33
Profit before tax	4	**1,823**	1,861
Tax	8	**(396)**	(414)
Profit for the year		**1,427**	1,447
Attributable to:			
Owners of the parent		**1,368**	1,409
Non-controlling interests		**59**	38
Earnings per ordinary share (pence)			
– Basic	10	**143.6**	147.6
– Diluted	10	**143.2**	147.2

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
for the year ended 30 September

£ million	Notes	2018	2017
Profit for the year		**1,427**	1,447
Other comprehensive income/(expense)			
Exchange movements		**176**	(57)
Items that may be reclassified to profit and loss		**176**	(57)
Net actuarial gains on retirement benefits	22	**196**	649
Deferred tax relating to net actuarial gains on retirement benefits	21	**(54)**	(120)
Items that will not be reclassified to profit and loss		**142**	529
Other comprehensive income for the year, net of tax		**318**	472
Total comprehensive income for the year		**1,745**	1,919
Attributable to:			
Owners of the parent		**1,683**	1,870
Non-controlling interests		**62**	49
Total comprehensive income for the year		**1,745**	1,919

RECONCILIATION FROM OPERATING PROFIT TO ADJUSTED OPERATING PROFIT

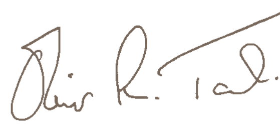
£ million	Notes	2018	2017
Operating profit		**2,407**	2,278
Amortisation of acquired intangibles	11	**1,053**	1,092
Administration of UK distributor	3	**110**	–
Restructuring costs	5	**196**	391
Adjusted operating profit		**3,766**	3,761

RECONCILIATION FROM NET FINANCE COSTS TO ADJUSTED NET FINANCE COSTS

£ million	Notes	2018	2017
Net finance costs		**(626)**	(450)
Net fair value and exchange losses/(gains) on financial instruments	7	**126**	(112)
Post-employment benefits net financing cost	7	**13**	25
Adjusted net finance costs		**(487)**	(537)

CONSOLIDATED BALANCE SHEET
at 30 September

£ million	Notes	2018	2017
Non-current assets			
Intangible assets	11	**19,117**	19,763
Property, plant and equipment	12	**1,891**	1,865
Investments accounted for using the equity method	13	**845**	785
Retirement benefit assets	22	**598**	358
Trade and other receivables	15	**82**	123
Derivative financial instruments	20	**462**	583
Deferred tax assets	21	**600**	617
		23,595	24,094
Current assets			
Inventories	14	**3,692**	3,604
Trade and other receivables	15	**2,585**	2,539
Current tax assets	8	**164**	69
Cash and cash equivalents	16	**775**	624
Derivative financial instruments	20	**37**	60
		7,253	6,896
Total assets		**30,848**	30,990
Current liabilities			
Borrowings	18	**(2,397)**	(2,353)
Derivative financial instruments	20	**(105)**	(42)
Trade and other payables	17	**(8,270)**	(8,104)
Current tax liabilities	8	**(286)**	(192)
Provisions	23	**(179)**	(187)
		(11,237)	(10,878)
Non-current liabilities			
Borrowings	18	**(9,598)**	(10,196)
Derivative financial instruments	20	**(1,073)**	(1,166)
Trade and other payables	17	**(47)**	(21)
Deferred tax liabilities	21	**(1,113)**	(1,091)
Retirement benefit liabilities	22	**(1,061)**	(1,074)
Provisions	23	**(274)**	(338)
		(13,166)	(13,886)
Total liabilities		**(24,403)**	(24,764)
Net assets		**6,445**	6,226
Equity			
Share capital	24	**103**	103
Share premium and capital redemption		**5,837**	5,837
Retained earnings		**(1,150)**	(1,084)
Exchange translation reserve		**980**	828
Equity attributable to owners of the parent		**5,770**	5,684
Non-controlling interests	31	**675**	542
Total equity		**6,445**	6,226



The financial statements on pages 83-128 were approved by the Board of Directors on 6 November 2018 and signed on its behalf by:

MARK WILLIAMSON
Chairman

OLIVER TANT
Director

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
for the year ended 30 September

£ million	Share capital	Share premium and capital redemption	Retained earnings	Exchange translation reserve	Equity attributable to owners of the parent	Non-controlling interests	Total equity
At 1 October 2017	**103**	**5,837**	**(1,084)**	**828**	**5,684**	**542**	**6,226**
Profit for the year	**–**	**–**	**1,368**	**–**	**1,368**	**59**	**1,427**
Exchange movements	**–**	**–**	**–**	**173**	**173**	**3**	**176**
Net actuarial gains on retirement benefits	**–**	**–**	**196**	**–**	**196**	**–**	**196**
Deferred tax relating to net actuarial gains on retirement benefits	**–**	**–**	**(54)**	**–**	**(54)**	**–**	**(54)**
Other comprehensive income	**–**	**–**	**142**	**173**	**315**	**3**	**318**
Total comprehensive income	**–**	**–**	**1,510**	**173**	**1,683**	**62**	**1,745**
Transactions with owners							
Cash from employees on maturity/exercise of share schemes	**–**	**–**	**2**	**–**	**2**	**–**	**2**
Costs of employees' services compensated by share schemes	**–**	**–**	**25**	**–**	**25**	**–**	**25**
Current tax on share-based payments	**–**	**–**	**1**	**–**	**1**	**–**	**1**
Cancellation of share capital	**–**	**–**	**(41)**	**–**	**(41)**	**–**	**(41)**
Changes in non-controlling interests	**–**	**–**	**(121)**	**(21)**	**(142)**	**142**	**–**
Proceeds, net of fees from disposal of Logista shares (note 31)	**–**	**–**	**234**	**–**	**234**	**–**	**234**
Dividends paid	**–**	**–**	**(1,676)**	**–**	**(1,676)**	**(71)**	**(1,747)**
At 30 September 2018	**103**	**5,837**	**(1,150)**	**980**	**5,770**	**675**	**6,445**
At 1 October 2016	104	5,836	(1,525)	896	5,311	431	5,742
Profit for the year	–	–	1,409	–	1,409	38	1,447
Exchange movements	–	–	–	(68)	(68)	11	(57)
Net actuarial gains on retirement benefits	–	–	649	–	649	–	649
Deferred tax relating to net actuarial gains on retirement benefits	–	–	(120)	–	(120)	–	(120)
Other comprehensive income	–	–	529	(68)	461	11	472
Total comprehensive income	–	–	1,938	(68)	1,870	49	1,919
Transactions with owners							
Cash from employees on maturity/exercise of share schemes	–	–	12	–	12	–	12
Purchase of shares by cost of employees' services compensated by share schemes	–	–	25	–	25	–	25
Current tax on share-based payments	–	–	3	–	3	–	3
Cancellation of share capital	(1)	1	(119)	–	(119)	–	(119)
Changes in non-controlling interests	–	–	(111)	–	(111)	111	–
Proceeds, net of fees from disposal of Logista shares (note 31)	–	–	221	–	221	–	221
Dividends paid	–	–	(1,528)	–	(1,528)	(49)	(1,577)
At 30 September 2017	103	5,837	(1,084)	828	5,684	542	6,226

CONSOLIDATED CASH FLOW STATEMENT
for the year ended 30 September

£ million	2018	2017
Cash flows from operating activities		
Operating profit	**2,407**	2,278
Dividends received from investments accounted for under the equity method	**25**	28
Depreciation, amortisation and impairment	**1,266**	1,364
Profit on disposal of assets	**(36)**	(24)
Profit on disposal of brands	**(40)**	–
Post-employment benefits	**(60)**	(157)
Costs of employees' services compensated by share schemes	**26**	27
Provision in respect of loan to third parties	**4**	–
Movement in provisions	**(87)**	52
Operating cash flows before movement in working capital	**3,505**	3,568
Increase in inventories	**(112)**	(76)
(Increase)/decrease in trade and other receivables	**(35)**	189
Increase/(decrease) in trade and other payables	**136**	(46)
Movement in working capital	**(11)**	67
Tax paid	**(407)**	(570)
Net cash generated from operating activities	**3,087**	3,065
Cash flows from investing activities		
Interest received	**10**	11
Loan to joint ventures	**–**	(17)
Loan to third parties	**28**	(30)
Proceeds from sale of assets	**87**	30
Proceeds from the sale of brands	**47**	–
Purchase of property, plant and equipment	**(259)**	(191)
Purchase of intangible assets – software	**(47)**	(44)
Purchase of intangible assets – intellectual property rights	**(21)**	(15)
Purchase of businesses (net of cash acquired)	**(8)**	–
Purchase of brands and operations (see note 11)	**(67)**	(31)
Net cash used in investing activities	**(230)**	(287)
Cash flows from financing activities		
Interest paid	**(501)**	(548)
Cash from employees on maturity/exercise of share schemes	**2**	12
Increase in borrowings	**1,619**	852
Repayment of borrowings	**(2,261)**	(2,183)
Cash flows relating to derivative financial instruments	**41**	(37)
Repurchase of shares	**(41)**	(119)
Proceeds from sale of shares in a subsidiary to non-controlling interests (net of fees) (see note 31)	**234**	221
Dividends paid to non-controlling interests	**(71)**	(49)
Dividends paid to owners of the parent	**(1,676)**	(1,528)
Net cash used in financing activities	**(2,654)**	(3,379)
Net increase/(decrease) in cash and cash equivalents	**203**	(601)
Cash and cash equivalents at start of year	**624**	1,274
Effect of foreign exchange rates on cash and cash equivalents	**(52)**	(49)
Cash and cash equivalents at end of year	**775**	624

1. ACCOUNTING POLICIES

BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the IFRS Interpretations Committee (IFRS IC) as published by the International Accounting Standards Board and adopted by the EU. In addition, the financial statements comply with those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The financial statements have been prepared under the historical cost convention except where fair value measurement is required under IFRS as described below in the accounting policies on financial instruments, and on a going concern basis as detailed on page 23.

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues and expenses during the period and of assets, liabilities and contingent liabilities at the balance sheet date. The key estimates and assumptions are set out in note 2 Critical Accounting Estimates and Judgements. Such estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable in the circumstances and constitute management's best judgement at the date of the financial statements. In the future, actual experience may deviate from these estimates and judgements. This could affect future financial statements as the original estimates and judgements are modified, as appropriate, in the year in which the circumstances change.

The Company provides guarantees to the following subsidiaries under section 479 of the Companies Act 2006, whereby the subsidiaries, incorporated in the UK and Ireland, are exempt from the requirements of the Act relating to the audit of individual accounts for the financial year ending 30 September 2018:

- Imperial Tobacco Holdings (2007) Limited
- Sinclair Collis Limited
- Imperial Tobacco Ventures Limited
- Imperial Tobacco Ireland Unlimited Company
- Newglade International Unlimited Company
- Rizla UK Limited
- Imperial Tobacco Overseas (Polska) Limited
- Imperial Tobacco Overseas Holdings (3) Limited
- Imperial Tobacco Altadis Limited
- La Flor de Copan UK Limited
- Tabacalera de Garcia UK Limited
- Imperial Brands Ventures Limited
- Nerudia Consulting Limited

The principal accounting policies, which have been applied consistently other than where new policies have been adopted, are set out below.

BASIS OF CONSOLIDATION

The consolidated financial statements comprise the results of Imperial Brands PLC (the Company), a publicly listed Company incorporated in the United Kingdom, and its subsidiary undertakings, together with the Group's share of the results of its associates and joint arrangements.

Subsidiaries are those entities controlled by the Group. Control exists when the Group is exposed to, or has the rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Where necessary, accounting policies of subsidiaries are changed to ensure consistency with the policies adopted by the Group.

The acquisition method of accounting is used to account for the purchase of subsidiaries. The excess of the value transferred to the seller in return for control of the acquired business together with the fair value of any previously held equity interest in that business over the Group's share of the fair value of the identifiable net assets is recorded as goodwill.

Intra-group transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless costs cannot be recovered.

JOINT VENTURES

The Group applies IFRS 11 to all joint arrangements. Under IFRS 11 investments in joint arrangements are classified as either joint operations or joint ventures depending on the contractual rights and obligations of each investor. The Group has assessed the nature of its joint arrangements and determined them to be joint ventures. The financial statements of joint ventures are included in the Group financial statements using the equity accounting method, with the Group's share of net assets included as a single line item entitled 'Investments accounted for using the equity method'. In the same way, the Group's share of earnings is presented in the consolidated income statement below operating profit entitled 'Share of profit of investments accounted for using the equity method'.

FOREIGN CURRENCY

Items included in the financial statements of each Group company are measured using the currency of the primary economic environment in which the company operates (the functional currency).

The income and cash flow statements of Group companies using non-sterling functional currencies are translated to sterling (the Group's presentational currency) at average rates of exchange in each period. Assets and liabilities of these companies are translated at rates of exchange ruling at the balance sheet date. The differences between retained profits and losses translated at average and closing rates are taken to reserves, as are differences arising on the retranslation of the net assets at the beginning of the year.

Transactions in currencies other than a company's functional currency are initially recorded at the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at exchange rates ruling at the balance sheet date of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated income statement with exchange differences arising on trading transactions being reported in operating profit, and those arising on financing transactions being reported in net finance costs unless as a result of net investment hedging they are reported in other comprehensive income.

The Group designates as net investment hedges certain external borrowings and derivatives up to the value of the net assets of Group companies that use non-sterling functional currencies after deducting permanent intra-group loans. Gains or losses on these hedges that are regarded as highly effective are transferred to other comprehensive income, where they offset gains or losses on translation of the net investments that are recorded in equity, in the exchange translation reserve.

The Group's financial results are principally exposed to euro and US dollar exchange rates, which are detailed in the table below.

Foreign exchange rate versus GBP	2018		2017	
	Closing rate	Average rate	Closing rate	Average rate
Euro	1.1270	1.1304	1.1341	1.1480
US Dollar	1.3046	1.3460	1.3389	1.2668

REVENUE RECOGNITION

For the Tobacco & Next Generation Products (Tobacco & NGP) business (previously referred to as Tobacco), revenue comprises the invoiced value for the sale of goods and services net of sales taxes, rebates and discounts. Revenue from the sale of goods is recognised when a Group company has delivered products to the customer, the customer has accepted the products and collectability of the related receivables is reasonably assured. Sales of services, which include fees for distributing certain third party products, are recognised in the accounting period in which the services are rendered. Income arising from the licencing or sale of intellectual property, occurring in the ordinary course of business, is treated as revenue.

For the Distribution business (previously referred to as Logistics), revenue comprises the invoiced value for the sale of goods and services net of sales taxes, rebates and discounts when goods have been delivered or services provided. The Logistics business only recognises commission revenue on purchase and sale transactions in which it acts as a commission agent. Distribution and marketing commissions are included in revenue. Revenue is recognised on products on consignment when these are sold by the consignee.

Customer rebates and discounts may be offered to promote sales. The calculated costs are accrued and accounted for as incurred and matched as a deduction from the associated revenues (i.e. excluded from revenues reported in the Group's consolidated income statement).

DUTY AND SIMILAR ITEMS

Duty and similar items includes duty and levies having the characteristics of duty. In countries where duty is a production tax, duty is included in revenue and in cost of sales in the consolidated income statement. Where duty is a sales tax, duty is excluded from revenue and cost of sales. Payments due in the USA under the Master Settlement Agreement are deducted from revenue.

TAXES

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Management periodically evaluates positions taken in tax returns where the applicable tax regulation is subject to interpretation and establishes provisions on the basis of amounts expected to be paid to the tax authorities only where it is considered more likely than not that an amount will be paid or received. This test is applied to each individual uncertain position which is then measured on the single most likely outcome based on interpretation of legislation, management experience and professional advice.

Deferred tax is provided in full on temporary differences between the carrying amount of assets and liabilities in the financial statements and the tax base, except if it arises from initial recognition of an asset or liability in a transaction, other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the assets can be realised. Deferred tax is determined using the tax rates that have been enacted or substantively enacted at the balance sheet date, and are expected to apply when the deferred tax liability is settled or the deferred tax asset is realised.

DIVIDENDS

Final dividends are recognised as a liability in the period in which the dividends are approved by shareholders, whereas interim dividends are recognised in the period in which the dividends are paid.

INTANGIBLE ASSETS – GOODWILL

Goodwill represents the excess of value transferred to the seller in return for control of the acquired business together with the fair value of any previously held equity interest in that business over the Group's share of the fair value of the identifiable net assets.

Goodwill is tested at least annually for impairment and carried at cost less accumulated impairment losses. Any impairment is recognised immediately in the consolidated income statement and cannot be subsequently reversed. For the purpose of impairment testing, goodwill is allocated to groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose.

INTANGIBLE ASSETS – OTHER

Other intangible assets are initially recognised in the consolidated balance sheet at historical cost unless they are acquired as part of a business combination, in which case they are initially recognised at fair value. They are shown in the balance sheet at historical cost or fair value (depending on how they are acquired) less accumulated amortisation and impairment.

These assets consist mainly of acquired trademarks, intellectual property, concessions and rights, acquired customer relationships and computer software. The Davidoff cigarette trademark and some premium cigar trademarks are considered by the Directors to have indefinite lives based on the fact that they are established international brands with global potential. Trademarks with indefinite lives are not amortised but are reviewed annually for impairment.

Intellectual property (including trademarks), supply agreements (including customer relationships) and computer software are amortised over their estimated useful lives as follows:

Intellectual property	5 – 30 years	straight line
Supply agreements	3 – 15 years	straight line
Software	3 – 10 years	straight line

1. ACCOUNTING POLICIES CONTINUED

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are shown in the consolidated balance sheet at historical cost or fair value (depending on how they are acquired), less accumulated depreciation and impairment. Costs incurred after initial recognition are included in the assets' carrying amounts or recognised as a separate asset as appropriate only when it is probable that future economic benefits associated with them will flow to the Group and the cost of the item can be measured reliably.

Land is not depreciated. Depreciation is provided on other property, plant and equipment so as to write down the initial cost of each asset to its residual value over its estimated useful life as follows:

Property	up to 50 years	straight line
Plant and equipment	2 – 20 years	straight line/reducing balance
Fixtures and motor vehicles	2 – 15 years	straight line

The assets' residual values and useful lives are reviewed and, if appropriate, adjusted at each balance sheet date.

FINANCIAL INSTRUMENTS AND HEDGING

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the relevant instrument. Financial assets are de-recognised when the rights to receive benefits have expired or been transferred, and the Group has transferred substantially all risks and rewards of ownership. Financial liabilities are de-recognised when the obligation is extinguished.

Non-derivative financial assets are classified as loans and receivables. Receivables are initially recognised at fair value and are subsequently stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. A provision for impairment of receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of those receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, and is recognised in the consolidated income statement. For interest-bearing assets, the carrying value includes accrued interest receivable. Factored receivables under non-recourse agreements are derecognised when rights to receive cashflows are transferred or there are contractual obligations to pay the cash flows to the factoring party.

Non-derivative financial liabilities are initially recognised at fair value and are subsequently stated at amortised cost using the effective interest method. For borrowings, the carrying value includes accrued interest payable, as well as unamortised transaction costs.

Cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments.

The Group transacts derivative financial instruments to manage the underlying exposure to foreign exchange and interest rate risks. The Group does not transact derivative financial instruments for trading purposes. Derivative financial instruments are initially recorded at fair value plus any directly attributable transaction costs. Derivative financial assets and liabilities are included in the consolidated balance sheet at fair value, and include accrued interest receivable and payable where relevant. However, as the Group has decided (as permitted under IAS 39) not to cash flow or fair value hedge account for its derivative financial instruments, changes in fair values are recognised in the consolidated income statement in the period in which they arise unless the derivative qualifies and has been designated as a net investment hedging instrument in which case the changes in fair values, attributable to foreign exchange, are recognised in other comprehensive income.

Collateral transferred under the terms and conditions of credit support annex documents under International Swaps and Derivatives Association (ISDA) agreements in respect of certain derivatives are netted off the carrying value of those derivatives in the consolidated balance sheet.

INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first in first out (FIFO) method. The cost of finished goods and work in progress comprises raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

Leaf tobacco inventory which has an operating cycle that exceeds 12 months is classified as a current asset, consistent with recognised industry practice.

PROVISIONS

A provision is recognised in the consolidated balance sheet when the Group has a legal or constructive obligation as a result of a past event, it is more likely than not that an outflow of resources will be required to settle that obligation, and a reliable estimate of the amount can be made.

A provision for restructuring is recognised when the Group has approved a detailed formal restructuring plan, and the restructuring has either commenced or has been publicly announced, and it is more likely than not that the plan will be implemented, and the amount required to settle any obligations arising can be reliably estimated. Future operating losses are not provided for.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

CONTINGENT LIABILITIES

Contingent liabilities are possible obligations that arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events, not wholly within the control of the Group. Contingent liabilities are not recognised, only disclosed, unless the possibility of a future outflow of resources is considered remote, or where a disclosure would seriously prejudice the position of the Group. In the event that the outflow of resources associated with a contingent liability is assessed as probable, and if the size of the outflow can be reliably estimated, a provision is recognised in the financial statements.

RETIREMENT BENEFIT SCHEMES

For defined benefit schemes, the amount recognised in the consolidated balance sheet is the difference between the present value of the defined benefit obligation at the balance sheet date and the fair value of the scheme assets to the extent that they are demonstrably recoverable either by refund or a reduction in future contributions. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash flows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

The service cost of providing retirement benefits to employees during the year is charged to operating profit. Past service costs are recognised immediately in operating profit, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time.

All actuarial gains and losses, including differences between actual and expected returns on assets and differences that arise as a result of changes in actuarial assumptions, are recognised immediately in full in the statement of comprehensive income for the period in which they arise. An interest charge is made in the income statement by applying the rate used to discount the defined benefit obligations to the net defined benefit liability of the schemes.

For defined contribution schemes, contributions are recognised as an employee benefit expense when they are due.

SHARE-BASED PAYMENTS

The Group applies the requirements of IFRS 2 Share-Based Payment Transactions to both equity-settled and cash-settled share-based employee compensation schemes. The majority of the Group's schemes are equity-settled.

Equity-settled share-based payments are measured at fair value at the date of grant and are expensed over the vesting period, based on the number of instruments that are expected to vest. For plans where vesting conditions are based on total shareholder returns, the fair value at the date of grant reflects these conditions. Earnings per share and net revenue vesting conditions are reflected in the estimate of awards that will eventually vest. For cash-settled share-based payments, a liability equal to the portion of the services received is recognised at its current fair value at each balance sheet date. Where applicable the Group recognises the impact of revisions to original estimates in the consolidated income statement, with a corresponding adjustment to equity for equity-settled schemes and current liabilities for cash-settled schemes. Fair values are measured using appropriate valuation models, taking into account the terms and conditions of the awards.

The Group funds the purchase of shares to satisfy rights to shares arising under share-based employee compensation schemes. Shares acquired to satisfy those rights are held in Employee Share Ownership Trusts. On consolidation, these shares are accounted for as a deduction from equity attributable to owners of the parent. When the rights are exercised, equity is increased by the amount of any proceeds received by the Employee Share Ownership Trusts.

TREASURY SHARES

When the Company purchases its own equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted on consolidation from equity attributable to owners of the parent until the shares are reissued or disposed of. When such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, increases equity attributable to owners of the parent. When such shares are cancelled they are transferred to the capital redemption reserve.

USE OF ADJUSTED MEASURES

Management believes that non-GAAP or adjusted measures provide an important comparison of business performance and reflect the way in which the business is controlled. Accordingly, adjusted measures of operating profit, net finance costs, profit before tax, tax, attributable earnings and earnings per share exclude, where applicable, one-off non-recurring events including acquisition costs, amortisation and impairment of acquired intangibles, restructuring costs, post-employment benefits net financing cost, fair value and exchange gains and losses on financial instruments, and related tax effects and tax matters. Reconciliations between adjusted and reported operating profit are included within note 3 to the financial statements, adjusted and reported net finance costs in note 7, adjusted and reported tax in note 8, and adjusted and reported earnings per share in note 10.

The adjusted measures in this report are not defined terms under IFRS and may not be comparable with similarly titled measures reported by other companies.

The items excluded from adjusted results are those which are one-off in nature or items which arose due to acquisitions and are not influenced by the day to day operations of the Group, and the movements in the fair value of financial instruments which are marked to market and not naturally offset. Adjusted net finance costs also excludes all post-employment benefit net finance cost since pension assets and liabilities and redundancy and social plan provisions do not form part of adjusted net debt. This allows comparison of the Group's cost of debt with adjusted net debt. The adjusted measures are used by management to assess the Group's financial performance and aid comparability of results year on year.

The principal adjustments made to reported profits are as follows:

ACQUISITION COSTS

Adjusted measures exclude costs associated with major acquisitions as they do not relate to the day to day operational performance of the Group.

AMORTISATION AND IMPAIRMENT OF ACQUIRED INTANGIBLES

Acquired intangibles are amortised over their estimated useful economic lives where these are considered to be finite. Acquired intangibles considered to have an indefinite life are not amortised. We exclude from our adjusted measures the amortisation and impairment of acquired intangibles, other than software and internally generated intangibles, and the deferred tax associated with amortisation of acquired intangibles. The deferred tax is excluded on the basis that it will only crystallise upon disposal of the intangibles and goodwill. The related current cash tax benefit is retained in the adjusted measure to reflect the ongoing tax benefit to the Group.

1. ACCOUNTING POLICIES CONTINUED

FAIR VALUE GAINS AND LOSSES ON DERIVATIVE FINANCIAL INSTRUMENTS AND EXCHANGE GAINS AND LOSSES ON BORROWINGS

IAS 39 requires that all derivative financial instruments are recognised in the consolidated balance sheet at fair value, with changes in the fair value being recognised in the consolidated income statement unless the instrument satisfies the hedge accounting rules under IFRS and the Group chooses to designate the derivative financial instrument as a hedge.

The Group hedges underlying exposures in an efficient, commercial and structured manner. However, the strict hedging requirements of IAS 39 may lead to some commercially effective hedge positions not qualifying for hedge accounting. As a result, and as permitted under IAS 39, the Group has decided not to apply cash flow or fair value hedge accounting for its derivative financial instruments. However, the Group does apply net investment hedging, designating certain borrowings and derivatives as hedges of the net investment in the Group's foreign operations, as permitted by IAS 39, in order to reduce income statement volatility.

We exclude fair value gains and losses on derivative financial instruments and exchange gains and losses on borrowings from adjusted net finance costs. Fair value gains and losses on the interest element of derivative financial instruments are excluded as they will reverse over time or are matched in future periods by interest charges. Fair value gains and losses on the currency element of derivative financial instruments and exchange gains and losses on borrowings are excluded as the relevant foreign exchange gains and losses on the commercially hedged item are accumulated as a separate component of other comprehensive income in accordance with the Group's policy on foreign currency.

RESTRUCTURING COSTS

Significant one-off costs incurred in integrating acquired businesses and in major rationalisation and optimisation initiatives together with their related tax effects are excluded from our adjusted earnings measures. These include restructuring costs incurred as part of fundamental multi-year transformational change projects but do not include costs related to ongoing cost reduction activity. These costs include impairment of property, plant and equipment which are surplus to requirements due to restructuring activity.

POST-EMPLOYMENT BENEFITS NET FINANCING COST

The net interest on defined benefit assets or liabilities, together with the unwind of discount on redundancy, social plans and other long-term provisions are reported within net finance costs. These items together with their related tax effects are excluded from our adjusted earnings measures.

TAX MATTERS

Tax matters are significant one-off tax charges or credits arising from:

- prior period tax items (including re-measurement of deferred tax balances on a change in tax rates); or
- a provision for uncertain tax items not arising in the normal course of business; or
- newly enacted taxes in the year;

or are tax items that are closely related to previously recognised tax matters, and are excluded from our adjusted tax charge to aid comparability and understanding of the Group's performance.

The recognition and utilisation of deferred tax assets relating to losses not historically generated in the normal course of business are excluded on the same basis.

OTHER NON-GAAP MEASURES USED BY MANAGEMENT

NET REVENUE

Tobacco & NGP net revenue comprises Tobacco & NGP revenue less duty and similar items, excluding peripheral products. Management considers this an important measure in assessing the performance of Tobacco & NGP operations.

DISTRIBUTION FEES

Distribution fees comprises the Distribution segment revenue less the cost of distributed products. Management considers this an important measure in assessing the performance of Distribution operations.

ADJUSTED NET DEBT

Management monitors the Group's borrowing levels using adjusted net debt which excludes interest accruals and the fair value of derivative financial instruments providing commercial cash flow hedges.

NEW ACCOUNTING STANDARDS AND INTERPRETATIONS

The Group has adopted the Amendment to IAS 7 Statement of Cash Flows with effect from 1 October 2017. This amendment requires reporting entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, by disclosing changes arising from cash flows as well as non-cash changes. There is no material impact of the adoption on the Group. There have been no other new standards or amendments which became effective for the current reporting period that have had a material effect on the Group.

The following Standards which have not been adopted in these financial statements that are in issue but not yet effective for the 2018 year end are: IFRS 9 'Financial Instruments' and IFRS 15 'Revenue from Contracts with Customers'. These will be adopted in the financial year commencing 1 October 2018. IFRS 16 'Leases' will be adopted in the year commencing 1 October 2019.

IFRS 9 'Financial Instruments' replaces IAS 39 'Financial Instruments: Recognition and Measurement' and includes revised guidance on:

Classification and measurement: Financial assets will be classified as either being accounted for as amortised cost, fair value through other comprehensive income, or fair value through profit or loss, depending on the entity's business model and the contractual cash flow characteristics of the instruments. There are no changes to the classification or accounting for financial liabilities. Other than trade receivables and derivative financial instruments, the Group does not currently hold any significant financial assets. The application of this requirement is not expected to materially impact the financial statements.

Impairment of financial assets: Impairment provisions will be calculated using a forward looking expected credit loss approach for financial assets, rather than the incurred loss approach applicable under IAS 39. The expected credit loss model requires the recognition of a provision which reflects future impairment risk. Provision levels will be calculated on the residual credit risk after consideration of any credit protection which is used by the Group.

Receivables which have already become overdue will continue to be provided in line with the current provisioning policy. With the exception of the Palmer and Harvey debt write-off, the Group has historically experienced low levels of credit default. Given this, we do not expect the level of the additional expected credit loss provision to be significant.

Hedge Accounting: Adoption of aspects of IFRS 9 relating to hedge accounting are currently optional as organisations are allowed to continue to apply the IAS 39 requirements. IFRS 9 aligns the accounting approach with an entity's risk management strategies and risk management objectives. The Group will adopt the hedge accounting aspects of IFRS 9 from 1 October 2019.

However, it is expected that the hedging approach will continue to be limited to the use of net investment hedging. Consequently, the adoption of this area of IFRS 9 is not expected to materially impact the financial statements.

IFRS 15 'Revenue from Contracts with Customers' will be effective for the period beginning 1 October 2018. IFRS 15 introduces an amended framework for revenue recognition and replaces the existing guidance in IAS 18 'Revenue'. The standard provides revised guidance on revenue accounting, matching income recognition to the delivery of performance obligations in contractual arrangements for the provision of goods or services. It also provides different guidance on the measurement of revenue contracts involving discounts, rebates and payments to customers.

The Group has assessed the impact of the adoption of IFRS 15. Following the review of our performance obligations revenue will continue to be recognised when a Group company has delivered products to a customer, the customer has accepted those products and collectability of the related receivables is reasonably assured. We will reclassify certain distribution, advertising and selling costs arising from payments to customers, from overheads / other costs of sales to discounts from revenue. These costs are judged as not distinct from the related sales to the customer. This will reduce revenue, but will have no net impact on gross profit. The Group will take the option to restate the comparative figures on adoption of the standard. We estimate that the adoption will reduce the level of revenue recorded in the year ended 30 September 2018 by approximately £458 million.

The Group has also reviewed the presentation of duties, levies and similar payments against the guidance given by IFRS 15. Levy payments made in the United States under the Master Settlement Agreement (MSA) are currently deducted from net revenue. Following the adoption of the standard MSA payments will be recognised in other cost of sales. We estimate that this change will increase the level of net revenue recorded in the year ended 30 September 2018 by approximately £425 million. The adoption of the standard is not expected to have any other material impact on the Group's net assets or gross profit.

IFRS 16 'Leases' will be effective for the period beginning 1 October 2019. The new standard requires operating leases to be accounted for through the recognition of a 'right of use asset' and a corresponding lease liability. Interest-bearing borrowings and non-current assets will increase on implementation of this standard. Operating lease costs will no longer be classified within the income statement based on amounts paid, but via a 'right of use asset' depreciation charge recognised within operating profit and a lease interest expense within finance costs, subject to the exemptions on amount and duration. The Group is currently assessing the impact of the new standard. Our initial assessment of IFRS 16 leases is that it will not have a material effect on the Group's net assets or results.

IFRIC 23 'Uncertainty over income tax treatments' will be effective, subject to EU endorsement, for the period beginning 1 October 2019. The Interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over income tax treatments. Work is ongoing to assess the impact of the Interpretation.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The Group makes estimates and judgements associated with accounting entries which will be affected by future events. Estimates and judgements are continually evaluated based on historical experience, and other factors, including current information that helps form a forward-looking view of expected future outcomes.

Estimates involve the determination of the quantum of accounting balances to be recognised. Judgements typically involve decisions such as whether to recognise an asset or liability.

The actual amounts recognised in the future may deviate from these estimates and judgements. The estimates and judgements that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

PROPERTY, PLANT AND EQUIPMENT

There is a significant degree of estimation required in assessing both the carrying value and useful economic life of assets in situations where they are underutilised or associated with a restructuring programme. In these situations, there is often a need to write down assets to their recoverable amounts or revise their depreciation rates. Details of asset impairments associated with restructuring programmes are detailed in note 5.

INTANGIBLE ASSETS

Judgements typically include determining both the existence and valuation of these type of assets when they are acquired, particularly where they arise as part of a business acquisition. Assets are only recognised when it is judged that the Group has beneficial right to the use of the assets as guided by applicable Accounting Standards. The valuation of these assets requires estimates of initial current and future carrying values. Estimation is also required in the assessment of the future life of these assets.

INITIAL CARRYING VALUE

The Group allocates the purchase price of acquired businesses to their identifiable tangible and intangible assets, including goodwill. For major acquisitions the Group engages external consultants to assist in the valuation of identifiable intangible assets. On acquisition intangible assets are valued at fair value using the income method. The valuation process is based on associated future cash flows and is also dependent on assumptions about economic factors and business strategy. Goodwill represents the excess of value transferred to the seller in return for control of the acquired business together with the fair value of any previously held equity interest in that business over the Group's share of the fair value of the identifiable net assets.

DETERMINATION OF USEFUL ECONOMIC LIFE

For non-goodwill intangible assets, there are critical judgements required in determining whether the asset has an indefinite useful economic life, or not. The Davidoff cigarette trademark and some premium cigar trademarks are currently considered to have indefinite lives, based on the fact that they are established international brands with global potential.

2. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS CONTINUED

AMORTISATION AND IMPAIRMENT

For non-indefinite life assets, which are amortised, the useful economic life and recoverable amounts are estimated based upon the expectation of the amount and time period during which an intangible asset will support future cashflows. Due to estimation uncertainties the useful economic lives and associated amortisation rates have to be reviewed and revised where necessary. In addition, where there are indications that the current carrying value of an intangible asset is greater than its recoverable amount, impairment in the carrying value of the asset may be required.

Factors considered important that could trigger an impairment review of intangible assets include the following:

- significant underperformance relative to historical or projected future operating results;
- significant changes in the manner of the use of the acquired assets or the strategy for the overall business; and
- significant negative industry or economic trends.

The complexity of the estimation process and issues related to the assumptions, risks and uncertainties inherent in the application of the Group's accounting estimates in relation to intangible assets affect the amounts reported in the financial statements, especially the estimates of the expected useful economic lives and the carrying values of those assets. If business conditions were different, or if different assumptions were used in the calculation of accounting estimates, it is likely that materially different amounts could be reported in the Group's financial statements.

Indefinite life intangible assets, including goodwill, are subject to annual impairment testing where an assessment of the carrying value of the asset against its recoverable amount is undertaken. There are uncertainties associated with estimating the valuation of the recoverable amount.

Details of goodwill and intangible asset impairment assessments and the newly acquired intangible assets arising from the Von Erl and Nerudia acquisitions are included in note 11.

INCOME TAXES

Judgement is involved in determining whether the Group is subject to a tax liability or not in line with tax law. Where liabilities exist estimation is often required to determine the potential future tax payments.

The Group is subject to income tax in numerous jurisdictions and significant judgement is required in determining the provision for tax. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Group recognises provisions for tax based on estimates of the taxes that are likely to become due. Where the final tax outcome is different from the amounts that were initially recorded, such differences will impact the current income tax and deferred tax provisions in the period in which such determination is made. Consideration of the judgements surrounding certain tax positions are applicable to the Group and consideration of the valuation estimates related to tax provisions are given in note 8 to these financial statements.

LEGAL PROCEEDINGS AND DISPUTES

The Group reviews outstanding legal cases following developments in the legal proceedings at each balance sheet date, considering the nature of the litigation, claim or assessment; the legal processes and potential level of damages in the jurisdiction in which the litigation, claim or assessment has been brought; the progress of the case (including progress after the date of the financial statements but before those statements are issued); the opinions or views of legal counsel and other advisers; experience of similar cases; and any decision of the Group's management as to how it will respond to the litigation, claim or assessment.

Judgement is required as to whether a liability exists. Where a liability is determined there can be a degree of estimation of the potential level of damages expected. Key areas of judgement include consideration as to whether certain claims associated with the acquisition of certain brands specifically in respect of three of the four US states that are not parties to the Master Settlement Agreement (MSA) are likely to succeed, and the likely outcome of a number of Product liability claims. More detail as to the considered position on claims is given in both note 28 and within the Directors Report – update on Tobacco and e-vapour related litigation.

To the extent that the Group's assessments at any time do not reflect subsequent developments or the eventual outcome of any claim, its future financial statements may be materially affected, with a favourable or adverse impact upon the Group's operating profit, financial position and liquidity.

RETIREMENT BENEFITS

Accounting for retirement benefits uses a number of accounting estimates. The Group holds a number of defined benefit retirement schemes across various jurisdictions. The valuation of these schemes requires estimates of various market, demographic and mortality assumptions, which are fully reviewed by external actuaries. Full disclosure of the estimates used in retirement benefit accounting is included within note 22.

PROVISIONS

Provision accounting involves judgement as to whether a liability should be recognised and requires estimates of the quantum of any such liability. The Group holds provisions where appropriate in respect of estimated future economic outflows, principally for restructuring activity, which arise due to past events. Estimates are based on management judgement and information available at the balance sheet date. Actual outflows may not occur as anticipated, and estimates may prove to be incorrect, leading to further charges or releases of provisions as circumstances dictate.

The main area of estimation risk relates to the estimation of restructuring provisions associated with various plans to transform the business, these include the cost of factory closures, scaling down of capacity and other structural changes to the business. These programmes are run as discreet projects with controls over the expected costs and the associated accounting impacts. The calculation of restructuring provisions includes estimation challenges relating to asset remediation costs, the valuation of disposals and termination costs. More details relating to the estimates associated with these restructuring programmes can be found in notes 5 and 23.

CONTROL OF LOGISTA

A key judgement relates to whether the Group has effective control of Logista sufficient that the Group can consolidate this entity within its Group accounts in line with the requirements of IFRS 10 Consolidated Financial Statements. Following the current year reduction in the shareholding interest in Logista, the Group now holds 50.01 per cent of the voting shares. The Group has reviewed its control of Logista. The Group continues to have Director presence on the Board of Logista with the ability to exercise voting control where necessary and has therefore concluded that it continues to be appropriate to recognise Logista as a fully consolidated subsidiary.

3. SEGMENT INFORMATION

Imperial Brands comprises two distinct businesses – Tobacco & NGP and Distribution. The Tobacco & NGP business comprises the manufacture, marketing and sale of Tobacco & NGP and Tobacco & NGP-related products, including sales to (but not by) the Distribution business. The Distribution business comprises the distribution of Tobacco & NGP products for Tobacco & NGP product manufacturers, including Imperial Brands, as well as a wide range of non-Tobacco & NGP products and services. The Distribution business is run on an operationally neutral basis ensuring all customers are treated equally, and consequently transactions between the Tobacco & NGP and Distribution businesses are undertaken on an arm's length basis reflecting market prices for comparable goods and services.

The Tobacco & NGP business is managed based on the strategic role of groups of markets rather than their geographic proximity, with divisions focused on prioritising growth or returns. Returns Markets are typically mature markets where we have relatively large market shares and our objective is to maximise returns over the long-term by growing profits while actively managing market share. Growth Markets are mainly large profit or volume pools where we typically have market shares below 15 per cent and where our total Tobacco & NGP approach provides many opportunities for share and profit growth both now and in the future. Following the 2015 acquisition, the USA has become a significant market and is therefore disclosed separately.

The function of Chief Operating Decision Maker (defined in IFRS 8), which is to review performance and allocate resources, is performed by the Board and the Chief Executive, who are regularly provided with information on our segments. This information is used as the basis of the segment revenue and profit disclosures provided below. The main profit measure used by the Board and the Chief Executive is adjusted operating profit. Segment balance sheet information is not provided to the Board or the Chief Executive. Our reportable segments are Growth Markets (which includes premium cigar and Fontem Ventures), USA, Returns Markets North, Returns Markets South and Distribution. Prevailing market characteristics such as maturity, excise structure and the breadth of the distribution networks determine the allocation of Returns Markets between Returns Markets North and Returns Markets South.

Operating segments are considered to be business markets. The main Tobacco & NGP business markets within the Growth, Returns Markets North and Returns Markets South reportable segments are:

Growth Markets – Iraq, Italy, Japan, Norway, Russia, Saudi Arabia, Taiwan (also includes premium cigar and Fontem Ventures);

Returns Markets North – Australia, Belgium, Germany, Netherlands, Poland, United Kingdom; and

Returns Markets South – France, Spain and our African markets including Algeria, Ivory Coast, Morocco.

Our focus on NGP and the growth opportunity this provides across all our markets means that our current segmental descriptors of Growth and Returns are no longer applicable. As a result of an internal reorganisation, our segmental reporting for our tobacco and NGP businesses for the year ending 30 September 2019 will be changed to: Europe, Americas and Africa, Asia & Australasia. These three regions will include all tobacco and NGP sales in their respective geographies, reflecting the new way we run the business. At the same time, blu will be reclassified as a Growth Brand, reinforcing our global ambitions for the brand, and all NGP revenue and profit, currently reported in Growth Markets, will be included within the countries and segments where the sales occur. We will also separately disclose our NGP revenue.

TOBACCO & NGP

£ million unless otherwise indicated	2018	2017
Revenue	**22,885**	22,786
Net revenue	**7,730**	7,757
Operating profit	**2,282**	2,199
Adjusted operating profit	**3,557**	3,595
Adjusted operating margin %	**46.0**	46.3

DISTRIBUTION

£ million unless otherwise indicated	2018	2017
Revenue	**8,383**	8,269
Distribution fees	**989**	914
Operating profit	**128**	94
Adjusted operating profit	**212**	181
Adjusted operating margin %	**21.4**	19.8

REVENUE

	2018		2017	
£ million	**Total revenue**	**External revenue**	Total revenue	External revenue
Tobacco & NGP				
Growth Markets	**3,754**	**3,686**	3,665	3,602
USA	**2,971**	**2,971**	3,125	3,125
Returns Markets North	**13,698**	**13,689**	13,533	13,503
Returns Markets South	**2,462**	**1,795**	2,463	1,748
Total Tobacco & NGP	**22,885**	**22,141**	22,786	21,978
Distribution	**8,383**	**8,383**	8,269	8,269
Eliminations	**(744)**	**–**	(808)	–
Total Group	**30,524**	**30,524**	30,247	30,247

3. SEGMENT INFORMATION CONTINUED

RECONCILIATION FROM TOBACCO & NGP REVENUE TO TOBACCO & NGP NET REVENUE

£ million	2018	2017
Revenue	22,885	22,786
Duty and similar items	(15,125)	(14,967)
Sale of peripheral products	(30)	(62)
Net Revenue	7,730	7,757

TOBACCO & NGP NET REVENUE

£ million	2018	2017
Growth Markets	1,795	1,768
USA	1,671	1,665
Returns Markets North	2,749	2,755
Returns Markets South	1,515	1,569
Total Tobacco & NGP	7,730	7,757

ADJUSTED OPERATING PROFIT AND RECONCILIATION TO PROFIT BEFORE TAX

£ million	2018	2017
Tobacco & NGP		
Growth Markets	364	411
USA	1,040	1,013
Returns Markets North	1,507	1,485
Returns Markets South	646	686
Total Tobacco & NGP	3,557	3,595
Distribution	212	181
Eliminations	(3)	(15)
Adjusted operating profit	3,766	3,761
Amortisation of acquired intangibles – Tobacco & NGP	(970)	(1,005)
Amortisation of acquired intangibles – Distribution	(83)	(87)
Administration of UK distributor	(110)	–
Restructuring costs – Tobacco & NGP	(196)	(391)
Operating profit	2,407	2,278
Net finance costs	(626)	(450)
Share of profit of investments accounted for using the equity method	42	33
Profit before tax	1,823	1,861

On 28 November 2017 Palmer & Harvey (P&H) announced that they had entered administration. As a result P&H receivables of £104 million have been written off and a provision has been made of £6 million in the current year financial statements in respect of loan and receivables monies considered irrecoverable. There has been no significant disruption to UK operations as well-prepared contingency plans ensured that the on-going supply to retail customers was unaffected.

OTHER INFORMATION

	2018		2017	
£ million	Additions to property, plant and equipment	Depreciation and software amortisation	Additions to property, plant and equipment	Depreciation and software amortisation
Tobacco & NGP				
Growth Markets	65	41	53	42
USA	52	33	36	38
Returns Markets North	54	71	54	70
Returns Markets South	44	33	29	41
Total Tobacco & NGP	215	178	172	191
Distribution	39	34	19	32
Total Group	254	212	191	223

ADDITIONAL GEOGRAPHIC ANALYSIS

External revenue and non-current assets are presented for the UK and for individually significant countries. The Group's products are sold in over 160 countries.

£ million	2018 External revenue	2018 Non-current assets	2017 External revenue	2017 Non-current assets
UK	**4,189**	**109**	4,243	83
Germany	**3,871**	**3,351**	3,841	3,401
France	**3,587**	**2,597**	3,711	2,720
USA	**3,154**	**7,037**	3,299	7,356
Other	**15,723**	**8,759**	15,153	8,853
Total Group	**30,524**	**21,853**	30,247	22,413

Non-current assets comprise intangible assets, property, plant and equipment, and investments accounted for using the equity method.

4. PROFIT BEFORE TAX

Profit before tax is stated after charging/(crediting):

£ million	2018	2017
Raw materials and consumables used	**927**	915
Changes in inventories of finished goods – Tobacco & NGP	**2,410**	2,341
Changes in inventories of finished goods – Distribution	**5,520**	5,499
Depreciation and impairment of fixed assets	**176**	233
Amortisation of intangible assets	**1,090**	1,131
Operating lease charges	**57**	52
Net foreign exchange losses/(gains)	**52**	(44)
Write down of inventories	**28**	45
Profit on disposal of assets and brands	**(76)**	(24)
Impairment of trade receivables	**9**	4

ANALYSIS OF FEES PAYABLES TO PRICEWATERHOUSECOOPERS LLP AND ITS ASSOCIATES

£ million	2018	2017
Audit of Parent Company and consolidated financial statements	**1.2**	0.8
Audit of the Company's subsidiaries	**4.2**	4.3
Audit of joint venture entities	**0.4**	0.4
Audit related assurance services	**0.3**	0.3
	6.1	5.8
Other services	**0.2**	0.2
	6.3	6.0

In addition to the above, PricewaterhouseCooper LLP audit the individual pension schemes in the UK and Ireland. Fees for these audits total £53.2 thousand (2017: £52.8 thousand).

5. RESTRUCTURING COSTS

£ million	2018	2017
Employment related	170	244
Asset impairments	3	79
Other charges	23	68
	196	391

Restructuring costs analysed by workstream:

£ million	2018	2017
Cost optimisation programme	181	383
Acquisition integration costs	15	4
Other restructuring activities	–	4
	196	391

The cost optimisation programme (Phase I announced in 2013 and Phase II announced in November 2016) is part of the Group's change in strategic direction to achieve a unique, non-recurring and fundamental transformation of the business. The costs of factory closures and implementation of a standardised operating model are considered to be one off as they are a permanent scaling down of capacity and a once in a generation transformational change respectively. The cost optimisation programme is a discrete, time bound project which, given its scale, will be delivered over a number of years and once delivered the associated restructuring costs will cease.

Costs of implementing cost savings that do not arise from the change in strategic direction are excluded from restructuring costs.

Cost optimisation programme costs of £181 million (2017: £383 million) comprise £56 million incurred in restructuring our product manufacturing activities including France, Morocco, Russia and the US, and £125 million in respect of restructuring overheads mainly by implementing a standardised operating model.

Of the remaining £15 million (2017: £8 million), £13 million of post-acquisition integration costs were in respect of the Nerudia acquisition and £2 million (2017: £4 million) of post-acquisition integration costs were in respect of the assets acquired from Lorillard in 2015, (2017: £4 million was in respect of pre-2013 restructuring).

Cost optimisation programme Phase I is expected to have a cash implementation cost in the region of £600 million in respect of the savings of £300 million per annum that the programme has generated by 2018 (the last year of the programme), and Phase II is expected to have a cash implementation cost in the region of £750 million, generating savings of a further £300 million per annum by 2020. In 2018 the cash cost of Phase I of the programme was £43 million (2017: £42 million) and £173 million (2017: £132 million) for Phase II, bringing the cumulative net cash cost of the programme to £826 million (Phase I £521 million, Phase II £305 million).

The total restructuring cash spend in the year was £241 million (2017: £201 million).

Restructuring costs are included within administrative and other expenses in the consolidated income statement.

6. DIRECTORS AND EMPLOYEES

EMPLOYMENT COSTS

£ million	2018	2017
Wages and salaries	836	856
Social security costs	173	173
Other pension costs (note 22)	90	–
Share-based payments (note 25)	26	27
	1,125	1,056

Details of Directors' emoluments and interests, and of key management compensation which represent related party transactions requiring disclosure under IAS 24, are provided within the Directors' Remuneration Report. The Directors Remuneration Report, on pages 56-75 includes details on salary, benefits, pension and share plans. These disclosures form part of the financial statements.

NUMBER OF PEOPLE EMPLOYED BY THE GROUP DURING THE YEAR

	2018		2017	
	At 30 September	Average	At 30 September	Average
Tobacco & NGP	27,100	27,200	27,800	27,900
Distribution	6,200	6,100	6,000	6,000
	33,300	33,300	33,800	33,900

NUMBER OF PEOPLE EMPLOYED BY THE GROUP BY LOCATION DURING THE YEAR

	2018		2017	
	At 30 September	**Average**	At 30 September	Average
European Union	**15,700**	**15,400**	15,500	15,600
Americas	**8,600**	**8,500**	8,600	8,500
Rest of the World	**9,000**	**9,400**	9,700	9,800
	33,300	**33,300**	33,800	33,900

7. NET FINANCE COSTS

RECONCILIATION FROM REPORTED NET FINANCE COSTS TO ADJUSTED NET FINANCE COSTS

£ million	2018	2017
Reported net finance costs	**626**	450
Fair value gains on derivative financial instruments	**492**	744
Fair value losses on derivative financial instruments	**(567)**	(679)
Exchange (losses)/gains on financing activities	**(51)**	47
Net fair value and exchange (losses)/gains on financial instruments	**(126)**	112
Interest income on net defined benefit assets (note 22)	**129**	107
Interest cost on net defined benefit liabilities (note 22)	**(142)**	(132)
Post-employment benefits net financing cost	**(13)**	(25)
Adjusted net finance costs	**487**	537
Comprising		
Interest on bank deposits	**(10)**	(12)
Interest on bank and other loans	**497**	549
Adjusted net finance costs	**487**	537

8. TAX

ANALYSIS OF CHARGE IN THE YEAR

£ million	2018	2017
Current tax		
UK corporation tax	**55**	97
Overseas tax	**367**	367
Total current tax	**422**	464
Deferred tax movement	**(26)**	(50)
Total tax charged to the consolidated income statement	**396**	414

RECONCILIATION FROM REPORTED TAX TO ADJUSTED TAX

The table below shows the tax impact of the adjustments made to reported profit before tax in order to arrive at the adjusted measure of earnings disclosed in note 10.

£ million	2018	2017
Reported tax	**396**	414
Deferred tax on amortisation of acquired intangibles	**196**	228
Administration of UK distributor	**21**	–
Tax on net fair value and exchange movements on financial instruments	**22**	(14)
Tax on post-employment benefits net financing cost	**5**	7
Tax on restructuring costs	**55**	121
Deferred tax impact of US tax reforms	**29**	–
Tax on unrecognised losses	**(76)**	(105)
Adjusted tax charge	**648**	651

The use of adjusted measures is explained in note 1, Accounting Policies (Use of Adjusted Measures).

8. TAX CONTINUED

FACTORS AFFECTING THE TAX CHARGE FOR THE YEAR

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the average of the enacted UK corporation tax rates for the year of 19.0 per cent (2017: 19.5 per cent) as follows:

£ million	2018	2017
Profit before tax	1,823	1,861
Tax at the UK corporation tax rate	346	363
Tax effects of:		
Differences in effective tax rates on overseas earnings	(44)	(47)
Movement in provision for uncertain tax positions	10	22
Remeasurement of deferred tax balances	51	4
Remeasurement of deferred tax balances arising from changes in tax rates	(68)	(93)
Deferred tax on unremitted earnings	26	42
Permanent differences	66	120
Adjustments in respect of prior years	9	3
Total tax charged to the consolidated income statement	396	414

Differences in effective tax rates on overseas earnings represents the impact of worldwide profits being taxed at rates different from 19.0 per cent. The effective tax rate benefits from internal financing arrangements between Group subsidiaries in different countries which are subject to differing tax rates and legislation and the application of double taxation treaties.

Remeasurement of deferred tax balances includes £35 million (2017: nil) in relation to the de-recognition of deferred tax assets for tax losses in the Group's Dutch business. The Group's assessment of the recoverability of deferred tax assets is based on a review of underlying performance of subsidiaries, changes in tax legislation and the interpretation thereof and changes in the Group structure.

Remeasurement of deferred tax balances arising from changes in tax rates includes £29 million (2017: nil) in relation to the remeasurement of deferred tax assets and liabilities on US liabilities and assets following the enactment of tax rate reductions and £39 million (2017: £93 million) in relation to the remeasurement of deferred tax liabilities on French assets following the enactment of future tax rate reductions which will be effective for the Group from 1 October 2019.

During the year the Group has provided for deferred tax on unremitted earnings of £26 million (2017: £42 million). The tax will arise on the distribution of profits through the Group and on planned Group simplification.

Permanent differences include £5 million (2017: £10 million) in respect of non-deductible exchange losses and £26 million (2017: £29 million) in respect of non-deductible interest expense and nil (2017: £57 million) in respect of taxable disposals of assets intra-group.

MOVEMENT ON THE CURRENT TAX ACCOUNT

£ million	2018	2017
At 1 October	(123)	(239)
Charged to the consolidated income statement	(422)	(464)
Credited to equity	1	3
Cash paid	407	570
Exchange movements	3	2
Other movements	12	5
At 30 September	(122)	(123)

The cash tax paid in the year is £15 million lower than the current tax charge (2017: £106 million higher). This arises as a result of timing differences between the accrual of income taxes and the actual payment of cash and the movement in the provision for uncertain tax positions.

Analysed as: £ million	2018	2017
Assets	164	69
Liabilities	(286)	(192)
	(122)	(123)

UNCERTAIN TAX POSITIONS

As an international business the Group is exposed to uncertain tax positions and changes in legislation in the jurisdictions in which it operates. The Group's uncertain tax positions principally include cross border transfer pricing, interpretation of new or complex tax legislation and tax arising on the valuation of assets.

Provisions arising from uncertain tax positions taken in the calculation of tax assets and liabilities are included within current tax liabilities. At 30 September 2018 the total value of these provisions, including foreign exchange movements, was £202 million (2017: £190 million). It is possible that amounts paid will be different from the amounts provided.

Management have assessed the Group's provision for uncertain tax positions and have concluded that apart from the French matter referred to below, the provisions in place are not material individually or in aggregate, and that a reasonably possible change in the next financial year would not have a material impact to the results of the Group.

In November 2015 the Group received a challenge from the French tax authorities that could lead to additional tax liabilities of up to £250 million. The challenge concerns the valuation placed on the shares of Altadis Distribution France (now known as Logista France) following an intra-group transfer of the shares in October 2012 and the tax consequences flowing from a potentially higher value that is argued for by the tax authorities. In September 2018 the dispute was heard before the Commission Nationale, an independent adjudication body, whose decision is advisory only. In October 2018 the Commission issued its report which is favourable to the Group's position. A meeting is being arranged with the French tax authorities to discuss the status of the French tax authority's challenge following the report. At this time it is appropriate to maintain the £42 million (2017: £42 million) held in the provision for uncertain tax positions in respect of this matter.

The Group continues to monitor developments in relation to EU State Aid investigations. If the EU Commission confirms its preliminary finding of State Aid in respect of the UK's Controlled Foreign Company regime and this is ultimately upheld through the judicial process the Group considers that the amount of additional tax payable would be between nil and £300 million depending on the basis of calculation. Based upon advice taken the Group does not consider any provision is required in relation to this investigation or any other EU State Aid investigation. The assessment of uncertain tax positions is subjective and significant management judgement is required. This judgement is based on interpretation of legislation, management experience and professional advice.

In 2017 new legislation was introduced, prospectively limiting the amount of production that could take place prior to new excise tax increases. On 28 September 2018, the Russian tax authorities issued a preliminary tax audit report for the calendar years 2014-2016 seeking to assess retrospectively additional excise and VAT with associated interest and penalties of approximately £132 million in respect of pre-production prior to new excise duty increases. In the event that the Russian tax authorities were to apply the same ruling to 2017, the Group estimates further excise and VAT with associated interest and penalties of £74 million could be assessed. The Group believe they have strong grounds for objecting to the preliminary report and are preparing a defence. The Group has complied with this legislation since it became effective. The Group is unable to make a reliable estimate of any provision until its objections to the preliminary report have been discussed with the Russian tax authorities, and furthermore, disclosure of a provision could be prejudicial.

9. DIVIDENDS

DISTRIBUTIONS TO ORDINARY EQUITY HOLDERS

£ million	2018	2017	2016
Paid interim of 56.87 pence per share (2017: 111.21 pence, 2016: 101.1 pence)			
– Paid June 2016	–	–	225
– Paid September 2016	–	–	225
– Paid December 2016	–	–	517
– Paid June 2017	–	247	–
– Paid September 2017	–	247	–
– Paid December 2017	–	567	–
– Paid June 2018	271	–	–
– Paid September 2018	271	–	–
Interim dividend paid	542	1,061	967
Proposed interim of 65.46 pence per share (2017: nil, 2016: nil)			
– To be paid December 2018	624	–	–
Interim dividend proposed	624	–	–
Proposed final of 65.46 pence per share (2017: 59.51 pence, 2016: 54.1 pence)			
– Paid March 2017	–	–	517
– Paid March 2018	–	567	–
– To be paid March 2019	624	–	–
Final dividend	624	567	517
Total ordinary share dividends of 187.79 pence per share (2017: 170.72 pence, 2016: 155.2 pence)	1,790	1,628	1,484

The third interim dividend for the year ended 30 September 2018 of 65.46 pence per share amounts to a proposed dividend of £624 million, which will be paid in December 2018.

The proposed final dividend for the year ended 30 September 2018 of 65.46 pence per share amounts to a proposed dividend payment of £624 million in March 2019 based on the number of shares ranking for dividend at 30 September 2018, and is subject to shareholder approval. If approved, the total dividend paid in respect of 2018 will be £1,790 million (2017: £1,628 million). The dividend paid during 2018 is £1,676 million (2017: £1,528 million).

10. EARNINGS PER SHARE

Basic earnings per share is based on the profit for the year attributable to the owners of the parent and the weighted average number of ordinary shares in issue during the year excluding shares held to satisfy the Group's employee share schemes and shares purchased by the Company and held as treasury shares. Diluted earnings per share have been calculated by taking into account the weighted average number of shares that would be issued if rights held under the employee share schemes were exercised. No instruments have been excluded from the calculation for any period on the grounds that they are anti-dilutive.

£ million	2018	2017
Earnings: basic and diluted – attributable to owners of the Parent Company	**1,368**	1,409

Millions of shares		
Weighted average number of shares:		
Shares for basic earnings per share	**952.4**	954.6
Potentially dilutive share options	**3.0**	2.3
Shares for diluted earnings per share	**955.4**	956.9

Pence		
Basic earnings per share	**143.6**	147.6
Diluted earnings per share	**143.2**	147.2

RECONCILIATION FROM REPORTED TO ADJUSTED EARNINGS AND EARNINGS PER SHARE

	2018		2017	
£ million unless otherwise indicated	Earnings per share (pence)	Earnings	Earnings per share (pence)	Earnings
Reported basic	**143.6**	**1,368**	147.6	1,409
Amortisation of acquired intangibles	**90.0**	**857**	90.5	864
Administration of UK distributor	**9.3**	**89**	–	–
Net fair value and exchange movements on financial instruments	**10.9**	**104**	(10.3)	(98)
Post-employment benefits net financing cost	**0.8**	**8**	1.9	18
Restructuring costs	**14.9**	**141**	28.3	270
Deferred tax impact of US tax reforms	**(3.0)**	**(29)**		
Tax on unrecognised losses	**8.0**	**76**	11.0	105
Adjustments above attributable to non-controlling interests	**(2.3)**	**(22)**	(2.0)	(19)
Adjusted	**272.2**	**2,592**	267.0	2,549
Adjusted diluted	**271.3**	**2,592**	266.4	2,549

11. INTANGIBLE ASSETS

£ million	Goodwill	Intellectual property	Supply agreements	Software	Total
					2018
Cost					
At 1 October 2017	**13,833**	**12,430**	**1,401**	**343**	**28,007**
Additions	**3**	**8**	**–**	**47**	**58**
Acquisitions	**63**	**68**	**–**	**–**	**131**
Disposals	**–**	**(7)**	**–**	**(13)**	**(20)**
Reclassifications	**(6)**	**–**	**6**	**–**	**–**
Exchange movements	**147**	**202**	**14**	**1**	**364**
At 30 September 2018	**14,040**	**12,701**	**1,421**	**378**	**28,540**
Amortisation and impairment					
At 1 October 2017	**1,568**	**5,452**	**1,008**	**216**	**8,244**
Amortisation charge for the year[1]	**–**	**942**	**112**	**36**	**1,090**
Disposals	**–**	**(4)**	**–**	**(10)**	**(14)**
Exchange movements	**9**	**82**	**11**	**1**	**103**
Accumulated amortisation	**–**	**6,098**	**1,131**	**243**	**7,472**
Accumulated impairment	**1,577**	**374**	**–**	**–**	**1,951**
At 30 September 2018	**1,577**	**6,472**	**1,131**	**243**	**9,423**
Net book value					
At 30 September 2018	**12,463**	**6,229**	**290**	**135**	**19,117**

1. Amortisation of acquired intangibles excluded from adjusted operating profit comprises amortisation on intellectual property of £941 million (2017: £982 million) and amortisation on supply agreements of £112 million (2017: £110 million). No adjustment is made for amortisation on internally generated intellectual property of £1 million (2017: £1 million).

£ million	Goodwill	Intellectual property	Supply agreements	Software	Total
					2017
Cost					
At 1 October 2016	13,631	12,470	1,358	309	27,768
Additions	10	15	–	44	69
Acquisitions	25	–	–	–	25
Disposals	–	(1)	–	(13)	(14)
Reclassifications	–	–	(2)	(1)	(3)
Exchange movements	167	(54)	45	4	162
At 30 September 2017	13,833	12,430	1,401	343	28,007
Amortisation and impairment					
At 1 October 2016	1,533	4,477	868	186	7,064
Amortisation charge for the year[1]	–	983	110	38	1,131
Disposals	–	(1)	–	(10)	(11)
Reclassifications	–	–	(1)	(1)	(2)
Exchange movements	35	(7)	31	3	62
Accumulated amortisation	–	5,078	1,008	216	6,302
Accumulated impairment	1,568	374	–	–	1,942
At 30 September 2017	1,568	5,452	1,008	216	8,244
Net book value					
At 30 September 2017	12,265	6,978	393	127	19,763

11. INTANGIBLE ASSETS CONTINUED

Intellectual property mainly comprises brands acquired in the USA in 2015 and through the purchases of Altadis in 2008 and Commonwealth Brands in 2007.

Supply agreements include Distribution customer relationships and exclusive supply arrangements in Cuba. All were acquired as part of the Altadis purchase.

Intangible amortisation and impairment are included within administrative and other expenses in the consolidated income statement.

Amortisation and impairment in respect of intangible assets other than software and internally generated intellectual property are treated as reconciling items between reported operating profit and adjusted operating profit.

ACQUISITIONS

For each acquisition, an exercise to value the net assets and apportion the consideration has taken place and the values have been recognised in the year end accounts. We engaged external consultants to assist in the valuation of the intangible assets, which make up the most significant element of the assets acquired and have been valued using the income method.

Adjustments to provisional fair values are made up to 12 months from the original acquisition date with any revisions to contingent consideration or asset values being adjusted through goodwill. Goodwill represents the value of the accumulated workforces and synergies expected to be realised following the acquisition.

VON ERL

On 14 June 2017 Imperial's subsidiary, Fontem Ventures B.V., completed the acquisition of 50 per cent plus one share of Von Erl Gmbh for an initial cash consideration of £17 million plus an estimated contingent consideration of £15 million payable on performance measures being achieved. There are also amounts payable as contingent consideration to purchase additional share capital of 40 per cent which is based on future product sales. The payment is capped at a maximum of €200 million. In August 2018 a payment of £3 million was made under this forward contract to purchase an additional 10 per cent of the share capital, taking the total shareholding to 60 per cent.

Following the completion of the measurement period, values for consideration of £32 million and acquired net liabilities of £4 million, including intangible assets of £18 million and goodwill of £36 million, have been recognised based on the valuation conditions existing at the acquisition date. The value of the contingent consideration will be reassessed at each future reporting point.

The acquisition builds on Imperial's strategy of developing non-tobacco consumer experiences.

NERUDIA

On 23 October 2017, the Group acquired 100 per cent of the share capital of Nerudia Limited for an estimated total cash consideration of £86 million, comprised of an initial consideration of £64 million plus an estimated contingent consideration of £22 million. The maximum amount of contingent consideration payable is £42 million with the amount payable based on certain performance targets being met.

Following the completion of the measurement period, values for consideration of £86 million and acquired net assets of £35 million, including intangible assets of £36 million and goodwill of £51 million, have been recognised based on the valuation conditions existing at the acquisition date. The value of the contingent consideration will be reassessed at each future reporting point.

Nerudia Limited is a nicotine products and services group with a strong track record of developing innovative e-vapour and nicotine products. The acquisition further strengthens our portfolio of intellectual property assets and our research and development capabilities across the entire next generation product landscape.

GOODWILL AND INTANGIBLE ASSET IMPAIRMENT REVIEW

Goodwill is allocated to groups of cash-generating units (CGUs) that are expected to benefit from the business combination in which the goodwill arose. For the Tobacco & NGP business CGUs are based on the markets where the business operates and are grouped in line with the divisional structure in operation during the year. The groupings represent the lowest level at which goodwill is monitored for internal management purposes. A summary of the carrying value of goodwill and intangible assets with indefinite lives is set out below.

	2018		2017	
£ million	Goodwill	Intangible assets with indefinite lives	Goodwill	Intangible assets with indefinite lives
Returns Markets North	**4,498**	**202**	4,471	200
Returns Markets South	**1,698**	**106**	1,685	105
Growth	**2,112**	**299**	2,022	295
USA	**2,412**	**–**	2,351	–
Tobacco & NGP	**10,720**	**607**	10,529	600
Distribution	**1,743**	**–**	1,736	–
	12,463	**607**	12,265	600

Goodwill has arisen principally on the acquisitions of Reemtsma in 2002 (all CGU groupings), Commonwealth Brands in 2007 (USA), Altadis in 2008 (all CGU groupings) and ITG Brands in 2015 (USA).

The Group tests goodwill and intangible assets with indefinite lives for impairment annually, or more frequently if there are any indications that impairment may have arisen. The value of a CGU, or group of CGUs as appropriate, is based on value-in-use calculations. These calculations use cash flow projections derived from financial plans which are based on detailed bottom-up market-by-market forecasts of projected sales volumes for each product line. These forecasts reflect, on an individual market basis, numerous assumptions and estimates regarding anticipated changes in market size, prices and duty regimes, consumer uptrading and downtrading, consumer preferences and other changes in product mix, based on long-term market trends, market data, anticipated regulatory developments, and management experience and expectations. We consider that pricing, market size, market shares and cost inflation are the key assumptions used in our plans.

GROWTH RATES AND DISCOUNT RATES USED

The compound annual growth rates implicit in these value-in-use calculations are shown below.

		2018	
%	Pre-tax discount rate	Initial growth rate	Long-term growth rate
Returns Markets North	9.1	3.3	1.8
Returns Markets South	12.9	(4.3)	1.8
Growth Markets	7.3–18.1	10.5	1.4–7.0
USA	8.7	3.9	2.5
Distribution	9.2	5.2	1.8

Cash flows from the business plan period are extrapolated out to year five using the implicit growth rate, shown in the table above as the initial growth rate. Estimated long-term weighted average compound growth rates of between 1.4 per cent and 7.0 per cent are used beyond year five.

Long-term growth rates are based on management's long-term expectations, taking account of industry specific factors such as the nature of our products, the role of excise in government fiscal policy, and relatively stable and predictable long-term macro trends in the Tobacco industry.

Discount rates used are based on the Group's weighted average cost of capital adjusted for the different risk profiles of the CGUs. Our impairment projections are prepared under the basis set out in IAS 36 which can differ from our internal plans. The cash flows recognised relate to tobacco product sales and do not currently include the potential benefits of future NGP launches.

GROWTH MARKETS

Within our Growth Markets reporting segment, there are a number of CGU groupings based on our operating segments, including Drive Growth and Other Premium Cigar.

The Drive Growth CGU grouping includes our markets in Russia, Italy, Japan and Turkey. Our impairment test for this CGU grouping indicated headroom of £164 million. However, the level of headroom remains sensitive to changes to individual assumptions which influences the on-going impairment risk.

Russia is a major market in this CGU grouping. Following various strategic investments which took place in the prior year and a more favourable pricing environment, market share and profitability expectations have now improved, with corresponding benefits for future net cashflows.

Our forecast for the next five years is based on the expectation of an on-going, steady, market recovery. The benefits arise from our actions to restructure the business and improved market conditions. The impairment test assumed a post-tax discount rate of 13.0 per cent (2017: 12.5 per cent) for the Russian market reflecting our view of current macroeconomic factors. The long-term growth rate of 4.0 percent has remained consistent with the prior year.

Any one or combination of the following changes in assumptions in the Russian CGU could represent a reasonably possible scenario:

- 100 basis point increase in the post-tax Russian Discount rate – headroom reduction of £53 million
- 10 per cent reduction in Russian cash flows – headroom reduction of £58 million
- 10 per cent devaluation of the Russian rouble – headroom reduction of £53 million

We are forecasting an improved outlook for the other markets within the CGU grouping. Japan is expected to achieve sufficient volume and pricing growth that will deliver significant growth in net cashflows. We are forecasting strong growth for Japanese cashflows for the period through to 2023. A 10 per cent reduction in Japanese cashflows would reduce headroom by £10 million.

Our impairment testing confirms there are sufficient future cash flows to support the current carrying values. Taking account of these factors, we have concluded that the carrying value for the Drive Growth CGU grouping included in our 30 September 2018 balance sheet is appropriate, but remains sensitive to adverse movements in any individual assumption or assumptions.

NGP sales in these markets represent a material opportunity for our business and these opportunities are currently being actively pursued. The NGP opportunities in these markets calculated on a fair value less costs of disposal basis would be at least £200 million. Our current headroom calculation for the Drive Growth CGU impairment review only assumes Tobacco cash flows and excludes NGP cash inflows, however the future inclusion of NGP cash flows will be considered as these businesses develop.

OTHER CGU GROUPINGS

For the rest of the Group, any reasonable movement in the assumptions used in the impairment tests would not result in an impairment.

12. PROPERTY, PLANT AND EQUIPMENT

				2018
£ million	**Property**	**Plant and equipment**	**Fixtures and motor vehicles**	**Total**
Cost				
At 1 October 2017	**960**	**1,989**	**408**	**3,357**
Additions	**10**	**183**	**58**	**251**
Acquisitions	**1**	**2**	**–**	**3**
Disposals	**(63)**	**(153)**	**(31)**	**(247)**
Reclassifications	**(2)**	**4**	**(2)**	**–**
Exchange movements	**3**	**(12)**	**(1)**	**(10)**
At 30 September 2018	**909**	**2,013**	**432**	**3,354**
Depreciation and impairment				
At 1 October 2017	**164**	**1,051**	**277**	**1,492**
Depreciation charge for the year	**19**	**127**	**30**	**176**
Impairment	**–**	**–**	**–**	**–**
Disposals	**(14)**	**(153)**	**(28)**	**(195)**
Reclassifications	**–**	**–**	**–**	**–**
Exchange movements	**–**	**(9)**	**(1)**	**(10)**
At 30 September 2018	**169**	**1,016**	**278**	**1,463**
Net book value				
At 30 September 2018	**740**	**997**	**154**	**1,891**

				2017
£ million	Property	Plant and equipment	Fixtures and motor vehicles	Total
Cost				
At 1 October 2016	1,012	2,106	390	3,508
Additions	7	146	38	191
Disposals	(72)	(286)	(19)	(377)
Reclassifications	4	3	(4)	3
Exchange movements	9	20	3	32
At 30 September 2017	960	1,989	408	3,357
Depreciation and impairment				
At 1 October 2016	180	1,111	258	1,549
Depreciation charge for the year	17	134	34	185
Impairment	2	45	1	48
Disposals	(40)	(253)	(18)	(311)
Reclassifications	1	2	(1)	2
Exchange movements	4	12	3	19
At 30 September 2017	164	1,051	277	1,492
Net book value				
At 30 September 2017	796	938	131	1,865

13. INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

The principal joint ventures are Corporación Habanos SA, Cuba and Altabana SL, Spain. Summarised financial information for the joint venture entities, which are accounted for by the Group under the equity method, is shown below:

					2018
£ million	Corporación Habanos	Altabana	Global Horizon Ventures	Others	Total
Revenue	**196**	**325**	**33**	**65**	**619**
Profit after tax	**39**	**48**	**4**	**9**	**100**
Non-current assets	**468**	**18**	**24**	**14**	**524**
Current assets	**89**	**225**	**33**	**64**	**411**
Total assets	**557**	**243**	**57**	**78**	**935**
Current liabilities	**(107)**	**(60)**	**(3)**	**(38)**	**(208)**
Non-current liabilities	**(22)**	**(5)**	**–**	**(7)**	**(34)**
Total liabilities	**(129)**	**(65)**	**(3)**	**(45)**	**(242)**
Net assets	**428**	**178**	**54**	**33**	**693**

					2017
£ million	Corporación Habanos	Altabana	Global Horizon Ventures	Others	Total
Revenue	184	308	3	67	562
Profit after tax	27	46	–	6	79
Non-current assets	449	15	24	13	501
Current assets	73	206	29	60	368
Total assets	522	221	53	73	869
Current liabilities	(79)	(52)	(6)	(41)	(178)
Non-current liabilities	(20)	(5)	–	(5)	(30)
Total liabilities	(99)	(57)	(6)	(46)	(208)
Net assets	423	164	47	27	661

TRANSACTIONS AND BALANCES WITH JOINT VENTURES

£ million	2018	2017
Sales to	**90**	81
Purchases from	**107**	92
Accounts receivable from	**13**	11
Accounts payable to	**(18)**	(13)

MOVEMENT ON INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

£ million	2018	2017
At 1 October	**785**	744
Profit for the year from joint ventures and associates	**42**	33
Increase in investment in joint ventures	**–**	38
Increase in investment in associates	**10**	2
Dividends	**(17)**	(16)
Foreign exchange	**25**	(16)
At 30 September	**845**	785

IFRS 11 Joint Arrangements came into effect for the Group from 1 October 2014. As a result of this standard the profit and loss items from joint ventures are shown in the consolidated income statement below net finance costs as “Share of investments accounted for using the equity method”. Similarly, the asset and liability amounts are classified as “Investments accounted for using the equity method”.

14. INVENTORIES

£ million	2018	2017
Raw materials	**908**	970
Work in progress	**78**	54
Finished inventories	**2,520**	2,349
Other inventories	**186**	231
	3,692	3,604

Other inventories mainly comprise duty-paid tax stamps.

It is generally recognised industry practice to classify leaf tobacco inventory as a current asset although part of such inventory, because of the duration of the processing cycle, ordinarily would not be consumed within one year. We estimate that around £139 million (2017: £181 million) of leaf tobacco held within raw materials will not be utilised within a year of the balance sheet date.

15. TRADE AND OTHER RECEIVABLES

	2018		2017	
£ million	Current	Non-current	Current	Non-current
Trade receivables	**2,370**	**5**	2,366	–
Less: provision for impairment of receivables	**(61)**	**(5)**	(58)	–
Net trade receivables	**2,309**	**–**	2,308	–
Other receivables	**119**	**74**	54	111
Prepayments and accrued income	**157**	**8**	177	12
	2,585	**82**	2,539	123

Trade receivables may be analysed as follows:

	2018		2017	
£ million	Current	Non-current	Current	Non-current
Within credit terms	**2,119**	**–**	2,179	–
Past due by less than 3 months	**107**	**–**	93	–
Past due by more than 3 months	**83**	**–**	36	–
Amounts that are impaired	**61**	**5**	58	–
	2,370	**5**	2,366	–

16. CASH AND CASH EQUIVALENTS

£ million	2018	2017
Cash at bank and in hand	**771**	599
Short-term deposits and other liquid assets	**4**	25
	775	624

£221 million (2017: £143 million) of total cash and cash equivalents is held in countries in which prior approval is required to transfer the funds abroad. Nevertheless, if the Group complies with these requirements, such liquid funds are at its disposition within a reasonable period of time.

17. TRADE AND OTHER PAYABLES

	2018		2017	
£ million	Current	Non-current	Current	Non-current
Trade payables	**1,198**	**–**	1,245	–
Duties payable	**4,808**	**–**	4,837	–
Other taxes and social security contributions	**1,436**	**–**	1,256	–
Other payables	**174**	**–**	163	–
Accruals and deferred income	**654**	**47**	603	21
	8,270	**47**	8,104	21

18. BORROWINGS

The Group's borrowings held at amortised cost, are as follows.

£ million	2018	2017
Current borrowings		
Bank loans and overdrafts	147	285
Capital market issuance:		
European commercial paper (ECP)	1,530	–
$1,250m 2.05% notes due February 2018	–	936
€850m 4.5% notes due July 2018	–	757
$500m 2.05% notes due July 2018	–	375
£200m 6.25% notes due December 2018	210	–
£500m 7.75% notes due June 2019	510	–
Total current borrowings	2,397	2,353
Non-current borrowings		
Bank loans	–	–
Capital market issuance:		
£200m 6.25% notes due December 2018	–	210
£500m 7.75% notes due June 2019	–	510
€750m 5.0% notes due December 2019	693	689
$1,250m 2.95% notes due July 2020	963	937
€1,000m 2.25% notes due February 2021	898	892
€500m 0.5% notes due July 2021	443	440
£1,000m 9.0% notes due February 2022	1,055	1,055
$1,250m 3.75% notes due July 2022	963	938
$1,000m 3.5% notes due February 2023	768	749
£600m 8.125% notes due March 2024	626	626
€500m 1.375% notes due January 2025	447	444
$1,500m 4.25% notes due July 2025	1,151	1,120
€650m 3.375% notes due February 2026	588	584
£500m 5.5% notes due September 2026	499	499
£500m 4.875% notes due June 2032	504	503
Total non-current borrowings	9,598	10,196
Total borrowings	11,995	12,549
Analysed as:		
Capital market issuance	11,848	12,264
Bank loans and overdrafts	147	285

Current and non-current borrowings include interest payable of £22 million (2017: £15 million) and £172 million (2017: £192 million) respectively as at the balance sheet date.

Interest payable on capital market issuances are at fixed rates of interest and interest payable on bank loans and overdrafts are at floating rates of interest.

On 12 February 2018, $1,250 million 2.05 per cent notes were repaid. On 5 July 2018, €850 million 4.5 per cent notes were repaid. On 20 July 2018, $500 million 2.05 per cent notes were repaid.

All borrowings are unsecured and the Group has not defaulted on any borrowings during the year (2017: no defaults).

18. BORROWINGS CONTINUED

NON-CURRENT FINANCIAL LIABILITIES

The maturity profile of the carrying amount of the Group's non-current liabilities as at 30 September 2018 (including net derivative financial instruments detailed in note 20) is as follows:

£ million	2018 Borrowings	2018 Net derivative financial liabilities/ (assets)	2018 Total	2017 Borrowings	2017 Net derivative financial liabilities/ (assets)	2017 Total
Amounts maturing:						
Between one and two years	**1,656**	**4**	**1,660**	720	47	767
Between two and five years	**4,128**	**123**	**4,251**	4,951	196	5,147
In five years or more	**3,814**	**484**	**4,298**	4,525	340	4,865
	9,598	**611**	**10,209**	10,196	583	10,779

FAIR VALUE OF BORROWINGS

The fair value of borrowings as at 30 September 2018 is estimated to be £12,484 million (2017: £13,530 million). £12,337 million (2017: £13,245 million) relates to capital market issuance and has been determined by reference to market prices as at the balance sheet date. A comparison of the carrying amount and fair value of capital market issuance by currency is provided below. The fair value of all other borrowings is considered to equal their carrying amount.

£ million	2018 Balance sheet amount	2018 Fair value	2017 Balance sheet amount	2017 Fair value
GBP	**3,405**	**3,861**	3,403	4,085
EUR	**4,598**	**4,681**	3,806	3,984
USD	**3,845**	**3,795**	5,055	5,176
Total capital market issuance	**11,848**	**12,337**	12,264	13,245

UNDRAWN BORROWING FACILITIES

At 30 September the Group had the following undrawn committed facilities:

£ million	2018	2017
Amounts maturing:		
In less than one year	**–**	–
Between one and two years	**1,040**	–
Between two and five years	**3,016**	3,000
	4,056	3,000

During the year four new bilateral facilities for a total €1,173 million were arranged.

19. FINANCIAL RISK FACTORS

FINANCIAL RISK MANAGEMENT

OVERVIEW

In the normal course of business, the Group is exposed to financial risks including, but not limited to, market, credit and liquidity risk. This note explains the Group's exposure to these risks, how they are measured and assessed, and summarises the policies and processes used to manage them, including those related to the management of capital.

The Group operates a centralised treasury function which is responsible for the management of the financial risks of the Group, together with its financing and liquidity requirements. Financial risks comprise, but are not limited to, exposures to funding and liquidity, interest rate, foreign exchange and counterparty credit risk. The treasury function is also responsible for the financial risk management of the Group's global defined benefit pension schemes and management of Group-wide insurance programs. The treasury function does not operate as a profit centre, nor does it enter into speculative transactions.

The Group's treasury activities are overseen by the Treasury Committee, which meets when required and comprises the Chief Financial Officer, the Company Secretary, the Deputy Chief Financial Officer and other senior management from finance and treasury. The Treasury Committee operates in accordance with the terms of reference set out by the Board and a framework (the Treasury Committee framework) which sets out the expectations and boundaries to assist in the effective oversight of treasury activities. The Director of Treasury reports on a regular basis to the Treasury Committee.

The Board reviews and approves all major treasury decisions.

The Group's management of financial risks cover the following:

(A) MARKET RISK

PRICE RISK

The Group is not exposed to equity securities price risk other than assets held by its pension funds disclosed in note 22. The Group is exposed to commodity price risk in that there may be fluctuations in the price of tobacco leaf. As with other agricultural commodities, the price of tobacco leaf tends to be cyclical as supply and demand considerations influence tobacco plantings in those countries where tobacco is grown. Also, different regions may experience variations in weather patterns that may affect crop quality or supply and so lead to changes in price. The Group seeks to reduce this price risk by sourcing tobacco leaf from a number of different countries and counterparties and by varying the levels of tobacco leaf held. Currently, these techniques reduce the expected exposure to this risk over the short to medium term to levels considered not material and accordingly, no sensitivity analysis has been presented.

FOREIGN EXCHANGE RISK

The Group is exposed to movements in foreign exchange rates due to its commercial trading transactions and profits denominated in foreign currencies, as well as the translation of cash, borrowings and derivatives held in non-functional currencies.

The Group's financial results are principally exposed to fluctuations in euro and US dollar exchange rates. Management of the Group's foreign exchange transaction and translation risk is addressed below.

TRANSACTION RISK

The Group's material transaction exposures arise on costs denominated in currencies other than the functional currencies of subsidiaries, including the purchase of tobacco leaf, which is sourced from various countries but purchased principally in US dollars, and packaging materials which are sourced from various countries and purchased in a number of currencies. The Group is also exposed to transaction foreign exchange risk on the conversion of foreign subsidiary earnings into sterling to fund the external dividends to shareholders. This is managed by selling euros and US dollars monthly throughout the year. Other foreign currency flows are matched where possible and remaining foreign currency transaction exposures are not hedged.

TRANSLATION RISK

The Group seeks to broadly match the currency of borrowings to the currency of its underlying investments in overseas subsidiaries, which are primarily euros and US dollars. The Group issues debt in the most appropriate market or markets at the time of raising new finance and has a policy of using derivative financial instruments, cross-currency swaps, to change the currency of debt as required. Borrowings denominated in, or swapped into foreign currencies to match the Group's investments in overseas subsidiaries are treated as a hedge against the net investment where appropriate.

FOREIGN EXCHANGE SENSITIVITY ANALYSIS

The Group's sensitivity to foreign exchange rate movements, which impacts the translation of monetary items held by subsidiary companies in currencies other than their functional currencies, is illustrated on an indicative basis below. The sensitivity analysis has been prepared on the basis that net debt and the proportion of financial instruments in foreign currencies remain constant, and that there is no change to the net investment hedge designations in place at 30 September 2018. The sensitivity analysis does not reflect any change to revenue or non-finance costs that may result from changing exchange rates, and ignores any taxation implications and offsetting effects of movements in the fair value of derivative financial instruments. In February 2018 the Group completed a subsidiary simplification exercise which resulted in a decrease in the foreign currency income statement sensitivity of the Group.

£ million	2018 Increase in income	2017 Increase in income
Income statement impact of non-functional currency foreign exchange exposures:		
10% appreciation of euro (2017: 10%)	**127**	491
10% appreciation of US dollar (2017: 10%)	**83**	111

An equivalent depreciation in the above currencies would cause a decrease in income of £155 million and £102 million for euro and US dollar exchange rates respectively (2017: £600 million and £136 million).

Movements in equity in the table below relate to hedging instruments designated as net investment hedges of the Group's Euro and US Dollar denominated assets.

£ million	2018 Change in equity	2017 Change in equity
Equity impact of non-functional currency foreign exchange exposures:		
10% appreciation of euro (2017: 10%)	**408**	484
10% appreciation of US dollar (2017: 10%)	**(44)**	20

An equivalent depreciation in the above currencies would result in a change in equity of (£499) million and £54 million for euro and US dollar exchange rates respectively (2017: (£591) million and (£24) million).

At 30 September 2018, after the effect of derivative financial instruments, approximately 68 per cent of the Group's net debt was denominated in euro and non USD currencies (2017: 58 per cent), 32 per cent in US dollars (2017: 42 per cent).

19. FINANCIAL RISK FACTORS CONTINUED

INTEREST RATE RISK

The Group's interest rate risk arises from its borrowings net of cash and cash equivalents, with the primary exposures arising from fluctuations in euro and US dollar interest rates. Borrowings at variable rates expose the Group to cash flow interest rate risk. Borrowings at fixed rates expose the Group to fair value interest rate risk.

The Group manages its exposure to interest rate risk on its borrowings by entering into derivative financial instruments, interest rate swaps, to achieve an appropriate mix of fixed and floating interest rate debt in accordance with the Treasury Committee framework and Treasury Committee discussions.

As at 30 September 2018, after adjusting for the effect of derivative financial instruments detailed in note 20, approximately 72 per cent (2017: 75 per cent) of net debt was at fixed rates of interest and 28 per cent (2017: 25 per cent) was at floating rates of interest.

INTEREST RATE SENSITIVITY ANALYSIS

The Group's sensitivity to interest rates on its euro and US dollar monetary items which are primarily external borrowings, cash and cash equivalents, is illustrated on an indicative basis below. The impact in the Group's income statement reflects the effect on net finance costs in respect of the Group's net debt and the fixed to floating rate debt ratio prevailing at 30 September 2018, ignoring any taxation implications and offsetting effects of movements in the fair value of derivative financial instruments.

The sensitivity analysis has been prepared on the basis that net debt and the derivatives portfolio remain constant and that there is no net impact on other comprehensive income (2017: nil).

	2018	2017
£ million	**Change in income**	Change in income
Income statement impact of interest rate movements:		
+/- 1% increase in euro interest rates (2017: 1%)	**20**	12
+/- 1% increase in US dollar interest rates (2017: 1%)	**14**	20

(B) CREDIT RISK

The Group is primarily exposed to credit risk arising from the extension of credit to its customers, cash deposits, derivatives and other amounts due from external financial counterparties arising on other financial instruments. The maximum aggregate credit risk to these sources was £3,644 million at 30 September 2018 (2017: £3,633 million).

TRADE AND OTHER RECEIVABLES

Policies are in place to manage the risk associated with the extension of credit to third parties to ensure that commercial intent is balanced effectively with credit risk management. Subsidiaries have policies in place that require appropriate credit checks on customers, and credit is extended with consideration to financial risk and creditworthiness. If a customer requires credit beyond an acceptable limit, security may be put in place to minimise the financial impact in the event of a payment default. Instruments that may typically be used as security include non-recourse receivables factoring and bank guarantees. At 30 September 2018 the level of trade receivables that were sold to a financial institution under a non-recourse factoring arrangement totaled £724 million (2017: £626 million). Analysis of trade and other receivables is provided in note 15.

FINANCIAL INSTRUMENTS

In order to manage its credit risk to any one counterparty, the Group places cash deposits and enters into derivative financial instruments with a diversified group of financial institutions carrying suitable credit ratings in line with the Treasury Committee framework. Utilisation of counterparty credit limits is regularly monitored by treasury and ISDA agreements are in place to permit the net settlement of assets and liabilities in certain circumstances. In connection with two ISDA Credit Support Annexes the Group had placed £82 million as at 30 September 2018 (2017: £75 million) as collateral with third parties in order to manage their counterparty risk on the Group under derivative financial instruments.

The table below summarises the Group's largest exposures to financial counterparties as at 30 September 2018. At the balance sheet date management does not expect these counterparties to default on their current obligations. The impact of the Group's own credit risk on the fair value of derivatives and other obligations held at fair value is not considered to be material.

	2018		2017	
Counterparty exposure	**S&P credit rating**	**Maximum exposure to credit risk £ million**	S&P credit rating	Maximum exposure to credit risk £ million
Highest	**A+**	**6**	A–	17
2nd highest	**BBB+**	**5**	AA–	8
3rd highest	**A**	**3**	A–	7
4th highest	**A**	**3**	A+	6
5th highest	**–**	**–**	A	4

(C) LIQUIDITY RISK

The Group is exposed to liquidity risk, which represents the risk of having insufficient funds to meet its financing needs in any particular subsidiary when needed. To manage this risk the Group has a policy of actively maintaining a mixture of short, medium and long-term committed facilities that are structured to ensure that the Group has sufficient available funds to meet the forecast requirements of the Group over the short to medium term. To prevent over-reliance on individual sources of liquidity, funding is provided across a range of instruments including debt capital market issuance, bank bi-lateral loans, bank revolving credit facilities and European commercial paper.

The Group primarily borrows centrally in order to meet forecast funding requirements, and the treasury function is in regular dialogue with subsidiary companies to ensure their liquidity needs are met. Subsidiary companies are funded by a combination of share capital and retained earnings, intercompany loans, and in very limited cases through external local borrowings. Cash pooling processes are used to centralise surplus cash held by subsidiaries where possible in order to minimise external borrowing requirements and interest costs. Treasury invests surplus cash in bank deposits and uses foreign exchange contracts to manage short-term liquidity requirements in line with short-term cash flow forecasts. As at 30 September 2018, the Group held liquid assets of £775 million (2017: £624 million).

The table below summarises the Group's non-derivative financial liabilities by maturity based on their contractual cash flows as at 30 September 2018. The amounts disclosed are undiscounted cash flows calculated using spot rates of exchange prevailing at the relevant balance sheet date. Contractual cash flows in respect of the Group's derivative financial instruments are detailed in note 20.

£ million	Balance sheet amount	Contractual cash flows total	<1 year	Between 1 and 2 years	Between 2 and 5 years	> 5 years
	2018					
Non-derivative financial liabilities:						
Bank loans	**147**	**152**	**152**	**–**	**–**	**–**
Capital market issuance	**11,848**	**13,745**	**2,670**	**2,002**	**4,843**	**4,230**
Trade payables	**1,198**	**1,198**	**1,198**	**–**	**–**	**–**
Total non-derivative financial liabilities	**13,193**	**15,095**	**4,020**	**2,002**	**4,843**	**4,230**

£ million	Balance sheet amount	Contractual cash flows total	<1 year	Between 1 and 2 years	Between 2 and 5 years	> 5 years
	2017					
Non-derivative financial liabilities:						
Bank loans	285	287	287	–	–	–
Capital market issuance	12,264	14,637	2,554	1,138	5,823	5,122
Trade payables	1,245	1,245	1,245	–	–	–
Total non-derivative financial liabilities	13,794	16,169	4,086	1,138	5,823	5,122

CAPITAL MANAGEMENT

The Group defines capital as adjusted net debt and equity and manages its capital structure through an appropriate balance of debt and equity in order to drive an efficient mix for the Group. Besides the minimum capitalisation rules that may apply to subsidiaries in certain countries, the Group's only external imposed capital requirements are interest cover and gearing covenants contained within its core external bank debt facilities, with which the Group was fully compliant during the current and prior periods and expects to be so going forward.

The Group continues to manage its capital structure to maintain investment grade credit rating which it monitors by reference to a number of key financial ratios, including ongoing consideration of the return of capital to shareholders via regular dividend payments and in on-going discussions with the relevant rating agencies.

As at 30 September 2018 the Group was rated Baa3/stable outlook by Moody's Investor Service Ltd, BBB/A-2/stable outlook by Standard and Poor's Credit Market Services Europe Limited and BBB/F3/stable outlook by Fitch Ratings Limited.

The Group regards its total capital as follows.

£ million	**2018**	2017
Adjusted net debt (note 29)	**11,474**	12,147
Equity attributable to the owners of the parent	**5,770**	5,684
Total capital	**17,244**	17,831

19. FINANCIAL RISK FACTORS CONTINUED

HEDGE ACCOUNTING

The Group hedges its underlying exposures in an efficient, commercial and structured manner in line with the policies above, although the strict hedging requirements of IAS 39 may lead to some commercially effective hedge positions not qualifying for hedge accounting. As a result, and as permitted under IAS 39, the Group has decided not to apply cash flow or fair value hedge accounting in respect of these transactions.

The Group does apply hedge accounting in respect of certain net investments in foreign operations where appropriate. The hedge of a net investment in a foreign operation is a hedge of the translation foreign currency risk arising on the foreign operation. As at 30 September 2018 the Group had made net investment hedge designations in foreign operations in respect of external euro borrowings with a carrying value of €3,400 million (2017: €4,250 million), US dollar borrowings with a carrying value of $5,000 million (2017: $7,050 million), and cross-currency swaps with a notional value of £4,164 million (2017: £4,164 million).

The Group also treats certain permanent intra-group loans that meet relevant qualifying criteria under IAS 21 as part of its net investment in foreign operations where appropriate. Intra-group loans with a notional value of €2,506 million (2017: €2,381 million) and US dollar loans with a notional value of $5,636 million (2017: $6,761 million) were treated as part of the Group's net investment in foreign operations at the balance sheet date.

FAIR VALUE ESTIMATION AND HIERARCHY

All financial assets and liabilities are carried on the balance sheet at amortised cost, other than derivative financial instruments which are carried at fair value. Derivative financial instruments are valued using techniques based significantly on observable market data such as yield curves and foreign exchange rates as at the balance sheet date (Level 2 classification hierarchy per IFRS 7) as detailed in note 20. There were no changes to the valuation methods or transfers between hierarchies during the year. With the exception of capital market issuance, the fair value of all financial assets and financial liabilities is considered approximate to their carrying amount as outlined in note 18.

NETTING ARRANGEMENTS OF FINANCIAL INSTRUMENTS

The following tables set out the Group's financial assets and financial liabilities that are subject to netting and set-off arrangements. Financial assets and liabilities that are subject to set-off arrangements and disclosed on a net basis in the Group's balance sheet primarily relate to cash pooling arrangements and collateral in respect of derivative financial instruments under ISDA Credit Support Annexes. Amounts which do not meet the criteria for offsetting on the balance sheet but could be settled net in certain circumstances principally relate to derivative transactions executed under ISDA agreements where each party has the option to settle amounts on a net basis in the event of default of the other party.

£ million	Gross financial assets/ liabilities	Gross financial assets/ liabilities set-off	Net financial assets/ liabilities per balance sheet	Related amounts not set-off in the balance sheet	Net
					2018
Assets					
Derivative financial instruments	**581**	**(82)**	**499**	**(481)**	**18**
Cash and cash equivalents	**775**	**–**	**775**	**–**	**775**
	1,356	**(82)**	**1,274**	**(481)**	**793**
Liabilities					
Derivative financial instruments	**(1,260)**	**82**	**(1,178)**	**481**	**(697)**
Bank loans and overdrafts	**(147)**	**–**	**(147)**	**–**	**(147)**
	(1,407)	**82**	**(1,325)**	**481**	**(844)**

£ million	Gross financial assets/ liabilities	Gross financial assets/ liabilities set-off	Net financial assets/ liabilities per balance sheet	Related amounts not set-off in the balance sheet	Net
					2017
Assets					
Derivative financial instruments	718	(75)	643	(603)	40
Cash and cash equivalents	624	–	624	–	624
	1,342	(75)	1,267	(603)	664
Liabilities					
Derivative financial instruments	(1,283)	75	(1,208)	603	(605)
Bank loans and overdrafts	(285)	–	(285)	–	(285)
	(1,568)	75	(1,493)	603	(890)

20. DERIVATIVE FINANCIAL INSTRUMENTS

The Group's derivative financial instruments held at fair value, are as follows.

			2018			2017
£ million	**Assets**	**Liabilities**	**Net Fair Value**	Assets	Liabilities	Net Fair Value
Current derivative financial instruments						
Interest rate swaps	**28**	**(24)**	**4**	47	(33)	14
Foreign exchange contracts	**6**	**(7)**	**(1)**	12	(9)	3
Cross-currency swaps	**3**	**(127)**	**(124)**	1	–	1
Total current derivatives	**37**	**(158)**	**(121)**	60	(42)	18
Collateral[1]	**–**	**53**	**53**	–	–	–
	37	**(105)**	**(68)**	60	(42)	18
Non-current derivative financial instruments						
Interest rate swaps	**462**	**(700)**	**(238)**	583	(734)	(151)
Cross-currency swaps	**–**	**(402)**	**(402)**	–	(507)	(507)
Total non-current derivatives	**462**	**(1,102)**	**(640)**	583	(1,241)	(658)
Collateral[1]	**–**	**29**	**29**	–	75	75
	462	**(1,073)**	**(611)**	583	(1,166)	(583)
Total carrying value of derivative financial instruments	**499**	**(1,178)**	**(679)**	643	(1,208)	(565)
Analysed as:						
Interest rate swaps	**490**	**(724)**	**(234)**	630	(767)	(137)
Foreign exchange contracts	**6**	**(7)**	**(1)**	12	(9)	3
Cross-currency swaps	**3**	**(529)**	**(526)**	1	(507)	(506)
Collateral[1]	**–**	**82**	**82**	–	75	75
Total carrying value of derivative financial instruments	**499**	**(1,178)**	**(679)**	643	(1,208)	(565)

1. Collateral deposited against derivative financial liabilities under the terms and conditions of ISDA Credit Support Annexes

Fair values are determined based on observable market data such as yield curves and foreign exchange rates to calculate the present value of future cash flows associated with each derivative at the balance sheet date. The classification of these derivative assets and liabilities under the IFRS 7 fair value hierarchy is provided in note 19.

MATURITY OF OBLIGATIONS UNDER DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial instruments have been classified in the balance sheet as current or non-current on an undiscounted contractual basis based on spot rates as at the balance sheet date. Some of the Group's derivative financial instruments contain early termination options. For the purposes of the above and following analysis, maturity dates have been based on the likelihood of an option being exercised with consideration to counterparty expectations and market conditions prevailing as at 30 September 2018. Any collateral transferred to counterparties in respect of derivative financial liabilities has been classified consistently with the related underlying derivative.

The table below summarises the Group's derivative financial instruments by maturity based on their remaining contractual cash flows as at 30 September 2018. The amounts disclosed are the undiscounted cash flows calculated using spot rates of exchange prevailing at the relevant balance sheet date. Contractual cash flows in respect of the Group's non-derivative financial instruments are detailed in note 19.

						2018
£ million	**Balance sheet amount**	**Contractual cash flows total**	**<1 year**	**Between 1 and 2 years**	**Between 2 and 5 years**	**>5 years**
Net settled derivatives	**(205)**	**(508)**	**(13)**	**(38)**	**(183)**	**(274)**
Gross settled derivatives	**(474)**					
– receipts		**5,364**	**2,249**	**102**	**1,228**	**1,785**
– payments		**(5,610)**	**(2,349)**	**(79)**	**(1,234)**	**(1,948)**
	(679)	**(754)**	**(113)**	**(15)**	**(189)**	**(437)**

						2017
£ million	Balance sheet amount	Contractual cash flows total	<1 year	Between 1 and 2 years	Between 2 and 5 years	>5 years
Net settled derivatives	(107)	(353)	12	(9)	(172)	(184)
Gross settled derivatives	(458)					
– receipts		5,449	1,548	818	1,273	1,810
– payments		(5,712)	(1,525)	(923)	(1,288)	(1,976)
	(565)	(616)	35	(114)	(187)	(350)

20. DERIVATIVE FINANCIAL INSTRUMENTS CONTINUED

DERIVATIVES AS HEDGING INSTRUMENTS

As outlined in note 19, the Group hedges its underlying interest rate exposure and foreign currency translation exposures in an efficient, commercial and structured manner, primarily using interest rate swaps and cross-currency swaps. Foreign exchange contracts are used to manage the Group's short-term liquidity requirements in line with short-term cash flow forecasts as appropriate.

The Group does not apply cash flow or fair value hedge accounting, as permitted under IAS 39, which results in fair value gains and losses attributable to derivative financial instruments being recognised in net finance costs unless they are designated as hedges of a net investment in foreign operations, in which case they are recognised in other comprehensive income.

INTEREST RATE SWAPS

To manage interest rate risk on its borrowings, the Group issues debt in the market or markets that are most appropriate at the time of raising new finance with regard to currency, interest denomination and/or duration, and then uses interest rate swaps to re-base the debt into the appropriate proportions of fixed and floating interest rates where necessary. Interest rate swaps are also transacted to manage and re-profile the Group's interest rate risk over the short, medium and long-term in accordance with the Treasury Committee framework and Treasury Committee discussions. Fair value movements are recognised in net finance costs in the relevant reporting period.

As at 30 September 2018, the notional amount of interest rate swaps outstanding that were entered into to convert fixed rate borrowings into floating rates of interest at the time of raising new finance were £10,353 million equivalent (2017: £12,393 million equivalent) with a fair value of £240 million asset (2017: £579 million asset). The fixed interest rates vary from 0.5 per cent to 8.7 per cent (2017: 0.5 per cent to 8.7 per cent), and the floating rates are EURIBOR, LIBOR and US LIBOR.

As at 30 September 2018, the notional amount of interest rate swaps outstanding that were entered into to convert the Group's debt into the appropriate proportion of fixed and floating rates to manage and re-profile the Group's interest rate risk were £10,285 million equivalent (2017: £11,049 million equivalent) with a fair value of £445 million liability (2017: £686 million liability). The fixed interest rates vary from 0.8 per cent to 4.4 per cent (2017: 0.8 per cent to 4.4 per cent), and the floating rates are EURIBOR, LIBOR and US LIBOR. This includes forward starting interest rate swaps with a total notional amount of £1,476 million equivalent (2017: £1,452 million equivalent) with tenors extending for 5 years, starting between October 2020 and May 2022.

CROSS-CURRENCY SWAPS

The Group enters into cross-currency swaps to convert the currency of debt into the appropriate currency with consideration to the underlying assets of the Group as appropriate. Fair value movements are recognised in net finance costs in the relevant reporting period unless they are designated as hedges of a net investment in foreign operations, in which case they are recognised in other comprehensive income.

As at 30 September 2018, the notional amount of cross-currency swaps entered into to convert floating rate sterling debt into the desired currency at floating rates of interest was £3,300 million (2016: £3,300 million) and the fair value of these swaps was £473 million net liability (2017: £461 million net liability).

HEDGES OF NET INVESTMENTS IN FOREIGN OPERATIONS

As at 30 September 2018, cross-currency swaps with a notional amount of €4,164 million (2017: €4,164 million) were designated as hedges of net investments in foreign operations. During the year, foreign exchange translation losses amounting to £23 million (2017: £92 million losses) were recognised in other comprehensive income in respect of cross-currency swaps that had been designated as hedges of a net investment in foreign operations.

FOREIGN EXCHANGE CONTRACTS

The Group enters into foreign exchange contracts to manage short-term liquidity requirements in line with cash flow forecasts. As at 30 September 2018, the notional amount of these contracts was £1,430 million equivalent (2017: £1,482 million equivalent) and the fair value of these contracts was a net liability of £1 million (2017: £3 million net asset).

21. DEFERRED TAX ASSETS AND LIABILITIES

Deferred tax assets and liabilities are offset only when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The following amounts, determined after appropriate offsetting, are shown in the consolidated balance sheet.

DEFERRED TAX ASSETS

£ million	Accelerated depreciation and amortisation	Retirement benefits	Other temporary differences	Total
				2018
At 1 October 2017	**181**	**129**	**307**	**617**
Credited/(charged) to consolidated income statement	**57**	**1**	**(68)**	**(10)**
Credited to other comprehensive income	**–**	**2**	**–**	**2**
Transfers	**(3)**	**1**	**(1)**	**(3)**
Exchange movements	**(4)**	**–**	**(2)**	**(6)**
At 30 September 2018	**231**	**133**	**236**	**600**

£ million	Accelerated depreciation and amortisation	Retirement benefits	Other temporary differences	Total
				2017
At 1 October 2016	(226)	269	588	631
Credited/(charged) to consolidated income statement	202	(1)	10	211
Charged to other comprehensive income	–	(28)	(1)	(29)
Transfers	212	(114)	(296)	(198)
Exchange movements	(7)	3	6	2
At 30 September 2017	181	129	307	617

DEFERRED TAX LIABILITIES

£ million	Accelerated depreciation and amortisation	Retirement benefits	Other temporary differences	Total
				2018
At 1 October 2017	**(1,403)**	**37**	**275**	**(1,091)**
Credited/(charged) to consolidated income statement	**219**	**(12)**	**(171)**	**36**
Charged to other comprehensive income	**–**	**(56)**	**–**	**(56)**
Transfers	**3**	**(1)**	**1**	**3**
Acquisitions	**(7)**	**–**	**2**	**(5)**
Exchange movements	**(5)**	**5**	**–**	**–**
At 30 September 2018	**(1,193)**	**(27)**	**107**	**(1,113)**

£ million	Accelerated depreciation and amortisation	Retirement benefits	Other temporary differences	Total
				2017
At 1 October 2016	(1,143)	47	62	(1,034)
Charged to consolidated income statement	(61)	(32)	(68)	(161)
Charged to other comprehensive income	–	(91)	–	(91)
Transfers	(212)	114	296	198
Other movements	–	–	(12)	(12)
Exchange movements	13	(1)	(3)	9
At 30 September 2017	(1,403)	37	275	(1,091)

21. DEFERRED TAX ASSETS AND LIABILITIES CONTINUED

DEFERRED TAX EXPECTED TO BE RECOVERED WITHIN 12 MONTHS

£ million	2018	2017
Deferred tax assets	**252**	340
Deferred tax liabilities	**(50)**	(270)
	202	70

DEFERRED TAX EXPECTED TO BE RECOVERED IN MORE THAN 12 MONTHS

£ million	2018	2017
Deferred tax assets	**348**	277
Deferred tax liabilities	**(1,063)**	(821)
	(715)	(544)

Within other temporary differences, deferred tax assets of £173 million (2017: £250 million) are recognised for tax losses carried forward to the extent that the realisation of the related tax benefit through future taxable profits is probable.

As at the balance sheet date, deferred tax assets of £133 million (2017: £106 million) have not been recognised due to the potential uncertainty of the utilisation of the underlying tax losses in certain jurisdictions. Of these unrecognised deferred tax assets £6 million (2017: £7 million) are expected to expire in 2019 and £37 million (2017: £7 million) are expected to expire within 5 years. The remaining £90 million (2017: £62 million) has no time expiry.

Also within Other temporary differences, deferred tax assets of £21 million (2017: £33 million) are recognised for tax credits carried forward to the extent that the realisation of the tax related benefit through future taxable profits is probable. Deferred tax assets of £146 million (2017: £143 million) have not been recognised due to the potential uncertainty of the utilisation of the credits. Of these unrecognised deferred tax assets £48 million (2017: £44 million) are expected to expire between 2021 and 2028.

We have reviewed the recoverability of deferred tax assets in overseas territories in the light of forecast business performance. In 2018 we derecognised deferred tax assets of £51 million that were previously recognised on the basis that it is more likely than not that these are irrecoverable. In 2017 there was no material movement.

A deferred tax liability of £115 million (2017: £89 million) is recognised in respect of taxation expected to arise on the future distribution of unremitted earnings totalling £9 billion (2017: £8 billion).

The aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised is nil (2017: £140 million). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences, and it is probable that such differences will not reverse in the foreseeable future.

22. RETIREMENT BENEFIT SCHEMES

The Group operates a number of retirement benefit schemes for its employees, including both defined benefit and defined contribution schemes. The Group's three principal schemes are defined benefit schemes and are operated by Imperial Tobacco Limited (ITL) in the UK, Reemtsma Cigarettenfabriken GmbH in Germany and ITG Brands in the USA; these schemes represent 64 per cent, 11 per cent and 7 per cent of the Group's total defined benefit obligations and 41 per cent, 24 per cent and 9 per cent of the current service cost respectively.

IMPERIAL TOBACCO PENSION FUND

The UK scheme, the Imperial Tobacco Pension Fund or ITPF, is a voluntary final salary pension scheme with a normal retirement age of 60 for most members. The ITPF was offered to employees who joined the company before 1 October 2010 and has a weighted average maturity of 18 years. Effective from 1 September 2017, members' pensionable pay was capped at the higher of £75,000 or their pensionable pay at 1 September 2017. The population as at the most recent funding valuation comprises 65 per cent in respect of pensioners, 32 per cent in respect of deferred members and 3 per cent in respect of current employees. New employees in the UK are now offered a defined contribution scheme. Should surplus funds arise in the defined benefit section they may be used to finance defined contribution section contributions on ITL's behalf with company contributions reduced accordingly.

The ITPF operates under trust law and is managed and administered by the Trustees on behalf of the members in accordance with the terms of the Trust Deed and Rules and relevant legislation. The ITPF's assets are held by the trust.

Annual increases in benefits in payment are dependent on inflation so the main uncertainties affecting the level of benefits payable under the ITPF are future inflation levels (including the impact of inflation on future salary increases and any salary increases above inflation) and the actual longevity of the membership.

The contributions paid to the ITPF are set by the ITPF Scheme Actuary every three years. The Scheme Actuary is an external consultant, appointed by the Trustees. Principal factors that the Scheme Actuary will have regard to include the covenant offered by the Group, the level of risk in the ITPF, the expected returns on the ITPF's assets, the results of the funding assessment on an ongoing basis and the expected cost of securing benefits if the fund were to be wound up.

The latest valuation of the ITPF was carried out as at 31 March 2016 when the market value of the invested assets was £3,302 million. Based on the ongoing funding target the total assets were sufficient to cover 96 per cent of the benefits that had accrued to members for past service, after allowing for expected future pay increases. The total assets were sufficient to cover 90 per cent of the total benefits that had accrued to members for past service and future service benefits for current members. In compliance with the Pensions Act 2004, ITL and the Trustee agreed a scheme-specific funding target, a statement of funding principles and a schedule of contributions accordingly.

Following the valuation, the level of employer's contributions to the scheme was increased from £65 million per year. ITL paid £80 million in the year to 31 March 2018 and agreed to pay £85 million each year for the subsequent 13 years. Further contributions were agreed to be paid by the ITL in the event of a downgrade of the Group's credit rating to non-investment grade by either Standard & Poor's or Moody's. In addition, surety guarantees with a total value of £600 million and a parental guarantee with Imperial Brands PLC have been put in place.

The main risk for the Group in respect of the ITPF is that additional contributions are required if the investment returns are not sufficient to pay for the benefits (which will be influenced by the factors noted above). The investment portfolio is subject to a range of risks typical of the asset classes held, in particular credit risk on bonds, exposure to equity markets, and exposure to the property market.

The IAS 19 liability measurement of the defined benefit obligation (DBO) and the current service cost are sensitive to the assumptions made about future inflation and salary growth levels, as well as the assumptions made about life expectation. They are also sensitive to the discount rate, which depends on market yields on sterling denominated AA corporate bonds. The main differences between the funding and IAS 19 assumptions are a more prudent longevity assumption for funding and a different approach to setting the discount rate. A consequence of the ITPF's investment strategy, with a proportion of the assets invested in equities and other return-seeking assets, is that the difference between the market value of the assets and the IAS 19 liabilities may be relatively volatile.

THE REEMTSMA CIGARETTENFABRIKEN PENSION PLAN

The German scheme, the Reemtsma Cigarettenfabriken Pension Plan (RCPP), is primarily a career average pension plan that is open to new entrants, though a small closed group of members has final salary benefits. It has a weighted average maturity of 19 years. The scheme population comprises 47 per cent in respect of pensioners, 17 per cent in respect of deferred members and 36 per cent in respect of current employees.

The plan is unfunded and the company pays benefits as they arise. The plan's obligations arise under a works council agreement and are subject to standard German legal requirements around such matters as the benefits to be provided to employees who leave service, and pension increases in payment. Over the next year Reemtsma Cigarettenfabriken GmbH expects to pay £21 million in respect of benefits.

Annual increases in benefits in payment are dependent on inflation so the main uncertainties affecting the level of benefits payable under the plan are future inflation levels and the actual longevity of the membership.

The IAS 19 liability measurement of the DBO and the current service cost are sensitive to the assumptions made about the above variables, as well as the discount rate, which depends on market yields on euro denominated AA corporate bonds.

ITG BRANDS HOURLY PENSION PLAN

The main USA pension scheme, the ITG Brands Hourly Pension Plan (ITGBH), is a defined benefit pension plan that is open to new entrants. It has a weighted average maturity of 10 years. The population comprises 73 per cent in respect of pensioners, 11 per cent in respect of deferred members and 16 per cent in respect of current employees.

The plan is funded and benefits are paid from the plan assets. Contributions to the plan are determined based on US regulatory requirements and ITG Brands is not expected to make any contributions in the next year.

Annual benefits in payment are assumed not to increase from current levels. The main uncertainty affecting the level of benefits payable under the plan is the actual longevity of the membership. Other key uncertainties impacting the plan include investment risk and potential past service benefit changes from future negotiations.

The IAS 19 liability measurement of the DBO and the service cost are sensitive to the assumptions made about the above variables, as well as the discount rate, which depends on market yields on US dollar denominated AA corporate bonds.

OTHER PLANS

Other plans of the Group include various pension plans, other post-employment and long-term employee benefit plans in several countries of operation. Many of the plans are funded, with assets backing the obligations held in separate legal vehicles such as trusts, others are operated on an unfunded basis. The benefits provided, the approach to funding and the legal basis of the plans reflect their local territories. IAS 19 requires that the discount rate for calculating the DBO and service cost is set according to the level of relevant market yields on corporate bonds where the market is considered "deep", or government bonds where it is not.

22. RETIREMENT BENEFIT SCHEMES CONTINUED

DEFINED BENEFIT PLANS

The results of the most recent available actuarial valuations for the various plans have been updated to 30 September 2018 in order to determine the amounts to be included in the Group's consolidated financial statements. The aggregate IAS 19 position is as follows:

			2018			2017
£ million	DBO	Assets	Total	DBO	Assets	Total
At 1 October	**(5,448)**	**4,732**	**(716)**	(6,099)	4,620	(1,479)
Consolidated income statement expense						
Current service cost	**(52)**	**–**	**(52)**	(64)	–	(64)
Settlements gains/(losses)	**12**	**(7)**	**5**	–	–	–
Past service credits	**12**	**–**	**12**	91	–	91
Cost of termination benefits	**(38)**	**–**	**(38)**	(10)	–	(10)
Net interest (expense)/income on net defined benefit (liability)/asset	**(142)**	**129**	**(13)**	(132)	107	(25)
Administration costs paid from plan assets	**–**	**(5)**	**(5)**	–	(3)	(3)
Cost recognised in the income statement			**(91)**			(11)
Remeasurements						
Actuarial (loss)/gain due to liability experience	**(20)**	**–**	**(20)**	204	–	204
Actuarial gain due to financial assumption changes	**105**	**–**	**105**	299	–	299
Actuarial gain due to demographic assumption changes	**–**	**–**	**–**	25	–	25
Return on plan assets excluding amounts included in net interest (expense)/income above	**–**	**111**	**111**	–	121	121
Remeasurement effects recognised in other comprehensive income			**196**			649
Cash						
Employer contributions	**–**	**158**	**158**	–	140	140
Employee contributions	**(1)**	**1**	**–**	(1)	1	–
Benefits paid directly by the company	**66**	**(66)**	**–**	46	(46)	–
Benefits paid from plan assets	**215**	**(215)**	**–**	205	(205)	–
Net cash			**158**			140
Other						
Exchange movements	**(20)**	**10**	**(10)**	(12)	(3)	(15)
Total other			**(10)**			(15)
At 30 September	**(5,311)**	**4,848**	**(463)**	(5,448)	4,732	(716)

The cost of termination benefits in the year ended 30 September 2018 mainly relate to restructuring activity in Germany. The past service credit arises as a result of curtailment gains in Germany and France, and the introduction of a pensionable pay cap in Ireland. Settlement gains have arisen following lump-sum exercises in both Germany and the US. The payment of €22.8 million arising from the lump-sum exercise in Germany has been accounted for through the pension scheme, however the monies have yet to be paid to the beneficiaries, and is held separately as a current payable on the balance sheet.

RETIREMENT BENEFIT SCHEME COSTS CHARGED TO OPERATING PROFIT

£ million	2018	2017
Defined benefit expense/(income) in operating profit	**78**	(14)
Defined contribution expense in operating profit	**17**	17
Total retirement benefit scheme cost in operating profit	**95**	3

Split as follows in the consolidated income statement:

£ million	2018	2017
Cost of sales	**29**	3
Distribution, advertising and selling costs	**40**	–
Administrative and other expenses	**26**	–
Total retirement benefit scheme costs in operating profit	**95**	3

ASSETS AND LIABILITIES RECOGNISED IN THE CONSOLIDATED BALANCE SHEET

£ million	2018	2017
Retirement benefit assets	**598**	358
Retirement benefit liabilities	**(1,061)**	(1,074)
Net retirement benefit liability	**(463)**	(716)

KEY FIGURES AND ASSUMPTIONS USED FOR MAJOR PLANS

	2018			2017		
£ million unless otherwise indicated	ITPF	RCPP	ITGBH	ITPF	RCPP	ITGBH
Defined benefit obligation (DBO)	**3,380**	**600**	**394**	3,485	613	418
Fair value of scheme assets	**(3,902)**	**–**	**(388)**	(3,790)	–	(394)
Net defined benefit (asset)/liability	**(522)**	**600**	**6**	(305)	613	24
Current service cost	**21**	**13**	**5**	28	15	5
Employer contributions	**80**	**–**	**–**	75	22	–
Principal actuarial assumptions used (% per annum)						
Discount rate	**2.9**	**1.9**	**4.3**	2.7	1.9	3.8
Future salary increases	**3.7**	**2.9**	**n/a**	3.7	2.9	n/a
Future pension increases	**3.2**	**1.8**	**n/a**	3.2	1.8	n/a
Inflation	**3.2**	**1.8**	**2.5**	3.2	1.8	2.5

	2018					
	ITPF		RCPP		ITGBH	
	Male	Female	Male	Female	Male	Female
Life expectancy at age 65 years:						
Member currently aged 65	**22.0**	**23.6**	**19.4**	**23.4**	**19.7**	**22.2**
Member currently aged 50	**23.4**	**25.5**	**21.4**	**25.3**	**20.9**	**23.3**

	2017					
	ITPF		RCPP		ITGBH	
	Male	Female	Male	Female	Male	Female
Life expectancy at age 65 years:						
Member currently aged 65	21.9	23.5	19.3	23.3	19.8	22.3
Member currently aged 50	23.3	25.5	21.3	25.2	21.1	23.5

Assumptions regarding future mortality experience are set based on advice that uses published statistics and experience in each territory. In particular for the ITPF, SAPS S2 tables are used with various adjustments for different groups of members, reflecting observed experience. The largest group of members uses the SAPS S2 All Pensioner Male Amounts table with a 97.7 per cent multiplier. An allowance for improvements in longevity is made using the 2015 CMI improvement rates with a long-term trend of 1.25 per cent per annum.

SENSITIVITY ANALYSIS FOR KEY ASSUMPTIONS AT THE END OF THE YEAR

Sensitivity analysis is illustrative only and is provided to demonstrate the degree of sensitivity of results to key assumptions. Generally, estimates are made by re-performing calculations with one assumption modified and all others held constant.

	2018			2017		
% increase in DBO	ITPF	RCPP	ITGBH	ITPF	RCPP	ITGBH
Discount rate: 0.5% decrease	**8.7**	**9.9**	**5.2**	9.0	9.4	5.6
Rate of inflation: 0.5% decrease	**7.1**	**6.5**	**n/a**	7.3	6.3	n/a
One year increase in longevity for a member currently age 65, corresponding changes at other ages	**3.5**	**4.5**	**4.0**	3.7	4.6	4.1

The sensitivity to the inflation assumption change includes corresponding changes to the future salary increases and future pension increases assumptions, but is assumed to be independent of any change to discount rate.

We estimate that a 0.5 per cent decrease in the discount rate at the start of the year would have increased the consolidated income statement pension expense by approximately £14 million.

22. RETIREMENT BENEFIT SCHEMES CONTINUED

An approximate split of the major categories of ITPF scheme assets is as follows:

	2018		2017	
£ million unless otherwise indicated	Fair value	Percentage of ITPF scheme assets	Fair value	Percentage of ITPF scheme assets
Equities	564	15	1,430	38
Bonds – index linked government	1,403	36	915	24
Bonds – corporate and other	361	9	305	8
Property	542	14	529	14
Absolute return	477	12	589	15
Other – including derivatives, commodities and cash	555	14	22	1
	3,902	100	3,790	100

The majority of the assets are quoted.

There is now no self-investments in the Imperial Brands PLC shares following termination of the mandates that previously held these shares. As in previous years, the value of ground leases have been allocated to the property asset class.

An approximate split of the major categories of ITGBH scheme assets is as follows:

	2018		2017	
£ million unless otherwise indicated	Fair value	Percentage of ITGBH scheme assets	Fair value	Percentage of ITGBH scheme assets
Investment funds	252	65	257	65
Bonds – fixed government	54	14	75	19
Bonds – corporate and other	66	17	58	15
Other – including derivatives, commodities and cash	16	4	4	1
	388	100	394	100

The majority of the assets are non-quoted.

23. PROVISIONS

	2018		
£ million	Restructuring	Other	Total
At 1 October 2017	380	145	525
Additional provisions charged to the consolidated income statement	99	62	161
Amounts used	(171)	(26)	(197)
Unused amounts reversed	(13)	(22)	(35)
Exchange movements	2	(3)	(1)
At 30 September 2018	297	156	453

Analysed as:

£ million	2018	2017
Current	179	187
Non-current	274	338
	453	525

Restructuring provisions relate mainly to our cost optimisation programme (see note 5), and other provisions principally relate to holiday pay, local tax and Logista provisions. It is expected that the majority of provisions will be utilised within a period of 10 years.

24. SHARE CAPITAL

£ million	2018	2017
Authorised, issued and fully paid		
1,031,026,084 ordinary shares of 10p each (2017: 1,032,340,000)	103	103

During the year 1,313,916 shares were repurchased and immediately cancelled, increasing the Capital Redemption reserve.

On 6 March 2014, 31,942,881 shares held in Treasury were cancelled creating the Capital Redemption reserve, and in September 2017, 3,660,000 shares were cancelled increasing this reserve.

25. SHARE SCHEMES

The Group operates four types of share-based incentive programmes, designed to incentivise staff and to encourage them to build a stake in the Group.

SHARE MATCHING SCHEME

Awards are made to eligible employees who are invited to invest a proportion of their eligible bonus in shares for a period of three years, after which matching shares are awarded on a 1:1 ratio, plus dividend equivalents.

LONG-TERM INCENTIVE PLAN (LTIP)

Awards of shares under the LTIP are made to the Executive Directors and senior executives at the discretion of the Remuneration Committee. They vest three years after grant and are subject to performance criteria. Dividend equivalents accrue on vested shares.

SHARESAVE PLAN

Options are granted to eligible employees who participate in a designated savings scheme for a three year period. Historically they were also granted for a five year period.

DISCRETIONARY SHARE AWARDS PLAN (DSAP)

Under the DSAP, one-off conditional awards are made to individuals to recognise exceptional contributions within the business. Awards, which are not subject to performance conditions and under which vested shares do not attract dividend roll-up, will normally vest on the third anniversary of the date of grant subject to the participant's continued employment. The limit of an award under the DSAP is capped at 25 per cent of the participant's salary at the date of grant. Shares used to settle awards under the DSAP will be market purchased.

Further details of the schemes including additional criteria applying to Directors and some senior executives are set out in the Directors' Remuneration Report.

ANALYSIS OF CHARGE TO THE CONSOLIDATED INCOME STATEMENT

£ million	2018	2017
Share Matching Scheme	14	19
Long-Term Incentive Plan	9	6
Sharesave Plan	2	2
Discretionary Share Awards Plan	1	–
	26	27

The awards are predominantly equity-settled. The balance sheet liability in respect of cash-settled schemes at 30 September 2018 was £0.9 million (2017: £2.1 million).

RECONCILIATION OF MOVEMENTS IN AWARDS/OPTIONS

	2018				
Thousands of shares unless otherwise indicated	Share matching scheme awards	LTIP awards	Sharesave options	DSAP awards	Sharesave weighted average exercise price £
Outstanding at 1 October 2017	1,907	1,190	997	45	27.73
Granted	175	2,002	972	26	22.24
Lapsed/cancelled	(78)	(25)	(302)	–	29.12
Exercised	(697)	(153)	(343)	–	23.87
Outstanding at 30 September 2018	1,307	3,014	1,324	71	25.03
Exercisable at 30 September 2018	–	–	98	–	25.22

25. SHARE SCHEMES CONTINUED

					2017
Thousands of shares unless otherwise indicated	Share matching awards	LTIP awards	Sharesave options	DSAP awards	Sharesave weighted average exercise price £
Outstanding at 1 October 2016	2,265	1,100	1,085	19	24.73
Granted	662	397	340	26	29.62
Lapsed/cancelled	(109)	(104)	(86)	–	25.59
Exercised	(911)	(203)	(342)	–	20.62
Outstanding at 30 September 2017	1,907	1,190	997	45	27.73
Exercisable at 30 September 2017	–	–	43	–	20.40

The weighted average Imperial Brands PLC share price at the date of exercise of awards and options was £26.80 (2017: £36.24). The weighted average fair value of sharesave options granted during the year was £4.00 (2017: £6.68).

SUMMARY OF AWARDS/OPTIONS OUTSTANDING AT 30 SEPTEMBER 2018

Thousands of shares unless otherwise indicated	Number of awards/options outstanding	Vesting period remaining in months	Exercise price of options outstanding £
Share Matching Scheme			
2016	**550**	**5**	**n/a**
2017	**583**	**17**	**n/a**
2018	**174**	**29**	**n/a**
Total awards outstanding	**1,307**		
Long-Term Incentive Plan			
2015	**243**	**–**	**n/a**
2016	**399**	**5**	**n/a**
2017	**397**	**17**	**n/a**
2018	**1,975**	**29**	**n/a**
Total awards outstanding	**3,014**		
Sharesave Plan			
2013	**1**	**–**	**18.40**
2014	**2**	**–**	**20.40**
2015	**95**	**–**	**25.40**
2016	**209**	**10**	**29.68**
2017	**271**	**22**	**29.62**
2018	**746**	**34**	**22.24**
Total options outstanding	**1,324**		
Discretionary Share Awards Plan			
2016	**18**	**2**	**n/a**
2016	**1**	**10**	**n/a**
2017	**24**	**20**	**n/a**
2017	**2**	**23**	**n/a**
2018	**26**	**31**	**n/a**
Total options outstanding	**71**		

The vesting period is the period between the grant of awards or options and the earliest date on which they are exercisable. The vesting period remaining and the exercise price of options outstanding are weighted averages. Participants in the Sharesave Plan have six months from the maturity date to exercise their option. Participants in the LTIP generally have seven years from the end of the vesting period to exercise their option. The exercise price of the options is fixed over the life of each option.

PRICING

For the purposes of valuing options to calculate the share-based payment charge, the Black-Scholes option pricing model has been used for the Share Matching Scheme, Sharesave Plan, Discretionary Shares Awards Plan and one Long-Term Incentive Plan with no market conditions. A summary of the assumptions used in the Black-Scholes model for 2018 and 2017 is as follows.

	2018				2017		
	Share matching	**Sharesave**	**DSAP**	**LTIP**	Share matching	Sharesave	DSAP
Risk-free interest rate %	**1.2**	**0.0–2.9**	**1.2**	**1.2–1.3**	0.8	0.1	0.6–0.9
Volatility (based on 3 or 5 year history) %	**24.1**	**24.0–24.1**	**24.2**	**23.9–24.5**	24.1	24.4	24.1–24.8
Expected lives of options granted years	**3**	**3**	**3**	**3–5**	3	3	3
Dividend yield %	**4.75**	**4.75**	**4.75**	**4.75**	4.2	4.2	4.2
Fair value £	**22.84**	**3.88–4.76**	**24.24**	**22.05–24.24**	32.66	6.02–6.48	28.25–32.03
Share price used to determine exercise price £	**26.34**	**26.08–26.32**	**27.96**	**27.96**	37.00	35.47–36.29	32.01–36.29
Exercise price £	**n/a**	**22.24**	**n/a**	**n/a**	n/a	29.62	n/a

Market conditions were incorporated into the Monte Carlo method used in determining the fair value of all other Long-Term Incentive Plan awards at grant date. Assumptions in 2018 and 2017 are given in the following table.

%	2018	2017
Future Imperial Brands share price volatility	**18.7–19.2**	21.0
Future Imperial Brands dividend yield	**–**	–
Share price volatility of the tobacco and alcohol comparator group	**17.0–38.0**	16.0–37.0
Correlation between Imperial Tobacco and the alcohol and tobacco comparator group	**32.0**	34.0

EMPLOYEE SHARE OWNERSHIP TRUSTS

The Imperial Tobacco Group PLC Employee and Executive Benefit Trust and the Imperial Tobacco Group PLC 2001 Employee Benefit Trust (the Trusts) have been established to acquire ordinary shares in the Company to satisfy rights to shares arising on the exercise and vesting of options and awards. The purchase of shares by the Trusts has been financed by a gift of £19.2 million and an interest free loan of £147.5 million. In addition the Group has gifted treasury shares to the Trusts. None of the Trusts' shares has been allocated to employees or Executive Directors as at 30 September 2017. All finance costs and administration expenses connected with the Trusts are charged to the consolidated income statement as they accrue. The Trusts have waived their rights to dividends and the shares held by the Trusts are excluded from the calculation of basic earnings per share.

SHARES HELD BY EMPLOYEE SHARE OWNERSHIP TRUSTS

Millions of shares	2018	2017
At 1 October	**1.9**	3.5
Distribution of shares held by Employee Share Ownership Trusts	**(1.2)**	(1.6)
At 30 September	**0.7**	1.9

The shares in the Trusts are accounted for on a first in first out basis and comprise nil shares acquired in the open market (2017: nil) and 0.7 million (2017: 1.9 million) treasury shares gifted to the Trusts by the Group. There were nil (2017: nil) shares gifted in the financial year 2018.

26. TREASURY SHARES

Shares purchased under the Group's buyback programme represent a deduction from equity shareholders' funds, and are only cancelled if the number of treasury shares approaches 10 per cent of issued share capital. During the year the Group purchased 1,313,916 shares at a cost of £41 million (2017: 3,660,000 shares at a cost of £119 million) which were immediately cancelled. Shares held in treasury do not qualify for dividends.

	2018		2017	
£ million unless otherwise indicated	**Millions of shares (number)**	**Value**	Millions of shares (number)	Value
At 1 October	**77.3**	**2,183**	77.3	2,183
Purchase of shares	**1.3**	**41**	3.7	119
Cancellation of shares	**(1.3)**	**(41)**	(3.7)	(119)
At 30 September	**77.3**	**2,183**	77.3	2,183
Percentage of issued share capital	**7.5**	**n/a**	7.5	n/a

27. COMMITMENTS

CAPITAL COMMITMENTS

£ million	2018	2017
Contracted but not provided for:		
Property, plant and equipment and software	208	195

OPERATING LEASE COMMITMENTS

Total future minimum lease payments under non-cancellable operating leases consist of leases where payments fall due:

	2018			2017		
£ million	Property	Other	Total	Property	Other	Total
Within one year	47	19	66	41	15	56
Between one and five years	107	29	136	92	33	125
Beyond five years	52	–	52	22	–	22
	206	48	254	155	48	203

A review of operating leases has identified four leases with a total commitment greater than £10 million. A summary of these commitments are detailed below.

Following the sale of the head office buildings in the UK, two new leases have commenced in respect of these. The lease in respect of 121 Winterstoke Road commenced on 23 August 2018 for a term of 20 years, due to terminate on 22 August 2038 and currently has an annual rental commitment of £2.5 million. The lease in respect of 123 Winterstoke Road commenced on 25 September 2018 for a term of 10 years, due to terminate on 24 September 2028 and has an annual rental commitment of £1.0 million. Both leases will have a review of the rental obligation five years after the lease commencement date.

The German head office lease commenced on 1 January 2014 for a term of 10 years, due to terminate on 31 December 2024. Currently there is an annual commitment of €3.2 million which is price index graduated on an annual basis. There is the option to terminate up to 30 per cent of the remaining lease space from 31 December 2019 to 31 December 2023, subject to notice of 14 months and a pro-rata payment penalty.

The Logista head office lease commenced on 1 January 2015 for a term of nine years, due to terminate on 31 December 2023. Currently there is an annual commitment of €1.8 million which is price index reviewed on an annual basis. There is the option to terminate the lease on 31 December 2021, subject to an indemnity of two months rent, and an option to extend the lease at expiry for a further nine years.

28. CONTINGENT LIABILITIES

LEGAL PROCEEDINGS

The Group is currently involved in a number of legal cases in which claimants are seeking damages for alleged smoking and health-related effects. In the opinion of the Group's lawyers, the Group has meritorious defences to these actions, all of which are being vigorously contested. Although it is not possible to predict the outcome of the pending litigation, the Directors believe that the pending actions will not have a material adverse effect upon the results of the operations, cash flow or financial condition of the Group. Consequently, the Group has not provided for any amounts in respect of these cases in the financial statements.

For further details see pages 53-54 of the Directors' Report.

COMPETITION AUTHORITY INVESTIGATIONS

The Group is currently co-operating with relevant national competition authorities in relation to a number of ongoing competition law investigations, none of which have resulted in findings of infringement.

29. NET DEBT

The movements in cash and cash equivalents, borrowings, and derivative financial instruments in the year were as follows:

£ million	Cash and cash equivalents	Current borrowings	Non-current borrowings	Derivative financial instruments	Total
At 1 October 2017	624	(2,353)	(10,196)	(565)	(12,490)
Reallocation of current borrowings from non-current borrowings	–	(721)	721	–	–
Cash flow	203	642	–	(41)	804
Accretion of interest	–	14	(2)	(2)	10
Change in fair values	–	–	–	(71)	(71)
Exchange movements	(52)	21	(121)	–	(152)
At 30 September 2018	775	(2,397)	(9,598)	(679)	(11,899)

ANALYSIS BY DENOMINATION CURRENCY

£ million	GBP	EUR	USD	Other	Total
					2018
Cash and cash equivalents	**47**	**225**	**39**	**464**	**775**
Total borrowings	**(3,419)**	**(4,700)**	**(3,844)**	**(32)**	**(11,995)**
	(3,372)	**(4,475)**	**(3,805)**	**432**	**(11,220)**
Effect of cross-currency swaps	**3,180**	**(3,706)**	**–**	**–**	**(526)**
	(192)	**(8,181)**	**(3,805)**	**432**	**(11,746)**
Derivative financial instruments					**(153)**
Net debt					**(11,899)**

£ million	GBP	EUR	USD	Other	Total
					2017
Cash and cash equivalents	45	176	43	360	624
Total borrowings	(3,436)	(3,814)	(5,278)	(21)	(12,549)
	(3,391)	(3,638)	(5,235)	339	(11,925)
Effect of cross-currency swaps	3,177	(3,683)	–	–	(506)
	(214)	(7,321)	(5,235)	339	(12,431)
Derivative financial instruments					(59)
Net debt					(12,490)

ADJUSTED NET DEBT

Management monitors the Group's borrowing levels using adjusted net debt which excludes interest accruals and the fair value of derivative financial instruments providing commercial cash flow hedges.

£ million	2018	2017
Reported net debt	**(11,899)**	(12,490)
Accrued interest	**197**	208
Fair value of derivatives providing commercial hedges	**228**	135
Adjusted net debt	**(11,474)**	(12,147)

30. RECONCILIATION OF CASH FLOW TO MOVEMENT IN NET DEBT

£ million	2018	2017
Increase/(decrease) in cash and cash equivalents	**203**	(601)
Cash flows relating to derivative financial instruments	**(41)**	37
Increase in borrowings	**(1,619)**	(852)
Repayment of borrowings	**2,261**	2,183
Change in net debt resulting from cash flows	**804**	767
Other non-cash movements including revaluation of derivative financial instruments	**(61)**	69
Exchange movements	**(152)**	(7)
Movement in net debt during the year	**591**	829
Opening net debt	**(12,490)**	(13,319)
Closing net debt	**(11,899)**	(12,490)

31. CHANGES IN NON-CONTROLLING INTERESTS

In August 2018 the Group reduced its holding in its Distribution business, Compañía de Distribución Integral Logista Holdings SA to a holding of 50.01 per cent. This increased non-controlling interests by £142 million. Sales proceeds were €264 million. Net proceeds after fees and costs were £234 million. A net gain of £92 million was recognised in equity attributable to owners of the parent.

32. POST BALANCE SHEET EVENTS

GUARANTEED MINIMUM PENSION EQUALISATION

The IAS 19 DBO does not make any allowance for the impact of Guaranteed Minimum Pension (GMP) equalisation. This issue may have a significant effect on the eventual cost of providing benefits, as well as the accounting results. There is currently too much uncertainty regarding the outcome to make appropriate allowance in the IAS 19 figures, although following the legal judgement of 26 October 2018 in relation to the Lloyds Banking Group case it is likely the Company will need to equalise GMPs. Given the timing of the approval of the Annual Report and Accounts and complexity of the calculation this has meant that it is not possible to estimate the additional liability. However, this will be reviewed during the next financial year, and any impact will be reflected in the DBO.

REIDSVILLE SITE CLOSURE

On 2 November 2018 the Group announced the closure, during 2020, of the Reidsville, North Carolina factory, a cigarette manufacturing facility employing 117 people. Production will be moved to the Greensboro, North Carolina site, lowering manufacturing and regulatory costs, and supporting the Group's strategy to continue to reinvest in its business and grow its brands.

33. RELATED UNDERTAKINGS

In accordance with Section 409 of the Companies Act 2006 a full list of subsidiaries, partnerships, associates, and joint ventures, the principal activity, the full registered address and the effective percentage of equity owned by the Imperial Brands PLC, as at 30 September 2018, are provided in the entity financial statements of Imperial Brands PLC. There are no material related parties other than Group companies.

IMPERIAL BRANDS PLC BALANCE SHEET
at 30 September

£ million	Notes	2018	2017
Fixed assets			
Investments	iii	**7,968**	7,968
Current Assets			
Debtors	iv	**8,017**	8,221
Creditors: amounts falling due within one year	v	**(2)**	(27)
Net current assets		**8,015**	8,194
Total assets less current assets		**15,983**	16,162
Net assets		**15,983**	16,162
Capital and reserves			
Called up share capital	vi	**103**	103
Capital redemption reserve		**4**	4
Share premium account		**5,833**	5,833
Profit and loss account		**10,043**	10,222
Total shareholders' funds		**15,983**	16,162

As permitted by section 408(3) of the Companies Act 2006, the profit and loss account of the Company is not presented.

The financial statements on pages 129-133 were approved by the Board of Directors on 6 November 2018 and signed on its behalf by:

MARK WILLIAMSON
Chairman

OLIVER TANT
Director

IMPERIAL BRANDS PLC STATEMENT OF CHANGES IN EQUITY
for the year ended 30 September

£ million	Share capital	Share premium and capital redemption	Retained earnings	Total equity
At 1 October 2017	**103**	**5,837**	**10,222**	**16,162**
Profit for the year	**–**	**–**	**38**	**38**
Dividends received	**–**	**–**	**1,500**	**1,500**
Total comprehensive income	**–**	**–**	**1,538**	**1,538**
Transactions with owners				
Cancellation of share capital	**–**	**–**	**(41)**	**(41)**
Dividends paid	**–**	**–**	**(1,676)**	**(1,676)**
At 30 September 2018	**103**	**5,837**	**10,043**	**15,983**
At 1 October 2016	104	5,836	11,090	17,030
Profit for the year	–	–	33	33
Dividends received	–	–	746	746
Total comprehensive income	–	–	779	779
Transactions with owners				
Cancellation of share capital	(1)	1	(119)	(119)
Dividends paid	–	–	(1,528)	(1,528)
At 30 September 2017	103	5,837	10,222	16,162

I. ACCOUNTING POLICIES

BASIS OF PREPARATION AND STATEMENT OF COMPLIANCE WITH FRS 101

Imperial Brands PLC (the Company) is the ultimate Parent Company within the Imperial Brands Group (the Group). The Company is publicly listed, incorporated in the United Kingdom, and its principal activity continued to be that of holding investments. The Company does not have any employees. The Directors of the Group manage the Group's risks at a Group level, rather than at an individual entity level. These risks are detailed in note 2 of the Group's Annual Report (see pages 93-94).

These financial statements were prepared in accordance with the Companies Act 2006 as applicable to Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101), FRS 101 and applicable accounting standards.

The financial statements have been prepared on the historical cost basis, and as a going concern. Historical cost is generally based on the fair value of the consideration given in exchange for the assets.

As permitted by section 408(3) of the Companies Act 2006, no separate profit and loss account has been presented for the Company.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available in the preparation of the financial statements, as detailed below:

- Paragraph 38 of IAS 1 'Presentation of financial statements' – comparative information requirements in respect of:
  - (i) paragraph 79(a)(iv) of IAS 1;
  - (ii) paragraph 118(e) of IAS 38 'Intangible assets' – reconciliations between the carrying amount at the beginning and end of the period;
- The following paragraphs of IAS 1 'Presentation of financial statements':
  - (i) 10(d) – statement of cash flows;
  - (ii) 10(f) – a statement of financial position as at the beginning of the preceding period when an entity applied an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements;
  - (iii) 16 – statement of compliance with all IFRS;
  - (iv) 38A – requirement for minimum of two primary statements, including cash flow statements;
  - (v) 38B-D – additional comparative information;
  - (vi) 40A-D – requirements for a third statement of financial position;
  - (vii) 111 – cash flow information; and
  - (viii) 134-136 – capital management disclosures;
- IAS 7 'Statement of cash flows';
- Paragraph 30 and 31 of IAS 8 'Accounting Policies, changes in accounting estimates and errors' – requirement for the disclosure of information when an entity has not applied a new IFRS that has been issued but is not yet effective;
- Paragraph 17 of IAS 24 'Related party disclosures' – key management compensation;
- The requirements in IAS 24 'Related party disclosures' to disclose related party transactions entered into between two or more members of a group;
- IFRS 7 'Financial Instruments: Disclosures'; and
- Paragraphs 91 to 99 of IFRS 13 'Fair value measurement' – disclosure of valuation techniques and inputs used for fair value measurement of assets and liabilities.

The principal accounting policies, which have been applied consistently, are set out below. The Directors do not consider there to be any critical accounting estimates or judgements in respect of the Company, see note 2 Critical Accounting Estimates and Judgements of the consolidated financial statements for further details.

INVESTMENTS

Investments held as fixed assets comprise the Company's investment in subsidiaries and are shown at historic purchase cost less any provision for impairment. Investments are tested for impairment annually to ensure that the carrying value of the investment is supported by their recoverable amount.

DIVIDENDS

Final dividends are recognised as a liability in the period in which the dividends are approved by shareholders, whereas interim dividends are recognised in the period in which the dividends are paid. Dividends receivable are recognised as an asset when they are approved.

FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are recognised when the Company becomes a party to the contractual provisions of the relevant instrument. Financial assets are de-recognised when the rights to receive benefits have expired or been transferred, and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are de-recognised when the obligation is extinguished.

Non-derivative financial assets are classified as loans and receivables. Receivables are initially recognised at fair value and are subsequently stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. A provision for impairment of receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of those receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, and is recognised in the income statement. For interest-bearing assets, the carrying value includes accrued interest receivable.

Non-derivative financial liabilities are classified as loans and payables. Payables are initially recognised at fair value and are subsequently stated at amortised cost using the effective interest method. For borrowings, the carrying value includes accrued interest payable.

Cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments.

TREASURY SHARES

When the Company purchases its own equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity until the shares are reissued or disposed of. When such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, increases shareholders' funds. When such shares are cancelled they are transferred to the capital redemption reserve.

II. DIVIDENDS

DISTRIBUTIONS TO ORDINARY EQUITY HOLDERS

£ million	2018	2017	2016
Paid interim of 56.87 pence per share (2017: 111.21 pence, 2016: 101.1 pence)			
– Paid June 2016	–	–	225
– Paid September 2016	–	–	225
– Paid December 2016	–	–	517
– Paid June 2017	–	247	–
– Paid September 2017	–	247	–
– Paid December 2017	–	567	–
– Paid June 2018	**271**	–	–
– Paid September 2018	**271**	–	–
Interim dividend paid	**542**	1,061	967
Proposed interim of 65.46 pence per share (2017: nil, 2016: nil)			
– To be paid December 2018	**624**	–	–
Interim dividend proposed	**624**	–	–
Proposed final of 65.46 pence per share (2017: 59.51 pence, 2016: 54.1 pence)			
– Paid March 2017	–	–	517
– Paid March 2018	–	567	–
– To be paid March 2019	**624**	–	–
Final dividend	**624**	567	517
Total ordinary share dividends of 187.79 pence per share (2017: 170.72 pence, 2016: 155.2 pence)	**1,790**	1,628	1,484

The third interim dividend for the year ended 30 September 2018 of 65.46 pence per share amounts to a proposed dividend of £624 million, which will be paid in December 2018.

The proposed final dividend for the year ended 30 September 2018 of 65.46 pence per share amounts to a proposed dividend payment of £624 million in March 2019 based on the number of shares ranking for dividend at 30 September 2018, and is subject to shareholder approval. If approved, the total dividend paid in respect of 2018 will be £1,790 million (2017: £1,628 million). The dividend paid during 2018 is £1,676 million (2017: £1,528 million).

III. INVESTMENTS

COST OF SHARES IN IMPERIAL TOBACCO HOLDINGS (2007) LIMITED

£ million	2018	2017
At 1 October	**7,968**	7,968
At 30 September	**7,968**	7,968

The Directors believe that the carrying value of the investments is supported by their underlying net assets.

A list of the subsidiaries of the Company is shown on pages 134-147.

IV. DEBTORS

£ million	2018	2017
Amounts owed from Group undertakings	**8,017**	8,221

Amounts owed from Group undertakings are unsecured, interest bearing, have no fixed date for repayment and are repayable on demand.

V. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

£ million	2018	2017
Cash at bank and in hand	**2**	27

VI. CALLED UP SHARE CAPITAL

£ million	2018	2017
Authorised, issued and fully paid		
1,031,026,084 ordinary shares of 10p each (2017: 1,032,340,000)	**103**	**103**

During the year 1,313,916 shares were repurchased and immediately cancelled, increasing the Capital Redemption reserve.

On 6 March 2014, 31,942,881 shares held in Treasury were cancelled creating the Capital Redemption reserve, and in September 2017, 3,660,000 shares were cancelled increasing this reserve.

VII. RESERVES

As permitted by section 408(3) of the Companies Act 2006, the profit and loss account of the Company is not presented. The profit attributable to shareholders, dealt with in the financial statements of the Company, is £1,538 million (2017: £779 million).

TREASURY SHARES

Shares purchased under the Group's buyback programme represent a deduction from equity shareholders' funds, and are only cancelled if the number of treasury shares approaches 10 percent of issued share capital. During the year the Group purchased 1,313,916 shares at a cost of £41 million (2017: 3,660,000 shares at a cost of £119 million) which were immediately cancelled. Shares held in treasury do not qualify for dividends.

	2018		2017	
£ million unless otherwise indicated shares	**Millions of shares (number)**	**Value**	Millions of shares (number)	Value
At 1 October	**77.3**	**2,183**	77.3	2,183
Purchase of shares	**1.3**	**41**	3.7	119
Cancellation of shares	**(1.3)**	**(41)**	(3.7)	(119)
At 30 September	**77.3**	**2,183**	77.3	2,183
Percentage of issued share capital	**7.5**	**n/a**	7.5	n/a

VIII. GUARANTEES

The Company provides guarantees to a number of subsidiaries under section 479 of the Companies Act 2006, whereby the subsidiaries, incorporated in the UK and Ireland, are exempt from the requirements of the Act relating to the audit of individual accounts for the financial year ending 30 September 2018. See note 1 Accounting Policies of the consolidated financial statements for further details.

The Company has guaranteed various committed and uncommitted borrowings facilities and liabilities of certain UK and overseas undertakings, including Dutch and Irish subsidiaries. As at 30 September 2018, the amount guaranteed is £18,374 million (2017: £16,981 million).

The guarantees include the Dutch subsidiaries, all of which are included in the consolidated financial statements as at 30 September 2018 and which, in accordance with Book 2, Article 403 of The Netherlands Civil Code, do not file separate financial statements with the Chamber of Commerce. Under the same article, the Company has issued declarations to assume any and all liabilities for any and all debts of the Dutch subsidiaries.

Many of the committed borrowing facilities remain undrawn as at 30 September 2018 but the maximum potential exposure under each facility has been included due to the ongoing commitment, only drawn utilised balances have been included for facilities that are uncommitted in nature.

The guarantees also cover the Irish subsidiaries, all of which are included in the consolidated financial statements as at 30 September 2018. The Irish companies, namely John Player & Sons Limited and Imperial Tobacco Mullingar, have therefore availed themselves of the exemption provided by section 17 of the Irish Companies (Amendment) Act 1986 in respect of documents required to be attached to the annual returns for such companies.

The Company has also provided a parent guarantee to the Imperial Tobacco Pension Trustees Ltd, the main UK pension scheme.

The Directors have assessed the fair value of the above guarantees and do not consider them to be material. They have therefore not been recognised on the balance sheet.

IX. RELATED PARY DISCLOSURES

Details of Directors' emoluments and interests are provided within the Directors' Remuneration Report. The Directors Remuneration Report, on pages 56-75 includes details on salary, benefits, pension and share plans. These disclosures form part of the financial statements.