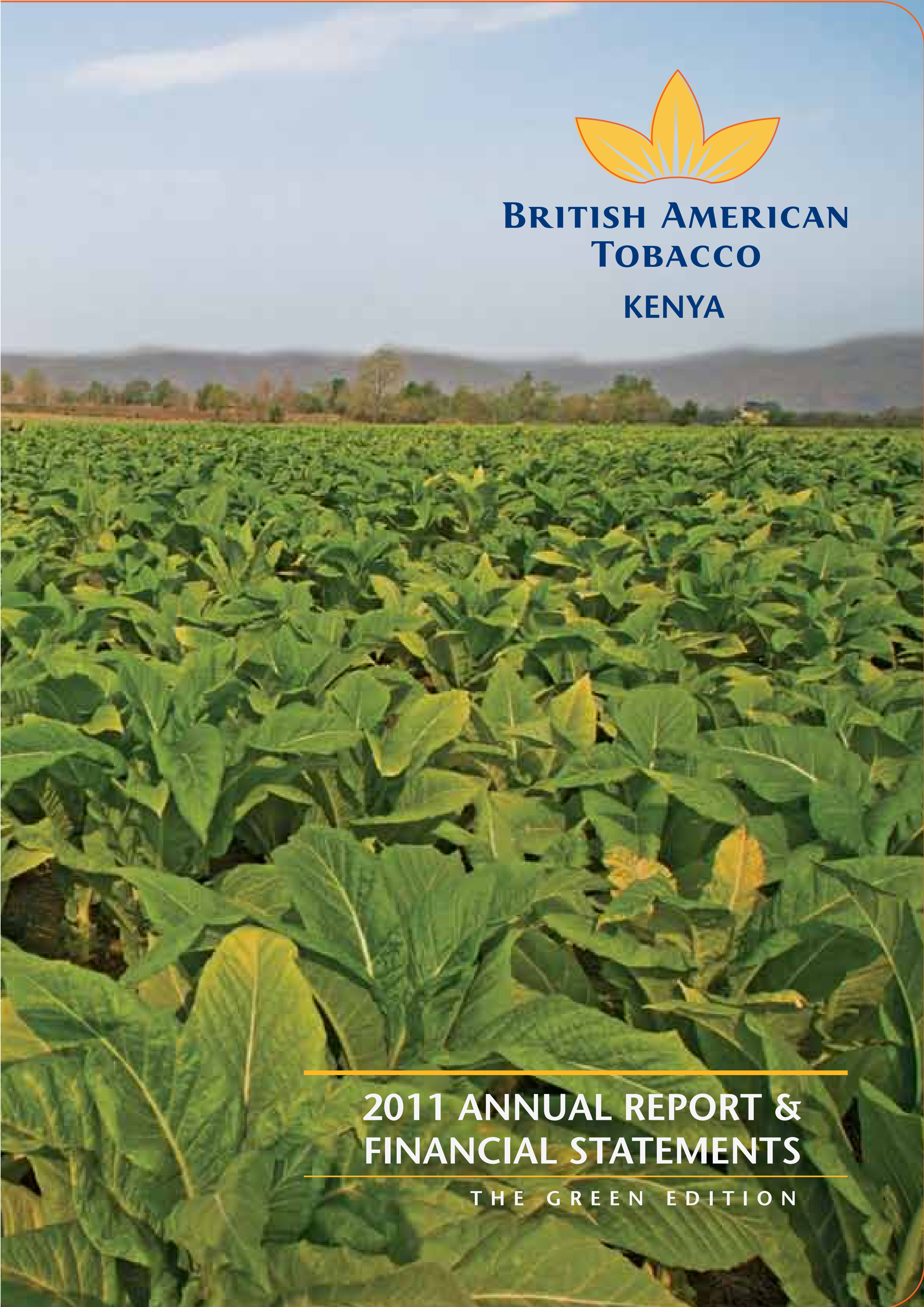


# British American Tobacco
## Kenya

# 2011 Annual Report & Financial Statements

The Green Edition



BRITISH AMERICAN TOBACCO

KENYA

*'The innovators that changed the world, were inspired by the smallest things'*



*Cover Image: Wanyila Farmers Cell Group, Kitabisi Extension Area, Malakisi 18th January 2012.*



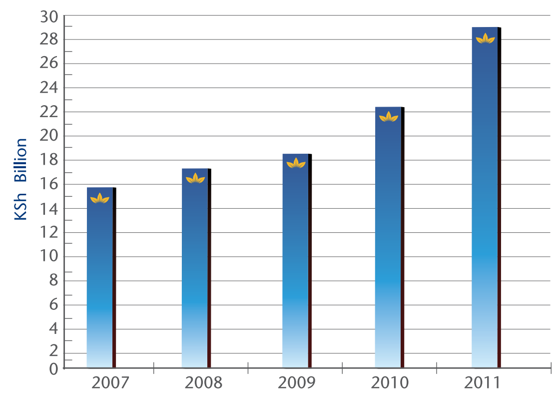
# CONTENTS

*'Together we succeed'*

GROWTH
BAT Kenya will continue to strengthen its distribution through increasing focus on the retail trade as we sharpen our focus on our consumers as part of our sustainable growth strategy.

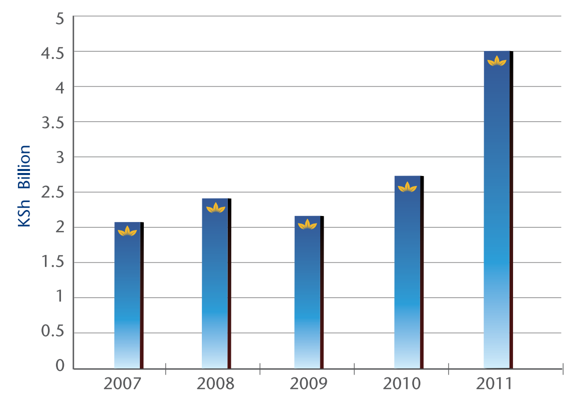

# HIGHLIGHTS

## Gross Turnover



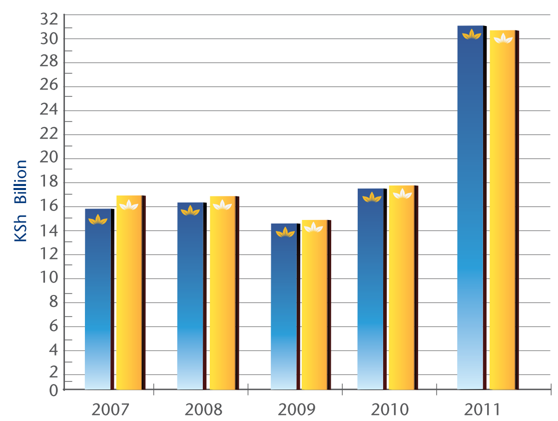

Gross Turnover increased by 27% in 2011 to Kshs 28.8 billion

## Profit Before Income Tax



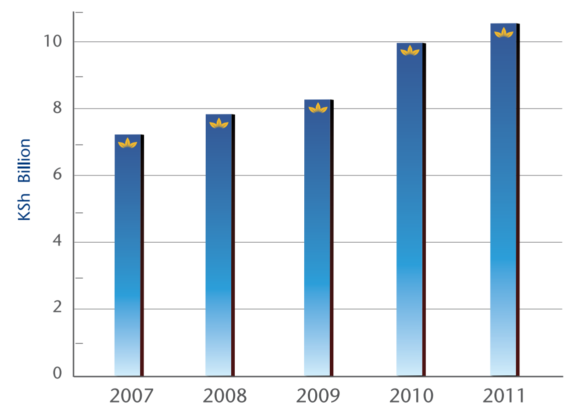

Profit Before Income Tax Increased by 65% to Kshs 4.5 billion

## Earnings/Dividend per share




Dividend per Share Increased by 74.3% in 2011

## Contribution to Government Revenue




Contribution to Government Revenues reached a record Kshs 10.5 billion in 2011

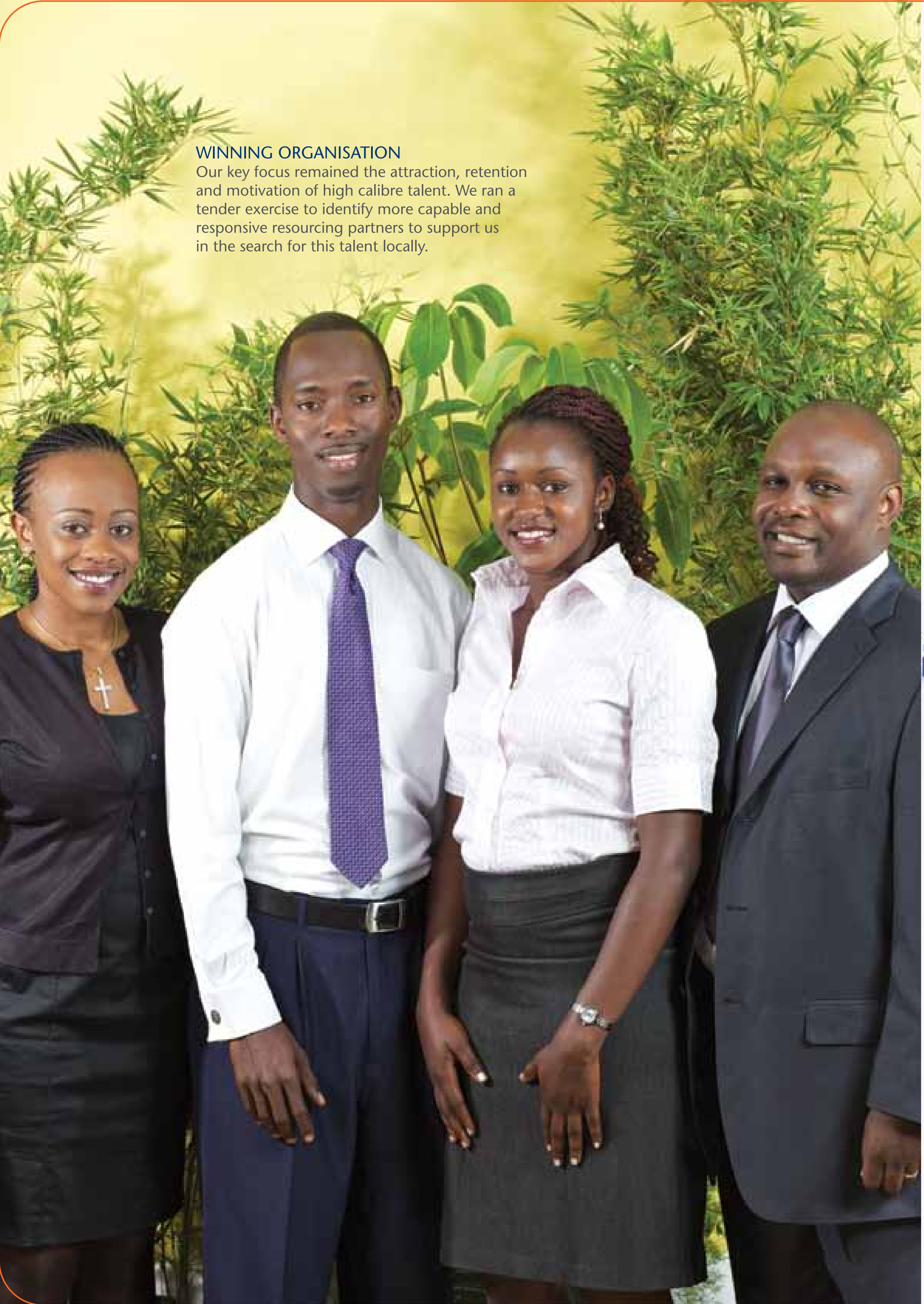
Key
Earnings per Share
Dividend per Share

## PRODUCTIVITY

Through prioritising factory needs, we were able to maintain agility in production, ensuring that our brands were manufactured at optimal periods each month. This enabled us to reduce complexity in the factory and increase productivity.

## RESPONSIBILITY

We are working with other like-minded and interested stakeholders to ensure that our regulatory strategies and proposals make sense not only for Kenya "here and now,"- but also for our evolving position as a leading corporate in East and Central Africa.



## WINNING ORGANISATION

Our key focus remained the attraction, retention and motivation of high calibre talent. We ran a tender exercise to identify more capable and responsive resourcing partners to support us in the search for this talent locally.



# HIGHLIGHTS

*"Leadership is the capacity to translate vision into reality"*

*'Our diversity is our strength'*

# BOARD OF DIRECTORS' PROFILES


1 **Mr. E. Mwaniki (age 73)**
*Non-Executive Chairman*
Appointed to the Board as Non-Executive Director of the Company in April 1995. He has been the Non-Executive Chairman of the Company since November 1995. He has vast business knowledge and worked for several blue-chip companies both locally and internationally. He is the Non-Executive Chairman of Kenya Airways Limited and also sits on the Boards of East African Breweries Limited, East African Packaging Industries Limited and Lion of Kenya Insurance Company Limited.

2 **Ms. C. Musyoka (age 39)**
*Non-Executive Director*
Appointed to the Board in February 2011. She is a Lawyer by profession. She was previously Executive Director and Chief Operating Officer of K-Rep Bank, Kenya's first microfinance institution. Prior to this, she was a Board member and Corporate Director of Barclays Bank Kenya. She currently provides consulting and training services for various local and international commercial banks and insurance companies and is also a popular weekly columnist on the Business Daily newspaper. She holds directorships in Transcentury Limited, SOS Childrens' Villages and Alliance Capital Partners.

3 **Mr. A.N. Ngugi (age 74)**
*Non-Executive Director*
Appointed to the Board in April 2000. He has over 30 years experience in the corporate sector, having worked in various organisations in Kenya. He is a former CEO of Kenya Association of Manufacturers and former Chairman of BOC Kenya Limited. He currently sits on the Board of the Kenindia Insurance Company and Githaka Limited.

4 **Mr. G.R. May (age 69)**
*Non-Executive Director*
Appointed to the Board in September 2005. He has a rich accounting background and is a Fellow of the Institute of Chartered Accountants in England and Wales. He has worked in various countries and has a history of 37 years with PricewaterhouseCoopers. He is currently the Regional Representative of the Eastern Africa Association. He holds directorships in Groove Limited, Airside Limited (Swissport Kenya), Heritage Insurance Company Limited, CFC Stanbic Bank Limited, CFC Stanbic Holdings Limited, CFC Financial Services Limited, and CFC Life Assurance Company Limited.

5 **Mr. M.M. Wanyoike (age 61)**
*Non-Executive Director*
Appointed to the Board in January 2001. He worked in different roles within the Company in Kenya and the East African Region, culminating in his appointment as Human Resources Director. Upon retiring from full time employment with the Company in December 2000, he took up Human Relations consultancy. He currently sits on the Board of Professional Clean Care Limited, Micos Drycleaners and Laundry Limited and Uwezo DTM Limited.

6 **Mr. G. Fagan (age 49)**
*Managing Director*
Appointed to the Board in September 2008. Prior to his appointment, he was the General Manager of BAT Southern African Markets. He began his career with BAT 21 years ago in Marketing and has filled various senior management roles within BAT Africa and Middle East region over the years. Also, he is currently the Area Director for BAT East and Central Africa Area based in Nairobi.

7 **Prof. J.H. Kimura (age 67)**
*Non-Executive Director*
Appointed to the Board in July 2001. He is an accountant by profession and is currently the Chairman for Higher Education Loans Board. He is a member of the Board of Directors of UAP Provincial Insurance Company Limited, Development Bank of Kenya Limited, and the Chairman of Phoenix Publishers Limited.He is also a member of the Revenue Allocation Commission set up in 2011 by the Government of Kenya.

10 **Ms. R. T. Ngobi (age 51)**
*Company Secretary*
Appointed Company Secretary in August 2002. Ruth was educated in both Kenya and the UK and qualified as a lawyer in 1985. She previously worked with Unilever Kenya Limited for 15 years as Company Secretary with responsibilities for legal support and services to Unilever's operations in Kenya, Uganda, Tanzania and Ethiopia. She was Area Legal Counsel for BAT East and Central Africa Area until June 2010, when she retired from full time employment with the Company but retained her role as Company Secretary.

9 **Mr. P. Lopokoiyit (age 45)**
*Finance Director*
Appointed to the Board in November 2010. He has extensive experience in financial management and served in senior management over the last ten years as Head of Finance in various BAT Business units. He was the BAT West Africa Area Finance Director based in Lagos, Nigeria before his new appointment. Philip is a member of ICPAK, a Fellow Member of the Institute of Chartered Accountants of England and Wales and holds an MBA from Warwick Business School.

8 **Mr. G. Maina (age 60)**
*Non-Executive Director*
Appointed to the Board in November 2010. He is an engineer by profession. He worked with the Shell Group of Companies for 26 years during which time he served in senior management in Kenya, Jamaica and Ghana. In 1998, he was appointed Managing Director of Kenya Shell and BP Kenya Ltd before leaving corporate employment to pursue private business in 2004. He holds directorships in NIC Bank, Insurance Company of East Africa, Afrika Investment Bank, Faulu Kenya Limited and Nairobi Stock Exchange. He is also a Trustee of Starehe Boys Centre, Africa Conservation Centre and Gertrude Gardens Children's Hospital.

# THE EAST & CENTRAL AFRICA LEADERSHIP TEAM (ECALT)

ANNUAL REPORT & FINANCIAL STATEMENTS 2011

1. **Wellingtone Masasabi** - *Head of Information Technology (IT)*
2. **Arturo Rodriguez** - *Demand Chain General Manager*
3. **Allan Wainaina** - *Head of Strategy & Planning*
4. **Philip Lopokoiyit** - *Finance Director*
5. **Gary Fagan** - *Managing Director*
6. **Wael Atari** - *Head of Marketing*
7. **Joe Muganda** - *Head of Corporate & Regulatory Affairs*
8. **Keith Gretton** - *General Manager East African Markets*
9. **Naushad Ramoly** - *Legal Counsel*
10. **Jonathan D'Souza** - *Head of Human Resources (HR)*

*"If everyone thinks the same, then none of us is thinking"*

*‘ We aim above the mark ’*




# Notice of the 2012 Annual General Meeting

NOTICE IS HEREBY GIVEN that the Fifty-Ninth Annual General Meeting of British American Tobacco Kenya Limited will be held in the Ball Room, Hotel Intercontinental, Nairobi, on 26th April 2012, at 11:00 a.m. for the following purposes:-

Ordinary Business

1. To receive, consider and if approved, adopt the Company’s audited financial statements for the year ended 31 December 2011, together with the reports of the Chairman, Directors and Auditors thereon.

2. To declare a dividend.

3. To elect Directors:s

(i) Ms. C. Musyoka retires and being eligible offers herself for re-election in accordance with Article 95 of the Articles of Association.

(ii) Prof. J. Kimura retires by rotation and being eligible, offers himself for re-election in accordance with Article 89 of the Articles of Association.

(iii) Mr. A. Ngugi having attained the age of 70 on 23 July 2007 retires in terms of section 186(2) of the Companies Act and being eligible by virtue of a Special Notice given under section 186 (5) offers himself for re-election.

(iii) Mr. E. Mwaniki having attained the age of 70 on 18 November 2008 retires in terms of section 186(2) of the Companies Act and being eligible by virtue of a Special Notice given under section 186 (5) offers himself for re-election.

4. To authorise the Directors to fix the remuneration of the Auditors, PricewaterhouseCoopers.

By Order of the Board

**R. T. Ngobi (Ms.)**
Company Secretary
P.O. Box 30000-00100
Likoni Road, Nairobi.

**23 February 2012**

NOTES:

1. Any Member who is entitled to attend and vote at the Annual General Meeting is entitled to appoint a proxy to attend and vote in his stead. Such proxy need not be a member of the Company.

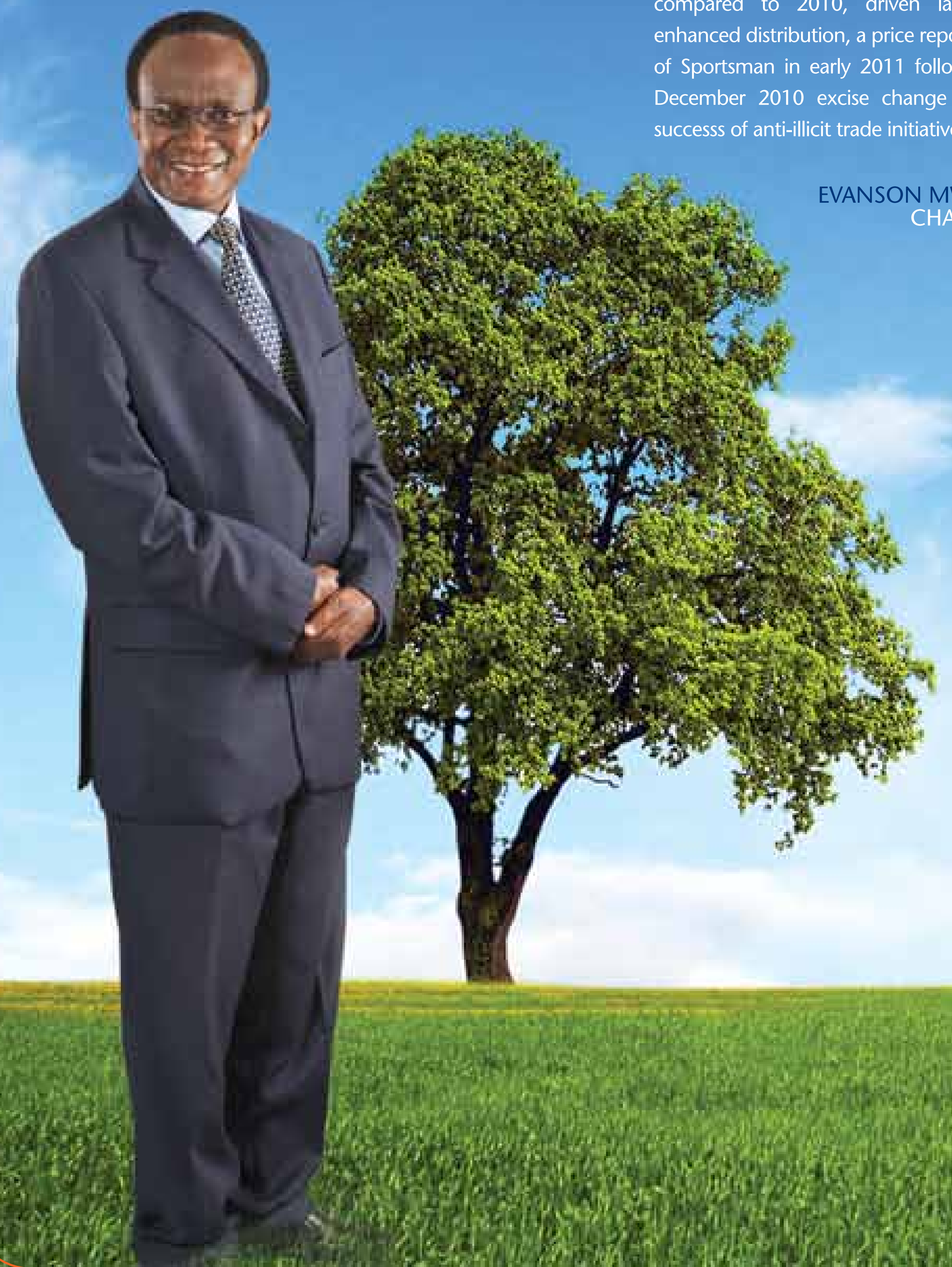
2. A proxy form is provided with this report. Shareholders who do not propose to be at the Annual General Meeting are requested to complete and return the form to the Registered Office of the Company so as to arrive not later than 2:30 p.m. on 25 April 2012.

# CHAIRMAN'S STATEMENT

*"The price of greatness is responsibility"*

"Despite the overall decline in industry volumes, BAT Kenya registered a notable 12 per cent growth in domestic volume compared to 2010, driven largely by enhanced distribution, a price repositioning of Sportsman in early 2011 following the December 2010 excise change and the successs of anti-illicit trade initiatives."

EVANSON MWANIKI
CHAIRMAN



ANNUAL REPORT & FINANCIAL STATEMENTS 2011

## Macro-Economic Environment

The Kenyan economy recorded a real growth rate of 4.3 per cent against the 6 per cent that had been estimated at the start of the year. This was a result of high import prices for food and fuel, which drove high inflation and contributed to the sustained weakening of the shilling for much of 2011. At the close of the year, inflation for the year stood at 18.9 per cent, up from below 5 per cent in December 2010.

Exchange rates remained stable in the first half of the year, but the shilling weakened considerably against major international currencies in the second half of 2011 and reached its lowest level against the US Dollar in a decade. Interventions by Central Bank to stabilise the weakening shilling and curb inflation bore fruit towards the end of the year as the Central Bank rate was adjusted to 16.5 per cent in November 2011, up from 7 per cent in January. The Shilling has since appreciated to stand at Kshs 83 to the dollar in March 2012 and inflation declined to 16.7 per cent in February 2012.

The main drivers behind 2011's economic growth were industry and agriculture. The industrial sector expanded by 7.6 per cent in 2011 while the agricultural sector delivered an unexpectedly strong performance in the first half of the year, registering an overall growth of 5 per cent in 2011. The tourism sector also contributed significantly to economic growth in 2011 as arrivals rose by 16 per cent between January and October. The services industry recorded a small but noteworthy growth of 4 per cent during the year.

The private sector experienced some challenges in the implementation of the East African Community (EAC) Common Market Protocol. Policy and operational bottlenecks hindered optimal realisation of the potential commercial benefits within the common market area.

## Socio – Political Environment

Implementation of the new constitution got off to a promising start in 2011 with evidence of enhanced transparency and accountability in government processes, indicating the government's commitment to improving governance and promoting a stable business environment.

Kenyan Defence Forces entered Somalia in pursuit of the Somali militant group, Al Shabaab, following a number of tourist kidnappings which threatened the stability of the tourism sector.

In early 2012, the International Criminal Court (ICC) confirmed charges against four suspected perpetrators of the 2008 post-election violence. This announcement came after more than a year since the original list of suspects was unveiled.

## Regulatory Environment

### *Excise*

A new excise system was introduced in June 2011. The previous four tier Retail Selling Price (RSP) based system was replaced with a hybrid system of the higher of Kshs 1,200/mille or 35 per cent of RSP. BAT Kenya welcomed this reform as the new system will maintain industry value for legitimate market players whilst providing reasonable and sustainable revenue for government.

### *Contribution to Government Revenues*

The Company's remittances to the Exchequer in the form of excise duty, VAT and corporate tax in 2011 amounted to a record Kshs 10.5 billion. The Kenya Revenue Authority (KRA) for the fifth consecutive year bestowed the Overall Distinguished Taxpayer Award 2011 upon BAT Kenya, ranking the Company as the fourth largest taxpayer in the country. The KRA further commended BAT Kenya for its cooperation with revenue officers, voluntary compliance with tax legislation, accuracy in tax computations and timeliness in remitting taxes due.

### *Tobacco Control Act, 2007*

No new tobacco regulations were introduced in 2011. In November 2011 the Ministry of Public Health and Sanitation was instructed to draft a tobacco control policy and review the Tobacco Control Act, 2007 (TCA), highlighting opportunities for amendments to introduce clarity and support more balanced enforcement of the statute. We are optimistic that this will simplify adherence to the law.

### *Illicit Trade*

In 2011, the Company continued to collaborate with the Kenya Police, the Kenya Revenue Authority and the Anti-Counterfeit Agency to improve interventions against anti-illicit trade. Kenyan authorities carried out a successful raid on a counterfeiting syndicate that led to the shutting down of a 1 billion stick capacity factory and issuing of arrest warrants for the directors of the company.

# CHAIRMAN'S STATEMENT *(Continued)*

## Company Performance
Domestic industry volume dropped by 1 per cent compared to 2010. This decline is attributable to the reduction in disposable income arising from the aforementioned inflationary pressures.

Despite the overall decline in industry volumes, BAT Kenya registered a notable 12 per cent growth in domestic volume as compared to 2010, driven largely by enhanced distribution, a price repositioning of Sportsman in early 2011 following the December 2010 excise change and the success of anti-illicit trade initiatives. Domestic market share grew by 2 per cent in the same period while finished goods export volumes grew by 15 per cent as compared to 2010. The Company benefited from the first full year export of cut rag (semi-processed) tobacco to Egypt, which generated Kshs 4.8 billion of the overall Kshs 11.3 billion in exports turnover in 2011.

Domestic volume growth and higher exports resulted in a 49 per cent growth in revenue in 2011 to Kshs 20 billion. Pre-tax profit in the same period rose to Kshs 4.5 billion, up 65 per cent from 2010.

BAT Kenya was named 'Best Employer' by the Institute of Human Resource Management at the inaugural Human Resource (HR) Index Awards. This award is a testament to the positive impact of the various interventions and activities effected by the Company's management following the 2010 "Your Voice" organizational climate survey. The Company was also commended for its diligent efforts in providing green solutions in energy management during the Kenya Association of Manufacturers Energy Management Awards. During the auspicious celebration of excellence in energy management BAT Kenya received two commendations, Runners up for the 'Overall Energy Award' and runners up for the 'Best Energy Management Team' Award.

## Dividend
The directors recommend a final dividend of Kshs 27 per ordinary share which when added to the interim dividend of Kshs 3.50 per ordinary share paid out during the year brings total dividends to Kshs 30.50. The total dividend per ordinary share for 2011 is the largest ever declared in the history of BAT Kenya. The dividend will be payable on the 26th of April 2012 to shareholders on the share register as at close of business on the 23rd of March 2012. The dividend shall be subject to the deduction of withholding tax where applicable.

## Directors
Ms. Carol Musyoka was appointed to the Board in February 2011. She has vast knowledge and experience in the banking sector and has served as director in several other Kenyan companies. I am pleased to welcome Ms. Musyoka to the BAT Kenya Board.

Mr. Dirk Eloff resigned from the Board in February 2011 and he continues to serve within the BAT Group.

Messrs. John Dowd and Martin Oduor-Otieno resigned from the Board in March 2011 and May 2011 respectively.

I take this opportunity to thank Messrs. Eloff, Dowd and Oduor-Otieno for their invaluable contribution while serving on the BAT Kenya Board, and wish them the best in their future endeavours.

## Outlook
*Economic Growth*

The EAC has embarked on addressing the policy and operational bottlenecks experienced to-date with the implementation of the common market protocol. Addressing these bottlenecks will further open up regional trade and permit the realisation of optimal commercial benefits from the common trade area. BAT Kenya will in 2012 work to fully exploit the development opportunities which emerge as the EAC addresses the aforementioned implementation challenges.

Global food and fuel prices are on the decline and the Kenya Shilling is expected to remain stable against major international currencies. A tight monetary policy by the Central Bank is expected to reduce core inflation in 2012. The pricing pressure on private companies and the erosion of consumer incomes are expected to ease and the World Bank estimates a GDP growth rate of 5 per cent for 2012. Agriculture is expected to contribute significantly towards this growth with good harvests anticipated in 2012, implying lower food prices and enhanced food security which will further reduce the need for food imports.

The construction industry is also expected to contribute significantly to economic growth in 2012 as the road network continues to expand through heavy government investment towards the actualisation of Vision 2030. Further, the Information Communications and Technology sector is expected to expand significantly in 2012 and beyond. Overall infrastructure improvements will drive economic growth in 2012 by according the private sector the opportunity to realise enhanced efficiencies in their operations.

*Political Environment and Governance*

We urge the government to continue to develop and implement progressive economic policies. This will enable the private sector to realise optimal growth and thereby further contribute to government revenues and national economic growth. Stabilising the economic environment by enhancing export competitiveness, which would shield the national economy from external exchange rate shocks, will further support growth of the private sector. We also call upon the government to put in place measures to enhance food security in 2012. We believe that the combined effect of strong progressive economic policies, greater export competitiveness and improved food security will further national economic growth in the future.

The forthcoming general elections and the commencement of the ICC trials of the 2008 post-election violence suspects pose a potential threat to political stability, but we trust that measures will be put in place to mitigate this risk.

*Tobacco Regulation*

In 2012 we will maintain diligent dialogue with government and relevant stakeholders on regulatory matters affecting the Company' operating environment. We will continue to pursue further excise reforms to protect our commercial interests while maintaining government revenue growth. Furthermore, we will maintain our partnership with the regulatory authorities to curtail the growth in illicit trade. We will also work with the government to ensure that Kenya develops a coherent country position ahead of the Framework Convention on Tobacco Control (FCTC) in South Korea in November 2012.

## Conclusion
Maintaining the growth momentum from 2011 into 2012 will be challenging in view of heightened political risks, lingering impact of high inflation and tight monetary policy on economic growth and the changing regulatory landscape. However, we are confident we have the right strategy in place to deliver growth and enhance shareholder value in 2012 and beyond. Focus will be placed on continuing to grow market share, expanding manufacturing capacity and improving productivity and operating margin while maintaining strong advocacy for stability of the excise policy which is crucial for both the industry and the government.

I acknowledge with appreciation the support received from my Board colleagues, the dedication and diligence of the management and staff of BAT Kenya and the support of our tobacco farmers, business partners and consumers for their unrelenting contribution to the strength and sustainability of our business.

**Evanson Mwaniki**
Chairman

ANNUAL REPORT & FINANCIAL STATEMENTS 2011

# MUHTASARI WA KIUCHUMI

*Akiba haiozi*

"Licha kupungua kwa jumla ya viwango vya uzalishaji kwenye sekta hii, BAT Kenya ilisajili asilimia 12 ya ukuaji katika mapato ya uzalishaji wa biashara kwenye masoko ya humu nchini ikilinganishwa na mwaka wa 2010. Uthabiti huo ulisababishwa na kuimarika kwa njia na mbinu za usambazaji bidhaa, mabadiliko ya bei ya sigara ya Sportsman katika kipindi cha mwanzo cha mwaka wa 2011, kwa kufuatia mabadiliko ya ulipaji ushuru ya mwezi Desemba 2010 na hali kadhalika kufaulu kwa miradi ya mapambano dhidi ya biashara haramu ya bidhaa zetu."

EVANSON MWANIKI
MWENYEKITI

*Governors' Camp, Maasai Mara, 17th January 2012.*

ANNUAL REPORT & FINANCIAL STATEMENTS 2011

## Mazingira ya Kibiashara

Uchumi wa Kenya umekua kwa kiwango cha asilimia 4.3 dhidi ya asilimia 6 ambayo ilitazamiwa kufikiwa mwanzoni wa mwaka huu. Hali hii ilitokana na kuongezeka kwa bei ya vyakula na mafuta hususan katika gharama za uingizaji wa bidhaa hizo nchini. Mazingira haya, yalisababisha mfumko wa bei ya bidhaa mbali mbali na kudhoofisha thamani ya shilingi ya Kenya katika mwaka wa 2011. Mwishoni mwa mwaka huo, mfumko wa bei za bidhaa ulifikia asilimia 18.9, kutoka asilimia 5 iliyokuwa mnamo mwezi Desemba, 2010.

Viwango vya Ubadilishanaji wa fedha vilibakia imara katika kipindi cha kwanza cha nusu-mwaka, kisha katika kipindi cha pili cha mwaka wa 2011, thamani ya shilingi ya Kenya ilidorora dhidi ya sarafu nyingi za kimataifa hadi kufikia kiwango cha chini kwenye kipindi cha miaka kumi dhidi ya Dola ya Marekani. Benki Kuu ya Kenya ililazimika kuingilia kati ili kusaidia kuinua thamani ya shilingi ya Kenya na kadhalika kuzuia mfumko wa bei za bidhaa. Hatua hiyo ya Benki Kuu ilisaidia pakubwa kwani kufikia mwisho wa mwaka huo, kiwango cha riba kilithibitiwa hadi kufikia asilimia 16.5 kwenye mwezi wa Novemba mwaka wa 2011, ukilinganisha na asilimia 7 iliyokuwepo mwezi Januari mwaka huo huo. Hata hivyo, thamani ya shilingi ilipanda hadi kufikia shilingi 83 dhidi ta Dola mnamo mwezi wa Machi 2012 na kusababisha kupungua kwa mfumko wa bei za bidhaa hadi asilimia 16.7 katika mwezi wa Februari, mwaka wa 2012.

Nguzo muhimu za kukua kwa uchumikatika mwaka wa 2011 zilikuwa ni viwanda na kilimo. Sekta ya Viwanda ilikua kwa asilimia 7.6 kwenye mwaka wa 2011, huku sekta ya Kilimo ikiimarika katika nusu ya kwanza ya mwaka na kuwa na matokeo ya jumla ya asilimia 5 mnamo mwaka wa 2011. Sekta ya Utalii ilichangia pakubwa katika kipato cha uchumi wa nchi katika mwaka wa 2011, huku wageni kutoka nje wakiongezeka kwa asilimia 16 kati ya Januari na Oktoba. Kadhalika, Sekta ya utoaji huduma ilizalisha kwa kiwango wastani cha asilimia 4 mnamo mwaka huo.

Sekta ya Kibinafsi nayo ilikumbwa na changamoto kubwa katika utekelezaji wa Sheria ya Itifaki ya Kibiashara ya Soko Huru la Jumuiya ya Afrika Mashariki. Mgongano wa Sera za Utendakazi uliletakizungumkuti na kusababisha kutokuwepo kwa maafikiano ya faida za mapato ya kibiashara katika masoko na kwenye mipaka ya Jumuiya hiyo.

## Mazingira ya Siasa-Jamii

Kupatikana na utekelezaji wa Katiba Mpya ulipokelewa vyema mnamo mwaka wa 2011, hii ikiwa ni ishara nzuri kwa Serikali kuthibisha kwamba pana uwezekano wa kuwepo kwa uwazi na uwajibikaji katika utendakazi wa taratibu za Kiserikali, na hali kadhalika ishara ya serikali kuboresha na kutangaza kuwepo kwa mazingira thabiti kufanyia biashara.

Jeshi la Kenya liliingia nchini Somalia ili kukabiliana na wanamgambo wa kundi la Al-Shabab, hii ni baada ya visa vya kutekwa nyara kwa watalii wengi, hali iliyotishia kuimarika kwa sekta ya utalii nchini.

Mwanzoni mwa mwaka wa 2012, Mahakama ya "International Criminal Court (ICC)", ilithibitisha mashtaka ya washukiwa wanne wa ghasia za baada ya uchaguzi zilizotokea mwaka wa 2008. Hukumu hii ilifanyika mwaka mmoja baada ya orodha asilia ya washukiwa ilipotangazwa.

## Mazingira ya Kiusimamizi

### *Mfumo Mpya wa Matozo*

Mfumo mpya wa matozo ulianzishwa mwezi wa Juni, 2011. Mfumo wa awali wa 'Retail Selling Price (RSP)' ulibadilishwa na kuletwa mwingine wenye ubora zaidi wa Kshs 1,200 kwa 'mille' ama asilimia 35 ya 'RSP'. Kampuni ya BAT Kenya inayakubali mabadiliko hayo kwani mfumo huu mpya utaleta thamani kuu kwa washikadau halisi huku ikilipa ushuru unaofaa kwa serikali.

### *Mchango wetu kwa Mapato ya Serikali*

Mchango wa Kampuni hii kwa Serikali kwa njia ya ushuru wa bidhaa, Ushuru wa Mapato na Ushuru wa Kiushirika katika mwaka wa 2011 ulifikia Shilingi Bilioni 10.5. Halmashauri ya Mapato na Ushuru ya Kenya (KRA) kwa mwaka wa tano mfululizo walituzawadia (BAT Kenya) tuzo la moja ya kampuni walipaji ushuru bora linalofahamika kama 'Overall Distinguished Taxpayer Award 2011'. Kadhalika, BAT Kenya iliorodheshwa kama kampuni bora ya nne katika ulipaji ushuru nchini Kenya. Hali kadhalika, Halmashauri ya KRA ilipongeza BAT Kenya kwa ushirikiano wake na maafisa wake wa ushuru, kujitolea kuwajibikia sheria za ushuru, umakini katika uwasilishaji wake wa ushuru na kuzingatia muda uliowekwa wa uwasilishaji wa matozo ya ushuru unaofaa kulipa.

### *Sheria ya Kuthibiti Tumbaku, 2007*

Hakuna sheria mpya ya tumbaku iliyoanzishwa mwaka wa 2011. Mnamo mwezi Novemba 2011, Wizara ya Afya ya Umma na Usafi iliagizwa kuandaa mswada wa sera ya kuthibiti matumizi yaTumbaku na kuhakiki Sheria ya Kuthibiti Tumbaku, 2007 (TCA), kwa kuweka wazi nafasi za marekebisho yatakayoleta uwazi na kuunga mkono njia nzuri ya sheria hiyo isiyoegemea upande wowote. Tuna matumaini kwamba hii itakuwa nafasi nzuri ya kufuata sheria.

### *Biashara Haramu*

Katika mwaka wa 2011, Kikosi cha Kampuni hii Kinachohusika na Mapambano dhidi ya Biashara Haramu kiliendelea kushirikiana na Idara ya Polisi, Halmashauri ya Mapato na Ushuru na hali kadhalika Shirika la Uwakala linalopambana na Bidhaa Bandia na Ghushi. Hatua hii ilikuwa na lengo la kuimarisha mapambano dhidi ya biashara haramu ya bidhaa bandia na ghushi. Halmashauri husika za Kenya ziliandaa msako mkali na kufaulu kupata baadhi ya makundi ya wahalifu yanaohusika na uuzaji wa bidhaa bandia na ghushi. Makundi hayo yalipelekea

# MUHTASARI WA KIUCHUMI

kufungwa kwa kiwanda chao cha thamani ya shilingi Bilioni 1, na hatimaye mawakala hao kutoa maagizo ya wakurugenzi wakuu wa kiwanda hicho kutiwa mbaroni.

*Utendakazi wa Kampuni*
Utendakazi na uzalishaji wa Viwanda vya humu nchini ulipungua kwa asilimia 1, ikilinganishwa na matokeo ya mwaka wa 2010. Upungufu huo ulisababishwa na kuzoroteka kwa kutowepo kwa pesa taslimu za utendakazi. Hali iliyotokana na shinikizo la mfumko wa bei za bidhaa. Licha kupungua kwa jumla ya viwango vya uzalishaji kwenye sekta hii, BAT Kenya ilisajili asilimia 12 ya ukuaji katika mapato ya uzalishaji wa biashara kwenye masoko ya humu nchini ikilinganishwa na mwaka wa 2010. Uthabiti huo ulisababishwa na kuimarika kwa njia na mbinu za usambazaji bidhaa, mabadiliko ya bei ya sigara ya Sportsman katika kipindi cha mwanzo cha mwaka wa 2011, kufuatia mabadiliko ya ulipaji ushuru ya mwezi Desemba 2010 na hali kadhalika kufaulu kwa miradi ya mapambano dhidi ya biashara haramu ya bidhaa zetu. Mgao wa soko la humu nchini ulikua kwa asilimia 2 katika kipindi hicho hicho cha mwaka huku mapato ya bidhaa za kuuzwa ng'ambo yalikua kwa asilimia 15 ikilinganishwa na mwaka wa 2010. Kampuni hii ilifaidika katika nusu ya kwanza ya mwaka kutokana na usafirishaji wa ugoro hadi taifa la Misri, na kimsingi biashara hii ilizalisha Shilingi Bilioni 4.8 ya kiwango cha jumla cha shilingi Bilioni 11.3 kwenye maduhuli ya mapato yote ya mwaka wa 2011.

Ukuaji wa kiwango kikubwa cha biashara ya humu nchini ulikuwa ni asilimia 49 mnamo 2011 na kufikia shilingi 4.5 Bilioni kutoka asilimia 65 kutokea 2010.

BAT Kenya ilitawazwa kuwa 'Muajiri Bora' na Taasisi ya Usimamizi wa Masuala ya Wafanyikazi katika uzinduzi wa tuzo za Usimamizi wa Wafanyikazi. Tuzo hizo ni ushahidi tosha wamiradi mbali mbali iliyoendeshwa na wahusika wakuu wa Kampuni kufuatia utafitiwa kimazingira na kauli mbiu iliyowekwa mnamo mwaka wa 2010 ya "Sauti Yako" yaani "Your Voice". Kadhalika Kampuni hii ilipongezwa pia kwa kutoa suluhu za usimamizi wa kawi wakati wa maadhimisho ya Tuzo za Usimamizi wa Kawi za Shirika la Kiviwanda la Kenya (KAM). Katika maadhimisho hayo, kampuni ya BAT Kenya ilipokezwa matuzo mawili ya ubora. Matuzo hayo yakiwa ni: Nambari ya Pili ya "Tuzo Bora la Kawi" na nambari ya Pili ya "Tuzo la Kikosi Bora cha Usimamizi wa Maswala ya Kawi".

**Mgao wa Hisa**
Wakurugenzi wanapendekeza mgao wa mwisho wa hisa wa Kshs 27 kwa kila hisa ya kawaida ambao ukiongezwa katika mgao wa hisa wa muda maalum wa Kshs 3.50 kwa hisa ya kawaida iliyolipwa mwaka huo, utafikisha kiwango cha mgao wa mwisho wa hisa kuwa kshs 30.50. Mgao wa jumla kwa kila hisa ya kawaida wa mwaka wa 2011 ndio utakaokuwa mkubwa zaidi kuwahi kutangazwa katika historia ya kampuni ya BAT Kenya. Mgao huo utalipwa kufikia tarehe 26 ya Mwezi Aprili mwaka wa 2012 kwa wanahisa wote walioko kwenye sajili ya wanahisa, kufikia mwisho wa siku ya tarehe 23 Machi 2012. Malipo ya mgao huo, yatatozwa ushuru wa hifadhi (withholding tax) kila inapofaa.

**Wakurugenzi Wakuu**
Bi. Carol Musyoka aliteuliwa kwa Bodi mnamo Februari 2011. Ana utaalamu na tajriba kubwa kutoka kwa sekta ya benki na amehudumu kama mkurugenzi katika kampuni nyingi za humu nchini. Nina furaha ya kumkaribisha kwa dhati Bi. Musyoka kwenye Bodi Kuu ya BAT Kenya.

Bw. Dirk Eloff alijiuzulu kutoka kwenye Bodi mnamo Februari 2011 na bado anaendelea kuhudumu kwingineko katika kampuni ya BAT Group.

Mstahiki John Dowd na Martin Oduor-Otieno walijiuzulu kutoka kwenye Bodi mnamo Machi 2011 na Mei 2011 mtawalia.

Nachukua fursa hii kumshukuru Mstahiki Eloff, Dowd na Oduor-Otieno kwa mchango wao usiopimika kwa Bodi na nawatakia mema katika shughuli zao nyingi za baadae.

**Mtazamo**
*Ukuaji wa Kiuchumi*
Jumuiya ya Afrika Mashariki (EAC) imeanza mikakati ya kulishughulikia swala sera na sokomoko la kiusimamizi ambalo limesumbua Jumuiya hili kwa kipindi kirefu sasa. Kutokana na hayo, Jumuiya imeafikiana kutekelezwa na kuwajibikia swala la Kanuni na Itifaki za Soko Huru. Kuyashughulikia matatizo haya, kutafungua biashara katika ukanda mzima wa Afrika Mashariki na kuruhusu kufikiwa kwa faida ya kibiashara kwa mataifa wanachama hasa kwenye maeneo yaliyotengwa maalum shughuli hiyo. Katika mwaka wa 2012, BAT Kenya itaweka mikakati kabambe ya kutumia nafasi zitakazojitokeza za kibiashara wakati Jumuiya ya Afrika Mashariki inapolishughulikia swala hili lenye changamoto nyingi za utekelezaji.

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Bei za kimataifa za vyakula na mafuta zimeanza kupungua na thamani ya shilingi ya Kenya inatazamiwa kuimarika dhidi ya sarafu za kimataifa. Sera maalum ya kifedha iliyoandaliwa na Benki Kuu ya Kenya inatarajiwa kuthibiti na kupunguza mfumko wa bei za bidhaa katika mwaka huu wa 2012. Msukumo wa mfumko wa bei ulioathiri kampuni nyingi za kibinafsi na kumomonyoa akiba na mapato ya watumiaji wengi unatarajiwa kupungua, na Benki ya Ulimwengu inatazamia kwamba Kiwango cha Uzalishaji wa Bidhaa Duniani (GDP) kitakua kwa asilimia 5 katika mwaka wa 2012. Kilimo kinatazamiwa kuchangia pakubwa katika ukuaji huo kwani mwaka huu wa 2012 unatarajiwa kwamba utakuwa na mavuno mengi. Hali hii itapelekea kupungua kwa bei ya vyakula na kufanya kuimarika kwa hifadhi ya chakula na kusababisha kutokuwepo kwa haja ya kuagiza chakula kutoka nje ya nchi.

Kadhalika, sekta ya Ujenzi inatarajiwa kuchangia pakubwa katika ukuaji wa uchumi katika mwaka wa 2012, huku serikali ikiwekeza pesa nyingi katika upanuzi wa mtandao wa barabara zetu ili kufikia Ruwaza ya 2030. Zaidi ya hayo, sekta ya Teknolojia na Mawasiliano inatazamiwa kupanuka mnamo mwaka wa 2012 na baada ya hapo. Ujumla wa kuimarika kwa muundo-msingi utasababisha na kusaidia ukuaji wa kiuchumi katika 2012. Kulingana na Sekta ya Kibinafsi, kutakuwa na nafasi nzuri za uwekezaji na hali kadhalika kuimarika kwa utendakazi kwenye sekta hiyo.

*Utawala Bora na Mazingira ya Kisiasa*
Tunaiomba serikali iendelee kujenga na kukuza sera bora za kiuchumi. Hatua hii itaiwezesha sekta ya kibinafsi kukua na hatimaye kuchangia kupatikana kwa mapato ya serikali na ukuaji wa uchumi wa kitaifa kwa ujumla. Kudhibiti mazingira ya kiuchumi na kuboresha ushindani wa kupeleka bidhaa zetu nje ya nchi, ni hatua zitakazokinga uchumi wa kitaifa kuathirika kwa mtitigo wa viwango vya ubadilishanaji wa fedha za kigeni, na hali kadhalika, itasaidia kuimarisha ukuaji wa sekta ya kibinafsi. Kadhalika tunaihimiza serikali kuweka mikakati kabambe ya kuhakikisha kwamba mwaka wa 2012 utakuwa ni mwaka wenye chakula cha kutosha nchini. Tunaamini kwamba kuwepo kwa ushirikiano kutaimarisha sera za kiuchumi, kupanua viwango vya ushindani wa uuzaji wa bidhaa zetu nje ya nchi na kadhalika kuboresha hifadhi ya chakula na kukua kwa uchumi wa kitaifa kwenye siku za usoni.

Uchaguzi Mkuu ujao na kuanza kwa kesi za mashtaka ya washukiwa wa ghasia baada ya uchaguzi mnamo 2008 huko ICC, inatishia mazingira ya kisiasa, lakini tuna imani kwamba mikakati kabambe itawekwa ili kuhakikisha uwepo wa utulivu wa kutosha na usalama.

*Sheria ya Tumbaku*
Katika mwaka wa 2012, tutaendelea kujadiliana na serikali na washikadau wengineo kuhusu maswala ya kisheria yanayoathiri mazingira ya utendakazi wa kampuni hii. Tutaendelea kufuatilia harakati zetu za mabadiliko ili kulinda biashara yetu huku tukizingatia hoja ya kukua kwa mapato ya serikali. Zaidi ya hayo, tutaheshimu ushirikiano wetu na halmashauri za kiusimamizi zinazosaidiana nasi katika swala la kupambana na mawakala wa bidhaa haramu zinazosambazwa kwenye masoko yetu. Kadhalika, tutafanya kazi na serikali ili kuhakikisha kwamba Kenya inachukua msimamo kamili wa kitaifa kabla ya Kongamano la Kimataifa la Sheria ya Tumbaku (FCTC) litakalofanyika huko Korea Kusini mnamo mwezi Novemba 2012.

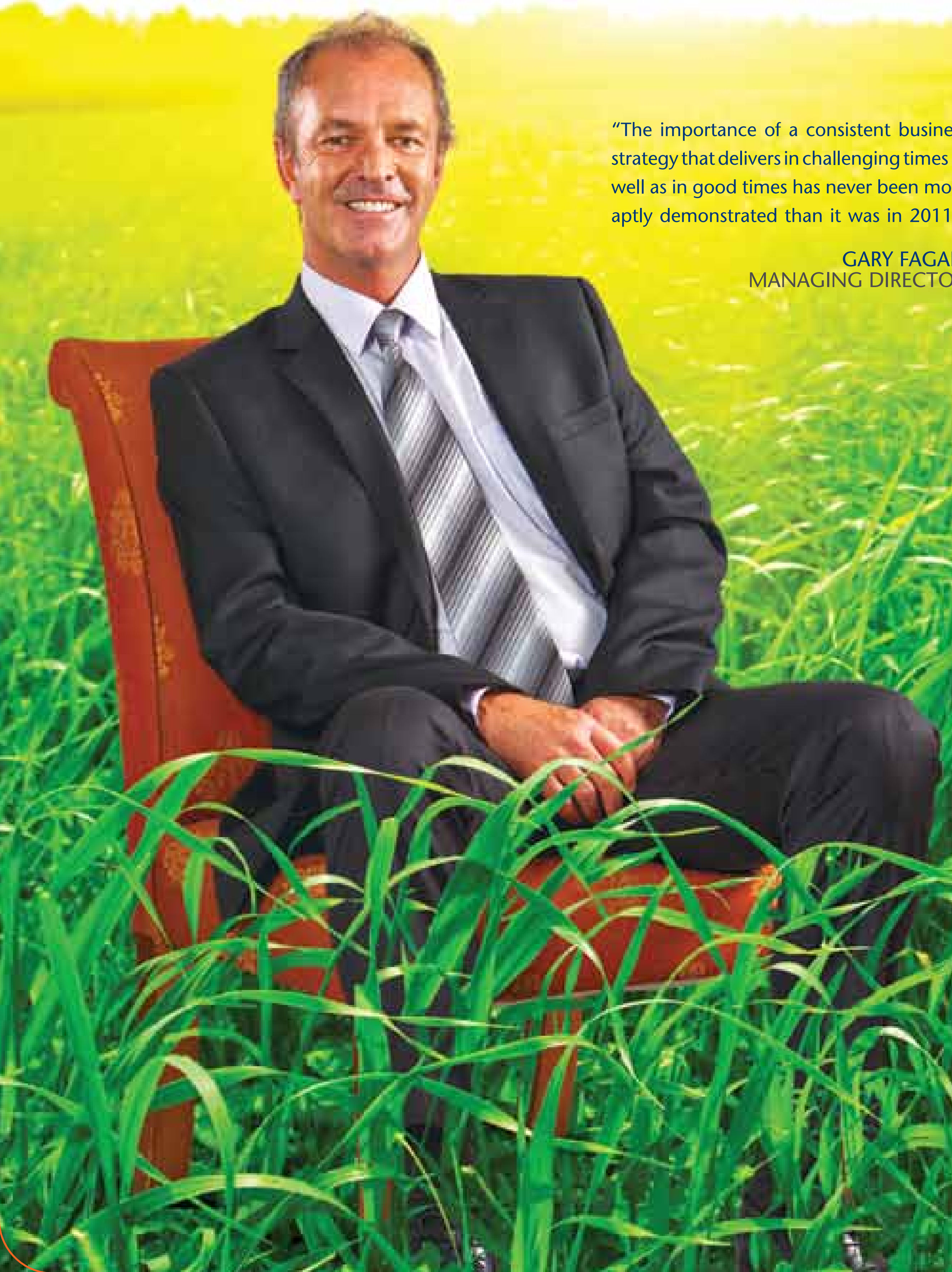
**Hitimisho**
Kustahamili kiwango hiki cha ukuaji kutoka mwaka wa 2011 mpaka 2012 kutakuwa ni changamoto kubwa ukizingatia kwamba pana uwezekano wa athari nyingi za kisiasa, hali isiyoeleweka ya mfumko wa bei za bidhaa na kuwepo kwa sera ngumu za ukuaji wa kiuchumi na hali kadhalika mabadiliko ya mara kwa mara ya mandhari ya misimamo ya kisheria. Fauka ya hayo, tuna imani kwamba mikakati iliyopo ni thabiti na itatuwezesha kukua na kuboresha thamani ya wenyehisa katika mwaka wa 2012 na mpaka siku za usoni. Tutaweka msisitizo katika kupanua mgao wa soko letu, kuongezea kiwango cha uwezo wa uzalishaji wa bidhaa na kuimarisha mbinu za uzalishaji huku tukilingania kuboresha sera za utendakazi wetu ambao ni muhimu sana kwa serikali yetu na hata sekta nzima kwa jumla.

Ninafurahi na natoa shukrani zangu za dhati kwa msaada mkubwa nilioupata kutoka kwa wenzangu kwenye Bodi Kuu, bidii ya mchwa na uungwana wa mameneja na wafanyikazi wote wa BAT Kenya na ushirikiano wa wakulima wa tumbaku, washirika wetu wa kibiashara na watumiaji wa bidhaa zetu, kwa mchango wao ambao umeimarisha na kuendeleza ubora wa biashara yetu.

**Evanson Mwaniki**
Mwenyekiti

# MESSAGE FROM THE MANAGING DIRECTOR

*"The moment you think you can do it all on your own, is the moment you fail"*



"The importance of a consistent business strategy that delivers in challenging times as well as in good times has never been more aptly demonstrated than it was in 2011."

GARY FAGAN
MANAGING DIRECTOR



## A Sustainable Business in a Challenging Marketplace

### Growth in Difficult Circumstances

The first half of 2011 posed myriad challenges to the business and our operating environment. Yet, in the midst of these tough times, with considerable effort and commitment to our business strategy, we managed to reinforce our leadership position in the tobacco industry, attaining a record achievement in the process with our market share growing to 88 per cent by end of 2011.

The importance of a consistent business strategy that delivers in challenging times as well as in good times has never been more aptly demonstrated than it was in 2011. Despite the volatile socio-economic climate and as a result of our Functional Teams' diligent efforts, our market share grew by 2 per cent over 2010. This is attributable to the strength of the business and concerted focus and investment in our optimized distribution network to enhance efficiency and ensure speed to market. Our national pride brand, Sportsman, delivered an unprecedented 27 per cent volume growth in 2011 driving the overall profitability of the business. Domestic volume grew by 12 per cent in the year.

### Productivity Driving Sustainable Growth

We can only sustain the growth realized in 2011 if it is funded by improved productivity across the business. BAT Kenya generated Kshs 20.2 billion in revenue in 2011. The domestic market accounted for 44 per cent of this exceptional growth, bringing in Kshs 8.8 billion. Our export business - which includes exports of cut rag (semi-processed tobacco) to Egypt under COMESA and contract manufacture for cigarettes within the East African Community (EAC); Mauritius, Madagascar, the Horn of Africa, Malawi and Zambia - accounted for the remaining 56 per cent of our annual revenues at Kshs 11.3 billion.

Exports represent our greatest opportunity for increased throughput. 2011 was the first annualized production of cut rag exports for Egypt. We also commenced the shipment of export cigarettes to South Sudan in November 2011 and have achieved weekly growth on in-market sales. Our engagement with the newly-formed government in Juba is on-going and focused on identifying opportunities to improve national infrastructure and law enforcement mechanisms to support development and business growth.

The investment in the upgrade of our Primary Manufacturing Department (PMD) is bearing fruit. We achieved the highest cut rag (semi-processed tobacco) volume ever at 17.5 million kilos, up from 10.6 million in 2010. Operations also realised the largest export of cut rag to-date, totalling 8.1 million kilos – equivalent to 46 per cent of the total PMD production for the year.

As part of our 5 year plan to refurbish our regional manufacturing hub in Nairobi, we commenced the first phase of the PMD upgrade project to improve the factory's reliability, efficiency and product quality.

We plan to replace the main equipment over three phases between 2011-2013. This project, which entails an investment of Kshs 1 billion, will increase capacity from 22 million kilos/year to 32 million kilos/year.

Productivity savings represent released resources that can be reinvested in the business and drive growth. Supply chain savings are a key component of our sustainability agenda. Sustainability for us means business sustainability, as well as being green. In spite of increases in production costs which adversely affected nearly all manufacturers in Kenya, we were able to reduce our overall production costs in 2011 by optimizing our resources, implementing energy saving initiatives and leveraging on economies of scale as a result of our increased volumes.

To enhance tobacco utilisation, reduce tobacco waste and ensure sustainable operations in our regional manufacturing hub, we embraced new FIBEX technology and installed a state-of-the-art plant for recovery of tobacco waste generated from our manufacturing processes. The benefits realized thus far include the reduction in tobacco waste to 4.2 per cent, down from 5.7 per cent in 2010. This innovation has the potential of reducing tobacco waste to below 3 per cent on average and delivering productivity savings of up to Kshs 116 million per year. The new technology will also have the additional benefit of supporting our "Green Initiative" by reducing our land-fill waste.

Our contribution to long-term, economic development in Kenya is clear. As I told you last year, BAT Kenya's associated activities generate direct and indirect employment opportunities for hundreds of thousands of Kenyans through: tobacco farming, tobacco processing, cigarette manufacturing, urban and rural retailing, wholesale trade, distribution networks, transport, logistics, warehousing, clearing and forwarding and domestic procurement. This is a significant effort towards poverty-alleviation and improved social welfare in urban and rural areas as outlined in Kenya's Vision 2030.

The Company's purchase of local leaf from BAT Kenya's tobacco farmers increased by 500 million kgs in 2011, primarily due to the improved application of agronomical best practices supported by cell based farmer extension models. As a result, BAT Kenya tobacco farmers collectively earned over Kshs 700 million in 2011, up from Kshs 660 million in 2010.

# MESSAGE FROM THE MANAGING DIRECTOR *(Continued)*

We have a strong reputation for sustainability and responsibility in the tobacco industry. However, we cannot become complacent or reach for higher achievements independently. We need to work with our stakeholders and develop solutions to emerging concerns – like the impact of climate change and environmental degradation. In 2012, we will refine our approach towards achieving excellence in sustainability and growing value for our stakeholders.

## The Quality of Our People

Sustainable growth can only be delivered through our employees collaborating and cooperating to form a winning organisation that acts responsibly at all times. We integrate sustainability not just into our business priorities and strategies, but also with our people. We continually seek new talent and set high standards for those who join our culturally diverse Company.

We value people who are committed to creating an environment in which they thrive and deliver value to consumers and shareholders. We work to ensure that we have the right people and the right work environment to deliver our vision and contribute to our long-term business sustainability.

Thank you to each and every one of my colleagues at BAT Kenya. I am tremendously proud of what we have achieved together and look forward to even greater success in the coming years.

## Sustainable Regulation

The tobaco industry continues to operate under the threat of increasingly stringent regulatory regimes.
We expect more regulation as a result of the World Health Organization's Framework Convention on Tobacco Control (FCTC) and the activities of an emerging, vocal anti- tobacco lobby in the region.

Consequently, it is important for us to maintain channels of communication with regulators and legislators in Kenya. We believe that there is much to be gained by including responsible tobacco businesses that compete in the legal market in the regulatory process. BAT Kenya remains in dialogue with government on the following:

### *The Tobacco Control Act, 2007*

Corporate Social Responsibility (CSR) lies at the core of our sustainability agenda. One of our core values is supporting the communities in areas where we operate. We commend the Attorney-General for clarifying the interpretation of provisions of the Tobacco Control Act, 2007 (TCA) which previously disallowed us from corporate communication and seek further clarity from the State Law Office on expanding the scope of our involvement in activities to promote sustainable agriculture, environmental conservation and other priorities on the national development agenda.

As I indicated to you in 2010, the concerted and exclusive focus on the public health issues associated with the use of tobacco products is de-normalising the legitimate trade and consequently, discouraging investment in the tobacco industry.

Our key areas of concern remain the misinterpretation of key provisions of the TCA, including, but not limited to: product display, public place smoking, industry participation and product regulation. We have highlighted these challenges to the Ministry of Public Health and Sanitation, Ministry of Local Government and Attorney-General and seek the assistance of their esteemed offices with achieving balanced interpretation and enforcement of the law.

BAT Kenya's support for the implementation of pragmatic regulation is unwavering. We support tobacco regulation that balances the preferences of adult consumers with the interests of society, establishes an open-minded approach to product innovation and enables our business to continue to compete and prosper. The partnership and cordial relationship we have with Government is something we are proud of. Our request is that Government builds on the gains and inroads made in 2011 to promote an even more favorable environment for private sector – driven economic growth in 2012.

### *Excise*

In order to protect government excise revenues and revenues from other corporate taxes which tobacco manufacturers like ourselves remit to the Exchequer, there should be thorough consultations with affected stakeholders during the various stages of regulatory drafting.

For the fifth consecutive year, the Company was lauded for its unrelenting patriotism and consistent support of the Government's vision of achieving financial independence, sovereignty and national pride when we were recognized as the 4th largest tax payer by the Kenya Revenue Authority in October 2011. In 2011, our remittance to the exchequer in the form of excise, VAT and corporate taxes grew by Kshs 500 million over 2010, registering at Kshs 10.5 billion, the highest remittance in the history of our business.



We are encouraged by the pragmatic treatment of tobacco excise under the Finance Bill, 2011. Good progress has been made on simplifying the excise regime, and this translates into annualised growth in revenues. Further opportunities to simplify the excise regime that would improve government's ability to plan and forecast their revenues exist. We have submitted our 2012 excise submissions to Treasury for consideration, and encourage government to further simplify the excise regime by introducing a single-tier, fully specific excise structure.

Cigarettes are subject to substantial excise, levied in accordance with divergent tax regimes throughout the East African Community (EAC). We support proposals being submitted to harmonise taxation structures across the East African Community and recognise this efforts as a means to create shared value for government, manufacturers, shareholders and other stakeholders in the customs union.

### *Illicit Trade*

Cigarettes rank highly on the list of counterfeit products sold in Kenya. The illicit trade in tobacco products - counterfeit, smuggled, or locally manufactured cigarettes on which applicable taxes are evaded - represents a significant and growing threat to the legitimate tobacco industry. We continue to work with the Kenya Revenue Authority (KRA) to implement reforms in the management of exports and transit goods within the EAC and beyond. The presence of illegal goods in the common market hinders the integration of the Community and sends the wrong signal – investors become apprehensive and associate the growth in illicit trade with a relaxed and ineffective trade regime.

Like Kenya, other EAC partner states have taken positive steps to counter this menace. The operationalisation of the Anti-Counterfeit Agency in 2011 presents a new opportunity for collaboration in arresting the growth of counterfeiting and the illicit trade of cigarettes and other fast moving consumer goods at the expense of legitimate business in Kenya.

We are also keenly following the introduction of innovative excise collection and product traceability technology in the region. We recognize that developments like this provide a more efficient option and represent a significant step in the anti-illicit trade effort.

We look forward to collaborating with stakeholders in both the private and public sectors towards achieving alignment of best business practice and harmonisation of intellectual property and anti-counterfeiting and tobacco control legislation across the East African Community.

## The Future

We appreciate the need to balance our commercial objectives with the expectations of a broad range of stakeholders to ensure the sustainability of our business as we position the Company for continued growth.

New challenges for our business are out there. The next few years may be just as turbulent in the marketplace as the last two have been. However, we will remain committed to our business strategy. Our strong, revamped brand portfolio with its balance of products across price segments has allowed us to deliver consistent growth for the last three years. This sustained effort drove our profitability in 2011, culminating in the achievement of a historic dividend payment of Kshs 30.50 based on our full year results.

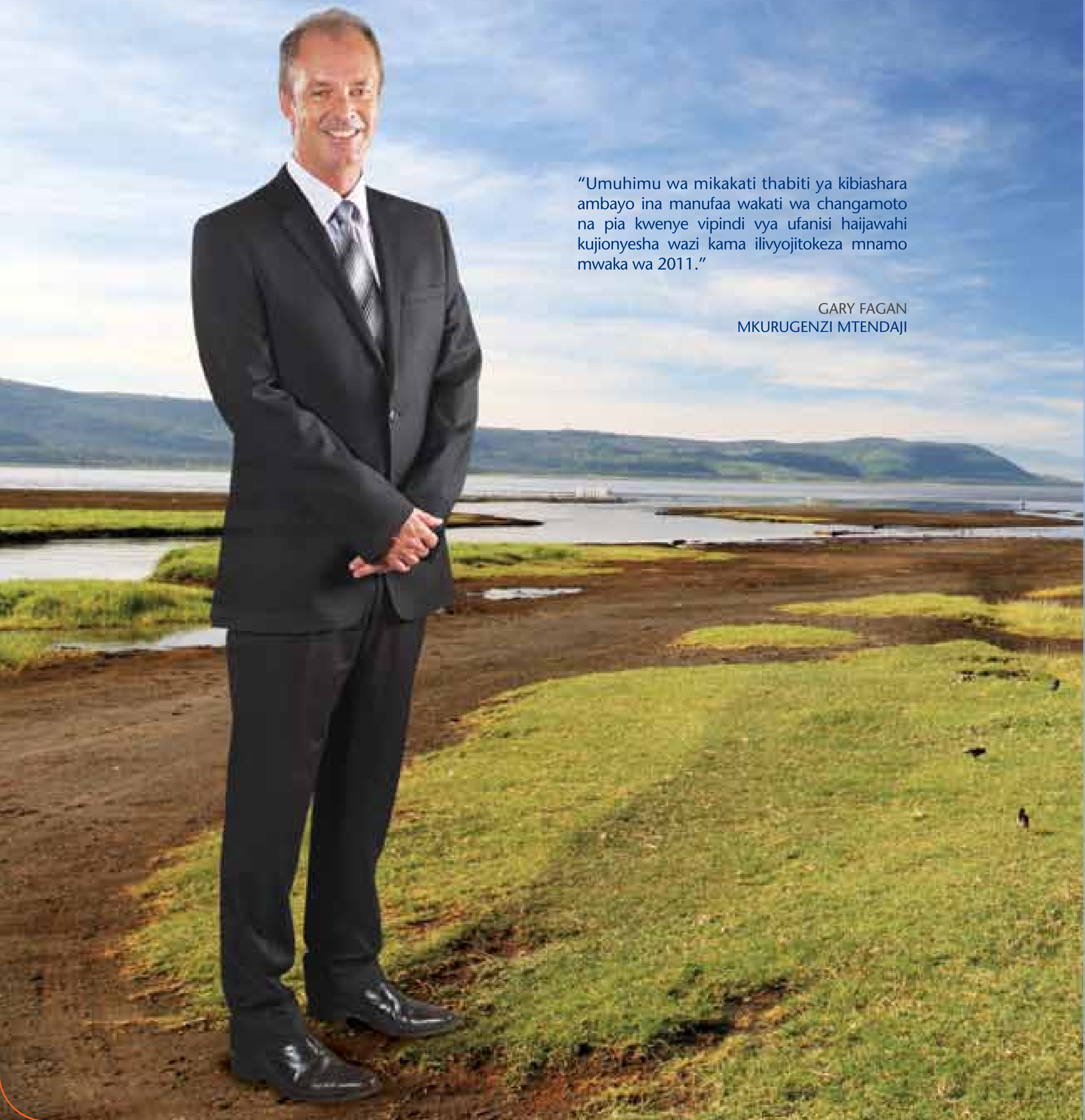
Whatever the trading conditions might be in 2012 and in the coming years, with the right products and the right people, dedicated to working hard to ensure that our strategy effectively and efficiently sustains our growth we are destined for continued success.

On behalf of the Management and Staff of British American Tobacco Kenya, I sincerely thank the Board of Directors for their guidance and support in 2011. I also extend my gratitude to our shareholders, consumers of our products and our business partners. I join you all in looking forward to many successful years ahead for our business.

**Gary Fagan**
Managing Director

# UJUMBE KUTOKA KWA MKURUGENZI MTENDAJI

*Kidole kimoja hakivunji chawa*



"Umuhimu wa mikakati thabiti ya kibiashara ambayo ina manufaa wakati wa changamoto na pia kwenye vipindi vya ufanisi haijawahi kujionyesha wazi kama ilivyojitokeza mnamo mwaka wa 2011."

GARY FAGAN
MKURUGENZI MTENDAJI

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## Biashara-endelevu katika Soko lenye Changamoto nyingi

### Ukuaji katika Mazingira Magumu

Kulikuwa na changamoto nyingi katika sehemu ya kwanza ya nusu ya mwaka wa 2011, hasa kwenye biashara yetu na pia katika mazingira ya utendakazi. Licha ya matatizo hayo, tulilazimika kutia bidii ya mchwa na kujitolea mhanga na hatimaye tulifanikiwa kuthibiti uongozi wetu katika soko la tumbaku nchini na kupata mafanikio bora kutokana na hatua hiyo ambayo iliongeza pato la soko letu hadi asilimia 88 mwaka wa 2011.

Umuhimu wa mikakati thabiti ya kibiashara ambayo ina manufaa wakati wa changamoto na pia kwenye vipindi vya ufanisi haijawahi kujionyesha wazi kama ilivyojitokeza mnamo mwaka wa 2011. Licha ya kubadilikabadilika kwa hali ya kiuchumi-jamii, na kufuatia umilisi na jitihada za wafanyikazi wetu, pato la soko letu liliongezeka kwa asilimia 2 zaidi ukilinganisha na mwaka wa 2010. Hali hii, ilitokana na kuimarika kwa biashara na ushirikiano wa mikakati ya uwekezaji katika matokeo mazuri ya mtandao wa usambazaji ili kuleta uboreshaji na ufikishwaji haraka wa bidhaa zetu kwenye soko. Bidhaa yetu ya Sportsman iliyo na fahari ya kitaifa, ilileta mafanikio ambayo hayajawahi kutokea ya ongezeko la asilimia 27 katika mwaka wa 2011 na kuzidisha ongezeko la faida kwenye biashara kwa ujumla. Ongezeko la biashara ya humu nchini lilikua kwa asilimia 12 kwenye mwaka huo.

### Uzalishaji Unaoendesha Ukuaji wa Biashara-endelevu

Tunaweza tu kuumudu ukuaji uliopatikana mwaka wa 2011 ikiwa tutasimamia vyema mikakati ya uzalishaji wetu katika biashara yetu. Katika mwaka wa 2011, BAT Kenya ilifanikiwa kupata Shilingi bilioni 20.2 kwenye mapato yake. Soko la nyumbani liliandikisha asilimia 44 katika ukuaji huu wa kipekee kwa kuzalisha Shilingi bilioni 8.8. Biashara zetu za nje ya nchi (Mahuruji) – zikijumuisha kusafirisha tumbaku ghafi kwa kuipeleka Misri chini ya soko la COMESA, na hali kadhalika sigara kwenye Washirika Dau wa Jumuiya ya Afrika Mashariki, Mauritius, Kisiwa cha Bukini na hadi maeneo ya Shungwaya na upembe wa Afrika - zilizalisha kiwango cha asilimia 56 kwenye mapato yetu. Asilimia hiyo ndiyo iliyokuwa imesalia kutoka kwa mapato ya jumla mwaka ya Shilingi billioni 11.3.

Biashara ya nje ya nchi ndio inawakilisha nafasi yetu kubwa kwenye biashara hii. Mwaka wa 2011 ulikuwa ni mwaka wetu wa kwanza wa uzalishaji wa tumbaku ambayo haijasafishwa iliyosafirishwa nchini Misri. Kadhalika, tulianza kusafirisha sigara na kupeleka Sudan Kusini mwezi wa Novemba mwaka wa 2011 na tunaona inaleta mafanikio wiki baada ya wiki kwenye soko la mauzo. Muungano wetu na serikali mpya ya Juba unaridhisha sana, hasa katika kipindi hiki ambapo tunaposhirikiana kuboresha muundo-msingi wa kitaifa na mbinu za kuzingatia sheria ili kuimarisha na maendeleo. Uwekezaji katika upanuaji wa Idara na Kitengo cha Kimsingi cha Uzalishaji (PMD) unaelekea kuzaa matunda mema. Tulifaulu kuimarika mno kwenye uzalishaji wa tumbaku ghafi kwa kupata kilo milioni 17.5 kutoka kilo milioni 10.6 mnamo katika mwaka wa 2010. Hata utendakazi wetu ulikua kwa kiwango kisicho cha kawaida, kwa kufikia jumla ya kilo milioni 8.1 – ikilinganishwa na asilimia 46 ya mapato ya jumla ya uzalishaji katika kitengo cha PDM cha mwaka huo.

Kama mojawapo ya mipango yetu ya kuboresha kiwanda cha uzalishaji hapa Nairobi, tulianza kujenga sehemu ya kwanza ya mradi wa kuboresha Idara ya Kiwanda cha Kimsingi cha Uzalishaji (PMD) ili kuhakikisha kuna ufanisi, uthabiti na ubora wa bidhaa.

Tunapanga kubadilisha vifaa muhimu kwa sehemu tatu kati ya mwaka wa 2011 hadi 2013. Mradi huu utakao gharimu shilingi billioni 1, utaongeza kiwango cha kilo kwa mwaka kutoka kilo milioni 22 kwa mwaka hadi kilo milioni 32 kwa mwaka.

Akiba ya uzalishaji inajumuisha rasilimali ambazo zinaweza kuwekezwa tena kwenye biashara na kuleta ukuaji wa faida. Kuwekeza akiba mara kwa mara ndio kiungo muhimu cha ajenda ya kuendeleza biashara. Biashara hii endelevu kwetu sisi inamaanisha uwezo wa kufanya biashara kwa kipindi kirefu na kadhalika kuwa katika soko la tumbaku ya kijani kwa muda. Licha ya ongezeko la gharama ya uzalishaji ambayo iliathiri vibaya karibu wazalishaji wote nchini Kenya, tuliweza kupunguza gharama zetu zote za uzalishaji kwa ujumla mwaka wa 2011 kwa kuthibiti gharama za rasilimali zetu, kutekeleza mbinu za kuhifadhi nishati na uwezo kwenye viwango vya uchumi kama matokeo ya ongezeko la viwango vyetu vya uzalishaji.

Ili kuimarisha matumizi ya tumbaku, kupunguza mabaki ya Tumbaku na kuhakikisha kumudu oparesheni kwenye maeneo ya kibiashara, tumeikubali teknolojia mpya ya FIBEX na tumesimika mtambo wa kifahari wa kurejeleza mabaki ya tumbaku yanayozalishwa kutokana na njia zetu za utengenezaji. Manufaa yaliyoonekana hadi sasa ni pamoja na kupungua kwa mabaki ya tumbaku kwa asilimia 4.2 kutoka kwa asilimia 5.7 mwaka wa 2010. Uvumbuzi huu una uwezo wa kupunguza mabaki ya tumbaku hadi chini ya asilimia 3 kwa wastani na kutoa akiba ya uzalishaji hadi kufikia milion 116 kwa mwaka. Hii Teknolojia mpya pia itakuwa na faida ya ziada ya kusaidia "Green Initiative" kwa kupunguza mabaki ardhini.

Mchango wetu wa kudumu na maendeleo ya kiuchumi nchini Kenya uko sawa. Kama nilivyowaambia mwaka jana, BAT Kenya inajihusisha na shughuli za kutoa nafasi za ajira za moja kwa moja na zisizo kuwa za moja kwa moja kwa maelfu ya Wakenya kupitia: ukulima wa tumbaku, kutengeneza tumbaku, utengenezaji sigara, uuzaji wa sigara kwa njia ya rejareja huko mashambani na mijini, biashara ya jumla, mtandao wa usambazaji, usafiri, usimamizi wa mipango, maghala, bohari, ushuru wa forodha na ununuzi wa kawaida. Hii ni juhudi muhimu ya kuondoa umasikini na kuboresha maslahi ya jamii, sehemu za mijini na mashambani kama ilivyo kwenye Ruwaza ya 2030.

Wakulima wa tumbaku walifurahia ongezeko la kilo 500 baada ya kampuni kununua tumbaku kwa wakulima mnamo mwaka wa 2011. Hii ilitokana na kuboreshwa kwa mbinu za shughuli za ukulima. Wakulima wa tumbaku wa BAT Kenya kwa pamoja walipata shilingi milioni 700 katika mwaka wa 2011 ukilinganisha na mapato ya shilingi milioni 660 mnamo mwaka wa 2010.

Tuna sifa nzuri ya kumudu na uwajibikaji kwenye kiwanda cha tumbaku. Hata hivyo, hatuwezi kujiridhisha ama kufikia mafanikio ya juu sisi wenyewe. Tunahitajika kushirikiana na washika dau wetu na kuweza kutoa suluhisho kwenye mambo yanayotukabili - kama vile madhara ya mabadiliko ya hali ya hewa na hali kadhalika udhoofishaji wa mazingira kwa pamoja. Mwaka huu wa 2012, tutapiga msasa njia zetu za kufanikisha utendakazi wetu kwa kumudu na kuongeza thamani zaidi kwa washika dau wetu.

**Ubora wa Wafanyikazi Wetu**

Ukuaji-endelevu ni lazima uandaliwe na wafanyikazi kwa ushirikiano ili kuunda umoja utakaoleta ushindi utakaokuwa wa kudumu. Tunajumuika pamoja kuimarisha sio tu kwenye vipaumbele na mikakati ya biashara zetu, mbali pamoja na wafanyakazi wetu. Tunazidi kutafuta vipaji vipya na kuweka viwango vyetu juu kwa wale wanaojiunga na kampuni yetu iliyo na tamaduni mbali mbali.

Tunathamini watu ambao wanajitolea kutengeneza mazingira ambayo yanaleta mafanikio kwa wanunuzi na washika dau. Tunafanya bidii ili kuhakikisha kwamba tuna wafanyikazi wazuri na mazingira mazuri ya utendajikazi ili kufanikisha maono yetu na kuchangia kumudu biashara yetu kwa muda mrefu.

Nashukuru sana kila mmoja wenu na kila tunayefanya kazi pamoja hapa BAT Kenya. Nimefurahia sana kwa kile ambacho tumefanikisha pamoja na kutazamia ufanisi bora zaidi kwenye miaka ijayo.

**Kanuni za Sheria za Kusimamia Biashara**

Biashara yetu inazidi kuendeshwa chini ya tishio la kuongezeka kwa mfumo wa kanuni kali za kisheria. Tunatarajia kuwepo kwa kanuni zaidi huku tukingojea matokeo ya Mkutano wa Mipango ya Mashirika ya Afya yanayoshughulikia Uthibiti wa Tumbaku (FCTC) na shughuli za kuzuka kwa mashirika yanayopinga uzalishaji wa tumbaku kwenye ukanda mzima.

Kutokana na hilo, ni muhimu kudumisha njia bora ya mawasiliano kati yetu na wahusika wa sekta hii na wabunge kuhusu swala hili la biashara ya sigara. Tunaamini kuwa kuna mambo mengi ya kufaidi kwa kujumuisha biashara mbalimbali za tumbaku ambazo zina ushindani katika soko halali kwenye kufuata kanuni. Kampuni ya BAT bado ina zungumza na serikali kuhusu:

*Sheria ya Uthibiti wa Tumbaku ya 2007*

Jukumu la Kijamii la Kiushirika (CSR) ndio imekuwa uti wa mgongo wa ajenda yetu. Mojawapo ya jukumu letu kuu ni kusaidia jamii katika maeneo tunayotekelezea shughuli zetu. Tunamshukuru mkuu wa sheria kwa kufasiri kitengo cha sheria cha 2007 (TCA) ambayo awali ilikuwa imetuzuia mawasiliano ya pamoja na kutafuta ufafanuzi kutoka afisi ya sheria ya nchi kuhusu kupanua upeo wetu tukijihusisha na shughuli za kuendeleza kilimo-endelevu, utunzaji wa mazingira na vipaumbele vingine kulingana na ajenda za maendeleo ya kitaifa.

Kama nilivyoashiria katika mwaka wa 2010, zingatio la pamoja na kipekee kuhusu maswala ya afya ya umma yanayohusishwa na utumiaji wa bidhaa za tumbaku inaathiri biashara halali, hivyo basi kudororesha uwekezaji katika kiwanda cha tumbaku.

Matatizo yetu makubwa kwa sasa ni kutafsiriwa vibaya kwa sheria na masharti ya TCA, ikiwa ni pamoja na maonyesho ya bidhaa, uvutaji wa sigara hadharani, uhusika wa kiwanda na udhibiti wa zao. Tumesisitizia changamoto hizi kwa Wizara ya Afya ya Umma na Usafi, Wizara ya Serikali za Wilaya na hata kwa Mwanasheria Mkuu na kutafuta usaidizi kutoka katika afisi zao ili tupate tafsiri inayofaa kwa vipengee hivyo vya sheria na hali kadhalika kutekelezwa kwa sheria.

Kuunga mkono kwa kampuni ya BAT katika shughuli ya kutekeleza udhibiti halisi ni kwa dhati na wala sio lelemama. Tunaunga mkono sheria za uratibu wa tumbaku ambazo zinasawazisha tatizo la mapendeleo ya wanunuzi pamoja na matakwa ya wanajamii, inathibitisha mtazamo wazi kuhusu mageuzi ya bidhaa na hali itakayowezesha biashara kuendelea kushindana na kupata ufanisi. Tunajivunia ushirika na uhusiano murua tulionao na serikali. Ombi letu kwa serikali ni itusaidie kuangalia mapato na matumizi mabaya ya mwaka wa 2011 ili kuboresha hata mazingira bora katika ukuzaji wa uchumi kwenye sekta za kibinafsi katika mwaka wa 2012.

*Ushuru wa Mapato*

Ili kulinda mapato ya ushuru wa Serikali na mapato ya kodi nyinginezo za mashirika yanayojishughulisha na uzalishaji wa Tumbaku, kama ile kodi ambayo BAT Kenya inatoa kwa serikali, panafaa kuwa na midahalo na makubaliano ya kikamilifu na washikadau wote wa sekta hii katika ngazi zote za uandaaji wa sheria na kanuni hizo.

Kwa miaka mitano mfululizo, kampuni hii ilisifiwa kwa uzalendo wake na kuunga mkono hatua ya serikali ya kujitegemea kiuchumi, uhuru na fahari ya taifa, na tulitangazwa kuwa kampuni ya nne bora katika ulipaji wa kodi na Halmashauri ya Mapato na Ushuru ya Kenya (KRA) mnamo mwezi wa Oktoba mwaka wa 2011. Katika mwaka wa 2011, fedha tulizotoa kwa katibu wa hazina kama ushuru, Kodi Ya Ongezeko la Thamani (VAT) na kodi nyingine za kibiashara, kodi hizo ziliongezeka kwa shilingi milioni 500 katika mwaka wa 2012 na kufika billioni 10.5 ambayo ndiyo mapato ya juu katika historia ya biashara yetu.

Tumeridhishwa na jinsi ambavyo Mswada wa Fedha wa 2011, ulivyoshughulikia swala zima la ushuru wa tumbaku. Kuna mabadiliko makubwa yalifikiwa katika ubadilishaji wa mfumo wa matozo ya ushuru, na hali hii inaashiria kuimarika kwa mapato ya jumla ya kila mwaka. Kuna nafasi kubwa ya kupunguza makali ya mfumo mzima wa matozo ya ushuru ambayo itaimarisha uwezo wa serikali wa kupanga na kubashiri viwango vya mapato yake. Tayari tumepelekea ushuru wetu wa 2012 kwa Wizara ya Fedha kwa lengo la kutimiza kanuni zilizowekwa, huku tukiihimiza serikali kulipigia darubini swala zima la matozo ya ushuru kwa kuanzisha mfumo mpya wa "malipo ya mseto", kama mfumo kamilifu na maalum wa kulipia ushuru.

Sigara hutozwa ushuru madhubuti kulingana na mifumo tofauti katika Jumuia ya Afrika Mashariki (EAC). Tunaunga mkono juhudi zinazoendeshwa na Wizara ya Fedha katika kusawazisha mifumo ya kodi katika Jumuiya nzima ya Afrika Mashariki na kutambua juhudi hizi kama mbinu zinazoleta ushirikiano wa maadili kati ya serikali, watengenezaji, washika dau na wabia katika muungano wa ushuru.

*Biashara Haramu*

Sigara ziko katika mstari wa mbele wa bidhaa ghushi zinazouzwa Kenya. Biashara haramu ya bidhaa za tumbaku – ghushi, za magendo au zilizotengenezwa hapa nchini ambapo kodi hukwepwa, huwa ni tishio kubwa sana kwa biashara halali ya tumbaku. Tunaendelea kushirikiana na Halmashauri ya Mapato na Ushuru ya Kenya (KRA) ili kuunda mabadiliko katika usimamizi wa mahuruji na bidhaa zinazotoka Afrika Mashariki na nje ya nchi. Kuweko kwa bidhaa haramu katika soko la kawaida huzuia muungano wa Jumuiya na huleta mwonekano mbaya - na wawekezaji hushuku na kuhusisha ukuaji wa biashara haramu kuwa umetokana na mfumo usiofaa au haramu wa biashara hii.

Wabia kama nchi ya Kenya wamechukua hatua ya kupigana na tishio hili. Ufanyikazi wa uwakala unaopigana na bidhaa ghushi katika mwaka wa 2011 unatoa nafasi mpya ya kushirikiana katika kuzuia ukuaji wa kughushi na biashara haramu ya sigara na bidhaa nyingine za matumizi kwa kuathiri biashara halali nchini Kenya.

Pia tunafanya juhudi za kuvumbua mbinu mpya za kutoza ushuru na teknolojia ya kufikia bidhaa kwenye eneo. Tunatambua ya kwamba maendeleo kama haya hutoa chaguo fanisi zaidi na huwakilisha umuhimu wa hatua hiyo katika juhudi za kupambana na biashara haramu.

Tunatarajia kushiriki na washikadau kwenye sekta za kibinafsi na serikali ili kufaulisha usawa wa shughuli za biashara na kughushi kwa mali na kudumisha udhibiti wa tumbaku katika Jumuiya ya Afrika Mashariki.

**Siku za Usoni**

Tunashukuru kuwepo kwa mahitaji ya kusawazisha malengo yetu ya kibiashara huku tukiwa na matarajio ya kuwa na kiwango kikubwa cha washika dau ili kuhakikisha uendelevu wa biashara yetu huku tukiiweka Kampuni yetu katika mkondo bora wa ukuaji.

Changamoto mpya za biashara yetu zipo na zimetuzunguka. Miaka michache ijayo inaweza kuwa tu kama mabadiliko mabaya ya ghafla yaliyotokea kwenye soko katika miaka miwili iliyopita. Hata hivyo, tutabaki tukijitolea kuimarisha mikakati yetu ya kibiashara. Uthabiti wa uboreshaji wa bidhaa zetu zenye chapa na nembo mbali mbali zikiwa na usawa wa bei za bidhaa, umesababisha ukuaji mwaka baada ya mwaka, na kuboresha historia ya mgao wa hisa wa shilingi 30.50.

Kwa hali zozote za kibiashara zitakazokuwa mwaka huu wa 2012 na miaka ijayo, kwa kuwa na bidhaa zinazofaa na kuwa na wafanyikazi wanaofaa na ambao wamejitolea kutia bidii ili kuhakikisha kwamba mikakati yetu inafanikiwa kisawasawa huku tukiendelea kukua kibiashara. BAT itafaulu kila wakati.

Kwa niaba ya wasimamizi na wafanyikazi wa British American Tobacco Kenya, naishukuru Bodi ya Wakurugenzi kwa dhati ya moyo wangu kwa kutuongoza na kutusaidia katika mwaka wa 2011. Na pia natoa shukrani zangu kwa Washika Dau, wanunuzi wa bidhaa zetu na wabia wenzetu. Tunaungana pamoja huku tukitarajia mafanikio mengi katika biashara yetu kwenye miaka ijayo.

**Gary Fagan**
Mkurugenzi Mkuu

# FINANCE

*"Put great people and great values together, the result is money"*

"Notwithstanding the volatility in the foreign exchange market, the company as a net exporter benefited from the exchange gains arising from the depreciation of the Kenya Shilling against the Dollar. Both domestic and export finished goods volumes grew over last year by 14 per cent."

**PHILIP LOPOKOIYIT**
FINANCE DIRECTOR

ANNUAL REPORT & FINANCIAL STATEMENTS 2011

The Business benefited from the first full year of export of cut rag (semi-processed tobacco) which commenced in September 2010. Notwithstanding the volatility in the foreign exchange market, the company as a net exporter benefited from the exchange gains arising from the depreciation of the Kenya Shilling against the US Dollar. Both domestic and export finished goods volumes grew over the same period last year by 14 per cent. During 2011, there was continued focus on generating savings through prudent cost management in order to sustainably grow the operating margin.

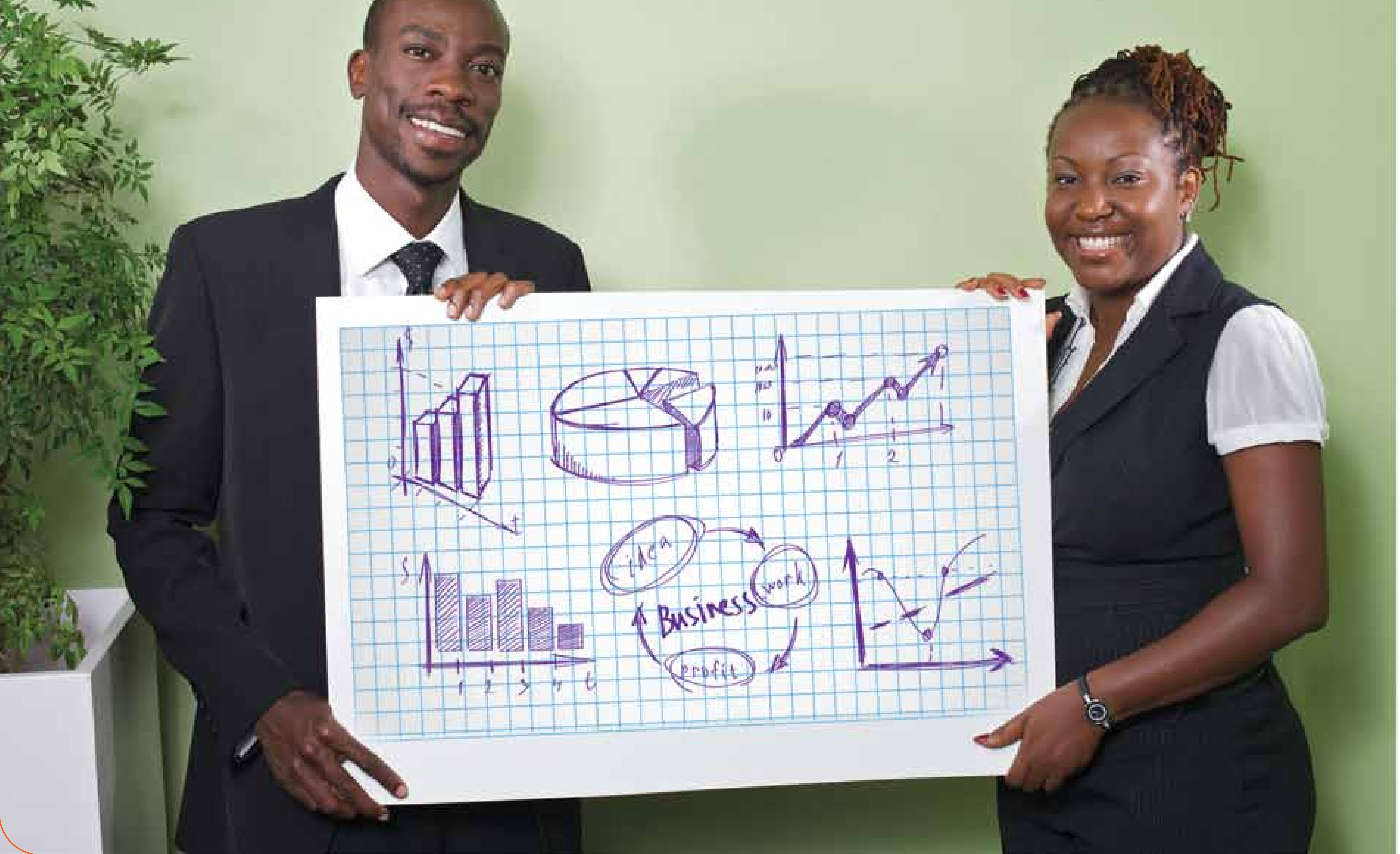
The improved profitability coupled with enhanced working capital management enabled the company to significantly improve the cash generation and continue with the factory expansion initiative amounting to a total capital expenditure of Kshs 1 billion in 2011.

# AUDIT

*"First get your facts right, then everything else will fall into place"*

"Going forward, we will continue to work with management to embed a proactive approach in the identification and management of existing and emerging risks."

DENNIS WASIKE
HEAD OF AUDIT






Focus areas in 2011 included building internal controls awareness across the business and enhancing value addition through collaboration with management in order to identify areas for improvement and oversee the implementation of corrective actions.

As part of the Audit function's efforts for continuous improvement, the Business Audit Methodology was revised to ensure that Internal Audit remains effective and efficient in addressing business risks in a dynamic environment.

Going forward, we will continue to work with management to embed a proactive approach to the identification and management of existing and emerging risks.

# STRATEGY & PLANNING

*'Failing to plan is planning to fail'*

"During 2011 we continued to engage with local and international existing and prospective shareholders, business journalists and other stakeholders in the investment community."

ALLAN WAINAINA
HEAD OF STRATEGY & PLANNING


Our Strategy for Sustainable Growth

ANNUAL REPORT & FINANCIAL STATEMENTS 2011

The four pillars of BAT Kenya's strategy (Growth, Productivity, Winning Organisation and Responsibility) support its vision of delivering sustainable volume and profit growth. The four pillars remained unchanged in 2011, reflecting their continuing relevance to the unique opportunities and challenges facing BAT Kenya as a responsible, 21st century tobacco company.

## Driving Organisational Alignment

The company's annual line of sight process drove organisational alignment by providing a link between key initiatives, activities, projects and indeed, individuals' day jobs to the achievement of one or more strategic objectives. This ensured that the strategy remained relevant, well understood and embedded within the organisation.

The monitoring of the effectiveness of the delivery of the strategy (including recommending corrective actions where necessary) was provided by the Board of Directors and the Leadership Team.

In addition to measuring the delivery of the key strategic initiatives during the year under review, management also carried out longer-term strategic planning, to ensure that the company is positioned to continue to deliver sustainable growth over a longer term horizon.

## Portfolio Management Office (PMO)

The Portfolio Management Office (PMO) continued to provide oversight and support over the company's key projects and initiatives to ensure that the significant resources expended on them were effectively managed in order to deliver the intended objectives.

## Risk Management and Business Continuity Planning

Our risk management activities in 2011 focused on improving our business continuity capabilities in our dynamic operating environment. This saw the development and cascading of methodologies and structures to ensure that the business can continue to operate in the event of significant, unforeseen disruptions.

## Investor Relations

During 2011 we continued to engage with local and international existing and prospective shareholders, business journalists and other stakeholders in the investment community. Through formal briefings and other interactions the investor community had the opportunity to engage management on the company's strategy and financial and operational performance.

# TRADE MARKETING & DISTRIBUTION


"Our market share in 2011 grew to exit the year at 88 per cent. This share growth is attributed to distribution reinforcement, an optimal pricing strategy and improved working relations with the retail trade."

WAEL ATARI
HEAD OF MARKETING

## Distribution Reinforcement

Ensuring the availability of quality products to our consumers at the right outlets, at the right price, every time is an integral part of our distribution strategy. The optimized Route to Market distribution model implemented in the Coast and Nairobi in 2010 was extended to Lake and North Rift areas in the last quarter of 2011. The rollout will continue into the Mountain area in 2012, resulting in the realisation of a complete, national Route to Market distribution model. This translates into a strong competitive edge for our distribution capability in the Kenyan market.

BAT Kenya will continue to strengthen its distribution through increasing focus on the retail trade as we sharpen our focus on our consumers as part of our sustainable growth strategy.

The tangible benefits envisaged include optimised distribution and operating costs emanating from improved economies of scale, trade margins optimisation, a more professional approach to business and sharing best practices with our business partners.

## Market Share and Volume Performance

During 2011, Kenya recorded outstanding volume and share performance. Domestic volume grew by 12 per cent. This was despite the myriad challenges we faced during the year, including escalating inflation and threats to the tourism industry which arose from terrorist attacks in the country. Both factors had a negative impact on consumers' disposable income.

The Company's exceptional performance was largely driven by continued strengthening of Sportsman's performance as a result of its price repositioning in early 2011, Route to Market gains due to the pay for performance distribution model and improved interventions in collaboration with government authorities in anti-illicit trade initiatives. This coordinated response led to increased disruptions and seizures of contraband product.

The Company reinforced its leadership position and attained its highest market share since 2004. Our market share in 2011 grew to exit the year at 88 per cent. This share growth is attributed to distribution rein forcement, an optimal pricing strategy and improved working relations with the retail trade.

Total industry volume dropped by 1 per cent compared to 2010. This performance is attributable to the erosion of consumers' disposable income due to inflationary pressure. However, BAT recorded a performance better than last year with a 12 per cent increase in total volume.

*Wael Atari was photographed at Fundi Kiosk, Likoni Road on 21st February 2012.*

# TRADE MARKETING & DISTRIBUTION *(Continued)*

## Portfolio Strategy
No major changes were undertaken within our brand portfolio in 2011. However, we have decided to delist Dunhill Menthol from the market in 2012. This is driven by a need to consolidate our national portfolio offer for the benefit of our consumers.

Major investments were made in merchandising, specifically in-store furniture with a key focus on Key accounts to enhance the presence of our brands at the point of sale thus uplifting the look and feel of the category.

## Global Drive Brands
Dunhill made significant gains in 2011 towards building a long term sustainable future. The brand augmented its position as the ultimate destination brand in the portfolio and registered a volume growth of 24 per cent over the previous year. The distribution footprint of the brand was also expanded in line with growth of its consumer base through initiatives to match its distribution to that of Embassy. Innovations through trade marketing initiatives focused on growing Dunhill volumes and in-store furniture deployment has improved its appeal amongst premium consumers.

## National Brands
Although the total volume of the Global Drive Brands (GDBs) has grown, the core of the business continues to be from our local brands in our portfolio. Sportsman, our market leader in the Value Seekers category, delivered an outstanding performance with a 27 per cent volume growth over 2010 driving the overall profitability of the business. Sportsman has continued to register double-digit percentage growth during the last two years due to the brands strong equity amongst Kenyan consumers and improved availability through investments throughout our national distribution network.

## Pricing Strategy and Regulation
A new excise system was introduced in June 2011. The previous four tier Retail Selling Price (RSP) based system was replaced with a hybrid system of the higher of Kshs 1,200/mille or 35 per cent of RSP. BAT Kenya welcomed this reform as the new system will maintain industry value for legitimate market players whilst providing reasonable revenue for government.

During the 2011 National budget in June, the excise structure was reviewed and excise rates were also increased. The tax structure for tobacco products changed from that of specific tax per tier to and ad valorem basis which triggered an adjustment of our prices – for Sportsman and SM - in June 2011.

We continued to educate smokers and traders on the various provisions of the Tobacco Control Act (TCA). We continue to work closely with the authorities to build an aligned understanding to the content of the TCA by all stakeholders and work towards ensuring its equitable implementation.

***Although the total volume of the Global Drive Brands (GDBs) has grown, the core of the business continues to be from our local brands in our portfolio.***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The presence of illicit cigarettes in the market remains a key threat to our business. We have invested in sensitising enforcement agencies on the scale of the problem, how to identify illicit products and what enforcement activities can be undertaken with the ambit of existing laws. Some benefits have been realised from these investments as witnessed through seizures of significant quantities of illicit products by the relevant authorities in 2011.

## Outlook
2012 performance will largely be influenced by the anticipated economic recovery, stability in the political environment during the election period and our sustained efforts to strengthen our distribution capability and our market leadership position.

We remain well poised for further growth.

*(**Left**) Ken Gichubi - Regional Manager West of Nairobi, (**Right**) Louis Kamau - Group Brand Manager, Value Seekers and (**Centre**) Vicky Mumassabba - Key Account Representative, were photographed at the Dunhill Shop-in-Shop, Westgate on 29th February 2012.*

# OPERATIONS

"The positive results achieved during the year bear witness to the great teamwork within the team and our dedication to achieving our vision of transforming BAT Kenya into a first-class production facility."

ARTURO RODRIGUEZ
DEMAND CHAIN GENERAL MANAGER



2011 was a successful year on the Operations front. The function embarked on the journey to meet the Strategic Leadership Agenda agreed upon at the beginning of the year. The partnership between Management and the Union, and concerted efforts from various supporting functional teams, enabled us to deliver on operational commitments and improve service to our internal and external customers. The positive results achieved during the year bear witness to great teamwork and our dedication to achieving our vision of transforming the Nairobi factory into a first-class production facility.

## Supply Chain

During the year, BAT Kenya's Supply Chain maintained a high level of customer satisfaction, scoring 91% in this indicator. This is one of the highest scores in the Eastern Europe, Middle East and Africa (EEMEA) region. The Function also commenced the export of small volumes of processed cut rag (semi-processed tobacco) to Madagascar and cigarettes to South Sudan, leveraging on the benefits offered by Kenya's membership in the COMESA trade bloc.

## Procurement

Procurement realised savings in excess of Kshs 67 million from the purchase of goods and services in 2011. These savings - from categories such as medical services, catering and mobile telephony - were realised from all areas of the business, in spite of high inflation and unfavorable exchange rates prevailing during the course of the year.

Considerable effort was put into improving our relationships with our suppliers, resulting in better service and security of supply, even during periods of constrained market supply for key items like fuel.

## Logistics

In its drive towards excellence, BAT Kenya's Logistics team increased the logistics supplier base from two to three to enhance our capability to handle increased volumes, and implemented a new business model enabling Operations to handle an additional volume increase of 1 per cent from 2010. This resulted in better service to our internal and external customers in a year where all requirements were met, including new product introductions and emergency orders. The overall transition to the new Logistics model has already begun to deliver the envisioned service benefits, with anticipated annualised savings estimated at Kshs 28 million.

# OPERATIONS *(Continued)*

During the year, all the leaf logistics activities were integrated with mainstream logistics based in Nairobi, thereby allowing the leaf operations teams to focus on their core business and implement best practice.

## Manufacturing Highlights

### Production Volume

The manufacturing department had a fantastic year and set several records including;

- The highest production volume ever at 12.8 billion cigarette sticks up from 11.4 billion in 2010
- The largest export of semi-processed tobacco (CRT) totaling 7500 tonnes – equivalent to 42 per cent of the total PMD production for the year
- The highest productivity, quality and efficiency performance
- Maintained competitive product costs despite the volume and mix changes

### Capacity Planning

Capacity planning and utilisation improved in 2011 and the team was able to handle increased finished goods production. The Secondary Manufacturing Department (SMD) improved its performance from a Conformance to Plan score of 73 per cent in 2010 to 78 per cent in 2011, while the Primary Manufacturing Department (PMD) increased its score from 45 per cent to 82 per cent. Through prioritising factory needs, we were able to maintain agility in production, ensuring that our brands were manufactured at optimal periods each month. This enabled us to reduce complexity in the factory and increase productivity. The team migrated and incorporated new SMD machines without halting production, within the shortest time possible, thereby avoiding short supplies to our customers.

### Teams

The Self Directed Work Team's concept (SDWT) implemented in 2006 and non–management bonus scheme (NAWIRI) continued to deliver additional value in 2011, with productivity measured in cigarettes per man-hour (cpmh), improving by 7.5 per cent from 29,130 cpmh in 2010 to 31,311 cpmh in 2011. The SDWT concept has also motivated the teams to deliver higher efficiency and lower waste.

### Projects

The factory continued to invest in new technology and processes to deliver world class quality standards, improve reliability and productivity and deliver cost benefits. Key investments in 2011 included:

- **Primary Manufacturing Department (PMD) Upgrade Project**

Our current PMD equipment is on average more than 25 years old and due for replacement considering the local & export demands. Phase one of the upgrade project began in 2011 and we plan to replace the main equipment over three phases between 2011 and 2013. This project will improve the plant reliability, efficiency & quality and also increase the capacity from 22 million kilos/year to 32 million kilos/year at a cost of Kshs 1.0 billion.

- **FIBEX Plant**

To enhance tobacco utilisation and reduce waste, we embraced new technology and installed a state of the art plant for recovery of our by-products (FIBEX). The benefits realised so far include the reduction in tobacco waste to 4.2 per cent, down from 5.7 per cent in 2010. This innovation has the potential of reducing tobacco waste to below 3 per cent on average, and deliver productivity savings of up to Kshs 116 million per year. The new technology will also have the additional benefit of supporting the Green initiative by reducing our waste to the Land-fill.

- **Additional Production Lines**

To accommodate increased export demands, we have acquired three additional production lines. These lines will increase our annualised capacity.

- **Innovations**

Innovation has been a key focus for our business and in line with this, we incorporated the following improvements in our processes and products;



**a. Bevel Edge:**

To support Global Drive Brands (GDB) growth, we have invested in a Bevel Edge Kit. This is an innovative rounded corner pack format that will enhance our factory capability to manufacture in this format.

**b. Digital Tax Verification System:**

We successfully piloted a new Digital Tax Verification (DTV) System that is more efficient than the paper tax stamps and will help fight illicit trade and counterfeits.

## Quality & Product Assurance

The Nairobi factory implemented an enhanced global methodology for measuring the quality of our products (FPI-X) that will give us opportunities for continual improvements in the quality of our products and deliver more value to our consumers. Quality performance ex-factory was sustained at above the world class quality standard, and our products consistently delivered superior performance against the competition in the market.

In 2011, we carried out a consumer product test (Product Space Mapping) to enable us further understand the emerging trends in the market place and the drivers for consumer choice. We shall use this valuable information in 2012 and beyond for improvements in our product offers to our consumers.

The Operations team managed to revalidate the ISO 17025 accreditation status following an annual surveillance audit by our accreditation body South Africa National Accreditation System (SANAS).

The journey towards standardising our factory systems to ISO 9001 standards was sustained through the conducting of a gap assessment with the identified gaps closed during the year. The factory is on a journey towards establishing a quality management system that adheres to ISO standards.

***This innovation has the potential of reducing tobacco waste to below 3 per cent on average, and deliver productivity savings of up to Kshs 116 million per year.***

Self-Directed Work Teams (SDWT) continued to play a leading role in quality ownership, ensuring quality at source and carrying out gap analysis to further improve manufacturing processes. The SDWT quality champions continue to play a central role in our continuous improvement journey.

## OPERATIONS *(Continued)*

ANNUAL REPORT & FINANCIAL STATEMENTS 2011

*Stanley Mugwe - Head of Leaf Kenya, (**first from right**) with members of the Leaf Team. Malakisi, 18th January 2012.*

The roll out of MATerial QUality Information System (MatQuIs) developed in Western Europe commenced in Q4 2010 and was finalised in the first quarter of 2011 as per plan. This system has provided a standardised way to assess supplier performance and direct material quality, hence enabling us to benchmark suppliers and further improve the quality of our inputs, thereby positively impacting on the quality of our products.

The management of our Product Specifications went online within the entire BAT Group. This will drive synergies by sharing information with sister companies and benchmarking our process inputs. This information will allow us to identify opportunities for reducing complexities in our processes and deliver productivity improvements.

### Going Green

BAT Kenya continued to maintain a strong focus on Social Responsibility in Tobacco Production (SRTP). Overall, the afforestation Programme saw more than 2 million seedlings distributed in 2011, with more than 40 per cent being indigenous species. Other initiatives contributing towards increasing the national forest cover and safeguarding the country's diverse ecosystem included the rehabilitation of dams, river lines and hills. Some of the afforestation and rehabilitation projects undertaken by the company were:

- Kisawayi Dam Rehabilitation (4,000 trees)
- Kabkara and Bukokholo Dam Rehabilitation (7,500 trees)
- Ena Riverbank Rehabilitation (4,000 trees)
- Magina Hill and Oyani River Rehabilitation (8,000 trees)

Our sustained focus and commitment to Environmental Health and Safety (EH&S) standards crossed another significant milestone on 24th July 2011, when the Company's Nairobi factory marked its third consecutive year with no disabling accident. This speaks volumes about the safe environment within which our staff works. The company has also been honoured with Global and Local awards in; Energy Management & Conservation, Afforestation and Recycling & Re-use.

In 2011, BAT Kenya signed an Energy Accord in partnership with the Government and the Kenya Association of Manufacturers (KAM). This is a voluntary agreement to improve energy efficiency and accrue benefits to both the enterprise and the national economy. The benefits from this initiative include; energy cost reduction, an opportunity to partner with Government in shaping of energy policies & regulations, opportunities for Government funding and concessions for energy initiatives.

The Operations Team continues to ensure that aiming for growth and aiming for sustainability are complementary, not competing, elements in our strategy.

### Leaf Growing

During the 2011 season, leaf volume increased by over 8 per cent versus 2010. Farmer productivity per unit area maintained its upward trend achieving over 4 per cent growth in 2011 primarily due to the improved application of agronomical best practices supported by cell based farmer extension model. As a result, our contracted tobacco farmers collectively earned over Kshs. 700 million in 2011, up from Kshs 660 million in 2010, representing an 11 per cent improvement.

The Self Directed Work Team (SDWT) extension model enhanced the adoption of new technologies through practical learning and benchmarking against the best cell members. Leading farmers were also able to assist their counterparts in achieving cell parameters.

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# OPERATIONS *(Continued)*

Online buying was successfully piloted in Malakisi and will be rolled out to other tobacco growing areas by end of 2012. Online buying ensures faster payment to farmers, enhances product traceability and provides a controlled buying environment.

The Crop Insurance Scheme launched by UAP Insurance in conjunction with British American Tobacco Kenya Limited continued to gain popularity amongst our farmers with 100% of our contracted farmers enrolled in the scheme by the end of 2011.

## Processing

The Green Leaf Processing Team recorded remarkable improvement in 2011 versus 2010 performance.

The Green Leaf Threshing (GLT) plant processed over 23,000 metric tons of tobacco in 2011, up 21 per cent from 2010. The volume increase and other efficiency improvement initiatives saw productivity improve by 14 per cent. Improvements were also registered in both yield and product quality.

***Overall, the afforestation Programme saw more than 2 million seedlings distributed in 2011 with more than 40 per cent being indigenous species.***

In an effort to improve the plant to international standards, the team successfully implemented Gemba walks, which have delivered improvements in terms of safety and general housekeeping standards.

A number of projects were initiated to improve efficiency and working environment. Warehouse optimisation remained a key pillar in ensuring efficient product flow during the peak seasons. A new warehouse is due for completion in March 2012 and this will increase total storage capacity from 18mn kgs to 20 mn kgs to serve both domestic and export requirements.

Work on the installation of a new dust unit began and will be completed by March 2012. This will improve plant throughput and working environment.

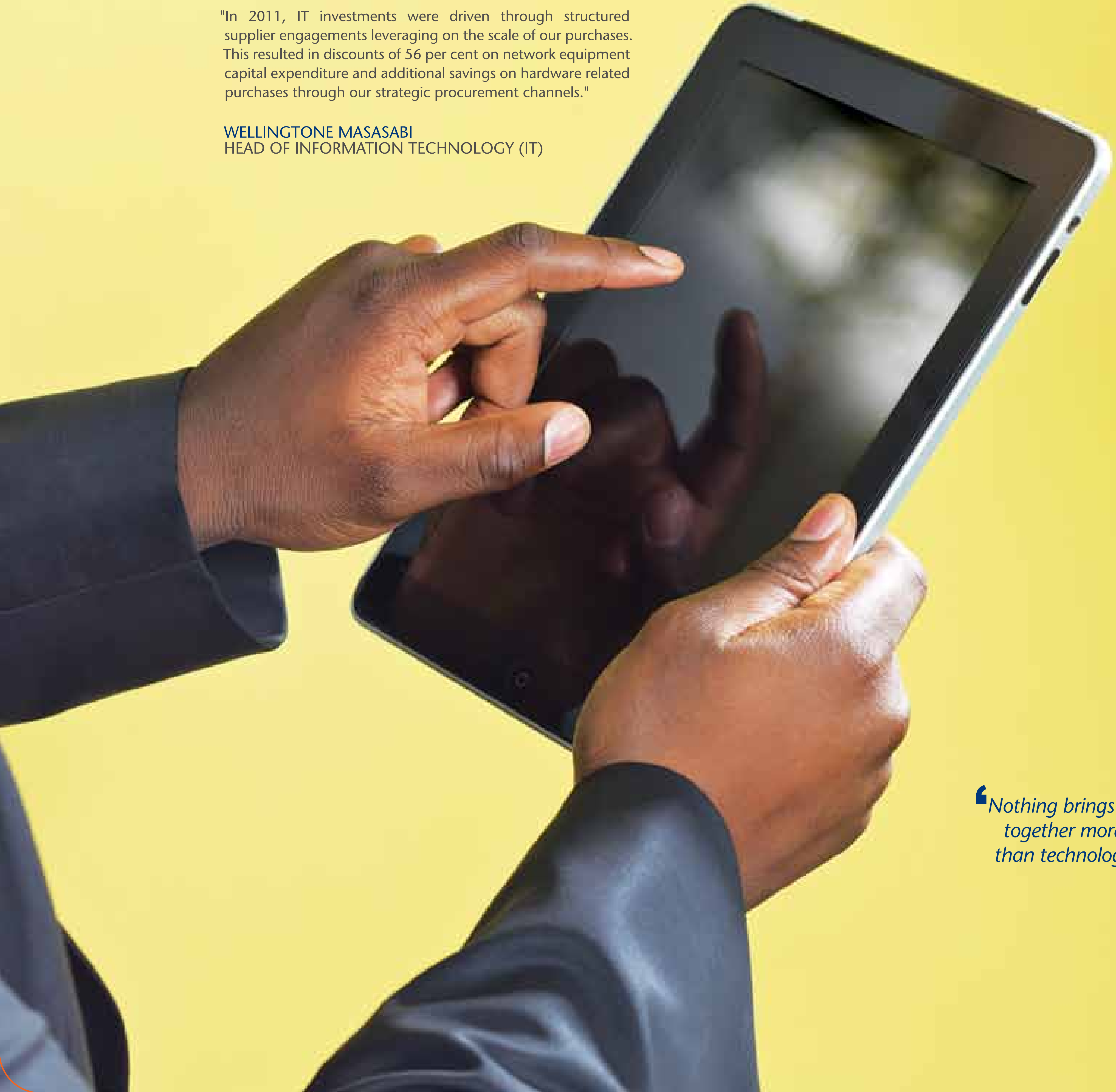
The Self Directed Work Team (SDWT) continued to deliver value to the business. During the 2011 processing season, they championed Formula 1 pit-stop maintenance approach and delivered substantial benefits to the business.

Focus on safety awareness across the Group has been heightened as we strive to achieve the ultimate goal in health and safety-zero accidents. This is aimed at ensuring that our employees return to their families safely at the end of every working day.

# INFORMATION TECHNOLOGY (IT)

"In 2011, IT investments were driven through structured supplier engagements leveraging on the scale of our purchases. This resulted in discounts of 56 per cent on network equipment capital expenditure and additional savings on hardware related purchases through our strategic procurement channels."

**WELLINGTONE MASASABI**
HEAD OF INFORMATION TECHNOLOGY (IT)



*"Nothing brings us together more than technology"*

ANNUAL REPORT & FINANCIAL STATEMENTS 2011

### Value Driven Technology

The growth of the business has resulted in increasing demand on the technology infrastructure and quality of IT services.
In addition, the business expects to see value delivered from the investments in technology and a positive impact on the bottom line.

### Business Productivity

A key focus area for IT in 2011 was increasing efficiencies from our Enterprise Resource Planning System, SAP. In conjunction with our business functions, we have implemented a set of metrics used to monitor process health and identify opportunities for improving the use of SAP. This has resulted in a number of training initiatives for the System Users that have resulted in improvements in utilization and overall health of key process such as reporting, as measured by the dashboard. This ensures that our users have the appropriate skill-set as we continue to seek more opportunities to support the growing business using SAP.

### Increasing Employee Productivity

In 2011, we undertook several initiatives to improve the User Experience for employees with a view to enhancing productivity. We overhauled our User Desktop environment by implementing the latest versions of our desktop productivity tools and collaboration environment, dubbed "Blend 7". We further enhanced the ability of our employees to have remote access and telecommuting capability due to increasing demand for off-site access and employee work-life balance. Also of significance was the investment in a digital media platform, at our Likoni Road Headquarters and Thika GLT site. This has provided an engaging office environment for employees and improved the delivery and quality of communication across the company.

### Capabilities to support business expansion

In order to meet the increasing demand for technology to support the growth of the business, we implemented a number of capabilities across the organization. These included the enhancement of our Leaf Online buying platform which provides improved efficiencies in our Leaf Buying centers. In collaboration with our Corporate & Regulatory Affairs and Operations colleagues, we conducted a successful pilot of a Digital Tax Verification (DTV) system which will be a key enabler in the fight against illicit trade.

Underlying the effective management of a growing business is the need to have reliable market information. To this end we invested in an innovative Forecasting tool to further advance the forecasting and analysis capabilities within the Marketing Insights team.

### Smarter Investment

Sustainable growth requires more investment in IT. In 2011, IT investments were driven through structured supplier engagements leveraging on the scale of our purchases. This resulted in discounts of 56 per cent on network equipment capital expenditure and additional savings on hardware related purchases though our strategic procurement channels.

# CORPORATE & REGULATORY AFFAIRS


"We re-doubled our previous efforts to sensitise key stakeholders on the trade, socio-economic and legal issues which also impact tobacco control legislation ."

JOE MUGANDA
HEAD OF CORPORATE & REGULATORY AFFAIRS

In 2011, the focus remained on supporting business growth by managing the regulatory environment and safeguarding the Company's license to operate in Kenya. Engaging in carefully selected Corporate Social Responsibility (CSR) initiatives in collaboration with the Leaf Team and our tobacco farmers also formed a considerable and noteworthy element of the Function's work. We re-doubled our previous efforts to sensitise key stakeholders on the trade, socio-economic and legal issues which inter alia, impact tobacco control legislation.

## Tobacco Regulation

No new tobacco control regulation was introduced in 2011. Nonetheless, we maintained dialogue with the government throughout the year towards addressing key concerns with the tobacco control environment in Kenya. This dialogue bore fruit near the close of 2011 as the government called upon the Ministry of Public Health and Sanitation to prepare a policy paper on tobacco regulation and consider amending sections of the Tobacco Control Act, 2007 (TCA). The Company is optimistic that issues of discord in the industry will be addressed and implementation and enforcement of the law will be improved. The government's action towards the end of 2011 was demonstrative of the gains made in shifting the debate from a purely public health discourse to a more evidence-based and multi-sectoral approach.

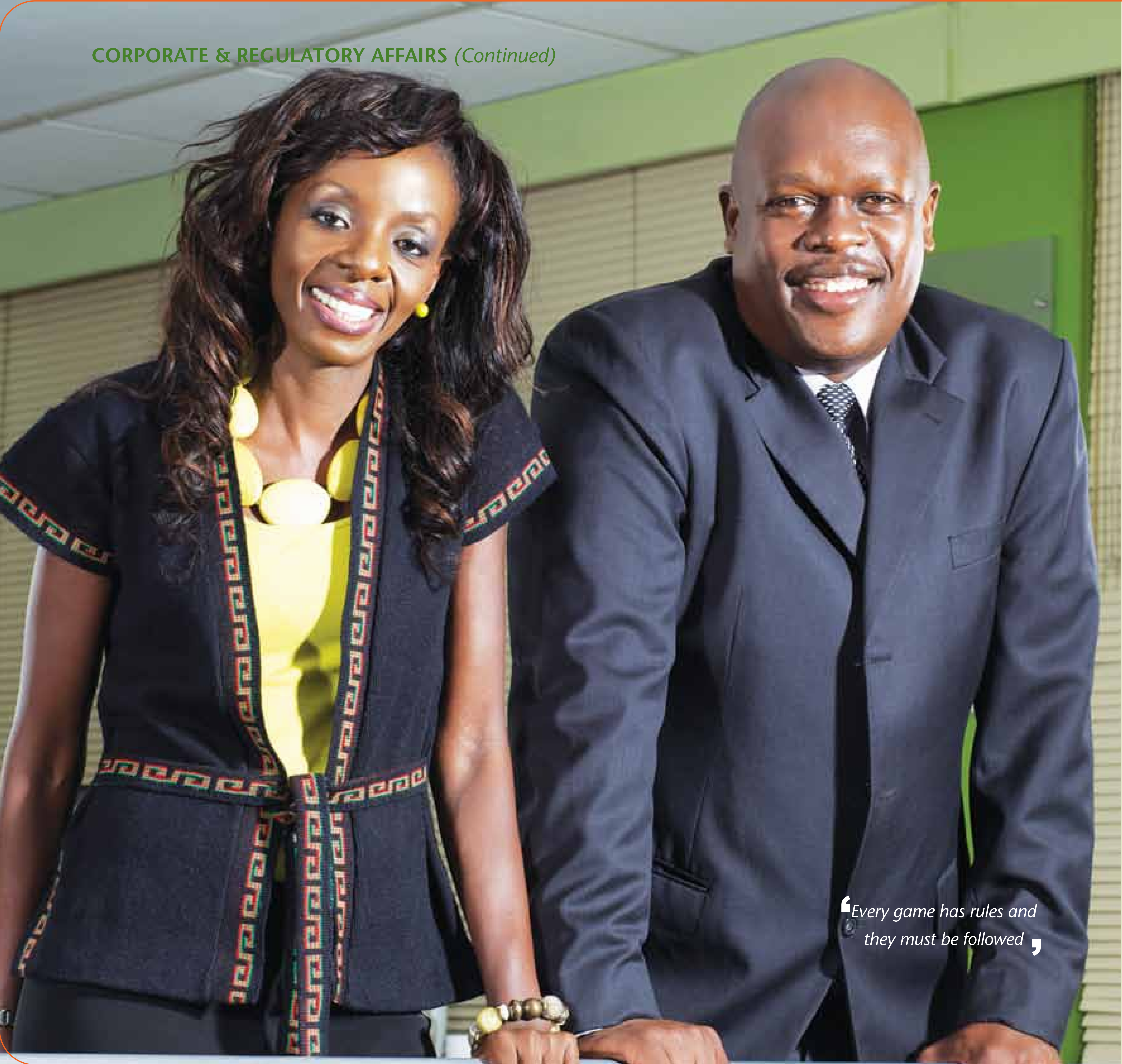
The forthcoming World Health Organization (WHO) Fifth Conference of Parties (COP 5) meeting which will be held in Seoul, South Korea in November 2012 was another key regulatory focus area in 2011. As part of the preparations for COP 5, we have engaged government and shared information towards ensuring the development of a comprehensive, inter-ministerial country position ahead of the Conference.

Our strategy going into 2012 is to support business growth by continuing to proactively monitor regulatory trends and drive the realisation of balanced, evidenced-based tobacco legislation. On the Framework Convention on Tobacco Control (FCTC) front, we will maintain diligent dialogue with the government as it develops a coherent country position that promotes public health gains without inflicting undue damage to the tobacco industry, tobacco farmers and other stakeholders.

## Excise

In June 2011, the 4-tier tobacco excise system introduced in January 2011 was replaced with a simpler structure which leveled the industry playing field. The current excise system has brought stability to both industry revenues and government excise revenues.

BAT Kenya registered remarkable growth in Sportsman as a result of the change in excise. This growth was fuelled by consumers' preference for the value offered by Sportsman, and our repositioning of our national pride brand at a sustainable price point. In 2012, we will continue to pursue an excise system which maximises the opportunity for business growth and shareholder value, while protecting government revenues.




## Illicit Trade

Illicit trade in tobacco products is an on-going challenge to the industry. It negatively affects our key asset - our brands - and our consumers and defrauds the Kenyan Government of billions of shillings from corporate tax and excise revenue.

In 2011, BAT Kenya collaborated with the Kenya Police Service, the Kenya Revenue Authority (KRA) and the Anti-Counterfeiting Agency in fighting illicit trade in tobacco. In addition to working to clamp down on illicit traders, the Company supported the training of various authorities in identifying illicit trade in tobacco and assisted in the prosecution of offenders.

The net effect of the above mentioned initiatives and anti-illicit trade activities was the seizure of 40 million counterfeit and smuggled cigarettes for which duty was not paid, valued at Kshs 160 million, and the disruption of illegal supply chains resulting in halting the production of 300 million illicit cigarettes worth an estimated Kshs 1.2 billion.

## Corporate Social Responsibility (CSR) in a Sustainable Way

The Tobacco Control Act, 2007 currently limits the scope of CSR activities the Company can participate in. Creating and safeguarding a legitimate corporate space within which we can meaningfully give back to the communities in which we operate is one of the issues we will continue to engage government on in 2012.

Within the permissible parameters for CSR in 2011 – afforestation and environmental conservation - BAT Kenya committed 500,000 seedlings to the Office of the Prime Minister's Greening Kenya Initiative, donated over 20,000 trees to national dam and river rehabilitation projects; and supported the planting of 100,000 seedlings in the Mau catchment area to promote agriculture and water sector development, alongside the larger Mau's peace efforts. In solidarity with other Kenyans and friends of Kenya, BAT Kenya employees around the world also supported the "Kenyans for Kenya" Drought and Famine Relief Campaign, donating over 10 million shillings towards the cause.

## Sustaining an Integrated Corporate Existence

The operationalisation of the East African Community (EAC) Protocol in July 2011 and greater participation in COMESA occasioned by BAT Kenya's exports to Egypt and South Sudan in 2011 necessitated a step-change in the manner in which the business leveraged Kenya's membership in both trade blocs to enhance stakeholder and shareholder value. BAT Kenya stands with the government in their quest to realise the full potential of this dynamic regional connexus. We welcome the opportunity to help shape an expanding regulatory environment and ensure that our voice is heard and point-of-view duly considered in this increasingly integrated region. We are working with other like-minded and interested stakeholders to ensure that our regulatory strategies and proposals make sense not only for Kenya "here and now," - but also for our evolving position as a leading corporate in East and Central Africa.

# HUMAN RESOURCES (HR)

"In addition to being commended for having the best "Work-Life Balance" among Kenyan corporates by Strathmore Business School, we also participated in the Kenya Institute of Human Resources Management (IHRM) sponsored HR Index, which seeks to benchmark organizations HR practices."

JONATHAN D'SOUZA
HEAD OF HUMAN RESOURCES

*"Experience is learning from each other"*

## Continuing on the Journey to Excellence

In 2011 HR continued to build on the programs started in 2010, while responding to employee views collected through the biennial "Your Voice Survey" run in 2010. Talent Management, Performance Culture and Engagement were re-prioritised, while data and systems, which had a high priority before, took a back seat as the Service Center consolidated the gains made. The HR Charter for 2011 focused on fewer areas, and sought to execute these better.

Our key focus remained the attraction, retention and motivation of high calibre talent. We ran a tender exercise to identify more capable and responsive resourcing partners to support us in the search for this talent locally.

In September, we launched our Global Learning Zone, an on-line portal that consolidated development tools and facilities into a one-stop shop that allowed managers to plan, execute and monitor their personal development.

We maintained a competitive reward proposition, and had another year with an excellent bonus payout, based on 2010 business performance. Despite the rapid acceleration of inflation in the latter half of the year, we did not suffer loss of any key staff due to remuneration issues, and concluded the Collective Bargaining Agreement with the Union in record time.

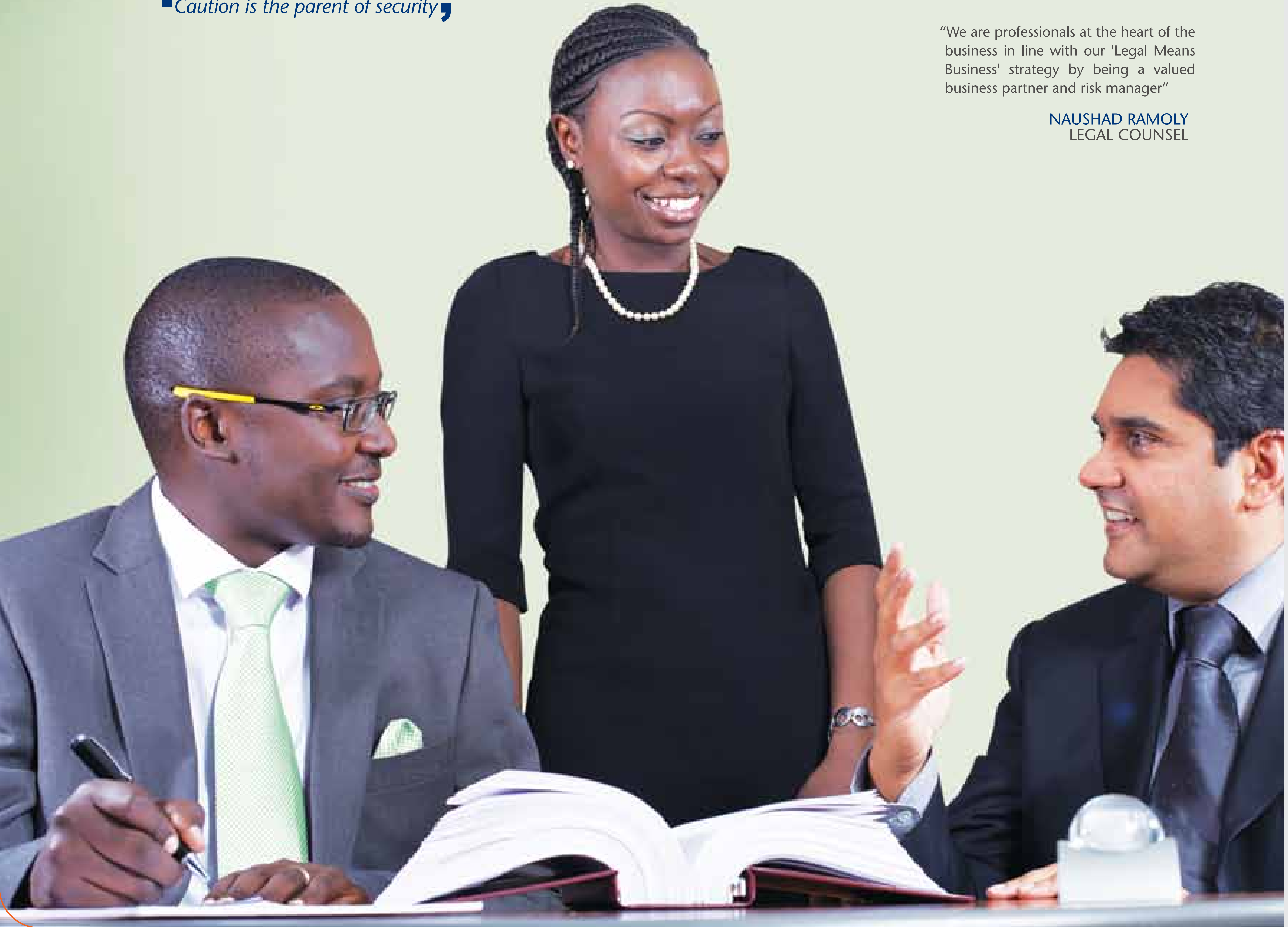
At BAT Kenya, we continuously review our structures to ensure they are optimal, and in the course of the year, management numbers were reduced by 10. However, we recruited 3 people externally, and promoted 6 employees into the management structure, with voluntary management turnover being under 4 per cent. Non-management numbers increased by 30, mainly due to the increased production volumes, and voluntary turnover at non-management level was under 2 per cent, with total turnover (including involuntary exits) at 7.6 per cent.

To develop the leadership pipeline of the future, we brought in 10 Management Trainees, 2 each in Production, Leaf, Marketing & Finance, 1 in Human Resources and one in Corporate & Regulatory Affairs. These Management Trainees (MTs) will go through a rigorous two-year program, coached and guided by senior managers and be exposed to various aspects of the Company. Successful MTs will join the management team.

During the year, we took part in a number of external engagements, including participating at University career fairs and other professional fora, seeking to showcase some of the processes and practices we've implemented. In addition to being commended for having the best "Work-Life Balance" among Kenyan corporates by Strathmore Business School, we also participated in the Kenya Institute of Human Resources Management (IHRM) sponsored HR Index, which seeks to benchmark organisations HR practices. In its inaugural edition, BAT Kenya won the overall award as "Best Employer" and led in the categories of "Compensation & Benefits", "Employee Communication" and "Work-Life Balance".

# LEGAL/ ANTI-ILLICIT TRADE (AIT) & SECURITY

*Caution is the parent of security*



"We are professionals at the heart of the business in line with our 'Legal Means Business' strategy by being a valued business partner and risk manager"

NAUSHAD RAMOLY
LEGAL COUNSEL

In addition to maintaining good corporate governance, the Legal/ AIT/ Security Team aims to work with the rest of the business to mitigate risk and identify opportunities for sustainable growth.

## The First Line of Defence

We continue to ensure that the business receives high quality legal advice on regulatory matters to ensure compliance with the evolving regulatory landscape, for example the introduction of the Competition Act and the implementation of the new Constitution in 2011.

## Fighting Illicit Trade

The illicit trade in tobacco products is an on-going challenge to the industry. Illicit Trade negatively affects our brands, our consumers and defrauds the Kenyan Government of billions of shillings from its entitled tax and excise revenue.

BAT Kenya, in collaboration with the Kenya Police, the Kenya Revenue Authority (KRA) and the Anti-Counterfeiting Agency, has stepped up the fight against illicit traders in tobacco products. The Company trained the relevant authorities in effective methods to thrust illicit trade and assisted with the prosecution of a number of offenders.

## Efficient Contracts Management

In view of increasing efficiency and productivity, BAT Kenya has put in place an effective end to end process for the management of suppliers from the sourcing stage up to the provision of goods and services. This has largely been achieved through proactive business partnering and effecting service level agreements supported by training of all managers in charge of specific high impact contracts.

## Business Continuity Management

In 2011, there was an increased focus on risk management and Business Continuity Management. Through a holistic management process that identifies potential threats to our business, BAT Kenya embarked on a process to build resilience and the capability to respond effectively, to safeguard our business, our reputation and our brands. In 2011 we created a Business Continuity Management system as well as trained and equipped a dedicated Business Continuity Planning and Crisis Management team.

## Management of regulatory risks and acting as the first line of defence

We continue to ensure that the business receives high quality legal advice on regulatory matters and shape our business to ensure compliance with the ever changing regulatory landscape of Kenya. In 2011, a major change occurred with the introduction of the Competition Act and the implementation of the new Constitution. Several workshops were held to ensure compliance and understanding throughout the organisation.

## Records Management

Records management entails not only proper storage of all business records but also constantly adapting to best practise in terms of how and where we keep our records as well as complying with the various legal, audit and tax obligations surrounding these records. This has enhanced business efficiency by giving the business the necessary support to sustain its high performance but also acts as the first line of defence in litigation matters as part and parcel of risk management.

# CORPORATE GOVERNANCE

ANNUAL REPORT & FINANCIAL STATEMENTS 2011

The Company is committed to sustained high performance, supported by the highest standards of good corporate governance. As a listed company, it adheres to the standards of good corporate governance set out in the Capital Markets Authority Guidelines on Corporate Governance Practices by Public Listed Companies in Kenya (CMA Guidelines). The Company however believes that the most potent form of corporate governance comes from within, with external guides and codes being overlays to the standards of business integrity which we set ourselves.

These standards are codified in the Standards of Business Conduct which every employee adheres to and which form an integral part of our business strategy. In addition we also adhere to our *Statement of Business Principles* which is designed to help meet the expectations placed on us by our various stakeholders.

## The Board Of Directors

The Board is collectively responsible to the Company's shareholders for the Company's long-term success and for its overall strategic direction, its values and its governance. It provides the leadership necessary for the Company to meet its business objectives within the framework of its internal controls, while also discharging the Company's obligations to its shareholders.

Responsibility for implementing strategy and day-to-day operations has been delegated by the Board to the Managing Director and the senior management team.

## Composition Of The Board Of Directors

The Board's current membership consists of seven Non-Executive Directors and two Executive Directors. They are appointed for a period of two years; subsequent reappointment is subject to endorsement by the Board and the approval of shareholders at an AGM in the usual manner. The Board meets at least four times a year.

## Evaluation Of Board Performance

Every year, the Board conducts a critical evaluation of its performance for the preceding year. This evaluation is done by each Director completing a Board Effectiveness evaluation form. The information is then collated by the Company Secretary and presented to the Nominations Committee with a view to improving upon identified areas of weakness.

## Board Committees

Committees are established to assist the Board in the performance of its duties. There are three standing committees:-

### The Audit Committee

The Audit Committee was chaired by Prof. J.H. Kimura (Non-Executive Director) during 2011. It meets three times a year with internal and external auditors, as well as with management. The Committee monitors and reviews the integrity of the Company's financial statements and as appropriate, makes recommendations to the Board on business risks, internal controls and compliance. The scope of the Committee also includes the monitoring of corporate social responsibility issues; specifically - reputation, social and environmental risks.

### The Nominations Committee

The Nominations Committee is chaired by Mr. E. Mwaniki (Non-Executive Director). It makes recommendations to the Board on the suitability of candidates for appointment to the Board, whilst ensuring that the Board has an appropriate balance of expertise and ability. The Nominations Committee also evaluates and makes recommendations with regard to the composition of all Board Committees. In so doing, it monitors and ensures that appropriate Non-Executive and Executive Directors' ratios are maintained. This Committee is also charged with the responsibility of evaluating and reporting to the Board on an annual basis, the effectiveness of the Board and effectiveness of the Directors in the discharge of their responsibilities.

### The Remuneration Committee

The Remunerations Committee is chaired by Mr. M. M. Wanyoike (Non-Executive Director). It determines the Company's remuneration policy for employees, management and Non-Executive Directors.

## Provident Funds

The two British American Tobacco Provident Funds are under the stewardship of a joint Board of Trustees. Chaired by Non-Executive Director, Mr. M. M. Wanyoike, the Board of Trustees includes representatives of employees and management. Both Funds are compliant with the requirements of the Retirement Benefits Act.

## Corporate Citizenship

British American Tobacco Kenya has adopted a structured approach to environmental, health and safety management in compliance with the Group's best practice from all global operations.

## Employees

British American Tobacco Kenya actively encourages dialogue and participation in the company's business through regular team briefs, internal publications, employee surveys and regular meetings between employees and their representatives. The Company is an equal opportunity employer and recruits people on the basis of their ability without discrimination.

## Communication With Shareholders

British American Tobacco Kenya is committed to ensuring that shareholders and the financial markets are provided with full and timely information about its performance. This is achieved through the release of its half-year and annual results in the local press, distribution of annual reports and holding investor briefings as appropriate. Information is also available on the Group Company's website; **www.bat.com**

# SHAREHOLDING STRUCTURE

| Major Shareholders as at 23 February 2012 | Total Shares | % Shareholding |
|---|---|---|
| Molensteegh Invest BV | 60,000,000 | 60.00% |
| Board of Trustees NSSF | 5,700,136 | 5.70% |
| Standard Chartered Nominees Ltd A/c 9002 | 2,786,100 | 2.78% |
| Standard Chartered Nominees Ltd Non Resident A/c 9057 | 1,382,010 | 1.38% |
| Standard Chartered Nominees Ltd Non Resident A/c 9866 | 1,228,585 | 1.23% |
| Standard Chartered Nominees Ltd Non Resident A/c 9296 | 1,047,531 | 1.05% |
| Old Mutual Insurance Co. Ltd | 877,734 | 0.88% |
| Standard Chartered Nominees Ltd A/c 9054 | 817,400 | 0.82% |
| Kenya Commercial Bank Nominees Ltd A/c 769G | 816,500 | 0.82% |
| Kenya Reinsurance Corporation Ltd | 700,000 | 0.70% |
| **SHARES SELECTED** | **75,355,996** | **75.36%** |
| **Others (5,353 shareholders)** | **24,644,004** | **24.64%** |
| **TOTAL** | **100,000,000** | **100.00%** |

### Summary of Shareholders as at 23 February 2012

| Shareholder | No. of Shareholders | No. of Shares | % Shareholding |
|---|---|---|---|
| Foreign Companies | 35 | 70,504,684 | 70.50% |
| Foreign Individuals | 82 | 205,188 | 0.21% |
| Local Companies | 548 | 21,676,573 | 21.68% |
| Local Individuals | 4,698 | 7,613,555 | 7.61% |
| **TOTAL** | **5,363** | **100,000,000** | **100.00%** |

### Distribution of Shareholders as at 23 February 2012

| Shareholding | No. of Shareholders | No. of Shares | % Shareholding |
|---|---|---|---|
| Less than 500 | 2,615 | 630,165 | 0.63% |
| 501 - 5,000 | 2,231 | 3,604,719 | 3.60% |
| 5,001- 10,000 | 202 | 1,459,971 | 1.46% |
| 10,001 - 100,000 | 251 | 7,765,186 | 7.77% |
| 100,001 - 1,000,000 | 58 | 14,395,597 | 14.40% |
| Above 1,000,000 | 6 | 72,144,362 | 72.14% |
| **TOTALS** | **5,363** | **100,000,000** | **100.00%** |

ANNUAL REPORT & FINANCIAL STATEMENTS 2011
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011

# CORPORATE INFORMATION

### Board of Directors

Mr. E. Mwaniki* (Chairman)
Mr. G. Fagan (Managing Director)
Mr. P. Lopokoiyit (Finance Director)
Mr. M.M. Wanyoike*
Mr. A. Ngugi*
Prof. J.H. Kimura*
Mr. G.R. May*
Mr. G. Maina*
Ms. C. Musyoka*
Ms. R.T. Ngobi (Company Secretary)

### Audit Committee

Prof. J. H. Kimura* (Chairman)
Mr. G. R. May*
Mr. G. Maina*
Ms. C. Musyoka*
Mr. G. Fagan (Permanent invitee)
Mr. P. Lopokoiyit (Permanent invitee)
Mr. E. Mwaniki* (Permanent invitee)
Mr. A. Rodriguez (Permanent invitee)
Mr. J. Muganda (Permanent invitee)
Mr. N. Ramoly (Permanent invitee)
Mr. D. Wasike (Secretary)

### Nominations Committee

Mr. E. Mwaniki* (Chairman)
Mr. A. N. Ngugi*
Mr. G. May*
Mr. G. Fagan
Ms. R.T. Ngobi (Secretary)

### Remuneration Committee

Mr. M. M. Wanyoike* (Chairman)
Mr. E. Mwaniki*
Mr. G. Fagan
Mr. P. Lopokoiyit
Mr. P. Ciucci
Mr. J. D'Souza (Secretary)

### Auditor

PricewaterhouseCoopers,
The Rahimtulla Tower, Upper Hill Road,
P. O. Box 43693-00100
NAIROBI

### Transfer Agents

Custody & Registrar Services Limited,
Bruce House, 6th Floor, Standard Street,
P. O. Box 8484-00100,
NAIROBI

### Advocates

Kaplan & Stratton,
Williamson House,
4th Ngong Avenue,
P.O. Box 4011-00100
NAIROBI

### Bankers

Barclays Bank of Kenya Limited
Citibank NA
Commercial Bank of Africa Limited
Standard Chartered Bank Kenya Limited

### Secretary and Registered Office

R.T. Ngobi (Ms.)
Likoni Road
P.O. Box 30000-00100
NAIROBI

* Non-Executive Directors


# British American Tobacco Kenya Limited

## Annual Report & Financial Statements

For the Year Ended 31 December 2011

**BRITISH AMERICAN TOBACCO KENYA LIMITED**
**ANNUAL REPORT AND FINANCIAL STATEMENTS**
**FOR THE YEAR ENDED 31 DECEMBER 2011**



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*Sophia Mukoba, Finance Controller (third from Left) with members of the BAT Kenya Finance Team.*

# DIRECTORS' REPORT

The Directors submit their report together with the audited financial statements for the year ended 31 December 2011, which disclose the state of affairs of the group and of the Company.

## Principal activities

The principal activities of the group are the manufacture and sale of cigarettes and tobacco.

## Results and Dividend

The net profit for the year of Shs 3,097,755,000 has been added to retained earnings. During the year, an interim dividend of Shs 350,000,000 (2010: Shs 300,000,000) was paid. The Directors recommend the approval of a final dividend of Shs 2,700,000,000 (2010: Shs 1,450,000,000).

## Board of Directors

The following changes have taken place in the Board of Directors since the last Annual General Meeting:

Messrs. H. Eloff, J. Dowd and M. Oduor-Otieno resigned from the Board on 1 February 2011, 1 March 2011 and 4 May 2011 respectively.

Ms. C. Musyoka was appointed a Director on 23 February 2011.

In accordance with Article 95 Ms. C. Musyoka retires from the Board and being eligible, offers herself for re-election.

Prof. J. Kimura retires by rotation and being eligible, offers himself for re-election in accordance with Article 89 of the Articles of Association.

Mr. A. Ngugi having attained the age of 70 on 23 July 2007 retires in terms of section 186(2) of the Companies Act and being eligible by virtue of a Special Notice given under section 186 (5) offers himself for re-election.

Mr. E. Mwaniki having attained the age of 70 on 18 November 2008 retires in terms of section 186(2) of the Companies Act and being eligible by virtue of a Special Notice given under section 186 (5) offers himself for re-election.

## Auditor

The Company's auditor, PricewaterhouseCoopers, has expressed interest to continue in office in accordance with section 159(2) of the Companies Act.

By order of the Board
R.T. Ngobi (Ms.)
Company Secretary

**23 February 2012**



# TAARIFA YA WAKURUGENZI

Wakurungenzi wanawasilisha taarifa yao pamoja na taarifa za ukaguzi wa kifedha kwa kipindi kilichomalizikia tarehe 31 Desemba 2011 kinachoelezea maswala ya kampuni.

## Shughuli Kuu

Shughuli kuu za kampuni ni utengenezaji na uuzaji wa sigara na bidhaa za tumbaku.

## Matokeo na Mgao wa Faida

Faida ya mwaka ya kampuni ya Shilingi 3,097,755,000 imeongezwa kwa mapato yaliyoko. Katika mwaka huo mgao wa muda wa faida wa Shilingi 350,000,000 (2010: Shilingi 300,000,000) ulilipwa. Wakurugenzi wanapendekeza kuidhinishwa kwa mgao wa mwisho wa faida wa Shilingi 2,700,000,000 (2010: Shilingi 1,450,000,000).

## Halmashauri ya Wakurugenzi

Mabadiliko yafuatayo yametekelezwa katika Halmashauri ya wakurugenzi tangu mkutano mkuu wa kila mwaka uliopita:

Bwana H. Eloff, Bwana J. Dowd na Bwana M. Oduor-Otieno walijiuzulu kwenye Halmashauri tarehe 1 Februari 2011, 1 Machi 2011 na 4 Mei 2011, kwa mtiririko huo.

Bi C. Musyoka aliteuliwa kuwa mkurugenzi tarehe 23 Februari 2011.

Kwa mujibu wa kifungu nambari 95 cha sheria za kampuni, Bi. C. Musyoka anastaafu kwenye Halmashauri kwa zamu wakati wa mkutano mkuu wa kila mwaka na kwa vile anastahili kujiwasilisha kuchaguliwa tena.

Kwa mujibu wa kifungu nambari 89 cha sheria za kampuni, Bwana J. Kimura anastaafu kwenye Halmashauri kwa zamu wakati wa mkutano mkuu wa kila mwaka na kwa vile anastahili kujiwasilisha kuchaguliwa tena.

Bwana A. Ngugi ambaye alitimiza umri wa miaka 70 tarehe 23 Julai 2007 anastaafu kuambatana na kifungu 186(2) cha sheria za kampuni na kwa vile anastahili kwa mujibu wa ilani maalum iliyotolewa chini ya kifungu nambari 186(5) anajiwasilisha kuchaguliwa tena.

Bwana E. Mwaniki ambaye alitimiza umri wa miaka 70 tarehe 18 Novemba 2008 anastaafu kuambatana na kifungu 186(2) cha sheria za kampuni na kwa vile anastahili kwa mujibu wa ilani maalum iliyotolewa chini ya kifungu nambari 186(5) anajiwasilisha kuchaguliwa tena.

## Wakaguzi

Wakaguzi wa hesabu PriceWaterhouseCoopers wameonyesha hamu ya kuendelea na kazi ya ukaguzi kuambatana na kifungu nambari 159(2) cha sheria za kampuni.

Kwa amri ya Halmashauri
R.T. Ngobi (Ms.)
Katibu wa Kampuni

**23 Februari 2012**

# STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Kenyan Companies Act requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the group and of the company as at the end of the financial year and of the group's profit or loss. It also requires the directors to ensure that the company keeps proper accounting records that disclose, with reasonable accuracy, the financial position of the company. They are also responsible for safeguarding the assets of the company.

The directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable estimates, in conformity with International Financial Reporting Standards and the requirements of the Companies Act. The directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the group and of the company and of the group's profit in accordance with International Financial Reporting Standards. The directors further accept responsibility for the maintenance of accounting records that may be relied upon in the preparation of financial statements, as well as designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement.

Nothing has come to the attention of the directors to indicate that the company and its subsidiaries will not remain a going concern for at least twelve months from the date of this statement.

| | |
|---|---|
| **G. Fagan**<br>Managing Director | **P. Lopokoiyit**<br>Finance Director |

**23 February 2012**

ANNUAL REPORT & FINANCIAL STATEMENTS 2011
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011

# REPORT OF THE INDEPENDENT AUDITOR TO THE MEMBERS OF BRITISH AMERICAN TOBACCO KENYA LIMITED

## Report on the consolidated financial statements

We have audited the accompanying consolidated financial statements of British American Tobacco Kenya Limited (the company) and its subsidiaries (together, the group), as set out on pages 78 to 111. These financial statements comprise the consolidated statement of financial position as at 31 December 2011 and the consolidated statement of comprehensive income, statement of changes in equity and the statement of cash flows for the year then ended, together with the statement of financial position of the company standing alone as at 31 December 2011 and the statement of changes in equity of the company for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## Directors' responsibility for the financial statements

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and with the requirements of the Kenyan Companies Act and for such internal control, as the directors determine necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

## Auditor's responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements, plan and perform our audit to obtain reasonable assurance that the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Opinion

In our opinion the accompanying financial statements give a true and fair view of the state of the group and company's financial affairs at 31 December 2011 and of the profit and cash flows of the group for the year then ended in accordance with International Financial Reporting Standards and the Kenyan Companies Act.

## Report on other legal requirements

The Kenyan Companies Act requires that in carrying out our audit we consider and report to you on the following matters. We confirm that:

i) we have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit;
ii) in our opinion proper books of account have been kept by the company, so far as appears from our examination of those books;
iii) the company's statement of financial position and statement of comprehensive income are in agreement with the books of account.

pwc

**Certified Public Accountants**
**Nairobi**

**23 February 2012**

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| | Notes | Year ended 31 December 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|---|
| **Revenue** | 5 | 20,138,122 | 13,539,233 |
| Other income | | 298,885 | 200,266 |
| Cost of operations | 6 | (15,650,541) | (10,576,979) |
| Restructuring costs | | (124,050) | (223,001) |
| Finance costs | 7 | (178,300) | (216,947) |
| **Profit before income tax** | 8 | 4,484,116 | 2,722,572 |
| Income tax expense | 10 | (1,386,361) | (955,336) |
| **Profit for the year** (all of which has been dealt with in the accounts of the Company) | | 3,097,755 | 1,767,236 |
| Other comprehensive income | | - | - |
| **Total comprehensive income for the year** | | 3,097,755 | 1,767,236 |
| **Earnings per share** | | | |
| Basic and diluted (Shs per share) | 11 | 30.98 | 17.67 |



# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

| | Notes | At 31 December 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|---|
| **Capital and reserves attributable to the company's equity holders** | | | |
| Share capital | 13 | 1,000,000 | 1,000,000 |
| Share premium | 13 | 23 | 23 |
| Revaluation surplus | 14 | 1,063,978 | 1,108,422 |
| Retained earnings | | 1,648,066 | 1,555,867 |
| Proposed dividend | | 2,700,000 | 1,450,000 |
| **Total equity** | | 6,412,067 | 5,114,312 |
| **Non-current liabilities** | | | |
| Borrowings | 22 | 1,024,064 | 968,400 |
| Deferred income tax liabilities | 15 | 973,785 | 932,196 |
| **Total non-current liabilities** | | 1,997,849 | 1,900,596 |
| **Total equity and non-current liabilities** | | 8,409,916 | 7,014,908 |
| **Non-current assets** | | | |
| Deferred income tax assets | 15 | 14,491 | 8,133 |
| Property, plant and equipment | 16 | 6,756,340 | 6,309,139 |
| | | 6,770,831 | 6,317,272 |
| **Current assets** | | | |
| Inventories | 18 | 4,374,777 | 2,972,758 |
| Receivables and prepayments | 19 | 1,648,650 | 1,601,049 |
| Current income tax | | 235,607 | 109,617 |
| Cash and cash equivalents | 20 | 720,680 | 120,865 |
| | | 6,979,714 | 4,804,289 |
| **Current liabilities** | | | |
| Payables and accrued expenses | 21 | 4,024,355 | 2,407,222 |
| Borrowings | 22 | 21,606 | 553,000 |
| Provisions for liabilities and charges | 23 | 1,005,589 | 983,549 |
| Current income tax | | 289,079 | 162,882 |
| | | 5,340,629 | 4,106,653 |
| **Net current assets** | | 1,639,085 | 697,636 |
| | | 8,409,916 | 7,014,908 |

The financial statements on pages 78 to 111 were approved for issue by the board of directors on 23 February 2012 and signed on its behalf by:

**G. Fagan**
Managing Director

**P. Lopokoiyit**
Finance Director

## COMPANY STATEMENT OF FINANCIAL POSITION

| | Notes | At 31 December 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|---|
| **Capital and reserves attributable to the company's equity holders** | | | |
| Share capital | 13 | 1,000,000 | 1,000,000 |
| Share premium | 13 | 23 | 23 |
| Revaluation surplus | 14 | 1,063,978 | 1,108,422 |
| Retained earnings | | 1,648,066 | 1,555,867 |
| Proposed dividend | | 2,700,000 | 1,450,000 |
| **Total equity** | | 6,412,067 | 5,114,312 |
| **Non-current liabilities** | | | |
| Borrowings | 22 | 1,024,064 | 968,400 |
| Deferred income tax liabilities | 15 | 973,785 | 932,196 |
| **Total non-current liabilities** | | 1,997,849 | 1,900,596 |
| **Total equity and non-current liabilities** | | 8,409,916 | 7,014,908 |
| **Non-current assets** | | | |
| Property, plant and equipment | 16 | 6,756,340 | 6,309,139 |
| Investment in subsidiaries | 17 | 12,000 | 12,000 |
| | | 6,768,340 | 6,321,139 |
| **Current assets** | | | |
| Inventories | 18 | 4,374,777 | 2,972,758 |
| Receivables and prepayments | 19 | 1,656,623 | 1,586,377 |
| Current income tax | | - | 109,617 |
| Cash and cash equivalents | 20 | 712,685 | 95,768 |
| | | 6,744,085 | 4,764,520 |
| **Current liabilities** | | | |
| Payables and accrued expenses | 21 | 3,786,235 | 2,534,202 |
| Borrowings | 22 | 21,606 | 553,000 |
| Provisions for liabilities and charges | 23 | 1,005,589 | 983,549 |
| Current income tax | | 289,079 | - |
| | | 5,102,509 | 4,070,751 |
| **Net current assets** | | 1,641,576 | 693,769 |
| | | 8,409,916 | 7,014,908 |

The financial statements on pages 78 to 111 were approved for issue by the board of directors on 23 February 2012 and signed on its behalf by:

**G. Fagan**
Managing Director

**P. Lopokoiyit**
Finance Director



FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2011

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| | Notes | Share capital Shs'000 | Share premium Shs'000 | Revaluation surplus Shs'000 | Retained earnings Shs'000 | Proposed dividends Shs'000 | Total equity Shs'000 |
|---|---|---|---|---|---|---|---|
| **Year ended 31 December 2010** | | | | | | | |
| At start of year | | 1,000,000 | 23 | 1,152,866 | 1,494,187 | 1,025,000 | 4,672,076 |
| Total comprehensive income for the year | | - | - | - | 1,767,236 | - | 1,767,236 |
| Transfer of excess depreciation | | - | - | (63,492) | 63,492 | - | - |
| Deferred income tax on transfer | | - | - | 19,048 | (19,048) | - | - |
| Net (losses)/gains recognised directly in equity | | - | - | (44,444) | 44,444 | - | - |
| **Transactions with owners** | | | | | | | |
| Distribution to owners | | | | | | | |
| Dividends: | | | | | | | |
| - Final for 2009 | 12 | - | - | - | - | (1,025,000) | (1,025,000) |
| - Interim for 2010 | 12 | - | - | - | (300,000) | - | (300,000) |
| - Proposed Final for 2010 | 12 | - | - | - | (1,450,000) | 1,450,000 | - |
| Total transactions with owners | | - | - | - | (1,750,000) | 425,000 | (1,325,000) |
| At end of year | | 1,000,000 | 23 | 1,108,422 | 1,555,867 | 1,450,000 | 5,114,312 |
| **Year ended 31 December 2011** | | | | | | | |
| At start of year | | 1,000,000 | 23 | 1,108,422 | 1,555,867 | 1,450,000 | 5,114,312 |
| Total comprehensive income for the year | | - | - | - | 3,097,755 | - | 3,097,755 |
| Transfer of excess depreciation | | - | - | (63,492) | 63,492 | - | - |
| Deferred income tax on transfer | | - | - | 19,048 | (19,048) | - | - |
| Net (losses)/gains recognised directly in equity | | - | - | (44,444) | 44,444 | - | - |
| **Transactions with owners** | | | | | | | |
| Distribution to owners | | | | | | | |
| Dividends: | | | | | | | |
| - Final for 2010 | 12 | - | - | - | - | (1,450,000) | (1,450,000) |
| - Interim for 2011 | 12 | - | - | - | (350,000) | - | (350,000) |
| - Proposed final for 2011 | 12 | - | - | - | (2,700,000) | 2,700,000 | - |
| Total transactions with owners | | - | - | - | (3,050,000) | 1,250,000 | (1, 800,000) |
| At end of year | | 1,000,000 | 23 | 1,063,978 | 1,648,066 | 2,700,000 | 6,412,067 |

The notes on pages 84 to 111 are an integral part of these consolidated financial statements.

# COMPANY STATEMENT OF CHANGES IN EQUITY

| | Notes | Share capital Shs'000 | Share premium Shs'000 | Revaluation surplus Shs'000 | Retained earnings Shs'000 | Proposed dividends Shs'000 | Total equity Shs'000 |
|---|---|---|---|---|---|---|---|
| **Year ended 31 December 2010** | | | | | | | |
| At start of year | | 1,000,000 | 23 | 1,152,866 | 1,494,187 | 1,025,000 | 4,672,076 |
| Total comprehensive income for the year | | - | - | - | 1,767,236 | - | 1,767,236 |
| Transfer of excess depreciation | | - | - | (63,492) | 63,492 | - | - |
| Deferred income tax on transfer | | - | - | 19,048 | (19,048) | - | - |
| Net (losses)/gains recognised directly in equity | | - | - | (44,444) | 44,444 | - | - |
| **Transactions with owners** | | | | | | | |
| Distribution to owners | | | | | | | |
| Dividends: | | | | | | | |
| - Final for 2009 | 12 | - | - | - | - | (1,025,000) | (1,025,000) |
| - Interim for 2010 | 12 | - | - | - | (300,000) | - | (300,000) |
| - Proposed final for 2010 | 12 | - | - | - | (1, 450,000) | 1, 450,000 | - |
| Total transactions with owners | | - | - | - | (1,750,000) | 425,000 | (1,325,000) |
| At end of year | | 1,000,000 | 23 | 1,108,422 | 1,555,867 | 1,450,000 | 5,114,312 |
| **Year ended 31 December 2011** | | | | | | | |
| At start of year | | 1,000,000 | 23 | 1,108,422 | 1,555,867 | 1,450,000 | 5,114,312 |
| Total comprehensive income for the year | | - | - | - | 3,097,755 | - | 3,097,755 |
| Transfer of excess depreciation | | - | - | (63,492) | 63,492 | - | - |
| Deferred income tax on transfer | | - | - | 19,048 | (19,048) | - | - |
| Net (losses)/gains recognised directly in equity | | - | - | (44,444) | 44,444 | - | - |
| **Transactions with owners** | | | | | | | |
| Distribution to owners | | | | | | | |
| Dividends: | | | | | | | |
| - Final for 2010 | 12 | - | - | - | - | (1,450,000) | (1, 450,000) |
| - Interim for 2011 | 12 | - | - | - | (350,000) | - | (350,000) |
| - Proposed final for 2011 | 12 | - | - | - | (2,700,000) | 2,700,000 | - |
| Total transactions with owners | | - | - | - | (3,050,000) | 1,250,000 | (1,800,000) |
| At end of year | | 1,000,000 | 23 | 1,063,978 | 1,648,066 | 2,700,000 | 6,412,067 |

The notes on pages 84 to 111 are an integral part of these consolidated financial statements.



# CONSOLIDATED STATEMENT OF CASH FLOWS

| | Notes | Year ended 31 December 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|---|
| **Operating activities** | | | |
| Cash generated from operations | 24 | 5,391,782 | 3,133,997 |
| Interest received | | 634 | 245 |
| Interest paid | | (172,675) | (169,899) |
| Income tax paid | | (1,350,923) | (750,731) |
| Net cash generated from operating activities | | 3,868,818 | 2,213,612 |
| **Investing activities** | | | |
| Purchase of property, plant and equipment | 16 | (1,006,161) | (768,133) |
| Proceeds from disposal of property, plant and equipment | | 12,888 | 216,374 |
| Net cash used in investing activities | | (993,273) | (551,759) |
| **Financing activities** | | | |
| Dividends paid to the company's shareholders | | (1,800,000) | (1,325,000) |
| Proceeds from borrowings | | 38,703 | 369,600 |
| Net cash used in financing activities | | (1,761,297) | (995,400) |
| **Net increase in cash and cash equivalents** | | 1,114,248 | 706,453 |
| **Movement in cash and cash equivalents** | | | |
| At start of year | | (415,174) | (1,121,627) |
| Increase | | 1,114,248 | 706,453 |
| At end of year | 20 | 699,074 | (415,174) |

The notes on pages 84 to 111 are an integral part of these consolidated financial statements.

# NOTES

## 1. General information

BAT Kenya Limited is incorporated in Kenya under the Companies Act as a public limited liability company and is domiciled in Kenya. The address of its registered office is:

Likoni Road
P.O Box 30000-00100
Nairobi

The company's shares are listed on the Nairobi Securities Exchange.

For Kenyan Companies Act reporting purposes, the balance sheet is represented by the statement of financial position and the profit and loss account by the statement of comprehensive income, in these financial statements.

## 2. Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

(a) Basis of preparation

The financial statements are prepared in accordance with International Financial Reporting Standards (IFRS). The measurement basis applied is the historical cost basis, except where otherwise stated in the accounting policies below.

The financial statements are presented in Kenya Shillings (Shs), rounded to the nearest thousand.
The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires directors to exercise judgement in the process of applying the group's accounting policies. The areas involving a higher degree of judgement or complexity, or where assumptions and estimates are significant to the financial statements, are disclosed in Note 3.

### Changes in accounting policy and disclosures

(a) New and amended standards adopted by the Group

The following new standards and amendments to standards are mandatory for the first time for the financial period beginning 1 January 2011.

| Standard | Title |
|---|---|
| IAS 1 | Presentation of financial statements |
| IAS 24 | Related party disclosures |
| IFRS 7 | Financial instruments: Disclosures |

- The amendments to IAS 1 'Presentation of financial statements' is part of the 2010 Annual Improvements and clarifies that an entity shall present an analysis of other comprehensive income for each component of equity, either in the statement of changes in equity or in the notes to the financial statements. The application of this amendment has no significant impact as the Group and Company was already disclosing the analysis of other comprehensive income on its statement of changes in equity.

- The amendments to IAS 24 'Related party disclosures' clarifies and simplifies the definition of a related party and removes the requirement for government-related entities to disclose details of all transactions with the government and other government-related entities. The amended definition means that some entities will be required to make additional disclosures, e.g. an entity that is controlled by an individual that is part of the key management personnel of another entity is now required to disclose transactions with that second entity. Related party disclosures have increased following the adoption of this amendment.



# NOTES *(continued)*

## 2. Summary of significant accounting policies (continued)

- The amendments to IFRS 7 'Financial Instruments' Disclosures' are part of the 2010 Annual Improvements and emphasises the interaction between quantitative and qualitative disclosures about the nature and extent of risks associated with financial instruments. The amendment has also removed the requirement to disclose the following;
  - Maximum exposure to credit risk if the carrying amount best represents the maximum exposure to credit risk;
  - Fair value of collaterals; and
  - Renegotiated assets that would otherwise be past due but not impaired.

  The application of the above amendment has simplified financial risk disclosures made by the Group and Company.

  Other amendments and interpretations to standards became mandatory for the year beginning 1 January 2011but had no significant effect on the Group's financial statements.

  (b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been earlier adopted by the Group

Numerous new standards, amendments and interpretations to existing standards have been issued but are not yet effective. Below is the list of new standards that are likely to be relevant to the Group and Company.

| Standard | Title | Applicable for financial years beginning on/after |
|---|---|---|
| IAS 1 | Presentation of financial statements | 1 July 2012 |
| IFRS 10 | Consolidated financial statements | 1 January 2013 |
| IFRS 12 | Disclosure of interests in other entities | 1 January 2013 |
| IFRS 13 | Fair value measurement | 1 January 2013 |
| IFRS 9 | Financial instruments | 1 January 2015 |

- IAS 1, 'Presentation of financial statements' – effective 1 July 2012.
  The amendment changes the disclosure of items presented in other comprehensive income (OCI) in the statement of comprehensive income. Entities will be required to separate items presented in other comprehensive income ("OCI") into two groups, based on whether or not they may be recycled to profit or loss in the future. Items that will not be recycled will be presented separately from items that may be recycled in the future. Entities that choose to present OCI items before tax will be required to show the amount of tax related to the two groups separately.

  The title used by IAS 1 for the statement of comprehensive income has changed to 'statement of profit or loss and other comprehensive income', though IAS 1 still permits entities to use other titles.

- IFRS 9 'Financial Instruments' – effective 1 January 2015.
  IFRS 9, was issued in November 2009 and October 2010 and replaces those parts of IAS 39 relating to the classification and measurement of financial instruments.

  IFRS 9 requires financial assets to be classified into two measurement categories: those measured at fair value and those measured at amortised cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument.

  For financial liabilities, the standard retains most of the IAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than in profit or loss, unless this creates an accounting mismatch. The Group and Company is yet to assess IFRS 9's full impact and intends to adopt IFRS 9 no later than the accounting period beginning on or after 1 January 2015.

- IFRS 10 'Consolidated Financial Statements' – effective 1 January 2013.
  This is a new standard that replaces the consolidation requirements in SIC-12 Consolidation—Special Purpose Entities and IAS 27 Consolidated and Separate Financial Statements. Standard builds on existing principles

# NOTES *(continued)*

## 2. Summary of significant accounting policies (continued)

by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company and provides additional guidance to assist in the determination of control where this is difficult to assess.

The revised definition of control focuses on the need to have both power and variable returns before control is present. The Group will need to consider the new guidance.

- IFRS 12 'Disclosure of interests in other entities' – effective 1 January 2013.
  IFRS 12 includes the disclosure requirements for all forms of interests in other entities, including interests in subsidiaries, associates, joint arrangements, special purpose entities and other off balance sheet vehicles. The Group is yet to assess IFRS 12s full impact.

- IFRS 13 'Fair Value Measurement' – effective 1 January 2013.
  IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across all IFRSs. The requirements, which are largely aligned between IFRS and US GAAP, do not extend the use of fair value accounting but provide guidance on how it should be applied where its use is already required or permitted by other standards within IFRS. The Group is yet to assess IFRS 13s full impact.

There are no other IFRSs or IFRIC interpretations that are not yet effective that would be expected to have a material impact on the Group or Company.

(b) Consolidation

(i) Subsidiaries

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. The Group also assesses existence of control where it does not have more than 50% of the voting power but is able to govern the financial and operating policies by virtue of de-facto control. De-facto control may arise in circumstances where the size of the group's voting rights relative to the size and dispersion of holdings of other shareholders give the group the power to govern the financial and operating policies etc.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date the control ceases.

The Group uses the acquisition method of accounting to account for business combinations. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognises any non-controlling interest in the acquiree on an acquisition- by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognised amounts of acquiree's identifiable net assets.

**Acquisition-related costs are expensed as incurred.**

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date through profit or loss.

Any contingent consideration to be transferred by the group is recognised at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognised in accordance with IAS 39 either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.



# NOTES *(continued)*

## 2. Summary of significant accounting policies (continued)

Goodwill is initially measured as the excess of the aggregate of the consideration transferred and the fair value of non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in profit or loss.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

Investments in subsidiaries are accounted for at cost less impairment. Cost is adjusted to reflect changes in consideration arising from contingent consideration amendments. Cost also includes direct attributable costs of investment.

(ii) Changes in ownership interests in subsidiaries without change of control

Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions – that is, as transactions with the owners in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

(iii) Disposal of subsidiaries

When the Group ceases to have control, any retained interest in the entity is remeasured to its fair value at the date when control is lost, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

(c) Functional currency and translation of foreign currencies

(i) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in Kenya Shillings (Kshs), which is the Group's presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in profit or loss within 'finance income or cost'. All other foreign exchange gains and losses are presented in profit or loss within 'other income' or 'other expenses'.

(d) Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Leadership Team that makes strategic decisions.

# NOTES *(continued)*

## 2. Summary of significant accounting policies (continued)

(e) Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group and Company's activities. Revenue is shown net of value-added tax (VAT), excise duty, returns, rebates and discounts and after eliminating sales within the group.
The Group and Company recognises revenue when the amount of revenue can be reliably measured, it is probable that future economic benefits will flow to the Group and Company and when specific criteria have been met for each of the Group and Company's activities as described below. The amount of revenue is not considered to be reliably measurable until all contingencies relating to the sale have been resolved. The Group and Company bases its estimates on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Revenue is recognised as follows:
(i) Sales of goods: The Group manufactures and sells cigarettes to distributors and fellow subsidiaries of the ultimate parent company. Sales of goods are recognised in the period in which the Group delivers products to the customer, the customer has full discretion over the channel to sell the products and there is no unfulfilled obligation that could affect the customer's acceptance of the goods. Delivery does not occur until the products are shipped to the specified location, the risk of obsolescence and loss has been transferred to the customer and the customer has accepted the products. No element of financing is deemed present as the sales are made with a credit term of 30 days, which is consistent with the market practice.
(ii) Sales of services are recognised in the period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a percentage of the total services to be provided.
(iii) Royalty income is recognised on an accruals basis in accordance with the substance of the relevant agreements.
(iv) Interest income is recognised using the effective interest method.
(v) Dividends are recognised as income in the period in which the right to receive payment is established.

(f) Property, plant and equipment

All categories of property, plant and equipment are initially recorded at cost. Buildings, freehold land and long term leasehold land are subsequently shown at fair value, based on periodic, but at least once every five years, valuations by external independent valuers, less subsequent depreciation for buildings. All other property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. The carrying value of the replaced part is derecognised. All other repairs and maintenance are charged to profit or loss during the financial period in which they are incurred.

Increases in the carrying amount arising on revaluation are credited to other comprehensive income and shown in the revaluation surplus reserve in equity. Decreases that offset previous increases of the same asset are charged in other comprehensive income and debited against the revaluation surplus reserve in equity; all other decreases are charged to profit or loss.

Each year, the difference between depreciation based on the revalued carrying amount of the asset (i.e. the depreciation charged to profit or loss) and the depreciation based on the asset's original cost is transferred from the revaluation surplus to retained earnings.



# NOTES *(continued)*

## 2. Summary of significant accounting policies (continued)

Freehold land is not depreciated. Depreciation on other assets is calculated using the straight line method to allocate their cost or revalued amounts to their residual values over their estimated useful lives, as follows:

| | |
|---|---|
| Leasehold land: | Over the period of the lease |
| Buildings: | 2.5% - 10% per annum or over the period of the lease if less than 40 years |
| Plant and machinery: | 7% per annum |
| Vehicles and equipment: | 10% to 25% per annum |

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

The carrying amount of the group's non-current assets is written down immediately to its estimated recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.
Gains and losses on disposal of property, plant and equipment are determined by comparing proceeds with the carrying amount and are included in the profit or loss. On disposal of revalued assets, amounts in the revaluation surplus reserve relating to that asset are transferred to retained earnings.

(g) Impairment of non-financial assets

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use.

For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

(h) Accounting for leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

The Group and Company leases certain property, plant and equipment. Leases of property, plant and equipment where the Group and Company has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's commencement at the lower of the fair value of the lease property and the present value of the minimum lease payments.

Each lease payment is allocated between the liability and finance charges. The corresponding rental obligations, net of finance charges, are included in non-current liabilities. The interest element of the finance charge is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. Property, plant and equipment acquired under finance leases are depreciated over the shorter of the assets useful life and the lease term.

(i) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined by the weighted average 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), but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the costs of completion and applicable variable selling expenses.

# NOTES *(continued)*

## 2. Summary of significant accounting policies (continued)

(j) Financial assets

(i) Classification

The Group and Company classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, and available-for-sale. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the reporting date. These are classified as non-current assets. The Group and Company's loans and receivables comprise 'trade and other receivables', 'non current receivables and prepayments' and 'cash and cash equivalents' in the statement of financial position.

(ii) Recognition and measurement

Regular purchases and sales of financial assets are recognised on the trade date, which is the date on which the group commits to purchase or sell the asset. Financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the group has transferred substantially all risks and rewards of ownership. Loans and receivables and are carried at amortised cost using the effective interest method.

(iii) Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realise the asset and settle the liability simultaneously.

(iv) Impairment of financial assets

Assets carried at amortised cost
The Group and Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Evidence of impairment may include indications that the debtors or a group of debtors is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganisation, and where observable data indicate that there is a measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

For loans and receivables category, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced and the amount of the loss is recognised in profit or loss. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group and Company may measure impairment on the basis of an instrument's fair value using an observable market price.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the reversal of the previously recognised impairment loss is recognised in profit or loss.



# NOTES *(continued)*

## 2. Summary of significant accounting policies (continued)

(k) Derivative financial instruments

Derivatives, which comprise solely forward foreign exchange contracts, are initially recognised at fair value on the date the derivative contract is entered into and are subsequently re-measured at their fair value. The derivatives do not qualify for hedge accounting. Changes in the fair value of derivatives are recognised immediately in profit or loss. These derivatives are trading derivatives and are classified as a current asset or liability.

(l) Trade receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are a classified as current assets. If not, they are presented as non-current assets.
Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method, less provision for impairment (note j).

(m) Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.
Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest rate method.

(n) Share capital

Ordinary shares are classified as 'share capital' in equity. Any premium received over and above the par value of the shares is classified as 'share premium' in equity.

(o) Cash and cash equivalents

In the statement of cash flows, cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the statement of financial position.

(p) Employee benefits

Pension obligations
The Group and Company operates two defined contribution retirement benefit schemes for all its employees. The assets of each scheme are held in separate funds which are administered by an independent fund manager and are funded by contributions from both the group and employees. The group's contributions to the schemes are charged to profit or loss in the year to which they relate.

Prior to 1 January 2006, the group operated an unfunded retirement benefit scheme to provide additional "top up" retirement benefits to management staff. The scheme operated on a defined benefit basis. No contributions were payable to the scheme, but a provision would be made in the financial statements for the estimated cost of the future benefits under the scheme.

Effective 1 January 2006, the "top up" arrangement was discontinued and instead the employer contributions to the Provident Fund adjusted to replicate the benefits that would have previously been payable from the Provident Fund and the "top up" arrangement. The group has put in place a provision for the defined benefit obligation to ensure that for the next five years employees leaving benefits will not be less than they would have been under the previous arrangements.

# NOTES *(continued)*

## 2. Summary of significant accounting policies (continued)

This arrangement came to an end during 2010 and the Group and Company will operate defined contribution retirement benefit schemes for all its employees going forward.
The group and all its employees also contribute to the National Social Security Fund (NSSF), which is a defined contribution scheme.

Other entitlements
Employee entitlements to long service awards are recognised when they accrue to employees. The estimated monetary liability for employees' accrued annual leave entitlement at the statement of financial position date is recognised as an expense accrual.

The Group and Company recognises a liability and an expense for bonuses based on a formula that takes into consideration the profit attributable to the Group and Company's shareholders after certain adjustments. The Group and Company recognises a provision where contractually obliged or where there is past practice that has created a constructive obligation.

Termination benefits
Termination benefits are payable when employment is terminated by the group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. Employee termination benefits are recognised only after either an agreement is in place with the appropriate employee representatives specifying the terms of redundancy and numbers of employees affected or after individual employees have been advised of the specific terms.

(q) Current and deferred income tax

The tax expense for the period comprises current and deferred income tax. Tax is recognised in the profit or loss except to the extent that it relates to items recognised in other comprehensive income or directly in equity. In this case, the tax is also recognised in other comprehensive income or directly in equity, respectively.

The current income tax charge is calculated on the basis of the tax enacted or substantively enacted at the reporting date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying values in the financial statements. However, if the deferred tax liabilities are not recognised if they arise from the initial recognition of goodwill; deferred income tax is not accounted for 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 income tax is determined using tax rates and laws that have been enacted or substantively enacted at the reporting date and are expected to apply when the related deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, 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 income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.



# NOTES *(continued)*

## 2. Summary of significant accounting policies (continued)

(r) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in profit or loss over the period of the borrowings using the effective interest rate method.

Fees paid on the establishment of loan facilities are recognised as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. In this case, the fee is deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalised as a pre-payment for liquidity services and amortised over the period of the facility to which it relates.

Borrowings are classified as current liabilities unless there is an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

(s) Dividend distribution

Dividends payable to the Company's shareholders are recognised as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders. Proposed dividends are shown as a separate component of equity until declared.

(t) Provisions

Provisions are recognised when: the Group and Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

(u) Borrowing costs

General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

## 3. Critical accounting estimates and judgements

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including experience of future events that are believed to be reasonable under the circumstances. The Group and Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

In the process of applying the group's accounting policies, management has made judgements in determining:
- the classification of financial assets, liabilities and leases;
- whether assets are impaired;
- the amount of provisions and contingent liabilities.

# NOTES *(continued)*

## 4. Financial risk management

The Group and Company's activities expose it to a variety of financial risks, market risk (including currency and interest risk), credit risk and liquidity risk. The Group and Company's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on its financial performance. The Group occasionally uses forward exchange contracts to hedge against foreign exchange risk.

Risk management is carried out by the treasury and tax committee under policies approved by the Board of Directors. The committee identifies and evaluates financial risks where applicable. The Board provides written principles for overall risk management, as well as written policies covering specific areas such as foreign exchange risk, interest rate risk, credit risk, use of derivative and non-derivative financial instruments and investing excess liquidity.

### Market risk

(i) Foreign exchange risk
The Group and Company operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar, British Pound and Euro. Foreign exchange risk arises from future commercial transactions and recognised assets and liabilities that are denominated in a currency that is not the entity's functional currency. The group manages foreign exchange risk arising from future commercial transactions and recognised assets and liabilities by regularly revising prices and robust working capital management and has not designated any derivative instruments as hedging instruments.

At 31 December 2011, if the Shilling had weakened by 10% against the US dollar with all other variables held constant, consolidated and company post tax profit for the year would have been Shs 80,533,097 (2010: Shs 2,012,342) lower, mainly as a result of US dollar payables.

At 31 December 2011, if the Shilling had weakened by 10% against the GBP with all other variables held constant, consolidated post tax profit for the year would have been Shs 25,179,583 (2010: Shs 43,272,297) lower, mainly as a result of GBP denominated trade payables.

At 31 December 2011, if the Shilling had weakened by 10% against the Euro with all other variables held constant, consolidated and company post tax profit for the year would have been Shs 31,804,177 (2010: Shs 9,562,252) higher, mainly as a result of euro receivables.

(ii) Price risk
The Group and the company are not exposed to equity securities price risk.

(iii) Cash flow and fair value interest rate risk
The Group and Company's interest rate risk arises from long-term borrowings. Borrowings issued at variable rates expose the Group and Company to cash flow interest rate risk which is partially offset by cash held at variable rates. The Group and Company regularly monitors financing options available to ensure optimum interest rates are obtained. At 31 December 2011 and 2010, an increase/decrease of 100 basis points would have resulted in an insignificant change in consolidated and company post tax profit.

### Credit risk

Credit risk is managed on a group basis. Credit risk arises from deposits with banks, as well as trade and other receivables. Neither the group nor the company has any significant concentrations of credit risk. Credit risk is the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group and Company.

For banks and financial institutions, only reputable well established financial institutions are accepted. For trade receivables, group management assesses the credit quality of each customer, taking into account its financial position, past experience and other factors. Individual risk limits are set based on internal or external ratings in accordance with limits set by the Board. The utilisation of credit limits is regularly monitored.

No credit limits were exceeded during the reporting period, and management does not expect any losses from non-performance by these counterparties.



# NOTES *(continued)*

## 4. Financial risk management (continued)

The amount that best represents the Group and Company's maximum exposure to credit risk at 31 December 2011 is made up as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 | 2011 Shs'000 | 2010 Shs'000 |
| Cash and cash equivalents | 720,680 | 120,865 | 712,685 | 95,678 |
| Trade and related party receivables | 1,137,555 | 1,140,085 | 1,137,555 | 1,127,022 |
| Other receivables | 511,095 | 380,451 | 519,068 | 380,010 |
| | 2,369,330 | 1,641,401 | 2,369,308 | 1, 602,710 |

No collateral is held for any of the above assets. All receivables that are neither past due nor impaired are within their approved credit limits, and no receivables have had their terms renegotiated.

None of the above assets are either past due or impaired except for the following amounts in trade and related party receivables (which are due within 30 days of the end of the month in which they are invoiced):

| | Group | | Company | |
|---|---|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 | 2011 Shs'000 | 2010 Shs'000 |
| Past due but not impaired: | | | | |
| - by up to 3 months | 99,939 | 59,342 | 98,497 | 59,370 |
| - by 4 to 6 months | 60,181 | 93,019 | 58,123 | 92,991 |
| - by 7 to 12 months | 76,632 | 17,155 | 76,632 | 17,169 |
| - beyond 1 year | - | 204,373 | - | 201,995 |
| Total past due but not impaired | 236,752 | 373,889 | 233,252 | 371,525 |
| Receivables individually determined to be impaired: | | | | |
| Carrying amount before provision for impairment loss | - | 1,320 | - | - |
| Provision for impairment loss (Note 19) | - | (1,320) | - | - |
| Net carrying amount | - | - | - | - |

*Past due amounts mainly relate to related party balances.*

### Liquidity risk

Liquidity risk is the risk that the group and company will not be able to meet its financial obligations as they fall due. Prudent liquidity risk management includes maintaining sufficient cash, and the availability of funding from an adequate amount of committed credit facilities. Due to the dynamic nature of the underlying businesses, the Treasury department maintains flexibility in funding by maintaining availability under committed credit lines. Management perform cash flow forecasting and monitor rolling the group and company's liquidity requirements to ensure it has sufficient cash to meet its operational needs while maintaining sufficient headroom on its undrawn committed borrowing facilities (Note 22) at all times so that the group and company does not breach borrowing limits or covenants (where applicable) on any of its borrowing facilities.

## NOTES *(continued)*

### 4. Financial risk management (continued)

**Liquidity risk (continued)**

The group's approach when managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, without incurring unacceptable losses or risking damage to the group's reputation.

The table below analyses the group's and the company's financial liabilities that will be settled on a net basis into relevant maturity groupings based on the remaining period at the statement of financial position date to the contractual maturity date. The amounts disclosed in the table below are the contractual undiscounted cash flows.

| | Less than 1 year Shs'000 | Between 1 and 2 years Shs'000 |
|---|---|---|
| **(a) Group** | | |
| **At 31 December 2011** | | |
| **Liabilities** | | |
| - borrowings | 21,606 | 1,024,064 |
| - trade and other payables | 2,734,986 | - |
| - amounts due to related parties | 1,289,369 | - |
| **Total financial liabilities** (contractual maturity dates) | 4,045,961 | 1,024,064 |
| **Assets** | | |
| - cash and bank balances | 720,680 | - |
| - amounts due from Group companies | 1,130,524 | - |
| - trade and other receivables | 518,126 | - |
| **Total financial assets** (expected maturity dates) | 2,369,330 | - |
| **At 31 December 2010** | | |
| **Liabilities** | | |
| - borrowings | 553,000 | 1,013,630 |
| - trade and other payables | 1,482,879 | - |
| - amounts due to related parties | 585,072 | - |
| **Total financial liabilities** (contractual maturity dates) | 2,620,951 | 1,013,630 |
| **Assets** | | |
| - cash and bank balances | 120,865 | - |
| - amounts due from Group companies | 1,105,968 | - |
| - trade and other receivables | 414,568 | - |
| **Total financial assets** (expected maturity dates) | 1,641,401 | - |

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## NOTES *(continued)*

### 4. Financial risk management (continued)

**Liquidity risk (continued)**

| | Less than 1 year Shs'000 | Between 1 and 2 years Shs'000 |
|---|---|---|
| **(b) Company** | | |
| **At 31 December 2011:** | | |
| **Liabilities** | | |
| - borrowings | 21,606 | 1,024,064 |
| - trade and other payables | 2,509,355 | - |
| - amounts due to related parties | 1,276,880 | - |
| **Total financial liabilities** (contractual maturity dates) | 3,807,841 | 1,024,064 |
| **Assets** | | |
| - cash and bank balances | 712,685 | - |
| - amounts due from Group companies | 1,130,524 | - |
| - trade and other receivables | 518,126 | - |
| **Total financial assets** (expected maturity dates) | 2,361,335 | - |
| **At 31 December 2010:** | | |
| **Liabilities** | | |
| - borrowings | 553,000 | 1,013,630 |
| - trade and other payables | 1,979,080 | - |
| - amounts due to related parties | 555,122 | - |
| **Total financial liabilities** (contractual maturity dates) | 3,087,202 | 1,013,630 |
| **Assets** | | |
| - cash and bank balances | 95,768 | - |
| - amounts due from Group companies | 1,105,968 | - |
| - trade and other receivables | 401,064 | - |
| **Total financial assets** (expected maturity dates) | 1,602,800 | - |

For both group and company, there are no financial assets or liabilities older than 2 years (2010: Nil).

**Capital risk management**

Capital comprises all components of equity as shown in the statements of changes in equity. The group's objectives when managing capital are to safeguard the group's ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to reduce the cost of capital. In order to maintain or adjust the capital structure, the group may adjust the amount of dividends paid to shareholders, issue new capital or sell assets to reduce debt.

# NOTES *(continued)*

## 4. Financial risk management (continued)

### Capital risk management (continued)

The group monitors capital on the basis of the gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings less cash and cash equivalents. Total capital is calculated as equity plus net debt.

| | Group | | Company | |
|---|---|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 | 2011 Shs'000 | 2010 Shs'000 |
| Total borrowings | 1,045,670 | 1,521,400 | 1,045,670 | 1,521,400 |
| Less: cash and cash equivalents | (720,680) | (120,865) | (712,685) | (95,768) |
| Net debt | 324,990 | 1,400,535 | 332,985 | 1,425,632 |
| Total equity | 6,412,067 | 5,114,312 | 6,412,067 | 5,114,312 |
| Total capital | 6,737,057 | 6,514,847 | 6,745,052 | 6,539,944 |
| Gearing ratio | 4.8% | 21.5% | 4.9% | 21.8% |
| **Financial instruments by category** | | | | |
| Financial assets: | | | | |
| All of the group and company's financial assets are classified as loans and receivables and comprise: | | | | |
| Trade and other receivables (excluding prepayments) | 1,652,897 | 1,520,536 | 1,643,423 | 1,507,032 |
| Cash and cash equivalents | 720,680 | 120,865 | 712,685 | 95,768 |
| | 2,373,577 | 1,641,401 | 2,356,108 | 1,602,800 |
| Financial liabilities: | | | | |
| All of the group and company's financial liabilities are classified as liabilities at amortised cost and comprise | | | | |
| Borrowings | 1,045,670 | 1,521,400 | 1,045,670 | 1,521,400 |
| Trade and other payables (excluding statutory liabilities) | 3,525,170 | 1,482,879 | 3,292,494 | 1,357,898 |
| | 4,570,840 | 3,004,279 | 4,338,164 | 2,879,298 |

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# NOTES *(continued)*

## 5. Segment information

The group operates in one business segment - manufacture and sale of cigarettes and tobacco and one geographic segment based on the location of the manufacturing site in Kenya hence no segmental information is presented.

The group's revenues by destination are as follows:

| | 2011 Shs '000 | 2010 Shs '000 |
|---|---|---|
| Local sales | 8,744,643 | 7,567,850 |
| Exports | | |
| - Cigarettes | 6,596,074 | 5,050,224 |
| - Cutrag (semi-processed tobacco) | 4,797,405 | 921,159 |
| | 20,138,122 | 13,539,233 |
| Analysis of revenue by category: | | |
| Sale of goods | 19,667,003 | 13,091,616 |
| Sale of services | 471,119 | 447,617 |
| | 20,138,122 | 13,539,233 |

## 6. Cost of operations

| | 2011 Shs '000 | 2010 Shs '000 |
|---|---|---|
| Raw materials and consumables | 11,150,767 | 7,334,644 |
| Write-down of raw materials | 170,318 | 178,333 |
| Marketing and distribution costs | 1,718,330 | 1,448,860 |
| Administrative and other operating expenses | 2,057,488 | 1,011,350 |
| Depreciation of property, plant and equipment (Note 16) | 553,638 | 547,456 |
| Amortisation of intangible assets | - | 56,336 |
| | 15,650,541 | 10,576,979 |

## 7. Finance costs

| | 2011 Shs '000 | 2010 Shs '000 |
|---|---|---|
| Interest income | (634) | (245) |
| Interest expense - bank borrowings and related party loans | 172,675 | 186,860 |
| Net foreign exchange losses | 6,259 | 30,332 |
| Net finance costs | 178,300 | 216,947 |

# NOTES *(continued)*

## 8. Profit before income tax

The following items have been charged in arriving at the profit before income tax.

| | Group 2011 Shs'000 | Group 2010 Shs'000 |
|---|---|---|
| Employee benefits expense (Note 9) | 2,117,458 | 1,859,486 |
| Auditor's remuneration | 7,802 | 7,424 |

## 9. Employee benefits expense

| | 2011 | 2010 |
|---|---|---|
| Salaries and wages | 2,035,119 | 1,776,436 |
| Retirement benefits costs: | | |
| - Defined contribution scheme | 80,374 | 80,336 |
| - National Social Security Fund | 1,965 | 2,714 |
| | 2,117,458 | 1,859,486 |

## 10. Income tax expense

| | 2011 | 2010 |
|---|---|---|
| Current income tax | | |
| - Current tax on profits for the year | 1,355,549 | 929,652 |
| - Adjustments in respect of prior years | (4,419) | 41,068 |
| **Total current tax** | 1,351,130 | 970,720 |
| Deferred income tax (Note 15) | | |
| - Deferred income tax credit/ (charge) | 35,491 | (57,532) |
| - Adjustments in respect of prior years | (260) | 42,148 |
| **Total deferred income tax** | 35,231 | (15,384) |
| Income tax expense | 1,386,361 | 955,336 |

The tax on the group's profit before income tax differs from the theoretical amount that would arise using the statutory income tax rate as follows:

| | 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|
| Profit before income tax | 4,484,116 | 2,722,572 |
| Tax calculated at domestic rate applicable to profit -30% (2010:30%) | 1,345,235 | 816,772 |
| Tax effect of: | | |
| Income not subject to tax | (164) | (653) |
| Expenses not deductible for tax purposes | 45,969 | 56,001 |
| (Over)/ under provision of current tax in prior years | (4,419) | 41,068 |
| (Over)/ under provision of deferred tax in prior years | (260) | 42,148 |
| Income tax expense | 1,386,361 | 955,336 |



# NOTES *(continued)*

## 10. Income tax expense (continued)

The tax (charge)/credit relating to components of equity are as follows:

| | 2011 Shs'000 | | | 2010 Shs'000 | | |
|---|---|---|---|---|---|---|
| | Before tax | Tax charge | After tax | Before tax | Tax charge | After tax |
| Transfer of excess depreciation | 63,492 | (19,048) | 44,444 | 63,492 | (19,048) | 44,444 |
| Effect on equity | 63,492 | (19,048) | 44,444 | 63,492 | (19,048) | 44,444 |

## 11. Earnings per share

Basic earnings per share are calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

| | 2011 | 2010 |
|---|---|---|
| Profit attributable to equity holders of the Company (Shs '000) | 3,097,755 | 1,767,236 |
| Weighted average number of ordinary shares in issue (thousands) | 100,000 | 100,000 |
| Basic earnings per share (Shs) | 30.98 | 17.67 |

There were no potentially dilutive shares outstanding at 31 December 2011 or 2010. Diluted earnings per share are therefore the same as basic earnings per share.

# NOTES *(continued)*

## 12. Dividends per share

During the year a final dividend in respect of the 2010 financial results of Shs 14.50 (2009: Shs 10.25) and an interim dividend of Shs 3.50 per share (2010: Shs 3.00) was declared and paid. The total dividend for the year is therefore Shs 18.00 per share (2010: Shs 13.25), amounting to a total of Shs 1,800,000,000 (2010: Shs 1,325,000,000).

At the annual general meeting to be held on 26 April 2012, a final dividend in respect of the year ended 31 December 2011 of Shs 27.00 per share amounting to a total of Shs 2,700,000,000 is to be proposed. These financial statements do not reflect this dividend as a liability.

Payment of dividends is subject to withholding tax at a rate of either 5% or 10% depending on the residence of the respective shareholders.

## 13. Share capital

| | Number of shares (Thousands) | Ordinary shares Shs'000 | Share premium Shs'000 |
|---|---|---|---|
| **Issued** | | | |
| Balance at beginning and end of year | 100,000 | 1,000,000 | 23 |

The total authorised number of ordinary shares is 100,000,000 with a par value of Shs 10 per share. All issued shares are fully paid.

## 14. Revaluation reserve

The revaluation reserve surplus relates to the revaluation of the group and company's buildings and freehold and leasehold land net of deferred income tax and is non-distributable. The movements in the revaluation surplus are set out in the consolidated and company statements of changes in equity.

## 15. Deferred income tax

The analysis of deferred tax assets and deferred tax liabilities is as follows:

| | 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|
| Deferred tax assets | (14,491) | (8,133) |
| Deferred tax liabilities | 973,785 | 932,196 |
| Deferred tax liabilities (net) | 959,294 | 924,063 |

Deferred income tax is calculated using the enacted income tax rate of 30% (2010: 30%). The movement on the group deferred income tax account is as follows:

| | 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|
| At start of year | 924,063 | 939,447 |
| Charge for the period (Note 10) | 35,231 | (15,384) |
| At end of year | 959,294 | 924,063 |



# NOTES *(continued)*

## 15. Deferred income tax (continued)

Consolidated deferred tax assets liabilities and deferred income tax charge in the consolidated income statement are attributable to the following items.

| | 1.1.2011 Shs'000 | Charged/ (credited) to P/L Shs'000 | 31.12.2011 Shs'000 |
|---|---|---|---|
| **Year ended 31 December 2011** | | | |
| **Deferred income tax liabilities** | | | |
| Property, plant and equipment: | | | |
| - on historical cost basis | 808,586 | 277,643 | 1,086,229 |
| - on revaluation surpluses | 509,061 | (164,897) | 344,164 |
| Unrealised exchange gains | 822 | 45,347 | 46,169 |
| | 1,318,469 | 158,093 | 1,476,562 |
| **Deferred income tax assets** | | | |
| Provisions | (319,499) | (144,364) | (463,863) |
| Unrealised exchange losses | (24,318) | (29,087) | (53,405) |
| Tax losses | (50,589) | 50,589 | - |
| | (394,406) | (122,862) | (517,268) |
| Net deferred income tax liability | 924,063 | 35,231 | 959,294 |

| | 1.1.2010 Shs'000 | Charged/ (credited) to P/L Shs'000 | 31.12.2010 Shs'000 |
|---|---|---|---|
| **Year ended 31 December 2010** | | | |
| **Deferred income tax liabilities** | | | |
| Property, plant and equipment: | | | |
| - on historical cost basis | 789,401 | 19,185 | 808,586 |
| - on revaluation surpluses | 494,084 | 14,977 | 509,061 |
| Unrealised exchange gains | 99,344 | (98,522) | 822 |
| | 1,382,829 | (64,360) | 1,318,469 |
| **Deferred income tax assets** | | | |
| Provisions | (163,109) | (156,390) | (319,499) |
| Unrealised exchange losses | (94,681) | 70,363 | (24,318) |
| Tax losses | (185,592) | 135,003 | (50,589) |
| | (443,382) | 48,976 | (394,406) |
| Net deferred income tax liability | 939,447 | (15,384) | 924,063 |

## NOTES *(continued)*

### 15. Deferred income tax (continued)

Deferred income tax of Shs 19,048,000 (2010: Shs 19,048,000) was transferred within shareholders' equity from revaluation reserves to retained earnings. This represents deferred income tax on the difference between the actual depreciation on the property and the equivalent depreciation based on the historical cost of the property.

Company deferred income tax assets and liabilities are attributable to the following items:

| | 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|
| **Deferred income tax liabilities** | | |
| Property, plant and equipment: | | |
| - on historical cost basis | 1,086,229 | 808,586 |
| - on revaluation surpluses | 344,164 | 509,061 |
| Unrealised exchange gains | 45,641 | 822 |
| Total deferred income tax liabilities | 1,476,034 | 1,318,469 |
| **Deferred income tax assets** | | |
| Provisions | (456,319) | (315,938) |
| Unrealised exchange losses | (45,930) | (19,746) |
| Tax losses | - | (50,589) |
| Total deferred income tax assets | (502,249) | (386,273) |
| Net deferred income tax liability | 973,785 | 932,196 |



## NOTES *(continued)*

### 16. Property, plant and equipment - Group and Company

| | Land and Buildings Shs'000 | Plant Vehicles and machinery Shs'000 | Work and Equipment Shs'000 | Capital Work in Progress Shs'000 | Total Shs'000 |
|---|---|---|---|---|---|
| **At 1 January 2010** | | | | | |
| Cost or valuation | 2,522,850 | 5,144,574 | 513,991 | 423,230 | 8,604,645 |
| Accumulated depreciation | (143,893) | (1,973,013) | (244,403) | - | (2,361,309) |
| Net book amount | 2,378,957 | 3,171,561 | 269,588 | 423,230 | 6,243,336 |
| **Year ended 31 December 2010** | | | | | |
| Opening net book amount | 2,378,957 | 3,171,561 | 269,588 | 423,230 | 6,243,336 |
| Reclassifications | 48,610 | 221,134 | - | (269,744) | - |
| Additions | 51,108 | 295,676 | 48,700 | 372,649 | 768,133 |
| Disposals | | | | | |
| - Cost | (859) | (155,300) | (72,470) | - | (228,629) |
| - Accumulated depreciation | - | 15,058 | 58,697 | - | 73,755 |
| Depreciation charge | (88,843) | (351,922) | (106,691) | - | (547,456) |
| Closing net book amount | 2,388,973 | 3,196,207 | 197,824 | 526,135 | 6,309,139 |
| **At 31 December 2010** | | | | | |
| Cost or valuation | 2,621,709 | 5,506,084 | 490,221 | 526,135 | 9,144,149 |
| Accumulated depreciation | (232,736) | (2,309,877) | (292,397) | - | (2,835,010) |
| Net book amount | 2,388,973 | 3,196,207 | 197,824 | 526,135 | 6,309,139 |
| **Year ended 31 December 2011** | | | | | |
| Opening net book amount | 2,388,973 | 3,196,207 | 197,824 | 526,135 | 6,309,139 |
| Reclassifications | 63,794 | 440,642 | 6,541 | (510,977) | - |
| Additions | 23,546 | 324,147 | 53,966 | 604,502 | 1,006,161 |
| Disposals | | | | | |
| - Cost | - | (36,134) | (119,264) | - | (155,398) |
| - Accumulated depreciation | - | 35,350 | 114,726 | - | 150,076 |
| Depreciation charge | (91,617) | (384,327) | (77,694) | - | (553,638) |
| Closing net book amount | 2,384,696 | 3,575,885 | 176,099 | 619,660 | 6,756,340 |
| **At 31 December 2011** | | | | | |
| Cost or valuation | 3,099,288 | 6,343,997 | 820,184 | 619,660 | 10,883,129 |
| Accumulated depreciation | (714,592) | (2,768,112) | (644,085) | - | (4,126,789) |
| Net book amount | 2,384,696 | 3,575,885 | 176,099 | 619,660 | 6,756,340 |

# NOTES *(continued)*

## 16. Property, plant and equipment - Group and Company (continued)

Buildings and freehold land were last revalued during 2007, by independent valuers. Valuations were made on the basis of the open market value for land and residential properties in major urban areas and net current replacement cost on existing use basis for all other properties. The book values of the properties were adjusted to the revaluations and the resultant surplus net of deferred income tax was credited to the revaluation surplus in shareholders' equity.

If the buildings and freehold land were stated on the historical cost basis, the amounts would be as follows:

| | 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|
| Cost | 1,119,345 | 1,033,098 |
| Accumulated depreciation | (254,204) | (226,324) |
| Net book amount | 865,141 | 806,774 |

## 17. Investment in subsidiaries (at cost)

The company's interest in its subsidiaries, all of which are wholly owned, incorporated in Kenya, un-listed and have the same year end as the company, were as follows:

| | Principal activity |
|---|---|
| BAT Kenya Tobacco Company Limited | Selling of cigarettes |
| African Cigarette Company (Overseas) Limited | Dormant |
| East Africa Tobacco Company Kenya Limited | Dormant |

The investment in BAT Kenya Tobacco Company Limited is Shs 12,000,000 while the investment in the dormant companies is Shs 40,000 each.

## 18. Inventories

| | Group and Company | |
|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 |
| Raw materials (at net realisable value) | 3,698,557 | 2,467,862 |
| Work in progress (at cost) | 53,510 | 97,229 |
| Finished goods (at cost) | 622,710 | 407,667 |
| | 4,374,777 | 2,972,758 |



# NOTES *(continued)*

## 19. Receivables and prepayments

| | Group | | Company | |
|---|---|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 | 2011 Shs'000 | 2010 Shs'000 |
| Trade receivables | 7,031 | 35,437 | 7,031 | 21,054 |
| Less: Provision for impairment losses | - | (1,320) | - | - |
| | 7,031 | 34,117 | 7,031 | 21,054 |
| Prepayments and other receivables | 511,095 | 460,964 | 519,068 | 459,355 |
| Due from related parties (Note 25) | 1,130,524 | 1,105,968 | 1,130,524 | 1,105,968 |
| | 1,648,650 | 1,601,049 | 1,656,623 | 1,586,377 |

Movements on the provision for impairment of trade receivables are as follows:

| | Group | | Company | |
|---|---|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 | 2011 Shs'000 | 2010 Shs'000 |
| At start of year | (1,320) | (1,320) | - | - |
| Reversed in the year | 1,320 | - | - | - |
| At end of year | - | (1,320) | - | - |

The carrying amounts of receivables and prepayments approximate to their fair values.

## 20. Cash and cash equivalents

| | Group | | Company | |
|---|---|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 | 2011 Shs'000 | 2010 Shs'000 |
| Cash at bank and in hand | 720,680 | 120,865 | 712,685 | 95,768 |

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise the following:

| | 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|
| Cash at bank and in hand | 720,680 | 120,865 |
| Bank overdrafts (Note 22) | (21,606) | (536,039) |
| | 699,074 | (415,174) |

## NOTES *(continued)*

### 21. Payables and accrued expenses

| | Group | | Company | |
|---|---|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 | 2011 Shs'000 | 2010 Shs'000 |
| Trade payables | 842,031 | 523,633 | 705,901 | 542,555 |
| Due to related companies (Note 25) | 1,289,369 | 585,072 | 1,276,880 | 555,122 |
| Accrued expenses and other payables | 1,892,955 | 1,298,517 | 1,803,454 | 1,436,525 |
| | 4,024,355 | 2,407,222 | 3,786,235 | 2,534,202 |

The carrying amounts of payables and accrued expenses approximate to their fair values.

### 22. Borrowings

| | Group | | Company | |
|---|---|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 | 2011 Shs'000 | 2010 Shs'000 |
| The borrowings are made up as follows: | | | | |
| **Non-current** | | | | |
| Loan from BAT Investments | 1,024,064 | 968,400 | 1,024,064 | 968,400 |
| **Current** | | | | |
| Bank overdrafts | 21,606 | 536,039 | 21,606 | 536,039 |
| Loan from BAT Investments | - | 16,961 | - | 16,961 |
| | 21,606 | 553,000 | 21,606 | 553,000 |

The loan from BAT Investments is an unsecured US Dollar denominated floating rate loan repayable in two years at an interest rate of LIBOR plus 2.5% up to July 2012 and thereafter LIBOR plus 4.0%.
The carrying amounts of short-term borrowings approximate to their fair value. Fair values are based on discounted cash flows using a discount rate based upon the borrowing rate that directors expect would be available to the group at the statement of financial position date.

None of the borrowings was in default at any time during the year.

The group and company has the following undrawn borrowing facilities:

| | 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|
| Overdraft facilities | 3,272,608 | 2,850,216 |
| Bond guarantees | 316,067 | 906,932 |
| | 3,588,675 | 3,757,148 |

The facilities expire within one year and are subject to review at various dates during the year. Bond guarantees are issued in favour of the Kenya Revenue Authority to cover import duty, VAT and excise payable for all imported goods that are utilised to manufacture cigarettes for the export market.

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## NOTES *(continued)*

### 23. Provisions for liabilities and charges

| | Group Shs'000 | Company Shs'000 |
|---|---|---|
| **Year ended 31 December 2010** | | |
| At start of year | 353,588 | 353,588 |
| Additional provisions | 750,750 | 750,750 |
| Unused amounts reversed | (65,893) | (65,893) |
| Charged to statement of comprehensive income | 684,857 | 684,857 |
| Utilised during year | (54,896) | (54,896) |
| At end of year | 983,549 | 983,549 |
| **Year ended 31 December 2011** | | |
| At start of year | 983,549 | 983,549 |
| Additional provisions | 130,612 | 130,612 |
| Unused amounts reversed | (104,205) | (104,205) |
| Charged to statement of comprehensive income | 26,407 | 26,407 |
| Utilised during the year | (4,367) | (4,367) |
| At end of year | 1,005,589 | 1,005,589 |

Provisions comprise balances set up in the ordinary course of business and are related to general liabilities to various stakeholders.

### 24. Cash generated from operations

Reconciliation of consolidated profit before income tax to cash generated from operations:

| | 2011 Shs'000 | 2010 Shs'000 |
|---|---|---|
| Profit before income tax | 4,484,116 | 2,722,572 |
| Adjustments for: | | |
| Interest income (Note 7) | (634) | (245) |
| Interest expense (Note 7) | 172,675 | 186,860 |
| Depreciation (Note 16) | 553,638 | 547,456 |
| Amortisation of intangible assets | - | 56,336 |
| Profit on sale of property, plant and equipment | (7,566) | (61,500) |
| Changes in working capital | | |
| – receivables and prepayments | (47,601) | (74,593) |
| – inventories | (1,402,019) | (673,187) |
| – payables and accrued expenses | 1,617,133 | (199,663) |
| – provisions for liabilities and charges | 22,040 | 629,961 |
| Cash generated from operations | 5,391,782 | 3,133,997 |

# NOTES *(continued)*

## 25. Related party transactions

The group is controlled by British American Tobacco Plc incorporated in the United Kingdom, which is also the ultimate parent of the group. There are other companies that are related to BAT Kenya Limited through common shareholdings or common directorships.

The company has an operating subsidiary, BAT Tobacco Limited.

The following transactions were carried out with related parties.

| | Group | | Company | |
|---|---|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 | 2011 Shs'000 | 2010 Shs'000 |
| **i) Sale of goods and services** | | | | |
| Subsidiary | - | - | 4,741,101 | 3,965,281 |
| Other related parties | 10,109,284 | 4,950,689 | 10,109,284 | 4,950,689 |
| | 10,109,284 | 4,950,689 | 14,850,385 | 8,915,970 |
| **ii) Purchase of goods and services** | | | | |
| Parent company | 617,504 | 507,578 | 617,504 | 507,578 |
| Other related parties | 482,476 | 411,135 | 482,476 | 411,135 |
| | 1,099,980 | 918,713 | 1,099,980 | 918,713 |
| **iii) Outstanding balances arising from sale and purchase of goods/services** | | | | |
| Receivables from other related parties | 1,130,524 | 1,105,968 | 1,130,524 | 1,105,968 |
| Payables to the parent company | 284,494 | 209,457 | 284,494 | 209,457 |
| Payables to other group companies | 1,004,875 | 375,615 | 992,386 | 345,665 |
| | 1,289,369 | 585,072 | 1,276,880 | 555,122 |
| **iv) Loans from related parties** | | | | |
| Loan from related party (BAT Investments) | 1,024,064 | 985,361 | 1,024,064 | 985,361 |



# NOTES *(continued)*

## 25. Related party transactions (continued)

**(v) Key management compensation**

| | Group and company | |
|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 |
| Salaries and other short-term employment benefits | 160,005 | 133,441 |
| Other long-term benefits | 73,731 | 85,312 |
| | 233,736 | 218,753 |
| **(vi) Directors' remuneration** | | |
| Fees for services as a director | 13,021 | 12,979 |
| Other emoluments (included in key management compensation above) | 83,483 | 128,215 |
| Total remuneration of directors of the company | 96,504 | 141,194 |

## 26. Contingent liabilities

The group is a defendant in various legal actions. Based on professional advice received, the directors are confident that the resolution of these cases is not likely to have a material effect.

At 31 December 2011 and 2010, the group had no guarantees given on behalf of third parties.

## 27. Commitments

Capital commitments

Capital expenditure contracted for at the statement of financial position date but not recognised in the financial statements is as follows:

| | Group and Company | |
|---|---|---|
| | 2011 Shs'000 | 2010 Shs'000 |
| Property, plant and equipment | 82,671 | 85,631 |

*Members of the Echair Farmers Cell Group, Kolanya Extension Area, Malakisi, 18th January 2012.*



# FORM OF PROXY

BRITISH AMERICAN TOBACCO
KENYA

To: ..........................................................................................................................................................

The Secretary,

British American Tobacco Kenya Limited,

P.O. Box 30000 - 00100,

Nairobi

I/We ..........................................................................................................................................................

...............................................................of P.O. Box ..........................................................................................

member/members of British American Tobacco Kenya Limited appoint

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..........................................................................................................................................................

or failing him, the Chairman of the Meeting as my/our proxy, to vote for me/us and on my/our behalf at the Annual General Meeting of the Company to be held on 26th April 2012 in the Ball Room, Hotel Intercontinental Nairobi, or at any adjournment thereof.

As witness my/our hand/s this ..........................................................................................................

day of.........................................................................................................................................2012

.................................................................................................................................(Signature)

## NOTES:

1. If a member is unable to attend this meeting personally this Form of Proxy should be completed and returned to reach the Company's Registered Office not later than 2.30 p.m. on 25th April 2012.

2. A person appointed to act as a proxy need not be a member of the Company.

3. If the appointer is a corporation, this Form of Proxy must be under its Common Seal or under the hand of the officer or attorney duly authorised in that behalf.

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BRITISH AMERICAN TOBACCO
KENYA


**WARNING:** SMOKING HARMS PEOPLE NEXT TO YOU

**ONYO:** UVUTAJI SIGARA HUDHURU WATU WALIO KARIBU NAWE

BRITISH AMERICAN TOBACCO
KENYA

With the continued investments in our brands we are well poised to ensure that we maintain our market **leadership** position.



**WARNING:** SMOKING HARMS PEOPLE NEXT TO YOU

**ONYO:** UVUTAJI SIGARA HUDHURU WATU WALIO KARIBU NAWE

BRITISH AMERICAN TOBACCO
KENYA

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