

B.A.T. INTERNATIONAL FINANCE p.l.c.

**2015
Annual Report**

B.A.T. INTERNATIONAL FINANCE p.l.c.

ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2015

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Notice of Meeting

Notice is hereby given that the Annual General Meeting of B.A.T. International Finance p.l.c. will be held at Globe House, 4 Temple Place, London, WC2R 2PG on 24 February 2016 at 2pm for the transaction of the following business:

1. To receive the financial statements for the year ended 31 December 2015 and the reports of the Directors and the Auditors thereon.
2. To re-elect Directors.
3. To reappoint the Auditors.
4. To authorise the Directors to determine the Auditors' remuneration.

By Order of the Board

Ann Griffiths, Assistant Secretary
24 February 2016

Note:

A member entitled to attend and vote is entitled to appoint a proxy to attend and vote instead of him. Such proxy need not be a member of the Company.

Secretary and Registered Office

Nicola Snook
Globe House
4 Temple Place
London WC2R 2PG

Registered Number 01060930

Independent Auditors

KPMG LLP
Chartered Accountants and Statutory Auditors
15 Canada Square, London, E14 5GL

Strategic Report

The Directors present their strategic report on B.A.T. International Finance p.l.c. (the 'Company') and its subsidiaries (the 'Group') for the year ended 31 December 2015.

Principal activities

The principal activities of the Group and the Company comprise the raising of finance for British American Tobacco p.l.c. and its subsidiaries (the 'BAT Group'), the management of financial risks arising from the BAT Group's underlying operations and the management of the BAT Group's cash resources. The Group's treasury operations and management of financial risks are described fully in note 12 on pages 23-28. All these activities are carried out under defined policies, procedures and limits. It is intended that the Group will continue to undertake business relating to these activities.

Review of the year ended 31 December 2015

The Group's profit for the financial year amounted to **£114 million** (2014: £241 million). Total equity has increased by **£158 million** (2014: increased by £295 million).

In February 2015, the Group signed a one-year bridge facility of £2.5 billion with an extension option of up to one year for the BAT Group's public tender offer to acquire up to all of the 24.7% of Souza Cruz shares, which were not owned by the BAT Group. The facility was partially cancelled in September, October and November 2015. The facility was cancelled as at 31 December 2015.

In March 2015, the Group issued €3 billion of bonds in four tranches as follows: €800 million maturing in 2019, €800 million maturing in 2023, €800 million maturing in 2027 and €600 million maturing in 2045. A €1.25 billion bond was repaid.

In March 2015, a one-year extension option was exercised for the £3 billion main bank facility, extending the final maturity to May 2020. The facility was undrawn as at 31 December 2015 (2014: undrawn). The US\$2 billion US commercial paper programme was increased in size to US\$3 billion.

In June 2015, the Group issued US\$4.5 billion of bonds in five tranches as follows: US\$750 million maturing in 2018, US\$1,250 million maturing in 2020, US\$500 million maturing in 2022, US\$1,500 million maturing in 2025 and US\$500 million of floating rate notes maturing in 2018. A US\$500 million bond was repaid. The US\$4.7 billion bridge facility in respect of the BAT Group's investment in Reynolds American Inc. was cancelled following the issue of the bonds.

In November 2015, the Group issued a €600 million bond maturing in 2022 and a £350 million bond maturing in 2055.

The Directors expect the Group's activities to continue on a similar basis in the foreseeable future.

Key performance indicators


Given the nature of the Group's activities, the Group's capital base is managed within the overall framework of the BAT Group and the Company's Directors consider that key performance indicators based solely on the Group's results are not necessary or appropriate for an understanding of the Group's specific development, performance or position of its business. However, key performance indicators relevant to the BAT Group, are disclosed in the Strategic Report of British American Tobacco p.l.c. and do not form part of this report.

Principal risks and uncertainties

The Board of British American Tobacco p.l.c. reviews and agrees the overall treasury policies and procedures, delegating appropriate authority to the Company. The BAT Group Finance Director is a member of the Board of the Company and any significant change to agreed policies is subject to prior approval by the Board of British American Tobacco p.l.c..

Clear parameters have been established, including levels of authority, on the type and use of financial instruments to manage the financial risks facing the Group. Such instruments are only used if they relate to an underlying exposure; speculative transactions are expressly forbidden under the BAT Group's treasury policy. The Group's treasury position is monitored by the BAT Group Corporate Finance Committee ('CFC'), which meets regularly and is chaired by the BAT Group Finance Director. Regular reports are provided to senior management and treasury operations are subject to periodic independent reviews and audits, both internal and external. Details of the risks mitigated are detailed in note 12 of the Group's financial statements.

On behalf of the Board



Neil Arthur Wadey, Director
24 February 2016

Directors' Report

Introduction

The Directors present their Annual Report and the audited financial statements for the Company and the Group for the year ended 31 December 2015.

Board of Directors

The names of the persons who served as Directors of the Company and the Group during the period 1 January 2015 to the date of this report are as follows:

John Benedict Stevens
Richard Remon Bakker
Robert James Casey
Tadeu Luiz Marroco
Neil Arthur Wadey
Steven Glyn Dale

All of the Directors will seek re-election at the forthcoming Annual Group Meeting.

Dividends

The Directors do not recommend payment of a dividend for the year (2014: £nil).

Directors' indemnities

Throughout the period from 1 January 2015 to the date of this report, an indemnity has been in force under which Mr John Benedict Stevens, as a Director of the Company and the Group, is, to the extent permitted by law, indemnified by British American Tobacco p.l.c., the ultimate parent undertaking, in respect of all costs, charges, expenses or liabilities which he may incur in or about the execution of his duties to the Company and the Group or as a result of things done by him as a Director on behalf of the Company and the Group.

Throughout the period from 1 January 2015 to the date of this report, indemnities have been in force for each of the remaining Directors under which they, as Directors of the Company and the Group, are, to the extent permitted by law, indemnified in respect of all costs, charges, expenses or liabilities which they may incur in or about the execution of their duties to the Company and the Group or as a result of things done by them as Directors on behalf of the Company and the Group since their appointment.

Directors' responsibilities in relation to the financial statements

The directors are responsible for preparing the Strategic Report, the Directors' Report and the group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they have elected to prepare the group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice), including FRS 101 *Reduced Disclosure Framework*.

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and parent company and of their profit or loss for that period. In preparing each of the group and parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Strategic Report, Directors' Report, and Corporate Governance Statement that complies with that law and those regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' Report continued

Directors' declaration in relation to relevant audit information

Having made appropriate enquiries, each of the Directors who held office at the date of approval of this Annual Report confirms that:

- to the best of his knowledge and belief, there is no relevant audit information of which the Company's and the Group's auditors are unaware; and
- he has taken all steps that a Director might reasonably be expected to have taken in order to make himself aware of relevant audit information and to establish that the Company's and the Group's auditors are aware of that information.

Directors' responsibilities statement

The Directors confirm to the best of their knowledge that:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the strategic report and directors' report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

The names of the Directors are listed in this Directors' Report on page 3. Neither the Company, the Group nor the Directors accept any liability to any person in relation to this Annual Report, except to the extent that such liability could arise under English law. Accordingly, any liability to a person who has demonstrated reliance on any untrue or misleading statement or omission shall be determined in accordance with section 90A of the Financial Services and Markets Act 2000.

Corporate Governance Statement

The Company and the Group are wholly-owned subsidiaries of British American Tobacco p.l.c.. Therefore, there is no requirement for any further disclosure under paragraph 13(2)(c) and (d) of Schedule 7 to the Large and Medium-sized and Groups (Accounts and Reports) Regulations 2008 ("Schedule 7"), nor are there any restrictions on the voting rights of the shares held (Schedule 7, 13(2)(f)).

There are no specific rules regarding the appointment and replacement of Directors other than the provisions set out in the Company's and the Group's Articles of Association, nor are there any pertaining to the amendment of those Articles.

Subject to the provisions of the Companies Acts 1985 and 2006 and the Articles of Association, the Directors may issue, offer, allot or grant rights to subscribe for, or convert any security into shares in the Company and the Group and the Company and the Group may also purchase, or may enter into a contract under which it will or may purchase, its own shares.

The Company and the Group has established internal control and risk management systems in relation to the process for preparing consolidated financial statements. The key features of these internal control and risk management systems are:

- the Risk Assurance function and management of the BAT Group conduct periodic review of the Groups' risks and mitigation;
- management regularly monitors and considers developments in accounting regulations and best practice in financial reporting, and, where appropriate, reflects developments in the financial statements. Appropriate briefings and/or training are provided to key finance personnel on relevant developments in accounting and financial reporting;
- the Group's consolidation is subject to various levels of review by the Group Finance function;
- the draft financial statements are reviewed by an individual independent from those individuals responsible for preparing the financial statements. The review includes checking internal consistency, consistency with other statements, consistency with internal accounting records and arithmetical accuracy; and
- the BAT Group receives reports from management and the external auditors on significant judgements, changes in accounting policies, changes in accounting estimates and other pertinent matters relating to the consolidated BAT Group financial statements. These are then assessed and applied consistently to the Group.

The above disclosure is made in accordance with Disclosure and Transparency Rules 7.2.

Going concern

After reviewing the Group's annual budget and plans, the Directors consider that the Group and Company have adequate resources to continue in operational existence for the foreseeable future and that it is therefore appropriate to continue to adopt the going concern basis in preparing the financial statements.

Directors' Report continued

Auditor

PricewaterhouseCoopers LLP resigned as auditor on 23 March 2015 pursuant to section 516 of the Companies Act 2006. On 23 March 2015 the Directors' appointed KPMG LLP as auditor of the company. A resolution to reappoint KPMG LLP as auditors to the Company will be proposed at the Annual General Meeting.

On behalf of the Board



Neil Arthur Wadey, Director
24 February 2016
B.A.T. International Finance p.l.c.
Registered Number 01060930

Group Income Statement for the year ended 31 December 2015

	2015	2014
	£m	£m
Interest income (note 3)	553	615
Interest expense (note 4)	(468)	(455)
Net commitment fee income (note 5)	1	8
Net fair value gains on derivatives and exchange differences (note 6)	<u>33</u>	<u>80</u>
Net finance income	119	248
Other operating expenses (note 7)	<u>(3)</u>	<u>(4)</u>
Profit before taxation	116	244
Taxation on ordinary activities (note 8)	<u>(2)</u>	<u>(3)</u>
Profit for the year	<u>114</u>	<u>241</u>

All the activities during both years are in respect of continuing operations.

The accompanying notes are an integral part of the Group financial statements.

Group Statement of Comprehensive Income for the year ended 31 December 2015

	2015	2014
	£m	£m
Profit for the year	114	241
Other comprehensive income		
Items that may be reclassified subsequently to profit or loss:		
Gains on exchange	54	53
Cash flow hedges		
- net fair value gains	8	-
- reclassified and reported in profit for the year	<u>(18)</u>	<u>1</u>
Total other comprehensive income for the year	<u>44</u>	<u>54</u>
Total comprehensive income for the year	<u>158</u>	<u>295</u>

The accompanying notes are an integral part of the Group financial statements.

**Group Statement of Changes in Equity
for the year ended 31 December 2015**

					2015
	Share capital £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
Balance at 1 January 2015	231	-	225	1,315	1,771
Total comprehensive income for the year (page 6)	-	(10)	54	114	158
Balance at 31 December 2015	231	(10)	279	1,429	1,929
					2014
	Share capital £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
Balance at 1 January 2014	231	(1)	172	1,074	1,476
Total comprehensive income / (loss) for the year (page 6)	-	1	53	241	295
Balance at 31 December 2014	231	-	225	1,315	1,771

The accompanying notes are an integral part of the Group financial statements.

Group Balance Sheet at 31 December 2015

	2015 £m	2014 £m
<i>Assets</i>		
Cash and cash equivalents (note 9)	362	50
Amounts due on demand from fellow subsidiaries (note 10)	644	977
Derivative financial instruments (note 11)	703	731
Other receivables (note 13)	10	14
Loans due from parent undertaking (note 14a)	3,621	3,624
Loans due from fellow subsidiaries (note 14b)	<u>32,384</u>	<u>30,049</u>
Total assets	<u>37,724</u>	<u>35,445</u>
<i>Liabilities</i>		
Bank overdrafts (note 15)	133	152
Amounts repayable on demand to parent undertaking (note 16a)	7,309	9,036
Amounts repayable on demand to fellow subsidiaries (note 16b)	13,049	14,125
Derivative financial instruments (note 11)	765	714
Other payables (note 17)	5	8
Term deposits repayable to fellow subsidiaries (note 18)	596	735
Issued debt (note 15)	<u>13,938</u>	<u>8,904</u>
Total liabilities	<u>35,795</u>	<u>33,674</u>
<i>Equity</i>		
Share capital	231	231
Cash flow hedge reserve	(10)	-
Translation reserve	279	225
Retained earnings	<u>1,429</u>	<u>1,315</u>
Total equity (note 19)	<u>1,929</u>	<u>1,771</u>
Total equity and liabilities	<u>37,724</u>	<u>35,445</u>

The accompanying notes are an integral part of the Group financial statements.

The financial statements on page 6 to 35 were approved by the Board and signed on its behalf by



Neil Arthur Wadey, Director
24 February 2016

**Group Cash Flow Statement
for the year ended 31 December 2015**

	2015 £m	2014 £m
<i>Cash flows from operating activities</i>		
Interest receipts	327	319
Interest payments	(474)	(449)
Net outflow on fees	(5)	(2)
Other payments	(5)	-
	<u>(157)</u>	<u>(132)</u>
<i>(Decrease) / Increase in operating assets and liabilities:</i>		
Net short-term funds (outflow) / inflow from fellow subsidiaries and parent undertaking	(5,474)	1,483
Proceeds from external debt	6,538	981
Repayment of external debt	(1,648)	(369)
Proceeds relating to derivative financial instruments	148	63
Net cash inflow / (outflow) on loans to fellow subsidiaries	1,091	(2,221)
Net cash (outflow) / inflow on borrowings from fellow subsidiaries	(132)	51
Net cash inflow / (outflow) from operating activities	366	(144)
(Losses) / gains on exchange	(35)	4
Net increase / (decrease) in cash and cash equivalents	331	(140)
Net cash and cash equivalents at 1 January	(102)	38
Net cash and cash equivalents at 31 December (note 9)	<u>229</u>	<u>(102)</u>

The accompanying notes are an integral part of the Group financial statements.

Notes are shown on pages 10 to 35.

Group Notes on the Accounts

1. Accounting policies

Basis of accounting

The Group financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union, IFRIC interpretations, and with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The Group financial statements are prepared on a going concern basis.

The financial statements have been prepared under the historical cost convention except as described in the accounting policy below on financial instruments. The presentation of the Group balance sheet is based on liquidity.

The preparation of the Group financial statements requires management to make estimates and assumptions that affect the reported amounts of income, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the financial statements. The key estimates and assumptions relate to calculation of fair value assets and liabilities using exchange rates and market expectations of future interest rates as at the balance sheet date. These are set out in the accounting policies below, together with the related notes on the accounts.

Due to the nature of the entity, investing and financing activities are captured as part of operating activities within the Group cash flow statement.

Basis of consolidation

The consolidated financial information includes the financial statements of B.A.T. International Finance p.l.c. and its subsidiary undertakings.

A subsidiary is an entity controlled by the Group. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Intragroup balances and transactions, and any unrealised gains arising from intragroup transactions, are eliminated in preparing the consolidated financial statements.

Foreign currencies

The functional currency of the Group is sterling and this is also the presentation currency of the Group.

The income and cash flow statements of Group undertakings expressed in currencies other than sterling are translated to sterling at average rates of exchange in each year, provided that the average rate approximates the exchange rate at the date of the underlying transactions. Assets and liabilities of Group undertakings are translated at rates of exchange at the end of each year.

The differences between retained profits of foreign currency subsidiary undertakings translated at average and closing rates of exchange are taken to reserves, as are differences arising on the retranslation to sterling (using closing rates of exchange) of foreign currency net assets at the beginning of the year. Any differences that have arisen since 1 January 2004 are presented as a separate component of equity. As permitted under IFRS 1, any differences prior to that date are not included in this separate component of equity. Where a disposal of an investment in a Group undertaking results in a loss of control of a subsidiary undertaking, the cumulative amount of the related foreign exchange differences deferred in the separate component of equity are recognised in the income statement when the gain or loss on disposal is recognised. These related exchange differences comprise the exchange differences on all amounts deemed to be part of the net investment in the undertaking, which are recycled to the income statement when a disposal occurs.

Foreign currency transactions are initially recognised in the functional currency of each entity in the Group at the exchange rate ruling at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of foreign currency assets and liabilities at year end rates of exchange are recognised in the income statement, except when deferred as qualifying cash flow hedges in the hedging reserve, on intercompany net investment loans and qualifying net investment hedges in the translation reserve.

Group Notes on the Accounts

1. Accounting policies continued

Accounting for income

As a financing vehicle, the Group's primary sources of income comprise interest on loans to fellow subsidiaries and net fee income. These are recognised on an effective interest rate method, and all income is only recognised to the extent that it is considered to be collectable.

Net fee income comprises commitment fees received in respect of undrawn revolving credit facilities provided to fellow subsidiaries, and commitment fees paid in respect of revolving credit facilities provided by external banks.

Taxation

Taxation is that chargeable on the profits for the period, together with deferred taxation.

The current income tax charge is calculated on the basis of tax laws enacted or substantially enacted at the balance sheet date in the countries where the Group operates and generates taxable income.

Deferred taxation is provided in full using the liability method for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for taxation purposes. Deferred tax is provided on temporary differences arising on investments in Group undertakings, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that it will not reverse in the foreseeable future. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. As required under IAS 12 Income Taxes, deferred tax assets and liabilities are not discounted.

Deferred tax is determined using the tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or deferred tax liability is settled.

Tax is recognised in the income statement except to the extent that it relates to items recognised in other comprehensive income or directly in equity, in which case it is recognised in other comprehensive income or changes in equity.

Financial instruments

Financial assets and financial liabilities are recognised when the Group becomes a party to the contractual provisions of the relevant instrument and derecognised when it ceases to be a party to such provisions.

Financial assets and financial liabilities are initially recognised at fair value, plus directly attributable transaction costs where applicable, with subsequent measurement as set out below.

Non-derivative financial assets are classified on initial recognition as either loans and receivables or cash and cash equivalents as follows:

- Loans and receivables: these are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market; and
- Cash and cash equivalents: cash and cash equivalents include cash in hand and deposits held on call, together with other short-term highly liquid investments including investments in certain money market funds. Cash equivalents normally comprise instruments with maturities of three months or less at date of acquisition. In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts, which are shown as a separate category in the liabilities section on the balance sheet.

Non-derivative financial assets are stated at amortised cost using the effective interest method, subject to reduction for allowances for estimated irrecoverable amounts. These estimates for irrecoverable amounts are recognised when there is objective evidence that the full amount receivable will not be collected according to the original terms of the asset. Such evidence might include financial difficulties of the counterparty, defaults of payment or significant overdue balances. For interest-bearing assets, their carrying value includes accrued interest receivable.

Non-derivative financial liabilities are stated at amortised cost using the effective interest method. For borrowings, their carrying value includes accrued interest payable, as well as unamortised issue costs.

Derivative financial assets and liabilities are initially recognised, and subsequently measured, at fair value, which includes accrued interest receivable and payable, where relevant. The fair values of derivatives are determined based on market data (primarily yield curves, implied volatilities and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. Changes in their fair values are recognised as follows:

Group Notes on the Accounts

1. Accounting policies continued

Financial instruments continued

- for derivatives that are designated as cash flow hedges, the changes in their fair values are recognised directly in other comprehensive income, to the extent that they are effective, with the ineffective portion being recognised in the income statement. The accumulated gains and losses are reclassified to the income statement in the same period as the hedged item;
- for derivatives that are designated as fair value hedges, the carrying value of the hedged item is adjusted for the fair value changes attributable to the risk being hedged, with the corresponding entry being made in the income statement. The changes in fair value of these derivatives are also recognised in the income statement;
- for derivatives that are designated as hedges of net investments in foreign currency operations, the changes in their fair values are recognised directly in other comprehensive income, to the extent that they are effective, with the ineffective portion being recognised in the income statement. Where non-derivatives, such as foreign currency borrowings, are designated as net investment hedges, the relevant exchange differences are similarly recognised. The accumulated gains and losses are recognised in the income statement when the foreign currency operation is disposed of; and
- for derivatives that do not qualify for hedge accounting or are not designated as hedges, the changes in their fair values are recognised in the income statement in the period in which they arise.

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed at each reporting date to ensure that the hedge has remained, and is expected to remain, highly effective.

Hedge accounting is discontinued when a hedging instrument is derecognised (e.g. through expiry or disposal) or no longer qualifies for hedge accounting. Where the hedged item is a highly probable forecast transaction, the related gains and losses remain in equity until the transaction takes place, when they are reclassified to the income statement in the same manner as for cash flow hedges as described above. When a hedged future transaction is no longer expected to occur, any related gains and losses, previously recognised in other comprehensive income, are immediately reclassified to the income statement.

Segmental analysis

Senior management of the BAT Group Treasury function, including the BAT Group Head of Treasury, who is also a Director of the Company, are identified as the chief operating decision makers (CODM), and are responsible for managing within an overall policy framework, the BAT Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. The Group is the central vehicle used by BAT Group Treasury for managing these risks. The Group does not report segment information internally as the Group is managed by senior management of the BAT Group Treasury function as a single segment entity in the context of the BAT Group as a whole.

The prices agreed between Group companies, and with BAT Group entities, for intra-BAT Group loans and borrowings, and charges for such are based on normal commercial practices, which would apply between independent businesses.

Dividends

Dividend distributions are recognised as a liability in the financial statements in the period in which the dividends are payable.

Group Notes on the Accounts

1. Accounting policies continued

Future changes to Group accounting policies

Certain changes to IFRS will be applicable to the Group financial statements in future years. Set out below are those which are considered to be most relevant to the Group.

IFRS 9 Financial Instruments. This standard was finalised and published in July 2014 as the replacement for IAS 39 Financial Instruments: Recognition and Measurement. Further due diligence will be carried out before implementation, but the anticipated impact from restatement on the Group's reported profit and equity for 2015 and 2014 is not expected to be material. The Standard is largely retrospective in application. Subject to EU endorsement, the expected mandatory effective date of implementation is 1 January 2018.

In addition, a number of other interpretations and revisions to existing standards have been issued which will be applicable to the Group's financial statements in future years, but will not have a material effect on reported profit or equity or on the disclosures in the financial statements.

Group Notes on the Accounts

2. Segmental reporting

As the Company is the central financing vehicle for the BAT Group which is domiciled in the UK, all income other than interest on cash and cash equivalents is earned from counterparties within the BAT Group. Interest on cash and cash equivalents of **£3 million** (2014: £1 million) comprises **£3 million** (2014: £1 million) from money market funds.

Interest income from cash and cash equivalents attributable to the UK is **£3 million** (2014: £1 million) and **£nil** (2014: £nil) attributable to foreign countries.

IFRS 8 considers a group of entities under common control as a single customer. **£69 million** (2014: £66 million) of interest income is generated from the parent undertaking and **£481 million** (2014: £548 million) from fellow subsidiaries controlled directly or indirectly by the parent undertaking, British American Tobacco p.l.c..

3. Interest income

	2015 £m	2014 £m
Interest income		
From the parent undertaking	69	66
From fellow subsidiaries	481	548
Cash and cash equivalents	3	1
	<u>553</u>	<u>615</u>

4. Interest expense

	2015 £m	2014 £m
Interest expense		
Commercial paper	2	-
Bank borrowings	6	7
Issued debt	402	388
	<u>410</u>	<u>395</u>
To the parent undertaking	16	17
To fellow subsidiaries	42	43
	<u>468</u>	<u>455</u>

5. Net fee income

	2015 £m	2014 £m
Fee income		
Commitment fees on undrawn revolving credit facilities to fellow subsidiaries	12	19
Fee expense		
Fees charged on committed borrowing facilities	(11)	(11)
	<u>1</u>	<u>8</u>

86% of the fees charged on the committed borrowing facility in 2015 are borne by the Group (2014: 75%), with 14% being borne by fellow subsidiaries (2014: 25%).

6. Net fair value gains on derivatives and exchange differences

	2015 £m	2014 £m
Fair value changes on derivatives and hedged items comprise:		
Fair value hedging instruments – exchange related movements	9	(39)
Fair value hedging instruments – net interest income	56	56
Fair value hedging instruments – interest related movements	(10)	140
Fair value changes on hedged items	13	(131)
Cash flow hedging instruments – exchange related movements	18	-
Instruments held-for-trading	6	(96)
Net fair value gains on derivatives	<u>92</u>	<u>(70)</u>
Exchange differences	(59)	150
	<u>33</u>	<u>80</u>

Group Notes on the Accounts

6. Net fair value gains on derivatives and exchange differences continued

The Group's borrowings are arranged on both a fixed rate and a floating rate basis and in different currencies. The Group uses a combination of currency and interest rate derivatives to achieve the desired debt profile on a post-hedged basis. The impact from these derivatives, together with the fair value adjustment and exchange differences on the debt are shown within "Net fair value gains on derivatives and exchange differences" above whereas the interest expense on the debt is shown within Note 4 "Interest expense".

As such, the **£33 million** (2014: £80 million) fair value gain reported within "Net fair value gains on derivatives and exchange differences" represents the net impact of the debt and related derivatives and is primarily driven by:

- net interest income on swaps for the year of **£56 million** (2014: £56 million) to offset the interest expense on issued debt reported within Note 4 "Interest expense"; and
- a gain of **£3 million** (2014: £8 million gain) due to the ineffective portion of fair value hedges and a gain of **£nil million** (2014: £1 million gain) from the release of fair value basis adjustments to debt.

Most foreign currency assets and liabilities are maintained in US dollars and euro, which have been translated to sterling at the closing rates on 31 December 2015 of **US\$1.4739** and **€1.3568** (2014: US\$1.5593 and €1.2886).

7. Other operating expenses

	2015 £m	2014 £m
Other operating expenses	<u>3</u>	<u>4</u>

Other operating charges include remuneration of **£160,000** payable to KPMG LLP for the audit of the Group and Company's annual financial statements (2014: £164,000 payable to PwC LLP). There were no non-audit fees payable to KPMG LLP during the year (2014: £30,000 payable to PwC LLP).

The Group has no directly employed employees (2014: nil) and consequently utilises the services of a number of employees whose contracts of service are with fellow subsidiaries, and their remuneration is included in the financial statements of these subsidiaries. An annual management charge is levied from two of these fellow subsidiaries in respect of the cost of employees in the Asia Pacific Treasury Service Centre (Singapore), and in the British American Shared Service Centre (Romania). These charges are included in 'Other operating expenses' above.

8. Taxation on ordinary activities

a) Summary of tax

	2015 £m	2014 £m
UK corporation tax		
Comprising:		
- current tax at 20.25% (2014: 21.50%)	2	3
- double tax relief	(2)	(3)
Overseas tax comprising:		
- tax on current income	<u>2</u>	<u>3</u>
Total current tax expense (<i>note 8b</i>)	<u>2</u>	<u>3</u>

The Group has not recognised deferred tax assets as there are no deductible temporary differences (2014: £nil).

Group Notes on the Accounts

8. Taxation on ordinary activities continued

b) Factors affecting the tax charge

The standard rate of corporation taxation in the UK changed from 21.0 per cent to 20.0 per cent with effect from 1 April 2015. Further reductions to 19.0% (effective from 1 April 2017) and to 18.0% (effective from 1 April 2020) were substantively enacted on 26 October 2015. This will reduce the Company's future tax charge. Accordingly, the Company's profit for this accounting period is taxed at an effective rate of 20.25 per cent. The taxation charge differs from the standard 20.25 per cent rate of corporation tax in the UK. The major causes of this difference are listed below:

	2015 £m	2014 £m
Profit before taxation	116	244
UK corporation tax at 20.25% (2014: 21.50%)	23	53
Factors affecting the tax rate:		
Permanent differences	-	(1)
Temporary differences	(1)	-
Overseas taxation	2	3
Double tax relief	(2)	(3)
BAT Group loss relief claimed for no consideration	(20)	(49)
Total current tax expense (<i>note 8a</i>)	2	3

9. Cash and cash equivalents

	2015 £m	2014 £m
Cash and bank balances	28	50
Cash equivalents	334	-
	362	50

Cash equivalents comprise short-term deposits and investments in money market funds with an original maturity of three months or less. The carrying value of cash and cash equivalents approximates their fair value.

As part of its short-term cash management, the Company invests in a range of cash and cash equivalents, including money market funds, which are regarded as highly liquid and are not exposed to significant changes in fair value. These are kept under continuous review as described in the credit risk section below. At 31 December 2015, cash and cash equivalents include **£334 million** invested in money market funds (2014: £nil).

The currency in which cash and cash equivalents are held, are as follows:

	2015 £m	2014 £m
UK sterling	336	27
US dollar	10	-
Australian dollar	3	8
Romanian leu	-	3
Other	13	12
	362	50

Group Notes on the Accounts

9. Cash and cash equivalents continued

In the Group cash flow statement, net cash and cash equivalents are shown after deducting bank overdrafts (note 15) and accrued interest, where applicable:

	2015 £m	2014 £m
Cash and cash equivalents as above	362	50
Less: bank overdrafts	(133)	(152)
Net cash and cash equivalents	<u>229</u>	<u>(102)</u>

10. Amounts due on demand from fellow subsidiaries

Amounts due on demand from fellow subsidiaries comprise unsecured current accounts and cash pooling accounts referred to as In-House Cash ('IHC') accounts between fellow subsidiaries and the Group. These are denominated in the following currencies:

	2015 £m	2014 £m
UK sterling	7	107
US dollar	143	225
Swiss franc	49	41
Hong Kong dollar	94	96
Euro	240	284
Singapore dollar	7	8
Australian dollar	-	127
New Zealand dollar	-	36
Hungarian forint	60	-
Other	44	53
	<u>644</u>	<u>977</u>

There is no material difference between the book value and fair value for amounts due on demand from fellow subsidiaries.

11. Derivative financial instruments

The fair values of derivatives are determined based on market data (primarily yield curves and exchange rates) to calculate the present value of all estimated flows associated with each derivative at the balance sheet date. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives. The classification of these assets and liabilities under the IFRS 13 fair value hierarchy is given in note 12.

	2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges				
Interest rate swaps	127	-	137	1
Cross-currency swaps	39	28	6	1
Cash flow hedges				
Cross-currency swaps	8	-	-	-
Held-for-trading*				
Cross-currency swaps	10	10	18	17
Interest rate swaps	235	235	264	264
Forward foreign currency contracts	284	492	306	431
	<u>703</u>	<u>765</u>	<u>731</u>	<u>714</u>

All balances above relate to derivatives with external parties other than those disclosed in note 21.

* Some derivative financial instruments are not designated as hedges and are required to be classified as held-for-trading.

Cash flows for items in cash flow hedges are expected to incur, and impact profit and loss, over the next 12 years.

Group Notes on the Accounts

11. Derivative financial instruments continued

The maturity dates of all derivative financial instruments as recognised in the balance sheet are as follows:

	2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year*	276	245	282	268
Between one and two years	38	279	40	40
Between two and three years	1	-	35	174
Between three and four years	41	-	-	-
Between four and five years	91	59	52	-
Beyond five years*	256	182	322	232
	<u>703</u>	<u>765</u>	<u>731</u>	<u>714</u>

* Derivative liabilities above include certain interest rate swaps maturing in 2016 and 2021 with a combined fair value of **£32 million**, where the contracting parties hold the right to exercise mutual break-up clauses on 15 March 2016 and 9 November 2016.

The tables below set out the maturities of the Group's derivative financial instruments on an undiscounted contractual basis, based on spot rates.

The maturity dates of all gross-settled derivative financial instruments are as follows:

	2015			
	Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year				
- Cross-currency swaps	485	(364)	359	(362)
- Forward foreign exchange contracts	8,328	(8,066)	6,663	(6,893)
Between one and two years				
- Cross-currency swaps	15	(29)	16	(14)
- Forward foreign exchange contracts	440	(425)	2,118	(2,391)
Between two and three years				
- Cross-currency swaps	15	(32)	16	(16)
- Forward foreign exchange contracts	29	(28)	28	(29)
Between three and four years				
- Cross-currency swaps	29	(47)	30	(32)
Between four and five years				
- Cross-currency swaps	14	(35)	16	(18)
Beyond five years				
- Cross-currency swaps	1,465	(1,500)	458	(537)
	<u>10,820</u>	<u>(10,526)</u>	<u>9,704</u>	<u>(10,292)</u>

Group Notes on the Accounts

11. Derivative financial instruments continued

	2014			
	Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year				
- Cross-currency swaps	21	(29)	19	(6)
- Forward foreign exchange contracts	6,493	(6,243)	5,292	(5,529)
Between one and two years				
- Cross-currency swaps	388	(356)	344	(373)
- Forward foreign exchange contracts	512	(489)	489	(512)
Between two and three years				
- Cross-currency swaps	18	(16)	1	(4)
- Forward foreign exchange contracts	49	(46)	1,714	(1,885)
Between three and four years				
- Cross-currency swaps	18	(17)	1	(5)
Between four and five years				
- Cross-currency swaps	47	(45)	1	(5)
Beyond five years				
- Cross-currency swaps	499	(555)	209	(219)
	8,045	(7,796)	8,070	(8,538)

The maturity dates of net-settled derivative financial instruments are as follows:

	2015		2014	
	Assets	Liabilities	Assets	Liabilities
	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year	124	(76)	71	(29)
Between one and two years	94	(64)	82	(51)
Between two and three years	63	(47)	71	(49)
Between three and four years	49	(39)	51	(34)
Between four and five years	31	(31)	44	(30)
Beyond five years	55	(45)	85	(72)
	416	(302)	404	(265)

The above maturity analysis comprises the Group's interest rate swaps and non-deliverable forwards.

Group Notes on the Accounts

11. Derivative financial instruments continued

In both 2015 and 2014, swaps denoted with **A** were used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 15 on page 31. All other swaps were not designated as hedging instruments.

(b) Cross-currency swaps

Note	Maturity date	Interest rate (%)	Original Currency (m)	Principal £m	Interest rate (%)	Swapped Currency (m)	Principal £m	2015	
								Assets £m	Liabilities £m
Fixed – floating									
	2016	5.5	GBP 325	325	<i>Note (b)</i>	EUR 473	367	-	10
B	2019	4.6	EUR 20	15	<i>Note (b)</i>	USD 22	14	2	-
B	2021	3.6	EUR 600	442	<i>Note (b)</i>	GBP 518	518	-	28
B	2021	0.6	CHF 320	217	<i>Note (b)</i>	GBP 210	210	18	-
B	2023	0.9	EUR 800	590	<i>Note (b)</i>	GBP 566	566	20	-
Floating – fixed									
	2016	<i>Note (b)</i>	EUR 473	349	5.5	GBP 325	325	8	-
Fixed – fixed									
	2027	1.3	EUR 800	590	2.6	GBP 572	572	9	-
								57	38
2014									
Note	Maturity date	Interest rate (%)	Original Currency (m)	Principal £m	Interest rate (%)	Swapped Currency (m)	Principal £m	Assets £m	Liabilities £m
Fixed – floating									
	2016	5.5	GBP 325	325	<i>Note (b)</i>	EUR 473	367	-	17
B	2019	4.6	EUR 20	16	<i>Note (b)</i>	USD 22	14	5	-
B	2021	3.6	EUR 600	466	<i>Note (b)</i>	GBP 518	518	1	-
B	2021	0.6	CHF 320	207	<i>Note (b)</i>	GBP 210	210	-	1
Floating – fixed									
	2016	<i>Note (b)</i>	EUR 473	394	5.5	GBP 325	325	18	-
								24	18

Note (b): The floating interest rates in 2015 and 2014 are based on LIBOR, CHF LIBOR, EURIBOR, USD LIBOR plus a margin ranging between 64 and 154 basis points (2014: 64 and 154 basis points).

In both 2015 and 2014, swaps denoted with **B** have been used to manage the interest rate profile of external borrowings and are reflected in the repricing table in note 15 on page 31.

All other swaps have been entered into in order to manage the interest rate risk of debt held by fellow subsidiaries, and are therefore not reflected in the repricing table in note 15 on page 31.

Group Notes on the Accounts

11. Derivative financial instruments continued

(c) Forward foreign currency contracts

Forward foreign currency contracts have been used to hedge both internal and external forecast transactions as well as the hedging of internal and external assets and liabilities.

Forward foreign currency contracts are denominated in the following currencies:

	2015	2015	2014	2014
	Asset	Liability	Asset	Liability
	£m	£m	£m	£m
AUD/GBP	38	9	-	19
GBP/EUR	8	17	38	-
GBP/AUD	9	28	19	-
GBP/ZAR	1	-	-	1
GBP/JPY	7	13	22	-
GBP/USD	-	75	-	63
GBP/NZD	-	17	-	-
EUR/USD	1	19	-	46
EUR/GBP	25	222	-	153
JPY/GBP	14	7	-	22
JPY/USD	-	-	-	43
NOK/GBP	-	28	1	16
NZD/GBP	16	-	-	1
USD/EUR	19	1	46	-
USD/GBP	73	-	63	-
USD/JPY	-	-	43	-
ZAR/GBP	-	2	1	-
Others	73	54	73	67
	284	492	306	431

Certain contracts were used to manage the currency profile of external borrowings and are reflected in the currency table in note 15 on page 31, and their nominal values are as follows:

	2015		2014	
	Sell	Purchase	Sell	Purchase
	£m	£m	£m	£m
Forward contracts to purchase CHF, sell GBP	264	(272)	228	(223)
Forward contracts to purchase GBP, sell CAD	178	(181)	202	(204)
Forward contracts to purchase GBP, sell USD	541	(529)	192	(192)
Forward contracts to purchase GBP, sell EUR	71	(70)	75	(76)
Forward contracts to purchase GBP, sell NOK	115	(115)	-	-
Forward contracts to purchase EUR, sell DKK	321	(321)	339	(339)
Forward contracts to purchase EUR, sell NOK	115	(120)	128	(137)
Forward contracts to purchase EUR, sell SEK	112	(111)	114	(116)
Forward contracts to purchase EUR, sell GBP	1,808	(1,579)	1,694	(1,540)
Forward contracts to purchase NOK, sell GBP	143	(115)	143	(128)
Forward contracts to purchase NOK, sell EUR	116	(115)	-	-

Group Notes on the Accounts

12. Management of financial risks

One of the principal responsibilities of the Company is to manage the financial risks arising from the BAT Group's underlying operations. Specifically, Treasury manages, within an overall policy framework set by the BAT Group's Main Board and Corporate Finance Committee ('CFC'), the BAT Group's exposure to funding and liquidity, interest rate, foreign exchange and counterparty risks. The overall BATIF Group Treasury position is monitored by the CFC, which meets regularly throughout the year and is chaired by the BAT Group Finance Director.

Given the nature of the Group's activities, the Group is managed in accordance with BAT Group Treasury policies and procedures. These policies and procedures include a set of financing principles, including the monitoring of credit ratings, interest cover and liquidity. These provide a framework within which the Group's capital base is managed. The Group defines capital as equity (see note 19) and net debt, which is defined as external borrowings, including derivatives in respect of debt, less cash and cash equivalents. The Group's net debt balances, which are managed as part of the BAT Group's net debt, are as follows:

	2015 £m	2014 £m
Borrowings - bank overdrafts and issued debt (note 15)	14,071	9,056
Derivatives in respect of debt:		
- Assets	(470)	(450)
- Liabilities	537	432
Cash and cash equivalents (note 9)	(362)	(50)
	<u>13,776</u>	<u>8,988</u>

The Group manages its financial risks in line with the classification of its financial assets and liabilities in the Group's balance sheet and related notes.

The Group's management of specific risks is dealt with as follows:

Liquidity risk

It is the policy of the Group to maximise financial flexibility and minimise refinancing risk by issuing debt with a range of maturities, generally matching the projected cash flows of the BAT Group, and to obtain this financing from a wide range of providers. The BAT Group has a target average centrally managed debt maturity of at least five years with no more than twenty per cent of centrally managed debt maturing in a single rolling year. The debt held by the Group is part of the BAT Group's centrally managed debt and is therefore not managed to separate targets. As at 31 December 2015, the average debt to maturity of the Group was **8.3 years** (2014: 6.7 years) and the highest proportion of total issued debt maturing in a single rolling year was **17.8 per cent** (2014: 18.6 per cent).

At 31 December 2015, commercial paper of £505 million was outstanding (2014: £160 million).

In February 2015, the Group signed a one-year bridge facility of £2.5 billion with an extension option of up to one year for the BAT Group's public tender offer to acquire up to all of the 24.7% of Souza Cruz shares, which were not owned by the BAT Group. The facility was partially cancelled in September, October and November 2015. The facility was cancelled as at 31 December 2015.

In March 2015, the Group issued €3 billion of bonds in four tranches as follows: €800 million maturing in 2019, €800 million maturing in 2023, €800 million maturing in 2027 and €600 million maturing in 2045. A €1.25 billion bond was repaid.

In March 2015, a one-year extension option was exercised for the £3 billion main bank facility, extending the final maturity to May 2020. The facility was undrawn as at 31 December 2015 (2014: undrawn). The US\$2 billion US commercial paper programme was increased in size to US\$3 billion.

In June 2015, the Group issued US\$4.5 billion of bonds in five tranches as follows: US\$750 million maturing in 2018, US\$1,250 million maturing in 2020, US\$500 million maturing in 2022, US\$1,500 million maturing in 2025 and US\$500 million of floating rate notes maturing in 2018. A US\$500 million bond was repaid. The US\$4.7 billion bridge facility in respect of the BAT Group's investment in Reynolds American Inc. was cancelled following the issue of the bonds.

In November 2015, the Group issued a €600 million bond maturing in 2022 and a £350 million bond maturing in 2055.

In September 2014, the Group signed a one year bridge facility of US\$4.7 billion with an extension option of up to one year on behalf of BAT Group for their proposed investment in Reynolds American Inc.. This facility was undrawn as at 31 December 2014.

In September 2014, the Group issued a new CHF 350 million bond with a maturity of 2016; a new CHF 400 million bond with a maturity of 2021 and a new CHF 250 million bond with a maturity of 2026.

Group Notes on the Accounts

12. Management of financial risks continued

In March 2014, the Group issued a €400 million bond with a maturity of 2018.

The Group ensures that there is flexibility in funding arrangements with fellow subsidiaries by providing short-term facilities or early repayment rights.

In May 2014, the Group negotiated a new central banking facility of £3 billion with a final maturity of May 2019 (with two additional one-year extensions at the option of the banks). This facility is provided by 22 banks. The new facility is on significantly improved terms compared to the previous central banking facility of £2 billion, with a maturity of December 2015, which was cancelled at the same time. The facility was undrawn as at 31 December 2015 (2014: undrawn).

It is Group policy that short-term sources of funds (including drawings under both the US\$2 billion programme and the £1 billion euro commercial paper ('ECP') programme) are backed by undrawn committed lines of credit and cash.

As the Group is the principal central financing vehicle for the BAT Group, it is used to mobilise cash for the BAT Group through participation in cash pooling and zero balancing bank account structures with fellow subsidiaries.

As part of its short-term cash management, the Company invests in a range of cash and cash equivalents, including money market funds, which are regarded as highly liquid and are not exposed to significant changes in fair value. These are kept under continuous review as described in the credit risk section below. At 31 December 2015, cash and cash equivalents include **£334 million** (2014: £nil) invested in money market funds.

Although term deposits repayable to fellow subsidiaries as shown in note 18 fall due within one year, they are typically renewed subject to the funding requirements of the counterparty. Loans to fellow subsidiaries, subsidiary companies and the parent undertaking are made on commercial terms. All contractual borrowing covenants have been met and none of them are expected to inhibit the Group's operations or funding plans.

Currency risk

The Group is subject to exposure on the translation of the net assets of foreign currency subsidiaries into its reporting currency, sterling. Lending and borrowing activities with fellow subsidiaries are usually in the currency of the counterparty resulting in primary balance sheet translation exposures to the US dollar, euro, Canadian dollar, and Danish krone. These exposures are kept under continuous review and the Group's policy is to minimise all balance sheet translation exposure where it is practical and cost effective to do so through matching of currency assets with currency borrowings. At 31 December 2015, the currency profile of the Group's gross issued debt, after taking into account derivative contracts, was **37 per cent** (2014: 25 per cent) US dollar, **9 per cent** (2014: 10 per cent) euro, **48 per cent** (2014: 56 per cent) sterling, **1 per cent** (2014: 2 per cent) Canadian dollar, **2 per cent** (2014: 4 per cent) Danish krone, and **3 per cent** (2014: 3 per cent) other currencies.

The Group faces currency exposures arising from the translation of profits earned in foreign currency subsidiaries; these exposures are not normally hedged.

IFRS 7 requires a sensitivity analysis that shows the impact on the income statement and on items recognised directly in equity of hypothetical changes of exchange rates in respect of non-functional currency financial assets and liabilities held by the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. All financial assets and liabilities held in the functional currency of the Group's subsidiaries, as well as non-financial assets and liabilities and translation risk, are not included in the analysis. The Group considers a 10 per cent strengthening or weakening of the functional currency against the non-functional currency of its subsidiaries as a reasonably possible change. The impact is calculated with reference to the financial asset or liability held as at the year-end, unless this is unrepresentative of the position during the year.

Group Notes on the Accounts

12. Management of financial risks continued

Currency risk continued

The Group hedges substantially all of its financial currency exposures not denominated in the functional currency either economically or through use of derivative contracts. This mitigates the sensitivity of fluctuations in the underlying exchange rates. As a result, a 10 per cent strengthening of functional currencies against non-functional currencies would result in no material change to pre-tax profit (2014: no material change to pre-tax profit). A 10 per cent weakening of functional currencies against non-functional currencies would result in no material change to pre-tax profit (2014: no material change to pre-tax profit).

A 10 per cent change in exchange rates would have no material impact on items recognised directly in other comprehensive income for the current and prior year.

Interest rate risk

The objectives of the Group's interest rate risk management policy are to lessen the impact of adverse interest rate movements on earnings, cash flow and economic value of the Group and to safeguard against any possible breach of its financial covenants. Additional objectives are to minimise the cost of hedging and the associated counterparty risk.

The BAT Group has an externally imposed capital requirement in respect of its centrally managed banking facilities, which requires a gross interest cover of 4.5 times. Although the Company is a joint borrower under these central banking facilities, the requirement is based on the half-yearly group financial statements of British American Tobacco p.l.c..

In order to manage its interest rate risk, the Group maintains both floating and fixed rate debt. The Group's ratio of fixed to floating rate debt forms part of overall BAT Group debt for which targets are set for the desired ratio of floating to fixed rate debt on both a gross basis and net basis (at least 50 per cent fixed on a net basis in the short to the medium-term) as a result of regular reviews of market conditions and strategy by the CFC and the Board of the Company. At 31 December 2015, the relevant ratios of floating to fixed rate external borrowings were **38:62** (2014: 45:55) on a gross basis and **41:59** (2014: 45:55) on a net basis within the Group. Underlying borrowings are arranged on both a fixed and a floating rate basis and, where appropriate, the Group uses derivatives, primarily interest rate swaps, to vary the fixed and floating mix. The interest rate profile of liquid assets is taken into account in determining the net interest rate exposure.

Group Notes on the Accounts

12. Management of financial risks continued

Interest rate risk continued

IFRS 7 requires a sensitivity analysis that shows the impact on the income statement and on items recognised directly in other comprehensive income of hypothetical changes of interest rates in respect of interest-bearing financial assets and financial liabilities of the Group. All other variables are held constant although, in practice, market rates rarely change in isolation. For the purposes of this sensitivity analysis, financial assets and liabilities with fixed interest rates are not included. The Group considers a 100 basis point change in interest rates as a reasonably possible change except where rates are less than 100 basis points. In these instances, it is assumed that the interest rates increase by 100 basis points and decrease to zero for the purpose of performing the sensitivity analysis. The impact is calculated with reference to the financial asset or liability held as at the year-end, unless this is unrepresentative of the position during the year.

A 100 basis point increase in interest rates would result in pre-tax profit being **£110 million** higher (2014: £31 million higher). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being **£84 million** lower (2014: £35 million lower).

A 100 basis point change in interest rates would have no material impact on items recognised directly in other comprehensive income for the current and prior year.

Credit risk

The Group has no significant concentrations of counterparty credit risk in respect of its external financial assets. As the central financing vehicle for the BAT Group, concentrations of credit risk arise from financial assets due from fellow subsidiaries and the parent undertaking. All loans to fellow subsidiaries, subsidiary companies and the parent are priced on an arm's length basis. To determine the appropriate risk premium, the Group consults, where appropriate, with independent financial institutions who assess the asset base and sovereign risk specific to the relevant counterparty. The Group recognises that the sovereign risk of a fellow subsidiary can be the determining factor of default.

Intragroup counterparties have appropriate capital structures to meet their obligations as they fall due. All loans to fellow subsidiaries, subsidiary companies and the parent undertaking are therefore between parties which have been individually reviewed and are considered to be in a position to continue to meet their obligations.

All external derivatives are subject to ISDA documentation.

Group Notes on the Accounts

12. Management of financial risks continued

Credit risk continued

Cash deposits and other financial instruments give rise to credit risk on the amounts due from the related counterparties. Generally, the Group targets a long term counterparty credit rating of at least A-/A3. From time to time, the Group may invest in short dated corporate commercial paper. For this, the Group has identified specific counterparties with a minimum short-term rating of A1/P1.

External counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of bank counterparties are reviewed regularly. The Group ensures that it has sufficient counterparty credit capacity of requisite quality to undertake all anticipated transactions.

The maximum exposure to credit risk of financial assets at the balance sheet date is reflected by the carrying values included in the Group balance sheet. In addition, the Group provides committed credit facilities to certain fellow subsidiaries. The undrawn portion of these committed facilities at 31 December 2015 is **£8,153 million** (2014: £5,802 million). Guarantees provided to third parties are shown in note 20 on page 34.

Price risk

At 31 December 2015 and 31 December 2014, the Group's financial instruments are not sensitive to price risk.

Hedge accounting

In order to qualify for hedge accounting, the Group is required to document prospectively the relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is reperformed periodically to ensure that the hedge has remained and is expected to remain highly effective.

Fair value estimation

The fair values of financial assets and liabilities with maturities of less than one year, other than derivatives, are assumed to approximate their book values. For other financial instruments which are measured at fair value in the balance sheet, the basis for fair values is described below.

Fair value hierarchy

In accordance with the IFRS 13 classification hierarchy, all derivatives held by the Group at 31 December 2015 and 31 December 2014, fall within Level 2. Level 2 financial instruments are not traded in an active market but the fair values are based on quoted market prices, broker dealer quotations or alternative pricing sources with reasonable levels of price transparency. Level 2 financial instruments include OTC derivatives.

Group Notes on the Accounts

12. Management of financial risks continued

Netting arrangement of derivative financial instruments

The gross fair value of derivative financial instruments as presented in the Group balance sheet, together with the Group's right of offset associated with recognised financial assets and recognised financial liabilities, subject to enforceable master netting arrangements and similar agreements, is summarised as follows:

	2015			2014		
	Amount presented in the Group balance sheet	Related to amounts not offset in the Group balance sheet	Net amount	Amount presented in the Group balance sheet	Related to amounts not offset in the Group balance sheet	Net amount
	£m	£m	£m	£m	£m	£m
Financial Assets						
-Derivative Financial Instruments (note 11)	703	(417)	286	731	(369)	362
Financial Liabilities						
-Derivative Financial Instruments (note 11)	(765)	417	(348)	(714)	369	(345)

The Group is subject to master netting arrangements in force with financial counterparties with whom the Group trade derivatives.

The master netting arrangements determine the proceedings should either party default on their obligations. In case of any event of default: the non-defaulting party will calculate the sum of the replacement cost of outstanding transaction and amounts owed to it by the defaulting party. If that sum exceeds the amount owed to the defaulting party, the defaulting party will pay the balance to the non-defaulting party. If the sum is less than the amounts owed to the defaulting party, the non-defaulting party will pay the balance to the defaulting party.

13. Other receivables

	2015 £m	2014 £m
Prepayments and accrued income:		
Due from fellow subsidiaries	3	6
Other	7	8
	<u>10</u>	<u>14</u>

Within the 'Other' category of other receivables are prepaid facility fees of **£6 million** (2014: £5 million), which relate to periods which fall beyond one year.

The currency profile of other receivables is **£9 million** (2014: £13 million) sterling and **£1 million** (2014: £1 million) US dollar.

All amounts are unsecured and interest free. Due to their short-term nature, there is no material difference between the book values and fair values of all amounts due from fellow subsidiaries included above as determined using discounted cash flow analysis.

Group Notes on the Accounts

14a. Loans due from parent undertaking

Loans due from the parent undertaking at 31 December 2015 of **£3,621 million** fall due within one to two years (2014: £3,624 million within two to three years) and are unsecured and reprice within one year. This loan is in sterling.

Loans due from the parent undertaking include **£4 million** of interest receivable at 31 December 2015 (2014: £7 million). There is no material difference between the book value and fair value for loans due from the parent undertaking as determined using discounted cash flow analysis.

Loans due from the parent undertaking are unsecured with interest charged at 1.9% per annum and are repayable at maturity dates in 2017.

14b. Loans due from fellow subsidiaries

Unsecured loans due from fellow subsidiaries are denominated in the following currencies:

	2015 £m	2014 £m
UK sterling	24,146	24,708
Euro	1,245	1,224
US dollar	6,081	2,943
Danish krone	323	343
Canadian dollar	262	477
Swiss franc	203	228
Swedish krona	114	117
Polish zloty	10	9
	32,384	30,049

There is no material difference between the book value and fair value for loans due from fellow subsidiaries as determined using discounted cash flow analysis.

Loans due from fellow subsidiaries are unsecured with interest charged at between 0.4% and 9.8% per annum and repayable at maturity dates between 2016 and 2020.

The maturity dates of loans due from fellow subsidiaries as recognised in the balance sheet are as follows:

	2015 £m	2014 £m
Within one year	23,480	23,946
Between one and two years	480	3,231
Between two and three years	4,817	460
Between three and four years	14	2,412
Between four and five years	3,593	-
Total	32,384	30,049

Loans due from subsidiary and fellow subsidiaries repayable within one year are expected to be renewed upon maturity and accordingly are classified as Loans due from fellow subsidiaries in the Group balance sheet.

The timing exposure to interest rate changes when loans reprice is as follows:

	Total £m	Within 1 year £m	Between 1 and 2 years £m	Between 2 and 3 years £m	Between 3 and 4 years £m	Between 4 and 5 years £m	Greater than 5 years £m
As at 31 December 2015	32,384	32,063	321	-	-	-	-
As at 31 December 2014	30,049	29,596	-	453	-	-	-

Interest rate risk on loans due from fellow subsidiaries is not hedged by the Group.

Loans due from fellow subsidiaries include **£87 million** of interest receivable (2014: £65 million).

Group Notes on the Accounts

15. Bank overdrafts and issued debt

	Currency	Maturity dates	Interest rates	2015 £m	2014 £m
Issued debt					
Eurobonds	Euro	2017-2045	0.4 to 5.4%	4,621	3,118
	Euro	2018	3m Euribor +50bps	294	309
	Swiss franc	2021-2026	0.7 to 1.4%	446	420
	Swiss franc	2016	CHF 3m libor +16bps	238	226
	UK sterling	2019-2055	4.0 to 7.3%	3,084	2,753
	US dollar	2016	1.1%	203	194
Other bonds issued pursuant to Rule 144A and RegS under the US Securities Act	US dollar	2017-2025	1.9 to 9.5% USD 3m libor	4,208 339	1,724 -
	US dollar	2018	+51 bps	505	160
Commercial paper				13,938	8,904
Bank overdrafts				133	152
				14,071	9,056

In March 2015, the Group issued €3 billion of bonds in four tranches as follows: €800 million maturing in 2019, €800 million maturing in 2023, €800 million maturing in 2027 and €600 million maturing in 2045. A €1.25 billion bond was repaid.

In June 2015, the Group issued US\$4.5 billion of bonds in five tranches as follows: US\$750 million maturing in 2018, US\$1,250 million maturing in 2020, US\$500 million maturing in 2022, US\$1,500 million maturing in 2025 and US\$500 million of floating rate notes maturing in 2018. A US\$500million bond was repaid.

In November 2015, the Group issued a €600 million bond maturing in 2022 and a £350 million bond maturing in 2055.

Included within borrowings of £13,938 million (2014: £8,904 million) above are £5,612 million (2014: £4,004 million) where the amortised cost has been adjusted as part of a fair value hedge. The carrying value of borrowings subject to fair value hedges has been increased by £153 million at 31 December 2015 (2014: increased by £166 million) included in the table above.

Bank overdrafts are all repayable within one year, and are denominated in euro, Turkish lira, Australian dollar, Bulgarian Lev, Swiss franc, Hong Kong dollar, Mexican peso, Hungarian forint, New Zealand dollar, Romanian leu, Russian rouble, Swedish krona, Norwegian krona, Kuwaiti dinar, US dollar, Danish krone, Polish zloty, and Saudi riyal (2014: Czech krona, euro, Singapore dollar, Turkish lira, Norwegian krona, Kuwaiti dinar, US dollar, Danish krone, Polish zloty, Japanese yen, South African rand, Bulgarian lev and Saudi riyal).

Borrowings are repayable as follows:

	Per balance sheet		Contractual gross maturities	
	2015 £m	2014 £m	2015 £m	2014 £m
Within one year	1,224	1,775	1,538	1,978
Between one and two years	1,323	418	1,821	734
Between two and three years	1,613	1,346	2,039	1,682
Between three and four years	1,135	755	1,447	1,011
Between four and five years	852	557	1,151	725
Beyond five years	7,924	4,205	10,232	5,515
Total	14,071	9,056	18,228	11,645

The contractual gross maturities in each year include the borrowings maturing in that year, together with forecast interest payments on all borrowings which are outstanding for all or part of the year.

Issued debt repayable within one year includes interest payable of £145 million (2014: £173 million).

Group Notes on the Accounts

15. Bank overdrafts and issued debt continued

Issued debt is denominated in the following currencies. The Group often uses derivatives to manage the profile of the debt.

	Total £m	GBP £m	USD £m	EUR £m	CHF £m	CAD £m	DKK £m	SEK £m
As at 31 December 2015								
Total issued debt	13,938	3,589	4,750	4,915	684	-	-	-
Effect of derivative financial instruments								
Cross-currency swaps	27	1,866	15	(1,637)	(217)	-	-	-
Forward foreign exchange contracts	256	1,320	541	(1,944)	(272)	178	321	112
	14,221	6,775	5,306	1,334	195	178	321	112
As at 31 December 2014								
Total issued debt	8,904	2,753	2,078	3,427	646	-	-	-
Effect of derivative financial instruments								
Cross-currency swaps	53	728	14	(482)	(207)	-	-	-
Forward foreign exchange contracts	160	1,593	192	(2,057)	(223)	202	339	114
	9,117	5,074	2,284	888	216	202	339	114

Details of the derivative financial instruments included in these tables are given in note 11 on pages 17-22.

The timing exposure to interest rate changes when borrowings are repriced is as follows:

	Total £m	Within 1 year £m	Between 1 and 2 years £m	Between 2 and 3 years £m	Between 3 and 4 years £m	Between 4 and 5 years £m	Beyond 5 years £m
At 31 December 2015							
Total issued debt	13,938	1,091	1,323	1,613	1,135	852	7,924
Effect of derivative financial instruments							
Interest rate swaps	-	3,754	(407)	(509)	(250)	(1,498)	(1,090)
Cross-currency swaps	27	1,309	-	-	(15)	-	(1,267)
	13,965	6,154	916	1,104	870	(646)	5,567
At 31 December 2014							
Total issued debt	8,904	1,623	418	1,346	755	557	4,205
Effect of derivative financial instruments							
Interest rate swaps	-	2,366	-	(385)	-	(250)	(1,731)
Cross-currency swaps	53	742	-	-	-	(16)	(673)
	8,957	4,731	418	961	755	291	1,801

Details of the derivative financial instruments included in these tables are given in note 11 on pages 17-22.

British American Tobacco p.l.c. has provided guarantees for all of the Group's public indebtedness. As at 31 December 2015, the amount of these guarantees was **£13,763 million** (2014: £8,641 million).

The fair value of issued debt is **£13,904 million** (2014: £10,070 million) and has been determined using quoted market prices. **£13,771 million** (2014: £9,918 million) has been calculated using quoted market prices and are within Level 1 of the fair value hierarchy. **£133 million** (2014: £152 million) has been calculated based on discounted cash flow analysis and are within Level 2 of the fair value hierarchy.

Group Notes on the Accounts

16a Amounts repayable on demand to parent undertaking

Amounts repayable on demand to the parent undertaking at 31 December 2015 of **£7,309 million** (2014: £9,036 million) are unsecured and comprise current account borrowings from the parent. These are denominated in sterling. There is no accrued interest repayable in the current or prior year.

There is no material difference between the book value and fair value for amounts repayable on demand to parent undertaking.

16b Amounts repayable on demand to fellow subsidiaries

Amounts repayable on demand to fellow subsidiaries comprise fellow subsidiary current accounts and cash pooling accounts held with the Group. These are unsecured, and are denominated in the following currencies:

	2015 £m	2014 £m
UK sterling	12,003	13,243
Euro	303	353
US dollar	290	248
Swiss franc	16	44
Norwegian krona	52	50
Australian dollar	59	4
Hong Kong dollar	19	21
Romanian leu	110	91
New Zealand dollar	95	-
Other	102	71
	<u>13,049</u>	<u>14,125</u>

Amounts repayable on demand to fellow subsidiaries include **£nil** of interest repayable at 31 December 2015 (2014: £nil). There is no material difference between the book value and fair value for amounts repayable on demand to fellow subsidiaries as determined using discounted cash flow analysis.

17. Other payables

	2015 £m	2014 £m
Accrued charges		
Due to fellow subsidiaries	-	6
Other	5	2
	<u>5</u>	<u>8</u>

The currency profile of other payables is **£5 million** (2014: £8 million) UK sterling.

There is no material difference between the book values of other payables and their fair values as determined using discounted cash flow analysis.

Group Notes on the Accounts

18. Term deposits repayable to fellow subsidiaries

Term deposits repayable to fellow subsidiaries are unsecured, and are denominated in the following currencies:

	2015 £m	2014 £m
UK sterling	264	484
Euro	111	58
US dollar	17	21
Mexican pesos	39	52
Hong Kong dollar	5	5
Bulgarian lev	8	13
Singapore dollar	31	32
Japanese yen	71	67
Romanian leu	-	3
Russian rouble	50	-
	596	735

Term deposits repayable to fellow subsidiaries include **£0.3 million** of interest payable at 31 December 2015 and reprice within one year (2014: £0.1 million within one year).

In 2015 and 2014, term deposits repayable to fellow subsidiaries fall due within one year.

There is no material difference between the above amounts for term deposits repayable to fellow subsidiaries and their fair values as determined using discounted cash flow analysis.

19. Total equity

	Share capital £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
1 January 2015	231	-	225	1,315	1,771
Comprehensive income					
Profit for the year	-	-	-	114	114
Differences on exchange	-	-	54	-	54
Cash flow hedges					
net fair value gains / (losses)	-	8	-	-	8
reclassified and reported in other operating expenses	-	(18)	-	-	(18)
31 December 2015	231	(10)	279	1,429	1,929
	Share capital £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
1 January 2014	231	(1)	172	1,074	1,476
Comprehensive income					
Profit for the year	-	-	-	241	241
Differences on exchange	-	-	53	-	53
Cash flow hedges					
reclassified and reported in other operating expenses	-	1	-	-	1
31 December 2014	231	-	225	1,315	1,771

Group Notes on the Accounts

19. Total equity continued

Details relating to the allotted and issued share capital, and movements therein, are included on page 44, note 13 to the Company financial statements.

The translation reserve is as explained in the accounting policy on foreign currencies on page 10. The hedging reserve is as explained in the accounting policy on financial instruments on pages 11-12.

20. Contingent liabilities

The Group is one of the four entities in the BAT Group which have jointly guaranteed borrowing facilities available to B.A.T. Netherlands Finance B.V. of **£2,476 million** (€2,600 million and £325 million) (2014: £2,343 million (€2,600 million and £325 million)). All such facilities have been utilised at the balance sheet date.

The full fair value of the above guarantees is **£73 million** (2014: £91 million) and recognised in the financial statements of the ultimate parent undertaking, British American Tobacco p.l.c.

Contingent liabilities mature as follows:

	2015 £m	2014 £m
Within one year	335	-
Between one and two years	-	325
Between four and five years	505	-
Beyond five years	1,636	2,018
Total	<u>2,476</u>	<u>2,343</u>

21. Related party disclosures

The Group has a number of transactions and relationships with related parties, as defined in IAS 24 Related Party Disclosures, all of which are undertaken in the normal course of the Group's business as a primary financing vehicle for the BAT Group.

Transactions and balances with fellow subsidiaries and the parent undertaking relate mainly to the provision of finance to companies within the BAT Group.

Details of these transactions in the Group balance sheet are set out in notes 10, 13, 14, 16, 17, and 18. In addition, outstanding balances with fellow subsidiaries are included within the balance disclosed in note 11 as follows:

	2015		2014	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Derivative financial instruments				
Cross-currency swaps	10	-	18	-
Interest rate swaps	125	353	92	327
Forward foreign currency contracts	93	142	101	164
	<u>228</u>	<u>495</u>	<u>211</u>	<u>491</u>

Details of these transactions in the Group income statement are set out in notes 3, 4 and 5. In addition, balances with fellow subsidiaries are included within the balance disclosed in note 6 as follows:

	2015	2014
	Income/(Expense) £m	Income/(Expense) £m
Derivative financial instruments		
Cross-currency swaps	(22)	(33)
Interest rate swaps	(3)	(54)
Forward foreign currency contracts	(144)	(237)
	<u>(169)</u>	<u>(324)</u>

Group Notes on the Accounts

21. Related party disclosures continued

The key management of the Company consists of the members of the Board of Directors and no such person had any material interest during the year in a contract of significance with the Group. The term key management in this context includes the respective members of their households.

22. Principal subsidiary undertakings

The Company holds the entire issued share capital of BATIF Dollar Limited, and of B.A.T Finance B.V., finance companies incorporated in England and Wales and the Netherlands, respectively.

23. Directors' remuneration

None of the Directors received any remuneration in respect of their services to the Group during the year (2014: £nil).

24. Parent undertaking

The Company's immediate and ultimate parent undertaking and ultimate controlling party is British American Tobacco p.l.c., being incorporated in the United Kingdom and registered in England and Wales and registered as an external company in the Republic of South Africa. Consolidated Group financial statements are prepared by British American Tobacco p.l.c. and are publicly available.

25. Copies of the report and accounts

Copies of the report and accounts of British American Tobacco p.l.c. may be obtained from the Company Secretary, Globe House, 4 Temple Place, London WC2R 2PG.

Independent Auditor's report to the members of B.A.T. International Finance p.l.c.

We have audited the financial statements of B.A.T. International Finance p.l.c. for the year ended 31 December 2015 which comprise the Group Income Statement, the Group Statement of Comprehensive Income, the Group and Parent Company Balance Sheets, the Group Cash Flow Statement, the Group Statement of Changes in Equity and the related notes. The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice), including FRS 101 *Reduced Disclosure Framework*.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2015 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with UK Generally Accepted Accounting Practice;
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Independent Auditor's report to the members of B.A.T. International Finance p.l.c.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



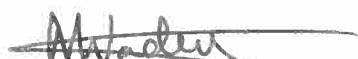
Richard Ackland (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square
London
E14 5GL

24 February 2016

Balance Sheet – B.A.T. International Finance p.l.c.
at 31 December 2015
Registered Number 01060930

	2015 £m	2014 £m
<i>Assets</i>		
<i>Fixed assets</i>		
Investments in subsidiaries (note 2)	718	718
Loans due from parent undertaking (note 3a)	3,621	3,624
Loans due from subsidiary and fellow subsidiaries (note 3b)	<u>31,406</u>	<u>29,415</u>
	<u>35,745</u>	<u>33,757</u>
<i>Current assets</i>		
Amounts due on demand from fellow subsidiaries (note 4)	644	977
Prepayments and accrued income (note 5)	10	14
Derivative financial instruments (note 6)	703	731
Short-term deposits and cash (note 8)	<u>362</u>	<u>50</u>
	<u>1,719</u>	<u>1,772</u>
Total assets	<u>37,464</u>	<u>35,529</u>
<i>Liabilities</i>		
<i>Creditors</i>		
Issued debt (note 9)	13,938	8,904
Bank overdrafts (note 9)	133	152
Amounts payable on demand to parent undertaking (note 10a)	7,309	9,036
Amounts payable on demand to fellow subsidiaries (note 10b)	13,072	14,397
Borrowings from fellow subsidiaries (note 11)	596	735
Derivative financial instruments (note 6)	765	714
Accruals and deferred income (note 12)	<u>5</u>	<u>8</u>
	<u>35,818</u>	<u>33,946</u>
<i>Equity</i>		
Called up share capital (note 13)	231	231
Hedging reserve (note 13)	(10)	-
Retained earnings (note 13)	<u>1,425</u>	<u>1,352</u>
Total shareholders' funds	<u>1,646</u>	<u>1,583</u>
Total equity and liabilities	<u>37,464</u>	<u>35,529</u>

On behalf of the Board


Neil Arthur Wadey, Director
24 February 2016

The accompanying notes are an integral part of the Company financial statements. Notes are shown on pages 39-45.

Notes on the Accounts – B.A.T. International Finance p.l.c.

1. Accounting policies

Basis of accounting

With effect from 1 January 2015, the financial statements of the Parent Company have been prepared on the going concern basis, under the historical cost convention and in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework (“FRS 101”).

The preparation of the Group’s financial statements under International Financial Reporting Standards has led to the use of the ‘liquidity format’ for the balance sheet in those financial statements. In order to aid comparability between the Group and Company, the format of the Company balance sheet has been presented within the limits of the Companies Act 2006, to match as closely as possible the ‘liquidity format’ in order to present a true and fair view of the state of affairs of the Company. As permitted by Section 408 of the Companies Act 2006, the profit and loss of the Company has not been presented in these financial statements.

In preparing these financial statements, the Company applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU (“IFRS”), but makes amendments where necessary in order to comply with Companies Act 2006 and where advantage of certain disclosure exemptions available under FRS 101 have been taken, including those relating to:

- a cash flow statement and related notes;
- comparative period reconciliations for investments in subsidiaries;
- disclosures in respect of transactions with wholly-owned subsidiaries;
- disclosures in respect of capital management; and
- the effects of new but not yet effective IFRSs.

In the transition from UK Generally Accepted Accounting Principles to FRS 101, the company has applied IFRS 1, whilst ensuring that its assets and liabilities are measured in compliance with FRS 101. There were no material measurement or recognition adjustments to previously reported amounts as a result of applying FRS 101. The financial statements have been prepared under the historical cost convention except as described in the accounting policy below on financial instruments.

The preparation of the financial statements requires the Directors to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the financial statements. The key estimates and assumptions are set out in the accounting policies below, together with the related notes to the accounts.

Foreign currencies

The functional currency of the Company is sterling. Transactions arising in currencies other than sterling are translated at the rate of exchange ruling on the date of the transaction. Assets and liabilities expressed in currencies other than sterling are translated at rates of exchange ruling at the end of the financial year. All exchange differences are taken to the profit and loss account in the year.

Taxation

Taxation is that chargeable on the profits for the period, together with deferred taxation. Income tax charges, where applicable, are calculated on the basis of tax laws enacted or substantially enacted at the balance sheet date.

Deferred tax is determined using the tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred tax asset is realised or deferred tax liability is settled. As required under IAS 12 Income Taxes, deferred tax assets and liabilities are not discounted.

Investments in Group companies

Investments in Group companies are stated at cost, together with subsequent capital contributions, less provision for any impairment in value, where appropriate.

Cash flow

The Company is a wholly owned subsidiary of British American Tobacco p.l.c.. The cash flows of the Company are included in the consolidated cash flow statement of British American Tobacco p.l.c., which is publicly available. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of FRS 101.

Financial instruments

The financial instrument disclosures of the Company are included in the Group financial statements, which are included in this Annual Report. Consequently, the Company is exempt under FRS 101 from publishing these financial instruments disclosures.

Financial guarantees are initially recorded at fair value, and subsequently carried at this fair value less accumulated amortisation.

Notes on the Accounts – B.A.T. International Finance p.l.c.

1. Accounting policies continued

Related parties

The Company has taken advantage of the exemption under FRS 101 from disclosing transactions with related parties that are wholly-owned subsidiaries of BAT Group.

Dividends

Final dividend distributions 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 while the interim dividend distributions are recognised in the period in which the dividends are declared and paid.

Similarly, dividend income is recognised at the same time as the paying company recognises the liability to pay a dividend.

Notes on the Accounts – B.A.T. International Finance p.l.c.

2. Investments in subsidiaries

The Company holds the entire issued share capital of BATIF Dollar Limited and of B.A.T Finance B.V., finance companies incorporated in England and Wales and the Netherlands respectively. The cost of these investments as at 31 December 2015 was **£718 million** (2014: £718 million).

The Directors are of the opinion that the individual investments in the subsidiary undertakings have a value of not less than the amount at which they are shown in the balance sheet.

3a. Loans due from parent undertaking

Loans due from parent undertaking of **£3,621 million** (2014: £3,624 million) comprise exactly the same balances and disclosures as Loans due from parent undertaking detailed in Group note 14a.

3b. Loans due from subsidiary and fellow subsidiaries

Unsecured loans due from subsidiary and fellow subsidiaries are denominated in the following currencies:

	2015 £m	2014 £m
UK sterling	24,146	24,708
Euro	1,245	1,224
Danish krone	323	342
Canadian dollar	262	477
Swiss franc	203	228
Swedish krona	114	117
Polish zloty	10	9
US dollar	5,103	2,310
	<u>31,406</u>	<u>29,415</u>

There is no material difference between the book value and fair value for loans due from subsidiary and fellow subsidiaries.

The maturity dates of loans due from subsidiary and fellow subsidiaries as recognised in the balance sheet are as follows:

	2015 £m	2014 £m
Within one year	23,202	25,724
Between one and two years	480	3,231
Between two and three years	2,245	460
Between four and five years	5,479	-
Total	<u>31,406</u>	<u>29,415</u>

Loans due from subsidiary and fellow subsidiaries repayable within one year are expected to be renewed upon maturity and, accordingly, are classified as Loans due from fellow subsidiaries in the Company balance sheet.

The timing exposure to interest rate changes when loans reprice is as follows:

	Total £m	Within 1 year £m	Between 1 and 2 years £m	Between 2 and 3 years £m	Between 3 and 4 years £m	Between 4 and 5 years £m
As at 31 December 2015	<u>31,406</u>	<u>31,085</u>	<u>321</u>	<u>-</u>	<u>-</u>	<u>-</u>
As at 31 December 2014	<u>29,415</u>	<u>28,962</u>	<u>-</u>	<u>453</u>	<u>-</u>	<u>-</u>

Interest rate risk of loans to subsidiary and fellow subsidiaries is not hedged. Loans to subsidiary and fellow subsidiaries include **£69 million** of interest receivable at 31 December 2015 (2014: £50 million).

Notes on the Accounts – B.A.T. International Finance p.l.c.

4. Amounts due on demand from fellow subsidiaries

Amounts due on demand from fellow subsidiaries of **£644 million** (2014: £977 million) for the Company comprise the same balances and disclosures as amounts due on demand from fellow subsidiaries for the Group detailed in Group note 10. Consequently no additional information is presented here.

5. Prepayments and accrued income

Prepayments and accrued income of **£10 million** (2014: £14 million) for the Company comprise exactly the same balances and disclosures as other receivables detailed in Group note 13. Consequently, no additional information is presented here.

6. Derivative financial instruments

Derivative financial instruments comprise the same balances as derivative financial instruments detailed in Group note 11.

Under FRS 29, the disclosures required are the same as under IFRS 7. Consequently, no additional information is presented in this note.

7. Management of financial risks

The disclosures provided by Group note 12 under IFRS 7 are the same as the disclosures required by FRS 29. Consequently, no additional information is presented here, except for additional disclosure requirements for FRS 29 in respect of interest rate risk and credit risk.

Interest rate risk

FRS 29 requires a sensitivity analyses that shows the impact on the income statement and on items recognised directly in equity of hypothetical changes of interest rates in respect of interest-bearing financial instruments recognised in the balance sheet at 31 December 2015. All other variables are held constant although, in practice, market rates rarely change in isolation. For the purposes of the sensitivity analyses, financial assets and liabilities with fixed interest rates are not included. Interest sensitivity in respect of foreign exchange forward contracts is not included in the analysis for 2015 as it is considered as fixed rate interest. The Company considers a 100 basis point change in interest rates as a reasonably possible change, except where rates are less than 100 basis points. In these instances it is assumed that the interest rates increase by 100 basis points and decrease to zero for the purpose of performing the sensitivity analysis. The impact is calculated with reference to the financial asset or liability held as at the year-end, unless this is unrepresentative of the position during the year.

A 100 basis point increase in interest rates would result in pre-tax profit being **£90 million** higher (2014: £10 million higher). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being **£76 million** lower (2014: £16 million lower).

A 100 basis point change in interest rates would have no material impact on items recognised directly in other comprehensive income for the current and prior year.

Notes on the Accounts – B.A.T. International Finance p.l.c.

7. Management of financial risks continued

Credit risk

The maximum exposure to credit risk of financial assets at the balance sheet date is reflected by the carrying values included in the Company balance sheet. In addition, the Company provides committed credit facilities to certain fellow subsidiaries. The undrawn portion of these committed facilities at 31 December 2015 is **£7,978 million** (2014: £5,633 million). Guarantees provided to third parties are shown in note 16 page 44.

8. Short-term deposits and cash

Short-term deposits and cash of **£362 million** (2014: £50 million) comprise the same balances and disclosures as cash and cash equivalents detailed in Group note 9. Consequently, no additional information is presented here.

9. Bank overdrafts and issued debt

Bank overdrafts and issued debt of **£14,071 million** (2014: £9,056 million) comprise the same balances and disclosures as Bank overdrafts and issued debt detailed in Group note 15. Consequently, no additional information is presented here.

10a. Amounts payable on demand to parent undertaking

Amounts payable on demand to the parent undertaking of **£7,309 million** (2014: £9,036 million) comprise the same balances and disclosures as Amounts repayable on demand to the parent undertaking detailed in Group note 16a. Consequently, no additional information is presented here.

10b. Amounts payable on demand to fellow subsidiaries

Amounts payable on demand to fellow subsidiaries comprise fellow subsidiary current accounts and cash pooling accounts held with the Company. These are unsecured, and are denominated in the following currencies:

	2015 £m	2014 £m
UK sterling	12,003	13,243
Euro	303	353
US dollar	313	519
Swiss franc	16	44
Norwegian krona	52	50
Australian dollar	59	4
Hong Kong dollar	19	21
Romanian leu	110	91
New Zealand dollar	95	-
Other	102	72
	13,072	14,397

Amounts payable on demand to fellow subsidiaries include **£nil** of interest repayable at 31 December 2015 (2014: £nil). There is no material difference between the book value and fair value for amounts payable on demand to fellow subsidiaries.

11. Borrowings from fellow subsidiaries

Borrowings from fellow subsidiaries of **£596 million** (2014: £735 million) for the Company comprise the same balances and disclosures as Term deposits repayable to fellow subsidiaries detailed in Group note 18. Consequently, no additional information is presented here.

12. Accruals and deferred income

Accruals and deferred income of **£5 million** (2014: £8 million) for the Company comprise the same balances and disclosures as Other payables detailed in Group note 17. Consequently, no additional information is presented here.

Notes on the Accounts – B.A.T. International Finance p.l.c.

13. Total shareholders' funds

	Called up share capital	Hedging reserve	Retained earnings	Total Shareholders' funds
	£m	£m	£m	£m
1 January 2015	231	-	1,352	1,583
Profit for the financial year	-	(10)	73	63
31 December 2015	231	(10)	1,425	1,646

As permitted by Section 408(3) of the Companies Act 2006, the profit and loss account of the Company has not been presented in these Company financial statements. The profit for the financial year ended 31 December 2015 was **£73 million** (2014: £199 million). No tax is payable on profit in either period due to BAT Group tax relief.

Share capital consists of 231 million (2014: 231 million) Ordinary shares of £1 each, allotted, issued and fully paid.

The hedging reserve is explained in the accounting policy on financial instruments on pages 39-40.

Audit fees of **£158,500** where payable to KPMG LLP for the audit of the Company's annual financial statements (2014: £162,500 payable to PwC LLP).

14. Directors' remuneration

None of the Directors received any remuneration in respect of their services to the Company during the year (2014: £nil).

15. Contingent liabilities

Contingent liabilities of **£2,476million** (2014: £2,373 million) for the Company in relation to guarantees provided to fellow subsidiaries comprise the same balances and disclosures as contingent liabilities detailed in Group note 20. Consequently, no additional information is presented here.

16. Related parties

As explained in the accounting policies in note 1, the Company has taken advantage of the exemption under FRS 101 from disclosing transactions with related parties that are wholly-owned subsidiaries of the BAT Group. Details of balances and transactions with related parties that are not wholly-owned by the BAT Group are disclosed below.

As at 31 December 2015, total assets on the balance sheet included **£nil** (2014: £nil) of loans due from related parties that are not wholly-owned by the BAT Group. Total liabilities included amounts repayable on demand of **£5 million** (2014: £4 million).

The Company did not earn any material income or incur any material expenses in transactions with related parties that are not wholly-owned by the BAT Group.

Cash flows for the year ended 31 December 2015, included net cash flows of **£nil** (2014: £nil) in respect of loans advanced to fellow subsidiaries that are not wholly-owned by the BAT Group and net cash inflows of **£1 million** (2014: £1 million outflows) in respect of net borrowings obtained.

17. Parent undertaking

The Company's immediate and ultimate parent undertaking and ultimate controlling party is British American Tobacco p.l.c., being incorporated in the United Kingdom and registered in England and Wales and registered as an external company in the Republic of South Africa. Consolidated Group financial statements are prepared by British American Tobacco p.l.c. and are publicly available.

18. Copies of the report and accounts

Copies of the report and accounts of British American Tobacco p.l.c. may be obtained from the Company Secretary, Globe House, 4 Temple Place, London WC2R 2PG.

Notes on the Accounts – B.A.T. International Finance p.l.c.

19. FRS 101 Reduced Disclosure Framework

The Financial Reporting Council has issued FRS 100 Application of Financial Reporting Requirements, FRS 101 Reduced Disclosure Framework and FRS 102 The Financial Reporting Standard applicable in the UK and Ireland. These standards are applicable to all companies and entities in the UK and Republic of Ireland, other than listed groups which continue to report under IFRS, for accounting periods beginning on or after 1 January 2015.

FRS 100 sets out the overall financial reporting framework for companies in the UK and Ireland. FRS 101 applies to the individual financial statements of subsidiaries and ultimate parents, allowing them to apply the same accounting policies as in their listed group accounts, but with fewer disclosures. FRS 102 is a single financial reporting standard that applies to the financial statements of entities that are not applying IFRS, FRS 101 or the FRSSE. The primary statements of entities applying FRS 101 or FRS 102 would continue to follow the requirements of the Companies Act 2006.

The Company has adopted the accounting requirements of the reduced disclosure framework under FRS 101 in these financial statements, with a transition date of 1 January 2014. The adoption of FRS 101 had no material impact to previously reported amounts in profit or equity.

The Company's financial statements still meet the requirements of the Companies Act 2006 including giving a true and fair view of the Company's assets, liabilities, financial position and profit or loss. This means the Company will therefore always be required to include in its accounts all information relevant to shareholders and necessary to show a true and fair view.

The Company has informed its shareholders and received no objections to the use of FRS 101.