

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

**2018
Annual Report**

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

ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2018

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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 27 February 2019 at 1.15pm for the transaction of the following business:

1. To receive the financial statements for the year ended 31 December 2018 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



Noelle Colfer, Assistant Secretary
27 February 2019

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

Paul McCrory
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 2018.

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 20-24. 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 2018

The Group’s profit for the financial year amounted to **£195 million** (2017: £87 million). Total equity has increased by **£225 million** (2017: decreased by £36 million).

In January 2018, the Group repaid £600 million that was drawn down under the Group’s 364 day £3 billion revolving credit facility (“RCF”). The facility’s one year extension option was exercised by the Group in July 2018.

In March and June 2018, the Group repaid a €400 million and US\$1,250 million bonds at maturity respectively.

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 the Group can use to manage the financial risks facing the BAT 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 the 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.

The consequences of the United Kingdom’s (“U.K.”) potential exit from the European Union (“EU”) are uncertain, however, the Group has assessed the potential impact and has concluded that it is well positioned, and the exit from EU will not limit the Group’s access to funding. The Group has access to the United Kingdom, United States and European debt capital markets for both long-term funding via the issuance of bonds and short-term funding via issuance of commercial paper from the United States and European commercial paper programmes. If access to debt capital markets is temporarily disrupted due to U.K.’s exit, the Group has access to the £6 billion RCF syndicated bank facility with 19 global banks.

On behalf of the Board



Neil Arthur Wadey, Director
27 February 2019

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 2018.

Board of Directors

The names of the persons who served as Directors of the Company and the Group during the period 1 January 2018 to the date of this report are as follows:

Andrew James Barrett (appointed on 19 January 2018)
John Benedict Stevens
Richard Remon Bakker (resigned on 1 January 2018)
Robert James Casey
Neil Arthur Wadey
Steven Glyn Dale

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

Dividends

The Directors do not recommend payment of a dividend for the year (2017: £nil).

Directors' indemnities

Throughout the period from 1 January 2018 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 2018 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.

Statement of Directors' responsibilities in relation to the financial statements

The directors' are responsible for preparing the Annual Report, 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 are required to prepare the Group financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (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, relevant, reliable 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;
- assess the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

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 are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and 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 and Directors' Report that complies with that law and those regulations.

Directors' Report continued

Directors' responsibilities in relation to the financial statements continued

Responsibility statement of the Directors in respect of the annual financial report

We confirm that to the best of our knowledge:

- 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 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 Group's (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, 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 Group's 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 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.

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 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 auditors are aware of that information.

Directors' Report continued

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.

Auditor

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
27 February 2019
B.A.T. International Finance p.l.c.
Registered Number 01060930

Group Income Statement for the year ended 31 December 2018

	2018	2017
	£m	£m
Interest income (note 3)	807	635
Interest expense (note 4)	(677)	(618)
Net commitment fee expense (note 5)	(4)	(24)
Net fair value gains on derivatives and exchange differences (note 6)	73	98
Net finance income	199	91
Other operating expenses (note 7)	(1)	(2)
Profit before taxation	198	89
Taxation on profit (note 8)	(3)	(2)
Profit for the year	195	87

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 2018

	2018	2017
	£m	£m
Profit for the year	195	87
Other comprehensive income/(expense)		
Items that may be reclassified subsequently to profit or loss:		
Gains/(losses) on exchange	78	(113)
Cash flow hedges		
- net fair value gains	23	17
- reclassified and reported in profit for the year	(8)	(27)
Total other comprehensive income/(expense) income for the year	93	(123)
Total comprehensive income/(expense) for the year	288	(36)

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

**Group Statement of Changes in Equity
for the year ended 31 December 2018**

	2018				
	Share capital £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
Balance at 1 January 2018	231	(15)	365	1,568	2,149
Accounting policy change (IFRS 9 see note 1)	-	-	-	(63)	(63)
Revised balance at 1 January 2018	231	(15)	365	1,505	2,086
Total comprehensive income for the year (page 6)	-	15	78	195	288
Balance at 31 December 2018	231	-	443	1,700	2,374
	2017				
	Share capital £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
Balance at 1 January 2017	231	(5)	478	1,481	2,185
Total comprehensive income for the year (page 6)	-	(10)	(113)	87	(36)
Balance at 31 December 2017	231	(15)	365	1,568	2,149

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

Group Balance Sheet at 31 December 2018

	2018 £m	2017 £m
<i>Assets</i>		
Cash and cash equivalents (note 9)	74	750
Amounts due on demand from fellow subsidiaries (note 10)	438	646
Derivative financial instruments (note 11)	1,114	933
Deferred tax asset (note 13)	13	-
Other receivables (note 14)	5	4
Loans due from parent undertaking (note 15a)	3,623	3,629
Loans due from fellow subsidiaries (note 15b)	38,598	40,053
Total assets	43,865	46,015
<i>Liabilities</i>		
Bank overdrafts (note 16)	108	193
Amounts repayable on demand to parent undertaking (note 17a)	7,278	7,306
Amounts repayable on demand to fellow subsidiaries (note 17b)	11,523	11,793
Derivative financial instruments (note 11)	586	444
Other payables (note 18)	34	12
Term deposits repayable to fellow subsidiaries (note 19)	812	717
Borrowings (note 16)	21,150	23,401
Total liabilities	41,491	43,866
<i>Equity</i>		
Share capital	231	231
Cash flow hedge reserve	-	(15)
Translation reserve	443	365
Retained earnings	1,700	1,568
Total equity (note 20)	2,374	2,149
Total equity and liabilities	43,865	46,015

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

The financial statements on pages 6 to 32 were approved by the Board and signed on its behalf by



Neil Arthur Wadey, Director
27 February 2019

Group Cash Flow Statement for the year ended 31 December 2018

	2018 £m	2017 £m
<i>Cash flows from operating activities</i>		
Interest receipts	767	414
Interest payments	(647)	(648)
Net outflow on fees	(3)	(2)
Other receipts	<u>19</u>	<u>12</u>
	136	(224)
<i>(Decrease)/increase in operating assets and liabilities:</i>		
Net short-term funds outflow from fellow subsidiaries and parent undertaking	(3,067)	(862)
Proceeds from external debt	-	6,541
Repayment of external debt	(2,638)	(1,578)
Proceeds relating to derivative financial instruments	135	31
Net cash inflow / (outflow) on loans to fellow subsidiaries	4,774	(3,574)
Net cash inflow on borrowings from fellow subsidiaries	<u>34</u>	<u>260</u>
Net cash (outflow) / inflow from operating activities	(626)	594
Gains on exchange	<u>35</u>	<u>19</u>
Net (decrease) / increase in cash and cash equivalents	(591)	613
Net cash and cash equivalents at 1 January	<u>557</u>	<u>(56)</u>
Net cash and cash equivalents at 31 December (note 9)	<u>(34)</u>	<u>557</u>

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

Notes are shown on pages 10 to 32.

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, 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.

With effect from 1 January 2018, the Group has adopted IFRS 9 *Financial Instruments* with no revision of prior periods, as permitted by the Standard. The cumulative impact of adopting the Standard, including the effect of tax entries, has been recognised as a restatement of opening reserves in 2018, and is £63 million, arising from the impairment of financial assets under the expected credit loss model required under IFRS 9, which accelerates recognition of potential impairment on loans and receivables.

The credit risk on financial instruments has not increased significantly since initial recognition of loans and receivables, and therefore the Group has measured the loss allowance for financial instruments at an amount equal to the 12-month expected credit loss, whether or not any actual losses have been recognised, and whether or not the counterparty has insurance cover or guarantees in place to cover the potential economic loss. The effective interest rate is based on gross (pre-impairment) assets.

The adoption of IFRS 9 has not resulted in a material change to net assets for the Group as at 1 January 2018. Given the significant amount of loans due from the parent undertaking and fellow subsidiaries, being £43,682 million at 1 January 2018, the Group has assessed the credit worthiness of the counterparties and has recognised an estimated expected credit loss of £76 million (pre-tax) at 1 January 2018. This amount has been recognised as an opening reserves adjustment in the Group financial statements as a change in accounting policy. Loans due from parent undertaking and fellow subsidiaries are subsequently reported net of the expected credit loss.

All loans and receivables in the Group are held to maturity with fixed or determinable payments that are solely payments of principal and interest on the principal amount outstanding, which are primarily held in order to collect contractual cash flows and therefore measured at amortised cost.

The Group has adopted the hedge accounting requirements of IFRS 9 prospectively from 1 January 2018.

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 subsidiaries 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.

Group Notes on the Accounts

1. Accounting policies continued

Foreign currencies

The functional currency of the Company 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 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 overseas net assets at the beginning of the year, and are presented as a separate component of equity. They are recognised in the income statement when the gain or loss on disposal of a Group undertaking is recognised.

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.

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 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. 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

The Group's business model for managing financial assets is set out in the Group Treasury Manual of the BAT Group ("BAT Group" referred as British American Tobacco p.l.c. and its subsidiaries) which notes that the primary objective with regard to the management of cash and investments is to protect against the loss of principal. Additionally, the Group aims: to maximise BAT Group liquidity by concentrating cash at the Group, to align the maturity profile of external investments with that of the forecast liquidity profile, wherever practicable, match the interest rate profile of external investments to that of debt maturities or fixings, and to optimise the investment yield within the Group's investment parameters. The majority of financial assets are held in order to collect contractual cash flows (typically cash and cash equivalents and loans and other receivables).

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. Such assets and liabilities are classified as current if they are expected to be realised or settled within 12 months after the balance sheet date. If not, they are classified as non-current.

Non-derivative financial assets are classified on initial recognition in accordance with the Group's business as loans and receivables, or cash and cash equivalents and accounted for as follows:

- Loans and other receivables: These are non-derivative financial assets with fixed or determinable payments that are solely payments of principal and interest on the principal amount outstanding that are primarily held in order to collect contractual cash flows. These balances include trade and other receivables, loans due from parent undertaking and from fellow subsidiaries and are measured at amortised cost, using the effective interest rate method, and stated net of allowances for credit losses; and

Group Notes on the Accounts

1. Accounting policies continued

Financial instruments continued

- 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 included as current borrowings 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 irrecoverable amounts measured under the expected credit loss method. The new impairment model applies to financial assets measured at amortised cost.

Prior to 1 January 2018, non-derivative financial assets were stated as amortised cost using the effective interest method, subject to deduction for allowances for estimated irrecoverable amounts. These estimates for irrecoverable amounts were recognised when there was objective evidence that the full amount receivable would not be collected according to original terms of the assets. Such evidence might have included financial difficulties of the counterparty, defaults of payment or significant overdue balances.

Non-derivative financial liabilities, including borrowings and trade payables, 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. As shown in note 16, certain borrowings are subject to fair value hedges, as defined below.

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:

- 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. Where the underlying transaction does not result in such an asset, the accumulated gains and losses are reclassified to the income statement in the same periods 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 these derivatives are also recognised in the income statement; 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. These are referred to as “held-for-trading”.

Hedge accounting

In order to qualify for hedge accounting, the Group is required to document prospectively the economic relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the economic relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an on-going basis. This effectiveness testing is re-performed periodically 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.

Derivative fair value changes recognised in the income statement are in finance income and costs.

All of the Group’s hedging relationships at the end of 2017 are considered to be continuing hedge relationships on the adoption of IFRS 9.

The Group has adopted the hedge accounting requirements of IFRS 9 prospectively from 1 January 2018.

Group Notes on the Accounts

1. Accounting policies continued

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.

Future changes to accounting policies

A number of 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, which is centrally domiciled in the UK is the central financing vehicle for the BAT Group, 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 **£4 million** (2017: £3 million) includes **£2 million** (2017: £2 million) from money market funds.

Interest income from cash and cash equivalents attributable to the UK is **£4 million** (2017: £3 million) and **£nil** (2017: £nil) attributable to foreign countries.

IFRS 8 considers a group of entities under common control as a single customer. **£56 million** (2017: £53 million) of interest income is generated from the loans to parent undertaking and **£747 million** (2017: £579 million) from loans to fellow subsidiaries controlled directly or indirectly by the parent undertaking, British American Tobacco p.l.c..

3. Interest income

Interest income
From the parent undertaking
From fellow subsidiaries
Cash and cash equivalents

	2018 £m	2017 £m
	56	53
	747	579
	4	3
	807	635

4. Interest expense

Interest expense
Issued debt
Other borrowings
Commercial paper

	2018 £m	2017 £m
	522	552
	63	33
	4	6
	589	591
	15	2
	73	25
	677	618

To the parent undertaking
To fellow subsidiaries

5. Net commitment fee expense

Fee income
Commitment fees on undrawn revolving credit facilities to fellow subsidiaries
Fee expense
Fees charged on committed borrowing facilities

	2018 £m	2017 £m
	8	14
	(12)	(38)
	(4)	(24)

100% of the above fees charged on the committed borrowing facility in 2018 are borne by the Group (2017: 100%), with nil% being borne by fellow subsidiaries (2017: nil%).

6. Net fair value gains on derivatives and exchange differences

Fair value changes on derivatives and hedged items comprise:
Fair value hedging instruments – exchange related movements
Fair value hedging instruments – net interest income
Fair value hedging instruments – interest related movements
Fair value changes on hedged items
Cash flow hedging instruments – exchange related movements
Cash flow hedging instruments – net interest expense
Instruments held-for-trading
Net fair value gains on derivatives
Exchange differences

	2018 £m	2017 £m
	25	38
	41	52
	3	(84)
	24	99
	8	27
	(4)	(5)
	128	45
	225	172
	(152)	(74)
	73	98

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" whereas the interest expense on the debt is shown within Note 4 "Interest expense".

The "Net fair value gains on derivatives and exchange differences" represents the net impact of the debt and related derivatives, this includes:

- net interest income on swaps for the year of **£33 million** (2017: £36 million) to offset the interest expense on issued debt reported within Note 4 "Interest expense". This comprises of net interest income from swaps as fair value hedge instruments of **£41 million** (2017: £52 million) and net interest expense on swaps as cash flow hedge instruments and held for trading of **£4 million** and **£5 million** respectively (2017: £5 million and £11 million respectively).
- a loss of **£1 million** (2017: £8 million loss) due to the ineffective portion of fair value hedges.
- Exchange differences include most foreign currency assets and liabilities that are maintained in US dollars and euro, which have been translated to sterling at the closing rates on 31 December 2018 of **US\$1.2736** and **€1.1141** (2017: US\$1.3528 and €1.1265).

7. Other operating expenses

	2018 £m	2017 £m
Other operating expenses	<u>1</u>	<u>2</u>

Other operating charges include remuneration of **£237,000** payable to KPMG LLP for the audit of the Group and Company's annual financial statements (2017: £197,100). Costs relating to non-audit fees payable to KPMG LLP is **£48,000** (2017: £67,000 and was borne by British American Tobacco p.l.c.).

The Group has no directly employed employees (2017: 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 those subsidiaries. An annual management charge is levied from a fellow subsidiary in respect of the cost of employees 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

	2018 £m	2017 £m
UK corporation tax		
Comprising:		
- current tax at 19% (2017: 19.25%)	3	2
- double tax relief	(3)	(2)
Overseas tax comprising:		
- tax on current income	3	2
Total current tax expense (<i>note 8b</i>)	<u>3</u>	<u>2</u>

Group Notes on the Accounts

8. Taxation on ordinary activities continued

b) Factors affecting the tax charge

A reduction in the UK corporation tax rate from 20% to 19% (effective from 1 April 2017) and to 18% (effective 1 April 2020) were substantially enacted on 25 October 2015, and an additional reduction to 17% (effective 1 April 2020) was substantially enacted on 6 September 2016. This will reduce the Company's future current tax charge accordingly

The current taxation charge differs from the standard 19% (2017: 19.25%) rate of corporation taxation in the UK. The major causes of this difference are listed below:

	2018 £m	2017 £m
Profit before taxation		
UK corporation tax at 19% (2017: 19.25%)	198	89
	<u>38</u>	<u>17</u>
Factors affecting the tax rate:		
Overseas taxation	3	2
Double tax relief	(3)	(2)
BAT Group loss relief claimed for no consideration	(35)	(15)
Total current tax expense (<i>note 8a</i>)	<u>3</u>	<u>2</u>

9. Cash and cash equivalents

Cash and bank balances
Cash equivalents

2018 £m	2017 £m
49	82
<u>25</u>	<u>668</u>
74	750

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. At 31 December 2018, cash and cash equivalents include **£25 million** invested in money market funds (2017: £668 million).

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

	2018 £m	2017 £m
UK sterling	20	684
Other	<u>54</u>	<u>66</u>
	74	750

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 16) and accrued interest, where applicable:

	2018 £m	2017 £m
Cash and cash equivalents as above	74	750
Less: bank overdrafts (note 16)	(108)	(193)
Net cash and cash equivalents	(34)	557

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:

	2018 £m	2017 £m
UK sterling	38	10
US dollar	1	254
Swiss franc	86	79
Hong Kong dollar	35	50
Euro	61	122
Croatian Kuna	53	8
New Zealand Dollar	108	79
Other	56	44
	438	646

The balance above is measured at amortised cost, with an immaterial impact of expected credit losses (as explained in accounting policies in note 1).

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.

	2018		2017	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges				
Interest rate swaps	181	83	97	14
Cross-currency swaps	282	-	263	-
Cash flow hedges				
Interest rate swaps	-	-	1	-
Cross-currency swaps	149	-	125	-
Held-for-trading*				
Interest rate swaps	104	98	68	77
Cross-currency swaps	56	56	62	62
Forward foreign currency contracts	342	349	317	291
	1,114	586	933	444

All balances above relate to derivatives with external parties other than those disclosed in note 22.

* Derivative financial instruments which are not designated as hedges are classified as held-for-trading as explained in note 1.

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:

	2018		2017	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Within one year	333	339	303	276
Between one and two years	16	16	19	15
Between two and three years	177	36	8	3
Between three and four years	-	4	158	22
Between four and five years	231	77	-	1
Beyond five years	357	114	445	127
	1,114	586	933	444

There were no derivative liabilities which included interest rate swaps where the contracting parties hold the right to exercise mutual break clauses.

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:

	2018			
	Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year				
- Cross-currency swaps				
- Forward foreign exchange contracts	55	(54)	14	(17)
Between one and two years	12,621	(12,287)	14,079	(14,380)
- Cross-currency swaps	36	(43)	-	-
- Forward foreign exchange contracts	1,100	(1,086)	769	(782)
Between two and three years				
- Cross-currency swaps	830	(771)	-	-
Between three and four years				
- Cross-currency swaps	15	(26)	-	-
Between four and five years				
- Cross-currency swaps	733	(592)	-	-
Beyond five years				
- Cross-currency swaps	754	(625)	-	-
	16,144	(15,484)	14,862	(15,179)

Group Notes on the Accounts

11. Derivative financial instruments continued

	2017			
	Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year				
- Cross-currency swaps	56	(97)	61	(19)
- Forward foreign exchange contracts	13,785	(13,514)	9,754	(10,003)
Between one and two years				
- Cross-currency swaps	89	(135)	66	(21)
- Forward foreign exchange contracts	563	(550)	550	(563)
Between two and three years				
- Cross-currency swaps	60	(108)	66	(24)
Between three and four years				
- Cross-currency swaps	1,812	(1,782)	1,012	(1,001)
Between four and five years				
- Cross-currency swaps	32	(62)	36	(17)
Beyond five years				
- Cross-currency swaps	2,623	(2,366)	1,149	(1,152)
	19,020	(18,614)	12,694	(12,800)

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

	2018				2017			
	Assets		Liabilities		Assets		Liabilities	
	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m	Inflow £m	Outflow £m
Within one year	67	(40)	44	(26)				
Between one and two years	48	(19)	34	(5)				
Between two and three years	45	(15)	28	(6)				
Between three and four years	26	(13)	26	(6)				
Between four and five years	23	(15)	12	(7)				
Beyond five years	-	(8)	28	(51)				
	209	(110)	172	(101)				

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

Group Notes on the Accounts

12. Management of financial risks

One of the principal responsibilities of the Group is to manage the financial risks arising from the BAT Group's underlying operations. Specifically, BAT Group 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 BAT 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 20) 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:

	2018 £m	2017 £m
Bank overdrafts and borrowings (note 16)	21,258	23,594
Derivatives in respect of debt:		
- Assets	(797)	(651)
- Liabilities	269	172
Cash and cash equivalents (note 9)	74	(750)
	<u>20,804</u>	<u>22,365</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 managed within the Group's target.

In January 2018, the Group repaid £600 million that was drawn down under the Group's 364 day £3 billion revolving credit facility. The facility's one year extension option was exercised by the Group in July 2018.

In March and June 2018, the Group repaid a €400 million and US\$1,250 million bonds at maturity respectively.

In March and April 2017, the Group arranged short-term bilateral facilities with core relationship banks for a total of approximately £1.6 billion. These facilities provided an alternative source of cost effective short-term funding for the BAT Group and all matured prior to year-end 2017. In June 2017, the Group repaid US\$600 million and €1.25 billion bonds at maturity.

In July 2017, following the shareholder approvals in respect of the acquisition of Reynolds American Inc. ("RAI"), the Group drew the two term loans totalling £3.9 billion (equivalent of US\$5 billion) under its US\$25 billion acquisition facility provided by a syndicate of relationship banks; £1.9 billion term loan maturing in 2020 and £1.9 billion term loan maturing in 2022. In August 2017, the bridge facilities were refinanced in the US and European capital markets.

In August 2017, the Group issued a €1.25 billion bond maturing in January 2030 under the EMTN programme.

Additionally in 2017, the Group replaced its existing £3 billion revolving credit facility maturing in 2021 with a new two-tranche £6 billion revolving credit facility. This consist of a 364-day revolving credit facility of £3 billion (with a one-year option extension which was exercised in July 2018 and a one-year term out option), and a £3 billion revolving credit facility maturing in 2021. At 31 December 2018, the facility was undrawn (2017: £600 million was drawn down).

It is BAT Group policy that sources of short-term funds (including drawings under both the US\$4 billion US commercial paper ("USCP") programme and the £3 billion euro commercial paper ("ECP") programme) are backed by undrawn committed lines of credit and cash. At 31 December 2018, commercial paper outstanding was £536 million (2017: £1,200 million).

Group Notes on the Accounts

12. Management of financial risks continued

Liquidity risk continued

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

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 Group 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 2018, cash and cash equivalents include **£25 million** (2017: £668 million) invested in money market funds.

Although term deposits repayable to fellow subsidiaries (as shown in note 19) 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, 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 2018, the currency profile of the Group's gross issued debt, after taking into account derivative contracts, was **28 per cent** (2017: 25 per cent) US dollar, **31 per cent** (2017: 30 per cent) euro, **38 per cent** (2017: 41 per cent) sterling, **nil per cent** (2017: 1 per cent) Canadian dollar, **2 per cent** (2017: 2 per cent) Danish krone, and **1 per cent** (2017: 1 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 Company and 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 Company and subsidiaries as a reasonable 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.

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 (2017: 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 (2017: 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.

Group Notes on the Accounts

12. Management of financial risks continued

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 at least 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 sets targets (within overall guidelines) for the desired ratio of floating to fixed rate debt on a net basis (at least 50 per cent fixed on a net basis in the short to the medium-term); market conditions and strategy are reviewed by the CFC on regular basis. The debt and associated derivatives held by the Group are part of the BAT Group's centrally managed debt and derivatives and are therefore managed within Group's targets. 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.

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 **£118 million** higher (2017: £117 million higher). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being **£199 million** lower (2017: £115 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.

Intra-BAT Group counterparties have appropriate capital structures to meet their obligations as they fall due. All loans to fellow subsidiaries 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 (International Swaps and Derivatives Association) documentation.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from the related counterparties. Generally, the Group aims to transact with counterparties with strong investment grade credit ratings. 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 all counterparties are reviewed regularly.

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 2018 is **£2,969 million** (2017: £7,124 million). Guarantees provided to third parties are shown in note 21 on page 31.

Group Notes on the Accounts

12. Management of financial risks continued

Hedge accounting

In order to qualify for hedge accounting, the Group is required to document prospectively the economic relationship between the item being hedged and the hedging instrument. The Group is also required to demonstrate an assessment of the economic 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 re-performed periodically to ensure that the hedge has remained and is expected to remain highly effective. The prospective effectiveness testing determines that an economic relationship between the hedged item and the hedging instrument exists.

In accordance with the Group Treasury Manual of BAT Group, the exact hedge ratios and profile of a hedge relationship will depend on several factors, including the desired degree of certainty and reduced volatility of net interest costs and market conditions, trends and expectations in the relevant markets. The sources of ineffectiveness include spot and forward differences, impact of time value and timing differences between periods in the hedged item and hedging instrument.

The Group's risk management strategy has been explained in further detail in note 12 under interest rate risk and currency risk.

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 2018 and 31 December 2017, 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 Over The Counter ("OTC") derivatives.

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:

	2018			2017		
	Amount presented in the Group balance sheet	Related to amounts not offset in the Group balance sheet	Net amount £m	Amount presented in the Group balance sheet £m	Related to amounts not offset in the Group balance sheet £m	Net amount £m
Financial assets						
-Derivative financial instruments (note 11)	1,114	(327)	787	933	(283)	650
Financial liabilities						
-Derivative financial instruments (note 11)	(586)	327	(259)	(444)	283	(161)

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.

Group Notes on the Accounts

12. Management of financial risks continued

Hedging instrument

The items designated as hedging instruments are as follows:

	Nominal amount of hedging instrument £m	2018 Changes in fair value used for calculating hedge ineffectiveness for the year £m
Interest rate risk		
Fair value hedges		
- interest rate swaps	4,470	11
- cross-currency swaps	1,561	19
Cash flow hedges		
- cross currency swaps	726	23

Hedging item

The hedged items by risk category are presented below:

	Carrying value of the hedged item £m	Accumulated amount of fair value hedge adjustments on hedged item included in the carrying amount of the hedged item Liabilities £m	Line item in the statement of financial position where the hedged item is included	Changes in fair value used for calculating hedge ineffectiveness for 2018	2018 Cash flow hedge reserve
Fair value hedges					
Interest rate risk					
- borrowings	6,377	132	Borrowings	31	£m
Cash flow hedges					
Interest rate risk	710		Borrowings	23	-
- borrowings					

Group Notes on the Accounts

13. Deferred tax asset

With effect from 1 January 2018, the Group and Company has adopted IFRS 9 *Financial Instruments*. As a result, a deferred tax asset of £13 million has been recognised through reserves in the current year (2017: £nil) as a result of the IFRS 9 expected loss model. For further details please refer to the accounting policies on page 10 of the annual report.

14. Other receivables

	2018 £m	2017 £m
Prepayments and accrued income:		
Due from fellow subsidiaries	5	1
Other	-	3
	<u>5</u>	<u>4</u>

The balance above is measured at amortised costs, with an immaterial impact of expected credit losses (as explained in accounting policies in note 1).

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.

15a. Loans due from parent undertaking

Loans due from the parent undertaking at 31 December 2018 of **£2,052 million** fall due within one year (2017: £2,058 million within one year) and **£1,571 million** fall due beyond one year (2017: £1,571 million beyond year). These loans are unsecured and repaid within one year. These loans are in sterling.

Loans due from Parent undertaking are measured at amortised cost as they are held to maturity. The balance is net of expected credit losses of **£10 million** (pre-tax) as explained in accounting policies in note 1.

Loans due from the parent undertaking include **£16 million** of interest receivable at 31 December 2018 (2017: £12 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 1.5% and 2.3% per annum and are repayable at maturity dates in 2019 and 2022 respectively.

15b. Loans due from fellow subsidiaries

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

	2018 £m	2017 £m
UK sterling	26,561	28,194
Euro	4,139	4,169
US dollar	7,182	6,781
Danish krone	392	389
Canadian dollar	-	215
Swiss franc	203	227
Polish zloty	121	78
	<u>38,598</u>	<u>40,053</u>

Loans due from fellow subsidiaries are measured at amortised cost as they are held to maturity. The balance is net of expected credit losses of **£66 million** (pre-tax) as explained in accounting policies in note 1.

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

Loans due from fellow subsidiaries are unsecured with interest charged at between **0.04% and 12.5%** (2017: 0.2% and 11.2%) per annum and repayable at maturity dates between **2019 and 2023** (2017: 2018 and 2022).

Group Notes on the Accounts

15b. Loans due from fellow subsidiaries continued

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

	2018 £m	2017 £m
Within one year		
Between one and two years	22,419	32,004
Between two and three years	6,633	245
Between three and four years	6,726	5,886
Between four and five years	1,918	-
Total	902	1,918
	38,598	40,053

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	Within 1 year	Between 1 and 2 years	Between 2 and 3 years	Between 3 and 4 years	Between 4 and 5 years	Greater than 5 years
	£m	£m	£m	£m	£m	£m	£m
As at 31 December 2018	38,598	37,626	549	411	-	-	12
As at 31 December 2017	40,053	36,193	-	1,942	-	1,918	-

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

Loans due from fellow subsidiaries include **£154 million** of interest receivable (2017: £117 million).

Group Notes on the Accounts

16. Bank overdrafts and borrowings

Issued debt	Currency	Maturity dates	Interest rates	2018 £m	2017 £m
Eurobonds					
	Euro	2019-2045	0.4 to 4.9% 3m Euribor	8,260	8,171
	Euro	2018	+50bps	-	355
	Swiss franc	2021-2026	0.6 to 1.4%	523	498
	UK sterling	2019-2055	1.8 to 7.3%	4,221	4,230
	US dollar	2019	1.6%	512	481
Other bonds issued pursuant to Rule 144A and RegS under the US Securities Act of 1933					
	US dollar	2018-2025	1.9 to 4%	3,239	3,631
	US dollar	2018	USD 3m Libor +51 bps	-	370
Commercial paper				536	1,200
				17,291	18,936
Other borrowings				3,859	4,465
Bank overdrafts				108	193
				21,258	23,594

Included within issued debt of **£17,291 million** (2017: £18,936 million) above are **£7,172 million** (2017: £7,559 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 **£132 million** at 31 December 2018 (2017: increased by £157 million) included in the table above.

Other borrowings comprise of a **£nil** (2017: £600 million) drawn down from the Group's £6 billion revolving credit facility and **£3,859 million** (2017: £3,865) relating to two £1.9 billion term loans that are maturing in 2020 and 2022.

Bank overdrafts are all repayable within one year, and are denominated in **sterling, euro, Polish zloty, Japanese yen, Canadian dollar, Qatari riyal, Turkish lira, Romanian leu, Bulgarian lev, US dollar, Hong Kong dollar, Czech krona, Norwegian krona, Swiss franc, Mexican peso and Kuwaiti dinar** (2017: in sterling, Turkish lira, Romanian leu, Bulgarian lev, Russian rouble, US dollar, Hong Kong dollar, Czech krona, Norwegian krona, Swiss franc, Mexican peso and Kuwaiti dinar).

Borrowings are repayable as follows:

	Per balance sheet		Contractual gross maturities	
	2018 £m	2017 £m	2018 £m	2017 £m
Within one year	2,863	3,774	2,853	3,922
Between one and two years	3,417	1,724	3,851	2,175
Between two and three years	1,967	3,359	2,302	3,788
Between three and four years	3,799	1,941	4,107	2,297
Between four and five years	1,398	3,750	1,641	4,038
Beyond five years	7,814	9,046	9,924	11,518
Total	21,258	23,594	24,678	27,738

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 **£204 million** (2017: £189 million).

Group Notes on the Accounts

16. Bank overdrafts and borrowings continued

Borrowings are 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	TRY £m	Other £m
As at 31 December 2018									
Total borrowings	21,258	8,224	3,791	8,691	523	-	-	-	29
Effect of derivative financial instruments	(365)	1,866	17	(1,993)	(255)	-	-	-	-
Cross-currency swaps	(13)	(2,233)	1,961	(97)	(70)	35	391	-	-
Forward foreign exchange contracts	20,880	7,857	5,769	6,601	198	35	391	-	29
As at 31 December 2017									
Total borrowings	23,594	8,855	4,602	9,452	493	-	-	131	61
Effect of derivative financial instruments	(331)	1,867	16	(1,971)	(243)	-	-	-	-
Cross-currency swaps	(5)	(1,142)	922	(388)	-	215	388	-	-
Forward foreign exchange contracts	23,258	9,580	5,540	7,093	250	215	388	131	61

Details of the derivative financial instruments included in these tables are given in note 11.

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

	Total	Within 1 year	Between 1 and 2 years	Between 2 and 3 years	Between 3 and 4 years	Between 4 and 5 years	Beyond 5 years
	£m	£m	£m	£m	£m	£m	£m
At 31 December 2018							
Total borrowings	21,258	6,462	1,488	1,967	1,870	1,398	8,073
Effect of derivative financial instruments	-	3,069	(589)	(539)	(236)	-	(1,705)
Interest rate swaps	(365)	1,292	-	(793)	-	(718)	(146)
Cross-currency swaps	20,893	10,823	899	635	1,634	680	6,222
At 31 December 2017							
Total issued debt	23,594	7,327	1,724	1,430	1,941	1,821	9,351
Effect of derivative financial instruments	-	2,995	-	(554)	(533)	(222)	(1,686)
Interest rate swaps	(331)	1,311	(17)	-	(775)	-	(850)
Cross-currency swaps	23,263	11,633	1,707	876	633	1,599	6,815

Details of the derivative financial instruments included in these tables are given in note 11.

British American Tobacco p.l.c. has provided guarantees for all of the Group's public indebtedness. As at 31 December 2018, the amount of these guarantees was **£20,684 million** (2017: £22,892 million).

The fair value of total borrowings are **£20,721 million** (2017: £24,185 million) and has been determined using quoted market prices. **£16,218 million** (2017: £18,327 million) has been calculated using quoted market prices and are within Level 1 of the fair value hierarchy. **£4,503 million** (2017: £5,858 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

17a Amounts repayable on demand to parent undertaking

Amounts repayable on demand to the parent undertaking at 31 December 2018 of **£7,278 million** (2017: £7,306 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.

17b 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:

	2018 £m	2017 £m
UK sterling	8,288	9,746
Euro	964	687
US dollar	1,709	824
Swiss franc	53	67
Norwegian krona	41	19
Australian dollar	128	207
Hong Kong dollar	43	33
Romanian leu	67	88
Danish krone	141	81
Other	89	41
	11,523	11,793

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.

18. Other payables

Accrued charges

2018 £m	2017 £m
34	12

The currency profile of other payables is **£34 million** (2017: £12 million) 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

19. Term deposits repayable to fellow subsidiaries

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

	2018 £m	2017 £m
UK sterling	78	70
Euro	247	234
US dollar	5	8
Mexican pesos	68	57
Hong Kong dollar	6	5
Bulgarian lev	14	14
Singapore dollar	3	3
Japanese yen	89	82
Canadian dollar	57	-
Russian rouble	245	244
	812	717

Term deposits repayable to fellow subsidiaries include **£1.3 million** of interest payable at 31 December 2018 and repriced within one year (2017: £0.6 million within one year).

In 2018 and 2017, 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.

20. Total equity

	Share capital £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
1 January 2018	231	(15)	365	1,568	2,149
Accounting policy change (IFRS 9 see note 1)	-	-	-	(63)	(63)
Revised balance as at 1 January 2018	231	(15)	365	1,505	2,086
Comprehensive income					
Profit for the year	-	-	-	195	195
Differences on exchange	-	-	78	-	78
Cash flow hedges					
net fair value gains	-	23	-	-	23
reclassified and reported in other operating expenses	-	(8)	-	-	(8)
31 December 2018	231	-	443	1,700	2,374

	Share capital £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
1 January 2017	231	(5)	478	1,481	2,185
Comprehensive income					
Profit for the year	-	-	-	87	87
Differences on exchange	-	-	(113)	-	(113)
Cash flow hedges					
net fair value gains	-	17	-	-	17
reclassified and reported in other operating expenses	-	(27)	-	-	(27)
31 December 2017	231	(15)	365	1,568	2,149

Group Notes on the Accounts

20. Total equity continued

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

The share capital is the amount subscribed at nominal value. Retained earnings are the cumulative net gains recorded in the Group income statement.

The translation reserve is as explained in the accounting policy on foreign currencies in note 1. The hedging reserve is as explained in the accounting policies in note 1.

The accounting policy change is as explained in the accounting policies in note 1.

21. Contingent liabilities

The Group is one of the five entities in the BAT Group which have jointly guaranteed borrowings in B.A.T Capital Corporation. At 31 December 2018 the Group has guaranteed **£14,265 million** of this debt (2017: £15,024 million).

The guaranteed debts mature as follows:

	2018 £m	2017 £m
Within one year	-	-
Between one and two years	2,500	-
Between two and three years	969	2,397
Between three and four years	2,246	985
Between four and five years	662	2,215
Beyond five years	7,888	9,427
Total	14,265	15,024

In addition to the above, the ultimate parent company has recognised a provision of **£1,070 million** (2017: £1,108 million) in respect of B.A.T Capital Corporation's borrowings guaranteed. This can be referred to the ultimate parent company's accounts which are publicly available.

22. 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, 14, 15, 17, 18, and 19. In addition, outstanding balances with fellow subsidiaries are included within the balance disclosed in note 11 as follows:

	2018		2017	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Derivative financial instruments				
Cross-currency swaps	56	-	-	62
Interest rate swaps	98	-	-	-
Forward foreign currency contracts	238	80	122	164
	392	80	122	226

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:

	2018 Income £m	2017 Expense £m
Derivative financial instruments		
Cross-currency swaps	164	(53)
Interest rate swaps	98	-
Forward foreign currency contracts	266	(104)
	528	(157)

Group Notes on the Accounts

22. 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.

23. Principal subsidiary undertakings

The Company holds the entire issued share capital of BATIF Dollar Limited (registered office is Globe House, 1 Water Street, London, WC2R 3LA), and of B.A.T Finance B.V. (registered office is Handelsweg 53 A, 1181 ZA, Amstelveen, Netherlands), finance companies incorporated in England and Wales and The Netherlands, respectively.

24. Directors' remuneration

None of the Directors received any remuneration in respect of their services to the Group during the year (2017: £nil). The Group considers that there is no practicable method to allocate a portion of the emoluments the Directors receive from their respective Group company employer for any qualifying services in respect of the Group, as these are considered to be incidental and part of the Directors overall management responsibilities within the Group.

25. 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.

26. Post balance sheet event

On 23 January 2019, the Directors have signed an agreement to purchase B.A.T. Netherlands Finance B.V. from a fellow BAT subsidiary, British American Holdings (the Netherlands) B.V..

27. 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.

1 Our opinion is unmodified

We have audited the financial statements of B.A.T. International Finance p.l.c. ("the Company") for the year ended 31 December 2018 which comprise the Group Income Statement, Group Statement of Comprehensive Income, Group Statement of Changes in Equity, Group Balance Sheet, Group Cash Flow Statement, parent Company Balance Sheet, and the related notes, including the accounting policies in note 1.

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 2018 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the parent Company financial statements have been properly prepared in accordance with UK accounting standards, including FRS 101 *Reduced Disclosure Framework* and as applied in accordance with the provisions of the Company's Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our report to the Directors.

We were first appointed as auditor by the directors on 23 March 2015. The period of total uninterrupted engagement is for the 4 financial years ended 31 December 2018. We have fulfilled our ethical responsibilities under, and we remain independent of the Group in accordance with, UK ethical requirements including the FRC Ethical Standard as applied to listed public interest entities. No non-audit services prohibited by that standard were provided.

2 Key audit matters: our assessment of risks of material misstatement

Key audit matters are those matters that, in our professional judgment, were of most significance in the audit of the financial statements and include the most significant assessed risks of material misstatement (whether or not due to fraud) identified by us, including those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. We summarise below the key audit matter (unchanged from 2017), in decreasing order of audit significance, in arriving at our audit opinion above, together with our key audit procedures to address those matters and, as required for public interest entities, our results from those procedures. These matters were addressed, and our results are based on procedures undertaken, in the context of, and solely for the purpose of, our audit of the financial statements as a whole, and in forming our opinion thereon, and consequently are incidental to that opinion, and we do not provide a separate opinion on these matters.

Recoverability of loans due from other British American Tobacco p.l.c subsidiaries - Group balance of £42,221 million, comprising of Loans due from fellow subsidiaries of £38,598 million and Loans due from parent undertaking of £3,623 million (2017: Group balance of £43,682 million, comprising of Loans due from fellow subsidiaries of £40,053 million and Loans due from parent undertaking of £3,629 million). Parent company balance of £40,966 million, comprising of Loans due from fellow subsidiaries of £37,343 million and Loans due from parent undertaking of £3,623 million (2017: Parent Company balance of £42,470 million, comprising of Loans due from fellow subsidiaries of £38,841 million and Loans due from parent undertaking of £3,629 million).

Refer to page 11 ("accounting policies") and page 25 (the Group's financial disclosures) and page 40 (the Parent's financial disclosures).

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

Low risk, high value

The carrying amount of loans due from group entities represents 96.3% of the Group's total assets and 94.5% of the Parent company's total assets. Their recoverability is not at a high risk of significant misstatement or subject to significant judgement. However, due to their materiality in the context of the financial statements, this is considered to be the area that had the greatest effect on our overall Group and Parent company audit.

Our procedures included:

- **Tests of detail:** Assessing a sample of the highest value group debtors representing 99.2% of the total Group debtors balance and 94.1% of the Parent company balance to identify, with reference to the relevant subsidiaries' draft balance sheet, whether they have a positive net asset value and therefore coverage of the debt owed, as well as assessing whether those subsidiaries' have historically been profit-making.
- **Assessing subsidiary audits:** Assessing the audit work performed over the subsidiaries and considering the results of that work, on those subsidiaries' profits and net assets, including assessing the liquidity of the assets or ability of the subsidiary to obtain liquid funds and therefore the ability of the subsidiary to fund the repayment of the receivable.

Our results:

We found the Director's assessment of the recoverability of loans due from group entities to be acceptable for both the Group and the Parent company receivables balance.

3 Our application of materiality and an overview of the scope of our audit

The Group is part of a group headed by British American Tobacco p.l.c. Materiality of £70 million (2017: £70 million), as communicated by the group audit team, has been applied to the audit of the Group. This is lower than the materiality we would otherwise have determined by reference to total assets, and represents 0.16% of the Group's total assets (2017: 0.15%). Materiality for the parent company financial statements as a whole was set at £69 million (2017: £70 million), determined with reference to a benchmark of total assets (of which it represents 0.16% (2017: 0.15%)).

We agreed to report to those charged with governance any corrected or uncorrected identified misstatements exceeding £3 million (2017: £3 million) in addition to other identified misstatements that warranted reporting on qualitative grounds.

The Group team performed the audit of the Group, as if it was a single aggregated set of financial information. The audit, including the audit of the parent company, was performed using the materiality level set out above.

4 We have nothing to report on going concern

The Directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the Company or the Group or to cease their operations, and as they have concluded that the Company's and the Group's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over their ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

Our responsibility is to conclude on the appropriateness of the Directors' conclusions and, had there been a material uncertainty related to going concern, to make reference to that in this audit report. However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the group or the company will continue in operation.

In our evaluation of the Directors' conclusions, we considered the inherent risks to the Group's and Company's business model, including the impact of Brexit, and analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. We evaluated those risks and concluded that they were not significant enough to require us to perform additional audit procedures.

Based on this work, we are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. We have nothing to report in these respects, and we did not identify going concern as a key audit matter.

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

5 We have nothing to report on the other information in the Annual Report

The directors are responsible for the other information presented in the Annual Report together with the financial statement. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Strategic report and directors' report

Based solely on our work on the other information:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

6 We have nothing to report on the other matters on which we are required to report by exception

Under the Companies Act 2006, we are required 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.

We have nothing to report in these respects.

7 Respective responsibilities

Directors' responsibilities

As explained more fully in their statement set out on pages 3 to 4, the Directors are responsible for: the preparation of the financial statements including being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Group and parent Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the Group or the parent Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities

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

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

Irregularities – ability to detect

We identified areas of laws and regulations that could reasonably be expected to have a material effect on the financial statements from our sector experience and through discussion with the directors (as required by auditing standards), and discussed with the directors the policies and procedures regarding compliance with laws and regulations. We communicated identified laws and regulations throughout our team and remained alert to any indications of non-compliance throughout the audit.

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

The potential effect of these laws and regulations on the financial statements varies considerably.

The group is subject to laws and regulations that directly affect the financial statements including financial reporting legislation (including related companies legislation), distributable profits legislation, and taxation legislation and we assessed the extent of compliance with these laws and regulations as part of our procedures on the related financial statement items.

Whilst the group is subject to many other laws and regulations, we did not identify any others where the consequences of non-compliance alone could have a material effect on amounts or disclosures in the financial statements.

Owing to the inherent limitations of an audit, there is an unavoidable risk that we may not have detected some material misstatements in the financial statements, even though we have properly planned and performed our audit in accordance with auditing standards. For example, the further removed non-compliance with laws and regulations (irregularities) is from the events and transactions reflected in the financial statements, the less likely the inherently limited procedures required by auditing standards would identify it. In addition, as with any audit, there remained a higher risk of non-detection of irregularities, as these may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls. We are not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

8 The purpose of our audit work and to whom we owe our responsibilities

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.



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

27 February 2019

Parent Company Balance Sheet – B.A.T. International Finance p.l.c.
at 31 December 2018
Registered Number 01060930

	2018 £m	2017 £m
<i>Assets</i>		
<i>Fixed assets</i>		
Investments in subsidiaries (note 2)	718	718
Deferred tax asset (note 14)	13	-
Loans due from parent undertaking (note 3a)	3,623	3,629
Loans due from subsidiary and fellow subsidiaries (note 3b)	<u>37,343</u>	<u>38,841</u>
	<u>41,697</u>	<u>43,188</u>
<i>Current assets</i>		
Amounts due on demand from fellow subsidiaries (note 4)	438	646
Prepayments and accrued income (note 5)	5	4
Derivative financial instruments (note 6)	1,114	933
Short-term deposits and cash (note 8)	<u>74</u>	<u>750</u>
	<u>1,631</u>	<u>2,333</u>
Total assets	<u>43,328</u>	<u>45,521</u>
<i>Liabilities</i>		
<i>Creditors</i>		
Borrowings (note 9)	21,150	23,401
Bank overdrafts (note 9)	108	193
Amounts payable on demand to parent undertaking (note 10a)	7,278	7,306
Amounts payable on demand to fellow subsidiaries (note 10b)	11,628	11,800
Borrowings from fellow subsidiaries (note 11)	812	717
Derivative financial instruments (note 6)	586	444
Accruals and deferred income (note 12)	<u>34</u>	<u>12</u>
	<u>41,596</u>	<u>43,873</u>
<i>Equity</i>		
Called up share capital (note 13)	231	231
Hedging reserve (note 13)	-	(15)
Retained earnings (note 13)	<u>1,501</u>	<u>1,432</u>
Total shareholders' funds	<u>1,732</u>	<u>1,648</u>
Total equity and liabilities	<u>43,328</u>	<u>45,521</u>

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

The financial statements on pages 37 to 44 were approved by the Board and signed on its behalf by



Neil Arthur Wadey, Director
27 February 2019

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

1. Accounting policies

Basis of accounting

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 as adopted by the European Union (“IFRS”) 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 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.

The preparation of the financial statements requires the directors 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 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.

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

1. Accounting policies continued

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.

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

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.

Parent Company 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 (registered office is Globe House, 1 Water Street, London, WC2R 3LA) and of B.A.T Finance B.V. (registered office is Handelsweg 53 A, 1181 ZA, Amstelveen, Netherlands), finance companies incorporated in England and Wales and The Netherlands, respectively. The cost of these investments as at 31 December 2018 was **£718 million** (2017: £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 **£3,623 million** (2017: £3,629 million) comprise exactly the same balances and disclosures as loans due from parent undertaking detailed in Group note 15a. Consequently, no additional information is presented here.

The above balance is measured at amortised cost as it is held to maturity. The balance is net of expected credit losses of **£10 million** (pre-tax) as explained in Group note 1.

3b. Loans due from subsidiary and fellow subsidiaries

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

	2018 £m	2017 £m
UK sterling	26,561	28,193
Euro	4,139	4,169
Danish krone	392	389
Canadian dollar	-	216
Swiss franc	203	227
Polish zloty	121	78
US dollar	5,927	5,569
	37,343	38,841

The above balance is measured at amortised cost as it is held to maturity. The balance is net of expected credit losses of **£66 million** (pre-tax) as explained in Group note 1.

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 BAT Group subsidiaries as recognised in the balance sheet are as follows:

	2018 £m	2017 £m
Within one year	19,095	28,915
Between one and two years	8,730	67
Between two and three years	6,709	7,941
Between three and four years	1,918	-
Between four and five years	891	1,918
Total	37,343	38,841

Loans due from subsidiary and fellow BAT Group 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	Within 1 year	Between 1 and 2 years	Between 2 and 3 years	Between 3 and 4 years	Between 4 and 5 years
As at 31 December 2018	£m 37,343	£m 36,501	£m 448	£m 394	£m -	£m -
As at 31 December 2017	£m 38,841	£m 34,996	£m -	£m 1,927	£m 1,918	£m -

Interest rate risk of loans to subsidiary and fellow BAT Group subsidiaries is not hedged. Loans to subsidiary and fellow BAT Group subsidiaries include **£126 million** of interest receivable at 31 December 2018 (2017: £90 million).

Parent Company 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 BAT Group subsidiaries of **£438 million** (2017: £646 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.

The balance above is measured at amortised costs, with an immaterial impact of expected credit losses (as explained in Group note 1).

5. Prepayments and accrued income

Prepayments and accrued income of **£5 million** (2017: £4 million) for the Company comprise exactly the same balances and disclosures as other receivables detailed in Group note 14. Consequently, no additional information is presented here.

The balance above is measured at amortised costs, with an immaterial impact of expected credit losses (as explained in Group note 1).

6. Derivative financial instruments

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

7. Management of financial risks

Additional disclosure that is required under FRS101 in respect of interest rate risk and credit risk is per below.

Interest rate risk

IFRS 7 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 2018. 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 2018 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 **£108 million** higher (2017: £98 million higher). A 100 basis point decrease in interest rates, or less where applicable, would result in pre-tax profit being **£190 million** lower (2017: £97 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.

Parent Company 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 2018 is **£2,937 million** (2017: £6,866 million).

The impact of the IFRS 9 “Expected Credit loss” model is explained in Group note 1.

8. Short-term deposits and cash

Short-term deposits and cash of **£74 million** (2017: £750 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

Borrowings and bank overdraft of **£21,258 million** (2017: £23,594 million) comprise the same balances and disclosures as bank overdrafts and borrowings detailed in Group note 16. Consequently, no additional information is presented here.

10a. Amounts payable on demand to parent undertaking

Amounts payable on demand to the parent undertaking of **£7,278 million** (2017: £7,306 million) comprise the same balances and disclosures as amounts repayable on demand to the parent undertaking detailed in Group note 17a. Consequently, no additional information is presented here.

10b. Amounts payable on demand to fellow subsidiaries

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

	2018 £m	2017 £m
UK sterling	8,288	9,746
Euro	964	687
US dollar	1,814	831
Swiss franc	53	67
Norwegian krona	41	19
Australian dollar	128	207
Hong Kong dollar	43	33
Romanian leu	67	88
Danish krone	141	-
Other	89	122
	11,628	11,800

Amounts payable on demand to fellow subsidiaries include **£nil** of interest repayable at 31 December 2018 (2017: **£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 BAT Group subsidiaries of **£812 million** (2017: £717 million) for the Company comprise the same balances and disclosures as term deposits repayable to fellow subsidiaries detailed in Group note 19. Consequently, no additional information is presented here.

12. Accruals and deferred income

Accruals and deferred income of **£34 million** (2017: £12 million) for the Company comprise the same balances and disclosures as other payables detailed in Group note 18. Consequently, no additional information is presented here.

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

13. Total shareholders' funds

	Called up share capital	Hedging reserve	Retained earnings	Shareholders' funds	Total
	£m	£m	£m	£m	£m
1 January 2018	231	(15)	1,432	1,648	1,648
Accounting policy change (IFRS 9 – refer to Group note 1)	-	-	(63)	(63)	(63)
Revised balance at 31 January 2018	231	(15)	1,369	1,585	1,585
Profit / (loss) for the financial year	-	15	132	147	147
31 December 2018	231	-	1,501	1,732	1,732

1 January 2017
Profit / (loss) for the financial year
31 December 2018

Called up share capital	Hedging reserve	Retained earnings	Shareholders' funds	Total
£m	£m	£m	£m	£m
231	(5)	1,415	1,641	1,641
-	(10)	17	7	7
231	(15)	1,432	1,648	1,648

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 2018 was **£132 million** (2017: £17 million). No tax is payable on the profit or loss in either period due to BAT Group tax relief.

The accounting policy change is as explained in the accounting policy in Group note 1.

Share capital consists of **£231 million** (2017: £231 million) ordinary shares of £1 each, allotted, issued and fully paid.

Audit fees of **£234,650** were payable to KPMG LLP for the audit of the Company's annual financial statements (2017: £195,250).

14. Deferred tax asset

Deferred tax asset of **£13 million** (2017: £nil) comprise the same balances and disclosures as deferred tax asset note detailed in Group note 13. Consequently, no additional information is presented here.

15. Directors' remuneration

None of the Directors received any remuneration in respect of their services to the Company during the year (2017: £nil). The Company considers that there is no practicable method to allocate a portion of the emoluments the Directors receive from their respective Group company employer for any qualifying services in respect of the Company, as these are considered to be incidental and part of the Directors overall management responsibilities within the Group.

16. Contingent liabilities

Contingent liabilities of **£14,265 million** (2017: £15,024 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 21. Consequently, no additional information is presented here.

17. 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 2018, total assets on the balance sheet included **£nil** (2017: £nil) of loans due from related parties that are not wholly-owned by the BAT Group. Total liabilities included amounts repayable on demand of **£nil** (2017: £1 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 2018, included net cash flows of **£nil** (2017: £36) in respect of loans advanced to fellow subsidiaries that are not wholly-owned by the BAT Group and net cash outflows of **£nil** (2017: £1 million inflows) in respect of net borrowings obtained.

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

18. 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.

19. Post balance sheet event

On 23 January 2019, the Directors have signed an agreement to purchase B.A.T. Netherlands Finance B.V. from a fellow BAT Subsidiary, British American Holdings (the Netherlands) B.V..

20. 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.

