B.A.T CAPITAL CORPORATION

Financial Statements

December 31, 2018 and 2017

(With Independent Auditors' Report Thereon)

B.A.T CAPITAL CORPORATION

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KPMG LLP
Suite 400
300 North Greene Street
Greensboro, NC 27401

Independent Auditors' Report

The Board of Directors
B.A.T Capital Corporation:

We have audited the accompanying financial statements of B.A.T Capital Corporation, which comprise the balance sheets as of December 31, 2018 and 2017, and the related statements of operations, shareholder's equity, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of B.A.T Capital Corporation as of December 31, 2018 and 2017, and the results of its operations and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Greensboro, North Carolina
April 8, 2019

B.A.T CAPITAL CORPORATION

Balance Sheets

December 31, 2018 and December 31, 2017

(Dollars in thousands)

Assets	**2018**	**2017**
Current assets:		
Cash and cash equivalents	$ 11,288	$ 165,089
Due from affiliates	913,221	79,301
Guarantee fee receivable from affiliate	31,856	72,338
Accrued interest receivable from affiliate	240,270	234,624
Term loan receivable from affiliate	1,200,000	-
Other amounts due from affiliates	492	305,501
Total current assets	2,397,127	856,853
Long-term assets:		
Loan receivable from affiliate	19,932,536	19,923,641
Derivative financial instruments	-	83,391
Deferred income tax assets, net	86,374	62,792
Total assets	$ 22,416,037	$ 20,926,677
Liabilities and Shareholder’s Equity		
Current liabilities:		
Due to affiliates	$ 2,184,056	$ 225,747
Guarantee fee payable to affiliate	31,856	72,338
Accounts payable and accrued liabilities	503	147
Accrued interest payable	218,800	216,191
Derivative financial instruments	188,471	119
Income taxes payable	10,143	109,798
Total current liabilities	2,633,829	624,340
Long-term liabilities:		
Long-term debt	19,873,430	19,999,599
Total liabilities	22,507,259	20,623,939
Shareholder’s equity:		
Common shares, $1 par value (2,000 shares authorized, issued and outstanding)	2	2
Additional paid-in capital	29,499	334,999
Accumulated other comprehensive loss	(98,727)	-
Accumulated deficit	(21,996)	(32,263)
Total shareholder’s equity	(91,222)	302,738
Total liabilities and shareholder's equity	$ 22,416,037	$ 20,926,677

See accompanying notes to financial statements.

B.A.T CAPITAL CORPORATION

Statements of Operations

Years ended December 31, 2018 and December 31, 2017

(Dollars in thousands)

	2018	2017
Interest income	$ 281	$ 287
Interest income from affiliates	739,708	287,025
Guarantee fee reimbursement from affiliate	191,266	72,338
Other reimbursement income from affiliates	8,896	383,052
Total income	940,151	742,702
Interest expense	625,149	252,759
Interest expense to affiliates	91,481	29,612
Guarantee fees to affiliate	191,266	72,338
Net loss on derivatives	143,735	235,865
Foreign exchange (gains) losses	(134,855)	75,758
Fees and expenses incurred for acquisition credit facility	—	61,083
General and administrative expenses	303	589
Total expenses	917,079	728,004
Income before income taxes	23,072	14,698
Income tax expense	12,805	47,006
Net income (loss)	$ 10,267	$ (32,308)
Other comprehensive loss:		
Loss on forward starting interest rate swaps, net of tax benefit of $26,244	(98,727)	—
Comprehensive loss	$ (88,460)	$ (32,308)

See accompanying notes to financial statements.

B.A.T CAPITAL CORPORATION

Statements of Shareholder's Equity

Yeards ended December 31, 2018 and December 31, 2017

(Dollars in thousands)

	Common shares		Additional	Accumulated other comprehensive	Accumulated earnings	
	Shares	Amount	paid-in capital	loss	(deficit)	Total
Balance at December 31, 2016	2,000	$ 2	$ 9,999	$ —	$ 45	$ 10,046
Net loss	—	—	—	—	(32,308)	(32,308)
Capital contribution from parent	—	—	325,000	—	—	325,000
Balance at December 31, 2017	2,000	2	334,999	—	(32,263)	302,738
Net income	—	—	—	—	10,267	10,267
Derivative, net of $26,244 tax benefit	—	—	—	(98,727)	—	(98,727)
Return of capital	—	—	(305,500)	—	—	(305,500)
Balance at December 31, 2018	2,000	$ 2	$ 29,499	$ (98,727)	$ (21,996)	$ (91,222)

See accompanying notes to financial statements.

B.A.T CAPITAL CORPORATION

Statements of Cash Flows

Years ended December 31, 2018 and December 31, 2017

(Dollars in thousands)

		2018		2017
Cash flows from operating activities:				
Net income (loss)	$	10,267	$	(32,308)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:				
Amortization of loan fees received from affiliate		(8,896)		(3,062)
Amortization of debt issuance costs and discounts		8,722		3,235
Foreign exchange (gains) losses		(134,855)		75,758
Derivative losses, net		143,735		235,865
Deferred income tax expense		2,662		(62,792)
Other changes that provided (used) cash:				
Accrued interest receivable from affiliate		(5,646)		(234,624)
Other amounts due from affiliates		305,009		(305,501)
Accounts payable and accrued liabilities		356		146
Accrued interest payable		2,609		216,191
Income taxes payable		(99,655)		109,795
Interest payable on derivative financial instruments		2,373		8,134
Other, net		(36)		—
Net cash flows from operating activities		226,645		10,837
Cash flows (used in) from investing activities:				
Net proceeds from in-house cash agreements with affiliates		1,124,389		156,496
Proceeds received from repayment of loans made to affiliate		—		20,000,000
Loans to affiliate		(1,200,000)		(40,004,459)
Loan fees received from affiliate		—		83,880
Net cash flows used in investing activities		(75,611)		(19,764,083)
Cash flows from (used in) financing activities:				
Capital contribution from parent		—		325,000
Return of capital to parent		(305,500)		—
Repayment of acquisition credit facility		—		(20,000,000)
Borrowings under acquisition credit facility		—		20,000,000
Proceeds from issuance of notes, net of discount		—		20,000,383
Payment of debt issuance costs and financing fees		—		(79,777)
Proceeds (payment) on termination of derivative contracts		665		(327,271)
Net cash flows (used in) from financing activities		(304,835)		19,918,335
Net (decrease) increase in cash		(153,801)		165,089
Cash and cash equivalents – beginning of year		165,089		—
Cash and cash equivalents – end of year	$	11,288	$	165,089
Supplemental cash flow information:				
Interest paid	$	613,813	$	33,333
Income taxes paid	$	109,798	$	—

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation

The accompanying financial statements present the financial position, results of operations and cash flows of B.A.T Capital Corporation, referred to as the Company, an indirect wholly owned subsidiary of British American Tobacco p.l.c., referred to as BAT, a company incorporated under the laws of England and Wales. Until December 7, 2016, the Company was a direct subsidiary of BAT. On December 7, 2016, following a sale of the Company by BAT to Louisville Securities Limited, referred to as LSL, the Company was purchased by BATUS Holdings Inc., referred to as BHI, from LSL pursuant to a stock purchase agreement and BHI became the sole stockholder and parent of the Company. Both LSL and BHI are indirect wholly-owned subsidiaries of BAT. The sale and purchase were at carrying value as the entities were under common control. The Company, incorporated in Delaware, has 2,000 common shares authorized, issued and outstanding with a par value of one dollar per share. The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. All US dollar amounts are presented in thousands unless otherwise noted.

(b) Nature of Business

The Company is a U.S. finance company that has historically been an issuer and a guarantor under the BAT Euro Medium Term Note Programme, referred to as the EMTN Program, (see note 3 and note 8) and has provided financing and cash management services to BAT companies in the U.S. Other than its role as a guarantor, the Company had been inactive for several years prior to 2017. On July 24, 2017, the Company borrowed $20 billion from a syndicate of third party banks under a bridge facility agreement and loaned the proceeds to BHI to fund a portion of the acquisition price paid to purchase the remaining 58% of Reynolds American Inc., referred to as RAI, not already owned by the BAT group, referred to as the RAI merger. On August 15 and August 16, 2017, the Company repaid the borrowings under the bridge facility agreement and issued approximately $20 billion of notes denominated in US dollars (USD), British pounds sterling (GBP) and euros (EUR) with tenors ranging from 3 years to 30 years.

Subsequent to the merger, in addition to the financing provided to BHI, the Company is providing financing and cash management services to RAI. In addition, the Company guarantees certain debt of B.A.T. International Finance p.l.c., referred to as BATIF, an affiliated subsidiary of BAT. BATIF serves as the primary financing and cash management company for the BAT group.

(c) Cash and Cash Equivalents

Cash and cash equivalents may include money market funds, commercial paper and time deposits in major institutions to minimize investment risk. As short-term, highly liquid investments readily convertible to known amounts of cash, with remaining maturities of three months or less at the time of purchase, cash equivalents have carrying values that approximate fair values.

The Company's cash is swept into a cash pooling structure managed by BATIF. The Company has an In-House Cash, or IHC, account which represents its interest in the cash pooling structure and amounts in the Company's IHC account are due on demand and earn interest. As further discussed below in note 5, the IHC agreement provides the Company with a $900.0 million overdraft facility.

(d) Fair Value Measurement

The Company determines the fair value of assets and liabilities using a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity, and the reporting entity's own assumptions about market participant assumptions based on the best information available in the circumstances.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, essentially an exit price.

The levels of the fair value hierarchy are:

Level 1: inputs are quoted prices, unadjusted, in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. A Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: inputs are unobservable and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

(e) ***Derivative Financial Instruments***

The Company uses derivative instruments to manage certain interest rate and foreign currency risks. All derivative contracts entered into by the Company are with BATIF as the counterparty.

Derivatives are recognized on the Company's balance sheets at fair value and are classified according to their asset or liability position and the expected timing of settlement. Changes in the fair values of derivatives are recorded in net income (loss) or other comprehensive income (loss) based on whether the instrument is designated and effective as a hedge transaction and, if so, the type of hedge transaction.

(f) ***Revenue Recognition***

Effective January 1, 2018, the Company adopted ASU 2014-09, *Revenue from Contracts with Customers* (Topic 606), together with its related supplemental implementation guidance, which replaces most existing GAAP revenue recognition guidance. The Company utilized the modified retrospective transition method. Adoption of the new guidance did not have an impact on the Company's financial position, results of operations or cash flows.

This new accounting standard establishes principles for reporting information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Substantially all of the Company's net revenues are from transactions with BHI and consist of interest income and reimbursements of guarantee fees and other related financing expenses incurred by the Company. Loan and reimbursement agreements provide the terms and conditions for transactions between the Company and BHI. Interest income is recognized as earned in accordance with the interest provisions in the underlying loan agreements. Reimbursement income is recognized when qualified expenses under the reimbursement agreements are incurred by the Company.

(g) ***Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Interest and penalties related to uncertain tax positions are accounted for as tax expense.

For federal income tax purposes, the Company's results have been included in the consolidated United States federal income tax return of BHI since December 7, 2016 when BHI became its sole shareholder. For state income tax purposes, the Company's results are included in 26 combined state income tax returns that include members of the consolidated United States federal income tax return of BHI. For financial reporting purposes, the Company's current and deferred income taxes are calculated using the separate return method under Accounting Standard Codification, referred to as ASC, 740 *Income Taxes*. All current and deferred tax expense and current and deferred tax liabilities are calculated as if the Company files separate federal and state income tax returns that exclude the income, deductions and tax attributes of BHI.

The Company accounts for uncertain tax positions which require that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (a likelihood of more than

50%) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The Company did not have any uncertain tax positions for 2018 or 2017. The federal statute of limitations remains open for tax years 2015 through 2018.

(h) Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

(i) Contingencies

In accordance with ASC 450, *Contingencies*, the Company records any loss related to a contingency at the time that likelihood of a loss becomes probable and the amount of the loss can be reasonably estimated. When the reasonable estimate is a range, the best estimate within that range will be recorded. When no amount within the range is more likely, the lowest amount within the range will be recorded. No such amounts were recorded for the years ended December 31, 2018 and 2017.

(j) Recently Adopted Accounting Pronouncements

Effective January 1, 2018, the Company adopted ASU No. 2017-12, *Derivatives and Hedging (Topic 815)-Targeted Improvements to Accounting for Hedging Activities*, which eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires, for qualifying hedges, the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. The guidance also modifies the accounting for components excluded from the assessment of hedge effectiveness, eases documentation and assessment requirements and modifies certain disclosure requirements. The amended guidance did not have an impact on the Company's results of operations, cash flows and financial position.

(2) Acquisition Credit Facility

In January 2017, BAT and RAI entered into the RAI merger agreement to acquire the remaining 58% of RAI's outstanding common stock not already owned by BAT. In connection with the signing of the merger agreement, the Company and BATIF entered into a $25 billion multi-currency facility, referred to as the acquisition facility, that was utilized to fund the cash portion of the merger consideration. The acquisition facility provided for advances under four different tranches, with Facilities A and B being drawn down by the Company, and Facilities C and D being drawn down by BATIF. Facility A had a term of twelve months and Facility B had a term of 24 months, each with two six-month extensions available at the option of BAT. The rate of interest for advances under Facility A was USD London Inter-Bank Offered Rate, referred to as LIBOR, plus an applicable margin of 0.5125% with such margin subject to increases with the passage of time. The rate of interest for advances under Facility B was USD LIBOR plus an applicable margin of 0.5625% with such margin subject to increases with the passage of time. The acquisition facility also provided for payment of a syndication fee and certain up-front, duration, extension and commitment fees that varied for each tranche and were due upon achievement of certain milestones. The acquisition facility was guaranteed by BAT.

On July 24, 2017, the Company borrowed $15 billion under Facility A and $5 billion under Facility B of the acquisition facility, the maximum amount available to be borrowed under each facility, and immediately loaned the $20 billion in proceeds to BHI under two separate loan agreements with similar terms to the acquisition facility (discussed further below). On July 25, 2017, in a cash and stock transaction valued at approximately $54.5 billion, BHI acquired the remaining outstanding common stock of RAI.

The Company repaid Facility A in full on August 15, 2017. The Company repaid Facility B in full with payments of $2.25 billion and $2.75 billion on August 15, 2017 and August 16, 2017, respectively. The Company incurred interest expense of approximately $21.2 million for the borrowings under the acquisition facility while they were outstanding.

The Company expensed $61.1 million in 2017 in fees and expenses incurred for the acquisition facility when the acquisition facility was terminated.

(3) Long-Term Debt

Revolving Credit Facillity

In connection with the RAI acquisition, the Company, along with other subsidiaries of BAT and with BAT as Guarantor, entered into a two-tranche £6.0 billion forward starting revolving credit facility, which consists of a £3.0 billion 364-day revolving credit facility (with a one-year extension option and a one-year term-out option) and a £3.0 billion revolving credit facility, maturing in 2021. The Company had no amounts outstanding under either revolving credit facility as of December 31, 2018 or December 31, 2017.

Long-term Notes

On August 15, 2017 and August 16, 2017, the Company refinanced the acquisition facility with proceeds from the issuance of approximately $20 billion in notes consisting of $17.25 billion in USD denominated notes, referred to as the USD notes, $2.2 billion equivalent in EUR denominated notes, and $0.6 billion equivalent in GBP denominated notes, in the aggregate referred to as the BATCAP Notes. The USD notes were issued in a private offering exempt from, or not subject to, the registration requirements of the federal securities laws and were subject to a registration rights agreement. The USD notes have maturities that vary between 3 and 30 years. The notes denominated in GBP and EUR were sold to investors under the existing EMTN Program. The maturity date for the EUR denominated notes is between 4 and 6.25 years, and the maturity date for the GBP denominated notes is 8 years. Under the terms of the EMTN Program, the notes were guaranteed by BAT, BATIF and certain other BAT affiliates.

The BATCAP Notes were issued net of discounts of $4.2 million and the Company paid $79.8 million in fees and expenses. The discounts and debt issuance costs are being amortized, using the effective interest method, as interest expense over the life of the respective notes. The Company recognized interest expense of $625.1 million and $252.8 million in 2018 and 2017, respectively and, as of December 31, 2018 and 2017, had accrued $218.8 million and $216.2 million in accrued interest payable related to the BATCAP Notes.

Details of the BATCAP Notes at carrying value, including a schedule of maturities, included in the Company's long-term debt is as follows (in thousands):

	For the years ended December 31, 2018	For the years ended December 31, 2017
USD notes:		
2.297% notes due 08/14/2020	$ 2,250,000	$ 2,250,000
3 month LIBOR plus 0.59% notes due 08/14/2020	1,000,000	1,000,000
3 month LIBOR plus 0.88% notes due 08/15/2022	750,000	750,000
2.764% notes due 08/15/2022	2,250,000	2,250,000
3.222% notes due 08/15/2024	2,500,000	2,500,000
3.557% notes due 08/15/2027	3,500,000	3,500,000
4.390% notes due 08/15/2037	2,500,000	2,500,000
4.540% notes due 08/15/2047	2,500,000	2,500,000
EUR notes:		
3 month EURIBOR plus 0.5% notes due 08/16/2021, face value €1,100,000,000	1,261,370	1,320,879
1.125% notes due 11/16/2023, face value €750,000,000	860,025	900,600
GBP notes:		
2.125% notes due 08/15/2025, face value £450,000,000	573,930	608,737
Total principal	19,945,325	20,080,216
Unamortized discount	(3,386)	(3,888)
Unamortized debt issuance costs	(68,509)	(76,729)
Total long-term debt at carrying value	$ 19,873,430	$ 19,999,599

The EUR denominated debt and GBP denominated debt is valued using the foreign denominated face value and the related spot rate for the respective currency at the respective measurement date. Accordingly, in 2018, the Company recognized a gain of $134.9 million from the revaluation of the carrying value of the EUR denominated debt and GBP denominated debt to the December 31, 2018 spot rate. In 2017, the Company recognized a loss of $75.5 million for the revaluation of the carrying value of the EUR denominated debt and GBP denominated debt to the December 31, 2017 spot rate.

As of December 31, 2018, the maturities of the BATCAP notes, excluding unamortized discount and debt issuance costs, for the next five years and thereafter are as follows:

Year	Total
2019	$ —
2020	3,250,000
2021	1,261,370
2022	3,000,000
2023	860,025
2024 and thereafter	11,573,930
	$ 19,945,325

Fair Value of Debt

The estimated fair value of the Company's outstanding debt, in the aggregate, was $18.2 billion and $20.3 billion as of December 31, 2018 and 2017, respectively. The fair value is derived from a third-party pricing source and is classified in Level 2 of the fair value hierarchy.

Registration of USD Notes and Subsequent Exchange Offer

In October 2018, the Company, as issuer of the USD notes, filed a Form F-4 with the Securities and Exchange Commission, referred to as the SEC, to register notes, referred to as Registered Notes, under the Securities Act of 1933, referred to as the 1933 Act. The Registered Notes contained terms and conditions substantially identical to the $17.25 billion in privately placed USD notes, referred to as the Exchange Notes, issued in August 2017. On October 22, 2018, upon the Form F-4 being declared effective by the SEC, the Company launched an exchange offer to exchange any and all (to the extent held by eligible holders) Exchange Notes for its Registered Notes. On November 20, 2018, the Company completed the exchange offer, and of the total $17.25 billion in Exchange Notes outstanding, approximately $17.2 billion, or 99.7%, were exchanged for Registered Notes. Each series of Registered Notes is substantially identical to the Exchange Notes of the corresponding series, except that the Registered Notes are registered under the 1933 Act and do not bear any legends restricting transfer, and except that the registration rights pertaining to the Exchange Notes do not apply to the Registered Notes.

The Company remains the principal obligor of the $56 million in Exchange Notes that were not tendered in the exchange offer. Both the Registered Notes and the Exchange Notes have been guaranteed by BAT and RAI.

(4) Income Taxes

The components of the provision for income taxes for the years ended December 31 were as follows:

	2018	2017
Current:		
Federal	$ 10,143	$ 109,798
State and other	—	—
	10,143	109,798
Deferred:		
Federal	2,662	(62,792)
State and other	—	—
	2,662	(62,792)
Income tax expense	$ 12,805	$ 47,006

Significant components of deferred tax assets and liabilities for the years ended December 31 included the following:

	2018	**2017**
Deferred tax assets:		
Losses on derivatives	$ 99,589	$ 47,680
Unrealized foreign exchange (gains) losses	(13,215)	15,112
Net deferred tax assets	$ 86,374	$ 62,792

As of December 31, 2018 and 2017, the Company has no valuation allowance recorded against deferred tax assets.

On December 22, 2017, the U.S. government enacted the Tax Cuts and Jobs Act, referred to as the Tax Reform Act. The Tax Reform Act includes significant changes to the U.S. corporate income tax system including a federal corporate rate reduction from 35% to 21%, a limitation on the deductibility of interest expense, and the creation of a new minimum tax on certain payments to foreign related parties called the base erosion anti-abuse tax, referred to as BEAT, all of which are effective as of January 1, 2018.

The differences between the provision for income taxes and income taxes computed at statutory U.S. federal income tax rates for the years ended December 31 were as follows:

	2018	**2017**
Income taxes computed at the statutory U.S. federal income tax rate	$ 4,845	$ 5,144
Tax impact of U.S. federal tax reform	—	41,862
BEAT	7,960	—
Income tax expense	$ 12,805	$ 47,006
Effective tax rate	55.5%	319.8%

The effective tax rates for 2018 and 2017 were impacted by the enactment of the Tax Reform Act. In 2017, income tax expense was increased by remeasurement of the Company's deferred tax assets at the 21% federal tax rate provided for in the Tax Reform Act. In 2018, income tax expense increased as a result of the tax liability under BEAT. Excluding the impacts of BEAT and the Tax Reform Act, the effective tax rate for 2018 and 2017 were 21.0% and 35.0%, respectively. As of December 31, 2018, the Company's accounting for the Tax Reform Act is complete.

The Company recognized $26.2 million in accumulated other comprehensive loss at December 31, 2018 for the deferred income tax benefit related to the loss from the change in the fair value of the forward starting pay-fix interest rate swaps entered into in October 2018 (see note 5). No amounts were recognized in accumulated other comprehensive loss at December 31, 2017.

The forward starting interest rate swaps and US Treasury locks entered into in 2017, the cross currency interest rate swaps entered into in 2017 and the forward starting pay-fix interest rate swaps entered into in 2018, as discussed in note 5, have been properly identified as hedging transactions for U.S. federal income tax purposes and are therefore being accounted for as hedging transactions for U.S. federal income tax purposes under the relevant sections of the Internal Revenue Code and underlying regulations.

(5) Related Party Transactions

As a U.S. finance company, the Company enters into transactions with multiple BAT affiliates, including its direct parent, BHI. The following is a summary of balances and transactions with BAT and its affiliates.

Term Loan Receivable

In September 2018, the Company advanced RAI a principal amount of $1.2 billion under a one-year term loan agreement. The term loan bears a floating interest rate based the three-month U.S. dollar LIBOR plus a margin of 1.14%, per annum. Interest is payable on the term loan quarterly. The amount outstanding was $1.2 billion at December 31, 2018. Related to this loan receivable, the Company recognized $11.2 million in interest income in 2018 and had $0.7 million accrued as interest receivable at December 31, 2018.

Due from (to) affiliates

The Company's excess cash balances are swept into a cash pooling arrangement managed by BATIF. The Company's interest in the cash pooling structure is represented by its balances in its IHC account. Excess cash advances on deposit at BATIF are payable to the Company on demand and bear interest at a rate of 0.275% under the overnight LIBOR rate. If necessary, the Company has the ability to overdraft its IHC account at BATIF up to $900.0 million in the aggregate. Overdraft positions bear interest at 0.75% over the overnight LIBOR rate. At December 31, 2018, the Company had excess cash advances on deposit at BATIF of $913.2 million classified as Due from affiliates in current assets on the Company's accompanying balance sheets. At December 31, 2017, the Company had an overdraft of $225.7 million on its IHC account with BATIF classified as Due to affiliates in current liabilities on the Company's accompanying balance sheets.

The Company provides cash management services to RAI. On July 25, 2017, upon completion of the RAI merger, the Company entered into a zero balance account credit agreement and revolving note with RAI. Under the zero balance credit agreement, RAI's cash balances were transferred daily to the Company. These excess cash advances were payable to RAI on demand and bore interest at a rate of 0.275% under one-month LIBOR. Under the credit agreement and revolving note, if RAI was not in a position where it had advances outstanding with the Company, RAI was permitted to borrow, on a revolving basis, up to $900.0 million at any one time from the Company. Borrowings bore interest at a rate of 0.75% over one-month LIBOR. The amount due to the Company from RAI was $79.3 million at December 31, 2017 and was classified as Due from affiliates in the Company's balance sheet. The zero balance account credit agreement and revolving note were terminated in November 2018.

In September 2018, the Company entered into separate IHC agreements with RAI and certain of its subsidiaries which replaced the zero balance account credit agreement and revolving note. Under the terms of these IHC agreements, excess daily cash balances are swept to the Company from RAI and its subsidiaries bank accounts. Excess cash balances on deposit with the Company are payable to each respective entity on demand and bear interest at a rate of 0.275% under the overnight LIBOR rate. Certain IHC agreements provide a separate overdraft facility that provides for advances that may not exceed the overdraft limits set forth in each respective agreement. Overdraft advances bear interest at a rate of 0.75% over the overnight LIBOR rate. Any outstanding advances and interest are due and payable no later than the maturity date of May 1, 2019. The net amount on deposit in the IHC accounts for the benefit of RAI and its subsidiaries was approximately $2.2 billion at December 31, 2018 and is classified as Due to affiliates in the Company's balance sheet.

In 2018 and 2017, the Company recognized approximately $27.2 million and $9.8 million, respectively, in interest expense and approximately $20.3 million and $7.7 million, respectively, in interest income related to the IHC accounts.

Guarantee Fees

The Company entered into an agreement with BAT whereby BAT would provide an unconditional guarantee of the Company's notes issued in August 2017 in exchange for a guarantee fee based on a fee rate and the nominal amount of the notes issued. At the same time, upon lending the proceeds from the note issuance to BHI, BHI agreed to reimburse the Company for the guarantee fees at the same rate the Company was paying BAT. At December 31, 2018 and December 31, 2017, the Company has a payable to BAT for $31.9 million and $72.3 million, respectively, and a corresponding receivable from BHI for $31.9 million and $72.3 million, respectively, for guarantee fees. In addition, in 2018 and 2017, the Company has recognized guarantee fee income of $191.3 million and $72.3 million, respectively, and guarantee fee expense of $191.3 million and $72.3 million, respectively.

Revolving Credit Facility with Affiliate

On December 7, 2016, the Company entered into a $50 million Uncommitted Revolving Credit Facility, referred to as the RCF, with Brown & Williamson Holdings, Inc., referred to as BWH, a BHI affiliate, that matured on December 7, 2018. The RCF agreement contained standard terms and conditions including, at the option of the borrower, the ability to prepay advances and to select a variable interest rate based on a one-month, three-month or six-month USD LIBOR, plus 0.425%.

No advances were made under the RCF in 2018 prior to its maturity. In January 2017, the Company advanced $21.5 million dollars under the RCF in two draws. The advances were repaid in July 2017 together with approximately $200,000 in interest expense. As of December 31, 2017, there were no advances outstanding under this facility.

Derivatives

(a) Forward Starting Interest Rate Swaps and US Treasury Locks

In January and February 2017, in anticipation of the highly probable future note issuance necessary to fund the cash portion of the merger consideration for the RAI acquisition, the Company entered into forward starting pay-fix interest rate swaps for a notional amount of $10.2 billion to lock in the three, five, seven, ten and thirty-year forward swap rates. The counterparty exposure under these swaps was with BATIF with BATIF entering into identical swaps with external banks. Of the $10.2 billion notional amount, $6.2 billion notional amount were deal contingent interest rate swaps and $4.0 billion were non-deal contingent interest rate swaps.

In July and August 2017, the Company terminated substantially all of the forward starting interest rate swaps and at approximately the same time entered into corresponding US Treasury locks, with a notional value of $9.45 billion, to lock in the three, five, seven, ten and thirty-year forward US Treasury rates, with BATIF as the counterparty. BATIF had entered identical contracts with external banks.

Prior to issuance of the BATCAP Notes, the remaining forward starting interest rate swaps and all US Treasury locks were terminated. The Company settled these contracts by making a cash payment of $327.3 million which represented the fair value of the derivative instruments at the time of termination. The Company recognized the entire balance of $327.3 million as a loss on derivatives in the accompanying statement of operations.

(b) Cross-Currency Interest Rate Swaps

In order to manage currency fluctuation risk on the EUR and GBP denominated notes, the Company entered into cross currency interest rate swaps pursuant to which it swapped the EUR and GBP denominated principal amounts bearing fixed or floating interest rates, as applicable, for a USD denominated principal amount bearing a corresponding fixed or floating interest rate, as applicable. The objective of these cross-currency swaps is to reduce volatility of cash flows associated with the underlying debt from changes in foreign currency exchange rates. Under the terms of these contracts, the Company will make interest payments in U.S dollars and receive interest in British pounds sterling or euros, as applicable. Upon the maturity of these contracts, the Company will pay the principal amount of the loans in U.S dollars and receive British pounds sterling or euros, as applicable. BATIF is the counterparty in these contracts. The key terms for the cross-currency swaps were as follows (USD/EUR/GBP amounts in thousands):

Cross currency swaps	Number of Contracts	Inception Date	Maturity Date	Pay Notional Amount	Interest Rate (Pay USD)	Receive Notional Amount	Interest Rate (Receive EUR/GBP)
EUR-USD	5	8/16/2017	8/16/2021	$ 1,288,969	3M Libor+86.7 bp	€ 1,100,000	3M Euribor+50 bp
EUR-USD	4	8/16/2017	11/16/2023	880,755	3.220%	€ 750,000	1.125%
GBP-USD	3	8/16/2017	8/15/2025	584,735	3.370%	£450,000	2.125%
				$ 2,754,459			

The Company recognized a net liability of $52.6 million plus associated accrued interest payable of $10.9 million at December 31, 2018 for the cross-currency swaps. At December 31, 2017, the Company had recognized an asset of $91.9 million less associated accrued interest payable of $8.5 million.

The change in fair value of the cross-currency interest rate swaps was a loss of $144.5 million in 2018 and a gain of $91.9 million in 2017 and is reported in Net loss on derivatives in the accompanying statements of operations. In addition, the Company recognized net interest expense of $64.3 million and $19.8 million, respectively, in 2018 and 2017 related to the cross-currency swaps.

(c) Foreign Currency Forward Contracts

The Company will enter into foreign currency exchange contracts with BATIF to minimize the financial impact from exposure to changes in the exchange rates for GBP and EUR on certain liabilities denominated in those currencies. At December 31, 2018 and December 31, 2017, the Company had a liability recorded of $31,000 and $119,000, respectively, for the fair value of forward exchange contracts. In 2018, the Company recognized $753,000 as income and in 2017, the Company recognized $302,000 as expense related to foreign currency forward contracts. Changes in the fair value are recognized as either income or expense, as applicable, as loss on derivatives in the accompanying statements of operations.

(d) Forward Starting Interest Rate Swaps

In October and November 2018, in anticipation of highly probable future note issuances to be used to refinance certain note maturities, the Company entered into forward starting pay-fix interest rate swaps, referred to as forward swaps, for a notional amount of $3.4 billion to lock in the five and ten year forward swap rates. The forward swaps are for anticipated note issuances in 2019 and 2020. The counterparty exposure under these forward swaps is with BATIF with BATIF entering into identical swaps with external banks. The Company is utilizing cash flow hedge accounting for these forward swaps. Accordingly, at December 31, 2018, the Company had recognized a liability of $125.0 million for the fair value of the forward swaps with a corresponding balance for the same amount, before tax, in accumulated other comprehensive loss. If the highly probable future note issuances occur on the anticipated issue dates or within the following two months, the amount recorded in accumulated other comprehensive loss that is considered to be effective shall be reclassified as interest expense in the statement of operations in the same periods during which the interest expense on the anticipated debt is recognized. If the forecasted transaction does not occur within the specified time period, any amounts in accumulated other comprehensive loss will be reclassified as interest expense in the statement of operations immediately.

Loan to BHI with Acquisition Facility Proceeds

On July 24, 2017, the Company loaned BHI $20.0 billion under two separate term loans to fund a portion of the acquisition price paid to purchase RAI. The Company used the $20.0 billion in proceeds from the borrowings under the acquisition facility to fund the loans to BHI. The first term loan, with a nominal value of $15.0 billion, had a maturity date of July 23, 2018 and bore interest at USD one month LIBOR plus an applicable margin of 0.5125% with such margin subject to additional increases with the passage of time. The second term loan, with a nominal value of $5.0 billion, had a maturity date of July 23, 2019 and bore interest at USD one month LIBOR plus an applicable margin of 0.5625% with such margin subject to additional increases with the passage of time. The two loans required an aggregate payment of $61.1 million to the Company as an upfront fee for extending the loans. The Company recognized the $61.1 million as other reimbursement income from affiliates in 2017.

BHI subsequently repaid the two loans in August 2017 with the proceeds from the new loans made by the Company to BHI using the proceeds of the BATCAP Notes issuance.

Loan receivable from affiliate

On August 15, 2017 and August 16, 2017, the Company issued approximately $20 billion in notes (see note 3). The proceeds from those notes were loaned to BHI in a series of term loans whereby BHI used the proceeds to repay the two loans aggregating $20.0 billion provided by the Company in July 2017 to fund a portion of the acquisition of RAI.

The amount borrowed by BHI consisted of 11 separate term loans that were made in U.S. dollars with amounts and maturity dates that matched the corresponding notes issued by the Company. BHI paid the Company $83.9 million in upfront fees related to the loans and the Company is amortizing those fees over the life of the respective notes using the effective interest method.

Details of the loans receivable at carrying value, including a schedule of maturities, recoognized as the Company's loans receivable from affiliate is provided below:

	For the years ended December 31, 2018	2017
Fixed rate loans:		
2.417% note due 08/14/2020	$ 2,250,000	$ 2,250,000
2.937% note due 08/15/2022	2,250,000	2,250,000
3.219% note due 11/16/2023	880,755	880,755
3.385% note due 08/15/2024	2,500,000	2,500,000
3.372% note due 08/15/2025	584,735	584,735
3.840% note due 08/15/2027	3,500,000	3,500,000
4.462% note due 08/15/2037	2,500,000	2,500,000
4.699% note due 08/15/2047	2,500,000	2,500,000
Variable rate loans:		
Three-month LIBOR plus 0.59% note due 08/14/2020	1,000,000	1,000,000
Three-month LIBOR plus 0.87% note due 08/16/2021	1,288,969	1,288,969
Three-month LIBOR plus 0.88% note due 08/15/2022	750,000	750,000
Total principal	20,004,459	20,004,459
Facility commitment fees	(71,923)	(80,818)
Total loan receivable from affiliate	$ 19,932,536	$ 19,923,641

As of December 31, 2018, the maturities of the Company's loan receivable from affiliate, excluding facility commitment fees, were as follows:

Year	Total
2019	$ —
2020	3,250,000
2021	1,288,969
2022	3,000,000
2023	880,755
2024 and thereafter	11,584,735
	$ 20,004,459

Related to these loans receivable, the Company recognized $707.0 million and $279.3 million in interest income in 2018 and 2017, respectively, and had $239.6 million and $234.6 million accrued as interest receivable at December 31, 2018 and December 31, 2017, respectively.

Other income – affiliates

Pursuant to an agreement with BHI, certain expenses of the Company are reimbursed by BHI related to the financing transactions that occurred in 2017. In 2018 and 2017, the Company recognized $8.9 million and $383.1 million, respectively, as other income from affiliates for these reimbursements as follows (dollars in thousands):

	2018	2017
Losses on forward starting interest rate swaps and treasury locks	$ -	$ 318,896
Acquisition facility fees	-	61,083
Other	8,896	3,073
	$ 8,896	$ 383,052

General and administrative services

The Company had no direct employees in 2018 and 2017. The Company has a services agreement with Louisville Corporate Services Inc., a direct subsidiary of BHI, for the provision of general and adminstrative services to the Company consisting primarily of administrative, accounting, income tax and other support services.

(6) Fair Value

The Company records its derivative contracts at their fair value as of the balance sheet date. All derivatives held by the Company at December 31, 2018 and December 31, 2017, are categorized in Level 2 of the fair value hierarchy. Level 2 financial instruments are not traded in an active market but rather the fair values 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 contract 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.

(7) Shareholder's Equity

Capital Contribution

In December 2017, BHI made a capital contribution of $325.0 million to the Company. No additional shares were issued in exchange for the capital contribution.

Return of Capital to BHI

In July 2018, the Board of Directors for the Company approved a cash distribution of $305.5 million in the form of a return of capital be made to BHI.

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of $26.2 million in tax, were as follows:

	Forward Starting Pay-Fix Interest Rate Swaps
Balance at December 31, 2017	$ -
Net current period other comprehensive loss	(98,727)
Balance at December 31, 2018	$ (98,727)

(8) Contingent Liabilities

On December 9, 2011, the Company ceased to be a party to the EMTN Program under which the issuers, that also include BATIF, B.A.T. Netherlands Finance B.V. and British American Tobacco Holdings (The Netherlands) B.V., can from time to time issue notes in amounts not to exceed the EMTN Program limits or its equivalent in other currencies. The payments of all amounts in respect of any notes issued under the EMTN Program prior to December 9, 2011 are unconditionally and irrevocably guaranteed by BAT, the Company and each of the other issuers (except where it is the relevant issuer).

On May 31, 2017, the EMTN Program was amended and restated to increase the size of the EMTN Program from £15.0 billion to £25.0 billion and to add the Company as an issuer and a guarantor. At December 31, 2018 and December 31, 2017, the Company had issued $2.7 billion and $2.8 billion, respectively, equivalent of notes under the EMTN Program at the related spot rate for the respective currency at the respective measurement date.

Effective February 13, 2018, the Company became an additional guarantor of the notes issued pursuant to the EMTN Program that it was not already a guarantor of during the period since it ceased participation. With the additional guarantees in place, as of December 31, 2018 and December 31, 2017, the Company was a guarantor in the amount of approximately $16.6 billion and $6.5 billion, respectively, plus accrued interest which represents the maximum potential exposure (at applicable year-end exchange rates) had the relevant issuers defaulted.

The Company's guarantee of the notes issued under the EMTN is unconditional and irrevocable, joint and several with the other guarantors and is triggered when the issuer of the EMTN securities defaults on its payment obligations. If the Company is required by law to withhold any U.S. taxes (or taxes of any of its political subdivisions) from payments it makes under its guarantee, the Company is required to pay additional amounts so that security holders receive the same payment they would receive absent such withholding, subject to exceptions. The Company does not maintain a guarantee liability related to its guarantees with respect to the EMTN Program.

(9) Subsequent Events

In February 2019, the Company entered into three forward starting, floating-to-fixed interest rate swaps, referred to as IRS, with BATIF as the counterparty. The IRS cover an aggregate notional amount of approximately $3.0 billion with fixed rates ranging from 3.23% to 3.53%. The IRS are effective from May 2019 to February 2020.

Subsequent events have been evaluated through April 8, 2019, the date the financial statements were issued.