Japan Tobacco Inc.
Annual Report FY2017
Year ended December 31, 2017

Investment leading to sustainable growth.

Management

Operations & Analysis

Corporate Information

Financial Information

Performance Indicators

Adjusted Operating Profit

585.3

(JPY BN)

-0.3%

Year-on-Year Change

-0.6%

Year-on-Year Change at Constant Exchange Rates

Dividend per Share

140

(JPY)

+7.7%

Year-on-Year Change

Factsheets available at:
https://www.jt.com/investors/results/annual_report/

Unless the context indicates otherwise, references in this Annual Report to ‘we’, ‘us’, ‘our’, ‘Japan Tobacco’, ‘JT Group’ or ‘JT’ are to Japan Tobacco Inc. and its consolidated subsidiaries. References to ‘JTI’ are to JTI Holding B.V., our consolidated subsidiary, and its consolidated subsidiaries. References to ‘TableMark’ are to TableMark Holdings Co., Ltd., TableMark Co., Ltd. and its Group companies. References to ‘Japan Tobacco Inc.’ are only to Japan Tobacco Inc. and references to ‘JT International Holding B.V.’ are only to JTI Holding B.V. References to ‘audit & supervisory board’ are to ‘kansayaku-kai’ (as defined in the Companies Act of Japan) that performs certain supervisory functions through its monitoring and audit activities within the overall scheme of corporate governance pursuant to the Companies Act of Japan. References to ‘audit & supervisory board member’ are to a member or members of an audit & supervisory board, also referred to in Japanese as ‘kansayaku’ (as defined in the Companies Act of Japan).

Forward-looking statements
This report contains forward-looking statements. These statements appear in a number of places in this report and include statements regarding the intent, belief, or current and future expectations of our management with respect to our business, financial condition and results of operations. In some cases, you can identify forward-looking statements by terms such as ‘may’, ‘will’, ‘should’, ‘would’, ‘expect’, ‘intend’, ‘project’, ‘plan’, ‘aim’, ‘seek’, ‘target’, ‘anticipate’, ‘believe’, ‘estimate’, ‘predict’, ‘potential’ or the negative of these terms or other similar terminology.
These statements are not guarantees of future performance and are subject to various risks and uncertainties. Actual results, performance or achievements, or those of the industries in which we operate, may differ materially from any future results, performance or achievements expressed or implied by these forward-looking statements.

In addition, these forward-looking statements are necessarily dependent upon assumptions, estimates and data that may be incorrect or imprecise and involve known and unknown risks and uncertainties. Forward-looking statements regarding operating results are particularly subject to a variety of assumptions, some or all of which may not be realized.

Risks, uncertainties or other factors that could cause actual results to differ materially from those expressed in any forward-looking statement include, without limitation:

1. change in consumer’s needs and preferences, and decrease in demand for tobacco products in key markets;
2. restrictions on promoting, marketing, packaging, labeling and usage of tobacco products in markets in which we operate;
3. increases in excise, consumption or other taxes on tobacco products in markets in which we operate;
4. litigation around the world alleging adverse health and financial effects resulting from, or relating to, tobacco products;
5. our ability to realize anticipated results of our acquisition or other similar investments;
6. competition in markets in which we operate or into which we seek to expand;
7. deterioration in economic conditions in areas that matter to us;
8. economic, regulatory and political changes, such as nationalization, terrorism, wars and civil unrest, in countries in which we operate;
9. fluctuations in foreign exchange rates and the costs of raw materials; and
10. catastrophes, including natural disasters.

At a Glance

Our Businesses

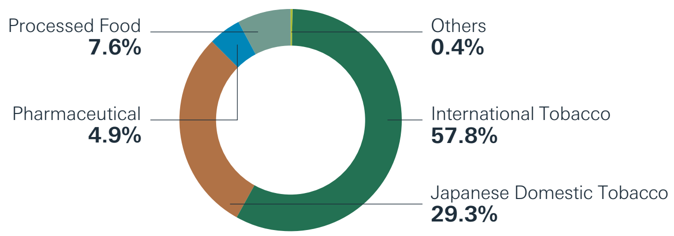
FY2017: Results for the fiscal year ended December 31, 2017

The JT Group is a leading international tobacco company with operations in over 70 countries.

Our products are sold in over 130 countries and our internationally recognized brands include Winston, Camel, MEVIUS and LD.

We are also active in pharmaceutical and processed food businesses and we expect them to establish a foundation for continuous profit contribution, as we strive for sustainable growth.

Revenue breakdown by business segment



International Tobacco Business

The international tobacco business is the JT Group's growth engine, generating over 60% of the Group's consolidated adjusted operating profit. Looking ahead, we expect it will continue its strong contribution, strengthening competitiveness of the JT Group to drive sustainable growth in the mid- to long-term.

Our international brands portfolio is competitive and well-balanced, with strong equity brands across all relevant product categories and price segments. The portfolio includes leading international brands in cigarettes and fine cut, such as Winston, MEVIUS, Camel and LD, as well as in Reduced-Risk Products (RRP)*, such as Ploom TECH and Logic.

Results for FY2017:
Robust profit growth at constant exchange rates underpinned by resilient volume performance, positive Global Flagship Brands (GFB) momentum and planned initiatives to optimize the manufacturing footprint and overall cost base.

Key Drivers:
- Positive GFB momentum driven by share gains
- Stronger business base from acquisitions
- Global supply chain optimization
- Focused investments behind
  - Global Flagship Brands,
  - Emerging Markets, and
  - Reduced-Risk Products (RRP)*
- Over 39,000 dedicated and talented employees

Global Flagship Brands

* Reduced-Risk Products (RRP): Products with the potential to reduce the risks associated with smoking.

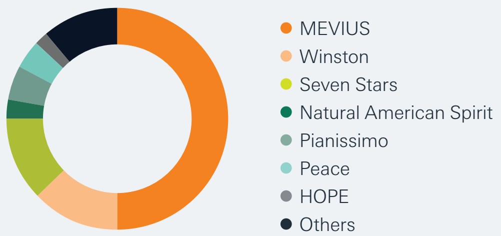
Japanese Domestic Tobacco Business

We are the market leader in Japan, which is one of the largest markets in the world, generating about 40% of our consolidated adjusted operating profit. We continue to be a significant profit contributor to the JT Group.

During 2017, our SOM** reached 61.3%, thanks to the solid performance of our core brands, such as MEVIUS and Natural American Spirit. Thus, we further solidified our No. 1 position in cigarettes. In addition, we launched Ploom shops and expanded the sales of Ploom TECH in Tokyo.

Results for FY2017:
Adjusted operating profit decreased due to lower cigarette sales volume partially offset by the optimization of investments.

Composition of JT SOM as of 2017**



Key Brands

** SOM: Share of market.

Pharmaceutical Business

JT Group's pharmaceutical business focuses on the research and development, production and sale of prescription pharmaceutical products. Its mission is to build world-class, unique research and development capabilities and reinforce its market presence through innovative drugs. JT concentrates on research and development activities mainly on the fields of metabolic diseases; viral infection; and autoimmune/inflammatory diseases, while Torii Pharmaceutical Co., Ltd. is in charge of manufacturing as well as sales and promotion in the domestic market.

Results for FY2017:
Earnings increased and achieved a record high profit.

Processed Food Business

With Group company TableMark Co., Ltd. taking a central role, the processed food business is primarily engaged in business concerning frozen and ambient processed food, mainly staple food products such as frozen noodles, frozen rice, packed cooked rice and frozen baked bread, and seasoning including yeast extracts and oyster sauce.

We have solidified its No. 3 position in the frozen food industry with several top-selling products within respective categories, such as frozen Udon noodles and frozen Okonomiyaki.

Results for FY2017:
Achieved profit growth for the fifth consecutive year.

Japan Tobacco around the World (Tobacco Business)

Note: Locations of manufacturing factories to be closed by the end of 2018: Belgium and Malaysia

Consolidated Five-Year Financial Summary

Japan Tobacco Inc. and Consolidated Subsidiaries

FY2017: Results for the fiscal year ended December 31, 2017

	FY2013 (IFRS)	2014 (Jan-Dec)	FY2015 (IFRS)	FY2016 (IFRS)	FY2017 (IFRS)
					Billions of yen
For the year:		(Continuing operations)			
Revenue (Note 1)	2,399.8	2,259.2	2,252.9	2,143.3	**2,139.7**
International Tobacco	1,270.0	1,328.0	1,317.2	1,199.2	**1,237.6**
Japanese Domestic Tobacco	710.3	687.4	677.3	684.2	**626.8**
Pharmaceutical	64.4	65.8	75.6	87.2	**104.7**
Beverage	184.5	–	–	–	**–**
Processed Food	156.9	161.2	165.8	164.1	**163.1**
Others	13.6	16.9	17.0	8.6	**7.5**
Core revenue (Note 2)					
International Tobacco	1,200.7	1,258.2	1,252.5	1,138.8	**1,177.0**
Japanese Domestic Tobacco	676.2	649.8	642.2	649.7	**590.6**
Operating profit (Note 3)	648.3	572.6	565.2	593.3	**561.1**
International Tobacco	376.4	379.5	346.9	301.8	**325.6**
Japanese Domestic Tobacco	258.1	181.5	249.2	244.1	**215.8**
Pharmaceutical	(9.0)	(7.3)	(2.3)	9.7	**24.1**
Beverage	(2.1)	–	–	–	**–**
Processed Food	(0.2)	(1.2)	3.2	5.0	**5.4**
Others	25.0	20.2	(31.8)	32.7	**(9.8)**
Adjusted operating profit (Note 3)	641.8	661.0	626.7	586.8	**585.3**
International Tobacco	410.8	447.1	394.4	336.2	**351.3**
Japanese Domestic Tobacco	257.7	238.7	254.1	260.2	**232.3**
Pharmaceutical	(9.0)	(7.3)	(2.3)	9.7	**24.1**
Beverage	(2.1)	–	–	–	**–**
Processed Food	0.6	1.4	2.7	5.0	**5.4**
Others	(16.2)	(18.9)	(22.2)	(24.4)	**(27.8)**
Depreciation and amortization (Note 3)	132.9	128.6	133.1	140.8	**145.4**
Profit (attributable to owners of the parent company) (Note 4)	428.0	391.4	398.5	421.7	**392.4**
Free cash flow (FCF)* (Note 5)	212.6	455.4*	386.7*	(316.2)	**72.6**

* Results from continuing operations and discontinued operations combined for both FY2015 and Jan–Dec 2014.

FY2017: Results for the fiscal year ended December 31, 2017

Consolidated (Continuing and discontinued operations combined)

	FY2013 (IFRS)	FY2014 (IFRS)	FY2015 (IFRS)	FY2016 (IFRS)	FY2017 (IFRS)
					Billions of yen
At year-end:					
Assets	4,616.8	4,704.7	4,558.2	4,744.4	**5,221.5**
Interest-bearing debts (Note 6)	375.9	228.2	255.3	555.3	**755.8**
Liabilities	2,020.7	2,082.2	2,036.7	2,216.3	**2,379.5**
Equity	2,596.1	2,622.5	2,521.5	2,528.0	**2,842.0**
Major Financial Ratios					
ROE (Note 7)	19.9%	14.4%	19.5%	17.2%	**15.0%**
ROA (Note 8)	15.0%	10.8%	14.8%	12.4%	**10.8%**
Amounts per share: (in yen)					
Diluted EPS (Notes 9/10)	235.35	199.56	270.37	235.33	**218.97**
Book value per share (attributable to owners of the parent company) (Note 10)	1,378.57	1,395.74	1,369.06	1,371.39	**1,541.94**
Dividend per share (Note 10)	96	100	118	130	**140**
Dividend payout ratio (Note 11)	40.8%	50.1%	53.2%**	55.2%	**63.9%**

** Payout ratio for FY2015 is based on basic EPS from continuing operations.

Notes:

1. Excluding tobacco excise taxes and revenue from agent transactions.
2. Excluding revenue from distribution business of imported tobacco, among others, in the Japanese Domestic Tobacco business, in addition to the distribution, private label, contract manufacturing, and other peripheral businesses in the international tobacco business.
3. Adjusted operating profit = Operating profit + amortization cost of acquired intangibles arising from business acquisitions + adjusted items (income and costs)*
   *adjusted items (income and costs) = impairment losses on goodwill ± restructuring income and costs ± others.
4. Under IFRS, profit is presented before deducting non-controlling interests.
   For comparison, we show the profit attributable to the owners of the parent company.
5. FCF = cash flows from operating activities + cash flows from investing activities excluding the following items:
   From 'cash flows from operating activities': Interests and dividends received, and their tax effect/interest paid and its tax effect.
   From 'cash flows from investing activities': Purchase of securities/proceeds from sale and redemption of securities/payments into time deposits/Proceeds from withdrawal of time deposits/others (but not business-related investment securities, which are included in the investment securities item).
6. Including lease obligation.
7. ROE = Return on equity (attributable to owners of the parent company).
8. ROA = (Profit before income taxes)/Total assets (average of beginning and ending balance of the period).
9. Based on profit (attributable to owners of the parent company).
10. A 200-for-one share split is done, effective as of July 1, 2012.
11. Based on profit (attributable to owners of the parent company).
12. Financial data disclosed herein are basically rounded.

Message from the Chairman and CEO


Yasutake Tango
Chairman of the Board

Masamichi Terabatake
Representative Director and President, Chief Executive Officer

Under the 4S model, we strive to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society.

Delivered Solid Profitability Under a Challenging Environment

In 2017, the operating environment surrounding us continued to be difficult due to a lack of clarity over the global economy, changes in the international political climate and the increases in geopolitical risks as well as industry contractions in various markets, tighter regulations, excise tax hikes and price competition. However, under such a rapidly-changing environment, we have been managing various risks and delivered solid profitability while actively investing in business for the future growth.

"We believe that pursuing 4S model is the best approach to achieve sustainable profit growth over the mid- to long-term and thus increase the Group's enterprise value. It means that this conveys benefits to the four stakeholder groups."

Toward Future Growth

We expect that the operating environment will change at an unprecedented speed and scale. To survive and succeed in these circumstances, we have to further enhance our organizational capabilities, based on which the JT Group continuously aim to achieve sustainable profit growth through business investments over the mid- to long-term. Under the Business Plan 2018, a three-year plan through 2020, we will turn the tables on competition in the Reduced-Risk Products category in the Japanese market during 2018. In order to ensure the turnaround as well as create an earnings growth momentum from the ensuing year, we will accelerate investments in this category to strengthen our business foundations. This initiative will lead to a challenging year for 2018 from a short-term viewpoint in terms of profit; however, we envision our adjusted operating profit growth at constant currency to return to mid- to high single-digit rate in and beyond 2019. This will be achieved as traditional tobacco products in established markets will continue to generate solid profit through brand equity investments, and on top of that, we expect the increasing returns from emerging markets, the success of Reduced-Risk Products and the continuing contributions by the pharmaceutical and processed food businesses to the Group profit growth.

Shareholders Return

We allocate resources by considering the balance between business investments for sustainable profit growth and shareholder returns. Regarding our shareholders return policy, we strive to improve it based on the mid- to long-term profit growth outlook while maintaining a solid balance sheet which enables us to respond to various changes in our operating environment. Specifically, we intend to grow dividend per share in a stable and sustainable manner. Under this approach, the annual dividend for 2017 was 140 yen as we initially committed. As for 2018, we plan to pay an annual dividend of 150 yen per share, which represents an increase of 7.1% year-on-year, considering the Group's mid- to long-term profit growth outlook.

4S Model

Our management principle is the 4S model. Under the 4S model, we strive to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society, carefully considering the respective interests of these four key stakeholder groups, and exceeding their expectations wherever we can. We believe that pursuing 4S model is the best approach to achieve sustainable profit growth over the mid- to long-term and thus increase the Group's enterprise value. It means that this conveys benefits to the four stakeholder groups.

As part of our pursuit of the 4S model, we continue to carry out a variety of sustainability initiatives. In 2017, we made a solid progress on this front as well. Throughout the year, we continued to extend our support to supply chain with a particular emphasis on tobacco leaf sourcing, promoted human rights initiatives, remained committed to fighting illegal trade of tobacco products and addressed to reduce environmental impact. Our efforts towards sustainability were well recognized by external bodies that monitor such activities and we were selected by Dow Jones Sustainability Index for Asia Pacific for the fourth consecutive years since 2014. We continuously aim to make contribution to realize a sustainable society.

Message from the CFO on p.71

CEO Business Review

In 2017 we continued to deliver solid profit while investing to strengthen our future competitiveness.

A Year of Mixed Results for the JT Group
2017 was a year of mixed results in which we performed as planned or even exceeded our initial expectations in certain fronts, but also encountered unexpected developments.

In the Japanese Domestic Tobacco business, we maintained a market share of over 60% in the ready-made cigarettes category. In the international tobacco business, we delivered a solid performance mainly driven by our forward-looking measures taken in the past, notably the manufacturing footprint optimization. Moreover, the pharmaceutical and processed food businesses continued to grow their profits and made a significant contribution to the JT Group.

On the other hand, there were unexpected developments. Most notably, Reduced Risk Products market in Japan expanded so rapidly and we were not able to adapt ourselves to the change. Furthermore, our performance was hit by a key distributor in the UK going into administration; that was certainly not assumed in our plan. However, under these circumstances, adjusted operating profit at constant FX remained at the same level as the prior year.

Masamichi Terabatake
Representative Director and President, Chief Executive Officer

"We will continue our business investment and achieve mid- to long-term profit growth."

2017 Key highlights

Adjusted Operating Profit (JPY BN)	Dividend Per Share
585.3	+7.7%
(2016: 586.8)	(2016: +10.2%)

Business Results by Segment
In the international tobacco business, we continue to focus our investments on three pillars for future growth, notably sustainable growth in established markets led by brand equity enhancement, geographic expansion in emerging markets and the accelerated growth in the Reduced-Risk Products category.

Although the industry contraction continued in various markets, our total shipment volume remained stable due to the contribution from emerging markets in the Middle East, South-East Asia and the Africa as well as from the acquisitions in the Philippines and Indonesia. More importantly, GFB shipment volume increased 0.8% mainly driven by share gains in several key markets.

On a constant FX basis, core revenue remained flat year-on-year. Despite the one-time loss related to a key UK distributor going into administration, adjusted operating profit grew by 4% mainly led by the cost reduction achieved through manufacturing footprint optimization. Excluding the one-time impact, we delivered a profit growth of approximately 10% year-on-year. We will continue to invest with a focus on the three pillars and target to achieve sustainable profit growth driven by quality top-line growth.

In the Japanese Domestic Tobacco business, our cigarette sales volume declined 12.5% due to the underlying trend and the expansion of Reduced-Risk Products. But our cigarette market share reached 61.3%, an increase by 0.3 percentage points year-on-year, thanks to the solid performance of the core brands. Thus, we further solidified our No. 1 position in cigarettes.

As for Ploom TECH, we have been working on the manufacturing capacity increase as the top priority. In line with the manufacturing capacity increase, we expanded its sales area across Tokyo in 2017. Core revenue declined 9.1% year-on-year, with the cigarette sales decline more than offsetting the Ploom TECH related sales increase as well as the pricing gains mainly from MEVIUS. Thus, adjusted operating profit decreased 10.7%.

Going forward, we position Reduced-Risk Products category as the growth driver and will prioritize it in allocating resources and further invest in this category. Meanwhile, ready-made cigarettes category remains important and continues to be the platform of profitability. Therefore, we will fortify our position as the market leader with an overwhelming share of market. We will consistently enhance consumers' satisfaction through investment in brand equity, especially of four core brands—MEVIUS, Natural American Spirit, Seven Stars and Winston.

In the pharmaceutical business, profit grew significantly by 14.4 billion yen, mainly driven by the royalty revenue growth thanks to the strong sales of license out compounds. In the processed food business, profit increased by 0.4 billion yen through our sales efforts to focus on higher margin products and cost reduction. As a result, we achieved profit growth for the fifth consecutive year.

In 2017, the pharmaceutical and processed food businesses combined together achieved a profit growth of about 15 billion yen, making a significant contribution to the Group's profit. Going forward, we aim to consistently grow their profits to realize the profit contribution to the JT Group.

Revolution of Organization Capability
The JT Group has achieved growth by promptly responding to changes in the operating environment and implementing initiatives with foresight. Now, the operating environment surrounding us is revolving at an unprecedented speed, leading to more and more uncertainties. In addition, the evolution of digital technology such as IoT and AI is re-defining competition from within an industry to among industries as well as altering consumers' behaviors, and thus making it more difficult for us to have a clear outlook.

To survive and succeed in such a high uncertain circumstance, responding to changes is not enough; rather we have to develop ourselves into a company that initiates change and drive evolution. The organizations and functions in the JT Group must be bold and agile in decision-making and execution. To build such organizations and functions, each employee is encouraged to take action towards changes and innovations for improvements in a bold and prompt manner, and achieve sustainable growth over the mid- to long-term.

Message from the CFO on p.71

Please be reminded that this section is intended to explain the business operations of JT to investors, not to promote sales of tobacco products to encourage smoking by consumers.

2017 Highlights

The Japan Tobacco Group's Activities

2017

January

Launch of novel anti-HIV drugs, 'Descovy Combination Tablets LT and HT' in Japan 1

April

Launch of portable super slim size with an aroma-changing capsule 'Mevius Premium Menthol Option Purple 100's Slim'

May

'Look up to the sky'. Fifteen products of Mevius in limited edition packs have been launched in selected retail stores nationwide with a limited quantity 2

June 29

Ploom TECH sales to start in the Tokyo metropolitan area 3

July

Launch of Ploom TECH in Switzerland

August

Renewal of 'Mevius Premium Menthol Frozen' were rolled out nationwide 4

September

JT has been selected as a member of the Dow Jones Sustainability Asia/Pacific Index for the fourth consecutive year

September 7

Completed the acquisition of assets related to the tobacco business of Mighty Corporation in the Philippines 5

October

Launch of 'Natural American Spirit Organic Leaf ONE' in Japan 6

October 30

Expanded the Ploom TECH sales area in Tokyo 7

October 31

Acquired Indonesian kretek cigarette company 'PT. Karyadibya Mahardhika' (KDM) and its Distributor 'PT. Surya Mustika Nusantara' 8

November

Launch of two new flavors of Ploom TECH tobacco capsules 9

November 21

Announcement of JT's new President and CEO, effective from 1 January 2018

December

Launch of Ploom TECH in Canada

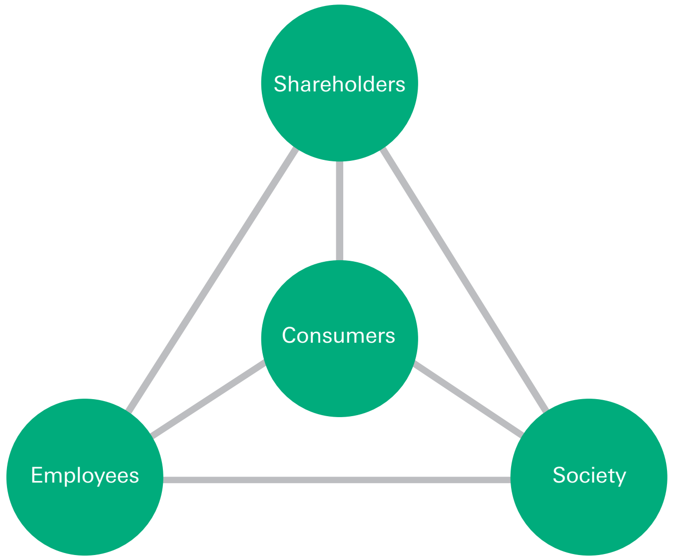
December 21

Additional share purchase from the Ethiopian government of approximately 30% of the total shares in National Tobacco Enterprise S.C. bringing our total share ownership to over 70%

Management Principle, Strategic Framework and Resource Allocation

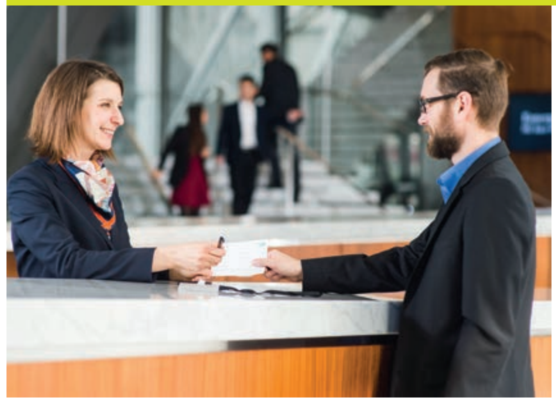
Management Principle

The 4S model, our management principle, is the most shared value among JT Group employees across business and countries.



The 4S model – We strive to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society, carefully considering the respective interests of these four key stakeholder groups, and exceeding their expectations wherever we can.

The 4S model is the JT Group's core competency. Our decision-making has been and will continue to be based on this management principle. To strive to fulfill our responsibilities to our valued stakeholders and exceed their expectations.



Consumers

For our consumers, we will offer superior products which meet or even go beyond their evolving needs. To achieve that, we will make the most of JT Group's diversity to enhance our capacity in innovation.

Shareholders

For our shareholders, we intend to strike an optimal balance between profit growth and shareholder returns. This means that we will enhance our shareholder returns based on the mid- to long-term outlook of our profit growth.

Employees

For our employees, we will further evolve to become an attractive and respected company so that employees feel proud to be a part of it. For that, we will highly value employees with a strong sense of commitment to deliverables and properly reward their accomplishments.

Society

The growth of the JT Group is dependent on sustainability of society. We will continue to enhance our corporate value through contributing to society.

Strategic Framework

Our track record proves that our strategy was right. We will continue to develop our strategy in accordance with the business environment and achieve strong profit growth.

Quality Top-Line Growth

Among the strategic pillars, the JT Group places a particular emphasis on quality top-line growth, which is indispensable for sustainable growth. We aim to grow top-line by consistently offering innovative products.

Competitive Cost Base

We continue to strive for further cost base improvement, while investing for future sustainable growth.

Robust Business Foundation

The business environment surrounding the JT Group has been changing fast. In order to respond, to drive evolution and even take advantage of the changes, we encourage each employee and organization to take actions towards change and innovation for continuous improvement.

Resource Allocation

First, we grow profit through business investment. Then, we allocate this profit to return cash to our shareholders.

Business Investment and Capital Policy

The JT Group is a global growth company. Investing for both external and organic growth, we historically increased profit, and eventually corporate value. We believe that opportunities exist to expand the earnings base, especially for tobacco business. Our investment will mainly focus on this core business to fuel its growth. As we expect pharmaceutical and processed food businesses to further contribute to the Group profit in the future, we will allocate our funds to best utilize existing assets and to further improve their profitability.

Under the Japan Tobacco Inc. law, we are subject to the restriction in issuing new shares. Given the circumstances, we plan to maintain a strong balance sheet for debt financing and to not cancel treasury stock. With sufficient debt capacity, we can consider share repurchase when the Government, who holds one-third of our outstanding shares, releases them in whole or in part in the future.

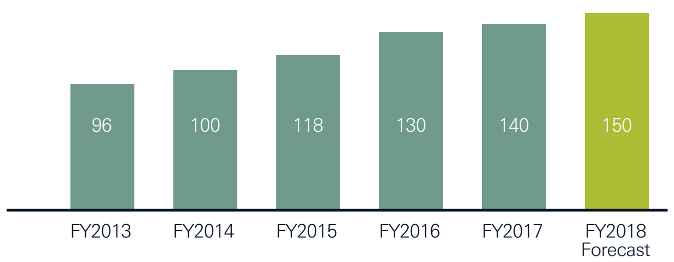
Shareholder Return

We believe that maintaining a solid balance sheet is essential for JT Group as it will provide us the ground to continue aggressively pursuing business investment opportunities and cope with any adversity arising out of the volatile environment. At the same time, as we already mentioned, we intend to strike an optimal balance between profit growth and shareholder returns.

This means that we will enhance our shareholder returns based on our profit growth outlook in the mid-to long-term. In particular, we will deliver sustainable and steady increase of dividend per share. Dividend payout ratio is not an indicator for our management target, although it will be taken into consideration when deciding the dividend amounts. As for share buy-back, we will consider it after scrutinizing the mid-to long-term expectations of the company's business environment as well as financial achievements and position, among other factors.

We will continue to monitor trends amongst the global FMCG companies that have a stakeholder model similar to our 4S model and that have achieved strong business growth.

Dividend Per Share (JPY)



Business Plan 2018

The JT Group's Business Plan covers a three-year period, and is rolled-over annually to reflect the most recent changes in our business environment including economics, geopolitics and competition. However the operating environment surrounding us is revolving at an unprecedented speed and scale. By developing ourselves into a company that initiates change and drive evolution, we aim to achieve sustainable profit growth under such circumstances.

Group profit target:

- Annual average growth rate of adjusted operating profit at constant currency over mid- to long-term:
  - Mid- to high single-digit

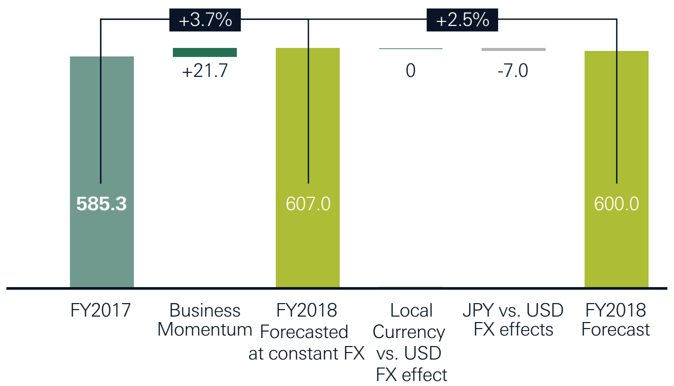
Shareholder return policy:

- Aim to enhance shareholder returns considering the Company's mid- to long-term profit growth trend, while maintaining a solid balance sheet*
  - Deliver consistent dividend per share growth
  - Consider implementing share buy-back, which takes into account the Company's mid-term operating environment and financial outlook
  - Continue to closely monitor shareholder returns of global FMCG companies**

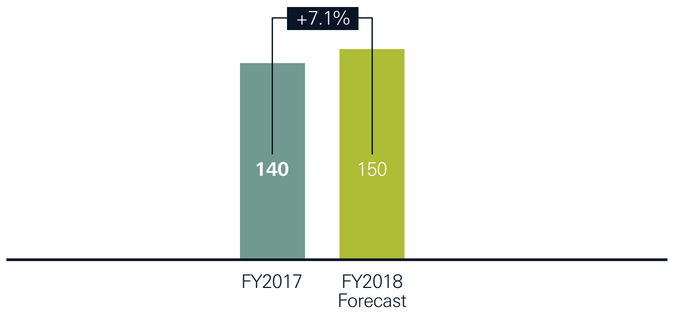
* As its financial policy, the Company maintains a solid balance sheet. This provides the capacity to withstand any adversity arising out of a volatile environment, such as an economic crisis. It also allows for sufficient flexibility to capture attractive investment opportunities.

** The Company monitors global FMCG companies which have a stakeholder model similar to our '4S' model, and have realized strong business growth.

Adjusted Operating Profit (JPY BN)



Dividend Per Share (JPY)



Forecast for FY2018

On a consolidated basis, we target to grow our KPI which is adjusted operating profit at constant FX by 3.7% year-on-year, driven by a persistent level of the profit growth in the international tobacco business and continuous profit contribution in the pharmaceutical and processed food businesses. On a reported basis, adjusted operating profit is forecast to grow 2.5%, as we expect a slight negative FX impact mainly due to the yen appreciation.

In the international tobacco business as the profit growth engine of the JT Group, we expect to return to the topline growth led by robust pricing in the various markets and volume increase driven by geographical expansion, namely acquisitions and the growing contribution from emerging markets. Adjusted operating profit at constant FX is expected to grow as much as 14.7%† year-on-year, mainly driven by the top-line growth in combination with a favorable comparison due to the absence of one-time loss, which happened in prior year.

† Excluding the favorable comparison, we forecast a profit growth of 8%

In the Japanese Domestic Tobacco business, adjusted operating profit is forecast to decline by 13.0% year-on-year. We expect that the negative impacts of the cigarette sales decline and an increased spending for nationwide expansion of Ploom TECH will outweigh the sales growth of Ploom TECH. The pharmaceutical and processed food businesses are expected to achieve continuous profit contribution and aim to fulfill its role as complement profit growth of the JT Group.

Based on the shareholder return policy, we are expecting an annual dividend per share of 150 yen, representing 7.1% increase year-on-year.

Role and Target of Each Business

The mid- to long-term role and target of each business are:

- prioritize quality top-line growth
- competitive cost base
- robust business foundation.

Tobacco Business

We aim to grow adjusted operating profit at constant FX at mid- to high single-digit growth rate over the mid- to long-term.

International Tobacco Business

Continue to strengthen its role as the Group's profit growth engine.

Japanese Domestic Tobacco Business

Maintain its highly competitive platform of profitability.

Pharmaceutical Business

Aim to make stable profit contribution to the JT Group through R&D promotion for the next generation of strategic compounds and maximize value of each product.

Processed Food Business

Aim to make further profit contribution to the JT Group through mid- to long-term profit growth driven by quality top-line growth.

Performance Measures

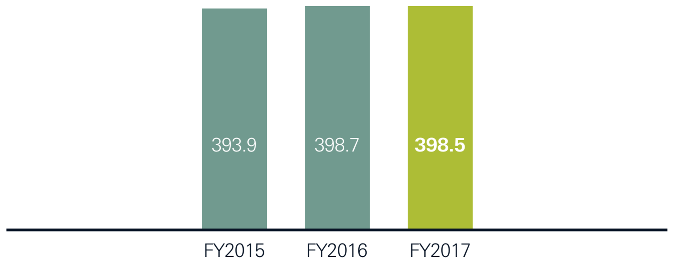
FY2017: Results for the fiscal year ended December 31, 2017

In our Business Plan 2018, a target is set for adjusted operating profit growth rate at constant exchange rates. While it is a mid- to long-term target, we also monitor the performance measures annually.

In our strategic framework to achieve adjusted Operating Profit growth, the JT Group places a particular emphasis on 'quality top-line growth', while, at the same time, focusing on building a 'competitive cost base' and 'robust business foundation'. In line with our strategic emphasis, the measures to review our business performance are skewed towards top-line related indicators. As for shareholder return, we will deliver sustainable and steady increase of dividend per share.

Tobacco Sales Volume

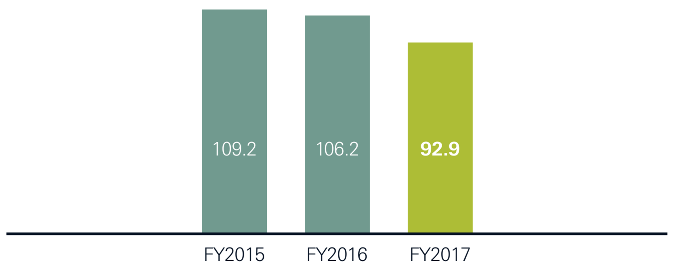
International Tobacco (BnU)



-0.1% to 398.5 BnU

For the international tobacco business, total shipment volume includes fine cut, cigars, pipe tobacco, snus and kretek, but excludes contract manufactured products, waterpipe tobacco products and Reduced-Risk Products.

Japanese Domestic Tobacco (BnU)



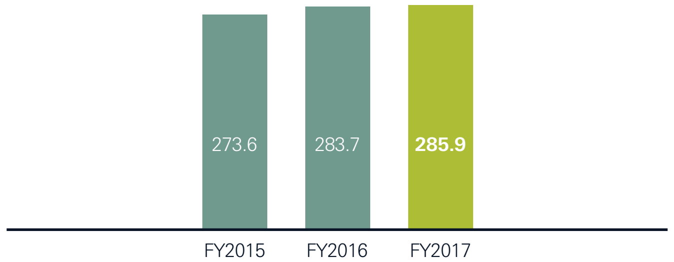
-12.5% Year-on-Year

92.9 BnU

For Japanese Domestic Tobacco, total sales volume excludes sales volume of Japanese domestic duty free, the Chinese business and Reduced-Risk Products.

GFB Shipment Volume

GFB Shipment Volume (BnU)

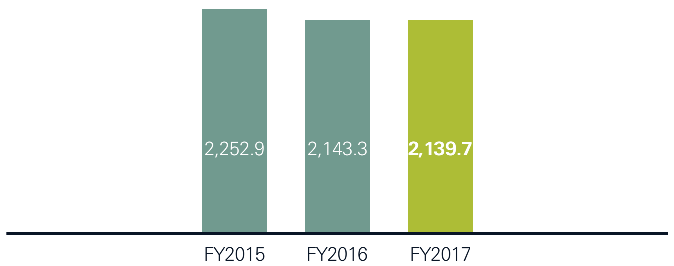


+0.8% to 285.9 BnU

Shipment volume of GFBs, namely Winston, Camel, MEVIUS, LD, B&H, Silk Cut, Glamour, Sobranie and Natural American Spirit in the international tobacco business.

Consolidated Revenue

Revenue (JPY BN)



-0.2% to

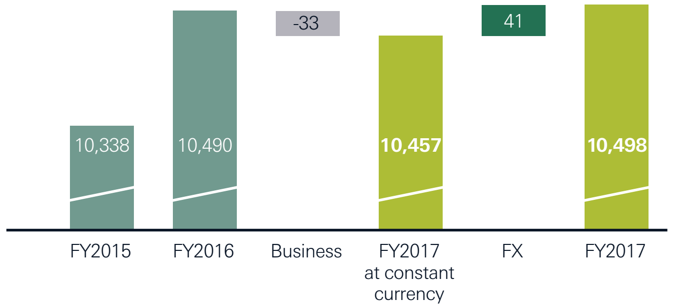
2,139.7 BN

Revenue on a consolidated basis which, for the avoidance of doubt, excludes excise and other similar taxes, as well as sales from transactions in which the JT Group acts as an agent.

Note: The figures of FY2015 were the results from continuing operations only.

Core Revenue

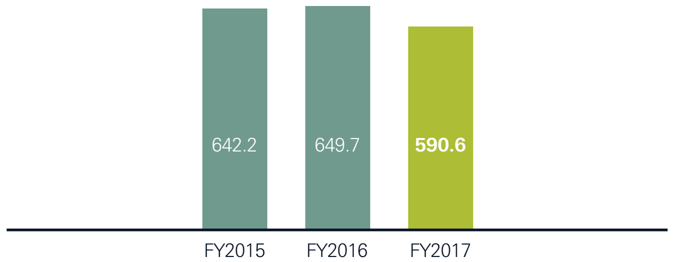
International Tobacco (US$ MM)



-0.3% at constant exchange rates to US$10,457 MM

For the international tobacco business, US dollar-based core revenue includes revenue from waterpipe tobacco products and Reduced-Risk Products, but excludes revenues from distribution, contract manufacturing and other peripheral businesses.

Japanese Domestic Tobacco (JPY BN)

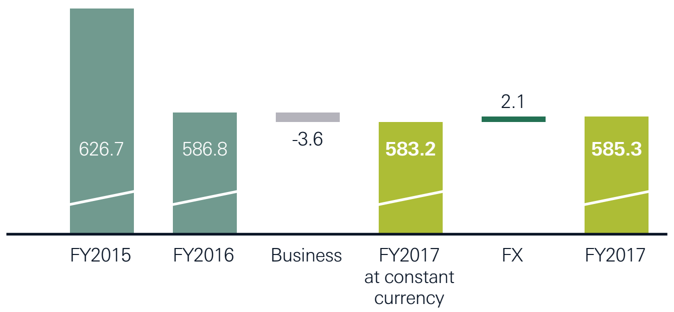


-9.1% to JPY 590.6 BN

For the Japanese Domestic Tobacco business, core revenue excludes revenue from distribution of imported tobacco in Japan, among others, and includes revenue from domestic duty free, the China business and Reduced-Risk Products such as Ploom TECH device and capsules.

Consolidated Adjusted Operating Profit

Adjusted Operating Profit (JPY BN)



-0.6% at constant exchange rates to JPY 583.2 BN

-0.3% including currency impact to JPY

585.3 BN

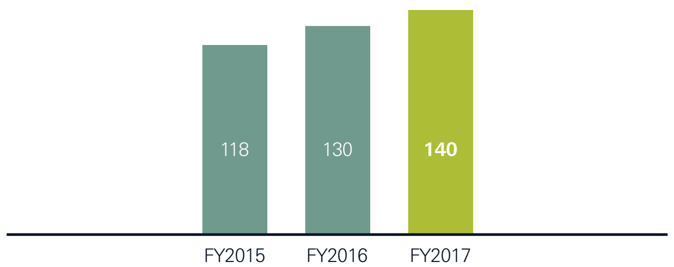
Adjusted operating profit is calculated as follows: Adjusted operating profit = operating profit + amortization cost of acquired intangibles arising from business acquisitions + adjustment items (income and costs)*

* Adjustment items (income and costs) are impairment losses on goodwill, restructuring related income and costs and others.

Note: The figures of FY2015 were the results from continuing operations only.

Dividend Per Share

Dividend Per Share (JPY)



+10 yen to

140 yen

The sum of interim and year-end dividends per share, the record dates of which fall in the relevant fiscal year.

Please be reminded that this section is intended to explain the business operations of JT to investors, not to promote sales of tobacco products to encourage smoking by consumers.

Industry Overview

Tobacco Business

Tobacco Industry

Market Dynamics

There are many types of tobacco products available in today's marketplace. Cigarettes remain the most popular choice for consumers, while fine cut, cigars, pipe tobacco, snuff, chewing tobacco and waterpipe tobacco continue to draw consumers' interest, with some of these product categories increasing their volumes worldwide.

In addition, Reduced-Risk Products* have become widely popular. In particular the market size of 'E-Vapor' products or 'Electronic Cigarettes (e-cigarettes)' has been expanding at a fast rate notably in the US and Europe. The products use vaporized liquid solutions often containing nicotine, and vapor is inhaled to offer a different experience. As E-Vapor products do not use tobacco leaf, they are usually not regulated or taxed as tobacco products, however, regulation or taxation of E-Vapor products vary across markets.

Another type of Reduced-Risk Products* referred to as 'T-Vapor' or 'Tobacco Vapor' has been growing particularly in Japan. Unlike E-Vapor, T-Vapor products use tobacco leaf and are therefore taxed and regulated as tobacco products in principle. We expect further innovation and product offerings will drive growth in T-Vapor category, as market players take keen interest in this new growing market.

Approximately 5.5 trillion cigarettes are consumed around the world, reaching global sales of approximately US$700 billion. China is by far the largest market, accounting for over 40% of global consumption, but it is almost exclusively operated by a state monopoly. Indonesia, Russia, the US and Japan are the next four largest markets, according to a survey conducted in 2017.**

In general, the market dynamics of cigarettes are distinctively different between mature and emerging markets. In mature markets, industry volume tends to decline reflecting various factors such as limited economic growth, tax increases, tightening regulations, and demographic changes, among others. In addition, down-trading is prevalent in these markets. Consumers are inclined to seek more value as they feel tobacco products become less affordable in the context of limited growth of disposable income.

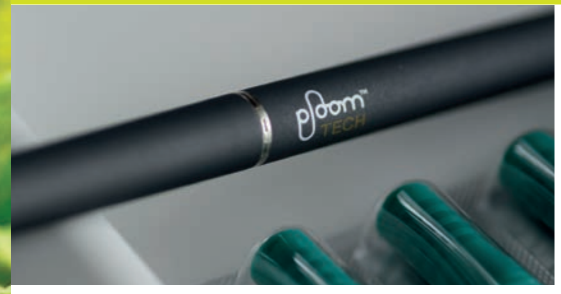
In emerging markets, on the other hand, total consumption tends to increase, driven by population growth and economic development, particularly in Asia, the Middle East and Africa. As their disposable income increases, consumers look for quality and trade up to products in higher price bands.

* Reduced-Risk Products (RRP): Products with the potential to reduce the risks associated with smoking.

Overall, global cigarette industry volume has been slightly decreasing in 2017.** However, more importantly, industry value continues to grow even in the current difficult operating environment, mainly driven by price increases. This is a sign of the resilience of the industry. These trends – decline in volume and increase in value – are expected to continue in the years ahead.

** Source: JT estimate (2016 data, as of December 2017).

"Reduced-Risk Products* have been expanding at a fast rate in markets such as the US and Europe, Japan reaching global sales of approximately US$12 billion."



Top market players

	Share of market (%)				
	2013	2014	2015	2016	2017
Philip Morris International Inc.	24.5	24.5	24.9	24.7	24.7
British American Tobacco Plc.	17.9	18.3	19.1	19.4	20.5
Japan Tobacco Inc.	14.1	13.8	13.7	14.2	14.7
Imperial Brands Plc.	6.4	6.3	6.7	6.5	6.5

Source: JT estimate (2017 data, as of Aug 2018).
Excluding China National Tobacco Corp (CNTC).

Top 10 countries by cigarette volume

	Billion units				
Country	2013	2014	2015	2016	2017
China	2,490.5	2,549.5	2,489.5	2,350.5	2,368.9
Indonesia	308.3	314.3	320.4	316.1	308.2
Russia	346.3	316.2	292.5	278.9	258.9
USA	279.5	270.6	269.9	262.5	252.7
Japan	194.1	186.2	182.3	173.8	151.4
Turkey	91.7	94.7	103.2	105.5	106.2
Egypt	80.2	83.2	86.4	90.0	93.1
Bangladesh	78.6	80.6	83.4	86.1	88.9
India	100.9	95.9	88.1	84.9	81.3
Germany	79.6	80.3	80.0	78.2	79.0

Source: JT estimate (2017 data, as of Aug 2018).

* Reduced-Risk Products (RRP): Products with the potential to reduce the risks associated with smoking.

Regulations

The regulatory environment continues to be more restrictive for the tobacco industry. Restrictions on promotions and advertisements are the most common around the world. An increasing number of markets are introducing bans on smoking in public places and promoting larger health warnings on product packaging, in some cases with pictorial health warnings. There are also some markets where displaying tobacco products at retail stores is banned.

Recent regulations are focusing more on the product itself. Plain packaging, or branding ban, have been introduced in some markets and furthermore, regulators are becoming more aggressive by restricting ingredients and emissions, following the guidelines on these attributes proposed by the Framework Convention on Tobacco Control.

In Europe, all members states have already implemented the new Tobacco Products Directive, which adopted extended health warnings, minimum packaging requirements or restrictions on the use of additives, among others. EU Member States have started implementing these restrictions. These moves to commoditize tobacco products will undermine fair competition among tobacco manufacturers trying to meet increasingly diverse consumer preferences. Worse, they could result in an undesired increase in illicit trade, as commoditized products with less uniqueness are easier to counterfeit and more difficult to detect when smuggled.

Recently new standards or frameworks for reduced risk claims have been established in a few countries such as the US and parts of Europe. In order to gain official approval from governments, activities in developing reduced risk claims have been intensified among major global tobacco manufacturers.

Taxation

Tobacco products are subject to excise or similar taxes in addition to value-added tax in most countries as governments seek to secure their revenue or promote public health. Excise taxes were raised in various markets during the past year, including for vapor products, and in general, tax increases are passed onto prices. Therefore, repeated tax increases in a short period of time, or steep tax increases, could lead to a decline in industry volume. Often, tax increases coincide with an increase in illicit trade, which could in turn affect our business.

Competition

Excluding China, two-thirds of world industry volume is produced by four major global tobacco companies, namely Philip Morris International Inc., British American Tobacco Plc., Japan Tobacco Inc. and Imperial Brands Plc.* The competition within the industry is intense and, as consumers' needs and preferences continue to diversify, a strong portfolio with established brands is increasingly important to support market share gains. Therefore, major global companies are focusing on brand equity enhancement to strengthen their brand portfolios by introducing innovative products. Competition in the Reduced-Risk Products (RRP)** category has been intensifying as recently the products have subsequently been launched in many markets.

In addition to the pursuit of organic growth, M&A is an effective way to supplement growth opportunities in this industry.

* Source: JT estimate (2016 data, as of December 2017).
** Reduced-Risk Products (RRP): Products with the potential to reduce the risks associated with smoking.

Top brands

		Billion units				
Brand	**We Own**	**2013**	**2014**	**2015**	**2016**	**2017**
Marlboro		395.9	391.4	392.5	384.0	365.4
Winston*	✓	140.8	132.6	135.0	141.5	146.7
Pall Mall		105.7	110.1	109.3	108.2	118.3
L&M		98.6	98.7	103.2	102.4	97.1
Camel*	✓	62.7	66.8	71.0	71.5	71.1
Rothmans		25.8	34.8	50.5	69.2	77.5
Cleopatra		53.7	56.2	59.3	65.9	68.7
Mevius	✓	83.7	79.1	77.3	76.2	68.6

Source: JT estimate (2017 data, as of Aug 2018).
Excluding China National Tobacco Corp (CNTC).
* Winston and Camel are also owned, respectively, by Imperial Brands Plc. and Reynolds American Inc. in the US.

Pharmaceutical Business

Market dynamics

The global pharmaceutical market continues to grow, reaching sales of approximately US$1,105 billion in 2016.* Advanced countries lead the global pharmaceutical market. North America is the largest market and accounts for approx. 44% of the worldwide market.* In emerging countries, demand for advanced medicine is also rapidly growing due to multiple factors including growing consciousness of health, increase in population, and development of public healthcare systems, among others. Facing a rapidly aging society and a fiscal deficit, the governments in these markets try to control drug prices and hold back medical costs.

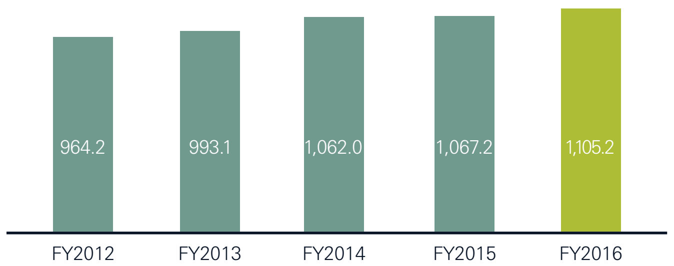
In Japan, the main market for our pharmaceutical business, the majority of net sales comes from originator drugs. The Japanese generic drugs market share for prescription drugs is still small compared with that in the US and Europe. However, its market size has been expanding more recently due in part to government promotion of generic drugs in order to control medical care expenses. The drug pricing reform package would be in effected such as an annual drug price revisions, limiting the number of price maintenance premium drugs and a price reduction of long-listed drugs according to replacement rate will bring us to difficult circumstances.

Competition

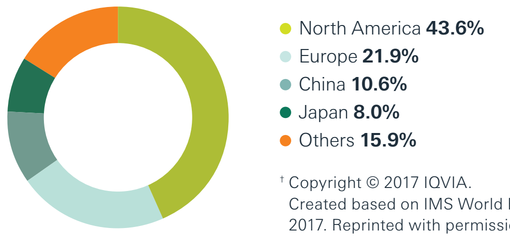
Global competition for creating an innovative drug is becoming more and more difficult, because searching for new drug targets has become harder and the regulatory standard for new drug approval has become stricter than before.

We build an R&D-led business and aim at original compounds internationally competent, therefore we are competing with not only Japanese domestic makers but many foreign companies including global mega pharma and start-up companies.

Worldwide Pharmaceutical Market* (USD BN)



2016 Regional Composition†



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Processed Food Business

Market dynamics

The size of Japanese frozen food market in 2016 (on a consumption basis including imports) was ¥989.4 billion, down 2.6% year-on-year. Annual consumption was 2,728,211 tons, increased 1.7% year-on-year, but the volume gain was not enough to offset the effect of foreign exchange (Source: Japan Frozen Food Association).

Regarding the domestic production of frozen food, in 2016 the volume hit an all-time high of 1,554,265 tons but the production monetary amount was stabilized because the effect of foreign exchange reduced the cost of raw materials.

We expect the Japanese processed food industry to continue to grow, due to increasing number of one-person households and the progress of women's social advancement.

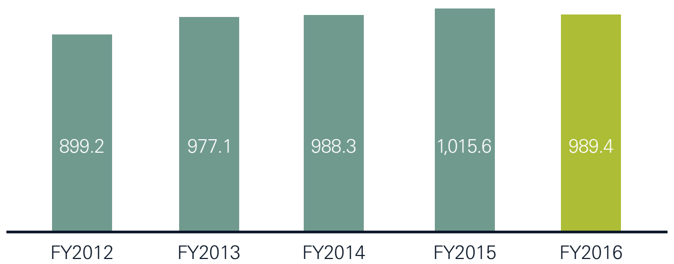
We must deal with not only fluctuations in exchange rate and prices of raw materials but the recent trend of our sales channels including wholesalers and retailers, especially their business integration. Their movement significantly impact our business.

Competition

TableMark is competing against major players like Maruha Nichiro, Nichirei, Ajinomoto and Nissui as well as a multitude of mid- or small-scale producers.

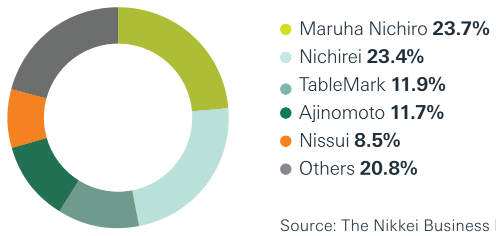
We are seeing a polarization of retailers as well as reorganization and oligopolization of the wholesale sector led by sogo shosha, the general trading companies, resulting in stronger price negotiation power against manufacturers. We are also seeing the expansion of own-brand products deployed in major retail companies.

Japanese Frozen Food Market (JPY BN)



Source: Japan Frozen Food Association.

2016 Share of Market by Frozen Food Manufacturer



Source: The Nikkei Business Daily.

Review of Operations

International Tobacco Business

FY2017: Results for the fiscal year ended December 31, 2017

Key Highlights

Total Shipment Volume	Global Flagship Brands Volume
398.5 (BnU)	285.9 (BnU)
-0.1% Year-On-Year Change	+0.8% Year-On-Year Change

Core Revenue	Adjusted Operating Profit
10,498 (USD million)	3,138 (USD million)
+0.1% Year-On-Year Change	+1.4% Year-On-Year Change
-0.3% Year-On-Year Change At Constant Currency	+4.0% Year-On-Year Change At Constant Currency

In 2017 we delivered on the full-year targets while further investing to strengthen our foundations for sustainable long-term growth. We entered 2018 with positive momentum, stronger business fundamentals and a highly talented team with a winning mindset, making me confident in our ability to maximize new growth opportunities ahead.

Last year we continued to gain share in many markets and strongly grew our Global Flagship Brands (GFB) volume. Winston and Camel achieved double-digit volume growth in 38 and 26 markets, respectively, a remarkable result given the challenging operating environment.

Our two sizeable acquisitions in Indonesia and the Philippines boosted our total volume and strengthened the outstanding organic growth in Asia Pacific. Iran was also a key contributor, with Winston achieving record volume and share supported by our superior in-market capabilities.

The planned price and portfolio investments paid off, strengthening our competitiveness in selected markets. In Russia, we returned to market share growth, consolidating our No. 1 position. In the UK, we exited 2017 with positive market share momentum in both cigarettes and fine cut categories despite intense competition. These results reconfirm the strong equity of our brands when it comes to consumer choice.

Another important contributor to our performance in 2017 was cost management. The benefits generated by the supply chain efficiencies were key to deliver on our profit growth target. These initiatives enabled JTI to have more efficient and flexible operations, notably in Europe and Asia Pacific.

For 2018, the operating environment is expected to remain challenging with excise tax increases fueling industry volume contraction and down-trading. In spite of that, we anticipate a year of strong revenue and profit growth at constant currency, driven by positive volume, continued GFB momentum, favorable pricing as well as increasing contribution from emerging markets and Reduced-Risk Products.

"We are committed to be the fastest growing and most responsible company in our industry."

Eddy Pirard
Chief Executive Officer, JT International

Roadmap to Sustainable Growth

Our ambition is to be the most successful and responsible tobacco company of the world. As a result, JTI remains fully committed to generate sustainable long-term growth, both in conventional and Reduced-Risk Products.

In the former, we will seize market share opportunities through continued investments behind our people, brands and capabilities. We have made decisive acquisitions in Asia and more recently in Ethiopia that will support our footprint expansion and complement the GFB efforts in markets that matter. We will keep pursuing relevant business development opportunities going forward.

In Reduced-Risk Products, we will enhance our consumer offering and presence in this rapidly evolving category, both in terms of geographies and products, focusing on anticipating future consumer needs.

In the area of talent management, we will continue to deploy a series of programs to enhance our people empowerment and accountability, which are key to boost our business agility, innovation and speed-to-market.

We believe that by focusing and prioritizing our combustible investments in markets that matter, accelerating our efforts in Reduced-Risk Products and empowering our talented employees, JTI will continue to achieve sustainable growth over the long-term period.

2017 Performance Review

Volume & Share

Total shipment volume was stable, declining 0.1% to 398.5 billion cigarette equivalent units, supported by strong organic volume growth in Brazil, Egypt, Iran, the Philippines and Tunisia, acquisitions in Indonesia and the Philippines, as well as market share gains in the key markets of France, Russia, Spain and Taiwan. Excluding acquisitions and unfavorable inventory movements, total shipment volume declined 1.6%, and 2.1% when excluding acquisitions only.

The volume performance in Rest-of-the-World was strong, primarily driven by our exceptional organic growth in Iran and the successful acquisitions in Indonesia and the Philippines. In South & West Europe and North & Central Europe, although industry contraction and intense competition resulted in total volume declining, JTI closed the year with improving market share trends in a number of markets, including the UK. In CIS+, despite total volume declining due to industry contraction, our share increased in several markets, including Russia, where Winston and LD achieved new share records.

GFB shipment volume grew for the fourth consecutive year, increasing 0.8% to 285.9 billion cigarette equivalent units, driven by share gains in both key and emerging markets. Winston and Camel were the main growth drivers, continuing their positive share momentum across JTI's Top30 markets.

In Rest-of-the-World cluster, GFB volume grew strongly driven by share gains in markets like Brazil, Iran and the Philippines, where the organic expansion was facilitated and supported by our acquisitions and improved distribution networks. In South & West Europe, North & Central Europe and CIS+, GFB market share gains could not offset the impact of industry volume contraction.

Total and GFB Volume

BnU	South & West Europe	North & Central Europe	CIS+	Rest-of-the-World	Total JTI
Total shipment volume	64.2	51.8	133.0	149.5	**398.5**
GFB shipment volume	57.9	32.7	104.3	91.0	**285.9**

Across our Top30 markets, in 2017 JTI's market share achieved 27.1%, increasing 0.3 percentage points versus prior year, while GFB market share was up 0.7 percentage points to 19.6%.

This excellent performance, notably in the key markets of Russia, France, Spain and Taiwan, demonstrates once again the strength of our GFB portfolio and the value of our equity building initiatives.

Across our Top30 markets, we grew total and GFB share of value to 24.8% and 18.0%, respectively.

Financials

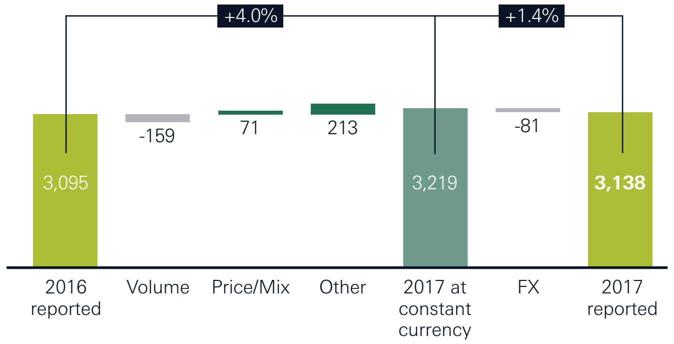
Core revenue performance was in line with expectations. The strong growth in several emerging markets, such as Iran and the Philippines, did not offset the impact from price and portfolio investments in the key markets of Russia and the UK. As a result, core revenue at constant currency declined 0.3%, despite a positive price/mix contribution of US$90 million mainly coming from the Rest-of-the-World cluster (Iran, Canada, Turkey and the Philippines).

Excluding the impact of a non-recurring loss related to a key UK distributor entering into administration, adjusted operating profit at constant currency increased 9.9%, driven by cost optimization and price/mix gains. Otherwise, adjusted operating profit grew 4.0% at constant currency. The benefits generated by the supply chain efficiencies were key to deliver on our 2017 profit growth target.

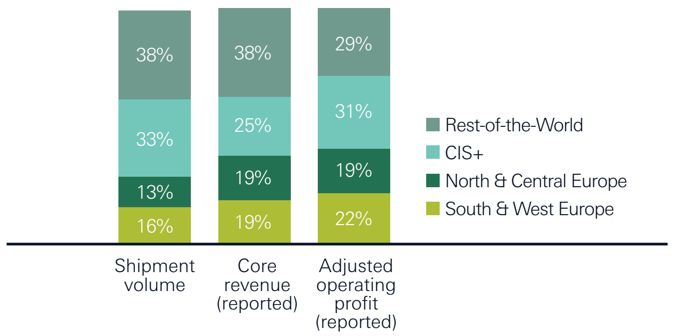
The planned initiatives to optimize our manufacturing footprint generated savings in excess of US$150 million in 2017. These initiatives also enabled JTI to have more efficient and flexible operations worldwide. Last year we also benefitted from lower leaf and non-tobacco material costs, which combined generated savings close to US$150 million. Leaf costs benefitted from a favorable purchasing price while non-tobacco material costs decreased due to improved economies of scale.

South & West Europe and CIS+ delivered high single-digit adjusted operating profit growth at constant currency, while Rest-of-the-World's contribution grew double digit versus prior year. In North & Central Europe, adjusted operating profit decreased, mainly due to the UK being impacted by a non-recurring loss of US$182 million and intense price competition.

Adjusted Operating Profit (US$ MM)



Cluster Breakdown



2017 Key Highlights

Investments That Matter

In 2017, we continued to invest in both key and emerging markets in order to strengthen our business fundamentals and competitiveness in the combustible business.

Investments were primarily focused on further enhancing our GFB portfolio and equity, as well as expanding our distribution network and trade partnerships.

In the key markets of Russia, Taiwan and the UK, we reinforced our leading positions. In emerging markets, such as Brazil, Iran and the Philippines, our GFB investments drove strong volume growth and market share gains.

In addition to our efforts in the combustible business, we invested significantly behind Reduced-Risk Products. We focused on Logic and Ploom in markets that together represent approximately 80% of the vapor category's global retail value (excluding Japan and China). Throughout the year, we launched our vapor propositions in five new markets and expanded our presence to 12 countries outside Japan.

Our focused investment strategy provided JTI with a more balanced and competitive business base, which will be key to accelerate our sustainable growth in 2018 and beyond.

Expanding the Business Footprint

To complement our organic growth, we have broadened our business footprint through three acquisitions during 2017.

In September 2017, we acquired the assets related to the tobacco business of Mighty, the second largest tobacco company in the Philippines. This deal consolidated our business foundation through expanded distribution and a strengthened brand portfolio, enabling JTI to reach a 29% share in one of the largest tobacco markets worldwide.

In October 2017, we completed the acquisition of a kretek cigarette company (PT. Karyadibya Mahardhika) and its distributor (PT. Surya Mustika Nusantara) in Indonesia, further expanding our footprint in the thriving South-East Asia region. This deal provided JTI with immediate scale and enhanced presence in the Indonesian kretek category, which accounts for nearly 94% of the market. It also provides JTI with an expanded distribution platform to fuel our GFB future growth.

Lastly, in December 2017 we signed a share purchase agreement with the Ethiopian Government for approximately 30% of the total shares in National Tobacco Enterprise Share Company (NTE), bringing our total share ownership to over 70%. This deal, following our past acquisitions in Iran (2015) and Sudan (2011), further strengthened our presence in the fast growing region of Middle East & Africa.

Our People, the Cornerstone of our Growth

JTI's focus on people is long-term, as we firmly believe a sustainable growth can only be achieved by attracting and empowering the best talents. Our company is international and opportunities are vast. We always welcome fresh thinking and new ideas.

Following the 2017 acquisitions, we have now more than 39,000 talented employees representing more than 100 nationalities, a significant point of strength to win in a diverse and changing environment.

Our people drive our success – that is why we are dedicated to offering the most rewarding careers in the best workplaces around the world. We continuously invest in our people, setting high standards and fostering a diverse work environment where they feel empowered and accountable. This approach allows JTI to attract new talents and maximize their contribution across the business.

Our best-in-class human resources practices are acknowledged by several certifications around the world. In 2018 and for the fourth consecutive year, JTI was certified as Global Top Employer, with awards in 50 countries around the world and ranking No. 1 Top Employer in Europe, North America and Asia Pacific regions.

Our People
JTI celebrating the Global Top Employer award in the official ceremony in Amsterdam, February 2018.

For more information, please visit
https://www.jti.com/

2018 Outlook

Industry volume will remain challenging in 2018. We expect continued contraction in Russia, broadly in line with last year's trend, and accelerated declines in markets such as France, Taiwan and the UK, mainly due to excise tax increases.

In 2018, we target robust total volume growth of approximately 4% as we benefit from the volume contribution from our acquisitions in Asia and more recently in Ethiopia.

To strengthen our portfolio's competitiveness and trade effectiveness, we will narrow our GFB focus from nine to four brands: Winston, Camel, LD and Mevius. These four brands will grow volume by approximately 2%, keeping our GFB mix in total volume above 60%.

The positive volume performance will, together with improved pricing gains and increased contribution from Reduced-Risk Products, enable JTI to achieve strong core revenue and adjusted operating profit growth in 2018. On a constant currency basis, these are expected to increase by 8.1% and 14.7%, respectively.

To ensure long-term competitiveness and sustainable growth, we will continue to focus our investment strategy on GFB portfolio, emerging markets and Reduced-Risk Products.

Our Portfolio*

Global Flagship Brands (GFB)

Our four GFBs are amongst the world's most iconic and best-known tobacco brands, and they are the core of our portfolio and investment strategy.

Winston

Global sales
144.3 BnU

Winston is the leading brand of the JTI portfolio. Launched in 1954, Winston became the world's second biggest cigarette brand as of 2007. Following its 2017 introduction in Laos and Ivory Coast, Winston is now present in more than 130 markets and in 27 of these it sells more than 1 billion cigarette equivalent units per year.

In 2017, Winston's volume grew 3.5% to 144.3 billion cigarette equivalent units, and recorded double-digit volume growth in 38 markets. Its strong performance was driven by a comprehensive portfolio architecture comprised of two sub-families – Core and XS.

Winston Core family, of which the lead styles are Winston Blue and Red, is Winston's global bestseller. The XS family, which grew more than 30% in 2017, is a more progressive range with a refined taste signature and features such as the LSS technology (Less Smoke Smell). Its growth was driven by the Compact line extensions and the success of its Flavor-on-Demand propositions in many markets, including Russia.

Winston grew share in 34 markets, achieving records in 22 of them, including Iran, Russia, Spain and Taiwan. As a result, Winston further strengthened its market share across JTI's Top30 markets, growing 0.5 percentage points to 10.3%.

CAMEL

Global sales
52.7 BnU

Camel is the world's most inspiring tobacco brand since 1913, a global icon of creativity with over 100 years of tobacco experience and a distinctive taste signature. Following its introduction in Colombia, Dominican Republic and Guatemala, Camel is sold today in more than 100 markets. In 13 of these markets, Camel's annual sales are over 1 billion cigarette equivalent units.

In 2017, Camel grew volume and share for the fourth consecutive year. The brand reached 52.7 billion cigarette equivalent units, an increase of 1.1% versus 2016, and achieved double-digit volume growth in 26 markets. This positive volume performance was driven by the strong contribution of several emerging markets, notably Brazil, the Philippines, Thailand and Tunisia.

Last year, Camel's portfolio was strengthened with new consumer-relevant propositions, such as Camel Kretek in Indonesia. Such initiative enabled the brand to enter a compelling category in one of the largest Asian markets.

Camel grew share in 25 markets in 2017, with solid growth momentum not only in its European strongholds (Austria, Belgium, Czech Republic, Luxembourg, France, the Netherlands and Spain) but also in many emerging markets, such as Brazil, Lebanon and the Philippines. As a result, Camel exited 2017 having reached a 3.8% share in our Top30 markets, up 0.2 percentage points versus prior year.

* In line with the 2018 GFB classification.

Specialist Flagship Brands (SFB)

Our Specialist Flagship Brands address more specific local needs of consumers all over the world.

BENSON & HEDGES

Global Sales
12.7 BnU

Originally established in 1873, Benson & Hedges has a proud British heritage. In 2017, B&H's volume declined 5.4% to 12.7 billion cigarette equivalent units, keeping its market share stable at 1% in JTI's Top30 markets.

Glamour

Global Sales
5.3 BnU

Glamour is JTI's leading super slims brand introduced in 2005. In 2017, mainly due to the industry size contraction in Russia, its volume declined 9.8% to 5.3 billion cigarette equivalent units.

LD

Global sales

45.6 BnU

LD is one of the top bestselling tobacco brands in the world and a key value proposition globally. LD is now present in more than 50 markets following the 2017 launch in Jordan, Malaysia, Maldives and Palestine.

In the highly competitive value segment, LD delivered 45.6 billion cigarette equivalent units in 2017. Industry size contractions in CIS+ resulted in a volume decrease of 4.2% versus prior year. Excluding the impact of Ukraine, LD's volume would have increased 0.2%, mainly led by Russia. In the Rest-of-the-World cluster, LD volume continued to grow at double-digit rates.

The brand achieved its highest ever share in nine markets, including Canada, Kazakhstan, Latvia, Russia and Singapore. In Russia, despite the market contraction, LD reached a record share of market of 7.8%, up 2 percentage points versus prior year. Overall, LD reached a 2.7% market share in JTI's Top30 markets, up 0.1 percentage points versus prior year.

MEVIUS

Global sales

17.8 BnU

Launched as Mild Seven in 1977 and rebranded in 2013, Mevius is the top-selling brand in Japan with over 30% market share. Internationally, Mevius enjoys consumer popularity in several Asian markets, as demonstrated by the record market share achieved in 2017 in Cambodia, Malaysia, Myanmar, Singapore and South Korea.

Mevius' volume decreased by a modest 0.9% in 2017, mainly due to industry volume contraction in Taiwan following an excise tax increase. Excluding this impact, its volume would have increased by 6.1%, driven by a robust performance in Malaysia and South Korea, and by an expanded presence in many emerging markets, such as Cambodia, Indonesia, Myanmar and Vietnam.

The brand continued to grow its share of the premium segment in its top Asian markets. In Taiwan, Mevius remained the No. 1 brand with a share of market of 21.3%, strengthening its leadership in premium by exceeding a 60% share of segment. In JTI's Top30 markets, Mevius' market share reached 0.8%.

* In line with the 2018 GFB classification.

SOBRANIE

Global Sales

3.2 BnU

Since 1879, Sobranie constantly reinvents the prestige tobacco experience offering elegantly crafted cigarettes. In 2017, Sobranie grew volume by 10.5% to 3.2 billion cigarette equivalent units.

SILK CUT

Global Sales

2.2 BnU

Launched in 1964, Silk Cut delivers a refined statement of timeless elegance through premium tobacco experiences. In 2017, Silk Cut volume declined 10.3% to 2.2 billion cigarette equivalent units due to industry volume contraction in Ireland and the UK.

NATURAL AMERICAN SPIRIT

Global Sales

2.1 BnU

Natural American Spirit offers a unique positioning as the only global exclusively 'additive-free' premium cigarette. In 2017, its volume grew 5.7% to 2.1 billion cigarette equivalent units.

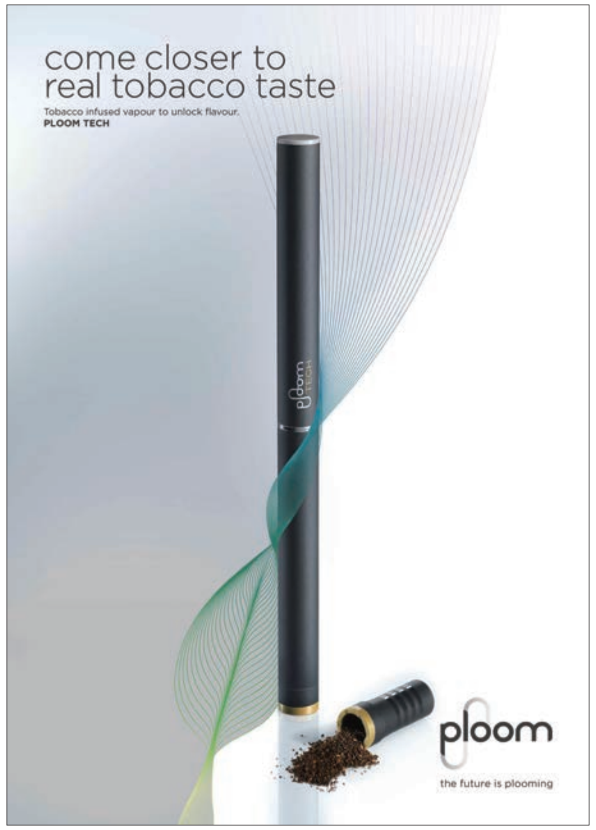
Please be reminded that this section is intended to explain the business operations of JT to investors, not to promote sales of tobacco products to encourage smoking by consumers.

Reduced-Risk Products

Vapor products and its subcategories E-Vapor (e-cigarettes) and T-Vapor (including Heated Tobacco and Tobacco-Infused Vapor) have become an established category in their own right.

Reduced-Risk Products* have potential to reduce the risks associated with smoking, as they come with no combustion, thus generating no smoke. We believe that Reduced-Risk Products* enhance consumers' satisfaction and offer real benefits to shareholders, society and our business.

In the T-Vapor category, Ploom TECH, our Tobacco-Infused Vapor product that warms tobacco at low temperature, was made available on a trial-basis in 2017 in three markets outside Japan: US**, Canada and Switzerland, with positive feedback from consumers.



In the E-Vapor category and under the Logic brand, we have a comprehensive e-cigarette portfolio including cig-a-likes (Logic Power), closed tanks (Logic Pro) and open tanks (Logic LQD) systems with high quality e-liquids. By the end of 2017, Logic was present in 10 markets including the US, the largest vapor market in the world, and the UK, where Logic Pro was recognized as 'Product of the Year' in a Consumer Survey of Product Innovation.

While the E-Vapor category is evolving rapidly from a product and regulatory standpoint, JTI is already a main player in some of the biggest markets for these products. In the US, we hold an 8% share of value in this category. Logic Pro is also the No. 1 brand in the closed tank segment in the UK, France and in Ireland – where JTI is as well the leading E-Vapor company – with shares of value of 11.5%, 28.6% and 25.6%, respectively.

For more information about our Reduced-Risk Products, please visit **https://www.jti.com/**

In 2017, JT Group had Reduced-Risk* Products offerings in 12 markets (excluding Japan), which together represent ca. 80% of the global retail value (excluding Japan and China) of the total Vapor products category.

We will continue investing strategically in this growing category to strengthen our portfolio and pursue further geographical expansion in selected new markets.

Fine Cut

This category, which encompasses Roll-Your-Own and Make-Your-Own products, in 2017 was impacted by industry contraction and intense price competition, notably in Belgium, Germany and the UK. This led our fine cut volume to decrease 3.0% versus prior year. Nevertheless, in our Top30 markets, our overall market share in the fine cut category reached 23.6%, supported by gains in a number of markets, including the Benelux, France, Italy and Spain.

Shisha

JTI entered the shisha tobacco business in 2013, and since then we have continuously improved the quality of the products, in addition to rationalizing the portfolio, rejuvenating the offering and expanding our presence. In 2017, continued geopolitical tensions in the Middle East, a key geography for shisha tobacco, have caused volumes to decrease by 12.3% to 16,700 tons.

* Reduced-Risk Products (RRP): Products with the potential to reduce the risks associated with smoking.
** In the US, Ploom is sold by Logic Technology Development LLC, a member of the JT Group, under the name 'Logic Vapeleaf'.

Japanese Domestic Tobacco Business

FY2017: Results for the fiscal year ended December 31 2017

Key Highlights

Sales Volume	Core Revenue	Adjusted Operating Profit
92.9 (BnU)	590.6 (JPY BN)	232.3 (JPY BN)
-12.5% Year-On-Year Change	-9.1% Year-On-Year Change	-10.7% Year-On-Year Change

> "We aim to achieve No.1 share of market position in both Reduced-Risk Products* and cigarette categories in 2020. We are committed to maintain our role as a highly competitive platform of profitability for the Group."
>
> **Chito Sasaki**
> President, Japanese Tobacco Business

Cigarette industry volume declined 12.9% and JT cigarette sales volume declined 12.5% year-on-year due to the underlying trend and the expansion of Reduced-Risk Products (RRP).*

Under this situation, as for cigarette market share, our SOM reached 61.3%, an increase by 0.3 percentage points year-on-year, thanks to the solid performance of our core brands, such as MEVIUS and Natural American Spirit. Thus, we further solidified our No. 1 position.

In the RRP* category, we gradually expanded the sales area of Ploom TECH in line with the manufacturing capacity increase, after we launched Ploom Shops and started the sales of Ploom TECH in some parts of Tokyo at the end of June, 2017.

We are planning to start nationwide sales of Ploom TECH in September 2018. Under the continuous challenging business environment in Japan, we aim to gain 40% share of market by the end of 2020 with the expanded portfolio. For this strategy to work, we make sure two things happen: Ploom TECH needs to succeed, and we need to gain share of market from competitors by entering the Heated Tobacco category.

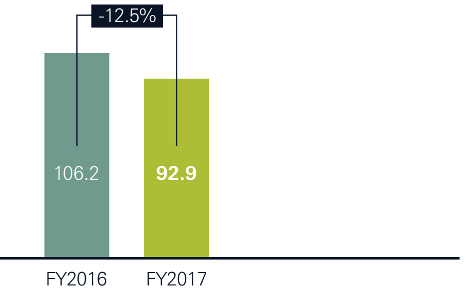
Looking forward, we will maintain our role as a highly competitive platform of profitability for the Group by means of continuous investments in cigarettes and the increased emphasis on RRP* category.

Performance Review (volume/financial)

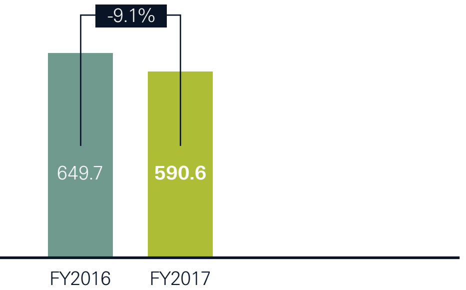
- Revenue and profit decreased due to cigarette industry volume decline.
  - In FY2017, JT sales volume decreased 12.5% to 92.9 BnU mainly due to cigarette industry volume decline.
  - Core revenue decreased 9.1% to 590.6 billion yen mainly because of JT sales volume decrease.
  - Adjusted operating profit decreased 10.7% to 232.3 billion yen affected by revenue decline.

* Reduced-Risk Products (RRP): Products with the potential to reduce the risks associated with smoking.

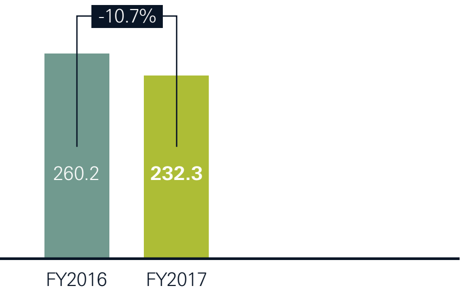
Sales Volume (BnU)



Core Revenue (JPY BN)



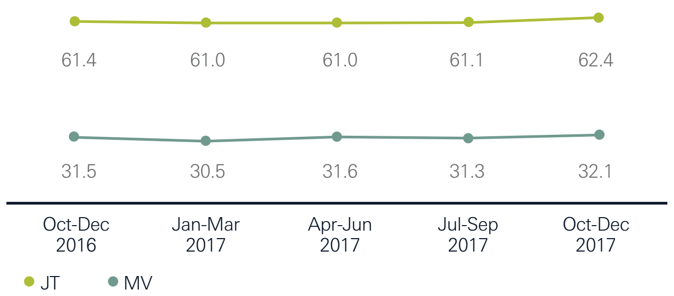
Adjusted Operating Profit (JPY BN)



Performance Review (Market share)

- Our total cigarette market share including core brands such as MEVIUS and Natural American Spirit was resilient in the context of cigarette industry volume decline.
  - In FY2017, JT market share increased 0.3 percentage points to 61.3.

Share Evolution of JT and MEVIUS (%)



Amid the intensifying competition, we continued to invest in sales promotion and brand equity enhancement with a focus on MEVIUS.

As a result, both our total and our MEVIUS brand market shares were resilient over the period.

Furthermore, with the addition of NAS in 2016, we started the production in Japan in July 2017 and sell the new model in October 2017. The market share and volume of Natural American Spirit increased steadily during the year.

1mg Natural American Spirit Organic Leaf ONE unveiled in October 2017.

* Reduced-Risk Products (RRP): products with the potential to reduce the risks associated with smoking.

Please be reminded that this section is intended to explain the business operations of JT to investors,but not to promote sales of tobacco products to encourage smoking by consumers.

Our Strategies

We expect RRP* market in Japan to continue growing while the multi-year excise tax increases and possibly tightening regulations will lead to a continuous cigarette industry volume decline.

Under this business environment, we will fortify our position within the cigarette market as the market leader with an overwhelming share of market. We will consistently enhance consumers' satisfaction through investments in brand equity, especially of four core brands–MEVIUS, Natural American Spirit, Seven Stars and Winston.

Positioning RRP* as the growth driver, we will prioritize this category in allocating resources. By doing so, we will gain No. 1 share of market in the T-Vapor market.

Outlook

In FY2018, revenue and profit are forecast to decrease due mainly to cigarette industry volume decline and increased spending for nationwide expansion of Ploom TECH, despite the sales volume growth of Ploom TECH. In addition, a tax-led price increase in October 2018 is included in the forecast based on certain assumptions.

Despite a challenging business environment, we will not compromise our business investments for the profit growth in 2019 and beyond. We ensure the success of Ploom TECH as well as strengthen our dominant position in cigarette market and thus strive to turn the tables on the competition.

Please be reminded that this section is intended to explain the business operations of JT to investors,but not to promote sales of tobacco products to encourage smoking by consumers.

Our core brands

Prestige
Share of Segment

35.7%

Premium
Share of Segment*

49.5%

Sub-premium+
Share of Segment*

99.9%

Sub-premium
Share of Segment*

32.2%

Natural American Spirit

- The Natural American Spirit brand was born in the US in 1982, and introduced to Japan in 1996.
- JT Group has completed the acquisition of the Natural American Spirit business outside the US in January 2016 and been expanding its markets such as Japan, Germany, Switzerland, Italy, Spain and the UK.
- The Natural American Spirit brand vision is unchanged even after its phenomenal growth globally with the idea to provide the most premium, additive-free, all natural tobacco product.
- The Natural American Spirit family comprises a line-up of nine cigarette products as well as three Roll-your-own products.

Seven Stars

- Launched in 1969, Seven Stars featured Japan's first domestically produced charcoal filter in pursuit of better taste.
- Since its launch, Seven Stars has consistently offered unique value in terms of taste, aroma and product design.
- Seven Stars Original soft package with 14mg tar had been the most sold product in the Japanese domestic market for 10 years until 2017.
- The Seven Stars family comprises a line-up of 15 products.

MEVIUS

- Evolved in 2013 from Mild Seven, MEVIUS has commanded the No. 1 share in the Japanese domestic market for more than 30 years.
- Its regular products offers smooth taste as well as menthol products allows consumers to enjoy premium and high quality products with only 100% natural menthol.
- The MEVIUS family comprises a line-up of 40 cigarette products as well as five capsule products for Ploom TECH.

Winston

- First introduced in 1954 in the US.
- In 2015, CABIN and CASTER were migrated into Winston in Japan. Winston has three types of taste, 'Bitter', 'Straight' and 'Sweet', in both Regular and Menthol segment.
- The Winston family comprises a line-up of 27 products.

* JT total. 2017 results as of December 31. 2017

Global Tobacco Strategy

Tobacco business: the JT Group's profit growth engine.

Global tobacco strategy
Our core tobacco business remains committed and well positioned to drive JT Group's future profit growth as highlighted in our Business Plan 2018.

We have redefined E-Vapor products (known as e-cigarettes which do not contain tobacco and create an inhalable vapor by electronically heating an e-liquid) and Tobacco Vapor products (containing tobacco that is heated directly or indirectly to create an inhalable vapor) as 'Reduced-Risk Products'* or 'RRP'.

These products have the potential to reduce the risks associated with smoking, as they come with no combustion, thus generating no smoke. We will significantly strengthen our investments behind Reduced-Risk Products* aiming to turn this category into the future growth driver of our tobacco business.

In the meantime, conventional tobacco products will continue to play a key role as a strong platform for profitability. Our successful strategy remains unchanged. We will keep investing to strengthen the equity of our Global Flagship Brands, to enhance our distribution network and trade partnerships and to broaden our footprint in emerging markets.

We believe that by pursuing a balanced strategy, focused on providing consumers with a broad range of options both in reduced-risk and conventional products, our tobacco business will grow adjusted operating profit at constant FX at mid- to high single-digit rate in the mid- to long-term.

Reduced-Risk Products*
We believe that Reduced-Risk Products* enhance consumers' satisfaction and provide benefits to shareholders, society and our business. Therefore, the Reduced-Risk Products* category will become a centerpiece of our strategy for future growth and we will allocate our resources accordingly. Over the next three years, we plan to invest more than 100 billion yen in R&D, CAPEX and acquiring scientific evidences to obtain certification for reduced-risk claim from authorities.

* Reduced-Risk Products (RRP): Products with the potential to reduce the risks associated with smoking.

Please be reminded that this section is intended to explain the business operations of JT to investors, not to promote sales of tobacco products to encourage smoking by consumers.

Mutsuo Iwai
Representative Director and Executive Vice President

Key highlights of 2017

- Acquired Mighty, the second biggest tobacco company in the Philippines
- Acquired 'PT. Karyadibya Mahardhika', a kretec cigarette company and distributor based in Indonesia
- Continued expansion of Ploom TECH in Japan and in a number of international markets

"We believe that Reduced-Risk Products* enhance consumers' satisfaction and provide benefits to shareholders, society and our business."

Within the JT Group, three different sub-categories define the RRP category: E-Vapor, Tobacco-Infused Vapor and Heated Tobacco. In each category, we will enrich our product pipeline and portfolio, offering consumers propositions that meet diverse needs and actively providing factual information on our products.

In the E-Vapor category, we have a comprehensive e-cigarette portfolio under our brand Logic, whose products are already sold in 10 markets globally. Going forward, Logic will continue its portfolio and geographic expansion, supported by new compelling product offerings. Ploom TECH, our proprietary Tobacco-Infused Vapor product, is already available in four markets including Japan, and we are working on line extensions that will further enhance the consumers' experience.

Our plans include the introduction of a Heated Tobacco product in Japan by the end of 2018 or beginning of 2019 at the latest.

Conventional tobacco products
We make and sell some of the most iconic and best-known brands in the world. From the globally recognized Winston, Mevius, Camel and LD, to local brands with loyal consumers franchise. The strong equity of our brands driven by quality products and on-trend innovations, combined with our growing presence in both mature and emerging markets, enable us to balance market share and pricing opportunities as appropriate.

Looking ahead, we will further strengthen our competitiveness and business fundamentals through focused investments that can generate sustainable returns in the long-term. While mature markets will continue to be the main drivers of top line growth, returns on investment in emerging markets will broaden JT Group's revenue base. Our organic growth will continue to be complemented by business development initiatives in markets of importance, like the recent acquisitions in Ethiopia, Indonesia and the Philippines. We are confident that this strategy will enable us to sustain our business momentum in the conventional tobacco products category for the years to come.

* Reduced-Risk Products (RRP): Products with the potential to reduce the risks associated with smoking.

Pharmaceutical Business

FY2017: Results for the fiscal year ended December 31, 2017

Key Highlights

Revenue	Adjusted Operating Profit
104.7 (JPY BN)	24.1 (JPY BN)
+17.5 Year-On-Year Change (JPY BN)	+14.4 Year-On-Year Change (JPY BN)

"We build a R&D-led business for aiming at first-in-class internationally competent compounds, to increase our market presence."

Muneaki Fujimoto
President, Pharmaceutical Division

We aim to make stable profit contribution to the JT Group through R&D promotion for next-generation strategic compounds and value maximization of each product.

Strategy

- Promote R&D for next-generation strategic compounds and seek optimum timing to license them out
- Maximize the value of each product

Performance Overview

In-house development

- Entered the clinical trial stage
  - JTS-661 (NK-1 antagonist): Phase 2
- Advanced to the further stage
  - JTE-052 (JAK inhibitor): Phase 3
  - JTZ-951(HIF-PH inhibitor): Phase 3

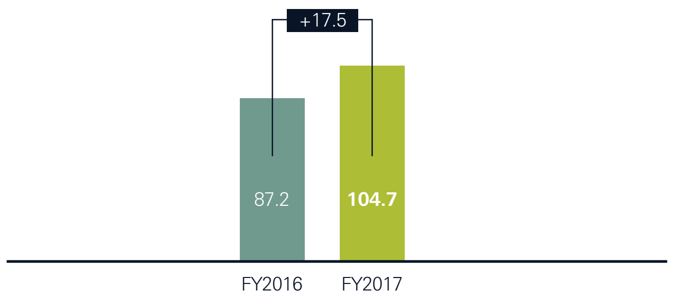
Licensed Compounds

- Trametinib (MEK inhibitor);
  - In combination with dabrafenib:
    - approved in US and EU for the treatment of NSCLC with BRAF V600E mutation and BRAF V600 mutation respectively
    - submitted in US and EU for the treatment of melanoma (adjuvant) with BRAF V600E/K mutation and BRAF V600 mutation respectively

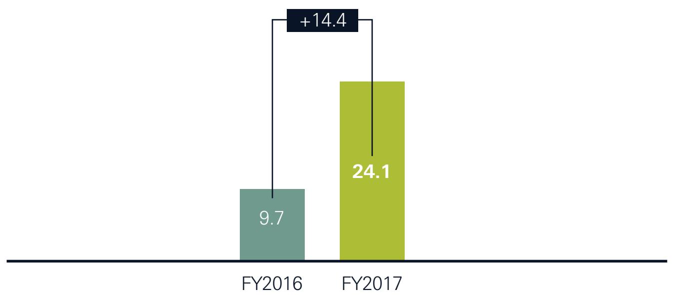
Business Results (financial overview):

- Revenue grew year-on-year by 17.5 billion yen driven by the growth of royalty revenue from our license partners, mainly Genvoya and the domestic sales increase in Torii Pharmaceutical.
- Adjusted operating profit significantly improved by 14.4 billion yen year-on-year through top-line growth.

Revenue (JPY BN)



Adjusted Operating Profit (JPY BN)



R&D

Continue to strengthen R&D capability, a cornerstone of our pharmaceutical business

By focusing our resources on specific therapeutics areas, we continue to strengthen our R&D capability which enables us to create innovative drugs.

Manufacturing

Ensure a reliable supply of quality products

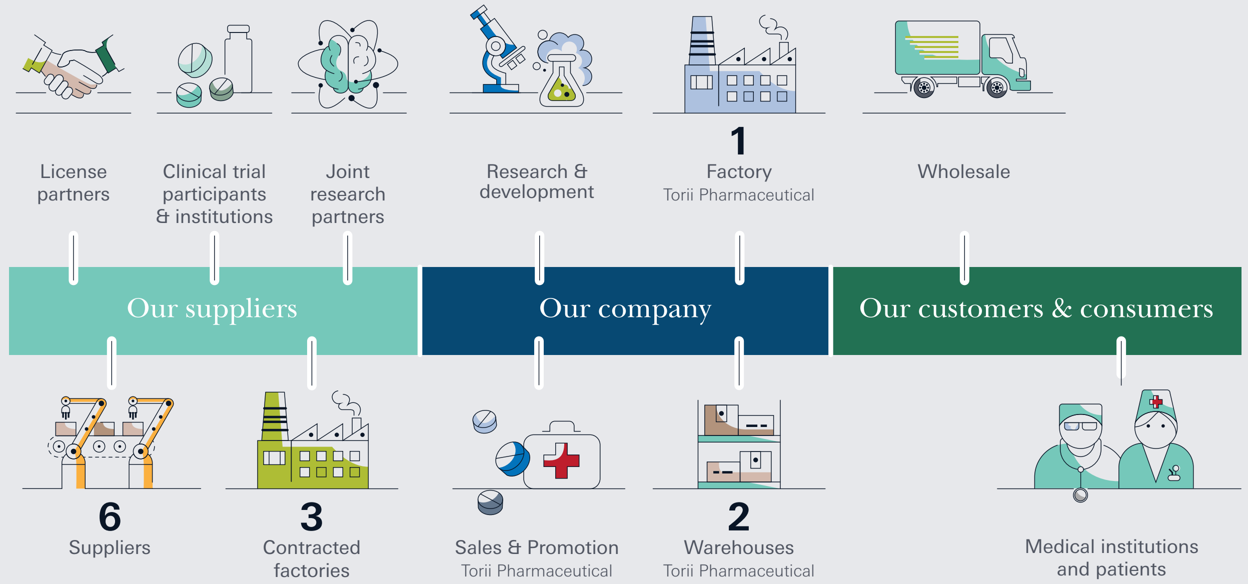
We are proud of ourselves with a sustainable supply chain that delivers high quality products to our patients. We also pursue efficiency in our manufacturing arrangements; products marketed in Japan are mainly produced by Torii Pharmaceutical to maximize intra-group synergies, while outsourcing to contract manufacturers where appropriate.

Sales & Promotion

Build marketing competence on our MRs

In the pharmaceutical industry, medical representatives (MRs) play a crucial role in successful sales & promotion by providing medical and scientific knowledge with clients. At the same time, they collect valuable information from the medical front which could be reflected in the ongoing or future R&D activities. Torii Pharmaceutical is marketing our products in Japan through approximately 500 highly-trained MRs. Outside Japan, instead of directly marketing our products, we receive royalties based on sales performance from our license partners for the compounds for which we license out the right to develop and market.

Our Pharmaceutical Business Value Chain



* This diagram represents the value chain of products manufactured and/or developed by JT and sold and promoted by Torii Pharmaceutical.

Pharmaceutical Business

Japan Tobacco Inc. Clinical Development

(as of February 6, 2018)

In-house development

Code (Generic name)	Potential indication/ dosage form	Mechanism	Description	Location	Phase 1	Phase 2	Phase 3	Preparing to file	Filed	Origin
JTZ-951	Anemia associated with chronic kidney disease/Oral	HIF-PH inhibitor	Increases red blood cells by stimulating production of erythropoietin, an erythropoiesis-stimulating hormone, via inhibition of HIF-PHD.	Japan	●	━	●	○	○	In-house; Co-development with Torii
				Overseas	●	○	○	○	○	
JTE-052	Autoimmune/allergic diseases/Oral, Topical *Atopic dermatitis/Topical	JAK inhibitor	Suppresses overactive immune response via inhibition of Janus kinase (JAK) related to immune signal.	Japan	●	━	●	○	○	In-house; *Co-development with Torii
JTE-051	Autoimmune/allergic diseases/Oral	Interleukin-2 inducible T cell kinase inhibitor	Suppresses overactive immune response via inhibition of the signal to activate T cells related to immune response.	Overseas	●	●	○	○	○	In-house
JTT-251	Type 2 diabetes mellitus/Oral	PDHK inhibitor	Decreases blood glucose by activation of pyruvate dehydrogenase (PDH) related to carbohydrate metabolism.	Overseas	●	○	○	○	○	In-house
JTK-351	HIV infection/Oral	HIV integrase inhibitor	Suppresses blood HIV levels by inhibiting the activity of integrase, an enzyme involved in the replication of HIV.	Japan	●	○	○	○	○	In-house
JTE-451	Autoimmune/allergic diseases/Oral	RORγ antagonist	Suppresses overactive immune response via inhibition of RORγ related to Th 17 activation.	Overseas	●	○	○	○	○	In-house
JTS-661 (serlopitant)	Pruritus/Oral	NK-1 antagonist	Suppresses pruritus involving the neurokinin (NK-1) receptor antagonist signalling pathway.	Japan	●	●	○	○	○	In-license (Menlo Therapeutics) Co-development with Torii
JTT-751 (ferric citrate)	Iron-deficiency anemia/Oral	Oral iron replacement	Corrects iron-deficiency anemia by using absorbed iron for synthesis of hemoglobin.	Japan	●	●	○	○	○	In-license (Keryx Biopharmaceuticals); Co-development with Torii Additional indication

Clinical trial phase presented above is based on the first dose.

Licensed compounds

Compound (JT's code)	Licensee	Mechanism	Description	Note
trametinib	Novartis	MEK inhibitor	Inhibits cellular growth by specifically inhibiting the activity of MAPK/ERK pathway.	NSCLC with BRAF V600E mutation, trametinib+dabrafenib Japan marketing application submitted Melanoma(adjuvant) with BRAF V600E/K mutation, trametinib+dabrafenib US marketing application submitted
Anti-ICOS monoclonal antibody	MedImmune	ICOS antagonist	Suppresses overactive immune response via inhibition of ICOS which regulates activation of T cells.	
JTE-052	LEO Pharma	JAK inhibitor	Suppresses overactive immune response via inhibition of Janus kinase (JAK) related to immune signal.	
JTZ-951	JW Pharmaceutical	HIF-PH inhibitor	Increases red blood cells by stimulating production of erythropoietin, an erythropoiesis-stimulating hormone, via inhibition of HIF-PHD.	

Processed Food Business

FY2017: Results for the fiscal year ended December 31, 2017

TableMark began operation as a food manufacturer with frozen and ambient processed foods, seasonings and bakery items as our business pillars.

In particular, we strive to provide high value-added products by focusing on staple foods such as frozen noodles, frozen rice, packed cooked rice and frozen baked bread.

Strategy

- Increase the attractiveness of our offerings with a particular emphasis on staple food products* with our own expertise.
- Minimize negative impact of rising raw material costs and weak yen.

* Staple food products: frozen noodles, frozen rice, packed cooked rice and frozen baked bread.

Performance Overview

We primarily engaged in business concerning frozen and ambient processed food, mainly staple food products such as frozen noodles, frozen rice, packed cooked rice and frozen baked bread, seasonings including yeast extracts and oyster sauce and bakery chain outlets in the Tokyo metropolitan area.

Business Results (financial performance):

- Revenue decreased because the sales growth of seasoning products was offset by the other products sales decline.
- Adjusted operating profit increased by 0.4 billion yen year-on-year through our sales efforts to focus on higher margin products and cost reduction. As a result, we achieved profit growth for the fifth consecutive year.

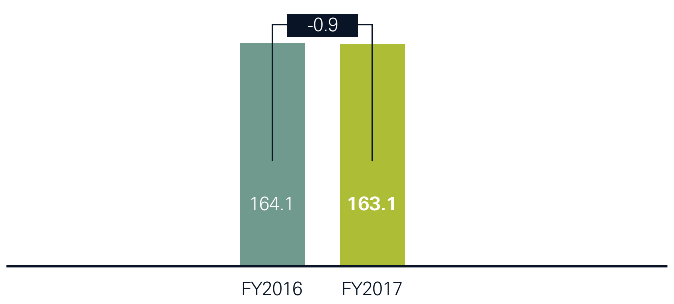
Key Highlights

Revenue	Adjusted Operating Profit
163.1 (JPY BN)	5.4 (JPY BN)
-0.9 Year-On-Year Change (JPY BN)	+0.4 Year-On-Year Change (JPY BN)

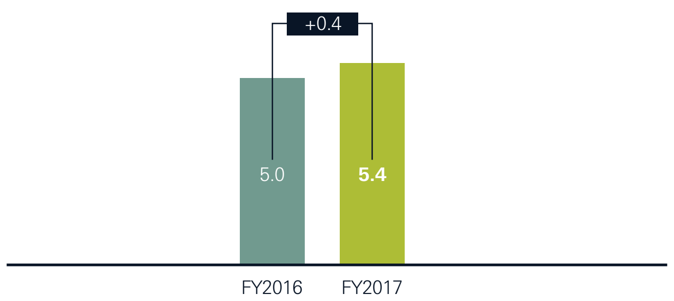
"If we are going to prepare food for those who matter to us most, we wish to do so cordially and with care. This is our desire when running our business at TableMark."

Atsuhiro Kawamata
President and CEO, TableMark

Revenue (JPY BN)



Adjusted Operating Profit (JPY BN)



Our Processed Food Business Value Chain

* We do not deal directly with raw material producers such as farmers, who provide raw materials to the trading firms or to the contracted factories that supply us.

Procurement

Ensure procurement of safe and quality raw materials

- Review of quality assurance certificates submitted by our suppliers.
- Inspections and monitoring of agrochemical residues and regular inspection at processing plants, in compliance with JT Group's internal standards, the Food Sanitation Act and other relevant laws.
- Examination of safety of production sites for raw materials sourced abroad.
- As for agricultural farms, inspections are made not only for soil and water but also in terms of how products are cultivated and how agrochemicals are handled. Breeding farms are also inspected.

Production

Prioritize safety and follow established quality control procedures

- JT Group is pursuing the adoption of the HACCP system, ISO22000 and FSSC22000 in our and business partners' factories. Under the ISO22000 and FSSC22000 standard, continuous improvements are made following effective rules to control sanitation and other key issues. These rules are based on the HACCP system, and their effectiveness is tested using scientific evidence.
- All of JT Group's 31 frozen food factories in and outside Japan have achieved the ISO22000 or FSSC22000 certification.

Sales & Distribution

Increase penetration to retail outlets

- Strive to enhance profitability through our initiatives to increase our presence in supermarkets and convenience stores, by offering a wider range of products while also seeking better shelf space.
- TableMark products are also sold to restaurants and other public facilities.

Risk Factors

The JT Group operates diverse businesses, namely tobacco, pharmaceutical, and processed food. In addition, we conduct our business on a global basis, extending to Europe, CIS countries, Africa, the Middle East and others. Due to this diversity and these changing environments, we are exposed to various risks.

Considering such circumstances, we have put in place a risk management framework. Under the framework, relevant divisions are assigned to carefully monitor the development of events that may adversely impact us and prevent their materialization where possible.

When risks materialize, we promptly respond in order to minimize their unfavorable impacts. In reviewing risks, the magnitude of potential impact and likelihood of occurrence are most prudently assessed among other factors. Material risks, which could have a significant impact on our sustainable profit growth and business continuity, are reported to the CEO together with the request for approval to implement countermeasures against them.

The following section describes certain risks which potentially have a material impact on our business operations and financial results, but is not intended to be an exhaustive list of the risks we face. In addition, it is possible that risks that are currently considered immaterial or even unknown could turn out to be material in the future, as the business environment changes.

This section should be read together with the forward-looking and cautionary statements contained in this Annual Report.

1 Disruptive tax increases

Tobacco products are subject to excise or similar taxes in addition to value-added tax. Excise taxes are increasing in most markets where the JT Group operates as governments seek to secure their revenue or promote public health.

In general, value-added tax is also increasing. As a general principle, we fully pass on any tax increase to consumers by adjusting our sales prices. In addition, to the extent possible, we increase our prices more than the tax increase, considering the financial impact of an expected volume decline. A tax increase within a reasonable range is manageable through such a price increase as well as our efforts to support top-line and pursue efficiency. Most governments are aware that a substantial tax increase or repeated tax increases can reduce their revenue and they take a rational approach.

However, in the past we have experienced tax increases in some markets that have disrupted our business.

Risk description and potential impact

A disruptive tax increase on tobacco products could result in a large industry volume decline due to lower consumption and, in many cases, increased illicit trade. In addition, down-trading to lower priced products could be initiated or accelerated. Our shipment volume, revenue and profit could decrease due to these negative reactions by consumers.

Measures to address the risk

- Promote the understanding of relevant authorities that a disruptive tax increase does not necessarily serve their purpose.
- Optimize our product offerings to capture the potential changes in consumer preference.
- Enhance our geographical portfolio to limit the negative impact of a disruptive tax increase in a specific market.
- Further improve efficiency to protect revenue and earnings.
- If a disruptive tax increase takes place, find an optimal price for each product which minimizes the unfavorable influence in the market.

2 Pressure from illicit trade

Illicit trade is a major concern not only for the tobacco industry, but for wider society. For the tobacco industry, it undermines legitimate tobacco business. For society, illicit trade reduces excise revenue for the government, often fuels organized crime, and may increase health concerns due to poor manufacturing standards and improper product handling. The tobacco industry has been fighting against illicit trade, which takes the forms of contraband, counterfeit and illicit whites.

Illegally traded products in a market tend to increase after a steep tax increase. Regulatory actions seeking to commoditize packages and products could also trigger the acceleration of illicit trade because such commoditization could make counterfeit manufacturing easier and detection of illicit products more difficult. The JT Group takes a zero tolerance approach towards all these criminal activities with an emphasis on eliminating contraband products.

Risk description and potential impact

An increase in illicit trade could reduce legitimate industry volume, leading to a decline in our shipment volume, revenue and profit. In addition, the industry bears the cost to combat illicit trade, resulting in pressure on its earnings. Furthermore, it is possible that low quality counterfeits and improperly handled smuggled products damage the credibility of genuine brands, as well as the reputation of their owners.

Measures to address the risk

- Engage with governments, regulatory bodies and law enforcement agencies to eradicate illicit trade.
- Ensure we buy from and sell to only reputable business partners following our rigorous compliance initiatives.
- Raise awareness among individual consumers of the negative consequences of purchasing illegally traded products.

Working together with authorities:
In 2007, JT International Holding B.V. and JT International S.A., JT Group subsidiaries, entered a cooperation agreement with the European Commission, the executive branch of the European Union (EU), and 28 EU Member States as part of efforts to combat illicit trade. In 2009, the United Kingdom joined the agreement.

Under the terms of the agreement, we contributed US$50 million annually in the first five years from its execution and contribute US$15 million annually in the subsequent ten years. This financial contribution is to be used to support anti-smuggling and anti-counterfeiting initiatives led by the EU or EU Member States.

In 2010, JTI-Macdonald Corp., our Canadian subsidiary, also signed a similar agreement with the Government and Provinces of Canada.

3 Tightening tobacco regulations

The tobacco industry is highly regulated in various aspects, and regulations could influence the business performance of the JT Group and financial results. Among the regulations on products, for example, we may incur additional costs in order to comply with ingredients and packaging requirements.

Furthermore, the regulatory attempt to commoditize tobacco products could lead to an increase in illicit trade and negatively influence our legitimate business.

Business activities of tobacco companies are also restricted. With more prohibitive regulations on communication with consumers, our ability to effectively market products becomes further limited, and our top-line performance may be adversely impacted.

As a responsible organization, we abide by applicable laws and regulations wherever we operate. That said, we believe that laws and regulations should differ country by country, reflecting legal, social and cultural background. We endeavor to hold constructive dialogues with governments and regulators for a reasonable and balanced approach towards tobacco regulation.

Risk description and potential impact

Further tightening of tobacco regulations on marketing activities could undermine our strategy for top-line growth as we lose opportunities to enhance brand equity. Moreover, certain regulations may impose on us additional compliance costs. These may negatively influence our volume, revenue and profit.

Measures to address the risk

- Identify ongoing regulatory initiatives as early as possible by promptly collecting accurate information.
- Endeavor to hold constructive dialogues with governments and regulators for reasonable and balanced regulations that meet their objectives.

For further details, please refer to 'Regulation and Other Relevant Laws' contained in this Annual Report.

4 Country risks

The tobacco business of the JT Group has consistently expanded our earnings base to secure long-term growth by making acquisitions, entering new markets and increasing share in markets where we had limited presence. Geographical expansion may increase our exposure to country risks. In any market where we operate, we may face economic, political or social turmoil which may negatively affect our operations and financial results.

Risk description and potential impact

Political instability, economic downturn, social unrest or other unfavorable developments in a certain market could disrupt our business, leading to lower volume, revenue and profit in the market.

Measures to address the risk

- Avoid over-dependence on a small number of markets as sources of profits by expanding the pool of highly profitable markets.

5 Instability in the procurement of key materials

Across its businesses, the JT Group procures raw and processed materials for product manufacturing.

In particular, we strive to procure key materials in the required quantity and at reasonable costs. Our key materials include agricultural products: most notably, tobacco leaf for the tobacco business, and grains for the processed food business. Availability of agricultural products is often affected by natural phenomena, such as weather conditions. In addition, there is a growing concern that agricultural production costs may increase, due to the high demand in energy resources, global population increases, and economic growth in emerging countries.

Risk description and potential impact

Insufficient supply of key materials could lead to inability to manufacture our products, subsequently resulting in the loss of revenue and profit. Furthermore, the increase in procurement costs driven by higher production costs for agricultural products would directly pressure our earnings.

Measures to address the risk

- Reinforce ability to procure key materials by building a strong relationship with suppliers. In the case of tobacco leaf, further promote internal sourcing.
- Promote efficient use of materials by continuously reviewing the manufacturing process and product specifications where possible.

6 Unfavorable developments in litigation

JT and some of its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking. As of December 31, 2017, 21 smoking and health-related cases were pending in which one or more members of the JT Group were named as defendant or for which JT may have certain indemnity obligations pursuant to the agreement such as for JT's acquisition of RJR Nabisco Inc.'s overseas (non-US) tobacco operations. JT and its subsidiaries, who are defendants in such lawsuits, believe that we have valid grounds to defend the claims in such lawsuits; however, we cannot predict the outcome of any pending or future litigation.

Risk description and potential impact

A decision unfavorable to us could materially affect our financial performance due to the payment of monetary compensation. Critical media coverage of such lawsuits may reduce social tolerance of and strengthen regulations on smoking. Such media coverage may also prompt the filing of a number of similar lawsuits against JT or its subsidiaries, resulting in increased litigation costs.

Measures to address the risk

- Continue to build well-organized teams coordinating with external legal counsel to defend ourselves against these lawsuits.
- Continue legitimate and appropriate business operations.

For further details, see section regarding 'Litigation'.

7 Natural disasters

The operations of the JT Group may be disturbed by natural disasters such as earthquakes, typhoons, floods, volcanic eruptions and others. Japan is one of the most important markets for our businesses and subject in particular to various natural disasters. The Great East Japan Earthquake was devastating. The impacts on us included casualties among our employees, physical damage to our factories, and supply shortages of certain tobacco product materials. Our tobacco business was forced to temporarily suspend product shipment and limit shipment volume for an extended period.

We have developed a Business Continuity Plan to minimize the impact of such disasters, with a particular emphasis on the optimization of the global supply chain.

Risk description and potential impact

Natural disasters could cause damage to us as well as our suppliers, trade partners and consumers, leading to disruption of our business and negatively impacting financial results.

Measures to address the risk

- Continuously review the Business Continuity Plan and revise it as necessary.
- Carry out emergency drills to increase employees' preparedness against disasters.
- Insure key assets such as buildings, machinery, equipment and inventory to recover financial losses as appropriate.

8 Currency fluctuations

As the JT Group is operating globally, we are exposed to the risks associated with currency fluctuations. The reporting currency of our consolidated financial statements is Japanese yen, while the financial statements of our international subsidiaries are reported in other currencies such as Russian ruble, Euro, British pound, Taiwanese dollar, US dollar, and Swiss franc.

Therefore, exchange rate fluctuations of these currencies against Japanese yen influence our reported financial results. As for the financial reporting of the international tobacco business, JT International Holding B.V. consolidates the financial results of the international tobacco subsidiaries and reports its consolidated financial statements in US dollars. We often communicate the financial performance of our international tobacco business in US dollars, which is affected by exchange rate fluctuations against the US dollar. In principle, we do not hedge these risks which arise from the translation of financial statements.

However, we hedge against risks which arise when equity denominated in each functional currency of ours is translated into Japanese yen to be consolidated by using foreign currency-denominated interest-bearing debts and part of these are designated as net investment hedges. In addition, many companies make transactions in currencies other than their reporting currencies for day-to-day operations. Such transactions also involve the risk of exchange rate fluctuations. We mitigate these transaction risks through hedging activities; however, it is not possible to completely eliminate them.

Furthermore, if we liquidate or sell a group subsidiary which we acquired in a currency other than Japanese yen or impair a substantial value of such a subsidiary, the gain or loss from the transaction includes the currency fluctuation impact. Specifically, the impact comes from the difference in the exchange rates of the relevant currency against Japanese yen at the time of the acquisition and at the time of such transaction.

Risk description and potential impact

Fluctuations of exchange rates against Japanese yen affect our reported financial results. Reported financial results of our international tobacco business in US dollars are similarly influenced by the fluctuations of exchange rates against the US dollar. In addition, we are exposed to the exchange rate fluctuation risks when a group company makes a transaction in a currency other than its reporting currency.

Measures to address the risk

- Mitigate the risk through hedging activities such as derivative contracts, possession of interest bearing debts in a foreign currency, etc.

9 Competition

The JT Group competes fiercely in both domestic and international tobacco business with our competitors.

In the Japanese Domestic Tobacco market, import of tobacco products was deregulated in 1985, followed by the provisional suspension of custom duties on imported tobacco in 1987. Since then, competition has intensified each year, as smokers' preferences diversify and as our competitors pursue aggressive promotional activities. In addition, with the diversification of customer needs, the RRP market is rapidly expanding in recent years, and it is more important than ever to continue to produce products that accurately capture customer needs.

In the overseas tobacco markets, we expanded our own business organically as well as through M&A, by acquiring the non-US tobacco operations of RJR Nabisco Inc. and thereafter acquiring Gallaher Ltd. As a result, we are in competition with global players in the international tobacco business or with local competitors with strength in specific markets. Market share can fluctuate due to a number of factors, including increasing regulations, increases in health awareness, changes in smokers' preferences or changes to economic conditions of each market. It can also fluctuate from competitors' pricing strategies or strength of brand equity. Moreover, market share can fluctuate in the short-term due to new product launches by each market player and the accompanying promotional activities.

Risk description and potential impact

Fluctuation of our market share may affect the JT Group business performance. In addition, price competition (price reductions or brand repositioning, among others) aimed at increasing market share, may negatively affect our profit margins.

Measures to address the risk

- Optimize our product portfolio by:
  - developing and providing products that can capture changing consumer preferences and needs
  - placing brands with strong brand equity in each price category
- Provide product support by enhancing trade marketing capability and effective promotional initiatives.
- Further improve efficiency to protect revenue and earnings.
- Avoid over-dependence on a small number of markets as sources of profits by expanding the pool of highly profitable markets.

JT Group and Sustainability

Our approach to sustainability is underpinned by our management principles known as the 4S model.

We strive to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society, carefully considering the respective interests of these four key stakeholder groups, and exceeding their expectations wherever we can. We believe that pursuing this model enhances corporate value and helps us to meet and exceed stakeholders' interest in the most balanced way possible.

Summarized in this page is an overview and topics for 2017. Should you wish to learn more about our approach and commitment to sustainability or specific programs, 'JT Group Sustainability Report FY2016' is currently available on JT Group website.

The FY2017 report will be available on our website in June 2018. This report will be compiled in accordance with the Global Reporting Initiative (GRI) G4 Sustainability Reporting Guidelines 'Core' level.

JT Group Sustainability Report and GRI G4 index:
https://www.jt.com/sustainability/report/

Our community investment
We are committed to being a good corporate citizen ensuring that our businesses deliver positive impact in local communities.

Our processed food business
The product portfolio of TableMark, our processed food business in Japan, includes frozen noodles, frozen and packed cooked rice, frozen baked bread, pastries, and seasonings.

Our people
As a responsible business, we are committed to protecting the environment in which we operate for our future generations.

Our tobacco business
Managing sustainability across our value chain is a complex operation, which includes, among other things, manufacturing, processing warehousing, and distribution.

Sustainability highlights 2017

Our approach to sustainability
JT's corporate governance is rooted in our adherence to the 4S model – our commitment to the four stakeholder groups which guides our business conduct.

Our planet
As a responsible business, we are committed to protecting the environment in which we operate for our future generations.

Our pharmaceutical business
Our pharmaceutical business has a mission to deliver innovative drugs to patients in the shortest time possible, in a safe and secure manner.

Respecting human rights

We operate in parts of the world where human rights are potentially at risk. We strive to make a positive impact on communities in the areas where we are present and to make sure the highest standards of behavior are upheld within our business and our value chain.

Over the past three years, we have been working on a more systematic approach to human rights issues. In September 2016, we launched the JT Group Human Rights Policy (the Policy), which follows the UN Guiding Principles on Business and Human Rights, and delivers on our management principles, as set out in our 4S model.

Since the launch of the Policy in 2016, we have rolled out e-learning modules and trainings on human rights across our business. Gap assessments were performed for our international tobacco business as well as in our Japanese operations and as per our commitment in the Policy, we began carrying out human rights due diligence programs across our businesses in 2017.

Supply chain management

Our supply chain is large and complex as we have large-scale operations around the world. In terms of our raw materials, we purchase half of our tobacco leaf directly from contracted farmers and the other half from tobacco leaf merchants. We also partner with suppliers for non-tobacco materials and other products and services. Managing our supply chain responsibly is a priority for our business: we believe this is beneficial not only for our sustainable growth but also for our stakeholders and the wider society.

All our tobacco leaf growers, both directly contracted, as well as those contracted by our tobacco leaf merchants, are subject to our Agricultural Labor Practices (ALP) program which address labor practices in our leaf supply chain. Our suppliers for non-tobacco materials and other products in our international tobacco business are managed by JTI's newly established Supplier Life Cycle (SLC) management tool. For further details about the JT Group's supplier policies and standards, please visit our group website.

Agricultural labor practices (ALP):

Sourcing a sustainable supply of tobacco leaf lies at the heart of what we do, and our tobacco leaf sourcing and growing operations are a key part of our supply chain. Securing a long-term supply of quality leaf, at the best cost, is critical for our future business growth. We source 50% of our tobacco leaf from merchants, the other 50% of our tobacco leaf is directly sourced from JTI contracted growers. These farmers and their communities hold a central position in our leaf-growing operations.

ALP was developed as the foundation for sustainable tobacco leaf farming. It helps us to address challenges faced by the tobacco industry. These vary from country to county and differ widely from developing to developed regions. Since launching ALP in 2013, we have built strong relationships with thousands of growers. Together, we are improving incomes, living standards, labor practices and having a positive environmental and social impact in countries that supply us with tobacco. In 2017, 90% of our directly contracted leaf growers were observed by farming experts against the ALP standards. As for our leaf merchants, 70% reported on ALP in 2017.

ARISE: Our contribution to preventing child labor

Our ARISE program launched in 2012 aims to address roots causes of child labor in tobacco growing. The program, which covers Brazil, Malawi, Zambia and Tanzania, tackles social and economic factors that tempt farmers to employ children.

This program aims to ensure that children are not part of the workforce by providing education and engaging with tobacco farming communities in various ways. This ranges from providing educational materials, after-school tutoring, and mentoring, to vocational training for older children in farming schools.

Environment, Social and Governance Initiatives

The JT Group actively works for sustainable business through environmental, social and governance (ESG) initiatives. Currently we have programs in each area as detailed below.

Environment	As a responsible business, the JT Group is committed to protecting the environment. By reducing our environmental impacts, we are able to conserve resources, improve performance and enhance our reputation, as well as managing costs. All of this supports the sustainability of the environment and our business. This ethos is at the heart of our approach to environmental management, laid out in our Company Environmental Charter. The Charter is supported by the JT Group's Environment Plan, which presents our targets for greenhouse gas (GHG) emission reduction and our approach to managing water, waste and biodiversity. We are making good progress towards achieving commitments in these areas by 2020.
Social	In recent times, JT has placed a special focus on stress management and prevention of lifestyle diseases. As a result, JT was named a 'White 500' company in 2017, in recognition of exceptional efforts towards employee health. The 'White 500' award is presented by Japan's Ministry of Economy, Trade and Industry (METI) and recognizes large enterprises that are making outstanding progress towards better health and productivity among their employees. Our international tobacco business was certified as a Global Top Employer for its consistent high-quality work environment in 2017, and we were recognized by the Top Employers Institute in 33 countries around the world. 2017 健康経営優良法人 Health and productivity ホワイト500 · top EMPLOYER GLOBAL 2017
Governance	For the information regarding our corporate governance, please refer to the next section.

Our Recognition in Socially Responsible Investment Indexes

We have been selected as a member of the Dow Jones Sustainability Asia/Pacific Index (http://www.sustainability-indices.com) for four consecutive years since 2014.

In 2017, we were selected as a member of FTSE Blossom Japan index (http://www.ftse.com/products/indices/blossom-japan).

And we are also a member of the Morningstar Socially Responsible Investment Index (MS-SRI) (https://www.morningstar.co.jp/sri/list.htm, in Japanese).

MEMBER OF Dow Jones Sustainability Indices In Collaboration with RobecoSAM · FTSE Blossom Japan · MS-SRI

Our Agricultural Labor Practices (ALP) are implemented in all the farming regions where we directly operate, such as Brazil, Serbia, Malawi, Tanzania, Zambia, the US and Turkey. In addition, 2017 also saw ALP piloted in Japan for the first time.

Our ARISE program aims to address root causes of child labor.

Corporate Governance

Decision-Making, Business Execution, Supervision

Corporate Governance at JT

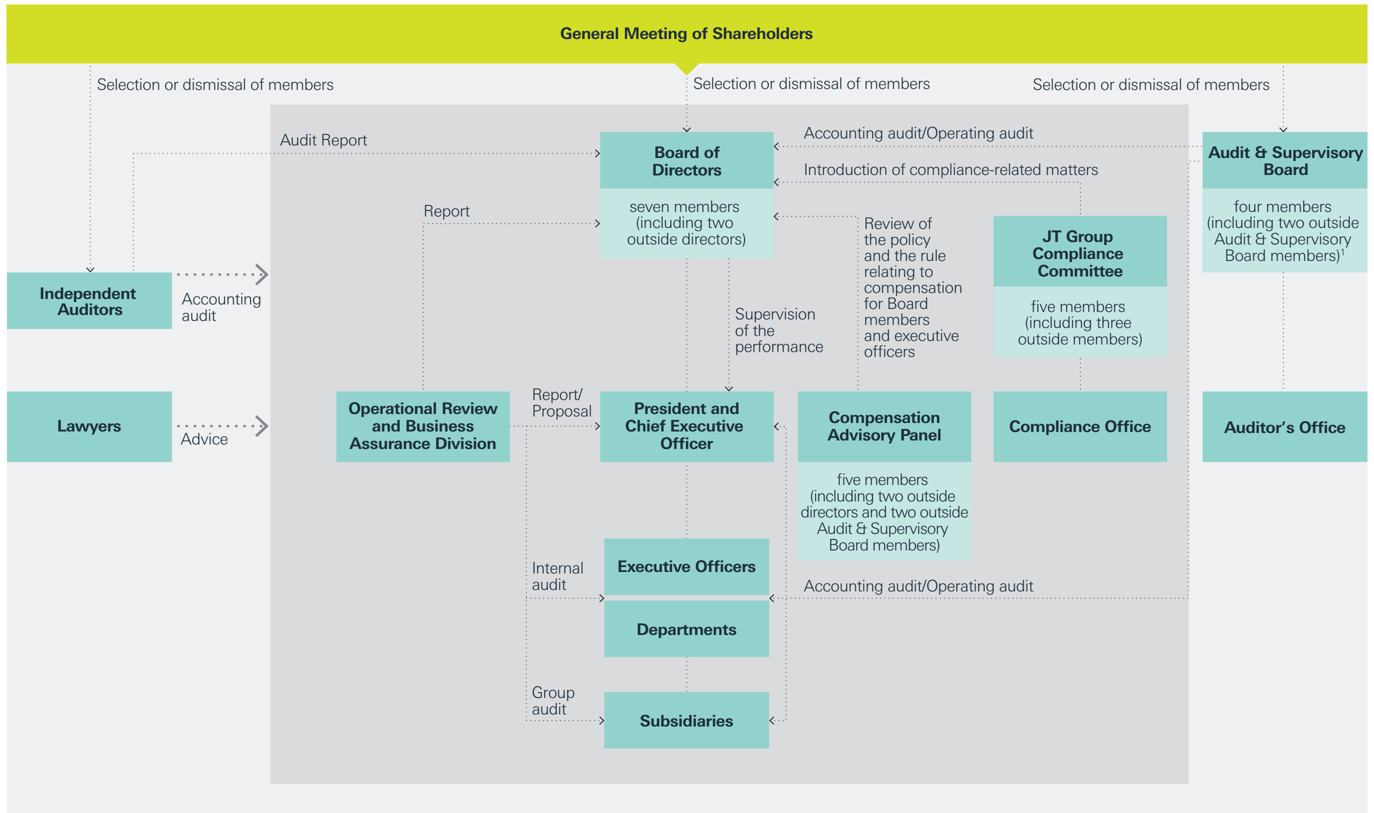
We have enhanced our corporate governance, based on our belief that it is the means for conducting transparent, fair, timely and decisive decision-making for pursuing JT's management principle, the '4S model'. Specifically the 4S model aims "to balance the interests of consumers, shareholders, employees and the wider society, and fulfill our responsibilities towards them, aiming to exceed their expectations." We have set out the 'JT Corporate Governance Policies' and continuously strive to make enhancements based on our belief that it will enable us to achieve mid- to long-term sustainable profit growth and increase corporate value, which will contribute to the development of our group's stakeholders and eventually the economic society as a whole.

Initiatives to enhance corporate governance

Rigorous supervisory and advisory function	Quality and prompt decision-making	Efficient business execution
Set up the Compliance Committee FY2000	Reduced number of directors FY2000	Introduced executive officer system FY2001
Set up the Advisory Committee* FY2001	Promoted the delegation of business execution to the executive officers FY2000, FY2008 and FY2011	
Set up the Compensation Advisory Panel FY2006	Invited outside directors FY2012	

* Abolition of the Advisory Committee on June 30, 2014.

Our corporate governance system



[1] In preparation against a situation where the number of outside Audit & Supervisory Board Members falls below the required number, one substitute Audit & Supervisory Board Member is elected.

The 'JT Corporate Governance Policies' is available at:
https://www.jt.com/about/corporate_governance/

General Meeting of Shareholders

A general meeting of shareholders resolves the matters stipulated by law and our Articles of Incorporation. Under the Companies Act, certain matters are required to be resolved at a shareholder meeting including, most notably, the appointment and dismissal of the directors, audit & supervisory board members and external accounting auditors, dividend amount, loss compensation, as well as change in the Articles of Incorporation. Our Articles of Incorporation do not stipulate any additional matter to be resolved at our shareholders' meeting other than matters legally required. The Annual General Shareholders' Meeting is held in March, and a special meeting of shareholders shall be called by the Board of Directors, as necessary. The President chairs the shareholders' meetings.

Within the extent as permitted by law, requirements for resolutions at our shareholders' meeting were lowered by amending our Articles of Incorporation. A resolution at a general meeting of shareholders can be adopted by a majority of the voting rights present or represented at the meeting. A resolution for the appointment of the Company's director and audit & supervisory board members additionally require a quorum, which is one-third of the total number of voting rights. A special resolution as stipulated under Section 2, Article 309 of the Companies Act, such as amendment to the Articles of Incorporation, requires the quorum of one-third of the total number of voting rights and the approval of at least two-thirds of the voting rights present or represented at the meeting. Certain matters resolved at our shareholders' meetings need further approval by the Minister of Finance in Japan.

The Japan Tobacco Inc. Act

JT was established pursuant to the Japan Tobacco, Inc. Act ('the JT Act') for the purpose of managing businesses related to the manufacturing, sale and imports of tobacco products. The JT Act provides that the Government of Japan must continue to hold over one-third of all of the issued shares except for the class shares, which have no voting right against all matters that can be resolved at our shareholders' meeting. The JT Act also states that the issuance of new shares and stock acquisition rights requires the approval of the Minister of Finance. In the case of a share-for-share exchange, the same approval is required for issuance of new shares, stock acquisition rights and bonds with stock acquisition rights. Under the JT Act, subject to the approval by the Minister of Finance, JT is allowed to engage in businesses other than manufacturing, sales and imports of tobacco products or tobacco-related business, provided that our engagement in such businesses serves the purpose of the Company. JT is also required to obtain approval from the Minister of Finance for certain matters, including the appointment or dismissal of directors, executive officers and audit & supervisory board members as well as amendment to our Articles of Incorporation, distribution of surplus (excluding loss compensation), merger, corporate split, or dissolution. In addition, within three months after the end of each fiscal year, we are required to issue a statement of financial position, a statement of income, and a business report to the Minister of Finance.

The supplementary provisions of the Reconstruction Financing Act*, which came into effect on December 2, 2011 states that the Government shall study by the year ending March 31, 2023 the possibility of full disposal of government-owned JT shares by reassessing the Government's holding in JT shares considering the Government's involvement in the tobacco-related industries based on the Tobacco Business Act.

* Act on Special Measures for Securing Financial Resources Necessary for Reconstruction from the Great East Japan Earthquake.

The Board of Directors

The Board of Directors assumes responsibility in making decisions for important issues including the Group strategy as well as supervising all the activities of the Group. In view of the point that the Board of Directors determines company-wide management strategy and important matters and effectively assumes roles and responsibilities as the body exercising supervision over all business activities, the concept concerning the composition of the Board of Directors shall be set forth as follows.

- The number of Members of the Board in the Board of Directors shall be fifteen (15) or less, within necessary and appropriate scope, composed of diverse people with a high-integrity sense of ethics as professionals, knowledge, experience and skills.
- JT shall appoint two (2) or more independent outside Members of the Board with qualities that will contribute to its sustainable profit growth and increase of corporate value in the mid- to long-term from the viewpoint of strengthening supervisory functions and transparency of business.

A board meeting, in principle, is held every month and a special board meeting may be called, as necessary. The Board of Directors decides those matters required to be resolved by the Board of Directors under the Companies Act, such as important business plans, disposal or acquisition of important assets, significant amount of borrowings, conclusion of important agreements. For the purpose of supervising the Company's activities, the Board of Directors requires directors to deliver a report on the progress of operations at least on a quarterly basis. In year ended December 2017, we had 17 board meetings to discuss important issues including the management plan.

Members

7 (including two independent outside directors)
The directors marked with * are also the executive officers.

Yasutake Tango
Chairman of the Board

Date of birth: March 21, 1951
Term of office: 2 years since March 2018
Number of shares held: 5,300

April 1974
Entered Ministry of Finance

October 2006
Director-General of the Financial Bureau

July 2007
Deputy Vice Minister

July 2008
Director-General of the Budget Bureau

July 2009
Administrative Vice Minister

July 2010
Retired from the office of Administrative Vice Minister

December 2010
Corporate Auditor, The Yomiuri Shimbun Holdings

December 2012
Special Advisor to the Cabinet

April 2014
Retired from Special Advisor to the Cabinet

June 2014
Chairman of the Board of the Company (Current Position)

Significant Concurrent Positions outside the Company
Outside Director, The Ogaki Kyoritsu Bank, Ltd.

Masamichi Terabatake*
Representative Director and President, Chief Executive Officer

Date of birth: November 26, 1965
Term of office: 2 years since March 2018
Number of shares held: 17,400

April 1989
Joined the Company

July 2005
Vice President, Secretary's Office

July 2008
Vice President, Corporate Strategy Division

June 2011
Senior Vice President, Chief Strategy Officer and in charge of Food Business, Vice President, Corporate Strategy Division

March 2012
Senior Vice President, Chief Strategy Officer and in charge of Food Business

June 2012
Senior Vice President and Chief Strategy Officer

June 2013
Member of the Board Executive Vice President, JT International S.A.

January 2018
President and Chief Executive Officer

March 2018
Representative Director and President, Chief Executive Officer (Current Position)

Mutsuo Iwai*
Representative Director and Executive Vice President

Date of birth: October 29, 1960
Term of office: 2 years since March 2018
Number of shares held: 22,200

April 1983
Joined the Company (Japan Tobacco and Salt Public Corporation)

June 2003
Vice President, Corporate Planning Division

July 2004
Vice President, Corporate Strategy Division

June 2005
Senior Vice President and Vice President, Food Business Division, Food Business

June 2006
Member of the Board and Executive Vice President, President, Food Business

June 2008
Executive Vice President, Chief Strategy Officer

June 2010
Member of the Board and Senior Vice President, Chief Strategy Officer and Assistant to CEO in Food Business

June 2011
Member of the Board Executive Vice President, JT International S.A.

June 2013
Senior Executive Vice President, Chief Strategy Officer

January 2016
Senior Executive Vice President, President, Tobacco Business

March 2016
Representative Director and Executive Vice President (Current Position)

Significant Concurrent Positions outside the Company
Chairman, JT International Group Holding B.V.

Naohiro Minami*
Representative Director and Executive Vice President

Date of birth: January 21, 1964
Term of office: 2 years since March 2018
Number of shares held: 11,300

April 1986
Joined the Company

December 2005
Controller

July 2010
Deputy Chief Financial Officer and Controller

June 2012
Senior Vice President, Chief Financial Officer and Controller

July 2012
Senior Vice President, Chief Financial Officer

January 2018
Executive Vice President

March 2018
Representative Director and Executive Vice President (Current Position)

Significant Concurrent Positions outside the Company
Supervisory Director, JT International Holding B.V.

Kiyohide Hirowatari*
Representative Director and Executive Vice President

Date of birth: November 11, 1965
Term of office: 2 years since March 2018
Number of shares held: 4,400

April 1989
Joined the Company

July 2010
Vice President, Legal Division

June 2012
Senior Vice President, Chief Legal Officer and Vice President, Legal Division

July 2014
Senior Vice President, Chief Legal Officer

January 2015
Senior Vice President, Head of Tobacco Business Planning Division, Tobacco Business

January 2017
Senior Vice President, Human Resources

January 2018
Executive Vice President

March 2018
Representative Director and Executive Vice President (Current Position)

Main Kohda
Outside Director of the Company

Date of birth: April 25, 1951
Term of office: 2 years since March 2018
Number of shares held: 0

September 1995
Started independently as Novelist (Current Position)

January 2003
Member of Financial System Council, Ministry of Finance Japan

April 2004
Visiting professor, Faculty of Economics, Shiga University

March 2005
Member of the Council for Transport Policy, Ministry of Land, Infrastructure, Transport and Tourism

November 2006
Member of the Tax Commission, Cabinet Office, Government of Japan

June 2010
Member of the Board of Governors, Japan Broadcasting Corporation

June 2012
Outside Director of the Company (Current Position)

Significant Concurrent Positions outside the Company
Novelist
Outside Director, LIXIL Group Corporation (Current Position)
Outside Director, Japan Exchange Group, Inc (Current Position)

Koichiro Watanabe
Outside Director of the Company

Date of birth: April 16, 1953
Term of office: 2 years since March 2018
Number of shares held: 0

April 1976
Joined The Dai-ichi Mutual Life Insurance Company

July 2001
Director, The Dai-ichi Mutual Life Insurance Company

April 2004
Managing Director, The Dai-ichi Mutual Life Insurance Company

July 2004
Managing Executive Officer, The Dai-ichi Mutual Life Insurance Company

July 2007
Director and Managing Executive Officer, The Dai-ichi Mutual Life Insurance Company

April 2008
Director and Senior Managing Executive Officer, The Dai-ichi Mutual Life Insurance Company

April 2010
Representative Director and President, The Dai-ichi Life Insurance Company, Limited.

October 2016
Representative Director and President, Dai-ichi Life Holdings, Inc.

April 2017
Representative Director and Chairman of the Board, Dai-ichi Life Holdings, Inc. (Current Position)
Representative Director and Chairman of the Board, The Dai-ichi Life Insurance Company, Limited (Current Position)

March 2018
Outside Director of the Company (Current Position)

Significant Concurrent Positions outside the Company
Representative Director and Chairman of the Board, Dai-ichi Life Holdings, Inc.
Representative Director and Chairman of the Board, The Dai-ichi Life Insurance Company, Limited

The Audit & Supervisory Board

Entrusted by shareholders and ensured of its autonomy, the Audit & Supervisory Board conducts accounting audits as well as operating audits. Currently, we have four audit & supervisory board members including two independent outside audit & supervisory board members. Collectively, they have experience in management, legal, finance and accounting among other areas. Audit & supervisory board members have various statutory rights in order to accomplish their roles and responsibilities, including making requests to deliver reports to the directors, executive officers and employees, issuing an injunction to prevent illegal activities by directors, and representing the Company in case of litigation between any director and the Company. In addition, the Audit & Supervisory Board has a right to dismiss the auditing firm which conducts accounting audit. The Audit & supervisory board members' report containing the results of both the accounting and operating audits is submitted to the annual general meeting of shareholders.

Tomotaka Kojima
Standing Audit & Supervisory Board Member

Date of birth: December 19, 1953
Term of office: 4 years since March 2015
Number of shares held: 0

April 1976
Joined Ministry of Finance

July 2000
Director-General of the Fukuoka Local Finance Branch Bureau

July 2002
Deputy Head of Finance Group of the Company

July 2004
Deputy Director-General of Employee Welfare Bureau, Secretariat of National Personnel Authority

April 2007
Deputy Director-General of General Secretariat, National Personnel Authority

January 2008
Director-General of Equity and Investigation Bureau, Secretariat of National Personnel

August 2009
Commissioner, National Hospital Organization

November 2010
Executive Secretary, Japan Association of Corporate Directors

June 2013
Standing Audit & Supervisory Board Member, the Company (Current Position)

Ryoko Nagata
Standing Audit & Supervisory Board Member

Date of birth: July 14, 1963
Term of office: 1 year since March 2018
Number of shares held: 12,000

April 1987
Joined the Company

April 2001
Vice President, Products Division, Food Business Division, Food Business

June 2008
Senior Vice President, Head of Beverage Business Division and Vice President, Product Division, Food Business Division, Food Business

July 2008
Senior Vice President, Head of Beverage Business, Food Business

July 2010
Senior Vice President, Head of Beverage Business

July 2013
Senior Vice President, CSR

January 2018
Senior Vice President, Assistant to President

March 2018
Standing Audit & Supervisory Board Member, the Company (Current Position)

Yoshinori Imai
Audit & Supervisory Board Member (Outside Audit & Supervisory Board Member)

Date of birth: December 3, 1944
Term of office: 4 years since March 2015
Number of shares held: 700

April 1968
Joined Japan Broadcasting Corporation

June 1995
Bureau Chief of General Bureau for Europe, Japan Broadcasting Corporation

May 2000
Director General, Planning & Broadcasting Department, Japan Broadcasting Corporation

June 2003
Executive Editor and Programme Host, Japan Broadcasting Corporation

January 2008
Executive Vice President, Japan Broadcasting Corporation

January 2011
Retired from Executive Vice President, Japan Broadcasting Corporation

April 2011
Visiting Professor, Ritsumeikan University (Current Position)

June 2011
Audit & Supervisory Board Member, the Company (Current Position)

Hiroshi Obayashi
Audit & Supervisory Board Member (Outside Audit & Supervisory Board Member)

Date of birth: June 17, 1947
Term of office: 4 years since March 2015
Number of shares held: 0

April 1970
Judicial Apprentice

April 1972
Appointed as Public Prosecutor

May 2001
Director-General of the Rehabilitation Bureau, Ministry of Justice

January 2002
Deputy Vice-Minister of Justice, Ministry of Justice

June 2004
Director-General of the Criminal Affairs Bureau, Ministry of Justice

June 2006
Vice-Minister of Justice, Ministry of Justice

July 2007
Superintending Prosecutor, Sapporo High Public Prosecutors' Office

July 2008
Superintending Prosecutor, Tokyo High Public Prosecutors' Office

June 2010
Prosecutor-General

December 2010
Retired from the office of Prosecutor-General

March 2011
Registered as Attorney at Law

March 2015
Audit & Supervisory Board Member, the Company (Current Position)

Significant Concurrent Positions outside the Company
Attorney at Law, Obayashi Law Office
Outside Audit & Supervisory Board Members, Daiwa Securities Co. Ltd.
Outside director, Mitsubishi Electric Corporation
Outside Audit & Supervisory Board Members, NIPPON STEEL & SUMITOMO METAL CORPORATION

If directors and executive officers find any issue that may cause a substantial damage to the Company, they are obliged to report it to the Audit & Supervisory Board, along with other relevant matters that could affect the Company. Audit & supervisory board members are authorized to attend the meetings of the Board of Directors and other important meetings. Our directors and executive officers respond in a prompt and appropriate manner, when requested by audit & supervisory board members to deliver documents for their inspection, to arrange field audits and to submit reports. The Operational Review and Business Assurance Division, which conducts internal audits, as well as the Compliance Office, exchanges necessary information and works together with audit & supervisory board members.

Members

4 (including two independent outside audit & supervisory board members)

Independence of Outside Directors and Outside Audit & Supervisory Board Members

JT reports to the securities exchanges on which it is listed that the two outside directors and two outside audit & supervisory board members are designated as independent executives. We have a criteria list to assess the independence of an executive. Based on the criteria, the independence of the four executives has been confirmed. Main Kohda, Koichiro Watanabe, Yoshinori Imai and Hiroshi Obayashi, who are outside directors and outside audit & supervisory board members, serve as members of the Compensation Advisory Panel.

Criteria list for independence of an executive

A person who fits any of the following descriptions is not designated as an independent executive.

1. A person who belongs or belonged to JT or an affiliate or sister company of JT
2. A person who belongs to a company or any other form of organization of which JT is a major shareholder
3. A person who is a major shareholder of JT or who belongs to a company or any other form of organization which is a major shareholder of JT
4. A person who is a major supplier or customer of JT (if the supplier or customer is a company or any other form of organization, a person who belongs thereto)
5. A major creditor of JT including a major loan lender (if the creditor is a company or any other form of organization, a person who belongs thereto)
6. A certified public accountant who serves as an accounting auditor or an audit advisor of JT, or a person who belongs to an auditing firm which serves as an accounting auditor or an audit advisor of JT
7. A person who receives a large amount of fees from JT in exchange for providing professional services for legal, financial and tax affairs or business consulting services (if the recipient of such fee is a company or any other form of organization, a person who belongs thereto)
8. A person who receives a large amount of donation from JT (if the recipient of such donation is a company or any other form of organization, a person who belongs thereto)
9. A person who has fit any of the descriptions in 2 to 8 above in the recent past
10. A close relative of a person who fits any of the following descriptions:
    a) A person who fits any of the descriptions in 2 to 8 above (if such descriptions apply to a company or any other form of organization, a person who performs important duties thereof)
    b) A director, audit & supervisory board member, audit advisor, executive officer or employee of JT or an affiliate or sister company of JT
    c) A person who has fit the descriptions in 1 or 2 in the recent past

Support for Outside Directors and Outside Audit & Supervisory Board Members

We provide supports to outside directors and outside audit & supervisory board members. The Corporate Strategy Division or Secretary Division explains the agendas for board meetings in advance, submits requested documents and delivers necessary information to outside directors for them to contribute to the quality of board discussion. As an independent body entrusted by shareholders, the Audit & Supervisory Board is expected to monitor the performance of the directors and executive officers, with an aim to underpin the Company's healthy and sustainable growth as well as increase its credibility. For outside audit & supervisory board members to perform their expected roles, we are supporting them by making necessary information available and allocating adequate human resources to the Auditor Office which assists audit & supervisory board members.

Executive Officer System

JT employs the Executive Officer System to ensure effective and efficient management by promptly responding to the changing environment, and thus aims to increase its company value. Executive officers are appointed by the Board of Directors. At the same time, the board assigns certain responsibilities and delegates relevant authorities to the executive officers in accordance with the Rules Defining the Extent of Responsibility and Authority. In addition, we have the structure for quick decision-making about plan and strategy relevant to all business execution except the matters which are submitted to the Board of Directors. This structure has been established by an articulate decision-making process based on the Rules Defining the Extent of Responsibility and Authority.

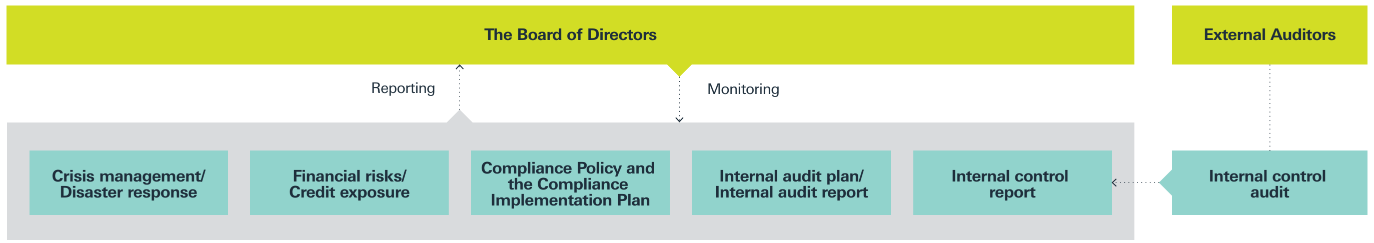
Please refer to p. 66 for the list of executive officers.

Internal Control System & Risk Management System

Overview

JT devotes its efforts to ensure appropriate business operation by reinforcing internal control such as compliance, internal audit and risk management among other matters. The developments of these internal control focuses are reported regularly to the Board of Directors. In addition, we have the Auditor Office, a department dedicated to support the Audit & Supervisory Board, for our audit & supervisory board members to effectively perform their duties. JT works with the Group companies to enhance the framework for compliance (including the reporting concerns system), reliable financial reporting, internal audit and risk management.

Internal control framework



Compliance

A Code of Conduct has been created based on our internal guidelines approved by the Board of Directors. Under the Code of Conduct, all directors and employees are expected to fully comply with applicable laws, our Articles of Incorporation, social norms and other compliance standards. In addition, the Board of Directors has established a fair and effective compliance framework as described below.

- Set up the JT Group Compliance Committee, which reviews and discusses compliance-related matters, reporting directly to the Board of Directors
- Appoint an Executive Vice President responsible for compliance
- Appoint an Executive Officer responsible for the Compliance Office
- Discuss and approve the Annual Compliance Plan as well as the Annual Compliance Action Plans
- Report the status of implemented compliance initiatives to the Board of Directors

The Compliance Office is in charge of enhancing the compliance framework, while identifying any issues in the framework. The Compliance Office also promotes compliance by conducting various training programs to Board Members and employees.

The JT Group has both internal and external hotlines through which employees may consult or report any violations or possible violations of the JT Group Code of Conduct. The Compliance Office is responsible for investigating reported cases and implementing corrective measures after discussing it with the divisions concerned. Significant cases are reviewed by the JT Group Compliance Committee, and further reported to the Board of Directors as necessary.

The JT Group Compliance Committee is headed by the Chairman of the Board, with the majority of the members consisting of external members. The JT Group Compliance Committee met three times in the year ended December 31, 2017, and discussed initiatives to promote compliance throughout the Group among other matters.

Reliable financial reporting

In order to ensure the reliability of its financial reporting, JT has introduced a relevant internal control system in accordance with the Financial Instruments and Exchange Act and other standards. In addition, a dedicated division has been created which reviews the internal control system and reports the result of the assessment. Reliability of our financial reporting is confirmed by the external accounting auditor who makes an assessment of our internal control system based on the Internal Control Report prepared by us.

Risk management

Financial risk management

JT has put in place the internal guidelines for financial risk management. The executive officer in charge updates the status of financial risks together with the countermeasures against these risks. Meanwhile, these risks and the countermeasures against them are reported to CEO and the Board of Directors on a quarterly basis.

Crisis management and disaster control

In order to deal with possible crises or disasters, JT has produced a manual for crisis management and disaster control so that we can make a proper initial response. In the event of a crisis or a disaster, a project team led by the President is immediately assembled. In the project team, the Corporate Strategy Division assumes the key role to support the CEO. Under the leadership of the President, we respond promptly and properly, ensuring close cooperation across the organization. Crisis or disaster incidents shall be reported to the Board of Directors.

Management of other risks

In accordance with the Rules Defining the Extent of Responsibility and Authority, management of other risks is delegated to relevant divisions, which identify and monitor the risks in their areas of responsibility. Significant risks are reported to CEO, together with the request for approval to implement countermeasures against them, where necessary.

Please refer to p. 40 for our risk factors.

Internal audit system

JT has an Operational Review and Business Assurance Division, which is thoroughly independent of other JT Group divisions and organizations engaging in operations. Under such a capacity, it conducts internal audits and directly reports to the CEO. The Operational Review and Business Assurance Division has unlimited access to all activities, records and employees Group-wide to accomplish its roles and responsibilities. The head of the division is required to report to the CEO the results of internal audits along with their analysis and assessment, and also reports to the Board of Directors. The head of the division has the right to contact the management of JT and the Group companies regularly and as frequently as needed.

Executive Remuneration

Overview

Remuneration for our directors is determined by resolution at the Board of Directors, taking into account discussion at the Compensation Advisory Panel. Remuneration for our audit & supervisory board members is determined through the deliberations of the Audit & Supervisory Board. The aggregate remuneration of directors and audit & supervisory board members cannot exceed the respective ceilings approved at a general meeting of shareholders. In determining remuneration, we refer to research management remuneration conducted by a third party, and benchmark Japanese manufacturing companies operating globally with a scale or profit comparable with ours.

The Compensation Advisory Panel

The Compensation Advisory Panel has been established as an advisory body to the Board of Directors with an aim to increase the objectiveness and transparency of our executive remuneration. The Compensation Advisory Panel comprises the Chairman, two outside directors and two outside audit & supervisory board members. Upon request, the Panel reviews and provides advice on the policy, framework and calculation method for remuneration of our directors and executive officers. It also monitors whether our executive remuneration level is reasonable. During the past fiscal year, the Compensation Advisory Panel met 5 times to discuss the level of remuneration among other matters.

Based on the recommendation by the Compensation Advisory Panel, the key policy for our executive remuneration is as follows:

- Set the remuneration at an adequate level to retain personnel with superior capabilities.
- Link the remuneration to company performance so as to motivate executives to achieve their performance targets
- Link the remuneration to company value in the mid- to long-term.
- Ensure transparency by implementing an objective and quantitative framework.

Structure of executive remuneration

In accordance with the above policy, remuneration for our executive comprises:

1. **base salary** paid monthly,
2. **executive bonus** linked to our business performance in the relevant year, and
3. **stock option grants**, the value of which is linked to our mid- to long-term company value.

In 2007, JT introduced a stock option program as an incentive linked to the mid- to long-term company value. The Companies Act requires a special resolution at a shareholders' meeting if stock options are granted under particularly advantageous terms or at particularly advantageous prices. This is not the case with our stock option program, as our stock options are compensation for the executives who perform their duties, and the options are granted in exchange for certain considerations.

Remuneration for the directors and audit & supervisory board members are structured as follows:

Remuneration for the directors who also serve as executive officers comprises 'base salary', 'executive bonus' and 'stock option grants'. 'Executive bonus' is included, as they are responsible for the achievement of assigned annual targets through their day-to-day management.

The combined amount of 'executive bonus' at a 100% grant basis and 'stock option grants' is targeted at approximately 80% of respective annual base salary. Excluding outside directors, remuneration for the directors not serving as executive officers comprises 'base salary' and 'stock option grants', as they focus on decision-making on the Group strategies in addition to supervision of business and corporate activities. Remuneration for outside directors consists solely of 'base salary' and does not include performance linked compensation from the perspective of sustaining their independence.

Remuneration for the audit & supervisory board members is also composed of 'base salary' alone, in light of their key responsibility to conduct audits.

The maximum amount of the annual aggregate remuneration excluding 'stock option grants' for the directors and audit & supervisory board members was approved at our 22nd Annual General Shareholders' Meeting in June 2007. The maximum remuneration for all the directors combined is ¥870 million and ¥190 million for all the audit & supervisory board members combined. In addition, the ceiling for annual 'stock option grants' for the directors was approved at the same shareholders' meeting. The ceiling is 800 options in number and ¥200 million in value. The number of the stock options granted to the directors and the executive officers who are not directors is decided each year by the Board of Directors.

The remuneration payments to the directors and audit & supervisory board members for the year ended December 2017 are as follows:

Category	Total remuneration and other payments (million yen)	Total amount of remuneration and other payments by type (million yen)			Number to be paid (people)
		Basic remuneration	Director's bonus	Stock option grants	
Directors (excluding Outside Directors)	482	362	–*	120	5
Audit & Supervisory Board member (excluding Outside Audit & Supervisory Board members)	86	86	–	–	2
Outside Directors and Outside Audit & Supervisory Board members	67	67	–	–	4
Total	**635**	**515**	**–**	**120**	**11**

* Director's bonus (excluding Outside Directors) to be zero in 2017.

The remuneration payments to the directors and the audit & supervisory board members whose total remuneration exceeds ¥100 million for the year ended December 2017 are as follows:

Name	Category	Company	Amount of consolidated remuneration and other payments by type (million yen)			Total (million yen)
			Basic remuneration	Director's bonus	Stock option grants	
Mitsuomi Koizumi	Representative Director	JT	106	–*	35	**141**

* Director's bonus (excluding Outside Directors) to be zero in 2017.

The stock options granted for the year ended December 2017 are as follows:

Resolution date	June 14, 2017
Positions and number of people grants	Directors (excluding Outside Directors): 5 persons Executive officers (excluding persons serving as Directors): 19 persons
Number of shares	53,000 shares to Directors (excluding outside Directors) 89,400 shares to Executive officers (excluding persons serving as Directors) Total 142,400 shares (200 shares per stock acquisition right)

History of the JT Group

Before 1985

JT's history in Japan dates back to 1898, when the Government formed a monopoly bureau to operate the exclusive sale of domestic tobacco leaf.

The JT Group's overseas history began with the founding of Austria Tabak in 1784. Roughly 70 years later, Tom Gallaher started out in business in Northern Ireland, laying the foundations for the Gallaher Group. Meanwhile, R.J. Reynolds Tobacco Co. (RJR), which would subsequently create the Camel and Winston brands, was established in 1874 in the US. In this manner, the current JT Group can trace its origins to many different countries and regions such as Austria, Northern Ireland, the US and Japan. The JT Group has a long history and extensive experience in the tobacco business.

History in Japan from the early 20th century to 1984, when the Japan Tobacco Inc. Act was enacted
Our history in Japan dates back to 1898, when the Government formed a monopoly bureau to undertake the exclusive sale of domestic leaf tobacco. In the early 1900s, the Japanese Government extended this monopoly to all tobacco products in Japan and to the domestic salt business. On June 1, 1949, the bureau was established and duly named the Japan Tobacco and Salt Public Corporation, or JTS. This corporation helped to ensure the stable supply of tobacco and secure fiscal revenues for the Government.

The growth in demand for cigarettes in Japan began to slow in the mid-1970s as a result of demographic trends and growing concern about health risks associated with smoking. This trend continued, such that growth in industry sales essentially stopped. In addition to the structural change, the domestic tobacco market opened up substantially to foreign suppliers, triggering competition between domestic and foreign tobacco products in Japan.

Foreign countries stepped up pressure on Japan to take further measures to open the market that were difficult to implement within the framework of the monopoly tobacco sales system. Amid such pressure as well as moves toward the reform of Government-run public corporations, a Government panel was established in March 1981 to conduct research into the public corporation system. In its third report (July 30, 1982), the panel proposed drastic reform of the monopoly and public corporation systems. In response to this proposal, the Government conducted a comprehensive review of these systems and drafted bills to:

- Abolish the tobacco monopoly law to liberalize tobacco imports and establish a tobacco business law to make necessary adjustments related to the tobacco business.
- Abolish the JTS law, reorganize JTS as a joint stock corporation so as to enable it to pursue rational corporate management as much as possible and establish the Japan Tobacco Inc. Act, which provides for a necessary minimum level of regulation in light of the corporation's need to compete with foreign tobacco companies on an equal footing in the domestic market following the liberalization of tobacco imports.

These bills were enacted on August 3, 1984 in the 101st session of the Diet and promulgated on August 10 of the same year. In April 1985, JT was founded as an entity that took over the whole of the business operations and assets of JTS.

1784
Austria Tabak is founded by Emperor Joseph II.

1857
Tom Gallaher sets up his business in Londonderry, Northern Ireland.

1874
RJR is founded by Richard Joshua Reynolds in Winston, North Carolina.

1879
Sobranie is registered in London, to become one of the oldest cigarette brands in the world.

1891
The Moscow-based Ducat factory is founded.

1898
The Japanese Monopoly Bureau is established for the sale of domestic leaf tobacco.

1913
Camel is launched.

1931
Cellophane is introduced by RJR in order to preserve the freshness of tobacco.

1949
The Monopoly Bureau becomes the Japan Tobacco and Salt Public Corporation.

1954
Winston is launched.

1955
Benson & Hedges is acquired by Gallaher.

1956
Salem is launched.

1957
HOPE (10) is launched as Japan's first domestically produced filter cigarettes.

1964
Silk Cut is launched.

1968
Gallaher is acquired by the American Tobacco Company.

1969
Seven Stars is launched, featuring Japan's first domestically produced charcoal filter.

1977
Mild Seven is launched (Japan).

1981
Mild Seven is launched internationally.

1984
Japan Tobacco Inc. Act is enacted.

In and After 1985

The corporate history of JT is summarized in the table to the right. For the international tobacco business, the history before JT's acquisitions of RJR Nabisco's non-US tobacco operations and Gallaher is included.

The operating environment for JT changed drastically in just two years after the foundation of the Company, with the yen's strong appreciation following the Plaza Accord in 1985, a tobacco tax hike in 1986 and the abolition of tariffs on imported cigarettes in 1987. Amid the yen's upsurge, a price increase for JT products due to the tobacco tax hike, coupled with price cuts for imported cigarettes attributable to the tariff abolition, eliminated the price advantage of JT products over imported products, which had stood at around ¥60 to ¥80 when JT was founded in 1985. As a result, competition between JT and foreign tobacco makers intensified in the Japanese market, leading to a decline in JT's market share from 97.6% in fiscal 1985 to 90.2% in fiscal 1987.

To cope with the rapid deterioration of the operating environment, JT implemented rationalization measures to enhance its cost-competitiveness and pursued diversification while taking measures to strengthen its marketing capability. In the 1990s, JT's competition with foreign rivals in the Japanese market intensified further. Furthermore, overall cigarette demand in Japan peaked in the latter half of the 1990s due to a contraction of the adult population and growing concerns with health problems associated with smoking. Amid the increasingly difficult operating environment for the Japanese Domestic Tobacco business, JT took additional rationalization steps, pursued consolidation of operations in its areas of business diversification and expanded the international tobacco business, thereby strengthening its business foundation.

JT significantly strengthened the international tobacco business by acquiring RJR Nabisco's non-US tobacco operations in 1999 and Gallaher in 2007. With its international sales volume exceeding its domestic sales volume, the JT Group continues to grow as a global tobacco company. The international tobacco business is the engine of the JT Group's profit growth through its comprehensive brand portfolio which includes Winston, Camel, Mild Seven – MEVIUS and LD as well as Benson & Hedges, Silk Cut, Sobranie, Glamour and Natural American Spirit.

1985

April
Japan Tobacco Inc. is established. (Japanese tobacco market opened to Foreign tobacco manufacturers).

The Business Development Division is established to promote new businesses.

The Business Development Division is later reorganized into operational divisions engaged in the food and pharmaceutical businesses, finishing in July 1990.

1987

April
Import tariffs on imported cigarettes are abolished.

1988

October
JT communication name is introduced.

1992

Acquisition of Manchester Tobacco Company Ltd.
Acquisition of AS-Petro (Russia).*

1993

September
The Central Pharmaceutical Research Institute is established to enhance in-house research capabilities.

1994

October
Government releases first tranche of outstanding JT shares for initial public offering (394,276 shares offered at ¥1,438,000 apiece).

JT stock is listed on the first sections of stock exchanges in Tokyo, Osaka and Nagoya.

November
JT stock is listed on the stock exchanges in Kyoto, Hiroshima, Fukuoka, Niigata and Sapporo.

Acquisition of Yelets (Russia).*

1995

May
Head office is moved back to Minato-ku from Shinagawa-ku.

Peter I is launched (Russia).*

1996

June
Government releases second tranche of outstanding JT shares (272,390 shares offered at ¥815,000 apiece).

Acquisition of Tanzanian tobacco production facility.*

1997

April
JT ends its salt monopoly business in line with abolition of the salt monopoly system.

The Tobacco Mutual Aid Pension scheme is integrated into the Employees' Pension scheme.

American Brands spins off Gallaher which becomes Gallaher Group Plc and is listed on the London and New York stock exchanges.**

1998

April
JT signs an agreement with Unimat Corporation (currently, Japan Beverage Holdings Inc.) on a tie-up regarding beverage business. JT later acquires a majority stake in Unimat.

December
JT acquires a majority stake in Torii Pharmaceutical Co., Ltd. through a tender offer.

1999

May
JT acquires the non-US tobacco business of RJR Nabisco Inc.

July
JT acquires the food business of Asahi Kasei Corporation, including Asahi Foods and seven other subsidiaries.

October
Under a business tie-up between JT and Torii Pharmaceutical Co., Ltd., the two companies' R&D operations related to medical pharmaceuticals are concentrated at JT, while their promotion operations are combined at Torii Pharmaceutical.

LD launched (Russia).**

2000

Acquisition of Liggett-Ducat (Russia).**

2001

Acquisition of Austria Tabak.**

2003

October
JT repurchases 45,800 of its own shares to increase its management options.

2004

June
Government releases third tranche of outstanding JT shares (289,334 shares offered at ¥843,000 apiece), reducing its stake in JT to the minimum level allowed under law.

November–March 2005
JT repurchases 38,184 of its own shares to increase its management options.

2005

April
JT terminates a licensing contract under which it had exclusive rights to produce and sell Marlboro brand products in Japan and use the Marlboro trademark in the country.

June
Acquisition of CRES Neva Ltd. (Russia).

Glamour is launched (Russia, Ukraine, Kazakhstan).**

2006

April
JT implements a 5 for 1 stock split in order to expand the investor base, effective April 1, 2006.

May
Acquisition of AD Duvanska Industrija Senta in Serbia.

2007

April
JT acquires all outstanding shares of Gallaher Group Plc.

2008

January
JT acquires a majority stake in Katokichi Co., Ltd. through a tender offer.

April
JT acquires a majority stake in Fuji Foods Corporation.

July
JT concentrates its processed food operations, including frozen food and seasonings operations, at the Katokichi Group.

2009

May
JTI celebrates its 10th anniversary.

June
JTI Leaf Services (US) LLC is established.

October
Acquisition of leaf suppliers Kannenberg & Cia. Ltda. (Brazil) and Kannenberg, Barker, Hail & Cotton Tabacos Ltda. (Brazil).

November
Acquisition of leaf suppliers Tribac Leaf Limited (UK).

2010

January
Katokichi Co., Ltd. is renamed TableMark Co., Ltd.

May
Smokeless tobacco product Zerostyle Mint is launched.

2011

March
JT repurchases 58,630 of its own shares, as part of its shareholder return measures.

November
Acquisition of Haggar Cigarette & Tobacco Factory Ltd. (North Sudan) and Haggar Cigarette & Tobacco Factory Ltd. (South Sudan).

2012

July
For the purpose of enlarging Company's investor base, a 200 for 1 stock split is conducted. At the same time, JT adopts the share unit system, setting a share trading unit at 100 shares.

August
Acquisition of Gryson NV, a Belgium Fine Cut maker.

2013

February
The name change of Mild Seven to MEVIUS in Japan.

Government releases fourth tranche of outstanding JT shares (333,333,200 shares offered).

On February 27, JT repurchases 86,805,500 shares through ToSTNeT-3, including 80,071,400 shares from the Government.

Excluding the share repurchased by JT, 253,261,800 shares are offered by the Government in March.

March
Acquisition of Al Nakhla Tobacco Company S.A.E. and Al Nakhla Tobacco Company – Free Zone S.A.E., a leading Egyptian water-pipe company.

May
Launch of a novel anti-HIV drug 'Stribild Combination Tablets' in Japan, containing our original compound (elvitegravir).

December
JT acquires a minority interest in Megapolis, the leading Russian distribution company.

2014

April
TableMark establishes a holding company.

October
Launch of 'CEDARTOLEN SUBLINGUAL DROP – Japanese Cedar Pollen', a sublingual immunotherapy drug for Japanese cedar pollinosis.

November
Acquisition of e-cigarettes company Zandera Ltd. (UK).

2015

February–March
JT repurchases 26,896,200 shares as part of its shareholder return measures.

July
Acquisition of leading US e-cigarette company Logic.

Transfer shares of JT's subsidiaries conducting vending machine operation business and JT beverage brands 'Roots' and 'Momono Tennensui'. Afterwards, JT withdrew from the manufacture and sale of JT beverage products in September and JT's beverage business division was abolished in December 2015.

August
Integration of 'Cabin' and 'Caster' with 'Winston'.

September
Acquisition of Iranian Tobacco company Arian Tobacco Industries

2016

January
Acquisition of Natural American Spirit Business outside the United States.

July
Launch of a novel anti-HIV drug 'Genvoya Combination Tablets' in Japan.

Acquisition of 40% shares of National Tobacco Enterprise Ethiopia S.C.

2017

June
Ploom TECH sales to start in the Tokyo metropolitan area

September
Completes the acquisition of assets related to the tobacco business of Mighty Corporation in the Philippines.

October
Completes the share transfer of Indonesian kretek cigarette company 'PT. Karyadibya Mahardhika' and its distributor 'PT. Surya Mustika Nusantara.'

December
Additional share purchase from the Ethiopian government of approximately 30% of the total shares in National Tobacco Enterprise S.C. to become majority shareholder with over 70% of the shares.

* Topics of RJR Nabisco's non-US operations before participating in the JT Group.
** Topics of Gallaher before participating in the JT Group.

Regulation and Other Relevant Laws

Tobacco Business

Regulation in the international markets
In international markets where JT Group's tobacco products are sold, World Health Organization (WHO) adopted the Framework Convention on Tobacco Control ('FCTC') at its 56th World Health Assembly held in May 2003. It came into force in February 2005 (Government of Japan accepted it in June 2004).

Since then, there has been a rising trend in regulations regarding sales promotions, packages and outer wrappers, marketing of tobacco products and smoking.

The purpose of the FCTC is to continuously and substantively control the proliferation of smoking.

Its provisions include, among others, price and tax measures to reduce tobacco demand, non-price measures to reduce the demand for tobacco (such as protection from exposure to tobacco smoke, regulation of contents and emissions of tobacco products, regulation of disclosure of tobacco products, regulations on packaging and labeling of tobacco products, regulations on tobacco advertising, promotion and sponsorship, among others), and measures relating to the reduction of the supply of tobacco (such as prevention of illicit trade, prohibition of sale of tobacco products to minors, among others). Moreover, in November 2012, the protocol to eliminate illicit trade in tobacco products was adopted at the fifth session of the Conference of the Parties. As general obligation, signatories to the protocol are to formulate, adopt, periodically update and review strategies, plans and programs for tobacco regulation. However, the content, scope and method of specific controls undertaken in these nations are ultimately legislated by each respective nation.

Regulation by country or region
In May 2014, the 'EU Tobacco Product Directive (EU TPD)' revised from the earlier Directive promulgated in July 2001, entered into force. This revised Directive includes, among others, strengthening of packaging and labeling regulations, restrictions on the use of additives including menthol for cigarettes and fine cut, and regulations related to electronic cigarettes. All EU member states are required to establish their domestic laws, regulations and ordinances to conform the revised directive. This revised directive has been legislated or implemented in each EU member.

In addition, in the UK, plain packaging regulations have been introduced whereby individual packages for tobacco products must be of a prescribed color, and product names must be displayed on the packages in a prescribed printing location, font, font size, and font color with an additional requirement for graphic warnings to be printed on the package. In addition to these, a number of other countries have implemented or are considering the implementation of various restrictions.

In Russia, one of our key markets, legislation was passed in February 2013, which includes protection from exposure to tobacco smoke and other matters related to tobacco consumption. The legislation came into effect and has been implemented. It contains a number of provisions including display ban, restrictions on sales of tobacco products in certain retail stores, ban on advertising, sponsorship and promotions, introduction of minimal pricing and ban on smoking in public places.

Although it is impossible to predict the content of future laws, regulations and industry guidelines relating to sales activities, marketing and smoking, the JT Group expects regulations like the above and new regulations (including those of local governments) to spread across Japan and other countries where the group sells its products.

Regulation in Japan
The Tobacco Business Act, related acts and statutes and voluntary standards set forth the regulations for the sale and promotion activities of tobacco products in Japan that include the indication of warning labels on tobacco product advertisements and packages that urge caution over the relationship between the consumption of tobacco products and health.

In November 2003, the Ordinance for Enforcement of the Tobacco Business Act was revised including the wording of the cautions over the relationship between the consumption of tobacco products and health indicated on tobacco product packages and, starting July 2005, all tobacco products sold in Japan have been in conformity to the revised regulations. In addition, the Japanese Minister of Finance has indicated a 'Guideline for Advertising of Tobacco Products' based on the Tobacco Business Act which, in March 2004, was revised with tougher language. The Tobacco Institute of Japan has established voluntary standards regarding the advertising and sales promotion activities for tobacco products. All member companies, including JT, comply with these standards. In addition, the ministry of finance has started to discuss for revising the wording of the cautions and advertising regulation. We expect these regulations will be materialized followed by the future discussion.

Recently in Japan from the perspective of passive smoking prevention, cases where smoking in public areas including restaurants and office buildings has been restricted by laws. Moreover, the discussion regarding the strengthening measures against the prevention of secondhand smoke has been started by the Japanese government in January 2016 and it will be enhanced in near future.

Tobacco Business Act
Importers and wholesalers of tobacco products must register with the Minister of Finance and, retailers of tobacco products must obtain the license of the Minister of Finance. The retailers of tobacco products are required to sell the tobacco products manufactured by JT and imported tobacco products at the fixed retail price which is approved by the Minister of Finance. The Minister of Finance must approve the filed retail sales prices unless otherwise considered unfairly prejudicial to consumers. The Tobacco Business Act requires JT to annually enter into purchase contracts with tobacco growers regarding the aggregate cultivation area for specific varieties of leaf tobacco and the prices for leaf tobacco by variety and grade. JT must purchase all leaf tobacco produced pursuant to such contracts, except for any not suited for the manufacture of tobacco products. When JT decides the aggregate cultivation area and the prices of leaf tobacco for its contracts with tobacco growers, it is required to respect the opinion of the Leaf Tobacco Deliberative Council (hatabako shingi kai), which consists of members appointed by JT with the approval of the Minister of Finance from among the representatives of domestic leaf tobacco growers and academic appointees. Much like many other agricultural products in Japan, production costs for domestically grown leaf tobacco is higher than those of foreign-grown leaf tobacco to the extent that the purchasing price for the former (before re-drying) is approximately three times that of the latter (after re-drying).

In November 2003, the Ordinance for Enforcement of the Tobacco Business Act was revised and the wording of warnings concerning tobacco consumption and health indicated on the tobacco product package was changed. In addition, the Ordinance stipulated that when wording like 'mild' and 'light' is used on the package, they must be accompanied by a warning that clarifies that such words do not mean that the risk to their health is lower than other tobacco products so as to prevent consumers from misunderstanding the relationship between the consumption of tobacco products and health. JT has been adhering to this rule since July 1, 2005.

Self-regulation on marketing
JT Global Marketing Principles
The JT Group complies with all regulation of respective countries in which we operate. At the same time, we pursue our business based on the 'JT Global Marketing Principles (the Principles)'. The Principles place importance on responsible marketing of tobacco products and outline our thoughts on advertising and promotions or health warnings, among others. Moreover, we recognize that youth smoking prevention is an issue which must be addressed by society as a whole. Based on the Principle, we govern our business and marketing activities, while working with government and other relevant organizations to take steps towards preventing youth smoking.

For further details, please refer to the JT Group websites.

Pharmaceutical Business

The pharmaceutical industry operates in a highly regulated environment. In many countries, R&D, manufacturing and sales promotion activities are strictly regulated. Moreover, in recent years, the approval process for new drugs has been tightening due to the increased requirements to promote public health and safety. Today, compared to the past, pharmaceutical companies are required to spend more time to examine pharmaceutical safety issues and conduct a greater number of clinical trials on subjects to collect more data on the efficacy of new compounds. Consequently, clinical trials are growing in scale, cost and time. Meanwhile, the standards of reliability and amount of research data have been internationally harmonized. Therefore, more efficient and reasonable development process with internationally utilized data has been carried out.

In Japan, the marketing of pharmaceutical products is subject to the supervision of the Ministry of Health, Labor and Welfare, or MHLW, primarily under the Act on Securing Quality, Efficacy and Safety of Pharmaceuticals, Medical Devices, Regenerative and Cellular Therapy Products, Gene Therapy Products, and Cosmetics, while part of its supervisory authority is undertaken by the relevant prefecture. Under the act, in order to conduct the marketing business of pharmaceuticals, a person is required to obtain from the relevant prefecture a renewable, generally five-year marketing business license. In addition, under the act, in order to market pharmaceuticals, it is necessary to obtain marketing approval from the MHLW for each kind of product.

The national health insurance system covers virtually the entire Japanese population. To sell a pharmaceutical product in Japan, a marketing business license holder of pharmaceutical products must first have a new pharmaceutical product listed on the National Health Insurance Pharmaceutical Price List for coverage under the national health insurance system. The drug pricing reform package would be in effected such as an annual drug price revisions, limiting the number of price maintenance premium drugs and a price reduction of long-listed drugs according to replacement rate.

Processed Food Business

As a producer and seller of food products, the JT Group's processed food business is subject to regulations mainly under the Food Safety Basic Act, the Food Sanitation Act and the Food Labeling Act.

The Food Safety Basic Act requires food-related companies to take necessary measures to ensure food safety in each process of the supply chain, as well as to make efforts to provide accurate information about foods and food-related goods in an appropriate manner.

The Food Sanitation Act concentrates on prevention of sanitary problems arising from consumption of foods and beverages. This Act requires food companies to take necessary measures under their own responsibility to ensure the safety of foods, additives, appliances and packages. The measures discussed in the Act include the acquisition of knowledge and skills, assurance of the safety of raw materials and voluntary inspection. The Food Labeling Act sets the standards for labeling of food that is intended for sales which define the labeling requirements such as allergen and expiration date, materials, or origin. Persons Engaged in Food-related Business and others must comply with the standards in preparing their product labels.

The JT Group is striving to establish a high level of food safety control from the above-mentioned four perspectives – 'food safety', 'food defence', 'food quality' and 'food communication' – in addition to complying with these laws and regulations and ensuring thorough awareness about them.

Litigation

JT and/or some of its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking, the marketing of tobacco products, or exposure to tobacco smoke. As of the fiscal year-end date, there were a total of 21 smoking and health-related cases pending in which one or more members of the JT Group were named as a defendant or for which JT may have certain indemnity obligations pursuant to the agreement such as for JT's acquisition of RJR Nabisco Inc.'s overseas (non-US) tobacco operations. We believe it is possible that other similar smoking and health-related lawsuits may be filed in the future.

In addition, JT and some of its subsidiaries are also defendants in lawsuits other than the smoking and health-related cases. Please refer to 'Note 39' to the consolidated financial statements (Contingencies-Contingent Liabilities) for major lawsuits to which JT and some of its subsidiaries are named as defendants. Similar lawsuits involving us may be filed and contested in courts in the future.

To date, we have never lost a case or paid any settlement award in connection with smoking and health-related litigation. However, we are unable to predict the outcome of currently pending or future lawsuits. If a court ruling is unfavorable for us, in such cases whether lawsuits are smoking and health related or not, our financial results, production, sales and imports/exports of tobacco products may be adversely affected.

As of the fiscal year-end date, there are 10 ongoing health-care cost recovery cases in Canada pending against JTI-Macdonald Corp. and JT's indemnities (RJR Nabisco Inc.'s affiliates), brought by Canadian provinces. In addition, there are eight pending class actions in Canada, of which 6 are currently dormant, where plaintiffs are seeking damages for harm allegedly caused by smoking of cigarettes. Damages claimed in some of these cases reach sums in the multi-billion dollar range. We will continue to take all appropriate actions to defend such claims vigorously, and believe there are a number of valid defences.

In recent decades, numerous, large-scale, smoking and health-related cases have been brought against tobacco product manufacturers in the US, and some of the cases initially resulted in verdicts with massive damage awards. JT and its subsidiaries are not defendants in any of these lawsuits, nor are they subject to any indemnity claims with respect to them. The tobacco business which JT acquired from RJR Nabisco Inc. in 1999 and the Natural American Spirit business which JT acquired from the Reynolds American Inc. group of companies in January 2016 did not include brands in the US, and even now, our historic and current tobacco business scale in the US remains small. Accordingly, we consider potential exposure to smoking and health-related litigation in the US to be low, and we thus believe that litigation in the US will not materially affect our businesses in the near future.

Following the 2015 acquisition of Logic Technology Development LLC, JT Group operates an e-cigarette business in the US. We are not aware of any related ongoing litigation alleging chronic effects on health associated with e-cigarette use. However, cases were filed against e-cigarette manufacturers in the US alleging harm caused to consumers by misleading representations and advertising for which plaintiffs are seeking damages and/or demanding health warnings. As of 31st December 2017, neither JT nor any of its subsidiaries are a party to these cases.

As a tobacco product manufacturer, we continue to monitor closely the developments and trends of litigation involving tobacco companies in the US, Canada, and elsewhere, with particular interest and attention.

Members of the Board, Audit & Supervisory Board Members, and Executive Officers

As of March 27, 2018

Members of the Board

Chairman of the Board
Yasutake Tango

Representative Directors
Masamichi Terabatake
Mutsuo Iwai
Naohiro Minami
Kiyohide Hirowatari

Members of the Board
Main Kohda*
Koichiro Watanabe*

*Outside Directors under the Companies Act of Japan.

Audit and Supervisory Board Members

Standing Audit and Supervisory Board Members
Tomotaka Kojima
Ryoko Nagata

Audit and Supervisory Board Members
Yoshinori Imai**
Hiroshi Obayashi**

**Outside Audit and Supervisory Board Members under the Companies Act of Japan.

Executive Officers

President
Masamichi Terabatake
Chief Executive Officer

Executive Vice Presidents
Mutsuo Iwai
President, Tobacco Business

Naohiro Minami
Chief Financial Officer and Communications

Kiyohide Hirowatari
Compliance, General Affairs, Legal, Corporate Strategy, IT, CSR, Human Resources and Operation Review & Business Assurance

Senior Vice Presidents
Ryoji Chijiiwa
Compliance and General Affairs

Chito Sasaki
President, Japanese Tobacco Business, Tobacco Business

Kazuhito Yamashita
Head of China Division, Tobacco Business

Shiroji Maeda
Chief Marketing & Sales Officer, Tobacco Business

Senior Vice Presidents
Junichi Fukuchi
Corporate, Scientific & Regulatory Affairs Division, Tobacco Business

Takehisa Shibayama
Chief R&D Officer, Tobacco Business

Hirakazu Otomo
Manufacturing Group, Tobacco Business

Kenji Ogura
Head of Leaf Procurement Group, Tobacco Business

Hiroyuki Ikuma
Head of Quality Assurance Group, Tobacco Business

Muneaki Fujimoto
President, Pharmaceutical Business

Shigenori Ohkawa
Head of Central Pharmaceutical Research Institute, Pharmaceutical Business

Haruhiko Yamada
Legal

Yuki Maeda
Corporate Strategy and IT

Takehiko Tsutsui
Business Development

Kei Nakano
Communications

Takanori Kikuchi
General Affairs

Chigusa Ogawa
CSR

Koichi Mori
Human Resources

Members of the JTI Executive Committee

As of January 1, 2018

Eddy Pirard
President and Chief Executive Officer

Koji Shimayoshi
Deputy CEO and Executive Vice President, Business Development and Corporate Strategy

Roland Kostantos
Chief Operating and Financial Officer

Howard Parks
Senior Vice President, Human Resources

Daniel Torras
Senior Vice President, Reduced-Risk Products

Suzanne Wise
Senior Vice President, Corporate Development

Wade Wright
Senior Vice President, Legal and Regulatory Affairs

Bilgehan Anlas
Senior Vice President, Global Supply Chain

Antoine Ernst
Senior Vice President, Marketing and Sales, Chief Brand Officer

Stefan Fitz
Regional President, Asia Pacific

Marchant Kuys
Regional President, Americas

Hiroyuki Miki
Senior Vice President, Research and Development

Jorge da Motta
Regional President, Middle East, Near East, Africa, Turkey and Worldwide Duty Free

Kevin Tomlinson
Regional President, Eastern Europe

Vassilis Vovos
Regional President, Western Europe

Corporate Data

Head Office
2-1, Toranomon 2-chome,
Minato-ku, Tokyo 105-8422, Japan
Tel: 81-3-3582-3111
Fax: 81-3-5572-1441
URL: https://www.jt.com/

Date of Establishment
April 1, 1985

Paid-in Capital
¥100 billion

JT International S.A.
8, rue Kazem Radjavi
1202 Geneva
Switzerland
Tel: +41 (0)22-703-0777
Fax: +41 (0)22-703-0789
URL: https://www.jti.com/

Investor Relations Activity

We promote the engagement for a variety of shareholders through IR activities.

We are pursuing the fair and broad disclosure of financial information such as operating results and non-financial information including management strategy, corporate governance, ESG information and each business condition through direct communication with shareholders and institutional investors.

Our dedicated IR team based in Tokyo and Geneva take an initiative to communicate with analysts and institutional investors on a daily basis. You can see our IR activities in 2017 below:

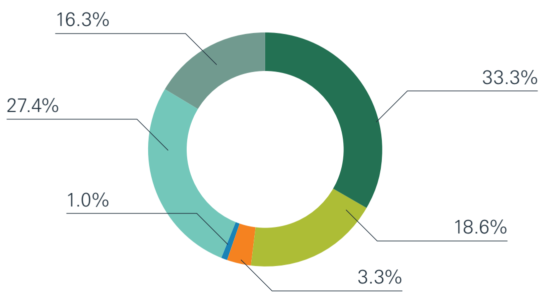
The number of IR interviews with analysts and institutional investors in 2017

650

Approx.

Activities	Results	Details
Report to the board of directors	2	We report our IR activities to the board of directors every six months. In addition, we edit an internal report of IR-related activities and submit the report to the management by monthly basis.
IR meeting for financial results	4	We hold telephone conferences for the financial results of first quarter, second quarter and third quarter. In addition, we organize an IR meeting for the end of year results. The speakers are president, chief financial officer and other executives.
Business conference for analysts and institutional investors	1	We have a business conference at which a representative from each business segment speaks. In July 2017, we held a pharmaceutical business conference. The number of participants was approx. 90 persons including those attending and participating through the teleconference.
IR interview	Approx. 650	We have IR interviews and teleconferences for analysts and institutional investors.
IR road show overseas	5	A president, executive vice president or senior vice president visits shareholders and institutional investors in key financial cities. (North America, Europe and Asia).
IR conferences in Japan and overseas	9	We participate in IR conferences organized by financial institutions and our executive officers or IR members meet analysts and institutional investors in Japan and overseas.
IR meeting for individual investors	5	An executive vice president or senior vice president visits IR meetings for individual investors which are held nationwide.
Factory tour for analysts and institutional investors	1	We organize a factory tour for analysts and institutional investors on an ad hoc basis. In 2017, we had a tour of the Kita-Kanto factory in Utsunomiya, Japan.

Composition of shareholders, December 31, 2017



- Government and local governments
- Financial institutions
- Securities companies
- Other Japanese companies
- Foreign institutions, etc.
- Individuals and others

Shareholder Information

As of December 31, 2017

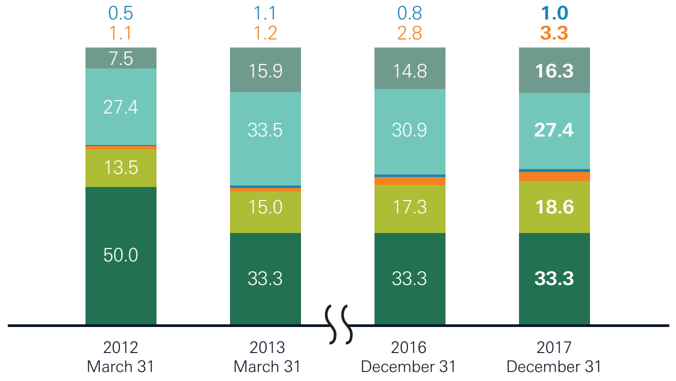
Common Stock
Note: A 200 for 1 stock split was completed on July 1, 2012.

Authorized:	8,000,000,000
Issued:	2,000,000,000
Number of shareholders:	205,939

Share Registrar
Mitsubishi UFJ Trust and Banking Corporation
4-5, Marunouchi 1-chome, Chiyoda-ku, Tokyo

Stock Exchange Listings
1st Section of Tokyo Stock Exchange

Composition of shareholders (%)



- Government and local governments
- Financial institutions
- Securities companies
- Other Japanese companies
- Foreign institutions, etc.
- Individuals and others

As of December 31, 2017

Principal Shareholders

Name	Shares held
Minister of Finance	666,926,200
Master Trust Bank of Japan, Ltd. (Trust Account)	72,269,400
Japan Trustee Services Bank, Ltd. (Trust Account)	60,387,900
GIC Private Limited – C (Standing proxy: Bank of Tokyo-Mitsubishi UFJ, Ltd.)	37,829,600
Trust & Custody Services Bank, Ltd. as trustee for Mizuho Bank, Ltd. Retirement Benefit Trust Account re-entrusted by Mizuho Trust and Banking Co., Ltd.	33,800,000
State Street Bank and Trust Company 505223 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	32,751,576
Japan Trustee Services Bank, Ltd. (Trust Account 5)	23,678,900
State Street Bank and Trust Company (Standing proxy: Hongkong and Shanghai Banking Corporation Limited, Tokyo Branch)	23,641,185
State Street Bank West Client – Treaty 505234 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	21,021,193
GIC Private Limited – H (Standing proxy: Bank of Tokyo-Mitsubishi UFJ, Ltd.)	20,314,500

Offering JT Shares by Government

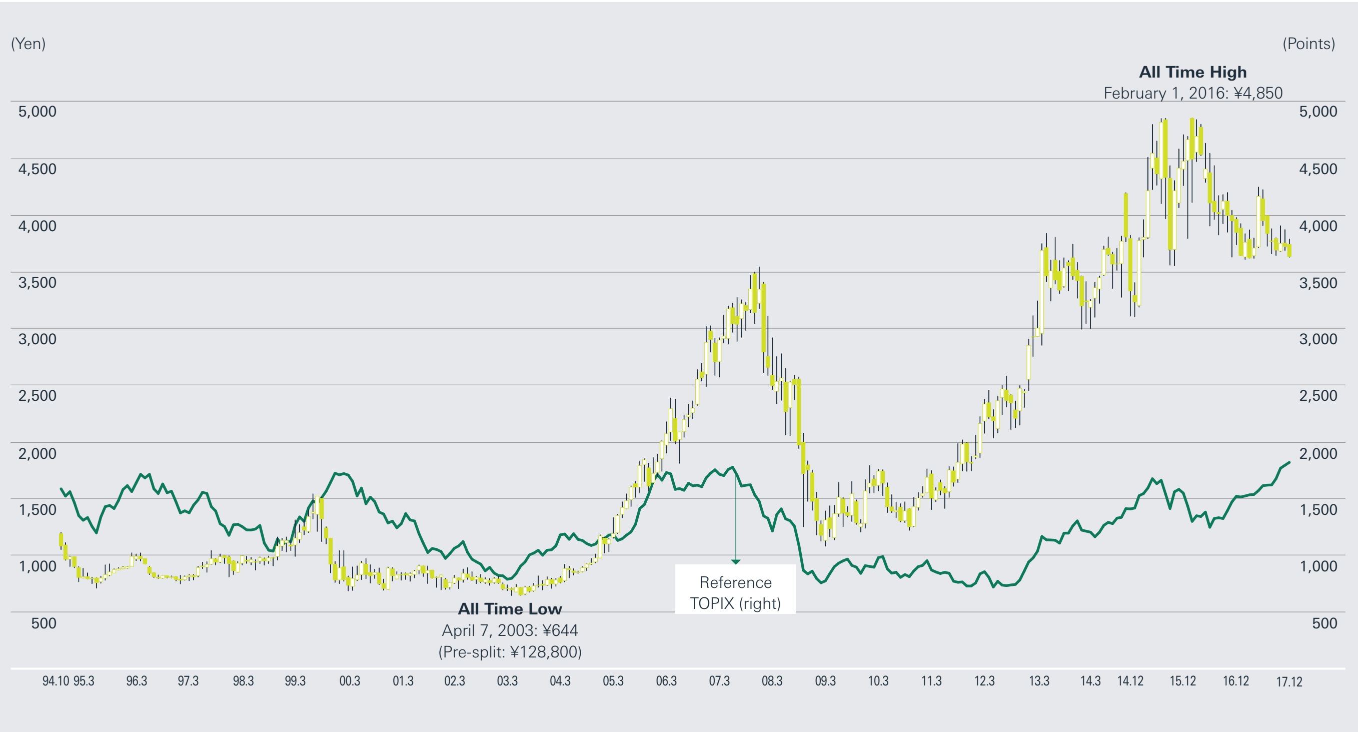
1st Offering		
Method	Offering by Bids	Offering by non-Bids
Offer Price (Pricing Date)	Bid Price: From ¥1,362,000 to ¥2,110,000 Weighted Average Price: ¥1,438,000 (August 29, 1994)	¥1,438,000 (August 31, 1994)
Number of Offering shares	229,920 shares	164,356 shares
Offering Term	From August 15 to 18, 1994	From September 2 to 8, 1994

Note:
The Listing date
October 27, 1994: First Sections of Tokyo Stock Exchange.

2nd and 3rd, 4th Offering

	2nd Offering	3rd Offering	4th Offering
Method	**Offering by Book-Building formula**	**Offering by Book-Building formula**	**Offering by Book-Building formula**
Offer Price (Pricing Date)	Bid Price: ¥815,000 (June 17, 1996)	¥843,000 (June 7, 2004)	¥2,949 (March 11, 2013)
Number of Offering shares	Japan: 237,390 shares, International: 35,000 shares (Total: 272,390 shares)	Japan: 198,334 shares, International: 91,000 shares (Total: 289,334 shares)	Japan: 145,625,500 shares, International: 107,636,300 shares (Total: 253,261,800 shares)
Offering Term	From June 18 to 19, 1996	From June 8 to 10, 2004	From March 12 to 13, 2013

Stock Price Chart



Note:
Due to a 5 for 1 stock split on April 1, 2006, and a 200 for 1 stock split on July 1, 2012, stock prices reflect post-split levels.

Message from the CFO

Naohiro Minami
Representative Director and
Executive Vice President

"Adjusted operating profit at constant FX delivered solid profit despite a challenging business environment."

2017 Financial Results

Despite the challenging business environment, adjusted operating profit at constant FX, our KPI, remained almost at the same level as prior year, ¥583.2 billion yen (-0.6%). In spite of the cost reduction achieved through the manufacturing footprint optimization in international tobacco business, sales volume declined in domestic market and the one-time loss which was due to a key distributor in international tobacco business going into administration, impacted our profits.

Revenue and adjusted operating profit remained flat year-on-year at -0.2% and -0.3%, showing a limited FX impact in the international tobacco business.

Operating profit and profit attributable to owners of the parent company both declined year-on-year by -5.4% and -6.9% to ¥561.1 billion and ¥392.4 billion respectively. This was mainly due to the decrease in gains from the sale of real estate assets.

Free cash flow was ¥72.6 billion, reflecting a total spending of over ¥200 billion yen for acquisitions in the Philippines, Indonesia and Ethiopia as well as active CAPEX for the sustainable future growth in domestic tobacco business.

Shareholder return policy – Financial policy

Our shareholder return policy aims to enhance shareholder returns considering the Company's mid- to long-term profit growth outlook, while maintaining a solid balance sheet. As for dividend, we aim to achieve consistent dividend per share growth.

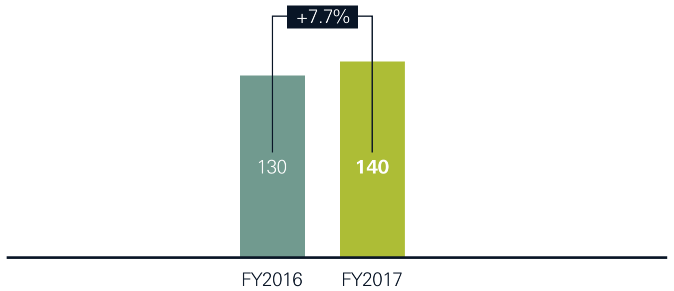
Based on the above shareholder return policy, we pay 2017 annual dividend of ¥140 per share, representing the 7.7% increase year-on-year. In 2018, we are planning an annual dividend of ¥150 per share, representing an increase of 7.1% year-on-year. These dividend increases reflect our aim to achieve mid- to long-term growth in adjusted operating profit at constant FX.

To maintain a solid balance sheet, we hold the following financial principle:

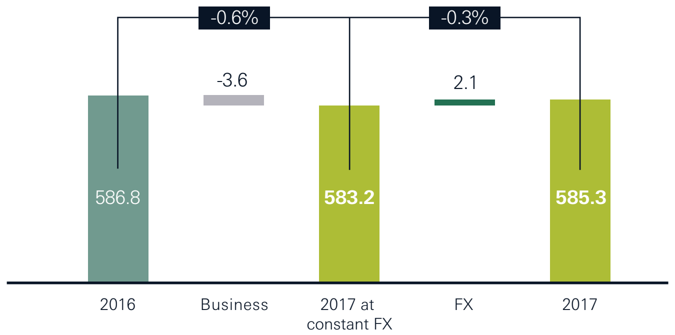
- The Company maintains a solid balance sheet. This provides the capacity to withstand any adversity arising out of a volatile environment, such as economic crisis. It also allows for sufficient flexibility to capture attractive investment opportunities.

Based on our 4S model, we prioritize investment and seeking a balance between investment and shareholder return under our resource allocation policy. We aim to deliver a sustainable and stable increase in dividend based on mid- to long-term profit growth outlook while maintaining a solid balance sheet.

Dividend Per Share (JPY)



Adjusted Operating profit

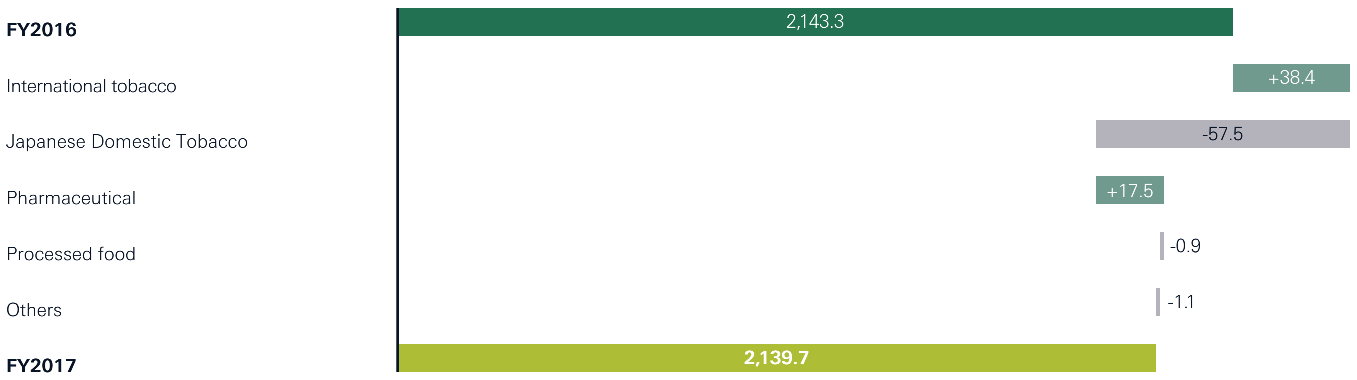


Financial Review

Analysis of the Results

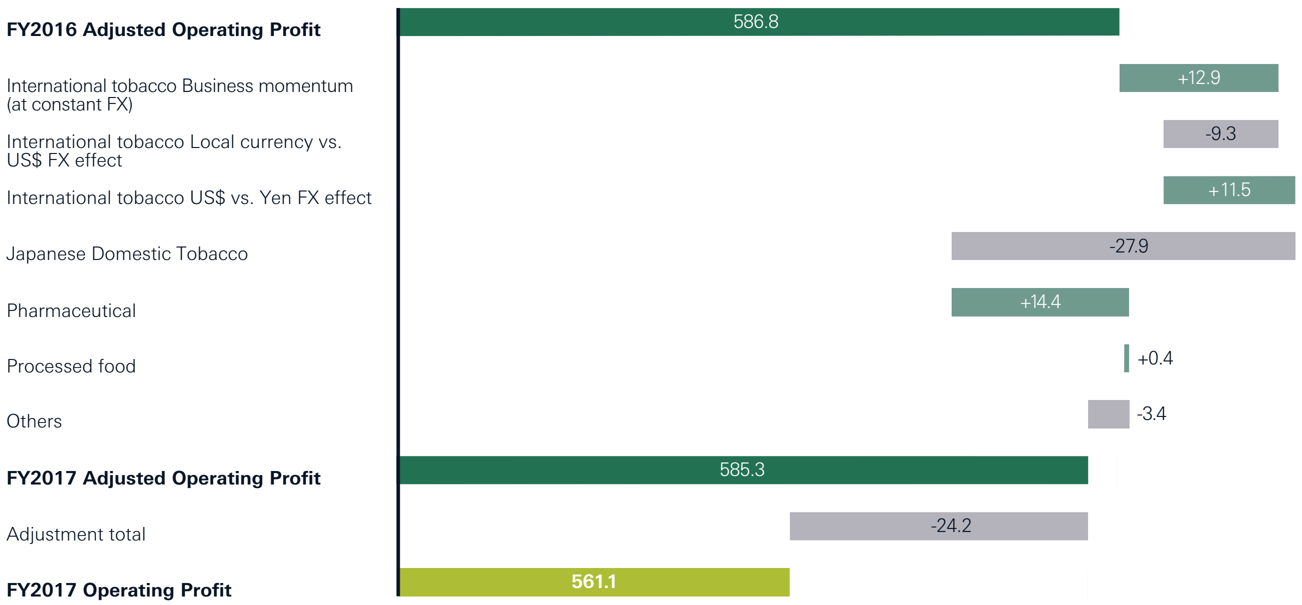
FY2017: Results for the fiscal year ended December 31, 2017

Revenue[1]



- Revenue decreased ¥3.6 billion or -0.2% year-on-year to ¥2,139.7 billion.
- This was mainly due to the Japanese Domestic Tobacco business cigarette sales volume decline, despite the pricing effect in MEVIUS, Ploom TECH sales increase in Tokyo expansion and positive impact of Yen effect in international tobacco business.
- In addition, the revenue of pharmaceutical business increased mainly driven by the increase of royalty revenue from out-licensed compounds.

Adjusted Operating Profit[2]/Operating Profit



Adjusted operating profit decreased ¥1.5 billion or -0.3% year-on-year to ¥585.3 billion.

- Despite international tobacco business impacted by a loss related to a UK distributor going into administration , adjusted operating profit at constant FX grew mainly driven by cost reduction through planned manufacturing footprint optimization and adjusted operating profit also increased due to the positive impact of foreign currency movements.
- In Japanese Domestic Tobacco business, despite the pricing effect in MEVIUS, Ploom TECH sales increased in Tokyo expansion and optimization of investment in the cigarette category, adjusted operating profit significantly decreased mainly due to the cigarette sales volume decline.
- In pharmaceutical business, adjusted operating profit improved significantly. This was mainly driven by the increased royalty revenue from out-licensed compounds.

Adjusted operating profit at constant foreign currency decreased 0.6% year-on-year.

Operating profit decreased 5.4% year-on-year to ¥561.1billion.

- Mainly because other income of proceeds from the sales of investment properties decreased.

Profit[3]

Profit decreased ¥29.3 billion or -6.9% year-on-year to ¥392.4 billion.

- Financial costs increased (decreased as in the graph) mainly due to the increase in bonds and borrowings.
- Income tax expenses decreased (increased as in the graph) due to the decrease in profit before income tax.

Revenue by business segment

(Billions of yen)

	FY2016	FY2017
Revenue	2,143.3	**2,139.7**
International tobacco	1,199.2	**1,237.6**
Core revenue[4]	1,138.8	**1,177.0**
Japanese Domestic Tobacco	684.2	**626.8**
Core revenue[5]	649.7	**590.6**
Pharmaceutical	87.2	**104.7**
Processed food	164.1	**163.1**
Other/Elimination	8.6	**7.5**

Average Exchange Rate

	FY2016	FY2017
YEN/US$	108.78	**112.16**
RUB/US$	67.07	**58.35**
GBP/US$	0.74	**0.78**
EUR/US$	0.90	**0.89**

Adjusted Operating Profit and Operating profit by business segment

(Billions of yen)

	FY2016	FY2017
Operating profit	593.3	**561.1**
Adjustment total[6]	(6.6)	**24.2**
Adjusted operating profit	586.8	**585.3**
International tobacco: Operating profit	301.8	**325.6**
Adjustment total[6]	34.4	**25.7**
Adjusted operating profit	336.2	**351.3**
Japanese Domestic Tobacco: Operating profit	244.1	**215.8**
Adjustment total[6]	16.1	**16.4**
Adjusted operating profit	260.2	**232.3**
Pharmaceutical: Operating profit	9.7	**24.1**
Adjustment total[6]	–	**–**
Adjusted operating profit	9.7	**24.1**
Processed Food: Operating profit	5.0	**5.4**
Adjustment total[6]	0.0	**0.0**
Adjusted operating profit	5.0	**5.4**
Others/Elimination: Operating profit	32.7	**(9.8)**
Adjustment total[6]	(57.1)	**(18.0)**
Adjusted operating profit	(24.4)	**(27.8)**

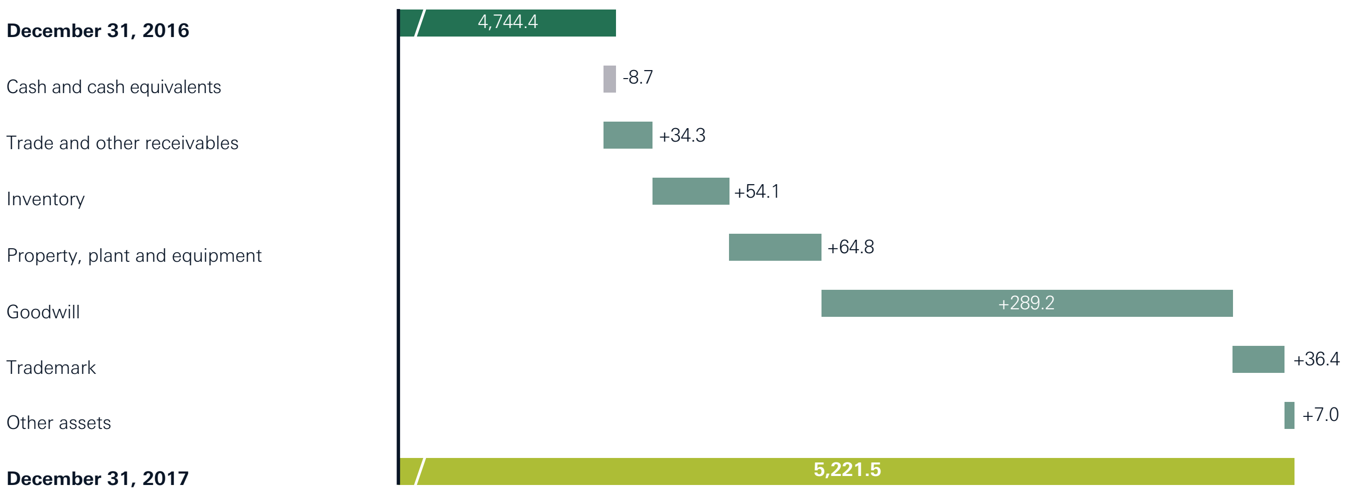
1. Excludes tobacco excise taxes and agency transactions.
2. Adjusted operating profit = operating profit + amortization cost of acquired intangibles arising from business acquisitions + adjusted items (income and costs)*.
3. Profit attributable to owners of the parent.
4. Includes revenue from waterpipe tobacco and Reduced-Risk Products, but excludes revenues from distribution, contract manufacturing and other peripheral business.
5. Includes revenue from domestic duty free, the China business and Reduced-Risk Products such as Ploom TECH devices and capsules but excludes revenue from distribution of imported. tobacco in the Japanese Domestic Tobacco business, among others.
6. Depreciation and amortization ± adjustment items (income and costs)**.

* Adjusted items (income and costs) = impairment losses on goodwill ± restructuring income and costs ± others.
** Adjustment items income and costs = impairment losses on goodwill ± restructuring income and costs ± others.

Analysis of the Results

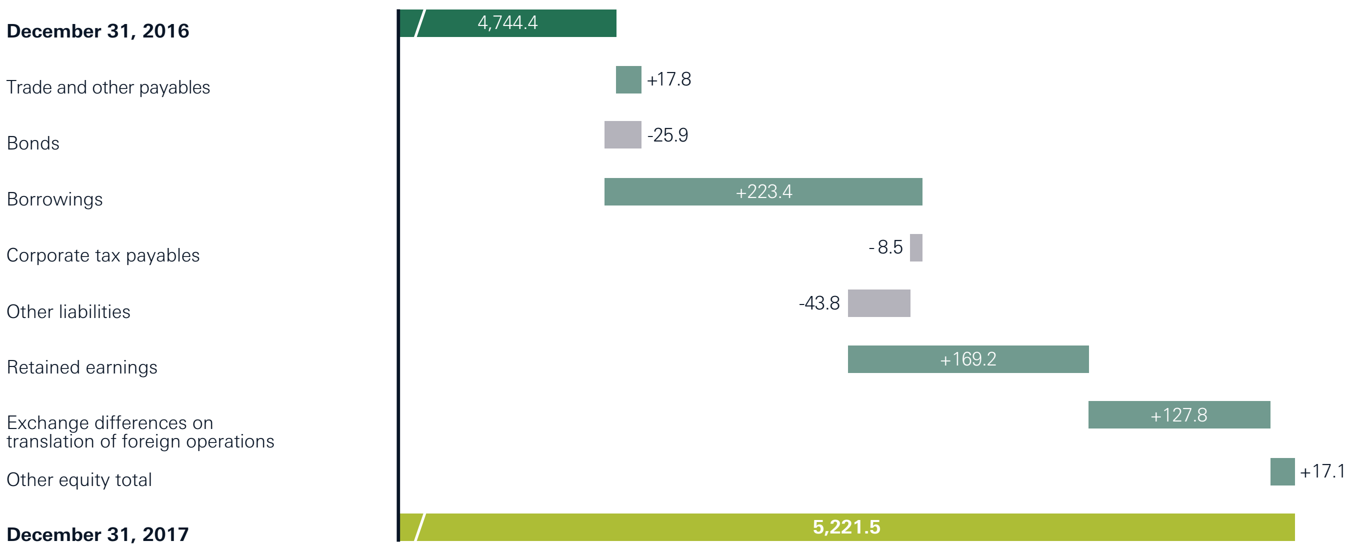
FY2017: Results for the fiscal year ended December 31, 2017

Consolidated Statement of Financial Position (Assets)



- Total assets increased ¥477.1 billion to ¥5,221.5 billion, mainly due to the increase in goodwill, trademark and etc., which is related to the acquisition in international tobacco business.

Consolidated Statement of Financial Position (Debt and Equity)



- Total liabilities increased ¥163.1 billion to ¥2,379.5 billion mainly due to the increase in short-term and long-term borrowings.
- Total equity increased ¥314.0 billion to ¥2,842.0 billion mainly because of the increase in retained earnings and positive impact of exchange differences on translation of foreign operations.

1. Significant Accounting Policies

Having acquired RJR Nabisco's non-US tobacco operation in 1999 and Gallaher Group Plc. in the UK in 2007, the JT Group has been growing steadily as a global company with operations in over 70 countries and with our products sold in more than 130 countries and regions around the world. In this context, the JT Group has adopted IFRS from the year ended March 31, 2012 to improve international comparability of financial information in capital markets and to diversify the group's sources of financing through international capital markets.

For further details of significant accounting policies, please refer to Note 3 to the consolidated financial statements.

2. Non-GAAP financial measures

The JT Group discloses certain additional financial measures that are not required or defined under IFRS. These measures help to explain underlying performance of each business and are used for internal performance management. We believe that they are useful information for users of our financial statements to assess the Group's performance.

For our international tobacco business, its consolidated financial statements reported in US dollars are internally reviewed and therefore revenue and adjusted operating profit are externally communicated in US dollars. These non-GAAP financial measures should be treated as supplementary information, rather than alternative measures to corresponding financial numbers prepared in accordance with IFRS.

Core Revenue

For the tobacco business, core revenue is disclosed additionally as a breakdown of revenue. Specifically, the core revenue for the Japanese Domestic Tobacco business excludes revenue accounted for distribution of imported tobacco products, among others, and includes revenue from domestic duty free, the China business and Reduced-Risk Products such as Ploom TECH devices and capsules. Core revenue for the international tobacco business is presented after deducting the revenue accounted for the distribution business and contract manufacturing, among other areas, from revenue, and including revenue from waterpipe tobacco and Reduced-Risk Products.

Adjusted Operating Profit

In order to provide useful comparative information on our business performance, adjusted operating profit is presented as operating profit plus amortization cost of acquired intangibles arising from business acquisitions and adjusted items (income and costs). Adjusted items (income and costs) are impairment losses on goodwill and restructuring income and costs, and other items. Furthermore, for the international tobacco business, adjusted operating profit at constant rates of exchange which excludes foreign exchange effects, is also presented as additional information. Adjusted operating profit at constant exchange rate for a relevant period in the international tobacco business is calculated using the foreign exchange rates of the prior year.

3. Analysis of consolidated financial results for FY2017

3.1. Consolidated financial results

For analysis of 'Revenue', 'Adjusted operating profit', 'Operating profit' and 'Profit attributable to owners of the parent company' from continuing operations, please refer to page 74 and 75. For analysis of 'Assets', 'Debt' and 'Equity', please refer to page 76. For analysis of financial results by business segment, please refer to 'Review of Operations'.

3.2. Results and plans of capital expenditures

Capital expenditures include outlays on property, plants and equipment such as land, buildings, and structures; machinery; vehicles and others; and intangible assets such as goodwill, trademark, software, and others that are necessary for enhancing the productivity of our factories and other facilities; strengthening our competitiveness, and operating in various business fields.

Total amount of capital expenditures amounted to ¥140.9 billion in FY2017.

Capital Expenditure

	(Unit: JPY billion)	
	FY2016	**FY2017**
Total	113.0	**140.9**
International tobacco	70.6	**68.4**
Japanese Domestic Tobacco	29.8	**51.5**
Pharmaceutical	3.8	**6.2**
Processed food	5.7	**10.4**
Other/Elimination	3.1	**4.3**

In international tobacco business, capital expenditures amounted to ¥68.4 billion which was spent on factory manufacturing facilities and for improvement of product specifications. In Japanese Domestic Tobacco business, capital expenditures amounted to ¥51.5 billion which was mainly spent on the development of Reduced-Risk Products. In pharmaceutical business, capital expenditures amounted to ¥6.2 billion which was spent on the manufacturing capacity enhancement and reinforcement of R&D capabilities and construction of new research building. In processed food business, capital expenditures amounted to ¥10.4 billion, which was spent on constructing new buildings and new factory lines to enhance and maintain the production capacity. These capital expenditures were internally funded through cash generated by operations and borrowings.

Plans for new installations and disposal of facilities

Regarding the mid- to long-term resource allocation of the JT Group, we will place top priority on business investments that will lead to sustainable profit growth in the mid- to long-term based on our management principles. We position the international and Japanese Domestic Tobacco business as the core business and profit growth engine and place top priority on business investments that will lead to their sustainable profit growth. Meanwhile, regarding the pharmaceutical business and processed food business, we will strive to strengthen foundations that will lead to further profit contribution, and we will make investments to that end. Based on this policy, we plan capital expenditures totaling ¥199.0 billion for FY2018.

As JT and JT Group companies have wide-ranging plans for capital expenditure, figures are disclosed by segment. Our actual capital expenditures may differ significantly from the planned figures mentioned above as a result of a number of factors, including those discussed in 'Risk Factors'.

4. Dividends

The year-end dividends for FY2017 were ¥70 per share. The total annual dividends per share, including the interim dividends per share of ¥70, were ¥140 per share, with a ¥10 increase of dividend per share year-on-year.

The year-end dividends related to the current year are recognized in the following year for accounting purposes. The year-end dividend related to FY2016 (record date of December 31, 2016) and the interim dividends for FY2017 (record date of June 30, 2017) are recorded in the financial statements for FY2017. For more details, please refer to Note 24 to the consolidated financial statements 'Dividends'.

5. Capital management

The JT Group's management principle is pursuit of the 4S model: we strive to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society, carefully considering the respective interests of these four key stakeholder groups, and exceeding their expectations wherever we can. The JT Group believes that sustainable profit growth in the mid- to long-term based on this principle will increase the JT Group's value in the mid- to long-term, and is consequently in the best interest of all stakeholders, including our shareholders.

As its financial policy, JT Group maintains a solid balance sheet. This provides the capacity to withstand any adversity arising out of a volatile environment, such as economic crisis. It also allows for sufficient flexibility to capture attractive investment opportunities. JT Group monitors financial indicators in order to maintain a well-balanced capital structure that ensures an appropriate return on equity and a solid balance sheet for future investment. We monitor credit ratings for a solid balance sheet, and ROE (return on equity) for profitability, while focusing on changes in the domestic and overseas environment.

The JT Group manages net interest-bearing debt, where cash and cash equivalents are deducted from interest-bearing debt, and capital (the part attributable to owners of the parent company). The amounts as of each year-end are as follows as of December 31, 2017:

Capital Management

(Unit: JPY billion)

	As of Dec. 31 2016	As of Dec. 31 2017
Interest-bearing debt	555.3	**755.8**
Cash and cash equivalents	(294.2)	**(285.5)**
Net interest-bearing debt	261.1	**470.3**
Capital (equity attributable to owners of the parent company)	2,456.1	**2,761.7**

Capital Expenditure plan

	FY2018 (Billions of yen)	Main purpose of investing	Funding
International tobacco	90.0	Investment for RRP-related and improvement of product specification	Internally funded
Japanese Domestic Tobacco	76.0	Investment for IT and RRP	Internally funded
Pharmaceutical	12.0	Investment for the maintaining and reinforcing of R&D	Internally funded
Processed food	15.0	Investment for enhancing and maintaining production capacity	Internally funded

Share buy-back

As of December 31, 2017 we held 208,956,589 shares of common stock as treasury stock, amounting to 10.45% of total number of shares issued.

A repurchase of our shares requires cash outlays. In order to repurchase our shares in a flexible manner, we amended the Articles of Incorporation at the general meeting of shareholders held on June 24, 2004 so that we could make repurchase based on a resolution made by the Board of Directors. We may continue to hold the repurchased shares as treasury stock or use them for other purposes. Stock repurchase provides our management with an additional option for increasing flexibility and speed in capital management in order to adopt to a rapidly changing business environment.

6. Financial activities

Our Group Treasury Division provides Group-wide support to enable secure and efficient financing activities. JT Group is exposed to financial risks (credit risks, liquidity risks, foreign exchange risks, interest rate risks, and market price fluctuation risks). Treasury operations are conducted pursuant to a set of Group-wide financial risk management policies and results are reported to the CEO and the Board of Directors of JT on a regular basis. For more details on financial risk management, please refer to '(2) Financial Risk Management' and to '(8) Market Price Fluctuation Risk' of Note 34 to the consolidated financial statements 'Financial Instruments'.

6.1. Cash Management Systems

To maximize the total group cash efficiency, we give first priority to utilizing internal financing mainly by the Cash Management Systems (CMS) within our Group, where legally permissible and economically viable.

6.2. External financing

Short-term working capital needs are basically financed through short-term borrowings from financial institutions or through commercial paper, or a combination of both. Mid-to long-term capital needs are financed through long-term borrowings from financial institutions, bond or equity, or a combination of those previously stated.

We continue to diversify our financing method and correspondent financial institutions to secure stable and efficient funding sources through activities such as the establishment of committed facilities. The condition of the Group's wide external debt is reported to the CEO and the Board of Directors of JT on a regular basis.

6.3. External investments

Our financial investments are always made taking into account safety, liquidity and optimal yield. Speculative dealings in pursuit of profit margin are not allowed. The results of the financial investment are reported to the CEO and the Board of Directors of JT on a regular basis.

7. Results of Cash flows of FY2017 and FY2016

Cash and cash equivalents at the end of FY2017 decreased by ¥8.7 billion from the end of FY2016 to ¥285.5 billion. Cash and cash equivalents at the end of FY2016 were ¥294.2 billion.

Cash flows from (used in) operating activities

Net cash flows from operating activities during FY2017 were ¥419.2 billion. The main factors were the generation of a stable cash inflow from the tobacco business. Net cash flows from operating activities were ¥376.5 billion for FY2016.

Cash flows from (used in) investing activities

Net cash flows used in investing activities during FY2017 were ¥352.6 billion. This was mainly due to the acquisition in international tobacco business, the investment in factory's equipment and Reduced-Risk Products. Net cash flows used in investing activities were ¥687.5 billion for FY2016.

Cash flows from (used in) financing activities

Net cash flows used in financing activities during FY2017 were ¥77.0 billion. This was mainly because the increase of dividends per share partially offset by borrowings increased in FY2017. Net cash flows from financing activities were ¥91.3 billion for FY2016.

8. Liquidity

We have historically had, and expect to continue to have, significant cash flows from operating activities. We expect that cash generated from operating activities will continue to be stable and cover funds needed for ordinary business activities. On December 31, 2017, we had approximately ¥601.6 billion committed facilities for both domestic and international major financial institutions, of which 81% was unused. In addition, we have a domestic commercial paper program, uncommitted facilities, a domestic bond shelf registration and EMTN program.

8.1. Long-term debt

Bonds issued (including the current portion) as of December 31, 2016 and December 31, 2017 accounted for ¥358.2 billion and ¥332.2 billion respectively and long-term borrowings as loans from financial institutions (including the current portion) accounted for ¥1.4 billion and ¥71.9 billion respectively. Long-term lease obligations accounted for ¥7.3 billion as of December 31, 2016 and ¥9.3 billion as of December 31, 2017. Maturities of interest-bearing debts are shown in the table below.

As of December 31, 2017, our long-term debt was rated Aa3 by Moody's Japan K.K. (Moody's), AA- by Standard & Poor's Ratings Japan K.K. (S&P), and AA by Rating and Investment Information Inc. (R&I), with a 'stable' outlook from Moody's, a 'stable' outlook from S&P and a 'stable' outlook from R&I. These ratings are among the highest ratings for international tobacco companies.

These ratings are affected by a number of factors such as developments in our major markets, our business strategies and general economic trends that are beyond control. The ratings may be withdrawn or revised at any time. Each rating should be evaluated separately from other ratings. Under the Japan Tobacco Inc. Act, the bondholders of JT can enjoy statutory preferential rights over unsecured creditors in seeking repayment, with the exception of national and local taxes and other statutory obligations.

8.2. Short-term debt

Short-term borrowings totaled ¥187.9 billion as of December 31, 2016 and ¥274.2 billion as of December 31, 2017. There was commercial paper total ¥66.8 billion as of December 31, 2017.

Short-term lease obligations totaled ¥0.4 billion as of December 31, 2016 and ¥1.3 billion as of December 31, 2017.

Liquidity

	(Billions of Yen)						
Year ended December 31, 2017	**Book Value**	**Due within 1 year**	**Due after 1 year through 2 years**	**Due after 2 year through 3 years**	**Due after 3 year through 4 years**	**Due after 4 year through 5 years**	**Due after 5 years**
Short-term borrowings as loans	274.2	274.2	–	–	–	–	–
Short-term lease obligations	1.3	1.3	–	–	–	–	–
CP	66.8	66.8	–	–	–	–	–
Long-term borrowings as loans (current portion)	0.7	0.7	–	–	–	–	–
Bonds (current portion)	56.5	56.5	–	–	–	–	–
Long-term borrowings as loans	71.2	–	0.4	0.2	0.1	30.1	40.3
Bonds	275.8	–	–	80.0	84.8	30.0	81.5
Long-term lease obligations	9.3	–	0.9	0.7	0.5	0.2	7.0
Total	**755.8**	**399.6**	**1.3**	**80.9**	**85.4**	**60.3**	**128.9**

Consolidated Financial Statements

Consolidated Statement of Financial Position

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2017: Year ended December 31, 2017

Millions of yen

Assets	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Current assets		
Cash and cash equivalents (Note 7)	¥ 294,157	¥ 285,486
Trade and other receivables (Note 8)	396,934	431,199
Inventories (Note 9)	558,846	612,954
Other financial assets (Note 10)	14,921	14,016
Other current assets (Note 11)	340,312	361,715
Subtotal	1,605,169	1,705,370
Non-current assets held-for-sale (Note 12)	821	2,396
Total current assets	1,605,990	1,707,767
Non-current assets		
Property, plant and equipment (Note 13)	680,835	745,607
Goodwill (Notes 14, 38)	1,601,987	1,891,210
Intangible assets (Note 14)	423,970	479,175
Investment property (Note 16)	18,184	16,700
Retirement benefit assets (Note 22)	23,680	51,377
Investments accounted for using the equity method	123,753	81,253
Other financial assets (Note 10)	99,358	114,970
Deferred tax assets (Note 17)	166,617	133,425
Total non-current assets	3,138,384	3,513,717
Total assets	¥4,744,374	¥5,221,484

Millions of yen

Liabilities and equity	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Liabilities		
Current liabilities		
Trade and other payables (Note 18)	¥ 377,933	¥ 395,733
Bonds and borrowings (Note 19)	208,521	398,182
Income tax payables	54,940	46,452
Other financial liabilities (Note 19)	13,023	6,906
Provisions (Note 20)	12,529	13,028
Other current liabilities (Note 21)	689,629	618,322
Total current liabilities	1,356,574	1,478,623
Non-current liabilities		
Bonds and borrowings (Note 19)	339,036	346,955
Other financial liabilities (Note 19)	9,009	11,013
Retirement benefit liabilities (Note 22)	333,410	330,762
Provisions (Note 20)	4,423	4,005
Other non-current liabilities (Note 21)	102,221	120,779
Deferred tax liabilities (Note 17)	71,660	87,319
Total non-current liabilities	859,759	900,833
Total liabilities	2,216,333	2,379,456
Equity		
Share capital (Note 23)	100,000	100,000
Capital surplus (Note 23)	736,400	736,400
Treasury shares (Note 23)	(443,822)	(443,636)
Other components of equity (Note 23)	(303,554)	(167,338)
Retained earnings	2,367,067	2,536,262
Equity attributable to owners of the parent company	2,456,091	2,761,687
Non-controlling interests	71,950	80,340
Total equity	2,528,041	2,842,027
Total liabilities and equity	¥4,744,374	¥5,221,484

Consolidated Statement of Income

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2017: Year ended December 31, 2017

		Millions of yen
	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Revenue (Notes 6, 25)	¥2,143,287	¥2,139,653
Cost of sales (Notes 14, 22)	(872,433)	(843,558)
Gross profit	1,270,854	1,296,094
Other operating income (Note 26)	70,101	45,724
Share of profit in investments accounted for using the equity method	6,489	6,194
Selling, general and administrative expenses (Notes 12, 13, 14, 16, 22, 27, 33, 38)	(754,115)	(786,911)
Operating profit (Note 6)	593,329	561,101
Financial income (Notes 28, 34)	6,618	4,780
Financial costs (Notes 22, 28, 34)	(21,710)	(27,349)
Profit before income taxes	578,237	538,532
Income taxes (Note 17)	(152,464)	(141,783)
Profit for the period	¥ 425,773	¥ 396,749
Attributable to:		
Owners of the parent company	¥ 421,695	¥ 392,409
Non-controlling interests	4,078	4,340
Profit for the period	¥ 425,773	¥ 396,749
Earnings per share		
Basic (Yen) (Note 30)	¥ 235.47	¥ 219.10
Diluted (Yen) (Note 30)	235.33	218.97

Reconciliation from "Operating profit" to "Adjusted operating profit"

		Millions of yen
	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Operating profit	¥593,329	¥561,101
Amortization cost of acquired intangibles arising from business acquisitions	46,767	50,414
Adjustment items (income)	(65,212)	(37,569)
Adjustment items (costs)	11,894	11,354
Adjusted operating profit (Note 6)	¥586,777	¥585,300

Consolidated Statement of Comprehensive Income

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2017: Year ended December 31, 2017

		Millions of yen
	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Profit for the period	¥425,773	¥396,749
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income (Notes 29, 34)	(3,159)	9,402
Remeasurements of defined benefit plans (Notes 22, 29)	(22,202)	20,028
Total of items that will not be reclassified to profit or loss	(25,361)	29,430
Items that may be reclassified subsequently to profit or loss		
Exchange differences on translation of foreign operations (Notes 29, 34)	(163,683)	128,073
Net gain (loss) on derivatives designated as cash flow hedges (Notes 29, 34)	(1,479)	(54)
Total of items that may be reclassified subsequently to profit or loss	(165,162)	128,019
Other comprehensive income (loss), net of taxes	(190,523)	157,449
Comprehensive income (loss) for the period	¥235,250	¥554,198
Attributable to:		
Owners of the parent company	¥231,590	¥549,309
Non-controlling interests	3,660	4,889
Comprehensive income (loss) for the period	¥235,250	¥554,198

Consolidated Statement of Changes in Equity

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2017: Year ended December 31, 2017

Millions of yen

	Share capital	Capital surplus	Treasury shares	Subscription rights to shares	Exchange differences on translation of foreign operations	Net gain (loss) on derivatives designated as cash flow hedges	Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income
	Equity attributable to owners of the parent company						
					Other components of equity		
As of January 1, 2016	¥100,000	¥736,400	¥(444,333)	¥1,941	¥(172,473)	¥ 125	¥33,284
Profit for the period	—	—	—	—	—	—	—
Other comprehensive income (loss)	—	—	—	—	(163,169)	(1,479)	(3,069)
Comprehensive income (loss) for the period	—	—	—	—	(163,169)	(1,479)	(3,069)
Acquisition of treasury shares (Note 23)	—	—	(0)	—	—	—	—
Disposal of treasury shares (Note 23)	—	—	512	(413)	—	—	—
Share-based payments (Note 33)	—	—	—	265	—	—	—
Dividends (Note 24)	—	—	—	—	—	—	—
Changes in the scope of consolidation	—	—	—	—	—	—	—
Changes in the ownership interest in a subsidiary without a loss of control	—	—	—	—	—	—	—
Transfer from other components of equity to retained earnings	—	—	—	—	—	—	(360)
Other increase (decrease)	—	—	—	—	—	1,794	—
Total transactions with the owners	—	—	512	(147)	—	1,794	(360)
As of December 31, 2016	100,000	736,400	(443,822)	1,794	(335,642)	440	29,854
Profit for the period	—	—	—	—	—	—	—
Other comprehensive income (loss)	—	—	—	—	127,758	(54)	9,276
Comprehensive income (loss) for the period	—	—	—	—	127,758	(54)	9,276
Acquisition of treasury shares (Note 23)	—	—	(1)	—	—	—	—
Disposal of treasury shares (Note 23)	—	—	187	(166)	—	—	—
Share-based payments (Note 33)	—	—	—	336	—	—	—
Dividends (Note 24)	—	—	—	—	—	—	—
Changes in the scope of consolidation	—	—	—	—	—	—	—
Changes in the ownership interest in a subsidiary without a loss of control	—	—	—	—	—	—	—
Transfer from other components of equity to retained earnings	—	—	—	—	—	—	(461)
Other increase (decrease)	—	—	—	—	—	(475)	—
Total transactions with the owners	—	—	186	170	—	(475)	(461)
As of December 31, 2017	**¥100,000**	**¥736,400**	**¥(443,636)**	**¥1,964**	**¥(207,884)**	**¥ (88)**	**¥38,670**

Millions of yen

	Remeasurements of defined benefit plans	Total	Retained earnings	Total	Non-controlling interests	Total equity
	Equity attributable to owners of the parent company					
	Other components of equity					
As of January 1, 2016	¥ —	¥(137,122)	¥2,196,651	¥2,451,596	¥69,929	¥2,521,524
Profit for the period	—	—	421,695	421,695	4,078	425,773
Other comprehensive income (loss)	(22,387)	(190,105)	—	(190,105)	(419)	(190,523)
Comprehensive income (loss) for the period	(22,387)	(190,105)	421,695	231,590	3,660	235,250
Acquisition of treasury shares (Note 23)	—	—	—	(0)	—	(0)
Disposal of treasury shares (Note 23)	—	(413)	(99)	0	—	0
Share-based payments (Note 33)	—	265	—	265	4	270
Dividends (Note 24)	—	—	(229,223)	(229,223)	(2,038)	(231,261)
Changes in the scope of consolidation	—	—	—	—	1,069	1,069
Changes in the ownership interest in a subsidiary without a loss of control	—	—	69	69	(675)	(606)
Transfer from other components of equity to retained earnings	22,387	22,027	(22,027)	—	—	—
Other increase (decrease)	—	1,794	—	1,794	—	1,794
Total transactions with the owners	22,387	23,674	(251,280)	(227,094)	(1,639)	(228,733)
As of December 31, 2016	—	(303,554)	2,367,067	2,456,091	71,950	2,528,041
Profit for the period	—	—	392,409	392,409	4,340	396,749
Other comprehensive income (loss)	19,919	156,900	—	156,900	550	157,449
Comprehensive income (loss) for the period	19,919	156,900	392,409	549,309	4,889	554,198
Acquisition of treasury shares (Note 23)	—	—	—	(1)	—	(1)
Disposal of treasury shares (Note 23)	—	(166)	(21)	0	—	0
Share-based payments (Note 33)	—	336	—	336	5	341
Dividends (Note 24)	—	—	(243,572)	(243,572)	(1,547)	(245,119)
Changes in the scope of consolidation	—	—	—	—	4,884	4,884
Changes in the ownership interest in a subsidiary without a loss of control	—	—	(1)	(1)	159	158
Transfer from other components of equity to retained earnings	(19,919)	(20,380)	20,380	—	—	—
Other increase (decrease)	—	(475)	—	(475)	—	(475)
Total transactions with the owners	(19,919)	(20,684)	(223,214)	(243,713)	3,501	(240,212)
As of December 31, 2017	**¥ —**	**¥(167,338)**	**¥2,536,262**	**¥2,761,687**	**¥80,340**	**¥2,842,027**

Consolidated Statement of Cash Flows

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2017: Year ended December 31, 2017

Millions of yen

	FY2016 (Year ended December 31, 2016)	**FY2017 (Year ended December 31, 2017)**
Cash flows from operating activities		
Profit before income taxes	¥578,237	**¥538,532**
Depreciation and amortization	140,794	**145,407**
Impairment losses	1,239	**3,427**
Reversal of impairment losses on investments in associates	—	**(8,848)**
Interest and dividend income	(6,372)	**(4,381)**
Interest expense	8,680	**11,604**
Share of profit in investments accounted for using the equity method	(6,489)	**(6,194)**
(Gains) losses on sale and disposal of property, plant and equipment, intangible assets and investment property	(33,473)	**(21,221)**
(Gains) losses on sale of investments in subsidiaries	(26,106)	**—**
(Increase) decrease in trade and other receivables	(20,128)	**(28,810)**
(Increase) decrease in inventories	(686)	**(41,102)**
Increase (decrease) in trade and other payables	16,157	**15,655**
Increase (decrease) in retirement benefit liabilities	(4,724)	**(15,296)**
(Increase) decrease in prepaid tobacco excise taxes	(48,228)	**(10,281)**
Increase (decrease) in tobacco excise tax payables	(14,192)	**(60,250)**
Increase (decrease) in consumption tax payables	2,787	**1,117**
Other	(31,938)	**12,228**
Subtotal	555,557	**531,587**
Interest and dividends received	13,064	**11,250**
Interest paid	(6,788)	**(11,035)**
Income taxes paid	(185,285)	**(112,591)**
Net cash flows from operating activities	376,549	**419,212**
Cash flows from investing activities		
Purchase of securities	(2,303)	**(11,479)**
Proceeds from sale and redemption of securities	5,340	**4,893**
Purchase of property, plant and equipment	(101,072)	**(123,726)**
Proceeds from sale of investment property	42,046	**21,195**
Purchase of intangible assets	(9,929)	**(16,412)**
Payments into time deposits	(346)	**(84)**
Proceeds from withdrawal of time deposits	298	**101**
Payments for business combinations (Note 38)	(589,737)	**(212,707)**
Proceeds from sale of investments in subsidiaries	26,979	**—**
Purchase of investments in associates	(52,291)	**(5,253)**
Other	(6,493)	**(9,160)**
Net cash flows from investing activities	(687,509)	**(352,632)**
Cash flows from financing activities		
Dividends paid to owners of the parent company (Note 24)	(229,261)	**(243,552)**
Dividends paid to non-controlling interests	(2,011)	**(1,502)**
Capital contribution from non-controlling interests	129	**15**
Increase (decrease) in short-term borrowings and commercial paper (Note 32)	186,570	**116,371**
Proceeds from long-term borrowings (Note 32)	856	**70,861**
Repayments of long-term borrowings (Note 32)	(578)	**(669)**
Proceeds from issuance of bonds (Note 32)	136,181	**—**
Redemption of bonds (Note 32)	—	**(20,000)**
Proceeds from sale and leaseback transactions	—	**2,819**
Repayments of finance lease obligations (Note 32)	(569)	**(1,373)**
Acquisition of treasury shares	(0)	**(1)**
Other	0	**0**
Net cash flows from financing activities	91,318	**(77,032)**
Net increase (decrease) in cash and cash equivalents	(219,643)	**(10,452)**
Cash and cash equivalents at the beginning of the period	526,765	**294,157**
Effect of exchange rate changes on cash and cash equivalents	(12,965)	**1,782**
Cash and cash equivalents at the end of the period (Note 7)	¥294,157	**¥285,486**

Notes to Consolidated Financial Statements

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2017: Year ended December 31, 2017 / FY2016: Year ended December 31, 2016

1. Reporting Entity

Japan Tobacco Inc. (hereinafter referred to as the "Company") is a joint stock corporation under the Companies Act of Japan, pursuant to the Japan Tobacco Inc. Act, with its principal places of business located in Japan since its incorporation. The addresses of the Company's registered head office and principal business offices are available on the Company's website (https://www.jti.co.jp/).

The details of businesses and principal business activities of the Company and its subsidiaries (hereinafter referred to as the "Group") are stated in "6. Operating Segments."

The Group's consolidated financial statements for the year ended December 31, 2017, were approved on March 27, 2018 by Masamichi Terabatake, President and Chief Executive Officer.

2. Basis of Preparation

(1) Compliance with IFRS

The Group's consolidated financial statements are prepared in accordance with International Financial Reporting Standards (hereinafter referred to as "IFRS").

(2) Basis of Measurement

Except for the financial instruments, stated in "3. Significant Accounting Policies," the Group's consolidated financial statements are prepared on the historical cost basis.

(3) Functional Currency and Presentation Currency

The Group's consolidated financial statements are presented in Japanese yen, which is the functional currency of the Company. The units are in millions of yen, and figures less than one million yen are rounded to the nearest million yen.

(4) Early Adoption of New Accounting Standards

The Group has early adopted IFRS 9 "Financial Instruments" (amended in November 2013) (hereinafter referred to as "IFRS 9") from January 1, 2015.

IFRS 9 replaces IAS 39 "Financial Instruments: Recognition and Measurement" (hereinafter referred to as "IAS 39") and provides two measurement categories for financial instruments: amortized cost and fair value. Changes in fair value of financial assets measured at fair value are recognized in profit or loss. However, changes in fair value of investments in equity instruments, except for equity instruments held for trading purposes, are allowed to be recognized in other comprehensive income.

For hedge accounting, the hedging relationships that meet the qualifying criteria are reviewed to appropriately reflect an entity's risk management activities in the consolidated financial statements.

3. Significant Accounting Policies

(1) Basis of Consolidation

The consolidated financial statements include financial statements of the Company and its subsidiaries, and interests in investments in associates and joint arrangements.

A. Subsidiaries

A subsidiary is an entity that is controlled by the Group and the Group has control over the entity if it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The acquisition date of a subsidiary is the date on which the Group obtains control of the subsidiary, and the subsidiary is included in the consolidation from the date of acquisition until the date on which the Group loses control.

In cases where the accounting policies applied by a subsidiary are different from those applied by the Group, adjustments are made to the subsidiary's financial statements, if necessary.

All intergroup balances, transactions, income and expenses are eliminated on consolidation.

Comprehensive income for subsidiaries is attributed to owners of the parent company and non-controlling interests even if this results in the non-controlling interests having a deficit balance.

B. Associates

An associate is an entity over which the Group has significant influence. The Group has significant influence over the entity if it has the power to participate in the financial and operating policy decisions of the investee but it does not have control or joint control over the investee. Investments in associates are accounted for using the equity method from the date on which the Group has the significant influence until the date on which it ceases to have the significant influence.

C. Joint Arrangements

A joint arrangement is a contractual arrangement in which two or more parties have joint control. Depending upon the rights and obligations of the parties to the arrangement, the Group classifies a joint arrangement into a joint operation whereby the Group has rights to the assets and obligations for the liabilities relating to the arrangement, and a joint venture whereby the Group has rights to the net assets of the arrangement only. The Group recognizes the assets, liabilities, revenues and expenses relating to its interest in a joint operation while a joint venture is accounted for using the equity method.

(2) Business Combination

Business combinations are accounted for using the acquisition method. Consideration transferred in a business combination is measured as the sum of the acquisition-date fair value of the assets transferred, the liabilities assumed and equity instruments issued by the Company in exchange for control over an acquiree. Any excess of the consideration of acquisition over the fair value of identifiable assets and liabilities is recognized as goodwill in the consolidated statement of financial position. If the consideration of acquisition is lower than the fair value of the identifiable assets and liabilities, the difference is immediately recognized as profit in the consolidated statement of income. If the amount of initial accounting for a business combination is not determined by the end of the reporting period in which the combination occurs, the provisional amounts for the items for which the accounting is incomplete are reported and are adjusted during the measurement period, which is one year from the acquisition date. Acquisition-related costs incurred are recognized as expenses. The additional acquisition of non-controlling interests after obtaining control is accounted for as a capital transaction. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognized directly in retained earnings and no goodwill is recognized with respect to such transaction.

(3) Foreign Currency Translation

Consolidated financial statements of the Group are presented in Japanese yen, which is the functional currency of the Company. Each company in the Group specifies its own functional currency and measures transactions based on it.

Foreign currency transactions are translated into the functional currency at the rates of exchange prevailing at the dates of transactions or an approximation of the rate. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rates of exchange prevailing at the fiscal year end date. Differences arising from the translation and settlement are recognized as profit or loss. However, exchange differences arising from the translation of financial instruments designated as hedging instruments for net investment in foreign operations (foreign subsidiaries), financial assets measured at fair value through other comprehensive income, and cash flow hedges are recognized as other comprehensive income.

The assets and liabilities of foreign operations are translated into Japanese yen at the rates of exchange prevailing at the fiscal year end date, while income and expenses of foreign operations are translated into Japanese yen at the rates of exchange prevailing at the dates of transactions or an approximation of the rate. The resulting translation differences are recognized as other comprehensive income. In cases where foreign operations are disposed of, the cumulative amount of translation differences related to the foreign operations is recognized as profit or loss in the period of disposition.

(4) Financial Instruments

A. Financial Assets

(i) Initial Recognition and Measurement

Financial assets are classified into financial assets measured at fair value through profit or loss, fair value through other comprehensive income, and amortized cost. The Group determines the classification at initial recognition.

Financial assets are classified as financial assets measured at amortized cost if both of the following conditions are met. Otherwise, they are classified as financial assets measured at fair value.

- The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding

For financial assets measured at fair value, each equity instrument is designated as measured at fair value through profit or loss or as measured at fair value through other comprehensive income, except for equity instruments held for trading purposes that must be measured at fair value through profit or loss. Such designations are applied consistently.

All financial assets are measured at fair value plus transaction costs that are attributable to the financial assets, except for the case of being classified in the category of financial assets measured at fair value through profit or loss.

(ii) Subsequent Measurement

After initial recognition, financial assets are measured based on the classification as follows:

(a) Financial Assets Measured at Amortized Cost

Financial assets measured at amortized cost are measured at amortized cost using the effective interest method.

(b) Other Financial Assets

Financial assets other than those measured at amortized cost are measured at fair value.

Changes in the fair value of financial assets measured at fair value are recognized as profit or loss.

However, changes in the fair value of equity instruments designated as measured at fair value through other comprehensive income are recognized as other comprehensive income and the amount in other comprehensive income is transferred to retained earnings when equity instruments are derecognized or the decline in its fair value compared to its acquisition cost is significant. Dividends on the financial assets are recognized in profit or loss for the year.

(iii) Derecognition
Financial assets are derecognized when the rights to receive benefits from them expire or are transferred, or when substantially all the risks and rewards of the ownership are transferred.

B. Impairment of Financial Assets
In accordance with IAS 39, the Group assesses at the end of each reporting period whether there is any objective evidence that financial assets measured at amortized cost are impaired. Evidence of impairment includes significant financial difficulty of the borrower or a group of borrowers, a default or delinquency in interest or principal payments, and bankruptcy of the borrower.

The Group assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and collectively for financial assets that are not individually significant.

If there is objective evidence that impairment losses on financial assets measured at amortized cost have been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows.

When impairment is recognized, the carrying amount of the financial asset is reduced by an allowance for doubtful accounts and impairment losses are recognized in profit or loss. The carrying amount of financial assets measured at amortized cost is directly reduced for the impairment when they are expected to become uncollectible in the future and all collateral is implemented or transferred to the Group. If, in a subsequent period, the amount of the impairment loss provided changes due to an event occurring after the impairment was recognized, the previously recognized impairment losses are adjusted through the allowance for doubtful accounts.

C. Financial Liabilities
(i) Initial Recognition and Measurement
Financial liabilities are classified into financial liabilities measured at fair value through profit or loss and financial liabilities measured at amortized cost. The Group determines the classification at initial recognition.

All financial liabilities are measured at fair value at initial recognition. However, financial liabilities measured at amortized cost are measured at cost after deducting transaction costs that are directly attributable to the financial liabilities.

(ii) Subsequent Measurement
After initial recognition, financial liabilities are measured based on the classification as follows:

(a) Financial Liabilities Measured at Fair Value through Profit or Loss
Financial liabilities measured at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated as measured at fair value through profit or loss at initial recognition.

(b) Financial Liabilities Measured at Amortized Cost
After initial recognition, financial liabilities measured at amortized cost are measured at amortized cost using the effective interest method. Amortization under the effective interest method and gains or losses on derecognition are recognized as profit or loss in the consolidated statement of income.

After initial recognition, financial guarantee contracts are measured at the higher of:

- The best estimate of expenditure required to settle the obligation as of the end of the fiscal year, and
- The amount initially recognized less cumulative amortization.

(iii) Derecognition
Financial liabilities are derecognized when the obligation is discharged, canceled or expired.

D. Offsetting of Financial Instruments
Financial assets and financial liabilities are offset and presented as a net amount in the consolidated statement of financial position only when there is a legally enforceable right to set off the recognized amounts and the Group intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

E. Derivatives and Hedge Accounting
The Group utilizes derivatives, including forward foreign exchange contracts and interest rate swap contracts, to hedge foreign exchange and interest rate risks. These derivatives are initially measured at fair value when the contract is entered into, and are subsequently remeasured at fair value. Changes in the fair value of derivatives are recognized as profit or loss in the consolidated statement of income. However, the gains or losses on the hedging instrument relating to the effective portion of cash flow hedges and hedges of net investment in foreign operations are recognized as other comprehensive income in the consolidated statement of comprehensive income.

At the inception of the hedge, the Group formally designates and documents the hedging relationship to which hedge accounting is applied and the objectives and strategies of risk management for undertaking the hedge. The documentation includes identification of the hedging instruments, the hedged items, the nature of the risks being hedged and how the hedging relationship's effectiveness is assessed. These hedges are assessed on an ongoing basis to determine whether the hedging relationship is effective prospectively, even though it is expected that there is an economic relationship between the hedged item and the hedging instrument, that the effect of credit risk does not dominate the value changes that result from that economic relationship, and that the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the Group actually hedges and the quantity of the hedging instrument that the Group actually uses to hedge that quantity of the hedged item.

If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio due to changes in an economic relationship between the hedged item and the hedging instrument but the risk management objective remains the same, the Group would adjust the hedge ratio so that it meets the qualifying criteria again. The Group discontinues hedge accounting for the portion that does not meet the requirement when the hedging relationship ceases to meet the qualifying criteria even after adjusting the hedge ratio.

Hedges that meet the stringent requirements for hedge accounting are classified in the following categories and accounted for in accordance with IFRS 9.

(i) Fair Value Hedge
The gain or loss on the hedging instrument is recognized as profit or loss in the consolidated statement of income. However, changes in the fair value of the hedging instrument are recognized as other comprehensive income in the consolidated statement of comprehensive income if the hedging instrument hedges an equity instrument designated as at fair value through other comprehensive income. Regarding the hedging gain or loss on the hedged item, the carrying amount of the hedged item is adjusted and the change is recognized as profit or loss in the consolidated statement of income. However, changes in the fair value of an equity instrument which the Group elected to present in other comprehensive income are recognized as other comprehensive income.

(ii) Cash Flow Hedge
The effective portion of gains or losses on hedging instruments is recognized as other comprehensive income in the consolidated statement of comprehensive income, while the ineffective portion is recognized immediately as profit or loss in the consolidated statement of income.

The amounts of hedging instruments recognized in other comprehensive income are reclassified to profit or loss when the transactions of the hedged items affect profit or loss. In cases where hedged items result in the recognition of non-financial assets or liabilities, the amounts recognized as other comprehensive income are accounted for as adjustments to the original carrying amount of non-financial assets or liabilities.

If the hedged future cash flows are no longer expected to occur, any related cumulative gain or loss that has been recognized in equity as other comprehensive income is reclassified to profit or loss. If the hedged future cash flows are still expected to occur, amounts that have been recognized in other comprehensive income are continued to be recognized in other comprehensive income until the future cash flows occur.

(iii) Hedge of Net Investment in Foreign Operations
Translation differences resulting from the hedge of net investment in foreign operations are accounted for similarly to a cash flow hedge. The effective portion of gains or losses on hedging instruments is recognized as other comprehensive income in the consolidated statement of comprehensive income, while the ineffective portion is recognized as profit or loss in the consolidated statement of income. At the time of the disposal of the foreign operations, any related cumulative gain or loss that has been recognized in equity as other comprehensive income is reclassified to profit or loss.

F. Fair Value of Financial Instruments
Fair value of financial instruments that are traded in active financial markets at the fiscal year end refers to quoted prices or dealer quotations.

If there is no active market, fair value of financial instruments is determined using appropriate valuation models.

(5) Cash and Cash Equivalents
Cash and cash equivalents consist of cash on hand, demand deposits, and short-term investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value and due within three months from the date of acquisition.

(6) Inventories
The cost of inventories includes all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Inventories are measured at the lower of cost or net realizable value, and the costs are determined by using the weighted-average method. Net realizable value is determined as the estimated selling price in the ordinary course of business less the estimated costs of completion and estimated costs necessary to make the sale.

Leaf tobacco which is stored for more than 12 months before being used for production is included in current assets since it is held within the normal operating cycle.

(7) Property, Plant and Equipment
Property, plant and equipment is measured by using the cost model and is stated at cost less accumulated depreciation and accumulated impairment losses.

The acquisition cost includes any costs directly attributable to the acquisition of the asset and dismantlement, removal and restoration costs, as well as borrowing costs eligible for capitalization.

Except for assets that are not subject to depreciation such as land, assets are depreciated using the straight-line method over their estimated useful lives. The estimated useful lives of major asset items are as follows:

- Buildings and structures: 38 to 50 years
- Machinery and vehicles: 10 to 15 years

The estimated useful lives and depreciation method are reviewed at each fiscal year end and if there are any changes made to the estimated useful lives and depreciation method, such changes are applied prospectively as changes in estimate.

(8) Goodwill and Intangible Assets

A. Goodwill

Goodwill is stated at acquisition cost less accumulated impairment losses.

Goodwill is not amortized. It is allocated to cash-generating units that are identified according to locations and types of businesses and tested for impairment annually or whenever there is any indication of impairment. Impairment losses on goodwill are recognized in the consolidated statement of income and no subsequent reversal is made.

B. Intangible Assets

Intangible assets are measured by using the cost model and are stated at cost less accumulated amortization and accumulated impairment losses.

Intangible assets acquired separately are measured at cost at the initial recognition, and the costs of intangible assets acquired through business combinations are recognized at fair value at the acquisition date. Expenditures on internally generated intangible assets are recognized as expense in the period when incurred, except for development expenses that satisfy the capitalization criteria.

Intangible assets with finite useful lives are amortized using the straight-line method over their estimated useful lives and are tested for impairment whenever there is any indication of impairment. The estimated useful lives and amortization method of intangible assets with finite useful lives are reviewed at each fiscal year end, and the effect of any changes in estimate would be accounted for on a prospective basis.

The estimated useful lives of major intangible assets with finite useful lives are as follows:

- Trademarks: 10 to 20 years
- Software: 5 years

Intangible assets with indefinite useful lives and intangible assets that are not ready to use are not amortized, but they are tested for impairment individually or by cash-generating unit annually or whenever there is any indication of impairment.

(9) Leases

Leases are classified as finance leases whenever substantially all the risks and rewards incidental to ownership are transferred to the Group. All other leases are classified as operating leases.

In finance lease transactions, leased assets and lease obligations are recognized in the consolidated statement of financial position at the lower of the fair value of the leased property or the present value of the minimum lease payments, each determined at the inception of the lease. Lease payments are apportioned between the financial cost and the reduction of the lease obligations based on the effective interest method. Financial costs are recognized in the consolidated statement of income. Leased assets are depreciated using the straight-line method over their estimated useful lives or lease terms, whichever is shorter.

In operating lease transactions, lease payments are recognized as an expense using the straight-line method over the lease terms in the consolidated statement of income. Contingent rents are recognized as an expense in the period when they are incurred.

Determining whether an arrangement is, or contains, a lease is based on the substance of the arrangement in accordance with IFRIC 4 "Determining Whether an Arrangement Contains a Lease," even if the arrangement does not take the legal form of a lease.

(10) Investment Property

Investment property is property held to earn rentals or for capital appreciation or both.

Investment property is measured by using the cost model and is stated at cost less accumulated depreciation and accumulated impairment losses.

(11) Impairment of Non-financial Assets

The Group assesses for each fiscal year whether there is any indication that an asset may be impaired. If any such indication exists, or in cases where the impairment test is required to be performed each year, the recoverable amount of the asset is estimated. In cases that the recoverable amount cannot be estimated for each asset, it is estimated by the cash-generating unit to which the asset belongs. The recoverable amount of an asset or a cash-generating unit is determined at the higher of its fair value less costs of disposal or its value in use. If the carrying amount of the asset or cash-generating unit exceeds the recoverable amount, impairment losses are recognized and the carrying amount is reduced to the recoverable amount. In determining the value in use, estimated future cash flows are discounted to the present value, using pretax discount rates that reflect current market assessments of the time value of money and the risks specific to the asset. In determining the fair value less costs of disposal, the Group uses an appropriate valuation model supported by available fair value indicators.

The Group assesses whether there is any indication that an impairment loss recognized in prior years for an asset other than goodwill may no longer exist or may have decreased, such as any changes in assumptions used for the determination of the recoverable amount. If any such indication exists, the recoverable amount of the asset or cash-generating unit is estimated. In cases that the recoverable amount exceeds the carrying amount of the asset or cash-generating unit, impairment losses are reversed up to the lower of the estimated recoverable amount or the carrying amount (net of depreciation) that would have been determined if no impairment losses had been recognized in prior years.

(12) Non-current Assets Held-for-Sale

An asset or asset group for which the value is expected to be recovered through a sales transaction rather than through continuing use is classified into a non-current asset or disposal group held-for-sale when the following conditions are met: it is highly probable that the asset or asset group will be sold within one year, the asset or asset group is available for immediate sale in its present condition, and the Group management commits to the sale plan. In such cases, the non-current asset is not depreciated or amortized and is measured at the lower of its carrying amount or its fair value less costs of disposal.

(13) Post-employment Benefits

The Group sponsors defined benefit plans and defined contribution plans as employee retirement benefit plans.

The Company is obligated to bear pension expenses for a mutual assistance association incurred with respect to services in or before June 1956 (prior to the enforcement of the Act on the Mutual Aid Association of Public Corporation Employees). Such obligations are calculated and included in liabilities related to the retirement benefits.

For each plan, the Group calculates the present value of defined benefit obligations, related current service cost and past service cost using the projected unit credit method. For a discount rate, a discount period is determined based on the period until the expected date of benefit payment in each fiscal year, and the discount rate is determined by reference to market yields for the period corresponding to the discount period at the end of the fiscal year on high quality corporate bonds or government bonds. Liabilities or assets for defined benefit plans are calculated by the present value of the defined benefit obligation, deducting the fair value of any plan assets (including adjustments for the asset ceiling for defined benefit plans and minimum funding requirements, if necessary). Expected interest costs and interest income are recognized as financial costs.

Remeasurements of defined benefit plans are recognized in full as other comprehensive income in the period when they are incurred and transferred to retained earnings immediately. Past service costs are recognized as profit or loss in the period when incurred.

The cost for retirement benefits for defined contribution plans is recognized as an expense at the time of contribution.

(14) Share-based Payments

The Group has a share option plan as an equity-settled share-based payment plan. Share options are estimated at fair value at grant date and are recognized as an expense over the vesting period in the consolidated statement of income after considering the number of share options that are expected to be eventually vested. The corresponding amount is recognized as an increase in equity in the consolidated statement of financial position.

(15) Provisions

The Group has present obligations (legal or constructive) resulting from past events and recognizes provisions when it is probable that the obligations are required to be settled and the amount of the obligations can be estimated reliably.

Where the effect of the time value of money is material, the amount of provisions is measured at the present value of the expenditures expected to be required to settle the obligations. In calculating the present value, the Group uses the pretax discount rate reflecting current market assessments of the time value of money and the risks specific to the liability.

In accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets," the Group recognizes a provision for restructuring when it has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main scheme to those affected by it. Restructuring provisions include only the direct expenditures arising from the restructuring, which meet both of the following criteria:

- necessarily entailed by the restructuring;
- not associated with the ongoing activities of the entity.

(16) Revenue

A. Sale of Goods

The Group mainly engages in the sale of tobacco products, prescription drugs and processed foods. Revenue from the sale of these goods is recognized when the significant risks and rewards of ownership of the goods transfer to the buyers, the Group retains neither continuing managerial involvement nor effective control over the goods sold, it is probable that the future economic benefits will flow to the Group, and the amount of revenue and the corresponding costs can be measured reliably. Therefore, revenue is usually recognized at the time of delivery of goods to customers. In addition, revenue is recognized at fair value of the consideration received or receivable less discounts, rebates and taxes, including consumption taxes.

Since the amount of turnover where the Group is involved as an agency, including tobacco excise taxes, is deducted from revenue, the Group recognizes only the economic benefit inflow, excluding such amount as revenue in the consolidated statement of income.

B. Interest Income

Interest income is recognized using the effective interest rate method.

C. Dividend Income

Dividend income is recognized when the shareholder's right to receive payment is established.

D. Royalties

Royalties are recognized on an accrual basis in accordance with the substance of the relevant agreement.

(17) Government Grants

Government grants are recognized at fair value when there is a reasonable assurance that the Group will comply with the conditions attached to them and receive the grants.

In the case that the government grants are related to expense items, they are recognized in profit or loss on a systematic basis over the period in which the grants are intended to compensate are recognized. With regard to government grants for assets, the amount of the grants is deducted from the acquisition cost of the assets.

(18) Borrowing Costs

With respect to assets that necessarily take a substantial period of time to get ready for their intended use or sale, the borrowing costs that are directly attributable to the acquisition, construction or production of the assets are capitalized as part of the acquisition cost of the assets. Other borrowing costs are recognized as an expense in the period when they are incurred.

(19) Income Taxes

Income taxes in the consolidated statement of income are presented as the total of current income taxes and deferred income taxes.

Current income taxes are measured at the amount that is expected to be paid to or refunded from the taxation authorities. For the calculation of the tax amount, the Group uses the tax rates and tax laws that have been enacted or substantively enacted by the end of the fiscal year. The current income taxes are recognized in profit or loss, except for taxes arising from items that are recognized in other comprehensive income or directly in equity and taxes arising from business combinations.

Deferred income taxes are calculated based on the temporary differences between the tax base for assets and liabilities and the carrying amount at the fiscal year end. Deferred tax assets are recognized for deductible temporary differences, carryforward of unused tax credits and unused tax losses to the extent that it is probable that future taxable profit will be available against which they can be utilized. Deferred tax liabilities are recognized for taxable temporary differences.

The deferred tax assets or liabilities are not recognized for the following temporary differences:

- the initial recognition of goodwill
- the initial recognition of assets or liabilities in transactions that are not business combinations and at the time of transaction, affect neither accounting profit nor taxable profit or tax loss
- deductible temporary differences arising from investments in subsidiaries and associates, and interests in joint ventures to the extent that it is probable that the timing of the reversal of the temporary difference in the foreseeable future and it is not probable that future taxable profits will be available against which they can be utilized
- taxable temporary differences arising from investments in subsidiaries and associates, and interests in joint ventures to the extent that the timing of the reversal of the temporary difference is controlled and that it is probable the temporary difference will not reverse in the foreseeable future.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the fiscal year when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted by the fiscal year end.

(20) Treasury Shares

Treasury shares are recognized at cost and deducted from equity. No gain or loss is recognized on the purchase, sale or cancellation of the treasury shares. Any difference between the carrying amount and the consideration paid is recognized in capital surplus.

(21) Earnings per Share

Basic earnings per share are calculated by dividing profit or loss attributable to ordinary shareholders of the parent company by the weighted-average number of ordinary shares outstanding during the year, adjusted by the number of treasury shares. Diluted earnings per share are calculated by adjusting the effects of dilutive potential ordinary shares.

(22) Dividends

Dividend distributions to the shareholders of the Company are recognized as liabilities in the period in which, for year end dividends, the Annual Shareholders' Meeting approves the distribution and, for interim dividends, the Board of Directors approves the distribution.

(23) Contingencies

A. Contingent Liabilities

The Group discloses contingent liabilities in the notes to consolidated financial statements if it has possible obligations at the fiscal year end, whose existence cannot be confirmed at that date, or if the obligations do not meet the recognition criteria of a provision described in "20. Provisions."

B. Contingent Assets

The Group discloses contingent assets in the notes to consolidated financial statements if an inflow of future economic benefits to the Group is probable, but not virtually certain at the fiscal year end.

(24) Adjusted Financial Measures

The adjusted financial measures are calculated by adding certain adjustment items to the non-adjusted financial data or by deducting the items from the non-adjusted financial data.

The adjustment items are determined by management's judgment, taking into consideration the nature and frequency of the income and costs such that they provide effective comparative information on the Group performance and that they reflect the way of managing our business appropriately. Adjusted financial measures are presented in the consolidated statement of income and "6. Operating Segments."

The adjusted financial measures are not defined under IFRS and are not comparable with equivalent indicators for other entities.

(Changes in Accounting Policies)

The Group has adopted the following new accounting standards, amended standards and new interpretations from the fiscal year ended December 31, 2017.

IFRS		Description of new standards and amendments
IAS 7	Statement of Cash Flows	Additional disclosures about changes in liabilities arising from financing activities

The effect of adopting the above standards and interpretations on the consolidated financial statements is immaterial.

4. Significant Accounting Estimates and Judgments

Preparation of consolidated financial statements of the Group requires management estimates and assumptions in order to measure income, expenses, assets and liabilities, and disclose contingencies as of the fiscal year end date. These estimates and assumptions are based on the best judgment of management in light of historical experience and various factors deemed to be reasonable as of the fiscal year end date. Given their nature, actual results may differ from those estimates and assumptions.

The estimates and assumptions are continuously reviewed by management. The effects of a change in estimates and assumptions are recognized in the period of the change or the period of the change and future periods.

Among the above estimates and assumptions, the following are items that may have a material effect on the amounts recognized in the consolidated financial statements of the Group:

A. Impairment of Property, Plant and Equipment, Goodwill, Intangible Assets and Investment Properties

With regard to property, plant and equipment, goodwill, intangible assets and investment properties, if there is any indication that the recoverable amount declines below the carrying amounts of the assets, the Group performs an impairment test.

The important indications include significant changes with adverse effect on the results of past or projected business performance, significant changes in the use of acquired assets or in overall business strategy, and significant deteriorations in industry trends and economic trends. With regard to goodwill, an impairment test is conducted at least once a year, regardless of any indication of impairment, in order to ensure that the recoverable amount exceeds the carrying amount.

The impairment test is performed by comparing the carrying amount and the recoverable amount of assets. If the recoverable amount declines below the carrying amount, impairment losses are recognized. The recoverable amount is mainly calculated based on the discounted cash flow model. Certain assumptions are made for the useful lives and the future cash flows of the assets, discount rates and long-term growth rates. These assumptions are based on the best estimates and judgments made by management; however, there is a possibility that these assumptions may be affected by changes in uncertain future economic conditions, which may have a material impact on the consolidated financial statements in future periods.

The method for calculating the recoverable amount is described in "13. Property, Plant and Equipment," "14. Goodwill and Intangible Assets" and "16. Investment Property." With regard to goodwill, the sensitivity analysis is described in "14. Goodwill and Intangible Assets."

B. Post-employment Benefits

The Group has various types of retirement benefit plans, including defined benefit plans. In addition, the mutual pension benefits plan of the Company is one of the public pension systems under the jurisdiction of the government of Japan and the Company is legally obligated to bear a part of the pension costs of the plan.

The present value of defined benefit obligations on each of these plans and the related service costs are calculated based on actuarial assumptions. These actuarial assumptions require estimates and judgments on variables, such as discount rates and inflation rate.

The Group obtains advice from external pension actuaries with respect to the appropriateness of these actuarial assumptions including these variables.

The actuarial assumptions are determined based on the best estimates and judgments made by management; however, there is a possibility that these assumptions may be affected by changes in uncertain future economic conditions, or by the publication or the amendment of related laws, which may have a material impact on the consolidated financial statements in future periods.

These actuarial assumptions and the related sensitivity analysis are described in "22. Employee Benefits."

C. Provisions

The Group recognizes various provisions, including provisions for asset retirement obligations and restructuring, in the consolidated statement of financial position.

These provisions are recognized based on the best estimates of the expenditures required to settle the obligations taking risks and uncertainty related to the obligations into account as of the fiscal year end date.

Expenditures required to settle the obligations are calculated by taking possible results into account comprehensively; however, they may be affected by the occurrence of unexpected events or changes in conditions which may have a material impact on the consolidated financial statements in future periods.

The nature and amount of recognized provisions are described in "20. Provisions."

D. Income Taxes

The Group operates business activities around the world, and it recognizes current tax liabilities and income taxes as the estimated amounts to be paid to the tax authorities, based on the estimation in accordance with their laws and regulations.

Calculating current tax liabilities and income taxes requires estimates and judgment on various factors, including the interpretation of tax regulations by taxable entities and the tax authority in the jurisdiction or the experience of past tax audits.

Therefore, there may be differences between the amount recognized as tax liabilities and income taxes and the amount of actual tax liabilities and income taxes. These differences may have a material impact on the consolidated financial statements in future periods.

In addition, deferred tax assets are recognized to the extent that it is probable that taxable income will be available against which deductible temporary differences can be utilized.

In recognizing the deferred tax assets, when judging the possibility of the future taxable income, we reasonably estimate the timing and amount of future taxable income based on the business plan.

The timing when taxable income arises and the amount of such income may be affected by changes in uncertain future economic conditions. Therefore, this may have a material impact on the consolidated financial statements in future periods.

The content and amount related to income taxes are described in "17. Income Taxes."

E. Contingencies

With regard to contingencies, any items that may have a material impact on business in the future are disclosed in light of all the available evidence as of the fiscal year end date and by taking into account the probability of these contingencies and their impact on financial reporting.

The content of contingencies is described in "39. Contingencies."

5. New Accounting Standards Not Yet Adopted by the Group

By the date of approval of the consolidated financial statements, new accounting standards, amended standards and new interpretations that have been issued, but have not been early adopted by the Group are as follows.

The implications from adoption of these standards and interpretations are assessed by the Group; however, we evaluate that none of them will have a material impact on our operating results and financial condition.

In relation to adoption of IFRS 15 "Revenue from Contracts with Customers," expenses previously recognized in "Selling, general and administrative expenses" will be partially recognized as a reduction of "Revenue" or as "Cost of sales." There will be immaterial impact on operating profit from this change.

IFRS		Mandatory adoption (From the year beginning)	To be adopted by the Group	Description of new standards and amendments
IFRS 1	First-time Adoption of International Financial Reporting Standards	January 1, 2018	Fiscal year ending December 2018	Deleting short-term exemptions for first-time adopters
IFRS 2	Share-based Payment	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for the effects of vesting conditions on cash-settled share-based payment transactions
IFRS 3	Business Combinations	January 1, 2019	Fiscal year ending December 2019	Clarifying accounting treatment for previously held interests in a joint operation
IFRS 4	Insurance Contracts	January 1, 2018	Fiscal year ending December 2018	Adding the option to defer the adoption of IFRS 9 for entities engaging mainly in insurance business
IFRS 9	Financial Instruments	January 1, 2018	Fiscal year ending December 2018	Limited changes to classification and measurement of financial assets, and introduction of an expected credit loss impairment model
		January 1, 2019	Fiscal year ending December 2019	Amendments to classification of financial assets included in prepayment features
IFRS 11	Joint Arrangements	January 1, 2019	Fiscal year ending December 2019	Clarifying accounting treatment for previously held interests in a joint operation
IFRS 15	Revenue from Contracts with Customers	January 1, 2018	Fiscal year ending December 2018	Amendments to accounting treatment for recognizing revenue
IFRS 16	Leases	January 1, 2019	Fiscal year ending December 2019	Amendments to accounting treatment for lease arrangements
IFRS 17	Insurance Contracts	January 1, 2021	Fiscal year ending December 2021	Amendments to accounting treatment for insurance contracts
IAS 12	Income Taxes	January 1, 2019	Fiscal year ending December 2019	Clarifying accounting treatment for income tax consequences of dividends
IAS 19	Employee Benefits	January 1, 2019	Fiscal year ending December 2019	Clarifying treatment on a defined benefit plan curtailment or settlement
IAS 23	Borrowing Costs	January 1, 2019	Fiscal year ending December 2019	Clarifying the method for calculating the borrowing costs eligible for capitalization
IAS 28	Investments in Associates and Joint Ventures	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for investments in associates and joint ventures
		January 1, 2019	Fiscal year ending December 2019	Clarifying accounting treatment for impairment loss of investments in associates and joint ventures
IAS 40	Investment Property	January 1, 2018	Fiscal year ending December 2018	Clarifying the rules for transfers of property to or from investment property
IFRIC 22	Foreign Currency Transactions and Advance Consideration	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for the transactions that include payment/receipt of advance consideration in a foreign currency
IFRIC 23	Uncertainty over Income Tax Treatments	January 1, 2019	Fiscal year ending December 2019	Clarifying accounting treatment for uncertainty over income tax treatments
IFRS 10 IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	Not yet determined	Not yet determined	Amendments to accounting treatment for sale or contribution of assets between an investor and its associate or joint venture

6. Operating Segments

(1) Outline of Reportable Segments

The reportable segments of the Group are determined based on the operating segments that are components of the Group for which separate financial information is available and are evaluated regularly by the Board of Directors in deciding how to allocate resources and in assessing performance.

The Group is mainly engaged in the manufacture and sale of tobacco products, prescription drugs and processed foods. With respect to tobacco products, operations are managed separately for domestic and overseas markets. The reportable segments of the Group are composed of four segments: "Domestic Tobacco Business," "International Tobacco Business," "Pharmaceutical Business," and "Processed Food Business." They are determined by types of products, characteristics, and markets.

The "Domestic Tobacco Business" manufactures and sells tobacco products in domestic areas (which include duty-free shops in Japan and markets in China, Hong Kong, and Macau where the Company's China Division operates). The "International Tobacco Business" manufactures and sells tobacco products overseas mainly through JT International S.A., which controls manufacturing and sales operations. The "Pharmaceutical Business" consists of research and development, and the manufacture and sale of prescription drugs. The "Processed Food Business" consists of the manufacture and sale of frozen and ambient processed foods, bakery products and seasonings.

(2) Revenues and Performances of Reportable Segments

Revenues and performances of reportable segments are as follows. The Board of Directors assesses the segment performance and determines resource allocation after reviewing revenues and adjusted operating profit. Since financial income, financial costs and income taxes are managed by the Group head office, these income and expenses are excluded from segment performance. Transactions within the segments are based mainly on prevailing market prices.

FY2016: Year ended December 31, 2016

Millions of yen

FY2016

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Revenue								
External revenue (Note 3)	¥684,233	¥1,199,190	¥87,183	¥164,078	¥2,134,683	¥ 8,604	¥ —	¥2,143,287
Intersegment revenue	18,245	30,280	—	30	48,554	9,653	(58,207)	—
Total revenue	¥702,478	¥1,229,470	¥87,183	¥164,108	¥2,183,237	¥ 18,257	¥(58,207)	¥2,143,287
Segment profit (loss)								
Adjusted operating profit (Note 1)	¥260,205	¥ 336,227	¥ 9,717	¥ 4,998	¥ 611,146	¥(24,725)	¥ 356	¥ 586,777
Other items								
Depreciation and amortization	¥ 57,994	¥ 69,129	¥ 4,908	¥ 6,423	¥ 138,453	¥ 2,675	¥ (335)	¥ 140,794
Impairment losses on other than financial assets	54	615	—	16	685	554	—	1,239
Reversal of impairment losses on other than financial assets	—	27	—	—	27	—	—	27
Share of profit (loss) in investments accounted for using the equity method	33	6,327	—	(4)	6,355	134	—	6,489
Capital expenditures	29,820	70,592	3,823	5,707	109,942	3,902	(847)	112,998

FY2017: Year ended December 31, 2017

Millions of yen

FY2017

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Revenue								
External revenue (Note 3)	**¥626,758**	**¥1,237,577**	**¥104,714**	**¥163,138**	**¥2,132,187**	**¥ 7,466**	**¥ —**	**¥2,139,653**
Intersegment revenue	**8,558**	**31,465**	**—**	**22**	**40,045**	**7,543**	**(47,588)**	**—**
Total revenue	**¥635,315**	**¥1,269,042**	**¥104,714**	**¥163,159**	**¥2,172,232**	**¥ 15,008**	**¥(47,588)**	**¥2,139,653**
Segment profit (loss)								
Adjusted operating profit (Note 1)	**¥232,275**	**¥ 351,302**	**¥ 24,094**	**¥ 5,397**	**¥ 613,069**	**¥(28,156)**	**¥ 388**	**¥ 585,300**
Other items								
Depreciation and amortization	**¥ 56,001**	**¥ 76,098**	**¥ 5,120**	**¥ 6,137**	**¥ 143,355**	**¥ 2,288**	**¥ (237)**	**¥ 145,407**
Impairment losses on other than financial assets	**53**	**2,599**	**—**	**286**	**2,938**	**489**	**—**	**3,427**
Reversal of impairment losses on other than financial assets	**—**	**455**	**—**	**—**	**455**	**—**	**—**	**455**
Share of profit (loss) in investments accounted for using the equity method	**22**	**6,102**	**—**	**17**	**6,140**	**53**	**—**	**6,194**
Capital expenditures	**51,549**	**68,427**	**6,230**	**10,424**	**136,631**	**4,838**	**(564)**	**140,905**

Reconciliation from "Adjusted operating profit" to "Profit before income taxes"
FY2016: Year ended December 31, 2016

Millions of yen

FY2016

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Adjusted operating profit (Note 1)	¥260,205	¥336,227	¥9,717	¥4,998	¥611,146	¥(24,725)	¥356	¥586,777
Amortization cost of acquired intangibles arising from business acquisitions	(16,245)	(30,522)	—	—	(46,767)	—	—	(46,767)
Adjustment items (income) (Note 4)	282	34	—	2	318	64,894	—	65,212
Adjustment items (costs) (Note 5)	(137)	(3,960)	—	(8)	(4,105)	(7,789)	—	(11,894)
Operating profit (loss)	¥244,106	¥301,779	¥9,717	¥4,991	¥560,592	¥ 32,380	¥356	¥593,329
Financial income								6,618
Financial costs								(21,710)
Profit before income taxes								¥578,237

FY2017: Year ended December 31, 2017

Millions of yen

FY2017	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Adjusted operating profit (Note 1)	¥232,275	¥351,302	¥24,094	¥5,397	¥613,069	¥(28,156)	¥388	¥585,300
Amortization cost of acquired intangibles arising from business acquisitions	(16,245)	(34,170)	—	—	(50,414)	—	—	(50,414)
Adjustment items (income) (Note 4)	6	16,723	—	—	16,729	20,840	—	37,569
Adjustment items (costs) (Note 5)	(197)	(8,272)	—	(20)	(8,489)	(2,865)	—	(11,354)
Operating profit (loss)	¥215,839	¥325,584	¥24,094	¥5,377	¥570,894	¥(10,181)	¥388	¥561,101
Financial income								4,780
Financial costs								(27,349)
Profit before income taxes								¥538,532

(Note 1) For adjusted operating profit, amortization cost of acquired intangibles arising from business acquisitions, and adjustment items (income and costs) are excluded from operating profit (loss).
(Note 2) "Other" includes business activities relating to rent of real estate and corporate expenses relating to corporate communication and operation of the head office.
(Note 3) Core revenue as part of the "Domestic Tobacco Business" and the "International Tobacco Business" is as follows:

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Domestic Tobacco	¥ 649,744	¥ 590,605
International Tobacco	1,138,805	1,176,956

(Note 4) The breakdown of "Adjustment items (income)" is as follows:

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Restructuring incomes	¥65,178	¥21,645
Reversal of impairment losses on investments in associates	—	8,848
Gains on remeasurement related to the business combination	—	5,042
Others	34	2,034
Adjustment items (income)	¥65,212	¥37,569

Restructuring incomes for the year ended December 31, 2016 mainly relate to gains on sale of real estate and gains on sale of investments in subsidiaries. Restructuring incomes for the year ended December 31, 2017 mainly relate to gains on sale of real estate. The breakdown of restructuring income is described in "26. Other Operating Income."

(Note 5) The breakdown of "Adjustment items (costs)" is as follows:

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Restructuring costs	¥11,894	¥ 8,398
Others	—	2,956
Adjustment items (costs)	¥11,894	¥11,354

Restructuring costs for the year ended December 31, 2016 mainly relate to disposal of real estate. Restructuring costs for the year ended December 31, 2017 mainly relate to rationalization of the production and distribution system in some markets in the "International Tobacco Business". Restructuring costs included in "Cost of sales" were ¥84 million for the year ended December 31, 2017. Restructuring costs included in "Selling, general and administrative expenses" were ¥11,894 million and ¥8,314 million for the year ended December 31, 2016 and 2017, respectively. The breakdown of restructuring costs in "Selling, general and administrative expenses" is described in "27. Selling, General and Administrative Expenses."

(3) Geographic Information

The regional breakdown of non-current assets and external revenue as of each fiscal year end is as follows:

Non-current Assets

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Japan	¥ 833,543	¥ 830,838
Overseas	1,891,433	2,301,854
Consolidated	¥2,724,975	¥3,132,692

(Note) Non-current assets, exclusive of financial instruments, deferred tax assets and retirement benefits assets, are segmented by the location of the assets.

External Revenue

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Japan	¥ 889,742	¥ 831,216
Overseas	1,253,545	1,308,437
Consolidated	¥2,143,287	¥2,139,653

(Note) Revenue is segmented by the sales destination.

(4) Major Customers Information

The "International Tobacco Business" of the Group sells products to the Megapolis Group that engages in distribution and wholesale business in Russia and other countries. The external revenues from the Megapolis Group were ¥235,932 million (11.0% of consolidated revenue) for the year ended December 31, 2016 and ¥248,881 million (11.6% of consolidated revenue) for the year ended December 31, 2017.

7. Cash and Cash Equivalents

The breakdown of "Cash and cash equivalents" as of each fiscal year end is as follows:

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Cash and deposits	¥234,957	¥215,885
Short-term investments	59,200	69,601
Total	¥294,157	¥285,486

Cash and cash equivalents are classified as financial assets measured at amortized cost.

8. Trade and Other Receivables

The breakdown of "Trade and other receivables" as of each fiscal year end is as follows:

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Note and account receivables	¥386,708	¥439,562
Other	11,742	15,226
Allowance for doubtful accounts	(1,515)	(23,589)
Total	¥396,934	¥431,199

Trade and other receivables are presented net of allowance for doubtful accounts in the consolidated statement of financial position.
Trade and other receivables are classified as financial assets measured at amortized cost.

9. Inventories

The breakdown of "Inventories" as of each fiscal year end is as follows:

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Merchandise and finished goods (Note 1)	¥176,702	¥193,179
Leaf tobacco (Note 2)	324,802	352,803
Other	57,343	66,971
Total	¥558,846	¥612,954

(Note 1) For imported tobacco products (merchandise) that are sold by TS Network Co., Ltd., a subsidiary of the Company, commissions solely from wholesale are included in revenue. The amount of imported tobacco products (merchandise) that the company holds at the end of each fiscal year is included in inventories and presented as "Merchandise and finished goods."

(Note 2) Leaf tobacco includes those products that will be used after 12 months from the end of each fiscal year, but they are included in inventories since they are held within the normal operating cycle.

10. Other Financial Assets

(1) The breakdown of "Other financial assets" as of each fiscal year end is as follows:

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Derivative assets	¥ 11,769	¥ 5,978
Equity securities	65,548	77,642
Debt securities	4,572	11,352
Time deposits	965	977
Other	38,345	39,607
Allowance for doubtful accounts	(6,920)	(6,569)
Total	¥114,279	¥128,987
Current assets	¥ 14,921	¥ 14,016
Non-current assets	99,358	114,970
Total	¥114,279	¥128,987

Other financial assets are presented net of allowance for doubtful accounts in the consolidated statement of financial position.

Derivative assets are classified as financial assets measured at fair value through profit or loss excluding those to which hedge accounting is applied, equity securities are classified as financial assets measured at fair value through other comprehensive income, and time deposits and debt securities are classified as financial assets measured at amortized cost.

(2) Names of major securities held as financial assets measured at fair value through other comprehensive income and their fair values as of each fiscal year end are as follows:

Millions of yen

Company name	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
KT&G Corporation	¥28,010	¥35,141
Seven & i Holdings Co., Ltd.	3,808	4,005
DOUTOR•NICHIRES Holdings Co., Ltd.	2,872	3,715
Mizuho Financial Group, Inc.	2,683	2,609
KATO SANGYO CO., LTD.	1,541	2,325
Mitsubishi UFJ Financial Group, Inc.	2,165	2,031

Equity securities are held mainly for strengthening relationships with investees. Therefore, they are designated as financial assets measured at fair value through other comprehensive income.

In order to pursue the efficiency of assets held and to use them effectively, sales of financial assets measured at fair value through other comprehensive income have been carried out (derecognition).

The fair value at the time of sale and cumulative gain or loss that is recognized in equity through other comprehensive income for each fiscal year is as follows:

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Fair Value	¥1,532	¥1,545
Cumulative gain or loss recognized in equity as other comprehensive income (Note)	(360)	(461)

(Note) The figure represents the amount transferred to retained earnings.
The cumulative gain or loss recognized in equity as other comprehensive income is transferred to retained earnings when an equity instrument is sold or the decline in its fair value compared to its acquisition cost is significant.

11. Other Current Assets

The breakdown of "Other current assets" as of each fiscal year end is as follows:

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Prepaid tobacco excise taxes	¥274,157	¥297,332
Prepaid expenses	15,743	19,339
Consumption tax receivables	18,575	19,496
Other	31,836	25,547
Total	¥340,312	¥361,715

12. Non-current Assets Held-for-Sale

The breakdown of "Non-current assets held-for-sale" as of each fiscal year end is as follows:

Breakdown of Major Assets

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Non-current assets held-for-sale		
Property, plant and equipment	¥309	¥1,453
Investment property	512	943
Total	¥821	¥2,396

"Non-current assets held-for-sale" are mainly idle properties which are currently actively marketed for sale.

With regard to such assets and assets sold, impairment losses of ¥518 million are recognized in "Selling, general and administrative expenses" in the consolidated statement of income for the year ended December 31, 2017.

13. Property, Plant and Equipment

(1) Schedule of Property, Plant and Equipment

The schedules of the carrying amount, acquisition cost, and accumulated depreciation and accumulated impairment losses of "Property, plant and equipment" are as follows:

Millions of yen

Carrying Amount	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2016	¥339,542	¥249,160	¥46,355	¥46,808	¥681,865
Individual acquisition	13,053	30,787	12,390	43,758	99,989
Acquisition through business combinations	1,066	451	241	3	1,762
Transfer to investment property	(5,702)	(9)	(16)	—	(5,726)
Transfer to non-current assets held-for-sale	(180)	—	(0)	—	(180)
Depreciation	(15,709)	(47,121)	(14,670)	—	(77,500)
Impairment losses	(24)	(537)	(3)	(10)	(575)
Reversal of impairment losses	—	8	19	—	27
Sale or disposal	(507)	(3,646)	(736)	(162)	(5,050)
Exchange differences on translation of foreign operations	(4,722)	(8,864)	(766)	(4,252)	(18,604)
Other	17,420	25,963	1,377	(39,932)	4,827
As of December 31, 2016	344,237	246,192	44,193	46,213	680,835
Individual acquisition	17,833	43,586	15,071	38,647	115,137
Acquisition through business combinations	12,401	14,424	315	1,599	28,739
Transfer to investment property	(1,721)	(5)	(6)	—	(1,732)
Transfer to non-current assets held-for-sale	(2,250)	—	—	—	(2,250)
Depreciation	(15,813)	(48,717)	(14,634)	—	(79,164)
Impairment losses	(699)	(1,108)	(46)	(37)	(1,891)
Reversal of impairment losses	—	451	3	—	455
Sale or disposal	(581)	(4,685)	(1,011)	(17)	(6,295)
Exchange differences on translation of foreign operations	3,230	5,056	1,002	(226)	9,061
Other	6,610	23,894	1,486	(29,277)	2,712
As of December 31, 2017	**¥363,245**	**¥279,088**	**¥46,373**	**¥56,902**	**¥745,607**

Millions of yen

Acquisition Cost	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2016	¥633,789	¥706,561	¥144,618	¥46,808	¥1,531,776
As of December 31, 2016	643,073	693,378	147,223	46,213	1,529,888
As of December 31, 2017	**664,779**	**761,581**	**156,169**	**56,902**	**1,639,431**

Millions of yen

Accumulated Depreciation and Accumulated Impairment Losses	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2016	¥294,247	¥457,401	¥ 98,263	¥ —	¥849,910
As of December 31, 2016	298,836	447,187	103,030	—	849,053
As of December 31, 2017	**301,534**	**482,493**	**109,797**	**—**	**893,824**

The carrying amount of property, plant and equipment as of each fiscal year end includes the carrying amount of the following leased assets:

Millions of yen

	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Total
As of January 1, 2016	¥6,801	¥1,853	¥ 9	¥ 8,662
As of December 31, 2016	6,538	1,201	7	7,746
As of December 31, 2017	**6,509**	**4,669**	**11**	**11,189**

(2) Impairment Losses

The grouping of property, plant and equipment for impairment test is the smallest cash-generating unit that independently generates cash inflow.

The Group recognized impairment losses of ¥575 million for the year ended December 31, 2016, and ¥1,891 million for the year ended December 31, 2017 in "Selling, general and administrative expenses" in the consolidated statement of income.

Impairment losses recognized in the year ended December 31, 2016 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles, such as due to the decision of individual selection for demolition.

The recoverable amounts of these assets are calculated mainly by their values in use, which are set at "zero."

Impairment losses recognized in the year ended December 31, 2017 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles, such as due to the decision of closing down of a factory.

The recoverable amounts of these assets are calculated mainly by their values in use, which are set at "zero."

14. Goodwill and Intangible Assets

(1) Schedule of Goodwill and Intangible Assets

The schedules of carrying amount, acquisition cost, and accumulated amortization and accumulated impairment losses of "Goodwill" and "Intangible assets" are as follows:

Millions of yen

Carrying Amount	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2016	¥1,429,287	¥268,828	¥33,418	¥30,232	¥1,761,765
Individual acquisition	—	222	5,597	6,852	12,670
Acquisition through business combinations	289,720	180,297	8	2,243	472,268
Amortization (Note)	—	(44,154)	(12,795)	(5,696)	(62,645)
Impairment losses	—	—	(102)	—	(102)
Sale or disposal	—	—	(90)	(40)	(130)
Exchange differences on translation of foreign operations	(114,709)	(40,315)	(406)	(280)	(155,710)
Other	(2,312)	17	1,448	(1,314)	(2,161)
As of December 31, 2016	1,601,987	364,896	27,078	31,996	2,025,957
Individual acquisition	—	257	7,724	17,482	25,462
Acquisition through business combinations	202,144	71,450	—	12,831	286,425
Amortization (Note)	—	(46,786)	(12,808)	(6,079)	(65,673)
Impairment losses	—	(940)	(75)	(4)	(1,019)
Sale or disposal	—	—	(89)	(43)	(132)
Exchange differences on translation of foreign operations	87,080	12,410	(153)	(108)	99,229
Other	—	—	1,546	(1,409)	136
As of December 31, 2017	**¥1,891,210**	**¥401,286**	**¥23,223**	**¥54,666**	**¥2,370,385**

(Note) The amortization of intangible assets is included in "Cost of sales" and "Selling, general and administrative expenses" in the consolidated statement of income.

Millions of yen

Acquisition Cost	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2016	¥1,429,287	¥ 818,982	¥135,951	¥ 92,062	¥2,476,282
As of December 31, 2016	1,601,987	928,876	137,761	96,994	2,765,618
As of December 31, 2017	**1,891,210**	**1,028,189**	**142,531**	**126,263**	**3,188,192**

Millions of yen

Accumulated Amortization and Accumulated Impairment Losses	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2016	¥ —	¥550,154	¥102,533	¥61,830	¥714,517
As of December 31, 2016	—	563,981	110,683	64,997	739,661
As of December 31, 2017	**—**	**626,903**	**119,308**	**71,597**	**817,808**

(2) Material Goodwill and Intangible Assets

Goodwill and intangible assets recognized in the consolidated statement of financial position are mainly composed of goodwill and trademarks in the JTIH Group. The carrying amounts of goodwill as of December 31, 2016 and 2017 were ¥1,310,727 million and ¥1,599,950 million, respectively. The carrying amounts of trademarks as of December 31, 2016 and 2017 were ¥216,617 million and ¥269,453 million, respectively.

The majority of goodwill and trademark in the JTIH Group was recognized as a result of the acquisitions of RJR Nabisco's non-U.S. tobacco operations in 1999 and Gallaher in 2007.

Other than the above, goodwill and trademark in Domestic Tobacco business were recognized as a result of the acquisition of Natural American Spirit's non-U.S. tobacco operations in 2016. The carrying amounts of goodwill as of December 31, 2016 and 2017 were ¥265,891 million and ¥265,891 million, respectively. The carrying amounts of trademarks as of December 31, 2016 and 2017 were ¥148,260 million and ¥131,822 million, respectively.

The trademarks are amortized using the straight-line method and the remaining amortization period is mainly from 8 to 9 years.

(3) Impairment Test for Goodwill

For the year ended December 31, 2017, the carrying amount of the majority of goodwill is allocated to the domestic tobacco cash-generating unit of ¥265,891 million (¥265,891 million for the year ended December 31, 2016), the international tobacco cash-generating unit of ¥1,599,950 million (¥1,310,727 million for the year ended December 31, 2016) and the processed food cash-generating unit of ¥25,368 million (¥25,368 million for the year ended December 31, 2016). Details of the result of impairment tests are as follows:

A. Domestic Tobacco Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group conservatively decreases a growth rate from 3.9% (FY2016: 2.9%) in the fourth year to 0% (FY2016: 0%) in the ninth year gradually, and calculates the value in use from the tenth year by using the same cash flows as the ninth year.

The discount rate before taxes is 4.9% (FY2016: 4.6%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

B. International Tobacco Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group sets a growth rate from 6.4% in the fourth year (FY2016: 2.8%) to 2.8% in the ninth year (FY2016: 1.4%), and the same growth rate as the ninth year from the tenth year as a continued growth rate for inflation.

The discount rate before taxes is 9.8% (FY2016: 9.7%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

C. Processed Food Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group sets a growth rate from 1.6% in the fourth year (FY2016: 1.6%) to 1.0% in the ninth year (FY2016: 1.0%), and the same growth rate as the ninth year issued from the tenth year as a continued growth rate for inflation.

The discount rate before taxes is 3.9% (FY2016: 3.9%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

(4) Impairment Losses

Goodwill is allocated to cash-generating units that are identified according to locations and types of businesses. The grouping of intangible assets for impairment test is the smallest cash-generating unit that independently generates cash inflow.

The Group recognized impairment losses of ¥102 million for the year ended December 31, 2016, and ¥1,019 million for the year ended December 31, 2017 in "Selling, general and administrative expenses" in the consolidated statement of income.

15. Lease Transactions

The Group leases factory sites, vehicles and other assets as a lessee. Some of the lease contracts have renewal options or escalation clauses. There are no restrictions on additional debt and further leasing imposed by the lease arrangements.

(1) Present Value of Finance Lease Obligations

The total of future minimum lease payments for leased assets recognized based on the finance lease contracts, their present value and future financial costs as of each fiscal year end are as follows:

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Not later than 1 year		
Total of future minimum lease payments	¥ 589	¥ 1,630
Future financial costs	218	284
Present value	372	1,346
Later than 1 year and not later than five years		
Total of future minimum lease payments	1,696	3,503
Future financial costs	1,018	1,203
Present value	678	2,300
Later than 5 years		
Total of future minimum lease payments	9,489	9,626
Future financial costs	2,838	2,605
Present value	6,652	7,021
Total		
Total of future minimum lease payments	11,775	14,760
Future financial costs	4,074	4,092
Present value	7,701	10,667

(2) Future Minimum Lease Payments under Non-cancellable Operating Leases

The total of future minimum lease payments under non-cancellable operating leases as of each fiscal year end is as follows:

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Not later than 1 year	¥ 7,287	¥ 8,059
Later than 1 year and not later than 5 years	8,382	10,719
Later than 5 years	7,871	9,217
Total	¥23,539	¥27,995

(3) Total of Minimum Lease Payments and Contingent Rents

The total of minimum lease payments and contingent rents of operating lease contracts recognized as an expense for each fiscal year is as follows:

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Total of minimum lease payments	¥8,099	¥10,220
Contingent rents	1,147	1,135

16. Investment Property

(1) Schedule of Investment Property

The schedule of the carrying amount of "Investment property" for each fiscal year is as follows:

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Balance at the beginning of the period	¥23,614	¥18,184
Expenditure after acquisition	338	305
Transfer from property, plant and equipment	5,726	1,732
Transfer to non-current assets held-for-sale	(3,130)	(2,777)
Transfer to property, plant and equipment	(1,799)	—
Depreciation	(649)	(570)
Impairment losses	(562)	—
Sale or disposal	(1,904)	(162)
Exchange differences on translation of foreign operations	(5)	6
Other	(3,446)	(17)
Balance at the end of the period	¥18,184	¥16,700
Acquisition cost at the beginning of the period	¥69,106	¥51,245
Accumulated depreciation and accumulated impairment losses at the beginning of the period	45,493	33,061
Acquisition cost at the end of the period	51,245	45,768
Accumulated depreciation and accumulated impairment losses at the end of the period	33,061	29,068

The investment properties as of December 31, 2017 are mainly idle properties.

(2) Fair Value

The fair value of investment property is determined based on a valuation conducted by an external real estate appraiser. The valuation is made in accordance with the appraisal standards of the country where the investment property is located and based on market evidence of transaction prices for similar assets.

The fair value hierarchy of investment property is categorized from Level 1 to Level 3 as follows:

Level 1: Fair value measured at the quoted price in the active market
Level 2: Fair value that is calculated using the observable price other than categorized in Level 1 directly or indirectly
Level 3: Fair value that is calculated based on valuation techniques which include inputs that are not based on observable market data

The fair value of investment property based on the fair value hierarchy as of each fiscal year end is as follows:

Millions of yen

	FY2016 (As of December 31, 2016)			
	Level 1	Level 2	Level 3	Total
Investment property	¥ —	¥45,763	¥1,570	¥47,334

Millions of yen

	FY2017 (As of December 31, 2017)			
	Level 1	Level 2	Level 3	Total
Investment property	¥ —	¥34,646	¥1,921	¥36,567

(3) Impairment Losses

The grouping of investment properties for impairment test is based on the smallest cash-generating unit that independently generates cash inflow. Impairment test for idle properties is carried out individually.

The Group recognized impairment losses of ¥562 million for the year ended December 31, 2016 in "Selling, general and administrative expenses" in the consolidated statement of income.

Impairment losses recognized for the year ended December 31, 2016 represent the difference between the recoverable amount and the carrying amount of land and buildings as idle properties were individually selected for demolition. The recoverable amount is calculated based on value in use basis, which is zero for buildings due to the decision of demolition, and the recoverable amount of other properties is calculated by the fair value less costs of disposal.

17. Income Taxes

(1) Deferred Tax Assets and Deferred Tax Liabilities

The breakdown and schedule of "Deferred tax assets" and "Deferred tax liabilities" by major causes of their occurrence for each fiscal year are as follows:

FY2016: Year ended December 31, 2016

Millions of yen

Deferred Tax Assets	As of January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2016
Fixed assets (Note 2)	¥ 40,392	¥(12,218)	¥ —	¥108,540	¥136,713
Retirement benefits	91,870	(11,902)	1,441	(1,468)	79,940
Carryforward of unused tax losses	57,582	(2,029)	—	(2,419)	53,135
Other	76,839	(1,372)	4,192	(3,688)	75,971
Subtotal	266,683	(27,522)	5,633	100,966	345,760
Valuation allowance	(65,788)	322	1,914	2,320	(61,231)
Total	¥200,895	¥(27,200)	¥7,547	¥103,285	¥284,528

Millions of yen

Deferred Tax Liabilities	As of January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2016
Fixed assets (Note 2)	¥ (87,915)	¥11,097	¥ —	¥ 3,013	¥ (73,805)
Retirement benefits	(7,696)	234	1,824	1,132	(4,506)
Other	(100,693)	(7,467)	(9,030)	5,931	(111,260)
Total	¥(196,305)	¥ 3,864	¥(7,206)	¥10,075	¥(189,572)

FY2017: Year ended December 31, 2017

Deferred Tax Assets	As of January 1, 2017	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2017
					Millions of yen
Fixed assets (Note 2)	¥136,713	¥(15,864)	¥ —	¥ 3,859	¥124,709
Retirement benefits	79,940	(6,395)	(2,135)	2,211	73,621
Carryforward of unused tax losses	53,135	399	—	1,694	55,228
Other	75,971	(4,222)	(177)	2,860	74,433
Subtotal	345,760	(26,082)	(2,312)	10,625	327,991
Valuation allowance	(61,231)	(1,527)	(269)	(2,347)	(65,374)
Total	¥284,528	¥(27,609)	¥(2,581)	¥ 8,278	¥262,617

Deferred Tax Liabilities	As of January 1, 2017	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2017
					Millions of yen
Fixed assets (Note 2)	¥ (73,805)	¥ 1,677	¥ —	¥(12,577)	¥ (84,705)
Retirement benefits	(4,506)	(232)	(3,971)	(534)	(9,244)
Other	(111,260)	(3,539)	(5,196)	(2,568)	(122,563)
Total	¥(189,572)	¥(2,093)	¥(9,167)	¥(15,679)	¥(216,511)

(Note 1) "Other" includes exchange differences on translation of foreign operations and acquisition through business combinations.
(Note 2) "Fixed assets" include property, plant and equipment, goodwill, intangible assets and investment property.

The deferred tax assets are recognized for the amount considered to be recoverable on deductible temporary differences, carryforward of unused tax losses and tax credits by taking taxable temporary differences and future taxable profits plan into account. The carryforward of unused tax losses, for which the deferred tax assets are not recognized, was ¥44,484 million (including ¥12,644 million, for which the carryforward expires after five years) as of December 31, 2016, and ¥46,809 million (including ¥11,903 million, for which the carryforward expires after five years) as of December 31, 2017. Tax credits, for which the deferred tax assets are not recognized, were ¥4,951 million (including ¥4,541 million, for which the carryforward expires after five years) as of December 31, 2016, and ¥5,185 million (including ¥4,810 million, for which the carryforward expires after five years) as of December 31, 2017.

(2) Income Taxes

The breakdown of "Income taxes" for each fiscal year is as follows:

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
		Millions of yen
Current income taxes	¥129,128	¥112,081
Deferred income taxes	23,336	29,702
Total income taxes	¥152,464	¥141,783

Deferred income taxes increased by ¥167 million and decreased by ¥801 million for the years ended December 31, 2016 and 2017, respectively, due to the effect of changes in tax rates in Japan and other countries.

(3) Reconciliation of the Effective Tax Rate

The breakdown of major items that caused differences between the effective statutory tax rate and the average actual tax rate for each fiscal year is as follows:

The Company is subject mainly to corporate tax, inhabitant tax and enterprise tax, and the effective statutory tax rate is calculated based on these taxes. The effective statutory tax rates were 32.78% and 30.66% for the years ended December 31, 2016 and 2017, respectively. Foreign subsidiaries are subject to income taxes at their locations.

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
		%
Effective statutory tax rate	32.78	30.66
Different tax rates applied to foreign subsidiaries	(7.62)	(8.86)
Non-deductible expenses	1.31	0.95
Valuation allowance	(0.03)	1.54
Withholding tax in foreign countries	0.97	1.29
Tax contingencies	0.16	1.26
Other	(1.22)	(0.52)
Average actual tax rate	26.37	26.33

18. Trade and Other Payables

The breakdown of "Trade and other payables" as of each fiscal year end is as follows:

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
		Millions of yen
Accounts payable	¥188,285	¥218,378
Other payables	85,646	66,864
Other	104,002	110,491
Total	¥377,933	¥395,733

Trade and other payables are classified as financial liabilities measured at amortized cost.

19. Bonds and Borrowings (including Other Financial Liabilities)

(1) Breakdown of Financial Liabilities

The breakdown of "Bonds and borrowings" and "Other financial liabilities" as of each fiscal year end is as follows:

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)	Due
		Millions of yen	
Derivative liabilities	¥ 12,516	¥ 5,425	—
Short-term borrowings	187,949	274,233	—
Commercial paper	—	66,808	—
Current portion of long-term borrowings	572	690	—
Current portion of bonds (Note)	20,000	56,451	—
Long-term borrowings	877	71,164	2019–2028
Bonds (Note)	338,158	275,791	—
Other	9,516	12,494	—
Total	¥569,589	¥763,056	
Current liabilities	¥221,544	¥405,088	
Non-current liabilities	348,045	357,968	
Total	¥569,589	¥763,056	

(Note) The summary of the issuing conditions of the bonds is as follows:

Company	Name of bond	Date of issuance	FY2016 (As of December 31, 2016) Millions of yen	FY2017 (As of December 31, 2017) Millions of yen	Interest rate %	Collateral	Date of maturity
Japan Tobacco Inc.	7th domestic straight bond	December 9, 2010	¥ 20,000 (20,000)	¥ —	0.84	Yes	December 8, 2017
Japan Tobacco Inc.	8th domestic straight bond	December 9, 2010	20,000	20,000	1.30	Yes	December 9, 2020
Japan Tobacco Inc.	9th domestic straight bond	July 15, 2015	60,000	60,000	0.22	Yes	July 15, 2020
Japan Tobacco Inc.	10th domestic straight bond	July 15, 2015	30,000	30,000	0.36	Yes	July 15, 2022
Japan Tobacco Inc.	11th domestic straight bond	July 15, 2015	25,000	25,000	0.60	Yes	July 15, 2025
Japan Tobacco Inc.	Straight bond in USD	July 23, 2013	58,106 [USD 500 mil.]	56,451 (56,451) [USD 500 mil.]	2.10	Yes	July 23, 2018
Japan Tobacco Inc.	Straight bond in USD	April 13, 2016	87,109 [USD 750 mil.]	84,556 [USD 750 mil.]	2.00	Yes	April 13, 2021
Japan Tobacco Inc.	Straight bond in USD	April 13, 2016	57,943 [USD 500 mil.]	56,235 [USD 500 mil.]	2.80	Yes	April 13, 2026
Total			¥358,158 (20,000)	¥332,242 (56,451)			

(Note 1) The figure in parentheses ( ) represents the amount of the current portion of the bond.
(Note 2) The figure in parentheses [ ] represents the amount of foreign currency-denominated bond.

Derivative liabilities are classified as financial liabilities measured at fair value through profit or loss excluding those to which hedge accounting is applied, and bonds and borrowings are classified as financial liabilities measured at amortized cost.

There are no financial covenants that have a significant impact on the Group on the bonds and borrowings.

(2) Assets Pledged as Collateral for Liabilities

A. Pursuant to the provisions of Article 6 of the Japan Tobacco Inc. Act, the Company's properties are pledged as general collateral for bonds issued by the Company. Bondholders are entitled to claim satisfaction in preference to unsecured creditors of the Company properties (with the exception of national and local taxes and certain other statutory obligations).

B. Assets pledged as collateral by some subsidiaries are ¥66 million and ¥1,097 million as of December 31, 2016 and 2017, respectively. Their corresponding debts are ¥53 million and ¥241 million as of December 31, 2016 and 2017, respectively.

20. Provisions

The breakdown and schedule of "Provisions" for each fiscal year are as follows:

FY2016: Year ended December 31, 2016

Millions of yen

	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of January 1, 2016	¥2,728	¥21,267	¥3,323	¥1,189	¥28,507
Provisions	685	4,774	3,459	450	9,368
Interest cost associated with passage of time	31	—	—	—	31
Provisions used	(85)	(13,414)	(3,323)	(430)	(17,253)
Provisions reversed	(10)	(748)	—	(153)	(911)
Exchange differences on translation of foreign operations	—	(2,755)	—	(35)	(2,790)
As of December 31, 2016	¥3,348	¥ 9,124	¥3,459	¥1,021	¥16,952
Current liabilities	¥ 26	¥ 8,287	¥3,459	¥ 757	¥12,529
Non-current liabilities	3,322	837	—	264	4,423
Total	¥3,348	¥ 9,124	¥3,459	¥1,021	¥16,952

FY2017: Year ended December 31, 2017

Millions of yen

	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of January 1, 2017	¥3,348	¥9,124	¥3,459	¥1,021	¥16,952
Provisions	169	5,709	3,312	2,443	11,633
Interest cost associated with passage of time	40	—	—	—	40
Provisions used	(94)	(6,829)	(3,459)	(135)	(10,516)
Provisions reversed	(1)	(1,350)	—	(178)	(1,529)
Exchange differences on translation of foreign operations	—	418	—	34	453
As of December 31, 2017	¥3,463	¥7,074	¥3,312	¥3,185	¥17,033
Current liabilities	¥ —	¥6,739	¥3,312	¥2,977	¥13,028
Non-current liabilities	3,463	335	—	208	4,005
Total	¥3,463	¥7,074	¥3,312	¥3,185	¥17,033

A. Asset Retirement Provisions

In order to settle the obligation of restoring and of removing hazardous substances from plant facilities and premises that the Group uses, the probable amount to be paid in the future is recognized based on past performances. These expenses are expected to be paid after one year or more; however, they may be affected by future business plans.

B. Restructuring Provisions

These provisions are mainly related to business integration and measures for the rationalization of the "International Tobacco Business." The timing of the payment may be affected by future business plans.

C. Provisions for Sales Rebates

These provisions are for contracts which reward the customers with discounts when the sales volume or sales amount in a given period exceeds a specified volume or amount. They are expected to be paid within one year.

21. Other Liabilities

The breakdown of "Other current liabilities" and "Other non-current liabilities" as of each fiscal year end is as follows:

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Tobacco excise tax payables	¥306,816	**¥265,343**
Tobacco special excise tax payables	13,882	**11,989**
Tobacco local excise tax payables	180,799	**167,420**
Consumption tax payables	105,497	**103,511**
Bonus to employees	33,828	**31,412**
Employees' unused paid vacations liabilities	18,832	**18,741**
Other	132,195	**140,685**
Total	¥791,850	**¥739,101**
Current liabilities	¥689,629	**¥618,322**
Non-current liabilities	102,221	**120,779**
Total	¥791,850	**¥739,101**

22. Employee Benefits

(1) Post-employment Benefits

The Group sponsors funded or unfunded defined benefit plans and defined contribution plans as employee retirement benefit plans. The benefits of defined benefit plans are predetermined based on conditions, such as points employees have gained in compensation for each year of service, the payment rate, years of service, and average salaries in their final years of service before retirement.

The Company is obligated to bear pension costs for a mutual assistance association incurred with respect to services in or before June 1956 (prior to enforcement of the Act on the Mutual Aid Association of Public Corporation Employees). Such obligations are recognized as liabilities at their present value using the actuarial valuation method and are included in retirement benefit liabilities.

Special termination benefits may be provided to employees on their early retirements under certain circumstances.

The funded defined benefit plans are administrated by the Group or the fund that is legally separated from the Group in accordance with statutory requirements. The Group, or the board of the pension fund and the trustee of the plan, are required by law to act in the best interests of the plan participants, and are responsible for managing the plan assets in accordance with the designated investment strategy.

The Group's main defined benefit plans expose the Group to actuarial risks, such as investment risk, interest rate risk, inflation risk, and longevity risk.

(i) Investment risk

The present value of the defined benefit obligations is calculated using a discount rate set with reference to a yield on high quality corporate bonds or government bonds. If the return on the plan assets is below this yield, there is a possibility that the plan is underfunded.

(ii) Interest rate risk

A decrease in a yield on high quality corporate bonds or government bonds will increase the present value of the defined benefit obligations. However, this will be partially offset by an increase in the fair value of the debt instruments (plan assets).

(iii) Inflation risk

The level of benefit for certain defined benefit plans of the Group is linked to inflation. Accordingly, a rise in inflation will increase the present value of the defined benefit obligations.

(iv) Longevity risk

Some defined benefit plans of the Group provide a lifetime annuity, and the Group is obligated to provide pension benefits to the plan participants for the rest of their lives after their retirements. The present value of the defined benefit obligations is calculated by reference to the best estimate of the mortality of plan participants during or after employment. An increase in average life expectancy of the plan participants will increase the defined benefit obligations.

A. Schedule of Defined Benefit Obligations

The schedule of the defined benefit obligations is as follows:

Millions of yen

	Japan (Note 3)	Overseas	Total
As of January 1, 2016 (Notes 1, 2)	¥266,213	¥519,079	¥785,292
Current service cost	11,324	8,777	20,100
Past service cost and gains and losses on settlement	—	(5,362)	(5,362)
Interest expense	1,790	12,644	14,434
Contributions by plan participants	—	1,300	1,300
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	(1,158)	7,703	6,545
Actuarial gains and losses arising from changes in financial assumptions	4,222	59,529	63,751
Actuarial gains and losses arising from experience adjustments	(1,264)	(527)	(1,791)
Benefits paid	(20,953)	(23,963)	(44,916)
Exchange differences on translation of foreign operations	—	(62,630)	(62,630)
Other	(51)	324	273
As of December 31, 2016 (Notes 1, 2)	260,122	516,875	776,997
Current service cost	**10,978**	**9,408**	**20,386**
Past service cost and gains and losses on settlement	**(222)**	**(8,263)**	**(8,485)**
Interest expense	**1,213**	**11,272**	**12,485**
Contributions by plan participants	**—**	**1,470**	**1,470**
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	**2**	**(4,437)**	**(4,435)**
Actuarial gains and losses arising from changes in financial assumptions	**27**	**248**	**276**
Actuarial gains and losses arising from experience adjustments	**(714)**	**(3,608)**	**(4,322)**
Benefits paid	**(21,435)**	**(26,974)**	**(48,410)**
Exchange differences on translation of foreign operations	**—**	**32,870**	**32,870**
Other	**1**	**1,554**	**1,554**
As of December 31, 2017 (Notes 1, 2)	**¥249,972**	**¥530,415**	**¥780,386**

(Note 1) The Group's weighted-average duration of the defined benefit obligations is 7.7 years for Japan and 15.7 years for overseas (FY2016: 7.7 years for Japan and 16.2 years for overseas).

(Note 2) The Group's breakdown of the defined benefit obligation by plan participant is as follows:

Millions of yen

	FY2016 (As of December 31, 2016)			FY2017 (As of December 31, 2017)		
	Japan	Overseas	Total	Japan	Overseas	Total
Active members	¥165,390	¥191,202	¥356,592	**¥163,592**	**¥184,639**	**¥348,231**
Deferred members	15,006	70,980	85,986	**15,102**	**73,182**	**88,284**
Pensioners	79,726	254,693	334,418	**71,278**	**272,594**	**343,872**
Total	¥260,122	¥516,875	¥776,997	**¥249,972**	**¥530,415**	**¥780,386**

(Note 3) The schedule of mutual pension benefits obligations included in the category of Japan is as follows:

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Balance at the beginning of the period	¥52,710	**¥48,607**
Interest expense	264	**146**
Remeasurement gains and losses	1,600	**(1,081)**
Benefits paid	(5,967)	**(5,387)**
Balance at the end of the period	¥48,607	**¥42,284**

B. Schedule of Plan Assets

The schedule of the plan assets is as follows:

Millions of yen

	Japan	Overseas	Total
As of January 1, 2016	¥96,806	¥393,878	¥490,684
Interest income	679	10,263	10,942
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	906	42,132	43,037
Contributions by the employer (Notes 1, 2)	2,099	7,015	9,113
Contributions by plan participants	—	1,300	1,300
Benefits paid	(6,918)	(20,311)	(27,229)
Exchange differences on translation of foreign operations	—	(58,376)	(58,376)
Other	—	(2,206)	(2,206)
As of December 31, 2016	93,571	373,696	467,267
Interest income	**456**	**8,424**	**8,879**
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	**1,223**	**16,430**	**17,653**
Contributions by the employer (Notes 1, 2)	**1,690**	**10,172**	**11,862**
Contributions by plan participants	**—**	**1,470**	**1,470**
Benefits paid	**(6,943)**	**(22,174)**	**(29,116)**
Exchange differences on translation of foreign operations	**—**	**22,986**	**22,986**
As of December 31, 2017	**¥89,998**	**¥411,004**	**¥501,002**

(Note 1) Pursuant to laws and regulations, the Group and the pension fund review the financial condition of the pension plan regularly and recalculate contributions for allocating future benefit and keeping the balance of the pension financing when the plan is underfunded.
(Note 2) The Group plans to pay contributions of ¥12,160 million in the year ending December 31, 2018.

C. Reconciliation of Defined Benefit Obligations and Plan Assets

The reconciliation of the defined benefit obligations and plan assets to the net defined benefit liabilities (assets) recognized in the consolidated statement of financial position as of each fiscal year end is as follows:

FY2016: As of December 31, 2016

Millions of yen

	FY2016		
	Japan	Overseas	Total
Present value of the funded defined benefit obligations	¥ 92,436	¥ 383,213	¥ 475,648
Fair value of the plan assets	(93,571)	(373,696)	(467,267)
Subtotal	(1,136)	9,517	8,381
Present value of the unfunded defined benefit obligations	167,686	133,662	301,348
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	¥166,550	¥ 143,179	¥ 309,729
Retirement benefit liabilities	¥170,804	¥ 162,606	¥ 333,410
Retirement benefit assets	(4,254)	(19,426)	(23,680)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	¥166,550	¥ 143,179	¥ 309,729

FY2017: As of December 31, 2017

Millions of yen

	FY2017		
	Japan	Overseas	Total
Present value of the funded defined benefit obligations	**¥ 87,999**	**¥382,679**	**¥470,678**
Fair value of the plan assets	**(89,998)**	**(411,004)**	**(501,002)**
Subtotal	**(1,998)**	**(28,325)**	**(30,324)**
Present value of the unfunded defined benefit obligations	**161,973**	**147,736**	**309,709**
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	**¥159,974**	**¥119,411**	**¥279,385**
Retirement benefit liabilities	**¥164,793**	**¥165,969**	**¥330,762**
Retirement benefit assets	**(4,818)**	**(46,558)**	**(51,377)**
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	**¥159,974**	**¥119,411**	**¥279,385**

D. Major Breakdown of Plan Assets

The breakdown of plan assets by major category as of each fiscal year end is as follows:

Japan

Millions of yen

	FY2016 (As of December 31, 2016)			**FY2017 (As of December 31, 2017)**		
	Market price in an active market			Market price in an active market		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Cash and cash equivalents	¥18,233	¥ —	¥18,233	**¥12,243**	**¥ —**	**¥12,243**
Equity instruments	3,579	—	3,579	**3,939**	**—**	**3,939**
Japan	2,381	—	2,381	**2,065**	**—**	**2,065**
Overseas	1,198	—	1,198	**1,874**	**—**	**1,874**
Debt instruments	11,000	—	11,000	**10,512**	**—**	**10,512**
Japan	9,758	—	9,758	**9,220**	**—**	**9,220**
Overseas	1,242	—	1,242	**1,292**	**—**	**1,292**
General account of life insurance companies (Note)	—	60,155	60,155	**—**	**61,241**	**61,241**
Other	—	603	603	**1,433**	**629**	**2,062**
Total	¥32,813	¥60,759	¥93,571	**¥28,127**	**¥61,870**	**¥89,998**

Overseas

Millions of yen

	FY2016 (As of December 31, 2016)			**FY2017 (As of December 31, 2017)**		
	Market price in an active market			Market price in an active market		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Cash and cash equivalents	¥ 5,397	¥ —	¥ 5,397	**¥ 29,815**	**¥ —**	**¥ 29,815**
Equity instruments	123,669	—	123,669	**65,725**	**—**	**65,725**
United Kingdom	30,212	—	30,212	**5,093**	**—**	**5,093**
North America	38,532	—	38,532	**23,487**	**—**	**23,487**
Other	54,925	—	54,925	**37,144**	**—**	**37,144**
Debt instruments	207,393	5,035	212,427	**273,724**	**5,593**	**279,317**
United Kingdom	137,158	—	137,158	**185,607**	**—**	**185,607**
North America	47,524	—	47,524	**46,723**	**—**	**46,723**
Other	22,711	5,035	27,746	**41,394**	**5,593**	**46,988**
Real estate	9,026	441	9,468	**10,035**	**258**	**10,293**
Other	15,808	6,927	22,735	**17,187**	**8,667**	**25,854**
Total	¥361,293	¥12,403	¥373,696	**¥396,485**	**¥14,519**	**¥411,004**

Total

	FY2016 (As of December 31, 2016) Market price in an active market Quoted	Unquoted	Total	FY2017 (As of December 31, 2017) Market price in an active market Quoted	Unquoted	Total
						Millions of yen
Cash and cash equivalents	¥ 23,630	¥ —	¥ 23,630	¥ 42,058	¥ —	¥ 42,058
Equity instruments	127,248	—	127,248	69,664	—	69,664
Debt instruments	218,393	5,035	223,428	284,236	5,593	289,829
Real estate	9,026	441	9,468	10,035	258	10,293
General account of life insurance companies (Note)	—	60,155	60,155	—	61,241	61,241
Other	15,808	7,530	23,338	18,620	9,297	27,916
Total	¥394,106	¥73,161	¥467,267	¥424,612	¥76,389	¥501,002

(Note) A certain interest rate and principal for the general account of life insurance are guaranteed by life insurance companies.

The investment strategy for the Group's major plans is as follows:

(Japan)

The Company's pension fund is managed in accordance with the internal policy for securing stable profits in the middle- and long-term in order to ensure the redemption of the plan liability. Concretely, by setting a target rate of return and composition ratio of plan assets by asset category within the risk tolerance that is annually assessed, the Company invests plan assets consistently with the composition ratio. When reviewing the composition ratio, the Company considers introducing an asset investment which has a high correlation with the liability.

In the case where an unexpected situation occurs in the market environment, it is temporarily allowed to make an adjustment on the weight of risk assets complying with the policy.

(Overseas)

The investment strategy for the foreign subsidiaries' funded pension plans is decided properly by the trustee of the plan or the management of overseas subsidiaries according to local legislation. The Company's objective for the foreign subsidiaries' funded pension plans is to manage risks arising from its defined benefit obligation, and meanwhile to achieve a return on assets in excess of the movement in the value of the defined benefit obligation.

The majority of the plan assets have been allocated to liability matching bonds and the remaining parts of the plan assets are mainly invested in equities targeting long-term return.

E. Matters Related to Actuarial Assumptions

The major items of actuarial assumptions as of each fiscal year end are as follows:

%	FY2016 (As of December 31, 2016) Japan	Overseas	FY2017 (As of December 31, 2017) Japan	Overseas
Discount rate	0.5	2.2	0.5	2.1
Inflation rate	—	2.6	—	2.4

FY2016: As of December 31, 2016

Years / FY2016	Japan Males	Japan Females	Overseas Males	Overseas Females
Average life expectancy at retirement (Note 1)				
Current pensioners	23.6 (Note 2)	29.3 (Note 2)	21.9 (Note 3)	24.3 (Note 3)
Future pensioners			23.3 (Note 4)	25.8 (Note 4)

FY2017: As of December 31, 2017

Years / FY2017	Japan Males	Japan Females	Overseas Males	Overseas Females
Average life expectancy at retirement (Note 1)				
Current pensioners	23.6 (Note 2)	29.3 (Note 2)	21.9 (Note 3)	24.2 (Note 3)
Future pensioners			23.2 (Note 4)	25.5 (Note 4)

(Note 1) The average life expectancies underlie the values of the defined benefit obligations on major plans. Assumptions regarding future mortality rate are based on published statistics and mortality tables.

(Note 2) Life expectancy for a pensioner currently aged 60. Regardless of the plan participant's current age, the Group performs actuarial calculations based on the assumption that life expectancy remains the same.

(Note 3) Life expectancy for a pensioner currently aged 65

(Note 4) Life expectancy at the age of 65 for an active member currently aged 50

(Note 5) The valuation of defined benefit obligations reflects a judgment on uncertain future events. The sensitivities of defined benefit obligations due to changes in major assumptions as of each fiscal year end are as follows. Each of these sensitivities assumes that other variables remain fixed; however, in fact, they do not always change independently. Negative figures show a decrease in pension plan obligations, while positive figures show an increase.

Millions of yen	Change in assumptions	FY2016 (As of December 31, 2016) Japan	Overseas	FY2017 (As of December 31, 2017) Japan	Overseas
Discount rate	Increase by 0.5%	¥ (9,636)	¥(39,870)	¥(9,259)	¥(39,316)
	Decrease by 0.5%	10,363	43,735	9,971	44,188
Inflation rate	Increase by 0.5%	—	29,449	—	26,909
	Decrease by 0.5%	—	(25,654)	—	(25,490)
Mortality rate	Extended 1 year	5,540	19,321	4,956	17,777
	Shortened 1 year	(5,370)	(17,860)	(4,794)	(18,423)

F. Breakdown of Defined Benefit Cost

The breakdown of defined benefit cost for each fiscal year is as follows:

FY2016: Year ended December 31, 2016

Millions of yen / FY2016	Japan	Overseas	Total
Current service cost	¥11,324	¥ 8,777	¥20,100
Past service cost and gains and losses on settlement	—	(2,956)	(2,956)
Interest expense (income)	1,111	2,381	3,492
Defined benefit cost through profit or loss	12,435	8,201	20,636
Actuarial gains and losses arising from changes in demographic assumptions	(1,158)	7,703	6,545
Actuarial gains and losses arising from changes in financial assumptions	4,222	59,529	63,751
Actuarial gains and losses arising from experience adjustments	(1,264)	(527)	(1,791)
Return on plan assets (excluding amounts included in interest income)	(906)	(42,132)	(43,037)
Defined benefit cost through other comprehensive income	¥ 894	¥24,573	¥25,467
Total of defined benefit cost	¥13,328	¥32,775	¥46,103

FY2017: Year ended December 31, 2017

	Millions of yen		
	FY2017		
	Japan	Overseas	Total
Current service cost	¥10,978	¥ 9,408	¥ 20,386
Past service cost and gains and losses on settlement	(222)	(8,263)	(8,485)
Interest expense (income)	757	2,849	3,605
Defined benefit cost through profit or loss	11,514	3,993	15,507
Actuarial gains and losses arising from changes in demographic assumptions	2	(4,437)	(4,435)
Actuarial gains and losses arising from changes in financial assumptions	27	248	276
Actuarial gains and losses arising from experience adjustments	(714)	(3,608)	(4,322)
Return on plan assets (excluding amounts included in interest income)	(1,223)	(16,430)	(17,653)
Defined benefit cost through other comprehensive income	¥ (1,908)	¥(24,226)	¥(26,135)
Total of defined benefit cost	¥ 9,605	¥(20,233)	¥(10,628)

(Note 1) The net amount of interest expense and interest income is included in "Financial costs." Other expenses are included in "Cost of sales" and "Selling, general and administrative expenses."
(Note 2) Contributions to the defined contribution plans were ¥6,917 million for the year ended December 31, 2016 and ¥7,383 million for the year ended December 31, 2017 and were not included in the table above.

(2) Other Employee Benefit Expenses

The employee benefit expenses other than post-employment benefits that are included in the consolidated statement of income for each fiscal year are as follows:

	Millions of yen	
	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Remuneration and salary	¥211,838	¥221,896
Bonus to employees	59,474	60,274
Legal welfare expenses	39,803	43,192
Welfare expenses	34,581	37,399
Termination benefits	1,479	1,577

23. Equity and Other Equity Items

(1) Share Capital and Capital Surplus

A. Authorized Shares

The number of authorized shares as of December 31, 2016 and 2017 is 8,000,000 thousand ordinary shares.

B. Fully Paid Issued Shares

The schedule of the number of issued shares and share capital is as follows:

	Thousands of shares	Millions of yen	
	Number of ordinary issued shares	Share capital	Capital surplus
As of January 1, 2016	2,000,000	¥100,000	¥736,400
Increase (decrease)	—	—	—
As of December 31, 2016	2,000,000	100,000	736,400
Increase (decrease)	—	—	—
As of December 31, 2017	**2,000,000**	**¥100,000**	**¥736,400**

(Note) The shares issued by the Company are non-par value ordinary shares that have no restriction on any content of rights.

(2) Treasury Shares

The schedule of the number of treasury shares and its amount as of each fiscal year end is as follows:

	Thousands of shares	Millions of yen
	Number of shares	Amount
As of January 1, 2016	209,285	¥444,333
Increase (decrease) (Note 2)	(241)	(512)
As of December 31, 2016	209,044	443,822
Increase (decrease) (Note 2)	(88)	(186)
As of December 31, 2017	**208,957**	**¥443,636**

(Note 1) The Company adopts share option plans and utilizes treasury shares for delivery of shares due to its exercise. Contract conditions and amount are described in "33. Share-based Payments."
(Note 2) Purchases of shares less than one unit are 0 thousand shares for the year ended December 31, 2016 and 0 thousand shares for the year ended December 31, 2017. The number of shares delivered upon exercise of share options is 241 thousand shares for the year ended December 31, 2016 and 88 thousand shares for the year ended December 31, 2017. Sales of shares less than one unit were 0 thousand shares for the year ended December 31, 2016.

(3) Other Components of Equity

A. Subscription Rights to Shares

The Company adopts share option plans and issues subscription rights to shares based on the Companies Act. Contract conditions and amount are described in "33. Share-based Payments."

B. Exchange Differences on Translation of Foreign Operations

Exchange differences on translation of foreign operations are composed of foreign currency translation difference that occurs when consolidating financial statements of foreign subsidiaries prepared in foreign currencies, and the effective portion of net gain (loss) on the hedging instruments designated as hedge of net investment.

C. Net Gain (Loss) on Derivatives Designated as Cash Flow Hedges

The Company uses derivatives for hedging to avoid the risk of fluctuation in future cash flows. This is the effective portion of changes in the fair value of hedging instruments designated as cash flow hedges.

D. Net Gain (Loss) on Revaluation of Financial Assets Measured at Fair Value through Other Comprehensive Income

This is the valuation difference in the fair value of financial assets measured at fair value through other comprehensive income.

E. Remeasurements of Defined Benefit Plans

Remeasurements of defined benefit plans comprise actuarial gains and losses, the return on plan assets excluding amounts included in interest income, and any change in the effect of the asset ceiling excluding amounts included in interest income. In addition, actuarial gains and losses are the effects of differences between the actuarial assumptions at the beginning of the year and what has actually occurred, and the effects of changes in actuarial assumptions. Remeasurements are recognized as other comprehensive income when they occur and are transferred immediately from other components of equity to retained earnings.

24. Dividends

Dividends paid for each fiscal year are as follows:

FY2016: Year ended December 31, 2016

		Millions of yen	Yen		FY2016
	Class of shares	Total dividends	Dividends per share	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 23, 2016)	Ordinary shares	¥114,606	¥64	December 31, 2015	March 24, 2016
Board of Directors (August 1, 2016)	Ordinary shares	114,617	64	June 30, 2016	September 1, 2016

FY2017: Year ended December 31, 2017

		Millions of yen	Yen		FY2017
	Class of shares	Total dividends	Dividends per share	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 24, 2017)	**Ordinary shares**	**¥118,203**	**¥66**	**December 31, 2016**	**March 27, 2017**
Board of Directors (August 2, 2017)	**Ordinary shares**	**125,369**	**70**	**June 30, 2017**	**September 1, 2017**

Dividends, for which the effective date falls in the following fiscal year, are as follows:

FY2016: Year ended December 31, 2016

		Millions of yen	Yen		FY2016
	Class of shares	Total dividends	Dividends per share	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 24, 2017)	Ordinary shares	¥118,203	¥66	December 31, 2016	March 27, 2017

FY2017: Year ended December 31, 2017

		Millions of yen	Yen		FY2017
	Class of shares	Total dividends	Dividends per share	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 27, 2018)	**Ordinary shares**	**¥125,373**	**¥70**	**December 31, 2017**	**March 28, 2018**

25. Revenue

The reconciliation from "Gross turnover" to "Revenue" for each fiscal year is as follows:

		Millions of yen
	FY2016 (Year ended December 31, 2016)	**FY2017 (Year ended December 31, 2017)**
Gross turnover	¥ 7,062,848	**¥ 7,286,883**
Tobacco excise taxes and agency transaction amount	(4,919,561)	**(5,147,230)**
Revenue	¥ 2,143,287	**¥ 2,139,653**

The tobacco excise taxes and other transactions in which the Group is involved as an agency are excluded from revenue. The inflow of economic benefits after deducting the tobacco excise taxes and other transactions is presented as "Revenue" in the consolidated statement of income.

Gross turnover is an item that the Group discloses voluntarily and is not "Revenue" as defined by IFRS.

26. Other Operating Income

The breakdown of "Other operating income" for each fiscal year is as follows:

		Millions of yen
	FY2016 (Year ended December 31, 2016)	**FY2017 (Year ended December 31, 2017)**
Reversal of impairment losses on investments in associates	¥ —	**¥ 8,848**
Gain on sale of property, plant and equipment, intangible assets and investment properties (Note)	41,161	**24,025**
Gain on sale of investments in subsidiaries (Note)	26,106	**—**
Other (Note)	2,835	**12,851**
Total	¥70,101	**¥45,724**

(Note) The amount of restructuring income included in each account for each fiscal year is as follows:

		Millions of yen
	FY2016 (Year ended December 31, 2016)	**FY2017 (Year ended December 31, 2017)**
Gain on sale of property, plant and equipment, intangible assets and investment properties	¥38,973	**¥21,616**
Gain on sale of investments in subsidiaries	26,106	**—**
Other	100	**29**
Total	¥65,178	**¥21,645**

27. Selling, General and Administrative Expenses

The breakdown of "Selling, general and administrative expenses" for each fiscal year is as follows:

		Millions of yen
	FY2016 (Year ended December 31, 2016)	**FY2017 (Year ended December 31, 2017)**
Advertising expenses	¥ 26,108	**¥ 24,413**
Promotion expenses	124,766	**112,212**
Shipping, warehousing expenses	26,793	**26,950**
Commission	50,860	**54,458**
Employee benefit expenses (Note 2)	241,752	**254,045**
Research and development expenses (Note 1)	58,193	**60,600**
Depreciation and amortization	79,088	**81,298**
Impairment losses on other than financial assets (Note 2)	1,239	**3,427**
Losses on sale and disposal of property, plant and equipment, intangible assets, and investment property (Note 2)	11,256	**4,848**
Other (Note 2)	134,060	**164,661**
Total	¥754,115	**¥786,911**

(Note 1) All research and development expenses are included in "Selling, general and administrative expenses."
(Note 2) The amount of restructuring costs included in each account is as follows:

		Millions of yen
	FY2016 (Year ended December 31, 2016)	**FY2017 (Year ended December 31, 2017)**
Employee benefit expenses	¥ 1,243	**¥1,578**
Impairment losses on other than financial assets	743	**1,554**
Losses on sale and disposal of property, plant and equipment, intangible assets, and investment property	5,676	**1,224**
Other	4,231	**3,957**
Total	¥11,894	**¥8,314**

28. Financial Income and Financial Costs

The breakdown of "Financial income" and "Financial costs" for each fiscal year is as follows:

Millions of yen

Financial Income	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Dividend income		
Financial assets measured at fair value through other comprehensive income	¥1,707	**¥1,814**
Interest income		
Financial assets measured at amortized cost		
Deposits and bonds	4,664	**2,567**
Other	247	**399**
Total	¥6,618	**¥4,780**

Millions of yen

Financial Costs	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Interest expenses		
Financial liabilities measured at amortized cost		
Bonds and borrowings (Note 2)	¥ 8,592	**¥11,517**
Other	87	**87**
Foreign exchange losses (Note 1)	9,183	**11,257**
Employee benefit expenses (Note 3)	3,492	**3,605**
Other	355	**882**
Total	¥21,710	**¥27,349**

(Note 1) Valuation gain (loss) of currency derivatives is included in foreign exchange losses.
(Note 2) Valuation gain (loss) of interest rate derivatives is included in interest expenses.
(Note 3) The employee benefit expenses are the net amount of interest cost and interest income related to employee benefits.

29. Other Comprehensive Income

Amount arising during the year, reclassification adjustments to profit or loss and tax effects for each component of "Other comprehensive income" for each fiscal year are as follows:

FY2016: Year ended December 31, 2016

Millions of yen

FY2016	Amount arising	Reclassification adjustments	Before tax effects	Tax effects	Net of tax effects
Items that will not be reclassified to profit or loss					
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	¥ (5,574)	¥ —	¥ (5,574)	¥ 2,416	¥ (3,159)
Remeasurements of defined benefit plans	(25,467)	—	(25,467)	3,265	(22,202)
Total of items that will not be reclassified to profit or loss	¥ (31,042)	¥ —	¥ (31,042)	¥ 5,681	¥ (25,361)
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	¥(157,539)	¥ 19	¥(157,520)	¥(6,163)	¥(163,683)
Net gain (loss) on derivatives designated as cash flow hedges	(2,986)	849	(2,136)	658	(1,479)
Total of items that may be reclassified subsequently to profit or loss	¥(160,525)	¥868	¥(159,657)	¥(5,506)	¥(165,162)
Total	¥(191,567)	¥868	¥(190,699)	¥ 175	¥(190,523)

FY2017: Year ended December 31, 2017

Millions of yen

FY2017	Amount arising	Reclassification adjustments	Before tax effects	Tax effects	Net of tax effects
Items that will not be reclassified to profit or loss					
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	**¥ 13,518**	**¥ —**	**¥ 13,518**	**¥ (4,116)**	**¥ 9,402**
Remeasurements of defined benefit plans	**26,135**	**—**	**26,135**	**(6,107)**	**20,028**
Total of items that will not be reclassified to profit or loss	**¥ 39,653**	**¥ —**	**¥ 39,653**	**¥(10,223)**	**¥ 29,430**
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	**¥130,167**	**¥(341)**	**¥129,826**	**¥ (1,753)**	**¥128,073**
Net gain (loss) on derivatives designated as cash flow hedges	**(532)**	**455**	**(77)**	**23**	**(54)**
Total of items that may be reclassified subsequently to profit or loss	**¥129,634**	**¥ 115**	**¥129,749**	**¥ (1,730)**	**¥128,019**
Total	**¥169,287**	**¥ 115**	**¥169,402**	**¥(11,952)**	**¥157,449**

30. Earnings per Share

(1) Basis of Calculating Basic Earnings per Share

A. Profit Attributable to Ordinary Shareholders of the Parent Company

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Profit for the period attributable to owners of the parent company	¥421,695	**¥392,409**
Profit not attributable to ordinary shareholders of the parent company	—	**—**
Profit for the period used for calculation of basic earnings per share	¥421,695	**¥392,409**

B. Weighted-average Number of Ordinary Shares Outstanding During the Period

Thousands of shares

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Weighted-average number of shares during the period	1,790,878	**1,790,995**

(2) Basis of Calculating Diluted Earnings per Share

A. Profit Attributable to Diluted Ordinary Shareholders

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Profit for the period used for calculation of basic earnings per share	¥421,695	**¥392,409**
Adjustment	—	**(0)**
Profit for the period used for calculation of diluted earnings per share	¥421,695	**¥392,409**

B. Weighted-average Number of Diluted Ordinary Shares Outstanding During the Period

Thousands of shares

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Weighted-average number of ordinary shares during the period	1,790,878	**1,790,995**
Increased number of ordinary shares under subscription rights to shares	1,030	**1,042**
Weighted-average number of diluted ordinary shares during the period	1,791,908	**1,792,037**

31. Non-cash Transactions

Significant Non-cash Transactions

The amount of assets acquired under finance leases was ¥202 million for the year ended December 31, 2016 and ¥3,599 million for the year ended December 31, 2017.

32. Reconciliation of Liabilities Arising from Financing Activities

Reconciliation of liabilities arising from financing activities for the year ended December 31, 2017 is as follows:

Millions of yen

			Non-cash changes				
	As of January 1, 2017	Cash flows	Acquisition through business combinations	Foreign exchange movement	Fair value changes	Other	As of December 31, 2017
Short-term borrowings and commercial paper	¥187,949	¥116,371	¥35,349	¥ 1,373	¥ –	¥ –	¥341,041
Long-term borrowings (Note 1)	1,449	70,191	131	82	–	–	71,854
Bonds (Note 1)	358,158	(20,000)	–	(6,086)	–	169	332,242
Finance lease obligations	7,701	(1,373)	324	416	–	3,599	10,667
Derivatives (Note 2)	(3,052)	–	–	–	562	–	(2,490)
Total	¥552,205	¥165,189	¥35,804	¥(4,214)	¥562	¥3,768	¥753,314

(Note 1) Current portion is included.
(Note 2) Derivatives are held for the purpose of hedging bonds.

33. Share-based Payments

The Company and Torii Pharmaceutical adopt share option plans. Share options are granted by the resolutions of the Board of Directors based on the approvals at the Annual Shareholders' Meeting.

The outline of the share option plan of the Company is as follows:

(1) Share Option Contract Conditions of the Company

Positions of persons granted : Directors and Executive Officers
Settlement : Issuance of shares
Effective period of granted share option : 30 years after the date of grant
Vesting conditions : None

Conditions related to the exercise of share options are as follows:

(a) The subscription rights to shares become exercisable when a holder of a subscription right to shares no longer holds a position as a director, an audit & supervisory board member or an executive officer. In the subscription rights to shares allocation contract with holders of such rights, it is provided for that the rights become exercisable from the date following the date on which they no longer hold their positions.
(b) In the case where any holders of subscription rights to shares waive such rights, they cannot exercise them.

(2) Changes in the Number of Share Options of the Company

Shares

	FY2016 (Year ended December 31, 2016)			FY2017 (Year ended December 31, 2017)		
	Directors	Executive Officers	Total	Directors	Executive Officers	Total
Balance at the beginning of the period	324,800	807,200	1,132,000	**275,800**	**701,000**	**976,800**
Granted	34,200	51,800	86,000	**53,000**	**89,400**	**142,400**
Exercised	—	(241,200)	(241,200)	**–**	**(88,000)**	**(88,000)**
Transferred	(83,200)	83,200	—	**–**	**–**	**–**
Balance at the end of the period	275,800	701,000	976,800	**328,800**	**702,400**	**1,031,200**
Exercisable balance at the end of the period	—	442,200	442,200	**–**	**378,800**	**378,800**

(Note 1) The number of share options is presented as the number of underlying shares.
(Note 2) All share options are granted with an exercise price of ¥1 per share.
(Note 3) Share options are granted to 5 directors and 18 executive officers for the year ended December 31, 2016, and 5 directors and 19 executive officers for the year ended December 31, 2017.
"Transferred" included in the "Changes in the Number of Share Options" represents the number of share options for persons granted whose management position changed during the period.
(Note 4) The weighted-average fair values per share of share options granted during the period were ¥2,863 and ¥2,411 for the years ended December 31, 2016 and 2017, respectively.
(Note 5) The weighted-average share prices of share options at the time of exercise during the period were ¥4,258 and ¥3,810 for the years ended December 31, 2016 and 2017, respectively.
(Note 6) The weighted-average remaining contract years of unexercised share options at the end of each period were 25.2 years and 25.0 years for the years ended December 31, 2016 and 2017, respectively.

(3) Method of Measuring Fair Value of Share Options Granted During the Period of the Company

A. Valuation Model

Black-Scholes Model

B. Main Assumptions and Estimation

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Share price	¥4,315	**¥3,950**
Volatility of share price (Note 1)	32.9%	**31.9%**
Estimated remaining period (Note 2)	15 years	**15 years**
Estimated dividends (Note 3)	¥118/share	**¥130/share**
Risk free interest rate (Note 4)	(0.12)%	**0.32%**

(Note 1) Calculated based on daily share prices quoted for the past 15 years
(Note 2) Because of the difficulty of a reasonable estimation due to insufficient data, the remaining period is estimated based on the assumption that share option rights would be exercised at a midpoint of the exercise period.
(Note 3) Based on the latest dividends paid
(Note 4) The yield on government bonds for a period of the expected remaining period

(4) Share-based Payment Expenses

The costs for share options included in "Selling, general and administrative expenses" in the consolidated statement of income were ¥270 million and ¥341 million for the years ended December 31, 2016 and 2017, respectively.

34. Financial Instruments

(1) Capital Management

The Group's management principle is pursuit of the "4S" model: balancing the interests of consumers, shareholders, employees and wider society, and fulfilling our responsibilities towards them, aiming to exceed their expectations.

The Group believes that sustainable profit growth in the mid- to long-term based on this principle will increase the Group's value in the mid- to long-term, and is consequently in the best interest of all stakeholders, including our shareholders.

For that reason, as its financial policy, the Group maintains a strong financial base that secures stability in the case of changes in business environment such as economic crises, and flexibility enabling expeditious responses to business investment opportunities.

The Group manages net interest-bearing debt, where cash and cash equivalents are deducted from interest-bearing debt, and capital (the part attributable to the owners of the parent company). The amounts as of each fiscal year end are as follows:

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
		Millions of yen
Interest-bearing debt	¥ 555,257	**¥ 755,804**
Cash and cash equivalents	(294,157)	**(285,486)**
Net interest-bearing debt	261,101	**470,318**
Capital (equity attributable to owners of the parent company)	2,456,091	**2,761,687**

There are specific rules for shares of the Company under the Japan Tobacco Inc. Act as follows:

The Japanese government shall hold more than one-third of all of the shares issued by the Company (excluding the type of shares, for which it is stipulated that voting rights may not be exercised on any matters that can be resolved by the Annual Shareholders' Meeting) (Article 2 (1)).

In cases where the Company intends to solicit persons to subscribe for shares to be issued or subscription rights to shares or where the Company intends to deliver shares (excluding treasury shares), subscription rights to shares (excluding subscription right to own shares) or bonds with subscription rights to shares (excluding bonds with subscription rights to shares) when exchanging with shares, the Company shall obtain the approval of the Minister of Finance (Article 2 (2)).

Disposal of shares owned by the Japanese government shall be within the limits on the number of shares decided by the Diet in the relevant annual budget (Article 3).

The Group monitors financial indicators in order to maintain a well-balanced capital structure that ensures an appropriate return on equity and a stable and flexible financial condition for future investment. We monitor credit ratings for financial stability and flexibility, and ROE (return on equity) for profitability, while focusing on changes in the domestic and overseas environment.

(2) Financial Risk Management

The Group is exposed to financial risks (credit risk, liquidity risk, foreign exchange risk, interest rate risk, and market price fluctuation risk) in the process of its management activities and it manages risks based on a specific policy in order to avoid or reduce said risks. The results of risk management are regularly reported by the Treasury Division to the president and the Board of Directors of the Company.

The Group policy limits derivatives to transactions for the purpose of mitigating risks from transactions based on actual demand. Therefore, we do not transact derivatives for speculation purposes or trading purposes.

(3) Credit Risk

Receivables, such as note and account receivables, acquired from the operating activities of the Group are exposed to customer credit risk.

The Group holds mainly debt securities for surplus investment and equity securities of customers and suppliers to strengthen relationships with them; those securities are exposed to the issuer's credit risk. In addition, through derivative transactions that the Group conducts in order to hedge foreign exchange fluctuation risks and interest rate fluctuation risks, we are exposed to the credit risk of the financial institutions which are counterparties to these transactions.

In principle, the Group sets credit lines or transaction conditions with respect to trade receivables for counterparties based on the Credit Management Guidelines in order to control the credit risk relating to counterparties. In addition, the receivable balances of counterparties with high credit risk are monitored. The Treasury Division of the Company regularly monitors the status of the occurrence and collection of bad debts, and reports them to the president and the Board of Directors of the Company.

With regard to the investment of cash surpluses and derivatives, the Group invests in debt securities and other financial instruments with a certain credit rating and transacts with financial institutions with a high credit rating in principle in order to prevent credit risks from occurring and based on the Group Financial Operation Basic Policy. In addition, the Treasury Division of the Company regularly monitors the performance of these transactions and reports the results to the president and the Board of Directors of the Company.

The maximum exposure pertaining to credit risks for financial assets is the carrying amount after considering impairment in the consolidated financial statements.

The analysis of the aging of financial assets that are past due but not impaired as of each fiscal year end date is as follows:
The financial assets include amounts considered recoverable by credit insurance and collateral.

FY2016: As of December 31, 2016

		Amount past due			
	Total	Within 30 days	Over 30 days, within 60 days	Over 60 days, within 90 days	Over 90 days
					Millions of yen / FY2016
Trade and other receivables	¥6,916	¥2,612	¥1,004	¥8	¥3,292

FY2017: As of December 31, 2017

		Amount past due			
	Total	Within 30 days	Over 30 days, within 60 days	Over 60 days, within 90 days	Over 90 days
					Millions of yen / **FY2017**
Trade and other receivables	**¥6,347**	**¥4,724**	**¥814**	**¥214**	**¥595**

The Group reviews collectability of trade receivables depending on the credit conditions of counterparties and recognizes allowance for doubtful accounts. The schedule of the allowance for doubtful accounts is as follows:

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
		Millions of yen
Balance at the beginning of the period	¥9,345	**¥ 8,436**
Addition	335	**22,090**
Decrease (intended use)	(515)	**(780)**
Decrease (reversal)	(336)	**(127)**
Other	(394)	**539**
Balance at the end of the period	¥8,436	**¥30,158**

(4) Liquidity Risk

The Group raises funds by borrowings, commercial paper and bonds; however, these liabilities are exposed to the liquidity risk that we would not be able to repay liabilities on the due date due to the deterioration of the financing environment.

In accordance with the Group Financial Operation Basic Policy, the Group establishes a finance plan based on the annual business plan and the Treasury Division of the Company regularly monitors and collects information on the balance of liquidity-in-hand and interest-bearing debt and reports it to the president and the Board of Directors of the Company. In addition, the Group keeps necessary credit facilities to manage liquidity risk by having commitment lines with several financial institutions.

The financial liability balance (including derivative financial instruments) by maturity as of each fiscal year end is as follows:

FY2016: As of December 31, 2016

	Carrying amount	Contractual cash flow	Due within one year	Due after one year through two years	Due after two years through three years	Due after three years through four years	Due after four years through five years	Due after five years
								Millions of yen / FY2016
Non-derivative financial liabilities								
Trade and other payables	¥377,933	¥377,933	¥377,933	¥ —	¥ —	¥ —	¥ —	¥ —
Short-term borrowings	187,949	187,949	187,949	—	—	—	—	—
Current portion of long-term borrowings	572	572	572	—	—	—	—	—
Long-term borrowings	877	877	—	360	92	41	43	341
Current portion of bonds	20,000	20,000	20,000	—	—	—	—	—
Bonds	338,158	338,858	—	58,245	—	80,000	87,368	113,245
Subtotal	925,489	926,188	586,453	58,605	92	80,041	87,411	113,586
Derivative financial liabilities								
Foreign exchange forward contract	12,516	12,516	12,516	—	—	—	—	—
Subtotal	12,516	12,516	12,516	—	—	—	—	—
Total	¥938,005	¥938,704	¥598,970	¥58,605	¥92	¥80,041	¥87,411	¥113,586

FY2017: As of December 31, 2017

	Millions of yen							
	FY2017							
	Carrying amount	Contractual cash flow	Due within one year	Due after one year through two years	Due after two years through three years	Due after three years through four years	Due after four years through five years	Due after five years
Non-derivative financial liabilities								
Trade and other payables	¥ 395,733	¥ 395,733	¥395,733	¥ —	¥ —	¥ —	¥ —	¥ —
Short-term borrowings	274,233	274,233	274,233	—	—	—	—	—
Commercial paper	66,808	66,808	66,808	—	—	—	—	—
Current portion of long-term borrowings	690	690	690	—	—	—	—	—
Long-term borrowings	71,164	71,164	—	386	201	117	30,119	40,341
Current portion of bonds	56,451	56,500	56,500	—	—	—	—	—
Bonds	275,791	276,250	—	—	80,000	84,750	30,000	81,500
Subtotal	1,140,870	1,141,378	793,964	386	80,201	84,867	60,119	121,841
Derivative financial liabilities								
Foreign exchange forward contract	5,425	5,425	5,425	—	—	—	—	—
Subtotal	5,425	5,425	5,425	—	—	—	—	—
Total	¥1,146,295	¥1,146,803	¥799,389	¥386	¥80,201	¥84,867	¥60,119	¥121,841

The total of commitment lines and withdrawal as of each fiscal year end are as follows:

	Millions of yen	
	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Total committed line of credit	¥574,432	¥601,580
Withdrawing	—	114,130
Unused balance	¥574,432	¥487,450

(5) Foreign Exchange Risk

The Group operates businesses globally and, therefore, is exposed to the following risks due to foreign exchange fluctuation:

(i) The risk where the profit or loss and cash flow in each functional currency of the Group is influenced by foreign exchange fluctuation as a result of external transactions and intergroup transactions, including the payment and receipt of dividends, in currencies that are different from each functional currency of the Group.

(ii) The risk that the equity of the Group is influenced by foreign exchange fluctuation when equity denominated in each functional currency of the Group is translated into Japanese yen and consolidated.

(iii) The risk that the profit or loss of the Group is influenced by foreign exchange fluctuation when profit or loss denominated in each functional currency of the Group is translated into Japanese yen and consolidated.

The Group hedges against risk (i) using derivatives or foreign currency-denominated interest-bearing debts for example, when future cash flow is projected or when receivables and payables are fixed, and some of them are designated as cash flow hedges.

The Group hedges against risk (ii) using foreign currency-denominated interest-bearing debts for example, and part of these are designated as net investment hedges. The Group does not hedge against risk (iii) in principle.

In order to mitigate risks mentioned above resulting from the foreign exchange fluctuation, in accordance with the Group Financial Operation Basic Policy, and under the supervision of the Financial Risk Management Committee of the Company, the Group establishes and implements a foreign currency hedge policy, taking into consideration the impact on the Group's performance and the current conditions of the foreign exchange market in a comprehensive manner. The Treasury Division of the Company regularly reports the performances to the president and the Board of Directors of the Company.

Foreign Exchange Sensitivity Analysis

In cases where each currency other than the functional currency that denominates the financial instruments held by the Group as of each fiscal year end increases by 10% in value against the functional currency, the impact on profit before income taxes in the consolidated statement of income is as follows:

The impact from the translation of functional currency-denominated financial instruments, and assets, liabilities, income and expenses of foreign operations into Japanese yen is not included. Also, it is based on the assumption that currencies other than the currencies used for the calculation do not fluctuate.

	Millions of yen	
	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Profit before income taxes	¥(1,502)	¥(9,473)

(6) Interest Rate Risk

Interest rate risk within the Group arises from interest-bearing debts after deducting cash equivalents. Borrowings and bonds with floating rates are exposed to interest rate fluctuation risk.

In order to reduce the interest rate fluctuation risk related to borrowings and bonds, in accordance with the Group Financial Operation Basic Policy, and under the supervision of the Financial Risk Management Committee of the Company, the Group establishes and implements an interest rate hedging policy, taking into consideration the impact on the Group's performance and the current condition of the interest rates in a comprehensive manner. The Treasury Division of the Company reports the performances to the president and the Board of Directors of the Company.

Interest Rate Sensitivity Analysis

In cases where the interest rate of financial instruments held by the Group as of each fiscal year end increases by 100bp, the impact on profit before income taxes in the consolidated statement of income is as follows:

The analysis is subject to financial instruments affected by interest rate fluctuation and based on the assumption that other factors, including the impacts of foreign exchange fluctuation, are constant.

	Millions of yen	
	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Profit before income taxes	¥(559)	¥(2,593)

(7) Hedging Transactions

The Group's policy for hedging transactions is stated in "3. Significant Accounting Policies."

A. Cash Flow Hedges

The details of hedging instruments designated as cash flow hedges are as follows:

FY2016: As of December 31, 2016

	FY2016				
			Carrying amount (Note) (Millions of yen)		
	Contract amount	Over one year	Assets	Liabilities	Average rates (yen, %)
Foreign exchange risk					
Foreign exchange forward contract					
JPY/USD	USD 259 mil.	USD —	¥1,077	¥478	¥109.84
Interest rate risk					
Cross currency swap					
Fixed rate receipt and fixed rate payment	USD 175 mil.	USD 175 mil.	3,052	—	0.24%

FY2017: As of December 31, 2017

	FY2017				
			Carrying amount (Note) (Millions of yen)		
	Contract amount	Over one year	Assets	Liabilities	Average rates (yen, %)
Foreign exchange risk					
Foreign exchange forward contract					
JPY/USD	USD 338 mil.	USD —	¥ 176	¥414	¥109.75
Interest rate risk					
Cross currency swap					
Fixed rate receipt and fixed rate payment	USD 175 mil.	USD —	2,490	—	0.24%

(Note) Carrying amounts of derivatives are presented as "Other financial assets" or "Other financial liabilities" in the consolidated statement of financial position, and the portion with over one year maturity is classified as "Non-current assets" or "Non-current liabilities."

The schedule of net gains (losses) on hedging instrument designated as cash flow hedges is as follows:

Millions of yen

	Effective portion of changes in the fair value of cash flow hedges: Foreign exchange risk	Interest rate risk	Total
As of January 1, 2016	¥ (12)	¥137	¥ 125
Other comprehensive income			
Amount arising (Note 1)	(2,168)	(818)	(2,986)
Reclassification adjustments (Note 2)	128	721	849
Tax effects	625	33	658
Others	1,794	—	1,794
As of December 31, 2016	367	73	440
Other comprehensive income			
Amount arising (Note 1)	**30**	**(562)**	**(532)**
Reclassification adjustments (Note 2)	**(155)**	**611**	**455**
Tax effects	**39**	**(15)**	**23**
Others	**(475)**	**—**	**(475)**
As of December 31, 2017	**¥ (195)**	**¥106**	**¥ (88)**

(Note 1) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness approximates the change in fair value of the hedging instrument.
(Note 2) The amount, which is reclassified when the hedged item affects profit or loss, is recognized in "Revenue", "Financial income" or "Financial costs" in the consolidated statement of income. The amount of hedge ineffectiveness is immaterial.

B. Hedge of Net Investment in Foreign Operations

The details of hedging instruments designated as hedge of net investment are as follows:

FY2016: As of December 31, 2016

FY2016

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen): Assets	Liabilities	Average rates (yen)
Short-term borrowings	USD 500 mil.	USD —	¥ —	¥ 58,245	¥117.91
Bonds in USD	USD 1,575 mil.	USD 1,575 mil.	—	182,773	107.36

FY2017: As of December 31, 2017

FY2017

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen): Assets	Liabilities	Average rates (yen)
Bonds in USD	**USD 1,575 mil.**	**USD 1,250 mil.**	**¥ —**	**¥177,467**	**¥107.36**

(Note) Carrying amounts of bonds and short-term borrowings are presented as "Bonds and borrowings" in the consolidated statement of financial position, and the portion with over one year maturity is classified as "Non-current liabilities."

The schedule of net gains (losses) on hedging instrument designated as hedge of net investment in foreign operations is as follows:

Millions of yen

	FY2016 (Year ended December 31, 2016)	**FY2017 (Year ended December 31, 2017)**
Balance at the beginning of the period	¥ (4,497)	**¥ 8,784**
Other comprehensive income		
Amount arising (Note 1)	19,444	**3,763**
Tax effects	(6,163)	**(1,753)**
Balance at the end of the period (Note 2)	¥ 8,784	**¥10,793**

(Note 1) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness approximates the change in fair value of the hedging instrument.
(Note 2) Net gain arising from the hedging instruments for which hedge accounting is discontinued were ¥18,241 million and ¥16,936 million as of December 31, 2016 and 2017 respectively those which are included in the exchange differences on translation of foreign operations.

(8) Market Price Fluctuation Risk

With respect to securities, the Group regularly assesses the fair value and financial conditions of the issuers, and each relevant department reviews the portfolio held by taking into account the relationship with counterparty entities as necessary.

(9) Fair Value of Financial Instruments

The fair value hierarchy of financial instruments is categorized from Level 1 to Level 3 as follows:

Level 1: Fair value measured at the quoted price in the active market
Level 2: Fair value that is calculated using the observable price other than categorized in Level 1 directly or indirectly
Level 3: Fair value that is calculated based on valuation techniques which include inputs that are not based on observable market data

(i) Financial instruments measured at amortized cost

The carrying amount and fair value hierarchy of financial instruments measured at amortized cost as of each fiscal year end are as follows:

FY2016: As of December 31, 2016

Millions of yen

	FY2016: Carrying amount	Fair value: Level 1	Level 2	Level 3	Total
Long-term borrowings (Note)	¥ 1,449	¥ —	¥ —	¥1,449	¥ 1,449
Bonds (Note)	358,158	357,126	—	—	357,126

FY2017: As of December 31, 2017

Millions of yen

	FY2017: Carrying amount	Fair value: Level 1	Level 2	Level 3	Total
Long-term borrowings (Note)	**¥ 71,854**	**¥ —**	**¥ —**	**¥71,829**	**¥ 71,829**
Bonds (Note)	**332,242**	**331,998**	**—**	**—**	**331,998**

(Note) Current portion is included.

With regard to short-term financial assets and short-term financial liabilities measured at amortized cost, their fair value approximates the carrying amount.

The fair value of long-term borrowings is calculated based on the present value which is obtained by discounting the total of the principal and interest by the interest rate assumed in a case where the same loan is newly made.

(ii) Financial instruments measured at fair value

The fair value hierarchy of financial instruments measured at fair value is as follows:

FY2016: As of December 31, 2016

Millions of yen

	FY2016: Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	¥ —	¥11,769	¥ —	¥11,769
Equity securities	60,662	—	4,886	65,548
Other	368	—	2,316	2,683
Total	¥61,030	¥11,769	¥7,202	¥80,001
Derivative liabilities	¥ —	¥12,516	¥ —	¥12,516
Total	¥ —	¥12,516	¥ —	¥12,516

FY2017: As of December 31, 2017

	Level 1	Level 2	Level 3 (Note)	Total
				Millions of yen FY2017
Derivative assets	¥ —	¥5,978	¥ —	¥ 5,978
Equity securities	71,859	—	5,783	77,642
Other	408	—	3,559	3,967
Total	¥72,267	¥5,978	¥9,342	¥87,587
Derivative liabilities	¥ —	¥5,425	¥ —	¥ 5,425
Total	¥ —	¥5,425	¥ —	¥ 5,425

(Note) The schedule of financial instruments that are classified in Level 3 is as follows:

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Balance at the beginning of the period	¥6,966	¥7,202
Total gain (loss)		
Profit or loss (Note 1)	(16)	391
Other comprehensive income (Note 2)	80	914
Purchases	448	995
Sales	(76)	(159)
Other	(200)	—
Balance at the end of the period	¥7,202	¥9,342

(Note 1) Gains and losses included in profit or loss for the year ended December 31, 2016 and 2017 are related to financial assets measured at fair value through profit or loss as of the fiscal year end date. These gains and losses are included in "Financial income" and "Financial costs."
(Note 2) Gains and losses included in other comprehensive income for the year ended December 31, 2016 and 2017 are related to financial assets measured at fair value through other comprehensive income as of the fiscal year end date. These gains and losses are included in "Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income."

35. Related Parties

Based on the Japan Tobacco Inc. Act, the Japanese government shall hold more than one-third of all of the shares issued by the Company (excluding the type of shares, for which it is stipulated that voting rights may not be exercised on any matters that can be resolved by Annual Shareholders' Meeting). As of December 31, 2017, the Japanese government held 33.35% of all outstanding shares of the Company.

(1) Related-party Transactions

Related-party transactions are conducted under the same conditions as regular business transactions.

The Group's revenue from CJSC TK Megapolis, the local Russian distribution affiliate, was ¥207,768 million and ¥216,852 million for the years ended December 31, 2016 and 2017, respectively. The Group held trade receivables of ¥38,373 million and ¥49,097 million from CJSC TK Megapolis as of December 31, 2016 and 2017, respectively.

(2) Remuneration for Directors and Audit and Supervisory Board Members

Remuneration for directors and audit and supervisory board members for each fiscal year is as follows:

Millions of yen

	FY2016 (Year ended December 31, 2016)	FY2017 (Year ended December 31, 2017)
Remuneration and bonuses	¥620	¥540
Share-based payments	117	120
Total	¥737	¥660

36. Subsidiaries, Associates and Others

(The composition of the Group)

The composition of the Group by reportable segment as of each fiscal year end is as follows:

	FY2016 (As of December 31, 2016)		FY2017 (As of December 31, 2017)	
Reportable Segments	Number of subsidiaries	Number of entities accounted for using the equity method (Note)	Number of subsidiaries	Number of entities accounted for using the equity method (Note)
Domestic Tobacco	12	2	13	2
International Tobacco	150	5	156	5
Pharmaceuticals	2	—	2	—
Processed Food	28	3	28	3
Other	10	2	11	3
Total	202	12	210	13

(Note) No associates or joint ventures are considered to be material to the Group.

There is no significant change in the composition of the Group for the year ended December 31, 2017.

37. Commitments

(1) Commitments for the Acquisition of Assets

Commitments for the acquisition of assets after each fiscal year end date are as follows:

Millions of yen

	FY2016 (As of December 31, 2016)	FY2017 (As of December 31, 2017)
Acquisition of property, plant and equipment	¥41,889	¥74,732
Acquisition of intangible assets	3,374	3,103
Total	¥45,264	¥77,835

(2) Procurement of Domestic Leaf Tobacco

With regard to the procurement of domestic leaf tobacco by the Company, based on the Tobacco Business Act, the Company enters into purchase contracts with domestic leaf tobacco growers every year, and the contracts determine the area under cultivation by type of tobacco and the prices by type and quality of tobacco leaf. Under the contracts, the Company is obligated to purchase all domestic leaf tobacco produced pursuant to such contracts, except for any domestic leaf tobacco not suited for the manufacture of tobacco products.

38. Business Combinations

(1) Acquisition of the Mighty Corporation assets and intellectual property rights related to the tobacco business

(i) Summary of Business Combinations

On September 7, 2017, the Group acquired the tobacco business of Mighty Corporation ("MC"), a company operating tobacco business in the Philippines, including its assets and intellectual property rights.

MC holds brands such as "Mighty" and "Marvels" which have strong brand equity in the Philippine tobacco market. In addition, MC also has a well-established distribution and sales network throughout the Philippines.

The purpose of this acquisition is to strengthen the Group's brand portfolio and expand distribution and sales area.

(ii) Consideration and Details (Total of the Acquisition)

The consideration is ¥102,392 million and paid fully in cash.

(Note) Out of the total consideration, ¥99,479 million has been paid as of the fiscal year end date and ¥2,913 million will be paid after the fiscal year end date.

(iii) Fair Values of the Assets Acquired and Liabilities Assumed

	Millions of yen
	Fair value
Current assets	¥12,294
Trademarks	41,686
Non-current assets	9,747
Total assets	¥63,728
Current liabilities	¥ 2,176
Non-current liabilities	68
Total liabilities	¥ 2,244
Goodwill	¥40,908

Goodwill represents future economic benefits for integration synergies including enhanced business scale.

The amount of fair value of assets acquired and liabilities assumed are provisional amounts recognized at the acquisition date and may change during the measurement period (one year from the acquisition date).

Transaction costs of ¥247 million are expensed as incurred and recognized in "Selling, general and administrative expense".

(2) Acquisition of the kretek cigarette company and its distributor in Indonesia

(i) Summary of Business Combinations

On October 31, 2017, the Group completed the transfer of the 100% shares of PT. Karyadibya Mahardhika ("KDM"), a company operating kretek cigarette business in Indonesia, and its distributor, PT. Surya Mustika Nusantara ("SMN").

KDM produces kretek cigarettes in nine production facilities in Java and SMN and its affiliated distributors ("SMN Group") sell its products throughout Indonesia.

The purpose of this acquisition is to expand the presence in the Indonesian kretek cigarette market by leveraging KDM's supply chain, including production and procurement, as well as SMN Group's distribution and sales network throughout Indonesia.

(ii) Financial Impact on the Group

It is assumed that had the business been acquired on January 1, 2017, total consolidated revenue would have increased by ¥23,401 million to ¥2,163,053 million and total consolidated operating profit would have decreased by ¥6,288 million to ¥554,813 million.

The above operating profit includes the amortization of trademarks acquired from the business combinations, etc.

(iii) Consideration and Details (Total of the Acquisition)

The consideration is ¥74,318 million and paid fully in cash.

(Note) Out of the total consideration, ¥66,886 million has been paid as of the fiscal year end date and ¥7,432 million will be paid after the fiscal year end date.

(iv) Cash Out for the Business Combinations (Total of the Acquisition)

	Millions of yen
	Net cash outflow for the business combinations
Cash consideration	¥74,318
Cash and cash equivalents in subsidiaries acquired	(1,071)
Net cash outflow for the business combinations	¥73,246

(v) Fair Values of the Assets Acquired and Liabilities Assumed

	Millions of yen
	Fair value
Current assets	¥22,935
Trademarks	16,736
Non-current assets	27,061
Total assets	¥66,732
Current liabilities	¥42,095
Non-current liabilities	8,239
Total liabilities	¥50,334
Non-controlling interests	226
Goodwill	¥58,146

Goodwill represents future economic benefits for integration synergies including enhanced business scale.

Fair value of assets acquired and liabilities assumed are provisional amounts recognized at the acquisition date and may change during the measurement period (one year from the acquisition date).

Transaction costs of ¥2,216 million are expensed as incurred and recognized in "Selling, general and administrative expense".

(3) Made Ethiopian Tobacco company a consolidated subsidiary through acquisition of additional shares

(i) Summary of Business Combinations

On December 21, 2017, the Group purchased 30.95% of the total issued shares of National Tobacco Enterprise Share Company ("NTE"), a company operating Tobacco business in Ethiopia, from the Ethiopian Government. This additional shares purchase brought the Group's share ownership to 70.95% of the total number of NTE's shares and made it a consolidated subsidiary.

The purpose of this additional shares purchase is to strengthen its business foundation in the Ethiopian tobacco market which has the importance in African market.

(ii) Financial Impact on the Group

It is assumed that had the business been acquired on January 1, 2017, total consolidated revenue would have increased by ¥7,061 million to ¥2,146,713 million and total consolidated operating profit would have increased by ¥379 million to ¥561,481 million.

The above operating profit includes the amortization of trademarks acquired from the business combinations, etc.

(iii) Consideration and Details (Total of the Acquisition)

	Millions of yen
	Consideration
Cash	¥ 49,044
Fair value of equity interest in NTE held at the time of the acquisition	63,385
Total consideration	¥112,428

As a result of the Group's re-evaluation of 40% of equity interest in NTE held at the time of the acquisition at fair value on the acquisition date, the Group recognized a gain on the step acquisition of ¥5,042 million in "Other operating income" in the consolidated statement of income.

(iv) Cash Out for the Business Combinations

	Millions of yen
	Net cash outflow for the business combinations
Cash consideration	¥49,044
Cash and cash equivalents in subsidiaries acquired	(2,476)
Net cash outflow for the business combinations	¥46,568

(v) Fair Values of the Assets Acquired and Liabilities Assumed

	Millions of yen
	Fair value
Current assets	¥ 4,566
Trademarks	13,771
Non-current assets	1,875
Total assets	¥ 20,212
Current liabilities	¥ 983
Non-current liabilities	4,459
Total liabilities	¥ 5,442
Non-controlling interests	4,291
Goodwill	¥101,948

Goodwill represents future economic benefits for integration synergies including enhanced business scale.

Non-controlling interests are measured at the non-controlling interest's proportionate share of the fair value of the identifiable net assets of NTE.

Fair value of assets acquired and liabilities assumed are provisional amounts recognized at the acquisition date and will change during the measurement period (one year from the acquisition date).

Other Acquisitions

In addition to the above, the Group acquired other entities through business combinations for the year ended December 31, 2017, which are omitted as they are immaterial both individually and in aggregate.

39. Contingencies

Contingent Liabilities

The Company and some of its subsidiaries are defendants in legal proceedings. Provisions are not accounted for in matters where it is not practicable to reasonably estimate the final outcomes.

The Company and some of its subsidiaries, who are defendants in such legal proceedings, believe that our defenses asserted in these proceedings are based on substantial evidence and implement the system for the response to action with the assistance of external lawyers.

(1) Smoking and Health Related Litigation

The Company and some of its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking, the marketing of tobacco products, or exposure to tobacco smoke. As of December 31, 2017, there were a total of 21 smoking and health related cases pending in which one or more members of the Group were named as a defendant or for which the Company may have certain indemnity obligations pursuant to the agreement such as for the Company's acquisition of RJR Nabisco Inc.'s overseas (non-U.S.) tobacco operations.

The major ongoing smoking and health related cases are as follows:

a. Individual Claim

There is one individual case brought against the Company's indemnitee in South Africa.

South Africa Individual Claim (Joselowitz):

The individual claim was brought against the Company's indemnitee in South Africa in October 2000. Plaintiff seeks compensatory and punitive damages, alleging that the Company's indemnitee marketed products which it knew to be dangerous to health, manipulated nicotine content to foster addiction, failed to comply with South African labeling requirements and participated in a clandestine worldwide operation to encourage children to smoke. This case has been dormant since February 2001.

In addition, there is one individual case (which is currently dormant) brought against the Company's subsidiary in Ireland.

b. Class Actions

There are eight ongoing class actions in Canada against the Company's subsidiary and/or indemnitees.

Canada Quebec Class Action (Cecilia Letourneau):

This class action was brought in September 1998 against three Canadian tobacco manufacturers including JTI-Macdonald Corp. (hereinafter referred to as "JTI-Mac"), the Company's Canadian subsidiary. Plaintiffs are seeking a total of approximately ¥413 billion (approximately CAD 4.6 billion) in compensatory damages, an amount for which all the defendants are jointly and severally liable. Plaintiffs are seeking an additional amount of approximately ¥413 billion (approximately CAD 4.6 billion) in punitive damages, to be divided among all the defendants based on their respective market shares. The class was certified by the court in February 2005, and the trial was conducted from March 2012 through December 2014.

The Quebec Superior Court rendered the first instance judgment in May 2015, ordering a punitive damage award against the defendants of approximately ¥11.8 billion (CAD 131 million), in which the share of the total damage award against JTI-Mac is approximately ¥1.1 billion (approximately CAD 13 million). Although the Court found that the defendants had all committed some faults, it refused to award moral damages because the evidence did not establish the total amount of the claims of class members. In June 2015, JTI-Mac appealed the judgment to the Quebec Court of Appeal, and the appeal on the merits was heard in November 2016. The timing of the decision is at the Court's discretion.

Canada Quebec Class Action (Conseil Québécois sur le tabac et la santé):

This class action was brought in November 1998 against three Canadian tobacco manufacturers including JTI-Mac. Plaintiffs are seeking a total of approximately ¥1,118.8 billion (approximately CAD 12.4 billion) in compensatory damages, an amount for which all the defendants are jointly and severally liable. Plaintiffs are seeking an additional amount of approximately ¥72.9 billion (approximately CAD 0.8 billion) in punitive damages, to be divided among all the defendants based on their respective market shares. The class was certified by the court in February 2005, and the trial was conducted from March 2012 through December 2014.

The Quebec Superior Court rendered the first instance judgment in May 2015, ordering a compensatory damage award jointly and severally against the defendants of approximately ¥1,394.2 billion (CAD 15.5 billion), in which the share of the total damage award against JTI-Mac is approximately ¥181.2 billion (CAD 2.015 billion). Given the enormity of the damage award, the Court granted a symbolic amount of punitive damages of approximately ¥3 million (CAD 30,000) per defendant. In June 2015, JTI-Mac appealed the judgment to the Quebec Court of Appeal, and the appeal on the merits was heard in November 2016. The timing of the decision is at the Court's discretion.

Canada Saskatchewan Class Action (Adams):

This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The preliminary motions are pending. The case is currently dormant.

Canada Manitoba Class Action (Kunta):

This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The statement of claim was served on the Company's indemnitees but not on JTI-Mac. The case is currently dormant.

Canada Nova Scotia Class Action (Semple):

This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The statement of claim was served on the Company's indemnitees but not on JTI-Mac. The case is currently dormant.

Canada British Columbia Class Action (Bourassa):

This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2010. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

Canada British Columbia Class Action (McDermid):

This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2010. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

Canada Ontario Class Action (Jacklin):

This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2012. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

In addition, there is one class action brought in Israel against an indemnitee of the Company's subsidiary.

c. Health-Care Cost Recovery Litigation

There are 10 ongoing health-care cost recovery cases in Canada pending against the Company's subsidiary and indemnitees brought by all the Canadian provinces (except three Canadian territories). These provinces filed lawsuits under their own provincial legislation which was enacted exclusively for the purpose of authorizing the provincial government to file a direct action against tobacco manufacturers to recoup the health-care costs the government has allegedly incurred and will incur, resulting from "tobacco related wrongs."

Canada British Columbia Health-Care Cost Recovery Litigation:

This health-care cost recovery litigation was filed by the Province of British Columbia in January 2001 against tobacco industry members including JTI-Mac and the Company's indemnitees based on its provincial legislation, the "Tobacco Damages and Health-Care Costs Recovery Act." The claim amount is unspecified. In 2001, several defendants challenged the legislation's constitutionality, which was ultimately rejected by the Supreme Court of Canada in September 2005. The action remains pending in the first instance. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada New Brunswick Health-Care Cost Recovery Litigation:

This health-care cost recovery litigation was filed by the Province of New Brunswick in March 2008 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. The trial is set to begin in November 2019.

Canada Ontario Health-Care Cost Recovery Litigation:

This health-care cost recovery litigation was filed by the Province of Ontario in September 2009 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total claimed amount of ¥4,497.5 billion (CAD 50.0 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Newfoundland and Labrador Health-Care Cost Recovery Litigation:

This health-care cost recovery litigation was filed by the Province of Newfoundland and Labrador in February 2011 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Manitoba Health-Care Cost Recovery Litigation:

This health-care cost recovery litigation was filed by the Province of Manitoba in May 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Quebec Health-Care Cost Recovery Litigation:

This health-care cost recovery litigation was filed by the Province of Quebec in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total amount of the claim approximately ¥5,456.1 billion (approximately CAD 60.7 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Alberta Health-Care Cost Recovery Litigation:

This health-care cost recovery litigation was filed by the Province of Alberta in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total claimed amount of at least ¥899.5 billion (CAD 10.0 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Saskatchewan Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Saskatchewan in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.
Canada Prince Edward Island Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Prince Edward Island in September 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.
Canada Nova Scotia Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Nova Scotia in January 2015 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

(2) Other Legal Proceedings
The Company and some of its subsidiaries are also engaged in other legal proceedings such as commercial and tax disputes, which may include proceedings that are conducted pursuant to applicable confidentiality obligations. Details of such proceedings and their outcomes are disclosed by the Company only where permitted by such confidentiality obligations.
One major commercial litigation case is pending.
Japan Compensatory Damages Claim:
In February 2010, a former President & CEO of Katokichi Co., Ltd. filed a claim against TableMark Holdings Co., Ltd. (renamed after acquisition of Katokichi Co., Ltd. by the Company) and its subsidiary seeking damages allegedly incurred by the plaintiff from an asset purchase agreement between the plaintiff and Katokichi Co., Ltd. and a joint and several guarantee provided by the plaintiff. The plaintiff argues the invalidity of the asset purchase agreement.

(Note) The amount of damages sought denominated in foreign currencies is translated into Japanese yen at the rates as of December 31, 2017.

40. Subsequent Events

The Group has signed an agreement to purchase 100% of the outstanding shares of JSC Donskoy Tabak, a company operating Tobacco business in Russia, on March 16, 2018 (Note 1). The purpose of this acquisition is to expand brand portfolio in the value segment and strengthen distribution and sales network in the Russian Tobacco market, a cornerstone of the Group's earnings growth.

The acquisition cost (Note 2) is estimated at around RUB 90 billion (approximately ¥166.5 billion) (Notes 3, 4). The transaction is expected to be completed by the beginning of the third quarter of the fiscal year 2018 following regulatory clearance.

(Note 1) To purchase 100% of the outstanding shares of JSC Pereslavl-Tabak and 94.97% of the outstanding shares of Syneteristiki Kapnoviomihania Ellados Sekap S.A. are included.
(Note 2) After deduction of net debt.
(Note 3) Translated at the rate of ¥1.85 per RUB
(Note 4) The acquisition cost would change at closing due to the impact of currency exchange and net debt adjustment.

Consolidated Supplementary Information

A. Quarterly Information for the Year ended December 31, 2017

Millions of yen

	Q1 From January 1, 2017 to March 31, 2017	Q2 From January 1, 2017 to June 30, 2017	Q3 From January 1, 2017 to September 30, 2017	FY2017 From January 1, 2017 to December 31, 2017
Revenue	¥506,138	¥1,045,330	¥1,592,899	¥2,139,653
Profit before income taxes for the period (year)	142,493	302,913	453,935	538,532
Profit attributable to owners of the parent company for the period (year)	105,491	225,635	333,698	392,409
Basic earnings per share for the period (year) (yen)	58.90	125.98	186.32	219.10

	Q1 From January 1, 2017 to March 31, 2017	Q2 From April 1, 2017 to June 30, 2017	Q3 From July 1, 2017 to September 30, 2017	Q4 From October 1, 2017 to December 31, 2017
Basic earnings per share for the quarter (yen)	¥58.90	¥67.08	¥60.34	¥32.78

B. Significant Lawsuits

The significant lawsuits of the Group are as stated in "39. Contingencies" in the notes to consolidated financial statements.

Deloitte.

Deloitte Touche Tohmatsu LLC
Shinagawa Intercity
2-15-3 Konan
Minato-ku, Tokyo 108-6221
Japan
Tel: +81 (3) 6720 8200
Fax: +81 (3) 6720 8205
www.deloitte.com/jp/en

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Japan Tobacco Inc.:

We have audited the accompanying consolidated statement of financial position of Japan Tobacco Inc. and its consolidated subsidiaries as of December 31, 2017, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the fiscal year from January 1, 2017 to December 31, 2017, and notes to consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Japan Tobacco Inc. and its consolidated subsidiaries as of December 31, 2017, and the consolidated results of their operations and their cash flows for the fiscal year then ended in accordance with International Financial Reporting Standards.

Deloitte Touche Tohmatsu LLC

March 27, 2018

Member of
Deloitte Touche Tohmatsu Limited

Glossary of Terms

Unless otherwise stated, terms and numbers reported in this glossary are in accordance with IFRS.

Adjusted Operating Profit: Operating profit + Amortization cost of acquired intangibles arising from business acquisitions + Adjusted items (income and costs).*

Adjusted Profit: Profit for the year (profit attributable to owners of the parent company) ± adjustment items (income and costs)* ± (tax and minority interests adjustments)

BnU: Billion Units.

Contraband: Genuine products smuggled from abroad. Genuine products diverted from the legitimate supply chain and sold in a country different from the intended market of retail sale and without domestic duty paid in that country.

Constant Exchange Rates: Constant exchange rates measures are computed by restating current year results at the previous year's foreign currency exchange rate. Results at constant rates of exchange should be considered in addition to, not as a substitute for, results reported in accordance with IFRS.

Core Revenue (International Tobacco Business): Includes revenues from waterpipe tobacco and Reduced-Risk Products, but excludes revenues from distribution, contract manufacturing and other peripheral businesses.

Core Revenue (Japanese Domestic Tobacco Business): Excludes revenue from distribution of imported tobacco in the Japanese Domestic Tobacco business, among others, but includes revenue from domestic duty free, the China business and Reduced-Risk Products such as Ploom TECH device and capsules.

Counterfeit: Fake products appearing to be a genuine brand. Products protected by intellectual property rights which are manufactured without authorization from the rights' owners and with the intent to copy the genuine brand to deceive the consumer, also sold without duties being paid.

FCF (Free Cash Flow): The sum of cash flows from operating activities and investing activities but excluding the following items:

- Cash flows from operating activities: interest received, dividends received, interest paid and the tax effect related to these items.
- Cash flows from investing activities: purchase of investment securities (for both short-term and long- term), payments into time deposits, proceeds from sale or redemption of investment securities (for both short-term and long-term), proceeds from withdrawal of time deposits and other investing activities not for business operation purposes.

GFB: Global Flagship Brands (Winston, Camel, MEVIUS, LD, Benson & Hedges, Glamour, Silk Cut, Sobranie and Natural American Spirit).

* Global Flagship Brands from 2018 (Winston, Camel, MEVIUS, LD). The other five brands are categorized as Specialist Flagship Brands (SFB).

Reduced-Risk Products (RRP): Products with the potential to reduce the risks associated with smoking.

FY2014: Results for the fiscal year ended December 31, 2014.

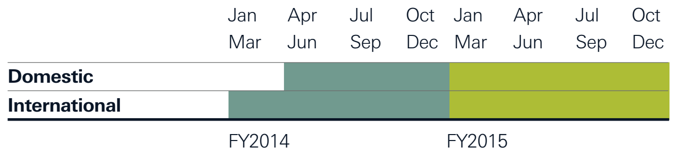
In FY2014, the Company and its subsidiaries with fiscal year-ends other than December 31 have changed their fiscal year-ends to December 31.

The fiscal year-end for international business continues to be December 31 as before, hence the Group consolidates financial results of international business for the twelve- month period from January 1, 2014 to December 31, 2014 into the Group's consolidated financial results for the nine months ended December 31, 2014 (Reported basis).

For the purpose of fair comparison of business performance, we are providing figures for the twelve- month period from January 1, 2014 to December 31, 2014 (Like-for-Like basis) with regard to all business segments in continuing operations.

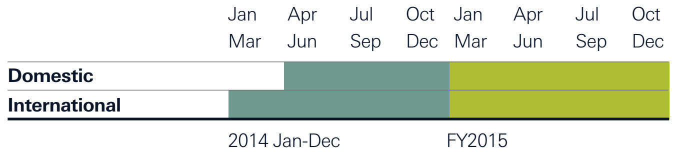
* Adjustment items (income and costs) = impairment losses on goodwill ± restructuring income and costs ± others

Results for Nine months ended December 31, 2014 (Reported basis): For domestic businesses: consolidated nine-month results from April 1 to December 31, 2014.



For international business: consolidated twelve-month results from January 1 to December 31, 2014.

Results of Jan-Dec 2014 (Like-for-Like basis): For the purpose of fair comparison of business performance, we are providing figures with regard to all business segments in continuing operations for January to December, 2014.



- Revenue, operating profit, adjusted operating profit from continuing operations and profit attributed to owners of the parent company from continuing and discontinued operations combined for January to December, 2014 were disclosed in the FY2015 Annual Securities Report, which was audited.

Illicit Whites: Legitimately manufactured brands intentionally sold on the illicit market. Brands manufactured legitimately in one country but smuggled into another country to provide consumers with cheap brands, also without duties being paid.

IFRS: International Financial Reporting Standards.

JPY BN: Billion Japanese Yen.

Restated: See 'Constant Exchange Rates'.

Revenue: Excluding tobacco excise taxes and revenue from agent transactions.

Profit: Profit attributable to owners of the Parent.

TableMark: References to 'TableMark' are to TableMark Holdings Co. Ltd., TableMark Co. Ltd.

Total Shipment Volume (International Tobacco Business): Includes fine cut, cigars, pipe tobacco, snus and kretek, but excludes contract manufactured products, waterpipe tobacco and Reduced-Risk Products.

Total Sales Volume (Japanese Domestic Tobacco Business): Excludes sales volume of domestic duty free, the Chinese business and Reduced-Risk Products.

USD MM: Million US dollars.