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**[Cover]**

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Company name (Japanese):	日本たばこ産業株式会社 ( <i>Nihon Tabako Sangyo Kabushiki-Kaisha</i> )
Company name (English):	JAPAN TOBACCO INC.
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## A. Company Information

### I. Overview of the JT Group

#### 1. Trends in principal management benchmarks

##### (1) Management benchmarks (consolidated)

Term	International Financial Reporting Standards				
	26th term	27th term	28th term	29th term	30th term
Accounting period	From April 1, 2010 to March 31, 2011	From April 1, 2011 to March 31, 2012	From April 1, 2012 to March 31, 2013	From April 1, 2013 to March 31, 2014	From April 1, 2014 to December 31, 2014
Revenue (Millions of yen)	2,059,365	2,033,825	2,120,196	2,399,841	2,153,970
Profit before income taxes (Millions of yen)	385,242	441,355	509,355	636,203	502,299
Profit for the year (Millions of yen)	248,736	328,559	351,448	435,291	368,626
Profit attributable to owners of the parent company (Millions of yen)	243,315	320,883	343,596	427,987	362,919
Comprehensive income (loss) for the year (Millions of yen)	(48,967)	192,143	544,407	850,261	244,868
Total equity (Millions of yen)	1,601,311	1,714,626	1,892,431	2,596,091	2,622,503
Total assets (Millions of yen)	3,655,201	3,667,007	3,852,567	4,616,766	4,704,706
Equity attributable to owners of the parent company per share (Yen)	160,179.52	858.09	993.98	1,378.57	1,395.74
Basic earnings per share (Yen)	25,414.33	168.50	181.07	235.48	199.67
Diluted earnings per share (Yen)	25,407.09	168.44	180.98	235.35	199.56
Ratio of equity attributable to owners of the parent company to total assets (%)	41.73	44.56	46.89	54.27	53.92
Ratio of profit to equity attributable to owners of the parent company (%)	15.30	20.31	19.97	19.85	14.39
Price earnings ratio (PER) (Times)	11.82	13.83	16.57	13.76	16.67
Net cash flows from (used in) operating activities (Millions of yen)	406,847	551,573	466,608	396,496	543,696
Net cash flows from (used in) investing activities (Millions of yen)	(125,993)	(103,805)	(147,928)	(163,473)	(49,110)
Net cash flows from (used in) financing activities (Millions of yen)	(185,379)	(279,064)	(569,473)	(145,189)	(388,859)
Cash and cash equivalents at the end of the year (Millions of yen)	244,240	404,740	142,713	253,219	385,820
Number of employees [Separately, average number of temporary employees] (Person)	48,472 [11,611]	48,529 [10,702]	49,507 [9,313]	51,563 [9,130]	51,341 [8,700]

- Notes: 1. Effective from the 27th term, the consolidated financial statements are prepared in accordance with International Financial Reporting Standards (hereinafter, "IFRS").
2. The yen amounts are rounded to the nearest million.
  3. Revenue does not include consumption taxes.
  4. JT conducted a share split at a ratio of 200 to one with July 1, 2012 as effective date. Consequently, equity attributable to owners of the parent company per share, basic earnings per share and diluted earnings per share are calculated on the assumption that this share split was conducted at the beginning of the 27th term.
  5. The JT Group made a partial change to its accounting policies effective from the 29th term. Related principal management benchmarks for the 28th term have been adjusted retrospectively to reflect the change.
  6. The JT Group made a partial change to its accounting policies effective from the 30th term. Related principal management benchmarks for the 29th term have been adjusted retrospectively to reflect the change. For details, please refer to "V. Accounting, 1. Consolidated financial statements, Notes to consolidated financial statements, 3. Significant accounting policies, (Changes in accounting policies)."
  7. JT changed its fiscal year end from March 31 to December 31 effective from the 30th term. The same change was made to consolidated subsidiaries with fiscal year ends other than December 31. As a consequence of this change, the 30th term was the 9-month period from April 1, 2014 to December 31, 2014, for JT and its main consolidated subsidiaries that do not belong to the international tobacco business segment. For consolidated subsidiaries that belong to the international tobacco business segment, the 30th term was the 12-month period from January 1, 2014 to December 31, 2014.

Term	Japanese GAAP		
	25th term	26th term	27th term
Accounting period	From April 1, 2009 to March 31, 2010	From April 1, 2010 to March 31, 2011	From April 1, 2011 to March 31, 2012
Net sales (Millions of yen)	6,134,695	2,432,639	2,547,060
Ordinary income (Millions of yen)	255,377	313,066	362,728
Income before income taxes and minority interests (Millions of yen)	276,054	281,147	345,028
Net income (Millions of yen)	138,448	145,366	227,399
Comprehensive income (loss) (Millions of yen)	–	(110,352)	117,047
Net assets (Millions of yen)	1,723,278	1,571,751	1,610,535
Total assets (Millions of yen)	3,872,595	3,544,107	3,472,612
Net assets per share (Yen)	172,139.61	156,996.72	160,570.98
Net income per share (Yen)	14,451.67	15,183.52	23,882.77
Diluted net income per share (Yen)	14,448.89	15,179.19	23,873.42
Equity ratio (%)	42.58	42.18	44.03
Return on equity (ROE) (%)	8.65	9.25	15.04
Price earnings ratio (PER) (Times)	24.08	19.79	19.51
Net cash flows from (used in) operating activities (Millions of yen)	320,024	399,638	551,617
Net cash flows from (used in) investing activities (Millions of yen)	(84,057)	(119,407)	(104,530)
Net cash flows from (used in) financing activities (Millions of yen)	(250,398)	(184,951)	(278,383)
Cash and cash equivalents at the end of the year (Millions of yen)	154,368	244,240	404,740
Number of employees [Separately, average number of temporary employees] (Person)	49,665 [11,870]	48,472 [11,611]	48,529 [10,702]

Notes: 1. Audits pursuant to Article 193-2, paragraph 1 of the Financial Instruments and Exchange Act have not been conducted for the figures for the 26th term and the 27th term.

2. Effective from the 27th term, the method used for the consolidated financial statements in accordance with Japanese GAAP has been changed to one which excludes the amount equivalent to tobacco excise taxes from net sales and cost of sales. As a consequence, the consolidated financial statements in accordance with Japanese GAAP for the 26th term are presented reflecting retrospective application of this accounting policy change.

3. Effective from the 27th term, the “Accounting Standard for Earnings Per Share” (ASBJ Statement No. 2, June 30, 2010) and the “Guidance on Accounting Standard for Earnings Per Share” (ASBJ Guidance No. 4, June 30, 2010) are applied. As a consequence, diluted net income per share for the 26th term (Japanese GAAP) is presented reflecting retrospective application of this accounting policy change.

4. Foreign subsidiaries classified under the JT Group’s international tobacco business apply IFRS effective from the first quarter of the 27th term. As a consequence, the figures for the 27th term presented above are consolidated closing figures in accordance with Japanese GAAP that include the portion of the international tobacco business to which IFRS is applied. In addition, all figures for the 26th term are consolidated closing figures in accordance with Japanese GAAP that reflect retrospective application of this accounting policy change related to the international tobacco business.

5. Whereas the JT Group previously discarded fractional amounts of less than ¥1 million, effective from the 26th term, they are rounded to the nearest million.

6. Net sales do not include consumption taxes.

## (2) Filing company's management benchmarks (non-consolidated)

Term	25th term	26th term	27th term	28th term	29th term	30th term
Accounting period	From April 1, 2009 to March 31, 2010	From April 1, 2010 to March 31, 2011	From April 1, 2011 to March 31, 2012	From April 1, 2012 to March 31, 2013	From April 1, 2013 to March 31, 2014	From April 1, 2014 to December 31, 2014
Net sales (Millions of yen)	2,052,654	749,252	734,902	781,067	809,967	572,323
Ordinary income (Millions of yen)	161,606	182,819	198,071	210,568	230,900	159,746
Net income (Millions of yen)	107,361	32,216	142,726	149,773	168,779	108,656
Capital stock (Millions of yen)	100,000	100,000	100,000	100,000	100,000	100,000
Total number of shares issued (Thousands of shares)	10,000	10,000	10,000	2,000,000	2,000,000	2,000,000
Net assets (Millions of yen)	1,901,759	1,854,401	1,924,739	1,714,529	1,734,379	1,649,151
Total assets (Millions of yen)	3,027,503	2,879,354	3,016,651	2,784,914	2,732,637	2,729,270
Net assets per share (Yen)	198,452.58	194,679.73	1,010.20	942.65	953.45	906.45
Cash dividends per share (Yen)	5,800	6,800	10,000	68	96	100
[Interim dividends per share] (Yen)	[2,800]	[2,800]	[4,000]	[30]	[46]	[50]
Net income per share (Yen)	11,206.74	3,365.00	74.95	78.93	92.86	59.78
Diluted net income per share (Yen)	11,204.58	3,364.04	74.92	78.89	92.81	59.75
Equity ratio (%)	62.8	64.4	63.8	61.5	63.4	60.4
Return on equity (ROE) (%)	5.73	1.72	7.56	8.24	9.80	6.43
Price earnings ratio (PER) (Times)	31.05	89.30	31.09	38.01	34.89	55.67
Dividend payout ratio (%)	51.8	202.1	66.7	82.5	103.4	167.3
Number of employees [Separately, average number of temporary employees] (Person)	8,961 [1,349]	8,928 [1,387]	8,936 [1,393]	8,925 [1,390]	8,774 [1,377]	8,915 [1,272]

Notes: 1. The financial statements of the filing company are prepared in accordance with Japanese GAAP.

- Effective from the 27th term, the method used for the financial statements has been changed to one which excludes the amount equivalent to tobacco excise taxes from net sales and cost of sales. As a consequence, the financial statements for the 26th term are presented reflecting retrospective application of this accounting policy change.
- Effective from the 27th term, the "Accounting Standard for Earnings Per Share" (ASBJ Statement No. 2, June 30, 2010) and the "Guidance on Accounting Standard for Earnings Per Share" (ASBJ Guidance No. 4, June 30, 2010) are applied. As a consequence, diluted net income per share for the 26th term is presented reflecting retrospective application of this accounting policy change.
- Cash dividend per share for the 25th term of ¥5,800 includes the 25th anniversary commemorative dividend of ¥200.
- Whereas JT previously discarded fractional amounts of less than ¥1 million, effective from the 26th term, they are rounded to the nearest million.
- Net sales do not include consumption taxes.
- JT conducted a share split at a ratio of 200 to one effective as of July 1, 2012 as effective date. Consequently, net assets per share, net income per share and diluted net income per share are calculated on the assumption that this share split was conducted at the beginning of the 27th term. However, total number of shares issued and cash dividends per share are not calculated with the impact of the share split taken into consideration.
- JT changed its fiscal year end from March 31 to December 31 effective from the 30th term. As a consequence of this change, the 30th term is the 9-month period from April 1, 2014 to December 31, 2014,

## **2. History**

### **(1) Background of JT's transition to stock company**

Before it became a stock company, Japan Tobacco Inc. (hereinafter, "JT") was formerly Japan Tobacco and Salt Public Corporation, or JTS. JTS was established in June 1, 1949 with the "Aim to bring soundness and efficiency to the operation of the national government monopolies." JTS, serving as the main body for conducting operations of the tobacco monopoly system and other government monopolies, contributed to establishing stable supply of tobacco and securing tobacco-derived financial revenues.

However, the growth in demand for cigarettes in Japan began to slow in the mid-1970s as the 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 Japanese domestic tobacco market was virtually opened to foreign tobacco suppliers, triggering competition between domestic and foreign tobacco products in Japan, and foreign countries stepped up pressure on Japan to take further market-opening measures 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, Ad Hoc Commission on Administrative Reform was established in March 1981 to conduct research on the public corporation system. In its third report (July 30, 1982), the commission proposed drastic reform of the monopoly system and the public corporation system.

In response to this proposal, the government conducted a comprehensive review of these systems and drafted bills to:

- Abolish the tobacco monopoly law in order to liberalize tobacco imports and establish a tobacco business law in order to make necessary adjustments related to the tobacco business.
- Abolish the JTS law, reorganize JTS as stock company so as to enable it to pursue rational corporate management as much as possible and establish the Act on Japan Tobacco Inc., 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.

### **(2) Status of JT after its incorporation**

JT was incorporated on April 1, 1985, pursuant to the Act on Japan Tobacco Inc. (Act No. 69 of August 10, 1984; hereinafter, the "JT Act"), and all of the start-up capital was provided by the Japan Tobacco and Salt Public Corporation, or JTS. When incorporated, JT succeeded all the rights and obligations of JTS.

The main changes since the incorporation of JT are as follows:

Date	Details of change
April 1985	Japan Tobacco Inc. was incorporated.
April 1985	The Business Development Division was established to promote active development of new businesses. Subsequently until July 1990, in order to reinforce the promotion system for each business, this division was transformed into business departments such as pharmaceutical, food, etc.
March 1986	Fukuoka and Tosu Factories closed and Kitakyushu Factory built to modernize and streamline tobacco production. By June 1996, nine more tobacco factories were closed down to further streamline the tobacco production system.
October 1988	The communication name “JT” was introduced.
July 1991	The Head Office was relocated from Minato-ku to Shinagawa-ku to make way for the construction of the new Head Office building.
September 1993	The Central Pharmaceutical Research Institute was established to reinforce JT’s internal pharmaceutical research and development capabilities.
October 1994	The initial public offering of JT shares held by the Japanese government. (394,276 shares) JT shares were listed on the First Section of the Tokyo, Osaka and Nagoya Stock Exchanges.
November 1994	JT shares were listed on the Kyoto, Hiroshima, Fukuoka, Niigata and Sapporo Stock Exchanges.
May 1995	The Head Office was relocated from Shinagawa-ku to Minato-ku.
June 1996	The second public offering of JT shares held by the Japanese government. (272,390 shares)
April 1997	In accordance with the abolition of the salt monopoly, JT ended its salt monopoly business. The Tobacco Mutual Aid Pension scheme was united with the Employees’ Pension scheme.
April 1998	JT signed an agreement with Unimat Corporation to form a business alliance in the soft drinks business and acquired a majority stake in the company.
December 1998	JT acquired a majority stake in Torii Pharmaceutical Co., Ltd. through a tender offer.
May 1999	JT acquired the non-US tobacco operations of RJR Nabisco Inc.
July 1999	JT acquired the food business of Asahi Kasei Corporation, including eight subsidiaries such as Asahi Foods Corporation.
October 1999	Through the business alliance with Torii Pharmaceutical Co., Ltd., research and development functions in the prescription drug business were concentrated in JT while promotion functions were united within Torii Pharmaceutical.
March 2003	In order to establish a basis for future profit growth in the domestic tobacco business, Sendai, Nagoya and Hashimoto Factories were closed down.
March 2004	In order to establish a basis for future profit growth in the domestic tobacco business, Hiroshima, Fuchu, Matsuyama and Naha Factories were closed down.
June 2004	The third public offering of JT shares held by the Japanese government. (289,334 shares)
March 2005	In order to establish a basis for future profit growth in the Japanese domestic tobacco business, Ueda, Hakodate, Takasaki, Takamatsu, Tokushima, Usuki, Kagoshima and Miyakonojo Factories were closed down.
April 2006	JT ceased to produce, sell and use Marlboro brand cigarette exclusively in Japan upon the expiration of the exclusive license agreement.
April 2007	JT acquired shares issued of the Gallaher Group Plc of the United Kingdom through an acquisition method under English act known as a scheme of arrangement.
January 2008	JT acquired the shares of Katokichi Co., Ltd. through a tender offer.
March 2009	In order to restructure the domestic tobacco business in ways to make it more competitive, Kanazawa Factory was closed down.
March 2010	In order to restructure the domestic tobacco business in ways to make it more competitive, Morioka and Yonago Factories were closed down.
March 2011	In order to restructure the domestic tobacco business in ways to make it more competitive, Odawara Factory was closed down.
March 2012	In order to restructure the domestic tobacco business in ways to make it more competitive, Hofu Factory was closed down.
February 2013	The Mild Seven brand was renewed as “Mevisus” in Japan.
February 2013	JT repurchased 86,805,500 of its own shares as part of its efforts to increase shareholder returns, to improve capital efficiency and ease the impact on the stock market from the government’s sale of JT shares it holds.
March 2013	The fourth public offering of JT shares held by the Japanese government took place. (253,261,800 shares)

Notes: 1. The stock split of 5-for-1 was conducted as of April 1, 2006 and the stock split of 200-for-1 was conducted as of July 1, 2012.

2. JT decided by resolution at a meeting of the Board of Directors held on February 4, 2015, to withdraw from manufacture and sale of JT beverage products.

### **3. Business description**

Our management principle is based on the pursuit of the “4S” model. We will balance the interests of consumers, shareholders, employees and wider society, and fulfill our responsibilities towards them, aiming to exceed their expectations.

We set our vision and mission based on the “4S” model. Our vision is to become a company committed to global growth by providing diversified value that is uniquely available from JT Group. Our mission is to create, develop and nurture our unique brands to win consumer trust, while understanding and respecting the environment and the diversity of societies and individuals.

In achieving our mission, we have set “The JT Group Way” as code of conduct which all of the JT Group members are committed to: “fulfilling the expectations of our consumers and behave responsibly”, “striving for quality in everything we do through continuous improvement”, and “leveraging diversity across the JT Group”.

The main business activities operated by JT, its 215 consolidated subsidiaries and 12 companies accounted for by the equity method, and the relationship of each company to the Group’s business activities are stated below.

The following five segments are the same as the segmentation of reportable segments in “V. Accounting, 1. Consolidated financial statements, (1) Consolidated financial statements, Notes to consolidated financial statements, 6. Operating segments, (1) Outline of reportable segments.”

The JT Group is a global company operating the domestic and international tobacco businesses, pharmaceutical business, beverage business and processed food business.

#### **Domestic Tobacco Business**

The domestic tobacco business consists of the manufacture and sale of tobacco products.

JT manufactures and sells tobacco products, and TS Network Co., Ltd. conducts distribution-related operations such as distribution of JT’s tobacco products and wholesale of foreign tobacco products (imported tobacco products). Japan Filter Technology Co., Ltd. and other subsidiaries manufacture materials.

#### *Major subsidiaries and affiliates*

TS Network Co., Ltd., JT Logistics Co., Ltd., Japan Filter Technology Co., Ltd., Fuji Flavor Co., Ltd., JT Engineering Inc.

Besides the companies named above, there are 9 consolidated subsidiaries and 2 companies accounted for by the equity method.



## **International Tobacco Business**

The international tobacco business consists of the manufacture and sale of tobacco products with JT International S.A. as the core company.

### *Major subsidiaries and affiliates*

JT International S.A., Gallaher Ltd., JTI Marketing and Sales CJSC, LLC Petro, Liggett-Ducat CJSC, JT International Germany GmbH, JTI Tütün Urunleri Sanayi A.S.

Besides the companies named above, there are 138 consolidated subsidiaries and 6 companies accounted for by the equity method.

## **Pharmaceutical Business**

The pharmaceutical business consists of research and development, manufacture and sale of prescription drugs.

JT concentrates on research and development while Torii Pharmaceutical Co., Ltd. manufactures and promotes sales of drugs (including JT's products).

### *Major subsidiaries and affiliates*

Torii Pharmaceutical Co., Ltd., Akros Pharma Inc.

Besides the companies named above, there is 1 consolidated subsidiary.

## **Beverage Business**

The beverage business consists of the manufacture and sale of beverages.

JT develops products while JT Beverage Inc., Japan Beverage Holdings Inc. and certain other subsidiaries sell them.

### *Major subsidiaries and affiliates*

JT Beverage Inc., Japan Beverage Holdings Inc.

Besides the companies named above, there are 15 consolidated subsidiaries.

JT decided by resolution at a meeting of the Board of Directors held on February 4, 2015, to withdraw from manufacture and sale of JT beverage products. The manufacture and sale of JT beverage products conducted by JT and JT Beverage Inc. is expected to be discontinued by the end of September 2015. The vending machine operation business conducted by Japan Beverage Holdings Inc. and other subsidiaries will continue to operate as before. Going forward, JT will consider various options for this business.

## **Processed Food Business**

In the processed food business, TableMark Co., Ltd. and certain other subsidiaries are engaged in manufacture and sale of frozen and ambient processed foods, bakery products and seasonings.

### *Major subsidiaries and affiliates*

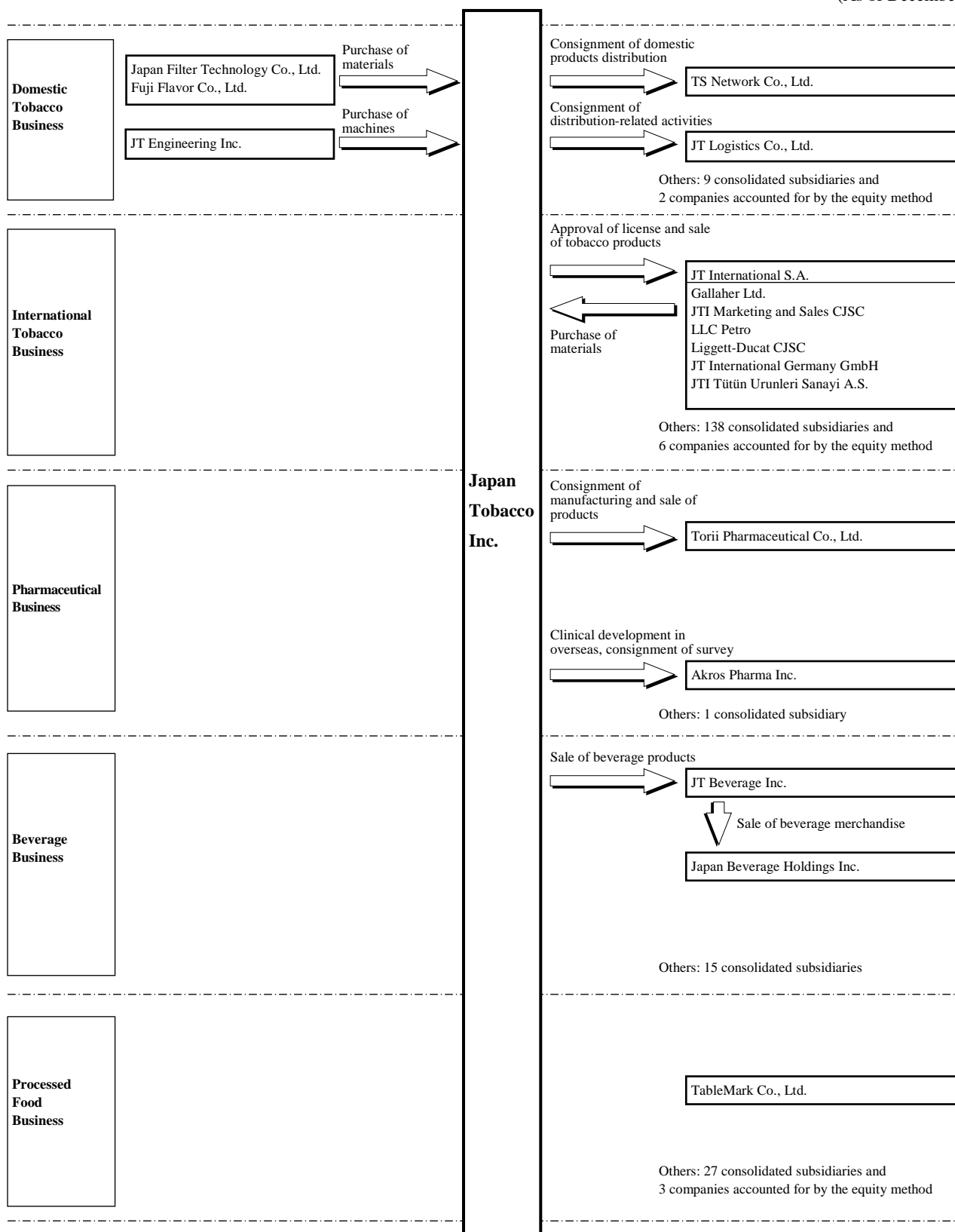
TableMark Co., Ltd.

Besides the companies named above, there are 27 consolidated subsidiaries and 3 companies accounted for by the equity method.

In addition to the reportable segments mentioned above, the JT Group runs businesses including business relating to the rent of real estate. There are 8 consolidated subsidiaries and 1 company accounted for by the equity method deemed as subsidiaries and affiliates not affiliated to any reportable segment.

The following business activities diagram shows the matters described above.

(As of December 31, 2014)



\* In addition to the reportable segments mentioned above, the JT Group runs businesses including business relating to the rent of real estate. There are 8 consolidated subsidiaries and 1 company accounted for by the equity method deemed as subsidiaries and affiliates not affiliated to any reportable segment.

With an effective date of April 1, 2014, TableMark Co., Ltd., which is shown in the above illustration, conducted a company split into TableMark Co., Ltd., as a business operating company and TableMark Holdings Co., Ltd., a pure holding company.

In addition, JT decided by resolution at a meeting of the Board of Directors held on February 4, 2015, to withdraw from manufacture and sale of JT beverage products.

An overview of each of the fields of research and development, procurement, manufacturing and sales in each business is as follows.

## **Tobacco Business**

The JT Group's tobacco business (the JT Group's tobacco business is managed separately for domestic and overseas markets. The tobacco business' reportable segments are accordingly divided into "domestic tobacco business" and "international tobacco business") has the third largest sales volume in the world (excluding China National Tobacco Corporation), operates in over 70 countries and territories, and sells products in over 120 countries. Our portfolio includes 3 of the top 10 selling global brands.

### <Research and development>

We are committed to strengthening our R&D capabilities to ensure a long-term competitive advantage. Our focus areas in the R&D activities are the development of new leaf tobacco varieties, improvement of tobacco leaves and their processing, enhancement of aroma and taste, upgrading manufacturing technology, and continuous progress on emerging product development capabilities. We aim to add value to our products in these focus areas in a cost efficient manner. We have established a global research platform in Japan, which focuses on the fundamental research and product technology development. To best meet consumers' needs and preferences, our market teams are continuously engaged in the product development.

### <Procurement of tobacco leaves>

The supply of tobacco leaves, raw materials used in manufacturing tobacco products is affected by a variety of factors, such as climate conditions, agricultural product prices, and energy costs. As a result of an increase in costs, the supply of tobacco leaves has been unstable, leading to the fluctuations in tobacco leaf prices. Given these circumstances, the JT Group aims to secure a stable supply and ensure competitive leaf purchase prices. This will be achieved through further vertical integration and strengthening of our relationships with our leaf suppliers.

- Procurement of non-Japan origin tobacco leaf

The JT Group sources leaves both directly, from major tobacco leaf producing countries (the United States, Brazil, Malawi, etc.), and indirectly, mainly from the two leading international suppliers.

Our internal source was established in 2009, when we acquired the tobacco leaf suppliers (in Brazil and in Africa), and we set up a U.S. joint venture operation. Since then, our efforts have been focused on ensuring the stable procurement through vertical integration, strengthening quality control by supporting farmers, and reinforcing the leaf procurement organization by developing our expertise in this area.

- Procurement of Japan origin tobacco leaves

In Japan, the Tobacco Business Act requires us to enter into purchase contracts with tobacco farmers every year and purchase the entire usable tobacco harvest. The aggregate cultivation area size and leaf prices for the subsequent year are determined respecting the recommendations from the Leaf Tobacco Deliberative Council<sup>(Note)</sup>.

Note: The Leaf Tobacco Deliberative Council is a council which confers on important matters concerning the cultivation and purchase of domestically grown leaf tobacco in response to inquiries by the JT representatives. The council consists of no more than 11 members, who represent domestic leaf tobacco growers as well as appointees from the academia appointed by JT with the approval of the Minister of Finance (MOF).

### <Manufacturing>

We have a global manufacturing footprint in order to manufacture quality tobacco products that secure consumers' reliability trust. We operate 9 factories in Japan (6 tobacco manufacturing and 3 tobacco-related factories), and 30 factories in 26 other countries (including tobacco-related factories). In a limited number of cases, we also partner with competing manufacturers under contracts and or license agreements to manufacture our products.

With the aim of realizing sustainable growth, we decided to restructure our sales operations to strengthen competitiveness and to close two tobacco manufacturing factories and two other tobacco-related factories to further strengthen cost competitiveness.

### <Marketing>

To enhance brand loyalty, we are conducting extensive and effective marketing activities in accordance to the various regulations and standards.

Globally, our marketing activities are focused on Global Flagship Brands (GFBs)<sup>(Note)</sup>, while complementing our brand portfolio by promoting local brands as well.

Note: We have identified eight brands which constitute the core of the JT Group's brand portfolio, Winston, Camel, Mevius, Benson & Hedges, Silk Cut, LD, Sobranie and Glamour, which we collectively call GFBs.

### <Retail prices>

In setting a retail price for a product, we consider various factors, including positioning of the brand, perceived value of the product, retail price of competing products, and our margin. In addition, there are regulations that influence our price-setting decisions. For example, some countries adopt a fixed retail price requirement, and forms of excise taxation on tobacco products (specific and/or ad valorem) differ among the countries. Retail price changes most often occur in case of tax increase. Globally, governments increase taxes to secure tax revenues and promote public health.

### <Sales (distribution)>

To ensure that our products are delivered to consumers, we make sure to use optimal distribution networks for each market complying with the restrictions and in accordance with established local business practices, and other factors. Our distribution networks can be independent distribution networks or local agencies and distributors.

There are various sales channels for tobacco products; chain stores such as convenience stores, gas stations and supermarkets, small independent retailers and vending machines. The contribution of each channel to the total industry sales varies from market to market. Accordingly, we develop different trade marketing initiatives for each market, depending on the focus channels as well as consumer trend and competitors' strategies.

## **Pharmaceutical Business**

JT commenced the pharmaceutical business in 1987. Our mission is to build world-class, unique R&D capabilities and reinforce our market presence through innovative drugs. The pharmaceutical business is currently focusing on the development, production, and sale of prescription drugs.

In December 1998, the JT Group acquired a majority of the outstanding shares in Torii Pharmaceutical Co., Ltd. (hereinafter, "Torii Pharmaceutical"). After the acquisition, all production as well as sales and promotion functions were integrated under Torii Pharmaceutical, while all R&D functions were grouped under JT.

In April 2000, we established an R&D base outside Japan by adding a clinical development function to Akros Pharma Inc., a JT Group company based in the state of New Jersey, United States.

In order to further strengthen our earnings base, we are maximizing the value of all products, enhancing our R&D pipeline, exploring opportunities for strategic in- or out-licensing and strengthening collaboration with license partners.

### <Research and development>

- Overview

R&D activities are the foundation of JT's pharmaceutical business and are critical for our long-term growth and profitability. Our R&D activities focus mainly on the fields of glucose and lipid metabolism, virus research and

immune disorders and inflammation. In the period from January through December 2014, we invested ¥28.9 billion in these activities.

- R&D process

JT's Central Pharmaceutical Research Institute is responsible for discovery research, drug development, and pre-clinical trial research. JT's pharmaceutical development division and Akros Pharma Inc. undertake clinical trials and handle the application process to receive certification for any new drugs. Concerning compounds out-licensed for development and commercialization outside Japan, the licensees implement the subsequent processes.

<Production>

The JT Group's pharmaceutical products are produced by Torii Pharmaceutical or contract manufacturers outside the JT Group.

<Sales and promotion>

- Sales and promotion outside Japan

At present, the JT Group does not have its own sales organization for pharmaceutical products outside Japan. We out-license the right to develop and commercialize outside Japan for certain compounds in the development stage and receive royalties from our partners linked to their sales performance.

- Sales and promotion in Japan

Torii Pharmaceutical is mainly responsible for sales of our pharmaceutical products to pharmaceutical wholesalers and promotion to medical facilities. Promotional activities are conducted by 499 medical representatives (MRs) stationed at Torii Pharmaceutical's 14 sales branches across Japan.

REMITCH, the treatment drug of pruritus in hemodialysis patients and Truvada, an anti-HIV drug, are our main products among others.

## **Beverage Businesses**

JT decided by resolution at a meeting of the Board of Directors held on February 4, 2015, to withdraw from manufacture and sale of JT beverage products. The manufacture and sale of JT beverage products conducted by JT and JT Beverage Inc. is expected to be discontinued by the end of September 2015. The vending machine operation business conducted by Japan Beverage Holdings Inc. and other subsidiaries will continue to operate as before. Going forward, JT will consider various options for this business.

## **Processed Food Businesses**

The JT Group started its processed food business in 1998. Since then, we have been expanding the business through organic growth as well as business investments in the form of M&As and strategic partnerships.

In 2008, we acquired Katokichi Co., Ltd., a major frozen food manufacturing company in Japan, through a tender offer. The JT Group's processed food operations were transferred over to Katokichi as part of the integration. In 2010, Katokichi changed its corporate name to TableMark to pursue synergies and foster a sense of unity within the group. At present, that role is filled by a structure established through a company split conducted on April 1, 2014, with the aim of creating a flexible and competitive business management framework. This consists of the pure holding company TableMark Holdings Co., Ltd., the business company TableMark Co., Ltd., and TableMark group companies (hereinafter, collectively, "TableMark").

The business pillars of TableMark, which operates mainly in Japan, include frozen and ambient processed foods, mainly staple food products such as frozen noodles, frozen rice, packed rice and frozen bread, bakery chain outlets in the Tokyo metropolitan area and seasonings, including yeast, kelp and bonito extracts, combination seasonings and processed seasonings for direct consumer consumption such as oyster sauce. Major processed food products include "Reito-Sanuki-Udon" (frozen noodles), "Takitata-Gohan" (packed rice) and the "Vertex" yeast extract seasonings in particular.

#### <Research and development>

Regarding R&D, we devote our efforts to the development of innovative products that meet consumers' needs and preferences. In order to meet the diversifying needs of customers, we work to develop value-added products using TableMark's original techniques.

Specifically, we have used TableMark's original techniques for fermentation, baking and freezing to recreate and preserve the taste and texture of fresh bread, and developed frozen bread products which allow consumers to simply enjoy the taste of freshly baked bread at home. In addition, in the area of frozen noodles we developed a new production method, the "Tannen-jikomi" weaving and maturing process. This enabled us to realize udon noodle products with higher quality and higher added value.

#### <Procurement>

The first step to produce safe foods is to procure safe and high-quality raw materials. For the procurement, the JT Group reviews quality assurance certificates submitted by its suppliers. We also carry out monitoring inspections to check agrochemical residues as well as conduct regular inspections at processing factories to ensure compliance with the JT Group's internal standards, in addition to the Food Sanitation Act and other relevant laws.

Furthermore, we examine the safety of production sites for raw materials which are procured from overseas. Concerning agricultural farms, we check not only soil and water, but also how products are cultivated and how agrochemicals are handled. Breeding farms and fish farms are also inspected.

#### <Production>

The JT Group operates 22 factories in Japan and 8 outside Japan. We outsource production of some processed foods to domestic and international contract manufacturers. All of the JT Group's 30 factories in and outside Japan, as well as our business partners' factories which produce our frozen foods, have achieved the ISO 22000 certification. Under the ISO 22000 standard, continuous improvements are made following effective rules to control sanitation and other key issues. These rules are set based on the HACCP concept and their effectiveness is tested using scientific evidence. FSSC22000 has already been obtained at the Kanaya Plant of Group company Fuji Foods Corporation. We are making preparations for gradually obtaining this certification at other Group company plants while keeping the business environment under consideration.

#### <Marketing>

We analyze the market from consumers' point of view and, by combining the technology owned by TableMark, we strive to provide products with new values to expand the market and increase our place there. We strive for effective marketing in order to improve consumer awareness of our products.

#### <Sales and distribution>

We strive to enhance profitability through sales division structure optimization and our initiatives to increase our presence in supermarkets and convenience stores, by offering a wider range of products while also seeking better shelf space.

#### <Food safety>

To ensure that consumers can continue to enjoy our products safely, we have established an independent food safety management division at TableMark Holdings Co., Ltd., which is responsible for overall food safety controls. At TableMark, we have established Quality Control Centers in Tokyo and Qingdao (China), and we not only inspect and monitor the raw materials we use from the product planning and development stages, but also make inspections at factories at the time of production and before shipment, and carry out safety management throughout the product manufacturing process. We seek assessment and advice on our initiatives from external food safety experts. We reflect the experts' knowledge and viewpoints in our business by actively incorporating them into food safety controls.

Details of the food safety activities, including the discussions described in the above "Procurement" and "Production" sections, are disclosed on our website.

#### 4. Status of subsidiaries and affiliates

As of December 31, 2014

Name	Location	Capital (Millions of yen)	Principal business	Holding rate of voting rights (%)	Relationship				
					Interlocking of officers		Financial assistance	Business relationship	Facility leasing
					Officer of JT	Employee of JT			
(Consolidated subsidiaries) 215 companies									
TS Network Co., Ltd.	Taito-ku, Tokyo	460	Domestic tobacco	74.5	No	Yes	No	Consignment of tobacco products distribution	Yes
JT Logistics Co., Ltd.	Shibuya-ku, Tokyo	207	Domestic tobacco	100.0	No	Yes	No	Consignment of tobacco products and raw materials distribution	Yes
Japan Filter Technology Co., Ltd. *1	Shibuya-ku, Tokyo	461	Domestic tobacco	87.6	No	Yes	No	Purchase of filter for tobacco products	Yes
Fuji Flavor Co., Ltd.	Hamura-shi, Tokyo	196	Domestic tobacco	100.0	No	Yes	No	Purchase of flavors for tobacco products	No
JT Engineering Inc.	Sumida-ku, Tokyo	200	Domestic tobacco	100.0	No	Yes	No	Purchase of machines	Yes
JT International Group Holding B.V. *1	Netherlands	Thousands of USD 1,800,372	International tobacco	100.0	Yes	Yes	No	No	No
JT International Holding B.V. *1	Netherlands	Thousands of USD 1,800,372	International tobacco	100.0 (100.0)	No	Yes	No	No	No
JT International S.A. *1, *2	Swiss	Thousands of CHF 1,215,425	International tobacco	100.0 (100.0)	No	No	No	Approval of license and sale of tobacco products	No
Gallaher Ltd. *1	U.K.	Thousands of GBP 172,495	International tobacco	100.0 (100.0)	No	No	No	No	No
JTI Marketing and Sales CJSC *2	Russia	Thousands of RUB 108,700	International tobacco	100.0 (100.0)	No	No	No	No	No
LLC Petro	Russia	Thousands of RUB 328,439	International tobacco	100.0 (100.0)	No	No	No	No	No
Liggett-Ducat CJSC	Russia	Thousands of RUB 260,366	International tobacco	100.0 (100.0)	No	No	No	No	No
JT International Germany GmbH	Germany	Thousands of EUR 37,394	International tobacco	100.0 (100.0)	No	No	No	No	No
JTI Tütün Urunleri Sanayi A.S.	Turkey	Thousands of TRY 148,825	International tobacco	100.0 (100.0)	No	No	No	No	No
Torii Pharmaceutical Co., Ltd. *3	Chuo-ku, Tokyo	5,190	Pharmaceutical	54.5	No	No	No	Consignment of manufacturing and sale of products	No
Akros Pharma Inc.	U.S.A.	Thousands of USD 1	Pharmaceutical	100.0 (100.0)	No	Yes	No	Clinical development in overseas, consignment of survey	No
JT Beverage Inc.	Shinagawa-ku, Tokyo	90	Beverage	100.0	No	Yes	No	Consignment of selling beverages	Yes
Japan Beverage Holdings Inc.	Shinjuku-ku, Tokyo	500	Beverage	70.5	No	Yes	No	Sale of beverages through JT Beverage Inc.	Yes
TableMark Holdings Co., Ltd. *1	Chuo-ku, Tokyo	47,503	Processed food	100.0	No	Yes	Yes	No	No
TableMark Co., Ltd. *1	Chuo-ku, Tokyo	22,500	Processed food	100.0 (100.0)	No	Yes	No	No	Yes
Other 195 companies *1									
(Companies accounted for by the equity method) 12 companies									
Megapolis Distribution B.V.	Netherlands	EUR 15	International tobacco	20.0 (20.0)	No	No	No	No	No
Other 11 companies									

- Notes: 1. Descriptions in the “Principal business” column are names of segments.  
 2. The figures in parentheses in the “Holding rate of voting rights” column are indirect holding rates included in the figures outside the parentheses.  
 3. “Interlocking of officers” includes interlocking of officers of associated companies and secondment of officers of JT.  
 4. \*1: These companies are classified as specified subsidiaries. Companies that fall under the category of specified subsidiaries included in “Other 195 companies” are as follows.  
 JTI-Macdonald Corp., JTI (UK) MANAGEMENT LTD, JT Canada LLC Inc., Gallaher Europe Finance, Austria Tabak GmbH  
 5. \*2: Revenues of JT International S.A. and JTI Marketing and Sales CJSC (excluding revenue among the consolidated companies) exceed 10% of consolidated revenue of the JT Group.

Name	Major profit/loss information (Millions of yen)				
	Revenue	Profit before income taxes	Profit for the year	Total equity	Total assets
JT International S.A.	523,701	100,084	90,003	373,728	938,361

Name	Major profit/loss information (Millions of yen)				
	Revenue	Profit before income taxes	Profit for the year	Total equity	Total assets
JTI Marketing and Sales CJSC	299,542	110,912	87,775	71,750	133,215

6. \*3: This company files Annual Securities Report.  
 7. Consolidated subsidiary Green Foods Co., Ltd. is insolvent, with liabilities exceeding assets by ¥11,240 million. Green Foods Co., Ltd. suspended business operations in December 2012.



## 5. Status of employees

### (1) Consolidated companies

(As of December 31, 2014)

Segment	Number of employees (Person)
Domestic Tobacco Business	11,648 [3,432]
International Tobacco Business	25,829 [2,533]
Pharmaceutical Business	1,840 [182]
Beverage Business	5,122 [376]
Processed Food Business	5,968 [2,091]
Common company-wide services within the filing company	934 [86]
Total	51,341 [8,700]

Notes: 1. The number of employees indicates the number of working employees, and the average number of temporary employees during this fiscal year ended December 31, 2014 is given in parentheses separately.

2. The number of employees in the "Common company-wide services within the filing company" row is the number of those working for departments unclassifiable to specific segments, such as the administrative department.

### (2) Filing company (JT)

(As of December 31, 2014)

Number of employees (Person)	Average age (Year old)	Average years of service (Year)	Average annual salary (Yen)
8,915 [1,272]	44.4	21.8	8,757,255

The numbers of employees by segment are as follows.

Segment	Number of employees (Person)
Domestic Tobacco Business	7,545 [1,264]
Pharmaceutical Business	745 [4]
Beverage Business	71 [2]
Common company-wide services within the filing company	554 [2]
Total	8,915 [1,272]

Notes: 1. The number of employees indicates the number of working employees, and the average number of temporary employees during this fiscal year ended December 31, 2014 is given in parentheses separately.

2. The number of employees in the "Common company-wide services within the filing company" row is the number of those working for departments unclassifiable to specific segments, such as the administrative department.

3. The number of employees includes contract employees (83), employees on leave (110) and employees transferred to JT (70), but excludes employees transferred from JT (959).

4. Average years of service includes years of service at Japan Tobacco and Salt Public Corporation.

5. Average annual salary (including taxes) includes bonuses and surplus wages.

6. Although the fiscal year ended December 31, 2014, is a 9-month period due to a change of the fiscal year end, the average annual salary presented is based on the 12 months from January 1 through December 31, 2014.

**(3) Status of labor union**

In the JT Group, the labor-management relations are stable and there are no matters that should be reported.

## **II. Review of operations**

### **1. Overview of operating results**

JT changed its fiscal year end from March 31 to December 31 effective from the fiscal year ended December 31, 2014. The same change was made to consolidated subsidiaries with fiscal year ends other than December 31.

As a consequence of this change, the fiscal year ended December 31, 2014 was the 9-month period from April 1, 2014 to December 31, 2014, for JT and its main consolidated subsidiaries that do not belong to the international tobacco business segment. For consolidated subsidiaries that belong to the international tobacco business segment, the fiscal year ended December 31, 2014 was the 12-month period from January 1, 2014 to December 31, 2014.

In the following information, in order to provide a basis to enable comparisons that contribute to investment decisions, some figures provided may have been calculated on the assumption that the fiscal period of JT and all of its consolidated subsidiaries was January through December in both the previous fiscal year and the fiscal year ended December 31, 2014. However, in cases where there is no statement to that effect, the figures provided are based on the fiscal periods and fiscal year ends under the accounting system.

Revenue, operating profit, adjusted operating profit and profit attributable to owners of the parent company for all companies in the period from January through December 2014 are provided in "V. Accounting." On the other hand, although the figures for the period from January through December 2013 were calculated using the same method used for the period from January through December 2014, they are reference figures that have not been audited.

(Non-GAAP financial measures)

The Group also discloses certain additional financial measures that are not required or defined under IFRS, which is the accounting standard JT applies. These financial measures are used internally to manage each of our business operations to understand their underlying performance, in view of our target for mid- to long-term sustainable growth, and we believe that they provide useful information for users of our financial statements to assess the Group's performance.

#### **Core revenue**

For tobacco business, core revenue is disclosed additionally as a breakdown of revenue. Specifically, the revenue for the domestic tobacco business is presented after deducting imported tobacco delivery charges, among others, while the revenue for the international tobacco business is presented after deducting the revenue accounted for in distribution business and contract manufacturing, among others.

#### **Adjusted operating profit**

In order to provide useful comparative information on our performance, adjusted operating profit presented is operating profit less amortization of intangible assets associated with acquisitions and adjustment items (income and costs). Adjustment items (income and costs) are impairment losses on goodwill, and restructuring income and costs, and other items.

Furthermore, adjusted operating profit (at constant rates of exchange) growth rate in the consolidated performance is also presented as additional information. This is a financial measurement that excludes foreign exchange effects by translating and calculating adjusted operating profit for the current period in the international tobacco business using the foreign exchange rates of the same period of the previous fiscal year.

## (1) Operating results

Information provided in (1) Operating results has been calculated on the assumption that the fiscal period of JT and all of its consolidated subsidiaries was a 12-month period from January through December.

### <Revenue>

Revenue increased by ¥61.3 billion or 2.6%, from the same period of the previous year to ¥2,433.5 billion. This was mainly the result of favorable pricing in the international tobacco business and weaker yen.

(Billions of yen)

	January through December 2013	January through December 2014	Change	
Revenue	2,372.2	2,433.5	61.3	2.6%
Domestic Tobacco Business	690.5	685.9	(4.6)	(0.7)%
Of which, core revenue	656.3	649.8	(6.5)	(1.0)%
International Tobacco Business	1,270.0	1,328.0	58.0	4.6%
Of which, core revenue	1,200.7	1,258.2	57.5	4.8%
Pharmaceutical Business	58.2	65.8	7.6	13.1%
Beverage Business	183.8	181.3	(2.5)	(1.4)%
Processed Food Business	157.2	161.2	4.0	2.6%

\* Figures exclude intersegment revenue.

\* Revenue includes rent received from leased properties in addition to items relating to the segments shown above.

### <Operating profit, adjusted operating profit and profit attributable to owners of the parent company>

Adjusted operating profit increased by ¥47.5 billion, or 7.8%, from the same period of the previous year to ¥660.1 billion. This was mainly the result of favorable pricing in the international tobacco business and weaker yen. Adjusted operating profit at constant rates of exchange increased by 10.6% from the same period of the previous year. Operating profit decreased by ¥70.9 billion, or 11.0%, from the same period of the previous year to ¥571.8 billion, mainly due to recording of costs associated with measures to strengthen the competitiveness of the domestic tobacco business and restructuring of manufacturing facilities in Europe in the international tobacco business.

Profit attributable to owners of the parent company decreased by ¥54.0 billion, or 12.2%, from the same period of the previous year to ¥389.1 billion.

(Billions of yen)

	January through December 2013	January through December 2014	Change	
Adjusted operating profit	612.6	660.1	47.5	7.8%
Domestic Tobacco Business	234.6	238.7	4.1	1.8%
International Tobacco Business	410.8	447.1	36.2	8.8%
Pharmaceutical Business	(13.7)	(7.3)	6.3	–
Beverage Business	(2.1)	(0.5)	1.6	–
Processed Food Business	0.6	1.4	0.8	136.5%
Operating profit	642.7	571.8	(70.9)	(11.0)%
Profit attributable to owners of the parent company	443.0	389.1	(54.0)	(12.2)%

\* Operating profit and adjusted operating profit include business activities relating to rent of real estate and corporate expenses relating to corporate communication and operation of the head office in addition to operating profit and adjusted operating profit relating to factors other than the segments shown above.

\* Adjusted operating profit, operating profit and profit attributable to owners of the parent company for the period from January through December 2013 are calculated using the same method used for the period from January through December 2014.

Operating results by segment are as follows.

### Domestic Tobacco Business

In the period from January through December 2014, despite our continuing efforts to further strengthen brand equity in order to achieve customer retention, sales volume decreased by 3.6% from the same period of the previous year due to a decline in total demand following the consumption tax hike and an intensification of competition.

Although market share fell as low as 59.1% in April, it has been firm since May owing to traction from Mevius and other focus brands, and our market share from January through December 2014, was 60.4% (compared with 60.5% for the same period of the previous year).

Domestic Tobacco Business	January through December 2013	January through December 2014	Change	
Sales volume	116.5	112.4	(4.2)	(3.6)%

\* In addition to the figure stated above, during January through December 2014, 3.4 billion cigarettes were sold at duty-free shops in Japan, as well as at markets in China, Hong Kong and Macau that are under the control of JT's China Division (3.3 billion cigarettes in the same period of the previous year).

The decline in sales volume was partially offset by favorable pricing resulting from customer retention, and core revenue decreased by 1.0% from the same period of the previous year. Domestic cigarette revenue per 1,000 cigarettes was ¥5,617.

On the other hand, adjusted operating profit increased by 1.8% from the same period of the previous year, despite the decrease in sales volume, partly due to continued cost reductions.

Domestic Tobacco Business	January through December 2013	January through December 2014	Change	
Revenue	690.5	685.9	(4.6)	(0.7)%
Of which, core revenue	656.3	649.8	(6.5)	(1.0)%
Adjusted operating profit	234.6	238.7	4.1	1.8%

The volume of cigarettes manufactured in Japan in the period from January through December 2014 decreased by 5.4 billion cigarettes, or 4.0%, from the same period of the previous year to 128.4 billion cigarettes.

### International Tobacco Business

In the period from January through December 2014, despite increasing market share in multiple key markets such as U.K. and Spain, total shipment volume decreased by 4.7% from the same period of the previous year due mainly to a decrease in total demand in Russia, and shipment volume among GFBs decreased by 2.0%.

International Tobacco Business	January through December 2013	January through December 2014	Change	
Shipment volume	417.5	398.0	(19.5)	(4.7)%
Of which, GFBs	267.5	262.2	(5.3)	(2.0)%

\* The translation method for RYO/MYO<sup>(Note)</sup> has been partially amended.

Although there were impacts from the decrease in shipment volume, and from unfavorable foreign exchange effects on some local currencies, particularly the ruble, dollar-based core revenue declined by 3.0% from the same period of the previous year and adjusted operating profit increased by 1.1%, partly due to favorable pricing. Adjusted operating profit at constant rates of exchange increased by 13.1%.

International Tobacco Business (U.S. dollar-based)	January through December 2013	January through December 2014	Change	
Revenue	12,985	12,573	(412)	(3.2)%
Of which, core revenue	12,273	11,911	(363)	(3.0)%
Adjusted operating profit	4,206	4,253	47	1.1%

As a result of the effects of weaker yen when making conversions to that currency, yen-based core revenue increased 4.8% and adjusted operating profit increased 8.8% from the same period of the previous year.

(Billions of yen)

International Tobacco Business	January through December 2013	January through December 2014	Change	
Revenue	1,270.0	1,328.0	58.0	4.6%
Of which, core revenue	1,200.7	1,258.2	57.5	4.8%
Adjusted operating profit	410.8	447.1	36.2	8.8%

The volume manufactured overseas including outsourced manufacturing in the period from January through December 2014 decreased by 20.8 billion cigarettes, or 4.9%, from the same period of the previous year to 405.8 billion cigarettes.

Note: RYO, which is an abbreviation of Roll Your Own, signifies fine cut tobacco to be used by a customer to roll a cigarette by hand, using rolling paper. MYO, which is an abbreviation of Make Your Own, signifies fine cut tobacco to be used by a customer to make a cigarette, using a specialized tool and cigarette tubes.

\* The exchange rates of currencies against the U.S. dollar were as follows.

Foreign exchange rate per U.S. dollar	January through December 2013	January through December 2014
Yen	97.73	105.79
Ruble	31.84	38.40
Pounds sterling	0.64	0.61
Euro	0.75	0.75

## Pharmaceutical Business

In the pharmaceutical business, we are striving to establish a stronger profit platform by maximizing the value of each product and promoting R&D on next-generation strategic products. In the area of product development, the number of compounds developed in-house that are under clinical development is now 10.

In the period from January through December 2014, in November 2014 the JAK inhibitor JTE-052 was out-licensed to LEO Pharma for development and commercialization globally excluding Japan for topical treatment of skin conditions. As for original JT compounds that have been out-licensed, Gilead Sciences, Inc., which is the licensee for JTK-303, has filed marketing applications for the anti-HIV drug “elvitegravir (JTK-303)/cobicistat/emtricitabine/tenofovir alafenamide tablets” to the US Food and Drug Administration (FDA) and European Medicines Agency (EMA). JT Group company Torii Pharmaceutical Co., Ltd. started sales in Japan of hyperphosphatemia treatment Riona<sup>®</sup> Tablets 250mg in May 2014 and of CEDARTOLEN<sup>®</sup> SUBLINGUAL DROP - Japanese Cedar Pollen, a sublingual immunotherapy drug for Japanese cedar pollinosis, in October 2014. In addition, an application for manufacturing and marketing approval in Japan was filed in January 2015 for TO-203, an allergen immunotherapy drug for patients with house dust mite allergies, for the indication of allergic rhinitis.

Revenue in the period from January through December 2014 increased by ¥7.6 billion, or 13.1%, from the same period of the previous year to ¥65.8 billion. This was due to increased royalty income from expansion in sales of original out-licensed compounds, and growth in sales of Riona<sup>®</sup> Tablets 250mg (hyperphosphatemia treatment), Stribild<sup>®</sup> Combination Tablets (anti-HIV drug) and others at Torii Pharmaceutical Co., Ltd. Adjusted operating loss improved by ¥6.3 billion to adjusted operating loss of ¥7.3 billion (compared to adjusted operating loss of ¥13.7 billion in the same period of the previous year) mainly due to the increase in revenue.

## Beverage Business

In the beverage business, we continued striving to improve profitability. To this end, we not only implemented product launches centered on the flagship coffee brand “Roots,” but also enhanced expenditure execution efficiency throughout the business, and continued to implement productivity improvement measures centered on Japan Beverage Holdings Inc., a Group company that operates vending machines.

Revenue in the period from January through December 2014 decreased by ¥2.5 billion, or 1.4%, from the same period of the previous year to ¥181.3 billion, due to the effect of unseasonable weather patterns over the summer and

intensification of competition in store sales channels. Adjusted operating loss improved ¥1.6 billion to ¥0.5 billion (compared with an adjusted operating loss of ¥2.1 billion in the same period of the previous year) due mainly to efficient execution of expenditure and a reduction in raw material costs, despite the effect of lower revenue.

### **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 rice and baked frozen bread, bakery chain outlets in the Tokyo metropolitan area, and seasonings including yeast extracts and oyster sauce. In the processed food business, we make every effort to produce strong staple food products with established market shares and work to improve cost competitiveness, thus striving to improve profitability.

Revenue in the period from January through December 2014 increased by ¥4.0 billion, or 2.6%, from the same period of the previous year to ¥161.2 billion, due mainly to sales growth in staple food products. Adjusted operating profit increased by ¥0.8 billion, or 136.5%, from the same period of the previous year to ¥1.4 billion as a result of the increase in revenue.

## **(2) Cash flows**

Cash and cash equivalents at the end of the fiscal year ended December 31, 2014 increased by ¥132.6 billion from the end of the previous fiscal year to ¥385.8 billion. Cash and cash equivalents at the end of the previous fiscal year was ¥253.2 billion.

- \* In Japan, the end of the fiscal year ended December 31, 2014 (December 31, 2014) was a holiday for financial institutions. Consequently, an additional month's worth of tobacco excise taxes payable is included in cash and cash equivalents at the period-end in comparison to the equivalent amounts if the period-end had been a business day for financial institutions. The amount of national excise taxes paid on the business day immediately following the end of the fiscal year ended December 31, 2014 was ¥136.8 billion.

### **Cash flows from (used in) operating activities**

Net cash flows from operating activities during the fiscal year ended December 31, 2014 were ¥543.7 billion, compared with ¥396.5 billion provided in the previous fiscal year. The main driver was the generation of a stable cash inflow from our tobacco business. As a result of holidays for financial institutions, the amount of tobacco excise taxes paid in Japan for the previous fiscal year is for 13 months, while the amount for the fiscal year ended December 31, 2014 is for 8 months.

### **Cash flows from (used in) investing activities**

Net cash flows used in investing activities during the fiscal year ended December 31, 2014 were ¥49.1 billion, compared with ¥163.5 billion used in the previous fiscal year, due mainly to the purchase of property, plant and equipment, despite proceeds from the sale of investment property.

### **Cash flows from (used in) financing activities**

Net cash flows used in financing activities during the fiscal year ended December 31, 2014 were ¥388.9 billion, compared with ¥145.2 billion used in the previous fiscal year, due mainly to the payment of cash dividends and the redemption of bonds.

## **(3) Parallel disclosure**

The differences between the main items in the consolidated financial statements prepared in accordance with IFRS and the equivalent items in the consolidated financial statements as prepared in accordance with Japanese GAAP are as described below.

### **(Amortization of goodwill)**

Under Japanese GAAP, we estimated substantially the amortization period and goodwill was amortized over the years estimated; however, amortization after the date of transition to IFRS is suspended.

As a result of the impact from this change, amortization of goodwill (selling, general and administrative expenses) has decreased by ¥91,925 million for the fiscal year ended December 31, 2014 and by ¥88,793 million for the previous fiscal year under IFRS in comparison with under Japanese GAAP.



## 2. Status of production, orders received and sales

The JT Group conducts production and sales of broad and various products in the domestic tobacco business, international tobacco business, pharmaceutical business, beverage business and processed food business. Moreover, the types, formats, content volumes, and packages of their products are broad, and major products are not based on a made-to-order basis. For this reason, size of production and orders received are presented neither in the amount of money nor in volume by segment.

Therefore, details of “production, orders received and sales” are presented in connection with the operating results by segment in “1. Overview of operating results.”

Regarding business partners which are the source for 10% or more of JT Group’s total revenue, the revenue from such partners and the percentage of total revenue are as follows.

Business partner	Fiscal year ended March 31, 2014		Fiscal year ended December 31, 2014	
	Amount (Billions of yen)	Percentage	Amount (Billions of yen)	Percentage
Megapolis Group	358.0	14.9	335.4	15.6

Note: The JT Group’s international tobacco business sells products to Megapolis Group, which runs logistics and wholesale businesses mainly in Russia.

### 3. Issues to be addressed

We recognize that the increasing uncertainties in the business environment in which the JT Group operates due to uncertainties in the global economy, heightened foreign exchange risks and increasing geopolitical risks. Enhancing adaptability to such a changing environment remains critical to achieve sustainable profit growth by leveraging on the uncertain business environment and adequately executing business on a global scale. “Adaptability” refers to the ability to assume a wider range of contingencies than in the past, during the planning phase, and to quickly and flexibly respond to changes and events that surpass our assumptions so that we can deal with increasing uncertainty over the future. We believe that how well and how quickly companies can overcome uncertainties will be the key to determine their competitiveness.

Based on the concept of strengthening adaptability to a changing environment, the JT Group’s business plan covers a three-year period, and rolled-over annually in order to speed up the Group’s ability to respond appropriately to unexpected changes.

JT decided by resolution at a meeting of the Board of Directors held on February 4, 2015, to withdraw from manufacture and sale of JT beverage products in the beverage business.

#### (1) Management principle

Our management principle is based on the pursuit of the “4S” model (“S” is for satisfaction). We will balance the interests of consumers, shareholders, employees and wider society, and fulfill our responsibilities towards them, aiming to exceed their expectations.

We created our vision and mission based on the “4S” model. Our vision is to become a company committed to global growth by providing diversified value that is uniquely available from JT Group. Our mission is to create, develop and nurture our unique brands to win consumer trust, while understanding and respecting the environment and the diversity of societies and individuals.

In achieving our mission, we have set “The JT Group Way” as code of conduct which all of the JT Group members are committed to: “fulfilling the expectations of our consumers and behave responsibly”, “striving for quality in everything we do through continuous improvement”, and “leveraging diversity across the JT Group”.

The JT Group has attained sustainable profit growth and will continue to do so through the pursuit of the “4S” model. Since attaining sustainable profit growth requires us to continue to provide new value and satisfaction to consumers, we believe it is essential to steadily make business investments for future mid-to long-term profit growth. We believe that the pursuit of the “4S” model will lead to a consistent increase in corporate value in the mid- to long-term and therefore that it is the best approach to serve the interests of all stakeholders.

#### (2) Allocation of management resource

Concerning 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 the management principles.

Of our core businesses, we regard the tobacco business as the core business and profit growth engine, so we place top priority on business investments that will lead to the sustainable profit growth of the tobacco business. In the meantime, we will invest and devote efforts to strengthen the business foundations of the pharmaceutical and processed food businesses in order to generate future profits.

JT seeks to provide shareholder returns that are attractive for a company in the global Fast-Moving Consumer Goods (FMCG) sector<sup>(Note 1)</sup>. In accordance with these priorities, JT has put in place targets for the consolidated dividend payout ratio<sup>(Note 2)</sup> and adjusted earnings per share (EPS)<sup>(Note 3)</sup> growth rate at constant rates of exchange. In achieving its adjusted EPS growth rate target at constant rates of exchange, JT will base such improvements mainly on business growth, while considering share buy-backs as a complementary initiative.

Notes: 1. Fast Moving Consumer Goods (daily consumer goods)

2. Consolidated dividend payout ratio is obtained by dividing annual dividend per share by basic earnings per share.

3. Adjusted EPS = (Profit or loss attributable to owners of the parent company ± adjustment items (income and costs)\* ± tax and minority interests adjustments) / (weighted-average common shares + increased number of ordinary shares under subscription rights to shares)

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

### **(3) Company-wide profit targets and policy on shareholder return**

The JT Group has set company-wide profit targets and a mid- to long-term guidance on shareholder return in the Business Plan 2015 in accordance with the management principles and the resource allocation policy.

For adjusted operating profit growth rate (at constant rates of exchange), which is the company-wide profit target, JT aims to achieve mid to high single-digit growth per annum over the mid- to long-term at constant rates of exchange.

Regarding shareholder return, in order to be on par with global players in the FMCG business with a consolidated dividend payout ratio of at least 50%, JT aims to realize a consolidated dividend payout ratio of 50% in the fiscal year ending December 31, 2015. JT also aims to achieve an adjusted EPS growth rate of high single-digit per annum over the mid- to long-term at constant rates of exchange.

### **(4) Basic strategies for attaining company-wide profit targets**

As basic strategies for attaining our targets, we will strive for “achieving quality top-line growth,” “strengthening cost competitiveness” and “strengthening business foundations,” implementing the strategies based on the concept of selection and focus.

Mainly, we place emphasis on “achieving quality top-line growth” and concentrating resources in key brands and product categories, in order to increase value added to products and services, as described in the following explanations of business strategies.

Concerning “strengthening cost competitiveness,” we aim at improving profitability and enhancing cash generation capability by optimizing business and corporate costs and establishing quick and efficient business operation systems, while leveraging our efforts of maintaining and enhancing quality.

Additionally, we will reinforce our business continuity capabilities, as the experience of the Great East Japan Earthquake has reminded us of the importance of doing so. We will seek to simultaneously improve business continuity capabilities and cost competitiveness.

When strengthening business foundations, it is critical to accurately identify changes in the business environment and to keep ourselves ready to readjust in order to meet challenges without being constrained by precedents. We will make continuous improvement efforts from that perspective. In addition, we will maximize synergies by leveraging the diversity of our global footprint as represented by our worldwide business operations, which are spread across at least 70 countries and territories, and our global workforce, which represents at least approximately 110 nationalities, and by promoting collaboration on a global scale. As we strongly believe that the quality of human resources is the key to business activity and performance, we will strengthen human resource development.

In summary, we will maintain the “4S” model as the basis of the JT Group’s management principles, enhance our ability to adapt to changes and consistently execute our growth strategy. Through these initiatives, we will achieve sustainable profit growth and continuously increase corporate value in the mid- to long-term.

#### **a. Tobacco business**

The tobacco business is the JT Group’s core business and profit growth engine and aims for annual average growth at a mid to high single-digit rate over the mid- to long-term for adjusted operating profit growth rate (at constant rates of exchange). The domestic tobacco business acts as highly competitive platform of profitability, while the international tobacco business serves as the profit growth engine of the JT Group.

#### **<Quality top-line growth>**

- Maintaining and increasing shares in our key markets through brand equity enhancement

Over the past years, our tobacco business has grown its share in most of our key markets; this performance is mainly the result of our outstanding brand portfolio.

In order to further grow market share, we will continue strengthening our brands, especially our Global Flagship Brands, through consistent investments.

At the same time, we will also strengthen our local brands. These diverse local brands allow us to meet the unique preferences of the consumers and complement our brand portfolios in the diverse markets and regions where we are active. In the Japanese market, for example, in addition to our GFB Mevius, our focus has been on local brands Seven Stars and Pianissimo and we will continue to invest in these brands to enhance their

equity. We will continue to focus our investments in innovation, as it is one of the most effective methods to enhance brand equity.

Our innovation efforts target five key elements which add value to our tobacco products: 1) tobacco blends, 2) flavors, 3) filters and other non-tobacco materials—these three are important elements to determine quality of taste—4) capability to process these innovations into products and 5) package design, which is critical to visual quality.

We recognize the growing importance of connection especially at point-of-sale for “brand communications” with consumers, which support share gains, since the use of mass media (TV, radio, newspapers and magazines) to promote tobacco products is severely restricted by regulations on advertisement and promotion.

With this in mind, we will enhance our trade marketing activities to improve point-of-sale visibility. Our approach will be tailored to each market, where local regulations, the key sales channels, consumers’ purchasing patterns and competitors’ trade marketing tactics vary greatly among one another. The approach includes, for example, building mid- to long-term partnerships with key accounts and designing unique promotional activities for each account.

- Broadening the base

Over the years, we have increased our presence as a leading global tobacco manufacturer through large-scale M&As, most notably RJR Nabisco’s non-US tobacco operations in 1999 and Gallaher Group Plc. in 2007.

The geographical expansion achieved with these two acquisitions has been the main driver of our growth for over a decade. The success of these acquisitions, owing in part to the prompt postmerger integration within our business, has reinforced our global business base.

Following the acquisitions mentioned above, we have built a geographical portfolio of businesses with a good balance between high-margin markets primarily in developed countries and high-growth markets primarily in emerging countries. Of particular note are the acquisitions of Haggar Cigarette & Tobacco Factory Ltd., which has the largest market share in Sudan and also operates in the new Republic of South Sudan, Gryson NV, which is headquartered in Belgium and has established an important presence in the Roll Your Own (“RYO”) and Make Your Own (“MYO”) market across several European countries as well as in a number of other countries, and Al Nakhla Tobacco Company S.A.E. and Al Nakhla Tobacco Company - Free Zone S.A.E., major global companies that are headquartered in Egypt and engaged in the manufacture and sale of waterpipe tobacco products. Moving forward, we will continue to seek out growth opportunities. The strengthening of our tobacco business base as well as expansion into emerging markets will help promote organic growth. In addition, growth opportunities will be pursued by other strategic alternatives that may arise.

- Creation of a new product category

Currently, the JT Group’s tobacco business focuses mainly on conventional cigarettes, while seeking business opportunities in the existing other tobacco product categories, such as cigars and pipes.

In the tobacco business, as the business environment and consumers’ needs evolve, it is essential for us to aim to introduce innovative new product categories, with unique value propositions. We believe that this is one of our important strategies for quality top line growth. Developing an innovative new category requires understanding of consumers’ preferences as well as regulations in each country or region. It is also challenging from a technological standpoint. Nevertheless, we see the creation of new categories as essential to our mid- to long-term growth, and we will aggressively invest to introduce innovative new product categories.

So far, the JT Group has launched “Ploom,” a method of tobacco consumption in which consumers can enjoy tobacco taste and flavor with special tobacco pods containing tobacco leaves that are heated not with a flame but a battery-powered heating piece, in Austria, Italy, Korea, Japan, France and the U.K. In February 2015, JT acquired intellectual property rights for the Ploom brand, and JT will further strengthen its initiatives in this field. In 2014, JT acquired Zandera Ltd., an industry leader in e-cigarettes and best known for its E-Lites brand. In the Japanese market the JT Group has launched “Zerostyle,” a smokeless tobacco product which can be used in a variety of places without causing disturbance to those around the consumer.

We will continue to focus on the creation of new product categories, leveraging our own technologies as well as exploring external opportunities.

#### <Strengthening cost competitiveness>

Our tobacco business will persistently pursue continuous cost efficiency improvement of our operations, in particular with respect to the global supply chain, with an emphasis on agility and efficiency without compromising quality.

We will enhance our cost competitiveness by optimizing the global supply chain through various initiatives, including: further vertical integration in global leaf procurement; extended use of common non-tobacco materials; increased collaboration among suppliers; flexible procurement to benefit from attractive market prices; and improved inventory management for both tobacco and non-tobacco materials. Furthermore, enhanced productivity through realignment of manufacturing process and optimal level of capital expenditures will ensure conversion cost containment. We are also determined to improve our business continuity capability by securing options for sourcing and geographically spreading critical functions. Specifically, we will ensure a framework of multiple supply sources, optimal manufacturing capacity allocation on a global basis and diversification of production capability for priority SKUs (Stock Keeping Units).

We will improve our margin through increased cost efficiency while maintaining quality, and enhance cash flow generation by optimizing working capital and capital expenditures.

With the aim of realizing sustainable growth, we have decided to restructure our sales operations to strengthen competitiveness and to close two tobacco manufacturing factories and two other tobacco-related factories to further strengthen cost competitiveness.

#### <Strengthening business foundations>

We believe that human resource development is the key driver of sustainable profit growth in the tobacco business.

The JT Group has business operations in at least 70 countries and territories, and our global workforce of employees representing at least approximately 110 nationalities works regardless of nationality, gender and age. We maximize synergies by leveraging this diversity and promoting collaboration on a global scale.

As we believe that the quality of human resources is the key to business activity and performance, we will strengthen human resource development and enhance our ability to recruit, develop and retain employees on a global basis.

The tobacco business remains committed to increasing its presence as a leading global tobacco manufacturer and further strengthening its role as the core business and profit growth engine of the JT Group, by steadily implementing the above business strategies.

#### b. Pharmaceutical business

The JT Group's pharmaceutical business will strive to establish a stronger earnings base through the maximization of each product's value and the promotion of R&D on next-generation strategic products. With this goal in mind, we will concentrate business resources on three priority areas where we have R&D experience and have built up know-how: 1) glucose and lipid metabolism, 2) virus research, and 3) immune disorders and inflammation. Our immediate goal is to achieve profitability in the near future, while maintaining our continued investments in R&D to realize mid- and long-term optimization of resource allocation.

#### <Strengthening the earnings base>

To strengthen the earnings base further, we will step up efforts to promote R&D on next-generation strategic products and seek optimum timing for out-licensing, and maximize the value of each product, as key tasks.

- Promoting R&D on next-generation strategic products and seeking optimum timing for out-licensing

Promoting R&D on next-generation strategic products is a key task from the perspective of the sustainable development of the JT Group's pharmaceutical business. Market launch of new drugs is becoming increasingly difficult every year. However, the JT Group will explore appropriate drug development opportunities by collecting information concerning unmet needs of medical facilities around the world. We will also conduct flexible research management, carefully tailored to each drug candidate.

With the intensification of worldwide R&D competition in recent years, it is essential to define a sophisticated development strategy that takes into account of the requirements of medical facilities and implementation of clinical tests quickly. In order to accelerate the speed of our R&D and swiftly provide the new drugs we have created to patients around the world, we not only promote in-house development but also continue to out-license compounds to other companies, particularly global pharmaceutical companies, and aggressively explore alliance opportunities.

- Maximizing the value of each product

In 2013 and after, we launched in Japan Stribild<sup>®</sup> Combination Tablets (anti-HIV drug), Riona<sup>®</sup> Tablets, a hyperphosphatemia treatment, CEDARTOLEN<sup>®</sup> SUBLINGUAL DROP - Japanese Cedar Pollen, a sublingual immunotherapy drug. Outside Japan, all of our licensing partners are currently selling Stribild<sup>®</sup> Combination Tablets (anti-HIV drug) and Mekinist<sup>®</sup> (melanoma treatment).

In order to maximize our contribution to medical facilities through these products, we will work to steadily spread the products in the market in close partnership with JT Group company Torii Pharmaceutical Ltd. and our licensing partners.

In order to conduct these various activities in an effective manner, we recognize the urgent requirement of training personnel who can collect accurate information regarding unmet needs at medical facilities and the latest pharmaceutical research, and use the information to formulate a sophisticated development strategy and a strategy to maximize product value, and global personnel capable of competing with academia and pharmaceutical companies around the world. We will concentrate efforts on our initiatives for these purposes.

#### c. Processed food business

The JT Group's processed food business will strive to achieve an operating profit margin on par with the industry average with the aim of making a profit contribution to the Group.

##### <Quality top-line growth>

With TableMark taking a central role, the processed food business is primarily engaged in business concerning frozen and room temperature processed food, mainly staple food products such as frozen noodles, frozen rice, packed rice and baked frozen bread, bakery chain outlets in the Tokyo metropolitan area, and seasonings including yeast extracts and oyster sauce. In the processed food business, we make every effort to produce strong staple food products with established market shares. Specifically, in the area of product line-up, we plan to create products that offer good value for the price from consumers' perspective while using our unique technology. This will be achieved by improving our ability to identify consumers' needs, generate ideas based on the identified needs, and transform the generated ideas into products. Concerning marketing, we will develop effective and efficient advertising and promotional activities in line with this product strategy and reinforce our trade marketing capabilities. By adopting these measures, we aim to further expand our market share.

##### <Strengthening cost competitiveness>

In the processed food business, we have a variety of cost containment programs, including strengthening our raw materials procurement capabilities, efficiently managing the distribution network, and improving the productivity of the JT Group factories. In addition, consistent group-wide efforts will be made to lower fixed costs, including more efficient use of sales activity expenditures, through better selection and focus of promotional activities. By these means, we will work to improve cost competitiveness.

##### <Strengthening business foundations>

- Food safety control

Looking ahead, we will continue to manage our businesses while taking all possible measures to ensure food safety control from the four perspectives of "food safety," "food defense," "food quality" and "food communication" in order to deliver safe and high-quality food products to our customers.

Regarding “food safety,” we will seek to minimize risks by utilizing food safety management systems already introduced.

Regarding “food defense,” we will further promote the already implemented Food Defense Program in order to prevent purposeful attacks.

Regarding “food quality,” we will pursue “deliciousness,” which should be the fundamental quality of foods. We will also seek to enhance product added value and customer satisfaction through continued improvement in accordance with inquiries and information from customers.

Regarding “food communication,” we will conscientiously listen to the voices of customers and actively provide information so as to make our activities more visible to the outside.

- Human resource development

Development of human resources that support our business activities is critically important. Competence development programs as well as appropriate career paths of our employees will be created and implemented in order to develop personnel with various skills including marketing expertise and product development knowhow.

## 4. Business and other risks

Listed below are items that, among those relating to the review of operations and accounting revealed in the Annual Securities Report, may significantly influence investor decisions. The following includes forward-looking statements determined, unless otherwise indicated, as of the filing date.

### (1) Items relating to the business, profit structure and management policy of the JT Group

#### a. Significance of tobacco revenue from the Japanese market in consolidated revenue

The JT Group operates in at least 70 countries and territories around the world, mainly in the tobacco business, and sells products in at least 120 countries. Among these, tobacco revenue in the Japanese market makes a considerable contribution to the Group's revenue. Accordingly, any adverse influence on the Japanese market may negatively impact the result of the JT Group as a whole (for details of risks relating to the JT Group's tobacco business, see (2) below).

#### b. Business expansion

The JT Group believes that the pharmaceutical business and processed food business will contribute to its future earnings and the Group plans to invest in these businesses, however, there are no guarantees as to the returns expected from these investments.

The JT Group worked proactively to obtain external resources for the business expansion for its international tobacco business, the acquisition of Gallaher Ltd. (acquired in 2007 for approximately GBP 7.5 billion, or ¥1,720.0 billion as calculated by the exchange rate at the time of the acquisition; the same applies hereinafter) as well as the non-US tobacco operations of the RJR Nabisco Inc. (acquired in 1999 for approximately USD 7.8 billion, or ¥944.0 billion) and, for its processed food business, the acquisition of the Katokichi Group (now TableMark Holdings Co., Ltd.) (acquired in 2008 for approximately ¥109.0 billion). In an effort to further strengthen the business foundation, the JT Group will consider acquisitions, capital movements, business tie-ups and cooperative arrangements with other companies and may execute when we judge such transactions would contribute to the future earnings of the JT Group. However, should such transactions not generate the expected outcome, or should a significant, unforeseen problem be discovered after the acquisition, same may negatively affect the JT Group's business performance. Examples that may have such an impact include a failure to carry out operational, personnel, technological or organizational integration due to geographical or cultural differences; a failure to maintain sustained demand for the products of a business subject to acquisition or tie-up, or manufacture and sell said products; a failure to continue the JT Group's present operations; a failure to retain personnel with superior capabilities at an acquired business or maintain the motivation of its employees; a failure to apply the JT Group's internal control system to an acquired business; a failure to build an effective brand and product portfolio; a failure to link sales and market strategies of different product lines; or a dispersal of management's attention from the JT Group's present operations.

Also, as a result of the acquisitions, we have recorded a substantial amount of goodwill and intangible assets in the consolidated statements of financial position, the amounts of goodwill and intangible assets account for 32.7% (¥1,539.4 billion) and 7.8% (¥364.9 billion) of the consolidated total assets, respectively, as of the end of the fiscal year. The JT Group believes that the abovementioned goodwill and intangible assets appropriately reflect the future profitability that will result from the unleashing of synergy effects of each business value and integration, however, if it is determined that this expected outcome does not materialize as a result of factors such as changes in the business environment or competitive forces, or if the discount rate applied becomes higher, the JT Group may incur an impairment loss that negatively impacts our performance.

#### c. Effects of foreign exchange fluctuations

JT reports its consolidated financial statements indicating all figures in yen, however, overseas Group companies draft their financial statements in other currencies such as Russian ruble, euro, British pound, Taiwanese dollar, U.S. dollar, and Swiss franc. Accordingly, the results, assets and liabilities of overseas Group companies are converted into yen when the consolidated financial statements of JT are prepared and indicated in yen therein. As a result, those figures are affected by fluctuations from the currency used by overseas Group companies in their accounts settlement against the yen. The respective ratios of the JT Group's revenue and adjusted operating profit attributable to the international tobacco business were 54.6% and 67.7% in the period from January through December 2014. Therefore, foreign exchange fluctuation may greatly impact consolidated financial statements along with the expansion of the international tobacco business and its contribution to our results.



JT International Holding B.V. (hereinafter referred to as “JTIH”), which is responsible for consolidating the financial results of the JT Group’s international tobacco business, uses the U.S. dollar for its financial reporting. However, JTIH does business through consolidated subsidiaries and affiliates around the world, some of which use foreign currencies other than the U.S. dollar. This means that the JT Group’s consolidated results are affected not only by exchange rate fluctuations between the Japanese yen and the U.S. dollar but also by those between the U.S. dollar and other foreign currencies used by the consolidated subsidiaries and affiliates for their financial reporting.

In addition, any liquidation, sale or significant drop in the value of a foreign Group company whose foreign currency denominated stock was acquired by JT will result in the recording of an investment loss with respect to said company in the consolidated financial statements of JT and this loss will be affected by the exchange rate fluctuation between the yen and the foreign currency that was used to acquire said stock.

Furthermore, most of the JT Group’s international transactions are subject to the effects of foreign currency exchange rates. As an example of this risk, in the domestic tobacco business or the international tobacco business, the JT Group uses foreign-grown leaf tobacco (see h. below). While this leaf tobacco is procured to some degree in U.S. dollars, the tobacco products that contain it are sold in the local currencies of various countries. Therefore, should the U.S. dollar appreciate against these various local currencies, this may have a negative effect on profitability at the JT Group.

Although the JT Group hedges a portion of the foreign exchange risk generated by its transactions, it is impossible to completely avoid this risk for the entire group by such hedges and there is always the possibility that foreign exchange fluctuations will negatively affect the Group’s earnings.

#### d. Outline of the Tax Reform Proposals

The Outline of the 2012 Tax Reform Proposals determined by the Cabinet of Japan on December 10, 2011 mentions that, in order to hold down tobacco consumption from the perspective of national health, a future tax rate increase for the tobacco excise tax is necessary. The proposals also mention that tax hikes in the tax reform proposals for 2013 or after will be decided with sufficient attention paid to tobacco consumption and tax revenue, the impact on related parties such as leaf tobacco growers, retailers and manufacturer, and other such considerations.

In the Outline of the 2015 Tax Reform Proposals determined by the Cabinet of Japan on January 14, 2015, it is mentioned that the special tax rates of national and local tobacco excise taxes for former third-class cigarettes will be abolished as a revision of tobacco excise tax. Accordingly, from the perspective of reducing dramatic changes and other such considerations, tax rate revisions will be implemented in stages as a transitional measure during the period from April 1, 2016 through April 1, 2019.

There is no mention of a tobacco excise tax hike for items other than former third-class cigarettes. Nevertheless, should a tax hike occur in the 2016 Tax Reform or after, this could have a substantial effect on the JT Group’s business performance depending on the size of the hike and whether the JT Group can react to a tax increase promptly and appropriately.

#### e. Natural disasters and other contingency situations

The Great East Japan Earthquake that occurred in March 2011 has inflicted damage on some factories of the JT Group and raw materials suppliers, thereby creating an impact on the Group’s business operations, mainly in the domestic tobacco business. Although the JT Group is working to reinforce its business continuity capabilities, incidents related to the earthquake disaster may negatively affect the Group’s business performance in the future. Furthermore, future large-scale disasters in Japan or overseas, including natural disasters such as earthquakes, tsunamis, typhoons or floods, or human-made disasters such as suspension of infrastructure, political instability or bombings, or other such unforeseen emergencies, may negatively affect the JT Group’s business performance. Such effects may be caused by supply shortages from damage to suppliers; disruptions to traffic, logistics services or sales channels; suspension of utilities such as electric or water; declines in demand; or employees suffering damage in a disaster.

The earthquake and subsequent tsunami in March 2011 caused partial meltdowns at the Fukushima Daiichi Nuclear Power Plant in Japan. The JT Group is focused on conducting activities to eliminate consumers’ concerns over the radioactive pollution on tobacco leaves, and continue to deliver products free of any risk of contamination. We have established an internal standard comparable to the official standards for other agricultural products (the Food Sanitation Act does not set a standard for the maximum allowable radioactivity level in tobacco leaves). Multiple inspections are conducted, i.e. before leaf purchase, before leaf processing,

before product manufacturing, and before shipping from our factories.

f. Country risk

The JT Group operates in at least 70 countries and territories around the world, mainly in the tobacco business, and sells products in at least 120 countries. As a consequence, the international tobacco business in particular is growing in importance. In order to achieve long-term growth, we will continue to expand the business base. Geographical expansion increases our exposure to country risks, such as a change in the political environment, a change in the economic conditions, a change in the social environment, a change in the legal system, or the occurrence of riots, terrorism or war. If materialized, these risks could negatively affect our business performances due to blockage to supply chains or distribution networks, damage to assets or facilities, or difficulties in allocation of personnel or sales management. Furthermore, the JT Group conducts business in countries that are subject to economic sanctions by the United States, the EU, Switzerland, Canada and others. Although the JT Group manages its business operations appropriately and lawfully in accordance with these various economic sanctions, if the JT Group were to violate the sanctions, it would be at risk of being subject to large monetary penalties or other such consequences. Also, if there is a development such as a change in the details of the sanctions, this may negatively affect the JT Group's business performances by, for example, making the Group unable to continue operating in the countries subject to the sanctions. Even if the Group obeys the sanctions, simply operating in the countries subject to the sanctions may have a detrimental effect on the public image of the Group.

With regard to cash and cash equivalents held by an Iranian subsidiary of the JT Group, due to international sanctions and other factors in connection to Iran, the subsidiary's ability to remit funds outside of Iran is restricted.

g. Economic deterioration

In the global economy, although moderate recovery has been seen in developed countries, the overall outlook remains unclear primarily because of a slowdown in economic growth in emerging countries. While Japan is also showing signs of economic recovery mainly on the back of weaker yen, it remains unclear whether this trend will be sustained partly because consumption tax was raised to 8% on April 1, 2014. In many of the main markets of the JT Group's international tobacco business including France, Italy, Russia, Spain, Taiwan, Turkey and the U.K., total demand for tobacco has declined in recent years because of economic deterioration and societal reasons such as changes in the composition of their populations. The pace of this trend has accelerated since the financial crisis of 2008. Total tobacco demand is also continuing to decline in Japan, and JT expects this trend to continue. In this way, economic deterioration and other such developments may lead to lower purchasing power and confidence among consumers, and customer demand may shift towards brands and categories in lower price ranges. There may be declines in demand for the JT Group's beverages and processed food products for similar reasons. Such developments may negatively affect the JT Group's business performance.

h. Instability in supplies of key materials

The raw material used in JT's manufacture of tobacco products in Japan is leaf tobacco sourced domestically and leaf tobacco from overseas. The raw material the JT Group currently uses in its manufacture of tobacco products overseas is leaf tobacco from overseas only.

Materials, both raw and processed, are critical inputs to our products. Therefore, our ability to procure needed materials in the required quantities and at manageable costs can affect our business performance. Climate and other natural changes, and commodity markets, could affect the availability of agricultural products, such as tobacco leaves, and other natural materials procured for our beverages and processed food products. In addition to the raw inputs, global population increase and economic growth in the emerging countries could lead to an explosive increase in the consumption of resources. This could result in an increase in the costs of our raw and processed materials, as well as unavailability of those resources.

i. Difficulty in maintaining human resource competitiveness

The JT Group believes that a diversified employee base is a major factor of our competitiveness, therefore, we seek to attract, develop, and retain talented people worldwide. However, in the particular case of tobacco business, we are aware of the negative social image placed on this business line, therefore, it is becoming major

issues for us to recruit and retain talented people. Should the Group be unable to sufficiently fulfill such needs as retaining human resources, future business operations may become difficult, thus having a negative impact on the JT Group's business performance.

j. Infringement of intellectual property rights

If the JT Group infringes the intellectual property rights of an outside party, or if an outside party infringes the JT Group's intellectual property rights, the Group may have to pay a substantial amount of compensation for damages or court costs, or there may be a detrimental effect on the Group's product development, commercialization and business strategy. Such occurrences may negatively affect the JT Group's business performance.

k. Environmental regulations

The JT Group is subject to a wide variety of legal restraints both in Japan and overseas related to environmental protection with respect to hazardous substances, waste and other effects of research and development and production processes. In future, if environmental pollution or a similar problem occurs as a result of the JT Group's business activities, or if environmental regulations are introduced or existing ones are changed, this may negatively affect the JT Group's business performance.

**(2) Risks relating to the JT Group's tobacco business**

a. Decreasing tobacco demand

In the Japanese domestic tobacco market, with the aging population and declining birth rate, growing awareness about the health risks associated with smoking and the tightening of smoking-related regulations, as well as higher tobacco excise taxes, total demand for cigarettes has continued to decline and JT expects this downward trend to continue unabated into the future. Demand overseas could also decrease depending on the economic conditions, other societal conditions, trends in regulations, changes in the compositions of populations, price rises due to tax increases and other factors, although the trends in demand will vary from region to region.

Should demand decrease, sales volumes of the domestic tobacco business and shipment volume of the international tobacco business may decrease, and this may negatively affect our business performance.

b. Competition with rival companies

The JT Group is competing fiercely in both the domestic and international tobacco businesses with rivals such as Phillip Morris International and British American Tobacco.

In the Japanese domestic tobacco market, competition has intensified partly due to the diversification of smoker preferences and aggressive marketing activities by rival companies ever since the easing of regulations relating to imported tobacco products in 1985 and the abolishment of tariffs on imported cigarettes in 1987.

In overseas tobacco markets, the JT Group expanded its business by building on its self-sustaining growth and by acquiring the non-US tobacco operations of RJR Nabisco and Gallaher Ltd. As a result, its competitive relationships with global players in the international tobacco business such as Phillip Morris International and British American Tobacco as well as strong firms operating in localized markets are observed.

Each tobacco market share fluctuates under multiple factors including competition, regulations, pricing strategies, changing smoker preferences, heightened societal interest in health issues, brand strengths and economic conditions occurring in different markets not to mention short-term fluctuations caused by temporary factors such as the introduction of new products by the JT Group and other companies and the special promotional activities effected for them. A lower market share due to these factors may negatively affect the JT Group's business performance.

c. Taxes levied on tobacco

Depending on their objectives, governments increase tobacco excise tax, VAT (value-added tax) and other taxes in most countries we operate, including Japan, to secure state budgets and also to promote public health.

The JT Group can predict neither increases nor changes in types of taxes or tax rates imposed on tobacco products in various countries. If tax hikes are implemented at an unexpected timing, frequency or rate of

increase, or in a region where tax hikes were not anticipated, the JT Group may be unable to react to such tax hikes promptly and appropriately.

Increases in tobacco taxes may, if accompanied by a hike in retail prices, push down demand, move consumers toward lower priced brands, or cause or increase illicit product trading such as smuggling and counterfeiting. On the other hand, if there is no retail price hike, such tax increases may cause the earnings structure of the tobacco business to deteriorate. As such, either case may negatively affect the JT Group's business performance.

#### d. Regulations on tobacco products

- Situation overseas

The 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 (Japanese Government accepted in June 2004). Since then, there has been a rising trend in regulations regarding sales promoting activities and the marketing of tobacco products and smoking in the international markets where JT Group's tobacco products are sold.

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 (specifically, the following is stipulated: 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), and measures relating to the reduction of the supply of tobacco (specifically, prevention of illicit trade and prohibition of sale of tobacco products to minors are stipulated). Furthermore, various measures are being taken partly related to provisions regulating descriptive labeling such as "mild" and "light." 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 a 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.

As examples of specific controls undertaken in these nations, laws including "Restrictions on the in-store display of tobacco products" and "Ban on sale of tobacco products through vending machines" have been enforced in the U.K. In Australia, individual packages of tobacco products must be of a prescribed color, and product names must be displayed on the packages in a prescribed location, font size, color and style. In addition, visual warning labels must take up 75% of the front side and 90% of the reverse of packages. This plain packaging (PP) legislation was passed in 2011 and came into effect in December 2012. In March 2015, laws and regulations came into effect in Ireland and the U.K. introducing plain packaging regulations. In addition to these, a number of other countries are considering the implementation of similar measures.

Also in Russia, legislation was passed in February 2013, which includes protection from exposure to tobacco smoke and other matters related to tobacco consumption. Gradual implementation of the legislation started in June 2013 and it will continue to come into effect in stages until 2017. It contains a number of provisions including a display ban, restrictions on sales of tobacco products in certain retail stores, a ban on advertising, sponsorship and promotions, and the introduction of minimal pricing or a ban on smoking in public places.

In the EU, "EU Tobacco Product Directive (EU TPD)," which was promulgated in July 2001, was revised, and the revised EU TPD came into effect in May 2014. The revised EU TPD includes strengthened regulation on packaging and labeling, restriction on the use of additives in tobacco products and regulation related to electronic cigarettes, and requires all EU member countries to develop their own laws, regulations and ordinances to ensure that the requirements of the directive are enforced. Going forward, this revised EU TPD is scheduled to become law in all EU member states by May 2016, and to come into force by May 2017.

- Situation 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 (for details, see (4) c. (i), Note 2 below). 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. From the perspective of passive smoking prevention, cases of restrictions on smoking in areas in Japan including public places such as restaurants and office buildings have been on the increase for a while. This reflects the impact of regulations including the Health Promotion Act, which impose obligations on managers of facilities to make certain efforts. In recent years, considerations related to worker protection at workplaces have also become an issue, and the national government, local governments and others are planning and promoting various measures or implementing revisions of relevant laws. JT expects these kinds of trends to continue in the future.

- Impact on the JT Group’s business performance

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

The JT Group’s position is to support any regulation relating to tobacco that is appropriate and reasonable. Nevertheless, if regulations such as those mentioned above are tightened, or if the JT Group is unable to respond to this tightening of regulations in a timely and appropriate manner, subsequent declines in tobacco demand or market share, costs for compliance with new regulations or other factors may negatively affect the JT Group’s business performance.

e. Illicit product trading such as smuggling and counterfeiting

One of the most serious issues in the tobacco industry is the increase of illicit trade, including smuggling and counterfeit product distribution. Motivations for illicit trade are believed to include the high profit margin of tobacco products and cross-border price gaps arising from different taxation systems and tax levels among countries. As historical evidence shows, illicit trade in a market tends to increase after a steep tax increase.

Illicitly traded products not only significantly damage the credibility of brands and the companies that own those brands, but also negatively affect governments’ tax revenues. Therefore, we and other tobacco companies are working together with governments to eliminate illicit trade.

The JT Group is making efforts towards countermeasures, such as by concluding cooperation agreements to counter illicit trade with the EU (including its member countries) and the governments of Canada and all its provinces and territories, respectively. Even so, growth in illicit trade such as smuggling and counterfeiting of tobacco products may negatively affect the JT Group’s business performance because of consequences including damage to its brand equity or the need for substantial expenses for countermeasures and the like to eliminate illicit trade.

f. Litigation

JT 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 the fiscal year end date, there were a total of 19 smoking and health-related cases pending in which one or more members of the JT Group were named as defendant, including cases for which JT may have certain indemnity obligations pursuant to the agreement for JT’s acquisition of RJR Nabisco Inc.’s overseas (non-U.S.) tobacco operations. In addition, JT and some of its subsidiaries are also defendants in lawsuits other than the smoking and health-related cases.

We are unable to predict the outcome of currently pending or future lawsuits. If these actions result in a decision unfavorable to the JT Group, its business could be materially affected by, for example, the payment of a substantial amount of monetary compensation. Moreover, regardless of the results of these lawsuits, critical media coverage may reduce social tolerance of smoking, strengthen public regulations concerning smoking and prompt the filing of a number of similar lawsuits against the JT Group, forcing it to bear litigation costs and materially affecting its business performance. In addition to the smoking and health-related litigation, the JT Group may be a party to further cases should litigation occur in the future. Such litigation cases may negatively

affect the business performance or manufacture, sale, and import and export of tobacco products by the JT Group should their outcomes prove unfavorable.

Regarding major litigation cases to which the JT Group is a party, please refer to “V. Accounting, 1. Consolidated financial statements, (1) Consolidated financial statements, Notes to consolidated financial statements, 37. Contingencies.”

### **(3) Risks relating to the JT Group’s pharmaceutical, beverage and processed food businesses**

#### **a. Risks relating to pharmaceutical business**

The following are various risks relating to the pharmaceutical business of the JT Group.

- The JT Group may fail to develop and launch commercially valuable pharmaceutical products.
- The JT Group may have to invest an enormous amount of time and funds in research and development before it successfully develops pharmaceutical products.
- The JT Group may be forced to abandon the clinical development or sale of a pharmaceutical product that involves another company as a co-developer or a licensee on the basis of its or its partner company’s judgment or due to some internal or external factors.
- Even if the JT Group succeeds in developing and launching a commercially valuable pharmaceutical product, research and development expenses may exceed the revenue generated from it.
- The JT Group may become dependent on a certain pharmaceutical product.
- The JT Group may fail to produce or outsource manufacturing of our pharmaceutical products efficiently and cost-effectively on a large scale.
- Even if a pharmaceutical product developed by the JT Group proves to be commercially successful, the success may be offset by competition with rival products developed by other companies in Japan or overseas, a government-mandated price reduction and other factors.
- The JT Group may become dependent on the license of pharmaceutical products developed by other companies and on third party distribution channels.
- The JT Group may become dependent on a certain outside source for the supply of part of critical raw materials.
- If any problem arises regarding the quality of a pharmaceutical product of the JT Group or regarding information provided by the Group about such product, the Group may become the target of claims seeking product liability, or may be forced to suspend sales of such product.
- JT’s business performance may be affected by lawsuits concerning patents and other intellectual property rights.
- Regulation may be applied broadly, covering a full range of activities from the research and development stage to the post-launch stage of a new drug.
- The JT Group may become dependent on a certain business partner in research and development or sales of a pharmaceutical product.
- The JT Group may be forced to abandon clinical development as well as manufacturing and sale of a pharmaceutical product because of unexpected side effects or insufficient clinical trial results.
- In relation to the JT Group’s use and management of radioactive or other hazardous substances, social or legal problems may arise, such as damage to the environment caused by such substances.

#### **b. Risks relating to beverage and processed food businesses**

The following are various risks relating to the beverage and processed food businesses of the JT Group.

- Products developed by the JT Group may fail to meet consumer preferences and their product lives may prove to be short.
- The JT Group’s profit and loss may fluctuate due to fluctuations in the prices of raw materials (including those due to changes in the exchange rate).
- The sales of JT Group’s products may be affected by weather conditions.

- The regulation of the procurement, manufacture and sale of products in Japan or overseas may be strengthened, including the possibility that additional costs may arise due to compliance with such regulation.
- The JT Group may be unable to compete with major companies with larger distribution networks, stronger development capabilities and more experience.
- The JT Group may be unable to engage in efficient marketing activities.
- The JT Group may be unable to produce, or outsource the production of, products in an efficient, stable and effective manner.
- The JT Group may outsource the production of most beverage products to other domestic manufacturers, thus becoming dependent on outside sources.
- If any problem arises regarding the quality of the JT Group's products, it may cause health damage to customers, the Group may become the target of claims seeking product liability, or the reputation of the Group and its products may be undermined.

#### **(4) Other factors which may materially affect investment decisions**

##### **a. Relations with the Japanese government and the Minister of Finance**

The JT Act obligates the government to continue to hold more than one-third of all JT shares issued. As of December 31, 2014, the government held 33.35% of all JT shares issued. As a consequence, the Japanese government is able to have a substantial influence on proposals for ordinary resolutions at JT's General Meetings of Shareholders such as the election of Directors. Furthermore, the Japanese government has the veto power for special resolutions for such actions as mergers, capital reductions or amendments to the articles of incorporation.

In addition, the Minister of Finance has the authority to supervise JT under the JT Act and Tobacco Business Act. Under the JT Act, the scope of JT's businesses includes the "manufacture, sale and importation of tobacco products and ancillary businesses, as well as businesses required for attaining the objective of JT," and "business required for attaining the objective of JT" are subject to the Minister of Finance's approval. Consequently, the Minister of Finance's approval is required in order for JT to engage in new businesses outside the scope of currently-approved businesses (for details, see c. (ii) below).

As mentioned above, in addition to the Japanese government's rights as a shareholder of JT, the government has the authority to supervise JT and other powers under the JT Act and Tobacco Business Act. Since it cannot be guaranteed that the interests of the government will always coincide with the interests of other shareholders, this may have a negative effect on the interests of other shareholders.

Under the "Act on Special Measures for Securing Financial Resources Necessary for Reconstruction from the Great East Japan Earthquake", which was promulgated on December 2, 2011, the government makes it a principle to secure revenue to fund reconstruction resources until the fiscal year ending March 31, 2023. To this end, it is required for an examination to be made of the feasibility of selling JT shares by reassessing the framework under which the government holds the shares, while taking into consideration the framework of the country's commitment to tobacco-related business based on the Tobacco Business Act and the like.

##### **b. Purchasing of leaf tobacco**

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 Ministry of Finance from among the representatives of domestic leaf tobacco growers and academic appointees (for details, see c. (i) below). 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 redrying) is approximately three times that of the latter (after redrying). The obligation to purchase virtually all leaf tobacco produced in Japan may adversely impact the JT Group's relative competitiveness in Japan because other global tobacco companies use foreign-grown leaf tobacco only.

c. Legal matters relating to the business of filing company

(i) Tobacco Business Act (Act No. 68 of August 10, 1984)

	Description
1. Purpose	The object of this Act is, in consideration of the tax relating to tobacco products as a portion of the treasury revenue incidental to the abolishment of the tobacco monopoly system, to promote a sound development of the tobacco industry in our country by making necessary adjustments in the production and purchase of domestically produced leaf tobacco as raw material for tobacco products and in business activities etc. of manufacture and sale of the tobacco products, whereby it will contribute to ensuring treasury revenue and a sound development of the national economy. (Article 1)
2. Cultivation and purchase of domestically grown leaf tobacco for use as raw material	<p>(1) When intending to purchase the domestically produced leaf tobacco, Japan Tobacco Inc. (hereinafter, "JT") shall enter into agreements in advance with those who intend to cultivate leaf tobacco for the purpose of selling it to JT regarding the cultivation area for each item of leaf tobacco and the prices for each item and each grade of the leaf tobacco. (Article 3)</p> <p>(2) JT shall purchase all leaf tobacco produced pursuant to such agreements, except those which are not suitable as raw materials for manufacture red tobacco. (Article 3)</p> <p>(3) In the case where JT intends to enter into an agreement, JT shall consult with the Leaf Tobacco Deliberative Council that JT establishes, and respect its opinion concerning the total cultivation area and the prices of leaf tobacco. (Articles 4 and 7)</p> <p>(4) The Leaf Tobacco Deliberative Council shall deliberate on the price of the leaf tobacco so that subsequent production of leaf tobacco is ensured, by taking into account the production costs, commodity prices and other economic conditions. (Article 4)</p> <p>(5) JT shall determine the regional breakdown of the aggregate cultivation area for the respective items of leaf tobacco seeking the opinion of the Japan Tobacco Growers Association (hereinafter, "JTGA") and, within the scope of such regional breakdown, enter into agreements with growers. (Article 5)</p> <p>(6) If a member grower of a tobacco growers association entrusts JTGA with entering into an agreement regarding a fundamental matters of the agreements such as the price of leaf tobacco, JT shall establish said fundamental matters with JTGA and such agreement shall be deemed as a part of the agreements executed between JT and said grower. (Article 6)</p>
3. Manufacture of tobacco products	<p>(1) No tobacco products shall be manufactured by any party other than JT. (Article 8)</p> <p>(2) JT shall obtain the approval of the Minister of Finance on the maximum wholesale price for each item of tobacco products. (Article 9)</p> <p>(3) JT shall make efforts to ensure a smooth supply of tobacco products taking into account regional demand conditions for tobacco products. (Article 10)</p>
4. Sale of tobacco products	<p>(1) A party wanting to engage in the sale of tobacco products imported by themselves shall register with the Minister of Finance, who establishes necessary regulations relating to said registration and registered party (hereinafter, "Specified Distributor"). (Articles 11 to 19)</p> <p>(2) A party wanting to engage in the wholesaling of tobacco products shall, for the time being, register with the Minister of Finance, who establishes necessary regulations relating to said registration and registered party. (Articles 20 and 21)</p> <p>(3) A party wanting to engage in the retailing of tobacco products shall, for the time being, obtain the approval of the Minister of Finance, who establishes necessary regulations relating to said registration and registered party (hereinafter, "Retailer"). (Articles 22 to 32)</p> <p>(4) If JT and a Specified Distributor want to sell manufactured or imported tobacco products, the list price of each item, and any subsequent change thereof, shall be approved by the Minister of Finance for the time being. Necessary regulations are in place with respect to the approval: for example, the Minister of Finance shall grant approval unless it deems such price is unfair to consumers, etc. (Articles 33 to 35) <sup>(Note 1)</sup></p> <p>(5) A Retailer is only permitted to sell tobacco products at list prices that have been approved by the Minister of Finance. (Article 36)</p>



	Description
5. Other	<p>(1) JT or a Specified Distributor shall indicate the wording as prescribed by Ordinance of the Ministry of Finance for warning consumers of the relationship between the consumption of tobacco products and health prior to the commencement of sale of the tobacco products that it manufactured or imported. (Article 39) <sup>(Note 2)</sup></p> <p>(2) Advertisers of tobacco products shall give due consideration to the prevention of smoking by minors, etc. and make efforts lest such advertisement should be made to an excessive extent. The Minister of Finance may implement necessary measures with respect to advertisers. (Article 40) <sup>(Note 3)</sup></p>

- Notes:
1. The so-called list price system is maintained for the time being as a means to prevent confusion in the distribution order, a well-established constant that materialized after the list price system was adopted in 1904. Tobacco is a luxury item different from the so-called commodities and services and, in a distribution market completely liberalized after the opening of import markets and other factors, JT and Specified Distributors stipulate prices on application (POA) to the Minister of Finance based on their respective, independent management decisions.  
Concerning the approval of list prices, JT understands that a government delegate gave the following explanation of the gist of the process at the 1984 Diet deliberations on the proposed Tobacco Business Act:  
Pertaining to tobacco product list prices, under the Tobacco Business Act, in the event an application is made for the approval of list prices, the Minister of Finance may exceptionally deny approval if it deems such list price unfair to consumers or unfairly low in comparison with wholesale prices of domestic products or import prices of imported products. In all other cases, the Minister approves list prices in line with the spirit of Tobacco Business Act.
  2. 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 tobacco product packages was changed to specify risks related to eight items, four of which are diseases associated with direct smoking (lung cancer, heart attack, stroke and emphysema), while the other four are smoking by pregnant women, passive smoking, addiction to smoking and youth smoking. Each tobacco product package must indicate, on its main surfaces, a warning regarding at least one of the four items associated with direct smoking and at least one of the other four items. The Ordinance stipulates, among others, (1) that these warnings must be rotated throughout the year in ways to ensure that they receive equal exposure on each product item and each type of package and (2) that the display area must occupy 30% or more of the main surfaces of the package.  
In addition, the Ordinance stipulates that when wording like “mild” and “light” are 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.
  3. In March 2004, the “Guideline for Advertising of Tobacco Products” was revised to stipulate that the outdoor advertising of tobacco products (posters, billboards, etc.) shall generally be prohibited. It also specifies matters concerning the presentation and content of the health warnings that accompany tobacco advertising.

(ii) Act on Japan Tobacco Inc. (Act No. 69 of August 10, 1984)

	Description
1. Purpose	Japan Tobacco Inc. (“JT”) is a stock company whose purpose is to engage in business related to the manufacture, sale, and importation of tobacco products in order to attain the objectives set forth in Article 1 of the Tobacco Business Act. (Article 1)
2. Stock	<p>The Japanese government must continue to hold more than one-third of all Japan Tobacco Inc. (“JT”) shares issued (excluding shares of a class for which it is provided that the voting rights may not be exercised for all the matters that are subject to resolution at the shareholders meeting; the same shall apply to the following items). (Article 2, paragraph 1)</p> <p>Whenever JT intends to solicit subscribers for an issuance of shares or subscription rights to shares of JT, or deliver shares (excluding own shares), subscription rights to shares (excluding subscription rights to treasury shares), or issuance of bonds with subscription rights to shares (excluding bonds with subscription rights to treasury shares) at the time of share exchange, the approval of the Minister of Finance is required. (Article 2, paragraph 2)</p> <p>The disposal of JT shares held by the government shall be effectuated within the maximum range stipulated by resolution of the Diet based on the budget of the corresponding year. (Article 3)</p>
3. Scope of business	<p>JT shall engage in the following businesses in order to attain the objectives stated in 1 above.</p> <p>(1) business of manufacture, sale and importation of tobacco products  (2) business incidental or relating to the business in the preceding item  (3) other business required for attaining the object of JT</p> <p>JT shall obtain authorization from the Minister of Finance before engaging in any business corresponding to (3) above. (Article 5)</p>
4. Monitoring	<p>(1) The appointment or dismissal of Directors, Executive Officers (<i>sikkoyaku at a company with committees</i>), and Audit &amp; Supervisory Board Members require authorization from the Minister of Finance. (Article 7)</p> <p>(2) Amendments to JT’s articles of incorporation, appropriations of surplus (except disposal of losses), and any merger, corporate split, or dissolution of JT require authorization from the Minister of Finance. (Article 8)</p> <p>(3) JT shall formulate a business plan prior to each business year and obtain authorization from the Minister of Finance. Any change thereof also requires authorization from same. (Article 9)</p> <p>(4) Within three months after the closing of each business year, JT shall issue its balance sheet, statement of income, and business report to the Minister of Finance. (Article 10)</p> <p>(5) Transfers of manufacturing facilities or similar material assets require authorization from the Minister of Finance. (Article 11)</p> <p>(6) The Minister of Finance shall monitor JT in accordance with this Act as well as the Tobacco Business Act and may implement necessary measures in the execution of same. (Articles 12 and 13)</p>

## (iii) Acts relating to tobacco excise taxes (including tobacco special excise taxes)

	Description			
	National Tobacco Excise Tax	National Tobacco Special Excise Tax	Local Tobacco Excise Tax	
1. Tax item <sup>(Note 1)</sup>	Tobacco Excise Tax	Tobacco Special Excise Tax	Prefectural Tobacco Excise Tax (also applies to Tokyo)	Municipal Tobacco Excise Tax (also applies to special wards)
2. Taxpayers <sup>(Note 2)</sup>	Manufacturers of tobacco products or those who removes tobacco products from bonded areas		Manufacturers of tobacco products, specified distributors or wholesalers selling to retailers	
3. Tax base <sup>(Note 3)</sup>	Number of cigarettes removed from the manufacturing site or bonded area (for tobacco products other than cigarettes, prescribed cigarette count conversion)		Number of cigarettes relating to sales to retailers (for tobacco products other than cigarettes, prescribed cigarette count conversion)	
4. Tax rate <sup>(Note 4)</sup>	¥5,302 per 1,000 cigarettes	¥820 per 1,000 cigarettes	¥860 per 1,000 cigarettes	¥5,262 per 1,000 cigarettes
	Former third-class products <sup>(Note 5)</sup> ¥2,517 per 1,000 cigarettes	¥389 per 1,000 cigarettes	¥411 per 1,000 cigarettes	¥2,495 per 1,000 cigarettes
5. Declaration and payment <sup>(Note 6)</sup>	Tobacco product manufacturers are to declare and pay taxes for each month's shipment by the end of the following month. Parties removing tobacco products from bonded areas are to declare and pay taxes by the time of extraction		For sales of tobacco products relating to sales locations of retailers located within a given prefecture, a declaration and payment of taxes is to be made to that prefecture for each month's transfer by the end of the following month	For sales of tobacco products relating to sales locations of retailers located within a given municipality, a declaration and payment of taxes is to be made to that municipality for each month's transfer by the end of the following month

- Notes:
- Article 3 of the Tobacco Excise Tax Act, Article 4 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Article 1, paragraph 2 and Articles 4 and 5 of the Local Tax Act
  - Article 4 of the Tobacco Excise Tax Act, Article 5 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Article 74-2, paragraph 1 and Article 465, paragraph 1 of the Local Tax Act
  - Article 10 of the Tobacco Excise Tax Act, Article 7 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Articles 74-4 and 467 of the Local Tax Act
  - Article 11, paragraph 1 of the Tobacco Excise Tax Act, Article 8, paragraph 1 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Articles 74-5 and 468 of the Local Tax Act
  - Article 2 of the Supplemental Provisions of the Tobacco Excise Tax Act, Article 8, paragraph 2 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Articles 12-2 and 30-2 of the Supplemental Provisions of the Local Tax Act
  - Articles 17 to 20 of the Tobacco Excise Tax Act, Article 12 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Articles 74-10 and 473 of the Local Tax Act
  - Concerning "4. Tax rate"  
The term "Former third-class products" refers to tobacco products stipulated as third-class cigarettes in the Tobacco Product Price Act, repealed on April 1, 1985. These are same products as those at the time of abolishment, and, for the time being, the aforementioned tax rates are applied.
  - In the event the tax system relating to tobacco subject to high excise taxes is examined, on a general basis, as part of a revision of the tax system by the government each year and the tax system is revised, a decision is made upon the deliberation and resolution of the legislature subsequent to the determination of government policy through deliberation by the Tax System Council and other bodies. Relevant government policy is determined once cabinet approval of a bill is secured following the cabinet's approval of an outline of the tax reform proposal.
    - See the following page for revisions to the tax system relating to tobacco after the April 1985 transfer from the monopoly profit system to the tobacco consumption tax system.

[Main movements relating to the tobacco tax system and JT's responses]

Month/Year	Item	Description	JT's response
May 1986	1986 Tax Reform	Tax increase equivalent to ¥900 per 1,000 cigarettes	Fixed price revised by amount equivalent to tax increase
April 1989	1989 Tax Reform	Following the introduction of the consumption tax, "tobacco consumption tax" changed to "tobacco excise tax" and taxation formula unified to a unit tax	Basically, fixed price revision unnecessary
April 1997	1997 Tax Reform	[Revision of Local Tax Act] Local Tobacco Excise Tax revenue transferred from the Prefectural Tobacco Excise Tax to the Municipal Tobacco Excise Tax	Fixed price revision unnecessary
		[Revision of Consumption Tax Act] Consumption tax rate revised from 3% to 5%	Prices raised by ¥10 per pack for some brands in an effort to revise fixed prices overall by the amount equivalent to the consumption tax rate revision
December 1998	1998 Tax Reform	Act Concerning Special Measures for Financing Debt Transferred to the General Accounts established and ¥820 per 1,000 cigarettes of Tobacco Special Excise Tax introduced	Basically, price per cigarette raised by ¥1
May 1999	1999 Tax Reform	[Revision of Special Taxation Measures Act and Local Tax Act] Tax revenue transferred from Tobacco Excise Tax to Prefectural Tobacco Excise Tax and Municipal Tobacco Excise Tax	Fixed price revision unnecessary
July 2003	2003 Tax Reform	Acts revising a portion of the Income Tax Act, Local Tax Act, among others, established and tax increase by ¥820 per 1,000 cigarettes	Price per cigarette raised by approx. ¥1
July 2006	2006 Tax Reform	Acts revising a portion of the Income Tax Act, Local Tax Act, among others, established and tax increase by ¥852 per 1,000 cigarettes	Amount equivalent to tax increase shifted to fixed price of all brands with some prices increased higher than said amount
October 2010	2010 Tax Reform	Acts revising a portion of the Income Tax Act, Local Tax Act, among others, established and tax increase by ¥3,500 per 1,000 cigarettes	With exception of some brands, prices increased higher than the amount equivalent to tax increase
April 2014	2014 Tax Reform	[Revision of Consumption Tax Act] Consumption tax rate revised from 5% to 8%	With exception of some brands, prices raised by ¥10 or ¥20 per pack to revise fixed prices overall by the amount equivalent to the consumption tax rate revision

Note: In the Outline of the 2015 Tax Reform Proposals determined by the Cabinet of Japan on January 14, 2015, it is mentioned that the special tax rates of national and local tobacco excise taxes for former third-class cigarettes will be abolished as a revision of tobacco excise tax. Accordingly, from the perspective of reducing dramatic changes and other such considerations, tax rate revisions will be implemented in stages as a transitional measure during the period from April 1, 2016 through April 1, 2019.

## **5. Important operational contracts**

No items to report

## **6. Research and development activities**

Research and development activities are mainly undertaken at JT's Tobacco Science Research Center and Central Pharmaceutical Research Institute, which have 753 staffers.

Research and development expenses for the entire JT Group over the period from January through December 2014 amounts to ¥56.0 billion and the research objectives and research and development expenses by each segment are as follows.

Please note that the aforementioned research and development expenses includes ¥0.7 billion relating to basic research not affiliated to any segment (plant biotechnology related research) and conducted by JT corporate division.

### **(1) Domestic and international tobacco businesses**

We are committed to strengthening our R&D capabilities to ensure a long-term competitive advantage. Our focus areas in the R&D activities are the development of new leaf tobacco varieties, improvement of tobacco leaves and their processing, enhancement of aroma and taste, upgrading manufacturing technology, and continuous progress on emerging product development capabilities. We aim to add value to our products in these focus areas in a cost efficient manner. We have established a global research platform in Japan, which focuses on the fundamental research and product technology development. To best meet consumers' needs and preferences, our market teams are continuously engaged in the product development.

Research and development expenses relating to the domestic tobacco business for the period from January through December 2014 amounts to ¥18.0 billion with that of the international tobacco business amounting to ¥7.9 billion.

### **(2) Pharmaceutical business**

R&D activities are the foundation of the JT's pharmaceutical business and are critical for our long-term growth and profitability. Our R&D activities focus mainly on the fields of glucose and lipid metabolism, virus research and immune disorders and inflammation.

Research and development expenses for the pharmaceutical business for the period from January through December 2014 is ¥28.9 billion.

### **(3) Beverage and processed food businesses**

Regarding R&D in the beverage and processed food businesses, we devote our efforts to the development of innovative products that meet consumers' needs and preferences.

Research and development expenses for the beverage and processed food businesses for the period from January through December 2014 is ¥0.5 billion.

## **7. Analysis of financial position, operating results and cash flow position**

### **(1) Significant accounting policies**

#### **a. Adoption of IFRS**

Having acquired RJR Nabisco's non-U.S. tobacco operations in 1999 and Gallaher Group Plc. in 2007, the JT Group has been growing steadily as a global company and now operates in at least 70 countries and territories, and sells products in at least 120 countries. In this context, the JT Group has decided to opt for an early adoption of the IFRS from the year ended March 31, 2012. A decision based on the Japanese authorities' permission for the listed companies conducting financial and business activities internationally to adopt IFRS voluntarily from the year ended March 31, 2010. Upon the adoption of IFRS, the JT Group aims to diversify the group's sources of financing through international markets and to improve quality of business management.

#### **b. Significant accounting estimates and judgment on estimates**

Preparation of consolidated financial statements of the Group requires the management to make 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 the management, considering past results and various factors deemed to be appropriate 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 the management. The effects of a change in the estimates and assumptions are recognized prospectively, including the period reviewed.

As for the estimates and assumptions that may have a material effect on the amounts recognized in the consolidated financial statements of the JT Group, please refer to "V. Accounting, 1. Consolidated financial statements, (1) Consolidated financial statements, Notes to consolidated financial statements, 4. Significant accounting estimates and judgments."

#### **c. Change of fiscal year end**

JT changed its fiscal year end from March 31 to December 31. The same change was made to consolidated subsidiaries with fiscal year ends other than December 31. As a consequence of this change, the fiscal year ended December 31, 2014, was the 9-month period from April 1, 2014, to December 31, 2014, for JT and its main consolidated subsidiaries that do not belong to the international tobacco business segment. For consolidated subsidiaries that belong to the international tobacco business segment, the fiscal year was the 12-month period from January 1, 2014, to December 31, 2014.

## **(2) Analysis of business results for the fiscal year**

### **a. Revenue**

Revenue for the period from January through December 2014 increased by ¥61.3 billion or 2.6%, from the same period of the previous year to ¥2,433.5 billion. This was mainly the result of favorable pricing in the international tobacco business and weaker yen.

### **b. Cost of sales, other operating income, share of profit in investments accounted for using the equity method, selling, general and administrative expenses**

Cost of sales for the period from January through December 2014 increased by ¥14.4 billion, or 1.5%, from the same period of the previous year to ¥987.2 billion, while other operating income decreased by ¥24.7 billion, or 32.8%, from the same period of the previous year to ¥50.5 billion. Share of profit in investments accounted for using the equity method increased by ¥6.1 billion, or 359.1%, from the same period of the previous year to ¥7.8 billion. Selling, general and administrative expenses increased by ¥99.3 billion, or 11.9%, from the same period of the previous year to ¥932.8 billion.

### **c. Operating profit and adjusted operating profit**

Adjusted operating profit for the period from January through December 2014 increased by ¥47.5 billion, or 7.8%, from the same period of the previous year to ¥660.1 billion. This was mainly the result of favorable pricing in the international tobacco business and weaker yen. Adjusted operating profit at constant rates of exchange increased by 10.6% from the same period of the previous year. Operating profit decreased by ¥70.9 billion, or 11.0%, from the same period of the previous year to ¥571.8 billion, mainly due to recording of costs associated with measures to strengthen the competitiveness of the domestic tobacco business and restructuring of manufacturing facilities in Europe in the international tobacco business.

### **d. Profit attributable to owners of the parent company**

Profit before income taxes for the period from January through December 2014 decreased by ¥56.9 billion, or 9.0%, from the same period of the previous year to ¥573.6 billion. Profit attributable to owners of the parent company decreased by ¥54.0 billion, or 12.2%, from the same period of the previous year to ¥389.1 billion.

## **(3) Basic policies of financing activities**

JT Group's basic policies of financing activities are as follows.

### **a. Group Cash Management Systems**

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

### **b. External financing**

Short-term working capital needs are normally financed through short-term borrowings from financial institutions or through commercial paper, or a combination of both; mid- to long-term financing is done through long-term borrowings from financial institutions, bond or equity, or a combination of those.

For secure and efficient financing, we continue to diversify our financing means as well as the financial institutions, and set up secure financing means, such as multiple committed facilities.

### **c. External investments**

Investments with financial institutions should be transacted ensuring safety, liquidity and optimal yield. Speculative dealings in pursuit of profit margin are not allowed.

### **d. Financial risk management**

We are exposed to financial risks such as credit risk, liquidity risk, foreign exchange risk, interest rate risk, and market price fluctuation risk. We manage such risks according to our risk management policies and procedures to avoid or mitigate such risks. The major financial risk management status is reported regularly to the President and the Board of Directors.

It is our policy that derivatives are only used if it is intended to mitigate risks of transactions for actual business needs, and speculative and trading transactions are not allowed.

For more details on financial risk management, please refer to “V. Accounting, 1. Consolidated financial statements, (1) Consolidated financial statements, Notes to consolidated financial statements, 33. Financial instruments, (2) Financial risk management to (7) Market price fluctuation risk.”

#### **(4) Analysis of capital resources and liquidity of funds**

##### **a. Funding requirements**

Funds are allocated for capital expenditure, working capital and acquiring external capital resources as well as the repayment of loans, the payment of interest and dividends, the acquisition of treasury shares and the payment of income taxes.

##### **b. Resources of funds**

The necessary funds are mainly procured from net cash flows from operating activities, loans from financial institutions and bond and commercial paper issuances.

##### **<Cash flows>**

Net cash flows from operating activities in the fiscal year ended December 31, 2014 came to ¥543.7 billion, while net cash flows used in investing activities and financing activities were ¥49.1 billion and ¥388.9 billion, respectively. Cash and cash equivalents on a consolidated basis at December 31, 2014, including the effect of exchange rate changes, increased by ¥132.6 billion from the end of the previous fiscal year to ¥385.8 billion (end of previous fiscal year balance of ¥253.2 billion).



## <Interest-bearing debt>

Amounts of interest-bearing debt of the JT Group to be repaid or redeemed as of December 31, 2014 are as follows.

(Billions of yen)

	Book value	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
Short-term borrowings as loans	27.6	27.6	–	–	–	–	–
Short-term lease obligations	4.3	4.3	–	–	–	–	–
Long-term borrowings as loans (current portion)	39.9	39.9	–	–	–	–	–
Bonds (current portion)	40.0	40.0	–	–	–	–	–
Long-term borrowings as loans	1.0	–	0.1	0.1	0.2	0.1	0.5
Bonds	100.0	–	–	20.0	60.3	–	20.0
Long-term lease obligations	15.3	–	3.6	2.8	1.8	0.7	6.4
Total	228.2	111.9	3.7	22.9	62.3	0.8	26.9

### Long-term debt

Bonds issued (including the current portion) as of March 31, 2014 and as of December 31, 2014 accounted for ¥303.5 billion and ¥140.0 billion, respectively, and long-term borrowings as loans from financial institutions (including the current portion) accounted for ¥36.3 billion and ¥41.0 billion, respectively. Annual interest rates applicable to long-term borrowings outstanding as of March 31, 2014 and December 31, 2014 ranged from 0.43% to 5.90% and from 0.43% to 5.90%, respectively. Long-term lease obligations totaled ¥9.7 billion as of March 31, 2014 and ¥15.3 billion as of December 31, 2014.

As of December 31, 2014, our long-term debt was rated Aa3 (stable) by Moody's Japan K.K., AA- (stable) by Standard & Poor's Ratings Japan K.K., and AA (stable) by Rating and Investment Information, Inc. (R&I), all with a "stable" outlook. 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 business markets, the quality of execution of our business strategies, and general economic trends that are beyond our control. The ratings may be withdrawn or revised at any time. Each rating should be evaluated separately from other ratings. Under the JT Act, bonds issued by JT are secured by statutory preferential rights to the property of JT. These rights give bondholders precedence over unsecured creditors in seeking repayment, with the exception of national and local taxes and other statutory obligations.

### Short-term debt

Short-term borrowings from financial institutions totaled ¥21.9 billion as of March 31, 2014 and ¥27.6 billion as of December 31, 2014. There was no commercial paper outstanding as of March 31, 2014 and as of December 31, 2014. Annual interest rates applicable to short-term borrowings ranged from 0.45% to 13.00% as of March 31, 2014, and from 0.43% to 10.00% as of December 31, 2014. Short-term lease obligations totaled ¥4.4 billion as of March 31, 2014 and ¥4.3 billion as of December 31, 2014.

### c. 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 regular business activities. On December 31, 2014, we had ¥386.5 billion in committed lines of credit from major financial institutions both domestic and international, none of which was used. In addition, we have a domestic commercial paper program, uncommitted lines of credit, and a domestic bond shelf registration.

### III. Facilities

#### 1. Outline of capital expenditures

In the period from January through December 2014, we made capital expenditures totaling ¥140.9 billion.

In the domestic tobacco business, we spent ¥41.0 billion, mainly on measures to streamline manufacturing processes, strengthen our ability to respond flexibly to supply and demand fluctuations with regard to an increasingly diverse range of products and develop new products. In the international tobacco business, we invested ¥74.2 billion mainly for improvements in product specifications in addition to improvement, maintenance and renewals of production capability. In the pharmaceutical business, we spent ¥4.7 billion on enhancing and strengthening research and development structures and the like. In the beverage business, we spent ¥10.7 billion on maintenance and renewals of vending machines. In the processed food business, we spent ¥4.7 billion on improvement, maintenance and renewals of production capability.

Please note that our own capital was allocated for 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.

#### 2. Main facilities

Main facilities of the JT Group (JT and its consolidated subsidiaries) are as follows.

##### (1) Filing company (JT)

(As of December 31, 2014)

Office and factory name (Location)	Segment	Description	Book value (Millions of yen)						Number of employees (Person)
			Land		Buildings and structures	Machinery, equipment and vehicles	Tools, furniture and fixtures	Total	
			Size (thousand m <sup>2</sup> )	Amount					
Kita-kanto Factory (Utsunomiya-shi, Tochigi) <small>Note 1</small>	Domestic Tobacco	Tobacco manufacturing facilities	150	2,062	7,023	26,512	985	36,581	399
Tokai Factory (Iwata-shi, Shizuoka) <small>Note 1</small>	Domestic Tobacco	Tobacco manufacturing facilities	223	2,309	6,590	10,756	379	20,034	348
Kansai Factory (Fushimi-ku, Kyoto-shi)	Domestic Tobacco	Tobacco manufacturing facilities	116	5,831	10,487	30,107	883	47,308	475
Kyushu Factory (Chikushino-shi, Fukuoka)	Domestic Tobacco	Tobacco manufacturing facilities	166	4,042	2,527	8,236	262	15,067	269
Other factories (5) (Municipality) <small>Note 1, Note 4</small>	Domestic Tobacco	Mainly tobacco manufacturing facilities	452	2,215	8,282	6,936	427	17,860	663
Tobacco Science Research Center (Aoba-ku, Yokohama-shi) <small>Note 1</small>	Domestic Tobacco	Research and development facilities	35	642	3,681	0	744	5,068	86
Central Pharmaceutical Research Institute (Takatsuki-shi, Osaka)	Pharmaceutical	Research and development facilities	95	2,730	14,621	9	1,654	19,013	592
Head Office (Minato-ku, Tokyo)	General administration	Other	7	21,487	21,745	10	1,651	44,893	1,748
Domestic Sales Offices (25) (Municipality) <small>Note 4</small>	Domestic Tobacco (includes administration)	Other	60	3,119	3,829	1,397	1,013	9,359	3,676

## (2) Domestic subsidiaries

(As of December 31, 2014)

Office and factory name (Location)	Segment	Description	Book value (Millions of yen)						Number of employees (Person)
			Land		Buildings and structures	Machinery, equipment and vehicles	Tools, furniture and fixtures	Total	
			Size (thousand m <sup>2</sup> )	Amount					
TS Network Co., Ltd. Head Office and other 27 distribution bases (Head Office: Taito-ku, Tokyo) Note 1, Note 2	Domestic Tobacco	Distribution facilities	27	-	4,827	1,683	524	7,034	1,407
Japan Filter Technology Co., Ltd. Head Office and other 3 factories (Head Office: Shibuya-ku, Tokyo) Note 1	Domestic Tobacco	Material manufacturing facilities	142	761	3,489	8,458	247	12,954	422
Torii Pharmaceutical Co., Ltd. Head Office, other factories and branch offices (Head Office: Chuo-ku, Tokyo) Note 1, Note 2	Pharmaceutical	Pharmaceuticals manufacturing facility and other	59	518	2,909	2,077	453	5,956	1,047
Japan Beverage Holdings Inc. Head Office and other business locations (Head Office: Shinjuku-ku, Tokyo) Note 1, Note 2	Beverage	Sales and distribution facilities	69	3,055	2,331	4,647	12,027	22,060	189
TableMark Co., Ltd. Head Office and other 8 factories (Head Office: Chuo-ku, Tokyo) Note 2	Processed Food	Frozen food production facilities	-	-	6,296	9,029	215	15,541	1,295

## (3) Foreign subsidiaries

(As of December 31, 2014)

Office and factory name (Location)	Segment	Description	Book value (Millions of yen)						Number of employees (Person)
			Land		Buildings and structures	Machinery, equipment and vehicles	Tools, furniture and fixtures	Total	
			Size (thousand m <sup>2</sup> )	Amount					
Gallaher Ltd. (U.K.) Note 5	International Tobacco	Tobacco manufacturing facilities	536	4,032	5,641	16,681	1,138	27,492	1,487
LLC Petro (Russia) Note 2	International Tobacco	Tobacco manufacturing facilities	187	34	5,552	16,040	1,969	23,596	1,199
Liggett-Ducat CJSC (Russia) Note 2	International Tobacco	Tobacco manufacturing facilities	32	125	2,277	3,392	446	6,239	589
JT International Germany GmbH (Germany) Note 5	International Tobacco	Tobacco manufacturing facilities	346	349	11,731	23,679	1,528	37,287	1,779
JTI Tütün Ürünleri Sanayi A.S. (Turkey)	International Tobacco	Tobacco manufacturing facilities	149	177	2,284	11,740	114	14,315	442
JTI Polska Sp. z o. o. (Poland) Note 5	International Tobacco	Tobacco manufacturing facilities	158	101	6,895	18,763	937	26,696	905

Notes: 1. Companies have land leased to entities other than the Group companies.

2. Companies have land leased from entities other than the Group companies.

3. Book values include lease assets.

4. JT will carry out closures, etc. at some of its tobacco production factories and the like by the end of March 2016 in order to further strengthen cost competitiveness. In addition, as of April 1, 2015, JT will transform its current 25-office structure into a 15-office structure with more enhanced and expanded capabilities, and reconstruct its sales structure in order to strengthen competitiveness.

5. JT decided by resolution at a meeting of the Board of Directors held on October 6, 2014, to undertake appropriate consultations with the European Works Council and employees' representatives on the proposal to restructure manufacturing facilities in the EU.

According to the proposal, the facilities in Lisnafillan (Northern Ireland) and Wervik (Belgium) would cease to operate, with production moving to other facilities, potentially in Poland and Romania. Make Your Own tobacco products manufacturing in Trier (Germany) would also be relocated.

### 3. Plans for new installation and retirement 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. Of the reportable segments, we position the domestic and international tobacco businesses 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 and processed food businesses, we will devote efforts to strengthening business foundations to generate future profits, so we will make investments to that end.

Based on this policy, we plan capital expenditures (facility construction and expansion) totaling ¥161.0 billion in the fiscal year ending December 31, 2015.

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 presented in “II. Review of operations, 4. Business and other risks.”

Segment	Capital expenditure plan for the fiscal year ending December 31, 2015 (Billions of yen)	Main purpose of investment	Funding
Domestic Tobacco Business	41.0	Expenditures for the development and reinforcement of sales and production facilities for strengthening brand equity	Internally generated funds
International Tobacco Business	85.0	Expenditures for the improvement of product specifications, the expansion of production capacity, the maintenance and upgrading of facilities and expansion of the business base	Same as above
Pharmaceutical Business	6.5	Expenditures for the development and reinforcement of R&D capabilities	Same as above
Beverage Business	13.0	Expenditures for the development and reinforcement of sales facilities	Same as above
Processed Food Business	7.0	Expenditures for the expansion of production capacity and the maintenance and upgrading of facilities	Same as above

Note: There were no plans for sales or retirement of important facilities except for the regular renewal of facilities.

- \* 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.
- \* Capital expenditure plans for the fiscal year ending December 31, 2015, do not factor in the impact from the withdrawal from manufacture and sale of JT beverage products as announced on February 4, 2015.

## IV. Filing company

### 1. Information on the Company (JT)'s shares

#### (1) Total number of shares authorized

##### a. Total number of shares authorized

Class	Total number of shares authorized (Share)
Ordinary shares	8,000,000,000
Total	8,000,000,000

##### b. Number of shares issued

Class	Number of shares issued (Share; as of December 31, 2014)	Number of shares issued (Share; as of the date of filing: March 20, 2015)	Name of financial instruments exchange where the stock of JT is traded or the name of authorized financial instruments firms association where JT is registered	Details
Ordinary shares	2,000,000,000	2,000,000,000	Tokyo Stock Exchange (First Section)	(Note 2)
Total	2,000,000,000	2,000,000,000	—	—

Notes: 1. The provisions of Article 2 of the Act on Japan Tobacco Inc. prescribe that the Japanese government must continue to hold more than one-third of all JT shares issued (excluding shares of a class for which it is provided that the voting rights may not be exercised for all the matters that are subject to resolution at the shareholders meeting).

2. JT's standard class of shares with no rights limitations. Its share trading unit is 100 shares.

## (2) Status of subscription rights to shares

Subscription rights to shares issued pursuant to the Companies Act are as follows.

### a. Resolution of a meeting of the Board of Directors on December 21, 2007

	As of December 31, 2014	As of February 28, 2015
Number of subscription rights to shares	335 units	310 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (JT's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	67,000 shares <sup>(Notes 1, 4)</sup>	62,000 shares <sup>(Notes 1, 4)</sup>
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From January 9, 2008 to January 8, 2038	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥581,269 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Director (including <i>sikkoyaku</i> at a company with committees), Audit & Supervisory Board Member and Executive Officer ( <i>sikkoyakuin</i> ) of JT. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. The class of shares to be issued upon exercise of subscription rights to shares shall be ordinary shares. The number of shares to be issued upon exercise of each stock acquisition right (hereinafter, "Number of Shares Granted") shall be one.

However, in cases where JT conducts stock split (including stock allotment without contribution; hereinafter, the same shall apply to description of stock split) or stock consolidation of ordinary shares of JT after the date on which JT allots subscription rights to shares

(hereinafter, “Allotment Date”), the Number of Shares Granted shall be adjusted according to the following formula.

$$\begin{array}{rcccl} \text{Number of Shares Granted} & & \text{Number of Shares Granted} & & \text{Ratio of stock split or stock} \\ \text{after adjustment} & = & \text{before adjustment} & \times & \text{consolidation} \end{array}$$

Any fraction of less than one share that occurs as a result of the above adjustment shall be rounded down to two decimal places.

In the case of a stock split, the Number of Shares Granted after adjustment shall be applied on and after the date following the base date (if the base date is not specified, on and after the effective date), while in the case of stock consolidation, it shall be applied on and after the effective date. However, in cases where stock split is conducted subject to approval of the proposal to reduce surplus and increase capital or reserve fund at the General Meeting of Shareholders of JT and where the base date for stock split is set on or before the date of conclusion of that General Meeting of Shareholders, the Number of Shares Granted after adjustment shall be applied retrospectively to the date following that base date, on and after the date following the date of conclusion of that General Meeting of Shareholders.

In addition, in cases where the adjustment of the Number of Shares Granted is proper, JT shall conduct adjustments deemed necessary after the Allotment Date.

When adjusting the Number of Shares Granted, JT shall notify Subscription rights to shares Holders or make public notice of necessary information by the date before the date on which the Number of Shares Granted after adjustment is applied. However, in cases where the notice or public notice by the date before the date of the application is impracticable, JT shall later do so as soon as possible.

2. In cases where proposal a., b. or c. below is approved at the General Meeting of Shareholders of JT (if a resolution by the General Meeting of Shareholders is not necessary, it is read as “in cases where the resolution of a meeting of the Board of Directors or the decision by the representative Executive Officer (*sikkoyaku* at a company with committees) is made”), JT may acquire subscription rights to shares on the date separately provided for by the Board of Directors.

In this case, JT shall, in exchange for acquiring each stock acquisition right, deliver money at the amount obtained by multiplying the value per share calculated according to the following formula by the Number of Shares Granted (if adjusted pursuant to Note 1 above, the Number of Shares Granted after adjustment) to the Subscription rights to shares Holders of respective such subscription rights to shares.

Value per share = Closing price for regular transactions of ordinary shares of JT on the Tokyo Stock Exchange (if there is no closing price, the base price thereof on the following business day) on the date on which such proposal is approved at the General Meeting of Shareholders of JT (if a resolution by the General Meeting of Shareholders is not necessary, it is read as “the resolution of a meeting of the Board of Directors or the decision by the representative Executive Officer (*sikkoyaku* at a company with committees) is made”) – ¥1

- a. Proposal to ask approval of a contract of merger where JT is not to be the surviving company
- b. Proposal to ask approval of a contract or plan of company split where JT would be the split company
- c. Proposal to ask approval of a share exchange contract or share transfer plan where JT becomes a wholly-owned subsidiary

3. In cases where JT merges (limited to cases where JT is to be extinguished as a result of the merger), splits and absorbs or splits and incorporates (limited to cases where JT becomes the split company in either case), or exchanges or transfers shares (limited to cases where JT becomes a wholly-owned subsidiary in either case) (collectively, hereinafter, “Reorganization”), JT shall, in each case, deliver subscription rights to shares of the companies as listed in Article 236, paragraph 1, item (viii), sub-items (a) to (e) of the Companies Act (hereinafter, the “Company Subject to Reorganization”) to the Subscription rights to shares Holders that have subscription rights to shares existing immediately before the effective date of the Reorganization, which is either the effective date of absorption-type merger when it is an absorption-type merger, the consolidation date of a company as a result of the consolidated-type merger when it is a consolidated-type merger, the effective date of absorption-type company split when it is an absorption-type company split, the incorporation date of a company as a result of the incorporation-type company split when it is an incorporation-type company split, the effective date of share exchange when it is a share exchange, or the incorporation date of a wholly-owning parent company as a result of the share transfer when it is a share transfer (hereinafter, “Remaining Subscription rights to shares”). However, it is subject to a condition that the provision that the subscription rights to shares of the Company Subject to Reorganization shall be delivered pursuant to the provisions of the items below, is specified in the absorption-type merger contract, consolidated-type merger contract, absorption-type company split contract, incorporation-type company split plan, share exchange contract or share transfer plan.

- a. Number of subscription rights to shares to be delivered of the Company Subject to Reorganization  
Subscription rights to shares whose number is identical to the number of the Remaining Subscription rights to shares held by Subscription rights to shares Holder
- b. Class of shares of the Company Subject to Reorganization to be issued upon exercise of subscription rights to shares  
Ordinary shares of the Company Subject to Reorganization
- c. Number of shares of the Company Subject to Reorganization to be issued upon exercise of subscription rights to shares  
To be determined in the same manner as Note 1 above, taking into consideration terms and other conditions of the Reorganization.
- d. Value of property to be contributed when subscription rights to shares are exercised  
The value of the property to be contributed when each stock acquisition right to be delivered is exercised shall be the amount obtained by multiplying the paid-in amount after Reorganization as specified below by the number of shares of the Company Subject to Reorganization to be issued upon exercise of each stock acquisition right, which is decided pursuant to c. above. The paid-in amount after Reorganization shall be ¥1 per share of the shares of the Company Subject to Reorganization that would be delivered by exercising the delivered subscription rights to shares.
- e. Period during which subscription rights to shares can be exercised  
From the effective date of the Reorganization to the expiration date of the period during which such subscription rights to shares can be exercised as specified in “Exercise period of subscription rights to shares” mentioned above.
- f. Matters regarding capital and capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares  
To be determined in the same manner as “Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares” mentioned above.
- g. Restrictions on transferring of subscription rights to shares  
Transferring the subscription rights to shares is subject to approval of the Board of Directors of the Company Subject to Reorganization.



- h. Provisions for acquiring subscription rights to shares  
To be determined in the same manner as Note 2 above.
  - i. Other conditions for exercising subscription rights to shares  
To be determined in the same manner as “Conditions for exercising subscription rights to shares” mentioned above.
4. JT conducted a share split at a ratio of 200 to one ordinary share with July 1, 2012 as effective date. As a consequence, the number of shares to be issued upon exercise of the subscription rights to shares issued before this share split has been adjusted at a ratio of 200 to one share and is presented accordingly.

b. Resolution of a meeting of the Board of Directors on September 19, 2008

	As of December 31, 2014	As of February 28, 2015
Number of subscription rights to shares	499 units	494 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (JT's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	99,800 shares <sup>(Notes 1, 4)</sup>	98,800 shares <sup>(Notes 1, 4)</sup>
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 7, 2008 to October 6, 2038	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥285,904 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	<p>a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen.</p> <p>b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.</p>	Same as left
Conditions for exercising subscription rights to shares	<p>a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Director (including <i>sikkoyaku</i> at a company with committees), Audit &amp; Supervisory Board Member and Executive Officer (<i>sikkoyakuin</i>) of JT.</p> <p>b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.</p>	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of a meeting of the Board of Directors on December 21, 2007.

c. Resolution of a meeting of the Board of Directors on September 28, 2009

	As of December 31, 2014	As of February 28, 2015
Number of subscription rights to shares	1,049 units	1,049 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (JT's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	209,800 shares <sup>(Notes 1, 4)</sup>	209,800 shares <sup>(Notes 1, 4)</sup>
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 14, 2009 to October 13, 2039	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥197,517 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	<p>a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen.</p> <p>b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.</p>	Same as left
Conditions for exercising subscription rights to shares	<p>a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Director (including <i>sikkoyaku</i> at a company with committees), Audit &amp; Supervisory Board Member and Executive Officer (<i>sikkoyakuin</i>) of JT.</p> <p>b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.</p>	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of a meeting of the Board of Directors on December 21, 2007.

d. Resolution of a meeting of the Board of Directors on September 17, 2010

	As of December 31, 2014	As of February 28, 2015
Number of subscription rights to shares	861 units	861 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (JT's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	172,200 shares <sup>(Notes 1, 4)</sup>	172,200 shares <sup>(Notes 1, 4)</sup>
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 5, 2010 to October 4, 2040	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥198,386 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	<p>a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen.</p> <p>b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.</p>	Same as left
Conditions for exercising subscription rights to shares	<p>a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Director (including <i>sikkoyaku</i> at a company with committees), Audit &amp; Supervisory Board Member and Executive Officer (<i>sikkoyakuin</i>) of JT.</p> <p>b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.</p>	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of a meeting of the Board of Directors on December 21, 2007.

e. Resolution of a meeting of the Board of Directors on September 16, 2011

	As of December 31, 2014	As of February 28, 2015
Number of subscription rights to shares	1,038 units	1,038 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (JT's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	207,600 shares <sup>(Notes 1, 4)</sup>	207,600 shares <sup>(Notes 1, 4)</sup>
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 4, 2011 to October 3, 2041	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥277,947 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	<p>a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen.</p> <p>b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.</p>	Same as left
Conditions for exercising subscription rights to shares	<p>a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Director (including <i>sikkoyaku</i> at a company with committees), Audit &amp; Supervisory Board Member and Executive Officer (<i>sikkoyakuin</i>) of JT.</p> <p>b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.</p>	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of a meeting of the Board of Directors on December 21, 2007.

f. Resolution of a meeting of the Board of Directors on September 21, 2012

	As of December 31, 2014	As of February 28, 2015
Number of subscription rights to shares	729 units	729 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (JT's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	145,800 shares <sup>(Note 1)</sup>	145,800 shares <sup>(Note 1)</sup>
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 10, 2012 to October 9, 2042	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥320,000 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	<p>a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen.</p> <p>b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.</p>	Same as left
Conditions for exercising subscription rights to shares	<p>a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Director (including <i>sikkoyaku</i> at a company with committees), Audit &amp; Supervisory Board Member and Executive Officer (<i>sikkoyakuin</i>) of JT.</p> <p>b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.</p>	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. The class of shares to be issued upon exercise of subscription rights to shares shall be ordinary shares. The number of shares to be issued upon exercise of each stock acquisition right (hereinafter, "Number of Shares Granted") shall be 200. However, in cases where JT conducts stock split (including stock allotment without contribution; hereinafter, the same shall apply to description of stock split) or stock consolidation of ordinary shares of JT after the date on which JT allots subscription rights to shares (hereinafter, "Allotment Date"), the Number of Shares Granted shall be adjusted according to the following formula.

$$\text{Number of Shares Granted after adjustment} = \text{Number of Shares Granted before adjustment} \times \text{Ratio of stock split or stock consolidation}$$

Any fraction of less than one share that occurs as a result of the above adjustment shall be rounded down to two decimal places. In the case of a stock split, the Number of Shares Granted after adjustment shall be applied on and after the date following the base date (if the base date is not specified, on and after the effective date), while in the case of stock consolidation, it shall be applied on and after the effective date. However, in cases where stock split is conducted subject to approval of the proposal to reduce surplus and increase capital or reserve fund at the General Meeting of Shareholders of JT and where the base date for stock split is set on or before the date of conclusion of that General Meeting of Shareholders, the Number of Shares Granted after adjustment shall be applied retrospectively to the date following that base date, on and after the date following the date of conclusion of that General Meeting of Shareholders.

In addition, in cases where the adjustment of the Number of Shares Granted is proper, JT shall conduct adjustments deemed necessary after the Allotment Date.

When adjusting the Number of Shares Granted, JT shall notify Subscription rights to shares Holders or make public notice of necessary information by the date before the date on which the Number of Shares Granted after adjustment is applied. However, in cases where the notice or public notice by the date before the date of the application is impracticable, JT shall later do so as soon as possible.

2. and 3. Same as Notes 2. and 3. of subscription rights to shares pursuant to a. Resolution of a meeting of the Board of Directors on December 21, 2007.

g. Resolution of a meeting of the Board of Directors on September 20, 2013

	As of December 31, 2014	As of February 28, 2015
Number of subscription rights to shares	500 units	500 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (JT's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	100,000 shares <sup>(Note 1)</sup>	100,000 shares <sup>(Note 1)</sup>
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 8, 2013 to October 7, 2014	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥513,400 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	<p>a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen.</p> <p>b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.</p>	Same as left
Conditions for exercising subscription rights to shares	<p>a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Director (including <i>sikkoyaku</i> at a company with committees), Audit &amp; Supervisory Board Member and Executive Officer (<i>sikkoyakuin</i>) of JT.</p> <p>b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.</p>	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. Same as Note 1. of subscription rights to shares pursuant to f. Resolution of a meeting of the Board of Directors on September 21, 2012.

2. and 3. Same as Notes 2. and 3. of subscription rights to shares pursuant to a. Resolution of a meeting of the Board of Directors on December 21, 2007.



#### h. Resolution of a meeting of the Board of Directors on September 19, 2014

	As of December 31, 2014	As of February 28, 2015
Number of subscription rights to shares	344 units	344 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (JT's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	68,800 shares <sup>(Note 1)</sup>	68,800 shares <sup>(Note 1)</sup>
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 7, 2014 to October 6, 2044	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥483,200 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	<p>a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen.</p> <p>b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.</p>	Same as left
Conditions for exercising subscription rights to shares	<p>a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Director (including <i>sikkoyaku</i> at a company with committees), Audit &amp; Supervisory Board Member and Executive Officer (<i>sikkoyakuin</i>) of JT.</p> <p>b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.</p>	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. Same as Note 1. of subscription rights to shares pursuant to f. Resolution of a meeting of the Board of Directors on September 21, 2012.

2. and 3. Same as Notes 2. and 3. of subscription rights to shares pursuant to a. Resolution of a meeting of the Board of Directors on December 21, 2007.

### (3) Exercise of bond certificates with subscription rights to shares with exercise price amendment clause

No items to report

### (4) Details of rights plan

No items to report

### (5) Trends in total number of shares issued, capital stock

Date	Fluctuation in the number of shares issued (Thousands of shares)	Balance of shares issued (Thousands of shares)	Fluctuation in capital stock (Millions of yen)	Balance of capital stock (Millions of yen)	Fluctuation in capital reserve (Millions of yen)	Balance of capital reserve (Millions of yen)
July 1, 2012	1,990,000	2,000,000	–	100,000	–	736,400

Note: JT conducted a share split at a ratio of 200 to one share with July 1, 2012 as effective date. Consequently, the balance of shares issued increased by 1,990,000 thousand shares to 2,000,000 thousand shares.

### (6) Shareholder composition

(As of December 31, 2014)

Category	Shareholder composition (100 shares in one share unit)								Shares less than one unit (Share)
	Public sector	Financial institutions	Financial instruments business operators	Other corporations	Foreign investors		Individuals	Total	
					Companies	Individuals			
Number of shareholders (Person)	1	236	72	1,096	859	44	144,635	146,943	–
Number of shares held (Share)	6,669,300	3,173,483	450,390	249,361	6,725,108	243	2,731,870	19,999,755	24,500
Holding rate of shares (%)	33.35	15.87	2.25	1.25	33.63	0.00	13.66	100.00	–

Notes: 1. 1,824,433 units of treasury shares are included in "Individuals"

2. The number of "Other corporations" includes 336 units in the name of Japan Securities Depository Center, Inc.

**(7) Status of major shareholders**

(As of December 31, 2014)

Name of shareholder	Address	Number of shares held (Share)	Percentage of number of shares held in the total number of shares issued (%)
The Minister of Finance	1-1, Kasumigaseki 3-chome, Chiyoda-ku, Tokyo, Japan	666,930,000	33.35
The Master Trust Bank of Japan, Ltd. (Trust Account)	11-3, Hamamatsucho 2-chome, Minato-ku, Tokyo, Japan	48,016,600	2.40
Japan Trustee Services Bank, Ltd. (Trust Account)	8-11, Harumi 1-chome, Chuo-ku, Tokyo, Japan	44,042,200	2.20
JPMorgan Chase Bank 380055 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	270 Park Avenue, New York, NY 10017, United States of America (16-13, Tsukishima 4-chome, Chuo-ku, Tokyo, Japan)	40,614,441	2.03
State Street Bank and Trust Company (Standing proxy: The Hongkong and Shanghai Banking Corporation Limited, Tokyo Branch)	One Lincoln Street, Boston MA USA 02111 (11-1, Nihonbashi 3-chome, Chuo-ku, Tokyo, Japan)	37,725,319	1.89
State Street Bank and Trust Company 505223 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	P.O. Box 351 Boston Massachusetts 02101 U.S.A. (16-13, Tsukishima 4-chome, Chuo-ku, Tokyo, Japan)	37,079,564	1.85
Trust & Custody Services Bank, Ltd. as trustee for Mizuho Bank, Ltd. Retirement Benefit Trust Account re-entrusted by Mizuho Trust and Banking Co., Ltd.	Harumi Island Triton Square Office Tower Z, 8-12, Harumi 1-chome, Chuo-ku, Tokyo, Japan	33,800,000	1.69
State Street Bank and Trust Company (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	P.O. Box 351 Boston Massachusetts 02101 U.S.A. (16-13, Tsukishima 4-chome, Chuo-ku, Tokyo, Japan)	33,575,126	1.68
HSBC Bank plc A/C The Children's Investment Master Fund (Standing proxy: The Hongkong and Shanghai Banking Corporation Limited, Tokyo Branch)	8 Canada Square, London E14 5HQ, United Kingdom (11-1, Nihonbashi 3-chome, Chuo-ku, Tokyo, Japan)	28,362,300	1.42
JPMorgan Chase Bank 385632 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	25 Bank Street, Canary Wharf, London, E14 5JP, United Kingdom (16-13, Tsukishima 4-chome, Chuo-ku, Tokyo, Japan)	16,560,688	0.83
Total	–	986,706,238	49.34

Note: In addition to the above, JT held 182,443,388 shares of ordinary shares as treasury shares.

**(8) Status of voting rights**

## a. Shares issued

(As of December 31, 2014)

Classification	Number of shares (Share)	Number of voting rights	Details
Shares without voting rights	–	–	–
Shares with restricted voting rights (Treasury shares)	–	–	–
Shares with restricted voting rights (Other)	–	–	–
Shares with full voting rights (Treasury shares)	Ordinary shares 182,443,300	–	(Note 2)
Shares with full voting rights (Other)	Ordinary shares 1,817,532,200	18,175,322	(Note 2)
Shares less than one unit	Ordinary shares 24,500	–	(Note 3)
Total number of shares issued	2,000,000,000	–	–
Total number of voting rights	–	18,175,322	–

Notes: 1. The number of “Shares with full voting rights (Other)” includes 33,600 shares in the name of Japan Securities Depository Center, Inc. “Number of voting rights” includes 336 units of voting rights related to shares with full voting rights in its name.

2. JT’s standard class of shares with no rights limitations. Its share trading unit is 100 shares.

3. Includes 88 shares of treasury shares.

## b. Treasury shares

(As of December 31, 2014)

Name of shareholder	Address	Number of shares held under own name (Share)	Number of shares held under the name of others (Share)	Total number of shares held (Share)	Percentage of number of shares held in the total number of shares issued (%)
Japan Tobacco Inc.	2-1, Toranomom 2-chome, Minato-ku, Tokyo, Japan	182,443,300	–	182,443,300	9.12
Total	–	182,443,300	–	182,443,300	9.12

## (9) Stock options

JT has adopted a system of stock options that involves the issuance of subscription rights to shares in accordance with the Companies Act.

Details are as follows.

(By resolution of the Board of Directors at a meeting held on December 21, 2007)

The Board of Directors at a meeting held on December 21, 2007, resolved to issue subscription rights to shares as share remuneration type stock options to JT Directors and Executive Officers (*sikkoyakuin*) in accordance with the Companies Act.

Resolution date	December 21, 2007
Positions and number of persons granted	Directors 11 persons Executive Officers ( <i>sikkoyakuin</i> ) (excluding persons serving as Director) 16 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	46,600 shares to Directors, 38,600 shares to Executive Officers ( <i>sikkoyakuin</i> ), total 85,200 shares (200 shares per stock acquisition right) <sup>(Notes 1, 2)</sup>
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Notes: 1. In cases where JT conducts stock split (including stock allotment without contribution; hereinafter, the same shall apply to description of stock split) or stock consolidation of ordinary shares of JT after the date on which JT allots subscription rights to shares (hereinafter, “Allotment Date”), the number of shares to which each stock acquisition right applies (hereinafter, “Number of Shares Granted”) shall be adjusted according to the following formula.

$$\text{Number of Shares Granted after adjustment} = \text{Number of Shares Granted before adjustment} \times \text{Ratio of stock split or stock consolidation}$$

Any fraction of less than one share that occurs as a result of the above adjustment shall be rounded down to two decimal places.

In the case of a stock split, the Number of Shares Granted after adjustment shall be applied on and after the date following the base date (if the base date is not specified, on and after the effective date), while in the case of stock consolidation, it shall be applied on and after the effective date. However, in cases where stock split is conducted subject to approval of the proposal to reduce surplus and increase capital or reserve fund at the General Meeting of Shareholders of JT and where the base date for stock split is set on or before the date of conclusion of that General Meeting of Shareholders, the Number of Shares Granted after adjustment shall be applied retrospectively to the date following that base date, on and after the date following the date of conclusion of that General Meeting of Shareholders.

In addition, in cases where the adjustment of the Number of Shares Granted is proper, JT shall conduct adjustments deemed necessary after the Allotment Date.

When adjusting the Number of Shares Granted, JT shall notify holders of subscription rights to shares being recorded in the registry of subscription rights to shares or make public notice of necessary information by the date before the date on which the Number of Shares Granted after adjustment is applied. However, in cases where the notice or public notice by the date before the date of the application is impracticable, JT shall later do so as soon as possible.

2. JT conducted a share split at a ratio of 200 to one ordinary share with July 1, 2012 as effective date. As a consequence, the number of shares to be issued upon exercise of the subscription rights to shares issued before this share split has been adjusted at a ratio of 200 to one share and is presented accordingly.

(By resolution of the Board of Directors at a meeting held on September 19, 2008)

The Board of Directors at a meeting held on September 19, 2008, resolved to issue subscription rights to shares as share remuneration type stock options to JT Directors and Executive Officers (*sikkoyakuin*) in accordance with the Companies Act.

Resolution date	September 19, 2008
Positions and number of persons granted	Directors 11 persons Executive Officers ( <i>sikkoyakuin</i> ) (excluding persons serving as Director) 14 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	63,000 shares to Directors, 46,400 shares to Executive Officers ( <i>sikkoyakuin</i> ), total 109,400 shares (200 shares per stock acquisition right) <sup>(Notes 1, 2)</sup>
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Notes 1. and 2.: Same as Notes 1. and 2. of (By resolution of the Board of Directors at a meeting held on December 21, 2007).

(By resolution of the Board of Directors at a meeting held on September 28, 2009)

The Board of Directors at a meeting held on September 28, 2009, resolved to issue subscription rights to shares as share remuneration type stock options to JT Directors and Executive Officers (*sikkoyakuin*) in accordance with the Companies Act.

Resolution date	September 28, 2009
Positions and number of persons granted	Directors 9 persons Executive Officers ( <i>sikkoyakuin</i> ) (excluding persons serving as Director) 14 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	125,200 shares to Directors, 105,400 shares to Executive Officers ( <i>sikkoyakuin</i> ), total 230,600 shares (200 shares per stock acquisition right) <sup>(Notes 1, 2)</sup>
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Notes 1. and 2.: Same as Notes 1. and 2. of (By resolution of the Board of Directors at a meeting held on December 21, 2007).

(By resolution of the Board of Directors at a meeting held on September 17, 2010)

The Board of Directors at a meeting held on September 17, 2010, resolved to issue subscription rights to shares as share remuneration type stock options to JT Directors and Executive Officers (*sikkoyakuin*) in accordance with the Companies Act.

Resolution date	September 17, 2010
Positions and number of persons granted	Directors 9 persons Executive Officers ( <i>sikkoyakuin</i> ) (excluding persons serving as Director) 14 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	104,200 shares to Directors, 91,600 shares to Executive Officers ( <i>sikkoyakuin</i> ), total 195,800 shares (200 shares per stock acquisition right) <sup>(Notes 1, 2)</sup>
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Notes 1. and 2.: Same as Notes 1. and 2. of (By resolution of the Board of Directors at a meeting held on December 21, 2007).

(By resolution of the Board of Directors at a meeting held on September 16, 2011)

The Board of Directors at a meeting held on September 16, 2011, resolved to issue subscription rights to shares as share remuneration type stock options to JT Directors and Executive Officers (*sikkoyakuin*) in accordance with the Companies Act.

Resolution date	September 16, 2011
Positions and number of persons granted	Directors 8 persons Executive Officers ( <i>sikkoyakuin</i> ) (excluding persons serving as Director) 15 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	102,800 shares to Directors, 104,800 shares to Executive Officers ( <i>sikkoyakuin</i> ), total 207,600 shares (200 shares per stock acquisition right) <sup>(Notes 1, 2)</sup>
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Notes 1. and 2.: Same as Notes 1. and 2. of (By resolution of the Board of Directors at a meeting held on December 21, 2007).

(By resolution of the Board of Directors at a meeting held on September 21, 2012)

The Board of Directors at a meeting held on September 21, 2012, resolved to issue subscription rights to shares as share remuneration type stock options to JT Directors (excluding Outside Directors) and Executive Officers (*sikkoyakuin*) in accordance with the Companies Act.

Resolution date	September 21, 2012
Positions and number of persons granted	Directors (excluding Outside Directors) 7 persons Executive Officers ( <i>sikkoyakuin</i> ) (excluding persons serving as Director) 17 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	65,600 shares to Directors (excluding Outside Directors), 80,200 shares to Executive Officers ( <i>sikkoyakuin</i> ), total 145,800 shares (200 shares per stock acquisition right) <sup>(Note)</sup>
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Note: Same as Note 1. of (By resolution of the Board of Directors at a meeting held on December 21, 2007).

(By resolution of the Board of Directors at a meeting held on September 20, 2013)

The Board of Directors at a meeting held on September 20, 2013, resolved to issue subscription rights to shares as share remuneration type stock options to JT Directors (excluding Outside Directors) and Executive Officers (*sikkoyakuin*) in accordance with the Companies Act.

Resolution date	September 20, 2013
Positions and number of persons granted	Directors (excluding Outside Directors) 7 persons Executive Officers ( <i>sikkoyakuin</i> ) (excluding persons serving as Director) 19 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	42,000 shares to Directors (excluding Outside Directors), 58,000 shares to Executive Officers ( <i>sikkoyakuin</i> ), total 100,000 shares (200 shares per stock acquisition right) <sup>(Note)</sup>
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Note: Same as Note 1. of (By resolution of the Board of Directors at a meeting held on December 21, 2007).



(By resolution of the Board of Directors at a meeting held on September 19, 2014)

The Board of Directors at a meeting held on September 19, 2014, resolved to issue subscription rights to shares as share remuneration type stock options to JT Directors (excluding Outside Directors) and Executive Officers (*sikkoyakuin*) in accordance with the Companies Act.

Resolution date	September 19, 2014
Positions and number of persons granted	Directors (excluding Outside Directors) 6 persons Executive Officers ( <i>sikkoyakuin</i> ) (excluding persons serving as Director) 19 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	35,600 shares to Directors (excluding Outside Directors), 33,200 shares to Executive Officers ( <i>sikkoyakuin</i> ), total 68,800 shares (200 shares per stock acquisition right) <sup>(Note)</sup>
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Note: Same as Note 1. of (By resolution of the Board of Directors at a meeting held on December 21, 2007).

## 2. Acquisition of treasury shares

[Class of shares] Acquisition of ordinary shares falling under Article 155, item (iii) of the Companies Act

### (1) Acquisition by resolution of the General Meeting of Shareholders

No items to report

### (2) Acquisition by resolution of the Board of Directors

Category	Number of shares (Share)	Total value (Millions of yen)
Resolution at a meeting of the Board of Directors (February 5, 2015) (Acquisition period: From February 9, 2015 to June 9, 2015)	36,000,000	100,000
Treasury shares acquired before this fiscal year ended December 31, 2014	–	–
Treasury shares acquired during this fiscal year ended December 31, 2014	–	–
Total number and amount of remaining shares to be acquired by resolution	36,000,000	100,000
Ratio of unexercised shares to the number resolved as of the end of this fiscal year ended December 31, 2014 (%)	100.0	100.0
Treasury shares acquired during the period from January 1, 2015 to the filing date of this Annual Securities Report	26,896,200	100,000
Ratio of unexercised shares to the number resolved as of the date of filing (%)	25.3	0.0

Notes: 1. At the meeting of the Board of Directors mentioned above, it was resolved for the acquisition of treasury shares to be carried out on the stock exchange via a trust bank.

2. Based on this resolution, JT acquired 26,896,200 shares of its ordinary shares for a total acquisition price of ¥100,000 million during the period between February 9, 2015 and March 18, 2015 (contract basis), and has completed the acquisition of its ordinary shares based on the resolution.

3. The number of shares and total value of treasury shares acquired during the period from January 1, 2015 to the filing date of this Annual Securities Report are presented on a contract basis.

### (3) Items not based on resolutions of the General Meeting of Shareholders or Board of Directors

No items to report

### (4) Status of disposal and ownership of acquired treasury shares

Category	Fiscal year ended December 31, 2014		From January 1, 2015 until the filing date of this Annual Securities Report	
	Number of shares (Share)	Total disposal value (Millions of yen)	Number of shares (Share)	Total disposal value (Millions of yen)
Acquired treasury shares offered for subscription	–	–	–	–
Acquired treasury shares that were disposed	–	–	–	–
Acquired treasury shares transferred for merger, share exchange and company split	–	–	–	–
Other (exercise of subscription rights to shares)	8,600	16,237	6,000	11,357
Treasury shares held	182,443,388	–	209,333,588	–

Note: The number of shares of treasury shares held in the “From January 1, 2015 until the filing date of this Annual Securities Report” column is presented on a contract basis.

### 3. Dividend policy

JT attaches a high priority to business investment that contributes to sustainable medium- to long-term profit growth, and seeks to provide competitive shareholder returns comparable to global Fast-Moving Consumer Goods (FMCG) players. In accordance with these priorities, JT has put in place targets for the consolidated dividend payout ratio and adjusted earnings per share (EPS) growth rate (at constant rates of exchange).

Regarding the consolidated dividend payout ratio, in order to be on par with global players in the FMCG business with a consolidated dividend payout ratio of at least 50%, JT aims to realize a consolidated dividend payout ratio of 50% in the fiscal year ending December 31, 2015. JT also aims to achieve an adjusted EPS growth rate (at constant rates of exchange) of high single digit per annum over the medium to long term.

It is also a basic policy of JT to pay an interim dividend and year-end dividend, with the former determined by the Board of Directors and the latter by the General Meeting of Shareholders.

In light of business performance in the current fiscal year ended December 31, 2014, the year-end dividend for the fiscal year ended December 31, 2014 was ¥50 per share. Therefore, the total annual dividend for the fiscal year ended December 31, 2014, including the interim dividend of ¥50, is ¥100 per share.

Also, internal reserves will be prepared not only for present and future business investments and to acquire external resources but also for the purchase of own shares and other objectives.

JT's articles of incorporation stipulate that JT may pay interim dividends to shareholders with the record date of June 30 each year upon a resolution by the Board of Directors.

The dividend for the 30th term is as follows.

Resolution date	Total amount of dividends (Millions of yen)	Cash dividends per share (Yen)
Meeting of the Board of Directors held on October 30, 2014	90,878	50.00
Annual General Meeting of Shareholders held on March 20, 2015	90,878	50.00

#### 4. Trends in share price

##### (1) Highest and lowest share prices for the most recent 5 years by term

Term	25th term	26th term	27th term	28th term	29th term	30th term
Accounting period	From April 1, 2009 to March 31, 2010	From April 1, 2010 to March 31, 2011	From April 1, 2011 to March 31, 2012	From April 1, 2012 to March 31, 2013	From April 1, 2013 to March 31, 2014	From April 1, 2014 to December 31, 2014
Highest (Yen)	358,000	352,000	474,500	490,500 *3,240	3,835	4,193
Lowest (Yen)	227,000	243,900	282,600	406,500 *2,108	2,850	3,097

Notes: 1. The yearly highest and lowest share prices were those recorded on the first section of the Tokyo Stock Exchange.

2. JT conducted a share split at a ratio of 200 to one share with July 1, 2012 as effective date. Numbers marked with \* are the highest and lowest share prices on an ex-rights basis in accordance with the share split.

3. The 30th term is the 9-month period from April 1, 2014 through December 31, 2014, due to a change of the fiscal year end.

##### (2) Monthly highest and lowest share prices for the most recent 6 months

Month	July 2014	August 2014	September 2014	October 2014	November 2014	December 2014
Highest (Yen)	3,804.0	3,669.0	3,704.5	3,810.0	4,193.0	3,819.0
Lowest (Yen)	3,640.0	3,351.0	3,510.0	3,272.5	3,761.5	3,107.0

Note: The monthly highest and lowest share prices were those recorded on the first section of the Tokyo Stock Exchange.

## 5. Status of officers

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Chairman of the Board		Yasutake Tango	March 21, 1951	<p>April 1974 Entered Ministry of Finance</p> <p>October 2006 Director-General of the Financial Bureau</p> <p>July 2007 Deputy Vice Minister</p> <p>July 2008 Director-General of the Budget Bureau</p> <p>July 2009 Administrative Vice Minister</p> <p>July 2010 Retired from the office of Administrative Vice Minister</p> <p>December 2010 Corporate Auditor, The Yomiuri Shimbun Holdings</p> <p>December 2012 Special Advisor to the Cabinet</p> <p>June 2014 Chairman of the Board, the Company (Current Position)</p>	1 year and 9 months since June 2014	500
* President, Chief Executive Officer and Representative Director		Mitsuomi Koizumi	April 15, 1957	<p>April 1981 Joined the Company (Japan Tobacco and Salt Public Corporation)</p> <p>June 2001 Vice President of Corporate Planning Division</p> <p>June 2003 Senior Vice President, and Head of Human Resources and Labor Relations Group</p> <p>June 2004 Senior Vice President, and Vice President of Tobacco Business Planning Division, Tobacco Business Headquarters</p> <p>June 2006 Executive Vice President, and Vice President of Tobacco Business Planning Division, Tobacco Business Headquarters</p> <p>June 2007 Member of the Board, Executive Vice President, and Head of Marketing &amp; Sales General Division, Tobacco Business Headquarters</p> <p>July 2007 Member of the Board, Executive Vice President, and Chief Marketing &amp; Sales Officer, Tobacco Business Headquarters</p> <p>June 2009 Representative Director and Executive Deputy President</p> <p>June 2012 President, Chief Executive Officer and Representative Director (Current Position)</p>	1 year and 9 months since June 2014	24,400

Title	Post	Name	Date of birth	Summary of career		Term of office	Number of shares held (Share)	
* Representative Director and Executive Deputy President		Yasushi Shingai	January 11, 1956	April	1980	Joined the Company (Japan Tobacco and Salt Public Corporation)	1 year and 9 months since June 2014	23,800
				July	2001	Vice President of Financial Planning Division		
				June	2004	Senior Vice President, and Head of Finance Group, Vice President of Financial Planning Division		
				July	2004	Senior Vice President, and Chief Financial Officer		
				June	2005	Member of the Board, Senior Vice President, and Chief Financial Officer		
				June	2006	Member of the Board Executive Vice President, JT International S.A.		
				June	2011	Member of the Board, Senior Vice President, and Executive Vice President in charge of International Tobacco Business		
				June	2011	Representative Director and Executive Deputy President (Current Position)		
				June	2014	Outside Director, Recruit Holdings Co., Ltd. (Current Position)		
* Representative Director and Executive Deputy President		Noriaki Okubo	May 22, 1959	April	1983	Joined the Company (Japan Tobacco and Salt Public Corporation)	1 year and 9 months since June 2014	9,900
				April	2000	Vice President of Business Development Dept., Pharmaceutical Division		
				June	2002	Vice President of Business Planning Dept., Pharmaceutical Division		
				June	2004	Member of the Board, Senior Vice President, and President, Pharmaceutical Business		
				June	2006	Member of the Board, Executive Vice President, and President, Pharmaceutical Business		
				June	2009	Member of the Board, Senior Executive Vice President, and President, Pharmaceutical Business		
				May	2010	Member of the Board, Senior Executive Vice President, and President, Pharmaceutical Business, Vice President of Business Planning Dept., Pharmaceutical Division		
				January	2011	Member of the Board, Senior Executive Vice President, and President, Pharmaceutical Business		
				June	2012	Representative Director and Executive Deputy President (Current Position)		

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)	
* Representative Director and Executive Deputy President		Akira Saeki	August 25, 1960	April 1985	Joined the Company	1 year and 9 months since June 2014	15,500
	June 2005			Vice President of Corporate Strategy Division			
	June 2007			Senior Vice President, Vice President of Tobacco Business Planning Division, Tobacco Business Headquarters			
	May 2008			Senior Vice President, Vice President of Tobacco Business Planning Division, Tobacco Business Headquarters, Head of China Division, Tobacco Business			
	June 2008			Senior Vice President, Vice President of Tobacco Business Planning Division, Tobacco Business Headquarters, Chief Corporate, Scientific & Regulatory Affairs Officer, Tobacco Business, Head of China Division, Tobacco Business			
	July 2008			Senior Vice President, Vice President of Tobacco Business Planning Division, Tobacco Business Headquarters, Chief Corporate, Scientific & Regulatory Affairs Officer, Tobacco Business			
	July 2009			Senior Vice President, Vice President of Tobacco Business Planning Division, Tobacco Business Headquarters, Chief Corporate, Scientific & Regulatory Affairs Officer, Tobacco Business			
	June 2010			Executive Vice President, and Vice President of Tobacco Business Planning Division, Tobacco Business Headquarters			
				June 2012	Representative Director and Executive Deputy President (Current Position)		

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
* Member of the Board and Executive Deputy President		Hideki Miyazaki	January 22, 1958	<p>April 1980 Joined Nomura Securities Co., Ltd.</p> <p>July 2005 Joined the Company</p> <p>January 2006 Deputy Chief Financial Officer</p> <p>June 2008 Senior Vice President, and Chief Financial Officer, Vice President, Tax Division</p> <p>October 2009 Senior Vice President, and Chief Financial Officer</p> <p>May 2010 Senior Vice President, and Chief Financial Officer, Vice President, Treasury Division</p> <p>June 2010 Executive Vice President and Chief Financial Officer, Vice President, Treasury Division</p> <p>July 2010 Executive Vice President and Chief Financial Officer, Vice President, Treasury Division and Vice President, Procurement Planning Division</p> <p>August 2010 Executive Vice President and Chief Financial Officer</p> <p>June 2012 Member of the Board and Executive Vice President (Current Position)</p>	1 year and 9 months since June 2014	12,100
Member of the Board		Motoyuki Oka	September 15, 1943	<p>April 1966 Joined Sumitomo Corporation</p> <p>June 1994 Director, Sumitomo Corporation</p> <p>April 1998 Managing Director, Sumitomo Corporation</p> <p>April 2001 Senior Managing Director, Sumitomo Corporation</p> <p>June 2001 President, Chief Executive Officer, Sumitomo Corporation</p> <p>June 2007 Chairman of the Board of Directors, Sumitomo Corporation</p> <p>June 2012 Advisor, Sumitomo Corporation (Current Position)</p> <p>Member of the Board, the Company (Current Position)</p> <p>June 2013 Member of the Board (outside director), NEC Corporation (Current Position)</p>	1 year and 9 months since June 2014	0



Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Member of the Board		Main Kohda	April 25, 1951	<p>September 1995 Started independently as Novelist</p> <p>January 2003 Member of Financial System Council, Ministry of Finance Japan</p> <p>April 2004 Visiting professor, Faculty of Economics, Shiga University</p> <p>March 2005 Member of the Council for Transport Policy, Ministry of Land, Infrastructure, Transport and Tourism</p> <p>November 2006 Member of the Tax Commission, Cabinet Office, Government of Japan</p> <p>June 2010 Member of the Board of Governors, Japan Broadcasting Corporation</p> <p>June 2012 Member of the Board, the Company (Current Position)</p> <p>June 2013 Member of the Board (outside director), LIXIL Group Corporation (Current Position)</p>	1 year and 9 months since June 2014	0
Audit & Supervisory Board Member		Futoshi Nakamura	November 23, 1957	<p>April 1981 Joined the Company (Japan Tobacco and Salt Public Corporation)</p> <p>July 2004 Head of Procurement Planning Division</p> <p>July 2005 Senior Manager of Operational Review and Business Assurance Division</p> <p>September 2005 Senior Manager of Operational Review and Business Assurance Division Vice President, JT International Holding B.V.</p> <p>July 2009 Senior Manager of Accounting Division</p> <p>July 2010 Head of Operational Review and Business Assurance Division</p> <p>June 2012 Audit &amp; Supervisory Board Member, the Company (Current Position)</p>	4 years since March 2015	4,800

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)	
Audit & Supervisory Board Member		Tomotaka Kojima	December 19, 1953	April 1976	Joined Ministry of Finance	4 years since March 2015	0
				July 2000	Director 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 for Administrative Policy Matters, National Personnel Authority		
				January 2008	Director General of Equity and Investigation Bureau, Secretariat of National Personnel Authority		
				August 2009	Executive Director, National Hospital Organization		
				March 2010	Retired from Executive Director, National Hospital Organization		
				October 2010	Adviser, Japan Association of Corporate Directors		
				November 2010	Secretary General, Japan Association of Corporate Directors		
June 2013	Audit & Supervisory Board Member, the Company (Current Position)						
Audit & Supervisory Board Member		Yoshinori Imai	December 3, 1944	April 1968	Joined Japan Broadcasting Corporation	4 years since March 2015	700
				June 1995	Bureau Chief of General Bureau for Europe		
				May 2000	Director General, Planning & Broadcasting Department		
				June 2003	Executive Editor and Programme Host		
				January 2008	Executive Vice President		
				January 2011	Retired from Executive Vice President		
				April 2011	Visiting Professor, Ritsumeikan University (Current Position)		
June 2011	Audit & Supervisory Board Member, the Company (Current Position)						

Title	Post	Name	Date of birth	Summary of career		Term of office	Number of shares held (Share)
Audit & Supervisory Board Member		Hiroshi Obayashi	June 17, 1947	April 1970	Judicial Apprentice	4 years since March 2015	0
	April 1972			Appointed as Public Prosecutor			
	May 2001			Director-General of the Rehabilitation Bureau, Ministry of Justice			
	January 2002			Deputy Vice-Minister of Justice			
	June 2004			Director-General of the Criminal Affairs Bureau			
	June 2006			Vice-Minister 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			
	April 2011			Outside Audit & Supervisory Board Member, Daiwa Securities Co., Ltd. (Current Position)			
June 2013	Outside Director, Mitsubishi Electric Corporation (Current Position)						
June 2014	Outside Audit & Supervisory Board Member, NIPPON STEEL & SUMITOMO METAL CORPORATION (Current Position)						
March 2015	Audit & Supervisory Board Member, the Company (Current Position)						
Total							91,700

Notes: 1. Directors Motoyuki Oka and Main Kohda are Outside Directors.

2. Audit & Supervisory Board Members Yoshinori Imai and Hiroshi Obayashi are Outside Audit & Supervisory Board Members.

3. Persons with the title marked with \* concurrently serve as Executive Officer (*sikkoyakuin*).

4. In preparation against a situation where the number of Audit & Supervisory Board Members falls below the statutory required number, JT appointed one Substitute for Audit & Supervisory Board Member as stipulated in Article 329, paragraph 2 of the Companies Act. The summary of the career of the Substitute for Audit & Supervisory Board Member is as follows.

Name	Date of birth	Summary of career		Term of office	Number of shares held (Share)
Michio Masaki	February 20, 1961	April 1987	Judicial Apprentice	(Note)	0
		April 1989	Appointed as Public Prosecutor		
		July 2003	Head of Takasaki Branch, Maebashi District Public Prosecutors Office		
		April 2004	Registered as Attorney at Law City-Yuwa Partners (Current Position)		

Note: The term of office for the Substitute for Audit & Supervisory Board Member shall be from the time of his assumption of office until the expiration of the term of office of the Audit & Supervisory Board Member who retired.

(Status of Executive Officers (*sikkoyakuin*) )

JT has introduced the Executive Officer (*sikkoyakuin*) System since June 2001 in order to realize prompt and proper decision-making and business execution. The following 23 persons were appointed effective January 1, 2015, at the meeting of the Board of Directors held on November 27, 2014.

Title	Name	Post
President	Mitsuomi Koizumi	
Executive Deputy President	Yasushi Shingai	Compliance, Strategy, HR, General Administration, Legal and Operation Review & Business Assurance
Executive Deputy President	Noriaki Okubo	Pharmaceutical, Beverage and Processed Food Businesses
Executive Deputy President	Akira Saeki	President, Tobacco Business
Executive Deputy President	Hideki Miyazaki	CSR, Finance and Communications
Senior Executive Vice President	Kenji Iijima	Chief Marketing & Sales Officer, Tobacco Business
Senior Executive Vice President	Ryoji Chijiwa	Compliance and Chief General Affairs Officer
Senior Executive Vice President	Mutsuo Iwai	Chief Strategy Officer
Executive Vice President	Kazuhito Yamashita	Head of China Division, Tobacco Business
Senior Vice President	Junichi Fukuchi	Chief Corporate, Scientific & Regulatory Affairs Officer, Tobacco Business
Senior Vice President	Yasuyuki Yoneda	Chief R&D Officer, Tobacco Business
Senior Vice President	Masahiko Sato	Head of Manufacturing General Division, Tobacco Business
Senior Vice President	Kiyohide Hirowatari	Head of Tobacco Business Planning Division, Tobacco Business
Senior Vice President	Yasushi Hasegawa	Head of Domestic Leaf Tobacco General Division, Tobacco Business
Senior Vice President	Muneaki Fujimoto	President, Pharmaceutical Business
Senior Vice President	Shigenori Ohkawa	Head of Central Pharmaceutical Research Institute, Pharmaceutical Business
Senior Vice President	Goichi Matsuda	Head of Beverage Business
Senior Vice President	Ryoko Nagata	CSR
Senior Vice President	Takehiko Tsutsui	Business Development and Corporate Strategy
Senior Vice President	Chito Sasaki	Chief Human Resources Officer
Senior Vice President	Naohiro Minami	Chief Financial Officer
Senior Vice President	Yuki Maeda	Chief Communications Officer
Senior Vice President	Haruhiko Yamada	Chief Legal Officer

## 6. Status of corporate governance

### (1) Status of corporate governance

#### a. Basic concept on the corporate governance

JT recognizes that prompt and proper decision-making and business execution are vital to increasing our corporate value and responding appropriately to new challenges to come in the future, as the business and social environment change. Based on this recognition, JT has been striving hard to enhance corporate governance as a top management priority.

#### b. Implementation status of measures concerning corporate governance (as of the date of filing)

##### i. Corporate governance system

###### (a) Organization of JT

The Board of Directors meets once a month in principle and on more occasions if necessary, in order to make decisions with regard to the matters specified by laws and regulations and other important matters, to supervise business execution and to receive reports from the Directors on the status of business execution.

In order to maintain a high quality of business execution, JT has adopted the Executive Officer (*sikkoyakuin*) System, under which Executive Officers (*sikkoyakuin*) appointed by the Board of Directors execute business in their respective areas of responsibility, in accordance with a company-wide business strategy decided by the Board, by exercising the authority delegated to them. In addition, the Chairman of the Board has been positioned as a non-executive Director in order to concentrate on the function of supervising management while also serving as the chairman of meetings of the Board of Directors. JT appointed two Outside Directors in order to strengthen the supervisory function of the Board of Directors and enhance transparency over its management.

For important management issues, particularly management policy and basic plans regarding overall business operations of JT, in addition to matters to be referred to the Board of Directors, a clear decision-making process is stipulated in internal rules on the allocation of responsibilities and authorities (hereinafter, the “Responsibilities/Authorities Allocation Rules”), and a structure enabling prompt decision making is in place.

JT has adopted the Audit & Supervisory Board System under which Audit & Supervisory Board Members, in their capacity as independent agents with a mandate from shareholders, examine the performance of duties by Directors and Executive Officers (*sikkoyakuin*) in order to ensure sound and sustainable growth, and maintain and enhance public trust in JT. Moreover, the Audit & Supervisory Board Member of JT, Mr. Futoshi Nakamura, is eligible as an Audit & Supervisory Board Member with profound expertise and experience concerning financial and accounting affairs including his past experience as the head of JT’s Operational Review and Business Assurance Division after engaging in the accounting division and corporate treasury division. In addition, the Audit & Supervisory Board Member of JT, Mr. Tomotaka Kojima, is eligible as an Audit & Supervisory Board Member because he has not only profound expertise and experience concerning financial and accounting affairs including his past experience as Deputy Head of JT’s Finance Group, but also wide-ranging governmental experience and knowledge of corporate governance through his experience at the Japan Association of Corporate Directors.

###### (b) Internal control system and risk management system

JT has been endeavoring to ensure appropriate business operations through efforts to enhance compliance, internal audits and risk management, and implementing measures to ensure the effectiveness of audits, such as improving arrangements and procedures for reporting the necessary matters to Audit & Supervisory Board Members, as is required of a company adopting the Audit & Supervisory Board System.

We will continue these efforts while reviewing and revising the current system as necessary, and ensure appropriate business execution by taking the following steps:

<System to ensure that Directors and employees perform their duties in accordance with laws, regulations and JT’s articles of incorporation>

With regard to the compliance system, JT has established a code of conduct based on internal rules concerning compliance in order to ensure that Directors, Executive Officers (*sikkoyakuin*) and employees comply with laws, regulations, JT’s articles of incorporation and the social norms and set up a JT Group Compliance Committee as an organization responsible for ensuring thorough compliance. This committee,

headed by JT's Chairman, includes three outside experts among its members and reports directly to the Board of Directors. In addition, JT appoints an Executive Officer (*sikkoyakuin*) in charge of compliance with overseeing the Compliance Office in an effort to establish and promote a company-wide, cross-sectional system and shed light on issues. The Compliance Office distributes to all Directors and employees the "JT Group Code of Conduct", which explains the Code of Conduct and enhances the effectiveness of the compliance system by enlightening officers and employees about compliance through various compliance education programs.

Regarding the internal reporting system (whistle-blower system), JT has a counter through which employees may report any misconduct they have detected. The Compliance Office is charged with investigating reported cases and implementing company-wide measures to prevent the recurrence of misconduct after holding consultations with the departments and divisions concerned. Matters of particular importance shall be referred to the JT Group Compliance Committee for deliberation.

Under the system for excluding anti-social elements, JT is resolved to fight against, not to comply with, an unreasonable demand and not to have any relations with anti-social elements. With the General Administration Division at JT's headquarters assuming the responsibility for supervising efforts to exclude anti-social elements, JT cooperates with police, lawyers and other relevant organizations and parties to gather and share information in order to deal with such elements in an organized way. In addition, the "prohibition of involvement with anti-social elements" has been provided for in the "JT Group Code of Conduct" and fully communicated to all officers and employees. At the same time, an awareness raising program for excluding anti-social elements is to be consistently administered for all officers and employees, including those working for its affiliates, by providing relevant training as necessary.

In order to ensure the reliability of its financial reporting, JT is operating a relevant internal control system that it has established in accordance with the Financial Instruments and Exchange Act. By allocating a sufficient level of staff to the task of evaluating financial results and reporting them, JT is striving to maintain and improve the reliability of its financial reporting.

The internal audit system is overseen by the Operational Review and Business Assurance Division (staffed with 19 members as of the end of this fiscal year), which examines and evaluates systems for supervising and managing the overall operations of JT and the status of business execution from the viewpoints of legality and rationality, in order to protect JT's assets and improve management efficiency.

#### <System for storage and management of information on the performance of duties by the Directors>

JT makes sure to properly store and manage the minutes of Annual General Meetings of Shareholders and meetings of the Board of Directors, in line with laws, regulations and internal rules.

Information on other important matters relating to business execution and decision-making are stored and managed by the relevant departments and divisions as specified by the Responsibilities/Authorities Allocation Rules, in accordance with rules on the supervision of the processes of decision-making, procurement and accounting.

#### <Rules on management of risk of loss and procedures/arrangements for other matters>

JT has established internal rules on the management of risk of loss relating to monetary and financial affairs, and ensures that relevant reports are made to the President and the Board of Directors on a regular basis.

With regard to risk of loss relating to other affairs, the relevant departments and divisions specified by the Responsibilities/Authorities Allocation Rules not only conduct proper management but also report risk to the President and acquire approval for countermeasures, depending on the importance of the identified risk.

JT has assigned sufficient staff to the Operational Review and Business Assurance Division, which functions as JT's internal audit organization. This division examines and evaluates the internal control systems of JT and JT Group companies – in light of the importance of internal control procedures and arrangements and the risks involved – from an objective viewpoint, in its capacity as an entity independent of the organizations responsible for business execution, and reports its findings and present proposals to the President, as well as reporting to the Board of Directors.

To prepare for possible emergencies, JT has produced a manual for crisis management and disaster response. In the event of an emergency or a disaster, JT is ready to establish an emergency project system under the supervision of the Corporate Planning Division, and make prompt and proper responses under the leadership of senior management and through close cooperation between the relevant departments and divisions. Events to which a response has been made and the details of such events shall be reported to the Board of Directors on a quarterly basis.

<System to ensure that Directors perform their duties efficiently>

The Board of Directors meets once a month in principle and on more occasions if necessary, in order to make decisions with regard to the matters specified by laws and regulations and other important matters and to supervise business execution. For important management issues, particularly management policy and basic plans regarding overall business operations of JT, in addition to matters to be referred to the Board of Directors, decision making is carried out in accordance with deliberations at meetings composed of the President and persons selected by the President, and internal rules that clearly prescribe responsibilities and authorities.

JT has adopted the Executive Officer (*sikkoyakuin*) System, under which Executive Officers (*sikkoyakuin*) appointed by the Board of Directors execute business in their respective areas of responsibility, in accordance with a company-wide business strategy decided by the Board, by exercising the authority delegated to them.

Moreover, in order to ensure that business operations are managed in ways that contribute to the business efficiency and flexibility of JT as a whole, basic matters concerning JT's organization, allocation of duties to officers and staff and the roles of individual divisions are specified by the relevant internal rules. Meanwhile, in order to enable prompt decision-making, the departments and divisions responsible for business execution are specified by the "Responsibilities/Authorities Allocation Rules."

<System to ensure the appropriateness of business operations within the JT Group>

The JT Group has set itself the mission of creating, developing and nurturing its unique brands to win consumer trust, while understanding and respecting the environment and the diversity of societies and individuals, and there is a group-wide consensus on the mission. We have specified the functions and rules necessary for group management based on a group management policy, in order to optimize the operations of the JT Group as a whole.

Moreover, we have been enhancing our systems for compliance (including the internal consultation and reporting system), ensuring the reliability of financial reporting, risk management, and internal audits, in cooperation with the JT Group companies.

<System for assisting Audit & Supervisory Board Members and reporting to Audit & Supervisory Board Members, and other systems to ensure effective auditing>

JT has allocated sufficient staff to the Audit & Supervisory Board Member's Office as an organization supporting the Audit & Supervisory Board Members in performing their duties. In addition, JT makes sure to review and reform the staffing structure as necessary based on consultations with the Audit & Supervisory Board. The Audit & Supervisory Board is involved in the selection of personnel of the Audit & Supervisory Board Member's Office in order to ensure the office's independence from Directors.

When Directors and Executive Officers (*sikkoyakuin*) detect any matter that may cause substantial damage to the Company, they are due to report it to the Audit & Supervisory Board. Moreover, when Directors, Executive Officers (*sikkoyakuin*) and employees detect any evidence of malfeasance in financial documents or serious breaches of laws or JT's articles of incorporation, they are due to report them to the Audit & Supervisory Board, along with other relevant matters that could affect JT's management.

Audit & Supervisory Board Members may attend not only meetings of the Board of Directors but also other important meetings. When Directors, Executive Officers (*sikkoyakuin*) and employees are asked by Audit & Supervisory Board Members to compile important documents available for their perusal, to accept field audits and to submit reports, they are due to respond to the request in a prompt and appropriate manner.

Furthermore, Directors are due to cooperate with audits and ensure the provision of funds necessary for covering audit-related expenses so as to secure their effectiveness. The Operational Review and Business Assurance Division and the Compliance Office maintain cooperation with Audit & Supervisory Board Members by exchanging information.

(c) Implementation status of audits by Audit & Supervisory Board Members and Independent Auditor

- JT has an Audit & Supervisory Board System under which Audit & Supervisory Board Members, in their capacity as independent agents with a mandate from shareholders, examine the performance of duties by Directors and Executive Officers (*sikkoyakuin*) in order to ensure sound and sustainable growth, and maintain and enhance public trust in JT.
- JT has employed Deloitte Touche Tohmatsu LLC as its Independent Auditor and Deloitte Touche Tohmatsu LLC has conducted audits based on the Companies Act and the Financial Instruments and Exchange Act. The certified public accountants who audited JT's financial statements for the fiscal year ended December 31, 2014 and the persons who assisted the auditing work are as follows.

(Certified public accountants)

Yasuyuki Miyasaka, Koji Ishikawa, Takenao Ohashi

(Assistants for the audit work)

Certified public accountants: 9 persons, Junior accountants: 16 persons, Others: 11 persons

While Audit & Supervisory Board Members, internal audit organizations including the Operational Review and Business Assurance Division, and the Independent Auditor conduct audits individually, they endeavor to enhance their cooperation in order to ensure appropriate audits, for example by sharing information on the results of their respective audits. Also, Audit & Supervisory Board Members, internal audit organizations including the Operational Review and Business Assurance Division, and the Independent Auditor cooperate with JT's Internal Control Division to ensure appropriate business execution by exchanging information when necessary as per "(b) Internal control system and risk management system."

(d) Outside Directors and Outside Audit & Supervisory Board Members

- Numbers of Outside Directors and Outside Audit & Supervisory Board Members as well as their human, capital, business or other relationships of interest

JT has two Outside Directors and two Outside Audit & Supervisory Board Members.

Mr. Motoyuki Oka, one of the Outside Directors, is an advisor to Sumitomo Corporation. Although JT did business, such as purchasing manufacturing machinery, with Sumitomo Corporation, at which Mr. Oka served as chairman and representative director until June 22, 2012, the value of the business was equivalent to just around 0.02% of JT's consolidated revenue in the fiscal year ended December 31, 2014. Therefore, we have concluded that this business relationship is not so relevant as to generate any special relationship of interest.

Other than the above, there are no human, capital, business or other relationships of interest between JT and the Outside Directors and Outside Audit & Supervisory Board Members.

- Outside Directors appointed and functions and roles of Outside Directors in corporate governance of the filing company

JT has appointed Mr. Motoyuki Oka and Ms. Main Kohda as Outside Directors. We expect that Mr. Oka will reflect his abundant experience and extensive insight into the management of global companies in the management of JT. As for Ms. Kohda, we expect that she will reflect in the management of JT her abundant insight into international finance, her extensive experience in teaching as a university professor and serving on governmental advisory bodies and her deep insight and objective point of view developed through her activities as a fiction writer, as well of other literary works. We believe that they will supervise business execution from a fair and independent standpoint.

- Outside Audit & Supervisory Board Members appointed and functions and roles of Outside Audit & Supervisory Board Members in corporate governance of the filing company

Outside Audit & Supervisory Board Members are appointed in light of their significant experience in their respective backgrounds and broad perspective. JT has appointed Mr. Yoshinori Imai and Mr. Hiroshi Obayashi as Outside Audit & Supervisory Board Members. Mr. Imai has gained management experience and developed a global perspective during his tenure as Vice Chairman of Japan Broadcasting Corporation. Mr. Obayashi has gained abundant experience and developed a broad perspective through his service in the judicial world. We expect that their experiences and perspectives will be reflected in their audit activity, and we believe that they will maintain objective and neutral surveillance over the management of JT by conducting audits from a fair and independent standpoint.



In preparation against a situation where the number of Outside Audit & Supervisory Board Members falls below the statutory required number, JT appointed Mr. Michio Masaki as a substitute for Audit & Supervisory Board Member.

- Independence of Outside Directors and Outside Audit & Supervisory Board Members

At a Board of Directors meeting on April 26, 2012, JT established a set of criteria for evaluating the independence of outside executives. According to this set of criteria, a person who fits any of the following descriptions is prohibited from serving at JT as an independent executive.

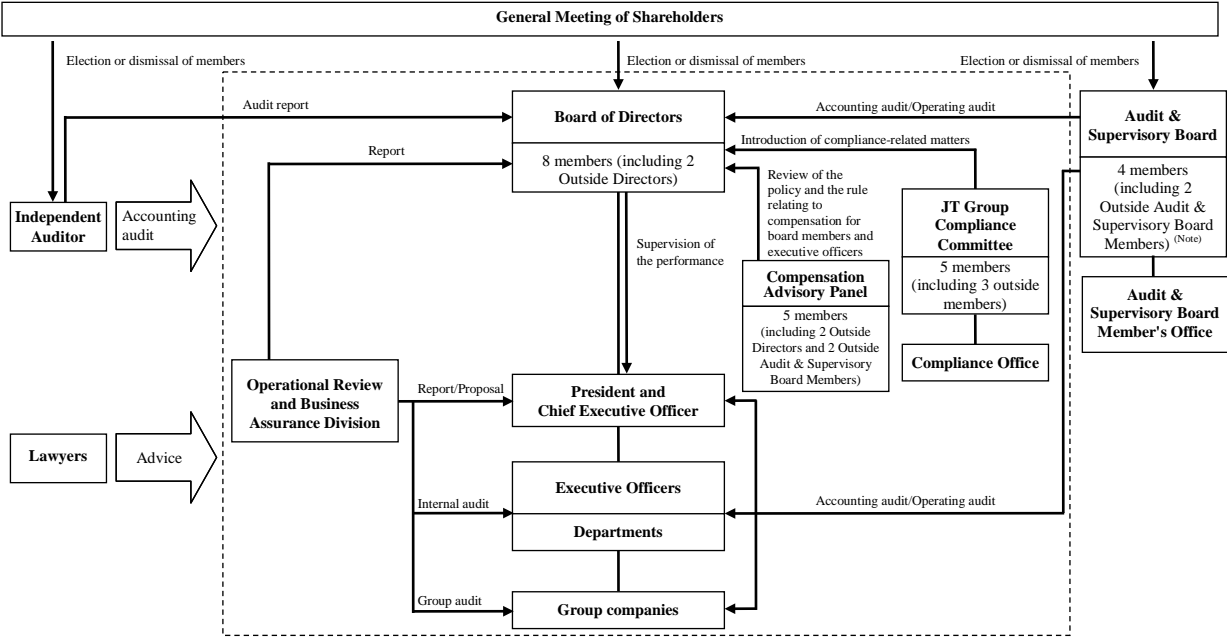
1. A person who belongs or belonged to JT or an affiliate or sister company of JT
2. A person who belongs to a corporation or other organization of which JT is a major shareholder
3. A person who is a major shareholder of JT or who belongs to a corporation or other organization which is a major shareholder of JT
4. A person who is a major supplier or customer of JT (the term person is a corporation or other organization, the prohibition also applies to a person who belongs thereto)
5. A large-lot creditor of JT, including a major loan lender (when the creditor is a corporation or other organization, the prohibition also applies to a person belonging thereto)
6. A certified public accountant who serves as an auditor or an audit advisor of JT, or a person who belongs to an auditing firm which serves as an 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 concerning legal, financial and tax affairs or business consulting services (the term person is a corporation or other organization, the prohibition also applies to a person who belongs thereto)
8. A person who receives a large amount of donation from JT (the term person is a corporation or other organization, the prohibition also applies to 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
  - (1) A person who fits any of the descriptions in 2. to 8. above (the term person is a corporation or other organization, the prohibition also applies to a person who performs important job duties therefore)
  - (2) A Director, Audit & Supervisory Board Member, audit advisor, Executive Officer or employee of JT or an affiliate or sister company of JT.
  - (3) A person who has fit the descriptions in (1) or (2) in the recent past

JT has designated Mr. Motoyuki Oka and Ms. Main Kohda, who are Outside Directors, and Mr. Yoshinori Imai and Mr. Hiroshi Obayashi, who are Outside Audit & Supervisory Board Members, as independent executives as defined by financial instruments exchanges, based on its judgment that in light of the above set of criteria, there is no risk of conflict of interest arising between them and ordinary shareholders.

- Key points of the partial exemption of liability and liability limitation agreement

JT's articles of incorporation stipulate that JT may enter into an agreement with Outside Directors and Outside Audit & Supervisory Board Members to limit the scope of their liabilities in advance to the extent permitted by the Companies Act and JT may exempt Directors and Audit & Supervisory Board Members from liabilities to the extent permitted by the same act. This provision is intended to enable Directors and Audit & Supervisory Board Members to fulfill their expected role and make it easier to appoint the right persons from a broad choice both within and outside the company. As of the date of submission, JT has such liability limiting agreements with its Outside Directors and Outside Audit & Supervisory Board Members.

The status of the development of JT's corporate governance system is represented as the following schematic depiction.



Note: In preparation against a situation where the number of Outside Audit & Supervisory Board Members falls below the required number, JT appointed one substitute for Audit & Supervisory Board Member.

ii. Remuneration for Directors and Audit & Supervisory Board Members

Remuneration for Directors and Audit & Supervisory Board Members for the fiscal year ended December 31, 2014 are as follows.

(a) Total amount of remuneration and other payments, total amount of remuneration and other payments by type and number to be paid by Director and Audit & Supervisory Board Member category

Category	Total amount of remuneration and other payments (Millions of yen)	Total amount of remuneration and other payments by type (Millions of yen)			Number to be paid (Person)
		Basic remuneration	Directors' bonus	Stock option grants	
Directors (excluding Outside Directors)	423	235	102	86	8
Audit & Supervisory Board Members (excluding Outside Audit & Supervisory Board Members)	54	54	–	–	2
Outside Directors and Outside Audit & Supervisory Board Members	41	41	–	–	4
Total	517	329	102	86	14

Notes: 1. For Directors' bonuses, the amounts planned to be paid are shown.

2. For stock option grants, the total amounts granted during this fiscal year are shown.

(b) Total amount of consolidated remuneration and other payments for individuals whose consolidated remuneration and other payments amount to ¥100 million or more

Name	Category	Company	Amount of consolidated remuneration and other payments by type (Millions of yen)			Total (Millions of yen)
			Basic remuneration	Directors' bonus	Stock option grants	
Mitsuomi Koizumi	Representative Director	Filing company	56	34	21	111

(c) Policy on determining the amount of remuneration and other payments for Directors and Audit & Supervisory Board Members and calculation method thereof, and the method for establishing said policy

JT has a Compensation Advisory Panel, acting as an advisory body for the Board of Directors established voluntarily in order to enhance the objectiveness and transparency of our executive remuneration system. The Compensation Advisory Panel deliberates and reports in response to the consultation request with regard to the compensation for our Directors and Executive Officers (*sikkoyakuin*) including its policy, framework, and calculation method. The Compensation Advisory Panel meets at least annually and monitors the executive compensation status. The Compensation Advisory Panel comprises 5 members; 2 Outside Directors, 2 Outside Audit & Supervisory Board Members and the Chairman of the Board of Directors, who acts as chairman of the Compensation Advisory Panel.

Outside members of the Compensation Advisory Panel

Motoyuki Oka JT's Outside Director  
 Main Kohda JT's Outside Director  
 Yoshinori Imai JT's Outside Audit & Supervisory Board Member  
 Hiroshi Obayashi JT's Outside Audit & Supervisory Board Member

Based on deliberation by the Compensation Advisory Panel, our basic policy of executive remuneration for senior officers is set as follows:

- Setting the remuneration at an adequate level to retain secure personnel with superior capabilities
- Linking the remuneration to business performance so as to motivate senior officers to achieve performance
- Linking the remuneration to mid- and long-term corporate value

- Ensuring transparency based on an objective and quantitative framework

In accordance with the above policy, remuneration for the senior officers comprises (1) “basic monthly pay,” (2) an “executive bonus” linked to our business performance in the relevant year, and (3) “stock option grants,” the value of which is linked to our medium- to long-term corporate value. In 2007, JT introduced a stock option program in stock compensation style as an incentive linked to the mid- to long-term corporate value of JT.

Remuneration for the Directors is structured as follows:

Remuneration for the Directors also serving as Executive Officers (*sikkoyakuin*) comprises “basic monthly pay,” an “executive bonus,” and “stock option grants,” as their duty is to achieve targets of their assigned business through their daily execution of business. As for the president and the executive vice presidents, if the amount of their “executive bonus” is a standard amount, the total amount of “executive bonus” and “stock option grants” is set at slightly less than 80% of the aggregate amount of their “basic monthly pay.” For other Directors, this amount is set at approximately 70% of their basic monthly pay.

Remuneration for the Directors not serving as Executive Officers (*sikkoyakuin*) excluding Outside Directors comprises “basic monthly pay” and “stock option grants” as their duties require them to participate in decision making regarding group-wide management strategies and perform a supervisory function.

Remuneration for Outside Directors, which is not linked to business performance from the perspective of maintaining their independence, comprises only “basic monthly pay.”

Remuneration for the Audit & Supervisory Board Members comprises basic monthly pay alone, in light of their major duty of conducting compliance audits.

The upper limit of the total remuneration for JT’s Directors and Audit & Supervisory Board Members, which was approved at the 22nd Ordinary General Meeting of Shareholders (held in June 2007), is ¥870 million per year for all Directors and ¥190 million per year for all Audit & Supervisory Board Members. In addition, the upper limit on total annual stock options for the Directors was approved at the same shareholders’ meeting. The limit is 800 options in number and ¥200 million in value. The number of options allocated for each term, including the number allocated to Executive Officers (*sikkoyakuin*) who are not also Directors, is decided by resolution of the Board of Directors.

Remuneration for the Directors and Audit & Supervisory Board Members is determined by the resolution at the Board of Directors and by the consultation among the Audit & Supervisory Board Members, respectively, within the approved ceilings, based on the report of the management’s remuneration issued by the third party, after setting a benchmark as the compensation level of domestic peer manufacturers whose scale and profit are as same as us and which presents business overseas, and discussion by the Compensation Advisory Panel.

### iii. Share ownership

- (a) Number of issues and balance sheet amount for investment stocks whose purpose of holding is other than for financial investment

55 issues, ¥49,521 million

(b) Issue, number of shares, balance sheet amount and purpose of holding for investment stocks whose purpose of holding is other than for financial investment

(Fiscal year ended March 31, 2014)

Specified investment stocks

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
KT&G Corporation	2,864,904	22,163	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Seven & i Holdings Co., Ltd.	852,000	3,360	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Mizuho Financial Group, Inc.	12,750,700	2,601	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
DOUTOR-NICHIRETS Holdings Co., Ltd.	1,320,000	2,398	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Mitsubishi UFJ Financial Group, Inc.	3,511,050	1,991	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Sumitomo Mitsui Financial Group, Inc.	340,901	1,503	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Central Japan Railway Company	100,000	1,206	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
OKAMURA CORPORATION	1,206,000	1,090	Held for policy-based investment under business alliance with JT for joint venture
Japan Airport Terminal Co., Ltd.	400,000	1,072	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
NIPPON EXPRESS CO., LTD.	1,730,400	874	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
NIPPON TELEGRAPH AND TELEPHONE CORPORATION	153,000	860	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Electric Power Development Co., Ltd.	213,600	623	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Sumitomo Mitsui Trust Holdings, Inc.	1,218,820	568	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
West Japan Railway Company	133,000	560	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Daicel Corporation	602,000	509	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
Tokyo Automatic Machinery Works, Ltd.	2,700,000	365	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
MEGMILK SNOW BRAND Co., Ltd.	246,900	332	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Nifco Inc.	110,000	321	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
KEY COFFEE INC.	200,000	317	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Tomoku Co., Ltd.	1,000,000	293	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
HOKKAN HOLDINGS LIMITED	1,000,000	286	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Tokio Marine Holdings, Inc.	38,600	120	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
Hitachi, Ltd.	94,000	72	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
MS&AD Insurance Group Holdings, Inc.	18,400	43	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
ITOCHU-SHOKUHIN Co., Ltd.	100	0	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term

(Fiscal year ended December 31, 2014)

Specified investment stocks

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
KT&G Corporation	2,864,904	23,939	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Seven & i Holdings Co., Ltd.	852,000	3,713	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Mizuho Financial Group, Inc.	12,750,700	2,582	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Mitsubishi UFJ Financial Group, Inc.	3,511,050	2,333	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
DOUTOR-NICHIRETS Holdings Co., Ltd.	1,320,000	2,288	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Japan Airport Terminal Co., Ltd.	400,000	1,914	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Central Japan Railway Company	100,000	1,814	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Sumitomo Mitsui Financial Group, Inc.	340,901	1,491	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
NIPPON EXPRESS CO., LTD.	1,730,400	1,062	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
OKAMURA CORPORATION	1,206,000	1,025	Held for policy-based investment under business alliance with JT for joint venture
NIPPON TELEGRAPH AND TELEPHONE CORPORATION	153,000	950	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Electric Power Development Co., Ltd.	213,600	871	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Daicel Corporation	602,000	854	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
West Japan Railway Company	133,000	760	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Sumitomo Mitsui Trust Holdings, Inc.	1,218,820	565	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
Tokyo Automatic Machinery Works, Ltd.	2,700,000	475	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Nifco Inc.	110,000	431	Held for policy-based investment under business alliance with JT for joint venture
MEGMILK SNOW BRAND Co., Ltd.	246,900	355	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
KEY COFFEE INC.	200,000	334	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
HOKKAN HOLDINGS LIMITED	1,000,000	292	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Tomoku Co., Ltd.	1,000,000	285	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Tokio Marine Holdings, Inc.	33,100	130	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
Hitachi, Ltd.	94,000	85	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
MS&AD Insurance Group Holdings, Inc.	18,400	53	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
ITOCHU-SHOKUHIN Co., Ltd.	100	0	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term

(c) Investment stocks whose purpose for holding is for financial investment

No items to report



iv. Number of Directors

JT's articles of incorporation stipulate that the number of Directors must be 15 or less.

v. Appointment of Directors

JT's articles of incorporation stipulate that Directors must be appointed by a majority of the shareholder votes cast on an occasion where shareholders representing at least one-third of the total voting rights are present.

vi. Matters to be decided by the Board of Directors without referral to General Meeting of Shareholders

*Acquisition of treasury shares*

In order to enable flexible management that meets changes in business environment, JT's articles of incorporation stipulate that JT may acquire its treasury shares through means such as market, transaction upon a resolution by the Board of Directors under Article 165, paragraph 2 of the Companies Act.

*Interim dividends*

In order to enable profits to be returned to shareholders in a flexible manner, JT's articles of incorporation stipulate that JT may pay interim dividends to shareholders, upon a resolution by the Board of Directors under Article 454, paragraph 5 of the Companies Act.

vii. Requirements for special resolutions at General Meeting of Shareholders

In order to facilitate the smooth conduct of General Meeting of Shareholders with an easier quorum requirement for special resolutions, JT's articles of incorporation stipulate that a resolution as specified by Article 309, paragraph 2 of the Companies Act is valid if it is supported by at least two-thirds of the votes cast at a General Meeting of Shareholders attended by shareholders representing at least one-third of JT's total voting rights (compared with the usual requirement of "at least half").

## (2) Audit fees

### a. Audit fees paid to certified public accountants

(Millions of yen)

Classification	Fiscal year ended March 31, 2014		Fiscal year ended December 31, 2014	
	Fees for audit attestation services	Fees for non-audit services	Fees for audit attestation services	Fees for non-audit services
JT	317	12	266	13
Consolidated subsidiaries in Japan	145	8	154	6
Total	462	21	420	19

Note: Fees paid to Deloitte Touche Tohmatsu LLC

### b. Other important fees

(Millions of yen)

Classification	Fiscal year ended March 31, 2014		Fiscal year ended December 31, 2014	
	Fees for audit attestation services	Fees for non-audit services	Fees for audit attestation services	Fees for non-audit services
JTIH Group	746	365	819	895

Note: Fees paid to member firms of Deloitte Touche Tohmatsu Limited

#### *Fiscal year ended March 31, 2014*

Our foreign subsidiaries receive accounting audits mainly by Deloitte Touche Tohmatsu Limited member firms, which Tohmatsu belongs to. In particular, fees paid by the JTIH Group for the accounting audit of their financial statements and the non-audit services are significant.

#### *Fiscal year ended December 31, 2014*

Our foreign subsidiaries receive accounting audits mainly by Deloitte Touche Tohmatsu Limited member firms, which Tohmatsu belongs to. In particular, fees paid by the JTIH Group for the accounting audit of their financial statements and tax consulting as non-audit services are significant.

### c. Non-audit services to filing company

#### *Fiscal year ended March 31, 2014*

Non-audit services for which fees are paid by JT to certified public accountants include the issuance of the comfort letter in relation to the bond issuing.

#### *Fiscal year ended December 31, 2014*

Non-audit services for which fees are paid by JT to certified public accountants include the issuance of the comfort letter in relation to preparation for bond issuing.

### d. Policy for determining audit fees

The audit fee is determined through the necessary and sufficient negotiations with auditors based on the audit plan and audit fee estimates provided by them. More specifically, the audit fee is determined based on the overall information by confirming that the focused audit areas under the audit plan and the scope of group-wide audit and review considering changes in consolidation status are appropriately reflected in the audit hours, and comparing the actual hours to planning in the prior audits.

Consent from the Audit & Supervisory Board is acquired before the determination of the audit fee to ensure the independence of auditors.

## **V. Accounting**

### **1. Preparation policy of the consolidated and nonconsolidated financial statements**

- (1) The consolidated financial statements of Japan Tobacco Inc. (hereinafter referred to as the “Company”) are prepared in accordance with International Financial Reporting Standards (hereinafter referred to as “IFRS”) pursuant to the provisions of Article 93 of the Ordinance on Terminology, Forms and Preparation Methods of Consolidated Financial Statements (Ordinance of the Ministry of Finance No. 28 of 1976; hereinafter referred to as the Ordinance on CFS).
- (2) The nonconsolidated financial statements of the Company are prepared based on the Ordinance on Terminology, Forms, and Preparation Methods of Financial Statements (Ordinance of the Ministry of Finance No. 59 of 1963; hereinafter referred to as the Ordinance on FS).
- (3) The Company has changed its fiscal year end from March 31 to December 31 by the resolution of the partial amendments to the Article of Incorporation made at the 29th Annual General Shareholders’ Meeting held on June 24, 2014.  
As a consequence of this change of fiscal year end, fiscal year 2014 was a nine-month period from April 1, 2014 to December 31, 2014.
- (4) Figures stated in the consolidated and nonconsolidated financial statements are rounded to the nearest million yen.

### **2. Audit Certification**

In accordance with the provisions of Article 193-2 (1) of the Financial Instruments and Exchange Act, the consolidated financial statements and the nonconsolidated financial statements for the fiscal year ended December 31, 2014 were audited by Deloitte Touche Tohmatsu LLC.

### **3. Special Effort to Ensure the Appropriateness of Consolidated Financial Statements, and Development of a System for Fair Preparation of Consolidated Financial Statements, in accordance with IFRS**

The Company is making special effort to ensure the appropriateness of consolidated financial statements, and developing a system for the appropriate preparation of consolidated financial statements, in accordance with IFRS. The content thereof is as follows:

- (1) In order to develop a system, which is capable of responding to changes of accounting standards adequately, we strive to accumulate expert knowledge by assigning employees with sufficient knowledge on IFRS, and participating in organizations, such as the Financial Accounting Standards Foundation and attending their seminars.
- (2) In order to prepare appropriate consolidated financial statements in accordance with IFRS, we established IFRS Group Accounting Guidelines and we comply with them. The IFRS Group Accounting Guidelines are revised and updated as needed after obtaining press releases and standards issued by the International Accounting Standards Board, understanding the latest standards and examining their impact on our results.

**1.【Consolidated Financial Statements】**  
**(1)【Consolidated Financial Statements】**  
**A.【Consolidated Statement of Financial Position】**

	As of March 31, 2014 Restated*	(Millions of yen) As of December 31, 2014
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents (Note 7)	253,219	385,820
Trade and other receivables (Note 8)	440,210	448,402
Inventories (Note 9)	550,987	587,849
Other financial assets (Note 10)	17,333	43,907
Other current assets (Note 11)	226,012	230,530
Subtotal	1,487,761	1,696,507
Non-current assets held-for-sale (Note 12)	1,952	367
Total current assets	1,489,713	1,696,874
<b>Non-current assets</b>		
Property, plant and equipment (Notes 13, 19)	779,987	756,127
Goodwill (Note 14)	1,584,432	1,539,376
Intangible assets (Note 14)	385,101	364,912
Investment property (Note 16)	61,421	17,870
Retirement benefit assets (Note 22)	16,530	35,402
Investments accounted for using the equity method	106,107	76,825
Other financial assets (Note 10)	92,596	91,959
Deferred tax assets (Note 17)	100,880	125,361
Total non-current assets	3,127,053	3,007,832
<b>Total assets</b>	4,616,766	4,704,706

	As of March 31, 2014 Restated*	(Millions of yen) As of December 31, 2014
<b>Liabilities and equity</b>		
<b>Liabilities</b>		
<b>Current liabilities</b>		
Trade and other payables (Note 18)	360,025	419,764
Bonds and borrowings (Note 19)	195,562	107,562
Income tax payables	77,158	54,942
Other financial liabilities (Note 19)	9,491	14,463
Provisions (Note 20)	7,362	9,200
Other current liabilities (Note 21)	606,161	754,169
Subtotal	1,255,759	1,360,098
Liabilities directly associated with non-current assets held-for-sale (Note 12)	75	—
Total current liabilities	1,255,834	1,360,098
<b>Non-current liabilities</b>		
Bonds and borrowings (Note 19)	166,165	101,001
Other financial liabilities (Note 19)	17,731	18,617
Retirement benefit liabilities (Note 22)	340,462	351,915
Provisions (Note 20)	5,241	25,425
Other non-current liabilities (Note 21)	126,539	121,792
Deferred tax liabilities (Note 17)	108,703	103,356
Total non-current liabilities	764,842	722,106
Total liabilities	2,020,675	2,082,204
<b>Equity</b>		
Share capital (Note 23)	100,000	100,000
Capital surplus (Note 23)	736,400	736,400
Treasury shares (Note 23)	(344,463)	(344,447)
Other components of equity (Note 23)	251,107	142,425
Retained earnings	1,762,566	1,902,460
Equity attributable to owners of the parent company	2,505,610	2,536,838
Non-controlling interests	90,481	85,665
Total equity	2,596,091	2,622,503
<b>Total liabilities and equity</b>	4,616,766	4,704,706

\* Please refer to Note “3. Significant Accounting Policies.”

## B. 【Consolidated Statement of Income】

(Millions of yen)

	Year ended March 31, 2014	Nine months ended December 31, 2014
Revenue (Notes 6, 25)	2,399,841	2,153,970
Cost of sales (Notes 14, 22)	(979,975)	(886,267)
Gross profit	1,419,866	1,267,703
Other operating income (Note 26)	55,634	47,651
Share of profit in investments accounted for using the equity method	1,702	7,812
Selling, general and administrative expenses (Notes 12, 13, 14, 16, 22, 27, 32)	(828,942)	(823,410)
Operating profit (Note 6)	648,260	499,757
Financial income (Notes 28, 33)	8,351	13,847
Financial costs (Notes 22, 28, 33)	(20,408)	(11,304)
Profit before income taxes	636,203	502,299
Income taxes (Note 17)	(200,912)	(133,673)
Profit for the period	435,291	368,626
<b>Attributable to:</b>		
Owners of the parent company	427,987	362,919
Non-controlling interests	7,304	5,708
Profit for the period	435,291	368,626
<b>Earnings per share</b>		
Basic (Yen) (Note 30)	235.48	199.67
Diluted (Yen) (Note 30)	235.35	199.56

## Reconciliation from “Operating profit” to “Adjusted operating profit”

(Millions of yen)

	Year ended March 31, 2014	Nine months ended December 31, 2014
Operating profit	648,260	499,757
Amortization cost of acquired intangibles	25,984	29,465
Adjustment items (income)	(47,047)	(44,302)
Adjustment items (costs)	14,580	103,641
Adjusted operating profit (Note 6)	641,777	588,561

## C. [Consolidated Statement of Comprehensive Income]

(Millions of yen)

	Year ended March 31, 2014	Nine months ended December 31, 2014
Profit for the period	435,291	368,626
<b>Other comprehensive income</b>		
<b>Items that will not be reclassified to profit or loss</b>		
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income (Notes 29, 33)	4,725	3,725
Remeasurements of defined benefit plans (Notes 22, 29)	8,824	(14,164)
Total of items that will not be reclassified to profit or loss	13,549	(10,439)
<b>Items that may be reclassified subsequently to profit or loss</b>		
Exchange differences on translation of foreign operations (Note 29)	400,941	(114,242)
Net gain (loss) on derivatives designated as cash flow hedges (Note 29)	481	922
Total of items that may be reclassified subsequently to profit or loss	401,421	(113,319)
Other comprehensive income (loss), net of taxes	414,970	(123,759)
Comprehensive income (loss) for the period	850,261	244,868
<b>Attributable to:</b>		
Owners of the parent company	842,867	240,363
Non-controlling interests	7,394	4,505
Comprehensive income (loss) for the period	850,261	244,868

## D. 【Consolidated Statement of Changes in Equity】

(Millions of yen)

	Equity attributable to owners of the parent company						
	Share capital	Capital surplus	Treasury shares	Other components of equity			
				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
<b>As of April 1, 2013</b>	100,000	736,411	(344,573)	1,274	(171,341)	(187)	14,835
Profit for the period	—	—	—	—	—	—	—
Other comprehensive income (loss)	—	—	—	—	401,331	481	4,663
Comprehensive income (loss) for the period	—	—	—	—	401,331	481	4,663
Acquisition of treasury shares (Note 23)	—	—	(0)	—	—	—	—
Disposal of treasury shares (Note 23)	—	(11)	110	(81)	—	—	—
Share-based payments (Note 32)	—	—	—	251	—	—	—
Dividends (Note 24)	—	—	—	—	—	—	—
Changes in the ownership interest in a subsidiary without a loss of control	—	—	—	—	—	—	—
Transfer from other components of equity to retained earnings	—	—	—	—	—	—	(118)
Other increase (decrease)	—	—	—	—	—	—	—
Total transactions with the owners	—	(11)	110	169	—	—	(118)
<b>As of March 31, 2014</b>	100,000	736,400	(344,463)	1,443	229,990	293	19,380
Profit for the period	—	—	—	—	—	—	—
Other comprehensive income (loss)	—	—	—	—	(112,972)	922	3,753
Comprehensive income (loss) for the period	—	—	—	—	(112,972)	922	3,753
Acquisition of treasury shares (Note 23)	—	—	—	—	—	—	—
Disposal of treasury shares (Note 23)	—	—	16	(14)	—	—	—
Share-based payments (Note 32)	—	—	—	202	—	—	—
Dividends (Note 24)	—	—	—	—	—	—	—
Changes in the ownership interest in a subsidiary without a loss of control	—	—	—	—	(597)	—	—
Transfer from other components of equity to retained earnings	—	—	—	—	—	—	23
Other increase (decrease)	—	—	—	—	—	—	—
Total transactions with the owners	—	—	16	188	(597)	—	23
<b>As of December 31, 2014</b>	<u>100,000</u>	<u>736,400</u>	<u>(344,447)</u>	<u>1,631</u>	<u>116,421</u>	<u>1,215</u>	<u>23,156</u>



## Equity attributable to owners of the parent company

	Other components of equity		Retained earnings	Total	Non-controlling interests	Total equity
	Remeasurements of defined benefit plans	Total				
<b>As of April 1, 2013</b>	—	(155,420)	1,470,125	1,806,543	85,887	1,892,431
Profit for the period	—	—	427,987	427,987	7,304	435,291
Other comprehensive income (loss)	8,405	414,880	—	414,880	90	414,970
Comprehensive income (loss) for the period	8,405	414,880	427,987	842,867	7,394	850,261
Acquisition of treasury shares (Note 23)	—	—	—	(0)	—	(0)
Disposal of treasury shares (Note 23)	—	(81)	(18)	0	—	0
Share-based payments (Note 32)	—	251	—	251	—	251
Dividends (Note 24)	—	—	(152,669)	(152,669)	(3,179)	(155,849)
Changes in the ownership interest in a subsidiary without a loss of control	—	—	(1,011)	(1,011)	(2,509)	(3,520)
Transfer from other components of equity to retained earnings	(8,405)	(8,523)	8,523	—	—	—
Other increase (decrease)	—	—	9,629	9,629	2,888	12,517
Total transactions with the owners	(8,405)	(8,353)	(135,546)	(143,800)	(2,801)	(146,601)
<b>As of March 31, 2014</b>	—	251,107	1,762,566	2,505,610	90,481	2,596,091
Profit for the period	—	—	362,919	362,919	5,708	368,626
Other comprehensive income (loss)	(14,259)	(122,556)	—	(122,556)	(1,203)	(123,759)
Comprehensive income (loss) for the period	(14,259)	(122,556)	362,919	240,363	4,505	244,868
Acquisition of treasury shares (Note 23)	—	—	—	—	—	—
Disposal of treasury shares (Note 23)	—	(14)	(3)	0	—	0
Share-based payments (Note 32)	—	202	—	202	—	202
Dividends (Note 24)	—	—	(181,755)	(181,755)	(2,736)	(184,491)
Changes in the ownership interest in a subsidiary without a loss of control	—	(597)	(26,985)	(27,581)	(7,623)	(35,204)
Transfer from other components of equity to retained earnings	14,259	14,282	(14,282)	—	—	—
Other increase (decrease)	—	—	—	—	1,039	1,039
Total transactions with the owners	14,259	13,874	(223,025)	(209,135)	(9,321)	(218,455)
<b>As of December 31, 2014</b>	—	142,425	1,902,460	2,536,838	85,665	2,622,503

## E. 【Consolidated Statement of Cash Flows】

(Millions of yen)

	Year ended March 31, 2014 Restated*	Nine months ended December 31, 2014
<b>Cash flows from operating activities</b>		
Profit before income taxes	636,203	502,299
Depreciation and amortization	132,921	122,171
Impairment losses	2,446	21,877
Impairment losses of investments in associates	9,717	—
Interest and dividend income	(7,933)	(13,560)
Interest expense	8,612	4,651
Share of profit in investments accounted for using the equity method	(1,702)	(7,812)
(Gains) losses on sale and disposal of property, plant and equipment, intangible assets and investment property	(38,800)	(31,315)
(Increase) decrease in trade and other receivables	(13,631)	(12,130)
(Increase) decrease in inventories	(15,530)	(16,808)
Increase (decrease) in trade and other payables	11,055	83,885
Increase (decrease) in retirement benefit liabilities	(17,661)	(25,736)
(Increase) decrease in prepaid tobacco excise taxes	(14,274)	(23,963)
Increase (decrease) in tobacco excise tax payables	(103,515)	103,651
Increase (decrease) in consumption tax payables	(5,148)	37,550
Other	(2,013)	(37,055)
Subtotal	580,748	707,703
Interest and dividends received	9,514	22,569
Interest paid	(8,469)	(7,050)
Income taxes paid	(185,298)	(179,526)
Net cash flows from operating activities	396,496	543,696
<b>Cash flows from investing activities</b>		
Purchase of securities	(8,880)	(3,280)
Proceeds from sale and redemption of securities	23,716	4,769
Purchase of property, plant and equipment	(132,256)	(106,655)
Proceeds from sale of investment property	56,159	85,653
Purchase of intangible assets	(18,263)	(7,749)
Payments into time deposits	(798)	(852)
Proceeds from withdrawal of time deposits	4,744	778
Purchase of investments in subsidiaries	—	(20,977)
Purchase of investments in associates	(74,801)	—
Other	(13,095)	(800)
Net cash flows from investing activities	(163,473)	(49,110)

	Year ended March 31, 2014 Restated*	(Millions of yen) Nine months ended December 31, 2014
<b>Cash flows from financing activities</b>		
Dividends paid to owners of the parent company (Note 24)	(152,570)	(181,635)
Dividends paid to non-controlling interests	(3,195)	(2,663)
Capital contribution from non-controlling interests	59	44
Increase (decrease) in short-term borrowings and commercial paper	(8,936)	6,373
Proceeds from long-term borrowings	70	—
Repayments of long-term borrowings	(20,558)	(1,225)
Proceeds from issuance of bonds	49,395	—
Redemption of bonds	—	(170,670)
Repayments of finance lease obligations	(4,992)	(3,837)
Acquisition of treasury shares	(0)	—
Payments for acquisition of interests in subsidiaries from non-controlling interests	(4,462)	(35,246)
Other	0	0
Net cash flows from financing activities	(145,189)	(388,859)
<b>Net increase (decrease) in cash and cash equivalents</b>	87,834	105,727
<b>Cash and cash equivalents at the beginning of the period</b>	142,713	253,219
<b>Effect of exchange rate changes on cash and cash equivalents</b>	22,672	26,874
<b>Cash and cash equivalents at the end of the period (Note 7)</b>	253,219	385,820

\* Please refer to Note “3. Significant Accounting Policies.”

## Notes to Consolidated Financial Statements

### 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 (<http://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 nine months ended December 31, 2014, were approved on March 20, 2015 by Mitsuomi Koizumi, President and Chief Executive Officer.

### 2. Basis of Preparation

#### (1) Compliance with IFRS

The Group’s consolidated financial statements, which satisfy the requirements concerning the “Specified Company” prescribed in Article 1-2 of the “Regulations for Consolidated Financial Statements”, are prepared in accordance with IFRS pursuant to the provision of Article 93 of the same regulations.

#### (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” (revised in October 2010) (hereinafter referred to as “IFRS 9”) from April 1, 2011.

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.

#### (5) Change of fiscal year end

In this fiscal year, the Company and its subsidiaries with fiscal year ends other than December 31 have changed their fiscal year ends to December 31 for the purpose of unifying the fiscal year end with overseas consolidated subsidiaries of the Group, which will enhance and improve the efficiency of the closing and management systems.

As a consequence of this change of fiscal year end, fiscal year 2014 was a nine-month period from April 1, 2014 to December 31, 2014.

In addition, the fiscal year end date of JT International Holding B.V. and its subsidiaries which operate the Group’s international tobacco business, continues to be December 31 as before, hence the Group consolidates financial results of the JTIH Group 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.

For the consolidated statement of income assuming that the fiscal year of the Group had been the twelve-month period from January 1, 2014 to December 31, 2014, please refer to Note “39. Consolidated Statement of Income (2014 January - December)”.

### 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 of 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 to 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 collaterals are 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 hedging instruments, the hedged items or transactions, the nature of the risks being hedged and how the hedging instrument's effectiveness is assessed in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risks. Even though these hedges are expected to be highly effective in offsetting changes in fair value or cash flows, they are assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedges were designated.

Hedges that meet the stringent requirements for hedge accounting are classified in the following categories and accounted for in accordance with IAS 39.

### (i) Fair Value Hedge

Changes in the fair value of derivatives are recognized as profit or loss in the consolidated statement of income. Regarding changes in the fair value of hedged items attributable to the hedged risks, the carrying amount of the hedged item is adjusted and the change is recognized as profit or loss in the consolidated statement of 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.

When forecast transactions or firm commitments 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. When hedging instruments expire, are sold, terminated or exercised without the replacement or rollover of other hedging instruments, or when the hedge designation is revoked, amounts that have been recognized in other comprehensive income are continued to be recognized in other comprehensive income until the forecast transactions or firm commitments 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: 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 plan 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 Company 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, beverages 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 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 related costs for 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 venture 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 venture 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' Meeting 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, “6. Operating Segments” and “30. Earnings per Share.”

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, 2014.

IFRS		Description of new standards and amendments
IAS 39	Financial Instruments: Recognition and Measurement	Requirements for continuation of hedge accounting in certain circumstances in which there is a change in counterparty to a hedging instrument
IFRIC 21	Levies	Clarifying the accounting for levies

The effect of the above standards on the consolidated financial statements is immaterial.

Regarding IFRIC 21 mentioned above, the comparative information was retrospectively adjusted in accordance with the transitional provisions.

#### 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, the impairment test is conducted at least once a year, regardless of any indication of the 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's 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 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 “37. 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.

IFRS	Mandatory adoption (From the year beginning)	To be adopted by the Group	Description of new standards and amendments
IFRS 2	Share-based Payment	July 1, 2014	Fiscal year ending December 2015 Amendments to the definition of vesting conditions
IFRS 3	Business Combinations	July 1, 2014	Fiscal year ending December 2015 Amendments to accounting treatment for contingent consideration in a business combination
		July 1, 2014	Fiscal year ending December 2015 Clarifying scope exceptions for joint arrangements under IFRS 3
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations	January 1, 2016	Fiscal year ending December 2016 Clarifying accounting treatment in cases where the criteria to classify a non-current asset as held for distribution to owners are no longer met or cases where a non-current asset is reclassified from held for sale to held for distribution to owners
IFRS 7	Financial Instruments: Disclosures	January 1, 2016	Fiscal year ending December 2016 Clarifying the criteria on whether a servicing contract is continuing involvement in a transferred financial asset Clarifying the applicability of the offset disclosure of financial assets and financial liabilities to condensed interim financial statements
IFRS 8	Operating Segments	July 1, 2014	Fiscal year ending December 2015 Adding disclosure requirements for aggregation of operating segments and clarifying rules relating to segment assets
IFRS 9	Financial Instruments	January 1, 2018	Fiscal year ending December 2015 Amendments to hedge accounting
		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
IFRS 11	Joint Arrangements	January 1, 2016	Fiscal year ending December 2016 Modifications of accounting for the acquisition of an interest in a joint operation in circumstances in which the activity of the joint operation constitutes a business as defined in IFRS 3
IFRS 13	Fair Value Measurement	July 1, 2014	Fiscal year ending December 2015 Clarifying a scope exception for measuring the fair value of a portfolio



	IFRS	Mandatory adoption (From the year beginning)	To be adopted by the Group	Description of new standards and amendments
IFRS 14	Regulatory Deferral Accounts	January 1, 2016	Fiscal year ending December 2016	Issuance of requirements for accounting treatment for regulatory deferral accounts for rate-regulated activities
IFRS 15	Revenue from Contracts with Customers	January 1, 2017	Fiscal year ending December 2017	Amendments to accounting treatment for recognizing revenue
IAS 1	Presentation of Financial Statements	January 1, 2016	Fiscal year ending December 2016	Clarifying disclosure requirement regarding materiality considerations
IAS 16	Property, Plant and Equipment	July 1, 2014	Fiscal year ending December 2015	Amendments to accounting treatment for the revaluation model
IAS 19	Employee Benefits	July 1, 2014 January 1, 2016	Fiscal year ending December 2015 Fiscal year ending December 2016	Clarifying accounting treatment for contributions from employees or third parties as required in the terms of defined benefit plans Clarifying the method to determine the discount rate for post-employment benefit obligations
IAS 24	Related Party Disclosures	July 1, 2014	Fiscal year ending December 2015	Clarifying that a management entity that provides key management personnel services to a reporting entity is deemed to be identified as a related party
IAS27	Separate Financial Statements	January 1, 2016	Fiscal year ending December 2016	Amendments to accounting treatment for investments in subsidiaries, joint ventures and associates in separate financial statements
IAS 34	Interim Financial Reporting	January 1, 2016	Fiscal year ending December 2016	Clarifying disclosure requirement for information "elsewhere in the interim financial report"
IAS 38	Intangible Assets	July 1, 2014	Fiscal year ending December 2015	Amendments to accounting treatment for the revaluation model
IAS 40	Investment Property	July 1, 2014	Fiscal year ending December 2015	Clarifying the interrelationship of IFRS 3 and IAS 40 when classifying property as investment property or owner-occupied property
IFRS 10 IFRS 12 IAS 28	Investment Entities	January 1, 2016	Fiscal year ending December 2016	Clarifying exceptions for applying consolidation and the equity method for investment entities
IFRS 10 IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	January 1, 2016	Fiscal year ending December 2016	Amendments to accounting treatment for sale or contribution of assets between an investor and its associate or joint venture

IFRS	Mandatory adoption (From the year beginning)	To be adopted by the Group	Description of new standards and amendments
IAS 16 IAS 38	January 1, 2016	Fiscal year ending December 2016	Clarification of Acceptable Methods of Depreciation and Amortization Clarifying that a revenue-based method is not considered to be an acceptable method of depreciation and amortization in principle
IAS 16 IAS 41	January 1, 2016	Fiscal year ending December 2016	Agriculture Provisions of accounting treatment for bearer plants

## 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 about 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, beverages 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 five segments: “Domestic Tobacco Business,” “International Tobacco Business,” “Pharmaceutical Business,” “Beverage 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 “Beverage Business” consists of the manufacture and sale of beverages. The “Processed Food Business” consists of the manufacture and sale of frozen and room-temperature processed foods, bakery products and seasonings.

## (2) Revenues and Performances for Reportable Segments

Revenues and performances for 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, this income and these expenses are excluded from the segment performance. Transactions within the segments are based mainly on the prevailing market price.

Year ended March 31, 2014		(Millions of yen)							
		Reportable Segments							
	Domestic Tobacco	International Tobacco (Note 2)	Pharma- ceuticals	Beverage	Processed Food	Total	Other (Note 3)	Elimination	Consolidated
<b>Revenue</b>									
External revenue (Note 4)	710,299	1,270,020	64,448	184,506	156,920	2,386,194	13,648	—	2,399,841
Intersegment revenue	23,770	36,902	—	100	760	61,532	10,014	(71,546)	—
<b>Total revenue</b>	<b>734,069</b>	<b>1,306,922</b>	<b>64,448</b>	<b>184,607</b>	<b>157,680</b>	<b>2,447,725</b>	<b>23,662</b>	<b>(71,546)</b>	<b>2,399,841</b>
<b>Segment profit (loss)</b>									
Adjusted operating profit (Note 1)	257,687	410,847	(9,008)	(2,097)	563	657,993	(16,277)	61	641,777
<b>Other items</b>									
Depreciation and amortization	44,411	63,745	3,624	10,761	6,903	129,444	3,787	(310)	132,921
Impairment losses on other than financial assets	427	1,746	—	—	29	2,202	244	—	2,446
Reversal of impairment losses on other than financial assets	—	157	—	—	—	157	—	—	157
Share of profit (loss) in investments accounted for using the equity method	47	1,613	—	—	(2)	1,657	44	—	1,702
Capital expenditures	49,101	78,527	3,859	14,643	4,900	151,029	5,129	—	156,158
Nine months ended December 31, 2014		(Millions of yen)							
		Reportable Segments							
	Domestic Tobacco	International Tobacco (Note 2)	Pharma- ceuticals	Beverage	Processed Food	Total	Other (Note 3)	Elimination	Consolidated
<b>Revenue</b>									
External revenue (Note 4)	505,602	1,328,005	47,555	139,519	122,919	2,143,600	10,370	—	2,153,970
Intersegment revenue	13,899	39,445	—	63	454	53,861	7,784	(61,645)	—
<b>Total revenue</b>	<b>519,501</b>	<b>1,367,450</b>	<b>47,555</b>	<b>139,582</b>	<b>123,373</b>	<b>2,197,461</b>	<b>18,154</b>	<b>(61,645)</b>	<b>2,153,970</b>
<b>Segment profit (loss)</b>									
Adjusted operating profit (Note 1)	172,235	447,053	(6,914)	153	1,259	613,786	(25,266)	41	588,561
<b>Other items</b>									
Depreciation and amortization	33,475	69,940	3,283	8,182	5,135	120,016	2,383	(228)	122,171
Impairment losses on other than financial assets	4,926	16,842	—	—	110	21,877	—	—	21,877
Reversal of impairment losses on other than financial assets	—	33	—	—	—	33	—	—	33
Share of profit (loss) in investments accounted for using the equity method	114	7,671	—	—	(26)	7,758	54	—	7,812
Capital expenditures	27,915	74,244	2,856	8,321	3,615	116,951	3,818	—	120,769

## Reconciliation from “Adjusted operating profit” to “Profit before income taxes”

Year ended March 31, 2014

(Millions of yen)

	Reportable Segments						Other (Note 3)	Elimination	Consolidated
	Domestic Tobacco	International Tobacco (Note 2)	Pharma- ceuticals	Beverage	Processed Food	Total			
Adjusted operating profit (Note 1)	257,687	410,847	(9,008)	(2,097)	563	657,993	(16,277)	61	641,777
Amortization cost of acquired intangibles	—	(25,984)	—	—	—	(25,984)	—	—	(25,984)
Adjustment items (income) (Note 5)	1,122	3,031	—	—	244	4,397	42,650	—	47,047
Adjustment items (costs) (Note 5)	(712)	(11,477)	—	—	(1,002)	(13,191)	(1,389)	—	(14,580)
Operating profit (loss)	258,098	376,416	(9,008)	(2,097)	(195)	623,215	24,984	61	648,260
Financial income									8,351
Financial costs									(20,408)
Profit before income taxes									<u>636,203</u>

Nine months ended December 31, 2014

(Millions of yen)

	Reportable Segments						Other (Note 3)	Elimination	Consolidated
	Domestic Tobacco	International Tobacco (Note 2)	Pharma- ceuticals	Beverage	Processed Food	Total			
Adjusted operating profit (Note 1)	172,235	447,053	(6,914)	153	1,259	613,786	(25,266)	41	588,561
Amortization cost of acquired intangibles	—	(29,465)	—	—	—	(29,465)	—	—	(29,465)
Adjustment items (income) (Note 5)	76	4,221	—	—	3	4,300	40,002	—	44,302
Adjustment items (costs) (Note 5)	(56,680)	(42,351)	—	—	(2,215)	(101,246)	(2,395)	—	(103,641)
Operating profit (loss)	115,631	379,458	(6,914)	153	(953)	487,375	12,341	41	499,757
Financial income									13,847
Financial costs									(11,304)
Profit before income taxes									<u>502,299</u>

(Note 1) For adjusted operating profit, amortization cost of acquired intangibles, and adjustment items (income and costs) are excluded from operating profit (loss).

In addition, the key performance indicator of the Group has changed from “Adjusted EBITDA” to “Adjusted operating profit” since the quarter ended June 30, 2014. Accordingly, the segment information of the comparative period was retrospectively adjusted.

(Note 2) The foreign subsidiaries group, which includes the core company of JT International S.A., that is part of the “International Tobacco Business” segment continues to have December 31 as its fiscal year end date and the profit or loss for the period from January 1 to December 31 is included in the year ended March 31, 2014 and in the nine months ended December 31, 2014, respectively.

(Note 3) “Other” includes business activities relating to rent of real estate and corporate expenses relating to corporate communication and operation of the head office.

(Note 4) Core revenue as part of the “Domestic Tobacco Business” and the “International Tobacco Business” is as follows:

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Domestic tobacco	676,171	478,692
International tobacco	1,200,694	1,258,176

(Note 5) “Adjustment items (income)” include restructuring income of gains on sale of real estate.

“Adjustment items (costs)” include restructuring costs of the closing down of a factory and impairment losses of investments in associates.

The breakdown of restructuring income is described in “26. Other Operating Income.” Restructuring costs included in “Cost of sales” were ¥70 million for the nine months ended December 31, 2014. Restructuring costs included in “Selling, general and administrative expenses” were ¥4,862 million and ¥100,335 million for the year ended March 31, 2014 and for the nine months ended December 31, 2014, respectively. The breakdown of restructuring costs in “Selling, general and administrative expenses” is described in “27. Selling, General and Administrative Expenses.”

The breakdown of “Adjustment items (costs)” for each fiscal year is as follows:

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Restructuring costs	4,862	100,405
Impairment losses of investments in associates	9,717	—
Other	—	3,236
Adjustment items (costs)	14,580	103,641

Restructuring costs for the nine months ended December 31, 2014 mainly relate to costs of measures to strengthen the competitiveness of “Domestic Tobacco Business” and restructuring of manufacturing facilities in Europe in the “International Tobacco Business.”

### (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)	
	As of March 31, 2014	As of December 31, 2014
Japan	587,768	522,920
Overseas	2,223,173	2,155,365
Consolidated	<u>2,810,941</u>	<u>2,678,285</u>

(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)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Japan	1,100,874	801,752
Overseas	1,298,967	1,352,218
Consolidated	<u>2,399,841</u>	<u>2,153,970</u>

(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 ¥357,980 million (14.9% of consolidated revenue) for the year ended March 31, 2014 and ¥335,446 million (15.6% of consolidated revenue) for the nine months ended December 31, 2014.

## 7. Cash and Cash Equivalents

The breakdown of “Cash and cash equivalents” as of each fiscal year end is as follows:

(Millions of yen)

	As of March 31, 2014	As of December 31, 2014
Cash and deposits	238,959	297,000
Short-term investments	14,260	88,820
Total	253,219	385,820

Cash and cash equivalents are classified as financial assets measured at amortized cost.

“Cash and cash equivalents” include ¥42,139 million (IRR 12,055 billion) as of March 31, 2014 and ¥49,884 million (IRR 14,566 billion) as of December 31, 2014 held by the Group’s Iranian subsidiary, JTI Pars PJS Co. Due to international sanctions and other factors imposed on Iran, the subsidiary’s ability to remit funds outside of Iran is restricted.

## 8. Trade and Other Receivables

The breakdown of “Trade and other receivables” as of each fiscal year end is as follows:

(Millions of yen)

	As of March 31, 2014	As of December 31, 2014
Note and account receivables	430,211	435,824
Other	12,326	14,487
Allowance for doubtful accounts	(2,327)	(1,910)
Total	440,210	448,402

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)

	As of March 31, 2014	As of December 31, 2014
Merchandise and finished goods (Note 1)	160,248	163,436
Leaf tobacco (Note 2)	334,318	367,991
Other	56,420	56,422
Total	550,987	587,849

(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)

	As of March 31, 2014	As of December 31, 2014
Derivative assets	8,600	31,837
Equity securities	53,705	59,355
Debt securities	7,177	8,787
Time deposits	1,538	1,044
Other	47,202	43,530
Allowance for doubtful accounts	(8,293)	(8,685)
Total	<u>109,929</u>	<u>135,866</u>
Current assets	17,333	43,907
Non-current assets	92,596	91,959
Total	<u>109,929</u>	<u>135,866</u>

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 hedge accounting is applied to, 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	As of March 31, 2014	As of December 31, 2014
KT&G Corporation	22,163	23,939
Seven & i Holdings Co., Ltd.	3,373	3,728
Mizuho Financial Group, Inc.	2,609	2,590
Mitsubishi UFJ Financial Group, Inc.	2,043	2,394
DOUTOR・NICHIRETS Holdings Co., Ltd.	2,426	2,314
Japan Airport Terminal Co., Ltd.	1,072	1,914

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)

	Year ended March 31, 2014	Nine months ended December 31, 2014
Fair value	286	227
Cumulative gain or loss recognized in equity as other comprehensive income (Note)	(118)	23

(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)	
	As of March 31, 2014	As of December 31, 2014
Prepaid tobacco excise taxes	176,277	180,160
Prepaid expenses	16,636	16,914
Consumption tax receivables	12,527	12,818
Other	20,572	20,637
Total	<u>226,012</u>	<u>230,530</u>

## 12. Non-current Assets Held-for-Sale

The breakdown of “Non-current assets held-for-sale” and “Liabilities directly associated with non-current assets held-for-sale” as of each fiscal year end is as follows:

Breakdown of Major Assets and Liabilities		(Millions of yen)	
	As of March 31, 2014	As of December 31, 2014	
Non-current assets held-for-sale			
Property, plant and equipment	221	115	
Investment property	1,730	252	
Total	<u>1,952</u>	<u>367</u>	
Liabilities directly associated with non-current assets held-for-sale			
Guarantee deposits	68	—	
Long-term guarantee deposits	6	—	
Total	<u>75</u>	<u>—</u>	

“Non-current assets held-for-sale” as of March 31, 2014 are mainly rental properties and idle properties which are currently actively marketed for sale. Guarantee deposits and long-term guarantee deposits related to the rental properties are included in “Liabilities directly associated with non-current assets held-for-sale.”

With regard to such assets and assets sold, impairment losses of ¥400 million are recognized in “Selling, general and administrative expenses” in the consolidated statement of income for the year ended March 31, 2014.

“Non-current assets held-for-sale” as of December 31, 2014 are mainly rental properties and idle properties which are currently actively marketed for sale.

With regard to such assets and assets sold, impairment losses of ¥46 million are recognized in “Selling, general and administrative expenses” in the consolidated statement of income for the nine months ended December 31, 2014.

### 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:

Carrying Amount	(Millions of yen)				
	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of April 1, 2013	307,332	271,207	65,256	28,522	672,316
Individual acquisition	14,255	50,973	21,750	50,371	137,349
Capitalization of borrowing costs (Note)	—	—	—	287	287
Transfer to investment property	(1,623)	(4)	(5)	—	(1,633)
Depreciation	(15,892)	(50,521)	(22,387)	—	(88,801)
Impairment losses	(27)	(922)	(2)	(282)	(1,233)
Reversal of impairment losses	—	157	—	—	157
Sale or disposal	(1,612)	(3,914)	(363)	(111)	(6,000)
Exchange differences on translation of foreign operations	16,204	28,189	3,438	6,201	54,031
Other	12,672	16,764	1,024	(16,947)	13,514
As of March 31, 2014	331,308	311,929	68,710	68,041	779,987
Individual acquisition	15,646	33,818	16,944	42,215	108,623
Capitalization of borrowing costs (Note)	—	—	—	141	141
Acquisition through business combinations	4	1	10	—	15
Transfer to investment property	(2,627)	(1)	(5)	—	(2,633)
Depreciation	(13,545)	(48,444)	(18,086)	—	(80,075)
Impairment losses	(7,552)	(10,663)	(177)	(653)	(19,045)
Reversal of impairment losses	—	33	—	—	33
Sale or disposal	(655)	(7,867)	(461)	(444)	(9,427)
Exchange differences on translation of foreign operations	(3,070)	(11,808)	(1,086)	(4,480)	(20,443)
Other	6,385	25,406	774	(33,614)	(1,050)
As of December 31, 2014	<u>325,895</u>	<u>292,404</u>	<u>66,622</u>	<u>71,206</u>	<u>756,127</u>

(Note) The capitalization rates calculating the borrowing costs for capitalization were 4.3% for the year ended March 31, 2014 and 4.6% for the nine months ended December 31, 2014, respectively.

(Millions of yen)

<b>Acquisition Cost</b>	<b>Land, buildings and structures</b>	<b>Machinery and vehicles</b>	<b>Tools, furniture and fixtures</b>	<b>Construction in progress</b>	<b>Total</b>
As of April 1, 2013	615,682	720,165	171,351	28,522	1,535,719
As of March 31, 2014	654,008	811,079	187,959	68,041	1,721,087
As of December 31, 2014	661,172	804,276	188,732	71,206	1,725,386

(Millions of yen)

<b>Accumulated Depreciation and Accumulated Impairment Losses</b>	<b>Land, buildings and structures</b>	<b>Machinery and vehicles</b>	<b>Tools, furniture and fixtures</b>	<b>Construction in progress</b>	<b>Total</b>
As of April 1, 2013	308,350	448,958	106,095	—	863,403
As of March 31, 2014	322,700	499,150	119,250	—	941,099
As of December 31, 2014	335,277	511,872	122,110	—	969,259

The carrying amount of property, plant and equipment as of each fiscal year end includes the carrying amount of the following leased assets:

	<b>Land, buildings and structures</b>	<b>Machinery and vehicles</b>	<b>Tools, furniture and fixtures</b>	<b>Total</b>
As of April 1, 2013	1,378	3,364	6,798	11,540
As of March 31, 2014	1,335	5,015	6,763	13,113
As of December 31, 2014	6,910	5,250	6,766	18,926

## (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 ¥1,233 million for the year ended March 31, 2014 and ¥19,045 million for the nine months ended December 31, 2014 in “Selling, general and administrative expenses” in the consolidated statement of income.

Impairment losses recognized in the year ended March 31, 2014 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles due to 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 nine months ended December 31, 2014 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles due to 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:

Carrying Amount	(Millions of yen)				
	Goodwill	Trademarks	Software	Other	Total
As of April 1, 2013	1,316,476	287,622	31,869	29,321	1,665,289
Individual acquisition	24	388	6,573	11,287	18,271
Amortization (Note)	—	(25,378)	(11,093)	(5,336)	(41,807)
Impairment losses	—	—	(2)	(713)	(715)
Sale or disposal	—	(1)	(137)	(66)	(203)
Exchange differences on translation of foreign operations	266,105	60,164	693	783	327,745
Other	1,828	(1,562)	6,462	(5,775)	953
As of March 31, 2014	1,584,432	321,234	34,366	29,501	1,969,532
Individual acquisition	49	256	5,176	6,354	11,836
Acquisition through business combinations	29,615	376	4	—	29,995
Amortization (Note)	—	(27,326)	(9,457)	(4,299)	(41,082)
Impairment losses	—	(2,672)	(6)	—	(2,678)
Sale or disposal	—	—	(87)	(148)	(234)
Exchange differences on translation of foreign operations	(74,720)	10,085	977	376	(63,281)
Other	—	7	4,882	(4,688)	201
As of December 31, 2014	1,539,376	301,960	35,856	27,096	1,904,288

(Note) The amortization of intangible assets is included in “Cost of sales” and “Selling, general and administrative expenses” in the consolidated statement of income.

Acquisition Cost	(Millions of yen)				
	Goodwill	Trademarks	Software	Other	Total
As of April 1, 2013	1,316,476	733,745	111,640	87,671	2,249,531
As of March 31, 2014	1,584,432	824,669	123,940	92,853	2,625,893
As of December 31, 2014	1,539,376	845,499	132,309	92,280	2,609,465

Accumulated Amortization and Accumulated Impairment Losses	(Millions of yen)				
	Goodwill	Trademarks	Software	Other	Total
As of April 1, 2013	—	446,122	79,770	58,350	584,242
As of March 31, 2014	—	503,435	89,574	63,352	656,361
As of December 31, 2014	—	543,539	96,453	65,184	705,177

The carrying amount of intangible assets as of each fiscal year end includes the carrying amount of the following leased assets:

(Millions of yen)

Software

As of April 1, 2013	5
As of March 31, 2014	3
As of December 31, 2014	1

## (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 March 31, 2014 and December 31, 2014 were ¥1,541,904 million and ¥1,496,799 million, respectively. The carrying amounts of trademarks as of March 31, 2014 and December 31, 2014 were ¥318,671 million and ¥299,502 million, respectively.

The majority of the goodwill and trademarks was recognized as a result of acquisitions of RJR Nabisco's non-U.S. tobacco operations in 1999 and Gallaher in 2007.

The trademarks are amortized using the straight-line method and the remaining amortization period is mainly 12 years.

## (3) Impairment Test for Goodwill

For the nine months ended December 31, 2014, the carrying amount of the majority of goodwill is allocated to the international tobacco cash-generating unit of ¥1,496,799 million (¥1,541,904 million for the year ended March 31, 2014) and the processed food cash-generating unit of ¥25,368 million (¥25,368 million for the year ended March 31, 2014). Details of the result of impairment tests are as follows:

### A. 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 that decreases gradually from 5.1% in the fourth year (Prior year: 6.0%) to 3.9% in the ninth year (Prior year: 4.4%), 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 11.1% (Prior year: 10.7%). 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.

### B. 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 that decreases gradually from 2.8% in the fourth year (Prior year: 3.1%) to 2.1% in the ninth year (Prior year: 2.1%), 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% (Prior year: 3.6%). The value in use exceeds the carrying amount. If the discount rate increases by 2.1%, impairment losses would be recognized. In case that growth rate fluctuates within a reasonable range, 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 ¥2,678 million for the nine months ended December 31, 2014 in "Selling, general and administrative expenses" in the consolidated statement of income.

Impairment losses recognized in the nine months ended December 31, 2014 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of trademarks and software as the recoverable amounts were lower than the carrying amounts.

The recoverable amounts of these assets are calculated mainly by their values in use.

## 15. Lease Transactions

The Group leases factory sites, vehicles, vending machines 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)	
	As of March 31, 2014	As of December 31, 2014
Not later than 1 year		
Total of future minimum lease payments	4,831	4,675
Future financial costs	392	357
Present value	4,439	4,318
Later than 1 year and not later than five years		
Total of future minimum lease payments	9,666	10,071
Future financial costs	620	1,168
Present value	9,045	8,902
Later than 5 years		
Total of future minimum lease payments	708	10,447
Future financial costs	38	4,015
Present value	670	6,432
Total		
Total of future minimum lease payments	15,204	25,192
Future financial costs	1,050	5,540
Present value	14,154	19,652

(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)	
	As of March 31, 2014	As of December 31, 2014
Not later than 1 year	8,521	8,250
Later than 1 year and not later than 5 years	13,804	9,957
Later than 5 years	7,908	7,996
Total	<u>30,233</u>	<u>26,203</u>

(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)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Total of minimum lease payments	11,266	12,059
Contingent rents	1,028	773



## 16. Investment Property

### (1) Schedule of Investment Property

The schedule of the carrying amount of “Investment property” for each fiscal year is as follows:

	Year ended March 31, 2014	(Millions of yen) Nine months ended December 31, 2014
Balance at the beginning of the period	58,995	61,421
Expenditure after acquisition	244	77
Transfer from property, plant and equipment	1,633	2,633
Transfer to non-current assets held-for-sale	(4,114)	(44,381)
Transfer to property, plant and equipment	(6,339)	—
Depreciation	(2,313)	(1,014)
Impairment losses	(98)	(108)
Sale or disposal	(1,513)	(760)
Exchange differences on translation of foreign operations	18	0
Other	14,908	2
Balance at the end of the period	<u>61,421</u>	<u>17,870</u>
Acquisition cost at the beginning of the period	127,493	108,831
Accumulated depreciation and accumulated impairment losses at the beginning of the period	68,498	47,410
Acquisition cost at the end of the period	108,831	46,084
Accumulated depreciation and accumulated impairment losses at the end of the period	47,410	28,214

### (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 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:

As of March 31, 2014	(Millions of yen)			
	Level 1	Level 2	Level 3	Total
Investment property	—	112,070	2,387	114,457

As of December 31, 2014	(Millions of yen)			
	Level 1	Level 2	Level 3	Total
Investment property	—	44,687	1,986	46,674

The carrying amount of investment property as of each fiscal year end is as follows:

	(Millions of yen)	
	As of March 31, 2014	As of December 31, 2014
Investment property	61,421	17,870

### (3) Income and Expenses from Investment Property

The rental income from investment property and direct operating expenses for each fiscal year are as follows:

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Rental income	7,915	3,796
Direct operating expenses	6,106	2,674

### (4) 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 ¥98 million for the year ended March 31, 2014, and ¥108 million for the nine months ended December 31, 2014 in “Selling, general and administrative expenses” in the consolidated statement of income.

Impairment losses recognized for the year ended March 31, 2014 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.

Impairment losses recognized for the nine months ended December 31, 2014 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:

Year ended March 31, 2014

(Millions of yen)

<b>Deferred Tax Assets</b>	As of April 1, 2013	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of March 31, 2014
Fixed assets (Note 2)	43,075	(6,138)	—	5,826	42,763
Retirement benefits	99,362	(7,435)	(3,953)	6,127	94,101
Carryforward of unused tax losses	65,572	(11,451)	—	5,248	59,369
Other	79,462	(3,113)	1,891	7,946	86,186
Subtotal	287,472	(28,136)	(2,062)	25,146	282,420
Valuation allowance	(71,829)	11,231	97	(4,409)	(64,911)
Total	215,642	(16,906)	(1,965)	20,737	217,508

(Millions of yen)

<b>Deferred Tax Liabilities</b>	As of April 1, 2013	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of March 31, 2014
Fixed assets (Note 2)	(118,937)	2,954	—	(15,030)	(131,013)
Retirement benefits	(3,440)	3,192	(410)	(2,745)	(3,403)
Other	(57,297)	(17,923)	(4,249)	(11,447)	(90,916)
Total	(179,675)	(11,776)	(4,659)	(29,222)	(225,332)

Nine months ended December 31, 2014

(Millions of yen)

<b>Deferred Tax Assets</b>	As of April 1, 2014	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2014
Fixed assets (Note 2)	42,763	2,051	—	414	45,228
Retirement benefits	94,101	22,786	6,550	893	124,330
Carryforward of unused tax losses	59,369	3,401	—	280	63,050
Other	86,186	(10,195)	6,628	3,064	85,684
Subtotal	282,420	18,043	13,178	4,651	318,292
Valuation allowance	(64,911)	(144)	11	(1,433)	(66,478)
Total	217,508	17,898	13,189	3,218	251,814

(Millions of yen)

<b>Deferred Tax Liabilities</b>	As of April 1, 2014	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2014
Fixed assets (Note 2)	(131,013)	15,715	—	(455)	(115,753)
Retirement benefits	(3,403)	(2,043)	(1,968)	80	(7,334)
Other	(90,916)	(10,636)	(5,753)	583	(106,722)
Total	(225,332)	3,035	(7,721)	209	(229,809)

(Note 1) “Other” includes exchange differences on translation of foreign operations.

(Note 2) “Fixed assets” include property, plant and equipment, goodwill, intangible assets and investment property.

The deferred tax assets are recognized by taking taxable temporary differences, future taxable profits plan and tax planning into account. The carryforward of unused tax losses, for which the deferred tax assets are not recognized, was ¥46,162 million (including ¥30,707 million, for which the carryforward expires after five years) as of March 31, 2014, and ¥50,549 million (including ¥23,962 million, for which the carryforward expires after five years) as of December 31, 2014. Tax credits, for which the deferred tax assets are not recognized, were ¥729 million (including ¥46 million, for which the carryforward expires after five years) as of March 31, 2014, and ¥606 million (including ¥192 million, for which the carryforward expires after five years) as of December 31, 2014.

## (2) Income Taxes

The breakdown of “Income taxes” for each fiscal year is as follows:

	Year ended March 31, 2014	Nine months ended December 31, 2014
Current income taxes	172,230	154,606
Deferred income taxes	28,682	(20,933)
Total income taxes	<u>200,912</u>	<u>133,673</u>

Deferred income taxes decreased by ¥1,667 million and increased by ¥62 million for the year ended March 31, 2014 and for the nine months ended December 31, 2014, 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. The effective statutory tax rates calculated based on these taxes were 37.78% and 35.41% for the year ended March, 2014 and for the nine months ended December 2014, respectively. Special Corporation Tax for Reconstruction has been abolished in this fiscal year. Foreign subsidiaries are subject to income taxes at their locations.

	Year ended March 31, 2014	Nine months ended December 31, 2014
Effective statutory tax rate	37.78	35.41
Different tax rates applied to foreign subsidiaries	(10.98)	(13.28)
Non-deductible expenses	3.71	1.90
Undistributed earnings of subsidiaries	3.20	2.00
Other	(2.13)	0.58
Average actual tax rate	<u>31.58</u>	<u>26.61</u>

## 18. Trade and Other Payables

The breakdown of “Trade and other payables” as of each fiscal year end is as follows:

(Millions of yen)

	As of March 31, 2014	As of December 31, 2014
Accounts payable	190,408	188,674
Other payables	78,662	147,918
Other	90,955	83,173
Total	360,025	419,764

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:

	(Millions of yen)		(%)	
	As of March 31, 2014	As of December 31, 2014	Average interest rate (Note1)	Due
Derivative liabilities	4,856	10,010	—	—
Short-term borrowings	21,936	27,632	1.47	—
Current portion of long-term borrowings	1,225	39,930	0.33	—
Current portion of bonds (Note 2)	172,401	40,000	—	—
Long-term borrowings	35,034	1,046	4.44	2016–2028
Bonds (Note 2)	131,131	99,954	—	—
Other	22,366	23,070	—	—
Total	388,949	241,642		
Current liabilities	205,053	122,024		
Non-current liabilities	183,895	119,618		
Total	388,949	241,642		

(Note 1) The average interest rate is calculated using the interest rate and outstanding balance as of December 31, 2014.

Derivative liabilities are classified as financial liabilities measured at fair value through profit or loss excluding those hedge accounting is applied to, 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 bonds and borrowings.

(Note 2) The summary of the issuing conditions of the bonds is as follows:

Company	Name of bond	Date of issuance	(Millions of yen)		(%)	Collateral	Date of maturity
			As of March 31, 2014	As of December 31, 2014	Interest rate		
Japan Tobacco Inc.	5th domestic straight bond	June 3, 2009	99,993 (99,993)	—	1.13	Yes	June 3, 2014
Japan Tobacco Inc.	6th domestic straight bond	December 9, 2010	40,000	40,000 (40,000)	0.53	Yes	December 9, 2015
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.	Straight bond in USD	July 23, 2013	51,131 [USD 500 mil.]	59,954 [USD 500 mil.]	2.10	Yes	July 23, 2018
JTI (UK) Finance Plc	Straight bond in EUR	October 2, 2006	72,408 (72,408) [EUR 500 mil.]	— —	4.50	Non	April 2, 2014
	Total		303,532 (172,401)	139,954 (40,000)			

(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.

(2) Assets Pledged as Collateral for Liabilities

A. Pursuant to the provisions of Article 6 of 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 and their corresponding debts as of each fiscal year end are as follows:

(Millions of yen)

<b>Assets Pledged as Collateral</b>	As of March 31, 2014	As of December 31, 2014
Land, buildings, and structures	5,838	—
Other	114	125
<b>Total</b>	<b>5,952</b>	<b>125</b>

(Millions of yen)

<b>Corresponding Debts</b>	As of March 31, 2014	As of December 31, 2014
Current portion of long-term borrowings	1,072	—
Other	156	125
<b>Total</b>	<b>1,227</b>	<b>125</b>



## 20. Provisions

The breakdown and schedule of “Provisions” for each fiscal year are as follows:

Year ended March 31, 2014					
	(Millions of yen)				
	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of April 1, 2013	1,695	450	4,073	3,824	10,043
Provisions	72	1,910	4,288	557	6,827
Interest cost associated with passage of time	19	—	—	—	19
Provisions used	(92)	(309)	(3,958)	(185)	(4,544)
Provisions reversed	—	(202)	(116)	(360)	(678)
Exchange differences on translation of foreign operations	—	206	—	730	936
As of March 31, 2014	<u>1,695</u>	<u>2,055</u>	<u>4,288</u>	<u>4,566</u>	<u>12,603</u>
Current liabilities	5	2,055	4,288	1,014	7,362
Non-current liabilities	1,690	—	—	3,552	5,241
Total	<u>1,695</u>	<u>2,055</u>	<u>4,288</u>	<u>4,566</u>	<u>12,603</u>
Nine months ended December 31, 2014					
	(Millions of yen)				
	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of April 1, 2014	1,695	2,055	4,288	4,566	12,603
Provisions	1,110	31,154	3,994	969	37,227
Interest cost associated with passage of time	28	—	—	—	28
Provisions used	(91)	(10,902)	(4,148)	(247)	(15,388)
Provisions reversed	—	(462)	(140)	(800)	(1,402)
Exchange differences on translation of foreign operations	—	1,110	—	447	1,557
As of December 31, 2014	<u>2,742</u>	<u>22,954</u>	<u>3,994</u>	<u>4,935</u>	<u>34,624</u>
Current liabilities	—	3,950	3,994	1,256	9,200
Non-current liabilities	2,742	19,004	—	3,679	25,425
Total	<u>2,742</u>	<u>22,954</u>	<u>3,994</u>	<u>4,935</u>	<u>34,624</u>

### 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 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 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)

	As of March 31, 2014	As of December 31, 2014
Tobacco excise tax payables (Note)	291,372	325,171
Tobacco special excise tax payables (Note)	9,995	14,758
Tobacco local excise tax payables (Note)	121,474	186,197
Consumption tax payables	91,733	138,810
Bonus to employees	52,618	45,982
Employee’s unused paid vacations liabilities	21,521	21,173
Other	143,987	143,869
Total	<u>732,700</u>	<u>875,960</u>
Current liabilities	606,161	754,169
Non-current liabilities	126,539	121,792
Total	<u>732,700</u>	<u>875,960</u>

(Note) Tobacco excise tax payables, tobacco special excise tax payables and tobacco local excise tax payables include those unpaid on December 31, 2014 due to bank holiday.

## 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 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 bond or government bond. 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 April 1, 2013 (Notes 1, 2)	335,312	364,893	700,205
Current service cost	12,377	7,755	20,132
Past service cost and gains and losses on settlement	–	2,627	2,627
Interest expense	3,046	14,972	18,018
Contributions by plan participants	–	972	972
Special termination benefits	–	37	37
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	4	4,211	4,215
Actuarial gains and losses arising from changes in financial assumptions	(679)	1,173	494
Actuarial gains and losses arising from experience adjustments	(86)	3,029	2,943
Benefits paid	(30,703)	(17,871)	(48,574)
Exchange differences on translation of foreign operations	–	88,196	88,196
Other	308	237	545
As of March 31, 2014 (Notes 1, 2)	319,579	470,230	789,809
Current service cost	9,957	9,028	18,984
Past service cost and gains and losses on settlement	590	(1,293)	(703)
Interest expense	2,135	18,102	20,236
Contributions by plan participants	–	1,156	1,156
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	(4)	3,120	3,116
Actuarial gains and losses arising from changes in financial assumptions	5,539	47,891	53,430
Actuarial gains and losses arising from experience adjustments	(2,571)	(5,648)	(8,219)
Benefits paid	(43,044)	(21,829)	(64,872)
Exchange differences on translation of foreign operations	–	31,249	31,249
Other	(42)	–	(42)
As of December 31, 2014 (Notes 1, 2)	292,138	552,006	844,144

(Note 1) The Group's weighted-average duration of the defined benefit obligations is 8.1 years for Japan and 15.4 years for overseas (Prior year: 7.6 years for Japan and 14.5 years for overseas).

(Note 2) The Group's breakdown of the defined benefit obligation by plan participant is as follows:

	(Millions of yen)					
	As of March 31, 2014			As of December 31, 2014		
	Japan	Overseas	Total	Japan	Overseas	Total
Active members	200,292	187,191	387,483	183,381	214,855	398,236
Deferred members	14,791	49,900	64,691	14,542	58,165	72,707
Pensioners	104,497	233,139	337,635	94,216	278,986	373,202
Total	<u>319,579</u>	<u>470,230</u>	<u>789,809</u>	<u>292,138</u>	<u>552,006</u>	<u>844,144</u>

(Note 3) The schedule of mutual pension benefits obligations included in the category of Japan is as follows:

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Balance at the beginning of the period	76,814	67,825
Interest expense	461	254
Remeasurement gains and losses	(1,070)	(3,748)
Benefits paid	(8,380)	(5,140)
Balance at the end of the period	<u>67,825</u>	<u>59,191</u>

## B. Schedule of Plan Assets

The schedule of the plan assets is as follows:

	(Millions of yen)		
	Japan	Overseas	Total
As of April 1, 2013	107,590	264,835	372,425
Interest income	1,065	11,116	12,181
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	4,363	16,391	20,754
Contributions by the employer (Notes 1, 2)	4,453	11,890	16,342
Contributions by plan participants	–	972	972
Benefits paid	(8,293)	(13,378)	(21,671)
Exchange differences on translation of foreign operations	–	64,357	64,357
Other	306	210	516
As of March 31, 2014	109,484	356,392	465,876
Interest income	821	14,003	14,823
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	3,592	26,027	29,618
Contributions by the employer (Notes 1, 2)	3,087	9,433	12,519
Contributions by plan participants	–	1,156	1,156
Benefits paid	(5,425)	(15,743)	(21,168)
Exchange differences on translation of foreign operations	–	26,811	26,811
Other	(43)	(1,962)	(2,005)
As of December 31, 2014	<u>111,515</u>	<u>416,117</u>	<u>527,631</u>

(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 ¥14,350 million in the year ending December 31, 2015.

### 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:

As of March 31, 2014	(Millions of yen)		
	Japan	Overseas	Total
Present value of the funded defined benefit obligations	115,400	358,842	474,242
Fair value of the plan assets	(109,484)	(356,392)	(465,876)
Subtotal	5,916	2,450	8,365
Present value of the unfunded defined benefit obligations	204,179	111,388	315,568
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	210,095	113,838	323,933
Retirement benefit liabilities	210,096	130,366	340,462
Retirement benefit assets	(1)	(16,529)	(16,530)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	210,095	113,838	323,933
As of December 31, 2014	(Millions of yen)		
	Japan	Overseas	Total
Present value of the funded defined benefit obligations	115,668	413,149	528,817
Fair value of the plan assets	(111,515)	(416,117)	(527,631)
Subtotal	4,154	(2,968)	1,186
Present value of the unfunded defined benefit obligations	176,470	138,858	315,327
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	180,624	135,889	316,513
Retirement benefit liabilities	181,548	170,367	351,915
Retirement benefit assets	(924)	(34,477)	(35,402)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	180,624	135,889	316,513

## D. Major Breakdown of Plan Assets

The breakdown of plan assets by major category as of each fiscal year end is as follows:

(Millions of yen)

	Japan					
	As of March 31, 2014			As of December 31, 2014		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	8,524	—	8,524	24,172	—	24,172
Equity instruments	18,238	—	18,238	7,946	—	7,946
Japan	8,369	—	8,369	4,668	—	4,668
Overseas	9,869	—	9,869	3,278	—	3,278
Debt instruments	20,483	—	20,483	15,383	—	15,383
Japan	18,248	—	18,248	12,820	—	12,820
Overseas	2,235	—	2,235	2,563	—	2,563
Real estate	60	—	60	75	—	75
General account of life insurance companies (Note 2)	—	61,330	61,330	—	63,023	63,023
Other	46	803	850	84	830	914
Total	<u>47,351</u>	<u>62,133</u>	<u>109,484</u>	<u>47,662</u>	<u>63,853</u>	<u>111,515</u>

(Millions of yen)

	Overseas					
	As of March 31, 2014			As of December 31, 2014		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	19,313	—	19,313	18,725	—	18,725
Equity instruments	139,446	—	139,446	142,301	—	142,301
United Kingdom	50,670	—	50,670	49,318	—	49,318
North America	42,537	—	42,537	39,859	—	39,859
Other	46,238	—	46,238	53,124	—	53,124
Debt instruments	167,683	4,623	172,305	218,662	5,518	224,180
United Kingdom	108,883	—	108,883	136,578	—	136,578
North America	28,553	—	28,553	46,413	—	46,413
Other	30,246	4,623	34,869	35,671	5,518	41,189
Real estate	5,479	1,199	6,679	6,225	1,051	7,276
Other	4,763	13,886	18,649	7,360	16,275	23,635
Total	<u>336,684</u>	<u>19,708</u>	<u>356,392</u>	<u>393,272</u>	<u>22,844</u>	<u>416,117</u>



(Millions of yen)

	Total					
	As of March 31, 2014			As of December 31, 2014		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	27,837	—	27,837	42,897	—	42,897
Equity instruments	157,684	—	157,684	150,247	—	150,247
Debt instruments	188,166	4,623	192,788	234,046	5,518	239,563
Real estate	5,539	1,199	6,738	6,300	1,051	7,351
General account of life insurance companies (Note 2)	—	61,330	61,330	—	63,023	63,023
Other	4,810	14,689	19,499	7,444	17,105	24,549
Total	384,035	81,841	465,876	440,934	86,697	527,631

(Note 1) The fair value of the plan assets is provided for each of quoted and unquoted market price in an active market as defined in IFRS 13 “Fair Value Measurement.”

(Note 2) 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 legislations. 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:

As of March 31, 2014

	Japan	Overseas
	(%)	(%)
Discount rate	0.9	3.9
Inflation rate	—	2.6

	Japan		Overseas	
	Males	Females	Males	Females
	(years)	(years)	(years)	(years)
Average life expectancy at retirement (Note 1)				
Current pensioners	23.4 (Note 2)	29.3 (Note 2)	21.2 (Note 3)	23.8 (Note 3)
Future pensioners			22.5 (Note 4)	25.1 (Note 4)

As of December 31, 2014

	Japan	Overseas
	(%)	(%)
Discount rate	0.7	2.9
Inflation rate	—	2.4

	Japan		Overseas	
	Males	Females	Males	Females
	(years)	(years)	(years)	(years)
Average life expectancy at retirement (Note 1)				
Current pensioners	23.4 (Note 2)	29.3 (Note 2)	21.7 (Note 3)	24.1 (Note 3)
Future pensioners			23.1 (Note 4)	25.6 (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 statics 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.

As of March 31, 2014

		(Millions of yen)	
	Change in assumptions	Japan	Overseas
Discount rate	Increase by 0.5%	(11,555)	(32,618)
	Decrease by 0.5%	12,394	36,585
Inflation rate	Increase by 0.5%	–	23,784
	Decrease by 0.5%	–	(21,928)
Mortality rate	Extended 1 year	7,094	15,870
	Shortened 1 year	(6,970)	(14,384)

As of December 31, 2014

		(Millions of yen)	
	Change in assumptions	Japan	Overseas
Discount rate	Increase by 0.5%	(11,283)	(40,281)
	Decrease by 0.5%	12,081	44,274
Inflation rate	Increase by 0.5%	–	28,231
	Decrease by 0.5%	–	(26,185)
Mortality rate	Extended 1 year	6,441	17,700
	Shortened 1 year	(6,317)	(17,698)

## F. Breakdown of defined benefit cost

The breakdown of defined benefit cost for each fiscal year is as follows:

Year ended March 31, 2014

	(Millions of yen)		
	Japan	Overseas	Total
Current service cost	12,377	7,755	20,132
Past service cost and gains and losses on settlement	—	2,627	2,627
Interest expense (income)	1,981	3,856	5,836
Special termination benefits	—	37	37
Defined benefit cost through profit or loss	14,358	14,275	28,632
Actuarial gains and losses arising from changes in demographic assumptions	4	4,211	4,215
Actuarial gains and losses arising from changes in financial assumptions	(679)	1,173	494
Actuarial gains and losses arising from experience adjustments	(86)	3,029	2,943
Return on plan assets (excluding amounts included in interest income)	(4,363)	(16,391)	(20,754)
Defined benefit cost through other comprehensive income	(5,125)	(7,978)	(13,103)
Total of defined benefit cost	9,233	6,297	15,530

Nine months ended December 31, 2014

	(Millions of yen)		
	Japan	Overseas	Total
Current service cost	9,957	9,028	18,984
Past service cost and gains and losses on settlement	590	(1,293)	(703)
Interest expense (income)	1,314	4,099	5,413
Defined benefit cost through profit or loss	11,861	11,834	23,695
Actuarial gains and losses arising from changes in demographic assumptions	(4)	3,120	3,116
Actuarial gains and losses arising from changes in financial assumptions	5,539	47,891	53,430
Actuarial gains and losses arising from experience adjustments	(2,571)	(5,648)	(8,219)
Return on plan assets (excluding amounts included in interest income)	(3,592)	(26,027)	(29,618)
Defined benefit cost through other comprehensive income	(628)	19,336	18,708
Total of defined benefit cost	<u>11,233</u>	<u>31,170</u>	<u>42,403</u>

(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 ¥6,224 million for the year ended March 31, 2014 and ¥6,833 million for the nine months ended December 31, 2014 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)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Remuneration and salary	247,730	231,254
Bonus to employees	70,066	55,648
Legal welfare expenses	45,994	45,544
Welfare expenses	26,696	30,660
Termination benefits	(242)	61,621

## 23. Equity and Other Equity Items

### (1) Share Capital and Capital Surplus

#### A. Authorized Shares

The number of authorized shares as of March 31, 2014 and as of December 31, 2014 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:

(Millions of yen)

	(Thousands of shares) Number of ordinary issued shares	Share capital	Capital surplus
As of April 1, 2013	2,000,000	100,000	736,411
Increase (Decrease)	—	—	(11)
As of March 31, 2014	2,000,000	100,000	736,400
Increase (Decrease)	—	—	—
As of December 31, 2014	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) Number of shares	(Millions of yen) Amount
As of April 1, 2013	182,510	344,573
Increase (Decrease) (Note 2)	(58)	(110)
As of March 31, 2014	182,452	344,463
Increase (Decrease) (Note 2)	(9)	(16)
As of December 31, 2014	182,443	344,447

(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 “32. Share-based Payments.”

(Note 2) The decrease of treasury shares is due to the exercise of share option.

### (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 “32. 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 derivative transactions 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 occurred and are transferred immediately from other components of equity to retained earnings.

## 24. Dividends

Dividends paid for each fiscal year are as follows:

Year ended March 31, 2014		(Millions of yen)	(Yen)		
	Class of shares	Total dividends	Dividends per share	Basis date	Effective date
(Resolution)					
Annual Shareholders Meeting (June 21, 2013)	Ordinary shares	69,065	38	March 31, 2013	June 24, 2013
Board of Directors (October 31, 2013)	Ordinary shares	83,605	46	September 30, 2013	November 29, 2013

Nine months ended December 31, 2014

		(Millions of yen)	(Yen)		
	Class of shares	Total dividends	Dividends per share	Basis date	Effective date
(Resolution)					
Annual Shareholders Meeting (June 24, 2014)	Ordinary shares	90,877	50	March 31, 2014	June 25, 2014
Board of Directors (October 30, 2014)	Ordinary shares	90,878	50	September 30, 2014	December 1, 2014

Dividends, for which the effective date falls in the following fiscal year, are as follows:

Year ended March 31, 2014

		(Millions of yen)	(Yen)		
	Class of shares	Total dividends	Dividends per share	Basis date	Effective date
(Resolution)					
Annual Shareholders Meeting (June 24, 2014)	Ordinary shares	90,877	50	March 31, 2014	June 25, 2014

Nine months ended December 31, 2014

		(Millions of yen)	(Yen)		
	Class of shares	Total dividends	Dividends per share	Basis date	Effective date
(Resolution)					
Annual Shareholders Meeting (March 20, 2015)	Ordinary shares	90,878	50	December 31, 2014	March 23, 2015



## 25. Revenue

The reconciliation from “Gross turnover” to “Revenue” for each fiscal year is as follows:

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Gross turnover	7,442,722	6,577,993
Tobacco excise taxes and agency transaction amount	(5,042,881)	(4,424,023)
Revenue	<u>2,399,841</u>	<u>2,153,970</u>

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)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Gains on sale of property, plant and equipment, intangible assets and investment properties (Notes 1, 2)	44,954	40,917
Other (Note 2)	10,680	6,734
Total	<u>55,634</u>	<u>47,651</u>

(Note 1) Mainly from sales of old factory sites and rental properties.

(Note 2) The amount of restructuring income included in each account for each fiscal year is as follows:

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Gains on sale of property, plant and equipment, intangible assets and investment properties	43,877	40,005
Other	138	669
Total	<u>44,016</u>	<u>40,674</u>

## 27. Selling, General and Administrative Expenses

The breakdown of “Selling, general and administrative expenses” for each fiscal year is as follows:

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Advertising expenses	21,736	21,258
Promotion expenses	147,793	129,998
Shipping, warehousing expenses	27,089	21,092
Commission	49,294	46,136
Employee benefit expenses (Note 2)	275,831	321,410
Research and development expenses (Note 1)	57,103	43,998
Depreciation and amortization	68,767	63,092
Impairment losses on other than financial assets (Note 2)	2,446	21,877
Impairment losses of investments in associates	9,717	—
Losses on sale and disposal of property, plant and equipment, intangible assets, and investment property (Note 2)	9,467	14,077
Other (Note 2)	159,699	140,471
Total	828,942	823,410

(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)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Employee benefit expenses	(205)	66,814
Impairment losses on other than financial assets	668	18,078
Losses on sale and disposal of property, plant and equipment, intangible assets, and investment property	1,650	5,111
Other	2,749	10,333
Total	4,862	100,335

## 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	Year ended March 31, 2014	Nine months ended December 31, 2014
Dividend income		
Financial assets measured at fair value through other comprehensive income	1,520	691
Interest income		
Financial assets measured at amortized cost		
Deposits and bonds	6,413	12,870
Other	418	287
Total	<u>8,351</u>	<u>13,847</u>

(Millions of yen)

Financial Costs	Year ended March 31, 2014	Nine months ended December 31, 2014
Interest expenses		
Financial liabilities measured at amortized cost		
Bonds and borrowings (Note 2)	8,144	4,293
Other	468	357
Foreign exchange losses (Note 1)	4,728	426
Employee benefit expenses (Note 3)	5,836	5,413
Other	1,233	815
Total	<u>20,408</u>	<u>11,304</u>

(Note 1) Valuation gain (loss) of currency derivatives is included in the 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 year, reclassification adjustments to profit or loss and tax effects for each component of “Other comprehensive income” for each fiscal year are as follows:

Year ended March 31, 2014	(Millions of yen)				
	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	7,235	—	7,235	(2,509)	4,725
Remeasurements of defined benefit plans	13,103	—	13,103	(4,279)	8,824
Total of items that will not be reclassified to profit or loss	20,337	—	20,337	(6,788)	13,549
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	400,578	(32)	400,546	395	400,941
Net gain (loss) on derivatives designated as cash flow hedges	4,444	(3,700)	744	(264)	481
Total of items that may be reclassified subsequently to profit or loss	405,022	(3,733)	401,290	131	401,421
<b>Total</b>	<b>425,360</b>	<b>(3,733)</b>	<b>421,627</b>	<b>(6,657)</b>	<b>414,970</b>
Nine months ended December 31, 2014	(Millions of yen)				
	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	5,895	—	5,895	(2,171)	3,725
Remeasurements of defined benefit plans	(18,708)	—	(18,708)	4,544	(14,164)
Total of items that will not be reclassified to profit or loss	(12,813)	—	(12,813)	2,374	(10,439)
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	(117,734)	(122)	(117,856)	3,614	(114,242)
Net gain (loss) on derivatives designated as cash flow hedges	10,998	(9,570)	1,428	(506)	922
Total of items that may be reclassified subsequently to profit or loss	(106,736)	(9,693)	(116,428)	3,109	(113,319)
<b>Total</b>	<b>(119,548)</b>	<b>(9,693)</b>	<b>(129,241)</b>	<b>5,483</b>	<b>(123,759)</b>

### 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)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Profit attributable to owners of the parent company	427,987	362,919
Profit not attributable to ordinary shareholders of the parent company	—	—
Profit used for calculation of basic earnings per share	<u>427,987</u>	<u>362,919</u>

##### B. Weighted-average Number of Ordinary Shares Outstanding During the Period

	(Thousands of shares)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Weighted-average number of shares during the period	1,817,507	1,817,553

#### (2) Basis of Calculating Diluted Earnings per Share

##### A. Profit Attributable to Diluted Ordinary Shareholders

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Profit used for calculation of basic earnings per share	427,987	362,919
Adjustment	—	—
Profit used for calculation of diluted earnings per share	<u>427,987</u>	<u>362,919</u>

##### B. Weighted-average Number of Diluted Ordinary Shares Outstanding During the Period

	(Thousands of shares)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Weighted-average number of ordinary shares during the period	1,817,507	1,817,553
Increased number of ordinary shares under subscription rights to shares	1,014	1,048
Weighted-average number of diluted ordinary shares during the period	<u>1,818,521</u>	<u>1,818,601</u>

(3) Adjusted Diluted Earnings per Share

(Millions of yen)

	Year ended March 31, 2014	Nine months ended December 31, 2014
Profit used for calculation of adjusted diluted earnings per share	427,987	362,919
Adjustment items (income)	(47,047)	(44,302)
Adjustment items (costs)	14,580	103,641
Adjustments on income taxes and non-controlling interests	11,856	(13,534)
Adjusted profit for the period	<u>407,377</u>	<u>408,724</u>
Adjusted diluted earnings per share (yen)	224.02	224.75

**31. Non-cash Transactions**

Significant Non-cash Transactions

The amount of assets acquired under finance leases was ¥5,835 million for the year ended March 31, 2014 and ¥9,199 million for the nine months ended December 31, 2014, respectively.

### 32. Share-based Payments

The Company adopts share option plans. Share options are granted by the resolution of the Board of Directors based on the approval at the Annual Shareholders Meeting.

The outline of the share option plan is as follows:

#### (1) Share Option Contract Conditions

Positions of persons granted	:	Directors and Executive Officers
Settlement	:	Issuance of share
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 one year has elapsed after leaving their positions (however, the rights become exercisable even within one year after leaving their positions only in the case where the Board of Directors find it to be unavoidable).
- (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

	Year ended March 31, 2014			Nine months ended December 31, 2014		
	Directors	Executive Officers	Total	Directors	Executive Officers	Total
Balance at the beginning of the period	324,400	644,600	969,000	351,000	659,800	1,010,800
Granted	42,000	58,000	100,000	35,600	33,200	68,800
Exercised	—	(58,200)	(58,200)	—	(8,600)	(8,600)
Transfer	(15,400)	15,400	—	(110,800)	110,800	—
Balance at the end of the period	351,000	659,800	1,010,800	275,800	795,200	1,071,000
Exercisable balance at the end of the period	—	332,800	332,800	—	341,000	341,000

(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 were granted to 7 directors and 19 executive officers for the year ended March 31, 2014, and 6 directors and 19 executive officers for the nine months ended December 31, 2014.

“Transfer” 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 ¥2,567 and ¥2,416 for the year ended March 31, 2014 and for the nine months ended December 31, 2014, respectively.

(Note 5) The weighted-average share prices of share options at the time of exercise during the period were ¥3,445 and ¥3,600 for the year ended March 31, 2014 and for the nine months ended December 31, 2014, respectively.

(Note 6) The weighted-average remaining contract year of unexercised share options at the end of each period was 26.7 years and 26.2 years for the year ended March 31, 2014 and for the nine months ended December 31, 2014, respectively.

(3) Method of Measuring Fair Value of Share Options Granted During the Period

A. Valuation Model

Black-Scholes Model

B. Main Assumptions and Estimation

	Year ended March 31, 2014	Nine months ended December 31, 2014
Share price	¥3,450	¥3,603
Volatility of share price (Note 1)	36.1%	34.6%
Estimated remaining period (Note 2)	15 years	15 years
Estimated dividends (Note 3)	¥68 /share	¥96 /share
Risk free interest rate (Note 4)	1.10%	0.93%

(Note 1) Calculated based on daily share prices quoted for the past 15 years

(Note 2) With difficulty in 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 ¥251 million for the year ended March 31, 2014, and ¥202 million for the nine months ended December 31, 2014.



### 33. 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.

The Group understands that it is inevitable to maintain a sufficient financing capacity in order to make agile business investments which link to sustainable growth such as acquisitions of external resources. For that reason, the Group aims to maintain a well-balanced capital structure that ensures an appropriate return on equity and to maintain a sound and flexible financial condition for future business investments.

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:

	(Millions of yen)	
	As of March 31, 2014	As of December 31, 2014
Interest-bearing debt	375,881	228,214
Cash and cash equivalents	(253,219)	(385,820)
Net interest-bearing debt (Note)	122,662	(157,605)
Capital (equity attributable to owners of the parent company)	2,505,610	2,536,838

(Note) The figure in parentheses ( ) represents the net amount of cash and cash equivalents after deducting interest-bearing debt.

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 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 sound and flexible financial condition for future investment. We monitor credit ratings for financial soundness 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 risks, liquidity risks, foreign exchange risks, interest rate risks, and market price fluctuation risks) 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 performances 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.

As of March 31, 2014

(Millions of yen)

	Total	Amount past due			
		Within 30 days	Over 30 days, within 60 days	Over 60 days, within 90 days	Over 90 days
Trade and other receivables	6,271	5,353	612	140	165
Other financial assets	86	—	—	—	86

As of December 31, 2014

(Millions of yen)

	Total	Amount past due			
		Within 30 days	Over 30 days, within 60 days	Over 60 days, within 90 days	Over 90 days
Trade and other receivables	2,518	1,515	696	252	55
Other financial assets	86	—	—	—	86

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 of doubtful accounts is as follows:

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Balance at the beginning of the period	10,681	10,620
Addition	1,486	782
Decrease (intended use)	(1,609)	(616)
Decrease (reversal)	(480)	(378)
Other	541	187
Balance at the end of the period	10,620	10,595

#### (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:

As of March 31, 2014		(Millions of yen)						
	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	360,025	360,025	360,025	—	—	—	—	—
Short-term borrowings	21,936	21,936	21,936	—	—	—	—	—
Current portion of long-term borrowings	1,225	1,225	1,225	—	—	—	—	—
Long-term borrowings	35,034	35,034	—	34,096	131	133	135	539
Current portion of bonds	172,401	172,412	172,412	—	—	—	—	—
Bonds	131,131	131,460	—	40,000	—	20,000	51,460	20,000
Subtotal	721,752	722,092	555,599	74,096	131	20,133	51,595	20,539
Derivative financial liabilities								
Foreign exchange forward contract	4,681	4,681	4,681	—	—	—	—	—
Interest rate swap	175	166	103	62	—	—	—	—
Subtotal	4,856	4,846	4,784	62	—	—	—	—
Total	726,608	726,939	560,383	74,158	131	20,133	51,595	20,539

As of December 31, 2014		(Millions of yen)						
	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	419,764	419,764	419,764	—	—	—	—	—
Short-term borrowings	27,632	27,632	27,632	—	—	—	—	—
Current portion of long-term borrowings	39,930	39,930	39,930	—	—	—	—	—
Long-term borrowings	1,046	1,046	—	146	149	151	97	503
Current portion of bonds	40,000	40,000	40,000	—	—	—	—	—
Bonds	99,954	100,275	—	—	20,000	60,275	—	20,000
Subtotal	628,326	628,647	527,325	146	20,149	60,426	97	20,503
Derivative financial liabilities								
Foreign exchange forward contract	9,901	9,901	9,901	—	—	—	—	—
Interest rate swap	109	97	95	1	—	—	—	—
Subtotal	10,010	9,998	9,997	1	—	—	—	—
Total	638,336	638,644	537,322	147	20,149	60,426	97	20,503

The total of commitment lines and withdrawal as of each fiscal year end are as follows:

(Millions of yen)

	As of March 31, 2014	As of December 31, 2014
Total committed line of credit	364,826	386,492
Withdrawing	—	—
Unused balance	<u>364,826</u>	<u>386,492</u>

(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.

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, the Group establishes a foreign currency hedge policy based on the current conditions and forecast of the foreign exchange market, implement the aforementioned hedges under the supervision of the Financial Risk Management Committee of the Company, and the Treasury Division of the Company regularly reports the performances to the president and the Board of Directors of the Company.

The breakdown of currency derivatives is as follows:

(i) Derivative transactions to which hedge accounting is not applied

(Millions of yen)

	As of March 31, 2014			As of December 31, 2014		
	Contract amount	Over one year	Fair value	Contract amount	Over one year	Fair value
Foreign exchange forward contract						
Buying	269,718	—	764	293,425	—	15,797
Selling	307,880	—	(1,937)	285,503	—	(9,419)
Total	<u>577,598</u>	<u>—</u>	<u>(1,173)</u>	<u>578,928</u>	<u>—</u>	<u>6,379</u>

(ii) Derivative transactions to which hedge accounting is applied

(Millions of yen)

	As of March 31, 2014			As of December 31, 2014		
	Contract amount	Over one year	Fair value (Note)	Contract amount	Over one year	Fair value (Note)
Foreign exchange forward contract						
Buying	14,122	—	505	13,950	—	1,899
Total	<u>14,122</u>	<u>—</u>	<u>505</u>	<u>13,950</u>	<u>—</u>	<u>1,899</u>

(Note) Cash flow hedge or fair value hedge is applied, and derivative transactions are recognized at fair value in the consolidated statement of financial position.

Foreign currency-denominated interest-bearing debts, for example, are designated as hedging instruments for the Group in order to reduce fluctuation risk of foreign currency translation differences that are incurred by translating net investment in foreign operations into the reporting currency.

Bonds designated as hedging instruments as of each fiscal year end are as follows:

(Millions of yen)

	As of March 31, 2014		As of December 31, 2014	
	Carrying amount	Due	Carrying amount	Due
Bonds in EUR	64,448	2014	—	—
Bonds in USD	33,120	2018	38,858	2018

### 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)

	As of March 31, 2014	As of December 31, 2014
Profit before income taxes	(4,262)	(3,255)

### (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 accordance with the Group Financial Operation Basic Policy, the Group establishes an interest rate hedging policy based on the current condition and the forecast of the interest rates to reduce the interest rate fluctuation risk related to borrowings and bonds, implement the hedges using derivatives under the supervision of the Financial Risk Management Committee of the Company and the Treasury Division of the Company reports the performances to the president and the Board of Directors of the Company.

The descriptions of interest rate derivatives are as follows:

#### (i) Derivative transactions to which hedge accounting is not applied

(Millions of yen)

	As of March 31, 2014			As of December 31, 2014		
	Contract amount	Over one year	Fair value	Contract amount	Over one year	Fair value
Interest rate swap						
Floating rate receipt and fixed rate payment	2,607	2,607	(175)	2,880	2,880	(109)
Total	2,607	2,607	(175)	2,880	2,880	(109)

**(ii) Derivative transactions to which hedge accounting is applied**

(Millions of yen)

	As of March 31, 2014			As of December 31, 2014		
	Contract amount	Over one year	Fair value (Note)	Contract amount	Over one year	Fair value (Note)
Cross currency swap						
Floating rate receipt and fixed rate payment	30,000	30,000	3,866	30,000	—	9,731
Fixed rate receipt and fixed rate payment	17,439	17,439	721	17,439	17,439	3,927
Total	<u>47,439</u>	<u>47,439</u>	<u>4,587</u>	<u>47,439</u>	<u>17,439</u>	<u>13,658</u>

(Note) Cash flow hedge is applied, and derivative transactions are recognized at fair value in the consolidated statement of financial position.

**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)

	As of March 31, 2014	As of December 31, 2014
Profit before income taxes	(634)	1,589

**(7) 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.

**(8) 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:

As of March 31, 2014

(Millions of yen)

	Carrying amount	Fair value			Total
		Level 1	Level 2	Level 3	
Long-term borrowings (Note)	36,259	—	—	36,259	36,259
Bonds (Note)	303,532	309,025	—	—	309,025

As of December 31, 2014

(Millions of yen)

	Carrying amount	Fair value			Total
		Level 1	Level 2	Level 3	
Long-term borrowings (Note)	40,976	—	—	40,976	40,976
Bonds (Note)	139,954	142,586	—	—	142,586

(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:

As of March 31, 2014

(Millions of yen)

	Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	—	8,600	—	8,600
Equity securities	49,809	—	3,896	53,705
Other	201	—	1,333	1,534
Total	50,011	8,600	5,229	63,840
Derivative liabilities	—	4,856	—	4,856
Total	—	4,856	—	4,856

As of December 31, 2014

(Millions of yen)

	Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	—	31,837	—	31,837
Equity securities	55,499	—	3,856	59,355
Other	279	—	1,555	1,834
Total	55,778	31,837	5,411	93,025
Derivative liabilities	—	10,010	—	10,010
Total	—	10,010	—	10,010

(Note) The schedule of financial instruments that are classified in Level 3 is as follows:

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Balance at the beginning of the period	4,625	5,229
Total gain (loss)		
Profit or loss (Note 1)	289	294
Other comprehensive income (Note 2)	258	212
Purchases	89	—
Sales	(32)	(324)
Balance at the end of the period	5,229	5,411

(Note 1) Gains and losses included in profit or loss for the year ended March 31, 2014 and for the nine months ended December 31, 2014 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 March 31, 2014 and for the nine months ended December 31, 2014 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.”

### 34. 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, 2014, 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 Company’s revenue from CJSC TK Megapolis, the local Russian distribution affiliate, for the nine months ended December 31, 2014 was ¥309,519 million. The Company held trade receivables of ¥47,393 million and ¥33,302 million from CJSC TK Megapolis as of March 31, 2014 and December 31, 2014, respectively.

#### (2) Remuneration for Directors and Audit & Supervisory Board Members

Remuneration for directors and audit & supervisory board members for each fiscal year is as follows:

	(Millions of yen)	
	Year ended March 31, 2014	Nine months ended December 31, 2014
Remuneration and bonuses	814	526
Share-based payments	107	84
Total	921	610



### 35. 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:

Reportable Segments	As of March 31, 2014		As of December 31, 2014	
	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	14	2	14	2
International Tobacco	148	7	145	6
Pharmaceuticals	3	—	3	—
Beverage	17	—	17	—
Processed Food	28	3	28	3
Other	8	1	8	1
Total	218	13	215	12

(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 nine months ended December 31, 2014. Regarding the restrictions on its ability to use the assets of the Group, please refer to Note “7. Cash and Cash Equivalents.”

### 36. 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)	
	As of March 31, 2014	As of December 31, 2014
Acquisition of property, plant and equipment	62,670	64,832
Acquisition of intangible assets	934	2,612
Total	63,605	67,444

#### (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.

## 37. Contingencies

### Contingent Liabilities

The Company and some of its subsidiaries are defendants in lawsuits. Provisions are not accounted for in matters it is not practicable to reasonably estimate the final outcomes.

The Company and its subsidiaries, who are defendants in such lawsuits, believe that our defenses asserted in these lawsuits are based on substantial evidence and implements 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, 2014, there were a total of 19 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 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 ¥475.8 billion (approximately CAD 4.6 billion) in compensatory damages, an amount for which all the defendants would be jointly and severally liable. Plaintiffs are seeking an additional amount of approximately ¥475.8 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. The trial commenced in March 2012. The defendants filed a third-party claim against the Government of Canada seeking contribution and indemnity on the grounds that the Canadian government was highly involved in the tobacco industry in respect of smoking and health related matters. The Court of First Instance denied the Government of Canada's motion to dismiss such third-party claim in February 2012. The Court of Appeal thereafter granted the Government of Canada's appeal of the decision of the Court of First Instance in November 2012. The defendants did not appeal that decision, which dismissed the Government of Canada as a defendant in the case. The Court of First Instance granted plaintiffs' motion to amend their claims in March 2014, and thereby the claim amount currently sought is as set out above.

##### 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 ¥1,288.9 billion (approximately CAD 12.4 billion) in compensatory damages, an amount for which all the defendants would be jointly and severally liable. Plaintiffs are seeking an additional amount of approximately ¥84 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. The trial commenced in March 2012. The defendants filed a third-party claim against the Government of Canada seeking contribution and indemnity on the grounds that the Canadian government was highly involved in the tobacco industry in respect of smoking and health related matters. The Court of First Instance denied the Government of Canada's motion to dismiss such third-party claim in February 2012. The Court of Appeal thereafter granted the Government of Canada's appeal of the decision of the Court of First Instance in November 2012. The defendants did not appeal that decision, which dismissed the Government of Canada as a defendant in the case. The Court of First Instance granted plaintiffs' motion to amend their claims in March 2014, and thereby the claim amount currently sought is as set out above.

##### 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 the 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 the 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 class action 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 the 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 class action 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 pre-trial process is ongoing. A trial date is not yet scheduled.

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 class action has been dormant since the date it was served on defendants.

**c. Health-Care Cost Recovery Litigation**

There are nine ongoing health-care cost recovery cases in Canada pending against the Company's subsidiary and indemnitees brought by the Provinces of British Columbia, New Brunswick, Ontario, Newfoundland and Labrador, Manitoba, Quebec, Alberta, Saskatchewan and Prince Edward Island. 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 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 defendants further filed a third-party claim against the Government of Canada seeking contribution and indemnity on the grounds that the Canadian government was highly involved in the tobacco industry in respect of smoking and health related matters. In July 2011, the Supreme Court of Canada ultimately dismissed the defendants' third-party claim against the Government of Canada. 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. A trial date is not yet scheduled.

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 ¥5,181.5 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 in this case 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 ¥6,285.9 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 the legislation similar to that introduced in the Province of British Columbia. The statement of claim in this case 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 ¥1,036.3 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.

## **(2) Other Litigation**

The Company and some of its subsidiaries are also named as defendants in other litigation such as commercial and tax disputes. One major case is pending:

#### Commercial Litigation

##### 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 of December 31, 2014.

### 38. Subsequent Events

(1) Legal matter

Subsequent to December 31, 2014, the following health-care cost recovery litigation was filed.

Canada Nova Scotia Health-Care Cost Recovery Litigation:

This health-care cost recovery litigation was filed by the Province of Nova Scotia on January 2, 2015 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 Province of Nova Scotia is seeking to recoup the health-care costs the province has incurred and will incur, resulting from "tobacco related wrongs." The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

(2) Withdrawal from the manufacture and sale of JT beverage products

The Company decided by resolution at a meeting of the Board of Directors held on February 4, 2015 to withdraw from manufacture and sale of JT beverage products in the beverage business. The manufacture and sale of JT beverage products conducted by JT's beverage business division and JT Beverage Inc. is expected to be discontinued by the end of September 2015. The impact of the decision on the consolidated financial statements for fiscal year ending December 31, 2015 has not been confirmed at present.

(3) Acquisition of own shares

As a supplemental measure for the adjusted EPS growth at constant FX in the mid- to long-term in the framework of shareholder return, the Company's Board of Directors made a resolution on February 5, 2015 for the Company to acquire its own shares according to the particulars stated below pursuant to the provision of Article 156 of the Companies Act, as applied by replacing the relevant terms pursuant to the Act's provision of Article 165, paragraph 3.

a. Class of shares to be acquired

Common stock

b. Number of shares to be acquired

Up to 36,000,000 shares

c. Total payment amount to acquire shares

Up to ¥100,000 million

d. Period of share acquisition

From February 9, 2015 to June 9, 2015

e. Method of acquisition

Purchase on the stock exchange via a trust bank

Based on this resolution, the Company acquired 26,896,200 shares of its common stock for a total acquisition price of ¥100,000 million during the period between February 9, 2015 and March 18, 2015 (contract basis), and has completed the acquisition of its common stock as resolved by the Board of Directors.

### 39. Consolidated Statement of Income (2014 January – December)

Consolidated statement of income assuming that the fiscal year of the Group had been the twelve-month period from January 1, 2014 to December 31, 2014 is as follows:

	(Millions of yen)
	<b>2014 January - December</b>
	<hr/>
Revenue	2,433,463
Cost of sales	(987,231)
Gross profit	<hr/> 1,446,232
Other operating income	50,477
Share of profit in investments accounted for using the equity method	7,812
Selling, general and administrative expenses	( 932,754)
Operating profit	<hr/> 571,767
Financial income	14,773
Financial costs	(12,976)
Profit before income taxes	<hr/> 573,565
Income taxes	(177,857)
Profit for the year	<hr/> <hr/> 395,708
<b>Attributable to:</b>	
Owners of the parent company	389,065
Non-controlling interests	6,643
Profit for the year	<hr/> <hr/> 395,708
<b>Earnings per share</b>	
Basic (Yen)	214.06
Diluted (Yen)	213.94

### Reconciliation from “Operating profit” to “Adjusted operating profit” (Millions of yen)

	<b>2014 January - December</b>
	<hr/>
Operating profit	571,767
Amortization cost of acquired intangibles	29,465
Adjustment items (income)	(46,113)
Adjustment items (costs)	104,980
Adjusted operating profit	<hr/> <hr/> 660,099

## Consolidated Supplementary Information

### A. Quarterly Information for the Nine Months ended December 31, 2014

(Millions of yen)

	Q1 From April 1, 2014 to June 30, 2014	Q2 From April 1, 2014 to September 30, 2014	Q3 From April 1, 2014 to December 31, 2014
Revenue	556,448	1,174,450	2,153,970
Profit before income taxes for the period (year)	147,516	302,952	502,299
Profit for the period (year)	107,796	223,149	368,626
Basic earnings per share for the period (year) (yen)	58.42	120.68	199.67

	Q1 From April 1, 2014 to June 30, 2014	Q2 From July 1, 2014 to September 30, 2014	Q3 (Note) From October 1, 2014 to December 31, 2014
Basic earnings per share for the quarter (yen)	58.42	62.26	79.00

(Note) The period from October 1, 2014 to December 31, 2014 consists of financial results of the Company and its subsidiaries whose fiscal year end was March 31 for the three-month period from October 1, 2014 to December 31, and financial results of the JTIH Group for the six-month period from July 1, 2014 to December 31, 2014.

### B. Significant Lawsuits

The significant lawsuits of the Group are as stated in “37. Contingencies” and “38. Subsequent Events” in the notes to consolidated financial statements.

## 2. Nonconsolidated financial statements

### (1) Nonconsolidated financial statements

#### a. Nonconsolidated balance sheet

(Millions of yen)

	As of March 31, 2014	As of December 31, 2014
Assets		
Current assets		
Cash and deposits	3,178	44,231
Accounts receivable-trade	*2 63,058	*2 63,296
Securities	1,960	72,220
Merchandise and finished goods	24,812	31,768
Semi-finished goods	51,853	54,635
Work in process	2,951	2,924
Raw materials and supplies	35,419	38,721
Advance payments-trade	632	2,052
Prepaid expenses	4,873	7,477
Deferred tax assets	11,707	37,248
Short-term loans receivable from subsidiaries and affiliates	47,801	47,190
Other	*2 29,286	*2,*3 27,294
Allowance for doubtful accounts	(23)	(24)
Total current assets	277,508	429,031
Noncurrent assets		
Property, plant and equipment		
Buildings	110,449	96,800
Structures	3,099	2,851
Machinery and equipment	79,885	70,710
Vehicles	1,803	1,794
Tools, furniture and fixtures	30,809	29,507
Land	84,780	80,340
Construction in progress	5,393	4,367
Total property, plant and equipment	316,217	286,369
Intangible assets		
Patent right	614	558
Right of trademark	4,056	3,794
Software	20,774	17,973
Other	2,091	2,347
Total intangible assets	27,535	24,672
Investments and other assets		
Investment securities	45,595	50,464
Stocks of subsidiaries and affiliates	2,022,534	1,906,853
Investments in capital of subsidiaries and affiliates	782	782
Long-term loans receivable from subsidiaries and affiliates	8,595	7,656
Long-term prepaid expenses	7,570	7,407
Deferred tax assets	11,762	6,270
Other	14,948	10,169
Allowance for doubtful accounts	(408)	(402)
Total investments and other assets	2,111,377	1,989,198
Total noncurrent assets	2,455,129	2,300,239
Total assets	2,732,637	2,729,270



(Millions of yen)

		As of March 31, 2014		As of December 31, 2014
<b>Liabilities</b>				
<b>Current liabilities</b>				
Accounts payable-trade	*2	14,875	*2	13,218
Current portion of bonds	*1	100,000	*1	40,000
Current portion of long-term loans payable		—		30,000
Lease obligations	*2	5,599	*2	5,595
Accounts payable-other	*2	45,474	*2	123,390
National tobacco excise taxes payable		64,627	*6	95,426
National tobacco special excise taxes payable		9,995	*6	14,758
Local tobacco excise taxes payable		74,735	*6	110,414
Income taxes payable		48,794		33,966
Accrued consumption taxes		18,743		53,078
Cash management system deposits received	*4	267,410	*4	297,060
Provision for bonuses		11,489		5,424
Other	*2	3,779		11,807
<b>Total current liabilities</b>		<b>665,519</b>		<b>834,135</b>
<b>Noncurrent liabilities</b>				
Bonds payable	*1	130,840	*1	96,572
Long-term loans payable		30,000		—
Lease obligations	*2	11,444	*2	11,075
Provision for retirement benefits		151,921		132,344
Long-term accounts payable-other	*2	8,534	*2	5,993
<b>Total noncurrent liabilities</b>		<b>332,739</b>		<b>245,983</b>
<b>Total liabilities</b>		<b>998,258</b>		<b>1,080,118</b>

(Millions of yen)

	As of March 31, 2014	As of December 31, 2014
Net assets		
Shareholders' equity		
Capital stock	100,000	100,000
Capital surplus		
Legal capital surplus	736,400	736,400
Total capital surpluses	736,400	736,400
Retained earnings		
Legal retained earnings	18,776	18,776
Other retained earnings		
Reserve for reduction entry	48,211	44,531
Special account for reduction entry	14,440	17,043
General reserve	955,300	955,300
Retained earnings brought forward	187,349	109,126
Total retained earnings	1,224,077	1,144,777
Treasury stock	(344,463)	(344,447)
Total shareholders' equity	1,716,013	1,636,730
Valuation and translation adjustments		
Valuation difference on available-for-sale securities	17,786	21,087
Deferred gains or losses on hedges	(863)	(10,298)
Total valuation and translation adjustments	16,922	10,790
Subscription rights to shares	1,443	1,631
Total net assets	1,734,379	1,649,151
Total liabilities and net assets	2,732,637	2,729,270

b. Nonconsolidated statement of income

(Millions of yen)

		Year ended March 31, 2014		Year ended December 31, 2014
Net sales	*1,*6	809,967	*1,*6	572,323
Cost of sales	*6	277,148	*6	185,407
Gross profit		532,818		386,916
Selling, general and administrative expenses	*2,*6	302,573	*2,*6	229,203
Operating income		230,245		157,712
Non-operating income				
Interest income	*6	326	*6	220
Dividends income	*6	1,906	*6	2,615
Other	*6	3,653	*6	2,663
Total of non-operating income		5,885		5,498
Non-operating expenses				
Interest expenses	*6	1,193	*6	821
Interest on bonds		2,286		1,296
Other	*6	1,752	*6	1,348
Total non-operating expenses		5,230		3,465
Ordinary income		230,900		159,746
Extraordinary income				
Gain on sales of noncurrent assets	*3	42,646	*3	68,995
Other		2,507		6
Total extraordinary income		45,153		69,001
Extraordinary loss				
Loss on sales of noncurrent assets	*4	1,001	*4	752
Loss on retirement of noncurrent assets	*5,*6	6,753	*5,*6	7,293
Impairment loss		388		—
Business restructuring costs		—	*7	56,726
Other	*6	801	*6	427
Total extraordinary losses		8,944		65,198
Income before income taxes		267,109		163,549
Income taxes-current		86,573		73,800
Income taxes-deferred		11,757		(18,908)
Total income taxes		98,330		54,893
Net income		168,779		108,656

c. Nonconsolidated statement of changes in net assets

Year ended March 31, 2014

(Millions of yen)

	Shareholders' equity									
	Capital stock	Capital surplus			Retained earnings					
		Legal capital surplus	Other capital surplus	Total capital surplus	Legal retained earnings	Other retained earnings				Total retained earnings
						Reserve for reduction entry	Special account for reduction entry	General reserve	Retained earnings brought forward	
Balance at the beginning of current period	100,000	736,400	11	736,411	18,776	43,744	10,675	955,300	179,489	1,207,984
Cumulative effects of changes in accounting policies									—	—
Balance after cumulative effects of changes in accounting policies	100,000	736,400	11	736,411	18,776	43,744	10,675	955,300	179,489	1,207,984
Changes of items during the period										
Provision of reserve for reduction entry						10,675			(10,675)	—
Reversal of reserve for reduction entry						(6,208)			6,208	—
Provision of reserve for special account for reduction entry							14,440		(14,440)	—
Reversal of reserve for special account for reduction entry							(10,675)		10,675	—
Dividends from surplus									(152,669)	(152,669)
Net income									168,779	168,779
Purchase of treasury stock										
Disposal of treasury stock			(11)	(11)					(18)	(18)
Net changes of items other than shareholders' equity										
Total changes of items during the period	—	—	(11)	(11)	—	4,467	3,766	—	7,860	16,092
Balance at the end of current period	100,000	736,400	—	736,400	18,776	48,211	14,440	955,300	187,349	1,224,077

	Shareholders' equity		Valuation and translation adjustments			Subscription rights to shares	Total net assets
	Treasury stock	Total shareholders' equity	Valuation difference on available-for-sale securities	Deferred gains or losses on hedges	Total valuation and translation adjustments		
Balance at the beginning of current period	(344,573)	1,699,822	13,433	—	13,433	1,274	1,714,529
Cumulative effects of changes in accounting policies		—					—
Balance after cumulative effects of changes in accounting policies	(344,573)	1,699,822	13,433	—	13,433	1,274	1,714,529
Changes of items during the period							
Provision of reserve for reduction entry		—					—
Reversal of reserve for reduction entry		—					—
Provision of reserve for special account for reduction entry		—					—
Reversal of reserve for special account for reduction entry		—					—
Dividends from surplus		(152,669)					(152,669)
Net income		168,779					168,779
Purchase of treasury stock	(0)	(0)					(0)
Disposal of treasury stock	110	81					81
Net changes of items other than shareholders' equity			4,353	(863)	3,490	169	3,659
Total changes of items during the period	110	16,191	4,353	(863)	3,490	169	19,850
Balance at the end of current period	(344,463)	1,716,013	17,786	(863)	16,922	1,443	1,734,379

Year ended December 31, 2014

(Millions of yen)

	Shareholders' equity									
	Capital stock	Capital surplus			Retained earnings					
		Legal capital surplus	Other capital surplus	Total capital surplus	Legal retained earnings	Other retained earnings			Retained earnings brought forward	Total retained earnings
Reserve for reduction entry	Special account for reduction entry	General reserve								
Balance at the beginning of current period	100,000	736,400	—	736,400	18,776	48,211	14,440	955,300	187,349	1,224,077
Cumulative effects of changes in accounting policies									(6,198)	(6,198)
Balance after cumulative effects of changes in accounting policies	100,000	736,400	—	736,400	18,776	48,211	14,440	955,300	181,151	1,217,879
Changes of items during the period										
Provision of reserve for reduction entry						5,094			(5,094)	—
Reversal of reserve for reduction entry						(8,773)			8,773	—
Provision of reserve for special account for reduction entry							7,696		(7,696)	—
Reversal of reserve for special account for reduction entry							(5,094)		5,094	—
Dividends from surplus									(181,755)	(181,755)
Net income									108,656	108,656
Purchase of treasury stock										
Disposal of treasury stock									(3)	(3)
Net changes of items other than shareholders' equity										
Total changes of items during the period	—	—	—	—	—	(3,680)	2,603	—	(72,025)	(73,102)
Balance at the end of current period	100,000	736,400	—	736,400	18,776	44,531	17,043	955,300	109,126	1,144,777

(Millions of yen)

	Shareholders' equity		Valuation and translation adjustments			Subscription rights to shares	Total net assets
	Treasury stock	Total shareholders' equity	Valuation difference on available-for-sale securities	Deferred gains or losses on hedges	Total valuation and translation adjustments		
Balance at the beginning of current period	(344,463)	1,716,013	17,786	(863)	16,922	1,443	1,734,379
Cumulative effects of changes in accounting policies		(6,198)					(6,198)
Balance after cumulative effects of changes in accounting policies	(344,463)	1,709,816	17,786	(863)	16,922	1,443	1,728,181
Changes of items during the period							
Provision of reserve for reduction entry		—					—
Reversal of reserve for reduction entry		—					—
Provision of reserve for special account for reduction entry		—					—
Reversal of reserve for special account for reduction entry		—					—
Dividends from surplus		(181,755)					(181,755)
Net income		108,656					108,656
Purchase of treasury stock							
Disposal of treasury stock	16	14					14
Net changes of items other than shareholders' equity			3,302	(9,434)	(6,133)	188	(5,945)
Total changes of items during the period	16	(73,086)	3,302	(9,434)	(6,133)	188	(79,030)
Balance at the end of current period	(344,447)	1,636,730	21,087	(10,298)	10,790	1,631	1,649,151

## 【Notes to nonconsolidated financial statements】

### Significant accounting policies

#### 1. Basis and method of valuation for securities

##### (1) Investments in subsidiaries and affiliates:

Stated at cost determined by the moving-average method.

##### (2) Available-for-sale securities:

Securities with a fair value:

Stated at fair value based on market prices on the closing date of the accounting period. (Valuation difference is stated as a component of net assets and the cost of securities sold is calculated applying the moving-average method.)

Securities without a fair value:

Stated at cost determined by the moving-average method.

#### 2. Basis and method of valuation for derivatives

Derivatives

Stated based on the fair value method.

#### 3. Basis and method of valuation for inventories

Stated at cost determined by the average cost method.

(Balance sheet amounts are measured at the lower of cost or net selling value.)

#### 4. Depreciation methods for depreciable assets

##### (1) Property, plant and equipment (excluding lease assets)

The declining-balance method (straight-line method is applied for buildings (excluding accompanying facilities) acquired on or after April 1, 1998).

The main useful lives are as follows:

Buildings (excluding accompanying facilities):	38 to 50 years
Machinery and equipment:	10 years

##### (2) Intangible assets (excluding lease assets)

Straight-line method

The main useful lives are as follows:

Patent right:	8 years
Right of trademark:	10 years
Software:	5 years

##### (3) Lease assets

For finance leases that do not transfer ownership of the leased property to the lessee, depreciation expense is mainly computed on the straight-line method over the lease period as the useful life assuming no residual value.

#### 5. Policy on translation of assets and liabilities denominated in foreign currency into Japanese yen

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the rates prevailing at the closing date of the accounting period with translation differences treated as gains or losses.



## 6. Policy on accounting of provisions

### (1) Allowance for doubtful accounts

Provided for possible losses from bad debts at an amount determined based on the historical default ratio for ordinary receivables and the individual recoverability of specific doubtful receivables from customers experiencing financial difficulties.

### (2) Provision for bonuses

Provided based on the estimated payable amount to provide for the payment of bonuses to employees and directors.

### (3) Provision for retirement benefits

Provided in preparation for the payment of retirement benefits to employees based on the estimated retirement benefits obligation and fair value of plan assets as of the end of this fiscal year. In calculating retirement benefit obligations, the benefit formula basis is used as the method of attributing expected benefit to periods up to the fiscal year ended December 31, 2014.

Past service cost is amortized using the straight-line method over the average remaining years of service of the employees (10 years).

Actuarial gains and losses are amortized from the year following the year in which the gains or losses are recognized using the straight-line method over the average remaining years of service of the employees (10 years).

Also included in the provision for retirement benefits is the portion of public pension expenses for mutual assistance association during certain periods in or before June 1956 (prior to the enforcement of the Act on the Mutual Aid Association of Public Corporation Employees).

## 7. Method of hedge accounting

Method of hedge accounting

Deferral hedge accounting is applied.

For interest rate and currency swaps, if they satisfy the requirements for treatment that incorporates swaps into underlying accounting items (accounting by applying foreign exchange rate stipulated in the contracts; exceptional treatment), they are accounted for by incorporating swaps into underlying accounting items.

## 8. Other significant accounting policies

### (1) Accounting treatment relating to retirement benefits

Regarding unrecognized actuarial gains and losses and unrecognized past service cost relating to retirement benefits, different accounting treatments have been applied compared to those in the consolidated financial statements.

### (2) Consumption taxes

National consumption tax and local consumption tax are excluded from each amount in the nonconsolidated statement of income.

## 9. Change of fiscal year end

In this fiscal year, the Company has changed its fiscal year end from March 31 to December 31 by the resolution of the 29<sup>th</sup> Annual General Shareholders' Meeting held on June 24, 2014, for the purpose of unifying the fiscal year end with overseas consolidated subsidiaries of the Group, which will enhance and improve the efficiency of the closing and management systems.

As a consequence of this change of fiscal year end, fiscal year 2014 was a nine-month period from April 1, 2014 to December 31, 2014.

### **Changes in accounting policies**

#### Adoption of accounting standard for retirement benefit

In this fiscal year, the Company has adopted “Accounting Standard for Retirement Benefits” (Accounting Standard Board of Japan (ASBJ) Statement No. 26, revised on May 17, 2012) and “Guidelines on Accounting Standard for Retirement Benefits” (ASBJ Guidelines No. 25, revised on May 17, 2012). The calculation method for retirement benefit obligations and current service cost was reviewed and the method of attributing expected benefit to periods has been changed from the straight-line basis to the benefit formula basis.

The Company has applied the transitional treatment of paragraph 37 of the Accounting Standard for Retirement Benefits and the effects of the changes in calculation method for retirement benefit obligations and current service cost arising from initial application have been recognized as an adjustment to the beginning balance of retained earnings.

As a consequence of this change, the beginning balance of retained earnings decreased by ¥6,198 million. The effect on the statement of income is immaterial.

## Notes to nonconsolidated balance sheet

\*1. Pursuant to Article 6 of the Japan Tobacco Inc. Act, the Company's assets are pledged as general collateral for corporate bonds issued by JT. Bondholders have the right to receive payment of their own claims for assets of JT in preference to other general creditors (with the exception of national taxes, local taxes and other obligations of a public nature).

\*2. Inter-company receivables and payables excluding those separately presented are as follows:

(Millions of yen)

	As of March 31, 2014	As of December 31, 2014
Short-term receivables	43,198	33,768
Short-term payables	25,373	26,037
Long-term payables	15,399	11,551

\*3. In this fiscal year, "Repurchase agreement" of ¥6,000 million is included in "Other" in "Current assets" and the fair value of securities received as collateral is ¥6,000 million.

\*4. "Cash management system deposits received" represents the fund entrusted in the cash management system of domestic group companies.

### 5. Contingent obligations

Guarantees are provided for bank loans and bonds of subsidiaries and affiliates as follows:

#### Bank loans

As of March 31, 2014			As of December 31, 2014		
	(Millions of yen)			(Millions of yen)	
JT International Company Netherlands B.V.	28,901	(EUR 204 million)	JT International Hellas A.E.B.E.	41,695	(EUR 285 million)
JTI Ireland Limited	27,640	(EUR 195 million)	JT International Company Netherlands B.V.	38,711	(EUR 264 million)
JT International Hellas A.E.B.E.	19,265	(EUR 136 million)	JTI Ireland Limited	28,605	(EUR 195 million)
LLC Petro	17,966	(RUB 6,230 million)	JT International S.A.	14,168	(USD 9 million) (EUR 49 million) (CHF 48 million)
JT International S.A.	12,090	(USD 23 million) (EUR 29 million) (CHF 48 million)			
Other (45 companies)	64,254		Other (44 companies)	72,198	
Total	170,116		Total	195,377	

#### Bonds

As of March 31, 2014		As of December 31, 2014	
	(Millions of yen)		(Millions of yen)
JTI (UK) Finance PLC	73,949	(EUR 522 million)	—
Total	73,949		—

Note: Guarantee obligations denominated in foreign currencies were translated to yen amounts using the exchange rate as of the closing date of the accounting period.

\*6. National tobacco excise taxes payable, national tobacco special excise taxes payable and local tobacco excise taxes payable include the following amounts because the last day of this fiscal year was a holiday of financial institutions.

(Millions of yen)

	As of March 31, 2014	As of December 31, 2014
National tobacco excise taxes payable	—	44,129
National tobacco special excise taxes payable	—	6,825
Local tobacco excise taxes payable	—	50,838

## Notes to nonconsolidated statement of income

### \*1. Net sales including tobacco excise taxes

(Millions of yen)

	Fiscal year ended March 31, 2014	Fiscal year ended December 31, 2014
Net sales including tobacco excise taxes	2,222,741	1,532,755

Note: Net sales including tobacco excise taxes are net sales plus the amount equivalent to tobacco excise taxes.

### \*2. The main components of “Selling, general and administrative expenses” are as follows:

(Millions of yen)

	Fiscal year ended March 31, 2014	Fiscal year ended December 31, 2014
Promotion expenses	57,633	39,367
Compensations, salaries and allowances	34,262	26,410
Provision for bonus	7,083	3,383
Employee benefit expenses	12,430	10,201
Commission	30,207	25,534
Depreciation and amortization	18,813	13,392
Research and development expenses	44,910	33,197
Selling expenses ratio	56%	54%
General and administrative expenses ratio	44%	46%

### \*3. The main component of “Gains on sales of noncurrent assets” is as follows:

(Millions of yen)

	Fiscal year ended March 31, 2014	Fiscal year ended December 31, 2014
Land	42,629	50,218

### \*4. The main component of “Losses on sales of noncurrent assets” is as follows:

(Millions of yen)

	Fiscal year ended March 31, 2014	Fiscal year ended December 31, 2014
Buildings	719	624

### \*5. The main components of “Losses on disposal of noncurrent assets” are as follows:

(Millions of yen)

	Fiscal year ended March 31, 2014	Fiscal year ended December 31, 2014
Buildings	2,392	1,118
Machinery and equipment	3,044	4,863

### \*6. Amounts of transactions with subsidiaries and affiliates are as follows:

(Millions of yen)

	Fiscal year ended March 31, 2014	Fiscal year ended December 31, 2014
Revenue	134,070	94,275
Cost of purchased goods	86,791	65,063
Selling, general and administrative expenses	69,037	47,981
Total amount of non-operating transactions	40,763	19,902

\*7. Business restructuring costs mainly relate to costs of measures to strengthen the competitiveness of “Domestic Tobacco Business”. They mainly consist of extra severance payment for early retirement.



**(Securities)**

## Investments in subsidiaries and affiliates

As of March 31, 2014

(Millions of yen)

Type	Balance sheet amount	Fair value	Difference
Investments in subsidiaries	41,580	51,586	10,006
Total	41,580	51,586	10,006

As of December 31, 2014

(Millions of yen)

Type	Balance sheet amount	Fair value	Difference
Investments in subsidiaries	41,580	45,442	3,862
Total	41,580	45,442	3,862

Note: Balance sheet amount of investments in subsidiaries and affiliates whose fair value is deemed extremely difficult to determine

(Millions of yen)

Type	As of March 31, 2014	As of December 31, 2014
Investments in subsidiaries	1,980,799	1,865,118
Investments in affiliates	155	155

The above are not included in “Investments in subsidiaries and affiliates” because their market values are not available and their fair values are deemed extremely difficult to determine.

**(Tax effect accounting)**

## 1. Breakdown of deferred tax assets and deferred tax liabilities by major cause

	(Millions of yen)	
	As of March 31, 2014	As of December 31, 2014
Deferred tax assets		
Provision for retirement benefits	27,174	22,135
Obligations pertaining to mutual assistance pension benefits	26,621	24,728
Provision for bonuses	4,068	1,921
Accounts payable to employees who have agreed for early retirement	—	28,039
Other	15,698	20,555
Subtotal	73,561	97,378
Less valuation allowance	(2,827)	(6,518)
Total	70,735	90,859
Deferred tax liabilities		
Reserve for reduction entry	(26,431)	(24,413)
Other	(20,835)	(22,928)
Total	(47,265)	(47,341)
Net deferred tax assets	23,469	43,518

## 2. Reconciliation between the effective statutory tax rate and the actual effective tax rate reflected in the nonconsolidated statement of income, if there is a significant difference

	(%)	
	As of March 31, 2014	As of December 31, 2014
Effective statutory tax rate	—	35.41
(Adjustments)		
Permanent difference arising from non-deductible items including entertainment expenses	—	0.32
Permanent difference arising from non-taxable items including dividend income	—	(0.30)
Tax credit of items including research and development expenses	—	(1.91)
Valuation allowance	—	0.04
Other	—	0.00
Actual effective tax rate after applying tax effect accounting	—	33.56

Note: In the prior fiscal year, the note relating to the reconciliation between the effective statutory tax rate and the actual effective tax rate was omitted due to the fact that the difference was less than 5 percent of the effective statutory tax rate.

**(Business combination)**

No items to report.



## **(Subsequent events)**

### **(1) Withdrawal from the manufacture and sale of JT beverage products**

The Company decided by resolution at a meeting of the Board of Directors held on February 4, 2015 to withdraw from manufacture and sale of JT beverage products in the beverage business. The manufacture and sale of JT beverage products conducted by JT's beverage business division and JT Beverage Inc. is expected to be discontinued by the end of September 2015. The impact of the decision on the nonconsolidated financial statements for fiscal year ending December 31, 2015 has not been confirmed at present.

### **(2) Acquisition of own shares**

As a supplemental measure for the adjusted EPS growth at constant FX in the mid- to long-term in the framework of shareholder return, the Company's Board of Directors made a resolution on February 5, 2015 for the Company to acquire its own shares according to the particulars stated below pursuant to the provision of Article 156 of the Companies Act, as applied by replacing the relevant terms pursuant to the Act's provision of Article 165, paragraph 3.

#### **a. Class of shares to be acquired**

Common stock

#### **b. Number of shares to be acquired**

Up to 36,000,000 shares

#### **c. Total payment amount to acquire shares**

Up to ¥100,000 million

#### **d. Period of share acquisition**

From February 9, 2015 to June 9, 2015

#### **e. Method of acquisition**

Purchase on the stock exchange via a trust bank

Based on this resolution, the Company acquired 26,896,200 shares of its common stock for a total acquisition price of ¥100,000 million during the period between February 9, 2015 and March 18, 2015 (contract basis), and has completed the acquisition of its common stock as resolved by the Board of Directors.

d. Supplementary statements

**Detailed schedule of property, plant and equipment and others**

(Millions of yen)

	Type of assets	Balance as of April 1, 2014	Increase in the fiscal year ended December 31, 2014	Decrease in the fiscal year ended December 31, 2014	Depreciation during the fiscal year ended December 31, 2014	Balance as of December 31, 2014	Accumulated depreciation or accumulated amortization as of December 31, 2014
Property, plant and equipment	Buildings	110,449	5,678	12,541	6,785	96,800	251,666
	Structures	3,099	175	145	279	2,851	14,687
	Machinery and equipment	79,885	13,651	9,972 (3,154)	12,853	70,710	214,426
	Vehicles	1,803	420	79	349	1,794	1,429
	Tools, furniture and fixtures	30,809	7,831	802	8,330	29,507	75,706
	Land	84,780	29	4,469	—	80,340	—
	Construction in progress	5,393	3,600	4,626	—	4,367	—
	Total property, plant and equipment	316,217	31,384	32,635 (3,154)	28,597	286,369	557,914
Intangible assets	Patent right	614	7	—	64	558	—
	Right of trademark	4,056	256	—	519	3,794	—
	Software	20,774	2,179	110	4,870	17,973	—
	Other	2,091	895	559	80	2,347	—
	Total intangible assets	27,535	3,338	669	5,533	24,672	—

Notes: 1. The figures in parentheses in the “Decrease in the fiscal year ended December 31, 2014” column represent decreases due to impairment loss included in the figures above.

2. Other includes software in progress.

3. Major breakdowns of “Increase in the fiscal year ended December 31, 2014” and “Decrease in the fiscal year ended December 31, 2014” are as follows:

(Millions of yen)

Machinery and equipment	Increase	Tobacco products manufacturing equipment and other	13,622
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**Detailed schedule of reserve allowances**

(Millions of yen)

Category	Balance as of April 1, 2014	Increase in the fiscal year ended December 31, 2014	Decrease in the fiscal year ended December 31, 2014	Balance as of December 31, 2014
Allowance for doubtful accounts	431	4	9	426
Provision for bonuses	11,489	5,424	11,489	5,424

**(2) Major assets and liabilities**

Note is omitted due to the fact that the relevant parts are prepared in the consolidated financial statements.

**(3) Others**

No items to report.

(TRANSLATION)

## INDEPENDENT AUDITOR'S REPORT

March 20, 2015

To the Board of Directors of  
Japan Tobacco Inc.:

Deloitte Touche Tohmatsu LLC

Designated Unlimited Liability Partner,  
Engagement Partner,  
Certified Public Accountant:

Yasuyuki Miyasaka (Seal)

Designated Unlimited Liability Partner,  
Engagement Partner,  
Certified Public Accountant:

Koji Ishikawa (Seal)

Designated Unlimited Liability Partner,  
Engagement Partner,  
Certified Public Accountant:

Takenao Ohashi (Seal)

### Audit of Financial Statements

Pursuant to the first paragraph of Article 193-2 of the Financial Instruments and Exchange Act, we have audited the consolidated financial statements included in the Accounting Section, namely, the consolidated statement of financial position, and the related consolidated statements of income, comprehensive income, changes in equity and cash flows of Japan Tobacco Inc. (the "Company") and its consolidated subsidiaries for the fiscal year from April 1, 2014 to December 31, 2014, and notes to the 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 under the provision of Article 93 of the Ordinance on Terminology, Forms and Preparation Methods of Consolidated Financial Statements, 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.

#### *Audit Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company and its consolidated subsidiaries as of December 31, 2014, and the results of their operations and their cash flows for the fiscal year then ended in accordance with International Financial Reporting Standards.

#### *Emphasis of Matter*

As discussed in "2. Basis of Preparation—(5) Change of fiscal year end," the Company has changed its fiscal year end from March 31 to December 31. Our opinion is not qualified in respect of this matter.

#### **Audit of Internal Control**

Pursuant to the second paragraph of Article 193-2 of the Financial Instruments and Exchange Act, we have audited management's report on internal control over financial reporting of the Company as of December 31, 2014.

#### *Management's Responsibility for the Report on Internal Control*

Management is responsible for designing and operating effective internal control over financial reporting and for the preparation and fair presentation of its report on internal control in accordance with assessment standards for internal control over financial reporting generally accepted in Japan. There is a possibility that misstatements may not be completely prevented or detected by internal control over financial reporting.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on management's report on internal control based on our internal control audit. We conducted our internal control audit in accordance with auditing standards for internal control over financial reporting generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether management's report on internal control is free from material misstatement.

An internal control audit involves performing procedures to obtain audit evidence about the results of the assessment of internal control over financial reporting in management's report on internal control. The procedures selected depend on the auditor's judgment, including the significance of effects on reliability of financial reporting. An internal control audit includes examining representations on the scope, procedures and results of the assessment of internal control over financial reporting made by management, as well as evaluating the overall presentation of management's report on internal control.

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, management's report on internal control over financial reporting referred to above, which represents that the internal control over financial reporting of the Company as of December 31, 2014 is effectively maintained, presents fairly, in all material respects, the results of the assessment of internal control over financial reporting in accordance with assessment standards for internal control over financial reporting generally accepted in Japan.

### **Interest**

Our firm and the engagement partners do not have any interest in the Company for which disclosure is required under the provisions of the Certified Public Accountants Act.

The above represents a translation, for convenience only, of the original report issued in the Japanese language.

(TRANSLATION)

**INDEPENDENT AUDITOR'S REPORT**

March 20, 2015

To the Board of Directors of  
Japan Tobacco Inc.:

Deloitte Touche Tohmatsu LLC

Designated Unlimited Liability Partner,  
Engagement Partner,  
Certified Public Accountant:

Yasuyuki Miyasaka (Seal)

Designated Unlimited Liability Partner,  
Engagement Partner,  
Certified Public Accountant:

Koji Ishikawa (Seal)

Designated Unlimited Liability Partner,  
Engagement Partner,  
Certified Public Accountant:

Takenao Ohashi (Seal)

Pursuant to the first paragraph of Article 193-2 of the Financial Instruments and Exchange Act, we have audited the financial statements included in the Accounting Section, namely, the nonconsolidated balance sheet, and the related nonconsolidated statements of income, and changes in net assets of Japan Tobacco Inc. (the "Company") for the 30th fiscal year from April 1, 2014 to December 31, 2014, and the significant accounting policies and other related notes and supplemental schedules.

**Management's Responsibility for the Nonconsolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these nonconsolidated financial statements in accordance with accounting principles generally accepted in Japan, and for such internal control as management determines is necessary to enable the preparation of nonconsolidated 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 nonconsolidated 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 nonconsolidated financial statements are free from material misstatement.



An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the nonconsolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the nonconsolidated 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 nonconsolidated 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 nonconsolidated financial statements.

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

### **Audit Opinion**

In our opinion, the nonconsolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2014, and the results of its operations for the fiscal year then ended in accordance with accounting principles generally accepted in Japan.

### **Interest**

Our firm and the engagement partners do not have any interest in the Company for which disclosure is required under the provisions of the Certified Public Accountants Act.

The above represents a translation, for convenience only, of the original report issued in the Japanese language.