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Company name (Japanese):	日本たばこ産業株式会社 (*Nihon Tabako Sangyo Kabushiki-Kaisha*)
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A. Company Information

I. Overview of the Group

1. Trends in principal management benchmarks

(1) Management benchmarks (consolidated)

Term	International Financial Reporting Standards					
	27th term	28th term	29th term	30th term	31st term	32nd term
Accounting period	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	From January 1, 2015 to December 31, 2015	From January 1, 2016 to December 31, 2016
Revenue (Millions of yen)	2,033,825	2,120,196	2,399,841	2,019,745	2,252,884	2,143,287
Profit before income taxes (Millions of yen)	441,355	509,355	636,203	502,526	565,113	578,237
Profit for the year (Millions of yen)	328,559	351,448	435,291	368,626	490,242	425,773
Profit attributable to owners of the parent company (Millions of yen)	320,883	343,596	427,987	362,919	485,691	421,695
Comprehensive income (loss) for the year (Millions of yen)	192,143	544,407	850,261	244,868	207,708	235,250
Total equity (Millions of yen)	1,714,626	1,892,431	2,596,091	2,622,503	2,521,524	2,528,041
Total assets (Millions of yen)	3,667,007	3,852,567	4,616,766	4,704,706	4,558,235	4,744,374
Equity attributable to owners of the parent company per share (Yen)	858.09	993.98	1,378.57	1,395.74	1,369.06	1,371.39
Basic earnings per share (Yen)	168.50	181.07	235.48	199.67	270.54	235.47
Diluted earnings per share (Yen)	168.44	180.98	235.35	199.56	270.37	235.33
Ratio of equity attributable to owners of the parent company to total assets (%)	44.56	46.89	54.27	53.92	53.78	51.77
Ratio of profit to equity attributable to owners of the parent company (%)	20.31	19.97	19.85	14.39	19.47	17.19
Price earnings ratio (PER) (Times)	13.83	16.57	13.76	16.67	16.53	16.32
Net cash flows from operating activities (Millions of yen)	551,573	466,608	396,496	543,696	468,432	376,549
Net cash flows from investing activities (Millions of yen)	(103,805)	(147,928)	(163,473)	(49,110)	(63,271)	(687,509)
Net cash flows from financing activities (Millions of yen)	(279,064)	(569,473)	(145,189)	(388,859)	(254,852)	91,318
Cash and cash equivalents at the end of the year (Millions of yen)	404,740	142,713	253,219	385,820	526,765	294,157
Number of employees [Separately, average number of temporary employees] (Person)	48,529 [10,702]	49,507 [9,313]	51,563 [9,130]	51,341 [8,700]	44,485 [7,858]	44,667 [7,904]

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. The Company 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 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 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.
7. The Company 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 the Company 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.
8. The Group has classified “Beverage Business” as discontinued operations from the 31st term, and the figures presented for the 30th term have been restated. Consequently, only revenue and profit before income taxes from continuing operations are presented for the 30th and 31st terms.

Term	Japanese GAAP
	27th term
Accounting period	From April 1, 2011 to March 31, 2012
Net sales (Millions of yen)	2,547,060
Ordinary income (Millions of yen)	362,728
Income before income taxes and minority interests (Millions of yen)	345,028
Profit attributable to owners of the parent company (Millions of yen)	227,399
Comprehensive income (loss) (Millions of yen)	117,047
Net assets (Millions of yen)	1,610,535
Total assets (Millions of yen)	3,472,612
Net assets per share (Yen)	160,570.98
Net income per share (Yen)	23,882.77
Diluted net income per share (Yen)	23,873.42
Equity ratio (%)	44.03
Return on equity (ROE) (%)	15.04
Price earnings ratio (PER) (Times)	19.51
Net cash flows from operating activities (Millions of yen)	551,617
Net cash flows from investing activities (Millions of yen)	(104,530)
Net cash flows from financing activities (Millions of yen)	(278,383)
Cash and cash equivalents at the end of the year (Millions of yen)	404,740
Number of employees [Separately, average number of temporary employees] (Person)	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 27th term.

2. Foreign subsidiaries classified under the 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.

3. The yen amounts are rounded to the nearest million.

4. Net sales do not include consumption taxes.

5. As a consequence of applying “Revised Accounting Standard for Business Combinations” (ASBJ Statement No. 21 of September 13, 2013) etc. to the Japanese GAAP financial statements, “Net income” is referred to as “Profit attributable to owners of the parent” from this fiscal year onward.

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

Term	27th term	28th term	29th term	30th term	31st term	32nd term
Accounting period	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	From January 1, 2015 to December 31, 2015	From January 1, 2016 to December 31, 2016
Net sales (Millions of yen)	734,902	781,067	809,967	572,323	732,483	729,286
Ordinary income (Millions of yen)	198,071	210,568	230,900	159,746	371,989	203,242
Net income (Millions of yen)	142,726	149,773	168,779	108,656	345,009	173,607
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	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Net assets (Millions of yen)	1,924,739	1,714,529	1,734,379	1,649,151	1,713,068	1,663,675
Total assets (Millions of yen)	3,016,651	2,784,914	2,732,637	2,729,270	2,756,785	2,849,913
Net assets per share (Yen)	1,010.20	942.65	953.45	906.45	955.56	927.93
Cash dividends per share (Yen) [Interim dividends per share] (Yen)	10,000 [4,000]	68 [30]	96 [46]	100 [50]	118 [54]	130 [64]
Net income per share (Yen)	74.95	78.93	92.86	59.78	192.18	96.94
Diluted net income per share (Yen)	74.92	78.89	92.81	59.75	192.06	96.88
Equity ratio (%)	63.8	61.5	63.4	60.4	62.1	58.3
Return on equity (ROE) (%)	7.56	8.24	9.80	6.43	20.54	10.29
Price earnings ratio (PER) (Times)	31.09	38.01	34.89	55.67	23.26	39.65
Dividend payout ratio (%)	66.7	82.5	103.4	167.3	61.4	134.1
Number of employees [Separately, average number of temporary employees] (Person)	8,936 [1,393]	8,925 [1,390]	8,774 [1,377]	8,915 [1,272]	7,549 [1,125]	7,298 [1,117]

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

2. The yen amounts are rounded to the nearest million.

3. Net sales do not include consumption taxes.

4. The Company conducted a share split at a ratio of 200 to one with 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.

5. The Company 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 the Company's transition to stock company

Before it became a stock company, Japan Tobacco Inc. (hereinafter, "the Company") was formerly Japan Tobacco and Salt Public Corporation, or JTS. JTS was established on 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, which 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 the Company after its incorporation

The Company 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, the Company succeeded all the rights and obligations of JTS.

The main changes since the incorporation of the Company 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 the internal pharmaceutical research and development capabilities.
October 1994	The initial public offering of the Company shares held by the Japanese government. (394,276 shares) The Company shares were listed on the First Section of the Tokyo, Osaka and Nagoya Stock Exchanges.
November 1994	The Company 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 the Company shares held by the Japanese government. (272,390 shares)
April 1997	In accordance with the abolition of the salt monopoly, the Company ended its salt monopoly business. The Tobacco Mutual Aid Pension scheme was united with the Employees' Pension scheme.
April 1998	The Company 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	The Company acquired a majority stake in Torii Pharmaceutical Co., Ltd. through a tender offer.
May 1999	The Company acquired the non-US tobacco operations of RJR Nabisco Inc.
July 1999	The Company 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 the Company 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 the Company shares held by the Japanese government. (289,334 shares)
March 2005	In order to establish a basis for future profit growth in the Domestic Tobacco Business, Ueda, Hakodate, Takasaki, Takamatsu, Tokushima, Usuki, Kagoshima and Miyakonojo Factories were closed down.
April 2006	The Company ceased to produce, sell and use Marlboro brand cigarette exclusively in Japan upon the expiration of the exclusive license agreement.
April 2007	The Company 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	The Company 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 "Mevius" in Japan.
March 2013	The fourth public offering of the Company shares held by the Japanese government. (253,261,800 shares)
March 2015	In order to further strengthen the competitiveness of Domestic Tobacco Business, Koriyama, Hamamatsu and Okayama Printing Factories were closed down.

Date		Details of change
July	2015	The Company transferred shares the Company held in Japan Beverage Holdings Inc., JT A-Star Co., Ltd. and others, and JT beverage brands “Roots” and “Momono Tennensui.” Subsequently, the Company withdrew from manufacture and sale of JT beverage products in September 2015 and the Beverage Business Division was closed down in December 2015.
March	2016	In order to further strengthen the competitiveness of Domestic Tobacco Business, Hiratsuka factory was closed down.

Note: The stock split of at a ratio of five to one was conducted as of April 1, 2006 and the stock split at a ratio of 200 to one was conducted as of July 1, 2012.

3. Business description

The Group's management principles are based on the pursuit of the "4S" model. The model requires the Group to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society, carefully considering the respective interests of these four key stakeholder groups, and exceeding their expectations wherever we can.

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

The Group has also adopted "The JT Group Way" as a code of conduct which all members of the Group should follow. The JT Group Way requires that the Group fulfills the expectations of the Group's consumers and behaves responsibly, strives for quality in everything we do through continuous improvement, and leverages diversity across the Group.

The Group, consisting of the Company, its 202 consolidated subsidiaries and 12 companies accounted for by the equity method, is a global company operating the Domestic and International Tobacco Businesses, Pharmaceutical Business and Processed Food Business. The main business activities operated by the Group and the relationship of each affiliates to the Group's business activities are stated below.

The following four 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."

Domestic Tobacco Business

The Domestic Tobacco Business consists of the manufacture and sale of tobacco products. The Company manufactures and sells tobacco products, and TS Network Co., Ltd. conducts distribution-related operations such as distribution of the Company's tobacco products and wholesale of foreign tobacco products (imported tobacco products). Japan Filter Technology Co., Ltd. and other subsidiaries manufacture materials. Moreover, some of the operations related to Natural American Spirit products are carried out by TRUE SPIRIT TOBACCO COMPANY.

Major subsidiaries and affiliates

TS Network Co., Ltd., JT Logistics Co., Ltd., Japan Filter Technology Co., Ltd., Fuji Flavor Co., Ltd., JT Engineering Inc., TRUE SPIRIT TOBACCO COMPANY

Besides the companies named above, there are 6 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., LLC JTI Russia, Gallaher Ltd., LLC Petro, JT International Germany GmbH, JTI Polska Sp. z o. o., JTI Tütün Urunleri Sanayi A.S.

Besides the companies named above, there are 143 consolidated subsidiaries and 5 companies accounted for by the equity method.

Pharmaceutical Business

The Pharmaceutical Business consists of research and development, and the manufacture and sale of prescription drugs. The Company concentrates on research and development while Torii Pharmaceutical Co., Ltd. manufactures and promotes sales of drugs (including the Company's products).

Major subsidiaries and affiliates

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

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

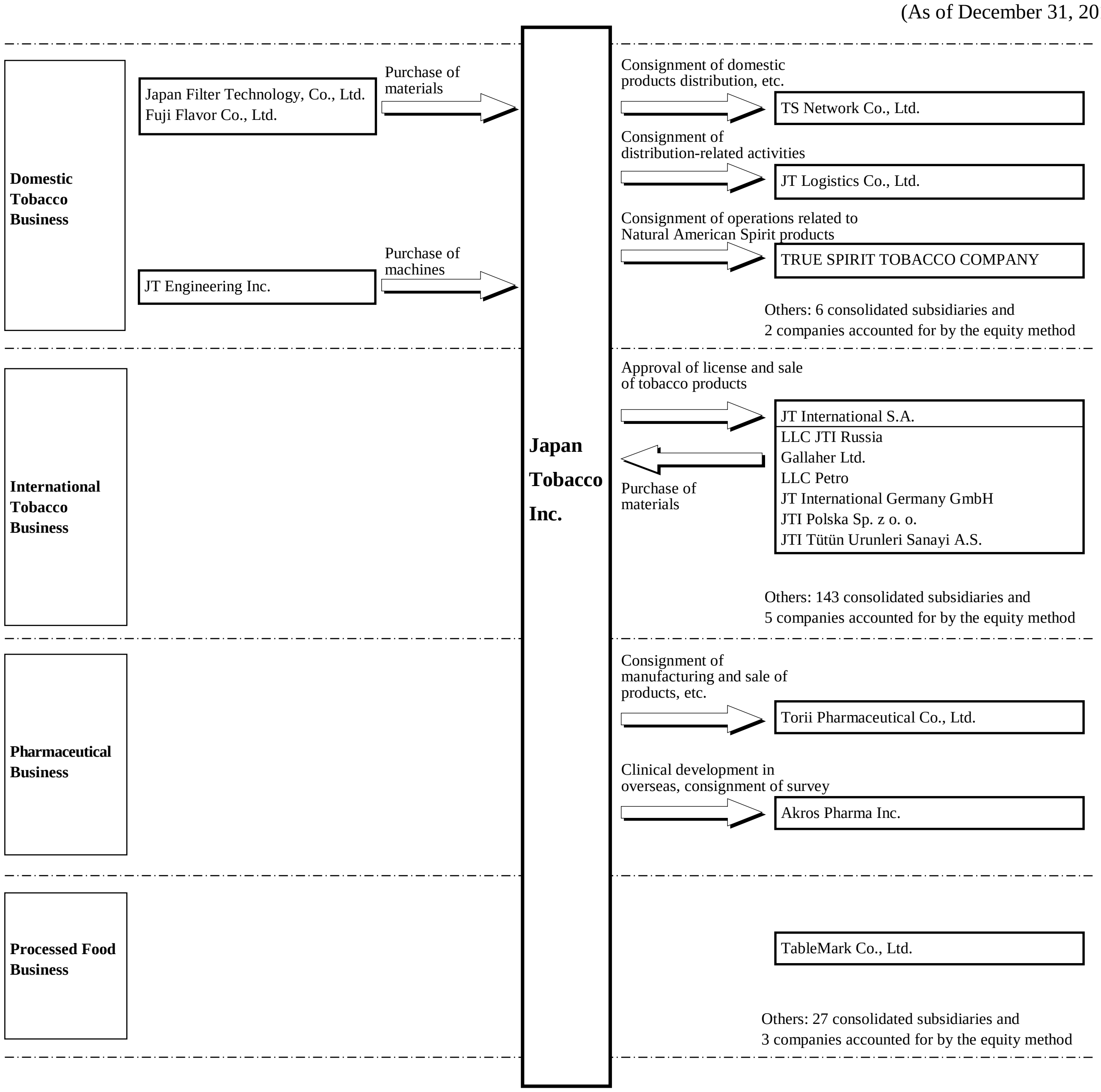
TableMark Co., Ltd.

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 Group runs businesses, including business relating to the rent of real estate. There are 10 consolidated subsidiaries and 2 companies accounted for by 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, 2016)



* In addition to the reportable segments mentioned above, the Group runs businesses including business relating to the rent of real estate. There are 10 consolidated subsidiaries and 2 companies accounted for by the equity method deemed as affiliates not affiliated to any reportable segment.

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

Tobacco Business

The Group's tobacco business (the 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 at least 70 countries and territories, and sells products in at least 120 countries and territories. The Group's portfolio includes 3 of the top 10 selling global brands.

<Research and development>

The Group is committed to strengthening its R&D capabilities to ensure a long-term competitive advantage. The focus areas in the R&D activities are the development of new leaf tobacco varieties, improvement of tobacco leafs and their processing, enhancement of aroma and taste, upgrading manufacturing technology, and continuous progress on emerging product development capabilities. The Group has been striving to add value to the products in these focus areas in a cost efficient manner. It has established a global research platform in Japan, which focuses on the fundamental research and product technology development. To best meet consumers' needs and preferences, the 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 Group has been striving to secure a stable supply and ensure competitive leaf purchase prices. This will be achieved through further vertical integration and strengthening of the relationships with the leaf suppliers.

- Procurement of non-Japan origin tobacco leaf

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

The internal source was established in 2009, when the Group acquired the tobacco leaf suppliers (in Brazil and in Africa), and set up a U.S. joint venture operation. Since then, the 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 expertise in this area.

- Procurement of Japan origin tobacco leaves

In Japan, the Tobacco Business Act requires the Company 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 Council (Note).

Note: The Leaf Tobacco 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 Company's 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 the Company with the approval of the Minister of Finance (MOF).

<Manufacturing>

The Group has a global manufacturing footprint in order to manufacture quality tobacco products that secure consumers' reliability trust. The Group operates 5 factories in Japan (4 tobacco manufacturing and 1 tobacco-related factory), and 30 factories in 27 other countries (including tobacco-related factories). In a limited number of cases, the Group also partners with competing manufacturers under contracts and/or license agreements to manufacture the Group's products.

<Marketing>

To enhance brand loyalty, the Group is conducting extensive and effective marketing activities in accordance to the various regulations and standards. Globally, the marketing activities are focused on Global Flagship Brands (hereinafter, "GFBs")(Note), while complementing the brand portfolio by promoting local brands as well.

Note: GFBs (Global Flagship Brands) consist of nine brands, which serve as flagships of the Group's brand portfolio - Winston, Camel, Mevius, LD, Benson & Hedges, Glamour, Sobranie, Silk Cut and Natural American Spirit.

<Retail prices>

In setting a retail price for a product, the Group considers various factors, including positioning of the brand, perceived value of the product, retail price of competing products, and the margin. In addition, there are regulations that influence the 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 the products are delivered to consumers, the Group makes sure to use optimal distribution networks for each market complying with the restrictions and in accordance with established local business practices, and other factors. The distribution networks of the Group 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, the Group develops different trade marketing initiatives for each market, depending on the focus channels as well as consumer trend and competitors' strategies.

Pharmaceutical Business

The Group commenced the Pharmaceutical Business in 1987. The Group's mission is to build world-class, unique R&D capabilities and reinforce its market presence through innovative drugs. The Pharmaceutical Business is currently focusing on the development, production, and sale of prescription drugs.

In December 1998, the Company 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 the Company.

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

In order to make stable profit contribution, the Group is maximizing the value of each product, enhancing the 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 the Group's Pharmaceutical Business and are critical for its long-term growth and profitability. The R&D activities focus mainly on the fields of glucose and lipid metabolism, virus research and immune disorders and inflammation. In the fiscal year ended December 31, 2016, the Group invested ¥30.7 billion in these activities.

- R&D process

The Central Pharmaceutical Research Institute is responsible for discovery research, drug development, and pre-clinical trial research. The Company'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 Group’s pharmaceutical products are produced by Torii Pharmaceutical or contract manufacturers outside the Group.

<Sales and promotion>

- Sales and promotion outside Japan

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

- Sales and promotion in Japan

Torii Pharmaceutical is mainly responsible for sales of the Group’s pharmaceutical products to pharmaceutical wholesalers and promotion to medical facilities. Promotional activities are conducted by 511 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 the main products among others.

Processed Food Business

The Group started its Processed Food Business in 1998. Since then, the Group has been expanding the business through organic growth as well as business investments in the form of M&As and strategic partnerships.

In 2008, the Group acquired Katokichi Co., Ltd., a major frozen food manufacturing company in Japan, through a tender offer. The Group’s processed food operations were transferred over to Katokichi Co., Ltd. as part of the integration. In 2010, Katokichi Co., Ltd. changed its corporate name to TableMark Co., Ltd. to pursue synergies and foster a sense of unity within the group. At present, this business is operated by 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), “Takitate-Gohan” (packed rice), and the “Vertex” yeast extract seasonings in particular.

<Research and development>

Regarding R&D, the Group devotes its efforts to the development of innovative products that meet consumers’ needs and preferences. In order to meet the diversifying needs of customers, the Group works to develop value-added products using TableMark’s original techniques.

Specifically, the Group has 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 the Group developed a new production method, the “Tannen-jikomi” weaving and maturing process. This enabled the Group 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 Group reviews quality assurance certificates submitted by its suppliers. The Group also carries out monitoring inspections to check agrochemical residues as well as conducts regular inspections at processing factories to ensure compliance with the Group’s internal standards, in addition to the Food Sanitation Act and other relevant laws.

Furthermore, the Group examines the safety of production sites for raw materials which are procured from overseas. Concerning agricultural farms, the Group checks 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 Group operates 23 factories in Japan and 8 outside Japan. The Group outsources production of some processed foods to domestic and international contract manufacturers. All of the Group's 31 factories in and outside Japan, as well as the Group's business partners' factories which produce the frozen foods, have achieved the ISO 22000 or FSSC 22000 certification. Under the ISO 22000 and FSSC 22000 standards, 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. FSSC 22000 has already been obtained at 19 factories of the Group. The Group is making preparations for gradually obtaining this certification at other Group company plants while keeping the business environment under consideration.

<Marketing>

The Group analyzes the market from consumers' point of view and, by combining the technology owned by TableMark, it has been striving to provide products with new values to expand the market and increase its place there. The Group has been striving for effective marketing in order to improve consumer awareness of its products.

<Sales and distribution>

The Group has been striving to enhance profitability through sales division structure optimization and its initiatives to increase its 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 the products safely, the Group has established an independent food safety management division at TableMark Holdings Co., Ltd., which is responsible for overall food safety controls. At TableMark, the Group has established Quality Control Centers in Tokyo and Qingdao (China), and it not only inspects and monitors the raw materials it uses from the product planning and development stages, but also makes inspections at factories at the time of production and before shipment, and carries out safety management throughout the product manufacturing process. The Group seeks assessment and advice on its initiatives from external food safety experts. The Group reflects the experts' knowledge and viewpoints in its 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 the website.

4. Status of subsidiaries and affiliates

(As of December 31, 2016)

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 the Company	Employee of the Company			
(Consolidated subsidiaries) 202 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.	Chuo-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	Sumida-ku, Tokyo	461	Domestic tobacco	88.6	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. *1	Sumida-ku, Tokyo	200	Domestic tobacco	100.0	No	Yes	No	Purchase of machines	Yes
TRUE SPIRIT TOBACCO COMPANY	Minato-ku, Tokyo	45	Domestic tobacco	100.0	No	Yes	No	Consignment of operations related to Natural American Spirit products	No
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	Switzerland	Thousands of CHF 1,215,425	International tobacco	100.0 (100.0)	No	No	No	Approval of license and sale of tobacco products	No
LLC JTI Russia	Russia	Thousands of RUB 108,700	International tobacco	100.0 (100.0)	No	No	No	No	No
Gallaher Ltd. *1	U.K.	Thousands of GBP 172,495	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
JT International Germany GmbH	Germany	Thousands of EUR 37,394	International tobacco	100.0 (100.0)	No	No	No	No	No
JTI Polska Sp. z o. o.	Poland	Thousands of PLN 200,000	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	55.0	No	No	No	Consignment of manufacturing and sale of products	Yes
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
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 183 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 the Company.

4. *1: These companies are classified as specified subsidiaries. Companies that fall under the category of specified subsidiaries included in "Other 183 companies" are as follows.

JTI-Macdonald Corp., JT Canada LLC Inc., JT International (Philippines) Inc., Japan Tobacco International Manufacturing Co., Ltd, JTI (UK) Management Ltd., Gallaher Group Ltd., Benson & Hedges Ltd., Gallaher Overseas (Holdings) Ltd., Austria Tabak GmbH

5. *2: Revenue (excluding revenue among the consolidated companies) exceeds 10% of consolidated revenue of the Group. Major profit/loss information of this company is as follows.

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.	708,351	102,840	95,600	285,711	781,259

6. *3: This company files Annual Securities Report.

7. Consolidated subsidiary Green Foods Co., Ltd. is insolvent, with liabilities exceeding assets by ¥11,830 million. Green Foods Co., Ltd. suspended business operations in December 2012.

5. Status of employees

(1) Consolidated companies

(As of December 31, 2016)

Segment	Number of employees (Person)
Domestic Tobacco Business	9,486 [3,467]
International Tobacco Business	26,558 [2,160]
Pharmaceutical Business	1,850 [173]
Processed Food Business	5,683 [2,012]
Common company-wide services within the filing company	1,090 [92]
Total	44,667 [7,904]

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, 2016 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 (the Company)

(As of December 31, 2016)

Number of employees (Person)	Average age (Year old)	Average years of service (Year)	Average annual salary (Yen)
7,298 [1,117]	42.0	18.6	8,991,126

The numbers of employees by segment are as follows.

Segment	Number of employees (Person)
Domestic Tobacco Business	5,806 [1,106]
Pharmaceutical Business	746 [8]
Common company-wide services within the filing company	746 [3]
Total	7,298 [1,117]

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, 2016 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 (49), employees on leave (91) and employees transferred to the Company (70), but excludes employees transferred from the Company (737).

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

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

(3) Status of labor union

In the 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

(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 the Company applies. These financial measures are used internally to manage each of the business operations to understand their underlying performance, in view of the Group's target for mid- to long-term sustainable growth, and the Group believes that these financial measures are useful information for users of the financial statements to assess the Group's performance.

Core revenue from tobacco business

Regarding tobacco business, core revenue is disclosed additionally as a breakdown of revenue. Specifically, the Domestic Tobacco Business includes revenue from the domestic duty-free market as well as from markets in China, Hong Kong and Macau that are under the control of the Company's China Division, in addition to revenue related to emerging products, but it excludes revenue related to imported tobacco delivery charges, among others. In addition, the International Tobacco Business includes revenue related to waterpipe tobacco products and emerging products, but excludes revenue related to the distribution business and contract manufacturing, among others.

Adjusted operating profit

Adjusted operating profit presented is operating profit (loss) less amortization cost of acquired intangibles arising from business 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 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 year.

(Emerging products)

In the tobacco business, in addition to our existing products we are aiming to create value in innovative new product categories by working on Emerging Products such as E-Vapor (electronic cigarette) and T-Vapor (tobacco vapor).

E-Vapor products do not use tobacco leaf, instead using electrical heating of a liquid inside a device or specialized cartridge to generate vapor for the user to enjoy.

Conversely, T-Vapor products do use tobacco leaf, but instead of burning it they use methods such as heating the leaf to generate vapor (which includes compounds derived from the tobacco leaf) for the user to enjoy.

(1) Operating results

The Group classified “Beverage Business” as discontinued operations in the previous fiscal year. As a result, profit (loss) from discontinued operations for the fiscal year ended December 31, 2015 is presented separately from that from continuing operations as “profit for the year from discontinued operations (attributable to owners of the parent company).”

<Revenue>

Revenue decreased by ¥109.6 billion, or 4.9%, from the previous fiscal year to ¥2,143.3 billion due to major unfavorable foreign exchange effects on the International Tobacco Business, despite increases in revenue in the Pharmaceutical Business and the Domestic Tobacco Business.

(Billions of yen)

	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016	Change	
Revenue	2,252.9	2,143.3	(109.6)	(4.9)%
Domestic Tobacco Business	677.3	684.2	6.9	1.0%
Of which, core revenue	642.2	649.7	7.5	1.2%
International Tobacco Business	1,317.2	1,199.2	(118.0)	(9.0)%
Of which, core revenue	1,252.5	1,138.8	(113.7)	(9.1)%
Pharmaceutical Business	75.6	87.2	11.6	15.4%
Processed Food Business	165.8	164.1	(1.8)	(1.1)%

* Figures exclude intersegment revenue.
* Revenue includes rent received from leased properties in addition to items relating to the segments shown above.

<Adjusted operating profit, operating profit and profit attributable to owners of the parent company>

Despite an increase of 11.3% year on year in adjusted operating profit at constant rates of exchange, adjusted operating profit decreased by ¥39.9 billion, or 6.4%, from the previous fiscal year to ¥586.8 billion, due to major unfavorable foreign exchange effects on the International Tobacco Business.

Operating profit benefited from gain on sales of real estate and the like, rising by ¥28.1 billion, or 5.0%, from the previous fiscal year to ¥593.3 billion.

Profit for the year from continuing operations attributable to owners of the parent company increased by ¥23.2 billion, or 5.8%, from the previous fiscal year to ¥421.7 billion. Profit attributable to owners of the parent company decreased by ¥64.0 billion, or 13.2%, from the previous fiscal year to ¥421.7 billion. However, this was a consequence mainly of the inclusion in the aforementioned profit for the previous fiscal year of gains from the transfer of shares of subsidiaries conducting the vending machine operation business.

(Billions of yen)

	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016	Change	
Adjusted operating profit	626.7	586.8	(39.9)	(6.4)%
Domestic Tobacco Business	254.1	260.2	6.2	2.4%
International Tobacco Business	394.4	336.2	(58.2)	(14.7)%
Pharmaceutical Business	(2.3)	9.7	12.0	–
Processed Food Business	2.7	5.0	2.3	83.2%
Operating profit	565.2	593.3	28.1	5.0%
Profit for the year from continuing operations (attributable to owners of the parent)	398.5	421.7	23.2	5.8%
Profit for the year from discontinued operations (attributable to owners of the parent)	87.2	–	–	–
Profit attributable to owners of the parent company	485.7	421.7	(64.0)	(13.2)%

* 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.

Operating results by segment are as follows.

Domestic Tobacco Business

Sales volume in the current fiscal year(Note 1) was affected by a decline in cigarette industry volume(Note 2) caused by the expansion of the T-Vapor market and the downtrend in total demand, as well as the impact of retail price amendments for some products, including Mevius, but this was partially offset by the impact of the acquisition of the Natural American Spirit business outside the U.S. As a result, sales volume fell by 2.8% year-on-year. Market share, helped by the aforementioned acquisition, was 61.1% (compared with a share of 59.9% for the previous fiscal year).

(Billions of cigarettes)

Domestic Tobacco Business	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016	Change	
Sales volume	109.2	106.2	(3.1)	(2.8)%

Core revenue rose by 1.2% from the previous fiscal year, despite a decline in sales volume, driven by the impact of the acquisition of the Natural American Spirit business outside the U.S. and retail price amendments of certain products, including Mevius.

Adjusted operating profit rose by 2.4% from the previous fiscal year, due mainly to higher core revenue and the effects of measures to strengthen competitiveness.

(Billions of yen)

Domestic Tobacco Business	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016	Change	
Revenue	677.3	684.2	6.9	1.0%
Of which, core revenue	642.2	649.7	7.5	1.2%
Adjusted operating profit	254.1	260.2	6.2	2.4%

The volume of cigarettes manufactured in Japan in the fiscal year ended December 31, 2016 decreased by 1.0 billion cigarettes, or 0.8%, from the previous fiscal year to 118.5 billion cigarettes.

Notes: 1. In addition to the figure stated above for sales volume, during the fiscal year ended December 31, 2016, 3.9 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 the Company's China Division (3.8 billion cigarettes in the previous fiscal year). Note also that the figure stated above for sales volume does not include the sales volume associated with emerging products and the like.

2. Cigarette industry volume includes sales volume for the whole Japanese cigarette market, but it does not include sales volume for emerging products and so on.

International Tobacco Business

In the fiscal year ended December 31, 2016, despite factors including the impact of a decline in total demand in Russia, total shipment volume(Note 3) grew by 1.2% from the previous fiscal year, and GFB shipment volume increased by 3.7%. This mainly reflected the strong performance in emerging markets and major European markets, the effects of the acquisition of an operating company in Iran and the Natural American Spirit business outside the U.S., and positive impacts from trade inventory adjustments primarily in the first quarter ended March 31, 2016.

(Billions of cigarettes)

International Tobacco Business	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016	Change	
Total shipment volume	393.9	398.7	4.8	1.2%
Of which, GFBs	273.6	283.7	10.2	3.7%

Despite favorable pricing, dollar-based core revenue and adjusted operating profit increased by 1.5% and decreased by 5.0% from the previous fiscal year respectively, as a result of unfavorable foreign exchange effects related to local currencies, including the ruble and the pound.

(Millions of U.S. dollar)

International Tobacco Business (U.S. dollar-based)	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016	Change	
Revenue	10,873	11,045	172	1.6%
Of which, core revenue	10,338	10,490	152	1.5%
Adjusted operating profit	3,257	3,095	(163)	(5.0)%

Yen-based core revenue and adjusted operating profit fell by 9.1% and 14.7% from the previous fiscal year respectively, as a result of the effects of the stronger yen when making conversions to that currency.

(Billions of yen)

International Tobacco Business	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016	Change	
Revenue	1,317.2	1,199.2	(118.0)	(9.0)%
Of which, core revenue	1,252.5	1,138.8	(113.7)	(9.1)%
Adjusted operating profit	394.4	336.2	(58.2)	(14.7)%

The volume manufactured overseas including outsourced manufacturing in the fiscal year ended December 31, 2016 decreased by 11.6 billion cigarettes, or 2.8%, from the previous fiscal year to 399.6 billion cigarettes.

Note: 3. Includes fine cut tobacco, cigars, pipe tobacco and snus, except for contract manufacturing products, waterpipe tobacco products and emerging products.

The exchange rates of currencies against the U.S. dollar for the fiscal year ended December 31, 2016 were as follows.

Foreign exchange rate per U.S. dollar	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016
Yen	121.10	108.78
Ruble	60.98	67.07
Pounds sterling	0.65	0.74
EUR	0.90	0.90

Pharmaceutical Business

The Company has been striving to make a stable contribution to the Group’s profits by promoting R&D on next-generation strategic products and by maximizing the value of each product. In the area of product development, seven compounds are in clinical development. During the current fiscal year, the Company obtained approval for domestic manufacturing and distribution of anti-HIV drug “Genvoya Combination Tablets” and “Descovy Combination Tablets LT and HT,” and Group Company Torii Pharmaceutical launched sales of these in July 2016 and January 2017 respectively.

Revenue in the fiscal year ended December 31, 2016 increased ¥11.6 billion, or 15.4%, from the previous fiscal year to ¥87.2 billion, driven by higher royalty revenue and a one off milestone revenue related to R&D progress of an original JT compound that has been out-licensed. Adjusted operating profit rose by ¥12.0 billion as a result of higher revenue to reach ¥9.7 billion (compared to adjusted operating loss of ¥2.3 billion in the previous fiscal year).

Processed Food Business

The Group company TableMark Co., Ltd. is taking a central role in the development of the Group’s Processed Food Business, which consists primarily of frozen and ambient processed foods such as staple food products, as well as bakery and seasonings. The Group has been making every effort to produce strong staple food products with established market shares and work to improve cost competitiveness, thus striving to improve profitability.

Despite growth in sales of staple food products and seasonings, revenue in the fiscal year ended December 31, 2016 decreased by ¥1.8 billion, or 1.1%, from the previous fiscal year to ¥164.1 billion, due to a decline in sales of other products. On the other hand, adjusted operating profit rose by ¥2.3 billion, or 83.2%, from the previous fiscal year to ¥5.0 billion, due to improvements in the sales product mix, as well as declining raw material costs caused by the stronger yen, and cost-reduction efforts.

(2) Cash flows

Cash and cash equivalents at the end of the current fiscal year decreased by ¥232.6 billion from the end of the previous fiscal year to ¥294.2 billion. Cash and cash equivalents at the end of the previous fiscal year was ¥526.8 billion.

Cash flows from (used in) operating activities

Net cash flows from operating activities during the current fiscal year were ¥376.5 billion, compared with ¥468.4 billion provided in the previous fiscal year. This was mainly due to payments of national and international tobacco excise taxes and income taxes despite the generation of a stable cash inflow from the tobacco business.

Cash flows from (used in) investing activities

Net cash flows used in investing activities during the current fiscal year were ¥687.5 billion, compared with ¥63.3 billion used in the previous fiscal year. This was mainly due to the acquisition of the Natural American Spirit business outside the U.S.

Cash flows from (used in) financing activities

Net cash flows from financing activities during the current fiscal year were ¥91.3 billion, compared with ¥254.9 billion used in the previous fiscal year. This was mainly due to short-term borrowings for the acquisition of the Natural American Spirit business outside the U.S. and the issuance of bonds with the aim of refinancing of part of said short-term borrowings, despite the payment of cash dividends.

(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, the Company 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 ¥116,736 million for the fiscal year ended December 31, 2016 and by ¥88,493 million for the previous fiscal year under IFRS in comparison with under Japanese GAAP.

2. Status of production, orders received and sales

The Group conducts production and sales of broad and various products in the Domestic Tobacco Business, International Tobacco Business, Pharmaceutical 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 the Group’s total revenue, the revenue from such partners and the percentage of total revenue are as follows.

Business partner	Fiscal year ended December 31, 2015		Fiscal year ended December 31, 2016	
	Amount (Billions of yen)	Percentage	Amount (Billions of yen)	Percentage
Megapolis Group	293.5	13.0	235.9	11.0

Note: The Group’s International Tobacco Business sells products to Megapolis Group, which runs logistics and wholesale businesses mainly in Russia.

3. Issues to be addressed

The Group recognizes uncertainties in the business environment in which it operates remain high due to factors such as global economic trends, foreign exchange risks and geopolitical risks. Enhancing adaptability to such a changing environment remains critical to achieve sustainable profit growth by overcoming 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 the assumptions so that the Group can deal with uncertainty over the future. The Group believes that how well and how quickly companies can overcome uncertainties will be the key to determine their competitiveness.
The Group formulates its business plan, a three-year plan that is renewed each year on a rolling basis in order to speed up the Group’s ability to respond appropriately to unexpected changes in accordance with its recognition that strengthening its “adaptability to a changing environment” is an important theme.

(1) Management Principles

The Group’s management principles are based on the pursuit of the “4S” model. The model requires the Group to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society, carefully considering the respective interests of these four key stakeholder groups, and exceeding their expectations wherever we can.

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

The Group has also adopted “The JT Group Way” as a code of conduct which all members of the Group should follow. The JT Group Way requires that the Group fulfills the expectations of the Group’s consumers and behaves responsibly, strives for quality in everything we do through continuous improvement, and leverages diversity across the Group.

The 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 the Group to continue to provide new value and satisfaction to consumers, the Group believes it is essential to steadily make business investments for future mid- to long-term profit growth.

The Group believes 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 Group, it 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 the Group’s core businesses, the Group regards the tobacco business as the core business and profit growth engine, so it places top priority on business investments that will lead to the sustainable profit growth of the tobacco business. Meanwhile, the Group will make investment with the aims of strengthening the business foundations of the Pharmaceutical Business in order to generate stable profits, and strengthening the business foundations of the Processed Food Business in order to generate further profits.

From 2017 onward, there is no change in the Group’s management resources allocation policy, under which the Group will continue to place a high priority on making business investments that contribute to sustainable mid- to long-term profit growth as well as on valuing the balance between profit growth through business investments and shareholder returns.

(3) Group-wide profit targets and policy on shareholder return

The Group has set group-wide profit targets and a mid- to long-term guidance on shareholder return in the Business Plan 2017 in accordance with the management principles and the resource allocation policy.
In the "Business Plan 2017," the Group will continue to pursue mid to high single-digit annual average growth rate over the mid- to long-term in adjusted operating profit at constant rates of exchange.
With regard to shareholder return policies, the Group will pursue enhanced shareholder returns in proportion to the mid- to long-term profit growth by continually making proactive business investments while maintaining a strong financial base (Note 1) that enables response to any possible environmental changes.
Specifically, the Group will work toward stable and consistent growth in dividend per share.
Whether to execute the acquisition of treasury shares will be considered in view of factors including the medium-term outlook on business environment and financial positions.
The Group will also continue to monitor a trend in shareholder returns of global FMCG (Note 2) companies.

Notes: 1. As its financial policy, the Company will maintain a strong financial base that secures stability in case of changes in business environment such as economic crises and flexibility enabling expeditious responses to business investment opportunities.

2. A global Fast-Moving Consumer Goods (daily consumer goods) company which have a stakeholder model similar to our "4S" model, and have realized strong business growth.

(4) Basic strategies for attaining group-wide profit targets

As basic strategies for attaining the targets, the Group 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, the Group places emphasis on "achieving quality top-line growth," 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," the Group aims at improving profitability and enhancing cash generation capability by optimizing business and corporate costs and establishing quick and efficient business operation systems, while leveraging the efforts of maintaining and enhancing quality. Additionally, the Group will reinforce its business continuity capabilities, as the experience of the Great East Japan Earthquake has reminded the Group of the importance of doing so, while seeking to improve 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. The Group will make continuous improvement efforts from that perspective. In addition, the Group will maximize synergies by leveraging the global footprint as represented by the Group's worldwide business operations, which are spread across at least 70 countries and territories, and the diversity of the Group's global workforce, which represents at least 100 nationalities, and by promoting collaboration on a global scale. As the Group strongly believes that the quality of human resources is the key to business activity and performance, it will strengthen human resource development.

a. Tobacco Business

The tobacco business is the Group's core business and profit growth engine and aims for mid to high single-digit annual average growth rate over the mid- to long-term in 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 Group.

<Quality top-line growth>

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

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

In order to further grow market share, the Group will continue strengthening its brands, especially through consistent investments in the GFBs. At the same time, the Group will also strengthen its local brands. These diverse local brands allow the Group to meet the unique preferences of the consumers and complement the brand portfolios in the diverse markets and regions where the Group is active. The Group will continue to focus the investments in innovation, as it is one of the most effective methods to enhance brand equity.

The Group's innovation efforts target five key elements which add value to its 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.

The Group recognizes 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, the Group believes that the enhancement of its trade marketing activities is critical to improve point-of-sale visibility. The Group's 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.

- Broadening the base

Over the years, the Group has increased its 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 the growth for over a decade. The success of these acquisitions, owing in part to the prompt postmerger integration within the Group's business, has reinforced its global business base.

Since that time, with the aim of both entering new markets and expanding its presence in existing markets, the Group has continued to build a geographically balanced portfolio primarily in high-margin markets in developed countries and primarily in high-growth markets in emerging countries, through such measures as strengthening investment in existing businesses and acquiring external resources through acquisition and by taking equity stakes. Moving forward, the Group will continue to seek out growth opportunities. The strengthening of the 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.

- Strengthening Emerging Products initiatives

Currently, the Group's tobacco business focuses mainly on conventional cigarettes, while seeking growth opportunities in the existing other tobacco product categories, such as RYO (Roll Your Own).

In addition, the Group believes it is vital to seek to create value in innovative new product categories by reading customer needs and the changing environment of the Tobacco Business. Accordingly, the Group believes that strengthening initiatives for Emerging Products such as E-Vapor (electronic cigarettes) and T-Vapor (tobacco vapor) is an important strategy for securing high-quality top-line growth. This requires understanding of consumers' preferences as well as regulations in each country or region. It is also challenging from a technological standpoint. Nevertheless, the Group sees the initiatives as essential to the mid- to long-term growth.

Going forward, the Group aims to make effective use not only of internal but also of external resources, while focusing our efforts on broadening the product portfolio in this area, on geographical expansion and on further enriching the pipeline.

<Strengthening cost competitiveness>

The tobacco business will persistently pursue continuous cost efficiency improvement of the operations, in particular with respect to the global supply chain, with an emphasis on agility and efficiency without compromising quality. The Group will enhance its 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. The Group is also determined to improve its business continuity capability by securing options for sourcing and geographically spreading critical functions. Specifically, the Group has been striving to 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).

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

<Strengthening business foundations>

The Group believes that human resource development is the key driver of sustainable profit growth in the tobacco business.

The Group has business operations in at least 70 countries and territories, and the global workforce of employees representing at least 100 nationalities works regardless of nationality, gender, and age. The Group maximizes synergies by leveraging this diversity and promoting collaboration on a global scale.

As the Group believes that the quality of human resources is the key to business activity and performance, it will strengthen human resource development and enhance its 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 Group, by steadily implementing the above business strategies.

b. Pharmaceutical Business

The Group's Pharmaceutical Business will strive to make stable profit contribution to the Group through the promotion of R&D on next-generation strategic products and by maximizing the value of each product. With this goal in mind, the Group will concentrate business resources on three priority areas where the Group has R&D experience and have built up know-how: 1) glucose and lipid metabolism, 2) virus research, and 3) immune disorders and inflammation. The Group will maintain its continued investments in R&D to realize mid- to long-term optimization of resource allocation.

<Stable profit contribution>

To make stable profit contribution, the Group 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 to strengthen the earnings base further.

- 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 Group's Pharmaceutical Business. Market launch of new drugs is becoming increasingly difficult every year. However, the Group will explore appropriate drug development opportunities by collecting information concerning unmet needs of medical facilities around the world. The Group 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 the R&D and swiftly provide the new drugs the Group has created to patients around the world, the Group not only promotes in-house development but also continues 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, the Group launched in Japan Stribild® Combination Tablets (anti-HIV drug), Riona® Tablets (hyperphosphatemia treatment), CEDARTOLEN® SUBLINGUAL DROP - Japanese Cedar Pollen, MITICURE® House Dust Mite Sublingual Tablets (allergen immunotherapy drugs), and Genvoya® Combination Tablets (anti-HIV drug). Outside Japan, the licensing partners are currently selling Stribild® Combination Tablets (anti-HIV drug), Genvoya® (anti-HIV drug) and Mekinist® (melanoma treatment).

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

The Group recognizes, in order to conduct these various activities in an effective manner, 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. The Group will concentrate efforts on its initiatives for these purposes.

c. Processed Food Business

The Group’s Processed Food Business will strive to achieve operating profit margin that is, at very least, on par with industry average and aim to make further profit contribution to the Group.

<Quality top-line growth>

The Group company TableMark is taking a central role in the development of the Group’s Processed Food Business, which consists primarily of frozen and ambient processed foods such as staple food products, as well as bakery and seasonings. In the Processed Food Business, the Group makes every effort to produce strong staple food products with established market shares. Specifically, in the area of product line-up, the Group plans to create products that offer good value for the price from consumers’ perspective while using its unique technology. This will be achieved by improving the ability to identify consumers’ needs, generate ideas based on the identified needs, and transform the generated ideas into products. Concerning marketing, the Group will develop effective and efficient advertising and promotional activities in line with this product strategy and reinforce the trade marketing capabilities. By adopting these measures, the Group aims to further expand its market share.

<Strengthening cost competitiveness>

In the Processed Food Business, the Group has a variety of cost containment programs, including strengthening the raw materials procurement capabilities, efficiently managing the distribution network, and improving the productivity of the 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, the Group will work to improve cost competitiveness.

<Strengthening business foundations>

- Food safety control

Looking ahead, the Group will continue to manage the 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 customers.

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

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

Regarding “food quality,” the Group will pursue “deliciousness,” which should be the fundamental quality of foods. The Group 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,” the Group will conscientiously listen to the voices of customers and actively provide information so as to make the Group’s activities more visible to the outside.

- Human resource development

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

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

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 Group

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

The 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 and territories. 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 Group as a whole (for details of risks relating to the tobacco business, see (2) below).

b. Business expansion

The Group views the role of Pharmaceutical Business and the Processed Food Business as that of supplementing sustainable profit growth over the mid- to long-term, and believes that also in the future they will make a stable and even larger profit contribution. However, although the Group plans to continue to invest in these businesses, this investment is not guaranteed to generate the returns that the Group anticipates.

The Group worked proactively to obtain external resources for the business expansion, such as the non-US tobacco operations of the RJR Nabisco Inc. (acquired in 1999 for approximately USD 7.8 billion, or ¥944.0 billion as calculated by the exchange rate at the time of the acquisition; the same applies hereinafter), as well as the acquisition of Gallaher Ltd. (acquired in 2007 for approximately GBP 7.5 billion, or ¥1,720.0 billion), the acquisition of the Katokichi Group (now TableMark Holdings Co., Ltd.) (acquired in 2008 for approximately ¥109.0 billion), and the acquisition of the non-US tobacco operations of Natural American Spirit (acquired in 2016 for approximately USD 5.0 billion, or ¥591.4 billion). In an effort to expand its business, the Group will consider acquisitions, capital movements, business tie-ups and cooperative arrangements with other companies and may execute when the Group judges such transactions would contribute to the future earnings of the 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 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 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 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 Group's present operations.

Also, as a result of the acquisitions, the Group has recorded a substantial amount of goodwill and intangible assets in the consolidated statements of financial position, and the amounts of goodwill and intangible assets account for 33.8% (¥1,602.0 billion) and 8.9% (¥424.0 billion) of the consolidated total assets, respectively, as of the end of the fiscal year. The 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 Group may incur an impairment loss that negatively impacts the Group's performance.

c. Effects of foreign exchange fluctuations

The Company 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 the Company 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 Group's revenue and adjusted operating profit attributable to the International Tobacco Business were 56.0% and 57.3% in the fiscal year ended December 31, 2016. Therefore, foreign exchange fluctuation may greatly impact consolidated financial statements along with the expansion of the International Tobacco Business and its contribution to the results.

JT International Holding B.V. (hereinafter referred to as “JTIH”), which is responsible for consolidating the financial results of the 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 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 an foreign Group company whose foreign currency denominated stock was acquired by the Company will result in the recording of an investment loss with respect to said company in the consolidated financial statements of the Company 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 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 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 appreciated against these various local currencies, this may have a negative effect on profitability at the Group.

Although the 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

In the Outline of the 2017 Tax Reform Proposals determined by the Cabinet of Japan on December 22, 2016, there is no mention of a tobacco excise tax hike. Nevertheless, should a tax hike occur in 2018 or after, this could have a substantial effect on the Group’s business performance depending on the size of the hike and whether the Group can react to a tax increase promptly and appropriately.

In the Outline of the 2017 Tax Reform Proposals compiled by the Liberal Democratic Party and the Komeito Party on December 8, 2016, one of the items for consideration is “In the future, when reviewing the level of burden for the tobacco tax, this shall be given comprehensive consideration from such perspectives as its basic nature as a financial commodity, the impact on tobacco farms and tobacco retailers, the mid- to long-term impact on the market and the industry, and the promotion of the health of the people, while at the same time paying attention to the need to ensure predictability.”

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 Group and raw materials suppliers, thereby creating an impact on the Group’s business operations, mainly in the Domestic Tobacco Business. Although the 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 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 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. The Group has 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 the factories.

f. Country risk

The 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 and territories. As a consequence, the International Tobacco Business in particular is growing in importance. In order to achieve long-term growth, the Group will continue to expand the business base. Geographical expansion increases 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 the Group's 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 Group conducts business in countries that are subject to economic sanctions. Although the Group manages its business operations appropriately and lawfully in accordance with these various economic sanctions, if the 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 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.

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 gradual economic recovery mainly on the back of an improving employment and income environment, it remains unclear whether this trend will be sustained partly given that the government is poised to raise the consumption tax to 10% on October 1, 2019. In many of the main markets of the Group's International Tobacco Business, 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. Cigarette industry volume is also continuing to decline in Japan, and the Group 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 Group's processed food products for similar reasons. Such developments may negatively affect the Group's business performance.

h. Instability in supplies of key materials

The raw material used in the Company's manufacture of tobacco products in Japan is leaf tobacco sourced domestically and leaf tobacco from overseas. The raw material the 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 the products. Therefore, the ability to procure needed materials in the required quantities and at manageable costs can affect the Group's 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 the 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 the raw and processed materials, as well as unavailability of those resources.

i. Difficulty in maintaining human resource competitiveness

The Group believes that a diversified employee base is a major factor of its competitiveness; therefore, the Group seeks to attract, develop, and retain talented people worldwide. However, in the particular case of tobacco business, the Group is aware of the negative social image placed on this business line. Therefore, it is becoming major issues for the Group 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 Group's business performance.

j. Infringement of intellectual property rights

If the Group infringes the intellectual property rights of an outside party, or if an outside party infringes the 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 Group's business performance.

k. Environmental regulations

The 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 Group's business activities, or if environmental regulations are introduced or existing ones are changed, this may negatively affect the Group's business performance.

(2) Risks relating to the 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, tobacco demand has continued to decline and the Company 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 the Group's business performance.

b. Competition with rival companies

The 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 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 Group and other companies and the special promotional activities effected for them. A lower market share due to these factors may negatively affect the 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 the Group operates, including Japan, to secure state budgets and also to promote public health.

The 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 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 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 activities, marketing, packaging and labeling for tobacco products, tobacco products themselves, and smoking in the international markets where 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). 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, implementation of the legislation which includes protection from passive smoking and other matters related to tobacco consumption has continued to come into effect in stages in Russia. 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 addition, in the UK, plain packaging regulations have been introduced whereby individual packages for tobacco products must be of a prescribed color, and product names must be displayed on the packages in a prescribed printing location, font, font size, and font color with an additional requirement for graphic warnings to be printed on the package. In addition to these, a number of other countries have implemented or are considering the implementation of various restrictions.

In 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. Work on legislating for this revised EU TPD and enforcing it is under way in all EU member states.

- 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. The guideline was revised in March 2004 in accordance with the revision of the Ordinance for Enforcement of the Tobacco Business Act mentioned above (for details, see (4) c. (i), Notes 2 and 3 below).

The Tobacco Institute of Japan has established voluntary standards regarding the advertising and sales promotion activities for tobacco products. All member companies, including the Company, comply with these standards. In February 2016 under the Financial System Council tobacco business subcommittee meeting, a new labeling subcommittee was established, which performed a specialized investigation in relation to means of guidance with respect to advertising that pertains to tobacco products in accordance with the Tobacco Business Act, Article 39 (warning labels) and Article 40 (advertising regulations). The labeling subcommittee reported the results of its investigation to the tobacco business subcommittee in June 2016, and we believe that further discussions will be conducted within the tobacco business subcommittee.

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 addition, from January 2016 onward, the government has been moving ahead to consider strengthening measures to prevent passive smoking, and the Company expects that such trends will continue going forward.

- Impact on the 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 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 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 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 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, the Group and other tobacco companies are working together with governments to eliminate illicit trade.

The 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 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

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 the fiscal year end date, there were a total of 20 smoking and health-related cases pending in which one or more members of the Group were named as defendant, including cases 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. In addition, the Company and some of its subsidiaries are also defendants in lawsuits other than the smoking and health-related cases.

The Group is unable to predict the outcome of currently pending or future lawsuits. If these actions result in a decision unfavorable to the 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 Group, forcing it to bear litigation costs and materially affecting its business performance. In addition to the smoking and health-related litigation, the 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 Group should their outcomes prove unfavorable.

Regarding major litigation cases to which the Group is a party, please refer to “V. Accounting, 1. Consolidated financial statements, (1) Consolidated financial statements, Notes to consolidated financial statements, 39. Contingencies.”

(3) Risks relating to the Group’s Pharmaceutical and Processed Food Businesses

a. Risks relating to Pharmaceutical Business

The following are various risks relating to the Pharmaceutical Business of the Group.

-The Group may fail to develop and launch commercially valuable pharmaceutical products.

-The Group may have to invest an enormous amount of time and funds in research and development before it successfully develops pharmaceutical products.

-The 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 Group succeeds in developing and launching a commercially valuable pharmaceutical product, research and development expenses may exceed the revenue generated from it.

-The Group may become dependent on a certain pharmaceutical product.

-The Group may fail to produce or outsource manufacturing of the pharmaceutical products efficiently and cost-effectively on a large scale.

-Even if a pharmaceutical product developed by the 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 Group may become dependent on the license of pharmaceutical products developed by other companies and on third party distribution channels.

-The 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 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.

-The Group’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 Group may become dependent on a certain business partner in research and development or sales of a pharmaceutical product.

-The 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 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 Processed Food Business

The following are various risks relating to the Processed Food Business of the Group.

-Products developed by the Group may fail to meet consumer preferences and their product lives may prove to be short.

-The 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 the 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 Group may be unable to compete with major companies with larger distribution networks, stronger development capabilities and more experience.

-The Group may be unable to engage in efficient marketing activities.

-The Group may be unable to produce, or outsource the production of, products in an efficient, stable and effective manner.

-If any problem arises regarding the quality of the 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 the Company's shares issued. As of December 31, 2016, the government held 33.35% of all the Company's shares issued. As a consequence, the Japanese government is able to have a substantial influence on proposals for ordinary resolutions at the Company's General Meetings of Shareholders such as the election of Members of the Board. 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 the Company under the JT Act and Tobacco Business Act. Under the JT Act, the scope of the Company's businesses includes the "manufacture, sale and importation of tobacco products and ancillary businesses, as well as businesses required for attaining the objective of the Company," and "business required for attaining the objective of the Company" are subject to the Minister of Finance's approval. Consequently, the Minister of Finance's approval is required in order for the Company 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 the Company, the government has the authority to supervise the Company 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 the Company's 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 the Company 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. The Company must purchase all leaf tobacco produced pursuant to such contracts, except for any not suited for the manufacture of tobacco products. When the Company 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 Council (*hatabako shingi kai*), which consists of members appointed by the Company 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 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	(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) (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) (3) In the case where JT intends to enter into an agreement, JT shall consult with the Leaf Tobacco Council that JT establishes, and respect its opinion concerning the total cultivation area and the prices of leaf tobacco. (Articles 4 and 7) (4) The Leaf Tobacco 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) (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) (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)
3. Manufacture of tobacco products	(1) No tobacco products shall be manufactured by any party other than JT. (Article 8) (2) JT shall obtain the approval of the Minister of Finance on the maximum wholesale price for each item of tobacco products. (Article 9) (3) JT shall make efforts to ensure a smooth supply of tobacco products taking into account regional demand conditions for tobacco products. (Article 10)
4. Sale of tobacco products	(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) (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) (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) (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) [Note 1] (5) A Retailer is only permitted to sell tobacco products at list prices that have been approved by the Minister of Finance. (Article 36)

	Description
5. Other	(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) (Note 2) (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) (Note 3)

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 public property and public services and, in a distribution market completely liberalized after the opening of import markets and other factors, the Company 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, the Company 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. The Company 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	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) 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) 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)
3. Scope of business	JT shall engage in the following businesses in order to attain the objectives stated in 1 above. (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 JT shall obtain authorization from the Minister of Finance before engaging in any business corresponding to (3) above. (Article 5)
4. Monitoring	(1) The appointment or dismissal of Members of the Board, Executive Officers (*sikkoyaku at a company with committees*), and Audit & Supervisory Board Members require authorization from the Minister of Finance. (Article 7) (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) (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) (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) (5) Transfers of manufacturing facilities or similar material assets require authorization from the Minister of Finance. (Article 11) (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)

(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 (Note 1)	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 (Note 2)	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 (Note 3)	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 (Note 4)	¥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 (Note 5)	¥2,950 per 1,000 cigarettes	¥456 per 1,000 cigarettes	¥481 per 1,000 cigarettes	¥2,925 per 1,000 cigarettes
Former third-class products From April 1, 2017	¥3,383 per 1,000 cigarettes	¥523 per 1,000 cigarettes	¥551 per 1,000 cigarettes	¥3,355 per 1,000 cigarettes
Former third-class products From April 1, 2018	¥4,032 per 1,000 cigarettes	¥624 per 1,000 cigarettes	¥656 per 1,000 cigarettes	¥4,000 per 1,000 cigarettes
Former third-class products From April 1, 2019	¥5,302 per 1,000 cigarettes	¥820 per 1,000 cigarettes	¥860 per 1,000 cigarettes	¥5,262 per 1,000 cigarettes
5. Declaration and payment (Note 6)	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:
1. 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
2. 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
3. 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
4. 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
5. Article 50 of the Act for Partial Amendment of the Income Tax Act, etc. (Act No. 9 of March 31, 2015) and Article 103 of the Supplementary Provisions of the act, and Article 12, paragraph 2 and Article 20, paragraph 2 of the Supplementary Provisions of the Act for Partial Amendment of the Local Tax Act, etc. (Act No. 2 of March 31, 2015)
6. 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
7. 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. As a result of the Act for Partial Amendment of the Income Tax Act, etc. (Act No. 9 of March 31, 2015) and the Act for Partial Amendment of the Local Tax Act, etc. (Act No. 2 of March 31, 2015), special tax rates for former third-class products were abolished. Accordingly, tax rate revisions are to be implemented in stages as a transitional measure during the period from April 1, 2016 to April 1, 2019.
8. (i) 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.

(ii) 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 the Company’s responses]

Month/Year	Item	Description	The Company’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
April 2016	2015 Tax Reform	Acts revising a portion of the Income Tax Act, Local Tax Act, among others, established and tax increase by ¥1,000 per 1,000 cigarettes for former third-class products	For former third-class products, prices raised by ¥30 to ¥50 per pack

Note: In April 2017, as was the case in April 2016, cigarette prices for former third-class products are scheduled to be raised by ¥30 per pack due to the implementation of a tax increase of ¥1,000 per 1,000 cigarettes.

5. Important operational contracts

No items to report

6. Research and development activities

Research and development activities are mainly undertaken at the Company's Tobacco Science Research Center and Central Pharmaceutical Research Institute.

Research and development expenses of the Group during the fiscal year ended December 31, 2016 amounts to ¥58.2 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 ¥0.8 billion relating to basic research not affiliated to any segment (plant biotechnology related research) and conducted by the corporate divisions of the Company.

(1) Domestic and International Tobacco Businesses

The Group is committed to strengthening its R&D capabilities to ensure a long-term competitive advantage. The focus areas in the R&D activities are the development of new leaf tobacco varieties, improvement of tobacco leafs and their processing, enhancement of aroma and taste, upgrading manufacturing technology, and continuous progress on emerging product development capabilities. The Group has been striving to add value to the products in these focus areas in a cost efficient manner. It has established a global research platform in Japan, which focuses on the fundamental research and product technology development. To best meet consumers' needs and preferences, the market teams are continuously engaged in the product development. Research and development expenses relating to the Domestic Tobacco Business amounts to ¥17.8 billion with that of the International Tobacco Business amounting to ¥8.3 billion.

(2) Pharmaceutical Business

R&D activities are the foundation of the Group's Pharmaceutical Business and are critical for its long-term growth and profitability. The 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 is ¥30.7 billion.

(3) Processed Food Business

Regarding R&D in the Processed Food Business, the Group devotes its efforts to the development of innovative products that meet consumers' needs and preferences. Research and development expenses for the Processed Food Business is ¥0.6 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 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 and territories. In this context, the Group has decided to opt for an early adoption of the IFRS from the fiscal 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 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 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. Discontinued operations

The Group classified "Beverage Business" as discontinued operations in the previous fiscal year. As a result, profit (loss) from discontinued operations for the previous fiscal year is presented separately from that from continuing operations as "profit for the year from discontinued operations (attributable to owners of the parent)" in "(2) Analysis of business results for the fiscal year."

(2) Analysis of business results for the fiscal year

a. Revenue

Revenue decreased by ¥109.6 billion, or 4.9%, from the previous fiscal year to ¥2,143.3 billion due to major unfavorable foreign exchange effects on the International Tobacco Business, despite increases in revenue in the Pharmaceutical Business and the Domestic Tobacco Business.

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 fiscal year ended December 31, 2016 decreased by ¥47.6 billion, or 5.2%, from the previous fiscal year to ¥872.4 billion, while other operating income increased by ¥54.7 billion, or 356.2%, from the previous fiscal year to ¥70.1 billion. Share of profit in investments accounted for using the equity method increased by ¥0.1 billion, or 1.7%, from the previous fiscal year to ¥6.5 billion. Selling, general and administrative expenses decreased by ¥35.2 billion, or 4.5%, from the previous fiscal year to ¥754.1 billion.

c. Adjusted operating profit, operating profit and profit attributable to owners of the parent company

Despite an increase of 11.3% year on year in adjusted operating profit at constant rates of exchange, adjusted operating profit decreased by ¥39.9 billion, or 6.4%, from the previous fiscal year to ¥586.8 billion, due to major unfavorable foreign exchange effects on the International Tobacco Business.

Operating profit benefited from gain on sales of real estate and the like, rising by ¥28.1 billion, or 5.0%, from the previous fiscal year to ¥593.3 billion.

Profit for the year from continuing operations attributable to owners of the parent company increased by ¥23.2 billion, or 5.8%, from the previous fiscal year to ¥421.7 billion. Profit attributable to owners of the parent company decreased by ¥64.0 billion, or 13.2%, from the previous fiscal year to ¥421.7 billion. However, this was a consequence mainly of the inclusion in the aforementioned profit for the previous fiscal year of gains from the transfer of shares of subsidiaries conducting the vending machine operation business.

(3) Basic policies of financing activities

The Group’s basic policies of financing activities are as follows.

a. Group Cash Management Systems

To maximize the total group cash efficiency, the Group gives 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, the Group continues to diversify its 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

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

It is the Group’s 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 (8) Market price fluctuation risk.”

(4) Analysis of capital resources and liquidity of funds

a. Funding requirements

Funds are mainly 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 and financing activities in the fiscal year ended December 31, 2016 came to ¥376.5 billion and ¥91.3 billion respectively, while net cash flows used in investing activities were ¥687.5 billion. Cash and cash equivalents on a consolidated basis as of December 31, 2016, including the effect of exchange rate changes, decreased by ¥232.6 billion from the end of the previous year to ¥294.2 billion (end of previous year balance of ¥526.8 billion).

<Interest-bearing debt>

Amounts of interest-bearing debt of the Group to be repaid or redeemed as of December 31, 2016 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	187.9	187.9	–	–	–	–	–
Short-term lease obligations	0.4	0.4	–	–	–	–	–
Long-term borrowings as loans (current portion)	0.6	0.6	–	–	–	–	–
Bonds (current portion)	20.0	20.0	–	–	–	–	–
Long-term borrowings as loans	0.9	–	0.4	0.1	0.0	0.0	0.3
Bonds	338.2	–	58.2	–	80.0	87.4	113.2
Long-term lease obligations	7.3	–	0.2	0.2	0.2	0.1	6.7
Total	555.3	208.9	58.8	0.3	80.2	87.5	120.2

Long-term debt

Bonds issued (including the current portion) as of December 31, 2015 and as of December 31, 2016 accounted for ¥215.1 billion and ¥358.2 billion, respectively, and long-term borrowings as loans from financial institutions (including the current portion) accounted for ¥1.0 billion and ¥1.4 billion, respectively. Annual interest rates applicable to long-term borrowings outstanding as of December 31, 2015 and December 31, 2016 ranged from 2.32% to 4.64% and from 1.05% to 4.41%, respectively. Long-term lease obligations totaled ¥7.8 billion as of December 31, 2015 and ¥7.3 billion as of December 31, 2016.

As of December 31, 2016, the 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 the major business markets, the quality of execution of the business strategies, and general economic trends that are beyond the Group’s 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 the Company are secured by statutory preferential rights to the property of the Company. 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 ¥30.8 billion as of December 31, 2015 and ¥187.9 billion as of December 31, 2016. There was no commercial paper outstanding as of December 31, 2015 and as of December 31, 2016. Annual interest rates applicable to short-term borrowings ranged from 0.43% to 11.30% as of December 31, 2015, and from 0.33% to 15.00% as of December 31, 2016. Short-term lease obligations totaled ¥0.6 billion as of December 31, 2015 and ¥0.4 billion as of December 31, 2016.

c. Liquidity

The Group has historically had, and expects to continue to have, significant cash flows from operating activities. The Group expects that cash generated from operating activities will continue to be stable and cover funds needed for regular business activities. As of December 31, 2016, the Group had ¥574.4 billion in committed lines of credit from major financial institutions both domestic and international, none of which was used. In addition, the Group has a commercial paper program, uncommitted lines of credit, a domestic bond shelf registration, and a euro MTN program.

III. Facilities

1. Outline of capital expenditures

In the fiscal year ended December 31, 2016, the Group made capital expenditures totaling ¥113.0 billion.

In the Domestic Tobacco Business, the Group spent ¥29.8 billion, mainly on investments accompanying maintenance and upgrade of manufacturing processes, productivity improvements, adaptation to new products, improvements in product specifications, and others. In the International Tobacco Business, the Group invested ¥70.6 billion mainly for improvements in product specifications in addition to optimization of manufacturing facilities. In the Pharmaceutical Business, the Group spent ¥3.8 billion on enhancing and strengthening research and development structures and the like. In the Processed Food Business, the Group invested ¥5.7 billion in improvement, maintenance and renewals of production capability.

Please note that the Group's own capital was allocated for capital expenditures.

* Capital expenditures includes land; building and structures; machinery and vehicles; and other property, plant and equipment, as well as goodwill, right of trademark, software and other intangible assets, necessary for production improvements at factories and other facilities, strengthening competitiveness and executing business in a variety of fields, excluding assets acquired through business combinations.

2. Main facilities

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

(1) Filing company (the Company)

(As of December 31, 2016)

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^2)	Amount					
Kita-kanto Factory (Utsunomiya-shi, Tochigi) Note 1	Domestic Tobacco	Tobacco manufacturing facilities	150	2,062	9,012	23,923	719	35,716	408
Tokai Factory (Iwata-shi, Shizuoka) Note 1	Domestic Tobacco	Tobacco manufacturing facilities	223	2,309	6,960	12,481	376	22,125	317
Kansai Factory (Fushimi-ku, Kyoto-shi)	Domestic Tobacco	Tobacco manufacturing facilities	116	5,831	11,435	26,803	596	44,665	476
Kyushu Factory (Chikushino-shi, Fukuoka)	Domestic Tobacco	Tobacco manufacturing facilities	166	4,042	2,700	7,084	210	14,035	265
Tobacco Science Research Center (Aoba-ku, Yokohama-shi) Note 1	Domestic Tobacco	Research and development facilities	35	642	3,256	0	856	4,754	82
Central Pharmaceutical Research Institute (Takatsuki-shi, Osaka)	Pharmaceutical	Research and development facilities	95	2,730	13,771	7	1,470	17,978	595
Head Office (Minato-ku, Tokyo)	General administration	Other	14	21,487	21,501	16	1,958	44,961	1,476
Area Sales Headquarters(15) (Municipality) Note 2	Domestic Tobacco (includes administration)	Other	30	866	2,067	1,313	78	4,325	2,890

(2) Domestic subsidiaries

(As of December 31, 2016)

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^2)	Amount					
TS Network Co., Ltd. Head Office and other 26 distribution bases (Head Office: Taito-ku, Tokyo) Note 2	Domestic Tobacco	Distribution facilities	35	–	8,660	1,708	537	10,905	1,660
Japan Filter Technology, Co., Ltd. Head Office and other 3 factories (Head Office: Sumida-ku, Tokyo) Note 2	Domestic Tobacco	Material manufacturing facilities	118	744	4,602	8,524	316	14,187	609
Torii Pharmaceutical Co., Ltd. Head Office, other factories and branch offices (Head Office: Chuo-ku, Tokyo)	Pharmaceutical	Pharmaceuticals manufacturing facility and other	55	604	3,218	2,032	395	6,249	1,059
TableMark Co., Ltd. Head Office and other 8 factories (Head Office: Chuo-ku, Tokyo)	Processed Food	Frozen food production facilities	–	–	5,613	7,530	237	13,380	1,334

(3) Foreign subsidiaries

(As of December 31, 2016)

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^2)	Amount					
LLC Petro (Russia) Note 2	International Tobacco	Tobacco manufacturing facilities	194	314	6,589	12,851	2,375	22,128	1,285
JT International Germany GmbH (Germany) Note 4	International Tobacco	Tobacco manufacturing facilities	346	291	14,689	17,504	1,490	33,974	1,852
JTI Polska Sp. z o. o. (Poland) Note 4	International Tobacco	Tobacco manufacturing facilities	409	133	9,197	23,348	790	33,468	1,188
JTI Tütün Urunleri Sanayi A.S. (Turkey)	International Tobacco	Tobacco manufacturing facilities	249	1,305	1,765	8,145	111	11,326	478

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. From the perspective of building a more efficient framework for manufacturing products, plans call for closing facilities in Lisnafillan (Northern Ireland) and Wervik (Belgium), and terminating operations in Trier (Germany) involving Make Your Own tobacco products, and consequently relocating the manufacturing capacity of those facilities to factories in Poland and Romania. We have concluded consultations with the European Works Council and employees’ representatives, pertaining to the closures, termination of operations and relocations.

3. Plans for new installation and retirement of facilities

Regarding the mid- to long-term resource allocation of the Group, it will place top priority on business investments that will lead to sustainable profit growth in the mid- to long-term based on the Group's management principles. Of the reportable segments, the Group positions the Domestic and International Tobacco Businesses as the core business and profit growth engine and places top priority on business investments that will lead to their sustainable profit growth. Meanwhile, the Group will make investment with the aims of strengthening the business foundations of the Pharmaceutical Business in order to generate stable profits, and strengthening the business foundations of the Processed Food Business in order to generate further profits.

Based on this policy, the Group plans capital expenditures (facility construction and expansion) totaling ¥136.0 billion in the fiscal year ending December 31, 2017.

As the Company and its consolidated subsidiaries have wide-ranging plans for capital expenditure, figures are disclosed by segment.

The Group's 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, 2017 (Billions of yen)	Main purpose of investment	Funding
Domestic Tobacco Business	42.0	Expenditures for the maintenance and upgrade of manufacturing processes, productivity improvements, adaptation to new products and improvements in product specifications	Internally generated funds
International Tobacco Business	64.0	Expenditures for the improvements in product specifications and the optimization of manufacturing facilities	Same as above
Pharmaceutical Business	9.0	Expenditures for the development and reinforcement of R&D capabilities	Same as above
Processed Food Business	15.5	Expenditures for the expansion of production capacity, and improvements, maintenance and upgrading of productivity	Same as above

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

* Capital expenditures includes land; building and structures; machinery and vehicles; and other property, plant and equipment, as well as goodwill, right of trademark, software and other intangible assets, necessary for production improvements at factories and other facilities, strengthening competitiveness and executing business in a variety of fields, excluding assets acquired through business combinations.

IV. Filing company

1. Information on the Company'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, 2016)	Number of shares issued (Share; as of the date of filing: March 24, 2017)	Name of financial instruments exchange where the stock of the Company is traded or the name of authorized financial instruments firms association where the Company 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 shares issued by the Company (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 General Meeting of Shareholders).

2. The Company'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 the Board of Directors on December 21, 2007

	As of December 31, 2016	As of February 28, 2017
Number of subscription rights to shares	200 units	183 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 (the Company'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	40,000 shares (Notes 1, 4)	36,600 shares (Notes 1, 4)
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 Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. 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 subscription right to shares (hereinafter, "Number of Shares Granted") shall be one. However, in cases where the Company 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 the Company after the date on which the Company 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 the Company 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, the Company shall conduct adjustments deemed necessary after the Allotment Date.

When adjusting the Number of Shares Granted, the Company 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, the Company 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 the Company (if a resolution by the General Meeting of Shareholders is not necessary, it is read as “in cases where the resolution of the Board of Directors or the decision by the representative Executive Officer (sikkoyaku at a company with committees) is made”), the Company may acquire subscription rights to shares on the date separately provided for by the Board of Directors. In this case, the Company shall, in exchange for acquiring each subscription right to shares, 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 the Company 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 the Company (if a resolution by the General Meeting of Shareholders is not necessary, it is read as “the resolution 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 the Company is not to be the surviving company
b. Proposal to ask approval of a contract or plan of company split where the Company would be the split company
c. Proposal to ask approval of a share exchange contract or share transfer plan where the Company becomes a wholly-owned subsidiary

3. In cases where the Company merges (limited to cases where the Company is to be extinguished as a result of the merger), splits and absorbs or splits and incorporates (limited to cases where the Company becomes the split company in either case), or exchanges or transfers shares (limited to cases where the Company becomes a wholly-owned subsidiary in either case) (collectively, hereinafter, “Reorganization”), the Company 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 subscription right to shares 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 subscription right to shares, 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. The Company 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 from one share to 200 shares and is presented accordingly.

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

	As of December 31, 2016	As of February 28, 2017
Number of subscription rights to shares	345 units	345 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 (the Company'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	69,000 shares (Notes 1, 4)	69,000 shares (Notes 1, 4)
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	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 Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. 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. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

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

	As of December 31, 2016	As of February 28, 2017
Number of subscription rights to shares	695 units	695 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 (the Company'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	139,000 shares (Notes 1, 4)	139,000 shares (Notes 1, 4)
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	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 Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. 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. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

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

	As of December 31, 2016	As of February 28, 2017
Number of subscription rights to shares	652 units	652 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 (the Company'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	130,400 shares (Notes 1, 4)	130,400 shares (Notes 1, 4)
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	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 Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. 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. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

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

	As of December 31, 2016	As of February 28, 2017
Number of subscription rights to shares	794 units	759 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 (the Company’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	158,800 shares (Notes 1, 4)	151,800 shares (Notes 1, 4)
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	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 Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. 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. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

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

	As of December 31, 2016	As of February 28, 2017
Number of subscription rights to shares	607 units	607 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 (the Company'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	121,400 shares (Note 1)	121,400 shares (Note 1)
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	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 Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. 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 subscription right to shares (hereinafter, "Number of Shares Granted") shall be 200. However, in cases where the Company 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 the Company after the date on which the Company 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 the Company 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, the Company shall conduct adjustments deemed necessary after the Allotment Date.

When adjusting the Number of Shares Granted, the Company 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, the Company 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 the Board of Directors on December 21, 2007.

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

	As of December 31, 2016	As of February 28, 2017
Number of subscription rights to shares	422 units	408 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 (the Company'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	84,400 shares (Note 1)	81,600 shares (Note 1)
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, 2043	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	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 Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. 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. Same as Note 1. of subscription rights to shares pursuant to f. Resolution 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 the Board of Directors on December 21, 2007.

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

	As of December 31, 2016	As of February 28, 2017
Number of subscription rights to shares	291 units	283 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 (the Company'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	58,200 shares (Note 1)	56,600 shares (Note 1)
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	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 Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. 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. Same as Note 1. of subscription rights to shares pursuant to f. Resolution 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 the Board of Directors on December 21, 2007.

i. Resolution of the Board of Directors on July 17, 2015

	As of December 31, 2016	As of February 28, 2017
Number of subscription rights to shares	448 units	415 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 (the Company'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	89,600 shares (Note 1)	83,000 shares (Note 1)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From August 4, 2015 to August 3, 2045	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥711,200 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	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 Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. 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. Same as Note 1. of subscription rights to shares pursuant to f. Resolution 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 the Board of Directors on December 21, 2007.

j. Resolution of the Board of Directors on June 17, 2016

	As of December 31, 2016	As of February 28, 2017
Number of subscription rights to shares	430 units	403 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 (the Company'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	86,000 shares (Note 1)	80,600 shares (Note 1)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From July 5, 2016 to July 4, 2046	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥572,600 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 Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. 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. Same as Note 1. of subscription rights to shares pursuant to f. Resolution 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 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: The Company 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, 2016)

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	263	84	1,054	897	57	151,230	153,586	–
Number of shares held (Unit)	6,669,272	3,465,542	554,278	166,996	6,184,578	193	2,958,831	19,999,690	31,000
Holding rate of shares (%)	33.35	17.33	2.77	0.83	30.92	0.00	14.79	100.00	–

Notes: 1. 2,090,442 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, 2016)

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	666,927,200	33.35
Japan Trustee Services Bank, Ltd. (Trust Account)	8-11, Harumi 1-chome, Chuo-ku, Tokyo, Japan	57,243,800	2.86
The Master Trust Bank of Japan, Ltd. (Trust Account)	11-3, Hamamatsucho 2-chome, Minato-ku, Tokyo, Japan	56,742,000	2.84
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)	35,920,351	1.80
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
GIC Private Limited-C (Standing proxy: The Bank of Tokyo-Mitsubishi UFJ, Ltd.)	168 Robinson Road #37-01 CAPITAL TOWER SINGAPORE 068912 (Transaction Services Division, 7-1, Marunouchi 2-chome Chiyoda-ku, Tokyo, Japan)	31,123,800	1.56
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. (Shinagawa Intercity Tower A, 15-1, Konan 2-chome, Minato-ku, Tokyo, Japan)	29,825,673	1.49
State Street Bank and Trust Company 505001 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	P.O. Box 351 Boston Massachusetts 02101 U.S.A. (Shinagawa Intercity Tower A, 15-1, Konan 2-chome, Minato-ku, Tokyo, Japan)	25,502,286	1.28
JPMorgan Chase Bank 380055 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	270 Park Avenue, New York, NY 10017, United States of America (Shinagawa Intercity Tower A, 15-1, Konan 2-chome, Minato-ku, Tokyo, Japan)	22,489,094	1.12
The Bank of New York 133522 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	RUE MONTOYERSTRAAT 46, 1000 BRUSSELS, BELGIUM (Shinagawa Intercity Tower A, 15-1, Konan 2-chome, Minato-ku, Tokyo, Japan)	20,434,226	1.02
Total	–	980,008,430	49.00

Note: In addition to the above, the Company held 209,044,267 shares of ordinary shares as treasury shares.

(8) Status of voting rights

a. Shares issued

(As of December 31, 2016)

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 209,044,200	–	(Note 2)
Shares with full voting rights (Other)	Ordinary shares 1,790,924,800	17,909,248	(Note 2)
Shares less than one unit	Ordinary shares 31,000	–	(Note 3)
Total number of shares issued	2,000,000,000	–	–
Total number of voting rights	–	17,909,248	–

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. The Company's standard class of shares with no rights limitations. Its share trading unit is 100 shares.
3. Includes 67 shares of treasury shares.

b. Treasury shares

(As of December 31, 2016)

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, Toranomon 2-chome, Minato-ku, Tokyo, Japan	209,044,200	–	209,044,200	10.45
Total	–	209,044,200	–	209,044,200	10.45

(9) Stock options

The Company 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 on December 21, 2007)

The Board of Directors on December 21, 2007, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	December 21, 2007
Positions and number of persons granted	Members of the Board 11 persons Executive Officers (excluding persons serving as Member of the Board) 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 Members of the Board, 38,600 shares to Executive Officers, total 85,200 shares (200 shares per subscription right to shares) (Notes 1, 2)
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 the Company 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 the Company after the date on which the Company allots subscription rights to shares (hereinafter, “Allotment Date”), the number of shares to which each subscription right to shares 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 the Company 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, the Company shall conduct adjustments deemed necessary after the Allotment Date.

When adjusting the Number of Shares Granted, the Company 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, the Company shall later do so as soon as possible.

2. The Company 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 from one share to 200 shares and is presented accordingly.

(By resolution of the Board of Directors on September 19, 2008)

The Board of Directors on September 19, 2008, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 19, 2008
Positions and number of persons granted	Members of the Board 11 persons Executive Officers (excluding persons serving as Member of the Board) 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 Members of the Board, 46,400 shares to Executive Officers, total 109,400 shares (200 shares per subscription right to shares) (Notes 1, 2)
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 on December 21, 2007).

(By resolution of the Board of Directors on September 28, 2009)

The Board of Directors on September 28, 2009, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 28, 2009
Positions and number of persons granted	Members of the Board 9 persons Executive Officers (excluding persons serving as Member of the Board) 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 Members of the Board, 105,400 shares to Executive Officers, total 230,600 shares (200 shares per subscription right to shares) (Notes 1, 2)
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 on December 21, 2007).

(By resolution of the Board of Directors on September 17, 2010)

The Board of Directors on September 17, 2010, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 17, 2010
Positions and number of persons granted	Members of the Board 9 persons Executive Officers (excluding persons serving as Member of the Board) 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 Members of the Board, 91,600 shares to Executive Officers, total 195,800 shares (200 shares per subscription right to shares) (Notes 1, 2)
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 on December 21, 2007).

(By resolution of the Board of Directors on September 16, 2011)

The Board of Directors on September 16, 2011, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 16, 2011
Positions and number of persons granted	Members of the Board 8 persons Executive Officers (excluding persons serving as Member of the Board) 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 Members of the Board, 104,800 shares to Executive Officers, total 207,600 shares (200 shares per subscription right to shares) (Notes 1, 2)
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 on December 21, 2007).

(By resolution of the Board of Directors on September 21, 2012)

The Board of Directors on September 21, 2012, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 21, 2012
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 7 persons Executive Officers (excluding persons serving as Member of the Board) 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 Members of the Board (excluding Outside Directors), 80,200 shares to Executive Officers, total 145,800 shares (200 shares per subscription right to shares) (Note)
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 on December 21, 2007).

(By resolution of the Board of Directors on September 20, 2013)

The Board of Directors on September 20, 2013, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 20, 2013
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 7 persons Executive Officers (excluding persons serving as Member of the Board) 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 Members of the Board (excluding Outside Directors), 58,000 shares to Executive Officers, total 100,000 shares (200 shares per subscription right to shares) (Note)
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 on December 21, 2007).

(By resolution of the Board of Directors on September 19, 2014)

The Board of Directors on September 19, 2014, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 19, 2014
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 6 persons Executive Officers (excluding persons serving as Member of the Board) 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 Members of the Board (excluding Outside Directors), 33,200 shares to Executive Officers, total 68,800 shares (200 shares per subscription right to shares) (Note)
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 on December 21, 2007).

(By resolution of the Board of Directors on July 17, 2015)

The Board of Directors on July 17, 2015, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	July 17, 2015
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 6 persons Executive Officers (excluding persons serving as Member of the Board) 18 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	49,000 shares to Members of the Board (excluding Outside Directors), 66,200 shares to Executive Officers, total 115,200 shares (200 shares per subscription right to shares) (Note)
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 on December 21, 2007).

(By resolution of the Board of Directors on June 17, 2016)

The Board of Directors on June 17, 2016, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	June 17, 2016
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 5 persons Executive Officers (excluding persons serving as Member of the Board) 18 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	34,200 shares to Members of the Board (excluding Outside Directors), 51,800 shares to Executive Officers, total 86,000 shares (200 shares per subscription right to shares) (Note)
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 on December 21, 2007).

2. Acquisition of treasury shares

[Class of shares] Acquisition of ordinary shares falling under Article 155, item (vii) 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

No items to report

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

Category	Number of shares (Share)	Total value (Millions of yen)
Treasury shares acquired during this fiscal year ended December 31, 2016	86	0
Treasury shares acquired during the period from January 1, 2017 to the filing date of this Annual Securities Report	–	–

Note: The figure for treasury shares acquired during the period from January 1, 2017 to the filing date of this Annual Securities Report does not include the number of shares from purchases of shares less than one unit from March 1, 2017 until the filing date of this Annual Securities Report.

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

Category	Fiscal year ended December 31, 2016		From January 1, 2017 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 cancelled	–	–	–	–
Acquired treasury shares transferred for merger, share exchange and company split	–	–	–	–
Others				
(exercise of subscription rights to shares)	241,200	512	26,800	57
(Sales resulting from requests for sale of shares less than one unit)	50	0	–	–
Treasury shares held	209,044,267	–	209,017,467	–

Notes: 1. The number of disposed shares and total disposal value in the “From January 1, 2017 until the filing date of this Annual Securities Report” column does not include transfers by the exercise of subscription rights to shares performed from March 1, 2017 until the filing date of this Annual Securities Report, nor does it include sales of shares less than one unit during that period.

2. The number of treasury shares held in the “From January 1, 2017 until the filing date of this Annual Securities Report” column does not include transfers by the exercise of subscription rights to shares performed from March 1, 2017 until the filing date of this Annual Securities Report, nor does it include purchases and sales of shares less than one unit during that period.

3. Dividend policy

With regard to shareholder return policies, the Group will pursue enhanced shareholder returns in proportion to the mid- to long-term profit growth by continually making proactive business investments while maintaining a strong financial base that enables response to any possible environmental changes.

Specifically, the Group will work toward stable and consistent growth in dividend per share. Whether to execute the acquisition of treasury shares will be considered in view of factors including the medium-term outlook on business environment and financial positions.

The Company will also continue to monitor a trend in shareholder returns of global FMCG companies.

It is also a basic policy of the Company 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. The Company's Articles of Incorporation stipulate that the Company may pay interim dividends to shareholders with the record date of June 30 each year upon a resolution by the Board of Directors.

In light of business performance in the current fiscal year ended December 31, 2016, the year-end dividend for the fiscal year ended December 31, 2016 was ¥66 per share. Therefore, the total annual dividend for the fiscal year ended December 31, 2016, including the interim dividend of ¥64, is ¥130 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 treasury shares and other objectives.

The dividend for the 32nd term is as follows.

Resolution date	Total amount of dividends (Millions of yen)	Cash dividends per share (Yen)
The Board of Directors on August 1, 2016	114,617	64.00
Annual General Meeting of Shareholders held on March 24, 2017	118,203	66.00

4. Trends in Share Price

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

Term	27th term	28th term	29th term	30th term	31st term	32nd term
Accounting period	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	From January 1, 2015 to December 31, 2015	From January 1, 2016 to December 31, 2016
Highest (Yen)	474,500	490,500 *3,240	3,835	4,193	4,848	4,850
Lowest (Yen)	282,600	406,500 *2,108	2,850	3,097	3,101	3,627

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

2. The Company 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 to 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 2016	August 2016	September 2016	October 2016	November 2016	December 2016
Highest (Yen)	4,432	4,168	4,177	4,195	4,038	3,975
Lowest (Yen)	3,958	3,822	3,920	3,846	3,627	3,735

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

5. Status of officers

There are ten male officers and one female officer (9.1% of the officers are women).

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	April 1974 Entered Ministry of Finance October 2006 Director-General of the Financial Bureau July 2007 Deputy Vice Minister July 2008 Director-General of the Budget Bureau July 2009 Administrative Vice Minister July 2010 Retired from the office of Administrative Vice Minister December 2010 Corporate Auditor, The Yomiuri Shimbun Holdings December 2012 Special Advisor to the Cabinet April 2014 Retired from Special Advisor to the Cabinet June 2014 Chairman of the Board, the Company (Current Position) (Significant Concurrent Positions outside the Company) Outside Director, The Ogaki Kyoritsu Bank, Ltd.	2 years since March 2016	2,800
* President, Chief Executive Officer and Representative Director		Mitsuomi Koizumi	April 15, 1957	April 1981 Joined the Company (Japan Tobacco and Salt Public Corporation) June 2001 Vice President of Corporate Strategy Division June 2003 Senior Vice President, and Head of Human Resources and Labor Relations Group June 2004 Senior Vice President, and Vice President of Tobacco Business Planning Division, Tobacco Business Headquarters June 2006 Executive Vice President, and Vice President of Tobacco Business Planning Division, Tobacco Business Headquarters June 2007 Member of the Board, Executive Vice President, and Head of Marketing & Sales General Division, Tobacco Business Headquarters July 2007 Member of the Board, Executive Vice President, and Chief Marketing & Sales Officer, Tobacco Business Headquarters June 2009 Representative Director and Executive Deputy President June 2012 President, Chief Executive Officer and Representative Director (Current Position)	2 years since March 2016	29,500

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
* Executive Vice President and Representative Director		Yasushi Shingai	January 11, 1956	April 1980 Joined the Company (Japan Tobacco and Salt Public Corporation) July 2001 Vice President of Financial Planning Division June 2004 Senior Vice President, and Head of Finance Group 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 Executive Vice President and Representative Director (Current Position) (Significant Concurrent Positions outside the Company) Outside Director, Recruit Holdings Co., Ltd.	2 years since March 2016	26,700
* Executive Vice President and Representative Director		Mutsuo Iwai	October 29, 1960	April 1983 Joined the Company (Japan Tobacco and Salt Public Corporation) June 2003 Vice President of Corporate Strategy Division July 2004 Vice President of Corporate Strategy Division June 2005 Senior Vice President, and Vice President of Food Business Division, Food Business June 2006 Member of the Board, Executive Vice President, and President, Food Business June 2008 Executive Vice President, and Chief Strategy Officer June 2010 Member of the Board, Senior Vice President, and Chief Strategy Officer and Assistant to CEO in Food Business June 2011 Member of the Board Executive Vice President, JT International S.A. June 2013 Senior Executive Vice President, and Chief Strategy Officer January 2016 Senior Executive Vice President, and President, Tobacco Business Headquarters March 2016 Executive Vice President and Representative Director (Current Position) (Significant Concurrent Positions outside the Company) Chairman, JT International Group Holding B.V.	2 years since March 2016	21,000

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
* Executive Vice President, Member of the Board		Hideki Miyazaki	January 22, 1958	April 1980 Joined Nomura Securities Co., Ltd. July 2005 Senior Manager of Accounting Division of the Company January 2006 Deputy Chief Financial Officer June 2008 Senior Vice President, and Chief Financial Officer June 2010 Executive Vice President and Chief Financial Officer June 2012 Executive Vice President, Member of the Board (Current Position)	2 years since March 2016	16,600
Member of the Board		Motoyuki Oka	September 15, 1943	April 1966 Joined Sumitomo Corporation June 1994 Director, Sumitomo Corporation April 1998 Managing Director, Sumitomo Corporation April 2001 Senior Managing Director, Sumitomo Corporation June 2001 President, Chief Executive Officer, Sumitomo Corporation June 2007 Chairman of the Board of Directors, Sumitomo Corporation June 2012 Advisor, Sumitomo Corporation (Current Position) June 2012 Outside Member of the Board, the Company (Current Position) (Significant Concurrent Positions outside the Company) Outside Director, NEC Corporation	2 years since March 2016	0
Member of the Board		Main Kohda	April 25, 1951	September 1995 Started independently as Novelist January 2003 Member of Financial System Council, Ministry of Finance Japan April 2004 Visiting professor, Faculty of Economics, Shiga University March 2005 Member of the Council for Transport Policy, Ministry of Land, Infrastructure, Transport and Tourism November 2006 Member of the Tax Commission, Cabinet Office, Government of Japan June 2010 Member of the Board of Governors, Japan Broadcasting Corporation June 2012 Outside Member of the Board, the Company (Current Position) (Significant Concurrent Positions outside the Company) Novelist Outside Director, LIXIL Group Corporation Outside Director, Japan Exchange Group, Inc.	2 years since March 2016	0

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Audit & Supervisory Board Member		Futoshi Nakamura	November 23, 1957	April 1981 Joined the Company (Japan Tobacco and Salt Public Corporation) July 2004 Head of Procurement Planning Division September 2005 Senior Manager of Operational Review and Business Assurance Division Vice President, JT International Holding B.V. July 2009 Senior Manager of Accounting Division July 2010 Vice President of Operational Review and Business Assurance Division June 2012 Standing Audit & Supervisory Board Member, the Company (Current Position)	4 years since March 2015	4,800
Audit & Supervisory Board Member		Tomotaka Kojima	December 19, 1953	April 1976 Joined Ministry of Finance 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 November 2010 Executive Secretary, Japan Association of Corporate Directors June 2013 Standing Audit & Supervisory Board Member, the Company (Current Position)	4 years since March 2015	0
Audit & Supervisory Board Member		Yoshinori Imai	December 3, 1944	April 1968 Joined Japan Broadcasting Corporation 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 Outside Audit & Supervisory Board Member, the Company (Current Position)	4 years since March 2015	700

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 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 March 2015 Outside Audit & Supervisory Board Member, the Company (Current Position) (Significant Concurrent Positions outside the Company) Attorney at Law, Obayashi Law Office Outside Audit & Supervisory Board Member, Daiwa Securities Co., Ltd. Outside Director, Mitsubishi Electric Corporation Outside Audit & Supervisory Board Member, NIPPON STEEL & SUMITOMO METAL CORPORATION	4 years since March 2015	0
Total						102,100

Notes: 1. Members of the Board 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.

4. In preparation against a situation where the number of Audit & Supervisory Board Members falls below the statutory required number, the Company appointed one Substitute Audit & Supervisory Board Member as stipulated in Article 329, paragraph 3 of the Companies Act. The summary of the career of the Substitute 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 April 1989 Appointed as Public Prosecutor July 2003 Head of Takasaki Branch, Maebashi District Public Prosecutors Office April 2004 Registered as Attorney at Law (Significant Concurrent Positions outside the Company) Attorney at Law, City-Yuwa Partners Outside Director, Hamai Co., Ltd.	(Note)	0

Note: If the Substitute Audit & Supervisory Board Member assumes office as Audit & Supervisory Board Member, his or her term of office 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.

5. The Company has introduced the Executive Officer System since June 2001 in order to realize prompt and proper decision-making and business execution. The following 23 persons were appointed effective March 24, 2017.

Title	Name	Post
President	Mitsuomi Koizumi	Chief Executive Officer
Executive Vice President	Yasushi Shingai	Deputy Chief Executive Officer, Compliance, General Affairs, Legal, HR, Corporate Strategy, IT, Business Development and Operation Review & Business Assurance
Executive Vice President	Mutsuo Iwai	President, Tobacco Business
Executive Vice President	Hideki Miyazaki	Finance, CSR and Communications
Senior Vice President	Ryoji Chijiiwa	Compliance and General Affairs
Senior Vice President	Chito Sasaki	President, Japanese Tobacco Business, Tobacco Business
Senior Vice President	Kazuhito Yamashita	Head of China Division, Tobacco Business
Senior Vice President	Shiroji Maeda	Chief Marketing & Sales Officer, Tobacco Business
Senior Vice President	Junichi Fukuchi	Corporate, Scientific & Regulatory Affairs Division, Tobacco Business
Senior Vice President	Koji Shimayoshi	Head of Tobacco Business Planning Division, Tobacco Business
Senior Vice President	Takehisa Shibayama	Chief R&D Officer, Tobacco Business
Senior Vice President	Hirakazu Otomo	Manufacturing Group, Tobacco Business
Senior Vice President	Kenji Ogura	Head of Leaf Procurement Group, 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	Naohiro Minami	Chief Financial Officer
Senior Vice President	Ryoko Nagata	CSR
Senior Vice President	Haruhiko Yamada	Legal
Senior Vice President	Kiyohide Hirowatari	HR
Senior Vice President	Yuki Maeda	Corporate Strategy and IT
Senior Vice President	Takehiko Tsutsui	Business Development
Senior Vice President	Kei Nakano	Communications
Senior Vice President	Takanori Kikuchi	General Affairs

* As of January 1, 2016, the Company has changed to a system whereby Executive Officers of the corporate divisions are put in charge of respective operations, in order to ensure a framework that enables the Company to flexibly address challenges with respect to business strategy.

6. Status of corporate governance

(1) Status of corporate governance

Whereas the following contains statements regarding the fiscal year ended December 31, 2016, the final day of that fiscal year, and the fiscal year ended December 31, 2015, the statements herein are current as of the filing date, unless otherwise indicated.

a. Basic concept on the corporate governance

The Company's belief is that corporate governance is the means for conducting transparent, fair, timely and decisive decision-making for pursuing the Company's management principle, the "4S model." Specifically the 4S model aims "to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society, carefully considering the respective interests of these four key stakeholder groups, and exceeding their expectations wherever we can."

The Company has set out the "JT Corporate Governance Policy," and strives to make enhancements based on its belief that it will enable the Group to achieve mid- to long-term sustainable profit growth and increase corporate value, which will contribute to the development of the Group's stakeholders and eventually the economic society as a whole.

The Company will continue to strive to make enhancements of its corporate governance as one of the key challenges for its management.

b. Organization of the Company

In addition to opting to be a company with Audit & Supervisory Board, the Company seeks to enhance corporate governance through the utilization of voluntary structures such as the establishment of the Compensation Advisory Panel, which is largely composed of the Outside Directors and the Outside Audit & Supervisory Board Members, and the JT Group Compliance Committee, which is largely composed of outside committee members, from a viewpoint of creating an effective governance system.

The Board of Directors meets once a month in principle and on more occasions as necessary, in order to make decisions with regard to the matters specified by laws and regulations and other important matters, to supervise implementation of business and to receive reports from the Members of the Board on the status of implementation of business. In addition, the Chairman of the Board has been positioned as a non-executive Director in order to concentrate on supervising management while also serving as the chairman of the Board of Directors. The Company appoints at least two Outside Directors who possess the qualities to contribute to sustained profit growth and enhancement of corporate value over the mid- to long-term from a viewpoint of strengthening the supervising function and management transparency.

The Board of Directors has set forth in the Board of Directors Regulations matters to be discussed at the Board of Directors meetings. In addition, from the viewpoint of realizing swift decision making and high-quality implementation of business, the Board of Directors has set forth a clear decision-making process based on internal rules on the allocation of responsibilities and authorities (hereinafter referred to as the "Responsibilities/Authorities Allocation Rules") concerning essential business matters as well as delegates authority as necessary to Executive Officers based on company-wide management strategies, under the Executive Officer system.

The Company has adopted the Audit & Supervisory Board system under which Audit & Supervisory Board Members of the Company (hereinafter simply "Audit & Supervisory Board Members," with the terms "Audit & Supervisory Board," "Audit & Supervisory Board Member's Office," and "Manager of the Audit & Supervisory Board Member's Office" also referring to those items within the Company) assertively exercise authority as an independent body with the mandate of shareholders, which includes attending and speaking at the Board of Directors meetings and other important meetings as well as actively inspecting business sites. In addition, they also perform audits appropriately from an objective viewpoint in accordance with the characteristics of the duties of the Outside Audit & Supervisory Board Members and the standing Audit & Supervisory Board Members. The Audit & Supervisory Board Members work to ensure sound and sustainable growth and maintain and enhance public trust in the Company by examining the performance of duties by Members of the Board and Executive Officers.

The Audit & Supervisory Board is composed of members with substantial knowledge of management, law, finance, accounting and other aspects of business. The standing Audit & Supervisory Board Member, 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 Vice President of

Operational Review and Business Assurance Division of the Company after engaging in the Accounting Division and the Treasury Division of the Company. In addition, standing Audit & Supervisory Board Member, 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 Finance Group of the Company, but also wide-ranging governmental experience and knowledge of corporate governance through his experience at the Japan Association of Corporate Directors. In preparation against a situation where the number of Audit & Supervisory Board Members falls below the statutory required number one Substitute Audit & Supervisory Board Member as stipulated in Article 329, paragraph 3 of the Companies Act is elected.

c. Implementation status of internal control system, risk management system and systems necessary to ensure the properness of operations in subsidiaries

The Company has always endeavored to run an internal control system of the Company and the Group through initiatives in such areas as compliance, internal audits, and risk management. Moreover, the Company has created the systems required under the Companies Act and the Ordinance for the Enforcement of the Companies Act by implementing measures aimed at ensuring the effectiveness of audits by Audit & Supervisory Board Members. The Company will work to maintain and enhance the systems in each company while consecutively reviewing and revising the current system as necessary, and ensure appropriate implementation of business. For the foreign subsidiaries, the Company builds and operates the necessary system in conformity with the following provisions concerning subsidiaries, in principle, while complying with the laws and regulations in the country in which the subsidiary is incorporated.

- Systems to ensure that the performance of duties by the Members of the Board and employees of the Company, as well as by Directors, etc. and employees of subsidiaries (with Members of the Board, etc. Directors, etc., and employees hereafter collectively referred to as “directors and employees”), conforms to laws, regulations, and the Articles of Incorporation

With regard to the compliance system, the Company and its subsidiaries have established the code of conduct based on internal rules concerning compliance system in order to ensure that directors and employees of the Company and its subsidiaries comply with laws and regulations, respective Articles of Incorporation, the social norms, etc., and set up the JT Group Compliance Committee as an organization responsible for ensuring thorough compliance. This committee, headed by the Chairman of the Board, consists mainly of outside members. Meanwhile, the Company appoints an Executive Officer (*sikkoyakuin*) in charge of compliance with overseeing the Compliance Office in an effort to establish and promote a group-wide, crosssectional system and shed light on issues. The compliance promotion departments of the Company and its subsidiaries (meaning the Compliance Office within the Company, and corresponding departments within subsidiaries) distribute materials including the “JT Group Code of Conduct,” which explains the Code of Conduct, etc., to directors and employees, and work to enhance the effectiveness of the compliance system by enlightening directors and employees about compliance through training and other programs, etc.

Regarding the internal reporting system (whistle-blower system), each of the Company and its subsidiaries has a counter inside and outside the company through which employees and others may consult or report in case that they detect any conduct, etc. that may violate laws and regulations. Matters of particular importance shall be referred to the JT Group Compliance Committee for deliberation. The Company will bring matters of particular importance involving the JT Group to the JT Group Compliance Committee, and will request deliberation or will report on the issue.

Under the system for excluding anti-social elements, the Company and its subsidiaries are resolved to fight against, not to comply with, an unreasonable demand and not to have any relations with anti-social elements. Designating the General Administration Division of the Company as the department assuming the responsibility for supervising efforts to exclude anti-social elements at the Group level, the Officers are cooperating 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. The Company also consistently makes enlightening activities to eliminate anti-social forces by making directors and employees of the Company and its subsidiaries informed about the rules not to have any relations with anti-social groups and organizations and by educating the directors and employees through providing relevant training as necessary.

In order to ensure the reliability of financial reporting of the Group, the Company 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, the company 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 of the Company (18 persons as of December 31, 2016), which examines and evaluates systems for supervising and managing the overall operations of the company and the status of business execution from the viewpoints of legality and rationality, in order to protect the company's assets and improve management efficiency. In coordination with the internal audit functions of all subsidiaries, the Operational Review and Business Assurance Division also undertakes the planning and performance of the Group's internal audit systems and policies, and supplements the internal audit functions of subsidiaries.

- Procedures and arrangements for storage and management of information on the performance of duties by the Members of the Board of the Company

The Company makes sure to properly store and manage the minutes of General Meetings of Shareholders and meetings of the Board of Directors in line with laws and regulations. The Company makes sure that the information on important matters relating to business execution and decision-making including the conclusion of corporate contracts 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.

- System for reporting matters concerning the performance of duties by Directors, etc. of subsidiaries to the Company

The Company makes subsidiaries to regularly report important information to the Company's departments and divisions that are in charge of the subsidiaries.

- Rules on management of risk of loss of the Company and its subsidiaries, and procedures/arrangements for other matters

The Company has established internal policies, rules and manuals relating to the Group for the management of risk of loss relating to monetary and financial affairs, and ensures that relevant reports are made to the President and Chief Executive Officer and the Board of Directors on a quarterly basis via Chief Financial Officer. With regard to the risk of loss relating to other affairs, in accordance with authority delegated to each department and division as per the Responsibilities/Authorities Allocation Rules, responsible departments and divisions take on a supervisory role creating all types of committees to conduct proper management and, depending on the level of importance, report risks to the President and Chief Executive Officer and obtain approval for countermeasures.

In cooperation with the internal audit functions of subsidiaries, the Operational Review and Business Assurance Division of the Company examines and evaluates the internal control systems, etc. of the Group companies in light of the level of importance and the risks involved, and from an objective standpoint that is independent of organizations responsible for business execution. It provides reports and counsel to the President and Chief Executive Officer and also reports to the Board of Directors.

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

- System to ensure that Members of the Board of the Company and Directors, etc. of its subsidiaries can perform their duties efficiently

The Board of Directors of the Company meets once a month in principle and on more occasions as 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. The Board of Directors of the Company receives reports from Members of the Board of the Company on the status of business execution at least once every three months. For important management issues, particularly management policy and basic plans regarding overall business operations of the Company, in addition to matters to be referred to the Board of Directors of the Company, a clear decision-making process is stipulated in the Responsibilities/Authorities Allocation Rules to have a system that enables to realize swift decision-making and high-quality business execution. The Company has adopted the Executive Officer System, under which Executive Officers appointed by the Company's Board of Directors execute business properly by exercising the authority delegated to them in their respective areas, in accordance with company-wide management strategies decided by the Board. In order to manage business operations in ways that contribute to the business efficiency and flexibility of the Company, basic matters concerning the Company's organization, allocation of duties to officers and staff and the roles of individual divisions are specified by the relevant internal rules.

The Company has been constructing an efficient system for business execution within the Group through the formulation, etc. of rules and policies that apply to the Group.

- Systems necessary to ensure the properness of operations in the Company and the Group

  The 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. The Company has specified the functions and rules necessary for group management based on a group management policy, in order to optimize the operations of the entire the Group as a whole. Moreover, the Company has been putting in place systems for compliance (including the internal reporting system), internal audits, financial affairs management, etc. in cooperation with its subsidiaries.

- Matters for employees assisting Audit & Supervisory Board Members in their duties in the event such employees were requested by Audit & Supervisory Board Members

  The Company has allocated sufficient staff to the Audit & Supervisory Board Member's Office (4 persons as of December 31, 2016) as an organization supporting the Audit & Supervisory Board Members in performing their duties. In addition, the Company makes sure to review and reform the staffing structure as necessary based on consultations with the Audit & Supervisory Board.

- Matters relating to the independence of employees belonging to the Audit & Supervisory Board Member's Office from the Company's Members of the Board, and matters relating to the assurance of the effectiveness of instruction by Audit & Supervisory Board Members to those employees

  The evaluation of the Manager of the Audit & Supervisory Board Member's Office is made by the Audit & Supervisory Board and the evaluation of the other employees assigned to the Audit & Supervisory Board Member's Office is made by the Manager of the Audit & Supervisory Board Member's Office based on the advice of the Audit & Supervisory Board. The transfer and discipline of employees assigned to the Audit & Supervisory Board Member's Office is to be deliberated in advance with the Audit & Supervisory Board.

  The Company makes the employees belonging to the Audit & Supervisory Board Member's Office follow the direction and orders of Audit & Supervisory Board Members in assisting the duties of the latter, and not be assigned to other concurrent positions relating to the business execution of the Company.

- System for reporting by directors and employees of the Company and its subsidiaries or persons reported by directors and employees of its subsidiaries to the Audit & Supervisory Board and Audit & Supervisory Board Members

  When directors and employees of the Company and its subsidiaries detect any evidence of malfeasance in financial documents or serious breaches of laws or regulations or the Company's Articles of Incorporation, they are due to report them to the Audit & Supervisory Board, along with other relevant matters that could affect the Company's management. In addition, when directors and employees of the Company and its subsidiaries are asked by Audit & Supervisory Board Members to compile important documents 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.

  The Compliance Office makes reports regularly to Audit & Supervisory Board Members on the status of whistleblowing involving the Group, and makes non-regular reports as necessary.

- System to ensure that persons reporting to Audit & Supervisory Board Members are not subject to disadvantageous treatment due to having reported

  The Company thoroughly communicates within the Group that persons engaging in consultation or whistleblowing are not to be subject to any disadvantageous treatment for reason of those actions.

- Matters concerning policies for the prepayment of expenses involving the performance of duties by Audit & Supervisory Board Members, procedures for reimbursement, and the handling of other expenses or debts involving the performance of those duties

  When an Audit & Supervisory Board Member has made claim to the Company for the prepayment of expenses, etc. in accordance with Article 388 of the Companies Act, the Company will promptly handle the relevant expenses or debt, with the exception of cases in which the Company deems the claimed expenses or debt to be unnecessary to the performance of the duties of the Audit & Supervisory Board Member.

  The Company makes a budget covering audit-related expenses so as to secure effectiveness of audits by Audit & Supervisory Board Members. The Company also bears the portion of miscellaneous expenses for audits by Audit & Supervisory Board Members that are in excess of budget, with the exception of cases in which the Company deems the expenses to be unnecessary to the performance of duties.

- Other systems to ensure effective auditing by Audit & Supervisory Board Members

  Audit & Supervisory Board Members are allowed to attend not only meetings of the Board of Directors of the Company but also other important meetings of the Company. The Operational Review and Business Assurance Division and the Compliance Office maintain cooperation with Audit & Supervisory Board Members by exchanging information.

d. Implementation status of accounting audits

The Company, in order to ensure the Independent Auditor’s appropriate audit, secures sufficient time for audit enabling high-quality audit and provide the Independent Auditor with opportunities to contact Members of the Board and Executive Officers, as well as provide appropriate auditing environment enabling sufficient cooperation between the Independent Auditor and Audit & Supervisory Board Members, the internal auditing division and Outside Directors. Further, in the event that an Independent Auditor indicates a deficiency or problem or discovers misconduct, the Company shall appropriately take measures correspondingly.

The Audit & Supervisory Board has established the “Standards for Evaluating and Selecting Independent Auditor.” The evaluation and selection of Independent Auditor are conducted in accordance with said standards, and are based on a comprehensive judgment, considering the various factors such as independence from the Company, degree of expertise, adequate experience, size and overseas network which enables efficient implementation of accounting services corresponding to the Company’s broad range of business, well established auditing system, fair and reasonable audit plans and expenses.

The Company 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 the Company’s financial statements for the fiscal year ended December 31, 2016 and the persons who assisted the auditing work are as follows.

(Certified public accountants)
Masahiko Tezuka, Koji Ishikawa, Takehisa Ohashi

All of the certified public accountants have spent not more than 7 years auditing the Company, and as such figures for continuous audit years have been omitted.

(Assistants for the accounting audit work)
Certified public accountants: 11 persons, Junior accountants: 6 persons, Others: 10 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 the Company's Internal Control Division to ensure appropriate implementation of business by exchanging information when necessary.

e. 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

  The Company has two Outside Directors and two Outside Audit & Supervisory Board Members.

  Mr. Motoyuki Oka, one of the Outside Directors, is Outside Director of NEC Corporation. Although the Company has had a business relationship with NEC Corporation, the value of the business was less than 0.001% of the Company's consolidated revenue in the fiscal year ended December 31, 2016. Therefore, the Company has concluded that this business relationship is not so relevant as to generate any special relationship of interest. In addition, Outside Audit & Supervisory Board Member Mr. Yoshinori Imai is originally from Japan Broadcasting Corporation. Although the Company pays reception fees to Japan Broadcasting Corporation pursuant to the Broadcast Act, those payments are routine and immaterial, and made in accordance with laws and regulations. Therefore, the Company has 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 the Company 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

  The Company has appointed Mr. Motoyuki Oka and Ms. Main Kohda as Outside Directors. In that capacity, the Company expects that he will draw on his abundant experience and extensive insight into the management of global companies and the financial sector gained over many years, and that she will draw on her abundant insight into international finance, her extensive experience serving on governmental advisory bodies and other such forums, and also draw on her deep insight and objective point of view developed through her activities as a novelist, with both individuals thereby reflecting their respective attributes in management of the Company in the course of actively providing proposals and advice to the Board of Directors. Moreover, the Company believes that they will supervise implementation of business 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. The Company 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. The Company expects that their experiences and perspectives will be reflected in their audit activity, and the Company believes that they will maintain objective and neutral surveillance over the management of the Company 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, the Company appointed Mr. Michio Masaki as a Substitute Audit & Supervisory Board Member.

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

  At the Board of Directors on April 26, 2012, the Company established a Criteria for Evaluating the Independence of Outside Executives. According to the Criteria, Independent Directors/Audit & Supervisory Board Members must not fall under any of the following categories.

  1. A person who belongs or belonged to the Company or an affiliate or sister company of the Company
  2. A person who belongs to a company or any other form of organization of which the Company is a major shareholder
  3. A person who is a major shareholder of the Company or who belongs to a company or any other form of organization which is a major shareholder of the Company

4. A person who is a major supplier or customer of the Company (if the supplier or customer is a company or any other form of organization, a person who belongs thereto)
5. A major creditor of the Company including a major loan lender (if the creditor is a company or any other form of organization, a person who belongs thereto)
6. A certified public accountant who serves as an independent auditor or an audit advisor of the Company, or a person who belongs to an auditing firm which serves as an independent auditor or an audit advisor of the Company
7. A person who receives a large amount of fees from the Company in exchange for providing professional services for legal, financial and tax affairs or business consulting services (if the recipient of such fee is a company or any other form of organization, a person who belongs thereto)
8. A person who receives a large amount of donation from the Company (if the recipient of such donation is a company or any other form of organization, a person who belongs thereto)
9. A person who has fit any of the descriptions in 2 to 8 above in the recent past
10. A close relative of a person who fits any of the following descriptions:

(i) A person who fits any of the descriptions in 2 to 8 above (if such descriptions apply to a company or any other form of organization, a person who performs important duties thereof)

(ii) A member of the board, audit & supervisory board member, audit advisor, executive officer or employee of the Company or an affiliate or sister company of the Company

(iii) A person who has fit the descriptions in (i) or (ii) in the recent past.

The Company 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.

To ensure that supervisory tasks and audits are conducted appropriately, information is shared regarding supervision and audit results and other steps are taken to ensure cooperation among operations involving supervision or audits performed by Outside Directors or Outside Audit & Supervisory Board Members, and operations involving internal audits, audits by Audit & Supervisory Board Members and audits by the Independent Auditor. To ensure appropriate implementation of business, information is exchanged as necessary and other means of cooperation are implemented among operations involving supervision or audits performed by Outside Directors or Outside Audit & Supervisory Board Members, and the Company’s Internal Control Division.

f. Key points of the partial exemption of liability and liability limitation agreement

The Company’s Articles of Incorporation stipulate that the Company may enter into an agreement with Members of the Board (excluding those who are Executive Directors, etc.) and Audit & Supervisory Board Members to limit the scope of their liabilities in advance to the extent permitted by the Companies Act and the Company may exempt Members of the Board and Audit & Supervisory Board Members from liabilities to the extent permitted by the same act. This provision is intended to enable Members of the Board 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, the Company has such liability limiting agreements with its Members of the Board (excluding those who are Executive Directors, etc.) and Audit & Supervisory Board Members.

g. Number of Members of the Board

The Company’s Articles of Incorporation stipulate that the number of Members of the Board must be 15 or less.

h. Appointment of Members of the Board

The Company’s Articles of Incorporation stipulate that Members of the Board 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.

i. 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, the Company’s Articles of Incorporation stipulate that the Company 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, the Company’s Articles of Incorporation stipulate that the Company may pay interim dividends to shareholders, upon a resolution by the Board of Directors under Article 454, paragraph 5 of the Companies Act.

j. Requirements for special resolutions at General Meeting of Shareholders

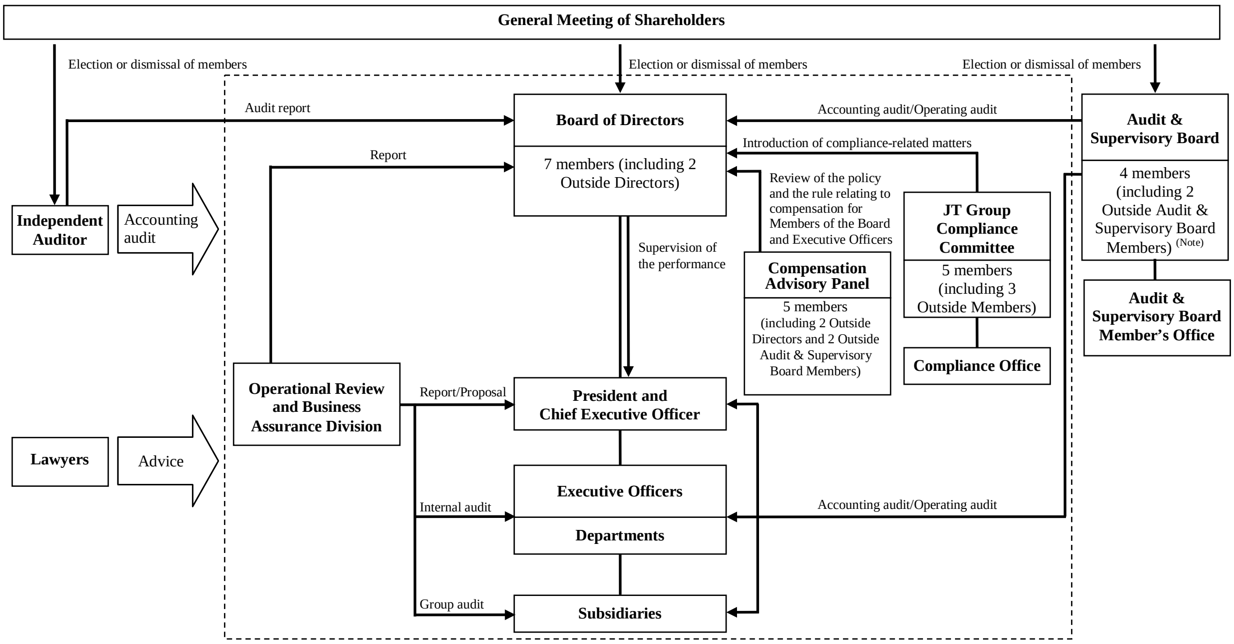
In order to facilitate the smooth conduct of General Meeting of Shareholders with an easier quorum requirement for special resolutions, the Company’s Articles of Incorporation stipulate that a resolution as specified by Article 309, paragraph 2 of the Companies Act is valid if it is supported by at least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

k. Measures regarding transactions that involve possible conflict of interest between the Company and specified shareholders to avoid harming the interests of shareholders (excluding the shareholder who is a party to such a transaction)

The Company requires resolution by the Board of Directors with respect to gaining approval for uncustomary transactions between the Company and its major shareholders.

l. Schematic depiction

The status of the development of the Company'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, one Substitute Audit & Supervisory Board Member is elected.

m. Remuneration for Members of the Board and Audit & Supervisory Board Members

Remuneration for Members of the Board and Audit & Supervisory Board Members are as follows.

(i) Total amount of remuneration and other payments, total amount of remuneration and other payments by type, and number of Members of the Board and Audit & Supervisory Board Members to be paid, by member category for the fiscal year ended December 31, 2016

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	Officers' bonus	Stock option grants	
Members of the Board (excluding Outside Directors)	603	316	170	117	7
Audit & Supervisory Board Members (excluding Outside Audit & Supervisory Board Members)	77	77	–	–	2
Outside Directors and Outside Audit & Supervisory Board Members	56	56	–	–	4
Total	736	449	170	117	13

Note: For officers' bonuses, the amounts planned to be paid are shown.

(ii) Total amount of consolidated remuneration and other payments for individuals whose consolidated remuneration and other payments amount to ¥100 million or more for the fiscal year ended December 31, 2016

Name	Category	Company	Amount of consolidated remuneration and other payments by type (Millions of yen)			Total (Millions of yen)
			Basic remuneration	Officers' bonus	Stock option grants	
Mitsuomi Koizumi	Representative Director	Filing company	85	69	31	185
Yasushi Shingai	Representative Director	Filing company	52	41	19	112

(iii) Policy concerning the remuneration amount for Members of the Board and Audit & Supervisory Board Members or the remuneration calculation method thereof and the method of determining the policy

The Company has the Compensation Advisory Panel in place as a non-statutory advisory body to the Board of Directors in order to increase objectivity and transparency regarding the remuneration of Members of the Board and Audit & Supervisory Board Members. The Compensation Advisory Panel, which holds meetings several times a year, holds deliberations and makes reports in accordance with its advice on such matters as the Company's policy, system and calculation method regarding remuneration for its Members of the Board and Executive Officers (sikkoyakuin), and monitors the status of remuneration for Members of the Board and Audit & Supervisory Board Members at the Company. The Compensation Advisory Panel currently consists of five members: the Chairman of the Board, who has the role of the panel's chairman, and two Outside Directors and two Outside Audit & Supervisory Board Members.

Outside members of Compensation Advisory Panel

Motoyuki Oka	Outside Director of the Company
Main Kohda	Outside Director of the Company
Yoshinori Imai	Outside Audit & Supervisory Board Member of the Company
Hiroshi Obayashi	Outside Audit & Supervisory Board Member of the Company

In light of reports by the Compensation Advisory Panel, the Company's basic concept of remuneration for Members of the Board and Audit & Supervisory Board Members is as follows:

- Setting the remuneration at a level sufficient to secure personnel with superior capabilities
- Linking the remuneration to business performance so as to motivate Members of the Board and Audit & Supervisory Board Members to enhance performance
- Linking the remuneration to mid- to long-term corporate value
- Ensuring transparency based on an objective point of view and quantitative schemes

In accordance with the above concept, the remuneration for Members of the Board and Audit & Supervisory Board Members is made of three components. In addition to the monthly "basic remuneration," there is an "officers' bonus," which reflects the Company's business performance in the relevant fiscal year, and a "stock option," which is linked to the mid- to long-term corporate value of the Company. The said "stock option" was introduced in 2007 as remuneration that is linked to the mid- to long-term corporate value, thereby providing an incentive towards increasing shareholder value.

The composition of the remuneration for Members of the Board is as follows:

For Members of the Board who also serve as Executive Officers (sikkoyakuin), remuneration consists of the "basic remuneration," the "officers' bonus," and the "stock option" because they are required to achieve results by executing their duties on a daily basis. If the "officers' bonus" is paid at the standard amount, the sum of this bonus and the "stock option" is set to be equivalent to approximately 80% of the basic remuneration.

Members of the Board (excluding Outside Directors) who do not serve as Executive Officers (sikkoyakuin) receive remuneration that consists of the "basic remuneration" and the "stock option" since they are required to make decisions on company-wide management strategies and fulfill supervisory functions to enhance corporate value.

Remuneration for Outside Directors, which is not linked to business performance with the purpose of maintaining their independence, is composed of "basic remuneration" only.

In the light of the role of Audit & Supervisory Board Members, which is primarily to conduct audits on legal compliance, their remuneration consists solely of the "basic remuneration."

The upper limit of remuneration for the Company's Members of the Board 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 of "stock option" that may be granted to Members of the Board separately to the remuneration mentioned above is 800 units and ¥200 million per year. This was also approved at the 22nd Ordinary General Meeting of Shareholders. The number of units allocated for each term, including the number allocated to Executive Officers (sikkoyakuin) who are not also Members of the Board, is decided by resolution of the Board of Directors.

The amounts of remunerations for Members of the Board and Audit & Supervisory Board Members are determined by resolution of the Board of Directors in the case of remuneration for Members of the Board, and through discussions among Audit & Supervisory Board Members in the case of remunerations for Audit & Supervisory Board Members, within the approved upper limits, in light of deliberations by the Compensation Advisory Panel. These processes are carried out after benchmarking of levels of remuneration at major Japanese manufacturers that operate globally and whose size and profits are at similar levels to those of the Company, and are undertaken based on third-party research into remuneration for corporate executives.

n. Share ownership

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

(Fiscal year ended December 31, 2016)

49 issues, ¥53,727 million

(ii) 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 December 31, 2015)

Specified investment stocks

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
KT&G Corporation	2,864,904	30,926	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	4,729	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	3,105	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Mitsubishi UFJ Financial Group, Inc.	3,511,050	2,658	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
DOUTOR-NICHIRES Holdings Co., Ltd.	1,320,000	2,468	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	2,168	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	2,160	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	1,570	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
NIPPON TELEGRAPH AND TELEPHONE CORPORATION	306,000	1,480	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	1,459	Held for policy-based investment under business alliance with the Company for joint venture
West Japan Railway Company	133,000	1,116	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	1,092	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	990	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	924	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	619	Held for policy-based investment under business alliance with the Company for joint venture

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
Sumitomo Mitsui Trust Holdings, Inc.	1,218,820	562	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Tokyo Automatic Machinery Works, Ltd.	2,700,000	529	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	386	Policy-based investment acquired when engaging in past transactions or building cooperative relations
HOKKAN HOLDINGS LIMITED	1,000,000	319	Policy-based investment acquired when engaging in past transactions or building cooperative relations
Tomoku Co., Ltd.	1,000,000	286	Policy-based investment acquired when engaging in past transactions or building cooperative relations
Tokio Marine Holdings, Inc.	21,300	100	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
MS&AD Insurance Group Holdings, Inc.	18,400	66	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
Hitachi, Ltd.	94,000	65	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, 2016)

Specified investment stocks

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
KT&G Corporation	2,864,904	28,010	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	3,794	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
DOUTOR-NICHIRES Holdings Co., Ltd.	1,320,000	2,839	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	2,675	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Mitsubishi UFJ Financial Group, Inc.	2,994,150	2,156	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Central Japan Railway Company	100,000	1,923	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	1,690	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
Sumitomo Mitsui Financial Group, Inc.	340,901	1,520	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
NIPPON TELEGRAPH AND TELEPHONE CORPORATION	306,000	1,503	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	1,268	Held for policy-based investment under business alliance with the Company for joint venture
NIPPON EXPRESS CO., LTD.	1,730,400	1,088	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	954	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	777	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	679	Held for policy-based investment under business alliance with the Company for joint venture
Electric Power Development Co., Ltd.	213,600	575	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.	121,882	510	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Yoshimura Food Holdings K.K.	210,500	434	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Tokyo Automatic Machinery Works, Ltd.	2,700,000	410	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.	21,300	102	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
Hitachi, Ltd.	94,000	59	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.	9,200	33	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term

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

No items to report for the fiscal years ended December 31, 2015 and 2016.

(2) Audit fees

a. Audit fees paid to certified public accountants

(Millions of yen)

Classification	Fiscal year ended December 31, 2015		Fiscal year ended December 31, 2016	
	Fees for audit attestation services	Fees for non-audit services	Fees for audit attestation services	Fees for non-audit services
The Company	325	4	330	20
Consolidated subsidiaries in Japan	137	2	140	–
Total	462	6	470	20

Note: Fees paid to Deloitte Touche Tohmatsu LLC

b. Other important fees

(Millions of yen)

Classification	Fiscal year ended December 31, 2015		Fiscal year ended December 31, 2016	
	Fees for audit attestation services	Fees for non-audit services	Fees for audit attestation services	Fees for non-audit services
JTIH Group	806	633	701	570

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

Fiscal year ended December 31, 2015

Foreign subsidiaries of the Group 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.

Fiscal year ended December 31, 2016

Foreign subsidiaries of the Group 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 December 31, 2015

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

Fiscal year ended December 31, 2016

Non-audit services for which fees are paid by the Company to certified public accountants include the issuance of the comfort letter in relation to the 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). The Company is categorized as a company allowed to file specified financial statements, and prepares the nonconsolidated financial statements in accordance with the provisions of Article 127 of the Ordinance on FS.

(3) 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, 2016 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】

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Assets		
Current assets		
Cash and cash equivalents (Note 7)	526,765	294,157
Trade and other receivables (Note 8)	406,387	396,934
Inventories (Note 9)	563,820	558,846
Other financial assets (Note 10)	17,849	14,921
Other current assets (Note 11)	280,493	340,312
Subtotal	1,795,313	1,605,169
Non-current assets held-for-sale (Note 12)	2,904	821
Total current assets	1,798,217	1,605,990
Non-current assets		
Property, plant and equipment (Note 13)	681,865	680,835
Goodwill (Notes 14, 37)	1,429,287	1,601,987
Intangible assets (Note 14)	332,478	423,970
Investment property (Note 16)	23,614	18,184
Retirement benefit assets (Note 22)	38,954	23,680
Investments accounted for using the equity method	59,523	123,753
Other financial assets (Note 10)	101,727	99,358
Deferred tax assets (Note 17)	92,570	166,617
Total non-current assets	2,760,017	3,138,384
Total assets	4,558,235	4,744,374

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Liabilities and equity		
Liabilities		
Current liabilities		
Trade and other payables (Note 18)	373,032	377,933
Bonds and borrowings (Note 19)	30,980	208,521
Income tax payables	106,391	54,940
Other financial liabilities (Note 19)	6,459	13,023
Provisions (Note 20)	19,297	12,529
Other current liabilities (Note 21)	729,761	689,629
Total current liabilities	1,265,920	1,356,574
Non-current liabilities		
Bonds and borrowings (Note 19)	215,938	339,036
Other financial liabilities (Note 19)	10,143	9,009
Retirement benefit liabilities (Note 22)	333,562	333,410
Provisions (Note 20)	9,210	4,423
Other non-current liabilities (Note 21)	113,958	102,221
Deferred tax liabilities (Note 17)	87,979	71,660
Total non-current liabilities	770,790	859,759
Total liabilities	2,036,710	2,216,333
Equity		
Share capital (Note 23)	100,000	100,000
Capital surplus (Note 23)	736,400	736,400
Treasury shares (Note 23)	(444,333)	(443,822)
Other components of equity (Note 23)	(137,122)	(303,554)
Retained earnings	2,196,651	2,367,067
Equity attributable to owners of the parent company	2,451,596	2,456,091
Non-controlling interests	69,929	71,950
Total equity	2,521,524	2,528,041
Total liabilities and equity	4,558,235	4,744,374

B.【Consolidated Statement of Income】

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Continuing operations		
Revenue (Notes 6, 25)	2,252,884	2,143,287
Cost of sales (Notes 14, 22)	(920,056)	(872,433)
Gross profit	1,332,828	1,270,854
Other operating income (Note 26)	15,367	70,101
Share of profit in investments accounted for using the equity method	6,381	6,489
Selling, general and administrative expenses (Notes 12, 13, 14, 16, 22, 27, 32, 37)	(789,346)	(754,115)
Operating profit (Note 6)	565,229	593,329
Financial income (Notes 28, 33)	15,016	6,618
Financial costs (Notes 22, 28, 33)	(15,132)	(21,710)
Profit before income taxes	565,113	578,237
Income taxes (Note 17)	(162,386)	(152,464)
Profit for the period from continuing operations	402,727	425,773
Discontinued operations		
Profit for the period from discontinued operations (Note 38)	87,515	—
Profit for the period	490,242	425,773
Attributable to:		
Owners of the parent company	485,691	421,695
Non-controlling interests	4,551	4,078
Profit for the period	490,242	425,773
Earnings per share		
Basic (Yen)		
Continuing operations (Note 30)	221.95	235.47
Discontinued operations (Note 30)	48.59	—
Total basic earnings per share for the period (Note 30)	270.54	235.47
Diluted (Yen)		
Continuing operations (Note 30)	221.81	235.33
Discontinued operations (Note 30)	48.56	—
Total diluted earnings per share for the period (Note 30)	270.37	235.33

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

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Continuing operations		
Operating profit	565,229	593,329
Amortization cost of acquired intangibles arising from business acquisitions	31,875	46,767
Adjustment items (income)	(10,346)	(65,212)
Adjustment items (costs)	39,900	11,894
Adjusted operating profit (Note 6)	626,657	586,777

C.【Consolidated Statement of Comprehensive Income】

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Profit for the period	490,242	425,773
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income (Notes 29, 33)	10,735	(3,159)
Remeasurements of defined benefit plans (Notes 22, 29)	(4,102)	(22,202)
Total of items that will not be reclassified to profit or loss	6,633	(25,361)
Items that may be reclassified subsequently to profit or loss		
Exchange differences on translation of foreign operations (Notes 29, 33)	(289,400)	(163,683)
Net gain (loss) on derivatives designated as cash flow hedges (Notes 29, 33)	233	(1,479)
Total of items that may be reclassified subsequently to profit or loss	(289,167)	(165,162)
Other comprehensive income (loss), net of taxes	(282,534)	(190,523)
Comprehensive income (loss) for the period	207,708	235,250
Attributable to:		
Owners of the parent company	203,257	231,590
Non-controlling interests	4,450	3,660
Comprehensive income (loss) for the period	207,708	235,250

D.【Consolidated Statement of Changes in Equity】

(Millions of yen)

	Equity attributable to owners of the parent company						
				Other components of equity			
	Share capital	Capital surplus	Treasury shares	Subscription rights to shares	Exchange differences on translation of foreign operations	Net gain (loss) on derivatives designated as cash flow hedges	Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income
As of January 1, 2015	100,000	736,400	(344,447)	1,631	116,421	1,215	23,156
Profit for the period	—	—	—	—	—	—	—
Other comprehensive income (loss)	—	—	—	—	(288,894)	233	10,500
Comprehensive income (loss) for the period	—	—	—	—	(288,894)	233	10,500
Acquisition of treasury shares (Note 23)	—	—	(100,000)	—	—	—	—
Disposal of treasury shares (Note 23)	—	—	114	(85)	—	—	—
Share-based payments (Note 32)	—	—	—	395	—	—	—
Dividends (Note 24)	—	—	—	—	—	—	—
Changes in the scope of consolidation	—	—	—	—	—	—	(140)
Changes in the ownership interest in a subsidiary without a loss of control	—	—	—	—	—	—	—
Transfer from other components of equity to retained earnings	—	—	—	—	—	—	(232)
Other increase (decrease)	—	—	—	—	—	(1,324)	—
Total transactions with the owners	—	—	(99,886)	310	—	(1,324)	(372)
As of December 31, 2015	100,000	736,400	(444,333)	1,941	(172,473)	125	33,284
Profit for the period	—	—	—	—	—	—	—
Other comprehensive income (loss)	—	—	—	—	(163,169)	(1,479)	(3,069)
Comprehensive income (loss) for the period	—	—	—	—	(163,169)	(1,479)	(3,069)
Acquisition of treasury shares (Note 23)	—	—	(0)	—	—	—	—
Disposal of treasury shares (Note 23)	—	—	512	(413)	—	—	—
Share-based payments (Note 32)	—	—	—	265	—	—	—
Dividends (Note 24)	—	—	—	—	—	—	—
Changes in the scope of consolidation	—	—	—	—	—	—	—
Changes in the ownership interest in a subsidiary without a loss of control	—	—	—	—	—	—	—
Transfer from other components of equity to retained earnings	—	—	—	—	—	—	(360)
Other increase (decrease)	—	—	—	—	—	1,794	—
Total transactions with the owners	—	—	512	(147)	—	1,794	(360)
As of December 31, 2016	100,000	736,400	(443,822)	1,794	(335,642)	440	29,854

(Millions of yen)

	Equity attributable to owners of the parent company					
	Other components of equity					
	Remeasurements of defined benefit plans	Total	Retained earnings	Total	Non-controlling interests	Total equity
As of January 1, 2015	―	142,425	1,902,460	2,536,838	85,665	2,622,503
Profit for the period	―	―	485,691	485,691	4,551	490,242
Other comprehensive income (loss)	(4,272)	(282,433)	―	(282,433)	(101)	(282,534)
Comprehensive income (loss) for the period	(4,272)	(282,433)	485,691	203,257	4,450	207,708
Acquisition of treasury shares (Note 23)	―	―	―	(100,000)	―	(100,000)
Disposal of treasury shares (Note 23)	―	(85)	(29)	0	―	0
Share-based payments (Note 32)	―	395	―	395	―	395
Dividends (Note 24)	―	―	(187,574)	(187,574)	(13,809)	(201,383)
Changes in the scope of consolidation	―	(140)	140	―	(6,044)	(6,044)
Changes in the ownership interest in a subsidiary without a loss of control	―	―	4	4	(321)	(318)
Transfer from other components of equity to retained earnings	4,272	4,040	(4,040)	―	―	―
Other increase (decrease)	―	(1,324)	―	(1,324)	(13)	(1,337)
Total transactions with the owners	4,272	2,886	(191,500)	(288,500)	(20,187)	(308,686)
As of December 31, 2015	―	(137,122)	2,196,651	2,451,596	69,929	2,521,524
Profit for the period	―	―	421,695	421,695	4,078	425,773
Other comprehensive income (loss)	(22,387)	(190,105)	―	(190,105)	(419)	(190,523)
Comprehensive income (loss) for the period	(22,387)	(190,105)	421,695	231,590	3,660	235,250
Acquisition of treasury shares (Note 23)	―	―	―	(0)	―	(0)
Disposal of treasury shares (Note 23)	―	(413)	(99)	0	―	0
Share-based payments (Note 32)	―	265	―	265	4	270
Dividends (Note 24)	―	―	(229,223)	(229,223)	(2,038)	(231,261)
Changes in the scope of consolidation	―	―	―	―	1,069	1,069
Changes in the ownership interest in a subsidiary without a loss of control	―	―	69	69	(675)	(606)
Transfer from other components of equity to retained earnings	22,387	22,027	(22,027)	―	―	―
Other increase (decrease)	―	1,794	―	1,794	―	1,794
Total transactions with the owners	22,387	23,674	(251,280)	(227,094)	(1,639)	(228,733)
As of December 31, 2016	―	(303,554)	2,367,067	2,456,091	71,950	2,528,041

E.【Consolidated Statement of Cash Flows】

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Cash flows from operating activities		
Profit before income taxes	565,113	578,237
Profit before income taxes from discontinued operations	119,009	—
Depreciation and amortization	139,057	140,794
Impairment losses	12,654	1,239
Interest and dividend income	(14,818)	(6,372)
Interest expense	4,030	8,680
Share of profit in investments accounted for using the equity method	(6,381)	(6,489)
(Gains) losses on sale and disposal of property, plant and equipment, intangible assets and investment property	6,697	(33,473)
(Gains) losses on sale of investments in subsidiaries	(134,287)	(26,106)
(Increase) decrease in trade and other receivables	3,866	(20,128)
(Increase) decrease in inventories	(5,272)	(686)
Increase (decrease) in trade and other payables	(6,697)	16,157
Increase (decrease) in retirement benefit liabilities	(5,162)	(4,724)
(Increase) decrease in prepaid tobacco excise taxes	(59,789)	(48,228)
Increase (decrease) in tobacco excise tax payables	31,714	(14,192)
Increase (decrease) in consumption tax payables	(34,585)	2,787
Other	(33,839)	(31,938)
Subtotal	581,310	555,557
Interest and dividends received	22,687	13,064
Interest paid	(3,538)	(6,788)
Income taxes paid (Note 38)	(132,027)	(185,285)
Net cash flows from operating activities	468,432	376,549
Cash flows from investing activities		
Purchase of securities	(1,320)	(2,303)
Proceeds from sale and redemption of securities	3,687	5,340
Purchase of property, plant and equipment	(116,976)	(101,072)
Proceeds from sale of investment property	8,372	42,046
Purchase of intangible assets	(12,123)	(9,929)
Payments into time deposits	(1,002)	(346)
Proceeds from withdrawal of time deposits	977	298
Payments for business combinations (Note 37)	(70,110)	(589,737)
Proceeds from sale of investments in subsidiaries	126,774	26,979
Purchase of investments in associates	—	(52,291)
Other	(1,550)	(6,493)
Net cash flows from investing activities	(63,271)	(687,509)

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Cash flows from financing activities		
Dividends paid to owners of the parent company (Note 24)	(187,646)	(229,261)
Dividends paid to non-controlling interests	(13,734)	(2,011)
Capital contribution from non-controlling interests	―	129
Increase (decrease) in short-term borrowings and commercial paper	5,255	186,570
Proceeds from long-term borrowings	―	856
Repayments of long-term borrowings	(30,147)	(578)
Proceeds from issuance of bonds	114,724	136,181
Redemption of bonds	(40,000)	―
Repayments of finance lease obligations	(2,986)	(569)
Acquisition of treasury shares	(100,000)	(0)
Payments for acquisition of interests in subsidiaries from non-controlling interests	(318)	―
Other	0	0
Net cash flows from financing activities	(254,852)	91,318
Net increase (decrease) in cash and cash equivalents	150,309	(219,643)
Cash and cash equivalents at the beginning of the period	385,820	526,765
Effect of exchange rate changes on cash and cash equivalents	(9,365)	(12,965)
Cash and cash equivalents at the end of the period (Note 7)	526,765	294,157

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 (https://www.jti.co.jp/).

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

The Group’s consolidated financial statements for the year ended December 31, 2016, were approved on March 24, 2017 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 applying Designated International Financial Reporting Standards” 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” (amended in November 2013) (hereinafter referred to as “IFRS 9”) from January 1, 2015.

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

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

(5) Changes in Method of Presentation

“Purchase of investments in subsidiaries,” which was presented in cash flows from investing activities for the prior year, has been presented as “Payments for business combinations” to appropriately reflect the substance of the transaction for the year ended December 31, 2016.

3. Significant Accounting Policies

(1) Basis of Consolidation

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

A. Subsidiaries

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

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

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

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

B. Associates

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

C. Joint Arrangements

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

(2) Business Combination

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

(3) Foreign Currency Translation

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

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

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

(4) Financial Instruments

A. Financial Assets

(i) Initial Recognition and Measurement

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

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

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

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

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

(ii) Subsequent Measurement

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

(a) Financial Assets Measured at Amortized Cost

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

(b) Other Financial Assets

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

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

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

(iii) Derecognition

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

B. Impairment of Financial Assets

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

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

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

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

C. Financial Liabilities

(i) Initial Recognition and Measurement

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

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

(ii) Subsequent Measurement

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

(a) Financial Liabilities Measured at Fair Value through Profit or Loss

Financial liabilities measured at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated as measured at fair value through profit or loss at initial recognition.

(b) Financial Liabilities Measured at Amortized Cost

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

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

• The best estimate of expenditure required to settle the obligation as of the end of the fiscal year, and

• The amount initially recognized less cumulative amortization.

(iii) Derecognition

Financial liabilities are derecognized when the obligation is discharged, canceled or expired.

D. Offsetting of Financial Instruments

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

E. Derivatives and Hedge Accounting

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

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

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

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

(i) Fair Value Hedge

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

(ii) Cash Flow Hedge

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

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

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

(iii) Hedge of Net Investment in Foreign Operations

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

F. Fair Value of Financial Instruments

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

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

(5) Cash and Cash Equivalents

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

(6) Inventories

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

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

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

(7) Property, Plant and Equipment

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

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

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

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

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

(8) Goodwill and Intangible Assets

A. Goodwill

Goodwill is stated at acquisition cost less accumulated impairment losses.

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

B. Intangible Assets

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

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

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

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

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

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

(9) Leases

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

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

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

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

(10) Investment Property

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

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

(11) Impairment of Non-financial Assets

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

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

(12) Non-current Assets Held-for-Sale and Discontinued Operations

A. 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.

B. Discontinued Operations

The Group has classified a business segment that has been disposed of, or is classified as held-for-sale, into discontinued operations.

(13) Post-employment Benefits

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

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

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

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

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

(14) Share-based Payments

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

(15) Provisions

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

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

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

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

(16) Revenue

A. Sale of Goods

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

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

B. Interest Income

Interest income is recognized using the effective interest rate method.

C. Dividend Income

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

D. Royalties

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

(17) Government Grants

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

In the case that the government grants are related to expense items, they are recognized in profit or loss on a systematic basis over the period in which the 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 ventures to the extent that it is probable that the timing of the reversal of the temporary difference in the foreseeable future and it is not probable that future taxable profits will be available against which they can be utilized
- taxable temporary differences arising from investments in subsidiaries and associates, and interests in joint ventures to the extent that the timing of the reversal of the temporary difference is controlled and that it is probable the temporary difference will not reverse in the foreseeable future.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the fiscal year when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted by the fiscal year end.

(20) Treasury Shares

Treasury shares are recognized at cost and deducted from equity. No gain or loss is recognized on the purchase, sale or cancellation of the treasury shares. Any difference between the carrying amount and the consideration paid is recognized in capital surplus.

(21) Earnings per Share

Basic earnings per share are calculated by dividing profit or loss attributable to ordinary shareholders of the parent company by the weighted-average number of ordinary shares outstanding during the year, adjusted by the number of treasury shares. Diluted earnings per share are calculated by adjusting the effects of dilutive potential ordinary shares.

(22) Dividends

Dividend distributions to the shareholders of the Company are recognized as liabilities in the period in which, for year end dividends, the Annual Shareholders’ Meeting approves the distribution and, for interim dividends, the Board of Directors approves the distribution.

(23) Contingencies

A. Contingent Liabilities

The Group discloses contingent liabilities in the notes to consolidated financial statements if it has possible obligations at the fiscal year end, whose existence cannot be confirmed at that date, or if the obligations do not meet the recognition criteria of a provision described in “20. Provisions.”

B. Contingent Assets

The Group discloses contingent assets in the notes to consolidated financial statements if an inflow of future economic benefits to the Group is probable, but not virtually certain at the fiscal year end.

(24) Adjusted Financial Measures

The adjusted financial measures are calculated by adding certain adjustment items to the non-adjusted financial data or by deducting the items from the non-adjusted financial data.

The adjustment items are determined by management’s judgment, taking into consideration the nature and frequency of the income and costs such that they provide effective comparative information on the Group performance and that they reflect the way of managing our business appropriately. Adjusted financial measures are presented in the consolidated statement of income and “6. Operating Segments.”

The adjusted financial measures are not defined under IFRS and are not comparable with equivalent indicators for other entities.

(Changes in Accounting Policies)

The Group has adopted the following new accounting standards, amended standards and new interpretations from the fiscal year ended December 31, 2016.

IFRS		Description of new standards and amendments
IAS 19	Employee Benefits	Clarifying the method of determining the discount rate for post-employment benefit obligations

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

4. Significant Accounting Estimates and Judgments

Preparation of consolidated financial statements of the Group requires management estimates and assumptions in order to measure income, expenses, assets and liabilities, and disclose contingencies as of the fiscal year end date. These estimates and assumptions are based on the best judgment of management in light of historical experience and various factors deemed to be reasonable as of the fiscal year end date. Given their nature, actual results may differ from those estimates and assumptions.

The estimates and assumptions are continuously reviewed by management. The effects of a change in estimates and assumptions are recognized in the period of the change or the period of the change and future periods.

Among the above estimates and assumptions, the following are items that may have a material effect on the amounts recognized in the consolidated financial statements of the Group:

A. Impairment of Property, Plant and Equipment, Goodwill, Intangible Assets and Investment Properties

With regard to property, plant and equipment, goodwill, intangible assets and investment properties, if there is any indication that the recoverable amount declines below the carrying amounts of the assets, the Group performs an impairment test.

The important indications include significant changes with adverse effect on the results of past or projected business performance, significant changes in the use of acquired assets or in overall business strategy, and significant deteriorations in industry trends and economic trends. With regard to goodwill, an impairment test is conducted at least once a year, regardless of any indication of impairment, in order to ensure that the recoverable amount exceeds the carrying amount.

The impairment test is performed by comparing the carrying amount and the recoverable amount of assets. If the recoverable amount declines below the carrying amount, impairment losses are recognized. The recoverable amount is mainly calculated based on the discounted cash flow model. Certain assumptions are made for the useful lives and the future cash flows of the assets, discount rates and long-term growth rates. These assumptions are based on the best estimates and judgments made by management; however, there is a possibility that these assumptions may be affected by changes in uncertain future economic conditions, which may have a material impact on the consolidated financial statements in future periods.

The method for calculating the recoverable amount is described in “13. Property, Plant and Equipment,” “14. Goodwill and Intangible Assets” and “16. Investment Property.” With regard to goodwill, the sensitivity analysis is described in “14. Goodwill and Intangible Assets.”

B. Post-employment Benefits

The Group has various types of retirement benefit plans, including defined benefit plans. In addition, the mutual pension benefits plan of the Company is one of the public pension systems under the jurisdiction of the government of Japan and the Company is legally obligated to bear a part of the pension costs of the plan.

The present value of defined benefit obligations on each of these plans and the related service costs are calculated based on actuarial assumptions. These actuarial assumptions require estimates and judgments on variables, such as discount rates and inflation rate.

The Group obtains advice from external pension actuaries with respect to the appropriateness of these actuarial assumptions including these variables.

The actuarial assumptions are determined based on the best estimates and judgments made by management; however, there is a possibility that these assumptions may be affected by changes in uncertain future economic conditions, or by the publication or the amendment of related laws, which may have a material impact on the consolidated financial statements in future periods.

These actuarial assumptions and the related sensitivity analysis are described in “22. Employee Benefits.”

C. Provisions

The Group recognizes various provisions, including provisions for asset retirement obligations and restructuring, in the consolidated statement of financial position.

These provisions are recognized based on the best estimates of the expenditures required to settle the obligations taking risks and uncertainty related to the obligations into account as of the fiscal year end date.

Expenditures required to settle the obligations are calculated by taking possible results into account comprehensively; however, they may be affected by the occurrence of unexpected events or changes in conditions which may have a material impact on the consolidated financial statements in future periods.

The nature and amount of recognized provisions are described in “20. Provisions.”

D. Income Taxes

The Group operates business activities around the world, and it recognizes current tax liabilities and income taxes as the estimated amounts to be paid to the tax authorities, based on the estimation in accordance with their laws and regulations.

Calculating current tax liabilities and income taxes requires estimates and judgment on various factors, including the interpretation of tax regulations by taxable entities and the tax authority in the jurisdiction or the experience of past tax audits.

Therefore, there may be differences between the amount recognized as tax liabilities and income taxes and the amount of actual tax liabilities and income taxes. These differences may have a material impact on the consolidated financial statements in future periods.

In addition, deferred tax assets are recognized to the extent that it is probable that taxable income will be available against which deductible temporary differences can be utilized.

In recognizing the deferred tax assets, when judging the possibility of the future taxable income, we reasonably estimate the timing and amount of future taxable income based on the business plan.

The timing when taxable income arises and the amount of such income may be affected by changes in uncertain future economic conditions. Therefore, this may have a material impact on the consolidated financial statements in future periods.

The content and amount related to income taxes are described in “17. Income Taxes.”

E. Contingencies

With regard to contingencies, any items that may have a material impact on business in the future are disclosed in light of all the available evidence as of the fiscal year end date and by taking into account the probability of these contingencies and their impact on financial reporting.

The content of contingencies is described in “39. Contingencies.”

5. New Accounting Standards Not Yet Adopted by the Group

By the date of approval of the consolidated financial statements, new accounting standards, amended standards and new interpretations that have been issued, but have not been early adopted by the Group are as follows.

The implications from adoption of these standards and interpretations are assessed by the Group; however, we evaluate that none of them will have a material impact on our operating results and financial condition.

IFRS		Mandatory adoption (From the year beginning)	To be adopted by the Group	Description of new standards and amendments
IFRS 1	First-time Adoption of International Financial Reporting Standards	January 1, 2018	Fiscal year ending December 2018	Deleting short-term exemptions for first-time adopters
IFRS 2	Share-based Payment	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for the effects of vesting conditions on cash-settled share-based payment transactions
IFRS 4	Insurance Contracts	January 1, 2018	Fiscal year ending December 2018	Adding the option to defer the adoption of IFRS 9 for entities engaging mainly in insurance business
IFRS 9	Financial Instruments	January 1, 2018	Fiscal year ending December 2018	Limited changes to classification and measurement of financial assets, and introduction of an expected credit loss impairment model
IFRS 12	Disclosure of Interests in Other Entities	January 1, 2017	Fiscal year ending December 2017	Clarifying the scope for adoption of the Standard
IFRS 15	Revenue from Contracts with Customers	January 1, 2018	Fiscal year ending December 2018	Amendments to accounting treatment for recognizing revenue
IFRS 16	Leases	January 1, 2019	Fiscal year ending December 2019	Amendments to accounting treatment for lease arrangements
IAS 7	Statement of Cash Flows	January 1, 2017	Fiscal year ending December 2017	Requiring disclosure of changes in liabilities arising from financing activities
IAS 12	Income Taxes	January 1, 2017	Fiscal year ending December 2017	Clarifying the requirements for the recognition of deferred tax assets for unrealized losses
IAS 28	Investments in Associates and Joint Ventures	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for investments in associates and joint ventures
IAS 40	Investment Property	January 1, 2018	Fiscal year ending December 2018	Clarifying the rules for transfers of property to or from investment property
IFRIC 22	Foreign Currency Transactions and Advance Consideration	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for the transactions that include payment/receipt of advance consideration in a foreign currency
IFRS 10 IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	Not yet determined	Not yet determined	Amendments to accounting treatment for sale or contribution of assets between an investor and its associate or joint venture

6. Operating Segments

(1) Outline of Reportable Segments

The reportable segments of the Group are determined based on the operating segments that are components of the Group for which separate financial information is available and are evaluated regularly by the Board of Directors in deciding how to allocate resources and in assessing performance.

The Group is mainly engaged in the manufacture and sale of tobacco products, prescription drugs and processed foods. With respect to tobacco products, operations are managed separately for domestic and overseas markets. The reportable segments of the Group are composed of four segments: “Domestic Tobacco Business,” “International Tobacco Business,” “Pharmaceutical Business,” and “Processed Food Business.” They are determined by types of products, characteristics, and markets.

The “Domestic Tobacco Business” manufactures and sells tobacco products in domestic areas (which include duty-free shops in Japan and markets in China, Hong Kong, and Macau where the Company’s China Division operates). The “International Tobacco Business” manufactures and sells tobacco products overseas mainly through JT International S.A., which controls manufacturing and sales operations. The “Pharmaceutical Business” consists of research and development, and the manufacture and sale of prescription drugs. The “Processed Food Business” consists of the manufacture and sale of frozen and ambient processed foods, bakery products and seasonings.

(2) Revenues and Performances of Reportable Segments

Revenues and performances of reportable segments from continuing operations are as follows. The Board of Directors assesses the segment performance and determines resource allocation after reviewing revenues and adjusted operating profit. Since financial income, financial costs and income taxes are managed by the Group head office, these income and expenses are excluded from segment performance. Transactions within the segments are based mainly on prevailing market prices.

Year ended December 31, 2015 (Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Revenue								
External revenue (Note 3)	677,331	1,317,178	75,564	165,843	2,235,916	16,968	—	2,252,884
Intersegment revenue	20,342	46,738	—	37	67,117	9,858	(76,976)	—
Total revenue	697,672	1,363,917	75,564	165,880	2,303,034	26,826	(76,976)	2,252,884
Segment profit (loss)								
Adjusted operating profit (Note 1)	254,053	394,395	(2,315) ,	2,728	648,860	(21,802)	(402)	626,657
Other items								
Depreciation and amortization	43,668	76,007	4,603	6,476	130,754	2,673	(303)	133,123
Impairment losses on other than financial assets	1,168	4,393	187	56	5,805	3,757	(47)	9,516
Reversal of impairment losses on other than financial assets	—	276	—	—	276	—	—	276
Share of profit (loss) in investments accounted for using the equity method	61	6,252	—	37	6,351	30	—	6,381
Capital expenditures	37,416	77,217	6,200	5,651	126,484	3,970	(703)	129,751

Year ended December 31, 2016 (Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Revenue								
External revenue (Note 3)	684,233	1,199,190	87,183	164,078	2,134,683	8,604	—	2,143,287
Intersegment revenue	18,245	30,280	—	30	48,554	9,653	(58,207)	—
Total revenue	702,478	1,229,470	87,183	164,108	2,183,237	18,257	(58,207)	2,143,287
Segment profit (loss)								
Adjusted operating profit (Note 1)	260,205	336,227	9,717	4,998	611,146	(24,725)	356	586,777
Other items								
Depreciation and amortization	57,994	69,129	4,908	6,423	138,453	2,675	(335)	140,794
Impairment losses on other than financial assets	54	615	—	16	685	554	—	1,239
Reversal of impairment losses on other than financial assets	—	27	—	—	27	—	—	27
Share of profit (loss) in investments accounted for using the equity method	33	6,327	—	(4)	6,355	134	—	6,489
Capital expenditures	29,820	70,592	3,823	5,707	109,942	3,902	(847)	112,998

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

Year ended December 31, 2015

(Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Adjusted operating profit (Note 1)	254,053	394,395	(2,315)	2,728	648,860	(21,802)	(402)	626,657
Amortization cost of acquired intangibles arising from business acquisitions	―	(31,875)	―	―	(31,875)	―	―	(31,875)
Adjustment items (income) (Note 4)	97	3,548	―	464	4,108	6,238	―	10,346
Adjustment items (costs) (Note 4)	(4,946)	(19,148)	―	(9)	(24,103)	(15,798)	―	(39,900)
Operating profit (loss)	249,204	346,921	(2,315)	3,182	596,992	(31,361)	(402)	565,229
Financial income								15,016
Financial costs								(15,132)
Profit before income taxes								565,113

Year ended December 31, 2016

(Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Adjusted operating profit (Note 1)	260,205	336,227	9,717	4,998	611,146	(24,725)	356	586,777
Amortization cost of acquired intangibles arising from business acquisitions	(16,245)	(30,522)	―	―	(46,767)	―	―	(46,767)
Adjustment items (income) (Note 4)	282	34	―	2	318	64,894	―	65,212
Adjustment items (costs) (Note 4)	(137)	(3,960)	―	(8)	(4,105)	(7,789)	―	(11,894)
Operating profit (loss)	244,106	301,779	9,717	4,991	560,592	32,380	356	593,329
Financial income								6,618
Financial costs								(21,710)
Profit before income taxes								578,237

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

(Note 2) "Other" includes business activities relating to rent of real estate and corporate expenses relating to corporate communication and operation of the head office.

(Note 3) Core revenue as part of the "Domestic Tobacco Business" and the "International Tobacco Business" is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Domestic Tobacco	642,240	649,744
International Tobacco	1,252,496	1,138,805

(Note 4) "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.

The breakdown of restructuring income is described in "26. Other Operating Income." Restructuring costs included in "Cost of sales" were ¥57 million for the year ended December 31, 2015. Restructuring costs included in "Selling, general and administrative expenses" were ¥39,843 million and ¥11,894 million for the years ended December 31, 2015 and 2016, 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)" is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Restructuring costs	39,900	11,894
Adjustment items (costs)	39,900	11,894

Restructuring costs for the year ended December 31, 2015 mainly relate to rationalization of distribution system and factory platform in some markets in the "International Tobacco Business" and disposal of real estate. Restructuring costs for the year ended December 31, 2016 mainly relate to disposal of real estate.

(3) Geographic Information

The regional breakdown of non-current assets and external revenue from continuing operations as of each fiscal year end is as follows:

Non-current Assets

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Japan	461,265	833,543
Overseas	2,005,979	1,891,433
Consolidated	2,467,244	2,724,975

(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 from Continuing Operations

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Japan	894,710	889,742
Overseas	1,358,174	1,253,545
Consolidated	2,252,884	2,143,287

(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 ¥293,541 million (13.0% of consolidated revenue) for the year ended December 31, 2015 and ¥235,932 million (11.0% of consolidated revenue) for the year ended December 31, 2016.

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 December 31, 2015	As of December 31, 2016
Cash and deposits	399,265	234,957
Short-term investments	127,499	59,200
Total	526,765	294,157

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

8. Trade and Other Receivables

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

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Note and account receivables	392,882	386,708
Other	15,316	11,742
Allowance for doubtful accounts	(1,812)	(1,515)
Total	406,387	396,934

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 December 31, 2015	As of December 31, 2016
Merchandise and finished goods (Note 1)	162,208	176,702
Leaf tobacco (Note 2)	344,623	324,802
Other	56,989	57,343
Total	563,820	558,846

(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 December 31, 2015	As of December 31, 2016
Derivative assets	7,106	11,769
Equity securities	72,795	65,548
Debt securities	6,600	4,572
Time deposits	994	965
Other	39,614	38,345
Allowance for doubtful accounts	(7,533)	(6,920)
Total	119,576	114,279
Current assets	17,849	14,921
Non-current assets	101,727	99,358
Total	119,576	114,279

Other financial assets are presented net of allowance for doubtful accounts in the consolidated statement of financial position.

Derivative assets are classified as financial assets measured at fair value through profit or loss excluding those to which hedge accounting is applied, equity securities are classified as financial assets measured at fair value through other comprehensive income, and time deposits and debt securities are classified as financial assets measured at amortized cost.

(2) Names of major securities held as financial assets measured at fair value through other comprehensive income and their fair values as of each fiscal year end are as follows:

(Millions of yen)

Company name	As of December 31, 2015	As of December 31, 2016
KT&G Corporation	30,926	28,010
Seven & i Holdings Co., Ltd.	4,747	3,808
DOUTOR・NICHIRES Holdings Co., Ltd.	2,496	2,872
Mizuho Financial Group, Inc.	3,114	2,683
Mitsubishi UFJ Financial Group, Inc.	2,668	2,165
Mitsubishi Shokuhin Co., Ltd.	1,794	2,089

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 December 31, 2015	Year ended December 31, 2016
Fair value	800	1,532
Cumulative gain or loss recognized in equity as other comprehensive income (Note)	(232)	(360)

(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 December 31, 2015	As of December 31, 2016
Prepaid tobacco excise taxes	219,942	274,157
Prepaid expenses	14,144	15,743
Consumption tax receivables	17,125	18,575
Other	29,282	31,836
Total	280,493	340,312

12. Non-current Assets Held-for-Sale

The breakdown of “Non-current assets held-for-sale” as of each fiscal year end is as follows:

Breakdown of Major Assets

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Non-current assets held-for-sale		
Property, plant and equipment	105	309
Investment property	2,799	512
Total	2,904	821

“Non-current assets held-for-sale” are mainly rental properties and idle properties which are currently actively marketed for sale.

With regard to such assets and assets sold, impairment losses from continuing operations of ¥47 million are recognized in “Selling, general and administrative expenses” in the consolidated statement of income for the year ended December 31, 2015.

13. Property, Plant and Equipment

(1) Schedule of Property, Plant and Equipment

The schedules of the carrying amount, acquisition cost, and accumulated depreciation and accumulated impairment losses of "Property, plant and equipment" are as follows:

(Millions of yen)

Carrying Amount	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2015	325,895	292,404	66,622	71,206	756,127
Individual acquisition	27,483	29,903	20,601	42,433	120,420
Acquisition through business combinations	560	3,538	69	1	4,168
Transfer to investment property	(19,439)	(90)	(192)	−	(19,721)
Transfer to non-current assets held-for-sale	(193)	(415)	(0)	−	(608)
Depreciation	(16,380)	(54,478)	(19,237)	−	(90,094)
Impairment losses	(1,988)	(2,826)	(3,133)	(56)	(8,003)
Reversal of impairment losses	−	229	1	46	276
Sale or disposal	(2,025)	(4,103)	(3,836)	(189)	(10,154)
Decrease resulting from transfer of subsidiaries	(5,617)	(4,732)	(14,059)	−	(24,407)
Exchange differences on translation of foreign operations	(14,886)	(23,311)	(2,475)	(3,964)	(44,635)
Other	46,130	13,041	1,994	(62,667)	(1,503)
As of December 31, 2015	339,542	249,160	46,355	46,808	681,865
Individual acquisition	13,053	30,787	12,390	43,758	99,989
Acquisition through business combinations	1,066	451	241	3	1,762
Transfer to investment property	(5,702)	(9)	(16)	−	(5,726)
Transfer to non-current assets held-for-sale	(180)	−	(0)	−	(180)
Depreciation	(15,709)	(47,121)	(14,670)	−	(77,500)
Impairment losses	(24)	(537)	(3)	(10)	(575)
Reversal of impairment losses	−	8	19	−	27
Sale or disposal	(507)	(3,646)	(736)	(162)	(5,050)
Exchange differences on translation of foreign operations	(4,722)	(8,864)	(766)	(4,252)	(18,604)
Other	17,420	25,963	1,377	(39,932)	4,827
As of December 31, 2016	344,237	246,192	44,193	46,213	680,835

(Millions of yen)

Acquisition Cost	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2015	661,172	804,276	188,732	71,206	1,725,386
As of December 31, 2015	633,789	706,561	144,618	46,808	1,531,776
As of December 31, 2016	643,073	693,378	147,223	46,213	1,529,888

(Millions of yen)

Accumulated Depreciation and Accumulated Impairment Losses	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2015	335,277	511,872	122,110	―	969,259
As of December 31, 2015	294,247	457,401	98,263	―	849,910
As of December 31, 2016	298,836	447,187	103,030	―	849,053

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

(Millions of yen)

	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Total
As of January 1, 2015	6,910	5,250	6,766	18,926
As of December 31, 2015	6,801	1,853	9	8,662
As of December 31, 2016	6,538	1,201	7	7,746

(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 from continuing operations of ¥5,185 million for the year ended December 31, 2015, and ¥575 million for the year ended December 31, 2016 in “Selling, general and administrative expenses” in the consolidated statement of income.

Impairment losses recognized in the year ended December 31, 2015 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.”

Impairment losses recognized in the year ended December 31, 2016 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles due to decision of individual selection for demolition.

The recoverable amounts of these assets are calculated mainly by their values in use, which are set at “zero.”

14. Goodwill and Intangible Assets

(1) Schedule of Goodwill and Intangible Assets

The schedules of carrying amount, acquisition cost, and accumulated amortization and accumulated impairment losses of “Goodwill” and “Intangible assets” are as follows:

(Millions of yen)

Carrying Amount	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2015	1,539,376	301,960	35,856	27,096	1,904,288
Individual acquisition	—	794	7,232	7,024	15,051
Acquisition through business combinations	65,252	14,967	8	8,740	88,967
Amortization (Note)	—	(30,216)	(12,852)	(5,040)	(48,107)
Impairment losses	—	—	(268)	(362)	(631)
Sale or disposal	—	(0)	(316)	(140)	(456)
Decrease resulting from transfer of subsidiaries	(882)	(0)	(193)	(3,022)	(4,097)
Exchange differences on translation of foreign operations	(174,516)	(20,182)	(172)	(206)	(195,076)
Other	57	1,505	4,124	(3,858)	1,827
As of December 31, 2015	1,429,287	268,828	33,418	30,232	1,761,765
Individual acquisition	—	222	5,597	6,852	12,670
Acquisition through business combinations	289,720	180,297	8	2,243	472,268
Amortization (Note)	—	(44,154)	(12,795)	(5,696)	(62,645)
Impairment losses	—	—	(102)	—	(102)
Sale or disposal	—	—	(90)	(40)	(130)
Exchange differences on translation of foreign operations	(114,709)	(40,315)	(406)	(280)	(155,710)
Other	(2,312)	17	1,448	(1,314)	(2,161)
As of December 31, 2016	1,601,987	364,896	27,078	31,996	2,025,957

(Note) The amortization of intangible assets is included in “Cost of sales” and “Selling, general and administrative expenses” in the consolidated statement of income. The amortization of intangible assets from discontinued operations for the year ended December 31, 2015 is included in “Profit for the period from discontinued operations.”

(Millions of yen)

Acquisition Cost	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2015	1,539,376	845,499	132,309	92,280	2,609,465
As of December 31, 2015	1,429,287	818,982	135,951	92,062	2,476,282
As of December 31, 2016	1,601,987	928,876	137,761	96,994	2,765,618

(Millions of yen)

Accumulated Amortization and Accumulated Impairment Losses	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2015	—	543,539	96,453	65,184	705,177
As of December 31, 2015	—	550,154	102,533	61,830	714,517
As of December 31, 2016	—	563,981	110,683	64,997	739,661

(2) Material Goodwill and Intangible Assets

Goodwill and intangible assets recognized in the consolidated statement of financial position are mainly composed of goodwill and trademarks in the JTIH Group. The carrying amounts of goodwill as of December 31, 2015 and 2016 were ¥1,387,593 million and ¥1,310,727 million, respectively. The carrying amounts of trademarks as of December 31, 2015 and 2016 were ¥266,521 million and ¥216,617 million, respectively.

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

Other than the above, goodwill and trademark in Domestic Tobacco business were recognized as a result of the acquisition of Natural American Spirit’s non-U.S. tobacco operations in 2016 and the carrying amounts are ¥265,891 million for goodwill and ¥148,260 million for trademark as of December 31, 2016.

The trademarks are amortized using the straight-line method and the remaining amortization period is mainly from 9 to 10 years.

(3) Impairment Test for Goodwill

For the year ended December 31, 2016, the carrying amount of the majority of goodwill is allocated to the domestic tobacco cash-generating unit of ¥265,891 million, the international tobacco cash-generating unit of ¥1,310,727 million (¥1,387,593 million for the year ended December 31, 2015) and the processed food cash-generating unit of ¥25,368 million (¥25,368 million for the year ended December 31, 2015). Details of the result of impairment tests are as follows:

A. Domestic Tobacco Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group conservatively decreases a growth rate from 2.9% in the fourth year to 0% in the ninth year gradually, and calculates the value in use from the tenth year by using the same cash flows as the ninth year.

The discount rate before taxes is 4.6%. The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

B. International Tobacco Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group sets a growth rate from 2.8% in the fourth year (Prior year: 3.2%) to 1.4% in the ninth year (Prior year: 3.8%), and the same growth rate as the ninth year from the tenth year as a continued growth rate for inflation.

The discount rate before taxes is 9.7% (Prior year: 11.7%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

C. Processed Food Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group sets a growth rate from 1.6% in the fourth year (Prior year: 2.8%) to 1.0% in the ninth year (Prior year: 1.1%), 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: 4.1%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

(4) Impairment Losses

Goodwill is allocated to cash-generating units that are identified according to locations and types of businesses. The grouping of intangible assets for impairment test is the smallest cash-generating unit that independently generates cash inflow.

The Group recognized impairment losses from continuing operations of ¥311 million for the year ended December 31, 2015, and ¥102 million for the year ended December 31, 2016 in “Selling, general and administrative expenses” in the consolidated statement of income.

15. Lease Transactions

The Group leases factory sites, vehicles and other assets as a lessee. Some of the lease contracts have renewal options or escalation clauses. There are no restrictions on additional debt and further leasing imposed by the lease arrangements.

(1) Present Value of Finance Lease Obligations

The total of future minimum lease payments for leased assets recognized based on the finance lease contracts, their present value and future financial costs as of each fiscal year end are as follows:

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Not later than 1 year		
Total of future minimum lease payments	702	589
Future financial costs	149	218
Present value	553	372
Later than 1 year and not later than five years		
Total of future minimum lease payments	2,201	1,696
Future financial costs	1,062	1,018
Present value	1,140	678
Later than 5 years		
Total of future minimum lease payments	10,066	9,489
Future financial costs	3,385	2,838
Present value	6,680	6,652
Total		
Total of future minimum lease payments	12,969	11,775
Future financial costs	4,596	4,074
Present value	8,373	7,701

(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 December 31, 2015	As of December 31, 2016
Not later than 1 year	6,446	7,287
Later than 1 year and not later than 5 years	8,968	8,382
Later than 5 years	7,419	7,871
Total	22,833	23,539

(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 from continuing operations for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Total of minimum lease payments	11,621	8,099
Contingent rents	1,057	1,147

16. Investment Property

(1) Schedule of Investment Property

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

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Balance at the beginning of the period	17,870	23,614
Expenditure after acquisition	556	338
Transfer from property, plant and equipment	19,721	5,726
Transfer to non-current assets held-for-sale	(3,560)	(3,130)
Transfer to property, plant and equipment	(731)	(1,799)
Depreciation	(856)	(649)
Impairment losses	(3,973)	(562)
Sale or disposal	(5,399)	(1,904)
Exchange differences on translation of foreign operations	(8)	(5)
Other	(6)	(3,446)
Balance at the end of the period	23,614	18,184
Acquisition cost at the beginning of the period	46,084	69,106
Accumulated depreciation and accumulated impairment losses at the beginning of the period	28,214	45,493
Acquisition cost at the end of the period	69,106	51,245
Accumulated depreciation and accumulated impairment losses at the end of the period	45,493	33,061

The investment properties as of December 31, 2016 are mainly idle properties.

(2) Fair Value

The fair value of investment property is determined based on a valuation conducted by an external real estate appraiser. The valuation is made in accordance with the appraisal standards of the country where the investment property is located and based on market evidence of transaction prices for similar assets.

The fair value hierarchy of investment property is categorized from Level 1 to Level 3 as follows:

Level 1: Fair value measured at the quoted price in the active market
Level 2: Fair value that is calculated using the observable price other than categorized in Level 1 directly or indirectly
Level 3: Fair value that is calculated based on valuation techniques which include inputs that are not based on observable market data

The fair value of investment property based on the fair value hierarchy as of each fiscal year end is as follows:

As of December 31, 2015

(Millions of yen)

	Level 1	Level 2	Level 3	Total
Investment property	－	64,829	3,526	68,355

As of December 31, 2016

(Millions of yen)

	Level 1	Level 2	Level 3	Total
Investment property	－	45,763	1,570	47,334

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

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Investment property	23,614	18,184

(3) Impairment Losses

The grouping of investment properties for impairment test is based on the smallest cash-generating unit that independently generates cash inflow. Impairment test for idle properties is carried out individually.

The Group recognized impairment losses from continuing operations of ¥3,973 million for the year ended December 31, 2015, and ¥562 million for the year ended December 31, 2016 in “Selling, general and administrative expenses” in the consolidated statement of income.

Impairment losses recognized for the year ended December 31, 2015 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 year ended December 31, 2016 represent the difference between the recoverable amount and the carrying amount of land and buildings as idle properties were individually selected for demolition. The recoverable amount is calculated based on value in use basis, which is zero for buildings due to the decision of demolition, and the recoverable amount of other properties is calculated by the fair value less costs of disposal.

17. Income Taxes

(1) Deferred Tax Assets and Deferred Tax Liabilities

The breakdown and schedule of "Deferred tax assets" and "Deferred tax liabilities" by major causes of their occurrence for each fiscal year are as follows:

Year ended December 31, 2015

(Millions of yen)

Deferred Tax Assets	As of January 1, 2015	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2015
Fixed assets (Note 2)	45,228	(4,868)	–	32	40,392
Retirement benefits	124,330	(25,886)	(3,495)	(3,080)	91,870
Carryforward of unused tax losses	63,050	1,479	–	(6,946)	57,582
Other	85,684	(1,513)	(4,860)	(2,472)	76,839
Subtotal	318,292	(30,788)	(8,355)	(12,466)	266,683
Valuation allowance	(66,478)	(4,403)	(611)	5,704	(65,788)
Total	251,814	(35,191)	(8,966)	(6,762)	200,895

(Millions of yen)

Deferred Tax Liabilities	As of January 1, 2015	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2015
Fixed assets (Note 2)	(115,753)	24,602	–	3,236	(87,915)
Retirement benefits	(7,334)	(476)	(502)	615	(7,696)
Other	(106,722)	(913)	2,147	4,794	(100,693)
Total	(229,809)	23,214	1,646	8,645	(196,305)

Year ended December 31, 2016

(Millions of yen)

Deferred Tax Assets	As of January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2016
Fixed assets (Note 2)	40,392	(12,218)	—	108,540	136,713
Retirement benefits	91,870	(11,902)	1,441	(1,468)	79,940
Carryforward of unused tax losses	57,582	(2,029)	—	(2,419)	53,135
Other	76,839	(1,372)	4,192	(3,688)	75,971
Subtotal	266,683	(27,522)	5,633	100,966	345,760
Valuation allowance	(65,788)	322	1,914	2,320	(61,231)
Total	200,895	(27,200)	7,547	103,285	284,528

(Millions of yen)

Deferred Tax Liabilities	As of January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2016
Fixed assets (Note 2)	(87,915)	11,097	—	3,013	(73,805)
Retirement benefits	(7,696)	234	1,824	1,132	(4,506)
Other	(100,693)	(7,467)	(9,030)	5,931	(111,260)
Total	(196,305)	3,864	(7,206)	10,075	(189,572)

(Note 1) “Other” includes exchange differences on translation of foreign operations and acquisition through business combinations. The outline of the major business combination and the deferred tax assets recognized in the year ended December 31, 2016 are described in “37. Business Combinations.”
(Note 2) “Fixed assets” include property, plant and equipment, goodwill, intangible assets and investment property.

The deferred tax assets are recognized for the amount considered to be recoverable on deductible temporary differences, carryforward of unused tax losses and tax credits by taking taxable temporary differences and future taxable profits plan into account. The carryforward of unused tax losses, for which the deferred tax assets are not recognized, was ¥47,738 million (including ¥14,609 million, for which the carryforward expires after five years) as of December 31, 2015, and ¥44,484 million (including ¥12,644 million, for which the carryforward expires after five years) as of December 31, 2016. Tax credits, for which the deferred tax assets are not recognized, were ¥3,953 million (including ¥3,669 million, for which the carryforward expires after five years) as of December 31, 2015, and ¥4,951 million (including ¥4,541 million, for which the carryforward expires after five years) as of December 31, 2016.

(2) Income Taxes

The breakdown of "Income taxes" from continuing operations for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Current income taxes	150,774	129,128
Deferred income taxes	11,612	23,336
Total income taxes	162,386	152,464

Deferred income taxes decreased by ¥1,358 million and increased by ¥167 million for the years ended December 31, 2015 and 2016, 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 in continuing operations for each fiscal year is as follows:

The Company is subject mainly to corporate tax, inhabitant tax and enterprise tax, and the effective statutory tax rate is calculated based on these taxes. The corporate tax rate and other tax rates were changed for the year ended December 31, 2016 and the effective statutory tax rates were 35.41% and 32.78% for the years ended December 31, 2015 and 2016, respectively. Foreign subsidiaries are subject to income taxes at their locations.

(%)

	Year ended December 31, 2015	Year ended December 31, 2016
Effective statutory tax rate	35.41	32.78
Different tax rates applied to foreign subsidiaries	(10.20)	(7.62)
Non-deductible expenses	0.53	1.31
Valuation allowance	1.74	(0.03)
Other	1.26	(0.08)
Average actual tax rate	28.74	26.37

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 December 31, 2015	As of December 31, 2016
Accounts payable	178,709	188,285
Other payables	104,193	85,646
Other	90,130	104,002
Total	373,032	377,933

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 December 31, 2015	As of December 31, 2016	Average interest rate (Note1)	Due
Derivative liabilities	5,595	12,516	—	—
Short-term borrowings	30,832	187,949	1.99	—
Current portion of long-term borrowings	148	572	1.63	—
Current portion of bonds (Note 2)	—	20,000	—	—
Long-term borrowings	866	877	3.34	2018–2028
Bonds (Note 2)	215,072	338,158	—	—
Other	11,007	9,516	—	—
Total	263,520	569,589		
Current liabilities	37,439	221,544		
Non-current liabilities	226,080	348,045		
Total	263,520	569,589		

(Note 1) The average interest rate is calculated using the interest rate and outstanding balance as of December 31, 2016.

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

Company	Name of bond	Date of issuance	As of December 31, 2015 (Millions of yen)	As of December 31, 2016 (Millions of yen)	Interest rate (%)	Collateral	Date of maturity
Japan Tobacco Inc.	7th domestic straight bond	December 9, 2010	20,000	20,000 (20,000)	0.84	Yes	December 8, 2017
Japan Tobacco Inc.	8th domestic straight bond	December 9, 2010	20,000	20,000	1.30	Yes	December 9, 2020
Japan Tobacco Inc.	9th domestic straight bond	July 15, 2015	60,000	60,000	0.22	Yes	July 15, 2020
Japan Tobacco Inc.	10th domestic straight bond	July 15, 2015	30,000	30,000	0.36	Yes	July 15, 2022
Japan Tobacco Inc.	11th domestic straight bond	July 15, 2015	25,000	25,000	0.60	Yes	July 15, 2025
Japan Tobacco Inc.	Straight bond in USD	July 23, 2013	60,072 [USD 500 mil.]	58,106 [USD 500 mil.]	2.10	Yes	July 23, 2018
Japan Tobacco Inc.	Straight bond in USD	April 13, 2016	—	87,109 [USD 750 mil.]	2.00	Yes	April 13, 2021
Japan Tobacco Inc.	Straight bond in USD	April 13, 2016	—	57,943 [USD 500 mil.]	2.80	Yes	April 13, 2026
	Total		215,072 (—)	358,158 (20,000)			

(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.

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

There are no financial covenants that have a significant impact on the Group on the bonds and borrowings.

(2) Assets Pledged as Collateral for Liabilities

A. Pursuant to the provisions of Article 6 of the Japan Tobacco Inc. Act, the Company’s properties are pledged as general collateral for bonds issued by the Company. Bondholders are entitled to claim satisfaction in preference to unsecured creditors of the Company properties (with the exception of national and local taxes and certain other statutory obligations).

B. Assets pledged as collateral by some subsidiaries are ¥70 million and ¥66 million as of December 31, 2015 and 2016, respectively. Their corresponding debts are ¥82 million and ¥53 million as of December 31, 2015 and 2016, respectively.

20. Provisions

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

Year ended December 31, 2015

(Millions of yen)

	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of January 1, 2015	2,742	22,954	3,994	4,935	34,624
Provisions	498	15,039	3,323	742	19,603
Interest cost associated with passage of time	36	—	—	—	36
Provisions used	(100)	(13,416)	(3,941)	(1,149)	(18,606)
Provisions reversed	(447)	(1,161)	(53)	(3,299)	(4,960)
Exchange differences on translation of foreign operations	—	(2,150)	—	(40)	(2,190)
As of December 31, 2015	2,728	21,267	3,323	1,189	28,507
Current liabilities	—	15,058	3,323	915	19,297
Non-current liabilities	2,728	6,209	—	273	9,210
Total	2,728	21,267	3,323	1,189	28,507

Year ended December 31, 2016

(Millions of yen)

	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of January 1, 2016	2,728	21,267	3,323	1,189	28,507
Provisions	685	4,774	3,459	450	9,368
Interest cost associated with passage of time	31	—	—	—	31
Provisions used	(85)	(13,414)	(3,323)	(430)	(17,253)
Provisions reversed	(10)	(748)	—	(153)	(911)
Exchange differences on translation of foreign operations	—	(2,755)	—	(35)	(2,790)
As of December 31, 2016	3,348	9,124	3,459	1,021	16,952
Current liabilities	26	8,287	3,459	757	12,529
Non-current liabilities	3,322	837	—	264	4,423
Total	3,348	9,124	3,459	1,021	16,952

A. Asset Retirement Provisions

In order to settle the obligation of restoring and of removing hazardous substances from plant facilities and premises that the Group uses, the probable amount to be paid in the future is recognized based on past performances. These expenses are expected to be paid after one year or more; however, they may be affected by future business plans.

B. Restructuring Provisions

These provisions are mainly related to business integration and measures for the rationalization of the “International Tobacco Business.” The timing of the payment may be affected by future business plans.

C. Provisions for Sales Rebates

These provisions are for contracts which reward the customers with discounts when the sales volume or sales amount in a given period exceeds a specified volume or amount. They are expected to be paid within one year.

21. Other Liabilities

The breakdown of “Other current liabilities” and “Other non-current liabilities” as of each fiscal year end is as follows:

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Tobacco excise tax payables	334,557	306,816
Tobacco special excise tax payables	14,548	13,882
Tobacco local excise tax payables	183,492	180,799
Consumption tax payables	103,933	105,497
Bonus to employees	34,014	33,828
Employees’ unused paid vacations liabilities	18,827	18,832
Other	154,348	132,195
Total	843,719	791,850
Current liabilities	729,761	689,629
Non-current liabilities	113,958	102,221
Total	843,719	791,850

22. Employee Benefits

(1) Post-employment Benefits

The Group sponsors funded or unfunded defined benefit plans and defined contribution plans as employee retirement benefit plans. The benefits of defined benefit plans are predetermined based on conditions, such as points employees have gained in compensation for each year of service, the payment rate, years of service, and average salaries in their final years of service before retirement.

The Company is obligated to bear pension costs for a mutual assistance association incurred with respect to services in or before June 1956 (prior to enforcement of the Act on the Mutual Aid Association of Public Corporation Employees). Such obligations are recognized as liabilities at their present value using the actuarial valuation method and are included in retirement benefit liabilities. Special termination benefits may be provided to employees on their early retirements under certain circumstances.

The funded defined benefit plans are administrated by the Group or the fund that is legally separated from the Group in accordance with statutory requirements. The Group, or the board of the pension fund and the trustee of the plan, are required by law to act in the best interests of the plan participants, and are responsible for managing the plan assets in accordance with the designated investment strategy.

The Group's main defined benefit plans expose the Group to actuarial risks, such as investment risk, interest rate risk, inflation risk, and longevity risk.

(i) Investment risk

The present value of the defined benefit obligations is calculated using a discount rate set with reference to a yield on high quality corporate bonds or government bonds. If the return on the plan assets is below this yield, there is a possibility that the plan is underfunded.

(ii) Interest rate risk

A decrease in a yield on high quality corporate bonds or government bonds will increase the present value of the defined benefit obligations. However, this will be partially offset by an increase in the fair value of the debt instruments (plan assets).

(iii) Inflation risk

The level of benefit for certain defined benefit plans of the Group is linked to inflation. Accordingly, a rise in inflation will increase the present value of the defined benefit obligations.

(iv) Longevity risk

Some defined benefit plans of the Group provide a lifetime annuity, and the Group is obligated to provide pension benefits to the plan participants for the rest of their lives after their retirements. The present value of the defined benefit obligations is calculated by reference to the best estimate of the mortality of plan participants during or after employment. An increase in average life expectancy of the plan participants will increase the defined benefit obligations.

A. Schedule of Defined Benefit Obligations

The schedule of the defined benefit obligations is as follows:

(Millions of yen)

	Japan (Note 3)	Overseas	Total
As of January 1, 2015 (Notes 1, 2)	292,138	552,006	844,144
Current service cost	11,802	11,216	23,018
Past service cost and gains and losses on settlement	310	389	699
Interest expense	1,923	15,337	17,261
Contributions by plan participants	–	1,697	1,697
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	(634)	(327)	(961)
Actuarial gains and losses arising from changes in financial assumptions	(105)	(2,266)	(2,371)
Actuarial gains and losses arising from experience adjustments	(47)	346	299
Benefits paid	(25,941)	(20,823)	(46,764)
Decrease resulting from transfer of subsidiaries	(13,277)	–	(13,277)
Exchange differences on translation of foreign operations	–	(38,030)	(38,030)
Other	42	(466)	(423)
As of December 31, 2015 (Notes 1, 2)	266,213	519,079	785,292
Current service cost	11,324	8,777	20,100
Past service cost and gains and losses on settlement	–	(5,362)	(5,362)
Interest expense	1,790	12,644	14,434
Contributions by plan participants	–	1,300	1,300
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	(1,158)	7,703	6,545
Actuarial gains and losses arising from changes in financial assumptions	4,222	59,529	63,751
Actuarial gains and losses arising from experience adjustments	(1,264)	(527)	(1,791)
Benefits paid	(20,953)	(23,963)	(44,916)
Exchange differences on translation of foreign operations	–	(62,630)	(62,630)
Other	(51)	324	273
As of December 31, 2016 (Notes 1, 2)	260,122	516,875	776,997

(Note 1) The Group's weighted-average duration of the defined benefit obligations is 7.7 years for Japan and 16.2 years for overseas (FY2015: 7.7 years for Japan and 15.3 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 December 31, 2015			As of December 31, 2016		
	Japan	Overseas	Total	Japan	Overseas	Total
Active members	165,996	208,743	374,739	165,390	191,202	356,592
Deferred members	16,235	51,014	67,249	15,006	70,980	85,986
Pensioners	83,982	259,322	343,304	79,726	254,693	334,418
Total	266,213	519,079	785,292	260,122	516,875	776,997

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

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Balance at the beginning of the period	59,191	52,710
Interest expense	296	264
Remeasurement gains and losses	276	1,600
Benefits paid	(7,052)	(5,967)
Balance at the end of the period	52,710	48,607

B. Schedule of Plan Assets

The schedule of the plan assets is as follows:

(Millions of yen)

	Japan	Overseas	Total
As of January 1, 2015	111,515	416,117	527,631
Interest income	765	12,517	13,282
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	1,605	(4,724)	(3,119)
Contributions by the employer (Notes 1, 2)	3,754	10,536	14,290
Contributions by plan participants	–	1,697	1,697
Benefits paid	(9,162)	(17,091)	(26,253)
Decrease resulting from transfer of subsidiaries	(11,670)	–	(11,670)
Exchange differences on translation of foreign operations	–	(24,708)	(24,708)
Other	–	(466)	(466)
As of December 31, 2015	96,806	393,878	490,684
Interest income	679	10,263	10,942
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	906	42,132	43,037
Contributions by the employer (Notes 1, 2)	2,099	7,015	9,113
Contributions by plan participants	–	1,300	1,300
Benefits paid	(6,918)	(20,311)	(27,229)
Exchange differences on translation of foreign operations	–	(58,376)	(58,376)
Other	–	(2,206)	(2,206)
As of December 31, 2016	93,571	373,696	467,267

(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 ¥6,941 million in the year ending December 31, 2017.

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:

(Millions of yen)

As of December 31, 2015	Japan	Overseas	Total
Present value of the funded defined benefit obligations	96,583	387,804	484,387
Fair value of the plan assets	(96,806)	(393,878)	(490,684)
Subtotal	(223)	(6,074)	(6,297)
Present value of the unfunded defined benefit obligations	169,629	131,275	300,905
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	169,406	125,201	294,608
Retirement benefit liabilities	172,385	161,176	333,562
Retirement benefit assets	(2,979)	(35,975)	(38,954)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	169,406	125,201	294,608

(Millions of yen)

As of December 31, 2016	Japan	Overseas	Total
Present value of the funded defined benefit obligations	92,436	383,213	475,648
Fair value of the plan assets	(93,571)	(373,696)	(467,267)
Subtotal	(1,136)	9,517	8,381
Present value of the unfunded defined benefit obligations	167,686	133,662	301,348
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	166,550	143,179	309,729
Retirement benefit liabilities	170,804	162,606	333,410
Retirement benefit assets	(4,254)	(19,426)	(23,680)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	166,550	143,179	309,729

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 December 31, 2015			As of December 31, 2016		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	23,002	―	23,002	18,233	―	18,233
Equity instruments	3,383	―	3,383	3,579	―	3,579
Japan	2,251	―	2,251	2,381	―	2,381
Overseas	1,132	―	1,132	1,198	―	1,198
Debt instruments	10,395	―	10,395	11,000	―	11,000
Japan	9,142	―	9,142	9,758	―	9,758
Overseas	1,252	―	1,252	1,242	―	1,242
General account of life insurance companies (Note)	―	59,454	59,454	―	60,155	60,155
Other	―	572	572	―	603	603
Total	36,779	60,027	96,806	32,813	60,759	93,571

(Millions of yen)

	Overseas					
	As of December 31, 2015			As of December 31, 2016		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	12,084	―	12,084	5,397	―	5,397
Equity instruments	122,613	―	122,613	123,669	―	123,669
United Kingdom	29,719	―	29,719	30,212	―	30,212
North America	35,974	―	35,974	38,532	―	38,532
Other	56,920	―	56,920	54,925	―	54,925
Debt instruments	220,473	4,968	225,441	207,393	5,035	212,427
United Kingdom	143,809	―	143,809	137,158	―	137,158
North America	48,969	―	48,969	47,524	―	47,524
Other	27,695	4,968	32,663	22,711	5,035	27,746
Real estate	9,266	464	9,731	9,026	441	9,468
Other	18,105	5,905	24,009	15,808	6,927	22,735
Total	382,541	11,337	393,878	361,293	12,403	373,696

(Millions of yen)

	Total					
	As of December 31, 2015			As of December 31, 2016		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	35,086	—	35,086	23,630	—	23,630
Equity instruments	125,996	—	125,996	127,248	—	127,248
Debt instruments	230,868	4,968	235,836	218,393	5,035	223,428
Real estate	9,266	464	9,731	9,026	441	9,468
General account of life insurance companies (Note)	—	59,454	59,454	—	60,155	60,155
Other	18,105	6,477	24,582	15,808	7,530	23,338
Total	419,320	71,364	490,684	394,106	73,161	467,267

(Note) A certain interest rate and principal for the general account of life insurance are guaranteed by life insurance companies.

The investment strategy for the Group's major plans is as follows:

(Japan)
The Company's pension fund is managed in accordance with the internal policy for securing stable profits in the middle- and long-term in order to ensure the redemption of the plan liability. Concretely, by setting a target rate of return and composition ratio of plan assets by asset category within the risk tolerance that is annually assessed, the Company invests plan assets consistently with the composition ratio. When reviewing the composition ratio, the Company considers introducing an asset investment which has a high correlation with the liability.

In the case where an unexpected situation occurs in the market environment, it is temporarily allowed to make an adjustment on the weight of risk assets complying with the policy.

(Overseas)
The investment strategy for the foreign subsidiaries' funded pension plans is decided properly by the trustee of the plan or the management of overseas subsidiaries according to local legislation. The Company's objective for the foreign subsidiaries' funded pension plans is to manage risks arising from its defined benefit obligation, and meanwhile to achieve a return on assets in excess of the movement in the value of the defined benefit obligation.

The majority of the plan assets have been allocated to liability matching bonds and the remaining parts of the plan assets are mainly invested in equities targeting long-term return.

E. Matters Related to Actuarial Assumptions

The major items of actuarial assumptions as of each fiscal year end are as follows:

As of December 31, 2015

	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	23.6 (Note 2)	29.3 (Note 2)	21.7 (Note 3)	24.2 (Note 3)
Future pensioners			23.1 (Note 4)	25.7 (Note 4)

As of December 31, 2016

	Japan	Overseas
	(%)	(%)
Discount rate	0.5	2.2
Inflation rate	—	2.6

	Japan		Overseas	
	Males	Females	Males	Females
	(years)	(years)	(years)	(years)
Average life expectancy at retirement (Note 1)				
Current pensioners	23.6 (Note 2)	29.3 (Note 2)	21.9 (Note 3)	24.3 (Note 3)
Future pensioners			23.3 (Note 4)	25.8 (Note 4)

(Note 1) The average life expectancies underlie the values of the defined benefit obligations on major plans. Assumptions regarding future mortality rate are based on published statistics and mortality tables.

(Note 2) Life expectancy for a pensioner currently aged 60. Regardless of the plan participant's current age, the Group performs actuarial calculations based on the assumption that life expectancy remains the same.

(Note 3) Life expectancy for a pensioner currently aged 65

(Note 4) Life expectancy at the age of 65 for an active member currently aged 50

(Note 5) The valuation of defined benefit obligations reflects a judgment on uncertain future events. The sensitivities of defined benefit obligations due to changes in major assumptions as of each fiscal year end are as follows. Each of these sensitivities assumes that other variables remain fixed; however, in fact, they do not always change independently. Negative figures show a decrease in pension plan obligations, while positive figures show an increase.

As of December 31, 2015

(Millions of yen)

	Change in assumptions	Japan	Overseas
Discount rate	Increase by 0.5%	(9,672)	(37,287)
	Decrease by 0.5%	10,368	42,058
Inflation rate	Increase by 0.5%	–	27,545
	Decrease by 0.5%	–	(25,543)
Mortality rate	Extended 1 year	5,809	16,859
	Shortened 1 year	(5,649)	(16,964)

As of December 31, 2016

(Millions of yen)

	Change in assumptions	Japan	Overseas
Discount rate	Increase by 0.5%	(9,636)	(39,870)
	Decrease by 0.5%	10,363	43,735
Inflation rate	Increase by 0.5%	-	29,449
	Decrease by 0.5%	-	(25,654)
Mortality rate	Extended 1 year	5,540	19,321
	Shortened 1 year	(5,370)	(17,860)

F. Breakdown of Defined Benefit Cost

The breakdown of defined benefit cost for each fiscal year is as follows:

Year ended December 31, 2015

(Millions of yen)

	Japan	Overseas	Total
Current service cost	11,802	11,216	23,018
Past service cost and gains and losses on settlement	310	389	699
Interest expense (income)	1,159	2,820	3,979
Defined benefit cost through profit or loss	13,270	14,426	27,696
Actuarial gains and losses arising from changes in demographic assumptions	(634)	(327)	(961)
Actuarial gains and losses arising from changes in financial assumptions	(105)	(2,266)	(2,371)
Actuarial gains and losses arising from experience adjustments	(47)	346	299
Return on plan assets (excluding amounts included in interest income)	(1,605)	4,724	3,119
Defined benefit cost through other comprehensive income	(2,390)	2,476	86
Total of defined benefit cost	10,880	16,902	27,782

Year ended December 31, 2016

(Millions of yen)

	Japan	Overseas	Total
Current service cost	11,324	8,777	20,100
Past service cost and gains and losses on settlement	—	(2,956)	(2,956)
Interest expense (income)	1,111	2,381	3,492
Defined benefit cost through profit or loss	12,435	8,201	20,636
Actuarial gains and losses arising from changes in demographic assumptions	(1,158)	7,703	6,545
Actuarial gains and losses arising from changes in financial assumptions	4,222	59,529	63,751
Actuarial gains and losses arising from experience adjustments	(1,264)	(527)	(1,791)
Return on plan assets (excluding amounts included in interest income)	(906)	(42,132)	(43,037)
Defined benefit cost through other comprehensive income	894	24,573	25,467
Total of defined benefit cost	13,328	32,775	46,103

(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." The defined benefit cost through profit or loss from discontinued operations for the year ended December 31, 2015 is included in "Profit for the period from discontinued operations."

(Note 2) Contributions to the defined contribution plans were ¥7,649 million for the year ended December 31, 2015 and ¥6,917 million for the year ended December 31, 2016 and were not included in the table above.

(2) Other Employee Benefit Expenses

The employee benefit expenses other than post-employment benefits from continuing operations that are included in the consolidated statement of income for each fiscal year are as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Remuneration and salary	233,512	211,838
Bonus to employees	62,134	59,474
Legal welfare expenses	43,861	39,803
Welfare expenses	36,183	34,581
Termination benefits	4,392	1,479

23. Equity and Other Equity Items

(1) Share Capital and Capital Surplus

A. Authorized Shares

The number of authorized shares as of December 31, 2015 and 2016 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 January 1, 2015	2,000,000	100,000	736,400
Increase (decrease)	—	—	—
As of December 31, 2015	2,000,000	100,000	736,400
Increase (decrease)	—	—	—
As of December 31, 2016	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 January 1, 2015	182,443	344,447
Increase (decrease) (Note 2)	26,842	99,886
As of December 31, 2015	209,285	444,333
Increase (decrease) (Note 2)	(241)	(512)
As of December 31, 2016	209,044	443,822

(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 number of treasury shares purchased based on the resolution made by the Board of Directors was 26,896 thousand shares and the total purchase cost was ¥100,000 million for the year ended December 31, 2015. Purchases of shares less than one unit are 0 thousand shares for the year ended December 31, 2015 and 0 thousand shares for the year ended December 31, 2016. The number of shares delivered upon exercise of share options is 54 thousand shares for the year ended December 31, 2015 and 241 thousand shares for the year ended December 31, 2016. Sales of shares less than one unit are 0 thousand shares for the year ended December 31, 2016.

(3) Other Components of Equity

A. Subscription Rights to Shares

The Company adopts share option plans and issues subscription rights to shares based on the Companies Act. Contract conditions and amount are described in “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 hedging instruments designated as cash flow hedges.

D. Net Gain (Loss) on Revaluation of Financial Assets Measured at Fair Value through Other Comprehensive Income

This is the valuation difference in the fair value of financial assets measured at fair value through other comprehensive income.

E. Remeasurements of Defined Benefit Plans

Remeasurements of defined benefit plans comprise actuarial gains and losses, the return on plan assets excluding amounts included in interest income, and any change in the effect of the asset ceiling excluding amounts included in interest income. In addition, actuarial gains and losses are the effects of differences between the actuarial assumptions at the beginning of the year and what has actually occurred, and the effects of changes in actuarial assumptions. Remeasurements are recognized as other comprehensive income when they occur and are transferred immediately from other components of equity to retained earnings.

24. Dividends

Dividends paid for each fiscal year are as follows:

Year ended December 31, 2015

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 20, 2015)	Ordinary shares	90,878	50	December 31, 2014	March 23, 2015
Board of Directors (August 3, 2015)	Ordinary shares	96,696	54	June 30, 2015	September 1, 2015

Year ended December 31, 2016

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 23, 2016)	Ordinary shares	114,606	64	December 31, 2015	March 24, 2016
Board of Directors (August 1, 2016)	Ordinary shares	114,617	64	June 30, 2016	September 1, 2016

Dividends, for which the effective date falls in the following fiscal year, are as follows:

Year ended December 31, 2015

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 23, 2016)	Ordinary shares	114,606	64	December 31, 2015	March 24, 2016

Year ended December 31, 2016

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 24, 2017)	Ordinary shares	118,203	66	December 31, 2016	March 27, 2017

25. Revenue

The reconciliation from “Gross turnover” to “Revenue” from continuing operations for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Gross turnover	7,436,141	7,062,848
Tobacco excise taxes and agency transaction amount	(5,183,257)	(4,919,561)
Revenue	2,252,884	2,143,287

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” from continuing operations for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Gain on sale of property, plant and equipment, intangible assets and investment properties (Note)	7,277	41,161
Gain on sale of investments in subsidiaries (Note)	—	26,106
Other (Note)	8,089	2,835
Total	15,367	70,101

(Note) The amount of restructuring income included in each account for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Gain on sale of property, plant and equipment, intangible assets and investment properties	6,193	38,973
Gain on sale of investments in subsidiaries	—	26,106
Other	606	100
Total	6,799	65,178

27. Selling, General and Administrative Expenses

The breakdown of “Selling, general and administrative expenses” from continuing operations for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Advertising expenses	25,644	26,108
Promotion expenses	120,270	124,766
Shipping and warehousing expenses	26,859	26,793
Commission	51,330	50,860
Employee benefit expenses (Note 2)	264,725	241,752
Research and development expenses (Note 1)	57,796	58,193
Depreciation and amortization	65,999	79,088
Impairment losses on other than financial assets (Note 2)	9,516	1,239
Losses on sale and disposal of property, plant and equipment, intangible assets, and investment property (Note 2)	19,156	11,256
Other (Note 2)	148,052	134,060
Total	789,346	754,115

(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 December 31, 2015	Year ended December 31, 2016
Employee benefit expenses	4,720	1,243
Impairment losses on other than financial assets	7,643	743
Losses on sale and disposal of property, plant and equipment, intangible assets, and investment property	12,523	5,676
Other	14,957	4,231
Total	39,843	11,894

28. Financial Income and Financial Costs

The breakdown of “Financial income” and “Financial costs” from continuing operations for each fiscal year is as follows:

(Millions of yen)

Financial Income	Year ended December 31, 2015	Year ended December 31, 2016
Dividend income		
Financial assets measured at fair value through other comprehensive income	1,771	1,707
Interest income		
Financial assets measured at amortized cost		
Deposits and bonds	13,010	4,664
Other	235	247
Total	15,016	6,618

(Millions of yen)

Financial Costs	Year ended December 31, 2015	Year ended December 31, 2016
Interest expenses		
Financial liabilities measured at amortized cost		
Bonds and borrowings (Note 2)	3,745	8,592
Other	153	87
Foreign exchange losses (Note 1)	6,010	9,183
Employee benefit expenses (Note 3)	3,971	3,492
Other	1,253	355
Total	15,132	21,710

(Note 1) Valuation gain (loss) of currency derivatives is included in foreign exchange losses.
(Note 2) Valuation gain (loss) of interest rate derivatives is included in interest expenses.
(Note 3) The employee benefit expenses are the net amount of interest cost and interest income related to employee benefits.

29. Other Comprehensive Income

Amount arising during the year, reclassification adjustments to profit or loss and tax effects for each component of "Other comprehensive income" for each fiscal year are as follows:

Year ended December 31, 2015

(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	14,220	－	14,220	(3,485)	10,735
Remeasurements of defined benefit plans	(86)	－	(86)	(4,016)	(4,102)
Total of items that will not be reclassified to profit or loss	14,134	－	14,134	(7,501)	6,633
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	(289,270)	(223)	(289,493)	93	(289,400)
Net gain (loss) on derivatives designated as cash flow hedges	1,084	(812)	271	(38)	233
Total of items that may be reclassified subsequently to profit or loss	(288,186)	(1,036)	(289,222)	55	(289,167)
Total	(274,052)	(1,036)	(275,088)	(7,446)	(282,534)

Year ended December 31, 2016

(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	(5,574)	－	(5,574)	2,416	(3,159)
Remeasurements of defined benefit plans	(25,467)	－	(25,467)	3,265	(22,202)
Total of items that will not be reclassified to profit or loss	(31,042)	－	(31,042)	5,681	(25,361)
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	(157,539)	19	(157,520)	(6,163)	(163,683)
Net gain (loss) on derivatives designated as cash flow hedges	(2,986)	849	(2,136)	658	(1,479)
Total of items that may be reclassified subsequently to profit or loss	(160,525)	868	(159,657)	(5,506)	(165,162)
Total	(191,567)	868	(190,699)	175	(190,523)

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 December 31, 2015	Year ended December 31, 2016
Profit for the period attributable to owners of the parent company	485,691	421,695
Profit not attributable to ordinary shareholders of the parent company	—	—
Profit for the period used for calculation of basic earnings per share	485,691	421,695
Profit for the period from discontinued operations attributable to ordinary shareholders of the parent company	87,237	—
Profit for the period from continuing operations used for calculation of basic earnings per share	398,454	421,695

B. Weighted-average Number of Ordinary Shares Outstanding During the Period

(Thousands of shares)

	Year ended December 31, 2015	Year ended December 31, 2016
Weighted-average number of shares during the period	1,795,254	1,790,878

(2) Basis of Calculating Diluted Earnings per Share

A. Profit Attributable to Diluted Ordinary Shareholders

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Profit for the period used for calculation of basic earnings per share	485,691	421,695
Adjustment	—	—
Profit for the period used for calculation of diluted earnings per share	485,691	421,695
Profit for the period from discontinued operations attributable to ordinary shareholders of the parent company	87,237	—
Profit for the period from continuing operations used for calculation of diluted earnings per share	398,454	421,695

B. Weighted-average Number of Diluted Ordinary Shares Outstanding During the Period

(Thousands of shares)

	Year ended December 31, 2015	Year ended December 31, 2016
Weighted-average number of ordinary shares during the period	1,795,254	1,790,878
Increased number of ordinary shares under subscription rights to shares	1,128	1,030
Weighted-average number of diluted ordinary shares during the period	1,796,382	1,791,908

31. Non-cash Transactions

Significant Non-cash Transactions

The amount of assets acquired under finance leases was ¥3,507 million for the year ended December 31, 2015 and ¥202 million for the year ended December 31, 2016.

32. Share-based Payments

The Company and Torii Pharmaceutical adopt share option plans. Share options are granted by the resolutions of the Board of Directors based on the approvals at the Annual Shareholders' Meeting.

The outline of the share option plan of the Company is as follows:

(1) Share Option Contract Conditions of the Company

Positions of persons granted	:	Directors and Executive Officers
Settlement	:	Issuance of shares
Effective period of granted share option	:	30 years after the date of grant
Vesting conditions	:	None

Conditions related to the exercise of share options are as follows:

(a) The subscription rights to shares become exercisable when a holder of a subscription right to shares no longer holds a position as a director, an audit & supervisory board member or an executive officer. In the subscription rights to shares allocation contract with holders of such rights, it is provided for that the rights become exercisable from the date following the date on which they no longer hold their positions.

(b) In the case where any holders of subscription rights to shares waive such rights, they cannot exercise them.

(2) Changes in the Number of Share Options of the Company

(Shares)

	Year ended December 31, 2015			Year ended December 31, 2016		
	Directors	Executive Officers	Total	Directors	Executive Officers	Total
Balance at the beginning of the period	275,800	795,200	1,071,000	324,800	807,200	1,132,000
Granted	49,000	66,200	115,200	34,200	51,800	86,000
Exercised	–	(54,200)	(54,200)	–	(241,200)	(241,200)
Transferred	–	–	–	(83,200)	83,200	–
Balance at the end of the period	324,800	807,200	1,132,000	275,800	701,000	976,800
Exercisable balance at the end of the period	–	424,400	424,400	–	442,200	442,200

(Note 1) The number of share options is presented as the number of underlying shares.

(Note 2) All share options are granted with an exercise price of ¥1 per share.

(Note 3) Share options are granted to 6 directors and 18 executive officers for the year ended December 31, 2015, and 5 directors and 18 executive officers for the year ended December 31, 2016.
"Transferred" included in the "Changes in the Number of Share Options" represents the number of share options for persons granted whose management position changed during the period.

(Note 4) The weighted-average fair values per share of share options granted during the period were ¥3,556 and ¥2,863 for the years ended December 31, 2015 and 2016, respectively.

(Note 5) The weighted-average share prices of share options at the time of exercise during the period were ¥4,497 and ¥4,258 for the years ended December 31, 2015 and 2016, respectively.

(Note 6) The weighted-average remaining contract years of unexercised share options at the end of each period were 25.7 years and 25.2 years for the years ended December 31, 2015 and 2016, respectively.

(3) Method of Measuring Fair Value of Share Options Granted During the Period of the Company
A. Valuation Model
Black-Scholes Model

B. Main Assumptions and Estimation

	Year ended December 31, 2015	Year ended December 31, 2016
Share price	¥4,847	¥4,315
Volatility of share price (Note 1)	32.7%	32.9%
Estimated remaining period (Note 2)	15 years	15 years
Estimated dividends (Note 3)	¥100/share	¥118/share
Risk free interest rate (Note 4)	0.78%	(0.12)%

(Note 1) Calculated based on daily share prices quoted for the past 15 years
(Note 2) Because of the difficulty of a reasonable estimation due to insufficient data, the remaining period is estimated based on the assumption that share option rights would be exercised at a midpoint of the exercise period.
(Note 3) Based on the latest dividends paid
(Note 4) The yield on government bonds for a period of the expected remaining period

(4) Share-based Payment Expenses
The costs for share options from continuing operations included in “Selling, general and administrative expenses” in the consolidated statement of income were ¥383 million and ¥270 million for the years ended December 31, 2015 and 2016.

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.

For that reason, as its financial policy, the Group maintains a strong financial base that secures stability in the case of changes in business environment such as economic crises, and flexibility enabling expeditious responses to business investment opportunities.

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

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Interest-bearing debt	255,291	555,257
Cash and cash equivalents	(526,765)	(294,157)
Net interest-bearing debt (Note)	(271,474)	261,101
Capital (equity attributable to owners of the parent company)	2,451,596	2,456,091

(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 the Annual Shareholders' Meeting) (Article 2 (1)).

In cases where the Company intends to solicit persons to subscribe for shares to be issued or subscription rights to shares or where the Company intends to deliver shares (excluding treasury shares), subscription rights to shares (excluding subscription right to own shares) or bonds with subscription rights to shares (excluding bonds with subscription rights to shares) when exchanging with shares, the Company shall obtain the approval of the Minister of Finance (Article 2 (2)).

Disposal of shares owned by the Japanese government shall be within the limits on the number of shares decided by the Diet in the relevant annual budget (Article 3).

The Group monitors financial indicators in order to maintain a well-balanced capital structure that ensures an appropriate return on equity and a stable and flexible financial condition for future investment. We monitor credit ratings for financial stability and flexibility, and ROE (return on equity) for profitability, while focusing on changes in the domestic and overseas environment.

(2) Financial Risk Management

The Group is exposed to financial risks (credit risk, liquidity risk, foreign exchange risk, interest rate risk, and market price fluctuation risk) in the process of its management activities and it manages risks based on a specific policy in order to avoid or reduce said risks. The results of risk management are regularly reported by the Treasury Division to the president and the Board of Directors of the Company.

The Group policy limits derivatives to transactions for the purpose of mitigating risks from transactions based on actual demand. Therefore, we do not transact derivatives for speculation purposes or trading purposes.

(3) Credit Risk

Receivables, such as note and account receivables, acquired from the operating activities of the Group are exposed to customer credit risk.

The Group holds mainly debt securities for surplus investment and equity securities of customers and suppliers to strengthen relationships with them; those securities are exposed to the issuer's credit risk. In addition, through derivative transactions that the Group conducts in order to hedge foreign exchange fluctuation risks and interest rate fluctuation risks, we are exposed to the credit risk of the financial institutions which are counterparties to these transactions.

In principle, the Group sets credit lines or transaction conditions with respect to trade receivables for counterparties based on the Credit Management Guidelines in order to control the credit risk relating to counterparties. In addition, the receivable balances of counterparties with high credit risk are monitored. The Treasury Division of the Company regularly monitors the status of the occurrence and collection of bad debts, and reports them to the president and the Board of Directors of the Company.

With regard to the investment of cash surpluses and derivatives, the Group invests in debt securities and other financial instruments with a certain credit rating and transacts with financial institutions with a high credit rating in principle in order to prevent credit risks from occurring and based on the Group Financial Operation Basic Policy. In addition, the Treasury Division of the Company regularly monitors the performance of these transactions and reports the results to the president and the Board of Directors of the Company.

The maximum exposure pertaining to credit risks for financial assets is the carrying amount after considering impairment in the consolidated financial statements.

The analysis of the aging of financial assets that are past due but not impaired as of each fiscal year end date is as follows: The financial assets include amounts considered recoverable by credit insurance and collateral.

As of December 31, 2015 (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	3,238	2,260	349	38	591

As of December 31, 2016 (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	6,916	2,612	1,004	8	3,292

The Group reviews collectability of trade receivables depending on the credit conditions of counterparties and recognizes allowance for doubtful accounts. The schedule of the allowance for doubtful accounts is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Balance at the beginning of the period	10,595	9,345
Addition	346	335
Decrease (intended use)	(357)	(515)
Decrease (reversal)	(986)	(336)
Other	(253)	(394)
Balance at the end of the period	9,345	8,436

(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 December 31, 2015

(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	373,032	373,032	373,032	—	—	—	—	—
Short-term borrowings	30,832	30,832	30,832	—	—	—	—	—
Current portion of long-term borrowings	148	148	148	—	—	—	—	—
Long-term borrowings	866	866	—	150	152	97	45	422
Bonds	215,072	215,305	—	20,000	60,305	—	80,000	55,000
Subtotal	619,949	620,183	404,012	20,150	60,457	97	80,045	55,422
Derivative financial liabilities								
Foreign exchange forward contract	5,594	5,594	5,594	—	—	—	—	—
Interest rate swap	1	1	1	—	—	—	—	—
Subtotal	5,595	5,595	5,595	—	—	—	—	—
Total	625,544	625,778	409,607	20,150	60,457	97	80,045	55,422

As of December 31, 2016

(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	377,933	377,933	377,933	—	—	—	—	—
Short-term borrowings	187,949	187,949	187,949	—	—	—	—	—
Current portion of long-term borrowings	572	572	572	—	—	—	—	—
Long-term borrowings	877	877	—	360	92	41	43	341
Current portion of bonds	20,000	20,000	20,000	—	—	—	—	—
Bonds	338,158	338,858	—	58,245	—	80,000	87,368	113,245
Subtotal	925,489	926,188	586,453	58,605	92	80,041	87,411	113,586
Derivative financial liabilities								
Foreign exchange forward contract	12,516	12,516	12,516	—	—	—	—	—
Subtotal	12,516	12,516	12,516	—	—	—	—	—
Total	938,005	938,704	598,970	58,605	92	80,041	87,411	113,586

The total of commitment lines and withdrawal as of each fiscal year end are as follows:

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Total committed line of credit	682,286	574,432
Withdrawing	—	—
Unused balance	682,286	574,432

(5) Foreign Exchange Risk

The Group operates businesses globally and, therefore, is exposed to the following risks due to foreign exchange fluctuation:

(i) The risk where the profit or loss and cash flow in each functional currency of the Group is influenced by foreign exchange fluctuation as a result of external transactions and intergroup transactions, including the payment and receipt of dividends, in currencies that are different from each functional currency of the Group.

(ii) The risk that the equity of the Group is influenced by foreign exchange fluctuation when equity denominated in each functional currency of the Group is translated into Japanese yen and consolidated.

(iii) The risk that the profit or loss of the Group is influenced by foreign exchange fluctuation when profit or loss denominated in each functional currency of the Group is translated into Japanese yen and consolidated.

The Group hedges against risk (i) using derivatives or foreign currency-denominated interest-bearing debts for example, when future cash flow is projected or when receivables and payables are fixed, and some of them are designated as cash flow hedges.

The Group hedges against risk (ii) using foreign currency-denominated interest-bearing debts for example, and part of these are designated as net investment hedges. The Group does not hedge against risk (iii) in principle.

In order to mitigate risks mentioned above resulting from the foreign exchange fluctuation, in accordance with the Group Financial Operation Basic Policy, and under the supervision of the Financial Risk Management Committee of the Company, the Group establishes and implements a foreign currency hedge policy, taking into consideration the impact on the Group’s performance and the current conditions of the foreign exchange market in a comprehensive manner. The Treasury Division of the Company regularly reports the performances to the president and the Board of Directors of the Company.

Foreign Exchange Sensitivity Analysis

In cases where each currency other than the functional currency that denominates the financial instruments held by the Group as of each fiscal year end increases by 10% in value against the functional currency, the impact on profit before income taxes in the consolidated statement of income is as follows:

The impact from the translation of functional currency-denominated financial instruments, and assets, liabilities, income and expenses of foreign operations into Japanese yen is not included. Also, it is based on the assumption that currencies other than the currencies used for the calculation do not fluctuate.

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Profit before income taxes	(866)	(1,502)

(6) Interest Rate Risk

Interest rate risk within the Group arises from interest-bearing debts after deducting cash equivalents. Borrowings and bonds with floating rates are exposed to interest rate fluctuation risk.

In order to reduce the interest rate fluctuation risk related to borrowings and bonds, in accordance with the Group Financial Operation Basic Policy, and under the supervision of the Financial Risk Management Committee of the Company, the Group establishes and implements an interest rate hedging policy, taking into consideration the impact on the Group's performance and the current condition of the interest rates in a comprehensive manner. The Treasury Division of the Company reports the performances to the president and the Board of Directors of the Company.

Interest Rate Sensitivity Analysis

In cases where the interest rate of financial instruments held by the Group as of each fiscal year end increases by 100bp, the impact on profit before income taxes in the consolidated statement of income is as follows:

The analysis is subject to financial instruments affected by interest rate fluctuation and based on the assumption that other factors, including the impacts of foreign exchange fluctuation, are constant.

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
Profit before income taxes	2,058	(559)

(7) Hedging Transactions

The Group's policy for hedging transactions is stated in "3. Significant Accounting Policies."

A. Cash flow hedges

The details of hedging instruments designated as cash flow hedges are as follows:

As of December 31, 2015

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rates (yen, %)
			Assets	Liabilities	
Foreign exchange risk					
Foreign exchange forward contract					
JPY/ USD	USD 129 mil.	USD −	70	75	¥119.95
Interest rate risk					
Cross currency swap					
Fixed rate receipt and fixed rate payment	USD 175 mil.	USD 175 mil.	3,870	−	0.24%

As of December 31, 2016

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rates (yen, %)
			Assets	Liabilities	
Foreign exchange risk					
Foreign exchange forward contract					
JPY/ USD	USD 259 mil.	USD −	1,077	478	¥109.84
Interest rate risk					
Cross currency swap					
Fixed rate receipt and fixed rate payment	USD 175 mil.	USD 175 mil.	3,052	−	0.24%

(Note) Carrying amounts of derivatives are presented as "Other financial assets" or "Other financial liabilities" in the consolidated statement of financial position, and the portion with over one year maturity is classified as "Non-current assets" or "Non-current liabilities."

The schedule of net gains (losses) on hedging instrument designated as cash flow hedges is as follows:

(Millions of yen)

	Effective portion of changes in the fair value of cash flow hedges		
	Foreign exchange risk	Interest rate risk	Total
As of January 1, 2015	1,077	139	1,215
Other comprehensive income			
Amount arising (Note 1)	284	800	1,084
Reclassification adjustments (Note 2)	―	(812)	(812)
Tax effects	(49)	11	(38)
Others	(1,324)	―	(1,324)
As of December 31, 2015	(12)	137	125
Other comprehensive income			
Amount arising (Note 1)	(2,168)	(818)	(2,986)
Reclassification adjustments (Note 2)	128	721	849
Tax effects	625	33	658
Others	1,794	―	1,794
As of December 31, 2016	367	73	440

(Note 1) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness approximates the change in fair value of the hedging instrument.

(Note 2) The amount, which is reclassified when the hedged item affects profit or loss, is recognized in “Revenue”, “Financial income” or “Financial costs” in the consolidated statement of income. The amount of hedge ineffectiveness is immaterial.

B. Hedge of net investment in foreign operations

The details of hedging instruments designated as hedge of net investment are as follows:

As of December 31, 2015

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rates (yen)
			Assets	Liabilities	
Bonds in USD	USD 325 mil.	USD 325 mil.	―	38,965	¥99.45

As of December 31, 2016

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rates (yen)
			Assets	Liabilities	
Short-term borrowings	USD 500 mil.	USD ―	―	58,245	¥117.91
Bonds in USD	USD 1,575 mil.	USD 1,575mil.	―	182,773	¥107.36

(Note) Carrying amounts of bonds and short-term borrowings are presented as “Bonds and borrowings” in the consolidated statement of financial position, and the portion with over one year maturity is classified as “Non-current liabilities.”

The schedule of net gains (losses) on hedging instrument designated as hedge of net investment in foreign operations is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Balance at the beginning of the period	(3,100)	(4,497)
Other comprehensive income		
Amount arising (Note 1)	(1,490)	19,444
Tax effects	93	(6,163)
Balance at the end of the period (Note 2)	(4,497)	8,784

(Note 1) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness approximates the change in fair value of the hedging instrument.

(Note 2) Net gain arising from the hedging instruments for which hedge accounting is discontinued were ¥136 million and ¥18,241 million as of December 31, 2015 and 2016 respectively those which are included in the exchange differences on translation of foreign operations.

(8) Market Price Fluctuation Risk

With respect to securities, the Group regularly assesses the fair value and financial conditions of the issuers, and each relevant department reviews the portfolio held by taking into account the relationship with counterparty entities as necessary.

(9) Fair Value of Financial Instruments

The fair value hierarchy of financial instruments is categorized from Level 1 to Level 3 as follows:

Level 1: Fair value measured at the quoted price in the active market
Level 2: Fair value that is calculated using the observable price other than categorized in Level 1 directly or indirectly
Level 3: Fair value that is calculated based on valuation techniques which include inputs that are not based on observable market data

(i) Financial instruments measured at amortized cost

The carrying amount and fair value hierarchy of financial instruments measured at amortized cost as of each fiscal year end are as follows:

As of December 31, 2015

(Millions of yen)

	Carrying amount	Fair value			
		Level 1	Level 2	Level 3	Total
Long-term borrowings (Note)	1,014	—	—	1,014	1,014
Bonds	215,072	217,215	—	—	217,215

As of December 31, 2016

(Millions of yen)

	Carrying amount	Fair value			
		Level 1	Level 2	Level 3	Total
Long-term borrowings (Note)	1,449	—	—	1,449	1,449
Bonds	358,158	357,126	—	—	357,126

(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:

(Millions of yen)

As of December 31, 2015

	Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	—	7,106	—	7,106
Equity securities	67,557	—	5,239	72,795
Other	319	—	1,727	2,046
Total	67,876	7,106	6,966	81,948
Derivative liabilities	—	5,595	—	5,595
Total	—	5,595	—	5,595

(Millions of yen)

As of December 31, 2016

	Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	—	11,769	—	11,769
Equity securities	60,662	—	4,886	65,548
Other	368	—	2,316	2,683
Total	61,030	11,769	7,202	80,001
Derivative liabilities	—	12,516	—	12,516
Total	—	12,516	—	12,516

(Note) The schedule of financial instruments that are classified in Level 3 is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Balance at the beginning of the period	5,411	6,966
Total gain (loss)		
Profit or loss (Note 1)	172	(16)
Other comprehensive income (Note 2)	1,154	80
Purchases	478	448
Sales	(250)	(76)
Other	—	(200)
Balance at the end of the period	6,966	7,202

(Note 1) Gains and losses included in profit or loss for the year ended December 31, 2015 and 2016 are related to financial assets measured at fair value through profit or loss as of the fiscal year end date. These gains and losses are included in “Financial income” and “Financial costs.”

(Note 2) Gains and losses included in other comprehensive income for the year ended December 31, 2015 and 2016 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, 2016, 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, was ¥240,837 million and ¥207,768 million for the years ended December 31, 2015 and 2016, respectively. The Company held trade receivables of ¥27,396 million and ¥38,373 million from CJSC TK Megapolis as of December 31, 2015 and 2016, respectively.

(2) Remuneration for Directors and Audit and Supervisory Board Members

Remuneration for directors and audit and supervisory board members for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2015	Year ended December 31, 2016
Remuneration and bonuses	650	620
Share-based payments	159	117
Total	809	737

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 December 31, 2015		As of December 31, 2016	
	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	11	2	12	2
International Tobacco	144	5	150	5
Pharmaceuticals	3	―	2	―
Processed Food	28	3	28	3
Other	8	2	10	2
Total	194	12	202	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 year ended December 31, 2016.

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 December 31, 2015	As of December 31, 2016
Acquisition of property, plant and equipment	41,879	41,889
Acquisition of intangible assets	1,402	3,374
Total	43,281	45,264

(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. Business Combinations

Acquisition of the Natural American Spirit Business outside the United States

(1) Summary of Business Combinations

On January 13, 2016, the Group acquired from the Reynolds American Inc. group ("RAI") the Natural American Spirit business outside the United States which included the non-U.S. trademarks and all outstanding shares of RAI's subsidiaries outside the U.S. which sold the brand, Santa Fe Natural Tobacco Company Japan K.K. (Note) and eight other subsidiaries.

Natural American Spirit, the tobacco brand that Santa Fe Natural Tobacco Company, Inc. launched in the U.S. in 1982, has established a unique brand positioning due to its additive-free tobacco products that abundantly use high quality leaf tobacco. The brand has steadily increased the sales volume in the U.S., Japan, Germany, Switzerland, Italy, Spain, the U.K. and others.

The purpose of this acquisition is that Natural American Spirit, which has a strong presence in a premium priced category, allows the Group to further extend its brand portfolio and strengthen the business foundation.

Notably in Japan, which accounts for the majority of the sales volume worldwide excluding the U.S., the brand has enjoyed broad support of consumers and experienced significant growth in sales volume. This acquisition is positioned as part of business investments to underpin the Group's sustainable long-term profit growth in Japan, which is one of the Group's most significant markets.

(Note) Santa Fe Natural Tobacco Company Japan K.K. changed its name to K.K. TRUE SPIRIT TOBACCO COMPANY on May 1, 2016.

(2) Financial Impact on the Group

Since the acquisition date, the acquired business has contributed to total revenue and operating loss of ¥28,291 million and ¥13,946 million, respectively.

The amortization of trademarks acquired from the business combinations included in the above operating loss is ¥17,928 million.

(3) Consideration and Details (Total of the Acquisition)

The consideration is ¥591,420 million and all is paid in cash.

(4) Cash Out for the Business Combinations (Total of the Acquisition)

(Millions of yen)

	Net cash outflow for the business combinations
Cash consideration	591,420
Cash and cash equivalents in subsidiaries acquired	(4,335)
Net cash outflow for the business combinations	587,085

(5) Fair Values of the Assets Acquired and Liabilities Assumed

(Millions of yen)

	Fair value
Current assets	21,369
Trademarks	180,471
Deferred tax assets	113,185
Other non-current assets	9,207
Total assets	324,232
Current liabilities	11,376
Non-current liabilities	8,415
Total liabilities	19,791
Goodwill	286,979

Goodwill represents future economic benefits for integration synergies including enhanced business scale in each market, and it is expected that most of the trademarks and goodwill are deductible for tax purposes.
Fair values of assets acquired and liabilities assumed are provisional amounts recognized at the acquisition date and may change during the measurement period (one year from the acquisition date).
Transaction costs of ¥293 million are expensed as incurred and recognized in “Selling, general and administrative expense.”

Other acquisitions

In addition to the above, the Group acquired other entities through business combinations for the year ended December 31, 2016, which are omitted as they are immaterial both individually and in aggregate.

38. Discontinued Operations

The Group classifies continuing operations and discontinued operations based on operating segments. As a result, for a business not managed as an independent operating segment, it will not be classified as discontinued operations when sold or discontinued and its operating income (loss) and cash flows will be included in the operating income (loss) and cash flows of continuing operations.
Shares of Japan Beverage Holdings Inc., JT A-star Co., Ltd. and other subsidiaries conducting vending machine operation business were transferred to Suntory Beverage & Food Limited on July 31, 2015 and the manufacture and sale of JT beverage products were discontinued at the end of September, 2015. Accordingly, in the prior year, “Beverage Business” was classified as discontinued operations and presented separately from continuing operations. ¥134,287 million of gain on sale of investments in subsidiaries and ¥36,494 million of income taxes related to the transfer of subsidiaries are included in “Profit for the period from discontinued operations” in the consolidated statement of income for the year ended December 31, 2015. ¥36,494 million of income taxes paid related to the transfer of subsidiaries for the prior year are included in the consolidated statement of cash flows for the year ended December 31, 2016.

39. Contingencies

Contingent Liabilities

The Company and some of its subsidiaries are defendants in legal proceedings. Provisions are not accounted for in matters where it is not practicable to reasonably estimate the final outcomes.

The Company and some of its subsidiaries, who are defendants in such legal proceedings, believe that our defenses asserted in these proceedings are based on substantial evidence and implement the system for the response to action with the assistance of external lawyers.

(1) Smoking and Health Related Litigation

The Company and some of its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking, the marketing of tobacco products, or exposure to tobacco smoke. As of December 31, 2016, there were a total of 20 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, and one individual case brought against the Company's subsidiaries in Russia on February 20, 2017.

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 ¥396.9 billion (approximately CAD 4.6 billion) in compensatory damages, an amount for which all the defendants are jointly and severally liable. Plaintiffs are seeking an additional amount of approximately ¥396.9 billion (approximately CAD 4.6 billion) in punitive damages, to be divided among all the defendants based on their respective market shares. The class was certified by the court in February 2005, and the trial was conducted from March 2012 through December 2014.

The Quebec Superior Court rendered the first instance judgment in May 2015, ordering a punitive damage award against the defendants of approximately ¥11.3 billion (CAD 131 million), in which the share of the total damage award against JTI-Mac is approximately ¥1.1 billion (approximately CAD 13 million). Although the Court found that the defendants had all committed some faults, it refused to award moral damages because the evidence did not establish the total amount of the claims of class members. In June 2015, JTI-Mac appealed the judgment to the Quebec Court of Appeal, and the appeal on the merits was heard in November 2016. The timing of the decision is at the Court's discretion.

Canada Quebec Class Action (Conseil Québécois sur le tabac et la santé):

This class action was brought in November 1998 against three Canadian tobacco manufacturers including JTI-Mac. Plaintiffs are seeking a total of approximately ¥1,075.4 billion (approximately CAD 12.4 billion) in compensatory damages, an amount for which all the defendants are jointly and severally liable. Plaintiffs are seeking an additional amount of approximately ¥70.1 billion (approximately CAD 0.8 billion) in punitive damages, to be divided among all the defendants based on their respective market shares. The class was certified by the court in February 2005, and the trial was conducted from March 2012 through December 2014.

The Quebec Superior Court rendered the first instance judgment in May 2015, ordering a compensatory damage award jointly and severally against the defendants of approximately ¥1,340.1 billion (CAD 15.5 billion), in which the share of the total damage award against JTI-Mac is approximately ¥174.2 billion (CAD 2.015 billion). Given the enormity of the damage award, the Court granted a symbolic amount of punitive damages of approximately ¥3 million (CAD 30,000) per defendant. In June 2015, JTI-Mac appealed the judgment to the Quebec Court of Appeal, and the appeal on the merits was heard in November 2016. The timing of the decision is at the Court's discretion.

Canada Saskatchewan Class Action (Adams):

This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The preliminary motions are pending. The case is currently dormant.

Canada Manitoba Class Action (Kunta):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The statement of claim was served on the Company's indemnitees but not on JTI-Mac. The case is currently dormant.

Canada Nova Scotia Class Action (Semple):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The statement of claim was served on the Company's indemnitees but not on JTI-Mac. The case is currently dormant.

Canada British Columbia Class Action (Bourassa):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2010. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

Canada British Columbia Class Action (McDermid):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2010. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

Canada Ontario Class Action (Jacklin):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2012. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

c. Health-Care Cost Recovery Litigation

There are 10 ongoing health-care cost recovery cases in Canada pending against the Company's subsidiary and indemnitees brought by all the Canadian provinces (except three Canadian territories). These provinces filed lawsuits under their own provincial legislation which was enacted exclusively for the purpose of authorizing the provincial government to file a direct action against tobacco manufacturers to recoup the health-care costs the government has allegedly incurred and will incur, resulting from "tobacco related wrongs."

Canada British Columbia Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of British Columbia in January 2001 against tobacco industry members including JTI-Mac and the Company's indemnitees based on its provincial legislation, the "Tobacco Damages and Health-Care Costs Recovery Act." The claim amount is unspecified. In 2001, several defendants challenged the legislation's constitutionality, which was ultimately rejected by the Supreme Court of Canada in September 2005. The action remains pending in the first instance. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada New Brunswick Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of New Brunswick in March 2008 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. 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 ¥4,323 billion (CAD 50.0 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Newfoundland and Labrador Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Newfoundland and Labrador in February 2011 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Manitoba Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Manitoba in May 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Quebec Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Quebec in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total amount of the claim approximately ¥5,244.4 billion (approximately CAD 60.7 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Alberta Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Alberta in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total claimed amount of at least ¥864.6 billion (CAD 10.0 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Saskatchewan Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Saskatchewan in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Prince Edward Island Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Prince Edward Island in September 2012 against tobacco industry members including JTI-Mac and the Company’s indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Nova Scotia Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Nova Scotia in January 2015 against tobacco industry members including JTI-Mac and the Company’s indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

(2) Other Legal Proceedings

The Company and some of its subsidiaries are also engaged in other legal proceedings such as commercial and tax disputes, which may include proceedings that are conducted pursuant to applicable confidentiality obligations. Details of such proceedings and their outcomes are disclosed by the Company only where permitted by such confidentiality obligations.

One major commercial litigation case is pending.
Japan Compensatory Damages Claim:
In February 2010, a former President & CEO of Katokichi Co., Ltd. filed a claim against TableMark Holdings Co., Ltd. (renamed after acquisition of Katokichi Co., Ltd. by the Company) and its subsidiary seeking damages allegedly incurred by the plaintiff from an asset purchase agreement between the plaintiff and Katokichi Co., Ltd. and a joint and several guarantee provided by the plaintiff. The plaintiff argues the invalidity of the asset purchase agreement.

(Note) The amount of damages sought denominated in foreign currencies is translated into Japanese yen at the rates as of December 31, 2016.

40. Subsequent Events

No items to report

Consolidated Supplementary Information

A. Quarterly Information for the Year ended December 31, 2016

(Millions of yen)

	Q1 From January 1, 2016 to March 31, 2016	Q2 From January 1, 2016 to June 30, 2016	Q3 From January 1, 2016 to September 30, 2016	2016 From January 1, 2016 to December 31, 2016
Revenue	534,088	1,076,879	1,618,537	2,143,287
Profit before income taxes for the period (year)	200,339	339,364	484,275	578,237
Profit attributable to owners of the parent company for the period (year)	145,445	247,094	350,008	421,695
Basic earnings per share for the period (year) (yen)	81.22	137.98	195.44	235.47

	Q1 From January 1, 2016 to March 31, 2016	Q2 From April 1, 2016 to June 30, 2016	Q3 From July 1, 2016 to September 30, 2016	Q4 From October 1, 2016 to December 31, 2016
Basic earnings per share for the quarter (yen)	81.22	56.76	57.47	40.03

B. Significant Lawsuits

The significant lawsuits of the Group are as stated in “39. Contingencies” in the notes to consolidated financial statements.

2. Nonconsolidated financial statements

(1) Nonconsolidated financial statements

a. Nonconsolidated balance sheet

(Millions of yen)

		As of December 31, 2015		As of December 31, 2016
Assets				
Current assets				
Cash and deposits		154,666		74,565
Accounts receivable-trade	*2	52,269	*2	54,410
Securities		110,000		50,000
Merchandise and finished goods		21,699		30,767
Semi-finished goods		52,954		40,421
Work in process		3,205		2,793
Raw materials and supplies		42,318		43,053
Advance payments-trade		1,849		2,196
Prepaid expenses		5,729		6,826
Deferred tax assets		24,020		13,017
Short-term loans receivable from subsidiaries and affiliates		45,797		44,085
Other	*2	13,502	*2	16,802
Allowance for doubtful accounts		(26)		(27)
Total current assets		527,980		378,907
Noncurrent assets				
Property, plant and equipment				
Buildings		89,584		86,673
Structures		3,151		2,912
Machinery and equipment		62,769		52,941
Vehicles		1,746		1,654
Tools, furniture and fixtures		21,300		18,492
Land		78,383		75,118
Construction in progress		2,440		2,530
Total property, plant and equipment		259,374		240,321
Intangible assets				
Patent right		418		363
Right of trademark		3,424		149,174
Software		16,038		13,172
Goodwill		—		321,939
Other		1,687		2,892
Total intangible assets		21,566		487,539
Investments and other assets				
Investment securities		61,982		54,961
Shares of subsidiaries and affiliates		1,854,137		1,669,714
Investments in capital of subsidiaries and affiliates		782		—
Long-term loans receivable from subsidiaries and affiliates		5,430		3,519
Long-term prepaid expenses		6,689		5,904
Deferred tax assets		8,821		—
Other		10,339		9,338
Allowance for doubtful accounts		(315)		(291)
Total investments and other assets		1,947,865		1,743,146
Total noncurrent assets		2,228,805		2,471,006
Total assets		2,756,785		2,849,913

(Millions of yen)

		As of December 31, 2015		As of December 31, 2016
Liabilities				
Current liabilities				
Accounts payable-trade	*2	8,604	*2	8,618
Short-term loans payable		―		58,245
Current portion of bonds		―	*1	20,000
Lease obligations	*2	4,303	*2	3,754
Accounts payable-other	*2	82,212	*2	60,464
National tobacco excise taxes payable		94,095		89,763
National tobacco special excise taxes payable		14,548		13,882
Local tobacco excise taxes payable		108,856		102,616
Income taxes payable		82,169		24,994
Accrued consumption taxes		32,212		31,192
Cash management system deposits received	*3	251,827	*3	278,136
Provision for bonuses		5,290		5,596
Other		6,298		7,785
Total current liabilities		690,416		705,045
Noncurrent liabilities				
Bonds payable	*1	211,604	*1	335,808
Lease obligations	*2	7,681	*2	6,355
Provision for retirement benefits		130,530		131,165
Deferred tax liabilities		―		4,987
Other	*2	3,486	*2	2,877
Total noncurrent liabilities		353,301		481,194
Total liabilities		1,043,717		1,186,238

(Millions of yen)

	As of December 31, 2015	As of December 31, 2016
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 investment loss on developing new business	—	28
Reserve for reduction entry	47,587	43,687
Special account for reduction entry	2,582	3,057
General reserve	955,300	955,300
Retained earnings brought forward	277,938	225,620
Total retained earnings	1,302,183	1,246,469
Treasury shares	(444,333)	(443,822)
Total shareholders’ equity	1,694,250	1,639,047
Valuation and translation adjustments		
Valuation difference on available-for-sale securities	29,791	26,207
Deferred gains or losses on hedges	(12,914)	(3,373)
Total valuation and translation adjustments	16,877	22,833
Subscription rights to shares	1,941	1,794
Total net assets	1,713,068	1,663,675
Total liabilities and net assets	2,756,785	2,849,913

b. Nonconsolidated statement of income

(Millions of yen)

		Year ended December 31, 2015		Year ended December 31, 2016
Net sales	*1,*6	732,483	*1,*6	729,286
Cost of sales	*6	229,551	*6	208,648
Gross profit		502,931		520,638
Selling, general and administrative expenses	*2,*6	271,227	*2,*6	323,938
Operating income		231,704		196,700
Non-operating income				
Interest income	*6	318	*6	237
Dividends income	*6	139,238	*6	6,929
Other	*6	5,142	*6	6,944
Total non-operating income		144,697		14,109
Non-operating expenses				
Interest expenses	*6	951	*6	2,020
Interest on bonds		1,703		3,884
Other	*6	1,759	*6	1,663
Total non-operating expenses		4,413		7,567
Ordinary income		371,989		203,242
Extraordinary income				
Gain on sales of noncurrent assets	*3	7,300	*3	36,638
Gain on sales of shares of subsidiaries		116,259		28,503
Other		408		1,073
Total extraordinary income		123,967		66,214
Extraordinary losses				
Loss on sales of noncurrent assets	*4	158	*4	1,186
Loss on retirement of noncurrent assets	*5,*6	15,740	*5,*6	8,680
Impairment loss		3,707		593
Loss on liquidation of business	*7	12,902		—
Other	*6	5,045		2,781
Total extraordinary losses		37,552		13,240
Income before income taxes		458,404		256,217
Income taxes-current		104,829		65,901
Income taxes-deferred		8,566		16,708
Total income taxes		113,395		82,609
Net income		345,009		173,607

c. Nonconsolidated statement of changes in net assets

Year ended December 31, 2015

(Millions of yen)

	Shareholders' equity									
		Capital surplus		Retained earnings						
					Other retained earnings					
	Capital stock	Legal capital surplus	Total capital surplus	Legal retained earnings	Reserve for investment loss on developing new business	Reserve for reduction entry	Special account for reduction entry	General reserve	Retained earnings brought forward	Total retained earnings
Balance at the beginning of current period	100,000	736,400	736,400	18,776	―	44,531	17,043	955,300	109,126	1,144,777
Changes of items during the period										
Provision of reserve for investment loss on developing new business										
Provision of reserve for reduction entry						10,169			(10,169)	―
Reversal of reserve for reduction entry						(9,493)			9,493	―
Adjustment to reserve due to change in tax rate						2,380			(2,380)	―
Provision of special account for reduction entry							2,453		(2,453)	―
Reversal of special account for reduction entry							(17,043)		17,043	―
Adjustment to special account due to change in tax rate							129		(129)	―
Dividends from surplus									(187,574)	(187,574)
Net income									345,009	345,009
Purchase of treasury shares										
Disposal of treasury shares									(29)	(29)
Net changes of items other than shareholders' equity										
Total changes of items during the period	―	―	―	―	―	3,056	(14,461)	―	168,811	157,406
Balance at the end of current period	100,000	736,400	736,400	18,776	―	47,587	2,582	955,300	277,938	1,302,183

	Shareholders' equity		Valuation and translation adjustments			Subscription rights to shares	Total net assets
	Treasury shares	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	(344,447)	1,636,730	21,087	(10,298)	10,790	1,631	1,649,151
Changes of items during the period							
Provision of reserve for investment loss on developing new business							
Provision of reserve for reduction entry		–					–
Reversal of reserve for reduction entry		–					–
Adjustment to reserve due to change in tax rate		–					–
Provision of special account for reduction entry		–					–
Reversal of special account for reduction entry		–					–
Adjustment to special account due to change in tax rate		–					–
Dividends from surplus		(187,574)					(187,574)
Net income		345,009					345,009
Purchase of treasury shares	(100,000)	(100,000)					(100,000)
Disposal of treasury shares	114	85					85
Net changes of items other than shareholders' equity			8,704	(2,617)	6,087	310	6,397
Total changes of items during the period	(99,886)	57,520	8,704	(2,617)	6,087	310	63,917
Balance at the end of current period	(444,333)	1,694,250	29,791	(12,914)	16,877	1,941	1,713,068

Year ended December 31, 2016

(Millions of yen)

	Shareholders' equity									
		Capital surplus		Retained earnings						
					Other retained earnings					
	Capital stock	Legal capital surplus	Total capital surplus	Legal retained earnings	Reserve for investment loss on developing new business	Reserve for reduction entry	Special account for reduction entry	General reserve	Retained earnings brought forward	Total retained earnings
Balance at the beginning of current period	100,000	736,400	736,400	18,776	—	47,587	2,582	955,300	277,938	1,302,183
Changes of items during the period										
Provision of reserve for investment loss on developing new business					28				(28)	—
Provision of reserve for reduction entry						3,913			(3,913)	—
Reversal of reserve for reduction entry						(8,805)			8,805	—
Adjustment to reserve due to change in tax rate						992			(992)	—
Provision of special account for reduction entry							2,987		(2,987)	—
Reversal of special account for reduction entry							(2,582)		2,582	—
Adjustment to special account due to change in tax rate							69		(69)	—
Dividends from surplus									(229,223)	(229,223)
Net income									173,607	173,607
Purchase of treasury shares										
Disposal of treasury shares									(99)	(99)
Net changes of items other than shareholders' equity										
Total changes of items during the period	—	—	—	—	28	(3,900)	474	—	(52,318)	(55,714)
Balance at the end of current period	100,000	736,400	736,400	18,776	28	43,687	3,057	955,300	225,620	1,246,469

	Shareholders' equity		Valuation and translation adjustments			Subscription rights to shares	Total net assets
	Treasury shares	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	(444,333)	1,694,250	29,791	(12,914)	16,877	1,941	1,713,068
Changes of items during the period							
Provision of reserve for investment loss on developing new business		—					—
Provision of reserve for reduction entry		—					—
Reversal of reserve for reduction entry		—					—
Adjustment to reserve due to change in tax rate		—					—
Provision of special account for reduction entry		—					—
Reversal of special account for reduction entry		—					—
Adjustment to special account due to change in tax rate		—					—
Dividends from surplus		(229,223)					(229,223)
Net income		173,607					173,607
Purchase of treasury shares	(0)	(0)					(0)
Disposal of treasury shares	512	413					413
Net changes of items other than shareholders' equity			(3,584)	9,541	5,956	(147)	5,809
Total changes of items during the period	512	(55,203)	(3,584)	9,541	5,956	(147)	(49,394)
Balance at the end of current period	(443,822)	1,639,047	26,207	(3,373)	22,833	1,794	1,663,675

【Notes to nonconsolidated financial statements】

(Significant accounting policies)

1. Basis and method of valuation for securities

(1) Shares of 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 by 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

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 is applied. However, the straight-line method is applied for buildings (excluding accompanying facilities) acquired on or after April 1, 1998 and for accompanying facilities and structures acquired on or after April 1, 2016.

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)

The straight-line method.

The main useful lives are as follows:

Patent right:	8 years
Right of trademark:	10 years
Software:	5 years
Goodwill	10 years

(3) Lease assets

For finance leases that do not transfer ownership of the leased property to the lessee, depreciation expense is mainly computed by 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 rate 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 benefit obligations 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 year ended December 31, 2016.

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

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.

(Changes in accounting policies)

(Application of Practical Solution on a change in depreciation method due to Tax Reform 2016)

Following the revision to the Corporation Tax Act, the “Practical Solution on a change in depreciation method due to Tax Reform 2016” (ASBJ Practical Issues Task Force No. 32 of June 17, 2016) was applied from this fiscal year and the depreciation method for accompanying facilities with buildings and structures acquired on or after April 1, 2016 was changed from the declining-balance method to the straight-line method.
The impact of these changes on operating income, ordinary income and income before income tax is immaterial.

(Application of Revised Accounting Standard for Business Combinations)

From the beginning of this fiscal year, the Company has adopted the "Revised Accounting Standard for Business Combinations" (ASBJ Statement No. 21 of September 13, 2013; the "Business Combinations Accounting Standard") and the "Revised Accounting Standard for Business Divestitures" (ASBJ Statement No. 7 of September 13, 2013; the "Business Divestiture Accounting Standard"), etc., and the accounting method was changed to recognize the acquisition-related costs as expenses for the fiscal year in which they occurred. In addition, for business combinations that take place from the beginning of this fiscal year, the accounting method was changed to retroactively reflect adjustments to the amount allocated to acquisition cost under tentative accounting treatment on the nonconsolidated financial statements for the fiscal year in which the relevant business combinations became or will become effective.

In accordance with the transitional accounting treatment set forth in Article 58-2 (4) of the Business Combinations Accounting Standard and Article 57-4 (4) of the Business Divestiture Accounting Standard, these accounting standards have been prospectively applied from the beginning of this fiscal year.

The impact of these changes on operating income, ordinary income and income before income tax is immaterial.

(Change in method of presentation)

(Nonconsolidated statement of income)

In the previous fiscal year, "Business restructuring costs" was presented separately in "Extraordinary losses;" however, in this fiscal year, it is included in "Other" in "Extraordinary losses" due to its decreased materiality. In order to reflect this change in method of presentation, the financial statements for the previous fiscal year have been reclassified.

Accordingly, in the statement of income for the previous fiscal year, ¥ 3,333 million that was previously shown as "Business restructuring costs" has been reclassified to "Other" in "Extraordinary losses".

(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 December 31, 2015	As of December 31, 2016
Short-term receivables	19,920	25,277
Short-term payables	23,079	26,330
Long-term payables	7,673	6,367

*3. "Cash management system deposits received" represents the fund entrusted in the cash management system of domestic group companies.

4. Contingent obligations

Guarantees are provided for bank loans and others of subsidiaries and affiliates as follows:

Bank loans and others

As of December 31, 2015			As of December 31, 2016		
	(Millions of yen)			(Millions of yen)	
JT International Company Netherlands B.V	32,850	(EUR 249 million)	JT International Holding B.V.	58,311	(USD 500 million) others
JT International Hellas A.E.B.E.	28,655	(EUR 218 million)	JT International Hellas A.E.B.E.	40,698	(EUR 333 million)
JTI Ireland Limited	17,267	(EUR 131 million)	JT International S.A.	14,983	(USD 80 million)
JT Tobacco International Taiwan Corp.	11,021	(TWD 3,000 million)			(EUR 37 million) (RUB 312 million) others
JT International Spol s r.o.	10,676	(CZK 2,195 million)	LLC Petro	11,304	(EUR 5,886 million)
Other (36 companies)	56,108		Other (39 companies)	54,893	
Total	156,578		Total	180,189	

Note: Guarantee obligations denominated in foreign currencies were translated into yen amounts using the exchange rate as of the closing date of the accounting period.

(Notes to nonconsolidated statement of income)

*1. Net sales including tobacco excise taxes

(Millions of yen)

	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016
Net sales including tobacco excise taxes	2,011,896	1,955,218

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 December 31, 2015	Fiscal year ended December 31, 2016
Promotion expenses	42,265	48,832
Compensations, salaries and allowances	30,772	28,260
Provision for bonus	3,493	3,493
Employee benefit expenses	11,658	11,928
Commission	27,469	23,743
Depreciation and amortization	16,470	66,520
Research and development expenses	45,589	47,783
Selling expenses ratio	49%	57%
General and administrative expenses ratio	51%	43%

*3. The main component of "Gains on sales of noncurrent assets" is as follows:

(Millions of yen)

	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016
Land	6,865	36,546

*4. The main component of "Losses on sales of noncurrent assets" is as follows:

(Millions of yen)

	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016
Buildings	49	939

*5. The main components of "Losses on disposal of noncurrent assets" are as follows:

(Millions of yen)

	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016
Buildings	12,573	4,510
Machinery and equipment	1,352	2,479

*6. Amounts of transactions with subsidiaries and affiliates are as follows:

(Millions of yen)

	Fiscal year ended December 31, 2015	Fiscal year ended December 31, 2016
Net sales	84,780	89,831
Purchase of goods	88,434	73,784
Selling, general and administrative expenses	52,480	53,243
Dividends income	137,634	5,445
Amount of non-operating transactions	28,329	22,191

*7. “Loss on liquidation of business” for the fiscal year ended December 31, 2015 relates to costs of withdrawal from the beverage business.

(Securities)

Investments in subsidiaries and affiliates

As of December 31, 2015

(Millions of yen)

Type	Balance sheet amount	Fair value	Difference
Investments in subsidiaries	41,580	42,716	1,136
Total	41,580	42,716	1,136

As of December 31, 2016

(Millions of yen)

Type	Balance sheet amount	Fair value	Difference
Investments in subsidiaries	41,580	39,806	(1,774)
Total	41,580	39,806	(1,774)

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 December 31, 2015	As of December 31, 2016
Investments in subsidiaries	1,812,393	1,627,971
Investments in affiliates	163	163

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 December 31, 2015	As of December 31, 2016
Deferred tax assets		
Provision for retirement benefits	22,158	23,534
Obligations pertaining to mutual assistance pension benefits	19,625	16,379
Accounts payable to employees who have agreed to early retirement	10,418	4,293
Other	26,123	23,999
Subtotal	78,324	68,205
Less valuation allowance	(6,326)	(11,136)
Total	71,998	57,070
Deferred tax liabilities		
Reserve for reduction entry	(22,404)	(19,109)
Deferred gains or losses on hedges	(35)	(10,751)
Valuation difference on available-for-sale securities	(12,764)	(10,290)
Other	(3,955)	(8,890)
Total	(39,157)	(49,040)
Net deferred tax assets	32,840	8,030

2. Reconciliation between the effective statutory tax rate and the actual effective tax rate after applying tax effect accounting, if there is a significant difference

(%)

	As of December 31, 2015	As of December 31, 2016
Effective statutory tax rate	35.41	Note relating to the reconciliation between the effective statutory tax rate and the actual effective tax rate after applying tax effect accounting is omitted due to the fact that the difference is less than 5 percent of effective statutory tax rate.
(Adjustments)		
Permanent difference arising from non-taxable items including dividend income	(11.17)	
Tax credit of items including research and development expenses	(0.63)	
Effect of tax rate change	0.92	
Other	0.21	
Actual effective tax rate after applying tax effect accounting	24.74	

3. Adjustment of amounts of deferred tax assets and deferred tax liabilities due to changes in corporate tax rates

With the enactment of “Act for Partial Revision of the Income Tax Act and Other Acts” (Act No. 15 of 2016) and “Act for Partial Revision of Local Taxation Act and Other Acts” (Act No. 13 of 2016) on March 29, 2016 in the National Diet of Japan, corporate tax rates are reduced from fiscal years beginning on or after April 1, 2016. Accordingly, the effective statutory tax rate used for the calculation of deferred tax assets and deferred tax liabilities is changed from 32.01% to 30.66% for the temporary differences to be reversed in the fiscal year beginning on January 1, 2017 and to 30.43% for the temporary differences to be reversed in the fiscal years beginning on or after January 1, 2018.

As a consequence of this tax rate change, deferred tax assets (net of deferred tax liabilities) are decreased by ¥641 million, and income taxes–deferred, valuation difference on available-for-sale securities and deferred gains or losses on hedges are increased by ¥1,729 million, ¥534 million and ¥553 million, respectively.

(Business combination)

(1) Summary of business combinations

i) Acquired business

The Natural American Spirit business outside the United States from the Reynolds American Inc. group

ii) Major reason for the business combinations

The reason for this acquisition is that Natural American Spirit, which has a strong presence in a premium priced category, allows the Company to further extend its brand portfolio, strengthen the business foundation and underpin the Company's sustainable long-term profit growth.

iii) Date of business combinations

January 13, 2016

iv) Legal form of the business combinations

Transfer of business

v) Major reasons for the determination of the acquiring company

Transfer of business for consideration of cash

(2) Period of operating result of the acquired business included in the financial statements

From January 13, 2016 to December 31, 2016

(3) Acquisition costs of the acquired business and its breakdown

Cash consideration	¥ 520,159 million

(4) Amount, reason and amortization method and period of goodwill incurred

i) Amount	¥ 357,710 million

ii) Reason

Goodwill represents future economic benefits from integration synergies including enhanced business scale in the "Domestic Tobacco Business"

iii) Amortization method and period

Straight-line method over 10 years

(5) Assets acquired and liabilities assumed on the business combination date and their major breakdown

Trademark	¥ 162,449 million

(Significant subsequent events)

Return of paid-in capital from a subsidiary

On January 11, 2017, the Company received approximately $0.5 billion (approximately ¥57.9 billion) return of paid-in capital from JT International Group Holding B.V. to repay a bank loan.

d. Supplementary statements

Detailed schedule of property, plant and equipment and others

(Millions of yen)

	Type of assets	Balance as of January 1, 2016	Increase in the fiscal year ended December 31, 2016	Decrease in the fiscal year ended December 31, 2016	Depreciation during the fiscal year ended December 31, 2016	Balance as of December 31, 2016	Accumulated depreciation or accumulated amortization as of December 31, 2016
Property, plant and equipment	Buildings	89,584	8,322	3,763 (120)	7,469	86,673	219,575
	Structures	3,151	438	310 (6)	367	2,912	11,453
	Machinery and equipment	62,769	6,840	3,301	13,366	52,941	161,926
	Vehicles	1,746	455	89	459	1,654	1,717
	Tools, furniture and fixtures	21,300	5,840	642	8,006	18,492	73,596
	Land	78,383	34	3,300 (467)	—	75,118	—
	Construction in progress	2,440	2,234	2,144	—	2,530	—
	Total property, plant and equipment	259,374	24,163	13,549 (593)	29,667	240,321	468,267
Intangible assets	Patent right	418	11	—	66	363	—
	Right of trademark	3,424	162,690	—	16,940	149,174	—
	Software	16,038	3,962	82	6,746	13,172	—
	Goodwill	—	357,710	—	35,771	321,939	
	Other	1,687	2,261	920	136	2,892	—
	Total intangible assets	21,566	526,634	1,002	59,659	487,539	—

Notes: 1. The figures in parentheses in the “Decrease in the fiscal year ended December 31, 2016” column represent decreases due to impairment loss included in the figures above.

2. Other includes software in progress.

3. The major item of “Increase in the fiscal year ended December 31, 2016” and “Decrease in the fiscal year ended December 31, 2016” is as follows:

(Millions of yen)

Right of trademark	Increase	Right of trademark in tobacco business	162,449
Goodwill	Increase	Goodwill in tobacco business	357,710

Detailed schedule of reserve allowances

(Millions of yen)

Category	Balance as of January 1, 2016	Increase in the fiscal year ended December 31, 2016	Decrease in the fiscal year ended December 31, 2016	Balance as of December 31, 2016
Allowance for doubtful accounts	341	5	27	318
Provision for bonuses	5,290	5,596	5,290	5,596

(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

VI. Outline of filing company’s business concerning shares

Business year	From January 1 to December 31
Ordinary General Meeting of Shareholders	March
Record date	December 31
Record dates for dividends from surplus	June 30, December 31
Share trade unit	100 shares
Purchase/sale of shares less than one unit: Office for handling business Shareholder registry administrator Forwarding office Handling charge for purchase/sale	 (Special account) 4-5, Marunouchi 1-chome, Chiyoda-ku, Tokyo, Japan Mitsubishi UFJ Trust and Banking Corporation, Corporate Agency Division (Special account) 4-5, Marunouchi 1-chome, Chiyoda-ku, Tokyo, Japan Mitsubishi UFJ Trust and Banking Corporation – Free
Method of public notice	Electronic public notice will be made. However, if the Company is unable to make electronic public notice due to an accident or any other compelling reason, it will make an alternative public notice on “The Nikkei” newspaper. Electronic public notice will be notified on the Company’s website: URL: https://www.jt.com/
Special benefits for shareholders	Special benefits for shareholders (1) Scope: All shareholders who appear in the shareholder registry as of December 31 and June 30 each year and hold 100 or more shares. (2) Description: The Company presents its own products (including products of the group companies and gifts and novelties with the Company name) 1) Shareholders with 100 or more than 100 and less than 200 shares — ¥1,000 equivalent 2. Shareholders with 200 or more than 200 and less than 1,000 shares — ¥2,000 equivalent 3) Shareholders with 1,000 or more than 1,000 and less than 2,000 shares — ¥3,000 equivalent 4) Shareholders with 2,000 or more shares — ¥6,000 equivalent * It is possible to choose for a contribution to be made to an organization that carries out social contribution activities in lieu of the presentation of products.

VII. Reference information on filing company

1. Information on filing company's parent company

The Company does not have a parent company as described by the provisions of Article 24-7, paragraph 1 of the Financial Instruments and Exchange Act.

2. Other reference information

From the beginning of this fiscal year until the filing date of this Annual Securities Report, the Company has filed the following documents.

(1) Annual Securities Report and Appendices, and Written Confirmation

Filed to Director-General of Kanto Local Finance Bureau on March 23, 2016

Business year: 31st term (from January 1, 2015 to December 31, 2015)

(2) Internal Control Report

Filed to Director-General of Kanto Local Finance Bureau on March 23, 2016

Business year: 31st term (from January 1, 2015 to December 31, 2015)

(3) Quarterly Securities Reports and Written Confirmations

Filed to Director-General of Kanto Local Finance Bureau on May 6, 2016

First quarter of the 32nd term (from January 1, 2016 to March 31, 2016)

Filed to Director-General of Kanto Local Finance Bureau on August 2, 2016

Second quarter of the 32nd term (from April 1, 2016 to June 30, 2016)

Filed to Director-General of Kanto Local Finance Bureau on November 1, 2016

Third quarter of the 32nd term (from July 1, 2016 to September 30, 2016)

(4) Extraordinary Reports

Filed to Director-General of Kanto Local Finance Bureau on March 24, 2016

Extraordinary Report based on Article 19, paragraph 2, item (ix-2) (Results of Exercise of Voting Rights at the Annual General Meeting of Shareholders) of the Cabinet Office Ordinance on Disclosure of Corporate Information, etc.

Filed to Director-General of Kanto Local Finance Bureau on June 17, 2016

Extraordinary Report based on Article 19, paragraph 2, item (ii-2) (Issuance of Subscription Rights to Shares as Stock Options) of the Cabinet Office Ordinance on Disclosure of Corporate Information, etc.

(5) Amendment Report of Extraordinary Report

Filed to Director-General of Kanto Local Finance Bureau on July 5, 2016

Amendment Report of Extraordinary Report filed on June 17, 2016.

(6) Amendment to Shelf Registration Statements

Filed to Director-General of Kanto Local Finance Bureau on March 24, 2016, June 17, 2016 and on July 5, 2016

Amendment to Shelf Registration Statements pertaining to Shelf Registration Statement (straight bonds) filed on August 4, 2015.

B. Information on Guarantee Companies, etc. of Filing Company

No items to report

INDEPENDENT AUDITOR'S REPORT

March 24, 2017

To the Board of Directors of
Japan Tobacco Inc.:

Deloitte Touche Tohmatsu LLC

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Masahiko Tezuka (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 January 1, 2016 to December 31, 2016, 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 pursuant to the provisions 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 Japan Tobacco Inc. and its consolidated subsidiaries as of December 31, 2016, and the results of their operations and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

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 Japan Tobacco Inc. as of December 31, 2016.

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 Japan Tobacco Inc. as of December 31, 2016 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.

INDEPENDENT AUDITOR'S REPORT

March 24, 2017

To the Board of Directors of
Japan Tobacco Inc.:

Deloitte Touche Tohmatsu LLC

Designated Unlimited Liability Partner, Engagement Partner, Certified Public Accountant:	Masahiko Tezuka	(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 nonconsolidated 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 32nd fiscal year from January 1, 2016 to December 31, 2016, 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 Japan Tobacco Inc. as of December 31, 2016, and the results of its operations for the 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.