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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					
	29th term	30th term	31st term	32nd term	33rd term	34th term
Accounting period	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	From January 1, 2017 to December 31, 2017	From January 1, 2018 to December 31, 2018
Revenue (Millions of yen)	2,399,841	2,019,745	2,252,884	2,143,287	2,139,653	2,215,962
Profit before income taxes (Millions of yen)	636,203	502,526	565,113	578,237	538,532	531,486
Profit for the year (Millions of yen)	435,291	368,626	490,242	425,773	396,749	387,431
Profit attributable to owners of the parent company (Millions of yen)	427,987	362,919	485,691	421,695	392,409	385,677
Comprehensive income (loss) for the year (Millions of yen)	850,261	244,868	207,708	235,250	554,198	129,302
Total equity (Millions of yen)	2,596,091	2,622,503	2,521,524	2,528,041	2,842,027	2,700,445
Total assets (Millions of yen)	4,616,766	4,704,706	4,558,235	4,744,374	5,221,484	5,461,400
Equity attributable to owners of the parent company per share (Yen)	1,378.57	1,395.74	1,369.06	1,371.39	1,541.94	1,468.44
Basic earnings per share (Yen)	235.48	199.67	270.54	235.47	219.10	215.31
Diluted earnings per share (Yen)	235.35	199.56	270.37	235.33	218.97	215.20
Ratio of equity attributable to owners of the parent company to total assets (%)	54.27	53.92	53.78	51.77	52.89	48.17
Ratio of profit to equity attributable to owners of the parent company (%)	19.85	14.39	19.47	17.19	15.04	14.30
Price earnings ratio (PER) (Times)	13.76	16.67	16.53	16.32	16.57	12.15
Net cash flows from operating activities (Millions of yen)	396,496	543,696	468,432	376,549	419,212	461,389
Net cash flows from investing activities (Millions of yen)	(163,473)	(49,110)	(63,271)	(687,509)	(352,632)	(383,307)
Net cash flows from financing activities (Millions of yen)	(145,189)	(388,859)	(254,852)	91,318	(77,032)	(62,360)
Cash and cash equivalents at the end of the year (Millions of yen)	253,219	385,820	526,765	294,157	285,486	282,063
Number of employees [Separately, average number of temporary employees] (Person)	51,563 [9,130]	51,341 [8,700]	44,485 [7,858]	44,667 [7,904]	57,963 [6,744]	63,968 [6,618]

Notes: 1. The Group prepares the consolidated financial statements 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 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.
5. 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.
6. 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.

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

Term	29th term	30th term	31st term	32nd term	33rd term	34th term
Accounting period	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	From January 1, 2017 to December 31, 2017	From January 1, 2018 to December 31, 2018
Net sales (Millions of yen)	809,967	572,323	732,483	729,286	681,840	696,250
Ordinary income (Millions of yen)	230,900	159,746	371,989	203,242	199,336	190,343
Net income (Millions of yen)	168,779	108,656	345,009	173,607	160,120	164,595
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)	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Net assets (Millions of yen)	1,734,379	1,649,151	1,713,068	1,663,675	1,592,966	1,493,562
Total assets (Millions of yen)	2,732,637	2,729,270	2,756,785	2,849,913	2,885,760	2,682,344
Net assets per share (Yen)	953.45	906.45	955.56	927.93	888.31	832.87
Cash dividends per share (Yen) [Interim dividends per share] (Yen)	96 [46]	100 [50]	118 [54]	130 [64]	140 [70]	150 [75]
Net income per share (Yen)	92.86	59.78	192.18	96.94	89.40	91.89
Diluted net income per share (Yen)	92.81	59.75	192.06	96.88	89.35	91.84
Equity ratio (%)	63.4	60.4	62.1	58.3	55.1	55.6
Return on equity (ROE) (%)	9.80	6.43	20.54	10.29	9.84	10.68
Price earnings ratio (PER) (Times)	34.89	55.67	23.26	39.65	43.00	28.48
Dividend payout ratio (%)	103.4	167.3	61.4	134.1	156.6	163.3
Number of employees [Separately, average number of temporary employees] (Person)	8,774 [1,377]	8,915 [1,272]	7,549 [1,125]	7,298 [1,117]	7,336 [1,222]	7,457 [1,225]

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 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 2005	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.
June	2018	The Company began selling T-Vapor products nationwide.

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 224 consolidated subsidiaries and 11 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 7 consolidated subsidiaries and 1 company 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 Ürünleri Sanayi A.S.

Besides the companies named above, there are 159 consolidated subsidiaries and 5 companies accounted for by the equity method.

Pharmaceutical Business

The Pharmaceutical Business consists of research and development, manufacture, sale and promotion of prescription drugs. The Company concentrates on research and development while Torii Pharmaceutical Co., Ltd. manufactures, sells and promotes 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

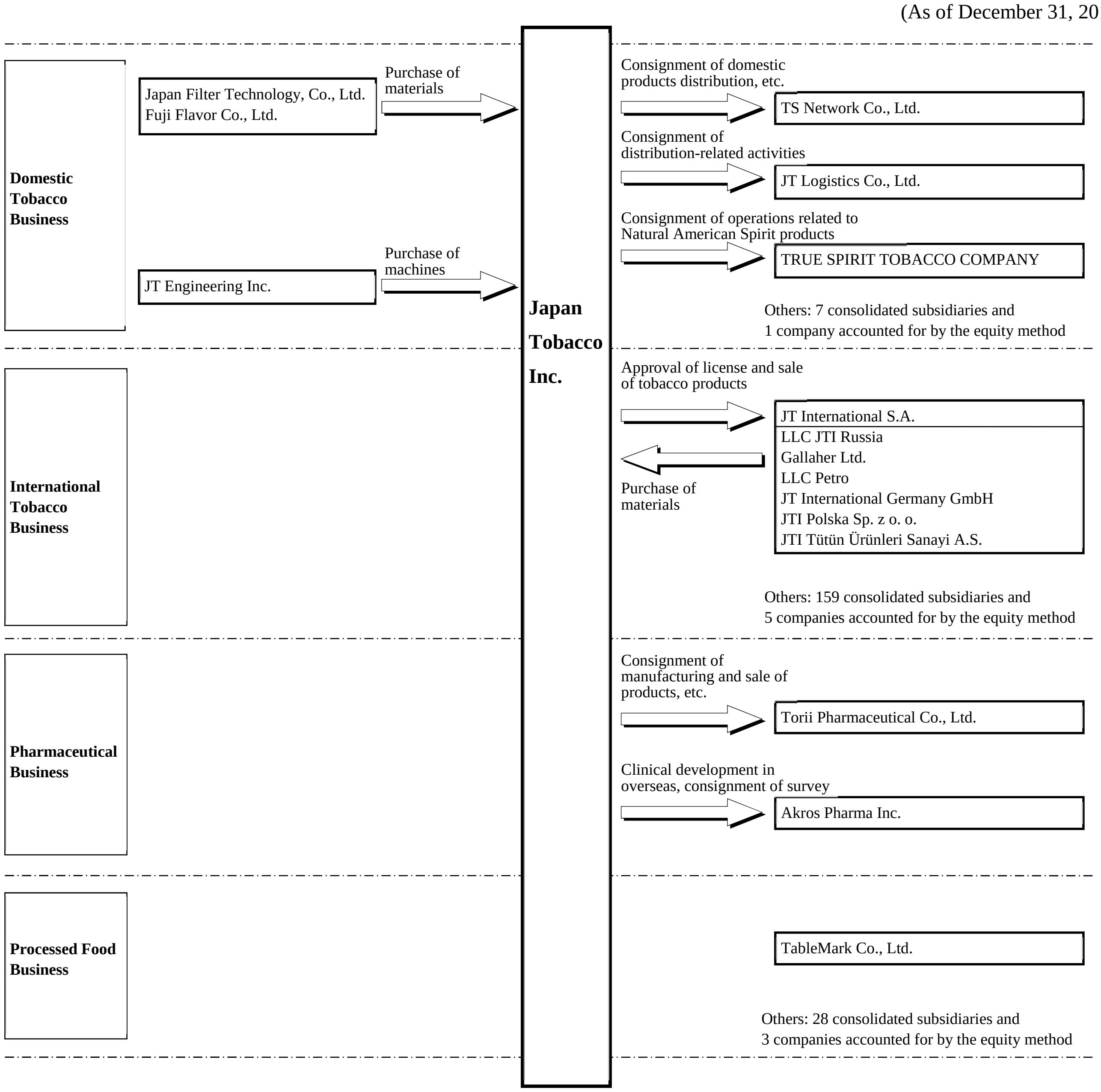
TableMark Co., Ltd.

Besides the companies named above, there are 28 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 14 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, 2018)



* In addition to the reportable segments mentioned above, the Group runs businesses including business relating to the rent of real estate. There are 14 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 130 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 RRP(Note)-related technologies. 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.

Note: Reduced-Risk Products (RRP) are products with potential to reduce the risks associated with smoking such as E-Vapor products and T-Vapor products.

<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 35 factories in 28 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 consist of four brands, which serve as flagships of the Group's brand portfolio - Winston, Camel, MEVIUS and LD.

<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, manufacture, and sales and promotion 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 manufacture, 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, immune disorders and inflammation, and virus research. In the fiscal year ended December 31, 2018, the Group invested ¥37.1 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.

<Manufacturing>

The Group’s pharmaceutical products are manufactured 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 507 medical representatives (MRs) stationed at Torii Pharmaceutical’s 14 sales branches across Japan.

Descovy Combination Tablets, an anti-HIV drug, and REMITCH, the treatment drug of pruritus in dialysis patients are the main products among others.

In addition, the domestic licensing agreement (hereinafter, “the original agreement”) for the exclusive development and commercialization of six anti-HIV drugs, including Descovy Combination Tablets, which had been concluded between the Company, Gilead Sciences Inc. (hereinafter, “Gilead”) and Torii Pharmaceutical, expired on January 1, 2019. For the period extending from the expiration of the original contract to the point at which Gilead’s Japanese subsidiary, Gilead Sciences, Inc., completes the process of obtaining approval for domestic manufacturing and distribution, the Company will purchase the six anti-HIV drugs from Gilead under interim terms of business, with Torii Pharmaceutical being responsible for sales and distribution within Japan.

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 the end of the current fiscal year, this business is operated by the pure holding company TableMark Holdings Co., Ltd. (hereinafter, “TMHD”), 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.

In addition, it was resolved at a meeting of the Board of Directors of the Company on October 31, 2018, that the Processed Food Business would undergo a reorganization. Accordingly, the Company established the Processed Food Business Planning Division on January 1, 2019, with the liquidation of TMHD scheduled for March 2019, but there has been no change in the content of the Group’s Processed Food Business.

<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.

<Manufacturing>

The Group operates 23 factories in Japan and 8 outside Japan. The Group outsources manufacturing 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 31 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 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 “Manufacturing” sections, are disclosed on the website.

4. Status of subsidiaries and affiliates

(As of December 31, 2018)

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) 224 companies									
TS Network Co., Ltd. *1	Taito-ku, Tokyo	460	Domestic tobacco	85.3	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	88.9	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)	Yes	No	No	No	No
JT International S.A. *1	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 Ürünleri Sanayi A.S.	Turkey	Thousands of TRY 148,825	International tobacco	100.0 (100.0)	No	No	No	No	No
Torii Pharmaceutical Co., Ltd. *2	Chuo-ku, Tokyo	5,190	Pharmaceutical	54.9	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 *3	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 205 companies *1									
(Companies accounted for by the equity method) 11 companies									
Megapolis Distribution B.V.	Netherlands	EUR 15	International tobacco	23.0 (23.0)	No	No	No	No	No
Other 10 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 205 companies” are as follows.

   JTI-Macdonald Corp., JT Canada LLC Inc., JT International (Philippines) Inc., JTI Processadora de Tabaco do Brasil Ltda., Japan Tobacco International Manufacturing Co., Ltd., PT. Karyadibya Mahardhika, JT International Asia Manufacturing Corp., JTI (UK) Management Ltd., Gallaher Group Ltd., Benson & Hedges Ltd., Gallaher Overseas (Holdings) Ltd., Austria Tabak GmbH

5. *2: This company files Annual Securities Report.

6. *3: Liquidation is scheduled for March 2019.

7. Consolidated subsidiary Green Foods Co., Ltd. is insolvent, with liabilities exceeding assets by ¥11,088 million. Green Foods Co., Ltd. suspended business operations in December 2012.

5. Status of employees

(1) Consolidated companies

(As of December 31, 2018)

Segment	Number of employees (Person)
Domestic Tobacco Business	10,566 [3,198]
International Tobacco Business	45,319 [1,579]
Pharmaceutical Business	1,877 [159]
Processed Food Business	5,303 [1,606]
Common company-wide services within the filing company	903 [76]
Total	63,968 [6,618]

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, 2018 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 has increased by 6,005 people compared to the end of the previous fiscal year, but this is due mainly to acquisition of the tobacco business of the Akij Group (hereinafter, "Akij").

* The Company acquired all of the shares issued of United Dhaka Tobacco Company Limited to which Akij had transferred assets related to its tobacco business, and also tobacco-related rights of trademarks owned by Akij.

(2) Filing company (the Company)

(As of December 31, 2018)

Number of employees (Person)	Average age (Year old)	Average years of service (Year)	Average annual salary (Yen)
7,457 [1,225]	42.7	18.3	8,224,787

The numbers of employees by segment are as follows.

Segment	Number of employees (Person)
Domestic Tobacco Business	6,210 [1,211]
Pharmaceutical Business	785 [10]
Common company-wide services within the filing company	462 [4]
Total	7,457 [1,225]

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, 2018 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 (86), employees on leave (121) and employees transferred to the Company (73), but excludes employees transferred from the Company (747).

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. Management policy, business environment, issues to be addressed, etc.

The following includes forward-looking statements determined, unless otherwise indicated, as of the filing date.

(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) Business environment

The Group recognizes that uncertainties in the business environment in which it operates are growing, due to factors such as global economic trends, foreign exchange risks and international geopolitical risks. Enhancing adaptability to such a changing environment is 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.

In addition, in recognition of changes in customer behavior, and of the emergence of competitive situations that transcend industry boundaries, as a result of the forward march of digital technology, we believe that, rather than merely responding passively while enhancing adaptability to such a changing environment, we should initiate transformation ourselves, while accelerating evolution to an organization that will lead this revolution.

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.

(3) 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. On the other hand, with the aim of positioning the Pharmaceutical Business and the Processed Food Business as complementary drivers of profit growth for the Group as a whole, the focus will be on rebuilding their business foundations, and making the investments required to implement that.

From 2019 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.

(4) 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 2019 in accordance with the management principles and the resource allocation policy.

In the "Business Plan 2019," 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 has a stakeholder model similar to our "4S" model, and has realized strong business growth.

The above-mentioned shareholder return policies have not changed, but while continuing to use as a base the projected rate of growth over the mid- to long-term in adjusted operating profit at constant rates of exchange, going forward the dividend per share will also be set with reference to the level of profit for the year.

(5) 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>

- Strengthening RRP initiatives

The Group believes that RRP are beneficial to the consumer, to society, and to the business of the Group, and has positioned RRP as the pillar of sustainable growth for the Tobacco Business, with resources to this area being given priority allocation going forward. The Group will focus on developing RRP that will be chosen by more consumers, and leverage innovation to broaden its portfolio of high-quality products, thus satisfying the changing needs of consumers.

With regard to existing tobacco products, there has been no change to their importance as the foundation of our profits, and the Group will continue to make business investments with the aim of achieving sustainable 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 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.

<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 (hyposensitization therapy (allergen immunotherapy) drug), Genvoya® Combination Tablets, Descovy® Combination Tablets LT and HT (anti-HIV drug) and CEDARCURE® Japanese Cedar Pollen Sublingual Tablets (hyposensitization therapy (allergen immunotherapy) drug). Outside Japan, the licensing partners are currently selling Stribild® Combination Tablets (anti-HIV drug), Genvoya® (anti-HIV drug) and Mekinist® (melanoma and NSCLC 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 aims to contribute to the earnings of the Group through mid- to long-term profit growth driven by high-quality expansion in the top line.

<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, implement bold and expeditious reforms of mindset and behavior, 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.

2. 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. However, the risks described below do not constitute an exhaustive list of all the risks related to the Group, and risks not described below also exist. All of the risk factors may potentially have an effect on investment 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 130 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 36.8% (¥2,008.4 billion) and 9.2% (¥503.1 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 59.2% and 64.6% in the fiscal year ended December 31, 2018. 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 a 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. 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.

e. Climate Change

The climate change that accompanies global warming is the cause of a variety of suffering, including inundation, flooding and landslide damage resulting from abnormal weather, such as concentrated, torrential rain; extreme heat, heavy snowfall and droughts caused by unseasonable weather; fluctuations in water reserves; loss of biodiversity. The impact of climate change damages not only the Group but also the Group's value chain, and so may negatively affect its business performance.

In order to reduce its environmental impact, the Group has implemented a range of measures, such as cutting greenhouse gas emissions, making more efficient use of water resources, and reducing waste products, and is also strengthening its initiatives in relation to environmental issues in its value chain. The Group is also putting in place a system that will enable it to more accurately grasp, and create appropriate responses to, the way that climate change affects its business, such as by setting science-based targets for reductions in greenhouse gas emissions, and by considering scenario analyses.

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 130 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. Total tobacco demand 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 an outside party infringes the Group's intellectual property rights, the Group's technology may not be sufficiently protected, which in turn could lead to negative effects on the Group's business strategies and financial position. Or, if it is acknowledged that the Group has infringed the intellectual property rights of an outside party, the Group may risk having to pay compensation for damages, or becoming unable to sell the product in the market, which could negatively affect the Group's business strategies and the financial position.

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.

l. Information Security

The Group has put in place a variety of rules in relation to information security, and works to protect and manage information assets, such as the systems and data owned by the Group, in an appropriate manner.

However, in the event that damage to systems, or leaks of confidential information occur as a result of unforeseen circumstances, such as attacks by illicit access or computer viruses, or disasters, the business performance of the Group may be negatively affected.

(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 addition, in accordance with the diversifying needs of consumers, the RRP market has been expanding rapidly in recent years, and the Group perceives that continuing to provide products that precisely capture consumer needs is even more important than it has been hitherto.

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.

The Act for Partial Amendment of the Income Tax Act, etc. (Act No. 7 of March 31, 2018) and the Act for Partial Amendment of the Local Tax Act, etc. (Act No. 3 of March 31, 2018) were established as part of the 2018 Tax Reform. For details, see "(4) Other factors which may materially affect investment decisions, c. Legal matters relating to the business of filing company, (iii) Acts relating to tobacco excise taxes."

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, and came into effect in September 2018.

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 enforcing this revised EU TPD 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" (hereinafter, "Advertising Guideline") based on the Tobacco Business Act, Article 39 (warning labels) and Article 40 (advertising regulations). The Advertising 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 the Advertising Guideline. The labeling subcommittee reported the results of its investigation to the tobacco business subcommittee in June 2016, and as a result of further discussions conducted within the tobacco business subcommittee, "Review of Warning Labels Regulations / Advertising Regulations" was published on December 28, 2018. In relation to warning labels on tobacco product packages, the document concludes that it is appropriate to implement, by July 1, 2020, a full-scale switch to new methods of presentation, such as adding to or revising the wording to reflect the latest scientific knowledge, and increasing the surface area of the warning label by at least 50%. In addition, with regard to advertising regulations, based on the forthcoming review of the Advertising Guideline the industry is being required to review and revise its voluntary standards, such as by devising more effective measures to avoid targeting minors in Internet advertising, etc., and by accepting the necessity for new restrictions on the size and presentation methods for point-of-sale advertising.

From the perspective of passive smoking prevention, due in part to the enactment of the Health Promotion Act in May 2003, cases of restrictions on smoking in certain areas in Japan, including public places such as restaurants and office buildings, have been on the increase. Given that the Act for Partial Amendment of the Health Promotion Act (Act No. 78 of July 25, 2018) was enacted in July 2018, the Group expects such trends to 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 21 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 smoking and health-related litigation, the Group may be a party to further cases should litigation occur in the future, such as if any problems arise regarding product quality that lead to the Group becoming the target of claims seeking product liability. Such litigation cases may negatively affect the Group's business performance or manufacture, sale, and import and export of the Company's products, 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, 2018, 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, 7)		¥5,802 per 1,000 cigarettes	¥820 per 1,000 cigarettes	¥930 per 1,000 cigarettes	¥5,692 per 1,000 cigarettes
	On and after October 1, 2020	¥6,302 per 1,000 cigarettes	¥820 per 1,000 cigarettes	¥1,000 per 1,000 cigarettes	¥6,122 per 1,000 cigarettes
	On and after October 1, 2021	¥6,802 per 1,000 cigarettes	¥820 per 1,000 cigarettes	¥1,070 per 1,000 cigarettes	¥6,552 per 1,000 cigarettes
5. Tax rate of former third-class products (Note 5, 8)		¥4,032 per 1,000 cigarettes	¥624 per 1,000 cigarettes	¥656 per 1,000 cigarettes	¥4,000 per 1,000 cigarettes
	On and after October 1, 2019	Due to the abolishment of special tax rates, same as for 4. above			
6. 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"

   As a result of the 2018 Tax Reform, new national and local tobacco excise tax rates have been applied since October 1, 2018. Further changes to the tax rates are scheduled for October 1, 2020 and October 1, 2021.
8. Concerning "5. Tax rate of former third-class products"

   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. The Act for Partial Amendment of the Income Tax Act, etc. (Act No. 7 of March 31, 2018) and the Act for Partial Amendment of the Local Tax Act, etc. (Act No. 3 of March 31, 2018) were established as part of the 2018 Tax Reform. As such, the rate of excise tax applied to former third-class products for the period between April 1, 2018 and March 31, 2019, will be extended to September 30, 2019.
9. 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.

(iv) Taxation methods applied to tobacco products other than cigarettes

The tax base for the tobacco excise tax is held to be the number of cigarettes, but based on the fact that the number of tobacco products other than cigarettes is not understood, the following tobacco product categories are converted into the equivalent of single cigarettes, based on the respective category weights.

Classification		Tax base	Conversion method
Tobacco products for smoking			
	Pipe tobacco	Number of cigarettes resulting from conversion by weight	Converted at the rate of 1g per cigarette
	Cigar tobacco		
	Flake tobacco		Converted at the rate of 2g per cigarette
	Heated tobacco	Separate (refer to figure)	
Chewing tobacco products		Number of cigarettes resulting from conversion by weight	Converted at the rate of 2g per cigarette
Snuff products			

Heated tobacco products were categorized as “pipe tobacco” before the 2018 Tax Reform, and were converted to cigarettes at the rate of 1 g per cigarette, with the cigarette excise tax rate being applied to the resulting number. After the reform a new tax category was established for heated tobacco on October 1, 2018, with these tobacco products being converted to cigarettes at a rate prescribed by the new conversion methods described below. Moreover, with regard to the review of the form of excise taxation for such heated tobacco products, transitional measures have been devised to allow staged implementation between October 1, 2018 and October 1, 2022.

Tax base of heated tobacco			Conversion method
Conversion method before reform	Number of cigarettes resulting from conversion by weight	(A)	Heated tobacco is converted at the rate of 1 g per cigarette
Conversion method after reform	Number of cigarettes resulting from conversion by weight and price	(B)	The prescribed weight of heated tobacco[Note 1] of 0.4g converts to 0.5 cigarettes
		(C)	Based on the average retail price per cigarette[Note 2], the retail price of heated tobacco (excluding the equivalent of consumption tax) is converted to 0.5 cigarettes.

Notes: 1. Weight does not include weight of filter and certain other goods
2. Calculated by dividing the total of the national and local tobacco excise tax per cigarette, and a figure equivalent to tobacco special excise tax, by 60%

		Conversion volume during the transitional measures period (tax base)
On and before September 30, 2018		(A) × 1.0
Revision	October 2018	(A) × 0.8 + {(B) + (C)} × 0.2
	October 2019	(A) × 0.6 + {(B) + (C)} × 0.4
	October 2020	(A) × 0.4 + {(B) + (C)} × 0.6
	October 2021	(A) × 0.2 + {(B) + (C)} × 0.8
	October 2022	{(B) + (C)} × 1.0

[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 portions 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 portions 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 portions 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 portions 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
April 2017	2015 Tax Reform	Based on 2015 Tax Reform, tax increase by ¥1,000 per 1,000 cigarettes for former third-class products	For former third-class products, prices raised by ¥30 per pack
April 2018	2015 Tax Reform	Based on 2015 Tax Reform, tax increase by ¥1,500 per 1,000 cigarettes for former third-class products	For former third-class products, prices raised by ¥40 per pack

Month/Year	Item	Description	The Company's response
October 2018	2018 Tax Reform	Tax increase based on 2018 Tax Reform (Note)	With exception of some brands, prices increased higher than the amount equivalent to tax increase

Note: The review of tobacco excise tax caused by the 2018 Tax Reform resulted in an increase in the national and local tobacco excise tax rate of ¥3,000 per 1,000 cigarettes, with the establishment of a new tax category for heated tobacco, and a review of the form of excise taxation based on the characteristics of these products. These reviews, viewed from the perspective of mitigating radical change, etc., have been respectively devised as transitional measures, with the former implemented in three stages, in which each stage consists of a ¥1,000 increase per 1,000 cigarettes between October 2018 and October 2021 (with no increase in the rate of excise tax in October 2019), and with the latter implemented in five stages between October 2018 and October 2022. In addition, the rate of excise tax applied to former third-class products for the period between April 1, 2018 and March 31, 2019, will be extended to September 30, 2019.

3. Management analysis of financial position, operating results and cash flows

Major notes concerning the operating results from the viewpoint of the management are as follows.

(Analyses and examinations concerning the operating results from the viewpoint of the management begins on the next page.)

(IFRS 15)

From the fiscal year ended December 31, 2018, the Group has adopted IFRS 15 “Revenue from Contracts with Customers.” As a result, compared to the application of the former accounting standard, “Revenue” and “Selling, general and administrative expenses” decreased by ¥10,944 million and ¥70,905 million respectively, and “Cost of sales” increased by ¥59,962 million on the consolidated statement of income for the fiscal year ended December 31, 2018. The above effects include promotion expenses (¥9,028 million) accounted for as reductions of revenue, as well as shipping and warehousing expenses (¥28,000 million) accounted for as cost of sales.

These changes have no effect on operating profit and profit for the year. For details, please refer to “V. Accounting, 1. Condensed financial statements, (1) Consolidated financial statements, Notes to consolidated financial statements, 3. Significant accounting policies.”

(Non-GAAP financial measures)

The Group also discloses certain non-GAAP financial measures that are not required or defined under IFRS, which is the accounting standard the Company applies. These non-GAAP 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.

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, restructuring income and costs, and other items.

Furthermore, growth rate in adjusted operating profit at constant rates of exchange 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. The Group has set its group-wide target for annual average growth rate in adjusted operating profit at constant rates of exchange, at mid to high single-digit over the mid- to long-term, and will continue to pursue this goal.

(Core revenue from tobacco business)

Regarding tobacco business, core revenue is disclosed 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 RRP, 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 RRP, but excludes revenue related to the distribution business and contract manufacturing, among others.

(RRP)

Reduced-Risk Products (RRP) are products with potential to reduce the risks associated with smoking such as E-Vapor products and T-Vapor products.

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 the leaf, they use methods such as heating the leaf to generate vapor (which includes compounds derived from the tobacco leaf) for the user to enjoy.

At the Group, we are committed to developing, testing and bringing to market such new and innovative products for sustainable growth.

Analyses and examinations concerning the operating results from the viewpoint of the management are as follows.

(1) Business results

a. Consolidated results

(Billions of yen)

	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2018	Change
Revenue	2,139.7	2,216.0	3.6%
Adjusted operating profit	585.3	595.5	1.7%
Operating profit	561.1	565.0	0.7%
Profit attributable to owners of the parent company	392.4	385.7	(1.7)%

<Revenue>

In the International Tobacco Business, revenue was affected by the unfavorable foreign exchange effects mainly from weaker local currencies in emerging countries, while the Domestic Tobacco Business was hit by the impact of lower cigarette sales volume, but due to the effects of favorable pricing and the volume effects as a result of business acquisition in the International Tobacco Business, as well as rising RRP-related revenue and the effects of favorable cigarette pricing in the Domestic Tobacco Business, in addition to increased royalty revenue in the Pharmaceutical Business, revenue rose by 3.6% from the previous fiscal year to ¥2,216.0 billion.

<Adjusted operating profit>

Adjusted operating profit at constant rates of exchange grew by 8.9% from the previous fiscal year, with declines in the Domestic Tobacco Business and the Processed Food Business being offset by increases in the International Tobacco Business and the Pharmaceutical Business, with another factor being the posting in the previous year of the one-time loss in relation to the filing for bankruptcy of a distributor in the United Kingdom. Adjusted operating profit including foreign exchange effects increased by 1.7% from the previous fiscal year to ¥595.5 billion, despite unfavorable foreign exchange effects. Excluding the one-time loss in the previous year, adjusted operating profit at constant rates of exchange increased by 4.9%, and adjusted operating profit including foreign exchange effects declined by 1.9%.

<Operating profit>

Operating profit increased by 0.7% from the previous fiscal year to ¥565.0 billion, driven by growth in adjusted operating profit and an increase in gains from the sale of real estate-related assets, despite countering factors including the increase in amortization cost of acquired intangibles arising from business acquisitions.

<Profit attributable to owners of the parent company>

Despite an increase in operating profit, profit attributable to owners of the parent declined by 1.7% from the previous fiscal year to ¥385.7 billion due to an increase in financial costs.

b. Segment results

Domestic Tobacco Business

(Billions of cigarettes, Billions of yen)

Domestic Tobacco Business	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2018	Change
Cigarette industry volume [Note 1]	151.4	132.7	(12.4)%
Sales volume [Note 2]	92.9	82.0	(11.7)%
Core revenue	590.6	582.4	(1.4)%
Adjusted operating profit	232.3	209.0	(10.0)%

<JT cigarette sales volume>

Cigarette industry volume fell 12.4% from the previous fiscal year as a result of the expansion of the RRP market and the downtrend in total demand. Hit by the effects of the decline in cigarette industry volume, JT cigarette sales volume fell by 11.7% from the previous fiscal year. Cigarette market share increased 0.5ppt from the previous fiscal year to 61.8% led by the solid performance of core brands.

The volume of cigarettes manufactured in Japan in the fiscal year ended December 31, 2018 decreased by 14.1 billion cigarettes, or 14.4%, from the previous fiscal year to 83.3 billion cigarettes.

<RRP sales results>

The share of RRP in the domestic tobacco market is estimated to have been 21% for the January - December 2018 period (shipment base). The Company's RRP sales volume reached 2.8 billion cigarette equivalent units.

<Core revenue from tobacco business and adjusted operating profit>

Core revenue from the tobacco business fell by 1.4% from the previous fiscal year, with the positive effects of cigarette pricing and an increase of RRP-related revenue, etc., not offsetting the impact of lower cigarette sales volume and other factors. RRP-related revenue amounted to ¥64.6 billion. Adjusted operating profit decreased by 10.0% from the previous fiscal year, due to the impact of lower cigarette sales volume and an increase of sales promotion expenses, partially offset by an increase in RRP-related revenue and the positive effects of cigarette pricing.

Notes: 1. Cigarette industry volume includes sales volume for the whole Japanese cigarette market. Note also that this does not include the sales volume associated with RRP and the like.

2. In addition to the figure stated above for sales volume, during the fiscal year ended December 31, 2018, 4.0 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 (4.0 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 RRP and the like.

International Tobacco Business

(Billions of cigarettes, Billions of yen)

International Tobacco Business	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2018	Change
Total shipment volume (Note 3)	398.5	427.6	7.3%
GFB shipment volume	260.4	266.4	2.3%
Core revenue	1,177.0	1,250.7	6.3%
Adjusted operating profit	351.3	384.5	9.5%

(Millions of U.S. dollar)

International Tobacco Business (U.S. dollar-based)	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2018	Change
Core revenue	10,498	11,330	7.9% (12.2%)
Adjusted operating profit	3,138	3,493	11.3% (21.3%)
Adjusted operating profit (Excluding the one-time loss recorded in the previous fiscal year)	3,332	3,493	4.8% (14.3%)

* The figures in parentheses show change from previous fiscal year at constant rates of exchange (dollar-based)

<Total shipment volume and market share>

Total shipment volume increased by 7.3% from the previous fiscal year, due to the positive effects of acquisitions in the Indonesia, Ethiopia, Greece, Bangladesh, Philippines and Russia. Total shipment volume excluding the effects of acquisitions fell by 1.1% from the previous fiscal year. Total shipment volume and market share rose in Italy, Iran, the Netherlands, Switzerland, Sweden, Spain, Czech Republic, Germany, Hungary, the United States, Poland, Luxembourg and multiple emerging markets, but due to the fall in total demand in markets such as Taiwan, France and Russia, there was a decline in total shipment volume.

GFB shipment volume rose by 2.3% from the previous year, driven by volume growth of Winston (+3.9%), Camel (+2.8%) and LD (+2.2%). In addition, market share grew in the key markets of Italy, Spain, the United Kingdom, Taiwan, France and Russia.

The volume manufactured overseas including outsourced manufacturing in the fiscal year ended December 31, 2018 increased by 36.6 billion cigarettes, or 9.2%, from the previous fiscal year to 433.0 billion cigarettes.

<Core revenue from tobacco business and adjusted operating profit>

Core revenue from the tobacco business increased by 6.3% from the previous fiscal year, due to the robust manifestation of favorable pricing effects, and the effects of acquisitions. Adjusted operating profit rose by 9.5% from the previous fiscal year, due to higher revenue despite the increase in investments to strengthen the business in the markets where the Company made acquisitions. Adjusted operating profit excluding the one-time loss recorded in the previous fiscal year increased by 3.0%. Moreover, both core revenue and adjusted operating profit were subject to the unfavorable foreign exchange effects.

The effects of favorable pricing and volume effects, primarily in Iran, Ukraine, Canada, Sudan, Taiwan, Philippines, Romania and Russia outweighed unfavorable foreign exchange effects, resulting in dollar-based core revenue rising by 7.9% from the previous fiscal year, and increasing by 12.2% at constant rates of exchange.

Adjusted operating profit at constant rates of exchange, excluding the one-time loss recorded in the previous fiscal year, rose 14.3%, due mainly to favorable pricing effects.

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

*The exchange rates of currencies against the U.S. dollar for the fiscal year ended December 31, 2018 were as follows.

Foreign exchange rate per U.S. dollar	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2018	Change	
USD/¥	112.16	110.44	(1.72)	1.5% appreciation
USD/RUB	58.35	62.68	4.33	6.9% depreciation
USD/GBP	0.78	0.75	(0.03)	3.7% appreciation
USD/EUR	0.89	0.85	(0.04)	4.8% appreciation
USD/CHF	0.98	0.98	(0.01)	0.7% appreciation
USD/TWD	30.44	30.14	(0.30)	1.0% appreciation
USD/TRY	3.64	4.82	1.18	24.5% depreciation
USD/IRR	38,811	61,649	22,838	37.0% depreciation

Pharmaceutical Business

(Billions of yen)

Pharmaceutical Business	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2018	Change
Revenue	104.7	114.0	8.9%
Adjusted operating profit	24.1	28.4	18.0%

<Revenue and adjusted operating profit>

Revenue increased by 8.9% from the previous fiscal year, driven by higher royalty revenue of an original JT compound that has been out-licensed and milestone revenue. Adjusted operating profit increased by 18.0% from the previous fiscal year, driven by the revenue growth, despite increased R&D investment.

Processed Food Business

(Billions of yen)

Processed Food Business	Fiscal year ended December 31, 2017	Fiscal year ended December 31, 2018	Change
Revenue	163.1	161.4	(1.1)%
Adjusted operating profit	5.4	4.1	(23.6)%

<Revenue and adjusted operating profit>

Despite growth in sales of staple food products and seasonings, revenue decreased by 1.1% from the previous fiscal year, due to a decline in sales of other products. Adjusted operating profit decreased by 23.6% from the previous fiscal year, due mainly to higher raw material costs.

(2) Financial position and cash flow position

a. Financial position

Assets

Total assets as of December 31, 2018 increased by ¥239.9 billion from the end of the previous fiscal year to ¥5,461.4 billion. This was mainly due to an increase in goodwill related to business combinations in Russia and Bangladesh.

Liabilities

Total liabilities as of December 31, 2018 increased by ¥381.5 billion from the end of the previous fiscal year to ¥2,761.0 billion. This was mainly due to the issuance of bonds, despite the repayment of short-term borrowings and the redemption of bonds.

Equity

Total equity as of December 31, 2018 decreased by ¥141.6 billion from the end of the previous fiscal year to ¥2,700.4 billion. This was mainly due to the decline in equity caused by the payment of cash dividends and the fall in exchange differences on translation of foreign operations, despite an increase in retained earnings as a result of the recording of profit attributable to owners of the parent company.

b. Cash flow position

Cash and cash equivalents at the end of the current fiscal year decreased by ¥3.4 billion from the end of the previous fiscal year to ¥282.1 billion. Cash and cash equivalents at the end of the previous fiscal year was ¥285.5 billion.

Cash flows from (used in) operating activities

Net cash flows from operating activities during the current fiscal year were ¥461.4 billion, compared with ¥419.2 billion provided in the previous fiscal year. This was mainly due to the generation of a stable cash inflow from the tobacco business, and payments of national and international tobacco excise taxes and income taxes.

Cash flows from (used in) investing activities

Net cash flows used in investing activities during the current fiscal year were ¥383.3 billion, compared with ¥352.6 billion used in the previous fiscal year. This was mainly due to disbursements related to business combinations in Russia and Bangladesh, and the purchase of property, plant and equipment.

Cash flows from (used in) financing activities

Net cash flows used in financing activities during the current fiscal year were ¥62.4 billion, compared with ¥77.0 billion used in the previous fiscal year. This was mainly due to the payment of cash dividends and the repayment of loans, despite the proceeds from issuance of bonds.

(3) Results 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, results of “production, orders received and sales” are presented in connection with the operating results by segment in “(1) Business 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, 2017		Fiscal year ended December 31, 2018	
	Amount (Billions of yen)	Percentage	Amount (Billions of yen)	Percentage
Megapolis Group	248.9	11.6	249.8	11.3

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

(4) 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 130 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."

(5) Target management benchmarks

The Group considers the most important issue to be the pursuit of the "4S" model, which represents its management principles, to achieve sustainable profit growth over the mid- to long-term. In order to measure the performance of the businesses that form the foundation for sustainable profit growth, we consider it appropriate to exclude foreign exchange effects, temporary factors and special factors, and have set a group-wide profit target of mid to high single-digit annual average growth rate over the mid- to long-term in adjusted operating profit at constant rates of exchange.

In FY2018, adjusted operating profit at constant rates of exchange grew by 8.9% from the previous fiscal year, achieving steady growth in profit despite the challenging business environment. Our perception is that the Tobacco Business, which is the core driver of the Group's profit growth, also succeeded in strengthening its business base in preparation for sustainable future growth.

In the Domestic Tobacco Business, the expansion to nationwide sales of the Company's Ploom TECH RRP product has been completed, achieving a further strengthening of its presence in the RRP market. Moreover, in the cigarette market which is the platform for profit generation, we are also working to increase our share to further reinforce our leading position.

In the International Tobacco Business, in addition to increasing our share of key markets and using pricing to achieve strong performance, we saw the emergence of the fruits of postmerger integration for acquisitions completed in FY2017 in the three markets of the Philippines, Indonesia and Ethiopia, resulting in a further strengthening of the earnings base.

In FY2019 our objective is to pursue appropriate pricing, and a higher market share for combined RRP and cigarettes, with the aim of achieving mid to high single-digit growth for the Tobacco Business as a whole. In the Pharmaceutical

Business and Processed Food Business we will continue to rebuild the business base, aiming to create complementary drivers of profit growth for the Group.
For details of management policies aimed at achieving these targets, please refer to “II. Review of operations 1. Management policy, business environment, issues to be addressed, etc.”.

(6) Factors causing significant effects on operating results, etc.

Along with the expansion of the International Tobacco Business and its contribution to the results, foreign exchange fluctuation greatly impacts consolidated financial statements. Adjusted operating profit at constant rates of exchange in FY2018 increased by 8.9% from the previous fiscal year, and adjusted operating profit including foreign exchange effects increased by 1.7% despite unfavorable foreign exchange effects. Unfavorable foreign exchange effects are also expected to arise in FY2019.

In order to mitigate foreign exchange risk, the Group is working to implement a natural hedging strategy by matching revenue currencies to payment currencies. We hedge some foreign exchange risks using derivatives or foreign currency-denominated interest-bearing debt, etc.

With regard to factors causing significant effects on the Group’s operating results, etc. including the above, please refer to “II. Review of operations 2. Business and other risks.”

(7) 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, 34. Financial instruments, (2) Financial risk management to (8) Market price fluctuation risk.”

(8) 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.

Scheduled material capital expenditures and approaches to procuring funds are as presented in “III. Facilities 3. Plans for new installation and retirement of facilities.”

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>

Please refer to “(2) Financial position and cash flow position, b. Cash flow position.”

<Interest-bearing debt>

Amounts of interest-bearing debt of the Group to be repaid or redeemed as of December 31, 2018 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	166.0	166.0	–	–	–	–	–
Short-term lease obligations	1.0	1.0	–	–	–	–	–
Commercial paper	72.0	72.2	–	–	–	–	–
Long-term borrowings as loans (current portion)	12.4	12.4	–	–	–	–	–
Long-term borrowings as loans	116.9	–	12.0	11.6	41.6	11.6	40.3
Bonds	610.4	–	80.0	83.3	30.0	118.3	302.2
Long-term lease obligations	8.8	–	0.8	0.7	0.4	0.2	6.7
Total	987.6	251.6	92.8	95.5	72.0	130.0	349.2

(Long-term debt)

Bonds issued (including the current portion) as of December 31, 2017 and as of December 31, 2018 accounted for ¥332.2 billion and ¥610.4 billion, respectively, and long-term borrowings as loans from financial institutions (including the current portion) accounted for ¥71.9 billion and ¥129.3 billion, respectively. Long-term lease obligations totaled ¥9.3 billion as of December 31, 2017 and ¥8.8 billion as of December 31, 2018.

As of December 31, 2018, the long-term debt was rated Aa3 (negative) by Moody’s Japan K.K., AA- (negative) 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 ¥274.2 billion as of December 31, 2017 and ¥166.0 billion as of December 31, 2018. Commercial paper outstanding totaled ¥66.8 billion as of December 31, 2017 and ¥72.0 billion as of December 31, 2018. Short-term lease obligations totaled ¥1.3 billion as of December 31, 2017 and ¥1.0 billion as of December 31, 2018.

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, 2018, the Group had ¥478.5 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.

(9) Information on differences between the main items in relation to the outline of operating results

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 ¥133,440 million for the fiscal year ended December 31, 2018 and by ¥121,828 million for the previous fiscal year under IFRS in comparison with under Japanese GAAP.

4. Important operational contracts

No items to report.

5. 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, 2018 amounts to ¥65.4 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 RRP-related technologies. 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 ¥18.1 billion with that of the International Tobacco Business amounting to ¥8.5 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, immune disorders and inflammation, and virus research. Research and development expenses for the Pharmaceutical Business is ¥37.1 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 ¥0.8 billion.

III. Facilities

1. Outline of capital expenditures

In the fiscal year ended December 31, 2018, the Group made capital expenditures totaling ¥159.8 billion.

In the Domestic Tobacco Business, the Group spent ¥55.4 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 ¥75.7 billion mainly for compliance with regulations in addition to improvements in product specifications. In the Pharmaceutical Business, the Group spent ¥11.3 billion on enhancing and strengthening research and development structures and the like. In the Processed Food Business, the Group invested ¥12.7 billion in improvement, maintenance and renewals of production capability.

* 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, 2018)

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)	Domestic Tobacco	Tobacco manufacturing facilities	150	2,062	8,648	18,097	354	29,161	362
Tokai Factory (Iwata-shi, Shizuoka) (Note 1)	Domestic Tobacco	Tobacco manufacturing facilities	223	2,309	7,517	24,176	410	34,412	423
Kansai Factory (Fushimi-ku, Kyoto-shi, Kyoto) (Note 1)	Domestic Tobacco	Tobacco manufacturing facilities	116	5,831	10,282	20,241	440	36,794	393
Kyushu Factory (Chikushino-shi, Fukuoka)	Domestic Tobacco	Tobacco manufacturing facilities	166	4,042	3,139	12,680	317	20,178	246
Tobacco Science Research Center (Aoba-ku, Yokohama-shi, Kanagawa) (Note 1)	Domestic Tobacco	Research and development facilities	35	642	2,824	0	1,142	4,608	76
Central Pharmaceutical Research Institute (Takatsuki-shi, Osaka) (Note 1)	Pharmaceutical	Research and development facilities	95	2,733	16,301	15	1,801	20,850	624
Head Office (Minato-ku, Tokyo)	General administration	Other	7	21,487	19,927	60	1,953	43,427	1,350
Area Sales Headquarters(15) (Municipality) (Notes 1, 2)	Domestic Tobacco (includes administration)	Other	26	862	1,914	859	146	3,781	3,073

(2) Domestic subsidiaries

(As of December 31, 2018)

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 24 distribution bases (Head Office: Taito-ku, Tokyo) (Note 2)	Domestic Tobacco	Distribution facilities	35	–	9,704	1,536	854	12,093	1,824
Japan Filter Technology, Co., Ltd. Head Office and other 3 factories (Head Office: Sumida-ku, Tokyo) (Note 1, 2)	Domestic Tobacco	Material manufacturing facilities	114	714	4,703	8,330	499	14,247	584
Torii Pharmaceutical Co., Ltd. Head Office, other factories and branch offices (Head Office: Chuo-ku, Tokyo)	Pharmaceutical	Pharmaceuticals manufacturing facility and other	55	369	1,827	1,189	304	3,689	1,049
TableMark Co., Ltd. Head Office and other 8 factories (Head Office: Chuo-ku, Tokyo)	Processed Food	Frozen food production facilities	–	–	9,633	14,012	355	24,000	1,371

(3) Foreign subsidiaries

(As of December 31, 2018)

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	164	126	4,950	10,701	2,680	18,456	1,142
JTI Polska Sp. z o. o. (Poland)	International Tobacco	Tobacco manufacturing facilities	409	140	9,973	32,620	837	43,570	2,057
JT International Germany GmbH (Germany)	International Tobacco	Tobacco manufacturing facilities	346	303	13,823	14,627	1,622	30,375	1,923
JTI Tütün Ürünleri Sanayi A.S. (Turkey)	International Tobacco	Tobacco manufacturing facilities	231	718	1,705	5,598	122	8,143	512

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.

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. On the other hand, with the aim of positioning the Pharmaceutical Business and the Processed Food Business as complementary drivers of profit growth for the Company as a whole, the focus will be on rebuilding their business bases, and making the investments required to implement that.

Based on this policy, the Group plans capital expenditures (facility construction and expansion) totaling ¥156.0 billion in the fiscal year ending December 31, 2019.

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, 2. Business and other risks.”

Segment	Capital expenditure plan for the fiscal year ending December 31, 2019 (Billions of yen)	Main purpose of investment	Funding
Domestic Tobacco Business	57.0	RRP-related investments and IT-related investments	Internally generated funds
International Tobacco Business	80.0	RRP-related investments and expenditures for the improvements in product specifications	Same as above
Pharmaceutical Business	5.0	Expenditures for the development and reinforcement of R&D capabilities	Same as above
Processed Food Business	8.0	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, 2018)	Number of shares issued (Share; as of the date of filing: March 20, 2019)	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

a. Stock options

Subscription rights to shares issued pursuant to the Companies Act are as follows. Also, the matters presented below reflect the situation as of the last day of the Company's fiscal year (December 31, 2018).

Matters that have undergone change between the last day of the Company's fiscal year and the last day of the end of the month before the date of filing are presented in parentheses [ ], while other matters have undergone no change since the last day of the Company's fiscal year.

・ Stock options based on resolutions taken at meetings of the Board of Directors held between December 21, 2007 and September 16, 2011

Resolution date	December 21, 2007	September 19, 2008	September 28, 2009	September 17, 2010	September 16, 2011
Positions and number of persons granted	Members of the Board 11 persons Executive Officers (excluding persons serving as Member of the Board) 16 persons	Members of the Board 11 persons Executive Officers (excluding persons serving as Member of the Board) 14 persons	Members of the Board 9 persons Executive Officers (excluding persons serving as Member of the Board) 14 persons	Members of the Board 9 persons Executive Officers (excluding persons serving as Member of the Board) 14 persons	Members of the Board 8 persons Executive Officers (excluding persons serving as Member of the Board) 15 persons
Number of subscription rights to shares	72 units [67 units]	191 units [165 units]	335 units [282 units]	391 units [361 units]	409 units [365 units]
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	Same as left	Same as left	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	14,400 shares [13,400 shares] (Notes 1, 6)	38,200 shares [33,000 shares] (Notes 1, 6)	67,000 shares [56,400 shares] (Notes 1, 6)	78,200 shares [72,200 shares] (Notes 1, 6)	81,800 shares [73,000 shares] (Notes 1, 6)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left	Same as left	Same as left	Same as left
Exercise period of subscription rights to shares	From January 9, 2008 to January 8, 2038	From October 7, 2008 to October 6, 2038	From October 14, 2009 to October 13, 2039	From October 5, 2010 to October 4, 2040	From October 4, 2011 to October 3, 2041
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	¥285,904 per unit	¥197,517 per unit	¥198,386 per unit	¥277,947 per unit
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	(Note 2)	Same as left	Same as left	Same as left	Same as left
Conditions for exercising subscription rights to shares	(Note 3)	Same as left	Same as left	Same as left	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	Same as left	Same as left	Same as left
Provisions for acquiring subscription rights to shares	(Note 4)	Same as left	Same as left	Same as left	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 5)	Same as left	Same as left	Same as left	Same as left

Notes: 1. Number of shares to be issued upon exercise of subscription rights to shares

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. 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 Regulation on Corporate Accounting. 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.

3. 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.

4. Provisions for acquiring subscription rights to shares

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

5. Matters regarding delivery of subscription rights to shares accompanied by reorganization

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 "Provisions for acquiring subscription rights to shares" mentioned 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.

6. 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.

・ Stock options based on resolutions taken at meetings of the Board of Directors held between September 21, 2012 and June 15, 2018

Resolution date	September 21, 2012	September 20, 2013	September 19, 2014	July 17, 2015	June 17, 2016
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	Members of the Board (excluding Outside Directors) 7 persons Executive Officers (excluding persons serving as Member of the Board) 19 persons	Members of the Board (excluding Outside Directors) 6 persons Executive Officers (excluding persons serving as Member of the Board) 19 persons	Members of the Board (excluding Outside Directors) 6 persons Executive Officers (excluding persons serving as Member of the Board) 18 persons	Members of the Board (excluding Outside Directors) 5 persons Executive Officers (excluding persons serving as Member of the Board) 18 persons
Number of subscription rights to shares	289 units [256 units]	258 units [223 units]	191 units [179 units]	288 units [263 units]	310 units [276 units]
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	Same as left	Same as left	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	57,800 shares [51,200 shares] (Note 1)	51,600 shares [44,600 shares] (Note 1)	38,200 shares [35,800 shares] (Note 1)	57,600 shares [52,600 shares] (Note 1)	62,000 shares [55,200 shares] (Note 1)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left	Same as left	Same as left	Same as left
Exercise period of subscription rights to shares	From October 10, 2012 to October 9, 2042	From October 8, 2013 to October 7, 2043	From October 7, 2014 to October 6, 2044	From August 4, 2015 to August 3, 2045	From July 5, 2016 to July 4, 2046
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	¥513,400 per unit	¥483,200 per unit	¥711,200 per unit	¥572,600 per unit
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	(Note 2)	Same as left	Same as left	Same as left	Same as left
Conditions for exercising subscription rights to shares	(Note 3)	Same as left	Same as left	Same as left	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	Same as left	Same as left	Same as left
Provisions for acquiring subscription rights to shares	(Note 4)	Same as left	Same as left	Same as left	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 5)	Same as left	Same as left	Same as left	Same as left

Resolution date	June 14, 2017	June 15, 2018
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) 19 persons	Members of the Board (excluding Outside Directors) 5 persons Executive Officers (excluding persons serving as Member of the Board) 18 persons
Number of subscription rights to shares	522 units [449 units]	891 units [798 units]
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	104,400 shares [89,800 shares] (Note 1)	178,200 shares [159,600 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 4, 2017 to July 3, 2047	From July 3, 2018 to July 2, 2048
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥482,200 per unit	¥300,000 per unit
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	(Note 2)	Same as left
Conditions for exercising subscription rights to shares	(Note 3)	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
Provisions for acquiring subscription rights to shares	(Note 4)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 5)	Same as left

Notes: 1. Number of shares to be issued upon exercise of subscription rights to shares

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. to 5. Same as (Notes) 2-5 for stock options based on resolutions of the Board of Directors taken between December 21, 2007 and September 16, 2011.

b. Details of rights plan

No items to report.

c. Other status of subscription rights to shares

No items to report.

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

No items to report.

(4) 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.

(5) Shareholder composition

(As of December 31, 2018)

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	293	78	2,358	854	257	388,255	392,096	–
Number of shares held (Unit)	6,669,262	3,988,101	643,338	225,998	3,996,434	1,031	4,474,921	19,999,085	91,500
Holding rate of shares (%)	33.35	19.94	3.22	1.13	19.98	0.01	22.38	100.00	–

Notes: 1. 2,085,766 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.

(6) Status of major shareholders

(As of December 31, 2018)

Name of shareholder	Address	Number of shares held (Share)	Percentage of number of shares (excluding treasury shares) held in the total number of shares issued (%)
The Minister of Finance	1-1, Kasumigaseki 3-chome, Chiyoda-ku, Tokyo, Japan	666,926,200	37.23
The Master Trust Bank of Japan, Ltd. (Trust Account)	11-3, Hamamatsucho 2-chome, Minato-ku, Tokyo, Japan	91,137,400	5.09
Japan Trustee Services Bank, Ltd. (Trust Account)	8-11, Harumi 1-chome, Chuo-ku, Tokyo, Japan	68,848,700	3.84
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	23,660,000	1.32
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)	23,351,971	1.30
Japan Trustee Services Bank, Ltd. (Trust Account 5)	8-11, Harumi 1-chome, Chuo-ku, Tokyo, Japan	22,744,400	1.27
SSBTC CLIENT OMNIBUS ACCOUNT (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)	22,178,610	1.24
Japan Trustee Services Bank, Ltd. (Trust Account 9)	8-11, Harumi 1-chome, Chuo-ku, Tokyo, Japan	21,978,900	1.23
State Street Bank West Client - Treaty 505234 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	1776 Heritage Drive, North Quincy, MA 02171, U.S.A. (Shinagawa Intercity Tower A, 15-1, Konan 2-chome, Minato-ku, Tokyo, Japan)	20,542,232	1.15
JP Morgan Chase Bank 385151 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	25 BANK STREET, CANARY WHARF, LONDON, E14 5JP, UNITED KINGDOM (Shinagawa Intercity Tower A, 15-1, Konan 2-chome, Minato-ku, Tokyo, Japan)	20,367,542	1.14
Total	–	981,735,955	54.80

Note: In addition to the above, the Company held 208,576,641 shares of ordinary shares as treasury shares.

(7) Status of voting rights

a. Shares issued

(As of December 31, 2018)

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 208,576,600	–	(Note 2)
Shares with full voting rights (Other)	Ordinary shares 1,791,331,900	17,913,319	(Note 2)
Shares less than one unit	Ordinary shares 91,500	–	(Note 3)
Total number of shares issued	2,000,000,000	–	–
Total number of voting rights	–	17,913,319	–

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 41 shares of treasury shares.

b. Treasury shares

(As of December 31, 2018)

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	208,576,600	–	208,576,600	10.43
Total	–	208,576,600	–	208,576,600	10.43

2. Acquisition of treasury shares

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

Category	Number of shares (Share)	Total value (Millions of yen)
Resolution of the Board of Directors (February 7, 2019) (Acquisition period: From February 8, 2019 to April 22, 2019)	23,000,000	50,000
Treasury shares acquired before this fiscal year ended December 31, 2018	–	–
Treasury shares acquired during this fiscal year ended December 31, 2018	–	–
Total number and amount of remaining shares to be acquired by resolution	–	–
Ratio of unexercised shares to the number resolved as of the end of this fiscal year ended December 31, 2018 (%)	–	–
Treasury shares acquired during the period from January 1, 2019 to the filing date of this Annual Securities Report	17,787,600	50,000
Ratio of unexercised shares to the number resolved as of the date of filing (%)	22.7	0.0

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

2. The acquisition of treasury shares based on this resolution of the Board of Directors was completed on March 18, 2019.

3. The number and total value of treasury shares acquired during this period are presented on a contract basis.

(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, 2018	52	0
Treasury shares acquired during the period from January 1, 2019 to the filing date of this Annual Securities Report	10	0

Notes: 1 The figure for treasury shares acquired during the period from January 1, 2019 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 19, 2019 until the filing date of this Annual Securities Report.

2: The number and total value of treasury shares acquired during this period are presented on a contract basis.

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

Category	Fiscal year ended December 31, 2018		From January 1, 2019 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)	380,000	807	95,200	202
(Sales resulting from requests for sale of shares less than one unit)	–	–	–	–
Treasury shares held	208,576,641	–	226,269,051	–

Notes: 1. The number of disposed shares and total disposal value in the "From January 1, 2019 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 19, 2019 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, 2019 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 19, 2019 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. The number of treasury shares acquired during this period is presented on a contract basis.

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, 2018, the year-end dividend for the fiscal year ended December 31, 2018 was ¥75 per share. Therefore, the total annual dividend for the fiscal year ended December 31, 2018, including the interim dividend of ¥75, is ¥150 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 34th 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, 2018	134,351	75.00
Annual General Meeting of Shareholders held on March 20, 2019	134,357	75.00

4. Trends in share price

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

Term	29th term	30th term	31st term	32nd term	33rd term	34th term
Accounting period	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	From January 1, 2017 to December 31, 2017	From January 1, 2018 to December 31, 2018
Highest (Yen)	3,835	4,193	4,848	4,850	4,243	3,708
Lowest (Yen)	2,850	3,097	3,101	3,627	3,607	2,481

Notes: 1. The yearly highest and lowest share prices were those recorded on the first section of the Tokyo Stock Exchange.
2. 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 2018	August 2018	September 2018	October 2018	November 2018	December 2018
Highest (Yen)	3,188	3,196	3,005	3,010	2,910	2,888
Lowest (Yen)	2,902	2,921	2,850	2,850	2,800	2,481

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 eleven male officers and three female officers (21.4% 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 December 2010 Corporate Auditor, The Yomiuri Shimbun Holdings December 2012 Special Advisor to the Cabinet June 2014 Chairman of the Board, the Company (Current Position) June 2015 Outside Director, The Ogaki Kyoritsu Bank, Ltd. (Current Position) (Significant Concurrent Positions outside the Company) Outside Director, The Ogaki Kyoritsu Bank, Ltd.	2 years since March 2018	9,100
* President, Chief Executive Officer and Representative Director		Masamichi Terabatake	November 26, 1965	April 1989 Joined the Company July 2005 Vice President, Secretary's Office July 2008 Vice President, Corporate Strategy Division June 2011 Senior Vice President, Chief Strategy Officer and in charge of Food Business, Vice President, Corporate Strategy Division March 2012 Senior Vice President, Chief Strategy Officer and in charge of Food Business June 2012 Senior Vice President, Chief Strategy Officer June 2013 Member of the Board Executive Vice President, JT International S.A. January 2018 President and Chief Executive Officer, the Company March 2018 President, Chief Executive Officer and Representative Director (Current Position)	2 years since March 2018	19,000

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
* 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 President, 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 and Managing Director, JT International Group Holding B.V.	2 years since March 2018	23,800
* Executive Vice President and Representative Director		Naohiro Minami	January 21, 1964	April 1986 Joined the Company December 2005 Controller July 2010 Deputy Financial Officer and Controller June 2012 Senior Vice President, Chief Finance Officer and Controller July 2012 Senior Vice President, Chief Finance Officer January 2018 Executive Vice President March 2018 Executive Vice President and Representative Director (Current Position) (Significant Concurrent Positions outside the Company) Supervisory Board member, JT International Holding B.V.	2 years since March 2018	12,600

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
* Executive Vice President and Representative Director		Kiyohide Hirowatari	November 11, 1965	April 1989 Joined the Company July 2010 Vice President, Legal Division June 2012 Senior Vice President, Chief Legal Officer and Vice President, Legal Division July 2014 Senior Vice President, Chief Legal Officer January 2015 Senior Vice President, Head of Tobacco Business Planning Division, Tobacco Business January 2017 Senior Vice President, Human Resources January 2018 Executive Vice President March 2018 Executive Vice President and Representative Director (Current Position)	2 years since March 2018	5,800
* Member of the Board		Kazuhito Yamashita	February 4, 1963	April 1986 Joined the Company May 2007 Vice President, Corporate, Scientific & Regulatory Affairs Division, Tobacco Business Headquarters July 2009 Vice President, Corporate Affairs Division, Tobacco Business Headquarters June 2010 Senior Vice President, Chief Corporate, Scientific & Regulatory Affairs Officer, Tobacco Business Headquarters January 2015 Senior Vice President, Head of China Division, Tobacco Business Headquarters January 2019 Senior Vice President, Compliance, Sustainability Management and General Affairs March 2019 Member of the Board (Current Position)	1 year since March 2019	6,400

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Member of the Board		Main Kohda	April 25, 1951	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 Director, the Company (Current Position) June 2013 Outside Director, LIXIL Group Corporation (Current Position) June 2016 Outside Director, Japan Exchange Group, Inc. (Current Position) June 2018 Outside Director, MITSUBISHI MOTORS CORPORATION (Current Position) (Significant Concurrent Positions outside the Company) Novelist Outside Director, LIXIL Group Corporation Outside Director, Japan Exchange Group, Inc. Outside Director, MITSUBISHI MOTORS CORPORATION	2 years since March 2018	0

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Member of the Board		Koichiro Watanabe	April 16, 1953	April 1976 Joined The Dai-ichi Mutual Life Insurance Company July 2001 Director, The Dai-ichi Mutual Life Insurance Company April 2004 Managing Director, The Dai-ichi Mutual Life Insurance Company July 2004 Managing Executive Officer, The Dai-ichi Mutual Life Insurance Company July 2007 Director and Managing Executive Officer, The Dai-ichi Mutual Life Insurance Company April 2008 Director and Senior Managing Executive Officer, The Dai-ichi Mutual Life Insurance Company April 2010 Representative Director and President, The Dai-ichi Life Insurance Company, Limited October 2016 Representative Director and President, Dai-ichi Life Holdings, Inc. April 2017 Representative Director and Chairman of the Board, Dai-ichi Life Holdings, Inc. (Current Position) Representative Director and Chairman of the Board, The Dai-ichi Life Insurance Company, Limited (Current Position) March 2018 Outside Director, the Company (Current Position) (Significant Concurrent Positions outside the Company) Representative Director and Chairman of the Board, Dai-ichi Life Holdings, Inc. Representative Director and Chairman of the Board, The Dai-ichi Life Insurance Company, Limited	2 years since March 2018	0
Member of the Board		Yukiko Nagashima	April 4, 1961	April 1985 Joined Recruit Co., Ltd. (Current Recruit Holdings Co., Ltd.) April 2006 Corporate Executive Officer, Recruit Co., Ltd. January 2008 President and Representative Director, Recruit Staffing Co., Ltd. October 2012 Corporate Executive Officer, Recruit Holdings Co., Ltd. June 2016 Standing Audit and Supervisory Board Member, Recruit Holdings Co., Ltd. (Current Position) April 2018 Standing Audit and Supervisory Board Member, Recruit Co., Ltd. (Current Position) March 2019 Outside Director, the Company (Current Position) (Significant Concurrent Positions outside the Company) Standing Audit and Supervisory Board Member, Recruit Holdings Co., Ltd. Standing Audit and Supervisory Board Member, Recruit Co., Ltd.	1 year since March 2019	0

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Audit & Supervisory Board Member		Ryoko Nagata	July 14, 1963	April 1987 Joined the Company April 2001 Vice President, Head of Products Division, Food Business Division, Food Business Headquarters June 2008 Senior Vice President, Head of Beverage Business Division, Food Business Headquarters and Products Division, Food Business Division, Food Business July 2008 Senior Vice President, Head of Beverage Business Division, Food Business Headquarters July 2010 Senior Vice President, Head of Beverage Business Division June 2013 Senior Vice President, CSR January 2018 Senior Vice President, Assistant to President March 2018 Standing Audit & Supervisory Board Member (Current Position)	4 years since March 2019	12,400
Audit & Supervisory Board Member		Hiroshi Yamamoto	November 29, 1963	April 1987 Joined the Company July 2008 Vice President, NTM Procurement Division, Tobacco Business June 2012 Vice President, Operational Review and Business Assurance Division March 2019 Standing Audit & Supervisory Board Member (Current Position)	4 years since March 2019	0

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Audit & Supervisory Board Member		Toru Mimura	December 26, 1955	April 1979 Entered Ministry of Finance July 2010 Deputy Director-General of the Planning and Coordination Bureau, and Secretary-General of the Executive Bureau, Certified Public Accountants and Auditing Oversight Board, Financial Services Agency July 2011 Director General, Kinki Local Finance Bureau, Ministry of Finance January 2012 Deputy Director-General, Minister’s Secretariat, Ministry of Defense September 2012 Director General, Bureau of Personnel and Education, Ministry of Defense July 2013 Director General, National Institute for Defense Studies, Ministry of Defense July 2014 Director General, Bureau of Finance and Equipment, Ministry of Defense October 2015 Vice-Minister of Defense for International Affairs, Ministry of Defense September 2016 Chairman, Sompo Japan Nipponkoa Research Institute Inc. October 2017 Director, Eltes Co., Ltd. March 2018 Registered as Attorney at Law March 2019 Outside Standing Audit & Supervisory Board Member, the Company (Current Position) (Significant Concurrent Positions outside the Company) Attorney at Law, Shiba International Law Offices	4 years since March 2019	0

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, Ministry of Justice June 2004 Director-General of the Criminal Affairs Bureau, Ministry of Justice June 2006 Vice-Minister of Justice, Ministry of Justice July 2007 Superintending Prosecutor, Sapporo High Public Prosecutors' Office July 2008 Superintending Prosecutor, Tokyo High Public Prosecutors Office June 2010 Prosecutor-General March 2011 Registered as Attorney at Law April 2011 Outside Audit & Supervisory Board Member, Daiwa Securities Co., Ltd. (Current Position) June 2013 Outside Director, Mitsubishi Electric Corporation (Current Position) June 2014 Outside Audit & Supervisory Board Member, NIPPON STEEL & SUMITOMO METAL CORPORATION (Current Position) March 2015 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 2019	0

Title	Post	Name	Date of birth	Summary of career			Term of office	Number of shares held (Share)
Audit & Supervisory Board Member		Koji Yoshikuni	September 7, 1952	April	1975	Joined Japan Broadcasting Corporation	4 years since March 2019	0
				June	2003	Director Responsible for Finance of News Department, Japan Broadcasting Corporation		
				June	2005	Executive Director, Yokohama Broadcasting Station, Japan Broadcasting Corporation		
				June	2007	Chief of Secretariat for Board of Governors, Japan Broadcasting Corporation		
				February	2010	Senior Director, Japan Broadcasting Corporation		
				April	2012	Executive Director, Japan Broadcasting Corporation		
				April	2017	Vice President, the Graduate School of Project Design (Current position) Auditor, Hosei University (Current position)		
				March	2019	Outside Audit & Supervisory Board Member, the Company (Current Position)		
Total								89,100

Notes: 1. Members of the Board Main Kohda, Koichiro Watanabe and Yukiko Nagashima are Outside Directors.
2. Standing Audit & Supervisory Board Member Toru Mimura and Audit & Supervisory Board Members Hiroshi Obayashi and Koji Yoshikuni are Outside Audit & Supervisory Board Members.
3. Persons with the title marked with * concurrently serve as Executive Officer.
4. The Company has introduced the Executive Officer System in June 2001 in order to realize prompt and proper decision-making and business execution. The following 26 persons were appointed effective March 20, 2019.

Title	Name	Post
President	Masamichi Terabatake	Chief Executive Officer
Executive Vice President	Mutsuo Iwai	President, Tobacco Business
Executive Vice President	Naohiro Minami	Chief Finance Officer and Communications
Executive Vice President	Kiyohide Hirowatari	Corporate, Pharmaceutical Business and Food Business
Senior Vice President	Kazuhito Yamashita	Compliance, Sustainability Management and General Affairs
Senior Vice President	Chito Sasaki	President, Japanese Tobacco Business, Tobacco Business
Senior Vice President	Junichi Fukuchi	Tobacco Business Planning, Corporate, Scientific & Regulatory Affairs, Tobacco Business
Senior Vice President	Eiichi Kiyokawa	Sales, Tobacco Business
Senior Vice President	Kenji Ogura	Leaf Procurement, Tobacco Business
Senior Vice President	Hiroyuki Ikuma	Quality Assurance, Tobacco Business
Senior Vice President	Yasuhiro Nakajima	RRP Development, Tobacco Business
Senior Vice President	Shuichi Hirosue	Marketing, Tobacco Business
Senior Vice President	Hiroyuki Miki	R&D, Tobacco Business
Senior Vice President	Akihiro Koyanagi	Manufacturing, Tobacco Business
Senior Vice President	Toru Oguchi	Head of China Division, Tobacco Business
Senior Vice President	Muneaki Fujimoto	President, Pharmaceutical Business
Senior Vice President	Shigenori Ohkawa	Head of Central Pharmaceutical Research Institute, Pharmaceutical Business
Senior Vice President	Atsuhiro Kawamata	Food Business
Senior Vice President	Haruhiko Yamada	Legal
Senior Vice President	Yuki Maeda	Corporate Strategy
Senior Vice President	Takehiko Tsutsui	Business Development
Senior Vice President	Kei Nakano	Communications
Senior Vice President	Takehisa Shibayama	Digitalization
Senior Vice President	Takanori Kikuchi	General Affairs
Senior Vice President	Chigusa Ogawa	Sustainability Management
Senior Vice President	Koichi Mori	Human Resources

6. Status of corporate governance

(1) Status of corporate governance

Whereas the following contains statements regarding the fiscal year ended December 31, 2018, the final day of that fiscal year, and the fiscal year ended December 31, 2017, 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 Group'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 the Group's 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 Advisory Panel on Nomination and Compensation, which is largely composed of the independent outside Members of the Board, 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 independent outside Members of the Board 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 Advisory Panel on Nomination and Compensation was established as an optional advisory body to the Board of Directors on March 20, 2019, and integrates the functions of the previous Meeting for Talent Development and Compensation Advisory Panel. The establishment of the panel is intended to further enhance the objectivity and transparency of the Board of Directors' decision making by having the panel support the development of a group of executive candidates, deliberate on the selection of Member of the Board and Audit & Supervisory Board Member candidates, deliberate on dismissal of Executive Directors and Members of the Board who execute the business, and deliberate on matters regarding remuneration for Members of the Board and Executive Officers, then report to the Board of Directors. The Advisory Panel on Nomination and Compensation, which shall meet at least once a year, consists of four members: the Chairman of the Board, who takes the role of the panel's chairman, and three independent outside Members of the Board.

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. Standing Audit & Supervisory Board Member, Ms. Ryoko Nagata has served as Senior Vice President, Head of Beverage Business Division and in charge of CSR, etc., and has abundant experience and wide-ranging insights with regard to the Group's business operations from the perspective both of the business operations and the internal department. Furthermore, standing Audit & Supervisory Board Member Mr. Hiroshi Yamamoto has knowledge of finance and accounting as well as insight into corporate governance in the Group's business operations having served as the Company's Vice President of the Operational Review and Business Assurance.

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 hereinafter 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, cross-sectional 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. Compliance promotion departments that receive a report or request for consultation investigate the details and take necessary action, while working to prevent recurrence of the issue. The Company will bring matters of particular importance involving the 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 them, not to comply with an unreasonable demand and not to have any relations with them. 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 Company cooperates with police, lawyers and other relevant organizations and parties to gather and share information in order to deal with such elements in an organized way. 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 (19 persons as of December 31, 2018), which examines and evaluates systems for supervising and managing the overall operations 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 is stored and managed by the relevant departments and divisions as specified by the Responsibilities/Authorities Allocation Rules, and establishes rules on managing 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 common for the Group to effectuate group management that optimizes the operations of the entire 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 (five persons as of December 31, 2018) 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 and 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, 2018 and the persons who assisted the auditing work are as follows.

(Certified public accountants)
Masahiko Tezuka, Yasuhiko Haga, Yoichi Matsushita

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: 13 persons, People who have passed the Certified Public Accountants Examination: 4 persons, Others: 14 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 three Outside Directors and three Outside Audit & Supervisory Board Members.

  Outside Director Mr. Koichiro Watanabe is Representative Director and Chairman of the Board, The Dai-ichi Life Insurance Company, Limited. The Dai-ichi Life Insurance Company, Limited holds shares of the Company, but this constitutes less than 1% of the total shares. The Company and The Dai-ichi Life Insurance Company, Limited do have a business relationship in relation to pension fund management, etc., but the value of the business in the fiscal year ended December 31, 2018 was less than 0.01% of the Company's consolidated revenue, and the Company has therefore concluded that there is no risk of a special relationship of interest arising. Outside Director Ms. Yukiko Nagashima is standing Audit and Supervisory Board Member of Recruit Holdings Co., Ltd. and Recruit Co., Ltd. Although the Company has a business relationship with both in the area of recruitment, etc., the value of the business was less than 0.01% of the Company's consolidated revenue in the fiscal year ended December 31, 2018, and the Company has therefore concluded that there is no risk of a special relationship of interest arising.

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

  Furthermore, for transactions such as those related to usage fees for public infrastructure, in which there are extraordinarily heavy restrictions on arbitrary selection of the counterparty and the value of the transaction, the Company does not perceive there to be a risk of a special relationship of interest arising, and so has not described them here. The value of such transactions in the fiscal year ended December 31, 2018, was less than 0.001% of the Company's consolidated revenue, and were all therefore insignificant.

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

  The Company has appointed Ms. Main Kohda, Mr. Koichiro Watanabe and Ms. Yukiko Nagashima as Outside Directors. The Company expects that Ms. Kohda 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. The Company also anticipates that Mr. Watanabe will leverage his outstanding experience in corporate management that, over the course of many years, he has used to drive business operations that successfully combined both healthy financials and high profitability, as well as utilizing his abundant experience in working to improve the quality of management and to actively strengthen governance structures, his deep familiarity with capital markets, and his wide-ranging insight into the perspective of investors. Furthermore, the Company counts on Ms. Nagashima to make use of her experience acquired through her deep involvement in emerging businesses and corporate management, her experience as a Member of the Audit and Supervisory Boards, and also her wide-ranging insights from the perspectives of both management and auditing. Accordingly, as well as expecting that all their experiences will be reflected in the management of the Company through their active provision of proposals and advice to the Board of Directors, 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. Toru Mimura, Mr. Hiroshi Obayashi and Mr. Koji Yoshikuni as Outside Audit & Supervisory Board Members. Mr. Mimura has developed a perspective based on the deep knowledge of such fields as finance, global risk management, geopolitics and company law through his extensive experience over many years of serving in a wide range of important positions in ministries and agencies, in addition to his role as research institute chairman. Mr. Obayashi has gained extensive experience in the legal circles and developed a perspective based on experience as an Outside Director and Outside Audit & Supervisory Board Member across a wide range of industries. Mr. Yoshikuni has served in such roles at Japan Broadcasting Corporation as the Director Responsible for Finance of News Department, Chief of Secretariat for Board of Governors, and Executive Director. In addition to his knowledge of politics and economics cultivated over long years in his journalistic career, his perspective is also informed by his management experience, characterized by thorough acquaintance with all business operations and internal departments, and by his knowledge of finance and accounting. The Company expects that their experiences, perspectives and knowledge 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.

- 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.

In light of the above set of criteria, the Company has designated Ms. Main Kohda, Mr. Koichiro Watanabe and Ms. Yukiko Nagashima, who are Outside Directors, and Mr. Hiroshi Obayashi and Mr. Koji Yoshikuni, who are Outside Audit & Supervisory Board Members, as independent officers as defined by financial instruments exchanges. Outside Audit & Supervisory Board Member Mr. Toru Mimura fulfills the requirements for independent officers prescribed by financial instruments exchanges, but because of his professional experience at the Ministry of Finance, after having taken into account the above-mentioned criteria for independence, the Company has not designated him as independent officer. More than seven years have elapsed since he resigned from his post at the Ministry of Finance.

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

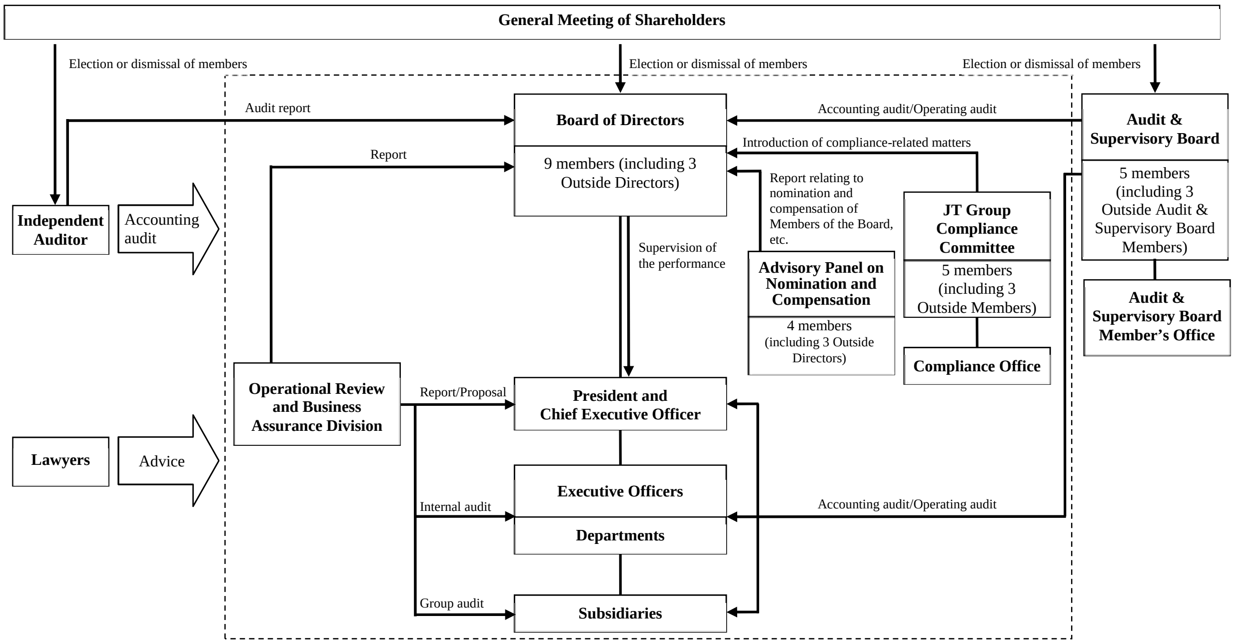
In order to facilitate the smooth conduct of General Meeting of Shareholders with an easier quorum requirement for special resolutions, the Company's Articles of Incorporation stipulate that a resolution as specified by Article 309, paragraph 2 of the Companies Act is valid if it is supported by at least 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.



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, 2018

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)	655	369	176	109	8
Audit & Supervisory Board Members (excluding Outside Audit & Supervisory Board Members)	94	94	–	–	3
Outside Directors and Outside Audit & Supervisory Board Members	70	70	–	–	5
Total	818	533	176	109	16

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, 2018

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	
Masamichi Terabatake	Representative Director	Filing company	89	65	25	179
Mutsuo Iwai	Representative Director	Filing company	63	45	19	126

(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 Compensation Advisory Panel holds deliberations and makes reports in accordance with its advice on such matters as the Company's policy, system and calculation method for remuneration of 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.

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,"(Note) 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 34th Ordinary General Meeting of Shareholders (held in March 2019), is ¥1.2 billion per year for all Directors and ¥240 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 960 units and ¥240 million per year. This was also approved at the 34th 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 remuneration amount for Members of the Board is determined by resolution of the Board of Directors within the approved upper limit, 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. The remuneration amount for Audit & Supervisory Board Members is determined through discussions among Audit & Supervisory Board Members within the approved upper limit after benchmarking in the same way.

On March 20, 2019, the functions of the Compensation Advisory Panel were integrated into the newly established Advisory Panel on Nomination and Compensation. Accordingly, the functions of the above-mentioned Compensation Advisory Panel will in future be the responsibility of the Advisory Panel on Nomination and Compensation.

Note: 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, Audit & Supervisory Board Member and Executive Officer of the Company, and there are no plans to change this exercise condition going forward.

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, 2018)

45 issues, ¥52,026 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, 2017)

Specified investment stocks

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
KT&G Corporation	2,864,904	35,141	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	3,990	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	3,674	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	2,609	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Mitsubishi UFJ Financial Group, Inc.	2,457,750	2,031	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Central Japan Railway Company	100,000	2,018	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	1,986	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	1,672	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
NIPPON TELEGRAPH AND TELEPHONE CORPORATION	306,000	1,622	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Yoshimura Food Holdings K.K.	210,500	1,452	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.	173,040	1,296	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.	227,401	1,107	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
West Japan Railway Company	133,000	1,094	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	846	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
Daicel Corporation	602,000	772	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	648	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.	270,000	492	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.	60,982	273	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Tokio Marine Holdings, Inc.	21,300	110	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
Hitachi, Ltd.	94,000	83	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	35	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term

(Fiscal year ended December 31, 2018)

Specified investment stocks

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
KT&G Corporation	2,864,904	28,904	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	4,075	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	2,651	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	2,317	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	1,710	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	1,524	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.	8,925,500	1,520	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
NIPPON TELEGRAPH AND TELEPHONE CORPORATION	306,000	1,371	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Mitsubishi UFJ Financial Group, Inc.	2,189,550	1,178	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
NIPPON EXPRESS CO., LTD.	173,040	1,059	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	1,032	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	681	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.	170,501	621	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Nifco Inc.	220,000	572	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	557	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Yoshimura Food Holdings K.K.	1,052,500	510	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.	60,982	245	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Tokyo Automatic Machinery Works, Ltd.	134,700	234	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.	10,700	56	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
Hitachi, Ltd.	18,800	55	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.	6,400	20	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, 2017 and 2018.

(2) Audit fees

a. Audit fees paid to certified public accountants

(Millions of yen)

Classification	Fiscal year ended December 31, 2017		Fiscal year ended December 31, 2018	
	Fees for audit attestation services	Fees for non-audit services	Fees for audit attestation services	Fees for non-audit services
The Company	330	37	330	81
Consolidated subsidiaries in Japan	141	3	126	7
Total	471	40	456	88

Note: Fees paid to Deloitte Touche Tohmatsu LLC

b. Other important fees

(Millions of yen)

Classification	Fiscal year ended December 31, 2017		Fiscal year ended December 31, 2018	
	Fees for audit attestation services	Fees for non-audit services	Fees for audit attestation services	Fees for non-audit services
JTIH Group	728	694	735	990

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

Fiscal year ended December 31, 2017

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, 2018

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, 2017

Non-audit services for which fees are paid by the Company to certified public accountants include the advisory services relating to CSR activities.

Fiscal year ended December 31, 2018

Non-audit services for which fees are paid by the Company to certified public accountants include the advisory services relating to sustainability management and 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 year ended December 31, 2018 were audited by Deloitte Touche Tohmatsu LLC.

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

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

(1) In order to develop a system, which is capable of responding to changes of accounting standards adequately, we strive to accumulate expert knowledge by assigning employees with sufficient knowledge on IFRS, and participating in organizations, such as the Financial Accounting Standards Foundation and attending their seminars.

(2) In order to prepare appropriate consolidated financial statements in accordance with IFRS, we established IFRS Group Accounting Guidelines and we comply with them. The IFRS Group Accounting Guidelines are revised and updated as needed after obtaining press releases and standards issued by the International Accounting Standards Board, understanding the latest standards and examining their impact on our results.

1. Consolidated Financial Statements

(1) Consolidated Financial Statements

A. Consolidated Statement of Financial Position

As of December 31, 2017 and 2018 (Millions of yen)

	2017	**2018**
Assets		
Current assets		
Cash and cash equivalents (Note 7)	285,486	282,063
Trade and other receivables (Note 8)	431,199	456,591
Inventories (Note 9)	612,954	649,238
Other financial assets (Note 10)	14,016	35,633
Other current assets (Note 11)	361,715	385,872
Subtotal	1,705,370	1,809,396
Non-current assets held-for-sale (Note 12)	2,396	10
Total current assets	1,707,767	1,809,406
Non-current assets		
Property, plant and equipment (Note 13)	745,607	758,841
Goodwill (Notes 14, 38)	1,891,210	2,008,416
Intangible assets (Note 14)	479,175	503,076
Investment property (Note 16)	16,700	17,558
Retirement benefit assets (Note 22)	51,377	57,140
Investments accounted for using the equity method	81,253	66,807
Other financial assets (Note 10)	114,970	115,046
Deferred tax assets (Note 17)	133,425	125,109
Total non-current assets	3,513,717	3,651,993
Total assets	5,221,484	5,461,400

(Millions of yen)

	2017	**2018**
Liabilities and equity		
Liabilities		
Current liabilities		
Trade and other payables (Note 18)	395,733	380,516
Bonds and borrowings (Note 19)	398,182	250,466
Income tax payables	46,452	72,449
Other financial liabilities (Note 19)	6,906	4,486
Provisions (Note 20)	13,028	6,078
Other current liabilities (Note 21)	618,322	716,190
Total current liabilities	1,478,623	1,430,185
Non-current liabilities		
Bonds and borrowings (Note 19)	346,955	727,314
Other financial liabilities (Note 19)	11,013	10,067
Retirement benefit liabilities (Note 22)	330,762	321,838
Provisions (Note 20)	4,005	3,780
Other non-current liabilities (Note 21)	120,779	179,274
Deferred tax liabilities (Note 17)	87,319	88,497
Total non-current liabilities	900,833	1,330,770
Total liabilities	2,379,456	2,760,955
Equity		
Share capital (Note 23)	100,000	100,000
Capital surplus (Note 23)	736,400	736,400
Treasury shares (Note 23)	(443,636)	(442,829)
Other components of equity (Note 23)	(167,338)	(423,357)
Retained earnings	2,536,262	2,660,381
Equity attributable to owners of the parent company	2,761,687	2,630,594
Non-controlling interests	80,340	69,851
Total equity	2,842,027	2,700,445
Total liabilities and equity	5,221,484	5,461,400

B. Consolidated Statement of Income

Years Ended December 31, 2017 and 2018

(Millions of yen)

	2017	**2018**
Revenue (Notes 6, 25)	2,139,653	2,215,962
Cost of sales (Notes 14, 22)	(843,558)	(933,034)
Gross profit	1,296,094	1,282,928
Other operating income (Note 26)	45,724	48,532
Share of profit in investments accounted for using the equity method	6,194	3,931
Selling, general and administrative expenses (Notes 12, 13, 14, 16, 22, 27, 33, 38)	(786,911)	(770,407)
Operating profit (Note 6)	561,101	564,984
Financial income (Notes 28, 34)	4,780	5,754
Financial costs (Notes 22, 28, 34)	(27,349)	(39,252)
Profit before income taxes	538,532	531,486
Income taxes (Note 17)	(141,783)	(144,055)
Profit for the period	396,749	387,431
Attributable to		
Owners of the parent company	392,409	385,677
Non-controlling interests	4,340	1,755
Profit for the period	396,749	387,431
Earnings per share		
Basic (Yen) (Note 30)	219.10	215.31
Diluted (Yen) (Note 30)	218.97	215.20

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

(Millions of yen)

	2017	**2018**
Operating profit	561,101	564,984
Amortization cost of acquired intangibles arising from business acquisitions	50,414	61,772
Adjustment items (income)	(37,569)	(40,447)
Adjustment items (costs)	11,354	9,154
Adjusted operating profit (Note 6)	585,300	595,463

C. Consolidated Statement of Comprehensive Income

Years Ended December 31, 2017 and 2018

(Millions of yen)

	2017	**2018**
Profit for the period	396,749	387,431
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income (Notes 29, 34)	9,402	(8,215)
Remeasurements of defined benefit plans (Notes 22, 29)	20,028	(3,195)
Total of items that will not be reclassified to profit or loss	29,430	(11,410)
Items that may be reclassified subsequently to profit or loss		
Exchange differences on translation of foreign operations (Notes 29, 34)	128,073	(247,731)
Net gain (loss) on derivatives designated as cash flow hedges (Notes 29, 34)	(54)	1,012
Total of items that may be reclassified subsequently to profit or loss	128,019	(246,719)
Other comprehensive income (loss), net of taxes	157,449	(258,129)
Comprehensive income (loss) for the period	554,198	129,302
Attributable to		
Owners of the parent company	549,309	128,340
Non-controlling interests	4,889	962
Comprehensive income (loss) for the period	554,198	129,302

D. Consolidated Statement of Changes in Equity
Years Ended December 31, 2017 and 2018

(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, 2017	100,000	736,400	(443,822)	1,794	(335,642)	440	29,854
Profit for the period	―	―	―	―	―	―	―
Other comprehensive income (loss)	―	―	―	―	127,758	(54)	9,276
Comprehensive income (loss) for the period	―	―	―	―	127,758	(54)	9,276
Acquisition of treasury shares (Note 23)	―	―	(1)	―	―	―	―
Disposal of treasury shares (Note 23)	―	―	187	(166)	―	―	―
Share-based payments (Note 33)	―	―	―	336	―	―	―
Dividends (Note 24)	―	―	―	―	―	―	―
Changes in the scope of consolidation	―	―	―	―	―	―	―
Changes in the ownership interest in a subsidiary without a loss of control	―	―	―	―	―	―	―
Transfer from other components of equity to retained earnings	―	―	―	―	―	―	(461)
Other increase (decrease)	―	―	―	―	―	(475)	―
Total transactions with the owners	―	―	186	170	―	(475)	(461)
As of December 31, 2017	100,000	736,400	(443,636)	1,964	(207,884)	(88)	38,670
Profit for the period	―	―	―	―	―	―	―
Other comprehensive income (loss)	―	―	―	―	(247,034)	1,012	(8,239)
Comprehensive income (loss) for the period	―	―	―	―	(247,034)	1,012	(8,239)
Acquisition of treasury shares (Note 23)	―	―	(0)	―	―	―	―
Disposal of treasury shares (Note 23)	―	―	807	(691)	―	―	―
Share-based payments (Note 33)	―	―	―	274	―	―	―
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	―	―	―	―	―	―	(860)
Other increase (decrease)	―	―	―	―	―	(480)	―
Total transactions with the owners	―	―	807	(417)	―	(480)	(860)
As of December 31, 2018	100,000	736,400	(442,829)	1,547	(454,918)	443	29,570

(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, 2017	—	(303,554)	2,367,067	2,456,091	71,950	2,528,041
Profit for the period	—	—	392,409	392,409	4,340	396,749
Other comprehensive income (loss)	19,919	156,900	—	156,900	550	157,449
Comprehensive income (loss) for the period	19,919	156,900	392,409	549,309	4,889	554,198
Acquisition of treasury shares (Note 23)	—	—	—	(1)	—	(1)
Disposal of treasury shares (Note 23)	—	(166)	(21)	0	—	0
Share-based payments (Note 33)	—	336	—	336	5	341
Dividends (Note 24)	—	—	(243,572)	(243,572)	(1,547)	(245,119)
Changes in the scope of consolidation	—	—	—	—	4,884	4,884
Changes in the ownership interest in a subsidiary without a loss of control	—	—	(1)	(1)	159	158
Transfer from other components of equity to retained earnings	(19,919)	(20,380)	20,380	—	—	—
Other increase (decrease)	—	(475)	—	(475)	—	(475)
Total transactions with the owners	(19,919)	(20,684)	(223,214)	(243,713)	3,501	(240,212)
As of December 31, 2017	—	(167,338)	2,536,262	2,761,687	80,340	2,842,027
Profit for the period	—	—	385,677	385,677	1,755	387,431
Other comprehensive income (loss)	(3,075)	(257,337)	—	(257,337)	(792)	(258,129)
Comprehensive income (loss) for the period	(3,075)	(257,337)	385,677	128,340	962	129,302
Acquisition of treasury shares (Note 23)	—	—	—	(0)	—	(0)
Disposal of treasury shares (Note 23)	—	(691)	(116)	0	—	0
Share-based payments (Note 33)	—	274	2	275	36	311
Dividends (Note 24)	—	—	(259,724)	(259,724)	(1,914)	(261,638)
Changes in the scope of consolidation	—	—	—	—	139	139
Changes in the ownership interest in a subsidiary without a loss of control	—	—	495	495	(9,713)	(9,218)
Transfer from other components of equity to retained earnings	3,075	2,215	(2,215)	—	—	—
Other increase (decrease)	—	(480)	—	(480)	—	(480)
Total transactions with the owners	3,075	1,318	(261,558)	(259,433)	(11,452)	(270,885)
As of December 31, 2018	—	(423,357)	2,660,381	2,630,594	69,851	2,700,445

E. Consolidated Statement of Cash Flows

Years Ended December 31, 2017 and 2018

(Millions of yen)

	2017	**2018**
Cash flows from operating activities		
Profit before income taxes	538,532	531,486
Depreciation and amortization	145,407	158,671
Impairment losses	3,427	8,454
Reversal of impairment losses on investments in associates	(8,848)	—
Interest and dividend income	(4,381)	(5,751)
Interest expense	11,604	16,343
Share of profit in investments accounted for using the equity method	(6,194)	(3,931)
(Gains) losses on sale and disposal of property, plant and equipment, intangible assets and investment property	(21,221)	(34,905)
(Increase) decrease in trade and other receivables	(28,810)	(30,818)
(Increase) decrease in inventories	(41,102)	(53,058)
Increase (decrease) in trade and other payables	15,655	(4,618)
Increase (decrease) in retirement benefit liabilities	(15,296)	(8,864)
(Increase) decrease in prepaid tobacco excise taxes	(10,281)	(36,662)
Increase (decrease) in tobacco excise tax payables	(60,250)	53,408
Increase (decrease) in consumption tax payables	1,117	(11,026)
Other	12,228	8,969
Subtotal	531,587	587,697
Interest and dividends received	11,250	11,743
Interest paid	(11,035)	(13,685)
Income taxes paid	(112,591)	(124,366)
Net cash flows from operating activities	419,212	461,389
Cash flows from investing activities		
Purchase of securities	(11,479)	(36,705)
Proceeds from sale and redemption of securities	4,893	10,159
Purchase of property, plant and equipment	(123,726)	(138,605)
Proceeds from sale of investment property	21,195	46,868
Purchase of intangible assets	(16,412)	(20,205)
Payments into time deposits	(84)	(878)
Proceeds from withdrawal of time deposits	101	812
Payments for business combinations (Note 38)	(212,707)	(247,632)
Purchase of investments in associates	(5,253)	—
Other	(9,160)	2,878
Net cash flows from investing activities	(352,632)	(383,307)

(Millions of yen)

	2017	**2018**
Cash flows from financing activities		
Dividends paid to owners of the parent company (Note 24)	(243,552)	(259,671)
Dividends paid to non-controlling interests	(1,502)	(1,747)
Capital contribution from non-controlling interests	15	109
Increase (decrease) in short-term borrowings and commercial paper (Note 32)	116,371	(133,849)
Proceeds from long-term borrowings (Note 32)	70,861	59,135
Repayments of long-term borrowings (Note 32)	(669)	(2,710)
Proceeds from issuance of bonds (Note 32)	—	341,516
Redemption of bonds (Note 32)	(20,000)	(54,086)
Proceeds from sale and leaseback transactions	2,819	—
Repayments of finance lease obligations (Note 32)	(1,373)	(1,637)
Acquisition of treasury shares	(1)	(0)
Payments for acquisition of interests in subsidiaries from non-controlling interests	—	(9,421)
Other	0	0
Net cash flows from financing activities	(77,032)	(62,360)
Net increase (decrease) in cash and cash equivalents	(10,452)	15,721
Cash and cash equivalents at the beginning of the period	294,157	285,486
Effect of exchange rate changes on cash and cash equivalents	1,782	(19,145)
Cash and cash equivalents at the end of the period (Note 7)	285,486	282,063

Notes to Consolidated Financial Statements
Years ended December 31, 2017 and 2018

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.jt.com/).

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, 2018 were approved on March 20, 2019 by Masamichi Terabatake, 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.

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 year end. 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 year end, 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 following classifications:

(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

With respect to financial assets measured at amortized cost, the Group recognizes an allowance for doubtful accounts for expected credit losses. The expected credit losses are calculated based on historical loss experience or future recoverable amounts.

An allowance for doubtful accounts for trade receivables is always recognized in an amount equal to the full lifetime expected credit losses. In principle, with respect to financial assets except for trade receivables, an allowance for doubtful accounts is measured at an amount equal to the 12-month expected credit losses. However, the allowance for doubtful accounts is measured at an amount equal to the full lifetime expected credit losses if a credit risk on the financial asset has increased significantly since initial recognition.

The Group assesses whether a credit risk on a financial asset has increased significantly based on a change of the default risk considering past due information, financial difficulties of obligors or downgrades of the internal credit rating.

The Group assesses a whole or part of the financial asset which is deemed extremely difficult to be collected as a default and recognizes it as a credit-impaired financial asset. If the Group reasonably determines that a whole or part of the financial asset is uncollectible, the carrying amounts of financial assets are written-off directly.

The expected credit losses on trade receivables which are not assessed as credit-impaired financial assets are measured collectively by an asset group consisting of a number of homogeneous counterparties.

An allowance for doubtful accounts for financial assets is recognized in profit or loss. If an event which causes a reduction in the allowance for doubtful accounts occurs, a reversal of an allowance for doubtful accounts is recognized in profit or loss.

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 following classifications:

(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 amount of an allowance for doubtful accounts calculated in accordance with “B Impairment of Financial Assets” above, and
- The amount initially measured less cumulative revenue recognized in accordance with IFRS 15 “Revenue from Contracts with Customers.”

(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 "Financial Instruments."

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

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

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

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

(13) Post-employment Benefits

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

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

For each plan, the Group calculates the present value of defined benefit obligations, related current service cost and past service cost using the projected unit credit method. For a discount rate, a discount period is determined based on the period until the expected date of benefit payment in each 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 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. Revenue from Contracts with Customers

Revenue is recognized based on the following five-step approach.

Step 1: Identify the contract with a customer
Step 2: Identify the performance obligations in the contract
Step 3: Determine the transaction price
Step 4: Allocate the transaction price to the performance obligations in the contract
Step 5: Recognize revenue when the entity satisfies a performance obligation

The Group mainly engages in the sale of tobacco products, prescription drugs, and processed foods. Revenue is recognized upon delivery of the products because the customer obtains control of the products upon delivery, by which the Group evaluates that the performance obligation is satisfied. Revenue is measured at the consideration promised in a contract with a customer, less discounts, rebates and taxes, including consumption tax.

The tobacco excise taxes and other transactions in which the Group is involved as an agency are excluded from revenue. The amount after deducting the tobacco excise taxes and other transactions is presented 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 shareholders' right to receive payment is established.

(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 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 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 year when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted by year end.

In the year ended December 31, 2018, the Company and certain domestic subsidiaries applied for approval of the adoption of the consolidated taxation system, and it is to be adopted from the following year. Therefore, from the year ended December 31, 2018, deferred tax assets and liabilities are accounted for assuming the adoption of the consolidated taxation system.

(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 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 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 year ended December 31, 2018.

IFRS		Description of new standards and amendments
IFRS 9	Financial Instruments	Limited changes to classification and measurement of financial assets, and introduction of an expected credit loss impairment model
IFRS 15	Revenue from Contracts with Customers	Amendments to accounting treatment for recognizing revenue

The effect of adopting IFRS 9 on the consolidated financial statements is immaterial.

In adopting IFRS 15, the Group used a transition method by which the cumulative effect of initially applying this Standard was recognized at the date of initial application.

As a result of identification of performance obligations under contracts with customers based on the five-step approach stated in "(16) Revenue A. Revenue from Contracts with Customers," the sales promotion and other expenses paid by the Group to customers, which have been previously accounted for as selling, general and administrative expenses, are partially deducted from revenue from the year ended December 31, 2018. In addition, shipping and warehousing expenses and other expenses necessary for satisfying performance obligations that have been previously accounted for as selling, general and administrative expenses are accounted for as cost of sales from the year ended December 31, 2018.

As a result, compared to the application of the former accounting standard, "Revenue" and "Selling, general and administrative expenses" decreased by ¥10,944 million and ¥70,905 million respectively, and "Cost of sales" increased by ¥59,962 million on the consolidated statement of income for the year ended December 31, 2018. The above effects include promotion expenses (¥9,028 million) accounted for as reductions in revenue, as well as shipping and warehousing expenses (¥28,000 million) accounted for as cost of sales.

These changes have no effect on operating profit and profit for the period.

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 year end. 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 year end. 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 year end.

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 year end and by taking into account the probability of these contingencies and their impact on financial reporting.

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

5. New Accounting Standards Not Yet Adopted by the Group

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

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

In relation to adoption of IFRS 16 "Leases," operating lease payments are previously recognized as expenses using the straight-line method over the lease term in "Cost of sales" and "Selling, general and administrative expenses" without recognizing as assets and obligations in the consolidated statement of financial position. Operating lease payments will be recognized as right-of-use assets and lease liabilities in the consolidated statement of financial position. The amount of depreciation would be recognized in "Cost of sales" and "Selling, general and administrative expenses" and the amount of interest cost would be recognized in "Financial costs." Due to adoption of the standard, "Assets" and "Liabilities" in the consolidated statement of financial position are expected to increase by ¥39,033 million. There will be immaterial impact on operating profit and profit for the period from this change.

IFRS		Mandatory adoption (From the year beginning)	To be adopted by the Group	Description of new standards and amendments
IFRS 3	Business Combinations	January 1, 2019	Year ending December 2019	Clarifying accounting treatment for previously held interests in a joint operation
		January 1, 2020	Year ending December 2020	Amendments to definition of "business"
IFRS 9	Financial Instruments	January 1, 2019	Year ending December 2019	Amendments to classification of financial assets included in prepayment features
IFRS 11	Joint Arrangements	January 1, 2019	Year ending December 2019	Clarifying accounting treatment for previously held interests in a joint operation
IFRS 16	Leases	January 1, 2019	Year ending December 2019	Amendments to accounting treatment for lease arrangements
IFRS 17	Insurance Contracts	January 1, 2021	Year ending December 2021	Amendments to accounting treatment for insurance contracts
IAS 1	Presentation of Financial Statements	January 1, 2020	Year ending December 2020	Amendments to definition of "material"
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors	January 1, 2020	Year ending December 2020	Amendments to definition of "material"
IAS 12	Income Taxes	January 1, 2019	Year ending December 2019	Clarifying accounting treatment for income tax consequences of dividends
IAS 19	Employee Benefits	January 1, 2019	Year ending December 2019	Clarifying treatment on a defined benefit plan curtailment or settlement
IAS 23	Borrowing Costs	January 1, 2019	Year ending December 2019	Clarifying the method for calculating the borrowing costs eligible for capitalization
IAS 28	Investments in Associates and Joint Ventures	January 1, 2019	Year ending December 2019	Clarifying accounting treatment for impairment loss of investments in associates and joint ventures
IFRIC 23	Uncertainty over Income Tax Treatments	January 1, 2019	Year ending December 2019	Clarifying accounting treatment for uncertainty over income tax treatments
IFRS 10 IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	Not yet determined	Not yet determined	Amendments to accounting treatment for sale or contribution of assets between an investor and its associate or joint venture

6. Operating Segments

(1) Outline of Reportable Segments

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

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

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

(2) Revenues and Performances of Reportable Segments

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

Year ended December 31, 2017

(Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Revenue								
External revenue (Note 3)	626,758	1,237,577	104,714	163,138	2,132,187	7,466	—	2,139,653
Intersegment revenue	8,558	31,465	—	22	40,045	7,543	(47,588)	—
Total revenue	635,315	1,269,042	104,714	163,159	2,172,232	15,008	(47,588)	2,139,653
Segment profit (loss)								
Adjusted operating profit (Note 1)	232,275	351,302	24,094	5,397	613,069	(28,156)	388	585,300
Other items								
Depreciation and amortization	56,001	76,098	5,120	6,137	143,355	2,288	(237)	145,407
Impairment losses on other than financial assets	53	2,599	—	286	2,938	489	—	3,427
Reversal of impairment losses on other than financial assets	—	455	—	—	455	—	—	455
Share of profit (loss) in investments accounted for using the equity method	22	6,102	—	17	6,140	53	—	6,194
Capital expenditures	51,549	68,427	6,230	10,424	136,631	4,838	(564)	140,905

Year ended December 31, 2018

(Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Revenue								
External revenue (Note 3)	621,426	1,312,342	113,992	161,387	2,209,147	6,815	—	2,215,962
Intersegment revenue	7,976	27,637	—	1	35,615	5,737	(41,353)	—
Total revenue	629,403	1,339,979	113,992	161,388	2,244,762	12,553	(41,353)	2,215,962
Segment profit (loss)								
Adjusted operating profit (Note 1)	208,977	384,524	28,438	4,123	626,062	(30,440)	(159)	595,463
Other items								
Depreciation and amortization	55,044	89,887	5,071	6,708	156,710	2,193	(233)	158,671
Impairment losses on other than financial assets	—	5,336	2,141	146	7,623	831	—	8,454
Reversal of impairment losses on other than financial assets	—	692	—	—	692	—	—	692
Share of profit (loss) in investments accounted for using the equity method	35	3,849	—	11	3,895	36	—	3,931
Capital expenditures	55,444	75,727	11,333	12,749	155,253	4,844	(289)	159,808

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

Year ended December 31, 2017

(Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Adjusted operating profit (Note 1)	232,275	351,302	24,094	5,397	613,069	(28,156)	388	585,300
Amortization cost of acquired intangibles arising from business acquisitions	(16,245)	(34,170)	–	–	(50,414)	–	–	(50,414)
Adjustment items (income) (Note 4)	6	16,723	–	–	16,729	20,840	–	37,569
Adjustment items (costs) (Note 5)	(197)	(8,272)	–	(20)	(8,489)	(2,865)	–	(11,354)
Operating profit (loss)	215,839	325,584	24,094	5,377	570,894	(10,181)	388	561,101
Financial income								4,780
Financial costs								(27,349)
Profit before income taxes								538,532

Year ended December 31, 2018

(Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Adjusted operating profit (Note 1)	208,977	384,524	28,438	4,123	626,062	(30,440)	(159)	595,463
Amortization cost of acquired intangibles arising from business acquisitions	(16,245)	(45,527)	–	–	(61,772)	–	–	(61,772)
Adjustment items (income) (Note 4)	9	1,711	–	37	1,757	38,691	–	40,447
Adjustment items (costs) (Note 5)	(288)	(1,195)	(2,141)	(1,240)	(4,864)	(4,290)	–	(9,154)
Operating profit (loss)	192,453	339,514	26,297	2,919	561,183	3,960	(159)	564,984
Financial income								5,754
Financial costs								(39,252)
Profit before income taxes								531,486

(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)

	2017	**2018**
Domestic Tobacco	590,605	582,379
International Tobacco	1,176,956	1,250,719

(Note 4) The breakdown of “Adjustment items (income)” is as follows:

(Millions of yen)

	2017	**2018**
Restructuring incomes	21,645	39,284
Reversal of impairment losses on investments in associates	8,848	–
Gains on remeasurement related to the business combination	5,042	–
Other	2,034	1,163
Adjustment items (income)	37,569	40,447

Restructuring incomes for the years ended December 31, 2017 and 2018 mainly relate to gains on sale of real estate. The breakdown of restructuring incomes is described in “26. Other Operating Income.”

(Note 5) The breakdown of “Adjustment items (costs)” is as follows:

(Millions of yen)

	2017	**2018**
Restructuring costs	8,398	7,934
Other	2,956	1,220
Adjustment items (costs)	11,354	9,154

Restructuring costs for the year ended December 31, 2017 mainly relate to rationalization of the production and distribution system in some markets in the “International Tobacco Business.” Restructuring costs for the year ended December 31, 2018 mainly relate to disposal of real estate, business structure reform in the “Pharmaceutical Business” and rationalization of the production and distribution system in some markets in the “International Tobacco Business.”

Restructuring costs included in “Cost of sales” were ¥84 million and ¥13 million, and those costs included in “Selling, general and administrative expenses” were ¥8,314 million and ¥7,921 million for the years ended December 31, 2017 and 2018, respectively. The breakdown of restructuring costs included in “Selling, general and administrative expenses” is described in “27. Selling, General and Administrative Expenses.”

Other for the year ended December 31, 2018 mainly relates to settlement of the litigation in September 2018.

(3) Geographic Information

The regional breakdown of non-current assets as of December 31 is as follows:

Non-current Assets (Millions of yen)

	2017	**2018**
Japan	830,838	835,386
Overseas	2,301,854	2,452,505
Consolidated	3,132,692	3,287,891

(Note) Non-current assets, exclusive of financial instruments, deferred tax assets and retirement benefits assets, are segmented by the location of the assets.

The regional breakdown of external revenue for each year is as follows:

External Revenue (Millions of yen)

	2017	**2018**
Japan	831,216	822,070
Overseas	1,308,437	1,393,892
Consolidated	2,139,653	2,215,962

(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 ¥248,881 million (11.6% of consolidated revenue) for the year ended December 31, 2017 and ¥249,797 million (11.3% of consolidated revenue) for the year ended December 31, 2018.

7. Cash and Cash Equivalents

The breakdown of “Cash and cash equivalents” as of December 31 is as follows:

(Millions of yen)

	2017	**2018**
Cash and deposits	215,885	234,263
Short-term investments	69,601	47,800
Total	285,486	282,063

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

“Cash and cash equivalents” includes cash and cash equivalents of ¥24,772 million (IRR 18,595 billion) as of December 31, 2018 held by the Group’s Iranian subsidiaries. Due to international sanctions and other factors imposed on Iran, the subsidiaries’ ability to remit funds outside of Iran is restricted.

8. Trade and Other Receivables

The breakdown of “Trade and other receivables” as of December 31 is as follows:

(Millions of yen)

	2017	**2018**
Note and account receivables	439,562	449,863
Other	15,226	8,378
Allowance for doubtful accounts	(23,589)	(1,650)
Total	431,199	456,591

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 December 31 is as follows:

(Millions of yen)

	2017	**2018**
Merchandise and finished goods (Note 1)	193,179	209,491
Leaf tobacco (Note 2)	352,803	364,084
Other	66,971	75,662
Total	612,954	649,238

(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 as of December 31 of each 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 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 December 31 is as follows:

(Millions of yen)

	2017	**2018**
Derivative assets	5,978	8,653
Equity securities	77,642	64,684
Debt securities	11,352	26,816
Time deposits	977	979
Other	39,607	55,656
Allowance for doubtful accounts	(6,569)	(6,108)
Total	128,987	150,679
Current assets	14,016	35,633
Non-current assets	114,970	115,046
Total	128,987	150,679

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 December 31 are as follows:

(Millions of yen)

Company name	2017	**2018**
KT&G Corporation	35,141	28,904
Seven & i Holdings Co., Ltd.	4,005	4,091
DOUTOR・NICHIRES Holdings Co., Ltd.	3,715	2,681
Central Japan Railway Company	2,018	2,317
OKAMURA CORPORATION	1,986	1,710
KATO SANGYO CO., LTD.	2,325	1,709

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 year is as follows:

(Millions of yen)

	2017	**2018**
Fair value	1,545	2,241
Cumulative gain or loss recognized in equity as other comprehensive income (Note)	(461)	(860)

(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 December 31 is as follows:

(Millions of yen)

	2017	**2018**
Prepaid tobacco excise taxes	297,332	308,815
Prepaid expenses	19,339	21,262
Consumption tax receivables	19,496	17,177
Other	25,547	38,618
Total	361,715	385,872

12. Non-current Assets Held-for-Sale

The breakdown of "Non-current assets held-for-sale" as of December 31 is as follows:

Breakdown of Major Assets

(Millions of yen)

	2017	**2018**
Non-current assets held-for-sale		
Property, plant and equipment	1,453	4
Investment property	943	6
Total	2,396	10

"Non-current assets held-for-sale" are mainly idle properties which are currently actively marketed for sale.

With regard to such assets and assets sold, impairment losses of ¥518 million and ¥74 million are recognized in "Selling, general and administrative expenses" in the consolidated statement of income for the years ended December 31, 2017 and 2018, respectively.

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, 2017	344,237	246,192	44,193	46,213	680,835
Individual acquisition	17,833	43,586	15,071	38,647	115,137
Acquisition through business combinations	12,401	14,424	315	1,599	28,739
Transfer to investment property	(1,721)	(5)	(6)	–	(1,732)
Transfer to non-current assets held-for-sale	(2,250)	–	–	–	(2,250)
Depreciation	(15,813)	(48,717)	(14,634)	–	(79,164)
Impairment losses	(699)	(1,108)	(46)	(37)	(1,891)
Reversal of impairment losses	–	451	3	–	455
Sale or disposal	(581)	(4,685)	(1,011)	(17)	(6,295)
Exchange differences on translation of foreign operations	3,230	5,056	1,002	(226)	9,061
Other	6,610	23,894	1,486	(29,277)	2,712
As of December 31, 2017	363,245	279,088	46,373	56,902	745,607
Individual acquisition	18,972	56,901	14,873	48,735	139,480
Acquisition through business combinations	7,275	8,498	107	21	15,902
Transfer to investment property	(3,211)	(0)	(3)	–	(3,215)
Transfer to non-current assets held-for-sale	(1,945)	(4)	–	–	(1,949)
Depreciation	(16,647)	(50,794)	(14,987)	–	(82,428)
Impairment losses	(1,561)	(3,442)	(86)	(131)	(5,220)
Reversal of impairment losses	248	432	–	12	692
Sale or disposal	(764)	(3,221)	(773)	(82)	(4,841)
Exchange differences on translation of foreign operations	(14,716)	(22,895)	(2,162)	(4,208)	(43,981)
Other	11,691	24,025	991	(37,913)	(1,206)
As of December 31, 2018	362,586	288,587	44,333	63,335	758,841

(Millions of yen)

Acquisition Cost	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2017	643,073	693,378	147,223	46,213	1,529,888
As of December 31, 2017	664,779	761,581	156,169	56,902	1,639,431
As of December 31, 2018	671,434	773,836	152,793	63,443	1,661,505

(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, 2017	298,836	447,187	103,030	—	849,053
As of December 31, 2017	301,534	482,493	109,797	—	893,824
As of December 31, 2018	308,847	485,249	108,460	107	902,664

The carrying amount of property, plant and equipment as of December 31 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, 2017	6,538	1,201	7	7,746
As of December 31, 2017	6,509	4,669	11	11,189
As of December 31, 2018	6,386	5,846	271	12,503

(2) Impairment Losses

The grouping of property, plant and equipment for impairment test is the smallest cash-generating unit that independently generates cash inflow.

The Group recognized impairment losses of ¥1,891 million for the year ended December 31, 2017, and ¥5,220 million for the year ended December 31, 2018 in “Selling, general and administrative expenses” in the consolidated statement of income.

Impairment losses recognized in the year ended December 31, 2017 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles, such as due to the decision of closing down of a factory.

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

Impairment losses recognized in the year ended December 31, 2018 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles, such as due to the decision of individual demolition.

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

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, 2017	1,601,987	364,896	27,078	31,996	2,025,957
Individual acquisition	－	257	7,724	17,482	25,462
Acquisition through business combinations	202,144	71,450	－	12,831	286,425
Amortization (Note)	－	(46,786)	(12,808)	(6,079)	(65,673)
Impairment losses	－	(940)	(75)	(4)	(1,019)
Sale or disposal	－	－	(89)	(43)	(132)
Exchange differences on translation of foreign operations	87,080	12,410	(153)	(108)	99,229
Other	－	－	1,546	(1,409)	136
As of December 31, 2017	1,891,210	401,286	23,223	54,666	2,370,385
Individual acquisition	－	188	10,831	8,970	19,990
Acquisition through business combinations	279,606	104,833	163	6,758	391,360
Amortization (Note)	－	(57,539)	(11,242)	(6,888)	(75,669)
Impairment losses	－	－	(17)	(2,389)	(2,406)
Reversal of impairment losses	－	－	0	－	0
Sale or disposal	－	(70)	(124)	(1,556)	(1,750)
Exchange differences on translation of foreign operations	(162,240)	(27,423)	(271)	(1,099)	(191,033)
Other	(161)	－	9,355	(8,579)	615
As of December 31, 2018	2,008,416	421,276	31,919	49,882	2,511,492

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

(Millions of yen)

Acquisition Cost	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2017	1,601,987	928,876	137,761	96,994	2,765,618
As of December 31, 2017	1,891,210	1,028,189	142,531	126,263	3,188,192
As of December 31, 2018	2,008,416	1,078,596	157,191	94,698	3,338,901

(Millions of yen)

Accumulated Amortization and Accumulated Impairment Losses	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2017	－	563,981	110,683	64,997	739,661
As of December 31, 2017	－	626,903	119,308	71,597	817,808
As of December 31, 2018	－	657,320	125,272	44,817	827,409

(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, 2017 and 2018 were ¥1,599,950 million and ¥1,717,156 million, respectively. The carrying amounts of trademarks as of December 31, 2017 and 2018 were ¥269,453 million and ¥305,997 million, respectively.

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

Other than the above, goodwill and trademark in Domestic Tobacco business were recognized as a result of the acquisition of Natural American Spirit’s non-U.S. tobacco operations in 2016. The carrying amounts of goodwill as of December 31, 2017 and 2018 were ¥265,891 million and ¥265,891 million, respectively. The carrying amounts of trademarks as of December 31, 2017 and 2018 were ¥131,822 million and ¥115,274 million, respectively.

The trademarks are amortized using the straight-line method and the remaining amortization period is mainly from 7 to 8 years.

(3) Impairment Test for Goodwill

For the year ended December 31, 2018, the carrying amount of the majority of goodwill is allocated to the domestic tobacco cash-generating unit of ¥265,891 million (¥265,891 million for the year ended December 31, 2017), the international tobacco cash-generating unit of ¥1,717,156 million (¥1,599,950 million for the year ended December 31, 2017) and the processed food cash-generating unit of ¥25,368 million (¥25,368 million for the year ended December 31, 2017). 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, given the current domestic tobacco market situation, the Group calculates the value in use by using cash flows with a growth rate of 0% conservatively. For the previous year, the Group decreased a growth rate from 3.9% in the fourth year to 0% in the ninth year gradually, and calculated the value in use from the tenth year by using the same cash flows as the ninth year.

The discount rate before taxes is 4.9% (2017: 4.9%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

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 8.1% in the fourth year (2017: 6.4%) to 3.0% in the ninth year (2017: 2.8%), 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 9.9% (2017: 9.8%). 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 1.2% in the fourth year (2017: 1.6%) to 1.2% in the ninth year (2017: 1.0%), 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 4.0% (2017: 3.9%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

(4) Impairment Losses

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

The Group recognized impairment losses of ¥1,019 million for the year ended December 31, 2017, and ¥2,406 million for the year ended December 31, 2018 in "Selling, general and administrative expenses" in the consolidated statement of income.

Impairment losses recognized in the year ended December 31, 2018 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of software and other intangible assets since the recoverable amounts were lower than the carrying amounts.

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

15. Lease Transactions

The Group leases factory sites, vehicles 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 December 31 are as follows:

(Millions of yen)

	2017	**2018**
Not later than 1 year		
Total of future minimum lease payments	1,630	1,305
Future financial costs	284	263
Present value	1,346	1,042
Later than 1 year and not later than five years		
Total of future minimum lease payments	3,503	3,305
Future financial costs	1,203	1,191
Present value	2,300	2,114
Later than 5 years		
Total of future minimum lease payments	9,626	8,790
Future financial costs	2,605	2,139
Present value	7,021	6,651
Total		
Total of future minimum lease payments	14,760	13,401
Future financial costs	4,092	3,593
Present value	10,667	9,807

(2) Future Minimum Lease Payments under Non-cancellable Operating Leases

The total of future minimum lease payments under non-cancellable operating leases as of December 31 is as follows:

(Millions of yen)

	2017	**2018**
Not later than 1 year	8,059	11,841
Later than 1 year and not later than 5 years	10,719	15,870
Later than 5 years	9,217	14,696
Total	27,995	42,407

(3) Total of Minimum Lease Payments and Contingent Rents

The total of minimum lease payments and contingent rents of operating lease contracts recognized as an expense for each year is as follows:

(Millions of yen)

	2017	**2018**
Total of minimum lease payments	10,220	13,445
Contingent rents	1,135	1,188

16. Investment Property

(1) Schedule of Investment Property

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

(Millions of yen)

	2017	**2018**
As of January 1	18,184	16,700
Expenditure after acquisition	305	338
Transfer from property, plant and equipment	1,732	3,215
Acquisition by business combination	—	139
Transfer to non-current assets held-for-sale	(2,777)	(1,171)
Depreciation	(570)	(573)
Impairment losses	—	(754)
Sale or disposal	(162)	(303)
Exchange differences on translation of foreign operations	6	(6)
Other	(17)	(28)
As of December 31	16,700	17,558
Acquisition cost as of January 1	51,245	45,768
Accumulated depreciation and accumulated impairment losses as of January 1	33,061	29,068
Acquisition cost as of December 31	45,768	38,355
Accumulated depreciation and accumulated impairment losses as of December 31	29,068	20,797

(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 December 31 is as follows:

As of December 31, 2017 (Millions of yen)

	Level 1	Level 2	Level 3	Total
Investment property	－	34,646	1,921	36,567

As of December 31, 2018 (Millions of yen)

	Level 1	Level 2	Level 3	Total
Investment property	－	34,678	2,485	37,164

(3) Impairment Losses

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

The Group recognized impairment losses of ¥754 million for the year ended December 31, 2018 in “Selling, general and administrative expenses” in the consolidated statement of income.

Impairment losses recognized for the year ended December 31, 2018 represent the difference between the recoverable amount and the carrying amount of land and buildings as idle properties were decided individual 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 year are as follows:

Year ended December 31, 2017

(Millions of yen)

Deferred Tax Assets	As of January 1, 2017	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2017
Fixed assets (Note 2)	136,713	(15,864)	—	3,859	124,709
Retirement benefits	79,940	(6,395)	(2,135)	2,211	73,621
Carryforward of unused tax losses	53,135	399	—	1,694	55,228
Other	75,971	(4,222)	(177)	2,860	74,433
Subtotal	345,760	(26,082)	(2,312)	10,625	327,991
Valuation allowance	(61,231)	(1,527)	(269)	(2,347)	(65,374)
Total	284,528	(27,609)	(2,581)	8,278	262,617

(Millions of yen)

Deferred Tax Liabilities	As of January 1, 2017	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2017
Fixed assets (Note 2)	(73,805)	1,677	—	(12,577)	(84,705)
Retirement benefits	(4,506)	(232)	(3,971)	(534)	(9,244)
Other	(111,260)	(3,539)	(5,196)	(2,568)	(122,563)
Total	(189,572)	(2,093)	(9,167)	(15,679)	(216,511)

Year ended December 31, 2018 (Millions of yen)

Deferred Tax Assets	As of January 1, 2018	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2018
Fixed assets (Note 2)	124,709	(10,763)	—	(1,436)	112,509
Retirement benefits	73,621	(1,563)	1,731	(1,543)	72,248
Carryforward of unused tax losses	55,228	(589)	—	(1,513)	53,126
Other	74,433	13,522	(2,043)	(1,697)	84,215
Subtotal	327,991	607	(312)	(6,188)	322,098
Valuation allowance	(65,374)	(1,012)	(1,248)	1,648	(65,986)
Total	262,617	(406)	(1,560)	(4,540)	256,112

(Millions of yen)

Deferred Tax Liabilities	As of January 1, 2018	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2018
Fixed assets (Note 2)	(84,705)	5,971	—	(12,944)	(91,678)
Retirement benefits	(9,244)	(1,530)	(254)	902	(10,125)
Other	(122,563)	(5,001)	4,337	5,529	(117,697)
Total	(216,511)	(559)	4,083	(6,513)	(219,500)

(Note 1) “Other” includes exchange differences on translation of foreign operations and acquisition through business combinations.

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

The deferred tax assets are recognized for the amount considered to be recoverable on deductible temporary differences, carryforward of unused tax losses and tax credits by taking taxable temporary differences and future taxable profits plan into account. The carryforward of unused tax losses, for which the deferred tax assets are not recognized, was ¥46,809 million (including ¥11,903 million, for which the carryforward expires after five years) as of December 31, 2017, and ¥44,610 million (including ¥15,696 million, for which the carryforward expires after five years) as of December 31, 2018. Tax credits, for which the deferred tax assets are not recognized, were ¥5,185 million (including ¥4,810 million, for which the carryforward expires after five years) as of December 31, 2017, and ¥5,417 million (including ¥5,183 million, for which the carryforward expires after five years) as of December 31, 2018.

(2) Income Taxes

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

(Millions of yen)

	2017	**2018**
Current income taxes	112,081	143,090
Deferred income taxes	29,702	965
Total income taxes	141,783	144,055

Deferred income taxes decreased by ¥801 million and increased by ¥96 million for the years ended December 31, 2017 and 2018, respectively, due to the effect of changes in tax rates in Japan and other countries.

(3) Reconciliation of the Effective Tax Rate

The breakdown of major items that caused differences between the effective statutory tax rate and the average actual tax rate for each year is as follows:

The Company is subject mainly to corporate tax, inhabitant tax and enterprise tax, and the effective statutory tax rate for each year calculated based on these taxes was 30.66%. Foreign subsidiaries are subject to income taxes at their locations.

(%)

	2017	**2018**
Effective statutory tax rate	30.66	30.66
Different tax rates applied to foreign subsidiaries	(8.86)	(9.57)
Non-deductible expenses	0.95	1.13
Valuation allowance	1.54	0.95
Withholding tax in foreign countries	1.29	1.50
Tax contingencies	1.26	2.32
Other	(0.52)	0.11
Average actual tax rate	26.33	27.10

18. Trade and Other Payables

The breakdown of "Trade and other payables" as of December 31 is as follows:

(Millions of yen)

	2017	**2018**
Accounts payable	218,378	197,426
Other payables	66,864	68,246
Other	110,491	114,844
Total	395,733	380,516

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 December 31 is as follows:

(Millions of yen)

	2017	**2018**	Due
Derivative liabilities	5,425	3,176	—
Short-term borrowings	274,233	165,985	—
Commercial paper	66,808	72,038	—
Current portion of long-term borrowings	690	12,443	—
Current portion of bonds (Note)	56,451	—	—
Long-term borrowings	71,164	116,870	2020 – 2028
Bonds (Note)	275,791	610,444	—
Other	12,494	11,377	—
Total	763,056	992,334	
Current liabilities	405,088	254,953	
Non-current liabilities	357,968	737,381	
Total	763,056	992,334	

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

Company	Name of bond	Date of issuance	As of December 31, 2017 (Millions of yen)	As of December 31, 2018 (Millions of yen)	Interest rate (%)	Collateral	Date of maturity
Japan Tobacco Inc.	8th domestic straight bond	December 9, 2010	20,000	20,000	1.300	Yes	December 9, 2020
Japan Tobacco Inc.	9th domestic straight bond	July 15, 2015	60,000	60,000	0.217	Yes	July 15, 2020
Japan Tobacco Inc.	10th domestic straight bond	July 15, 2015	30,000	30,000	0.358	Yes	July 15, 2022
Japan Tobacco Inc.	11th domestic straight bond	July 15, 2015	25,000	25,000	0.599	Yes	July 15, 2025
Japan Tobacco Inc.	12th domestic straight bond	September 10, 2018	—	60,000	0.110	Yes	September 8, 2023
Japan Tobacco Inc.	13th domestic straight bond	September 10, 2018	—	30,000	0.355	Yes	September 8, 2028
Japan Tobacco Inc.	14th domestic straight bond	September 10, 2018	—	10,000	0.758	Yes	September 10, 2038
Japan Tobacco Inc.	Straight bond in USD	July 23, 2013	56,451 (56,451) [USD 500 mil.]	—	2.100	Yes	July 23, 2018
Japan Tobacco Inc.	Straight bond in USD	April 13, 2016	84,556 [USD 750 mil.]	83,116 [USD 750 mil.]	2.000	Yes	April 13, 2021
Japan Tobacco Inc.	Straight bond in USD	April 13, 2016	56,235 [USD 500 mil.]	55,268 [USD 500 mil.]	2.800	Yes	April 13, 2026
JT International Financial Services B.V.	Straight bond in USD	September 28, 2018	—	57,871 [USD 525 mil.]	3.500	No	September 28, 2023
JT International Financial Services B.V.	Straight bond in USD	September 28, 2018	—	54,827 [USD 500 mil.]	3.875	No	September 28, 2028
JT International Financial Services B.V.	Straight bond in EUR	September 28, 2018	—	69,134 [EUR 550 mil.]	1.125	No	September 28, 2025
JT International Financial Services B.V.	Straight bond in GBP	September 28, 2018	—	55,228 [GBP 400 mil.]	2.750	No	September 28, 2033
		Total	332,242 (56,451)	610,444 (—)			

(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 bonds and borrowings of the Group.

(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 ¥1,097 million and ¥2,138 million as of December 31, 2017 and 2018, respectively. Their corresponding debts are ¥241 million and ¥71 million as of December 31, 2017 and 2018, respectively.

20. Provisions

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

Year ended December 31, 2017 (Millions of yen)

	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of January 1, 2017	3,348	9,124	3,459	1,021	16,952
Provisions	169	5,709	3,312	2,443	11,633
Interest cost associated with passage of time	40	－	－	－	40
Provisions used	(94)	(6,829)	(3,459)	(135)	(10,516)
Provisions reversed	(1)	(1,350)	－	(178)	(1,529)
Exchange differences on translation of foreign operations	－	418	－	34	453
As of December 31, 2017	3,463	7,074	3,312	3,185	17,033
Current liabilities	－	6,739	3,312	2,977	13,028
Non-current liabilities	3,463	335	－	208	4,005
Total	3,463	7,074	3,312	3,185	17,033

Year ended December 31, 2018 (Millions of yen)

	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of January 1, 2018	3,463	7,074	3,312	3,185	17,033
Provisions	157	1,657	3,668	657	6,138
Interest cost associated with passage of time	29	－	－	－	29
Provisions used	(70)	(7,590)	(3,312)	(309)	(11,280)
Provisions reversed	－	(686)	－	(1,058)	(1,744)
Exchange differences on translation of foreign operations	－	(133)	－	(185)	(318)
As of December 31, 2018	3,579	322	3,668	2,289	9,858
Current liabilities	－	309	3,668	2,101	6,078
Non-current liabilities	3,579	12	－	189	3,780
Total	3,579	322	3,668	2,289	9,858

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 and correspond to “Refund liabilities” in IFRS 15 “Revenue from Contracts with Customers.” 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 December 31 is as follows:

(Millions of yen)

	2017	**2018**
Tobacco excise tax payables	265,343	297,728
Tobacco special excise tax payables	11,989	10,562
Tobacco local excise tax payables	167,420	163,704
Consumption tax payables	103,511	95,781
Bonus to employees	31,412	38,977
Employees’ unused paid vacations liabilities	18,741	19,130
Other	140,685	269,582
Total	739,101	895,464
Current liabilities	618,322	716,190
Non-current liabilities	120,779	179,274
Total	739,101	895,464

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 Company and its subsidiary transferred a portion of their pension plans from a defined benefit plan to a defined contribution plan as of April 1, 2018.

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, 2017 (Notes 1, 2)	260,122	516,875	776,997
Current service cost	10,978	9,408	20,386
Past service cost and settlement	(222)	(8,263)	(8,485)
Interest expense	1,213	11,272	12,485
Contributions by plan participants	―	1,470	1,470
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	2	(4,437)	(4,435)
Actuarial gains and losses arising from changes in financial assumptions	27	248	276
Actuarial gains and losses arising from experience adjustments	(714)	(3,608)	(4,322)
Benefits paid	(21,435)	(26,974)	(48,410)
Exchange differences on translation of foreign operations	―	32,870	32,870
Other	1	1,554	1,554
As of December 31, 2017 (Notes 1, 2)	249,972	530,415	780,386
Current service cost	10,214	9,348	19,562
Past service cost and settlement	(26,868)	450	(26,418)
Interest expense	1,049	10,646	11,695
Contributions by plan participants	―	1,675	1,675
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	(249)	(1,189)	(1,438)
Actuarial gains and losses arising from changes in financial assumptions	(85)	(9,860)	(9,946)
Actuarial gains and losses arising from experience adjustments	3,350	1,255	4,605
Benefits paid	(21,159)	(23,942)	(45,101)
Exchange differences on translation of foreign operations	―	(34,097)	(34,097)
Other	―	263	263
As of December 31, 2018 (Notes 1, 2)	216,223	484,964	701,187

（Note 1）The Group’s weighted-average duration of the defined benefit obligations is 7.1 years for Japan and 15.1 years for overseas (2017 : 7.7 years for Japan and 15.7 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, 2017			**As of December 31, 2018**		
	Japan	Overseas	Total	Japan	Overseas	Total
Active members	163,592	184,639	348,231	140,274	158,329	298,603
Deferred members	15,102	73,182	88,284	13,158	74,678	87,836
Pensioners	71,278	272,594	343,872	62,792	251,957	314,748
Total	249,972	530,415	780,386	216,223	484,964	701,187

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

(Millions of yen)

	2017	**2018**
As of January 1	48,607	42,284
Interest expense	146	127
Remeasurement gains and losses	(1,081)	(875)
Benefits paid	(5,387)	(4,861)
As of December 31	42,284	36,675

B. Schedule of Plan Assets

The schedule of the plan assets is as follows:

(Millions of yen)

	Japan	Overseas	Total
As of January 1, 2017	93,571	373,696	467,267
Interest income	456	8,424	8,879
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	1,223	16,430	17,653
Contributions by the employer (Notes 1, 2)	1,690	10,172	11,862
Contributions by plan participants	－	1,470	1,470
Benefits paid	(6,943)	(22,174)	(29,116)
Exchange differences on translation of foreign operations	－	22,986	22,986
As of December 31, 2017	89,998	411,004	501,002
Interest income	322	8,460	8,782
Decrease due to settlement	(22,481)	－	(22,481)
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	(31)	(11,420)	(11,451)
Contributions by the employer (Notes 1, 2)	1,159	10,885	12,044
Contributions by plan participants	－	1,675	1,675
Benefits paid	(6,180)	(19,163)	(25,343)
Exchange differences on translation of foreign operations	－	(27,738)	(27,738)
As of December 31, 2018	62,788	373,702	436,489

(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 ¥6,300 million in the year ending December 31, 2019.

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 December 31 is as follows:

As of December 31, 2017

(Millions of yen)

	Japan	Overseas	Total
Present value of the funded defined benefit obligations	87,999	382,679	470,678
Fair value of the plan assets	(89,998)	(411,004)	(501,002)
Subtotal	(1,998)	(28,325)	(30,324)
Present value of the unfunded defined benefit obligations	161,973	147,736	309,709
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	159,974	119,411	279,385
Retirement benefit liabilities	164,793	165,969	330,762
Retirement benefit assets	(4,818)	(46,558)	(51,377)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	159,974	119,411	279,385

As of December 31, 2018

(Millions of yen)

	Japan	Overseas	Total
Present value of the funded defined benefit obligations	60,453	343,304	403,757
Fair value of the plan assets	(62,788)	(373,702)	(436,489)
Subtotal	(2,334)	(30,398)	(32,732)
Present value of the unfunded defined benefit obligations	155,770	141,660	297,430
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	153,435	111,262	264,697
Retirement benefit liabilities	158,297	163,541	321,838
Retirement benefit assets	(4,861)	(52,279)	(57,140)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	153,435	111,262	264,697

D. Major Breakdown of Plan Assets

The breakdown of plan assets by major category as of December 31 is as follows:

(Millions of yen)

	Japan					
	As of December 31, 2017			As of December 31, 2018		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	12,243	―	12,243	7,183	―	7,183
Equity instruments	3,939	―	3,939	3,052	―	3,052
Japan	2,065	―	2,065	1,530	―	1,530
Overseas	1,874	―	1,874	1,523	―	1,523
Debt instruments	10,512	―	10,512	10,388	―	10,388
Japan	9,220	―	9,220	9,147	―	9,147
Overseas	1,292	―	1,292	1,242	―	1,242
General account of life insurance companies (Note)	―	61,241	61,241	―	40,309	40,309
Other	1,433	629	2,062	1,208	646	1,855
Total	28,127	61,870	89,998	21,832	40,956	62,788

(Millions of yen)

	Overseas					
	As of December 31, 2017			As of December 31, 2018		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	29,815	―	29,815	15,269	―	15,269
Equity instruments	65,725	―	65,725	47,856	―	47,856
United Kingdom	5,093	―	5,093	3,871	―	3,871
North America	23,487	―	23,487	17,539	―	17,539
Other	37,144	―	37,144	26,445	―	26,445
Debt instruments	273,724	5,593	279,317	277,109	5,134	282,242
United Kingdom	185,607	―	185,607	195,193	―	195,193
North America	46,723	―	46,723	39,583	0	39,583
Other	41,394	5,593	46,988	42,333	5,134	47,466
Real estate	10,035	258	10,293	11,581	65	11,646
Other	17,187	8,667	25,854	8,206	8,482	16,688
Total	396,485	14,519	411,004	360,021	13,681	373,702

(Millions of yen)

	Total					
	As of December 31, 2017			As of December 31, 2018		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	42,058	−	42,058	22,452	−	22,452
Equity instruments	69,664	−	69,664	50,908	−	50,908
Debt instruments	284,236	5,593	289,829	287,497	5,134	292,631
Real estate	10,035	258	10,293	11,581	65	11,646
General account of life insurance companies (Note)	−	61,241	61,241	−	40,309	40,309
Other	18,620	9,297	27,916	9,414	9,129	18,543
Total	424,612	76,389	501,002	381,852	54,637	436,489

(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 December 31 are as follows:

As of December 31, 2017 (%)

	Japan	Overseas
Discount rate	0.5	2.1
Inflation rate	—	2.4

(years)

	Japan		Overseas	
	Males	Females	Males	Females
Average life expectancy at retirement (Note 1)				
Current pensioners	23.6 (Note 2)	29.3 (Note 2)	21.9 (Note 3)	24.2 (Note 3)
Future pensioners			23.2 (Note 4)	25.5 (Note 4)

As of December 31, 2018 (%)

	Japan	Overseas
Discount rate	0.5	2.2
Inflation rate	—	2.4

(years)

	Japan		Overseas	
	Males	Females	Males	Females
Average life expectancy at retirement (Note 1)				
Current pensioners	23.6 (Note 2)	29.3 (Note 2)	22.0 (Note 3)	24.2 (Note 3)
Future pensioners			23.4 (Note 4)	25.5 (Note 4)

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

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

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

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

(Note 5) The valuation of defined benefit obligations reflects a judgment on uncertain future events. The sensitivities of defined benefit obligations due to changes in major assumptions as of December 31 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, 2017

(Millions of yen)

	Change in assumptions	Japan	Overseas
Discount rate	Increase by 0.5%	(9,259)	(39,316)
	Decrease by 0.5%	9,971	44,188
Inflation rate	Increase by 0.5%	－	26,909
	Decrease by 0.5%	－	(25,490)
Mortality rate	Extended 1 year	4,956	17,777
	Shortened 1 year	(4,794)	(18,423)

As of December 31, 2018

(Millions of yen)

	Change in assumptions	Japan	Overseas
Discount rate	Increase by 0.5%	(7,192)	(34,758)
	Decrease by 0.5%	7,711	38,496
Inflation rate	Increase by 0.5%	－	23,889
	Decrease by 0.5%	－	(22,326)
Mortality rate	Extended 1 year	4,420	16,812
	Shortened 1 year	(4,267)	(16,915)

F. Breakdown of Defined Benefit Cost

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

Year ended December 31, 2017 (Millions of yen)

	Japan	Overseas	Total
Current service cost	10,978	9,408	20,386
Past service cost and gains and losses on settlement	(222)	(8,263)	(8,485)
Interest expense (income)	757	2,849	3,605
Defined benefit cost through profit or loss	11,514	3,993	15,507
Actuarial gains and losses arising from changes in demographic assumptions	2	(4,437)	(4,435)
Actuarial gains and losses arising from changes in financial assumptions	27	248	276
Actuarial gains and losses arising from experience adjustments	(714)	(3,608)	(4,322)
Return on plan assets (excluding amounts included in interest income)	(1,223)	(16,430)	(17,653)
Defined benefit cost through other comprehensive income	(1,908)	(24,226)	(26,135)
Total of defined benefit cost	9,605	(20,233)	(10,628)

Year ended December 31, 2018

(Millions of yen)

	Japan	Overseas	Total
Current service cost	10,214	9,348	19,562
Past service cost and gains and losses on settlement	(4,388)	450	(3,937)
Interest expense (income)	727	2,186	2,913
Defined benefit cost through profit or loss	6,553	11,985	18,538
Actuarial gains and losses arising from changes in demographic assumptions	(249)	(1,189)	(1,438)
Actuarial gains and losses arising from changes in financial assumptions	(85)	(9,860)	(9,946)
Actuarial gains and losses arising from experience adjustments	3,350	1,255	4,605
Return on plan assets (excluding amounts included in interest income)	31	11,420	11,451
Defined benefit cost through other comprehensive income	3,047	1,626	4,673
Total of defined benefit cost	9,600	13,611	23,210

(Note 1) The net amount of interest expense and interest income is included in "Financial costs." Other expenses are included in "Cost of sales" and "Selling, general and administrative expenses."

(Note 2) Contributions to the defined contribution plans were ¥7,383 million for the year ended December 31, 2017 and ¥11,517 million for the year ended December 31, 2018 and were not included in the table above.

(2) Other Employee Benefit Expenses

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

(Millions of yen)

	2017	**2018**
Remuneration and salary	221,896	236,971
Bonus to employees	60,274	67,379
Legal welfare expenses	43,192	44,535
Welfare expenses	37,399	39,086
Termination benefits	1,577	(304)

23. Equity and Other Equity Items

(1) Share Capital and Capital Surplus

A. Authorized Shares

The number of authorized shares as of December 31, 2017 and 2018 is 8,000,000 thousand ordinary shares.

B. Fully Paid Issued Shares

The schedule of the number of issued shares and share capital is as follows:

	(Thousands of shares) Number of ordinary issued shares	Share capital	(Millions of yen) Capital surplus
As of January 1, 2017	2,000,000	100,000	736,400
Increase (decrease)	—	—	—
As of December 31, 2017	2,000,000	100,000	736,400
Increase (decrease)	—	—	—
As of December 31, 2018	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 year end is as follows:

	(Thousands of shares) Number of shares	(Millions of yen) Amount
As of January 1, 2017	209,044	443,822
Increase (decrease) (Note 2)	(88)	(186)
As of December 31, 2017	208,957	443,636
Increase (decrease) (Note 2)	(380)	(807)
As of December 31, 2018	208,577	442,829

(Note 1) The Company adopts share option plans and utilizes treasury shares for delivery of shares due to its exercise. Contract conditions and amounts are described in “33. Share-based Payments.”

(Note 2) Purchases of shares less than one unit are 0 thousand shares for the year ended December 31, 2017 and 0 thousand shares for the year ended December 31, 2018. The number of shares delivered upon exercise of share options is 88 thousand shares for the year ended December 31, 2017 and 380 thousand shares for the year ended December 31, 2018.

(3) Other Components of Equity

A. Subscription Rights to Shares

The Company adopts share option plans and issues subscription rights to shares based on the Companies Act. Contract conditions and amount are described in “33. Share-based Payments.”

B. Exchange Differences on Translation of Foreign Operations

Exchange differences on translation of foreign operations are composed of foreign currency translation difference that occurs when consolidating financial statements of foreign subsidiaries prepared in foreign currencies, and the effective portion of net gain (loss) on the hedging instruments designated as hedge of net investment.

C. Net Gain (Loss) on Derivatives Designated as Cash Flow Hedges

The Group 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 year are as follows:

Year ended December 31, 2017

	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
Board of Directors (August 2, 2017)	Ordinary shares	125,369	70	June 30, 2017	September 1, 2017

Year ended December 31, 2018

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 27, 2018)	Ordinary shares	125,373	70	December 31, 2017	March 28, 2018
Board of Directors (August 1, 2018)	Ordinary shares	134,351	75	June 30, 2018	September 3, 2018

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

Year ended December 31, 2017

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 27, 2018)	Ordinary shares	125,373	70	December 31, 2017	March 28, 2018

Year ended December 31, 2018

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 20, 2019)	Ordinary shares	134,357	75	December 31, 2018	March 22, 2019

25. Revenue

(1) Disaggregation of Revenue

The disaggregation of “Revenue” for the year ended December 31, 2018 is as follows. The amounts are presented after eliminations of intercompany transactions.

Year ended December 31, 2018 (Millions of yen)

	Reportable Segments				Other	Consolidated
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food		
Core revenue from tobacco business	582,379	1,250,719	―	―	―	1,833,098
Other	39,047	61,622	113,992	161,387	6,815	382,864
Total	621,426	1,312,342	113,992	161,387	6,815	2,215,962

A. Domestic and International Tobacco Businesses

Domestic and international tobacco businesses engage in the sale of tobacco products.

Revenue from sales of products is recognized upon delivery of the products because the customer obtains control of the products upon delivery, by which the Group evaluates that the performance obligation is satisfied. Revenue is measured at the consideration promised in a contract with a customer, less discounts, rebates and taxes, including consumption tax. In addition, where the Group makes payments to the customer, except the case when consideration payable to the customer is a payment for a distinct product or service from the customer, revenue is measured at the amount which is consideration promised with the customer, less consideration payable to the customer.

Considerations for transactions are received mainly within one year from satisfying their performance obligations and includes no significant financing components.

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.

B. Pharmaceutical Business

Pharmaceutical business mainly engages in the sale of prescription drugs and licensing.

Revenue from sales of products is recognized upon delivery of the products because the customer obtains control of the products upon delivery, by which the Group evaluates that the performance obligation is satisfied. Revenue is measured at the consideration promised in a contract with a customer, less discounts, rebates and taxes, including consumption tax. In addition, where the Group makes payments to the customer, except the case when consideration payable to the customer is a payment for a distinct product or service from the customer, revenue is measured at the amount which is consideration promised with the customer, less consideration payable to the customer.

Revenue from licensing is generated by licensing out the rights to develop and market of each compound to licensees in the development stage, and the Group receives upfront income, milestone revenue and sales-based royalties. Upfront income is recognized at the time the customer obtains control of the license. Milestone revenue is recognized at the time the milestone agreed between the parties such as the progress of development is achieved. Sales-based royalties are measured based on the Group’s licensees’ sales, and recognized by taking into consideration the timing of occurrence.

Considerations for transactions are received mainly within one year from satisfying their performance obligations and includes no significant financial component.

C. Processed Foods Business

Processed foods business engages in the sale of frozen and ambient processed foods, bakery products and seasonings.

Revenue from sales of products is recognized upon delivery of the products because the customer obtains control of the products upon delivery, by which the Group evaluates that the performance obligation is satisfied. Revenue is measured at the consideration promised in a contract with a customer, less discounts, rebates and taxes, including consumption tax. In addition, where the Group makes payments to the customer, except the case when consideration payable to the customer is a payment for a distinct product or service from the customer, revenue is measured at the amount which is consideration promised with the customer, less consideration payable to the customer.

Considerations for transactions are received mainly within one year from satisfying their performance obligations and includes no significant financial component.

Transactions in which the Group is involved as an agency are excluded from revenue. The inflow of economic benefits after deducting these transactions is presented as “Revenue” in the consolidated statement of income.

(2) Transaction Price Allocated to the Remaining Performance Obligations

The Group uses the practical expedient and does not disclose information on the remaining performance obligations because it has no significant transactions with initial expected contractual terms exceeding one year. There are no significant amounts of considerations from contracts with customers that are not included in transaction prices.

(3) Gross Turnover

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

(Millions of yen)

	2017	**2018**
Gross turnover	7,286,883	7,532,248
Tobacco excise taxes and agency transaction amount	(5,147,230)	(5,316,285)
Revenue	2,139,653	2,215,962

The tobacco excise taxes and other transactions in which the Group is involved as an agency are excluded from revenue. The inflow of economic benefits after deducting the tobacco excise taxes and other transactions is presented as “Revenue” in the consolidated statement of income.

Gross turnover is an item that the Group discloses voluntarily and is not “Revenue” as defined by IFRS.

26. Other Operating Income

The breakdown of “Other operating income” for each year is as follows:

(Millions of yen)

	2017	**2018**
Gain on sale of property, plant and equipment, intangible assets and investment property (Notes 1, 2)	24,025	39,402
Reversal of impairment losses on investments in associates	8,848	—
Other (Note 2)	12,851	9,129
Total	45,724	48,532

(Note 1) The amount of gain on sale for the year ended December 31, 2018 mainly relates to the sale of the old plant sites.

(Note 2) The amount of restructuring incomes included in each account is as follows:

(Millions of yen)

	2017	**2018**
Gain on sale of property, plant and equipment, intangible assets and investment property	21,616	38,559
Other	29	725
Total	21,645	39,284

27. Selling, General and Administrative Expenses

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

(Millions of yen)

	2017	**2018**
Advertising expenses	24,413	29,111
Promotion expenses	112,212	106,199
Commission	54,458	52,749
Employee benefit expenses (Note 2)	254,045	268,956
Research and development expenses (Note 1)	60,600	65,377
Depreciation and amortization	81,298	87,926
Impairment losses on other than financial assets (Note 2)	3,427	8,454
Losses on sale and disposal of property, plant and equipment, intangible assets and investment property (Note 2)	4,848	8,845
Other (Note 2)	191,610	142,790
Total	786,911	770,407

(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)

	2017	**2018**
Employee benefit expenses	1,578	24
Impairment losses on other than financial assets	1,554	3,105
Losses on sale and disposal of property, plant and equipment, intangible assets and investment property	1,224	3,262
Other	3,957	1,530
Total	8,314	7,921

28. Financial Income and Financial Costs

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

(Millions of yen)

Financial Income	2017	**2018**
Dividend income		
Financial assets measured at fair value through other comprehensive income	1,814	2,056
Interest income		
Financial assets measured at amortized cost		
Deposits and bonds	2,567	3,695
Other	399	2
Total	4,780	5,754

(Millions of yen)

Financial Costs	2017	**2018**
Interest expenses		
Financial liabilities measured at amortized cost		
Bonds and borrowings (Note 2)	11,517	16,267
Other	87	77
Foreign exchange losses (Note 1)	11,257	15,974
Employee benefit expenses (Note 3)	3,605	2,913
Other	882	4,022
Total	27,349	39,252

(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 year are as follows:

Year ended December 31, 2017

(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	13,518	—	13,518	(4,116)	9,402
Remeasurements of defined benefit plans	26,135	—	26,135	(6,107)	20,028
Total of items that will not be reclassified to profit or loss	39,653	—	39,653	(10,223)	29,430
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	130,167	(341)	129,826	(1,753)	128,073
Net gain (loss) on derivatives designated as cash flow hedges	(532)	455	(77)	23	(54)
Total of items that may be reclassified subsequently to profit or loss	129,634	115	129,749	(1,730)	128,019
Total	169,287	115	169,402	(11,952)	157,449

Year ended December 31, 2018

(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	(11,703)	—	(11,703)	3,488	(8,215)
Remeasurements of defined benefit plans	(4,673)	—	(4,673)	1,478	(3,195)
Total of items that will not be reclassified to profit or loss	(16,375)	—	(16,375)	4,965	(11,410)
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	(244,898)	(230)	(245,128)	(2,603)	(247,731)
Net gain (loss) on derivatives designated as cash flow hedges	1,138	236	1,374	(363)	1,012
Total of items that may be reclassified subsequently to profit or loss	(243,760)	6	(243,754)	(2,965)	(246,719)
Total	(260,135)	6	(260,129)	2,000	(258,129)

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)

	2017	**2018**
Profit for the period attributable to owners of the parent company	392,409	385,677
Profit not attributable to ordinary shareholders of the parent company	–	–
Profit for the period used for calculation of basic earnings per share	392,409	385,677

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

(Thousands of shares)

	2017	**2018**
Weighted-average number of shares during the period	1,790,995	1,791,296

(2) Basis of Calculating Diluted Earnings per Share

A. Profit Attributable to Diluted Ordinary Shareholders

(Millions of yen)

	2017	**2018**
Profit for the period used for calculation of basic earnings per share	392,409	385,677
Adjustment	(0)	–
Profit for the period used for calculation of diluted earnings per share	392,409	385,677

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

(Thousands of shares)

	2017	**2018**
Weighted-average number of ordinary shares during the period	1,790,995	1,791,296
Increased number of ordinary shares under subscription rights to shares	1,042	863
Weighted-average number of diluted ordinary shares during the period	1,792,037	1,792,159

31. Non-cash Transactions

Significant Non-cash Transactions

The amount of assets acquired under finance leases was ¥3,599 million for the year ended December 31, 2017 and ¥1,041 million for the year ended December 31, 2018.

32. Reconciliation of Liabilities Arising from Financing Activities

Reconciliation of liabilities arising from financing activities for each year is as follows:

Year ended December 31, 2017

(Millions of yen)

	As of January 1, 2017	Cash flows	Non-cash changes				As of December 31, 2017
			Acquisition through business combinations	Foreign exchange movement	Fair value changes	Other	
Short-term borrowings and commercial paper	187,949	116,371	35,349	1,373	－	－	341,041
Long-term borrowings (Note 1)	1,449	70,191	131	82	－	－	71,854
Bonds (Note 1)	358,158	(20,000)	－	(6,086)	－	169	332,242
Finance lease obligations	7,701	(1,373)	324	416	－	3,599	10,667
Derivatives (Note 2)	(3,052)	－	－	－	562	－	(2,490)
Total	552,205	165,189	35,804	(4,214)	562	3,768	753,314

Year ended December 31, 2018

(Millions of yen)

	As of January 1, 2018	Cash flows	Non-cash changes				As of December 31, 2018
			Acquisition through business combinations	Foreign exchange movement	Fair value changes	Other	
Short-term borrowings and commercial paper	341,041	(133,849)	49,137	(19,586)	－	1,280	238,023
Long-term borrowings (Note 1)	71,854	56,425	1,795	(764)	－	2	129,313
Bonds (Note 1)	332,242	285,136	－	(7,346)	－	413	610,444
Finance lease obligations	10,667	(1,637)	－	(264)	－	1,041	9,807
Derivatives (Note 2)	(2,490)	2,294	－	－	196	－	－
Total	753,314	208,370	50,932	(27,960)	196	2,736	987,588

(Note 1) Current portion is included.

(Note 2) Derivatives are held for the purpose of hedging bonds.

33. Share-based Payments

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

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

(1) Share Option Contract Conditions of the Company

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

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

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

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

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

(Shares)

	2017			**2018**		
	Directors	Executive Officers	Total	Directors	Executive Officers	Total
Balance as of January 1	275,800	701,000	976,800	328,800	702,400	1,031,200
Granted	53,000	89,400	142,400	68,800	109,400	178,200
Exercised	－	(88,000)	(88,000)	－	(380,000)	(380,000)
Transferred	－	－	－	(202,200)	202,200	－
Balance as of December 31	328,800	702,400	1,031,200	195,400	634,000	829,400
Exercisable balance as of December 31	－	378,800	378,800	－	239,600	239,600

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

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

(Note 3) Share options are granted to 5 directors and 19 executive officers for the year ended December 31, 2017, and 5 directors and 18 executive officers for the year ended December 31, 2018.
"Transferred" included in the "Changes in the Number of Share Options" represents the number of share options for persons granted whose management position changed during the period.

(Note 4) The weighted-average fair values per share of share options granted during the period were ¥2,411 and ¥1,500 for the years ended December 31, 2017 and 2018, respectively.

(Note 5) The weighted-average share prices of share options at the time of exercise during the period were ¥3,810 and ¥3,086 for the years ended December 31, 2017 and 2018, respectively.

(Note 6) The weighted-average remaining contract years of unexercised share options at the end of each period were 25.0 years and 25.4 years for the years ended December 31, 2017 and 2018, 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

	2017	**2018**
Share price	¥3,950	¥3,013
Volatility of share price (Note 1)	31.9%	31.7%
Estimated remaining period (Note 2)	15 years	15 years
Estimated dividends (Note 3)	¥130/share	¥140/share
Risk free interest rate (Note 4)	0.32%	0.26%

(Note 1) Calculated based on daily share prices quoted for the past 15 years.

(Note 2) Because of the difficulty of a reasonable estimation due to insufficient data, the remaining period is estimated based on the assumption that share option rights would be exercised at a midpoint of the exercise period.

(Note 3) Based on the latest dividends paid.

(Note 4) The yield on government bonds for a period of the expected remaining period.

(4) Share-based Payment Expenses

The costs for share options included in "Selling, general and administrative expenses" in the consolidated statement of income were ¥341 million and ¥275 million for the years ended December 31, 2017 and 2018, respectively.

34. Financial Instruments

(1) Capital Management

The Group's management principle is pursuit of the "4S" model: balancing the interests of consumers, shareholders, employees and wider society, and fulfilling our responsibilities towards them, aiming to exceed their expectations.

The Group believes that sustainable profit growth in the mid- to long-term based on this principle will increase the Group's value in the mid- to long-term, and is consequently in the best interest of all stakeholders, including our shareholders.

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

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

(Millions of yen)

	2017	**2018**
Interest-bearing debt	755,804	987,588
Cash and cash equivalents	(285,486)	(282,063)
Net interest-bearing debt	470,318	705,526
Capital (equity attributable to owners of the parent company)	2,761,687	2,630,594

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.

There is no excessive concentration of the credit risks to certain counterparties.

The analysis of the aging of financial assets that are past due but not impaired as of December 31, 2017 is as follows:
The financial assets include amounts considered recoverable by credit insurance and collateral.

As of December 31, 2017 (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	6,347	4,724	814	214	595

The Group reviews collectability of trade receivables depending on the credit conditions of counterparties and recognizes allowance for doubtful accounts. The schedule of the allowance for doubtful accounts is as follows.
The amounts of the allowance for doubtful accounts for the year ended December 31, 2017 are recognized based on IAS 39.

(Millions of yen)

	2017
As of January 1, 2017	8,436
Addition	22,090
Decrease (intended use)	(780)
Decrease (reversal)	(127)
Other	539
As of December 31, 2017	30,158

(Millions of yen)

	Trade receivables	Other financial assets: Measured at an amount equal to the 12-month expected credit losses	Other financial assets: Measured at an amount equal to the full lifetime expected credit losses: Non-credit-impaired financial assets	Other financial assets: Measured at an amount equal to the full lifetime expected credit losses: Credit-impaired financial assets	Total
As of January 1, 2018	23,589	−	317	6,252	30,158
Addition	228	−	13	906	1,147
Decrease (intended use)	(19,537)	−	(3)	(117)	(19,656)
Decrease (reversal)	(591)	−	(58)	(979)	(1,628)
Other	(2,040)	−	−	(223)	(2,263)
As of December 31, 2018	1,650	−	269	5,839	7,758

(Note) There is no significant change in the carrying amounts of financial assets which affects the change in the allowance for doubtful accounts for the year ended December 31, 2018.

(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 December 31 is as follows:

As of December 31, 2017 (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	395,733	395,733	395,733	—	—	—	—	—
Short-term borrowings	274,233	274,233	274,233	—	—	—	—	—
Commercial paper	66,808	66,808	66,808	—	—	—	—	—
Current portion of long-term borrowings	690	690	690	—	—	—	—	—
Long-term borrowings	71,164	71,164	—	386	201	117	30,119	40,341
Current portion of bonds	56,451	56,500	56,500	—	—	—	—	—
Bonds	275,791	276,250	—	—	80,000	84,750	30,000	81,500
Subtotal	1,140,870	1,141,378	793,964	386	80,201	84,867	60,119	121,841
Derivative financial liabilities								
Foreign exchange forward contract	5,425	5,425	5,425	—	—	—	—	—
Subtotal	5,425	5,425	5,425	—	—	—	—	—
Total	1,146,295	1,146,803	799,389	386	80,201	84,867	60,119	121,841

As of December 31, 2018 (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	380,516	380,516	380,516	—	—	—	—	—
Short-term borrowings	165,985	165,985	165,985	—	—	—	—	—
Commercial paper	72,038	72,150	72,150	—	—	—	—	—
Current portion of long-term borrowings	12,443	12,443	12,443	—	—	—	—	—
Long-term borrowings	116,870	117,006	—	11,956	11,608	41,610	11,576	40,257
Bonds	610,444	613,773	—	80,000	83,250	30,000	118,275	302,248
Subtotal	1,358,297	1,361,873	631,094	91,956	94,858	71,610	129,851	342,505
Derivative financial liabilities								
Foreign exchange forward contract	3,176	3,176	3,176	—	—	—	—	—
Subtotal	3,176	3,176	3,176	—	—	—	—	—
Total	1,361,472	1,365,049	634,270	91,956	94,858	71,610	129,851	342,505

The total of commitment lines and withdrawal as of December 31 are as follows:

(Millions of yen)

	2017	**2018**
Total committed line of credit	601,580	478,531
Withdrawing	114,130	—
Unused balance	487,450	478,531

(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 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)

	2017	**2018**
Profit before income taxes	(9,473)	(2,725)

(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 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)

	2017	**2018**
Profit before income taxes	(2,593)	(955)

(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, 2017

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rate, etc.
			Assets	Liabilities	
Foreign exchange risk					
Foreign exchange forward contract					
JPY / USD	USD 338 mil.	—	176	414	¥109.75
Interest rate risk					
Cross currency swap					
Fixed rate receipt and fixed rate payment	USD 175 mil.	—	2,490	—	0.24%

As of December 31, 2018

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rate, etc.
			Assets	Liabilities	
Foreign exchange risk					
Foreign exchange forward contract					
JPY / USD	USD 638 mil.	—	1,329	613	¥109.21
JPY / CNY	CNY 49 mil.	—	—	8	¥15.92

(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, 2017	367	73	440
Other comprehensive income			
Amount arising (Note 1)	30	(562)	(532)
Reclassification adjustments (Note 2)	(155)	611	455
Tax effects	39	(15)	23
Other	(475)	－	(475)
As of December 31, 2017	(195)	106	(88)
Other comprehensive income			
Amount arising (Note 1)	1,334	(196)	1,138
Reclassification adjustments (Note 2)	194	42	236
Tax effects	(410)	47	(363)
Other	(480)	－	(480)
As of December 31, 2018	443	－	443

(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 mainly as follows:

As of December 31, 2017

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rate, etc.
			Assets	Liabilities	
Bonds in USD	USD 1,575 mil.	USD 1,250mil.	－	177,467	¥107.36

As of December 31, 2018

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rate, etc.
			Assets	Liabilities	
Bonds in USD	USD 1,250 mil.	USD 1,250 mil.	－	138,384	¥109.41
Bonds in GBP	GBP 400 mil.	GBP 400 mil.	－	55,216	$0.76
Foreign exchange forward contract					
EUR / RUB	RUB 19,973 mil.	－	516	338	€0.012
USD / TWD	TWD 6,113 mil.	－	67	－	$0.033

(Note) Carrying amounts of bonds 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.” 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 hedge of net investment in foreign operations is as follows:

(Millions of yen)

	2017	**2018**
As of January 1	8,784	10,793
Other comprehensive income		
Amount arising (Note 1)	3,763	9,652
Tax effects	(1,753)	(2,603)
As of December 31	10,793	17,842

(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 ¥16,936 million and ¥17,505 million as of December 31, 2017 and 2018 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

A. Financial Instruments Measured at Amortized Cost

The carrying amount and fair value hierarchy of financial instruments measured at amortized cost as of December 31 are as follows:

As of December 31, 2017 (Millions of yen)

	Carrying amount	Fair value			
		Level 1	Level 2	Level 3	Total
Long-term borrowings (Note)	71,854	–	–	71,829	71,829
Bonds (Note)	332,242	331,998	–	–	331,998

As of December 31, 2018 (Millions of yen)

	Carrying amount	Fair value			
		Level 1	Level 2	Level 3	Total
Long-term borrowings (Note)	129,313	–	–	129,978	129,978
Bonds	610,444	606,495	–	–	606,495

(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.

B. Financial Instruments Measured at Fair Value

The fair value hierarchy of financial instruments measured at fair value as of December 31 is as follows:

As of December 31, 2017 (Millions of yen)

	Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	—	5,978	—	5,978
Equity securities	71,859	—	5,783	77,642
Other	408	—	3,559	3,967
Total	72,267	5,978	9,342	87,587
Derivative liabilities	—	5,425	—	5,425
Total	—	5,425	—	5,425

As of December 31, 2018 (Millions of yen)

	Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	—	8,653	—	8,653
Equity securities	58,847	—	5,837	64,684
Other	401	11,025	4,514	15,940
Total	59,248	19,677	10,351	89,277
Derivative liabilities	—	3,176	—	3,176
Total	—	3,176	—	3,176

(Note) The schedule of financial instruments that are classified in Level 3 is as follows:

(Millions of yen)

	2017	**2018**
As of January 1	7,202	9,342
Total gain (loss)		
Profit or loss (Note 1)	391	(341)
Other comprehensive income (Note 2)	914	(1003)
Purchases	995	2,270
Sales	(159)	(81)
Other	—	164
As of December 31	9,342	10,351

(Note 1) Gains and losses included in profit or loss for the years ended December 31, 2017 and 2018 are related to financial assets measured at fair value through profit or loss as of the year end. These gains and losses are included in "Financial income" and "Financial costs."

(Note 2) Gains and losses included in other comprehensive income for the years ended December 31, 2017 and 2018 are related to financial assets measured at fair value through other comprehensive income as of the year end. These gains and losses are included in "Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income."

35. Related Parties

Based on the Japan Tobacco Inc. Act, the Japanese government shall hold more than one-third of all of the shares issued by the Company (excluding the type of shares, for which it is stipulated that voting rights may not be exercised on any matters that can be resolved by Annual Shareholders' Meeting). As of December 31, 2018, the Japanese government held 33.35% of all outstanding shares of the Company.

(1) Related-party Transactions

Related-party transactions are conducted under the same conditions as regular business transactions.

The Group's revenue from CJSC TK Megapolis, the local Russian distribution affiliate, was ¥216,852 million and ¥216,913 million for the years ended December 31, 2017 and 2018, respectively. The Group held trade receivables of ¥49,097 million and ¥44,436 million from CJSC TK Megapolis as of December 31, 2017 and 2018, respectively.

(2) Remuneration for Directors and Audit and Supervisory Board Members

Remuneration for directors and audit and supervisory board members for each year is as follows:

(Millions of yen)

	2017	**2018**
Remuneration and bonuses	540	795
Share-based payments	120	109
Total	660	904

36. Subsidiaries, Associates and Others

(The composition of the Group)

The composition of the Group by reportable segment as of December 31 is as follows:

	2017		**2018**	
Reportable Segments	Number of subsidiaries	Number of entities accounted for using the equity method (Note)	Number of subsidiaries	Number of entities accounted for using the equity method (Note)
Domestic Tobacco	13	2	13	1
International Tobacco	156	5	166	5
Pharmaceuticals	2	—	2	—
Processed Food	28	3	29	3
Other	11	3	14	2
Total	210	13	224	11

(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, 2018.

Regarding the restrictions on the ability to use the assets of the Group, please refer to "7. Cash and Cash Equivalents."

37. Commitments

(1) Commitments for the Acquisition of Assets

Commitments for the acquisition of assets as of December 31 are as follows:

(Millions of yen)

	2017	**2018**
Acquisition of property, plant and equipment	74,732	54,030
Acquisition of intangible assets	3,103	3,127
Total	77,835	57,157

(2) Procurement of Domestic Leaf Tobacco

With regard to the procurement of domestic leaf tobacco by the Company, based on the Tobacco Business Act, the Company enters into purchase contracts with domestic leaf tobacco growers every year, and the contracts determine the area under cultivation by type of tobacco and the prices by type and quality of tobacco leaf. Under the contracts, the Company is obligated to purchase all domestic leaf tobacco produced pursuant to such contracts, except for any domestic leaf tobacco not suited for the manufacture of tobacco products.

38. Business Combinations

(1) Acquisition of the Tobacco Company in Russia

A. Summary of the Business Combination

On July 31, 2018, the Group acquired 100% of the outstanding shares of JSC Donskoy Tabak ("DT"), a company operating tobacco business in Russia (Note).

DT has well-established brands such as "Donskoy Tabak", "Kiss" and "Play" in the value segment, the largest and growing price segment in Russia.

The purpose of this acquisition is to expand brand portfolio in the value segment and strengthen a distribution and sales network in the Russian tobacco market, a cornerstone of the Group's earnings growth.

(Note) The acquisition also includes purchases of 100% of the outstanding shares of JSC Pereslavl-Tabak and 94.97% of the outstanding shares of Syneteristiki Kapnoviomihania Ellados Sekap S.A.

B. Financial Impact on the Group

Since the acquisition date, the acquired business has contributed to consolidated revenue of ¥12,682 million and consolidated operating profit of ¥304 million.

It is assumed that had the business been acquired on January 1, 2018, total consolidated revenue would have increased by ¥22,253 million to ¥2,238,215 million, and total consolidated operating profit would have decreased by ¥1,893 million to ¥563,091 million (Unaudited).

The above operating profit includes the amortization of trademarks acquired from the business combination, etc.

C. Consideration and Details (Total of the Acquisition)

The consideration is ¥163,127 million and paid fully in cash.

Out of the total consideration, ¥134,644 million has been paid as of the year end and ¥28,484 million will be paid after the year end.

D. Net Cash Outflow for the Business Combination (Total of the Acquisition)

(Millions of yen)

	Net cash outflow for the business combination
Cash consideration	163,127
Cash and cash equivalents in subsidiaries acquired	(293)
Net cash outflow for the business combination	162,834

E. Fair Values of the Assets Acquired and Liabilities Assumed

(Millions of yen)

	Fair value
Current assets	44,762
Trademarks	60,353
Non-current assets	9,707
Total assets	114,822
Current liabilities	75,909
Non-current liabilities	44,494
Total liabilities	120,403
Non-controlling interests	(13)
Goodwill	168,696

Goodwill represents future economic benefits for integration synergies including enhanced business scale.

Fair value of assets acquired and liabilities assumed are provisional amounts recognized at the acquisition date and may change during the measurement period (one year from the acquisition date).

Transaction costs of ¥369 million are expensed as incurred and recognized in "Selling, general and administrative expense."

(2) Acquisition of the Tobacco Business in Bangladesh

A. Summary of the Business Combination

On November 29, 2018, the Group acquired the tobacco business of Akij Group (“Akij”), a tobacco business in Bangladesh.

Akij has well-established brands such as “Navy” and “Sheikh” in the value and base segments, together covering majority of the Bangladeshi tobacco market.

The purpose of this acquisition is to expand the presence in Bangladesh which is large and growing market.

(Note) The Group acquired 100% of the outstanding shares of United Dhaka Tobacco Company Limited, the entity taking over the tobacco business assets of Akij, as well as all tobacco related trademarks and design rights from Akij.

B. Financial Impact on the Group

Since the acquisition date, the acquired business has contributed to consolidated revenue of ¥1,345 million and consolidated operating loss of ¥454 million.

It is assumed that had the business been acquired on January 1, 2018, total consolidated revenue would have increased by ¥23,802 million to ¥2,239,765 million, and total consolidated operating profit would have decreased by ¥727 million to ¥564,257 million (Unaudited).

The above operating profit includes the amortization of trademarks acquired from the business combination, etc.

C. Consideration and Details (Total of the Acquisition)

The consideration is ¥174,019 million and paid fully in cash.

Out of the total consideration, ¥111,066 million has been paid as of the year end and ¥62,953 million will be paid after the year end.

D. Net Cash Outflow for the Business Combination (Total of the Acquisition)

(Millions of yen)

	Net cash outflow for the business combination
Cash consideration	174,019
Cash and cash equivalents in subsidiaries acquired	(388)
Net cash outflow for the business combination	173,632

E. Fair Values of the Assets Acquired and Liabilities Assumed

(Millions of yen)

	Fair value
Current assets	15,725
Trademarks	43,498
Non-current assets	16,468
Total assets	75,691
Current liabilities	5,149
Non-current liabilities	4,665
Total liabilities	9,814
Goodwill	108,142

Goodwill represents future economic benefits for integration synergies including enhanced business scale.

Fair value of assets acquired and liabilities assumed are provisional amounts recognized at the acquisition date and may change during the measurement period (one year from the acquisition date).

Transaction costs of ¥516 million are expensed as incurred and recognized in “Selling, general and administrative expense.”

(3) Other Acquisitions

The information on the business combinations other than the above for the year ended December 31, 2018, is omitted as it is immaterial both individually and in the aggregate.

39. Contingencies

Contingent Liabilities

The Company and some of its subsidiaries are defendants in legal proceedings. Provisions are not accounted for in matters where it is not practicable to reasonably estimate the final outcomes.

The Company and some of its subsidiaries, who are defendants in such legal proceedings, believe that our defenses asserted in these proceedings are based on substantial evidence and implement the system for the response to action with the assistance of external lawyers.

(1) Smoking and Health Related Litigation

The Company and some of its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking, the marketing of tobacco products, or exposure to tobacco smoke. As of December 31, 2018, there were a total of 21 smoking and health related cases pending in which one or more members of the Group were named as a defendant or for which the Company may have certain indemnity obligations pursuant to the agreement such as for the Company's acquisition of RJR Nabisco Inc.'s overseas (non-U.S.) tobacco operations.

The major ongoing smoking and health related cases are as follows:

On March 8, 2019, JTI-Macdonald Corp. (hereinafter referred to as "JTI-Mac"), the Company's Canadian subsidiary, filed for protection from its creditors under the Companies' Creditors Arrangement Act (CCAA). The Ontario Superior Court has granted the CCAA application and extended protection in favor of JTI-Mac. All of the below Canadian matters against JTI-Mac have been stayed by the court order. JTI-Mac carries on business in the ordinary course under the CCAA.

A. Individual Claim

There is one individual case brought against the Company's indemnitee in South Africa.

<u>South Africa Individual Claim (Joselowitz)</u>:

The individual claim was brought against the Company's indemnitee in South Africa in October 2000. Plaintiff seeks compensatory and punitive damages, alleging that the Company's indemnitee marketed products which it knew to be dangerous to health, manipulated nicotine content to foster addiction, failed to comply with South African labeling requirements and participated in a clandestine worldwide operation to encourage children to smoke. This case has been dormant since February 2001.

In addition, there is one individual case (which is currently dormant) brought against the Company's subsidiary in Ireland.

B. Class Actions

There are eight ongoing class actions in Canada against the Company's subsidiary and/or indemnitees.

<u>Canada Quebec Class Action (Cecilia Letourneau)</u>:

This class action was brought in September 1998 against three Canadian tobacco manufacturers including JTI-Mac. Plaintiffs were seeking a total of approximately ¥374.3 billion (approximately CAD 4.6 billion) in compensatory damages, an amount for which all the defendants are jointly and severally liable, and a total amount of approximately ¥374.3 billion (approximately CAD 4.6 billion) in punitive damages, to be divided among all the defendants based on their respective market shares.

The Quebec Superior Court published the first instance judgment in favor of the plaintiffs in June 2015. In June 2015, JTI-Mac and other tobacco manufacturers appealed the judgment to the Quebec Court of Appeal, and the appeal on the merits was heard and concluded in November 2016.

In March 2019, the Quebec Court of Appeal dismissed the appeal of defendants by substantively upholding the first instance judgment and ordering a punitive damage award against the appellants of approximately ¥13.1 billion (approximately CAD 161 million), in which the share of the total damage award against JTI-Mac is approximately ¥1.3 billion (approximately CAD 15 million).

<u>Canada Quebec Class Action (Conseil Québécois sur le tabac et la santé)</u>:

This class action was brought in November 1998 against three Canadian tobacco manufacturers including JTI-Mac. Plaintiffs were seeking a total of approximately ¥1,013.9 billion (approximately CAD 12.4 billion) in compensatory damages, an amount for which all the defendants are jointly and severally liable, and a total amount of approximately ¥66.1 billion (approximately CAD 0.8 billion) in punitive damages, to be divided among all the defendants based on their respective market shares.

The Quebec Superior Court published the first instance judgment in favor of the plaintiffs in June 2015. In June 2015, JTI-Mac and other tobacco manufacturers appealed the judgment to the Quebec Court of Appeal, and the appeal on the merits was heard and concluded in November 2016.

In March 2019, the Quebec Court of Appeal dismissed the appeal of the defendants by substantively upholding the first instance judgment and ordering a compensatory damage award jointly and severally against the defendants of approximately ¥1,102.9 billion (approximately CAD 13.5 billion), in which the share of the total damage award against JTI-Mac is approximately ¥143.4 billion (approximately CAD 1.8 billion), and a punitive damage award of approximately ¥3 million (approximately CAD 0.04 million) per defendants,

The Quebec Court of Appeal rendered one judgment for both class actions against the defendants and ordered them to make an initial deposit of approximately ¥94.7 billion (approximately CAD 1.2 billion), in which the share of JTI-Mac is approximately ¥11.9 billion (approximately CAD 145 million).

Canada Saskatchewan Class Action (Adams):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The preliminary motions are pending. The case is currently dormant.

Canada Manitoba Class Action (Kunta):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The statement of claim was served on the Company's indemnitees but not on JTI-Mac. The case is currently dormant.

Canada Nova Scotia Class Action (Semple):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The statement of claim was served on the Company's indemnitees but not on JTI-Mac. The case is currently dormant.

Canada British Columbia Class Action (Bourassa):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2010. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

Canada British Columbia Class Action (McDermid):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2010. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

Canada Ontario Class Action (Jacklin):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2012. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

In addition, there is one class action brought in Israel against an indemnitee of the Company's subsidiary.

C. Health-Care Cost Recovery Litigation
There are 10 ongoing health-care cost recovery cases in Canada pending against the Company's subsidiary and indemnitees brought by all the Canadian provinces (except three Canadian territories). These provinces filed lawsuits under their own provincial legislation which was enacted exclusively for the purpose of authorizing the provincial government to file a direct action against tobacco manufacturers to recoup the health-care costs the government has allegedly incurred and will incur, resulting from "tobacco related wrongs."

Canada British Columbia Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of British Columbia in January 2001 against tobacco industry members including JTI-Mac and the Company's indemnitees based on its provincial legislation, the "Tobacco Damages and Health-Care Costs Recovery Act." The claim amount is unspecified. In 2001, several defendants challenged the legislation's constitutionality, which was ultimately rejected by the Supreme Court of Canada in September 2005. The action remains pending in the first instance. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada New Brunswick Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of New Brunswick in March 2008 against tobacco industry members including JTI-Mac and the Company’s indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The trial is set to begin in November 2019.

Canada Ontario Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Ontario in September 2009 against tobacco industry members including JTI-Mac and the Company’s indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total claimed amount of ¥4,076.0 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 ¥4,944.8 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 ¥815.2 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.

(Note) The amount of damages sought denominated in foreign currencies is translated into Japanese yen at the rates as of December 31, 2018.

40. Subsequent Events

As part of the shareholder return based on our shareholder return policy, the Company’s Board of Directors made a resolution on February 7, 2019 for the Company to acquire its own shares according to the particulars stated below pursuant to the provision of Article 156 of the Companies Act, as applied by replacing the relevant terms pursuant to the Act’s provision of Article 165, paragraph 3.

a. Class of shares to be acquired
   Common stock
b. Number of shares to be acquired
   Up to 23,000,000 shares
c. Total payment amount to acquire shares
   Up to ¥50,000 million
d. Period of share acquisition
   From February 8, 2019 to April 22, 2019
e. Method of acquisition
   Purchase on the stock exchange via a trust bank

(2) Others

A. Quarterly Information for the Year ended December 31, 2018

(Millions of yen)

	Q1 January 1, 2018 to March 31, 2018	Q2 January 1, 2018 to June 30, 2018	Q3 January 1, 2018 to September 30, 2018	2018 January 1, 2018 to December 31, 2018
Revenue	515,050	1,075,271	1,675,819	2,215,962
Profit before income taxes for the period (year)	139,891	290,367	449,402	531,486
Profit attributable to owners of the parent company for the period (year)	104,011	216,093	332,686	385,677
Basic earnings per share for the period (year) (yen)	58.07	120.64	185.73	215.31

	Q1 January 1, 2018 to March 31, 2018	Q2 April 1, 2018 to June 30, 2018	Q3 July 1, 2018 to September 30, 2018	Q4 October 1, 2018 to December 31, 2018
Basic earnings per share for the quarter (yen)	58.07	62.57	65.09	29.58

B. Significant Lawsuits

The significant lawsuits of the Group are as stated in “39. Contingencies” in the notes to consolidated financial statements.

1. Nonconsolidated Financial Statements
(1) Nonconsolidated Financial Statements
A. Nonconsolidated Balance Sheet

As of December 31, 2017 and 2018 (Millions of yen)

		2017		**2018**
Assets				
Current assets				
Cash and deposits		89,775		106,089
Accounts receivable-trade	*2	47,335	*2	54,296
Securities		50,000		39,800
Merchandise and finished goods		33,448		33,304
Semi-finished goods		47,731		61,625
Work in process		2,480		2,294
Raw materials and supplies		46,057		43,226
Advance payments-trade		1,988		2,667
Prepaid expenses		9,293		9,742
Deferred tax assets		8,991		13,657
Short-term loans receivable from subsidiaries and affiliates		201,555		46,357
Other	*2,*3	17,856	*2,*3	19,931
Allowance for doubtful accounts		(26)		(26)
Total current assets		556,483		432,963
Noncurrent assets				
Property, plant and equipment				
Buildings		86,955		86,012
Structures		2,981		2,740
Machinery and equipment		54,829		69,652
Vehicles		1,416		1,387
Tools, furniture and fixtures		18,262		17,412
Land		73,177		71,394
Construction in progress		10,047		13,869
Total property, plant and equipment		247,668		262,466
Intangible assets				
Patent right		301		243
Right of trademark		132,508		115,732
Software		11,965		20,231
Goodwill		286,168		250,397
Other		7,447		2,082
Total intangible assets		438,389		388,684
Investments and other assets				
Investment securities		65,693		54,855
Shares of subsidiaries and affiliates		1,546,411		1,504,796
Long-term loans receivable from subsidiaries and affiliates		16,552		19,215
Long-term prepaid expenses		7,483		9,888
Other		7,337		9,708
Allowance for doubtful accounts		(255)		(232)
Total investments and other assets		1,643,220		1,598,230
Total noncurrent assets		2,329,277		2,249,380
Total assets		2,885,760		2,682,344

(Millions of yen)

		2017		**2018**
Liabilities				
Current liabilities				
Accounts payable-trade	*2	7,957	*2	9,806
Short-term loans payable		159,330		–
Current portion of bonds	*1	54,158		–
Lease obligations	*2	3,059	*2	3,085
Accounts payable-other	*2	47,608	*2	62,403
National tobacco excise taxes payable		77,523		74,403
National tobacco special excise taxes payable		11,989		10,562
Local tobacco excise taxes payable		89,814		85,145
Income taxes payable		21,336		39,364
Accrued consumption taxes		24,677		23,790
Cash management system deposits received	*4	283,490	*4	250,231
Provision for bonuses		4,646		5,675
Other		8,048		28,976
Total current liabilities		793,635		593,441
Noncurrent liabilities				
Bonds payable	*1	276,180	*1	373,692
Long-term loans payable		70,000		70,000
Lease obligations	*2	5,773	*2	4,874
Provision for retirement benefits		131,472		131,041
Deferred tax liabilities		12,686		11,460
Other	*2	3,047	*2	4,274
Total noncurrent liabilities		499,159		595,341
Total liabilities		1,292,794		1,188,782

(Millions of yen)

	2017	**2018**
Net assets		
Shareholders' equity		
Capital stock	100,000	100,000
Capital surplus		
Legal capital surplus	736,400	736,400
Total capital surplus	736,400	736,400
Retained earnings		
Legal retained earnings	18,776	18,776
Other retained earnings		
Reserve for investment loss on developing new business	169	287
Reserve for reduction entry	42,987	41,753
Special account for reduction entry	8,356	10,179
Retained earnings brought forward	1,092,709	996,757
Total retained earnings	1,162,996	1,067,752
Treasury shares	(443,636)	(442,829)
Total shareholders' equity	1,555,760	1,461,323
Valuation and translation adjustments		
Valuation difference on available-for-sale securities	33,579	25,815
Deferred gains or losses on hedges	1,662	4,877
Total valuation and translation adjustments	35,242	30,693
Subscription rights to shares	1,964	1,547
Total net assets	1,592,966	1,493,562
Total liabilities and net assets	2,885,760	2,682,344

B. Nonconsolidated Statement of Income

Years Ended December 31, 2017 and 2018 (Millions of yen)

		2017		**2018**
Net sales	*1,*6	681,840	*1,*6	696,250
Cost of sales	*6	182,446	*6	192,604
Gross profit		499,394		503,646
Selling, general and administrative expenses	*2,*6	330,951	*2,*6	348,375
Operating income		168,443		155,271
Non-operating income				
Interest income	*6	529	*6	502
Dividends income	*6	30,386	*6	36,387
Other	*6	6,564	*6	6,478
Total non-operating income		37,479		43,366
Non-operating expenses				
Interest expenses	*6	784	*6	846
Interest on bonds		4,827		4,344
Other	*6	975	*6	3,103
Total non-operating expenses		6,586		8,294
Ordinary income		199,336		190,343
Extraordinary income				
Gain on sales of noncurrent assets	*3	20,826	*3	38,607
Other		672		1,106
Total extraordinary income		21,499		39,714
Extraordinary losses				
Loss on sales of noncurrent assets	*4	352	*4	247
Loss on retirement of noncurrent assets	*5,*6	3,274	*5,*6	6,750
Impairment loss		518		746
Other		1,695		1,215
Total extraordinary losses		5,839		8,958
Income before income taxes		214,996		221,098
Income taxes-current		46,309		59,263
Income taxes-deferred		8,567		(2,760)
Total income taxes		54,875		56,503
Net income		160,120		164,595

C. Nonconsolidated Statement of Changes in Net Assets
Years ended December 31, 2017 and 2018

(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
As of January 1, 2017	100,000	736,400	736,400	18,776	28	43,687	3,057	955,300	225,620	1,246,469
Changes of items during the period										
Provision of reserve for investment loss on developing new business					169				(169)	—
Reversal of reserve for investment loss on developing new business					(28)				28	—
Provision of reserve for reduction entry						4,440			(4,440)	—
Reversal of reserve for reduction entry						(5,141)			5,141	—
Provision of special account for reduction entry							8,356		(8,356)	—
Reversal of special account for reduction entry							(3,057)		3,057	—
Reversal of general reserve								(955,300)	955,300	—
Dividends from surplus									(243,572)	(243,572)
Net income									160,120	160,120
Purchase of treasury shares										
Disposal of treasury shares									(21)	(21)
Net changes of items other than shareholders' equity										
Total changes of items during the period	—	—	—	—	140	(700)	5,299	(955,300)	867,088	(83,473)
As of December 31, 2017	100,000	736,400	736,400	18,776	169	42,987	8,356	—	1,092,709	1,162,996

(Millions of yen)

	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		
As of January 1, 2017	(443,822)	1,639,047	26,207	(3,373)	22,833	1,794	1,663,675
Changes of items during the period							
Provision of reserve for investment loss on developing new business		―					―
Reversal of reserve for investment loss on developing new business		―					―
Provision of reserve for reduction entry		―					―
Reversal of reserve for reduction entry		―					―
Provision of special account for reduction entry		―					―
Reversal of special account for reduction entry		―					―
Reversal of general reserve		―					―
Dividends from surplus		(243,572)					(243,572)
Net income		160,120					160,120
Purchase of treasury shares	(1)	(1)					(1)
Disposal of treasury shares	187	166					166
Net changes of items other than shareholders' equity			7,373	5,036	12,409	170	12,579
Total changes of items during the period	186	(83,287)	7,373	5,036	12,409	170	(70,708)
As of December 31, 2017	(443,636)	1,555,760	33,579	1,662	35,242	1,964	1,592,966

(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
As of January 1, 2018	100,000	736,400	736,400	18,776	169	42,987	8,356	—	1,092,709	1,162,996
Changes of items during the period										
Provision of reserve for investment loss on developing new business					287				(287)	—
Reversal of reserve for investment loss on developing new business					(169)				169	—
Provision of reserve for reduction entry						3,893			(3,893)	—
Reversal of reserve for reduction entry						(5,127)			5,127	—
Provision of special account for reduction entry							10,179		(10,179)	—
Reversal of special account for reduction entry							(8,356)		8,356	—
Reversal of general reserve										
Dividends from surplus									(259,724)	(259,724)
Net income									164,595	164,595
Purchase of treasury shares										
Disposal of treasury shares									(116)	(116)
Net changes of items other than shareholders' equity										
Total changes of items during the period	—	—	—	—	118	(1,234)	1,823	—	(95,952)	(95,244)
As of December 31, 2018	100,000	736,400	736,400	18,776	287	41,753	10,179	—	996,757	1,067,752

(Millions of yen)

	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		
As of January 1, 2018	(443,636)	1,555,760	33,579	1,662	35,242	1,964	1,592,966
Changes of items during the period							
Provision of reserve for investment loss on developing new business		—					—
Reversal of reserve for investment loss on developing new business		—					—
Provision of reserve for reduction entry		—					—
Reversal of reserve for reduction entry		—					—
Provision of special account for reduction entry		—					—
Reversal of special account for reduction entry		—					—
Reversal of general reserve							
Dividends from surplus		(259,724)					(259,724)
Net income		164,595					164,595
Purchase of treasury shares	(0)	(0)					(0)
Disposal of treasury shares	807	691					691
Net changes of items other than shareholders' equity			(7,764)	3,215	(4,549)	(417)	(4,967)
Total changes of items during the period	807	(94,438)	(7,764)	3,215	(4,549)	(417)	(99,404)
As of December 31, 2018	(442,829)	1,461,323	25,815	4,877	30,693	1,547	1,493,562

Notes to Nonconsolidated Financial Statements
Years ended December 31, 2017 and 2018

(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:
A. 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.)

B. 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 the lower of cost as 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 is applied.
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, 2018.

Past service cost is amortized using the straight-line method over the average remaining years of service of the employees (mainly 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 (mainly 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.

(3) Adoption of Consolidated Taxation System

In the year ended December 31, 2018, the Company applied for approval of the adoption of the consolidated taxation system, and it is to be adopted from the following fiscal year. Therefore, from the year ended December 31, 2018, deferred tax assets and liabilities are accounted for assuming the adoption of the consolidated taxation system.

(Additional Information)

The Company transferred a portion of its pension plan from a defined benefit plan to a defined contribution plan as of April 1, 2018 and recognized a gain or loss on settlement in this year.

(Accounting Standards Not Yet Adopted)

• “Accounting Standard for Revenue Recognition” (Accounting Standards Board of Japan (ASBJ) Statement No. 29, March 30, 2018)
• “Implementation Guidance on Accounting Standard for Revenue Recognition” (ASBJ Guidance No. 30, March 30, 2018)

(1) Overview

These are the comprehensive accounting standards for revenue recognition. Revenue is recognized based on the following five-step approach.

Step 1: Identify the contract with a customer
Step 2: Identify the performance obligations in the contract
Step 3: Determine the transaction price
Step 4: Allocate the transaction price to the performance obligations in the contract
Step 5: Recognize revenue when the entity satisfies a performance obligation

(2) Scheduled Date of Adoption

The Company has not decided on the date of adoption.

(3) Effect of Adoption

Expenses previously recognized in “Selling, general and administrative expenses” will be partially recognized as a reduction of “Net sales,” for example.

(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 the Company. Bondholders have the right to receive payment of their own claims for assets of the Company 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 as of December 31 are as follows:

(Millions of yen)

	2017	**2018**
Short-term receivables	20,939	19,991
Short-term payables	25,106	36,739
Long-term payables	4,890	4,233

*3. Repurchase agreement of ¥5,000 million is included in "Other" of Current assets in this year and the fair value of securities received as collateral is ¥5,000 million.

*4. "Cash management system deposits received" represents the fund entrusted in the cash management system of domestic group companies.

5. Contingent obligations

Guarantees provided for bank loans, bonds and others of subsidiaries and affiliates as of December 31 are as follows:

Bank loans and others

2017			**2018**		
	(Millions of yen)			(Millions of yen)	
JT International Company Netherlands B.V.	32,450	(EUR 239 million)	JT International Holding B.V.	57,180	(EUR 450 million) others
JT International S.A.	27,411	(USD 160 million) (CHF 48 million) (EUR 22 million) others	PT. Karyadibya Mahardhika	47,023	(IDR 6,167,141 million) others
			JT International (Philippines) Inc.	36,380	(PHP 17,215 million)
JT International Hellas A.E.B.E.	24,404	(EUR 180 million)	JT International S.A.	35,388	(USD 208 million) (CHF 60 milion) Others
JT International (Philippines) Inc.	19,848	(PHP 8,785 million)	JT International Company Netherlands B.V	34,245	(EUR 270 million)
LLC Petro	10,153	(RUB 5,175 million)	JT International Hellas A.E.B.E.	27,297	(EUR 215 million)
JT International Korea Inc.	10,143	(KRW 95,810 million)	JT International Germany GmbH	24,151	(EUR 190 million)
			JT International Korea Inc.	17,283	(KRW 173,924 million)
Other (39 companies)	64,448		Other (46 companies)	65,522	
Total	188,858		Total	344,469	

Bonds

2017			**2018**		
	(Millions of yen)			(Millions of yen)	
	—		JT International Financial Services B.V.	240,023	(USD 1,025 million) (EUR 550 million) (GBP 400 million)
Total	—		Total	240,023	

(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 for each year are as follows:

(Millions of yen)

	2017	**2018**
Net sales including tobacco excise taxes	1,780,038	1,704,086

(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" for each year are as follows:

(Millions of yen)

	2017	**2018**
Promotion expenses	44,386	50,698
Compensations, salaries and allowances	28,700	29,378
Provision for bonus	2,823	3,654
Employee benefit expenses	12,108	10,568
Commission	32,728	41,935
Depreciation and amortization	65,427	64,074
Research and development expenses	50,442	53,154
Selling expenses ratio	54%	53%
General and administrative expenses ratio	46%	47%

*3. The main component of "Gains on sales of noncurrent assets" for each year is as follows:

(Millions of yen)

	2017	**2018**
Land	20,806	38,510

*4. The main component of "Losses on sales of noncurrent assets" for each year is as follows:

(Millions of yen)

	2017	**2018**
Buildings	194	72
Structures	56	137

*5. The main components of "Losses on disposal of noncurrent assets" for each year are as follows:

(Millions of yen)

	2017	**2018**
Buildings	1,308	3,734
Machinery and equipment	998	2,057

*6. Amounts of transactions with subsidiaries and affiliates for each year are as follows:

(Millions of yen)

	2017	**2018**
Net sales	76,550	87,976
Purchase of goods	67,433	62,255
Selling, general and administrative expenses	64,550	69,448
Dividends income	28,857	34,596
Amount of non-operating transactions	22,311	22,613

(Securities)

Investments in Subsidiaries and Affiliates as of December 31 are as follows:

2017 (Millions of yen)

Type	Balance sheet amount	Fair value	Difference
Investments in subsidiaries	41,580	46,581	5,001
Total	41,580	46,581	5,001

2018 (Millions of yen)

Type	Balance sheet amount	Fair value	Difference
Investments in subsidiaries	41,580	37,465	(4,115)
Total	41,580	37,465	(4,115)

(Note) Balance sheet amount of investments in subsidiaries and affiliates whose fair value is deemed extremely difficult to determine as of December 31 is as follows:

(Millions of yen)

Type	2017	**2018**
Investments in subsidiaries	1,504,667	1,463,062
Investments in affiliates	163	153

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

As of December 31, 2017 and 2018 (Millions of yen)

	2017	**2018**
Deferred tax assets		
Provision for retirement benefits	25,599	27,270
Obligations pertaining to mutual assistance pension benefits	14,331	12,428
Other	23,150	27,397
Subtotal	63,080	67,094
Less valuation allowance	(10,162)	(9,393)
Total	52,918	57,701
Deferred tax liabilities		
Reserve for reduction entry	(18,803)	(18,263)
Deferred gains or losses on hedges	(10,665)	(10,936)
Valuation difference on available-for-sale securities	(13,515)	(10,103)
Other	(13,631)	(16,203)
Total	(56,614)	(55,504)
Net deferred tax assets/liabilities	(3,696)	2,197

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, 2017 and 2018 (%)

	2017	**2018**
Effective statutory tax rate	30.66	30.66
(Adjustments)		
Permanent difference arising from non-deductible items including entertainment expenses	0.21	0.36
Permanent difference arising from non-taxable items including dividends income	(4.33)	(4.57)
Tax credit of items including research and development expenses	(1.31)	(1.20)
Other	0.30	0.31
Actual effective tax rate after applying tax effect accounting	25.52	25.56

(Business Combination)

No items to report.

(Significant Subsequent Events)

As part of the shareholder return based on our shareholder return policy, the Company’s Board of Directors made a resolution on February 7, 2019 for the Company to acquire its own shares according to the particulars stated below pursuant to the provision of Article 156 of the Companies Act, as applied by replacing the relevant terms pursuant to the Act’s provision of Article 165, paragraph 3.

a. Class of shares to be acquired
   Common stock
b. Number of shares to be acquired
   Up to 23,000,000 shares
c. Total payment amount to acquire shares
   Up to ¥50,000 million
d. Period of share acquisition
   From February 8, 2019 to April 22, 2019
e. Method of acquisition
   Purchase on the stock exchange via a trust bank

D. Supplementary Statements
Detailed Schedule of Property, Plant and Equipment and Others

(Millions of yen)

	Type of assets	As of January 1, 2018	Increase in the year ended December 31, 2018	Decrease in the year ended December 31, 2018	Depreciation during the year ended December 31, 2018	As of December 31, 2018	Accumulated depreciation or accumulated amortization as of December 31, 2018
Property, plant and equipment	Buildings	86,955	6,859	1,016 (482)	6,786	86,012	220,958
	Structures	2,981	209	141 (8)	309	2,740	11,267
	Machinery and equipment	54,829	29,743	1,775 (2)	13,144	69,652	162,609
	Vehicles	1,416	564	148	445	1,387	1,665
	Tools, furniture and fixtures	18,262	7,299	484	7,665	17,412	69,254
	Land	73,177	37	1,821 (254)	—	71,394	—
	Construction in progress	10,047	10,033	6,211	—	13,869	—
	Total property, plant and equipment	247,668	54,744	11,596 (746)	28,350	262,466	465,754
Intangible assets	Patent right	301	10	—	69	243	—
	Right of trademark	132,508	188	70	16,895	115,732	—
	Software	11,965	14,078	78	5,734	20,231	—
	Goodwill	286,168	—	—	35,771	250,397	—
	Other	7,447	1,638	6,856	147	2,082	—
	Total intangible assets	438,389	15,914	7,004	58,616	388,684	—

(Note 1) The figures in parentheses in the “Decrease in the year ended December 31, 2018” column represent decreases due to impairment loss included in the figures above.

(Note 2) Other includes software in progress.

(Note 3) The major item of “Increase in the year ended December 31, 2018” and “Decrease in the year ended December 31, 2018” is as follows:

Machinery and equipment	Increase	Tobacco products manufacturing equipment	¥29,063 million

Detailed Schedule of Reserve Allowances

(Millions of yen)

Category	As of January 1, 2018	Increase in the year ended December 31, 2018	Decrease in the year ended December 31, 2018	As of December 31, 2018
Allowance for doubtful accounts	281	0	23	258
Provision for bonuses	4,646	5,675	4,646	5,675

(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 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.

Notes: At the board meeting on November 26, 2018, our company passed a resolution to change a shareholder benefit program as below

(1) Details of the change

① The company has decided to provide a benefit once a year to shareholders of record on December 31

② For shareholders holding 100 or more shares (share unit) over a year, the company will increase the equivalent amount of the gift items

- Shareholders holding 100 to less than 200 shares ¥2,500 equivalent
- 200 to less than 1,000 shares ¥4.500 equivalent
- 1,000 to less than 2,000 shares ¥7,000 equivalent
- 2,000 or more shares ¥13,500 equivalent

(2) Date of change

The current program will be completed with compliments for shareholders enrolled on our shareholder list as of June 30, 2019, and the new program will be applied for shareholders enrolled on our shareholder list as of December 31, 2019

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 27, 2018

Business year: 33rd term (from January 1, 2017 to December 31, 2017)

(2) Internal Control Report

Filed to Director-General of Kanto Local Finance Bureau on March 27, 2018

Business year: 33rd term (from January 1, 2017 to December 31, 2017)

(3) Amendment Report of Annual Securities Report and Written Confirmation

Filed to Director-General of Kanto Local Finance Bureau on April 24, 2018

Business year: 33rd term (from January 1, 2017 to December 31, 2017)

(4) Quarterly Securities Reports and Written Confirmations

Filed to Director-General of Kanto Local Finance Bureau on May 2, 2018

First quarter of the 34th term (from January 1, 2018 to March 31, 2018)

Filed to Director-General of Kanto Local Finance Bureau on August 2, 2018

Second quarter of the 34th term (from April 1, 2018 to June 30, 2018)

Filed to Director-General of Kanto Local Finance Bureau on November 1, 2018

Third quarter of the 34th term (from July 1, 2018 to September 30, 2018)

(5) Extraordinary Reports

Filed to Director-General of Kanto Local Finance Bureau on March 28, 2018

Extraordinary Report based on Article 19, paragraph 2, item (ix-2) (Results of Exercise of Voting Rights at the Ordinary 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 15, 2018

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.

Filed to Director-General of Kanto Local Finance Bureau on October 31, 2018

Extraordinary Report based on Article 19, paragraph 2, item (iii) (Change to a Specified Subsidiary Company) of the Cabinet Office Ordinance on Disclosure of Corporate Information, etc.

(6) Amendment Report of Extraordinary Report

Filed to Director-General of Kanto Local Finance Bureau on July 3, 2018

Amendment Report of Extraordinary Report filed on June 15, 2018.

(7) Shelf Registration Statement (straight bonds) and Appendices

Filed to Director-General of Kanto Local Finance Bureau on August 2, 2018

(8) Shelf Registration Statement supplementary document and Appendices

Filed to Director-General of Kanto Local Finance Bureau on September 4, 2018

Supplementary documents related to Shelf Registration Statements (straight bonds) filed on August 2, 2018.

(9) Amendment to Shelf Registration Statements

Filed to Director-General of Kanto Local Finance Bureau on October 31, 2018

Amendment to Shelf Registration Statements pertaining to Shelf Registration Statement (straight bonds) filed on August 2, 2018.

INDEPENDENT AUDITOR'S REPORT

March 20, 2019

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: Yasuhiko Haga (Seal)

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Yoichi Matsushita (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, 2018 to December 31, 2018, 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 the Company and its consolidated subsidiaries as of December 31, 2018, and the results of their operations and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

As discussed in Note 39, "Contingencies" to the consolidated financial statements, the Quebec Court of Appeal ordered JTI-Macdonald Corp. ("JTI-Mac"), the Company's Canadian subsidiary, a punitive damage award of approximately ¥1.3 billion for the Canada Quebec Class Action (Cecilia Letourneau), and a compensatory damage award of approximately ¥143.4 billion and a punitive damage award of approximately ¥3 million for the Canada Quebec Class Action (Conseil Québécois sur le tabac et la santé) in March 2019. JTI-Mac filed an application for protection from its creditors under the Companies' Creditors Arrangement Act ("CCAA") on March 8, 2019. The Ontario Superior Court has granted the CCAA application and extended protection in favor of JTI-Mac. All of the Canadian matters against JTI-Mac have been stayed by the court order. JTI-Mac carries on business in the ordinary course under the CCAA. Our opinion is not qualified in respect of this matter.

Audit of Internal Control

Pursuant to the second paragraph of Article 193-2 of the Financial Instruments and Exchange Act, we have audited management's report on internal control over financial reporting of the Company as of December 31, 2018.

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, 2018 is effectively maintained, presents fairly, in all material respects, the results of the assessment of internal control over financial reporting in accordance with assessment standards for internal control over financial reporting generally accepted in Japan.

Interest

Our firm and the engagement partners do not have any interest in the Company for which disclosure is required under the provisions of the Certified Public Accountants Act.

The above represents a translation, for convenience only, of the original report issued in the Japanese language.

(TRANSLATION)

INDEPENDENT AUDITOR'S REPORT

March 20, 2019

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: Yasuhiko Haga (Seal)

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Yoichi Matsushita (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 34th fiscal year from January 1, 2018 to December 31, 2018, 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, 2018, 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.