



Hiroshi Kimura
President and CEO and Representative Director

To Our Shareholders, Customers, and Employees

Strategic Significance and Overview of FY 3/2006

FY 3/2006 was a year of immense change and challenge that will leave an indelible mark on the company's history.

At the end of April 2005, the Marlboro license agreement for the Japanese market with Philip Morris, which had lasted approximately 30 years, was terminated. With this decision, we parted company with the Marlboro brand, which commands the largest sales of any cigarette brand in the world. In so doing, we lost a brand that accounted for more than 10% of the total sales volume of our domestic tobacco business.

However, our brand portfolio was strengthened by transferring Camel, Winston, Salem, and other products which had been managed by JT international in Japan, to the domestic tobacco business. Competition between Philip Morris, British American Tobacco and JT in the Japanese market has entered a new dimension that finds the world-leading brands of each of these makers engaged in increasingly severe competition for market share.

As the adult population of Japan declines, and the aging of

society progresses, the environment surrounding tobacco has become more severe, and the demand for tobacco products in the Japanese market is undergoing a structural decline. During FY 3/2006, these fundamentals were compounded by the risk that JT's profitability would decline substantially due to the loss of business resulting from the termination of the Marlboro license agreement.

"JT PLAN-V" was formulated in response to these changes, and drove a number of painful cost structure reform measures, including the consolidation of domestic tobacco production factories and the voluntary retirement of the equivalent of one third of our employees on a non-consolidated basis. These policies allowed us to firmly maintain the profitability of our domestic tobacco business. In addition, buoyed by solid performances from the international tobacco, pharmaceutical and foods businesses, we achieved results that far exceeded all management targets set under "JT PLAN-V."

(1) Domestic tobacco business

The domestic tobacco business—the core source of profits of the JT

During FY 3/2006, the final year of “JT PLAN-V,” we achieved results that far exceeded all EBITDA, ROE, and Cumulative FCF management targets for the period between FY3/2004 and FY3/2006. We feel that these results demonstrate that JT has the power to overcome the current severe business environment. The results also provide clear feedback that the company is realizing its aspirations to create an appropriate corporate image and organizational culture.

Group—succeeded in reforming its cost structure. Although the tobacco excise tax will increase from July 2006 and further declines in sales volume are expected, we believe we have already constructed a business base that is capable of coping with these changes.

(2) International tobacco business

The international tobacco business continued to strengthen its role as the driving force for profit growth of the JT Group. In FY 3/2006, sales volume of this business exceeded that of the domestic tobacco business. On the profit side, our international tobacco business achieved a remarkable degree of organic growth, led by the sustained growth of its Global Flagship Brands (GFB), and outstripping that of its rivals.

(3) Pharmaceutical business

In the pharmaceutical business, we moved four new compounds into the clinical development stage during “JT PLAN-V” period, exceeding the management target set under “JT PLAN-V” of entering three new compounds into clinical development. In addition, during FY 3/2005, we licensed JTT-705 (dyslipidemia) to F. Hoffmann-La Roche Ltd., and JTK-303 (anti-HIV) to Gilead Sciences Inc. These developments have demonstrated the strength of JT’s research and development capabilities and have contributed to increasing the company’s business value.

(4) Foods business

After achieving an operating income surplus in FY 3/2005, a year ahead of the target set under “JT PLAN-V,” the foods business went on to

solidify its profit-generating characteristics by further expanding its earnings in FY 3/2006. Now that we have put this business on a firm footing, we have reached the stage where we can look ahead to the prospect of achieving new growth.

FY 3/2006 Performance

JT’s net sales for FY 3/2006 totaled ¥4,637.7 billion, a decrease of ¥26.9 billion (0.6%) from the previous fiscal year, mainly caused by the decline in sales volume of the domestic tobacco business.

We succeeded in overcoming the effects of this reduction in sales through the implementation of cost structure reforms in the domestic tobacco business, and the achievement of expanded earnings growth in the international tobacco and the foods businesses. Thanks to these efforts, EBITDA grew by ¥33.3 billion to ¥433.4 billion (an 8.3% increase) compared with the previous fiscal year, and operating income rose by ¥33.6 billion to ¥306.9 billion (a 12.3% increase) compared with the previous fiscal year. Moreover, with the significant decrease in business restructuring costs that had totaled ¥224.8 billion during the previous fiscal year, the extraordinary profit and loss balance improved. As a result, net income for the fiscal year totaled ¥201.5 billion, an increase of ¥139.0 billion (222.0%) compared with the previous fiscal year.

Accordingly, EBITDA, operating income, recurring profit and net income all set new record highs, an outstanding performance which

allowed the company to complete “JT PLAN-V” with great success.

After taking into account the above performance, JT has decided to pay a dividend for FY 3/2006 of ¥16,000 per share. With respect to dividends, our basic policy is aimed at providing a competitive level of returns to shareholders in the capital market through an optimal cash flow allocation in accordance with our consolidated financial results. Taking this into account, during the period of “JT PLAN-V,” we have sought to increase the dividend level on a continual basis.

Moreover, in order to create an environment that makes it easier for investors to invest in our company, we have lowered the minimum unit of investment by conducting a stock split for the purpose of expanding the company’s investor base. Under this measure, we carried out a five-for-one split for all existing shares held by shareholders listed or recorded on the final shareholders’ name list dated March 31, 2006.

New Medium Term Management Plan “JT2008”

In May 2006, we announced “JT2008” as the new medium term management plan to follow “JT PLAN-V.” It is vitally important that we realize sustainable growth in the future from the strong business foundation we have constructed through the implementation of “JT PLAN-V” so that the results gained over the past three years will not be merely temporary. In the course of “JT PLAN-V” we realized results that far exceeded the targets set out in the plan—an achievement that has proven JT’s power to overcome severe changes in the

business environment. We also obtained feedback through “JT PLAN-V” that has allowed us to realize our desired corporate image and organizational culture.

We consider people to be the most important prerequisite for sustainable growth. Over the next three years, we will focus both on enhancing the competitiveness of our personnel who will become a driving force for growth, and against this background, on reinforcing our organizational strength. In addition, we will invest actively in R&D to promote further organic growth.

The major tasks for each business are as follows.

(1) Domestic tobacco business

The domestic tobacco business will remain as the core source of profits of the JT Group in the future. In this business, we will aim to maintain current level of profits as well as boldly rise to the challenge of achieving top-line growth. In addition, we will make efforts to improve customer satisfaction and will try to achieve harmonious coexistence between smokers and nonsmokers in an environment in which various tobacco-related regulations are being enforced.

(2) International tobacco business

The international tobacco business will continue to achieve powerful growth as the driving force for profit growth of the JT Group over the coming years. To achieve this, we will continue to implement our basic strategy, which includes strengthening the equity of GFB, concentrating on core markets, continuous investment in quality, and cost efficiencies.

(3) Pharmaceutical business

The pharmaceutical business will focus on advancing its clinical compounds to higher phases of clinical study, and further enhancing its R&D pipelines by promoting drug discovery. We will work to steadily advance the pipeline status of compounds currently under development and work towards the development of new world-class drugs.

(4) Foods business

The foods business will aim at even greater profit expansion. By further strengthening its profitability, this business will make a growing contribution to improving the corporate value of the JT Group.

With regard to the use of capital under “JT2008,” top priority will be given to business investment. In addition to ordinary investment in plant and equipment, for example, we will also explore ways of gaining access to external resources. Moreover, we are preparing to meet flexible capital demands by expanding our internal reserves for business investment where appropriate.

Our basic dividend policy and aim is to provide a competitive level of returns to shareholders in the capital market. In consideration of the status of our medium and long-term growth strategy and our consolidated financial results forecast, we are aiming at a consolidated pay-out ratio of 20%, while also endeavoring to increase the dividend level. Furthermore, we are considering a share buy-back with the objective of expanding our future management options.

Toward Delight Which Exceeds Stakeholder Expectations

In the new medium term management plan “JT2008,” our management vision and our commitment to improving the satisfaction of our shareholders, customers, employees, and society, while maintaining a good balance between our responsibilities to each, remains unchanged. We consider this to be the most challenging attitude and approach to corporate management, and we are united in our resolve to pursue this path by maintaining a healthy sense of crisis at all times. I believe that by continuing to follow our present course, we are ensuring a bright future for the JT Group.

In closing, I ask our stakeholders to continue to provide us with your full understanding and support as we implement our management strategy into the future.

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Hiroshi Kimura
President and CEO and Representative Director