Review of Operations

Review of Operations

Domestic Tobacco Business

We are positioning the domestic tobacco business as a core profit-generating source in the JT Group. Market share competition is becoming more severe as total demand continues to decline, driven by the ageing of Japanese society, growing awareness of smoking and health issues, and the tightening of regulations regarding smoking. In this business environment, JT plans to increase the value of the domestic tobacco business through our sales growth strategy and improving productivity.

Business Performance

FY 3/2007 Business Performance Summary

- Total sales volume of JT products: 174.9 billion cigarettes, down 7.7% (see note)
- Net sales (excluding excise): ¥1,147.2 billion, down 2.2%
- Operating income: ¥245.4 billion, up 11.5%
- EBITDA: ¥326.5 billion, up 6.8%

(Note) In addition to the figure stated above, we also sold 3.4 billion cigarettes at duty-free shops in Japan and in the markets of China, Hong Kong and Macau, which are under the control of our China Division.

In the domestic tobacco business, the business environment has become more severe as total demand is decreasing and as the severity of competition increased following the rise in the tobacco excise tax effective from July 2006. Under these conditions, JT is aiming to retain market share through the introduction of new products in growing segments and the refreshment and strengthening of existing brands. Since May 2006, we have employed the "Blue Wind" brand symbol on the packages of the five box products in our core Mild Seven brand family, and we also renewed the designs of nine brands of soft pack products and 1-mg tar products beginning from December 2006 to unify and strengthen the brand image of those products.

In order to effectively launch new products in growing segments, JT launched 9 products in 7 brands including 7 D-spec products (known as "Less Smoke Smell" products abroad, these products incorporate the company's odor-reducing technology). Also, in response to strong customer demand, we expanded 4 products in 4 brands to nationwide distribution. Through these changes, we are executing sales promotion more efficiently and effectively.

Sales of JT cigarette products in FY 3/2007 totaled 174.9 billion cigarettes, a decline of 14.5 billion cigarettes (7.7%) in comparison with the previous year, while the company's market share declined by 1.6 points to 64.8%. The factors behind this result included the termination of the Marlboro domestic license agreement on April 30, 2005, and pricing changes associated with the rise in the tobacco excise tax effective from July 2006.

Products that JT positioned in growing segments steadily expanded the company's market share in these segments. In FY 3/2007, our market shares of the following categories, excluding Marlboro products and including JTI products, were: 1-mg tar: 12.9% (up 1.0%), menthol: 6.8% (up 0.3%), and premium products: 5.5% (up 0.1%). In addition, the new category D-spec products reached 4.0% market share, and are steadily becoming established in the market.

Ichiro Kumakura
President, Tobacco Business

Strategy and Measures

Toward Sustainable Growth.

- Product strategy
- Distribution strategy
- Marketing strategy
- Improving productivity and fulfilling our responsibility as a leading company

Maximizing Our Marketing Mix

In the domestic tobacco market, the total demand for cigarettes has continued to decline due to the aging of the Japanese population, a growing consciousness of smoking and health risks, and tightening of smoking regulations. Increases in the tobacco excise tax, which went into effect in July 2003 and July 2006, further had an affect, with the percentage of smokers dropping to 26.3% according to a August 2006 survey.

Various tobacco-related regulations are being strengthened, and competition with foreign brands for domestic market share is becoming increasingly severe. In the future, JT will overcome the reduction in sales volume by optimizing its product strategy, distribution strategy, and sales strategy.

[**Product Strategy**]

Concentrating resources in growing segments and improving the value of core brands is the focus of JT's product strategy.

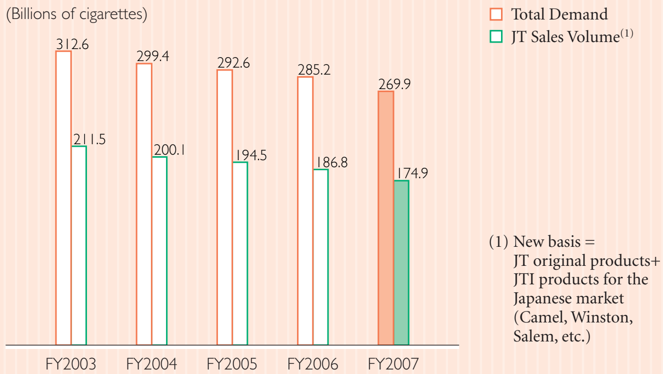
We will achieve steady growth for our existing brands within growing market segments (1-mg tar, menthol, and premium products) while at the same time expanding our market share by effectively introducing new products.

Furthermore, we are steadily increasing the value of our core brands. For example, in May 2006, we redesigned the packaging for five box products in the Mild Seven brand family and also renewed the packaging designs of nine brands of soft pack products and 1-mg tar products beginning in December 2006. In addition, we are raising unit prices through the development and introduction of high value-added products as represented by our D-spec brands. These activities are further building the equity of our core brand portfolio.

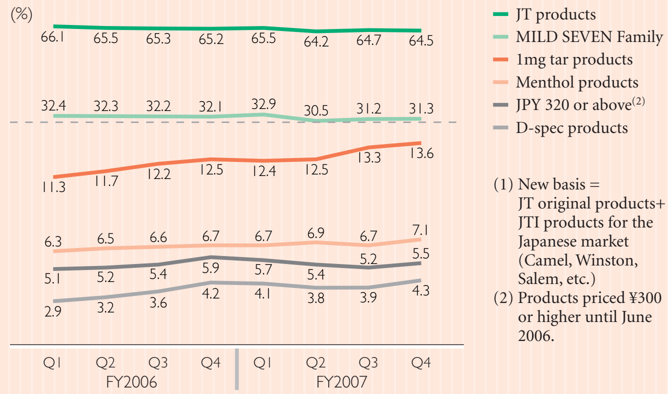
[**Distribution Strategy**]

JT enjoys a powerful and unrivalled distribution network. In Japan, approximately 60% of all tobacco sales are carried out via vending machines, and JT owns more than one-third of all cigarette vending machines in the country. Going forward, we will strengthen our activities in growing sales channels such as convenience stores, while maintaining our overwhelming competitiveness in the important vending machine channel.

Sales Volume



Market Share of JT Products(1)



[Marketing Strategy]

We employ a marketing team that surpasses those of our competitors in terms of scale. This team conducts marketing activities that are carefully tailored to the needs of retailers throughout the country. As we move forward, we will continue to implement best-of-class sales promotion activities through one-to-one marketing while following applicable regulations and helping to address the problem of smoking by minors.

[Improving Productivity and Fulfilling Responsibilities as a Leading Company]

Productivity improvements are an important challenge for manufacturers. At JT, we work constantly in order to respond appropriately to diversified customer needs and changes in demand.

Moreover, we will continue to fulfill our responsibilities as the leading tobacco company in the Japanese market, and we will continue to promote a society in which smokers and nonsmokers can coexist. We will work to promote improvements in smoking manners, while developing and supporting suitable locations and opportunities for smoking, including the provision of comfortable smoking areas.

Furthermore, as an ongoing objective for the entire tobacco industry, we will continue to work towards preventing smoking by minors in cooperation with local governments and related organizations. In this context, we are preparing for the nationwide introduction of cigarette vending machines with adult identification functions (scheduled for implementation in 2008).

As a Core Source of Profits of the JT Group

The domestic tobacco business will continue to fulfill its role as a core profit-generating source in the JT Group in the future by overcoming the changes in the business environment, including the decline in total demand in the domestic tobacco market and the intensifying competition associated with this decline.

New Cigarette Brands Launched in FY3/2007

Release	Product	D-spec	Menthol	Tar (mg)	Nicotine (mg)	Price
Oct.06	CABIN ONE TASTY 100's BOX			1	0.1	¥300
Oct.06	CAMEL MENTHOL BOX	○	○	8	0.7	¥320
Oct.06	SAKURA	○		7	0.6	¥350
Oct.06	PEACE INFINITY	○		8	0.7	¥350
Oct.06	SALEM ICE BLUE*	○	○	8	0.6	¥320
Dec.06	MILD SEVEN SUPER LIGHTS 100's BOX			6	0.5	¥300
Jan.07	D-spec H SIDE SLIDE BOX	○		12	0.9	¥320
Jan.07	D-spec R SIDE SLIDE BOX	○		5	0.5	¥320
Jan.07	D-spec C SIDE SLIDE BOX	○	○	7	0.6	¥320

* This product is to be ended when the existing stock is cleared.

Cigarette Brands Expanded to Nationwide Sales in FY3/2007

Release	Nationwide	Product	D-spec	Menthol	Tar (mg)	Nicotine (mg)	Price
Jan.06	Apr.06	SEVEN STARS REVO ULTRA LIGHTS MENTHOL BOX	○	○	3	0.2	¥320
Oct.06	Dec.06	CABIN ONE TASTY 100's BOX			1	0.1	¥300
Dec.06	Feb.07	MILD SEVEN SUPER LIGHTS 100's BOX			6	0.5	¥300
Oct.06	Mar.07	CAMEL MENTHOL BOX	○	○	8	0.7	¥320

Celebrating the 30th Anniversary of the Mild Seven Brand Family

International Tobacco Business

JT International (JTI) is the core of JT's international tobacco operations, and is the fastest organically growing international tobacco company in the industry, with operations in 120 countries around the world. JTI is today the driving force of profit growth for the entire JT Group, and has achieved double digit EBITDA growth for six consecutive years.

JTI's performance is driven by the company's central focus on its Global Flagship Brands (GFB) and its core markets, and reflects a broadening of the company's earnings base as well as balanced growth between mature and the increasingly important emerging markets. JTI's Global Flagship Brands are Camel, Winston, Mild Seven, and Salem.

Business Performance

FY 2006 Business Performance Summary*

- Total sales volume: 240.1 billion cigarettes, up 10.4%
- GFB sales volume: 149.1 billion cigarettes, up 13.6%
- Net sales excluding taxes: US$ 4,729 million, up 11.1%
- EBITDA**: US$1,090 million, up 17.8%

*The consolidated accounting period for the international tobacco business is January through December.
**Before royalty payment to JT

In 2006, JTI total sales volume increased 22.6 billion cigarettes to 240.1 billion cigarettes, an increase of 10.4% from the previous fiscal year, driven by the continuing strong performance of JTI's emerging markets.

GFB sales volume increased 13.6% from the previous fiscal year, led by the growth of Winston in Russia, Spain, Iran, Turkey, Ukraine and Italy, Camel in Italy and France and Mild Seven in South Korea and Russia.

The above performance excludes the Japan market, where JTI products were transferred to JT in May 2005.

Global Flagship Brands and the Strengthening of JTI's Brand Portfolio

JTI's focus on GFB performance and the strengthening of the company's brand portfolio and brand equity are important factors supporting the company's growth momentum. Global consistency in brand communication and the positioning of Camel, Mild Seven and Salem in the premium segment and Winston in the sub-premium segment are important factors which drive GFB growth.

JTI continues to develop brand portfolios which are relevant for consumers in each market, with a central focus on GFB growth. As a result, both total sales volume and GFB sales volume continue to grow despite the emergence and growing popularity of value products in a number of markets.

The consistent implementation of this strategy remains critical to JTI's continued growth as changes in the company's operating environment, particularly in cigarette taxation and industry pricing, affect consumer behavior in many of the company's markets.

Core Market Performance Broadens JTI's Earnings Base

JTI has 11 core markets which today include France, Spain, Italy, Russia, Ukraine, Turkey, Iran, Canada, Taiwan, Malaysia, and South Korea. 8 out of 11 core markets increased net sales at the end of 2006, and thus helped drive JTI's overall growth momen-

Pierre de Labouchere
President & CEO, JT International S.A.

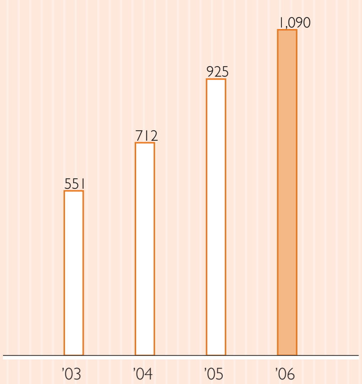
tum. This broadening of the company's earnings base is a direct result of JTI's focus on its Global Flagship Brands and on the company's core markets.

Toward Sustainable Organic Growth

JTI's continued focus on its core business strategies is the principle factor which underlies its performance. JTI has achieved or exceeded its profit targets for 6 consecutive years, and has grown GFB volume by more than 50% and EBITDA by more than 200% since 2000.

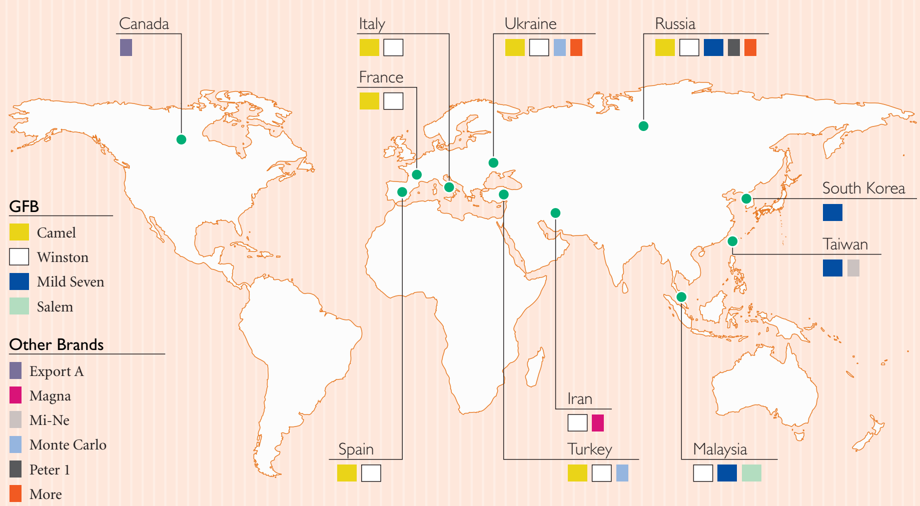
While competition within the industry will intensify, changes in consumer behavior will continue to provide JTI with opportunities for growth. Consistent execution of JTI's core strategies—the continued focus on Global Flagship Brands and on core markets—will ultimately provide the foundation for sustainable organic growth.

EBITDA
before Royalty Payment to JT
(Millions of U.S. dollars)



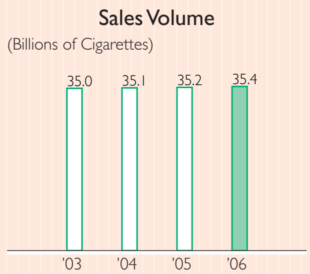
Like-for-like basis: excl. Japan business

Focus on GFB Growth and Core Markets



Global Flagship Brands Drive JTI's Performance

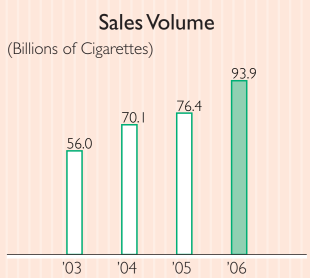
[Camel]



Camel remains a powerful international brand, ranking No.2 in sales volume in Western Europe. In 2006, total sales volume grew 1% for the third consecutive year despite adverse trading conditions in Western European markets, with Camel registering market share increases in Italy, and France.

Camel is one of the world's few iconic cigarette brands, and JTI will continue to strengthen the brand's equity through globally consistent taste, pack designs, and focused marketing investment.

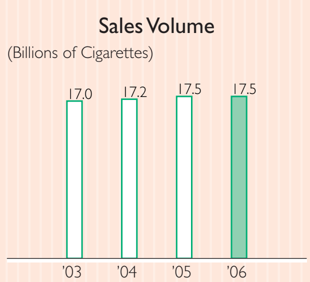
[Winston]



Winston is ideally positioned in the sub premium segment due to its strong international heritage and big brand status, and continues to benefit from consumer up-trading trends in emerging markets and down-trading trends in mature markets. Winston registered its 6th consecutive year of double digit sales volume growth, increasing 23% in 2006, with solid gains in Russia, Spain, Iran, Turkey, Ukraine, and Italy. Winston currently ranks as the world's No.4 brand and is the key driver of JTI's GFB volume performance.

JTI will continue to strengthen Winston's brand equity, leveraging the brand's unique positioning as new opportunities for further growth are identified.

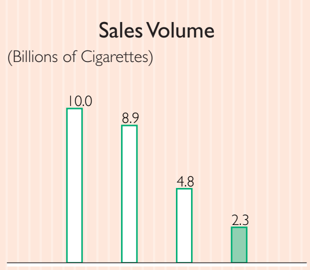
[Mild Seven]



JTI continues to strengthen Mild Seven's brand equity through globally consistent brand communication, and the introduction of new packaging graphics. In 2006, Mild Seven sales volume increased in South Korea and Russia as consumers responded to the new package design. In Taiwan, the brand's largest market outside of Japan, Mild Seven volume registered a decline as a result of a price increase in late 2006.

JTI will continue to invest consistently in Mild Seven's international premium brand equity in an effort to further expand brand sales volume and market share performance.

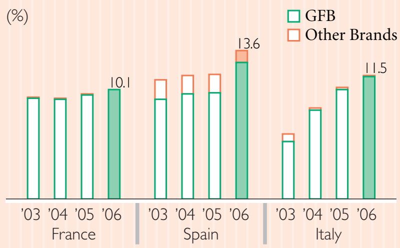
[Salem]



As a result of the transfer of JTI's Japan business to JT, Salem's role in our GFB portfolio has diminished, and currently represents 1% of total JTI sales volume. Salem however remains unique in its positioning as a premium menthol brand, and JTI continues to enhance Salem's communications and product mix. JTI will invest to revitalize the brand in the core Malaysian market, and thereafter in markets where the brand has potential to grow.

[France, Spain and Italy]

Share of Market Performance



France, Spain and Italy are profitable, mature markets which have undergone significant change as tobacco tax increases, prices increases and public smoking restrictions drive declines in consumption, and as demand grows for value brands.

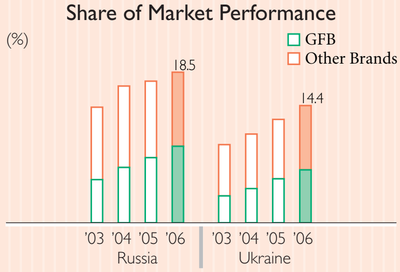
In France, total industry volume stabilized in 2006 following a substantial 21% decline in 2004 and a gradual recovery in 2005. In 2006, JTI grew its share of market by 0.4 share points, driven by solid performances from Camel and Winston.

In Spain, JTI repositioned Winston and optimized its brand portfolio in response to market turmoil caused by successive tobacco tax increases in 2005 and 2006. As a direct result of this strategy, Winston volume growth accelerated and JTI's share of market increased by 2.1 share points in 2006.

In Italy, JTI's share of market increased by 1.2 share points, driven by strong performances from both Camel and Winston.

[Russia and Ukraine]

Share of Market Performance

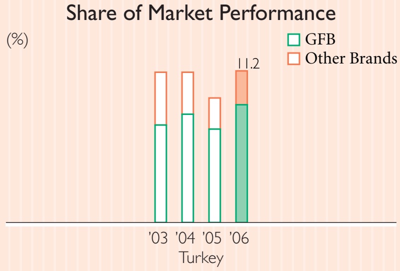


The emerging markets of Russia and Ukraine continue to be the main sources of JTI's GFB growth, as economic conditions improve and as consumers continue to trade up to international brands.

In 2006, JTI's total share of market reached an all time high of 18.5% in Russia and 14.4% in Ukraine, both led by the strong momentum of Winston. Winston is now one of the leading brands in Russia both in terms of sales volume and retail sales value. Nearly 40 percent of JTI's volume growth in these markets was driven by brands other than Winston.

[Turkey and Iran]

Share of Market Performance

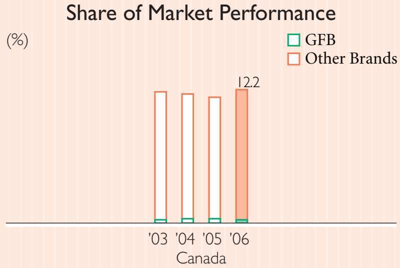


In Turkey, JTI's share of market increased by 1.9 share points, driven by a solid performance from Winston as the market stabilized following two successive changes in the market's excise tax structure during 2005.

In Iran, JTI continued its growth momentum in 2006, driven by the strong brand equity of Winston and Magna, combined with an enhanced sales and distribution system. While share data still remains elusive in Iran, the company further expanded its leadership position as the No.1 international tobacco company in the market.

[Canada]

Share of Market Performance

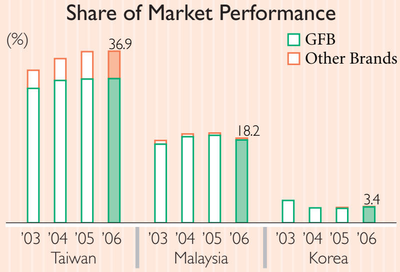


In Canada, a profitable, mature market, JTI's share of market increased by 0.6 share points in 2006 as Export A solidified its position as the No.3 premium brand in the market.

JTI's performance was also supported by Macdonald Special, which JTI launched in late 2005 in response to the emergence of a strong value segment.

[Taiwan, Malaysia and South Korea]

Share of Market Performance



Taiwan, South Korea and Malaysia remain attractive markets for potential sales volume and profit growth.

JTI continued its growth momentum in Taiwan, and achieved 36.9% share of market in 2006, driven by Mild Seven, Mi-ne and Winston. The company is now the No.1 tobacco company for the second consecutive year.

In South Korea, JTI's share of market increased by 0.2 share points, due to the steady recovery of Mild Seven as consumers responded to new packaging introduced in 2005.

In Malaysia, JTI's share of market declined slightly as a result of tobacco tax and related price increases. JTI will continue to search for opportunities to improve performance in this important market.

Pharmaceutical Business

JT is developing its pharmaceutical business as a pillar of its operations for the future, thereby further enhancing the value of the JT Group's diversified business portfolio. To this end, we have built a solid foundation by establishing a unique pharmaceutical business with world-class R&D capabilities, and by increasing our market presence through the development of innovative drugs.

Business Performance

FY 3/2007 Business Performance Summary

- Net sales: ¥45.5 billion, down 7.7%
- Operating loss: ¥-11.2 billion, down ¥6.1 billion
- EBITDA: ¥-8.2 billion, down ¥6.4 billion

Reinforcing Our In-house Drug Discovery Capabilities

In FY 3/2007, based on previous developments in this field, we have further improved and strengthened our in-house R&D capabilities.

With regard to drug development, we have moved one compound, JTT-552 - a hyperuricemia treatment, into the clinical trial stage this year. We currently have a total of seven compounds undergoing clinical study as of April 27, 2007.

Accelerating Development Through Partnership

In FY 3/2005, JT entered into licensing agreements with the Roche Group concerning dyslipidemia treatment JTT-705, and with Gilead Sciences concerning anti-HIV agent JTK-303. Moreover, in April 2006, we licensed a new pre-clinical trial stage compound to GlaxoSmithKline, and separately licensed a pre-clinical trial stage antibody drug candidate to MedImmune in December 2006. As these examples illustrate, JT has been promoting accelerated development of promising in-house drug discoveries through partnerships with other members of the industry.

Our Core Strategies

- Steadily advance compounds under development and improve our R&D pipeline
- Search for strategic licensing opportunities

[**Steadily Advance Compounds under Development and Enhance the R&D Pipeline**]
In the pharmaceutical business, JT will continue its strategy of further enhancing its R&D pipeline by promoting drug discovery research while advancing the development status of compounds currently in the pipeline.

While making use of our accumulated knowledge, our strategic focus remains on research and development. Accordingly, we are concentrating our R&D resources on the glucose and lipid metabolism, anti-virus, immune disorders and inflammation, and bone metabolism areas.

[**Search for Strategic Licensing Opportunities**]
In the face of escalating global R&D competition, it is becoming increasingly important to accelerate R&D and bring new products promptly to the market. Bearing this in mind, JT is searching for strategic opportunities for licensing both in and out in order to maximize its business value.

Noriaki Okubo
President, Pharmaceutical Business

The Creation and Provision of New Drugs

The creation of new drugs is never an easy task. At JT, however, we feel a sense of pride and challenge in taking up the development of world-class innovative drugs as our corporate mission. Moreover, we are tackling this mission with real determination, creating what is original and attempting to do what can only be done by JT. We do this so that patients and medical professionals all over the world will be able to say “We could not have done without JT’s drug.”

Clinical Development (as of April 27, 2007)

Code	Stage	Indication	Characteristics
JTT-705 (oral)	Phase I (JPN)	Dyslipidemia	Decreases LDL and increases HDL by inhibition of CETP -CETP: Cholesteryl Ester Transfer Protein, facilitates transfer of cholesteryl ester from HDL to LDL -HDL: High density lipoprotein, Good Cholesterol -LDL: Low density lipoprotein, Bad Cholesterol
JTT-130 (oral)	Phase II (JPN) Phase II (Overseas)	Hyperlipidemia	Treatment of hyperlipidemia by reducing absorption of cholesterol and triglyceride via inhibition of MTP MTP: Microsomal Triglyceride Transfer Protein
JTK-303 (oral)	Phase I (JPN)	HIV	Integrase inhibitor which works by blocking integrase, an enzyme that is involved in the replication of HIV (HIV: Human Immunodeficiency Virus)
JTT-302 (oral)	Phase II (Overseas)	Dyslipidemia	Decreases LDL and increases HDL by inhibition of CETP -CETP: Cholesteryl Ester Transfer Protein, facilitates transfer of cholesteryl ester from HDL to LDL -HDL: High density lipoprotein, Good Cholesterol -LDL: Low density lipoprotein, Bad Cholesterol
JTT-305 (oral)	Phase II (JPN) Phase I (Overseas)	Osteoporosis	Increases BMD and decreases new vertebral fractures by accelerating endogenous PTH secretion via antagonism of circulating Ca on CaSR in parathyroid cells -BMD: Bone Mineral Density -PTH: Parathyroid Hormone -CaSR: Calcium-Sensing Receptor
JTT-551 (oral)	Phase I (JPN) Phase I (Overseas)	Type 2 diabetes mellitus	Decreases blood glucose by enhancing insulin signal via inhibition of PTP1B. -PTP1B: Protein Tyrosine Phosphatase 1B This enzyme negatively regulates insulin signaling pathway.
JTT-552 (oral)	Phase I (JPN)	Hyperuricemia	Decreases serum urate concentration by increasing urinary urate excretion via inhibition of URAT1. -URAT 1: Urate Transporter 1

Phase I: Testing conducted on healthy volunteers to verify product safety and disposition (ADME: absorption, distribution, metabolism, and excretion).
Phase II: Testing conducted on a small number of patients, with their consent, to study the drug’s effectiveness as well as safety.
Phase III: Testing conducted on a large number of patients, with their consent, to compare product effectiveness and safety with standard treatments.

Foods Business

As a core business of the JT Group, we are focusing on the three areas of beverages, processed foods, and seasonings. We are working to strengthen our competitive advantage in the foods business as a whole, particularly in the fields of raw materials procurement, research and development, and product development. In addition, we are establishing a framework through which synergies can be delivered across multiple business categories. Through these measures we are working to further establish our foundation as an integrated foods manufacturer.

Business Performance

FY 3/2007 Business Performance Summary

- Net sales: ¥286.6 billion, up 2.9%
- Operating income: ¥6.7 billion, up 6.0%
- EBITDA: ¥12.0 billion, up 1.3%

In the foods business, we have further improved our business value through the development and introduction of new products, the reinforcement of existing sales channels, the promotion of greater efficiency across all operations, and the establishment of a strong business structure to cope with the severe operating environment.

We have steadily expanded the beverages business mainly through the vending machine operations of Japan Beverage Inc., a JT subsidiary. In addition, JT has actively developed and launched new products that reinforce its core brands, centered on the Roots brand, while delivering competitive differentiation.

In the processed foods business, we are enhancing and enriching our commercial frozen processed foods product lineup, including the Obento Dai-Ninki! and Imadoki-Wazen series, while also striving to expand business volume and strengthen profitability.

In the seasonings business, we are reinforcing our business foundation through the development and marketing of natural flavorings based upon our in-house technology such as High IG yeast extract.

Strategy and Measures

Aim to further establish world-class competitive advantage through the following initiatives:

- Establish and strengthen competitive advantage
- Realize the synergies inherent in being a foods manufacturer that has multiple business categories

Beverages Business

In the beverages business, with an eye on continued growth, we will further develop the core Roots brand. We will promote product development and marketing that thoroughly pursues differentiation and quality under the brand, backed by our original in-house technology. Also, we will progressively expand our vending machine sales channels centered on Japan Beverage Inc.

Processed Foods Business

The processed foods business covers a wide area including frozen processed foods, bakery products, and chilled processed foods. We are steadily expanding the scale of operations. In the future, we will develop highly distinguished products in each product category using our superior in-house R&D capabilities and our ability to procure safe raw materials. In doing so, we will further expand operations and enhance profitability.

Seasonings Business

In the seasonings business, we are promoting the development of compound additives, while also strengthening and expanding our natural flavorings-based seasonings business framework. In this

Mutsuo Iwai
President, Food Business

context, we will focus on expanding the production and sale of high value yeast products using our in-house technology as well as other extracts derived from high quality traceable ingredients, such as kelp, bonito, and pork. Furthermore, to meet consumer needs, we are promoting the development of compound additives and will actively promote the shift to natural flavoring-based seasonings.

Aiming at the Creation of New Value in the Food World

In keeping with the sentiment that "We want our foods to be eaten by the most important persons," JT's foods business has provided high-value products and services, gained support from consumers, and created of a string of hit products.

Going forward, with "safety and reliability" as our motto we are making efforts to ensure the procurement of high-quality ingredients, improved traceability, and the development of operations technology and management systems for safety and quality maintenance. At the same time we are further strengthening our research and product development capabilities. In this way, we will continue to strive towards the creation of new forms of value that meet global demands through the world of food, which is the basis of human life.

Major Beverages Products

Roots

Momo no Tennen-Sui

GABA COOLWATER

Major Processed Foods Products

"Obento Dai-Ninki!" series

"Imadoki-Wazen" series

"Green Giant" series

Rice products

Major Seasonings Products