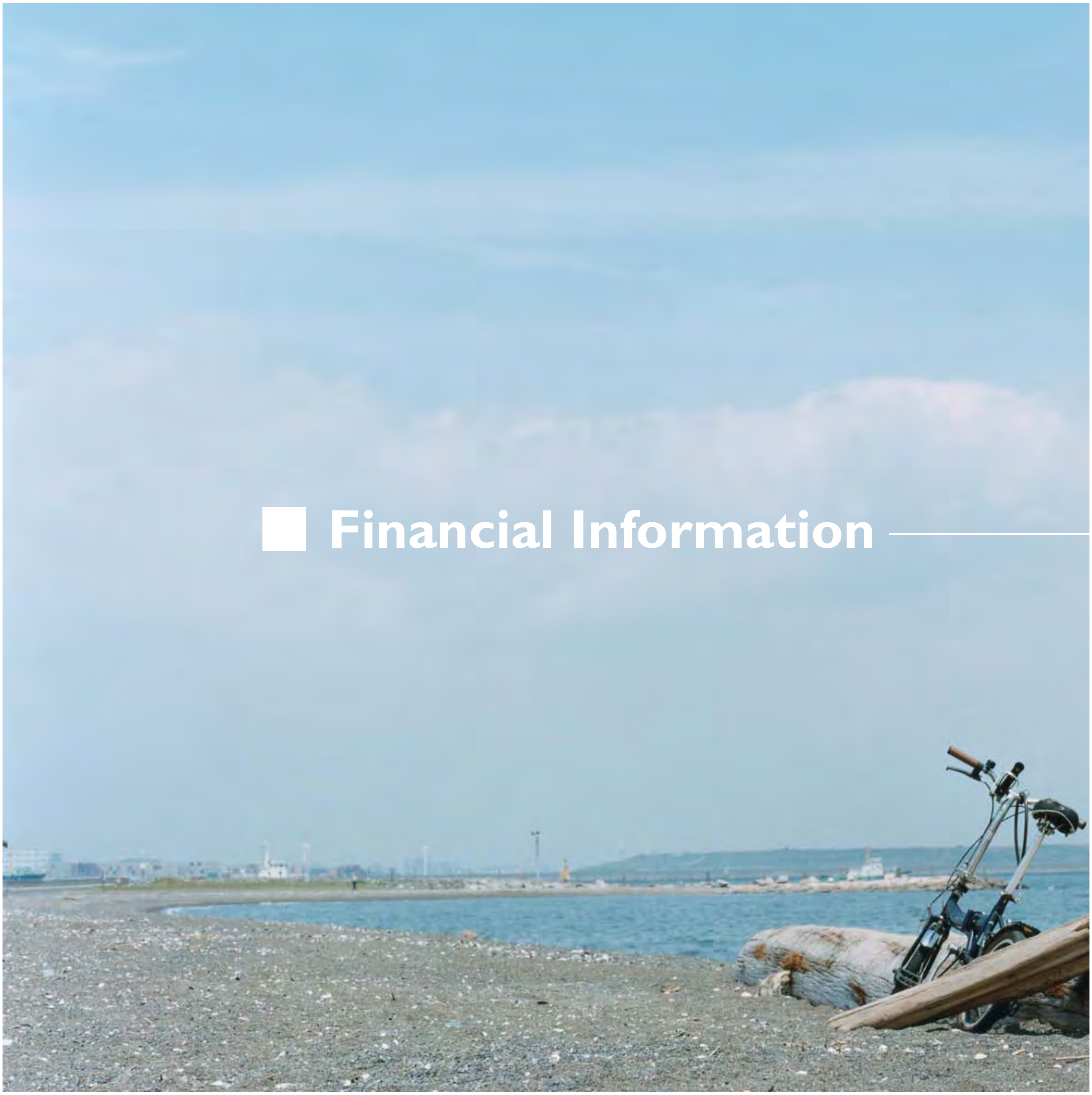

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Consolidated Five-Year Financial Summary

Japan Tobacco Inc. and Consolidated Subsidiaries / Years ended March 31

	Millions of yen					Millions of U.S. dollars (Note 1)
	2004	2005	2006	2007	2008	2008
For the year:						
Net sales	¥ 4,625,151	¥ 4,664,514	¥ 4,637,657	¥ 4,769,387	¥ 6,409,727	$ 63,976
Taxation	2,605,343	2,650,586	2,628,878	2,718,358	3,822,331	38,151
Net sales excluding excise taxes	2,019,807	2,013,927	2,008,780	2,051,029	2,587,396	25,825
Net sales excluding excise taxes, distribution business	N/A	1,684,404	1,596,151	1,633,186	2,068,368	20,644
EBITDA (Note 2)	373,435	400,115	433,391	464,634	602,096	6,010
Depreciation and amortization (Note 2)	139,401	126,744	126,445	132,643	171,542	1,712
Operating income	234,034	273,371	306,946	331,991	430,554	4,297
Net income (loss)	(7,603)	62,584	201,542	210,772	238,702	2,382
For the year:						
Net cash provided by operating activities	¥ 334,501	¥ 250,840	¥ 150,343	¥ 435,958	¥ 145,030	$ 1,448
Net cash provided by (used in) investing activities	(228,620)	176,914	(26,358)	(149,692)	(1,668,635)	(16,655)
Net cash used in financing activities	(109,335)	(202,196)	(48,135)	(32,635)	519,001	5,180
Free cash flow (Note 3)	269,174	269,459	145,590	223,007	(1,493,717)	(14,909)
At year-end:						
Net property, plant and equipment	¥ 708,221	¥ 639,655	¥ 596,544	¥ 600,436	¥ 763,332	$ 7,619
Total assets	3,029,084	2,982,056	3,037,379	3,364,663	5,087,214	50,776
Interest bearing debt	381,203	230,716	216,608	219,269	1,389,296	13,867
Liabilities	1,467,322	1,430,256	1,217,306	1,340,047	2,932,585	29,270
Total equity	1,507,937	1,498,204	1,762,512	2,024,616	2,154,629	21,505
Ratios:						
Return on equity (ROE)	(0.5%)	4.2%	12.4%	11.3%	11.8%	—
Return on asset (ROA)	7.9%	9.2%	10.4%	10.7%	10.5%	—
Operating income margin	5.1%	5.9%	6.6%	7.0%	6.7%	—
Total assets turnover	1.55	1.55	1.54	1.49	1.52	—
Equity ratio	49.8%	50.2%	58.0%	58.3%	40.8%	—
Debt/Equity ratio (times)	0.25	0.15	0.12	0.11	0.64	—
Current ratio	195.3%	202.7%	256.7%	226.4%	96.1%	—
Fixed assets/ Long-term capital ratio	69.9%	67.6%	60.7%	61.3%	103.4%	—

Notes: 1. Figures stated in U.S. dollars in this report are translated solely for convenience at the rate of ¥100.19 per $1, the rate of exchange as of March 31, 2008.
2. EBITDA = operating income + depreciation and amortization
Depreciation and amortization = depreciation of tangible fixed assets + amortization of intangible fixed assets + amortization of long-term prepaid expenses + amortization of goodwill
3. FCF = (cash flow from operating activities + cash flow from investing activities) excluding the following items:
From "cash flow from operating activities": Dividends received / interest received and its tax effect / interest paid and its tax effect
From "cash flow from investing activities": Cash outflow from purchase of marketable securities / proceeds from sales of marketable securities / cash outflow from purchases of investment securities / proceeds from sales of investment securities / others (but not business-related investment securities, which are included in the investment securities item)

Segment Information

	Millions of yen					Millions of U.S. dollars
	2004	2005	2006	2007	2008	2008
Net sales	¥ 4,625,151	¥ 4,664,514	¥ 4,637,657	¥ 4,769,387	¥ 6,409,727	$ 63,976
Tobacco	4,236,920					
Domestic		3,491,488	3,405,281	3,416,274	3,362,398	33,560
International		792,705	881,188	999,658	2,639,969	26,350
Pharmaceutical	51,242	57,676	49,257	45,452	49,064	490
Foods	250,138	265,380	278,378	286,554	336,420	3,358
Others	86,851	57,265	23,553	21,449	21,876	218
EBITDA	¥ 373,435	¥ 400,115	¥ 433,391	¥ 464,634	¥ 602,096	$ 6,010
Tobacco	343,163					
Domestic		296,031	305,753	326,470	306,726	3,061
International		65,462	94,093	112,668	270,757	2,702
Pharmaceutical	(4,426)	5,474	(1,803)	(8,197)	(6,269)	(63)
Foods	3,300	7,931	11,869	12,018	8,353	83
Others	30,674	26,810	22,140	21,586	22,055	220
Elimination/Corporate	724	(1,593)	1,339	89	474	5
Operating income	¥ 234,034	¥ 273,371	¥ 306,946	¥ 331,991	¥ 430,554	$ 4,297
Tobacco	238,409					
Domestic		215,833	220,095	245,388	222,348	2,219
International		44,458	71,031	81,085	205,360	2,050
Pharmaceutical	(12,840)	1,855	(5,057)	(11,207)	(9,644)	(96)
Foods	(4,851)	1,948	6,325	6,705	667	7
Others	11,976	10,427	8,673	9,331	10,448	104
Elimination/Corporate	1,340	(1,150)	5,879	689	1,375	13

Four business segments, namely Tobacco, Pharmaceutical, Foods and Others, had been used for the consolidated financial statements up to the year ended March 31, 2005. From the year ended March 31, 2006, the tobacco segment is divided into Domestic tobacco and International tobacco in order for our business results to be more properly shown, considering the importance of the Group's tobacco business in which JT International S.A., a foreign consolidated subsidiary, conducts the main operational role. As a result, five business segments, namely Domestic tobacco, International tobacco, Pharmaceutical, Foods and Others, are used for the consolidated financial statements. As for the results of the year ended March 31, 2005, retroactive application was made in accordance with the new business segments as well.

Management's Discussion and Analysis of Financial Condition and Business Results

The following discussion of our financial conditions and business results should be read in reference to our consolidated financial statements prepared in accordance with Japanese Generally Accepted Accounting Principles ("Japanese GAAP") and other information included in other sections of this annual report. This discussion and analysis contains forward-looking statements that involve risks, uncertainties and assumptions. Actual results may differ materially from those estimated in these statements as a result of a number of factors, including, but not limited to, those described in "Major Risks of Businesses".

Business Description and Acquisition of Outside Resources

Japan Tobacco Inc. ("JT") is a joint stock corporation (*kabushiki kaisha*) incorporated under the corporate law of Japan (the "Corporate Law") pursuant to the Japan Tobacco Inc. Law (the "JT Law"). JT is primarily engaged in the manufacture and sale of tobacco products in the domestic and international markets, as one of the largest producers of tobacco products in the world. The total sales of cigarettes of JT and its consolidated subsidiaries (the "JT Group" or "Group") in the fiscal year ended March 31, 2008, excluding tobacco products purchased from overseas tobacco manufacturers and sold to retail stores through its subsidiary, TS Network Co., Ltd. ("TS Network"), was 556.9 billion cigarettes (167.8 billion cigarettes in the domestic market; 3.5 billion cigarettes in the domestic duty-free market and the markets in China, Hong Kong and Macau, which are covered by JT's China Division; and 385.6 billion cigarettes in other overseas markets).

In the domestic tobacco market, JT manufactures and sells its tobacco products to retail stores all over the country in accordance with the Tobacco Business Law. This law provides that (1) JT shall be the sole manufacturer of tobacco products in Japan and (2) the maximum wholesale price of each tobacco product manufactured and sold and the retail price of each product sold in Japan, as well as any changes in these prices, shall be subject to approval by the Minister of Finance. The products are transported from its factories to its distribution bases by its subsidiary, JT Logistics Co., Ltd., and then distributed to retail stores through TS Network. TS Network also acts as the wholesaler of foreign tobacco manufacturers, purchasing and selling their products to retail stores in the domestic market.

JT greatly expanded its international tobacco business through the acquisition of the non-U.S. tobacco operations of RJR Nabisco, Inc. ("RJR Nabisco") on May 12, 1999. JT paid $5.0 billion for the non-U.S. tobacco operations of RJR Nabisco, which resulted in $3.5 billion of goodwill. JT also acquired non-U.S. tobacco-related trademarks and intellectual properties for $2.7 billion and other assets for $0.1 billion. The acquisition, worth a total of $7.8 billion, was financed by a syndicated loan of $5.0 billion and $2.8 billion in cash. The syndicated loan was later refinanced through domestic and foreign bond issues and long-term loans from banks and insurance companies. JT repaid in full the long-term loans from banks and insurance companies, and redeemed the foreign bonds by July 2004. We are due to redeem the domestic bonds in June 2009. As a result of this acquisition, JT obtained increased access to overseas markets, especially in Europe and Russia, and the rights in almost all countries outside the United States to internationally recognized trademarks such as Winston, Camel and Salem. Since this acquisition, JT's international tobacco business - of which JT International (JTI) constitutes the core - has consistently maintained strong growth.

In the fiscal year ended March 31, 2008, we completed the procedures for the acquisition of Gallaher Group Plc to make it a wholly owned subsidiary of JT on April 18, 2007. The acquisition price was approximately £7.50 billion (approximately ¥1,720 billion), and the total acquisition price including the assumption of net interest-bearing debt was approximately £9.44 billion (approximately ¥2,180 billion). This acquisition resulted in goodwill of US$15.1 billion. Of the total value, approximately ¥820 billion was covered by our own funds, ¥450 billion by a loan from Mizuho Bank, Ltd, and £1.9 billion (approximately ¥450 billion) by a syndicated loan arranged by Merrill Lynch. Of the funds borrowed from Mizuho Bank, the JT Group repaid a total of ¥150 billion in May and July 2007 out of its own funds and refinanced ¥300 billion through new loans totaling ¥150 billion from other domestic banks and through the issuance of domestic bonds totaling ¥150 billion. It repaid the syndicated loan of £1.9 billion with cash and funds borrowed under a new credit line established abroad. As for the domestic bonds, the JT Group is due to redeem ¥50 billion in July 2010, ¥40 billion in July 2011 and ¥60 billion in July 2012.

With the acquisition of Gallaher, we have further strengthened our position as the world's third largest tobacco company. In addition to our strong business foundation in Asia, JT now has an increasing presence in Europe and the CIS region. We aim to maintain sustainable growth as a major tobacco company on the strength of our geographically well-balanced operations and our ample growth potential. JT's international tobacco business aims to enhance its role as the driver of the JT Group's profit growth by achieving top-line growth. As we proceed with the business integration of JTI and Gallaher, we will seek to gain both top-line synergy and cost synergy. We now count eight brands among our list of global flagship brands ("GFBs"): Winston, Camel, Mild Seven, Benson & Hedges, Silk Cut, LD, Sobranie and Glamour. We intend to actively explore opportunities for top-line growth on the strength of these GFBs, which form the core of our new brand portfolio.

As of the end of April 2005, JT terminated its contracts with

Mitsubishi Corporation ("Mitsubishi") and Kokuba-Gumi Co., Ltd., under which Mitsubishi imported Camel, Winston and Salem, from JT International S.A. to Japan and sold them through TS Network throughout Japan except for Okinawa Prefecture, where they were imported and sold by Kokuba-Gumi. Since then, JT has been importing, manufacturing and selling these products in Japan on its own.

JT also terminated the production and sale of Marlboro brand cigarettes in April 2005 upon the expiration of its licensing contract with Philip Morris Products S.A. for this brand, which was signed in 1973.

In addition to the tobacco business, the JT Group has been actively engaged in its foods and pharmaceutical businesses in order to diversify its source of future profits and cash flow.

In its pharmaceutical business, the JT Group focuses on the research and development of prescription drugs. In the domestic market, Torii Pharmaceutical Co., Ltd., in which JT acquired a stake of 53.5% for approximately ¥42 billion in December 1998, manufactures and sells prescription drugs through its extensive marketing network. In the overseas market, JT derives revenue principally from royalties on the licensing of its successful anti-HIV drug.

In its foods business, the JT Group principally manufactures and sells beverages, processed foods and seasonings in the domestic market. Chilled foods operations are mainly undertaken by its Australian foods subsidiary, Hans Continental Smallgoods Pty. Ltd. JT's presence in the beverage market was substantially expanded through the acquisition of a majority stake in Unimat Corporation, a nationwide operator of soft drink vending machines that was later renamed Japan Beverage Inc., for approximately ¥29 billion in a two-stage deal implemented in April and September 1998. In addition, JT acquired the food business of Asahi Kasei Corporation for approximately ¥24 billion in July 1999. In the fiscal year ended March 31, 2008, the JT Group made Katokichi Co. a subsidiary by acquiring additional shares in the company for approximately ¥102 billion, increasing its equity stake in Katokichi Co. from 5% to approximately 94%, in January 2008. Following the acquisition of all voting rights of Katokichi Co. on April 18, 2008, the JT Group intend to concentrate its processed foods operations, including frozen foods operations and seasonings operations, at Katokichi beginning on July 1, 2008. Through this realignment, Katokichi will consolidate its foundation as a unique foods manufacturer on the strength of its processed foods business - including the frozen foods business, which will be the largest in Japan - and its superior technology for the production of seasonings.

Under the JT Law, JT must obtain approval from the Minister of Finance with regard to certain matters, such as (1) the issuance of new shares (as well as subscription rights for new shares and bonds with subscription rights for new shares) and (2) resolutions adopted at shareholder meetings for any amendments to the Articles of Incorporation and appropriation of retained earnings. Pursuant to the JT Law, the Japanese government is required to hold one-half or more of the JT shares that were issued upon the company's establishment in 1985, as adjusted for any subsequent stock split or consolidation of shares. The amended JT Law allows JT to issue new shares to the extent that the number of shares held by the government remains at more than one-third of the outstanding shares.

Overview

Our net sales totaled ¥6,409.7 billion for the year ended March 31, 2008, compared with ¥4,769.4 billion for the year ended March 31, 2007. The domestic and international tobacco businesses accounted for 52.5% and 41.2%, respectively, of our net sales in the year ended March 31, 2008, compared with 71.6% and 21.0% in the year ended March 31, 2007. In recent years, net sales for our international tobacco business have become an increasingly important component of our total net sales.

Our operating income totaled ¥430.6 billion for the year ended March 31, 2008, compared with ¥332.0 billion for the year ended March 31, 2007. Although our foods business has generated operating income since the year ended March 31, 2005, our pharmaceutical business has posted operating losses every year since the year ended March 31, 1998, when we started to disclose segment-by-segment information, with the exception of the year ended March 31, 2005. As a result, we derive almost all of our operating income from our tobacco business.

Results by Industry Segment

Table of Results by Industry Segment

For years ended March 31	Millions of yen 2006	2007	2008	Millions of U.S. dollars 2008
Net sales	¥ 4,637,657	¥ 4,769,387	¥ 6,409,727	$ 63,976
Tobacco Business				
Domestic	3,405,281	3,416,274	3,362,398	33,560
International	881,188	999,658	2,639,969	26,350
Pharmaceutical Business	49,257	45,452	49,064	490
Foods Business	278,378	286,554	336,420	3,358
Other Business	23,553	21,449	21,876	218

	Millions of yen 2006	2007	2008	Millions of U.S. dollars 2008
Operating income	¥ 306,946	¥ 331,991	¥ 430,554	$ 4,297
Tobacco Business				
Domestic	220,095	245,388	222,348	2,219
International	71,031	81,085	205,360	2,050
Pharmaceutical Business	(5,057)	(11,207)	(9,644)	(96)
Foods Business	6,325	6,705	667	7
Other Business	8,673	9,331	10,448	104
Elimination/Corporate	5,879	689	1,375	13

Domestic Tobacco: Net sales for our domestic tobacco business totaled ¥3,362.4 billion in the year ended March 31, 2008, compared with ¥3,416.3 billion in the year ended March 31, 2007. Although these sales figures include sales of tobacco products manufactured by foreign tobacco companies and sold by us in Japan, our profit margins on such products are significantly lower than those on our own products, since our role in their sales is limited to distribution.

International Tobacco: Net sales for our international tobacco business totaled ¥2,640 billion in the year ended March 31, 2008, compared with ¥999.7 billion in the year ended March 31, 2007. International tobacco sales include overseas sales of products manufactured by our overseas subsidiaries and sales of tobacco products manufactured in Japan and exported to foreign countries.

Pharmaceutical: Our pharmaceutical business accounted for approximately 0.8% of our net sales in the year ended March 31, 2008, compared with 1.0% in the year ended March 31, 2007. The pharmaceutical business recorded an operating loss of ¥9.6 billion in the business year ended March 31, 2008, compared with an operating loss of ¥11.2 billion in the year ended March 31, 2007. We expect the pharmaceutical business to remain unprofitable for at least the next few years.

Foods: Our foods business accounted for approximately 5.2% of our net sales in the year ended March 31, 2008, compared with 6.0% in the year ended March 31, 2007. Operating income generated by the foods business totaled ¥0.7 billion in the year ended March 31, 2008, compared with ¥6.7 billion in the year ended March 31, 2007.

Other: Our "other business" segment accounted for approximately 0.3% of our net sales in the year ended March 31, 2008 compared with 0.4% in the year ended March 31, 2007. Net sales in this segment have been gradually decreasing in recent years. Operating income generated by this segment totaled ¥10.4 billion in the year ended March 31, 2008, compared with ¥9.3 billion in the year ended March 31, 2007. Currently, we have no plans to expand our "other business" segment. Therefore, we expect sales in this segment to decrease gradually as we review operations.

Results by Geographic Segment

We divide our operations into three geographic segments based on the business territories of the JT Group's main business entities: Japan, Western Europe (including Switzerland, France and Germany) and other regions. Our "other regions" segment comprises primarily Asia (excluding Japan but including China, Hong Kong and Macau), Canada, Russia and the other Commonwealth of Independent States nations, the Middle East and Africa.

Table of Results by Geographic Segment

	Millions of yen			Millions of U.S. dollars
For years ended March 31	2006	2007	2008	2008
Net sales	¥ 4,637,657	¥ 4,769,387	¥ 6,409,727	$ 63,976
Japan	3,709,964	3,718,450	3,711,763	37,047
Western Europe	338,606	353,831	1,678,770	16,756
Other	589,087	697,106	1,019,194	10,173

	Millions of yen			Millions of U.S. dollars
	2006	2007	2008	2008
Operating income	¥ 306,946	¥ 331,991	¥ 430,554	$ 4,297
Japan	228,137	248,482	222,340	2,219
Western Europe	(847)	(18,810)	55,936	558
Other	72,865	101,552	151,398	1,512
Elimination/Corporate	6,791	767	880	8

Japan: Net sales in Japan in the year ended March 31, 2008 decreased by ¥6.7 billion, or 0.2%, from the previous year to ¥3,711.8 billion, as a decline in the sales volume outweighed the positive effects of a rise in unit sales prices based on the revision of retail prices. Operating income in the year ended March 31, 2008 dropped by ¥26.1 billion, or 10.5%, from the previous year to ¥222.3 billion. This was primarily due to increases in sales promotion expenses and raw materials costs, as well as the decline in the sales volume.

Net sales in Japan in the year ended March 31, 2007 increased by ¥8.5 billion, or 0.2%, from the previous year to ¥3,718.5 billion. Despite a sales volume decrease in our domestic tobacco business, revenue increased in line with unit sales price increases based on the revision of retail prices. Operating income for the year ended March 31, 2007 increased by ¥20.3 billion, or 8.9%, to ¥248.5 billion in comparison with the previous fiscal year. This was due primarily to the above mentioned unit sales price increase and cost reductions.

Western Europe: Net sales in Western Europe in the year ended March 31, 2008 increased by ¥1,324.9 billion, or 374.5%, from the previous year to ¥1,678.8 billion, mainly due to the acquisition of Gallaher, which has a large market share in Britain, Ireland, etc. Operating income in the year ended March 31, 2008 totaled ¥55.9 billion, an improvement of ¥74.7 billion from the previous year's loss of ¥18.8 billion.

Net sales in Western Europe for the year ended March 31, 2007 increased by ¥15.2 billion, or 4.5%, from the previous year to ¥353.8 billion. This was primarily due to favorable exchange rates that expanded yen-denominated revenue and thus offset the negative impact of a hike in the tobacco excise tax in Spain. Operating losses in the year ended March 31, 2007 increased by ¥18.0 billion from the previous year to ¥18.8 billion. This was primarily due to the negative effects of Spain's tobacco tax hike and a change in the way of booking sales in Japan of products handled by JT's international tobacco business (such sales, which had previously been booked in the account of our international business, have been booked in the account of the domestic business since May 2005).

Other Regions: Net sales in other regions in the year ended March 31, 2008 increased by ¥322.1 billion, or 46.2%, from the previous year to ¥1,019.2 billion. This was primarily due to the acquisition of Gallaher. Operating income in the year ended March 31, 2008 increased by ¥49.8 billion, or 49.1%, from the previous year to ¥151.4 billion.

Net sales in other regions in the year ended March 31, 2007 increased by ¥108.0 billion, or 18.3%, from the previous year to ¥697.1 billion. This was primarily due to an increase in international tobacco sales by JT International, particularly in countries such as Russia, Iran, Turkey and Ukraine. Operating income in the year ended March 31, 2007 increased by ¥28.7 billion, or 39.4%, from the previous year to ¥101.6 billion.

Outlook of Results for the Year Ending March 31, 2009

It is too early to forecast business results for the fiscal year ending March 31, 2009. However, based on current trends and other factors that we are aware of at this point, we expect a revenue increase and a profit decrease in our business performance. We believe that net sales for JT's domestic tobacco business will fall amid the accelerating decline in overall tobacco demand in Japan, while those for JT's international tobacco business will increase due to the inclusion of JT's full-year results of Gallaher and growth in sales of the GFBs, which will offset the unfavorable effects of exchange rate movements. We also expect net sales for JT's foods business to grow thanks to the inclusion of the Katokichi Group's results.

Meanwhile, we expect our operating income to decline due to factors such as the start of goodwill amortization related to our international tobacco business, following a revision of accounting standards, the additional cost of goodwill amortization stemming from our acquisition of the Katokichi Group and an increase in raw materials costs.

Although we expect our bottom line to benefit from a decrease in the exchange losses we incurred on euro-denominated bonds held by a consolidated subsidiary in the term-end evaluation of the previous year, we expect our net income to decline due to factors such as a decrease in operating profit, an increase in interest payments on borrowings and bonds related to the acquisition of Gallaher, a decrease in profits from the sale of fixed assets, and costs related to the demolition of company-owned residences for employees.

Our actual operating results may differ significantly from those described above as a result of a number of factors including, but not limited to, those discussed in the "Major Risks of Businesses."

Consolidated Business Results

Consolidated Income Statement

	Millions of yen			Millions of U.S. dollars
For years ended March 31	2006	2007	2008	2008
Net sales	¥ 4,637,657	¥ 4,769,387	¥ 6,409,727	$ 63,976
Cost of sales	3,734,074	3,844,768	5,228,926	52,190
Gross profit	903,583	924,619	1,180,801	11,786
Selling, general and administrative expenses	596,637	592,628	750,247	7,489
Operating income	306,946	331,991	430,554	4,297
Other income (expenses), net	(5,953)	5,205	(57,940)	(578)
Income before income taxes and minority interest	300,993	337,196	372,614	3,719
Income taxes	94,896	121,405	128,379	1,281
Income before minority interest	206,097	215,791	244,235	2,438
Minority interest	4,555	5,019	5,533	55
Net income	¥ 201,542	¥ 210,772	¥ 238,702	$ 2,383

Year Ended March 31, 2008 Compared with Year Ended March 31, 2007

Net Sales

Net sales for the year ended March 31, 2008 increased by ¥1,640.3 billion, or 34.4% from the previous year to ¥6,409.7 billion. The net sales amounts indicated below represent the amounts excluding inter-segment transactions.

• Domestic Tobacco Business

Net sales in our domestic tobacco business are comprised of domestic sales (including duty-free sales) of tobacco products manufactured by the JT Group in and outside Japan, domestic sales of products manufactured by foreign tobacco manufacturers and distributed by our subsidiaries as wholesalers and sales in the China, Hong Kong and Macau markets, which are covered by JT's China Division. Net sales for our domestic tobacco business totaled ¥3,362.4 billion in the year ended March 31, 2008, a decrease of ¥53.9 billion, or 1.6%, from the previous year. The sales volume of JT's tobacco products in Japan decreased by 7.2 billion cigarettes, or 4.1%, from the previous year to 167.8 billion cigarettes (see note). The sales volume declined due to the continued decrease in total cigarette demand caused by factors such as: the aging Japanese population, growing consciousness of health risks associated with smoking, tightened smoking regulations, and revision of retail prices based on a hike in the tobacco excise tax implemented in July 2006. Our market share increased by 0.1 percentage points compared with the previous year, to 64.9%. Net sales (excluding excise tax) per 1,000 cigarettes increased by ¥67, or 1.7%, from the previous year to ¥4,057, mainly due to a hike in unit sales prices caused by the revision of retail prices.

Note: Our domestic sales volume includes 3.5 billion cigarettes sold in domestic duty-free markets and in the China, Hong Kong and Macau markets, which are covered by JT's China Division.

• International Tobacco Business

Net sales for our international tobacco business totaled ¥2,640 billion, an increase of ¥1,640.3 billion, or 164.1%, from the previous year. The sales volume of our international tobacco business increased by 145.5 billion cigarettes, or 60.6%, to 385.6 billion cigarettes, thanks mainly to the acquisition of Gallaher and strong demand for GFBs, which we are prioritizing as the driver of our profit growth. The sales volume of GFBs increased by 58 billion cigarettes, or 40%, to 203.2 billion cigarettes. The increase was attributable to brisk sales of Winston in Russia, Ukraine, Turkey and Spain and of Camel in Spain, France, Italy and Russia, as well as the addition to our collection of GFBs of Benson & Hedges and Silk Cut, sold mainly in Britain and Ireland, and LD, Sobranie and Glamour, sold mainly in Russia, Ukraine and Kazakhstan. Sales denominated in foreign currencies are first converted into dollar terms and then into yen terms based on the average exchange rate for the relevant accounting period. Sales in dollar terms increased due to an expansion in the sales volume of GFBs as well as the acquisition of Gallaher. Sales in yen terms increased due in part to the yen's depreciation against the dollar.

The 12-month average exchange rate between the Japanese yen and the U.S. dollar that was used for the conversion of sales for the year ended March 31, 2008 was ¥117.85 to $1.00, compared with ¥116.38 to $1.00 for the year ended March 31, 2007.

• Pharmaceutical Business

Net sales for our pharmaceutical business increased by ¥3.6 billion, or 7.9%, from the previous fiscal year to ¥49.1 billion in the year ended March 31, 2008. A decrease in royalty revenue from Viracept, an anti-HIV drug, was more than offset by the milestone revenue related to the progress made in the development of the anti-dyslipidemia agent JTT-705, licensed to the Roche Group in October 2004, and an increase in Torii Pharmaceutical's sales.

• Foods Business

Net sales for our foods business increased by ¥49.9 billion, or 17.4%, from the previous year to ¥336.4 billion. Sales of beverage products increased by ¥4.2 billion, or 2.2%, to ¥194.9 billion. We have steadily expanded our beverage business, mainly through the vending machine operations of Japan Beverage Inc., a JT subsidiary. Sales of processed foods increased by ¥45.7 billion, or 47.7%, from the previous year to ¥141.5 billion. The impact of food poisoning cases caused by frozen foods contaminated with pesticide was more than offset by the integration of the Katokichi Group.

Cost of Sales

Cost of sales in the year ended March 31, 2008 increased by ¥1,384.2 billion, or 36.0%, from the previous year to ¥5,228.9 billion, mainly due to the inclusion of Gallaher's results in those of our international tobacco business and an increase in raw materials costs in our domestic tobacco business. These factors were partially offset by a decrease in the sales volume of the domestic tobacco business.

Selling, General and Administrative Expenses

Selling, general and administrative expenses in the year ended March 31, 2008 increased by ¥157.6 billion, or 26.6%, from the previous year to ¥750.2 billion. The increase was attributable to the acquisition of Gallaher and an increase in sales promotion expenses in our domestic tobacco business.

Operating Income

As a result of the above factors, operating income in the year ended March 31, 2008 increased by ¥98.6 billion, or 29.7%, from the previous year to ¥430.6 billion. Operating income by business segment was as follows:

• Domestic Tobacco Business

Operating income for our domestic tobacco business in the year ended March 31, 2008 decreased by ¥23.0 billion, or 9.4%, from the previous year to ¥222.3 billion. The decrease was attributable mainly to a decline in the sales volume and increases in sales promotion expenses and raw materials costs.

• International Tobacco Business

Operating income for our international tobacco business in the year ended March 31, 2008 increased by ¥124.3 billion, or 153.3%, from the previous year to ¥205.4 billion, mainly due to the acquisition of Gallaher. A decline in the exchange rate of the Japanese yen against the U.S. dollar contributed to the increase in profit in yen terms.

• Pharmaceutical Business

Our pharmaceutical business recorded an operating loss of ¥9.6 billion in the year ended March 31, 2008, representing an improvement of ¥1.6 billion in the operating balance from the previous year. An increase in R&D expenses, including a down payment made for Keryx's hyperphosphatemia drug, was more than offset by the milestone revenue related to the progress made in the development of the anti-dyslipidemia agent JTT-705, licensed to the Roche Group.

• Foods Business

Operating income for our foods business in the year ended March 31, 2008 decreased by ¥6.0 billion, or 90.1%, from the previous year to ¥0.7 billion. The decrease was attributable to an increase in raw materials costs and goodwill amortization related to the acquisition of the Katokichi Group.

• Others

Operating income for our other businesses in the year ended March 31, 2008 increased by ¥1.1 billion, or 12.0%, from the previous year to ¥10.4 billion mainly due to an increase in real estate rental revenue.

Other Expenses/Income (on a net basis)

We booked other expenses totaling ¥57.9 billion (on a net basis) in the year ended March 31, 2008, a deterioration of ¥63.1 billion from the previous year's net income of ¥5.2 billion. This reflected increases in interest payments on borrowings and bonds related to the acquisition of Gallaher, exchange losses, losses on securities holdings of a consolidated subsidiary, an increase in costs related to the introduction of age-verifying cigarette vending machines, rationalization costs resulting from progress in the integration of our international tobacco business, an improvement in the balance of profits and losses on the sale of fixed assets, and costs related to the withdrawal of some frozen foods products in response to cases of pesticide contamination.

Income before Income Taxes and Minority Interests

As a result of the above factors, income before income taxes and minority interests in the year ended March 31, 2008 increased by ¥35.4 billion, or 10.5%, from the previous year to ¥372.6 billion.

Income Taxes

Income taxes in the year ended March 31, 2008 increased by ¥7.0 billion, or 5.7%, from the previous year to ¥128.4 billion. The actual effective tax rate in the year ended March 31, 2008 decreased by 1.55 points to 34.45%, mainly due to a rise in the proportion of profits earned in overseas markets, where the effective tax rates are relatively low.

Income before Minority Interests

Income before minority interests in the year ended March 31, 2008 increased by ¥28.4 billion, or 13.2%, from the previous year to ¥244.2 billion. Minority interests in the year ended March 31, 2008 increased by ¥0.5 billion, or 10.2%, from the previous year to ¥5.5 billion.

Net Income

As a result of the above factors, net income in the year ended March 31, 2008 increased by ¥27.9 billion, or 13.3%, from the previous year to ¥238.7 billion.

Year Ended March 31, 2007 Compared with Year Ended March 31, 2006

Net Sales

Net sales in the year ended March 31, 2007 decreased by ¥131.7 billion, or 2.8%, from the previous year to ¥4,769.4 billion. The net sales amounts indicated below represent the amounts excluding inter-segment transactions.

• Domestic Tobacco Business

Net sales for our domestic tobacco business are comprised of domestic sales (including duty-free sales) of tobacco products manufactured by the JT Group in and outside Japan, domestic sales of products manufactured by foreign tobacco manufacturers and distributed by our subsidiaries as wholesalers, and sales in the China, Hong Kong and Macau markets, which are covered by JT's China Division. Net sales for our domestic tobacco business in the year ended March 31, 2007 totaled ¥3,416.3 billion, an increase of ¥11.0 billion, or 0.3%, from the previous year. The sales volume of JT's tobacco products in Japan in the year ended March 31, 2007 decreased by 14.5 billion cigarettes, or 7.7%, from the previous year to 174.9 billion cigarettes. The sales volume declined despite the positive effects of the introduction of JTI products such as Camel, Winston and Salem into Japan in May 2005, mainly due to the continued decrease in the total tobacco demand caused by the aging Japanese population, growing consciousness of health risks associated with smoking, tightened smoking regulations and a revision of retail prices based on a hike in the tobacco excise tax implemented in July 2006. The decline also reflected the termination of the licensing agreement for Marlboro products in Japan at the end of April 2005. Our market share decreased by 1.6 percentage points to 64.8%, while net sales (excluding excise tax) per 1,000 cigarettes increased by ¥126, or 3.3%, from the previous year to ¥3,990 due to a hike in unit sales prices caused by the revision of retail prices.

The sales volume of tobacco products in Japan, excluding Marlboro products and including Camel, Winston and Salem (on a like-for-like basis for comparability), in the year ended March 31, 2007 decreased by 11.9 billion cigarettes, or 6.4%, from the previous year, while market share declined 0.7 percentage points. Net sales (excluding excise tax) per 1,000 cigarettes in the year ended March 31, 2007 increased by ¥141, or 3.7%, from the previous year.

Note: Our domestic sales volume includes 3.4 billion cigarettes sold in domestic duty-free markets and in the China, Hong Kong and Macau markets, which are covered by JT's China Division.

• International Tobacco Business

Net sales for our international tobacco business in the year ended March 31, 2007 totaled ¥999.7 billion, an increase of ¥118.5 billion, or 13.4% from the previous year. The sales volume of our international tobacco business in the year ended March 31, 2007 increased by 19.8 billion cigarettes, or 9.0%, to 240.1 billion cigarettes due mainly to strong demand for GFBs, on which we are prioritizing as the driver of our profit growth. The sales volume of GFBs in the year ended March 31, 2007 increased by 15.3 billion cigarettes, or 11.4%, from the previous year to 149.1 billion cigarettes. The increase was attributable to brisk sales of Camel in Italy and France, of Winston in Russia, Spain, Iran, Turkey and Ukraine and of Mild Seven in Russia. The total sales volume and the GFB sales volume of our international tobacco business excluding sales in the Japanese market (on a like-for-like basis for comparability) in the year ended March 31, 2007 increased by 22.7 billion cigarettes, or 10.4%, and by 17.9 billion cigarettes, or 13.6%, from the previous year, respectively. Sales denominated in foreign currencies are first converted into dollar terms and then into yen terms based on the average exchange rate for the relevant accounting period. Sales in dollar terms increased due to an increase in the sales volume of GFBs, among other factors, despite the negative effects of a change in the accounting method used and intense price competition in the Spanish market. Sales in yen terms increased due in part to the yen's depreciation against the dollar.

The 12-month average exchange rate between the Japanese yen and the U.S. dollar that was used for the conversion of sales in the year ended March 31, 2007 was ¥116.38 to $1.00, compared with ¥110.26 to $1.00 in the year ended March 31, 2006.

• Pharmaceutical Business

Net sales for our pharmaceutical business in the year ended March 31, 2007 decreased by ¥3.8 billion, or 7.7%, from the previous year to ¥45.5 billion. Although there were one-time revenues related to the licensing out of a pre-clinical trial stage compound to GlaxoSmithKline and a pre-clinical trial stage antibody drug candidate to MedImmune, royalty revenue from the anti-HIV drug Viracept declined due to increased competition, and sales at subsidiary Torii Pharmaceutical decreased due to the effects of the revision of drug prices and other factors. The decline in net sales also reflected the absence of the one-time revenue from the licensing-out of the anti-HIV agent JTK-303 to Gilead Sciences, which had boosted sales the previous year.

• Foods Business

Net sales for our foods business in the year ended March 31, 2007 increased by ¥8.2 billion, or 2.9%, from the previous year to ¥286.6 billion. Net sales in the beverage sector in the year ended March 31, 2007 increased by ¥5.5 billion, or 2.9%, to ¥190.8 billion due mainly to steady expansion of the beverage vending machine sales channel and increased sales of the Roots brand of canned coffee. Net sales in the processed foods sector in the year ended March 31, 2007 increased by ¥2.7 billion, or 2.9%, to ¥95.8 billion as a result of the expansion of operations for frozen processed foods and chilled processed foods.

• Others

Net sales for our other businesses in the year ended March 31, 2007 decreased by ¥2.1 billion, or 8.9%, from the previous year to ¥21.4 billion, due mainly to a decrease in the number of consolidated subsidiaries as a result of the transfer of their shares to other parties.

Cost of Sales

Cost of sales in the year ended March 31, 2007 increased by ¥110.7 billion, or 3.0%, from the previous year to ¥3,844.8 billion, principally as a result of the hike in the tobacco excise tax implemented in July 2006, the sales volume increase of our international tobacco business, and the expansion of our foods business. The effects of these factors were partially offset by a decrease in the sales volume of our domestic tobacco business, an improvement in the balance of evaluation gains and losses on our holdings of leaf tobacco due to an increase in the use of domestic-grown tobacco, and the impact of job reductions resulting from an early retirement program introduced in the previous year.

Selling, General and Administrative Expenses

Selling, general and administrative expenses in the year ended March 31, 2007, decreased by ¥4.0 billion, or 0.7%, from the previous year to ¥592.6 billion. The decrease was attributable mainly to factors such as: job reductions resulting from the early retirement program introduced in the previous year, a decrease in sales promotion costs due to a change in the method of booking sales in our international tobacco business and a decrease in royalty payments as a result of the termination of the domestic manufacturing license for Marlboro products at the end of April 2005. However, these positive factors were partially offset by a rise in R&D costs for our pharmaceutical business and an increase in amortization expenses due to a change in the amortization periods applied to a portion of the trademarks held by our international tobacco business.

Operating Income

As a result of the above factors, operating income in the year ended March 31, 2007 increased by ¥25.0 billion, or 8.2%, from the previous year to ¥332.0 billion. Operating income by business segment was as follows:

• Domestic Tobacco Business

Operating income for our domestic tobacco business in the year ended March 31, 2007 increased by ¥25.3 billion, or 11.5%, from the previous year to ¥245.4 billion. The increase was mainly attributable to factors such as: a rise in unit sales prices due to the revision of retail prices based on a hike in the tobacco tax implemented in July 2006, job reductions resulting from the early retirement program introduced in the previous year, and an improvement in the balance of evaluation gains and losses on holdings of leaf tobacco due to an increase in the use of domestic-grown tobacco. These positive factors were partially offset by the decrease in sales volume.

• International Tobacco Business

Operating income for our international tobacco business in the year ended March 31, 2007 increased by ¥10.1 billion, or 14.2%, from the previous year to ¥81.1 billion. This was primarily due to brisk sales of the GFBs, which we are prioritizing as the driver of our profit growth. However, the brisk sales of the GFBs were partially offset by the impact of the transfer of JTI's Japan business to our domestic tobacco business in May 2005, intense price competition in the Spanish market, an increase in the cost of investment to boost our production capacity, and a rise in amortization expenses due to a change in the amortization periods applied to a portion of the trademarks held by our international tobacco business. The decline in the exchange rate of the Japanese yen against the U.S. dollar contributed to the increase in profit in yen terms.

• Pharmaceutical Business

Our pharmaceutical business recorded an operating loss of 11.2 billion yen in the year ended March 31, 2007, representing a deterioration of ¥6.1 billion from the previous year in the operating balance. This was attributable mainly to a decrease in net sales and an increase in R&D expenses due to progress in our R&D activities.

• Foods Business

Operating income for our foods business in the year ended March 31, 2007 increased by ¥0.4 billion, or 6.0%, from the previous year to ¥6.7 billion. This was due mainly to an improvement in margins resulting from an expansion of the business. However, the improved margins were partially offset by an increase in fixed costs such as personnel expenses.

• Others

Operating income for our other businesses in the year ended March 31, 2007 increased by ¥0.7 billion, or 7.6%, from the previous year to ¥9.3 billion. The increase was due mainly to a rise in real estate rental revenue. The increased real estate rental revenue was partially offset by a decline in the number of consolidated subsidiaries as a result of the transfer of their shares to other parties.

Other Expenses/Income (on a net basis)

We booked net income of ¥5.2 billion on a net basis in the year ended March 31, 2007, an improvement of ¥11.2 billion from the previous year's net expenses. Although we incurred costs related to currency hedging and bridge loans related to the acquisition of Gallaher, as well as expenses related to the introduction of vending machines with an age verification function, we benefited from an increase in net gains on the sales and disposal of fixed assets, a decrease in impairment losses, and a decrease in business restructuring costs.

Income before Income Taxes and Minority Interests

As a result of the above factors, income before income taxes and minority interests in the year ended March 31, 2007 increased by ¥36.2 billion, or 12.0%, from the previous year to ¥337.2 billion.

Income Taxes

Income taxes in the year ended March 31, 2007 increased by ¥26.5 billion, or 27.9%, from the previous year to ¥121.4 billion. The actual effective tax rate in the year ended March 31, 2007 increased by 4.5 percentage points to 36.0%. This was due mainly to a rise in the effective tax rate applied in Japan due to the termination of tax deductions for IT investments and reduction of tax credit for R&D expenses. Also, the increase was partly a reaction to the previous year's temporary drop, which resulted from the application of deferred tax accounting to some foreign consolidated subsidiaries.

Income before Minority Interests

Income before minority interests in the year ended March 31, 2007 increased by ¥9.7 billion, or 4.7%, from the previous year to ¥215.8 billion. Minority interests in the year ended March 31, 2007 increased by ¥0.5 billion, or 10.2%, from the previous year to ¥5.0 billion.

Net Income

As a result of the above factors, net income in the year ended March 31, 2007 increased by ¥9.2 billion, or 4.6%, from the previous year to ¥210.8 billion.

Liquidity and Capital Resources

In our financial management, we strive to maintain a stable financial base that enables the implementation of capital expenditures, the acquisition of outside resources, and R&D activities in a cost-efficient manner, in order to achieve business expansion without being affected by short-term fluctuations in revenues. We raise the necessary funds principally from cash flows provided by operations, borrowing from financial institutions and the issuance of long-term bonds.

Cash Flows

• Overview

As of March 31, 2007 and March 31, 2008, cash and cash equivalents totaled ¥1,179.5 billion and ¥215.0 billion, respectively.

	Millions of yen			Millions of U.S. dollars
For years ended March 31	2006	2007	2008	2008
Net cash provided by operating activities	¥ 150,343	¥ 435,958	¥ 145,030	$ 1,448
Net cash provided by (used in) investing activities	(26,358)	(149,692)	(1,668,635)	(16,655)
Net cash used in financing activities	(48,135)	(32,635)	519,001	5,180
Effect of exchange rate changes and other	15,205	5,749	40,091	400
Net increase in cash and cash equivalents	91,055	259,380	(964,513)	(9,627)
Cash and cash equivalents at beginning of the period	829,087	920,142	1,179,522	11,773
Cash and cash equivalents at end of the period	¥ 920,142	¥ 1,179,522	¥ 215,009	$ 2,146

Year Ended March 31, 2008 Compared with Year Ended March 31, 2007

Net cash generated by operating activities was ¥145.0 billion in the year ended March 31, 2008, down from ¥436.0 billion in the year ended March 31, 2007. The acquisition of Gallaher has enhanced the ability of our tobacco business to generate cash flows in a stable manner. However, this was more than offset by the one-time factor of an increase in the payment of tobacco excise tax. In the year ended March 31, 2008, we paid 13 months' worth of tobacco excise tax compared with the 11 months' worth paid in the previous year, because the tax payment for the last month of the previous year was carried over to the following year as a result of the last day of that month falling on a bank holiday.

Net cash used in investment activities in the year ended March 31, 2008 was ¥1,668.6 billion compared with ¥149.7 billion for the year ended March 31, 2007. The increase mainly reflected the acquisition of shares in Gallaher Plc and Katokichi Co.

Net cash generated by financing activities was ¥519.0 billion, compared with ¥32.6 billion in net cash used in such activities in the year ended March 31, 2007. This was mainly due to the issuance of bonds and borrowings from banks made for the purpose of raising funds for the acquisition of Gallaher.

Year Ended March 31, 2007 Compared with Year Ended March 31, 2006

Net cash generated by operating activities was ¥436.0 billion in the year ended March 31, 2007, compared with ¥150.3 billion in the year ended March 31, 2006. The increase was mainly due to the ability of our tobacco business to generate cash flows in a stable manner, an increase in tobacco excise taxes payable as the last day of the year ended March 31, 2007 fell on a bank holiday, and a decrease in the payment of retirement benefits related to a voluntary retirement program.

Net cash used in investment activities was ¥149.7 billion in the year ended March 31, 2007, compared with ¥26.4 billion used in the year ended March 31, 2006. An increase in proceeds from the sale and redemption of securities was more than offset by an increase in outlays due to the acquisition of shares in Gallaher.

Net cash used in financing activities was ¥32.6 billion in the year ended March 31, 2007, compared with ¥48.1 billion in the year ended March 31, 2006. The decrease in net cash used was primarily due to short-term borrowing by our subsidiaries, which offset an increase in dividend payments.

Liquidity and Fund Needs

We need liquidity mainly for capital expenditures, working capital, acquisition of outside resources and debt repayments, as well as payments of interest, dividends and income taxes.

• Capital Expenditures

Capital expenditures include outlays on machinery and equipment for factories, trademarks and other tangible and intangible assets necessary for enhancing the productivity of our factories and other facilities, strengthening our competitiveness, and operating in various business fields.

	Millions of yen			Millions of U.S. dollars
For years ended March 31	2006	2007	2008	2008
Capital expenditures	¥ 98,927	¥ 102,147	¥ 129,555	$ 1,293

In the year ended March 31, 2008, we made capital expenditures totaling ¥129.6 billion. In our domestic tobacco business, we spent ¥57.2 billion, mainly on measures to streamline manufacturing processes, strengthen our ability to respond flexibly to supply and demand fluctuations with regard to an increasingly diverse range of products, develop new products and replace vending machines. In our international tobacco business, we invested ¥48.4 billion for the purpose of expanding our production capacity. In our pharmaceutical business, we spent ¥4.3 billion on the construction of production and research facilities, while we invested ¥6.0 billion in our foods business, mainly for enhancing production facilities. In our other businesses, we made capital expenditures of ¥14.8 billion, mainly for real estate development.

For the year ended March 31, 2007, we made capital expenditures totaling ¥102.1 billion. In our domestic tobacco business, we invested ¥55.2 billion, principally to streamline manufacturing processes, strengthen our ability to respond flexibly to supply and demand fluctuations with regard to an increasingly diverse range of products, enhance development of new products and install new vending machines. In our international tobacco business, we invested ¥32.0 billion, mainly to increase our production capacity. In our pharmaceutical business, we invested ¥3.0 billion to improve production and R&D facilities. In our foods business, we invested ¥4.9 billion, primarily to strengthen production facilities. In our other businesses, we invested ¥8.1 billion, principally to improve sales facilities.

In the year ended March 31, 2006, we made capital expenditures totaling ¥98.9 billion. In our domestic and international tobacco businesses, we invested ¥75.0 billion and ¥25.0 billion, respectively, mainly to streamline manufacturing processes, strengthen our ability to respond flexibly to supply and demand fluctuations with regard to an increasingly diverse range of products, and enhance new product development. In our pharmaceutical business, we invested ¥2.1 billion for the improvement of production and R&D facilities and other purposes. In our foods business, we invested ¥4.6 billion, primarily to strengthen production facilities. In our other businesses, we invested ¥19.3 billion, principally for real estate development. The amount of capital expenditures made for our domestic tobacco business includes spending on the acquisition of goodwill in relation to the integration of Japanese operations acquired from foreign tobacco business subsidiaries. The amount of spending on the goodwill, together with the amount of other internal transactions, was excluded from the total capital expenditures.

For the year ending March 31, 2009, we plan to make capital expenditures totaling approximately ¥149.0 billion. In our domestic tobacco business, we plan to invest approximately ¥63.0 billion to improve productivity and reduce costs, while in our international tobacco business, we plan to spend approximately ¥56.0 billion to increase production capacity. We have earmarked approximately ¥3.0 billion in investment for our pharmaceutical business to improve the R&D, approximately ¥23.0 billion for our foods business to enhance production facilities and approximately ¥4.0 billion for our other businesses to carry out real estate development.

Our actual capital expenditures may differ significantly from the planned figures as a result of a number of factors including, but not limited to, those discussed in the "Major Risks of Businesses."

• Working Capital

We need working capital mainly for purchasing raw materials, including leaf tobacco and other inventory items, the payment of salaries and wages, sales expenses, advertising and promotion expenses, tax payments and R&D expenses.

• Acquisition of Outside Resources

As necessary, we may invest in or acquire companies deemed to have the potential to help us diversify our cash flow sources and improve our profitability.

• Dividends

We need sufficient liquidity to make our scheduled dividend payments. As our basic dividend policy, we aim to achieve a consolidated dividend payout ratio of 20% as a first step, with the impact of goodwill amortization excluded from the net income used as a basis for calculating the payout ratio. We will continue to provide a competitive level of return to shareholders in light of the implementation status of our mid- to long-term growth strategies and the outlook of our consolidated financial results, with a view to increasing our dividend payments further.

• Stock Repurchases

A repurchase of our own shares requires cash outlays. In order to repurchase our own shares in a flexible manner, we amended the Articles of Incorporation at the general shareholders' meeting held on June 24, 2004 so that we could make repurchases based on a resolution made by the Board of Directors. As of March 31, 2008, we held 419,920 shares of common stock as treasury stock. We may continue to hold the repurchased shares as treasury stock or use them for share retirement or for other purposes. Stock repurchases provide our management with an additional option for increasing flexibility and speed in capital management in order to adapt to a rapidly changing business environment. We will determine the timing, scale and manner of any further repurchase in an appropriate manner in light of our business needs and market trends.

Capital Resources and Use

We have historically had, and expect to continue to have, significant cash flows from operating activities. Cash provided by operating activities was ¥436.0 billion in the year ended March 31, 2007 and ¥145 billion in the year ended March 31, 2008. We expect that cash generated by operating activities will continue to cover capital expenditures and debt repayments.

For substantial capital needs related to the acquisition of outside resources, we may utilize debt financing, primarily borrowings from financial institutions or the issuance of bonds, as needed. (Please see "Long and Short-term Debt" below.)

Equity financing, including warrants and bonds with warrants, requires the approval of the Minister of Finance under the Japan Tobacco Inc. Law. Revisions to the Japan Tobacco Inc. Law that took effect on April 19, 2002 provide us with the flexibility to issue new shares upon the approval of the Minister of Finance to the extent that the Japanese government retains more than one-third of the outstanding shares in JT. In the future, we may choose to raise capital through stock issuance, which would dilute the value of existing shareholders' equity holdings.

Long and Short-term Debt

• Long-term Debt

Our long-term liabilities consist mainly of long-term debt and liabilities for retirement benefits. As of March 31, 2008, long-term debt was ¥1,118.7 billion, of which bonds accounted for ¥716.7 billion. Our remaining long-term debt (including the current portion) consisted of loans from banks and life insurance companies. Annual interest rates applicable to yen-denominated long-term bank loans outstanding as of March 31, 2007 and 2008 ranged from 1.50% to 5.20% and 0.65% to 6.17%, respectively. Annual interest rates for long-term loans denominated in other currencies ranged from 6.30% to 8.37% for those outstanding as of March 31, 2007 and from 2.35% to 9.20% for those outstanding as of March 31, 2008.

Maturities of long-term debt (including the current portion) as of March 31, 2008 were as follows:

For years ended March 31	Millions of yen	Millions of U.S. dollars
2009	¥ 79,218	$ 791
2010	368,464	3,678
2011	253,254	2,528
2012	194,542	1,942
2013	61,382	613
2014 and thereafter	161,856	1,616
Total	¥ 1,118,716	$ 11,168

As of March 31, 2008, our long-term debt was rated Aa3 by Moody's Investors Service, Inc. and A+ by Standard & Poor's Ratings Services. These ratings are among the highest ratings for international tobacco companies. By maintaining high credit ratings, we can finance large sums of capital at relatively low cost from third parties as needed. Our ability to maintain high ratings is affected by a number of factors such as developments in our major business markets, the quality of execution of our business strategies, and general economic trends in Japan that are beyond our control. The credit ratings are not recommendations for purchasing, selling or holding securities. The ratings could be withdrawn or revised at any time. Each rating should be evaluated separately from other ratings. Under the Japan Tobacco Inc. Law, bonds issued by Japan Tobacco Inc. are secured by statutory preferential rights to the property of Japan Tobacco Inc. These rights give bondholders precedence over unsecured creditors in seeking repayment, with the exception of national and local taxes and other statutory obligations.

In September 2002, in order to diversify our capital resources and enhance our debt financing capabilities, we established a medium-term note program in the Eurobond market that allows us to issue up to $5 billion. We may issue notes under this program, as needed, based on a resolution adopted by the Board of Directors.

• Short-term Debt

We take in short-term loans from banks and other financial institutions. Short-term loans totaled ¥53.7 billion as of March 31, 2007, including ¥53.5 billion in foreign currency-denominated loans, and ¥269.0 billion as of March 31, 2008, including ¥162.4 billion in foreign currency-denominated loans. Annual interest rates applicable to yen denominated short-term bank loans ranged from 1.625% to 1.875% as of March 31, 2007 and from 0.01% to 7.047% as of March 31, 2008. Annual interest rates applicable to short-term loans denominated in other currencies ranged from 4.40% to 16.00% as of March 31, 2007 and from 3.69% to 12.70% as of March 31, 2008.

As a Japanese commercial custom, short-term and long-term bank loans are extended under general agreements stipulating that, under certain circumstances, collateral or guarantees for present and future debts should be provided upon the request of the bank, and that the bank shall have the right, as the debt obligations become due or in the event of default, to offset cash deposits against debts due to it. We have never been requested to provide such collateral or guarantee.

Derivative Transactions

We are exposed to market risks principally from changes in interest rates, foreign exchange rates and equity and debt security prices. Our interest rate risk exposures primarily relate to financing activities. Our foreign currency exposures relate to buying, selling and financing in currencies other than the local currencies of our operations. In order to reduce foreign exchange rate risk and interest rate risk, we use derivative financial instruments including interest rate swaps, foreign currency forward contracts, currency swaps and option contracts. We do not hedge against price fluctuations of debt and equity securities.

We have risk management policies and procedures designed to mitigate the risks arising from the use of derivative financial instruments. We utilize derivatives solely for risk management purposes, and no derivatives are held or issued for trading purposes. As part of our risk management procedures, we identify the specific risks and transactions to be hedged and the appropriate hedging instruments to be used to reduce the risk, and assess the correlation between the hedged risks and the hedging instruments. The effectiveness of our hedging activities is assessed in accordance with our risk management policies and practice manual for hedging transactions.

We are exposed to credit-related risk in the event of default by counterparties to derivative financial instruments. However, we strive to mitigate this risk by limiting counterparties to international financial institutions with high credit ratings deemed to have no significant risk of default.

We use interest rate swaps for the purpose of managing interest rate risk in relation to financing activities. Interest rate swap agreements that qualify for hedge accounting under Japanese GAAP and meet specific matching criteria are not measured at market value, but the differential to be paid or received under the swap agreement is accrued and included in interest expenses.

We use foreign currency forward contracts, currency swaps and currency option contracts for the purpose of managing the risk of fluctuations in foreign exchange rates on our borrowings, bonds and forecasted transactions in foreign currencies. Gains or losses arising from changes in the value of the contracts that qualify for hedge accounting are deferred and recognized in the period in which corresponding losses or gains from transactions being hedged by such contracts are recognized. On the other hand, hedging contracts mainly related to our international tobacco operations do not qualify for hedge accounting and therefore we recognize changes in the value of foreign currency derivative instruments against earnings in the period in which they occur. This could result in gains or losses from fluctuations in exchange rates related to a derivative contract being recognized in a different period from the one in which the gains or losses expected from the underlying forecasted transactions are recognized.

For information about the contract and notional amount of interest rate swaps, foreign currency forward contracts and currency option and other derivative contracts outstanding as of March 31, 2007 and 2008 that did not qualify for hedge accounting, see Note 18 to the audited consolidated financial statements included in this annual report.

Consolidated Balance Sheets

Japan Tobacco Inc. and Consolidated Subsidiaries / March 31, 2007 and 2008

Assets	Millions of yen 2007	Millions of yen 2008	Millions of U.S. dollars (Note 2) 2008
Current assets:			
Cash and cash equivalents (Note 5)	¥ 1,179,522	¥ 215,009	$ 2,146
Short-term investments (Note 6)	6,167	3,830	38
Trade notes and accounts receivable	149,385	325,076	3,245
Inventories (Note 7)	417,276	558,850	5,578
Other current assets (Note 9)	89,997	136,435	1,362
Allowance for doubtful accounts	(1,539)	(4,504)	(45)
Total current assets	1,840,808	1,234,696	12,324
Property, plant and equipment (Note 8):			
Land	131,818	157,381	1,571
Buildings and structures	598,558	679,900	6,786
Machinery, equipment and vehicles	567,495	704,664	7,033
Tools	203,214	220,932	2,206
Construction in progress	28,212	32,120	321
Total	1,529,297	1,794,997	17,917
Accumulated depreciation	(928,861)	(1,031,665)	(10,298)
Net property, plant and equipment	600,436	763,332	7,619
Investments and other assets:			
Investment securities (Note 6)	260,211	97,534	973
Investments in and advances to unconsolidated subsidiaries and associated companies	2,725	35,577	355
Trademarks	154,981	613,497	6,123
Goodwill	360,682	2,106,887	21,029
Deferred tax assets (Note 9)	75,457	110,709	1,105
Other assets	70,962	155,238	1,550
Allowance for doubtful accounts	(1,231)	(30,076)	(300)
Allowance for loss on investments	(368)	(180)	(2)
Total investments and other assets	923,419	3,089,186	30,833
Total	¥ 3,364,663	¥ 5,087,214	$ 50,776

See notes to consolidated financial statements.

Liabilities and Equity	Millions of yen 2007	Millions of yen 2008	Millions of U.S. dollars (Note 2) 2008
Current liabilities:			
Short-term bank loans (Note 8)	¥ 53,706	¥ 269,034	$ 2,685
Current portion of long-term debt (Note 8)	10,550	79,722	796
Tobacco excise taxes payable	337,940	300,614	3,000
Trade notes and accounts payable	129,765	175,370	1,750
Other payable (Note 11)	93,568	79,015	789
Income taxes payable (Note 9)	60,108	71,694	716
Consumption taxes payable	35,756	62,654	625
Other current liabilities (Notes 8, 9 and 11)	91,803	246,293	2,459
Total current liabilities	813,196	1,284,396	12,820
Non-current liabilities:			
Long-term debt (Note 8)	155,013	1,040,539	10,386
Liabilities for retirement benefits (Note 11)	282,377	283,387	2,828
Deferred tax liabilities (Note 9)	43,436	174,395	1,741
Other non-current liabilities (Notes 8 and 11)	46,025	149,868	1,496
Total non-current liabilities	526,851	1,648,189	16,451
Commitments and contingent liabilities (Note 15)			
Equity (Notes 3 (p) and 12):			
Common stock – authorized, 40,000,000 shares; issued, 10,000,000 shares in 2007 and 2008	100,000	100,000	998
Capital surplus	736,400	736,400	7,350
Stock acquisition rights (Note 10)	—	186	2
Retained earnings	1,158,337	1,344,490	13,419
Unrealized gain on available-for-sale securities	33,330	21,339	213
Deferred gain on derivatives under hedge accounting	14,580	220	2
Pension liability adjustment of foreign consolidated subsidiaries	(15,560)	(10,712)	(107)
Foreign currency translation adjustments	7,745	(41,086)	(410)
Treasury stock, at cost – 419,920 shares in 2007 and 2008	(74,578)	(74,578)	(744)
Total	1,960,254	2,076,259	20,723
Minority interests	64,362	78,370	782
Total Equity	2,024,616	2,154,629	21,505
Total	¥ 3,364,663	¥ 5,087,214	$ 50,776

Consolidated Statements of Income

Japan Tobacco Inc. and Consolidated Subsidiaries / Years ended March 31, 2006, 2007 and 2008

	Millions of yen			Millions of U.S. dollars (Note 2)
	2006	2007	2008	2008
Net sales	¥ 4,637,657	¥ 4,769,387	¥ 6,409,727	$ 63,976
Cost of sales	3,734,074	3,844,768	5,228,926	52,190
Gross profit	903,583	924,619	1,180,801	11,786
Selling, general and administrative expenses (Notes 10 and 13)	596,637	592,628	750,247	7,489
Operating income	306,946	331,991	430,554	4,297
Other income (expenses):				
Interest and dividend income	5,910	12,103	13,410	134
Gain on disposition of property, plant and equipment–net	22,881	33,952	57,179	571
Loss on impairment of long-lived assets (Note 16)	(11,439)	(2,712)	(3,825)	(38)
Interest expense (Note 8)	(5,776)	(6,940)	(41,759)	(417)
Write-down of investment securities	(11)	—	(11,154)	(111)
Business restructuring costs (Notes 11 and 16)	(8,009)	—	(6,442)	(64)
Other–net (Note 16)	(9,509)	(31,198)	(65,349)	(653)
Other income (expenses)–net	(5,953)	5,205	(57,940)	(578)
Income Before Income Taxes and Minority Interests	300,993	337,196	372,614	3,719
Income taxes (Note 9):				
Current	49,686	84,481	117,272	1,170
Deferred	45,210	36,924	11,107	111
Total income taxes	94,896	121,405	128,379	1,281
Income Before Minority Interests	206,097	215,791	244,235	2,438
Minority interests	4,555	5,019	5,533	55
Net income	¥ 201,542	¥ 210,772	¥ 238,702	$ 2,383

	Yen			U.S. dollars
	2006	2007	2008	2008
Amounts per share:				
Basic net income (Notes 3 (o) and 19)	¥ 105,085	¥ 22,001	¥ 24,917	$ 249
Diluted net income (Notes 3 (o) and 19)	—	—	24,916	249
Cash dividends applicable to the year (Note 3 (o))	16,000	4,000	4,800	48

See notes to consolidated financial statements.

Consolidated Statements of Changes in Equity

Japan Tobacco Inc. and Consolidated Subsidiaries / Years ended March 31, 2006, 2007 and 2008

	Thousands	Millions of yen											
	Number of shares of common stock	Common stock	Capital surplus	Stock Acquisition Rights (Note 10)	Retained earnings	Unrealized gain on available-for-sale securities	Deferred gain on derivatives under hedge accounting	Pension liability adjustment of foreign consolidated subsidiaries (Note 11)	Foreign currency translation adjustments	Treasury stock	Total	Minority interests	Total equity
Balance, March 31, 2005	2,000	¥100,000	¥736,400	¥ —	¥ 805,927	¥16,888	¥ —	¥ —	¥(86,433)	¥(74,578)	¥1,498,204	¥ —	¥1,498,204
Net income	—	—	—	—	201,542	—	—	—	—	—	201,542	—	201,542
Minimum pension liability adjustment of foreign consolidated subsidiaries	—	—	—	—	(5,981)	—	—	—	—	—	(5,981)	—	(5,981)
Appropriations:													
Cash dividends paid (¥15,000 per share)	—	—	—	—	(28,740)	—	—	—	—	—	(28,740)	—	(28,740)
Bonuses to directors and corporate auditors	—	—	—	—	(236)	—	—	—	—	—	(236)	—	(236)
Net increase in unrealized gain on available-for-sale securities	—	—	—	—	—	18,644	—	—	—	—	18,644	—	18,644
Net change in foreign currency translation adjustments	—	—	—	—	—	—	—	—	79,079	—	79,079	—	79,079
Balance, March 31, 2006	2,000	100,000	736,400	—	972,512	35,532	—	—	(7,354)	(74,578)	1,762,512	—	1,762,512
Reclassified balance as of March 31, 2006 (Note 3 (p))	—	—	—	—	—	—	—	—	—	—	—	57,561	57,561
Stock split (Notes 12 and 19)	8,000	—	—	—	—	—	—	—	—	—	—	—	—
Net income	—	—	—	—	210,772	—	—	—	—	—	210,772	—	210,772
Minimum pension liability adjustment of foreign consolidated subsidiaries	—	—	—	—	9,818	—	—	—	—	—	9,818	—	9,818
Appropriations:													
Cash dividends paid (¥9,000 per share) for year ended 2006	—	—	—	—	(17,244)	—	—	—	—	—	(17,244)	—	(17,244)
Cash dividends paid (¥1,800 per share) for interim of year ended 2007	—	—	—	—	(17,244)	—	—	—	—	—	(17,244)	—	(17,244)
Bonuses to directors and corporate auditors	—	—	—	—	(197)	—	—	—	—	—	(197)	—	(197)
Adjustment to retained earnings for change in the number of equity method affiliates	—	—	—	—	(80)	—	—	—	—	—	(80)	—	(80)
Net changes in the year	—	—	—	—	—	(2,202)	14,580	(15,560)	15,099	—	11,917	6,801	18,718
Balance, March 31, 2007	10,000	¥100,000	¥736,400	¥ —	¥1,158,337	¥33,330	¥14,580	¥(15,560)	¥ 7,745	¥(74,578)	¥1,960,254	¥64,362	¥2,024,616

Consolidated Statements of Changes in Equity

Japan Tobacco Inc. and Consolidated Subsidiaries / Years ended March 31, 2006, 2007 and 2008

	Thousands	Millions of yen											
	Number of shares of common stock	Common stock	Capital surplus	Stock Acquisition Rights (Note 10)	Retained earnings	Unrealized gain on available-for-sale securities	Deferred gain on derivatives under hedge accounting	Pension liability adjustment of foreign consolidated subsidiaries (Note 11)	Foreign currency translation adjustments	Treasury stock	Total	Minority interests	Total equity
Balance, March 31, 2007	10,000	¥100,000	¥736,400	¥ —	¥1,158,337	¥ 33,330	¥ 14,580	¥(15,560)	¥ 7,745	¥(74,578)	¥1,960,254	¥64,362	¥2,024,616
Adoption of FIN 48 (Note 3 (s))	—	—	—	—	(10,548)	—	—	—	—	—	(10,548)	—	(10,548)
Net income	—	—	—	—	238,702	—	—	—	—	—	238,702	—	238,702
Appropriations:													
Cash dividends paid (¥4,400 per share)	—	—	—	—	(42,152)	—	—	—	—	—	(42,152)	—	(42,152)
Adjustment to retained earnings for change in the number of equity method affiliates	—	—	—	—	151	—	—	—	—	—	151	—	151
Net changes in the year	—	—	—	186	—	(11,991)	(14,360)	4,848	(48,831)	—	(70,148)	14,008	(56,140)
Balance, March 31, 2008	10,000	¥100,000	¥736,400	¥186	¥1,344,490	¥ 21,339	¥ 220	¥(10,712)	¥(41,086)	¥(74,578)	¥2,076,259	¥78,370	¥2,154,629

	Millions of U.S. dollars (Note 2)											
	Common stock	Capital surplus	Stock Acquisition Rights (Note 10)	Retained earnings	Unrealized gain on available-for-sale securities	Deferred gain on derivatives under hedge accounting	Pension liability adjustment of foreign consolidated subsidiaries (Note 11)	Foreign currency translation adjustments	Treasury stock	Total	Minority interests	Total equity
Balance, March 31, 2007	$ 998	$ 7,350	$ —	$ 11,561	$ 333	$ 145	$ (155)	$ 77	$ (744)	$ 19,565	$ 643	$ 20,208
Adoption of FIN 48 (Note 3 (s))	—	—	—	(106)	—	—	—	—	—	(106)	—	(106)
Net income	—	—	—	2,383	—	—	—	—	—	2,383	—	2,383
Appropriations:												
Cash dividends paid ($44 per share)	—	—	—	(421)	—	—	—	—	—	(421)	—	(421)
Adjustment to retained earnings for change in the number of equity method affiliates	—	—	—	2	—	—	—	—	—	2	—	2
Net changes in the year	—	—	2	—	(120)	(143)	48	(487)	—	(700)	139	(561)
Balance, March 31, 2008	$ 998	$ 7,350	$ 2	$ 13,419	$ 213	$ 2	$ (107)	$ (410)	$ (744)	$ 20,723	$ 782	$ 21,505

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Japan Tobacco Inc. and Consolidated Subsidiaries / Years ended March 31, 2006, 2007 and 2008

	Millions of yen			Millions of U.S. dollars (Note 2)
	2006	2007	2008	2008
Operating Activities:				
Income before income taxes and minority interests	¥ 300,993	¥ 337,196	¥ 372,614	$ 3,719
Adjustments for:				
Income taxes paid	(59,015)	(57,185)	(132,725)	(1,325)
Depreciation and amortization other than goodwill	124,855	130,106	167,658	1,673
Amortization of goodwill	1,590	2,537	3,883	39
Gain on disposition of property, plant and equipment	(22,881)	(33,952)	(57,179)	(571)
Loss on impairment of long-lived assets	11,439	2,712	3,825	38
Write-down of investment securities	11	—	11,154	111
Change in assets and liabilities:				
Decrease (increase) in trade notes and accounts receivable	765	(9,476)	47,485	474
Decrease (increase) in inventories	44,091	(6,171)	27,115	271
Increase (decrease) in tobacco excise taxes payable	(13,973)	160,020	(213,134)	(2,127)
Increase (decrease) in trade notes and accounts payable	20,260	(12,878)	(16,650)	(166)
Decrease in other payable	(125,689)	(22,088)	(39,956)	(399)
Decrease in liabilities for retirement benefits	(6,591)	(21,164)	(4,932)	(49)
Decrease in non-current other payable	(87,377)	(43,142)	(5,778)	(57)
Other — net	(38,135)	9,443	(18,350)	(183)
Total adjustments	(150,650)	98,762	(227,584)	(2,271)
Net cash provided by operating activities	150,343	435,958	145,030	1,448
Investing Activities:				
Purchases of short-term investments	(146,467)	(332,975)	(2,443)	(24)
Proceeds from sale and redemption of short-term investments	122,118	386,816	6,846	68
Purchases of investment securities	(2,734)	(158,385)	(22,563)	(225)
Proceeds from sale and redemption of investment securities	4,342	5,345	2,153	21
Purchases of property, plant and equipment	(82,850)	(96,717)	(124,832)	(1,246)
Proceeds from sale of property, plant and equipment	82,147	57,094	83,336	832
Purchases of trademarks and other assets	(8,966)	(7,928)	(6,831)	(68)
Purchases of shares of newly consolidated subsidiaries, net of cash acquired (Note 4)	(1,400)	(4,085)	(1,608,081)	(16,050)
Other — net	7,452	1,143	3,780	37
Net cash used in investing activities	(26,358)	(149,692)	(1,668,635)	(16,655)
Financing Activities:				
Net increase in short-term bank loans	1,552	18,571	136,063	1,358
Proceeds from long-term debt	—	—	378,863	3,782
Repayments of long-term debt	(19,474)	(19,840)	(90,199)	(900)
Proceeds from issuance of common stock to minority shareholders	—	4,928	—	—
Proceeds from issuance of bonds	—	—	149,723	1,494
Payment for redemption of bonds	—	—	(10,000)	(100)
Dividends paid	(28,740)	(34,488)	(42,152)	(421)
Dividends paid to minority shareholders	(1,468)	(1,474)	(2,890)	(29)
Other — net	(5)	(332)	(407)	(4)
Net cash provided by (used in) financing activities	(48,135)	(32,635)	519,001	5,180
Foreign Currency Translation Adjustments on Cash and Cash Equivalents	15,205	5,749	40,091	400
Net Increase (decrease) in Cash and Cash Equivalents	91,055	259,380	(964,513)	(9,627)
Cash and Cash Equivalents, Beginning of Year	829,087	920,142	1,179,522	11,773
Cash and Cash Equivalents, End of Year	¥ 920,142	¥ 1,179,522	¥ 215,009	$ 2,146

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Japan Tobacco Inc. and Consolidated Subsidiaries

1. Business

Japan Tobacco Inc. ("JT") is a joint stock corporation (kabushikikaisya) incorporated under the corporate law of Japan (the "Corporate Law") pursuant to the Japan Tobacco Inc. Law (the "JT Law"). JT and its consolidated subsidiaries (the "Group") operate primarily in the domestic and international tobacco businesses, the pharmaceutical business and the foods business. In the Group's domestic and international tobacco businesses, the Group develops, manufactures, distributes, and sells tobacco products, primarily cigarettes. In the Group's pharmaceutical business, the Group develops, manufactures and sells pharmaceutical products. In the Group's foods business, the Group develops, manufactures and sells processed foods, and develops and sells beverages. The Group's other business segment includes its commercial real estate and other operations.

2. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in Japan ("Japanese GAAP") and in accordance with the provisions set forth in the Japanese Financial Instruments and Exchange Law (Formerly, The Japanese Securities and Exchange Law) and its related accounting regulations, which are different in certain respects from application, and disclosure requirements of accounting principles generally accepted in the United States of America ("U.S. GAAP") and International Financial Reporting Standards. In the case of most foreign consolidated subsidiaries, their financial statements are prepared in conformity with U.S. GAAP (see Note 3 "Summary of Significant Accounting Policies" (n) Foreign Consolidated Subsidiaries) and are included in the consolidated financial statements on that basis.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. In addition, the notes to the consolidated financial statements include information which is not required under Japanese GAAP but is presented herein as additional information. Certain reclassifications of previously reported amounts have been made to conform with classifications for the year ended March 31, 2008.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which JT is incorporated and operates. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥100.19 to $1, the rate of exchange at March 31, 2008. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

3. Summary of Significant Accounting Policies

a) Consolidation

The consolidated financial statements as of March 31, 2008 include the accounts of JT and its 299 significant (157 as of March 31, 2006 and 153 as of March 31, 2007) subsidiaries. Consolidation of the remaining unconsolidated subsidiaries would not have had a material effect on the accompanying consolidated financial statements. Most foreign consolidated subsidiaries have a December 31 fiscal year-end, which differs from the March 31 fiscal year-end of JT. Any necessary adjustments for the three-month period are made for consolidation purposes.

Under the control or influence concept, those companies in which JT, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Group has the ability to exercise significant influence are accounted for by the equity method.

Investments in 25 material associated companies as of March 31, 2008 (11 as of March 31, 2006 and 2007) are accounted for by the equity method. The equity method is not applied to account for the investments in unconsolidated subsidiaries and the remaining associated companies, since the effect on the accompanying consolidated financial statements would not have been material. Investments in the unconsolidated subsidiaries and the remaining associated companies are stated at cost (see (c) Securities).

All significant inter-company balances and transactions have been eliminated in consolidation. All material unrealized gains resulting from inter-company transactions have been eliminated.

The excess of the cost of the Group's investments in consolidated subsidiaries over its equity in (prior to April 1, 1999) or the fair value of (from April 1, 1999) the net assets purchased at the date of acquisition is recorded as goodwill. Goodwill, except for that recorded at JT International S.A. and other consolidated subsidiaries of JT International Holding B.V. ("JT International"), a wholly-owned subsidiaries of JT (see (n) Foreign Consolidated Subsidiaries), is amortized on a straight-line basis over five to twenty years. Such amortization expense is included in selling, general and administrative expenses. However, insignificant goodwill is charged to income when incurred.

b) Cash Equivalents

Cash equivalents are all short-term, highly liquid investments that are convertible to known amounts of cash and that have original maturities of three months or less.

c) Securities

The Group's securities are classified as held-to-maturity debt securities or available-for-sale securities, depending on management's holding intent. Held-to-maturity debt securities are reported at amortized cost. Available-for-sale marketable securities are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of equity.

The cost of available-for-sale marketable securities sold is determined based on the moving-average method. In addition, compound financial instruments, including embedded derivatives which cannot be measured separately, are reported at fair value in aggregate, with these gains and losses reported in the consolidated statements of income. Non-marketable available-for-sale securities are stated at cost determined by the moving-average method. For significant impairment in value that is judged unrecoverable, carrying amounts of securities are reduced to fair value, with a resulting charge to income. An allowance for loss on investments is recorded to provide for the loss on investments in certain non-marketable equity accounted for by the cost method and is determined based on the respective financial condition of the investees.

d) Inventories

Inventories are stated at cost determined principally by the average cost method. In addition, leaf tobacco held by JT was subject to annual devaluation prior to April 1, 2008. JT no longer applies annual devaluation for its leaf inventories from the year ended March 31, 2008. (see (s) Accounting Change and Note 7 "Inventories").

e) Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is generally computed using the declining-balance method while the straight-line method is applied to buildings acquired after April 1, 1998. The useful lives of buildings and structures, and machinery, equipment and vehicles are principally from 38 to 50 years and 8 years, respectively.

f) Impairment of Long-Lived Assets

In August 2002, the Business Accounting Council issued a Statement of Opinion, "Accounting for Impairment of Fixed Assets", and in October 2003 the Accounting Standards Board of Japan ("ASBJ") issued ASBJ Guidance No.6, "Guidance for Accounting Standard for Impairment of Fixed Assets". These new pronouncements are effective for fiscal years beginning on or after April 1, 2005. JT and its domestic subsidiaries (the "Domestic Group") adopted the new accounting standard for impairment of fixed assets as of April 1, 2005.

The Domestic Group reviews its long-lived assets for impairment whenever events or changes in circumstance indicate the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group.

The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

g) Intangible Assets

Trademarks are carried at cost less accumulated amortization, which is calculated by the straight-line method principally over 10 years.

h) Income Taxes

The provision for income taxes is computed based on the pretax income or loss included in the consolidated statements of income. The asset and liability approach is used to recognize deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities, and tax operating loss and other credit carry-forwards. Deferred taxes are measured by applying currently enacted tax laws to the temporary differences, tax operating loss and other credit carry-forwards. A valuation allowance is provided for any portion of the deferred tax assets where it is considered more likely than not that they will not be realized.

i) Liabilities for Retirement Benefits

(1) Employees' retirement benefits

JT has an unfunded severance indemnity plan and a cash balance pension plan (the "Pension Plans") as well as a defined contribution plan, which cover substantially all of its employees. Its consolidated subsidiaries principally have unfunded severance indemnity plans and/or non-contributory defined pension plans.

The Pension Plans and the subsidiaries' plans are stated based on actuarially estimated retirement benefit obligations, considering the estimated fair value of plan assets at each balance sheet date. Certain domestic subsidiaries apply a simplified method, under which retirement benefit obligations are recorded based on the amount required if all employees terminated their employment as of the balance sheet date. Contributions to the defined contribution plan are charged to expenses when they are paid or accrued.

Liabilities for retirement benefits to directors and corporate auditors of certain domestic subsidiaries are provided at the amount which would be required if all directors and corporate auditors retired at each balance sheet date.

(2) Obligations under the Public Official Mutual Assistance Association Law

As a formerly wholly government-owned company, JT is obligated by the Public Official Mutual Assistance Association Law to reimburse the Japanese government for pension expenses incurred each year by the government for former employees of Japan Tobacco and Salt Public Corporation ("JTSPC"), JT's predecessor entity, and others for their services during certain periods before July 1, 1956. Such obligations are recognized as liabilities at their present value using the actuarially determined computation method.

j) Leases

All leases are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that deemed to have transferred ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the lessee's financial statements.

k) Appropriations of Retained Earnings

Appropriation of retained earnings are reflected in the financial statements for the following year upon shareholders' approval.

l) Foreign Currency Transactions

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the rates prevailing at each balance sheet date. The exchange gains or losses from translation are recognized in the consolidated statements of income to the extent that hedging derivative financial instruments for foreign currency transactions do not qualify for hedge accounting (see (m) Derivatives).

All assets and liabilities of foreign consolidated subsidiaries are translated into Japanese yen at the exchange rate at each subsidiary's respective fiscal year end. All revenue and expense accounts are translated at average exchange rates during each subsidiary's respective fiscal year.

Differences arising from such translation are shown as "Foreign currency translation adjustments" and "Minority interests" in a separate component of equity.

m) Derivatives

All derivatives, except for certain foreign exchange forward contracts, foreign currency option contracts, foreign currency swap contracts and interest rate swap contracts described below, are recognized as either assets or liabilities and measured at fair value, and gains or losses on derivative transactions are recognized in the consolidated statements of income.

For derivatives which qualify for hedge accounting because of high correlation and effectiveness between the hedging instruments and the hedged items, gains or losses on derivatives are deferred until the corresponding hedged items are recognized in earnings.

JT's trade payables that are denominated in foreign currencies and have been hedged by foreign exchange forward contracts are translated at the foreign exchange rate stipulated in the contracts.

Interest rate swaps that qualify for hedge accounting and meet specific matching criteria are not remeasured at market value, but the differential to be paid or received under the swap agreements are accrued and included in interest expense or income.

n) Foreign Consolidated Subsidiaries

JT International and other foreign consolidated subsidiaries principally maintain their accounting records in conformity with U.S. GAAP. The significant accounting policies, which are different from JT's policies, are as follows:

(1) Inventories

Inventories are generally stated at the lower of cost or market, cost being determined by the first-in, first-out method or average cost.

(2) Property, plant and equipment

Depreciation of property, plant and equipment is generally computed using the straight-line method over the estimated useful lives of the respective assets.

(3) Goodwill and trademarks

Goodwill recorded at JT International is not subject to amortization but is tested for impairment at least annually. Trademarks are principally amortized using straight-line method over 20 years.

(4) Retirement benefit pension plans

According to FASB statement 158 "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB statements No. 87, 88, 106 and 132(R)" ("FASB 158"), the difference of retirement benefits obligation and fair value of plan assets is recognized on the consolidated balance sheets as of March 31, 2007 and 2008 as assets/liabilities.

Unrecognized net actuarial loss and prior service cost, net of applicable taxes, is recorded as a part of equity as pension liability adjustment of foreign consolidated subsidiaries.

Prior to the adoption of FASB 158, if the liability for retirement benefits already recognized was less than the unfunded accumulated benefit obligation, an additional minimum liability was recognized.

The additional minimum liability was charged directly to retained earnings, if such amount exceeded unrecognized prior service cost, net of any tax benefits.

(5) Derivatives

All derivatives are used to hedge the exposure to foreign exchange risk and interest rate risk are recognized as either assets or liabilities in the balance sheet and measured at fair value.

Changes in the fair value of derivatives are recorded in current earnings for each fiscal year.

o) Per Share Information

Each share of common stock was split into five shares on April 1, 2006.

Basic net income per share is computed by dividing net income available to common shareholders, by the weighted-average number of common shares outstanding in each period, which were 1,916,016 shares for the year ended March 31, 2006, not retroactively adjusted for the stock split, and 9,580,080 shares for the years ended March 31, 2007 and 2008 (see Note 19 "Net Income Per Share").

Diluted net income per share was not disclosed for the years ended March 31, 2006 and 2007 because there were no potentially dilutive common shares that were outstanding for each period.

Diluted net income per share for the year ended March 31, 2008 reflects the potential dilution that could occur if stock acquisition rights were exercised (see Note 19 "Net Income Per Share").

Cash dividends per share presented in the Consolidated Statements of Income are dividends applicable to the respective years including dividends to be paid after the end of the year, not retroactively adjusted for stock split.

p) Presentation of Equity

On December 9, 2005, the ASBJ published a new accounting standard for presentation of equity.

Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of equity. Such items include minority interests and any deferred gains or losses on derivatives accounted for under hedge accounting. This standard is effective for fiscal years ended on or after May 1, 2006.

The consolidated balance sheets as of March 31, 2007 and 2008 were presented in line with this new accounting standards. Japanese GAAP does not permit the restatement of prior years to reflect the change by this standard.

q) Stock Option

The ASBJ Statement No.8, "Accounting Standard for Stock Options" and related guidance are applicable to stock options granted on and after May 1, 2006.

This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the balance sheet, the stock option is presented as a stock acquisition right as a separate component of equity until exercised. JT has applied the accounting standard for stock options to those granted on and after May 1, 2006.

r) Bonuses to Directors and Cooperate Auditors

Bonuses to directors and cooperate auditors are accrued at the year end to which such bonuses are attributable.

s) Accounting Change

The adoption of new accounting standards

Accounting Standard for Measurement of Inventories –

On July 5, 2006, the ASBJ issued ASBJ Statement No.9, "Accounting Standard for Measurement of Inventories", which is effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted.

This statement requires that inventories held for sale in the ordinary course of business be measured at the lower of cost or net selling value, which is defined as the selling price less additional estimated manufacturing costs and estimated direct selling expenses. The replacement cost may be used in place of the net selling value, if appropriate.

The Domestic Group adopted the new accounting standard for measurement of inventories for the year ended March 31, 2008. The effect of adoption of this new accounting standard has no material impact on operating income and income before income taxes and minority interests.

Accounting for Uncertainty in Income Taxes of Foreign Consolidated Subsidiaries –

As for JT's main foreign consolidated subsidiaries, FIN48 "Accounting for Uncertainty in Income taxes (an interpretation of FASB statement No 109") that became effective for periods commencing after December 15, 2006, prescribes new rules governing the recognition and measurement of uncertain income tax positions. This interpretation requires to measure a liability if it is "more likely than not" that a position to be sustained, when judged purely on its technical merits.

JT's main foreign consolidated subsidiaries recognized cumulative effect of applying the provision of FIN 48 as an adjustment to the opening balance of retained earning for the year ended March 31, 2008.

t) New Accounting Pronouncements

Lease Accounting – On March 30, 2007, the ASBJ issued ASBJ Statement No.13, "Accounting Standard for Lease Transactions", which revised the existing accounting standard for lease transactions issued on June 17, 1993. The revised accounting standard for lease transactions is effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted for fiscal years beginning on or after April 1, 2007.

Lessee

Under the existing accounting standard, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, however, other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the note to the lessee's financial statements. The revised accounting standard requires that all finance lease transactions shall be capitalized recognizing lease assets and lease obligations in the balance sheet.

Lessor

Under the existing accounting standard, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, however, other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the note to the lessor's financial statements. The revised accounting standard requires that all finance leases that deem to transfer ownership of the leased property to the lessee shall be recognized as lease receivables, and all finance leases that deem not to transfer ownership of the leased property to the lessee shall be recognized as investments in lease.

Unification of Accounting Policies Applied to Foreign Subsidiaries for the Consolidated Financial Statements –

Under Japanese GAAP, a company currently can use the financial statements of its foreign subsidiaries which have been prepared in accordance with generally accepted accounting principles in their respective jurisdictions for its consolidation process unless they are clearly unreasonable. On May 17, 2006, the ASBJ issued ASBJ Practical Issues Task Force (PITF) No.18, "Practical Solution on Unification of Accounting Policies Applied to Foreign Subsidiaries for the Consolidated Financial Statements". The new standard prescribes: 1) the accounting policies and procedures applied to a parent company and its subsidiaries for similar transactions and events under similar circumstances should in principle be unified for the preparation of the consolidated financial statements, 2) financial statements prepared by foreign subsidiaries in accordance with either International Financial Reporting Standards or the generally accepted accounting principles in the United States tentatively may be used for the consolidation process, 3) however, the following items should be adjusted in the consolidation process so that net income is accounted for in accordance with Japanese GAAP unless they are not material:

1. Amortization of goodwill
2. Actuarial gains and losses of defined benefit plans recognized outside profit or loss
3. Capitalization of intangible assets arising from development phases
4. Fair value measurement of investment properties, and the revaluation model for property, plant and equipment, and intangible assets
5. Retrospective application when accounting policies are changed
6. Accounting for net income attributable to a minority interest

The new task force is effective for fiscal years beginning on or after April 1, 2008 with early adoption permitted.

4. Business Combinations

I. Via consolidated subsidiary JTI (UK) MANAGEMENT LTD, on April 18, 2007, JT acquired the outstanding shares of the Gallaher Group Plc (now known as "Gallaher Group Ltd.") of the United Kingdom through an acquisition method under English law known as a scheme of arrangement, converting Gallaher Group Plc into a wholly owned subsidiary.

As the direct acquirer of the outstanding shares in Gallaher Group Plc was JTI (UK) MANAGEMENT LTD, which follows generally accepted accounting principles and practices in the United States ("U.S. GAAP"), the business combination was accounted for under the purchase method, based on FASB Statement No. 141.

In August 2007, JT reorganized JTI (UK) MANAGEMENT LTD into a subsidiary of JT International Holding B.V., a consolidated subsidiary of JT.

1. The following are the name of the acquired company, business contents, main reasons for business combination, the date of business combination, the legal form of the business combination, and ratio of voting rights acquired.
   (1) The name of acquired company: Gallaher Group Plc
   (2) Business contents: Manufacturing and selling of tobacco products
   (3) Main reasons for business combination
   Through the acquisition of the Gallaher Group Plc, JT could expand its business and enjoy economies of scale, build a well-balanced and competitive brand portfolio in each market and price segmentation, strengthen technology/distribution infrastructures, and synergize business growth expected by the business combination through effective business operations.
   (4) Date of business combination: April 18, 2007
   (5) Legal form of the business combination: The issued shares were acquired for cash.
   (6) Ratio of voting rights acquired: 100%

2. Period of operating results included in the consolidated financial statements:

   As the closing date of the accounting period of the acquired company is set on December 31, operating results from April 18, 2007 to December 31, 2007 for this company have been included in the current consolidated statement of income.

3. Acquisition costs

The acquisition was conducted for 7.5 billion sterling pounds in cash.

4. Amount of goodwill recognized, basis for recognition and method and period for amortization of goodwill
   (1) Amount of goodwill recognized:
   ¥1,721,368 million ($17,181 million)
   (2) Basis for recognition:
   Goodwill was recognized because the acquisition cost of the company exceeded the net value allocated to the assets acquired and liabilities assumed.
   (3) Method and period for amortization of goodwill:
   In accordance with FASB Statement No. 142, "Goodwill and Other Intangible Assets," the amount of goodwill recognized shall not be amortized. Rather, the decision of whether to recognize impairment shall be made once each year, or each time an event occurs indicating that the fair value of goodwill has fallen below its book value.

5. Principal details of assets acquired and liabilities assumed on the day of the business combination are as follows:

Current assets:	¥410,572 million	($4,098 million)
Non-current assets:	2,531,125 million	(25,263 million)
Total assets:	¥2,941,697 million	($29,361 million)
Current liabilities:	¥405,712 million	($4,049 million)
Non-current liabilities:	749,479 million	(7,481 million)
Total liabilities:	¥1,155,191 million	($11,530 million)

Regarding allocation of acquisition costs, the major intangible asset that was acquired in addition to goodwill was ¥523,263 million ($5,223 million) in trademarks. This asset has an amortization period of 20 years.

Note: Amount of yen mentioned above is translated at the exchange rate as of the business combination date. The amount of goodwill (¥1,791,189 million ($17,878 million)) included in non-current assets differs from the amount of goodwill which is described in consolidated balance sheet.

II. On January 8, 2008, JT converted Katokichi Co., Ltd. into a subsidiary through tender offer for Katokichi shares.

In addition, JT acquired all of Katokichi's voting rights on April 18, 2008.

1. The following are the name of the acquired company, business contents, main reasons for business combination, the date of business combination, the legal form of the business combination, and ratio of voting rights acquired.
   (1) The name of acquired company: Katokichi Co., Ltd.
   (2) Business contents: The main business contents are manufacturing and selling of frozen foods and frozen fishery products. The other business contents are a distribution business incidental to the main business and a service business such as a hotel and restaurant management.
   (3) Main reasons for business combination
   JT anticipated that the Group could realize further expansion of its business value because the Group would enjoy the effect of mutual reinforcement and management resources synergy through the business combination.
   (4) Date of business combination: January 8, 2008
   (5) Legal form of the business combination: The issued shares were acquired for cash.
   (6) Ratio of voting rights acquired: 93.89%
2. Period of operating results included in the consolidated financial statements From January 1, 2008 to March 31, 2008
3. Acquisition costs

   The acquisition was conducted for ¥108.6 billion ($1,084 million) in cash.
4. Amount of goodwill recognized, basis for recognition, and method and period for amortization of goodwill
   (1) Amount of goodwill recognized
   ¥41,885 million ($418 million)
   (2) Basis for recognition
   Goodwill was recognized because the acquisition cost of the company exceeded the net value allocated to the assets acquired and liabilities assumed.
   (3) Method and period for amortization of goodwill
   Method for amortization: straight-line method
   Period for amortization: five years
5. Principal details of assets acquired and liabilities assumed on the day of the business combination are as follows:

Current assets:	¥89,279 million	($891 million)
Non-current assets:	136,995 million	(1,367 million)
Total assets:	¥226,274 million	($2,258 million)
Current liabilities:	¥84,813 million	($847 million)
Non-current liabilities:	24,532 million	(244 million)
Total liabilities:	¥109,345 million	($1,091 million)

	Millions of yen	Millions of U.S. dollars
Assets acquired and liabilities assumed in acquisition of shares of Gallaher Group Plc and Katokichi Co., Ltd. mainly consist of purchase of shares of newly consolidated subsidiaries, net of cash acquired in 2008):		
Current assets	¥ 499,851	$ 4,989
Non-current assets	835,046	8,335
Goodwill	1,833,074	18,296
Current liabilities	(490,525)	(4,897)
Non-current liabilities	(774,011)	(7,726)
Minority interest	(11,530)	(115)
Foreign currency translation adjustment	(47,824)	(477)
Acquisition price in 2007	(166,312)	(1,660)
Acquisition price in 2008	1,677,769	16,745
Cash and cash equivalents	(69,680)	(695)
Payments for purchases of shares of subsidiaries	1,608,089	16,050

5. Cash and Cash Equivalents

Cash and cash equivalents included gensaki transactions, securities purchased under repurchase agreements. The fair value of such securities received as collateral from the counterparty at March 31, 2007 was ¥51,970 million.

6. Short-Term Investments and Investment Securities

Short-term investments and investment securities at March 31, 2007 and 2008 consisted of the following:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Short-term investments:			
Time deposits	¥ 2,216	¥ 1,392	$ 14
Government and Corporate bonds	3,720	2,438	24
Trust fund investments and other	231	—	—
Total	¥ 6,167	¥ 3,830	$ 38
Investment securities:			
Equity securities	¥ 246,713	¥ 74,974	$ 748
Government and Corporate bonds	3,146	4,366	43
Trust fund investments and other	10,352	18,194	182
Total	¥ 260,211	¥ 97,534	$ 973

The costs and aggregate fair values of marketable securities at March 31, 2007 and 2008 were as follows:

	Millions of yen			
	2007			
	Cost	Unrealized gain	Unrealized loss	Fair value
Available-for-sale				
Equity securities	¥ 192,141	¥ 51,337	¥ 1,037	¥ 242,441
Corporate bonds	2,085	79	—	2,164
Trust fund investments and other	4,191	6,161	—	10,352
Held-to-maturity				
Government bonds and municipal bonds	1,199	0	5	1,194
Others	502	—	1	501

	Millions of yen			
	2008			
	Cost	Unrealized gain	Unrealized loss	Fair value
Available-for-sale				
Equity securities	¥ 36,728	¥ 36,238	¥ 3,674	¥ 69,292
Government and Corporate bonds	3,537	91	0	3,628
Trust fund investments and other	14,503	2,454	44	16,913
Held-to-maturity				
Government bonds and municipal bonds	900	1	1	900
Others	1,268	—	0	1,268

	Millions of U.S. dollars			
	2008			
	Cost	Unrealized gain	Unrealized loss	Fair value
Available-for-sale				
Equity securities	$ 367	$ 362	$ 37	$ 692
Government and Corporate bonds	35	1	0	36
Trust fund investments and other	145	24	0	169
Held-to-maturity				
Government bonds and municipal bonds	9	0	0	9
Others	13	—	0	13

The carrying amounts of non-marketable securities at March 31, 2007 and 2008 were as follows:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Available-for-sale			
Equity securities	¥ 4,273	¥ 5,682	$ 57
Corporate bonds	3,002	1,008	10
Trust fund investments and other	229	1,281	13
Total	¥ 7,504	¥ 7,971	$ 80

Amortized cost of held to maturity securities and related proceeds from sales and related realized losses on those sales for the years ended March 31, 2006, 2007 and 2008, were as follows:

	Millions of yen			Millions of U.S. dollars
	2006	2007	2008	2008
Amortized cost	¥ —	¥ —	¥ 300	$ 3
Proceed from sales	¥ —	¥ —	¥ 293	$ 3
Net realized loss	¥ —	¥ —	¥ (7)	$ (0)

A domestic consolidated subsidiary sold held-to-maturity security for the year ended March 31, 2008 due to significant deterioration in the issuer's creditworthiness, which is considered to be a reasonable reason consistent with Practical Guidelines on Accounting Standards for Financial Instruments No.83-1.

Proceeds from sales of available-for-sale securities and related gross realized gains and losses on those sales, computed on the moving average cost basis for the years ended March 31, 2006, 2007 and 2008, were as follows:

	Millions of yen			Millions of U.S. dollars
	2006	2007	2008	2008
Proceeds from sales	¥ 3,262	¥ 9,229	¥ 1,902	$ 19
Gross realized gains	¥ 959	¥ 2,125	¥ 566	$ 5
Gross realized losses	(9)	(3)	(43)	(0)
Net realized gain	¥ 950	¥ 2,122	¥ 523	$ 5

The amounts of securities classified as available-for-sale and held-to-maturity at March 31, 2008, based on their contractual maturity dates, were as follows:

	Millions of yen		Millions of U.S. dollars	
	Available for sale	Held-to-maturity	Available for sale	Held-to-maturity
Due within one year	¥ 870	¥ 1,568	$ 8	$ 16
Due after one year through five years	21,397	600	214	6
Due after five years through ten years	465	—	5	—
Due after ten years	0	—	0	—
Total	¥ 22,732	¥ 2,168	$ 227	$ 22

For the years ended March 31, 2006, 2007 and 2008, losses on write-downs of securities including investments in affiliated companies totaled ¥11, nil and ¥11,154 million ($111 million), respectively. In evaluating security values, a security whose value has declined by more than 50% is considered to have experienced "significant deterioration". A security whose value has declined from 30% to 50% and the effect of the decline on JT's financial position is material, is considered to have experienced "significant deterioration". If a security has a strong chance of regaining its value, the security is not written down.

7. Inventories

Inventories at March 31, 2007 and 2008 consisted of the following:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Leaf tobacco	¥ 278,567	¥ 300,671	$ 3,001
Finished products	49,736	102,331	1,021
Other	88,973	155,848	1,556
Total	¥ 417,276	¥ 558,850	$ 5,578

JT leaf tobacco inventory in excess of the minimum amount necessary for future production was subject to annual devaluation. The net effect of the change in the devaluation debited (credited) to cost of sales at March 31, 2006 and 2007 were ¥9,588 million and ¥(9,585) million, respectively.

Annual devaluation was discontinued from the year ended March 31, 2008.

8. Short-term Bank Loans and Long-term Debt

Short-term bank loans as of March 31, 2007 and 2008 consisted of the following:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Yen loans with interest rates of 1.625% to 1.875% at March 31, 2007 and of 0.010% to 7.047% at March 31, 2008	¥ 160	¥ 106,673	$ 1,065
Foreign currency loans with interest rates of 4.40% to 16.00% at March 31, 2007 and of 3.69% to 12.70% at March 31, 2008	53,546	162,361	1,620
Total	¥ 53,706	¥ 269,034	$ 2,685

Long-term debt at March 31, 2007 and 2008 comprised the following:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
1.98% yen bonds, due 2009	¥ 150,000	¥ 150,000	$ 1,497
1.34% yen bonds, due 2010	—	49,996	499
1.53% yen bonds, due 2011	—	40,000	399
1.68% yen bonds, due 2012	—	59,995	599
Unsecured 5.88% Euro bonds issued by foreign subsidiary due in 2008	—	63,054	629
Unsecured 6.63% sterling pound bond issued by foreign subsidiary due in 2009	—	68,904	688
Unsecured 4.63% Euro bonds issued by foreign subsidiary due in 2011	—	134,266	1,340
Unsecured 5.75% sterling pound bond issued by foreign subsidiary due in 2013	—	56,581	565
Unsecured 4.50% Euro bonds issued by foreign subsidiary due in 2014	—	83,390	832
Unsecured 0.99% yen bonds issued by domestic subsidiary due in 2009	—	10,000	100
Unsecured 0.77% yen bonds issued by domestic subsidiary due in 2010	—	500	5
Long-term bank loans due through 2015	15,563	403,575	4,029
Total	165,563	1,120,261	11,182
Less current portion	(10,550)	(79,722)	(796)
Long-term debt, less current portion	¥ 155,013	¥ 1,040,539	$ 10,386

JT entered into interest rate swap agreements in March 2004 to convert interest payments on 1.98% yen bonds due 2009 to floating rate payments on a LIBOR basis, which was at 1.24% at March 31 2005, in order to manage interest rate risks on these bonds. Taking changes in market conditions into consideration, JT unwound the above interest swap agreements in May 2005. Consequently, JT now pays a fixed rate interest of 1.61%.

In addition, certain domestic consolidated subsidiaries have entered into interest rate swap agreements to fix variable rate interest payments of Japanese yen loans.

Annual interest rates applicable to Japanese yen long-term loans of JT and certain domestic consolidated subsidiaries at March 31, 2007 and 2008 ranged from 1.50% to 5.20% and 0.65% to 6.17%, respectively.

Annual interest rates applicable to long-term loans denominated in foreign currencies outstanding at March 31, 2007 and 2008 ranged from 6.30% to 8.37% and 2.35% to 9.20%, respectively.

Annual maturities of long-term debt at March 31, 2008 were as follows:

Years ending March 31,	Millions of yen	Millions of U.S. dollars
2009	¥ 79,218	$ 791
2010	368,464	3,678
2011	253,254	2,528
2012	194,542	1,942
2013	61,382	613
2014 and thereafter	161,856	1,616
Total	¥ 1,118,716	$ 11,168

Under the JT Law, obligations created by the bonds issued by JT are secured by a statutory preferential right over the property of JT.

This right entitles the holders thereof to claim satisfaction in preference to unsecured creditors (with the exception of national and local taxes and certain other statutory obligations).

Substantially all of the short-term bank loans and long-term debt are unsecured. Secured loans and debt of certain consolidated subsidiaries at March 31, 2008 were as follows:

	Millions of yen	Millions of U.S. dollars
Long-term bank loans	¥ 4,624	$ 46
Current portion of Long-term bank loans	2,404	24
Short-term bank loans	2,605	26
Others	1,109	11
Total	¥ 10,742	$ 107

The carrying amounts of assets pledged as collateral for the above secured loans and debt at March 31, 2008 were as follows:

	Millions of yen	Millions of U.S. dollars
Buildings and structures	¥ 7,409	$ 74
Machinery, equipment and vehicles	7,384	74
Land	3,734	37
Other	1,506	15
Total	¥ 20,033	$ 200

General agreements with respective banks provide, as is customary in Japan, that additional collateral must be provided under certain circumstances if requested by such banks and that certain banks have the right to offset cash deposited with them against any long-term or short-term debt or other debt payable to the banks. JT has never been requested to provide additional collateral.

9. Income Taxes

The Domestic Group is subject to Japanese corporate tax, inhabitants tax and enterprise tax based on income which, in the aggregate, resulted in a normal effective statutory tax rate of approximately 40.35% for the years ended March 31, 2006, 2007 and 2008. Foreign consolidated subsidiaries are subject to income taxes of the countries in which they operate.

The tax effects of significant temporary differences and loss carry-forwards which resulted in deferred tax assets and liabilities at March 31, 2007 and 2008 were as follows:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Deferred tax assets:			
Liabilities for employees' retirement benefits	¥ 44,842	¥ 57,341	$ 572
Obligations under the Public Official Mutual Assistance Association Law	55,655	51,568	515
Net operating loss carryforwards	16,854	37,314	372
Other payable for benefits to retired employees	10,794	1,463	15
Other	59,975	94,725	946
Less valuation allowance	(20,370)	(44,964)	(449)
Total	167,750	197,447	1,971
Deferred tax liabilities:			
Deferred gain on sales of fixed assets for income tax purposes	(31,928)	(31,772)	(317)
Basis differences in assets acquired and liabilities assumed upon acquisition	(34,255)	(122,961)	(1,227)
Unrealized gain on available-for-sale securities	(23,170)	(13,221)	(132)
Prepaid pension costs	(8,497)	(26,286)	(262)
Other	(21,953)	(41,432)	(415)
Total	(119,803)	(235,672)	(2,353)
Net deferred tax assets (liabilities)	¥ 47,947	¥ (38,225)	$ (382)

Net deferred tax assets and liabilities at March 31, 2007 and 2008 were reflected on the accompanying consolidated balance sheets under the following captions:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Other current assets	¥ 18,172	¥ 32,008	$ 319
Deferred tax assets	75,457	110,709	1,105
Other current liabilities	(2,246)	(6,547)	(65)
Deferred tax liabilities	(43,436)	(174,395)	(1,741)
Net deferred tax assets (liabilities)	¥ 47,947	¥ (38,225)	$ (382)

A reconciliation between the normal effective statutory tax rates for the years ended March 31, 2006, 2007 and 2008 and the actual effective tax rates reflected in the accompanying consolidated statements of income was as follows:

	2006	2007	2008
Normal effective statutory tax rate	40.35%	40.35%	40.35%
Tax rate difference applied for foreign consolidated subsidiaries	(9.13)	(6.99)	(9.67)
Foreign withholding tax	0.27	0.46	1.22
Tax credits	(1.09)	(0.83)	(0.81)
Non-deductible expenses	1.86	3.06	2.34
Other - net	(0.73)	(0.05)	1.02
Actual effective tax rate	31.53%	36.00%	34.45%

10. Stock Options

Stock option expense of ¥186 million ($2 million) is accounted for as Selling, general and administrative expenses on the consolidated statement of income for the year ended March 31, 2008.

The stock options outstanding as of March 31, 2008 are as follows:

Stock Option	Persons Granted	Number of Options Granted	Date of Grant	Exercise Price	Exercise Period
2008 stock option	11 Directors 16 Executive officers	426 shares	2008. 1. 8	¥1 ($ 0.01)	From January 9, 2008 to January 8, 2038

The rights become exercisable from one year later when a holder no longer holds a position as a director, a corporate auditor or an executive officer.

The stock options activity is as follows:

	2008 Stock Option
For the year ended March 31, 2008	
Non-Vested	(Shares)
March 31, 2007 — Outstanding	—
Granted	426
Canceled	—
Vested	(320)
March 31, 2008 — Outstanding	106
Vested	
March 31, 2007 — Outstanding	—
Vested	320
Exercised	—
Canceled	—
March 31, 2008 — Outstanding	320
Exercise price	¥ 1 ($ 0.01)
Average stock price at exercise	—
Fair value price at the grant date	¥ 581,269 ($ 5,802)

The assumptions used to measure fair value of 2008 stock options are as follows:

Estimate Method	Black-Scholes option pricing model
Volatility of stock price*1	32.22%
Estimated remaining outstanding period*2	15 years
Estimated dividend*3	¥ 4,400 per share ($ 44 per share)
Interest rate with risk free*4	1.83%

*1 Calculated based on stock prices for the period on and after listing date (from October 27, 1994 to January 8, 2008).
*2 With difficulty in reasonable estimation due to insufficient data accumulation, expected remaining period is estimated on the assumption that stock option would be exercised at a mid-point of exercising period.
*3 Based on year-end dividend for the year 2007 and interim dividend for the year 2008.
*4 A yield of 15-year government bond, a period of which corresponds to expected remaining period.

11. Liabilities for Retirement Benefits

(1) Employees' Retirement Benefit

JT has unfunded severance indemnity plan and a cash balance pension plan as well as a defined contribution plan. The unfunded severance indemnity plan provides lump-sum retirement benefits based on credits earned in each year of service. Employees are entitled to receive larger payments in certain circumstances such as involuntary termination, retirement at the mandatory retirement age, voluntary termination at certain specific ages prior to mandatory retirement age or death. The cash balance pension plan provides retirement benefits in the form of a lump-sum payment or annuity payments based on current and past principal credits earned and interest credits over time based on these principal credits.

Domestic consolidated subsidiaries principally have unfunded severance indemnity plans and/or defined benefit pension plans covering substantially all of their employees, under which benefits are provided based on the rate of pay at the time of termination, years of service and certain other factors.

Foreign consolidated subsidiaries principally sponsor non-contributory defined benefit pension plans covering most of their employees. Plans covering regular full-time employees provide pension benefits based on credits, determined by age, earned throughout an employee's service and final average compensation before retirement.

The liabilities for employees' retirement benefits at March 31, 2007 and 2008 consisted of the following:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Projected benefit obligations	¥ (322,121)	¥ (567,044)	$ (5,660)
Fair value of plan assets	203,484	449,588	4,488
Funded status	(118,637)	(117,456)	(1,172)
Unrecognized actuarial net loss (gain)	(17,535)	12,033	120
Unrecognized prior service cost	27,349	8,094	81
Net amount recognized	(108,823)	(97,329)	(971)
Pension liability adjustment of foreign consolidated subsidiaries (see Note 3 (n))	(18,721)	(12,212)	(122)
Prepaid pension cost	(18,897)	(49,387)	(493)
Other current liabilities	1,995	3,342	33
Liabilities for employees' retirement benefits	¥ (144,446)	¥ (155,586)	$ (1,553)

As described in Note 3 "Summary of Significant Accounting Policies" (n) Foreign Consolidated Subsidiaries, "Pension liability adjustment of foreign consolidated subsidiaries" is the unfunded obligation recognized by foreign consolidated subsidiaries applying U.S.GAAP. "Other current liabilities" is the amount by which the actuarial present value of benefits included in the benefit obligation payable in the next 12 months exceeds the fair value of plan assets in foreign consolidated subsidiaries applying U.S.GAAP.

The amount reversed of minimum pension liability by foreign consolidated subsidiaries applying U.S.GAAP was recorded in "Minimum pension liability adjustment of foreign consolidated subsidiaries" of retained earnings in the accompanying consolidated statements of changes in Equity for the year ended March 31, 2006 and 2007.

JT transferred a portion of the unfunded severance indemnity plan to the defined contribution plan on April 1, 2006, and thereby recognized ¥3,097 million for the year ended March 31, 2006 as other expense which led to an increase of liabilities for retirement benefits by the same amount in accordance with "Accounting for the Transfer between Retirement Benefits Plans (ASBJ Guideline No.1)" and "Practical Solution on Accounting for Transfer Between Retirement Benefit Plans (Practical Issues Task Forces Report No.2)".

	Millions of yen
	2006
Settlement of projected benefit obligations	¥ 4,567
Prior service cost recognized in earnings	(199)
Actuarial gain recognized in earnings	139
Decrease in liabilities for retirement benefits	4,507
Related assets due to be transferred to defined contribution plan	(7,604)
Loss on partial termination of defined benefit plan	¥ (3,097)

Related assets of ¥7,604 million due to be transferred to defined contribution plan will be paid in installment by 2009.

The components of net periodic retirement benefit cost for the years ended March 31, 2006, 2007 and 2008 were as follows:

	Millions of yen			Millions of U.S. dollars
	2006	2007	2008	2008
Service cost	¥ 9,278	¥ 9,684	¥ 13,115	$ 131
Interest cost	9,409	9,685	20,149	201
Expected return on plan assets	(5,823)	(6,829)	(19,782)	(197)
Recognized actuarial loss	1,718	315	(430)	(4)
Amortization of prior service cost	541	1,502	1,530	15
Net periodic retirement benefit costs	¥ 15,123	¥ 14,357	¥ 14,582	$ 146

Significant assumptions used for the years ended March 31, 2006, 2007 and 2008 were as follows:

	2006	2007	2008
Discount rate	2.5%	2.5%	2.5%
Expected rate of return on plan assets	2.5%	2.5%	2.5%

Actuarial gains or losses that result from changes in plan experience and actuarial assumptions are principally amortized over 10 years. The amortization period for the prior service cost that resulted from retroactive application of a plan amendment is principally 10 years. The retirement benefit attributable to each year is calculated by assigning the same amount of pension benefits to each year of service.

The Group's contributions to the defined contribution plans which were charged to expenses, for the years ended March 31, 2006, 2007 and 2008 were ¥2,212 million, ¥3,002 million and ¥4,208 million ($42 million), respectively.

JT has offered additional retirement benefits to its employees under the early retirement programs as a part of various business restructuring efforts in order to rationalize operating efficiencies in administrative and other headquarter functions and to reduce costs in the domestic tobacco business. These efforts principally related to closure of eight cigarette factories and a company-wide offering of an early retirement plan to employees who are age 40 or older with more than 15 years of services during the year ended March 31, 2005 and other business restructuring during the year ended March 31, 2006.

Certain domestic and foreign subsidiaries also provided additional retirement benefits for early-retired employees in connection with the reorganization of domestic distribution operations or rationalization of other businesses for the years ended March 31, 2006, 2007 and 2008.

These restructuring activities resulted in recognition of additional retirement benefits as business restructuring costs of ¥8,557 million, nil and ¥2,285 million ($23 million) for the years ended March 31, 2006, 2007 and 2008, respectively, and as other expenses of nil, ¥790 million and ¥1,122 million ($11 million) for the year ended March 31, 2006, 2007 and 2008, respectively, which included a one-time charge for the unrecognized actuarial net loss and unrecognized prior service cost attributable to the employees who retired earlier than expected.

Certain domestic consolidated subsidiaries participate in multi-employer contributory pension plans, the required contributions to which are recognized as a net pension cost for the year. Of these pension plans, information about Tokyo pharmaceutical industry employees' pension fund is as follows:

	Millions of yen	Millions of U.S. dollars
	2007	2007
Funded status of the entire plan as of March 31, 2007:		
Fair value of plan assets	¥ 461,860	$ 4,610
Benefit obligations	(469,729)	(4,688)
Deficit	¥ (7,869)	$ (78)

	2008
Proportion of the Domestic consolidated subsidiary's contributions to the entire plan as of March 31, 2008	1.2%

Certain foreign consolidated subsidiaries also provide certain health and life insurance benefits for retired employees and their dependents.

The Domestic Group's liabilities for retirement benefits for directors and corporate auditors as of March 31, 2007 and 2008 were ¥1,018 million and ¥744 million ($7 million), respectively.

(2) Obligation under the Public Official Assistance Association Law

Employees of JT, including former employees of JTSPC, and others, are entitled to receive benefits under the government-sponsored pension plan by the Public Official Mutual Assistance Association Law (the "Law"). The benefits, in the form of lifetime annuity payments by the Social Insurance Agency, are determined based on the standard pay rate, the length of service and other factors. As a formerly wholly government-owned company, JT is obligated by the Law to reimburse the Japanese government for pension expenses incurred each year by the government in respect of former employees of JTSPC and others for their services during certain periods before July 1, 1956, the enactment date of the Law.

Such obligations were first recorded as liabilities at April 1, 2003 based on the actuarially determined computation method. Any actuarial gain or loss arising subsequent to April 1, 2003 is deferred and amortized over 10 years.

The liabilities and costs recognized for such obligations as of and for the year ended March 31, 2006, 2007 and 2008 were as follows:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Benefit obligations	¥ (139,569)	¥ (127,871)	$ (1,276)
Unrecognized actuarial loss	1,638	70	1
Liabilities recognized	¥ (137,931)	¥ (127,801)	$ (1,275)

	Millions of yen			Millions of U.S. dollars
	2006	2007	2008	2008
Interest cost	¥ 2,488	¥ 2,288	¥ 2,094	$ 21
Recognized actuarial loss	586	425	240	2
Net periodic costs	¥ 3,074	¥ 2,713	¥ 2,334	$ 23

The assumed discount rate used in the actuarial computation for the year ended March 31, 2006, 2007 and 2008 was 1.5%.

12. Equity

Since May 1, 2006, Japanese companies have been subject to the Corporate Law, which reformed and replaced the Commercial Code of Japan. The significant provisions in the Corporate Law that affect financial and accounting matters are summarized below:

(a) Dividends

Under the Corporate Law, companies can pay dividends at any time during the fiscal year in addition to the year-end dividend upon resolution at the shareholders meeting, if companies meet certain criteria such as; (1) having the Board of Directors, (2) having independent auditors, (3) having the Board of Corporate Auditors, and (4) the term of service of the directors is prescribed as one year rather than two years of normal term by its articles of incorporation. The Board of Directors of such company may declare dividends (except for dividends in kind) at any time during the fiscal year if the company has prescribed so in its articles of incorporation.

Semiannual interim dividends may also be paid once a year upon resolution by the Board of Directors if the articles of incorporation of the company so stipulate. The Corporate Law provides certain limitations on the amounts available for dividends or the purchase of treasury stock.

(b) Increases / Decreases and Transfer of Common Stock, Reserve and Surplus

The Corporate Law requires that an amount equal to 10% of dividends must be appropriated as a legal reserve (a component of retained earnings) or as additional paid-in capital (a component of capital surplus) depending on the equity account charged upon the payment of such dividends until the total of aggregate amount of legal reserve and additional paid-in capital equals 25% of the common stock. Under the Corporate Law, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. The Corporate Law also provides that common stock, legal reserve, additional paid-in capital, other capital surplus and retained earnings can be transferred among the accounts under certain conditions upon resolution of the shareholders.

(c) Treasury Stock

The Corporate Law also provides for companies to purchase treasury stock and dispose of such treasury stock by resolution of the Board of Directors. The amount of treasury stock purchased cannot exceed the amount available for distribution to the shareholders which is determined by specific formula.

Upon the meeting of the board of directors held on February 27, 2006, JT decided to split JT's shares on five for one basis with the effective date of April 1, 2006.

The Special Taxation Measures Law in Japan permits companies to take as tax deductions certain reserves if provided through year-end book closing. Under Japanese tax laws, these reserves must be reversed to income in future years. The deferred gain on sales of fixed assets, net of tax, included in retained earnings provided under the Special Taxation Measures Law at March 31, 2007 and 2008 were ¥51,130 million and ¥51,005million ($509 million), respectively.

13. Research and Development Costs and Advertising Costs

Research and development costs charged to expenses as incurred for the years ended March 31, 2006, 2007 and 2008 were ¥37,505 million, ¥41,239 million and ¥45,163 million ($451 million), respectively.

Advertising costs were charged to expenses as incurred and totaled ¥166,093 million, ¥151,523 million and ¥186,607 million ($1,863 million) for the years ended March 31, 2006, 2007 and 2008, respectively.

14. Lease Transactions

The Group, as a lessee, leases certain vehicles, vending machines and other assets.

Pro forma information of leased property, such as acquisition cost, accumulated depreciation, accumulated impairment loss, obligations under finance leases, allowance for impairment loss on leased property, depreciation expense and other information of finance lease that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis at March 31, 2007 and 2008 was as follows:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Acquisition cost:			
Machinery, equipment and vehicles	¥ 5,150	¥ 7,212	$ 72
Tools	18,495	20,903	209
Others	2,455	3,232	32
Total acquisition cost	26,100	31,347	313
Accumulated depreciation	11,605	15,032	150
Accumulated impairment loss	—	14	0
Net leased property	¥ 14,495	¥ 16,301	$ 163

The above acquisition costs includes related interest expenses.

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Obligations under finance leases:			
Due within one year	¥ 4,463	¥ 5,235	$ 52
Due after one year	10,032	11,080	111
Total	¥ 14,495	¥ 16,315	$ 163
Allowance for impairment loss on leased property	¥ —	¥ 8	$ 0

The above obligations under finance leases includes related interest expenses.

	Millions of yen			Millions of U.S. dollars
	2006	2007	2008	2008
Depreciation expense and other information:				
Depreciation expense	¥ 5,117	¥ 4,836	¥ 5,230	$ 52
Lease payments	5,117	4,836	5,230	52
Reversal of allowance for impairment loss on leased property	—	—	1	0

Depreciation expenses, which are not reflected in the accompanying consolidated statements of income, are computed by the straight-line method.

The minimum rental commitments under noncancellable operating leases at March 31, 2007 and 2008 were as follows:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Due within one year	¥ 4,511	¥ 7,724	$ 77
Due after one year	9,919	25,290	253
Total	¥ 14,430	¥ 33,014	$ 330

The Group, as a lessor, leases certain computer equipment and other assets. Total lease revenue under the above leases for the years ended March 31, 2006, 2007 and 2008 was ¥279 million, ¥253 million and ¥363 million ($3 million), respectively.

Information of leased property included in the accompanying financial statements, such as acquisition cost, accumulated depreciation and claims under finance leases that do not transfer ownership of the leased property to the lessee, at March 31, 2007 and 2008 was as follows:

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Acquisition cost:			
Machinery, equipment and vehicles	¥ 100	¥ 129	$ 1
Tools	1,336	1,679	17
Total acquisition cost	1,436	1,808	18
Accumulated depreciation	594	782	8
Net leased property	¥ 842	¥ 1,026	$ 10

	Millions of yen		Millions of U.S. dollars
	2007	2008	2008
Claims under finance leases:			
Due within one year	¥ 290	¥ 367	$ 3
Due after one year	634	769	8
Total	¥ 924	¥ 1,136	$ 11

The above claims under finance leases included related interest income.

Depreciation expenses for the years ended March 31, 2006, 2007 and 2008 which have been reflected in the accompanying consolidated statements of income were ¥250 million, ¥240 million and ¥347 million ($3 million), respectively.

15. Commitments and Contingencies

(1) On August 11, 2004, JTI-Macdonald received a Notice of Assessment from the Quebec Ministry of Revenue ("QMR") requiring an immediate payment of approximately 1.36 billion Canadian dollars (approximately ¥114.6 billion at the exchange rate effective at the time), based on allegations that the company had contributed to tobacco smuggling from 1990 to 1998, prior to JT's acquisition of RJR Nabisco Inc.'s overseas (non-US) tobacco operations.

JTI-Macdonald filed an application for protection with the Ontario Superior Court of Justice on August 24, 2004 under the Companies' Creditors Arrangement Act ("CCAA"), because the company's failure to pay the tax bill immediately could have prompted the QMR to confiscate its business assets, making it difficult for it to continue its normal business operations. As of March 31, 2008 (the end of fiscal 2007), the company was continuing business operations with its assets protected under the CCAA. In order to enable JTI-Macdonald to repay part of its debts to other subsidiaries of JT, JT International Holding B.V., the Dutch subsidiary of JT, provided a court-appointed monitor in April 2006 with a letter of credit issued by a financial institution for the amount corresponding to the repayment.

JT believes that if JTI-Macdonald incurs financial damage or bears costs associated with this case, it will be entitled to seek indemnification from RJR Nabisco Inc. or its successors, based on the contract entered into among JT, RJR Nabisco Inc. and RJR at the time of JT's acquisition of JTI-Macdonald in 1999.

In July 2004, ZAO JTI Marketing & Sales ("M&S Corp."), a Russian subsidiary of JT that oversees distribution-related business in the Russian market, received an assessment from the Moscow tax authorities in which it was ordered to pay approximately 2.4 billion rubles (approximately ¥8.8 billion at the exchange rate effective at the time) as VAT, etc. for the period of January to December 2000. The taxed amount includes unpaid taxes (VAT, etc.), interest and additional taxes. Believing that the assessment by the Moscow tax authorities was based upon a misinterpretation of facts, M&S Corp. filed a lawsuit with the Moscow Arbitration Court seeking to invalidate the assessment. Although the court of first instance, the Court of Appeals and the Court of Cassation dismissed M&S Corp.'s argument, the Russian Federation Higher Arbitration Court reversed the lower courts' judgments and remanded the case to the court of first instance in April 2006. In October 2007, the court of first instance rendered judgment upholding M&S Corp.'s argument and invalidated the tax assessment, and the Court of Appeals and the Court of Cassation dismissed the appeal by the tax authorities and upheld M&S Corp's argument in February and May 2008, respectively. The tax authorities may file a petition for appeal to the Russian Federation Higher Arbitration Court.

(2) Contingent Liabilities

At March 31, 2008, the Group had the following contingent liabilities:

	Millions of yen	Millions of U.S. dollars
	2008	2008
Trade notes discounted	¥ 1,008	$ 10
Guarantees and similar items of bank loans:		
Kotobuki Business Company Corp.,Ltd	733	7
Zhouzan Koumei Foods Co.,Ltd (38 Million of CNY and 332 Thousand of USD)*	570	6
Mitoyo Cable Television Co.,Ltd	406	4
Zhouzan Katoka Foods Co.,Ltd (24 Million of CNY and 350 Thousand of USD)*	380	4
Cook Foods. Co.ltd.	240	2
Others	127	2
Total	¥ 3,464	$ 35

* The translation of the guaranteed amounts that denominated in foreign currency were made at the rate of exchange at March 31, 2008.

16. Other Income (Expenses)

(1) Business Restructuring Costs

Business restructuring costs for the years ended March 31, 2006, 2007, and 2008 consisted of the following:

	Millions of yen			Millions of U.S. dollars
	2006	2007	2008	2008
Additional Retirement Benefits (see Note 11)	¥ (8,557)	¥ —	¥ (2,285)	$ (23)
Loss on disposition of property, plant and equipment	(99)	—	—	—
Others-net	647	—	(4,157)	(41)
Total	¥ (8,009)	¥ —	¥ (6,442)	$ (64)

Additional retirement benefits for the year ended March 31, 2006 were incurred for early retirements of employees as discussed in Note 11 "Liabilities for Retirement Benefits".

For the year ended March 31, 2006, "Others – net" in the Business restructuring costs includes the reversal of payables recognized due to the acceleration of planned retirement dates for employees on long-term leave who accepted the early retirement program implemented during the year ended March 31, 2005.

Business restructuring costs for the year ended March 31, 2008 were mainly incurred for the rationalization of International tobacco businesses.

(2) Loss on Impairment of Long-lived Assets

Asset grouping is based on the smallest identifiable unit that generates cash flows that are largely independent of the cash flows from other assets, except for idle property, which is grouped individually.

The Group reviewed its long-lived assets for impairment during the year ended March 31, 2006 and, as a result, recognized an impairment loss of ¥11,439 million, which principally consists of ¥7,738 million of land and ¥3,452 million of buildings and structures, as other expense mainly for company housing due to be discontinued which are mostly located in the Tokyo metropolitan area.

During the second half of the year ended March 31, 2006, land and buildings of company housing were finally assessed to be discontinued, resulting in the change of asset groups for impairment testing. Most of impairment losses were recognized on company housings after they are evaluated individually as a result of the asset group change.

Loss on Impairment for the years ended March 31, 2007 and 2008 amounted to ¥2,712 million and ¥3,825 million ($38 million), respectively, which relates principally to land, and certain buildings and structures which are planned to be demolished.

(3) Other – net

"Other – net" included in "Other Income (Expenses)" for the years ended March 31, 2006, 2007 and 2008 consisted of the following:

	Millions of yen			Millions of U.S. dollars
	2006	2007	2008	2008
Financial support for domestic tobacco growers (see Note 15)	¥ (863)	¥ (3,505)	¥ (2,005)	$ (20)
Foreign exchange loss-net	(2,893)	(14,465)	(31,790)	(317)
Gain on sales of investment securities-net	879	1,908	352	4
Loss on partial termination of defined benefit plan (see Note 11)	(3,097)	—	—	—
Introduction costs for vending machines with adult identification functions	(159)	(5,746)	(12,879)	(129)
Costs related to the recall of frozen foods products	—	—	(5,624)	(56)
Others-net	(3,376)	(9,390)	(13,403)	(135)
Total	¥ (9,509)	¥ (31,198)	¥ (65,349)	$ (653)

"Introduction costs for vending machines with adult identification functions" is the cost to establish system of vending machines with functions to prevent minors from purchasing cigarettes from vending machines and to dispense cigarettes only after scanning and verifying special IC cards that indicate whether the purchaser is an adult or not.

"Costs related to the recall of frozen foods products" is mainly the cost to recall some frozen foods products which were imported and sold by the Group.

17. Segment Information

The Group's business is divided into the domestic tobacco, international tobacco, pharmaceutical, foods and other industry segments. The domestic tobacco segment consists of manufacturing and sale of tobacco products, primarily cigarettes, in Japan, including tobacco products sold at duty free shops in Japan, as well as at markets in China, Hong Kong and Macau, which are covered by the China Division. The domestic tobacco segment includes the sales by TS Network Co., Ltd., JT's subsidiary. TS Network Co., Ltd. distributes the tobacco products and conducts wholesale etc. of foreign brand tobacco products purchased from foreign tobacco manufacturers through importers. The international tobacco segment consists of manufacturing and sale of cigarettes in other markets worldwide not covered by the domestic tobacco segment. The pharmaceutical segment is concerned with the development, manufacturing and sale of prescription drugs. The foods segment involves manufacturing and sale of beverages and processed foods. Other segments include the real estate business, engineering business and other operations.

With respect to the international tobacco business, the accounting period of consolidated overseas subsidiaries, represented by JT International, ends December 31, 2007 and the results for the twelve months ended December 31, 2007 are consolidated for the year ended March 31, 2008.

(1) Industry Segments

Information about the industry segments of the Group for the years ended March 31, 2006, 2007 and 2008 were as follows:

	Millions of yen							
	2006							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Foods	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	¥ 3,405,281	¥ 881,188	¥ 49,257	¥ 278,378	¥ 23,553	¥ 4,637,657	¥ —	¥ 4,637,657
Intersegment sales	41,554	36,914	—	123	25,212	103,803	(103,803)	—
Total sales	3,446,835	918,102	49,257	278,501	48,765	4,741,460	(103,803)	4,637,657
Operating expenses	3,226,740	847,071	54,314	272,176	40,092	4,440,393	(109,682)	4,330,711
Operating income (loss)	¥ 220,095	¥ 71,031	¥ (5,057)	¥ 6,325	¥ 8,673	¥ 301,067	¥ 5,879	¥ 306,946
Assets	¥ 1,131,751	¥ 994,834	¥ 117,903	¥ 141,477	¥ 194,401	¥ 2,580,366	¥ 457,013	¥ 3,037,379
Depreciation and amortization other than goodwill	84,570	23,062	3,254	5,042	13,467	129,395	(4,540)	124,855
Impairment Loss	991	184	—	70	—	1,245	10,194	11,439
Amortization of goodwill	1,088	—	—	502	—	1,590	—	1,590
Capital expenditures	75,028	24,995	2,107	4,576	19,318	126,024	(27,097)	98,927

	Millions of yen							
	2007							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Foods	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	¥ 3,416,274	¥ 999,658	¥ 45,452	¥ 286,554	¥ 21,449	¥ 4,769,387	¥ —	¥ 4,769,387
Intersegment sales	45,005	26,355	—	110	25,876	97,346	(97,346)	—
Total sales	3,461,279	1,026,013	45,452	286,664	47,325	4,866,733	(97,346)	4,769,387
Operating expenses	3,215,891	944,928	56,659	279,959	37,994	4,535,431	(98,035)	4,437,396
Operating income (loss)	¥ 245,388	¥ 81,085	¥ (11,207)	¥ 6,705	¥ 9,331	¥ 331,302	¥ 689	¥ 331,991
Assets	¥ 1,180,395	¥ 1,275,045	¥ 106,165	¥ 158,818	¥ 249,604	¥ 2,970,027	¥ 394,636	¥ 3,364,663
Depreciation and amortization other than goodwill	79,965	31,583	3,010	3,894	12,254	130,706	(600)	130,106
Impairment Loss	710	112	—	44	—	866	1,846	2,712
Amortization of goodwill	1,118	—	—	1,419	—	2,537	—	2,537
Capital expenditures	55,243	32,017	3,046	4,866	8,054	103,226	(1,079)	102,147

	Millions of yen							
	2008							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Foods	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	¥ 3,362,398	¥ 2,639,969	¥ 49,064	¥ 336,420	¥ 21,876	¥ 6,409,727	¥ —	¥ 6,409,727
Intersegment sales	48,981	35,341	—	115	22,332	106,769	(106,769)	—
Total sales	3,411,379	2,675,310	49,064	336,535	44,208	6,516,496	(106,769)	6,409,727
Operating expenses	3,189,031	2,469,950	58,708	335,868	33,760	6,087,317	(108,144)	5,979,173
Operating income (loss)	¥ 222,348	¥ 205,360	¥ (9,644)	¥ 667	¥ 10,448	¥ 429,179	¥ 1,375	¥ 430,554
Assets	¥ 847,123	¥ 3,804,414	¥ 111,422	¥ 353,283	¥ 90,001	¥ 5,206,243	¥ (119,029)	¥ 5,087,214
Depreciation and amortization other than goodwill	83,290	65,398	3,375	4,891	11,606	168,560	(902)	167,658
Impairment Loss	344	346	—	380	—	1,070	2,755	3,825
Amortization of goodwill	1,088	—	—	2,795	—	3,883	—	3,883
Capital expenditures	57,201	48,431	4,257	6,033	14,793	130,715	(1,160)	129,555

	Millions of U.S. dollars							
	2008							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Foods	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	$ 33,560	$ 26,350	$ 490	$ 3,358	$ 218	$ 63,976	$ —	$ 63,976
Intersegment sales	489	352	—	1	223	1,065	(1,065)	—
Total sales	34,049	26,702	490	3,359	441	65,041	(1,065)	63,976
Operating expenses	31,830	24,652	586	3,352	337	60,757	(1,078)	59,679
Operating income (loss)	$ 2,219	$ 2,050	$ (96)	$ 7	$ 104	$ 4,284	$ 13	$ 4,297
Assets	$ 8,455	$ 37,972	$ 1,112	$ 3,526	$ 899	$ 51,964	$ (1,188)	$ 50,776
Depreciation and amortization other than goodwill	831	652	34	49	116	1,682	(9)	1,673
Impairment Loss	3	4	—	4	—	11	27	38
Amortization of goodwill	11	—	—	28	—	39	—	39
Capital expenditures	571	484	42	60	148	1,305	(12)	1,293

Operating expenses represent the aggregate amount of the cost of sales and selling, general and administrative expenses. Capital expenditures include long-term prepaid expenses and expensed amounts of the long-term prepaid expenses are included in depreciation and amortization other than goodwill.

The change was to reflect the fact that JT, during the period ended March 31, 2006, started the import, manufacturing and sales of foreign consolidated subsidiaries' products for the Japanese market. Intersegment goodwill acquisition by JT was included in capital expenditures of the Domestic Tobacco segment, and is eliminated in Elimination / Corporate.

The domestic tobacco segment includes the sales by TS Network Co., Ltd. Net sales of such imported tobacco products via TS Network Co., Ltd. for the year ended March 31, 2006, 2007 and 2008 were ¥1,160,744 million, ¥1,216,249 million and ¥1,193,178 million ($11,909 million), respectively.

(2) Geographical Segments

The geographical segments of the Group for the years ended March 31, 2006, 2007 and 2008 were summarized as follows:

	Millions of yen					
	2006					
	Japan	Western Europe	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	¥ 3,709,964	¥ 338,606	¥ 589,087	¥ 4,637,657	¥ —	¥ 4,637,657
Intersegment sales	42,368	153,514	18,943	214,825	(214,825)	—
Total sales	3,752,332	492,120	608,030	4,852,482	(214,825)	4,637,657
Operating expenses	3,524,195	492,967	535,165	4,552,327	(221,616)	4,330,711
Operating income (loss)	¥ 228,137	¥ (847)	¥ 72,865	¥ 300,155	¥ 6,791	¥ 306,946
Assets	¥ 1,446,958	¥ 760,456	¥ 276,327	¥ 2,483,741	¥ 553,638	¥ 3,037,379

	Millions of yen					
	2007					
	Japan	Western Europe	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	¥ 3,718,450	¥ 353,831	¥ 697,106	¥ 4,769,387	¥ —	¥ 4,769,387
Intersegment sales	47,350	156,414	23,331	227,095	(227,095)	—
Total sales	3,765,800	510,245	720,437	4,996,482	(227,095)	4,769,387
Operating expenses	3,517,318	529,055	618,885	4,665,258	(227,862)	4,437,396
Operating income (loss)	¥ 248,482	¥ (18,810)	¥ 101,552	¥ 331,224	¥ 767	¥ 331,991
Assets	¥ 1,487,678	¥ 1,023,183	¥ 304,630	¥ 2,815,491	¥ 549,172	¥ 3,364,663

	Millions of yen					
	2008					
	Japan	Western Europe	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	¥ 3,711,763	¥ 1,678,770	¥ 1,019,194	¥ 6,409,727	¥ —	¥ 6,409,727
Intersegment sales	52,308	181,062	29,212	262,582	(262,582)	—
Total sales	3,764,071	1,859,832	1,048,406	6,672,309	(262,582)	6,409,727
Operating expenses	3,541,731	1,803,896	897,008	6,242,635	(263,462)	5,979,173
Operating income (loss)	¥ 222,340	¥ 55,936	¥ 151,398	¥ 429,674	¥ 880	¥ 430,554
Assets	¥ 1,160,749	¥ 3,436,185	¥ 420,170	¥ 5,017,104	¥ 70,110	¥ 5,087,214

	Millions of U.S. dollars					
	2008					
	Japan	Western Europe	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	$ 37,047	$ 16,756	$ 10,173	$ 63,976	$ —	$ 63,976
Intersegment sales	522	1,807	292	2,621	(2,621)	—
Total sales	37,569	18,563	10,465	66,597	(2,621)	63,976
Operating expenses	35,350	18,005	8,953	62,308	(2,629)	59,679
Operating income (loss)	$ 2,219	$ 558	$ 1,512	$ 4,289	$ 8	$ 4,297
Assets	$ 11,585	$ 34,297	$ 4,194	$ 50,076	$ 700	$ 50,776

"Western Europe" includes Switzerland, United Kingdom and Germany while "Others" includes Canada, Russia and Malaysia for the year ended March 31, 2008. Operating expenses represent the aggregate amount of the cost of sales and selling, general and administrative expenses.

For the years ended March 31, 2006 and 2007, "Western Europe" includes Switzerland, France and Germany.

(3) Sales to Foreign Customers

Sales to foreign customers for the years ended March 31, 2006, 2007 and 2008 amounted to ¥935,198 million, ¥1,056,762 million and ¥2,705,461 million ($27,003 million), respectively.

18. Derivatives

JT and certain consolidated subsidiaries use derivative financial instruments ("derivatives"), including derivatives described below, to hedge the foreign exchange risk associated with certain assets and liabilities in foreign currencies.

2006	2007	2008
Foreign currency forward contracts	Foreign currency forward contracts Currency options Currency swaps	Foreign currency forward contracts Currency options Currency swaps

JT and certain consolidated subsidiaries also entered into derivatives described below as a manner of managing their interest rate exposure.

2006	2007	2008
Interest rate swaps	Interest rate swaps	Interest rate swaps Interest rate cap options Interest rate swaption

Derivatives are subject to market risk and credit risk. Market risk is the exposure created by potential fluctuations in market conditions, including interest or foreign exchange rates. Credit risk is the possibility that a loss may result from a counterparty's failure to perform according to the terms and conditions of the contract.

The Group does not hold or issue derivatives for trading purposes. The main objective of using derivatives is to hedge the Group exposure to interest rate risks associated with certain future interest receipts on debt securities, certain interest payments on borrowings and bonds and forecasted foreign currency denominated transactions.

The effectiveness of the hedging instruments is assessed in accordance with the Risk Management Policy and Practice Manual for financial instruments of JT and certain consolidated subsidiaries by comparing the accumulated amount of changes in hedging instruments with hedged items. Hedging instruments and hedged items are summarized as follows:

2006	
Hedging instruments	Hedged items
Foreign currency forward contracts	Forecasted foreign currency transactions
Interest rate swaps	Borrowings and Japanese yen bonds

2007	
Hedging instruments	Hedged items
Foreign currency forward contracts	Forecasted foreign currency transactions
Currency options	Forecasted foreign currency transactions
Interest rate swaps	Borrowings

2008	
Hedging instruments	Hedged items
Foreign currency forward contracts	Forecasted foreign currency transactions
Currency options	Forecasted foreign currency transactions
Currency swaps	Forecasted foreign currency transactions

Because the counterparties to the derivatives are limited to major international financial institutions, the Group does not anticipate any losses arising from credit risk.

The Group had the following derivatives contracts that do not qualify for hedge accounting as of March 31, 2006, 2007 and 2008:

	Millions of yen								
	2006			2007			2008		
	Contract/ Notional Amount	Fair Value	Gain (Loss)	Contract/ Notional Amount	Fair Value	Gain (Loss)	Contract/ Notional Amount	Fair Value	Gain (Loss)
Foreign currency forward contracts:									
Buying	¥ 12,621	¥ 12,330	¥ (291)	¥ 2,972	¥ 3,113	¥ 141	¥ 312,993	¥ 323,740	¥10,747
Selling	43,234	43,663	(429)	40,624	40,839	(215)	607,955	610,758	(2,803)
Currency swaps:									
Buying	—	—	—	—	—	—	7,784	(307)	(307)
Selling	—	—	—	—	—	—	2,193	(151)	(151)
Currency options:									
Buying	24,201	212	212	—	—	—	1,935	1	1
Selling	—	—	—	2,615	(318)	(318)	—	—	—
Total			¥ (508)			¥ (392)			¥ 7,487
Interest rate swaps:									
Receive fixed pay floating	—	—	—	—	—	—	139,189	(1,218)	2,211
Interest rate cap options:									
Buying	—	—	—	—	—	—	279,668	718	718
Total			¥ —			¥ —			¥ 2,929

	Millions of U.S. dollars		
	2008		
	Contract/ Notional Amount	Fair Value	Gain (Loss)
Foreign currency forward contracts:			
Buying	$ 3,124	$ 3,231	$ 107
Selling	6,068	6,096	(28)
Currency swaps:			
Buying	78	(3)	(3)
Selling	22	(1)	(1)
Currency options:			
Buying	19	0	0
Selling	—	—	—
Total			$ 75
Interest rate swaps:			
Receive fixed pay floating	1,389	(12)	22
Interest rate cap options:			
Buying	2,791	7	7
Total			$ 29

The contract or notional amounts of derivatives which are shown in the above table do not represent the amounts exchanged by the parties and do not measure the Group's exposure to credit or market risks.

19. Net Income Per Share

(1) Net income per share and weighted-average number of common shares outstanding retroactively adjusted for stock split, for the year ended March 31, 2006 is as follows:

Years ended March 31,	2006
Net income per share	¥ 21,017
The weighted-average number of common shares outstanding	9,580,080

(2) Reconciliation of the differences between basic and diluted net income per share ("EPS") for the year ended March 31, 2008 is as follows:

	Millions of yen	Shares	Yen	U.S. dollars
	Net income	Weighted average shares	EPS	
For the year ended March 31, 2008:				
Basic EPS				
Net income available to common shareholders	¥ 238,702	9,580,080	¥ 24,917	$ 249
Effect of dilutive securities:				
Stock acquisition rights		97		
Diluted EPS:				
Net income for computation	¥ 238,702	9,580,177	¥ 24,916	$ 249

20. Subsequent Event

1. JT's board of directors decided on April 18, 2008 that, regarding the JT's now-defunct condominiums and unused warehouses, JT will demolish the existing buildings on the individual properties, if demolition would contribute to the sale of the land or increase its property value. JT estimates losses resulting from the demolition to be approximately ¥15.0 billion ($150 million), which would be allocated as other expenses in the fiscal year ending March 31, 2009.

2. On April 25, 2008, Gallaher Ltd. (Gallaher), JT's tobacco subsidiary in the United Kingdom, received a statement of objections from the Office of Fair Trading (OFT), the UK competition authority. The statement of objections addresses the possibility of anti-competitive behavior with respect to retail prices for tobacco products in the UK market prior to JT's acquisition of Gallaher.

   In August 2003, the OFT notified Gallaher of an inquiry into vertical agreements between manufacturers and retailers in the UK cigarette, tobacco and tobacco-related markets. Since that time Gallaher has been fully cooperating with the OFT regarding the inquiry.

   The Group is reviewing the statement of objections and will respond to the OFT as required.

   While the matter is still under review, a certain amount, based on the company's current assumptions, has been booked as non-current liabilities in the purchase price allocation related to JT's acquisition of Gallaher.

Independent Auditors' Report

Deloitte.

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To the Board of Directors of
Japan Tobacco Inc.:

We have audited the accompanying consolidated balance sheets of Japan Tobacco Inc. (JT) and consolidated subsidiaries (the "Company") as of March 31, 2007 and 2008, and the related consolidated statements of income, changes in equity, and cash flows for each of the three years in the period ended March 31, 2008, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of March 31, 2007 and 2008, and the consolidated results of their operations and their cash flows for each of the years in the period ended in conformity with accounting principles generally accepted in Japan.

As discussed in Note 15 to the consolidated financial statements, JTI-Macdonald Corp. ("JTI-MC"), JT's Canadian subsidiary, received a Notice of Assessment from the Quebec Ministry of Revenue on August 11, 2004, demanding payment of approximately Canadian dollar 1.36 billion (approximately ¥114.6 billion). JTI-MC filed an application of Companies' Creditors Arrangement Act ("CCAA") to the Ontario Superior Court of Justice on August 24, 2004, and the filing of CCAA makes it possible for JTI-MC to continue business operations with its assets safeguarded.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 2. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

Deloitte Touche Tohmatsu

Tokyo, Japan
June 24, 2008