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Major Elements of Regulation on Global Tobacco Business

WHO: "Framework Convention on Tobacco Control"

Following six rounds of intergovernmental negotiations, the Framework Convention on Tobacco Control (FCTC) was adopted by World Health Assembly of the WHO in May 2003 and came into force on February 27, 2005, 90 days after its ratification by 40 signatory nations. As of March 31, 2009, a total of 164 countries (including the EC) were party to the FCTC. Japan signed the FCTC on March 9, 2004 and accepted it on June 8, 2004. The FCTC contains a number of provisions, some of which are legally binding for the signatory nations, while others allow for discretion by each nation with regard to interpretation and implementation.

Key provisions of the FCTC include:

- Price and tax measures (implementation of tax policies and price policies and imposition of restrictions on duty-free sales, etc. as appropriate, without prejudice to the sovereign right of signatory nations to determine and establish their tax policies)
- Packaging and labeling (adoption of effective measures to ensure (1) that tobacco product packaging and labeling do not promote tobacco products by using terms that could create an erroneous impression, for example, that a particular tobacco product is less harmful than others; and (2) that health warnings on tobacco packaging cover not less than 30% of the principal display area)
- Advertising (introduction of a comprehensive ban on tobacco advertising, sales promotion and sponsorship, or imposition of appropriate restrictions if a country is not in a position to implement a comprehensive ban because of its constitution or constitutional principles)
- Sales to minors (adoption and implementation of effective measures to ban sales of tobacco products to minors)
- Support for alternative activities (promotion of alternative activities for tobacco workers, growers and sellers as appropriate)

The first session of the Conference of the Parties to the WHO

Framework Convention on Tobacco Control was held in February 2006 following the convention's entry into force. At this conference, discussions were held on matters such as the procedural rules for subsequent conferences, reports to be presented at the next conference and the development of draft guidelines and draft protocols. In June 2007, the second session of the convention was held. This time, guidelines for the implementation of Article 8 (protection from exposure to tobacco smoke) were adopted. In addition, resolutions were adopted with regard to establishing an intergovernmental negotiating body for the purpose of developing a protocol on Article 15 (illicit trade in tobacco products) and with regard to the timetable for developing guidelines concerning other major provisions. At the third session of the convention, which was held in November 2008, guidelines for Paragraph 3, Article 5 (protection against the tobacco industry), Article 11 (packaging and labeling) and Article 13 (tobacco advertising and promotion) were adopted, a report was made on the progress in intergovernmental negotiations concerning the adoption of a protocol regarding Article 15, and resolutions were adopted with regard to how to proceed with work concerning other major matters.

The JT Group has long been committed to many of the FCTC's provisions, including the prevention of youth smoking and the elimination of illicit trade, and engaged in active efforts to address those issues on a voluntary basis. Meanwhile, JT believes that tobacco should be regulated by individual countries in light of their own circumstances, such as the state of legislation and cultural and social conditions. The JT Group is ready to have dialogue with the governments of individual signatory nations of the FCTC as necessary, in order to ensure that they take appropriate and reasonable measures suited to their own circumstances when they implement the provisions of the convention.

International Tobacco Product Marketing Standards

In September 2001, JT decided to commit itself to comply with the International Tobacco Product Marketing Standards. The standards set principles for responsible tobacco product marketing worldwide. They represent a minimum set of standards for ensuring that brand marketing is never aimed at youth, but exclusively at adults who choose to smoke based on their recognition of the health risks associated with smoking.

The key provisions of the international standards include:

- Unified definitions of key words such as "advertisement/advertising," "promotional event" and "sponsorship."

- Tough guidelines applicable to advertising of tobacco products:
 - Print advertising is to be limited to publications with at least 75% adult readership.
 - Billboard advertising must not exceed 35 square meters in size.
 - Ads on TV, radio and the Internet are prohibited unless and until 100% adult verification is achieved.
 - Ads cannot run in cinemas unless there is a reasonable basis to believe that at least 75% of the audience is adult.
 - Ads cannot feature celebrities, show individuals that appear younger than 25, or suggest that smoking enhances athletic, professional, personal or sexual success.
- Indication of health warnings in ads and other media:
 - Health warnings must appear in almost all advertising, promotional and merchandising materials, except in rare instances such as point-of-sale materials smaller than 250 square centimeters.
- Restrictions on sponsorship:
 - For events or activities that bear a tobacco product brand name, all participants who compete or otherwise take an active part must be adults.
 - From December 1, 2006, attendance at an event or activity sponsored for the purpose of tobacco product brand promotion must be comprised of at least 75% adults, and these events can only generate incidental coverage in electronic media.
- All promotional activities are to be limited to verified adult smokers.

Prevention of Youth Smoking

The prevention of youth smoking is an issue to be addressed by society at large. From the viewpoint of fulfilling its corporate social responsibility, the JT Group has been conducting business operations in an appropriate manner and working with governments and other relevant organizations to take various steps toward dealing with this issue in the countries in which it operates, in accordance with voluntary standards and the International Marketing Standards as well as relevant local laws and regulations.

For detailed information on JT's efforts to prevent youth smoking, please refer to the following websites.

<http://www.jti.co.jp/sstyle/think/underage/index.html>
(for efforts in Japan)

http://www.jti.com/cr/positions/cr_positions_youth_smoking
(for efforts overseas)

Agreement with EU and EU Member States to Combat Cigarette Smuggling and Counterfeiting

On December 14, 2007, JT International S.A. and JT International Holding B.V., both of which are consolidated subsidiaries of JT, signed an agreement with the European Commission, the executive branch of the European Union (EU), and twenty-six member states of the EU on cooperation in combating cigarette smuggling and counterfeiting. We believe that this agreement, which builds upon initiatives implemented by the JT Group over the past years, will help to jointly establish an efficient and constructive framework for combating cigarette smuggling and counterfeiting with the EU and EU member states, and protect the brand value of our products against the threat of such illegal activities. The 27th member state, the United Kingdom joined the agreement on April 21, 2009.

The agreement calls for the JT Group to pay US\$50 million in each of the five years from signing and US\$15 million in each of the following 10 years to support anti-smuggling and anti-counterfeiting initiatives for the European territory.

Major Elements of Regulation of Tobacco Business in Japan

The Japan Tobacco, Inc. Law

JT was established under the Japan Tobacco, Inc. Law ("the JT Law") for the purpose of developing businesses related to the manufacture, sale, and importation of tobacco products. The JT Law provides that the Japanese government must continue to hold at least one-half of all of the shares that the government acquired by voluntary conveyance upon JT's establishment, as adjusted for any subsequent stock split or consolidation of shares (the number of such shares following the share split carried out on April 1, 2006 is 5 million shares), and that even if JT issues new shares in the future, the government must continue to hold more than one-third of all of the issued shares. The JT Law also states that the flotation of new shares, options to subscribe for new shares, or in the case of a share-for-share exchange, issuance of new shares, issuance of options for new shares, or issuance of bonds with options or warrants to subscribe for new shares, requires the approval of the Minister of Finance.

The JT Law grants JT the freedom to enter other non-tobacco-related business areas in line with its overall objectives as a corporation, dependent upon ministerial permission, in addition to the manufacture, distribution, and importation of tobacco products and tobacco-related businesses. JT must also obtain authorization from the Minister of Finance for certain matters, including the appointment or dismissal of directors,

executive officers, and auditors, amendments to JT's Articles of Incorporation, appropriations of capital surplus (except disposal of losses), and any merger, corporate split, or dissolution of JT. Within three months after the close of each business year, JT must issue its balance sheets, statements of income or loss, and business report to the Minister of Finance.

The Tobacco Business Law

The Tobacco Business Law was enacted in August 1984 for the purpose of achieving sound growth for Japan's tobacco industry, securing stable government revenues, and contributing to the healthy expansion of the Japanese economy. The Tobacco Business Law governs the cultivation and purchase of leaf tobacco and the manufacture and distribution of tobacco products. JT is obliged to negotiate contracts with domestic leaf tobacco growers to determine the total area used for tobacco cultivation and tobacco leaf prices based on type and quality. JT is also required to purchase the entire usable domestic tobacco crop.

Contracts stipulate the area to be cultivated and the prices of leaf tobacco for the subsequent year, and in this regard JT respects the opinion of the Leaf Tobacco Deliberative Council.*

As the sole manufacturer of tobacco products in Japan as established by law, JT must obtain the approval of the Minister of Finance on the maximum wholesale price of each class of tobacco released to the market. Tobacco product importers and wholesalers must register with the Minister of Finance, and retailers of tobacco products are required to obtain approval from the Minister of Finance. In addition, list prices for JT's tobacco products and imported tobacco products must be approved by the Minister of Finance, although in general, manufacturers' list prices are approved unless the Minister of Finance deems them unfair to consumers. Tobacco retailers are only permitted to sell tobacco products at list prices that have been approved by the Minister of Finance.

* The Leaf Tobacco Deliberative Council is a council which confers on important matters concerning the cultivation and purchase of domestically grown leaf tobacco in response to inquiries by JT representatives. The council consists of no more than 11 members, appointed by JT with the approval of the Minister of Finance from among representatives of domestic leaf tobacco growers and academic appointees.

Health Warnings, etc.

In Japan, the packages of tobacco products are required under Article 39 of the Tobacco Business Law to indicate "statements that urge caution over the relationship between the consumption of tobacco products and health" (health warnings) as specified in Article 36 of the Ordinance for Enforcement of the Tobacco Business Law. Details concerning the health warnings are

specified by the Ordinance for Enforcement of the Tobacco Business Law.

The ordinance requires the indication of warning labels regarding risks related to eight items. Four of the eight are diseases associated with direct smoking (lung cancer, heart attack, stroke and emphysema), while the other four are smoking by pregnant women, passive smoking, addiction to smoking and youth smoking. Each tobacco product package must indicate, on its main surface, a warning regarding at least one of the four items associated with direct smoking and at least one of the other four items. The ordinance stipulates (1) that these warnings must be rotated throughout the year in ways to ensure that they receive equal exposure on each product item and each type of package and (2) that the display area must occupy 30% or more of the main surface of the package.

In addition, the ordinance stipulates that when terms like "mild" and "light" are used on the package, they must be accompanied by a warning that prevents consumers from misunderstanding the relationship between the consumption of tobacco and health. JT ensures appropriate indications of the required health warnings with regard to all products intended for shipment in the Japanese market, as prescribed by the relevant laws and regulations.

Meanwhile, JT plans to continue using such terms as "mild" and "light" in the Japanese market in ways that maintain compliance with the provisions of the laws and regulations.

Guideline on Tobacco Advertising

In line with the purpose of a guideline for advertising of tobacco products promulgated by the Japanese Minister of Finance under Article 40 of the Tobacco Business Law, the Tobacco Institute of Japan (TIOJ)* has established voluntary standards. All TIOJ member companies, including JT, comply with these standards. The guideline stipulates that outdoor advertising of tobacco products (posters, billboards, etc.) must not be displayed except where tobacco products are sold and in designated smoking areas. It also stipulates that special care must be taken to ensure the use of appropriate advertising methods in daily newspapers (excluding sports tabloids, evening newspapers and the like) and specifies matters concerning the indication and content of the health warnings that accompany tobacco advertising. In accordance with the TIOJ's voluntary standards based on the guideline, the TIOJ member companies, including JT, have been implementing necessary measures, such as banning outdoor billboard advertising and brand-specific advertising on public transportation, limiting the volume of advertising

in newspapers, and limiting the scope of news sections in which ads may appear.

* Tobacco Institute of Japan: The TIOJ is a public interest corporation established for the purpose of contributing to the promotion of a fair and objective social understanding of tobacco through collecting and disseminating information regarding tobacco and supporting the sound development of Japan's tobacco industry and the national economy as a whole, by engaging in various activities in a manner suited to the social environment for tobacco consumption.

The TIOJ was established in 1987 as a voluntary organization based on the Association of Tobacco Manufacturers, which was established in 1985, and reorganized as an incorporated body in 1990.

Prevention of Youth Smoking

Age verification vending machines

The Tobacco Institute of Japan (TIOJ), the Japan Tobacconist Federation and the Japan Vending Machine Manufacturers Association announced co-developed an age verification vending machine and started introducing the machine in March 2008, aiming for a nationwide introduction.

This machine is intended to prevent minors from purchasing cigarettes from vending machines, as it only allows cigarettes to be dispensed when the customer is identified as an adult as a result of IC card scanning. Based on the results of the first-stage trial use program in Yokaichiba City, Chiba Prefecture, and the second trial use program in Tanegashima island, Kagoshima Prefecture, the nationwide introduction of the machine was completed in July 2008. We are actively involved in efforts to ensure the smooth introduction and operation of such machines, as we respect the purpose of the cooperative initiative to prevent youth smoking.

Tobacco-Related Legal Proceedings

Litigation Related to Health Risks Associated with Smoking

JT and its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking, the marketing of tobacco products, or exposure to tobacco smoke. To date, JT and its subsidiaries have never lost a case or paid any money to settle a case out of court.

In Japan, JT is currently involved in two lawsuits related to smoking and health as described below.

In one case, three smokers who alleged that they developed diseases as a result of smoking filed a lawsuit on January 19, 2005 with the Yokohama District Court against JT, the Government of Japan, et al., asking for a total of ¥30 million in compensation for damages and a strengthening of the wording of health warnings indicated on tobacco products, etc. The first hearing in this case took place on April 20, 2005, and the case is still pending in the district court.

In the other case, a taxi driver who alleging that he has developed laryngeal cancer and has suffered from aggravation of arteriosclerosis as a result of passive smoking in his car filed a lawsuit with the Tokyo District Court on February 25, 2008, asking for ¥10 million in compensation for damages and the suspension of the production and sale of tobacco products. The first hearing in this case took place on May 19, 2008, and the case is still pending in the district court.

Among the lawsuits filed overseas in relation to smoking and health in which JT subsidiaries are defendants are damages suits filed by individuals or classes of individuals and medical expense recovery suits filed by governments and insurers. As of the end of May 2009, there were a total of 21 such lawsuits pending in which JT subsidiaries are named as defendants or for which JT or a subsidiary may owe certain indemnity obligations pursuant to the relevant contracts, including the agreement for JT's acquisition of RJR Nabisco Inc.'s overseas (non-U.S.) tobacco operations.

These lawsuits include health care cost recovery actions brought by the provinces of British Columbia and New Brunswick against major cigarette companies—including R.J.Reynolds Tobacco Co. ("RJR") and the Canadian subsidiary of JT, JTI-Macdonald Corp. ("JTI-Macdonald")—and two class actions in Quebec brought against major Canadian cigarette companies, including JTI-Macdonald.

The British Columbia action has been brought under a provincial statute, the "Tobacco Damages and Health Care Costs Recovery Act", which was enacted exclusively for the purpose of this action. Several defendants challenged the statute's constitutionality. This challenge was ultimately rejected by the Supreme Court of Canada in September 2005. In March 2008, the province of New Brunswick filed a similar action under its own Tobacco Damages and Health Care Costs Recovery Act. For the time being, these actions remain in pre-trial proceedings with no decision yet made as to JTI-Macdonald's or RJR's liability.

In Quebec, a first-instance court authorized the two class actions to proceed in February 2005. The claims were filed in September 2005, and the actions remain in pre-trial proceedings with no decision yet made as to JTI-Macdonald's liability.

JT believes that it is possible that other similar smoking and health-related lawsuits will be filed in the future.

JT is unable to predict the outcome of currently pending or future lawsuits. However, if one or more actions result in a decision unfavorable to JT or its subsidiaries, its business could be materially affected by, for example, the payment of monetary compensation. Moreover, regardless of the results of

individual lawsuits, critical media coverage of such lawsuits may reduce social tolerance of smoking, increase interest in the relationship between smoking and health, strengthen public regulations concerning smoking and prompt the filing of a number of similar lawsuits against JT or its subsidiaries, forcing JT or its subsidiaries to bear litigation costs and materially affecting JT's business performance.

Other Tobacco-Related Legal Proceedings

Various kinds of smuggling and counterfeiting of tobacco products have posed a major challenge to the tobacco industry as a whole. JT and its subsidiaries are involved in certain proceedings overseas relating to the alleged smuggling of tobacco products. In addition, apart from the alleged smuggling of tobacco products, JT subsidiaries are also involved in certain proceedings, including those relating to tax assessment and possible violation of competition law.

In August 2003, the Canadian federal government filed a civil action in the Canadian province of Ontario against RJR and its subsidiaries, as well as JT and its subsidiaries, including JTI-Macdonald, which was acquired by JT when it took over the former non-U.S. tobacco operations of RJR Nabisco Inc. in 1999. The suit mainly claims as damages taxes allegedly lost by the Canadian government due to the smuggling of tobacco products into Canada in the 1990s.

In August 2004, JTI-Macdonald received a Notice of Assessment from the Quebec Ministry of Revenue requiring an immediate payment of approximately 1.36 billion Canadian dollars (approximately ¥101.4 billion at the exchange rate as of March 31, 2009, the end of the fiscal year 2008), claiming that JTI-Macdonald had allegedly contributed to tobacco smuggling from 1990 to 1998. This amount corresponded to the alleged loss of tobacco taxes plus penalties and interest.

JTI-Macdonald's failure to make the payment could have prompted the Quebec Ministry of Revenue to confiscate the company's business assets, making it difficult for the company to continue its normal business operations. Therefore, in order to continue its operations, JTI Macdonald filed an application with the Ontario Superior Court of Justice for protection under the Companies' Creditors Arrangement Act ("CCAA")*, and the application was granted. JTI-Macdonald has since been continuing its business under CCAA protection, which is due to remain in effect at least through March 15, 2010.

The filing for CCAA protection is in no way an admission that JTI-Macdonald contributed to smuggling as alleged by the Quebec Ministry of Revenue. JTI-Macdonald intends to

challenge the tax notice issued by the Quebec Ministry of Revenue through all appropriate means.

At the invitation of the court presiding over the CCAA proceedings, six other provinces have filed claims similar to Quebec's, seeking taxes, interest, and penalties. No procedure has yet been established for adjudicating these claims.

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

* Companies' Creditors Arrangement Act (CCAA): Companies doing business in Canada are eligible to seek protection under the CCAA if they encounter a financial situation that creates noticeable difficulties in their business operations. The CCAA is intended to enable these companies to continue their operations while restructuring. Many Canadian companies have undergone restructuring processes under the CCAA. Unlike bankruptcy proceedings, CCAA proceedings are not undertaken for liquidation. The fundamental characteristics of the CCAA are as follows:

- The company continues to manage and control its business and property;
- The CCAA is a very flexible law that can be tailored to fit the circumstances of each case;
- The company may seek to restructure its businesses or deal with contingent and other claims under court protection with the assistance of a court-appointed monitor;
- All lawsuits against the companies and other procedures are stayed, and companies are able to continue their businesses and carry out their restructuring;
- After the claims against the company are determined, the company may put a Plan of Arrangement before some or all of its creditors;
- If creditors have agreed to the aforementioned plan and the court approves it, it will be binding on the company and all affected creditors.

In May 2007, after a preliminary hearing on various charges arising from the alleged smuggling of tobacco products into Canada from 1991 to 1996, a preliminary inquiry judge in an Ontario court committed JTI-Macdonald and one former employee to stand trial. The judge at the same time dismissed the charges against another six former and current employees involved in the preliminary hearing. This latter ruling was reversed in February 2008 by the court hearing the review application and returned to the preliminary inquiry judge for reconsideration. A hearing on reconsideration was held in May 2008, and at the time of this writing judgment is reserved. These rulings determined neither the guilt nor innocence of the defendants, which is to be determined at trial.

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 ¥6.9 billion at the exchange rate as of March 31, 2009, the end of the fiscal year 2008) 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 is 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 both 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. Then the tax authorities filed a petition for appeal to the Russian Federation Higher Arbitration Court. In October 2008, the Court decided not to accept the appeal. As a result, the judgment in favor of M&S Corp. became final and binding.

On July 11, 2008, the Office of Fair Trading (OFT), the UK competition authority, announced that Gallaher Group Ltd, (former Gallaher Group Plc) and Gallaher Ltd.(together, hereinafter, "Gallaher"), JT's tobacco subsidiaries in the United Kingdom, have concluded an early resolution agreement with the OFT. Gallaher has agreed to pay a fine for anti-competitive business practices relating to the retail pricing of tobacco products in the UK market during the period 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 OFT regarding the investigation. Regarding this matter, the OFT issued a statement of objections on April 25, 2008. Following a careful and comprehensive review of the document, the JT Group decided to conclude an early resolution agreement with the OFT, which JT believes best serves the interest of all parties involved.

A certain amount, based on the company's assumptions about the fine, has been booked as noncurrent liabilities in the purchase price allocation related to JT's acquisition of Gallaher Group Plc (now Gallaher Group Ltd.). In the Balance Sheet ending March 2009, the amount is included in noncurrent liabilities. This agreement requires us to cooperate with the OFT regarding the investigation. The fine of approximately £93 million (approximately ¥13 billion as of March 31, 2009, the end of the fiscal year 2008) to payable by Gallaher is scheduled to be finally decided after such investigation has been completed. If the payment amount is set as the fine amount specified in the early resolution agreement, the difference between the actual fine and the liability already posted, approximately £71 million (approximately ¥10 billion as of March 31, 2009, the end of fiscal 2008),

will be recorded as extraordinary income.

While the agreement reached with the OFT relates only to Gallaher's past business activities prior to JT's acquisition of the Gallaher group of companies, JT takes it seriously. JT and its subsidiaries will continue to strive to ensure that they are in compliance with all laws and regulations applicable to them.

The possibilities cannot be ruled out that JT's performance, cash flows or financial condition could be materially affected by the ultimate outcome of certain pending litigation matters, among other factors. There also remains a possibility that other similar lawsuits could be filed in the future.

Major Risks of Businesses

The major risks to which the JT Group's businesses are exposed and factors that may materially affect investors' judgment, are described below. This section contains forward-looking statements based on judgments made as of the end of the fiscal year ended March 2009. Future potential risks include, but are not limited to, the risks listed below.

Risks Relating to the JT Group's Businesses, Earnings Structure and Management Policies

- Any negative impact on our domestic and international tobacco businesses, both of which are major contributors to the JT Group's sales and operating income, may adversely affect the group's overall business performance.
- Although the JT Group plans to invest in our pharmaceutical and food businesses, as it expects them to contribute to its business performance in the future, such investment may not generate the anticipated benefits.
- The JT Group may acquire, invest in, form alliances or build cooperative business frameworks with other companies, as it expects such measures to contribute to its future business performance. However, its future business performance may be negatively affected if results fall short of its expectations.
- On the JT Group's consolidated balance sheet, there is a large amount of goodwill related to the past acquisitions. We consider the goodwill to appropriately reflect profits which could be earned from the business values and synergy effects of those acquisitions. However, if those acquisitions fail to generate the anticipated benefits due to factors such as changes in the business environment or the competitive situation, we may be obliged to post an impairment loss, which may adversely affect the group's overall business performance.

- The JT Group's overseas operations may be negatively affected by exchange rate fluctuations, changes in laws and regulations, political unrest, uncertainty over economic developments, local labor-management relations, tax and tariff revisions, differences in business practices, etc.
- JT's consolidated financial statements may be affected by fluctuations in the exchange rates of the foreign currencies used by overseas subsidiaries for calculating their financial statements relative to the Japanese yen. There is also a risk that, if an overseas affiliate whose shares JT acquired by making payment in a foreign currency is liquidated or sold or if the value of such a subsidiary is significantly reduced, the gains/losses on investment in the affiliate recorded in JT's consolidated financial statements may be affected by fluctuations in the exchange rate between the foreign currency and the Japanese yen.
- Although JT partially hedges its exposure to foreign exchange risks related to transactions conducted in foreign currencies, the possibility cannot be ruled out that the JT Group's business performance will be negatively affected by exchange rate fluctuations.

Risks Relating to the JT Group's Domestic and International Tobacco Businesses

- The JT Group's business performance may be negatively affected by a decline in demand, as it expects overall cigarette demand in Japan to continue to decline mainly due to structural factors such as a contraction of the adult population, growing awareness about the health risks associated with smoking and tightening of smoking-related regulations, while demand overseas could also decrease depending on the economic conditions and other circumstances of the regions concerned, although the trends in demand will vary from region to region.
- Market shares in the domestic and overseas tobacco markets may fluctuate in the short term due to temporary factors, such as the launch of new products by JT and other tobacco manufacturers, and special sales promotion activities. Local market shares may also be affected by a number of other factors, including competition, pricing strategies, changes in consumer preferences, brand recognition and regional economic conditions. Such factors may lead to a decrease in the JT Group's market share. In addition, there is a risk that the measures adopted by the JT Group to counter the decrease in market share may entail additional costs, reducing its profits.
- Fluctuations in the prices of foreign leaf tobacco may have a direct impact on the JT Group's operating income.
- The tobacco tax rate may be raised in Japan or overseas.

- Tobacco demand may decrease due to the introduction of tighter tobacco regulations. There is also a risk that efforts to comply with new regulations may entail additional costs.
- If a country enacts legislation to ban the use of such terms as "mild" and "light" in product names, the JT Group may have to invest a large amount of time and funds into efforts to develop a new brand comparable to Mild Seven in that country, and the new brand thus developed may fail to achieve the same level of brand value and appeal.
- The JT Group has been sued in Japan and overseas for allegedly causing smoking-related health problems, and it may be held liable for such health problems in these lawsuits. There is also a risk that, regardless of the outcome of the lawsuits, negative publicity from the litigation and other factors may make smoking less acceptable to the public, lead to the introduction of tighter restrictions on smoking and prompt many similar lawsuits against the JT Group, thereby forcing it to become entangled in legal procedures and bear litigation costs.
- In addition to cases relating to smoking and health issues, the JT Group is a defendant in lawsuits filed by several Canadian governmental entities alleging that the group contributed to tobacco smuggling and seeking compensation for damages. Meanwhile, the JT Group has challenged what it regards as unreasonable notices of tax assessment that JT subsidiaries received from the Quebec Ministry of Revenue and from the Russian tax authorities. These claims may have a negative impact on the JT Group's business performance or on the manufacture, sale, importation/exportation of tobacco products if an unfavorable ruling is issued in the respective cases.

Risks Relating to Non-Tobacco Businesses

Risks Relating to Pharmaceutical Business

- The JT Group may fail to develop and launch commercially valuable pharmaceutical products. To this date, JT has never brought a pharmaceutical product to market that it has developed on its own.
- The JT Group may have to invest an enormous amount of time and funds in R&D before it successfully develops pharmaceutical products.
- The JT Group may be forced to abandon the clinical development of a pharmaceutical product that involves another company as a co-developer or a licensee on the basis of its or its partner company's judgment or due to some internal or external factors.
- Even if the JT Group succeeds in developing and launching a commercially valuable pharmaceutical product, the R&D cost may exceed the revenue generated from it.

- The JT Group may become dependent on a certain pharmaceutical product.
- The JT Group may fail to achieve efficient mass-production of pharmaceutical products.
- Even if a pharmaceutical product developed by the JT Group proves to be commercially successful, the success may be offset by competition with rival products developed by other companies in Japan or overseas, a government-mandated price reduction and other factors.
- The JT Group may become dependent on the license of pharmaceutical products developed by other companies and on revenues from such products.
- The JT Group may become dependent on a certain outside source for the supply of critical raw materials.
- If any problem arises regarding the quality of a pharmaceutical product of the JT Group or regarding information provided by the group about such product, the group may become the target of lawsuits seeking product liability or making other claims, or may be forced to suspend sales of such product.
- JT's business performance may be affected by lawsuits concerning patents and other intellectual property rights.
- Regulation may be applied broadly, covering a full range of activities from the R&D stage to the post-launch stage of a new drug.
- The JT Group may become dependent on a certain business partner in the R&D or sales of a pharmaceutical product.
- In relation to the JT Group's use and management of radioactive or other hazardous substances, social or legal problem may arise, such as damage to the environment caused by such substances.

Risks Relating to Food Business

- Food products developed by the JT Group may fail to meet consumer preferences and their product lives may prove to be short.
- The JT Group's profit/loss may fluctuate due to fluctuations in the prices of raw materials for food products (including those due to changes in the exchange rate).
- The sales of JT's food products may be affected by weather conditions.
- The regulation of the procurement, manufacture and sale of food products in Japan or overseas may influence the JT Group's business performance, including the possibility that additional costs may arise due to compliance with such regulation.
- The JT Group may be unable to compete with major companies with larger distribution networks, stronger development

capabilities and more experience.

- The JT Group may be unable to engage in efficient market-ing activities.
- The JT Group may be unable to produce, or outsource the production of, food products in an efficient, stable and effective manner.
- The JT Group may outsource the production of a large part of beverage products to other domestic manufacturers, thus becoming dependant on outside sources.
- If any problem arises regarding the quality of the JT Group's foods products, the group may become the target of lawsuits seeking product liability and making other claims, or the reputation of the group and its products may be undermined.

Other Factors which May Materially Affect Investment Decisions

- The Japan Tobacco Inc. Law (the "JT Law") obligates the government to hold at least one half of all JT shares it acquired upon JT's establishment, as adjusted for any subsequent stock split or consolidation of shares, and the government must continue to hold more than one third of all outstanding JT shares. As of the end of the fiscal year ended in March 2009, the government held 50.01% of all outstanding JT shares.
- The Minister of Finance has the authority to supervise JT under the JT Law and Tobacco Business Law.
- Under the JT Law, the scope of JT's businesses includes the "manufacture, distribution and importation of tobacco products and ancillary businesses, as well as businesses required for attaining the objective of JT," while "businesses required for attaining the objective of JT" are subject to the Minister of Finance's approval. Accordingly, the Minister of Finance's approval is required in order for JT to engage in new businesses outside the scope of currently-approved businesses.
- The Tobacco Business Law requires us to annually enter into purchase contracts with tobacco growers regarding the aggregate cultivation area for specific varieties of leaf tobacco and the prices for leaf tobacco by variety and grade. JT must purchase all leaf tobacco produced pursuant to such contracts, except for any not suited for the manufacture of tobacco products. When JT decides the aggregate cultivation area and the prices of leaf tobacco for its contracts with tobacco growers, it is required to respect the opinion of the Leaf Tobacco Deliberative Council (*hatabako shingi kai*), which consists of members appointed by JT with the approval of the Ministry of Finance from among the representatives of domestic leaf tobacco growers and academic appointees.