Financial Information

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Consolidated Eleven-Year Financial Summary

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

	1999	2000	2001	2002
For the year:				
Net sales	¥3,876,528	¥4,371,250	¥4,501,701	¥4,544,175
Tobacco	3,616,706	4,024,487	4,140,270	4,178,034
Domestic	—	—	—	—
International	—	—	—	—
Pharmaceutical	23,751	67,790	66,414	61,868
Food	150,742	195,026	210,332	221,197
Others	85,329	83,947	84,685	83,076
Taxation	—	—	—	—
Net sales excluding excise taxes	—	—	—	—
Net sales excluding excise taxes, distribution business	—	—	—	—
EBITDA (Note 2)	¥ —	¥ 315,132	¥ 312,045	¥ 334,119
Tobacco	—	299,477	296,318	320,969
Domestic	—	—	—	—
International	—	—	—	—
Pharmaceutical	—	(790)	(3,105)	(8,519)
Food	—	(490)	(2,660)	2,259
Others	—	16,093	20,033	19,617
Elimination/Corporate	—	842	1,459	(207)
Depreciation and Amortization (Note 2)	—	161,160	172,080	170,314
Operating income	¥ 168,899	¥ 153,972	¥ 139,965	¥ 163,805
Tobacco	193,855	181,520	165,923	192,114
Domestic	—	—	—	—
International	—	—	—	—
Pharmaceutical	(12,631)	(11,482)	(12,827)	(18,985)
Food	(8,663)	(14,582)	(17,362)	(11,860)
Others	(2,619)	(1,764)	3,428	1,797
Elimination/Corporate	(1,043)	280	803	739
Net income (loss)	74,633	50,792	43,687	36,850
For the year:				
Net cash provided by operating activities	¥ —	¥ 288,271	¥ 393,958	¥ 89,727
Net cash provided by (used in) investing activities	—	(899,139)	(90,477)	(40,472)
Net cash used in financing activities	—	472,593	(76,990)	(124,838)
Free cash flow (Note 3)	—	(786,499)	307,311	31,413
At year-end:				
Net property, plant and equipment	¥ 675,883	¥ 770,639	¥ 757,311	¥ 743,712
Total assets	2,228,566	3,095,298	3,188,230	3,063,077
Interest bearing debt (Note 4)	123,345	660,525	606,089	511,738
Liabilities	781,463	1,515,539	1,618,877	1,400,384
Total equity	1,415,996	1,526,583	1,513,846	1,613,105
Ratios:				
Return on equity (ROE)	5.4%	3.5%	2.9%	2.4%
Return on assets (ROA)	—	—	—	5.4%
Operating income margin	4.4%	3.5%	3.1%	3.6%
Total assets turnover	1.81	1.64	1.43	1.45
Equity ratio	63.5%	49.3%	47.5%	52.7%
Debt/Equity ratio (times)	0.09	0.43	0.40	0.32
Current ratio	275.0%	198.2%	169.7%	196.3%
Fixed assets/Long-term capital ratio	49.5%	72.5%	78.1%	74.9%

Notes: 1. Figures stated in U.S. dollars in this report are translated solely for convenience at the rate of ¥98.23 per $1, the rate of exchange as of March 31, 2009.
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)
4. Interest-bearing Debt includes lease obligation from FY 2009

							Millions of yen	Millions of U.S. dollars (Note 1)
	2003	2004	2005	2006	2007	2008	**2009**	**2009**
	¥4,492,264	¥4,625,151	¥4,664,514	¥4,637,657	¥4,769,387	¥ 6,409,727	**¥6,832,307**	**$69,554**
	4,134,466	4,236,920	—	—	—	—	**—**	**—**
	—	—	3,491,488	3,405,281	3,416,274	3,362,398	**3,200,494**	**32,581**
	—	—	792,705	881,188	999,658	2,639,969	**3,118,319**	**31,745**
	53,927	51,242	57,676	49,257	45,452	49,064	**56,758**	**578**
	232,404	250,138	265,380	278,378	286,554	336,420	**435,966**	**4,439**
	71,467	86,851	57,265	23,553	21,449	21,876	**20,770**	**211**
	—	2,605,343	2,650,586	2,628,878	2,718,358	3,822,331	**4,005,123**	**40,773**
	—	2,019,807	2,013,927	2,008,780	2,051,029	2,587,396	**2,827,184**	**28,781**
	—	—	1,684,404	1,596,151	1,633,186	2,068,368	**2,295,117**	**23,365**
	¥ 337,296	¥ 373,435	¥ 400,115	¥ 433,391	¥ 464,634	¥ 602,096	**¥ 646,217**	**$ 6,579**
	321,419	343,163	—	—	—	—	**—**	**—**
	—	—	296,031	305,753	326,470	306,726	**272,280**	**2,772**
	—	—	65,462	94,093	112,668	270,757	**337,968**	**3,441**
	(5,110)	(4,426)	5,474	(1,803)	(8,197)	(6,269)	**4,890**	**50**
	546	3,300	7,931	11,869	12,018	8,353	**17,030**	**173**
	19,674	30,674	26,810	22,140	21,586	22,055	**13,150**	**134**
	767	724	(1,593)	1,339	89	474	**899**	**9**
	148,333	139,401	126,744	126,445	132,643	171,542	**282,411**	**2,875**
	¥ 188,963	¥ 234,034	¥ 273,371	¥ 306,946	¥ 331,991	¥ 430,554	**¥ 363,806**	**$ 3,703**
	213,342	238,409	—	—	—	—	**—**	**—**
	—	—	215,833	220,095	245,388	222,348	**188,259**	**1,917**
	—	—	44,458	71,031	81,085	205,360	**174,772**	**1,779**
	(13,855)	(12,840)	1,855	(5,057)	(11,207)	(9,644)	**1,020**	**10**
	(13,168)	(4,851)	1,948	6,325	6,705	667	**(11,451)**	**(117)**
	932	11,976	10,427	8,673	9,331	10,448	**9,695**	**99**
	1,712	1,340	(1,150)	5,879	689	1,375	**1,511**	**15**
	75,302	(7,603)	62,584	201,542	210,772	238,702	**123,400**	**1,256**
	¥ 258,057	¥ 334,501	¥ 250,840	¥ 150,343	¥ 435,958	¥ 145,030	**¥ 275,271**	**$ 2,802**
	(74,877)	(228,620)	176,914	(26,358)	(149,692)	(1,668,635)	**(65,008)**	**(662)**
	(111,968)	(109,335)	(202,196)	(48,135)	(32,635)	519,001	**(217,470)**	**(2,214)**
	170,372	269,174	269,459	145,590	223,007	(1,493,717)	**240,199**	**2,445**
	¥ 733,314	¥ 708,221	¥ 639,655	¥ 596,544	¥ 600,436	¥ 763,332	**¥ 668,743**	**$ 6,808**
	2,957,665	3,029,084	2,982,056	3,037,379	3,364,663	5,087,214	**3,879,803**	**39,497**
	424,499	381,203	230,716	216,608	219,269	1,389,296	**996,079**	**10,140**
	1,283,939	1,467,322	1,430,256	1,217,306	1,340,047	2,932,585	**2,255,515**	**22,962**
	1,622,654	1,507,937	1,498,204	1,762,512	2,024,616	2,154,629	**1,624,288**	**16,536**
	4.7%	(0.5%)	4.2%	12.4%	11.3%	11.8%	**6.8%**	
	6.4%	7.9%	9.2%	10.4%	10.7%	10.5%	**8.4%**	
	4.2%	5.1%	5.9%	6.6%	7.0%	6.7%	**5.3%**	
	1.49	1.55	1.55	1.54	1.49	1.52	**1.52**	
	54.9%	49.8%	50.2%	58.0%	58.3%	40.8%	**40.0%**	
	0.26	0.25	0.15	0.12	0.11	0.67	**0.64**	
	226.4%	195.3%	202.7%	256.7%	226.4%	96.1%	**100.2%**	
	69.7%	69.9%	67.6%	60.7%	61.3%	103.4%	**102.5%**	

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" (See Page 39).

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, 2009, excluding tobacco products purchased from overseas tobacco manufacturers and sold to retail stores through its subsidiary, TS Network Co., Ltd. ("TS Network"), was 615.8 billion cigarettes (159.9 billion cigarettes in the domestic market; 3.6 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 452.3 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.

On April 18, 2007 we completed the procedures for the acquisition of Gallaher Group Plc to make it a wholly owned subsidiary of JT. The acquisition price was approximately £7.50 billion (approximately ¥1,720 billion at the exchange rate effective at the time), and the total acquisition price including the assumption of net interest-bearing debt was approximately £9.44 billion (approximately ¥2,180 billion at the exchange rate effective at the time). 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 at the exchange rate effective at the time) 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 its own 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 integration with Gallaher, we continue to gain both top-line synergies and cost saving synergies. We count eight brands among our list of global flagship brands ("GFB"): 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 GFB, which form the core of our brand portfolio.

In addition to the tobacco business, the JT Group has been actively engaged in its food 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 food business, the JT Group principally manufactures and sells beverages, processed foods and seasonings in the domestic market. 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 January 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%. Following the acquisition of all voting rights of Katokichi Co. on April 18, 2008, the JT Group concentrated its processed food operations, including frozen food operations and seasonings operations, at the Katokichi Group beginning on July 1, 2008. Through this realignment, the Katokichi Group will consolidate its foundation as a unique food manufacturer on the strength of its processed food business—including the frozen food business, which boasts Japan's leading scale—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 ¥6,832.3 billion for the year ended March 31, 2009, compared with ¥6,409.7 billion for the year ended March 31, 2008. The domestic and international tobacco businesses accounted for 46.8% and 45.6%, respectively, of our net sales in the year ended March 31, 2009, compared with 52.5% and 41.2% in the year ended March 31, 2008. 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 ¥363.8 billion for the year ended March 31, 2009, compared with ¥430.6 billion for the year ended March 31, 2008. Although our food business has generated operating income since the year ended March 31, 2005, it posted an operating loss in the year ended March 31, 2009. 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 and the year ended March 31, 2009. 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	2007	2008	Millions of yen 2009	Millions of U.S. dollars 2009
Net sales	¥4,769,387	¥6,409,727	**¥6,832,307**	**$69,554**
Tobacco Business				
Domestic	3,416,274	3,362,398	**3,200,494**	**32,581**
International	999,658	2,639,969	**3,118,319**	**31,745**
Pharmaceutical Business	45,452	49,064	**56,758**	**578**
Food Business	286,554	336,420	**435,966**	**4,439**
Other Business	21,449	21,876	**20,770**	**211**

	2007	2008	Millions of yen 2009	Millions of U.S. dollars 2009
Operating income	¥331,991	¥430,554	**¥363,806**	**$3,703**
Tobacco Business				
Domestic	245,388	222,348	**188,259**	**1,917**
International	81,085	205,360	**174,772**	**1,779**
Pharmaceutical Business	(11,207)	(9,644)	**1,020**	**10**
Food Business	6,705	667	**(11,451)**	**(117)**
Other Business	9,331	10,448	**9,695**	**99**
Elimination/Corporate	689	1,375	**1,511**	**15**

Domestic Tobacco: Net sales for our domestic tobacco business totaled ¥3,200.5 billion in the year ended March 31, 2009, compared with ¥3,362.4 billion in the year ended March 31, 2008. 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 ¥3,118.3 billion in the year ended March 31, 2009, compared with ¥2,640.0 billion in the year ended March 31, 2008. 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, 2009, unchanged from the year ended March 31, 2008. The pharmaceutical business recorded an operating profit of ¥1.0 billion in the business year ended March 31, 2009, compared with an operating loss of ¥9.6 billion in the year ended March 31, 2008, due to an upfront payment for the licensing of anti-osteoporosis compound JTT-305, and a milestone revenue associated with progress in the development of the JTT-705 compound for the treatment of dyslipidemia. We expect the pharmaceutical business to remain unprofitable for at least the next few years.

Food: Our food business accounted for approximately 6.4% of our net sales in the year ended March 31, 2009, compared with 5.2% in the year ended March 31, 2008. It posted an operating loss of ¥11.5 billion in the year ended March 31, 2009, compared with an operating income of ¥0.7 billion in the year ended March 31, 2008.

Other: Our "other business" segment accounted for approximately 0.3% of our net sales in the year ended March 31, 2009, unchanged from the year ended March 31, 2008. Net sales in this segment have been gradually decreasing in recent years. Operating income generated by this segment totaled ¥9.7 billion in the year ended March 31, 2009, compared with ¥10.4 billion in the year ended March 31, 2008. 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

For years ended March 31			Millions of yen	Millions of U.S. dollars
	2007	2008	**2009**	**2009**
Net sales	¥4,769,387	¥6,409,727	**¥6,832,307**	**$69,554**
Japan	3,718,450	3,711,763	**3,672,004**	**37,381**
Western Europe	353,831	1,678,770	**2,038,028**	**20,748**
Other	697,106	1,019,194	**1,122,275**	**11,425**

			Millions of yen	Millions of U.S. dollars
	2007	2008	**2009**	**2009**
Operating income (loss)	¥331,991	¥430,554	**¥363,806**	**$3,703**
Japan	248,482	222,340	**186,439**	**1,898**
Western Europe	(18,810)	55,936	**(24,188)**	**(246)**
Other	101,552	151,398	**199,633**	**2,032**
Elimination/Corporate	767	880	**1,922**	**19**

Japan: Net sales in Japan in the year ended March 31, 2009 declined by ¥39.8 billion, or 1.1%, from the previous year to ¥3,672.0 billion as a result of a decrease in the sales volume for the domestic tobacco business. Operating income in the year ended March 31, 2009 dropped by ¥35.9 billion, or 16.1%, from the previous year to ¥186.4 billion because of the reduced sales volume for the domestic tobacco business and the inclusion of the full-year cost of the amortization of the goodwill of the Katokichi Group.

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.

Western Europe: Net sales in Western Europe in the year ended March 31, 2009 grew by ¥359.3 billion, or 21.4% from the previous year to ¥2,038.0 billion as a result of the inclusion of the full-year results of Gallaher, which has a large market share in the United Kingdom and Ireland, where cigarette prices are high. Operating losses in the year ended March 31, 2009 totaled ¥24.1 billion, a deterioration of ¥80.1 billion from the previous year, because of the cost of goodwill amortization.

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 the United Kingdom, 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.

Other Regions: Net sales in other regions in the year ended March 31, 2009 grew by ¥103.1 billion, or 10.1%, from the previous year to ¥1,122.3 billion as a result of an increase in international sales by JT International, particularly in countries such as Russia and Turkey. Operating income in the year ended March 31, 2009 increased by ¥48.2 billion, or 31.9% from the previous year to ¥199.6 billion.

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.

Outlook of Results for the Year Ending March 31, 2010

It is too early to forecast business results for the fiscal year ending March 31, 2010. Based on current trends and other factors that we are aware of at this point, we expect a decline in both net sales and profits. We expect that net sales will drop because a decline in the sales volume for the domestic tobacco business due to overall cigarette demand in Japan and a negative foreign exchange impact will outweigh a sales increase for the international tobacco business resulting mainly from strong demand for GFB.

Meanwhile, we expect our operating income to decline as an increase in raw materials costs due to a rise in leaf tobacco prices and other negative factors more than offset a decrease in the amortization cost following the completion of the amortization of some trademark rights.

Although we expect our bottom line to benefit from a decrease in interest payments following the repayments of interest-bearing debts and the absence of the burden of introducing age verification cigarette vending machines, which hurt the bottom line until the previous year, our net income is projected to decline due to factors such as a drop in profit from the sale of fixed assets, the cost of rationalization related to the closure of domestic factories and the decrease in operating income. 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	2007	2008	**2009**	**2009**
Net sales	¥4,769,387	¥6,409,727	**¥6,832,307**	**$69,554**
Cost of sales	3,844,768	5,228,926	**5,554,399**	**56,545**
Gross profit	924,619	1,180,801	**1,277,908**	**13,009**
Selling, general and administrative expenses	592,628	750,247	**914,102**	**9,306**
Operating income	331,991	430,554	**363,806**	**3,703**
Other income (expenses), net	5,205	(57,940)	**(101,662)**	**(1,035)**
Income before income taxes and minority interests	337,196	372,614	**262,144**	**2,668**
Income taxes	121,405	128,379	**134,973**	**1,374**
Income before minority interests	215,791	244,235	**127,171**	**1,294**
Minority interests	5,019	5,533	**3,771**	**38**
Net income	¥ 210,772	¥ 238,702	**¥ 123,400**	**$ 1,256**

Year Ended March 31, 2009 Compared with Year Ended March 31, 2008

Net Sales

Net sales for the year ended March 31, 2009 increased by ¥422.6 billion, or 6.6% from the previous year to ¥6,832.3 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 ¥3,200.5 billion in the year ended March 31, 2009, a decrease of ¥161.9 billion, or 4.8%, from the previous year. The sales volume of JT's tobacco products in Japan decreased by 7.8 billion cigarettes, or 4.7%, from the previous year to 159.9 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 0.2 percentage points compared with the previous year, to 65.1%, marking the second consecutive year of market share increase. Net sales (excluding excise tax) per 1,000 cigarettes remained unchanged from the previous year at ¥4,057.

Note: Our domestic sales volume includes 3.6 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 ¥3,118.3 billion, an increase of ¥478.4 billion, or 18.1%, from the previous year. The sales volume of our international tobacco business increased by 66.7 billion cigarettes, or 17.3%, to 452.3 billion cigarettes, thanks mainly to Winston's sales growth in Russia, Turkey, Ukraine and Spain; Camel' sales growth in Italy, Russia and Spain; Mild Seven's sales growth in Korea, Taiwan, Russia and Malaysia. The sales volume of GFB grew 42.3 billion cigarettes, or 20.8%, to 245.5 billion cigarettes. 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 GFB as well as the inclusion of the full-year results of Gallaher. However, sales in yen terms increased despite negative effects from the yen's appreciation 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, 2009 was ¥103.48 to $1.00, compared with ¥117.85 to $1.00 for the year ended March 31, 2008.

• Pharmaceutical Business

Net sales for our pharmaceutical business increased by ¥7.7 billion, or 15.7%, from the previous year to ¥56.8 billion in the year ended March 31, 2009. A decrease in net sales for Torii Pharmaceutical was more than offset by an upfront payment for the licensing of anti-osteoporosis oral compound JTT-305 to Merck in September 2008 and a milestone revenue associated with progress in the development of the JTT-705 compound for the treatment of dyslipidemia, which was licensed to Roche in October 2004.

• Food Business

Net sales for our food business increased by ¥99.5 billion, or 29.6%, from the previous year to ¥436.0 billion. Sales of beverage products declined by ¥7.6 billion, or 3.9%, to ¥187.4 billion. Sales of processed foods increased by ¥107.1 billion, or 75.7%, from the previous year to ¥248.6 billion, as the consolidation of the Katokichi Group outweighed the impact of the frozen food products contamination, and negative effects of unfavorable weather conditions and increased competition in the beverages business as well as a slump in general consumption caused by the recent severe economic downturn.

Cost of Sales

Cost of sales in the year ended March 31, 2009 increased by ¥325.5 billion, or 6.2%, from the previous year to ¥5,554.4 billion, mainly as a result of the inclusion of the full-year results of Gallaher and the Katokichi Group. This and other favorable 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, 2009 increased by ¥163.9 billion, or 21.8%, from the previous year to ¥914.1 billion. This was attributable to the inclusion of the cost of the goodwill amortization related to the international tobacco business following a revision of the accounting standards and the inclusion of the full-year cost of the amortization of the goodwill of the Katokichi Group as well as the inclusion of the full-year results of Gallaher and the Katokichi Group.

Operating Income

As a result of the above factors, operating income in the year ended March 31, 2009 declined by ¥66.7 billion, or 15.5%, from the previous year to ¥363.8 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, 2009 decreased by ¥34.1 billion, or 15.3%, from the previous year to ¥188.3 billion. The decrease was attributable mainly to a decline in the sales volume and an increase in sales promotion expenses.

• International Tobacco Business

Operating income for our international tobacco business in the year ended March 31, 2009 declined by ¥30.6 billion, or 14.9%, from the previous year to ¥174.8 billion, mainly due to the start of the goodwill amortization following a revision of accounting standards. A rise in the exchange rate of the Japanese yen against the U.S. dollar contributed to the decrease in operating income in yen terms.

• Pharmaceutical Business

Our pharmaceutical business recorded an operating income of ¥1.0 billion in the year ended March 31, 2009, representing an improvement of ¥10.7 billion in the operating balance from the previous year. A decrease in net sales for Torii Pharmaceutical was more than offset by an upfront payment for the licensing of anti-osteoporosis oral compound JTT-305 to Merck in September 2008 and a milestone revenue associated with progress in the development of the JTT-705 compound for the treatment of dyslipidemia, which was licensed to Roche in October 2004.

• Food Business

Our food business posted an operating loss of ¥11.5 billion in the year ended March 31, 2009, representing a deterioration of ¥12.1 billion in the operating balance compared with the previous year. This was attributable to a rise in general expenses, an increase in raw materials costs and the inclusion of the full-year cost of the amortization of the goodwill of the Katokichi Group following the consolidation of the group.

• Others

Operating income for our other businesses in the year ended March 31, 2009 decreased by ¥0.8 billion or 7.2% from the previous year to ¥9.7 billion.

Other Expenses/Income (on a net basis)

We booked other expenses totaling ¥101.7 billion (on a net basis) in the year ended March 31, 2009, an increase of ¥43.7 billion from the previous year. This reflected the inclusion of full-year interest payments related to additional debts and corporate bonds associated with the acquisition of Gallaher, a decline in profits from the sale of fixed assets, losses related to the demolition of company-owned residences for employees, expenses incurred by the international tobacco business in relation to a revision of the business model in the Philippines market and the cost of reorganizing the Katokichi Group's business operations.

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, 2009 decreased by ¥110.5 billion, or 29.6%, from the previous year to ¥262.1 billion.

Income Taxes

Income taxes in the year ended March 31, 2009 increased by ¥6.6 billion, or 5.1%, from the previous year to ¥135.0 billion. The actual effective tax rate in the year ended March 31, 2009 increased by 17.03 points to 51.49%, mainly due to the impact of the cost of the goodwill amortization that was not covered by the deferred tax accounting.

Income before Minority Interests

Income before minority interests in the year ended March 31, 2009 declined by ¥117.1 billion, or 47.9%, from the previous year to ¥127.2 billion. Minority interests in the year ended March 31, 2009 decreased by ¥1.8 billion, or 31.8%, from the previous year to ¥3.8 billion.

Net Income

As a result of the above factors, net income in the year ended March 31, 2009 decreased by ¥115.3 billion, or 48.3%, from the previous year to ¥123.4 billion.

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 GFB, which we are prioritizing as the driver of our profit growth. The sales volume of GFB 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 GFB of Benson & Hedges and Silk Cut, sold mainly in the United Kingdom 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 GFB 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.

• Food Business

Net sales for our food 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 the frozen foods products contamination on the processed food business 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.

• Food Business

Operating income for our food 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 food products in response to the frozen foods products 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.

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, 2008 and March 31, 2009, cash and cash equivalents totaled ¥215.0 billion and ¥167.3 billion, respectively.

For years ended March 31	Millions of yen 2007	2008	2009	Millions of U.S. dollars 2009
Net cash provided by operating activities	¥ 435,958	¥ 145,030	**¥ 275,271**	**$ 2,802**
Net cash provided by (used in) investing activities	(149,692)	(1,668,635)	**(65,008)**	**(662)**
Net cash used in financing activities	(32,635)	519,001	**(217,470)**	**(2,214)**
Effect of exchange rate changes and other	5,749	40,091	**(39,591)**	**(402)**
Net increase (decrease) in cash and cash equivalents	259,380	(964,513)	**(46,798)**	**(476)**
Cash and cash equivalents at beginning of the period	920,142	1,179,522	**215,009**	**2,189**
Decrease in cash and cash equivalents resulting from exclusion of subsidiaries from consolidation	—	—	**(953)**	**(10)**
Cash and cash equivalents at end of the period	¥1,179,522	¥ 215,009	**¥ 167,258**	**$ 1,703**

Year Ended March 31, 2009 Compared with Year Ended March ended March 31, 2008.

Net cash generated by operating activities in the year ended March 31, 2009 came to ¥275.3 billion compared with ¥145.0 billion in the year ended March 31, 2008, as an increase in the working capital was more than offset by the creation of stable cash flow by the tobacco business, including the cash flow generated by the inclusion of the full-year results of Gallaher. In the year ended March 31, 2009, we paid 12 months' worth of tobacco excise tax compared with the 13 months' worth paid in the previous year, when there was a one-time factor related to a bank holiday. Net cash used in investment activities in the year ended March 31, 2009 was ¥65.0 billion compared with ¥1,668.6 billion for the year ended March 31, 2008. Cash was used mainly for the acquisition of additional shares in Katokichi Co. and shares in Fuji Foods Corporation.

Net cash used for financing activities in the year ended March 31, 2009 was ¥217.5 billion, compared with ¥519.0 billion in net cash generated from such activities in the year ended March 31, 2008. This was mainly due to the payment of dividends and the redemption of corporate bonds and the repayment of borrowings by a foreign subsidiary.

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

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	2007	2008	**2009**	**2009**
Capital expenditures	¥102,147	¥129,555	**¥134,273**	**$1,367**

In the year ended March 31, 2009, we made capital expenditures totaling ¥134.3 billion. In our domestic tobacco business, we spent ¥46.5 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 and develop new products. In our international tobacco business, we invested ¥59.8 billion for the purpose of expanding our production capacity. In our pharmaceutical business, we spent ¥3.4 billion on the construction of production and research facilities, while we invested ¥23.2 billion in our food business, mainly for enhancing production facilities. In our other businesses, we made capital expenditures of ¥1.1 billion, mainly for real estate development.

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 food 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 food 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.

For the year ending March 31, 2010, we plan to make capital expenditures totaling approximately ¥166.0 billion. In our domestic tobacco business, we plan to invest approximately ¥65.0 billion to improve productivity and reduce costs, while in our international tobacco business, we plan to spend approximately ¥64.0 billion to increase production capacity. We have earmarked approximately ¥3.0 billion in investment for our pharmaceutical business to improve the R&D, approximately ¥32.0 billion for our food business to enhance production facilities and approximately ¥1.0 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 30% under the Medium-Term Management Plan "JT-11," 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, 2009, 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 ¥145.0 billion in the year ended March 31, 2008 and ¥275.3 billion in the year ended March 31, 2009. 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, 2009, long-term debt was ¥882.8 billion, of which bonds accounted for ¥540.2 billion. Our remaining long-term debt (including the current portion) consisted of ¥325.9 billion loans from banks and life insurance companies and ¥16.7 billion long-term lease obligation. Annual interest rates applicable to yen-denominated long-term bank loans outstanding as of March 31, 2008 and 2009 ranged from 0.65% to 6.17% and 0.77% to 5.30%, respectively. Annual interest rates for long-term loans denominated in other currencies ranged from 2.35% to 9.20% for those outstanding as of March 31, 2008 and from 2.35% to 8.00% for those outstanding as of March 31, 2009.

Maturities of long-term debt (including the current portion) as of March 31, 2009 were as follows:

For years ended March 31	Millions of yen	Millions of U.S. dollars
2010	¥222,080	$2,261
2011	77,567	790
2012	167,555	1,706
2013	63,010	641
2014	287,289	2,925
2015 and thereafter	65,171	663
Total	¥888,672	$8,986

As of March 31, 2009, 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.

• Short-term Debt

We take in short-term loans from banks and other financial institutions. Short-term loans totaled ¥269.0 billion as of March 31, 2008, including ¥162.4 billion in foreign currency-denominated loans, and ¥113.2 billion as of March 31, 2009, including ¥61.8 billion in foreign currency-denominated loans. Annual interest rates applicable to yen denominated short-term bank loans ranged from 0.01% to 7.047% as of March 31, 2008 and from 0.216% to 2.750% as of March 31, 2009. Annual interest rates applicable to short-term loans denominated in other currencies ranged from 3.69% to 12.70% as of March 31, 2008 and from 0.130% to 83.000% as of March 31, 2009.

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, interest rate cap option contracts, foreign currency forward contracts, currency swaps and currency 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 and interest rate cap option contracts for the purpose of managing interest rate risk in relation to borrowings. 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 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, interest rate cap option contracts, foreign currency forward contracts and currency swaps outstanding as of March 31, 2008 and 2009 that did not qualify for hedge accounting, see Note 17 to the audited consolidated financial statements included in this annual report.

Consolidated Balance Sheets

Japan Tobacco Inc. and Consolidated Subsidiaries / March 31, 2008 and 2009

	Millions of yen		Millions of U.S. dollars (Note 2)
Assets	2008	**2009**	**2009**
Current assets:			
Cash and cash equivalents	¥ 215,009	**¥ 167,258**	**$ 1,703**
Short-term investments (Note 5)	3,830	**2,610**	**27**
Trade notes and accounts receivable	325,076	**290,069**	**2,953**
Merchandise & finished goods	138,871	**122,970**	**1,252**
Semi-finished goods	120,528	**119,291**	**1,214**
Work in process	7,938	**6,562**	**67**
Raw materials & supplies	226,736	**215,335**	**2,192**
Other current assets (Notes 7 and 8)	201,212	**174,749**	**1,778**
Allowance for doubtful accounts	(4,504)	**(3,162)**	**(32)**
Total current assets	1,234,696	**1,095,682**	**11,154**
Property, plant and equipment (Note 7)**:**			
Land	157,381	**147,219**	**1,499**
Buildings and structures	679,900	**621,469**	**6,327**
Machinery, equipment and vehicles	704,664	**642,149**	**6,537**
Tools	220,932	**165,435**	**1,684**
Construction in progress	32,120	**35,254**	**359**
Total	1,794,997	**1,611,526**	**16,406**
Accumulated depreciation	(1,031,665)	**(942,783)**	**(9,598)**
Net property, plant and equipment	763,332	**668,743**	**6,808**
Investments and other assets:			
Investment securities (Note 5)	97,534	**66,495**	**677**
Investments in and advances to unconsolidated subsidiaries and associated companies	35,577	**24,639**	**251**
Trademarks	613,497	**347,372**	**3,536**
Goodwill	2,106,887	**1,453,961**	**14,802**
Deferred tax assets (Note 8)	110,709	**128,787**	**1,311**
Other assets	155,238	**135,820**	**1,382**
Allowance for doubtful accounts	(30,076)	**(41,696)**	**(424)**
Allowance for loss on investments	(180)	**—**	**—**
Total investments and other assets	3,089,186	**2,115,378**	**21,535**
Total	¥ 5,087,214	**¥3,879,803**	**$39,497**

See notes to consolidated financial statements.

	Millions of yen		Millions of U.S. dollars (Note 2)
Liabilities and Equity	2008	**2009**	**2009**
Current liabilities:			
Short-term bank loans (Note 7)	¥ 269,034	**¥ 113,231**	**$ 1,153**
Current portion of long-term debt (Note 7)	81,062	**222,256**	**2,263**
Tobacco excise taxes payable	300,614	**268,999**	**2,738**
Trade notes and accounts payable	175,370	**158,544**	**1,614**
Other payable (Note 10)	79,015	**62,825**	**640**
Income taxes payable (Note 8)	71,694	**51,777**	**527**
Consumption taxes payable	62,654	**43,848**	**446**
Other current liabilities (Notes 7, 8 and 10)	244,953	**171,923**	**1,749**
Total current liabilities	1,284,396	**1,093,403**	**11,130**
Non-current liabilities:			
Long-term debt (Note 7)	1,041,651	**660,592**	**6,725**
Liabilities for retirement benefits (Note 10)	283,387	**259,146**	**2,638**
Deferred tax liabilities (Note 8)	174,395	**110,390**	**1,124**
Other non-current liabilities (Notes 7 and 10)	148,756	**131,984**	**1,344**
Total non-current liabilities	1,648,189	**1,162,112**	**11,831**
Commitments and contingent liabilities (Note 14)			
Equity (Note 11)**:**			
Common stock—authorized, 40,000,000 shares; issued, 10,000,000 shares in 2008 and 2009	100,000	**100,000**	**1,018**
Capital surplus	736,400	**736,400**	**7,497**
Stock acquisition rights (Note 9)	186	**365**	**4**
Retained earnings	1,344,490	**1,224,989**	**12,471**
Unrealized gain on available-for-sale securities	21,339	**8,438**	**86**
Deferred gain on derivatives under hedge accounting	220	**92**	**1**
Pension liability adjustment of foreign consolidated subsidiaries (Note 10)	(10,712)	**(18,966)**	**(193)**
Foreign currency translation adjustments	(41,086)	**(423,562)**	**(4,313)**
Treasury stock, at cost—419,920 shares in 2008 and 2009	(74,578)	**(74,578)**	**(759)**
Total	2,076,259	**1,553,178**	**15,812**
Minority interests	78,370	**71,110**	**724**
Total Equity	2,154,629	**1,624,288**	**16,536**
Total	¥5,087,214	**¥3,879,803**	**$39,497**

Consolidated Statements of Income

Japan Tobacco Inc. and Consolidated Subsidiaries / Years ended March 31, 2007, 2008 and 2009

			Millions of yen	Millions of U.S. dollars (Note 2)
	2007	2008	**2009**	**2009**
Net sales	¥4,769,387	¥6,409,727	**¥6,832,307**	**$69,554**
Cost of sales (Note 3 (f))	3,844,768	5,228,926	**5,554,399**	**56,545**
Gross profit	924,619	1,180,801	**1,277,908**	**13,009**
Selling, general and administrative expenses (Notes 9 and 12)	592,628	750,247	**914,102**	**9,306**
Operating income	331,991	430,554	**363,806**	**3,703**
Other income (expenses):				
Interest and dividend income	12,103	13,410	**12,276**	**125**
Gain on disposition of property, plant and equipment—net	33,952	57,179	**32,787**	**334**
Loss on impairment of long-lived assets (Note 15)	(2,712)	(3,825)	**(16,365)**	**(167)**
Interest expense (Note 7)	(6,940)	(41,759)	**(51,356)**	**(523)**
Write-down of investment securities	—	(11,154)	**(7,063)**	**(72)**
Business restructuring costs (Notes 10 and 15)	—	(6,442)	**(24,364)**	**(248)**
Other—net (Note 15)	(31,198)	(65,349)	**(47,577)**	**(484)**
Other income (expenses)—net	5,205	(57,940)	**(101,662)**	**(1,035)**
Income Before Income Taxes and Minority Interests	337,196	372,614	**262,144**	**2,668**
Income taxes (Note 8):				
Current	84,481	117,272	**126,732**	**1,290**
Deferred	36,924	11,107	**8,241**	**84**
Total income taxes	121,405	128,379	**134,973**	**1,374**
Income Before Minority Interests	215,791	244,235	**127,171**	**1,294**
Minority interests	5,019	5,533	**3,771**	**38**
Net income	¥ 210,772	¥ 238,702	**¥ 123,400**	**$ 1,256**

			Yen	U.S. dollars
	2007	2008	**2009**	**2009**
Amounts per share:				
Basic net income (Notes 3 (r) and 18)	¥ 22,001	¥ 24,917	**¥ 12,881**	**$ 131**
Diluted net income (Notes 3 (r) and 18)	—	24,916	**12,880**	**131**
Cash dividends applicable to the year (Note 3 (r))	4,000	4,800	**5,400**	**55**

See notes to consolidated financial statements.

Consolidated Statements of Changes in Equity

Japan Tobacco Inc. and Consolidated Subsidiaries / Years ended March 31, 2007, 2008 and 2009

	Thousands	Millions of yen											
	Number of shares of common stock	Common stock	Capital surplus	Stock Acquisition Rights (Note 9)	Retained earnings	Unrealized gain (loss) on available-for-sale securities	Deferred gain on derivatives under hedge accounting	Pension liability adjustment of foreign consolidated subsidiaries (Note 10)	Foreign currency translation adjustments	Treasury stock	Total	Minority interests	Total equity
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	—	—	—	—	—	—	—	—	—	—	—	57,561	57,561
Stock split (Note 11)	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
Adoption of FIN 48 (Note 3 (q))	—	—	—	—	(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
Adjustment of retained earnings due to an adoption of PITF No. 18 (Note 3 (b))	**—**	**—**	**—**	**—**	**(193,658)**	**—**	**—**	**—**	**—**	**—**	**(193,658)**	**—**	**(193,658)**
Net Income	**—**	**—**	**—**	**—**	**123,400**	**—**	**—**	**—**	**—**	**—**	**123,400**	**—**	**123,400**
Appropriations:													
Cash dividends paid (¥5,200 per share)	**—**	**—**	**—**	**—**	**(49,816)**	**—**	**—**	**—**	**—**	**—**	**(49,816)**	**—**	**(49,816)**
Adjustment to retained earnings for change in the number of consolidated subsidiaries	**—**	**—**	**—**	**—**	**47**	**—**	**—**	**—**	**—**	**—**	**47**	**—**	**47**
Adjustment to retained earnings for change in the number of equity method affiliates	**—**	**—**	**—**	**—**	**526**	**—**	**—**	**—**	**—**	**—**	**526**	**—**	**526**
Net changes in the year	**—**	**—**	**—**	**179**	**—**	**(12,901)**	**(128)**	**(8,254)**	**(382,476)**	**—**	**(403,580)**	**(7,260)**	**(410,840)**
Balance, March 31, 2009	**10,000**	**¥100,000**	**¥736,400**	**¥365**	**¥1,224,989**	**¥ 8,438**	**¥ 92**	**¥(18,966)**	**¥(423,562)**	**¥(74,578)**	**¥1,553,178**	**¥71,110**	**¥1,624,288**

	Millions of U.S. dollars (Note 2)											
	Common stock	Capital surplus	Stock Acquisition Rights (Note 9)	Retained earnings	Unrealized gain (loss) on available-for-sale securities	Deferred gain on derivatives under hedge accounting	Pension liability adjustment of foreign consolidated subsidiaries (Note 10)	Foreign currency translation adjustments	Treasury stock	Total	Minority interests	Total equity
Balance, March 31, 2008	$1,018	$7,497	$2	$13,687	$ 217	$ 2	$(109)	$ (418)	$(759)	$21,137	$798	$21,935
Adjustment of retained earnings due to an adoption of PITF No. 18 (Note 3 (b))	**—**	**—**	**—**	**(1,971)**	**—**	**—**	**—**	**—**	**—**	**(1,971)**	**—**	**(1,971)**
Net Income	**—**	**—**	**—**	**1,256**	**—**	**—**	**—**	**—**	**—**	**1,256**	**—**	**1,256**
Appropriations:												
Cash dividends paid ($53 per share)	**—**	**—**	**—**	**(507)**	**—**	**—**	**—**	**—**	**—**	**(507)**	**—**	**(507)**
Adjustment to retained earnings for change in the number of consolidated subsidiaries	**—**	**—**	**—**	**0**	**—**	**—**	**—**	**—**	**—**	**0**	**—**	**0**
Adjustment to retained earnings for change in the number of equity method affiliates	**—**	**—**	**—**	**6**	**—**	**—**	**—**	**—**	**—**	**6**	**—**	**6**
Net changes in the year	**—**	**—**	**2**	**—**	**(131)**	**(1)**	**(84)**	**(3,895)**	**—**	**(4,109)**	**(74)**	**(4,183)**
Balance, March 31, 2009	**$1,018**	**$7,497**	**$4**	**$12,471**	**$ 86**	**$ 1**	**$(193)**	**$(4,313)**	**$(759)**	**$15,812**	**$724**	**$16,536**

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Japan Tobacco Inc. and Consolidated Subsidiaries / Years ended March 31, 2007, 2008 and 2009

	Millions of yen			Millions of U.S. dollars (Note 2)
	2007	2008	**2009**	**2009**
Operating Activities:				
Income before income taxes and minority interests	¥ 337,196	¥ 372,614	**¥ 262,144**	**$ 2,669**
Adjustments for:				
Income taxes paid	(57,185)	(132,725)	**(114,414)**	**(1,165)**
Depreciation and amortization other than goodwill	130,106	167,658	**176,900**	**1,801**
Amortization of goodwill	2,537	3,883	**105,512**	**1,074**
Gain on disposition of property, plant and equipment	(33,952)	(57,179)	**(32,787)**	**(334)**
Loss on impairment of long-lived assets	2,712	3,825	**16,365**	**167**
Write-down of investment securities	—	11,154	**7,063**	**72**
Change in assets and liabilities:				
Decrease (increase) in trade notes and accounts receivable	(9,476)	47,485	**(43,141)**	**(439)**
Decrease (increase) in inventories	(6,171)	27,115	**(47,632)**	**(485)**
Increase (decrease) in tobacco excise taxes payable	160,020	(213,134)	**28,981**	**295**
Increase (decrease) in trade notes and accounts payable	(12,878)	(16,650)	**2,699**	**27**
Decrease in other payable	(22,088)	(39,956)	**(7,940)**	**(81)**
Decrease in liabilities for retirement benefits	(21,164)	(4,932)	**(13,159)**	**(134)**
Decrease in non-current other payable	(43,142)	(5,778)	**(3,707)**	**(38)**
Other—net	9,443	(18,350)	**(61,613)**	**(627)**
Total adjustments	98,762	(227,584)	**13,127**	**133**
Net cash provided by operating activities	435,958	145,030	**275,271**	**2,802**
Investing Activities:				
Purchases of short-term investments	(332,975)	(2,443)	**(1,643)**	**(17)**
Proceeds from sale and redemption of short-term investments	386,816	6,846	**3,272**	**33**
Purchases of investment securities	(158,385)	(22,563)	**(404)**	**(4)**
Proceeds from sale and redemption of investment securities	5,345	2,153	**3,058**	**31**
Purchases of property, plant and equipment	(96,717)	(124,832)	**(112,408)**	**(1,144)**
Proceeds from sale of property, plant and equipment	57,094	83,336	**55,256**	**563**
Purchases of trademarks and other assets	(7,928)	(6,831)	**(6,949)**	**(71)**
Purchases of shares of newly consolidated subsidiaries, net of cash acquired (Note 4)	(4,085)	(1,608,081)	**(3,061)**	**(31)**
Other—net	1,143	3,780	**(2,129)**	**(22)**
Net cash used in investing activities	(149,692)	(1,668,635)	**(65,008)**	**(662)**
Financing Activities:				
Net increase (decrease) in short-term bank loans	18,571	136,063	**(125,182)**	**(1,274)**
Proceeds from long-term debt	—	378,863	**94,130**	**958**
Repayments of long-term debt	(19,840)	(90,199)	**(54,663)**	**(556)**
Proceeds from issuance of common stock to minority shareholders	4,928	—	**—**	**—**
Proceeds from issuance of bonds	—	149,723	**—**	**—**
Payment for redemption of bonds	—	(10,000)	**(70,810)**	**(721)**
Dividends paid	(34,488)	(42,152)	**(49,752)**	**(506)**
Dividends paid to minority shareholders	(1,474)	(2,890)	**(3,540)**	**(36)**
Repayments of finance lease obligations	—	—	**(6,606)**	**(67)**
Other—net	(332)	(407)	**(1,047)**	**(12)**
Net cash provided by (used in) financing activities	(32,635)	519,001	**(217,470)**	**(2,214)**
Foreign Currency Translation Adjustments on Cash and Cash Equivalents	5,749	40,091	**(39,591)**	**(402)**
Net Increase (decrease) in Cash and Cash Equivalents	259,380	(964,513)	**(46,798)**	**(476)**
Cash and Cash Equivalents, Beginning of Year	920,142	1,179,522	**215,009**	**2,189**
Decrease in cash and cash equivalents resulting from exclusion of subsidiaries from consolidation	—	—	**(953)**	**(10)**
Cash and Cash Equivalents, End of Year	¥1,179,522	¥ 215,009	**¥ 167,258**	**$ 1,703**

Finance lease obligations regarded as non-cash transactions incurred for the year ended March, 2009 amounted to ¥6,176 million ($63 million).

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 companies act of Japan (the "Companies Act") 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 food 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 food business, the Group develops, manufactures and sells processed food, 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 Act 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" (q) 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, 2009.

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 ¥98.23 to $1, the rate of exchange at March 31, 2009. 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, 2009 include the accounts of JT and its 274 significant (153 as of March 31, 2007 and 299 as of March 31, 2008) 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 22 material associated companies as of March 31, 2009 (11 as of March 31, 2007 and 25 as of March 31, 2008) 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 (d) 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 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) Unification of Accounting Policies Applied to Foreign Subsidiaries for Consolidated Financial Statements

In May 2006, the Accounting Standards Board of Japan (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." PITF No. 18 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 of America 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. Scheduled amortization of actuarial gain or loss of pensions that has been directly recorded in the equity
3. Expensing capitalized development costs of R&D
4. Cancellation of the fair value model accounting for property, plant, and equipment and investment properties and incorporation of the cost model accounting
5. Recording the prior years' effects of changes in accounting policies in the income statement where retrospective adjustments to financial statements have been incorporated
6. Exclusion of minority interests from net income, if contained

JT applied this accounting standard effective April 1, 2008. As a result of this change, operating income and income before income taxes and minority interests for the year ended March, 2009 decreased by ¥94,235 million ($959 million) respectively, and as of April 1, 2008, retained earnings decreased by ¥193,658 million ($1,971 million) as JT amortized goodwill posted at consolidated foreign subsidiaries.

Also, income before income taxes and minority interests for the year ended March 31, 2009 decreased by ¥912 million ($9 million) respectively, as JT posted the retrospective adjustment in the Consolidated Statements of Income. The adjustment was caused by an accounting policy change in foreign subsidiaries as a result of a change of U.S. GAAP.

c) 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.

d) 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.

e) Allowance for Doubtful Accounts

The allowance for doubtful accounts is stated in amounts considered to be appropriate based on the companies' past credit loss experience and an evaluation of potential losses in the receivables outstanding.

f) Inventories

Inventories are stated at cost determined principally by the average cost method. In July 2006, the ASBJ issued ASBJ Statement No. 9, "Accounting Standard for Measurement of Inventories," and JT and its domestic subsidiaries adopted the standard from fiscal year beginning on April 1, 2007. This standard 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. 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 beginning in the year ended March 31, 2008 (see Note 6 "Inventories").

g) 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 10 years, respectively.

For finance leases that do not transfer ownership of the leased property to the lessee, depreciation expense is mainly computed on the straight-line method over the lease period as the useful life and assuming no residual value.

(Changes in useful life of property, plant and equipment)

The useful life of property, plant and equipment with respect to Domestic Group was changed as a result of the review of useful life of these assets in conjunction with the revision of the corporate tax act, principally, the useful life of tobacco manufacturing was changed 8 years to 10 years.

The effect of this change for the year ended March, 2009 is immaterial.

h) Impairment of Long-Lived Assets

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.

i) Intangible Assets

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

j) 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 carryforwards. 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.

k) Accrued bonuses

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

l) 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.

(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.

m) Leases

In March 2007, the ASBJ issued ASBJ Statement No. 13, "Accounting Standard for Lease Transactions," which revised the previous accounting standard for lease transactions issued in June 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 previous accounting standard, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized. However, other finance leases were 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 should be capitalized to recognize lease assets and lease obligations in the balance sheet.

In addition, the revised accounting standard permits leases which existed at the transition date and do not transfer ownership of the leased property to the lessee to be measured at the obligations under finance leases less interest expense at the transition date and recorded as acquisition cost of lease assets.

–Lessor–

Under the previous accounting standard, finance leases that deem to transfer ownership of the leased property to the lessee are to be treated as sales. However, other finance leases were permitted to be accounted for as operating lease transactions if certain "as if sold" 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 should be recognized as lease receivables, and all finance leases that deem not to transfer ownership of the leased property to the lessee should be recognized as investments in lease.

JT and its domestic subsidiaries applied this accounting standard effective April 1, 2008.

In addition, the Company accounted for leases which existed at the transition date and do not transfer ownership of the leased property to the lessee as acquisition cost of lease assets measured at the obligations under finance leases less interest expense at the transition date.

The effect of this change on operating income, and income before income taxes and minority interests is immaterial.

n) Appropriations of Retained Earnings

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

o) 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 (p) "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.

p) 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.

The Group's trade payable 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.

q) 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) Trademarks

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, 2008 and 2009 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.

(6) Income Taxes

Foreign consolidated subsidiaries that applied in conformity with U.S. GAAP adopted the provisions of FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes.

r) 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 9,580,080 shares for the years ended March 31, 2008 and 2009 (see Note 18 "Net Income Per Share").

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

Diluted net income per share for the years ended March 31, 2008 and 2009 reflects the potential dilution that could occur if stock acquisition rights were exercised (see Note 18 "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.

s) 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.

t) Retirement allowances for directors and corporate auditors

Retirement allowances for directors and corporate auditors are recorded to state the liability at the amount that would be required if all directors and corporate auditors retired at each balance sheet date.

u) Provision for loss on debt guarantees

Possible losses arose from debt guarantees are provided based on the financial position of guaranteed parties.

v) New Accounting Pronouncements

Construction Contracts—

Under the current Japanese GAAP, either the completed-contract method or the percentage-of-completion method is permitted to account for construction contracts and software development contracts.

On December 27, 2007, the ASBJ published a new accounting standard for construction contracts. Under this accounting standard, the construction revenue and construction costs should be recognized by the percentage-of-completion method, if the outcome of a construction contract can be estimated reliably. When total construction revenue, total construction costs and the stage of completion of the contract at the balance sheet date can be reliably measured, the outcome of a construction contract can be estimated reliably. If the outcome of a construction contract cannot be reliably estimated, the completed-contract method shall be applied. When it is probable that total construction costs will exceed total construction revenue, an estimated loss on the contract should be immediately recognized by providing for loss on construction contracts. This standard is applicable to construction contracts and software development contracts and effective for fiscal years beginning on or after April 1, 2009 with early adoption permitted for fiscal years beginning on or before March 31, 2009 but after December 27, 2007.

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**

III. Transactions under Common Control during the year ended March 31, 2009

1. Outline of the transactions

(1) Transferred business: Processed food business (excluding chilled processed food business) and seasoning business of JT

(2) Description of transferred business: Mainly manufacturing and sales of processed frozen foods and seasoning product

(3) Legal form of the business combination: Business transfer of JT's processed food business and seasoning business, and stock transfer of affiliated companies including JT Foods, and consolidated subsidiaries

(4) Name of the company after business combinations: Katokichi Co., Ltd.

(5) Outline and purpose of the transactions:

The business combination enables the group to integrate JT's food business head office function and affiliated companies which are engaged with processed food business and seasoning business into Katokichi. After the combination, Katokichi holds the processed food business including the largest scale of frozen food business in Japan and seasoning business with leading manufacturing capability. Katokichi keeps implementing a business restructuring and setting up further business fundamentals.

2. Overview of accounting methods used

These business combinations are accounted as transactions under common control with "Accounting for Business Combinations" issued by the Business Accounting Council ("BAC") on October 31, 2003, and "Guidance for Accounting Standard for Business Combinations and Business Divestitures" (ASBJ Guidance No.10 updated on November 15, 2007).

5. Short-Term Investments and Investment Securities

Short-term investments and investment securities at March 31, 2008 and 2009 consisted of the following:

	Millions of yen		Millions of U.S. dollars
	2008	**2009**	**2009**
Short-term investments:			
Time deposits	¥ 1,392	**¥ 713**	**$ 7**
Government and Corporate bonds	2,438	**1,700**	**18**
Trust fund investments and other	—	**197**	**2**
Total	¥ 3,830	**¥ 2,610**	**$ 27**
Investment securities:			
Equity securities	¥74,974	**¥54,217**	**$552**
Government and Corporate bonds	4,366	**4,137**	**42**
Trust fund investments and other	18,194	**8,141**	**83**
Total	¥97,534	**¥66,495**	**$677**

The costs and aggregate fair values of marketable securities at March 31, 2008 and 2009 were as follows:

	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 yen			
	2009			
	Cost	Unrealized gain	Unrealized loss	Fair value
Available-for-sale				
Equity securities	**¥35,334**	**¥19,286**	**¥5,105**	**¥49,515**
Government and Corporate bonds	**4,124**	**108**	**3**	**4,229**
Trust fund investments and other	**8,083**	**—**	**535**	**7,548**
Held-to-maturity				
Government bonds and municipal bonds	**600**	**1**	**—**	**601**

	Millions of U.S. dollars			
	2009			
	Cost	Unrealized gain	Unrealized loss	Fair value
Available-for-sale				
Equity securities	**$360**	**$196**	**$52**	**$504**
Government and Corporate bonds	**42**	**1**	**0**	**43**
Trust fund investments and other	**82**	**—**	**5**	**77**
Held-to-maturity				
Government bonds and municipal bonds	**6**	**0**	**—**	**6**

The carrying amounts of non-marketable securities at March 31, 2008 and 2009 were as follows:

	Millions of yen		Millions of U.S. dollars
	2008	**2009**	**2009**
Available-for-sale			
Equity securities	¥5,682	**¥4,702**	**$48**
Corporate bonds	1,008	**1,007**	**10**
Trust fund investments and other	1,281	**791**	**8**
Total	¥7,971	**¥6,500**	**$66**

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, 2007, 2008 and 2009, were as follows:

	Millions of yen			Millions of U.S. dollars
	2007	2008	**2009**	**2009**
Amortized cost	¥—	¥300	**¥—**	**$—**
Proceeds from sales	¥—	¥293	**¥—**	**$—**
Net realized loss	¥—	¥ (7)	**¥—**	**$—**

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, 2007, 2008 and 2009, were as follows:

	Millions of yen			Millions of U.S. dollars
	2007	2008	**2009**	**2009**
Proceeds from sales	¥9,229	¥1,902	**¥2,719**	**$28**
Gross realized gains	¥2,125	¥ 566	**¥ 220**	**$ 2**
Gross realized losses	(3)	(43)	**(48)**	**(0)**
Net realized gain	¥2,122	¥ 523	**¥ 172**	**$ 2**

The amounts of securities classified as available-for-sale and held-to-maturity at March 31, 2009, 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	**¥1,909**	**¥ 701**	**$19**	**$ 7**
Due after one year through five years	**6,145**	**1,522**	**62**	**16**
Due after five years through ten years	**410**	**—**	**4**	**—**
Due after ten years	**1**	**—**	**1**	**—**
Total	**¥8,465**	**¥2,223**	**$86**	**$23**

For the years ended March 31, 2007, 2008 and 2009, losses on write-downs of securities including investments in affiliated companies totaled nil, ¥11,154 million and ¥7,062 million ($72 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.

6. Inventories

Inventories at March 31, 2008 and 2009 consisted of the following:

	Millions of yen		Millions of U.S. dollars
	2008	2009	2009
Leaf tobacco	¥300,671	**¥294,020**	**$2,993**
Finished products	102,331	**88,234**	**898**
Other	91,071	**81,903**	**834**
Total	¥494,073	**¥464,157**	**$4,725**

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 credited to cost of sales at March 31, 2007 was ¥9,585 million.

Annual devaluation was discontinued beginning in the year ended March 31, 2008. Effective from April 1, 2008, JT and its domestic subsidiaries applied the "Accounting Standard for Measurement of Inventories" (see Note 3 (f)).

7. Short-term Bank Loans, Long-term Debt and Lease Obligations

Short-term bank loans as of March 31, 2008 and 2009 consisted of the following:

	Millions of yen		Millions of U.S. dollars
	2008	2009	2009
Yen loans with interest rates of 0.010% to 7.047% at March 31, 2008 and of 0.216% to 2.750% at March 31, 2009	¥106,673	**¥ 51,444**	**$ 524**
Foreign currency loans with interest rates of 3.69% to 12.70% at March 31, 2008 and of 0.130% to 83.000% at March 31, 2009	162,361	**61,787**	**629**
Total	¥269,034	**¥113,231**	**$1,153**

Long-term debt at March 31, 2008 and 2009 comprised the following:

	Millions of yen		Millions of U.S. dollars
	2008	2009	2009
1.98% yen bonds, due 2009	¥ 150,000	**¥ 150,000**	**$ 1,527**
1.34% yen bonds, due 2010	49,996	**49,998**	**509**
1.53% yen bonds, due 2011	40,000	**40,000**	**407**
1.68% yen bonds, due 2012	59,995	**59,996**	**611**
Unsecured 5.88% Euro bonds issued by foreign subsidiary due in 2008	63,054	**—**	**—**
Unsecured 6.63% Sterling pound bonds issued by foreign subsidiary due in 2009	68,904	**39,523**	**402**
Unsecured 4.63% Euro bonds issued by foreign subsidiary due in 2011	134,266	**102,673**	**1,045**
Unsecured 5.75% Sterling pound bonds issued by foreign subsidiary due in 2013	56,581	**32,733**	**333**
Unsecured 4.50% Euro bonds issued by foreign subsidiary due in 2014	83,390	**63,974**	**651**
Unsecured 0.99% yen bonds issued by domestic subsidiary due in 2009	10,000	**—**	**—**
Other bonds	500	**1,261**	**13**
Long-term bank loans due through 2028	403,575	**325,944**	**3,320**
Lease obligation due through 2019	2,452	**16,746**	**170**
Total	1,122,713	**882,848**	**8,988**
Less current portion	(81,062)	**(222,256)**	**(2,263)**
Long-term debt, less current portion	¥1,041,651	**¥ 660,592**	**$ 6,725**

The weighted average interest rate for long-term lease obligation outstanding at March 31, 2009 is 12.97% and current portion is 8.16%.

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, 2008 and 2009 ranged from 0.65% to 6.17% and 0.77% to 5.30%, respectively.

Annual interest rates applicable to long-term loans denominated in foreign currencies outstanding at March 31, 2008 and 2009 ranged from 2.35% to 9.20% and 2.35% to 8.00%, respectively.

Annual maturities of long-term debt at March 31, 2009 were as follows:

Years Ending March 31,	Millions of yen	Millions of U.S. dollars
2010	**¥222,080**	**$2,261**
2011	**77,567**	**790**
2012	**167,555**	**1,706**
2013	**63,010**	**641**
2014	**287,289**	**2,925**
2015 and thereafter	**65,171**	**663**
Total	**¥882,672**	**$8,986**

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, 2009 were as follows:

	Millions of yen	Millions of U.S. dollars
Long-term bank loans	**¥3,388**	**$35**
Current portion of Long-term bank loans	**2,694**	**27**
Short-term bank loans	**2,591**	**26**
Others	**680**	**7**
Total	**¥9,353**	**$95**

The carrying amounts of assets pledged as collateral for the above secured loans and debt at March 31, 2009 were as follows:

	Millions of yen	Millions of U.S. dollars
Buildings and structures	**¥ 5,331**	**$ 53**
Machinery, equipment and vehicles	**1,732**	**19**
Land	**4,316**	**44**
Others	**89**	**1**
Total	**¥11,468**	**$117**

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.

8. 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, 2007, 2008 and 2009. 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, 2008 and 2009 were as follows:

	Millions of yen		Millions of U.S. dollars
	2008	**2009**	**2009**
Deferred tax assets:			
Liabilities for employees' retirement benefits	¥ 57,341	**¥ 55,718**	**$ 567**
Obligations under the Public Official Mutual Assistance Association Law	51,568	**47,726**	**486**
Net operating loss carryforwards	37,314	**42,855**	**436**
Foreign currency exchange losses	2,757	**26,558**	**270**
Allowance for doubtful accounts	5,611	**16,330**	**166**
Other	87,820	**99,558**	**1,015**
Less valuation allowance	(44,964)	**(64,920)**	**(661)**
Total	197,447	**223,825**	**2,279**
Deferred tax liabilities:			
Deferred gain on sales of fixed assets for income tax purposes	(31,772)	**(32,360)**	**(329)**
Basis differences in assets acquired and liabilities assumed upon acquisition	(122,961)	**(73,387)**	**(747)**
Other	(80,939)	**(72,921)**	**(743)**
Total	(235,672)	**(178,668)**	**(1,819)**
Net deferred tax assets (liabilities)	¥ (38,225)	**¥ 45,157**	**$ 460**

Net deferred tax assets and liabilities at March 31, 2008 and 2009 were reflected on the accompanying consolidated balance sheets under the following captions:

	Millions of yen		Millions of U.S. dollars
	2008	**2009**	**2009**
Other current assets	¥ 32,008	**¥ 29,675**	**$ 302**
Deferred tax assets	110,709	**128,787**	**1,311**
Other current liabilities	(6,547)	**(2,915)**	**(29)**
Deferred tax liabilities	(174,395)	**(110,390)**	**(1,124)**
Net deferred tax assets (liabilities)	¥ (38,225)	**¥ 45,157**	**$ 460**

A reconciliation between the normal effective statutory tax rates for the years ended March 31, 2007, 2008 and 2009 and the actual effective tax rates reflected in the accompanying consolidated statements of income was as follows:

	2007	2008	**2009**
Normal effective statutory tax rate	40.35%	40.35%	**40.35%**
Tax rate difference applied for foreign consolidated subsidiaries	(6.99)	(9.67)	**(12.60)**
Non-deductible expenses	3.06	2.34	**3.77**
Amortization of goodwill	(0.31)	0.48	**10.05**
Increase in valuation allowance	0.21	7.26	**5.42**
Increase (reduction) of FIN48 liability, net	—	(1.51)	**3.41**
Increase (reduction) in enacted tax rates, net	0.29	(5.49)	**(0.49)**
Other—net	(0.61)	0.69	**1.58**
Actual effective tax rate	36.00%	34.45%	**51.49%**

9. Stock Options

Stock option expense that is accounted for as “Selling, general and administrative expenses” on the consolidated statement of income for the years ended March 31, 2007, 2008 and 2009 amounted to nil, ¥186 million and ¥179 million ($2 million), respectively.

The stock options outstanding as of March 31, 2009 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	January 8, 2008	¥1 ($0.01)	From January 9, 2008 to January 8, 2038
2009 stock option	11 Directors 14 Executive officers	547 shares	October 6, 2008	¥1 ($0.01)	From October 7, 2008 to October 6, 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 option activity is as follows:

	2008 stock option	2009 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	
For the year ended March 31, 2009		
Non-Vested	(Shares)	**(Shares)**
March 31, 2008—Outstanding	106	**—**
Granted	—	**547**
Canceled	—	**—**
Vested	(106)	**(410)**
March 31, 2009—Outstanding	0	**137**
Vested		
March 31, 2008—Outstanding	320	**—**
Vested	106	**410**
Exercised	—	**—**
Canceled	—	**—**
March 31, 2009—Outstanding	426	**410**
Exercise price	¥1	**¥1**
	($0.01)	**($0.01)**
Average stock price at exercise	—	**—**
Fair value price at the grant date	¥581,269	**¥285,904**
	($5,802)	**($2,911)**

The assumptions used to measure fair value of 2009 stock options are as follows:

	2009 stock option
Estimate Method	Black-Scholes option pricing model
Volatility of stock price*1	32.815%
Estimated remaining outstanding period*2	15 years
Estimated dividend*3	¥4,800 per share
	($49 per share)
Interest rate with risk free*4	1.841%

*1 Calculated based on stock prices for the period on and after listing date (from October 27, 1994 to October 6, 2008)

*2 Due to difficulty in reasonably estimating 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 interim dividend and year-end dividend for the year 2008

*4 A yield of 15-year government bond, a period of which corresponds to expected remaining period

10. 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, 2008 and 2009 consisted of the following:

	Millions of yen		Millions of U.S. dollars
	2008	**2009**	**2009**
Projected benefit obligations	¥(567,044)	**¥(424,413)**	**$(4,321)**
Fair value of plan assets	449,588	**280,513**	**2,856**
Funded status	(117,456)	**(143,900)**	**(1,465)**
Unrecognized actuarial net loss	12,033	**44,997**	**458**
Unrecognized prior service cost	8,094	**6,204**	**63**
Net amount recognized	(97,329)	**(92,699)**	**(944)**
Pension liability adjustment of foreign consolidated subsidiaries (see Note 3 (q))	(12,212)	**(25,662)**	**(261)**
Prepaid pension cost	(49,387)	**(27,642)**	**(281)**
Other current liabilities	3,342	**(5,136)**	**(52)**
Liabilities for employees' retirement benefits	¥(155,586)	**¥(140,867)**	**$(1,434)**

"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 of the reversal of the 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, 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 2010.

The components of net periodic retirement benefit cost for the years ended March 31, 2007, 2008 and 2009 were as follows:

			Millions of yen	Millions of U.S. dollars
	2007	2008	**2009**	**2009**
Service cost	¥ 9,684	¥ 13,115	**¥ 13,123**	**$ 134**
Interest cost	9,685	20,149	**21,720**	**221**
Expected return on plan assets	(6,829)	(19,782)	**(20,133)**	**(205)**
Recognized actuarial loss	315	(430)	**748**	**8**
Amortization of prior service cost	1,502	1,530	**1,256**	**12**
Net periodic retirement benefit costs	¥14,357	¥ 14,582	**¥ 16,714**	**$ 170**

Significant assumptions used for the years ended March 31, 2007, 2008 and 2009 were as follows:

	2007	2008	**2009**
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, 2007, 2008 and 2009 were ¥3,002 million, ¥4,208 million and ¥3,948 million ($40 million), respectively.

Certain domestic and foreign subsidiaries provided additional retirement benefits for early-retired employees in connection with the reorganization of domestic distribution operations or rationalization of Domestic and International tobacco 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 nil, ¥2,285 million and ¥2,691 million ($27 million) for the years ended March 31, 2007, 2008 and 2009, respectively, and as other expenses of ¥790 million, ¥1,122 million and ¥32 million ($0 million) for the years ended March 31, 2007, 2008 and 2009, 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 funds for the years ended March 31, 2007 and 2008 were as follows:

		Millions of Yen	Millions of U.S. dollars
	2007	2008	2008
Fair value of plan assets	¥ 461,860	¥ 415,833	$ 4,233
Benefit obligations	(469,729)	(497,473)	(5,064)
Deficit	¥ (7,869)	¥ (81,640)	(831)

	2008	**2009**
Proportion of the Domestic consolidated subsidiary's contributions to the entire plan	1.2%	**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, 2008 and 2009 were ¥1,018 million, ¥744 million and ¥624 million ($6 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 years ended March 31, 2007, 2008 and 2009 were as follows:

	Millions of yen		Millions of U.S. dollars
	2008	**2009**	**2009**
Benefit obligations	¥(127,871)	**¥(116,890)**	**$(1,190)**
Unrecognized actuarial (gain) loss	70	**(1,389)**	**(14)**
Liabilities recognized	¥(127,801)	**¥(118,279)**	**$(1,204)**

	Millions of yen			Millions of U.S. dollars
	2007	2008	**2009**	**2009**
Interest cost	¥2,288	¥2,094	**¥1,918**	**$20**
Recognized actuarial loss	425	240	**107**	**1**
Net periodic costs	¥2,713	¥2,334	**¥2,025**	**$21**

The assumed discount rate used in the actuarial computation for the years ended March 31, 2007, 2008 and 2009 was 1.5%.

11. Equity

Since May 1, 2006, Japanese companies have been subject to the Companies Act. The significant provisions in the Companies Act that affect financial and accounting matters are summarized below:

(a) Dividends

Under the Companies Act, 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 Companies Act 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 Companies Act 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 Companies Act, the total amount of additional paid-in capital and legal reserve may be reversed without limitation of such threshold. The Companies Act 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 Companies Act 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, 2008 and 2009 were ¥51,005 million and ¥47,969 million ($488 million), respectively.

12. Research and Development Costs and Advertising Costs

Research and development costs charged to expenses as incurred for the years ended March 31, 2007, 2008 and 2009 were ¥41,239 million, ¥45,163 million and ¥47,296 million ($481 million), respectively.

Advertising costs were charged to expenses as incurred and totaled ¥151,523 million, ¥186,607 million and ¥188,023 million ($1,914 million) for the years ended March 31, 2007, 2008 and 2009, respectively.

13. Lease Transactions

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

For the year ended March 31, 2008, the Group recorded an impairment loss of ¥14 million on certain leased property held under finance leases that do not transfer ownership and an allowance for impairment loss on leased property, which is included in current liabilities.

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, 2008 was as follows:

	Millions of yen
	2008
Acquisition cost:	
Machinery, equipment and vehicles	¥ 7,212
Tools	20,903
Others	3,232
Total acquisition cost	31,347
Accumulated depreciation	15,032
Accumulated impairment loss	14
Net leased property	¥16,301

The above acquisition costs includes related interest expenses.

	Millions of yen
	2008
Obligations under finance leases:	
Due within one year	¥ 5,235
Due after one year	11,080
Total	¥16,315
Allowance for impairment loss on leased property	¥ 8

The above obligations under finance leases includes related interest expenses.

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

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

The minimum rental commitments under noncancellable operating leases at March 31, 2008 and 2009 were as follows:

	Millions of yen		U.S. dollars
	2008	**2009**	**2009**
Due within one year	¥ 7,724	**¥ 7,497**	**$ 76**
Due after one year	25,290	**24,020**	**245**
Total	¥33,014	**¥31,517**	**$321**

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, 2007 and 2008 was ¥253 million and ¥363 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, 2008 was as follows:

	Millions of yen
	2008
Acquisition cost:	
Machinery, equipment and vehicles	¥ 129
Others	1,679
Total acquisition cost	1,808
Accumulated depreciation	782
Net leased property	¥1,026

	Millions of yen
	2008
Claims under finance leases:	
Due within one year	¥ 367
Due after one year	769
Total	¥1,136

The above claims under finance leases included related interest income.

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

14. 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 ¥106.4 billion), 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, 2009 (the end of fiscal 2008), the company was continuing its 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 any 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 the 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) 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 a 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. 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 liabilities in the purchase price allocation related to JT's acquisition of Gallaher Group Plc (now Gallaher Group Ltd.). In the Consolidated Balance Sheet ending March 2009, the amount is included in current and noncurrent liabilities. This agreement requires us to cooperate with the OFT regarding the investigation. The fine of approximately £93 million (approximately ¥13 billion) 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), will be recorded as other 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 continue to strive to enhance efforts to ensure that they are in compliance with all laws and regulations applicable to them.

(2) Contingent Liabilities

At March 31, 2008 and 2009, the Group had the following contingent liabilities:

	Millions of yen		Millions of U.S. dollars
	2008	**2009**	**2009**
Trade notes discounted	¥1,008	**¥106**	**$ 1**
Guarantees and similar items of bank loans:			
Kotobuki Business Company Corp.,Ltd	733	**128**	**1**
Zhouzan Koumei Foods Co.,Ltd (38 Million of CNY and 332 thousand of USD)*	570	**—**	**—**
Mitoyo Cable Television Co.,Ltd	406	**357**	**4**
Zhouzan Katoka Foods Co.,Ltd (24 Million of CNY and 350 thousand of USD)*	380	**—**	**—**
Cook Foods. Co.ltd.	240	**165**	**2**
Others*	127	**60**	**0**
Total	¥3,464	**¥816**	**$ 8**

* The translation of the guaranteed amounts denominated in foreign currency were made at the rate of exchange at March 31, 2008 and 2009.

15. Other Income (Expenses)

(1) Business Restructuring Costs

Business restructuring costs for the years ended March 31, 2007, 2008 and 2009 consisted of the following:

	Millions of yen			Millions of U.S. dollars
	2007	2008	**2009**	**2009**
Additional Retirement Benefits (see Note 10)	¥—	¥(2,285)	**¥ (2,691)**	**$ (27)**
Loss on disposition of property, plant and equipment	—	—	**(404)**	**(4)**
Others—net	—	(4,157)	**(21,269)**	**(217)**
Total	¥—	¥(6,442)	**¥(24,364)**	**$(248)**

Business restructuring costs were incurred in line with the business restructuring measures mainly for the rationalization of Domestic and International tobacco business. For the year ended March 31, 2009, others—net includes a revision of the business model in the Philippines.

(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.

Loss on Impairment for the years ended March 31, 2007, 2008 and 2009 amounted to ¥2,712 million, ¥3,825 million and ¥16,365 million ($167 million) respectively, which relates principally to land, and certain buildings and structures of company housing which are planned to be demolished.

The recoverable value of such assets was calculated mainly by its value in use, which is set at "nil."

(3) Other—net

"Other—net" included in "Other Income (Expenses)" for the years ended March 31, 2007, 2008 and 2009 consisted of the following:

	Millions of yen			Millions of U.S. dollars
	2007	2008	**2009**	**2009**
Financial support for domestic tobacco growers	¥ (3,505)	¥ (2,005)	**¥ (768)**	**$ (8)**
Foreign exchange loss—net	(14,465)	(31,790)	**(21,802)**	**(222)**
Gain on sales of investment securities—net	1,908	352	**172**	**2**
Introduction costs for vending machines with adult identification functions	(5,746)	(12,879)	**(13,469)**	**(137)**
Costs related to the recall of frozen foods products	—	(5,624)	**—**	**—**
Others—net	(9,390)	(13,403)	**(11,710)**	**(119)**
Total	¥(31,198)	¥(65,349)	**¥(47,577)**	**$(484)**

"Introduction costs for vending machines with adult identification functions" is the cost to establish the 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.

16. Segment Information

The Group's business is divided into the domestic tobacco, international tobacco, pharmaceutical, food 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 food 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, 2008 and the results for the twelve months ended December 31, 2008 are consolidated for the year ended March 31, 2009.

(1) Industry Segments

Information about the industry segments of the Group for the years ended March 31, 2007, 2008 and 2009 were as follows:

								Millions of yen
								2007
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Food	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	Food	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 yen

2009	Domestic Tobacco	International Tobacco	Pharmaceuticals	Food	Others	Total	Elimination / Corporate	Consolidated
Sales to customers	¥3,200,494	¥3,118,319	¥ 56,758	¥435,966	¥20,770	¥6,832,307	¥ —	¥6,832,307
Intersegment sales	48,390	40,631	—	133	12,044	101,198	(101,198)	—
Total sales	3,248,884	3,158,950	56,758	436,099	32,814	6,933,505	(101,198)	6,832,307
Operating expenses	3,060,625	2,984,178	55,738	447,550	23,119	6,571,210	(102,709)	6,468,501
Operating income (loss)	¥ 188,259	¥ 174,772	¥ 1,020	¥ (11,451)	¥ 9,695	¥ 362,295	¥ 1,511	¥ 363,806
Assets	¥ 788,673	¥2,700,099	¥111,519	¥332,670	¥87,432	¥4,020,393	¥(140,590)	¥3,879,803
Depreciation and amortization other than goodwill	82,933	68,960	3,870	18,293	3,456	177,512	(612)	176,900
Impairment Loss	—	—	—	3,830	—	3,830	12,535	16,365
Amortization of goodwill	1,089	94,235	—	10,188	—	105,512	—	105,512
Capital expenditures	46,506	59,776	3,426	23,201	1,129	134,038	235	134,273

Millions of U.S. dollars

2009	Domestic Tobacco	International Tobacco	Pharmaceuticals	Food	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	$32,581	$31,745	$ 578	$4,439	$211	$69,554	$ —	$69,554
Intersegment sales	493	414	—	0	123	1,030	(1,030)	—
Total sales	33,074	32,159	578	4,439	334	70,584	(1,030)	69,554
Operating expenses	31,157	30,380	568	4,556	235	66,896	(1,045)	65,851
Operating income (loss)	$ 1,917	$ 1,779	$ 10	$ (117)	$ 99	$ 3,688	$ 15	$ 3,703
Assets	$ 8,029	$27,488	$1,135	$3,387	$889	$40,928	$(1,431)	$39,497
Depreciation and amortization other than goodwill	844	702	39	186	36	1,807	(6)	1,801
Impairment Loss	—	—	—	39	—	39	128	167
Amortization of goodwill	11	959	—	104	—	1,074	—	1,074
Capital expenditures	473	609	35	236	12	1,365	2	1,367

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 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 years ended March 31, 2007, 2008 and 2009 were ¥1,216,249 million, ¥1,193,178 million and ¥1,135,320 million ($11,558 million), respectively.

Effective from April 1, 2008, JT applied the “Practical Solution on Unification of Accounting Policies Applied to Foreign Subsidiaries for Consolidated Financial Statements” (see Note 3 (b)). As a result of this change, the operating income for the international tobacco segment for the year ended March 31, 2009 decreased by ¥94,235 million ($959 million) as compared to the case where the previous method was adopted.

(2) Geographical Segments

The geographical segments of the Group for the years ended March 31, 2007, 2008 and 2009 were summarized as follows:

						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	¥ 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 yen
						2009
	Japan	Western Europe	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	**¥3,672,004**	**¥2,038,028**	**¥1,122,275**	**¥6,832,307**	**¥ —**	**¥6,832,307**
Intersegment sales	**53,334**	**223,872**	**39,186**	**316,392**	**(316,392)**	**—**
Total sales	**3,725,338**	**2,261,900**	**1,161,461**	**7,148,699**	**(316,392)**	**6,832,307**
Operating expenses	**3,538,899**	**2,286,088**	**961,828**	**6,786,815**	**¥(318,314)**	**6,468,501**
Operating income (loss)	**¥ 186,439**	**¥ (24,188)**	**¥ 199,633**	**¥ 361,884**	**¥ 1,922**	**¥ 363,806**
Assets	**¥1,083,962**	**¥2,378,679**	**¥ 351,080**	**¥3,813,721**	**¥ 66,082**	**¥3,879,803**
Amortization of goodwill	**11,277**	**94,235**	**—**	**105,512**	**—**	**105,512**

						Millions of U.S. dollars
						2009
	Japan	Western Europe	Others	Total	Elimination/ Corporate	Consolidated
Sales to customers	**$37,381**	**$20,748**	**$11,425**	**$69,554**	**$ —**	**$69,554**
Intersegment sales	**544**	**2,278**	**399**	**3,221**	**(3,221)**	**—**
Total sales	**37,925**	**23,026**	**11,824**	**72,775**	**(3,221)**	**69,554**
Operating expenses	**36,027**	**23,272**	**9,792**	**69,091**	**(3,240)**	**65,851**
Operating income (loss)	**$ 1,898**	**$ (246)**	**$ 2,032**	**$ 3,684**	**$ 19**	**$ 3,703**
Assets	**$11,035**	**$24,215**	**$ 3,574**	**$38,824**	**$ 673**	**$39,497**
Amortization of goodwill	**115**	**959**	**—**	**1,074**	**—**	**1,074**

"Western Europe" includes Switzerland, United Kingdom and Germany while "Others" includes Canada, Russia and Malaysia for the years ended March 31,2008 and 2009. Operating expenses represent the aggregate amount of the cost of sales and selling, general and administrative expenses.

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

Effective from April 1, 2008, JT applied the "Practical Solution on Unification of Accounting Policies Applied to Foreign Subsidiaries for Consolidated Financial Statements" (see Note 3 (b)). As a result of this change, the operating income for the Western Europe segment for the year ended March 31, 2009 decreased by ¥94,235 million ($959 million) as compared to the case where the previous method was adopted.

(3) Sales to Foreign Customers

Sales to foreign customers for the years ended March 31, 2007, 2008 and 2009 amounted to ¥1,056,762 million, ¥2,705,461 million and ¥3,179,852 million ($32,371 million), respectively.

17. 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.

Financial instruments

2007	2008	**2009**
Foreign currency forward contracts	Foreign currency forward contracts	**Foreign currency forward contracts**
Currency options	Currency options	**Currency options**
Currency swaps	Currency swaps	**Currency swaps**

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

Financial instruments

2007	2008	**2009**
Interest rate swaps	Interest rate swaps	**Interest rate swaps**
	Interest rate cap options	**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:

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

2009

Hedging instruments	Hedged items
Foreign currency forward contracts	**Forecasted foreign currency transactions**
Interest rate swaps	**Borrowings**

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, 2007, 2008 and 2009:

									Millions of yen
			2007			2008			**2009**
	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	¥ 2,972	¥ 3,113	¥ 141	¥317,417	¥311,944	¥(5,473)	**¥154,553**	**¥151,600**	**¥(2,953)**
Selling	40,624	40,839	(215)	607,925	611,502	(3,577)	**183,728**	**185,286**	**(1,558)**
Currency swaps:									
Buying	—	—	—	7,784	(306)	(306)	**59,712**	**(242)**	**(242)**
Selling	—	—	—	2,193	(151)	(151)	**3,148**	**287**	**287**
Currency options:									
Buying	—	—	—	1,935	1	1	**—**	**—**	**—**
Selling	2,615	(318)	(318)	—	—	—	**—**	**—**	**—**
Total			¥(392)			¥(9,506)			**¥(4,466)**
Interest rate swaps									
Receive fixed pay floating	—	—	—	270,582	(1,218)	2,211	**72,284**	**2,811**	**2,811**
Receive floating pay fixed	—	—	—	—	—	—	**470**	**(5)**	**(5)**
Interest rate cap options									
Buying	—	—	—	484,867	718	718	**318,042**	**101**	**(1,504)**
Total			¥ —			¥ 2,929			**¥ 1,302**

			Millions of U.S. dollars
			2009
	Contract/ Notional Amount	Fair Value	Gain (Loss)
Foreign currency forward contracts:			
Buying	**$1,573**	**$1,543**	**$(30)**
Selling	**1,870**	**1,886**	**(16)**
Currency swaps:			
Buying	**608**	**(2)**	**(2)**
Selling	**32**	**3**	**3**
Currency options:			
Buying	**—**	**—**	**—**
Selling	**—**	**—**	**—**
Total			**$(45)**
Interest rate swaps			
Receive fixed pay floating	**736**	**29**	**29**
Receive floating pay fixed	**5**	**(0)**	**(0)**
Interest rate cap options			
Buying	**3,238**	**1**	**(16)**
Total			**$ 13**

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

18. Net Income Per Share

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the years ended March 31, 2008 and 2009 is as follows:

	Millions of yen	Shares	Yen	U.S. dollars
	Net Income	Weighted average shares	EPS	EPS
For the year ended March 31, 2009				
Basic EPS				
Net income available to common shareholders	**¥123,400**	**9,580,080**	**¥12,881**	**$131**
Effect of dilutive securities:				
Stock acquisition rights		**846**		
Diluted EPS:				
Net income for computation	**¥123,400**	**9,580,926**	**¥12,880**	**$131**
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

19. Subsequent Event

1. JT's board of directors resolved on April 30, 2009 that the company would close three cigarette factories in Japan. The Morioka factory and the Yonago factory will cease to manufacture at the end of March 31, 2010, and the Odawara factory will cease to manufacture at the end of March 31, 2011.

   The financial impact of this resolution has not yet been confirmed.

2. JT's board of directors resolved on April 30, 2009 that they would issue a new corporate bond to refinance the existing first series straight bonds to be matured on June 25, 2009. The fifth series straight bond with general mortgage was issued with the following terms:

(1)	Type of bonds:	The fifth series straight bonds with general mortgage
(2)	Total issue amount:	¥100 billion ($1 billion)
(3)	Issue price:	¥100 per face value of ¥100
(4)	Issue date:	June 3, 2009
(5)	Interest rate:	1.128 % per annum
(6)	Redemption price:	¥100 per face value of ¥100
(7)	Final redemption date:	June 3, 2014
(8)	Method of redemption:	Redemption at maturity The company may repurchase and redeem the Bonds after the date of issuance.
(9)	Mortgage:	General mortgage under the JT Law (See note 1)
(10)	Purpose of funds:	Funds for bond retirement
(11)	Special contracts:	Not applicable

Independent Auditors' Report

Deloitte.

Deloitte Touche Tohmatsu
MS Shibaura Building
4-13-23, Shibaura
Minato-ku, Tokyo 108-8530
Japan

Tel: +81(3)3457 7321
Fax: +81(3)3457 1694
www.deloitte.com/jp

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, 2009 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, 2009, 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, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 2009, in conformity with accounting principles generally accepted in Japan.

As discussed in Note 14(1) 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 1.36 billion Canadian dollars (approximately ¥106.4 billion). JTI MC filed an application for protection with the Ontario Superior Court of Justice on August 24, 2004, under the Companies' Creditors Arrangement Act, to make 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

June 23, 2009

Member of
Deloitte Touche Tohmatsu