Business Environment & Risk

Business Environment for the JT Group

The JT Group has long been committed to many of the FCTC's provisions, including the prevention of youth smoking and the elimination of illicit trade, and has engaged in active efforts to address those issues on a voluntary basis.

Meanwhile, JT believes that tobacco should be regulated by individual countries in light of their own circumstances, such as their local laws and regulations and cultural and social conditions.

Major Elements of Regulation on Global Tobacco Business

WHO: "Framework Convention on Tobacco Control"

Following six rounds of intergovernmental negotiations, the Framework Convention on Tobacco Control (FCTC) was adopted by World Health Assembly of the WHO in May 2003 and came into force on February 27, 2005, 90 days after its ratification by 40 signatory nations. As of March 31, 2010, a total of 168 countries (including the EC) were party to the FCTC. Japan signed the FCTC on March 9, 2004 and accepted it on June 8, 2004. The FCTC contains a number of provisions, some of which are legally binding for the signatory nations, while others allow for discretion by each nation with regard to interpretation and implementation.

Key provisions of the FCTC include:

— Price and tax measures (implementation of tax policies and price policies and imposition of restrictions on duty-free sales, etc. as appropriate, without prejudice to the sovereign right of signatory nations to determine and establish their tax policies)

— Packaging and labeling (adoption of effective measures to ensure (1) that tobacco product packaging and labeling do not promote tobacco products by using terms that could create an erroneous impression, for example, that a particular tobacco product is less harmful than others; and (2) that health warnings on tobacco packaging cover not less than 30% of the principal display area)

— Advertising (introduction of a comprehensive ban on tobacco advertising, sales promotion and sponsorship, or imposition of appropriate restrictions if a country is not in a position to implement a comprehensive ban because of its constitution or constitutional principles)

— Sales to minors (adoption and implementation of effective measures to ban sales of tobacco products to minors)

— Support for alternative activities (promotion of alternative activities for tobacco workers, growers and sellers as appropriate)

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

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

International Tobacco Product Marketing Standards

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

The key provisions of the international standards include:

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

— Tough guidelines applicable to advertising of tobacco products:

- Print advertising is to be limited to publications with at least 75% adult readership.
- Billboard advertising must not exceed 35 square meters in size.
- Ads on TV, radio and the Internet are prohibited unless and until 100% adult verification is achieved.
- Ads cannot run in cinemas unless there is a reasonable basis to believe that at least 75% of the audience is adult.
- Ads cannot feature celebrities, show individuals that appear younger than 25, or suggest that smoking enhances athletic, professional, personal or sexual success.

— Indication of health warnings in ads and other media:

- Health warnings must appear in almost all advertising, promotional and merchandising materials, except in rare instances such as point-of-sale materials smaller than 250 square centimeters.

— Restrictions on sponsorship:

- For events or activities that bear a tobacco product brand name, all participants who compete or otherwise take an active part must be adults.
- From December 1, 2006, attendance at an event or activity sponsored for the purpose of tobacco product brand promotion must be comprised of at least 75% adults, and these events can only generate incidental coverage in electronic media.

— All promotional activities are to be limited to verified adult smokers.

Prevention of Youth Smoking

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

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

http://www.jti.co.jp/corporate/enterprise/tobacco/think/activity

As for the JT Group's similar efforts abroad, please refer to the following website.

http://www.jti.com/cr_home/cr_positions/cr_positions_youth_smoking

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

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

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

Major Elements of Regulation of Tobacco Business in Japan

The Japan Tobacco, Inc. Law

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

The JT Law grants JT the freedom to enter other non-tobacco-related business areas in line with its overall objectives as a corporation, dependent upon ministerial permission, in addition to the manufacture, distribution, and importation of tobacco products and tobacco-related businesses. JT must also obtain authorization from the Minister of Finance for certain matters, including the appointment or dismissal of directors, executive officers, and auditors, amendments to JT's Articles of Incorporation, appropriations of capital surplus (except disposal of losses), and any merger, corporate split, or dissolution of JT.

Within three months after the end of each business year, JT must issue its balance sheets, statements of income or loss, and business report to the Minister of Finance.

The Tobacco Business Law

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

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

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

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

Health Warnings, etc.

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

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

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

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

Guideline on Tobacco Advertising

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

* Tobacco Institute of Japan: The TIOJ is a public interest corporation established for the purpose of contributing to the promotion of a fair and objective social understanding of tobacco through collecting and disseminating information regarding tobacco and supporting the sound development of Japan's tobacco industry and the national economy as a whole, by engaging in various activities in a manner suited to the social environment for tobacco consumption. The TIOJ was established in 1987 as a voluntary organization based on the Association of Tobacco Manufacturers, which was established in 1985, and reorganized as an incorporated body in 1990.

Prevention of Youth Smoking

—Age verification vending machines

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

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

Regulations on Tobacco Products in Japan and Abroad

In Japan, restrictions on smoking have been increasingly introduced in recent years in public spaces and other locations, including restaurants and office buildings. Since the government adopted the Guideline on Smoking Restriction Measures in the Workplace to promote the Health Promotion Act, which requires facility managers to take measures to prevent passive smoking, as well as smoking restriction activities in the workplace, a variety of activities have been implemented by the central and local governments and other organizations. JT expects that similar activities will continue to be promoted. As such, JT continues to engage in various initiatives to promote separation of smoking and nonsmoking areas, in order to help create a society in which smokers and nonsmokers can coexist in harmony. Japan, one of the countries that are party to the FCTC, takes necessary measures based on relevant laws and regulations, including those regarding tax, packaging and labeling.

In overseas markets where the JT Group sells tobacco products, regulations on sales and marketing of tobacco products and smoking have been increasing. For example, the European Union issued a directive concerning tobacco products in July 2001, which requires the EU member states to harmonize their laws, regulations and administrative provisions concerning the maximum tar, nicotine and carbon monoxide yields of cigarettes; the warnings regarding health and other information to appear on unit packets of tobacco products; and the use on tobacco product packaging of such descriptions as "mild" and "light." In addition, the United Kingdom has put into force laws comprising restrictions on the in-store display of tobacco products and a ban on sales of tobacco products through vending machines. While it is impossible to predict exactly what kinds of laws, regulations and business guidelines will be introduced in the future in relation to sales and marketing of tobacco products and smoking, JT expects that more similar and new regulations (including those introduced by local governments) will be introduced in Japan and other countries where the JT Group sells products.

Although the JT Group supports appropriate and reasonable regulations on tobacco products and smoking, the JT Group has had and is ready to have dialogue and cooperation with governments. It is our belief that adults choose to smoke based on their recognition of the health risks associated with smoking, and those adults should have the freedom to smoke.

Tobacco-Related Legal Proceedings

Litigation Related to Health Risks Associated with Smoking

JT and its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking, the marketing of tobacco products, or exposure to tobacco smoke.

To date, JT and its subsidiaries have never lost a case or paid any money to settle a case out of court.

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

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

On January 20, 2010, the Yokohama District Court rendered a judgment dismissing all of the plaintiff's claims, against which the plaintiffs filed an appeal.

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

Among the lawsuits filed overseas in relation to smoking and health in which JT subsidiaries are defendants are damage suits filed by individuals or classes of individuals and medical expense recovery suits filed by governments and insurers. As of the end of May 2010, there were a total of 26 such lawsuits pending in which JT subsidiaries are named as defendants or for which JT or a subsidiary may owe certain indemnity obligations pursuant to the relevant contracts, including the agreement for JT's acquisition of RJR Nabisco Inc.'s overseas (non-US) tobacco operations.

These lawsuits include health care cost recovery actions brought by the Canadian provinces and two class actions brought in Quebec.

The province of British Columbia filed an action under a provincial statute, the "Tobacco Damages and Health Care Costs Recovery Act," which was enacted exclusively for the purpose of this action. Several defendants challenged the statute's constitutionality. This challenge was ultimately rejected by the Supreme Court of Canada in September 2005. The provinces of New Brunswick and Ontario filed similar actions in March 2008 and in September 2009, respectively. For the time being, these actions remain in pre-trial proceedings with no decision yet made as to the liability of the JT Group and other companies.

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

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

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

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

Other Tobacco-Related Legal Proceedings

Various kinds of smuggling and counterfeiting of tobacco products have posed a major challenge to the tobacco industry as a whole.

Business Environment for the JT Group

On April 13, 2010, JTI-Macdonald Corp. (“JTI-Mac”), JT’s Canadian consolidated subsidiary, entered into a comprehensive agreement with the Government of Canada and all provinces and territories (the “Canadian Governments”) to establish a cooperation mechanism in combating cigarette smuggling and contraband. In addition, JTI-Mac pleaded to a regulatory offense for its involvement in the illicit trade of cigarettes prior to JT’s acquisition of non-US tobacco operations of RJR Nabisco Inc. and paid CAD150 million (approximately ¥13.8 billion at the exchange rate as of April 13, 2010). As a result, all of the contraband-related claims against JTI-Mac and others associated with it by the Canadian Governments stated above and the Notice of Assessment from the Quebec Ministry of Revenue have been withdrawn. CCAA proceedings have also been terminated as of April 17, 2010. At the same time, the RJR Group entered into another agreement with the Canadian Governments and made payment of CAD400 million (approximately ¥37.0 billion at the exchange rate as of April 13, 2010), resulting in total payments by the JT Group and the RJR Group to the Canadian Governments of CAD550 million (approximately ¥50.9 billion at the exchange rate as of April 13, 2010). As a result of the indemnification rights under the RJRI Purchase Agreement in 1999 and subsequent negotiations with the RJR Group, the JT Group and the RJR Group entered into an agreement whereby the JT Group would incur CAD150 million among the aforementioned CAD550 million total.

* The following cases were pending in Canada prior to the comprehensive agreement with Canadian Governments:

– In August 2003, the Canadian federal government filed a civil action in the Canadian province of Ontario against RJR and its subsidiaries, as well as JT and its subsidiaries, including JTI-Mac. The suit mainly claimed as damages taxes allegedly lost by the Canadian government due to the smuggling of tobacco products into Canada in the 1990s.

– In August 2004, JTI-Mac received a Notice of Assessment from the Quebec Ministry of Revenue requiring an immediate payment of approximately CAD1.36 billion (approximately ¥126.0 billion at the exchange rate as of April 13, 2010), claiming that JTI-Mac had allegedly contributed to tobacco smuggling from 1990 to 1998. This amount corresponded to the alleged loss of tobacco taxes plus penalties and interest. JTI-Mac’s failure to make the payment could have prompted the Quebec Ministry of Revenue to confiscate the company’s business assets, making it difficult for the company to continue its normal business operations. Therefore, in order to continue its operations, JTI-Mac filed an application with the Ontario Superior Court of Justice for protection under the Companies’ Creditors Arrangement Act (“CCAA”) and the application was granted.

– In May 2007, after a preliminary hearing on various charges arising from the alleged smuggling of tobacco products into Canada from 1991 to 1996, a preliminary inquiry judge in an Ontario court committed JTI-Mac and one former employee to stand trial.

As for court cases not related to tobacco smuggling, there is a case in which JT Group companies are seeking to invalidate a tax assessment received from the Russian tax authorities.

In April 2008, the Office of Fair Trading (OFT), the UK competition authority, issued a Statement of Objections against JT subsidiaries Gallaher Group Ltd. (former Gallaher Group Plc), and Gallaher Ltd. (hereinafter, these two companies will be collectively referred to as “Gallaher”), alleging the possibility of anti-competitive behaviour with respect to retail prices for tobacco products in the UK market prior to JT’s acquisition of Gallaher. Gallaher concluded an early resolution agreement with the OFT in July 2008 and, in April 2010, the OFT notified Gallaher of its decision to impose a fine of approximately 50 million British pounds. The amount of the fine is smaller than the amount of liabilities booked as a result of the risk assessment of the imposition of a fine under the U.K. Competition Act in accounting treatment made at the time of JT’s acquisition of Gallaher Group Plc based on the Purchase Method. The JT Group recorded the difference of approximately 114 million British pounds between the booked liabilities, which totaled approximately 164 million British pounds, and the amount of the fine notified by the OFT, as extraordinary profit (approximately ¥16.7 billion) on a consolidated basis for the fiscal year ended March 2010.

As described above, in addition to lawsuits related to health risks associated with smoking, there are other pending lawsuits that could have a negative impact on the JT Group’s financial results and production, sales and imports/exports of tobacco products in the event of a court ruling unfavorable for the JT Group, and similar cases may continue to be contested in court in the future.

Major Risks of Businesses

The major risks to which the JT Group's businesses are exposed and factors that may materially affect investors' judgment, are described below. This section contains forward-looking statements based on judgments made as of the end of the fiscal year ended March 2010. Future potential risks include, but are not limited to, the risks listed below.

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

- Any negative impact on our domestic and international tobacco businesses, both of which are major contributors to the JT Group's sales and operating income, may adversely affect the group's overall business performance.
- Although the JT Group plans to invest in our pharmaceutical and food businesses, as it expects them to contribute to its business performance in the future, such investment may not generate the anticipated benefits.
- The JT Group may acquire, invest in, form alliances or build cooperative business frameworks with other companies, as it expects such measures to contribute to its future business performance. However, its future business performance may be negatively affected if results fall short of its expectations.
- On the JT Group's consolidated balance sheet, there is a large amount of goodwill related to the past acquisitions. We consider the goodwill to appropriately reflect profits which could be earned from the business values and synergy effects of those acquisitions. However, if those acquisitions fail to generate the anticipated benefits due to factors such as changes in the business environment or the competitive situation, we may be obliged to post an impairment loss, which may adversely affect the group's overall business performance.
- The JT Group's overseas operations may be negatively affected by exchange rate fluctuations, changes in laws and regulations, political unrest, uncertainty over economic developments, local labor-management relations, tax and tariff revisions, differences in business practices, etc.
- JT's consolidated financial statements may be affected by fluctuations in the exchange rates of the foreign currencies used by overseas subsidiaries for calculating their financial statements relative to the Japanese yen. There is also a risk that, if an overseas affiliate whose shares JT acquired by making payment in a foreign currency is liquidated or sold or if the value of such a subsidiary is significantly reduced, the gains/losses on investment in the affiliate recorded in JT's consolidated financial statements may be affected by fluctuations in the exchange rate between the foreign currency and the Japanese yen.
- Although JT partially hedges its exposure to foreign exchange risks related to transactions conducted in foreign currencies, the possibility cannot be ruled out that the JT Group's business performance will be negatively affected by exchange rate fluctuations.

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

- The JT Group's business performance may be negatively affected by a decline in demand, as it expects overall cigarette demand in Japan to continue to decline mainly due to structural factors such as a contraction of the adult population, growing awareness about the health risks associated with smoking and tightening of smoking-related regulations, while demand overseas could also decrease depending on the economic conditions and other circumstances of the regions concerned, although the trends in demand will vary from region to region.
- Market shares in the domestic and overseas tobacco markets may fluctuate in the short term due to temporary factors, such as the launch of new products by the JT Group and other tobacco manufacturers, and special sales promotion activities. Local market shares may also be affected by a number of other factors, including competition, pricing strategies, changes in consumer preferences, brand recognition and regional economic conditions. Such factors may lead to a decrease in the JT Group's market share. In addition, there is a risk that the measures adopted by the JT Group to counter the decrease in market share may entail additional costs, reducing its profits.
- Fluctuations in the prices of foreign leaf tobacco may have a direct impact on the JT Group's operating income.
- The tobacco tax rate may be raised in Japan or overseas.
- Tobacco demand may decrease due to the introduction of tighter tobacco regulations. There is also a risk that efforts to comply with new regulations may entail additional costs.
- If a country decides to ban the use of such terms as "mild" and "light" in descriptions of product names, the JT Group might be prevented from selling Mild Seven according to such a decision. In such a case, the JT Group may have to invest a large amount of time and funds into efforts to develop a new brand comparable to Mild Seven in that country, and the new brand thus developed may fail to achieve the same level of brand value and appeal.
- The JT Group has been sued in Japan and overseas for allegedly causing smoking-related health problems, and it may be held liable for such health problems in these lawsuits. There is also a risk that, regardless of the outcome of the lawsuits, negative publicity from the litigation and other factors may make smoking less acceptable to the public, lead to the introduction of tighter restrictions on smoking and prompt many similar lawsuits against the JT Group, thereby forcing it to become entangled in legal procedures and bear litigation costs.
- In addition to cases relating to smoking and health issues, the JT Group has challenged what it regards as unreasonable notices of tax assessment that JT subsidiaries received from the Russian tax authorities. These claims may have a negative impact on the JT Group's business performance or on the manufacture, sale, importation/exportation of tobacco products if an unfavorable ruling is issued in the respective cases.

Risks Relating to Non-Tobacco Businesses

Risks Relating to Pharmaceutical Business

- The JT Group may fail to develop and launch commercially valuable pharmaceutical products. To this date, JT has never brought a pharmaceutical product to market that it has developed on its own.
- The JT Group may have to invest an enormous amount of time and funds in R&D before it successfully develops pharmaceutical products.
- The JT Group may be forced to abandon the clinical development of a pharmaceutical product that involves another company as a co-developer or a licensee on the basis of its or its partner company's judgment or due to some internal or external factors.
- Even if the JT Group succeeds in developing and launching a commercially valuable pharmaceutical product, the R&D cost may exceed the revenue generated from it.
- The JT Group's business performance may become dependent on the sale of certain pharmaceutical products.
- The JT Group may fail to achieve efficient mass-production of pharmaceutical products.
- Even if a pharmaceutical product developed by the JT Group proves to be commercially successful, the success may be offset by competition with rival products developed by other companies in Japan or overseas, a government-mandated price reduction and other factors.
- The JT Group may become dependent on the license of pharmaceutical products developed by other companies and on revenues from such products.
- The JT Group may become dependent on a certain outside source for the supply of critical raw materials.
- If any problem arises regarding the quality of a pharmaceutical product of the JT Group or regarding information provided by the group about such product, the group may become the target of lawsuits seeking product liability or making other claims, or may be forced to suspend sales of such product.
- JT's business performance may be affected by lawsuits concerning patents and other intellectual property rights.
- Regulation may be applied broadly, covering a full range of activities from the R&D stage to the post-launch stage of a new drug.
- The JT Group may become dependent on a certain business partner in the R&D or sales of a pharmaceutical product.
- In relation to the JT Group's use and management of radioactive or other hazardous substances, social or legal problem may arise, such as damage to the environment caused by such substances.

Risks Relating to Food Business

- Food products developed by the JT Group may fail to meet consumer preferences and their product lives may prove to be short.
- The JT Group's profit/loss may fluctuate due to fluctuations in the prices of raw materials for food products (including those due to changes in the exchange rate).
- The sales of JT's food products may be affected by weather conditions.
- The regulation of the procurement, manufacture and sale of food products in Japan or overseas may influence the JT Group's business performance, including the possibility that additional costs may arise due to compliance with such regulation.
- The JT Group may be unable to compete with major companies with larger distribution networks, stronger development capabilities and more experience.
- The JT Group may be unable to engage in efficient marketing activities.
- The JT Group may be unable to produce, or outsource the production of, food products in an efficient, stable and effective manner.
- The JT Group may outsource the production of a large part of beverage products to other domestic manufacturers, thus becoming dependant on outside sources.
- If any problem arises regarding the quality of the JT Group's food products, the group may become the target of lawsuits seeking product liability and making other claims, or the reputation of the group and its products may be undermined.

Other Factors which May Materially Affect Investment Decisions

- The Japan Tobacco Inc. Law (the "JT Law") obligates the Japanese government to hold at least one half of all JT shares it acquired upon JT's establishment, as adjusted for any subsequent stock split or consolidation of shares, and the Japanese government must continue to hold more than one third of all outstanding JT shares. As of the end of the fiscal year ended in March 2010, the Japanese government held 50.01% of all outstanding JT shares.
- The Minister of Finance has the authority to supervise JT under the JT Law and Tobacco Business Law.
- Under the JT Law, the scope of JT's businesses includes the "manufacture, distribution and importation of tobacco products and ancillary businesses, as well as businesses required for attaining the objective of JT," while "businesses required for attaining the objective of JT" are subject to the Minister of Finance's approval. Accordingly, the Minister of Finance's approval is required in order for JT to engage in new businesses outside the scope of currently-approved businesses.
- The Tobacco Business Law requires us to annually enter into purchase contracts with tobacco growers regarding the aggregate cultivation area for specific varieties of leaf tobacco and the prices for leaf tobacco by variety and grade. JT must purchase all leaf tobacco produced pursuant to such contracts, except for any not suited for the manufacture of tobacco products. When JT decides the aggregate cultivation area and the prices of leaf tobacco for its contracts with tobacco growers, it is required to respect the opinion of the Leaf Tobacco Deliberative Council (*hatabako shingi kai*), which consists of members appointed by JT with the approval of the Minister of Finance from among the representatives of domestic leaf tobacco growers and academic appointees.

The outline of the tax reform plan for fiscal year 2010, which was adopted upon a cabinet decision on December 22, 2009, includes a statement to the effect that the tobacco excise tax rate will need to be raised in order to restrain tobacco consumption from the viewpoint of promoting public health.