We have been selected as a member of the Dow Jones Sustainability Asia/ Pacific Index (www.sustainability-indices.com) for two consecutive years since 2014. And we are also a member of the Morningstar Socially Responsible Investment Index (MS-SRI) (www.morningstar.co.jp/sri, in Japanese).

For the information regarding our approach to sustainability, please refer to page 44 ‘JT Group and Sustainability’.
Tobacco industry

Market dynamics

There are many types of tobacco products available in today’s marketplace. Cigarettes remain the most popular choice for consumers, while fine-cut, cigars, pipe tobacco, snuff, chewing tobacco and water-pipe tobacco continue to draw consumers’ interest, with some of these product categories increasing their volumes worldwide.

In addition, the next generation of emerging products such as electronic cigarettes (e-cigarettes) has become widely popular. E-cigarettes use vaporized liquid solutions often containing nicotine, and vapor is inhaled to offer a different experience. Sales volume of e-cigarettes has been growing at a fast rate in markets such as the U.S. or Europe. As e-cigarettes do not use tobacco leaf, they are often not regulated or taxed as tobacco products. We would, however, expect regulation or taxation of e-cigarettes to be tightened over the coming years.

Another type of emerging products referred to as ‘Tobacco-vapor’ or ‘Heat-not-Burn’ products, have become available to consumers. Unlike e-cigarettes, Tobacco-vapor products often use tobacco leaf and are therefore taxed and regulated as cigarette products. Although market size for e-cigarettes or Tobacco-vapor is still small, further innovation and product offerings are anticipated, as market players take keen interest in this new growing category.

Approximately 5.6 trillion cigarettes are consumed around the world. China is by far the largest market, accounting for over 40% of global consumption, but it is almost exclusively operated by a state monopoly. Russia, the U.S., Indonesia and Japan are the next four largest markets, according to a survey conducted for 2015.

In general, the market dynamics are distinctively different between mature and emerging markets. In mature markets, industry volume tends to decline reflecting various factors such as limited economic growth, tax increases, tightening regulations, and demographic changes, among others. In addition, down-trading is prevalent in these markets. Consumers are inclined to seek more value as they feel tobacco products become less affordable in the context of limited growth of disposable income. Recently, these trends have been observed in EU countries, resulting in industry contraction and down-trading in many markets.

In emerging markets, on the other hand, total consumption tends to increase, driven by population growth and economic development, particularly in Asia, the Middle East and Africa. As their disposable income increases, consumers look for quality and trade up to products in higher price bands.

Overall, when we exclude China, global industry volume has been slightly decreasing according to a survey conducted for 2015*. However, more importantly, industry value continues to grow even in the current difficult operating environment, mainly driven by price increases. This is a sign of the resilience of the industry. These trends – decline in volume and increase in value – are expected to continue in the years ahead.

* Source: JT estimate (2015 data, as of July 2016)

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Top market players

<table>
<thead>
<tr>
<th>Share of market (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
</tr>
<tr>
<td>Philip Morris International Inc.</td>
</tr>
<tr>
<td>British American Tobacco Plc.</td>
</tr>
<tr>
<td>Japan Tobacco Inc.</td>
</tr>
<tr>
<td>Imperial Tobacco Group Plc.*</td>
</tr>
</tbody>
</table>

Source: JT estimate (2015 data, as of July 2016)
** Company name changed to Imperial Brands as of February 2016.
Excluding China National Tobacco Corp (CNTC).

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Top 10 countries by volume

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>2,406.2</td>
<td>2,461.6</td>
<td>2,490.5</td>
<td>2,549.5</td>
<td>2,489.5</td>
</tr>
<tr>
<td>Russia</td>
<td>375.1</td>
<td>370.8</td>
<td>346.3</td>
<td>316.2</td>
<td>295.9</td>
</tr>
<tr>
<td>U.S.</td>
<td>300.6</td>
<td>292.7</td>
<td>279.5</td>
<td>270.6</td>
<td>269.5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>191.8</td>
<td>203.1</td>
<td>221.2</td>
<td>238.9</td>
<td>248.4</td>
</tr>
<tr>
<td>Japan</td>
<td>195.9</td>
<td>197.4</td>
<td>194.1</td>
<td>186.2</td>
<td>182.3</td>
</tr>
<tr>
<td>Turkey</td>
<td>91.2</td>
<td>95.3</td>
<td>91.7</td>
<td>94.7</td>
<td>104.9</td>
</tr>
<tr>
<td>Philippines</td>
<td>97.4</td>
<td>102.5</td>
<td>86.7</td>
<td>94.9</td>
<td>90.3</td>
</tr>
<tr>
<td>India</td>
<td>102.8</td>
<td>102.1</td>
<td>100.9</td>
<td>95.9</td>
<td>88.1</td>
</tr>
<tr>
<td>Germany</td>
<td>84.5</td>
<td>83.4</td>
<td>79.6</td>
<td>80.3</td>
<td>80.0</td>
</tr>
<tr>
<td>Egypt</td>
<td>73.3</td>
<td>71.0</td>
<td>73.4</td>
<td>76.1</td>
<td>79.0</td>
</tr>
</tbody>
</table>

Source: JT estimate (2015 data, as of July 2016)
Excluding China National Tobacco Corp (CNTC).
Regulations

The regulatory environment continues to be more restrictive for the tobacco industry. Restrictions on promotions and advertisements are the most common around the world. An increasing number of markets are introducing bans on smoking in public places and promoting larger health warnings on product packaging, in some cases with pictorial health warnings.

Recent regulations are focusing more on the product itself. Plain packaging has been introduced in some markets and furthermore, regulators are becoming more aggressive by restricting ingredients and emissions, following the guidelines on these attributes proposed by the Framework Convention on Tobacco Control. In Europe, the European Tobacco Product Directive adopted extended health warnings, minimum packaging requirements or restrictions on the use of additives, among others. We expect to see EU member states complying with these restrictions by May 2017. These moves to commoditize tobacco products will undermine fair competition among tobacco manufacturers trying to meet increasingly diverse consumer preferences. Worse, they could result in an undesired increase in illicit trade, as commoditized products with less uniqueness are easier to counterfeit and more difficult to detect when smuggled.

Excise taxes were raised in various markets during the past year, and in general, tax increases are passed onto prices. However, repeated tax increases in a short period of time, or steep tax increases, could lead to a decline in industry volume. Often, tax increases coincide with an increase in illicit trade, which could in turn affect our business.

Competition

Excluding China, two-thirds of world industry volume is produced by four major global tobacco companies, namely Philip Morris International Inc., British American Tobacco Plc., Japan Tobacco Inc. and Imperial Tobacco Group Plc. The competition within the industry is intense and, as consumers’ needs and preferences continue to diversify, a strong portfolio with established brands is increasingly important to support market share gains. Therefore, major global companies are focusing on brand equity enhancement to strengthen their brand portfolios by introducing innovative products. In addition to the pursuit of organic growth, M&A is an effective way to supplement growth opportunities in this industry.

Top brands

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>Marlboro</td>
<td>Philip Morris International Inc.</td>
<td>410.8</td>
<td>414.1</td>
<td>395.9</td>
<td>391.4</td>
<td>392.5</td>
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<tr>
<td>Winston</td>
<td>Japan Tobacco Inc.</td>
<td>122.4</td>
<td>130.2</td>
<td>135.9</td>
<td>127.9</td>
<td>130.2</td>
</tr>
<tr>
<td>Pall Mall</td>
<td>British American Tobacco Plc.</td>
<td>101.0</td>
<td>101.6</td>
<td>104.8</td>
<td>109.1</td>
<td>108.3</td>
</tr>
<tr>
<td>L&amp;M</td>
<td>Philip Morris International Inc.</td>
<td>87.3</td>
<td>88.1</td>
<td>89.5</td>
<td>89.0</td>
<td>92.4</td>
</tr>
<tr>
<td>Mevius</td>
<td>Japan Tobacco Inc.</td>
<td>81.2</td>
<td>84.4</td>
<td>83.7</td>
<td>79.1</td>
<td>77.3</td>
</tr>
<tr>
<td>Camel</td>
<td>Japan Tobacco Inc.</td>
<td>62.1</td>
<td>61.8</td>
<td>61.5</td>
<td>65.3</td>
<td>69.1</td>
</tr>
<tr>
<td>Gudang Garam</td>
<td>Gudang Garam Tbk PT.</td>
<td>50.5</td>
<td>55.0</td>
<td>57.5</td>
<td>61.0</td>
<td>62.5</td>
</tr>
<tr>
<td>Kent</td>
<td>British American Tobacco Plc.</td>
<td>60.2</td>
<td>63.6</td>
<td>61.8</td>
<td>60.2</td>
<td>62.0</td>
</tr>
<tr>
<td>Dunhill</td>
<td>British American Tobacco Plc.</td>
<td>47.1</td>
<td>47.0</td>
<td>51.5</td>
<td>52.8</td>
<td>55.7</td>
</tr>
<tr>
<td>Gold Flake</td>
<td>ITC Ltd.</td>
<td>59.0</td>
<td>61.9</td>
<td>60.6</td>
<td>52.9</td>
<td>49.9</td>
</tr>
</tbody>
</table>

Source: JT estimate (2015 data, as of July 2016); **Brand owned by Imperial Tobacco Group Plc. from 2015. Excluding China National Tobacco Corp (CNTC).
Pharmaceutical Business

Market dynamics
The global pharmaceutical market continues to grow, reaching sales of approximately US$1,057.2 billion in 2014 according to IMS Health. In emerging countries, demand for modern medicine is rapidly growing due to multiple factors including growing consciousness of health, increase in population, and development of public healthcare systems, among others. Mature markets also see a value increase, though the pace of growth is moderate.

![Worldwide Pharmaceutical Market (USD BN)](chart)

Facing a rapidly aging society and a fiscal deficit, the governments in these markets try to contain healthcare costs through wider promotion of generic drugs.

In addition, patents of commercially successful drugs have been expiring during recent years, which accelerates the global trend of industry consolidation.

Mature markets hold majority of share in global pharmaceutical markets. North America is the largest market and accounts for 38% of the worldwide market, followed by Europe and Japan, representing 25% and 8%, respectively.

2014 Regional Composition

In Japan, the main market for our pharmaceutical business, prescription drugs comprise the majority of the market in terms of net sales. The Japanese generic drug market for prescription drugs is still small compared with that in the U.S. and Europe. However, it has been expanding more recently due in part to government promotion of generic drugs in order to control medical care expenses.

In Japan, the government determines the price of pharmaceutical products with revisions being made every two years. In April 2014, the latest round of price revisions led to an industry-wide reduction of drug prices by 5.6% on average excluding consumption tax increase.

Competition
The pharmaceutical industry is highly competitive worldwide. Our pharmaceutical business focuses on building a R&D-led operational platform. Based on this platform, original compounds are developed and marketed as leading products in major global markets.

As such, we face competition with Japanese and multinational pharmaceutical companies. These companies are also focused on their research and development pipelines.
Industry overview continued

Processed Food Business

Market dynamics

JT’s processed food business is operated through our subsidiary TableMark Co., Ltd. (TableMark) which plays a central role. TableMark focuses on frozen food products, such as frozen noodles, frozen rice and bread, ambient processed food represented by packed-cooked rice, seasoning business utilizing our yeast technology, and bakery business.

The size of the Japanese frozen food market in 2014 on a consumption basis including imports was ¥983.7 billion, up 0.7% year-on-year (Source: Japan Frozen Food Association).

For the Japanese processed food industry, we expected to see additional price increases in imported raw materials and prices of raw materials remaining at high levels. The processed food business is also significantly impacted by developments in the wholesale and retail sales channels, particularly by their consolidation. We will continue to monitor the development of these channels, especially in the area of M&A.

Competition

TableMark is competing against major players like Nichirei, Maruha Nichiro, Ajinomoto and Nissui as well as a multitude of mid- or small-scale producers.

We are seeing a polarization of retailers as well as reorganization and oligopolization of the wholesale sector led by sogo-shosha, the general trading companies, resulting in stronger price negotiation power against manufacturers. We are also seeing an increase in private label brands.
Review of Operations
Tobacco Business Value Chain

**R&D**
We focus on fundamental research and product technology development, taking advantage of our global research platform, in close collaboration with other functions. In particular, focus areas in our R&D activities are:
- Develop products and analytical capabilities in line with market needs and our anticipation of regulatory trends.
- Maintain existing products to comply with regulatory changes.
- Develop new technologies and improve production processes to maintain competitiveness and increase efficiency.
- Drive product innovation to enhance equity from various aspects, including tobacco leaves, blends, filters, printing techniques and packaging.
- Develop emerging products.

**Procurement**
Tobacco leaf is the most important material for our products, and we dedicate our efforts to strengthen our capability to ensure a stable supply of quality leaf in the long term.
- Increase the proportion of leaf from our vertical integration bases in Africa, Brazil and the U.S.
- Enhance sustainability of tobacco farming by helping farmers to improve productivity.
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- Enhance sustainability of tobacco farming by helping farmers to improve productivity.

**Manufacturing**
Our emphasis on product quality is increasing to meet consumer expectations for innovative offerings. In addition, we consistently pursue an optimal manufacturing footprint which ensures efficient and timely product deliveries to markets.
- Strengthen our ability for business continuity in times of emergency.
- Ensure high quality of products and enhance flexibility in the manufacturing process, overcoming complexity in manufacturing due to an increase in number of products.
- At the same time, seek efficiency by containing cost increases through continuous improvement and reviewing manufacturing footprint for further optimization.

**Marketing**
Our strategic focus is placed on our flagship brands and we strive to enhance their equity through effective communications with consumers.
- Allocate appropriate resources to support GFB’s equity building.
- Implement effective marketing programs, in compliance with applicable laws and regulations as well as our own marketing code.

**Sales & Distribution**
There are various sales channels for tobacco products such as supermarkets, convenience stores, street and train station kiosks, small independent retailers and vending machines. Key channels are different depending on the market and we develop win-win relationships with them to increase the availability of our products.
- Strengthen relationship with key accounts, leveraging our trained sales forces.
- Develop trade marketing initiatives for each market, taking into account the channel development as well as consumer trends and competitors’ actions.

**Create value for the business through innovation and quality**
- Maintain existing products to comply with regulatory changes.
- Develop new technologies and improve production processes to maintain competitiveness and increase efficiency.
- Drive product innovation to enhance equity from various aspects, including tobacco leaves, blends, filters, printing techniques and packaging.
- Develop emerging products.

**Ensure stable supply of quality tobacco leaf**
- As well as taking initiatives to support their communities.
- Maintain good relationships with external suppliers to ensure sufficient supply at competitive prices.
- With regard to non-tobacco materials, we aim to mitigate cost increases due to design enhancements and investment in innovative products by, among others, effectively managing procurement lot-size.

**Support top-line growth by delivering quality products**
- Ensure high quality of products and enhance flexibility in the manufacturing process, overcoming complexity in manufacturing due to an increase in number of products.
- At the same time, seek efficiency by containing cost increases through continuous improvement and reviewing manufacturing footprint for further optimization.

**Enhance equity of flagship brands**
- Allocate appropriate resources to support GFB’s equity building.
- Implement effective marketing programs, in compliance with applicable laws and regulations as well as our own marketing code.

**Expand product availability by leveraging our trade marketing excellence**
- Strengthen relationship with key accounts, leveraging our trained sales forces.
- Develop trade marketing initiatives for each market, taking into account the channel development as well as consumer trends and competitors’ actions.
2015 was an excellent year for JTI. It is our fifth consecutive year of delivering double-digit profit growth at constant currency. We achieved our targets and strengthened our role as the profit growth engine of the JT Group.

Last year, JTI committed to invest more to expand and accelerate our business growth into new geographies and emerging products. We delivered on that commitment and through those investments we are establishing solid foundations on which we continue to build our business into the mid and long term.

2015 was not without its challenges due to ongoing industry contraction and an acceleration in the growth of the value segment across many of our key markets.

In Russia, our largest market, we experienced a high single-digit industry volume decline and intensified competition in the lower price segments. In this difficult operating environment, we successfully grew Global Flagship Brands (GFB) market share driven by a resilient Winston holding market share and the strong performance of LD.

In Europe, we registered a very strong volume, core revenue and adjusted operating profit performance driven by our GFBs. We grew share across most markets and we reached the leading position in the UK driven by our continued investments since the Gallaher acquisition.

We continued to grow our presence internationally, both organically and through acquisitions. Seeding investments, to expand in markets where our presence is limited, are already delivering positive results in terms of volume and market share growth.

In emerging products, we consolidated our global presence by entering the USA, the largest e-cigarette market worldwide, and expanded E-Lites and Logic in new geographies.

For 2016, we have a balanced plan that will support short-term profit delivery and long-term sustainable growth. We are targeting 9% adjusted operating profit growth at constant currency as we build on our 2015 momentum and continue investing for future growth.

Our strategies

The core mission of JTI is to be the profit growth engine of the JT Group. Using the JT 4S model as our guiding principle, JTI has developed a clear and actionable strategic growth agenda.

Our key strategic drivers are:
- Build and nurture outstanding brands.
- Enhance productivity continuously.
- Maintain focus on responsibility and credibility.
- Strengthen human resources as a cornerstone of growth.

JTI's strategic growth agenda sets out three key priorities:
- Organic growth in markets where JTI's presence is established.
- Expansion of our geographic footprint in emerging markets for future growth.
- Develop a leadership position in emerging products.

JTI manufactures and sells over 90 brands in more than 120 countries.
We believe the combination of these strategic initiatives and continuous improvement provide the right balance between short-term profitability and sustainable long-term growth.

2015 Performance Review

Volume & Share

Total shipment volume was down 1.0% to 393.9 billion cigarette equivalent units, due to significant industry contraction and a volatile operating environment in the Middle East. Our fine cut volume was up 13.1%, partially offsetting the decline in total cigarette volume.

The performance in South & West Europe was particularly strong with growth across all key markets. North & Central Europe also grew volume, fully offsetting the impact of industry contraction in the UK. In the Rest-of-the-World cluster, total volume was up, mainly driven by Turkey and Iran. The significant industry contraction across the CIS+ cluster drove total volume to decline.

GFB shipment volume increased 4.3% to 273.6 billion cigarette equivalent units. This positive performance was driven by the strong equity of our portfolio, and most notably Winston, Camel, LD, Benson & Hedges and Sobranie. As a result, GFB mix in our total shipment volume grew to 69.5%, an increase of 3.6 percentage points versus prior year.

Looking into the clusters, GFB volume was very strong, increasing by high single-digit and even double-digit, except in CIS+ due to industry volume contraction.

by France, Italy, Spain, Taiwan, Turkey and the UK. In these markets, our GFB market share was up 1.2 percentage points to 17.8% driven by all seven markets, demonstrating the strength of our GFB portfolio and the value of continued equity building investments. We also grew market share in fine cut, notably driven by strong growth in the key markets of France, Italy, Spain and the UK.

Importantly, we grew total and GFB share of value to 21.4% and 16.2%, respectively, in all our key markets except Russia, due to the large volume decline across the industry.

Financials

Core revenue grew 7.0% at constant currency driven by robust price/mix and GFB shipment volume growth. Price/mix contribution increased by almost US$1 billion, fully offsetting the volume decline impact. All clusters contributed to the price/mix increase, notably driven by Russia and the UK. The South & West Europe cluster generated US$55 million in price/mix, combined with US$178 million from North & Central Europe, US$628 million from CIS+ and US$136 million from Rest-of-the-World.

Pricing was the key driver of our 10.8% increase in adjusted operating profit at constant currency. While South & West Europe delivered high single-digit adjusted operating profit growth at constant currency, North & Central Europe and CIS+ both delivered double-digit adjusted operating profit growth at constant currency. In the Rest-of-the-World cluster, adjusted operating profit was flat at constant currency as we increased investments and redeployed our profit growth to further build our business for mid to long term profitability.

2015 key highlights

Investing for future sustainable growth

2015 was an investment year for JTI. Investments were directed at three main areas: equity building, seeding initiatives and emerging products.

Global Flagship Brands were the main focus of our equity building investments. As a result, our GFBs registered strong performance. Despite the challenging environment, Winston held its market share in Russia. It became the number two brand in France and Spain, and the number three brand in Taiwan. Camel became the number one brand in Turkey. The brand reached record market share in Italy and Turkey. LD achieved record market share in Russia and returned to the number three position in this market. In the UK, two brands were key contributors to our growth since 2007: Amber Leaf, the number one tobacco brand, and Sterling, the number one cigarette brand.

Overall as a company we grew total and GFB share of market as well as total and GFB share of value. Across our seven key markets, JTI’s market share grew to 21.3%, a 0.1 percentage point increase versus prior year driven

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Global Flagship Brands were the main focus of our equity building investments. As a result, our GFBs registered strong performance. Despite the challenging environment, Winston held its market share in Russia. It became the number two brand in France and Spain, and the number three brand in Taiwan. Camel became the number one brand in Turkey. The brand reached record market share in Italy and Turkey. LD achieved record market share in Russia and returned to the number three position in this market. In the UK, two brands were key contributors to our growth since 2007: Amber Leaf, the number one tobacco brand, and Sterling, the number one cigarette brand.

Overall as a company we grew total and GFB share of market as well as total and GFB share of value. Across our seven key markets, JTI’s market share grew to 21.3%, a 0.1 percentage point increase versus prior year driven
Furthermore, we have accelerated our investment plans in geographies where our presence is limited. These seeding initiatives included expanding our distribution in Brazil, Myanmar and Thailand. We also strengthened our portfolio and marketing and sales organization in several markets, including Hungary, Korea and the Philippines.

In addition to the Logic acquisition, we invested in emerging products by developing our product pipeline, expanding our geographic reach and strengthening our R&D capabilities.

People, cornerstone of our growth
Our 26,000 employees worldwide are a major enabler of our strategy. To ensure sustainable future growth, we continuously invest in our people by setting high standards and fostering a diverse work environment in which our employees can excel. This allows JTI to recruit the best candidates and develop their skills and competencies across the organization. These efforts were recognized by the Top Employer Global certification in 2015 and 2016, awarding 35 countries across Europe, Asia Pacific and the Middle East for their exceptional employee environment. The Top Employer organization also ranked JTI as number one in Asia Pacific and number two in Europe for 2016.

Strengthening our leadership
During the course of 2015, JTI achieved a number of important milestones, most notably reaching the number one position in the highly competitive UK market. With this achievement, JTI is now leading in three of its seven key markets, namely Russia, Taiwan and the UK. Furthermore, JTI reached record market share in many markets, including France, Spain and Turkey as well as being the fastest growing tobacco company in Italy.

Broadening the base
To complement our robust organic growth, we conducted a number of acquisitions during the year. Two of them related to our investments in emerging products with the transactions on Ploom Inc.’s patents and trademarks and the acquisition of Logic Inc.

A significant deal was the acquisition of Arian Tobacco Industry (ATI) by JTI PARS in Iran. This acquisition consolidated our presence in this market where we have been operating since 2002. ATI complements the JTI PARS set up, bringing strong value brands to an already robust premium and mid-price portfolio.

In addition, ATI strengthens our competitiveness in Iran by adding a state-of-the-art production facility to our existing set up and distribution capabilities.

Lastly, we acquired the Natural American Spirit business outside the United States. This brand offers a unique positioning as the only global exclusively “additive-free” premium cigarette. Positioned in ready-made cigarettes and fine cut, Natural American Spirit is available in 13 European and Asian countries. We are currently planning the future of this brand and will consider adding it to our Global Flagship Brands portfolio.

2016 Outlook
We are entering 2016 with confidence in our business outlook, strong fundamentals, positive momentum and the continuation of significant investments.

We expect the operating environment to remain challenging due to increasing regulation in Europe, continued recession in the CIS+, and volatility in the Middle East. Currencies are expected to negatively impact our reported financials in 2016.

Our total volume is expected to remain flat year-on-year despite the continued industry contraction, supported by market share progression and 2015 acquisitions. GFBs will grow volume and share as we continue to enhance brand equity and geographic reach, as well as benefiting from the opportunity to add Natural American Spirit.

Continued pricing gains combined with our GFB momentum will drive core revenue growth at constant currency. We will continue to increase investments to strengthen our leading positions across key markets, grow our presence where we are under-represented, and broaden our emerging products portfolio and its geographic footprint.

Our balanced approach between short-term profit delivery and investing to secure long-term sustainable growth is forecast to generate another strong year of earnings delivery at constant currency. JTI will remain the profit growth engine of the JT Group.

Please be reminded that this section is intended to explain the business operations of JT to investors, not to promote sales of tobacco products to encourage smoking by consumers.
Global Flagship Brands (GFB) Portfolio

Our GFBs form the core of our brand portfolio. We have eight GFBs providing a well-balanced portfolio to address consumer needs globally.

First introduced in 1954, Winston is one of our key growth drivers. The second largest cigarette brand worldwide since 2007, Winston is currently sold in more than 120 markets.

Winston consolidated its global ranking, growing its market share 0.3ppt to 9.1% in JTI’s top-40 markets. Winston achieved record market share in 23 markets, including Jordan and Malaysia where it became the number two brand. We continued expanding the reach of Winston, launching in Bangladesh, parts of Indonesia and Myanmar. In fine cut, Winston’s market share was up across Europe.

In 2015, Camel exceeded 50 billion units for the first time in its history, increasing by 9.7% versus prior year. Camel has stood the test of time and is now the benchmark of creativity amongst adult consumers. It is sold today in 88 markets and is one of the top five premium brands in many of our key markets. Camel continues to successfully reinvent itself, building on its strong heritage and genuine taste.

In 2015, Camel exceeded 50 billion units for the first time in its history, increasing by 9.7% versus prior year.
Launched as Mild Seven in 1977 and rebranded in 2013, Mevius is the top-selling brand in Japan with over 30% market share. Internationally, Mevius continued to expand geographically, entering Kazakhstan, Georgia, Poland, Romania and Tajikistan.

In 2015, Mevius international volume was flat at 17.1 billion cigarette equivalent units with volume growth in key Asian markets offsetting the decline in Korea following the significant industry contraction. Market share increased 0.1ppt to 0.7% in JTI’s top-40 markets. In addition, Mevius continued to grow its share of the premium segment in its top Asian markets. Mevius remained the number one brand in Taiwan with a share of market of 22.3%, enhancing its leadership in Premium reaching a 60% share of segment.

LD was launched in 1999 as a mid-price brand in the Russian market. The brand achieved immediate success and is now recognized as a compelling international brand, ranked number two in the Value segment. Since 2007, LD has grown continuously in all clusters, adding eight new markets in 2015 to reach 46 countries overall. LD has constantly expanded its portfolio to meet consumer aspirations, including in fine cut.

In 2015, LD volume grew at an impressive double-digit rate to 49.5 billion cigarette equivalent units. This was mainly driven by the strong performance of LD Club Compact in the CIS+ cluster. The brand achieved record market share in 12 markets, including Canada, the Czech Republic, Kazakhstan, Poland, Russia, Taiwan and Ukraine. Overall, the brand grew its share of market by 0.4ppt to reach 3.3% in JTI’s top-40 markets.

Originally established in 1873, Benson & Hedges has a proud British heritage. In 2015, B&H volume increased 10.9% to 12.1 billion cigarette equivalent units with growth in both ready-made cigarettes and fine cut. B&H increased its market share 0.1ppt to 0.7% in JTI’s top-40 markets.

Glamour is JTI’s leading super slims brand introduced in 2005. In 2015, mainly due to industry contraction in Russia, its volume declined 10.3% to 6.4 billion cigarette equivalent units.

Launched in 1964, Silk Cut established its premium credentials as one of the first low tar brands in the 1970s, long before it became the norm of other manufacturers. In 2015, Silk Cut volume declined 7.0% to 2.7 billion cigarette equivalent units due to industry volume contraction in Ireland and the UK.

Audacity, uncompromised excellence and noble characters define Sobranie, one of the oldest luxury cigarettes since 1879. In 2015, despite the downtrading environment, Sobranie grew volume by 4.5% to 2.7 billion cigarette equivalent units.
Other Tobacco Products Portfolio

**Fine Cut**
JT International’s fine cut share continued to grow in Europe. This category encompasses roll-your-own and make-your-own products. With a 13.1% increase, our fine cut volume growth has continued to accelerate in 2015, driven by the strong performance of our GFB fine cut volume growing 30.8%. This growth came mainly from Winston and Camel and, to a lesser extent, from Benson & Hedges and LD.

In 2015, our fine cut share of market in Europe reached 20.8%, an increase of 2.0ppt versus prior year, following gains in Austria, Belgium, France, Germany, Hungary, Italy, Ireland, Luxembourg, the Netherlands, Spain, Switzerland and the UK.

In the UK, market share of Amber Leaf, Sterling and Old Holborn continued to increase. Amber Leaf also performed well in Ireland and Spain while Fleur du Pays continued to gain share in France.

JT International maintained its number one or two market share position in Austria, Belgium, France, Greece, Ireland, Italy, Spain, Switzerland and the UK.

We will continue to enrich our fine cut product pipeline with innovative product features to keep delivering solid results in this category.

**Volume growth**
13.1%

**Shisha**
After entering the shisha tobacco business in 2013, we have continuously improved the quality of the products, rationalized the portfolio, rejuvenated the offering and further expanded our presence in this category.

In 2015, while we consolidated our position in existing markets as one of the leading shisha tobacco manufacturer in the world, the on-going geopolitical tensions in the Middle East impacted negatively our volume, declining to 18,300 tons.
2015 was an exciting year for emerging products, in which we acquired Logic and more than doubled our investments. We now have a broader scale, richer product pipeline and stronger R&D capabilities in line with JT Group’s vision to build leadership in this category.
E-Vapor

Building on the assets of Zandera, acquired in 2014, we have further invested to develop our portfolio as well as our geographic reach. We launched the new E-Lites Curv in the UK, Ireland and Germany. The feedback received by Curv from the trade and consumers is very positive across all three markets.

Following the Logic acquisition, we became the number three e-cigarette company in the USA, the world’s largest market for this category. We increased investments to focus on strengthening our footprint in the USA and expanding the presence of Logic in France and in the UK. In both markets, we introduced Logic Pro, our closed tank offering. We were the first company to propose a closed tank offering in France and the initial trade and consumer response is far exceeding our expectations.

In February 2015, we acquired a number of patents and trademarks from Ploom Inc. relating to the tobacco vaporization business. Since then, we have been investing to grow the pipeline of tobacco-vapor products.

Ploom TECH, our latest innovative and proprietary tobacco vaporizer being launched in Japan first, is the most recent addition to our portfolio. Ploom TECH allows consumers to enjoy smooth tobacco taste through tobacco vapor without any combustion nor heating. Initial feedback from adult consumers is very positive, driven by the clear tobacco taste provided by our unique technology. We plan to expand the geographic reach of Ploom TECH in selected markets and gain a better understanding of consumers’ reaction.

We will continue investing in this growing category to strengthen our portfolio and pursue more geographical expansion.

Please be reminded that this section is intended to explain the business operations of JT to investors, not to promote sales of tobacco products to encourage smoking by consumers.
Japanese domestic tobacco business is a highly competitive platform of profitability. In the year ended December 2015, industry volume was 182.3 billion units in Japan, which is one of the largest markets in the world. We own 9 of the top 10 selling products in this large market. We are the undisputed market leader in Japan with around 60% market share.

Since the consumption tax hike in April 2014, we have strengthened sales promotion activities to retain consumers, with a particular focus on MEVIUS and other core brands.

The industry volume in Japan, however, has been declining over the past years. In this challenging environment, we prioritized quality top-line growth by investing in brand equity enhancement and launching new products to meet consumers’ needs.

In 2015, we integrated Caster and Cabin into Winston and launched new products, MEVIUS and Seven Stars, in the growing menthol segment.

We continue to be a significant profit contributor to the JT Group by further quality top-line growth and continuous cost improvement.

Business results (vol./financial performance)
- Enhanced brand equity enabled price/mix improvement
  - JT sales volumes decreased 2.8% from the previous year in line with our forecast in 2015.
  - Core revenue decreased 1.2% year-on-year to ¥642.2 billion as our average unit price improved, supported by additional marketing investments in brands with higher price increase as well as the strong duty-free sales.
  - Adjusted operating profit grew 6.4% year-on-year to ¥254.1 billion driven by price/mix improvement and effective cost management.
Business results
(market share performance)
• MEVIUS performance led to resilient market share in the context of intensified competition.
  – In FY2015, JT market share decreased 0.4 percentage points to 59.9%.

Share evolution of JT and MEVIUS (%)

<table>
<thead>
<tr>
<th>Jan-Mar 2015</th>
<th>Oct-Dec 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>MEVIUS 60.0</td>
<td>JT 31.9</td>
</tr>
<tr>
<td>Oct-Dec 2015</td>
<td>Jul-Sep 2015</td>
</tr>
<tr>
<td>MEVIUS 60.0</td>
<td>JT 32.1</td>
</tr>
<tr>
<td>Apr-Jun 2015</td>
<td>Apr-Jun 2014</td>
</tr>
<tr>
<td>MEVIUS 60.0</td>
<td>JT 32.3</td>
</tr>
<tr>
<td>Jul-Sep 2015</td>
<td>Jul-Sep 2014</td>
</tr>
<tr>
<td>MEVIUS 59.7</td>
<td>JT 31.9</td>
</tr>
<tr>
<td>Sep-Oct 2015</td>
<td>Sep-Oct 2015</td>
</tr>
<tr>
<td>MEVIUS 60.1</td>
<td>JT 32.0</td>
</tr>
</tbody>
</table>

As a result, despite the intense competitive environment, sales volume proved to be almost in line with our forecast, falling 2.8% year-on-year. As for the market share, JT total share and share of MEVIUS both remained stable.

Our strategies:
We focus on quality top-line growth by increasing share of market and promoting consumers to shift to higher unit price products. In order to achieve this goal, we will continue to invest in brand equity enhancement and business foundation building with a mid- to long-term vision.

In addition, we also continue to pursue efficiency to further strengthen our profitability.
• Priority on quality top-line growth:
  – Continue to strengthen our brand equity, with a particular focus on MEVIUS and other core brands
  – Grow or maintain market share in Japanese domestic market
  – Develop emerging product category
• Continuous cost improvement

Amid the intensifying competition, we continued to make investments in sales promotion and brand equity enhancement for MEVIUS, which is our core brand, and for other brands.

In particular, we actively launched new extensions for Winston, which two other brands were integrated into in August 2015.

Outlook
The acquisition of Natural American Spirit was completed January 2016. We are still working on its business plan, however, the performance of Natural American Spirit is reflected in the forecasts based on certain assumptions.

In addition, the expected impact of the amendment of retail prices for certain brands, of which we received approval from the Minister of Finance in February 2016, is also included in the forecasts.

We expect our market share to be somewhat affected by the retail price revision, but we intend to minimize the impact by executing marketing strategy focusing on key brands in each of price segments, particularly MEVIUS and Winston.

In 2016, in order to build momentum for top-line growth over mid- to long-term, we will further enhance equity of our key brands, launch of Ploom TECH and support these initiatives with focused promotion activities.

Japanese domestic tobacco business is committed to fulfilling its role as a highly competitive platform of profitability. This will be achieved by quality top-line growth as well as further pursuit of a competitive cost base.

Please be reminded that this section is intended to explain the business operations of JT to investors, not to promote sales of tobacco products to encourage smoking by consumers.
Our core brands

**MEVIUS**
- Our leading brand in Japan is MEVIUS, evolved from Mild Seven in February 2013. MEVIUS inherits Mild Seven’s strong consumer base which has commanded the No.1 share in the Japanese domestic market for more than 30 years since 1978*.
- The MEVIUS family comprises a line-up of 35 products (as of February 29, 2016 cigarette products in domestic market), reflecting the evolution that it has undergone in step with the changing times and brand expansion.

**Winston**
- First introduced in 1954 in the United States, and today Winston is the second largest cigarette brand in the world.
- In 2015, CABIN and CASTER were migrated into Winston in Japan.
- Winston has three types of taste, “Bitter”, “Straight” and “Sweet”, in both Regular and Menthol segments.
- The Winston family comprises a line-up of 26 products (as of February 29, 2016).

**Seven Stars**
- Launched in 1969, Seven Stars featured Japan’s first domestically produced charcoal filter in pursuit of better taste.
- Since its launch, Seven Stars has consistently offered unique value in terms of taste, aroma, and product design.
- The Seven Stars family comprises a line-up of 19 products (as of February 29, 2016 including regional products).

**Natural American Spirit**
- The Natural American Spirit brand was born in the U.S. in 1982, with the idea to provide the most premium, additive-free, all natural tobacco products. The Natural American Spirit brand vision is unchanged even after its phenomenal growth globally. The brand has also been the leader in environmental stewardship and sustainability while creating mutually beneficial relationships with everyone it touches.
- The brand was introduced to Europe and Japan in 1996 with exactly the same vision, environmental leadership and relationship-based brand building. The brand has grown in every market it reached, particularly in Japan.
- The Natural American Spirit family comprises a line-up of 8 cigarette products (as of February 29, 2016 cigarette products in domestic market).

* Source: TIOJ.
Ploom TECH

Tobacco-vapor with a newly developed concept
Ploom TECH is different from existing tobacco-vapor products. It offers a smoother, clearer taste and aroma provided by unique technology with no combustion and no direct heating of tobacco.

The emerging products category will contribute to the Group’s profit growth in the mid- to long-term, not immediately. Furthermore, it provides an additional growth opportunity for the entire tobacco business in the long-run.

Please be reminded that this section is intended to explain the business operations of JT to investors, not to promote sales of tobacco products to encourage smoking by consumers.
We strive to strengthen the profit base through value maximization of each product and R&D promotion for next generation of strategic compounds.

**Strategy**
- Promote R&D of strategic compounds for next generation and seek optimum timing to out-license them
- Maximize the value of each product

**Performance Overview**

*Development in Japan*
- “Allergen Scratch Extract Positive control (Torii) Histamine Dihydrochloride”: Approved (Sep 2015)
- “MITICURE House Dust Mite Sublingual Tablets”, an Allergen Immunotherapy Tablet for House Dust Mite Allergy: Launched by Torii Pharmaceutical (Dec 2015)
- TO-206, an Allergen Immunotherapy Tablet for Japanese Cedar Pollinosis: – Regulatory application filed by Torii Pharmaceutical (Dec 2015)

*Licensed compounds*
- Elvitegravir (Anti-HIV) – E/C/F/TAF (single-tablet regimen “Genvoya”): Approved in the U.S. and EU
- Trametinib (Melanoma) – Regulatory application filed by partner in Japan – For use in combination with dabrafenib: Approved in EU

**Business results (financial performance):**
- Revenue grew ¥9.8 billion driven by an increased royalty from our license partners, most notably related to Stribild. Torii Pharmaceutical’s top-line growth related to Riona and Stribild also contributed.
- Operating loss improved by ¥5.0 billion due to revenue increase.

**Revenue**

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (JPY BN)</th>
<th>Change (JPY BN)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014 Jan–Dec</td>
<td>65.8</td>
<td></td>
</tr>
<tr>
<td>FY2015</td>
<td>75.6</td>
<td>+9.8</td>
</tr>
</tbody>
</table>

**Adjusted Operating Profit**

<table>
<thead>
<tr>
<th>Year</th>
<th>Amount (JPY BN)</th>
<th>Change (JPY BN)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014 Jan–Dec</td>
<td>-7.3</td>
<td></td>
</tr>
<tr>
<td>FY2015</td>
<td>-2.3</td>
<td>+5.0</td>
</tr>
</tbody>
</table>

“We aim to build a unique, world-class pharmaceutical business driven by R&D, and to increase our market presence through original and innovative drugs.”

Muneaki Fujimoto
President, Pharmaceutical Division

We aim to build a unique, world-class pharmaceutical business driven by R&D, and to increase our market presence through original and innovative drugs.
Value chain

R&D
Continue to strengthen R&D capability, a cornerstone of our pharmaceutical business
A particular emphasis is placed on research and development in line with our mission to establish a unique R&D oriented business model which can compete on a global basis. By focusing our resources on specific areas, we efficiently strengthen our R&D capability which enables us to create innovative drugs.
• Focus mainly on the fields of glucose and lipid metabolism; anti-virus; and immune disorders and inflammation to best leverage our expertise.
• Allocate adequate resources in R&D in light of the increasingly complex, time-consuming and therefore costly development process due to stringent regulations.
• Aiming at discovery of “first-in-class” compounds, enhance pre-clinical research capability and build development strategies tailored to accomplish the objective
• Translate innovation into medicines that are both approvable and commercially viable.

Manufacturing
Ensure a reliable supply of quality products
• Sustainable supply chain to deliver high quality products to our patients has established. We also pursue efficiency in our manufacturing arrangements; products marketed in Japan are mainly produced by Torii Pharmaceutical to maximize intra-group synergies, while outsourcing to contract manufacturers where appropriate.
• Remain focused on quality assurance and safely control.
• Maintain optimal manufacturing arrangements.
• Continuously strive to reduce environmental impacts, as evidenced by operation and maintenance of the ISO 14001 certificate by our Sakura plant.

Sales & Promotion
Build marketing competence on our MRs
In the pharmaceutical industry, medical representatives (MRs) play a crucial role in successful sales and promotion by providing medical and scientific knowledge with clients. At the same time, they collect valuable information from the medical front which could be reflected in the ongoing or future R&D activities. Torii Pharmaceutical is marketing our products in Japan through 512 highly-trained MRs. Outside Japan, we do not have a sales function. As such, instead of directly marketing our products, we receive royalties based on sales performance from our license partners for the compounds for which we out-license the right to develop and market.
• Provide extensive training programs to MRs and expand their knowledge to earn trust from our clients.
• Strengthen our marketing capabilities by leveraging the marketing support system, which integrates clients’ information including their needs spread across functions.
• Build a sales and marketing strategy to meet the existing and future market needs in the changing business environment.
### Japan Tobacco Inc. Clinical Development (as of February 4, 2016)

#### In-house development

<table>
<thead>
<tr>
<th>Code (Generic name)</th>
<th>Potential Indication/ Dosage form</th>
<th>Mechanism</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>JTK303 (elvitegravir/ cobicistat/ emtricitabine/ tenofovir alafenamide fumarate)</td>
<td>HIV infection /Oral</td>
<td>HIV integrase inhibitor/ Nucleoside reverse transcriptase inhibitor</td>
<td>Suppresses blood HIV levels by inhibiting the activities of integrase and reverse transcriptase, enzymes involved in the replication of HIV.</td>
</tr>
<tr>
<td>emtricitabine/ tenofovir alafenamide fumarate</td>
<td>HIV infection /Oral</td>
<td>Nucleoside reverse transcriptase inhibitor</td>
<td>Suppresses blood HIV levels by inhibiting the activity of reverse transcriptase, an enzyme involved in the replication of HIV.</td>
</tr>
<tr>
<td>JTE-851</td>
<td>Type 2 diabetes mellitus /Oral</td>
<td>G protein-coupled receptor 40 agonist</td>
<td>Decreases blood glucose by stimulation of glucose-dependent insulin secretion.</td>
</tr>
<tr>
<td>JTZ-951</td>
<td>Anemia associated with chronic kidney disease /Oral</td>
<td>HIF-PHD inhibitor</td>
<td>Increases red blood cells by stimulating production of erythropoietin, an erythropoiesis-stimulating hormone, via inhibition of HIF-PHD.</td>
</tr>
<tr>
<td>JTE-052</td>
<td>Autoimmune/allergic diseases /Oral, Topical</td>
<td>JAK inhibitor</td>
<td>Suppresses overactive immune response via inhibition of Janus kinase (JAK) related to immune signal.</td>
</tr>
<tr>
<td>JTE-051</td>
<td>Autoimmune/allergic diseases /Oral</td>
<td>Interleukin-2 inducible T cell kinase inhibitor</td>
<td>Suppresses overactive immune response via inhibition of the signal to activate T cells related to immune response.</td>
</tr>
<tr>
<td>JTE-151</td>
<td>Autoimmune/allergic diseases /Oral</td>
<td>RORγ antagonist</td>
<td>Suppresses overactive immune response via inhibition of RORγ related to Th 17 activation.</td>
</tr>
<tr>
<td>JTT-251</td>
<td>Type 2 diabetes mellitus /Oral</td>
<td>PDHK inhibitor</td>
<td>Decreases blood glucose by activation of pyruvate dehydrogenase (PDH) related to carbohydrate metabolism.</td>
</tr>
<tr>
<td>JTK-351</td>
<td>HIV infection /Oral</td>
<td>HIV integrase inhibitor</td>
<td>Suppresses blood HIV levels by inhibiting the activity of integrase, an enzyme involved in the replication of HIV.</td>
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</tbody>
</table>

Clinical trial phase presented above is based on the first dose.

#### Licensed compounds

<table>
<thead>
<tr>
<th>Compound (JLT’s code)</th>
<th>Licensee</th>
<th>Mechanism</th>
<th>Description</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>trametinib</td>
<td>Novartis</td>
<td>MEK inhibitor</td>
<td>Inhibits cellular growth by specifically inhibiting the activity of MAPK/ERK Kinase (MEK1/2).</td>
<td>Melanoma Japan marketing approval submitted</td>
</tr>
<tr>
<td>Anti-ICOS monoclonal antibody</td>
<td>MedImmune</td>
<td>ICOS antagonist</td>
<td>Suppresses overactive immune response via inhibition of ICOS which regulates activation of T cells.</td>
<td></td>
</tr>
<tr>
<td>JTE-052</td>
<td>LEO Pharma</td>
<td>JAK inhibitor</td>
<td>Suppresses overactive immune response via inhibition of Janus kinase (JAK) related to immune signal.</td>
<td></td>
</tr>
<tr>
<td>Location</td>
<td>Phase 1</td>
<td>Phase 2</td>
<td>Phase 3</td>
<td>Preparing to file</td>
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</tbody>
</table>

In-house development

Code (Generic name)

Potential Indication/Dosage form Mechanism Description

Location Phase 1 Phase 2 Phase 3 Preparing to file Filed Origin

Japan	JC-052 LEO Pharma JAK inhibitor Suppresses overactive immune response via inhibition of Janus kinase (JAK) related to immune signal.

Japan	JTE-052 LEO Pharma JAK inhibitor Suppresses overactive immune response via inhibition of Janus kinase (JAK) related to immune signal.

Japan	JTK-303(JT's code) Licensee MEK inhibitor Inhibits cellular growth by specifically inhibiting the activity of MAPK/ERK Kinase (MEK1/2).

Japan	Anti-ICOS monoclonal antibody MedImmune ICOS antagonist Suppresses overactive immune response via inhibition of ICOS which regulates activation of T cells.

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Japan	JTK-303(JT's code) Licensee MEK inhibitor Inhibits cellular growth by specifically inhibiting the activity of MAPK/ERK Kinase (MEK1/2).

Japan	Anti-ICOS monoclonal antibody MedImmune ICOS antagonist Suppresses overactive immune response via inhibition of ICOS which regulates activation of T cells.

Japan	JTE-052 LEO Pharma JAK inhibitor Suppresses overactive immune response via inhibition of Janus kinase (JAK) related to immune signal.
Processed Food Business

FY2015: Year ended December 31, 2015

"If we are going to prepare food for those who matter to us most, we wish to do so cordially and with care. This is our desire when running our business at TableMark."

Atsuhiro Kawamata
President and CEO, TableMark

From 2010 onwards, TableMark began its operation as a food manufacturer with frozen and ambient processed food, bakery items and seasoning as our business pillars. In particular, we strive to provide high value-added products by focusing on staple food such as frozen noodles, frozen rice, packed cooked rice and frozen baked bread.

Strategy
• Achieve operating profit margin on par with industry average and aim to make profit contribution to the JT Group:
  – Increase the attractiveness of our offerings with a particular emphasis on staple food products* by meeting consumer needs with our own expertise
  – Minimize negative impact of rising raw material costs and weak yen

Performance Overview
• The processed food business is primarily engaged in business concerning frozen and ambient processed food, mainly staple food products such as frozen noodles, frozen rice, packed rice and frozen baked bread, bakery chain outlets in the Tokyo metropolitan area, and seasonings including yeast extracts and oyster sauce.
• We increased revenue in all of our business areas, namely frozen and ambient processed food, bakery and seasoning.

Business results (financial performance):
• Revenue increased 4.7 billion yen driven by growth of staple products and frozen food for bento box use.
• Adjusted operating profit increased 1.3 billion yen. Revenue growth more than offset the effect of higher material cost and weak yen.

If we are going to prepare food for those who matter to us most, we wish to do so cordially and with care. This is our desire when running our business at TableMark.

* Staple food products: frozen noodles, frozen rice, packed cooked rice and frozen baked bread.
Value chain

R&D
Strive to develop innovative products to meet consumers’ needs
- Leveraging our own know-how, we aim to develop value-added products to meet diversified consumers’ needs.
- Frozen baked bread products have been developed which allow consumers to enjoy the taste of freshly baked bread at home. TableMark’s original techniques for fermentation, baking and freezing recreate and preserve the taste and texture of fresh bread.
  - A new process for making frozen udon noodles, called “Tamnenjikomi Aya Jyukusei-ho” has been developed. This process enables us to offer higher quality and value-added udon products.

Procurement
Ensure procurement of safe and quality raw materials
- Review of quality assurance certificates submitted by our suppliers.
- Inspections and monitoring of agrochemical residues and regular inspection at processing plants, in compliance with JT Group’s internal standards, the Food Sanitation Act and other relevant laws.
- Examination of safety of production sites for raw materials sourced abroad.
- As for agricultural farms, inspections are made not only for soil and water but also in terms of how products are cultivated and how agrochemicals are handled. Breeding farms are also inspected.

Production
Prioritize safety and follow established quality control procedures
- JT Group is pursuing the adoption of the HACCP system, ISO22000 and FSSC22000 in our and business partners’ factories. Under the ISO22000 and FSSC22000 standard, continuous improvements are made following effective rules to control sanitation and other key issues. These rules are based on the HACCP concept, and their effectiveness is tested using scientific evidence.
- All of JT Group’s 31 factories in and outside Japan and contract manufacturers have achieved the ISO22000 certification.

Marketing
Strive for effective marketing to improve product awareness
- We analyze the market from consumers’ point of view and, by combining the technology owned by TableMark, we strive to provide products with new values to increase our place in the market. We strive for effective marketing in order to improve consumer awareness of our products.

Sales & Distribution
Increase penetration to retail outlets
- Strive to enhance profitability through our initiatives to increase our presence in supermarkets and convenience stores, by offering a wider range of products while also seeking better shelf space.
- TableMark products are also sold to restaurants and other public facilities.

Food Safety Control
Ensure safety control at all levels of the value chain
- Independent food safety management division is responsible for overall safety control, ensuring that consumers can continue to enjoy our products safely.
- External food safety experts provide assessment and advice regarding our initiatives – their knowledge and viewpoints are actively incorporated into our business.
Considering such circumstances, we have put in place a risk management framework. Under the framework, relevant divisions are assigned to carefully monitor the development of events that may adversely impact the JT Group and prevent their materialization where possible.

When risks materialize, we promptly respond in order to minimize their unfavorable impacts. In reviewing risks, the magnitude of potential impact and likelihood of occurrence are most prudently assessed among other factors. Material risks, which could have a significant impact on our sustainable profit growth and business continuity, are reported to the CEO together with the request for approval to implement countermeasures against them.

The following section describes certain risks which potentially have a material impact on our business operations and financial results, but is not intended to be an exhaustive list of the risks we face. In addition, it is possible that risks that are currently considered immaterial or even unknown could turn out to be material in the future, as the business environment changes.

This section should be read together with the forward-looking and cautionary statements contained in this annual report.

### 1. Disruptive tax increases

Tobacco products are subject to excise or similar taxes in addition to value-added tax. Excise taxes are increasing in most markets where we operate as governments seek to secure their revenue or promote public health. In general, value-added tax is also increasing. As a general principle, we fully pass on any tax increase to consumers by adjusting our sales prices. In addition, to the extent possible, we increase our prices more than the tax increase, considering the financial impact of an expected volume decline. A tax increase within a reasonable range is manageable through such a price increase as well as our efforts to support top-line and pursue efficiency. Most governments are aware that a substantial tax increase or repeated tax increases can reduce their revenue and they take a rational approach. However, in the past we have experienced tax increases in some markets, that have disrupted our business.

**Risk description and potential impact**

A disruptive tax increase on tobacco products could result in a large industry volume decline due to lower consumption and, in many cases, increased illicit trade. In addition, down-trading to lower priced products could be initiated or accelerated. Our shipment volume, revenue and profit could decrease due to these negative reactions by consumers.

**Measures to address the risk**

- Promote the understanding of relevant authorities that a disruptive tax increase does not necessarily serve their purpose.
- Optimize our product offerings to capture the potential changes in consumer preference.
- Enhance our geographical portfolio to limit the negative impact of a disruptive tax increase in a specific market.
- Further improve efficiency to protect revenue and earnings.
- If a disruptive tax increase takes place, find an optimal price for each product which minimizes the unfavorable influence in the market.

### 2. Pressure from illicit trade

Illicit trade is a major concern not only for the tobacco industry, but for wider society. For the tobacco industry, it undermines legitimate tobacco business. For society, illicit trade reduces excise revenue for the government, often fuels organized crime, and may increase health concerns due to poor manufacturing standards and improper product handling. The tobacco industry has been fighting against illicit trade, which takes the forms of contraband, counterfeit and illicit whites.
Illegally traded products in a market tend to increase after a steep tax increase. Regulatory actions seeking to commoditize packages and products could also trigger the acceleration of illicit trade because such commoditization could make counterfeit manufacturing easier and detection of illicit products more difficult. We take a zero tolerance approach towards all these criminal activities with an emphasis on eliminating contraband products.

Risk description and potential impact
An increase in illicit trade could reduce legitimate industry volume, leading to a decline in our shipment volume, revenue and profit. In addition, the industry bears the cost to combat illicit trade, resulting in pressure on its earnings. Furthermore, it is possible that low quality counterfeits and improperly handled smuggled products damage the credibility of genuine brands, as well as the reputation of their owners.

Measures to address the risk
• Engage with governments, regulatory bodies and law enforcement agencies to eradicate illicit trade.
• Ensure we buy from and sell to only reputable business partners following our rigorous compliance initiatives.
• Raise awareness among individual consumers of the negative consequences of purchasing illegally traded products.

3. Tightening tobacco regulations
The tobacco industry is highly regulated in various aspects, and regulations could influence our business performance and financial results. Among the regulations on products, for example, we may incur additional costs in order to comply with ingredients and packaging requirements.

Furthermore, the regulatory attempt to commoditize tobacco products could lead to an increase in illicit trade and negatively influence our legitimate business.

Business activities of tobacco companies are also restricted. With more prohibitive regulations on communication with consumers, our ability to effectively market products becomes further limited, and our top-line performance may be adversely impacted.

As a responsible organization, the JT Group abides by applicable laws and regulations wherever we operate. That said, we believe that laws and regulations should differ country by country, reflecting legal, social and cultural background. We endeavor to hold constructive dialogues with governments and regulators for a reasonable and balanced approach towards tobacco regulation.

Risk description and potential impact
Further tightening of tobacco regulations on marketing activities could undermine our strategy for top-line growth as we lose opportunities to enhance brand equity. Moreover, certain regulations may impose on us additional compliance costs. These may negatively influence our volume, revenue and profit.

Measures to address the risk
• Identify ongoing regulatory initiatives as early as possible by promptly collecting accurate information.
• Endeavor to hold constructive dialogues with governments and regulators for reasonable and balanced regulations that meet their objectives.

For further details, please refer to ‘Regulation and Other Relevant Laws’ contained in this annual report on page 62.
4. Country risks
Our tobacco business has consistently expanded our earnings base to secure long-term growth by making acquisitions, entering new markets and increasing share in markets where we had limited presence. Geographical expansion may increase our exposure to country risks. In any market where we operate, we may face economic, political or social turmoil which may negatively affect our operations and financial results.

Risk description and potential impact
Political instability, economic downturn, social unrest or other unfavorable developments in a certain market could disrupt our business, leading to lower volume, revenue and profit in the market.

Measures to address the risk
• Avoid over dependence on a small number of markets as sources of profits by expanding the pool of highly profitable markets.

5. Instability in the procurement of key materials
Across its businesses, the JT Group procures raw and processed materials for product manufacturing. In particular, we strive to procure key materials in the required quantity and at reasonable costs. Our key materials include agricultural products: most notably, tobacco leaf for the tobacco business, and grains for the processed food business. Availability of agricultural products is often affected by natural phenomena including climate. In addition, there is a growing concern that agricultural production costs may increase, due to the high demand in energy resources, global population increases, and economic growth in emerging countries.

Risk description and potential impact
Insufficient supply of key materials could lead to inability to manufacture our products, subsequently resulting in the loss of revenue and profit. Furthermore, the increase in procurement costs driven by higher production costs for agricultural products would directly pressure our earnings.

Measures to address the risk
• Reinforce ability to procure key materials by building a strong relationship with suppliers. In the case of tobacco leaf, further promote internal sourcing.
• Promote efficient use of materials by continuously reviewing the manufacturing process and product specifications where possible.

6. Unfavorable development in litigation
JT and some of its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking. As of December 31, 2015, 20 smoking and health-related cases were pending in which one or more members of the JT Group were named as defendant or for which JT may have certain indemnity obligations pursuant to the agreement for JT’s acquisition of RJR Nabisco Inc.’s overseas (non-U.S.) tobacco operations. JT and its subsidiaries, who are defendants in such lawsuits, believe that we have valid grounds to defend the claims in such lawsuits; however, we cannot predict the outcome of any pending or future litigation.

Risk description and potential impact
A decision unfavorable to us could materially affect our financial performance due to the payment of monetary compensation. Critical media coverage of such lawsuits may reduce social tolerance of and strengthen regulations on smoking. Such media coverage may also prompt the filing of a number of similar lawsuits against JT or its subsidiaries, resulting in increased litigation costs.

Measures to address the risk
• Continue to build well-organized teams coordinating with external legal counsel to defend ourselves against these lawsuits.
• Continue legitimate and appropriate business operations. For further details, see section regarding ‘Litigation’ on page 65.

7. Natural disasters
Our operations may be disturbed by natural disasters such as earthquakes, typhoons, floods, volcano eruptions and others. Japan is one of the most important markets for the JT Group’s businesses and subject in particular to various natural disasters. The Great East Japan Earthquake was devastating. The impacts on the JT Group included casualties among our employees, physical damage to our factories, and supply shortages of certain tobacco product materials. Our tobacco business was forced to temporarily suspend product shipment and limit shipment volume for an extended period.

We have developed a Business Continuity Plan to minimize the impact of such disasters, with a particular emphasis on the optimization of the global supply chain.

Risk description and potential impact
Natural disasters could cause damage to the JT Group as well as our suppliers, trade partners and consumers, leading to disruption of our business and negatively impacting financial results.

Measures to address the risk
• Continuously review the Business Continuity Plan and revise it as necessary.
• Carry out emergency drills to increase employees’ preparedness against disasters.
• Insure key assets such as buildings, machinery, equipment and inventory to recover financial losses as appropriate.
8. Currency fluctuations
As the JT Group is operating globally, we are exposed to the risks associated with currency fluctuations. The reporting currency of the JT Group consolidated financial statements is Japanese yen, while the financial statements of our international subsidiaries are reported in other currencies such as Russian ruble, Euro, British pound, Taiwanese dollar, U.S. dollar, and Swiss franc.

Therefore, exchange rate fluctuations of these currencies against Japanese yen influence the Group’s reported financial results. As for the financial reporting of the international tobacco business, JT International Holding B.V. consolidates the financial results of the international tobacco subsidiaries and reports its consolidated financial statements in U.S. dollars. We often communicate the financial performance of our international tobacco business in U.S. dollars, which is affected by exchange rate fluctuations against the U.S. dollar. In principle, we do not hedge these risks which arise from the translation of financial statements.

However, we hedge against risks which arise when equity denominated in each functional currency of the JT Group is translated into Japanese yen to be consolidated by using foreign currency-denominated interest-bearing debts and part of these are designated as net investment hedges. In addition, many companies make transactions in currencies other than their reporting currencies for day-to-day operations. Such transactions also involve the risk of exchange rate fluctuations. We mitigate these transaction risks through hedging activities; however, it is not possible to completely eliminate them.

Furthermore, if we liquidate or sell a group subsidiary which we acquired in a currency other than Japanese yen or impair a substantial value of such a subsidiary, the gain or loss from the transaction includes the currency fluctuation impact. Specifically, the impact comes from the difference in the exchange rates of the relevant currency against Japanese yen at the time of the acquisition and at the time of such transaction.

Risk description and potential impact
Fluctuations of exchange rates against Japanese yen affect the JT Group’s reported financial results. Reported financial results of our international tobacco business in U.S. dollars are similarly influenced by the fluctuations of exchange rates against the U.S. dollar. In addition, we are exposed to the exchange rate fluctuation risks when a group company makes a transaction in a currency other than its reporting currency.

Measures to address the risk
• Mitigate the risk through hedging activities such as derivative contracts, possession of interest bearing debts in a foreign currency etc.

9. Competition
The JT Group is competing fiercely in both domestic and international tobacco business with our competitors.

In the overseas tobacco markets, the JT Group expanded its business organically as well as through M&A, by acquiring the non-U.S. tobacco operations of RJR Nabisco Inc. and thereafter acquiring Gallaher Ltd. As a result, we are in competition with global players in the international tobacco business or with local competitors with strength in specific markets.

In the Japanese domestic tobacco market, import of tobacco products was deregulated in 1985, followed by the provisional suspension of custom duties on imported tobacco in 1987. Since then, competition has intensified each year, as smokers’ preferences diversify and as our competitors pursue aggressive promotional activities.

Market share can fluctuate due to a number of factors, including change in smokers’ preferences or changes to economic conditions of each market. It can also fluctuate from competitors’ pricing strategies or strength of brand equity. Moreover, market share can fluctuate in the short term due to new product launches by each market player and the accompanying promotional activities.

Risk description and potential impact
Fluctuation of our market share may affect the JT Group business performance. In addition, price competition (price reductions or brand repositioning, among others) aimed at increasing market share, may negatively affect our profit margins.

Measures to address the risk
• Optimize our product portfolio by:
  – developing and providing products that can capture changing consumer preferences and needs
  – placing brands with strong brand equity in each price category
• Provide product support by enhancing trade marketing capability and effective promotional initiatives.
• Further improve efficiency to protect revenue and earnings.
• Avoid overdependence on a small number of markets as sources of profits by expanding the pool of highly profitable markets.
Our approach to sustainability is underpinned by our management principles known as the “4S” model. This provides us with a framework to balance the concerns and expectations of consumers, shareholders, employees and wider society, always with a view to fulfilling our responsibilities towards these stakeholders. We believe that pursuing this model enhances corporate value and helps us to meet and exceed stakeholders’ interest in the most balanced way possible.

Summarized below is an overview and topics for 2015. If you wish to learn more about our approach and commitment to sustainability or specific programs, ‘JT Group Sustainability Report FY2014’ is currently available on JT Group website. The FY2015 report will be available on our website in June 2016. This report will be compiled in accordance with the Global Reporting Initiative (GRI) G4 Sustainability Reporting Guidelines ‘Core’ level.


Contents

Overview and topics for 2015

JT Group Materiality Assessment
In 2015, we carried out our first materiality assessment covering the entire JT Group, building on the work done by our international tobacco business last year. The process began by conducting a media and peer review, which generated 31 sustainability topics of relevance. These were then calibrated through discussions with operational managers in the business.

We then held interviews with 15 JT Group top management, followed by talks with 17 external stakeholders who included suppliers, shareholders, trade unions, NGOs, and industry organizations. Finally we held a workshop with aforementioned 15 JT Group top management, including our CEO to validate the materiality assessment results.

This process allowed us to arrive at a final list of 22 material issues ranked by level of importance to the JT Group and our external stakeholders – see matrix on the right.

In the future we will regularly carry out a materiality assessment with stakeholders. This will help us to monitor any changes in materiality and to update the list if necessary.

Supply chain management
In 2015 our international tobacco business began work on developing an IT-based supplier life cycle management system that will enable assessment of all our non-leaf suppliers for the first time, with different levels of certification based on supply risk profiles.

Agricultural labor practices (ALP)
Our ALP defines minimum requirements for directly contracted farmers on preventing and eliminating child labor, respecting workers’ rights, and applying health and safety measures at the workplace. ALP plans to cover 100% of our directly contracted farmers by 2018. From 2016 we will extend the scope of ALP to cover all third party tobacco leaf suppliers by 2019.

Respecting human rights
In 2015 we began work on drafting a JT Group Human Rights Policy that will align with the UN Guiding Principles on Business and Human Rights. The Policy, which is being developed in consultation with stakeholders, will formalize and detail our commitment to respect human rights in our value chain and will be launched in 2016.

Child labor prevention
We have the ARISE program, which aims to address roots causes of child labor in tobacco growing. The program, which covers Brazil, Malawi, Zambia, and, from 2015, Tanzania, tackles social and economic factors that tempt farmers to employ children.