

## **2018 Small Meeting with Japanese Sell Side/Buy Side Analysts Questions and Answers**

Date: Thursday, 28 June, 2018 (18:30-19:20 Tokyo Time)  
Location: JT Building  
Presenters: Masamichi Terabatake, President and Chief Executive Officer  
Mutsuo Iwai, Executive Vice President, President of Tobacco Business  
Naohiro Minami, Executive Vice President, Chief Financial Officer  
Chito Sasaki, Senior Vice President, President of Japanese Tobacco Business

Disclaimer: This English question-and-answer material is an English translation of the Japanese material, not necessarily consistent with the Japanese version.

### **Q. What are the problems related to the current Ploom TECH? How can you differentiate Ploom TECH+ and Ploom S from existing products?**

(Sasaki)

- There are no problems related to Ploom TECH. We are noticing that consumers are still insufficiently informed about the difference between low and high heating temperature products. As a result, we are focusing our efforts to emphasize the benefits of low heating temperature products through marketing actions and communications in order to give consumers opportunities to experience the absence of odor.
- In addition, for those consumers convinced by the benefits of low heating temperature products but who are seeking a stronger flavor, we will be introducing Ploom TECH+. Compared to Ploom TECH, this new product has a strong flavor while remaining a low heating temperature product. Our communication on Ploom TECH+ will ensure consumers can make the difference between this product and the current Ploom TECH.
- Finally, for consumers who prefer product sensations closer to ready-made cigarettes (RMCs), we will add to our product lineup a high heating temperature product in the form of Ploom S. Through these three products, we aim to capture a share of 40% of the RRP category by the end of 2020.
- The current Ploom TECH is simple to use, while Ploom TECH+ has more punch to its taste. Ploom S is easy to use and has a superior taste. From the viewpoint of taste, how to make these products harmonious with MEVIUS is important.
- The new products are in the final stage of development and will be introduced toward the end of this year or early next year in Japan and will expand their sales area gradually.

### **Q. Could you tell me why Ploom TECH's share is not growing much?**

(Sasaki)

- Actually, Ploom TECH's share is steadily growing despite a sluggish growth of the overall T-Vapor category since the beginning of the year. The category accounts for around 20% of the total tobacco volume.

- We will increase our share through activities by our sales force of around 2,000 personnel across Japan. One area of focus will be to create many opportunities for consumers to experience the absence of odor. We intend to reinforce our communication with consumers regarding the benefits of low temperature heating products and the differences with high heating temperature products.
- In addition, acknowledging consumer feedback that the price of 4,000 yen for a starter kit is not a level at which the purchase decision can be instantly made, we have revised the price to 3,000 yen.

**Q. Please explain the factors behind the fact that the T-Vapor category's share in the Japanese domestic tobacco market has remained at around 20%? What change do you expect will occur when JT expands sales in earnest amid the sluggishness of the T-Vapor market?**

(Sasaki)

- It is true that the T-Vapor market's growth has slowed down recently. However, we expect that T-Vapor category share in the market will grow as we initially estimated as a result of an increase in options for consumers through our launch of various products, enhancement of sales promotion by competitors, and the tightening of smoking regulation indicated by the Tokyo Metropolitan government's passive smoking prevention ordinance and regulations being discussed in the Japanese parliament.
- In order to invigorate the T-Vapor market in the future, it is important to raise consumers' awareness about the presence of different categories (low and high heating temperature products) in the T-Vapor market.
- It is also important to raise awareness not only among smokers but also among their families and other people about the superiority of Ploom TECH by emphasizing its benefits, such as the absence of odor and simplicity of use.

**Q. What are the strengths and competitive advantages of JT's new products compared with competitors' products?**

(Terabatake, Sasaki)

- As we are a late comer with respect to the high heating temperature type, our products need to be superior. The strength of Ploom S, which is a high heating temperature product, is its superior taste. It is important to consider how we can reproduce the clear taste that represents MEVIUS's brand image. In addition, the relative absence of odor is also a strength. Our device will also include benefits in terms of cleaning frequency and ease of use.
- Concerning Ploom TECH+, which is a low heating temperature product, we believe that the key is further distinguishing our products from competitors' products by stepping up efforts to emphasize their benefits, such as the absence of odor and simplicity of use.

**Q. Concerning the three types of RRP products, including ones that you are planning to launch, which of them do you expect will draw the strongest demand as you prepare to sell them on a large scale? Please tell me about the mix of products in your portfolio,**

**from the viewpoint of production capacity as well.**

(Iwai)

- It is important to ensure flexibility in production volume for each offering when making manufacturing plans. Otherwise, we may find it difficult to respond when consumers' demand concentrates on a certain product. We are taking care to secure a certain level of production capacity for all products.
- Manufacturing of the device has been outsourced to China. We will increase production lines in line with demand, so we do not expect a significant time lag will arise between supply and demand.
- Concerning Ploom TECH consumables, it took more time than we expected to start up manufacturing operations because we had to construct a facility to make capsules from scratch. With the manufacturing process now under control and continuing to ramp-up, this is positive for Ploom TECH+ since it uses the same manufacturing machines. The consumables of Ploom S are a stick type, which is similar in shape to RMCs. As such, we can apply manufacturing knowhow concerning RMCs. Therefore, we will be able to supply whichever products are necessary in accordance with consumers' needs.
- Production capacity is calculated by multiplying the number of machines by output capacity per machine. Therefore, we will make sure that we can flexibly respond in terms of the number of machines installed and operating hours while watching demand.
- Outside Japan, a manufacturing base in Poland will soon start operation, so we will be able to respond in accordance with demand.

**Q. Under the current circumstances, what is your plan for the allocation of marketing resources?**

(Iwai)

- It is essential for consumers to understand that high and low heating temperature products represent different categories and to recognize the merits of each category.
- Only JT has products in the low heating temperature category. As many consumers associate T-Vapor with products offered by JT's competitors (high heating temperature products), we will continue our efforts to raise awareness about the low heating temperature category.
- As many users of Ploom TECH also consume RMCs, this product's market share appears to be small, but its share's growth is on schedule with our plan. To more vigorously promote Ploom TECH (low heating temperature category), we are allocating more resources to it. For example, we have made an organizational change and established a separate team dedicated to Ploom TECH.
- The forthcoming rollout of Ploom S means the launch of a product superior to current competitors' products without the necessity to create a new category. Therefore, we will devote efforts to differentiating Ploom S within the existing category.
- We will meet consumers' various needs by promoting the Ploom brand with respect to both high and low heating temperature products.
- We do not expect that promoting multiple types of products will lead to a wasteful dispersion of resources. It is important to communicate to consumers the presence of

various options within the Ploom brand and to raise awareness about the low heating temperature category.

**Q. The level of consumers' loyalty for T-Vapor products appear to be low compared with their loyalty for RMCs. While we assume that market share volatility is high in this category, what do you think is the key to increasing consumers' loyalty?**

(Iwai, Sasaki)

- We view the current high market share volatility in the T-Vapor category as an opportunity since it will enable us to increase our share as we grow our presence.
- Obviously, we are still gathering consumers' feedback on their relationship to this new category such as how they use the products, the key perceived benefits and their level of satisfaction with the products and the experience.
- Competitors initially emphasized merits on the health side, but the relative absence of odor compared with RMCs has turned out to be the factor of success in Japan.
- The perception of merits differs from consumer to consumer, so we will search for the optimal way while equally promoting the three types of T-Vapor products.
- As for consumers' attachment to products, we are increasing the variety of accessories. We will set a new direction in the tobacco industry by offering a wide variety of accessories to enable consumers to create their own original products, for example.
- As there are restrictions on tobacco advertising, we do not have full freedom in SNS-based advertising. We will continue to consider effective ways of advertising. As for our relationship with consumers, the key is using not only conventional marketing but also other ways, such as web-based marketing.
- It does appear that brand loyalty is different from the one experienced in RMCs, where brand image was created through the combination of packaging, taste and marketing.
- In the case of RRP products, due to the role of the heating device, we do not know for the moment whether branding can create loyalty.
- Looking at the situation of e-cigarettes in the U.S., competitors' products are growing thanks to the strength of nicotine impact levels and design superiority. Therefore, there is a high likelihood that new products can reverse this situation.
- It is also necessary to examine if consumables can be a brand element as in the case of RMCs or if they do not create loyalty and instead the device is the key factor of choice.
- While it is not clear whether competition in this category will center on the device, the way to compete will be different. So, it is important to consider how we can acquire organizational capability to respond to the change. We will also examine which method will be effective in this category.

**Q. Are you going to achieve the full-year sales target of 4 billion units through the current Ploom TECH alone? Are you confident about achieving the target?**

(Sasaki)

- Yes, we plan to achieve the target through Ploom TECH alone. New products are not

included in the sales forecast provided in February.

- While the full-fledged nationwide rollout of Ploom TECH is scheduled for next week, we started sales activities in most parts of the country in June and recognized some areas of improvements. We feel the need to take action while directly communicating with consumers and examining their response, instead of competing to secure more shelf space.
- Until now, T-Vapor has been regarded as an urban-market product. However, we believe that by listening to consumers and addressing their needs, we can expand the reach of the T-Vapor category through a differentiated sales approach, a new way of use and eventually new consumers.

**Q. In what way is Ploom S superior to rival products? Against which rival product are you comparing it?**

(Terabatake)

- We believe that Ploom S is superior to T-Vapor products that are already in-market
- We are already developing a new product incorporating new technology and we are confident that it is an excellent product. However, we must not forget the threat from competitors.
- Concerning the T-Vapor category, we recognize the need to regularly implement innovation with respect to devices and consumables.
- We have substantially reinforced investments in R&D activities, including those related to patents. As it is important to retain consumers by regularly developing new products, we will continue efforts in this respect.

**Q. In principle, T-Vapor is subject to the Tokyo Metropolitan government's passive smoking prevention ordinance, but what kind of advantage will this give you in terms of sales activity in the future?**

(Sasaki)

- As you know, related to our activity in the RMC category, we are conducting such activities as providing consulting services on the separation of smoking and non-smoking areas and the installation of ashtrays. As these activities will carry less weight in the future, we plan to shift sales efforts from consulting services to opening Ploom TECH-only shops.

**Q. Please explain the future trend in consolidated financial results. Until now, the international tobacco business has acted as the profit growth driver, but will it be replaced by other business as the driver of the "mid to high single digit" growth over the next three to five years?**

(Minami)

- Every year, under our three-year rolling forecast, we explore various plans to deliver on our target to achieve "mid to high single digit" adjusted operating profit growth at constant FX over mid- to long-term.
- In the near term, it is important to rebuild the Japanese domestic market first so that we can expect profit growth. To do so, we need to capture a share of 40% in the

T-Vapor category in the Japanese domestic tobacco business by the end of 2020, which translates into a share of 12% in the entire tobacco market. In addition to achieving this objective, it is important to continue gaining market share in the RMC category, which is now higher than 60%. By delivering on these objectives and reinforcing RRP in terms of both manufacturing and sales, the Japanese domestic tobacco business will not drag down our profit growth.

- In the international tobacco business, we are making investments in measures to consolidate our position in existing markets and investments in emerging markets, which will support our long-term growth, while carefully considering the investment time horizon.
- DPS growth reflects our capabilities, intentions and resources over the medium term. It will serve as a guidance for our future performance including cash flow.

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