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[Cover]

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A. Company Information

I. Overview of the Group

1. Trends in principal management benchmarks

(1) Management benchmarks (consolidated)

Term	International Financial Reporting Standards					
	28th term	29th term	30th term	31st term	32nd term	33rd term
Accounting period	From April 1, 2012 to March 31, 2013	From April 1, 2013 to March 31, 2014	From April 1, 2014 to December 31, 2014	From January 1, 2015 to December 31, 2015	From January 1, 2016 to December 31, 2016	From January 1, 2017 to December 31, 2017
Revenue (Millions of yen)	2,120,196	2,399,841	2,019,745	2,252,884	2,143,287	2,139,653
Profit before income taxes (Millions of yen)	509,355	636,203	502,526	565,113	578,237	538,532
Profit for the year (Millions of yen)	351,448	435,291	368,626	490,242	425,773	396,749
Profit attributable to owners of the parent company (Millions of yen)	343,596	427,987	362,919	485,691	421,695	392,409
Comprehensive income (loss) for the year (Millions of yen)	544,407	850,261	244,868	207,708	235,250	554,198
Total equity (Millions of yen)	1,892,431	2,596,091	2,622,503	2,521,524	2,528,041	2,842,027
Total assets (Millions of yen)	3,852,567	4,616,766	4,704,706	4,558,235	4,744,374	5,221,484
Equity attributable to owners of the parent company per share (Yen)	993.98	1,378.57	1,395.74	1,369.06	1,371.39	1,541.94
Basic earnings per share (Yen)	181.07	235.48	199.67	270.54	235.47	219.10
Diluted earnings per share (Yen)	180.98	235.35	199.56	270.37	235.33	218.97
Ratio of equity attributable to owners of the parent company to total assets (%)	46.89	54.27	53.92	53.78	51.77	52.89
Ratio of profit to equity attributable to owners of the parent company (%)	19.97	19.85	14.39	19.47	17.19	15.04
Price earnings ratio (PER) (Times)	16.57	13.76	16.67	16.53	16.32	16.57
Net cash flows from operating activities (Millions of yen)	466,608	396,496	543,696	468,432	376,549	419,212
Net cash flows from investing activities (Millions of yen)	(147,928)	(163,473)	(49,110)	(63,271)	(687,509)	(352,632)
Net cash flows from financing activities (Millions of yen)	(569,473)	(145,189)	(388,859)	(254,852)	91,318	(77,032)
Cash and cash equivalents at the end of the year (Millions of yen)	142,713	253,219	385,820	526,765	294,157	285,486
Number of employees [Separately, average number of temporary employees] (Person)	49,507 [9,313]	51,563 [9,130]	51,341 [8,700]	44,485 [7,858]	44,667 [7,904]	57,963 [6,744]

Notes: 1. The Group prepares the consolidated financial statements in accordance with International Financial Reporting Standards (hereinafter, "IFRS").

2. The yen amounts are rounded to the nearest million.
3. Revenue does not include consumption taxes.
4. The Company conducted a share split at a ratio of 200 to one with July 1, 2012 as effective date. Consequently, equity attributable to owners of the parent company per share, basic earnings per share and diluted earnings per share are calculated on the assumption that this share split was conducted at the beginning of the 28th term.
5. The Group made a partial change to its accounting policies effective from the 29th term. Related principal management benchmarks for the 28th term have been adjusted retrospectively to reflect the change.
6. The Group made a partial change to its accounting policies effective from the 30th term. Related principal management benchmarks for the 29th term have been adjusted retrospectively to reflect the change.
7. The Company changed its fiscal year end from March 31 to December 31 effective from the 30th term. The same change was made to consolidated subsidiaries with fiscal year ends other than December 31. As a consequence of this change, the 30th term was the 9-month period from April 1, 2014 to December 31, 2014, for the Company and its main consolidated subsidiaries that do not belong to the International Tobacco Business segment. For consolidated subsidiaries that belong to the International Tobacco Business segment, the 30th term was the 12-month period from January 1, 2014 to December 31, 2014.
8. The Group has classified "Beverage Business" as discontinued operations from the 31st term, and the figures presented for the 30th term have been restated. Consequently, only revenue and profit before income taxes from continuing operations are presented for the 30th and 31st terms.

(2) Filing company's management benchmarks (non-consolidated)

Term	28th term	29th term	30th term	31st term	32nd term	33rd term
Accounting period	From April 1, 2012 to March 31, 2013	From April 1, 2013 to March 31, 2014	From April 1, 2014 to December 31, 2014	From January 1, 2015 to December 31, 2015	From January 1, 2016 to December 31, 2016	From January 1, 2017 to December 31, 2017
Net sales (Millions of yen)	781,067	809,967	572,323	732,483	729,286	681,840
Ordinary income (Millions of yen)	210,568	230,900	159,746	371,989	203,242	199,336
Net income (Millions of yen)	149,773	168,779	108,656	345,009	173,607	160,120
Capital stock (Millions of yen)	100,000	100,000	100,000	100,000	100,000	100,000
Total number of shares issued (Thousands of shares)	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Net assets (Millions of yen)	1,714,529	1,734,379	1,649,151	1,713,068	1,663,675	1,592,966
Total assets (Millions of yen)	2,784,914	2,732,637	2,729,270	2,756,785	2,849,913	2,885,760
Net assets per share (Yen)	942.65	953.45	906.45	955.56	927.93	888.31
Cash dividends per share (Yen) [Interim dividends per share] (Yen)	68 [30]	96 [46]	100 [50]	118 [54]	130 [64]	140 [70]
Net income per share (Yen)	78.93	92.86	59.78	192.18	96.94	89.40
Diluted net income per share (Yen)	78.89	92.81	59.75	192.06	96.88	89.35
Equity ratio (%)	61.5	63.4	60.4	62.1	58.3	55.1
Return on equity (ROE) (%)	8.24	9.80	6.43	20.54	10.29	9.84
Price earnings ratio (PER) (Times)	38.01	34.89	55.67	23.26	39.65	43.00
Dividend payout ratio (%)	82.5	103.4	167.3	61.4	134.1	156.6
Number of employees [Separately, average number of temporary employees] (Person)	8,925 [1,390]	8,774 [1,377]	8,915 [1,272]	7,549 [1,125]	7,298 [1,117]	7,336 [1,222]

Notes: 1. The financial statements of the filing company are prepared in accordance with Japanese GAAP.

2. The yen amounts are rounded to the nearest million.

3. Net sales do not include consumption taxes.

4. The Company conducted a share split at a ratio of 200 to one with July 1, 2012 as effective date. Consequently, net assets per share, net income per share and diluted net income per share are calculated on the assumption that this share split was conducted at the beginning of the 28th term.

5. The Company changed its fiscal year end from March 31 to December 31 effective from the 30th term. As a consequence of this change, the 30th term is the 9-month period from April 1, 2014 to December 31, 2014.

2. History

(1) Background of the Company's transition to stock company

Before it became a stock company, Japan Tobacco Inc. (hereinafter, "the Company") was formerly Japan Tobacco and Salt Public Corporation, or JTS. JTS was established on June 1, 1949 with the "Aim to bring soundness and efficiency to the operation of the national government monopolies." JTS, serving as the main body for conducting operations of the tobacco monopoly system and other government monopolies, contributed to establishing stable supply of tobacco and securing tobacco-derived financial revenues.

However, the growth in demand for cigarettes in Japan began to slow in the mid-1970s as the result of demographic trends and growing concern about health risks associated with smoking. This trend continued, such that growth in industry sales essentially stopped. In addition to the structural change, the Japanese domestic tobacco market was virtually opened to foreign tobacco suppliers, triggering competition between domestic and foreign tobacco products in Japan, and foreign countries stepped up pressure on Japan to take further market-opening measures, which were difficult to implement within the framework of the monopoly tobacco sales system. Amid such pressure as well as moves toward the reform of government-run public corporations, Ad Hoc Commission on Administrative Reform was established in March 1981 to conduct research on the public corporation system. In its third report (July 30, 1982), the commission proposed drastic reform of the monopoly system and the public corporation system.

In response to this proposal, the government conducted a comprehensive review of these systems and drafted bills to:

- Abolish the tobacco monopoly law in order to liberalize tobacco imports and establish a tobacco business law in order to make necessary adjustments related to the tobacco business.
- Abolish the JTS law, reorganize JTS as stock company so as to enable it to pursue rational corporate management as much as possible and establish the Act on Japan Tobacco Inc., which provides for a necessary minimum level of regulation in light of the corporation's need to compete with foreign tobacco companies on an equal footing in the domestic market following the liberalization of tobacco imports.

These bills were enacted on August 3, 1984 in the 101st session of the Diet and promulgated on August 10 of the same year.

(2) Status of the Company after its incorporation

The Company was incorporated on April 1, 1985, pursuant to the Act on Japan Tobacco Inc. (Act No. 69 of August 10, 1984; hereinafter, the "JT Act"), and all of the start-up capital was provided by the Japan Tobacco and Salt Public Corporation, or JTS. When incorporated, the Company succeeded all the rights and obligations of JTS.

The main changes since the incorporation of the Company are as follows:

Date	Details of change
April 1985	Japan Tobacco Inc. was incorporated.
April 1985	The Business Development Division was established to promote active development of new businesses. Subsequently until July 1990, in order to reinforce the promotion system for each business, this division was transformed into business departments such as pharmaceutical, food, etc.
March 1986	Fukuoka and Tosu Factories closed and Kitakyushu Factory built to modernize and streamline tobacco production. By June 1996, nine more tobacco factories were closed down to further streamline the tobacco production system.
October 1988	The communication name “JT” was introduced.
July 1991	The Head Office was relocated from Minato-ku to Shinagawa-ku to make way for the construction of the new Head Office building.
September 1993	The Central Pharmaceutical Research Institute was established to reinforce the internal pharmaceutical research and development capabilities.
October 1994	The initial public offering of the Company shares held by the Japanese government. (394,276 shares) The Company shares were listed on the First Section of the Tokyo, Osaka and Nagoya Stock Exchanges.
November 1994	The Company shares were listed on the Kyoto, Hiroshima, Fukuoka, Niigata and Sapporo Stock Exchanges.
May 1995	The Head Office was relocated from Shinagawa-ku to Minato-ku.
June 1996	The second public offering of the Company shares held by the Japanese government. (272,390 shares)
April 1997	In accordance with the abolition of the salt monopoly, the Company ended its salt monopoly business. The Tobacco Mutual Aid Pension scheme was united with the Employees’ Pension scheme.
April 1998	The Company signed an agreement with Unimat Corporation to form a business alliance in the soft drinks business and acquired a majority stake in the company.
December 1998	The Company acquired a majority stake in Torii Pharmaceutical Co., Ltd. through a tender offer.
May 1999	The Company acquired the non-US tobacco operations of RJR Nabisco Inc.
July 1999	The Company acquired the food business of Asahi Kasei Corporation, including eight subsidiaries such as Asahi Foods Corporation.
October 1999	Through the business alliance with Torii Pharmaceutical Co., Ltd., research and development functions in the prescription drug business were concentrated in the Company while promotion functions were united within Torii Pharmaceutical.
March 2003	In order to establish a basis for future profit growth in the Domestic Tobacco Business, Sendai, Nagoya and Hashimoto Factories were closed down.
March 2004	In order to establish a basis for future profit growth in the Domestic Tobacco Business, Hiroshima, Fuchu, Matsuyama and Naha Factories were closed down.
June 2004	The third public offering of the Company shares held by the Japanese government. (289,334 shares)
March 2005	In order to establish a basis for future profit growth in the Domestic Tobacco Business, Ueda, Hakodate, Takasaki, Takamatsu, Tokushima, Usuki, Kagoshima and Miyakonojo Factories were closed down.
April 2006	The Company ceased to produce, sell and use Marlboro brand cigarette exclusively in Japan upon the expiration of the exclusive license agreement.
April 2007	The Company acquired shares issued of the Gallaher Group Plc of the United Kingdom through an acquisition method under English act known as a scheme of arrangement.
January 2008	The Company acquired the shares of Katokichi Co., Ltd. through a tender offer.
March 2009	In order to restructure the Domestic Tobacco Business in ways to make it more competitive, Kanazawa Factory was closed down.
March 2010	In order to restructure the Domestic Tobacco Business in ways to make it more competitive, Morioka and Yonago Factories were closed down.
March 2011	In order to restructure the Domestic Tobacco Business in ways to make it more competitive, Odawara Factory was closed down.
March 2012	In order to restructure the Domestic Tobacco Business in ways to make it more competitive, Hofu Factory was closed down.
February 2013	The Mild Seven brand was renewed as “Mevius” in Japan.
March 2013	The fourth public offering of the Company shares held by the Japanese government. (253,261,800 shares)
March 2015	In order to further strengthen the competitiveness of Domestic Tobacco Business, Koriyama, Hamamatsu and Okayama Printing Factories were closed down.

Date		Details of change
July	2015	The Company transferred shares the Company held in Japan Beverage Holdings Inc., JT A-Star Co., Ltd. and others, and JT beverage brands “Roots” and “Momono Tennensui.” Subsequently, the Company withdrew from manufacture and sale of JT beverage products in September 2015 and the Beverage Business Division was closed down in December 2015.
March	2016	In order to further strengthen the competitiveness of Domestic Tobacco Business, Hiratsuka factory was closed down.

Note: The stock split of at a ratio of five to one was conducted as of April 1, 2006 and the stock split at a ratio of 200 to one was conducted as of July 1, 2012.

3. Business description

The Group's management principles are based on the pursuit of the "4S" model. The model requires the Group to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society, carefully considering the respective interests of these four key stakeholder groups, and exceeding their expectations wherever we can.

The Group created its vision and mission based on the "4S" model. The vision is to become a company committed to global growth by providing diversified value that is uniquely available from JT Group. The mission is to create, develop and nurture the Group's unique brands to win consumer trust, while understanding and respecting the environment and the diversity of societies and individuals.

The Group has also adopted "The JT Group Way" as a code of conduct which all members of the Group should follow. The JT Group Way requires that the Group fulfills the expectations of the Group's consumers and behaves responsibly, strives for quality in everything we do through continuous improvement, and leverages diversity across the Group.

The Group, consisting of the Company, its 210 consolidated subsidiaries and 13 companies accounted for by the equity method, is a global company operating the Domestic and International Tobacco Businesses, Pharmaceutical Business and Processed Food Business. The main business activities operated by the Group and the relationship of each affiliates to the Group's business activities are stated below.

The following four segments are the same as the segmentation of reportable segments in "V. Accounting, 1. Consolidated financial statements, (1) Consolidated financial statements, Notes to consolidated financial statements, 6. Operating segments, (1) Outline of reportable segments."

Domestic Tobacco Business

The Domestic Tobacco Business consists of the manufacture and sale of tobacco products. The Company manufactures and sells tobacco products, and TS Network Co., Ltd. conducts distribution-related operations such as distribution of the Company's tobacco products and wholesale of foreign tobacco products (imported tobacco products). Japan Filter Technology Co., Ltd. and other subsidiaries manufacture materials. Moreover, some of the operations related to Natural American Spirit products are carried out by TRUE SPIRIT TOBACCO COMPANY.

Major subsidiaries and affiliates

TS Network Co., Ltd., JT Logistics Co., Ltd., Japan Filter Technology Co., Ltd., Fuji Flavor Co., Ltd., JT Engineering Inc., TRUE SPIRIT TOBACCO COMPANY

Besides the companies named above, there are 7 consolidated subsidiaries and 2 companies accounted for by the equity method.

International Tobacco Business

The International Tobacco Business consists of the manufacture and sale of tobacco products with JT International S.A. as the core company.

Major subsidiaries and affiliates

JT International S.A., LLC JTI Russia, Gallaher Ltd., LLC Petro, JT International Germany GmbH, JTI Polska Sp. z o. o., JTI Tütün Urunleri Sanayi A.S.

Besides the companies named above, there are 149 consolidated subsidiaries and 5 companies accounted for by the equity method.

Pharmaceutical Business

The Pharmaceutical Business consists of research and development, manufacture, sale and promotion of prescription drugs. The Company concentrates on research and development while Torii Pharmaceutical Co., Ltd. manufactures, sells and promotes drugs (including the Company's products).

Major subsidiaries and affiliates

Torii Pharmaceutical Co., Ltd., Akros Pharma Inc.

Processed Food Business

In the Processed Food Business, TableMark Co., Ltd. and certain other subsidiaries are engaged in manufacture and sale of frozen and ambient processed foods, bakery products and seasonings.

Major subsidiaries and affiliates

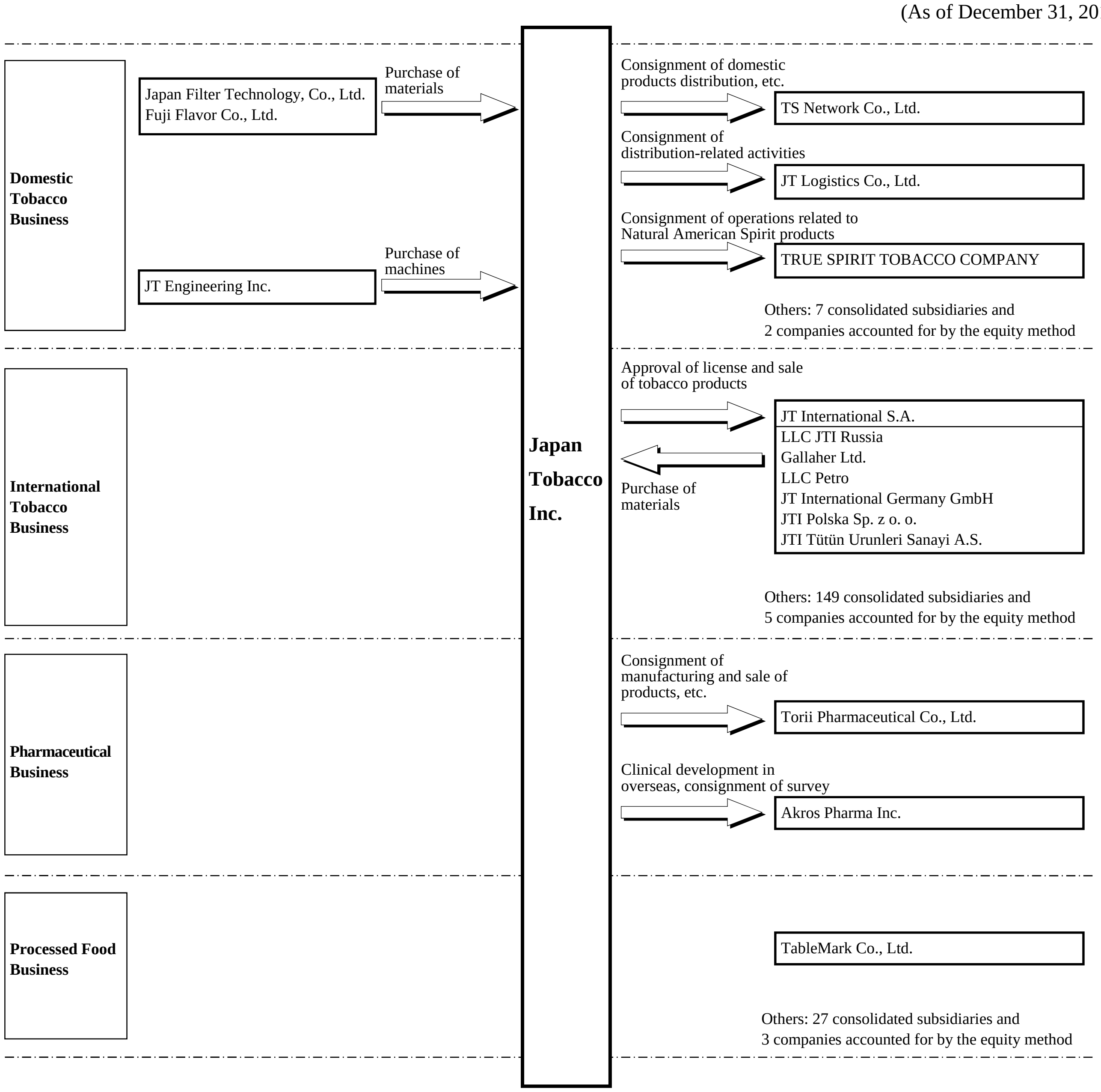
TableMark Co., Ltd.

Besides the companies named above, there are 27 consolidated subsidiaries and 3 companies accounted for by the equity method.

In addition to the reportable segments mentioned above, the Group runs businesses, including business relating to the rent of real estate. There are 11 consolidated subsidiaries and 3 companies accounted for by equity method deemed as subsidiaries and affiliates not affiliated to any reportable segment.

The following business activities diagram shows the matters described above.

(As of December 31, 2017)



* In addition to the reportable segments mentioned above, the Group runs businesses including business relating to the rent of real estate. There are 11 consolidated subsidiaries and 3 companies accounted for by the equity method deemed as affiliates not affiliated to any reportable segment.

An overview of each of the fields of research and development, procurement, manufacturing and sales in each business is as follows.

Tobacco Business

The Group's tobacco business (the Group's tobacco business is managed separately for domestic and overseas markets. The tobacco business' reportable segments are accordingly divided into "Domestic Tobacco Business" and "International Tobacco Business") has the third largest sales volume in the world (excluding China National Tobacco Corporation), operates in at least 70 countries and territories, and sells products in at least 130 countries and territories. The Group's portfolio includes 3 of the top 10 selling global brands.

<Research and development>

The Group is committed to strengthening its R&D capabilities to ensure a long-term competitive advantage. The focus areas in the R&D activities are the development of new leaf tobacco varieties, improvement of tobacco leafs and their processing, enhancement of aroma and taste, upgrading manufacturing technology, and continuous progress on RIP-related technologies. The Group has been striving to add value to the products in these focus areas in a cost efficient manner. It has established a global research platform in Japan, which focuses on the fundamental research and product technology development. To best meet consumers' needs and preferences, the market teams are continuously engaged in the product development.

<Procurement of tobacco leaves>

The supply of tobacco leaves, raw materials used in manufacturing tobacco products is affected by a variety of factors, such as climate conditions, agricultural product prices, and energy costs. As a result of an increase in costs, the supply of tobacco leaves has been unstable, leading to the fluctuations in tobacco leaf prices. Given these circumstances, the Group has been striving to secure a stable supply and ensure competitive leaf purchase prices. This will be achieved through further vertical integration and strengthening of the relationships with the leaf suppliers.

- Procurement of non-Japan origin tobacco leaf

The Group sources leaves both directly, from major tobacco leaf producing countries (the United States, Brazil, Malawi, etc.), and indirectly, mainly from the three leading international suppliers.

The internal source was established in 2009, when the Group acquired the tobacco leaf suppliers (in Brazil and in Africa), and set up a U.S. joint venture operation. Since then, the efforts have been focused on ensuring the stable procurement through vertical integration, strengthening quality control by supporting farmers, and reinforcing the leaf procurement organization by developing expertise in this area.

- Procurement of Japan origin tobacco leaves

In Japan, the Tobacco Business Act requires the Company to enter into purchase contracts with tobacco farmers every year and purchase the entire usable tobacco harvest. The aggregate cultivation area size and leaf prices for the subsequent year are determined respecting the recommendations from the Leaf Tobacco Council[(Note)].

Note: The Leaf Tobacco Council is a council which confers on important matters concerning the cultivation and purchase of domestically grown leaf tobacco in response to inquiries by the Company's representatives. The council consists of no more than 11 members, who represent domestic leaf tobacco growers as well as appointees from the academia appointed by the Company with the approval of the Minister of Finance (MOF).

<Manufacturing>

The Group has a global manufacturing footprint in order to manufacture quality tobacco products that secure consumers' reliability trust. The Group operates 5 factories in Japan (4 tobacco manufacturing and 1 tobacco-related factory), and 32 factories in 28 other countries (including tobacco-related factories). In a limited number of cases, the Group also partners with competing manufacturers under contracts and/or license agreements to manufacture the Group's products.

<Marketing>

To enhance brand loyalty, the Group is conducting extensive and effective marketing activities in accordance to the various regulations and standards.

Globally, the marketing activities are focused on Global Flagship Brands (hereinafter, “GFBs”)(Note), while complementing the brand portfolio by promoting local brands as well.

Note: GFBs (Global Flagship Brands) consist of nine brands, which serve as flagships of the Group’s brand portfolio - Winston, Camel, Mevius, LD, Benson & Hedges, Glamour, Sobranie, Silk Cut and Natural American Spirit. (However, from 2018, five of the existing nine brands will be removed, leaving the four brands of Winston, Camel, Mevius and LD as GFBs.)

<Retail prices>

In setting a retail price for a product, the Group considers various factors, including positioning of the brand, perceived value of the product, retail price of competing products, and the margin. In addition, there are regulations that influence the price-setting decisions. For example, some countries adopt a fixed retail price requirement, and forms of excise taxation on tobacco products (specific and/or ad valorem) differ among the countries. Retail price changes most often occur in case of tax increase. Globally, governments increase taxes to secure tax revenues and promote public health.

<Sales (distribution)>

To ensure that the products are delivered to consumers, the Group makes sure to use optimal distribution networks for each market complying with the restrictions and in accordance with established local business practices, and other factors. The distribution networks of the Group can be independent distribution networks or local agencies and distributors.

There are various sales channels for tobacco products; chain stores such as convenience stores, gas stations and supermarkets, small independent retailers and vending machines. The contribution of each channel to the total industry sales varies from market to market. Accordingly, the Group develops different trade marketing initiatives for each market, depending on the focus channels as well as consumer trend and competitors’ strategies.

Pharmaceutical Business

The Group commenced the Pharmaceutical Business in 1987. The Group’s mission is to build world-class, unique R&D capabilities and reinforce its market presence through innovative drugs. The Pharmaceutical Business is currently focusing on the development, manufacture, and sales and promotion of prescription drugs.

In December 1998, the Company acquired a majority of the outstanding shares in Torii Pharmaceutical Co., Ltd. (hereinafter, “Torii Pharmaceutical”). After the acquisition, all manufacture, sales and promotion functions were integrated under Torii Pharmaceutical, while all R&D functions were grouped under the Company.

In April 2000, the Company established an R&D base outside Japan by adding a clinical development function to Akros Pharma Inc., a Group company based in the state of New Jersey, United States.

In order to make stable profit contribution, the Group is maximizing the value of each product, enhancing the R&D pipeline, exploring opportunities for strategic in- or out-licensing and strengthening collaboration with license partners.

<Research and development>

- Overview

R&D activities are the foundation of the Group’s Pharmaceutical Business and are critical for its long-term growth and profitability. The R&D activities focus mainly on the fields of glucose and lipid metabolism, virus research and immune disorders and inflammation. In the fiscal year ended December 31, 2017, the Group invested ¥32.6 billion in these activities.

- R&D process

The Central Pharmaceutical Research Institute is responsible for discovery research, drug development, and pre-clinical trial research. The Company’s pharmaceutical development division and Akros Pharma Inc. undertake clinical trials and handle the application process to receive certification for any new drugs. Concerning compounds out-licensed for development and commercialization outside Japan, the licensees implement the subsequent processes.

<Manufacturing>

The Group's pharmaceutical products are manufactured by Torii Pharmaceutical or contract manufacturers outside the Group.

<Sales and promotion>

- Sales and promotion outside Japan

At present, the Group does not have its own sales organization for pharmaceutical products outside Japan. The Group out-licenses the right to develop and commercialize outside Japan for certain compounds in the development stage and receives royalties from the partners linked to their sales performance.

- Sales and promotion in Japan

Torii Pharmaceutical is mainly responsible for sales of the Group's pharmaceutical products to pharmaceutical wholesalers and promotion to medical facilities. Promotional activities are conducted by 526 medical representatives (MRs) stationed at Torii Pharmaceutical's 14 sales branches across Japan.

REMITCH, the treatment drug of pruritus in dialysis patients and Descovy Combination Tablets, an anti-HIV drug, are the main products among others.

Processed Food Business

The Group started its Processed Food Business in 1998. Since then, the Group has been expanding the business through organic growth as well as business investments in the form of M&As and strategic partnerships.

In 2008, the Group acquired Katokichi Co., Ltd., a major frozen food manufacturing company in Japan, through a tender offer. The Group's processed food operations were transferred over to Katokichi Co., Ltd. as part of the integration. In 2010, Katokichi Co., Ltd. changed its corporate name to TableMark Co., Ltd. to pursue synergies and foster a sense of unity within the group. At present, this business is operated by the pure holding company TableMark Holdings Co., Ltd., the business company TableMark Co., Ltd., and TableMark group companies (hereinafter, collectively, "TableMark").

The business pillars of TableMark, which operates mainly in Japan, include frozen and ambient processed foods, mainly staple food products such as frozen noodles, frozen rice, packed rice and frozen bread, bakery chain outlets in the Tokyo metropolitan area, and seasonings including yeast, kelp and bonito extracts, combination seasonings and processed seasonings for direct consumer consumption such as oyster sauce. Major processed food products include "Reito-Sanuki-Udon" (frozen noodles), "Takitate-Gohan" (packed rice), and the "Vertex" yeast extract seasonings in particular.

<Research and development>

Regarding R&D, the Group devotes its efforts to the development of innovative products that meet consumers' needs and preferences. In order to meet the diversifying needs of customers, the Group works to develop value-added products using TableMark's original techniques.
Specifically, the Group has used TableMark's original techniques for fermentation, baking, and freezing to recreate and preserve the taste and texture of fresh bread, and developed frozen bread products which allow consumers to simply enjoy the taste of freshly baked bread at home. In addition, in the area of frozen noodles the Group developed a new production method, the "Tannen-jikomi" weaving and maturing process. This enabled the Group to realize udon noodle products with higher quality and higher added value.

<Procurement>

The first step to produce safe foods is to procure safe and high-quality raw materials. For the procurement, the Group reviews quality assurance certificates submitted by its suppliers. The Group also carries out monitoring inspections to check agrochemical residues as well as conducts regular inspections at processing factories to ensure compliance with the Group’s internal standards, in addition to the Food Sanitation Act and other relevant laws.

Furthermore, the Group examines the safety of production sites for raw materials which are procured from overseas. Concerning agricultural farms, the Group checks not only soil and water, but also how products are cultivated and how agrochemicals are handled. Breeding farms and fish farms are also inspected.

<Manufacturing>

The Group operates 23 factories in Japan and 8 outside Japan. The Group outsources manufacturing of some processed foods to domestic and international contract manufacturers. All of the Group’s 31 factories in and outside Japan, as well as the Group’s business partners’ factories which produce the frozen foods, have achieved the ISO 22000 or FSSC 22000 certification. Under the ISO 22000 and FSSC 22000 standards, continuous improvements are made following effective rules to control sanitation and other key issues. These rules are set based on the HACCP concept and their effectiveness is tested using scientific evidence. FSSC 22000 has already been obtained at 19 factories of the Group. The Group is making preparations for gradually obtaining this certification at other Group company plants while keeping the business environment under consideration.

<Marketing>

The Group analyzes the market from consumers’ point of view and, by combining the technology owned by TableMark, it has been striving to provide products with new values to expand the market and increase its place there. The Group has been striving for effective marketing in order to improve consumer awareness of its products.

<Sales and distribution>

The Group has been striving to enhance profitability through sales division structure optimization and its initiatives to increase its presence in supermarkets and convenience stores, by offering a wider range of products while also seeking better shelf space.

<Food safety>

To ensure that consumers can continue to enjoy the products safely, the Group has established an independent food safety management division at TableMark Holdings Co., Ltd., which is responsible for overall food safety controls. At TableMark, the Group has established Quality Control Centers in Tokyo and Qingdao (China), and it not only inspects and monitors the raw materials it uses from the product planning and development stages, but also makes inspections at factories at the time of production and before shipment, and carries out safety management throughout the product manufacturing process. The Group seeks assessment and advice on its initiatives from external food safety experts. The Group reflects the experts’ knowledge and viewpoints in its business by actively incorporating them into food safety controls. Details of the food safety activities, including the discussions described in the above “Procurement” and “Manufacturing” sections, are disclosed on the website.

4. Status of subsidiaries and affiliates

(As of December 31, 2017)

Name	Location	Capital (Millions of yen)	Principal business	Holding rate of voting rights (%)	Relationship				
					Interlocking of officers		Financial assistance	Business relationship	Facility leasing
					Officer of the Company	Employee of the Company			
(Consolidated subsidiaries) 210 companies									
TS Network Co., Ltd.	Taito-ku, Tokyo	460	Domestic tobacco	74.5	No	Yes	No	Consignment of tobacco products distribution	Yes
JT Logistics Co., Ltd.	Chuo-ku, Tokyo	207	Domestic tobacco	100.0	No	Yes	No	Consignment of tobacco products and raw materials distribution	Yes
Japan Filter Technology, Co., Ltd. *1	Sumida-ku, Tokyo	461	Domestic tobacco	88.6	No	Yes	No	Purchase of filter for tobacco products	Yes
Fuji Flavor Co., Ltd.	Hamura-shi, Tokyo	196	Domestic tobacco	100.0	No	Yes	No	Purchase of flavors for tobacco products	No
JT Engineering Inc.	Sumida-ku, Tokyo	200	Domestic tobacco	100.0	No	Yes	No	Purchase of machines	Yes
TRUE SPIRIT TOBACCO COMPANY	Minato-ku, Tokyo	45	Domestic tobacco	100.0	No	Yes	No	Consignment of operations related to Natural American Spirit products	No
JT International Group Holding B.V. *1	Netherlands	Thousands of USD 1,800,372	International tobacco	100.0	Yes	Yes	No	No	No
JT International Holding B.V. *1	Netherlands	Thousands of USD 1,800,372	International tobacco	100.0 (100.0)	No	Yes	Yes	No	No
JT International S.A. *1	Switzerland	Thousands of CHF 1,215,425	International tobacco	100.0 (100.0)	No	No	No	Approval of license and sale of tobacco products	No
LLC JTI Russia	Russia	Thousands of RUB 108,700	International tobacco	100.0 (100.0)	No	No	No	No	No
Gallaher Ltd. *1	U.K.	Thousands of GBP 172,495	International tobacco	100.0 (100.0)	No	No	No	No	No
LLC Petro	Russia	Thousands of RUB 328,439	International tobacco	100.0 (100.0)	No	No	No	No	No
JT International Germany GmbH	Germany	Thousands of EUR 37,394	International tobacco	100.0 (100.0)	No	No	No	No	No
JTI Polska Sp. z o. o.	Poland	Thousands of PLN 200,000	International tobacco	100.0 (100.0)	No	No	No	No	No
JTI Tütün Urunleri Sanayi A.S.	Turkey	Thousands of TRY 148,825	International tobacco	100.0 (100.0)	No	No	No	No	No
Torii Pharmaceutical Co., Ltd. *2	Chuo-ku, Tokyo	5,190	Pharmaceutical	54.9	No	No	No	Consignment of manufacturing and sale of products	Yes
Akros Pharma Inc.	U.S.A.	Thousands of USD 1	Pharmaceutical	100.0 (100.0)	No	Yes	No	Clinical development in overseas, consignment of survey	No
TableMark Holdings Co., Ltd. *1	Chuo-ku, Tokyo	47,503	Processed Food	100.0	No	Yes	Yes	No	No
TableMark Co., Ltd. *1	Chuo-ku, Tokyo	22,500	Processed Food	100.0 (100.0)	No	Yes	No	No	Yes
Other 191 companies *1									
(Companies accounted for by the equity method) 13 companies									
Megapolis Distribution B.V.	Netherlands	EUR 15	International tobacco	23.0 (23.0)	No	No	No	No	No
Other 12 companies									

Notes: 1. Descriptions in the "Principal business" column are names of segments.

2. The figures in parentheses in the "Holding rate of voting rights" column are indirect holding rates included in the figures outside the parentheses.

3. "Interlocking of officers" includes interlocking of officers of associated companies and secondment of officers of the Company.

4. *1 These companies are classified as specified subsidiaries. Companies that fall under the category of specified subsidiaries included in "Other 191 companies" are as follows.

   JTI-Macdonald Corp., JT Canada LLC Inc., JT International (Philippines) Inc., JTI Processadora de Tabaco do Brasil Ltda., Japan Tobacco International Manufacturing Co., Ltd., PT. Karyadibya Mahardhika, JT International Asia Manufacturing Corp., JTI (UK) Management Ltd., Gallaher Group Ltd., Benson & Hedges Ltd., Gallaher Overseas (Holdings) Ltd., Austria Tabak GmbH

5. *2 This company files Annual Securities Report.

6. Consolidated subsidiary Green Foods Co., Ltd. is insolvent, with liabilities exceeding assets by ¥11,766 million. Green Foods Co., Ltd. suspended business operations in December 2012.

5. Status of employees

(1) Consolidated companies

(As of December 31, 2017)

Segment	Number of employees (Person)
Domestic Tobacco Business	10,291 [3,044]
International Tobacco Business	39,281 [1,534]
Pharmaceutical Business	1,883 [168]
Processed Food Business	5,489 [1,921]
Common company-wide services within the filing company	1,019 [77]
Total	57,963 [6,744]

Notes: 1. The number of employees indicates the number of working employees, and the average number of temporary employees during this fiscal year ended December 31, 2017 is given in parentheses separately.

2. The number of employees in the "Common company-wide services within the filing company" row is the number of those working for departments unclassifiable to specific segments, such as the administrative department.

3. The number of employees has increased by 13,296 people compared to the end of the previous fiscal year, but this is due mainly to inclusion of PT. Karyadibya Mahardhika and PT. Surya Mustika Nusantara in the scope of consolidation in the International Tobacco Business.

(2) Filing company (the Company)

(As of December 31, 2017)

Number of employees (Person)	Average age (Year old)	Average years of service (Year)	Average annual salary (Yen)
7,336 [1,222]	42.4	18.5	8,578,702

The numbers of employees by segment are as follows.

Segment	Number of employees (Person)
Domestic Tobacco Business	5,977 [1,209]
Pharmaceutical Business	763 [9]
Common company-wide services within the filing company	596 [4]
Total	7,336 [1,222]

Notes: 1. The number of employees indicates the number of working employees, and the average number of temporary employees during this fiscal year ended December 31, 2017 is given in parentheses separately.

2. The number of employees in the "Common company-wide services within the filing company" row is the number of those working for departments unclassifiable to specific segments, such as the administrative department.

3. The number of employees includes contract employees (47), employees on leave (100) and employees transferred to the Company (70), but excludes employees transferred from the Company (785).

4. Average years of service include years of service at Japan Tobacco and Salt Public Corporation.

5. Average annual salary (including taxes) includes bonuses and surplus wages.

(3) Status of labor union

In the Group, the labor-management relations are stable and there are no matters that should be reported.

II. Review of operations

1. Overview of operating results

(Non-GAAP financial measures)

The Group also discloses certain additional financial measures that are not required or defined under IFRS, which is the accounting standard the Company applies. These financial measures are used internally to manage each of the business operations to understand their underlying performance, in view of the Group's target for mid- to long-term sustainable growth, and the Group believes that these financial measures are useful information for users of the financial statements to assess the Group's performance.

Core revenue from tobacco business

Regarding tobacco business, core revenue is disclosed additionally as a breakdown of revenue. Specifically, the Domestic Tobacco Business includes revenue from the domestic duty-free market as well as from markets in China, Hong Kong and Macau that are under the control of the Company's China Division, in addition to revenue related to RRP, but it excludes revenue related to imported tobacco delivery charges, among others. In addition, the International Tobacco Business includes revenue related to waterpipe tobacco products and RRP, but excludes revenue related to the distribution business and contract manufacturing, among others.

Adjusted operating profit

Adjusted operating profit presented is operating profit (loss) less amortization cost of acquired intangibles arising from business acquisitions and adjustment items (income and costs). Adjustment items (income and costs) are impairment losses on goodwill, restructuring income and costs, and other items.

Furthermore, growth rate in adjusted operating profit at constant rates of exchange is also presented as additional information. This is a financial measurement that excludes foreign exchange effects by translating and calculating adjusted operating profit for the current period in the International Tobacco Business using the foreign exchange rates of the same period of the previous year. The Group has set its group-wide target for annual average growth rate in adjusted operating profit at constant rates of exchange, at mid to high single-digit over the mid- to long-term, and will continue to pursue this goal.

(RRP)

Reduced-Risk Products (RRP) are products with potential to reduce the risks associated with smoking such as E-Vapor (E-cigarettes) and T-Vapor (Tobacco Vapor).

E-Vapor products do not use tobacco leaf, instead using electrical heating of a liquid inside a device or specialized cartridge to generate vapor for the user to enjoy.

Conversely, T-Vapor products do use tobacco leaf, but instead of burning it they use methods such as heating the leaf to generate vapor (which includes compounds derived from the tobacco leaf) for the user to enjoy.

At the Group, we are committed to developing, testing and bringing to market such new and innovative products for sustainable growth.

(1) Operating results

<Revenue>

In terms of revenue, the increases in the International Tobacco Business and the Pharmaceutical Business were offset by the decrease in the Domestic Tobacco Business, etc., leading to revenue of a similar level to that of the previous fiscal year, at ¥2,139.7 billion, a decrease of 0.2% from the previous fiscal year.

(Billions of yen)

	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017	Change	
Revenue	2,143.3	2,139.7	(3.6)	(0.2)%
Domestic Tobacco Business	684.2	626.8	(57.5)	(8.4)%
Of which, core revenue	649.7	590.6	(59.1)	(9.1)%
International Tobacco Business	1,199.2	1,237.6	38.4	3.2%
Of which, core revenue	1,138.8	1,177.0	38.2	3.4%
Pharmaceutical Business	87.2	104.7	17.5	20.1%
Processed Food Business	164.1	163.1	(0.9)	(0.6)%

* Figures exclude intersegment revenue.

* Revenue includes rent received from leased properties in addition to items relating to the segments shown above.

<Adjusted operating profit, operating profit and profit attributable to owners of the parent company>

Adjusted operating profit including foreign exchange effects came in at approximately the same level as that of the previous fiscal year, at ¥585.3 billion, a decrease of 0.3% from the previous fiscal year, since increases in profit, etc. in the International Tobacco Business and the Pharmaceutical Business were offset by the decrease in profit in the Domestic Tobacco Business and by a non-recurring loss associated with a key UK distributor going into administration. Adjusted operating profit at constant rates of exchange decreased by 0.6%.

Operating profit declined in comparison to the previous fiscal year, in which a significant gain on sales of real estate and the like was recorded, due to a fall in gain on sales of real estate and the like, falling by ¥32.2 billion, or 5.4%, from the previous fiscal year to ¥561.1 billion.

Profit attributable to owners of the parent company decreased by ¥29.3 billion, or 6.9%, from the previous fiscal year to ¥392.4 billion, due mainly to decrease in operating profit.

(Billions of yen)

	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017	Change	
Adjusted operating profit	586.8	585.3	(1.5)	(0.3)%
Domestic Tobacco Business	260.2	232.3	(27.9)	(10.7)%
International Tobacco Business	336.2	351.3	15.1	4.5%
Pharmaceutical Business	9.7	24.1	14.4	148.0%
Processed Food Business	5.0	5.4	0.4	8.0%
Operating profit	593.3	561.1	(32.2)	(5.4)%
Profit attributable to owners of the parent company	421.7	392.4	(29.3)	(6.9)%

* Adjusted operating profit and operating profit include business activities relating to rent of real estate and corporate expenses relating to corporate communication and operation of the head office.

Operating results by segment are as follows.

Domestic Tobacco Business

JT cigarette sales volume(Note 1) in the current fiscal year was affected by a decline in cigarette industry volume(Note 2) caused by the expansion of RRP market and the downtrend in total demand, among others. As a result, JT cigarette sales volume fell by 12.5% from the previous fiscal year. Market share was 61.3% (compared with a share of 61.1% for the previous year).

(Billions of cigarettes)

Domestic Tobacco Business	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017	Change	
Sales volume	106.2	92.9	(13.3)	(12.5)%

Core revenue fell by 9.1% from the previous fiscal year, with the effects of the growing sales of Ploom TECH and retail price amendments implemented in April 2016 for some brands such as MEVIUS, not offsetting the impact of lower JT cigarette sales volume. Adjusted operating profit decreased by 10.7% from the previous fiscal year partly due to lower core revenue despite cost reductions.

(Billions of yen)

Domestic Tobacco Business	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017	Change	
Revenue	684.2	626.8	(57.5)	(8.4)%
Of which, core revenue	649.7	590.6	(59.1)	(9.1)%
Adjusted operating profit	260.2	232.3	(27.9)	(10.7)%

The volume of cigarettes manufactured in Japan in the fiscal year ended December 31, 2017 decreased by 21.1 billion cigarettes, or 17.8%, from the previous fiscal year to 97.3 billion cigarettes.

Notes: 1. In addition to the figure stated above for sales volume, during the fiscal year ended December 31, 2017, 4.0 billion cigarettes were sold at duty-free shops in Japan, as well as at markets in China, Hong Kong and Macau that are under the control of the Company's China Division (3.9 billion cigarettes in the previous fiscal year). Note also that the figure stated above for sales volume does not include the sales volume associated with RRP and the like.

2. Cigarette industry volume includes sales volume for the whole Japanese cigarette market. Note also that this does not include the sales volume associated with RRP and the like.

International Tobacco Business

In the fiscal year ended December 31, 2017, the effects of acquisitions in the Philippines, etc. and growth in sales in Iran and other markets were offset by the effects of falling total demand in Russia, etc., resulting in total shipment volume(Note 3) of a similar level to that of the previous fiscal year. On the other hand, GFB shipment volume rose by 0.8% from the previous fiscal year, as a result of having gained market share.

(Billions of cigarettes)

International Tobacco Business	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017	Change	
Total shipment volume	398.7	398.5	(0.2)	(0.1)%
Of which, GFBs	283.7	285.9	2.2	0.8%

Dollar-based core revenue including foreign exchange effects was at a similar level to that of the previous fiscal year.

Despite the recording of a one-off loss caused by a distributor in the United Kingdom filing for bankruptcy in accordance with UK insolvency laws, as well as unfavorable foreign exchange effects related to local currencies, including the pound, due to the emergence of effects related to the optimization of manufacturing facilities and other cost reduction efforts, dollar-based adjusted operating profit including foreign exchange effects increased by 1.4% from the previous fiscal year. Adjusted operating profit at constant rates of exchange (dollar-based) increased by 4.0%.

(Millions of U.S. dollar)

International Tobacco Business (U.S. dollar-based)	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017	Change	
Revenue	11,045	11,038	(6)	(0.1)%
Of which, core revenue	10,490	10,498	8	0.1%
Adjusted operating profit	3,095	3,138	44	1.4%

Yen-based core revenue and adjusted operating profit rose by 3.4% and 4.5% from the previous fiscal year respectively, as a result of the effects of the weaker yen when making conversions to that currency.

(Billions of yen)

International Tobacco Business	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017	Change	
Revenue	1,199.2	1,237.6	38.4	3.2%
Of which, core revenue	1,138.8	1,177.0	38.2	3.4%
Adjusted operating profit	336.2	351.3	15.1	4.5%

The volume manufactured overseas including outsourced manufacturing in the fiscal year ended December 31, 2017 decreased by 3.2 billion cigarettes, or 0.8%, from the previous fiscal year to 396.4 billion cigarettes.

Note: 3. Includes fine cut tobacco, cigars, pipe tobacco, snus and kretek, except for contract manufacturing products, waterpipe tobacco products and RRP.

The exchange rates of currencies against the U.S. dollar for the fiscal year ended December 31, 2017 were as follows.

Foreign exchange rate per U.S. dollar	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017
Yen	108.78	112.16
Ruble	67.07	58.35
Pounds sterling	0.74	0.78
EUR	0.90	0.89

Pharmaceutical Business

The Company has been striving to make a stable contribution to the Group’s profits by promoting R&D on next-generation strategic products and by maximizing the value of each product. In the area of product development, eight compounds are in clinical development.

Revenue in the fiscal year ended December 31, 2017 increased by ¥17.5 billion, or 20.1%, from the previous fiscal year to ¥104.7 billion, driven by higher royalty revenue of an original JT compound that has been out-licensed and strong sales for the Group company Torii Pharmaceutical. Adjusted operating profit increased by ¥14.4 billion, or 148.0%, from the previous fiscal year to ¥24.1 billion, due to the increase in revenue.

Processed Food Business

In the fiscal year ended December 31, 2017, the Group continued to concentrate on frozen and ambient processed foods, primarily staple food products such as frozen noodles, frozen rice, packed rice and baked frozen bread, as well as bakery and seasonings, while at the same time making efforts to strengthen cost competitiveness and working on initiatives to improve profitability.

Despite growth in sales of seasonings, revenue in the current fiscal year decreased by ¥0.9 billion, or 0.6%, from the previous fiscal year to ¥163.1 billion, due to a decline in sales of other products. Adjusted operating profit rose by ¥0.4 billion, or 8.0%, from the previous fiscal year to ¥5.4 billion, due mainly to improvements in the sales product mix in frozen and ambient processed foods, as well as declining raw material costs, and cost-reduction efforts.

(2) Cash flows

Cash and cash equivalents at the end of the current fiscal year decreased by ¥8.7 billion from the end of the previous fiscal year to ¥285.5 billion. Cash and cash equivalents at the end of the previous fiscal year was ¥294.2 billion.

Cash flows from (used in) operating activities

Net cash flows from operating activities during the current fiscal year were ¥419.2 billion, compared with ¥376.5 billion provided in the previous fiscal year. This was mainly due to the generation of a stable cash inflow from the tobacco business, and payments of national and international tobacco excise taxes and income taxes.

Cash flows from (used in) investing activities

Net cash flows used in investing activities during the current fiscal year were ¥352.6 billion, compared with ¥687.5 billion used in the previous fiscal year. This was mainly due to disbursements related to business combinations in the Philippines and Indonesia, etc., and the purchase of property, plant and equipment.

Cash flows from (used in) financing activities

Net cash flows used in financing activities during the current fiscal year were ¥77.0 billion, compared with ¥91.3 billion provided in the previous fiscal year. This was mainly the result of borrowings related to business combinations in the Philippines and Indonesia on the one hand, and the payment of cash dividends on the other.

(3) Parallel disclosure

The differences between the main items in the consolidated financial statements prepared in accordance with IFRS and the equivalent items in the consolidated financial statements as prepared in accordance with Japanese GAAP are as described below.

(Amortization of goodwill)

Under Japanese GAAP, the Company estimated substantially the amortization period and goodwill was amortized over the years estimated; however, amortization after the date of transition to IFRS is suspended.

As a result of the impact from this change, amortization of goodwill (selling, general and administrative expenses) has decreased by ¥121,828 million for the fiscal year ended December 31, 2017 and by ¥116,736 million for the previous fiscal year under IFRS in comparison with under Japanese GAAP.

2. Status of production, orders received and sales

The Group conducts production and sales of broad and various products in the Domestic Tobacco Business, International Tobacco Business, Pharmaceutical Business and Processed Food Business. Moreover, the types, formats, content volumes, and packages of their products are broad, and major products are not based on a made-to-order basis. For this reason, size of production and orders received are presented neither in the amount of money nor in volume by segment.

Therefore, details of “production, orders received and sales” are presented in connection with the operating results by segment in “1. Overview of operating results.”

Regarding business partners which are the source for 10% or more of the Group’s total revenue, the revenue from such partners and the percentage of total revenue are as follows.

Business partner	Fiscal year ended December 31, 2016		Fiscal year ended December 31, 2017	
	Amount (Billions of yen)	Percentage	Amount (Billions of yen)	Percentage
Megapolis Group	235.9	11.0	248.9	11.6

Note: The Group’s International Tobacco Business sells products to Megapolis Group, which runs logistics and wholesale businesses mainly in Russia.

3. Management policy, business environment, issues to be addressed, etc.

(1) Management principles

The Group's management principles are based on the pursuit of the "4S" model. The model requires the Group to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society, carefully considering the respective interests of these four key stakeholder groups, and exceeding their expectations wherever we can.

The Group created its vision and mission based on the "4S" model. The vision is to become a company committed to global growth by providing diversified value that is uniquely available from JT Group. The mission is to create, develop and nurture the Group's unique brands to win consumer trust, while understanding and respecting the environment and the diversity of societies and individuals.

The Group has also adopted "The JT Group Way" as a code of conduct which all members of the Group should follow. The JT Group Way requires that the Group fulfills the expectations of the Group's consumers and behaves responsibly, strives for quality in everything we do through continuous improvement, and leverages diversity across the Group.

The Group has attained sustainable profit growth and will continue to do so through the pursuit of the "4S" model. Since attaining sustainable profit growth requires the Group to continue to provide new value and satisfaction to consumers, the Group believes it is essential to steadily make business investments for future mid- to long-term profit growth.

The Group believes that the pursuit of the "4S" model will lead to a consistent increase in corporate value in the mid- to long-term and therefore that it is the best approach to serve the interests of all stakeholders.

(2) Business environment

The Group recognizes that uncertainties in the business environment in which it operates remain high, due to factors such as global economic trends, foreign exchange risks and international geopolitical risks. Enhancing adaptability to such a changing environment is critical to achieve sustainable profit growth by overcoming the uncertain business environment and adequately executing business on a global scale.

"Adaptability" refers to the ability to assume a wider range of contingencies than in the past, during the planning phase, and to quickly and flexibly respond to changes and events that surpass the assumptions so that the Group can deal with uncertainty over the future. The Group believes that how well and how quickly companies can overcome uncertainties will be the key to determine their competitiveness.

In addition, in recognition of changes in customer behavior, and of the emergence of competitive situations that transcend industry boundaries, as a result of the forward march of digital technology, we believe that, rather than merely responding passively while enhancing adaptability to such a changing environment, we should initiate transformation ourselves, with the aim of evolving into an organization that will lead this revolution.

The Group formulates its business plan, a three-year plan that is renewed each year on a rolling basis in order to speed up the Group's ability to respond appropriately to unexpected changes.

(3) Allocation of management resource

Concerning the mid- to long-term resource allocation of the Group, it will place top priority on business investments that will lead to sustainable profit growth in the mid- to long-term based on the management principles.

Of the Group's core businesses, the Group regards the tobacco business as the core business and profit growth engine, so it places top priority on business investments that will lead to the sustainable profit growth of the tobacco business. Meanwhile, the Group will make investment with the aims of strengthening the business foundations of the Pharmaceutical Business in order to generate stable profits, and strengthening the business foundations of the Processed Food Business in order to generate further profits.

From 2018 onward, there is no change in the Group's management resources allocation policy, under which the Group will continue to place a high priority on making business investments that contribute to sustainable mid- to long-term profit growth as well as on valuing the balance between profit growth through business investments and shareholder returns.

(4) Group-wide profit targets and policy on shareholder return

The Group has set group-wide profit targets and a mid- to long-term guidance on shareholder return in the Business Plan 2018 in accordance with the management principles and the resource allocation policy.

In the "Business Plan 2018," the Group will continue to pursue mid to high single-digit annual average growth rate over the mid- to long-term in adjusted operating profit at constant rates of exchange.

With regard to shareholder return policies, the Group will pursue enhanced shareholder returns in proportion to the mid- to long-term profit growth by continually making proactive business investments while maintaining a strong financial base(Note 1) that enables response to any possible environmental changes.

Specifically, the Group will work toward stable and consistent growth in dividend per share.

Whether to execute the acquisition of treasury shares will be considered in view of factors including the medium-term outlook on business environment and financial positions.

The Group will also continue to monitor a trend in shareholder returns of global FMCG(Note 2) companies.

Notes: 1. As its financial policy, the Company will maintain a strong financial base that secures stability in case of changes in business environment such as economic crises and flexibility enabling expeditious responses to business investment opportunities.

2. A global Fast-Moving Consumer Goods (daily consumer goods) company which has a stakeholder model similar to our "4S" model, and has realized strong business growth.

(5) Basic strategies for attaining group-wide profit targets

As basic strategies for attaining the targets, the Group will strive for "achieving quality top-line growth," "strengthening cost competitiveness," and "strengthening business foundations," implementing the strategies based on the concept of selection and focus.

Mainly, the Group places emphasis on "achieving quality top-line growth," concentrating resources in key brands and product categories, in order to increase value added to products and services, as described in the following explanations of business strategies.

Concerning "strengthening cost competitiveness," the Group aims at improving profitability and enhancing cash generation capability by optimizing business and corporate costs and establishing quick and efficient business operation systems, while leveraging the efforts of maintaining and enhancing quality. Additionally, the Group will reinforce its business continuity capabilities, as the experience of the Great East Japan Earthquake has reminded the Group of the importance of doing so, while seeking to improve cost competitiveness.

When strengthening business foundations, it is critical to accurately identify changes in the business environment and to keep ourselves ready to readjust in order to meet challenges without being constrained by precedents. The Group will make continuous improvement efforts from that perspective. In addition, the Group will maximize synergies by leveraging the global footprint as represented by the Group's worldwide business operations, which are spread across at least 70 countries and territories, and the diversity of the Group's global workforce, which represents at least 100 nationalities, and by promoting collaboration on a global scale. As the Group strongly believes that the quality of human resources is the key to business activity and performance, it will strengthen human resource development.

a. Tobacco Business

The tobacco business is the Group's core business and profit growth engine and aims for mid to high single-digit annual average growth rate over the mid- to long-term in adjusted operating profit growth rate at constant rates of exchange. The Domestic Tobacco Business acts as highly competitive platform of profitability, while the International Tobacco Business serves as the profit growth engine of the Group.

<Quality top-line growth>

- Strengthening RRP initiatives

The Group believes that RRP are beneficial to the consumer, to society, and to the business of the Group, and has positioned RRP as the pillar of sustainable growth for the Tobacco Business, with resources to this area being given priority allocation going forward. The Group will focus on developing RRP that will be chosen by more consumers, and leverage innovation to broaden its portfolio of high-quality products, thus satisfying the changing needs of consumers.

With regard to existing tobacco products, there has been no change to their importance as the foundation of our profits, and the Group will continue to make business investments with the aim of achieving sustainable growth.

- Maintaining and increasing shares in the key markets through brand equity enhancement

Over the past years, the Group's tobacco business has grown its share in most of the key markets; this performance is mainly the result of the Group's outstanding brand portfolio.

In order to further grow market share, the Group will continue strengthening its brands, especially through consistent investments in the GFBs. At the same time, the Group will also strengthen its local brands. These diverse local brands allow the Group to meet the unique preferences of the consumers and complement the brand portfolios in the diverse markets and regions where the Group is active. The Group will continue to focus the investments in innovation, as it is one of the most effective methods to enhance brand equity.

The Group's innovation efforts target five key elements which add value to its tobacco products: 1) tobacco blends, 2) flavors, 3) filters and other non-tobacco materials—these three are important elements to determine quality of taste—4) capability to process these innovations into products and 5) package design, which is critical to visual quality.

The Group recognizes the growing importance of connection especially at point-of-sale for "brand communications" with consumers, which support share gains, since the use of mass media (TV, radio, newspapers and magazines) to promote tobacco products is severely restricted by regulations on advertisement and promotion.

With this in mind, the Group believes that the enhancement of its trade marketing activities is critical to improve point-of-sale visibility. The Group's approach will be tailored to each market, where local regulations, the key sales channels, consumers' purchasing patterns and competitors' trade marketing tactics vary greatly among one another.

- Broadening the base

Over the years, the Group has increased its presence as a leading global tobacco manufacturer through large-scale M&As, most notably RJR Nabisco's non-US tobacco operations in 1999 and Gallaher Group Plc. in 2007.

The geographical expansion achieved with these two acquisitions has been the main driver of the growth for over a decade. The success of these acquisitions, owing in part to the prompt postmerger integration within the Group's business, has reinforced its global business base.

Since that time, with the aim of both entering new markets and expanding its presence in existing markets, the Group has continued to build a geographically balanced portfolio primarily in high-margin markets in developed countries and primarily in high-growth markets in emerging countries, through such measures as strengthening investment in existing businesses and acquiring external resources through acquisition and by taking equity stakes. Moving forward, the Group will continue to seek out growth opportunities. The strengthening of the tobacco business base as well as expansion into emerging markets will help promote organic growth. In addition, growth opportunities will be pursued by other strategic alternatives that may arise.

<Strengthening cost competitiveness>

The tobacco business will persistently pursue continuous cost efficiency improvement of the operations, in particular with respect to the global supply chain, with an emphasis on agility and efficiency without compromising quality. The Group will enhance its cost competitiveness by optimizing the global supply chain through various initiatives, including:

further vertical integration in global leaf procurement; extended use of common non-tobacco materials; increased collaboration among suppliers; flexible procurement to benefit from attractive market prices; and improved inventory management for both tobacco and non-tobacco materials. Furthermore, enhanced productivity through realignment of manufacturing process and optimal level of capital expenditures will ensure conversion cost containment. The Group is also determined to improve its business continuity capability by securing options for sourcing and geographically spreading critical functions. Specifically, the Group has been striving to ensure a framework of multiple supply sources, optimal manufacturing capacity allocation on a global basis and diversification of production capability for priority SKUs (Stock Keeping Units).

The Group will improve the margin through increased cost efficiency while maintaining quality, and enhance cash flow generation by optimizing working capital and capital expenditures.

<Strengthening business foundations>

The Group believes that human resource development is the key driver of sustainable profit growth in the tobacco business.

The Group has business operations in at least 70 countries and territories, and the global workforce of employees representing at least 100 nationalities works regardless of nationality, gender, and age. The Group maximizes synergies by leveraging this diversity and promoting collaboration on a global scale.

As the Group believes that the quality of human resources is the key to business activity and performance, it will strengthen human resource development and enhance its ability to recruit, develop, and retain employees on a global basis.

The tobacco business remains committed to increasing its presence as a leading global tobacco manufacturer and further strengthening its role as the core business and profit growth engine of the Group, by steadily implementing the above business strategies.

b. Pharmaceutical Business

The Group's Pharmaceutical Business will strive to make stable profit contribution to the Group through the promotion of R&D on next-generation strategic products and by maximizing the value of each product.

<Stable profit contribution>

To make stable profit contribution, the Group will step up efforts to promote R&D on next-generation strategic products and seek optimum timing for out-licensing, and maximize the value of each product, as key tasks to strengthen the earnings base further.

- Promoting R&D on next-generation strategic products and seeking optimum timing for out-licensing

Promoting R&D on next-generation strategic products is a key task from the perspective of the sustainable development of the Group's Pharmaceutical Business. Market launch of new drugs is becoming increasingly difficult every year. However, the Group will explore appropriate drug development opportunities by collecting information concerning unmet needs of medical facilities around the world. The Group will also conduct flexible research management, carefully tailored to each drug candidate.

With the intensification of worldwide R&D competition in recent years, it is essential to define a sophisticated development strategy that takes into account of the requirements of medical facilities and implementation of clinical tests quickly. In order to accelerate the speed of the R&D and swiftly provide the new drugs the Group has created to patients around the world, the Group not only promotes in-house development but also continues to out-license compounds to other companies, particularly global pharmaceutical companies, and aggressively explore alliance opportunities.

- Maximizing the value of each product

In 2013 and after, the Group launched in Japan Stribild® Combination Tablets (anti-HIV drug), Riona® Tablets (hyperphosphatemia treatment), CEDARTOLEN® SUBLINGUAL DROP - Japanese Cedar Pollen, MITICURE® House Dust Mite Sublingual Tablets (allergen immunotherapy drugs), Genvoya® Combination Tablets and Descovy® Combination Tablets LT and HT (anti-HIV drug). Outside Japan, the licensing partners are currently selling Stribild® Combination Tablets (anti-HIV drug), Genvoya® (anti-HIV drug) and Mekinist® (melanoma and NSCLC treatment).

In order to maximize the contribution to medical facilities through these products, the Company will work to steadily spread the products in the market in close partnership with the Group company Torii Pharmaceutical and the Company's licensing partners.

The Group recognizes, in order to conduct these various activities in an effective manner, the urgent requirement of training personnel who can collect accurate information regarding unmet needs at medical facilities and the latest pharmaceutical research, and use the information to formulate a sophisticated development strategy and a strategy to maximize product value, and global personnel capable of competing with academia and pharmaceutical companies around the world. The Group will concentrate efforts on its initiatives for these purposes.

c. Processed Food Business

The Group's Processed Food Business aims to contribute to the earnings of the Group through mid- to long-term profit growth driven by high-quality expansion in the top line.

<Quality top-line growth>

The Group company TableMark is taking a central role in the development of the Group's Processed Food Business, which consists primarily of frozen and ambient processed foods such as staple food products, as well as bakery and seasonings. In the Processed Food Business, the Group makes every effort to produce strong staple food products with established market shares. Specifically, in the area of product line-up, the Group plans to create products that offer good value for the price from consumers' perspective while using its unique technology. This will be achieved by improving the ability to identify consumers' needs, generate ideas based on the identified needs, and transform the generated ideas into products. Concerning marketing, the Group will develop effective and efficient advertising and promotional activities in line with this product strategy and reinforce the trade marketing capabilities. By adopting these measures, the Group aims to further expand its market share.

<Strengthening cost competitiveness>

In the Processed Food Business, the Group has a variety of cost containment programs, including strengthening the raw materials procurement capabilities, efficiently managing the distribution network, and improving the productivity of the Group factories. In addition, consistent group-wide efforts will be made to lower fixed costs, including more efficient use of sales activity expenditures, through better selection and focus of promotional activities. By these means, the Group will work to improve cost competitiveness.

<Strengthening business foundations>

- Food safety control

Looking ahead, the Group will continue to manage the businesses while taking all possible measures to ensure food safety control from the four perspectives of "food safety," "food defense," "food quality," and "food communication" in order to deliver safe and high-quality food products to customers.

Regarding "food safety," the Group will seek to minimize risks by utilizing food safety management systems already introduced.

Regarding "food defense," the Group will further promote the already implemented Food Defense Program in order to prevent purposeful attacks.

Regarding "food quality," the Group will pursue "deliciousness," which should be the fundamental quality of foods. The Group will also seek to enhance product added value and customer satisfaction through continued improvement in accordance with inquiries and information from customers.

Regarding "food communication," the Group will conscientiously listen to the voices of customers and actively provide information so as to make the Group's activities more visible to the outside.

- Human resource development

Development of human resources that support the business activities is critically important. Competence development programs as well as appropriate career paths of the employees will be created and implemented in order to develop personnel with various skills including marketing expertise and product development knowhow.

In summary, the Group will maintain the “4S” model as the basis of the Group’s management principles, enhance its ability to adapt to changes and consistently execute its growth strategy. Through these initiatives, the Group will achieve sustainable profit growth and continuously increase corporate value in the mid- to long-term.

4. Business and other risks

Listed below are items that, among those relating to the review of operations and accounting revealed in the Annual Securities Report, may significantly influence investor decisions. However, the risks described below do not constitute an exhaustive list of all the risks related to the Group, and risks not described below also exist. All of the risk factors may potentially have an effect on investment decisions.

The following includes forward-looking statements determined, unless otherwise indicated, as of the filing date.

(1) Items relating to the business, profit structure and management policy of the Group

a. Significance of tobacco revenue from the Japanese market in consolidated revenue

The Group operates in at least 70 countries and territories around the world, mainly in the tobacco business, and sells products in at least 130 countries and territories. Among these, tobacco revenue in the Japanese market makes a considerable contribution to the Group's revenue. Accordingly, any adverse influence on the Japanese market may negatively impact the result of the Group as a whole (for details of risks relating to the tobacco business, see (2) below).

b. Business expansion

The Group views the role of Pharmaceutical Business and the Processed Food Business as that of supplementing sustainable profit growth over the mid- to long-term, and believes that also in the future they will make a stable and even larger profit contribution. However, although the Group plans to continue to invest in these businesses, this investment is not guaranteed to generate the returns that the Group anticipates.

The Group worked proactively to obtain external resources for the business expansion, such as the non-US tobacco operations of the RJR Nabisco Inc. (acquired in 1999 for approximately USD 7.8 billion, or ¥944.0 billion as calculated by the exchange rate at the time of the acquisition; the same applies hereinafter), as well as the acquisition of Gallaher Ltd. (acquired in 2007 for approximately GBP 7.5 billion, or ¥1,720.0 billion), the acquisition of the Katokichi Group (now TableMark Holdings Co., Ltd.) (acquired in 2008 for approximately ¥109.0 billion), and the acquisition of the non-US tobacco operations of Natural American Spirit (acquired in 2016 for approximately USD 5.0 billion, or ¥591.4 billion). In an effort to expand its business, the Group will consider acquisitions, capital movements, business tie-ups and cooperative arrangements with other companies and may execute when the Group judges such transactions would contribute to the future earnings of the Group. However, should such transactions not generate the expected outcome, or should a significant, unforeseen problem be discovered after the acquisition, same may negatively affect the Group's business performance. Examples that may have such an impact include a failure to carry out operational, personnel, technological or organizational integration due to geographical or cultural differences; a failure to maintain sustained demand for the products of a business subject to acquisition or tie-up, or manufacture and sell said products; a failure to continue the Group's present operations; a failure to retain personnel with superior capabilities at an acquired business or maintain the motivation of its employees; a failure to apply the Group's internal control system to an acquired business; a failure to build an effective brand and product portfolio; a failure to link sales and market strategies of different product lines; or a dispersal of management's attention from the Group's present operations.

Also, as a result of the acquisitions, the Group has recorded a substantial amount of goodwill and intangible assets in the consolidated statements of financial position, and the amounts of goodwill and intangible assets account for 36.2% (¥1,891.2 billion) and 9.2% (¥479.2 billion) of the consolidated total assets, respectively, as of the end of the fiscal year. The Group believes that the abovementioned goodwill and intangible assets appropriately reflect the future profitability that will result from the unleashing of synergy effects of each business value and integration; however, if it is determined that this expected outcome does not materialize as a result of factors such as changes in the business environment or competitive forces, or if the discount rate applied becomes higher, the Group may incur an impairment loss that negatively impacts the Group's performance.

c. Effects of foreign exchange fluctuations

The Company reports its consolidated financial statements indicating all figures in yen; however, overseas Group companies draft their financial statements in other currencies such as Russian ruble, euro, British pound, Taiwanese dollar, U.S. dollar, and Swiss franc. Accordingly, the results, assets, and liabilities of overseas Group companies are converted into yen when the consolidated financial statements of the Company are prepared and indicated in yen therein. As a result, those figures are affected by fluctuations from the currency used by overseas Group companies in their accounts settlement against the yen. The respective ratios of the Group's revenue and adjusted operating profit attributable to the International Tobacco Business were 57.8% and 60.0% in the fiscal year ended December 31, 2017. Therefore, foreign exchange fluctuation may greatly impact consolidated financial statements along with the expansion of the International Tobacco Business and its contribution to the results.

JT International Holding B.V. (hereinafter referred to as "JTIH"), which is responsible for consolidating the financial results of the Group's International Tobacco Business, uses the U.S. dollar for its financial reporting. However, JTIH does business through consolidated subsidiaries and affiliates around the world, some of which use foreign currencies other than the U.S. dollar. This means that the Group's consolidated results are affected not only by exchange rate fluctuations between the Japanese yen and the U.S. dollar but also by those between the U.S. dollar and other foreign currencies used by the consolidated subsidiaries and affiliates for their financial reporting.

In addition, any liquidation, sale or significant drop in the value of an foreign Group company whose foreign currency denominated stock was acquired by the Company will result in the recording of an investment loss with respect to said company in the consolidated financial statements of the Company and this loss will be affected by the exchange rate fluctuation between the yen and the foreign currency that was used to acquire said stock.

Furthermore, most of the Group's international transactions are subject to the effects of foreign currency exchange rates. As an example of this risk, in the Domestic Tobacco Business or the International Tobacco Business, the Group uses foreign-grown leaf tobacco (see h. below). While this leaf tobacco is procured to some degree in U.S. dollars, the tobacco products that contain it are sold in the local currencies of various countries. Therefore, should the U.S. dollar appreciated against these various local currencies, this may have a negative effect on profitability at the Group.

Although the Group hedges a portion of the foreign exchange risk generated by its transactions, it is impossible to completely avoid this risk for the entire Group by such hedges and there is always the possibility that foreign exchange fluctuations will negatively affect the Group's earnings.

d. Outline of the Tax Reform Proposals

The Outline of the 2018 Tax Reform Proposals determined by the Cabinet of Japan on December 22, 2017, describes a review of tobacco excise tax such that an increase of ¥3 per cigarette in the rate of national and regional tobacco excise tax will be implemented, and, based on the establishing of a new tax category for heated tobacco(Note 1), also describes a review of the form of excise taxation that takes into account the characteristics of that product. These reviews, viewed from the perspective of mitigating radical change, etc., are respectively devised as transitional measures, with the former implemented in three stages, in which each stage consists of a ¥1 increase per cigarette between October 2018 and October 2021 (with no increase in the rate of excise tax in October 2019), and with the latter implemented in five stages between October 2018 and October 2022. In addition, the rate of excise tax applied to former third-class products(Note 2) for the period between April 1, 2018 and March 31, 2019, will be extended to September 30, 2019. These could have a substantial effect on the Group's business performance depending on whether the Group can react to the tax reform promptly and appropriately.

Notes: 1. Heated tobacco is recognized as being synonymous with items defined by the Group as T-Vapor (Tobacco Vapor) products.

2. The term "former third-class products" refers to tobacco products stipulated as third-class cigarettes in the Tobacco Product Price Act, repealed on April 1, 1985. These are same products as those at the time of abolishment.

e. Natural disasters and other contingency situations

The Great East Japan Earthquake that occurred in March 2011 has inflicted damage on some factories of the Group and raw materials suppliers, thereby creating an impact on the Group's business operations, mainly in the Domestic Tobacco Business. Although the Group is working to reinforce its business continuity capabilities, incidents related to the earthquake disaster may negatively affect the Group's business performance in the future. Furthermore, future large-scale disasters in Japan or overseas, including natural disasters such as earthquakes, tsunamis, typhoons or floods, or human-made disasters such as suspension of infrastructure, political instability or bombings, or other such unforeseen emergencies, may negatively affect the Group's business performance. Such effects may be caused by supply shortages from damage to suppliers; disruptions to traffic, logistics services or sales channels; suspension of utilities such as electric or water; declines in demand; or employees suffering damage in a disaster.

The earthquake and subsequent tsunami in March 2011 caused partial meltdowns at the Fukushima Daiichi Nuclear Power Plant in Japan. The Group is focused on conducting activities to eliminate consumers' concerns over the radioactive pollution on tobacco leaves, and continue to deliver products free of any risk of contamination. The Group has established an internal standard comparable to the official standards for other agricultural products (the Food Sanitation Act does not set a standard for the maximum allowable radioactivity level in tobacco leaves). Multiple inspections are conducted, i.e. before leaf purchase, before leaf processing, before product manufacturing, and before shipping from the factories.

f. Country risk

The Group operates in at least 70 countries and territories around the world, mainly in the tobacco business, and sells products in at least 130 countries and territories. As a consequence, the International Tobacco Business in particular is growing in importance. In order to achieve long-term growth, the Group will continue to expand the business base. Geographical expansion increases exposure to country risks, such as a change in the political environment, a change in the economic conditions, a change in the social environment, a change in the legal system, or the occurrence of riots, terrorism or war. If materialized, these risks could negatively affect the Group's business performances due to blockage to supply chains or distribution networks, damage to assets or facilities, or difficulties in allocation of personnel or sales management.

Furthermore, the Group conducts business in countries that are subject to economic sanctions. Although the Group manages its business operations appropriately and lawfully in accordance with these various economic sanctions, if the Group were to violate the sanctions, it would be at risk of being subject to large monetary penalties or other such consequences. Also, if there is a development such as a change in the details of the sanctions, this may negatively affect the Group's business performances by, for example, making the Group unable to continue operating in the countries subject to the sanctions. Even if the Group obeys the sanctions, simply operating in the countries subject to the sanctions may have a detrimental effect on the public image of the Group.

g. Economic deterioration

In the global economy, although moderate recovery has been seen in developed countries, the overall outlook remains unclear primarily because of a slowdown in economic growth in emerging countries. While Japan is also showing signs of gradual economic recovery mainly on the back of an improving employment and income environment, it remains unclear whether this trend will be sustained partly given that the government is poised to raise the consumption tax to 10% on October 1, 2019. In many of the main markets of the Group's International Tobacco Business, total demand for tobacco has declined in recent years because of economic deterioration and societal reasons such as changes in the composition of their populations. Total tobacco demand is also continuing to decline in Japan, and the Group expects this trend to continue. In this way, economic deterioration and other such developments may lead to lower purchasing power and confidence among consumers, and customer demand may shift towards brands and categories in lower price ranges. There may be declines in demand for the Group's processed food products for similar reasons. Such developments may negatively affect the Group's business performance.

h. Instability in supplies of key materials

The raw material used in the Company's manufacture of tobacco products in Japan is leaf tobacco sourced domestically and leaf tobacco from overseas. The raw material the Group currently uses in its manufacture of tobacco products overseas is leaf tobacco from overseas only.

Materials, both raw and processed, are critical inputs to the products. Therefore, the ability to procure needed materials in the required quantities and at manageable costs can affect the Group's business performance. Climate and other natural changes, and commodity markets, could affect the availability of agricultural products, such as tobacco leaves, and other natural materials procured for the processed food products. In addition to the raw inputs, global population increase and economic growth in the emerging countries could lead to an explosive increase in the consumption of resources. This could result in an increase in the costs of the raw and processed materials, as well as unavailability of those resources.

i. Difficulty in maintaining human resource competitiveness

The Group believes that a diversified employee base is a major factor of its competitiveness; therefore, the Group seeks to attract, develop, and retain talented people worldwide. However, in the particular case of tobacco business, the Group is aware of the negative social image placed on this business line. Therefore, it is becoming major issues for the Group to recruit and retain talented people. Should the Group be unable to sufficiently fulfill such needs as retaining human resources, future business operations may become difficult, thus having a negative impact on the Group's business performance.

j. Infringement of intellectual property rights

If the Group infringes the intellectual property rights of an outside party, or if an outside party infringes the Group's intellectual property rights, the Group may have to pay a substantial amount of compensation for damages or court costs, or there may be a detrimental effect on the Group's product development, commercialization and business strategy. Such occurrences may negatively affect the Group's business performance.

k. Environmental regulations

The Group is subject to a wide variety of legal restraints both in Japan and overseas related to environmental protection with respect to hazardous substances, waste and other effects of research and development and production processes. In future, if environmental pollution or a similar problem occurs as a result of the Group's business activities, or if environmental regulations are introduced or existing ones are changed, this may negatively affect the Group's business performance.

(2) Risks relating to the Group's tobacco business

a. Decreasing tobacco demand

In the Japanese domestic tobacco market, with the aging population and declining birth rate, growing awareness about the health risks associated with smoking and the tightening of smoking-related regulations, as well as higher tobacco excise taxes, tobacco demand has continued to decline and the Company expects this downward trend to continue unabated into the future. Demand overseas could also decrease depending on the economic conditions, other societal conditions, trends in regulations, changes in the compositions of populations, price rises due to tax increases and other factors, although the trends in demand will vary from region to region.

Should demand decrease, sales volumes of the Domestic Tobacco Business and shipment volume of the International Tobacco Business may decrease, and this may negatively affect the Group's business performance.

b. Competition with rival companies

The Group is competing fiercely in both the Domestic and International Tobacco Businesses with rivals such as Phillip Morris International and British American Tobacco.

In the Japanese domestic tobacco market, competition has intensified partly due to the diversification of smoker preferences and aggressive marketing activities by rival companies ever since the easing of regulations relating to imported tobacco products in 1985 and the abolishment of tariffs on imported cigarettes in 1987. In addition, in accordance with the diversifying needs of consumers, the RRP market has been expanding rapidly in recent years, and the Group perceives that continuing to provide products that precisely capture consumer needs is even more important than it has been hitherto.

In overseas tobacco markets, the Group expanded its business by building on its self-sustaining growth and by acquiring the non-US tobacco operations of RJR Nabisco and Gallaher Ltd. As a result, its competitive relationships with global players in the International Tobacco Business such as Phillip Morris International and British American Tobacco as well as strong firms operating in localized markets are observed.

Each tobacco market share fluctuates under multiple factors including competition, regulations, pricing strategies, changing smoker preferences, heightened societal interest in health issues, brand strengths and economic conditions occurring in different markets not to mention short-term fluctuations caused by temporary factors such as the introduction of new products by the Group and other companies and the special promotional activities effected for them. A lower market share due to these factors may negatively affect the Group's business performance.

c. Taxes levied on tobacco

Depending on their objectives, governments increase tobacco excise tax, VAT (value-added tax) and other taxes in most countries the Group operates, including Japan, to secure state budgets and also to promote public health.

The Group can predict neither increases nor changes in types of taxes or tax rates imposed on tobacco products in various countries. If tax hikes are implemented at an unexpected timing, frequency or rate of increase, or in a region where tax hikes were not anticipated, the Group may be unable to react to such tax hikes promptly and appropriately.

Increases in tobacco taxes may, if accompanied by a hike in retail prices, push down demand, move consumers toward lower priced brands, or cause or increase illicit product trading such as smuggling and counterfeiting. On the other hand, if there is no retail price hike, such tax increases may cause the earnings structure of the tobacco business to deteriorate. As such, either case may negatively affect the Group's business performance.

Furthermore, the Outline of the 2018 Tax Reform Proposals determined by the Cabinet of Japan on December 22, 2017, describes a review of tobacco excise tax such that an increase of ¥3 per cigarette in the rate of national and regional tobacco excise tax will be implemented.

d. Regulations on tobacco products

- Situation overseas

The World Health Organization (WHO) adopted the Framework Convention on Tobacco Control ("FCTC") at its 56th World Health Assembly held in May 2003. It came into force in February 2005 (Japanese Government accepted in June 2004). Since then, there has been a rising trend in regulations regarding sales activities, marketing, packaging and labeling for tobacco products, tobacco products themselves, and smoking in the international markets where Group's tobacco products are sold.

The purpose of the FCTC is to continuously and substantively control the proliferation of smoking. Its provisions include, among others, price and tax measures to reduce tobacco demand, non-price measures to reduce the demand for tobacco (specifically, the following is stipulated: protection from exposure to tobacco smoke, regulation of contents and emissions of tobacco products, regulation of disclosure of tobacco products, regulations on packaging and labeling of tobacco products, regulations on tobacco advertising, promotion and sponsorship), and measures relating to the reduction of the supply of tobacco (specifically, prevention of illicit trade and prohibition of sale of tobacco products to minors are stipulated). Moreover, in November 2012, the protocol to eliminate illicit trade in tobacco products was adopted at the fifth session of the Conference of the Parties.

As a general obligation, signatories to the protocol are to formulate, adopt, periodically update and review strategies, plans and programs for tobacco regulation. However, the content, scope and method of specific controls undertaken in these nations are ultimately legislated by each respective nation.

As examples of specific controls undertaken in these nations, implementation of the legislation which includes protection from passive smoking and other matters related to tobacco consumption has continued to come into effect in stages in Russia. It contains a number of provisions including a display ban, restrictions on sales of tobacco products in certain retail stores, a ban on advertising, sponsorship and promotions, and the introduction of minimal pricing or a ban on smoking in public places. In addition, in the UK, plain packaging regulations have been introduced whereby individual packages for tobacco products must be of a prescribed color, and product names must be displayed on the packages in a prescribed printing location, font, font size, and font color with an additional requirement for graphic warnings to be printed on the package. In addition to these, a number of other countries have implemented or are considering the implementation of various restrictions.

In the EU, "EU Tobacco Product Directive (EU TPD)," which was promulgated in July 2001, was revised, and the revised EU TPD came into effect in May 2014. The revised EU TPD includes strengthened regulation on packaging and labeling, restriction on the use of additives in tobacco products, and regulation related to electronic cigarettes, and requires all EU member countries to develop their own laws, regulations and ordinances to ensure that the requirements of the directive are enforced. Work on enforcing this revised EU TPD is under way in all EU member states.

- Situation in Japan

The Tobacco Business Act, related acts and statutes and voluntary standards set forth the regulations for the sale and promotion activities of tobacco products in Japan that include the indication of warning labels on tobacco product advertisements and packages that urge caution over the relationship between the consumption of tobacco products and health.

In November 2003, the Ordinance for Enforcement of the Tobacco Business Act was revised including the wording of the cautions over the relationship between the consumption of tobacco products and health indicated on tobacco product packages and, starting July 2005, all tobacco products sold in Japan have been in conformity to the revised regulations. In addition, the Japanese Minister of Finance has indicated a “Guideline for Advertising of Tobacco Products” based on the Tobacco Business Act. The guideline was revised in March 2004 in accordance with the revision of the Ordinance for Enforcement of the Tobacco Business Act mentioned above (for details, see (4) c. (i), Notes 2 and 3 below).

The Tobacco Institute of Japan has established voluntary standards regarding the advertising and sales promotion activities for tobacco products. All member companies, including the Company, comply with these standards. In February 2016 under the Financial System Council tobacco business subcommittee meeting, a new labeling subcommittee was established, which performed a specialized investigation in relation to means of guidance with respect to advertising that pertains to tobacco products in accordance with the Tobacco Business Act, Article 39 (warning labels) and Article 40 (advertising regulations). The labeling subcommittee reported the results of its investigation to the tobacco business subcommittee in June 2016, and we believe that further discussions will be conducted within the tobacco business subcommittee.

From the perspective of passive smoking prevention, due in part to the enactment of the Health Promotion Act in May 2003, cases of restrictions on smoking in certain areas in Japan, including public places such as restaurants and office buildings, have been on the increase. Given that a draft bill for the partial revision to the Health Promotion Act was decided upon by the Cabinet in March 2018, the Group expects such trends to continue going forward.

- Impact on the Group’s business performance

Although it is impossible to predict the content of future laws, regulations and industry guidelines relating to sales activities, marketing, packaging and labeling, tobacco products and smoking, the Group expects regulations like the above and new regulations (including those of local governments) to diffuse across Japan and other countries where the Group sells its products.

The Group’s position is to support any regulation relating to tobacco that is appropriate and reasonable. Nevertheless, if regulations such as those mentioned above are tightened, or if the Group is unable to respond to this tightening of regulations in a timely and appropriate manner, subsequent declines in tobacco demand or market share, costs for compliance with new regulations or other factors may negatively affect the Group’s business performance.

e. Illicit product trading such as smuggling and counterfeiting

One of the most serious issues in the tobacco industry is the increase of illicit trade, including smuggling and counterfeit product distribution. Motivations for illicit trade are believed to include the high profit margin of tobacco products and cross-border price gaps arising from different taxation systems and tax levels among countries. As historical evidence shows, illicit trade in a market tends to increase after a steep tax increase.

Illicitly traded products not only significantly damage the credibility of brands and the companies that own those brands, but also negatively affect governments’ tax revenues. Therefore, the Group and other tobacco companies are working together with governments to eliminate illicit trade. The Group is making efforts towards countermeasures, such as by concluding cooperation agreements to counter illicit trade with the EU (including its member countries) and the governments of Canada and all its provinces and territories, respectively. Even so, growth in illicit trade such as smuggling and counterfeiting of tobacco products may negatively affect the Group’s business performance because of consequences including damage to its brand equity or the need for substantial expenses for countermeasures and the like to eliminate illicit trade.

f. Litigation

The Company and some of its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking, the marketing of tobacco products, or exposure to tobacco smoke. As of the fiscal year end date, there were a total of 21 smoking and health-related cases pending in which one or more members of the Group were named as defendant, including cases for which the Company may have certain indemnity obligations pursuant to the agreement for the Company's acquisition of RJR Nabisco Inc.'s overseas (non-U.S.) tobacco operations. In addition, the Company and some of its subsidiaries are also defendants in lawsuits other than the smoking and health-related cases.

The Group is unable to predict the outcome of currently pending or future lawsuits. If these actions result in a decision unfavorable to the Group, its business could be materially affected by, for example, the payment of a substantial amount of monetary compensation. Moreover, regardless of the results of these lawsuits, critical media coverage may reduce social tolerance of smoking, strengthen public regulations concerning smoking and prompt the filing of a number of similar lawsuits against the Group, forcing it to bear litigation costs and materially affecting its business performance. In addition to smoking and health-related litigation, the Group may be a party to further cases should litigation occur in the future, such as if any problems arise regarding product quality that lead to the Group becoming the target of claims seeking product liability. Such litigation cases may negatively affect the business performance or manufacture, sale, and import and export of tobacco products by the Group should their outcomes prove unfavorable.

Regarding major litigation cases to which the Group is a party, please refer to "V. Accounting, 1. Consolidated financial statements, (1) Consolidated financial statements, Notes to consolidated financial statements, 39. Contingencies."

(3) Risks relating to the Group's Pharmaceutical and Processed Food Businesses

a. Risks relating to Pharmaceutical Business

The following are various risks relating to the Pharmaceutical Business of the Group.

- The Group may fail to develop and launch commercially valuable pharmaceutical products.
- The Group may have to invest an enormous amount of time and funds in research and development before it successfully develops pharmaceutical products.
- The Group may be forced to abandon the clinical development or sale of a pharmaceutical product that involves another company as a co-developer or a licensee on the basis of its or its partner company's judgment or due to some internal or external factors.
- Even if the Group succeeds in developing and launching a commercially valuable pharmaceutical product, research and development expenses may exceed the revenue generated from it.
- The Group may become dependent on a certain pharmaceutical product.
- The Group may fail to produce or outsource manufacturing of the pharmaceutical products efficiently and cost-effectively on a large scale.
- Even if a pharmaceutical product developed by the Group proves to be commercially successful, the success may be offset by competition with rival products developed by other companies in Japan or overseas, a government-mandated price reduction and other factors.
- The Group may become dependent on the license of pharmaceutical products developed by other companies and on third party distribution channels.
- The Group may become dependent on a certain outside source for the supply of part of critical raw materials.
- If any problem arises regarding the quality of a pharmaceutical product of the Group or regarding information provided by the Group about such product, the Group may become the target of claims seeking product liability, or may be forced to suspend sales of such product.
- The Group's business performance may be affected by lawsuits concerning patents and other intellectual property rights.
- Regulation may be applied broadly, covering a full range of activities from the research and development stage to the post-launch stage of a new drug.
- The Group may become dependent on a certain business partner in research and development or sales of a pharmaceutical product.

- The Group may be forced to abandon clinical development as well as manufacturing and sale of a pharmaceutical product because of unexpected side effects or insufficient clinical trial results.
- In relation to the Group's use and management of radioactive or other hazardous substances, social or legal problems may arise, such as damage to the environment caused by such substances.

b. Risks relating to Processed Food Business

The following are various risks relating to the Processed Food Business of the Group.

- Products developed by the Group may fail to meet consumer preferences and their product lives may prove to be short.
- The Group's profit and loss may fluctuate due to fluctuations in the prices of raw materials (including those due to changes in the exchange rate).
- The sales of the Group's products may be affected by weather conditions.
- The regulation of the procurement, manufacture and sale of products in Japan or overseas may be strengthened, including the possibility that additional costs may arise due to compliance with such regulation.
- The Group may be unable to compete with major companies with larger distribution networks, stronger development capabilities and more experience.
- The Group may be unable to engage in efficient marketing activities.
- The Group may be unable to produce, or outsource the production of, products in an efficient, stable and effective manner.
- If any problem arises regarding the quality of the Group's products, it may cause health damage to customers, the Group may become the target of claims seeking product liability, or the reputation of the Group and its products may be undermined.

(4) Other factors which may materially affect investment decisions

a. Relations with the Japanese government and the Minister of Finance

The JT Act obligates the government to continue to hold more than one-third of all the Company's shares issued. As of December 31, 2017, the government held 33.35% of all the Company's shares issued. As a consequence, the Japanese government is able to have a substantial influence on proposals for ordinary resolutions at the Company's General Meetings of Shareholders such as the election of Members of the Board. Furthermore, the Japanese government has the veto power for special resolutions for such actions as mergers, capital reductions or amendments to the Articles of Incorporation.

In addition, the Minister of Finance has the authority to supervise the Company under the JT Act and Tobacco Business Act. Under the JT Act, the scope of the Company's businesses includes the "manufacture, sale and importation of tobacco products and ancillary businesses, as well as businesses required for attaining the objective of the Company," and "business required for attaining the objective of the Company" are subject to the Minister of Finance's approval. Consequently, the Minister of Finance's approval is required in order for the Company to engage in new businesses outside the scope of currently-approved businesses (for details, see c. (ii) below).

As mentioned above, in addition to the Japanese government's rights as a shareholder of the Company, the government has the authority to supervise the Company and other powers under the JT Act and Tobacco Business Act. Since it cannot be guaranteed that the interests of the government will always coincide with the interests of other shareholders, this may have a negative effect on the interests of other shareholders.

Under the "Act on Special Measures for Securing Financial Resources Necessary for Reconstruction from the Great East Japan Earthquake," which was promulgated on December 2, 2011, the government makes it a principle to secure revenue to fund reconstruction resources until the fiscal year ending March 31, 2023. To this end, it is required for an examination to be made of the feasibility of selling the Company's shares by reassessing the framework under which the government holds the shares, while taking into consideration the framework of the country's commitment to tobacco-related business based on the Tobacco Business Act and the like.

b. Purchasing of leaf tobacco

The Tobacco Business Act requires the Company to annually enter into purchase contracts with tobacco growers regarding the aggregate cultivation area for specific varieties of leaf tobacco and the prices for leaf tobacco by variety and grade. The Company must purchase all leaf tobacco produced pursuant to such contracts, except for any not suited for the manufacture of tobacco products. When the Company decides the aggregate cultivation area and the prices of leaf tobacco for its contracts with tobacco growers, it is required to respect the opinion of the Leaf Tobacco Council (*hatabako shingi kai*), which consists of members appointed by the Company with the approval of the Ministry of Finance from among the representatives of domestic leaf tobacco growers and academic appointees (for details, see c. (i) below). Much like many other agricultural products in Japan, production costs for domestically-grown leaf tobacco is higher than those of foreign-grown leaf tobacco to the extent that the purchasing price for the former (before redrying) is approximately three times that of the latter (after redrying). The obligation to purchase virtually all leaf tobacco produced in Japan may adversely impact the Group’s relative competitiveness in Japan because other global tobacco companies use foreign-grown leaf tobacco only.

c. Legal matters relating to the business of filing company

(i) Tobacco Business Act (Act No. 68 of August 10, 1984)

	Description
1. Purpose	The object of this Act is, in consideration of the tax relating to tobacco products as a portion of the treasury revenue incidental to the abolishment of the tobacco monopoly system, to promote a sound development of the tobacco industry in our country by making necessary adjustments in the production and purchase of domestically produced leaf tobacco as raw material for tobacco products and in business activities, etc. of manufacture and sale of the tobacco products, whereby it will contribute to ensuring treasury revenue and a sound development of the national economy. (Article 1)
2. Cultivation and purchase of domestically grown leaf tobacco for use as raw material	(1) When intending to purchase the domestically produced leaf tobacco, Japan Tobacco Inc. (hereinafter, "JT") shall enter into agreements in advance with those who intend to cultivate leaf tobacco for the purpose of selling it to JT regarding the cultivation area for each item of leaf tobacco and the prices for each item and each grade of the leaf tobacco. (Article 3) (2) JT shall purchase all leaf tobacco produced pursuant to such agreements, except those which are not suitable as raw materials for manufactured tobacco. (Article 3) (3) In the case where JT intends to enter into an agreement, JT shall consult with the Leaf Tobacco Council that JT establishes, and respect its opinion concerning the total cultivation area and the prices of leaf tobacco. (Articles 4 and 7) (4) The Leaf Tobacco Council shall deliberate on the price of the leaf tobacco so that subsequent production of leaf tobacco is ensured, by taking into account the production costs, commodity prices and other economic conditions. (Article 4) (5) JT shall determine the regional breakdown of the aggregate cultivation area for the respective items of leaf tobacco seeking the opinion of the Japan Tobacco Growers Association (hereinafter, "JTGA") and, within the scope of such regional breakdown, enter into agreements with growers. (Article 5) (6) If a member grower of a tobacco grows association entrusts JTGA with entering into an agreement regarding a fundamental matters of the agreements such as the price of leaf tobacco, JT shall establish said fundamental matters with JTGA and such agreement shall be deemed as a part of the agreements executed between JT and said grower. (Article 6)
3. Manufacture of tobacco products	(1) No tobacco products shall be manufactured by any party other than JT. (Article 8) (2) JT shall obtain the approval of the Minister of Finance on the maximum wholesale price for each item of tobacco products. (Article 9) (3) JT shall make efforts to ensure a smooth supply of tobacco products taking into account regional demand conditions for tobacco products. (Article 10)
4. Sale of tobacco products	(1) A party wanting to engage in the sale of tobacco products imported by themselves shall register with the Minister of Finance, who establishes necessary regulations relating to said registration and registered party (hereinafter, "Specified Distributor"). (Articles 11 to 19) (2) A party wanting to engage in the wholesaling of tobacco products shall, for the time being, register with the Minister of Finance, who establishes necessary regulations relating to said registration and registered party. (Articles 20 and 21) (3) A party wanting to engage in the retailing of tobacco products shall, for the time being, obtain the approval of the Minister of Finance, who establishes necessary regulations relating to said registration and registered party (hereinafter, "Retailer"). (Articles 22 to 32) (4) If JT and a Specified Distributor want to sell manufactured or imported tobacco products, the list price of each item, and any subsequent change thereof, shall be approved by the Minister of Finance for the time being. Necessary regulations are in place with respect to the approval: for example, the Minister of Finance shall grant approval unless it deems such price is unfair to consumers, etc. (Articles 33 to 35) (Note 1) (5) A Retailer is only permitted to sell tobacco products at list prices that have been approved by the Minister of Finance. (Article 36)

	Description
5. Other	(1) JT or a Specified Distributor shall indicate the wording as prescribed by Ordinance of the Ministry of Finance for warning consumers of the relationship between the consumption of tobacco products and health prior to the commencement of sale of the tobacco products that it manufactured or imported. (Article 39) (Note 2) (2) Advertisers of tobacco products shall give due consideration to the prevention of smoking by minors, etc. and make efforts lest such advertisement should be made to an excessive extent. The Minister of Finance may implement necessary measures with respect to advertisers. (Article 40) (Note 3)

Notes: 1. The so-called list price system is maintained for the time being as a means to prevent confusion in the distribution order, a well-established constant that materialized after the list price system was adopted in 1904.

Tobacco is a luxury item different from the so-called public property and public services and, in a distribution market completely liberalized after the opening of import markets and other factors, the Company and Specified Distributors stipulate prices on application (POA) to the Minister of Finance based on their respective, independent management decisions.

Concerning the approval of list prices, the Company understands that a government delegate gave the following explanation of the gist of the process at the 1984 Diet deliberations on the proposed Tobacco Business Act:

Pertaining to tobacco product list prices, under the Tobacco Business Act, in the event an application is made for the approval of list prices, the Minister of Finance may exceptionally deny approval if it deems such list price unfair to consumers or unfairly low in comparison with wholesale prices of domestic products or import prices of imported products. In all other cases, the Minister approves list prices in line with the spirit of Tobacco Business Act.

2. In November 2003, the Ordinance for Enforcement of the Tobacco Business Act was revised and the wording of warnings concerning tobacco consumption and health indicated on tobacco product packages was changed to specify risks related to eight items, four of which are diseases associated with direct smoking (lung cancer, heart attack, stroke and emphysema), while the other four are smoking by pregnant women, passive smoking, addiction to smoking and youth smoking. Each tobacco product package must indicate, on its main surfaces, a warning regarding at least one of the four items associated with direct smoking and at least one of the other four items. The Ordinance stipulates, among others, (1) that these warnings must be rotated throughout the year in ways to ensure that they receive equal exposure on each product item and each type of package and (2) that the display area must occupy 30% or more of the main surfaces of the package. In addition, the Ordinance stipulates that when wording like “mild” and “light” are used on the package, they must be accompanied by a warning that clarifies that such words do not mean that the risk to their health is lower than other tobacco products so as to prevent consumers from misunderstanding the relationship between the consumption of tobacco products and health. The Company has been adhering to this rule since July 1, 2005.

3. In March 2004, the “Guideline for Advertising of Tobacco Products” was revised to stipulate that the outdoor advertising of tobacco products (posters, billboards, etc.) shall generally be prohibited. It also specifies matters concerning the presentation and content of the health warnings that accompany tobacco advertising.

(ii) Act on Japan Tobacco Inc. (Act No. 69 of August 10, 1984)

	Description
1. Purpose	Japan Tobacco Inc. ("JT") is a stock company whose purpose is to engage in business related to the manufacture, sale, and importation of tobacco products in order to attain the objectives set forth in Article 1 of the Tobacco Business Act. (Article 1)
2. Stock	The Japanese government must continue to hold more than one-third of all Japan Tobacco Inc. ("JT") shares issued (excluding shares of a class for which it is provided that the voting rights may not be exercised for all the matters that are subject to resolution at the shareholders meeting; the same shall apply to the following items). (Article 2, paragraph 1) Whenever JT intends to solicit subscribers for an issuance of shares or subscription rights to shares of JT, or deliver shares (excluding own shares), subscription rights to shares (excluding subscription rights to treasury shares), or issuance of bonds with subscription rights to shares (excluding bonds with subscription rights to treasury shares) at the time of share exchange, the approval of the Minister of Finance is required. (Article 2, paragraph 2) The disposal of JT shares held by the government shall be effectuated within the maximum range stipulated by resolution of the Diet based on the budget of the corresponding year. (Article 3)
3. Scope of business	JT shall engage in the following businesses in order to attain the objectives stated in 1 above. (1) business of manufacture, sale and importation of tobacco products (2) business incidental or relating to the business in the preceding item (3) other business required for attaining the object of JT JT shall obtain authorization from the Minister of Finance before engaging in any business corresponding to (3) above. (Article 5)
4. Monitoring	(1) The appointment or dismissal of Members of the Board, Executive Officers (*sikkoyaku* at a company with committees), and Audit & Supervisory Board Members require authorization from the Minister of Finance. (Article 7) (2) Amendments to JT's articles of incorporation, appropriations of surplus (except disposal of losses), and any merger, corporate split, or dissolution of JT require authorization from the Minister of Finance. (Article 8) (3) JT shall formulate a business plan prior to each business year and obtain authorization from the Minister of Finance. Any change thereof also requires authorization from same. (Article 9) (4) Within three months after the closing of each business year, JT shall issue its balance sheet, statement of income, and business report to the Minister of Finance. (Article 10) (5) Transfers of manufacturing facilities or similar material assets require authorization from the Minister of Finance. (Article 11) (6) The Minister of Finance shall monitor JT in accordance with this Act as well as the Tobacco Business Act and may implement necessary measures in the execution of same. (Articles 12 and 13)

(iii) Acts relating to tobacco excise taxes (including tobacco special excise taxes)

		Description			
		National Tobacco Excise Tax	National Tobacco Special Excise Tax	Local Tobacco Excise Tax	
1. Tax item (Note 1)		Tobacco Excise Tax	Tobacco Special Excise Tax	Prefectural Tobacco Excise Tax (also applies to Tokyo)	Municipal Tobacco Excise Tax (also applies to special wards)
2. Taxpayers (Note 2)		Manufacturers of tobacco products or those who removes tobacco products from bonded areas		Manufacturers of tobacco products, specified distributors or wholesalers selling to retailers	
3. Tax base (Note 3)		Number of cigarettes removed from the manufacturing site or bonded area (for tobacco products other than cigarettes, prescribed cigarette count conversion)		Number of cigarettes relating to sales to retailers (for tobacco products other than cigarettes, prescribed cigarette count conversion)	
4. Tax rate (Note 4)		¥5,302 per 1,000 cigarettes	¥820 per 1,000 cigarettes	¥860 per 1,000 cigarettes	¥5,262 per 1,000 cigarettes
	Former third-class products (Note 5) From April 1, 2016	¥2,950 per 1,000 cigarettes	¥456 per 1,000 cigarettes	¥481 per 1,000 cigarettes	¥2,925 per 1,000 cigarettes
	Former third-class products From April 1, 2017	¥3,383 per 1,000 cigarettes	¥523 per 1,000 cigarettes	¥551 per 1,000 cigarettes	¥3,355 per 1,000 cigarettes
	Former third-class products From April 1, 2018	¥4,032 per 1,000 cigarettes	¥624 per 1,000 cigarettes	¥656 per 1,000 cigarettes	¥4,000 per 1,000 cigarettes
	Former third-class products From April 1, 2019	¥5,302 per 1,000 cigarettes	¥820 per 1,000 cigarettes	¥860 per 1,000 cigarettes	¥5,262 per 1,000 cigarettes
5. Declaration and payment (Note 6)		Tobacco product manufacturers are to declare and pay taxes for each month’s shipment by the end of the following month. Parties removing tobacco products from bonded areas are to declare and pay taxes by the time of extraction		For sales of tobacco products relating to sales locations of retailers located within a given prefecture, a declaration and payment of taxes is to be made to that prefecture for each month’s transfer by the end of the following month	For sales of tobacco products relating to sales locations of retailers located within a given municipality, a declaration and payment of taxes is to be made to that municipality for each month’s transfer by the end of the following month

Notes: 1. Article 3 of the Tobacco Excise Tax Act, Article 4 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Article 1, paragraph 2 and Articles 4 and 5 of the Local Tax Act

2. Article 4 of the Tobacco Excise Tax Act, Article 5 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Article 74-2, paragraph 1 and Article 465, paragraph 1 of the Local Tax Act

3. Article 10 of the Tobacco Excise Tax Act, Article 7 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Articles 74-4 and 467 of the Local Tax Act

4. Article 11, paragraph 1 of the Tobacco Excise Tax Act, Article 8, paragraph 1 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Articles 74-5 and 468 of the Local Tax Act

5. Article 50 of the Act for Partial Amendment of the Income Tax Act, etc. (Act No. 9 of March 31, 2015) and Article 103 of the Supplementary Provisions of the act, and Article 12, paragraph 2 and Article 20, paragraph 2 of the Supplementary Provisions of the Act for Partial Amendment of the Local Tax Act, etc. (Act No. 2 of March 31, 2015)

6. Articles 17 to 20 of the Tobacco Excise Tax Act, Article 12 of the Act Concerning Special Measures for Financing Debt Transferred to the General Accounts, and Articles 74-10 and 473 of the Local Tax Act

7. Concerning “4. Tax rate”

The term “former third-class products” refers to tobacco products stipulated as third-class cigarettes in the Tobacco Product Price Act, repealed on April 1, 1985. These are same products as those at the time of abolishment. As a result of the Act for Partial Amendment of the Income Tax Act, etc. (Act No. 9 of March 31, 2015) and the Act for Partial Amendment of the Local Tax Act, etc. (Act No. 2 of March 31, 2015), special tax rates for former third-class products were abolished. Accordingly, tax rate revisions are to be implemented in stages as a transitional measure during the period from April 1, 2016 to April 1, 2019.

8. (i) In the event the tax system relating to tobacco subject to high excise taxes is examined, on a general basis, as part of a revision of the tax system by the government each year and the tax system is revised, a decision is made upon the deliberation and resolution of the legislature subsequent to the determination of government policy through deliberation by the Tax System Council and other bodies. Relevant government policy is determined once cabinet approval of a bill is secured following the cabinet's approval of an outline of the tax reform proposal.

   (ii) See the following page for revisions to the tax system relating to tobacco after the April 1985 transfer from the monopoly profit system to the tobacco consumption tax system.

[Main movements relating to the tobacco tax system and the Company's responses]

Month/Year	Item	Description	The Company's response
May 1986	1986 Tax Reform	Tax increase equivalent to ¥900 per 1,000 cigarettes	Fixed price revised by amount equivalent to tax increase
April 1989	1989 Tax Reform	Following the introduction of the consumption tax, "tobacco consumption tax" changed to "tobacco excise tax" and taxation formula unified to a unit tax	Basically, fixed price revision unnecessary
April 1997	1997 Tax Reform	[Revision of Local Tax Act] Local Tobacco Excise Tax revenue transferred from the Prefectural Tobacco Excise Tax to the Municipal Tobacco Excise Tax	Fixed price revision unnecessary
		[Revision of Consumption Tax Act] Consumption tax rate revised from 3% to 5%	Prices raised by ¥10 per pack for some brands in an effort to revise fixed prices overall by the amount equivalent to the consumption tax rate revision
December 1998	1998 Tax Reform	Act Concerning Special Measures for Financing Debt Transferred to the General Accounts established and ¥820 per 1,000 cigarettes of Tobacco Special Excise Tax introduced	Basically, price per cigarette raised by ¥1
May 1999	1999 Tax Reform	[Revision of Special Taxation Measures Act and Local Tax Act] Tax revenue transferred from Tobacco Excise Tax to Prefectural Tobacco Excise Tax and Municipal Tobacco Excise Tax	Fixed price revision unnecessary
July 2003	2003 Tax Reform	Acts revising a portion of the Income Tax Act, Local Tax Act, among others, established and tax increase by ¥820 per 1,000 cigarettes	Price per cigarette raised by approx. ¥1
July 2006	2006 Tax Reform	Acts revising a portion of the Income Tax Act, Local Tax Act, among others, established and tax increase by ¥852 per 1,000 cigarettes	Amount equivalent to tax increase shifted to fixed price of all brands with some prices increased higher than said amount
October 2010	2010 Tax Reform	Acts revising a portion of the Income Tax Act, Local Tax Act, among others, established and tax increase by ¥3,500 per 1,000 cigarettes	With exception of some brands, prices increased higher than the amount equivalent to tax increase
April 2014	2014 Tax Reform	[Revision of Consumption Tax Act] Consumption tax rate revised from 5% to 8%	With exception of some brands, prices raised by ¥10 or ¥20 per pack to revise fixed prices overall by the amount equivalent to the consumption tax rate revision
April 2016	2015 Tax Reform	Acts revising a portion of the Income Tax Act, Local Tax Act, among others, established and tax increase by ¥1,000 per 1,000 cigarettes for former third-class products	For former third-class products, prices raised by ¥30 to ¥50 per pack
April 2017	2015 Tax Reform	Based on 2015 Tax Reform, tax increase by ¥1,000 per 1,000 cigarettes for former third-class products	For former third-class products, prices raised by ¥30 per pack

Notes: 1. In April 2018, cigarette prices for former third-class products are scheduled to be raised by ¥40 per pack due to the implementation of a tax increase of ¥1,500 per 1,000 cigarettes.

2. The Outline of the 2018 Tax Reform Proposals determined by the Cabinet of Japan on December 22, 2017, describes a review of tobacco excise tax such that an increase of ¥3,000 per 1,000 cigarettes in the rate of national and regional tobacco excise tax will be implemented, and, based on the establishing of a new tax category for heated tobacco, also describes a review of the form of excise taxation that takes into account the characteristics of that product. These reviews, viewed from the perspective of mitigating radical change, etc., are respectively devised as transitional

measures, with the former implemented in three stages, in which each stage consists of a ¥1,000 increase per 1,000 cigarettes between October 2018 and October 2021 (with no increase in the rate of excise tax in October 2019), and with the latter implemented in five stages between October 2018 and October 2022. In addition, the rate of excise tax applied to former third-class products for the period between April 1, 2018 and March 31, 2019, will be extended to September 30, 2019.

5. Important operational contracts

No items to report

6. Research and development activities

Research and development activities are mainly undertaken at the Company's Tobacco Science Research Center and Central Pharmaceutical Research Institute.

Research and development expenses of the Group during the fiscal year ended December 31, 2017 amounts to ¥60.6 billion and the research objectives and research and development expenses by each segment are as follows. Please note that the aforementioned research and development expenses includes ¥0.8 billion relating to basic research not affiliated to any segment (plant biotechnology related research) and conducted by the corporate divisions of the Company.

(1) Domestic and International Tobacco Businesses

The Group is committed to strengthening its R&D capabilities to ensure a long-term competitive advantage. The focus areas in the R&D activities are the development of new leaf tobacco varieties, improvement of tobacco leafs and their processing, enhancement of aroma and taste, upgrading manufacturing technology, and continuous progress on RRP-related technologies. The Group has been striving to add value to the products in these focus areas in a cost efficient manner. It has established a global research platform in Japan, which focuses on the fundamental research and product technology development. To best meet consumers' needs and preferences, the market teams are continuously engaged in the product development. Research and development expenses relating to the Domestic Tobacco Business amounts to ¥18.5 billion with that of the International Tobacco Business amounting to ¥8.0 billion.

(2) Pharmaceutical Business

R&D activities are the foundation of the Group's Pharmaceutical Business and are critical for its long-term growth and profitability. The R&D activities focus mainly on the fields of glucose and lipid metabolism, virus research and immune disorders and inflammation. Research and development expenses for the Pharmaceutical Business is ¥32.6 billion.

(3) Processed Food Business

Regarding R&D in the Processed Food Business, the Group devotes its efforts to the development of innovative products that meet consumers' needs and preferences. Research and development expenses for the Processed Food Business is ¥0.7 billion.

7. Analysis of financial position, operating results and cash flow position

(1) Significant accounting policies

a. Adoption of IFRS

Having acquired RJR Nabisco's non-U.S. tobacco operations in 1999 and Gallaher Group Plc. in 2007, the Group has been growing steadily as a global company and now operates in at least 70 countries and territories, and sells products in at least 130 countries and territories. In this context, the Group has decided to opt for an early adoption of the IFRS from the fiscal year ended March 31, 2012. A decision based on the Japanese authorities' permission for the listed companies conducting financial and business activities internationally to adopt IFRS voluntarily from the year ended March 31, 2010. Upon the adoption of IFRS, the Group aims to diversify the group's sources of financing through international markets and to improve quality of business management.

b. Significant accounting estimates and judgment on estimates

Preparation of consolidated financial statements of the Group requires the management to make estimates and assumptions in order to measure income, expenses, assets and liabilities, and disclose contingencies as of the fiscal year end date. These estimates and assumptions are based on the best judgment of the management, considering past results and various factors deemed to be appropriate as of the fiscal year end date. Given their nature, actual results may differ from those estimates and assumptions.

The estimates and assumptions are continuously reviewed by the management. The effects of a change in the estimates and assumptions are recognized prospectively, including the period reviewed. As for the estimates and assumptions that may have a material effect on the amounts recognized in the consolidated financial statements of the Group, please refer to "V. Accounting, 1. Consolidated financial statements, (1) Consolidated financial statements, Notes to consolidated financial statements, 4. Significant accounting estimates and judgments."

(2) Analysis of business results for the fiscal year

a. Revenue

In terms of revenue, the increases in the International Tobacco Business and the Pharmaceutical Business were offset by the decrease in the Domestic Tobacco Business, etc., leading to revenue of a similar level to that of the previous fiscal year, at ¥2,139.7 billion, a decrease of 0.2% from the previous fiscal year.

b. Cost of sales, other operating income, share of profit in investments accounted for using the equity method, selling, general and administrative expenses

Cost of sales for the fiscal year ended December 31, 2017 decreased by ¥28.9 billion, or 3.3%, from the previous fiscal year to ¥843.6 billion, and other operating income decreased by ¥24.4 billion, or 34.8%, from the previous fiscal year to ¥45.7 billion. Share of profit in investments accounted for using the equity method decreased by ¥0.3 billion, or 4.5%, from the previous fiscal year to ¥6.2 billion. Selling, general and administrative expenses increased by ¥32.8 billion, or 4.3%, from the previous fiscal year to ¥786.9 billion.

c. Adjusted operating profit, operating profit and profit attributable to owners of the parent company

Adjusted operating profit including foreign exchange effects came in at approximately the same level as that of the previous fiscal year, at ¥585.3 billion, a decrease of 0.3% from the previous fiscal year, since increases in profit, etc. in the International Tobacco Business and the Pharmaceutical Business were offset by the decrease in profit in the Domestic Tobacco Business and by a non-recurring loss associated with a key UK distributor going into administration. Adjusted operating profit at constant rates of exchange decreased by 0.6%.

Operating profit declined in comparison to the previous fiscal year, in which a significant gain on sales of real estate and the like was recorded, due to a fall in gain on sales of real estate and the like, falling by ¥32.2 billion, or 5.4%, from the previous fiscal year to ¥561.1 billion.

Profit attributable to owners of the parent company decreased by ¥29.3 billion, or 6.9%, from the previous fiscal year to ¥392.4 billion, due mainly to decrease in operating profit.

(3) Basic policies of financing activities

The Group's basic policies of financing activities are as follows.

a. Group Cash Management Systems

To maximize the total group cash efficiency, the Group gives first priority to utilizing internal financing mainly by the Group Cash Management Systems (CMS), where legally permissible and economically viable.

b. External financing

Short-term working capital needs are normally financed through short-term borrowings from financial institutions or through commercial paper, or a combination of both; mid- to long-term financing is done through long-term borrowings from financial institutions, bond or equity, or a combination of those.

For secure and efficient financing, the Group continues to diversify its financing means as well as the financial institutions, and set up secure financing means, such as multiple committed facilities.

c. External investments

Investments with financial institutions should be transacted ensuring safety, liquidity and optimal yield. Speculative dealings in pursuit of profit margin are not allowed.

d. Financial risk management

The Group is exposed to financial risks such as credit risk, liquidity risk, foreign exchange risk, interest rate risk, and market price fluctuation risk. The Group manages such risks according to the risk management policies and procedures to avoid or mitigate such risks. The major financial risk management status is reported regularly to the President and Chief Executive Officer and the Board of Directors.

It is the Group's policy that derivatives are only used if it is intended to mitigate risks of transactions for actual business needs, and speculative and trading transactions are not allowed.

For more details on financial risk management, please refer to "V. Accounting, 1. Consolidated financial statements, (1) Consolidated financial statements, Notes to consolidated financial statements, 34. Financial instruments, (2) Financial risk management to (8) Market price fluctuation risk."

(4) Analysis of capital resources and liquidity of funds

a. Funding requirements

Funds are mainly allocated for capital expenditure, working capital and acquiring external capital resources as well as the repayment of loans, the payment of interest and dividends, the acquisition of treasury shares and the payment of income taxes.

b. Resources of funds

The necessary funds are mainly procured from net cash flows from operating activities, loans from financial institutions and bond and commercial paper issuances.

<Cash flows>

Net cash flows from operating activities in the fiscal year ended December 31, 2017 came to ¥419.2 billion, while net cash flows used in investing activities and financing activities were ¥352.6 billion and ¥77.0 billion respectively. Cash and cash equivalents on a consolidated basis as of December 31, 2017, including the effect of exchange rate changes, decreased by ¥8.7 billion from the end of the previous year to ¥285.5 billion (end of previous year balance of ¥294.2 billion).

<Interest-bearing debt>

Amounts of interest-bearing debt of the Group to be repaid or redeemed as of December 31, 2017 are as follows.

(Billions of yen)

	Book value	Due within one year	Due after one year through two years	Due after two years through three years	Due after three years through four years	Due after four years through five years	Due after five years
Short-term borrowings as loans	274.2	274.2	–	–	–	–	–
Short-term lease obligations	1.3	1.3	–	–	–	–	–
Commercial paper	66.8	66.8					
Long-term borrowings as loans (current portion)	0.7	0.7	–	–	–	–	–
Bonds (current portion)	56.5	56.5	–	–	–	–	–
Long-term borrowings as loans	71.2	–	0.4	0.2	0.1	30.1	40.3
Bonds	275.8	–	–	80.0	84.8	30.0	81.5
Long-term lease obligations	9.3	–	0.9	0.7	0.5	0.2	7.0
Total	755.8	399.6	1.3	80.9	85.4	60.3	128.9

Long-term debt

Bonds issued (including the current portion) as of December 31, 2016 and as of December 31, 2017 accounted for ¥358.2 billion and ¥332.2 billion, respectively, and long-term borrowings as loans from financial institutions (including the current portion) accounted for ¥1.4 billion and ¥71.9 billion, respectively. Long-term lease obligations totaled ¥7.3 billion as of December 31, 2016 and ¥9.3 billion as of December 31, 2017.

As of December 31, 2017, the long-term debt was rated Aa3 (stable) by Moody's Japan K.K., AA- (stable) by Standard & Poor's Ratings Japan K.K., and AA (stable) by Rating and Investment Information, Inc. (R&I), all with a "stable" outlook. These ratings are among the highest ratings for international tobacco companies.

These ratings are affected by a number of factors such as developments in the major business markets, the quality of execution of the business strategies, and general economic trends that are beyond the Group's control. The ratings may be withdrawn or revised at any time. Each rating should be evaluated separately from other ratings. Under the JT Act, bonds issued by the Company are secured by statutory preferential rights to the property of the Company. These rights give bondholders precedence over unsecured creditors in seeking repayment, with the exception of national and local taxes and other statutory obligations.

Short-term debt

Short-term borrowings from financial institutions totaled ¥187.9 billion as of December 31, 2016 and ¥274.2 billion as of December 31, 2017. There was no commercial paper outstanding as of December 31, 2016, but as of December 31, 2017, the outstanding balance was ¥66.8 billion. Short-term lease obligations totaled ¥0.4 billion as of December 31, 2016 and ¥1.3 billion as of December 31, 2017.

c. Liquidity

The Group has historically had, and expects to continue to have, significant cash flows from operating activities. The Group expects that cash generated from operating activities will continue to be stable and cover funds needed for regular business activities. As of December 31, 2017, the Group had ¥601.6 billion in committed lines of credit from major financial institutions both domestic and international, 81.0% of which were unused. In addition, the Group has a commercial paper program, uncommitted lines of credit, a domestic bond shelf registration, and a euro MTN program.

III. Facilities

1. Outline of capital expenditures

In the fiscal year ended December 31, 2017, the Group made capital expenditures totaling ¥140.9 billion.

In the Domestic Tobacco Business, the Group spent ¥51.5 billion, mainly on investments accompanying maintenance and upgrade of manufacturing processes, productivity improvements, adaptation to new products, improvements in product specifications, and others. In the International Tobacco Business, the Group invested ¥68.4 billion mainly for optimization of manufacturing facilities in addition to improvements in product specifications. In the Pharmaceutical Business, the Group spent ¥6.2 billion on enhancing and strengthening research and development structures and the like. In the Processed Food Business, the Group invested ¥10.4 billion in improvement, maintenance and renewals of production capability.

Please note that the Group's own capital was allocated for capital expenditures.

* Capital expenditures includes land; building and structures; machinery and vehicles; and other property, plant and equipment, as well as goodwill, right of trademark, software and other intangible assets, necessary for production improvements at factories and other facilities, strengthening competitiveness and executing business in a variety of fields, excluding assets acquired through business combinations.

2. Main facilities

Main facilities of the Group (the Company and its consolidated subsidiaries) are as follows.

(1) Filing company (the Company)

(As of December 31, 2017)

Office and factory name (Location)	Segment	Description	Book value (Millions of yen)						Number of employees (Person)
			Land		Buildings and structures	Machinery, equipment and vehicles	Tools, furniture and fixtures	Total	
			Size (thousand m^2)	Amount					
Kita-kanto Factory (Utsunomiya-shi, Tochigi) Note 1	Domestic Tobacco	Tobacco manufacturing facilities	150	2,062	8,886	20,875	582	32,405	402
Tokai Factory (Iwata-shi, Shizuoka) Note 1	Domestic Tobacco	Tobacco manufacturing facilities	223	2,309	7,304	17,735	371	27,719	337
Kansai Factory (Fushimi-ku, Kyoto-shi)	Domestic Tobacco	Tobacco manufacturing facilities	116	5,831	10,689	23,633	561	40,714	449
Kyushu Factory (Chikushino-shi, Fukuoka)	Domestic Tobacco	Tobacco manufacturing facilities	166	4,042	2,662	6,618	193	13,515	251
Tobacco Science Research Center (Aoba-ku, Yokohama-shi) Note 1	Domestic Tobacco	Research and development facilities	35	642	3,057	0	1,000	4,699	78
Central Pharmaceutical Research Institute (Takatsuki-shi, Osaka) Note 1	Pharmaceutical	Research and development facilities	95	2,733	18,731	9	1,786	23,259	607
Head Office (Minato-ku, Tokyo)	General administration	Other	7	21,487	20,562	38	1,975	44,062	1,421
Area Sales Headquarters (15) (Municipality) Notes 1, 2	Domestic Tobacco (includes administration)	Other	29	863	2,322	1,016	128	4,329	2,968

(2) Domestic subsidiaries

(As of December 31, 2017)

Office and factory name (Location)	Segment	Description	Book value (Millions of yen)						Number of employees (Person)
			Land		Buildings and structures	Machinery, equipment and vehicles	Tools, furniture and fixtures	Total	
			Size (thousand m^2)	Amount					
TS Network Co., Ltd. Head Office and other 26 distribution bases (Head Office: Taito-ku, Tokyo) Note 2	Domestic Tobacco	Distribution facilities	31	–	8,872	1,693	622	11,187	1,763
Japan Filter Technology, Co., Ltd. Head Office and other 3 factories (Head Office: Sumida-ku, Tokyo) Note 2	Domestic Tobacco	Material manufacturing facilities	114	714	4,841	7,918	378	13,851	608
Torii Pharmaceutical Co., Ltd. Head Office, other factories and branch offices (Head Office: Chuo-ku, Tokyo)	Pharmaceutical	Pharmaceuticals manufacturing facility and other	55	604	3,185	1,780	374	5,943	1,074
TableMark Co., Ltd. Head Office and other 8 factories (Head Office: Chuo-ku, Tokyo)	Processed Food	Frozen food production facilities	–	–	5,370	7,696	310	13,376	1,334

(3) Foreign subsidiaries

(As of December 31, 2017)

Office and factory name (Location)	Segment	Description	Book value (Millions of yen)						Number of employees (Person)
			Land		Buildings and structures	Machinery, equipment and vehicles	Tools, furniture and fixtures	Total	
			Size (thousand m^2)	Amount					
LLC Petro (Russia) Note 2	International Tobacco	Tobacco manufacturing facilities	164	253	6,189	14,041	2,876	23,358	1,194
JTI Polska Sp. z o. o. (Poland)	International Tobacco	Tobacco manufacturing facilities	409	154	11,164	33,750	1,004	46,073	1,460
JT International Germany GmbH (Germany)	International Tobacco	Tobacco manufacturing facilities	346	323	15,756	18,236	1,743	36,058	1,945
JTI Tütün Urunleri Sanayi A.S. (Turkey)	International Tobacco	Tobacco manufacturing facilities	249	1,181	2,778	7,259	157	11,375	489

Notes: 1. Companies have land leased to entities other than the group companies.
2. Companies have land leased from entities other than the group companies.
3. Book values include lease assets.

3. Plans for new installation and retirement of facilities

Regarding the mid- to long-term resource allocation of the Group, it will place top priority on business investments that will lead to sustainable profit growth in the mid- to long-term based on the Group's management principles. Of the reportable segments, the Group positions the Domestic and International Tobacco Businesses as the core business and profit growth engine and places top priority on business investments that will lead to their sustainable profit growth. Meanwhile, the Group will make investment with the aims of strengthening the business foundations of the Pharmaceutical Business in order to generate stable profits, and strengthening the business foundations of the Processed Food Business in order to generate further profits.

Based on this policy, the Group plans capital expenditures (facility construction and expansion) totaling ¥199.0 billion in the fiscal year ending December 31, 2018.

As the Company and its consolidated subsidiaries have wide-ranging plans for capital expenditure, figures are disclosed by segment.

The Group's actual capital expenditures may differ significantly from the planned figures mentioned above as a result of a number of factors including those presented in "II. Review of operations, 4. Business and other risks."

Segment	Capital expenditure plan for the fiscal year ending December 31, 2018 (Billions of yen)	Main purpose of investment	Funding
Domestic Tobacco Business	76.0	RRP-related investments and IT-related investments	Internally generated funds
International Tobacco Business	90.0	RRP-related investments and expenditures for the improvements in product specifications	Same as above
Pharmaceutical Business	12.0	Expenditures for the development and reinforcement of R&D capabilities	Same as above
Processed Food Business	15.0	Expenditures for the expansion of production capacity, and improvements, maintenance and upgrading of productivity	Same as above

Note: There were no plans for sales or retirement of important facilities except for the regular renewal of facilities.

* Capital expenditures includes land; building and structures; machinery and vehicles; and other property, plant and equipment, as well as goodwill, right of trademark, software and other intangible assets, necessary for production improvements at factories and other facilities, strengthening competitiveness and executing business in a variety of fields, excluding assets acquired through business combinations.

IV. Filing company

1. Information on the Company's shares

(1) Total number of shares authorized

a. Total number of shares authorized

Class	Total number of shares authorized (Share)
Ordinary shares	8,000,000,000
Total	8,000,000,000

b. Number of shares issued

Class	Number of shares issued (Share; as of December 31, 2017)	Number of shares issued (Share; as of the date of filing: March 27, 2018)	Name of financial instruments exchange where the stock of the Company is traded or the name of authorized financial instruments firms association where the Company is registered	Details
Ordinary shares	2,000,000,000	2,000,000,000	Tokyo Stock Exchange (First Section)	(Note 2)
Total	2,000,000,000	2,000,000,000	–	–

Notes: 1. The provisions of Article 2 of the Act on Japan Tobacco Inc. prescribe that the Japanese government must continue to hold more than one-third of all shares issued by the Company (excluding shares of a class for which it is provided that the voting rights may not be exercised for all the matters that are subject to resolution at the General Meeting of Shareholders).

2. The Company's standard class of shares with no rights limitations. Its share trading unit is 100 shares.

(2) Status of subscription rights to shares

Subscription rights to shares issued pursuant to the Companies Act are as follows.

a. Resolution of the Board of Directors on December 21, 2007

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	155 units	136 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	31,000 shares (Notes 1, 4)	27,200 shares (Notes 1, 4)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From January 9, 2008 to January 8, 2038	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥581,269 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. The class of shares to be issued upon exercise of subscription rights to shares shall be ordinary shares. The number of shares to be issued upon exercise of each subscription right to shares (hereinafter, "Number of Shares Granted") shall be one. However, in cases where the Company conducts stock split (including stock allotment without contribution; hereinafter, the same shall apply to description of stock split) or stock consolidation of ordinary shares of the Company after the date on which the Company allots subscription rights to shares (hereinafter, "Allotment Date"), the Number of Shares Granted shall be adjusted according to the following formula.

$$\text{Number of Shares Granted after adjustment} = \text{Number of Shares Granted before adjustment} \times \text{Ratio of stock split or stock consolidation}$$

Any fraction of less than one share that occurs as a result of the above adjustment shall be rounded down to two decimal places.

In the case of a stock split, the Number of Shares Granted after adjustment shall be applied on and after the date following the base date (if the base date is not specified, on and after the effective date), while in the case of stock consolidation, it shall be applied on and after the effective date. However, in cases where stock split is conducted subject to approval of the proposal to reduce surplus and increase capital or reserve fund at the General Meeting of Shareholders of the Company and where the base date for stock split is set on or before the date of conclusion of that General Meeting of Shareholders, the Number of Shares Granted after adjustment shall be applied retrospectively to the date following that base date, on and after the date following the date of conclusion of that General Meeting of Shareholders.

In addition, in cases where the adjustment of the Number of Shares Granted is proper, the Company shall conduct adjustments deemed necessary after the Allotment Date.

When adjusting the Number of Shares Granted, the Company shall notify Subscription rights to shares Holders or make public notice of necessary information by the date before the date on which the Number of Shares Granted after adjustment is applied. However, in cases where the notice or public notice by the date before the date of the application is impracticable, the Company shall later do so as soon as possible.

2. In cases where proposal a., b. or c. below is approved at the General Meeting of Shareholders of the Company (if a resolution by the General Meeting of Shareholders is not necessary, it is read as "in cases where the resolution of the Board of Directors or the decision by the representative Executive Officer (*sikkoyaku* at a company with committees) is made"), the Company may acquire subscription rights to shares on the date separately provided for by the Board of Directors. In this case, the Company shall, in exchange for acquiring each subscription right to shares, deliver money at the amount obtained by multiplying the value per share calculated according to the following formula by the Number of Shares Granted (if adjusted pursuant to Note 1 above, the Number of Shares Granted after adjustment) to the Subscription rights to shares Holders of respective such subscription rights to shares.

   Value per share = Closing price for regular transactions of ordinary shares of the Company on the Tokyo Stock Exchange (if there is no closing price, the base price thereof on the following business day) on the date on which such proposal is approved at the General Meeting of Shareholders of the Company (if a resolution by the General Meeting of Shareholders is not necessary, it is read as "the resolution of the Board of Directors or the decision by the representative Executive Officer (*sikkoyaku* at a company with committees) is made") – ¥1

   a. Proposal to ask approval of a contract of merger where the Company is not to be the surviving company
   b. Proposal to ask approval of a contract or plan of company split where the Company would be the split company
   c. Proposal to ask approval of a share exchange contract or share transfer plan where the Company becomes a wholly-owned subsidiary

3. In cases where the Company merges (limited to cases where the Company is to be extinguished as a result of the merger), splits and absorbs or splits and incorporates (limited to cases where the Company becomes the split company in either case), or exchanges or transfers shares (limited to cases where the Company becomes a wholly-owned subsidiary in either case) (collectively, hereinafter, "Reorganization"), the Company shall, in each case, deliver subscription rights to shares of the companies as listed in Article 236, paragraph 1, item (viii), sub-items (a) to (e) of the Companies Act (hereinafter, the "Company Subject to Reorganization") to the Subscription rights to shares Holders that have subscription rights to shares existing immediately before the effective date of the Reorganization, which is either the effective date of absorption-type merger when it is an absorption-type merger, the consolidation date of a company as a result of the consolidated-type merger when it is a consolidated-type merger, the effective date of absorption-type company split when it is an absorption-type company split, the incorporation date of a company as a result of the incorporation-type company split when it is an incorporation-type company split, the effective date of share exchange when it is a share exchange, or the incorporation date of a wholly-owning parent company as a result of the share transfer when it is a share transfer (hereinafter, "Remaining Subscription rights to shares"). However, it is subject to a condition that the provision that the subscription rights to shares of the Company Subject to Reorganization shall be delivered pursuant to the provisions of the items below, is specified in the absorption-type merger contract, consolidated-type merger contract, absorption-type company split contract, incorporation-type company split plan, share exchange contract or share transfer plan.

   a. Number of subscription rights to shares to be delivered of the Company Subject to Reorganization

      Subscription rights to shares whose number is identical to the number of the Remaining Subscription rights to shares held by Subscription rights to shares Holder

   b. Class of shares of the Company Subject to Reorganization to be issued upon exercise of subscription rights to shares

      Ordinary shares of the Company Subject to Reorganization

   c. Number of shares of the Company Subject to Reorganization to be issued upon exercise of subscription rights to shares

      To be determined in the same manner as Note 1 above, taking into consideration terms and other conditions of the Reorganization.

   d. Value of property to be contributed when subscription rights to shares are exercised

      The value of the property to be contributed when each subscription right to shares to be delivered is exercised shall be the amount obtained by multiplying the paid-in amount after Reorganization as specified below by the number of shares of the Company Subject to Reorganization to be issued upon exercise of each subscription right to shares, which is decided pursuant to c. above. The paid-in amount after Reorganization shall be ¥1 per share of the shares of the Company Subject to Reorganization that would be delivered by exercising the delivered subscription rights to shares.

e. Period during which subscription rights to shares can be exercised

   From the effective date of the Reorganization to the expiration date of the period during which such subscription rights to shares can be exercised as specified in “Exercise period of subscription rights to shares” mentioned above.

f. Matters regarding capital and capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares

   To be determined in the same manner as “Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares” mentioned above.

g. Restrictions on transferring of subscription rights to shares

   Transferring the subscription rights to shares is subject to approval of the Board of Directors of the Company Subject to Reorganization.

h. Provisions for acquiring subscription rights to shares

   To be determined in the same manner as Note 2 above.

i. Other conditions for exercising subscription rights to shares

   To be determined in the same manner as “Conditions for exercising subscription rights to shares” mentioned above.

4. The Company conducted a share split at a ratio of 200 to one ordinary share with July 1, 2012 as effective date. As a consequence, the number of shares to be issued upon exercise of the subscription rights to shares issued before this share split has been adjusted from one share to 200 shares and is presented accordingly.

b. Resolution of the Board of Directors on September 19, 2008

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	315 units	289 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	63,000 shares (Notes 1, 4)	57,800 shares (Notes 1, 4)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 7, 2008 to October 6, 2038	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥285,904 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

c. Resolution of the Board of Directors on September 28, 2009

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	642 units	519 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	128,400 shares (Notes 1, 4)	103,800 shares (Notes 1, 4)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 14, 2009 to October 13, 2039	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥197,517 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

d. Resolution of the Board of Directors on September 17, 2010

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	578 units	572 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	115,600 shares (Notes 1, 4)	114,400 shares (Notes 1, 4)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 5, 2010 to October 4, 2040	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥198,386 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

e. Resolution of the Board of Directors on September 16, 2011

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	727 units	727 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	145,400 shares (Notes 1, 4)	145,400 shares (Notes 1, 4)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 4, 2011 to October 3, 2041	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥277,947 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. to 4. Same as Notes 1. to 4. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

f. Resolution of the Board of Directors on September 21, 2012

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	563 units	541 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	112,600 shares (Note 1)	108,200 shares (Note 1)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 10, 2012 to October 9, 2042	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥320,000 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. The class of shares to be issued upon exercise of subscription rights to shares shall be ordinary shares. The number of shares to be issued upon exercise of each subscription right to shares (hereinafter, "Number of Shares Granted") shall be 200. However, in cases where the Company conducts stock split (including stock allotment without contribution; hereinafter, the same shall apply to description of stock split) or stock consolidation of ordinary shares of the Company after the date on which the Company allots subscription rights to shares (hereinafter, "Allotment Date"), the Number of Shares Granted shall be adjusted according to the following formula.

$$\text{Number of Shares Granted after adjustment} = \text{Number of Shares Granted before adjustment} \times \text{Ratio of stock split or stock consolidation}$$

Any fraction of less than one share that occurs as a result of the above adjustment shall be rounded down to two decimal places.

In the case of a stock split, the Number of Shares Granted after adjustment shall be applied on and after the date following the base date (if the base date is not specified, on and after the effective date), while in the case of stock consolidation, it shall be applied on and after the effective date. However, in cases where stock split is conducted subject to approval of the proposal to reduce surplus and increase capital or reserve fund at the General Meeting of Shareholders of the Company and where the base date for stock split is set on or before the date of conclusion of that General Meeting of Shareholders, the Number of Shares Granted after adjustment shall be applied retrospectively to the date following that base date, on and after the date following the date of conclusion of that General Meeting of Shareholders. In addition, in cases where the adjustment of the Number of Shares Granted is proper, the Company shall conduct adjustments deemed necessary after the Allotment Date. When adjusting the Number of Shares Granted, the Company shall notify Subscription rights to shares Holders or make public notice of necessary information by the date before the date on which the Number of Shares Granted after adjustment is applied. However, in cases where the notice or public notice by the date before the date of the application is impracticable, the Company shall later do so as soon as possible.

2. and 3. Same as Notes 2. and 3. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

g. Resolution of the Board of Directors on September 20, 2013

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	404 units	404 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	80,800 shares (Note 1)	80,800 shares (Note 1)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 8, 2013 to October 7, 2043	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥513,400 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. Same as Note 1. of subscription rights to shares pursuant to f. Resolution of the Board of Directors on September 21, 2012.

2. and 3. Same as Notes 2. and 3. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

h. Resolution of the Board of Directors on September 19, 2014

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	283 units	283 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	56,600 shares (Note 1)	56,600 shares (Note 1)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From October 7, 2014 to October 6, 2044	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥483,200 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. Same as Note 1. of subscription rights to shares pursuant to f. Resolution of the Board of Directors on September 21, 2012.

2. and 3. Same as Notes 2. and 3. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

i. Resolution of the Board of Directors on July 17, 2015

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	415 units	415 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	83,000 shares (Note 1)	83,000 shares (Note 1)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From August 4, 2015 to August 3, 2045	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥711,200 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. Same as Note 1. of subscription rights to shares pursuant to f. Resolution of the Board of Directors on September 21, 2012.

2. and 3. Same as Notes 2. and 3. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

j. Resolution of the Board of Directors on June 17, 2016

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	386 units	386 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	77,200 shares (Note 1)	77,200 shares (Note 1)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From July 5, 2016 to July 4, 2046	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥572,600 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. Same as Note 1. of subscription rights to shares pursuant to f. Resolution of the Board of Directors on September 21, 2012.

2. and 3. Same as Notes 2. and 3. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

k. Resolution of the Board of Directors on June 14, 2017

	As of December 31, 2017	As of February 28, 2018
Number of subscription rights to shares	688 units	688 units
Of which, the number of treasury subscription rights to shares	–	–
Class of shares to be issued upon exercise of subscription rights to shares	Ordinary shares (the Company's standard class of shares with no rights limitations.)	Same as left
Number of shares to be issued upon exercise of subscription rights to shares	137,600 shares (Note 1)	137,600 shares (Note 1)
Paying due upon exercise of subscription rights to shares	¥1 per share	Same as left
Exercise period of subscription rights to shares	From July 4, 2017 to July 3, 2047	Same as left
Issue price of shares in cases where shares will be issued as a result of exercise of subscription rights to shares	¥482,200 per unit	Same as left
Additional paid-in capital in issue price in cases where shares will be issued as a result of exercise of subscription rights to shares	a. Capital amount that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be a half of the maximum capital increase amount obtained by the calculation pursuant to Article 17, paragraph 1 of the Corporate Accounting Rules. If the obtained figure has a fraction less than ¥1, the figure is rounded up to the nearest yen. b. Capital reserves that will be increased in cases where shares will be issued as a result of the exercise of subscription rights to shares must be the amount obtained by subtracting the capital amount to be increased as specified in a. above from the maximum capital increase amount described in a. above.	Same as left
Conditions for exercising subscription rights to shares	a. The person who is a holder of subscription rights to shares and is recorded in the registry of subscription rights to shares (hereinafter, "Subscription rights to shares Holder") may exercise his/her subscription rights to shares only if he/she forfeit his/her all position as Member of the Board (including *sikkoyaku* at a company with committees), Audit & Supervisory Board Member and Executive Officer of the Company. b. In cases where Subscription rights to shares Holders waive their subscription rights to shares, they cannot exercise those subscription rights to shares.	Same as left
Assignment of subscription rights to shares	The approval of the Board of Directors is required for the assignment of subscription rights to shares.	Same as left
Matters regarding surrogate payments	–	–
Provisions for acquiring subscription rights to shares	(Note 2)	Same as left
Matters regarding delivery of subscription rights to shares accompanied by reorganization	(Note 3)	Same as left

Notes: 1. Same as Note 1. of subscription rights to shares pursuant to f. Resolution of the Board of Directors on September 21, 2012.

2. and 3. Same as Notes 2. and 3. of subscription rights to shares pursuant to a. Resolution of the Board of Directors on December 21, 2007.

(3) Exercise of bond certificates with subscription rights to shares with exercise price amendment clause

No items to report

(4) Details of rights plan

No items to report

(5) Trends in total number of shares issued, capital stock

Date	Fluctuation in the number of shares issued (Thousands of shares)	Balance of shares issued (Thousands of shares)	Fluctuation in capital stock (Millions of yen)	Balance of capital stock (Millions of yen)	Fluctuation in capital reserve (Millions of yen)	Balance of capital reserve (Millions of yen)
July 1, 2012	1,990,000	2,000,000	–	100,000	–	736,400

Note: The Company conducted a share split at a ratio of 200 to one share with July 1, 2012 as effective date. Consequently, the balance of shares issued increased by 1,990,000 thousand shares to 2,000,000 thousand shares.

(6) Shareholder composition

(As of December 31, 2017)

Category	Shareholder composition (100 shares in one share unit)								Shares less than one unit (Share)
	Public sector	Financial institutions	Financial instruments business operators	Other corporations	Foreign investors		Individuals	Total	
					Companies	Individuals			
Number of shareholders (Person)	1	300	81	1,330	963	94	202,009	204,778	–
Number of shares held (Unit)	6,669,262	3,723,232	652,900	203,691	5,487,598	350	3,262,515	19,999,548	45,200
Holding rate of shares (%)	33.35	18.62	3.26	1.02	27.44	0.00	16.31	100.00	–

Notes: 1. 2,089,565 units of treasury shares are included in “Individuals.”

2. The number of “Other corporations” includes 336 units in the name of Japan Securities Depository Center, Inc.

(7) Status of major shareholders

(As of December 31, 2017)

Name of shareholder	Address	Number of shares held (Share)	Percentage of number of shares held in the total number of shares issued (%)
The Minister of Finance	1-1, Kasumigaseki 3-chome, Chiyoda-ku, Tokyo, Japan	666,926,200	33.35
The Master Trust Bank of Japan, Ltd. (Trust Account)	11-3, Hamamatsucho 2-chome, Minato-ku, Tokyo, Japan	72,269,400	3.61
Japan Trustee Services Bank, Ltd. (Trust Account)	8-11, Harumi 1-chome, Chuo-ku, Tokyo, Japan	60,387,900	3.02
GIC Private Limited-C (Standing proxy: The Bank of Tokyo-Mitsubishi UFJ, Ltd.)	168 Robinson Road #37-01 CAPITAL TOWER SINGAPORE 068912 (Transaction Services Division, 7-1, Marunouchi 2-chome Chiyoda-ku, Tokyo, Japan)	37,829,600	1.89
Trust & Custody Services Bank, Ltd. as trustee for Mizuho Bank, Ltd. Retirement Benefit Trust Account re-entrusted by Mizuho Trust and Banking Co., Ltd.	Harumi Island Triton Square Office Tower Z, 8-12, Harumi 1-chome, Chuo-ku, Tokyo, Japan	33,800,000	1.69
State Street Bank and Trust Company 505223 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	P.O. Box 351 Boston Massachusetts 02101 U.S.A. (Shinagawa Intercity Tower A, 15-1, Konan 2-chome, Minato-ku, Tokyo, Japan)	32,751,576	1.64
Japan Trustee Services Bank, Ltd. (Trust Account 5)	8-11, Harumi 1-chome, Chuo-ku, Tokyo, Japan	23,678,900	1.18
State Street Bank and Trust Company (Standing proxy: The Hongkong and Shanghai Banking Corporation Limited, Tokyo Branch)	One Lincoln Street, Boston MA USA 02111 (11-1, Nihonbashi 3-chome, Chuo-ku, Tokyo, Japan)	23,641,185	1.18
State Street Bank West Client - Treaty 505234 (Standing proxy: Mizuho Bank, Ltd., Settlement Sales Department)	1776 Heritage Drive, North Quincy, MA 02171, U.S.A (Shinagawa Intercity Tower A, 15-1, Konan 2-chome, Minato-ku, Tokyo, Japan)	21,021,193	1.05
GIC Private Limited-H (Standing proxy: The Bank of Tokyo-Mitsubishi UFJ, Ltd.)	168 Robinson Road #37-01 CAPITAL TOWER SINGAPORE 068912 (Transaction Services Division, 7-1, Marunouchi 2-chome Chiyoda-ku, Tokyo, Japan)	20,314,500	1.02
Total	–	992,620,454	49.63

Note: In addition to the above, the Company held 208,956,589 shares of ordinary shares as treasury shares.

(8) Status of voting rights

a. Shares issued

(As of December 31, 2017)

Classification	Number of shares (Share)	Number of voting rights	Details
Shares without voting rights	–	–	–
Shares with restricted voting rights (Treasury shares)	–	–	–
Shares with restricted voting rights (Other)	–	–	–
Shares with full voting rights (Treasury shares)	Ordinary shares 208,956,500	–	(Note 2)
Shares with full voting rights (Other)	Ordinary shares 1,790,998,300	17,909,983	(Note 2)
Shares less than one unit	Ordinary shares 45,200	–	(Note 3)
Total number of shares issued	2,000,000,000	–	–
Total number of voting rights	–	17,909,983	–

Notes: 1. The number of "Shares with full voting rights (Other)" includes 33,600 shares in the name of Japan Securities Depository Center, Inc. "Number of voting rights" includes 336 units of voting rights related to shares with full voting rights in its name.

2. The Company's standard class of shares with no rights limitations. Its share trading unit is 100 shares.

3. Includes 89 shares of treasury shares.

b. Treasury shares

(As of December 31, 2017)

Name of shareholder	Address	Number of shares held under own name (Share)	Number of shares held under the name of others (Share)	Total number of shares held (Share)	Percentage of number of shares held in the total number of shares issued (%)
JAPAN TOBACCO INC.	2-1, Toranomon 2-chome, Minato-ku, Tokyo, Japan	208,956,500	–	208,956,500	10.45
Total	–	208,956,500	–	208,956,500	10.45

(9) Stock options

The Company has adopted a system of stock options that involves the issuance of subscription rights to shares in accordance with the Companies Act.

Details are as follows.

(By resolution of the Board of Directors on December 21, 2007)

The Board of Directors on December 21, 2007, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	December 21, 2007
Positions and number of persons granted	Members of the Board 11 persons Executive Officers (excluding persons serving as Member of the Board) 16 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	46,600 shares to Members of the Board, 38,600 shares to Executive Officers, total 85,200 shares (200 shares per subscription right to shares) (Notes 1, 2)
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Notes: 1. In cases where the Company conducts stock split (including stock allotment without contribution; hereinafter, the same shall apply to description of stock split) or stock consolidation of ordinary shares of the Company after the date on which the Company allots subscription rights to shares (hereinafter, “Allotment Date”), the number of shares to which each subscription right to shares applies (hereinafter, “Number of Shares Granted”) shall be adjusted according to the following formula.

$$\text{Number of Shares Granted after adjustment} = \text{Number of Shares Granted before adjustment} \times \text{Ratio of stock split or stock consolidation}$$

Any fraction of less than one share that occurs as a result of the above adjustment shall be rounded down to two decimal places.

In the case of a stock split, the Number of Shares Granted after adjustment shall be applied on and after the date following the base date (if the base date is not specified, on and after the effective date), while in the case of stock consolidation, it shall be applied on and after the effective date. However, in cases where stock split is conducted subject to approval of the proposal to reduce surplus and increase capital or reserve fund at the General Meeting of Shareholders of the Company and where the base date for stock split is set on or before the date of conclusion of that General Meeting of Shareholders, the Number of Shares Granted after adjustment shall be applied retrospectively to the date following that base date, on and after the date following the date of conclusion of that General Meeting of Shareholders.

In addition, in cases where the adjustment of the Number of Shares Granted is proper, the Company shall conduct adjustments deemed necessary after the Allotment Date.

When adjusting the Number of Shares Granted, the Company shall notify holders of subscription rights to shares being recorded in the registry of subscription rights to shares or make public notice of necessary information by the date before the date on which the Number of Shares Granted after adjustment is applied. However, in cases where the notice or public notice by the date before the date of the application is impracticable, the Company shall later do so as soon as possible.

2. The Company conducted a share split at a ratio of 200 to one ordinary share with July 1, 2012 as effective date. As a consequence, the number of shares to be issued upon exercise of the subscription rights to shares issued before this share split has been adjusted from one share to 200 shares and is presented accordingly.

(By resolution of the Board of Directors on September 19, 2008)

The Board of Directors on September 19, 2008, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 19, 2008
Positions and number of persons granted	Members of the Board 11 persons Executive Officers (excluding persons serving as Member of the Board) 14 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	63,000 shares to Members of the Board, 46,400 shares to Executive Officers, total 109,400 shares (200 shares per subscription right to shares) (Notes 1, 2)
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Notes 1. and 2.: Same as Notes 1. and 2. of (By resolution of the Board of Directors on December 21, 2007).

(By resolution of the Board of Directors on September 28, 2009)

The Board of Directors on September 28, 2009, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 28, 2009
Positions and number of persons granted	Members of the Board 9 persons Executive Officers (excluding persons serving as Member of the Board) 14 persons
Class of shares to be issued upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Number of shares	125,200 shares to Members of the Board, 105,400 shares to Executive Officers, total 230,600 shares (200 shares per subscription right to shares) (Notes 1, 2)
Paying due upon exercise of subscription rights to shares	See “(2) Status of subscription rights to shares”
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See “(2) Status of subscription rights to shares”

Notes 1. and 2.: Same as Notes 1. and 2. of (By resolution of the Board of Directors on December 21, 2007).

(By resolution of the Board of Directors on September 17, 2010)

The Board of Directors on September 17, 2010, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 17, 2010
Positions and number of persons granted	Members of the Board 9 persons Executive Officers (excluding persons serving as Member of the Board) 14 persons
Class of shares to be issued upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Number of shares	104,200 shares to Members of the Board, 91,600 shares to Executive Officers, total 195,800 shares (200 shares per subscription right to shares) (Notes 1, 2)
Paying due upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See "(2) Status of subscription rights to shares"

Notes 1. and 2.: Same as Notes 1. and 2. of (By resolution of the Board of Directors on December 21, 2007).

(By resolution of the Board of Directors on September 16, 2011)

The Board of Directors on September 16, 2011, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 16, 2011
Positions and number of persons granted	Members of the Board 8 persons Executive Officers (excluding persons serving as Member of the Board) 15 persons
Class of shares to be issued upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Number of shares	102,800 shares to Members of the Board, 104,800 shares to Executive Officers, total 207,600 shares (200 shares per subscription right to shares) (Notes 1, 2)
Paying due upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See "(2) Status of subscription rights to shares"

Notes 1. and 2.: Same as Notes 1. and 2. of (By resolution of the Board of Directors on December 21, 2007).

(By resolution of the Board of Directors on September 21, 2012)

The Board of Directors on September 21, 2012, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 21, 2012
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 7 persons Executive Officers (excluding persons serving as Member of the Board) 17 persons
Class of shares to be issued upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Number of shares	65,600 shares to Members of the Board (excluding Outside Directors), 80,200 shares to Executive Officers, total 145,800 shares (200 shares per subscription right to shares) (Note)
Paying due upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See "(2) Status of subscription rights to shares"

Note: Same as Note 1. of (By resolution of the Board of Directors on December 21, 2007).

(By resolution of the Board of Directors on September 20, 2013)

The Board of Directors on September 20, 2013, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 20, 2013
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 7 persons Executive Officers (excluding persons serving as Member of the Board) 19 persons
Class of shares to be issued upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Number of shares	42,000 shares to Members of the Board (excluding Outside Directors), 58,000 shares to Executive Officers, total 100,000 shares (200 shares per subscription right to shares) (Note)
Paying due upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See "(2) Status of subscription rights to shares"

Note: Same as Note 1. of (By resolution of the Board of Directors on December 21, 2007).

(By resolution of the Board of Directors on September 19, 2014)

The Board of Directors on September 19, 2014, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	September 19, 2014
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 6 persons Executive Officers (excluding persons serving as Member of the Board) 19 persons
Class of shares to be issued upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Number of shares	35,600 shares to Members of the Board (excluding Outside Directors), 33,200 shares to Executive Officers, total 68,800 shares (200 shares per subscription right to shares) (Note)
Paying due upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See "(2) Status of subscription rights to shares"

Note: Same as Note 1. of (By resolution of the Board of Directors on December 21, 2007).

(By resolution of the Board of Directors on July 17, 2015)

The Board of Directors on July 17, 2015, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	July 17, 2015
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 6 persons Executive Officers (excluding persons serving as Member of the Board) 18 persons
Class of shares to be issued upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Number of shares	49,000 shares to Members of the Board (excluding Outside Directors), 66,200 shares to Executive Officers, total 115,200 shares (200 shares per subscription right to shares) (Note)
Paying due upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See "(2) Status of subscription rights to shares"

Note: Same as Note 1. of (By resolution of the Board of Directors on December 21, 2007).

(By resolution of the Board of Directors on June 17, 2016)

The Board of Directors on June 17, 2016, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	June 17, 2016
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 5 persons Executive Officers (excluding persons serving as Member of the Board) 18 persons
Class of shares to be issued upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Number of shares	34,200 shares to Members of the Board (excluding Outside Directors), 51,800 shares to Executive Officers, total 86,000 shares (200 shares per subscription right to shares) (Note)
Paying due upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See "(2) Status of subscription rights to shares"

Note: Same as Note 1. of (By resolution of the Board of Directors on December 21, 2007).

(By resolution of the Board of Directors on June 14, 2017)

The Board of Directors on June 14, 2017, resolved to issue subscription rights to shares as share remuneration type stock options to the Members of the Board (excluding Outside Directors) and Executive Officers of the Company in accordance with the Companies Act.

Resolution date	June 14, 2017
Positions and number of persons granted	Members of the Board (excluding Outside Directors) 5 persons Executive Officers (excluding persons serving as Member of the Board) 19 persons
Class of shares to be issued upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Number of shares	53,000 shares to Members of the Board (excluding Outside Directors), 89,400 shares to Executive Officers, total 142,400 shares (200 shares per subscription right to shares) (Note)
Paying due upon exercise of subscription rights to shares	See "(2) Status of subscription rights to shares"
Exercise period of subscription rights to shares	Same as above
Conditions for exercising subscription rights to shares	Same as above
Assignment of subscription rights to shares	Same as above
Matters regarding surrogate payments	–
Matters regarding delivery of subscription rights to shares accompanied by reorganization	See "(2) Status of subscription rights to shares"

Note: Same as Note 1. of (By resolution of the Board of Directors on December 21, 2007).

2. Acquisition of treasury shares

[Class of shares] Acquisition of ordinary shares falling under Article 155, item (vii) of the Companies Act

(1) Acquisition by resolution of the General Meeting of Shareholders

No items to report

(2) Acquisition by resolution of the Board of Directors

No items to report

(3) Items not based on resolutions of the General Meeting of Shareholders or Board of Directors

Category	Number of shares (Share)	Total value (Millions of yen)
Treasury shares acquired during this fiscal year ended December 31, 2017	322	1
Treasury shares acquired during the period from January 1, 2018 to the filing date of this Annual Securities Report	–	–

Note: The figure for treasury shares acquired during the period from January 1, 2018 to the filing date of this Annual Securities Report does not include the number of shares from purchases of shares less than one unit from March 1, 2018 until the filing date of this Annual Securities Report.

(4) Status of disposal and ownership of acquired treasury shares

Category	Fiscal year ended December 31, 2017		From January 1, 2018 until the filing date of this Annual Securities Report	
	Number of shares (Share)	Total disposal value (Millions of yen)	Number of shares (Share)	Total disposal value (Millions of yen)
Acquired treasury shares offered for subscription	–	–	–	–
Acquired treasury shares that were cancelled	–	–	–	–
Acquired treasury shares transferred for merger, share exchange and company split	–	–	–	–
Others (exercise of subscription rights to shares)	88,000	187	39,200	83
(Sales resulting from requests for sale of shares less than one unit)	–	–	–	–
Treasury shares held	208,956,589	–	208,917,389	–

Notes: 1. The number of disposed shares and total disposal value in the “From January 1, 2018 until the filing date of this Annual Securities Report” column does not include transfers by the exercise of subscription rights to shares performed from March 1, 2018 until the filing date of this Annual Securities Report, nor does it include sales of shares less than one unit during that period.

2. The number of treasury shares held in the “From January 1, 2018 until the filing date of this Annual Securities Report” column does not include transfers by the exercise of subscription rights to shares performed from March 1, 2018 until the filing date of this Annual Securities Report, nor does it include purchases and sales of shares less than one unit during that period.

3. Dividend policy

With regard to shareholder return policies, the Group will pursue enhanced shareholder returns in proportion to the mid- to long-term profit growth by continually making proactive business investments while maintaining a strong financial base that enables response to any possible environmental changes.

Specifically, the Group will work toward stable and consistent growth in dividend per share. Whether to execute the acquisition of treasury shares will be considered in view of factors including the medium-term outlook on business environment and financial positions.

The Company will also continue to monitor a trend in shareholder returns of global FMCG companies.

It is also a basic policy of the Company to pay an interim dividend and year-end dividend, with the former determined by the Board of Directors and the latter by the General Meeting of Shareholders. The Company’s Articles of Incorporation stipulate that the Company may pay interim dividends to shareholders with the record date of June 30 each year upon a resolution by the Board of Directors.

In light of business performance in the current fiscal year ended December 31, 2017, the year-end dividend for the fiscal year ended December 31, 2017 was ¥70 per share. Therefore, the total annual dividend for the fiscal year ended December 31, 2017, including the interim dividend of ¥70, is ¥140 per share.

Also, internal reserves will be prepared not only for present and future business investments and to acquire external resources but also for the purchase of treasury shares and other objectives.

The dividend for the 33rd term is as follows.

Resolution date	Total amount of dividends (Millions of yen)	Cash dividends per share (Yen)
The Board of Directors on August 2, 2017	125,369	70.00
Ordinary General Meeting of Shareholders held on March 27, 2018	125,373	70.00

4. Trends in Share Price

(1) Highest and lowest share prices for the most recent 5 years by term

Term	28th term	29th term	30th term	31st term	32nd term	33rd term
Accounting period	From April 1, 2012 to March 31, 2013	From April 1, 2013 to March 31, 2014	From April 1, 2014 to December 31, 2014	From January 1, 2015 to December 31, 2015	From January 1, 2016 to December 31, 2016	From January 1, 2017 to December 31, 2017
Highest (Yen)	490,500 *3,240	3,835	4,193	4,848	4,850	4,243
Lowest (Yen)	406,500 *2,108	2,850	3,097	3,101	3,627	3,607

Notes: 1. The yearly highest and lowest share prices were those recorded on the first section of the Tokyo Stock Exchange.

2. The Company conducted a share split at a ratio of 200 to one share with July 1, 2012 as effective date. Numbers marked with * are the highest and lowest share prices on an ex-rights basis in accordance with the share split.

3. The 30th term is the 9-month period from April 1, 2014 to December 31, 2014, due to a change of the fiscal year end.

(2) Monthly highest and lowest share prices for the most recent 6 months

Month	July 2017	August 2017	September 2017	October 2017	November 2017	December 2017
Highest (Yen)	3,992	3,876	3,796	3,902	3,868	3,786
Lowest (Yen)	3,723	3,655	3,641	3,675	3,686	3,626

Note: The monthly highest and lowest share prices were those recorded on the first section of the Tokyo Stock Exchange.

5. Status of officers

There are nine male officers and two female officers (18.2% of the officers are women).

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Chairman of the Board		Yasutake Tango	March 21, 1951	April 1974 Entered Ministry of Finance October 2006 Director-General of the Financial Bureau July 2007 Deputy Vice Minister July 2008 Director-General of the Budget Bureau July 2009 Administrative Vice Minister July 2010 Retired from the office of Administrative Vice Minister December 2010 Corporate Auditor, The Yomiuri Shimbun Holdings December 2012 Special Advisor to the Cabinet April 2014 Retired from Special Advisor to the Cabinet June 2014 Chairman of the Board, the Company (Current Position) (Significant Concurrent Positions outside the Company) Outside Director, The Ogaki Kyoritsu Bank, Ltd.	2 years since March 2018	5,300
* President, Chief Executive Officer and Representative Director		Masamichi Terabatake	November 26, 1965	April 1989 Joined the Company July 2005 Vice President, Secretary's Office July 2008 Vice President, Corporate Strategy Division June 2011 Senior Vice President, Chief Strategy Officer and in charge of Food Business, Vice President, Corporate Strategy Division March 2012 Senior Vice President, Chief Strategy Officer and in charge of Food Business June 2012 Senior Vice President, Chief Strategy Officer June 2013 Member of the Board Executive Vice President, JT International S.A. January 2018 President and Chief Executive Officer, the Company March 2018 President, Chief Executive Officer and Representative Director (Current Position)	2 years since March 2018	17,400

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
* Executive Vice President and Representative Director		Mutsuo Iwai	October 29, 1960	April 1983 Joined the Company (Japan Tobacco and Salt Public Corporation) June 2003 Vice President of Corporate Strategy Division July 2004 Vice President of Corporate Strategy Division June 2005 Senior Vice President, and Vice President of Food Business Division, Food Business June 2006 Member of the Board, Executive Vice President, and President, Food Business June 2008 Executive Vice President, and Chief Strategy Officer June 2010 Member of the Board, Senior Vice President, and Chief Strategy Officer and Assistant to CEO in Food Business June 2011 Member of the Board Executive Vice President, JT International S.A. June 2013 Senior Executive Vice President, and Chief Strategy Officer January 2016 Senior Executive Vice President, and President, Tobacco Business Headquarters March 2016 Executive Vice President and Representative Director (Current Position) (Significant Concurrent Positions outside the Company) Chairman, JT International Group Holding B.V.	2 years since March 2018	22,200
* Executive Vice President and Representative Director		Naohiro Minami	January 21, 1964	April 1986 Joined the Company December 2005 Controller July 2010 Deputy Financial Officer and Controller June 2012 Senior Vice President, Chief Finance Officer and Controller July 2012 Senior Vice President, Chief Finance Officer January 2018 Executive Vice President March 2018 Executive Vice President and Representative Director (Current Position) (Significant Concurrent Positions outside the Company) Supervisory Director, JT International Holding B.V.	2 years since March 2018	11,300
* Executive Vice President and Representative Director		Kiyohide Hirowatari	November 11, 1965	April 1989 Joined the Company July 2010 Vice President, Legal Division June 2012 Senior Vice President, Chief Legal Officer and Vice President, Legal Division July 2014 Senior Vice President, Chief Legal Officer January 2015 Senior Vice President, Head of Tobacco Business Planning Division, Tobacco Business January 2017 Senior Vice President, Human Resources January 2018 Executive Vice President March 2018 Executive Vice President and Representative Director (Current Position)	2 years since March 2018	4,400

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Member of the Board		Main Kohda	April 25, 1951	September 1995 Started independently as Novelist January 2003 Member of Financial System Council, Ministry of Finance Japan April 2004 Visiting professor, Faculty of Economics, Shiga University March 2005 Member of the Council for Transport Policy, Ministry of Land, Infrastructure, Transport and Tourism November 2006 Member of the Tax Commission, Cabinet Office, Government of Japan June 2010 Member of the Board of Governors, Japan Broadcasting Corporation June 2012 Outside Member of the Board, the Company (Current Position) (Significant Concurrent Positions outside the Company) Novelist Outside Director, LIXIL Group Corporation Outside Director, Japan Exchange Group, Inc.	2 years since March 2018	0
Member of the Board		Koichiro Watanabe	April 16, 1953	April 1976 Joined The Dai-ichi Mutual Life Insurance Company July 2001 Director, The Dai-ichi Mutual Life Insurance Company April 2004 Managing Director, The Dai-ichi Mutual Life Insurance Company July 2004 Managing Executive Officer, The Dai-ichi Mutual Life Insurance Company July 2007 Director and, Managing Executive Officer, The Dai-ichi Mutual Life Insurance Company April 2008 Director and, Senior Managing Executive Officer, The Dai-ichi Mutual Life Insurance Company April 2010 Representative Director and President, The Dai-ichi Life Insurance Company, Limited October 2016 Representative Director and President, Dai-ichi Life Holdings, Inc. April 2017 Representative Director and Chairman of the Board, Dai-ichi Life Holdings, Inc. (Current Position) Representative Director and Chairman of the Board, The Dai-ichi Life Insurance Company, Limited (Current Position) March 2018 Outside Member of the Board, the Company (Current Position) (Significant Concurrent Positions outside the Company) Representative Director and Chairman of the Board, Dai-ichi Life Holdings, Inc. Representative Director and Chairman of the Board, The Dai-ichi Life Insurance Company, Limited	2 years since March 2018	0

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Audit & Supervisory Board Member		Tomotaka Kojima	December 19, 1953	April 1976 Joined Ministry of Finance July 2000 Director of the Fukuoka Local Finance Branch Bureau July 2002 Deputy Head of Finance Group of the Company July 2004 Deputy Director General of Employee Welfare Bureau, Secretariat of National Personnel Authority April 2007 Deputy Director General for Administrative Policy Matters, National Personnel Authority January 2008 Director General of Equity and Investigation Bureau, Secretariat of National Personnel Authority August 2009 Executive Director, National Hospital Organization November 2010 Executive Secretary, Japan Association of Corporate Directors June 2013 Standing Audit & Supervisory Board Member, the Company (Current Position)	4 years since March 2015	0
Audit & Supervisory Board Member		Ryoko Nagata	July 14, 1963	April 1987 Joined the Company April 2001 Vice President, Products Division, Food Business Division, Food Business June 2008 Senior Vice President, Head of Beverage Business Division and Vice President, Products Division, Food Business Division, Food Business July 2008 Senior Vice President, Head of Beverage Business, Food Business July 2010 Senior Vice President, Head of Beverage Business June 2013 Senior Vice President, CSR January 2018 Senior Vice President, Assistant to President March 2018 Standing Audit & Supervisory Board Member (Current Position)	1 year since March 2018	12,000
Audit & Supervisory Board Member		Yoshinori Imai	December 3, 1944	April 1968 Joined Japan Broadcasting Corporation June 1995 Bureau Chief of General Bureau for Europe May 2000 Director General, Planning & Broadcasting Department June 2003 Executive Editor and Programme Host January 2008 Executive Vice President January 2011 Retired from Executive Vice President April 2011 Visiting Professor, Ritsumeikan University (Current Position) June 2011 Outside Audit & Supervisory Board Member, the Company (Current Position)	4 years since March 2015	700

Title	Post	Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Audit & Supervisory Board Member		Hiroshi Obayashi	June 17, 1947	April 1970 Judicial Apprentice April 1972 Appointed as Public Prosecutor May 2001 Director-General of the Rehabilitation Bureau, Ministry of Justice January 2002 Deputy Vice-Minister of Justice June 2004 Director-General of the Criminal Affairs Bureau June 2006 Vice-Minister of Justice July 2007 Superintending Prosecutor, Sapporo High Public Prosecutors Office July 2008 Superintending Prosecutor, Tokyo High Public Prosecutors Office June 2010 Prosecutor-General December 2010 Retired from the office of Prosecutor-General March 2011 Registered as Attorney at Law March 2015 Outside Audit & Supervisory Board Member, the Company (Current Position) (Significant Concurrent Positions outside the Company) Attorney at Law, Obayashi Law Office Outside Audit & Supervisory Board Member, Daiwa Securities Co., Ltd. Outside Director, Mitsubishi Electric Corporation Outside Audit & Supervisory Board Member, NIPPON STEEL & SUMITOMO METAL CORPORATION	4 years since March 2015	0
Total						73,300

Notes: 1. Members of the Board Main Kohda and Koichiro Watanabe are Outside Directors.

2. Audit & Supervisory Board Members Yoshinori Imai and Hiroshi Obayashi are Outside Audit & Supervisory Board Members.

3. Persons with the title marked with * concurrently serve as Executive Officer.

4. In preparation against a situation where the number of Audit & Supervisory Board Members falls below the statutory required number, the Company appointed one Substitute Audit & Supervisory Board Member as stipulated in Article 329, paragraph 3 of the Companies Act. The summary of the career of the Substitute Audit & Supervisory Board Member is as follows.

Name	Date of birth	Summary of career	Term of office	Number of shares held (Share)
Michio Masaki	February 20, 1961	April 1987 Judicial Apprentice April 1989 Appointed as Public Prosecutor July 2003 Head of Takasaki Branch, Maebashi District Public Prosecutors Office April 2004 Registered as Attorney at Law (Significant Concurrent Positions outside the Company) Attorney at Law, City-Yuwa Partners Outside Director, Hamai Co., Ltd.	(Note)	0

Note: If the Substitute Audit & Supervisory Board Member assumes office as Audit & Supervisory Board Member, his term of office shall be from the time of his assumption of office until the expiration of the term of office of the Audit & Supervisory Board Member who retired.

5. The Company has introduced the Executive Officer System in June 2001 in order to realize prompt and proper decision-making and business execution. The following 22 persons were appointed effective March 27, 2018.

Title	Name	Post
President	Masamichi Terabatake	Chief Executive Officer
Executive Vice President	Mutsuo Iwai	President, Tobacco Business
Executive Vice President	Naohiro Minami	Chief Finance Officer, Communications
Executive Vice President	Kiyohide Hirowatari	Compliance, General Affairs, Legal, Corporate Strategy, IT, CSR, HR and Operation Review & Business Assurance
Senior Vice President	Ryoji Chijiiwa	Compliance and General Affairs
Senior Vice President	Chito Sasaki	President, Japanese Tobacco Business, Tobacco Business
Senior Vice President	Kazuhito Yamashita	Head of China Division, Tobacco Business
Senior Vice President	Shiroji Maeda	Chief Marketing & Sales Officer, Tobacco Business
Senior Vice President	Junichi Fukuchi	Corporate, Scientific & Regulatory Affairs Division, Tobacco Business
Senior Vice President	Takehisa Shibayama	Chief R&D Officer, Tobacco Business
Senior Vice President	Hirakazu Otomo	Manufacturing Group, Tobacco Business
Senior Vice President	Kenji Ogura	Head of Leaf Procurement Group, Tobacco Business
Senior Vice President	Hiroyuki Ikuma	Head of Quality Assurance Group, Tobacco Business
Senior Vice President	Muneaki Fujimoto	President, Pharmaceutical Business
Senior Vice President	Shigenori Ohkawa	Head of Central Pharmaceutical Research Institute, Pharmaceutical Business
Senior Vice President	Haruhiko Yamada	Legal
Senior Vice President	Yuki Maeda	Corporate Strategy and IT
Senior Vice President	Takehiko Tsutsui	Business Development
Senior Vice President	Kei Nakano	Communications
Senior Vice President	Takanori Kikuchi	General Affairs
Senior Vice President	Chigusa Ogawa	CSR
Senior Vice President	Koichi Mori	HR

6. Status of corporate governance

(1) Status of corporate governance

Whereas the following contains statements regarding the fiscal year ended December 31, 2017, the final day of that fiscal year, and the fiscal year ended December 31, 2016, the statements herein are current as of the filing date, unless otherwise indicated.

a. Basic concept on the corporate governance

The Company's belief is that corporate governance is the means for conducting transparent, fair, timely and decisive decision-making for pursuing the Company's management principle, the "4S model." Specifically the 4S model aims "to fulfill our responsibilities to our valued consumers, shareholders, employees and the wider society, carefully considering the respective interests of these four key stakeholder groups, and exceeding their expectations wherever we can."

The Company has set out the "JT Corporate Governance Policy," and strives to make enhancements based on its belief that it will enable the Group to achieve mid- to long-term sustainable profit growth and increase corporate value, which will contribute to the development of the Group's stakeholders and eventually the economic society as a whole. The Company will continue to strive to make enhancements of its corporate governance as one of the key challenges for its management.

b. Organization of the Company

In addition to opting to be a company with Audit & Supervisory Board, the Company seeks to enhance corporate governance through the utilization of voluntary structures such as the establishment of the Compensation Advisory Panel, which is largely composed of the Outside Directors and the Outside Audit & Supervisory Board Members, and the JT Group Compliance Committee, which is largely composed of outside committee members, from a viewpoint of creating an effective governance system.

The Board of Directors meets once a month in principle and on more occasions as necessary, in order to make decisions with regard to the matters specified by laws and regulations and other important matters, to supervise implementation of business and to receive reports from the Members of the Board on the status of implementation of business. In addition, the Chairman of the Board has been positioned as a non-executive Director in order to concentrate on supervising management while also serving as the chairman of the Board of Directors. The Company appoints at least two Outside Directors who possess the qualities to contribute to sustained profit growth and enhancement of corporate value over the mid- to long-term from a viewpoint of strengthening the supervising function and management transparency.

The Board of Directors has set forth in the Board of Directors Regulations matters to be discussed at the Board of Directors meetings. In addition, from the viewpoint of realizing swift decision making and high-quality implementation of business, the Board of Directors has set forth a clear decision-making process based on internal rules on the allocation of responsibilities and authorities (hereinafter referred to as the "Responsibilities/Authorities Allocation Rules") concerning essential business matters as well as delegates authority as necessary to Executive Officers based on company-wide management strategies, under the Executive Officer system.

The Company has adopted the Audit & Supervisory Board system under which Audit & Supervisory Board Members of the Company (hereinafter simply "Audit & Supervisory Board Members," with the terms "Audit & Supervisory Board," "Audit & Supervisory Board Member's Office," and "Manager of the Audit & Supervisory Board Member's Office" also referring to those items within the Company) assertively exercise authority as an independent body with the mandate of shareholders, which includes attending and speaking at the Board of Directors meetings and other important meetings as well as actively inspecting business sites. In addition, they also perform audits appropriately from an objective viewpoint in accordance with the characteristics of the duties of the Outside Audit & Supervisory Board Members and the standing Audit & Supervisory Board Members. The Audit & Supervisory Board Members work to ensure sound and sustainable growth and maintain and enhance public trust in the Company by examining the performance of duties by Members of the Board and Executive Officers.

The Audit & Supervisory Board is composed of members with substantial knowledge of management, law, finance, accounting and other aspects of business. Standing Audit & Supervisory Board Member, Mr. Tomotaka Kojima, is eligible as an Audit & Supervisory Board Member because he has not only profound expertise and experience concerning financial and accounting affairs including his past experience as Deputy Head of Finance Group of the Company, but also wide-ranging governmental experience and knowledge of corporate governance through his experience at the Japan Association of Corporate Directors. In addition, standing Audit & Supervisory Board Member, Ms. Ryoko Nagata has served as Senior Vice President, Beverage Business Division and in charge of CSR, etc., and has abundant experience and wide-ranging insights with regard to the Group's business operations from the perspective both of the business operations and the internal department. In preparation against a situation where the number of Audit & Supervisory Board Members falls below the statutory required number, one Substitute Audit & Supervisory Board Member as stipulated in Article 329, paragraph 3 of the Companies Act is elected.

c. Implementation status of internal control system, risk management system and systems necessary to ensure the properness of operations in subsidiaries

The Company has always endeavored to run an internal control system of the Company and the Group through initiatives in such areas as compliance, internal audits, and risk management. Moreover, the Company has created the systems required under the Companies Act and the Ordinance for the Enforcement of the Companies Act by implementing measures aimed at ensuring the effectiveness of audits by Audit & Supervisory Board Members. The Company will work to maintain and enhance the systems in each company while consecutively reviewing and revising the current system as necessary, and ensure appropriate implementation of business. For the foreign subsidiaries, the Company builds and operates the necessary system in conformity with the following provisions concerning subsidiaries, in principle, while complying with the laws and regulations in the country in which the subsidiary is incorporated.

- Systems to ensure that the performance of duties by the Members of the Board and employees of the Company, as well as by Directors, etc. and employees of subsidiaries (with Members of the Board, etc. Directors, etc., and employees hereinafter collectively referred to as "directors and employees"), conforms to laws, regulations, and the Articles of Incorporation

  With regard to the compliance system, the Company and its subsidiaries have established the code of conduct based on internal rules concerning compliance system in order to ensure that directors and employees of the Company and its subsidiaries comply with laws and regulations, respective Articles of Incorporation, the social norms, etc., and set up the JT Group Compliance Committee as an organization responsible for ensuring thorough compliance. This committee, headed by the Chairman of the Board, consists mainly of outside members. Meanwhile, the Company appoints an Executive Officer (*sikkoyakuin*) in charge of compliance with overseeing the Compliance Office in an effort to establish and promote a group-wide, cross-sectional system and shed light on issues. The compliance promotion departments of the Company and its subsidiaries (meaning the Compliance Office within the Company, and corresponding departments within subsidiaries) distribute materials including the "JT Group Code of Conduct," which explains the Code of Conduct, etc., to directors and employees, and work to enhance the effectiveness of the compliance system by enlightening directors and employees about compliance through training and other programs, etc.

  Regarding the internal reporting system (whistle-blower system), each of the Company and its subsidiaries has a counter inside and outside the company through which employees and others may consult or report in case that they detect any conduct, etc. that may violate laws and regulations. Compliance promotion departments that receive a report or request for consultation investigate the details and take necessary action, while working to prevent recurrence of the issue. The Company will bring matters of particular importance involving the Group to the JT Group Compliance Committee, and will request deliberation or will report on the issue.

  Under the system for excluding anti-social elements, the Company and its subsidiaries are resolved to fight against them, not to comply with an unreasonable demand and not to have any relations with them. Designating the General Administration Division of the Company as the department assuming the responsibility for supervising efforts to exclude anti-social elements at the Group level, the Company cooperates with police, lawyers and other relevant organizations and parties to gather and share information in order to deal with such elements in an organized way. The Company also consistently makes enlightening activities to eliminate anti-social forces by making directors and employees of the Company and its subsidiaries informed about the rules not to have any relations with anti-social groups and organizations and by educating the directors and employees through providing relevant training as necessary.

  In order to ensure the reliability of financial reporting of the Group, the Company is operating a relevant internal control system that it has established in accordance with the Financial Instruments and Exchange Act. By allocating a sufficient level of staff to the task of evaluating financial results and reporting them, the company is striving to maintain and improve the reliability of its financial reporting.

The internal audit system is overseen by the Operational Review and Business Assurance Division of the Company (17 persons as of December 31, 2017), which examines and evaluates systems for supervising and managing the overall operations and the status of business execution from the viewpoints of legality and rationality, in order to protect the Company's assets and improve management efficiency. In coordination with the internal audit functions of all subsidiaries, the Operational Review and Business Assurance Division also undertakes the planning and performance of the Group's internal audit systems and policies, and supplements the internal audit functions of subsidiaries.

- Procedures and arrangements for storage and management of information on the performance of duties by the Members of the Board of the Company

  The Company makes sure to properly store and manage the minutes of General Meetings of Shareholders and meetings of the Board of Directors in line with laws and regulations. The Company makes sure that the information on important matters relating to business execution and decision-making including the conclusion of corporate contracts is stored and managed by the relevant departments and divisions as specified by the Responsibilities/Authorities Allocation Rules, and establishes rules on managing the processes of decision-making, procurement and accounting.

- System for reporting matters concerning the performance of duties by Directors, etc. of subsidiaries to the Company

  The Company makes subsidiaries to regularly report important information to the Company's departments and divisions that are in charge of the subsidiaries.

- Rules on management of risk of loss of the Company and its subsidiaries, and procedures/arrangements for other matters

  The Company has established internal policies, rules and manuals relating to the Group for the management of risk of loss relating to monetary and financial affairs, and ensures that relevant reports are made to the President and Chief Executive Officer and the Board of Directors on a quarterly basis via Chief Financial Officer. With regard to the risk of loss relating to other affairs, in accordance with authority delegated to each department and division as per the Responsibilities/Authorities Allocation Rules, responsible departments and divisions take on a supervisory role creating all types of committees to conduct proper management and, depending on the level of importance, report risks to the President and Chief Executive Officer and obtain approval for countermeasures.

  In cooperation with the internal audit functions of subsidiaries, the Operational Review and Business Assurance Division of the Company examines and evaluates the internal control systems, etc. of the Group companies in light of the level of importance and the risks involved, and from an objective standpoint that is independent of organizations responsible for business execution. It provides reports and counsel to the President and Chief Executive Officer and also reports to the Board of Directors.

  To prepare for possible emergencies, the Company has produced a manual for crisis management and disaster response. In the event of an emergency or a disaster, the Company is ready to establish an emergency project system, and make prompt and proper responses under the leadership of senior management and through close cooperation between the relevant departments and divisions and subsidiaries. Events to which a response has been made and the details of such events shall be reported to the Board of Directors.

- System to ensure that Members of the Board of the Company and Directors, etc. of its subsidiaries can perform their duties efficiently

  The Board of Directors of the Company meets once a month in principle and on more occasions as necessary, in order to make decisions with regard to the matters specified by laws and regulations and other important matters and to supervise business execution. The Board of Directors of the Company receives reports from Members of the Board of the Company on the status of business execution at least once every three months. For important management issues, particularly management policy and basic plans regarding overall business operations of the Company, in addition to matters to be referred to the Board of Directors of the Company, a clear decision-making process is stipulated in the Responsibilities/Authorities Allocation Rules to have a system that enables to realize swift decision-making and high-quality business execution. The Company has adopted the Executive Officer System, under which Executive Officers appointed by the Company's Board of

Directors execute business properly by exercising the authority delegated to them in their respective areas, in accordance with company-wide management strategies decided by the Board. In order to manage business operations in ways that contribute to the business efficiency and flexibility of the Company, basic matters concerning the Company's organization, allocation of duties to officers and staff and the roles of individual divisions are specified by the relevant internal rules.

The Company has been constructing an efficient system for business execution within the Group through the formulation, etc. of rules and policies that apply to the Group.

- Systems necessary to ensure the properness of operations in the Company and the Group

The Group has set itself the mission of creating, developing and nurturing its unique brands to win consumer trust, while understanding and respecting the environment and the diversity of societies and individuals, and there is a group-wide consensus on the mission. The Company has specified the functions and rules common for the Group to effectuate group management that optimizes the operations of the entire Group. Moreover, the Company has been putting in place systems for compliance (including the internal reporting system), internal audits, financial affairs management, etc. in cooperation with its subsidiaries.

- Matters for employees assisting Audit & Supervisory Board Members in their duties in the event such employees were requested by Audit & Supervisory Board Members

The Company has allocated sufficient staff to the Audit & Supervisory Board Member's Office (four persons as of December 31, 2017) as an organization supporting the Audit & Supervisory Board Members in performing their duties. In addition, the Company makes sure to review and reform the staffing structure as necessary based on consultations with the Audit & Supervisory Board.

- Matters relating to the independence of employees belonging to the Audit & Supervisory Board Member's Office from the Company's Members of the Board, and matters relating to the assurance of the effectiveness of instruction by Audit & Supervisory Board Members to those employees

The evaluation of the Manager of the Audit & Supervisory Board Member's Office is made by the Audit & Supervisory Board and the evaluation of the other employees assigned to the Audit & Supervisory Board Member's Office is made by the Manager of the Audit & Supervisory Board Member's Office based on the advice of the Audit & Supervisory Board. The transfer and discipline of employees assigned to the Audit & Supervisory Board Member's Office is to be deliberated in advance with the Audit & Supervisory Board.

The Company makes the employees belonging to the Audit & Supervisory Board Member's Office follow the direction and orders of Audit & Supervisory Board Members in assisting the duties of the latter, and not be assigned to other concurrent positions relating to the business execution of the Company.

- System for reporting by directors and employees of the Company and its subsidiaries or persons reported by directors and employees of its subsidiaries to the Audit & Supervisory Board and Audit & Supervisory Board Members

When directors and employees of the Company and its subsidiaries detect any evidence of malfeasance in financial documents or serious breaches of laws and regulations or the Company's Articles of Incorporation, they are due to report them to the Audit & Supervisory Board, along with other relevant matters that could affect the Company's management. In addition, when directors and employees of the Company and its subsidiaries are asked by Audit & Supervisory Board Members to compile important documents for their perusal, to accept field audits and to submit reports, they are due to respond to the request in a prompt and appropriate manner.

The Compliance Office makes reports regularly to Audit & Supervisory Board Members on the status of whistleblowing involving the Group, and makes non-regular reports as necessary.

- System to ensure that persons reporting to Audit & Supervisory Board Members are not subject to disadvantageous treatment due to having reported

The Company thoroughly communicates within the Group that persons engaging in consultation or whistleblowing are not to be subject to any disadvantageous treatment for reason of those actions.

- Matters concerning policies for the prepayment of expenses involving the performance of duties by Audit & Supervisory Board Members, procedures for reimbursement, and the handling of other expenses or debts involving the performance of those duties

  When an Audit & Supervisory Board Member has made claim to the Company for the prepayment of expenses, etc. in accordance with Article 388 of the Companies Act, the Company will promptly handle the relevant expenses or debt, with the exception of cases in which the Company deems the claimed expenses or debt to be unnecessary to the performance of the duties of the Audit & Supervisory Board Member.

  The Company makes a budget covering audit-related expenses so as to secure effectiveness of audits by Audit & Supervisory Board Members. The Company also bears the portion of miscellaneous expenses for audits by Audit & Supervisory Board Members that are in excess of budget, with the exception of cases in which the Company deems the expenses to be unnecessary to the performance of duties.

- Other systems to ensure effective auditing by Audit & Supervisory Board Members

  Audit & Supervisory Board Members are allowed to attend not only meetings of the Board of Directors of the Company but also other important meetings of the Company. The Operational Review and Business Assurance Division and the Compliance Office maintain cooperation with Audit & Supervisory Board Members by exchanging information.

d. Implementation status of accounting audits

The Company, in order to ensure the Independent Auditor's appropriate audit, secures sufficient time for audit enabling high-quality audit and provide the Independent Auditor with opportunities to contact Members of the Board and Executive Officers, as well as provide appropriate auditing environment enabling sufficient cooperation between the Independent Auditor and Audit & Supervisory Board Members, the internal auditing division and Outside Directors. Further, in the event that an Independent Auditor indicates a deficiency or problem or discovers misconduct, the Company shall appropriately take measures correspondingly.

The Audit & Supervisory Board has established the "Standards for Evaluating and Selecting Independent Auditor." The evaluation and selection of Independent Auditor are conducted in accordance with said standards, and are based on a comprehensive judgment, considering the various factors such as independence from the Company, degree of expertise, adequate experience, size and overseas network which enables efficient implementation of accounting services corresponding to the Company's broad range of business, well established auditing system, fair and reasonable audit plans and expenses.

The Company has employed Deloitte Touche Tohmatsu LLC as its Independent Auditor and Deloitte Touche Tohmatsu LLC has conducted audits based on the Companies Act and the Financial Instruments and Exchange Act. The certified public accountants who audited the Company's financial statements for the fiscal year ended December 31, 2017 and the persons who assisted the auditing work are as follows.

(Certified public accountants)
Masahiko Tezuka, Yasuhiko Haga, Takehisa Ohashi, Yoichi Matsushita

All of the certified public accountants have spent not more than 7 years auditing the Company, and as such figures for continuous audit years have been omitted.

(Assistants for the accounting audit work)
Certified public accountants: 9 persons, Junior accountants: 5 persons, Others: 11 persons

While Audit & Supervisory Board Members, internal audit organizations including the Operational Review and Business Assurance Division, and the Independent Auditor conduct audits individually, they endeavor to enhance their cooperation in order to ensure appropriate audits, for example by sharing information on the results of their respective audits. Also, Audit & Supervisory Board Members, internal audit organizations including the Operational Review and Business Assurance Division, and the Independent Auditor cooperate with the Company's Internal Control Division to ensure appropriate implementation of business by exchanging information when necessary.

e. Outside Directors and Outside Audit & Supervisory Board Members

- Numbers of Outside Directors and Outside Audit & Supervisory Board Members as well as their human, capital, business or other relationships of interest

  The Company has two Outside Directors and two Outside Audit & Supervisory Board Members.

  Mr. Koichiro Watanabe, one of the Outside Directors, is Representative Director and Chairman of the Board, The Dai-ichi Life Insurance Company, Limited. The Dai-ichi Life Insurance Company, Limited holds shares of the Company, but this constitutes less than 1% of the total shares. Although the Company has a business relationship with The Dai-ichi Life Insurance Company, Limited in relation to pension fund management, etc., but the value of the business was less than 0.04% of the Company's revenue in the fiscal year ended December 31, 2017. Therefore, the Company has concluded that this business relationship is not so relevant as to generate any special relationship of interest. In addition, Outside Audit & Supervisory Board Member Mr. Yoshinori Imai is originally from Japan Broadcasting Corporation. Although the Company pays reception fees to Japan Broadcasting Corporation pursuant to the Broadcast Act, those payments are routine and immaterial, and made in accordance with laws and regulations. Therefore, the Company has concluded that this business relationship is not so relevant as to generate any special relationship of interest.

  Other than the above, there are no human, capital, business or other relationships of interest between the Company and the Outside Directors and Outside Audit & Supervisory Board Members.

- Outside Directors appointed and functions and roles of Outside Directors in corporate governance of the filing company

  The Company has appointed Ms. Main Kohda and Mr. Koichiro Watanabe as Outside Directors. The Company expects that Ms. Kohda will draw on her abundant insight into international finance, her extensive experience serving on governmental advisory bodies and other such forums, and also draw on her deep insight and objective point of view developed through her activities as a novelist. The Company also anticipates that Mr. Watanabe will leverage his outstanding experience in corporate management that, over the course of many years, he has used to drive business operations that successfully combined both healthy financials and high profitability, as well as utilizing his abundant experience in working to improve the quality of management and to actively strengthen governance structures, his deep familiarity with capital markets, and his wide-ranging insight into the perspective of investors. As well as expecting that their experiences will be reflected in the management of the Company through their active provision of proposals and advice to the Board of Directors, the Company believes that they will supervise implementation of business from a fair and independent standpoint.

- Outside Audit & Supervisory Board Members appointed and functions and roles of Outside Audit & Supervisory Board Members in corporate governance of the filing company

  Outside Audit & Supervisory Board Members are appointed in light of their significant experience in their respective backgrounds and broad perspective. The Company has appointed Mr. Yoshinori Imai and Mr. Hiroshi Obayashi as Outside Audit & Supervisory Board Members. Mr. Imai has gained management experience and developed a global perspective during his tenure as Vice Chairman of Japan Broadcasting Corporation. Mr. Obayashi has gained abundant experience and developed a broad perspective through his service in the judicial world. The Company expects that their experiences and perspectives will be reflected in their audit activity, and the Company believes that they will maintain objective and neutral surveillance over the management of the Company by conducting audits from a fair and independent standpoint.

  In preparation against a situation where the number of Outside Audit & Supervisory Board Members falls below the statutory required number, the Company appointed Mr. Michio Masaki as a Substitute Audit & Supervisory Board Member.

- Independence of Outside Directors and Outside Audit & Supervisory Board Members

  At the Board of Directors on April 26, 2012, the Company established a Criteria for Evaluating the Independence of Outside Executives. According to the Criteria, Independent Directors/Audit & Supervisory Board Members must not fall under any of the following categories.

  1. A person who belongs or belonged to the Company or an affiliate or sister company of the Company
  2. A person who belongs to a company or any other form of organization of which the Company is a major shareholder

3. A person who is a major shareholder of the Company or who belongs to a company or any other form of organization which is a major shareholder of the Company
4. A person who is a major supplier or customer of the Company (if the supplier or customer is a company or any other form of organization, a person who belongs thereto)
5. A major creditor of the Company including a major loan lender (if the creditor is a company or any other form of organization, a person who belongs thereto)
6. A certified public accountant who serves as an independent auditor or an audit advisor of the Company, or a person who belongs to an auditing firm which serves as an independent auditor or an audit advisor of the Company
7. A person who receives a large amount of fees from the Company in exchange for providing professional services for legal, financial and tax affairs or business consulting services (if the recipient of such fee is a company or any other form of organization, a person who belongs thereto)
8. A person who receives a large amount of donation from the Company (if the recipient of such donation is a company or any other form of organization, a person who belongs thereto)
9. A person who has fit any of the descriptions in 2 to 8 above in the recent past
10. A close relative of a person who fits any of the following descriptions:

(i) A person who fits any of the descriptions in 2 to 8 above (if such descriptions apply to a company or any other form of organization, a person who performs important duties thereof)

(ii) A member of the board, audit & supervisory board member, audit advisor, executive officer or employee of the Company or an affiliate or sister company of the Company

(iii) A person who has fit the descriptions in (i) or (ii) in the recent past.

The Company has designated Ms. Main Kohda and Mr. Koichiro Watanabe, who are Outside Directors, and Mr. Yoshinori Imai and Mr. Hiroshi Obayashi, who are Outside Audit & Supervisory Board Members, as independent officers as defined by financial instruments exchanges, based on its judgment that in light of the above set of criteria, there is no risk of conflict of interest arising between them and ordinary shareholders.

To ensure that supervisory tasks and audits are conducted appropriately, information is shared regarding supervision and audit results and other steps are taken to ensure cooperation among operations involving supervision or audits performed by Outside Directors or Outside Audit & Supervisory Board Members, and operations involving internal audits, audits by Audit & Supervisory Board Members and audits by the Independent Auditor. To ensure appropriate implementation of business, information is exchanged as necessary and other means of cooperation are implemented among operations involving supervision or audits performed by Outside Directors or Outside Audit & Supervisory Board Members, and the Company's Internal Control Division.

f. Key points of the partial exemption of liability and liability limitation agreement

The Company's Articles of Incorporation stipulate that the Company may enter into an agreement with Members of the Board (excluding those who are Executive Directors, etc.) and Audit & Supervisory Board Members to limit the scope of their liabilities in advance to the extent permitted by the Companies Act and the Company may exempt Members of the Board and Audit & Supervisory Board Members from liabilities to the extent permitted by the same act. This provision is intended to enable Members of the Board and Audit & Supervisory Board Members to fulfill their expected role and make it easier to appoint the right persons from a broad choice both within and outside the company. As of the date of submission, the Company has such liability limiting agreements with its Members of the Board (excluding those who are Executive Directors, etc.) and Audit & Supervisory Board Members.

g. Number of Members of the Board

The Company's Articles of Incorporation stipulate that the number of Members of the Board must be 15 or less.

h. Appointment of Members of the Board

The Company’s Articles of Incorporation stipulate that Members of the Board must be appointed by a majority of the shareholder votes cast on an occasion where shareholders representing at least one-third of the total voting rights are present.

i. Matters to be decided by the Board of Directors without referral to General Meeting of Shareholders

Acquisition of treasury shares

In order to enable flexible management that meets changes in business environment, the Company’s Articles of Incorporation stipulate that the Company may acquire its treasury shares through means such as market transaction upon a resolution by the Board of Directors under Article 165, paragraph 2 of the Companies Act.

Interim dividends

In order to enable profits to be returned to shareholders in a flexible manner, the Company’s Articles of Incorporation stipulate that the Company may pay interim dividends to shareholders, upon a resolution by the Board of Directors under Article 454, paragraph 5 of the Companies Act.

j. Requirements for special resolutions at General Meeting of Shareholders

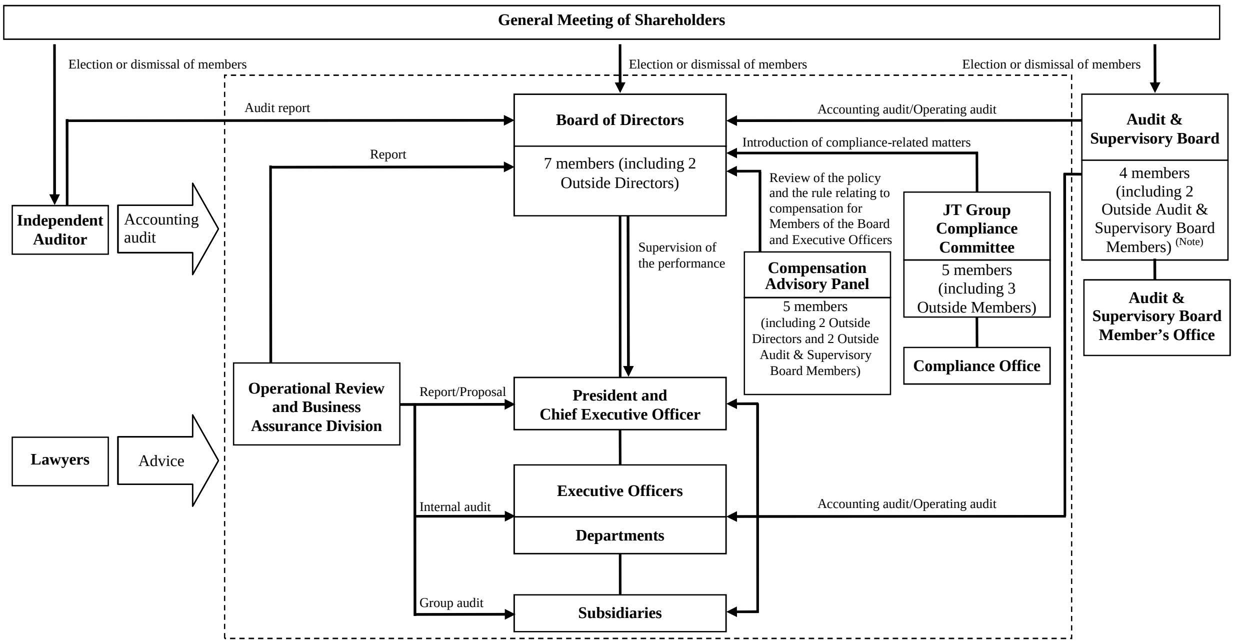
In order to facilitate the smooth conduct of General Meeting of Shareholders with an easier quorum requirement for special resolutions, the Company’s Articles of Incorporation stipulate that a resolution as specified by Article 309, paragraph 2 of the Companies Act is valid if it is supported by at least two-thirds of the votes cast at a General Meeting of Shareholders attended by shareholders representing at least one-third of the Company’s total voting rights (compared with the usual requirement of “at least half”).

k. Measures regarding transactions that involve possible conflict of interest between the Company and specified shareholders to avoid harming the interests of shareholders (excluding the shareholder who is a party to such a transaction)

The Company requires resolution by the Board of Directors with respect to gaining approval for uncustomary transactions between the Company and its major shareholders.

l. Schematic depiction

The status of the development of the Company's corporate governance system is represented as the following schematic depiction.



Note: In preparation against a situation where the number of Outside Audit & Supervisory Board Members falls below the required number, one Substitute Audit & Supervisory Board Member is elected.

m. Remuneration for Members of the Board and Audit & Supervisory Board Members

Remuneration for Members of the Board and Audit & Supervisory Board Members are as follows.

(i) Total amount of remuneration and other payments, total amount of remuneration and other payments by type, and number of Members of the Board and Audit & Supervisory Board Members to be paid, by member category for the fiscal year ended December 31, 2017

Category	Total amount of remuneration and other payments (Millions of yen)	Total amount of remuneration and other payments by type (Millions of yen)			Number to be paid (Person)
		Basic remuneration	Officers' bonus	Stock option grants	
Members of the Board (excluding Outside Directors)	482	362	– (Note)	120	5
Audit & Supervisory Board Members (excluding Outside Audit & Supervisory Board Members)	86	86	–	–	2
Outside Directors and Outside Audit & Supervisory Board Members	67	67	–	–	4
Total	635	515	–	120	11

Note: Officers' bonus payments for Members of the Board (excluding Outside Directors) were ¥0 for the fiscal year ended December 31, 2017.

(ii) Total amount of consolidated remuneration and other payments for individuals whose consolidated remuneration and other payments amount to ¥100 million or more for the fiscal year ended December 31, 2017

Name	Category	Company	Amount of consolidated remuneration and other payments by type (Millions of yen)			Total (Millions of yen)
			Basic remuneration	Officers' bonus	Stock option grants	
Mitsuomi Koizumi	Representative Director	Filing company	106	– (Note)	35	141

Note: Officers' bonus payments for Members of the Board (excluding Outside Directors) were ¥0 for the fiscal year ended December 31, 2017.

(iii) Policy concerning the remuneration amount for Members of the Board and Audit & Supervisory Board Members or the remuneration calculation method thereof and the method of determining the policy

The Company has the Compensation Advisory Panel in place as a non-statutory advisory body to the Board of Directors in order to increase objectivity and transparency regarding the remuneration of Members of the Board and Audit & Supervisory Board Members. The Compensation Advisory Panel, which holds meetings several times a year, holds deliberations and makes reports in accordance with its advice on such matters as the Company's policy, system and calculation method regarding remuneration for its Members of the Board and Executive Officers (*sikkoyakuin*), and monitors the status of remuneration for Members of the Board and Audit & Supervisory Board Members at the Company. The Compensation Advisory Panel currently consists of five members: the Chairman of the Board, who has the role of the panel's chairman, and two Outside Directors and two Outside Audit & Supervisory Board Members.

Outside members of Compensation Advisory Panel

Main Kohda	Outside Director of the Company
Koichiro Watanabe	Outside Director of the Company
Yoshinori Imai	Outside Audit & Supervisory Board Member of the Company
Hiroshi Obayashi	Outside Audit & Supervisory Board Member of the Company

In light of reports by the Compensation Advisory Panel, the Company's basic concept of remuneration for Members of the Board and Audit & Supervisory Board Members is as follows:

- Setting the remuneration at a level sufficient to secure personnel with superior capabilities
- Linking the remuneration to business performance so as to motivate Members of the Board and Audit & Supervisory Board Members to enhance performance
- Linking the remuneration to mid- to long-term corporate value
- Ensuring transparency based on an objective point of view and quantitative schemes

In accordance with the above concept, the remuneration for Members of the Board and Audit & Supervisory Board Members is made of three components. In addition to the monthly "basic remuneration," there is an "officers' bonus," which reflects the Company's business performance in the relevant fiscal year, and a "stock option," which is linked to the mid- to long-term corporate value of the Company. The said "stock option" was introduced in 2007 as remuneration that is linked to the mid- to long-term corporate value, thereby providing an incentive towards increasing shareholder value.

The composition of the remuneration for Members of the Board is as follows:

For Members of the Board who also serve as Executive Officers (*sikkoyakuin*), remuneration consists of the "basic remuneration," the "officers' bonus," and the "stock option" because they are required to achieve results by executing their duties on a daily basis. If the "officers' bonus" is paid at the standard amount, the sum of this bonus and the "stock option" is set to be equivalent to approximately 80% of the basic remuneration.

Members of the Board (excluding Outside Directors) who do not serve as Executive Officers (*sikkoyakuin*) receive remuneration that consists of the "basic remuneration" and the "stock option" since they are required to make decisions on company-wide management strategies and fulfill supervisory functions to enhance corporate value.

Remuneration for Outside Directors, which is not linked to business performance with the purpose of maintaining their independence, is composed of "basic remuneration" only.

In the light of the role of Audit & Supervisory Board Members, which is primarily to conduct audits on legal compliance, their remuneration consists solely of the "basic remuneration."

The upper limit of remuneration for the Company's Members of the Board and Audit & Supervisory Board Members, which was approved at the 22nd Ordinary General Meeting of Shareholders (held in June 2007), is ¥870 million per year for all Directors and ¥190 million per year for all Audit & Supervisory Board Members. In addition, the upper limit of "stock option" that may be granted to Members of the Board separately to the remuneration mentioned above is 800 units and ¥200 million per year. This was also approved at the 22nd Ordinary General Meeting of Shareholders. The number of units allocated for each term, including the number allocated to Executive Officers (*sikkoyakuin*) who are not also Members of the Board, is decided by resolution of the Board of Directors.

The amounts of remunerations for Members of the Board and Audit & Supervisory Board Members are determined by resolution of the Board of Directors in the case of remuneration for Members of the Board, and through discussions among Audit & Supervisory Board Members in the case of remunerations for Audit & Supervisory Board Members, within the approved upper limits, in light of deliberations by the Compensation Advisory Panel. These processes are carried out after benchmarking of levels of remuneration at major Japanese manufacturers that operate globally and whose size and profits are at similar levels to those of the Company, and are undertaken based on third-party research into remuneration for corporate executives.

n. Share ownership

(i) Number of issues and balance sheet amount for investment stocks whose purpose of holding is other than for financial investment

(Fiscal year ended December 31, 2017)

45 issues, ¥63,571 million

(ii) Issue, number of shares, balance sheet amount and purpose of holding for investment stocks whose purpose of holding is other than for financial investment

(Fiscal year ended December 31, 2016)

Specified investment stocks

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
KT&G Corporation	2,864,904	28,010	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Seven & i Holdings Co., Ltd.	852,000	3,794	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
DOUTOR-NICHIRES Holdings Co., Ltd.	1,320,000	2,839	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Mizuho Financial Group, Inc.	12,750,700	2,675	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Mitsubishi UFJ Financial Group, Inc.	2,994,150	2,156	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Central Japan Railway Company	100,000	1,923	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Japan Airport Terminal Co., Ltd.	400,000	1,690	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Sumitomo Mitsui Financial Group, Inc.	340,901	1,520	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
NIPPON TELEGRAPH AND TELEPHONE CORPORATION	306,000	1,503	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
OKAMURA CORPORATION	1,206,000	1,268	Held for policy-based investment under business alliance with the Company for joint venture
NIPPON EXPRESS CO., LTD.	1,730,400	1,088	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
West Japan Railway Company	133,000	954	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Daicel Corporation	602,000	777	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Nifco Inc.	110,000	679	Held for policy-based investment under business alliance with the Company for joint venture
Electric Power Development Co., Ltd.	213,600	575	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
Sumitomo Mitsui Trust Holdings, Inc.	121,882	510	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Yoshimura Food Holdings K.K.	210,500	434	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Tokyo Automatic Machinery Works, Ltd.	2,700,000	410	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Tokio Marine Holdings, Inc.	21,300	102	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
Hitachi, Ltd.	94,000	59	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
MS&AD Insurance Group Holdings, Inc.	9,200	33	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term

(Fiscal year ended December 31, 2017)

Specified investment stocks

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
KT&G Corporation	2,864,904	35,141	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Seven & i Holdings Co., Ltd.	852,000	3,990	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
DOUTOR-NICHIRES Holdings Co., Ltd.	1,320,000	3,674	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Mizuho Financial Group, Inc.	12,750,700	2,609	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Mitsubishi UFJ Financial Group, Inc.	2,457,750	2,031	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Central Japan Railway Company	100,000	2,018	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
OKAMURA CORPORATION	1,206,000	1,986	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Japan Airport Terminal Co., Ltd.	400,000	1,672	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term

Issue	Number of shares (Share)	Balance sheet amount (Millions of yen)	Purpose of holding
NIPPON TELEGRAPH AND TELEPHONE CORPORATION	306,000	1,622	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Yoshimura Food Holdings K.K.	210,500	1,452	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
NIPPON EXPRESS CO., LTD.	173,040	1,296	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Sumitomo Mitsui Financial Group, Inc.	227,401	1,107	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
West Japan Railway Company	133,000	1,094	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Nifco Inc.	110,000	846	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Daicel Corporation	602,000	772	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Electric Power Development Co., Ltd.	213,600	648	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Tokyo Automatic Machinery Works, Ltd.	270,000	492	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
Sumitomo Mitsui Trust Holdings, Inc.	60,982	273	Policy-based investment whose purpose is stable bank transactions and strengthened relations over the long term
Tokio Marine Holdings, Inc.	21,300	110	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term
Hitachi, Ltd.	94,000	83	Policy-based investment whose purpose is to maintain and strengthen business transactions and cooperative relations stably and over the long term
MS&AD Insurance Group Holdings, Inc.	9,200	35	Policy-based investment whose purpose is stable casualty insurance transactions and strengthened relations over the long term

(iii) Investment stocks whose purpose for holding is for financial investment

No items to report for the fiscal years ended December 31, 2016 and 2017.

(2) Audit fees

a. Audit fees paid to certified public accountants

(Millions of yen)

Classification	Fiscal year ended December 31, 2016		Fiscal year ended December 31, 2017	
	Fees for audit attestation services	Fees for non-audit services	Fees for audit attestation services	Fees for non-audit services
The Company	330	20	330	37
Consolidated subsidiaries in Japan	140	–	141	3
Total	470	20	471	40

Note: Fees paid to Deloitte Touche Tohmatsu LLC

b. Other important fees

(Millions of yen)

Classification	Fiscal year ended December 31, 2016		Fiscal year ended December 31, 2017	
	Fees for audit attestation services	Fees for non-audit services	Fees for audit attestation services	Fees for non-audit services
JTIH Group	701	570	728	694

Note: Fees paid to member firms of Deloitte Touche Tohmatsu Limited

Fiscal year ended December 31, 2016

Foreign subsidiaries of the Group receive accounting audits mainly by Deloitte Touche Tohmatsu Limited member firms, which Tohmatsu belongs to. In particular, fees paid by the JTIH Group for the accounting audit of their financial statements and tax consulting as non-audit services are significant.

Fiscal year ended December 31, 2017

Foreign subsidiaries of the Group receive accounting audits mainly by Deloitte Touche Tohmatsu Limited member firms, which Tohmatsu belongs to. In particular, fees paid by the JTIH Group for the accounting audit of their financial statements and tax consulting as non-audit services are significant.

c. Non-audit services to filing company

Fiscal year ended December 31, 2016

Non-audit services for which fees are paid by the Company to certified public accountants include the issuance of the comfort letter in relation to the bond issuing.

Fiscal year ended December 31, 2017

Non-audit services for which fees are paid by the Company to certified public accountants include the advisory services relating to CSR activities.

d. Policy for determining audit fees

The audit fee is determined through the necessary and sufficient negotiations with auditors based on the audit plan and audit fee estimates provided by them.

More specifically, the audit fee is determined based on the overall information by confirming that the focused audit areas under the audit plan and the scope of group-wide audit and review considering changes in consolidation status are appropriately reflected in the audit hours, and comparing the actual hours to planning in the prior audits.

Consent from the Audit & Supervisory Board is acquired before the determination of the audit fee to ensure the independence of auditors.

V. Accounting

1. Preparation policy of the consolidated and nonconsolidated financial statements

(1) The consolidated financial statements of Japan Tobacco Inc. (hereinafter referred to as the “Company”) are prepared in accordance with International Financial Reporting Standards (hereinafter referred to as “IFRS”) pursuant to the provisions of Article 93 of the Ordinance on Terminology, Forms and Preparation Methods of Consolidated Financial Statements (Ordinance of the Ministry of Finance No. 28 of 1976; hereinafter referred to as the Ordinance on CFS).

(2) The nonconsolidated financial statements of the Company are prepared based on the Ordinance on Terminology, Forms, and Preparation Methods of Financial Statements (Ordinance of the Ministry of Finance No. 59 of 1963; hereinafter referred to as the Ordinance on FS). The Company is categorized as a company allowed to file specified financial statements, and prepares the nonconsolidated financial statements in accordance with the provisions of Article 127 of the Ordinance on FS.

(3) Figures stated in the consolidated and nonconsolidated financial statements are rounded to the nearest million yen.

2. Audit Certification

In accordance with the provisions of Article 193-2 (1) of the Financial Instruments and Exchange Act, the consolidated financial statements and the nonconsolidated financial statements for the fiscal year ended December 31, 2017 were audited by Deloitte Touche Tohmatsu LLC.

3. Special Effort to Ensure the Appropriateness of Consolidated Financial Statements, and Development of a System for Fair Preparation of Consolidated Financial Statements, in accordance with IFRS

The Company is making special effort to ensure the appropriateness of consolidated financial statements, and developing a system for the appropriate preparation of consolidated financial statements, in accordance with IFRS. The content thereof is as follows:

(1) In order to develop a system, which is capable of responding to changes of accounting standards adequately, we strive to accumulate expert knowledge by assigning employees with sufficient knowledge on IFRS, and participating in organizations, such as the Financial Accounting Standards Foundation and attending their seminars.

(2) In order to prepare appropriate consolidated financial statements in accordance with IFRS, we established IFRS Group Accounting Guidelines and we comply with them. The IFRS Group Accounting Guidelines are revised and updated as needed after obtaining press releases and standards issued by the International Accounting Standards Board, understanding the latest standards and examining their impact on our results.

1.【Consolidated Financial Statements】
(1)【Consolidated Financial Statements】
A.【Consolidated Statement of Financial Position】

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Assets		
Current assets		
Cash and cash equivalents (Note 7)	294,157	285,486
Trade and other receivables (Note 8)	396,934	431,199
Inventories (Note 9)	558,846	612,954
Other financial assets (Note 10)	14,921	14,016
Other current assets (Note 11)	340,312	361,715
Subtotal	1,605,169	1,705,370
Non-current assets held-for-sale (Note 12)	821	2,396
Total current assets	1,605,990	1,707,767
Non-current assets		
Property, plant and equipment (Note 13)	680,835	745,607
Goodwill (Notes 14, 38)	1,601,987	1,891,210
Intangible assets (Note 14)	423,970	479,175
Investment property (Note 16)	18,184	16,700
Retirement benefit assets (Note 22)	23,680	51,377
Investments accounted for using the equity method	123,753	81,253
Other financial assets (Note 10)	99,358	114,970
Deferred tax assets (Note 17)	166,617	133,425
Total non-current assets	3,138,384	3,513,717
Total assets	4,744,374	5,221,484

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Liabilities and equity		
Liabilities		
Current liabilities		
Trade and other payables (Note 18)	377,933	395,733
Bonds and borrowings (Note 19)	208,521	398,182
Income tax payables	54,940	46,452
Other financial liabilities (Note 19)	13,023	6,906
Provisions (Note 20)	12,529	13,028
Other current liabilities (Note 21)	689,629	618,322
Total current liabilities	1,356,574	1,478,623
Non-current liabilities		
Bonds and borrowings (Note 19)	339,036	346,955
Other financial liabilities (Note 19)	9,009	11,013
Retirement benefit liabilities (Note 22)	333,410	330,762
Provisions (Note 20)	4,423	4,005
Other non-current liabilities (Note 21)	102,221	120,779
Deferred tax liabilities (Note 17)	71,660	87,319
Total non-current liabilities	859,759	900,833
Total liabilities	2,216,333	2,379,456
Equity		
Share capital (Note 23)	100,000	100,000
Capital surplus (Note 23)	736,400	736,400
Treasury shares (Note 23)	(443,822)	(443,636)
Other components of equity (Note 23)	(303,554)	(167,338)
Retained earnings	2,367,067	2,536,262
Equity attributable to owners of the parent company	2,456,091	2,761,687
Non-controlling interests	71,950	80,340
Total equity	2,528,041	2,842,027
Total liabilities and equity	4,744,374	5,221,484

B.【Consolidated Statement of Income】

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Revenue (Notes 6, 25)	2,143,287	2,139,653
Cost of sales (Notes 14, 22)	(872,433)	(843,558)
Gross profit	1,270,854	1,296,094
Other operating income (Note 26)	70,101	45,724
Share of profit in investments accounted for using the equity method	6,489	6,194
Selling, general and administrative expenses (Notes 12, 13, 14, 16, 22, 27, 33, 38)	(754,115)	(786,911)
Operating profit (Note 6)	593,329	561,101
Financial income (Notes 28, 34)	6,618	4,780
Financial costs (Notes 22, 28, 34)	(21,710)	(27,349)
Profit before income taxes	578,237	538,532
Income taxes (Note 17)	(152,464)	(141,783)
Profit for the period	425,773	396,749
Attributable to:		
Owners of the parent company	421,695	392,409
Non-controlling interests	4,078	4,340
Profit for the period	425,773	396,749
Earnings per share		
Basic (Yen) (Note 30)	235.47	219.10
Diluted (Yen) (Note 30)	235.33	218.97

Reconciliation from “Operating profit” to “Adjusted operating profit”

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Operating profit	593,329	561,101
Amortization cost of acquired intangibles arising from business acquisitions	46,767	50,414
Adjustment items (income)	(65,212)	(37,569)
Adjustment items (costs)	11,894	11,354
Adjusted operating profit (Note 6)	586,777	585,300

C.【Consolidated Statement of Comprehensive Income】

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Profit for the period	425,773	396,749
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income (Notes 29, 34)	(3,159)	9,402
Remeasurements of defined benefit plans (Notes 22, 29)	(22,202)	20,028
Total of items that will not be reclassified to profit or loss	(25,361)	29,430
Items that may be reclassified subsequently to profit or loss		
Exchange differences on translation of foreign operations (Notes 29, 34)	(163,683)	128,073
Net gain (loss) on derivatives designated as cash flow hedges (Notes 29, 34)	(1,479)	(54)
Total of items that may be reclassified subsequently to profit or loss	(165,162)	128,019
Other comprehensive income (loss), net of taxes	(190,523)	157,449
Comprehensive income (loss) for the period	235,250	554,198
Attributable to:		
Owners of the parent company	231,590	549,309
Non-controlling interests	3,660	4,889
Comprehensive income (loss) for the period	235,250	554,198

D.【Consolidated Statement of Changes in Equity】

(Millions of yen)

	Equity attributable to owners of the parent company						
				Other components of equity			
	Share capital	Capital surplus	Treasury shares	Subscription rights to shares	Exchange differences on translation of foreign operations	Net gain (loss) on derivatives designated as cash flow hedges	Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income
As of January 1, 2016	100,000	736,400	(444,333)	1,941	(172,473)	125	33,284
Profit for the period	—	—	—	—	—	—	—
Other comprehensive income (loss)	—	—	—	—	(163,169)	(1,479)	(3,069)
Comprehensive income (loss) for the period	—	—	—	—	(163,169)	(1,479)	(3,069)
Acquisition of treasury shares (Note 23)	—	—	(0)	—	—	—	—
Disposal of treasury shares (Note 23)	—	—	512	(413)	—	—	—
Share-based payments (Note 33)	—	—	—	265	—	—	—
Dividends (Note 24)	—	—	—	—	—	—	—
Changes in the scope of consolidation	—	—	—	—	—	—	—
Changes in the ownership interest in a subsidiary without a loss of control	—	—	—	—	—	—	—
Transfer from other components of equity to retained earnings	—	—	—	—	—	—	(360)
Other increase (decrease)	—	—	—	—	—	1,794	—
Total transactions with the owners	—	—	512	(147)	—	1,794	(360)
As of December 31, 2016	100,000	736,400	(443,822)	1,794	(335,642)	440	29,854
Profit for the period	—	—	—	—	—	—	—
Other comprehensive income (loss)	—	—	—	—	127,758	(54)	9,276
Comprehensive income (loss) for the period	—	—	—	—	127,758	(54)	9,276
Acquisition of treasury shares (Note 23)	—	—	(1)	—	—	—	—
Disposal of treasury shares (Note 23)	—	—	187	(166)	—	—	—
Share-based payments (Note 33)	—	—	—	336	—	—	—
Dividends (Note 24)	—	—	—	—	—	—	—
Changes in the scope of consolidation	—	—	—	—	—	—	—
Changes in the ownership interest in a subsidiary without a loss of control	—	—	—	—	—	—	—
Transfer from other components of equity to retained earnings	—	—	—	—	—	—	(461)
Other increase (decrease)	—	—	—	—	—	(475)	—
Total transactions with the owners	—	—	186	170	—	(475)	(461)
As of December 31, 2017	100,000	736,400	(443,636)	1,964	(207,884)	(88)	38,670

(Millions of yen)

	Equity attributable to owners of the parent company					
	Other components of equity					
	Remeasurements of defined benefit plans	Total	Retained earnings	Total	Non-controlling interests	Total equity
As of January 1, 2016	—	(137,122)	2,196,651	2,451,596	69,929	2,521,524
Profit for the period	—	—	421,695	421,695	4,078	425,773
Other comprehensive income (loss)	(22,387)	(190,105)	—	(190,105)	(419)	(190,523)
Comprehensive income (loss) for the period	(22,387)	(190,105)	421,695	231,590	3,660	235,250
Acquisition of treasury shares (Note 23)	—	—	—	(0)	—	(0)
Disposal of treasury shares (Note 23)	—	(413)	(99)	0	—	0
Share-based payments (Note 33)	—	265	—	265	4	270
Dividends (Note 24)	—	—	(229,223)	(229,223)	(2,038)	(231,261)
Changes in the scope of consolidation	—	—	—	—	1,069	1,069
Changes in the ownership interest in a subsidiary without a loss of control	—	—	69	69	(675)	(606)
Transfer from other components of equity to retained earnings	22,387	22,027	(22,027)	—	—	—
Other increase (decrease)	—	1,794	—	1,794	—	1,794
Total transactions with the owners	22,387	23,674	(251,280)	(227,094)	(1,639)	(228,733)
As of December 31, 2016	—	(303,554)	2,367,067	2,456,091	71,950	2,528,041
Profit for the period	—	—	392,409	392,409	4,340	396,749
Other comprehensive income (loss)	19,919	156,900	—	156,900	550	157,449
Comprehensive income (loss) for the period	19,919	156,900	392,409	549,309	4,889	554,198
Acquisition of treasury shares (Note 23)	—	—	—	(1)	—	(1)
Disposal of treasury shares (Note 23)	—	(166)	(21)	0	—	0
Share-based payments (Note 33)	—	336	—	336	5	341
Dividends (Note 24)	—	—	(243,572)	(243,572)	(1,547)	(245,119)
Changes in the scope of consolidation	—	—	—	—	4,884	4,884
Changes in the ownership interest in a subsidiary without a loss of control	—	—	(1)	(1)	159	158
Transfer from other components of equity to retained earnings	(19,919)	(20,380)	20,380	—	—	—
Other increase (decrease)	—	(475)	—	(475)	—	(475)
Total transactions with the owners	(19,919)	(20,684)	(223,214)	(243,713)	3,501	(240,212)
As of December 31, 2017	—	(167,338)	2,536,262	2,761,687	80,340	2,842,027

E.【Consolidated Statement of Cash Flows】

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Cash flows from operating activities		
Profit before income taxes	578,237	538,532
Depreciation and amortization	140,794	145,407
Impairment losses	1,239	3,427
Reversal of impairment losses on investments in associates	―	(8,848)
Interest and dividend income	(6,372)	(4,381)
Interest expense	8,680	11,604
Share of profit in investments accounted for using the equity method	(6,489)	(6,194)
(Gains) losses on sale and disposal of property, plant and equipment, intangible assets and investment property	(33,473)	(21,221)
(Gains) losses on sale of investments in subsidiaries	(26,106)	―
(Increase) decrease in trade and other receivables	(20,128)	(28,810)
(Increase) decrease in inventories	(686)	(41,102)
Increase (decrease) in trade and other payables	16,157	15,655
Increase (decrease) in retirement benefit liabilities	(4,724)	(15,296)
(Increase) decrease in prepaid tobacco excise taxes	(48,228)	(10,281)
Increase (decrease) in tobacco excise tax payables	(14,192)	(60,250)
Increase (decrease) in consumption tax payables	2,787	1,117
Other	(31,938)	12,228
Subtotal	555,557	531,587
Interest and dividends received	13,064	11,250
Interest paid	(6,788)	(11,035)
Income taxes paid	(185,285)	(112,591)
Net cash flows from operating activities	376,549	419,212
Cash flows from investing activities		
Purchase of securities	(2,303)	(11,479)
Proceeds from sale and redemption of securities	5,340	4,893
Purchase of property, plant and equipment	(101,072)	(123,726)
Proceeds from sale of investment property	42,046	21,195
Purchase of intangible assets	(9,929)	(16,412)
Payments into time deposits	(346)	(84)
Proceeds from withdrawal of time deposits	298	101
Payments for business combinations (Note 38)	(589,737)	(212,707)
Proceeds from sale of investments in subsidiaries	26,979	―
Purchase of investments in associates	(52,291)	(5,253)
Other	(6,493)	(9,160)
Net cash flows from investing activities	(687,509)	(352,632)

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Cash flows from financing activities		
Dividends paid to owners of the parent company (Note 24)	(229,261)	(243,552)
Dividends paid to non-controlling interests	(2,011)	(1,502)
Capital contribution from non-controlling interests	129	15
Increase (decrease) in short-term borrowings and commercial paper (Note 32)	186,570	116,371
Proceeds from long-term borrowings (Note 32)	856	70,861
Repayments of long-term borrowings (Note 32)	(578)	(669)
Proceeds from issuance of bonds (Note 32)	136,181	—
Redemption of bonds (Note 32)	—	(20,000)
Proceeds from sale and leaseback transactions	—	2,819
Repayments of finance lease obligations (Note 32)	(569)	(1,373)
Acquisition of treasury shares	(0)	(1)
Other	0	0
Net cash flows from financing activities	91,318	(77,032)
Net increase (decrease) in cash and cash equivalents	(219,643)	(10,452)
Cash and cash equivalents at the beginning of the period	526,765	294,157
Effect of exchange rate changes on cash and cash equivalents	(12,965)	1,782
Cash and cash equivalents at the end of the period (Note 7)	294,157	285,486

Notes to Consolidated Financial Statements

1. Reporting Entity

Japan Tobacco Inc. (hereinafter referred to as the “Company”) is a joint stock corporation under the Companies Act of Japan, pursuant to the Japan Tobacco Inc. Act, with its principal places of business located in Japan since its incorporation. The addresses of the Company’s registered head office and principal business offices are available on the Company’s website (https://www.jti.co.jp/).

The details of businesses and principal business activities of the Company and its subsidiaries (hereinafter referred to as the “Group”) are stated in “6. Operating Segments.”

The Group’s consolidated financial statements for the year ended December 31, 2017, were approved on March 27, 2018 by Masamichi Terabatake, President and Chief Executive Officer.

2. Basis of Preparation

(1) Compliance with IFRS

The Group’s consolidated financial statements, which satisfy the requirements concerning the “Specified Company applying Designated International Financial Reporting Standards” prescribed in Article 1-2 of the “Regulations for Consolidated Financial Statements”, are prepared in accordance with IFRS pursuant to the provision of Article 93 of the same regulations.

(2) Basis of Measurement

Except for the financial instruments, stated in “3. Significant Accounting Policies,” the Group’s consolidated financial statements are prepared on the historical cost basis.

(3) Functional Currency and Presentation Currency

The Group’s consolidated financial statements are presented in Japanese yen, which is the functional currency of the Company. The units are in millions of yen, and figures less than one million yen are rounded to the nearest million yen.

(4) Early Adoption of New Accounting Standards

The Group has early adopted IFRS 9 “Financial Instruments” (amended in November 2013) (hereinafter referred to as “IFRS 9”) from January 1, 2015.

IFRS 9 replaces IAS 39 “Financial Instruments: Recognition and Measurement” (hereinafter referred to as “IAS 39”) and provides two measurement categories for financial instruments: amortized cost and fair value. Changes in fair value of financial assets measured at fair value are recognized in profit or loss. However, changes in fair value of investments in equity instruments, except for equity instruments held for trading purposes, are allowed to be recognized in other comprehensive income.

For hedge accounting, the hedging relationships that meet the qualifying criteria are reviewed to appropriately reflect an entity’s risk management activities in the consolidated financial statements.

3. Significant Accounting Policies

(1) Basis of Consolidation

The consolidated financial statements include financial statements of the Company and its subsidiaries, and interests in investments in associates and joint arrangements.

A. Subsidiaries

A subsidiary is an entity that is controlled by the Group and the Group has control over the entity if it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The acquisition date of a subsidiary is the date on which the Group obtains control of the subsidiary, and the subsidiary is included in the consolidation from the date of acquisition until the date on which the Group loses control.

In cases where the accounting policies applied by a subsidiary are different from those applied by the Group, adjustments are made to the subsidiary's financial statements, if necessary.

All intergroup balances, transactions, income and expenses are eliminated on consolidation.

Comprehensive income for subsidiaries is attributed to owners of the parent company and non-controlling interests even if this results in the non-controlling interests having a deficit balance.

B. Associates

An associate is an entity over which the Group has significant influence. The Group has significant influence over the entity if it has the power to participate in the financial and operating policy decisions of the investee but it does not have control or joint control over the investee. Investments in associates are accounted for using the equity method from the date on which the Group has the significant influence until the date on which it ceases to have the significant influence.

C. Joint Arrangements

A joint arrangement is a contractual arrangement in which two or more parties have joint control. Depending upon the rights and obligations of the parties to the arrangement, the Group classifies a joint arrangement into a joint operation whereby the Group has rights to the assets and obligations for the liabilities relating to the arrangement, and a joint venture whereby the Group has rights to the net assets of the arrangement only. The Group recognizes the assets, liabilities, revenues and expenses relating to its interest in a joint operation while a joint venture is accounted for using the equity method.

(2) Business Combination

Business combinations are accounted for using the acquisition method. Consideration transferred in a business combination is measured as the sum of the acquisition-date fair value of the assets transferred, the liabilities assumed and equity instruments issued by the Company in exchange for control over an acquiree. Any excess of the consideration of acquisition over the fair value of identifiable assets and liabilities is recognized as goodwill in the consolidated statement of financial position. If the consideration of acquisition is lower than the fair value of the identifiable assets and liabilities, the difference is immediately recognized as profit in the consolidated statement of income. If the amount of initial accounting for a business combination is not determined by the end of the reporting period in which the combination occurs, the provisional amounts for the items for which the accounting is incomplete are reported and are adjusted during the measurement period, which is one year from the acquisition date. Acquisition-related costs incurred are recognized as expenses. The additional acquisition of non-controlling interests after obtaining control is accounted for as a capital transaction. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognized directly in retained earnings and no goodwill is recognized with respect to such transaction.

(3) Foreign Currency Translation

Consolidated financial statements of the Group are presented in Japanese yen, which is the functional currency of the Company. Each company in the Group specifies its own functional currency and measures transactions based on it.

Foreign currency transactions are translated into the functional currency at the rates of exchange prevailing at the dates of transactions or an approximation of the rate. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the rates of exchange prevailing at the fiscal year end date. Differences arising from the translation and settlement are recognized as profit or loss. However, exchange differences arising from the translation of financial instruments designated as hedging instruments for net investment in foreign operations (foreign subsidiaries), financial assets measured at fair value through other comprehensive income, and cash flow hedges are recognized as other comprehensive income.

The assets and liabilities of foreign operations are translated into Japanese yen at the rates of exchange prevailing at the fiscal year end date, while income and expenses of foreign operations are translated into Japanese yen at the rates of exchange prevailing at the dates of transactions or an approximation of the rate. The resulting translation differences are recognized as other comprehensive income. In cases where foreign operations are disposed of, the cumulative amount of translation differences related to the foreign operations is recognized as profit or loss in the period of disposition.

(4) Financial Instruments

A. Financial Assets

(i) Initial Recognition and Measurement

Financial assets are classified into financial assets measured at fair value through profit or loss, fair value through other comprehensive income, and amortized cost. The Group determines the classification at initial recognition.

Financial assets are classified as financial assets measured at amortized cost if both of the following conditions are met. Otherwise, they are classified as financial assets measured at fair value.

- The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding

For financial assets measured at fair value, each equity instrument is designated as measured at fair value through profit or loss or as measured at fair value through other comprehensive income, except for equity instruments held for trading purposes that must be measured at fair value through profit or loss. Such designations are applied consistently.

All financial assets are measured at fair value plus transaction costs that are attributable to the financial assets, except for the case of being classified in the category of financial assets measured at fair value through profit or loss.

(ii) Subsequent Measurement

After initial recognition, financial assets are measured based on the classification as follows:

(a) Financial Assets Measured at Amortized Cost

Financial assets measured at amortized cost are measured at amortized cost using the effective interest method.

(b) Other Financial Assets

Financial assets other than those measured at amortized cost are measured at fair value.

Changes in the fair value of financial assets measured at fair value are recognized as profit or loss.

However, changes in the fair value of equity instruments designated as measured at fair value through other comprehensive income are recognized as other comprehensive income and the amount in other comprehensive income is transferred to retained earnings when equity instruments are derecognized or the decline in its fair value compared to its acquisition cost is significant. Dividends on the financial assets are recognized in profit or loss for the year.

(iii) Derecognition

Financial assets are derecognized when the rights to receive benefits from them expire or are transferred, or when substantially all the risks and rewards of the ownership are transferred.

B. Impairment of Financial Assets

In accordance with IAS 39, the Group assesses at the end of each reporting period whether there is any objective evidence that financial assets measured at amortized cost are impaired. Evidence of impairment includes significant financial difficulty of the borrower or a group of borrowers, a default or delinquency in interest or principal payments, and bankruptcy of the borrower.

The Group assesses whether objective evidence of impairment exists individually for financial assets that are individually significant and collectively for financial assets that are not individually significant.

If there is objective evidence that impairment losses on financial assets measured at amortized cost have been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows.

When impairment is recognized, the carrying amount of the financial asset is reduced by an allowance for doubtful accounts and impairment losses are recognized in profit or loss. The carrying amount of financial assets measured at amortized cost is directly reduced for the impairment when they are expected to become uncollectible in the future and all collateral is implemented or transferred to the Group. If, in a subsequent period, the amount of the impairment loss provided changes due to an event occurring after the impairment was recognized, the previously recognized impairment losses are adjusted through the allowance for doubtful accounts.

C. Financial Liabilities

(i) Initial Recognition and Measurement

Financial liabilities are classified into financial liabilities measured at fair value through profit or loss and financial liabilities measured at amortized cost. The Group determines the classification at initial recognition.

All financial liabilities are measured at fair value at initial recognition. However, financial liabilities measured at amortized cost are measured at cost after deducting transaction costs that are directly attributable to the financial liabilities.

(ii) Subsequent Measurement

After initial recognition, financial liabilities are measured based on the classification as follows:

(a) Financial Liabilities Measured at Fair Value through Profit or Loss

Financial liabilities measured at fair value through profit or loss include financial liabilities held for trading and financial liabilities designated as measured at fair value through profit or loss at initial recognition.

(b) Financial Liabilities Measured at Amortized Cost

After initial recognition, financial liabilities measured at amortized cost are measured at amortized cost using the effective interest method. Amortization under the effective interest method and gains or losses on derecognition are recognized as profit or loss in the consolidated statement of income.

After initial recognition, financial guarantee contracts are measured at the higher of:

- The best estimate of expenditure required to settle the obligation as of the end of the fiscal year, and
- The amount initially recognized less cumulative amortization.

(iii) Derecognition

Financial liabilities are derecognized when the obligation is discharged, canceled or expired.

D. Offsetting of Financial Instruments

Financial assets and financial liabilities are offset and presented as a net amount in the consolidated statement of financial position only when there is a legally enforceable right to set off the recognized amounts and the Group intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

E. Derivatives and Hedge Accounting

The Group utilizes derivatives, including forward foreign exchange contracts and interest rate swap contracts, to hedge foreign exchange and interest rate risks. These derivatives are initially measured at fair value when the contract is entered into, and are subsequently remeasured at fair value. Changes in the fair value of derivatives are recognized as profit or loss in the consolidated statement of income. However, the gains or losses on the hedging instrument relating to the effective portion of cash flow hedges and hedges of net investment in foreign operations are recognized as other comprehensive income in the consolidated statement of comprehensive income.

At the inception of the hedge, the Group formally designates and documents the hedging relationship to which hedge accounting is applied and the objectives and strategies of risk management for undertaking the hedge. The documentation includes identification of the hedging instruments, the hedged items, the nature of the risks being hedged and how the hedging relationship's effectiveness is assessed. These hedges are assessed on an ongoing basis to determine whether the hedging relationship is effective prospectively, even though it is expected that there is an economic relationship between the hedged item and the hedging instrument, that the effect of credit risk does not dominate the value changes that result from that economic relationship, and that the hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the Group actually hedges and the quantity of the hedging instrument that the Group actually uses to hedge that quantity of the hedged item.

If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio due to changes in an economic relationship between the hedged item and the hedging instrument but the risk management objective remains the same, the Group would adjust the hedge ratio so that it meets the qualifying criteria again. The Group discontinues hedge accounting for the portion that does not meet the requirement when the hedging relationship ceases to meet the qualifying criteria even after adjusting the hedge ratio.

Hedges that meet the stringent requirements for hedge accounting are classified in the following categories and accounted for in accordance with IFRS 9.

(i) Fair Value Hedge

The gain or loss on the hedging instrument is recognized as profit or loss in the consolidated statement of income. However, changes in the fair value of the hedging instrument are recognized as other comprehensive income in the consolidated statement of comprehensive income if the hedging instrument hedges an equity instrument designated as at fair value through other comprehensive income. Regarding the hedging gain or loss on the hedged item, the carrying amount of the hedged item is adjusted and the change is recognized as profit or loss in the consolidated statement of income. However, changes in the fair value of an equity instrument which the Group elected to present in other comprehensive income are recognized as other comprehensive income.

(ii) Cash Flow Hedge

The effective portion of gains or losses on hedging instruments is recognized as other comprehensive income in the consolidated statement of comprehensive income, while the ineffective portion is recognized immediately as profit or loss in the consolidated statement of income.

The amounts of hedging instruments recognized in other comprehensive income are reclassified to profit or loss when the transactions of the hedged items affect profit or loss. In cases where hedged items result in the recognition of non-financial assets or liabilities, the amounts recognized as other comprehensive income are accounted for as adjustments to the original carrying amount of non-financial assets or liabilities.

If the hedged future cash flows are no longer expected to occur, any related cumulative gain or loss that has been recognized in equity as other comprehensive income is reclassified to profit or loss. If the hedged future cash flows are still expected to occur, amounts that have been recognized in other comprehensive income are continued to be recognized in other comprehensive income until the future cash flows occur.

(iii) Hedge of Net Investment in Foreign Operations

Translation differences resulting from the hedge of net investment in foreign operations are accounted for similarly to a cash flow hedge. The effective portion of gains or losses on hedging instruments is recognized as other comprehensive income in the consolidated statement of comprehensive income, while the ineffective portion is recognized as profit or loss in the consolidated statement of income. At the time of the disposal of the foreign operations, any related cumulative gain or loss that has been recognized in equity as other comprehensive income is reclassified to profit or loss.

F. Fair Value of Financial Instruments

Fair value of financial instruments that are traded in active financial markets at the fiscal year end refers to quoted prices or dealer quotations.

If there is no active market, fair value of financial instruments is determined using appropriate valuation models.

(5) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, demand deposits, and short-term investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value and due within three months from the date of acquisition.

(6) Inventories

The cost of inventories includes all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

Inventories are measured at the lower of cost or net realizable value, and the costs are determined by using the weighted-average method. Net realizable value is determined as the estimated selling price in the ordinary course of business less the estimated costs of completion and estimated costs necessary to make the sale.

Leaf tobacco which is stored for more than 12 months before being used for production is included in current assets since it is held within the normal operating cycle.

(7) Property, Plant and Equipment

Property, plant and equipment is measured by using the cost model and is stated at cost less accumulated depreciation and accumulated impairment losses.

The acquisition cost includes any costs directly attributable to the acquisition of the asset and dismantlement, removal and restoration costs, as well as borrowing costs eligible for capitalization.

Except for assets that are not subject to depreciation such as land, assets are depreciated using the straight-line method over their estimated useful lives. The estimated useful lives of major asset items are as follows:

- Buildings and structures: 38 to 50 years
- Machinery and vehicles: 10 to 15 years

The estimated useful lives and depreciation method are reviewed at each fiscal year end and if there are any changes made to the estimated useful lives and depreciation method, such changes are applied prospectively as changes in estimate.

(8) Goodwill and Intangible Assets

A. Goodwill

Goodwill is stated at acquisition cost less accumulated impairment losses.

Goodwill is not amortized. It is allocated to cash-generating units that are identified according to locations and types of businesses and tested for impairment annually or whenever there is any indication of impairment. Impairment losses on goodwill are recognized in the consolidated statement of income and no subsequent reversal is made.

B. Intangible Assets

Intangible assets are measured by using the cost model and are stated at cost less accumulated amortization and accumulated impairment losses.

Intangible assets acquired separately are measured at cost at the initial recognition, and the costs of intangible assets acquired through business combinations are recognized at fair value at the acquisition date. Expenditures on internally generated intangible assets are recognized as expense in the period when incurred, except for development expenses that satisfy the capitalization criteria.

Intangible assets with finite useful lives are amortized using the straight-line method over their estimated useful lives and are tested for impairment whenever there is any indication of impairment. The estimated useful lives and amortization method of intangible assets with finite useful lives are reviewed at each fiscal year end, and the effect of any changes in estimate would be accounted for on a prospective basis.

The estimated useful lives of major intangible assets with finite useful lives are as follows:

- Trademarks: 10 to 20 years
- Software: 5 years

Intangible assets with indefinite useful lives and intangible assets that are not ready to use are not amortized, but they are tested for impairment individually or by cash-generating unit annually or whenever there is any indication of impairment.

(9) Leases

Leases are classified as finance leases whenever substantially all the risks and rewards incidental to ownership are transferred to the Group. All other leases are classified as operating leases.

In finance lease transactions, leased assets and lease obligations are recognized in the consolidated statement of financial position at the lower of the fair value of the leased property or the present value of the minimum lease payments, each determined at the inception of the lease. Lease payments are apportioned between the financial cost and the reduction of the lease obligations based on the effective interest method. Financial costs are recognized in the consolidated statement of income. Leased assets are depreciated using the straight-line method over their estimated useful lives or lease terms, whichever is shorter.

In operating lease transactions, lease payments are recognized as an expense using the straight-line method over the lease terms in the consolidated statement of income. Contingent rents are recognized as an expense in the period when they are incurred.

Determining whether an arrangement is, or contains, a lease is based on the substance of the arrangement in accordance with IFRIC 4 “Determining Whether an Arrangement Contains a Lease,” even if the arrangement does not take the legal form of a lease.

(10) Investment Property

Investment property is property held to earn rentals or for capital appreciation or both.

Investment property is measured by using the cost model and is stated at cost less accumulated depreciation and accumulated impairment losses.

(11) Impairment of Non-financial Assets

The Group assesses for each fiscal year whether there is any indication that an asset may be impaired. If any such indication exists, or in cases where the impairment test is required to be performed each year, the recoverable amount of the asset is estimated. In cases that the recoverable amount cannot be estimated for each asset, it is estimated by the cash-generating unit to which the asset belongs. The recoverable amount of an asset or a cash-generating unit is determined at the higher of its fair value less costs of disposal or its value in use. If the carrying amount of the asset or cash-generating unit exceeds the recoverable amount, impairment losses are recognized and the carrying amount is reduced to the recoverable amount. In determining the value in use, estimated future cash flows are discounted to the present value, using pretax discount rates that reflect current market assessments of the time value of money and the risks specific to the asset. In determining the fair value less costs of disposal, the Group uses an appropriate valuation model supported by available fair value indicators.

The Group assesses whether there is any indication that an impairment loss recognized in prior years for an asset other than goodwill may no longer exist or may have decreased, such as any changes in assumptions used for the determination of the recoverable amount. If any such indication exists, the recoverable amount of the asset or cash-generating unit is estimated. In cases that the recoverable amount exceeds the carrying amount of the asset or cash-generating unit, impairment losses are reversed up to the lower of the estimated recoverable amount or the carrying amount (net of depreciation) that would have been determined if no impairment losses had been recognized in prior years.

(12) Non-current Assets Held-for-Sale

An asset or asset group for which the value is expected to be recovered through a sales transaction rather than through continuing use is classified into a non-current asset or disposal group held-for-sale when the following conditions are met: it is highly probable that the asset or asset group will be sold within one year, the asset or asset group is available for immediate sale in its present condition, and the Group management commits to the sale plan. In such cases, the non-current asset is not depreciated or amortized and is measured at the lower of its carrying amount or its fair value less costs of disposal.

(13) Post-employment Benefits

The Group sponsors defined benefit plans and defined contribution plans as employee retirement benefit plans.

The Company is obligated to bear pension expenses for a mutual assistance association incurred with respect to services in or before June 1956 (prior to the enforcement of the Act on the Mutual Aid Association of Public Corporation Employees). Such obligations are calculated and included in liabilities related to the retirement benefits.

For each plan, the Group calculates the present value of defined benefit obligations, related current service cost and past service cost using the projected unit credit method. For a discount rate, a discount period is determined based on the period until the expected date of benefit payment in each fiscal year, and the discount rate is determined by reference to market yields for the period corresponding to the discount period at the end of the fiscal year on high quality corporate bonds or government bonds. Liabilities or assets for defined benefit plans are calculated by the present value of the defined benefit obligation, deducting the fair value of any plan assets (including adjustments for the asset ceiling for defined benefit plans and minimum funding requirements, if necessary). Expected interest costs and interest income are recognized as financial costs.

Remeasurements of defined benefit plans are recognized in full as other comprehensive income in the period when they are incurred and transferred to retained earnings immediately. Past service costs are recognized as profit or loss in the period when incurred.

The cost for retirement benefits for defined contribution plans is recognized as an expense at the time of contribution.

(14) Share-based Payments

The Group has a share option plan as an equity-settled share-based payment plan. Share options are estimated at fair value at grant date and are recognized as an expense over the vesting period in the consolidated statement of income after considering the number of share options that are expected to be eventually vested. The corresponding amount is recognized as an increase in equity in the consolidated statement of financial position.

(15) Provisions

The Group has present obligations (legal or constructive) resulting from past events and recognizes provisions when it is probable that the obligations are required to be settled and the amount of the obligations can be estimated reliably.

Where the effect of the time value of money is material, the amount of provisions is measured at the present value of the expenditures expected to be required to settle the obligations. In calculating the present value, the Group uses the pretax discount rate reflecting current market assessments of the time value of money and the risks specific to the liability.

In accordance with IAS 37 “Provisions, Contingent Liabilities and Contingent Assets,” the Group recognizes a provision for restructuring when it has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main scheme to those affected by it. Restructuring provisions include only the direct expenditures arising from the restructuring, which meet both of the following criteria:

- necessarily entailed by the restructuring;
- not associated with the ongoing activities of the entity.

(16) Revenue

A. Sale of Goods

The Group mainly engages in the sale of tobacco products, prescription drugs and processed foods. Revenue from the sale of these goods is recognized when the significant risks and rewards of ownership of the goods transfer to the buyers, the Group retains neither continuing managerial involvement nor effective control over the goods sold, it is probable that the future economic benefits will flow to the Group, and the amount of revenue and the corresponding costs can be measured reliably. Therefore, revenue is usually recognized at the time of delivery of goods to customers. In addition, revenue is recognized at fair value of the consideration received or receivable less discounts, rebates and taxes, including consumption taxes.

Since the amount of turnover where the Group is involved as an agency, including tobacco excise taxes, is deducted from revenue, the Group recognizes only the economic benefit inflow, excluding such amount as revenue in the consolidated statement of income.

B. Interest Income

Interest income is recognized using the effective interest rate method.

C. Dividend Income

Dividend income is recognized when the shareholder’s right to receive payment is established.

D. Royalties

Royalties are recognized on an accrual basis in accordance with the substance of the relevant agreement.

(17) Government Grants

Government grants are recognized at fair value when there is a reasonable assurance that the Group will comply with the conditions attached to them and receive the grants.

In the case that the government grants are related to expense items, they are recognized in profit or loss on a systematic basis over the period in which the related costs for which the grants are intended to compensate are recognized. With regard to government grants for assets, the amount of the grants is deducted from the acquisition cost of the assets.

(18) Borrowing Costs

With respect to assets that necessarily take a substantial period of time to get ready for their intended use or sale, the borrowing costs that are directly attributable to the acquisition, construction or production of the assets are capitalized as part of the acquisition cost of the assets. Other borrowing costs are recognized as an expense in the period when they are incurred.

(19) Income Taxes

Income taxes in the consolidated statement of income are presented as the total of current income taxes and deferred income taxes.

Current income taxes are measured at the amount that is expected to be paid to or refunded from the taxation authorities. For the calculation of the tax amount, the Group uses the tax rates and tax laws that have been enacted or substantively enacted by the end of the fiscal year. The current income taxes are recognized in profit or loss, except for taxes arising from items that are recognized in other comprehensive income or directly in equity and taxes arising from business combinations.

Deferred income taxes are calculated based on the temporary differences between the tax base for assets and liabilities and the carrying amount at the fiscal year end. Deferred tax assets are recognized for deductible temporary differences, carryforward of unused tax credits and unused tax losses to the extent that it is probable that future taxable profit will be available against which they can be utilized. Deferred tax liabilities are recognized for taxable temporary differences.

The deferred tax assets or liabilities are not recognized for the following temporary differences:

- the initial recognition of goodwill
- the initial recognition of assets or liabilities in transactions that are not business combinations and at the time of transaction, affect neither accounting profit nor taxable profit or tax loss
- deductible temporary differences arising from investments in subsidiaries and associates, and interests in joint ventures to the extent that it is probable that the timing of the reversal of the temporary difference in the foreseeable future and it is not probable that future taxable profits will be available against which they can be utilized
- taxable temporary differences arising from investments in subsidiaries and associates, and interests in joint ventures to the extent that the timing of the reversal of the temporary difference is controlled and that it is probable the temporary difference will not reverse in the foreseeable future.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the fiscal year when the asset is realized or the liability is settled, based on tax rates that have been enacted or substantively enacted by the fiscal year end.

(20) Treasury Shares

Treasury shares are recognized at cost and deducted from equity. No gain or loss is recognized on the purchase, sale or cancellation of the treasury shares. Any difference between the carrying amount and the consideration paid is recognized in capital surplus.

(21) Earnings per Share

Basic earnings per share are calculated by dividing profit or loss attributable to ordinary shareholders of the parent company by the weighted-average number of ordinary shares outstanding during the year, adjusted by the number of treasury shares. Diluted earnings per share are calculated by adjusting the effects of dilutive potential ordinary shares.

(22) Dividends

Dividend distributions to the shareholders of the Company are recognized as liabilities in the period in which, for year end dividends, the Annual Shareholders’ Meeting approves the distribution and, for interim dividends, the Board of Directors approves the distribution.

(23) Contingencies

A. Contingent Liabilities

The Group discloses contingent liabilities in the notes to consolidated financial statements if it has possible obligations at the fiscal year end, whose existence cannot be confirmed at that date, or if the obligations do not meet the recognition criteria of a provision described in “20. Provisions.”

B. Contingent Assets

The Group discloses contingent assets in the notes to consolidated financial statements if an inflow of future economic benefits to the Group is probable, but not virtually certain at the fiscal year end.

(24) Adjusted Financial Measures

The adjusted financial measures are calculated by adding certain adjustment items to the non-adjusted financial data or by deducting the items from the non-adjusted financial data.

The adjustment items are determined by management’s judgment, taking into consideration the nature and frequency of the income and costs such that they provide effective comparative information on the Group performance and that they reflect the way of managing our business appropriately. Adjusted financial measures are presented in the consolidated statement of income and “6. Operating Segments.”

The adjusted financial measures are not defined under IFRS and are not comparable with equivalent indicators for other entities.

(Changes in Accounting Policies)

The Group has adopted the following new accounting standards, amended standards and new interpretations from the fiscal year ended December 31, 2017.

IFRS		Description of new standards and amendments
IAS 7	Statement of Cash Flows	Additional disclosures about changes in liabilities arising from financing activities

The efThe effect of adopting the above standards and interpretations on the consolidated financial statements is immaterial.

4. Significant Accounting Estimates and Judgments

Preparation of consolidated financial statements of the Group requires management estimates and assumptions in order to measure income, expenses, assets and liabilities, and disclose contingencies as of the fiscal year end date. These estimates and assumptions are based on the best judgment of management in light of historical experience and various factors deemed to be reasonable as of the fiscal year end date. Given their nature, actual results may differ from those estimates and assumptions.

The estimates and assumptions are continuously reviewed by management. The effects of a change in estimates and assumptions are recognized in the period of the change or the period of the change and future periods.

Among the above estimates and assumptions, the following are items that may have a material effect on the amounts recognized in the consolidated financial statements of the Group:

A. Impairment of Property, Plant and Equipment, Goodwill, Intangible Assets and Investment Properties

With regard to property, plant and equipment, goodwill, intangible assets and investment properties, if there is any indication that the recoverable amount declines below the carrying amounts of the assets, the Group performs an impairment test.

The important indications include significant changes with adverse effect on the results of past or projected business performance, significant changes in the use of acquired assets or in overall business strategy, and significant deteriorations in industry trends and economic trends. With regard to goodwill, an impairment test is conducted at least once a year, regardless of any indication of impairment, in order to ensure that the recoverable amount exceeds the carrying amount.

The impairment test is performed by comparing the carrying amount and the recoverable amount of assets. If the recoverable amount declines below the carrying amount, impairment losses are recognized. The recoverable amount is mainly calculated based on the discounted cash flow model. Certain assumptions are made for the useful lives and the future cash flows of the assets, discount rates and long-term growth rates. These assumptions are based on the best estimates and judgments made by management; however, there is a possibility that these assumptions may be affected by changes in uncertain future economic conditions, which may have a material impact on the consolidated financial statements in future periods.

The method for calculating the recoverable amount is described in “13. Property, Plant and Equipment,” “14. Goodwill and Intangible Assets” and “16. Investment Property.” With regard to goodwill, the sensitivity analysis is described in “14. Goodwill and Intangible Assets.”

B. Post-employment Benefits

The Group has various types of retirement benefit plans, including defined benefit plans. In addition, the mutual pension benefits plan of the Company is one of the public pension systems under the jurisdiction of the government of Japan and the Company is legally obligated to bear a part of the pension costs of the plan.

The present value of defined benefit obligations on each of these plans and the related service costs are calculated based on actuarial assumptions. These actuarial assumptions require estimates and judgments on variables, such as discount rates and inflation rate.

The Group obtains advice from external pension actuaries with respect to the appropriateness of these actuarial assumptions including these variables.

The actuarial assumptions are determined based on the best estimates and judgments made by management; however, there is a possibility that these assumptions may be affected by changes in uncertain future economic conditions, or by the publication or the amendment of related laws, which may have a material impact on the consolidated financial statements in future periods.

These actuarial assumptions and the related sensitivity analysis are described in “22. Employee Benefits.”

C. Provisions

The Group recognizes various provisions, including provisions for asset retirement obligations and restructuring, in the consolidated statement of financial position.

These provisions are recognized based on the best estimates of the expenditures required to settle the obligations taking risks and uncertainty related to the obligations into account as of the fiscal year end date.

Expenditures required to settle the obligations are calculated by taking possible results into account comprehensively; however, they may be affected by the occurrence of unexpected events or changes in conditions which may have a material impact on the consolidated financial statements in future periods.

The nature and amount of recognized provisions are described in “20. Provisions.”

D. Income Taxes

The Group operates business activities around the world, and it recognizes current tax liabilities and income taxes as the estimated amounts to be paid to the tax authorities, based on the estimation in accordance with their laws and regulations.

Calculating current tax liabilities and income taxes requires estimates and judgment on various factors, including the interpretation of tax regulations by taxable entities and the tax authority in the jurisdiction or the experience of past tax audits.

Therefore, there may be differences between the amount recognized as tax liabilities and income taxes and the amount of actual tax liabilities and income taxes. These differences may have a material impact on the consolidated financial statements in future periods.

In addition, deferred tax assets are recognized to the extent that it is probable that taxable income will be available against which deductible temporary differences can be utilized.

In recognizing the deferred tax assets, when judging the possibility of the future taxable income, we reasonably estimate the timing and amount of future taxable income based on the business plan.

The timing when taxable income arises and the amount of such income may be affected by changes in uncertain future economic conditions. Therefore, this may have a material impact on the consolidated financial statements in future periods.

The content and amount related to income taxes are described in “17. Income Taxes.”

E. Contingencies

With regard to contingencies, any items that may have a material impact on business in the future are disclosed in light of all the available evidence as of the fiscal year end date and by taking into account the probability of these contingencies and their impact on financial reporting.

The content of contingencies is described in “39. Contingencies.”

5. New Accounting Standards Not Yet Adopted by the Group

By the date of approval of the consolidated financial statements, new accounting standards, amended standards and new interpretations that have been issued, but have not been early adopted by the Group are as follows.

The implications from adoption of these standards and interpretations are assessed by the Group; however, we evaluate that none of them will have a material impact on our operating results and financial condition.

In relation to adoption of IFRS15 "Revenue from Contracts with Customers," expenses previously recognized in "Selling, general and administrative expenses" will be partially recognized as a reduction of "Revenue" or as "Cost of sales." There will be immaterial impact on operating profit from this change.

IFRS		Mandatory adoption (From the year beginning)	To be adopted by the Group	Description of new standards and amendments
IFRS 1	First-time Adoption of International Financial Reporting Standards	January 1, 2018	Fiscal year ending December 2018	Deleting short-term exemptions for first-time adopters
IFRS 2	Share-based Payment	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for the effects of vesting conditions on cash-settled share-based payment transactions
IFRS 3	Business Combinations	January 1, 2019	Fiscal year ending December 2019	Clarifying accounting treatment for previously held interests in a joint operation
IFRS 4	Insurance Contracts	January 1, 2018	Fiscal year ending December 2018	Adding the option to defer the adoption of IFRS 9 for entities engaging mainly in insurance business
IFRS 9	Financial Instruments	January 1, 2018	Fiscal year ending December 2018	Limited changes to classification and measurement of financial assets, and introduction of an expected credit loss impairment model
		January 1, 2019	Fiscal year ending December 2019	Amendments to classification of financial assets included in prepayment features
IFRS 11	Joint Arrangements	January 1, 2019	Fiscal year ending December 2019	Clarifying accounting treatment for previously held interests in a joint operation
IFRS 15	Revenue from Contracts with Customers	January 1, 2018	Fiscal year ending December 2018	Amendments to accounting treatment for recognizing revenue
IFRS 16	Leases	January 1, 2019	Fiscal year ending December 2019	Amendments to accounting treatment for lease arrangements
IFRS 17	Insurance Contracts	January 1, 2021	Fiscal year ending December 2021	Amendments to accounting treatment for insurance contracts
IAS 12	Income Taxes	January 1, 2019	Fiscal year ending December 2019	Clarifying accounting treatment for income tax consequences of dividends
IAS 19	Employee Benefits	January 1, 2019	Fiscal year ending December 2019	Clarifying treatment on a defined benefit plan curtailment or settlement
IAS 23	Borrowing Costs	January 1, 2019	Fiscal year ending December 2019	Clarifying the method for calculating the borrowing costs eligible for capitalization
IAS 28	Investments in Associates and Joint Ventures	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for investments in associates and joint ventures
		January 1, 2019	Fiscal year ending December 2019	Clarifying accounting treatment for impairment loss of investments in associates and joint ventures

IFRS		Mandatory adoption (From the year beginning)	To be adopted by the Group	Description of new standards and amendments
IAS 40	Investment Property	January 1, 2018	Fiscal year ending December 2018	Clarifying the rules for transfers of property to or from investment property
IFRIC 22	Foreign Currency Transactions and Advance Consideration	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for the transactions that include payment/receipt of advance consideration in a foreign currency
IFRIC 23	Uncertainty over Income Tax Treatments	January 1, 2019	Fiscal year ending December 2019	Clarifying accounting treatment for uncertainty over income tax treatments
IFRS 10 IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	Not yet determined	Not yet determined	Amendments to accounting treatment for sale or contribution of assets between an investor and its associate or joint venture

6. Operating Segments

(1) Outline of Reportable Segments

The reportable segments of the Group are determined based on the operating segments that are components of the Group for which separate financial information is available and are evaluated regularly by the Board of Directors in deciding how to allocate resources and in assessing performance.

The Group is mainly engaged in the manufacture and sale of tobacco products, prescription drugs and processed foods. With respect to tobacco products, operations are managed separately for domestic and overseas markets. The reportable segments of the Group are composed of four segments: “Domestic Tobacco Business,” “International Tobacco Business,” “Pharmaceutical Business,” and “Processed Food Business.” They are determined by types of products, characteristics, and markets.

The “Domestic Tobacco Business” manufactures and sells tobacco products in domestic areas (which include duty-free shops in Japan and markets in China, Hong Kong, and Macau where the Company’s China Division operates). The “International Tobacco Business” manufactures and sells tobacco products overseas mainly through JT International S.A., which controls manufacturing and sales operations. The “Pharmaceutical Business” consists of research and development, and the manufacture and sale of prescription drugs. The “Processed Food Business” consists of the manufacture and sale of frozen and ambient processed foods, bakery products and seasonings.

(2) Revenues and Performances of Reportable Segments

Revenues and performances of reportable segments are as follows. The Board of Directors assesses the segment performance and determines resource allocation after reviewing revenues and adjusted operating profit. Since financial income, financial costs and income taxes are managed by the Group head office, these income and expenses are excluded from segment performance. Transactions within the segments are based mainly on prevailing market prices.

Year ended December 31, 2016

(Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Revenue								
External revenue (Note 3)	684,233	1,199,190	87,183	164,078	2,134,683	8,604	−	2,143,287
Intersegment revenue	18,245	30,280	−	30	48,554	9,653	(58,207)	−
Total revenue	702,478	1,229,470	87,183	164,108	2,183,237	18,257	(58,207)	2,143,287
Segment profit (loss)								
Adjusted operating profit (Note 1)	260,205	336,227	9,717	4,998	611,146	(24,725)	356	586,777
Other items								
Depreciation and amortization	57,994	69,129	4,908	6,423	138,453	2,675	(335)	140,794
Impairment losses on other than financial assets	54	615	−	16	685	554	−	1,239
Reversal of impairment losses on other than financial assets	−	27	−	−	27	−	−	27
Share of profit (loss) in investments accounted for using the equity method	33	6,327	−	(4)	6,355	134	−	6,489
Capital expenditures	29,820	70,592	3,823	5,707	109,942	3,902	(847)	112,998

Year ended December 31, 2017

(Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Revenue								
External revenue (Note 3)	626,758	1,237,577	104,714	163,138	2,132,187	7,466	−	2,139,653
Intersegment revenue	8,558	31,465	−	22	40,045	7,543	(47,588)	−
Total revenue	635,315	1,269,042	104,714	163,159	2,172,232	15,008	(47,588)	2,139,653
Segment profit (loss)								
Adjusted operating profit (Note 1)	232,275	351,302	24,094	5,397	613,069	(28,156)	388	585,300
Other items								
Depreciation and amortization	56,001	76,098	5,120	6,137	143,355	2,288	(237)	145,407
Impairment losses on other than financial assets	53	2,599	−	286	2,938	489	−	3,427
Reversal of impairment losses on other than financial assets	−	455	−	−	455	−	−	455
Share of profit (loss) in investments accounted for using the equity method	22	6,102	−	17	6,140	53	−	6,194
Capital expenditures	51,549	68,427	6,230	10,424	136,631	4,838	(564)	140,905

Reconciliation from “Adjusted operating profit” to “Profit before income taxes”

Year ended December 31, 2016

(Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Adjusted operating profit (Note 1)	260,205	336,227	9,717	4,998	611,146	(24,725)	356	586,777
Amortization cost of acquired intangibles arising from business acquisitions	(16,245)	(30,522)	–	–	(46,767)	–	–	(46,767)
Adjustment items (income) (Note 4)	282	34	–	2	318	64,894	–	65,212
Adjustment items (costs) (Note 5)	(137)	(3,960)	–	(8)	(4,105)	(7,789)	–	(11,894)
Operating profit (loss)	244,106	301,779	9,717	4,991	560,592	32,380	356	593,329
Financial income								6,618
Financial costs								(21,710)
Profit before income taxes								578,237

Year ended December 31, 2017

(Millions of yen)

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharma-ceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Adjusted operating profit (Note 1)	232,275	351,302	24,094	5,397	613,069	(28,156)	388	585,300
Amortization cost of acquired intangibles arising from business acquisitions	(16,245)	(34,170)	–	–	(50,414)	–	–	(50,414)
Adjustment items (income) (Note 4)	6	16,723	–	–	16,729	20,840	–	37,569
Adjustment items (costs) (Note 5)	(197)	(8,272)	–	(20)	(8,489)	(2,865)	–	(11,354)
Operating profit (loss)	215,839	325,584	24,094	5,377	570,894	(10,181)	388	561,101
Financial income								4,780
Financial costs								(27,349)
Profit before income taxes								538,532

(Note 1) For adjusted operating profit, amortization cost of acquired intangibles arising from business acquisitions, and adjustment items (income and costs) are excluded from operating profit (loss).

(Note 2) "Other" includes business activities relating to rent of real estate and corporate expenses relating to corporate communication and operation of the head office.

(Note 3) Core revenue as part of the "Domestic Tobacco Business" and the "International Tobacco Business" is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Domestic Tobacco	649,744	590,605
International Tobacco	1,138,805	1,176,956

(Note 4) The breakdown of "Adjustment items (income)" is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Restructuring incomes	65,178	21,645
Reversal of impairment losses on investments in associates	—	8,848
Gains on remeasurement related to the business combination	—	5,042
Others	34	2,034
Adjustment items (income)	65,212	37,569

Restructuring incomes for the year ended December 31, 2016 mainly relate to gains on sale of real estate and gains on sale of investments in subsidiaries. Restructuring incomes for the year ended December 31, 2017 mainly relate to gains on sale of real estate. The breakdown of restructuring income is described in "26. Other Operating Income."

(Note 5) The breakdown of "Adjustment items (costs)" is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Restructuring costs	11,894	8,398
Others	—	2,956
Adjustment items (costs)	11,894	11,354

Restructuring costs for the year ended December 31, 2016 mainly relate to disposal of real estate. Restructuring costs for the year ended December 31, 2017 mainly relate to rationalization of the production and distribution system in some markets in the "International Tobacco Business". Restructuring costs included in "Cost of sales" were ¥84 million for the year ended December 31, 2017. Restructuring costs included in "Selling, general and administrative expenses" were ¥11,894 million and ¥8,314 million for the year ended December 31, 2016 and 2017, respectively. The breakdown of restructuring costs in "Selling, general and administrative expenses" is described in "27. Selling, General and Administrative Expenses."

(3) Geographic Information

The regional breakdown of non-current assets and external revenue as of each fiscal year end is as follows:

Non-current Assets

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Japan	833,543	830,838
Overseas	1,891,433	2,301,854
Consolidated	2,724,975	3,132,692

(Note) Non-current assets, exclusive of financial instruments, deferred tax assets and retirement benefits assets, are segmented by the location of the assets.

External Revenue

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Japan	889,742	831,216
Overseas	1,253,545	1,308,437
Consolidated	2,143,287	2,139,653

(Note) Revenue is segmented by the sales destination.

(4) Major Customers Information

The “International Tobacco Business” of the Group sells products to the Megapolis Group that engages in distribution and wholesale business in Russia and other countries. The external revenues from the Megapolis Group were ¥235,932 million (11.0% of consolidated revenue) for the year ended December 31, 2016 and ¥248,881 million (11.6% of consolidated revenue) for the year ended December 31, 2017.

7. Cash and Cash Equivalents

The breakdown of “Cash and cash equivalents” as of each fiscal year end is as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Cash and deposits	234,957	215,885
Short-term investments	59,200	69,601
Total	294,157	285,486

Cash and cash equivalents are classified as financial assets measured at amortized cost.

8. Trade and Other Receivables

The breakdown of “Trade and other receivables” as of each fiscal year end is as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Note and account receivables	386,708	439,562
Other	11,742	15,226
Allowance for doubtful accounts	(1,515)	(23,589)
Total	396,934	431,199

Trade and other receivables are presented net of allowance for doubtful accounts in the consolidated statement of financial position.

Trade and other receivables are classified as financial assets measured at amortized cost.

9. Inventories

The breakdown of “Inventories” as of each fiscal year end is as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Merchandise and finished goods (Note 1)	176,702	193,179
Leaf tobacco (Note 2)	324,802	352,803
Other	57,343	66,971
Total	558,846	612,954

(Note 1) For imported tobacco products (merchandise) that are sold by TS Network Co., Ltd., a subsidiary of the Company, commissions solely from wholesale are included in revenue. The amount of imported tobacco products (merchandise) that the company holds at the end of each fiscal year is included in inventories and presented as “Merchandise and finished goods.”

(Note 2) Leaf tobacco includes those products that will be used after 12 months from the end of each fiscal year, but they are included in inventories since they are held within the normal operating cycle.

10. Other Financial Assets

(1) The breakdown of "Other financial assets" as of each fiscal year end is as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Derivative assets	11,769	5,978
Equity securities	65,548	77,642
Debt securities	4,572	11,352
Time deposits	965	977
Other	38,345	39,607
Allowance for doubtful accounts	(6,920)	(6,569)
Total	114,279	128,987
Current assets	14,921	14,016
Non-current assets	99,358	114,970
Total	114,279	128,987

Other financial assets are presented net of allowance for doubtful accounts in the consolidated statement of financial position.

Derivative assets are classified as financial assets measured at fair value through profit or loss excluding those to which hedge accounting is applied, equity securities are classified as financial assets measured at fair value through other comprehensive income, and time deposits and debt securities are classified as financial assets measured at amortized cost.

(2) Names of major securities held as financial assets measured at fair value through other comprehensive income and their fair values as of each fiscal year end are as follows:

(Millions of yen)

Company name	As of December 31, 2016	As of December 31, 2017
KT&G Corporation	28,010	35,141
Seven & i Holdings Co., Ltd.	3,808	4,005
DOUTOR・NICHIRES Holdings Co., Ltd.	2,872	3,715
Mizuho Financial Group, Inc.	2,683	2,609
KATO SANGYO CO., LTD.	1,541	2,325
Mitsubishi UFJ Financial Group, Inc.	2,165	2,031

Equity securities are held mainly for strengthening relationships with investees. Therefore, they are designated as financial assets measured at fair value through other comprehensive income.

In order to pursue the efficiency of assets held and to use them effectively, sales of financial assets measured at fair value through other comprehensive income have been carried out (derecognition).

The fair value at the time of sale and cumulative gain or loss that is recognized in equity through other comprehensive income for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Fair value	1,532	1,545
Cumulative gain or loss recognized in equity as other comprehensive income (Note)	(360)	(461)

(Note) The figure represents the amount transferred to retained earnings.
The cumulative gain or loss recognized in equity as other comprehensive income is transferred to retained earnings when an equity instrument is sold or the decline in its fair value compared to its acquisition cost is significant.

11. Other Current Assets

The breakdown of “Other current assets” as of each fiscal year end is as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Prepaid tobacco excise taxes	274,157	297,332
Prepaid expenses	15,743	19,339
Consumption tax receivables	18,575	19,496
Other	31,836	25,547
Total	340,312	361,715

12. Non-current Assets Held-for-Sale

The breakdown of “Non-current assets held-for-sale” as of each fiscal year end is as follows:

Breakdown of Major Assets

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Non-current assets held-for-sale		
Property, plant and equipment	309	1,453
Investment property	512	943
Total	821	2,396

“Non-current assets held-for-sale” are mainly idle properties which are currently actively marketed for sale.

With regard to such assets and assets sold, impairment losses of ¥518 million are recognized in “Selling, general and administrative expenses” in the consolidated statement of income for the year ended December 31, 2017.

13. Property, Plant and Equipment

(1) Schedule of Property, Plant and Equipment

The schedules of the carrying amount, acquisition cost, and accumulated depreciation and accumulated impairment losses of “Property, plant and equipment” are as follows:

(Millions of yen)

Carrying Amount	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2016	339,542	249,160	46,355	46,808	681,865
Individual acquisition	13,053	30,787	12,390	43,758	99,989
Acquisition through business combinations	1,066	451	241	3	1,762
Transfer to investment property	(5,702)	(9)	(16)	－	(5,726)
Transfer to non-current assets held-for-sale	(180)	－	(0)	－	(180)
Depreciation	(15,709)	(47,121)	(14,670)	－	(77,500)
Impairment losses	(24)	(537)	(3)	(10)	(575)
Reversal of impairment losses	－	8	19	－	27
Sale or disposal	(507)	(3,646)	(736)	(162)	(5,050)
Exchange differences on translation of foreign operations	(4,722)	(8,864)	(766)	(4,252)	(18,604)
Other	17,420	25,963	1,377	(39,932)	4,827
As of December 31, 2016	344,237	246,192	44,193	46,213	680,835
Individual acquisition	17,833	43,586	15,071	38,647	115,137
Acquisition through business combinations	12,401	14,424	315	1,599	28,739
Transfer to investment property	(1,721)	(5)	(6)	－	(1,732)
Transfer to non-current assets held-for-sale	(2,250)	－	－	－	(2,250)
Depreciation	(15,813)	(48,717)	(14,634)	－	(79,164)
Impairment losses	(699)	(1,108)	(46)	(37)	(1,891)
Reversal of impairment losses	－	451	3	－	455
Sale or disposal	(581)	(4,685)	(1,011)	(17)	(6,295)
Exchange differences on translation of foreign operations	3,230	5,056	1,002	(226)	9,061
Other	6,610	23,894	1,486	(29,277)	2,712
As of December 31, 2017	363,245	279,088	46,373	56,902	745,607

(Millions of yen)
(Millions of yen)

Acquisition Cost	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2016	633,789	706,561	144,618	46,808	1,531,776
As of December 31, 2016	643,073	693,378	147,223	46,213	1,529,888
As of December 31, 2017	664,779	761,581	156,169	56,902	1,639,431

(Millions of yen)
(Millions of yen)

Accumulated Depreciation and Accumulated Impairment Losses	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2016	294,247	457,401	98,263	–	849,910
As of December 31, 2016	298,836	447,187	103,030	–	849,053
As of December 31, 2017	301,534	482,493	109,797	–	893,824

The carrying amount of property, plant and equipment as of each fiscal year end includes the carrying amount of the following leased assets:

	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Total
As of January 1, 2016	6,801	1,853	9	8,662
As of December 31, 2016	6,538	1,201	7	7,746
As of December 31, 2017	6,509	4,669	11	11,189

(2) Impairment Losses

The grouping of property, plant and equipment for impairment test is the smallest cash-generating unit that independently generates cash inflow.

The Group recognized impairment losses of ¥575 million for the year ended December 31, 2016, and ¥1,891 million for the year ended December 31, 2017 in "Selling, general and administrative expenses" in the consolidated statement of income.

Impairment losses recognized in the year ended December 31, 2016 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles, such as due to the decision of individual selection for demolition.

The recoverable amounts of these assets are calculated mainly by their values in use, which are set at "zero."

Impairment losses recognized in the year ended December 31, 2017 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles, such as due to the decision of closing down of a factory.

The recoverable amounts of these assets are calculated mainly by their values in use, which are set at "zero."

14. Goodwill and Intangible Assets

(1) Schedule of Goodwill and Intangible Assets

The schedules of carrying amount, acquisition cost, and accumulated amortization and accumulated impairment losses of "Goodwill" and "Intangible assets" are as follows:

(Millions of yen)

Carrying Amount	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2016	1,429,287	268,828	33,418	30,232	1,761,765
Individual acquisition	—	222	5,597	6,852	12,670
Acquisition through business combinations	289,720	180,297	8	2,243	472,268
Amortization (Note)	—	(44,154)	(12,795)	(5,696)	(62,645)
Impairment losses	—	—	(102)	—	(102)
Sale or disposal	—	—	(90)	(40)	(130)
Exchange differences on translation of foreign operations	(114,709)	(40,315)	(406)	(280)	(155,710)
Other	(2,312)	17	1,448	(1,314)	(2,161)
As of December 31, 2016	1,601,987	364,896	27,078	31,996	2,025,957
Individual acquisition	—	257	7,724	17,482	25,462
Acquisition through business combinations	202,144	71,450	—	12,831	286,425
Amortization (Note)	—	(46,786)	(12,808)	(6,079)	(65,673)
Impairment losses	—	(940)	(75)	(4)	(1,019)
Sale or disposal	—	—	(89)	(43)	(132)
Exchange differences on translation of foreign operations	87,080	12,410	(153)	(108)	99,229
Other	—	—	1,546	(1,409)	136
As of December 31, 2017	1,891,210	401,286	23,223	54,666	2,370,385

(Note) The amortization of intangible assets is included in "Cost of sales" and "Selling, general and administrative expenses" in the consolidated statement of income.

(Millions of yen)

(Millions of yen)

Acquisition Cost	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2016	1,429,287	818,982	135,951	92,062	2,476,282
As of December 31, 2016	1,601,987	928,876	137,761	96,994	2,765,618
As of December 31, 2017	1,891,210	1,028,189	142,531	126,263	3,188,192

(Millions of yen)

(Millions of yen)

Accumulated Amortization and Accumulated Impairment Losses	Goodwill	Trademarks	Software	Other	Total
As of January 1, 2016	—	550,154	102,533	61,830	714,517
As of December 31, 2016	—	563,981	110,683	64,997	739,661
As of December 31, 2017	—	626,903	119,308	71,597	817,808

(2) Material Goodwill and Intangible Assets

Goodwill and intangible assets recognized in the consolidated statement of financial position are mainly composed of goodwill and trademarks in the JTIH Group. The carrying amounts of goodwill as of December 31, 2016 and 2017 were ¥1,310,727 million and ¥1,599,950 million, respectively. The carrying amounts of trademarks as of December 31, 2016 and 2017 were ¥216,617 million and ¥269,453 million, respectively.

The majority of goodwill and trademark in the JTIH Group was recognized as a result of the acquisitions of RJR Nabisco's non-U.S. tobacco operations in 1999 and Gallaher in 2007.

Other than the above, goodwill and trademark in Domestic Tobacco business were recognized as a result of the acquisition of Natural American Spirit's non-U.S. tobacco operations in 2016. The carrying amounts of goodwill as of December 31, 2016 and 2017 were ¥265,891 million and ¥265,891 million, respectively. The carrying amounts of trademarks as of December 31, 2016 and 2017 were ¥148,260 million and ¥131,822 million, respectively.

The trademarks are amortized using the straight-line method and the remaining amortization period is mainly from 8 to 9 years.

(3) Impairment Test for Goodwill

For the year ended December 31, 2017, the carrying amount of the majority of goodwill is allocated to the domestic tobacco cash-generating unit of ¥265,891 million (¥265,891 million for the year ended December 31, 2016), the international tobacco cash-generating unit of ¥1,599,950 million (¥1,310,727 million for the year ended December 31, 2016) and the processed food cash-generating unit of ¥25,368 million (¥25,368 million for the year ended December 31, 2016). Details of the result of impairment tests are as follows:

A. Domestic Tobacco Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group conservatively decreases a growth rate from 3.9% (Prior year : 2.9%) in the fourth year to 0% (Prior year : 0%) in the ninth year gradually, and calculates the value in use from the tenth year by using the same cash flows as the ninth year.

The discount rate before taxes is 4.9% (Prior year : 4.6%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

B. International Tobacco Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group sets a growth rate from 6.4% in the fourth year (Prior year : 2.8%) to 2.8% in the ninth year (Prior year : 1.4%), and the same growth rate as the ninth year from the tenth year as a continued growth rate for inflation.

The discount rate before taxes is 9.8% (Prior year : 9.7%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

C. Processed Food Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group sets a growth rate from 1.6% in the fourth year (Prior year : 1.6%) to 1.0% in the ninth year (Prior year : 1.0%), and the same growth rate as the ninth year issued from the tenth year as a continued growth rate for inflation.

The discount rate before taxes is 3.9% (Prior year : 3.9%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

(4) Impairment Losses

Goodwill is allocated to cash-generating units that are identified according to locations and types of businesses. The grouping of intangible assets for impairment test is the smallest cash-generating unit that independently generates cash inflow.

The Group recognized impairment losses of ¥102 million for the year ended December 31, 2016, and ¥1,019 million for the year ended December 31, 2017 in “Selling, general and administrative expenses” in the consolidated statement of income.

15. Lease Transactions

The Group leases factory sites, vehicles and other assets as a lessee. Some of the lease contracts have renewal options or escalation clauses. There are no restrictions on additional debt and further leasing imposed by the lease arrangements.

(1) Present Value of Finance Lease Obligations

The total of future minimum lease payments for leased assets recognized based on the finance lease contracts, their present value and future financial costs as of each fiscal year end are as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Not later than 1 year		
Total of future minimum lease payments	589	1,630
Future financial costs	218	284
Present value	372	1,346
Later than 1 year and not later than five years		
Total of future minimum lease payments	1,696	3,503
Future financial costs	1,018	1,203
Present value	678	2,300
Later than 5 years		
Total of future minimum lease payments	9,489	9,626
Future financial costs	2,838	2,605
Present value	6,652	7,021
Total		
Total of future minimum lease payments	11,775	14,760
Future financial costs	4,074	4,092
Present value	7,701	10,667

(2) Future Minimum Lease Payments under Non-cancellable Operating Leases

The total of future minimum lease payments under non-cancellable operating leases as of each fiscal year end is as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Not later than 1 year	7,287	8,059
Later than 1 year and not later than 5 years	8,382	10,719
Later than 5 years	7,871	9,217
Total	23,539	27,995

(3) Total of Minimum Lease Payments and Contingent Rents

The total of minimum lease payments and contingent rents of operating lease contracts recognized as an expense for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Total of minimum lease payments	8,099	10,220
Contingent rents	1,147	1,135

16. Investment Property

(1) Schedule of Investment Property

The schedule of the carrying amount of "Investment property" for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Balance at the beginning of the period	23,614	18,184
Expenditure after acquisition	338	305
Transfer from property, plant and equipment	5,726	1,732
Transfer to non-current assets held-for-sale	(3,130)	(2,777)
Transfer to property, plant and equipment	(1,799)	—
Depreciation	(649)	(570)
Impairment losses	(562)	—
Sale or disposal	(1,904)	(162)
Exchange differences on translation of foreign operations	(5)	6
Other	(3,446)	(17)
Balance at the end of the period	18,184	16,700
Acquisition cost at the beginning of the period	69,106	51,245
Accumulated depreciation and accumulated impairment losses at the beginning of the period	45,493	33,061
Acquisition cost at the end of the period	51,245	45,768
Accumulated depreciation and accumulated impairment losses at the end of the period	33,061	29,068

The investment properties as of December 31, 2017 are mainly idle properties.

(2) Fair Value

The fair value of investment property is determined based on a valuation conducted by an external real estate appraiser. The valuation is made in accordance with the appraisal standards of the country where the investment property is located and based on market evidence of transaction prices for similar assets.

The fair value hierarchy of investment property is categorized from Level 1 to Level 3 as follows:

Level 1: Fair value measured at the quoted price in the active market
Level 2: Fair value that is calculated using the observable price other than categorized in Level 1 directly or indirectly
Level 3: Fair value that is calculated based on valuation techniques which include inputs that are not based on observable market data

The fair value of investment property based on the fair value hierarchy as of each fiscal year end is as follows:

As of December 31, 2016

(Millions of yen)

	Level 1	Level 2	Level 3	Total
Investment property	－	45,763	1,570	47,334

As of December 31, 2017

(Millions of yen)

	Level 1	Level 2	Level 3	Total
Investment property	－	34,646	1,921	36,567

(3) Impairment Losses

The grouping of investment properties for impairment test is based on the smallest cash-generating unit that independently generates cash inflow. Impairment test for idle properties is carried out individually.

The Group recognized impairment losses of ¥562 million for the year ended December 31, 2016 in “Selling, general and administrative expenses” in the consolidated statement of income.

Impairment losses recognized for the year ended December 31, 2016 represent the difference between the recoverable amount and the carrying amount of land and buildings as idle properties were individually selected for demolition. The recoverable amount is calculated based on value in use basis, which is zero for buildings due to the decision of demolition, and the recoverable amount of other properties is calculated by the fair value less costs of disposal.

17. Income Taxes

(1) Deferred Tax Assets and Deferred Tax Liabilities

The breakdown and schedule of “Deferred tax assets” and “Deferred tax liabilities” by major causes of their occurrence for each fiscal year are as follows:

Year ended December 31, 2016

(Millions of yen)

Deferred Tax Assets	As of January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2016
Fixed assets (Note 2)	40,392	(12,218)	–	108,540	136,713
Retirement benefits	91,870	(11,902)	1,441	(1,468)	79,940
Carryforward of unused tax losses	57,582	(2,029)	–	(2,419)	53,135
Other	76,839	(1,372)	4,192	(3,688)	75,971
Subtotal	266,683	(27,522)	5,633	100,966	345,760
Valuation allowance	(65,788)	322	1,914	2,320	(61,231)
Total	200,895	(27,200)	7,547	103,285	284,528

(Millions of yen)

Deferred Tax Liabilities	As of January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2016
Fixed assets (Note 2)	(87,915)	11,097	–	3,013	(73,805)
Retirement benefits	(7,696)	234	1,824	1,132	(4,506)
Other	(100,693)	(7,467)	(9,030)	5,931	(111,260)
Total	(196,305)	3,864	(7,206)	10,075	(189,572)

Year ended December 31, 2017

(Millions of yen)

Deferred Tax Assets	As of January 1, 2017	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2017
Fixed assets (Note 2)	136,713	(15,864)	—	3,859	124,709
Retirement benefits	79,940	(6,395)	(2,135)	2,211	73,621
Carryforward of unused tax losses	53,135	399	—	1,694	55,228
Other	75,971	(4,222)	(177)	2,860	74,433
Subtotal	345,760	(26,082)	(2,312)	10,625	327,991
Valuation allowance	(61,231)	(1,527)	(269)	(2,347)	(65,374)
Total	284,528	(27,609)	(2,581)	8,278	262,617

(Millions of yen)

Deferred Tax Liabilities	As of January 1, 2017	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2017
Fixed assets (Note 2)	(73,805)	1,677	—	(12,577)	(84,705)
Retirement benefits	(4,506)	(232)	(3,971)	(534)	(9,244)
Other	(111,260)	(3,539)	(5,196)	(2,568)	(122,563)
Total	(189,572)	(2,093)	(9,167)	(15,679)	(216,511)

(Note 1) "Other" includes exchange differences on translation of foreign operations and acquisition through business combinations.

(Note 2) "Fixed assets" include property, plant and equipment, goodwill, intangible assets and investment property.

The deferred tax assets are recognized for the amount considered to be recoverable on deductible temporary differences, carryforward of unused tax losses and tax credits by taking taxable temporary differences and future taxable profits plan into account. The carryforward of unused tax losses, for which the deferred tax assets are not recognized, was ¥44,484 million (including ¥12,644 million, for which the carryforward expires after five years) as of December 31, 2016, and ¥46,809 million (including ¥11,903 million, for which the carryforward expires after five years) as of December 31, 2017. Tax credits, for which the deferred tax assets are not recognized, were ¥4,951 million (including ¥4,541 million, for which the carryforward expires after five years) as of December 31, 2016, and ¥5,185 million (including ¥4,810 million, for which the carryforward expires after five years) as of December 31, 2017.

(2) Income Taxes

The breakdown of “Income taxes” for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Current income taxes	129,128	112,081
Deferred income taxes	23,336	29,702
Total income taxes	152,464	141,783

Deferred income taxes increased by ¥167 million and decreased by ¥801 million for the years ended December 31, 2016 and 2017, respectively, due to the effect of changes in tax rates in Japan and other countries.

(3) Reconciliation of the Effective Tax Rate

The breakdown of major items that caused differences between the effective statutory tax rate and the average actual tax rate for each fiscal year is as follows:

The Company is subject mainly to corporate tax, inhabitant tax and enterprise tax, and the effective statutory tax rate is calculated based on these taxes. The effective statutory tax rates were 32.78% and 30.66% for the years ended December 31, 2016 and 2017, respectively. Foreign subsidiaries are subject to income taxes at their locations.

(%)

	Year ended December 31, 2016	Year ended December 31, 2017
Effective statutory tax rate	32.78	30.66
Different tax rates applied to foreign subsidiaries	(7.62)	(8.86)
Non-deductible expenses	1.31	0.95
Valuation allowance	(0.03)	1.54
Withholding tax in foreign countries	0.97	1.29
Tax contingencies	0.16	1.26
Other	(1.22)	(0.52)
Average actual tax rate	26.37	26.33

18. Trade and Other Payables

The breakdown of “Trade and other payables” as of each fiscal year end is as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Accounts payable	188,285	218,378
Other payables	85,646	66,864
Other	104,002	110,491
Total	377,933	395,733

Trade and other payables are classified as financial liabilities measured at amortized cost.

19. Bonds and Borrowings (including Other Financial Liabilities)

(1) Breakdown of Financial Liabilities

The breakdown of “Bonds and borrowings” and “Other financial liabilities” as of each fiscal year end is as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017	Due
Derivative liabilities	12,516	5,425	—
Short-term borrowings	187,949	274,233	—
Commercial paper	—	66,808	—
Current portion of long-term borrowings	572	690	—
Current portion of bonds (Note)	20,000	56,451	—
Long-term borrowings	877	71,164	2019–2028
Bonds (Note)	338,158	275,791	—
Other	9,516	12,494	—
Total	569,589	763,056	
Current liabilities	221,544	405,088	
Non-current liabilities	348,045	357,968	
Total	569,589	763,056	

(Note) The summary of the issuing conditions of the bonds is as follows:

Company	Name of bond	Date of issuance	As of December 31, 2016	As of December 31, 2017	Interest rate	Collateral	Date of maturity
				(Millions of yen)	(%)		
Japan Tobacco Inc.	7th domestic straight bond	December 9, 2010	20,000 (20,000)	—	0.84	Yes	December 8, 2017
Japan Tobacco Inc.	8th domestic straight bond	December 9, 2010	20,000	20,000	1.30	Yes	December 9, 2020
Japan Tobacco Inc.	9th domestic straight bond	July 15, 2015	60,000	60,000	0.22	Yes	July 15, 2020
Japan Tobacco Inc.	10th domestic straight bond	July 15, 2015	30,000	30,000	0.36	Yes	July 15, 2022
Japan Tobacco Inc.	11th domestic straight bond	July 15, 2015	25,000	25,000	0.60	Yes	July 15, 2025
Japan Tobacco Inc.	Straight bond in USD	July 23, 2013	58,106 [USD 500 mil.]	56,451 (56,451) [USD 500 mil.]	2.10	Yes	July 23, 2018
Japan Tobacco Inc.	Straight bond in USD	April 13, 2016	87,109 [USD 750 mil.]	84,556 [USD 750 mil.]	2.00	Yes	April 13, 2021
Japan Tobacco Inc.	Straight bond in USD	April 13, 2016	57,943 [USD 500 mil.]	56,235 [USD 500 mil.]	2.80	Yes	April 13, 2026
	Total		358,158 (20,000)	332,242 (56,451)			

(Note 1) The figure in parentheses ( ) represents the amount of the current portion of the bond.
(Note 2) The figure in parentheses [ ] represents the amount of foreign currency-denominated bond.

Derivative liabilities are classified as financial liabilities measured at fair value through profit or loss excluding those to which hedge accounting is applied, and bonds and borrowings are classified as financial liabilities measured at amortized cost.

There are no financial covenants that have a significant impact on the Group on the bonds and borrowings.

(2) Assets Pledged as Collateral for Liabilities

A. Pursuant to the provisions of Article 6 of the Japan Tobacco Inc. Act, the Company’s properties are pledged as general collateral for bonds issued by the Company. Bondholders are entitled to claim satisfaction in preference to unsecured creditors of the Company properties (with the exception of national and local taxes and certain other statutory obligations).

B. Assets pledged as collateral by some subsidiaries are ¥66 million and ¥1,097 million as of December 31, 2016 and 2017, respectively. Their corresponding debts are ¥53 million and ¥241 million as of December 31, 2016 and 2017, respectively.

20. Provisions

The breakdown and schedule of “Provisions” for each fiscal year are as follows:

Year ended December 31, 2016

(Millions of yen)

	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of January 1, 2016	2,728	21,267	3,323	1,189	28,507
Provisions	685	4,774	3,459	450	9,368
Interest cost associated with passage of time	31	—	—	—	31
Provisions used	(85)	(13,414)	(3,323)	(430)	(17,253)
Provisions reversed	(10)	(748)	—	(153)	(911)
Exchange differences on translation of foreign operations	—	(2,755)	—	(35)	(2,790)
As of December 31, 2016	3,348	9,124	3,459	1,021	16,952
Current liabilities	26	8,287	3,459	757	12,529
Non-current liabilities	3,322	837	—	264	4,423
Total	3,348	9,124	3,459	1,021	16,952

Year ended December 31, 2017

(Millions of yen)

	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of January 1, 2017	3,348	9,124	3,459	1,021	16,952
Provisions	169	5,709	3,312	2,443	11,633
Interest cost associated with passage of time	40	—	—	—	40
Provisions used	(94)	(6,829)	(3,459)	(135)	(10,516)
Provisions reversed	(1)	(1,350)	—	(178)	(1,529)
Exchange differences on translation of foreign operations	—	418	—	34	453
As of December 31, 2017	3,463	7,074	3,312	3,185	17,033
Current liabilities	—	6,739	3,312	2,977	13,028
Non-current liabilities	3,463	335	—	208	4,005
Total	3,463	7,074	3,312	3,185	17,033

A. Asset Retirement Provisions

In order to settle the obligation of restoring and of removing hazardous substances from plant facilities and premises that the Group uses, the probable amount to be paid in the future is recognized based on past performances. These expenses are expected to be paid after one year or more; however, they may be affected by future business plans.

B. Restructuring Provisions

These provisions are mainly related to business integration and measures for the rationalization of the “International Tobacco Business.” The timing of the payment may be affected by future business plans.

C. Provisions for Sales Rebates

These provisions are for contracts which reward the customers with discounts when the sales volume or sales amount in a given period exceeds a specified volume or amount. They are expected to be paid within one year.

21. Other Liabilities

The breakdown of "Other current liabilities" and "Other non-current liabilities" as of each fiscal year end is as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Tobacco excise tax payables	306,816	265,343
Tobacco special excise tax payables	13,882	11,989
Tobacco local excise tax payables	180,799	167,420
Consumption tax payables	105,497	103,511
Bonus to employees	33,828	31,412
Employees' unused paid vacations liabilities	18,832	18,741
Other	132,195	140,685
Total	791,850	739,101
Current liabilities	689,629	618,322
Non-current liabilities	102,221	120,779
Total	791,850	739,101

22. Employee Benefits

(1) Post-employment Benefits

The Group sponsors funded or unfunded defined benefit plans and defined contribution plans as employee retirement benefit plans. The benefits of defined benefit plans are predetermined based on conditions, such as points employees have gained in compensation for each year of service, the payment rate, years of service, and average salaries in their final years of service before retirement.

The Company is obligated to bear pension costs for a mutual assistance association incurred with respect to services in or before June 1956 (prior to enforcement of the Act on the Mutual Aid Association of Public Corporation Employees). Such obligations are recognized as liabilities at their present value using the actuarial valuation method and are included in retirement benefit liabilities.

Special termination benefits may be provided to employees on their early retirements under certain circumstances.

The funded defined benefit plans are administrated by the Group or the fund that is legally separated from the Group in accordance with statutory requirements. The Group, or the board of the pension fund and the trustee of the plan, are required by law to act in the best interests of the plan participants, and are responsible for managing the plan assets in accordance with the designated investment strategy.

The Group's main defined benefit plans expose the Group to actuarial risks, such as investment risk, interest rate risk, inflation risk, and longevity risk.

(i) Investment risk

The present value of the defined benefit obligations is calculated using a discount rate set with reference to a yield on high quality corporate bonds or government bonds. If the return on the plan assets is below this yield, there is a possibility that the plan is underfunded.

(ii) Interest rate risk

A decrease in a yield on high quality corporate bonds or government bonds will increase the present value of the defined benefit obligations. However, this will be partially offset by an increase in the fair value of the debt instruments (plan assets).

(iii) Inflation risk

The level of benefit for certain defined benefit plans of the Group is linked to inflation. Accordingly, a rise in inflation will increase the present value of the defined benefit obligations.

(iv) Longevity risk

Some defined benefit plans of the Group provide a lifetime annuity, and the Group is obligated to provide pension benefits to the plan participants for the rest of their lives after their retirements. The present value of the defined benefit obligations is calculated by reference to the best estimate of the mortality of plan participants during or after employment. An increase in average life expectancy of the plan participants will increase the defined benefit obligations.

A. Schedule of Defined Benefit Obligations

The schedule of the defined benefit obligations is as follows:

(Millions of yen)

	Japan (Note 3)	Overseas	Total
As of January 1, 2016 (Notes 1, 2)	266,213	519,079	785,292
Current service cost	11,324	8,777	20,100
Past service cost and gains and losses on settlement	―	(5,362)	(5,362)
Interest expense	1,790	12,644	14,434
Contributions by plan participants	―	1,300	1,300
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	(1,158)	7,703	6,545
Actuarial gains and losses arising from changes in financial assumptions	4,222	59,529	63,751
Actuarial gains and losses arising from experience adjustments	(1,264)	(527)	(1,791)
Benefits paid	(20,953)	(23,963)	(44,916)
Exchange differences on translation of foreign operations	―	(62,630)	(62,630)
Other	(51)	324	273
As of December 31, 2016 (Notes 1, 2)	260,122	516,875	776,997
Current service cost	10,978	9,408	20,386
Past service cost and gains and losses on settlement	(222)	(8,263)	(8,485)
Interest expense	1,213	11,272	12,485
Contributions by plan participants	―	1,470	1,470
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	2	(4,437)	(4,435)
Actuarial gains and losses arising from changes in financial assumptions	27	248	276
Actuarial gains and losses arising from experience adjustments	(714)	(3,608)	(4,322)
Benefits paid	(21,435)	(26,974)	(48,410)
Exchange differences on translation of foreign operations	―	32,870	32,870
Other	1	1,554	1,554
As of December 31, 2017 (Notes 1, 2)	249,972	530,415	780,386

(Note 1) The Group’s weighted-average duration of the defined benefit obligations is 7.7 years for Japan and 15.7 years for overseas (Prior year : 7.7 years for Japan and 16.2 years for overseas).

(Note 2) The Group’s breakdown of the defined benefit obligation by plan participant is as follows:

(Millions of yen)

	As of December 31, 2016			As of December 31, 2017		
	Japan	Overseas	Total	Japan	Overseas	Total
Active members	165,390	191,202	356,592	163,592	184,639	348,231
Deferred members	15,006	70,980	85,986	15,102	73,182	88,284
Pensioners	79,726	254,693	334,418	71,278	272,594	343,872
Total	260,122	516,875	776,997	249,972	530,415	780,386

（Note 3）The schedule of mutual pension benefits obligations included in the category of Japan is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Balance at the beginning of the period	52,710	48,607
Interest expense	264	146
Remeasurement gains and losses	1,600	(1,081)
Benefits paid	(5,967)	(5,387)
Balance at the end of the period	48,607	42,284

B. Schedule of Plan Assets

The schedule of the plan assets is as follows:

(Millions of yen)

	Japan	Overseas	Total
As of January 1, 2016	96,806	393,878	490,684
Interest income	679	10,263	10,942
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	906	42,132	43,037
Contributions by the employer (Notes 1, 2)	2,099	7,015	9,113
Contributions by plan participants	―	1,300	1,300
Benefits paid	(6,918)	(20,311)	(27,229)
Exchange differences on translation of foreign operations	―	(58,376)	(58,376)
Other	―	(2,206)	(2,206)
As of December 31, 2016	93,571	373,696	467,267
Interest income	456	8,424	8,879
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	1,223	16,430	17,653
Contributions by the employer (Notes 1, 2)	1,690	10,172	11,862
Contributions by plan participants	―	1,470	1,470
Benefits paid	(6,943)	(22,174)	(29,116)
Exchange differences on translation of foreign operations	―	22,986	22,986
As of December 31, 2017	89,998	411,004	501,002

(Note 1) Pursuant to laws and regulations, the Group and the pension fund review the financial condition of the pension plan regularly and recalculate contributions for allocating future benefit and keeping the balance of the pension financing when the plan is underfunded.

(Note 2) The Group plans to pay contributions of ¥12,160 million in the year ending December 31, 2018.

C. Reconciliation of Defined Benefit Obligations and Plan Assets

The reconciliation of the defined benefit obligations and plan assets to the net defined benefit liabilities (assets) recognized in the consolidated statement of financial position as of each fiscal year end is as follows:

(Millions of yen)

As of December 31, 2016	Japan	Overseas	Total
Present value of the funded defined benefit obligations	92,436	383,213	475,648
Fair value of the plan assets	(93,571)	(373,696)	(467,267)
Subtotal	(1,136)	9,517	8,381
Present value of the unfunded defined benefit obligations	167,686	133,662	301,348
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	166,550	143,179	309,729
Retirement benefit liabilities	170,804	162,606	333,410
Retirement benefit assets	(4,254)	(19,426)	(23,680)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	166,550	143,179	309,729

(Millions of yen)

As of December 31, 2017	Japan	Overseas	Total
Present value of the funded defined benefit obligations	87,999	382,679	470,678
Fair value of the plan assets	(89,998)	(411,004)	(501,002)
Subtotal	(1,998)	(28,325)	(30,324)
Present value of the unfunded defined benefit obligations	161,973	147,736	309,709
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	159,974	119,411	279,385
Retirement benefit liabilities	164,793	165,969	330,762
Retirement benefit assets	(4,818)	(46,558)	(51,377)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	159,974	119,411	279,385

D. Major Breakdown of Plan Assets

The breakdown of plan assets by major category as of each fiscal year end is as follows:

(Millions of yen)

	Japan					
	As of December 31, 2016			As of December 31, 2017		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	18,233	―	18,233	12,243	―	12,243
Equity instruments	3,579	―	3,579	3,939	―	3,939
Japan	2,381	―	2,381	2,065	―	2,065
Overseas	1,198	―	1,198	1,874	―	1,874
Debt instruments	11,000	―	11,000	10,512	―	10,512
Japan	9,758	―	9,758	9,220	―	9,220
Overseas	1,242	―	1,242	1,292	―	1,292
General account of life insurance companies (Note)	―	60,155	60,155	―	61,241	61,241
Other	―	603	603	1,433	629	2,062
Total	32,813	60,759	93,571	28,127	61,870	89,998

(Millions of yen)

	Overseas					
	As of December 31, 2016			As of December 31, 2017		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	5,397	―	5,397	29,815	―	29,815
Equity instruments	123,669	―	123,669	65,725	―	65,725
United Kingdom	30,212	―	30,212	5,093	―	5,093
North America	38,532	―	38,532	23,487	―	23,487
Other	54,925	―	54,925	37,144	―	37,144
Debt instruments	207,393	5,035	212,427	273,724	5,593	279,317
United Kingdom	137,158	―	137,158	185,607	―	185,607
North America	47,524	―	47,524	46,723	―	46,723
Other	22,711	5,035	27,746	41,394	5,593	46,988
Real estate	9,026	441	9,468	10,035	258	10,293
Other	15,808	6,927	22,735	17,187	8,667	25,854
Total	361,293	12,403	373,696	396,485	14,519	411,004

(Millions of yen)

	Total					
	As of December 31, 2016			As of December 31, 2017		
	Market price in an active market		Total	Market price in an active market		Total
	Quoted	Unquoted		Quoted	Unquoted	
Cash and cash equivalents	23,630	—	23,630	42,058	—	42,058
Equity instruments	127,248	—	127,248	69,664	—	69,664
Debt instruments	218,393	5,035	223,428	284,236	5,593	289,829
Real estate	9,026	441	9,468	10,035	258	10,293
General account of life insurance companies (Note)	—	60,155	60,155	—	61,241	61,241
Other	15,808	7,530	23,338	18,620	9,297	27,916
Total	394,106	73,161	467,267	424,612	76,389	501,002

(Note) A certain interest rate and principal for the general account of life insurance are guaranteed by life insurance companies.

The investment strategy for the Group’s major plans is as follows:

(Japan)
The Company’s pension fund is managed in accordance with the internal policy for securing stable profits in the middle- and long-term in order to ensure the redemption of the plan liability. Concretely, by setting a target rate of return and composition ratio of plan assets by asset category within the risk tolerance that is annually assessed, the Company invests plan assets consistently with the composition ratio. When reviewing the composition ratio, the Company considers introducing an asset investment which has a high correlation with the liability.

In the case where an unexpected situation occurs in the market environment, it is temporarily allowed to make an adjustment on the weight of risk assets complying with the policy.

(Overseas)
The investment strategy for the foreign subsidiaries’ funded pension plans is decided properly by the trustee of the plan or the management of overseas subsidiaries according to local legislation. The Company’s objective for the foreign subsidiaries’ funded pension plans is to manage risks arising from its defined benefit obligation, and meanwhile to achieve a return on assets in excess of the movement in the value of the defined benefit obligation.

The majority of the plan assets have been allocated to liability matching bonds and the remaining parts of the plan assets are mainly invested in equities targeting long-term return.

E. Matters Related to Actuarial Assumptions

The major items of actuarial assumptions as of each fiscal year end are as follows:

As of December 31, 2016

	Japan	Overseas
	(%)	(%)
Discount rate	0.5	2.2
Inflation rate	–	2.6

	Japan		Overseas	
	Males	Females	Males	Females
	(years)	(years)	(years)	(years)
Average life expectancy at retirement (Note 1)				
Current pensioners	23.6 (Note 2)	29.3 (Note 2)	21.9 (Note 3)	24.3 (Note 3)
Future pensioners			23.3 (Note 4)	25.8 (Note 4)

As of December 31, 2017

	Japan	Overseas
	(%)	(%)
Discount rate	0.5	2.1
Inflation rate	–	2.4

	Japan		Overseas	
	Males	Females	Males	Females
	(years)	(years)	(years)	(years)
Average life expectancy at retirement (Note 1)				
Current pensioners	23.6 (Note 2)	29.3 (Note 2)	21.9 (Note 3)	24.2 (Note 3)
Future pensioners			23.2 (Note 4)	25.5 (Note 4)

(Note 1) The average life expectancies underlie the values of the defined benefit obligations on major plans. Assumptions regarding future mortality rate are based on published statistics and mortality tables.

(Note 2) Life expectancy for a pensioner currently aged 60. Regardless of the plan participant's current age, the Group performs actuarial calculations based on the assumption that life expectancy remains the same.

(Note 3) Life expectancy for a pensioner currently aged 65

(Note 4) Life expectancy at the age of 65 for an active member currently aged 50

(Note 5) The valuation of defined benefit obligations reflects a judgment on uncertain future events. The sensitivities of defined benefit obligations due to changes in major assumptions as of each fiscal year end are as follows. Each of these sensitivities assumes that other variables remain fixed; however, in fact, they do not always change independently. Negative figures show a decrease in pension plan obligations, while positive figures show an increase.

As of December 31, 2016

(Millions of yen)

	Change in assumptions	Japan	Overseas
Discount rate	Increase by 0.5%	(9,636)	(39,870)
	Decrease by 0.5%	10,363	43,735
Inflation rate	Increase by 0.5%	―	29,449
	Decrease by 0.5%	―	(25,654)
Mortality rate	Extended 1 year	5,540	19,321
	Shortened 1 year	(5,370)	(17,860)

As of December 31, 2017

(Millions of yen)

	Change in assumptions	Japan	Overseas
Discount rate	Increase by 0.5%	(9,259)	(39,316)
	Decrease by 0.5%	9,971	44,188
Inflation rate	Increase by 0.5%	―	26,909
	Decrease by 0.5%	―	(25,490)
Mortality rate	Extended 1 year	4,956	17,777
	Shortened 1 year	(4,794)	(18,423)

F. Breakdown of Defined Benefit Cost

The breakdown of defined benefit cost for each fiscal year is as follows:

Year ended December 31, 2016

(Millions of yen)

	Japan	Overseas	Total
Current service cost	11,324	8,777	20,100
Past service cost and gains and losses on settlement	—	(2,956)	(2,956)
Interest expense (income)	1,111	2,381	3,492
Defined benefit cost through profit or loss	12,435	8,201	20,636
Actuarial gains and losses arising from changes in demographic assumptions	(1,158)	7,703	6,545
Actuarial gains and losses arising from changes in financial assumptions	4,222	59,529	63,751
Actuarial gains and losses arising from experience adjustments	(1,264)	(527)	(1,791)
Return on plan assets (excluding amounts included in interest income)	(906)	(42,132)	(43,037)
Defined benefit cost through other comprehensive income	894	24,573	25,467
Total of defined benefit cost	13,328	32,775	46,103

Year ended December 31, 2017

(Millions of yen)

	Japan	Overseas	Total
Current service cost	10,978	9,408	20,386
Past service cost and gains and losses on settlement	(222)	(8,263)	(8,485)
Interest expense (income)	757	2,849	3,605
Defined benefit cost through profit or loss	11,514	3,993	15,507
Actuarial gains and losses arising from changes in demographic assumptions	2	(4,437)	(4,435)
Actuarial gains and losses arising from changes in financial assumptions	27	248	276
Actuarial gains and losses arising from experience adjustments	(714)	(3,608)	(4,322)
Return on plan assets (excluding amounts included in interest income)	(1,223)	(16,430)	(17,653)
Defined benefit cost through other comprehensive income	(1,908)	(24,226)	(26,135)
Total of defined benefit cost	9,605	(20,233)	(10,628)

(Note 1) The net amount of interest expense and interest income is included in “Financial costs.” Other expenses are included in “Cost of sales” and “Selling, general and administrative expenses.

(Note 2) Contributions to the defined contribution plans were ¥6,917 million for the year ended December 31, 2016 and ¥7,383 million for the year ended December 31, 2017 and were not included in the table above.

(2) Other Employee Benefit Expenses

The employee benefit expenses other than post-employment benefits that are included in the consolidated statement of income for each fiscal year are as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Remuneration and salary	211,838	221,896
Bonus to employees	59,474	60,274
Legal welfare expenses	39,803	43,192
Welfare expenses	34,581	37,399
Termination benefits	1,479	1,577

23. Equity and Other Equity Items

(1) Share Capital and Capital Surplus

A. Authorized Shares

The number of authorized shares as of December 31, 2016 and 2017 is 8,000,000 thousand ordinary shares.

B. Fully Paid Issued Shares

The schedule of the number of issued shares and share capital is as follows:

	(Thousands of shares) Number of ordinary issued shares	Share capital	(Millions of yen) Capital surplus
As of January 1, 2016	2,000,000	100,000	736,400
Increase (decrease)	―	―	―
As of December 31, 2016	2,000,000	100,000	736,400
Increase (decrease)	―	―	―
As of December 31, 2017	2,000,000	100,000	736,400

(Note) The shares issued by the Company are non-par value ordinary shares that have no restriction on any content of rights.

(2) Treasury Shares

The schedule of the number of treasury shares and its amount as of each fiscal year end is as follows:

	(Thousands of shares) Number of shares	(Millions of yen) Amount
As of January 1, 2016	209,285	444,333
Increase (decrease) (Note 2)	(241)	(512)
As of December 31, 2016	209,044	443,822
Increase (decrease) (Note 2)	(88)	(186)
As of December 31, 2017	208,957	443,636

(Note 1) The Company adopts share option plans and utilizes treasury shares for delivery of shares due to its exercise. Contract conditions and amount are described in “33. Share-based Payments.”

(Note 2) Purchases of shares less than one unit are 0 thousand shares for the year ended December 31, 2016 and 0 thousand shares for the year ended December 31, 2017. The number of shares delivered upon exercise of share options is 241 thousand shares for the year ended December 31, 2016 and 88 thousand shares for the year ended December 31, 2017. Sales of shares less than one unit were 0 thousand shares for the year ended December 31, 2016.

(3) Other Components of Equity

A. Subscription Rights to Shares
The Company adopts share option plans and issues subscription rights to shares based on the Companies Act. Contract conditions and amount are described in “33. Share-based Payments.”

B. Exchange Differences on Translation of Foreign Operations
Exchange differences on translation of foreign operations are composed of foreign currency translation difference that occurs when consolidating financial statements of foreign subsidiaries prepared in foreign currencies, and the effective portion of net gain (loss) on the hedging instruments designated as hedge of net investment.

C. Net Gain (Loss) on Derivatives Designated as Cash Flow Hedges
The Company uses derivatives for hedging to avoid the risk of fluctuation in future cash flows. This is the effective portion of changes in the fair value of hedging instruments designated as cash flow hedges.

D. Net Gain (Loss) on Revaluation of Financial Assets Measured at Fair Value through Other Comprehensive Income
This is the valuation difference in the fair value of financial assets measured at fair value through other comprehensive income.

E. Remeasurements of Defined Benefit Plans
Remeasurements of defined benefit plans comprise actuarial gains and losses, the return on plan assets excluding amounts included in interest income, and any change in the effect of the asset ceiling excluding amounts included in interest income. In addition, actuarial gains and losses are the effects of differences between the actuarial assumptions at the beginning of the year and what has actually occurred, and the effects of changes in actuarial assumptions. Remeasurements are recognized as other comprehensive income when they occur and are transferred immediately from other components of equity to retained earnings.

24. Dividends

Dividends paid for each fiscal year are as follows:

Year ended December 31, 2016

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 23, 2016)	Ordinary shares	114,606	64	December 31, 2015	March 24, 2016
Board of Directors (August 1, 2016)	Ordinary shares	114,617	64	June 30, 2016	September 1, 2016

Year ended December 31, 2017

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 24, 2017)	Ordinary shares	118,203	66	December 31, 2016	March 27, 2017
Board of Directors (August 2, 2017)	Ordinary shares	125,369	70	June 30, 2017	September 1, 2017

Dividends, for which the effective date falls in the following fiscal year, are as follows:

Year ended December 31, 2016

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 24, 2017)	Ordinary shares	118,203	66	December 31, 2016	March 27, 2017

Year ended December 31, 2017

	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 27, 2018)	Ordinary shares	125,373	70	December 31, 2017	March 28, 2018

25. Revenue

The reconciliation from “Gross turnover” to “Revenue” for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Gross turnover	7,062,848	7,286,883
Tobacco excise taxes and agency transaction amount	(4,919,561)	(5,147,230)
Revenue	2,143,287	2,139,653

The tobacco excise taxes and other transactions in which the Group is involved as an agency are excluded from revenue. The inflow of economic benefits after deducting the tobacco excise taxes and other transactions is presented as “Revenue” in the consolidated statement of income.

Gross turnover is an item that the Group discloses voluntarily and is not “Revenue” as defined by IFRS.

26. Other Operating Income

The breakdown of “Other operating income” for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Reversal of impairment losses on investments in associates	—	8,848
Gain on sale of property, plant and equipment, intangible assets and investment properties (Note)	41,161	24,025
Gain on sale of investments in subsidiaries (Note)	26,106	—
Other (Note)	2,835	12,851
Total	70,101	45,724

(Note) The amount of restructuring income included in each account for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Gain on sale of property, plant and equipment, intangible assets and investment properties	38,973	21,616
Gain on sale of investments in subsidiaries	26,106	—
Other	100	29
Total	65,178	21,645

27. Selling, General and Administrative Expenses

The breakdown of "Selling, general and administrative expenses" for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Advertising expenses	26,108	24,413
Promotion expenses	124,766	112,212
Shipping, warehousing expenses	26,793	26,950
Commission	50,860	54,458
Employee benefit expenses (Note 2)	241,752	254,045
Research and development expenses (Note 1)	58,193	60,600
Depreciation and amortization	79,088	81,298
Impairment losses on other than financial assets (Note 2)	1,239	3,427
Losses on sale and disposal of property, plant and equipment, intangible assets, and investment property (Note 2)	11,256	4,848
Other (Note 2)	134,060	164,661
Total	754,115	786,911

(Note 1) All research and development expenses are included in "Selling, general and administrative expenses."
(Note 2) The amount of restructuring costs included in each account is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Employee benefit expenses	1,243	1,578
Impairment losses on other than financial assets	743	1,554
Losses on sale and disposal of property, plant and equipment, intangible assets, and investment property	5,676	1,224
Other	4,231	3,957
Total	11,894	8,314

28. Financial Income and Financial Costs

The breakdown of “Financial income” and “Financial costs” for each fiscal year is as follows:

(Millions of yen)

Financial Income	Year ended December 31, 2016	Year ended December 31, 2017
Dividend income		
Financial assets measured at fair value through other comprehensive income	1,707	1,814
Interest income		
Financial assets measured at amortized cost		
Deposits and bonds	4,664	2,567
Other	247	399
Total	6,618	4,780

(Millions of yen)

Financial Costs	Year ended December 31, 2016	Year ended December 31, 2017
Interest expenses		
Financial liabilities measured at amortized cost		
Bonds and borrowings (Note 2)	8,592	11,517
Other	87	87
Foreign exchange losses (Note 1)	9,183	11,257
Employee benefit expenses (Note 3)	3,492	3,605
Other	355	882
Total	21,710	27,349

(Note 1) Valuation gain (loss) of currency derivatives is included in foreign exchange losses.

(Note 2) Valuation gain (loss) of interest rate derivatives is included in interest expenses.

(Note 3) The employee benefit expenses are the net amount of interest cost and interest income related to employee benefits.

29. Other Comprehensive Income

Amount arising during the year, reclassification adjustments to profit or loss and tax effects for each component of "Other comprehensive income" for each fiscal year are as follows:

Year ended December 31, 2016

(Millions of yen)

	Amount arising	Reclassification adjustments	Before tax effects	Tax effects	Net of tax effects
Items that will not be reclassified to profit or loss					
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	(5,574)	—	(5,574)	2,416	(3,159)
Remeasurements of defined benefit plans	(25,467)	—	(25,467)	3,265	(22,202)
Total of items that will not be reclassified to profit or loss	(31,042)	—	(31,042)	5,681	(25,361)
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	(157,539)	19	(157,520)	(6,163)	(163,683)
Net gain (loss) on derivatives designated as cash flow hedges	(2,986)	849	(2,136)	658	(1,479)
Total of items that may be reclassified subsequently to profit or loss	(160,525)	868	(159,657)	(5,506)	(165,162)
Total	(191,567)	868	(190,699)	175	(190,523)

Year ended December 31, 2017

(Millions of yen)

	Amount arising	Reclassification adjustments	Before tax effects	Tax effects	Net of tax effects
Items that will not be reclassified to profit or loss					
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	13,518	—	13,518	(4,116)	9,402
Remeasurements of defined benefit plans	26,135	—	26,135	(6,107)	20,028
Total of items that will not be reclassified to profit or loss	39,653	—	39,653	(10,223)	29,430
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	130,167	(341)	129,826	(1,753)	128,073
Net gain (loss) on derivatives designated as cash flow hedges	(532)	455	(77)	23	(54)
Total of items that may be reclassified subsequently to profit or loss	129,634	115	129,749	(1,730)	128,019
Total	169,287	115	169,402	(11,952)	157,449

30. Earnings per Share

(1) Basis of Calculating Basic Earnings per Share

A. Profit Attributable to Ordinary Shareholders of the Parent Company

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Profit for the period attributable to owners of the parent company	421,695	392,409
Profit not attributable to ordinary shareholders of the parent company	–	–
Profit for the period used for calculation of basic earnings per share	421,695	392,409

B. Weighted-average Number of Ordinary Shares Outstanding During the Period

(Thousands of shares)

	Year ended December 31, 2016	Year ended December 31, 2017
Weighted-average number of shares during the period	1,790,878	1,790,995

(2) Basis of Calculating Diluted Earnings per Share

A. Profit Attributable to Diluted Ordinary Shareholders

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Profit for the period used for calculation of basic earnings per share	421,695	392,409
Adjustment	–	(0)
Profit for the period used for calculation of diluted earnings per share	421,695	392,409

B. Weighted-average Number of Diluted Ordinary Shares Outstanding During the Period

(Thousands of shares)

	Year ended December 31, 2016	Year ended December 31, 2017
Weighted-average number of ordinary shares during the period	1,790,878	1,790,995
Increased number of ordinary shares under subscription rights to shares	1,030	1,042
Weighted-average number of diluted ordinary shares during the period	1,791,908	1,792,037

31. Non-cash Transactions

Significant Non-cash Transactions

The amount of assets acquired under finance leases was ¥202 million for the year ended December 31, 2016 and ¥3,599 million for the year ended December 31, 2017.

32. Reconciliation of Liabilities Arising from Financing Activities

Reconciliation of liabilities arising from financing activities for the year ended December 31, 2017 is as follows:

(Millions of yen)

			Non-cash changes				
	As of January 1, 2017	Cash flows	Acquisition through business combinations	Foreign exchange movement	Fair value changes	Other	As of December 31, 2017
Short-term borrowings and commercial paper	187,949	116,371	35,349	1,373	–	–	341,041
Long-term borrowings (Note 1)	1,449	70,191	131	82	–	–	71,854
Bonds (Note 1)	358,158	(20,000)	–	(6,086)	–	169	332,242
Finance lease obligations	7,701	(1,373)	324	416	–	3,599	10,667
Derivatives (Note 2)	(3,052)	–	–	–	562	–	(2,490)
Total	552,205	165,189	35,804	(4,214)	562	3,768	753,314

(Note 1) Current portion is included.

(Note 2) Derivatives are held for the purpose of hedging bonds.

33. Share-based Payments

The Company and Torii Pharmaceutical adopt share option plans. Share options are granted by the resolutions of the Board of Directors based on the approvals at the Annual Shareholders' Meeting.

The outline of the share option plan of the Company is as follows:

(1) Share Option Contract Conditions of the Company

Positions of persons granted	:	Directors and Executive Officers
Settlement	:	Issuance of shares
Effective period of granted share option	:	30 years after the date of grant
Vesting conditions	:	None

Conditions related to the exercise of share options are as follows:

(a) The subscription rights to shares become exercisable when a holder of a subscription right to shares no longer holds a position as a director, an audit & supervisory board member or an executive officer. In the subscription rights to shares allocation contract with holders of such rights, it is provided for that the rights become exercisable from the date following the date on which they no longer hold their positions.

(b) In the case where any holders of subscription rights to shares waive such rights, they cannot exercise them.

(2) Changes in the Number of Share Options of the Company

(Shares)

	Year ended December 31, 2016			Year ended December 31, 2017		
	Directors	Executive Officers	Total	Directors	Executive Officers	Total
Balance at the beginning of the period	324,800	807,200	1,132,000	275,800	701,000	976,800
Granted	34,200	51,800	86,000	53,000	89,400	142,400
Exercised	—	(241,200)	(241,200)	—	(88,000)	(88,000)
Transferred	(83,200)	83,200	—	—	—	—
Balance at the end of the period	275,800	701,000	976,800	328,800	702,400	1,031,200
Exercisable balance at the end of the period	—	442,200	442,200	—	378,800	378,800

(Note 1) The number of share options is presented as the number of underlying shares.

(Note 2) All share options are granted with an exercise price of ¥1 per share.

(Note 3) Share options are granted to 5 directors and 18 executive officers for the year ended December 31, 2016, and 5 directors and 19 executive officers for the year ended December 31, 2017.
"Transferred" included in the "Changes in the Number of Share Options" represents the number of share options for persons granted whose management position changed during the period.

(Note 4) The weighted-average fair values per share of share options granted during the period were ¥2,863 and ¥2,411 for the years ended December 31, 2016 and 2017, respectively.

(Note 5) The weighted-average share prices of share options at the time of exercise during the period were ¥4,258 and ¥3,810 for the years ended December 31, 2016 and 2017, respectively.

(Note 6) The weighted-average remaining contract years of unexercised share options at the end of each period were 25.2 years and 25.0 years for the years ended December 31, 2016 and 2017, respectively.

(3) Method of Measuring Fair Value of Share Options Granted During the Period of the Company

A. Valuation Model

Black-Scholes Model

B. Main Assumptions and Estimation

	Year ended December 31, 2016	Year ended December 31, 2017
Share price	¥4,315	¥3,950
Volatility of share price (Note 1)	32.9%	31.9%
Estimated remaining period (Note 2)	15 years	15 years
Estimated dividends (Note 3)	¥118/share	¥130/share
Risk free interest rate (Note 4)	(0.12)%	0.32%

(Note 1) Calculated based on daily share prices quoted for the past 15 years

(Note 2) Because of the difficulty of a reasonable estimation due to insufficient data, the remaining period is estimated based on the assumption that share option rights would be exercised at a midpoint of the exercise period.

(Note 3) Based on the latest dividends paid

(Note 4) The yield on government bonds for a period of the expected remaining period

(4) Share-based Payment Expenses

The costs for share options included in “Selling, general and administrative expenses” in the consolidated statement of income were ¥270 million and ¥341 million for the years ended December 31, 2016 and 2017, respectively.

34. Financial Instruments

(1) Capital Management

The Group's management principle is pursuit of the "4S" model: balancing the interests of consumers, shareholders, employees and wider society, and fulfilling our responsibilities towards them, aiming to exceed their expectations.

The Group believes that sustainable profit growth in the mid- to long-term based on this principle will increase the Group's value in the mid- to long-term, and is consequently in the best interest of all stakeholders, including our shareholders.

For that reason, as its financial policy, the Group maintains a strong financial base that secures stability in the case of changes in business environment such as economic crises, and flexibility enabling expeditious responses to business investment opportunities.

The Group manages net interest-bearing debt, where cash and cash equivalents are deducted from interest-bearing debt, and capital (the part attributable to the owners of the parent company). The amounts as of each fiscal year end are as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Interest-bearing debt	555,257	755,804
Cash and cash equivalents	(294,157)	(285,486)
Net interest-bearing debt	261,101	470,318
Capital (equity attributable to owners of the parent company)	2,456,091	2,761,687

There are specific rules for shares of the Company under the Japan Tobacco Inc. Act as follows:

The Japanese government shall hold more than one-third of all of the shares issued by the Company (excluding the type of shares, for which it is stipulated that voting rights may not be exercised on any matters that can be resolved by the Annual Shareholders' Meeting) (Article 2 (1)).

In cases where the Company intends to solicit persons to subscribe for shares to be issued or subscription rights to shares or where the Company intends to deliver shares (excluding treasury shares), subscription rights to shares (excluding subscription right to own shares) or bonds with subscription rights to shares (excluding bonds with subscription rights to shares) when exchanging with shares, the Company shall obtain the approval of the Minister of Finance (Article 2 (2)).

Disposal of shares owned by the Japanese government shall be within the limits on the number of shares decided by the Diet in the relevant annual budget (Article 3).

The Group monitors financial indicators in order to maintain a well-balanced capital structure that ensures an appropriate return on equity and a stable and flexible financial condition for future investment. We monitor credit ratings for financial stability and flexibility, and ROE (return on equity) for profitability, while focusing on changes in the domestic and overseas environment.

(2) Financial Risk Management

The Group is exposed to financial risks (credit risk, liquidity risk, foreign exchange risk, interest rate risk, and market price fluctuation risk) in the process of its management activities and it manages risks based on a specific policy in order to avoid or reduce said risks. The results of risk management are regularly reported by the Treasury Division to the president and the Board of Directors of the Company.

The Group policy limits derivatives to transactions for the purpose of mitigating risks from transactions based on actual demand. Therefore, we do not transact derivatives for speculation purposes or trading purposes.

(3) Credit Risk

Receivables, such as note and account receivables, acquired from the operating activities of the Group are exposed to customer credit risk.

The Group holds mainly debt securities for surplus investment and equity securities of customers and suppliers to strengthen relationships with them; those securities are exposed to the issuer's credit risk. In addition, through derivative transactions that the Group conducts in order to hedge foreign exchange fluctuation risks and interest rate fluctuation risks, we are exposed to the credit risk of the financial institutions which are counterparties to these transactions.

In principle, the Group sets credit lines or transaction conditions with respect to trade receivables for counterparties based on the Credit Management Guidelines in order to control the credit risk relating to counterparties. In addition, the receivable balances of counterparties with high credit risk are monitored. The Treasury Division of the Company regularly monitors the status of the occurrence and collection of bad debts, and reports them to the president and the Board of Directors of the Company.

With regard to the investment of cash surpluses and derivatives, the Group invests in debt securities and other financial instruments with a certain credit rating and transacts with financial institutions with a high credit rating in principle in order to prevent credit risks from occurring and based on the Group Financial Operation Basic Policy. In addition, the Treasury Division of the Company regularly monitors the performance of these transactions and reports the results to the president and the Board of Directors of the Company.

The maximum exposure pertaining to credit risks for financial assets is the carrying amount after considering impairment in the consolidated financial statements.

The analysis of the aging of financial assets that are past due but not impaired as of each fiscal year end date is as follows: The financial assets include amounts considered recoverable by credit insurance and collateral.

As of December 31, 2016

(Millions of yen)

	Total	Amount past due			
		Within 30 days	Over 30 days, within 60 days	Over 60 days, within 90 days	Over 90 days
Trade and other receivables	6,916	2,612	1,004	8	3,292

As of December 31, 2017

(Millions of yen)

	Total	Amount past due			
		Within 30 days	Over 30 days, within 60 days	Over 60 days, within 90 days	Over 90 days
Trade and other receivables	6,347	4,724	814	214	595

The Group reviews collectability of trade receivables depending on the credit conditions of counterparties and recognizes allowance for doubtful accounts. The schedule of the allowance for doubtful accounts is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Balance at the beginning of the period	9,345	8,436
Addition	335	22,090
Decrease (intended use)	(515)	(780)
Decrease (reversal)	(336)	(127)
Other	(394)	539
Balance at the end of the period	8,436	30,158

(4) Liquidity Risk

The Group raises funds by borrowings, commercial paper and bonds; however, these liabilities are exposed to the liquidity risk that we would not be able to repay liabilities on the due date due to the deterioration of the financing environment.

In accordance with the Group Financial Operation Basic Policy, the Group establishes a finance plan based on the annual business plan and the Treasury Division of the Company regularly monitors and collects information on the balance of liquidity-in-hand and interest-bearing debt and reports it to the president and the Board of Directors of the Company. In addition, the Group keeps necessary credit facilities to manage liquidity risk by having commitment lines with several financial institutions.

The financial liability balance (including derivative financial instruments) by maturity as of each fiscal year end is as follows:

As of December 31, 2016

(Millions of yen)

	Carrying amount	Contractual cash flow	Due within one year	Due after one year through two years	Due after two years through three years	Due after three years through four years	Due after four years through five years	Due after five years
Non-derivative financial liabilities								
Trade and other payables	377,933	377,933	377,933	—	—	—	—	—
Short-term borrowings	187,949	187,949	187,949	—	—	—	—	—
Current portion of long-term borrowings	572	572	572	—	—	—	—	—
Long-term borrowings	877	877	—	360	92	41	43	341
Current portion of bonds	20,000	20,000	20,000	—	—	—	—	—
Bonds	338,158	338,858	—	58,245	—	80,000	87,368	113,245
Subtotal	925,489	926,188	586,453	58,605	92	80,041	87,411	113,586
Derivative financial liabilities								
Foreign exchange forward contract	12,516	12,516	12,516	—	—	—	—	—
Subtotal	12,516	12,516	12,516	—	—	—	—	—
Total	938,005	938,704	598,970	58,605	92	80,041	87,411	113,586

As of December 31, 2017

(Millions of yen)

	Carrying amount	Contractual cash flow	Due within one year	Due after one year through two years	Due after two years through three years	Due after three years through four years	Due after four years through five years	Due after five years
Non-derivative financial liabilities								
Trade and other payables	395,733	395,733	395,733	—	—	—	—	—
Short-term borrowings	274,233	274,233	274,233	—	—	—	—	—
Commercial paper	66,808	66,808	66,808	—	—	—	—	—
Current portion of long-term borrowings	690	690	690	—	—	—	—	—
Long-term borrowings	71,164	71,164	—	386	201	117	30,119	40,341
Current portion of bonds	56,451	56,500	56,500	—	—	—	—	—
Bonds	275,791	276,250	—	—	80,000	84,750	30,000	81,500
Subtotal	1,140,870	1,141,378	793,964	386	80,201	84,867	60,119	121,841
Derivative financial liabilities								
Foreign exchange forward contract	5,425	5,425	5,425	—	—	—	—	—
Subtotal	5,425	5,425	5,425	—	—	—	—	—
Total	1,146,295	1,146,803	799,389	386	80,201	84,867	60,119	121,841

The total of commitment lines and withdrawal as of each fiscal year end are as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Total committed line of credit	574,432	601,580
Withdrawing	―	114,130
Unused balance	574,432	487,450

(5) Foreign Exchange Risk

The Group operates businesses globally and, therefore, is exposed to the following risks due to foreign exchange fluctuation:

(i) The risk where the profit or loss and cash flow in each functional currency of the Group is influenced by foreign exchange fluctuation as a result of external transactions and intergroup transactions, including the payment and receipt of dividends, in currencies that are different from each functional currency of the Group.

(ii) The risk that the equity of the Group is influenced by foreign exchange fluctuation when equity denominated in each functional currency of the Group is translated into Japanese yen and consolidated.

(iii) The risk that the profit or loss of the Group is influenced by foreign exchange fluctuation when profit or loss denominated in each functional currency of the Group is translated into Japanese yen and consolidated.

The Group hedges against risk (i) using derivatives or foreign currency-denominated interest-bearing debts for example, when future cash flow is projected or when receivables and payables are fixed, and some of them are designated as cash flow hedges.

The Group hedges against risk (ii) using foreign currency-denominated interest-bearing debts for example, and part of these are designated as net investment hedges. The Group does not hedge against risk (iii) in principle.

In order to mitigate risks mentioned above resulting from the foreign exchange fluctuation, in accordance with the Group Financial Operation Basic Policy, and under the supervision of the Financial Risk Management Committee of the Company, the Group establishes and implements a foreign currency hedge policy, taking into consideration the impact on the Group's performance and the current conditions of the foreign exchange market in a comprehensive manner. The Treasury Division of the Company regularly reports the performances to the president and the Board of Directors of the Company.

Foreign Exchange Sensitivity Analysis

In cases where each currency other than the functional currency that denominates the financial instruments held by the Group as of each fiscal year end increases by 10% in value against the functional currency, the impact on profit before income taxes in the consolidated statement of income is as follows:

The impact from the translation of functional currency-denominated financial instruments, and assets, liabilities, income and expenses of foreign operations into Japanese yen is not included. Also, it is based on the assumption that currencies other than the currencies used for the calculation do not fluctuate.

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Profit before income taxes	(1,502)	(9,473)

(6) Interest Rate Risk

Interest rate risk within the Group arises from interest-bearing debts after deducting cash equivalents. Borrowings and bonds with floating rates are exposed to interest rate fluctuation risk.

In order to reduce the interest rate fluctuation risk related to borrowings and bonds, in accordance with the Group Financial Operation Basic Policy, and under the supervision of the Financial Risk Management Committee of the Company, the Group establishes and implements an interest rate hedging policy, taking into consideration the impact on the Group's performance and the current condition of the interest rates in a comprehensive manner. The Treasury Division of the Company reports the performances to the president and the Board of Directors of the Company.

Interest Rate Sensitivity Analysis

In cases where the interest rate of financial instruments held by the Group as of each fiscal year end increases by 100bp, the impact on profit before income taxes in the consolidated statement of income is as follows:

The analysis is subject to financial instruments affected by interest rate fluctuation and based on the assumption that other factors, including the impacts of foreign exchange fluctuation, are constant.

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Profit before income taxes	(559)	(2,593)

(7) Hedging Transactions

The Group's policy for hedging transactions is stated in "3. Significant Accounting Policies."

A. Cash flow hedges

The details of hedging instruments designated as cash flow hedges are as follows:

As of December 31, 2016

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rates (yen, %)
			Assets	Liabilities	
Foreign exchange risk					
Foreign exchange forward contract					
JPY/ USD	USD 259 mil.	USD －	1,077	478	¥109.84
Interest rate risk					
Cross currency swap					
Fixed rate receipt and fixed rate payment	USD 175 mil.	USD 175 mil.	3,052	－	0.24%

As of December 31, 2017

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rates (yen, %)
			Assets	Liabilities	
Foreign exchange risk					
Foreign exchange forward contract					
JPY/ USD	USD 338 mil.	USD －	176	414	¥109.75
Interest rate risk					
Cross currency swap					
Fixed rate receipt and fixed rate payment	USD 175 mil.	USD －	2,490	－	0.24%

(Note) Carrying amounts of derivatives are presented as "Other financial assets" or "Other financial liabilities" in the consolidated statement of financial position, and the portion with over one year maturity is classified as "Non-current assets" or "Non-current liabilities."

The schedule of net gains (losses) on hedging instrument designated as cash flow hedges is as follows:

(Millions of yen)

	Effective portion of changes in the fair value of cash flow hedges		
	Foreign exchange risk	Interest rate risk	Total
As of January 1, 2016	(12)	137	125
Other comprehensive income			
Amount arising (Note 1)	(2,168)	(818)	(2,986)
Reclassification adjustments (Note 2)	128	721	849
Tax effects	625	33	658
Others	1,794	－	1,794
As of December 31, 2016	367	73	440
Other comprehensive income			
Amount arising (Note 1)	30	(562)	(532)
Reclassification adjustments (Note 2)	(155)	611	455
Tax effects	39	(15)	23
Others	(475)	－	(475)
As of December 31, 2017	(195)	106	(88)

(Note 1) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness approximates the change in fair value of the hedging instrument.

(Note 2) The amount, which is reclassified when the hedged item affects profit or loss, is recognized in “Revenue”, “Financial income” or “Financial costs” in the consolidated statement of income. The amount of hedge ineffectiveness is immaterial.

B. Hedge of net investment in foreign operations

The details of hedging instruments designated as hedge of net investment are as follows:

As of December 31, 2016

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rates (yen)
			Assets	Liabilities	
Short-term borrowings	USD 500 mil.	USD －	－	58,245	¥117.91
Bonds in USD	USD 1,575 mil.	USD 1,575mil.	－	182,773	¥107.36

As of December 31, 2017

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen)		Average rates (yen)
			Assets	Liabilities	
Bonds in USD	USD 1,575 mil.	USD 1,250mil.	－	177,467	¥107.36

(Note) Carrying amounts of bonds and short-term borrowings are presented as “Bonds and borrowings” in the consolidated statement of financial position, and the portion with over one year maturity is classified as “Non-current liabilities.”

The schedule of net gains (losses) on hedging instrument designated as hedge of net investment in foreign operations is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Balance at the beginning of the period	(4,497)	8,784
Other comprehensive income		
Amount arising (Note 1)	19,444	3,763
Tax effects	(6,163)	(1,753)
Balance at the end of the period (Note 2)	8,784	10,793

(Note 1) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness approximates the change in fair value of the hedging instrument.

(Note 2) Net gain arising from the hedging instruments for which hedge accounting is discontinued were ¥18,241 million and ¥16,936 million as of December 31, 2016 and 2017 respectively those which are included in the exchange differences on translation of foreign operations.

(8) Market Price Fluctuation Risk

With respect to securities, the Group regularly assesses the fair value and financial conditions of the issuers, and each relevant department reviews the portfolio held by taking into account the relationship with counterparty entities as necessary.

(9) Fair Value of Financial Instruments

The fair value hierarchy of financial instruments is categorized from Level 1 to Level 3 as follows:

Level 1: Fair value measured at the quoted price in the active market
Level 2: Fair value that is calculated using the observable price other than categorized in Level 1 directly or indirectly
Level 3: Fair value that is calculated based on valuation techniques which include inputs that are not based on observable market data

(i) Financial instruments measured at amortized cost

The carrying amount and fair value hierarchy of financial instruments measured at amortized cost as of each fiscal year end are as follows:

As of December 31, 2016

(Millions of yen)

	Carrying amount	Fair value			
		Level 1	Level 2	Level 3	Total
Long-term borrowings (Note)	1,449	—	—	1,449	1,449
Bonds(Note)	358,158	357,126	—	—	357,126

As of December 31, 2017

(Millions of yen)

	Carrying amount	Fair value			
		Level 1	Level 2	Level 3	Total
Long-term borrowings (Note)	71,854	—	—	71,829	71,829
Bonds (Note)	332,242	331,998	—	—	331,998

(Note) Current portion is included.

With regard to short-term financial assets and short-term financial liabilities measured at amortized cost, their fair value approximates the carrying amount.

The fair value of long-term borrowings is calculated based on the present value which is obtained by discounting the total of the principal and interest by the interest rate assumed in a case where the same loan is newly made.

(ii) Financial instruments measured at fair value

The fair value hierarchy of financial instruments measured at fair value is as follows:

(Millions of yen)

As of December 31, 2016

	Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	—	11,769	—	11,769
Equity securities	60,662	—	4,886	65,548
Other	368	—	2,316	2,683
Total	61,030	11,769	7,202	80,001
Derivative liabilities	—	12,516	—	12,516
Total	—	12,516	—	12,516

(Millions of yen)

As of December 31, 2017

	Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	—	5,978	—	5,978
Equity securities	71,859	—	5,783	77,642
Other	408	—	3,559	3,967
Total	72,267	5,978	9,342	87,587
Derivative liabilities	—	5,425	—	5,425
Total	—	5,425	—	5,425

(Note) The schedule of financial instruments that are classified in Level 3 is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Balance at the beginning of the period	6,966	7,202
Total gain (loss)		
Profit or loss (Note 1)	(16)	391
Other comprehensive income (Note 2)	80	914
Purchases	448	995
Sales	(76)	(159)
Other	(200)	—
Balance at the end of the period	7,202	9,342

(Note 1) Gains and losses included in profit or loss for the year ended December 31, 2016 and 2017 are related to financial assets measured at fair value through profit or loss as of the fiscal year end date. These gains and losses are included in "Financial income" and "Financial costs."

(Note 2) Gains and losses included in other comprehensive income for the year ended December 31, 2016 and 2017 are related to financial assets measured at fair value through other comprehensive income as of the fiscal year end date. These gains and losses are included in "Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income."

35. Related Parties

Based on the Japan Tobacco Inc. Act, the Japanese government shall hold more than one-third of all of the shares issued by the Company (excluding the type of shares, for which it is stipulated that voting rights may not be exercised on any matters that can be resolved by Annual Shareholders' Meeting). As of December 31, 2017, the Japanese government held 33.35% of all outstanding shares of the Company.

(1) Related-party Transactions

Related-party transactions are conducted under the same conditions as regular business transactions.

The Group's revenue from CJSC TK Megapolis, the local Russian distribution affiliate, was ¥207,768 million and ¥216,852 million for the years ended December 31, 2016 and 2017, respectively. The Group held trade receivables of ¥38,373 million and ¥49,097 million from CJSC TK Megapolis as of December 31, 2016 and 2017, respectively.

(2) Remuneration for Directors and Audit and Supervisory Board Members

Remuneration for directors and audit and supervisory board members for each fiscal year is as follows:

(Millions of yen)

	Year ended December 31, 2016	Year ended December 31, 2017
Remuneration and bonuses	620	540
Share-based payments	117	120
Total	737	660

36. Subsidiaries, Associates and Others

(The composition of the Group)

The composition of the Group by reportable segment as of each fiscal year end is as follows:

Reportable Segments	As of December 31, 2016		As of December 31, 2017	
	Number of subsidiaries	Number of entities accounted for using the equity method (Note)	Number of subsidiaries	Number of entities accounted for using the equity method (Note)
Domestic Tobacco	12	2	13	2
International Tobacco	150	5	156	5
Pharmaceuticals	2	—	2	—
Processed Food	28	3	28	3
Other	10	2	11	3
Total	202	12	210	13

(Note) No associates or joint ventures are considered to be material to the Group.

There is no significant change in the composition of the Group for the year ended December 31, 2017.

37. Commitments

(1) Commitments for the Acquisition of Assets

Commitments for the acquisition of assets after each fiscal year end date are as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Acquisition of property, plant and equipment	41,889	74,732
Acquisition of intangible assets	3,374	3,103
Total	45,264	77,835

(2) Procurement of Domestic Leaf Tobacco

With regard to the procurement of domestic leaf tobacco by the Company, based on the Tobacco Business Act, the Company enters into purchase contracts with domestic leaf tobacco growers every year, and the contracts determine the area under cultivation by type of tobacco and the prices by type and quality of tobacco leaf. Under the contracts, the Company is obligated to purchase all domestic leaf tobacco produced pursuant to such contracts, except for any domestic leaf tobacco not suited for the manufacture of tobacco products.

38. Business Combinations

(1) Acquisition of the Mighty Corporation assets and intellectual property rights related to the tobacco business

(i) Summary of Business Combinations

On September 7, 2017, the Group acquired the tobacco business of Mighty Corporation ("MC"), a company operating tobacco business in the Philippines, including its assets and intellectual property rights.

MC holds brands such as "Mighty" and "Marvels" which have strong brand equity in the Philippine tobacco market. In addition, MC also has a well-established distribution and sales network throughout the Philippines.

The purpose of this acquisition is to strengthen the Group's brand portfolio and expand distribution and sales area.

(ii) Consideration and Details (Total of the Acquisition)

The consideration is ¥102,392 million and paid fully in cash.

(Note) Out of the total consideration, ¥99,479 million has been paid as of the fiscal year end date and ¥2,913 million will be paid after the fiscal year end date.

(iii) Fair Values of the Assets Acquired and Liabilities Assumed

(Millions of yen)

	Fair value
Current assets	12,294
Trademarks	41,686
Non-current assets	9,747
Total assets	63,728
Current liabilities	2,176
Non-current liabilities	68
Total liabilities	2,244
Goodwill	40,908

Goodwill represents future economic benefits for integration synergies including enhanced business scale.

The amount of fair value of assets acquired and liabilities assumed are provisional amounts recognized at the acquisition date and may change during the measurement period (one year from the acquisition date).

Transaction costs of ¥247 million are expensed as incurred and recognized in "Selling, general and administrative expense".

(2) Acquisition of the kretek cigarette company and its distributor in Indonesia

(i) Summary of Business Combinations

On October 31, 2017, the Group completed the transfer of the 100% shares of PT. Karyadibya Mahardhika ("KDM"), a company operating kretek cigarette business in Indonesia, and its distributor, PT. Surya Mustika Nusantara ("SMN").

KDM produces kretek cigarettes in nine production facilities in Java and SMN and its affiliated distributors ("SMN Group") sell its products throughout Indonesia.

The purpose of this acquisition is to expand the presence in the Indonesian kretek cigarette market by leveraging KDM's supply chain, including production and procurement, as well as SMN Group's distribution and sales network throughout Indonesia.

(ii) Financial Impact on the Group

It is assumed that had the business been acquired on January 1, 2017, total consolidated revenue would have increased by ¥23,401 million to ¥2,163,053 million and total consolidated operating profit would have decreased by ¥6,288 million to ¥554,813 million.

The above operating profit includes the amortization of trademarks acquired from the business combinations, etc.

(iii) Consideration and Details (Total of the Acquisition)

The consideration is ¥74,318 million and paid fully in cash.

(Note) Out of the total consideration, ¥66,886 million has been paid as of the fiscal year end date and ¥7,432 million will be paid after the fiscal year end date.

(iv) Cash Out for the Business Combinations (Total of the Acquisition)

(Millions of yen)

	Net cash outflow for the business combinations
Cash consideration	74,318
Cash and cash equivalents in subsidiaries acquired	(1,071)
Net cash outflow for the business combinations	73,246

(v) Fair Values of the Assets Acquired and Liabilities Assumed

(Millions of yen)

	Fair value
Current assets	22,935
Trademarks	16,736
Non-current assets	27,061
Total assets	66,732
Current liabilities	42,095
Non-current liabilities	8,239
Total liabilities	50,334
Non-controlling interests	226
Goodwill	58,146

Goodwill represents future economic benefits for integration synergies including enhanced business scale.

Fair value of assets acquired and liabilities assumed are provisional amounts recognized at the acquisition date and may change during the measurement period (one year from the acquisition date).

Transaction costs of ¥2,216 million are expensed as incurred and recognized in "Selling, general and administrative expense".

(3) Made Ethiopian Tobacco company a consolidated subsidiary through acquisition of additional shares

(i) Summary of Business Combinations

On December 21, 2017, the Group purchased 30.95% of the total issued shares of National Tobacco Enterprise Share Company ("NTE"), a company operating Tobacco business in Ethiopia, from the Ethiopian Government. This additional shares purchase brought the Group's share ownership to 70.95% of the total number of NTE’s shares and made it a consolidated subsidiary.

The purpose of this additional shares purchase is to strengthen its business foundation in the Ethiopian tobacco market which has the importance in African market.

(ii) Financial Impact on the Group

It is assumed that had the business been acquired on January 1, 2017, total consolidated revenue would have increased by ¥7,061 million to ¥2,146,713 million and total consolidated operating profit would have increased by ¥379 million to ¥561,481 million.

The above operating profit includes the amortization of trademarks acquired from the business combinations, etc.

(iii) Consideration and Details (Total of the Acquisition)

(Millions of yen)

	Consideration
Cash	49,044
Fair value of equity interest in NTE held at the time of the acquisition	63,385
Total consideration	112,428

As a result of the Group’s re-evaluation of 40% of equity interest in NTE held at the time of the acquisition at fair value on the acquisition date, the Group recognized a gain on the step acquisition of ¥5,042 million in "Other operating income" in the consolidated statement of income.

(iv) Cash Out for the Business Combinations

(Millions of yen)

	Net cash outflow for the business combinations
Cash consideration	49,044
Cash and cash equivalents in subsidiaries acquired	(2,476)
Net cash outflow for the business combinations	46,568

(v) Fair Values of the Assets Acquired and Liabilities Assumed

(Millions of yen)

	Fair value
Current assets	4,566
Trademarks	13,771
Non-current assets	1,875
Total assets	20,212
Current liabilities	983
Non-current liabilities	4,459
Total liabilities	5,442
Non-controlling interests	4,291
Goodwill	101,948

Goodwill represents future economic benefits for integration synergies including enhanced business scale.

Non-controlling interests are measured at the non-controlling interest's proportionate share of the fair value of the identifiable net assets of NTE.

Fair value of assets acquired and liabilities assumed are provisional amounts recognized at the acquisition date and will change during the measurement period (one year from the acquisition date).

Other acquisitions

In addition to the above, the Group acquired other entities through business combinations for the year ended December 31, 2017, which are omitted as they are immaterial both individually and in aggregate.

39. Contingencies

Contingent Liabilities

The Company and some of its subsidiaries are defendants in legal proceedings. Provisions are not accounted for in matters where it is not practicable to reasonably estimate the final outcomes.

The Company and some of its subsidiaries, who are defendants in such legal proceedings, believe that our defenses asserted in these proceedings are based on substantial evidence and implement the system for the response to action with the assistance of external lawyers.

(1) Smoking and Health Related Litigation

The Company and some of its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking, the marketing of tobacco products, or exposure to tobacco smoke. As of December 31, 2017, there were a total of 21 smoking and health related cases pending in which one or more members of the Group were named as a defendant or for which the Company may have certain indemnity obligations pursuant to the agreement such as for the Company's acquisition of RJR Nabisco Inc.'s overseas (non-U.S.) tobacco operations.

The major ongoing smoking and health related cases are as follows:

a. Individual Claim

There is one individual case brought against the Company's indemnitee in South Africa.

South Africa Individual Claim (Joselowitz):

The individual claim was brought against the Company's indemnitee in South Africa in October 2000. Plaintiff seeks compensatory and punitive damages, alleging that the Company's indemnitee marketed products which it knew to be dangerous to health, manipulated nicotine content to foster addiction, failed to comply with South African labeling requirements and participated in a clandestine worldwide operation to encourage children to smoke. This case has been dormant since February 2001.

In addition, there is one individual case (which is currently dormant) brought against the Company's subsidiary in Ireland.

b. Class Actions

There are eight ongoing class actions in Canada against the Company's subsidiary and/or indemnitees.

Canada Quebec Class Action (Cecilia Letourneau):

This class action was brought in September 1998 against three Canadian tobacco manufacturers including JTI-Macdonald Corp. (hereinafter referred to as "JTI-Mac"), the Company's Canadian subsidiary. Plaintiffs are seeking a total of approximately ¥413 billion (approximately CAD 4.6 billion) in compensatory damages, an amount for which all the defendants are jointly and severally liable. Plaintiffs are seeking an additional amount of approximately ¥413 billion (approximately CAD 4.6 billion) in punitive damages, to be divided among all the defendants based on their respective market shares. The class was certified by the court in February 2005, and the trial was conducted from March 2012 through December 2014.

The Quebec Superior Court rendered the first instance judgment in May 2015, ordering a punitive damage award against the defendants of approximately ¥11.8 billion (CAD 131 million), in which the share of the total damage award against JTI-Mac is approximately ¥1.1 billion (approximately CAD 13 million). Although the Court found that the defendants had all committed some faults, it refused to award moral damages because the evidence did not establish the total amount of the claims of class members. In June 2015, JTI-Mac appealed the judgment to the Quebec Court of Appeal, and the appeal on the merits was heard in November 2016. The timing of the decision is at the Court's discretion.

Canada Quebec Class Action (Conseil Québécois sur le tabac et la santé):

This class action was brought in November 1998 against three Canadian tobacco manufacturers including JTI-Mac. Plaintiffs are seeking a total of approximately ¥1,118.8 billion (approximately CAD 12.4 billion) in compensatory damages, an amount for which all the defendants are jointly and severally liable. Plaintiffs are seeking an additional amount of approximately ¥72.9 billion (approximately CAD 0.8 billion) in punitive damages, to be divided among all the defendants based on their respective market shares. The class was certified by the court in February 2005, and the trial was conducted from March 2012 through December 2014.

The Quebec Superior Court rendered the first instance judgment in May 2015, ordering a compensatory damage award jointly and severally against the defendants of approximately ¥1,394.2 billion (CAD 15.5 billion), in which the share of the total damage award against JTI-Mac is approximately ¥181.2 billion (CAD 2.015 billion). Given the enormity of the damage award, the Court granted a symbolic amount of punitive damages of approximately ¥3 million (CAD 30,000) per defendant. In June 2015, JTI-Mac appealed the judgment to the Quebec Court of Appeal, and the appeal on the merits was heard in November 2016. The timing of the decision is at the Court's discretion.

Canada Saskatchewan Class Action (Adams):

This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The preliminary motions are pending. The case is currently dormant.

Canada Manitoba Class Action (Kunta):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The statement of claim was served on the Company's indemnitees but not on JTI-Mac. The case is currently dormant.

Canada Nova Scotia Class Action (Semple):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The statement of claim was served on the Company's indemnitees but not on JTI-Mac. The case is currently dormant.

Canada British Columbia Class Action (Bourassa):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2010. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

Canada British Columbia Class Action (McDermid):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2010. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

Canada Ontario Class Action (Jacklin):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2012. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

In addition, there is one class action brought in Israel against an indemnitee of the Company's subsidiary.

c. Health-Care Cost Recovery Litigation

There are 10 ongoing health-care cost recovery cases in Canada pending against the Company's subsidiary and indemnitees brought by all the Canadian provinces (except three Canadian territories). These provinces filed lawsuits under their own provincial legislation which was enacted exclusively for the purpose of authorizing the provincial government to file a direct action against tobacco manufacturers to recoup the health-care costs the government has allegedly incurred and will incur, resulting from "tobacco related wrongs."

Canada British Columbia Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of British Columbia in January 2001 against tobacco industry members including JTI-Mac and the Company's indemnitees based on its provincial legislation, the "Tobacco Damages and Health-Care Costs Recovery Act." The claim amount is unspecified. In 2001, several defendants challenged the legislation's constitutionality, which was ultimately rejected by the Supreme Court of Canada in September 2005. The action remains pending in the first instance. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada New Brunswick Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of New Brunswick in March 2008 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. The trial is set to begin in November 2019.

Canada Ontario Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Ontario in September 2009 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total claimed amount of ¥4,497.5 billion (CAD 50.0 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Newfoundland and Labrador Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Newfoundland and Labrador in February 2011 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Manitoba Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Manitoba in May 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province

of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Quebec Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Quebec in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total amount of the claim approximately ¥5,456.1 billion (approximately CAD 60.7 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Alberta Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Alberta in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total claimed amount of at least ¥899.5 billion (CAD 10.0 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Saskatchewan Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Saskatchewan in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Prince Edward Island Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Prince Edward Island in September 2012 against tobacco industry members including JTI-Mac and the Company’s indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Nova Scotia Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Nova Scotia in January 2015 against tobacco industry members including JTI-Mac and the Company’s indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

(2) Other Legal Proceedings

The Company and some of its subsidiaries are also engaged in other legal proceedings such as commercial and tax disputes, which may include proceedings that are conducted pursuant to applicable confidentiality obligations. Details of such proceedings and their outcomes are disclosed by the Company only where permitted by such confidentiality obligations.

One major commercial litigation case is pending.
Japan Compensatory Damages Claim:
In February 2010, a former President & CEO of Katokichi Co., Ltd. filed a claim against TableMark Holdings Co., Ltd. (renamed after acquisition of Katokichi Co., Ltd. by the Company) and its subsidiary seeking damages allegedly incurred by the plaintiff from an asset purchase agreement between the plaintiff and Katokichi Co., Ltd. and a joint and several guarantee provided by the plaintiff. The plaintiff argues the invalidity of the asset purchase agreement.

(Note) The amount of damages sought denominated in foreign currencies is translated into Japanese yen at the rates as of December 31, 2017.

40. Subsequent Events

The Group has signed an agreement to purchase 100% of the outstanding shares of JSC Donskoy Tabak, a company operating Tobacco business in Russia, on March 16, 2018 (Note 1). The purpose of this acquisition is to expand brand portfolio in the value segment and strengthen distribution and sales network in the Russian Tobacco market, a cornerstone of the Group's earnings growth.

The acquisition cost (Note 2) is estimated at around RUB 90 billion (approximately ¥166.5 billion) (Notes 3, 4). The transaction is expected to be completed by the beginning of the third quarter of the fiscal year 2018 following regulatory clearance.

(Note 1) To purchase 100% of the outstanding shares of JSC Pereslavl-Tabak and 94.97% of the outstanding shares of Syneteristiki Kapnoviomihania Ellados Sekap S.A. are included.

(Note 2) After deduction of net debt.

(Note 3) Translated at the rate of ¥1.85 per RUB

(Note 4) The acquisition cost would change at closing due to the impact of currency exchange and net debt adjustment.

(2)【Others】

A. Quarterly Information for the Year ended December 31, 2017

(Millions of yen)

	Q1 From January 1, 2017 to March 31, 2017	Q2 From January 1, 2017 to June 30, 2017	Q3 From January 1, 2017 to September 30, 2017	2017 From January 1, 2017 to December 31, 2017
Revenue	506,138	1,045,330	1,592,899	2,139,653
Profit before income taxes for the period (year)	142,493	302,913	453,935	538,532
Profit attributable to owners of the parent company for the period (year)	105,491	225,635	333,698	392,409
Basic earnings per share for the period (year) (yen)	58.90	125.98	186.32	219.10

	Q1 From January 1, 2017 to March 31, 2017	Q2 From April 1, 2017 to June 30, 2017	Q3 From July 1, 2017 to September 30, 2017	Q4 From October 1, 2017 to December 31, 2017
Basic earnings per share for the quarter (yen)	58.90	67.08	60.34	32.78

B. Significant Lawsuits

The significant lawsuits of the Group are as stated in “39. Contingencies” in the notes to consolidated financial statements.

2. Nonconsolidated Financial Statements

(1) Nonconsolidated Financial Statements

a. Nonconsolidated Balance Sheet

(Millions of yen)

		As of December 31, 2016		As of December 31, 2017
Assets				
Current assets				
Cash and deposits		74,565		89,775
Accounts receivable-trade	*2	54,410	*2	47,335
Securities		50,000		50,000
Merchandise and finished goods		30,767		33,448
Semi-finished goods		40,421		47,731
Work in process		2,793		2,480
Raw materials and supplies		43,053		46,057
Advance payments-trade		2,196		1,988
Prepaid expenses		6,826		9,293
Deferred tax assets		13,017		8,991
Short-term loans receivable from subsidiaries and affiliates		44,085		201,555
Other	*2	16,802	*2	17,856
Allowance for doubtful accounts		(27)		(26)
Total current assets		378,907		556,483
Noncurrent assets				
Property, plant and equipment				
Buildings		86,673		86,955
Structures		2,912		2,981
Machinery and equipment		52,941		54,829
Vehicles		1,654		1,416
Tools, furniture and fixtures		18,492		18,262
Land		75,118		73,177
Construction in progress		2,530		10,047
Total property, plant and equipment		240,321		247,668
Intangible assets				
Patent right		363		301
Right of trademark		149,174		132,508
Software		13,172		11,965
Goodwill		321,939		286,168
Other		2,892		7,447
Total intangible assets		487,539		438,389
Investments and other assets				
Investment securities		54,961		65,693
Shares of subsidiaries and affiliates		1,669,714		1,546,411
Long-term loans receivable from subsidiaries and affiliates		3,519		16,552
Long-term prepaid expenses		5,904		7,483
Other		9,338		7,337
Allowance for doubtful accounts		(291)		(255)
Total investments and other assets		1,743,146		1,643,220
Total noncurrent assets		2,471,006		2,329,277
Total assets		2,849,913		2,885,760

(Millions of yen)

		As of December 31, 2016		As of December 31, 2017
Liabilities				
Current liabilities				
Accounts payable-trade	*2	8,618	*2	7,957
Short-term loans payable		58,245		159,330
Current portion of bonds	*1	20,000	*1	54,158
Lease obligations	*2	3,754	*2	3,059
Accounts payable-other	*2	60,464	*2	47,608
National tobacco excise taxes payable		89,763		77,523
National tobacco special excise taxes payable		13,882		11,989
Local tobacco excise taxes payable		102,616		89,814
Income taxes payable		24,994		21,336
Accrued consumption taxes		31,192		24,677
Cash management system deposits received	*3	278,136	*3	283,490
Provision for bonuses		5,596		4,646
Other		7,785		8,048
Total current liabilities		705,045		793,635
Noncurrent liabilities				
Bonds payable	*1	335,808	*1	276,180
Long-term loans payable		-		70,000
Lease obligations	*2	6,355	*2	5,773
Provision for retirement benefits		131,165		131,472
Deferred tax liabilities		4,987		12,686
Other	*2	2,877	*2	3,047
Total noncurrent liabilities		481,194		499,159
Total liabilities		1,186,238		1,292,794

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Net assets		
Shareholders' equity		
Capital stock	100,000	100,000
Capital surplus		
Legal capital surplus	736,400	736,400
Total capital surplus	736,400	736,400
Retained earnings		
Legal retained earnings	18,776	18,776
Other retained earnings		
Reserve for investment loss on developing new business	28	169
Reserve for reduction entry	43,687	42,987
Special account for reduction entry	3,057	8,356
General reserve	955,300	-
Retained earnings brought forward	225,620	1,092,709
Total retained earnings	1,246,469	1,162,996
Treasury shares	(443,822)	(443,636)
Total shareholders' equity	1,639,047	1,555,760
Valuation and translation adjustments		
Valuation difference on available-for-sale securities	26,207	33,579
Deferred gains or losses on hedges	(3,373)	1,662
Total valuation and translation adjustments	22,833	35,242
Subscription rights to shares	1,794	1,964
Total net assets	1,663,675	1,592,966
Total liabilities and net assets	2,849,913	2,885,760

b. Nonconsolidated Statement of Income

(Millions of yen)

		Year ended December 31, 2016		Year ended December 31, 2017
Net sales	*1,*6	729,286	*1,*6	681,840
Cost of sales	*6	208,648	*6	182,446
Gross profit		520,638		499,394
Selling, general and administrative expenses	*2,*6	323,938	*2,*6	330,951
Operating income		196,700		168,443
Non-operating income				
Interest income	*6	237	*6	529
Dividends income	*6	6,929	*6	30,386
Other	*6	6,944	*6	6,564
Total non-operating income		14,109		37,479
Non-operating expenses				
Interest expenses	*6	2,020	*6	784
Interest on bonds		3,884		4,827
Other	*6	1,663	*6	975
Total non-operating expenses		7,567		6,586
Ordinary income		203,242		199,336
Extraordinary income				
Gain on sales of noncurrent assets	*3	36,638	*3	20,826
Gain on sales of shares of subsidiaries		28,503		-
Other		1,073		672
Total extraordinary income		66,214		21,499
Extraordinary losses				
Loss on sales of noncurrent assets	*4	1,186	*4	352
Loss on retirement of noncurrent assets	*5,*6	8,680	*5,*6	3,274
Impairment loss		593		518
Other		2,781		1,695
Total extraordinary losses		13,240		5,839
Income before income taxes		256,217		214,996
Income taxes-current		65,901		46,309
Income taxes-deferred		16,708		8,567
Total income taxes		82,609		54,875
Net income		173,607		160,120

c. Nonconsolidated Statement of Changes in Net Assets

Year ended December 31, 2016

(Millions of yen)

	Shareholders' equity									
		Capital surplus		Retained earnings						
					Other retained earnings					
	Capital stock	Legal capital surplus	Total capital surplus	Legal retained earnings	Reserve for investment loss on developing new business	Reserve for reduction entry	Special account for reduction entry	General reserve	Retained earnings brought forward	Total retained earnings
Balance at the beginning of current period	100,000	736,400	736,400	18,776	―	47,587	2,582	955,300	277,938	1,302,183
Changes of items during the period										
Provision of reserve for investment loss on developing new business					28				(28)	―
Reversal of reserve for investment loss on developing new business										
Provision of reserve for reduction entry						3,913			(3,913)	―
Reversal of reserve for reduction entry						(8,805)			8,805	―
Adjustment to reserve due to change in tax rate						992			(992)	―
Provision of special account for reduction entry							2,987		(2,987)	―
Reversal of special account for reduction entry							(2,582)		2,582	―
Adjustment to special account due to change in tax rate							69		(69)	―
Reversal of general reserve										
Dividends from surplus									(229,223)	(229,223)
Net income									173,607	173,607
Purchase of treasury shares										
Disposal of treasury shares									(99)	(99)
Net changes of items other than shareholders' equity										
Total changes of items during the period	―	―	―	―	28	(3,900)	474	―	(52,318)	(55,714)
Balance at the end of current period	100,000	736,400	736,400	18,776	28	43,687	3,057	955,300	225,620	1,246,469

	Shareholders' equity		Valuation and translation adjustments			Subscription rights to shares	Total net assets
	Treasury shares	Total shareholders' equity	Valuation difference on available-for-sale securities	Deferred gains or losses on hedges	Total valuation and translation adjustments		
Balance at the beginning of current period	(444,333)	1,694,250	29,791	(12,914)	16,877	1,941	1,713,068
Changes of items during the period							
Provision of reserve for investment loss on developing new business		―					―
Reversal of reserve for investment loss on developing new business							
Provision of reserve for reduction entry		―					―
Reversal of reserve for reduction entry		―					―
Adjustment to reserve due to change in tax rate		―					―
Provision of special account for reduction entry		―					―
Reversal of special account for reduction entry		―					―
Adjustment to special account due to change in tax rate		―					―
Reversal of general reserve							
Dividends from surplus		(229,223)					(229,223)
Net income		173,607					173,607
Purchase of treasury shares	(0)	(0)					(0)
Disposal of treasury shares	512	413					413
Net changes of items other than shareholders' equity			(3,584)	9,541	5,956	(147)	5,809
Total changes of items during the period	512	(55,203)	(3,584)	9,541	5,956	(147)	(49,394)
Balance at the end of current period	(443,822)	1,639,047	26,207	(3,373)	22,833	1,794	1,663,675

Year ended December 31, 2017

(Millions of yen)

	Shareholders' equity									
		Capital surplus		Retained earnings						
					Other retained earnings					
	Capital stock	Legal capital surplus	Total capital surplus	Legal retained earnings	Reserve for investment loss on developing new business	Reserve for reduction entry	Special account for reduction entry	General reserve	Retained earnings brought forward	Total retained earnings
Balance at the beginning of current period	100,000	736,400	736,400	18,776	28	43,687	3,057	955,300	225,620	1,246,469
Changes of items during the period										
Provision of reserve for investment loss on developing new business					169				(169)	—
Reversal of reserve for investment loss on developing new business					(28)				28	—
Provision of reserve for reduction entry						4,440			(4,440)	—
Reversal of reserve for reduction entry						(5,141)			5,141	—
Adjustment to reserve due to change in tax rate										
Provision of special account for reduction entry							8,356		(8,356)	—
Reversal of special account for reduction entry							(3,057)		3,057	—
Adjustment to special account due to change in tax rate										
Reversal of general reserve								(955,300)	955,300	—
Dividends from surplus									(243,572)	(243,572)
Net income									160,120	160,120
Purchase of treasury shares										
Disposal of treasury shares									(21)	(21)
Net changes of items other than shareholders' equity										
Total changes of items during the period	—	—	—	—	140	(700)	5,299	(955,300)	867,088	(83,473)
Balance at the end of current period	100,000	736,400	736,400	18,776	169	42,987	8,356	—	1,092,709	1,162,996

	Shareholders' equity		Valuation and translation adjustments			Subscription rights to shares	Total net assets
	Treasury shares	Total shareholders' equity	Valuation difference on available-for-sale securities	Deferred gains or losses on hedges	Total valuation and translation adjustments		
Balance at the beginning of current period	(443,822)	1,639,047	26,207	(3,373)	22,833	1,794	1,663,675
Changes of items during the period							
Provision of reserve for investment loss on developing new business		–					–
Reversal of reserve for investment loss on developing new business		–					–
Provision of reserve for reduction entry		–					–
Reversal of reserve for reduction entry		–					–
Adjustment to reserve due to change in tax rate							
Provision of special account for reduction entry		–					–
Reversal of special account for reduction entry		–					–
Adjustment to special account due to change in tax rate							
Reversal of general reserve		–					–
Dividends from surplus		(243,572)					(243,572)
Net income		160,120					160,120
Purchase of treasury shares	(1)	(1)					(1)
Disposal of treasury shares	187	166					166
Net changes of items other than shareholders' equity			7,373	5,036	12,409	170	12,579
Total changes of items during the period	186	(83,287)	7,373	5,036	12,409	170	(70,708)
Balance at the end of current period	(443,636)	1,555,760	33,579	1,662	35,242	1,964	1,592,966

【Notes to Nonconsolidated Financial Statements】

(Significant Accounting Policies)

1. Basis and Method of Valuation for Securities

(1) Shares of Subsidiaries and Affiliates:

Stated at cost determined by the moving-average method.

(2) Available-for-sale securities:

Securities with a Fair Value:

Stated at fair value based on market prices on the closing date of the accounting period. (Valuation difference is stated as a component of net assets and the cost of securities sold is calculated by applying the moving-average method.)

Securities without a fair value:

Stated at cost determined by the moving-average method.

2. Basis and Method of Valuation for Derivatives

Stated based on the fair value method.

3. Basis and Method of Valuation for Inventories

Stated at the lower of cost as determined by the average cost method.

(Balance sheet amounts are measured at the lower of cost or net selling value.)

4. Depreciation Methods for Depreciable Assets

(1) Property, Plant and Equipment (Excluding Lease Assets)

The declining-balance method is applied. However, the straight-line method is applied for buildings (excluding accompanying facilities) acquired on or after April 1, 1998 and for accompanying facilities and structures acquired on or after April 1, 2016.

The main useful lives are as follows:

Buildings (excluding accompanying facilities):	38 to 50 years
Machinery and equipment:	10 years

(2) Intangible Assets (Excluding Lease Assets)

The straight-line method.

The main useful lives are as follows:

Patent right:	8 years
Right of trademark:	10 years
Software:	5 years
Goodwill:	10 years

(3) Lease Assets

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

5. Policy on Translation of Assets and Liabilities Denominated in Foreign Currency into Japanese Yen

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the rates prevailing at the closing date of the accounting period with translation differences treated as gains or losses.

6. Policy on Accounting of Provisions

(1) Allowance for Doubtful Accounts

Provided for possible losses from bad debts at an amount determined based on the historical default rate for ordinary receivables and the individual recoverability of specific doubtful receivables from customers experiencing financial difficulties.

(2) Provision for Bonuses

Provided based on the estimated payable amount to provide for the payment of bonuses to employees and directors.

(3) Provision for Retirement Benefits

Provided in preparation for the payment of retirement benefits to employees based on the estimated retirement benefit obligations and fair value of plan assets as of the end of this fiscal year. In calculating retirement benefit obligations, the benefit formula basis is used as the method of attributing expected benefit to periods up to the year ended December 31, 2017.

Past service cost is amortized using the straight-line method over the average remaining years of service of the employees (10 years).

Actuarial gains and losses are amortized from the year following the year in which the gains or losses are recognized using the straight-line method over the average remaining years of service of the employees (10 years).

Also included in the provision for retirement benefits is the portion of public pension expenses for mutual assistance association during certain periods in or before June 1956 (prior to the enforcement of the Act on the Mutual Aid Association of Public Corporation Employees).

7. Method of Hedge Accounting

Deferral hedge accounting is applied.

For interest rate and currency swaps, if they satisfy the requirements for treatment that incorporates swaps into underlying accounting items (accounting by applying the foreign exchange rate stipulated in the contracts; exceptional treatment), they are accounted for by incorporating swaps into underlying accounting items.

8. Other Significant Accounting Policies

(1) Accounting Treatment relating to Retirement Benefits

Regarding unrecognized actuarial gains and losses and unrecognized past service cost relating to retirement benefits, different accounting treatments have been applied compared to those in the consolidated financial statements.

(2) Consumption Taxes

National consumption tax and local consumption tax are excluded from each amount in the nonconsolidated statement of income.

(Additional Information)

(Application of the Implementation Guidance on Recoverability of Deferred Tax Assets)

The "Implementation Guidance on Recoverability of Deferred Tax Assets" (Accounting Standards Board of Japan Guidance No. 26, March 28,2016) was applied from this fiscal year.

(Notes to Nonconsolidated Balance Sheet)

*1. Pursuant to Article 6 of the Japan Tobacco Inc. Act, the Company’s assets are pledged as general collateral for corporate bonds issued by the Company. Bondholders have the right to receive payment of their own claims for assets of the Company in preference to other general creditors (with the exception of national taxes, local taxes and other obligations of a public nature).

*2. Inter-company receivables and payables excluding those separately presented are as follows:

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Short-term receivables	25,277	20,939
Short-term payables	26,330	25,106
Long-term payables	6,367	4,890

*3. “Cash management system deposits received” represents the fund entrusted in the cash management system of domestic group companies.

4. Contingent obligations

Guarantees are provided for bank loans and others of subsidiaries and affiliates as follows:

Bank loans and others

As of December 31, 2016			As of December 31, 2017		
	(Millions of yen)			(Millions of yen)	
JT International Holding B.V.	58,311	(USD 500 million) others	JT International Company Netherlands B.V.	32,450	(EUR 239 million)
JT International Hellas A.E.B.E.	40,698	(EUR 333 million)	JT International S.A.	27,411	(USD 160 million) (CHF 48 million) (EUR 22 million) others
JT International S.A.	14,983	(USD 80 million) (EUR 37 million) (RUB 312 million) others	JT International Hellas A.E.B.E.	24,404	(EUR 180 million)
LLC Petro	11,304	(RUB 5,886 million)	JT International (Philippines) Inc.	19,848	(PHP 8,785 million)
			LLC Petro	10,153	(RUB 5,175 million)
			JT International Korea Inc.	10,143	(KRW 95,810 million)
Other (39 companies)	54,893		Other (39 companies)	64,448	
Total	180,189		Total	188,858	

Note: Guarantee obligations denominated in foreign currencies were translated into yen amounts using the exchange rate as of the closing date of the accounting period.

(Notes to Nonconsolidated Statement of Income)

*1. Net sales including tobacco excise taxes

(Millions of yen)

	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017
Net sales including tobacco excise taxes	1,955,218	1,780,038

Note: Net sales including tobacco excise taxes are net sales plus the amount equivalent to tobacco excise taxes.

*2. The main components of "Selling, general and administrative expenses" are as follows:

(Millions of yen)

	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017
Promotion expenses	48,832	44,386
Compensations, salaries and allowances	28,260	28,700
Provision for bonus	3,493	2,823
Employee benefit expenses	11,928	12,108
Commission	23,743	32,728
Depreciation and amortization	66,520	65,427
Research and development expenses	47,783	50,442
Selling expenses ratio	57%	54%
General and administrative expenses ratio	43%	46%

*3. The main component of "Gains on sales of noncurrent assets" is as follows:

(Millions of yen)

	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017
Land	36,546	20,806

*4. The main component of "Losses on sales of noncurrent assets" is as follows:

(Millions of yen)

	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017
Buildings	939	194

*5. The main components of "Losses on disposal of noncurrent assets" are as follows:

(Millions of yen)

	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017
Buildings	4,510	1,308
Machinery and equipment	2,479	998

*6. Amounts of transactions with subsidiaries and affiliates are as follows:

(Millions of yen)

	Fiscal year ended December 31, 2016	Fiscal year ended December 31, 2017
Net sales	89,831	76,550
Purchase of goods	73,784	67,433
Selling, general and administrative expenses	53,243	64,550
Dividends income	5,445	28,857
Amount of non-operating transactions	22,191	22,311

(Securities)

Investments in Subsidiaries and Affiliates

As of December 31, 2016

(Millions of yen)

Type	Balance sheet amount	Fair value	Difference
Investments in subsidiaries	41,580	39,806	(1,774)
Total	41,580	39,806	(1,774)

As of December 31, 2017

(Millions of yen)

Type	Balance sheet amount	Fair value	Difference
Investments in subsidiaries	41,580	46,581	5,001
Total	41,580	46,581	5,001

Note: Balance sheet amount of investments in subsidiaries and affiliates whose fair value is deemed extremely difficult to determine

(Millions of yen)

Type	As of December 31, 2016	As of December 31, 2017
Investments in subsidiaries	1,627,971	1,504,667
Investments in affiliates	163	163

The above are not included in “Investments in subsidiaries and affiliates” because their market values are not available and their fair values are deemed extremely difficult to determine.

(Tax Effect Accounting)

1. Breakdown of deferred tax assets and deferred tax liabilities by major cause

(Millions of yen)

	As of December 31, 2016	As of December 31, 2017
Deferred tax assets		
Provision for retirement benefits	23,534	25,599
Obligations pertaining to mutual assistance pension benefits	16,379	14,331
Other	28,292	23,150
Subtotal	68,205	63,080
Less valuation allowance	(11,136)	(10,162)
Total	57,070	52,918
Deferred tax liabilities		
Reserve for reduction entry	(19,109)	(18,803)
Deferred gains or losses on hedges	(10,751)	(10,665)
Valuation difference on available-for-sale securities	(10,290)	(13,515)
Other	(8,890)	(13,631)
Total	(49,040)	(56,614)
Net deferred tax assets/liabilities	8,030	(3,696)

2. Reconciliation between the effective statutory tax rate and the actual effective tax rate after applying tax effect accounting, if there is a significant difference

(%)

	As of December 31, 2016	As of December 31, 2017
Effective statutory tax rate	Note relating to the reconciliation between the effective statutory tax rate and the actual effective tax rate after applying tax effect accounting is omitted due to the fact that the difference is less than 5 percent of effective statutory tax rate.	30.66
(Adjustments)		
Permanent difference arising from non-deductible items including entertainment expenses		0.21
Permanent difference arising from non-taxable items including dividends income		(4.33)
Tax credit of items including research and development expenses		(1.31)
Other		0.30
Actual effective tax rate after applying tax effect accounting		25.52

(Business Combination)

No items to report.

(Significant Subsequent Events)

No items to report.

d. Supplementary Statements

Detailed Schedule of Property, Plant and Equipment and Others

(Millions of yen)

	Type of assets	Balance as of January 1, 2017	Increase in the fiscal year ended December 31, 2017	Decrease in the fiscal year ended December 31, 2017	Depreciation during the fiscal year ended December 31, 2017	Balance as of December 31, 2017	Accumulated depreciation or accumulated amortization as of December 31, 2017
Property, plant and equipment	Buildings	86,673	7,813	568 (81)	6,963	86,955	218,829
	Structures	2,912	467	65	334	2,981	11,255
	Machinery and equipment	52,941	15,001	845	12,267	54,829	168,848
	Vehicles	1,654	358	145	452	1,416	1,686
	Tools, furniture and fixtures	18,492	8,069	823	7.476	18,262	71,512
	Land	75,118	88	2,028 (437)	—	73,177	—
	Construction in progress	2,530	9,138	1,621	—	10,047	—
	Total property, plant and equipment	240,321	40,933	6,095 (518)	27,492	247,668	472,131
Intangible assets	Patent right	363	6	—	68	301	—
	Right of trademark	149,174	257	—	16,923	132,508	—
	Software	13,172	5,721	61	6,868	11,965	—
	Goodwill	321,939	—	—	35,771	286,168	—
	Other	2,892	5,431	733	142	7,447	—
	Total intangible assets	487,539	11,415	794	59,771	438,389	—

Notes: 1. The figures in parentheses in the "Decrease in the fiscal year ended December 31, 2017" column represent decreases due to impairment loss included in the figures above.

2. Other includes software in progress.

3. The major item of "Increase in the fiscal year ended December 31, 2017" and "Decrease in the fiscal year ended December 31, 2017" is as follows:

(Millions of yen)

Machinery and equipment	Increase	Tobacco products manufacturing equipment	14,819

Detailed Schedule of Reserve Allowances

(Millions of yen)

Category	Balance as of January 1, 2017	Increase in the fiscal year ended December 31, 2017	Decrease in the fiscal year ended December 31, 2017	Balance as of December 31, 2017
Allowance for doubtful accounts	318	1	38	281
Provision for bonuses	5,596	4,646	5,596	4,646

(2) Major Assets and Liabilities

Note is omitted due to the fact that the relevant parts are prepared in the consolidated financial statements.

(3) Others

No items to report

VI. Outline of filing company's business concerning shares

Business year	From January 1 to December 31
Ordinary General Meeting of Shareholders	March
Record date	December 31
Record dates for dividends from surplus	June 30, December 31
Share trade unit	100 shares
Purchase/sale of shares less than one unit:	
Office for handling business	(Special account) 4-5, Marunouchi 1-chome, Chiyoda-ku, Tokyo, Japan Mitsubishi UFJ Trust and Banking Corporation, Corporate Agency Division
Shareholder registry administrator	(Special account) 4-5, Marunouchi 1-chome, Chiyoda-ku, Tokyo, Japan Mitsubishi UFJ Trust and Banking Corporation
Forwarding office	–
Handling charge for purchase/sale	Free
Method of public notice	Electronic public notice will be made. However, if the Company is unable to make electronic public notice due to an accident or any other compelling reason, it will make an alternative public notice on "The Nikkei" newspaper. Electronic public notice will be notified on the Company's website: URL: https://www.jt.com/
Special benefits for shareholders	Special benefits for shareholders (1) Scope: All shareholders who appear in the shareholder registry as of December 31 and June 30 each year and hold 100 or more shares. (2) Description: The Company presents its own products (including products of the group companies and gifts and novelties with the Company name) 1) Shareholders with 100 or more than 100 and less than 200 shares — ¥1,000 equivalent 2. Shareholders with 200 or more than 200 and less than 1,000 shares — ¥2,000 equivalent 3) Shareholders with 1,000 or more than 1,000 and less than 2,000 shares — ¥3,000 equivalent 4) Shareholders with 2,000 or more shares — ¥6,000 equivalent * It is possible to choose for a contribution to be made to an organization that carries out social contribution activities in lieu of the presentation of products.

VII. Reference information on filing company

1. Information on filing company's parent company

The Company does not have a parent company as described by the provisions of Article 24-7, paragraph 1 of the Financial Instruments and Exchange Act.

2. Other reference information

From the beginning of this fiscal year until the filing date of this Annual Securities Report, the Company has filed the following documents.

(1) Annual Securities Report and Appendices, and Written Confirmation

Filed to Director-General of Kanto Local Finance Bureau on March 24, 2017

Business year: 32nd term (from January 1, 2016 to December 31, 2016)

(2) Internal Control Report

Filed to Director-General of Kanto Local Finance Bureau on March 24, 2017

Business year: 32nd term (from January 1, 2016 to December 31, 2016)

(3) Amendment Report of Annual Securities Report and Written Confirmation

Filed to Director-General of Kanto Local Finance Bureau on July 12, 2017

Business year: 32nd term (from January 1, 2016 to December 31, 2016)

(4) Quarterly Securities Reports and Written Confirmations

Filed to Director-General of Kanto Local Finance Bureau on May 11, 2017

First quarter of the 33rd term (from January 1, 2017 to March 31, 2017)

Filed to Director-General of Kanto Local Finance Bureau on August 3, 2017

Second quarter of the 33rd term (from April 1, 2017 to June 30, 2017)

Filed to Director-General of Kanto Local Finance Bureau on November 2, 2017

Third quarter of the 33rd term (from July 1, 2017 to September 30, 2017)

(5) Extraordinary Reports

Filed to Director-General of Kanto Local Finance Bureau on March 27, 2017

Extraordinary Report based on Article 19, paragraph 2, item (ix-2) (Results of Exercise of Voting Rights at the Ordinary General Meeting of Shareholders) of the Cabinet Office Ordinance on Disclosure of Corporate Information, etc.

Filed to Director-General of Kanto Local Finance Bureau on June 14, 2017

Extraordinary Report based on Article 19, paragraph 2, item (ii-2) (Issuance of Subscription Rights to Shares as Stock Options) of the Cabinet Office Ordinance on Disclosure of Corporate Information, etc.

Filed to Director-General of Kanto Local Finance Bureau on November 1, 2017

Extraordinary Report based on Article 19, paragraph 2, item (iii) (Change to a Specified Subsidiary Company) of the Cabinet Office Ordinance on Disclosure of Corporate Information, etc.

Filed to Director-General of Kanto Local Finance Bureau on January 5, 2018

Extraordinary Report based on Article 19, paragraph 2, item (ix) (Changes of Representative Directors) of the Cabinet Office Ordinance on Disclosure of Corporate Information, etc.

(6) Amendment Report of Extraordinary Report

Filed to Director-General of Kanto Local Finance Bureau on July 4, 2017

Amendment Report of Extraordinary Report filed on June 14, 2017.

(7) Shelf Registration Statement (straight bonds) and Appendices

Filed to Director-General of Kanto Local Finance Bureau on August 3, 2017

(8) Amendment to Shelf Registration Statements

Filed to Director-General of Kanto Local Finance Bureau on November 1, 2017

Amendment to Shelf Registration Statements pertaining to Shelf Registration Statement (straight bonds) filed on August 3, 2017.

Filed to Director-General of Kanto Local Finance Bureau on January 5, 2018

Amendment to Shelf Registration Statements pertaining to Shelf Registration Statement (straight bonds) filed on August 3, 2017.

(TRANSLATION)

INDEPENDENT AUDITOR'S REPORT

March 27, 2018

To the Board of Directors of
Japan Tobacco Inc.:

Deloitte Touche Tohmatsu LLC

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Masahiko Tezuka (Seal)

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Yasuhiko Haga (Seal)

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Takenao Ohashi (Seal)

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Yoichi Matsushita (Seal)

Audit of Financial Statements

Pursuant to the first paragraph of Article 193-2 of the Financial Instruments and Exchange Act, we have audited the consolidated financial statements included in the Accounting Section, namely, the consolidated statement of financial position, and the related consolidated statements of income, comprehensive income, changes in equity and cash flows of Japan Tobacco Inc. (the "Company") and its consolidated subsidiaries for the fiscal year from January 1, 2017 to December 31, 2017, and notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards pursuant to the provisions of Article 93 of the Ordinance on Terminology, Forms and Preparation Methods of Consolidated Financial Statements, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Audit Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Japan Tobacco Inc. and its consolidated subsidiaries as of December 31, 2017, and the results of their operations and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

Audit of Internal Control

Pursuant to the second paragraph of Article 193-2 of the Financial Instruments and Exchange Act, we have audited management's report on internal control over financial reporting of Japan Tobacco Inc. as of December 31, 2017.

Management's Responsibility for the Report on Internal Control

Management is responsible for designing and operating effective internal control over financial reporting and for the preparation and fair presentation of its report on internal control in accordance with assessment standards for internal control over financial reporting generally accepted in Japan. There is a possibility that misstatements may not be completely prevented or detected by internal control over financial reporting.

Auditor's Responsibility

Our responsibility is to express an opinion on management's report on internal control based on our internal control audit. We conducted our internal control audit in accordance with auditing standards for internal control over financial reporting generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether management's report on internal control is free from material misstatement.

An internal control audit involves performing procedures to obtain audit evidence about the results of the assessment of internal control over financial reporting in management's report on internal control. The procedures selected depend on the auditor's judgment, including the significance of effects on reliability of financial reporting. An internal control audit includes examining representations on the scope, procedures and results of the assessment of internal control over financial reporting made by management, as well as evaluating the overall presentation of management's report on internal control.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, management's report on internal control over financial reporting referred to above, which represents that the internal control over financial reporting of Japan Tobacco Inc. as of December 31, 2017 is effectively maintained, presents fairly, in all material respects, the results of the assessment of internal control over financial reporting in accordance with assessment standards for internal control over financial reporting generally accepted in Japan.

Interest

Our firm and the engagement partners do not have any interest in the Company for which disclosure is required under the provisions of the Certified Public Accountants Act.

The above represents a translation, for convenience only, of the original report issued in the Japanese language.

(TRANSLATION)

INDEPENDENT AUDITOR'S REPORT

March 27, 2018

To the Board of Directors of
Japan Tobacco Inc.:

Deloitte Touche Tohmatsu LLC

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Masahiko Tezuka (Seal)

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Yasuhiko Haga (Seal)

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Takenao Ohashi (Seal)

Designated Unlimited Liability Partner,
Engagement Partner,
Certified Public Accountant: Yoichi Matsushita (Seal)

Pursuant to the first paragraph of Article 193-2 of the Financial Instruments and Exchange Act, we have audited the nonconsolidated financial statements included in the Accounting Section, namely, the nonconsolidated balance sheet, and the related nonconsolidated statements of income and changes in net assets of Japan Tobacco Inc. (the "Company") for the 33rd fiscal year from January 1, 2017 to December 31, 2017, and the significant accounting policies and other related notes and supplemental schedules.

Management's Responsibility for the Nonconsolidated Financial Statements

Management is responsible for the preparation and fair presentation of these nonconsolidated financial statements in accordance with accounting principles generally accepted in Japan, and for such internal control as management determines is necessary to enable the preparation of nonconsolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these nonconsolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the nonconsolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the nonconsolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the nonconsolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the nonconsolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the nonconsolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Audit Opinion

In our opinion, the nonconsolidated financial statements referred to above present fairly, in all material respects, the financial position of Japan Tobacco Inc. as of December 31, 2017, and the results of its operations for the year then ended in accordance with accounting principles generally accepted in Japan.

Interest

Our firm and the engagement partners do not have any interest in the Company for which disclosure is required under the provisions of the Certified Public Accountants Act.

The above represents a translation, for convenience only, of the original report issued in the Japanese language.