



Operations and Analysis

Industry Overview

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

Tobacco Business

Tobacco industry Market dynamics

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

In addition, the next generation of emerging products such as vapor products has become widely popular. Especially the market size of 'E-Vapor' products or 'Electronic Cigarettes' (e-cigarettes) has been expanding at a fast rate in markets such as the U.S. and Europe, reaching global sales of approximately US\$10 billion in 2016. The products use vaporized liquid solutions often containing nicotine, and vapor is inhaled to offer a different experience. As E-Vapor products do not use tobacco leaf, they were not regulated or taxed as tobacco products, however, regulation or taxation of E-Vapor products is being developed in some markets.

Another type of emerging products referred to as 'T-Vapor' or 'Tobacco-vapor' has been growing particularly in Japan. Unlike E-Vapor, T-Vapor products use tobacco leaf and are therefore taxed and regulated as tobacco products in principle. Although the T-Vapor market is still in its making, we expect further innovation and product offerings will drive growth in this category, as market players take keen interest in this new growing market.

Approximately 5.5 trillion cigarettes are consumed around the world, reaching global sales of approximately US\$700 billion in 2016. China is by far the largest market, accounting for over 40% of global consumption, but it is almost exclusively operated by a state monopoly. Indonesia, Russia, the U.S. and Japan are the next four largest markets, according to a survey conducted in 2017*.

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

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

Overall, when we exclude China, global industry volume has been



slightly decreasing according to a survey conducted in 2017*.

However, more importantly, industry value continues to grow even in the current difficult operating environment, mainly driven by price increases. This is a sign of the resilience of the industry. These trends – decline in volume and increase in value – are expected to continue in the years ahead.

* Source: JT estimate (2016 data, as of July 2017).

Top market players

	Share of market (%)				
	2012	2013	2014	2015	2016
Philip Morris International Inc.	25.0	24.6	24.6	24.8	24.6
British American Tobacco Plc.	18.0	18.2	18.5	19.2	19.4
Japan Tobacco Inc.	14.1	14.2	13.9	14.1	14.4
Imperial Brands Plc.**	6.7	6.5	6.4	6.7	6.6

Source: JT estimate (2016 data, as of July 2017).

Excluding China National Tobacco Corp (CNTC).

** Company name changed to Imperial Brands Plc. as of February 2016.

Top 10 countries by volume

Country	Billion units				
	2012	2013	2014	2015	2016
China	2,461.6	2,490.5	2,549.5	2,489.5	2,350.5
Indonesia	302.5	308.3	314.3	320.4	316.1
Russia	370.8	346.3	316.2	292.5	278.4
U.S.	292.7	279.5	270.6	269.9	263.4
Japan	197.4	194.1	186.2	182.3	173.9
Turkey	95.3	91.7	94.7	103.2	105.5
Egypt	77.6	80.2	83.2	86.4	90.0
Bangladesh	76.3	78.6	80.6	83.4	86.1
India	102.1	100.9	95.9	88.1	84.9
Philippines	102.5	86.7	82.3	79.4	79.1

Source: JT estimate (2016 data, as of July 2017).



Regulations

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

Recent regulations are focusing more on the product itself. Plain packaging, or branding ban, has been introduced in some markets and furthermore, regulators are becoming more aggressive by restricting ingredients and emissions, following the guidelines on these attributes proposed by the Framework Convention on Tobacco Control. In Europe, the European Tobacco Product Directive adopted

extended health warnings, minimum packaging requirements or restrictions on the use of additives, among others. We expect to see EU member states complying with these restrictions by May 2017. These moves to commoditize tobacco products will undermine fair competition among tobacco manufacturers trying to meet increasingly diverse consumer preferences. Worse, they could result in an undesired increase in illicit trade, as commoditized products with less uniqueness are easier to counterfeit and more difficult to detect when smuggled.

Recently, new standards or frameworks for reduced risk claims have been established in a few countries such as the U.S. and part of Europe. In order to gain official approval from governments, activities in developing reduced risk claims have been intensified among major global tobacco manufacturers.

Taxations

Tobacco products are subject to excise or similar taxes in addition to value-added tax in most of countries as governments seek to secure their revenue or promote public health. Excise taxes were raised in various markets during the past year, and in general, tax increases are passed onto prices. Therefore, repeated tax increases in a short period of time, or steep tax increases, could lead

to a decline in industry volume. Often, tax increases coincide with an increase in illicit trade, which could, in turn, affect our business.

Competition

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

* Source: JT estimate (2016 data, as of July 2017).

** The company name of Imperial Tobacco Group Plc. was changed to Imperial Brands Plc. as of February 2016.

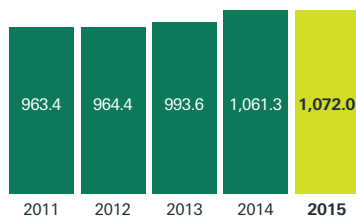
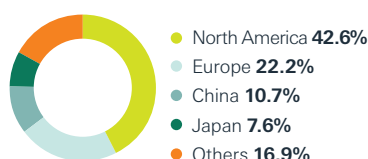
Top brands

Brand	Company	Billion units				
		2012	2013	2014	2015	2016
Marlboro	• Philip Morris International Inc. • Altria Group Inc.	414.1	395.9	391.4	392.5	385.8
Winston	• Japan Tobacco Inc. • Reynolds American Inc.***	135.0	140.8	132.6	135.0	141.5
Pall Mall	• British American Tobacco Plc. • Reynolds American Inc.	102.5	105.7	110.1	109.3	108.2
L&M	• Philip Morris International Inc. • Altria Group Inc.	96.0	98.6	98.7	103.2	102.5
Mevius	• Japan Tobacco Inc.	84.4	83.7	79.1	77.3	76.2
Camel	• Japan Tobacco Inc. • Reynolds American Inc.	62.9	62.7	66.8	71.0	71.3
Rothmans	• British American Tobacco Plc.	20.8	25.8	34.8	50.5	69.2
Cleopatra	• Eastern Co SAE	52.5	53.7	56.2	59.3	65.9
Gudang Garam	• Gudang Garam Tbk PT.	62.3	64.1	66.5	66.1	64.8
Kent	• British American Tobacco Plc.	63.6	61.8	60.2	62.0	62.6

Source: JT estimate (2016 data, as of July 2017).

Excluding China National Tobacco Corp (CNTC).

*** Brand owned by Imperial Brands Plc. from 2015.

Worldwide Pharmaceutical Market* (USD BN)**2015 Regional Composition***

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Pharmaceutical**Market dynamics**

The global pharmaceutical market continues to grow, reaching sales of approximately US\$1,072 billion in 2015*. North America, the largest market in the world, shows more than 10% growth over the previous year.

In emerging countries, demand for modern medicine is also rapidly growing due to multiple factors, including growing consciousness of health, increase in population, and development of public healthcare systems, among others. Facing a rapidly aging society and a fiscal deficit, the governments in these markets try to contain healthcare costs through wider promotion of generic drugs.

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

Mature markets take majority of shares in global pharmaceutical markets. North America is the largest market and accounts for approx. 43% of the worldwide market, followed by Europe and Japan, representing 22% and 8%, respectively*.

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

In Japan, the Government determines the price of pharmaceutical products with revisions being made every two years. In April 2016, the latest round of price revisions led to an industry-wide reduction of drug prices by 7.8% on average.

Competition

The pharmaceutical industry is highly competitive worldwide. Our pharmaceutical business focuses on building a R&D-led operational platform. Based on this platform, original compounds are developed and marketed as leading products in major global markets. As such, we face competition with Japanese and multinational pharmaceutical companies.

Processed Food**Market dynamics**

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

The size of the Japanese frozen food market in 2015 on a consumption basis including imports was ¥1,015.6 billion, up 2.8% year-on-year.

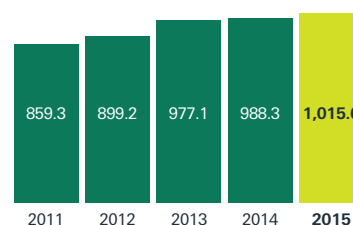
Regarding the domestic production of frozen food, the production monetary amount increased mainly as manufacturers amended the retail prices to adjust the increase in raw material costs.

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

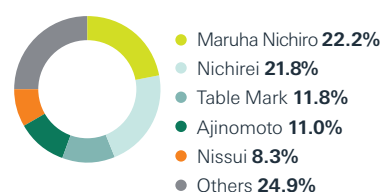
Competition

TableMark is competing against major players like Maruha Nichiro, Nichirei, Ajinomoto and Nissui as well as a multitude of mid-or small-scale producers. We are seeing a polarization of retailers as well as reorganization and oligopolization of the wholesale sector led by sogo-shosha, the general trading

companies, resulting in stronger price negotiation power against manufacturers. We are also seeing an increase in private label brands.

Japanese Frozen Food Market (JPY BN)

Source: Japan Frozen Food Association.

2015 Share of Market by Frozen Food Manufacturer

Source: The Nikkei Business Daily.

Review of Operations

Message from the President of Tobacco Business



Mutsuo Iwai
President, Tobacco Business

To strengthen the operation of our tobacco business, we established “Global Tobacco Strategic Committee” and appointed “President, Japanese Tobacco Business” as of January 1, 2017. Under this new organization structure, we will overcome present and future challenges. Our tobacco business, Japanese and international tobacco businesses as a whole, will remain committed to achieving our target of mid to high single-digit profit growth rate over mid- to long-term.

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We will continuously strive to achieve sustainable growth of the Group’s Tobacco Business under the new organization structure.”

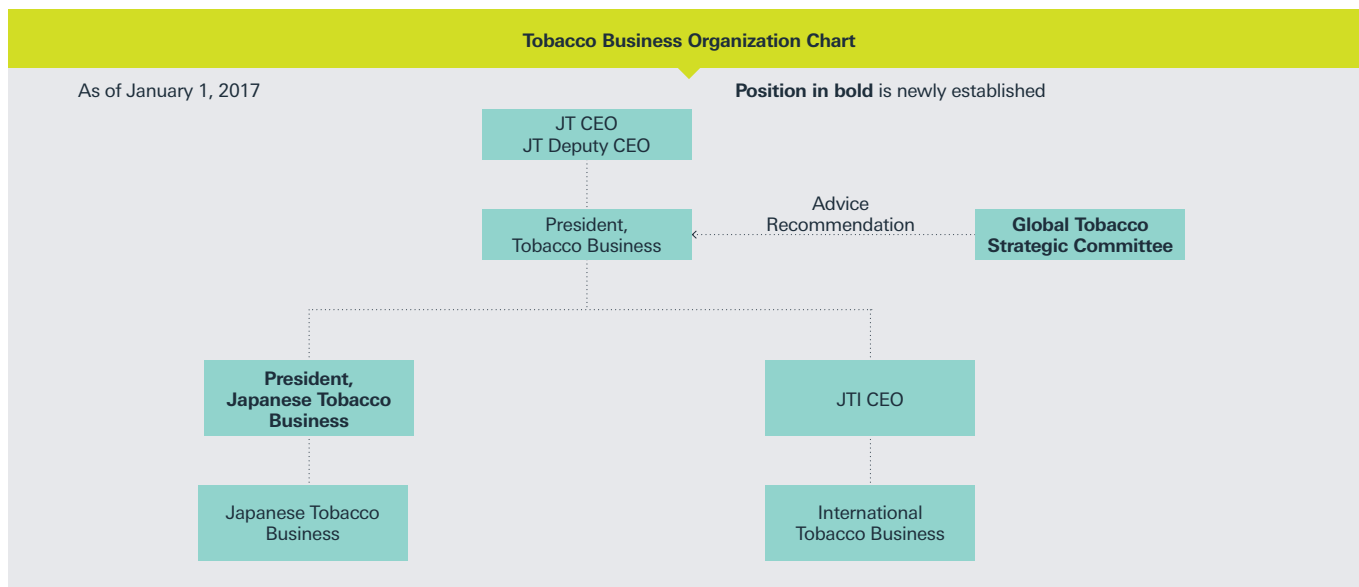
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“Global Tobacco Strategic Committee” is an advisory committee for the President of the Tobacco Business and is composed of JT and JTI Executives. Its principal objective is to facilitate future growth strategy of the Group’s Tobacco Business. The Committee will discuss the mid- to long-term growth strategies for the overall tobacco business including resource allocation related to business investments and provide advice and recommendations to the President of the Tobacco Business.

- Members of the Committee will be:
- President, Tobacco Business (Chairman),
 - President, Japanese Tobacco Business,
 - Head of Tobacco Business Planning Division,
 - JTI Chief Executive Officer,
 - JTI Deputy Chief Executive Officer,
 - JTI Chief Operating Officer etc.

“President, Japanese Tobacco Business” was appointed to be fully in charge of the Japanese domestic tobacco business, reporting directly to the President of the Tobacco Business, in order to accelerate business decision-making.

Meanwhile, by delegating the major roles and responsibilities for the operations in Japan, the President of the Tobacco Business will be able to better facilitate the overall management of tobacco business.



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Tobacco Business Value Chain



R&D

Create value for the business through innovation and quality

We focus on fundamental research and product technology development, taking advantage of our global research platform, in close collaboration with other functions. In particular, focus areas in our R&D activities are:

- Develop products and analytical capabilities in line with market needs and our anticipation of regulatory trends.
- Maintain existing products to comply with regulatory changes.
- Develop new technologies and improve production processes to maintain competitiveness and increase efficiency.
- Drive product innovation to enhance equity from various aspects, including tobacco leaves, blends, filters, printing techniques and packaging.
- Develop emerging products.



Procurement

Ensure stable supply of quality tobacco leaf

Tobacco leaf is the most important material for our products, and we dedicate our efforts to strengthen our capability to ensure a stable supply of quality leaf in the long-term.

- Increase the proportion of leaf from our vertical integration bases in Africa, Brazil and the U.S.
- Enhance sustainability of tobacco farming by helping farmers to improve productivity as well as taking initiatives to support their communities.
- Maintain good relationships with external suppliers to ensure sufficient supply at competitive prices.

With regard to non-tobacco materials, we aim to mitigate cost increases due to design enhancements and investment in innovative products by, among others, effectively managing procurement lot-size.



Manufacturing

Support top-line growth by delivering quality products

Our emphasis on product quality is increasing to meet consumer expectations for innovative offerings. In addition, we consistently pursue an optimal manufacturing footprint which ensures efficient and timely product deliveries to markets.

- Strengthen our ability for business continuity in times of emergency.
- Ensure high quality of products and enhance flexibility in the manufacturing process, overcoming complexity in manufacturing due to an increase in number of products.
- At the same time, seek efficiency by containing cost increases through continuous improvement and reviewing of manufacturing footprint for further optimization.



Marketing

Enhance equity of flagship brands

Our strategic focus is placed on our flagship brands and we strive to enhance their equity through effective communications with consumers.

- Allocate appropriate resources to support GFB's equity building.
- Implement responsible marketing programs, in compliance with applicable laws and regulations as well as our internal global marketing principles.



Sales & Distribution

Expand product availability by leveraging our trade marketing excellence

There are various sales channels for tobacco products such as supermarkets, convenience stores, street and train station kiosks, small independent retailers and vending machines. Key channels are different depending on the market and we develop win-win relationships with them to increase the availability of our products.

- Strengthen relationship with key accounts, leveraging our trained sales forces.
- Develop trade marketing initiatives for each market, taking into account the channel development as well as consumer trends and competitors' actions.

International Tobacco Business

FY2016: Results for the fiscal year ended December 31, 2016



Thomas A. McCoy
President and Chief Executive Officer, JT International

2016 was our sixth consecutive year of double-digit profit growth at constant currency. We were once again the fastest growing tobacco company, further strengthening our business fundamentals, competitiveness and our role as the profit growth engine of the JT Group.

Share gains, together with benefits from acquisitions, enabled JTI to achieve a total shipment volume growth of 1.2%, our best performance since 2012. In addition, our Global Flagship Brands, now including Natural American Spirit, grew volume for the second consecutive year.

This positive volume combined with robust pricing across all clusters drove core revenue and adjusted operating profit growth at constant currency. Importantly, this solid top and bottom-line performance was achieved while continuing our strategic investments behind Global Flagship Brands, seeding markets and emerging products; investments that are strengthening the business and paving the way for continued growth over the mid to long-term period.

In seeding markets our strategic investments are paying off, with strong GFB volume growth driving a significant year-on-year core revenue increase at constant currency.

We plan to continue investing in these initiatives going forward to increase their contribution to revenue and profit growth.

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The core mission of JTI is to be the profit growth engine of the JT Group.”

We also invested further toward our vision to become a global leader in emerging products. Following the acquisition of Logic in 2015, JTI became a leading E-Vapor player in the key markets of the USA, the UK and France. And we continued our international expansion.

For 2017, the operating environment is expected to remain challenging, primarily due to regulatory changes in Europe and continued price competition mainly in CIS+. Despite these anticipated challenges, JTI is targeting another year of strong earnings growth and we are confident that we will continue to deliver sustainable growth over the long term.

Our strategies

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

JTI’s strategic growth agenda sets out three key priorities:

- Organic growth in markets where JTI’s presence is established.
- Expansion of our geographic footprint in emerging markets for future growth.
- Develop a leadership position in emerging products.

Our key strategic drivers are:

- Build and nurture outstanding brands.
- Enhance productivity continuously.
- Maintain focus on responsibility and credibility.
- Strengthen human resources as a cornerstone of growth.

Total Shipment Volume

398.7

(BnU)

+1.2%

Year-On-Year Change

Global Shipment Volume

283.7

(BnU)

+3.7%

Year-On-Year Change

Core Revenue

10,490

(US\$ MM)

+1.5%

Year-On-Year Change

+8.5%

Year-On-Year Change At Constant Currency

Adjusted Operating Profit

3,095

(US\$ MM)

-5.0%

Year-On-Year Change

+13.4%

Year-On-Year Change At Constant Currency

We believe the combination of these strategic initiatives and continuous improvement provide the right balance between short-term profitability and sustainable long-term growth.

In line with our “4S” Model to deliver long-term sustainable growth, our company goal is to be the most successful and responsible tobacco company in the world. As a result, we have developed a Responsible Business Framework, which defines 12 relevant business topics to support this goal. Action plans are now being implemented and include, but are not limited to: respecting human rights across our value chain; developing reduced-risk products; and building sustainable supply chains.

2016 Performance Review Volume & Share

Total shipment volume grew 1.2% to 398.7 billion cigarette equivalent units, our best performance since 2012. This positive achievement was supported by acquisitions and favorable trade inventory adjustments, mainly in the first quarter.

The performance in South & West Europe and North & Central Europe was strong, driven by continued market share gains fully offsetting the impact of industry contraction, notably in the UK. In these two European clusters, our fine cut volume increased 8.1%, led by France, Germany, Hungary, Italy, Spain, Switzerland and the UK. In Rest-of-the-World, total volume was up significantly driven by positive performance in seeding markets and supported by our acquisition in Iran. The industry volume contraction across the CIS+ cluster and lower market share resulted in total volume declining.

GFB shipment volume increased 3.7% to 283.7 billion cigarette equivalent units, including the addition of two billion cigarette equivalent units from Natural American Spirit. This second consecutive year of volume growth was driven by the strong equity of our

portfolio, and most notably Winston, Camel and Mevius. As a result, GFB mix in our total shipment volume grew to 71.2%, an increase of 1.7 percentage points versus prior year.

Looking into the clusters, GFB volume was very strong, increasing at mid-single digit growth rate in South & West Europe and double-digit growth rate in North & Central Europe and Rest-of-the-World. In CIS+, GFB market share gains could not offset the GFB volume decline due to industry volume contraction.

	BnU				Total JTI
	South & West Europe	North & Central Europe	CIS+	Rest-of-the-World	
Total shipment volume	65.2	54.2	141.4	137.9	398.7
GFB shipment volume	58.6	33.6	107.1	84.4	283.7

Overall as a company we grew total and GFB share of market. Across our Top40 markets, JTI’s market share grew to 25.7%, a 0.3 percentage point increase versus prior year, including gains in the key markets of France, Italy, Spain and Taiwan.

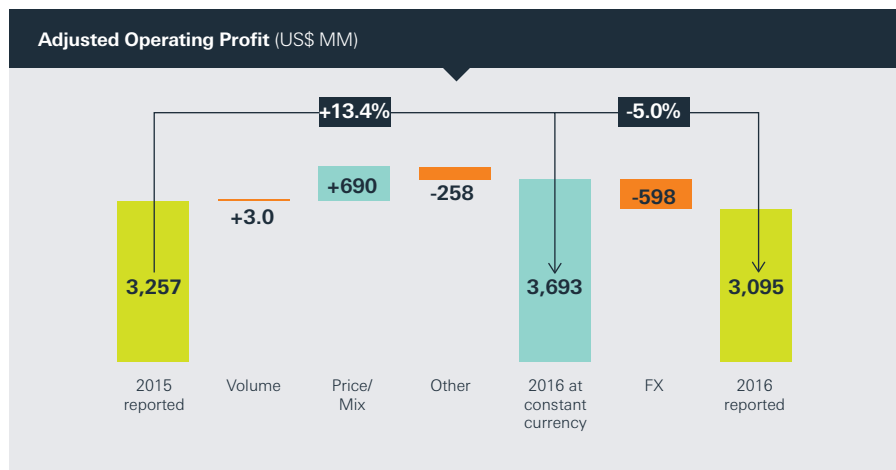
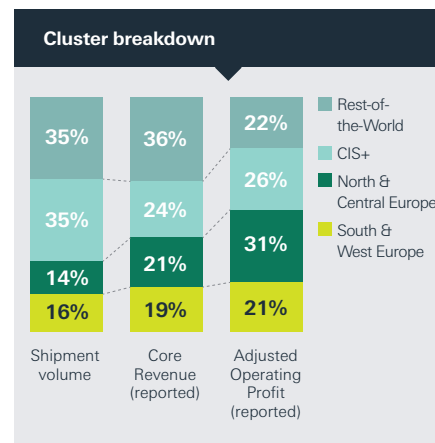
Our GFB market share in our Top40 markets was up 0.7 percentage points to 18.2% as GFBs continued to gain share in France, Italy, Russia, Spain, Taiwan and the UK demonstrating once again the strength of our GFB portfolio and the value of our continued equity building investments.

We also gained market share in fine cut, notably driven by growth in the key markets of France, Italy, Spain and the UK, as well as the addition of Natural American Spirit.

Importantly, across our Top40 markets, we grew total and GFB share of value to 23.6% and 17.0%, respectively.

Financials

Core revenue grew 8.5% at constant currency driven by robust price/mix and shipment volume growth. Price/mix contribution increased by US\$721 million. All clusters contributed to the price/mix increase, notably driven by Russia, Turkey and the UK. The South & West Europe cluster generated US\$45 million in price/mix, combined with US\$77 million from North & Central Europe, US\$289 million from CIS+ and US\$310 million from Rest-of-the-World.



Note: The selection of Top40 markets is based on profit contribution.

International Tobacco Business

FY2016: Results for the fiscal year ended December 31, 2016

Pricing was also the key driver of our 13.4% increase in adjusted operating profit at constant currency. South & West Europe, CIS+ and Rest-of-the-World all delivered double-digit adjusted operating profit growth at constant currency. In North & Central Europe, adjusted operating profit only grew low single-digit at constant currency as we increased investments to support the integration of Natural American Spirit and to strengthen our position ahead of new regulations in the UK.

2016 Key highlights Broadening the base for future sustainable growth

In 2016, we continued to invest in seeding markets. We define these as markets where JTI has a limited presence and where we have identified growth opportunities through sustained and focused investments.

Initiatives focused on strengthening our brand portfolio and equity, as well as expanding our distribution network and trade partnerships.

These investments generated solid results, with our total volume growing 29% versus 2015. This was driven by Global Flagship Brands, which increased their volume by more than 30%, led by Winston, Camel and Mevius.

This volume momentum delivered significant year-on-year core revenue growth at constant currency.

These seeding initiatives are important as they will enable JTI to benefit from a more balanced geographic footprint. As a result, they support our sustainable earnings growth over the mid to long term.

People, cornerstone of our growth

A major enabler of our strategy are the approx. 27,000 employees of JTI worldwide. To ensure sustainable future growth, we continuously invest in our people by setting high standards and fostering a diverse work environment where our employees excel. This allows JTI to recruit the best candidates and develop their skills and competencies across the organization.



These efforts were rewarded by the Top Employer Global certification in 2015, 2016 and 2017, recognizing 33 countries for their exceptional employee environment. In 2017, JTI is ranked number one by the Top Employers in Europe, Middle East and Asia Pacific regions.

Expanding the business footprint

To complement our robust growth, we conducted a number of footprint expansion during the course of 2016.

In July 2016, the JT Group won a bid to acquire a 40% equity stake in National Tobacco Enterprise Ethiopia S.C., the Ethiopian state tobacco company. This great opportunity will further expand our presence in Eastern Africa following our acquisition in Sudan in 2011.

To address the different growth opportunities in the Americas, in February 2016 we completed the purchase of a 50% stake in La Tabacalera in the Dominican Republic. La Tabacalera has more than 100 years of experience in the cigarette and cigar business and was the first company in the Dominican Republic to be certified under the International Standard ISO 9001:2000 at the end of 2003. Operated as a joint venture with the Government of the Dominican Republic, this provides JTI with a strategic asset in the Caribbean.

Lastly, we also strengthened our business footprint in Bolivia with the acquisition of BIS Overseas Bolivia S.R.L., the second largest tobacco-specific distributor in the market. This new addition will accelerate JTI's expansion in Bolivia and enhance our presence across Latin America.

2017 Outlook

We entered 2017 with confidence in our business fundamentals, positive GFB momentum and the continuation of our strategic investments.

However, we expect the operating environment will be challenging, primarily due to tightening regulations and price competition.

This will overshadow the continued volume and share growth of our Global Flagship Brands and the increasing top-line contribution from seeding markets and emerging products.

Despite the anticipated operating challenges, we are confident in achieving 9% adjusted operating profit growth at constant currency, driven by the significant efficiencies generated by the planned and already implemented manufacturing optimization programs.

We will continue our investment strategy toward brand equity building, seeding markets and emerging products to ensure long term sustainable growth and strengthen our role as the profit growth engine of the JT Group.

On March 31, 2017, Thomas A. McCoy will be retiring and stepping down from JTI as President and Chief Executive Officer. He will be succeeded by Eddy Pirard, JTI's Executive Vice President Business Development, Corporate Affairs and Corporate Communications. This management change will not affect JTI's strategy as confirmed by Eddy Pirard during the company's full year results investor meeting in Tokyo: *"As of April 1, my Excom colleagues and I will lead JTI in achieving its objectives and financial targets for the current year, while working hard and developing new plans to further enhance our business fundamentals and competitiveness, to ensure continued and sustained growth in the long term."*

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

Global Flagship Brands (GFB) Portfolio

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



Winston is the leading brand of the JTI portfolio. Launched in 1954, Winston became the world's second biggest cigarette brand as of 2007. Winston is now sold in more than 120 markets following the 2016 launches in Nepal, Laos, Ivory Coast and Dominican Republic.

In 2016, Winston volume grew 5.5% to 139.3 billion cigarette equivalent units. Winston's continued performance is driven by a comprehensive portfolio architecture comprised of two sub-families – Core and XS.

Winston Core family, of which the lead styles are Winston Blue and Red, is Winston's global bestseller. In 2016, Winston Core grew volume by 2%, primarily driven by business expansion in the Rest-of-the-World. The XS family, which grew double-digit in 2016, is a more progressive range with a refined taste signature and features such as the LSS technology (Less Smoke Smell) and the new water-activated filter recently launched in Russia as Winston XS Plus AQUA.



GLOBAL SALES

139.3BnU

Winston recorded double-digit volume growth in 34 markets and record market share in 20 markets, including Russia, France, Iran, Italy, the Philippines and Taiwan. As a result, Winston strengthened its global market share by 0.3 percentage points to 9.1% in JTI's Top40 markets.



GLOBAL SALES

52.2BnU

Camel is the world's most inspiring tobacco brand since 1913, a global icon of creativity with over 100 years of tobacco experience. With its distinctive taste signature, Camel is sold in almost 100 markets with 4 new market launches in 2016: Iran, Myanmar, Namibia and Thailand.

2016 set a new record year for Camel driven by volume and share growth for the third consecutive year. The brand reached 52.2 billion cigarette equivalent units, an increase of 2.5% versus 2015. Camel's market share reached 3.3% in JTI's Top40 markets, gaining 0.1 percentage point versus prior year.

This positive performance was driven by strong growth momentum in Camel's European strongholds such as Belgium, Czech Republic, Germany, Italy, the Netherlands, Portugal, Spain, and also in emerging markets like the Philippines and South Africa, the latter entering Camel's cluster of markets exceeding 1 billion cigarette equivalent units.

Camel continues to build relevance amongst adult smokers driven by its iconic and international brand equity together with product quality enhancement and innovation. Capsule and modern line products continued to be the key growth driver in 2016 with line extensions now representing one-third of Camel's total volume.

Global Flagship Brands (GFB) Portfolio continued



LD is one of the top bestselling tobacco brands in the world and a key value proposition globally. Constantly increasing its footprint, LD is now present in 50 countries and became the first Global Flagship Brand to launch in the US market. Relevant portfolio expansions combined with a focus on modern formats (versus 2015, compact format grew 53% and capsules increased 31%) and successful migrations continued to build the brand as a stronghold in the JTI portfolio.

In a highly competitive value segment, LD delivered 47.6 billion cigarette equivalent units in 2016. Industry size contractions and competitive price pressures in CIS+ resulted in a volume decrease of 3.9% versus prior year.

Outside CIS+, LD volume continued to grow, notably at double-digit rates versus prior year in the Rest-of-the-World cluster. The brand achieved its highest ever market share in Canada, Latvia, Montenegro, Singapore and Taiwan. In Kazakhstan, LD became the leading brand with a historical high share of market of 21.3% in December 2016. Overall, LD reached a 3.4% market share in JTI's Top40 markets.



GLOBAL SALES

47.6BnU



Launched as Mild Seven in 1977 and rebranded in 2013, Mevius is the top-selling brand in Japan with over 30% market share. Internationally, Mevius enjoys consumer popularity in Asian markets, and is expanding geographically to new markets.

For the full year of 2016, Mevius' international volume recorded an inspiring growth of 4.7%, to close at 17.9 billion cigarette equivalent units, driven by significant growth in South East Asia and World Wide Duty Free, while maintaining a steady growth momentum in stronghold markets.

Mevius continued to grow its share of the premium segment in its top Asian markets. In Taiwan, Mevius remained the number one brand with a share of market of over 20%, enhancing its leadership in premium by exceeding a 60% share of segment. In JTI's Top40 markets, Mevius' market share reached 0.7%.



GLOBAL SALES

17.9BnU

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

Global Flagship Brands (GFB) Portfolio continued



GLOBAL SALES
13.4BnU

Originally established in 1873, Benson & Hedges has a proud British heritage. In 2016, B&H volume increased 10.7% to 13.4 billion cigarette equivalent units driven by the success of B&H Blue in the UK. B&H increased its market share 0.1 percentage point to 0.8% in JTI's Top40 markets.



GLOBAL SALES
2.0BnU

Natural American Spirit joined the JTI portfolio in January 2016. This brand offers a unique positioning as the only global exclusively "additive-free" premium cigarette. Present in ready-made cigarettes and fine cut, Natural American Spirit is available in 16 countries, following the launches in Greece and Ireland. Volume grew 6.7% to 2.0 billion cigarette equivalent units.



GLOBAL SALES
5.9BnU

Glamour is JTI's leading super slims brand introduced in 2005. In 2016, mainly due to the industry size contraction in Russia, its volume declined 8.0% to 5.9 billion cigarette equivalent units.



GLOBAL SALES
2.9BnU

Audacity, uncompromised excellence and noble characters define Sobranie, one of the oldest luxury cigarette brands since 1879. In 2016, Sobranie grew volume by 7.0% to 2.9 billion cigarette equivalent units.



GLOBAL SALES
2.5BnU

Launched in 1964, Silk Cut established its premium credentials as one of the first low tar brands in the 1970s. In 2016, Silk Cut volume declined 7.4% to 2.5 billion cigarette equivalent units due to industry volume contraction in Ireland and the UK.

Other Tobacco Products Portfolio

Fine Cut

In this category which encompasses roll-your-own and make-your-own products, JTI's fine cut volume and share continued to grow.

With an 8.1% increase, our fine cut volume growth has continued in 2016, driven by the strong performance of our GFB fine cut volume (+17.7%) and the acquisition of Natural American Spirit.

JTI's fine cut market share was up in 11 of our 15 key markets for this category, essentially located in Europe.

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

Shisha

JTI entered the shisha tobacco business in 2013, and since then we have continuously improved the quality of the products, in addition to rationalizing the portfolio, rejuvenating the offering and expanding our presence.

In 2016, we returned to volume growth reaching 19,000 tons (+3.8%), despite the continued geopolitical tensions in the Middle East, a key geography for shisha tobacco.

E-Vapor

We continued to enhance our efforts to further develop JTI's presence and portfolio in E-Vapor. The acquisition of Logic provided JTI with the opportunity to become a leading E-Vapor player in the world's three largest markets in value, namely the USA, the UK and France.

Our E-Vapor portfolio encompasses all possible variants such as e-pens, closed tanks and open tanks with our own e-liquids.

While the category is evolving rapidly from a product and regulatory standpoint, JTI holds a 12.4% share of value in the USA and 12.3% in the UK market where we hold the number three position. JTI holds the number one E-Vapor company position in Ireland and is the number one closed tank proposition in France with Logic Pro.

We expanded further our presence in 2016, entering Austria, Germany, Italy and Korea. We will continue investing in this growing category to strengthen our portfolio and pursue more geographical expansion.

Japanese Domestic Tobacco Business

FY2016: Results for the fiscal year ended December 31, 2016



Chito Sasaki
President, Japanese Tobacco Business

“
Profit grew by quality top-line as well as cost optimization initiatives despite severe conditions.”

Our operating environment continues to be challenging, mainly due to the ongoing industry contraction and an intensifying competition in Tobacco-Vapor (T-Vapor) category.

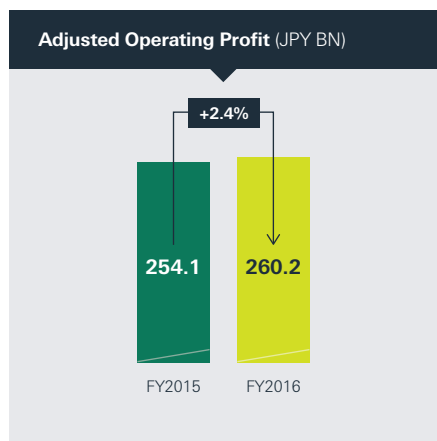
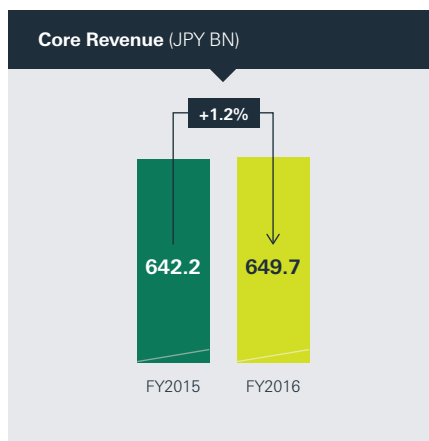
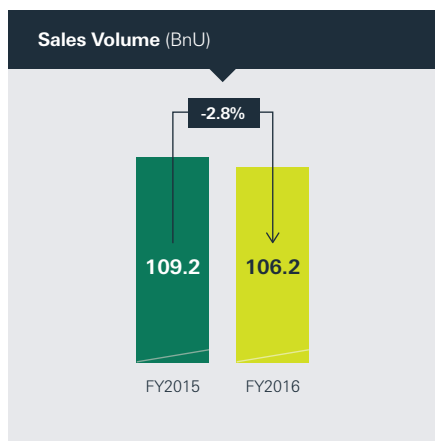
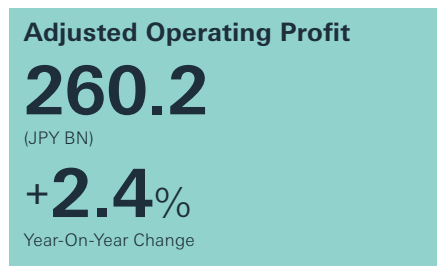
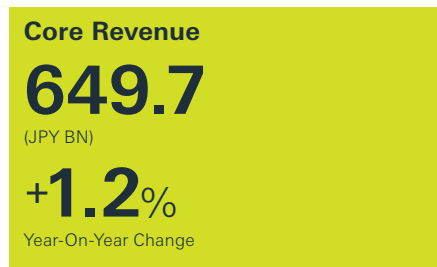
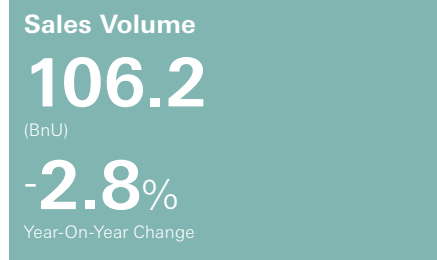
However, we are committed to taking various measures to secure our leadership position and to achieve quality top-line growth. In January 2016, we acquired Natural American Spirit (NAS) business outside the U.S. and have been pursuing the top-line synergy. In April, we also took a price increase of Mevius without tax hike. Driven by these initiatives, we have strived for strengthening our brand portfolio as well as growing revenue.

Regarding Ploom TECH, through the test marketing in Fukuoka city and our online store, we have become more confident in the superior features of the product, such as no smell of tobacco smoke and good usability.

Looking forward, we will maintain our role as a highly competitive platform of profitability for the Group by means of quality top-line growth, the optimization of investments in cigarette as well as the increased emphasis on T-Vapor category.

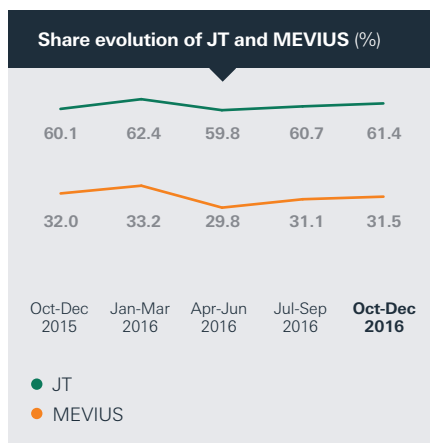
Performance Review (volume/financial)

- Revenue and profit grew mainly through Mevius price increase and the acquisition of NAS.
 - JT sales volume decreased 2.8% to 106.2 BnU mainly due to the decline of cigarette industry volume, partly offset by the addition of NAS.
 - Core revenue increased 1.2% to ¥649.7 billion, mainly because of the Mevius price increase.
 - Adjusted operating profit grew 2.4% to ¥260.2 billion driven by the pricing, the benefits from initiatives to strengthen our competitiveness and effective cost management.



Performance Review (Market share)

- Our total and Mevius cigarette market shares were resilient in the context of severe competition.
 - In FY2016, JT market share increased 1.2 percentage points to 61.1%.



Amid the intensifying competition, we continued to invest in sales promotion and brand equity enhancement with a focus on Mevius. Furthermore, with the addition of NAS, we can offer a compelling brand portfolio to consumers in each price segment.

Going forward, we will keep investing in our core brands to further reinforce our brand equity.

As a result of these investment initiatives, our market share including Mevius remained solid.

Our strategies

We respond to changes in the operating environment with an aim to generate stable profit. Meanwhile, we continue to invest in order to achieve sustainable profit growth.

In terms of cigarette, we are striving for maximizing our top-line through market share gains with a particular focus on our core brands. At the same time, we will optimize our investment in cigarette. With these efforts, we will secure and improve profitability in this category.

Regarding Ploom TECH, our priority is to complete the planned production capacity enhancement, which will lead to the expansion of its sales area. Also we will effectively communicate with consumers to improve awareness of this product and promote better understanding of its feature.

Outlook

We continue to pursue the maximization of our top-line as well as the optimization of investment in cigarette. However, revenue and profit are forecast to decrease in 2017, mainly due to cigarette industry volume contraction impacted by the expansion of T-Vapor category.

Despite this challenging environment, the Japanese domestic tobacco business is committed to fulfilling our role as a highly competitive platform of profitability in the mid- to long-term. Towards this goal, we will make necessary investment in T-Vapor and core brands to further build our business foundation which will underpin our sustainable profit growth from 2018 and beyond.

紅く香る、プレミアムメンソール。


100%天然メンソール ¥440

PREMIUM MENTHOL OPTION RED

IMAGINEERING THE FUTURE MEVIUS

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

Our core brands



Natural American Spirit

PRESTIGE

SHARE OF SEGMENT* 52.5%



- The Natural American Spirit brand was born in the U.S. in 1982, and introduced to Japan in 1996.
- JT Group has completed the acquisition of the Natural American Spirit business outside the United States in January 2016 and been expanding its markets such as Japan, Germany, Switzerland, Italy, Spain and the UK.
- The Natural American Spirit brand vision is unchanged even after its phenomenal growth globally with the idea to provide the most premium, additive-free, all natural tobacco product.
- The Natural American Spirit family comprises a line-up of 8 cigarette products as well as 3 Roll-your-own products.

Seven Stars


★★★★★★★

PREMIUM

SHARE OF SEGMENT* 44.3%



- Launched in 1969, Seven Stars featured Japan's first domestically produced charcoal filter in pursuit of better taste.
- Since its launch, Seven Stars has consistently offered unique value in terms of taste, aroma, and product design.
- Seven Stars Original soft package with 14mg tar had been the most sold product in the Japanese domestic market for 9 years until 2016.
- The Seven Stars family comprises a line-up of 19 products.




MEVIUS

SUB-PREMIUM+

SHARE OF SEGMENT* 99.6%



- Evolved in 2013 from Mild Seven, MEVIUS has commanded the No.1 share in the Japanese domestic market for more than 30 years.
- Its regular products offer smooth taste as well as menthol products allow consumers to enjoy premium and high quality products with only 100% natural menthol.
- The MEVIUS family comprises a line-up of 38 cigarette products as well as 3 capsule products for Ploom TECH, JT's tobacco vapor product.



Winston

SUB-PREMIUM

SHARE OF SEGMENT* 32.5%



- First introduced in 1954 in the United States, and today Winston is the second largest cigarette brand in the world.
- In 2015, CABIN and CASTER were migrated into Winston in Japan. Winston has three types of taste, "Bitter", "Straight" and "Sweet", in both Regular and Menthol segment.
- The Winston family comprises a line-up of 29 products.

* JT total, 2016 results.

As of December 31, 2016

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



Ploom-TECH

Tobacco-vapor with a newly developed concept

Ploom TECH offers clearer tobacco taste without ash or smell of tobacco smoke provided by unique technology with no combustion and no direct heating of tobacco. It makes a new way to enjoy tobacco that helps to avoid annoying those nearby. In addition, Ploom TECH is activated merely by inhaling, making it possible to enjoy the experience immediately and at any time, also easy to hold and carry.



the future is plooming

Review of Operations continued
Pharmaceutical Business

FY2016: Results for the fiscal year ended December 31, 2016



Muneaki Fujimoto
 President, Pharmaceutical Division

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

We strive to strengthen the profit base through R&D promotion of “first-in-class” compounds and value maximization of each product.

Strategy

- Promote R&D of “first-in-class” compounds and seek optimum timing to out-license them
- Maximize the value of each product

Performance Overview

[Development in Japan]

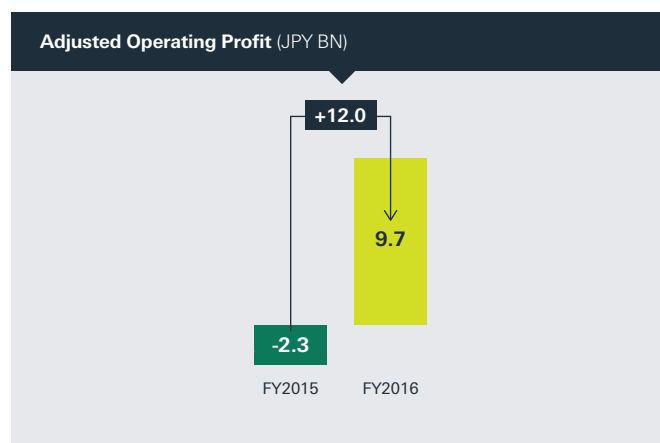
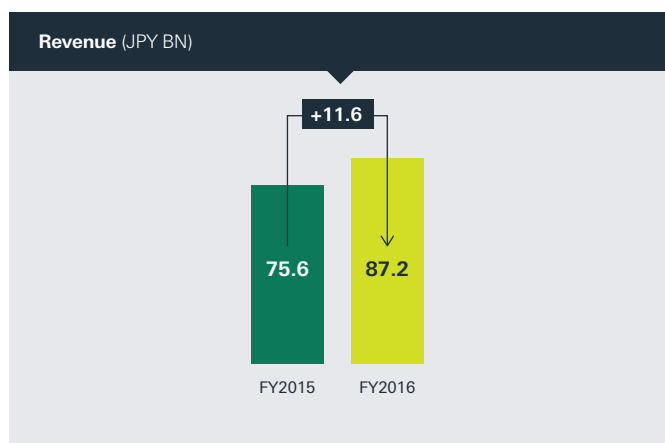
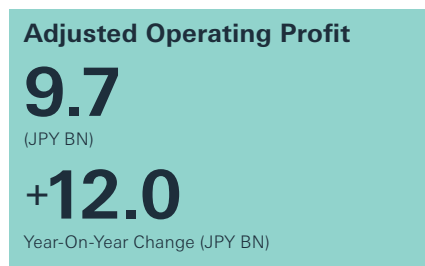
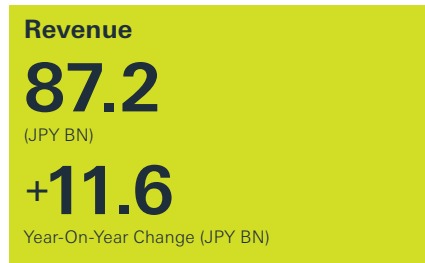
- “Genvoya Combination Tablets”: a novel anti-HIV drug, Launched by Torii Pharmaceutical (July 2016)
- “Descovy Combination Tablets LT/HT”: novel anti-HIV drugs, Launched by Torii Pharmaceutical (January 2017)

[Licensed compounds]

- Elvitegravir (Anti-HIV)
 - E/C/F/TAF (single-tablet regimen “Genvoya”): Launched by Gilead Sciences, Inc. in the U.S. and EU
- Trametinib (Melanoma)
 - For use in combination with dabrafenib: Approved in Japan and EU

Business results (financial overview):

- Revenue grew ¥11.6 billion driven by an increased royalty from our license partners, mainly Genvoya. Milestone revenue associated with the progress in drug development also supported the strong result.
- Adjusted operating profit improved by ¥12.0 billion achieving a record high profit due to revenue increase.



Value chain



R&D

Continue to strengthen R&D capability, a cornerstone of our pharmaceutical business. By focusing our resources on specific therapeutics areas, we continue to strengthen our R&D capability which enables us to create innovative drugs.

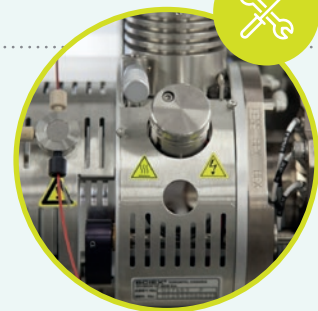
- Focus mainly on the fields of metabolic diseases; viral infection; and autoimmune/inflammatory diseases to best leverage our expertise.
- Allocate adequate resources in R&D in light of time-consuming and costly development process.

- Aiming at discovery of “first-in-class” compounds, enhance pre-clinical research capability and build development strategies tailored to accomplish the objective.
- Translate innovation into medicines that are both approvable and commercially viable.

Manufacturing

Ensure a reliable supply of quality products. We are proud of ourselves with a sustainable supply chain that delivers high quality products to our patients. We also pursue efficiency in our manufacturing arrangements; products marketed in Japan are mainly produced by Torii Pharmaceutical to maximize intra-group synergies, while outsourcing to contract manufacturers where appropriate.

- Remain focused on quality assurance and safety control.
- Maintain optimal manufacturing arrangements.
- Continuously strive to reduce environmental impacts, as evidenced by operation and maintenance of the ISO 14001 certificate by our Sakura plant.



Sales & Promotion

Build marketing competence on our MRs. In the pharmaceutical industry, medical representatives (MRs) play a crucial role in successful sales and promotion by providing medical and scientific knowledge with clients. At the same time, they collect valuable information from the medical front which could be reflected in the ongoing or future R&D activities.

Torii Pharmaceutical is marketing our products in Japan through approximately 500 highly-trained MRs. Outside Japan, instead of directly marketing our products, we receive royalties based on sales performance from our license partners for the compounds for which we out-license the right to develop and market.

- Provide extensive training programs to MRs and expand their knowledge to earn trust from our clients.

- Strengthen our marketing capabilities by leveraging the marketing support system, which integrates various clients' information.
- Build a sales and marketing strategy to meet the existing and future market needs in the changing business environment.

Review of Operations continued

Pharmaceutical Business

Japan Tobacco Inc. Clinical Development (as of February 6, 2017)

In-house development

Code (Generic name)	Potential Indication/ Dosage form	Mechanism	Description
JTZ-951	Anemia associated with chronic kidney disease/Oral	HIF-PHD inhibitor	Increases red blood cells by stimulating production of erythropoietin, an erythropoiesis-stimulating hormone, via inhibition of HIF-PHD.
JTE-052	Autoimmune/allergic diseases /Oral, Topical	JAK inhibitor	Suppresses overactive immune response via inhibition of Janus kinase (JAK) related to immune signal.
JTE-051	Autoimmune/allergic diseases/Oral	Interleukin-2 inducible T cell kinase inhibitor	Suppresses overactive immune response via inhibition of the signal to activate T cells related to immune response.
JTT-251	Type 2 diabetes mellitus/Oral	PDHK inhibitor	Decreases blood glucose by activation of pyruvate dehydrogenase (PDH) related to carbohydrate metabolism.
JTK-351	HIV infection/Oral	HIV integrase inhibitor	Suppresses blood HIV levels by inhibiting the activity of integrase, an enzyme involved in the replication of HIV.
JTE-451	Autoimmune/allergic diseases/Oral	RORγ antagonist	Suppresses overactive immune response via inhibition of RORγ related to Th 17 activation.
JTT-751 (ferric citrate)	Iron-deficiency anemia/Oral	Oral iron replacement	Corrects iron-deficiency anemia by using absorbed Iron for synthesis of hemoglobin.

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

Licensed compounds

Compound (JT's code)	Licensee	Mechanism	Note
trametinib	Novartis	MEK inhibitor	Inhibits cellular growth by specifically inhibiting the activity of MAPK/ERK Kinase (MEK1/2). NSCLC, trametinib+dabrafenib U.S., EU, Japan marketing approvals submitted
Anti-ICOS monoclonal antibody	MedImmune	ICOS antagonist	Suppresses overactive immune response via inhibition of ICOS which regulates activation of T cells.
JTE-052	LEO Pharma	JAK inhibitor	Suppresses overactive immune response via inhibition of Janus kinase (JAK) related to immune signal.
JTZ-951	JW Pharmaceutical	HIF-PHD inhibitor	Increases red blood cells by stimulating production of erythropoietin, an erythropoiesis-stimulating hormone, via inhibition of HIF-PHD.

Location	Phase 1	Phase 2	Phase 3	Preparing to file	Filed	Origin
Japan						In-house
Overseas						
Japan						In-house; Co-development with Torii
Overseas						
Overseas						In-house
Japan						In-house
Overseas						In-house
Japan						In-license (Keryx Biopharmaceuticals); Co-development with Torii *additional indication

Review of Operations continued
Processed Food Business

FY2016: Results for the fiscal year ended December 31, 2016



Atsuhiko Kawamata
 President and CEO, TableMark

“

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

”

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

Strategy

- Increase the attractiveness of our offerings with a particular emphasis on staple food products* by meeting consumer needs with our own expertise.
- Minimize negative impact of rising raw material costs and weak yen.

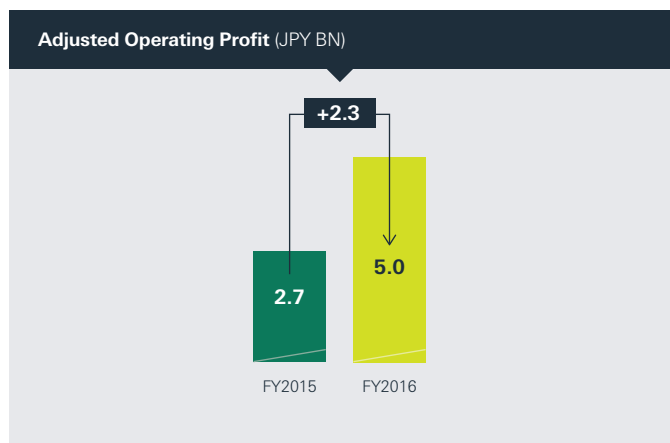
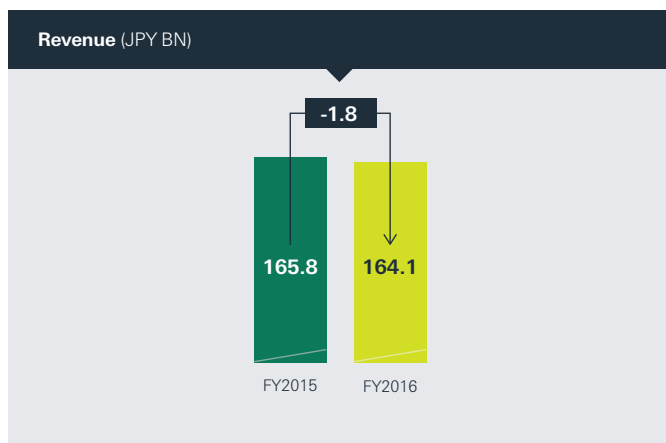
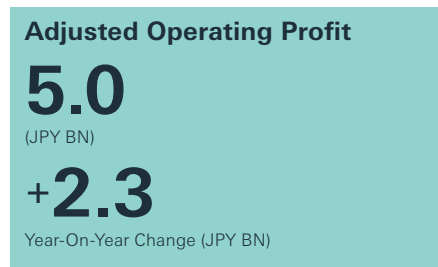
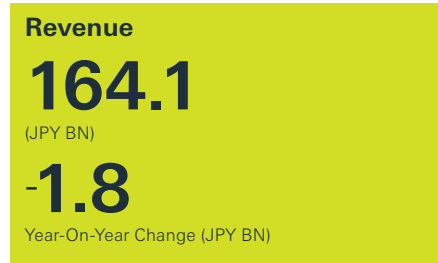
* Staple food products: frozen noodles, frozen rice, packed cooked rice and frozen baked bread.

Performance Overview

The processed food business is primarily engaged in business concerning frozen and ambient processed food, mainly staple food products such as frozen noodles, frozen rice and packed cooked rice, seasonings including yeast extracts and oyster sauce, and bakery chain outlets in the Tokyo metropolitan area.

Business results (financial performance):

- Revenue decreased despite favorable sales of staple products, offset by the decline of sales of other products.
- Adjusted operating profit increased by 2.3 billion yen year-on-year as better product mix, cost reduction efforts and the strong yen enhanced the profit margin.



Value chain



R&D

Strive to develop innovative products to meet consumers' needs

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



Procurement

Ensure procurement of safe and quality raw materials

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



Marketing

Strive for effective marketing to improve product awareness

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



Production

Prioritize safety and follow established quality control procedures

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



Sales & Distribution

Increase penetration to retail outlets

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

Food Safety Control

Ensure safety control at all levels of the value chain

- Independent food safety management division is responsible for overall safety control, ensuring that consumers can continue to enjoy our products safely.
- External food safety experts provide assessment and advice regarding our initiatives – their knowledge and viewpoints are actively incorporated into our business.

Risk Factors

The JT Group operates diverse businesses, namely tobacco, pharmaceutical, and processed food. In addition, we conduct our business on a global basis, extending to Europe, CIS countries, Africa, the Middle East and others. Due to this diversity and these changing environments, we are exposed to various risks.

Considering such circumstances, we have put in place a risk management framework. Under the framework, relevant divisions are assigned to carefully monitor the development of events that may adversely impact the JT Group and prevent their materialization where possible.

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

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

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

1 Disruptive tax increases

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

Risk description and potential impact

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

Measures to address the risk

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

2 Pressure from illicit trade

Illicit trade is a major concern not only for the tobacco industry, but for wider society. For the tobacco industry, it undermines legitimate tobacco business. For society, illicit trade reduces excise revenue for the government, often fuels organized crime, and may increase health concerns due to poor manufacturing standards and improper product handling. The tobacco industry has been fighting against illicit trade, which takes the forms of contraband, counterfeit and illicit whites.

Illegally traded products in a market tend to increase after a steep tax increase. Regulatory actions seeking to commoditize packages and products could also trigger the acceleration of illicit trade because such commoditization could make counterfeit manufacturing easier and detection of illicit products more difficult. We take a zero tolerance approach towards all these criminal activities with an emphasis on eliminating contraband products.

Risk description and potential impact

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

Measures to address the risk

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

Working together with authorities:

In 2007, JT International Holding B.V. and JT International S.A., JT Group subsidiaries, entered a cooperation agreement with the European Commission, the executive branch of the European Union (EU), and 26 EU Member States as part of efforts to combat illicit trade. In 2009, the United Kingdom joined the agreement.

Under the terms of the agreement, the JT Group contributed US\$50 million annually in the first five years from its execution and contributes US\$15 million annually in the subsequent ten years. This financial contribution is to be used to support anti-smuggling and anti-counterfeiting initiatives led by the EU or EU Member States.

In 2010, JTI-Macdonald Corp., a JT Group Canadian subsidiary, also signed a similar agreement with the Government and Provinces of Canada.

3 Tightening tobacco regulations

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

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

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

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

Risk description and potential impact

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

Measures to address the risk

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

For further details, please refer to 'Regulation and Other Relevant Laws' contained in this annual report.

4 Country risks

Our tobacco business has consistently expanded our earnings base to secure long-term growth by making acquisitions, entering new markets and increasing share in markets where we had limited presence. Geographical expansion may increase our exposure to country risks. In any market where we operate, we may face economic, political or social turmoil which may negatively affect our operations and financial results.

Risk description and potential impact

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

Measures to address the risk

- Avoid overdependence on a small number of markets as sources of profits by expanding the pool of highly profitable markets.

5 Instability in the procurement of key materials

Across its businesses, the JT Group procures raw and processed materials for product manufacturing.

In particular, we strive to procure key materials in the required quantity and at reasonable costs. Our key materials include agricultural products: most notably, tobacco leaf for the tobacco business, and grains for the processed food business. Availability of agricultural products is often affected by natural phenomena, such as weather conditions. In addition, there is a growing concern that agricultural production costs may increase, due to the high demand in energy resources, global population increases, and economic growth in emerging countries.

Risk description and potential impact

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

Measures to address the risk

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

6 Unfavorable developments in litigation

JT and some of its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking. As of December 31, 2016, 20 smoking and health-related cases were pending in which one or more members of the JT Group were named as defendant or for which JT may have certain indemnity obligations pursuant to the agreement for JT's acquisition of RJR Nabisco Inc.'s overseas (non-U.S.) tobacco operations. JT and its subsidiaries, who are defendants in such lawsuits, believe that we have valid grounds to defend the claims in such lawsuits; however, we cannot predict the outcome of any pending or future litigation.

Risk description and potential impact

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

Measures to address the risk

- Continue to build well-organized teams coordinating with external legal counsel to defend ourselves against these lawsuits.
- Continue legitimate and appropriate business operations. For further details, see section regarding 'Litigation'.

7 Natural disasters

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

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

Risk description and potential impact

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

Measures to address the risk

- Continuously review the Business Continuity Plan and revise it as necessary.
- Carry out emergency drills to increase employees' preparedness against disasters.
- Insure key assets such as buildings, machinery, equipment and inventory to recover financial losses as appropriate.

8 Currency fluctuations

As the JT Group operates globally, we are exposed to the risks associated with currency fluctuations. The reporting currency of the JT Group consolidated financial statements is Japanese Yen, while the financial statements of our international subsidiaries are reported in other currencies such as Russian ruble, Euro, British pound, Taiwanese dollar, U.S. dollar, and Swiss franc.

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

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

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

Risk description and potential impact

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

Measures to address the risk

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

9 Competition

The JT Group competes fiercely in both domestic and international tobacco business with our competitors.

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

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

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

Risk description and potential impact

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

Measures to address the risk

- Optimize our product portfolio by:
 - developing and providing products that can capture changing consumer preferences and needs
 - placing brands with strong brand equity in each price category
- Provide product support by enhancing trade marketing capability and effective promotional initiatives.
- Further improve efficiency to protect revenue and earnings.
- Avoid overdependence on a small number of markets as sources of profits by expanding the pool of highly profitable markets.

JT Group and Sustainability

Our approach to sustainability is underpinned by our management principles known as the “4S” model. We strive 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. We believe that pursuing this model enhances corporate value and helps us to meet and exceed stakeholders’ interest in the most balanced way possible.

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Our way of doing business

Our people

Our planet

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Our tobacco business

Our pharmaceutical business

Our processed food business

In focus:

- Respecting human rights
- Illegal trade



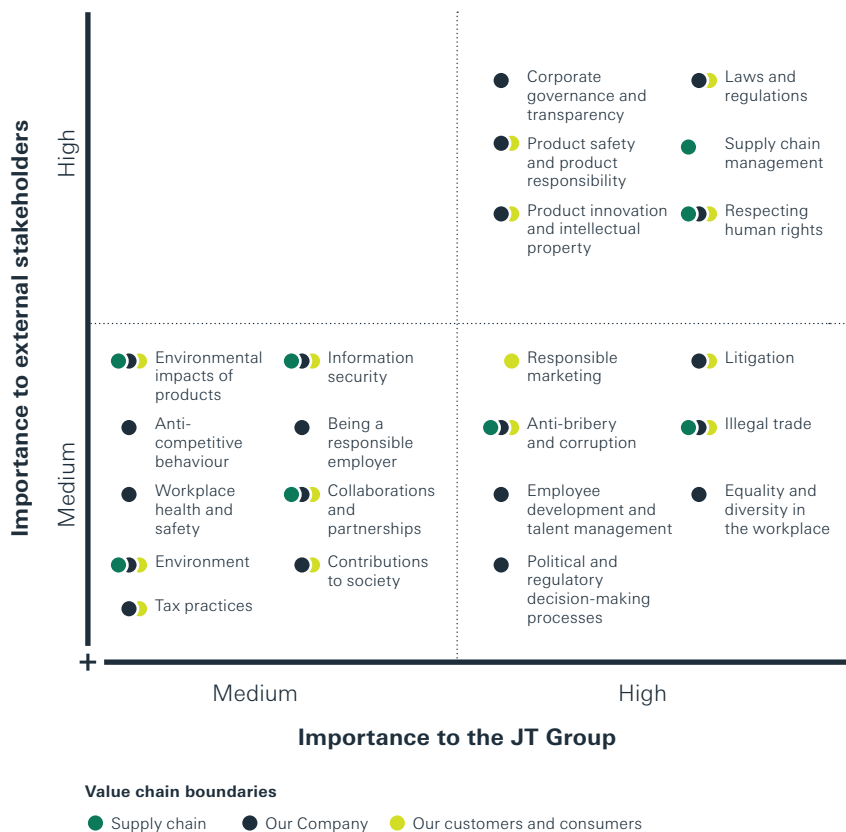
JT Group Sustainability Report and GRI G4 index:
www.jt.com/csr/report/index.html

Summarized below are material issues for the JT Group. If you wish to learn more about our approach and commitment to sustainability or specific programs, ‘JT Group Sustainability Report FY2015’ is currently available on JT Group website. The FY2016 report will be available on our website in June 2017. This report will be compiled in accordance with the Global Reporting Initiative (GRI) G4 Sustainability Reporting Guidelines ‘Core’ level.

JT Group Materiality Assessment

We carried out our first materiality assessment covering the entire JT Group, which allowed us to arrive at a final list of 22 material issues ranked by level of importance to the JT Group and our external stakeholders in 2015 – see matrix below. In 2016, we carried out various initiatives in our business and supply chain, taking each materiality into consideration.

JT Group materiality matrix



Respecting human rights

In 2016 we launched the JT Group Human Rights Policy that aligns with the UN Guiding Principles on Business and Human Rights. The Policy was developed in consultation with stakeholders, and it formalizes and details our commitment to respect human rights within our operations and in our value chain. From 2017 onward, we will carry out research on potential human rights risks related to our stakeholders. The results of this work will guide the development of our human rights due diligence process, which includes the identification, management, monitoring, and reporting of key issues.

Child labor prevention

Our ARISE program launched in 2012 aims to address roots causes of child labor in tobacco growing. The program, which covers Brazil, Malawi, Zambia and Tanzania, tackles social and economic factors that tempt farmers to employ children.

This program aims to ensure that children are not part of the workforce by providing education and engaging with tobacco farming communities in various ways. This ranges from providing educational materials, after-school tutoring, and mentoring, to vocational training for older children in farming schools.

Through ARISE, we work with communities to improve their understanding of the long-term value of education, and the future prospects that it can bring. ARISE also works to replace lost income through Family Support Scholarships, which can enable parents or guardians to send their children to school.

Supply chain management

In 2016 our international tobacco business made significant progress on developing an IT-based supplier life cycle management system that will enable assessment of Tier 1 suppliers against our standards, including on key compliance, environmental and social risks. The system will be implemented in 2017 alongside our Agricultural Labor Practices program for directly contracted tobacco farmers and merchants.

Agricultural Labor Practices (ALP)

Our ALP defines minimum requirements for farmers we source tobacco on preventing and eliminating child labor, respecting workers' rights, and applying health and safety measures at the workplace. From 2016 we started to extend the scope of ALP to cover third party tobacco leaf suppliers, and our objective is to implement ALP throughout our supply chain by 2019.



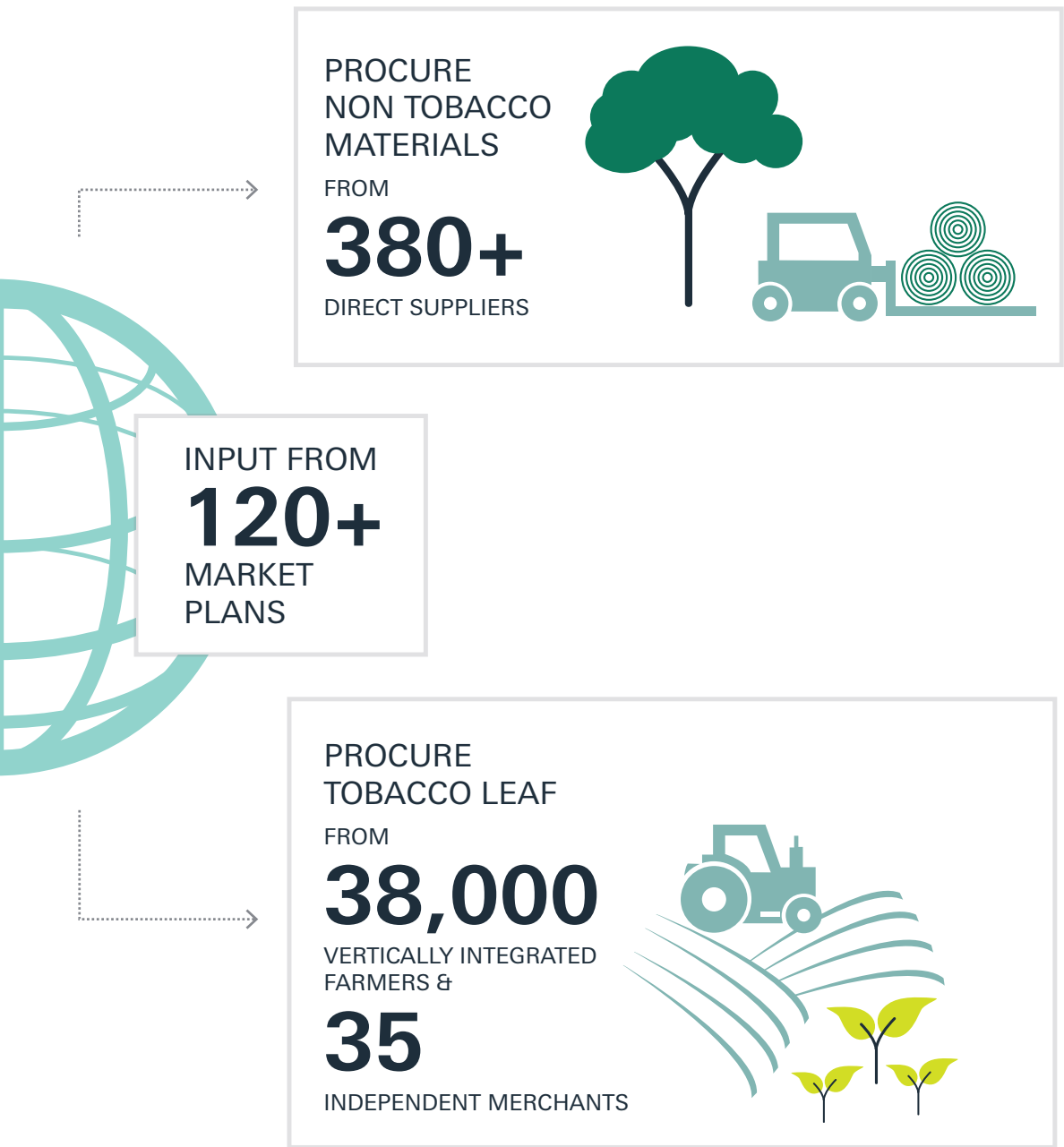
From tobacco leaves to consumers

The supply chain of our international tobacco business, JTI, ensures that the necessary quality products are produced and delivered to all markets at the right time and at the optimal cost. This is a large and diverse process flowing from farmer to consumer, and including a wide range of procurement, manufacturing and distribution activities.

When it comes to procuring quality tobacco leaf as well as non-tobacco materials and services, we continue to put sustainability first. Working with more than 38,000 tobacco

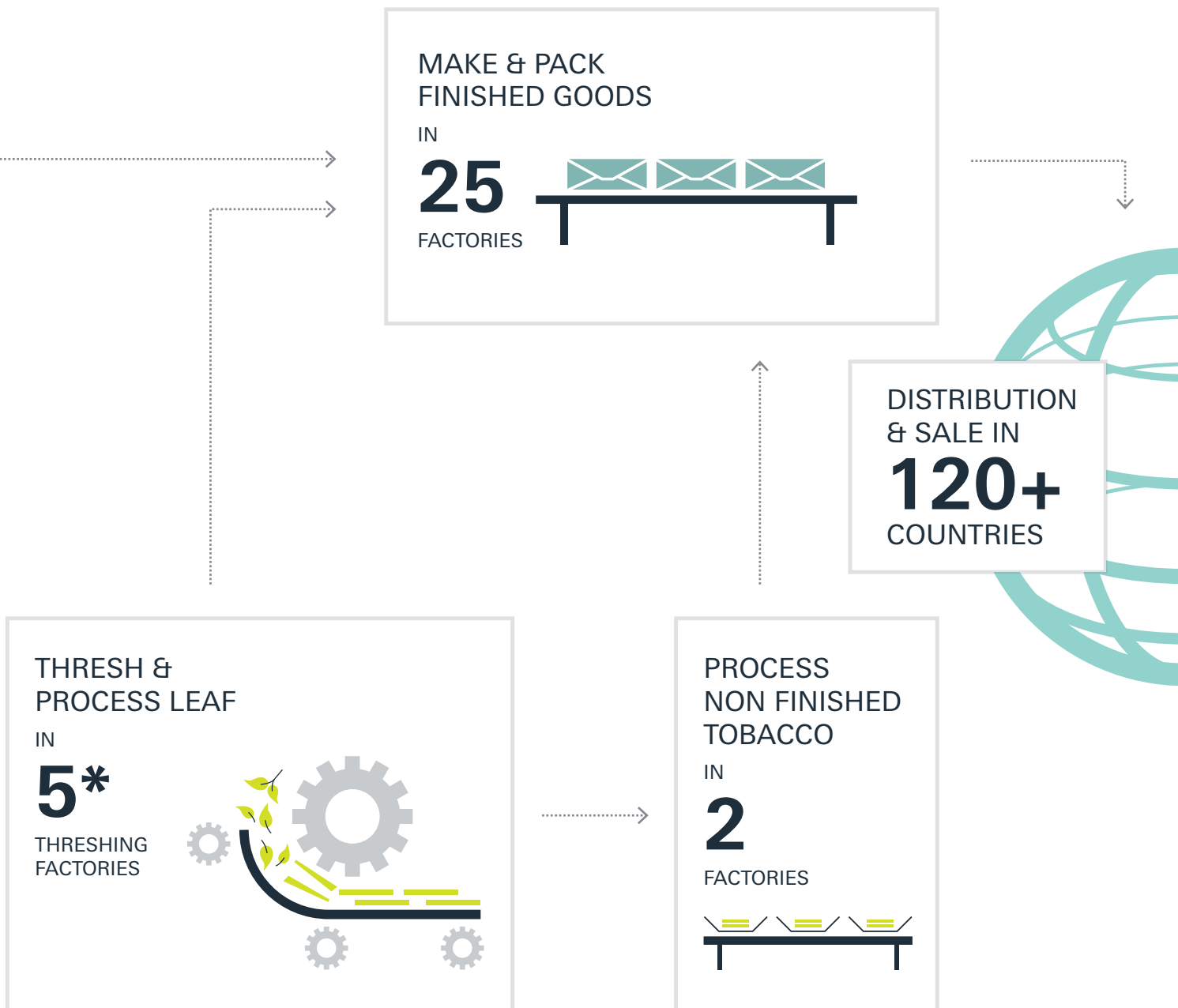
growers and countless supply partners around the world, we have been adapting our procurement models and supplier life cycle management system over the past few years to ensure a most responsible and sustainable approach.

This is particularly the case for tobacco leaf procurement. While we are committed to securing the long-term supply of quality leaf at the best cost, we strongly believe in creating shared value – for both the JT Group and the tobacco farming communities in which we operate.



To JTI, this means much more than securing fair returns to growers. It means taking effective action on issues including child labor, deforestation, or the reduction of environmental impacts of tobacco farming across the entire leaf supply chain. In order to be successful in these areas, we seek to build stable, long-term and mutually beneficial relationships with our leaf merchants, growers as well as their communities.

In the area of processing and manufacturing, our international tobacco business continues to optimize its global footprint and focus on delivering continuous improvement and excellence in execution throughout all manufacturing activities. With a current portfolio of 5 leaf processing facilities and 25 finished goods factories, we are well placed to overcome the increasing regulatory challenges and remain a most competitive industry player.



* Two of these threshing facilities are integrated in our finished goods factories.