

Message from the CFO

“Even in a highly uncertain business environment, we are working to maintain a firm financial foundation and accelerate investment to secure profit growth over the medium and long terms and increase shareholder returns.”

Nobuya Kato

Senior Vice President, Chief Financial Officer



As Senior Vice President in charge of finance and corporate communications, I construct financial and capital strategies to fulfill the JT Group Purpose and help build corporate value through dialogue with all stakeholders, including the capital markets.

Overall assessment of 2022 financial results

From revenue to profit, our all-financial results for 2022 exceeded our initial targets, rising to record highs.

We achieved profit growth in 2022 despite a difficult business environment marked by significant inflation and surging prices for resources worldwide. Our adjusted operating profit at constant currency, which is our profit index for the entire Group, grew by 9% year on year. In particular we attribute this to the tobacco business, which showed strong volume momentum and positive pricing effects through the year.

Our medium- and long-term KPI goal is mid to high single digit growth in adjusted operating profit at constant currency. Over the past three years, we have been delivering steady year on year growth in adjusted operating profit, even as we continue to lag behind our competitors in terms of RRP (Reduced-Risk Products) market share amid overall industry volume growth.

Revenue on a reported basis grew by 14.3% year on year, to 2,657.8 billion yen, thanks to growing momentum in the tobacco business, the positive exchange effects of the weaker yen, and revenue growth for both the pharmaceutical and processed food businesses. Our adjusted operating profit was also up year on year, by 19.2% to 727.8 billion yen, due to revenue growth and positive exchange effects.

Operating profit increased significantly, by 31.0% year on year to 653.6 billion yen, because adjusted operating profit grew and the cost of initiatives to reinforce the foundations of the tobacco business operation and for reducing leaf-to-tobacco farmland were non-recurring, accounted only in 2021. As a result, operating profit growth outpaced rising financial costs, making our profit for the term 442.7 billion yen, up 30.8% year on year.

Despite this major increase, free cash flow dropped by 99.1 billion yen from the 2021 figure due to increases in working capital, higher corporate income tax and payments related to initiatives to reinforce our tobacco operations in Japan.

Operating environment outlook 2023-2025

We predict that current trends will continue in our tobacco business, in both RRP and combustibles, over the course of our current business plan. The RRP segment is developing into the core pillar of business growth for the future, with demand continuing to increase, especially for HTS. Combustibles will likely continue to experience downtrading and contraction in demand, but we believe they can continue to reliably deliver profit by seizing appropriate pricing opportunities and building market share.

At the same time, we have to keep an eye on the influence of growing geopolitical risk on the world economy, rising

inflation worldwide, leading to surging interest rates and overall costs, and tax hikes worldwide under governmental policies to secure funds, tighten regulations and increase bureaucratic complexity.

Despite these risks, while we aim for top-line growth using pricing and share growth, we are working to grow profits through initiatives to raise efficiency, such as in production and R&D in the combustibles segment, projecting cost savings of about 20 billion yen in 2023 and 2024 combined.

Please see [Business Plan 2023 \(P. 48\)](#) for details.

Financial policy

The JT Group draws up and executes its financial plans in line with our two core values of resilience and flexibility. Resilience means the ability to maintain business despite significant or unexpected risk, such as economic crisis. Flexibility means promptly responding to attractive investment opportunities.

Currently we are further reinforcing our financial base by working to secure ample liquidity and fix liabilities for the long term, seeing it as more important than ever to be better prepared for future risk as our business environment grows less predictable and financial markets more volatile.

Cash flow management

In our cash flow management, we put highest priority on stable cash generation from top-line business growth. We are also undertaking initiatives to reduce foreign exchange impact and optimize operating capital.

In the tobacco business, particularly in emerging markets, we are working to optimize our businesses for local levels of economic growth and build the value of our businesses in local currency over the medium and long terms. We pursue cash creation via top-line growth, made possible both by, on the one hand, pricing that takes into consideration tax hikes and inflation, and on the other, share gains building on the strength of our brand portfolio, enhanced with a long-term strategic investment view. Pricing is a profit-growth driver for our tobacco business, but it's done with consideration for various factors and from all angles, including brand equity,

competition, consumer* behavior and acceptance, and the economic environment. In some markets, temporarily or for short periods, our retail prices may fall behind inflation growth, but we have been generally successful in raising prices to meet inflation rates over the medium and long terms.

Currently exchange risk is rising, due mainly to changes in the financial policies of leading nations to cope with inflation worldwide. To reduce foreign exchange impact in the current environment, we use natural hedging, by which we mean matching incoming and outgoing currencies, as well as hedging using exchange forwards and other derivatives, except for certain currencies. In principle, foreign-currency credits and debts are fully hedged. We also hedge 25-90% of future cash flow, and in some cases apply hedge accounting

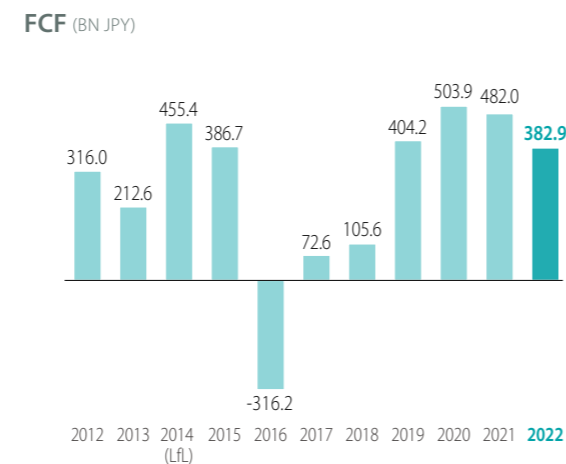
*Adult consumers. Minimum legal age for smoking varies in accordance with the legislation in each country. In Japan, smoking is not permitted for those under 20 years of age

Message from the CFO

to reduce foreign exchange risk, taking into account possible impact on the profit-and-loss statement.

To optimize operating capital, we continuously improve our cash-conversion cycle, reviewing terms for receivables and payables and applying methods such as liquidation of receivables and supplier finance, while optimizing inventory levels.

As a result of these initiatives, we have been reliably generating free cash flow of about 400 billion yen per year over the past 10 years, excluding the temporary impact of M&A and so forth.



Investment distribution

There has been no change in our two key policies for management resource allocation: give top priority to investment and balance profit growth resulting from investment with shareholder returns. Based on the 4S model, our management principle, and the JT Group Purpose, we will put top priority on investments leading to sustainable profit growth, especially in the tobacco business. We continue to designate the pharmaceutical and the processed food businesses as complementary to our core business, assisting profit growth for the entire Group.

Our benchmark payout ratio has been 75% since February 2021. This is based on the resource allocation policy as described above. Monitoring trends in shareholder returns among global FMCG firms, we have confirmed this as a competitive level in terms of capital markets in Japan

and abroad. During the term of the current business plan, we will invest about 300 billion yen, particularly in HTS, a category where further investments will be needed in the future. As for shareholder returns, we work to increase them by continuing to grow adjusted operating profit at constant currency, which is our foundation for profit growth over the medium and long terms, while maintaining a target payout ratio based on the policy I outlined earlier.

In discussing whether to buy back our own shares and in what quantities, in addition to financial prospects for the current fiscal year we carefully consider the medium- and long-term prospects of our environment; our FCF, balance sheet and the like; and levels of profit and progress with investments and initiatives.

Profitability of capital and market evaluation

In drawing up a business plan, we calculate and examine our capital costs and report them to the Board of Directors. We check and confirm that our return on equity is well above capital costs. We set up a hurdle rate, taking into consideration risks associated with each country in which we operate, as well as inflation and other external risks, and use that as our baseline for profitability. By maintaining that discipline, we make sure our ROE is always above capital costs. The JT Group uses adjusted operating profit at constant currency as a key performance indicator,* which excludes the effects of exchange rate fluctuations that can be substantial due to temporary factors, as well as depreciation costs related to M&A activities for the previous year. We work to grow profit, including for the current term, by achieving mid to high single digit growth in the KPI over the medium and long terms. We also believe it leads to improved ROE.

A comparison of our total shareholder returns, including dividends, with the TOPIX (total return) shows that ours were below the TOPIX over the long term due to the trend followed by our share prices, but they outperformed the TOPIX during the period between pre-pandemic late 2019 and

the end of 2022, thanks to profit growth during the period and a higher dividend for 2022. Continuous profit growth is important to the medium- and long-term stability of our equity value. We also believe that increasing quantitative corporate value through profit growth, while fostering an understanding of the JT Group through enhanced information disclosure from a qualitative perspective, will lead to higher TSR.

* Supplemental note: Why we use adjusted operating profit at constant currency as the primary index for performance management

- We use adjusted operating profit to show our business results for the current year in a way that's easy to understand, excluding the effects of depreciation costs related to any acquisitions in the previous year.
- Starting with our Business Plan 2014, to manage business investments and returns more appropriately, we changed our key performance indicator from adjusted EBITDA to adjusted operating profit, which does not require adding back depreciation or amortization costs, which fluctuate with investment scale for the year.
- We use figures at constant currency, believing we can show the true strength of our businesses much more clearly by disregarding exchange rates, which can fluctuate substantially over short periods due to geopolitical risks and other factors not directly related to our businesses.

IR activities

The JT Group appropriately discloses timely information, both financial, as with business results, and non-financial, such as management strategy, ESG factors and the status of each business segment, and engages in active dialogue with shareholders and institutional investors to ensure clear understanding. Our IR teams in Tokyo and Geneva, where JT and JTI are respectively headquartered, meet with securities analysts and institutional investors to discuss recently announced financial results and other disclosed information, as well as conduct individual meetings on ESG matters. Our plan for investor-focused events is in process.

These IR events are still held mostly online, as in 2022, when we held some 370 individual conferences. IR representatives participate in conferences hosted by securities houses and meet with domestic and overseas institutional investors. On some of these occasions, the CEO, the executive vice president in charge of finance and myself are present.

In meetings specifically focused on ESG we sometimes seek investor opinion, including assessments of our Integrated Reports. We will actively continue this kind of dialogue, making the most of the opportunities we have created.

The investor opinions we obtain through these IR efforts

Message from the CFO

are reported to our Board of Directors twice a year along with information related to market trends, including share price, and are shared with all executive officers and related divisions as a quarterly report.

We consider investor opinions when we improve and review

our ongoing initiatives and continue working to reflect their views and expectations appropriately in our strategies and operations, so they will better understand our results and initiatives.

Dialogues with investors in 2022

Number of meetings	About 370
Meeting participants	<ul style="list-style-type: none"> • A wide variety of stock and debt investors, both active and passive, in Japan and abroad • Analysts, fund managers, ESG managers, and responsible personnel for voting rights
Meeting formats	<ul style="list-style-type: none"> • Mainly virtual, online • One-on-one meetings and participation in conferences hosted by securities houses
JT personnel responsible	CEO, executive vice president in charge of finance, CFO, senior vice president in charge of communications, senior vice president in charge of sustainability management, among others
Main discussion themes	<ul style="list-style-type: none"> • Financial performance • Medium- and long-term strategies • Capital policies • Environment, Social, Governance (ESG) • Integrated report
Internal sharing of investor opinions	<ul style="list-style-type: none"> • Report to the Board of Directors twice a year • Quarterly report to directors, executive officers and related divisions on the status of IR efforts and investor opinions
Examples referencing investor opinions	<ul style="list-style-type: none"> • Enhancement of disclosures • Start of ESG-related talks • Review of KPIs related to remuneration

Better communication with debt investors

The JT Group is also working to enhance communications with bond investors. In compliance with the Japan Tobacco Inc. Act, on which our company was founded, the Japanese government is obliged to hold at least one-third of corporate equity at all times. Following this rule, the government must also accept one-third of any new shares issued for funds procurement. So debt finance is our primary method of funds procurement from the standpoint of fund maneuverability. Corporate bonds are a particularly important means for procuring funds to help achieve sustainable growth. To reliably procure funds even in an unstable financial environment, we are endeavoring to broaden our scope of communications with domestic and overseas bond investors. To create more opportunities for dialogue with them

and facilitate better understanding of the JT Group, we regularly hold non-deal roadshows in addition to those held at the time of bond issuances. These roadshows have been held in Europe, the Middle East and Asia since 2018, and we plan to introduce them in other regions to reach more bond investors and increase opportunities for communication.

In addition to these initiatives to enhance dialogue with bond investors, we are strengthening engagement with organizations that make ESG assessments widely referenced in the capital markets as we work to improve our ESG scores. We believe that we can further strengthen our relationships with bond investors by helping them better understand and appreciate our ESG initiatives.

Increasing corporate value in line with the JT Group Purpose

With a year now past since the new corporate structure began and the domestic and international tobacco businesses unified, we created the JT Group Purpose to show the evolutionary direction we want the entire Group to take for long-term, sustainable operations. In addition to discussing specific strategies to realize the JT Group Purpose, we will be freshly examining our current financial and capital strategies to determine whether there is anything we should change in our methods. An important challenge for our future will be designing strategies with the JT Group Purpose in mind and including non-financial factors like climate change and human capital. The JT Group Purpose is our new expression of who we are to investors. I think we have a responsibility to build up our practices of careful communications so investors and stakeholders can better understand the Purpose, reinforcing trust.

Rising to these difficult, high-level challenges, we are working to build a structure and formulate measures to resolve them. Since 2022 the Group Treasury has been operating on a single report line, unifying the financial divisions of JT and JTI and eliminating duplicate work. The JT Group human resources management philosophy offers every JT Group employee opportunities for personal growth, and the Group Treasury is focusing effort on employee career development in all regions. For better communications, we are improving the content of our Integrated Report and holding Tobacco Investor Conferences as opportunities to inform investors about our tobacco business strategy for the medium and long terms.

With my personal commitment to enhancing these initiatives, we are confident that we will continue to measure up to the expectations of all investors and stakeholders.