Financial Information

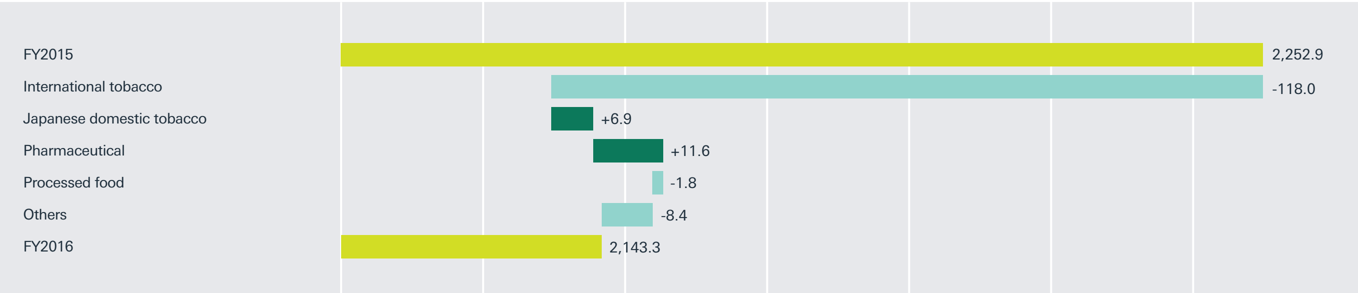
Financial Review
Analysis of the Results

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

Continuing Operations

● Actual Results ● Decrease ● Increase (Decrease in case of expense)

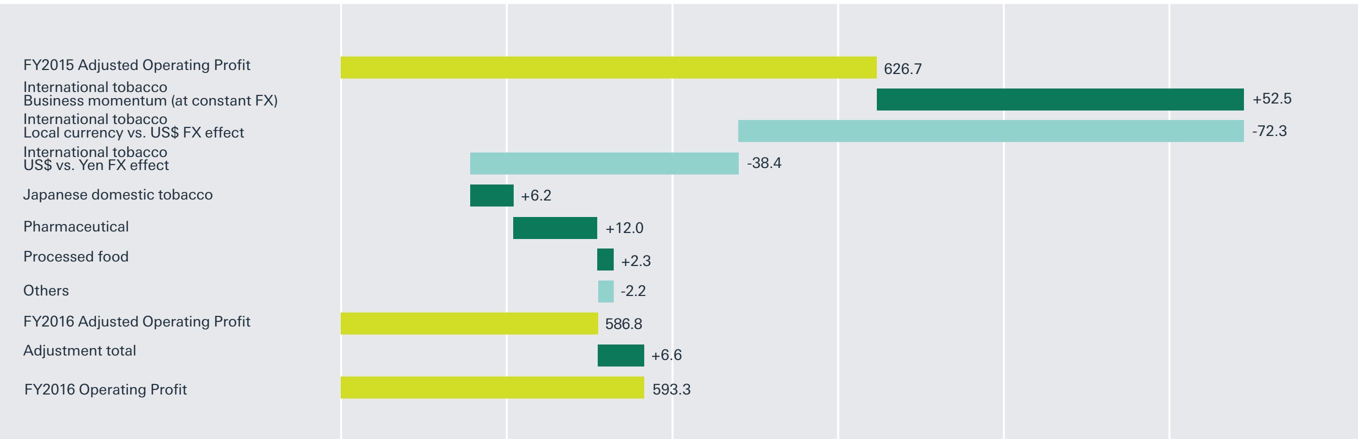
Revenue[1]
(billions of yen)



Revenue decreased ¥109.6 billion or -4.9% year-on-year to ¥2,143.3 billion.

- This was mainly due to the significant negative impact of foreign currency movements despite the robust pricing and mix effect in international tobacco business.
- The revenue of pharmaceutical business increased mainly driven by the increase of royalty revenue from out-licensed compounds.

Adjusted Operating Profit[2]/Operating Profit
(billions of yen)



Adjusted operating profit decreased ¥39.9 billion or -6.4% year-on-year to ¥586.8 billion.

- While international tobacco business achieved strong growth at constant FX mainly driven by robust pricing, adjusted operating profit still decreased due to the significant negative impact of foreign currency movements.
- In Japanese domestic tobacco business, although the sales volume declined, adjusted operating profit grew, mainly due to the MEVIUS price increase, the additional of Natural American Spirit and the effect of competitiveness enhancing measures.
- In pharmaceutical business, adjusted operating profit improved significantly. This was mainly driven by the increased royalty revenue from out-licensed compounds.

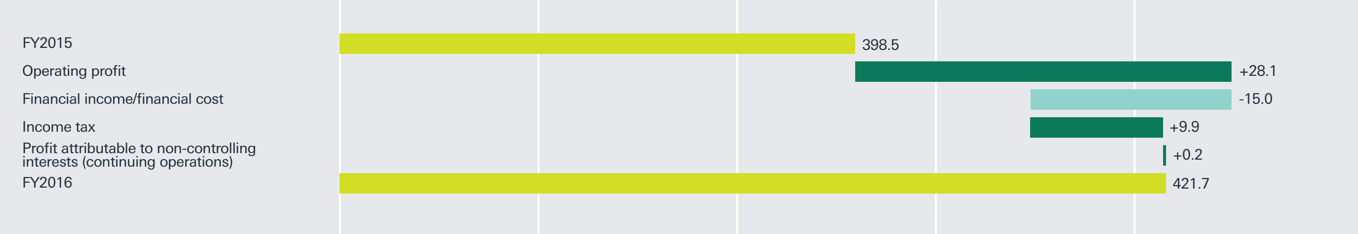
Adjusted operating profit at constant foreign currency increased +11.3% year-on-year.

Operating profit increased 5.0% year-on-year to ¥593.3 billion.

- Mainly because of other income of proceeds from the sales of real estates assets.

Continuing Operations

Profit[3]
(billions of yen)



Profit from continuing operations increased ¥23.2 billion or +5.8% year-on-year to ¥421.7 billion.

- Financial costs increased (shown as a decrease in the graph above) mainly due to the increase in bonds and short-term borrowings.
- Despite the increase in profit before income tax, income tax expenses decreased (shown as an increase in the graph above) as a result of the decrease in effective tax rate in both Japan and international tobacco businesses.

Revenue by business segment

	Billions of yen	
	FY2015	**FY2016**
Revenue (continuing operations)	2,252.9	**2,143.3**
International tobacco	1,317.2	**1,199.2**
Core revenue[4]	1,252.5	**1,138.8**
Japanese domestic tobacco	677.3	**684.2**
Core revenue[5]	642.2	**649.7**
Pharmaceutical	75.6	**87.2**
Processed Food	165.8	**164.1**
Others	17.0	**8.6**

Average Exchange Rate

	FY2015	**FY2016**
YEN/US$	121.10	**108.78**
RUB/US$	60.98	**67.07**
GBP/US$	0.65	**0.74**
EUR/US$	0.90	**0.90**

1. Excludes tobacco excise taxes and agency transactions.
2. Adjusted Operating profit = Operating profit + Amortization cost of acquired intangibles arising from business acquisitions ± Adjusted items (income and costs)*
*Adjusted items (income and costs) = impairment losses on goodwill ± restructuring income and costs ± others
3. Profit attributable to owners of the parent company.
4. Includes revenue from waterpipe tobacco and emerging products, but excludes revenues from distribution, contract manufacturing and other peripheral businesses.
5. Excludes revenue from distribution of imported tobacco in the Japanese domestic tobacco business, among others, includes revenue from domestic duty free, the China business and emerging products such as Ploom TECH device and capsules.
6. Depreciation and amortization ± adjustment items(income and costs)**
**Adjustment items (income and costs) = impairment losses on goodwill ± restructuring income and costs ± others.

Adjusted Operating Profit and Operating profit by business segment

	Billions of yen	
	FY2015	**FY2016**
Continuing Operations: Operating profit	565.2	**593.3**
Adjustment total[6]	61.4	**(6.6)**
Continuing Operations: Adjusted operating profit	626.7	**586.8**
International tobacco: Operating profit	346.9	**301.8**
Adjustment total[6]	47.5	**34.4**
International tobacco: Adjusted operating profit	394.4	**336.2**
Japanese domestic tobacco: Operating profit	249.2	**244.1**
Adjustment total[6]	4.8	**16.1**
Japanese domestic tobacco: Adjusted operating profit	254.1	**260.2**
Pharmaceutical: Operating profit	(2.3)	**9.7**
Adjustment total[6]	–	**–**
Pharmaceutical: Adjusted operating profit	(2.3)	**9.7**
Processed Food: Operating profit	3.2	**5.0**
Adjustment total[6]	(0.5)	**0.0**
Processed food: Adjusted operating profit	2.7	**5.0**
Others/Elimination: Operating profit	(31.8)	**32.7**
Adjustment total[6]	9.6	**(57.1)**
Others/Elimination: Adjusted operating profit	(22.2)	**(24.4)**

- For analysis of revenue, core revenue and adjusted operating profit of each business segment, please refer to section Review of Operation.

Analysis of the Results continued

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

Consolidated

● Actual Results ● Decrease ● Increase (Decrease in case of expense)

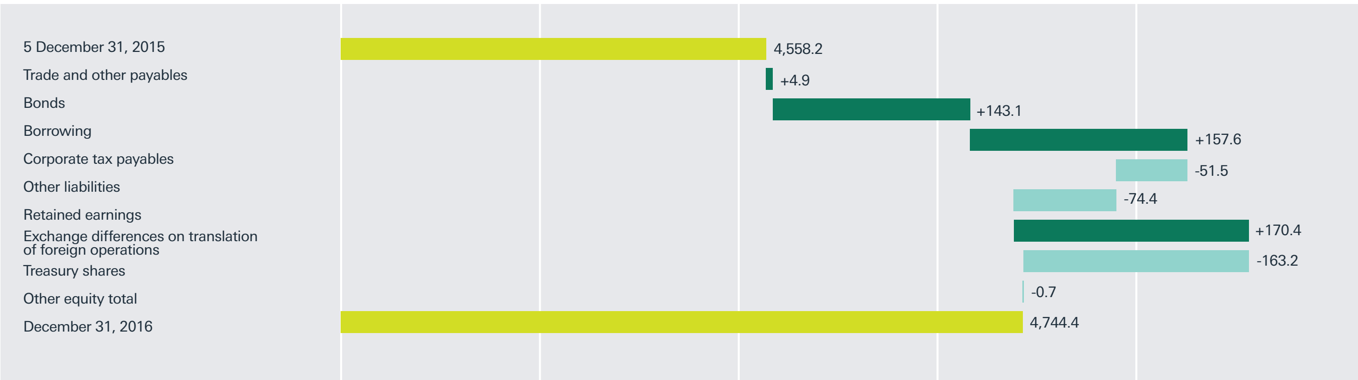
Consolidated Statements of Financial Position (Assets)

(billions of yen)

- Total assets increased ¥186.1 billion to ¥4,744.4 billion, mainly due to the increase in goodwill, trademark and other assets, which is related to the acquisition of Natural American Spirit business outside the United States.

Consolidated Statement of Financial Position (Debt and Equity)

(billions of yen)



- Total liabilities increased ¥179.6 billion to ¥2,216.3 billion mainly due to the increase in bonds and borrowings but partially offset by the decrease in corporate tax payables and other liabilities.
- Despite the increase in retained earnings, total equity increased only 6.5 billion to ¥2,528.0 billion mainly because of the significant negative impact of exchange differences on translation of foreign operations.

1. Significant Accounting Policies

Having acquired RJR Nabisco's non-U.S. tobacco operation in 1999 and Gallaher Group Plc. in the UK in 2007, the JT Group has been growing steadily as a global company with operations in over 70 countries and with our products sold in more than 120 countries and regions around the world. In this context, the JT Group has adopted IFRS from the year ended March 31, 2012 to improve international comparability of financial information in capital markets and to diversify the group's sources of financing through international capital markets.

In addition, from the third quarter of FY2015, beverage business has been classified as discontinued operations due to the withdrawal from beverage business in 2015. Consequently, profit (loss) and some items from continuing operations and discontinued operations are presented separately for the financial results of FY2015.

For further details of significant accounting policies, please refer to Note 3 to the consolidated financial statements.

2. Non-GAAP financial measures

The JT Group discloses certain additional financial measures that are not required or defined under IFRS. These measures help grasp underlying performance of each business and are used for internal performance management. We believe that they are useful information for users of our financial statements to assess the Group's performance.

For our international tobacco business, its consolidated financial statements reported in US dollars are internally reviewed and therefore revenue and adjusted operating profit are externally communicated in US dollars. These non-GAAP financial measures should be treated as supplementary information, rather than alternative measures to corresponding financial numbers prepared in accordance with IFRS.

Core Revenue

For the tobacco business, core revenue is disclosed additionally as a breakdown of revenue. Specifically, the core revenue for the Japanese domestic tobacco business excludes revenue accounted for distribution of imported tobacco products, among others, and includes revenue from domestic duty free, the China business and emerging products such as Ploom TECH device and capsules. Core revenue for the international tobacco business is presented after deducting the revenue accounted for the distribution business and contract manufacturing, among other areas, from revenue, and including revenue from waterpipe tobacco and emerging products.

Adjusted Operating Profit

In order to provide useful comparative information on our business performance, adjusted operating profit is presented as operating profit plus amortization of acquired intangibles arising from business acquisitions and adjusted items (income and costs). Adjusted items (income and costs) are impairment losses on goodwill and restructuring income and costs, and other items. Furthermore, for the international tobacco business, adjusted operating profit at constant rates of exchange which excludes foreign exchange effects, is also presented as additional information. Adjusted operating profit at constant exchange rate for a relevant period in the international tobacco business is calculated using the foreign exchange rates of the prior year.

Analysis of the Results continued

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

3. Analysis of consolidated financial results for FY2016

Consolidated financial results

For analysis of 'Revenue', 'Adjusted operating profit', 'Operating profit' and 'Profit attributable to owners of the parent company', please refer to page 74 and 75. For analysis of 'Assets', 'Debt' and 'Equity', please refer to page 76. For analysis of financial results by business segment, please refer to 'Review of Operations'.

(2) Results and plans of capital expenditures

Excluding the assets acquired through business combination, capital expenditures include outlays on property, plants and equipment such as land, buildings, and structures; machinery; vehicles and others; and intangible assets such as goodwill, trademark, software, and others that are necessary for enhancing the productivity of our factories and other facilities; strengthening our competitiveness, and operating in various business fields.

Total amount of capital expenditures amounted to ¥113.0 billion in FY2016.

(Billions of yen)

Capital expenditure	FY2015	**FY2016**
Continuing operations	129.8	**113.0**
International tobacco	77.2	**70.6**
Japanese domestic tobacco	37.4	**29.8**
Pharmaceutical	6.2	**3.8**
Processed Food	5.7	**5.7**
Other/Elimination and corporate	3.3	**3.1**

In international tobacco business, capital expenditures amounted to ¥70.6 billion which was mainly spent on the optimization of manufacturing bases and for improvement of product specifications. In Japanese domestic tobacco business, capital expenditures amounted to ¥29.8 billion which was mainly spent on the maintenance and upgrading of manufacturing bases, the enhancement of production, the improvement of product specifications in response to the new products. In pharmaceutical business, capital expenditures amounted to ¥3.8 billion which was mainly spent on the development and reinforcement of R&D capabilities. In processed food business, capital expenditures amounted to ¥5.7 billion, which was mainly spent on enhancing and maintaining the production capacity. These capital expenditures were internally funded through cash generated by operations.

Plans for new installations and disposal of facilities

Regarding the mid- to long-term resource allocation of the JT Group, we will place top priority on business investments that will lead to sustainable profit growth in the mid- to long-term based on our management principles. We position the international and Japanese domestic tobacco business as the core business and profit growth engine and place top priority on business investments that will lead to their sustainable profit growth. Meanwhile, regarding the pharmaceutical business and processed food business, we will strive to strengthen foundations that will lead to future profit contribution, and we will make investments to that end. Based on this policy, we plan capital expenditures totaling ¥136.0 billion for FY2017.

As JT and JT Group companies have wide-ranging plans for capital expenditure, figures are disclosed by segment. Our actual capital expenditures may differ significantly from the planned figures mentioned above as a result of a number of factors, including those discussed in 'Risk Factors'.

4. Dividends

The year-end dividends for FY2016 were ¥66 per share. The total annual dividends per share, including the interim dividends per share of ¥64, were ¥130 per share, with a ¥12 increase of dividend per share year-on-year.

The year-end dividends related to the current year are recognized in the following year for accounting purposes. The year-end dividend related to FY2015 (record date of December 31, 2015) and the interim dividends for FY2016 (record date of June 30, 2016) are recorded in the financial statements for FY2016. For more details, please refer to Note 24 to the consolidated financial statements "Dividends".

Capital Expenditure Plan	FY2017 (Billions of yen)	Main purpose of investment	Funding
International tobacco	64.0	Investment for the improvement of product specification and the optimization of manufacturing bases	Internally funded
Japanese domestic tobacco	42.0	Investment for the maintenance and upgrading of manufacturing bases, the enhancement of production, the improvement of product specifications in response to the new products	Same as above
Pharmaceutical	9.0	Investment for the maintaining and reinforcing of R&D	Same as above
Processed food	15.5	Investment for enhancing and maintaining production capacity	Same as above

5. Capital management

The JT Group's management principle is pursuit of 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. The JT Group believes that sustainable profit growth in the mid- to long-term based on this principle will increase the JT Group's value in the mid- to long-term, and is consequently in the best interest of all stakeholders, including our shareholders.

As its financial policy, JT Group maintains a solid balance sheet. This provides the capacity to withstand any adversity arising out of a volatile environment, such as economic crisis. It also allows for sufficient flexibility to capture attractive investment opportunities. JT Group monitors financial indicators in order to maintain a well-balanced capital structure that ensures an appropriate return on equity and a solid balance sheet for future investment. We monitor credit ratings for a solid balance sheet, and ROE (return on equity) for profitability, while focusing on changes in the domestic and overseas environment.

The JT Group manages net interest-bearing debt, where cash and cash equivalents are deducted from interest-bearing debt, and capital (the part attributable to owners of the parent company). The amounts as of each year-end are as follows:

		(Billions of yen)
	As of Dec 31, 2015	**As of Dec 31, 2016**
Interest-bearing debt	255.3	**555.3**
Cash and cash equivalents	(526.8)	**(294.2)**
Net interest-bearing debt (Note)	(271.5)	**261.1**
Capital (equity attributable to owners of the parent company)	2,451.6	**2,456.1**

Note: The figure in parentheses () represents the net amount of cash and cash equivalents after deducting interest-bearing debt.

Share buy-back:

As of December 31, 2016 we held 209,044,267 shares of common stock as treasury stock, amounting to 10.45% of total number of shares issued.

A repurchase of our shares requires cash outlays. In order to repurchase our shares in a flexible manner, we amended the Articles of Incorporation at the general meeting of shareholders held on June 24, 2004 so that we could make repurchase based on a resolution made by the Board of Directors. We may continue to hold the repurchased shares as treasury stock or use them for other purposes. Stock repurchase provides our management with an additional option for increasing flexibility and speed in capital management in order to adapt to a rapidly changing business environment.

6. Financial activities

Our Group Treasury Division provides Group-wide support to enable secure and efficient financing activities. JT Group is exposed to financial risks (credit risk, liquidity risk, foreign exchange risk, interest rate risk, and market price fluctuation risk). Treasury operations are conducted pursuant to a set of Group-wide financial risk management policies and results are reported to the CEO and the Board of Directors of JT on a regular basis. For more details on financial risk management, please refer to "(2) Financial Risk Management" to "(8) Market Price Fluctuation Risk" of Note 33 to the consolidated financial statements "Financial Instruments".

(1) Cash Management Systems

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

(2) External financing

Short-term working capital needs are basically financed through short-term borrowings from financial institutions or through commercial paper, or a combination of both. Mid- to long-term capital needs are financed through long-term borrowings from financial institutions, bond or equity, or a combination of those previously stated.

We continue to diversify our financing method and correspondent financial institutions to secure stable and efficient funding sources through activities such as the establishment of committed facilities. The condition of the Group's wide external debt is reported to the CEO and the Board of Directors of JT on a regular basis.

(3) External investments

Our financial investments are always made taking into account safety, liquidity and optimal yield. Speculative dealings in pursuit of profit margin are not allowed. The results of the financial investment are reported to the CEO and the Board of Directors of JT on a regular basis.

Analysis of the Results continued

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

7. Results of Cash flows of FY2016 and FY2015

Cash and cash equivalents at the end of FY2016 decreased by ¥232.6 billion from the end of FY2015 to ¥294.2 billion. Cash and cash equivalents at the end of FY2015 were ¥526.8 billion.

Cash flows from (used in) operating activities

Net cash flows from operating activities during FY2016 were ¥376.5 billion. The main factors were the generation of a stable cash inflow from the tobacco business. Net cash flows from operating activities were ¥468.4 billion for FY2015.

Cash flows from (used in) investing activities

Net cash flows used in investing activities during FY2016 were ¥687.5 billion. This was mainly due to the acquisition of Natural American Spirit business outside the U.S. and the payment for the purchase of property, plant and equipment and the investment in subsidiaries. Net cash flows used in investing activities were ¥63.3 billion for FY2015.

Cash flows from (used in) financing activities

Net cash flows from financing activities during FY2016 were ¥91.3 billion. This was mainly because short-term borrowings increased and bonds were issued in FY2016, partially offset by the increase of dividends per share. Net cash flows used in financing activities were ¥254.9 billion for FY2015.

8. Liquidity

We have historically had, and expect to continue to have, significant cash flows from operating activities. We expect that cash generated from operating activities will continue to be stable and cover funds needed for ordinary business activities. On December 31, 2016, we had approximately ¥574.4 billion committed facilities for both domestic and international major financial institutions, of which 100% was unused. In addition, we have a domestic commercial paper program, uncommitted facilities, a domestic bond shelf registration and EMTN program.

(1) Long-term debt

Bonds issued (including the current portion) as of December 31, 2015 and December 31, 2016 accounted for ¥215.1 billion and ¥358.2 billion respectively and long-term borrowings as loans from financial institutions (including the current portion) accounted for ¥1.0 billion and ¥1.4 billion respectively. Annual interest rates applicable to long-term borrowings outstanding as of December 31, 2015 and December 31, 2016 ranged from 2.32% to 4.64% and 1.05% to 4.41%, respectively. Long-term lease obligations accounted for ¥7.8 billion as of December 31, 2015 and ¥7.3 billion as of December 31, 2016. Maturities of interest-bearing debts are shown in the table on the next page.

As of December 31, 2016, our long-term debt was rated Aa3 by Moody's Japan K.K. (Moody's), AA- by Standard & Poor's Ratings Japan K.K. (S&P), and AA by Rating and Investment Information Inc. (R&I), with a "stable" outlook from Moody's, a "stable" outlook from S&P and a "stable" outlook from R&I. These ratings are among the highest ratings for international tobacco companies.

These ratings are affected by a number of factors such as developments in our major markets, our business strategies and general economic trends that are beyond our control. The ratings may be withdrawn or revised at any time. Each rating should be evaluated separately from other ratings. Under the Japan Tobacco Inc. Act, the bondholders of JT can enjoy statutory preferential rights over unsecured creditors in seeking repayment, with the exception of national and local taxes and other statutory obligations.

(2) Short-term debt

Short-term borrowings totaled ¥30.8 billion as of December 31, 2015 and ¥187.9 billion as of December 31, 2016. There was no commercial paper outstanding as of December 31, 2015 and December 31, 2016.

Annual interest rates applicable to short-term borrowings ranged from 0.43% to 11.30% as of December 31, 2015 and from 0.33% to 15.00% as of December 31, 2016. Short-term lease obligations totaled ¥0.6 billion as of December 31, 2015 and ¥0.4 billion as of December 31, 2016.

(Billions of yen)

Year ended December 31, 2016	Book Value	Due within 1 year	Due after 1 year through 2 years	Due after 2 years through 3 years	Due after 3 years through 4 years	Due after 4 years through 5 years	Due after 5 years
Short-term borrowings as loans	187.9	187.9	–	–	–	–	–
Short-term lease obligations	0.4	0.4	–	–	–	–	–
Long-term borrowings as loans (current portion)	0.6	0.6	–	–	–	–	–
Bonds (current portion)	20.0	20.0	–	–	–	–	–
Long-term borrowings as loans	0.9	–	0.4	0.1	0.0	0.0	0.3
Bonds	338.2	–	58.2	–	80.0	87.4	113.2
Long-term lease obligations	7.3	–	0.2	0.2	0.2	0.1	6.7
Total	**555.3**	**208.9**	**58.8**	**0.3**	**80.2**	**87.5**	**120.2**

Consolidated Financial Statements
Consolidated Statement of Financial Position

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2016: Year ended December 31, 2016

		Millions of yen
Assets	FY2015 (As of December 31, 2015)	**FY2016 (As of December 31, 2016)**
Current assets		
Cash and cash equivalents (Note 7)	¥ 526,765	**¥ 294,157**
Trade and other receivables (Note 8)	406,387	**396,934**
Inventories (Note 9)	563,820	**558,846**
Other financial assets (Note 10)	17,849	**14,921**
Other current assets (Note 11)	280,493	**340,312**
Subtotal	1,795,313	**1,605,169**
Non-current assets held-for-sale (Note 12)	2,904	**821**
Total current assets	1,798,217	**1,605,990**
Non-current assets		
Property, plant and equipment (Note 13)	681,865	**680,835**
Goodwill (Notes 14, 37)	1,429,287	**1,601,987**
Intangible assets (Note 14)	332,478	**423,970**
Investment property (Note 16)	23,614	**18,184**
Retirement benefit assets (Note 22)	38,954	**23,680**
Investments accounted for using the equity method	59,523	**123,753**
Other financial assets (Note 10)	101,727	**99,358**
Deferred tax assets (Note 17)	92,570	**166,617**
Total non-current assets	2,760,017	**3,138,384**
Total assets	¥4,558,235	**¥4,744,374**

Liabilities and equity	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
		Millions of yen
Liabilities		
Current liabilities		
Trade and other payables (Note 18)	¥ 373,032	**¥ 377,933**
Bonds and borrowings (Note 19)	30,980	**208,521**
Income tax payables	106,391	**54,940**
Other financial liabilities (Note 19)	6,459	**13,023**
Provisions (Note 20)	19,297	**12,529**
Other current liabilities (Note 21)	729,761	**689,629**
Total current liabilities	1,265,920	**1,356,574**
Non-current liabilities		
Bonds and borrowings (Note 19)	215,938	**339,036**
Other financial liabilities (Note 19)	10,143	**9,009**
Retirement benefit liabilities (Note 22)	333,562	**333,410**
Provisions (Note 20)	9,210	**4,423**
Other non-current liabilities (Note 21)	113,958	**102,221**
Deferred tax liabilities (Note 17)	87,979	**71,660**
Total non-current liabilities	770,790	**859,759**
Total liabilities	2,036,710	**2,216,333**
Equity		
Share capital (Note 23)	100,000	**100,000**
Capital surplus (Note 23)	736,400	**736,400**
Treasury shares (Note 23)	(444,333)	**(443,822)**
Other components of equity (Note 23)	(137,122)	**(303,554)**
Retained earnings	2,196,651	**2,367,067**
Equity attributable to owners of the parent company	2,451,596	**2,456,091**
Non-controlling interests	69,929	**71,950**
Total equity	2,521,524	**2,528,041**
Total liabilities and equity	¥4,558,235	**¥4,744,374**

Consolidated Statement of Income

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2016: Year ended December 31, 2016

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Millions of yen
Continuing operations		
Revenue (Notes 6, 25)	¥2,252,884	**¥2,143,287**
Cost of sales (Notes 14, 22)	(920,056)	**(872,433)**
Gross profit	1,332,828	**1,270,854**
Other operating income (Note 26)	15,367	**70,101**
Share of profit in investments accounted for using the equity method	6,381	**6,489**
Selling, general and administrative expenses (Notes 12, 13, 14, 16, 22, 27, 32, 37)	(789,346)	**(754,115)**
Operating profit (Note 6)	565,229	**593,329**
Financial income (Notes 28, 33)	15,016	**6,618**
Financial costs (Notes 22, 28, 33)	(15,132)	**(21,710)**
Profit before income taxes	565,113	**578,237**
Income taxes (Note 17)	(162,386)	**(152,464)**
Profit for the period from continuing operations	402,727	**425,773**
Discontinued operations		
Profit for the period from discontinued operations (Note 38)	87,515	**—**
Profit for the period	¥ 490,242	**¥ 425,773**
Attributable to:		
Owners of the parent company	¥ 485,691	**¥ 421,695**
Non-controlling interests	4,551	**4,078**
Profit for the period	¥ 490,242	**¥ 425,773**
Earnings per share		
Basic (Yen)		
Continuing operations (Note 30)	¥ 221.95	**¥ 235.47**
Discontinued operations (Note 30)	48.59	**—**
Total basic earnings per share for the period (Note 30)	¥ 270.54	**¥ 235.47**
Diluted (Yen)		
Continuing operations (Note 30)	¥ 221.81	**¥ 235.33**
Discontinued operations (Note 30)	48.56	**—**
Total diluted earnings per share for the period (Note 30)	¥ 270.37	**¥ 235.33**

Reconciliation from "Operating profit" to "Adjusted operating profit"

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Millions of yen
Continuing operations		
Operating profit	¥565,229	**¥593,329**
Amortization cost of acquired intangibles arising from business acquisitions	31,875	**46,767**
Adjustment items (income)	(10,346)	**(65,212)**
Adjustment items (costs)	39,900	**11,894**
Adjusted operating profit (Note 6)	¥626,657	**¥586,777**

Consolidated Statement of Comprehensive Income

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2016: Year ended December 31, 2016

		Millions of yen
	FY2015 (Year ended December 31, 2015)	**FY2016 (Year ended December 31, 2016)**
Profit for the period	¥ 490,242	**¥ 425,773**
Other comprehensive income		
Items that will not be reclassified to profit or loss		
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income (Notes 29, 33)	10,735	**(3,159)**
Remeasurements of defined benefit plans (Notes 22, 29)	(4,102)	**(22,202)**
Total of items that will not be reclassified to profit or loss	6,633	**(25,361)**
Items that may be reclassified subsequently to profit or loss		
Exchange differences on translation of foreign operations (Notes 29, 33)	(289,400)	**(163,683)**
Net gain (loss) on derivatives designated as cash flow hedges (Notes 29, 33)	233	**(1,479)**
Total of items that may be reclassified subsequently to profit or loss	(289,167)	**(165,162)**
Other comprehensive income (loss), net of taxes	(282,534)	**(190,523)**
Comprehensive income (loss) for the period	¥ 207,708	**¥ 235,250**
Attributable to:		
Owners of the parent company	¥ 203,257	**¥ 231,590**
Non-controlling interests	4,450	**3,660**
Comprehensive income (loss) for the period	¥ 207,708	**¥ 235,250**

Consolidated Statement of Changes in Equity

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2016: Year ended December 31, 2016

Millions of yen

	Equity attributable to owners of the parent company						
				Other components of equity			
	Share capital	Capital surplus	Treasury shares	Subscription rights to shares	Exchange differences on translation of foreign operations	Net gain (loss) on derivatives designated as cash flow hedges	Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income
As of January 1, 2015	¥100,000	¥736,400	¥(344,447)	¥1,631	¥ 116,421	¥ 1,215	¥23,156
Profit for the period	—	—	—	—	—	—	—
Other comprehensive income (loss)	—	—	—	—	(288,894)	233	10,500
Comprehensive income (loss) for the period	—	—	—	—	(288,894)	233	10,500
Acquisition of treasury shares (Note 23)	—	—	(100,000)	—	—	—	—
Disposal of treasury shares (Note 23)	—	—	114	(85)	—	—	—
Share-based payments (Note 32)	—	—	—	395	—	—	—
Dividends (Note 24)	—	—	—	—	—	—	—
Changes in the scope of consolidation	—	—	—	—	—	—	(140)
Changes in the ownership interest in a subsidiary without a loss of control	—	—	—	—	—	—	—
Transfer from other components of equity to retained earnings	—	—	—	—	—	—	(232)
Other increase (decrease)	—	—	—	—	—	(1,324)	—
Total transactions with the owners	—	—	(99,886)	310	—	(1,324)	(372)
As of December 31, 2015	100,000	736,400	(444,333)	1,941	(172,473)	125	33,284
Profit for the period	—	—	—	—	—	—	—
Other comprehensive income (loss)	—	—	—	—	(163,169)	(1,479)	(3,069)
Comprehensive income (loss) for the period	—	—	—	—	(163,169)	(1,479)	(3,069)
Acquisition of treasury shares (Note 23)	—	—	(0)	—	—	—	—
Disposal of treasury shares (Note 23)	—	—	512	(413)	—	—	—
Share-based payments (Note 32)	—	—	—	265	—	—	—
Dividends (Note 24)	—	—	—	—	—	—	—
Changes in the scope of consolidation	—	—	—	—	—	—	—
Changes in the ownership interest in a subsidiary without a loss of control	—	—	—	—	—	—	—
Transfer from other components of equity to retained earnings	—	—	—	—	—	—	(360)
Other increase (decrease)	—	—	—	—	—	1,794	—
Total transactions with the owners	—	—	512	(147)	—	1,794	(360)
As of December 31, 2016	**¥100,000**	**¥736,400**	**¥(443,822)**	**¥1,794**	**¥(335,642)**	**¥ 440**	**¥29,854**

Millions of yen

	Equity attributable to owners of the parent company					
	Other components of equity					
	Remeasurements of defined benefit plans	Total	Retained earnings	Total	Non-controlling interests	Total equity
As of January 1, 2015	¥ —	¥ 142,425	¥1,902,460	¥2,536,838	¥ 85,665	¥2,622,503
Profit for the period	—	—	485,691	485,691	4,551	490,242
Other comprehensive income (loss)	(4,272)	(282,433)	—	(282,433)	(101)	(282,534)
Comprehensive income (loss) for the period	(4,272)	(282,433)	485,691	203,257	4,450	207,708
Acquisition of treasury shares (Note 23)	—	—	—	(100,000)	—	(100,000)
Disposal of treasury shares (Note 23)	—	(85)	(29)	0	—	0
Share-based payments (Note 32)	—	395	—	395	—	395
Dividends (Note 24)	—	—	(187,574)	(187,574)	(13,809)	(201,383)
Changes in the scope of consolidation	—	(140)	140	—	(6,044)	(6,044)
Changes in the ownership interest in a subsidiary without a loss of control	—	—	4	4	(321)	(318)
Transfer from other components of equity to retained earnings	4,272	4,040	(4,040)	—	—	—
Other increase (decrease)	—	(1,324)	—	(1,324)	(13)	(1,337)
Total transactions with the owners	4,272	2,886	(191,500)	(288,500)	(20,187)	(308,686)
As of December 31, 2015	—	(137,122)	2,196,651	2,451,596	69,929	2,521,524
Profit for the period	—	—	421,695	421,695	4,078	425,773
Other comprehensive income (loss)	(22,387)	(190,105)	—	(190,105)	(419)	(190,523)
Comprehensive income (loss) for the period	(22,387)	(190,105)	421,695	231,590	3,660	235,250
Acquisition of treasury shares (Note 23)	—	—	—	(0)	—	(0)
Disposal of treasury shares (Note 23)	—	(413)	(99)	0	—	0
Share-based payments (Note 32)	—	265	—	265	4	270
Dividends (Note 24)	—	—	(229,223)	(229,223)	(2,038)	(231,261)
Changes in the scope of consolidation	—	—	—	—	1,069	1,069
Changes in the ownership interest in a subsidiary without a loss of control	—	—	69	69	(675)	(606)
Transfer from other components of equity to retained earnings	22,387	22,027	(22,027)	—	—	—
Other increase (decrease)	—	1,794	—	1,794	—	1,794
Total transactions with the owners	22,387	23,674	(251,280)	(227,094)	(1,639)	(228,733)
As of December 31, 2016	**¥ —**	**¥(303,554)**	**¥2,367,067**	**¥2,456,091**	**¥ 71,950**	**¥2,528,041**

Consolidated Statement of Cash Flows

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2016: Year ended December 31, 2016

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	**FY2016 (Year ended December 31, 2016)**
Cash flows from operating activities		
Profit before income taxes	¥ 565,113	**¥ 578,237**
Profit before income taxes from discontinued operations	119,009	**—**
Depreciation and amortization	139,057	**140,794**
Impairment losses	12,654	**1,239**
Interest and dividend income	(14,818)	**(6,372)**
Interest expense	4,030	**8,680**
Share of profit in investments accounted for using the equity method	(6,381)	**(6,489)**
(Gains) losses on sale and disposal of property, plant and equipment, intangible assets and investment property	6,697	**(33,473)**
(Gains) losses on sale of investments in subsidiaries	(134,287)	**(26,106)**
(Increase) decrease in trade and other receivables	3,866	**(20,128)**
(Increase) decrease in inventories	(5,272)	**(686)**
Increase (decrease) in trade and other payables	(6,697)	**16,157**
Increase (decrease) in retirement benefit liabilities	(5,162)	**(4,724)**
(Increase) decrease in prepaid tobacco excise taxes	(59,789)	**(48,228)**
Increase (decrease) in tobacco excise tax payables	31,714	**(14,192)**
Increase (decrease) in consumption tax payables	(34,585)	**2,787**
Other	(33,839)	**(31,938)**
Subtotal	581,310	**555,557**
Interest and dividends received	22,687	**13,064**
Interest paid	(3,538)	**(6,788)**
Income taxes paid (Note 38)	(132,027)	**(185,285)**
Net cash flows from operating activities	468,432	**376,549**
Cash flows from investing activities		
Purchase of securities	(1,320)	**(2,303)**
Proceeds from sale and redemption of securities	3,687	**5,340**
Purchase of property, plant and equipment	(116,976)	**(101,072)**
Proceeds from sale of investment property	8,372	**42,046**
Purchase of intangible assets	(12,123)	**(9,929)**
Payments into time deposits	(1,002)	**(346)**
Proceeds from withdrawal of time deposits	977	**298**
Payments for business combinations (Note 37)	(70,110)	**(589,737)**
Proceeds from sale of investments in subsidiaries	126,774	**26,979**
Purchase of investments in associates	—	**(52,291)**
Other	(1,550)	**(6,493)**
Net cash flows from investing activities	(63,271)	**(687,509)**
Cash flows from financing activities		
Dividends paid to owners of the parent company (Note 24)	(187,646)	**(229,261)**
Dividends paid to non-controlling interests	(13,734)	**(2,011)**
Capital contribution from non-controlling interests	—	**129**
Increase (decrease) in short-term borrowings and commercial paper	5,255	**186,570**
Proceeds from long-term borrowings	—	**856**
Repayments of long-term borrowings	(30,147)	**(578)**
Proceeds from issuance of bonds	114,724	**136,181**
Redemption of bonds	(40,000)	**—**
Repayments of finance lease obligations	(2,986)	**(569)**
Acquisition of treasury shares	(100,000)	**(0)**
Payments for acquisition of interests in subsidiaries from non-controlling interests	(318)	**—**
Other	0	**0**
Net cash flows from financing activities	(254,852)	**91,318**
Net increase (decrease) in cash and cash equivalents	150,309	**(219,643)**
Cash and cash equivalents at the beginning of the period	385,820	**526,765**
Effect of exchange rate changes on cash and cash equivalents	(9,365)	**(12,965)**
Cash and cash equivalents at the end of the period (Note 7)	¥ 526,765	**¥ 294,157**

Notes to Consolidated Financial Statements

Japan Tobacco Inc. and Consolidated Subsidiaries
FY2016: Year ended December 31, 2016 / FY2015: Year ended December 31, 2015

1. Reporting Entity

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

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

The Group's consolidated financial statements for the year ended December 31, 2016, were approved on March 24, 2017 by Mitsuomi Koizumi, President and Chief Executive Officer.

2. Basis of Preparation

(1) Compliance with IFRS

The Group's consolidated financial statements are prepared in accordance with International Financial Reporting Standards (hereinafter referred to as "IFRS").

(2) Basis of Measurement

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

(3) Functional Currency and Presentation Currency

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

(4) Early Adoption of New Accounting Standards

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

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

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

(5) Changes in Method of Presentation

"Purchase of investments in subsidiaries," which was presented in cash flows from investing activities for the prior year, has been presented as "Payments for business combinations" to appropriately reflect the substance of the transaction for the year ended December 31, 2016.

3. Significant Accounting Policies

(1) Basis of Consolidation

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

A. Subsidiaries

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

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

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

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

B. Associates

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

C. Joint Arrangements

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

(2) Business Combination

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

(3) Foreign Currency Translation

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

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

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

(4) Financial Instruments

A. Financial Assets

(i) Initial Recognition and Measurement

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

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

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

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

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

(ii) Subsequent Measurement

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

(a) Financial Assets Measured at Amortized Cost

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

(b) Other Financial Assets

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

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

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

(iii) Derecognition

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

B. Impairment of Financial Assets

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

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

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

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

C. Financial Liabilities

(i) Initial Recognition and Measurement

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

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

(ii) Subsequent Measurement

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

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

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

(b) Financial Liabilities Measured at Amortized Cost

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

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

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

(iii) Derecognition

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

D. Offsetting of Financial Instruments

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

E. Derivatives and Hedge Accounting

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

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

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

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

(i) Fair Value Hedge

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

(ii) Cash Flow Hedge

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

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

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

(iii) Hedge of Net Investment in Foreign Operations

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

F. Fair Value of Financial Instruments

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

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

(5) Cash and Cash Equivalents

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

(6) Inventories

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

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

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

(7) Property, Plant and Equipment

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

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

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

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

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

(8) Goodwill and Intangible Assets

A. Goodwill

Goodwill is stated at acquisition cost less accumulated impairment losses.

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

B. Intangible Assets

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

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

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

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

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

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

(9) Leases

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

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

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

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

(10) Investment Property

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

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

(11) Impairment of Non-financial Assets

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

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

(12) Non-current Assets Held-for-Sale and Discontinued Operations

A. Non-current Assets Held-for-Sale

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

B. Discontinued Operations

The Group has classified a business segment that has been disposed of, or is classified as held-for-sale, into discontinued operations.

(13) Post-employment Benefits

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

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

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

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

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

(14) Share-based Payments

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

(15) Provisions

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

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

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

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

(16) Revenue

A. Sale of Goods

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

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

B. Interest Income
Interest income is recognized using the effective interest rate method.

C. Dividend Income
Dividend income is recognized when the shareholder's right to receive payment is established.

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

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

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

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

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

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

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

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

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

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

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

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

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

(23) Contingencies

A. Contingent Liabilities

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

B. Contingent Assets

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

(24) Adjusted Financial Measures

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

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

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

(Changes in Accounting Policies)

The Group has adopted the following new accounting standards, amended standards and new interpretations from the fiscal year ended December 31, 2016.

IFRS		Description of new standards and amendments
IAS 19	Employee Benefits	Clarifying the method of determining the discount rate for post-employment benefit obligations

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

4. Significant Accounting Estimates and Judgments

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

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

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

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

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

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

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

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

B. Post-employment Benefits

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

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

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

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

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

C. Provisions

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

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

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

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

D. Income Taxes

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

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

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

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

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

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

The content and amount related to income taxes are described in "17. Income Taxes."

E. Contingencies

With regard to contingencies, any items that may have a material impact on business in the future are disclosed in light of all the available evidence as of the fiscal year end date and by taking into account the probability of these contingencies and their impact on financial reporting.

The content of contingencies is described in "39. Contingencies."

5. New Accounting Standards Not Yet Adopted by the Group

By the date of approval of the consolidated financial statements, new accounting standards, amended standards and new interpretations that have been issued, but have not been early adopted by the Group are as follows.

The implications from adoption of these standards and interpretations are assessed by the Group; however, we evaluate that none of them will have a material impact on our operating results and financial condition.

IFRS		Mandatory adoption (From the year beginning)	To be adopted by the Group	Description of new standards and amendments
IFRS 1	First-time Adoption of International Financial Reporting Standards	January 1, 2018	Fiscal year ending December 2018	Deleting short-term exemptions for first-time adopters
IFRS 2	Share-based Payment	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for the effects of vesting conditions on cash-settled share-based payment transactions
IFRS 4	Insurance Contracts	January 1, 2018	Fiscal year ending December 2018	Adding the option to defer the adoption of IFRS 9 for entities engaging mainly in insurance business
IFRS 9	Financial Instruments	January 1, 2018	Fiscal year ending December 2018	Limited changes to classification and measurement of financial assets, and introduction of an expected credit loss impairment model
IFRS 12	Disclosure of Interests in Other Entities	January 1, 2017	Fiscal year ending December 2017	Clarifying the scope for adoption of the Standard
IFRS 15	Revenue from Contracts with Customers	January 1, 2018	Fiscal year ending December 2018	Amendments to accounting treatment for recognizing revenue
IFRS 16	Leases	January 1, 2019	Fiscal year ending December 2019	Amendments to accounting treatment for lease arrangements
IAS 7	Statement of Cash Flows	January 1, 2017	Fiscal year ending December 2017	Requiring disclosure of changes in liabilities arising from financing activities
IAS 12	Income Taxes	January 1, 2017	Fiscal year ending December 2017	Clarifying the requirements for the recognition of deferred tax assets for unrealized losses
IAS 28	Investments in Associates and Joint Ventures	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for investments in associates and joint ventures
IAS 40	Investment Property	January 1, 2018	Fiscal year ending December 2018	Clarifying the rules for transfers of property to or from investment property
IFRIC 22	Foreign Currency Transactions and Advance Consideration	January 1, 2018	Fiscal year ending December 2018	Clarifying accounting treatment for the transactions that include payment/receipt of advance consideration in a foreign currency
IFRS 10 IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	Not yet determined	Not yet determined	Amendments to accounting treatment for sale or contribution of assets between an investor and its associate or joint venture

6. Operating Segments

(1) Outline of Reportable Segments

The reportable segments of the Group are determined based on the operating segments that are components of the Group for which separate financial information is available and are evaluated regularly by the Board of Directors in deciding how to allocate resources and in assessing performance.

The Group is mainly engaged in the manufacture and sale of tobacco products, prescription drugs and processed foods. With respect to tobacco products, operations are managed separately for domestic and overseas markets. The reportable segments of the Group are composed of four segments: "Domestic Tobacco Business," "International Tobacco Business," "Pharmaceutical Business," and "Processed Food Business." They are determined by types of products, characteristics, and markets.

The "Domestic Tobacco Business" manufactures and sells tobacco products in domestic areas (which include duty-free shops in Japan and markets in China, Hong Kong, and Macau where the Company's China Division operates). The "International Tobacco Business" manufactures and sells tobacco products overseas mainly through JT International S.A., which controls manufacturing and sales operations. The "Pharmaceutical Business" consists of research and development, and the manufacture and sale of prescription drugs. The "Processed Food Business" consists of the manufacture and sale of frozen and ambient processed foods, bakery products and seasonings.

(2) Revenues and Performances of Reportable Segments

Revenues and performances of reportable segments from continuing operations are as follows. The Board of Directors assesses the segment performance and determines resource allocation after reviewing revenues and adjusted operating profit. Since financial income, financial costs and income taxes are managed by the Group head office, these income and expenses are excluded from segment performance. Transactions within the segments are based mainly on prevailing market prices.

FY2015: Year ended December 31, 2015

								Millions of yen
								FY2015
	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Revenue								
External revenue (Note 3)	¥677,331	¥1,317,178	¥ 75,564	¥165,843	¥2,235,916	¥ 16,968	¥ —	¥2,252,884
Intersegment revenue	20,342	46,738	—	37	67,117	9,858	(76,976)	—
Total revenue	¥697,672	¥1,363,917	¥ 75,564	¥165,880	¥2,303,034	¥ 26,826	¥(76,976)	¥2,252,884
Segment profit (loss)								
Adjusted operating profit (Note 1)	¥254,053	¥ 394,395	¥ (2,315)	¥ 2,728	¥ 648,860	¥(21,802)	¥ (402)	¥ 626,657
Other items								
Depreciation and amortization	¥ 43,668	¥ 76,007	¥ 4,603	¥ 6,476	¥ 130,754	¥ 2,673	¥ (303)	¥ 133,123
Impairment losses on other than financial assets	1,168	4,393	187	56	5,805	3,757	(47)	9,516
Reversal of impairment losses on other than financial assets	—	276	—	—	276	—	—	276
Share of profit (loss) in investments accounted for using the equity method	61	6,252	—	37	6,351	30	—	6,381
Capital expenditures	37,416	77,217	6,200	5,651	126,484	3,970	(703)	129,751

FY2016: Year ended December 31, 2016

Millions of yen

FY2016

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Revenue								
External revenue (Note 3)	**¥684,233**	**¥1,199,190**	**¥87,183**	**¥164,078**	**¥2,134,683**	**¥ 8,604**	**¥ —**	**¥2,143,287**
Intersegment revenue	**18,245**	**30,280**	**—**	**30**	**48,554**	**9,653**	**(58,207)**	**—**
Total revenue	**¥702,478**	**¥1,229,470**	**¥87,183**	**¥164,108**	**¥2,183,237**	**¥ 18,257**	**¥(58,207)**	**¥2,143,287**
Segment profit (loss)								
Adjusted operating profit (Note 1)	**¥260,205**	**¥ 336,227**	**¥ 9,717**	**¥ 4,998**	**¥ 611,146**	**¥(24,725)**	**¥ 356**	**¥ 586,777**
Other items								
Depreciation and amortization	**¥ 57,994**	**¥ 69,129**	**¥ 4,908**	**¥ 6,423**	**¥ 138,453**	**¥ 2,675**	**¥ (335)**	**¥ 140,794**
Impairment losses on other than financial assets	**54**	**615**	**—**	**16**	**685**	**554**	**—**	**1,239**
Reversal of impairment losses on other than financial assets	**—**	**27**	**—**	**—**	**27**	**—**	**—**	**27**
Share of profit (loss) in investments accounted for using the equity method	**33**	**6,327**	**—**	**(4)**	**6,355**	**134**	**—**	**6,489**
Capital expenditures	**29,820**	**70,592**	**3,823**	**5,707**	**109,942**	**3,902**	**(847)**	**112,998**

Reconciliation from "Adjusted operating profit" to "Profit before income taxes"

FY2015: Year ended December 31, 2015

Millions of yen

FY2015

	Reportable Segments							
	Domestic Tobacco	International Tobacco	Pharmaceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
Adjusted operating profit (Note 1)	¥254,053	¥394,395	¥(2,315)	¥2,728	¥648,860	¥(21,802)	¥(402)	¥626,657
Amortization cost of acquired intangibles arising from business acquisitions	—	(31,875)	—	—	(31,875)	—	—	(31,875)
Adjustment items (income) (Note 4)	97	3,548	—	464	4,108	6,238	—	10,346
Adjustment items (costs) (Note 4)	(4,946)	(19,148)	—	(9)	(24,103)	(15,798)	—	(39,900)
Operating profit (loss)	¥249,204	¥346,921	¥(2,315)	¥3,182	¥596,992	¥(31,361)	¥(402)	¥565,229
Financial income								15,016
Financial costs								(15,132)
Profit before income taxes								¥565,113

FY2016: Year ended December 31, 2016

	Domestic Tobacco	International Tobacco	Pharmaceuticals	Processed Food	Total	Other (Note 2)	Elimination	Consolidated
								Millions of yen
								FY2016
	Reportable Segments							
Adjusted operating profit (Note 1)	**¥260,205**	**¥336,227**	**¥9,717**	**¥4,998**	**¥611,146**	**¥(24,725)**	**¥356**	**¥586,777**
Amortization cost of acquired intangibles arising from business acquisitions	**(16,245)**	**(30,522)**	**—**	**—**	**(46,767)**	**—**	**—**	**(46,767)**
Adjustment items (income) (Note 4)	**282**	**34**	**—**	**2**	**318**	**64,894**	**—**	**65,212**
Adjustment items (costs) (Note 4)	**(137)**	**(3,960)**	**—**	**(8)**	**(4,105)**	**(7,789)**	**—**	**(11,894)**
Operating profit (loss)	**¥244,106**	**¥301,779**	**¥9,717**	**¥4,991**	**¥560,592**	**¥ 32,380**	**¥356**	**¥593,329**
Financial income								**6,618**
Financial costs								**(21,710)**
Profit before income taxes								**¥578,237**

(Note 1) For adjusted operating profit, amortization cost of acquired intangibles arising from business acquisitions, and adjustment items (income and costs) are excluded from operating profit (loss).
(Note 2) "Other" includes business activities relating to rent of real estate and corporate expenses relating to corporate communication and operation of the head office.
(Note 3) Core revenue as part of the "Domestic Tobacco Business" and the "International Tobacco Business" is as follows:

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Millions of yen
Domestic Tobacco	¥ 642,240	**¥ 649,744**
International Tobacco	1,252,496	**1,138,805**

(Note 4) "Adjustment items (income)" include restructuring income of gains on sale of real estate.
"Adjustment items (costs)" include restructuring costs of the closing down of a factory.
The breakdown of restructuring income is described in "26. Other Operating Income." Restructuring costs included in "Cost of sales" were ¥57 million for the year ended December 31, 2015. Restructuring costs included in "Selling, general and administrative expenses" were ¥39,843 million and ¥11,894 million for the years ended December 31, 2015 and 2016, respectively. The breakdown of restructuring costs in "Selling, general and administrative expenses" is described in "27. Selling, General and Administrative Expenses."
The breakdown of "Adjustment items (costs)" is as follows:

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Millions of yen
Restructuring costs	¥39,900	**¥11,894**
Adjustment items (costs)	¥39,900	**¥11,894**

Restructuring costs for the year ended December 31, 2015 mainly relate to rationalization of distribution system and factory platform in some markets in the "International Tobacco Business" and disposal of real estate. Restructuring costs for the year ended December 31, 2016 mainly relate to disposal of real estate.

(3) Geographic Information

The regional breakdown of non-current assets and external revenue from continuing operations as of each fiscal year end is as follows:

Non-current Assets

	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
		Millions of yen
Japan	¥ 461,265	**¥ 833,543**
Overseas	2,005,979	**1,891,433**
Consolidated	¥2,467,244	**¥2,724,975**

(Note) Non-current assets, exclusive of financial instruments, deferred tax assets and retirement benefits assets, are segmented by the location of the assets.

External Revenue from Continuing Operations

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Millions of yen
Japan	¥ 894,710	¥ 889,742
Overseas	1,358,174	1,253,545
Consolidated	¥2,252,884	¥2,143,287

(Note) Revenue is segmented by the sales destination.

(4) Major Customers Information

The "International Tobacco Business" of the Group sells products to the Megapolis Group that engages in distribution and wholesale business in Russia and other countries. The external revenues from the Megapolis Group were ¥293,541 million (13.0% of consolidated revenue) for the year ended December 31, 2015 and ¥235,932 million (11.0% of consolidated revenue) for the year ended December 31, 2016.

7. Cash and Cash Equivalents

The breakdown of "Cash and cash equivalents" as of each fiscal year end is as follows:

	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
		Millions of yen
Cash and deposits	¥399,265	¥234,957
Short-term investments	127,499	59,200
Total	¥526,765	¥294,157

Cash and cash equivalents are classified as financial assets measured at amortized cost.

8. Trade and Other Receivables

The breakdown of "Trade and other receivables" as of each fiscal year end is as follows:

	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
		Millions of yen
Note and account receivables	¥392,882	¥386,708
Other	15,316	11,742
Allowance for doubtful accounts	(1,812)	(1,515)
Total	¥406,387	¥396,934

Trade and other receivables are presented net of allowance for doubtful accounts in the consolidated statement of financial position.

Trade and other receivables are classified as financial assets measured at amortized cost.

9. Inventories

The breakdown of “Inventories” as of each fiscal year end is as follows:

	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
		Millions of yen
Merchandise and finished goods (Note 1)	¥162,208	**¥176,702**
Leaf tobacco (Note 2)	344,623	**324,802**
Other	56,989	**57,343**
Total	¥563,820	**¥558,846**

(Note 1) For imported tobacco products (merchandise) that are sold by TS Network Co., Ltd., a subsidiary of the Company, commissions solely from wholesale are included in revenue. The amount of imported tobacco products (merchandise) that the company holds at the end of each fiscal year is included in inventories and presented as “Merchandise and finished goods.”

(Note 2) Leaf tobacco includes those products that will be used after 12 months from the end of each fiscal year, but they are included in inventories since they are held within the normal operating cycle.

10. Other Financial Assets

(1) The breakdown of “Other financial assets” as of each fiscal year end is as follows:

	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
		Millions of yen
Derivative assets	¥ 7,106	**¥ 11,769**
Equity securities	72,795	**65,548**
Debt securities	6,600	**4,572**
Time deposits	994	**965**
Other	39,614	**38,345**
Allowance for doubtful accounts	(7,533)	**(6,920)**
Total	¥119,576	**¥114,279**
Current assets	¥ 17,849	**¥ 14,921**
Non-current assets	101,727	**99,358**
Total	¥119,576	**¥114,279**

Other financial assets are presented net of allowance for doubtful accounts in the consolidated statement of financial position.

Derivative assets are classified as financial assets measured at fair value through profit or loss excluding those to which hedge accounting is applied, equity securities are classified as financial assets measured at fair value through other comprehensive income, and time deposits and debt securities are classified as financial assets measured at amortized cost.

(2) Names of major securities held as financial assets measured at fair value through other comprehensive income and their fair values as of each fiscal year end are as follows:

Company name	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
		Millions of yen
KT&G Corporation	¥30,926	**¥28,010**
Seven & i Holdings Co., Ltd.	4,747	**3,808**
DOUTOR•NICHIRES Holdings Co., Ltd.	2,496	**2,872**
Mizuho Financial Group, Inc.	3,114	**2,683**
Mitsubishi UFJ Financial Group, Inc.	2,668	**2,165**
Mitsubishi Shokuhin Co., Ltd.	1,794	**2,089**

Equity securities are held mainly for strengthening relationships with investees. Therefore, they are designated as financial assets measured at fair value through other comprehensive income.

In order to pursue the efficiency of assets held and to use them effectively, sales of financial assets measured at fair value through other comprehensive income have been carried out (derecognition).

The fair value at the time of sale and cumulative gain or loss that is recognized in equity through other comprehensive income for each fiscal year is as follows:

		Millions of yen
	FY2015 (Year ended December 31, 2015)	**FY2016 (Year ended December 31, 2016)**
Fair Value	¥ 800	**¥1,532**
Cumulative gain or loss recognized in equity as other comprehensive income (Note)	(232)	**(360)**

(Note) The figure represents the amount transferred to retained earnings.
The cumulative gain or loss recognized in equity as other comprehensive income is transferred to retained earnings when an equity instrument is sold or the decline in its fair value compared to its acquisition cost is significant.

11. Other Current Assets

The breakdown of "Other current assets" as of each fiscal year end is as follows:

		Millions of yen
	FY2015 (As of December 31, 2015)	**FY2016 (As of December 31, 2016)**
Prepaid tobacco excise taxes	¥219,942	**¥274,157**
Prepaid expenses	14,144	**15,743**
Consumption tax receivables	17,125	**18,575**
Other	29,282	**31,836**
Total	¥280,493	**¥340,312**

12. Non-current Assets Held-for-Sale

The breakdown of "Non-current assets held-for-sale" as of each fiscal year end is as follows:

Breakdown of Major Assets

		Millions of yen
	FY2015 (As of December 31, 2015)	**FY2016 (As of December 31, 2016)**
Non-current assets held-for-sale		
Property, plant and equipment	¥ 105	**¥309**
Investment property	2,799	**512**
Total	¥2,904	**¥821**

"Non-current assets held-for-sale" are mainly rental properties and idle properties which are currently actively marketed for sale.

With regard to such assets and assets sold, impairment losses from continuing operations of ¥47 million are recognized in "Selling, general and administrative expenses" in the consolidated statement of income for the year ended December 31, 2015.

13. Property, Plant and Equipment

(1) Schedule of Property, Plant and Equipment

The schedules of the carrying amount, acquisition cost, and accumulated depreciation and accumulated impairment losses of "Property, plant and equipment" are as follows:

Millions of yen

Carrying Amount	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2015	¥325,895	¥292,404	¥ 66,622	¥ 71,206	¥756,127
Individual acquisition	27,483	29,903	20,601	42,433	120,420
Acquisition through business combinations	560	3,538	69	1	4,168
Transfer to investment property	(19,439)	(90)	(192)	—	(19,721)
Transfer to non-current assets held-for-sale	(193)	(415)	(0)	—	(608)
Depreciation	(16,380)	(54,478)	(19,237)	—	(90,094)
Impairment losses	(1,988)	(2,826)	(3,133)	(56)	(8,003)
Reversal of impairment losses	—	229	1	46	276
Sale or disposal	(2,025)	(4,103)	(3,836)	(189)	(10,154)
Decrease resulting from transfer of subsidiaries	(5,617)	(4,732)	(14,059)	—	(24,407)
Exchange differences on translation of foreign operations	(14,886)	(23,311)	(2,475)	(3,964)	(44,635)
Other	46,130	13,041	1,994	(62,667)	(1,503)
As of December 31, 2015	339,542	249,160	46,355	46,808	681,865
Individual acquisition	**13,053**	**30,787**	**12,390**	**43,758**	**99,989**
Acquisition through business combinations	**1,066**	**451**	**241**	**3**	**1,762**
Transfer to investment property	**(5,702)**	**(9)**	**(16)**	**—**	**(5,726)**
Transfer to non-current assets held-for-sale	**(180)**	**—**	**(0)**	**—**	**(180)**
Depreciation	**(15,709)**	**(47,121)**	**(14,670)**	**—**	**(77,500)**
Impairment losses	**(24)**	**(537)**	**(3)**	**(10)**	**(575)**
Reversal of impairment losses	**—**	**8**	**19**	**—**	**27**
Sale or disposal	**(507)**	**(3,646)**	**(736)**	**(162)**	**(5,050)**
Exchange differences on translation of foreign operations	**(4,722)**	**(8,864)**	**(766)**	**(4,252)**	**(18,604)**
Other	**17,420**	**25,963**	**1,377**	**(39,932)**	**4,827**
As of December 31, 2016	**¥344,237**	**¥246,192**	**¥ 44,193**	**¥ 46,213**	**¥680,835**

Millions of yen

Acquisition Cost	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2015	¥661,172	¥804,276	¥188,732	¥71,206	¥1,725,386
As of December 31, 2015	633,789	706,561	144,618	46,808	1,531,776
As of December 31, 2016	**643,073**	**693,378**	**147,223**	**46,213**	**1,529,888**

Millions of yen

Accumulated Depreciation and Accumulated Impairment Losses	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Construction in progress	Total
As of January 1, 2015	¥335,277	¥511,872	¥122,110	¥ —	¥ 969,259
As of December 31, 2015	294,247	457,401	98,263	—	849,910
As of December 31, 2016	**298,836**	**447,187**	**103,030**	**—**	**849,053**

The carrying amount of property, plant and equipment as of each fiscal year end includes the carrying amount of the following leased assets:

	Land, buildings and structures	Machinery and vehicles	Tools, furniture and fixtures	Total
				Millions of yen
As of January 1, 2015	¥6,910	¥5,250	¥6,766	¥18,926
As of December 31, 2015	6,801	1,853	9	8,662
As of December 31, 2016	**6,538**	**1,201**	**7**	**7,746**

(2) Impairment Losses

The grouping of property, plant and equipment for impairment test is the smallest cash-generating unit that independently generates cash inflow.

The Group recognized impairment losses from continuing operations of ¥5,185 million for the year ended December 31, 2015, and ¥575 million for the year ended December 31, 2016 in "Selling, general and administrative expenses" in the consolidated statement of income.

Impairment losses recognized in the year ended December 31, 2015 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles due to decision of closing down of a factory.

The recoverable amounts of these assets are calculated mainly by their values in use, which are set at "zero."

Impairment losses recognized in the year ended December 31, 2016 represent the losses incurred to reduce the carrying amounts to the recoverable amounts of the buildings, structures, machinery and vehicles due to decision of individual selection for demolition.

The recoverable amounts of these assets are calculated mainly by their values in use, which are set at "zero."

14. Goodwill and Intangible Assets

(1) Schedule of Goodwill and Intangible Assets

The schedules of carrying amount, acquisition cost, and accumulated amortization and accumulated impairment losses of "Goodwill" and "Intangible assets" are as follows:

Carrying Amount	Goodwill	Trademarks	Software	Other	Total
					Millions of yen
As of January 1, 2015	¥1,539,376	¥301,960	¥ 35,856	¥27,096	¥1,904,288
Individual acquisition	—	794	7,232	7,024	15,051
Acquisition through business combinations	65,252	14,967	8	8,740	88,967
Amortization (Note)	—	(30,216)	(12,852)	(5,040)	(48,107)
Impairment losses	—	—	(268)	(362)	(631)
Sale or disposal	—	(0)	(316)	(140)	(456)
Decrease resulting from transfer of subsidiaries	(882)	(0)	(193)	(3,022)	(4,097)
Exchange differences on translation of foreign operations	(174,516)	(20,182)	(172)	(206)	(195,076)
Other	57	1,505	4,124	(3,858)	1,827
As of December 31, 2015	1,429,287	268,828	33,418	30,232	1,761,765
Individual acquisition	**—**	**222**	**5,597**	**6,852**	**12,670**
Acquisition through business combinations	**289,720**	**180,297**	**8**	**2,243**	**472,268**
Amortization (Note)	**—**	**(44,154)**	**(12,795)**	**(5,696)**	**(62,645)**
Impairment losses	**—**	**—**	**(102)**	**—**	**(102)**
Sale or disposal	**—**	**—**	**(90)**	**(40)**	**(130)**
Exchange differences on translation of foreign operations	**(114,709)**	**(40,315)**	**(406)**	**(280)**	**(155,710)**
Other	**(2,312)**	**17**	**1,448**	**(1,314)**	**(2,161)**
As of December 31, 2016	**¥1,601,987**	**¥364,896**	**¥ 27,078**	**¥31,996**	**¥2,025,957**

(Note) The amortization of intangible assets is included in "Cost of sales" and "Selling, general and administrative expenses" in the consolidated statement of income. The amortization of intangible assets from discontinued operations for the year ended December 31, 2015 is included in "Profit for the period from discontinued operations."

Acquisition Cost	Goodwill	Trademarks	Software	Other	Total
					Millions of yen
As of January 1, 2015	¥1,539,376	¥845,499	¥132,309	¥92,280	¥2,609,465
As of December 31, 2015	1,429,287	818,982	135,951	92,062	2,476,282
As of December 31, 2016	**1,601,987**	**928,876**	**137,761**	**96,994**	**2,765,618**

Accumulated Amortization and Accumulated Impairment Losses	Goodwill	Trademarks	Software	Other	Total
					Millions of yen
As of January 1, 2015	¥ —	¥543,539	¥ 96,453	¥65,184	¥705,177
As of December 31, 2015	—	550,154	102,533	61,830	714,517
As of December 31, 2016	**—**	**563,981**	**110,683**	**64,997**	**739,661**

(2) Material Goodwill and Intangible Assets

Goodwill and intangible assets recognized in the consolidated statement of financial position are mainly composed of goodwill and trademarks in the JTIH Group. The carrying amounts of goodwill as of December 31, 2015 and 2016 were ¥1,387,593 million and ¥1,310,727 million, respectively. The carrying amounts of trademarks as of December 31, 2015 and 2016 were ¥266,521 million and ¥216,617 million, respectively.

The majority of goodwill and trademark in the JTIH Group was recognized as a result of the acquisitions of RJR Nabisco's non-U.S. tobacco operations in 1999 and Gallaher in 2007.

Other than the above, goodwill and trademark in Domestic Tobacco business were recognized as a result of the acquisition of Natural American Spirit's non-U.S. tobacco operations in 2016 and the carrying amounts are ¥265,891 million for goodwill and ¥148,260 million for trademark as of December 31, 2016.

The trademarks are amortized using the straight-line method and the remaining amortization period is mainly from 9 to 10 years.

(3) Impairment Test for Goodwill

For the year ended December 31, 2016, the carrying amount of the majority of goodwill is allocated to the domestic tobacco cash-generating unit of ¥265,891 million, the international tobacco cash-generating unit of ¥1,310,727 million (¥1,387,593 million for the year ended December 31, 2015) and the processed food cash-generating unit of ¥25,368 million (¥25,368 million for the year ended December 31, 2015). Details of the result of impairment tests are as follows:

A. Domestic Tobacco Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group conservatively decreases a growth rate from 2.9% in the fourth year to 0% in the ninth year gradually, and calculates the value in use from the tenth year by using the same cash flows as the ninth year.

The discount rate before taxes is 4.6%. The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

B. International Tobacco Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group sets a growth rate from 2.8% in the fourth year (FY2015: 3.2%) to 1.4% in the ninth year (FY2015: 3.8%), and the same growth rate as the ninth year from the tenth year as a continued growth rate for inflation.

The discount rate before taxes is 9.7% (FY2015: 11.7%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

C. Processed Food Cash-generating Unit

The recoverable amount is calculated by the value in use based on the three-year business plan that was prepared by reflecting past experiences and external information and that was approved by management. After the three-year business plan, the Group sets a growth rate from 1.6% in the fourth year (FY2015: 2.8%) to 1.0% in the ninth year (FY2015: 1.1%), and the same growth rate as the ninth year issued from the tenth year as a continued growth rate for inflation.

The discount rate before taxes is 3.9% (FY2015: 4.1%). The value in use sufficiently exceeds the carrying amount of the cash-generating unit. Therefore, even in cases where the discount rate and growth rate used in calculating the value in use fluctuate within reasonable ranges, the Group assumes that the value in use will not become less than the carrying amount.

(4) Impairment Losses

Goodwill is allocated to cash-generating units that are identified according to locations and types of businesses. The grouping of intangible assets for impairment test is the smallest cash-generating unit that independently generates cash inflow.

The Group recognized impairment losses from continuing operations of ¥311 million for the year ended December 31, 2015, and ¥102 million for the year ended December 31, 2016 in "Selling, general and administrative expenses" in the consolidated statement of income.

15. Lease Transactions

The Group leases factory sites, vehicles and other assets as a lessee. Some of the lease contracts have renewal options or escalation clauses. There are no restrictions on additional debt and further leasing imposed by the lease arrangements.

(1) Present Value of Finance Lease Obligations

The total of future minimum lease payments for leased assets recognized based on the finance lease contracts, their present value and future financial costs as of each fiscal year end are as follows:

	Millions of yen	
	FY2015 (As of December 31, 2015)	**FY2016 (As of December 31, 2016)**
Not later than 1 year		
Total of future minimum lease payments	¥ 702	**¥ 589**
Future financial costs	149	**218**
Present value	553	**372**
Later than 1 year and not later than five years		
Total of future minimum lease payments	2,201	**1,696**
Future financial costs	1,062	**1,018**
Present value	1,140	**678**
Later than 5 years		
Total of future minimum lease payments	10,066	**9,489**
Future financial costs	3,385	**2,838**
Present value	6,680	**6,652**
Total		
Total of future minimum lease payments	12,969	**11,775**
Future financial costs	4,596	**4,074**
Present value	8,373	**7,701**

(2) Future Minimum Lease Payments under Non-cancellable Operating Leases

The total of future minimum lease payments under non-cancellable operating leases as of each fiscal year end is as follows:

	Millions of yen	
	FY2015 (As of December 31, 2015)	**FY2016 (As of December 31, 2016)**
Not later than 1 year	¥ 6,446	**¥ 7,287**
Later than 1 year and not later than 5 years	8,968	**8,382**
Later than 5 years	7,419	**7,871**
Total	¥22,833	**¥23,539**

(3) Total of Minimum Lease Payments and Contingent Rents

The total of minimum lease payments and contingent rents of operating lease contracts recognized as an expense from continuing operations for each fiscal year is as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	**FY2016 (Year ended December 31, 2016)**
Total of minimum lease payments	¥11,621	**¥8,099**
Contingent rents	1,057	**1,147**

16. Investment Property

(1) Schedule of Investment Property

The schedule of the carrying amount of "Investment property" for each fiscal year is as follows:

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
	Millions of yen	
Balance at the beginning of the period	¥17,870	**¥23,614**
Expenditure after acquisition	556	**338**
Transfer from property, plant and equipment	19,721	**5,726**
Transfer to non-current assets held-for-sale	(3,560)	**(3,130)**
Transfer to property, plant and equipment	(731)	**(1,799)**
Depreciation	(856)	**(649)**
Impairment losses	(3,973)	**(562)**
Sale or disposal	(5,399)	**(1,904)**
Exchange differences on translation of foreign operations	(8)	**(5)**
Other	(6)	**(3,446)**
Balance at the end of the period	¥23,614	**¥18,184**
Acquisition cost at the beginning of the period	¥46,084	**¥69,106**
Accumulated depreciation and accumulated impairment losses at the beginning of the period	28,214	**45,493**
Acquisition cost at the end of the period	69,106	**51,245**
Accumulated depreciation and accumulated impairment losses at the end of the period	45,493	**33,061**

The investment properties as of December 31, 2016 are mainly idle properties.

(2) Fair Value

The fair value of investment property is determined based on a valuation conducted by an external real estate appraiser. The valuation is made in accordance with the appraisal standards of the country where the investment property is located and based on market evidence of transaction prices for similar assets.

The fair value hierarchy of investment property is categorized from Level 1 to Level 3 as follows:

Level 1: Fair value measured at the quoted price in the active market
Level 2: Fair value that is calculated using the observable price other than categorized in Level 1 directly or indirectly
Level 3: Fair value that is calculated based on valuation techniques which include inputs that are not based on observable market data

The fair value of investment property based on the fair value hierarchy as of each fiscal year end is as follows:

	Level 1	Level 2	Level 3	Total
				Millions of yen
	FY2015 (As of December 31, 2015)			
Investment property	¥ —	¥64,829	¥3,526	¥68,355

	Level 1	Level 2	Level 3	Total
				Millions of yen
	FY2016 (As of December 31, 2016)			
Investment property	**¥ —**	**¥45,763**	**¥1,570**	**¥47,334**

The carrying amount of investment property as of each fiscal year end is as follows:

	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
		Millions of yen
Investment property	¥23,614	**¥18,184**

(3) Impairment Losses

The grouping of investment properties for impairment test is based on the smallest cash-generating unit that independently generates cash inflow. Impairment test for idle properties is carried out individually.

The Group recognized impairment losses from continuing operations of ¥3,973 million for the year ended December 31, 2015, and ¥562 million for the year ended December 31, 2016 in "Selling, general and administrative expenses" in the consolidated statement of income.

Impairment losses recognized for the year ended December 31, 2015 represent the difference between the recoverable amount and the carrying amount of land and buildings as idle properties were individually selected for demolition. The recoverable amount is calculated based on value in use basis, which is zero for buildings due to the decision of demolition, and the recoverable amount of other properties is calculated by the fair value less costs of disposal.

Impairment losses recognized for the year ended December 31, 2016 represent the difference between the recoverable amount and the carrying amount of land and buildings as idle properties were individually selected for demolition. The recoverable amount is calculated based on value in use basis, which is zero for buildings due to the decision of demolition, and the recoverable amount of other properties is calculated by the fair value less costs of disposal.

17. Income Taxes

(1) Deferred Tax Assets and Deferred Tax Liabilities

The breakdown and schedule of "Deferred tax assets" and "Deferred tax liabilities" by major causes of their occurrence for each fiscal year are as follows:

FY2015: Year ended December 31, 2015

Millions of yen

Deferred Tax Assets	As of January 1, 2015	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2015
Fixed assets (Note 2)	¥ 45,228	¥ (4,868)	¥ —	¥ 32	¥ 40,392
Retirement benefits	124,330	(25,886)	(3,495)	(3,080)	91,870
Carryforward of unused tax losses	63,050	1,479	—	(6,946)	57,582
Other	85,684	(1,513)	(4,860)	(2,472)	76,839
Subtotal	318,292	(30,788)	(8,355)	(12,466)	266,683
Valuation allowance	(66,478)	(4,403)	(611)	5,704	(65,788)
Total	¥251,814	¥(35,191)	¥(8,966)	¥ (6,762)	¥200,895

Millions of yen

Deferred Tax Liabilities	As of January 1, 2015	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2015
Fixed assets (Note 2)	¥(115,753)	¥24,602	¥ —	¥3,236	¥ (87,915)
Retirement benefits	(7,334)	(476)	(502)	615	(7,696)
Other	(106,722)	(913)	2,147	4,794	(100,693)
Total	¥(229,809)	¥23,214	¥1,646	¥8,645	¥(196,305)

FY2016: Year ended December 31, 2016

Deferred Tax Assets	As of January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2016
					Millions of yen
Fixed assets (Note 2)	¥ 40,392	¥(12,218)	¥ —	¥108,540	¥136,713
Retirement benefits	91,870	(11,902)	1,441	(1,468)	79,940
Carryforward of unused tax losses	57,582	(2,029)	—	(2,419)	53,135
Other	76,839	(1,372)	4,192	(3,688)	75,971
Subtotal	266,683	(27,522)	5,633	100,966	345,760
Valuation allowance	(65,788)	322	1,914	2,320	(61,231)
Total	¥200,895	¥(27,200)	¥7,547	¥103,285	¥284,528

Deferred Tax Liabilities	As of January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Other (Note 1)	As of December 31, 2016
					Millions of yen
Fixed assets (Note 2)	¥ (87,915)	¥11,097	¥ —	¥ 3,013	¥ (73,805)
Retirement benefits	(7,696)	234	1,824	1,132	(4,506)
Other	(100,693)	(7,467)	(9,030)	5,931	(111,260)
Total	¥(196,305)	¥ 3,864	¥(7,206)	¥10,075	¥(189,572)

(Note 1) "Other" includes exchange differences on translation of foreign operations and acquisition through business combinations. The outline of the major business combination and the deferred tax assets recognized in the year ended December 31, 2016 are described in "37. Business Combinations."
(Note 2) "Fixed assets" include property, plant and equipment, goodwill, intangible assets and investment property.

The deferred tax assets are recognized for the amount considered to be recoverable on deductible temporary differences, carryforward of unused tax losses and tax credits by taking taxable temporary differences and future taxable profits plan into account. The carryforward of unused tax losses, for which the deferred tax assets are not recognized, was ¥47,738 million (including ¥14,609 million, for which the carryforward expires after five years) as of December 31, 2015, and ¥44,484 million (including ¥12,644 million, for which the carryforward expires after five years) as of December 31, 2016. Tax credits, for which the deferred tax assets are not recognized, were ¥3,953 million (including ¥3,669 million, for which the carryforward expires after five years) as of December 31, 2015, and ¥4,951 million (including ¥4,541 million, for which the carryforward expires after five years) as of December 31, 2016.

(2) Income Taxes

The breakdown of "Income taxes" from continuing operations for each fiscal year is as follows:

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Millions of yen
Current income taxes	¥150,774	¥129,128
Deferred income taxes	11,612	23,336
Total income taxes	¥162,386	¥152,464

Deferred income taxes decreased by ¥1,358 million and increased by ¥167 million for the years ended December 31, 2015 and 2016, respectively, due to the effect of changes in tax rates in Japan and other countries.

(3) Reconciliation of the Effective Tax Rate

The breakdown of major items that caused differences between the effective statutory tax rate and the average actual tax rate in continuing operations for each fiscal year is as follows:

The Company is subject mainly to corporate tax, inhabitant tax and enterprise tax, and the effective statutory tax rate is calculated based on these taxes. The corporate tax rate and other tax rates were changed for the year ended December 31, 2016 and the effective statutory tax rates were 35.41% and 32.78% for the years ended December 31, 2015 and 2016, respectively. Foreign subsidiaries are subject to income taxes at their locations.

		%
	FY2015 (Year ended December 31, 2015)	**FY2016 (Year ended December 31, 2016)**
Effective statutory tax rate	35.41	**32.78**
Different tax rates applied to foreign subsidiaries	(10.20)	**(7.62)**
Non-deductible expenses	0.53	**1.31**
Valuation allowance	1.74	**(0.03)**
Other	1.26	**(0.08)**
Average actual tax rate	28.74	**26.37**

18. Trade and Other Payables

The breakdown of "Trade and other payables" as of each fiscal year end is as follows:

		Millions of yen
	FY2015 (As of December 31, 2015)	**FY2016 (As of December 31, 2016)**
Accounts payable	¥178,709	**¥188,285**
Other payables	104,193	**85,646**
Other	90,130	**104,002**
Total	¥373,032	**¥377,933**

Trade and other payables are classified as financial liabilities measured at amortized cost.

19. Bonds and Borrowings (including Other Financial Liabilities)

(1) Breakdown of Financial Liabilities

The breakdown of "Bonds and borrowings" and "Other financial liabilities" as of each fiscal year end is as follows:

	Millions of yen		%	
	FY2015 (As of December 31, 2015)	**FY2016 (As of December 31, 2016)**	Average interest rate (Note 1)	Due
Derivative liabilities	¥ 5,595	**¥ 12,516**	—	—
Short-term borrowings	30,832	**187,949**	1.99	—
Current portion of long-term borrowings	148	**572**	1.63	—
Current portion of bonds (Note 2)	—	**20,000**	—	—
Long-term borrowings	866	**877**	3.34	2018–2028
Bonds (Note 2)	215,072	**338,158**	—	—
Other	11,007	**9,516**	—	—
Total	¥263,520	**¥569,589**		
Current liabilities	¥ 37,439	**¥221,544**		
Non-current liabilities	226,080	**348,045**		
Total	¥263,520	**¥569,589**		

(Note 1) The average interest rate is calculated using the interest rate and outstanding balance as of December 31, 2016.

(Note 2) The summary of the issuing conditions of the bonds is as follows:

Company	Name of bond	Date of issuance	Millions of yen FY2015 (As of December 31, 2015)	Millions of yen FY2016 (As of December 31, 2016)	% Interest rate	Collateral	Date of maturity
Japan Tobacco Inc.	7th domestic straight bond	December 9, 2010	¥ 20,000	**¥ 20,000** **(20,000)**	0.84	Yes	December 8, 2017
Japan Tobacco Inc.	8th domestic straight bond	December 9, 2010	20,000	**20,000**	1.30	Yes	December 9, 2020
Japan Tobacco Inc.	9th domestic straight bond	July 15, 2015	60,000	**60,000**	0.22	Yes	July 15, 2020
Japan Tobacco Inc.	10th domestic straight bond	July 15, 2015	30,000	**30,000**	0.36	Yes	July 15, 2022
Japan Tobacco Inc.	11th domestic straight bond	July 15, 2015	25,000	**25,000**	0.60	Yes	July 15, 2025
Japan Tobacco Inc.	Straight bond in USD	July 23, 2013	60,072 [USD 500 mil.]	**58,106** **[USD 500 mil.]**	2.10	Yes	July 23, 2018
Japan Tobacco Inc.	Straight bond in USD	April 13, 2016	—	**87,109** **[USD 750 mil.]**	2.00	Yes	April 13, 2021
Japan Tobacco Inc.	Straight bond in USD	April 13, 2016	—	**57,943** **[USD 500 mil.]**	2.80	Yes	April 13, 2026
Total			¥215,072 (—)	**¥358,158** **(20,000)**			

(Note 1) The figure in parentheses ( ) represents the amount of the current portion of the bond.
(Note 2) The figure in parentheses [ ] represents the amount of foreign currency-denominated bond.

Derivative liabilities are classified as financial liabilities measured at fair value through profit or loss excluding those to which hedge accounting is applied, and bonds and borrowings are classified as financial liabilities measured at amortized cost.

There are no financial covenants that have a significant impact on the Group on the bonds and borrowings.

(2) Assets Pledged as Collateral for Liabilities

A. Pursuant to the provisions of Article 6 of the Japan Tobacco Inc. Act, the Company's properties are pledged as general collateral for bonds issued by the Company. Bondholders are entitled to claim satisfaction in preference to unsecured creditors of the Company properties (with the exception of national and local taxes and certain other statutory obligations).

B. Assets pledged as collateral by some subsidiaries are ¥70 million and ¥66 million as of December 31, 2015 and 2016, respectively. Their corresponding debts are ¥82 million and ¥53 million as of December 31, 2015 and 2016, respectively.

20. Provisions

The breakdown and schedule of "Provisions" for each fiscal year are as follows:

FY2015: Year ended December 31, 2015

Millions of yen

	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of January 1, 2015	¥2,742	¥ 22,954	¥ 3,994	¥ 4,935	¥ 34,624
Provisions	498	15,039	3,323	742	19,603
Interest cost associated with passage of time	36	—	—	—	36
Provisions used	(100)	(13,416)	(3,941)	(1,149)	(18,606)
Provisions reversed	(447)	(1,161)	(53)	(3,299)	(4,960)
Exchange differences on translation of foreign operations	—	(2,150)	—	(40)	(2,190)
As of December 31, 2015	¥2,728	¥ 21,267	¥ 3,323	¥ 1,189	¥ 28,507
Current liabilities	¥ —	¥ 15,058	¥ 3,323	¥ 915	¥ 19,297
Non-current liabilities	2,728	6,209	—	273	9,210
Total	¥2,728	¥ 21,267	¥ 3,323	¥ 1,189	¥ 28,507

FY2016: Year ended December 31, 2016

Millions of yen

	Asset retirement provisions	Restructuring provisions	Provisions for sales rebates	Other provisions	Total
As of January 1, 2016	**¥2,728**	**¥ 21,267**	**¥ 3,323**	**¥1,189**	**¥ 28,507**
Provisions	**685**	**4,774**	**3,459**	**450**	**9,368**
Interest cost associated with passage of time	**31**	**—**	**—**	**—**	**31**
Provisions used	**(85)**	**(13,414)**	**(3,323)**	**(430)**	**(17,253)**
Provisions reversed	**(10)**	**(748)**	**—**	**(153)**	**(911)**
Exchange differences on translation of foreign operations	**—**	**(2,755)**	**—**	**(35)**	**(2,790)**
As of December 31, 2016	**¥3,348**	**¥ 9,124**	**¥ 3,459**	**¥1,021**	**¥ 16,952**
Current liabilities	**¥ 26**	**¥ 8,287**	**¥ 3,459**	**¥ 757**	**¥ 12,529**
Non-current liabilities	**3,322**	**837**	**—**	**264**	**4,423**
Total	**¥3,348**	**¥ 9,124**	**¥ 3,459**	**¥1,021**	**¥ 16,952**

A. Asset Retirement Provisions

In order to settle the obligation of restoring and of removing hazardous substances from plant facilities and premises that the Group uses, the probable amount to be paid in the future is recognized based on past performances. These expenses are expected to be paid after one year or more; however, they may be affected by future business plans.

B. Restructuring Provisions

These provisions are mainly related to business integration and measures for the rationalization of the "International Tobacco Business." The timing of the payment may be affected by future business plans.

C. Provisions for Sales Rebates

These provisions are for contracts which reward the customers with discounts when the sales volume or sales amount in a given period exceeds a specified volume or amount. They are expected to be paid within one year.

21. Other Liabilities

The breakdown of "Other current liabilities" and "Other non-current liabilities" as of each fiscal year end is as follows:

		Millions of yen
	FY2015 (As of December 31, 2015)	**FY2016 (As of December 31, 2016)**
Tobacco excise tax payables	¥334,557	**¥306,816**
Tobacco special excise tax payables	14,548	**13,882**
Tobacco local excise tax payables	183,492	**180,799**
Consumption tax payables	103,933	**105,497**
Bonus to employees	34,014	**33,828**
Employees' unused paid vacations liabilities	18,827	**18,832**
Other	154,348	**132,195**
Total	¥843,719	**¥791,850**
Current liabilities	¥729,761	**¥689,629**
Non-current liabilities	113,958	**102,221**
Total	¥843,719	**¥791,850**

22. Employee Benefits

(1) Post-employment Benefits

The Group sponsors funded or unfunded defined benefit plans and defined contribution plans as employee retirement benefit plans. The benefits of defined benefit plans are predetermined based on conditions, such as points employees have gained in compensation for each year of service, the payment rate, years of service, and average salaries in their final years of service before retirement.

The Company is obligated to bear pension costs for a mutual assistance association incurred with respect to services in or before June 1956 (prior to enforcement of the Act on the Mutual Aid Association of Public Corporation Employees). Such obligations are recognized as liabilities at their present value using the actuarial valuation method and are included in retirement benefit liabilities.

Special termination benefits may be provided to employees on their early retirements under certain circumstances.

The funded defined benefit plans are administrated by the Group or the fund that is legally separated from the Group in accordance with statutory requirements. The Group, or the board of the pension fund and the trustee of the plan, are required by law to act in the best interests of the plan participants, and are responsible for managing the plan assets in accordance with the designated investment strategy.

The Group's main defined benefit plans expose the Group to actuarial risks, such as investment risk, interest rate risk, inflation risk, and longevity risk.

(i) Investment risk

The present value of the defined benefit obligations is calculated using a discount rate set with reference to a yield on high quality corporate bonds or government bonds. If the return on the plan assets is below this yield, there is a possibility that the plan is underfunded.

(ii) Interest rate risk

A decrease in a yield on high quality corporate bonds or government bonds will increase the present value of the defined benefit obligations. However, this will be partially offset by an increase in the fair value of the debt instruments (plan assets).

(iii) Inflation risk

The level of benefit for certain defined benefit plans of the Group is linked to inflation. Accordingly, a rise in inflation will increase the present value of the defined benefit obligations.

(iv) Longevity risk

Some defined benefit plans of the Group provide a lifetime annuity, and the Group is obligated to provide pension benefits to the plan participants for the rest of their lives after their retirements. The present value of the defined benefit obligations is calculated by reference to the best estimate of the mortality of plan participants during or after employment. An increase in average life expectancy of the plan participants will increase the defined benefit obligations.

A. Schedule of Defined Benefit Obligations

The schedule of the defined benefit obligations is as follows:

	Japan (Note 3)	Overseas	Total
			Millions of yen
As of January 1, 2015 (Notes 1, 2)	¥292,138	¥552,006	¥844,144
Current service cost	11,802	11,216	23,018
Past service cost and gains and losses on settlement	310	389	699
Interest expense	1,923	15,337	17,261
Contributions by plan participants	—	1,697	1,697
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	(634)	(327)	(961)
Actuarial gains and losses arising from changes in financial assumptions	(105)	(2,266)	(2,371)
Actuarial gains and losses arising from experience adjustments	(47)	346	299
Benefits paid	(25,941)	(20,823)	(46,764)
Decrease resulting from transfer of subsidiaries	(13,277)	—	(13,277)
Exchange differences on translation of foreign operations	—	(38,030)	(38,030)
Other	42	(466)	(423)
As of December 31, 2015 (Notes 1, 2)	266,213	519,079	785,292
Current service cost	**11,324**	**8,777**	**20,100**
Past service cost and gains and losses on settlement	**—**	**(5,362)**	**(5,362)**
Interest expense	**1,790**	**12,644**	**14,434**
Contributions by plan participants	**—**	**1,300**	**1,300**
Remeasurement gains and losses:			
Actuarial gains and losses arising from changes in demographic assumptions	**(1,158)**	**7,703**	**6,545**
Actuarial gains and losses arising from changes in financial assumptions	**4,222**	**59,529**	**63,751**
Actuarial gains and losses arising from experience adjustments	**(1,264)**	**(527)**	**(1,791)**
Benefits paid	**(20,953)**	**(23,963)**	**(44,916)**
Exchange differences on translation of foreign operations	**—**	**(62,630)**	**(62,630)**
Other	**(51)**	**324**	**273**
As of December 31, 2016 (Notes 1, 2)	**¥260,122**	**¥516,875**	**¥776,997**

(Note 1) The Group's weighted-average duration of the defined benefit obligations is 7.7 years for Japan and 16.2 years for overseas (FY2015: 7.7 years for Japan and 15.3 years for overseas).

(Note 2) The Group's breakdown of the defined benefit obligation by plan participant is as follows:

	FY2015 (As of December 31, 2015)			**FY2016 (As of December 31, 2016)**		Millions of yen
	Japan	Overseas	Total	Japan	Overseas	Total
Active members	¥165,996	¥208,743	¥374,739	**¥165,390**	**¥191,202**	**¥356,592**
Deferred members	16,235	51,014	67,249	**15,006**	**70,980**	**85,986**
Pensioners	83,982	259,322	343,304	**79,726**	**254,693**	**334,418**
Total	¥266,213	¥519,079	¥785,292	**¥260,122**	**¥516,875**	**¥776,997**

(Note 3) The schedule of mutual pension benefits obligations included in the category of Japan is as follows:

	FY2015 (Year ended December 31, 2015)	**FY2016 (Year ended December 31, 2016)**
		Millions of yen
Balance at the beginning of the period	¥59,191	**¥52,710**
Interest expense	296	**264**
Remeasurement gains and losses	276	**1,600**
Benefits paid	(7,052)	**(5,967)**
Balance at the end of the period	¥52,710	**¥48,607**

B. Schedule of Plan Assets

The schedule of the plan assets is as follows:

	Japan	Overseas	Total
			Millions of yen
As of January 1, 2015	¥111,515	¥416,117	¥527,631
Interest income	765	12,517	13,282
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	1,605	(4,724)	(3,119)
Contributions by the employer (Notes 1, 2)	3,754	10,536	14,290
Contributions by plan participants	—	1,697	1,697
Benefits paid	(9,162)	(17,091)	(26,253)
Decrease resulting from transfer of subsidiaries	(11,670)	—	(11,670)
Exchange differences on translation of foreign operations	—	(24,708)	(24,708)
Other	—	(466)	(466)
As of December 31, 2015	96,806	393,878	490,684
Interest income	**679**	**10,263**	**10,942**
Remeasurement gains and losses:			
Return on plan assets (excluding amounts included in interest income)	**906**	**42,132**	**43,037**
Contributions by the employer (Notes 1, 2)	**2,099**	**7,015**	**9,113**
Contributions by plan participants	**—**	**1,300**	**1,300**
Benefits paid	**(6,918)**	**(20,311)**	**(27,229)**
Exchange differences on translation of foreign operations	**—**	**(58,376)**	**(58,376)**
Other	**—**	**(2,206)**	**(2,206)**
As of December 31, 2016	**¥ 93,571**	**¥373,696**	**¥467,267**

(Note 1) Pursuant to laws and regulations, the Group and the pension fund review the financial condition of the pension plan regularly and recalculate contributions for allocating future benefit and keeping the balance of the pension financing when the plan is underfunded.

(Note 2) The Group plans to pay contributions of ¥6,941 million in the year ending December 31, 2017.

C. Reconciliation of Defined Benefit Obligations and Plan Assets

The reconciliation of the defined benefit obligations and plan assets to the net defined benefit liabilities (assets) recognized in the consolidated statement of financial position as of each fiscal year end is as follows:

FY2015: As of December 31, 2015

			Millions of yen
			FY2015
	Japan	Overseas	Total
Present value of the funded defined benefit obligations	¥ 96,583	¥ 387,804	¥ 484,387
Fair value of the plan assets	(96,806)	(393,878)	(490,684)
Subtotal	(223)	(6,074)	(6,297)
Present value of the unfunded defined benefit obligations	169,629	131,275	300,905
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	¥169,406	¥ 125,201	¥ 294,608
Retirement benefit liabilities	¥172,385	¥ 161,176	¥ 333,562
Retirement benefit assets	(2,979)	(35,975)	(38,954)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	¥169,406	¥ 125,201	¥ 294,608

FY2016: As of December 31, 2016

	Millions of yen		
	FY2016		
	Japan	Overseas	Total
Present value of the funded defined benefit obligations	¥ 92,436	¥ 383,213	¥ 475,648
Fair value of the plan assets	(93,571)	(373,696)	(467,267)
Subtotal	(1,136)	9,517	8,381
Present value of the unfunded defined benefit obligations	167,686	133,662	301,348
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	¥166,550	¥ 143,179	¥ 309,729
Retirement benefit liabilities	¥170,804	¥ 162,606	¥ 333,410
Retirement benefit assets	(4,254)	(19,426)	(23,680)
Net defined benefit liabilities (assets) recognized in the consolidated statement of financial position	¥166,550	¥ 143,179	¥ 309,729

D. Major Breakdown of Plan Assets

The breakdown of plan assets by major category as of each fiscal year end is as follows:

Japan

	Millions of yen					
	FY2015 (As of December 31, 2015)			FY2016 (As of December 31, 2016)		
	Market price in an active market			Market price in an active market		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Cash and cash equivalents	¥23,002	¥ —	¥23,002	¥18,233	¥ —	¥18,233
Equity instruments	3,383	—	3,383	3,579	—	3,579
Japan	2,251	—	2,251	2,381	—	2,381
Overseas	1,132	—	1,132	1,198	—	1,198
Debt instruments	10,395	—	10,395	11,000	—	11,000
Japan	9,142	—	9,142	9,758	—	9,758
Overseas	1,252	—	1,252	1,242	—	1,242
General account of life insurance companies (Note)	—	59,454	59,454	—	60,155	60,155
Other	—	572	572	—	603	603
Total	¥36,779	¥60,027	¥96,806	¥32,813	¥60,759	¥93,571

Overseas

	Millions of yen					
	FY2015 (As of December 31, 2015)			FY2016 (As of December 31, 2016)		
	Market price in an active market			Market price in an active market		
	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Cash and cash equivalents	¥ 12,084	¥ —	¥ 12,084	¥ 5,397	¥ —	¥ 5,397
Equity instruments	122,613	—	122,613	123,669	—	123,669
United Kingdom	29,719	—	29,719	30,212	—	30,212
North America	35,974	—	35,974	38,532	—	38,532
Other	56,920	—	56,920	54,925	—	54,925
Debt instruments	220,473	4,968	225,441	207,393	5,035	212,427
United Kingdom	143,809	—	143,809	137,158	—	137,158
North America	48,969	—	48,969	47,524	—	47,524
Other	27,695	4,968	32,663	22,711	5,035	27,746
Real estate	9,266	464	9,731	9,026	441	9,468
Other	18,105	5,905	24,009	15,808	6,927	22,735
Total	¥382,541	¥11,337	¥393,878	¥361,293	¥12,403	¥373,696

Total

	FY2015 (As of December 31, 2015)			FY2016 (As of December 31, 2016)		
	Market price in an active market			Market price in an active market		
Millions of yen	Quoted	Unquoted	Total	Quoted	Unquoted	Total
Cash and cash equivalents	¥ 35,086	¥ —	¥ 35,086	**¥ 23,630**	**¥ —**	**¥ 23,630**
Equity instruments	125,996	—	125,996	**127,248**	**—**	**127,248**
Debt instruments	230,868	4,968	235,836	**218,393**	**5,035**	**223,428**
Real estate	9,266	464	9,731	**9,026**	**441**	**9,468**
General account of life insurance companies (Note)	—	59,454	59,454	**—**	**60,155**	**60,155**
Other	18,105	6,477	24,582	**15,808**	**7,530**	**23,338**
Total	¥419,320	¥71,364	¥490,684	**¥394,106**	**¥73,161**	**¥467,267**

(Note) A certain interest rate and principal for the general account of life insurance are guaranteed by life insurance companies.

The investment strategy for the Group's major plans is as follows:

(Japan)

The Company's pension fund is managed in accordance with the internal policy for securing stable profits in the middle- and long-term in order to ensure the redemption of the plan liability. Concretely, by setting a target rate of return and composition ratio of plan assets by asset category within the risk tolerance that is annually assessed, the Company invests plan assets consistently with the composition ratio. When reviewing the composition ratio, the Company considers introducing an asset investment which has a high correlation with the liability.

In the case where an unexpected situation occurs in the market environment, it is temporarily allowed to make an adjustment on the weight of risk assets complying with the policy.

(Overseas)

The investment strategy for the foreign subsidiaries' funded pension plans is decided properly by the trustee of the plan or the management of overseas subsidiaries according to local legislation. The Company's objective for the foreign subsidiaries' funded pension plans is to manage risks arising from its defined benefit obligation, and meanwhile to achieve a return on assets in excess of the movement in the value of the defined benefit obligation.

The majority of the plan assets have been allocated to liability matching bonds and the remaining parts of the plan assets are mainly invested in equities targeting long-term return.

E. Matters Related to Actuarial Assumptions

The major items of actuarial assumptions as of each fiscal year end are as follows:

	FY2015 (As of December 31, 2015)		FY2016 (As of December 31, 2016)	
%	Japan	Overseas	Japan	Overseas
Discount rate	0.7	2.9	**0.5**	**2.2**
Inflation rate	—	2.4	**—**	**2.6**

FY2015: As of December 31, 2015

Years	FY2015			
	Japan		Overseas	
	Males	Females	Males	Females
Average life expectancy at retirement (Note 1)				
Current pensioners	23.6 (Note 2)	29.3 (Note 2)	21.7 (Note 3)	24.2 (Note 3)
Future pensioners			23.1 (Note 4)	25.7 (Note 4)

FY2016: As of December 31, 2016

	Years			
	FY2016			
	Japan		Overseas	
	Males	Females	Males	Females
Average life expectancy at retirement (Note 1)				
Current pensioners	23.6 (Note 2)	29.3 (Note 2)	21.9 (Note 3)	24.3 (Note 3)
Future pensioners			23.3 (Note 4)	25.8 (Note 4)

(Note 1) The average life expectancies underlie the values of the defined benefit obligations on major plans. Assumptions regarding future mortality rate are based on published statistics and mortality tables.
(Note 2) Life expectancy for a pensioner currently aged 60. Regardless of the plan participant's current age, the Group performs actuarial calculations based on the assumption that life expectancy remains the same.
(Note 3) Life expectancy for a pensioner currently aged 65
(Note 4) Life expectancy at the age of 65 for an active member currently aged 50
(Note 5) The valuation of defined benefit obligations reflects a judgment on uncertain future events. The sensitivities of defined benefit obligations due to changes in major assumptions as of each fiscal year end are as follows. Each of these sensitivities assumes that other variables remain fixed; however, in fact, they do not always change independently. Negative figures show a decrease in pension plan obligations, while positive figures show an increase.

		Millions of yen			
		FY2015 (As of December 31, 2015)		FY2016 (As of December 31, 2016)	
	Change in assumptions	Japan	Overseas	Japan	Overseas
Discount rate	Increase by 0.5%	¥ (9,672)	¥(37,287)	¥ (9,636)	¥(39,870)
	Decrease by 0.5%	10,368	42,058	10,363	43,735
Inflation rate	Increase by 0.5%	—	27,545	—	29,449
	Decrease by 0.5%	—	(25,543)	—	(25,654)
Mortality rate	Extended 1 year	5,809	16,859	5,540	19,321
	Shortened 1 year	(5,649)	(16,964)	(5,370)	(17,860)

F. Breakdown of Defined Benefit Cost

The breakdown of defined benefit cost for each fiscal year is as follows:

FY2015: Year ended December 31, 2015

	Millions of yen		
	FY2015		
	Japan	Overseas	Total
Current service cost	¥11,802	¥11,216	¥23,018
Past service cost and gains and losses on settlement	310	389	699
Interest expense (income)	1,159	2,820	3,979
Defined benefit cost through profit or loss	13,270	14,426	27,696
Actuarial gains and losses arising from changes in demographic assumptions	(634)	(327)	(961)
Actuarial gains and losses arising from changes in financial assumptions	(105)	(2,266)	(2,371)
Actuarial gains and losses arising from experience adjustments	(47)	346	299
Return on plan assets (excluding amounts included in interest income)	(1,605)	4,724	3,119
Defined benefit cost through other comprehensive income	¥ (2,390)	¥ 2,476	¥ 86
Total of defined benefit cost	¥10,880	¥16,902	¥27,782

FY2016: Year ended December 31, 2016

	Millions of yen		
	FY2016		
	Japan	Overseas	Total
Current service cost	**¥11,324**	**¥ 8,777**	**¥ 20,100**
Past service cost and gains and losses on settlement	**—**	**(2,956)**	**(2,956)**
Interest expense (income)	**1,111**	**2,381**	**3,492**
Defined benefit cost through profit or loss	**12,435**	**8,201**	**20,636**
Actuarial gains and losses arising from changes in demographic assumptions	**(1,158)**	**7,703**	**6,545**
Actuarial gains and losses arising from changes in financial assumptions	**4,222**	**59,529**	**63,751**
Actuarial gains and losses arising from experience adjustments	**(1,264)**	**(527)**	**(1,791)**
Return on plan assets (excluding amounts included in interest income)	**(906)**	**(42,132)**	**(43,037)**
Defined benefit cost through other comprehensive income	**¥ 894**	**¥ 24,573**	**¥ 25,467**
Total of defined benefit cost	**¥13,328**	**¥ 32,775**	**¥ 46,103**

(Note 1) The net amount of interest expense and interest income is included in "Financial costs." Other expenses are included in "Cost of sales" and "Selling, general and administrative expenses." The defined benefit cost through profit or loss from discontinued operations for the year ended December 31, 2015 is included in "Profit for the period from discontinued operations."

(Note 2) Contributions to the defined contribution plans were ¥7,649 million for the year ended December 31, 2015 and ¥6,917 million for the year ended December 31, 2016 and were not included in the table above.

(2) Other Employee Benefit Expenses

The employee benefit expenses other than post-employment benefits from continuing operations that are included in the consolidated statement of income for each fiscal year are as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	**FY2016 (Year ended December 31, 2016)**
Remuneration and salary	¥233,512	**¥211,838**
Bonus to employees	62,134	**59,474**
Legal welfare expenses	43,861	**39,803**
Welfare expenses	36,183	**34,581**
Termination benefits	4,392	**1,479**

23. Equity and Other Equity Items

(1) Share Capital and Capital Surplus

A. Authorized Shares

The number of authorized shares as of December 31, 2015 and as of December 31, 2016 is 8,000,000 thousand ordinary shares.

B. Fully Paid Issued Shares

The schedule of the number of issued shares and share capital is as follows:

	Thousands of shares	Millions of yen	
	Number of ordinary issued shares	Share capital	Capital surplus
As of January 1, 2015	2,000,000	¥100,000	¥736,400
Increase (decrease)	—	—	—
As of December 31, 2015	2,000,000	100,000	736,400
Increase (decrease)	**—**	**—**	**—**
As of December 31, 2016	**2,000,000**	**¥100,000**	**¥736,400**

(Note) The shares issued by the Company are non-par value ordinary shares that have no restriction on any content of rights.

(2) Treasury Shares

The schedule of the number of treasury shares and its amount as of each fiscal year end is as follows:

	Thousands of shares	Millions of yen
	Number of shares	Amount
As of January 1, 2015	182,443	¥344,447
Increase (decrease) (Note 2)	26,842	99,886
As of December 31, 2015	209,285	444,333
Increase (decrease) (Note 2)	**(241)**	**(512)**
As of December 31, 2016	**209,044**	**¥443,822**

(Note 1) The Company adopts share option plans and utilizes treasury shares for delivery of shares due to its exercise. Contract conditions and amount are described in "32. Share-based Payments."

(Note 2) The number of treasury shares purchased based on the resolution made by the Board of Directors was 26,896 thousand shares and the total purchase cost was ¥100,000 million for the year ended December 31, 2015. Purchases of shares less than one unit are 0 thousand shares for the year ended December 31, 2015 and 0 thousand shares for the year ended December 31, 2016. The number of shares delivered upon exercise of share options is 54 thousand shares for the year ended December 31, 2015 and 241 thousand shares for the year ended December 31, 2016. Sales of shares less than one unit are 0 thousand shares for the year ended December 31, 2016.

(3) Other Components of Equity

A. Subscription Rights to Shares

The Company adopts share option plans and issues subscription rights to shares based on the Companies Act. Contract conditions and amount are described in "32. Share-based Payments."

B. Exchange Differences on Translation of Foreign Operations

Exchange differences on translation of foreign operations are composed of foreign currency translation difference that occurs when consolidating financial statements of foreign subsidiaries prepared in foreign currencies, and the effective portion of net gain (loss) on the hedging instruments designated as hedge of net investment.

C. Net Gain (Loss) on Derivatives Designated as Cash Flow Hedges

The Company uses derivatives for hedging to avoid the risk of fluctuation in future cash flows. This is the effective portion of changes in the fair value of hedging instruments designated as cash flow hedges.

D. Net Gain (Loss) on Revaluation of Financial Assets Measured at Fair Value through Other Comprehensive Income

This is the valuation difference in the fair value of financial assets measured at fair value through other comprehensive income.

E. Remeasurements of Defined Benefit Plans

Remeasurements of defined benefit plans comprise actuarial gains and losses, the return on plan assets excluding amounts included in interest income, and any change in the effect of the asset ceiling excluding amounts included in interest income. In addition, actuarial gains and losses are the effects of differences between the actuarial assumptions at the beginning of the year and what has actually occurred, and the effects of changes in actuarial assumptions. Remeasurements are recognized as other comprehensive income when they occur and are transferred immediately from other components of equity to retained earnings.

24. Dividends

Dividends paid for each fiscal year are as follows:

FY2015: Year ended December 31, 2015

					FY2015
		Millions of yen	Yen		
	Class of shares	Total dividends	Dividends per share	Basis date	Effective date
(Resolution)					
Annual Shareholders' Meeting (March 20, 2015)	Ordinary shares	¥90,878	¥50	December 31, 2014	March 23, 2015
Board of Directors (August 3, 2015)	Ordinary shares	96,696	54	June 30, 2015	September 1, 2015

FY2016: Year ended December 31, 2016

	Class of shares	Millions of yen Total dividends	Yen Dividends per share	Basis date	Effective date
					FY2016
(Resolution)					
Annual Shareholders' Meeting (March 23, 2016)	**Ordinary shares**	**¥114,606**	**¥64**	**December 31, 2015**	**March 24, 2016**
Board of Directors (August 1, 2016)	**Ordinary shares**	**114,617**	**64**	**June 30, 2016**	**September 1, 2016**

Dividends, for which the effective date falls in the following fiscal year, are as follows:

FY2015: Year ended December 31, 2015

	Class of shares	Millions of yen Total dividends	Yen Dividends per share	Basis date	Effective date
					FY2015
(Resolution)					
Annual Shareholders' Meeting (March 23, 2016)	Ordinary shares	¥114,606	¥64	December 31, 2015	March 24, 2016

FY2016: Year ended December 31, 2016

	Class of shares	Millions of yen Total dividends	Yen Dividends per share	Basis date	Effective date
					FY2016
(Resolution)					
Annual Shareholders' Meeting (March 24, 2017)	**Ordinary shares**	**¥118,203**	**¥66**	**December 31, 2016**	**March 27, 2017**

25. Revenue

The reconciliation from "Gross turnover" to "Revenue" from continuing operations for each fiscal year is as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
Gross turnover	¥ 7,436,141	**¥ 7,062,848**
Tobacco excise taxes and agency transaction amount	(5,183,257)	**(4,919,561)**
Revenue	¥ 2,252,884	**¥ 2,143,287**

The tobacco excise taxes and other transactions in which the Group is involved as an agency are excluded from revenue. The inflow of economic benefits after deducting the tobacco excise taxes and other transactions is presented as "Revenue" in the consolidated statement of income.

Gross turnover is an item that the Group discloses voluntarily and is not "Revenue" as defined by IFRS.

26. Other Operating Income

The breakdown of "Other operating income" from continuing operations for each fiscal year is as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
Gain on sale of property, plant and equipment, intangible assets and investment properties (Note)	¥ 7,277	¥41,161
Gain on sale of investments in subsidiaries (Note)	—	26,106
Other (Note)	8,089	2,835
Total	¥15,367	¥70,101

(Note) The amount of restructuring income included in each account for each fiscal year is as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
Gain on sale of property, plant and equipment, intangible assets and investment properties	¥6,193	¥38,973
Gain on sale of investments in subsidiaries	—	26,106
Other	606	100
Total	¥6,799	¥65,178

27. Selling, General and Administrative Expenses

The breakdown of "Selling, general and administrative expenses" from continuing operations for each fiscal year is as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
Advertising expenses	¥ 25,644	¥ 26,108
Promotion expenses	120,270	124,766
Shipping, warehousing expenses	26,859	26,793
Commission	51,330	50,860
Employee benefit expenses (Note 2)	264,725	241,752
Research and development expenses (Note 1)	57,796	58,193
Depreciation and amortization	65,999	79,088
Impairment losses on other than financial assets (Note 2)	9,516	1,239
Losses on sale and disposal of property, plant and equipment, intangible assets, and investment property (Note 2)	19,156	11,256
Other (Note 2)	148,052	134,060
Total	¥789,346	¥754,115

(Note 1) All research and development expenses are included in "Selling, general and administrative expenses."
(Note 2) The amount of restructuring costs included in each account is as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
Employee benefit expenses	¥ 4,720	¥ 1,243
Impairment losses on other than financial assets	7,643	743
Losses on sale and disposal of property, plant and equipment, intangible assets, and investment property	12,523	5,676
Other	14,957	4,231
Total	¥39,843	¥11,894

28. Financial Income and Financial Costs

The breakdown of "Financial income" and "Financial costs" from continuing operations for each fiscal year is as follows:

Financial Income	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Millions of yen
Dividend income		
Financial assets measured at fair value through other comprehensive income	¥ 1,771	**¥ 1,707**
Interest income		
Financial assets measured at amortized cost		
Deposits and bonds	13,010	**4,664**
Other	235	**247**
Total	¥15,016	**¥6,618**

Financial Costs	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Millions of yen
Interest expenses		
Financial liabilities measured at amortized cost		
Bonds and borrowings (Note 2)	¥ 3,745	**¥ 8,592**
Other	153	**87**
Foreign exchange losses (Note 1)	6,010	**9,183**
Employee benefit expenses (Note 3)	3,971	**3,492**
Other	1,253	**355**
Total	¥15,132	**¥21,710**

(Note 1) Valuation gain (loss) of currency derivatives is included in foreign exchange losses.
(Note 2) Valuation gain (loss) of interest rate derivatives is included in interest expenses.
(Note 3) The employee benefit expenses are the net amount of interest cost and interest income related to employee benefits.

29. Other Comprehensive Income

Amount arising during the year, reclassification adjustments to profit or loss and tax effects for each component of "Other comprehensive income" for each fiscal year are as follows:

FY2015: Year ended December 31, 2015

	Amount arising	Reclassification adjustments	Before tax effects	Tax effects	Net of tax effects
					Millions of yen
					FY2015
Items that will not be reclassified to profit or loss					
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	¥ 14,220	¥ —	¥ 14,220	¥(3,485)	¥ 10,735
Remeasurements of defined benefit plans	(86)	—	(86)	(4,016)	(4,102)
Total of items that will not be reclassified to profit or loss	¥ 14,134	¥ —	¥ 14,134	¥(7,501)	¥ 6,633
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	¥(289,270)	¥ (223)	¥(289,493)	¥ 93	¥(289,400)
Net gain (loss) on derivatives designated as cash flow hedges	1,084	(812)	271	(38)	233
Total of items that may be reclassified subsequently to profit or loss	¥(288,186)	¥(1,036)	¥(289,222)	¥ 55	¥(289,167)
Total	¥(274,052)	¥(1,036)	¥(275,088)	¥(7,446)	¥(282,534)

FY2016: Year ended December 31, 2016

	Amount arising	Reclassification adjustments	Before tax effects	Tax effects	Net of tax effects
					Millions of yen
					FY2016
Items that will not be reclassified to profit or loss					
Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income	¥ (5,574)	¥ —	¥ (5,574)	¥ 2,416	¥ (3,159)
Remeasurements of defined benefit plans	(25,467)	—	(25,467)	3,265	(22,202)
Total of items that will not be reclassified to profit or loss	¥ (31,042)	¥ —	¥ (31,042)	¥ 5,681	¥ (25,361)
Items that may be reclassified subsequently to profit or loss					
Exchange differences on translation of foreign operations	¥(157,539)	¥ 19	¥(157,520)	¥(6,163)	¥(163,683)
Net gain (loss) on derivatives designated as cash flow hedges	(2,986)	849	(2,136)	658	(1,479)
Total of items that may be reclassified subsequently to profit or loss	¥(160,525)	¥868	¥(159,657)	¥(5,506)	¥(165,162)
Total	¥(191,567)	¥868	¥(190,699)	¥ 175	¥(190,523)

30. Earnings per Share

(1) Basis of Calculating Basic Earnings per Share

A. Profit Attributable to Ordinary Shareholders of the Parent Company

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Millions of yen
Profit for the period attributable to owners of the parent company	¥485,691	¥421,695
Profit not attributable to ordinary shareholders of the parent company	—	—
Profit for the period used for calculation of basic earnings per share	¥485,691	¥421,695
Profit for the period from discontinued operations attributable to ordinary shareholders of the parent company	¥ 87,237	¥ —
Profit for the period from continuing operations used for calculation of basic earnings per share	¥398,454	¥421,695

B. Weighted-average Number of Ordinary Shares Outstanding During the Period

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Thousands of shares
Weighted-average number of shares during the period	1,795,254	1,790,878

(2) Basis of Calculating Diluted Earnings per Share

A. Profit Attributable to Diluted Ordinary Shareholders

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
		Millions of yen
Profit for the period used for calculation of basic earnings per share	¥485,691	¥421,695
Adjustment	—	—
Profit for the period used for calculation of diluted earnings per share	¥485,691	¥421,695
Profit for the period from discontinued operations attributable to ordinary shareholders of the parent company	¥ 87,237	¥ —
Profit for the period from continuing operations used for calculation of diluted earnings per share	¥398,454	¥421,695

B. Weighted-average Number of Diluted Ordinary Shares Outstanding During the Period

Thousands of shares

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
Weighted-average number of ordinary shares during the period	1,795,254	**1,790,878**
Increased number of ordinary shares under subscription rights to shares	1,128	**1,030**
Weighted-average number of diluted ordinary shares during the period	1,796,382	**1,791,908**

31. Non-cash Transactions

Significant Non-cash Transactions

The amount of assets acquired under finance leases was ¥3,507 million for the year ended December 31, 2015 and ¥202 million for the year ended December 31, 2016.

32. Share-based Payments

The Company and Torii Pharmaceutical adopt share option plans. Share options are granted by the resolutions of the Board of Directors based on the approvals at the Annual Shareholders' Meeting.

The outline of the share option plan of the Company is as follows:

(1) Share Option Contract Conditions of the Company

Positions of persons granted : Directors and Executive Officers

Settlement : Issuance of shares

Effective period of granted share option : 30 years after the date of grant

Vesting conditions : None

Conditions related to the exercise of share options are as follows:

(a) The subscription rights to shares become exercisable when a holder of a subscription right to shares no longer holds a position as a director, an audit & supervisory board member or an executive officer. In the subscription rights to shares allocation contract with holders of such rights, it is provided for that the rights become exercisable from the date following the date on which they no longer hold their positions.

(b) In the case where any holders of subscription rights to shares waive such rights, they cannot exercise them.

(2) Changes in the Number of Share Options of the Company

Shares

	FY2015 (Year ended December 31, 2015)			FY2016 (Year ended December 31, 2016)		
	Directors	Executive Officers	Total	Directors	Executive Officers	Total
Balance at the beginning of the period	275,800	795,200	1,071,000	**324,800**	**807,200**	**1,132,000**
Granted	49,000	66,200	115,200	**34,200**	**51,800**	**86,000**
Exercised	—	(54,200)	(54,200)	**—**	**(241,200)**	**(241,200)**
Transferred	—	—	—	**(83,200)**	**83,200**	**—**
Balance at the end of the period	324,800	807,200	1,132,000	**275,800**	**701,000**	**976,800**
Exercisable balance at the end of the period	—	424,400	424,400	**—**	**442,200**	**442,200**

(Note 1) The number of share options is presented as the number of underlying shares.

(Note 2) All share options are granted with an exercise price of ¥1 per share.

(Note 3) Share options are granted to 6 directors and 18 executive officers for the year ended December 31, 2015, and 5 directors and 18 executive officers for the year ended December 31, 2016.

"Transferred" included in the "Changes in the Number of Share Options" represents the number of share options for persons granted whose management position changed during the period.

(Note 4) The weighted-average fair values per share of share options granted during the period were ¥3,556 and ¥2,863 for the years ended December 31, 2015 and 2016, respectively.

(Note 5) The weighted-average share prices of share options at the time of exercise during the period were ¥4,497 and ¥4,258 for the years ended December 31, 2015 and 2016, respectively.

(Note 6) The weighted-average remaining contract years of unexercised share options at the end of each period were 25.7 years and 25.2 years for the years ended December 31, 2015 and 2016, respectively.

(3) Method of Measuring Fair Value of Share Options Granted During the Period of the Company

A. Valuation Model

Black-Scholes Model

B. Main Assumptions and Estimation

	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
Share price	¥4,847	**¥4,315**
Volatility of share price (Note 1)	32.7%	**32.9%**
Estimated remaining period (Note 2)	15 years	**15 years**
Estimated dividends (Note 3)	¥100/share	**¥118/share**
Risk free interest rate (Note 4)	0.78%	**(0.12)%**

(Note 1) Calculated based on daily share prices quoted for the past 15 years

(Note 2) Because of the difficulty of a reasonable estimation due to insufficient data, the remaining period is estimated based on the assumption that share option rights would be exercised at a midpoint of the exercise period.

(Note 3) Based on the latest dividends paid

(Note 4) The yield on government bonds for a period of the expected remaining period

(4) Share-based Payment Expenses

The costs for share options from continuing operations included in "Selling, general and administrative expenses" in the consolidated statement of income were ¥383 million and ¥270 million for the years ended December 31, 2015 and 2016.

33. Financial Instruments

(1) Capital Management

The Group's management principle is pursuit of the "4S" model: balancing the interests of consumers, shareholders, employees and wider society, and fulfilling our responsibilities towards them, aiming to exceed their expectations.

The Group believes that sustainable profit growth in the mid- to long-term based on this principle will increase the Group's value in the mid- to long-term, and is consequently in the best interest of all stakeholders, including our shareholders.

For that reason, as its financial policy, the Group maintains a strong financial base that secures stability in the case of changes in business environment such as economic crises, and flexibility enabling expeditious responses to business investment opportunities.

The Group manages net interest-bearing debt, where cash and cash equivalents are deducted from interest-bearing debt, and capital (the part attributable to the owners of the parent company). The amounts as of each fiscal year end are as follows:

		Millions of yen
	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
Interest-bearing debt	¥ 255,291	**¥ 555,257**
Cash and cash equivalents	(526,765)	**(294,157)**
Net interest-bearing debt (Note)	(271,474)	**261,101**
Capital (equity attributable to owners of the parent company)	2,451,596	**2,456,091**

(Note) The figure in parentheses ( ) represents the net amount of cash and cash equivalents after deducting interest-bearing debt.

There are specific rules for shares of the Company under the Japan Tobacco Inc. Act as follows:

The Japanese government shall hold more than one-third of all of the shares issued by the Company (excluding the type of shares, for which it is stipulated that voting rights may not be exercised on any matters that can be resolved by the Annual Shareholders' Meeting) (Article 2 (1)).

In cases where the Company intends to solicit persons to subscribe for shares to be issued or subscription rights to shares or where the Company intends to deliver shares (excluding treasury shares), subscription rights to shares (excluding subscription right to own shares) or bonds with subscription rights to shares (excluding bonds with subscription rights to shares) when exchanging with shares, the Company shall obtain the approval of the Minister of Finance (Article 2 (2)).

Disposal of shares owned by the Japanese government shall be within the limits on the number of shares decided by the Diet in the relevant annual budget (Article 3).

The Group monitors financial indicators in order to maintain a well-balanced capital structure that ensures an appropriate return on equity and a stable and flexible financial condition for future investment. We monitor credit ratings for financial stability and flexibility, and ROE (return on equity) for profitability, while focusing on changes in the domestic and overseas environment.

(2) Financial Risk Management

The Group is exposed to financial risks (credit risk, liquidity risk, foreign exchange risk, interest rate risk, and market price fluctuation risk) in the process of its management activities and it manages risks based on a specific policy in order to avoid or reduce said risks. The results of risk management are regularly reported by the Treasury Division to the president and the Board of Directors of the Company.

The Group policy limits derivatives to transactions for the purpose of mitigating risks from transactions based on actual demand. Therefore, we do not transact derivatives for speculation purposes or trading purposes.

(3) Credit Risk

Receivables, such as note and account receivables, acquired from the operating activities of the Group are exposed to customer credit risk.

The Group holds mainly debt securities for surplus investment and equity securities of customers and suppliers to strengthen relationships with them; those securities are exposed to the issuer's credit risk. In addition, through derivative transactions that the Group conducts in order to hedge foreign exchange fluctuation risks and interest rate fluctuation risks, we are exposed to the credit risk of the financial institutions which are counterparties to these transactions.

In principle, the Group sets credit lines or transaction conditions with respect to trade receivables for counterparties based on the Credit Management Guidelines in order to control the credit risk relating to counterparties. In addition, the receivable balances of counterparties with high credit risk are monitored. The Treasury Division of the Company regularly monitors the status of the occurrence and collection of bad debts, and reports them to the president and the Board of Directors of the Company.

With regard to the investment of cash surpluses and derivatives, the Group invests in debt securities and other financial instruments with a certain credit rating and transacts with financial institutions with a high credit rating in principle in order to prevent credit risks from occurring and based on the Group Financial Operation Basic Policy. In addition, the Treasury Division of the Company regularly monitors the performance of these transactions and reports the results to the president and the Board of Directors of the Company.

The maximum exposure pertaining to credit risks for financial assets is the carrying amount after considering impairment in the consolidated financial statements.

The analysis of the aging of financial assets that are past due but not impaired as of each fiscal year end date is as follows:
The financial assets include amounts considered recoverable by credit insurance and collateral.

FY2015: As of December 31, 2015

					Millions of yen
	FY2015				
		Amount past due			
	Total	Within 30 days	Over 30 days, within 60 days	Over 60 days, within 90 days	Over 90 days
Trade and other receivables	¥3,238	¥2,260	¥349	¥38	¥591

FY2016: As of December 31, 2016

					Millions of yen
	FY2016				
		Amount past due			
	Total	Within 30 days	Over 30 days, within 60 days	Over 60 days, within 90 days	Over 90 days
Trade and other receivables	**¥6,916**	**¥2,612**	**¥1,004**	**¥8**	**¥3,292**

The Group reviews collectability of trade receivables depending on the credit conditions of counterparties and recognizes allowance for doubtful accounts. The schedule of the allowance for doubtful accounts is as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	**FY2016 (Year ended December 31, 2016)**
Balance at the beginning of the period	¥10,595	**¥9,345**
Addition	346	**335**
Decrease (intended use)	(357)	**(515)**
Decrease (reversal)	(986)	**(336)**
Other	(253)	**(394)**
Balance at the end of the period	¥ 9,345	**¥8,436**

(4) Liquidity Risk

The Group raises funds by borrowings, commercial paper and bonds; however, these liabilities are exposed to the liquidity risk that we would not be able to repay liabilities on the due date due to the deterioration of the financing environment.

In accordance with the Group Financial Operation Basic Policy, the Group establishes a finance plan based on the annual business plan and the Treasury Division of the Company regularly monitors and collects information on the balance of liquidity-in-hand and interest-bearing debt and reports it to the president and the Board of Directors of the Company. In addition, the Group keeps necessary credit facilities to manage liquidity risk by having commitment lines with several financial institutions.

The financial liability balance (including derivative financial instruments) by maturity as of each fiscal year end is as follows:

FY2015: As of December 31, 2015

	Millions of yen							
	FY2015							
	Carrying amount	Contractual cash flow	Due within one year	Due after one year through two years	Due after two years through three years	Due after three years through four years	Due after four years through five years	Due after five years
Non-derivative financial liabilities								
Trade and other payables	¥373,032	¥373,032	¥373,032	¥ —	¥ —	¥ —	¥ —	¥ —
Short-term borrowings	30,832	30,832	30,832	—	—	—	—	—
Current portion of long-term borrowings	148	148	148	—	—	—	—	—
Long-term borrowings	866	866	—	150	152	97	45	422
Bonds	215,072	215,305	—	20,000	60,305	—	80,000	55,000
Subtotal	619,949	620,183	404,012	20,150	60,457	97	80,045	55,422
Derivative financial liabilities								
Foreign exchange forward contract	5,594	5,594	5,594	—	—	—	—	—
Interest rate swap	1	1	1	—	—	—	—	—
Subtotal	5,595	5,595	5,595	—	—	—	—	—
Total	¥625,544	¥625,778	¥409,607	¥20,150	¥60,457	¥97	¥80,045	¥55,422

FY2016: As of December 31, 2016

	Carrying amount	Contractual cash flow	Due within one year	Due after one year through two years	Due after two years through three years	Due after three years through four years	Due after four years through five years	Due after five years
	Millions of yen FY2016							
Non-derivative financial liabilities								
Trade and other payables	**¥377,933**	**¥377,933**	**¥377,933**	**¥ —**	**¥ —**	**¥ —**	**¥ —**	**¥ —**
Short-term borrowings	**187,949**	**187,949**	**187,949**	**—**	**—**	**—**	**—**	**—**
Current portion of long-term borrowings	**572**	**572**	**572**	**—**	**—**	**—**	**—**	**—**
Long-term borrowings	**877**	**877**	**—**	**360**	**92**	**41**	**43**	**341**
Current portion of bonds	**20,000**	**20,000**	**20,000**	**—**	**—**	**—**	**—**	**—**
Bonds	**338,158**	**338,858**	**—**	**58,245**	**—**	**80,000**	**87,368**	**113,245**
Subtotal	**925,489**	**926,188**	**586,453**	**58,605**	**92**	**80,041**	**87,411**	**113,586**
Derivative financial liabilities								
Foreign exchange forward contract	**12,516**	**12,516**	**12,516**	**—**	**—**	**—**	**—**	**—**
Subtotal	**12,516**	**12,516**	**12,516**	**—**	**—**	**—**	**—**	**—**
Total	**¥938,005**	**¥938,704**	**¥598,970**	**¥58,605**	**¥92**	**¥80,041**	**¥87,411**	**¥113,586**

The total of commitment lines and withdrawal as of each fiscal year end are as follows:

	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
	Millions of yen	
Total committed line of credit	¥682,286	**¥574,432**
Withdrawing	—	**—**
Unused balance	¥682,286	**¥574,432**

(5) Foreign Exchange Risk

The Group operates businesses globally and, therefore, is exposed to the following risks due to foreign exchange fluctuation:

(i) The risk where the profit or loss and cash flow in each functional currency of the Group is influenced by foreign exchange fluctuation as a result of external transactions and intergroup transactions, including the payment and receipt of dividends, in currencies that are different from each functional currency of the Group.

(ii) The risk that the equity of the Group is influenced by foreign exchange fluctuation when equity denominated in each functional currency of the Group is translated into Japanese yen and consolidated.

(iii) The risk that the profit or loss of the Group is influenced by foreign exchange fluctuation when profit or loss denominated in each functional currency of the Group is translated into Japanese yen and consolidated.

The Group hedges against risk (i) using derivatives or foreign currency-denominated interest-bearing debts for example, when future cash flow is projected or when receivables and payables are fixed, and some of them are designated as cash flow hedges.

The Group hedges against risk (ii) using foreign currency-denominated interest-bearing debts for example, and part of these are designated as net investment hedges. The Group does not hedge against risk (iii) in principle.

In order to mitigate risks mentioned above resulting from the foreign exchange fluctuation, in accordance with the Group Financial Operation Basic Policy, and under the supervision of the Financial Risk Management Committee of the Company, the Group establishes and implements a foreign currency hedge policy, taking into consideration the impact on the Group's performance and the current conditions of the foreign exchange market in a comprehensive manner. The Treasury Division of the Company regularly reports the performances to the president and the Board of Directors of the Company.

Foreign Exchange Sensitivity Analysis

In cases where each currency other than the functional currency that denominates the financial instruments held by the Group as of each fiscal year end increases by 10% in value against the functional currency, the impact on profit before income taxes in the consolidated statement of income is as follows:

The impact from the translation of functional currency-denominated financial instruments, and assets, liabilities, income and expenses of foreign operations into Japanese yen is not included. Also, it is based on the assumption that currencies other than the currencies used for the calculation do not fluctuate.

	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
	Millions of yen	
Profit before income taxes	¥(866)	**¥(1,502)**

(6) Interest Rate Risk

Interest rate risk within the Group arises from interest-bearing debts after deducting cash equivalents. Borrowings and bonds with floating rates are exposed to interest rate fluctuation risk.

In order to reduce the interest rate fluctuation risk related to borrowings and bonds, in accordance with the Group Financial Operation Basic Policy, and under the supervision of the Financial Risk Management Committee of the Company, the Group establishes and implements an interest rate hedging policy, taking into consideration the impact on the Group's performance and the current condition of the interest rates in a comprehensive manner. The Treasury Division of the Company reports the performances to the president and the Board of Directors of the Company.

Interest Rate Sensitivity Analysis

In cases where the interest rate of financial instruments held by the Group as of each fiscal year end increases by 100bp, the impact on profit before income taxes in the consolidated statement of income is as follows:

The analysis is subject to financial instruments affected by interest rate fluctuation and based on the assumption that other factors, including the impacts of foreign exchange fluctuation, are constant.

Millions of yen

	FY2015 (As of December 31, 2015)	**FY2016 (As of December 31, 2016)**
Profit before income taxes	¥2,058	**¥(559)**

(7) Hedging Transactions

The Group's policy for hedging transactions is stated in "3. Significant Accounting Policies."

A. Cash Flow Hedges

The details of hedging instruments designated as cash flow hedges are as follows:

FY2015: As of December 31, 2015

FY2015

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen) Assets	Liabilities	Average rates (yen, %)
Foreign exchange risk					
Foreign exchange forward contract					
JPY/USD	USD 129 mil.	USD —	¥ 70	¥ 75	¥119.95
Interest rate risk					
Cross currency swap					
Fixed rate receipt and fixed rate payment	USD 175 mil.	USD 175 mil.	3,870	—	0.24%

FY2016: As of December 31, 2016

FY2016

	Contract amount	Over one year	Carrying amount (Note) (Millions of yen) Assets	Liabilities	Average rates (yen, %)
Foreign exchange risk					
Foreign exchange forward contract					
JPY/USD	**USD 259 mil.**	**USD —**	**¥1,077**	**¥ 478**	**¥109.84**
Interest rate risk					
Cross currency swap					
Fixed rate receipt and fixed rate payment	**USD 175 mil.**	**USD 175 mil.**	**3,052**	**—**	**0.24%**

(Note) Carrying amounts of derivatives are presented as "Other financial assets" or "Other financial liabilities" in the consolidated statement of financial position, and the portion with over one year maturity is classified as "Non-current assets" or "Non-current liabilities."

The schedule of net gains (losses) on hedging instrument designated as cash flow hedges is as follows:

	Millions of yen		
	Effective portion of changes in the fair value of cash flow hedges		
	Foreign exchange risk	Interest rate risk	Total
As of January 1, 2015	¥ 1,077	¥ 139	¥ 1,215
Other comprehensive income			
Amount arising (Note 1)	284	800	1,084
Reclassification adjustments (Note 2)	—	(812)	(812)
Tax effects	(49)	11	(38)
Others	(1,324)	—	(1,324)
As of December 31, 2015	(12)	137	125
Other comprehensive income			
Amount arising (Note 1)	**(2,168)**	**(818)**	**(2,986)**
Reclassification adjustments (Note 2)	**128**	**721**	**849**
Tax effects	**625**	**33**	**658**
Others	**1,794**	**—**	**1,794**
As of December 31, 2016	**¥ 367**	**¥ 73**	**¥ 440**

(Note 1) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness approximates the change in fair value of the hedging instrument.

(Note 2) The amount, which is reclassified when the hedged item affects profit or loss, is recognized in "Revenue", "Financial income" or "Financial costs" in the consolidated statement of income. The amount of hedge ineffectiveness is immaterial.

B. Hedge of Net Investment in Foreign Operations

The details of hedging instruments designated as hedge of net investment are as follows:

FY2015: As of December 31, 2015

					FY2015
			Carrying amount (Note) (Millions of yen)		
	Contract amount	Over one year	Assets	Liabilities	Average rates (yen)
Bonds in USD	USD 325 mil.	USD 325 mil.	¥ —	¥38,965	¥99.45

FY2016: As of December 31, 2016

					FY2016
			Carrying amount (Note) (Millions of yen)		
	Contract amount	Over one year	Assets	Liabilities	Average rates (yen)
Short-term borrowings	**USD 500 mil.**	**USD —**	**¥ —**	**¥ 58,245**	**¥117.91**
Bonds in USD	**USD 1,575 mil.**	**USD 1,575 mil.**	**—**	**182,773**	**107.36**

(Note) Carrying amounts of bonds and short-term borrowings are presented as "Bonds and borrowings" in the consolidated statement of financial position, and the portion with over one year maturity is classified as "Non-current liabilities."

The schedule of net gains (losses) on hedging instrument designated as hedge of net investment in foreign operations is as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	**FY2016 (Year ended December 31, 2016)**
Balance at the beginning of the period	¥(3,100)	**¥ (4,497)**
Other comprehensive income		
Amount arising (Note 1)	(1,490)	**19,444**
Tax effects	93	**(6,163)**
Balance at the end of the period (Note 2)	¥(4,497)	**¥ 8,784**

(Note 1) The change in value of the hedged item used as the basis for recognizing hedge ineffectiveness approximates the change in fair value of the hedging instrument.

(Note 2) Net gain arising from the hedging instruments for which hedge accounting is discontinued were ¥136 million and ¥18,241 million as of December 31, 2015 and 2016 respectively those which are included in the exchange differences on translation of foreign operations.

(8) Market Price Fluctuation Risk

With respect to securities, the Group regularly assesses the fair value and financial conditions of the issuers, and each relevant department reviews the portfolio held by taking into account the relationship with counterparty entities as necessary.

(9) Fair Value of Financial Instruments

The fair value hierarchy of financial instruments is categorized from Level 1 to Level 3 as follows:

Level 1: Fair value measured at the quoted price in the active market
Level 2: Fair value that is calculated using the observable price other than categorized in Level 1 directly or indirectly
Level 3: Fair value that is calculated based on valuation techniques which include inputs that are not based on observable market data

(i) Financial instruments measured at amortized cost

The carrying amount and fair value hierarchy of financial instruments measured at amortized cost as of each fiscal year end are as follows:

FY2015: As of December 31, 2015

					Millions of yen
	FY2015				
		Fair value			
	Carrying amount	Level 1	Level 2	Level 3	Total
Long-term borrowings (Note)	¥ 1,014	¥ —	¥ —	¥1,014	¥ 1,014
Bonds	215,072	217,215	—	—	217,215

FY2016: As of December 31, 2016

					Millions of yen
	FY2016				
		Fair value			
	Carrying amount	Level 1	Level 2	Level 3	Total
Long-term borrowings (Note)	**¥ 1,449**	**¥ —**	**¥ —**	**¥1,449**	**¥ 1,449**
Bonds (Note)	**358,158**	**357,126**	**—**	**—**	**357,126**

(Note) Current portion is included.

With regard to short-term financial assets and short-term financial liabilities measured at amortized cost, their fair value approximates the carrying amount.

The fair value of long-term borrowings is calculated based on the present value which is obtained by discounting the total of the principal and interest by the interest rate assumed in a case where the same loan is newly made.

(ii) Financial instruments measured at fair value

The fair value hierarchy of financial instruments measured at fair value is as follows:

FY2015: As of December 31, 2015

				Millions of yen
	FY2015			
	Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	¥ —	¥7,106	¥ —	¥ 7,106
Equity securities	67,557	—	5,239	72,795
Other	319	—	1,727	2,046
Total	¥67,876	¥7,106	¥6,966	¥81,948
Derivative liabilities	¥ —	¥5,595	¥ —	¥ 5,595
Total	¥ —	¥5,595	¥ —	¥ 5,595

FY2016: As of December 31, 2016

	Millions of yen			
	FY2016			
	Level 1	Level 2	Level 3 (Note)	Total
Derivative assets	¥ —	¥11,769	¥ —	¥11,769
Equity securities	60,662	—	4,886	65,548
Other	368	—	2,316	2,683
Total	¥61,030	¥11,769	¥7,202	¥80,001
Derivative liabilities	¥ —	¥12,516	¥ —	¥12,516
Total	¥ —	¥12,516	¥ —	¥12,516

(Note) The schedule of financial instruments that are classified in Level 3 is as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
Balance at the beginning of the period	¥5,411	¥6,966
Total gain (loss)		
Profit or loss (Note 1)	172	(16)
Other comprehensive income (Note 2)	1,154	80
Purchases	478	448
Sales	(250)	(76)
Other	—	(200)
Balance at the end of the period	¥6,966	¥7,202

(Note 1) Gains and losses included in profit or loss for the year ended December 31, 2015 and 2016 are related to financial assets measured at fair value through profit or loss as of the fiscal year end date. These gains and losses are included in "Financial income" and "Financial costs."

(Note 2) Gains and losses included in other comprehensive income for the year ended December 31, 2015 and 2016 are related to financial assets measured at fair value through other comprehensive income as of the fiscal year end date. These gains and losses are included in "Net gain (loss) on revaluation of financial assets measured at fair value through other comprehensive income."

34. Related Parties

Based on the Japan Tobacco Inc. Act, the Japanese government shall hold more than one-third of all of the shares issued by the Company (excluding the type of shares, for which it is stipulated that voting rights may not be exercised on any matters that can be resolved by Annual Shareholders' Meeting). As of December 31, 2016, the Japanese government held 33.35% of all outstanding shares of the Company.

(1) Related-party Transactions

Related-party transactions are conducted under the same conditions as regular business transactions.

The Company's revenue from CJSC TK Megapolis, the local Russian distribution affiliate, was ¥240,837 million and ¥207,768 million for the years ended December 31, 2015 and 2016, respectively. The Company held trade receivables of ¥27,396 million and ¥38,373 million from CJSC TK Megapolis as of December 31, 2015 and 2016, respectively.

(2) Remuneration for Directors and Audit and Supervisory Board Members

Remuneration for directors and audit and supervisory board members for each fiscal year is as follows:

	Millions of yen	
	FY2015 (Year ended December 31, 2015)	FY2016 (Year ended December 31, 2016)
Remuneration and bonuses	¥650	¥620
Share-based payments	159	117
Total	¥809	¥737

35. Subsidiaries, Associates and Others

(The composition of the Group)
The composition of the Group by reportable segment as of each fiscal year end is as follows:

	FY2015 (As of December 31, 2015)		FY2016 (As of December 31, 2016)	
Reportable Segments	Number of subsidiaries	Number of entities accounted for using the equity method (Note)	Number of subsidiaries	Number of entities accounted for using the equity method (Note)
Domestic Tobacco	11	2	**12**	**2**
International Tobacco	144	5	**150**	**5**
Pharmaceuticals	3	—	**2**	**—**
Processed Food	28	3	**28**	**3**
Other	8	2	**10**	**2**
Total	194	12	**202**	**12**

(Note) No associates or joint ventures are considered to be material to the Group.

There is no significant change in the composition of the Group for the year ended December 31, 2016.

36. Commitments

(1) Commitments for the Acquisition of Assets

Commitments for the acquisition of assets after each fiscal year end date are as follows:

	FY2015 (As of December 31, 2015)	FY2016 (As of December 31, 2016)
		Millions of yen
Acquisition of property, plant and equipment	¥41,879	**¥41,889**
Acquisition of intangible assets	1,402	**3,374**
Total	¥43,281	**¥45,264**

(2) Procurement of Domestic Leaf Tobacco

With regard to the procurement of domestic leaf tobacco by the Company, based on the Tobacco Business Act, the Company enters into purchase contracts with domestic leaf tobacco growers every year, and the contracts determine the area under cultivation by type of tobacco and the prices by type and quality of tobacco leaf. Under the contracts, the Company is obligated to purchase all domestic leaf tobacco produced pursuant to such contracts, except for any domestic leaf tobacco not suited for the manufacture of tobacco products.

37. Business Combinations

Acquisition of the Natural American Spirit Business outside the United States

(1) Summary of Business Combinations

On January 13, 2016, the Group acquired from the Reynolds American Inc. group ("RAI") the Natural American Spirit business outside the United States which included the non-U.S. trademarks and all outstanding shares of RAI's subsidiaries outside the U.S. which sold the brand, Santa Fe Natural Tobacco Company Japan K.K.(Note) and eight other subsidiaries.

Natural American Spirit, the tobacco brand that Santa Fe Natural Tobacco Company, Inc. launched in the U.S. in 1982, has established a unique brand positioning due to its additive-free tobacco products that abundantly use high quality leaf tobacco. The brand has steadily increased the sales volume in the U.S., Japan, Germany, Switzerland, Italy, Spain, the U.K. and others.

The purpose of this acquisition is that Natural American Spirit, which has a strong presence in a premium priced category, allows the Group to further extend its brand portfolio and strengthen the business foundation.

Notably in Japan, which accounts for the majority of the sales volume worldwide excluding the U.S., the brand has enjoyed broad support of consumers and experienced significant growth in sales volume. This acquisition is positioned as part of business investments to underpin the Group's sustainable long-term profit growth in Japan, which is one of the Group's most significant markets.

(Note) Santa Fe Natural Tobacco Company Japan K.K. changed its name to K.K. TRUE SPIRIT TOBACCO COMPANY on May 1, 2016.

(2) Financial Impact on the Group

Since the acquisition date, the acquired business has contributed to total revenue and operating loss of ¥28,291 million and ¥13,946 million, respectively.

The amortization of trademarks acquired from the business combinations included in the above operating loss is ¥17,928 million.

(3) Consideration and Details (Total of the Acquisition)

The consideration is ¥591,420 million and all is paid in cash.

(4) Cash Out for the Business Combinations (Total of the Acquisition)

	Millions of yen
	Net cash outflow for the business combinations
Cash consideration	¥591,420
Cash and cash equivalents in subsidiaries acquired	(4,335)
Net cash outflow for the business combinations	¥587,085

(5) Fair Values of the Assets Acquired and Liabilities Assumed

	Millions of yen
	Fair value
Current assets	¥ 21,369
Trademarks	180,471
Deferred tax assets	113,185
Other non-current assets	9,207
Total assets	¥324,232
Current liabilities	¥ 11,376
Non-current liabilities	8,415
Total liabilities	¥ 19,791
Goodwill	¥286,979

Goodwill represents future economic benefits for integration synergies including enhanced business scale in each market, and it is expected that most of the trademarks and goodwill are deductible for tax purposes.

Fair values of assets acquired and liabilities assumed are provisional amounts recognized at the acquisition date and may change during the measurement period (one year from the acquisition date).

Transaction costs of ¥293 million are expensed as incurred and recognized in “Selling, general and administrative expense.”

Other Acquisitions

In addition to the above, the Group acquired other entities through business combinations for the year ended December 31, 2016, which are omitted as they are immaterial both individually and in aggregate.

38. Discontinued Operations

The Group classifies continuing operations and discontinued operations based on operating segments. As a result, for a business not managed as an independent operating segment, it will not be classified as discontinued operations when sold or discontinued and its operating income (loss) and cash flows will be included in the operating income (loss) and cash flows of continuing operations.

Shares of Japan Beverage Holdings Inc., JT A-star Co., Ltd. and other subsidiaries conducting vending machine operation business were transferred to Suntory Beverage & Food Limited on July 31, 2015 and the manufacture and sale of JT beverage products were discontinued at the end of September, 2015. Accordingly, in the prior year, "Beverage Business" was classified as discontinued operations and presented separately from continuing operations. ¥134,287 million of gain on sale of investments in subsidiaries and ¥36,494 million of income taxes related to the transfer of subsidiaries are included in "Profit for the period from discontinued operations" in the consolidated statement of income for the year ended December 31, 2015. ¥36,494 million of income taxes paid related to the transfer of subsidiaries for the prior year are included in the consolidated statement of cash flows for the year ended December 31, 2016.

39. Contingencies

Contingent Liabilities

The Company and some of its subsidiaries are defendants in legal proceedings. Provisions are not accounted for in matters where it is not practicable to reasonably estimate the final outcomes.

The Company and some of its subsidiaries, who are defendants in such legal proceedings, believe that our defenses asserted in these proceedings are based on substantial evidence and implement the system for the response to action with the assistance of external lawyers.

(1) Smoking and Health Related Litigation

The Company and some of its subsidiaries are defendants in lawsuits filed by plaintiffs seeking damages for harm allegedly caused by smoking, the marketing of tobacco products, or exposure to tobacco smoke. As of December 31, 2016, there were a total of 20 smoking and health related cases pending in which one or more members of the Group were named as a defendant or for which the Company may have certain indemnity obligations pursuant to the agreement for the Company's acquisition of RJR Nabisco Inc.'s overseas (non-U.S.) tobacco operations.

The major ongoing smoking and health related cases are as follows:

a. Individual Claim

There is one individual case brought against the Company's indemnitee in South Africa.

South Africa Individual Claim (Joselowitz):

The individual claim was brought against the Company's indemnitee in South Africa in October 2000. Plaintiff seeks compensatory and punitive damages, alleging that the Company's indemnitee marketed products which it knew to be dangerous to health, manipulated nicotine content to foster addiction, failed to comply with South African labeling requirements and participated in a clandestine worldwide operation to encourage children to smoke. This case has been dormant since February 2001.

In addition, there is one individual case (which is currently dormant) brought against the Company's subsidiary in Ireland, and one individual case brought against the Company's subsidiaries in Russia on February 20, 2017.

b. Class Actions

There are eight ongoing class actions in Canada against the Company's subsidiary and/or indemnitees.

Canada Quebec Class Action (Cecilia Letourneau):

This class action was brought in September 1998 against three Canadian tobacco manufacturers including JTI-Macdonald Corp. (hereinafter referred to as "JTI-Mac"), the Company's Canadian subsidiary. Plaintiffs are seeking a total of approximately ¥396.9 billion (approximately CAD 4.6 billion) in compensatory damages, an amount for which all the defendants are jointly and severally liable. Plaintiffs are seeking an additional amount of approximately ¥396.9 billion (approximately CAD 4.6 billion) in punitive damages, to be divided among all the defendants based on their respective market shares. The class was certified by the court in February 2005, and the trial was conducted from March 2012 through December 2014.

The Quebec Superior Court rendered the first instance judgment in May 2015, ordering a punitive damage award against the defendants of approximately ¥11.3 billion (CAD 131 million), in which the share of the total damage award against JTI-Mac is approximately ¥1.1 billion (approximately CAD 13 million). Although the Court found that the defendants had all committed some faults, it refused to award moral damages because the evidence did not establish the total amount of the claims of class members. In June 2015, JTI-Mac appealed the judgment to the Quebec Court of Appeal, and the appeal on the merits was heard in November 2016. The timing of the decision is at the Court's discretion.

Canada Quebec Class Action (Conseil Québécois sur le tabac et la santé):

This class action was brought in November 1998 against three Canadian tobacco manufacturers including JTI-Mac. Plaintiffs are seeking a total of approximately ¥1,075.4 billion (approximately CAD 12.4 billion) in compensatory damages, an amount for which all the defendants are jointly and severally liable. Plaintiffs are seeking an additional amount of approximately ¥70.1 billion (approximately CAD 0.8 billion) in punitive damages, to be divided among all the defendants based on their respective market shares. The class was certified by the court in February 2005, and the trial was conducted from March 2012 through December 2014.

The Quebec Superior Court rendered the first instance judgment in May 2015, ordering a compensatory damage award jointly and severally against the defendants of approximately ¥1,340.1 billion (CAD 15.5 billion), in which the share of the total damage award against JTI-Mac is approximately ¥174.2 billion (CAD 2.015 billion). Given the enormity of the damage award, the Court granted a symbolic amount of punitive damages of approximately ¥3 million (CAD 30,000) per defendant. In June 2015, JTI-Mac appealed the judgment to the Quebec Court of Appeal, and the appeal on the merits was heard in November 2016. The timing of the decision is at the Court's discretion.

Canada Saskatchewan Class Action (Adams):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The preliminary motions are pending. The case is currently dormant.

Canada Manitoba Class Action (Kunta):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The statement of claim was served on the Company's indemnitees but not on JTI-Mac. The case is currently dormant.

Canada Nova Scotia Class Action (Semple):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2009. Plaintiffs are seeking unspecified compensatory and punitive damages on behalf of class members who allege to be or have been addicted to nicotine contained in cigarettes manufactured by the defendants. The statement of claim was served on the Company's indemnitees but not on JTI-Mac. The case is currently dormant.

Canada British Columbia Class Action (Bourassa):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2010. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

Canada British Columbia Class Action (McDermid):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2010. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

Canada Ontario Class Action (Jacklin):
This class action was brought against tobacco industry members including JTI-Mac and the Company's indemnitees in June 2012. Plaintiffs are seeking unspecified compensatory and punitive damages for class members. The preliminary motions are pending. The case is currently dormant.

c. Health-Care Cost Recovery Litigation

There are 10 ongoing health-care cost recovery cases in Canada pending against the Company's subsidiary and indemnitees brought by all the Canadian provinces (except three Canadian territories). These provinces filed lawsuits under their own provincial legislation which was enacted exclusively for the purpose of authorizing the provincial government to file a direct action against tobacco manufacturers to recoup the health-care costs the government has allegedly incurred and will incur, resulting from "tobacco related wrongs."

Canada British Columbia Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of British Columbia in January 2001 against tobacco industry members including JTI-Mac and the Company's indemnitees based on its provincial legislation, the "Tobacco Damages and Health-Care Costs Recovery Act." The claim amount is unspecified. In 2001, several defendants challenged the legislation's constitutionality, which was ultimately rejected by the Supreme Court of Canada in September 2005. The action remains pending in the first instance. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada New Brunswick Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of New Brunswick in March 2008 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Ontario Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Ontario in September 2009 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total claimed amount of ¥4,323 billion (CAD 50.0 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Newfoundland and Labrador Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Newfoundland and Labrador in February 2011 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Manitoba Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Manitoba in May 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Quebec Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Quebec in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total amount of the claim approximately ¥5,244.4 billion (approximately CAD 60.7 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Alberta Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Alberta in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The statement of claim contains allegations of joint and several liabilities among all the defendants but does not specify any individual amount or percentages within the total claimed amount of at least ¥864.6 billion (CAD 10.0 billion). The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Saskatchewan Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Saskatchewan in June 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Prince Edward Island Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Prince Edward Island in September 2012 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

Canada Nova Scotia Health-Care Cost Recovery Litigation:
This health-care cost recovery litigation was filed by the Province of Nova Scotia in January 2015 against tobacco industry members including JTI-Mac and the Company's indemnitees based on legislation similar to that introduced in the Province of British Columbia. The claim amount is unspecified. The pre-trial process is ongoing. A trial date is not yet scheduled.

(2) Other Legal Proceedings

The Company and some of its subsidiaries are also engaged in other legal proceedings such as commercial and tax disputes, which may include proceedings that are conducted pursuant to applicable confidentiality obligations. Details of such proceedings and their outcomes are disclosed by the Company only where permitted by such confidentiality obligations.

One major commercial litigation case is pending.

Japan Compensatory Damages Claim:
In February 2010, a former President & CEO of Katokichi Co., Ltd. filed a claim against TableMark Holdings Co., Ltd. (renamed after acquisition of Katokichi Co., Ltd. by the Company) and its subsidiary seeking damages allegedly incurred by the plaintiff from an asset purchase agreement between the plaintiff and Katokichi Co., Ltd. and a joint and several guarantee provided by the plaintiff. The plaintiff argues the invalidity of the asset purchase agreement.

(Note) The amount of damages sought denominated in foreign currencies is translated into Japanese yen at the rates as of December 31, 2016.

40. Subsequent Events

No items to report

Consolidated Supplementary Information

A. Quarterly Information for the Year ended December 31, 2016

Millions of yen

	Q1 From January 1, 2016 to March 31, 2016	Q2 From January 1, 2016 to June 30, 2016	Q3 From January 1, 2016 to September 30, 2016	FY2016 From January 1, 2016 to December 31, 2016
Revenue	¥534,088	¥1,076,879	¥1,618,537	¥2,143,287
Profit before income taxes for the period (year)	200,339	339,364	484,275	578,237
Profit attributable to owners of the parent company for the period (year)	145,445	247,094	350,008	421,695
Basic earnings per share for the period (year) (yen)	81.22	137.98	195.44	235.47

	Q1 From January 1, 2016 to March 31, 2016	Q2 From April 1, 2016 to June 30, 2016	Q3 From July 1, 2016 to September 30, 2016	Q4 From October 1, 2016 to December 31, 2016
Basic earnings per share for the quarter (yen)	¥81.22	¥56.76	¥57.47	¥40.03

B. Significant Lawsuits

The significant lawsuits of the Group are as stated in "39. Contingencies" in the notes to consolidated financial statements.

Deloitte.

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of Japan Tobacco Inc.:

We have audited the accompanying consolidated statement of financial position of Japan Tobacco Inc. and its consolidated subsidiaries as of December 31, 2016, and the related consolidated statements of income, comprehensive income, changes in equity, and cash flows for the fiscal year from January 1, 2016 to December 31, 2016, and notes to consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Japan Tobacco Inc. and its consolidated subsidiaries as of December 31, 2016, and the consolidated results of their operations and their cash flows for the fiscal year then ended in accordance with International Financial Reporting Standards.

Deloitte Touche Tohmatsu LLC

March 24, 2017

Member of
Deloitte Touche Tohmatsu Limited

Glossary of Terms

Unless otherwise stated, terms and numbers reported in this glossary are in accordance with IFRS.

Adjusted Operating Profit: Operating profit + Amortization cost of acquired intangibles arising from business acquisitions + Adjusted items (income and costs)*.

* Adjusted items (income and costs) = impairment losses on goodwill ± restructuring income and costs ± others

Adjusted Profit: Profit for the year (profit attributable to owners of the parent company) ± adjustment items (income and costs)* ± (tax and minority interests adjustments)

* Adjustment items (income and costs): impairment losses on goodwill ± restructuring income and costs ± others

BnU: Billion Units.

Contraband: Genuine products smuggled from abroad. Genuine products diverted from the legitimate supply chain and sold in a country different from the intended market of retail sale and without domestic duty paid in that country.

Constant Exchange Rates: Constant exchange rates measures are computed by restating current year results at the previous year's foreign currency exchange rate. Results at constant rates of exchange should be considered in addition to, not as a substitute for, results reported in accordance with IFRS.

Core Revenue (International Tobacco Business): Includes revenues from waterpipe tobacco and emerging products, but excludes revenues from distribution, contract manufacturing and other peripheral businesses.

Core Revenue (Japanese Domestic Tobacco Business): Excludes revenue from distribution of imported tobacco in the Japanese domestic tobacco business, among others, but includes revenue from domestic duty free, the China business and emerging products such as Ploom TECH device and capsules.

Counterfeit: Fake products appearing to be a genuine brand. Products protected by intellectual property rights which are manufactured without authorization from the rights' owners and with the intent to copy the genuine brand to deceive the consumer, also sold without duties being paid.

FCF (Free Cash Flow): The sum of cash flows from operating activities and investing activities but excluding the following items:

- Cash flows from operating activities: interest received, dividends received, interest paid and the tax effect related to these items.
- Cash flows from investing activities: purchase of investment securities (for both short-term and long-term), payments into time deposits, proceeds from sale or redemption of investment securities (for both short-term and long-term), proceeds from withdrawal of time deposits and other investing activities not for business operation purposes.

GFB: Global Flagship Brands (Winston, Camel, MEVIUS, LD, Benson & Hedges, Glamour, Silk Cut, Sobranie and Natural American Spirit)

FY2014: Results for the fiscal year ended December 31, 2014.

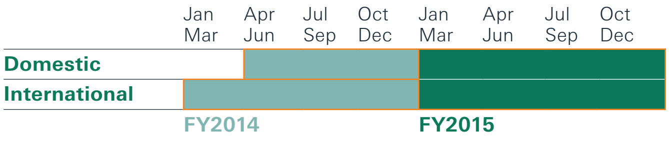
In FY2014, the Company and its subsidiaries with fiscal year ends other than December 31 have changed their fiscal year ends to December 31.

The fiscal year end for international business continues to be December 31 as before, hence the Group consolidates financial results of international business for the twelve-month period from January 1, 2014 to December 31, 2014 into the Group's consolidated financial results for the nine months ended December 31, 2014 (Reported basis).

For the purpose of fair comparison of business performance, we are providing figures for the twelve-month period from January 1, 2014 to December 31, 2014 (Like-for-Like basis) with regard to all business segments in continuing operations.

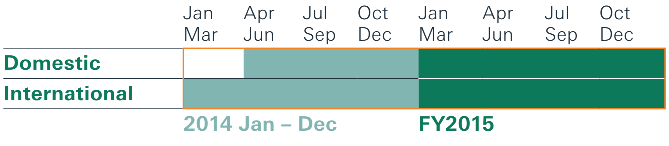
Results for Nine months ended December 31, 2014 (Reported basis): For domestic businesses: consolidated nine-month results from April 1 to December 31, 2014.

For international business: consolidated twelve-month results from January 1 to December 31, 2014.



Results of Jan-Dec 2014 (Like-for-Like basis): For the purpose of fair comparison of business performance, we are providing figures with regard to all business segments in continuing operations for January to December, 2014.

- Revenue, operating profit, adjusted operating profit from continuing operations and profit attributed to owners of the parent company from continuing and discontinued operations combined for January to December, 2014 were disclosed in the FY2015 Annual Securities Report, which was audited.



Illicit Whites: Legitimately manufactured brands intentionally sold on the illicit market. Brands manufactured legitimately in one country but smuggled into another country to provide consumers with cheap brands, also without duties being paid.

IFRS: International Financial Reporting Standards.

JPY BN: Billion Japanese Yen.

Restated: See 'Constant Exchange Rates'.

Revenue: Excluding tobacco excise taxes and revenue from agent transactions.

Profit: Profit attributable to owners of the Parent.

TableMark: References to "TableMark" are to TableMark Holdings Co. Ltd., TableMark Co. Ltd.

Total Shipment Volume (International Tobacco Business): Includes fine cut, cigars, pipe tobacco and snus but excludes contract manufactured products, waterpipe tobacco and emerging products.

Total Sales Volume (Japanese Domestic Tobacco Business): Excludes sales volume of domestic duty free, the Chinese business and emerging products.

US$ MM: Million US dollars.