[This is an English translation prepared for reference purpose only. Should there be any inconsistency between the translation and the original Japanese text, the latter shall prevail.]

To Our Shareholders

February 28, 2020

MATERIALS DISCLOSED VIA THE INTERNET CONCERNING NOTICE OF CONVOCATION OF THE 35TH ANNUAL SHAREHOLDERS' MEETING

The items listed below are posted on the Company's website (https://www.jti.co.jp/) to be offered to shareholders, pursuant to the provisions of laws and regulations as well as Article 17 of our Articles of Incorporation.

Business Report

- Overview of the Resolutions on the Development of Systems Necessary to Ensure the Properness of Operations and the Operating Status of the Systems

Consolidated Financial Statements

- Consolidated Statement of Changes in Equity
- Notes to Consolidated Financial Statements

Nonconsolidated Financial Statements

- Nonconsolidated Statement of Changes in Net Assets
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(For the fiscal year from January 1, 2019 to December 31, 2019)

Japan Tobacco Inc.

Business Report

Overview of the Resolutions on the Development of Systems Necessary to Ensure the Properness of Operations and the Operating Status of the Systems

The Board of Directors has resolved with regard to the development of systems necessary to ensure that the execution of the duties by the Members of the Board complies with the laws, regulations and the Articles of Incorporation, and other systems necessary to ensure the properness of operations of a stock company as follows:

(1) Systems to ensure that the performance of duties by the Members of the Board and employees of the Company, as well as by Directors, etc. (meaning "Directors, etc." as provided for in Article 100, Paragraph 1, Item 5 (i) of the Ordinance for Enforcement of the Companies Act) and employees (with Directors, etc. and employees hereafter collectively referred to as "directors and employees") of subsidiaries, conforms to laws, regulations and the Articles of Incorporation

A. Compliance system

The Company shall establish Code of Conduct based on regulations concerning the compliance system in order to ensure that directors and employees of the Company and its subsidiaries comply with laws and regulations, Company's Articles of Incorporation, the social norms, etc., and set up a JT Group Compliance Committee as an organization responsible for ensuring thorough compliance. This committee, headed by Company's Chairman of the Board, mainly consists of outside members and reports directly to the Board of Directors.

The Company appoints an Executive Officer in charge of compliance with overseeing the Compliance Office in an effort to establish and promote a group-wide, cross-sectional system and shed light on issues.

The compliance promotion departments of the Company and its subsidiaries (meaning the Compliance Office within the Company, and corresponding departments within subsidiaries) distribute materials including the "JT Group Code of Conduct," which explains the Code of Conduct, etc., to directors and employees, and work to enhance the effectiveness of the compliance system by enlightening directors and employees about compliance through training and other programs, etc.

(Internal reporting system)

In preparation for cases in which employees or other parties detect activities, etc. suspected of violating laws and regulations, the Company and its subsidiaries maintain consultation and reporting desks as internal whistleblower systems. Compliance promotion departments that receive a report or request for consultation investigate the details and take necessary action, while working to prevent recurrence of the issue.

The Company will bring matters of particular importance involving the JT Group to the JT Group Compliance Committee, and will request deliberation or will report on the issue.

(System for excluding anti-social elements)

The Company and its subsidiaries are resolved to fight against, not to comply with, an unreasonable demand and not to have any relations with anti-social elements.

The General Administration Division shall be the JT Group's headquarters assuming the responsibility for supervising efforts to exclude anti-social elements, the Company cooperates with police, lawyers and other relevant organizations and parties to gather and share information in order to deal with such elements in an organized way.

In addition, the Company and its subsidiaries shall prohibit involving with anti-social elements and fully communicate to all directors and employees of the Company and its subsidiaries. At the same time, an awareness raising program for excluding anti-social elements is to be consistently administered for all directors and employees, by providing relevant training, etc. as necessary.

B. System to ensure the reliability of financial reporting

The Company has in place and operates an internal control system relating to financial reporting of JT Group in accordance with the Financial Instruments and Exchange Act. The Company strives to maintain and improve the reliability of its financial reporting by allocating a sufficient level of staff to the task of evaluating and reporting financial results.

C. Internal audit system

The Operational Review and Business Assurance Division of the Company oversees the internal audit system and examines and evaluates systems for supervising and managing the overall operations and the status of business execution from the viewpoints of legality and rationality, in order to protect the Company’s assets and improve management efficiency. In coordination with the internal audit functions of all subsidiaries, the Operational Review and Business Assurance Division also undertakes the planning and performance of the JT Group’s internal audit systems and policies, and supplements the internal audit functions of subsidiaries.

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

A. Storage and management of minutes

The Company makes sure to properly store and manage the minutes of General Meetings of Shareholders and meetings of the Board of Directors, in line with laws and regulations.

B. Storage and management of other information

The Company makes sure that the information on important matters relating to business execution and decision-making including the conclusion of corporate contracts is stored and managed by the relevant departments and divisions as specified by the Responsibilities/Authorities Allocation Rules, and establishes rules on managing the processes of decision-making, procurement and accounting.

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

The Company will require subsidiaries to regularly report important information to the Company’s departments and divisions that are in charge of the subsidiaries.

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

A. System to evaluate and manage risk of loss under normal circumstances

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

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

B. Preparedness for possible emergencies

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

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

A. Board of Directors of the Company

The Board of Directors of the Company meets once a month in principle and on more occasions as necessary, in order to make decisions with regard to the matters specified by laws and regulations and other important matters and to supervise business execution.

The Board of Directors of the Company receives reports from Members of the Board of the Company on the status of business execution at least once every three months.

B. Proper delegation of authority and system of responsibilities of the Company

For important management issues, particularly management policy and basic plans regarding overall business operations of the Company, in addition to matters to be referred to the Board of Directors of the Company, a clear decision-making process is stipulated in the Responsibilities/Authorities Allocation Rules to have a system that enables to realize swift decision-making and high-quality business execution.

Executive Officers appointed by the Board of Directors execute business properly by exercising the authority delegated to them in their respective areas in accordance with a company-wide business strategy decided by the Board.

In order to manage business operations in ways that contribute to the business efficiency and flexibility of the Company, basic matters concerning the Company's organization, allocation of duties to officers and staff and the roles of individual divisions are specified by the relevant internal rules.

C. Formulation, etc. of rules and policies that apply to the JT Group

The Company will construct an efficient system for business execution within the JT Group through the formulation, etc. of rules and policies that apply to the JT Group.

(6) Systems necessary to ensure the properness of operations in the Company and the business group which consists of the Company and its subsidiaries

A. Mission of the JT Group

The JT Group has set itself the mission of creating, developing and nurturing its unique brands to win consumer trust, while understanding and respecting the environment and the diversity of societies and individuals, and there is a group-wide consensus on the mission.

B. Group management

The JT Group shall specify the functions and rules common for all group companies to effectuate group management that optimizes the operations of the entire JT Group as a whole.

The Company has put in place systems for compliance (including the internal reporting system), internal audits, financial affairs management, etc. in cooperation with its subsidiaries.

(7) Matters for employees assisting Audit & Supervisory Board Members of the Company in their duties in the event such employees were requested by Audit & Supervisory Board Members

A. Establishment of Audit & Supervisory Board Member's Office

The Company has established an Audit & Supervisory Board Member's Office as an organization to assist the duties of the Company's Audit & Supervisory Board Members (hereinafter simply "Audit & Supervisory Board Members," with the terms "Audit & Supervisory Board," "Audit & Supervisory Board Member's Office," and "Manager of the Audit & Supervisory Board Member's Office" also referring to those items within the Company).

B. Allocation of staff

The Company has allocated sufficient staff to the Audit & Supervisory Board Member's Office. In addition, the Company makes sure to review and reform the staffing structure as necessary based on consultations with the Audit & Supervisory Board.

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

A. Management of employees affiliated with the Audit & Supervisory Board Member's Office

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

B. Duties of employees belonging to the Audit & Supervisory Board Member's Office

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

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

A. Reporting to the Audit & Supervisory Board

When directors and employees of the Company and its subsidiaries detect any evidence of malfeasance in financial documents or serious breaches of laws or regulations or the Company's Articles of Incorporation, they are due to report them to the Audit & Supervisory Board, along with other relevant matters that could affect the Company's management.

B. Appropriate reporting in response to requests by Audit & Supervisory Board Members

Directors and employees of the Company and its subsidiaries shall respond in a prompt and appropriate manner when they are asked by Audit & Supervisory Board Members to compile important documents for their perusal, to accept field audits and to submit reports.

C. Reporting on the status of whistleblowing

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

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

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

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

A. Handling of expenses or debts in accordance with Article 388 of the Companies Act

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

B. Setting of budgets, etc.

With regard to miscellaneous expenses for audits by Audit & Supervisory Board Members, the Company will set a budget in order to secure the effectiveness of the audits. The Company will also bear the portion of miscellaneous expenses for audits by Audit & Supervisory Board Members that are in excess of budget, with the exception of cases in which the Company deems the expenses to be unnecessary to the performance of duties.

(12) Other systems to ensure effective auditing by Audit & Supervisory Board Members

A. Attendance at important meetings

Audit & Supervisory Board Members are allowed to attend not only meetings of the Board of Directors of the Company but also other important meetings of the Company.

B. Coordination between the Operational Review and Business Assurance Division and Compliance Office and the Audit & Supervisory Board Members

The Operational Review and Business Assurance Division and the Compliance Office maintain cooperation with Audit & Supervisory Board Members by exchanging information.

The status of systems necessary to ensure the properness of operations

A. Status of initiatives concerning compliance

- The JT Group has set itself the mission of creating, developing, and nurturing its unique brands to win consumer trust, while understanding and respecting the environment and the diversity of societies and individuals. The Company communicates this mission throughout the JT Group by means including its inclusion in the “JT Group Code of Conduct” booklet, which is distributed to the directors and employees of the Company and its subsidiaries.
- In accordance with the JT Group Compliance Rules, the Company performs appropriate reporting to the Board of Directors on the performance of the annual Compliance Plan, the occurrence of serious compliance violations, actions taken in response to these, and other matters of importance.
- In order to improve awareness of compliance and prevent improper actions, the Company conducts regular training for the directors and employees of the Company and its subsidiaries.
- With regard to whistleblowing systems, the Company maintains consultation and reporting desks inside and outside the Company, and thoroughly communicates to directors and employees of the Company and its subsidiaries that persons who engage in consultation or whistleblowing are not to be subject to any disadvantageous treatment for reason of those actions. In addition, the content of consultations and whistleblowing are regularly reported within the JT Group Compliance Committee.
- With regard to the handling of anti-social elements, the Company continues to collect related declarations and pledges from suppliers, and conducts regular training and other programs for the directors and employees of

the Company and its subsidiaries.

B. Status of initiatives to manage the risk of loss

- With regard to the monetary and financial risks, the Company makes quarterly reports to the President, Chief Executive Officer and the Board of Directors in accordance with the Basic Rules on Financial Work of the Group.
- With regard to the evaluation and examination of internal management systems, the Operational Review and Business Assurance Division provides reports and counsel to the President and Chief Executive Officer and also reports to the Board of Directors, in accordance with the Rules for Internal Audits.
- With regard to crises and disasters, the Company makes quarterly reports to the Board of Directors concerning events to which responses were made and the details of the events, in accordance with the "Decision Concerning the Preparation of Basic Policies and Systems Concerning the Construction of Internal Control Systems".

C. Status of initiatives concerning the properness and efficiency of the execution of duties

- Meetings of the Board of Directors are held every month and as appropriate, in accordance with the Regulations of the Board of Directors. The Members of the Board in charge of businesses make quarterly reports to the Board of Directors on the status of business execution within each business, including within its subsidiaries.
- With regard to decision-making, etc. on execution of important business, etc., the Company is converting resolution procedures to electronic methods and is constructing a fast and efficient management system. The Company also accurately records and creates minutes of meetings of the Board of Directors, and performs appropriate storage and management of the information.

D. Securing the effectiveness of audits by Audit & Supervisory Board Members

- Audit & Supervisory Board Members receive reports as appropriate from directors and employees of the Company and its subsidiaries, regarding necessary information for audits. In addition to attending important conferences, Audit & Supervisory Board Members also perform appropriate checks of the content of electronic resolutions concerning decision-making on the execution of business. In addition, Audit & Supervisory Board Members regularly exchange opinions and otherwise communicate with each subsidiary's own Audit & Supervisory Board Members to enhance audits performed by all Audit & Supervisory Board Members inside the JT Group.
- The Operational Review and Business Assurance Division and the Compliance Office also coordinate on conducting regular exchanges of information with Audit & Supervisory Board Members.
- In order to assist the duties of Audit & Supervisory Board Members, the Company has established an Audit & Supervisory Board Member's Office that is independent of divisions responsible for execution, and has assigned necessary personnel to the Office. In addition, through consultation with Audit & Supervisory Board Members, the Company records a budget for expenses expected to be necessary for the duties of the Audit & Supervisory Board Members.

Consolidated Statement of Changes in Equity

(Year ended December 31, 2019)

(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, 2019	100,000	736,400	(442,829)	1,547	(454,918)	443	29,570
Profit for the period	–	–	–	–	–	–	–
Other comprehensive income (loss)	–	–	–	–	10,553	(391)	(2,486)
Comprehensive income (loss) for the period	–	–	–	–	10,553	(391)	(2,486)
Acquisition of treasury shares	–	–	(50,001)	–	–	–	–
Disposal of treasury shares	–	–	361	(281)	–	–	–
Share-based payments	–	–	–	290	–	–	–
Dividends	–	–	–	–	–	–	–
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	–	–	–	–	–	–	(15,883)
Other increase (decrease)	–	–	–	–	–	(185)	–
Total transactions with the owners	–	–	(49,640)	10	–	(185)	(15,883)
As of December 31, 2019	100,000	736,400	(492,469)	1,556	(444,366)	(132)	11,201

(Millions of yen)

	Equity attributable to owners of the parent company				Non-controlling interests	Total equity
	Other components of equity		Retained earnings	Total		
	Remeasurements of defined benefit plans	Total				
As of January 1, 2019	—	(423,357)	2,660,381	2,630,594	69,851	2,700,445
Profit for the period	—	—	348,190	348,190	13,432	361,622
Other comprehensive income (loss)	(2,913)	4,763	—	4,763	(569)	4,194
Comprehensive income (loss) for the period	(2,913)	4,763	348,190	352,953	12,863	365,816
Acquisition of treasury shares	—	—	—	(50,001)	—	(50,001)
Disposal of treasury shares	—	(281)	(80)	0	—	0
Share-based payments	—	290	(19)	271	47	319
Dividends	—	—	(270,936)	(270,936)	(2,051)	(272,987)
Changes in the scope of consolidation	—	—	—	—	—	—
Changes in the ownership interest in a subsidiary without a loss of control	—	—	(1)	(1)	206	205
Transfer from other components of equity to retained earnings	2,913	(12,971)	12,971	—	—	—
Other increase (decrease)	—	(185)	—	(185)	—	(185)
Total transactions with the owners	2,913	(13,146)	(258,065)	(320,851)	(1,798)	(322,650)
As of December 31, 2019	—	(431,741)	2,750,506	2,662,696	80,916	2,743,611

Notes to Consolidated Financial Statements

1. Significant matters for preparing consolidated financial statements

(1) Accounting principles for preparing consolidated financial statements

The consolidated financial statements of Japan Tobacco Inc. (hereinafter referred to as the "Company") and its subsidiaries (hereinafter collectively referred to as the "Group") are prepared in accordance with International Financial Reporting Standards (hereinafter referred to as "IFRS") pursuant to the provisions of Article 120, Paragraph 1 of the Ordinance on Accounting of Companies. Pursuant to the provisions of the second sentence of the same paragraph of the same Ordinance, some disclosure items required under IFRS are omitted.

(2) Scope of consolidation

Number of consolidated subsidiaries: 231 companies

Major consolidated subsidiaries: TS Network Co., Ltd., Japan Filter Technology, Ltd., JT International S.A., Gallaher Ltd., Torii Pharmaceutical Co., Ltd., and TableMark Co., Ltd.

(3) Scope of equity method

Number of affiliates accounted for using the equity method: 13 companies

Major affiliates accounted for using the equity method: Megapolis Distribution B.V.

Joint ventures are accounted for using the equity method.

(4) Accounting policies

A. Basis and method of valuation for financial assets other than derivatives

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.

iv) Impairment of financial assets

With respect to financial assets measured at amortized cost, the Group recognizes an allowance for doubtful accounts for expected credit losses. The expected credit losses are calculated based on historical loss experience or future recoverable amounts.

An allowance for doubtful accounts for trade receivables is always recognized at an amount equal to the full lifetime expected credit losses. In principle, with respect to financial assets except for trade receivables, an allowance for doubtful accounts is measured at an amount equal to the 12-month expected credit losses. However, the allowance for doubtful accounts is measured at an amount equal to the full lifetime expected credit losses if a credit risk on the financial asset has increased significantly since initial recognition.

The Group assesses whether a credit risk on a financial asset has increased significantly based on a change of the default risk considering the past due information, financial difficulties of obligors or downgrades of the internal credit rating.

The Group assesses a whole or part of a financial asset which is deemed uncollectible or extremely difficult to be collected as a default and recognizes it as a credit-impaired financial asset.

The expected credit losses on trade receivables which are not assessed as credit-impaired financial assets are measured collectively by an asset group consisting of a number of homogeneous counterparties.

An allowance for doubtful accounts for financial assets is recognized in profit or loss. If an event which causes a reduction of the allowance for doubtful accounts occurs, a reversal of an allowance for doubtful accounts is recognized in profit or loss.

B. Basis and method of valuation for derivatives

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.

C. Basis and method of valuation for 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.

D. Depreciation methods for significant depreciable assets

i) Property, plant and equipment and investment property (excluding right-of-use assets)

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.

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.

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.

ii) Intangible assets (excluding right-of-use 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.

iii) Right-of-use assets

At inception of a contract, the Group assesses whether the contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The Group elects not to recognize right-of-use assets and lease liabilities for short-term leases within 12 months and leases of low-value assets.

If a contract is, or contains, a lease, except for short-term leases and leases of low-value assets, the Group recognizes right-of-use assets and lease liabilities on the consolidated statement of financial position at the commencement date. The Group recognizes the lease payments associated with short-term leases and leases of low-value assets as an expense on a straight-line basis over the lease term.

Right-of-use asset is measured by using the cost model and is stated at cost less accumulated depreciation and accumulated impairment losses.

An acquisition cost of a right-of-use asset includes the amount of the initial measurement of the lease liability, any lease payments made at or before the commencement date, and any initial direct costs. The right-of-use asset is depreciated using the straight-line method over its estimated useful life or lease term, whichever is shorter. The lease liability is initially measured at the present value of the lease payment that is not paid at the commencement date. The lease payments are apportioned between the financial cost and the reduction in the lease liability based on the effective interest method. The financial costs are recognized in the consolidated statement of income.

E. Policy on accounting of significant 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.

F. 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.

G. Accounting for revenue

i) Revenue from contracts with customers

Revenue is recognized based on the following five-step approach.

Step 1: Identify the contract with a customer
Step 2: Identify the performance obligations in the contract
Step 3: Determine the transaction price
Step 4: Allocate the transaction price to the performance obligations in the contract
Step 5: Recognize revenue when the entity satisfies a performance obligation

The Group mainly engages in the sale of tobacco products, prescription drugs, and processed foods. Revenue is recognized upon delivery of the products because the customer obtains control of the products upon delivery, by which the Group evaluates that the performance obligation is satisfied. Revenue is measured at the consideration promised in a contract with a customer, less discounts, rebates and taxes, including consumption tax.

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

ii) Interest income

Interest income is recognized using the effective interest rate method.

iii) Dividend income

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

H. 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.

I. Method of 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 to 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.

J. Method of significant 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.

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 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 part that does not meet the requirement when the hedging relationship ceases to meet the qualifying criteria after adjusting the hedge ratio.

Hedges that meet the stringent requirements for hedge accounting are classified into 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 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 fair value of an equity instruments 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, 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.

K. National consumption tax and local consumption tax are excluded from the consolidated statement of income.

L. The Company and certain subsidiaries apply for the consolidated taxation system.

(5) 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, 2019.

IFRS		Description of new standards and amendments
IFRS 16	Leases	Amendments to accounting treatment for lease arrangements
IAS 19	Employee Benefits	Clarifying treatment on a defined benefit plan curtailment or settlement

In adopting IFRS 16, the Group used a transition method by which the cumulative effect of initially adopting this standard was recognized at the date of initial application. The lessee’s weighted average incremental borrowing rate which applied to lease liabilities on the consolidated statement of financial position at the date of initial application is 4.1%.

The Group has adopted this standard for contracts that were previously identified as leases adopting IAS 17 and IFRIC 4, “Determining whether an Arrangement Contains a Lease” (hereinafter referred to as “IFRIC 4”), without reassessing whether a contract is, or contains, a lease at the date of initial application. The Group has not adopted this standard for contracts that were not previously identified as containing a lease adopting IAS 17 and IFRIC 4.

For leases previously classified as operating leases adopting IAS 17, the following practical expedients permitted as transition methods are adopted:

• A single discount rate is applied to a portfolio of leases with reasonably similar characteristics.
• Leases for which the lease term ends within 12 months of the date of initial application are accounted for in the same way as short-term leases.
• Initial direct costs are excluded from the measurement of right-of-use assets at the date of initial application.

As a result of the adoption of IFRS 16, “Assets” and “Liabilities” increased by ¥39,033 million at the date of initial application. There is an immaterial impact on operating profit and profit for the period.

The effect of adopting IAS 19 on the consolidated financial statements is immaterial.

2. Notes to consolidated statement of financial position

(1) Accumulated depreciation of assets (including accumulated impairment losses)

Property, plant and equipment:	¥	969,715	million
Goodwill and intangible assets:	¥	893,146	million
Investment property:	¥	23,674	million

(2) Assets pledged as collateral and liabilities relating to collateral

i) Pursuant to Article 6 of the Japan Tobacco Inc. Act, the Company's properties are pledged as general collateral for its corporate bonds.

Amount of liabilities relating to collateral

Bonds:	¥	371,675	million

ii) Assets pledged as collateral related to some consolidated subsidiaries are ¥2,060 million.

(3) Allowance for doubtful accounts directly deducted from assets

Trade and other receivables:	¥	2,475	million
Other financial assets:	¥	5,935	million

3. Notes to consolidated statement of changes in equity

(1) Class and total number of issued shares and class and total number of treasury shares

(Thousands of shares)

	Number of shares as of January 1, 2019	Increase for the year ended December 31, 2019	Decrease for the year ended December 31, 2019	Number of shares as of December 31, 2019
Issued shares				
Ordinary shares	2,000,000	-	-	2,000,000
Treasury shares				
Ordinary shares	208,577	17,788	168	226,197

(Notes) The increase of 17,788 thousand treasury shares (ordinary shares) is composed of 17,788 thousand treasury shares due to acquisition based on the resolution made by the Board of Directors and 0 thousand treasury shares due to purchase of shares less than one unit. The decrease of 168 thousand treasury shares (ordinary shares) is due to the exercise of share options.

(2) Cash dividends

i) Dividends payments

Resolution	Class of shares	Total dividends (Millions of yen)	Dividends per share (Yen)	Basis date	Effective date
Annual Shareholders' Meeting (March 20, 2019)	Ordinary shares	134,357	75	December 31, 2018	March 22, 2019
Board of Directors (July 31, 2019)	Ordinary shares	136,579	77	June 30, 2019	September 2, 2019

ii) Dividends whose basis date is in the year ended December 31, 2019 but whose effective date falls in the year ending December 31, 2020.

The following proposal will be placed on the agenda of the Annual Shareholders' Meeting to be held on March 19, 2020.

(Proposal)	Class of shares	Total dividends (Millions of yen)	Source of dividends	Dividends per share (Yen)	Basis date	Effective date
Annual Shareholders' Meeting (March 19, 2020)	Ordinary shares	136,583	Retained earnings	77	December 31, 2019	March 23, 2020

(3) Class and number of shares under subscription rights to shares as of December 31, 2019 (excluding rights whose exercise period has not yet begun)

Ordinary shares 974,600 shares

4. Financial instruments

(1) Status of financial instruments

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.

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.

(2) Fair value of financial instruments

The carrying amounts on the consolidated statement of financial position and the fair values as of December 31, 2019 are as follows:

(Millions of yen)

	Carrying amount on consolidated statement of financial position	Fair value
1) Long-term borrowings	115,297	116,804
2) Bonds	666,623	683,650

With regard to short-term financial assets and short-term financial liabilities measured at amortized cost, the 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.

The fair value of bonds issued by the Group is based on the market price for those having market prices, and based on the present value that is obtained by discounting the total of principal and interest by the interest rate, for which the remaining period and credit risk of such bonds are taken into consideration.

5. Investment property

(1) Status of investment property

The Group owns some rental properties such as office buildings in Tokyo Prefecture and other areas.

(2) Fair value of investment property

The carrying amount on the consolidated statement of financial position and the fair value of investment properties as of December 31, 2019 are as follows:

(Millions of yen)

	Carrying amount on consolidated statement of financial position	Fair value
Investment property	16,588	36,204

(Notes) 1. The carrying amount on the consolidated statement of financial position is the acquisition cost less accumulated depreciation and accumulated impairment losses, if any.

2. The fair value of investment properties 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.

6. Per share information

(1) Equity attributable to owners of the parent company per share:	¥	1,501.12
(2) Basic earnings per share:	¥	195.97
(3) Diluted earnings per share:	¥	195.87

7. Contingencies

Contingent liabilities

The Company and some of its subsidiaries are defendants in legal proceedings. Provisions are not accounted for in matters 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 response to action with the assistance of external lawyers.

(1) Smoking and health related litigation

The Company and some of its subsidiaries become 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, 2019, 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 such as for the Company's acquisition of RJR Nabisco Inc.'s overseas (non-U.S.) tobacco operations.

In March 2019, the Quebec Court of Appeal dismissed the appeal by three Canadian tobacco manufacturers including JTI-Macdonald Corp. (hereinafter referred to as "JTI-Mac"), the Company's Canadian subsidiary, of the lower court decision in the two class action lawsuits in Quebec. The Quebec Court of Appeal ordered a total damage award against the appellants of approximately ¥1.147 trillion (approximately CAD 13.7 billion), in which the share of the total damage award against JTI-Mac is approximately ¥148.7 billion (approximately CAD 1.8 billion). Given the Quebec Court of Appeal's decision, JTI-Mac filed for protection from its creditors under the Companies' Creditors Arrangement Act (CCAA), and the Ontario Superior Court has granted the CCAA application and extended protection in favor of JTI-Mac (hereinafter referred to as "CCAA Proceedings"). All of the below Canadian matters against JTI-Mac have been stayed by the CCAA Proceedings, under which JTI-Mac carries on business in the ordinary course.

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

i) Individual claim

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

ii) Class actions

There are eight ongoing class actions in Canada against the Company's subsidiary and/or indemnitees. The cases are stayed by the CCAA Proceedings.

iii) Health-care cost recovery litigation

There are ten 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). The cases are stayed by the CCAA Proceedings.

(2) Other legal proceedings

The Company and some of its subsidiaries are also engaged in other legal proceedings such as commercial and tax disputes.

8. Significant subsequent events

The Company entered into loan agreements with banks as follows:

(1) Lenders : Mizuho Bank, Ltd., MUFG Bank, Ltd., Sumitomo Mitsui Banking Corporation and Sumitomo Mitsui Trust Bank, Limited

(2) Aggregate amount of borrowings : ￥100 billion

(3) Interest rates : Floating rates（TIBOR plus spread）

(4) Drawdown date : January 31, 2020

(5) Repayment date : January 31, 2080

The Company may, at its option, repay early all or a portion of the principal on any Interest Payment Date on or after the Interest Payment Date of January 2025.

(6) Collateral/Guarantee : None

(7) Use of proceeds : Repayment of existing debts and working capital

(8) Other borrowing terms :

a. Interest deferral clause

The Company may, at its option, defer the payment of interest.

b. Subordination clause

The lenders shall have subordinated claim rights subordinated to senior debts in liquidation proceedings, bankruptcy proceedings, reorganization proceedings, civil rehabilitation proceedings or any other equivalent proceedings other than those under the laws of Japan.

No terms and conditions of the Subordinated Loan Agreement may be amended in a manner detrimental in any way to any creditors of the Company other than the creditors of the subordinated receivables.

c. Replacement restrictions

There is no contractual provision on replacement restrictions.

Provided, when making a prepayment of the Subordinated Loan, the Company intends to replace it with the funds raised by common stock or financial instruments that have equity credit attributes approved by rating agencies to be equal to or higher than the Subordinated Loan within twelve months prior to the prepayment date. However, the Company may decide not to replace the Subordinated Loan with the approved funds that have equal or higher equity credit attributes, if predefined financial requirements are met.

9. All figures are rounded off to the nearest unit.

Nonconsolidated Statement of Changes in Net Assets

(Year ended December 31, 2019)

(Millions of yen)

	Shareholders' equity								
	Capital stock	Capital surplus		Retained earnings					
		Legal capital surplus	Total capital surplus	Legal retained earnings	Other retained earnings				Total retained earnings
					Reserve for investment loss on developing new business	Reserve for reduction entry	Special account for reduction entry	Retained earnings brought forward	
As of January 1, 2019	100,000	736,400	736,400	18,776	287	41,753	10,179	996,757	1,067,752
Changes of items during the period									
Provision of reserve for investment loss on developing new business	–	–	–	–	378	–	–	(378)	–
Reversal of reserve for investment loss on developing new business	–	–	–	–	(287)	–	–	287	–
Provision of reserve for reduction entry	–	–	–	–	–	8,395	–	(8,395)	–
Reversal of reserve for reduction entry	–	–	–	–	–	(4,775)	–	4,775	–
Provision of special account for reduction entry	–	–	–	–	–	–	1,747	(1,747)	–
Reversal of special account for reduction entry	–	–	–	–	–	–	(10,179)	10,179	–
Dividends from surplus	–	–	–	–	–	–	–	(270,936)	(270,936)
Net income	–	–	–	–	–	–	–	262,469	262,469
Purchase of treasury shares	–	–	–	–	–	–	–	–	–
Disposal of treasury shares	–	–	–	–	–	–	–	(80)	(80)
Net changes of items other than shareholders' equity	–	–	–	–	–	–	–	–	–
Total changes of items during the period	–	–	–	–	91	3,620	(8,432)	(3,826)	(8,547)
As of December 31, 2019	100,000	736,400	736,400	18,776	378	45,373	1,747	992,930	1,059,205

(Millions of yen)

	Shareholders' equity		Valuation and translation adjustments			Subscription rights to shares	Total net assets
	Treasury shares	Total shareholders' equity	Valuation difference on available-for-sale securities	Deferred gains or losses on hedges	Total valuation and translation adjustments		
As of January 1, 2019	(442,829)	1,461,323	25,815	4,877	30,693	1,547	1,493,562
Changes of items during the period							
Provision of reserve for investment loss on developing new business	–	–	–	–	–	–	–
Reversal of reserve for investment loss on developing new business	–	–	–	–	–	–	–
Provision of reserve for reduction entry	–	–	–	–	–	–	–
Reversal of reserve for reduction entry	–	–	–	–	–	–	–
Provision of special account for reduction entry	–	–	–	–	–	–	–
Reversal of special account for reduction entry	–	–	–	–	–	–	–
Dividends from surplus	–	(270,936)	–	–	–	–	(270,936)
Net income	–	262,469	–	–	–	–	262,469
Purchase of treasury shares	(50,001)	(50,001)	–	–	–	–	(50,001)
Disposal of treasury shares	361	281	–	–	–	–	281
Net changes of items other than shareholders' equity	–	–	(18,533)	513	(18,020)	10	(18,010)
Total changes of items during the period	(49,640)	(58,187)	(18,533)	513	(18,020)	10	(76,197)
As of December 31, 2019	(492,469)	1,403,136	7,283	5,390	12,673	1,556	1,417,365

Notes to Nonconsolidated Financial Statements

1. Significant accounting policies

(1) Basis and method of valuation for securities

Shares of subsidiaries and affiliates:

Stated at cost determined by the moving-average method.

Available-for-sale securities:

Securities with a fair value:

Stated at fair value based on market prices on the closing date of the accounting period. (Valuation difference is stated as a component of net assets and the cost of securities sold is calculated by applying the moving-average method.)

Securities without a fair value:

Stated at cost determined by the moving-average method.

(2) Basis and method of valuation for derivatives

Stated based on the fair value method.

(3) Basis and method of valuation for inventories

Stated at the lower of cost as determined by the average cost method.

(Balance sheet amounts are measured at the lower of cost or net selling value.)

(4) Depreciation methods for depreciable assets

i) Property, plant and equipment (excluding leased assets)

The declining-balance method is applied. However, the straight-line method is applied for buildings (excluding accompanying facilities) acquired on or after April 1, 1998 and for accompanying facilities and structures acquired on or after April 1, 2016.

The main useful lives are as follows:

Buildings (excluding accompanying facilities):	38 to 50 years
Machinery and equipment:	10 years

ii) Intangible assets (excluding leased assets)

Straight-line method

The main useful lives are as follows:

Patent right:	8 years
Right of trademark:	10 years
Software:	5 years
Goodwill:	10 years

iii) Leased assets

For finance leases that do not transfer ownership of the leased property to the lessee, depreciation expense is mainly computed by the straight-line method over the lease period as the useful life assuming no residual value.

(5) Policy on accounting of provisions

i) Allowance for doubtful accounts

Provided for possible losses from bad debts at an amount determined based on the historical default rate for ordinary receivables and the individual recoverability of specific doubtful receivables from customers experiencing financial difficulties.

ii) Provision for bonuses

Provided based on the estimated payable amount to provide for the payment of bonuses to employees and directors.

iii) Provision for retirement benefits

Provided in preparation for the payment of retirement benefits to employees based on the estimated retirement benefit obligations and fair values of plan assets as of the end of this fiscal year. In calculating retirement benefit obligations, the benefit formula basis is used as the method of attributing expected benefit to periods up to the year ended December 31, 2019.

Past service cost is amortized using the straight-line method over the average remaining years of service of the employees (mainly 10 years).

Actuarial gains and losses are amortized from the year following the year in which the gains or losses are recognized using the straight-line method over the average remaining years of service of the employees (mainly 10 years).

Also included in the provision for retirement benefits is the portion of public pension expenses for mutual assistance association during certain periods in or before June 1956 (prior to the enforcement of the Act on the Mutual Aid Association of Public Corporation Employees).

(6) Policy on translation of assets and liabilities denominated in foreign currency into Japanese yen

Receivables and payables denominated in foreign currencies are translated into Japanese yen at the rates prevailing at the closing date of the accounting period with translation differences treated as gains or losses occurring in the corresponding fiscal year.

(7) Method of hedge accounting

Deferral hedge accounting is applied.

For interest rates and currency swaps, if they satisfy the requirements for treatment that incorporates swaps into underlying accounting items (accounting by applying foreign exchange rate stipulated in the contracts; exceptional treatment), they are accounted for by incorporating swaps into underlying accounting items.

(8) National consumption tax and local consumption tax are excluded from the nonconsolidated statement of income.

(9) Adoption of consolidated taxation system

The Company applies for the consolidated taxation system.

(10) Changes in method of presentation

i)"Partial Amendments to Accounting Standard for Tax Effect Accounting" (Statement No.28 issued by the Accounting Standards Board of Japan on February 16, 2018) was applied from this fiscal year, which required deferred tax assets to be classified as investments and other assets ,and deferred tax liabilities to be as noncurrent liabilities.

ii) For the year ended December 31,2018, "Gain on sale of investment securities" was included in "Other" in "Extraordinary income" in the nonconsolidated statement of income; however, for the year ended December 31, 2019,it is presented separately due to its increased materiality.

2. Notes to nonconsolidated balance sheet

(1) Receivables and payables with respect to subsidiaries and affiliates (excluding items separately presented)

Short-term receivables:	¥	23,832 million
Short-term payables:	¥	32,012 million
Long-term payables:	¥	5,010 million

(2) Accumulated depreciation of property, plant and equipment: ¥ 474,872 million

(3) Pursuant to Article 6 of the Japan Tobacco Inc. Act, the Company's assets are pledged as general collateral for its corporate bonds.

Amount of liabilities relating to collateral: Bonds ¥ 371,904 million

(4) Guarantee obligations

Guaranteed party	Guarantee amount	Type of guarantee obligation	
	(Millions of yen)		
JT International Financial Services B.V.	298,183	Bond guarantee, guarantee denominated in foreign currencies	¥ 298,183 million (EUR 1,050 million) (USD 1,025 million) (GBP 400 million)
JT International S.A.	68,609	Loan guarantee, guarantee denominated in foreign currencies	¥ 68,609 million (USD 411 million) (EUR 69 million) (CHF 67 million) others
PT. Karyadibya Mahardhika	54,878	Loan guarantee, guarantee denominated in foreign currencies	¥ 54,878 million (IDR 6,986,512 million) others
JT International Holding B.V.	44,129	Loan guarantee, guarantee denominated in foreign currencies	¥ 44,129 million (EUR 360 million) others
JT International Company Netherlands B.V.	37,926	Loan guarantee, guarantee denominated in foreign currencies	¥ 37,926 million (EUR 310 million)
JTI Ireland Limited	28,772	Loan guarantee, guarantee denominated in foreign currencies	¥ 28,772 million (EUR 235 million)
JT International Hellas A.E.B.E.	24,123	Loan guarantee, guarantee denominated in foreign currencies	¥ 24,123 million (EUR 197 million)
JT International (Philippines) Inc.	14,768	Loan guarantee, guarantee denominated in foreign currencies	¥ 14,768 million (PHP 6,850 million)
LLC Petro	11,838	Loan guarantee, guarantee denominated in foreign currencies	¥ 11,838 million (RUB 6,689 million)
JT International Spol s r.o.	10,209	Loan guarantee, guarantee denominated in foreign currencies	¥ 10,209 million (CZK 2,108 million)
Other (61 companies)	87,457	Loan guarantee	
Total	680,892		

(5) Payables to Directors and Audit & Supervisory Board Members

Long-term payables: ¥ 236 million

(6) "Cash management system deposits received" are funds entrusted in the cash management system for domestic group companies.

3. Notes to nonconsolidated statement of income

(1) Net sales including tobacco excise taxes for the year ended December 31, 2019 amounted to ¥1,655,611 million.
Net sales including tobacco excise taxes are the amount of net sales plus the amount equivalent to tobacco excise taxes.

(2) Amount of transactions with subsidiaries and affiliates

Net sales:	¥	86,017 million
Purchase of goods:	¥	62,101 million
Selling, general and administrative expenses:	¥	58,902 million
Dividends income:	¥	146,767 million
Amount of non-operating transactions:	¥	63,542 million

(3) Total research and development expenses are ¥54,017 million, all of which were recorded as general and administrative expenses.

4. Notes to nonconsolidated statement of changes in net assets

Class and number of shares of treasury shares

(Thousands of shares)

	Number of shares as of January 1, 2019	Increase for the year ended December 31, 2019	Decrease for the year ended December 31, 2019	Number of shares as of December 31, 2019
Treasury shares				
Ordinary shares	208,577	17,788	168	226,197
Total	208,577	17,788	168	226,197

(Note) The increase of 17,788 thousand treasury shares (ordinary shares) is composed of 17,788 thousand treasury shares due to acquisition based on the resolution made by the Board of Directors and 0 thousand treasury shares due to purchase of shares less than one unit. The decrease of 168 thousand treasury shares (ordinary shares) is due to the exercise of share options.

5. Tax effect accounting

(1) Breakdown of deferred tax assets and deferred tax liabilities by major cause

Deferred tax assets		
Provision for retirement benefits	¥	28,287 million
Obligations pertaining to mutual assistance pension benefits	¥	10,759 million
Investments in subsidiaries	¥	12,232 million
Other	¥	31,501 million
Subtotal	¥	82,779 million
Less valuation allowance	¥	(23,301)million
Deferred tax assets total	¥	59,478 million
Deferred tax liabilities		
Reserve for reduction entry	¥	(19,846)million
Deferred gains or losses on hedges	¥	(10,962)million
Valuation difference on available-for-sale securities	¥	(3,085)million
Other	¥	(12,532)million
Deferred tax liabilities total	¥	(46,425)million
Net deferred tax assets	¥	13,053 million

(Changes in method of presentation)

For the year ended December 31,2018,"Investments in subsidiaries" was included in "Other" in "Deferred tax assets"; however,

for the year ended December 31, 2019, it is presented separately due to its increased materiality.

(2) The breakdown of major items that caused significant differences between the effective statutory tax rate and the actual tax rate when applying tax effect accounting

Effective statutory tax rate	30.43%
(Adjustments)	
Permanent difference arising from non-deductible items including entertainment expenses	0.32%
Permanent difference arising from non-taxable items including dividends income	(14.35%)
Tax credit of items including research and development expenses	(2.12%)
Taking over tax losses carried forward from liquidation of subsidiaries	(4.97%)
Loss on liquidation of subsidiaries	2.10%
Other	(0.12%)
Actual effective tax rate after applying tax effect accounting	11.29%

6. Related-party transactions

Subsidiaries and Affiliates

Type	Name	Ownership ratio of voting rights	Relation with related-parties	Description of transaction	Transaction amount		Item	End-of-period balance
					Lending of funds	Receipt of repayment of funds		
					millions of yen	millions of yen		millions of yen
Subsidiary	Table Mark Holdings Co., Ltd.	Direct ownership 100%	Lending of funds	Lending of funds (Notes 1, 2)	—	49,868	Short-term loan receivables from subsidiaries and affiliates	—
							Long-term loan receivables from subsidiaries and affiliates	—
	Table Mark Co., Ltd.	Direct ownership 100%	Lending of funds	Lending of funds (Notes 1, 2)	70,271	31,787	Short-term loan receivables from subsidiaries and affiliates	31,003
							Long-term loan receivables from subsidiaries and affiliates	7,481
	JT International Holding B.V.	Indirect ownership 100%	Lending of funds	Lending of funds (Note 1)	54,265	—	Short-term loan receivables from subsidiaries and affiliates	54,780

Type	Name	Ownership ratio of voting rights	Relation with related-parties	Description of transaction	Transaction amount	Item	End-of-period balance
					millions of yen		millions of yen
Subsidiary	TS Network Co., Ltd.	Direct ownership 85.25%	Deposits received for cash management system	Receipt of surplus funds (Notes 1, 2)	-	Cash management system deposits received	205,564
	Torii Pharmaceutical CO., Ltd.	Direct ownership 54.85%	Marketing of pharmaceutical products Deposits received for cash management system	Transfer of rights to market from termination of license agreements (Notes 3)	42,137	-	-
				Receipt of surplus funds (Notes 1, 2)	-	Cash management system deposits received	37,796
	JT International Financial Services B.V.	Indirect ownership 100%	Guarantee of obligations	Guarantee of obligations (Note 4)	298,183	-	-
	JT International S.A.	Indirect ownership 100%	Guarantee of obligations	Guarantee of obligations (Note 4)	70,793	-	-
	PT. Karyadibya Mahardhika	Indirect ownership 100%	Guarantee of obligations	Guarantee of obligations (Note 4)	54,878	-	-
	JT International Holding B.V.	Indirect ownership 100%	Guarantee of obligations	Guarantee of obligations (Note 4)	44,129	-	-
	JT International Company Netherlands B.V.	Indirect ownership 100%	Guarantee of obligations	Guarantee of obligations (Note 4)	37,926	-	-

	JTI Ireland Limited	Indirect ownership 100%	Guarantee of obligations	Guarantee of obligations (Note 4)	28,772	-	-

Transaction conditions and policy on determination of transaction conditions

(Notes) 1. Interest rates on lending of funds and that on receipt of surplus funds are reasonably determined taking into account interest rates on the market.

2. For lending/borrowing from the cash management system, transaction amounts are omitted from the table above because of their frequent occurrence.

3.Taking into account general transaction and past trading performance, transfer of rights to market from termination of license agreements is conducted at reasonable price after mutual consultation.

4. Guarantees of obligations are made for bank loans, and guarantee fees are calculated based on the guarantee amount.

7. Per share information

(1) Net assets per share:	¥	798.18
(2) Net income per share:	¥	147.72
(3) Diluted net income per share:	¥	147.65

8. Significant subsequent events

The Company entered into loan agreements with banks as follows:

(1) Lenders : Mizuho Bank, Ltd., MUFG Bank, Ltd., Sumitomo Mitsui Banking Corporation and Sumitomo Mitsui Trust Bank, Limited

(2) Aggregate amount of borrowings : ￥100 billion

(3) Interest rates : Floating rates（TIBOR plus spread）

(4) Drawdown date : January 31, 2020

(5) Repayment date : January 31, 2080

The Company may, at its option, repay early all or a portion of the principal on any Interest Payment Date on or after the Interest Payment Date of January 2025.

(6) Collateral/Guarantee : None

(7) Use of proceeds : Repayment of existing debts and working capital

(8) Other borrowing terms :

a. Interest deferral clause

The Company may, at its option, defer the payment of interest.

b. Subordination clause

The lenders shall have subordinated claim rights subordinated to senior debts in liquidation proceedings, bankruptcy proceedings, reorganization proceedings, civil rehabilitation proceedings or any other equivalent proceedings other than those under the laws of Japan.

No terms and conditions of the Subordinated Loan Agreement may be amended in a manner detrimental in any way to any creditors of the Company other than the creditors of the subordinated receivables.

c. Replacement restrictions

There is no contractual provision on replacement restrictions.

Provided, when making a prepayment of the Subordinated Loan, the Company intends to replace it with the funds raised by common stock or financial instruments that have equity credit attributes approved by rating agencies to be equal to or higher than the Subordinated Loan within twelve months prior to the prepayment date. However, the Company may decide not to replace the Subordinated Loan with the approved funds that have equal or higher equity credit attributes, if predefined financial requirements are met.

9. All figures are rounded off to the nearest unit.