

**THE MANCHESTER TOBACCO
COMPANY LIMITED**

Report and Financial Statements

31 December 1998

**Deloitte & Touche
PO Box 500
201 Deansgate
Manchester
M60 2AT**



THE MANCHESTER TOBACCO COMPANY LIMITED

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THE MANCHESTER TOBACCO COMPANY LIMITED

OFFICERS AND PROFESSIONAL ADVISERS

DIRECTORS

Y Miyakita
K Katakura
N Nii
S Robinson
C Simpson
K Iijima
K Terada

SECRETARY

N Nii

REGISTERED OFFICE

Barton Dock Road
Urmston
Manchester
M41 7TB

BANKERS

Barclays Bank plc
54 Lombard Street
London
EC3V 9EX

Fuji Bank Limited
River Plate House
7-11 Finsbury Circus
London
EC2M 7DH

AUDITORS

Deloitte & Touche
Chartered Accountants
201 Deansgate
Manchester
M60 2AT

THE MANCHESTER TOBACCO COMPANY LIMITED

DIRECTORS' REPORT

The directors present their annual report and the audited financial statements for the year ended 31 December 1998.

ACTIVITIES

The company is involved in the manufacture for sale of tobacco products.

REVIEW OF THE BUSINESS AND FUTURE PROSPECTS

The company's profit for the year is shown in the profit and loss account on page 6.

On 1 January 1998 plant and machinery assets with a net book value of £15,860,698 were transferred to J T International Europe ("JTIE") Limited, a fellow subsidiary, at net book value. The consideration for these assets has been utilised to reduce the group loans in place. These assets have been leased back to the company for an annual charge.

On 9 April 1998 J T (UK) Limited purchased 615,000 ordinary equity shares in the company with a nominal value of £1 each. The total price paid for the shares was £6,150,000.

The directors consider the company is well placed to perform satisfactorily in the future and the company's targets are to achieve higher efficiency and lower cost by producing as many of the highest quality cigarettes as possible.

DIVIDENDS AND TRANSFERS TO RESERVES

The directors do not recommend the payment of a dividend (1997 - £Nil). The profit for the year of £1,322,204 has been transferred to reserves (1997 loss of £4,176,452 - rounded to £4,175,000 transferred from reserves).

FIXED ASSETS

Movements in fixed assets are shown in note 7.

YEAR 2000

Systems critical to the company's ongoing operations and preparation of financial information, including application systems, operating systems and hardware, as well as other non-financial computing and date dependent systems on which the directors rely, are being reviewed to establish the impact, if any, which the Year 2000 will have on the accuracy of the calculations, processing and reporting being undertaken on their behalf. Plans are being developed, designed to ensure that prior to the end of this millennium, the impact of the Year 2000 will not create significant errors in accounting records, or otherwise impact to any significant degree upon the directors' ability to administer the company.

Where critical systems include certain systems and data fields provided by third parties, the directors are taking steps to receive assurances from the management of these third parties that similar plans have been, or are being, implemented by them.

DIRECTORS AND THEIR INTERESTS

The following served as directors during the year:

Y Miyakita	
T Fukui	(resigned 26 June 1998)
E Ito	(resigned 1 July 1998)
N Nii	
S Robinson	
K Katakura	
C Simpson	(appointed 1 May 1998)
K Iijima	(appointed 26 June 1998)
K Terada	(appointed 1 July 1998)

None of the directors at the year end had any interests in the shares of the company (1997 - same).

Any interests held by the directors in the shares of the immediate or ultimate parent company are dealt with in the accounts of those companies (see note 21).

THE MANCHESTER TOBACCO COMPANY LIMITED

DIRECTORS' REPORT

DISABLED PERSONS

It is the Company's policy to give full and fair consideration to applications from disabled persons, having due regard to their particular aptitudes and abilities, and to provide opportunities for the continued employment and suitable retraining of employees who become disabled whilst employed by the Company.

In all other respects equal opportunities exist for the training, career development and promotion of disabled persons.

INFORMATION TO EMPLOYEES


Regular Communications Meetings are held with representatives of the employees to inform them of any developments in the Company or of any changes which are likely to affect their interests.

The Company operates a Profit Related Payment scheme and employees are given regular updates on the company's financial performance.

AUDITORS

A resolution for the reappointment of Deloitte & Touche as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

Approved by the Board of Directors
and signed on behalf of the Board



NAOKI NII
Secretary

THE MANCHESTER TOBACCO COMPANY LIMITED

STATEMENT OF DIRECTORS' RESPONSIBILITIES

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company as at the end of the financial year and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.



THE MANCHESTER TOBACCO COMPANY LIMITED

AUDITORS' REPORT TO THE MEMBERS

We have audited the financial statements on pages 6 to 16 which have been prepared under the accounting policies set out on page 9.

Respective responsibilities of directors and auditors

As described on page 4 the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 1998 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Chartered Accountants and Registered Auditors

16 May 1999

THE MANCHESTER TOBACCO COMPANY LIMITED

PROFIT AND LOSS ACCOUNT Year ended 31 December 1998

	Note	1998 £'000	1997 £'000
TURNOVER	2	14,301	9,966
Cost of sales		(10,657)	(12,900)
GROSS PROFIT/(LOSS)		3,644	(2,934)
Administrative expenses		(2,491)	(2,462)
OPERATING PROFIT/(LOSS)	4	1,153	(5,396)
Interest payable and similar charges	5	(111)	(242)
PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION		1,042	(5,638)
Tax on profit/(loss) on ordinary activities	6	280	1,463
PROFIT/(LOSS) FOR THE FINANCIAL YEAR		1,322	(4,175)
Deficit brought forward		(26,259)	(22,084)
Deficit carried forward		(24,937)	(26,259)

All the above results derive from continuing operations. There are no recognised gains and losses for the current financial year and preceding financial year other than as stated in the profit and loss account.

THE MANCHESTER TOBACCO COMPANY LIMITED

BALANCE SHEET
31 December 1998

	Note	1998 £'000	1997 £'000
FIXED ASSETS			
Tangible assets	7	20,079	36,269
CURRENT ASSETS			
Stocks	8	894	1,509
Debtors	9	4,772	4,311
Cash at bank and in hand		3	24
		<u>5,669</u>	<u>5,844</u>
CREDITORS: amounts falling due within one year	10	<u>(4,411)</u>	<u>(14,974)</u>
NET CURRENT ASSETS/(LIABILITIES)		<u>1,258</u>	<u>(9,130)</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		21,337	27,139
CREDITORS: amounts falling due after more than one year	11	(7,466)	(20,900)
PROVISIONS FOR LIABILITIES AND CHARGES	13	<u>(340)</u>	<u>(180)</u>
		<u>13,531</u>	<u>6,059</u>
CAPITAL AND RESERVES			
Called up share capital	14	4,077	3,462
Share premium account	16	34,391	28,856
Profit and loss account	16	<u>(24,937)</u>	<u>(26,259)</u>
Equity shareholders' funds		13,531	6,059

These financial statements were approved by the Board of Directors on 4th May 1999.
Signed on behalf of the Board of Directors

G. Mungath - Director

THE MANCHESTER TOBACCO COMPANY LIMITED

CASH FLOW STATEMENT Year ended 31 December 1998

	Note	£'000	1998 £'000	1997 £'000
Net cash inflow from operating activities	18		3,177	173
Returns on investments and servicing of finance				
Interest paid		(111)	(242)	
Net cash outflow from returns on investments and servicing of finance			(111)	(242)
Taxation				
UK corporation tax paid			-	-
Capital expenditure and financial investment				
Purchase of tangible fixed assets		(824)	(3,814)	
Disposal of tangible fixed assets		89	6	
Net cash outflow from investing activities			(735)	(3,808)
Net cash inflow/(outflow) before financing			2,331	(3,877)
Financing				
Issue of ordinary share capital	15	6,150	-	
(Decrease)/increase in group loans		(6,974)	4,000	
Net cash (outflow)/inflow from financing			(824)	4,000
Increase in cash	19		1,507	123

THE MANCHESTER TOBACCO COMPANY LIMITED

NOTES TO THE ACCOUNTS Year ended 31 December 1998

1. ACCOUNTING POLICIES

The financial statements are prepared in accordance with applicable accounting standards. The particular accounting policies adopted are described below.

Accounting convention

The financial statements are prepared under the historical cost convention.

Tangible fixed assets

Depreciation is provided on cost over the estimated useful lives of the assets. The rates of depreciation are as follows:

Land	nil
Buildings	4% per annum
Plant and machinery	25% per annum on a reducing balance basis
Motor vehicles	25% per annum
Computers	33% per annum
Furniture and fittings	25% per annum

Stocks

Stocks and work-in-progress are stated at the lower of cost and net realisable value. Cost includes materials, direct labour and production overheads appropriate to the relevant stage of production. Net realisable value is based on estimated selling price less all further costs to completion and all relevant marketing, selling and distribution costs.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Amounts payable in foreign currencies have been translated to sterling at the rate ruling at the accounting date. Gains or losses on translation are included in the profit and loss account.

Deferred taxation

Deferred taxation is provided at the anticipated tax rates on timing differences arising from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements to the extent that it is probable that a liability or asset will crystallise in the future.

Leases

Operating lease rentals are charged to income in equal annual amounts over the lease term.

Pension costs

The expected cost of providing pensions, as calculated periodically by professionally qualified actuaries, is charged to the profit and loss account so as to spread the cost over the service lives of employees in the scheme in such a way that the pension cost is a substantially level percentage of current and expected future pensionable payroll.

2. TURNOVER

Turnover represents amounts derived from the provision of goods and services which fall within the company's ordinary activities after deduction of trade discounts and value added tax. The turnover, is attributable to one activity, the manufacture, selling and distribution of tobacco products.

THE MANCHESTER TOBACCO COMPANY LIMITED

NOTES TO THE ACCOUNTS Year ended 31 December 1998

3. INFORMATION REGARDING DIRECTORS AND EMPLOYEES

	1998 £'000	1997 £'000
Directors' emoluments	258	237
	No	No
Number of directors who are members of the defined benefit pension scheme	2	1
	£'000	£'000
Highest paid director Emoluments	63	81
Accrued pension attributable to the highest paid director	6	5
	No	No
Average number of persons employed		
Production	305	302
Sales and distribution	-	-
Administration	15	16
	320	318
	£'000	£'000
Staff costs during the year (including directors)		
Wages and salaries	6,780	5,413
Social security costs	490	406
Pension costs	386	303
	7,656	6,122

4. OPERATING PROFIT/(LOSS)

	1998 £'000	1997 £'000
Operating profit/(loss) is after charging/(crediting):		
Depreciation	1,069	5,680
(Profit)/loss on disposal of fixed assets	(4)	4
Rentals under operating leases:		
Hire of plant and machinery	135	30
Other operating leases	26	415
Auditors' remuneration:		
Audit fees	17	17
Other services	9	10

THE MANCHESTER TOBACCO COMPANY LIMITED

NOTES TO THE ACCOUNTS Year ended 31 December 1998

5. INTEREST PAYABLE AND SIMILAR CHARGES

	1998 £'000	1997 £'000
Bank loans, overdrafts and other loans repayable within five years	111	242

6. TAX ON PROFIT/(LOSS) ON ORDINARY ACTIVITIES

	1998 £'000	1997 £'000
Group relief receivable	280	1,463

7. TANGIBLE FIXED ASSETS

	Land and buildings £'000	Plant and machinery £'000	Motor vehicles £'000	Furniture and fittings £'000	Assets in con- struction £'000	Total £'000
Cost						
At 1 January 1998	20,468	36,719	224	846	-	58,257
Additions	131	71	77	58	487	824
Disposals	-	(345)	(21)	-	-	(366)
Transfers to fellow subsidiary	-	(32,673)	-	-	-	(32,673)
At 31 December 1998	20,599	3,772	280	904	487	26,042
Accumulated depreciation						
At 1 January 1998	1,996	19,391	103	498	-	21,988
Charge for the year	699	130	67	173	-	1,069
Disposals	-	(265)	(16)	-	-	(281)
Transfers to fellow subsidiary	-	(16,813)	-	-	-	(16,813)
At 31 December 1998	2,695	2,443	154	671	-	5,963
Net book value						
At 31 December 1998	17,904	1,329	126	233	487	20,079
At 31 December 1997	18,472	17,328	121	348	-	36,269

8. STOCKS

	1998 £'000	1997 £'000
Consumables	894	1,509

THE MANCHESTER TOBACCO COMPANY LIMITED

NOTES TO THE ACCOUNTS Year ended 31 December 1998

9. DEBTORS

	1998 £'000	1997 £'000
Trade debtors	10	7
Amounts owed by group undertakings:		
Ultimate parent company	26	-
Fellow subsidiary undertakings	4,461	3,468
Prepayments and accrued income	275	836
	<u>4,772</u>	<u>4,311</u>

10. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	1998 £'000	1997 £'000
Bank overdraft	270	1,798
Trade creditors	596	790
Amounts owed to group undertakings:		
Ultimate parent company	706	1,147
Fellow subsidiary	518	10,750
Other creditors	38	3
Other tax and social security	174	196
Accruals and deferred income	2,109	290
	<u>4,411</u>	<u>14,974</u>

11. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	1998 £'000	1997 £'000
Amounts owed to group undertakings:		
Fellow subsidiary undertaking	7,466	20,900

12. BORROWINGS

	1998 £'000	1997 £'000
Loan from fellow subsidiary undertaking	7,466	30,300
Due within one year	-	6,700
Due within 1-2 years	7,466	2,700
Due within 2-5 years	-	20,900
	<u>7,466</u>	<u>30,300</u>

THE MANCHESTER TOBACCO COMPANY LIMITED

NOTES TO THE ACCOUNTS Year ended 31 December 1998

13. PROVISIONS FOR LIABILITIES AND CHARGES

	Vacant property provision £'000	Fixed asset provision £'000	Total provisions £'000
Balance at 1 January 1998	180	-	180
Created during the year	70	90	160
Balance at 31 December 1998	<u>250</u>	<u>90</u>	<u>340</u>

The amounts of deferred taxation provided in the accounts and the amounts not provided are as follows:

	Provided 1998 £'000	Provided 1997 £'000	Not Provided 1998 £'000	Not Provided 1997 £'000
Capital allowances in advance of depreciation	-	-	(1,310)	(547)
Other timing differences	-	-	(713)	(648)
	<u>-</u>	<u>-</u>	<u>(2,023)</u>	<u>(1,195)</u>

14. CALLED UP SHARE CAPITAL

	1998 £'000	1997 £'000
Authorised 10,000,000 ordinary shares of £1 each	<u>10,000</u>	<u>10,000</u>
Allotted and fully paid 4,077,000 (1997 – 3,462,000) ordinary shares of £1 each	<u>4,077</u>	<u>3,462</u>

On 9 April 1998, J T (UK) Limited, the immediate parent company, purchased 615,000 ordinary equity shares in the company, with a nominal value of £1 each. The total consideration paid for the shares was £6,150,000.

15. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	1998 £'000	1997 £'000
Profit/(loss) attributable to members of the company	1,322	(4,175)
Issue of shares	6,150	-
Net addition/(reduction) to shareholders' funds	<u>7,472</u>	<u>(4,175)</u>
Opening shareholders' funds	6,059	10,234
Closing shareholders' funds	<u>13,531</u>	<u>6,059</u>

THE MANCHESTER TOBACCO COMPANY LIMITED

NOTES TO THE ACCOUNTS Year ended 31 December 1998

16. MOVEMENTS ON RESERVES

	Profit and loss account £'000	Share premium account £'000	Total reserves £'000
Balance at 1 January 1998	(26,259)	28,856	2,597
Profit for the year	1,322	-	1,322
Premium on issue of share capital	-	5,535	5,535
Balance at 31 December 1998	<u>(24,937)</u>	<u>34,391</u>	<u>9,454</u>

17. FINANCIAL COMMITMENTS

	1998 £'000	1997 £'000
Capital commitments		
Contracted for but not provided	<u>673</u>	<u>1,655</u>
Operating lease commitments		
	Land and buildings £'000	Other £'000
Leases which expire:		
Within 1 year	-	4
Within 2 to 5 years	-	4
Over 5 years	-	148

Pension commitments

The company operates a pension scheme providing benefits based on final pensionable pay. The assets of the scheme are held separately from those of the company, being invested with insurance companies. Contributions to the scheme are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives with the company. The contributions are determined by a qualified actuary on the basis of triennial valuations using the projected unit method.

The most recent actuarial valuation, carried out as at 6 April 1997, showed that the market value of the scheme's assets was £1,812,703 which would be sufficient to secure the members entitlements based upon the latest available salaries. The contributions of the company and employees are 12.2% and 5% of earnings respectively.

The pension charge for the year was £386,000 (1997 - £303,000).

The assumptions which have the most significant effect on the results of the valuation are those relating to the rate of return on investments and the rates of increase in salaries and pensions. It was assumed that the investment returns would be 9% per annum and that salary increases would average 8% per annum.

THE MANCHESTER TOBACCO COMPANY LIMITED

NOTES TO THE ACCOUNTS

Year ended 31 December 1998

18. RECONCILIATION OF OPERATING PROFIT/(LOSS) TO NET CASH FLOW FROM OPERATING ACTIVITIES

	1998 £'000	1997 £'000
Operating profit/(loss)	1,153	(5,396)
Depreciation	1,069	5,680
(Profit)/loss on sale of fixed assets	(4)	4
Decrease in stock	615	28
Decrease/(increase) in debtors	562	(461)
Increase/(decrease) in creditors and provisions	2,217	(2,164)
Movement in group balances	(2,435)	2,482
Net cash inflow from operating activities	<u>3,177</u>	<u>173</u>

19. RECONCILIATION OF NET CASH FLOW TO MOVEMENT IN NET DEBT

	1998 £'000	1997 £'000
Increase in cash in the year	1,507	123
Cash outflow/(inflow) from decrease/(increase) in group loans	6,874	(2,650)
Non cash outflow from decrease in group loans	15,860	-
Change in net debt	<u>24,241</u>	<u>(2,527)</u>
Net debt at 1 January	<u>(32,074)</u>	<u>(29,547)</u>
Net debt at 31 December	<u>(7,833)</u>	<u>(32,074)</u>

20. ANALYSIS OF NET DEBT

	At 1 January 1998 £'000	Cash flow £'000	Non-cash flows £'000	At 31 December 1998 £'000
Cash at bank and in hand	24	(21)	-	3
Overdrafts	(1,798)	1,528	-	(270)
Debt due after 1 year	(1,774)	1,507	-	(267)
Debt due within 1 year	(20,900)	(2,426)	15,860	(7,466)
	(9,400)	9,300	-	(100)
Total	<u>(32,074)</u>	<u>8,381</u>	<u>15,860</u>	<u>(7,833)</u>

THE MANCHESTER TOBACCO COMPANY LIMITED

NOTES TO THE ACCOUNTS

Year ended 31 December 1998

21. ULTIMATE PARENT COMPANY

The immediate parent company is J T (UK) Limited, a company incorporated in Great Britain and registered in England and Wales, and the ultimate parent company is Japan Tobacco Inc., a company incorporated and registered in Japan.

Copies of the financial statements of J T (UK) Limited are filed at Companies House, Crown Way, Maindy, Cardiff, CF4 3UZ. Copies of the financial statements of Japan Tobacco Inc. are available from 2-1, Toranomom 2-chome, Minato-Ku, Tokyo 105, Japan.

The company has taken advantage of the exemptions included in Financial Reporting Standard No.8 "Related Party Disclosures" (para 3) for wholly owned subsidiaries not to disclose transactions with entities that are part of the group qualifying as related parties.