

The Accounts of JT Europe Holding BV are being filed
in conjunction with the ~~GALLAHER AUSTRIA LIMITED~~
Accounts under the consolidation exemption under
Section 400 of the Companies Act 2006.

GALLAHER AUSTRIA LIMITED

Annual Report and Financial Statements for the year ended 16 April 2009



Gallaher Austria Limited

Contents

- 2 Directors and Advisers
- 3 Directors' Report
- 5 Statement of Directors' Responsibilities
- 6 Independent Auditors' Report
- 7 Profit and Loss Account
- 7 Statement of Total Recognised Gains and Losses
- 8 Balance Sheet
- 9 Notes to the Financial Statements

Gallaher Austria Limited

Directors and Advisers

Directors

Lorenzo Pillinini

Eddy Pirard

Laura Carr *(resigned 20 March 2008)*

James Boxford *(appointed 20 March 2008)*

Brian Murphy *(appointed 27 March 2008)*

Andrew Chamberlain *(appointed 12 June 2009)*

Secretary

Andrew Bingham

Registered office

Members Hill, Brooklands Road, Weybridge, Surrey KT13 0QU

Statutory auditors

Deloitte LLP

Solicitors

Slaughter & May

Gallaher Austria Limited

Directors' Report

The directors present their report and the audited financial statements for the year ended 16 April 2009, which were approved by the Board on 29 June 2009.

Principal activities and review of business

Gallaher Austria Limited ("the Company") acts as an investment holding company. The Company's principal source of income is dividends from its investment, namely shares in a wholly owned subsidiary, Gallaher Benelux. The timing of such dividends is determined by the Board of the subsidiary, in conjunction with the shareholder, Gallaher Austria Limited. No ordinary dividends were received during the year (2008 - nil). The loss before taxation in the year represents financing costs associated with the funding of the Company's investments and losses due to adverse exchange rate movements on Euro denominated net liabilities.

Post balance sheet events

After the year-end, the Company has been involved in a corporate re-organisation designed to simplify the entity structure within the wider Japan Tobacco group. The Company has received a dividend from its subsidiary, Gallaher Benelux, and the Company's investment in that subsidiary will be further reduced to a nominal value through a return of capital. The Company will then distribute its retained reserves to the shareholder through the payment of a dividend. The overall effect of these actions, which will continue after the date of this report, is to take the Company's balance sheet down to almost a nil position, settling intercompany balances in the process, until no distributable reserves and only nominal share capital remains. These actions are not expected to result in a material loss. It is the intention of the directors that the Company will be sold outside of the Japan Tobacco group to a third party in the near future.

Going concern

Due to the post year end events mentioned above, the directors believe that the company no longer actively trades and this situation is expected to continue for the immediate future. The directors therefore consider it not appropriate to continue to prepare the financial statements on a going concern basis. Refer to note 1 for further information in this regard.

Results and dividends

The Company's profit and loss account set out on page 7 shows a loss on ordinary activities after taxation of £52,786,000 (2008 - loss of £57,585,000). No ordinary dividends were declared or paid during the year (2008 - nil).

Key performance indicators

Given the nature of the business, the Company's directors believe that analysis using key performance indicators for the Company is not necessary or appropriate for an understanding of the development, performance or position of the business.

Principal risks and uncertainties

The Company acts as an intermediate investment holding company and given the nature of the Company, it is not exposed to any credit or liquidity risks because the primary sources of income and expense are intergroup related. The inter-group financing arrangements are determined at the group level.

The Company's assets and liabilities are denominated in foreign currency and it is exposed to foreign current risks. The Company does not seek to manage foreign currency risk as these risks are managed by the Group's treasury function, rather than at an individual business unit level.

Directors

A list of the directors is given on page 2. No director had any interest during the year in the shares of the Company. No director had any interest during the year in any material contract with the Company.

Gallaher Austria Limited

Directors' Report

Continued

Auditors

Each of the persons who is a director at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and
- the director has taken all the steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditors are aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Deloitte LLP have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.



By order of the Board
Lorenzo Pillinini, Director
29 June 2009

Gallaher Austria Limited

Statement of Directors' Responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed; and
- 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 adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. 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.



By order of the Board
Lorenzo Pillinini, Director
29 June 2009

Independent Auditors' Report to the Members of Gallaher Austria Limited

We have audited the financial statements of Gallaher Austria Limited for the year ended 16 April 2009 which comprise Profit and Loss Account, the Balance Sheet, the Statement of total Recognised Gains and Losses and the related notes 1 to 11. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

This report is made solely to the company's members, as a body, in accordance with sections 495 and 496 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 16 April 2009 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Emphasis of matter - Financial statements prepared other than on a going concern basis

In forming our opinion on the financial statements, which is not qualified, we have considered the adequacy of the disclosure made in note 1 to the financial statements, which explains that the financial statements have been prepared on a basis other than that of a going concern.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



Anthony Morris, (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom

30 June 2009

Gallaher Austria Limited

Profit and Loss Account

YEAR ENDED 16 APRIL 2009

	Notes	2009 £000	2008 £000
Exchange losses		(25,065)	(32,844)
Interest payable - on loans from Group undertakings		(48,249)	(49,231)
Loss on ordinary activities before taxation		(73,314)	(82,075)
Taxation	4	20,528	24,490
Loss for the year		(52,786)	(57,585)

The results above relate to continuing operations.

There is no difference between the loss on ordinary activities before taxation and the loss for the year stated above and their historical cost equivalents.

Statement of Total Recognised Gains and Losses

YEAR ENDED 16 APRIL 2009

	2009 £000	2008 £000
Loss on ordinary activities after taxation	(52,786)	(57,585)
Exchange gains on foreign currency investments	86,543	140,421
Exchange losses on borrowings hedging overseas investments	(86,543)	(140,421)
Total recognised losses for the year	(52,786)	(57,585)

Gallaher Austria Limited

Balance Sheet

AT 16 APRIL 2009

	Notes	2009 £000	2008 £000
Fixed assets			
Investments	5	983,734	897,191
Current assets			
Debtors: amounts falling due within one year			
Group relief receivable		31,158	10,625
Amounts owed by Group undertakings		2,070	1,888
		33,228	12,513
Creditors: amounts falling due within one year			
Amounts owed to Group undertakings		(1,301,106)	(1,141,062)
Net current liabilities		(1,267,878)	(1,128,549)
Net liabilities		(284,144)	(231,358)
Capital and reserves			
Called up share capital	6	-	-
Profit and loss account	7	(284,144)	(231,358)
Shareholders' deficit		(284,144)	(231,358)

The financial statements on pages 7 to 11 were approved by the Board of Directors on 29 June 2009 and signed on its behalf by



Lorenzo Pillinini
Director

Gallaher Austria Limited

Notes to the Financial Statements

1. Accounting policies

Basis of accounting

The financial statements are prepared in accordance with the historical cost basis of accounting and accounting standards currently applicable in the United Kingdom.

As permitted under section 400 of the Companies Act 2006, the Company has not prepared consolidated financial statements since it is a wholly owned subsidiary undertaking of JT Europe Holding B.V., a company registered in The Netherlands. The Company and its subsidiaries' results are included in the consolidated financial statement of JT Europe Holding B.V.

The principal accounting policies, which have been applied consistently in the current and prior year are set out below.

Cash flow

The Company has adopted the provisions of Financial Reporting Standard No. 1 (Revised). Accordingly, a cash flow statement has not been included in these financial statements as the Company is a wholly owned subsidiary undertaking of Japan Tobacco Inc., which prepares a consolidated cash flow statement which incorporates the cash flows of the Company.

Foreign currencies

Assets and liabilities denominated in foreign currencies are translated into pounds sterling at rates of exchange ruling at the balance sheet date. The Company's overseas equity investment is hedged by borrowings in the currency in which the asset is denominated. Exchange differences arising on the retranslation of the overseas investment, less exchange differences on the borrowings, to the extent that they finance those investments, are taken to reserves. Other exchange gains and losses are dealt with in the profit and loss account at the exchange rate ruling on the date of the transactions.

Fixed asset investments

Fixed asset investments are carried at cost, less provision for impairment where appropriate.

Going concern

The Company's business activities, together with the factors likely to affect its future development, performance and position and subsequent events are set out in the Directors' Report on pages 3 and 4. Based on these factors, the financial statements have been prepared on a basis other than that of a going concern which includes, where appropriate, writing down the company's assets to net realisable value. Provision has also been made for any onerous contractual commitments at the balance sheet date. The financial statements do not include any provision for the future costs of terminating the business of the company except to the extent that such were committed at the balance sheet date.

Current taxation

Current taxation, including the UK corporation tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation

The Company provides for deferred tax assets and liabilities arising from reversing timing differences between the recognition of gains and losses in the financial statements and their recognition for tax purposes. Deferred tax assets are only recognised where it is more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

2. Directors and employees

The remuneration of the directors of the Company during the period was borne by other companies within the Group and no specific allocation is made in respect of the services of the directors to the Company. Accordingly their emoluments have not been disclosed in these financial statements.

The Company has no employees, other than the directors.

Gallaher Austria Limited

Notes to the Financial Statements

Continued

3. Auditors' remuneration

The auditors' remuneration of £5,000 in respect of the statutory audit of the financial statements of the Company is incurred by Gallaher Limited, a fellow subsidiary company (2008 - £5,000). The auditors have received no other remuneration during the period (2008 - nil).

4. Tax on loss on ordinary activities

a) Analysis of the credit for the year

	2009 £000	2008 £000
Current tax	-	-
Deferred tax	-	-
Group relief	(20,528)	(24,490)
Tax credit on loss on ordinary activities	(20,528)	(24,490)

b) Factors affecting the credit for the year

	2009 £000	2008 £000
Loss on ordinary activities before tax	(73,314)	(82,075)
Loss on ordinary activities multiplied by standard rate of corporation tax in the UK of 28% (2008 - 28%)	(20,528)	(22,981)
Effects of:		
Change in UK corporation tax rate	-	(1,509)
Losses surrendered to group companies	20,528	24,490
Current tax charge for the year	-	-

The UK corporation tax rate changed from 30% to 28% on 1 April 2008. The reconciliation has been performed using the rate applicable at the Company's year end.

No provision for deferred tax is made as there are no material timing differences.

5. Fixed asset investments

Shares in subsidiary undertaking	£000
At 17 April 2008	897,191
Exchange adjustments	86,543
At 16 April 2009	983,734

At 16 April 2009, the Company is the beneficial owner of all of the ordinary equity share capital of its subsidiary, Gallaher Benelux (formerly Gallaher Benelux Limited), an investment holding Company incorporated in Great Britain.

Exchange losses on foreign currency loans amounting to £86,543,000 (2008 - losses of £140,421,000) have been offset in reserves against exchange gains (2008 - gains) on the net investment in Gallaher Benelux.

6. Called up share capital

	2009 £000	2008 £000
Authorised - 500,000,000 ordinary shares of £1 each	500,000	500,000
Allotted and fully paid - 1 ordinary share of £1	-	-

Gallaher Austria Limited

Notes to the Financial Statements

Continued

7. Reserves

	Profit and loss account £000
Movements during the year:	
At 17 April 2008	(231,358)
Loss for the year	(52,786)
Exchange gains on foreign currency investments (note 5)	86,543
Exchange losses on borrowings hedging overseas investments (note 5)	(86,543)
At 16 April 2009	<u>(284,144)</u>

8. Reconciliation of movements in shareholders' deficit

	2009 £000	2008 £000
Loss for the year	(52,786)	(57,585)
Exchange gains on foreign currency investments	86,543	140,421
Exchange losses on borrowings hedging overseas investments	<u>(86,543)</u>	<u>(140,421)</u>
Net increase in shareholders' deficit	<u>(52,786)</u>	<u>(57,585)</u>
Opening shareholders' deficit	<u>(231,358)</u>	<u>(173,773)</u>
Closing shareholders' deficit	<u>(284,144)</u>	<u>(231,358)</u>

9. Related party transactions

In accordance with the exemptions offered by Financial Reporting Standard No. 8, there is no disclosure in the financial statements of transactions with entities that are part of Japan Tobacco Inc. and its subsidiaries.

10. Ultimate holding company and consolidation

The Company is a wholly owned subsidiary of Gallaher Group Limited (formerly "Gallaher Group Plc"), a company incorporated in Great Britain and registered in England and Wales.

The smallest group in which the results of the Company are consolidated is JT Europe Holding B.V., registered in the Netherlands. Copies of the consolidated financial statements of JT Europe Holding B.V. may be obtained from Vreelandseweg 46, Hilversum, Noord-Holland, Netherlands 1216.

Japan Tobacco Inc., which is registered in Japan, is regarded as the ultimate holding company and the largest group in which the results of the Company are consolidated. Copies of the consolidated financial statements of Japan Tobacco Inc. may be obtained from 2-2-1 Toranomon, Minato-ku, Tokyo, 105-8422, Japan.

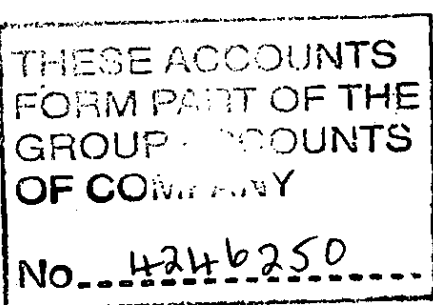
11. Post balance sheet events

As set out in the Directors' report on pages 3 and 4, after the year end as part of a JT group wide re-organisation, the Company has been involved in a restructuring that will eventually take the Company balance sheet to a nil position with the exception of nominal share capital. No material loss is expected to arise from this restructuring.

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in conjunction with the ~~GALLAHER AUSTRALIA LIMITED~~
Accounts under the consolidation exemption under
Section 400 of the Companies Act 2006.

ANNUAL REPORT 2008

JT EUROPE HOLDING B.V., AMSTERDAM



Statutory seat:
Office address:

Amsterdam, the Netherlands
Vreelandseweg 46
1216 CH Hilversum,
The Netherlands

CONTENTS

Managing Directors' Report

Managing Directors' Report	1
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Annual accounts 2008

Consolidated financial statements

Consolidated balance sheet as of December 31, 2008	6
Consolidated statement of income 2008	8
Consolidated cash flow statement 2008	9
Notes to the consolidated financial statements	11

Company financial statements

Company balance sheet as of December 31, 2008	58
Company statement of income 2008	59
Notes to the company financial statements	60

Other Information

Statutory rules concerning appropriation of result	64
Appropriation of result for the financial year 2007	64
Proposed appropriation of result for the financial year 2008	64
Subsequent events	64
Auditor's report	65

The page number of the last page is	64
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MANAGING DIRECTORS' REPORT

General

JT Europe Holding B.V. "the Company") and its JTI Group ("JTI") are a leading multinational tobacco business with a strong portfolio of brands deployed across numerous markets around the world. JT Europe Holding B.V. is a wholly-owned subsidiary of Japan Tobacco Inc. ("JT"). JTI has a license agreement with JT, granting JTI the exclusive rights to use certain JT trademarks outside the United States.

1 Developments in the period ended December 31, 2008

JTI is the profit growth engine of JT by taking advantage of its geographic profile and competitive edge in brands and people.

In 2008, JTI increased its sales volume by 17.3 percent to 452.3 billion cigarettes compared to the previous year. Gallaher results have been incorporated as of April 18, 2007.

Global Flagship Brands ("GFB") sales volume increased 20.8 percent to 245.5 billion cigarettes compared to the previous year. Total sales volume for Winston grew by 13.8 percent due to robust sales mainly in Russia, Turkey, Ukraine, Spain, France, Italy and the Near East. Total sales volume for Camel rose 10.3 percent, supported by strong sales in Italy, Russia and Spain. Total sales volume for Mild Seven increased 11.4 percent during the period with gains in Korea, Taiwan, Russia and Malaysia.

GFB performance also reflected the additional contribution of Benson & Hedges and Silk Cut in the United Kingdom and Ireland; and LD, Sobranie and Glamour in Russia, Kazakhstan and Ukraine.

Net sales excluding tax amounted to USD 10.652 billion, an increase of 32.7 percent from the previous year. Net sales per thousand cigarettes, excluding tax, rose to USD 23.6, up to 13.1 percent.

2 Financial position as at year-end 2008

The balance sheet as at year-end 2008 includes intangible fixed assets for an amount of USD 19,826 million (2007: USD 22,045 million). Total assets amount to USD 30,194 million (2007: USD 32,405 million). Total group equity of the Company amounts to USD 17,157 million (2007: USD 16,899 million). Current liabilities as per year-end amount to USD 5,236 million (2007: USD 6,330 million).

3 Result analysis

Net sales were USD 12,496 million (2007: USD 9,354 million), an increase of USD 3,142 million (2007: increase USD 4,336 million) or 33.6% (2007: + 86.4%) compared to the previous financial year. We refer to paragraph 1 for further details on the result analysis.

4 Risk exposure

Risks, uncertainties or other factors that could cause actual results to differ materially from those expressed in any forward-looking statement include, without limitation:

1. health concerns relating to the use of tobacco products;
2. legal or regulatory developments and changes, including, without limitation, tax increases and restrictions on the sale, marketing and usage of tobacco products, and governmental investigations and privately imposed smoking restrictions;
3. litigation and claims;
4. our ability to further diversify our business beyond the tobacco industry;
5. our ability to successfully expand internationally;
6. competition and changing consumer preferences;
7. the impact of any acquisitions or similar transactions;
8. global economic conditions; and
9. fluctuations in foreign exchange rates and the costs of raw materials.

JTI conducts business on a multi-national basis in a wide variety of foreign currencies and, as such, uses derivative financial instruments to reduce earnings and cash flow volatility associated with foreign exchange rate changes. In 2008 and 2007, JTI used foreign currency forwards, swaps and options to economically hedge its exposure to fluctuations in Euro, Sterling, Korean Won, Singapore Dollars, Mexican Peso, Taiwan Dollars, Japanese Yen and certain other currencies. All foreign currency derivative contracts have maturities of twelve months or less.

JTI does not designate derivative instruments in accounting hedge relationships. Accordingly, all changes in the fair values of derivatives are recorded in the income statement.

As a result of the use of derivative instruments, JTI is exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. To mitigate the counterparty

credit risk, JTI has a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors, and maintains strict dollar and term limits that correspond to each institution's credit rating.

JTI's established policies and procedures for mitigating credit risk on principal transactions include reviewing and establishing limits for credit exposure and continually assessing the creditworthiness of counterparties. ISDA agreements with counterparties give JTI the option to net amounts due from JTI to a counterparty with amounts due to JTI from a counterparty reducing the maximum loss from credit risk in the event of counterparty default. At December 31, 2008, there were no significant concentrations of credit risk with any individual counterparty or groups of counterparties related to JTI's use of derivative contracts.

5 Research and development

Costs incurred on development projects would be recognized as intangible fixed assets when it is probable that JTI will achieve economic benefits in the future, considering its commercial and technological feasibility, and costs can be measured reliably. However, as these costs do not meet aforementioned criteria, research and development costs are expensed as incurred. For 2008 the research and development costs amount to USD 68 million (2007: USD 53 million). During the years ended 31 December 2008 and 2007 JTI received reimbursements of product development costs from JT of USD 32 million and USD 24 million respectively.

6 Employee information

JTI employed an average number of 23,942 employees during 2008 (2007: 23,103).

7 Distribution of earnings

The distribution of the earnings of the Company is at the disposal of the general meeting of shareholders. The board of directors proposes that the 2008 profit is added to the retained earnings.

The financial statements do not yet reflect this proposal.

8 Future Outlook

The first quarter of 2009 showed a significant contraction because of persistent US dollar strength. On a neutral currency basis, however, our growth continued due to favorable pricing, higher GFB volumes and market share gains.

Total sales volume decreased by 1.4% to 100.9 billion cigarettes when compared to the previous

year. However, this decline was primarily driven by the timing of shipments in the Near East and Belarus, the enforcement of sales policies in Ukraine and the change of business model in the Philippines. Excluding the aforementioned factors, sales volumes increased by 2%, driven by share gains in a number of key markets including Russia, Italy, Taiwan, Spain, France, Turkey, Canada, Greece, Malaysia, Switzerland and Sweden.

Our GBF's grew by 2.6% versus the prior year to reach 57.1bn cigarettes. GFBs now account for 57% of total JTI volumes, compared to 54% in the same quarter of last year. Winston and Mild Seven enjoyed solid growth and LD and Glamour both posted strong double-digit gains over the period.

Volume of our non-global flagship brands declined by 6.2%, versus last year, to 43.8bn cigarettes.

Net Sales declined by 10.8% compared to the previous year, as a result of ongoing US dollar strength against key currencies. This, however, came as no surprise, and upon elimination of these adverse currency shifts, Net Sales grew 8.5% versus last year. Favorable pricing was the primary driver of this strong performance. GFB Net Sales grew 10.6% and GFB net sales-per-thousand reached US 29.70, up USD 2.13 versus last year.

As noted above, the latter part of 2008 was marked by the collapse of financial markets and rapidly weakening economies around the world. Whilst the tobacco industry is more resilient than most industries during periods of downturn, it is likely that the adverse currency shifts will have an impact on JTI. JTI reports its results in US dollars, which grew stronger against key currencies, most notably the Russian Ruble and British Pound, in the fourth quarter of last year. Whilst the fundamentals of the business remain strong, a stronger dollar will reduce earnings for JTI. JTI is currently reviewing its strategies to identify opportunities to mitigate the negative impact of the economic crisis.

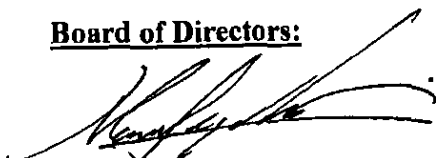
In June 2009, JTI concluded an agreement with Tribac Leaf Limited and its affiliates (Tribac), a leaf tobacco supplier, to acquire Tribac's business. In addition JTI will enter into a long-term agreement with Tribac for the supply of leaf tobacco from Zimbabwe. The legal ownership transfer for Tribac has not yet taken place, as it is subject to several conditions, including approval from relevant anti-trust authorities. JTI expects the legal ownership transfer to take place later in 2009, as soon as all conditions are met. In a separate transaction, JTI signed an agreement with U.S.-based leaf tobacco suppliers Hail & Cotton and J.E.B to form a joint venture company JTI Leaf Services LLC (JTILS) for the procurement and processing of U.S. leaf tobacco.

9 Others

Further information about the performance of JT can be found in the annual report 2008/2009 of Japan Tobacco Inc, Japan, the ultimate parent company of JT Europe Holding B.V.

Amsterdam, June 30, 2009

Board of Directors:



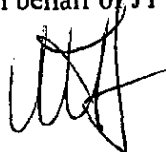
M. Yamaguchi



M. Terabatake

M. Franke

On behalf of JT International Netherlands B.V. (appointed as per 28 November, 2008)



CONSOLIDATED BALANCE SHEET
December 31, 2008
(before proposed appropriation of result)

A s s e t s

(in millions of USD)

	December 31, 2008		December 31, 2007	
	USD	USD	USD	USD
Fixed assets				
Goodwill	15,993		16,872	
Trademarks	3,762		5,074	
Distribution agreements	71		99	
		19,826		22,045
Intangible fixed assets (1)				
Land, buildings and structures	753		878	
Machinery and equipment	1,203		1,328	
Fixed assets under construction	270		194	
		2,226		2,400
Tangible fixed assets (2)				
Non-consolidated participations	211		253	
Debt and equity securities	60		113	
Deferred taxes	603		417	
		874		783
Financial fixed assets (3)				
Total fixed assets		22,926		25,228
Current assets				
Finished products	658		671	
Work in progress	19		23	
Leaf tobacco	1,693		1,414	
Wrapping materials	146		131	
Other	75		83	
		2,591		2,322
Inventories (4)				
Accounts and notes receivable	2,173		2,050	
Affiliates	2		1	
Prepaid expenses and excise taxes	873		650	
Other assets and deferred charges	199		352	
Other current assets	245		464	
		3,492		3,517
Receivables and prepaid expenses (5)				
Cash and cash equivalents (6)		1,185		1,338
Total current assets		7,268		7,177
Total assets		<u>30,194</u>		<u>32,405</u>

Group equity and liabilities

(in millions of USD)

	December 31, 2008		December 31, 2007	
	USD	USD	USD	USD
Group equity (7)				
Equity attributable to equity holder	17,057		16,785	
Minority interest	100		114	
Total Group equity		17,157		16,899
Provisions (8)				
Provision for pension obligations	736		794	
Provision for deferred income taxes	1,053		1,553	
Restructuring	359		357	
RGI valuation payment	165		202	
		2,313		2,906
Long-term liabilities (9)				
Long-term borrowings	4,751		5,713	
Tax liabilities	544		430	
Capital leases	8		8	
LTIP programme liability	107		50	
Reserve for indemnities	10		13	
Reserve for other employment benefit costs	19		51	
Others	49		5	
		5,488		6,270
Current liabilities (10)				
Affiliates	124		848	
Short-term borrowings	1,141		1,281	
Trade accounts payable	549		512	
Excise and sales tax payable	1,402		1,346	
RGI valuation payment, current portion	140		155	
Accrued expenses	835		875	
Other current liabilities	1,045		1,313	
		5,236		6,330
Total equity and liabilities		<u>30,194</u>		<u>32,405</u>

CONSOLIDATED STATEMENT OF INCOME
Year ended December 31, 2008

(in millions of USD)

	2008	2007
	USD	USD
Gross sales	30,655	22,818
Less: excise taxes	18,159	13,464
Net sales (11)	12,496	9,354
Cost of sales	6,463	4,863
Gross margin	6,033	4,491
Selling and related expenses	2,961	1,369
General and administrative expenses	1,598	2,161
Total expenses	4,559	3,530
Operating result	1,474	961
Net interest result (12)	(332)	(193)
Net foreign exchange result	(181)	(193)
Net other financial expenses (13)	32	(82)
Net financial result	(481)	(468)
Result on ordinary activities before taxation	993	493
Income taxes (14)	(572)	(216)
Result on ordinary activities after taxation	421	277
Minority interest	(21)	(17)
Net result for the year	400	260
Adjustment to initially apply FIN 48	–	(89)
Foreign currency translation adjustment	380	(103)
Hedge of net investment losses, net of tax	(384)	–
Current year change in deferred tax assets, originally credited to equity	–	(37)
Effect of changing pension plan measurement date, net of tax	(9)	–
Additional minimum pension liability, net of tax	(115)	35
Comprehensive income/(loss)	272	66

CONSOLIDATED STATEMENT OF CASH FLOWS
Year ended December 31, 2008

(in millions of USD)

	2008		2007	
(According to the indirect method)	USD	USD	USD	USD
Cash flows from operating activities				
Net result for the year	400		260	
Adjustment for:				
Depreciation and amortization	1,577		1,242	
Minority interest	21		17	
Provision against accounts receivable and inventories	(5)		(3)	
Loss on disposal of property, plant and equipment	1		29	
Earnings from equity-method investments	(22)		(19)	
Other-than-temporary impairment of marketable Securities	58		57	
Deferred income taxes	(41)		(14)	
Changes in assets and liabilities, net of acquired companies:				
(Increase)/decrease in accounts receivable	(411)		(326)	
(Increase)/decrease in inventories	(440)		(284)	
(Increase)/decrease in prepaid expenses and other receivables and current assets	(230)		293	
Increase/(decrease) in accounts payable	(89)		(164)	
Increase/(decrease) in other accounts payable and accrued liabilities	500		(66)	
Increase/(decrease) in balances due to/from affiliates	(7)		(6)	
Increase/(decrease) in accrued income taxes	2		(3)	
Net cash provided by (used in) operating activities		1,314		1,013

	2008		2007	
	USD	USD	USD	USD
Cash flows from investing activities				
Purchase of property, plant and equipment	(545)		(436)	
Proceeds from sale of property, plant and equipment	18		26	
Acquisitions, net of cash received	–		(14,520)	
Movement in intangible fixed assets			–	
Proceeds from sales of businesses	4		–	
Purchase of short-term investments, net of proceeds	6		(173)	
Net cash used in investing activities		(517)		(15,103)
Cash flows from financing activities				
Net increase/(decrease) in short-term borrowings from JT	(5)		690	
Repayment of short-term borrowings from JT	(703)		–	
Proceeds from long-term borrowings	465		2,532	
Repayment of long-term	(599)		(882)	
Proceeds from issuance of share capital	–		10,624	
Dividends paid to minority interest shareholders	(27)		(24)	
Current year changes in deferred tax assets, Originally credited to equity	–		(37)	
Net cash provided by financing activities		(869)		12,903
Effect of exchange rate changes on cash and cash equivalents		(81)		412
Net increase/(decrease) in cash and cash equivalents		(153)		(775)
Cash and cash equivalents at beginning of year		1,338		2,113
Cash and cash equivalents at end of year		1,185		1,338

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2008

General

JT Europe Holding B.V., ("the Company") having its statutory seat in Amsterdam and offices in Hilversum, the Netherlands, is a wholly-owned subsidiary of Japan Tobacco Inc. ("JT"), Tokyo, Japan.

Operations

JT Europe Holding B.V. ("the Company") and its JTI Group ("JTI") are a leading multinational tobacco business with a strong portfolio of brands deployed across numerous markets around the world. JT Europe Holding B.V. is a wholly-owned subsidiary of Japan Tobacco Inc. ("JT"). JTI has a license agreement with JT, granting JTI the exclusive rights to use certain JT trademarks outside the United States.

The Company and JTI are a leading multinational competitor in the global tobacco industry and compete in the American/Virginian blend segment of the international cigarette market.

The list of directly and indirectly held investments of the Company is filed with the Trade Register in line with article 2:379 sub 5 of the Netherlands Civil Code.

Relationship with Japan Tobacco Inc. and affiliated companies

JTI has a license agreement with JT, granting JTI the exclusive rights to use certain JT trade marks outside the United States and Japan.

RGI Valuation Payment

As part of 2007 Gallaher acquisition, JTI acquired a 50% interest in R.J. Reynolds-Gallaher International Sarl, a joint venture with R.J. Reynolds Tobacco C.V. ("RJRTCV"). The joint venture marketed American-blend cigarettes primarily in Italy, France and Spain.

RJRTCV exercised its contractual right to terminate the joint venture prior to its expiration date as a result of the change in control of Gallaher. The joint venture agreement required the party whose licensed trademarks had a greater value upon termination to pay the other party a valuation payment computed in accordance with the terms of the agreement.

The joint venture was terminated on December 31, 2007. In February 2008, JTI agreed to pay a valuation payment of USD 388 million (EUR 265 million). Of that amount, USD 155 million

JTI Group is JT International Holding B.V. ("JTIH"), statutory seat in Hilversum, The Netherlands, and its subsidiaries. JT International Holding B.V. is a fully-owned subsidiary of JT Europe Holding B.V., having its statutory seat in Amsterdam, which in turn is a fully-owned subsidiary of Japan Tobacco Inc., Japan or Japan Tobacco Inc.

(EUR 106 million) was paid on April 18, 2008 and USD 38.8 million (EUR 26.5 million) will be paid in each of the following six years. The present value of future payments was recognized in the Company's consolidated balance sheet as part of liabilities assumed in the Gallaher business combination.

Consolidation Principles

The consolidated financial statements include the international tobacco operations in which the Company directly or indirectly owns more than 50 percent of the voting stock. All significant inter company balances and transactions have been eliminated. The year-end of Japan Tobacco (Hong Kong) Limited differs from the year-end of the Company by three months.

Investments in entities over which JTI exercises significant influence and Joint Ventures are accounted for using the equity method of accounting, and JTI's proportionate share of income or loss is recorded in net other financial expenses, in its consolidated statements of income.

The financial information relating to the Company and JTI is presented in the consolidated financial statements. Accordingly, in accordance with article 2:402 of the Netherlands Civil Code, the Company financial statements only contain an abridged profit and loss account.

Financial information relating to the group companies and the other legal entities and companies included in the consolidation is fully included in the consolidated financial statements, eliminating the inter company relationships and transactions. Third-party shares in equity and results of group companies are separately disclosed in the consolidated financial statements.

The results of newly acquired group companies and the other legal entities included in the consolidation are consolidated from the acquisition date. At that date the assets, provisions and liabilities are measured at fair values. Goodwill paid is capitalised, to which amortisation is charged based on the estimated useful life. The results of participations sold during the year are recognised until the moment of disposal.

General accounting principles for the preparation of the consolidated financial statements

The financial statements have been prepared under the historical cost convention in accordance with accounting principles generally accepted in the Netherlands and comply with the financial reporting requirements included in Section 9 of Book 2 of the Netherlands Civil Code.

On January 1, 2007, JTI adopted the provisions of FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*. This Interpretation prescribes a recognition threshold and a measurement attribute for tax positions taken (or expected to be taken) in a tax return. Benefits of a tax position are recognized when the position is more likely than not to be sustained, based on its technical merits, upon examination by taxing authorities.

Management believes that FIN 48 can be applied by the Company in its consolidated statutory Dutch GAAP financial statements as it meets the requirements of a true and fair view.

The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. JTI classifies FIN 48 interest and penalties as a component of income tax expense.

On January 1, 2008, JTI adopted the provisions of SFAS No. 157, *"Fair Value Measurements"* that defines the term fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measurements. Fair value is defined as the price that would be received for an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants on the measurement date.

GAR 290 paragraph 524 mentions that the fair value of financial instruments is established based on generally accepted measurement models and evaluation techniques. GAR 290 does not prescribe a particular valuation model. Management believes that SFAS No. 157 can be applied by the Company in its consolidated statutory Dutch GAAP financial statements as it meets the requirements of fair value measurements and provides a framework for measuring fair value and enhances disclosures thereon.

SFAS No. 157 describes three levels of inputs that may be used to measure fair value:

Level 1

Level 1 inputs are quoted prices in active markets for identical assets or liabilities that JTI has the ability to access at the measurement date.

Level 2

Level 2 inputs are observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities. Level 2 assets and liabilities include derivative contracts whose value is determined using a pricing model or discounted cash flow methodologies with inputs that are

observable in the market or can be derived principally from or corroborated by observable market data.

Level 3

Level 3 inputs are unobservable inputs that are supported by little or no market activity. Valuation of Level 3 assets and liabilities requires significant management judgment.

Costs incurred on development projects would be recognized as intangible fixed assets when it is probable that JTI will achieve economic benefits in the future, considering its commercial and technological feasibility, and costs can be measured reliably. However, as these costs do not meet aforementioned criteria, research and development costs are expensed as incurred.

Valuation of assets and liabilities and determination of the result takes place under the historical cost convention. Unless presented otherwise at the relevant principle for the specific balance sheet item, assets and liabilities are presented at face value.

Income and expenses are accounted for on accrual basis. Profit is only included when realized on the balance sheet date. Losses originating before the end of the financial year are taken into account if they have become known before preparation of the financial statements.

Sales from goods are recognized upon delivery. The cost price of these goods is allocated to the same period. Revenues from services are recognised in proportion to the services rendered. The cost price of services is allocated to the same period.

Translation of foreign currency

Assets and liabilities denominated in foreign currencies are translated into the applicable local currencies at exchange rates prevailing on balance sheet date. Foreign currency transactions are translated at exchange rates prevailing on the date of transaction. Resulting foreign currency exchange results are included in the statement of income.

The Company's functional currency is the US dollar. Financial statements of subsidiaries are generally measured using the local currency as the functional currency. Financial statements of subsidiaries denominated in foreign currencies are translated into US dollars, the reporting currency, at the exchange rates prevailing on balance sheet date in respect of assets and liabilities, whereas revenues, expenses, gains and losses are translated into US dollars at the average exchange rate for the year. Resulting foreign currency gains and losses are included in the currency translation adjustment account as part of shareholder's equity. For subsidiaries operating in highly inflationary economies, the US dollar is the functional currency. Remeasurement adjustments for highly inflationary economies and other transactional gains and losses are included in the income statement.

US dollar financial statements

The Company belongs to a multinational, which is operating on a world-wide basis. Therefore, the Company chooses the US Dollar as its functional currency. Consequently, in accordance with Article 2:362, Section 7 of the Netherlands Civil Code, the financial statements are presented in US dollars. All amounts in these financial statements are recorded in millions of US dollars, unless stated otherwise.

Foreign currency arrangements

JTI uses various financial instruments, including foreign currency forward contracts, to manage and reduce risk to JTI by generating cash flows which offset the cash flows of certain transactions in foreign currencies or underlying financial instruments in relation to their amount and timing. JTI's derivative financial instruments are used as risk management tools and not for speculative or trading purposes. Although not material, these derivatives represent assets and liabilities and are classified as other current assets or other current liabilities on the Consolidated Balance Sheet. Gains and losses on the changes in the fair values of JTI's derivative instruments are included in other expense, net on the consolidated income statement.

Use of estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the Netherlands requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Intangible fixed assets

Intangible fixed assets are stated at historical cost less accumulated amortization. Amortization is reported on a straight-line basis over the estimated useful lives of the related assets. The estimated useful lives are as follows:

- Goodwill: 20 years. With the acquisition of the Gallaher Group in 2007, the estimated useful life was changed from 40 to 20 years; to bring the useful life more in line with the business and the estimated useful lives of the trademarks.
- Trademarks: 20 years.
- Distribution agreements: 6 years.

For the goodwill, management has selected a 20-year amortization period based on the long-established lives of JTI's major brands.

For the trademarks, management has selected a 20-year amortization period based on the long-established lives of JTI's major brands and JTI's significant ongoing support of such brands.

Management evaluates the recoverability of goodwill and trademarks on an annual basis? The carrying value of intangible fixed assets would be reduced if it is probable that management's best estimate of future operating income before amortization of goodwill and trademarks from related operations, on a discounted basis, will be less than the carrying value over the remaining amortization period.

Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation reported on a straight-line basis over the estimated useful lives of the related assets. The estimated useful lives of machinery and equipment generally vary between 3 and 8 years, while the estimated useful lives of buildings and structures vary generally between 20 and 50 years. Land and fixed assets under construction are not depreciated.

The cost of repairs and the maintenance expenses for buildings are expensed directly in the income statements in the year of occurrence.

Financial fixed assets

Investments in subsidiaries are stated at the Company's share of the respective net asset values. Investments and participations, which are not consolidated, are stated at the lower of cost or net realizable value.

Inventories

Inventories are stated at the lower of cost or market. The cost of inventories is primarily stated using the weighted-average cost method. In accordance with recognized industry practice, stocks of tobacco that must be cured for more than one year are classified as current assets.

Receivables

Trade receivables are stated at face value less any provision for doubtful accounts.

Cash and cash equivalents

Cash equivalents include all short-term, highly liquid investments that are readily convertible to known amounts of cash that have original maturities of three months or less.

Provisions

Retirement benefits

Under GAR 271, "Employee Benefits", paragraph 101, JTI accounts for its defined benefit pension plans and its non-pension postretirement benefit plans using actuarial models as required by SFAS No. 87, "Employers' Accounting for Pensions" as amended by SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 106 and 132(R)" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions," respectively. These models use an attribution approach that generally spreads individual events over the service lives of the employees in the plan. Examples of "events" are plan amendments and changes in actuarial assumptions such as discount rates, long-term rates of return, rates of compensation increases and mortality. The principle underlying the attribution approach is that employees render services over their service lives on a relatively smooth basis and, therefore, pensions and non-pension postretirement benefits are earned in, and should follow the same pattern.

JTI uses the "corridor approach" whereby to the extent that cumulative actuarial gains and losses and prior service costs exceed 10 percent of the greater of the fair value of the plan assets and the projected benefit obligation at the beginning of the fiscal year, they are amortized to income over the average remaining service lives of participating employees.

One of the principal components of the net periodic pension cost is the expected long-term rate of return on plan assets. The required use of expected long-term rates of return on plan assets may result in recognized pension income that is greater or less than the actual returns of those plan assets in any given year. Over time, however, the expected long-term returns are designed to approximate the actual long-term returns, and therefore, result in a pattern of income and expense recognition that more closely matches the pattern of services provided by employees.

Effective December 31, 2006, JTI adopted the recognition provisions of SFAS No. 158. Accordingly, the Company's consolidated balance sheets include the total of the fair value of the plan assets less the projected benefit obligation. The funded status for all plans in surplus is classified as a non-current asset. The funded status for all plans in deficit is classified as a non-current liability, except for benefits expected to be paid within 12 months of the balance sheet date, which are classified as a current liability.

Effective January 1, 2008, JTI adopted the measurement provisions of SFAS No. 158 (see Note 14). The effect of adoption is disclosed in the Company's consolidated statement of stockholder's equity for the year ended December 31, 2008.

Other provisions

Other provisions are valued at nominal value.

Other provisions include remaining liabilities from restructuring activities announced by JTI.

Long-term liabilities

Recorded interest-bearing loans and liabilities are valued at amortised cost.

Net sales

Net sales represent amounts invoiced for goods supplied, net of value added and excise taxes, discounts and commissions. Sales are recognized at the moment of the transfer of ownership of the goods.

Advertising

Advertising costs are generally expensed as incurred.

Financial instruments

JTI uses various financial instruments, including foreign currency forward contracts, to manage and reduce risk to JTI by generating cash flows which offset the cash flows of certain transactions in foreign currencies or underlying financial instruments in relation to their amount and timing.

JTI does not designate derivative instruments in accounting hedge relationships. JTI's derivative financial instruments are used as risk management tools and not for speculative or trading purposes. JTI measures all derivatives, including certain derivatives embedded in other contracts, at fair value and recognizes them in the balance sheet as an asset or liability. Gains and losses on the changes in the fair values of JTI's derivative instruments are included in foreign exchange result. This could result in a gain or loss from fluctuations in exchange rates related to a derivative contract, being recognized in a period which may be different from the loss or gain recognized from the underlying forecasted transaction. However, JTI has procedures to manage risks associated with its derivative instruments, which include limiting the duration of the contracts and the amount of the underlying exposures that can be economically hedged. JTI also utilizes non-derivative financial instruments including letters of credit.

Non-derivative instruments, such as foreign-currency-denominated debt, may be designated as hedges of the net investment in a foreign operation. Gains (losses) on non-derivative instruments that have been designated and have qualified as hedging instruments are included in the cumulative translation adjustment on a net of tax basis. JTI applies this on individual documentation per individual hedge relationship. JTI records the way in which the hedge relations suit the goals of the risk management, the hedge strategy and the expectation in respect of the hedge's effectiveness.

Cash and cash equivalents, debt and equity securities and derivative financial instruments are recognized and measured at fair value in the Company's consolidated balance sheets. Carrying amounts of receivables, payables, accrued expenses, and short-term debt approximate their fair values.

Long-term debt: At December 31, 2008, the carrying amount and the estimated fair value of long-term debt were USD 4.8 billion and USD 5.1 billion, respectively. Fair values are estimated based on market prices (for public debt) or interest rates currently available to JTI for borrowings with similar terms and remaining maturities (for bank debt).

Debt securities: Debt securities included in current assets represent securities that are expected to be realized in cash within 12 months of the balance sheet date. Debt securities that are not expected to be realized in cash within 12 months of the balance sheet date are classified as long-term assets.

Debt securities are classified as available-for-sale and reported at fair value with unrealized gains and losses, net of applicable taxes, recorded in accumulated other comprehensive income within stockholder's equity. Realized gains and losses are computed based on the specific identification method and included in 'Net other financial expenses', net, in the consolidated statement of income.

Other-than-temporary declines in fair value of debt securities are charged to earnings in the period in which the loss occurs. In determining whether an other-than-temporary decline in the market value has occurred, JTI considers the duration that, and extent to which, fair value of the investment is below its original cost. In 2008 and 2007, JTI recorded impairment charges of USD 58 million and USD 57 million, respectively, related to certain asset-backed commercial paper ("ABCP") held by its consolidated subsidiary in Canada (see Note 3).

To the extent financial instruments do not have quoted market prices, considerable judgment is required in developing estimates of fair value. Estimates are not necessarily indicative of the amounts JTI could realize in a current market transaction.

Effective January 1, 2008, JTI adopted the provisions of SFAS No. 157, "Fair Value Measurements," that defines the term fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measurements. Fair value is defined as the price that would be received for an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants on the measurement date. The adoption of this Statement did not have a material effect on the Company's consolidated financial statements.

SFAS No. 157 describes three levels of inputs that may be used to measure fair value:

Level 1

Level 1 inputs are quoted prices in active markets for identical assets or liabilities that JTI has the ability to access at the measurement date.

Level 2

Level 2 inputs are observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities. Level 2 assets and liabilities include derivative contracts whose value is determined using a pricing model or discounted cash flow methodologies with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

Level 3

Level 3 inputs are unobservable inputs that are supported by little or no market activity. Valuation of Level 3 assets and liabilities requires significant management judgment.

Financial assets and liabilities measured at fair value on a recurring basis are summarized below:

	December 31, 2008			
	Level 1	Level 2*	Level 3**	Total
(in millions of USD)				
Assets				
Debt and equity securities	16	-	46	62
Derivative assets	-	114	-	114
Total assets				176
Liabilities				
Derivative liabilities	-	101	-	101
Total liabilities				101

* Derivatives include USD 24 million of assets and USD 4 million of liabilities held with JT.

** See Note 3 for further discussion of ABCP valuation and related impairment charges. There were no amounts included in other comprehensive income with respect to Level 3 financial instruments in either 2008 or 2007.

In February 2008, the FASB issued FASB Staff Position ("FSP") No. 157-2 "Effective date of FASB Statement No. 157" which defers the effective date of SFAS No. 157 for one year for non-financial assets and non-financial liabilities that are recognized and measured at fair value in the financial statements on a non-recurring basis. In 2008, JT1 did not have such non-financial assets and liabilities.

Taxation

Deferred income taxes are recognized for timing differences arising in respect of the recording of certain items for accounting and tax purposes. Deferred tax assets are only recorded to the extent they will be realized in the near future. Recognized deferred tax assets are offset against deferred tax liabilities to the extent they will be realized within a consistent time frame.

The Company uses the asset and liability method under which deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts and the respective tax bases of existing assets and liabilities as well as tax loss and credit carry-forwards. A valuation allowance is used to reduce deferred tax assets based on management's evaluation of the probability that the deferred tax assets will be realized.

The deferred tax assets and liabilities are valued against nominal value and are calculated on the basis of the corporate income taxes enacted or substantially enacted as of the balance sheet date.

The effective tax rate differs from the nominal tax rate due to differences between Dutch and foreign tax rates, and also due to tax-exempt items and items which are non-deductible, either in whole or in part.

Cash flow statement

The consolidated statement of cash flows has been prepared according to the indirect method.

Cash considerations paid for investments in subsidiaries and participations in group companies acquired are recorded as a cash flow used in investing activities net of any cash and cash equivalents acquired.

Transactions, not resulting in cash flows, such as financial leasing, are not recorded in the statement of cash flows. Payments of the financial lease installments are recorded as a cash flow used in financing activities for the redemption component and as a cash flow used in operational activities for the interest component.

Differences in movements between balance sheet items from one period to another and the amount taken up in the cash flow statements is caused partly by exchange differences.

Notes to the specific items of the consolidated balance sheet**Intangible fixed assets (1)**

The movement in intangible fixed assets is as follows:

	Goodwill	Trademarks	Distribution agreements	Total
(in millions of USD)	USD	USD	USD	USD
Book value as at January 1, 2008	16,872	5,074	99	22,045
Tax-related movements	31	—	—	31
Foreign exchange results	—	(1,038)	(2)	(1,040)
Amortization for the year	(910)	(274)	(26)	(1,210)
Book value as at December 31, 2008	<u>15,993</u>	<u>3,762</u>	<u>71</u>	<u>19,826</u>
Accumulated amortization as at December 31, 2008	<u>2,235</u>	<u>734</u>	<u>30</u>	<u>2,999</u>

For the classification of the amortization expenses is referred to page 51.

Costs incurred on development projects would be recognized as intangible fixed assets when it is probable that JTI will achieve economic benefits in the future, considering its commercial and technological feasibility, and costs can be measured reliably. However, as these costs do not meet aforementioned criteria, research and development costs are expensed as incurred. For 2008 the research and development costs amount to USD 68 million (2007: USD 53 million). During the years ended 31 December 2008 and 2007 JTI received reimbursements of product development costs from JT of USD 32 million and USD 24 million respectively (see also note on related party disclosure, page 47).

Tangible fixed assets (2)

The movement in tangible fixed assets is as follows:

	Land, buildings and structures	Machinery and equipment	Fixed assets under construction	Total
(in millions of USD)	USD	USD	USD	USD
Book value as at January 1, 2008	878	1,328	194	2,400
Additions, net	42	249	287	578
Disposals, net	(1)	(16)	(-)	(17)
Transfers	49	170	(219)	-
Depreciation for the year	(40)	(327)	-	(367)
Currency translation adjustment	(175)	(201)	8	(368)
Book value as at December 31, 2008	<u>753</u>	<u>1,203</u>	<u>270</u>	<u>2,226</u>
Accumulated depreciation as at December 31, 2008	<u>193</u>	<u>1,669</u>	<u>-</u>	<u>1,862</u>

Included within long-lived assets are the following assets held on capital leases:

The present value of future minimum lease payments for assets under capital leases was USD 8 million at December 31, 2008. Of that amount, USD 3 million is due in 2009.

	2008	2007
(in millions of USD)	USD	USD
Capital leases recognized as:		
Machinery and equipment		
Net carrying amount	12	19
Less: accumulated depreciation	(4)	(11)
Book value as at December 31	<u>8</u>	<u>8</u>

The result on disposals of tangible fixed assets is a loss of USD 5 million (2007: USD 14 million loss). For the classification of the depreciation expenses is referred to page 51.

Financial fixed assets (3)

Financial fixed assets include 'non-consolidated participations', marketable securities and deferred taxes. Non-consolidated participations are not included in the consolidation due to the fact that these are joint-venture participations or are insignificant (see note 1 of the notes to the Company's financial statements). The movement in financial fixed assets is as follows:

	Non-Consolidated participations	Marketable securities	Deferred taxes	Total
(in millions of USD)	USD	USD	USD	USD
Book value as at January 1, 2008	253	113	417	783
Additions, net	(48)	1	186	139
Shares in result	23	–	–	23
Dividends received	(17)	–	–	(17)
Reclassified	–	4	–	4
Impairment	–	(58)	–	(58)
Book value as at December 31, 2008	211	60	603	874

The list of directly and indirectly held investments of the Company is filed with the Trade Register in line with article 2:379 sub 5 of the Netherlands Civil Code.

Debt and equity securities

At December 31, 2008, JTI's Canadian subsidiary held non-bank-sponsored asset-backed commercial paper ("ABCP") with a face value of USD 139 million. At the date of purchase, these securities carried the highest credit rating for commercial paper and were classified as cash equivalents in the consolidated balance sheets. The original maturity dates of ABCP ranged from August to October 2007.

In the wake of a severe liquidity crisis in global credit markets, non-bank-sponsored ABCP Conduits were unable to roll over maturing instruments and repay ABCP holders. As a result, in August 2007, a group of banks, asset providers and major investors agreed to pursue conversion of certain securities (the "Montreal Accord ABCP") into floating-rate notes ("FRN") maturing no earlier than the contractual maturity dates of the underlying assets.

As ABCP Conduits were unable to repay amounts due on the original maturity dates, JTI performed an impairment analysis and recorded a USD 115 million other-than-temporary impairment charge in its consolidated statements of earnings (USD 58 million in 2008 and USD 57 million in 2007). The impairment charge reduced the carrying amount of securities to their estimated fair value. JTI reclassified ABCP from cash equivalents to marketable securities in the consolidated balance sheets.

The Montreal Accord ABCP last traded in active markets in August 2007. In the absence of active market prices, JTI estimated the fair value of ABCP using a valuation technique which incorporated the "Moody's Corporate Default and Recovery Rates" and "JP Morgan's Asset-backed Securities" inputs while considering the best available data regarding market conditions for such investments. The fair value of the Montreal Accord ABCP held by JTI at December 31, 2008 was estimated at USD 43 million. Since the fair value of the Montreal Accord ABCP was estimated in the absence of quoted market prices, the fair value estimates are inherently uncertain and may change significantly in future periods. Because of exposure to leveraged credit derivatives, JTI could ultimately lose all of its initial investment in ABCP if credit markets deteriorate significantly in the future.

In January 2008, upon successful completion of the Montreal Accord restructuring activities, ABCP were exchanged for floating-rate notes (FRN) with the face value of USD 137 million. These securities are backed by leveraged credit derivatives as well as traditional assets that were underlying the original ABCP. The expected repayment date for FRN is January 2017; however, the legal maturity does not occur until July 2056. There is no legal obligation to pay interest before January 2019 and principal before July 2056; however, the terms of the FRN allow for certain quarterly interest payments as well as principal payments to occur prior to these dates as determined by the Plan Administrator. In January and February 2009, JTI received interest payments totaling USD 4.5 million that were recognized as interest income. Going forward, interest income will be recognized on a cash basis.

Deferred taxes

Of the deferred income taxes amounting to in total USD 603 million (2007: USD 417 million), an amount of USD 89 million (2007: USD 62 million) is considered to be of short-term nature. For a specification on the deferred income taxes (fixed and current) we refer to note 14 on income taxes.

Inventories (4)

Inventories comprise:

	2008	2007
(in millions of USD)	USD	USD
Finished products	658	671
Work in progress	19	23
Leaf tobacco	1,693	1,414
Wrapping materials	146	131
Other	75	83
	<u>2,591</u>	<u>2,322</u>

Receivables and prepaid expenses (5)

Receivables and prepaid expenses comprise:

	2008	2007
(in millions of USD)	USD	USD
Accounts and notes receivable, net	2,173	2,050
Receivables from affiliates	2	1
Prepaid expenses and excise taxes	873	650
Other assets and deferred charges	199	352
Other current assets	245	464
	<u>3,492</u>	<u>3,517</u>

The accounts and notes receivable are stated net of a valuation for doubtful accounts of USD 23 million (2007: USD 28 million).

Other assets and deferred charges are of a long-term nature, all other receivables and prepaid expenses are due within one year.

Cash and cash equivalents (6)

Cash balances are at free disposal of the group.

Equity attributable to equity holder (7)

For a breakdown of Equity attributable to equity holders, reference is made to the Company statement of changes in Equity attributable to equity holder on page 61.

Provisions (8)

Provisions comprise:

	2008	2007
(in millions of USD)	USD	USD
Provision for pension obligations	736	794
Provision for deferred income taxes (14)	1,053	1,553
Provision for? restructuring	359	357
RGI valuation payment	165	202
	<u>2,313</u>	<u>2,906</u>

Provisions are in general deemed to be of a long-term nature.

Provision for pension obligations

JTI sponsors a number of defined benefit pension plans covering most employees. JTI also provides certain health and life insurance benefits for retired employees and their dependents. Plans covering regular full-time employees provide pension benefits based on credits, determined by age, earned throughout an employee's service and final average compensation before retirement. JTI uses a measurement date of 31 October for its pension and postretirement benefit plans. The following table provides a reconciliation of the changes in JTI's plans' benefit obligation and fair value of assets over the two-year period ended December 31, 2008 and a statement of the funded status and net amount recognized as of December 31 for each year:

The components of net periodic benefit cost are as follows:

	2008		2007	
	Pension benefits	Post- retirement benefits	Pension benefits	Post- retirement benefits
(in millions of USD)	USD	USD	USD	USD
Change in benefit obligation:				
Obligation at measurement date	3,202	216	1,026	117
Additions as a result of Gallaher Business				
Combination	–	–	2,029	77
Service cost	55	3	48	3
Interest cost	163	11	127	9
Actuarial loss	(188)	(31)	(71)	–
Employees contributions	9	–	8	–
Currency loss	(560)	(38)	184	16
Curtailments, settlements and plan amendments	(32)	–	1	–
Benefit payments	(166)	(8)	(150)	(6)
Elimination of early measurement date	9	–	–	–
Obligation at measurement date	<u>2,492</u>	<u>153</u>	<u>3,202</u>	<u>216</u>

	2008		2007	
	Pension benefits	Post- retirement benefits	Pension benefits	Post- retirement benefits
(in millions of USD)	USD	USD	USD	USD
Change in plan assets:				
Fair value of plan assets at measurement date	2,838	–	504	–
Additions as a result of Gallaher Business	–	–	2,147	–
Actual return on plan assets	(220)	–	107	–
Employer contributions	92	–	70	6
Employee contributions	9	–	8	–
Currency (gain)/loss	(141)	–	126	–
Benefit payments	(638)	–	(127)	(6)
Post-measurement date contributions	8	–	3	–
Fair value of plan assets at measurement date	<u>1,948</u>	<u>–</u>	<u>2,838</u>	<u>–</u>
Funded status	<u>(544)</u>	<u>(153)</u>	<u>(364)</u>	<u>(216)</u>

At December 31, the overfunded and underfunded plans were presented as assets and liabilities, respectively, in the Company's consolidated balance sheets as follows:

	2008		2007	
	Pension benefits	Post- retirement benefits	Pension benefits	Post- retirement benefits
(in millions of USD)	USD	USD	USD	USD
Current liability	(56)	(6)	(28)	(8)
Non-current liability	(567)	(147)	(586)	(208)
Non-current asset	79	–	250	–
Funded status	<u>(544)</u>	<u>(153)</u>	<u>(364)</u>	<u>(216)</u>

JTI expects to contribute approximately USD 92 million to its funded defined benefit pension plans in 2009.

At December 31, the amounts recognized in accumulated other comprehensive loss, before tax, were as follows:

	2008		2007	
	Pension benefits	Post- retirement benefits	Pension benefits	Post- retirement benefits
(in millions of USD)	USD	USD	USD	USD
Actuarial losses	287	14	104	48
Prior service cost (credits)	(3)	(13)	3	(14)
	<u>284</u>	<u>1</u>	<u>107</u>	<u>34</u>

The amounts in accumulated other comprehensive loss that are expected to be recognized as components of net periodic benefit cost in 2009 are as follows:

	Pension plans	Postretirement plans
(in millions of USD)	USD	USD
Actuarial losses	13	–
Prior service costs / credits	–	(1)
	<u>13</u>	<u>(1)</u>

The accumulated benefit obligation ("ABO") for all pension plans at December 31, 2008 and 2007, was USD 2,315 million and USD 2,960 million, respectively.

At the measurement date, the benefit obligation and the fair value of assets of funded pension plans where the accumulated benefit obligation was in excess of the fair value of assets were as follows:

	2008	2007
(in millions of USD)	USD	USD
Accumulated benefit obligation	588	359
Projected benefit obligation	630	378
Fair value of plan assets	524	336

The pension and postretirement benefit components of the net periodic benefit cost were as follows:

	2008		2007	
	Pension benefits	Post-retirement benefits	Pension benefits	Post-retirement benefits
(in millions of USD)	USD	USD	USD	USD
Net service cost	55	3	48	3
Interest cost	163	11	127	9
Expected return on plan assets	(165)	–	(138)	–
Amortization of prior service costs and actuarial loss	4	2	8	2
Curtailment, settlement	–	–	1	–
Net periodic benefit expense	57	16	46	14

The weighted-average assumptions used to determine the net periodic benefit cost were as follows:

	2008		2007	
	Pension benefits	Post-retirement benefits	Pension benefits	Post-retirement benefits
	%	%	%	%
Discount rate	5.7	6.0	5.3	5.5
Expected return on plan assets	5.4	N/A	6.4	N/A
Rate of compensation increase	3.4	1.9	3.5	N/A

In general, the expected rate of return on plan assets is determined by reference to the sum of the product of the long-term target asset allocation and expected return for each class of assets. However, the estimate is adjusted as necessary to the extent that actual asset allocation differs significantly from the target allocation, and the pension fund is not expected to immediately rebalance the target.

Healthcare cost trend rate assumptions were as follows:

	2008	2007
	%	%
Health care cost trend rate for next year	8.3	8.1
Ultimate healthcare cost trend rates	5.3	5.4
Years to ultimate rate	6	3

Assumed healthcare cost trend rates have a significant effect on the amounts reported for healthcare plans. A one-percentage-point change in assumed healthcare cost trend rates would have the following effects on the JTI's benefit obligation at December 31, 2008:

	1-percentage point increase	1-percentage point decrease
(in millions of USD)	USD	USD
Effect on total of service and interest cost for 2009	2	(2)
Effect on post-retirement benefit obligation	21	(19)

The actual weighted-average asset allocation for the JTI's pension plans was as follows:

	2008	2007
	%	%
Equity securities	39.00	47.00
Debt securities	52.00	49.00
Real Estate	2.00	2.00
Other	7.00	2.00
	<u>100.0</u>	<u>100.0</u>

JTI's investment strategy for pension plan assets includes diversification of investments to minimize interest and market risks. Plan assets are rebalanced periodically to maintain target asset allocations. Maturities of investments are not necessarily related to the timing of expected future benefit payments; however, it JTI's aim to ensure that adequate liquidity is maintained to enable immediate and medium-term benefit payments. At December 31, 2008, the weighted-average target asset allocation for JTI's pension plans was as follows:

Asset category	2008	2007
Equity securities	45%	48%
Debt securities	51%	50%
Real estate	2%	2%
Cash, investment trust and other assets	2%	-
	<u>100%</u>	<u>100%</u>

All non-pension postretirement benefit plans provided by JTI are unfunded.

The table below reflects the total benefits expected to be paid from both the plan assets and from JTI's assets in the next ten years:

(in millions of USD)

	Pension benefits	Post retirement benefits
Expected future benefit payments:		
2009	177	6
2010	149	7
2011	147	7
2012	146	8
2013	150	8
2014 – 2018	817	47

In addition to defined benefit pension plans, JTI sponsors various defined contribution pension plans. Defined contribution pension cost was USD 23 million in 2008 and USD 20 million in 2007.

Restructuring provisions

	2008	2007
(in millions of USD)	USD	USD
Book value as at January 1	357	33
Provisions accrued in acquisition accounting	–	364
Additions	200	55
Cash payments	(152)	(119)
Currency translation adjustment	(46)	24
Book value as at December 31	359	357

In April 2007, JTI completed the acquisition of Gallaher Group Plc. In order to realize acquisition synergies, JTI committed to a global restructuring plan, including a reduction in the workforce, rationalization of certain distribution channels, and the closure and disposal of certain manufacturing facilities. The plan principally includes employee termination benefits and contract termination costs.

In December 2008, JTI restructured its relationship with Fortune Tobacco Company (FTC) in the Philippines. In exchange for a consideration of USD 143 million, FTC agreed to terminate the existing master license agreement and enter into a distribution and a contract manufacturing agreement both of which contain at-market terms and conditions. As a result of this restructuring, JTI expects to strengthen its competitive position and increase its profitability in the Philippines over a long-term period.

Restructuring activities are expected to be substantially completed by 2011.

Long-term liabilities (9)

	2008	2007
(in millions of USD)	USD	USD
Long-term borrowings	4,751	5,713
Tax liability (FIN 48 (see note 14))	440	430
Indirect tax provision	104	–
Capital leases	8	8
LTIP programme liability	107	50
Reserves for indemnities	10	13
Reserve for other employment benefit costs	19	51
Others	49	5
	<u>5,488</u>	<u>6,270</u>

The capital leases relate to the capital leases recognized under the tangible fixed assets under as machinery and equipment. The LTIP programme liability is a long-term incentive for management and has a cycle of 3 years. The reserve for indemnities relates to liabilities for self-insurance against probable future losses. Examples include estimated indemnity claims by employees for injuries and sickness not covered by workmen's compensation, estimated claims by customers for defective, lost or damaged products.

At December 31, the Company's long-term borrowings were as follows:

(in millions of USD)	Maturities	2008	2007
GBP 300 million Eurobond (6.625%)	2009	-	608
EUR 800 million Eurobond (4.625%)	2011	1,128	1,182
GBP 250 million Eurobond (5.75%)	2013	359	493
EUR 500 million Eurobond (4.5%)	2014	703	730
<i>(average interest rate in parenthesis)</i>			
Syndicated credit facilities			
EUR Term loan (3.95% for 2008 and 4.41% for 2007))	2012	284	434
GBP Term loan (6.07% for 2008 and 5.59% for 2007))	2012	722	998
EUR Revolver borrowings (4.79% for 2007)		-	1,099
GBP Revolver borrowings (5.94% for 2008 and 6.16% for 2007))	2012	930	140
USD Revolver borrowings (0.71% for 2008)	2012	370	-
YEN Revolver borrowings (1.06% for 2008)	2012	255	-
Other long-term borrowings		-	29
Total long-term borrowings		<u>4,751</u>	<u>5,713</u>

The expiry date of the syndicated multicurrency credit facility is 2012. As JTI intends to renew obligations incurred under the revolving portion of the facility for a period extending beyond one year from December 31, 2008, all revolver borrowings were classified as long-term liabilities; the amount maturing after one year is USD 4,751 million (2007: USD 5,713 million). Of the long-term borrowings an amount of USD 4,021 million (2007: USD 4,490 million) matures between one to five years and an amount of USD 730 million (2007: USD 1,223 million) has a maturity date beyond five years.

Interest rates on other long-term borrowings vary between 2.35% and 3.99% (2007: between 2.35% and 3.99%).

A portion of JTI's fixed-rate debt has been swapped into floating-rate debt. At December 31, 2008, the notional amount (denominated in Sterling) and the fair value of the related interest rate swap asset were USD 794 million and USD 30 million, respectively. At December 31, 2007, the notional amount and the fair value of the related interest rate swap liability were USD 1,272 million and USD 11 million, respectively. The post-swap weighted-average interest rate on the JTI's fixed-rate debt was 5.21% in 2008 and 5.63% in 2007.

JTI selectively uses interest rate caps to limit its exposure to unfavorable fluctuations in certain benchmark interest rates. The notional amount of interest rate caps outstanding at December 31, 2008 and 2007, was USD 3,493 million and USD 4,247 million, respectively. The interest rates are capped at 6.5% and 5.0% for Sterling and Euro, respectively. The aggregate fair value of the related derivative asset was USD 1 million and USD 6 million at December 31, 2008 and 2007, respectively.

Substantially all JTI's borrowings are guaranteed by JT.

Current liabilities (10)

Current liabilities comprise:

	2008	2007
(in millions of USD)	USD	USD
Payable to affiliates	124	848
Short-term borrowings from financial institutions	1,141	1,281
Trade accounts payable	549	512
Excise and sales tax payable	1,402	1,346
RGI Valuation payment, current portion	140	155
Accrued expenses	835	875
Other current liabilities, including social securities	1,045	1,313
	<u>5,236</u>	<u>6,330</u>

The total payable social securities amounts to USD 19 million as per December 31, 2008 (2007: USD 12 million).

Borrowings and borrowing arrangements

As part of Gallaher acquisition in 2007, JTI assumed all of the acquiree's debt obligations, including approximately USD 3.3 billion fixed-rate Eurobonds maturing 2008 through 2014. In addition, in connection with the acquisition, JTI negotiated a USD 5.4 billion (GBP 2.7 billion) syndicated multicurrency credit facility that comprises a floating-rate term loan and a revolving credit facility both maturing in 2012. Floating rates for EURO-denominated borrowings are linked to EURIBOR rates. Floating rates for borrowings in other currencies are linked to LIBOR rates.

At December 31, the Company's short-term borrowings and current portion of long-term debt were as follows:

(in millions of USD)	2008	2007
Short-term borrowings	678	718
Current portion of long-term debt	28	15
EUR 375 million 2008 Eurobond 5.875%)	-	548
GBP300 million Eurobond (6.625%)	435	-
	<u>1,141</u>	<u>1,281</u>

Short-term bank borrowings weighted-average interest rates were 14.3% and 8.4% for the years ended December 31, 2008 and 2007, respectively.

Commitments and contingencies

Lease commitments

JTI leases various buildings, computer equipment and vehicles under noncancellable operating leases. The aggregate rental expense was USD 103 and USD 75 million in 2008 and 2007, respectively. Future minimum rental payments required under noncancellable operating leases are as follows:

(in millions of USD)	
2009	71
2010	52
2011	44
2012	34
2013	23
Thereafter	77

Financial commitments

On December 14, 2007, JTI entered into a 15-year cooperation agreement with the European Commission ("EC") to combat the contraband and counterfeit of cigarettes in the European Union. The agreement calls for a payment of USD 400 million over 15 years, which will be used by the EC and the participating Member States to support anti-contraband and anti-counterfeit initiatives. JTI will pay USD 50 million annually for the first five years and USD 15 million in each of the following ten years. Payments are recognized as cost of sales ratably over the year in which they become due. For the first three years of the agreement, 50% of all the payments made under this agreement will be reimbursed by JTI's ultimate parent, JT. The rate of 50% will be reviewed and revised, as necessary, every three years during the term of the cooperation agreement.

In conjunction with the EC agreement, JTI has committed to providing a Track and Trace system for finished goods, which marks cigarette master cases and eventually cartons, with specific customer information for certain EU markets. Costs to develop this system are expensed as incurred, except for property and equipment acquired to support the system that are capitalized and depreciated.

At December 31, 2008, noncancellable commitments for purchases were as follows:

(in millions of USD)	2008	2007
Leaf purchase commitments	236	115
Capital expenditure	117	74
Other	109	83
	<u>462</u>	<u>272</u>

Contingencies

Tobacco litigations

Various legal actions, proceedings, and claims are pending or may be instituted against JTIH and its subsidiaries. Claims related to smoking and health usually fall within the following categories: (i) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs; (ii) smoking and health cases primarily alleging personal injury and purporting to be brought on behalf of a group or a class of individual plaintiffs; (iii) smoking and health cases brought by governmental and non-governmental plaintiffs seeking recovery of health care costs allegedly caused by cigarette smoking; and (iv) other claims alleging a defect in the product.

Whilst the Company has a number of valid defenses and claims in these pending cases, litigation is subject to many uncertainties and it is not possible to predict with certainty their outcome. JTIH and its subsidiaries could incur substantial costs in connection with litigation alleging damages resulting from the use of tobacco products or exposure to tobacco smoke or alleging loss of taxes from allegedly illegal importation of tobacco products. To date, the Company has never lost a case or paid any settlement award in connection with smoking and health-related litigation against any of its subsidiaries.

Smoking and Health Litigation Status

There are a number of smoking and health-related actions pending against JTIH affiliates. Cases brought by individuals are pending in Spain and Ireland. Smoking and health group or class actions are pending in Canada and Israel. Health care cost recovery actions are pending in Canada and Spain.

Class or group actions

In February 2005, a Québec (Canada) trial court authorized two class actions against a JTIH subsidiary. The actions were filed in late September 2005 and are currently pending. The first class, comprising Québec residents allegedly suffering from certain diseases, seeks collective recovery of USD 4.22 billion (CAD 5.15 billion) from all defendants (which include two competing cigarette manufacturers) in addition to damages for individual members. The second class, composed of allegedly addicted smokers in Québec, seeks collective recovery USD 14.59 billion (CAD 17.8 billion) from all defendants (which include two competing cigarette manufacturers) in addition to individual damages.

In December 2005, a class in Israel purporting to be composed of smokers of certain brand categories called "Lights" named a JTIH subsidiary as a defendant in an action seeking USD 1.54 billion (ILS 5.78 billion) in total damages from all defendants, which include a number of distributors and manufacturers of competing products in the Israeli market. The action has been

served on a distributor that may have indemnity rights against a JTIH subsidiary other than the one named in the action. The action has not, however, been served on any JTIH subsidiary. For now, the action is stayed pending the outcome of a request for certification in a similar action against a JTIH competitor in the Israeli market.

In May 2008, a petition was filed in Israel by claimants purporting to represent a class consisting of all those who purchased or smoked the cigarettes previously known as "Lights" which were manufactured, imported or marketed by the defendants in Israel after December 31, 2004. None of JTIH's subsidiaries are involved in this claim, although Globrands Limited (JTI SA's current Israeli distributor) is a named defendant. The claim is currently at the pre-certification stage. The claimants are seeking approximately USD 20.9 billion (ILS 78 billion) in damages for various alleged breaches of consumer protection and labeling laws.

Health care cost recovery actions

In January 2001, the province of British Columbia (Canada) brought an action under its Tobacco Damages and Health Care Costs Recovery Act against a JTIH affiliate, as well as a number of other manufacturers and others participating in the Canadian cigarette market, seeking unquantified damages. Some defendants challenged the constitutionality of the Act. The Supreme Court of Canada finally rejected that challenge in September 2005, and the action remains pending at first instance. A number of defendants have applied to join the Canadian Federal Government as a Third Party to this action. The application was dismissed at first instance but is currently on appeal. In March 2008, the Province of New Brunswick filed a health-care cost recovery action against a JTIH affiliate and other manufacturers under its own Tobacco Damages and Health Care Costs Recovery Act, seeking unquantified damages. These proceedings are at an early stage.

In February 2007, a JTIH subsidiary in Spain was formally joined as a defendant, along with a number of other manufacturers, in a contentious administrative proceeding brought by the Junta de Andalucía against the Spanish state (as former tobacco monopoly) to recover health-care expenditures for a number of individuals treated for alleged tobacco-related diseases. The Junta's claim was dismissed at first instance in November 2007, on procedural grounds. An appeal is pending with the Supreme Court.

Following the above proceeding, in July 2008, a JTIH subsidiary in Spain was also formally joined as a defendant, together with the same other manufacturers in a second contentious-administrative proceeding brought by the Junta de Andalucía and against the Spanish state. This claim seeks recovery of the same health care expenditure mentioned in the above proceeding and tries to remedy the procedural defects appreciated by the Court in the previous proceeding. The case is pending the claimant to file the claim.

In addition to these actions, JTIH employees oversee the defense of entities to which JT may owe certain indemnity obligations. Three health care cost recovery actions of that nature are currently pending.

Smoking and Health Litigation Claims and Defenses Generally

Plaintiffs' allegations of liability in smoking and health cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, defective design, failure to warn, breach of express and implied warranties, breach of special duty, conspiracy, concert of action and violations of deceptive trade practice laws and consumer protection statutes.

Plaintiffs in smoking and health actions seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits and injunctive and equitable relief. Defenses raised in these cases include, among other things, lack of proximate cause, assumption of the risk, comparative fault or contributory negligence, and statutes of limitations or repose.

Health Care Cost Recovery Litigation Claims and Defenses Generally

In certain of the pending proceedings, governmental and non-governmental plaintiffs, including insurers, are seeking reimbursement of health care cost expenditures allegedly caused by tobacco products and, in some cases, of future expenditures and damages as well. Other relief sought by some but not all plaintiffs includes punitive damages, treble/multiple damages and other statutory damages and penalties, injunction prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, disclosure of nicotine yields, and payment of attorney and expert witness fees.

Plaintiffs have asserted legal and equitable claims including that the defendants were "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking, indemnity, negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under statutes governing consumer fraud, antitrust, deceptive trade practices, and false advertising. In one instance, claims are asserted under a statute enacted specifically to permit such an action.

Defenses raised include lack of proximate cause, remoteness of injury, failure to state a valid claim, lack of benefit, adequate remedy at law, "unclean hands" (namely, that plaintiffs cannot obtain equitable relief because they participated in, and benefited from, the sale of cigarettes), lack of antitrust injury, lack of statutory authority to bring suit and statute of limitations. In addition, defendants argue that they should be entitled to "set off" any alleged damages to the extent the plaintiff benefits economically from the sale of cigarettes through the receipt of excise taxes or otherwise. Defendants also argue that these cases are improper because plaintiffs must proceed under principles of subrogation and assignment. Under traditional theories of recovery, a payer of medical costs (such as an insurer) can seek recovery of health care costs from a third party solely by "standing in the shoes" of the injured party. Defendants argue that plaintiffs should be required to bring any actions as subrogates of individual health care recipients and should be subject to all defenses available against the injured party.

Other Tobacco-Related Litigation

Canada

In February 2003, the Royal Canadian Mounted Police filed criminal charges against JTI-Macdonald Corp. ("JTI-M"), three non-Canadian JTIH subsidiaries, and eight current or former employees of JTIH subsidiaries or formerly related entities in connection with the alleged smuggling of tobacco products into Canada in the early 1990s. Following the evidence portion of a preliminary hearing that ran from April 2005 through November 2007, the court committed JTI-M and one former employee to trial. The Crown sought review of the dismissal of charges against the other defendants and notified JTI-M of its intent to seek a fine of USD 410 million (CAD 500 million) as well as restitution of lost taxes in an undetermined amount. In December 2007, the Crown and defendants' arguments on review were heard. In February 2008, the judge hearing the review application returned the case to the preliminary inquiry judge for reconsideration that all defendants be committed to stand trial. Argument on the issue of reconsideration was made in May 2008 in the Ontario Court of Justice. The Crown proceeded against JTI-M and the lone defendant in the Ontario Superior Court of Justice by way of indictment in June 2007. The indictment has returned to assignment court on a periodic basis and was next scheduled to be spoken to in assignment court in September 2009. A decision by the preliminary inquiry judge for reconsideration of the discharge of the individuals has not yet been released.

In July 2003, a former employee commenced a civil action in the Ontario Superior Court of Justice against JTI-M and three individual defendants seeking USD 10 million (CAD 12.25 million) in damages for his alleged unlawful treatment in the early 1990s when he was an employee of Northern Brands International, Inc. (a now-inactive R.J. Reynolds Tobacco Company affiliate) and later imprisoned in the United States after pleading guilty to criminal charges. This action remains stayed by order of the Ontario Superior Court of Justice in the CCAA proceeding described below.

In August 2003, the Canadian government filed a civil action in the Ontario Superior Court of Justice seeking USD 1.23 billion (CAD 1.5 billion) in damages from R.J. Reynolds Tobacco Holdings, Inc., R.J. Reynolds Tobacco Company, R.J. Reynolds Tobacco International, Inc., JTI-M, Northern Brands International, Inc., Japan Tobacco Inc., JT International S.A., and various other subsidiaries companies, based on allegations that the defendants conspired to defraud the federal government of applicable taxes and duties by smuggling and importing cigarettes and tobacco into Canada for sale and consumption without payment of applicable import duties and taxes. This action remains stayed by order of the Ontario Superior Court of Justice in the CCAA proceeding described below.

In August 2004, the Québec Minister of Revenue ("Revenue Québec") issued an assessment against JTI-M in the amount of USD 1.12 billion (CAD 1.36 billion) in taxes, penalties and interest for alleged failure to collect and remit Québec tobacco taxes during the years 1990 to 1998 in respect of tobacco products that would have been sold outside Canada, but were unlawfully re-introduced in Québec for retail sale in Québec. In August 2004, Revenue Québec further issued an order for immediate payment of the assessment, and obtained a judgment of the

Superior Court of Québec ordering such payment. In November 2004, JTI-M filed its administrative objection to the assessment denying all liability for the tax, on the ground that it denies any participation in alleged contraband, and that in any event the assessment under the circumstances is not justified by the tax legislation relied on by Revenue Québec. Further progress of these proceedings is subject to negotiations and arrangements that may be made in the course of CCAA proceeding described below.

In August 2004, Revenue Québec also instituted an oppression action under the Canada Business Corporations Act, alleging that a corporate reorganization of certain JTIH subsidiaries was intended to cause prejudice to Revenue Québec's claim for taxes as assessed in August 2004, and that contemporaneous acquisition and integration transactions constituted fraudulent conveyances to avoid payment of such taxes.

In August 2004, JTI-M instituted proceedings under Canada's Companies' Creditors Arrangement Act ("CCAA"). All actions against JTI-M were stayed by the Ontario Superior Court of Justice on that date and those not excepted will remain stayed at least through March 2010. In April 2007 ING Bank issued Letters of Credit in favor of JTI-M's court appointed Monitor to enable payments to be made by JTI Macdonald to JT International SA.

At the invitation of the court presiding over the CCAA proceedings, seven other provinces have filed claims similar to Québec's, seeking taxes, interest, and penalties in a total amount of approximately USD 7.8 billion (CAD 9.6 billion). No procedure is yet established for adjudicating these claims.

United States

The United States Attorney for the Southern District of New York served two subpoenas on JTIH affiliates seeking the production of documents relating to certain cigarette shipments. One subpoena, dated January 7, 2003, was served on JT International U.S.A., Inc., while the other, dated February 24, 2003, was served on JT International Manufacturing America, Inc. Both companies are cooperating as appropriate with the United States Attorney. Although R.J. Reynolds Tobacco Company retained liabilities relating to the events disclosed above, it is possible that the outcome of such investigation could have an adverse effect on JTIH.

Rest of world

JTI Marketing & Sales ("JTI MS"), a Russian subsidiary of JTIH, is in dispute with the Moscow City Tax Authorities for the alleged underpayment of VAT and profit taxes for the year 2000. The Tax Authorities submitted a final assessment for USD 68.07 million (RUB 2 billion principal amount, interest and penalties) in July 2004. JTI MS brought suit to challenge the assessment. In September 2004, JTI MS lost at the Court of First Instance. JTI MS's appeal of that decision was rejected in February 2005, and JTI MS sought further review. In April 2005, the Cassation Court remanded the action to the Court of Appeal for reconsideration. The Court of Appeal reaffirmed the decision. JTI MS's further appeal to the Court of Cassation was rejected in September 2005. At a hearing in April 2006, the Supreme Arbitration Court, Presidium, ruling from the bench, reversed the rulings of the intermediate courts against JTI MS and remanded the case to first instance. In October 2007, the first instance court ruled in JTI MS's favor. The Tax Authorities'

appeal from that decision was rejected in February 2008. The Tax Authorities subsequently appealed that decision. In May 2008, the Court of Cassation upheld the earlier ruling in favor of JTI MS. Following a further appeal by the Tax Authorities, in October 2008, the Supreme Arbitration Court refused to take the appeal and the case is now closed.

The Turkish Director of Quarantine has filed a smuggling-related criminal complaint against the Company's Turkish subsidiary. Turkish Customs in turn opened an investigation against the JTIH subsidiary and suspended the subsidiary's "Certificate of Approved Persons." The subsidiary obtained an injunction restoring the Certificate and in February 2009 the administrative court accepted that the "Certificate of Approved Persons" should be restored. The subsidiary also filed a criminal complaint against an employee of the subsidiary's customs agent, alleging forgery of signatures on certificates of conformity. The criminal complaints remain pending until the Customs investigation is completed. No fine or restitution amount has been specified.

Various JTIH subsidiaries are defendants in actions brought before French courts by the National Committee Against Smoking, accusing the Company of violating French tobacco advertising and packaging laws and seeking compensatory damages in the amount of USD 7.03 million (EUR 4.98 million).

A JTIH subsidiary in the Canary Islands has been sued in Spain civilly and criminally on smuggling-related allegations. The subsidiary has been required to establish a guarantee for its maximum potential liability of approximately USD 8.24 million (EUR 5.86 million).

Management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of pending tobacco-related litigation, and the Company has not provided any amounts in its consolidated financial statements for unfavorable outcomes, if any.

Litigation is subject to many uncertainties and it is possible that some of the tobacco-related legal actions, proceedings or claims could be decided against JTIH or its affiliates. Determinations of liability or adverse rulings against other cigarette manufacturers that are defendants in similar actions, even if such rulings are not final, could adversely affect the litigation against JTIH or its affiliates or indemnitees and could encourage and increase the number of such claims. There have been a number of political, legislative, regulatory and other developments relating to the tobacco industry and cigarette smoking that have received wide media attention, such as the various litigation settlements in the United States and the release and wide availability of various industry documents. These developments may negatively affect the perception of potential tiers of fact with respect to the tobacco industry, possibly to the detriment of certain pending litigation, and may prompt the commencement of additional similar litigation.

Although it is impossible to predict the outcome of such events on pending litigation and the rate at which new lawsuits are filed against JTIH or its subsidiaries, a significant increase in litigation and/or in adverse outcomes for tobacco defendants could have an adverse effect on the Company. The Company believes that it has a number of valid defenses to any such actions and intends to defend such actions vigorously.

Other Litigation

In October 2003, JT International (Thailand) Ltd ("JTI") filed an arbitration request with the International Chamber of Commerce against its former distributor, TI Trading Co. Ltd ("TIT") for unpaid invoices totaling USD 2.83 million (THB 98.44 million). The three-member arbitration tribunal awarded JTI USD 3 million in August 2006. TIT has sought to annul the award. Proceedings are still pending before the Bangkok Southern Civil Court and the Thai Supreme Court. In March 2006, TIT served JTI with a court action seeking damages of USD 13.61 million (THB 473 million) on grounds similar to those asserted as counterclaims in the arbitration. A first-instance court rejected this claim in October 2006, and TIT has appealed. The appeal remains pending.

A JTIH subsidiary, Gallaher International Ltd. ("GIL"), terminated a Middle Eastern distribution contract in March 2005, and commenced an action before the English high court for damages and a declaration that the termination was valid because of numerous material breaches. The former distributor counterclaimed for unlawful termination, ultimately seeking around USD 500 million in unparticularized damages from the termination. The high court dismissed the counterclaim and entered judgment for GIL in April 2008. In distantly related litigation, Khaled Al-Mahamid and Adam Trading LLC have filed an action in Cyprus against an affiliate of the Middle Eastern distributor and GIL, seeking more than USD 25 million in unparticularized damages for alleged breach of an exclusive distribution agreement for Yemen. The Order permitting service on GIL was set aside in February 2008; to date no further action has been taken to serve GIL.

In August 2003, the UK Office of Fair Trading ("OFT") notified the former Gallaher group of an enquiry into agreements between manufacturers and retailers in the UK cigarette, tobacco and tobacco-related markets. On April 24, 2008, the OFT issued a Statement of Objections ("SO") against Gallaher Ltd, another tobacco manufacturer and 11 UK retailers, alleging two specific anti-competitive practices in relation to retail prices for tobacco products in the UK.

The OFT indicated in the SO that it intended to impose financial penalties for each alleged infringement. The Company entered into an early resolution agreement with the OFT in July 2008. Under the terms of this agreement the Company has agreed to pay a fine of approximately USD 134.27 million (GBP 93 million) and is required to continue to co-operate with the OFT's enquiry. This amount will not become payable until after the OFT has concluded its enquiry and issued a final decision.

In connection with JT's purchase of certain assets of R.J. Reynolds Tobacco Company ("RJRTC") and RJR Nabisco, Inc. ("RJRN"), in addition to liabilities, costs and expenses relating to the matters described above under the headings "Canada" and "United States," RJRTC and RJRN also agreed to indemnify JT for (1) liabilities, costs, and expenses arising from any taxes arising prior to the acquisition in respect of the acquired business (except as reflected on the closing balance sheet) and (2) liabilities, costs, and expenses arising from the seller's employee benefit and welfare plans. RJRTC disputes the applicability of these indemnities to the matters described above under the headings "Canada" and "United States," and indeed claims that JT owes RJRTC indemnification with respect to the "United States" matters.

In June 2008, Tanzania Cigarette Company (TCC), a 75% subsidiary of JTIH received from the Fair Competition Commission a complaint concerning a transaction in 2005 involving the

purchase of manufacturing equipment and trademarks from another company. The complaint alleges the misuse of a dominant position and seeks a penalty of 7% of the subsidiary's 2005 turnover of USD 67.2 million (TSH 87.8 billion). In a decision dated March 31, 2009, the Tanzanian Office for Fair Competition issued a decision against the Company. The Company is presently examining with the assistance of outside counsels whether to appeal this decision.

The Company is also subject to other claims and suits which arise periodically relating to contracts, income and other taxes, advertising regulation, and other matters. The Company believes that, notwithstanding the quality of defenses available to it in litigation matters, it is possible that the results of its operations or cash flows or its financial position could be materially affected by the ultimate outcome of certain pending litigation matters. Management is unable to predict the outcome of the litigation.

Related party transactions

The Company and JTI have the following related party arrangements with JT: a royalty agreement that requires JTI to pay royalties to JT for the use of certain tobacco brands; a product cost sharing agreement under which JTI is reimbursed for certain product development costs; a cost sharing agreement under which JT reimburses JTI for 50% of payments made under the EC anti-contraband and anti-counterfeit agreement (see Note 10, financial commitment paragraph); and a service agreement that entitles JTI to receive from JT fees for certain accounting and administrative services.

The Company's operating income includes the following related-party transactions with JT:

(in millions of USD)	2008	2007
Reimbursement of product development costs by JT	32	24
Sale of leaf inventory and finished goods to JT	393	296
Reimbursement of payments made under the EC agreement	25	2
Other income	(2)	-
	<u>448</u>	<u>322</u>

Included in the Company's operating expenses are the following related-party transactions with JT:

(in millions of USD)	2008	2007
Royalties due to JT	186	157
Purchases of tobacco material, non-tobacco material and finished goods from JT	356	378
Purchases of tobacco flavors from Fuji Flavor Co., Ltd (a JT subsidiary)	24	20
Purchase of tobacco filters from Japan Filter Technology (a JT subsidiary)	19	11
	<u>585</u>	<u>566</u>

At December 31, the amounts payable to JT and its subsidiaries were as follows:

(in millions of USD)	2008	2007
Accounts payable	67	100
Loans payable	45	730
	<u>112</u>	<u>830</u>

In addition, JTI and JT entered into foreign exchange derivative contracts whose fair value was USD 20 million (asset) and USD 2 million (asset) at December 31, 2008 and 2007, respectively.

As part of Gallaher acquisition, JTI acquired investments in the RGI joint venture and Lekkerland GbmH & Co. KG ("Lekkerland"), a German distribution business (25.1% ownership interest). In 2007, JTI purchased goods in the amount of USD 92 million from the RGI joint venture. Recharges of services to the RGI joint venture amounted to USD 4 million in 2007. The joint venture was terminated on December 31, 2007 (see page 11, RGI valuation payment). JTI also purchased goods worth USD 4 million in each of 2008 and 2007 from Lekkerland. In 2008, JTI received dividends of USD 14 million from Lekkerland. Lekkerland did not pay dividends in 2007. At December 31, 2008, amounts due to Lekkerland were insignificant.

Foreign currency arrangements

JTI conducts business on a multi-national basis in a wide variety of foreign currencies and, as such, uses derivative financial instruments to reduce cash flow volatility associated with foreign exchange rate changes. In 2008 and 2007, JTI used foreign currency forwards and swaps to economically hedge its exposure to fluctuations in Euro, Sterling, Swiss Francs, Russian Ruble, Turkish Liras, Romanian Leu, Taiwan Dollars, Japanese Yen and certain other currencies. All foreign currency derivative contracts have maturities of twelve months or less.

The aggregate notional amounts and fair values of the Company's foreign exchange derivative contracts were as follows:

(in millions of USD)	2008 Notional amount	2008 Fair value asset (liability)	2007 Notional amount	2007 Fair value asset (liability)
Contracts to buy foreign currencies (sell USD)	1,516	(21)	929	4
Contracts to sell foreign currencies (buy USD)	9,030	(12)	3,292	(67)
Cross-currency swaps (currencies other than USD)	757	(8)	3,491	(10)

In connection with the acquisition of Gallaher Group Plc by JTI in 2007, JTI incurred floating-rate indebtedness and assumed the acquiree's fixed-rate debt obligations denominated in Euro

and Sterling. To reduce its cost of borrowing and to manage its interest rate risk related to fluctuations in LIBOR, the Company uses fixed-to-floating interest rate swaps maturing 2009 through 2014 and interest rate caps with outstanding contractual maturities of 20 to 50 months (see Note 9).

JTI does not designate derivative instruments in accounting hedge relationships. Accordingly, all changes in the fair values of derivatives are recorded in earnings.

As a result of the use of derivative instruments, JTI is exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. To mitigate the counterparty credit risk, JTI has a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors, and maintains strict dollar and term limits that correspond to each institution's credit rating. JTI's established policies and procedures for mitigating credit risk on principal transactions include reviewing and establishing limits for credit exposure and continually assessing the creditworthiness of counterparties. At December 31, 2008, there were no significant concentrations of credit risk with any individual counterparty or groups of counterparties related to JTI's use of derivative contracts.

Notes to the specific items of the consolidated statement of income**Net sales (11)**

All sales are generated with tobacco products, mainly being cigarettes.

Net sales per geographical areas are as follows:

	2008	2007
(in millions of USD)	USD	USD
Europe	6,514	4,686
Americas	320	300
Asia Pacific	1,074	945
CIS & Baltics / Middle East / Africa / other	4,588	3,423
Total net sales	<u>12,496</u>	<u>9,354</u>

Royalty expenses

Under a royalty agreement entered into in conjunction with the 1999 acquisition of the international tobacco operations of R.J. Reynolds, JTI pays royalties to JT for the use of certain brands used in tobacco operations. During the current year, the total amount of royalty fees paid to JT was USD 186 million (2007: USD 157 million).

Salaries, social security contributions and pension premiums

The costs for salaries, social security contributions and pension premiums are included in cost of sales, selling expenses and general and administrative expenses, and total as follows:

	2008	2007
(in millions of USD)	USD	USD
Salaries	1,249	1,155
Social security contributions	194	143
Net periodic pension cost	109	61
	<u>1,552</u>	<u>1,359</u>

Amortization and depreciation expenses

The expenses regarding amortization of intangible fixed assets and regarding depreciation of tangible fixed assets are included in costs of sales, selling expenses and general and administrative expenses, and total as follows:

	2008	2007
(in millions of USD)	USD	USD
Amortization for the year	1,210	911
Depreciation for the year	367	331
	<u>1,577</u>	<u>1,242</u>

Auditor fees

Total fees from Deloitte, our external auditor amounted to:

	2008	2007
(in millions of USD)	USD	USD
Audit fees	11	8
Tax fees	1	3
All other fees	3	5
	<u>15</u>	<u>16</u>

The fees paid for services rendered by Deloitte Accountants B.V. for the years ended December 31, 2008 and December 31, 2007 amount to EUR 32,760 and EUR 56,500 respectively. The fees relate to audit engagements only.

Employee information

The average number of personnel employed by JTI during the year was:

	2008	2007
Europe	9,676	9,293
Americas	592	578
Asia Pacific	1,677	1,464
CIS & Baltics/Middle East/Africa/Other	11,997	11,768
	<u>23,942</u>	<u>23,103</u>

Net interest result (12)

Net interest result comprises:

	2008	2007
(in millions of USD)	USD	USD
Interest income from third parties	90	85
Interest expenses to third parties	(422)	(278)
	<u>(332)</u>	<u>(193)</u>

Net other financial expenses (13)

Net other financial expenses include loss on sale of marketable securities, financing-related fees and other items of a financial nature and income or loss on investments in business entities over which JTI exercises significant influence.

Income taxes (14)

Income tax expense consists of the following:

	2008	2007
(in millions of USD)	USD	USD
Current:		
The Netherlands	14	2
Other countries	598	267
Total	612	269
Deferred:		
The Netherlands	26	25
Other countries	(66)	(78)
Total	(40)	(53)
Income tax expense	572	216

Pre-tax income related to domestic and foreign operations consist of the following:

	2008	2007
(in millions of USD)	USD	USD
The Netherlands	(1301)	(838)
Other countries	2,294	1,331
Pre-tax income	993	493

The differences between the provision (benefit) for income taxes and income taxes computed at statutory Dutch income tax rates are explained as follows:

	2008	2007
(in millions of USD)	USD	USD
Income taxes computed at statutory Dutch tax rates (25.5% for 2008 & 2007)	247	126
Increase/(decrease) in valuation allowance	109	223
Non-deductible expenses and non-taxable income	313	220
Increase/(decrease) of tax liability for FIN 48, net	86	(43)
Withholding taxes	38	39
Reduction in enacted taxes	(13)	-
Foreign tax less than domestic rates, net	(179)	(349)
Other	(28)	-
Provision for income taxes	<u>573</u>	<u>216</u>

The components of deferred income tax assets and liabilities are as follows:

Deferred tax assets:

(in millions of USD)	2008	2007
Deferred tax assets:		
Pension and other postretirement benefits	223	179
Property, plant and equipment	59	117
Restructuring and accrued liabilities	60	111
Reserves and allowances	136	9
Foreign exchange losses	292	24
Operating loss and credit carryforwards	349	289
Amortization of investments in subsidiaries	55	60
Other differences	95	-
Less: valuation allowance	(439)	(372)
Deferred tax assets, net	<u>830</u>	<u>417</u>

Deferred tax liabilities

Intangibles	806	1,077
Pensions	187	157
Undistributed earnings of subsidiaries	64	113
Property, plant and equipment	60	115
Interest	59	34
Other differences	104	59
Deferred tax liabilities	<u>1,280</u>	<u>1,555</u>

The corporate income tax as stated in the statement of income is computed based on income reported in the financial statements. The effective tax rate is 57.7% (2007: 43.8%). The nominal tax rate applicable for the Netherlands 25.5% (2007: 25.5%).

JTI assesses the realizability of deferred tax assets on a jurisdiction-by-jurisdiction basis. The assessment is based upon the weight of all available evidence, including factors such as the recent earnings history and expected future taxable income. A valuation allowance is recorded to reduce deferred tax assets to a level which, more likely than not, will be realized. The increase in the valuation allowance balance from 2007 to 2008 relates primarily to net operating loss carryforwards that may not be realized.

At December 31, 2008 and 2007, JTI had net operating loss (NOL) and tax credit carryforwards totaling USD 1,203 and USD 925 million respectively, which are available to reduce future taxable income of JTIH and certain international subsidiaries. Approximately USD 740 million of NOL and credit carryforwards (resulting in a tax benefit of USD 175 million) expire between fiscal years 2009 and 2024, with the remainder having no expiration date under current laws.

At December 31, 2008, JTI provided USD 64 million for income and withholding taxes on a portion of its foreign subsidiaries' undistributed earnings. No provision has been made in respect of the balance of unremitted earnings of foreign subsidiaries because such earnings are indefinitely reinvested in operations. Upon distribution, those earnings would be subject to income taxes. However, it is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

On January 1, 2007, JTI adopted the provisions of FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes*. This Interpretation prescribes a recognition threshold and a measurement attribute for tax positions taken (or expected to be taken) in a tax return. Benefits of a tax position are recognized when the position is more likely than not to be sustained, based on its technical merits, upon examination by taxing authorities.

Management believes that FIN 48 can be applied by the Company, in its consolidated statutory Dutch GAAP financial statements as it meets the requirements of a true and fair view.

The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. JTI classifies FIN 48 interest and penalties as a component of income tax expense.

A reconciliation of the beginning and ending amounts of unrecognized tax benefits, excluding interest and penalties, is as follows:

(in millions of USD)

January 1, 2007	84
Additions related to Gallaher acquisition	301
Reductions for prior year tax positions	(31)
Additions for current year tax positions	4
Lapse of statute of limitations	(17)
December 31, 2007	<u>341</u>
Reductions for prior year tax positions	(52)
Additions for prior year tax positions	101
Additions for current year tax positions	34
Settlements	(5)
Lapse of statute of limitations	(13)
December 31, 2008	<u>406</u>

If recognized, the entire amount of unrecognized tax benefits would reduce JTI's effective tax rate.

In 2008, JTI recognized interest and penalties of USD 23 million in its consolidated statement of earnings. At December 31, 2008, the Company's consolidated balance sheet included accrued interest and penalties of USD 54 million (2007: 45 million).

It is reasonably possible that provisions for unrecognized tax benefits will decrease by USD 20 million in 2009 upon completion of examination by tax authorities in certain tax jurisdictions.

JTI is not aware of significant tax positions for which it is reasonably possible that the amount of unrecognized tax benefits will significantly increase or decrease within 12 months of December 31, 2008.

Tax years that remain subject to examination by major tax jurisdictions are as follows:

Tax jurisdiction

Canada	2000 - forward
Malaysia	2001 - forward
Taiwan, The Netherlands	2002 - forward
Austria, Turkey, Greece, The United Kingdom	2003 - forward
Romania, Spain, Ireland, South Africa, Korea, ,	2004 - forward
Tanzania, Belgium	2005 - forward
Germany, Switzerland, Singapore	2006 - forward
Kazakhstan, Ukraine	2007 - forward
Russia	2008 - forward

COMPANY BALANCE SHEET**December 31, 2008**

(before proposed appropriation of the result)

A s s e t s

(in millions of USD)

	Dec. 31, 2008	Dec. 31, 2007
	<u>USD</u>	<u>USD</u>
Fixed assets		
Financial fixed assets (1)	17,057	16,786
Total assets	<u>17,057</u>	<u>16,786</u>

S h a r e h o l d e r ' s e q u i t y a n d l i a b i l i t i e s

(in millions of USD)

	December 31, 2008		December 31, 2007	
	<u>USD</u>	<u>USD</u>	<u>USD</u>	<u>USD</u>
Equity attributable to equity holder (2)				
Share capital	1,942		2,017	
Share premium	14,314		14,314	
Retained earnings	999		863	
Currency translation adjustment	(598)		(669)	
Unappropriated result	400		260	
		17,057		16,785
Current liabilities				
Amounts due to affiliated companies		-		1
Total equity and liabilities		<u>17,057</u>		<u>16,786</u>

COMPANY STATEMENT OF INCOME
Year ended December 31, 2008

(in millions of USD)

	2008	2007
	USD	USD
Share in earnings of investments	400	260
Other results	(-)	(-)
Net result for the year	400	260

NOTES TO THE COMPANY FINANCIAL STATEMENTS

December 31, 2008

Accounting principles

The company financial statements have been prepared according with Title 9, Book 2 of the Netherlands Civil Code.

General accounting principles for the preparation of the financial statements

For the general principles for the preparation of the financial statements, the principles for valuation of assets and liabilities and determination of the result, as well as for the notes to the specific assets and liabilities and the results, reference is made to the notes to the consolidated financial statements, if not presented otherwise here after.

Company income statement

Since the results of the Company are included in the consolidated income statement, the income statement of the Company is presented in an abbreviated version (Article 2:402 of the Netherlands Civil Code).

Notes to the specific items of the balance sheet

Financial fixed assets (1)

Financial fixed assets comprise:

	2008	2007
(in millions of USD)	USD	USD
Investments in subsidiaries and participations	17,057	16,786

The movement in financial fixed assets is as follows:

Balance as at January 1	16,786	6,097
Contribution in kind	–	10,624
Share in earnings (see also note 2)	277	169
Currency translation adjustments	380	(103)
Hedge net investment	(384)	–
Dividends received	(2)	(1)
Balance as at December 31	17,057	16,786

The list of directly and indirectly held investments of the Company is filed with the Trade Register in line with article 2:379 sub 5 of the Netherlands Civil Code.

Equity attributable to equity holder (2)

The movements in equity attributable to equity holder are as follows:

	Share capital	Share premium	Retained earnings	Currency translation adjustment	Unappro- priated result	Total 2008	Total 2007
(in millions of USD)	USD	USD	USD	USD	USD	USD	USD
Opening balance	2,017	14,314	863	(669)	260	16,785	6,095
Adjustment to initially apply FIN 48	-	-	-	-	-	-	(89)
Appropriation of net result	-	-	260	-	(260)	-	-
Hedge of net investment losses, net of tax benefit of USD 137	-	-	-	(384)	-	(384)	-
Foreign currency trans- lation adjustment investment	-	-	-	380	-	380	(103)
Effect of changing pension Plan measurement date, net of USD 2 tax benefit	-	-	(9)	-	-	(9)	-
Increase in deferred actuarial losses And prior service costs, net of tax benefit of USD 28	-	-	(115)	-	-	(115)	(2)
CTA share capital	(75)	-	-	75	-	-	-
Capital contribution in kind	-	-	-	-	-	-	10,624
Net result for the year	-	-	-	-	400	400	260
Closing balance	<u>1,942</u>	<u>14,314</u>	<u>999</u>	<u>(598)</u>	<u>400</u>	<u>17,057</u>	<u>16,785</u>

The share capital and share premium are treated as paid-in capital for tax purposes, therefore repayments are not subject to dividend withholding tax.

Two items, related to the investments in subsidiaries and participations under financial fixed assets, went directly through equity instead of income:

- a negative impact on the effect of changing pension plan measurement date amounting to USD 9;
- a negative impact as increase in deferred actuarial losses and prior service costs amounting to USD 1115.

Share capital issued

The authorized share capital amounts to EUR 6,900,000,000 and is divided into 15,000,000,000 shares of EUR 0.46. The issued share capital amounts to EUR 1,380,018,400 and consists of 3,000,040,002 shares of EUR 0.46 each.

The share capital denominated in EUR has been converted into USD against the following USD/EUR exchange rate 0.7107 at balance sheet date (2007: 0.6843).

Other notes and signing of the financial statements

Personnel

In 2008 the Company employed no employees (2007 : 0).

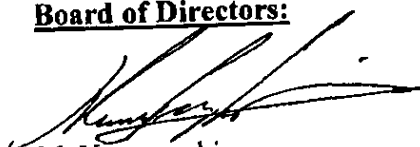
Remuneration of the Board of Directors

In 2008, the Board of Directors received no remuneration (2007: nihil).

Signing of the financial statements

Amsterdam, June 30, 2009

Board of Directors:



M. Yamaguchi



M. Terabatake

M. Franke

On behalf of JT International Netherlands B.V. (appointed as per 28 November, 2008)



Other information

Statutory rules concerning appropriation of result

According to the Article of Association of the Company, the net result of the Company is at the disposal of the General Meeting of Shareholders.

Appropriation of result for the financial year 2007

The annual report 2007 was adopted, by the shareholder, by means of a shareholder's resolution, on 4 November, 2008. The general meeting of shareholders determined the appropriation of result in accordance with the proposal being made to that end.

Proposed appropriation of result for the financial year 2008

Pending the decision of the General Meeting of Shareholders, the net result for the year 2008 is presented as unappropriated result in equity. Management proposes to add the result for the year to the retained earnings.

The financial statements do not yet reflect this proposal.

Subsequent events

In June 2009, JTI concluded an agreement with Tribac Leaf Limited and its affiliates (Tribac), a leaf tobacco supplier, to acquire Tribac's business. In addition JTI will enter into a long-term agreement with Tribac for the supply of leaf tobacco from Zimbabwe. The legal ownership transfer for Tribac has not yet taken place, as it is subject to several conditions, including approval from relevant anti-trust authorities. JTI expects the legal ownership transfer to take place later in 2009, as soon as all conditions are met. In a separate transaction, JTI signed an agreement with U.S.-based leaf tobacco suppliers Hail & Cotton and J.E.B to form a joint venture company JTI Leaf Services LLC (JTILS) for the procurement and processing of U.S. leaf tobacco.

Auditor's report

Reference is made to the auditors' report as included hereinafter.

To the Shareholder of JT Europe Holding B.V.
Hilversum

Date
June 30, 2009

From
P. Kuijpers

Reference
3100043195/OP9995/ahdr

Auditor's report

Report on the financial statements

We have audited the accompanying financial statements 2008 of JT Europe Holding B.V., Hilversum, which comprise the consolidated and company balance sheet as at December 31, 2008, the consolidated and company profit and loss account for the year then ended and the notes.

Management's responsibility

Management is responsible for the preparation and fair presentation of the financial statements and for the preparation of the managing director's report, both in accordance with Part 9 of Book 2 of the Netherlands Civil Code. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with Dutch law. This law requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial

June 30, 2009

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statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

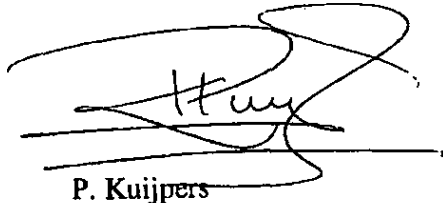
Opinion

In our opinion, the financial statements give a true and fair view of the financial position of JT Europe Holding B.V. as at December 31, 2008, and of its result for the year then ended in accordance with Part 9 of Book 2 of the Netherlands Civil Code.

Report on other legal and regulatory requirements

Pursuant to the legal requirement under 2:393 sub 5 part f of the Netherlands Civil Code, we report, to the extent of our competence, that the managing director's report is consistent with the financial statements as required by 2:391 sub 4 of the Netherlands Civil Code.

Deloitte Accountants B.V.



P. Kuijpers