

The Accounts of JT International Group Holding BV
are being filed in conjunction with the Accounts
of Gallaher Group Limited under the
consolidation exemption under Section 400 of the
Companies Act 2006

Company Registration No. 03299793

Gallaher Group Limited

Report and Financial Statements

31 December 2012

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Gallaher Group Limited

Report and financial statements 2012

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Gallaher Group Limited

Report and financial statements 2012

Officers and professional advisers

Directors

Martin Southgate
Mark Rock (resigned 3 April 2012)
Paul Williams
Samuel Pelichet

Secretary

Peter Ogden

Registered Office

Members Hill
Brooklands Road
Weybridge
Surrey
KT13 0QU

Solicitors

Slaughter and May
Freshfields Bruckhaus Deringer LLP

Auditor

Deloitte LLP
Chartered Accountants & Statutory Auditor
London
United Kingdom

Gallaher Group Limited

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2012

Principal activities and review of business

Gallaher Group Limited ("the Company") acts as an investment holding company. The Company's principal source of income is dividends from its investments, namely shares in wholly-owned subsidiaries. The timing of such dividends is determined by the Boards of the subsidiaries, in conjunction with the Company. No ordinary dividends were received from subsidiaries during the year (2011 £2,410,316,000). After accounting for net financing costs, exchange losses and other income, the Company reported a loss before tax of £5,949,000 for the year (2011 profit of £2,407,076,000). The directors are of the opinion that the Company is a going concern and the financial statements have been prepared on that basis (see note 1).

Results and dividends

The Company's profit and loss account set out on page 5 shows a loss on ordinary activities after taxation of £4,775,000 (2011 profit of £2,398,330,000). No ordinary dividends were declared or paid during the year (2011 £2,410,316,000).

Key performance indicators

Given the nature of the business, the Company's directors believe that analysis using key performance indicators other than the results above 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 principal risks and uncertainties that affect the Company include interest rate risk, liquidity risk, foreign currency risk and credit risk. These risks are partly managed at the Group level and partly at an individual business unit level. Further information on financial risk management is contained in note 10 to these financial statements.

Charitable and political donations

No political or charitable donations were made in the year (2011 £nil).

Directors

A list of the directors, together with dates of appointment and resignation, is given on page 1. No director held any interest in the shares of the Company during the year. No director had any interests during the year in any material contract with the Company. The Company has made qualifying third party indemnity provisions for the benefit of its directors which were made during the year and remain in force at the date of this report.

Auditor

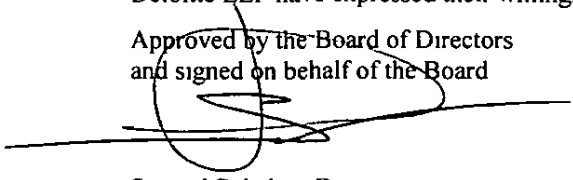
Each of the persons who is a director at the date of approval of this report confirms that

- so far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware, and
- the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is 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 auditor.

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



Samuel Pelichet, Director
25 March 2013

Gallaher Group Limited

Directors' responsibilities statement

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 judgements and accounting estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, 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 with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 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.

Independent auditor's report to the members of Gallaher Group Limited

We have audited the financial statements of Gallaher Group Ltd for the year ended 31 December 2012 which comprise the profit and loss account, the balance sheet and the related notes 1 to 16. 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 Chapter 3 of Part 16 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 auditor's 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 auditor

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 and express an opinion on 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 Ethical Standards for Auditors.

Scope of the audit of 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. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on the financial statements

In our opinion the financial statements

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 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.

Opinion on other matter prescribed in 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 Auditor
London, United Kingdom

26 March 2013

Gallaher Group Limited

Profit and loss account Year ended 31 December 2012

	Note	2012 £000	2011 £000
Income from ordinary shares in subsidiary undertakings	4	-	2,410,316
Administrative expenses		-	(28)
Exchange losses		(3,643)	(2,403)
Other income		1	-
Interest payable and other finance charges		(5,494)	(5,151)
Interest receivable and other finance income		3,187	4,342
Finance costs - net	5	(2,307)	(809)
(Loss)/profit on ordinary activities before taxation		(5,949)	2,407,076
Taxation	6	1,174	(8,746)
(Loss)/profit for the year		(4,775)	2,398,330

The results above relate to continuing operations

The Company has no recognised gains or losses other than the results above and therefore no separate statement of total recognised gains and losses has been presented.

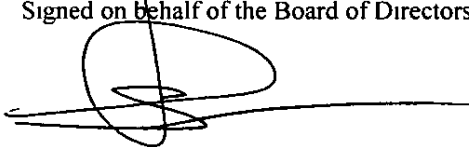
Gallaher Group Limited

Balance sheet 31 December 2012

	Note	2012 £000	2011 £000
Fixed assets			
Investments	7	<u>3,060,427</u>	<u>3,064,070</u>
Current assets			
Debtors	8	4,980	5,113
Creditors: amounts falling due within one year	9	<u>(426,575)</u>	<u>(425,576)</u>
Net current liabilities		<u>(421,595)</u>	<u>(420,463)</u>
Net assets		<u>2,638,832</u>	<u>2,643,607</u>
Capital and reserves			
Called up share capital	11	65,714	65,714
Capital contribution reserve	12	7,504	7,504
Share premium account	12	138,381	138,381
Revaluation reserve	12	1,756,529	1,756,529
Capital redemption reserve	12	7,872	7,872
Profit and loss account	12	<u>662,832</u>	<u>667,607</u>
Total equity shareholders' funds		<u>2,638,832</u>	<u>2,643,607</u>

The financial statements of Gallaher Group Limited (registered number 03299793) were approved by the Board of Directors on 25 March 2013

Signed on behalf of the Board of Directors



Samuel Pelichet
Director

Gallaher Group Limited

Notes to the accounts Year ended 31 December 2012

1. Accounting policies

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

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 BV, a company registered in the Netherlands, which prepares consolidated financial statements.

Going concern

The financial position of the Company, its cash flows and liquidity position are described in note 10 to the accounts. This includes an explanation as to how its financial risk management and exposures to credit risk and liquidity risk are managed at the Group level. The majority of the creditors classed as due with one year, whilst technically repayable on demand are not expected to be repaid within one year. The amounts that are expected to be repaid over the next year are matched against amounts that are expected to be received from other group companies either as dividends or repayment of the current receivable balances.

The Company is a holding company and indirectly owns several subsidiaries which deliver both strong profits and positive cash flows, notably Gallaher Limited in the UK, JTI Ireland Limited and JTI Kazakhstan LLC. The latest internal business plans of these companies, together with those of the other subsidiaries, have been considered by the directors.

After making enquiries, the directors have a reasonable expectation the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts.

Cash flow statement

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 has informed the directors of its intention to prepare a consolidated cash flow statement which incorporates the cash flows of the Company.

Revenue recognition

The Company's income comprises dividends from subsidiary undertakings and interest on loans provided to Group companies. Interest income is recognised on an accruals basis and dividends receivable are recognised when the company's right to receive payment has been established.

Foreign currencies

Transactions in foreign currencies are translated into sterling at the exchange rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into sterling at the exchange rates ruling at the balance sheet date and any exchange differences are taken to the profit and loss account.

Dividends

Dividend distributions to shareholders are recognised as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders or, in the case of interim dividends, when they are declared.

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.

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2012

1. Accounting policies (continued)

Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future, have occurred at the balance sheet date. Timing differences are differences between the Group's taxable profits and its results, as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on the tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

Fixed asset investment

Fixed asset investments comprise the Company's investments in its subsidiaries, which are carried at historical valuations, less provision for impairment where appropriate. The Company's investment in euro denominated preference shares issued by a subsidiary, Gallaher Limited, are retranslated into sterling at the exchange rates ruling at the balance sheet date and any exchange differences are taken to the profit and loss account.

Debtors

Debtors comprise amounts owed by group companies, prepayments and accrued income. They are measured at amortised cost using the effective interest method less impairment.

Creditors

Creditors are primarily related amounts owed to group companies and they are initially measured at fair value, and are subsequently measured at amortised cost, using the effective interest rate method.

Borrowings

Interest-bearing loans are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accruals basis to the income statement using the effective interest method and are added to the carrying amount of the instrument to the extent that they are not settled in the period in which they arise. All other borrowing costs are recognised in the income statement in the period in which they are incurred.

2. Directors' emoluments

The remuneration of the directors of the Company is 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 Group Limited

Notes to the accounts

Year ended 31 December 2012

3. Auditor's remuneration

The auditor's remuneration of £5,000 in respect of the statutory audit of the financial statements of the Company has been borne by Gallaher Limited, a related group company (2011 £5,000) The auditors have received no other remuneration during the year in respect of services provided to this company

4. Income from ordinary equity shares in subsidiary undertakings

	2012 £000	2011 £000
Dividends received and credited to income in the year		
Gallaher Overseas (Holdings) Limited	-	2,410,316

5. Finance costs - net

	2012 £000	2011 £000
Interest payable and other finance charges		
- on loans from Group undertakings	(5,494)	(5,151)
	(5,494)	(5,151)
Interest receivable and other finance income		
- income from preference shares in subsidiary undertaking	3,187	4,342
	3,187	4,342
Finance costs - net	(2,307)	(809)

6. Tax on profit on ordinary activities

a) Analysis of the tax (credit)/charge for the year

	2012 £000	2011 £000
UK corporation tax		
Current tax on profits for the year	-	-
Adjustments to tax charge in respect of prior periods	-	9,894
Current year group relief	(1,993)	(2,073)
Total current tax	(1,993)	7,821
Deferred tax		
Origination and reversal of timing differences in the year	819	925
Tax on (loss)/profit on ordinary activities	(1,174)	8,746

Gallaher Group Limited

Notes to the accounts Year ended 31 December 2012

6 Tax on profit on ordinary activities (continued)

b) Factors affecting the tax (credit)/charge for the year

The tax assessed for the year is lower than the standard rate of corporation tax in the UK at 24.5% (2011 26.5%)
The differences are explained below

	2012 £000	2011 £000
(Loss)/profit on ordinary activities before tax	(5,949)	2,407,076
(Loss)/profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 24.5% (2011 26.5%)	(1,457)	637,875
Effects of		
Timing differences relating to financial instruments	(647)	(700)
Non-taxable dividends received	(781)	(639,885)
Non-deductible expenditure and other items	892	637
Adjustments to tax charge in respect of prior periods	-	9,894
Current tax (credit)/charge for the year	(1,993)	7,821

A reduction in the corporation tax rate to 23% from 1 April 2013 was enacted in Finance Act 2012 prior to the balance sheet date. Further decreases to 21% from 1 April 2014 and 20% from 1 April 2015 have been announced, subject to enactment of Finance Bill 2013.

c) Analysis of deferred tax

	2012 £000	2011 £000
Movements during the year in the net deferred taxation asset		
At 1 January	2,642	3,567
Amount charged in the profit and loss account	(660)	(713)
Amount charged in the profit and loss account - effect of tax rate change	(159)	(212)
At 31 December	1,823	2,642

Deferred tax assets have been recognised in respect of temporary differences arising on derivative financial instruments because it is more likely than not that these assets will be recovered. There was no unprovided deferred tax at 31 December 2012 (2011 £nil).

Gallaher Group Limited

Notes to the accounts Year ended 31 December 2012

7. Fixed asset investments

	Ordinary shares in subsidiary undertakings £000	Preference shares in subsidiary undertakings £000	Total £000
At 1 January 2012	2,900,100	163,970	3,064,070
Exchange adjustments	-	(3,643)	(3,643)
At 31 December 2012	2,900,100	160,327	3,060,427

In 1997, the Company acquired 100% of the ordinary share capital of Gallaher Limited. The historical cost of this investment was £232,305,000. Following the acquisition, the investment was valued at £2,900,000,000 by the directors, based on external advice, the difference between the historical cost and the valuation being credited to a revaluation reserve. The Company's investment in Gallaher Limited euro-denominated preference shares and its investments in other subsidiaries are carried at a director's valuation, which is comparable to historical cost.

During 2008 and 2009, as part of corporate re-organisations, the Company transferred all of its investment in Gallaher Limited to another direct subsidiary, Gallaher Overseas (Holdings) Limited ("GOHL"), in exchange for ordinary shares issued by GOHL.

The investment in Gallaher Limited preference shares comprises 195 million non-voting variable rate cumulative preference shares of €1 each. The Company receives dividends based on 3-month Euribor plus 1.25% per annum, payable quarterly in arrears. On winding up, the preference shareholders rank above ordinary shareholders and are entitled to €1 per share and any dividends accrued but unpaid in respect of their shares. In the opinion of the directors, the carrying value of the preference shares approximates their fair value.

The directors have performed an annual impairment review and there is no indication of impairment at 31 December 2012.

Gallaher Group Limited is the beneficial owner of all of the equity share capital of its direct subsidiaries. The direct subsidiaries at 31 December 2012, both of which are unlisted, are shown below.

Name	Country of incorporation	Principal activity
Gallaher Overseas (Holdings) Limited	Great Britain	Investment holding company
JTI (UK) Finance PLC	Great Britain	Finance company

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2012

8. Debtors

	2012 £000	2011 £000
Amounts falling due within one year		
Amounts owed by Group undertakings - group relief	1,993	2,073
Amounts owed by Group undertakings - other	1,164	398
	<u>3,157</u>	<u>2,471</u>
Amounts falling due after more than one year		
Deferred tax assets (note 6)	1,823	2,642
	<u>4,980</u>	<u>5,113</u>

The carrying value of debtors approximates the fair value. Amounts owed by Group undertakings are unsecured and repayable on demand. There is no provision for impairment.

9. Creditors

	2012 £000	2011 £000
Amounts falling due within one year		
Amounts owed to Group undertakings - loans and interest payable	426,575	425,576

The carrying value of creditors approximates the fair value. Amounts due to Group undertakings are unsecured and repayable on demand.

10. Financial risk management

The Company's exposure to funding and liquidity, interest rates and foreign exchange is managed in line with JT Group's treasury policy framework. These risks are partly managed at the Group level and partly at an individual business unit level.

The Company does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

Interest rate risk management

The Company has interest bearing financial assets and liabilities.

The Company's financial assets are held for short periods before being used for working capital funding and the Company does not actively manage the interest rate risk on these assets. The interest rate exposure on the borrowings is managed with an appropriate mix between fixed and floating rate borrowings.

The sensitivity analyses below have been determined based on the exposure to interest rates for both derivative and non-derivative instruments at the reporting date. A 1% movement has been used and represents management's assessment of a reasonable possible change.

If interest rate had been 1% higher/lower and all other variables were held constant, the impact on the profit/loss for the year ended 31 December 2012 would be a decrease/increase of £2,649,000 (2011 increase/decrease of £2,609,000). This is mainly attributable to the Company's exposure to interest rates on its variable rate cash deposits and borrowings.

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2012

10. Financial risk management (continued)

Liquidity risk management

The Company manages the liquidity risk of financial liabilities by maintaining sufficient liquid financial assets and matching the maturity profiles of financial assets and liabilities. At 31 December 2012 and 31 December 2011, the creditors classed as due with one year, whilst technically repayable on demand are not expected to be repaid within one year. The amounts that are expected to be repaid over the next year will be matched against amounts that are expected to be received from other group companies either as dividends or repayment of current receivables balances.

The Company has no derivative financial instruments. Non-derivative financial liabilities at 31 December 2012 and 31 December 2011 comprise loans from Group undertakings that bear interest based on LIBOR plus a margin.

Foreign currency risk management

The Company has undertaken certain transactions denominated in Euros. Hence, exposures to exchange rate fluctuations arise. Exchange rate gains or losses are recognised in the profit and loss account in the period they are incurred.

Foreign currency sensitivity analysis

At 31 December 2012 and 31 December 2011, the Company's only foreign currency exposure relates to its Euro denominated investment in preference shares issued by Gallaher Limited, and the dividend income receivable thereon.

The table below details the Company's sensitivity to a 10% increase and decrease in the sterling rate against the Euro for both years, with all other variables remaining constant. A 10% movement in exchange rates based on the level of foreign currency denominated monetary assets and liabilities represent management's assessment of a reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items.

	Increase/(decrease) in profit	
	2012 £000	2011 £000
10% strengthening of sterling Euro	(14,575)	(14,906)
10% weakening of sterling Euro	<u>17,814</u>	<u>18,219</u>

Credit risk management

Credit risk relates to the risk that counterparty will default on its contractual obligations resulting in a financial loss to the Company. The Company's only financial assets are receivables owed by related parties.

The carrying amount of financial assets recorded in the financial statements, represents the Company's maximum exposure to credit risk.

Gallaher Group Limited

Notes to the accounts Year ended 31 December 2012

11. Called up share capital

	2012 £000	2011 £000
Allotted, called up and fully paid		
657,142,748 ordinary shares of 10p each	<u>65,714</u>	<u>65,714</u>

The Company has unlimited authorised share capital

12. Reserves

	Capital contribution reserve £000	Share premium account £000	Capital redemption reserve £000	Revaluation reserve £000	Profit and loss account £000
At 1 January 2012	7,504	138,381	7,872	1,756,529	667,607
Loss for the year	-	-	-	-	(4,775)
At 31 December 2012	<u>7,504</u>	<u>138,381</u>	<u>7,872</u>	<u>1,756,529</u>	<u>662,832</u>

Capital contribution reserve

Following the acquisition of the Company by Japan Tobacco Inc in April 2007, 1,444,926 share options held by eligible employees under the Savings related share option schemes ("SRSOS") were settled directly by JT at the acquisition share price of £11.40 per share. The cash amount received by the Company from the employees in respect of these share issues, being the appropriate share option price at the date of grant, has been credited to a capital contribution reserve

Capital redemption reserve

Upon the buy back of its own shares by the Company, the nominal value of the shares cancelled is transferred to a capital redemption reserve in accordance with Section 170(1) of the Companies Act 1985

13. Reconciliation of movements in shareholders' funds

	2012 £000	2011 £000
(Loss)/profit for year	(4,775)	2,398,330
Dividends paid on ordinary equity shares	-	(2,410,316)
Net decrease in shareholders' funds	(4,775)	(11,986)
Shareholders' funds at 1 January	<u>2,643,607</u>	<u>2,655,593</u>
Shareholders' funds at 31 December	<u>2,638,832</u>	<u>2,643,607</u>

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2012

14. 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

15. Contingencies

The Company has contingent liabilities in respect of bank and other guarantees and other matters arising in the ordinary course of business. It is not anticipated that any material liabilities will arise from the contingent liabilities. At 31 December 2012, the Company had no guarantees in respect of the financial obligations of subsidiaries (2011: £nil). In addition, the Company has provided a guarantee in respect of the financial obligations of Gallaher Limited related to the performance of interest rate swaps with a notional principal of £250,000,000 which were transferred during 2009, including all future cash flows under the swap contracts. At 31 December 2012, the Company had no contingent liabilities in respect of guarantees given in respect of third parties (2011: £nil).

16. Ultimate holding company and consolidation

The Company is a wholly-owned subsidiary of JTI (UK) Management Ltd, 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 International Group Holding B.V. (formerly JT Europe Holding B.V.), registered in Netherlands. Copies of the consolidated financial statements of JT International Group 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.

The Accounts of JT International Group Holding BV
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of Gallaher Group Limited under the
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ANNUAL REPORT 2012

JT INTERNATIONAL GROUP HOLDING B V , AMSTERDAM

(formerly known as JT Europe Holding BV)

Statutory seat
Office address

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

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MANAGING BOARD REPORT

General

JT International Group Holding B V (the “Company”) and its subsidiaries (together referred to as the “Group” or “JTI”) are a leading multinational tobacco business with a strong portfolio of brands deployed across numerous markets around the world. JT International Group 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, Japan and China.

Pursuant to new Dutch law effective January 1, 2013, the Company shall pursue a policy of having at least 30% of the seats on the Managing Board held by men and at least 30% of the seats held by women. Given the recent enactment of the new law and the fact that no new Managing Board Members have been appointed since January 1st, the Company did not meet the above-mentioned gender balance in 2012. The JTI Group will continue to strive for an adequate and balanced composition of its Managing Board in future appointments, by taking into account all relevant selection criteria, including but not limited to gender balance and executive experience.

1 Developments in the period ended December 31, 2012

The JTI Group delivered a strong performance in 2012 and has exceeded the Full Year earnings growth target. Our volume performance (+2.5%) was partly through acquisition but also as a result of organic growth, driven by the impressive volume increase of our Global Flagship Brands (GFB) (+4.8%), in particular Winston and LD. In Europe, we have successfully grown volume this year, an outstanding achievement considering the strong economic difficulties in the region. Furthermore, we have again grown our share in almost all of our key markets and improved our share of value in Russia.

Our financial results have also been strong with Core Revenue¹ and EBITDA² growing 13% and 23%, respectively, at constant rates of exchange. On a reported basis, this translates to growth of 5% and 9% for Core Revenue and EBITDA respectively, due to the strength of the US dollar against our major trading currencies.

On August 14, 2012 JTI Group acquired all outstanding share capital of Gryson NV and its subsidiaries (collectively referred to as “Gryson”). Gryson has established an important presence in the Roll Your Own (“RYO”) and Make Your Own (“MYO”) markets across Europe, including France, Belgium, Luxembourg, Spain and Portugal, as well as in a number of other countries. Through this acquisition, the Company enhanced its presence in the growing RYO/MYO segment. Total cash consideration of USD 634 million was paid to the selling shareholders.

¹ Core revenue does not include revenue from distribution, contract manufacturing and other peripheral businesses.

² Operating result adding back depreciation, impairment, amortization, restructuring gains and losses and all JT cross charges (service cross charge and royalties).

In June 2012, the JTI Group set up a new multicurrency syndicated credit facility with banks of EUR 1 billion for 5 years, in order to safeguard future potential funding requirements. The facility is guaranteed by JT Inc.

2 Financial position as at year-end 2012

The consolidated balance sheet as at year-end 2012 includes intangible fixed assets for an amount of USD 16,579 million (2011: USD 17,157 million). Total assets amount to USD 29,829 million (2011: USD 29,149 million). Total group equity of the Company amounts to USD 20,031 million (2011: USD 18,973 million). Current liabilities at year-end amount to USD 5,460 million (2011: USD 5,757 million).

3 Result analysis

Net sales were USD 13,096 million (2011: USD 12,545 million), an increase of USD 551 million (2011: increase USD 971 million) or 4.4% (2010: 8.4%) 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 cash flow volatility associated with foreign exchange rate changes. In 2012 and 2011, JTI used foreign currency forwards and swaps to economically hedge its exposure to fluctuations in Euro, GBP, Swiss Francs, Russian Ruble, Turkish Lira, Taiwan Dollar, Brazilian Real 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 statement of income.

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, the Company 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. The Company'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, 2012 there were no significant concentrations of credit risk with any individual counterparty or groups of counterparties related to the Company's use of derivative contracts. 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, 2012 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 the aforementioned criteria, research and development costs are expensed as incurred. For 2012, the research and development costs amount to USD 73 million (2011: USD 66 million).

6 Employee information

JTI employed an average number of 26,593 employees during 2012 (2011: 26,812).

7 Distribution of earnings

The distribution of the earnings of the Company is at the disposal of the general meeting of shareholders. The Managing Board proposes that the 2012 net result is added to the retained earnings. The financial statements do not yet reflect this proposal.

8 Future Outlook

Despite continued challenges from the economic and regulatory environment, JTI Group is committed to continue delivering 10% profit growth at constant rates of exchange. The Company forecasts a further increase of Core Revenue and EBITDA, driven by GFB volume growth and strong pricing.

2013 capex investment levels will increase from those in 2012, predominantly due to manufacturing and infrastructure projects. Research and Development investments remain broadly consistent with 2012. Management expects that future cash flows will be sufficient to repay existing external debt upon maturity. Headcount is planned at optimized levels sufficient to meet the requirements of the business as it continues to grow.

On March 1, 2013 JTI acquired all the outstanding shares of Al Nakhla Tobacco Company S A E and Al Nakhla Tobacco Company – Free Zone S A E (collectively, “Nakhla”). Headquartered in Egypt, Nakhla is one of the world’s leading waterpipe tobacco manufacturers with an important presence in its home market. The acquisition of Nakhla offers the Company an opportunity for growth in the waterpipe segment and widens the Company’s brand portfolio, in line with our strategy to address the needs of adult consumers across a range of tobacco product categories.

9 Others

Further information about the performance of JT can be found in the annual report 2012/2013 of Japan Tobacco Inc, Japan, the ultimate parent company of JT International Group Holding B V

Amsterdam, May 14, 2013

Managing Board:

PJO de Labouchere

GGA Vranken

A Saeki

M Iwai

J Fukuchi

CONSOLIDATED BALANCE SHEET
December 31, 2012
(before proposed appropriation of result)

A s s e t s

(in millions of USD)	December 31, 2012	December 31, 2011
Fixed assets		
Goodwill	13,306	13,792
Trademarks, distribution agreements and software	3,273	3,365
Intangible fixed assets (1)	16,579	17,157
Land, buildings and structures	869	842
Machinery and equipment	1,769	1,651
Fixed assets under construction	206	220
Assets not used for operations	-	4
Tangible fixed assets (2)	2,844	2,717
Participations in non-consolidated companies	242	213
Other securities	81	100
Deferred taxes	799	810
Financial fixed assets (3)	1,122	1,123
Total fixed assets	20,545	20,997
Current assets		
Leaf tobacco and consumables	2,410	2,466
Finished products	584	522
Others	311	277
Inventories (4)	3,305	3,265
Trade receivables	2,694	2,310
Other receivables	331	228
Prepaid expenses and excise taxes	1,780	1,436
Accrued income and others	124	112
Receivables and prepaid expenses (5)	4,929	4,086
Cash and cash equivalents (6)	1,050	801
Total current assets	9,284	8,152
Total assets	29,829	29,149

JT INTERNATIONAL GROUP HOLDING B V , AMSTERDAM

Group equity and liabilities

(in millions of USD)	December 31, 2012	December 31, 2011
Group equity (7)		
Equity attributable to equity holder	19,875	18,824
Minority interest	156	149
Total Group equity	20,031	18,973
Provisions (8)		
Pensions and post-retirement benefits	1,318	1,011
Other benefit obligation	104	83
Taxes	1,787	1,838
Others	48	63
	3,257	2,995
Long-term liabilities (9)		
Bonds	662	1,034
Others	419	390
	1,081	1,424
Current liabilities		
Current portion of long-term liabilities to third parties (9)	433	1,021
Taxes and social security contributions	2,959	2,593 *
Trade accounts payable	468	535
Short-term borrowings to banks	237	402
Amounts due to affiliates (10)	167	159
Accrued expenses	965	874
Others	231	173 *
	5,460	5,757
Total equity and liabilities	29,829	29,149

* The comparative figures have been adjusted to improve the comparability.

CONSOLIDATED STATEMENT OF INCOME
Year ended December 31, 2012

(in millions of USD)	2012	2011
Gross sales	35,354	33,963
Less excise taxes	22,258	21,418
Net sales (11)	13,096	12,545
Cost of sales	5,933	6,036
Gross margin	7,163	6,509
Selling and related expenses	3,338	3,218
General and administrative expenses	1,503	1,384
Total expenses	4,841	4,602
Operating result	2,322	1,907
Result of equity accounted investments	34	24
Net interest result (12)	(103)	(112)
Net foreign exchange result	(142)	(28)
Net other financial income and expenses	(2)	(4)
Net financial result	(247)	(144)
Result on ordinary activities before taxation	2,109	1,787
Income taxes (13)	(712)	(602)
Result on ordinary activities after taxation	1,397	1,185
Minority interest	(44)	(37)
Net result for the year	1,353	1,148
Foreign currency translation adjustment	(18)	(260)
Hedge of net investment losses, net of tax	-	48
Actuarial losses on post-employment benefit obligations	(284)	(18)
Other comprehensive income / (loss)	(302)	(230)
Comprehensive income / (loss)	1,051	918

CONSOLIDATED STATEMENT OF CASH FLOWS
Year ended December 31, 2012

(in millions of USD)

(According to the indirect method)	2012	2011
Cash flows from operating activities		
Net result for the year	1,353	1,148
Adjustments for		
Income taxes	712	602
Depreciation, amortization and impairments	1,592	1,671
Result of equity accounted investments	(34)	(24)
Unrealized foreign exchange (gain)/loss	101	67
Other non-cash items	(13)	(9)
Net interest result	43	100
Minority interest	44	37
	2,445	2,444
Changes in assets and liabilities, net of acquired companies		
Trade and other receivables	(354)	(360)
Inventories	12	152
Prepaid expenses and excise taxes	(353)	(46) *
Other assets	(22)	30 *
Trade payables	(52)	84 *
Taxes and social security contributions	357	120 *
Other liabilities	129	17 *
	(283)	(3)
Cash provided from operations	3,515	3,589
Dividends received from associates	22	15
Net interest paid	(26)	(124)
Income tax paid	(760)	(593)
Net cash provided by operating activities (carry forward)	2,751	2,887

* The comparative figures have been adjusted to improve the comparability

JT INTERNATIONAL GROUP HOLDING B V , AMSTERDAM

(in millions of USD)	2012	2011
Net cash provided by operating activities (brought forward)	2,751	2,887
Cash flows used in investing activities		
Purchase of tangible fixed assets	(546)	(503)
Proceeds from sale of assets	46	22
Proceeds from sale of subsidiary	3	-
Acquisitions, net of cash received	(580)	(433)
Investments in an associate	(12)	-
Net cash used in investing activities	(1,089)	(914)
Cash flows used in financing activities		
Net decrease in short-term borrowings	(172)	(16)
Repayment of borrowings	(998)	(1,627)
Proceeds (repayment) of borrowing from affiliates	8	(327)
Proceeds from long-term borrowings		
Other financing	(39)	(15)
Net cash used in financing activities	(1,201)	(1,985)
Net cash used in operating, investing and financing activities	461	(12)
Cash and cash equivalents as at January 1	801	888
Effect of exchange rate differences on cash and cash equivalents	(212)	(75)
Cash and cash equivalents as at December 31	1,050	801

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2012

General

JT International Group Holding B V , (“the Company”), having its statutory seat in Amsterdam, the Netherlands and offices in Hilversum, the Netherlands, is a wholly-owned subsidiary of Japan Tobacco Inc (‘JT’), Tokyo, Japan

The Company changed its legal name of JT Europe Holding B V into JT International Group Holding BV on October 17, 2012

The comparative figures for 2011 have been reclassified to conform with current year’s presentation

Operations

JT International Group Holding B V “(the Company)” and its subsidiaries (together referred to as the “Group” or “JTI”) are a leading multinational tobacco business with a strong portfolio of brands deployed across numerous markets around the world. JTI has a license agreement with JT, granting JTI the exclusive rights to use certain JT trademarks outside the United States, Japan and China

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

Basis of preparation

The financial statements have been prepared under the historical cost convention, except for certain financial instruments that have been measured at fair value, 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

US dollar financial statements

The Company belongs to a multinational, which operates on a world-wide basis. In accordance with Article 2:362, Section 7 of the Netherlands Civil Code, the US Dollar (“USD”) is the presentation currency of the Company’s financial statements. All amounts in these financial statements are recorded in millions of USD, unless stated otherwise

General accounting principles for the preparation of the consolidated financial statements

Consolidation Principles

The consolidated financial statements include the accounts of the Company and its controlled subsidiaries. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Investments in business entities over which the Company exercises significant influence (but not control) are accounted for using the equity method of accounting. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. Under the equity method, investments in associates are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Company's share of the net assets of the associate, less any impairment in the value of individual investments.

Non-controlling interests in subsidiaries are identified separately from the Company's equity therein. Those interests may initially be measured at fair value or at the proportionate share of the fair value of the acquiree's identifiable net assets. The choice of measurement is made on an acquisition-by-acquisition basis.

Subsequent to acquisition, the carrying amount of non-controlling interests is the amount of those interests at initial recognition plus the non-controlling interests' share of subsequent changes in equity. Total comprehensive income is attributed to non-controlling interests even if this results in the non-controlling interests having a deficit balance.

When the Company loses control of a subsidiary, the profit or loss on disposal is computed as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets (including goodwill), less liabilities of the subsidiary and any non-controlling interests. Amounts previously recognized in other comprehensive income in relation to the subsidiary are accounted for (i.e. reclassified to profit or loss or transferred directly to retained earnings) in the same manner as would be required if the relevant assets or liabilities are disposed of.

All significant intercompany balances and transactions have been eliminated in consolidation.

The financial information relating to the Company 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.

Foreign currencies

US Dollar is the functional currency of the Company and the presentation currency for these consolidated financial statements

Foreign currency transactions are translated in the functional currency of each subsidiary at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are translated at the rates prevailing at that date.

Assets and liabilities of the Company's foreign operations are translated at exchange rates prevailing at the balance sheet date. Income and expense items are translated at the exchange rates prevailing at the monthly average rate. Exchange differences are recognised in other comprehensive income and accumulated in equity (attributed to non-controlling interests as appropriate).

Financial instruments

Receivables

Trade and other receivables are stated at face value and, if applicable, less allowances 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 contractual maturities of three months or less at the date of purchase.

Derivative instruments and hedging activities

The Company uses derivative and non-derivative financial instruments to mitigate its foreign currency and interest rate risk and not for speculative or trading purposes. Derivatives are not designated as accounting hedges. All derivatives are recognized as assets or liabilities and measured at fair value in the Company's consolidated balance sheets. Derivatives are classified as other current assets and other current liabilities to the extent they mature within 12 months of the balance sheet date. Changes in the fair value of derivatives are included in the consolidated statement of income in the period in which they occur.

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 these instruments that have been designated and have qualified as hedging instruments are included in the consolidated statement of comprehensive income on a net of tax basis. The gain (loss) relating to the ineffective portion, if any, is recognized immediately in the statement of income within net financial income. Gains and losses accumulated in equity are included in the statement of income when the foreign operation is disposed of or sold.

Fair Value of Financial Instruments

The Company uses fair values to measure certain financial instruments. In addition, certain non-financial instruments are accounted for at fair value on a non-recurring basis.

The Dutch Accounting Standards ("DAS") 290 paragraph 524 states that the fair value of financial instruments is computed based on generally accepted measurement models and evaluation techniques. DAS 290 does not prescribe a particular valuation model. The Company therefore used three levels of inputs that may be used to measure fair value:

- 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 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 inputs are unobservable inputs that are supported by little or no market activity. Valuation of Level 3 assets and liabilities requires significant management judgment to develop estimates of fair value. Estimates are not necessarily indicative of the amounts that could be realized in a current market transaction.

Derivative financial instruments are recognized and measured at fair value in the Company's consolidated statement of financial position. Carrying amounts of receivables, payables, accrued expenses and short-term debt approximate their fair values.

The estimated fair value of long term debt is disclosed in note 11. Fair values are estimated based on market prices (for public debt) or interest rates currently available to the Company for borrowings with similar terms and remaining maturities (for bank and related party debt).

Long-term liabilities

Interest-bearing loans and liabilities are valued at amortized cost.

Inventories

Consistent with recognized industry practice, inventories of leaf tobacco that must be cured for more than 12 months are classified as current assets. Inventories are stated at the lower of weighted-average cost or market value. Inventory write-downs and write-offs are recorded as a component of cost of sales.

Leaf tobacco inventories include the following cost elements:

- Leaf purchasing and overhead costs
- Storage costs during leaf curing
- Inbound freight costs

Tangible fixed assets

Tangible fixed assets are stated at historical cost, net of accumulated depreciation and accumulated impairment losses. Costs incurred after the acquisition are recognised as assets if it is probable that additional economic benefits will flow to the Company, and the benefit can be measured reliably. Other repair and maintenance costs are recognised as expense when incurred.

Properties in the course of construction for production or administrative purposes are carried at cost less any recognized impairment loss. Cost includes professional fees and, for qualifying assets, borrowing costs capitalized in accordance with the Company's accounting policy. Depreciation of these assets, commences when the assets are ready for their intended use.

Depreciation charge is computed on a straight-line basis over the following estimated useful lives:

Buildings	20-50 years
Leasehold improvements	10-20 years (or lease term, if shorter)
Machinery and equipment	3-15 years

Land is not depreciated.

Business combinations and related goodwill

Most assets and liabilities of the acquired businesses are recorded at their estimated fair values at the acquisition date. Goodwill represents the excess of the purchase price over the fair value of net assets, including the amount assigned to identifiable intangible assets. Where applicable, the consideration includes any asset or liability resulting from a contingent consideration arrangement, measured at its acquisition-date fair value.

Goodwill arising in a business combination is recognized as an asset at the date that control is acquired.

Based on the long-established lives of JTI's global flag brands and significant support for such brands, a 20-year amortization period has been selected for goodwill

Goodwill is tested for impairment at least annually or more frequently if events occur or circumstances change, which indicate that the book value might not be recoverable

Intangible assets other than goodwill

Intangible assets on the Company's balance sheet are carried at cost less accumulated amortization and impairment, and consist mainly of trademarks acquired and software

Amortization is computed on a straight-line basis over the following estimated useful lives

Trademarks	20 years
Computer software	5 years
Other intangibles	3-6 years

Impairment of long-lived assets, other than goodwill

Long-lived tangible and intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or cash generating unit (CGU) may not be recoverable. An impairment loss is recognized to the extent that the carrying amount exceeds the higher of the asset's or CGU's fair value less costs to sell or its value in use. At each reporting period, an assessment is made as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased due to a change in the assumptions used to determine the recoverable amount. If such indication exists, the Company estimates the asset's or CGU's recoverable amount. When the recoverable amount exceeds the asset's or CGU's carrying amount, the impairment loss is reversed up to a ceiling of the lower of the estimated recoverable amount or the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years.

Leases

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

Assets held under finance leases are capitalized as part of the tangible fixed assets at the present value of the minimum lease payments and depreciated over their useful economic lives or the lease term, whichever is shorter. The corresponding lease commitments are shown as obligations to the lessor and the interest element of lease obligations is charged to the statement of income over the lease term. Rentals paid under operating leases are charged to the statement of income over the lease term on a straight-line basis.

Retirement Benefits

In alignment with the Dutch Accounting Standards (“DAS”) 271, “Employee Benefits”, paragraph 101, JTI elects to apply IAS 19

The Company offers both defined benefit and defined contribution plans. A defined contribution plan is a post-employment benefit plan under which the Company pays fixed contributions into a separate fund and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. A defined benefit plan is a post-employment benefit plan other than a defined contribution plan.

The cost of providing benefits under the defined benefit plans is determined separately for each plan using the projected unit credit method with actuarial valuations being carried out at each balance sheet date. The net defined benefit asset or liability comprises the present value of the defined benefit obligation, less the fair value of plan assets. The present value of the defined benefit obligation is computed using a discount rate based on high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension obligation. In countries where there is no deep market in corporate bonds, the discount rate reflected in this calculation is based on the market rates of government bonds.

Actuarial gains and losses relating to each plan are recognized in the statement of comprehensive income as incurred. Past service costs are recognized in the statement of income on a straight line basis over the average period until the benefits become vested. To the extent that the benefits are vested immediately following the introduction of, or changes to, a defined benefit plan, the Company recognizes past service cost immediately in the statement of income.

The value of any defined benefit asset recognized is restricted to the sum of any past service costs not yet recognized and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Contributions to defined contribution plans are recognized as an expense when employees have rendered service entitling them to the contributions.

Provisions

Provisions are recognized when the Company has a present obligation as a result of a past event, it is probable that the settlement of obligation is required, and a reliable estimate can be made of the amount of the obligation.

The amounts recognized as provisions are the current best estimate of the expenditure required to settle the present obligation at the end of the reporting period by taking into consideration the risks and uncertainties relating to the obligations. When the effect of the time value of money is material, the amount of a provision is measured at the present value of the expenditures expected to be required to settle the obligation.

Restructuring provisions are recognized when the Company has a detailed formal plan for restructuring and has raised a valid expectation in those affected that the restructuring will be carried out. Provisions include only the direct expenditures arising from the restructuring, which are necessarily entailed by the restructuring and not associated with the ongoing activities of the Company.

Contingencies

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

Revenue recognition

The Company recognizes revenue from the sale of goods when the significant risks and rewards of the goods are transferred to the buyer (usually this is upon delivery), the amount of revenue can be measured reliably and it is probable that economic benefits associated with the transaction will flow to the entity.

Revenue is recognized net of VAT, excise taxes, other sales related taxes, sales and marketing incentives, including prominent display fees, payments linked to specific performance criteria (such as targeted sales volumes, ranging and stock availability) and payments to support shelf price reduction in relation to promotional activity. Obligations related to sales incentives that involve retrospective payments to customers are estimated principally by reference to the Company's historical experience with similar programs and the probability that the sales incentive will take place.

Shipping and handling fees billed to customers are included in gross revenues, while shipping and handling costs incurred directly are included in cost of sales.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognized in the profit and loss in the period in which they are incurred. Capitalized borrowing costs were insignificant in 2012 and 2011.

Research and development

Research and development costs are expensed as incurred

Income taxes

The tax expense for the period comprises current and deferred tax. Tax is recognized in the statement of income, except to the extent that it relates to items recognized in other comprehensive income. In this case, the tax is also recognized in other comprehensive income.

The current income tax charge is computed on the basis of the tax laws enacted or substantively enacted at the balance sheet date in the countries where the Company operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions, where appropriate, on the basis of amounts expected to be paid to the tax authorities. The Company classifies any penalties as a component of income tax and interest as finance expense.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted at the balance sheet date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the parent and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Use of estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the Netherlands requires management to make judgments, estimates and assumptions about the carrying amounts of assets, liabilities, revenues and expenses and related disclosures, including the disclosure of contingent assets and liabilities. Actual results could differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision

affects only that period or in the period of the revision and future periods if the revision affects both current and future periods

The areas that require the most significant and sensitive judgments and estimates include

- **Impairment of Non-financial Assets** The impairment test for goodwill is based on value in use calculations that use a discounted cash flow model. The cash flows are derived from the annual plan for the following three years, and do not include restructuring activities that the Company is not yet committed to or significant future investments that will enhance the asset base of the cash generating unit being tested
- **Retirement Benefits** The cost of defined benefit pension plans and other post-employment medical benefits as well as the present value of the pension obligation is determined based on actuarial valuations. The actuarial valuations involve making assumptions about demographics (including mortality rates), discount and inflation rates, and future salary increases. All assumptions are reviewed at each reporting date. In determining the appropriate discount rate for the Company's most significant plans, management uses high-quality corporate bond yield curves reflecting the expected timing and amount of the future benefit payments for the respective countries. A consistent assumption is used across the Eurozone. For the other plans, the discount rate is based on high-quality corporate or government bond yields with a duration consistent with underlying pension obligations. The mortality rates are based on publicly available mortality tables for the specific country and include an allowance for future improvements in life expectancy, in all countries where this is available
- **Deferred tax assets** These assets are recognized for all available tax losses and deductible temporary differences to the extent that it is probable that taxable profit will be available against which the losses and deductible temporary differences can be utilized. Significant judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies
- **Provisions and contingencies** The determination of legal and tax contingencies, and the estimation of provisions for such liabilities are subject to uncertain future events, and may extend over several years. The timing and/or amount may differ from current assumptions

Statement of cash flows

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

The funds in the cash flow statement consist of cash and cash equivalents. Cash equivalents can be considered as highly liquid investments

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

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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)**

Movements are as follows

(in millions of USD)	Goodwill	Trademarks distribution agreements and software	Total
Acquisition price at historical cost	18 783	5,054	23 837
Accumulated amortization as of December 31, 2011	(4 991)	(1,689)	(6,680)
Book value as of December 31, 2011	13 792	3,365	17,157
Additions through business combinations	462	81	543
Additions acquired separately	-	18	18
Amortization for the year	(948)	(297)	(1,245)
Transfers	-	3	3
Currency translation adjustments	-	103	103
Book value as of December 31, 2012	13 306	3,273	16 579
Acquisition price at historical cost	19,245	5 305	24 550
Accumulated amortization as of December 31, 2012	(5,939)	(2 032)	(7,971)
Book value as of December 31 2012	13,306	3,273	16 579

On August 14, 2012 the Company acquired all outstanding share capital of Gryson NV and its subsidiaries (collectively referred to as "Gryson") for an amount of USD 634 million

Tangible fixed assets (2)

Movements are as follows

(in millions of USD)	Land, buildings and structures	Machinery and equipment	Assets under construction	Assets not used for operations	Total
Acquisition price at historical cost	1,128	3 417	220	4	4 769
Accumulated depreciation as of December 31, 2011	(286)	(1,766)	-	-	(2 052)
Book value as of December 31, 2011	842	1,651	220	4	2,717
Additions through business combinations	13	18	-	-	31
Additions acquired separately	28	227	197	-	452
	883	1,896	417	4	3,200
Book value of the disposals	(6)	(12)	(1)	-	(19)
Depreciation for the year	(45)	(298)	-	-	(343)
Impairments	-	(4)	-	-	(4)
Transfers	22	177	(206)	(4)	(11)
Currency translation adjustments	15	10	(4)	-	21
Book value as of December 31 2012	869	1,769	206	-	2 844
Acquisition price at historical cost	1 166	3,755	206	-	5,127
Accumulated depreciation as of December 31, 2012	(297)	(1,986)	-	-	(2,283)
Book value as of December 31, 2012	869	1 769	206	-	2 844

Net transfers out in 2012 and 2011 relate to assets transferred to assets held for sale and intangible assets

The present value of future minimum lease payments for assets under finance leases was USD 2 million at December 31, 2012 (2011 USD 2 million) Of that amount, USD 1 million is due within one year

No assets were pledged as collateral in 2012 or 2011

Financial fixed assets (3)

Movements are as follows

(in millions of USD)	Participations in non-con- solidated companies	Securities and deferred charges	Deferred income taxes	Total
Book value as of December 31, 2011	213	100	810	1,123
Purchases and loan granted	12	2	-	14
Sales and redemptions	-	(2)	-	(2)
Share in result	34	-	-	34
Dividends received	(22)	-	-	(22)
Charged to Other Comprehensive income / (loss)	-	-	92	92
Credited to Statement of Income, net	-	-	(143)	(143)
Transfers and reclassifications	-	(18)	19	1
Currency translation adjustments	5	(1)	21	25
	<u>242</u>	<u>81</u>	<u>799</u>	<u>1,122</u>
Book value as of December 31, 2012	<u>242</u>	<u>81</u>	<u>799</u>	<u>1,122</u>

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

Deferred income taxes

The components for the deferred income taxes are as follows

(in millions of USD)	2012	2011
Temporary differences	863	847
Tax credits and carry forward losses	347	333
	<u>1,210</u>	<u>1,180</u>
Offset deferred tax assets and liabilities	(289)	(145)
Valuation allowances	(122)	(225)
	<u>799</u>	<u>810</u>
Balance as of December 31		

The deferred tax assets are reflected in the balance sheet after offsetting assets and liabilities where there is a legally enforceable right to offset and where the deferred income taxes relate to the same fiscal authority

The realization of deferred tax assets is assessed 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 deferred income taxes include an amount of USD 134 million (2011: USD 136 million) which is of a short-term nature.

Inventories (4)

The carrying amounts of inventories were as follows

(in millions of USD)	2012	2011
Leaf tobacco and consumables	2,410	2,466
Finished products	584	522
Others	311	277
	<u>3,305</u>	<u>3,265</u>
Balance as of December 31		

Receivables, prepaid expenses and accrued income (5)

Receivables and prepaid expenses consist of

(in millions of USD)	2012	2011
Net trade receivables	2,694	2,310
Other receivables	331	228
Prepaid expenses and taxes	1,780	1,436
Accrued income and others	124	112
Balance as of December 31	4,929	4,086

The trade receivables are stated net of allowances of USD 17 million (2011 USD 18 million)

The receivables, prepaid expenses and accrued income include an amount of USD 202 million (2011 USD 203 million) of a long-term nature

Cash and cash equivalents (6)

Included in the cash balance above as of December 31, 2012 is USD 172 million (2011 USD 113 million) held by the Iranian subsidiary JTI Pars PJS Co. Due to international sanctions imposed on Iran, the subsidiary's ability to remit funds outside of Iran is restricted

Equity attributable to equity holder (7)

For the breakdown of equity attributable to equity holders, reference is made to the Company balance sheet and the notes to Company financial statements

The movement in minority interest is as follows

(in millions of USD)	2012	2011
Balances as of January 1	149	129
Result for the year	44	37
Currency translation adjustment	3	(4)
Adjustments arising from change in non-controlling interest	3	5
Dividend paid to minority interest	(43)	(18)
Balances as of December 31	156	149

Provisions (8)

Provisions comprise

(in millions of USD)	2012	2011
Pensions and post-retirement benefits	1,318	1,011
Other benefit obligations	104	83
Taxes	1,787	1,838
Others	48	63
Balances as of December 31	3,257	2,995

Provisions (continued)**Retirement benefit schemes**

The Company sponsors funded and unfunded defined benefit plans and defined contribution plans as employee retirement benefit plans. The benefits on defined benefit plans are based on conditions, such as points that employees acquired in compensation for each year of service, the payment rate, years of service, average salary in their final year of service before retirement and others.

Special termination benefits may be provided to employees on their leave before the usual retirement date under certain circumstances.

Schedule of defined benefit obligations

(in millions of USD)	Pension benefits 2012	Post- retirement benefits 2012	Total 2012	Total 2011
Change in defined benefit obligation				
Present value at 1 January	3,255	269	3,524	3,401
Current service cost	59	5	64	59
Interest cost	149	12	161	175
Curtailments, settlements and special termination benefits	7	2	9	24
Past service cost	(9)	3	(6)	2
Benefit payments	(189)	(10)	(199)	(176)
Contributions by plan members	11	-	11	13
Actuarial losses	465	39	504	62
Foreign exchange and other	128	8	136	(36)
Present value at 31 December	3,876	328	4,204	3,524

Provisions (continued)**Schedule of plan assets**

(in millions of USD)	Pension benefits 2012	Post- retirement benefits 2012	Total 2012	Total 2011
Change in plan assets				
Fair value at 1 January	2,700	-	2,700	2,585
Expected return on plan assets	112	-	112	140
Company contributions	114	1	115	104
Benefit payments	(134)	(2)	(136)	(133)
Contribution by plan members	11	-	11	13
Transfer in	-	23	23	-
Actuarial gains	123	2	125	14
Foreign exchange and other	107	1	108	(23)
Fair value at 31 December	3,033	25	3,058	2,700
Actual return on scheme assets	235	2	237	154

The Company expects to contribute USD 98 million to its funded defined benefit pension plans and USD1 million to its funded post-retirement medical plans in 2013

Provisions (continued)**Reconciliation of defined benefit obligations and plan assets**

The amounts recognized in the balance sheets and the funded status at December 31, 2012 and 2011 are as follows

(in millions of USD)	Pension benefits 2012	Post- retirement benefits 2012	Total 2012	Total 2011
Present value of funded obligations	(3,103)	(79)	(3,182)	(2,683)
Fair value of plan assets	3,033	25	3,058	2,700
Surplus / (deficit) of funded plans	(70)	(54)	(124)	17
Present value of unfunded obligations	(773)	(249)	(1,022)	(841)
Unrecognized past service credit	-	(1)	(1)	(2)
Net liability in the balance sheets	(843)	(304)	(1,147)	(826)
Presented as				
Non-current assets	171	-	171	185
Non-current liabilities	(1,014)	(304)	(1,318)	(1,011)
	(843)	(304)	(1,147)	(826)

The allocation of the funded pension plans' fair values of assets by asset category was as follows at December 31, 2012

Asset category	2012	2011
Equity securities	41%	39%
Debt securities	46%	50%
Real estate	2%	2%
Cash and other assets	11%	9%
	100%	100%

The Company's investment strategy for pension plan assets comprises a blend of assets that are a reasonable match for the pension liabilities and assets that are targeting long-term growth. The assets targeting long-term growth are well diversified across individual securities, industry sectors and countries. Plan assets are rebalanced periodically in line with the target asset

Provisions (continued)

allocations The Company aims to maintain adequate liquidity to enable immediate and medium-term benefit payments At December 31, 2012 and 2011, excluding any self-investment through pooled funds, none of the Company's pension plan assets had investments in JT shares, or in property occupied by or other assets used by JT International Holding BV or JT

Matters related to actuarial assumptions

The weighted-average assumptions used to determine the results are included in the following table The assumptions are those applicable to the net liability at the balance sheet date, and the costs for the annual period following that balance sheet date

	Pension benefits 2012	Post retirement benefits 2012	Pension benefits 2011	Post retirement benefits 2011
Discount rate	3.71%	3.83%	4.57%	4.58%
Expected long-term return on plan assets	(1)	(1)	4.08%	-
Rate of compensation increase	3.30%	3.27%	3.30%	3.25%
Inflation rate	2.37%	2.06%	2.49%	2.07%

- (1) The expected return on asset assumption will no longer be relevant under IAS 19 rev 2011, therefore this assumption is not applicable at this date for the determination of the 2013 pension and post-retirement benefit expenses

The expected rate of return on plan assets assumption at December 31, 2012 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 if the pension fund is not expected to rebalance to the target in the short term

Healthcare cost trend rate assumptions for the post-retirement benefit plans were as follows

	2012	2011
Health care cost trend rate for next year	5.78%	6.06%
Ultimate healthcare cost trend rates	5.25%	5.42%
Years to ultimate rate	3	5

Provisions (continued)

Assumed healthcare cost trend rates have a significant effect on the amounts reported for post-retirement benefit plans. A one-percentage-point change in the assumed healthcare cost trend rates would have had the following effects on the Company's net periodic benefit cost for 2012 and on the benefit obligation at December 31, 2012

(in millions of USD)	1-percentage point increase (in millions of USD)	1-percentage point decrease (in millions of USD)
Effect on sum of service cost and interest cost for 2012	4	(3)
Effect on postretirement benefit obligation at December 31, 2012	63	(50)

Experience adjustments based on results of defined benefit obligations and plan assets

The following table contains a summary of the present value of the defined benefit obligation and the fair value of the plan assets and the experience adjustments arising on these since the Company's transition to IAS 19 on 1 January 2010

(in millions of USD)	Pension benefits 2012	Post- retirement benefits 2012	Total 2012	Total 2011	Total 2010
Present value of defined benefit obligations	(3,876)	(328)	(4,204)	(3,524)	(3,401)
Fair value of scheme assets	3,033	25	3,058	2,700	2,585
Deficit in the scheme	(843)	(303)	(1,146)	(824)	(816)
Experience (gains) losses on scheme liabilities	58	7	65	(94)	(14)
Experience gains on scheme assets	(123)	(2)	(125)	(14)	(93)

Income statement related to retirement benefits

Amounts recognized in the income statement in respect of the Company's defined benefit schemes are as follows

(in millions of USD)	Pension benefits 2012	Post retirement benefits 2012	Total 2012	Total 2011
Current service cost	59	5	64	59
Past service cost	(9)	3	(6)	2
Curtailment, settlements and special termination benefits	7	2	9	25
Expected return of plan assets	(112)	-	(112)	(140)
Interest cost	149	12	161	175
	<u>94</u>	<u>22</u>	<u>116</u>	<u>121</u>

Of the expense for the year, USD 23 million (2011 USD 26 million) was included in the income statement as cost of sales, USD 33 million (2011 USD 37 million) as administrative expenses, USD 50 million (2011 USD 35 million) as finance expense and USD 10 million (2011 USD 23 million) as restructuring and impairment expense

The cumulative actuarial gains and losses recognized in other comprehensive income since the date of transition to IFRS is USD 369 million (2011 USD 85 million)

Other benefit obligation

The provision for other employee benefits relates to former and inactive employees, not being retired, such as salary continuation, supplemental unemployment benefits, severance benefits and disability-related benefits including continuation of benefits such as health benefits and life insurance coverage

(in millions of USD)	2012
Balance as of January 1, 2012	83
Additions	38
Withdrawals	(17)
Balance as of December 31, 2012	104

An amount of USD 15 million is considered to be of a short-term nature

Taxes

Movements in tax provisions are as follows

(in millions of USD)	Deferred income taxes	Uncertain tax positions	Total 2012
Book value as of January 1, 2012	1 022	816	1,838
Credited / (charged) to Income Statement	(53)	(33)	(86)
Credited / (charged) to Other Comprehensive Income / (expense)	(3)	-	(3)
Settlements	-	(63)	(63)
Transfers and nettings	19	-	19
Currency translation adjustments	71	19	90
Others	-	(8)	(8)
Book value as of December 31, 2012	<u>1,056</u>	<u>731</u>	<u>1,787</u>

The provisions for deferred income taxes and uncertain tax positions can be considered to be of as short-term nature for the amounts of USD 29 million and USD 33 million, respectively

Other provisions

The other provisions mainly relate to restructuring plans, litigation cases and jubilee plans for personnel. Movements are as follows

(in millions of USD)	2012	2011
Balance as of January 1,	63	76
Additions	45	97
Utilization	(9)	(14)
Release of unused amounts	(14)	-
Transfers and reclassifications	(37)	(96)
Balance as of December 31	<u>48</u>	<u>63</u>

In 2012, the Company announced a restructuring plan related to its Austrian distribution business. The plan principally includes employee termination costs of USD 10 million and post-employment costs of USD 21 million. Transfers out of restructuring provision relate to the reclassification of these amounts to post-employment liabilities at year end.

In 2011, the Company announced a restructuring plan that involved closure of the Hainburg (Austria) factory and rationalization of the Vienna Regional Office. The plan principally included employee termination costs of USD 23 million, post-employment costs of USD 20 million and impairment of buildings and machinery of USD 46 million. Transfers out of restructuring provision include USD 49 million to fixed assets (impairment), USD 41 million to post

employment liabilities and USD 6 million to other balance sheet accounts. Restructuring plans are expected to be completed by December 2013.

Long-term liabilities (9)

The long-term liabilities are as follows

(in millions of USD)	Long-term liability	Current portion	Total 2012
Bonds	662	402	1,064
Other bank loans	1	-	1
RGI valuation payment	35	31	66
Accrued and other liabilities	383	-	383
Total book value as of December 31, 2012	1,081	433	1,514

The long-term liabilities mature within a period of five years. The current portion of the long-term liabilities is classified as current liabilities.

Bonds

At December 31, 2012, the Company had outstanding bonds of 5.75% Eurobond of GBP 250 million (due 2013) and 4.5% Eurobond of EUR 500 million (due 2014), respectively.

Syndicated credit facilities to banks

At December 31, 2012, the Company had access to unused credit facilities of approximately 3.7 billion (2011: USD 5.2 billion), including USD 1.3 billion available under a committed syndicated facility (2011: USD 3.2 billion).

RGI Valuation Payment

As part of 2007 Gallaher acquisition, JTI acquired a 50% interest in R.J. Reynolds-Gallaher International Sarl ("RGI"), a joint venture with R.J. Reynolds Tobacco Co. The joint venture was terminated on December 31, 2007 and JTI agreed to pay a valuation payment in February 2008. The remaining liability as of December 31, 2012 amounts to USD 66 million.

Current liabilities

Amounts due to affiliates (10)

(in millions of USD)	2012	2011
Short-term borrowings to JT affiliates	26	8
Accounts payables	141	151
Balance as of December 31	167	159

Commitments and contingencies

Lease commitments

The Company leases various buildings, computer equipment and vehicles under non-cancellable operating leases. The aggregate rental expense was USD 98 million and USD 111 million in 2012 and 2011, respectively.

At the balance sheet date, the Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

(in millions of USD)	2012	2011
Within one year	68	85
Between two and five years	136	147
After five years	54	8
Balance as of December 31	258	240

Financial commitments

The Company is a party to the 2007 Cooperation Agreement with the European Commission ("EC") to combat the contraband and counterfeit of cigarettes in the European Union. Payments totaling USD 400 million will be made over 15 years and used by the EC and participating Member States to support anti-contraband and anti-counterfeit initiatives. The Company paid USD 15 million in 2012 and USD 50 million in 2011 as part of this Agreement. In 2012, USD 5 million was reimbursed by the Company's parent, JT, and USD 15 million in 2011. The remaining amount due to EC at December 31, 2012 is USD 135 million. The related expense will be recognized as incurred.

In the normal course of business the bank guarantees, issued on behalf of JTI, amounted to USD 1.5 billion and USD 1.6 billion as of December 31, 2012 and 2011 respectively.

CONTINGENCIES

Tobacco Litigation

Various legal actions, proceedings, and claims are pending or may be instituted against JT International Holding BV ("JTIH") and its subsidiaries. JTIH is a subsidiary of the Company. 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.

While JTIH and its subsidiaries have 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, JTIH has never lost a case or paid any settlement award in connection with smoking and health-related litigation against it or any of its subsidiaries.

Smoking and Health Litigation Status

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

Class or group actions

Canada - In February 2005, a Quebec trial court authorized two class actions against a JTIH subsidiary. The actions were filed in late September 2005. The first class, comprising Quebec residents allegedly suffering from certain diseases, seeks collective recovery of approximately USD 5.2 billion (CAD 5.2 billion) from all defendants (which include two competing cigarette manufacturers) in addition to damages for individual members and punitive damages. The second class, composed of allegedly addicted smokers in Quebec, seeks collective recovery of approximately USD 17.49 billion (CAD 17.8 billion) from all defendants (which include two competing cigarette manufacturers) in addition to individual and punitive damages. The joint trial began in March 2012 and is on-going.

CONTINGENCIES (continued)

In July 2009, four class actions seeking unquantified damages were filed in Saskatchewan, Manitoba, Alberta and Nova Scotia against a JTIH subsidiary as well as a number of other manufacturers participating in the Canadian cigarette market. In March 2010, the Saskatchewan claim was served upon the subsidiary. The Saskatchewan, Manitoba, and Nova Scotia class actions are currently dormant. The Alberta claim was not served within one year of filing, and has expired as a result.

In July 2010, two class actions seeking unquantified damages were filed and served in British Columbia against a JTIH subsidiary as well as a number of other manufacturers participating in the Canadian cigarette market. These class actions are currently dormant.

In June 2012, a class action seeking unquantified damages was filed in Ontario against a JTIH subsidiary as well as a number of other manufacturers participating in the Canadian cigarette market. It was served on the subsidiary in November 2012 and is currently dormant.

Israel - 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 1.6 billion (ILS 5.8 billion) in total damages from all defendants, which include a number of distributors and manufacturers of competing products in the Israeli market. The action was served on a distributor that may have indemnity rights against a JTIH subsidiary other than the one named in the action. The action was not, however, served on the named JTIH subsidiary. The Court of First Instance dismissed the Plaintiffs' claim in March 2013, and the decision became final on 27 April 2013.

Health-care cost recovery actions

Canada - In January 2001, the Province of British Columbia brought an action under its Tobacco Damages and Health-Care Costs Recovery Act against a JTIH subsidiary, 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.

In August 2009, a JTIH subsidiary commenced an action in the Quebec Superior Court against the Attorney General of Quebec challenging the validity of the Tobacco-Related Damages and Health-Care Costs Recovery Act on grounds of violation of the rule of law under the Canadian Constitution and of juridical rights and due process in relation to property rights under the Quebec Charter of Rights and Freedom. Discovery is on-going.

CONTINGENCIES (continued)

In March 2008, the Province of New Brunswick filed a health-care cost recovery action against a JTIH subsidiary and other manufacturers under its own Tobacco Damages and Health-Care Costs Recovery Act, seeking unquantified damages. These proceedings are at an early stage. Discovery is on-going.

In September 2009, the Province of Ontario filed a similar health-care cost recovery action against a JTIH subsidiary and other manufacturers under its own Health-Care Costs Recovery Act, seeking USD 50 billion (CAD 50 billion) in damages. These proceedings are at an early stage as some of the international defendants are waiting for the Court of Appeal's judgment further to the dismissal by the trial court of their application challenging the jurisdiction of the court.

In February 2011, the Province of Newfoundland and Labrador filed a similar health-care cost recovery action against a JTIH subsidiary and other manufacturers under its own Health-Care Costs Recovery Act, seeking unquantified damages. The proceedings are at an early stage as some of the defendants are challenging the jurisdiction of the court.

In May 2012, the Province of Manitoba filed a health-care cost recovery action against a JTIH subsidiary and other manufacturers under its own Tobacco Damages and Health-Care Costs Recovery Act, seeking an unspecified amount of damages. The subsidiary was served with the claim in July 2012. The proceedings are at an early stage as some of the defendants are challenging the jurisdiction of the court.

In June 2012, the Province of Alberta filed a health-care cost recovery action against a JTIH subsidiary and other manufacturers under its own Tobacco Damages and Health-Care Costs Recovery Act, seeking USD 10 billion (CAD 10 billion) in damages. The subsidiary was served with the claim in July 2012. The proceedings are at an early stage as some of the defendants may challenge the jurisdiction of the court.

In June 2012, the Province of Quebec filed a health-care cost recovery action against a JTIH subsidiary and other manufacturers under its own Tobacco Damages and Health-Care Costs Recovery Act, seeking USD 60 billion (CAD 60 billion) in damages. The subsidiary was served with the claim in June 2012. The proceedings are at an early stage as some of the defendants are challenging the jurisdiction of the court.

In June 2012, the Province of Saskatchewan filed a health-care cost recovery action against a JTIH subsidiary and other manufacturers under its own Tobacco Damages and Health-Care Costs Recovery Act, seeking an unspecified amount of damages. The subsidiary was served with the claim in July 2012. The proceedings are at an early stage as some of the defendants are challenging the jurisdiction of the court.

CONTINGENCIES (continued)

In September 2012, the Province of Prince Edward Island filed a health-care cost recovery action against a JTIH subsidiary and other manufacturers under its own Tobacco Damages and Health-Care Costs Recovery Act, seeking an unspecified amount of damages. The subsidiary was served with the claim in November 2012. The proceedings are at an early stage. Some of the defendants may challenge the jurisdiction of the court.

A number of defendants applied to join the Canadian Federal Government as a third party to the actions throughout Canada. In British Columbia, the application was challenged by the Federal Government and dismissed at first instance. The Court of Appeal reversed the decision in part. In July 2011, the Supreme Court of Canada decided that the Federal Government could not be added as a third party to the action in British Columbia. In November 2012, the Quebec Court of Appeal denied the right of the defendants to join the Federal Government as a third party.

Spain - 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 Andalucia 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. The Junta's appeal was ultimately rejected by the Supreme Court in September 2009.

Following the above proceeding, in July 2008, the subsidiary in Spain was, together with the same other manufacturers, informed of the existence of a second contentious-administrative proceeding brought by the Junta de Andalucia 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 recognized by the Court in the previous proceeding. In January 2009, the Court notified the subsidiary that the time for the filing of the Junta's claim was effectively suspended by their filing a procedural motion. In May 2009, the Defendants were notified that the Junta filed their claim following such suspension. Until early 2010, the proceedings were effectively stayed pursuant to a brief filed by the State Attorney claiming that the second case should not proceed until the appeal in the first contentious-administrative case was resolved. In January 2010, the Court dismissed the brief pursuant to the Supreme Court's decision in the first contentious-administrative case, resuming the proceedings in the second case. In April 2010, the State Attorney filed its defense. In May 2010, the Court ordered the remaining co-defendants to file their defenses within 20 days. In May 2010, the co-defendants filed preliminary objections and a request that the court file be completed. In June 2012, the Court ordered the Claimants to file the missing evidence in order to complete the court file. The Claimants failed to comply with this order. The case is pending.

CONTINGENCIES (continued)

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 nine instances in Canada, claims are asserted under a statute enacted specifically to permit such an action

CONTINGENCIES (continued)

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 alleged injured party.

Other Tobacco-Related Litigation

Canada - In April 2010, a class composed of tobacco growers in the province of Ontario served a JTIH subsidiary with an action seeking USD 50 million (CAD 50 million) for an alleged breach of contract between the Ontario Flue-Cured Tobacco Growers Marketing Board and the subsidiary. Similar proceedings were issued separately against two other manufacturers participating in the Canadian cigarette market. The proceedings are on-going.

In April 2012, a JTIH subsidiary filed a claim in the Ontario Superior Court of Justice seeking a declaration that the regulations, which increase the size of the health warnings in Canada from 50% to 75% of the packages' display area, are unconstitutional on the grounds that they are an unjustifiable interference with consumers' and the company's rights to freedom of expression as guaranteed by the *Canadian Charter of Rights and Freedoms*. The Federal Government has filed its statement of defense.

Rest of world - In 2006, a JTIH subsidiary in Spain was sued under a criminal procedure on smuggling-related allegations after a tax inspection by the Spanish authorities. The subsidiary was required to establish a guarantee for its maximum potential liability of approximately USD 8 million (EUR 6 million), which was delivered to the Court in July 2008. The trial hearing, scheduled to begin in April 2013, was postponed to July 2013.

CONTINGENCIES (continued)

A JTIH subsidiary in Turkey has disputed the Turkish Ministry of Finance's assessment of corporate tax for 2009. The amount of alleged tax due was assessed at USD 8 million (TRY 14 million) plus default interest. In November 2011, the subsidiary filed a claim for the cancellation of the assessment after the introduction of the Turkish Tax Amnesty Law. In February 2013, the Court of First Instance cancelled the corporate tax assessment. In March 2013, the Turkish Ministry of Finance filed its appeal.

In December 2011, a JTIH subsidiary filed a claim in the High Court of Australia challenging the constitutionality of Australia's "plain packaging" law of 1 December 2011. Other tobacco manufacturers have filed similar claims in the High Court challenging the constitutionality of the law. The claims were heard by the High Court in April 2012. In August 2012, the subsidiary's claim for declaratory relief was dismissed.

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 subsidiaries. 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 subsidiaries 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 or adverse outcomes for tobacco defendants could have an adverse effect on JTIH. JTIH and its subsidiaries believe that they have a number of valid defenses to any such actions and intend to defend such actions vigorously.

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 JTIH has not provided any amounts in its consolidated financial statements for unfavorable outcomes, if any.

CONTINGENCIES (continued)

Other Litigation

A JTIH subsidiary in the United Kingdom terminated a 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 the subsidiary in April 2008. In distantly related litigation, a business partner of the former distributor filed an action in Cyprus against the former distributor and the subsidiary, seeking more than USD 25 million in unparticularized damages for alleged breach of an exclusive distribution agreement for Yemen. An order permitting service on the subsidiary was set aside in February 2008.

In June 2008, a JTIH subsidiary in Tanzania received from the Tanzania Fair Competition Commission ("FCC") 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 56 million (TSH 87.7 billion). In a decision dated 31 March 2009, the FCC issued its findings and proposed penalties against the subsidiary. In turn, the latter objected and requested a full hearing. In October 2009, the FCC held that it has jurisdiction to hear and determine the complaint against the subsidiary. Accordingly, the subsidiary filed a petition with the Tanzanian High Court to seek a determination of all the preliminary issues raised before the FCC. The case is pending.

JTIH and its subsidiaries are also subject to other claims and suits which arise periodically relating to contracts, income and other taxes, advertising regulation, and other matters. JTIH and its subsidiaries believe 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 (10)

The Company and its subsidiaries have the following related party arrangements with its parent JT

- 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,
- Cost sharing agreement under which JT partially reimburses JTI for payments made under the EC anti-contraband and anti-counterfeit agreement (see Note 9, financial commitment paragraph),
- Service agreement that entitles JTI to receive from JT fees for certain accounting and administrative services

JTI's operating income includes the following related-party transactions with JT and other related parties

(in millions of USD)	2012	2011
Sale of leaf inventory and finished goods to		
• JT	389	345
• Other related parties	968	955
• Others	22	16
	<u>1,379</u>	<u>1,316</u>

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

(in millions of USD)	2012	2011
Royalties to JT	355	328
Purchases of tobacco material, non-tobacco material and finished goods from JT		
• JT	257	283
• Other related parties	69	78
Others	-	1
	<u>681</u>	<u>690</u>

Foreign currency arrangements (11)

The Company conducts business on a multinational basis in a wide variety of foreign currencies and is therefore exposed to the following risks due to foreign exchange fluctuations

- The risk that the profit or loss and cash flow in each functional currency is affected by foreign exchange fluctuations as a result of external transactions and intercompany transactions in currencies that are different from that functional currency
- The risk that the equity of the Company is affected by foreign exchange fluctuations when equity balances denominated in each functional currency is translated into US Dollars on consolidation
- The risk that the profit or loss of the Company is affected by foreign exchange fluctuations when profit or loss denominated in each functional currency of the group is translated into US Dollars on consolidation

The Company uses derivatives to reduce cash flow volatility associated with foreign exchange rate changes. In 2012 and 2011, the Company used foreign exchange forwards and swaps to economically hedge its exposure to fluctuations in Russian Ruble, Euro, Sterling, Swiss Francs, Turkish Lira, Taiwan Dollars, Brazilian Real and certain other currencies. All foreign currency derivative contracts have maturities of twelve months or less.

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

Interest rate risk

Interest rate risk is the risk that the Company's interest expense will fluctuate because of changes in market interest rates. The Company's exposure to the risk of changes in market interest rates relates primarily to the Company's short-term debt obligations (including bonds). In connection with the acquisition of Gallaher in 2007, the Company incurred floating-rate indebtedness and assumed the acquiree's fixed-rate debt obligations. To reduce its cost of borrowing and to manage its risk related to interest rate fluctuations, the Company uses fixed-to-floating interest rate swaps maturing through 2013.

At December 31, 2012 after taking into account the effect of interest rate swaps, approximately 58% (2011: 31%) of the Company's borrowings are at a fixed rate of interest.

Foreign currency arrangements (Continued)

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Company's profit before tax from the impact of floating rate borrowings

(in millions of USD)	(Increase) / decrease in basis points	(Increase) / decrease in profit before tax (in millions of USD)
GBP	+100Bp	5
Euro	+100Bp	2
GBP	-100Bp	(5)
Euro	-100Bp	(2)

Credit risk

Credit risk relates to the risk that a counter-party will default on its contractual obligations resulting in financial loss to the Company. The Company is exposed to credit risk from its trade receivables due from customers, as well as from cash and cash deposits and derivative financial instruments transacted with financial institutions.

The Company performs appropriate credit checks on customers before sales commence. The process for monitoring and managing credit risk once sales to the customer have been established varies depending on local practices in the countries concerned. Certain territories have bank guarantees, other guarantees and credit insurance provided in the Company's favor in respect of trade receivables. The issuance and terms of insurance and guarantees are dependent on local practices. Apart from Megapolis group, the largest customer of the Company, the Company does not have any significant credit risk exposure to any single counterparty.

Cash deposits and other financial instruments give rise to credit risk on the amounts due from counterparties. To mitigate the counterparty credit risk, the Company 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. Generally, the Company targets a long-term counterparty credit rating of at least A/A2. Counterparty credit risk is managed on a global basis by limiting the aggregate amount and duration of exposure to any one counterparty, taking into account its credit rating. The credit ratings of all counterparties are reviewed regularly. At December 31, 2012 there were no significant concentrations of credit risk with any individual counterparty or group of counterparties related to the Company's use of derivative contracts.

Foreign currency arrangements (Continued)

Fair Value of Financial Instruments

As of December 31, 2012, the fair value of the long-term portion of the bonds, issued by the Company, amounted to USD 717 million (2011 USD 1,100 million) and a corresponding carrying amount of USD 662 (2011 USD 1,034)

As of December 31, 2012, the fair value of the short-term portion of the bonds did not differ from the carrying amount of USD 402 million (2011 USD nil)

Financial assets and liabilities measured at fair value subsequent to initial recognition are as follows

	December 31, 2012			
	Level 1	Level 2	Level 3	Total
(in millions of USD)				
Assets				
Debt securities	1	-	-	1
Derivative assets	-	41	-	41
Total assets	<u>1</u>	<u>41</u>	<u>-</u>	<u>42</u>
Liabilities				
Derivative liabilities	-	47	-	47
Total liabilities	<u>-</u>	<u>47</u>	<u>-</u>	<u>47</u>

Foreign currency arrangements (Continued)

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

Asset Derivatives (in millions of USD)			
	Balance Sheet location	Fair Value	Notional Value
Foreign exchange swaps	Accrued income and others	39	3,600
Interest rate caps	Accrued income and others	-	402
Interest rate swaps	Accrued income and others	2	402
		<u>41</u>	<u>4,404</u>
Liability Derivatives (in millions of USD)			
	Balance Sheet location	Fair Value	Notional Value
Foreign exchange swaps	Other current liabilities	45	1,950
Interest rate swaps	Other current liabilities	2	24
		<u>47</u>	<u>1,974</u>

The impact of derivative contracts on the 2012 statement of income was as follows

(in millions of USD)	Statement of income location	Gain / (Loss)
Foreign exchange swaps	Net foreign exchange result	<u>(6)</u>
		<u>(6)</u>

Notes to the specific items of the consolidated statement of income

Net sales (12)

All sales are generated with tobacco products, mainly being cigarettes

Net sales per geographical areas are as follows

(in millions of USD)	2012	2011
Europe	5,887	5,921
CIS	4,054	3,738
Asia Pacific	1,184	1,192
Americas	397	391
Others	1,574	1,303
Total	13,096	12,545

Cost of sales

In 2012 USD 57 million (2011 USD 46 million) was recognized as an expense within cost of sales related to write down of inventories

Salaries, social security charges and pension costs

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

(in millions of USD)	2012	2011
Wages and salaries	1,603	1,527
Social security charges	227	201
Pension cost	187	188
	2,017	1,916

Amortization and depreciation expenses

Amortization expenses related to intangible fixed assets and depreciation expenses related to tangible fixed assets are included in costs of sales, selling and related expenses and general and administrative expenses, and totaled as follows

(in millions of USD)	2012	2011
Amortization for the year	1,245	1,226
Depreciation for the year	343	388
	<u>1,588</u>	<u>1,614</u>

Auditor fees

Total fees charged by Deloitte to the Group were as follows

(in millions of USD)	2012	2011
Audit fees	9	9
Tax fees	2	2
All other fees	2	2
	<u>13</u>	<u>13</u>

The fees paid for the audit of the statutory financial statements of JT International Group Holding B V , rendered by Deloitte Accountants B V , Amsterdam, amounted to USD 111 thousands and USD 118 thousands for the years 2012 and 2011, respectively

Employee information

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

	2012	2011
The Netherlands	110	104
Europe	10,392	10,462
CIS	8,282	8,490
Americas	1,955	2,513
Asia Pacific	1,800	1,817
Others	4,054	3,426
	<u>26,593</u>	<u>26,812</u>

Net interest result (13)

(in millions of USD)

	2012	2011
Interest income from third parties	56	62
Interest expenses to third parties	(159)	(174)
	<u>(103)</u>	<u>(112)</u>

Income taxes (14)

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

(in millions of USD)	2012	2011
Result on ordinary activities before taxation	2,107	1,787
Income taxes computed at statutory Dutch tax rates (25%)	527	447
Increase / (decrease) in valuation allowance on deferred tax positions	72	(44)
Non-deductible expenses, net of non-taxable income	307	287
Increase of uncertain tax positions, net	(55)	134
Cost of earnings repatriation	93	51
Foreign tax rate differential	(223)	(232)
Change in substantively enacted or enacted tax rates	(27)	(25)
Others	18	(16)
Provisions for income taxes	712	602
Effective tax rate in %	33.8	33.7

At December 31, 2012 and 2011, JTI had net operating losses (NOL) of USD 1.3 billion and USD 1.5 billion respectively, which are available to reduce future taxable income of JTI and certain international subsidiaries. Approximately USD 733 million of NOL expires within 15 years, with the remainder having no expiration date under current laws. Deferred taxes of USD 161 million were recognized in respect of these losses.

At December 31, 2012 JTI had tax credits carried forward of USD 12 million (2011: USD 10 million) having an expiry date within 15 years and USD 33 million (2011: USD 31 million) having no expiry date. Deferred taxes of USD 1 million were recognized in respect of these credits.

The provisions for income taxes on items of other comprehensive gains and losses amounted to a gain of USD 95 million (2011: USD 27 million loss).

JT INTERNATIONAL GROUP HOLDING B V , AMSTERDAM

COMPANY BALANCE SHEET

December 31, 2012

(before proposed appropriation of the result)

A s s e t s

(in millions of USD)

	December, 31, 2012	December, 31, 2011
Fixed assets		
Financial fixed assets (1)	19,851	18,820
Current assets		
Receivables from group companies	24	4
Total assets	<u>19,875</u>	<u>18,824</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, 2012	December, 31, 2011
Equity attributable to equity holder (2)		
Share capital	1,800	1,789
Share premium	14,314	14,314
Retained earnings	3,256	2,403
Currency translation adjustment	(848)	(830)
Unappropriated result	1,353	1,148
	19,875	18,824
Total equity and liabilities	<u>19,875</u>	<u>18,824</u>

JT INTERNATIONAL GROUP HOLDING B V , AMSTERDAM

COMPANY STATEMENT OF INCOME
Year ended December 31, 2012

(in millions of USD)	2012	2011
Share in net result of subsidiaries, net of tax	1,353	1,148
Other results	-	-
Net result for the year	1,353	1,148

NOTES TO THE COMPANY FINANCIAL STATEMENTS
December 31, 2012

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 statement of income

Since the results of the Company are included in the consolidated statement of income, the Company financial statements only contain an abridged statement of income in accordance with article 2 402 of the Netherlands Civil Code

Notes to the specific items of the balance sheet

Financial fixed assets (1)

The financial fixed assets consist of participations in group companies The movements in financial fixed assets were as follows

(in millions of USD)	2012	2011
Balance as of December 31	18,820	17,903
Share in net result of subsidiaries, net of tax	1,353	1,148
Currency translation adjustments	(18)	(260)
Hedge net investment, net of tax	-	48
Additional minimum pension liability, net of tax	(284)	(18)
Dividends received	(16)	(1)
Disposal of participation in a subsidiary	(3)	-
Others	(1)	-
Balance as of December 31	<u>19,851</u>	<u>18,820</u>

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)

Movements are as follows

(in millions of USD)	Share capital	Share premium	Retained earnings	Currency translation adjustments	Unappro- priated result	Total 2012	Total 2011
Balance as of January 1,	1,789	14,314	2,403	(830)	1,148	18,824	17,906
Appropriation of net result prior year	–	–	1,148	–	(1,148)	–	–
Hedge of net investment losses, net of tax	–	–	–	–	–	–	48
Foreign currency translation adjustments	–	–	–	(18)	–	(18)	(260)
Actuarial losses on post- employment benefit obligations	–	–	(284)	–	–	(284)	(18)
Foreign currency translation adjustment on share capital	11	–	(11)	–	–	–	–
Net result for the year	–	–	–	–	1,353	1,353	1,148
Balance as of December 31	<u>1,800</u>	<u>14,314</u>	<u>3,256</u>	<u>(848)</u>	<u>1,353</u>	<u>19,875</u>	<u>18,824</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

Share capital issued

On October 17, 2012, the share capital of EUR 1,380,018,401, consisting of 3,000,040,002 shares of EUR 0.46 each, was converted into USD. After the conversion, the share capital amounts to USD 1,800,372 (thousands) and consists of 1,800,372,005 shares of USD 1 each.

As of December 31, 2011, the share capital denominated in EUR was translated into USD against an USD/EUR exchange rate of 0.7715. The authorized share capital amounted to EUR 6,900,000,000 and was divided into 15,000,000,000 shares of EUR 0.46. The issued share capital amounted to EUR 1,380,018,401 and consisted of 3,000,040,002 shares of EUR 0.46 each.

Other notes and signing of the financial statements

Personnel

In 2012 the Company employed no employees (2011: 0)

Remuneration of the Managing Board

In 2012, the Managing Board of the Company received remuneration for their services to the Company and its subsidiaries amounting to USD 7.5 million (2011: nihil). The Managing Board members were not subject to the so-called crisis tax.

JT INTERNATIONAL GROUP HOLDING B V , AMSTERDAM

Signing of the financial statements

Amsterdam, May 14, 2013

Managing Board:

PJO de Labouchere

GGA Vranken

A Saeki

M Iwai

J Fukuchi

Other information

Independent auditor's report

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

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 2011

The annual report 2011 was adopted, by the shareholder, by means of a shareholder's resolution, on May 7, 2012. The shareholders determined the appropriation of result in accordance with the proposal being made to that end.

Proposed appropriation of result for the financial year 2012

Pending the decision of the General Meeting of Shareholders, the net result for the year 2012 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

On March 1, 2013, JTI acquired all the outstanding shares of Al Nakhla Tobacco Company S A E and Al Nakhla Tobacco Company – Free Zone S A E (collectively, "Nakhla"). The acquisition does not have a material effect on the Company's consolidated accounts.

Headquartered in Egypt, Nakhla is one of the world's leading waterpipe tobacco manufacturers with an important presence in its home market. The acquisition of Nakhla offers the Company an opportunity for growth in the waterpipe segment and widens the Company's brand portfolio, in line with our strategy to address the needs of adult consumers across a range of tobacco product categories.

At March 6, 2013, JTI granted an uncommitted multi-currency credit facility of USD 5 billion to its parent company JT Inc., Japan for a period of 5 years. JTI is not obliged to grant funds to JT Inc. if the funds are not available.

Independent auditor's report

To The Shareholder of JT International Group Holding B V

Report on the annual accounts

We have audited the accompanying annual accounts 2012 of JT International Group Holding B V , Amsterdam, which comprise the consolidated and company balance sheet as at December 31, 2012, the consolidated and company statement of income for the year then ended and the notes, comprising a summary of the accounting policies and other explanatory information

Management's responsibility

Management is responsible for the preparation and fair presentation of these annual accounts and for the preparation of the managing board report, both in accordance with Part 9 of Book 2 of the Dutch Civil Code Furthermore management is responsible for such internal control as it determines is necessary to enable the preparation of the annual accounts that are free from material misstatement, whether due to fraud or error

Auditor's responsibility

Our responsibility is to express an opinion on these annual accounts based on our audit We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing This requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the annual accounts are free from material misstatement

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual accounts. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the annual accounts, 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 annual accounts 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 annual accounts



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

Opinion with respect to the annual accounts

In our opinion, the annual accounts give a true and fair view of the financial position of JT International Group Holding B V as at December 31, 2012 and of its result for the year then ended in accordance with Part 9 of Book 2 of the Dutch Civil Code.

Report on other legal and regulatory requirements

Pursuant to the legal requirement under Section 2 393 sub 5 at e and f of the Dutch Civil Code, we have no deficiencies to report as a result of our examination whether the managing board report, to the extent we can assess, has been prepared in accordance with Part 9 of Book 2 of this Code, and whether the information as required under Section 2 392 sub 1 at b-h has been annexed. Further we report that the managing board report, to the extent we can assess, is consistent with the annual accounts as required by Section 2 391 sub 4 of the Dutch Civil Code.

Amsterdam, May 14, 2013

Deloitte Accountants B V

Signed on the original P Kuipers