

The Accounts of JT Europe Holding B V are being filed
in conjunction with the Gallaher Group Limited
Accounts 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 2009

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Gallaher Group Limited

Report and financial statements 2009

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Gallaher Group Limited

Report and financial statements 2009

Officers and professional advisers

Directors

Andrew Bingham

James Boxford

Laura Carr (appointed 11 February 2009, resigned 19 March 2010)

Brian Murphy

Lorenzo Pillarini

Eddy Pirard

Secretary

Andrew Bingham

Registered Office

Members Hill

Brooklands Road

Weybridge

Surrey

KT13 0QU

Solicitors

Slaughter and May

Freshfields Bruckhaus Deringer LLP

Auditors

Deloitte LLP

Chartered Accountants

London

Gallaher Group Limited

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2009

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. Ordinary dividends received from subsidiaries during the year amounted to £197m (2008 £4m). After accounting for net financing costs, exchange gains and administrative expenses, the Company reported a profit before tax of £306m for the year (2008 loss of £276m). 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 profit on ordinary activities after taxation of £303m (2008 loss of £216m). Ordinary dividends amounting to £200m were declared and paid during the year (2008 £200m).

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 managed at the Group level rather than 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 (2008 £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.

Auditors

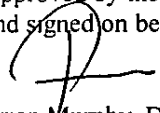
Each of the persons who is a director at the date of approval of this report confirms that

- so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware, and
- the director has taken all the steps that 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 auditors are aware of that information.

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

Deloitte LLP have expressed their willingness to continue in office as auditors.

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


Brian Murphy, Director
31 March 2010

Gallaher Group Limited

Statement of directors' responsibilities

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations

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

- select suitable accounting policies and then apply them consistently,
- make judgements and 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 auditors' report to the members of Gallaher Group Limited

We have audited the financial statements of Gallaher Group Ltd for the year ended 31 December 2009 which comprise the profit and loss account, the reconciliation of movements in shareholders' funds, the balance sheet and the related notes 1 to 15. 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 auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As more fully explained in the Directors' Responsibilities Statements, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practice Board's (APB'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.

Opinion

In our opinion the financial statements

- give a true and fair view of the state of the company's affairs as at 31 December 2009 and of its profit 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 matter prescribed in the Companies Act 2006

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

Matters on which we are required to report by exception

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

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



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

31 March 2010

Gallaher Group Limited

Profit and loss account

Year ended 31 December 2009

	Notes	2009 £m	2008 £m
Income from ordinary shares in subsidiary undertakings	4	197	4
Administrative expenses		-	(1)
Exchange gains/(losses)		141	(299)
Interest payable and other finance charges	5	(60)	(95)
Interest receivable and other finance income	5	28	115
Finance costs - net	5	(32)	20
Profit/(loss) on ordinary activities before taxation		306	(276)
Taxation	6	(3)	60
Profit/(loss) for the year		303	(216)

The results above relate to continuing operations

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

Gallaher Group Limited

Reconciliation of movements in shareholders' funds Year ended 31 December 2009

	2009	2008
	£m	£m
Profit/(loss) for year	303	(216)
Dividends paid on ordinary equity shares	(200)	(200)
Net increase/(decrease) in shareholders' funds	103	(416)
Shareholders' funds at 1 January	2,562	2,978
Shareholders' funds at 31 December	2,665	2,562

Gallaher Group Limited

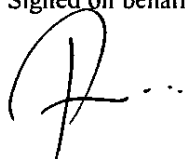
Balance sheet

31 December 2009

	Notes	2009 £m	2008 £m
Fixed assets			
Investments	7	<u>3,076</u>	<u>3,090</u>
Current assets			
Debtors	8	30	1,351
Creditors: amounts falling due within one year	9	<u>(441)</u>	<u>(1,879)</u>
Net current liabilities		<u>(411)</u>	<u>(528)</u>
Net assets		<u>2,665</u>	<u>2,562</u>
Capital and reserves			
Called up share capital	11	65	65
Capital contribution reserve	12	8	8
Share premium account	12	138	138
Revaluation reserve	12	1,757	1,757
Capital redemption reserve	12	8	8
Profit and loss account	12	<u>689</u>	<u>586</u>
Total equity shareholders' funds		<u>2,665</u>	<u>2,562</u>

The financial statements of Gallaher Group Limited (registered number 03299793) were approved by the Board of Directors on 31 March 2010

Signed on behalf of the Board of Directors



Brian Murphy
Director

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2009

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 Financial Statements. 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, CJSC Liggett-Ducat in Russia and JTI Kazakhstan LLC. Both Gallaher Limited and CJSC Liggett-Ducat have recently been independently valued, and these valuations, together with the business plans 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 rate ruling at the date of the transaction. 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 2009

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.

Financial instruments

Financial instruments are reported and measured in accordance with FRS 25, FRS 26 and FRS 29. Financial instruments comprise non-derivative financial assets and liabilities and derivative financial instruments.

Non-derivative financial assets are classified as fixed asset investments and debtors. Non-derivative financial liabilities are classified as creditors.

The Company does not have any derivative embedded in any other financial instruments or other host contracts.

The Company uses derivative financial instruments to hedge exposure to interest rate risks arising from financing and investing activities. In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for trading purposes. The Company has not entered into any foreign exchange contracts during the current or preceding financial year.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured to their fair value at each reporting date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event, the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

The fair value of the derivatives is classified as a non-current asset or non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the profit and loss immediately, together with any changes in the fair value of the hedged asset or liability that is attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in the hedge items attributable to the hedged risk are recognised in the line of the income statement relating to the hedged items.

Hedge accounting is discontinued when the Company revokes the hedging relationship, or no longer qualifies for hedge accounting. The adjustment to the carrying amount of the hedged items arising from the hedged risk is amortised to the profit or loss from that date.

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.

Debtors

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

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2009

1. Accounting policies (continued)

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the underlying contractual arrangements

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.

3. Auditors' remuneration

The auditors' 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 (2008 - £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

	2009 £m	2008 £m
Dividends received and credited to income in the year		
Agna 1 Limited (formerly Gallaher Austria Limited)	91	-
GAHL Limited (formerly Gallaher Austria (Holdings) Limited)	106	-
Aegaus Limited (formerly Gallaher Austria Investments Limited)	-	4
	<u>197</u>	<u>4</u>

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2009

5. Finance costs - net

	2009 £m	2008 £m
Interest payable and other finance charges		
- on loans from Group undertakings	(54)	(93)
- interest rate swaps	-	(2)
- fair value loss on derivative financial instruments not designated as hedges	(6)	-
	<u>(60)</u>	<u>(95)</u>
Interest receivable and other finance income		
- on loans to Group undertakings	11	79
- income from preference shares in subsidiary undertaking	5	9
- interest rate swaps	12	-
- fair value gain on derivative financial instruments not designated as hedges	-	27
	<u>28</u>	<u>115</u>
Finance costs - net	<u>(32)</u>	<u>20</u>

6. Tax on profit on ordinary activities

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

	2009 £m	2008 £m
Corporation tax on profits of the year at 28% (2008 28.5%)	-	-
Adjustment in respect of prior years	-	-
Group relief - current year	5	(97)
Group relief - prior years	(3)	36
	<u>2</u>	<u>(61)</u>
Total current tax	2	(61)
Deferred tax - origination and reversal of timing differences in the year	1	1
	<u>3</u>	<u>(60)</u>
Tax on profit/(loss) on ordinary activities	<u>3</u>	<u>(60)</u>

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2009

6. Tax on profit on ordinary activities (continued)

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

The tax assessed for the year is lower than the standard effective rate of corporation tax in the UK (28%). The differences are explained below:

	2009 £m	2008 £m
Profit/(loss) on ordinary activities before tax	306	(276)
Profit/(loss) on ordinary activities multiplied by standard rate of corporation tax in the UK of 28% (2008: 28.5%)	86	(79)
Effects of		
Utilisation of losses brought forward	(28)	-
Accelerated capital allowances and other timing differences	(1)	(1)
Non-taxable income and credits received	(56)	(16)
Non-deductible expenditure and other items	4	(1)
Adjustments to tax charge in respect of prior periods	(3)	36
Current tax charge/(credit) for the year	2	(61)

c) Analysis of deferred tax

	2009 £m	2008 £m
Movements during the year in the net deferred taxation asset		
At 1 January	5	6
Amount charged in the profit and loss account	(1)	(1)
	4	5

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. At 31 December 2008, the Company did not recognise a deferred tax asset in respect of non trading deficits and management expenses carried forward of £110m (2009: £nil) as there was insufficient evidence that there would be suitable future profits against which these assets would reverse. Due to unexpected exchange rate movements during the year, the whole of the unrecognised carried forward non trading deficits and management expenses at 31 December 2008 have now been fully utilised during 2009.

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2009

7. Fixed asset investments

	Ordinary shares in subsidiary undertakings £m	Preference shares in subsidiary undertakings £m	Total £m
At 1 January 2009	2,900	190	3,090
Disposals (see below)	-	-	-
Exchange adjustments	-	(14)	(14)
At 31 December 2009	2,900	176	3,076

In 1997, the Company acquired 100% of the ordinary share capital of Gallaher Limited. The historical cost of this investment was £232m. Following the acquisition, the investment was valued at £2,900m 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.

In December 2008, as part of a corporate re-organisation, Gallaher Limited issued additional ordinary shares to Gallaher Overseas (Holdings) Limited ("GOHL") as fair value consideration for the acquisition of one of GOHL's subsidiaries, Western Tobacco Investments LLC. Accordingly, the Company re-allocated £361,047,646 of its investment in Gallaher Limited to GOHL. The Company's aggregate investment in the two subsidiaries was unaltered by the transaction.

On 27 October 2009 the Company transferred its remaining investment in Gallaher Limited to GOHL at book value (£2,538,952,354). As consideration for the investment, GOHL issued 50,000 ordinary shares of £1 each with a premium of £2,538,902,354.

During the year the Company disposed of two of its subsidiaries, Agna 1 Limited (formerly Gallaher Austria Limited) and GAHL Limited (formerly Gallaher Austria (Holdings) Limited), to a third party, Vistra International SA. No gain or loss was recognised on either transaction.

The directors have performed an annual impairment review and there is no indication of impairment at 31 December 2009.

Gallaher Group Limited is the beneficial owner of all of the equity share capital of its direct subsidiaries. The direct subsidiaries at 31 December 2009, all 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 2009

8. Debtors

	2009 £m	2008 £m
Amounts falling due within one year		
Amounts owed by Group undertakings - loans	-	1,241
Amounts owed by Group undertakings - group relief	-	61
Amounts owed by Group undertakings - other	26	-
Derivative financial instruments	-	44
	<u>26</u>	<u>1,346</u>
Amounts falling due after more than one year		
Deferred tax assets (note 6)	4	5
	<u>30</u>	<u>1,351</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

	2009 £m	2008 £m
Amounts falling due within one year		
Amounts owed to Group undertakings - loans	441	1,814
Amounts owed to Group undertakings - loan interest payable	-	63
Amounts owed to Group undertakings - other	-	2
	<u>441</u>	<u>1,879</u>

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 rate and foreign exchange is managed in line with JT Group's treasury policy framework. These risks are managed at the Group level rather than at an individual business unit level.

In August 2009, as part of a wider UK corporate re-organisation within the JT Group, the Company transferred three fixed interest rate loans payable to a subsidiary, JTI (UK) Finance PLC, to a related company, Gallaher Limited, at book value, including accrued interest. The loans have principal values of £249.35m, €800.24m and €494.05m respectively. Consideration for the two loans denominated in Euro was by way of a fixed Sterling equivalent, based on prevailing JT corporate exchange rates, thereby removing the exchange rate risk to the Company going forward. The Company's derivative financial instruments, comprising interest rate swaps (notional principal £250m), were also transferred to Gallaher Limited during 2009 at fair value as part of the restructuring.

The Company has not sought to manage interest rate risk on its fixed interest rate loans payable to other Group entities as these risks have been managed by the Group's treasury function. The Company has, however, had financial derivative contracts outstanding which were undertaken during the period prior to the acquisition of the Company by Japan Tobacco Inc. These financial derivative contracts were entered into to manage the interest rate risk of the Company's Eurobonds before they were novated to JTI (UK) Finance PLC, a subsidiary of the Company. The Company does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2009

10. Financial risk management (continued)

Interest rate risk management

The Company has both 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 2009 would be a decrease/increase of £3m (2008 increase/decrease of £15m). This is mainly attributable to the Company's exposure to interest rates on its variable rate cash deposits and borrowings.

Liquidity risk management

The settlement dates of financial instruments at the balance sheet date are set out below. In the case of financial derivatives, settlement is on a gross basis. 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.

The table below analyses the maturities of the undiscounted cash flows relating to non-derivative financial liabilities of the Company based on the remaining period to the expected maturity date as the balance sheet date. At 31 December 2009, 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 will be matched against amounts that are expected to be received from other group companies either as dividends or repayment of current receivables balances.

	Less than 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m	Total £m
At 31 December 2009					
Non-derivative instruments					
Amounts owed to Group undertakings	441	-	-	-	441
At 31 December 2008					
Non-derivative instruments					
Amounts owed to Group undertakings	400	74	1,178	504	2,156

The carrying amounts owed to Group undertakings are due within one year and equals the sum of future cash flows.

Non-derivative financial liabilities at 31 December 2009 comprise loans from Group undertakings that bear interest based on LIBOR plus a margin. Non-derivative financial liabilities at 31 December 2008 comprise loans from Group undertakings that bear interest based on LIBOR plus a margin, together with four fixed rate loans from JTI (UK) Finance PLC that bear interest as follows:

Loan principal	Interest rate
£303.96m due 2009	6.6637%
€800.24m due 2011	4.7486%
£249.35m due 2013	5.8900%
€494.05m due 2014	4.6792%

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2009

10. Financial risk management (continued)

Liquidity risk management (continued)

During 2009, the Company's derivative financial instruments, comprising interest rate swaps, were transferred to a related company, Gallaher Limited, at fair value. Accordingly, the Company has no future cash flow receipts or payments outstanding on derivatives at 31 December 2009.

The table below analyses the Company's derivative financial instruments at 31 December 2008 which were to be settled on a gross basis based on the remaining period to the contractual maturity date at the balance sheet date.

	Less than 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m	Total £m
At 31 December 2008					
Gross settlement receipts					
Interest rate swaps					
- Sterling	14	14	43	-	71
- Euro	20	-	-	-	20
	<u>34</u>	<u>14</u>	<u>43</u>	<u>-</u>	<u>91</u>
Gross settlement payments					
Interest rate swaps					
- Sterling	(9)	(7)	(25)	-	(41)
- Euro	(4)	-	-	-	(4)
	<u>(13)</u>	<u>(7)</u>	<u>(25)</u>	<u>-</u>	<u>(45)</u>

As at 31 December 2009, the Company has no financial assets or liabilities measured at fair value in its balance sheet. Accordingly, no fair value hierarchy table, as set out in the amendment to FRS 29, has been presented.

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2009

10. Financial risk management (continued)

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 2009, 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. Prior to a re-organisation of its loans during 2009 (see page 15), the Company was also exposed to the Euro on a number of intergroup financing arrangements. The sensitivity analysis below has been prepared at the Company level and it does not fully reflect the inherent foreign exchange risk because the overall exposure risk is managed centrally at the Group level.

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 rate based on the level of foreign currency denominated monetary assets and liabilities represents management's assessment of a reasonably possible change in foreign exchange rates. The sensitivity analysis includes only outstanding foreign currency denominated monetary items including external loans.

	Increase/(decrease) in profit	
	2009	2008
	£m	£m
10% strengthening of sterling Euro	(16)	101
10% weakening of sterling Euro	20	(123)

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 loans and other 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.

11. Called up share capital

	2009	2008
	£m	£m
Allotted, called up and fully paid 657,142,748 ordinary shares of 10p each	65	65

At 31 December 2008, the authorised share capital of the Company was 1,050,000,000 ordinary shares of 10p each. Following changes to the Companies Act, the Company has opted for an unlimited authorised share capital, effective from 1 October 2009, and has amended its Articles of Association accordingly.

Gallaher Group Limited

Notes to the accounts

Year ended 31 December 2009

12. Reserves

	Capital contribution reserve £m	Share premium account £m	Capital redemption reserve £m	Revaluation reserve £m	Profit and loss account £m
At 1 January 2009	8	138	8	1,757	586
Profit for the year	-	-	-	-	303
Dividend paid on ordinary equity shares	-	-	-	-	(200)
At 31 December 2009	<u>8</u>	<u>138</u>	<u>8</u>	<u>1,757</u>	<u>689</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. 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

14. 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 2009, the Company had given guarantees in respect of the financial obligations of subsidiaries amounting to £19m (2008 £21m). 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 £250m which were transferred during 2009, including all future cash flows under the swap contracts. At 31 December 2009 the Company had no contingent liabilities in respect of guarantees given in respect of third parties (2008 £nil).

15. 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 Europe Holding BV, registered in Netherlands. Copies of the consolidated financial statements of JT Europe Holding BV 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 Europe Holding B V are being filed
in conjunction with the Gallaher Group Limited
Accounts under the consolidation exemption under
Section 400 of the Companies Act 2006

ANNUAL REPORT 2009

JT EUROPE HOLDING B V , AMSTERDAM

The Annual Report 2009 has been adopted in the Annual General Meeting
of Shareholders on 24 June 2010.

Statutory seat	Amsterdam, the Netherlands
Office address	Vreelandseweg 46 1216 CH Hilversum, The Netherlands
Chamber of Commerce	32073748

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MANAGING DIRECTORS' REPORT

General

JT Europe 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 Europe Holding B V is a wholly-owned subsidiary of Japan Tobacco Inc. (“JT”). JTI has a license agreement with JT, granting JTI the exclusive rights to use certain JT trademarks outside the United States.

1 Developments in the period ended December 31, 2009

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

The year 2009 was challenging, in an environment which can only be described as extraordinary. The year was marked by the economic crisis, leading to market contraction, down-trading and governments increasing excise taxes, all of which began to impact our business considerably in the third quarter. This was compounded by three specific events: the volatile operating environment in Iran, the delisting of some brands as part of our effort to combat illicit trade in Ukraine and our business model change in the Philippines.

All of the above had a negative impact on our 2009 results, with our total sales volume down by 2.5% to 434.9 billion cigarettes. However, excluding the impact of the specific events, our volume increased 1.5%, confirming our strong business fundamentals. This is further evidenced by our share of market growth in most of our key markets, including Turkey, Sweden, Italy, Russia, Kazakhstan, UK, Malaysia, Canada, France, Ireland and Spain.

Volume decline also affected our Global Flagship Brands (“GFBs”), with sales down by 0.9% to 243.4 billion cigarettes. Excluding the three specific events, our GFB volumes increased 2.4%. Winston lost 4.1% to 121.2 billion units, mostly due to Iran and Philippines, but grew in Italy, France and Turkey. LD volumes increased by 18.2% to 34.3 billion cigarettes, driven by strong performance in Russia, Poland, Ukraine and Turkey. Glamour also confirmed its strong momentum, with volumes up by 7.9% to 11.1 billion units, due to growth in Russia and Italy.

The weakness of our key local currencies against the US dollar in 2009 adversely affected our financial performance, with our Net Sales declining by 7.3%. However, excluding the impact of foreign exchange, our Net Sales increased by 8.1% year-on-year, mainly driven by favorable pricing.

On November 2nd 2009, JTI acquired Tribac Limited’s leaf business (Tribac) to achieve enhanced stability and capability in procurement of African leaf tobaccos.

On October 30th 2009, JTI acquired Kannenberg & Cia Ltd (Kannenberg) and Kannenberg Barker Tabacos Ltda Hail and Cotton (KBH&C) to further globalize JTI's scope of procurement by adding Brasil, which is second only to China in tobacco leaf production worldwide

In 2009, JTI also signed an agreement with U S based leaf tobacco suppliers Hail and Cotton and J E B to form a joint venture company JTI Leaf Services LLC for the procurement and processing of U S leaf tobacco

2 Financial position as at year-end 2009

The balance sheet as at year-end 2009 includes intangible fixed assets for an amount of USD 19,134 million (2008 USD 19,826 million) Total assets amount to USD 30,723 million (2008 USD 30,194 million) Total group equity of the Company amounts to USD 17,376 million (2008 USD 17,157 million) Current liabilities at year-end amount to USD 5,945 million (2008 USD 5,236 million)

3 Result analysis

Net sales were USD 11,584 million (2008 USD 12,496 million), a decrease of USD 912 million (2008 increase USD 3,142 million) or -7.3% (2008 +33.6%) compared to the previous financial year We refer to paragraph 1 for further details on the result analysis

4 Risk exposure

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

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

JTI conducts business on a multi-national basis in a wide variety of foreign currencies and, as such, uses derivative financial instruments to reduce earnings and cash flow volatility associated with foreign exchange rate changes In 2009 and 2008, JTI used foreign currency forwards, swaps and options to economically hedge its exposure to fluctuations in Euro, Sterling, Swiss Francs, Russian Ruble, Turkish Lira, Taiwan Dollar, and certain other currencies All foreign currency derivative contracts have maturities of twelve months or less

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

As a result of the use of derivative instruments, JTI is exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. To mitigate the counterparty credit risk, JTI has a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors, and maintains strict dollar and term limits that correspond to each institution's credit rating.

JTI's established policies and procedures for mitigating credit risk on principal transactions include reviewing and establishing limits for credit exposure and continually assessing the creditworthiness of counterparties. ISDA agreements with counterparties give JTI the option to net amounts due from JTI to a counterparty with amounts due to JTI from a counterparty, reducing the maximum loss from credit risk in the event of counterparty default. At December 31, 2009, there were no significant concentrations of credit risk with any individual counterparty or groups of counterparties related to JTI's use of derivative contracts.

5 Research and development

Costs incurred on development projects would be recognized as intangible fixed assets when it is probable that JTI will achieve economic benefits in the future, considering its commercial and technological feasibility, and costs can be measured reliably. However, as these costs do not meet aforementioned criteria, research and development costs are expensed as incurred. For 2009 the research and development costs amount to USD 67 million (2008: USD 68 million). During the year ended 31 December 2009 JTI did not receive reimbursements of product development costs from JT (2008: USD 32 million).

6 Employee information

JTI employed an average number of 26,543 employees during 2009 (2008: 23,942).

7 Distribution of earnings

The distribution of the earnings of the Company is at the disposal of the general meeting of shareholders. The board of directors proposes that the 2009 profit is added to the retained earnings.

The financial statements do not yet reflect this proposal.

8 Future Outlook

JTI's key local currencies weakened against the US dollar in 2009, which adversely affected JTI's financial performance in 2009. However, excluding the impact of foreign exchange, JTI's business results were strong and improved significantly versus 2008. The strong business performance in context of a challenging economic environment, are proof of our strong business foundations and provide a solid platform for future growth and profitability.

Management expects that the cash generated by the operating activities of the JTI Group will continue to cover its capital expenditures and repayment of debt.

9 Subsequent events

On April 13, 2010, JTI reached a global settlement with all Canadian authorities in connection with the illicit trade in the early 1990s. The criminal charges against JTI-Macdonald Corp ("JTI-M") and its current and former employees were withdrawn. As a result of the settlement, JTI-M was also released of certain other claims in regards of the illicit trade, including a tax assessment of CAD 1.36 billion by the Québec Minister of Revenue. JTI-M agreed to pay USD 144 million (CAD 150 million) as part of this global settlement. Furthermore, JTI-M obtained a court order terminating the proceedings under Canada's Companies' Creditors Arrangement Act ("CCAA"). Reference is made to the Other Tobacco related Litigation section on page 42 to page 44 of the Annual Report.

In August 2003, the UK Office of Fair Trading ("OFT") notified the former Gallaher group of an enquiry into agreements between manufacturers and retailers in the UK cigarette, tobacco and tobacco-related markets. On April 24, 2008, the OFT issued a Statement of Objections ("SO") against Gallaher Ltd, another tobacco manufacturer and 11 UK retailers, alleging anti-competitive practices in relation to retail prices for tobacco products in the UK. Gallaher entered into an Early Resolution Agreement with the OFT, as announced by the OFT on July 11, 2008, under which Gallaher agreed to pay a maximum fine of up to USD 148 million (GBP 93 million) and continue to co-operate with the OFT's investigation in return for a reduction of penalty. On April 16, 2010, the OFT announced its decision in the matter and imposed a significantly reduced fine on Gallaher of USD 80 million (GBP 50.4 million). The amount of the fine is approximately USD 181 million (GBP 114 million) smaller than the amount of liabilities booked at December 31, 2009 as a result of the assessment of the risk of the imposition of a fine under the UK Competition Act. Reference is made to the Other Litigation section on page 46 of the Annual Report.

In April 2010, a class composed of tobacco growers in the province of Ontario (Canada) served JTI-M with an action seeking USD 48 million (CAD 50 million) for an alleged breach of contract between the Ontario Flu-Cured Tobacco Growers Marketing Board and JTI-M. Reference is made to the Other Tobacco related Litigation section on page 44 of the Annual Report.

The above mentioned subsequent events do not have a material impact on the consolidated results, consolidated cash flow, and consolidated equity of the company at December 31, 2009

10 Others

Further information about the performance of JT can be found in the annual report 2009/2010 of Japan Tobacco Inc, Japan, the ultimate parent company of JT Europe Holding B V

Amsterdam, June 11, 2010

Board of Directors:

M Yamaguchi

M Terabatake

M Franke
On behalf of JT International Netherlands B V.

CONSOLIDATED BALANCE SHEET
December 31, 2009
(before proposed appropriation of result)

A s s e t s

(in millions of USD)

	December 31, 2009		December 31, 2008	
	USD	USD	USD	USD
Fixed assets				
Goodwill	15,262		15,993	
Trademarks	3,786		3,762	
Distribution agreements	86		71	
Intangible fixed assets (1)		19,134		19,826
Land, buildings and structures	811		753	
Machinery and equipment	1,490		1,203	
Fixed assets under construction	298		270	
Tangible fixed assets (2)		2,599		2,226
Non-consolidated participations	221		211	
Debt and equity securities	20		60	
Deferred taxes	464		603	
Financial fixed assets (3)		705		874
Total fixed assets		22,438		22,926
Current assets				
Finished products	875		658	
Work in progress	9		19	
Leaf tobacco	2,447		1,693	
Wrapping materials	144		146	
Other	85		75	
Inventories (4)		3,560		2,591
Accounts and notes receivable	2,242		2,173	
Affiliates	1		2	
Prepaid expenses and excise taxes	916		873	
Other assets and deferred charges	182		199	
Other current assets	239		245	
Receivables and prepaid expenses (5)		3,580		3,492
Cash and cash equivalents (6)		1,145		1,185
Total current assets		8,285		7,268
Total assets		30,723		30,194

Group equity and liabilities

(in millions of USD)

	December 31, 2009		December 31, 2008	
	USD	USD	USD	USD
Group equity (7)				
Equity attributable to equity holder	17,281		17,057	
Minority interest	95		100	
Total Group equity		17,376		17,157
Provisions (8)				
Provision for pension obligations	847		736	
Provision for deferred income taxes	999		1,053	
Restructuring	33		359	
RGI valuation payment	136		165	
		2,015		2,313
Long-term liabilities (9)				
Long-term borrowings	3,396		4,751	
Long-term borrowings due to affiliates	1,026		-	
Other non-current liabilities	965		737	
		5,387		5,488
Current liabilities (10)				
Affiliates	158		124	
Short-term borrowings	646		1,141	
Short-term borrowings due to affiliates	807		-	
Trade accounts payable	451		549	
Excise and sales tax payable	1,809		1,402	
RGI valuation payment, current portion	38		140	
Accrued expenses	861		835	
Other current liabilities	1,175		1,045	
		5,945		5,236
Total equity and liabilities		30,723		30,194

CONSOLIDATED STATEMENT OF INCOME
Year ended December 31, 2009

(in millions of USD)

	2009	2008
	USD	USD
Gross sales	28,646	30,655
Less excise taxes	17,062	18,159
Net sales (11)	11,584	12,496
Cost of sales	6,246	6,463
Gross margin	5,338	6,033
 Selling and related expenses	 2,964	 2,961
General and administrative expenses	1,258	1,598
Total expenses	4,222	4,559
Operating result	1,116	1,474
 Result of equity accounted investments	 25	 22
Net interest result (12)	(168)	(332)
Net foreign exchange result	(188)	(181)
Net other financial expenses (13)	22	10
Net financial result	(334)	(503)
 Result on ordinary activities before taxation	 807	 993
Income taxes (14)	(444)	(572)
Result on ordinary activities after taxation	363	421
Minority interest	(24)	(21)
Net result for the year	339	400
 Foreign currency translation adjustment	 (146)	 380
Hedge of net investment losses, net of tax	106	(384)
Effect of changing pension plan measurement date, net of tax	—	(9)
Additional minimum pension liability, net of tax	(75)	(115)
Comprehensive income/(loss)	224	272

CONSOLIDATED STATEMENT OF CASH FLOWS
Year ended December 31, 2009

(in millions of USD)

	2009		2008	
(According to the indirect method)	USD	USD	USD	USD
Cash flows from operating activities				
Net result for the year	339		400	
Adjustment for				
Impairment of fixed assets	11		–	
Depreciation and amortization	1,511		1,577	
Minority interest	24		21	
Provision against accounts receivable and inventories	(8)		(5)	
(Loss)/Gain on disposal of property, plant and equipment	(11)		1	
Earnings from equity-method investments	(25)		(22)	
Other-than-temporary impairment of marketable Securities	–		58	
Deferred income taxes	(36)		(41)	
Changes in assets and liabilities, net of acquired companies				
(Increase)/decrease in accounts receivable	276		(411)	
(Increase)/decrease in inventories	(743)		(440)	
(Increase)/decrease in prepaid expenses and other receivables and current assets	(120)		(230)	
Increase/(decrease) in accounts payable	(53)		(89)	
Increase/(decrease) in other accounts payable and accrued liabilities	58		500	
Increase/(decrease) in balances due to/from affiliates	–		(7)	
Increase/(decrease) in accrued income taxes	–		2	
Net cash provided by (used in) operating activities		1,223		1,314

JT EUROPE HOLDING B V , AMSTERDAM

	2009		2008	
	USD	USD	USD	USD
Cash flows from investing activities				
Purchase of property, plant and equipment	(673)		(545)	
Proceeds from sale of property, plant and equipment	36		18	
Acquisitions, net of cash received	(103)		–	
Proceeds from sales of businesses	–		4	
Proceeds from sale of debt securities	78		–	
Purchase of short-term investments, net of proceeds	–		6	
Net cash used in investing activities		(662)		(517)
Cash flows from financing activities				
Net decrease in short-term borrowings	(253)		(5)	
Repayment of short-term borrowings from JT	–		(703)	
Proceeds from long-term borrowings JT	1,882		–	
Proceeds from long-term borrowings	–		465	
Repayment of long-term borrowings	(2,222)		(599)	
Dividends paid to minority interest shareholders	(30)		(27)	
Net cash provided by financing activities		(623)		(869)
Effect of exchange rate changes on cash and cash equivalents		22		(81)
Net increase/(decrease) in cash and cash equivalents		(40)		(153)
Cash and cash equivalents at beginning of year		1,185		1,338
Cash and cash equivalents at end of year		1,145		1,185

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2009

General

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

Operations

JT Europe Holding B V “(the Company)” and its 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

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

RGI Valuation Payment

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

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

The joint venture was terminated on December 31, 2007 In February 2008, JTI agreed to pay a valuation payment of USD 388 million (EUR 265 million) Of that amount, USD 155 million (EUR 106 million) was paid on April 18, 2008 and USD 38 0 million (EUR 26 5 million) will be paid in each of the following six years The present value of future payments was recognized in the Company’s consolidated balance sheet as part of liabilities assumed in the Gallaher business combination

Business combinations

On November 2nd 2009, JTI acquired Tribac Limited’s leaf business (“Tribac”) to achieve enhanced stability and capability in procurement of African leaf tobaccos.

On October 30th 2009, JTI acquired Kannenberg & Cia Ltd (“Kannenberg”) and Kannenberg Barker Tabacos Ltda Hail and Cotton (KBH&C) to further globalize JTI’s scope of procurement by adding Brasil, which is second only to China in tobacco leaf production worldwide

In 2009, JTI also signed an agreement with U S based leaf tobacco suppliers Hail and Cotton and J E B to form a joint venture company JTI Leaf Services LLC for the procurement and processing of U S leaf tobacco

US dollar financial statements

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

Consolidation Principles

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

The consolidated financial statements include the accounts of the Company and its controlled subsidiaries Investments in business entities over which the Company exercises significant influence (but not control) are accounted for using the equity method of accounting and the Company's proportionate share of income or loss is recorded in result of equity accounted investments, in its consolidated statement of income All significant intercompany balances and transactions have been eliminated in consolidation

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

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

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

General accounting principles for the preparation of the consolidated financial statements

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

Revenue recognition

JTI recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. Delivery occurs upon shipment of products, provided title and risk of loss have transferred to the customer. The sales price is considered to be fixed or determinable when all contingencies related to the sale have been resolved.

Revenues are recognized net of 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 JTI's historical experience with similar programs.

Excise taxes and shipping and handling fees billed to customers are included in revenues. Net sales are reported net of excise taxes. Shipping and handling costs are included in cost of sales.

Business combinations and intangible assets, including goodwill

JTI accounts for business combinations using the acquisition method of accounting. 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. Identifiable intangible assets consist of, trademarks, distribution, supply and service agreements that are amortized over 20, 6 years and 3 years, respectively.

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

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

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

Impairment of long-lived assets, other than goodwill

JTI reviews long-lived tangible and intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset (asset group) may not be recoverable. Impairment exists when the estimated sum of the undiscounted cash flows of a long-lived asset (asset group) is less than its carrying amount. If identified, an impairment loss is recognized through a charge to earnings for the difference between the carrying amount and the estimated fair value of the asset.

Currency translation

The Company's functional currency is the U S dollar. Financial statements of its consolidated subsidiaries are generally measured using the local currency as the functional currency. However, the Company's major subsidiary, JT International S A ("JTI S A"), uses the U S dollar as its functional currency. In addition, subsidiaries operating in highly inflationary economies have the U S dollar as their functional currency.

Assets and liabilities of subsidiaries whose local currency is their functional currency are translated in to U S dollar at year-end exchange rates. Income and expense items are translated at weighted-average rates of exchange prevailing during the period in which they occur. Translation adjustments are recorded in accumulated other comprehensive income in JTI's consolidated balance sheets. Non-functional currency transactions give rise to foreign exchange gains (losses) that are recognized in earnings.

Non-monetary assets and liabilities of consolidated subsidiaries whose functional currency differs from their local currency are translated at historical exchange rates. Monetary assets and liabilities denominated in a currency other than the U S dollar are translated at current exchange rates with transaction gains and losses recognized in earnings. Cost of sales and depreciation are translated at historical exchange rates. All other income and expense items are translated at the weighted-average rate of exchange prevailing during the period in which they occur. Translation gains and losses are included in earnings.

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 (overhead costs)
- Storage costs
- Receipt of goods, storage, and withdrawal of goods from warehouse
- Freight costs for internal transfer

Software costs

JTI capitalizes certain computer software and software development costs incurred in connection with developing or obtaining computer software for internal use. Capitalized software costs are included in property, plant and equipment in JTI's consolidated balance sheets.

Leases

Assets held under capital leases are capitalized as part of property, plant and equipment 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 earnings over the lease term. Rentals paid under operating leases are charged to earnings over the lease term on a straight-line basis.

Financial fixed assets

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

Tangible fixed assets

Property, plant and equipment are stated at historical cost, net of accumulated depreciation. 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	3-8 years
Software	5 years

Depreciation expense was USD 340 million and USD 366 million for the years ended December 31, 2009 and 2008, respectively.

Marketing and advertising costs

Marketing and advertising costs are expensed as incurred. The total amounts charged to the consolidated statements of earnings as advertising expenses were USD 80 million in 2009 and USD 108 million in 2008.

Research and development

Research and development costs are expensed as incurred. The total amounts charged to the consolidated statements of earnings as research and development costs were USD 67 million in 2009 and USD 68 million in 2008.

Environmental costs

JTI is subject to laws and regulations relating to the protection of the environment. While it is not possible to quantify the potential impact of actions regarding environmental remediation and compliance efforts that may be undertaken in the future, in the opinion of management, environmental remediation and compliance costs, before taking into account any recoveries from third parties, will not have a material adverse effect on JTI's consolidated financial position, results of operations or cash flows.

Retirement Benefits

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

JTI uses the "corridor approach" whereby to the extent that cumulative actuarial gains and losses exceed 10 percent of the greater of the fair value of the plan assets and the projected benefit obligation at the beginning of the fiscal year, they are amortized to income over the average remaining service lives of participating employees. Prior service cost is not included in the "corridor approach" and is amortized over the remaining service lives of participating employees.

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

JTI's consolidated balance sheets include the total of the fair value of the plan assets less the projected benefit obligation. The funded status for all plans in surplus is classified as a current asset. The funded status for all plans in deficit is classified as a non-current liability.

In 2008, JTI changed pension plan measurement date to December 31 for all employee benefit plans. The effect of this change is disclosed in JTI's consolidated statement of changes in equity for the year ended December 31, 2008.

Net other financial expenses

Net other financial expenses, includes, gains (losses) on derivatives, gains (losses) on sale of debt securities, and certain other items of a financing nature.

Income taxes

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

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

Deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities as well as tax loss and credit carryforwards, using enacted tax rates in effect for the year in which the differences are expected to reverse. A valuation allowance is used to reduce deferred tax assets if it is more likely than not that these assets will not be realized. A deferred tax liability is not recognized for the undistributed earnings of foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration.

Total income tax expense or benefit for the year is the sum of deferred tax expense or benefit and income taxes currently payable or refundable. Significant judgment is required in determining income tax provisions and in evaluating tax positions.

Benefits of an uncertain tax position are recognized when the position is more likely than not to be sustained, based on its technical merits, upon examination by taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. JTI classifies interest and penalties as a component of income tax expense (see Note 14).

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

JTI 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 JTI'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 earnings 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 non-derivative instruments that have been designated and have qualified as hedging instruments are included in the cumulative translation adjustment on a net of tax basis.

Effective January 1, 2009, JTI adopted a new accounting pronouncement "Accounting for Derivatives Instruments and Hedging Activities" that requires expanded derivative disclosures (see Note 9).

Fair Value of Financial Instruments

JTI 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.

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

On January 1, 2008, JTI adopted the provisions of SFAS No 157, "Fair Value Measurements" that defines the term fair value, establishes a framework for measuring fair value and enhances disclosures about fair value measurements. Fair value is defined as the price that would be received for an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants on the measurement date. In 2009, JTI adopted new guidance on determining fair value of financial instruments in inactive markets. The adoption of this guidance did not have a material impact on the consolidated financial statements.

Fair value is defined as the price that would be received for an asset or paid to transfer a liability (exit price) in an orderly transaction between market participants on the measurement date. In 2009, JTI adopted new guidance on determining fair value of financial instruments in inactive markets. The adoption of this guidance did not have a material impact on the consolidated financial statements.

Fair value is measured using the following three levels of inputs:

Level 1

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

Level 2

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

Level 3

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

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

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

Long-term debt. In 2009, JTI adopted a new accounting pronouncement that specifies techniques that should be used to measure fair value when a quoted price in an active market for the identical liability is not available. The adoption of this new pronouncement did not have a significant impact on JTI's valuation techniques and inputs used to estimate the fair value of debt for disclosure purposes.

At December 31, 2009, the carrying amount and the estimated fair value of long-term debt were USD 4.4 billion and USD 4.5 billion, respectively. Fair values are estimated based on market prices (for public debt) or interest rates currently available to JTI for borrowings with similar terms and remaining maturities (for bank and related party debt).

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

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

JTI continuously reviews its debt securities for other-than-temporary impairment. In determining whether another-than-temporary impairment has occurred, JTI considers whether it has the intent

to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. Other-than-temporary declines in fair value of debt securities are recognized in earnings in the period in which the loss occurs.

Financial assets and liabilities measured at fair value on a recurring basis are as follows:

December 31, 2009				
	Level 1	Level 2*	Level 3**	Total
(in millions of U.S. dollars)				
Assets				
Debt securities	19	-	1	20
Derivative assets	-	101	-	101
Total assets				121
Liabilities				
Derivative liabilities	-	110	-	110
Total liabilities				110
December 31, 2008				
	Level 1	Level 2*	Level 3**	Total
(in millions of U.S. dollars)				
Assets				
Debt securities	19	-	43	62
Derivative assets	-	114	-	114
Total assets				176
Liabilities				
Derivative liabilities	-	101	-	101
Total liabilities				101

* Derivatives include USD 3 million (2008: USD 24 million) of assets and USD 45 million (2008: USD 4 million) of liabilities held with JT.

** See Note 3 for further discussion of ABCP valuation, related impairment charges and disposal during 2009.

Fair Value of Financial Instruments

Debt securities of USD 19 million and USD 18 million were pledged as collateral in favor of third parties at December 31, 2009 and December 31, 2008 respectively

Fair value measurements using significant unobservable inputs (Level 3)

(in millions of U S dollars)	2009 Debt securities	2008 Debt securities
January 1	43	113
Total losses included in earnings*	-	(58)
Settlements	(5)	-
Sales (see Note 3)	(43)	-
Currency translation adjustment	6	(12)
December 31	<u>1</u>	<u>43</u>

* included in net other financial expenses

Use of estimates

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

Receivables

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

Other provisions

Other provisions are valued at nominal value.

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

Long-term liabilities

Recorded interest-bearing loans and liabilities are valued at amortized cost. Cash flow statement: The consolidated statement of cash flows has been prepared according to the indirect method.

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

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

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

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

The movement in intangible fixed assets is as follows

	Goodwill	Trademarks	Distribution agreements	Total
(in millions of USD)				
Book value as at January 1, 2009	15,993	3,762	71	19,826
Acquisitions	231	—	32	263
Release of restructuring accrual	(50)	—	—	(50)
Disposals	—	—	(1)	(1)
Foreign exchange results	—	266	1	267
Amortization for the year	(912)	(242)	(17)	(1,171)
Book value as at December 31, 2009	<u>15,262</u>	<u>3,786</u>	<u>86</u>	<u>19,134</u>
Accumulated amortization as at December 31, 2009	<u>3,148</u>	<u>932</u>	<u>46</u>	<u>4,126</u>

For the classification of the amortization expenses reference is made to page 52

Costs incurred on development projects would be recognized as intangible fixed assets when it is probable that JTI will achieve economic benefits in the future, considering its commercial and technological feasibility, and costs can be measured reliably. However, as these costs do not meet aforementioned criteria, research and development costs are expensed as incurred. For 2009 the research and development costs amount to USD 67 million (2008: USD 68 million). During the year ended 31 December 2009 JTI did not receive reimbursements of product development costs from JT (2008: USD 32 million) (see also note on related party disclosure, page 47).

Tangible fixed assets (2)

The movement in tangible fixed assets is as follows

	Land, buildings and structures	Machinery and equipment	Fixed assets under construction	Total
(in millions of USD)				
Book value as at January 1, 2009	753	1,203	270	2,226
Additions, net	54	291	392	737
Disposals, net	(19)	(25)	(1)	(45)
Transfers	29	320	(375)	(26)
Depreciation for the year	(39)	(301)	—	(340)
Currency translation adjustment	33	2	12	47
Book value as at December 31, 2009	<u>811</u>	<u>1,490</u>	<u>298</u>	<u>2,599</u>
Accumulated depreciation as at December 31, 2009	<u>191</u>	<u>1,601</u>	<u>—</u>	<u>1,792</u>

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

The present value of future minimum lease payments for assets under capital leases was USD 4 million at December 31, 2009 (2008 USD 8 million) Of that amount, USD 2 million is due in 2010

	<u>2009</u>	<u>2008</u>
(in millions of USD)		
Capital leases recognized as Machinery and equipment		
Net carrying amount	9	12
Less accumulated depreciation	<u>(5)</u>	<u>(4)</u>
Book value as at December 31	<u>4</u>	<u>8</u>

The result on disposals of tangible fixed assets is a loss of USD 13 million (2008 USD 5 million loss) For the classification of the depreciation expenses reference is made to page 52

Financial fixed assets (3)

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

	Non- Consolidated participations	Marketable securities	Deferred taxes	Total
(in millions of USD)				
Book value as at January 1, 2009	211	60	603	874
Additions, net	–	5	(139)	(134)
Sale of securities	–	(47)	–	(47)
Shares in result	25	–	–	25
Dividends received	(19)	–	–	(19)
Reclassified	–	(4)	–	(4)
Other	4	6	–	10
Book value as at December 31, 2009	<u>221</u>	<u>20</u>	<u>464</u>	<u>705</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.

Debt and equity securities

At December 31, 2008, the Company's Canadian subsidiary held illiquid asset-backed commercial paper ("ABCP") with a face value of USD 139 million and a fair value of USD 43 million.

In 2008, JTI recorded an other-than-temporary impairment charge of USD 58 million related to Canadian ABCP.

In December 2009, JTI sold ABCP with the carrying amount of USD 43 million realizing a gain of USD 19 million. The fair value of the remaining ABCP at December 31, 2009 amounts to USD 1 million.

Deferred taxes

Of the deferred income taxes amounting to in total USD 464 million (2008: USD 603 million), an amount of USD 70 million (2008: USD 89 million) is considered to be of short-term nature. For a specification on the deferred income taxes (fixed and current) we refer to note 14 on income taxes.

Inventories (4)

Inventories comprise

	2009	2008
(in millions of USD)		
Finished products	875	658
Work in progress	9	19
Leaf tobacco	2,447	1,693
Wrapping materials	144	146
Other	85	75
	<u>3,560</u>	<u>2,591</u>

Receivables and prepaid expenses (5)

Receivables and prepaid expenses comprise

	2009	2008
(in millions of USD)		
Accounts and notes receivable, net	2,242	2,173
Receivables from affiliates	1	2
Prepaid expenses and excise taxes	916	873
Other assets and deferred charges	182	199
Other current assets	239	245
	<u>3,580</u>	<u>3,492</u>

The accounts and notes receivable are stated net of a valuation for doubtful accounts of USD 21 million (2008: USD 23 million)

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

Cash and cash equivalents (6)

Cash balances are at free disposal of the group

Equity attributable to equity holder (7)

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

The movement in minority interest is as follows

	2009	2008
Opening balance	100	114
Result for the year	24	21
Currency translation adjustment	1	(7)
Dividend paid to minority interest	(30)	(28)
Closing balance	95	100

Provisions (8)

Provisions comprise

	2009	2008
(in millions of USD)		
Provision for pension obligations	847	736
Provision for deferred income taxes (14)	999	1,053
Provision for restructuring	33	359
RGI valuation payment	136	165
	2,015	2,313

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

Provision for pension obligations

JTI sponsors a number of defined benefit pension plans covering most employees. JTI also provides certain health and life insurance benefits for retired employees and their dependents. Plans covering regular full-time employees provide pension benefits based on credits, determined by age, earned throughout an employee's service and final average compensation before retirement.

The following table provides a reconciliation of the changes in JTI's plans' benefit obligation and fair value of assets over the two-year period ended December 31, 2009

(in millions of U S dollars)	Pension benefits 2009	Post retirement benefits 2009	Pension benefits 2008	Post retirement benefits 2008
Change in benefit obligation				
Benefit obligation at January 1	2,492	153	3,202	216
Service cost	38	2	55	3
Interest cost	143	10	163	11
Curtailments, settlements and special termination benefits	3	-	(32)	-
Benefit payments	(170)	(8)	(166)	(8)
Employee contributions	9	-	9	-
Actuarial losses/(gains)	281	3	(188)	(31)
Foreign exchange and other	196	16	(560)	(38)
Elimination of early measurement date	-	-	9	-
Benefit obligation at December 31	<u>2,992</u>	<u>176</u>	<u>2,492</u>	<u>153</u>
Change in plan assets				
Assets at January 1	1,948	-	2,838	-
Actual return on plan assets	273	-	(220)	-
Employer contributions	105	-	92	-
Employee contributions	9	-	9	-
Benefit payments	(121)	-	(141)	-
Foreign exchange and other	183	-	(638)	-
Elimination of early measurement date	-	-	8	-
Assets at December 31	<u>2,397</u>	<u>-</u>	<u>1,948</u>	<u>-</u>
Funded status	<u>(595)</u>	<u>(176)</u>	<u>(544)</u>	<u>(153)</u>

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

(in millions of U S dollars)				
	Pension benefits 2009	Post retirement benefits 2009	Pension benefits 2008	Post retirement benefits 2008
Non-current liability	(651)	(176)	(623)	(153)
Non-current asset	56	–	79	–
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Funded status	<u>(595)</u>	<u>(176)</u>	<u>(544)</u>	<u>(153)</u>

JTI expects to contribute approximately USD 85 million to its funded defined benefit pension plans in 2010

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

(in millions of U S dollars)				
	Pension benefits 2009	Post retirement benefits 2009	Pension benefits 2008	Post retirement benefits 2008
Actuarial losses	390	16	287	14
Prior service cost (credit)	(2)	(12)	(3)	(13)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	<u>388</u>	<u>4</u>	<u>284</u>	<u>1</u>

The amounts in accumulated other comprehensive loss that are expected to be recognized as components of net periodic benefit cost in 2010 are as follows

(in millions of U S. dollars)

	Pension benefits	Post retirement benefits
Actuarial losses	18	-
Prior service cost (credit)	-	(1)
	<u>18</u>	<u>(1)</u>

The accumulated benefit obligation ("ABO") for all pension plans at December 31, 2009 and 2008, was USD 2,745 million and USD 2,315 million, respectively. At the measurement date, the benefit obligation and the fair value of assets of funded pension plans where the accumulated benefit obligation was in excess of the fair value of assets were as follows:

(in millions of U S. dollars)

	<u>2009</u>	<u>2008</u>
Accumulated benefit obligation	688	588
Projected benefit obligation	735	630
Fair value of plan assets	652	524

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

(in millions of U S. dollars)

	Pension benefits 2009	Post retirement benefits 2009	Pension benefits 2008	Post retirement benefits 2008
Net service cost	38	2	55	3
Interest cost	143	10	163	11
Expected return of plan assets	(110)	-	(165)	-
Amortization of prior service costs and actuarial losses	15	(1)	4	2
Curtailments, settlements and special termination benefits	5	-	-	-
	<u>91</u>	<u>11</u>	<u>57</u>	<u>16</u>

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

	Pension benefits 2009	Post retirement benefits 2009	Pension benefits 2008	Post retirement benefits 2008
Discount rate	5.4%	5.7%	5.7%	6.0%
Expected long-term return on plan assets	5.6%	N/A	5.4%	N/A
Rate of compensation increase	3.9%	N/A	3.4%	N/A

Note that the assumptions set out above were also used to determine the net periodic benefit cost for the following respective year

The expected rate of return on plan assets is determined by reference to the sum of the product of the long-term target asset allocation and expected return for each class of assets. However, the estimate is adjusted as necessary to the extent that the actual asset allocation differs significantly from the target allocation, and 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

	2009	2008
Health care cost trend rate for next year	8.0%	8.3%
Ultimate healthcare cost trend rates	4.8%	5.3%
Years to ultimate rate	6	6

Assumed healthcare cost trend rates have a significant effect on the amounts reported for healthcare plans. A one-percentage-point change in assumed healthcare cost trend rates would have the following effects on the JTI's benefit obligation at December 31, 2009

(in millions of U.S. dollars)	1-percentage point increase	1-percentage point decrease
Effect on total service and interest cost for 2010	2	(2)
Effect on post retirement benefit obligation	24	(18)

The fair values of JTI's pension plan assets by asset category were as follows at December 31

(in millions of U S dollars)	2009	Total	Level 1	Level 2	Level 3	2008
Asset category						
Cash and cash equivalents	3%	62	62	-	-	2%
Equity						
UK	19%	444	444	-	-	16%
EMEA (excluding UK)	9%	222	222	-	-	9%
North America	12%	279	279	-	-	8%
Other	4%	92	92	-	-	6%
Total equity	44%					39%
Government bonds						
UK	21%	557	557	-	-	25%
EMEA (excluding UK)	10%	232	195	37	-	13%
North America	6%	139	139	-	-	5%
Total government bonds	37%					43%
Corporate bonds.						
UK	4%	87	87	-	-	4%
EMEA (excluding UK)	5%	124	124	-	-	4%
North America	4%	85	85	-	-	4%
Total corporate bonds	12%					12%
Other investments						
Hedge funds	1%	17	1	10	6	1%
Real estate	2%	38	22	-	16	2%
Other	1%	19	-	19	-	1%
Total other investments	4%					4%
Total assets	100%	2,397	2,309	66	22	100%

The following table summarizes the movements in the fair value of plan assets classified in the Level 3 category:

(in millions of U.S. dollars)	Hedge funds	Real estate	Total
January 1, 2009	4	18	22
Actual return on assets			
Assets held at end of year	-	(2)	(2)
Purchases, sales and settlements	2	-	2
December 31, 2009	<u>6</u>	<u>16</u>	<u>22</u>

JTI'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 allocations. The Company aims to maintain adequate liquidity to enable immediate and medium-term benefit payments.

At December 31, 2009 and 2008, the weighted-average target asset allocation for the Company's funded pension plans was as follows:

Asset category	2009	2008
Equity securities	42%	45%
Debt securities	54%	51%
Real estate	2%	2%
Cash, investment trust and other assets	2%	2%
	<u>100%</u>	<u>100%</u>

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

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

(in millions of USD)	Pension benefits	Post retirement benefits
Expected future benefit payments:		
2010	176	8
2011	162	8
2012	160	9
2013	167	9
2014	177	10
2015 – 2019	914	55

In addition to defined benefit pension plans, JTI sponsors various defined contribution pension plans. Defined contribution pension cost was USD 40 million in 2009 and USD 23 million in 2008.

Restructuring provisions

In conjunction with the acquisition of Gallaher in 2007, JTI committed to a global restructuring plan, including a reduction in the workforce, rationalization of certain distribution channels, and the closure and disposal of certain manufacturing facilities. The plan principally included employee termination benefits and contract termination costs. In 2008 and 2009, JTI continued to execute the Gallaher restructuring plan.

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

In 2009, JTI incurred additional restructuring expense of USD 45 million relating to the Gallaher integration plan.

The following is a reconciliation of the restructuring liability balance

(in millions of U S dollars)

	Total
January 1, 2008	357
Additions (including FTC fee of 143)	200
Cash payments	(152)
Foreign exchange	(46)
December 31, 2008	359
Additions	45
Cash payments (including FTC fee of 129)	(228)
Release of excess FTC provision (1)	(14)
Release to goodwill (2)	(50)
Transfer to post-employment liability	(56)
Reclassification to other long-term liabilities (3)	(25)
Foreign exchange	2
December 31, 2009	33

(1) Recorded as part of G&A expense in the Income statement

(2) Release to goodwill of excess acquisition accruals related to restructuring of Gallaher

(3) Reclassification of a legal provision accrued in purchase price accounting

Restructuring activities are expected to be substantially completed in 2010.

Long-term liabilities (9)

	2009	2008
(in millions of USD)	USD	USD
Long-term borrowings	3,396	4,751
Long-term borrowings JT	1,026	-
Tax liability FIN 48 (see note 14)	457	440
Others	508	297
	<u>5,387</u>	<u>5,488</u>

At December 31, JTI's long-term borrowings were as follows

(in millions of U S dollars)	Maturities	2009	2008
Long-term borrowings		21	-
EUR 800 million Eurobond (4.625%)	2011	1,150	1,128
GBP 250 million Eurobond (5.75%)	2013	396	359
EUR 500 million Eurobond (4.5%)	2014	717	703
<i>(average interest rate in parenthesis)</i>			
Syndicated credit facilities			
GBP Term loan (0.97% in 2009 and 6.07% for 2008)	2012	1,112	722
EUR Revolver borrowings (3.95% in 2008)		-	284
GBP Revolver borrowings (5.94% in 2008)		-	930
USD Revolver borrowings (0.71% in 2008)		-	370
YEN Revolver borrowings (1.06% in 2008)		-	255
Credit facilities granted by JT ¹			
YEN Revolver borrowings (0.26% for 2009)		728	-
GBP Revolver borrowings (0.63% for 2009)		298	-
Total long-term borrowings		<u>4,422</u>	<u>4,751</u>

¹ JT borrowings of USD 807 million were classified as short term because JTI plans to repay this amount in 2010. The remaining JT borrowings of USD 1.026 million were classified as long-term because JTI does not intend to repay this amount and has an unconditional right to borrow an equivalent amount under its syndicated credit facilities, should JT refuse to extend credit beyond one year.

A portion of JTI's fixed-rate debt has been swapped into floating-rate debt. At December 31, 2009, the notional amount (denominated in Sterling) and the fair value of the related interest rate swap asset were USD 397 million and USD 25 million, respectively. At December 31, 2008, the notional amount and the fair value of the related interest rate swap liability were USD 794 million and USD 31 million, respectively. The post-swap weighted-average interest rate on JTI's fixed-rate debt was 4.14% in 2009 and 5.21% in 2008.

JTI selectively uses interest rate caps to limit its exposure to unfavorable fluctuations in certain benchmark interest rates. The notional amount of interest rate caps outstanding at December 31, 2009 and December 31, 2008, was USD 3,233 million and USD 3,493 million, respectively. The interest rates are capped at 6.5% and 5.0% for Sterling and Euro, respectively. The aggregate fair value of the related derivative asset was USD 2 million and USD 1 million at December 31, 2009 and 2008, respectively.

At December 31, 2009, JTI had access to unused credit facilities of approximately USD 5,908 million, including USD 3,132 million available under committed facilities. Substantially all JTI's borrowings are guaranteed by JT.

In the normal course of business, JTI issued bank guarantees totaling USD 2,127 million at December 31, 2009.

Current liabilities (10)

Current liabilities comprise

	2009	2008
(in millions of USD)	USD	USD
Payable to affiliates	158	124
Short-term borrowings from financial institutions	646	1,141
Short-term borrowings from JT	807	—
Trade accounts payable	451	549
Excise and sales tax payable	1,809	1,402
RGI Valuation payment, current portion	38	140
Accrued expenses	861	835
Other current liabilities, including social securities	1,175	1,045
	<u>5,945</u>	<u>5,236</u>

The total social securities payable amount to USD 19 million at December 31, 2009 (2008: USD 19 million).

Borrowings and borrowing arrangements

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

(in millions of USD)	2009	2008
Short-term borrowings	646	678
Current portion of long-term debt	-	28
GBP 300 million Eurobond	-	435
Credit facilities granted by JT ¹		
YEN Revolver borrowings (0.26% for 2009)	306	-
GBP Revolver borrowings (0.63% in 2009)	501	-
	<u>1,453</u>	<u>1,141</u>

¹ JT borrowings of USD 807 million were classified as short term because JTI plans to repay this amount in 2010. The remaining JT borrowings of USD 1,026 million were classified as long-term because JTI does not intend to repay this amount and has an unconditional right to borrow an equivalent amount under its syndicated credit facilities, should JT refuse to extend credit beyond one year.

Short-term bank borrowings weighted-average interest rates were 9.9% and 14.3% for 2009 and 2008, respectively.

Commitments and contingencies**Lease commitments**

JTI leases various buildings, computer equipment and vehicles under noncancellable operating leases. The aggregate rental expense was USD 109 million and USD 103 million in 2009 and 2008, respectively. Future minimum rental payments required under noncancellable operating leases are as follows:

(in millions of USD)	
2010	78
2011	60
2012	44
2013	30
2014	18
Thereafter	72

Financial commitments

On December 14, 2007, JTI entered into a 15-year cooperation agreement with the European Commission ("EC") to combat the contraband and counterfeit of cigarettes in the European Union. The agreement calls for a payment of USD 400 million over 15 years, which will be used by the EC and the participating Member States to support anti-contraband and anti-counterfeit initiatives. JTI will pay USD 50 million annually for the first five years and USD 15 million in each of the following ten years. Payments are recognized as cost of sales ratably over the year in which they become due. For the first three years of the agreement, 50% of all the payments made under this agreement will be reimbursed by JTI's ultimate parent, JT. The rate of 50% will be reviewed and revised, as necessary, every three years during the term of the cooperation agreement. The reimbursement rate of 50% percent is currently under review as a result of Gallaher brands inclusion in the EC Cooperation Agreement starting in 2010.

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

At December 31, 2009, noncancellable commitments for purchases were as follows:

(in millions of USD)	2009	2008
Leaf purchase commitments	537	236
Finished products purchase commitments	73	-
Non-tobacco materials purchase commitments	57	-
Capital expenditure	102	117
Other	128	109
	<u>897</u>	<u>462</u>

Contingencies

Tobacco Litigation

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

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

Smoking and Health Litigation Status

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

Class or group actions In February 2005, a Québec (Canada) trial court authorized two class actions against a JTIH subsidiary. The actions were filed in late September 2005 and are currently pending. The first class, comprising Québec residents allegedly suffering from certain diseases, seeks collective recovery of USD 10.54 billion (CAD 11 billion) from all defendants (which include two competing cigarette manufacturers) in addition to damages for individual members. The second class, composed of allegedly addicted smokers in Québec, seeks collective recovery of USD 14.59 billion (CAD 17.8 billion) from all defendants (which include two competing cigarette manufacturers) in addition to individual damages. 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. The Saskatchewan Claim has recently been served upon JTI-MC.

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 1.52 billion (ILS 5.78 billion) in total damages from all defendants, which include a number of distributors and manufacturers of competing products in the Israeli market. The action has been served on a distributor that may have indemnity rights against a JTIH subsidiary other than the one named in the action. The action has not, however, been served on any JTIH subsidiary. For now, the action is stayed pending the outcome of a request for certification in a similar action against a JTIH competitor in the Israeli market.

In May 2008, a petition was filed in Israel by claimants purporting to represent a class consisting of all those who purchased or smoked the cigarettes previously known as "Lights" which were manufactured, imported or marketed by the defendants in Israel after December 31, 2004. None of JTIH's subsidiaries are involved in this claim, although Globrands Limited (JT International SA's current Israeli distributor) is a named defendant. The claim is currently at the pre-certification stage. The claimants are seeking approximately USD 20.53 billion (ILS 78 billion) in damages for various alleged breaches of consumer protection and labeling laws.

Health care cost recovery actions In January 2001, the province of British Columbia (Canada) brought an action under its Tobacco Damages and Health Care Costs Recovery Act against a JTIH affiliate, as well as a number of other manufacturers and others participating in the Canadian cigarette market, seeking unquantified damages. Some defendants challenged the constitutionality of the Act. The Supreme Court of Canada finally rejected that challenge in September 2005, and the action remains pending at first instance.

A number of defendants have applied to join the Canadian Federal Government as a Third Party to this action. The application was dismissed at first instance but the appellate court reversed the decision in part. In March 2008, the Province of New Brunswick filed a health-care cost recovery action against a JTIH affiliate and other manufacturers under its own Tobacco Damages and Health Care Costs Recovery Act, seeking unquantified damages. These proceedings are at an early stage. In September 2009, the Province of Ontario filed a similar health care cost recovery action against a JTIH affiliate and other manufacturers under its own Health Care Costs Recovery Act.

In February 2007, a JTIH subsidiary in Spain was formally joined as a defendant, along with a number of other manufacturers, in a contentious administrative proceeding brought by the Junta de Andalucía against the Spanish state (as former tobacco monopoly) to recover health care expenditures for a number of individuals treated for alleged tobacco-related diseases. The Junta's claim was dismissed at first instance in November 2007, on procedural grounds. The Junta's appeal was ultimately rejected by the Supreme Court in September 2009.

Following the above proceeding, in July 2008, a JTIH subsidiary in Spain was also formally joined as a defendant, together with the same other manufacturers in a second contentious-administrative proceeding brought by the Junta de Andalucía and against the Spanish state. This claim seeks recovery of the same health care expenditure mentioned in the above proceeding and tries to remedy the procedural defects appreciated by the Court in the previous proceeding. The Defendants were notified that the Junta filed its claim in May 2009. Until early 2010, the proceedings were effectively stayed pursuant to a brief filed by the State Attorney claiming *litis pendens* on the grounds that the 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 addition to these actions, employees of JTIH subsidiaries oversee the defense of entities to which JT may owe certain indemnity obligations. Three health care cost recovery actions of that nature are currently pending.

Smoking and Health Litigation Claims and Defenses Generally

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

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

Health Care Cost Recovery Litigation Claims and Defenses Generally

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

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

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

Other Tobacco-Related Litigation

Canada - In February 2003, the Royal Canadian Mounted Police filed criminal charges against JTI-Macdonald Corp. ("JTI-M"), three non-Canadian JTIH subsidiaries, and eight current or former employees of JTIH subsidiaries or formerly related entities in connection with the alleged

smuggling of tobacco products into Canada in the early 1990s. Following the evidence portion of a preliminary hearing that ran from April 2005 through November 2007, the court committed JTI-M and one former employee to trial. The Crown sought review of the dismissal of charges against the other defendants and notified JTI-M of its intent to seek a fine of USD 479 million (CAD 500 million) as well as restitution of lost taxes in an undetermined amount. In December 2007, the Crown and defendants' arguments on review were heard. In February 2008, the judge hearing the review application returned the case to the preliminary inquiry judge for reconsideration that all defendants be committed to stand trial. Argument on the issue of reconsideration was made in May 2008 in the Ontario Court of Justice. The Crown proceeded against JTI-M and the lone defendant in the Ontario Superior Court of Justice by way of indictment in June 2007. On April 13, 2010, as a part of a global settlement with all Canadian authorities regarding illicit trade, the criminal charges were withdrawn and substituted by charges to which the company pleaded for a regulatory offence under the Excise Act. JTI-M agreed to pay USD 144 million (CAD 150 million) as part of this global settlement.

In July 2003, a former employee commenced a civil action in the Ontario Superior Court of Justice against JTI-M and three individual defendants seeking USD 12 million (CAD 12 million) in damages for his alleged unlawful treatment in the early 1990s when he was an employee of Northern Brands International, Inc. (a now-inactive R J Reynolds Tobacco Company affiliate) and later imprisoned in the United States after pleading guilty to criminal charges. The case was stayed for the duration of the CCAA proceeding, but it may now proceed as a result of the CCAA termination order of April 16, 2010.

In August 2003, the Canadian government filed a civil action in the Ontario Superior Court of Justice seeking USD 1.44 billion (CAD 1.5 billion) in damages from R J Reynolds Tobacco Holdings, Inc., R J Reynolds Tobacco Company, R J Reynolds Tobacco International, Inc., JTI-M, Northern Brands International, Inc., Japan Tobacco Inc., JT International SA, and various other subsidiary companies, based on allegations that the defendants conspired to defraud the federal government of applicable taxes and duties by smuggling and importing cigarettes and tobacco into Canada for sale and consumption without payment of applicable import duties and taxes. This action remained stayed by order of the Ontario Superior Court of Justice in the CCAA proceeding described below. Pursuant to the global settlement with Canadian authorities regarding illicit trade, JTI-M has been fully and definitely released of this claim.

In August 2004, the Québec Minister of Revenue ("Revenue Québec") issued an assessment against JTI-M in the amount of USD 1.30 billion (CAD 1.36 billion) in taxes, penalties and interest for alleged failure to collect and remit Québec tobacco taxes during the years 1990 to 1998 in respect of tobacco products that would have been sold outside Canada, but were unlawfully re-introduced in Québec for retail sale in Québec. In August 2004, Revenue Québec further issued an order for immediate payment of the assessment, and obtained a judgment of the Superior Court of Québec ordering such payment. In November 2004, JTI-M filed its administrative objection to the assessment denying all liability for the tax, on the ground that it denies any participation in alleged contraband, and that in any event the assessment under the circumstances is not justified by the tax legislation relied on by Revenue Québec. As part of the global settlement with Canadian authorities regarding illicit trade, the Revenue Québec

assessment has been withdrawn and replaced by a new assessment for CAD 0.00 JTI-M's objection to the 2004 assessment is accordingly terminated

In August 2004, Revenue Québec also instituted an oppression action under the Canada Business Corporations Act, alleging that a corporate reorganization of certain JTIH subsidiaries was intended to cause prejudice to Revenue Québec's claim for taxes as assessed in August 2004, and that contemporaneous acquisition and integration transactions constituted fraudulent conveyances to avoid payment of such taxes Pursuant to the global settlement with Canadian authorities regarding illicit trade, this action has been formally withdrawn with leave of the court given on April 30, 2010.

In August 2004, JTI-M instituted proceedings under Canada's Companies' Creditors Arrangement Act ("CCAA") All actions against JTI-M were stayed by the Ontario Superior Court of Justice on that date In April 2006 ING Bank issued Letters of Credit in favor of JTI-M's court appointed Monitor to enable payments to be made by JTI-M to JT International SA As a result of the global settlement with Canadian authorities regarding illicit trade, the company obtained a court order terminating the CCAA proceeding and ordering the return for cancellation of the Letters of Credit.

At the invitation of the court presiding over the CCAA proceedings, seven other provinces have filed claims similar to Québec's, seeking taxes, interest, and penalties in a total amount of approximately USD 9 20 billion (CAD 9 6 billion) As part of the global settlement with Canadian authorities regarding illicit trade, JTI-M has now been released fully and definitely of the said claims.

In April 2010, a class composed of tobacco growers in the province of Ontario (Canada) served JTI-M with an action seeking USD 48 million (CAD 50 million) for an alleged breach of contract between the Ontario Flu-Cured Tobacco Growers Marketing Board and JTI-M

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

Rest of world – JTI Marketing & Sales ("JTI MS"), a Russian subsidiary of JTIH, is in dispute with the Moscow City Tax Authorities regarding an assessment of VAT and profit taxes for the years 2005 to 2007 The amount of alleged tax arrears, penalties and default interest that were additionally charged as of November 2008, amounted to USD 41 million (RUB 1 30 billion) JTI MS brought suit to challenge the assessment In October 2009, JTI MS lost at the Court of First Instance JTI MS's appeals of that decision were only partially accepted by the Court Appeals in December 2009 and the Court of Cassation in March 2010

The Turkish Director of Quarantine has filed a smuggling-related criminal complaint against the Company's Turkish subsidiary in January 2006. Turkish Customs in turn opened an investigation against the JTIH subsidiary and suspended the subsidiary's "Certificate of Approved Persons." The subsidiary obtained an injunction restoring the Certificate and in February 2009 the administrative court accepted that the "Certificate of Approved Persons" should be restored. The subsidiary also filed a criminal complaint against an employee of the subsidiary's customs agent, alleging forgery of signatures on certificates of conformity. The criminal complaints remain pending until the Customs investigation is completed. No fine or restitution amount has been specified.

A JTIH subsidiary in the Canary Islands has been sued in Spain civilly and criminally on smuggling-related allegations. The subsidiary has been required to establish a guarantee for its maximum potential liability of approximately USD 8 million (EUR 6 million).

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

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

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

Other Litigation

In October 2003, JT International (Thailand) Ltd ("JTI Thailand") filed an arbitration request with the International Chamber of Commerce against its former distributor, TI Trading Co. Ltd ("TIT") for unpaid invoices totaling USD 3 million (THB 98 million). The three-member arbitration tribunal awarded JTI Thailand USD 3 million in August 2006. TIT has sought to annul the award. Proceedings are still pending before the Bangkok Southern Civil Court. In March 2006, TIT served JTI Thailand with a court action seeking damages of USD 14 million (THB 473 million) on grounds similar to those asserted as counterclaims in the arbitration. A first-instance court rejected this claim in October 2006, and TIT has appealed. The appeal remains pending.

A JTIH subsidiary, Gallaher International Ltd ("GIL"), terminated a distribution contract in March 2005, and commenced an action before the English high court for damages and a declaration that the termination was valid because of numerous material breaches. The former distributor counterclaimed for unlawful termination, ultimately seeking around USD 500 million in unparticularized damages from the termination. The high court dismissed the counterclaim and entered judgment for GIL in April 2008. In distantly related litigation, Khaled Al-Mahamid and Adam Trading LLC filed an action in Cyprus against the former distributor and GIL, seeking more than USD 25 million in unparticularized damages for alleged breach of an exclusive distribution agreement for Yemen. The Order permitting service on GIL was set aside in February 2008.

In August 2003, the UK Office of Fair Trading ("OFT") notified the former Gallaher group of an enquiry into agreements between manufacturers and retailers in the UK cigarette, tobacco and tobacco-related markets. On April 24, 2008, the OFT issued a Statement of Objections ("SO") against Gallaher Ltd, another tobacco manufacturer and 11 UK retailers, alleging anti-competitive practices in relation to retail prices for tobacco products in the UK. Gallaher entered into an Early Resolution Agreement with the OFT, as announced by the OFT on July 11, 2008, under which Gallaher agreed to pay a maximum fine of up to USD 148 million (GBP 93 million) and continue to co-operate with the OFT's investigation in return for a reduction of penalty. On April 16, 2010, the OFT announced its decision in the matter and imposed a significantly reduced fine on Gallaher of USD 80 million (GBP 50.4 million). The amount of the fine is approximately USD 181 million (GBP 114 million) smaller than the amount of liabilities booked at December 31, 2009 as a result of the assessment of the risk of the imposition of a fine under the UK Competition Act.

In connection with JT's purchase of certain assets of R J Reynolds Tobacco Company ("RJRTC") and RJR Nabisco, Inc ("RJRN"), in addition to liabilities, costs and expenses relating to the matters described above under the headings "Canada" and "United States," RJRTC and RJRN also agreed to indemnify JT for (1) liabilities, costs, and expenses arising from any taxes arising prior to the acquisition in respect of the acquired business (except as reflected on the closing balance sheet) and (2) liabilities, costs, and expenses arising from the seller's employee benefit and welfare plans. RJRTC disputes the applicability of these indemnities to the matters described above under the headings "Canada" and "United States," and indeed claims that JT owes RJRTC indemnification with respect to the "United States" matters. In April, 2010, the dispute with RJRTC was settled and RJRTC participated in the global settlement of April 13, 2010 with Canadian authorities regarding illicit trade.

In June 2008, Tanzania Cigarette Company (TCC), a 75% subsidiary of JTIH, received from the 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 66 million (TSH 88 billion). In a decision dated March 31, 2009, the Tanzanian Office for Fair Competition issued its findings and proposed penalties against TCC. In turn, TCC objected and requested a full hearing. In October 2009, the FCC held that it has jurisdiction to

hear and determine the complaint against TCC. Accordingly, TCC decided to file a petition with the High Court to seek a determination of all the preliminary issues raised before the FCC.

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

Related party transactions

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

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

(in millions of USD)	2009	2008
Reimbursement of product development costs by JT	-	32
Sale of leaf inventory and finished goods to JT	417	393
Reimbursement of payments made under the EC agreement	25	25
Other income	(1)	(2)
	<u>441</u>	<u>448</u>

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

(in millions of USD)	2009	2008
Royalties due to JT	297	186
Purchases of tobacco material, non-tobacco material and finished goods from JT	259	356
Purchases of tobacco flavors from Fuji Flavor Co , Ltd (a JT subsidiary)	28	24
Purchase of tobacco filters from Japan Filter Technology (a JT subsidiary)	20	19
Recharge of consultancy fees for the year	5	-
	<u>609</u>	<u>585</u>

Included in JTI's interest expense is the following related-party transaction with JT and its subsidiaries

(in millions of U S dollars)	2009	2008
Interest on credit facilities and loans granted by JT and its subsidiaries	<u>5</u>	<u>2</u>

Included in JTI's foreign exchange loss, net is the following related party transaction with JT

(in millions of U S dollars)	2009	2008
Foreign exchange forward contracts with JT gain / (loss)	<u>(45)</u>	<u>33</u>

JTI and JT entered into several foreign exchange derivative contracts JTI's exposure on these contracts is offset by mirror-image contracts with a third-party

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

(in millions of USD)	2009	2008
Accounts payable	130	67
Loans payable	17	45
Borrowings from JT (Note 9 and Note 10)	<u>1,833</u>	<u>-</u>
	<u>1,980</u>	<u>112</u>

JTI holds an equity-method investment in Lekkerland GmbH & Co. KG ("Lekkerland"), a German distribution business (25.1% ownership interest) JTI made sales to Lekkerland of USD 358 million in 2009 JTI purchased goods worth USD 4 million in 2008 from Lekkerland In 2009 and 2008, JTI received dividends of USD 16 million and USD 14 million respectively from Lekkerland. At December 31, 2009, amounts due to Lekkerland were insignificant

Foreign currency arrangements

JTI conducts business on a multi-national basis in a wide variety of foreign currencies and, as such, uses derivative financial instruments to reduce cash flow volatility associated with foreign exchange rate changes. In 2009 and 2008, JTI used foreign currency forwards and swaps to economically hedge its exposure to fluctuations in Euro, Sterling, Swiss Francs, Russian Ruble, Turkish Lira, Taiwan Dollar, 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 earnings.

The aggregate notional amounts and fair values of JTI's outstanding foreign exchange and interest rate derivative contracts were as follows at December 31, 2009:

Asset Derivatives (in millions of USD)		Fair Value	Notional Value
	Balance Sheet location		
Foreign exchange forwards	Other current assets	74	2,625
Interest rate caps	Other current assets	-	2,835
Interest rate caps	Other non-current assets	2	398
Interest rate swaps	Other non-current assets	25	397
		<u>101</u>	<u>6,255</u>
Liability Derivatives			
	Balance Sheet location	Fair Value	Notional Value
Foreign exchange forwards	Other current liabilities	105	3,268
Cross currency interest rate swaps	Other non-current liabilities	5	25
		<u>110</u>	<u>3,293</u>

JTI holds foreign exchange derivative contracts with JT. JTI's exposure on these contracts is offset by mirror-image contracts with third-parties. As a result, unrealized losses on the contracts with JT (amounting to USD 42 million at December 31, 2009) are offset by unrealized gains on back-to-back contracts that are included in Foreign exchange forwards in the table above.

The impact of derivative contracts on the 2009 statement of earnings was as follows:

(in millions of USD)		Gain (Loss)
Foreign exchange forwards	Foreign exchange gain (loss)	(122)
Interest rate caps	Other income (expense)	2
Interest rate swaps	Other income (expense)	32
Cross currency interest rate swaps	Other income (expense)	(5)
		<u>(93)</u>

As a result of the use of derivative instruments, JTI is exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. To mitigate the counterparty credit risk, JTI has a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors, and maintains strict dollar and term limits that correspond to each institution's credit rating. JTI's established policies and procedures for mitigating credit risk on principal transactions include reviewing and establishing limits for credit exposure and continually assessing the creditworthiness of counterparties. At December 31, 2009, there were no significant concentrations of credit risk with any individual counterparty or groups of counterparties related to JTI's use of derivative contracts.

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

All sales are generated with tobacco products, mainly being cigarettes

Net sales per geographical areas are as follows

	2009	2008
(in millions of USD)	USD	USD
Europe	6,083	6,514
Americas	331	320
Asia Pacific	1,007	1,074
CIS & Baltics / Middle East / Africa / other	4,163	4,588
Total net sales	11,584	12,496

Salaries, social security contributions and pension premiums

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

	2009	2008
(in millions of USD)	USD	USD
Salaries	1,224	1,249
Social security contributions	190	194
Net periodic pension cost	74	109
	1,488	1,552

Amortization and depreciation expenses

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

	2009	2008
(in millions of USD)	USD	USD
Amortization for the year	1,171	1,210
Depreciation for the year	340	367
	<u>1,511</u>	<u>1,577</u>

Auditor fees

Total fees from Deloitte, our external auditor amounted to

	2009	2008
(in millions of USD)	USD	USD
Audit fees	8	11
Tax fees	1	1
All other fees	3	3
	<u>12</u>	<u>15</u>

The fees paid for services rendered by Deloitte Accountants B V for the years ended December 31, 2009 and December 31, 2008 amount to EUR 111,533 and EUR 32,760 respectively The fees relate to audit engagements only

Employee information

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

	2009	2008
Europe	10,008	9,676
Americas	1,160	592
Asia Pacific	1,920	1,677
CIS & Baltics/Middle East/Africa/Other	13,455	11,997
	<u>26,543</u>	<u>23,942</u>

Net interest result (12)

Net interest result comprises

	2009	2008
(in millions of USD)	USD	USD
Interest income from third parties	45	90
Interest expenses to third parties	(213)	(422)
	<u>(168)</u>	<u>(332)</u>

Net other financial expenses (13)

Net other financial expenses include loss on sale of marketable securities, financing-related fees and other items of a financial nature

Income taxes (14)

Income tax expense consists of the following

	2009	2008
(in millions of USD)	USD	USD
Current		
The Netherlands	4	14
Other countries	476	598
Total	480	612
Deferred		
The Netherlands	2	26
Other countries	(38)	(66)
Total	(36)	(40)
Income tax expense	444	572

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

	2009	2008
(in millions of USD)	USD	USD
The Netherlands	(856)	(1,301)
Other countries	1,663	2,294
Pre-tax income	807	993

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

	2009	2008
(in millions of USD)	USD	USD
Income taxes computed at statutory Dutch tax rates (25.5%)	204	247
Increase/(decrease) in valuation allowance	17	109
Non-deductible expenses and non-taxable income	272	313
Increase/(decrease) of tax liability for FIN 48, net	34	86
Withholding taxes	50	38
Reduction in enacted taxes	1	(13)
Amortization of investment in subsidiaries	(34)	—
Foreign tax less than domestic rates, net	(82)	(179)
Other	(18)	(29)
Provision for income taxes	<u>444</u>	<u>572</u>
Effective tax rate	<u>55.0%</u>	<u>57.6%</u>

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

(in millions of USD)	2009	2008
Deferred tax assets:		
Pension and other postretirement benefits	189	223
Property, plant and equipment	42	59
Restructuring and accrued liabilities	19	60
Reserves and allowances	53	136
Foreign exchange losses	218	292
Operating loss and credit carryforwards	340	349
Amortization of investments in subsidiaries	79	55
Other differences	143	95
Less valuation allowance	<u>(437)</u>	<u>(439)</u>
Deferred tax assets, net	<u>646</u>	<u>830</u>
Deferred tax liabilities		
Intangibles	785	806
Pensions	109	187
Undistributed earnings of subsidiaries	51	64
Property, plant and equipment	44	60
Interest	65	59
Other differences	<u>127</u>	<u>104</u>
Deferred tax liabilities	<u>1,181</u>	<u>1,280</u>

JTI assesses the realizability of deferred tax assets on a jurisdiction-by-jurisdiction basis. The assessment is based upon the weight of all available evidence, including factors such as the recent earnings history and expected future taxable income. A valuation allowance is recorded to reduce deferred tax assets to a level which, more likely than not, will be realized.

At December 31, 2009 and 2008, JTI had net operating loss (NOL) and tax credit carryforwards totaling USD 1,354 million and USD 1,203 million respectively, which are available to reduce future taxable income of JTI and certain international subsidiaries. Approximately USD 760 million of NOL and credit carryforwards (resulting in a tax benefit of USD 190 million) expire between fiscal years 2009 and 2024, with the remainder having no expiration date under current laws.

At December 31, 2009, JTI provided USD 51 million for income and withholding taxes on a portion of its foreign subsidiaries' undistributed earnings. No provision has been made in respect of the balance of unremitted earnings of foreign subsidiaries because such earnings are indefinitely reinvested in operations. Upon distribution, those earnings would be subject to income taxes. However, it is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

Uncertain tax positions

JTI's uncertain tax positions were as follows:

(in millions of USD)

January 1, 2008	341
Reductions for prior year tax positions	(52)
Additions for prior year tax positions	101
Additions for current year tax positions	34
Settlements	(5)
Lapse of statute of limitations	(13)
December 31, 2008	<u>406</u>
Reductions for prior year tax positions	(29)
Additions for prior year tax positions	44
Additions for current year tax positions	28
Settlements	(23)
Lapse of statute of limitations	(21)
December 31, 2009	<u>405</u>

In 2009, JTI recognized in earnings a tax benefit of USD12 million related to acquired uncertain tax positions (primarily in conjunction with settlements).

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

In 2009, JTI recognized interest and penalties of USD 13 million in its consolidated statement of earnings (2008. USD 23 million) At December 31, 2009, JTI's consolidated balance sheet included accrued interest and penalties of USD 67 million (2008. USD 54 million)

It is reasonably possible that provisions for unrecognized tax benefits will decrease by USD 155 million in 2010 upon completion of examination by tax authorities in certain tax jurisdictions

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

Tax jurisdiction

Canada	2002 - forward
Germany, Netherlands, Malaysia, Italy, Taiwan, UK, Ireland	2003 - forward
Switzerland, Turkey, Romania, Korea, Singapore, Poland	2004 - forward
Czech Republic, Spain, South Africa, Thailand, Nigeria, Sweden, Bulgaria	2005 - forward
France, Russia, Tanzania, Latvia, Philippines, Belgium, Austria	2006 - forward
Kazakhstan, Iran, Luxembourg, Ukraine	2007 - forward
Greece	2009 - forward

COMPANY BALANCE SHEET**December 31, 2009**

(before proposed appropriation of the result)

A s s e t s

(in millions of USD)

	Dec. 31, 2009	Dec 31, 2008
	USD	USD
Fixed assets		
Financial fixed assets (1)	17,281	17,057
Total assets	17,281	17,057

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, 2009		December 31, 2008	
	USD	USD	USD	USD
Equity attributable to equity holder (2)				
Share capital	1,981		1,942	
Share premium	14,314		14,314	
Retained earnings	1,324		999	
Currency translation adjustment	(677)		(598)	
Unappropriated result	339		400	
		17,281		17,057
Total equity and liabilities		17,281		17,057

COMPANY STATEMENT OF INCOME
Year ended December 31, 2009

(in millions of USD)

	2009	2008
	USD	USD
Share in earnings of investments	339	400
Other results	—	—
Net result for the year	339	400

NOTES TO THE COMPANY FINANCIAL STATEMENTS

December 31, 2009

Accounting principles

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

General accounting principles for the preparation of the financial statements

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

Company income statement

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

Notes to the specific items of the balance sheet

Financial fixed assets (1)

Financial fixed assets comprise

	2009	2008
(in millions of USD)	USD	USD
Investments in subsidiaries and participations	17,281	17,057

The movement in financial fixed assets is as follows

Balance as at January 1	17,057	16,786
Share in earnings (see also note 2)	266	277
Currency translation adjustments	(146)	380
Hedge net investment	106	(384)
Dividends received	(2)	(2)
Balance as at December 31	17,281	17,057

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

Equity attributable to equity holder (2)

The movements in equity attributable to equity holder are as follows

	Share capital	Share premium	Retained earnings	Currency translation adjustment	Unappro- priated result	Total 2009	Total 2008
(in millions of USD)	USD	USD	USD	USD	USD	USD	USD
Opening balance	1,942	14,314	999	(598)	400	17,057	16,785
Adjustment to initially apply FIN 48	-	-	-	-	-	-	-
Appropriation of net result	-	-	400	-	(400)	-	-
Hedge of net investment losses, net of tax expense of USD 36	-	-	-	106	-	106	(384)
Foreign currency trans- lation adjustment	-	-	-	(146)	-	(146)	380
Effect of changing pension Plan measurement date, net of tax benefit	-	-	-	-	-	-	(9)
Increase in deferred actuarial losses And prior service costs, net of tax benefit of USD 31	-	-	(75)	-	-	(75)	(115)
CTA share capital	39	-	-	(39)	-	-	-
Net result for the year	-	-	-	-	339	339	400
Closing balance	1,981	14,314	1,324	(677)	339	17,281	17,057

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

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

- a negative impact as increase in deferred actuarial losses and prior service costs amounting to USD 75 million (2008 USD 115 million).
- In 2008 there was also a negative impact on the effect of changing pension plan measurement date amounting to USD 9 million (2009 0),

Share capital issued

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

The share capital denominated in EUR has been converted into USD against the following USD/EUR exchange rate 0.6967 at balance sheet date (2008: 0.7107).

Other notes and signing of the financial statements

Personnel

In 2009 the Company employed no employees (2008 0).

Remuneration of the Board of Directors

In 2009, the Board of Directors received no remuneration (2008 nihil).

JT EUROPE HOLDING B V , AMSTERDAM

Signing of the financial statements

Amsterdam, June 11, 2010

Board of Directors:

M Yamaguchi

M Terabatake

M Franke
On behalf of JT International Netherlands B V

Other information

Statutory rules concerning appropriation of result

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

Appropriation of result for the financial year 2008

The annual report 2008 was adopted, by the shareholder, by means of a shareholder's resolution, on July 20, 2009. The general meeting of shareholders determined the appropriation of result in accordance with the proposal being made to that end.

Proposed appropriation of result for the financial year 2009

Pending the decision of the General Meeting of Shareholders, the net result for the year 2009 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 April 13, 2010, JTI reached a global settlement with all Canadian authorities in connection with the illicit trade in the early 1990s. The criminal charges against JTI-Macdonald Corp ("JTI-M") and its current and former employees were withdrawn. As a result of the settlement, JTI-M was also released of certain other claims in regards of the illicit trade, including a tax assessment of CAD 1.36 billion by the Québec Minister of Revenue. Furthermore, JTI-M obtained a court order terminating the proceedings under Canada's Companies' Creditors Arrangement Act ("CCAA"). Reference is made to the Other Tobacco related Litigation section on page 42 to page 44 of the Annual Report.

In August 2003, the UK Office of Fair Trading ("OFT") notified the former Gallaher group of an enquiry into agreements between manufacturers and retailers in the UK cigarette, tobacco and tobacco-related markets. On April 24, 2008, the OFT issued a Statement of Objections ("SO") against Gallaher Ltd, another tobacco manufacturer and 11 UK retailers, alleging anti-competitive practices in relation to retail prices for tobacco products in the UK. Gallaher entered into an Early Resolution Agreement with the OFT, as announced by the OFT on July 11, 2008, under which Gallaher agreed to pay a maximum fine of up to USD 148 million (GBP 93 million) and continue to co-operate with the OFT's investigation in return for a reduction of penalty. On April 16, 2010, the OFT announced its decision in the matter and imposed a significantly reduced fine on Gallaher of USD 80 million (GBP 50.4 million). The amount of the fine is approximately

USD 181 million (GBP 114 million) smaller than the amount of liabilities booked at December 31, 2009 as a result of the assessment of the risk of the imposition of a fine under the U K Competition Act Reference is made to the Other Litigation section on page 46 of the Annual Report

In April 2010, a class composed of tobacco growers in the province of Ontario (Canada) served JTI-M with an action seeking USD 48 million (CAD 50 million) for an alleged breach of contract between the Ontario Flue-Cured Tobacco Growers Marketing Board and JTI-M

The above mentioned subsequent events do not have a material impact on the consolidated results, consolidated cash flow, or consolidated equity of the company at December 31, 2009. Reference is made to the Other Tobacco related Litigation section on page 44 of the Annual Report

Auditor's report

Reference is made to the auditors' report as included hereinafter

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

Date
June 11, 2010

From
P. Kuijpers

Reference
3100043195/OP9993/ahdr

Auditor's report

Report on the financial statements

We have audited the accompanying financial statements 2009 of JT Europe Holding B.V., Hilversum, which comprise the consolidated and company balance sheet as at December 31, 2009, the consolidated and company profit and loss account for the year then ended and the notes.

Management's responsibility

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

Auditor's responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.



2

June 11, 2010

3100043195/OP9993/ahdr

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

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

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of JT Europe Holding B.V. as at December 31, 2009, and of its result for the year then ended in accordance with Part 9 of Book 2 of the Netherlands Civil Code.

Report on other legal and regulatory requirements

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

Deloitte Accountants B.V.
already signed P. Kuijpers