

2002 ANNUAL REPORT

Commitment



a: the state or instance of being obligated or emotionally impelled <a *commitment* to a cause> ;
b: something pledged; c: an agreement or pledge to do something

To discover what our
commitment
can mean
for you, read on...

KT&G Corporation



■ New Corporate Identity

In 2002, Korea Tobacco & Ginseng adopted a new name and corporate identity.

While we are proud of our tradition, we believe the simple elegance of the redesigned KT&G logo embodies the essential values of our organization today.

It represents our open and ethical approach to business and our concern for the environment and our customers.

What's more, it symbolizes our confidence that those values will soon be familiar to millions more people around the world, as we aspire to become a global name in the tobacco industry.

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Company Profile

KT&G continues to build on its distinguished history. It is moving beyond being the dominant force in the Korean tobacco industry to become an important player in the global tobacco market.

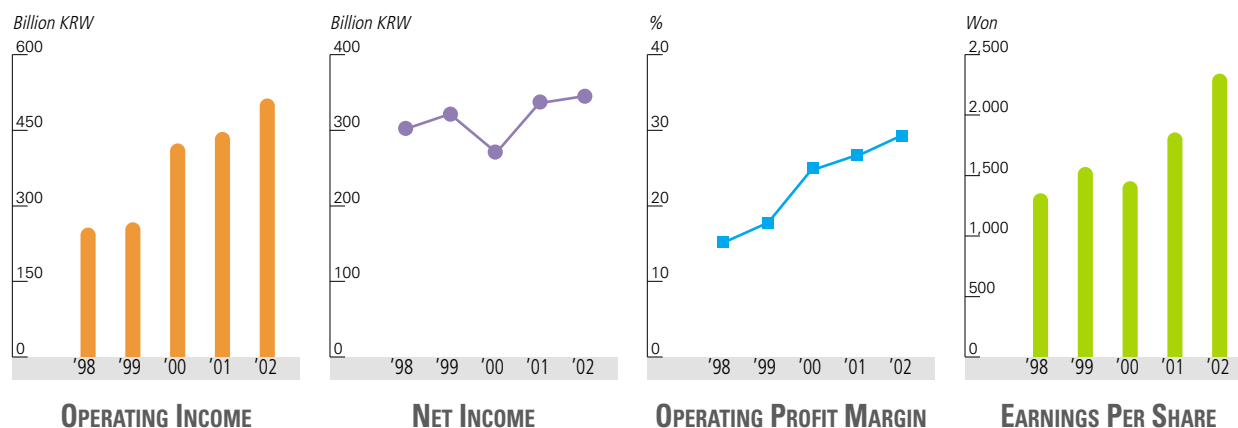
Originally established at the end of the 19th century as the Korean crown's agent for regulation of the red ginseng trade, by the middle of the 20th century KT&G had become a nationalized institution with a monopoly on ginseng and tobacco.

In 1987, the company was restructured as a government-invested company. In the years that followed, the renamed Korea Tobacco & Ginseng Corp. faced the gradual liberalization of the domestic market and loss of its privileges. By 1999, confronted with an influx of foreign competition and a government policy of privatization, the company set about overcoming its greatest challenge.

It achieved rapid success thanks to a rigorous program of rationalization and restructuring. In 1999, the company spun off its ginseng division to focus on its core business of tobacco. Later that year, it held a successful initial public offering and was listed on the Korea Stock Exchange. A well-received issue of global depositary receipts and convertible bonds in 2001 was followed in 2002 by the accomplishment of full privatization.

Throughout, KT&G remained committed to reform. It slimmed its workforce by over 40 percent, closed unproductive plants, and upgraded processing and manufacturing facilities. And it encouraged a corporate philosophy that emphasizes customer satisfaction, shareholders' value, and employee initiative.

Today, KT&G is an independent, globally competitive enterprise. Its nationwide franchise continues to dominate the domestic market, and its reputation as a force throughout the countries of the Middle East and Central Asia is growing rapidly. The global challenge awaits. And KT&G is ready.



In billions of Korean Won, except per share data

	2000	2001	2002	Change
Net operating revenues	1,705.0	1,701.4	1,806.9	6.2%
Operating income	425.9	449.2	527.1	17.3%
Net income	270.4	333.8	347.4	4.1%
Total assets	3,827.1	3,670.5	3,916.2	6.7%
Total liabilities	1,055.5	1,054.6	1,931.5	83.2%
Total shareholders' equity	2,771.6	2,615.9	1,984.7	(24.1)%
Operating profit margin (%)	25.0	26.4	29.2	2.8%p
Return on equity (%)	9.6	12.4	15.1	2.7%p
Interest-bearing debt to equity (%)	0.0	11.9	55.9	44.0%p
Number of shares outstanding, year-end (000's)	183,028	167,274	119,568	(28.5)%
Number of shares outstanding, average (000's)	185,030	179,718	146,989	18.2%
Earnings per share (Korean Won)	1,461	1,858	2,364	27.2%
Diluted earnings per share (Korean Won)	1,461	1,841	2,084	13.2%
Average dividend per share (Korean Won)	1,126	1,267	1,400	10.5%
Year-end stock price (Korean Won)	19,000	19,400	16,400	(15.5)%
Year-end KOSPI index (point)	504.6	693.7	627.6	(9.5)%
Average net selling price (Korean Won / pack)	345.6	379.6	441.4	16.3%
Domestic sales volume (in billions of cigarettes)	95.1	83.4	72.5	(13.1)%
Exports volume (in billions of cigarettes)	6.1	11.6	21.4	84.5%
Number of employees	4,468	4,426	4,635	4.7%



>> PRIVATIZATION ACCOMPLISHED

KT&G achieved full privatization in October with the disposal of its remaining publicly held equity. At an extraordinary general meeting of shareholders held on December 27, shareholders approved the abolition of restrictions on foreign and individual ownership of the company and the change of name from Korea Tobacco & Ginseng Corp. to KT&G Corporation.



>> EXPORTS PASS US\$100 MILLION MARK

KT&G won recognition for its outstanding export achievement in 2002 when it received an export trade award for sales amounting to more than US\$150 million.



>> KT&G CFO RECEIVES TOP AWARD

KT&G Chief Financial Officer Mr. Kwak Young-Kyoon was named CFO of the Year by the Korea CFO Association in November. He was awarded the honor based on his contribution to corporate transparency, corporate restructuring, and reform of management.



>> TREASURY STOCKS RETIRED

In September, KT&G purchased and retired 5% of its treasury stocks in a move to enhance shareholders' value. The company currently holds 34.1% of outstanding shares issued as treasury stocks.



>> KT&G COMMENDED FOR CORPORATE GOVERNANCE

In July, KT&G's corporate governance was named among the most outstanding of companies listed on the Korea Stock Exchange. In awarding the honor, the Corporate Governance Center cited factors including transparent KT&G's corporate governance and its 70% ratio of non-executive directors.



>> NEW PRODUCTS LAUNCHED

KT&G products introduced in 2002 included Raison, Seasons, Humming Time, Lumen, and Esse Lights. The high quality brands, which retail at KRW1,800 or more, were launched in response to growing consumer demand for premium products.

Our Commitment to... Customers



When customers reach for our products, they know they'll find our commitment to quality, from planting to packaging, every time.



First of all, it is my great pleasure to announce that in 2002 KT&G achieved its goal of becoming a fully privatized company. The disposal of our remaining publicly held shares and the official renaming of the company as KT&G marked the beginning of a new era for the company. Thanks to the continued support of our shareholders, we are now prepared to forge ahead and transform KT&G into a leading player in the tobacco industry.

Developments in the domestic market in 2002 made for a difficult year. Competition for market share continued to intensify as foreign tobacco companies aggressively marketed premium brands and stepped up production at local manufacturing facilities. Meanwhile, tax increases on tobacco products and the fad of a national anti-tobacco campaign put pressure on sales across the board. The notable exception was the premium brand segment of the market, which continued to exhibit strong growth.

Despite these challenges, we maintained our market dominance. This was largely due to the continuing implementation of measures that have increased efficiency and profitability throughout the organization. We successfully completed the reorganization of our business system, under which marketing and distribution operations were overhauled and separated, and we put our brand management system into full operation.

These initiatives strengthened the competitiveness of our established brands and contributed to the successful launch of five new premium products. The diversification of our product portfolio reflected growth in consumer demand for premium brands, while the greater margins on our higher priced products resulted in increases in profitability.

Overseas, our performance was once again outstanding. Thanks to strong demand, exports in 2002 generated sales of more than US\$150 million, with volume up by some 80% on the previous year. The significant growth offset the effects of increased competition in the domestic market. We intend to make still greater inroads into foreign markets and are committed to enlarging both the volume and profitability of our exports.

On the production front, we pressed ahead with a program of modernization and rationalization that continued to hone our competitive edge and promote efficient operation. During the year, we closed both our Jeonju manufacturing plant and our Choongju tobacco processing facility. At the same time, the construction of our new plant in Youngju, which will employ high-speed production line facilities and optimum quality control systems, was accelerated. We also took steps to improve the quality and procurement of tobacco. All material purchases are now subject to tighter quality control procedures, and the abolishment of mandatory procurement for domestic leaf tobacco enables KT&G to reduce raw material procurement costs.

In the coming year, we will continue to strive for greater satisfaction for our customers, value creation for our shareholders, and additional opportunity for our employees. To achieve that, we will focus on the following:

First, we will maintain our dominance of the domestic market. As well as strengthening competitiveness, we will focus on increasing profitability through the continued diversification of our brand portfolio and the upgrading of our brand management, marketing and distribution systems in order to meet the demands of the changing market.

We will also expand our international operations. Building on the recent advances we have made in overseas markets, we will promote KT&G brands through extensive marketing, strengthen our sales network, and enhance profitability through focusing on high-margin products.

Finally, we will remain committed to our program of rationalization. We will continue to modernize production lines, and concentrate on improving the efficiency of our manufacturing and processing facilities to improve both productivity and profitability levels.

In closing, I would like to extend my sincere gratitude to all of our shareholders for their continued support as we embark upon a journey that I believe will see KT&G emerge as a leading name in the tobacco industry and a truly global corporation.

Thank you.



We have come a long way in the past few years. The journey is not yet over, but global leadership is at hand. As we embrace every challenge and opportunity with equal passion, we're getting closer every day.

Chairman & CEO
Joo Young Kwak

Joo-Young Kwak



Executive Directors

Kwak, Joo Young	Chairman & CEO
Kwak, Young Kyoon	Executive Managing Director of Marketing Headquarters
Cho, Young Won*	Managing Director & Member of Audit Committee

Non-Executive Directors

Park, Jong Kew*	Chairman, KSS Line Ltd.
Lee, Man Woo*	Ph.D., CPA, Professor of Accounting and President of Institute for Business Research and Education, Korea University; Member of the Policy Committee of Korea Deposit Insurance Corporation
Oh, Yeon Cheon	Ph.D., Professor of Public Finance & Management and Dean of Graduate School of Public Administration, Seoul National University
Kim, Ki Ho	Non-standing Director, Incheon International Airport Corporation, Former Vice Chairman of Ssangyong Business Group
Ahn, Suck Kyo	Ph.D., Professor of Economics, College of Commerce & Economics, Hanyang University
Yu, Shi Kwon	President of the Northeast Asian Economic Institute and Non-standing Tax Judge of the National Tax Tribunal
Yoo, Jang Hee	Ph.D., Professor of Economics and Dean of Graduate School of International Studies, Ewha Womans University
Soh, Soon Moo*	Ph.D., Attorney at Law, WOO, YUN, KANG, JEONG & HAN
Kim, Choong Sup	Ph.D., President of Korean Research Institute of Chemical Technology

*refers to 'Member of Audit Committee'

As a newly privatized company competing in a rapidly changing domestic market, KT&G has concentrated on cutting costs and enhancing competitiveness. In 2002, the company introduced higher-margin products, restructured management, and closed inefficient production facilities as it sought to challenge foreign competition at home and strengthen its presence overseas.

●● PREMIUM BRANDS DRIVE PROFITABILITY

In 2002, KT&G expanded its product line-up with the introduction of five new premium brands: Lumen, Raison, Humming Time, Seasons, and Esse Lights. The inclusion of these new luxury brands in its product line-up served to broaden the company's product mix and meet consumer demand for differentiated products. Based on the success of these high-margin items, KT&G will maintain its focus on premium cigarettes and has several brands under development for introduction to domestic and overseas markets in the coming year.

●● RESTRUCTURED MANAGEMENT STRENGTHENS COMPETITIVENESS

KT&G recently completed implementation of its brand management system. Under the new system, managers are assigned to individual brands and coordinate all aspects of their development, marketing, and sales. The system has contributed to building brand equity across the company's entire product range.

In addition, KT&G manages its sales operation, which encompasses a network of over 155,000 retailers under 146 branch offices and 14 regional headquarters, entirely separate from its distribution system. The separation of the two functions has enhanced the efficiency of both.

●● RATIONALIZATION BOOSTS PRODUCTIVITY

In response to the rapid localization of production by foreign competitors, KT&G continued with its program of plant rationalization. In 2002, the company ceased operations at its Jeonju manufacturing facility and its Choongju processing facility. As a result of the closures, and of modernization at other facilities, both employee productivity and average per-pack production costs improved on the previous year.



Raison :

A mild-tasting, ultra-low tar premium brand introduced to the domestic market in June 2002.





Best Quality, Best Service

KT&G maintained profitable performance through increased efficiency, high-margin products, and strategic expansion into global markets

Rationalization of production facilities, diversification into premium brands, and expansion into new markets were the key components of KT&G's enhanced profitability in 2002.

Total sales volume amounted to an impressive 93.9 billion cigarettes for the year, with the introduction of high-margin products and improved productivity strengthening competitiveness. Sustained growth in exports expanded KT&G's growing international presence and helped to make the company's brands household names in markets throughout the Middle East and Central Asia.

Domestic Sales »

•• AGAINST A BACKGROUND OF FIERCE COMPETITION FROM IMPORTED BRANDS, KT&G MAINTAINED ITS DOMINANCE IN THE DOMESTIC MARKET

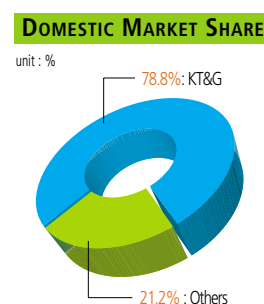
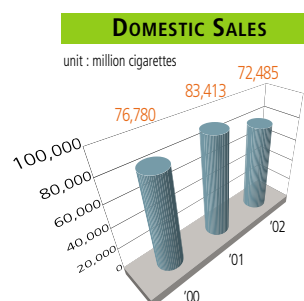
As well as remaining the most important source of revenue for KT&G, the Korean market is rapidly becoming a significant one for international tobacco companies. During 2002, the full effects of market deregulation started to take effect as foreign competitors carried out aggressive marketing campaigns of their premium brand products. In addition, tax increases on tobacco products and the rapid emergence of a widespread anti-tobacco movement were factors that put pressure on the all the players in the domestic market over the past twelve months.

Despite this, KT&G remained the dominant force in the domestic market, boasting a market share of 78.8%. With the diversification of its portfolio offering an enhanced product mix, the company achieved sales volume of 72.5 billion cigarettes. While this represented a reduction on the figure for the previous year, growth in sales of high-margin premium brands was a significant factor in improving profitability levels. A price rise during the year also contributed to the high returns from premium products.

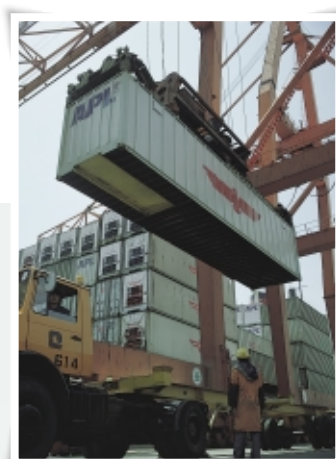


Lumen :

A mild-tasting premium brand in a distinctive octagonal pack introduced to the domestic market in June 2002.



Export of Cigarettes »



•• BOTH SALES VOLUME AND REVENUE EXCEEDED TARGETS FOR THE YEAR AS SUCCESSFUL EXPANSION INTO STRATEGIC MARKETS CONTINUED

Exports of cigarettes recorded impressive growth in 2002. Total overseas sales volume soared by more than 84% compared to the previous year, to 21.4 billion cigarettes. That translated into total export revenue of W189.7 billion and represented a remarkable year-on-year increase of 93%.

Central Asia and the Middle East remained the company's most important international markets. Sales in those regions, which accounted for the bulk of overseas business, averaged increases of around 87% over the previous year. Meanwhile, exports were also strong in markets where the company is still in the early stages of expansion. Sales in the USA, Southeast Asia, and China all showed healthy growth.

In addition to gains in volume, KT&G also enhanced its profit margins in overseas markets. This was largely thanks to the company's improved product mix and a strong demand for premium brands, which resulted in an increase in the average net selling price per pack.

Manufacturing »

Cigarette Production

•• ONGOING MODERNIZATION AND RATIONALIZATION RESULTED IN LOWERED CIGARETTE PRODUCTION COSTS

Total production in 2002 reached 95.6 billion cigarettes. This represented a reduction of 2.1%, or 2.1 billion cigarettes, on the previous year's output.

The company continued rationalization of its production facilities following suspension of production at its Youngju plant and closure of its Okchon factory in 2001. During 2002, it ceased operations at Choongju, one of its three leaf tobacco processing factories, and at Jeonju, one of its seven manufacturing plants. Combined with modernized production lines and reduced labor requirements at its remaining facilities, the consolidation resulted in increased efficiency and led to a reduction in per-pack production costs compared to the previous year.

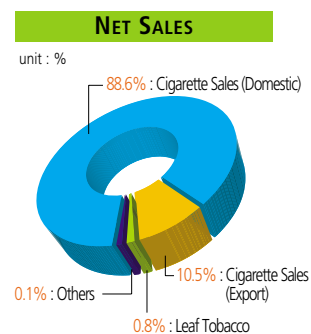
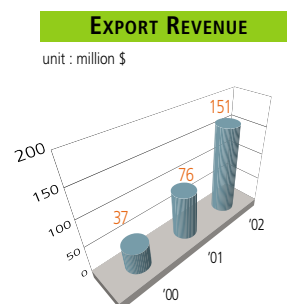


Leaf Tobacco Procurement and Usage

•• DECLINING DOMESTIC LEAF TOBACCO PURCHASES REDUCED COSTS

In order to reduce raw material costs, purchases of domestic leaf tobacco in 2002 were reduced by 14.5% compared to the previous year. Meanwhile, overseas leaf tobacco accounted for 33% of total usage, which increased from 28% of the total in 2001.

Esse & Esse Lights :
Extra-long, super slim premium brands. Esse was introduced to the domestic market in 1996. Esse Lights, an ultra-low tar version, was launched in December 2002.

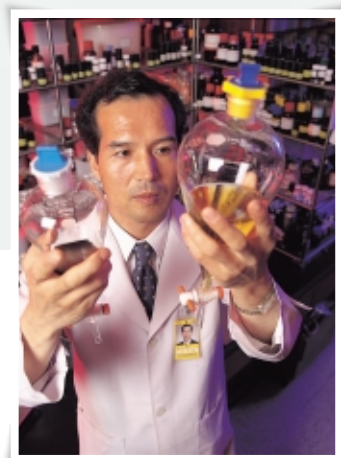


Research & Development »

•• WITH ITS OUTSTANDING RESEARCH STAFF AND STATE-OF-THE-ART FACILITIES, KT&G'S CENTRAL RESEARCH INSTITUTE IS ON THE LEADING EDGE OF INDUSTRY DEVELOPMENTS

March 2002 marked the opening of the KT&G Central Research Institute, formed when KT&G's research facility merged with the Korea Ginseng and Tobacco Research Institute, a non-profit organization previously funded by KT&G. The new Institute, which boasts enlarged facilities and state-of-the-art apparatus, has been reorganized to maximize efficiency and synergize the strengths of the two operations.

In addition to creating new tobacco products that satisfy changing consumer tastes and demands, members of staff at the Institute develop a wide range of red ginseng products. In 2002, nine new ginseng health food items were produced with others put at various stages of development. As well as product development, the staff carries out research into tobacco cultivation and processing. Their work has made a valuable contribution to reducing the company's costs in a number of areas. The Institute also conducts bioengineering research that has resulted in the development of several new agricultural and medicinal products.



Our Commitment to... the Future



Vision is more than word at KT&G. It's a force that unites us, enthuses, and inspires us to achieve our goals.



Value Driven for a Premier Company

KT&G possesses enormous potential for profitable growth. It also possesses the vision to realize its potential. The attainment of privatization in 2002 not only signaled a new stage in the company's development; it also demonstrated KT&G's capacity to achieve its goals.

KT&G is confident of realizing a vision of the future that it believes will enable it to sustain profitable growth and place it among the world's top five tobacco companies.

Our Strategy for Growth »

1. STRENGTHEN DOMINANCE OF THE DOMESTIC MARKET

KT&G is fully prepared to meet the challenge of foreign competition and is determined to extend its dominance of the domestic market. First, the company will focus on strengthening its competitiveness by diversifying its brand mix. This will enable it to target more effectively a wide consumer demographic. Moreover, the company will vigorously defend its share of the valuable premium brand segment of the market by maintaining an emphasis on differentiated brands that offer high profit margins and meet consumer demands for luxury products. The recently implemented brand management system will help strengthen competitiveness and create brand equity. Furthermore, the company will seek to enhance its channels of distribution nationwide in order to maintain the dominance of its franchise of retail outlets.

2. INCREASE SALES VOLUME AND PROFIT MARGINS OVERSEAS

Overseas markets represent the major potential for the future growth of KT&G. The company has already established a strong presence in the Middle East and Central Asia, where strategic marketing and quality brands have positioned its products among the market leaders. In the coming year, it intends to step up operations in recently developed markets, most notably in China and Mongolia, where the respective promotion of high-margin premium brand products and localization of production is anticipated to increase market share and profit margins. By 2005, KT&G aims to achieve an annual export target of 35 billion cigarettes and join the ranks of the world's top five tobacco exporters.



Seasons :

A regular-length premium brand with a distinctive sweet-spicy taste introduced to the domestic market in March 2002.





3. IMPROVE COST EFFICIENCY

KT&G will continue to seek ways to reduce costs and raise efficiency. The company will build on its enterprise-wide rationalization program, which has resulted in much progress already, and implement further cost-cutting measures. Manufacturing costs will be lowered by closures of inefficient facilities and consolidation of others. Modernization of plant and upgrading of employee skills will raise productivity levels and will help to maintain the current trend of falling production costs. Ongoing organizational changes will contribute to a more effective deployment of labor and will enhance operational efficiency from production to sales. Furthermore, purchases of domestic leaf tobacco will continue to be reduced.

4. REVITALIZE CORPORATE CULTURE

KT&G will revitalize its corporate culture to reflect its newly achieved status as a privatized organization contending for market share with globally competitive companies. The company will foster a dynamic workplace environment where initiative and excellence flourish and will promote values aimed at encouraging inclusiveness among employees throughout the organization. It will take steps to nurture the development of its human resources through education and training and encourage accountable management practices through continued transition to performance-based compensation. KT&G aims to create a workplace that attracts and retains talented individuals who will contribute to the growth and future success of the company.

Our Commitment to...

Society



At KT&G, business really is about enriching society. And we're doing that in more ways and in more communities than ever before



Building a better society for tomorrow and today

The diversity of KT&G's activities in the community reflects the strength of its commitment. Over the past five years, the company has contributed more than KRW17 billion to social welfare projects, public health funding, youth protection programs, educational endowments, and environmental protection initiatives among others.



Helping people help themselves and others

•• AFFORDABLE HOUSING FOR THE HOMELESS

Habitat for Humanity Korea was established in 1994 to construct affordable housing for the homeless using volunteer labor and donated funds and materials. KT&G has provided land for the construction of 138 houses in four regions across Korea and has funded the construction of housing for the Jimmy Carter Work Project.

•• COMPUTERS FOR THE DISABLED

With its support for a program run by the Korea Society for the Disabled that collects, refurbishes and distributes used computers to the physically challenged, KT&G is helping to ensure that equal access is a reality for thousands of people.

•• HALFWAY HOUSE FOR RELEASED PRISONERS

KT&G contributed to the construction of Hanbat House, a halfway house for released prisoners. Hanbat House is run by the Korea Rehabilitation Center, an organization that helps discharged inmates during their gradual transition from incarceration back into community life.

Bringing hope and saving lives

•• FIGHTING TUBERCULOSIS IN NORTH KOREA

North Korea reports up to 50,000 cases of tuberculosis each year. Without treatment, 70 percent of cases will be fatal. Through the Eugene Bell Foundation, KT&G is helping to save lives of young and old alike by providing mobile X-ray units, operating theater apparatus, and supply vehicles for the distribution of medicine and treatment of patients.

•• SUPPORTING CHILDHOOD LEUKEMIA SUFFERERS

After accidents, cancer is the major cause of death among children between one and 16 years of age. KT&G has funded the cost of treatment for more than 40 children suffering from leukemia, the most common form of childhood cancer, and organized activity camps to speed their recovery. In addition, KT&G funds the Home for Childhood Leukemia Patients, a fully equipped mobile home that offers patients and families who live outside major cities a place to stay during hospital visits.



This Plus :

Originally introduced to the domestic market in 1999, the popular mid-priced brand was relaunched with a new look and taste in February 2003.



Acting today to safeguard our future

●● PROTECTING OUR YOUTH

KT&G supports the Child Protection Fund, a charity that cares for and protects young people who have suffered abuse. The organization provides social and medical services, counseling, and temporary shelter. The company also funds the Youth Protection Association, which gives underprivileged and abused young people the opportunity to build a better future.

●● PRESERVING OUR ENVIRONMENT

KT&G plays an important role in supporting the Korea Animal Protection Center, the country's first wildlife sanctuary created to provide refuge for endangered species. The Center also educates the public about the importance of preserving native wildlife and its natural environment. Over 4,000 schoolchildren have visited the Center. As well as protecting animals, the Center breeds and rears endangered species for reintroduction into the wild. Particular successes in recent years include the first artificial incubation of Saunders' Gull and the rearing and breeding of three pairs of foxes from China.

Our Commitment to...

Investors



Our standards of corporate transparency, management innovation, and ethical business practices are meeting shareholder expectations and driving the value of the company.

Management's Discussion & Analysis

Management's discussion and analysis may contain forward-looking statements that are provided to assist in the understanding of anticipated financial performance. Words such as "plans", "anticipates", "expects", and similar expression are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those expressed in such statements. The term "the Company" used here without any other qualifying description will refer to "KT&G."

KT&G made significant progress in 2002. Amidst sluggish economies, a spreading anti-tobacco campaign and severe competition with imported cigarettes, the Company achieved sustainable growth and profitability improvement, maintaining its dominant market leadership at home. KT&G's growth was primarily driven by new market entries. In the domestic market, the Company developed the premium cigarette segment, effectively competing with foreign luxury brands. Separately, entries into new markets are a very important source of further volume growth. KT&G has aggressively expanded its market presence in Central Asia and the Middle East. In addition, the abolishment of mandatory procurement for domestic leaf tobacco paved the way for an epochal profitability improvement in the Company last year. Overall, taking into account the limited growth potential of the tobacco industry, the Company's operating and financial performance in 2002 was satisfactory.

KT&G took a number of strategic actions in 2002, which aimed not just for that year but also for the mid-term future of the Company. Those strategies centered on the improvement of the overall competitiveness of the Company and maximization of shareholders' value; independent management through privatization, product mix shift toward high-margin premium brands, costs cut through reduction in domestic leaf tobacco procurement, aggressive overseas marketing and purchase and retirement of treasury stocks.

Management's Discussion of Operations

SUMMARY INCOME STATEMENT

(In billions of Korean Won, except per share data)

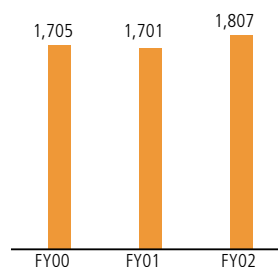
	2000	2001	2002
Total operating revenues	4,630	4,713	4,874
Net operating revenues	1,705	1,701	1,807
Operating income	426	449	527
Net Income	270	334	347
Earnings per share (Korean Won)	1,461	1,858	2,364

Operating Revenues

Total operating revenues are the sum of net operating revenues and tobacco excise taxes and dues. Tobacco excise taxes and dues for all but one brand total to a fixed KRW929 a pack. The sole exception is 'Pine Tree', sold at KRW200 a pack (tobacco excise taxes and dues are KRW60). In 2002, propelled by an improved brand mix, net operating revenues increased 6.2% YoY to KRW1,807 billion, whereas total operating revenues edged up 3.7% YoY to KRW4,874 billion.

NET OPERATING REVENUES

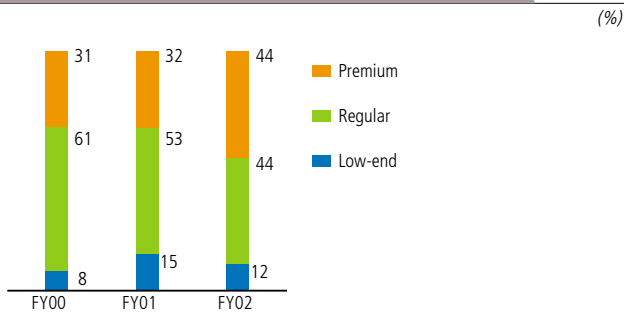
(In billions of Korean Won)



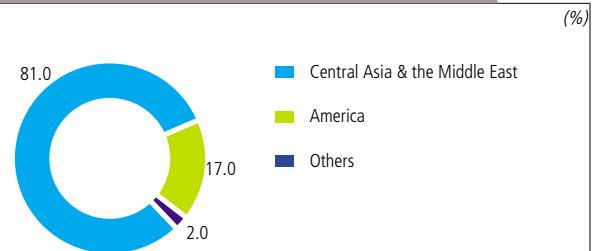
The Company's growth strategy has been and will be focused on the following three; preservation of its domestic market share, average price increase through higher margin brand mix and market diversification into the overseas markets. In short, the Company will do its best to maintain current domestic market share while it proactively proceeds into new foreign markets. This, in line with continuous sales mix improvement at home and abroad, will sustain the Company's growth.

The Company has gradually been losing domestic market share, affected by the aggressive marketing efforts by imported brands. However, the Company still holds the lion's shares in the market on the back of incomparably strong marketing and distribution network; there are more than 155,000 tobacco retailers nationwide and only KT&G deals with every tobacco retailer. To cope with the imported brands' threat, the Company has continuously moved toward premium brands, which meet diverse customer tastes. In addition, KT&G introduced efficient brand management systems, which successfully nurtured some strong representative brands such as 'Esse', 'Time', 'Lumen' and 'Raison'. All in all, the weighted average net selling price per pack has effectively risen for five consecutive years by 8.6% per annum to KRW441.4 in 2002 from KRW291.8 in 1997.

BRAND MIX

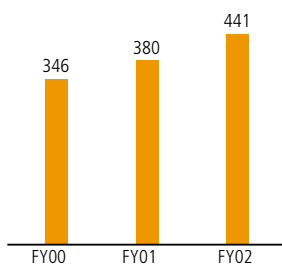


EXPORT REVENUE BY REGION



WEIGHTED AVERAGE NET SELLING PRICE

(Korean Won per pack)



While growth potential in the domestic market is inevitably limited, overseas markets offer a very important source of future volume growth. Cigarette exports more than doubled over the past three years. In 2002, exports, in terms of volume, jumped 83.5% YoY to 21.4 billion cigarettes, and accounted for more than 22% of total cigarette sales volume. Cigarette exports, in terms of value, surged 93.0% to KRW190 billion for the same period as brand reshuffle toward premium products was carried out in exports. By region, exports to Central Asia and the Middle East propelled the growth.

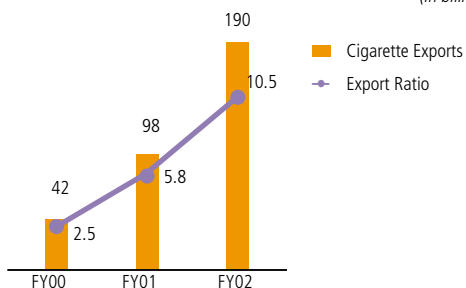
The Company became able to make independent product pricing decision to a large extent as a result of privatization. This, in addition to the tariffs imposed on imported cigarettes, enables KT&G to raise average net selling price of cigarettes gradually. The Company can launch new brands through its well-established nationwide sales network at higher prices and target to further strengthen its dominant market position in coming years.

Operating Cost and Expenses

While net operating revenues increased in 2002, COGS decreased by 5.7% YoY to KRW905 billion compared to KRW960 billion a year ago. A 6.3%p drop in cost of sales over net operating revenues to 50.1% last year from 56.4% in 2001 was the major factor, primarily driven by lowering domestic leaf tobacco usage. Also, per capita productivity improved by 10.5% from 23,640 cigarettes per man-hour in 2001 to 26,119 cigarettes per man-hour in 2002. As a result, the gross profit margin rose to 49.9% in 2002 from 43.6% in 2001; the gross profit increased 21.6% YoY to KRW902 billion in 2002.

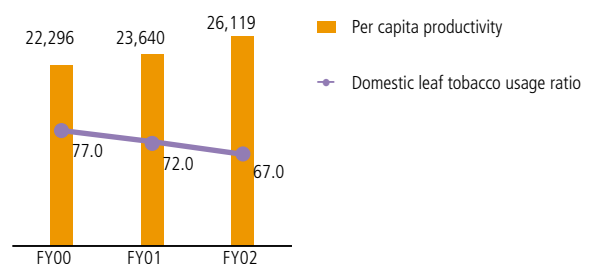
CIGARETTE EXPORTS

(In billions of Korean Won, %)



COST OF SALES

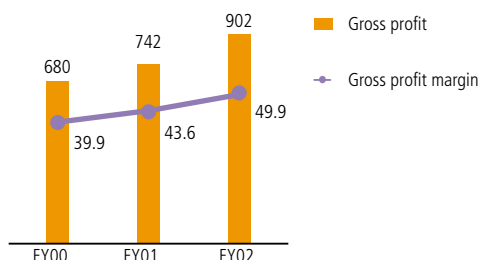
(cigarettes/m/h, %)



Management's Discussion & Analysis

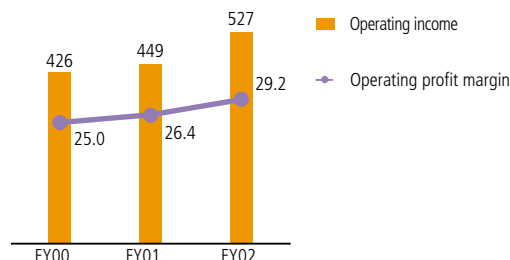
GROSS PROFIT & MARGIN

(In billions of Korean Won, %)



OPERATING INCOME & MARGIN

(In billions of Korean Won, %)



SG&A expenses jumped 28.2% YoY to KRW375 billion in 2002 compared to KRW292 billion in the previous year. In particular, labor costs and advertising expenses swelled for following reasons: separation of sales and distribution functions for efficient marketing management, advertising expense hike due to new luxury brand launches, intensification of brand management and aggressive overseas marketing activities. The Company has consistently been making efforts to strengthen market dominance. In order to develop star brands in growing and profitable segments, the Company will continue to launch new brands to meet various consumer demands and will give more responsibility and authority to brand managers.

SG&A EXPENSES

(In billions of Korean Won)

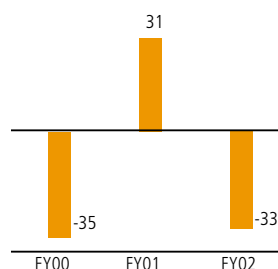
	2000	2001	2002
Labor	130	139	167
Advertising	32	45	76
Commissions	11	16	31
Depreciation	21	22	28
Others	61	71	73

Non-operating Items

While non-operating income remained relatively stable, non-operating expenses almost doubled in 2002. As interest-bearing debt (short-term borrowings and exchangeable bonds) surged to KRW1,110 billion in 2002 from KRW314 billion a year earlier to finance purchases of treasury stocks, interest expense skyrocketed to KRW32 billion in 2002 compared to KRW4 billion a year ago. The Company held foreign currency denominated debentures in order to hedge foreign exchange risk embedded in exchangeable bonds. Accordingly, upon the Korean Won appreciation, losses on foreign currency translation amounted to KRW22 billion in 2002. Meanwhile, since exchangeable bonds are a non-monetary item, the Company did not recognize gains on foreign currency translation. In addition, losses on disposal and valuation of marketable securities posted KRW47 billion last year. The year-ending balance of marketable securities substantially reduced to KRW29 billion in 2002 from KRW93 billion in 2001. All in all, KT&G recorded net non-operating expenses of KRW33 billion in 2002.

NET NON-OPERATING INCOME

(In billions of Korean Won)



Operating Profitability

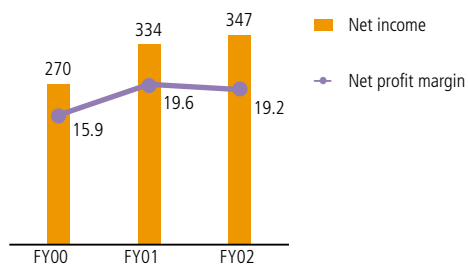
Operating profit margin gained 3.6%p in 2002 to record 29.2% compared to 26.4% a year earlier. Expansion of cheap imported leaf tobacco usage and premium brand sales was the major profit booster, in addition to the productivity gain. Overall, improvement in gross profit overwhelmed growth in SG&A expenses, elevating operating profit by 17.3% YoY to KRW527 billion in 2002 from KRW449 billion in the previous year.

Earnings and Dividends

Due to a sharp rise in non-operating expenses, increase in pretax income fell much short compared to the surge in operating profit. Pretax profit grew a mere 2.7% YoY to KRW494 billion in 2002 from KRW480 billion in the previous year; pretax profit margin deteriorated 0.9%p to 27.3% in 2002, and the margin erosion in pretax profit was transferred to net profit margin. However, as the effective tax rate declined from 30.5% in 2001 to 29.6% in 2002, net profit margin edged down by 0.4%p to 19.2% last year. The Company recorded net profit of KRW347 billion in 2002, up 4.1% YoY, and its ROE improved from 12.4% in 2001 to 15.1% in 2002. Its diluted earnings per share increased 13.2% YoY to KRW2,084 in 2002. Based on the share price of KRW16,400 as of the end of 2002, diluted price-to-earnings ratio stood at 7.9 times.

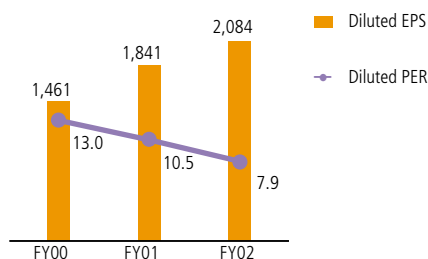
NET INCOME & MARGIN

(In billions of Korean Won, %)



DILUTED EPS AND DILUTED PER

(In Korean Won, X)

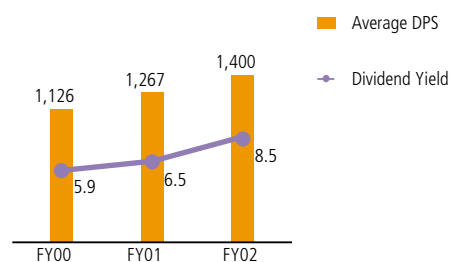


The Company has not only done its best to maximize shareholders' value but also has practically returned profits to shareholders. KT&G purchased and retired treasury stocks last year and plans to pay out 48.2% of the 2002 net profit as dividend. The 2002 dividend per share will be equal to all sharehold-

ers at KRW1,400, compared to KRW1,050 for major shareholders and KRW1,400 for minor shareholders in 2001. Its dividend yield over the year-end stock price comes up to 8.5%.

DIVIDEND PER SHARE & DIVIDEND YIELD

(In Korean Won, %)



Management's Discussion of Financial Condition

SUMMARY BALANCE SHEET

(In billions of Korean Won, except per share data)

	2000	2001	2002
Assets	3,827	3,671	3,916
Liabilities	1,055	1,055	1,932
Interest-bearing debt	—	314	1,110
Shareholders' equity	2,578	2,616	1,985
Book value per share (Korean Won)	15,143	15,639	16,599

The Company considers its strong financial position and financial flexibility to be a competitive advantage. This advantage is based on strong and solid operating cash flows, a commitment to cash discipline regarding working capital and capital expenditures, and the intent to pursue a fiscally responsible policy of maximizing shareholders' value.

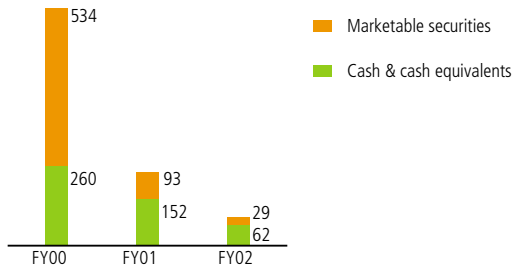
Cash and Marketable Securities

Cash, cash equivalents and marketable securities as of December 31, 2002 was reduced by KRW154 billion to KRW91 billion, from KRW245 billion at the end of 2001. As mentioned previously, the sharp decline was due mainly to the Company's financial strategy to preserve shareholders' value by purchasing treasury stocks and remove financial uncertainty by reducing marketable securities.

Management's Discussion & Analysis

CASH & MARKETABLE SECURITIES

(In billions of Korean Won)

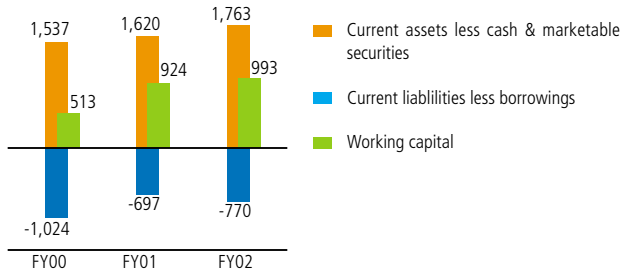


Working Capital

KT&G defines working capital as the difference between current assets less cash and marketable securities and current liabilities less borrowings. The Company's working capital requirements increased by KRW69 billion to KRW993 billion at December 31, 2002 from KRW924 billion at the end of 2001. On the back of efficient working capital management, the portion of working capital over total operating revenues remained firm at 20.4% in 2002, compared to 19.6% in 2001.

WORKING CAPITAL

(In billions of Korean Won)



Fixed Assets

Investment assets increased 13.7% YoY to KRW923 billion at year-end 2002 compared to KRW811 billion at the end of 2001, attributable to a KRW75 billion increase in long-term loans to employees. While investment securities

edged up to KRW651 billion at the end of 2002 from KRW646 billion at December 31, 2001, equity income soared 32.9% YoY from KRW21 billion in 2001 to KRW28 billion in 2002.

Year-end balance of property, plant and equipment (PP&E) rose by KRW146 billion or 14.7% YoY to KRW1,138 billion in 2002 due mainly to capital expenditures on facility rationalization and construction of the Young-Ju factory. Construction in progress amounted to KRW196 billion at the end of 2002, and additional capital expenditure of KRW40 billion will help complete the construction of the Young-Ju factory in 2003. Depreciation expenses on PP&E increased a little from KRW73 billion in 2001 to KRW79 billion in 2002.

Intangible assets grew 10.3% YoY to KRW2 billion at the end of 2002.

FIXED ASSETS

(In billions of Korean Won)

	2000	2001	2002
Investment assets	545	811	923
Property, plant & equipment	949	992	1,138
Intangible assets	1	2	2

Debt Financing

In order to preserve shareholders' value, the Company purchased and retired treasury stocks in 2002, which funded through external debt financing. As a result, interest-bearing debt skyrocketed to KRW1,110 billion at year-end 2002, compared to KRW314 billion at the end of 2001; debt-to-equity ratio jumped to 55.9% in 2002 from 11.9% in 2001. Nonetheless, the Company posted net interest income, and on the back of solid operating cash flows, its interest coverage ratio was 16.5 times in 2002.

BORROWINGS & DEBT-TO-EQUITY RATIO

(In billions of Korean Won, %)

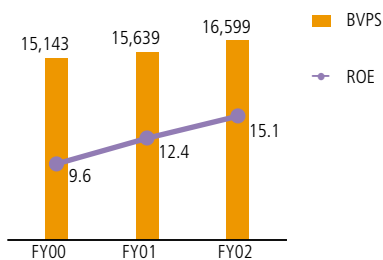
	2000	2001	2002
Short-term borrowings	—	—	290
Exchangable bonds	—	314	820
Interest-bearing debt-to-equity ratio	—	11.9	55.9

Shareholders' Equity

Total shareholders' equity was reduced to KRW1,985 billion at year-end 2002 compared to KRW2,616 billion at the end of 2001 due mainly to capital adjustments related to treasury stocks. While capital stock remained the same, capital surplus rose slightly because of disposal of treasury stocks and retained earnings increased to KRW2,124 billion at December 31, 2002 from KRW2,113 billion at year-end 2001. However, offsets in capital adjustments amounted to KRW1,096 billion as of December 31, 2002, overwhelming increases in other accounts in shareholders' equity. The combined effects of decrease in shareholders' equity and increase in net profit boosted ROE by 2.7%p to 15.1% in 2002 compared to 12.4% a year earlier.

TOTAL SHAREHOLDERS' EQUITY

(In Korean Won, %)



Management's Discussion of Cash Flows

SUMMARY CASH FLOWS STATEMENT

(In billions of Korean Won)

	2000	2001	2002
Cash flows from operating activities	482	(52)	451
Cash flows from investing activities	(206)	152	(203)
Cash flows from financing activities	(288)	(172)	(229)

Cash Provided by Operating Activities

Cash flows from operating activities dramatically turned to net inflow of KRW451 billion in 2002 compared to net outflow of KRW52 billion in the previous year. In addition to solid cash inflows from net profit and depreciation, additional working capital requirements plunged to KRW34 billion in 2002 from KRW450 billion a year earlier.

Cash Used In Investing Activities

Cash flows from investing activities, on the other hand, deteriorated to net outflow worth KRW203 billion in 2002 from net inflow of KRW152 billion in 2001. Capital expenditures on facility rationalization and construction of new plant in Young-Ju almost doubled to KRW238 billion in 2002 compared to KRW124 billion in 2001. In addition, long-term loans to employees increased by KRW107 billion in 2002.

Cash Used In Financing Activities

Net cash outflow from financing activities magnified to KRW229 billion in 2002 compared to KRW172 billion in 2001. Net purchase of treasury stocks and dividend paid amounted to KRW801 billion and KRW212 billion in 2002 respectively. At the same time, short-term borrowings and exchangeable bonds increased by KRW290 billion and KRW493 billion respectively in 2002.

NON-CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2002 AND 2001

A S S E T S	Korean Won		U.S. Dollars (Note 2)
	2002	2001	2002
CURRENT ASSETS			
Cash and cash equivalents (Note 11)	₩ 54,912,699,155	₩ 35,699,134,659	\$ 45,745,334
Short-term financial instruments (Note 4)	6,737,430,709	116,655,450,271	5,612,655
Marketable securities (Notes 2 and 4)	29,258,498,191	92,980,930,908	24,373,957
Accounts receivable :			
- Trade - net of allowance for doubtful accounts of ₩1,187,919,672 in 2002 and ₩509,779,903 in 2001 (Notes 2 and 11)	117,604,047,478	50,468,210,347	97,970,716
- Other - net of allowance for doubtful accounts of ₩941,169,256 in 2002 and ₩456,950,644 in 2001 (Note 2)	660,058,600	880,514,940	549,866
Short-term loans - net of allowance for doubtful accounts of ₩31,525,647 in 2002 and ₩85,304,692 in 2001 and present value discounts of ₩247,435,303 in 2002 and ₩669,530,820 in 2001 (Notes 2 and 7)	3,121,039,050	8,445,164,488	2,599,999
Short-term loans to employees (Note 25)	31,530,310,180	15,710,532,000	26,266,503
Accrued income	3,144,595,386	3,219,030,946	2,619,623
Advance payments	21,147,954,270	5,852,827,323	17,617,423
Prepaid expenses	331,382,842	591,748,772	276,060
Prepaid tobacco excise taxes and dues (Note 12)	149,843,845,024	145,531,786,893	124,828,261
Inventories (Notes 2, 5 and 21)	1,435,448,055,084	1,389,728,219,975	1,195,808,110
Total Current Assets	1,853,739,915,969	1,865,763,551,522	1,544,268,507
INVESTMENTS AND OTHER ASSETS			
Currency swaps (Notes 2 and 23)	6,707,495,972	4,218,876,575	5,587,717
Interest rate swaps (Notes 2 and 23)	8,909,346,548	-	7,421,981
Investment securities (Notes 2, 6 and 11)	650,806,934,737	646,436,621,989	542,158,393
Long-term loans - net of allowance for doubtful accounts of ₩694,549,713 in 2002 and ₩650,406,083 in 2001 and present value discounts of ₩51,745,028,671 in 2002 and ₩59,559,391,649 in 2001 (Notes 2 and 7)	68,760,421,616	64,390,202,268	57,281,258
Long-term loans to employees (Note 25)	143,554,472,732	68,244,949,736	119,588,864
Guarantee deposits	16,566,320,121	9,992,109,760	13,800,667
Long-term deposits in escrow fund - net of allowance for doubtful accounts of ₩16,219,913,237 in 2002 and ₩5,584,953,137 in 2001 (Notes 2, 3 and 11)	-	-	-

(Continued)

	Korean Won		U.S. Dollars (Note 2)
A S S E T S	2002	2001	2002
Deferred income tax assets (Notes 2 and 17)	₩ 11,300,899,772	₩ 2,722,649,081	\$ 9,414,278
Long-term loans to affiliates	205,408,400	-	171,116
Other investments	15,940,981,551	15,373,159,151	13,279,725
Total Investments and Other Assets	922,752,281,449	811,378,568,560	768,703,999
PROPERTY, PLANT AND EQUIPMENT			
- Net (Notes 2, 8, 9 and 21)	1,137,657,494,768	991,536,750,329	947,732,002
INTANGIBLE ASSETS			
- Net (Note 2)	2,021,217,512	1,832,710,717	1,683,787
TOTAL ASSETS	₩ 3,916,170,909,698	₩ 3,670,511,581,128	\$ 3,262,388,295
CURRENT LIABILITIES			
Accounts payable :			
- Trade (Note 11)	₩ 17,067,259,930	₩ 7,959,307,504	\$ 14,217,977
- Other	30,496,062,069	1,359,374,908	25,404,917
Short-term borrowings	290,000,000,000	-	241,586,138
Accrued interest expenses (Note 11)	1,136,814,391	1,079,135,093	947,030
Advance receipts	29,754,220,541	9,415,900,075	24,786,921
Withholdings	6,434,101,394	9,927,017,234	5,359,965
Value added tax (VAT) withholdings	95,890,047,050	92,921,960,080	79,881,745
Accrued expenses (Note 10)	16,042,777,204	15,193,738,744	13,364,526
Tobacco excise taxes and dues payable (Note 12)	310,854,715,776	270,133,547,150	258,959,277
Income taxes payable (Notes 2 and 17)	93,620,616,289	75,450,682,630	77,991,183
Dividends payable (Note 19)	167,394,907,400	212,015,635,650	139,449,273
Unearned income	1,412,321,918	1,311,878,003	1,176,543
Total Current Liabilities	1,060,103,843,962	696,768,177,071	883,125,495

(Continued)

	Korean Won		U.S. Dollars (Note 2)
LIABILITIES AND STOCKHOLDERS' EQUITY	2002	2001	2002
LONG-TERM LIABILITIES			
Convertible bonds - plus long-term accrued interest expenses of ₩16,324,270,335 in 2002 and ₩2,270,757,180 in 2001 and net of discount ₩6,533,904,417 in 2002 and ₩6,167,962,351 in 2001 (Note 10)	₩ 819,875,017,918	₩ 313,569,446,829	\$ 683,001,515
Interest rate swaps (Notes 2 and 23)	-	3,839,428,474	-
Accrued severance indemnities - net of deposits for severance indemnities of ₩42,185,316,961 in 2002 and ₩28,702,321,846 in 2001 (Notes 2 and 3)	27,638,545,178	18,278,292,852	23,024,446
Guarantee deposits received	23,888,521,181	22,109,669,868	19,900,467
Total Long-Term Liabilities	871,402,084,277	357,796,838,023	725,926,428
TOTAL LIABILITIES	₩ 1,931,505,928,239	₩ 1,054,565,015,094	\$ 1,609,051,923
STOCKHOLDERS' EQUITY			
Common stock - ₩5,000 par value			
Authorized: 800,000,000 shares			
Issued: 181,442,497 shares in 2002 and 190,991,897 shares in 2001 (Note 13)	₩ 954,959,485,000	₩ 954,959,485,000	\$ 795,534,393
Capital surplus	1,485,468,925	336,905,753	1,237,478
Retained earnings (Note 15)	2,124,478,860,662	2,112,517,453,752	1,769,809,114
Capital adjustments:			
Treasury stock (Note 14)	(1,102,637,693,342)	(470,695,607,462)	(918,558,558)
Gain on valuation of investment securities (Notes 2 and 6)	6,378,860,214	18,828,328,991	5,313,945
Total Stockholders' Equity	₩ 1,984,664,981,459	₩ 2,615,946,566,034	\$ 1,653,336,372
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	₩ 3,916,170,909,698	₩ 3,670,511,581,128	\$ 3,262,388,295

See accompanying Notes to non-consolidated Financial Statements.

NON-CONSOLIDATED STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31, 2002 AND 2001

	Korean Won		U.S. Dollars (Note 2)
	2002	2001	2002
SALES			
Tobacco sales	₩ 4,856,403,755,784	₩ 4,693,401,432,978	\$ 4,045,654,578
Export of leaf tobacco	14,807,390,048	19,938,986,658	12,335,380
Sales of buildings and merchandise sales (Notes 2 and 16)	2,816,876,344	-	2,346,615
Total Sales	4,874,028,022,176	4,713,340,419,636	4,060,336,573
TOBACCO EXCISE TAXES AND DUES (Note 12)	(3,067,109,972,185)	(3,011,939,057,211)	(2,555,073,286)
NET SALES	1,806,918,049,991	1,701,401,362,425	1,505,263,287
COST OF SALES (Notes 2 and 16)	(904,935,929,478)	(959,720,399,135)	(753,861,987)
GROSS PROFIT	901,982,120,513	741,680,963,290	751,401,300
SELLING AND ADMINISTRATIVE EXPENSES (Note 26)	(374,923,340,595)	(292,464,649,706)	(312,332,006)
OPERATING INCOME	527,058,779,918	449,216,313,584	439,069,294
OTHER INCOME (EXPENSE)			
Interest income	31,150,488,194	27,147,254,263	25,950,190
Interest expense	(31,847,102,590)	(3,558,587,195)	(26,530,409)
Gain on valuation of short-term financial instruments (Note 4)	38,058,026	145,725,482	31,704
Gain (loss) on valuation of currency swaps (Notes 2 and 23)	(2,264,603,151)	4,218,876,575	(1,886,540)
Gain (loss) on valuation of interest rate swaps (Notes 2 and 23)	12,598,252,054	(3,839,428,474)	10,495,045
Rental income	8,864,033,949	8,557,404,439	7,384,234
Gain on disposal of marketable securities - net	1,673,278,004	30,341,658,221	1,393,934
Gain (loss) on valuation of marketable securities - net (Notes 2 and 4)	(24,316,028,120)	1,007,763,211	(20,256,605)
Other bad debts (Note 7)	(12,336,317,630)	(21,925,124,910)	(10,276,839)
Loss on valuation of inventories (Note 2)	(12,583,292,157)	(13,503,571,050)	(10,482,583)
Loss on foreign currency transactions - net	(3,577,997,812)	(5,833,021,178)	(2,980,671)
Gain (loss) on foreign currency translations - net (Note 2)	(20,769,865,595)	6,476,714,044	(17,302,454)
Donations (Note 25)	(20,307,253,416)	(22,319,365,017)	(16,917,072)

(Continued)

	Korean Won		U.S. Dollars (Note 2)
	2002	2001	2002
Gain on valuation of investments using the equity method of accounting (Notes 2 and 6)	27,523,790,454	20,708,314,134	22,928,849
Gain on disposal of property and equipment - net	5,849,249,342	9,859,881,542	4,872,750
Income tax refunds	678,314,400	-	565,074
Honorary retirement allowance (Note 2)	(2,602,294,860)	(8,632,353,950)	(2,167,856)
Loss on redemption of convertible bonds - net (Note 10)	(65,118,452)	-	(54,248)
Other - net	8,836,785,404	2,342,601,618	7,361,534
Other income (expense) - net	(33,457,623,956)	31,194,741,755	(27,872,063)
ORDINARY INCOME	493,601,155,962	480,411,055,339	411,197,231
INCOME BEFORE INCOME TAXES	493,601,155,962	480,411,055,339	411,197,231
INCOME TAXES (Notes 2 and 17)	(146,157,082,092)	(146,566,491,308)	(121,756,983)
NET INCOME	₩ 347,444,073,870	₩ 333,844,564,031	\$ 289,440,248
ORDINARY INCOME PER SHARE (Note 18)	₩ 2,364	₩ 1,858	\$ 1.97
NET INCOME PER SHARE (Note 18)	₩ 2,364	₩ 1,858	\$ 1.97
DILUTED ORDINARY INCOME PER SHARE (Note 18)	₩ 2,084	₩ 1,841	\$ 1.74
DILUTED NET INCOME PER SHARE (Note 18)	₩ 2,084	₩ 1,841	\$ 1.74

See accompanying Notes to non-consolidated Financial Statements.

NON-CONSOLIDATED STATEMENTS OF APPROPRIATIONS OF RETAINED EARNINGS

YEARS ENDED DECEMBER 31, 2002 AND 2001

	Korean Won		U.S. Dollars (Note 2)
	2002	2001	2002
RETAINED EARNINGS BEFORE APPROPRIATIONS			
Beginning of the year	₩ 26,395,531,197	₩ -	\$ 21,988,946
Retirement of treasury shares (Note 13)	(168,087,759,560)	-	(140,026,457)
Net income for the year	347,444,073,870	333,844,564,031	289,440,248
End of the year	205,751,845,507	333,844,564,031	171,402,737
TRANSFER FROM RETAINED EARNINGS			
Reserve for technology development	11,619,591,000	5,850,387,000	9,679,766
Reserve for overseas business losses	193,540,360	193,540,360	161,230
Reserve for overseas market development	428,924,606	428,924,606	357,318
Reserve for energy saving facilities	134,480,563	134,813,900	112,030
TOTAL	218,128,382,036	340,452,229,897	181,713,081
APPROPRIATIONS			
Reserve for business rationalization	-	(2,041,063,050)	-
Other	(10,000,000,000)	(100,000,000,000)	(8,330,557)
Cash dividends (Note 19)	(167,394,907,400)	(212,015,635,650)	(139,449,273)
	(177,394,907,400)	(314,056,698,700)	(147,779,830)
RETAINED EARNINGS TO BE CARRIED FORWARD TO NEXT YEAR	₩ 40,733,474,636	₩ 26,395,531,197	\$ 33,933,251

See accompanying Notes to non-consolidated Financial Statements.

NON-CONSOLIDATED STATEMENTS OF CASH FLOWS

YEARS ENDED DECEMBER 31, 2002 AND 2001

	Korean Won		U.S. Dollars (Note 2)
	2002	2001	2002
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	₩ 347,444,073,870	₩ 333,844,564,031	\$ 289,440,248
Expenses not involving cash payments :			
Depreciation	79,233,831,013	72,823,221,597	6,006,190
Provision for severance indemnities	24,929,889,133	30,333,586,760	20,767,985
Bad debts	678,139,769	397,519,427	564,928
Loss from disposal of marketable securities	22,615,991,980	-	18,840,380
Loss from valuation of marketable securities	24,316,028,120	-	20,256,605
Loss from redemption of convertible bonds	67,666,588	-	56,370
Interest expense (amortization of bond discount)	1,452,803,704	181,370,689	1,210,266
Long-term accrued interest expense	14,077,269,759	2,270,757,180	11,727,149
Loss on valuation of currency swaps	2,264,603,151	-	1,886,540
Loss on valuation of interest rate swaps	-	3,839,428,474	-
Loss from foreign currency translation	20,770,950,879	167,236,969	17,303,358
Loss from valuation of inventories	12,583,292,157	13,503,571,05	10,482,583
Amortization	472,026,682	308,088,226	393,225
Other bad debts	12,336,317,630	21,925,124,910	10,276,839
Loss from disposal of property, plant and equipment	3,185,525,663	2,076,203,823	2,653,720
Miscellaneous losses	1,340,397,739	471,285,339	1,116,626
Sub-total	220,324,733,967	148,297,394,444	183,542,764
Revenues not involving cash inflows :			
Interest income (accretion of present value discount)	(8,236,458,495)	(8,599,004,113)	(6,861,428)
Gain on valuation of short-term financial instruments	(38,058,026)	(145,725,482)	(31,704)
Gain on valuation of currency swaps	-	(4,218,876,575)	-
Gain on valuation of interest rate swaps	(12,598,252,054)	-	(10,495,045)
Gain on disposal of marketable securities	(24,289,269,984)	(30,341,658,221)	(20,234,314)
Gain on valuation of marketable securities	-	1,007,763,211	-
Gain on redemption of convertible bonds	(2,548,136)	-	(2,123)
Gain on foreign currency translation	(340,927,260)	(6,637,526,719)	(284,011)
Gain on valuation of investments using the equity method of accounting	(27,523,790,454)	(20,708,314,134)	(22,928,849)
Gain on disposal of property, plant and equipment	(9,034,775,005)	(11,936,085,365)	(7,526,470)
Miscellaneous gains	(432,165,999)	-	(360,019)
Sub-total	(82,496,245,413)	(83,594,953,820)	(68,723,963)

(Continued)

	Korean Won		U.S. Dollars (Note 2)
	2002	2001	2002
Changes in assets and liabilities resulting from operations :			
Increase in accounts receivable - trade	₩ (67,921,127,237)	₩ (39,634,901,463)	\$ (56,582,079)
Increase in accounts receivable - other	(263,762,272)	(928,412,186)	(219,729)
Decrease in accrued income	74,435,560	7,417,884,749	62,009
Increase in advance payments	(15,295,126,947)	(1,966,797,128)	(12,741,692)
Decrease in prepaid expenses	260,365,930	151,518,514	216,899
Increase in prepaid tobacco excise taxes and dues	(4,312,058,131)	(33,411,345,913)	(3,592,184)
Increase in inventories	(54,396,885,033)	(44,168,515,965)	(45,315,632)
(Increase) decrease in deferred income tax assets	(8,578,250,691)	7,732,272,726	(7,146,160)
Dividends received	14,500,000,000	21,400,000,000	12,079,307
Increase in accounts payable - trade	9,448,794,777	3,956,068,742	7,871,372
Increase (decrease) in accounts payable - other	29,136,687,161	(1,717,912,085)	24,272,482
Increase in accrued interest expenses	57,679,298	1,058,221,281	48,050
Increase in advance receipts	20,338,320,466	6,191,676,774	16,942,953
(Decrease) increase in withholdings	(3,492,915,840)	4,432,383,374	(2,909,793)
Increase (decrease) in V.A.T withholdings	2,968,086,970	(9,984,154,620)	2,472,582
(Decrease) increase in accrued expenses	(563,557,304)	240,932,248	(469,475)
Increase (decrease) in tobacco excise taxes and dues payable	40,721,168,626	(347,317,686,666)	33,922,999
Increase in income taxes payable	18,169,933,659	538,255,700	15,136,566
Increase (decrease) in unearned income	100,443,915	(127,177,220)	83,675
Payments of severance indemnities	(4,695,114,950)	(1,113,119,760)	(3,911,292)
Increase in accrued severance indemnities - transfer	2,608,473,258	-	2,173,003
Decrease in transfers to the National Pension Fund	-	11,653,200	-
Increase in deposits for severance indemnities	(13,482,995,115)	(12,962,321,846)	(11,232,085)
Increase in other long-term liabilities	756,081,896	-	629,858
Sub-total	(33,861,322,004)	(450,201,477,544)	(28,208,366)
Net cash provided by (used in) operating activities	₩ 451,411,240,420	₩ (51,654,472,889)	\$ 376,050,683

(Continued)

	Korean Won		U.S. Dollars (Note 2)
	2002	2001	2002
CASH FLOWS FROM INVESTING ACTIVITIES			
Cash inflows from investing activities :			
Disposal of short-term financial instruments	₩ 116,655,450,271	₩ 37,241,306,052	\$ 97,180,482
Disposal of marketable securities	1,486,579,682,601	2,637,862,102,181	1,238,403,601
Decrease in short-term loans	9,200,000,000	22,100,000,000	7,664,112
Decrease in short-term loans to employees	15,710,532,000	18,327,896,508	13,087,747
Decrease in currency swaps	2,152,377,450	-	1,793,050
Decrease in interest rate swaps	4,943,546,286	-	4,118,249
Disposal of investment securities	688,951,788	20,176,353,000	573,935
Decrease in long-term loans to employees	10,756,924,944	3,401,299,166	8,961,117
Decrease in guarantee deposits	6,284,043,563	-	5,234,958
Decrease in other investments	89,805,100	-	74,813
Disposal of land	11,249,342,426	16,617,925,960	9,371,328
Disposal of buildings	1,010,699,006	700,706,748	841,96
Disposal of structures	66,855,767	82,461,970	55,695
Disposal of machinery and equipment	1,294,060,381	65,593,553	1,078,024
Disposal of vehicles and transportation equipment	162,975,819	101,981,020	135,768
Disposal of tools	1,822,887	454,058	1,519
Disposal of furniture and fixtures	8,400,728	29,000,131	6,998
Disposal of construction in-progress	-	608,467,235	-
Sub-total	1,666,855,471,017	2,757,315,547,582	1,388,583,365
Cash outflows for investing activities :			
Acquisition of short-term financial instruments	(6,614,680,271)	-	(5,510,397)
Acquisition of marketable securities	(1,445,500,000,000)	(2,165,400,000,000)	(1,204,181,939)
Increase in currency swaps	(6,905,599,998)	-	(5,752,749)
Increase in interest rate swaps	(5,094,069,254)	-	(4,243,643)
Acquisition of long-term deposits in escrow fund	(11,941,132,161)	(4,594,486,810)	(9,947,628)
Acquisition of investment securities	(23,410,320,432)	(307,418,014,676)	(19,502,100)
Increase in long-term loans to employees	(117,596,758,120)	-	(97,964,644)
Increase in long-term loans to affiliates	(205,408,400)	-	(171,117)
Increase in guarantee deposits	(12,858,253,924)	(953,866,510)	(10,711,641)
Increase in other investments	(657,627,500)	(589,042,400)	(547,840)

(Continued)

	Korean Won		U.S. Dollars (Note 2)
ASSETS	2002	2001	2002
Cash outflows for investing activities (Continued) :			
Acquisition of land	₩ (3,558,874,080)	₩ (1,839,706,250)	\$ (2,964,740)
Acquisition of buildings	(12,215,164,049)	(3,468,027,517)	(10,175,911)
Acquisition of structures	(960,148,421)	(678,059,441)	(799,857)
Acquisition of machinery and equipment	(1,696,320,927)	(2,799,404,735)	(1,413,130)
Acquisition of vehicles and transportation equipment	(2,559,967,833)	(598,335,616)	(2,132,596)
Acquisition of tools	(5,364,241,279)	(1,199,261,994)	(4,468,711)
Acquisition of furniture and fixtures	(19,621,339,036)	(12,407,631,119)	(16,345,667)
Acquisition of construction in-progress	(192,374,083,960)	(100,574,980,686)	(160,258,317)
Acquisition of intangible assets	(670,695,557)	(823,638,909)	(558,727)
Payment of special taxes on gains on disposal of tangible assets	-	(1,561,251,340)	-
Sub-total	(1,869,804,685,202)	(2,604,905,708,003)	(1,557,651,354)
Net cash (used in) provided by investing activities	₩ (202,949,214,185)	₩ 152,409,839,579	\$ (169,067,989)
CASH FLOWS FROM FINANCING ACTIVITIES			
Cash inflows from financing activities :			
Increase in short-term borrowings	₩ 290,000,000,000	₩ -	\$ 241,586,138
Increase in guarantee deposits received	1,022,769,417	928,533,737	852,024
Issuance of convertible bonds	492,957,846,323	311,117,318,960	410,661,318
Disposal of treasury stocks	16,152,500,000	-	13,455,931
Sub-total	800,133,115,740	312,045,852,697	666,555,411
Cash outflows for financing activities :			
Acquisition of treasury stock	(817,365,941,829)	(277,519,889,402)	(680,911,314)
Payment of dividends	(212,015,635,650)	(206,135,332,900)	(176,620,823)
Sub-total	(1,029,381,577,479)	(483,655,222,302)	(857,532,137)
Net cash used in financing activities	₩ (229,248,461,739)	₩ (171,609,369,605)	\$ (190,976,726)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	19,213,564,496	(70,854,002,915)	16,005,968
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	35,699,134,659	106,553,137,574	29,739,366
CASH AND CASH EQUIVALENTS AT END OF YEAR	₩ 54,912,699,155	₩ 35,699,134,659	\$ 45,745,334

See accompanying Notes to non-consolidated Financial Statements.

Ahn Kwon & Co.

4~7, 10, 11, 13th., Tae Young Bldg.,
252-5, Kongdeok-Dong, Mapo-Gu,
Seoul, 121-020, Korea

Telephone : 82(2)3271-3000
Facsimile : 82(2)3271-3100,3400
www.ahnkon.co.kr

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of
KT&G Corporation (Formerly, Korea Tobacco & Ginseng Corporation)

We have audited the accompanying non-consolidated balance sheets of KT&G Corporation (the "Company") as of December 31, 2002 and 2001, and the related non-consolidated statements of income, appropriations of retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these non-consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Korea. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such non-consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2002 and 2001, and the results of its operations, the appropriations of its retained earnings and its cash flows for the years then ended, in conformity with financial accounting standards generally accepted in the Republic of Korea ("Korean GAAP").

Without qualifying our opinion, we draw attention to the following:

Our audits also comprehended the translation of Korean won amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 2 to the accompanying non-consolidated financial statements. Such U.S. dollar amounts are presented solely for the convenience of readers outside of Korea.

As described in Note 22 to the accompanying non-consolidated financial statements, the Company and the Korean government are defendants in lawsuits (claims amount to 407 million Korean won) for compensation for injury caused by smoking. The ultimate effect of those lawsuits and similar lawsuits in which the Company may be defendants in the future on the financial position of the Company cannot presently be determined.

Accounting policies and auditing standards and their application in practice vary among countries. The accompanying financial statements are not intended to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries other than the Republic of Korea. In addition, the procedures and practices utilized in the Republic of Korea to audit such financial statements may differ from those generally accepted and applied in other countries. Accordingly, this report and the accompanying financial statements are for use by those knowledgeable about Korean accounting procedures and auditing standards and their application in practice.

January 23, 2003

Ahn Kwon & Co.

NOTES TO NON-CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2002 AND 2001

1. General

KT&G Corporation (the company changed its name from Korea Tobacco and Ginseng Corporation to KT&G Corporation on December 27, 2002 ; the "Company") was established on April 1, 1987 as Korea Monopoly Corporation, wholly owned by the Korean Government, pursuant to the Korea Monopoly Corporation Act, in order to secure financing and to promote and develop, through efficient management, the monopoly business of red ginseng and tobacco. On April 1, 1989, the Company changed its name to Korea Tobacco and Ginseng Corporation pursuant to the Korea Tobacco and Ginseng Corporation Act. Also, pursuant to the Act on Management Reform and Privatization of Public Enterprises, proclaimed on August 28, 1997 and enforced on October 1, 1997, the Company was excluded from the application of the Act for the Management of Government Invested Enterprises. Accordingly, the Company became a company pursuant to the Commercial Code of Korea. The Korean government sold 28,650,000 shares of the Company to the public during 1999 and the Company listed its stock on the Korea Stock Exchange on October 8, 1999.

The Company is primarily engaged in manufacturing and selling tobacco. As of December 31, 2002, the Company has 6 manufacturing plants including the Shin Tan Jin plant, and local headquarters and branches for the sale of tobacco throughout the country. Also, the Company has 2 plants for fabrication of leaf tobacco including the Nam won plant and the Chun Ahn printing plant for the manufacturing of wrapping papers.

Pursuant to the Korean government's privatization program and management reorganization plan, on December 28, 1998, the shareholders approved a plan to separate into two companies by setting up a subsidiary for its red ginseng business segment effective January 1, 1999. The separation was accomplished by the Company's contribution of the assets and liabilities in the red ginseng business segment, into a wholly owned subsidiary, the Korea Ginseng Corp.

On October 17, 2002 and October 31, 2001, certain shareholders of the Company listed 35,816,658 and 45,400,000 global depositary shares ("GDS") (each GDS represents the right to receive one-half share of common stock of the Company), respectively, on the Luxembourg Stock Exchange according to the Korean government's Privatization Program.

2. Summary Of Significant Accounting Policies

The Company maintains its official accounting records in Korean won and prepares statutory financial statements in the Korean language (Hangul) in conformity with accounting principles generally accepted in the Republic of Korea. Certain accounting principles applied by the Company that conform with financial accounting standards and accounting principles in the Republic of Korea may not conform with generally accepted accounting principles in other countries. Accordingly, these financial statements are intended for use by those who are informed about Korean accounting principles and practices. The accompanying financial statements have been restructured and translated into English from the Korean language financial statements. Certain information attached to the Korean language financial statements, but not required for a fair presentation of the Company's financial position, results of operations or cash flows, is not presented in the accompanying financial statements.

The translation of Korean won amounts into U.S. dollar amounts is included for the convenience of the readers outside of Korea. For this purpose, the Korean won amounts for year ended December 31, 2002 have been translated into U.S. dollar amounts at the Base Rate of ₩1,200.4 : US\$1 as of December 31, 2002 announced by the Korean government. This translation should not be construed as a representation that the Korean won amounts shown could be converted into U.S. dollar amounts at that or any other rate.

The significant accounting policies followed by the Company in the preparation of its financial statements are summarized as follows:

a. Marketable Securities

Marketable securities are initially carried at acquisition cost determined using the moving-average method, and reported at fair value. Valuation gains and losses are reported in current operations (See Note 4).

b. Allowance for Doubtful Accounts

The Company provides an allowance for doubtful accounts to cover estimated losses that may arise from non-collection of its receivables, based on past experience and management's review of the aging and current status of outstanding receivables.

c. Inventories

Inventories are stated at the lower of cost or net realizable value, with cost determined using the weighted-average method, for finished goods, added goods and work-in-process, using the moving average method for raw materials and supplies and using the specific identification method for materials in transit. During the year, perpetual inventory systems are used to value inventories, which are adjusted to physical inventory counts performed at the end of the year.

Net realizable value is determined based on the estimated selling price, less estimated completion and selling costs. Loss on valuation of inventories is ₩12,583 million and ₩13,504 million for the years ended December 31, 2002 and 2001, respectively.

d. Investment Securities

d-1 Investments in equity securities are initially recorded at cost with cost determined by the moving-average method (see Note 6).

1) Investments in equity securities of listed companies are carried at fair value and the net unrealized gain or loss is recorded as a capital adjustment until realized. If fair value of an investment declines significantly below the acquisition cost and is not expected to recover, such investment is carried at fair value and any impairment loss is charged to current operations. Subsequent recoveries or other future changes in fair value are recorded as a capital adjustment.

2) Investments in non-listed equity securities of non-controlled investees are reported at cost, except for declines in the Company's proportionate equity of the underlying book value of the investees which are anticipated to be not recoverable, which are recorded as impairment losses in current operations. Subsequent recoveries are also recorded in current operations up to the original cost of the investment.

3) Investments in equity securities of companies over which the Company controls or exercises significant influence are reported using the equity method of accounting. Differences between the purchase cost and net asset value of the investee are amortized over five years using the straight-line method. Unrealized profits arising from sales by the Company to equity-method investees are fully eliminated. The Company's proportionate unrealized profit arising from sales by equity-method investees to the Company or sales between equity-method investees is also eliminated. Under the equity method, the Company records changes in its proportionate

equity of the book value of the investee as current operations, capital adjustments or adjustments to retained earnings, depending on the nature of the underlying change in book value of the investee.

d-2 Investments in held-to-maturity bonds are stated at acquisition cost determined by the moving-average method. For investments in bonds where the face value differs from the carrying amount, such difference (representing a premium or discount) is amortized using the effective interest method (See Note 6).

e. Property and Equipment

Property and equipment are stated at acquisition cost. Major renewals and betterments are capitalized if there is an increase in the useful life or value of the asset but expenditures for repairs and maintenance are charged to expense as incurred.

Depreciation is computed using the straight-line method over the estimated useful lives of the related assets as follows :

Classification	Useful lives (years)
Buildings	10~60
Structures	10~40
Machinery and equipment	10~12
Vehicles and transportation equipment	4
Tools	4
Furniture and fixtures	4

f. Intangible Assets

Intangible assets are stated at amortized cost using the straight-line method over the following estimated periods :

Classification	Estimated periods (years)
Industrial property rights	5 ~ 10
Water facility use rights	15

g. Accrued Severance Indemnities and Severance Insurance

In accordance with the Company's policy, all employees with more than one year of service are entitled to receive severance indemnity payments, based on their average salary during the last three months of service and length of employment at termination. The accrual for severance indemnities is determined based on the amount which would be payable assuming all employees were to terminate at the balance sheet date.

Payments of severance indemnities for the years ended December 31, 2002 and 2001 amounted to ₩4,695 million and ₩11,113 million, respectively (including honorary retirement allowance payments of ₩2,602 million and ₩8,632 million, respectively).

Accrued severance benefits are funded approximately 60.42% and 61.09%, at December 31, 2002 and 2001, respectively, through a severance insurance plan. Amounts funded up to accrued severance indemnities are deducted from accrued severance indemnities.

h. Valuation of Assets and Liabilities at Present Value

Long-term accounts receivable and payable are valued at the net present value of future cash flows, calculated using the effective interest method. The difference between the nominal value and the present value of these accounts receivable or payable is presented as a present value discount and amortized using the effective interest method with amortization recognized as interest income or interest expense (See Note 7).

i. Foreign Currency Transactions and Translation

The Company's transactions in foreign currencies have been recorded in Korean won based on the prevailing rates of exchange at the transaction dates. Monetary assets and liabilities denominated in foreign currencies in the accompanying financial statements are translated at the Base Rates announced by the Korean government, which were ₩1,200.4 : US\$1 and ₩1,925.02 : GB £1 at December 31, 2002 and ₩1,326.1 : US\$1 and ₩1,923.11 : GB £1 at December 31, 2001. Gains and losses arising from the settlement of foreign currency transactions and the translation of foreign currency assets and liabilities are charged or credited to current operations (See Note 11).

j. Derivative Instruments

The Company records rights and obligations arising from derivative instruments as assets and liabilities, which are stated at fair value. The gains and losses that result from the change in the fair value of derivative instruments are reported in current earnings. However, for derivative instruments designated as hedging the exposure of variable cash flows, the effective portion of the gains or losses on the hedging instruments are recorded as a separate component of shareholders' equity and credited/charged to operations at the time the hedged transactions affect earnings, and the ineffective portion of the gains or losses is credited/charged immediately to operations (See Note 23).

k. Revenue Recognition for Construction and Sales of Real Properties

Revenue, related to the construction and sale of real properties, is recognized using the percentage-of-completion method. The percentage of completion is calculated based on the ratio of construction costs to date to total estimated construction costs to complete.

l. Income Tax Expense

Income tax expense consists of the amount currently payable under the Korean Corporate Income Tax Law and changes during the period in deferred income tax assets and liabilities for the future tax consequences of operating loss carry-forwards, tax credits and differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Korean financial accounting standards also require that deferred tax assets and liabilities be presented on the balance sheet as a single non-current net number (See Note 17).

3. Restricted Deposits

Restricted deposits at December 31, 2002 and 2001 are as follows (In millions of Korean Won):

Account	2002	2001	Description
Long-term deposits in escrow fund	₩ 16,220	₩ 5,585	Escrow fund
Deposits for employees' severance indemnities	42,185	28,702	Employees' severance indemnities
Total	₩ 58,405	₩ 34,287	

4. Short-Term Financial Instruments and Marketable Securities

Marketable securities at December 31, 2002 and 2001 consist of the following (In millions of Korean Won):

Account	Item	Acquisition cost		Book value(Fair value)		Gain (loss) on valuation	
		2002	2001	2002	2001	2002	2001
Short-term financial instruments	Hana Bank and other	₩ 6,699	₩ 116,509	₩ 6,737	₩ 116,655	₩ 38	₩ 146
Marketable securities	Beneficiary certificates	53,574	53,973	29,258	54,970	(24,316)	997
Marketable securities	Money market fund	-	38,000	-	38,011	-	11
Sub-total		53,574	91,973	29,258	92,981	(24,316)	1,008
Total		₩ 60,273	₩ 208,482	₩ 35,995	₩ 209,636	₩ (24,278)	₩ 1,154

5. Inventories

Inventories at December 31, 2002 and 2001 consist of the following (In millions of Korean Won):

Account	2002	2001
Finished goods	₩ 76,754	₩ 80,288
Work in-process	9,144	9,894
Raw materials	1,317,249	1,275,617
Supplies	13,198	14,764
Added goods	1,522	2,477
Buildings held for sale	296	-
Land held for construction	5,061	-
Other	12,224	6,688
Total	₩ 1,435,448	₩ 1,389,728

6. Investment Securities

(1) Investment securities at December 31, 2002 and 2001 consist of the following (In millions of Korean Won):

Description	Number of shares	Ownership percentage or interest rate (%)	2002	2001
Bonds:				
Government bonds and other	-	5.0 ~ 9.7	₩ 9,499	₩ 9,046
Samsung Corporation	-	Libor+1.95	96,030	106,085
Woori Finance Holdings Co.	-	Libor+1.60	88,830	98,132
Gibo Capital Co.	-	6.55	20,000	20,000
Hyundai Heavy Industries Co.	-	7.67	50,000	50,000
Hyundai Capital Co.	-	7.33	39,000	39,000
Crystal Genomics Co.	-	3.00	999	-
Sub-total			₩ 304,358	₩ 322,263
Listed stock				
Yonhap Television News (YTN)	8,380,000	19.95%	11,481	32,823
Non-listed stock				
Celltrion. Ltd. (preferred stock)	2,730,000	-	15,961	-
Nexgen Biotechnologies, Inc.	100,000	16.18%	2,150	-
KT&G, U.S.A.	100,000	100%	584	-
Sub-total			₩ 18,695	₩ -
Affiliates' stock accounted for using the equity method of accounting				
Korea Ginseng Co.	42,985,851	100%	289,288	267,788
Tongyang Mart Co., Ltd.	4,026,201	43.67%	24,445	23,562
Cosmo Tobacco Co., Ltd.	480,000	40.00%	2,540	-
Sub-total			₩ 316,273	₩ 291,350
Total			₩ 650,807	₩ 646,436

(2) Investments in affiliates accounted for using the equity method of accounting are as follows (In millions of Korean Won) :

Affiliate	Acquisition cost	Adjustment to retained earnings	Valuation gain (loss) reflected in current operations	Valuation gain (capital adjustment)	Dividend received	Book value
Korea Ginseng Co.	₩ 214,929	₩ 77,259	₩ 36,000	₩ -	₩ (38,900)	₩ 289,288
Tongyang Mart Co., Ltd.	26,314	(2,438)	569	-	-	24,445
Cosmo Tobacco Co., Ltd.	2,947	-	(407)	-	-	2,540
Total	₩ 244,190	₩ 74,821	₩ 36,162(*)	₩ -	₩ (38,900)	₩ 316,273

(*) A valuation loss for the Company's investment in YTN, amounting to 8,638 million, was recorded during the year ended December 31, 2002. As the Company sold 420,000 shares of YTN in 2002, the investments in YTN are recorded at fair value as of December 31, 2002.

(Note) The equity method adjustments, which comprise of the difference between the initial purchase price and the Company's initial proportionate ownership of net asset value of the investee at the date of purchase of Tongyang Mart Co., Ltd. in 2000, are amortized over 5 years using the straight-line method. Amortization of such adjustments amounted to ₩2,209 million in each year for the years ended December 31, 2002 and 2001, and the unamortized balances as of December 31, 2002 and 2001 were ₩4,419 million and ₩6,628 million, respectively.

7. Short-Term and Long-Term Loans

Loans as of December 31, 2002 and 2001 are as follows (In millions of Korean Won):

Classification	Annual interest rate (%)	Maturity date	2002	2001
Loan to National Leaf Tobacco Growers				
Cooperative Federation for the support of leaf tobacco cultivation (*)	0.7%(***)	2007.11.20	₩ 110,000	₩ 110,000
Loan to Korea Ginseng Cooperative				
Federation for the support of ginseng cultivation	1.5%	2002.12.21~2007.12.21	14,600	23,800
Total			124,600	133,800
Present value discount account (**)			(51,992)	(60,229)
Total present value			72,608	73,571
Less: Current portion			3,400	9,200
Present value discount for current portion			(247)	(670)
Long-term loans			₩ 121,200	₩ 124,600
Present value discount			₩ (51,745)	₩ (59,559)

(*) The National Agricultural Cooperative Federation guarantees the repayment of loans to the National Leaf Tobacco Growers Cooperative Federation for the same amount.

(**) The average market interest rates of 3-year non-guaranteed corporate bonds at the time of loan origination, 14.01% and 9.7%, were used for calculation of the present value of the loans to the National Leaf Tobacco Growers Cooperative Federation and the Korea Ginseng Cooperative Federation, respectively.

(***) The loan to the National Leaf Tobacco Growers Cooperative Federation for the support of leaf tobacco cultivation was renewed in 2001 with interest changed from 1.5% to 0.7%. The change in present value discount of 3,334 million won resulting from the renewal of the loan has been charged to other bad debt expense during the year ended December 31, 2001.

8. Land Standard Value Information

The Company's land with a book value of ₩298,804 million (excluding land of ₩1,756 million for which a standard value has not been announced) as of December 31, 2002, has a standard value of ₩863,613 million as announced by the Korean government for purposes of taxation and governmental land policies.

9. Property, Plant and Equipment

As of December 31, 2002 and 2001, property, plant and equipment consist of the following(In millions of Korean Won):

Accounts	2002	2001
Land	₩ 300,560	₩ 302,950
Buildings	461,640	434,086
Structures	35,335	32,214
Machinery and equipment	567,076	547,556
Vehicles and transportation equipment	16,281	15,469
Tools	14,808	9,473
Furniture and fixtures	81,399	62,008
Construction in-progress	195,908	63,676
Other tangible assets	362	352
Total cost	1,673,369	1,467,784
Less accumulated depreciation	(535,711)	(476,247)
Net	₩ 1,137,658	₩ 991,537

10. Convertible Bonds

Convertible bonds as of December 31, 2002 and 2001 and the repayment schedule are as follows (in millions of Korean Won) :

(1) The 1st foreign convertible bonds

Description	Issue date	Maturity date	Interest rate	2002	2001
The 1st foreign convertible bonds	2001.10.31	2006.10.31	2%	₩ 317,467	₩ 317,467
Plus : long-term accrued interest expenses				9,610	2,271
Less : discount upon issuance				(5,001)	(6,168)
Net				₩ 322,076	₩ 313,570

The 1st foreign convertible bonds denominated in US dollars are convertible into the Company's treasury stock at ₩20,886 per share, translated using a fixed exchange rate of US\$1 : ₩1,300.4, during the period from December 11, 2001 to October 20, 2006 at the option of the bondholders. Interest on such convertible bonds is payable at the end of each 6 month period. The bonds are to be redeemed on October 31, 2004 at 108.16 percent of their principal amount upon the request of the bondholders or any time from November 15, 2004 at an amount, as agreed at bond issuance, upon advance notice by the Company. For bonds not converted nor redeemed, 114.26 percent of principal will be due in one lump sum on October 31, 2006.

(2) The 1st domestic convertible bonds

Description	Issue date	Maturity date	Interest rate	2002	2001
The 1st domestic convertible bonds	2002. 6.29	2005. 6.29	3%	₩ 492,618	₩ -
Plus : long-term accrued interest expenses				6,714	-
Less : discount upon issuance				(1,533)	-
Net				₩ 497,799	₩ -

For the year ended December 31, 2002, 121,514 shares of treasury stock which were set aside for the Company's outstanding convertible bonds were transferred upon conversion of domestic convertible bonds amounting to ₩2,166 million.

The 1st domestic convertible bonds denominated in Won are convertible into the Company's treasury stock at ₩17,820 per share, during the period from July 29, 2002 to May 30, 2005 at the option of the bondholders. Interest on such convertible bonds is payable at the end of each 6 month period. For bonds not converted, 108.70% percent of principal will be due in one lump sum on June 29, 2005.

11. Assets and Liabilities Denominated in Foreign Currencies

Details of assets and liabilities denominated in foreign currencies at December 31, 2002 and 2001 are as follows (In millions of Korean Won, thousands of US Dollars and thousands of Great Britain pounds) :

Account	Foreign currency		Korean Won equivalent	
	2002	2001	2002	2001
(Assets)				
Accounts receivable - trade	US\$ 8,021	US\$ 3,713	₩ 9,628	₩ 4,923
Investment securities	153,998	153,998	184,859	204,217
Long-term deposits in escrow fund	13,512	4,212	16,220	5,585
Cash and cash equivalents	7,815	199	9,381	263
Total	US\$ 183,346	US\$ 162,122	₩ 220,088	₩ 214,988
(Liabilities)				
Accounts payable - trade	US\$ 6,585	US\$ 3,826	₩ 7,904	₩ 5,074
	GB£ 191	GB£ 309	367	595
Accrued interest expenses	US\$ 823	US\$ 814	₩ 988	₩ 1,079
Total	US\$ 7,408	US\$ 4,640	₩ 9,259	₩ 6,748
	GB£ 191	GB£ 309		

12. Excise Tax for Tobacco

Prepaid tobacco excise taxes and dues, tobacco excise taxes and dues payable as of December 31, 2002 and 2001 and tobacco excise taxes and dues for the years ended December 31, 2002 and 2001 are as follows (In millions of Korean Won):

Description	Prepaid tobacco excise taxes and dues		Tobacco excise taxes and dues payable		Tobacco excise taxes and dues	
	2002	2001	2002	2001	2002	2001
Tobacco excise taxes	₩ 82,364	₩ 96,267	₩ 164,051	₩ 169,130	₩ 1,732,621	₩ 1,997,540
Tobacco education taxes	41,182	48,134	82,026	84,565	866,311	990,835
Waste dues	641	754	13,462	15,777	13,574	15,709
Funds for the Promotion of Health	24,053	377	48,109	662	422,554	7,855
Funds for the Stabilization of Tobacco Production	1,604	-	3,207	-	32,050	-
Total	₩ 149,844	₩ 145,532	₩ 310,855	₩ 270,134	₩ 3,067,110	₩ 3,011,939

13. Common Stock

There were no changes in capital stock for the years ended December 31, 2002 and 2001. Details of capital stock as of December 31, 2002 and 2001 are as follows (in Korean Won) :

(1) Authorized shares	:	800,000,000 common share
(2) Issued shares	:	181,442,497 common share
(3) Common stock par value	:	₩ 5,000

On September 17, 2002, the Company retired 9,549,400 shares of issued common stock recorded as treasury stock with an aggregate purchase price of ₩168,088 million by offsetting such amount against retained earnings. Such retirement reduced the number of total issued common stock to 181,442,497 shares from 190,991,897 shares.

14. Treasury Stock

(1) Pursuant to the plan to split into two companies by setting up a subsidiary for its red ginseng business segment, after the approval of such plan at the shareholder' meeting on December 28, 1998, the Company repurchased 20,180 shares of treasury stock for ₩13,656 per share from 33 individuals who dissented from the plan.

The Company purchased 8,492,590 shares of treasury stock for ₩23,698 per share through its treasury stock fund. As of December 31, 2002, the acquisition cost of such treasury stock was ₩201,248 million.

The Company purchased treasury stocks in the stock market during the year ended December 31, 2002. Following such purchase of treasury stock, the Company held 10,517,820 shares of treasury stock at an average purchase price of ₩17,512 per share as of December 31, 2002.

The Company plans to sell certain shares of treasury stock in the market in the future.

(2) The Company purchased 15,200,000 shares of treasury stock on October 24, 2001 at an average price of ₩17,700 per share in connection with the issuance of the foreign convertible bonds.

(3) The Company purchased 27,765,630 shares of treasury stock on June 27, 2002 at an average price of ₩16,202 per share in connection with the issuance of the domestic convertible bonds. As of December 31, 2002, ₩2,166 million of convertible bonds were converted to 121,514 shares of common stock. Following such conversion, as of December 31, 2002, the Company held 27,644,116 shares of treasury stock.

15. Retained Earnings

Retained earnings as of December 31, 2002 and 2001 are comprised of the following(In millions of Korean Won):

	2002	2001
Legal reserve	₩ 602,937	₩ 602,937
Reserve for business expansion	698,881	698,881
Reserve for business rationalization	12,851	12,851
Reserve for technology development	36,196	47,816
Reserve for overseas business losses	194	387
Reserve for overseas market development	235	664
Reserve for energy saving facilities	131	266
Other	732,320	722,320
Unappropriated retained earnings to be carried forward	40,734	26,395
	₩ 2,124,479	₩ 2,112,517

(1) Legal reserve and reserve for business expansion

Under the old Korea Tobacco and Ginseng Corporation Act, the Company is required to appropriate at least 20% of net profit to a legal reserve and 20% of net profit to a reserve for business expansion, until such reserves equal 50% of capital stock. The Company did not appropriate such reserves for the years ended December 31, 2002 and 2001 as such reserves exceeded 50% of capital stock. This reserve may be used only for offset against future deficits or transfer to capital stock.

(2) Reserve for business rationalization

Pursuant to the Tax Reduction and Exemption Control Law of Korea, the Company is required to appropriate, as a reserve for business rationalization, the income tax credits utilized by the Company. The reserve may be used only for offset against future deficits or transfer to capital stock.

(3) Other Reserves

Reserves for technology development, overseas business losses, overseas market development and energy saving facilities were appropriated in order to recognize certain tax deductible benefits through the early recognition of future expenditures. These reserves will be unappropriated to retained earnings in accordance with the relevant tax laws. Such amount will be included in taxable income in year of unappropriation. Reserves without specific purposes will be unappropriated to retained earnings by approval at a general meeting of stockholders.

16. Summary of Construction Activity

(1) Construction contract logs as of December 31, 2002 are summarized as follows (In millions of Korean Won) :

Item	Beginning	Contract amounts	Revenue recognized	Remaining contract amounts
Multi-purpose buildings in Dongdaemoon area	₩ -	₩ 98,966	₩ 2,230	₩ 96,736
Total	₩ -	₩ 98,966	₩ 2,230	₩ 96,736

(2) Accumulated revenue from buildings constructed during the year ended December 31, 2002 is as follows (In millions of Korean Won) :

Item	Accumulated revenue	Billings for the year	Accumulated billings	Accumulated collections	Uncollected
Multi-purpose buildings in Dongdaemoon area	₩ 2,230	₩ 10,003	₩ 10,003	₩ 10,003	₩ -
Total	₩ 2,230	₩ 10,003	₩ 10,003	₩ 10,003	₩ -

(3) Guarantees

As of December 31, 2002 guarantees provided by other companies relating to construction are as follows (In millions of Korean Won) :

Guarantor	Builder	Types of guarantee	Description	Guaranteed amount
Seoul Guarantee Insurance	SsangYong Engineering & Construction Co., Ltd	Construction performance	Multi-purpose buildings in Dongdaemoon area	₩ 3,178

(4) Cost of sales of buildings

Cost of sales of constructed buildings for the years ended December 31, 2002 and 2001 is as follows(In millions of Korean Won) :

Account	2002	2001
Materials	₩ 82	₩ -
Labor	-	-
Outsourcing	992	-
Overhead	42	-
Total cost of buildings for the year	₩ 1,116	₩ -
Buildings held for sale	(296)	-
Cost of sales of buildings	₩ 820	₩ -

17. Income Tax Expense

(1) Reconciling items between accounting income and taxable income for the years ended December 31, 2002 and 2001 are as follows

(In millions of Korean Won):

Account	Temporary difference		Permanent difference		Total	
	2002	2001	2002	2001	2002	2001
1. Additions :						
Accrued income	3,175	10,571	-	-	3,175	10,571
Taxes and dues	-	-	15	73	15	73
Donations	-	-	712	745	712	745
Loss on valuation of inventories	12,583	13,504	-	-	12,583	13,504
Entertainment expense	-	-	8,248	6,413	8,248	6,413
Allowance for severance and retirement benefits	14,905	11,977	7	15	14,912	11,992
Deposits for severance and retirement benefits	825	111	-	-	825	111
Depreciation	3,896	100	-	-	3,896	100
Interest expense	-	-	328	81	328	81
Gain on valuation of marketable securities	889	-	-	-	889	-
Investment securities	14,500	21,400	-	-	14,500	21,400
Loss on valuation of marketable securities	24,316	-	-	-	24,316	-
Reserves for overseas market exploration	429	429	-	-	429	429
Reserves for energy saving facilities	132	135	-	-	132	135
Reserves for technological development	11,620	5,850	-	-	11,620	5,850
Reserves for export losses	194	194	-	-	194	194
Loss on valuation of investment securities	-	-	12,449	-	12,449	-
Long-term accrued interest expenses	14,054	2,271	-	-	14,054	2,271
Loss on valuation of interest rate swaps	-	3,839	-	-	-	3,839
Loss on valuation of currency swaps	2,265	-	-	-	2,265	-
Present value discounts	-	3,334	-	-	-	3,334
Other bad debts	13,168	12,721	-	-	13,168	12,721
Gain on valuation of short-term financial instruments	146	2,173	-	-	146	2,173
Bad debts	14,845	4,510	-	-	14,845	4,510
Other	-	-	1,834	398	1,834	398
Total	131,942	93,119	23,593	7,725	155,535	100,844

Account	Temporary difference		Permanent difference		Total	
	2002	2001	2002	2001	2002	2001
2. Deductions :						
Accrued income	3,097	3,175	-	-	3,097	3,175
Loss on valuation of inventories	13,504	1,958	-	-	13,504	1,958
Value added tax	1	1	-	-	1	1
loss on foreign currency translations	3	-	-	-	3	-
Loss on disposal of property and equipment	4	4	-	-	4	4
Construction in-progress	40	40	-	-	40	40
Debenture issuance costs	103	30	-	-	103	30
Gain on valuation of interest rate swaps	12,598	-	-	-	12,598	-
Dividend income	-	-	6,772	10,671	6,772	10,671
Gain on valuation of investment securities	-	-	12,449	-	12,449	-
Allowance for severance and retirement benefits	1,229	786	-	-	1,229	786
Deposits for severance and retirement benefits	14,854	11,907	-	-	14,854	11,907
Depreciation	228	1,386	-	-	228	1,386
Investment securities	29,368	20,708	-	-	29,368	20,708
Gain on valuation of short-term financial instruments	38	146	-	-	38	146
Present value discounts	11,305	5,530	-	-	11,305	5,530
Bad debts	4,553	-	-	-	4,553	-
Other bad debts	11,941	-	-	-	11,941	-
Loss on valuation of marketable securities	191	66,997	-	-	191	66,997
Gain on valuation of marketable securities	-	1,008	-	-	-	1,008
Gain on valuation of currency swaps	-	4,219	-	-	-	4,219
Other	-	-	737	15	737	15
Total	103,057	117,895	19,958	10,686	123,015	128,581

(2) Changes in cumulative temporary differences for the years ended December 31, 2002 and 2001 and deferred income tax assets as of December 31, 2002 and 2001 are as follows (in millions of Korean Won) :

(2002)

Account	December 31, 2001	Decrease	Increase	December 31, 2002
(Deductible temporary differences)				
Allowance for severance and retirement benefits	28,483	1,229	14,905	42,159
Loss on valuation of inventories	13,504	13,504	12,583	12,583
Depreciation	5,314	228	3,896	8,982
Construction in-progress	794	40	-	754
Gain on prior period error correction (depreciation)	7	-	-	7
Loss on disposal of property and equipment	202	4	-	198
Bad debts	4,510	4,553	14,845	14,802
Loss on valuation of marketable securities	1,469	191	24,316	25,594
Long-term accrued interest expenses	2,271	-	14,054	16,325
Value added tax	10	1	-	9
Present value discounts	63,298	11,305	-	51,993
Other bad debts	12,721	11,941	13,168	13,948
Total	132,583	42,996	97,767	187,354
(Taxable temporary differences)				
Accrued income	3,175	3,175	3,097	3,097
Additional acquisition tax	195	-	-	195
Deposits for severance and retirement benefits	27,469	825	14,854	41,497
Debenture issuance costs	30	-	103	133
Gain on valuation of marketable securities	1,008	889	-	119
Reserves for technological development	47,816	11,620	-	36,196
Reserves for export losses	387	194	-	194
Reserves for overseas market exploration	664	429	-	235
Reserves for energy saving facilities	266	132	-	134
Gain on valuation of short-term financial instruments	146	146	38	38
Investments using the equity method of accounting	41,880	14,500	29,368	56,749
Currency swaps	4,219	2,265	-	1,954
Interest rate swaps	(3,839)	-	12,598	8,759
Loss on foreign currency translations	-	-	3	3
Total	123,416	34,175	60,061	149,302
Tax effect of temporary differences :				
Deferred income tax assets	39,377	12,770	29,037	55,644
Deferred income tax liabilities	36,654	10,149	17,838	44,343
Deferred income tax assets-net	2,723	2,621	11,199	11,301

(2001)

Account	December 31, 2000	Decrease	Increase	December 31, 2001
(Deductible temporary differences)				
Allowance for severance and retirement benefits	17,292	786	11,977	28,483
Loss on valuation of inventories	1,958	1,958	13,504	13,504
Depreciation	6,600	1,386	100	5,314
Construction in-progress	834	40	-	794
Gain on prior period error correction (depreciation)	7	-	-	7
Loss on disposal of property and equipment	206	4	-	202
Bad debts	-	-	4,510	4,510
Loss on valuation of marketable securities	68,466	66,997	-	1,469
Value added tax	11	1	-	10
Long-term accrued interest expenses	-	-	2,271	2,271
Loss on valuation of interest rate swaps	-	-	3,839	3,839
Other bad debts	-	-	12,721	12,721
Present value discounts	65,494	5,530	3,334	63,298
Total	160,868	76,702	52,256	136,422
(Taxable temporary differences)				
Accrued income	10,571	10,571	3,175	3,175
Additional acquisition tax	195	-	-	195
Deposits for severance and retirement benefits	15,673	111	11,907	27,469
Debenture issuance costs	-	-	30	30
Gain on valuation of marketable securities	-	-	1,008	1,008
Reserves for energy saving facilities	400	135	-	265
Reserves for technological development	53,666	5,850	-	47,816
Reserves for export losses	581	194	-	387
Reserves for overseas market exploration	1,093	429	-	664
Gain on valuation of short-term financial instruments	2,173	2,173	146	146
Investments using the equity method of accounting	42,572	21,400	20,708	41,880
Currency swaps	-	-	4,219	4,219
Total	126,924	40,863	41,193	127,254
Tax effect of temporary differences :				
Deferred income tax assets	49,547	23,624	16,095	42,018
Deferred income tax liabilities	(39,092)	(12,586)	(12,688)	(39,194)
Deferred income tax assets-net	10,455	11,038	3,407	2,824
Effect of change in statutory tax rate (*)				(101)
Deferred income tax assets-net				2,723

(*) The statutory tax rate for the years beginning January 1, 2002 was changed from 30.8% to 29.7% in accordance with the revised Korean Tax Law.

(3) Effective tax rate

Effective tax rates for the years ended December 31, 2002 and 2001 are as follows (in millions of Korean Won):

	2002	2001
Income tax expense (A)	₩ 146,157	₩ 146,566
Income before income tax expense (B)	493,601	480,411
Effective tax rate (A)/(B)	29.61%	30.50%

(4) Detail of income tax expense

Income tax expenses for the years ended December 31, 2002 and 2001 consist of the following (in millions of Korean Won) :

	2002	2001
Current	₩ 154,735	₩ 138,834
Changes in deferred tax assets related to temporary differences (note)	(8,578)	7,732
Income tax expense	₩ 146,157	₩ 146,566

(note) Changes in deferred income tax assets related to temporary differences for the years ended December 31, 2002 and 2001 are as follows (in Korean Won):

	2002	2001
End of the year	₩ 11,301	₩ 2,723
Beginning of the year	2,723	10,455
Changes in deferred income tax assets related to temporary differences	₩ (8,578)	₩ 7,732

(5) Payment of special taxes in income tax expense

Payment of special taxes on gains from disposal of tangible assets amounted to ₩1,561 million for the year ended December 31, 2001.

18. Income Per Share

Income per share amounts for the years ended December 31, 2002 and 2001 are as follows :

(1) Basic income per share (in Korean Won, except for share data)

	2002	2001
Net income (A)	₩ 347,444,073,870	₩ 333,844,564,031
Weighted average number of shares outstanding(*) (B)	146,988,542	179,718,412
Ordinary income per share (A/B)	₩ 2,364	₩ 1,858
Net income per share (A/B) :	₩ 2,364	₩ 1,858

(*) The number of treasury shares is excluded from the calculation of weighted number of shares outstandings (see note 14).

(2) Diluted income per share

If all convertible bonds are converted, 42,844,116 shares of the Company's common stock would be additionally outstanding and the weighted average number of common shares outstanding would be 176,578,630. Details of diluted income per share amounts are as follows (in Korean Won, except for share data):

	2002	2001
Basic ordinary income	₩ 347,444,073,870	₩ 333,844,564,031
Add: interest on convertible bonds, (net of tax)	20,596,437,464	2,318,125,452
Diluted ordinary income(A)	368,040,511,334	336,162,689,483
Basic net income	347,444,073,870	333,844,564,031
Add: interest on convertible bonds, (net of tax)	20,596,437,464	2,318,125,452
Diluted net income(B)	368,040,511,334	336,162,689,483
Weighted average number of shares outstanding (C)	176,578,630	182,591,837
Diluted ordinary income per share(A/C)	₩ 2,084	₩ 1,841
Diluted net income per share(B/C)	₩ 2,084	₩ 1,841

19. Dividends

Details of cash dividends to be declared for the years ended December 31, 2002 and 2001 are computed as follows (in Korean Won except for shares) :

	2002	2001	
	All stockholders	To major stockholders	To minority stockholders
Outstanding shares (*)	119,567,791	63,336,149	103,937,628
Par value	₩ 5,000	₩ 5,000	₩ 5,000
Dividends per share (dividend ratio)	₩ 1,400 (28%)	₩ 1,050 (21%)	₩ 1,400 (28%)
Cash dividends	₩ 167,394,907,400	₩ 66,502,956,450	₩ 145,512,679,200
Stock price	₩ 16,400	₩ 19,400	₩ 19,400
Dividend yields	8.54%	5.41%	7.22%

(*) Excluding 61,874,706 shares and 23,718,120 shares in treasury as of December 31, 2002 and 2001, respectively (See Note 14)

Dividend payout ratios (dividends ÷ net income) are 48.18% and 63.50% for the years ended December 31, 2002 and 2001, respectively.

20. Statements of Cash Flows

The statements of cash flows have been presented using the indirect method. Non-cash transactions for the years ended December 31, 2002 and 2001 are detailed as follows (in millions of Korean Won) :

Description	2002	2001
Transfer to short-term loans from long-term loans	₩ 3,400	₩ 9,200
Transfer to property, plant and equipment from construction in-progress	60,142	94,198
Retirement of treasury shares	168,088	-
Transfer to short-term loans to employees from long-term loans to employees	31,530	15,711
Decrease in investment securities due to impairment	12,449	-
Decrease in retained earnings due to dividends payable	167,395	212,016
Other	5,061	1,278
Total	₩ 448,065	₩ 332,403

21. Insurance Coverage

As of December 31, 2002 certain of the Company's assets are insured with Dongbu Fire & Marine Insurance, as follows (in millions of Korean Won):

Assets insured	Type of insurance	Annual insurance premium	Coverage
Buildings, structures, inventories and machinery	Fire insurance	₩ 502	₩ 637,829

In addition, the Company carries comprehensive auto insurance for its vehicles, unemployment insurance and workers' compensation insurance.

22. Pending Litigation

- (1) A tobacco lawsuit of ₩100 million was filed against the Company and the Korean government for the first time in Korean history in September 1999. In addition, another ₩307 million of legal actions were taken by a group of 30 people alleging wrongful smoking related diseases in January 2000. Plaintiffs assert that the Company and the Korean government did not perform their obligation to notify smokers of the unhealthy influence of smoking. The lawsuits are currently pending as of December 31, 2002 and the ultimate outcome of the litigation can not be reasonably estimated.
- (2) There are six additional lawsuits against the Company involving approximately ₩4,766 million. The ultimate results of the litigation can not be reasonably estimated as of December 31, 2002.

23. Commitments and Contingencies

- (1) The Company has entered into a purchase contract with the president of the National Leaf Tobacco Growers Cooperative Federation, who has been given powers of attorney from tobacco cultivators to sell their leaf tobacco. In addition, the Company has entrusted the National Leaf Tobacco Growers Cooperative Federation with educating cultivators of raw material leaf tobacco and pays salaries to employees of the National Leaf Tobacco Growers Cooperative Federation in accordance with related laws.

- (2) Currency and interest rate swaps

Details of currency swap and interest rate swap contracts of the Company as of December 31, 2002 are as follows:

- 1) In November 2001 the Company had three currency swap and two interest rate swap contracts to match cash outflows from convertible bonds with cash inflows from investments in bonds, which were purchased using the proceeds from convertible bond issuance. Valuation gains or losses on such swap contracts are recorded in current operations.

2) Details of currency swap contracts as of December 31, 2002 are as follows (in millions of Korean Won and thousands of US Dollars) :

Counterpart	Period	Contract amount		Contracted exchange rate	
		To pay	To receive	To pay	To receive
Industrial Bank of Korea (IBK)	2001.11~2004.10	₩ 20,000	US\$ 15,576	6.39%	2%(*)
The Korea Development Bank (KDB)	2001.11~2004.10	₩ 39,000	US\$ 30,709	6.34%	2%(**)
The Korea Development Bank (KDB)	2001.11~2004.10	₩ 50,000	US\$ 38,941	6.31%	2%(***)
Total		₩ 109,000	US\$ 85,226		

(*) IBK pays the Company US\$ 1,271,028 (8.16% of notional amount) on October 29, 2004.

(**) KDB pays the Company US\$ 2,505,827 (8.16% of notional amount) on October 29, 2004.

(***) KDB pays the Company US\$ 3,177,570 (8.16% of notional amount) on October 29, 2004.

3) Details of interest rate swap contracts are as follows (in thousands of US Dollars) :

Counterpart	Period	Notional amount	Contracted exchange rate	
			To pay	To receive
UBS Warburg (UBS)	2001.11~2004.11	US\$ 74,000	6M Libor+1.60%	2.91%(*)
Credit Suisse First Boston (CSFB)	2001.11~2004.10	US\$ 80,000	6M Libor+1.95%	3.96%(**)
Total		US\$ 154,000		

(*) UBS pays the Company US\$ 6,038,400 (8.16% of notional amount) on October 29, 2004.

(**) CSFB pays the Company US\$ 6,528,000 (8.16% of notional amount) on October 29, 2004.

4) Details of valuation of derivative instruments at December 31, 2002 and 2001 are as follows (in millions of Korean Won) :

Type	Valuation gain (loss) (B/S)	Credited (charged) to current operations in the period	Capital adjustment
<2002>			
Currency swaps	6,707	(2,265)	-
Interest rate swaps	8,909	12,598	-
Total	15,616	10,333	-
<2001>			
Currency swaps	4,219	4,219	-
Interest rate swaps	(3,839)	(3,839)	-
Total	380	380	-

24. Value-added Information

Value-added amounts included in manufactured costs and selling and administrative expenses for the years ended December 31, 2002 and 2001 are as follows (In millions of Korean Won):

Account	Manufacturing costs		Selling general and administrative expenses		Total	
	2002	2001	2002	2001	2002	2001
Wages and salaries	₩ 121,111	₩ 125,276	₩ 141,168	₩ 117,321	₩ 263,279	₩ 242,597
Provision for severance indemnities	9,475	11,262	12,853	10,439	22,328	21,701
Employee welfare	11,625	11,621	12,934	11,303	24,559	22,924
Rent	83	91	1,311	549	1,394	640
Depreciation	51,122	51,095	28,584	22,036	79,706	73,131
Taxes and dues	3,682	3,956	8,363	7,802	12,045	11,758
Total	₩ 198,098	₩ 203,301	₩ 205,213	₩ 169,450	₩ 403,311	₩ 372,751

25. Employee Welfare and Contributions to Society

(1) The Company has provided loans to directors and employees for the purchase and lease of houses up to ₩20 million per person. At December 31, 2002 and 2001, the Company has loans of ₩175,084 million and ₩83,955 million, respectively, including loans for purchase of the Company's stock, purchase and lease of houses and other purposes.

(2) Contributions to society for the years ended December 31, 2002 and 2001 consist of the following (In millions of Korean Won):

Description	2002	2001
Construction support to Chung-Nam University Agricultural Center	₩ -	₩ 1,000
Fund for the welfare of the Company's employees	16,153	15,000
Other	4,154	6,319
Total	₩ 20,307	₩ 22,319

26. Selling and Administrative Expenses

Selling and administrative expenses for the years ended December 31, 2002 and 2001 consist of the following (In millions of Korean Won):

Account	2002	2001
Salaries	₩ 141,168	₩ 117,321
Provision for severance indemnities	12,853	10,439
Welfare	12,934	11,303
Travel	5,419	3,642
Communications	3,217	3,253
Water, light and heating	2,610	2,001
Taxes and dues	8,364	7,802
Supplies	2,743	2,099
Clothing	879	869
Rent	1,311	549
Depreciation	28,145	21,747
Amortization	439	289
Repairs and maintenance	2,341	1,662
Vehicles	2,934	2,817
Insurance	424	405
Commissions	30,556	15,550
Transportation and warehousing	18,272	14,863
Entertainment	313	435
Conventions	1,209	1,022
Advertising	76,113	44,722
Training	7,448	3,532
Prizes and rewards	1,063	809
Cooperation	256	193
Normal research and development	10,344	21,204
Samples	2,299	2,886
Bad debts	678	398
Miscellaneous	591	653
Total	₩ 374,923	₩ 292,465

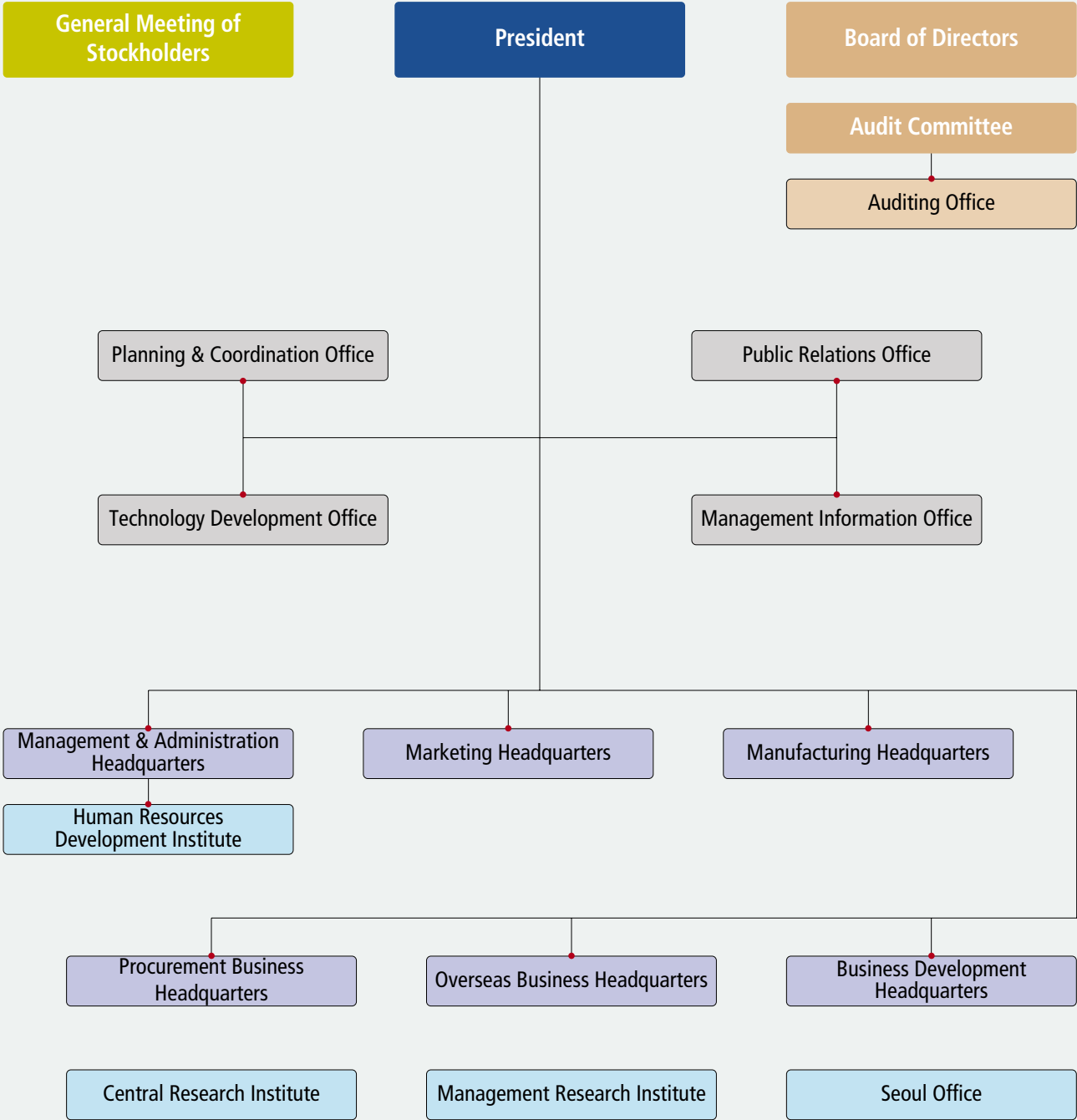
27. Reclassifications

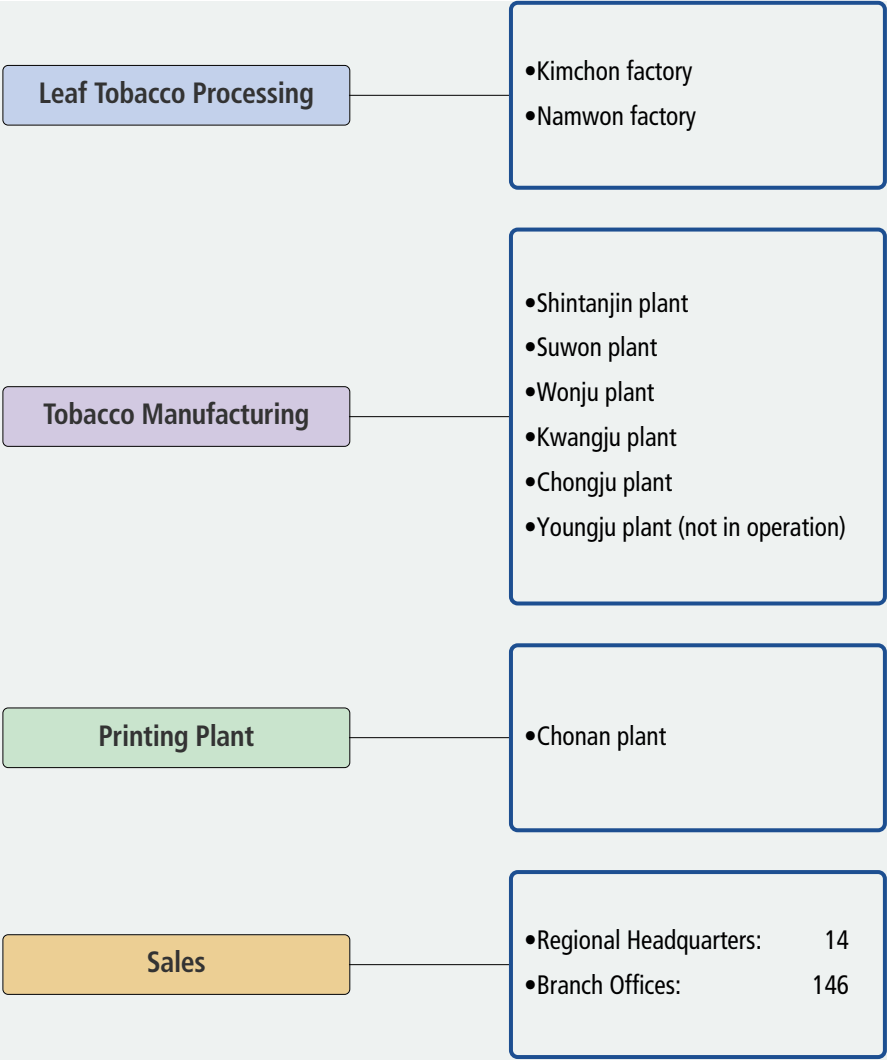
Certain reclassifications have been made in prior year's financial statements to conform to classifications used in the current year. Such reclassifications did not have an effect on the financial position and the operational results as of and for the year ended December 31, 2001.

28. Uncertainties in Business Environment

In response to general unstable economic conditions, the Korean government and the private sector have been implementing structural reforms to historical business practices. Implementation of these reforms is progressing slowly, particularly in the areas of restructuring private enterprises and reforming the banking industry. The Korean government continues to apply pressure to Korean companies to restructure into more efficient and profitable firms. The Company may be either directly or indirectly affected by these general unstable economic conditions and the reform program described above.

The accompanying financial statements reflect management's assessment of the impact to date of the economic situation on the financial position of the Company. Actual results may differ materially from management's current assessment.





Capital Stock	KRW955 billion
Number of Authorized Shares	800,000,000
Number of Issued Shares : Common Shares	181,442,497
Stockholders' Equity	KRW1,985 billion
Number of Employees	4,635

Ownership Structure (%)



Treasury Stocks	34.1%
Foreigners	27.7%
Industrial Bank of Korea(EB)	10.8%
Daehan Investment Trust Securities	7.4%
Employees	6.5%
Others	13.5%

Head Office

- KT&G Corporation
100, Pyongchon-dong, Taedeok-gu,
Taejeon City, 306-130, Korea
- Tel. (82-42)939-5000
- Fax. (82-42)939-5001
- <http://www.ktng.com>

Inquiries

- IR Team
KT&G Corporation
1904 KOSMO Tower, 1002, Daechi-dong,
Kangnam-gu, Seoul, 135-280, Korea
- Tel. (82-2)3404-4521, 4523~4
- Fax. (82-2)3404-4515



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