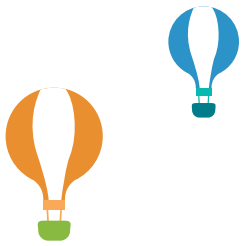


2017 KT&G Report

SUSTAINABLE SEED FOR SOCIETY



About this Report

Overview

We integrated the 2017 Annual Report and Sustainability Report to share our progress, activities and vision for sustainable growth and development with diverse stakeholders. The integrated report will be published every year to transparently disclose our performances in and plans for sustainable value creation.

Reporting Period

This report covers KT&G's sustainability activities and performances from January 1 through December 31, 2017. To provide a better understanding of our quantitative results, data for the last three fiscal years were applied. And some crucial results spanned the period up to the first quarter of 2018. Previous report had been published in September 2016 with the title of KT&G 2014/15 Sustainability Report.

Reporting Scope

The data for this report was collected from domestic business facilities including KT&G Head Office, R&D Center, Sintanjin Plant, Gwangju Plant, Yeongju Plant, Cheonan Plant and Gimcheon Plant.

Reporting Standards

This report was prepared in accordance with the GRI (Global Reporting Initiatives) G4 Guideline's Core Option. The IIRC (International Integrated Reporting Council) Integrated Reporting Framework was also used for the integration with Annual Report.

Assurance

The information of this report was verified by Deloitte, an independent assurance agency.

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Sustainable
Seed for the Society

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MESSAGE FROM THE CEO



President and CEO
Baek, Bok-In

Dear stakeholders,

On the back of your unwavering support and encouragement, KT&G has achieved balanced growth in all of our business areas in 2017. This has served as the foundation from which KT&G has continued its growth towards becoming a leading global corporation. Despite a tough business environment which entailed global economic uncertainties and a sluggish domestic economy, we have made a concerted effort to maximize both corporate value and stakeholder value, achieving meaningful results.

Despite fierce competition due to tightening regulations, we reclaimed 60% share in the domestic market through upright business practices and differentiated product competitiveness. Our next-generation tobacco products also successfully penetrated the market on the back of timely product development and differentiation strategies. In the overseas tobacco business, we won the USD 800 Million Export Tower thanks to proactive entrance into the global market and sales growth of localized products, which contributed to exceeding KRW 1 trillion in total sales revenue and 50 billion sticks in unit sales. In the red ginseng business, we have focused on diversifying business portfolio and expanding overseas markets since achieving KRW 1 trillion in sales in 2016. We have also built the foundations for a new leap of the pharmaceuticals and cosmetics businesses, while successfully completing the Daegu Development Project and pursuing profitable growth in the real estate business.

“KT&G has made a concerted effort to maximize both corporate value and stakeholder value, creating meaningful performances.”

KT&G has made the best efforts to create social value as well as economic value to fulfill its social responsibility. Various social contribution activities at home and abroad have helped us to share the fruits of our endeavour with local communities. The company has also endeavored to raise the awareness of ethical practices and pursue growth in an upright manner. Moreover, stakeholder communication has been further promoted to enhance stakeholder value and management transparency.

In 2018, business environment will be tough due to increasing comprehensive regulatory requirements and rapid growth of the next-generation tobacco market. Competition in the non-tobacco market is also expected to be intense. To respond to these challenges, we will take a more flexible approach and build growth-oriented strategies to improve our profitability and corporate value. We will particularly focus on the following areas.

First, we will continue building a balanced business portfolio that is centered on growth and profitability in the global markets. We will endeavor to increase our market share and profitability to build a solid foundation for the Group's growth. In the red ginseng business, our goal is to expedite market expansion in Africa and South and Central America while further strengthening the direct operation of local subsidiaries. The pharmaceuticals business will pursue broadening product lineups and diversifying exports. The cosmetics business will focus on profit-oriented approach to channels with growth potential and penetration into global markets. In the real estate business, we will lay the foundation for an independently sustainable growth by undertaking large-scale development projects and building a virtuous cycle of rent, operation, and investment.

Second, we will develop our next-generation tobacco business as a new growth engine. We will launch an innovative platform in the tobacco market to solidify our position as a first-mover, rather than a fast follower. Our plan is to build next-generation product infrastructure by optimizing our organization, increasing production facilities, and internalizing technologies, realizing a full value chain that encompasses marketing, R&D, materials, manufacturing, and sales.

Third, we will invest in three directions: "strengthening existing businesses", "expanding related businesses", and "creating new businesses". To strengthen existing businesses, we will continue to expand next-generation tobacco technologies, related facilities, and alliances with overseas tobacco companies. Advancement into front and rear industries will be promoted to create synergy with existing businesses and expand related businesses. We will also be active in creating new opportunities by preemptively investing in future technologies to lead the Fourth Industrial Revolution.

Lastly, we will also fulfill our social responsibility as a corporate citizen. KT&G is committed to increasing stakeholder value and fulfilling its responsibility as a corporate citizen by activating communication and building a culture of trust and passion. Global CSR activities will be continuously promoted to solidify our presence as a global player as well.

Our efforts for innovation and challenges will continue in 2018 to evolve into a leading global company. By capitalizing on our strength that helped us overcome difficulties and achieve sustainable growth, we will preemptively cope with market changes with the aim of enhancing corporate value and meeting the expectations of stakeholders. Your continued interest and support is greatly appreciated.

Thank you.

KT&G

AT A GLANCE

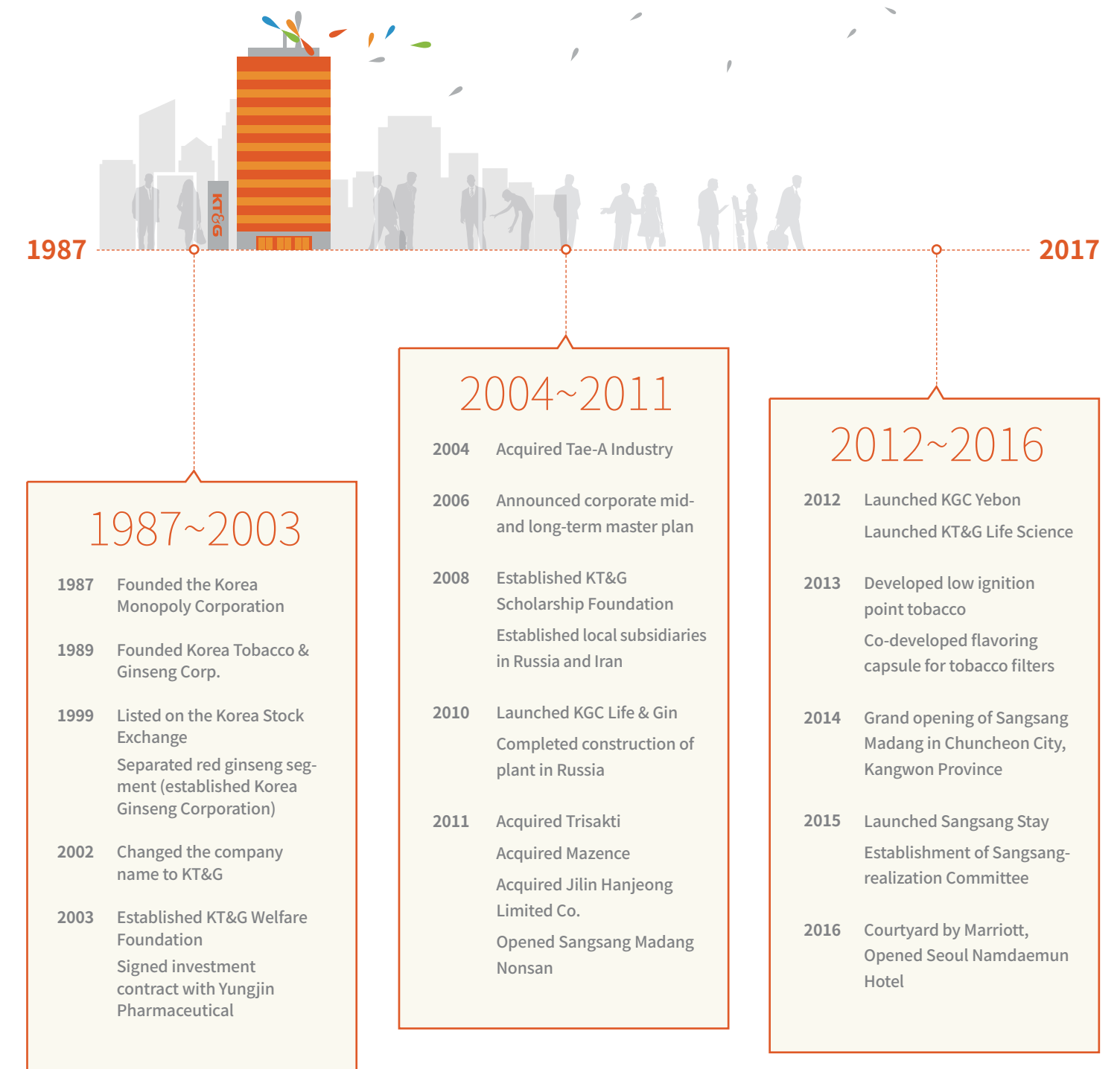
Corporate Profile

Under the management principle of "upright company", "a company that is awake", and "a company that shares with customers", KT&G is committed to creating a better future together with customers through responsible management.



Company Name and History

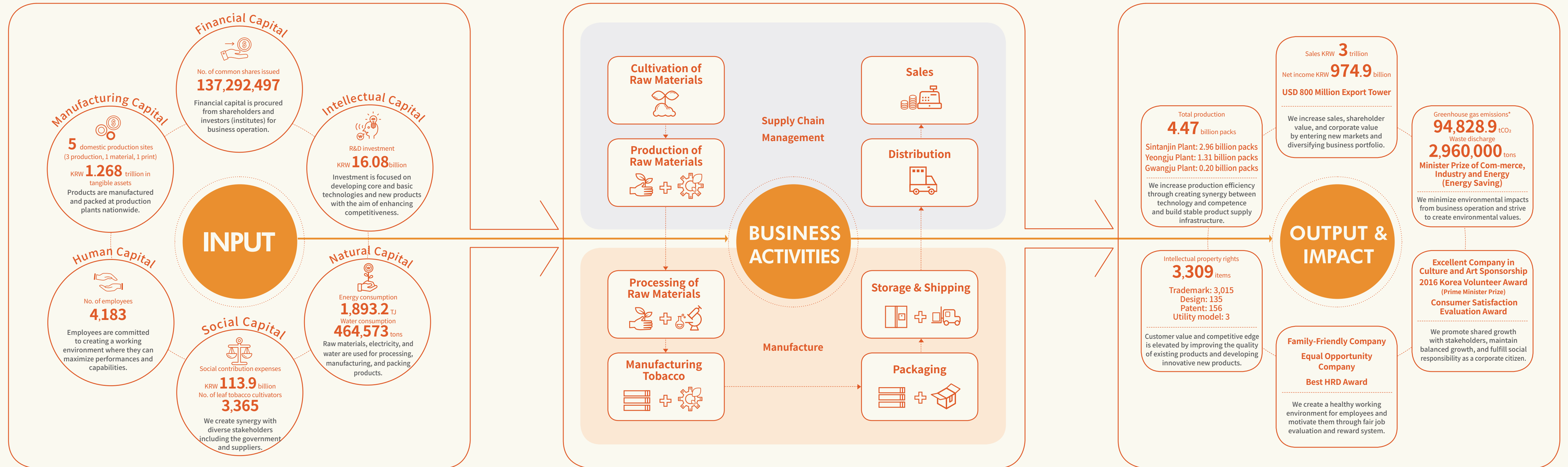
Official title of the company is "KT&G Corporation". The company was founded on April 1, 1987 as the "Korea Monopoly Corporation" under the "Korea Monopoly Corporation Act". The company changed its name to "Korea Tobacco & Ginseng Corporation" under the "Korea Tobacco and Ginseng Corporation Act" on April 1, 1989. In 1997, the company became a government-funded organization under the "Act on the Improvement of Managerial Structure and Privatization of Public Enterprises". At the same time, the corporation became a company limited by shares, to be governed under Commercial Law. On December 27, 2002, the company changed its name from "Korea Tobacco and Ginseng Corporation" to "KT&G Corporation".



VALUE CREATION MODEL

KT&G has been creating well-balanced performances in the aspects of economy, society, and environment through sustainability management activities.

External Environment



Key Figure in 2017

Sales growth (year-on-year)



Total assets growth (year-on-year)



ROA



Energy saving (in 2016, year-on-year)



Reduction of GHG emissions (in 2016, year-on-year)



New employees (year-on-year)



Investments in social contribution (year-on-year)

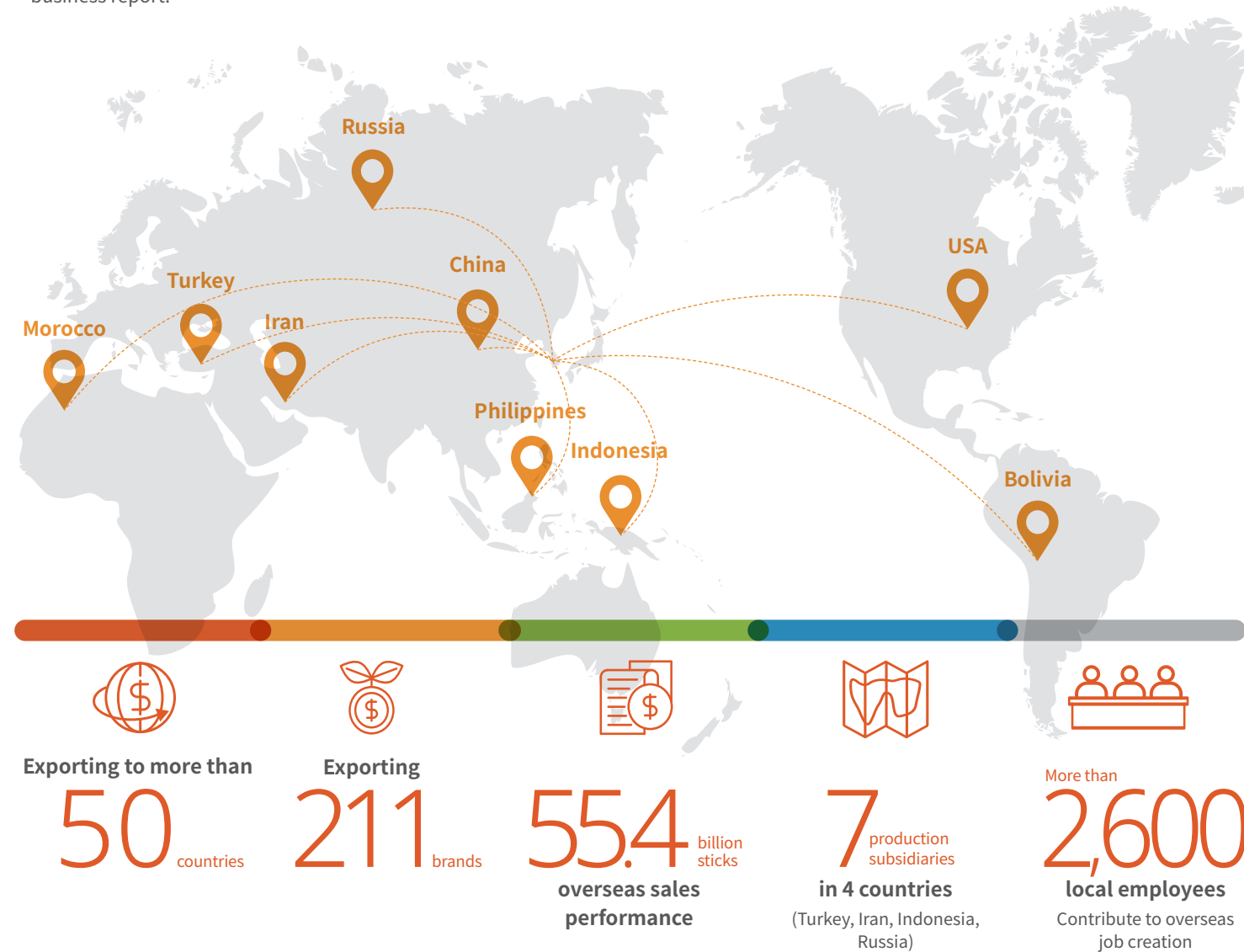


R&D performances (year-on-year)



GLOBAL NETWORK

KT&G produces major brands such as ESSE and BOHEM at overseas local plants to ensure better distribution in the global market. Our plants contribute to the development of local economy by employing local people. More details about our overseas business, please refer to our business report.



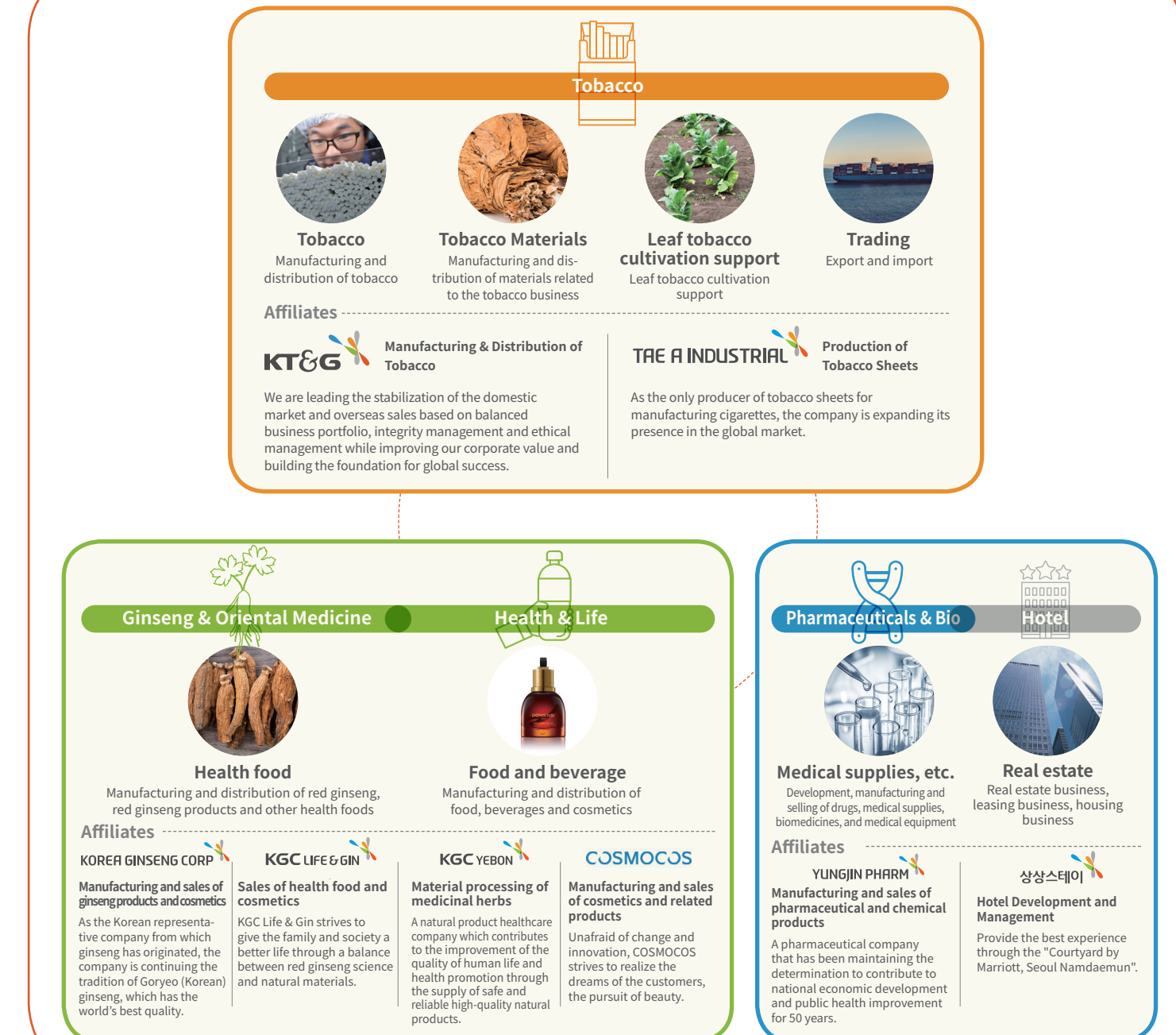
Overseas Organization

Country	Annual Production (100M sticks)	No. of Employees			Major Brands
		Resident Employees	Local Employees	Total	
Turkey	28	4	64	68	ESSE/PINE
Iran	8	3	15	18	ESSE/PINE
Russia	40	6	139	145	ESSE
Indonesia	47	20	2,272	2,292	ESSE/BOHEM
USA	-	3	60	63	TIME/CARNIVAL
China	-	3	52	55	ESSE

BUSINESS PORTFOLIO

KT&G takes the lead in developing the domestic pharmaceuticals technologies and improving people's health and the quality of their lives by engaging in the bio and health & beauty businesses. Our proactive global operation also contributes to the development of national economy. We are committed to vitalizing the ecosystem of related businesses to fulfill our responsibility as Korea's representative company.

Business Portfolio & Affiliates



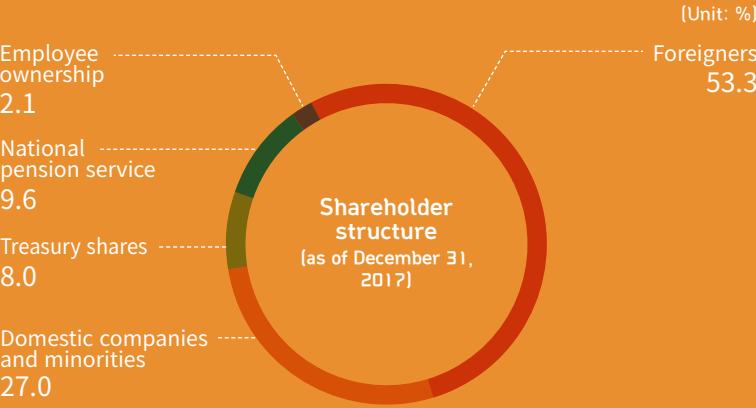
BUSINESS REVIEW

Financial Highlights

Operating performance (Unit: KRW in billions)			
Classification	2017	2016	2015
Sales	3,000	2,968	2,822
Cost of sales	1,099	1,048	947
Gross profit	1,901	1,920	1,875
Sales and administrative expenses	656	615	638
Operating profit	1,245	1,305	1,237
Net profit	975	1,087	988
Assets	8,675	8,469	7,449
Liabilities	1,531	1,890	1,553
Equity	7,144	6,579	5,896

Financial ratio (Unit: %)			
Classification	2017	2016	2015
ROA	11.2	12.8	13.3
ROE	13.6	16.5	16.8
Operating profit margin	41.5	44.0	43.8
Net profit margin	32.5	36.6	35.0
Earnings per share (KRW)	7,721	8,618	7,843
Payout ratio	51.8	41.8	43.4
Dividend per share (KRW)	4,000	3,600	3,400
Debt-to-equity	21.4	28.7	26.3

Investment Information



Stock price				
Classification	Unit	2017	2016	2015
Face value	KRW	5,000	5,000	5,000
No. of common shares issued	Common share	137,292,497	137,292,497	137,292,497
Weighted average stock price	KRW	107,503	115,013	97,450



Domestic Tobacco Business

Market Trend

The consumption of tobacco depends on the economy and season and smokers tend to stick to the brand they favor. In addition, the tobacco market is sensitive to such external factors as economic growth and government regulations.

Overall, in 2017, there were factors that caused market fluctuations including the introduction of images that warn against smoking and HNB (heat-not-burn) tobacco. Due to these factors, we preemptively responded to these changes and strengthened our market position by enhancing our strategic brands and meeting the demands of consumers with new products.

2017 Business Performance

Despite the challenging market conditions, we released new products including "RAISON Hyvaa", "THIS Africa Ice Jack", and "ESSE Change LiNN" and stayed ahead of our competition. As a result, our sales reached KRW 1.798 trillion with the market share increased to 60.6% by 1.4%p from the previous year. The five types of "ESSE Change" increased by 1.4%p making a strong contribution to the improved market share.

Speeding up the product development process and differentiation strategies allowed us to penetrate the HNB tobacco market with the HNB device "lii" and stick "Fiit".

In addition, we focused on optimizing our sales units to improve our efficiency in response to market changes by restructuring the jobs, relocating our workforce and diversifying the order and shipping methods. To ensure timely production and delivery of high-quality products, we further improved our technological expertise and expanded our production capacity. In response to increased demand for capsule-type products, we managed to enhance production and quality while optimizing the production facilities and improving the efficiency in our HR operation. As a result of these efforts, we produced 89.5 billion sticks in 2017, increasing our annual output by 600 million sticks. However, domestic sales declined to 43.5 billion sticks, a fall of 3.7% from the previous year.

Outlook

At KT&G, we are focusing our efforts in driving the sales of our strategic brands such as ESSE, RAISON, and BOHEM in the overseas market. Our plan is to reflect local demands and improve our brand awareness by building a local distribution channel.

In addition, we will increase our investment in the HNB tobacco sector and carry out marketing campaigns to meet the varying needs of consumers.

As part of our efforts to improve the quality of our products, we are going to conduct joint research with farmers to make sure that the quality of materials remains high.



Overseas Tobacco Business

Market Trend

As of the end of 2017, more than 55.4 billion sticks were sold in approximately 50 countries as a result of our aggressive overseas market strategy. However, overseas business environment is increasingly tough due to tightening regulations on tobacco as in the domestic market.

Nonetheless, KT&G is actively seeking for opportunities to enter overseas markets with greater demands for tobacco than the domestic market. Based on strict survey on local markets, we have delivered more choices to local customers by developing diverse products meeting their needs and launched special edition products with premium image. These efforts have resulted in achieving remarkable growth in new markets such as Indonesia, Taiwan, and Mongolia as well as the Middle East and Central Asian countries and evolving into world's fifth tobacco company.

2017 Business Performance

In 2017, tobacco exports totaled 47.1 billion sticks, an increase of 8% over the previous year, while sales grew 6% to KRW 878.5 billion with an operating profit of KRW 410.8 billion, a decrease of 2% from the previous year. This is mainly due to the success of our differentiated products including "ESSE MINI Slim" and capsule tobacco in the Middle East and Central Asia. In addition, the expansion of distribution channels in emerging markets, including Asia, Africa and Latin America along with our commitment to new market development and increased investment in the duty-free market contributed to our sales growth.

After exceeding domestic sales for the first time in 2015, the overseas sales reached 47.1 billion sticks in 2017, which is significantly higher than the domestic sales of 43.5 billion sticks. Thanks to this sales performance, KT&G was awarded the "USD 800 Million Export Tower" at the 54th Trade Day hosted by the Korea International Trade Association (KITA) in December 2017. Our overseas tobacco business achieved record high sales of more than KRW 1 trillion in 2017 by selling 55.4 billion sticks including sales of local subsidiaries.

Outlook

KT&G will continue to actively expand our business domain in order to solidify our status as a global company. We plan to increase our exports by developing various new products to expand our product portfolio. We will also promote our major brands and strategic products such as ESSE and BOHEM so that they can develop into global brands. Moreover, we plan to increase investments in markets with a high growth potential such as Central and South America and Africa in order to continue our expansion into overseas markets.



Ginseng Business

Market Trend

As the ginseng business is closely related to public health, building trust with consumers and maintaining stable production in consideration of the procurement of materials and maturation period are a key part of business. At KGC, we meet the expectation of consumers with the "CheongKwanJang" brand and signed a contract over the duration of the material procurement based on more than 110 years of experience and know-how in the industry. In addition, a stringent quality control process has been implemented for production facilities, distribution channels, and franchise system.

In 2017, there was uncertainty in our growth due to increased competition in the market, the enforcement of the Anti-Graft Act and the deployment of the THAAD. Despite these unexpected changes, we managed to demonstrate tangible performances through product diversification based on consumer trends, our competitive advantages, and active response to an aging population and increasing interest in health and well-being.

2017 Business Performance

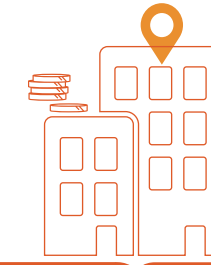
Despite the challenging market conditions, we managed to achieve remarkable results thanks to differentiated product competitiveness. After achieving KRW 1 trillion in sales for the first time in the industry in 2016, our sales in 2017 hit a record breaking KRW 1.2 trillion. Domestic sales took up 93% of our sales with overseas sales accounting for 7%.

At KGC, we take into consideration the lifestyle and age groups of our customers when developing new products. Our popular products include "Korean Red Ginseng Everytime" targeting the younger generation and "Women's Balance" targeting female consumers. In addition, "Good Base" made from materials selected from local regions such as red ginseng cultivated in Korea, Aronia in Poland, and blueberries in the U.S. was received with positive responses from consumers. The "Cheon Nok" brand, made from antlers produced in New Zealand also showed robust sales.

Our diversified business portfolio that includes the H&B Store "HUB" and new total health shopping mall "CheongKwanJang Mall" which opened in 2017 are expected to provide a solid foundation for our sustainable growth.

Outlook

In the domestic market, we are going to diversify business strategies based on unmatched technological expertise and product competitiveness. While reinforcing our market position through marketing campaign, localized promotional activities, and product development, we plan to optimize our business strategies in each country and increase sales in emerging markets.



Real Estate Business

Market Trend

In the real estate business, it is not easy to control supply and demand due to the characteristics of immobility. Its public and social nature faces a lot of legal restrictions. The market is also segmented by region, usage, and type of rights. This business is sensitive to consumer psychology and seasonal factors.

There are complex and diverse business categories such as construction and O&M (operation and management) and the market can be segmented into housing, office building, and hotel. Office building, factory, and logistics facility sectors are expected to stably grow on the back of economic recovery and GDP growth. Accommodation facilities such as hotel will also continue growth due to increasing foreign tourists. In response, KT&G promotes three strategies: "internalizing rental business & securing operation capability", "laying a foundation for fostering development projects", and "enhancing financial business portfolio".

2017 Business Performance

Our real estate business areas include rental, development, financial investment, and infrastructure for Group's target businesses. Major achievements in 2017 are as follows:

Despite sluggish market conditions, we were able to maintain vacancy rate at 3.0% with KRW 54.8 billion in sales and KRW 19.6 billion in operating profit thanks to aggressive marketing activities, CRM for lessees, and cost reduction. To ensure growth, we completed the Euljiro Tower remodeling project and achieved a 100% lease rate. In the development project sector, the Daegu Development Project achieved KRW135.2 billion in sales with KRW16.5 billion in operating profit on the back of proactive marketing activities and efficient project management. We also completed the masterplan for the land development project in Suwon with consideration for market conditions and the nature of land, and licensing process is underway. The Sejong Development Project is under construction after completing licensing process. Moreover, we are promoting the development of rental housing units with the purchase of the land near subway stations in Seoul.

At KT&G, we are building infrastructure by capitalizing on owned real estate to support target projects of the Group. Those include resort and training facilities in Busan and Jeju. We also engage in financing projects for real estate. In 2017, we signed 4 new deals for logistics center and office buildings at home and abroad (cumulative 24 projects) on the back of diversifying investment targets and developing promising properties. As a result, we achieved a total of KRW 21.7 billion in dividend income in 2017.

Outlook

Despite the economic downturn, we are looking for opportunities in the real estate market such as direct development and financing projects for office and business hotels based on our financial resources generated from the tobacco business and lands available for development to sustainably create profits. Our real estate business is expected to continue to generate profits based on the experience and know-how we have accumulated over the years.



Cosmetics Business

Market Trend

In 2017, Korean cosmetics companies faced tough challenges due to the THAAD issue and prolonged stagnant consumer demands in the domestic market. Entrance of pharmaceuticals and related companies caused fiercer competition, while products as Dermocosmetic and Cosmeceutical that combines cosmetics and pharmaceuticals enjoyed popularity with increasing demand for beauty and well-being. Moreover, the "K-BEAUTY" trend is firmly established in overseas markets and there is an increasing number of consumers who prefer multi-shops, online channels, and direct overseas purchase over select shops and duty-free stores.

2017 Business Performance

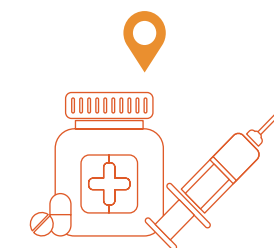
KGC acquired the cosmetic brand "Donginbi" in September 2016, and created three signature ingredients including red ginseng oil, red ginseng concentration, and red ginseng essence based on its exclusive technological expertise and know-how in red ginseng. Then, after major renovations on brand logo, concept, containers, and texture, we successfully launched new brands including 1899 Signature Oil, Donginbi Yun, and Donginbi Jin. To establish it as a premium brand, the distribution channels such as CheongKwanJang Road Shop, department stores and duty-free stores were remodeled while 8 new stores were launched on the first floor of department stores along with Lounge 1899 as a new distribution channel that differentiates itself with unique space design and service.

Particularly, we focused on raising brand awareness through experiential marketing for customers and active promotion that took a well-known actress "Han Ga-in" as the model for Donginbi. The first identification of antimicrobial ingredients of raw red ginseng and patent application helped enhance our brand value. We also built cosmetics manufacturing facilities to sharpen competitiveness. As a result, Donginbi gained a reputation as a premium red ginseng cosmetic brand.

COSMOCOS established companies in China and Hong Kong in February 2017 to target local customers and the Energy Factory brand strengthened its market leadership with its Men's BB cream through collaboration with Tottenham Hotspur. Being recognized for its quality and brand value, VPROVE Oil Paper Cream won first place in the Primer category of the Allure Award. The VPROVE brand has opened 25 stores including five direct shops and entered online shopping malls and department stores. Currently, we are preparing to introduce this brand to overseas markets while focusing on expanding sales channels and promotion in China and Southeast Asia. The renewed Milk Body Line reached 3 million in unit sales and became a hit in China.

Outlook

KGC plans to expand premium channels by launching new stores on the first floor of department stores and opening the "Lounge 1899" and pop-up stores to strengthen the position of Donginbi in the premium cosmetics market based on marketing strategies focusing on customer experience. COSMOCOS will continue to broaden its distribution channels to ensure easy access by VPROVE customers and become a global brand by targeting the Chinese market through local subsidiaries.



Pharmaceuticals Business

Market Trend

The pharmaceuticals market has been enjoying an annual growth rate of 4-5% due to rapidly aging populations at home and abroad. Market size demonstrates approximately KRW 1,200 trillion in the world and KRW 21 trillion in Korea (source: IMS healthcare in 2016 and KHIDI in 2017). The most noteworthy areas today include medical conditions afflicting the elderly such as dementia, paralysis, and Parkinson's disease as well as chronic diseases such as hypertension, diabetes, arthritis, rare diseases which are considered a niche market, and biopharmaceuticals. Moreover, medical expenses for improving health conditions are on the rise as the quality of life is increasing (source: KHIDI in 2017).

The characteristics of the domestic pharmaceuticals industry can be summarized in seven points: focus on domestically-produced finished goods, fierce competition between small manufacturers, government's regulations on entire process of clinical trial, license and permit, and distribution, dependence of doctors' choices instead of consumers (causing rebate issue), imbalance in information between suppliers and consumers (lack of rational choice), non-flexible pricing policy (less impact by economic conditions), and protection of intellectual properties (technology-intensive industry).

The government has been proactive in supporting innovative pharmaceuticals companies, forming an industry-friendly financing ecosystem by creating specialized funds, and encouraging entrance into the global market through G2G cooperation (joining the ICH, inviting health policy and licensing officers of emerging countries to training programs, dispatching health and medical delegates, and providing consultation for exporting). The government's R&D investment reached KRW 233.4 billion in 2016 (source: KHIDI in 2017).

2017 Business Performance

We have focused on sales activities and the introduction of licensed products for five major diseases (including chronic diseases such as circulatory disease) in the domestic market, while strengthening exports and developing overseas markets centered on Japan. In 2017, our sales reached KRW 195 billion¹⁾, 35%²⁾ of which came from overseas markets.

Our R&D division sold new drug for rare disease (targeting mitochondria) to NeuroVive in Sweden at a loyalty of USD 54 million and USD 3 million as a down payment in May 2017. In November, we successfully completed the phase 2 of the overseas clinical trial for the COPD (chronic obstructive disease), expecting technology export.

In the production sector, the Namyang plant was approved as an industrial complex on land covering 45,000m² in August, which will serve as a foundation to enhance our competitive in manufacturing. In December, Yungjin Pharmaceutical received the "USD 70 Million Export Tower" (hosted by KITA), demonstrating its technological prowess and global presence. Moreover, we established the Compliance Program (CP) to improve business constitution and fulfill our social responsibility.

Outlook

Yungjin Pharmaceutical will make a concerted effort to evolve into a leading pharmaceutical company with the responsibility as a member of KT&G Group and global competitiveness. The goal for 2018 is to reach KRW 200 billion in sales and develop new drugs through increasing investments in R&D. To this end, we plan to introduce competitive licensed products, increase the ratio of profitable products, expand R&D pipelines and diversify export strategies.

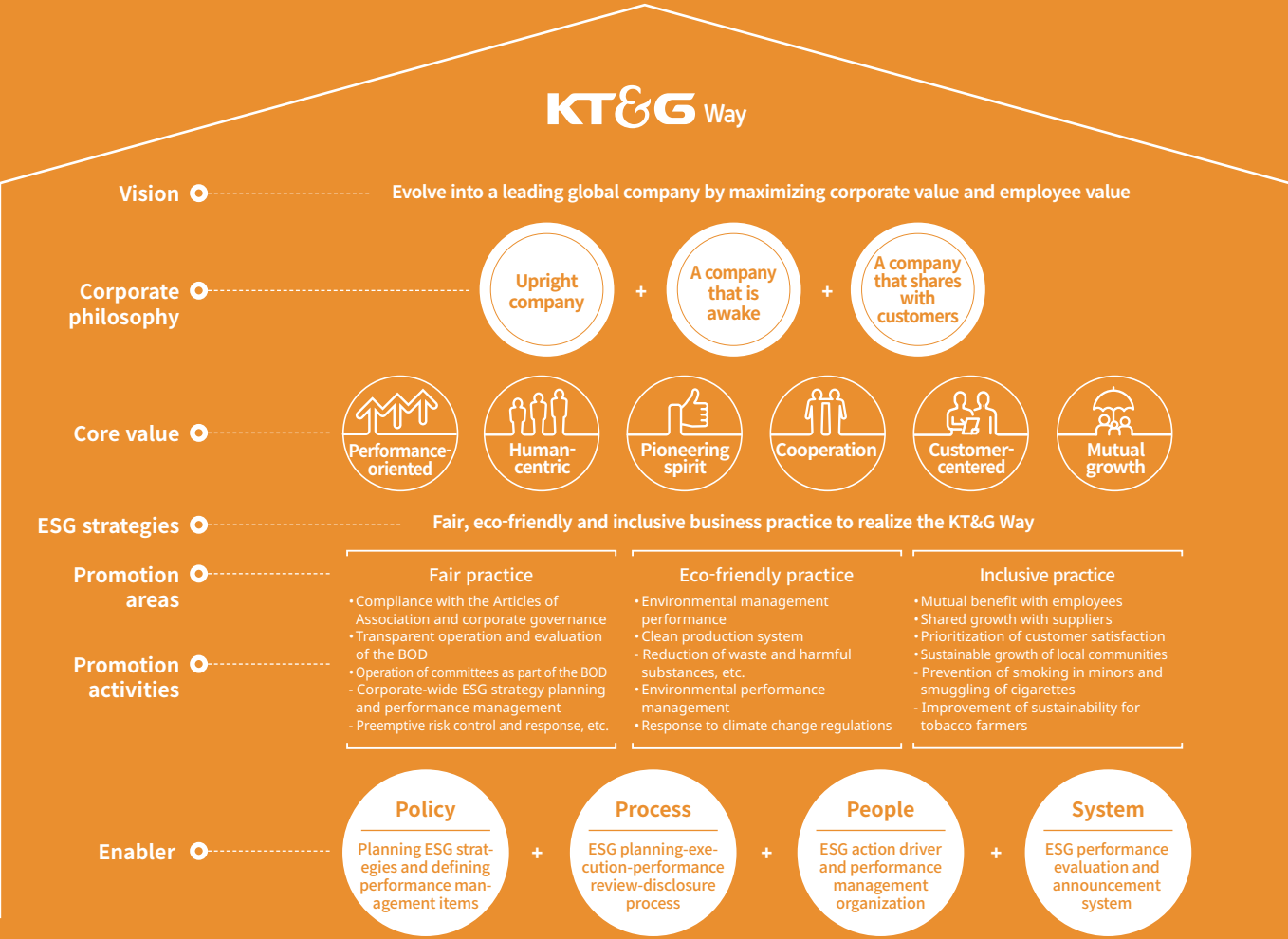
¹⁾ Based on net sales of Yungjin Pharmaceutical (before adjustment)

²⁾ Based on net export of pharmaceutical products and net export of pharmaceuticals compared with net sales of Yungjin Pharmaceutical

ESG PERFORMANCE REVIEW

ESG Strategy

In pursuit of becoming a global leader, we established strategies in relation to environment, society and governance in order to maximize both financial and non-financial values.



ESG Activities

At KT&G, all employees practice the KT&G Way, build fair governance to maximize corporate value, operate businesses in an eco-friendly way, and embrace various stakeholders to achieve sustainable growth.

Fair business practice

We will put emphasis on stakeholder interest by establishing responsible management system centered on the BOD consisting of independent non-executive directors. The BOD will serve as the top decision-making body for the company's environmental and social agendas included in the Rules of the Board of Directors in accordance with the applicable laws and Articles of Association.

Eco-friendly business practice

Recognizing environmental management as an important social responsibility, we will meet the increasing demands for environmental protection and improve our corporate value in the long run. In order to take a more integrated and systematic approach in environmental management, we will develop and apply various eco-friendly technologies and manage environmental impact throughout our business practice to support sustainable growth of our society.

Inclusive business practice

Serving roles as a corporate citizen, we are committed to making our society a better place to live in. In addition to maximizing the values for our customers and employees, we plan to establish a cooperation system for shared growth with stakeholders including sustainability management, social contribution activities, and compliance with domestic and overseas regulatory requirements.

KT&G Way

At KT&G, we are dedicated to implementing the KT&G Way in line with our business strategies and corporate culture and internalize it to create sustainable value with the aim of achieving the vision of evolving into a leading global company by maximizing corporate value and employee value.



Corporate Value

The company pursues becoming a global player by maximizing corporate value. To this end, in the tobacco business, we will focus on proactive investments in developing differentiated new products, enhancing quality, and exploring overseas markets as well as promoting qualitative and quantitative innovation, which will help us solidify the foundation for value creation. Ginseng and health food businesses will promote portfolio diversification to become future growth engines. In the pharmaceuticals and cosmetics sectors, we will secure differentiated competitiveness by reinforcing business efficiency and synergy and be proactive in seeking for new business opportunities.

Employee Value

Employee value can be maximized when individual efforts for demonstrating their ability and intra-company systems are well integrated. To this end, we are pursuing human-centric management philosophy which is in line with the global trend. We will also build a culture of trust where the creativity of employees can be maximized based on open-minded communication and self-responsibility approach.

Realizing Corporate Vision



Upright Company

MATERIAL TOPIC 1: ETHICS_Ethical Business Operation



Why is this important?

At KT&G, ethical management means not only strictly complying with regulations and laws, but also fulfilling our responsibilities and duties to create values for stakeholders while adhering to the highest ethical standards and transparency. It serves as the foundation for us to step up as a sustainable global leader. Therefore, we are going to ensure full compliance with the Charter of Ethics and Code of Ethics in everything we do.

How to manage the topic

Since 2003, we have reinforced our ethical management to make sure that our employees and executive officers fulfill their responsibilities and comply with corporate philosophy of "Upright Company", "A Company That Is Awake", and "A Company That Shares with Customers". In 2016, the company launched the Ethics Management Audit Team to accelerate the implementation of business ethics, building a strict ethical management system.

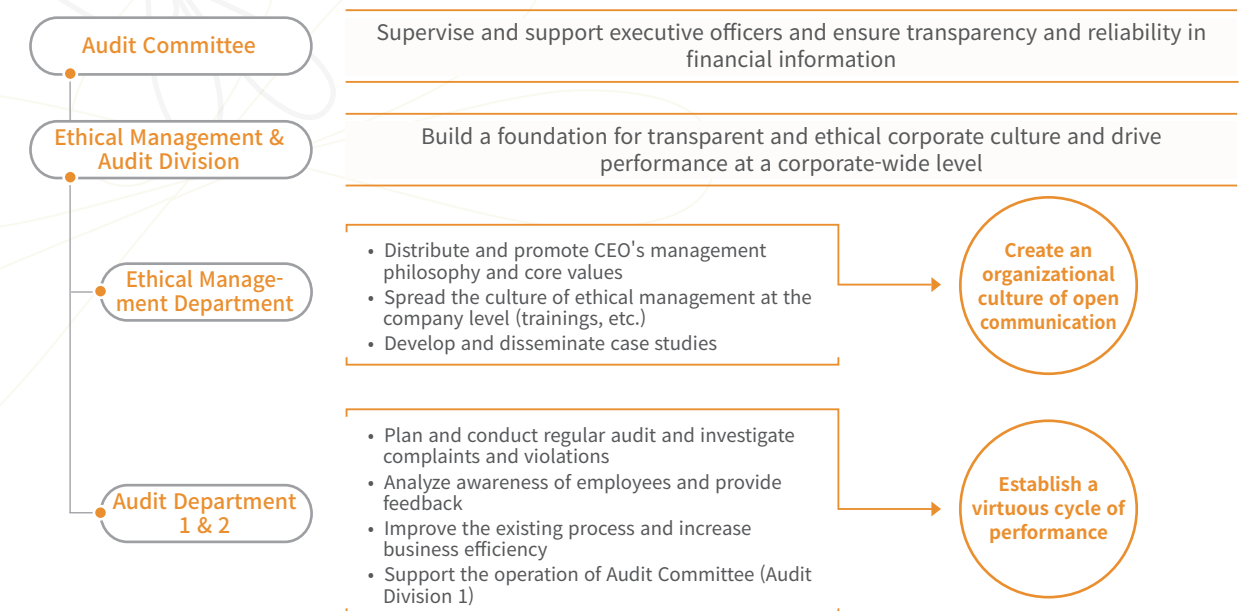


Materiality Matrix_ Upright Company



Ethical Management Organization

The Ethical Management & Audit Division was established under the Audit Committee in order to respond to ethical management issues in a prompt and efficient manner. Serving as a control tower of ethical management, the team engages in diagnosing and spreading ethical management, monitoring business risks, and investing and responding to violations.



Ethical Management Promotion System

KT&G operates the Charter of Ethics and Code of Ethics as standards for upright behaviors and value judgement with which all employees should comply. The Ethics Management & Audit Division plays a key role in encouraging all employees to implement business ethics and inspecting the status of ethical management practices by frequently checking business issues and work processes.

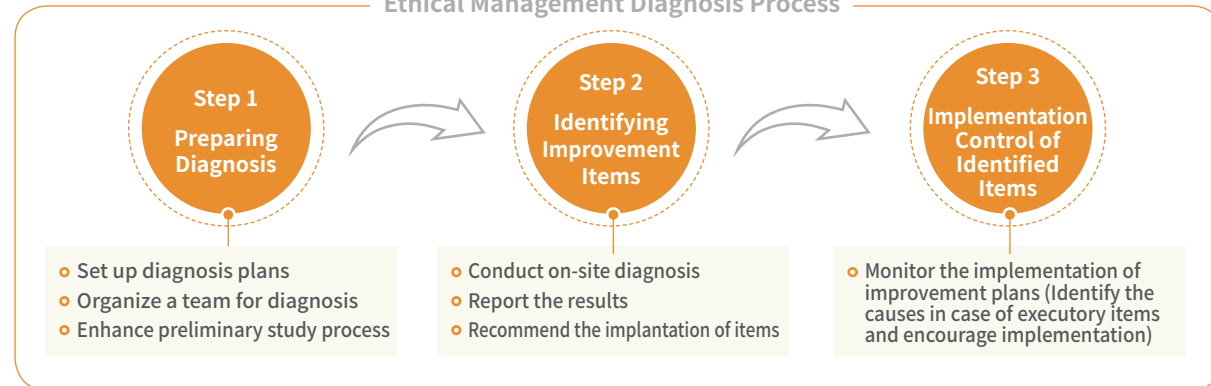




Management Diagnosis

Management diagnosis process consists of three steps: preparation, diagnosis and identification of improvement items, and implementation control of those. The history of identified items, improvement process, and follow-up results is strictly managed. Executory items are given on the table for consultation and mediation between relevant divisions for improvement.

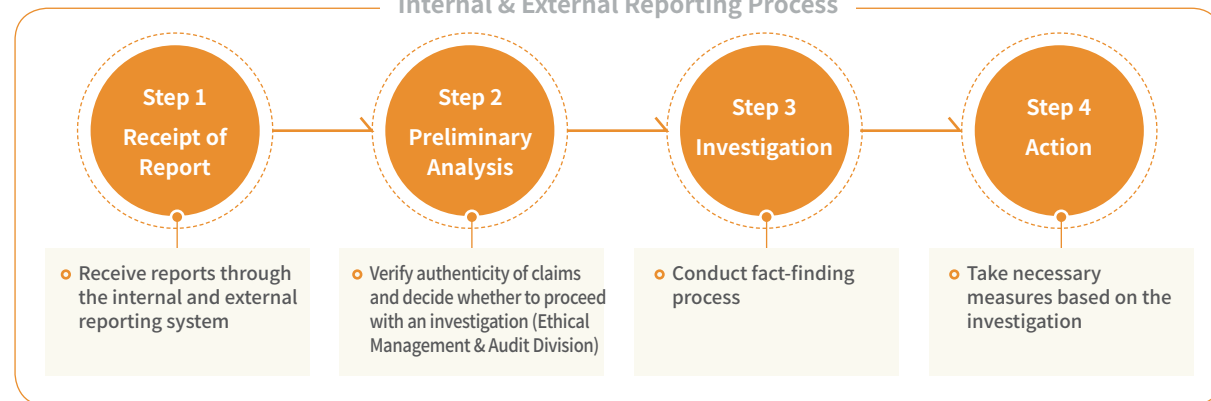
Ethical Management Diagnosis Process



Internal & External Reporting System

KT&G operates a reporting system through which any misconduct and violation of the Code of Ethics can be reported. The protection of whistleblowers is stipulated in the Code of Ethics.

Internal & External Reporting Process

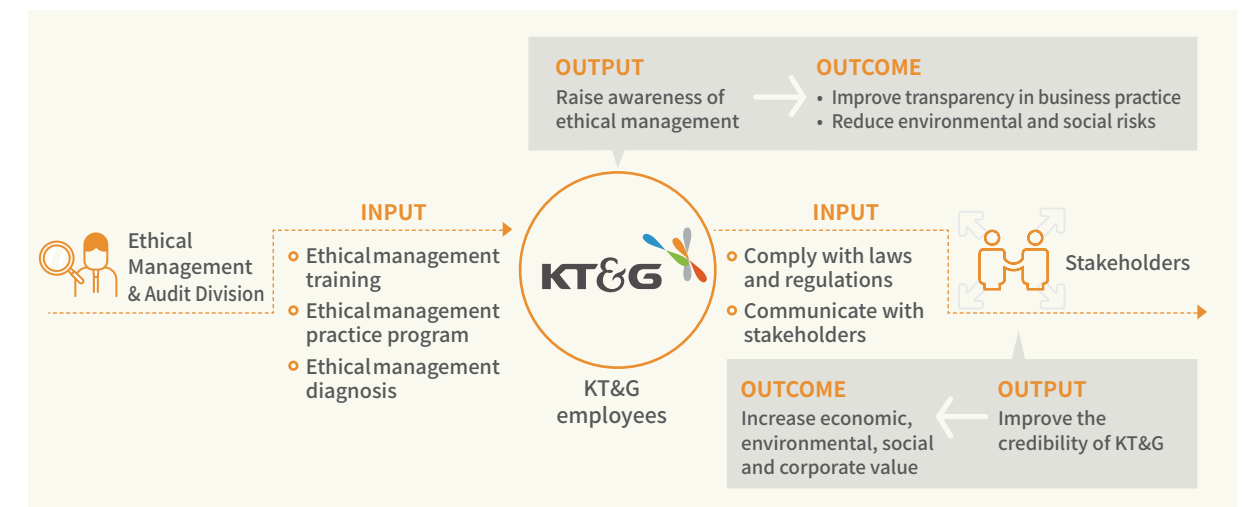


Dissemination of Ethical Management

We are committed to preventing any unethical conduct in the course of our business activities. We ensure full compliance with safety and health standards and working hours recommended by the ILO (International Labor Organization) as well as applicable laws and regulations while promoting the fair and transparent business practice in all countries and regions in which we do business. In addition, our dedicated team of ethical management works together with our suppliers and partners to prevent unethical labor practices such as child labor and forced labor.

Effect of Ethical Management

Through annual practice programs and frequent diagnosis programs, we raise awareness of ethical management for all our employees and conduct employee awareness surveys to measure their effectiveness on a regular basis. We plan to actively implement ethical management process to build trust with our stakeholders and to continue to improve our performance in the areas of economy, environment and society and increase our corporate value.

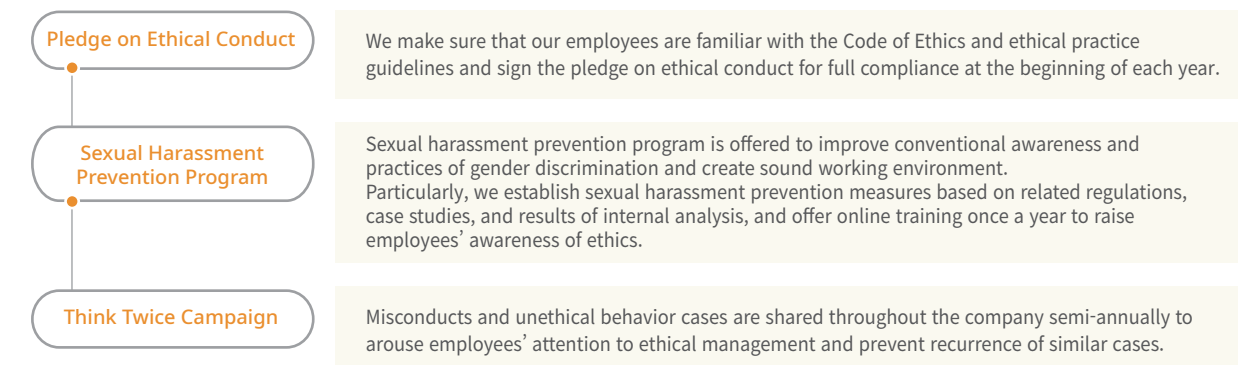


Plan for the Future

In order to spread ethical culture throughout the company, we conduct various programs including pledge on ethical conduct, sexual harassment prevention program, and "Think Twice" campaign for our employees.

Considering the expansion of our global network into China, Turkey and the U.S. as well as Indonesia, Iran, and Russia, we will continue to develop the Code of Ethics and action programs to be adopted to local business sites in the world.

Ethical Management Practice Program





Compliance

The entire process of tobacco business from production and licensing to manufacturing, distribution, and sales is strictly regulated by the government. Advertising for consumers is subject to restrictions. In this respect, as compliance is crucial for our business practice, we take a systematic approach to compliance management based on strict standards and procedures.

Compliance Operation System

For more efficient compliance practices, we operated the Legal Department and Compliance Officer system. In addition, we align our legal information system to the internal portal to keep our employees updated on the subject while providing preliminary review service on legal matters.

Main Responsibilities of the Legal Department

- 1. Legal consultation: Review legal risks in advance and propose necessary response measures to minimize risks
- 2. Contract review: Review contracts before signing to reduce the risks in legal matters
- 3. Litigation: Collect and establish response plans and strategies in a timely manner in case of litigation against KT&G
- 4. Intellectual property rights: Protect intangible assets by securing legal rights to our research results

Compliance Activities & Performances

KT&G Anti-Graft Act Compliance Guidelines

In response to the enforcement of the "Improper Solicitation and Graft Act" in 2016, we established "KT&G Anti-Graft Act Compliance Guidelines" to prevent violations and misconducts in September 2016. In addition, in December 2017, we published and distributed a handbook to address the practical elements of the law for our employees.

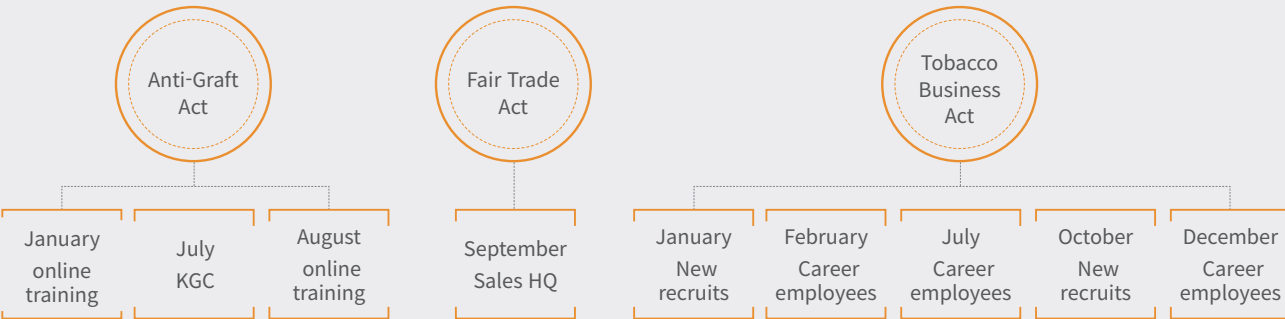
Compliance Management Review

In order to raise the awareness of fair business practice and compliance, we review our progress and conduct trainings on a regular basis.

Compliance Training

We also raise the awareness of compliance among our employees through training programs based on jobs and responsibilities. As part of this initiative, we implemented training programs with focus on enhancing compliance practices in 2017.

Compliance Training



Legal Information System

An online legal information system was established to provide consultation, prevent legal risks, and improve work efficiency in our business practice. It is linked to the internal portal to offer easy access to our employees and creates additional benefits of reducing the cost of publication and document management. In 2017, we conducted reviews on 1,765 legal cases related to our business practice.

KT&G Legal Information System Composition



Plan for the Future

Regulatory requirements on fair competition, anti-corruption, and environmental impact as well as tobacco products have become increasingly more complex and stringent. In response, we are going to identify legal risks in advance and cope with them in an effective and consistent manner.



Risk Management

The growing uncertainty in the business environment has a significant impact on corporate sustainability. In response, KT&G has established corporate-wide systematic risk management policies and procedures to mitigate risk factors and minimize their impact, building a solid foundation for sustainable growth.

Risk Management Organization

The Strategy Committee and Investment & Development Committee under the BOD are the top-level organizations that inspect financial and non-financial risks and make decisions on countermeasures to mitigate major risks.

Strategy Committee

The Strategy Committee reviews our corporate identity, vision and philosophy as well as mid- to long-term business plans. It is also in charge of improving the BOD operation standards and reviewing amendments to the Articles of Incorporation or the BOD Operation Regulations. In addition, it reviews our legal and institutional risks and develops countermeasures against major risks.

1. Composition of the Strategy Committee (as of December 2017)

The Strategy Committee consists of three non-executive directors (Choi, Kyung-Won, Song, Op-Kyo, Lee, JuneQ) and two executive directors (President & CEO Baek, Bok-In, Vice President Kim, Heung-Ryul). The chairman of the BOD (Choi, Kyung-Won) serves as the chairman of the committee for one year in accordance with the Rules of the Board of Directors.

2. Activities of the Strategy Committee in 2017

The Strategy Committee meeting was held on December 7 to review and decide on the mid- and long-term management strategy and business plans and budgets for 2018.

Major Resolutions of the Strategy Committee in 2017

Date of Meeting	Agenda	Vote	Committee Members' Vote				
			Choi, Kyung-Won	Song, Op-Kyo	Lee, JuneQ	Baek, Bok-In	Kim, Heung-Ryul
December 7, 2017	Agenda 1: Mid- and long-term management strategy and business plans and budgets for 2018	Passed as proposed (delivered to the BOD)	Agreed	Agreed	Agreed	Agreed	Agreed
	Agenda 2: Budget plan for 2018	Passed as proposed (delivered to the BOD)	Agreed	Agreed	Agreed	Agreed	Agreed

Investment & Development Committee

The Investment & Development Committee is responsible for reviewing the borrowing equivalent to 10% of equity, disposal and acquisition of properties exceeding 10% of the capital or KRW 50 billion, or investments exceeding KRW 20 billion or 5% of the capital. Other roles include developing major projects with growth potential, checking and managing risks of investment projects, and deciding social contribution projects exceeding KRW 500 million. Furthermore, it manages obligations under Commercial Law such as the establishment, relocation and retirement of branches.

1. Composition of the Investment & Development Committee (as of December 2017)

The Investment & Development Committee consists of three non-executive directors (Youn, Hai-Su, Lee, Eun-Kyung, Rho, Joon-Hwa) and two executive directors (President & CEO Baek, Bok-In, Vice President Kim, Heung-Ryul). The CEO was appointed as the chairman of the committee at the 6th BOD Meeting in 2017.

2. Activities of the Investment & Development Committee in 2017

In 2017, the Investment & Development Committee was held twice and decided the relocation of the branch office and loans to employees for the investment in ESOP.

Major Resolutions of the Investment & Development Committee in 2017

Date of Meeting	Agenda	Vote	Committee Members' Vote				
			Baek, Bok-In	Youn, Hai-Su	Lee, Eun-Kyung	Rho, Joon-Hwa	Kim, Heung-Ryul
July 27, 2017	Agenda 1: Relocation of the branch office	Passed as proposed	Agreed	Agreed	Agreed	Agreed	Agreed
October 26, 2017	Agenda 2: Loans to employees for the investment in ESOP	Passed as proposed	Agreed	Agreed	Agreed	Agreed	Agreed

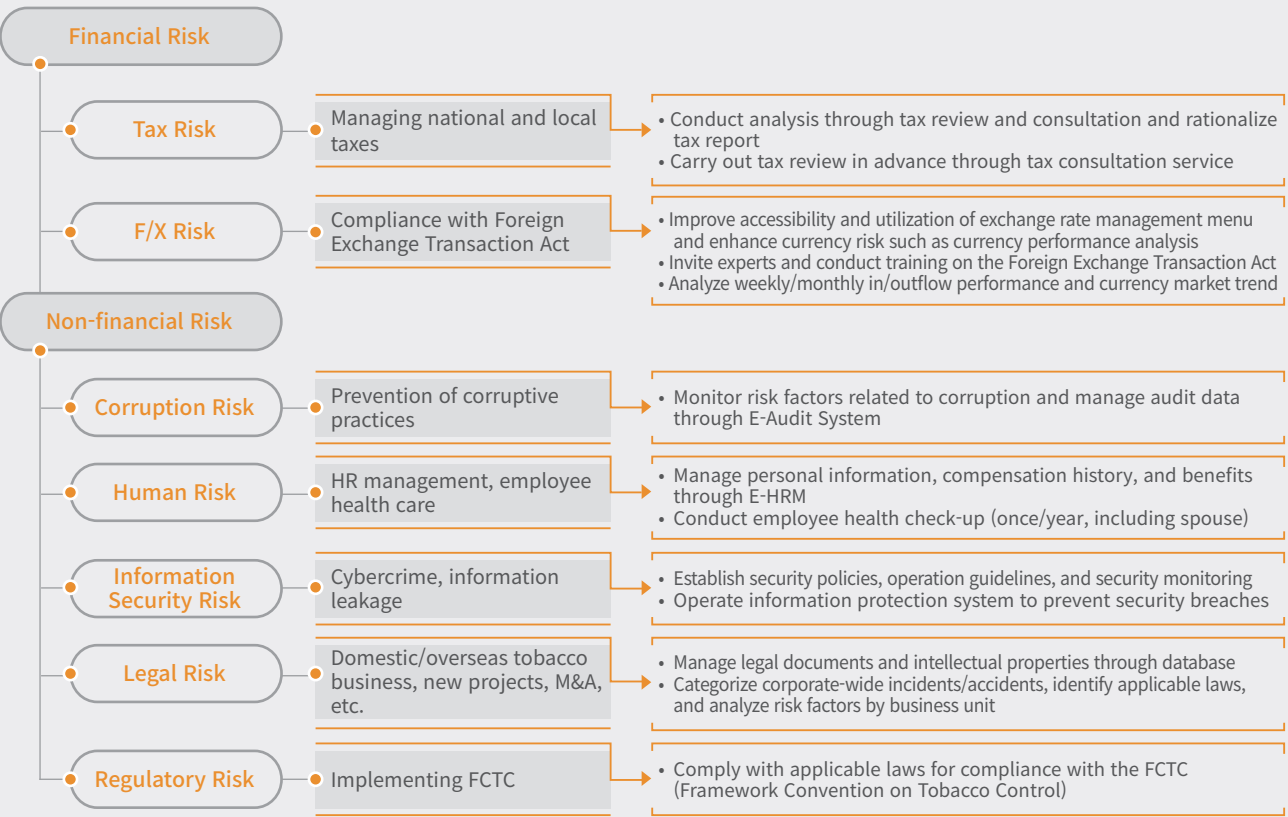
Plan for the Future

In response to financial risk, we are monitoring the status of financial transactions and reducing operational risks through Fund Manager Council while ensuring transparency in transactions. We are also identifying potential risks involving exchange rate and price fluctuations such as market risk, credit risk, and liquidity risk, and are working to eliminate or reduce it to an acceptable level.

In addition, various non-financial risks such as corruption, legal proceedings, and government regulations are categorized by type, and countermeasures are established while the compliance of risk management policies and procedures and the risk exposure limit are under review by our internal auditor.

At KT&G, we will continue to use our risk management system to mitigate any uncertainties in our business practice.

Countermeasures to Risk Factors





Stakeholder Communication

It is important for sustainability management to identify the expectations and demands of stakeholders and incorporate them in business practices. To this end, we defined stakeholder groups in consideration of their impacts and importance in our management activities and listened to opinions. In addition, we provide a comprehensive overview of our business performances and management activities through this report while operating communication channels based on the characteristics of each stakeholder group to disclose our corporate information as required by stakeholders.







Communication by Stakeholder Group

We categorize our stakeholders into shareholders & investors, government, local community, suppliers and customers and maintain close communication with them as part of our efforts to forge solid relationships.

Plan for the Future

KT&G engages in not only face-to-face communication with stakeholders through events and programs such as general shareholders' meeting, seminar, workshop, plant tour, and volunteer service, but also written communications including business report, sales report, and public disclosure. By focusing on programs such as grievance handling system, complaints handling process, Imagination Fulfillment Division, and prosumer activities, we identify our stakeholders' needs and potential complaints.

Going forward, we will continue not only to disclose our business information in a transparent manner to help stakeholders better understand KT&G, but also to run stakeholder communication programs to reflect their opinions in business activities.

Stakeholder	Definition	Communication Channels	KT&G Activities
 Shareholders & Investors	Stakeholders who provide capital needed for business operation and want to invest in companies with sustainable growth potential	<ul style="list-style-type: none">• General shareholders' meeting• Performance evaluation• Business report• Website	We share information about sustainability management activities with shareholders and investors through the IR Department under the Strategy & Planning Headquarters and collect feedback for improvement.
 Government	Stakeholder who oversees and monitors corporate activities to make sure they fulfill their legal and social responsibilities and control legal and regulatory environment	<ul style="list-style-type: none">• Conference and seminar about industrial policies• Sales report• Public hearing• Advisory council meeting	With the participation in the government's decision-making process, we comply with the laws throughout our business operation and sustainability activities.
 Local Community	Local residents and people who are interested in our business practice. Their supports and cooperation are considered important assets to our operation.	<ul style="list-style-type: none">• Employee volunteer activities• Sangsang Fund• Sangsang Madang• Welfare Foundation & Scholarship Foundation• Supports for farmers	The Social Contribution Office of the Sustainability Management Headquarters takes the initiative in fulfilling social responsibility and contributing to solving social issues by operating volunteer groups and Sangsang Fund.
 Employees	As key stakeholders who are responsible for our business activities, employees desire to communicate with the company on stable and fair employment. They also want to have safe, healthy work environment and their performance is evaluated in a fair and transparent manner.	<ul style="list-style-type: none">• Labor-Management Council• Grievance handling system• CSR training• Intranet• Imagination Fulfillment Division	The Human Resources Management Office of the Management Support Headquarters leads to create safe working environment and raise employees' awareness of sustainability management with the aim of encouraging their voluntary participation.
 Suppliers	Stakeholder who provides production facilities, manpower, and technological expertise. It is important to build fair, transparent business relationship and develop their expertise.	<ul style="list-style-type: none">• EDI• Complaint handling process• Supplier workshop• Supplier support program	We help suppliers develop technologies and enhance their competence by offering consultation through the Leaf Tobacco & Procurement Headquarters and provide farmers with a variety of benefits for their stabilization of living.
 Customers	Stakeholder who purchases and uses our products and provides feedbacks. It is essential to consistently communicate with them about information and value to offer products and services that satisfy them.	<ul style="list-style-type: none">• Public disclosure• Sales report• Reporting center• Plant tour• SNS• Prosumer activities• Satisfaction survey on new products	KT&G communicates with customers through the Marketing Headquarters faithfully implements CSR activities meeting customer expectations, and strives to develop high-quality products.

A Company That Is Awake

MATERIAL TOPIC 2: R&D_Enhancing Global Competitiveness through R&D



Why is this important?

In any industries, R&D is considered as a key activity for developing and commercializing intellectual properties in order to gain competitive advantages in the global market and the tobacco industry is no exception. As tobacco products are closely related to customers' lives, we have to reflect their demands in our practice and make sure to provide safe and pleasant experiences. In addition, as the only buyer of leaf tobacco grown in Korea, it is our duty to invest in developing cultivation techniques to increase the competitiveness and sustainability of our farmers.

How to manage the topic


KT&G is proactive in investing in R&D activities to strengthen technological competitiveness and profitability. Our R&D investment focuses on analyzing existing products as well as developing new products and technologies to ensure higher corporate value.

Materiality Matrix_ A Company That Is Awake



R&D Organization

KT&G R&D Center was established in March 2002 by integrating the Korea Ginseng and Tobacco Research Institute. It consists of 4 research labs (Product Research Lab, Future Technology Research Lab, Analysis Lab, Next-generation Product Lab) and one R&D Planning Team.

LAB	AREAS OF RESEARCH
 Product Research Lab	Develop new products and improve existing products based on customer needs
Future Technology Research Lab	Develop future technologies and conduct basic research on materials and flavoring
Next-generation Product Lab	Develop technologies for next platform products
Analysis Lab	Analyze product substances and develop analysis technologies (certified by KOLAS)
R&D Planning Team	Establish R&D strategies and goals and manage R&D projects

Overseas R&D Activities

Joint R&D activities are carried out at the PT Trisakti Purwosari Makmur, the Indonesian tobacco company we acquired in 2011, by dispatching our research team. By doing so, we accumulate know-how and technologies needed for targeting local markets and the subsidiary secures R&D resources and infrastructure.

In addition, in order to secure access to the Chinese tobacco market and build a foundation in the Chinese tobacco industry, we are organizing a technology exchange seminar with the R&D Center of the China Tobacco, CNTC.





Plan for the Future

In 2017, we carried out 63 research and development projects including new product development for global markets, new materials development as part of differentiation strategy, and next-generation product technologies. Our R&D Center will continue to develop core technologies and new products for domestic and overseas markets while improving existing products and developing next-generation products and technologies to expand our market share. In addition, we will continue our research efforts with a focus on analytical techniques and KS standardization of analytical methods.

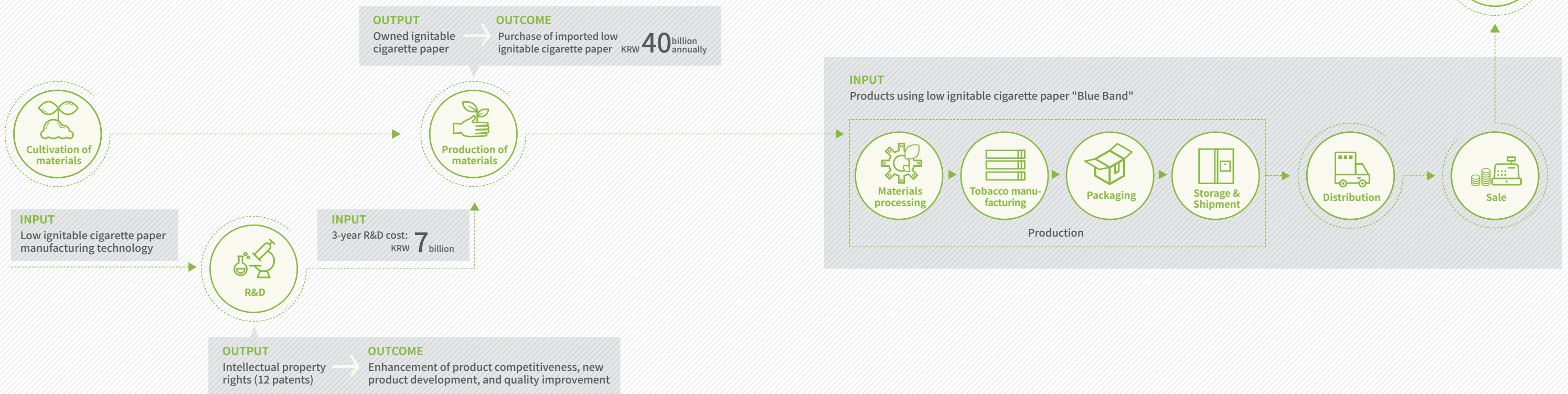


CASE STUDY

Development and Effect of Low Ignitable Cigarette Paper

By focusing on R&D, KT&G secures intellectual property rights and strengthens product competitiveness, maintaining dominant market share and developing new markets.

For example, as a result of this commitment, we developed the technology for manufacturing "Blue Band", the low ignitable cigarette paper, in 2013 and applied it to all our products in July 2015. Approximately KRW 7 billion has been invested in this R&D project for 3 years since 2011. This technology has acquired 12 patent rights and manufacturing technology and one patent is pending. The localization of low ignitable cigarette paper has helped us save KRW 40 billion annually as foreign low ignitable cigarette paper is 5 times more expensive.





Green Management

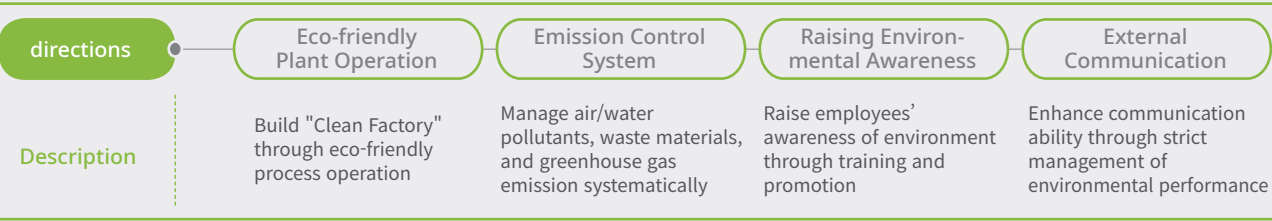
In response to increasing social demands for environmental management due to climate change and global warming, KT&G is managing environmental impacts throughout entire business processes based on the environmental management system while developing and applying eco-friendly technologies.

Environmental Management Organization

In order to take a more systemic approach in our environmental management, we have established the Green Management Division which takes charge of energy and environmental work process. The division plans for energy efficiency of our plants and reduction of greenhouse gas while responding to government policies and regulatory requirements on climate change, energy consumption, greenhouse gas emission and chemical control.

Environmental Management System

As part of our eco-friendly management initiatives, we are engaged in various environmental protection programs including eco-friendly plant operation, emission control, awareness improvement, and external communication.



Environmental Management Activities & Performance

KT&G is committed to saving resources and reducing greenhouse gas emissions by developing eco-friendly materials and investing in more efficient facilities. These efforts not only reduce our costs but also contribute to the government's response to climate change, leading to the enhancement of our long-term value.

Energy Efficiency Project

For more energy and cost-efficient operation at our 4 nationwide plants, we have established a management system while continuing various energy-saving initiatives including maximum power surveillance system, replacement with more efficient machinery, and installation of LEDs in workplace.

Energy Efficiency Programs & Performance by Plant

Plant	Activities	2017	
		No. of cases	Savings (KRW 100 million)
Sintanjin Plant	Improve the efficiency of cooling water pipes, recycle heated flash dryer water, shut down energy supply to non-operating facilities on time, operate facilities with large capacity more efficiently, etc.	4	1.8
Gwangju Plant	Replace one turbo freezer	1	0.6
Total		5	2.4

Establishment & Operation of Low Carbon Green Lines

KT&G works hard to create new value through environmental management. For example, we installed 804m of steam drainage pipes to reuse the steam energy generated by Novelis Korea Co., Ltd. located near Yeongju Plant and managed to save 329,000 tons of gas energy amounting to KRW 250 million per year and reduce 728 tons of greenhouse gas emissions.

Development of Eco-friendly Products

As a part of our eco-friendly quality management, we have developed eco-friendly paper to reduce pulp consumption and greenhouse gas emissions as well as removed vinyl materials from package. In addition, the development of biodegradable film enabled us to reduce time for decomposing products from 100 years to less than 10 years.

Efforts for and Effect of Eco-friendly Product Development

Classification	Areas of Improvement	Effect
Improvement of packaging material	Replaced vinyl cases with paper cases with low pulp consumption	Saved 1,500 tons of pulp per year
Improvement of inner wrapping paper within cigarette packs	Developed recyclable eco-friendly paper to replace aluminum material	Saved 850 tons of aluminum per year
Usage of recyclable pulp	Recycled paper to produce softened paper and cardboard	Saved 400 tons of pulp per year
Oxidative biodegradable OPP film	Developed eco-friendly film with short decomposition period	Reduced environmental impact by the burial of wasted vinyl

Response to Climate Change

We take various initiatives to protect environment and reduce greenhouse gas emissions while meeting government policies and regulations on climate change. Since being registered for the emission trading system implemented in 2015, we have established a greenhouse gas inventory and built a system to manage the energy used for plant operation more efficiently.

Environmental Communication

We disclose the amount of energy and water resources we used as well as the emission of greenhouse gas and waste material through our sustainability report in a transparent manner. In addition, Sintanjin Plant and Yeongju Plant organize tours to demonstrate our eco-friendly production facilities to the public.

Energy Efficiency Business Enterprise Award

Our Gwangju plant reduced 116,852 TOE of energy by changing the air compressor dryer system at the site and saved about KRW 120 million per year, which resulted in winning the Minister Prize of Trade, Industry and Energy at the Energy Efficiency Business Enterprise Award hosted by the Korea Energy Agency.

Plan for the Future

We will continue to create environmental values. To this end, comprehensive analysis of current environmental activities will be implemented to identify the areas of improvement in environmental management and eventually enhance our corporate competitiveness.

A Company That Shares with Customers

MATERIAL TOPIC 3: GWP_Great Workplace



Why is this important?

Employees are the most fundamental source of creating corporate value. As the performance of a company depends on its employees, it is crucial to keep them satisfied in their jobs. In this regard, we make sure that our employees are happy and improve their expertise and performance by creating a healthy work environment.

How to manage the topic

KT&G helps employees pursue healthy work-life balance and build a corporate culture based on trust through various communication channels among organizations.

Materiality Matrix_ A Company That Shares with Customers



HR Culture

We recognize that our employees are one of the most valuable assets for our future and recruit talented individuals without discrimination based on our core value of "I am C.E.O." With performance and job-oriented HR management philosophy in place, we promote a fair HR culture with a focus on equal opportunity to improve the expertise of our employees, assign jobs based on their individual strengths, and provide the CDP (Career Development Plan) to increase their job performance and satisfaction.

KT&G People

I am **CEO**

Challenge

Pioneer

Tackle new challenges with passion and determination to lead change and growth

- Passion and determination for growth
- Creative thinking and pioneering spirit
- Lead change and growth

Execute

Performer

Recognize problems and find the best solution to achieve goals

- Fact-based decision making
- Action-oriented and performance-driven approach
- Take initiative and responsibility

Optimize

Team Player

Appreciate support from others and understand the importance of communication and cooperation

- Team-oriented mindset
- Cooperative attitude
- Respect diversity and open-mindedness

HR Philosophy

Performance-oriented

Through fair, performance-based HR management

Establish HR culture where performance and ability are recognized and rewarded primarily

Job-oriented

Assign jobs based on individual strengths

Systematic HR Development

At KT&G, in order to raise the level of productivity and satisfaction of employees and cultivate global talents, the core value internalization training course is mandatory at the HR Development Center. Our regular training program consists of 10 value-based common competence training courses, 35 job training courses, and 18 leadership skill training courses. In addition, we provide various types of training programs such as online training, books, and mobile courses throughout the year to promote self-directed learning, by standardizing our training program for each job function. Furthermore, we encourage our employees to participate in learning activities and share successful cases.

Fair Evaluation and Compensation

Through the evaluation process standardized by the HR Management Policies, we evaluate the performance of our employees in an objective and transparent manner and provide compensation based on this. The results of performance and competence evaluation are used for various HR systems and coaching and mentoring programs are also available. The evaluation results are shared with the employees and used for interviews to ensure fair HR practice. New employees are compensated without discrimination based on gender and position. In 2017, the base salary of new college graduates was set to 230% of the statutory minimum wage in Korea.



Employee Welfare Benefit

To promote healthy work-life balance, we provide a welfare system to help our employees improve the quality of their lives and establish family-friendly working conditions. The welfare system is designed based on the lifecycle and age and employment period of each employee and we provide welfare benefits for their family members as well.

Welfare Benefit System

Support Area	Details
Livelihood Support	<ul style="list-style-type: none">• Housing for employees working remotely• Loan through internal welfare fund• Childcare allowance, financial support for children starting elementary/middle school, tuition for middle/high school and college• Allowance for congratulations and condolences• Employee stock ownership system
Medical Expense	<ul style="list-style-type: none">• Medical check-up: for employees and their spouses on an annual basis• Medical expenses: for employees, spouses and children
Leisure Activities	<ul style="list-style-type: none">• Welfare cards: used for fitness clubs, restaurants, movies and education based on individual needs• Resort facilities: condominium and resorts facilities nationwide (e.g. Jeju, Gangwon)• Cultural activities: sporting events, Sangsang Art Hall, Sangsang Madang Concert
Education & Work Life	<ul style="list-style-type: none">• Self-development support through various internal training and education systems• 4 Social Insurance coverage• Refresh leave: 3 weeks for every 5 years of employment (vacation allowance)• Corporate club activities/sporting competition support
Childcare Assistance	<ul style="list-style-type: none">• Educational support for children: childcare support up to 6 years of age, KRW 5 million for middle/high school student, 4-year college tuition• Maternity leave: KRW 1 million per month from pregnancy to birth for preventing miscarriage and premature birth• Childcare leave: up to 2 years after birth (KRW 1 million on the first year, KRW 2 million on the second year)

Enhancement of Intra-Company Communication

The Communication and Empathy Office takes the initiative in building a culture of trust and enhancing ties among employees. The Imagination Realization Committee and online bulletin board on the intranet “Idea of KT&G” play a major role for the establishment of workplace where employees can trust mutually and work pleasantly. The Imagination Fulfillment Division consisting of 199 local worksite heads and branch managers is proactive in embedding agendas of the Imagination Realization Committee in the company and activating various systems. The labor union strives to internalize the operation of the Labor-Management Council, develop management issues, and support information to business departments. KT&G’s labor union was established in compliance with the organizing criteria of Korea Tobacco & Ginseng Workers’ Union in 1958, and 3,577 employees are joined as of the end of 2017. In case that significant changes in business and organization influences on employment, both labor and management abide by the period they consulted and made decisions before.

Plan for the Future

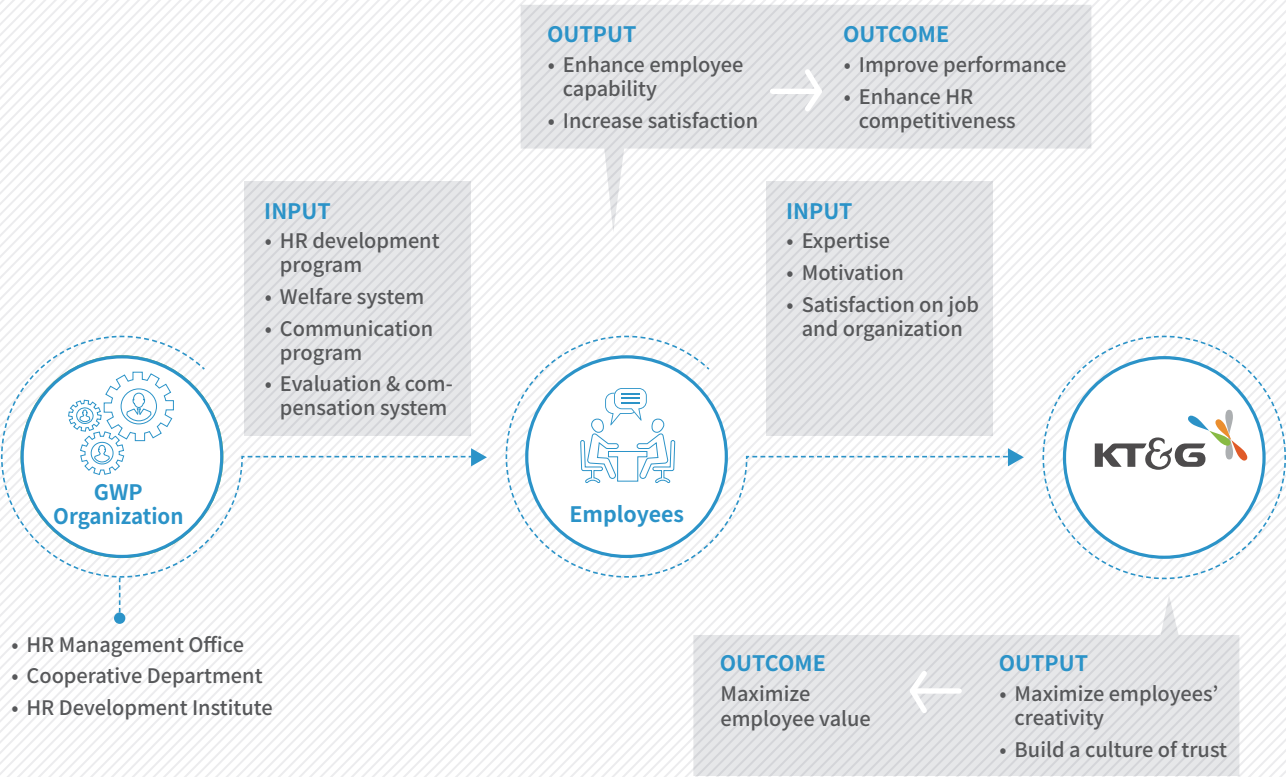
At KT&G, we will continue to establish HR development plans and implement strategies and tasks to make sure that our employees reach their full potential and grow as part of our company. In addition, our performance and job-oriented evaluation process will continue without any discrimination while further improving our performance evaluation system and keeping employees satisfied and motivated towards the organizational commitment. In order to continuously improve our HR system, we will use various channels to communicate with employees.



CASE STUDY Benefits of Great Workplace

KT&G fosters creative and trust-based corporate culture with a focus on communication and responsibility in our business practice.

To step up as a global leader, we are going to make sure that our employees develop their talents and maximize their potential while doing their best to contribute to the corporate mission.





Supply Chain Management

Recognizing that mutual growth and fair trade with suppliers is an essential part of creating a healthy eco-system in the industry, the government puts emphasis on mutual growth with suppliers by enforcing and amending the Fair Trade Act and Subcontract Act. KT&G is committed to building a foundation for mutual growth and creating synergy with our suppliers.

Directions for Shared Growth

In order to promote fair business practice, we revised our internal policies so that parties are referred to as "Company" and "Supplier" instead of "Kap (Party A)" and "Eul (Party B)" and all payments are made in cash to improve the liquidity of suppliers. Although there is no legal obligation to purchase leaf tobacco after privatization of the business, we purchase the entire amount of domestically-produced leaf tobacco to help farmers maintain their standard of living.

Shared Growth Activities




Supplier EDI (Electronic Data Interchange) System

We share our web-based production information system with suppliers in order to access our production plan and material inventory in real time. This enables our suppliers to conduct planned business operations based on the information and leads to improved production efficiency and reduced inventory pressure, ultimately contributing to our quality improvement and cost competitiveness.

Financial Support

To relieve financial pressure of our suppliers, we make full payment in cash within 5 business days and encourage our first-tier suppliers to settle their payment by the 25th of each month. In addition, we make payments in advanced to suppliers during periods such as the Lunar New Year and Chuseok holidays. This is to alleviate financial pressures on suppliers as they have a temporary shortage of funds during such periods due to various payment commitments. At the same time, we adjust the contract amount to help suppliers mitigate financial burdens due to increases in the price of materials and fluctuations as part of the commitment to shared growth.

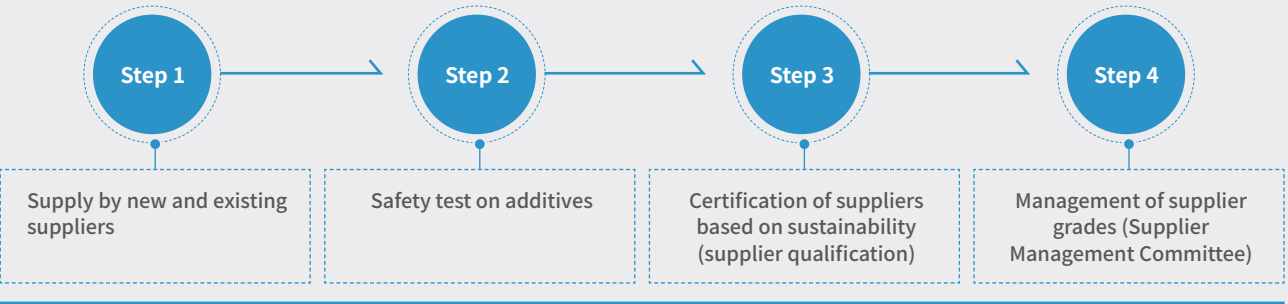
Advanced Payment to Suppliers

Lunar New Year 2017	Chuseok 2017	End of 2017
 16,028 KRW in ten thousand (Scheduled date of payment : Feb. 7, 2017 Actual date of payment: Jan. 25, 2017)	 16,548 KRW in ten thousand (Scheduled date of payment : Oct. 11, 2017 Actual date of payment: Sep. 27, 2017)	 14,090 KRW in ten thousand (Scheduled date of payment : Jan. 5, 2018 Actual date of payment: Dec. 29, 2017)

Raw Material Supplier Certification System

The company has established a supplier certification system for the selection of new suppliers and to build long-term partnerships with its existing suppliers. The partnership lasts for 3 years if there are no other qualified suppliers during that period. However, assessment is conducted after one year to identify areas of improvement and they are addressed by the suppliers. Since 2011, 74 of 75 companies in total have been certified. The system allows our suppliers to focus on production and technology development while we secure suppliers with high quality and excellent business standards.

Supplier Certification Process



Signing the Agreement on Shared Growth

As part of our contribution to the economic development and creation of jobs in Chungcheong where the headquarters are located, we signed a shared growth agreement with the IBK (Industrial Bank of Korea). Based on the agreement, we are going to use KRW 100 billion we deposited with the IBK to create a fund amounting to KRW 200 billion with the purpose of providing loans in 5 areas including business start-ups, small merchants and medical care at a low rate to support their business operation.

Support for Domestic Leaf Tobacco Farmers

To relieve the financial pressure of farmers, we pay 30% of the payment upfront for each cultivator from April to June. We also volunteer to help the farmers who are short of manpower due to aging and population decline each year.

Plan for the Future

We will continue to provide support for our suppliers as part of our shared growth initiative. To this end, we will review and analyze the effects of various activities that have been carried out so far and address the areas of improvement based on the results. In addition, we will maintain close communications with suppliers to identify their needs that have a direct impact on our market performance and actively engage in activities for sustainable growth with suppliers.



Volunteer Service for Domestic Leaf Tobacco Farmers

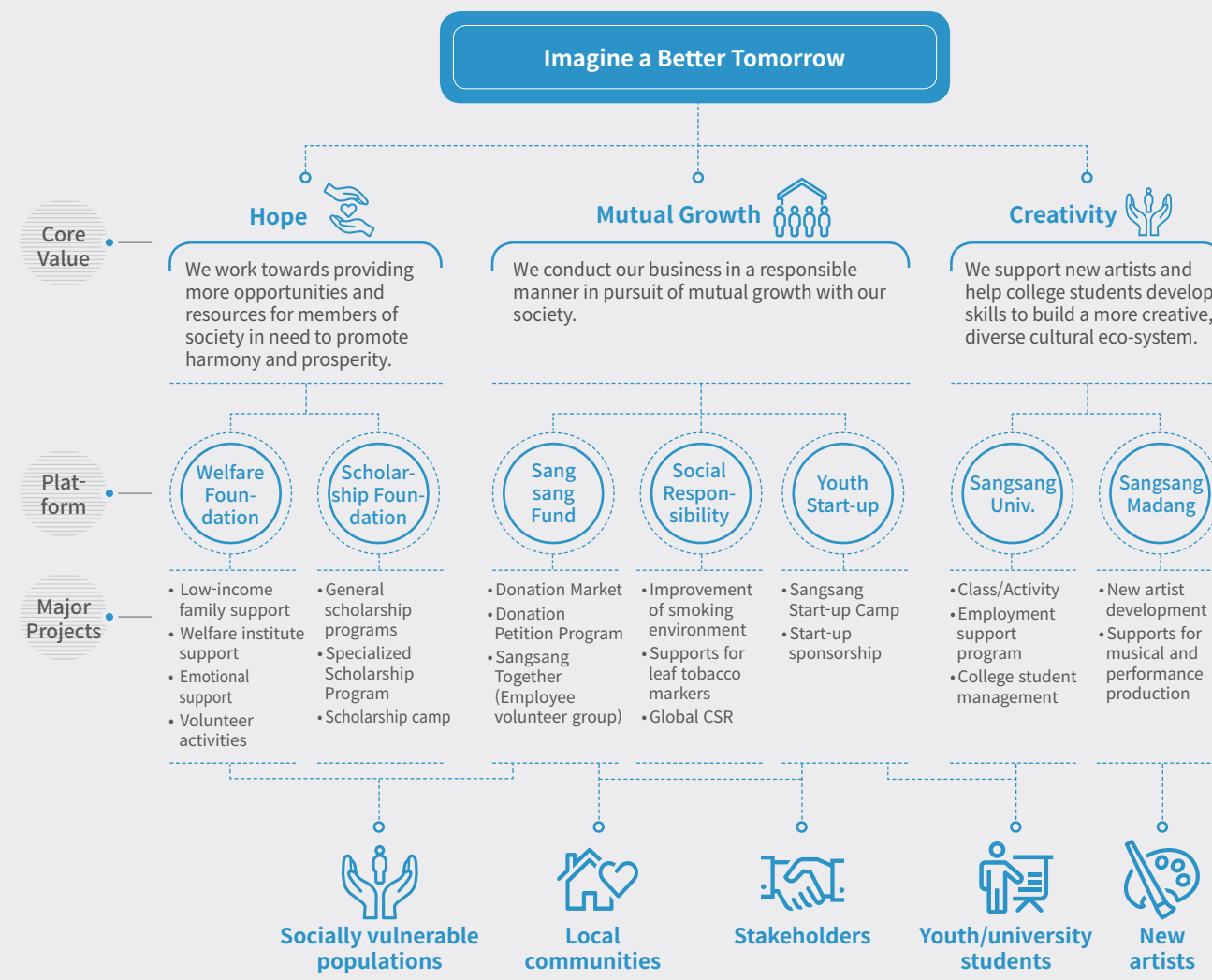


Social Contribution

KT&G actively engages in various corporate social responsibility programs from solving local community issues to promoting healthy growth in culture and art as part of realizing corporate philosophy “Completion of better life”. In addition, we plan and implement unique programs to spread the idea of sharing and raise awareness in creating a better place to live in.

Promotion of Social Contribution

Under the slogan "Imagine a Better Tomorrow", we carry out various social responsibility programs with a focus on our core values: "hope", "mutual growth", and "creativity". The company supports the marginalized to help them dream of the future, cultivates talents to lead the global era, joins the solution of social issues, and invests in culture & art sectors to contribute to improving the quality of lives. Going forward, KT&G will continue to strive not only to provide the underprivileged with more opportunities and resources but also to lead the solution of social issues by communicating with stakeholders.



Major Social Contribution Activities



Hope

As part of CSR programs, we established the KT&G Welfare Foundation in 2003 and KT&G Scholarship Foundation in 2008 to promote the idea of sharing and foster talents. The KT&G Welfare Foundation provides both financial and emotional supports to the marginalized while the KT&G Scholarship Foundation operates a total care system covering entire courses from middle school to high school and college to provide the next generation with opportunities for better education.

Welfare Foundation

The KT&G Welfare Foundation is committed to providing children, people with disabilities, senior citizens, and low-income families with financial supports through social welfare facilities as part of our efforts to improve the quality of their lives and create a social welfare community.

Major Activities of the KT&G Welfare Foundation

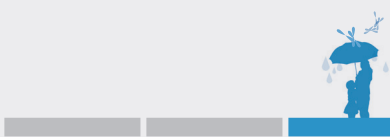
Low-Income Family Support	We carry out various low-income family support programs through 8 welfare centers in Seoul and metropolitan areas.	1. Welfare for children - Educational support - Book donation 2. Welfare for senior citizens - Food support - Kimchi and winter necessities
Welfare Institute Support	We are committed to providing facilities and small vehicles in support of our welfare programs and on-site operation.	1. Small car support 2. Child center support
Emotional Support	In addition to basic livelihood support, we organize various emotional support projects to improve the quality of lives for those in need.	1. Table tennis tournament for senior citizens 2. Sangsang Dream Picnic 3. Senior Literature Award
Volunteer Activities	In collaboration with the volunteer center "&Ter", we organize volunteer activities with college volunteer groups on a regular basis. We promote the importance of volunteer activities among college students through domestic and overseas volunteer programs.	1. Domestic - Wall painting for elementary schools - Environmental protection for Bukhan Mt. 2. Overseas - Cambodia SOC support - Building Mongolia Forest and Agricultural Center

Scholarship Foundation

The KT&G Scholarship Foundation is devoted to providing educational opportunities for youth in need and helping further their educational aspirations. In addition, we focus on the specialization of the areas of our support to include arts and sports going beyond the conventional scholarship program.

Major Activities of the KT&G Scholarship Foundation

Sangsang Scholarship Programs	We provide tuition and financial support for education as part of the total-care scholarship program that covers middle and high school and colleges to help students further their educational aspirations.	1. Sangsang Scholarship for middle school students 2. Sangsang Scholarship for high school students 3. Sangsang Scholarship for college students
Specialized Scholarship Program	We foster talents in the field of culture and art and provide support for education, employment, and start-up for social independence of the youth.	1. Scholarship program for art and sports 2. Sangsang RESTART Scholarship Program
Scholarship Camp	For continuous growth of students, we established Sangsang Scholarship Camp where students can gain cultural experience, listen to prestigious speakers, and get instructions for education.	1. Sangsang Scholarship Camp for high school students 2. Sangsang Scholarship Camp for college students

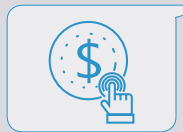


Mutual Growth

KT&G is committed to promoting mutual growth and creating a better place to live in. To this end, we fulfill our corporate social responsibilities for local communities as well as stakeholders through various programs including "Sangsang Fund", "Industrial CSR Programs", and "Youth Start-up Support".

Sangsang Fund

The Sangsang Fund was launched in March 2011 where all employees voluntarily donate money and the company matches grant to support the less fortunate. Approximately KRW 4 billion has been raised every year and a total of KRW 20.1 billion was used for seven years. The Sangsang Fund is also donated to emergent social problems such as Gyeongju earthquake damage restoration project as well as people in need at home and abroad. The Sangsang Fund Operation Committee ensures the independence and transparency of this fund.



1. Donation Petition

We started the donation petition program in 2013 where our employees choose recipients for donation and financial supports for living and medical expenses are given to those with at least 200 likes. Over 5 years, approximately KRW 370 million was delivered to 44 cases.



2. Donation Market

The Donation Market, introduced in 2015, is a participation-based donation system in which our employees choose recipients recommended by Happy Bean Foundation and KT&G Welfare Foundation. So far, we have donated KRW 1.5 billion to 321 cases with social vulnerability and overseas relief programs.

Global CSR

We have been proactive in global CSR activities to fulfill our responsibility as a global corporate citizen. Particularly, in line with the UN SDGs (Sustainable Development Goals), we address global issues such as poverty, environment, and housing problems in developing countries. Starting with Indonesia, we have organized "Sangsang Village" for the improvement of local housing conditions and "Sangsang Univ". program to support local university students. By establishing Mongolia Forestry and Agricultural Education Center, we are participating in environmental protection for local people and preventing desertification.

Improvement of Smoking Environment

As part of our industrial social responsibility program, we are undertaking a project to improve the environment for both smokers and non-smokers. In particular, in order to resolve the social conflicts caused by a lack of smoking areas, we have built about 200 smoking areas in multi-purpose facilities through consultation with local governments and public offices. We will continue to make efforts to protect the rights of both smokers and non-smokers.

Sangsang Start-up Camp

KT&G provides a full-time social innovation start-up support program to the youth who dream of creative entrepreneurs. This program contributes to solving currently significant youth unemployment issue by developing and cultivating innovative start-ups with passion, creating jobs for youth and a positive impact on our society. The “Sangsang Start-up Camp” is a full-time start-up program covering 14 weeks, including 8 weeks of Introductory Track and 6 weeks of Growth Track. The teams with excellent performance receive financial support for commercialization, opportunities for overseas tours, office rental costs, and follow-up investment support.



Creativity

The company offers artists and college students opportunities to turn their imagination into reality to build a more creative and diverse cultural eco-system. Since its inception at Hongik University in 2008, Sangsang Madang has given new artists and local communities opportunities to communicate through performance, movies, and exhibitions in Nonsan and Chuncheon. In addition, we organized Sangsang Univ. to help college students grow and fulfill their dreams.

Sangsang Madang

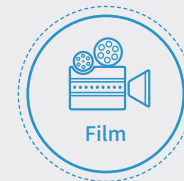
Started as part of our Mecenat program in 2007, Sangsang Madang is Korea's leading multi-cultural arts venues with annual visitors of 1.8 million. Sangsang Madang Hongdae, Nonsan, Chuncheon, and Daechi Art Hall have been places of communication and exchange with unique values and characteristics. Sangsang Madang Busan is scheduled to open in 2019.

Flagship Programs of the Sangsang Madang Project



Performance

We are committed to building a music distribution platform by developing planning performance and supporting new musicians while creating a positive culture and environment for the performance industry.



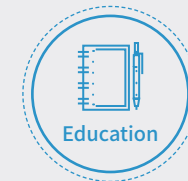
Film

By supporting the production of full-length and short films, Sangsang Madang discovers promising filmmakers and hidden gems. It contributes to the development of the Korean movie industry as a whole by supporting the post-production and exhibition of films.



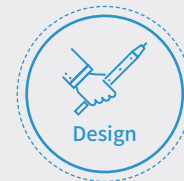
Exhibition

Serving as a contents market in the culture and art community to reflect the era of our young generations, we introduce works of new artists and designers.



Education

Sangsang Madang is a space for communication for imaginative creators, providing a variety of educational programs in culture and arts categorized into talent cultivation project, cultural and art program, and community arts program.



Design

Sangsang Madang runs a multi-brand store offering independent designer brand products and communicating their new ideas with consumers.

Musician Career Support

We help musicians to further their career with such programs as "Surround" and "Band Discovery" where we provide support for producing music and opportunities to perform for bands.

Indie Film Distribution Support

We provide support for indie films and filmmakers with their distribution and marketing with the aim to stimulate the development of the indie filmmaking industry.

Photography Art Support

Through SKOPF (Korean Photographer's Fellowship), we support young photographers with their publication and exhibition.

Indie Designers' Product Distribution Support

Through the Korea Design Challenge for commercialization of ideas and overseas market entry, we support product development and distribution.

Original Play/Musical Performance Support

We support original musicals and plays with great potential through Sangsang Stage Challenge.

Culture Art Talent Cultivation

We support culture planners and help them further their career through our culture art talent development programs.



Sangsang Univ.

Our Sangsang Univ. is established to support college students in their 20s and help them develop their minds and grow through various classes and activities organized in 16 areas nationwide. The programs are designed to help them turn imagination into reality and explore their potential as well as share their experiences with others.

Major Classes and Activities of Sangsang Univ. and Student Organization

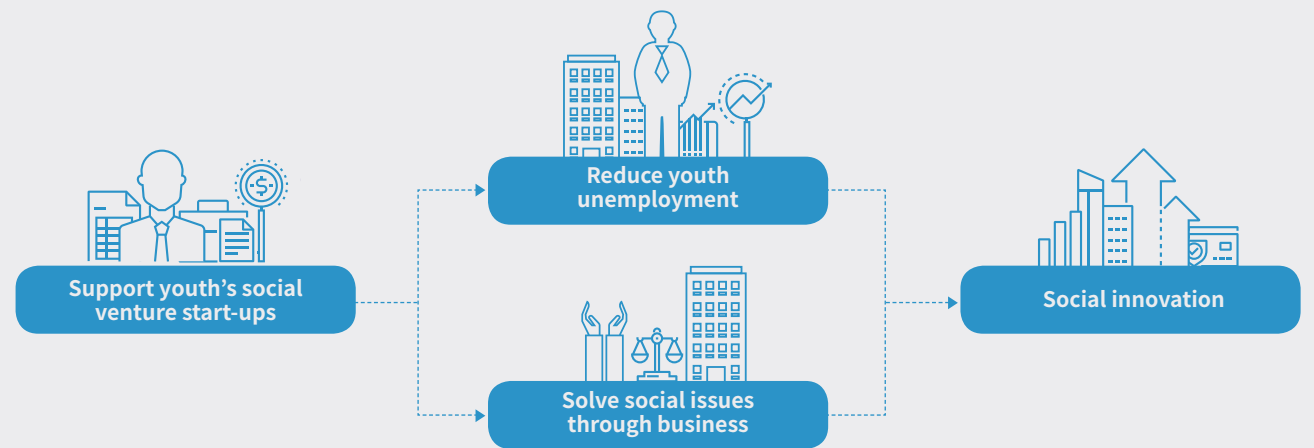
KT&G 상상 univ. Flagship Program	Classes	Activities	Student Organization
Sangsang Compass Camp Guide and motivate college students for their professional career through various missions and mentoring programs	Sangsang Art Department This program is designed to provide opportunities to exper-ience the excitement of stage performance including dance, vocal, musical and play as well as exhibition	Sangsang Festa As a key part of Sangsang Univ. it shares the knowledge and experience with others through various classes	Sangsang Friends A group of college students promoting Sangsang Univ. offline
Sangsang Career Camp Offer analysis and mentoring programs on career development for 100 hours and give a guide through preparation for employment by mentoring services	Sangsang Culture Department A hobby and culture program for barista, calligraphy, and florist that gives enriching experiences	Sangsang Sharing A volunteer program in which college students are directly involved in planning and activities	Sangsang Volunteer A college student volunteer group organized to donate their talents and plan their own volunteer activities
Sangsang Marketing School Organize lectures by corporate marketers and provide opportunities to debate, network, and experience through team-based missions and projects	Sangsang Life Department A sports-related programs for futsal, bowling, and climbing	Sangsang Tour A unique theme program that provides experience for KT&G on-site business and creates unforgettable memories with Sangsang Univ	Sangsang Editor A group of student journalists covering Sangsang Univ., student and campus news online
	Sangsang Career Department A program designed to help resume writing, image making, and speech for career development	Sangsang Lab Provide students with opportunities to develop and turn their ideas into reality	
		Sangsang Casting A contest project for college students who share common interests	

Plan for the Future

KT&G will continue to develop social contribution programs based on communication with our stakeholders. From addressing social issues to realizing values we pursue, we will establish an effective and balanced social contribution portfolio and implement it for sustainable growth of our society.

In 2018, as part of our social responsibility program, we plan to help reduce youth unemployment which is considered one of the major social issues today. Through supports for business start-ups and platform development, we are going to create new values required by the society.

Areas of Social Contribution



Sangsang Marketing School



Sangsang Career Camp

CORPORATE GOVERNANCE

Transparent & Professional Decision-Making

All employees of KT&G carry out businesses based on the decisions made by the Board of Directors and the CEO with the aim to maximize our corporate values and become a global leader.

Composition of the Board of Directors (as of December 31, 2017)

The Board of Directors ("BOD") establishes fundamental management policies and makes decisions for the benefit of our company and shareholders. The BOD Chairman is appointed by the resolution of the BOD among non-executive directors and serves for one-year. If the BOD Chairman is not present in the BOD meeting, a senior non-executive director will perform those duties instead.

Director	Name	Gender	Date of Birth	Residency	Experience	Position	Term
Executive Directors	Baek, Bok-In	Male	Sep. 1965	Executive	<div><div>• Director of Strategy and Planning</div><div>• Director of Marketing Headquarters, KT&G</div></div>	CEO, Chairman of the Investment & Development Committee	Oct. 8, 2015 - 2018 General Shareholders' Meeting
	Kim, Heung-Ryul	Male	Mar. 1961	Executive	<div><div>• Chief of Global Market Focus Headquarters, KT&G</div><div>• Support Director of Marketing, KT&G</div></div>	Head of General Management	Mar. 19, 2016 - 2018 General Shareholders' Meeting
Non-executive Directors	Choi, Kyung-Won	Male	Oct. 1946	Non-executive	<div><div>• Lawyer of Kim&Chang Law Firm</div><div>• Minister of Justice</div></div>	Chairman of the BOD, Chairman of the Strategy Committee	Feb. 28, 2015 - 2018 General Shareholders' Meeting
	Song, Op-Kyo	Male	May 1941	Non-executive	<div><div>• Advisory Member of National Assembly Committee for Constitutional Amendment</div><div>• Director of Asia-Pacific Economic Research Institute</div></div>	Chairman of the Evaluation Committee	Mar. 18, 2017 - 2020 General Shareholders' Meeting
	Lee, JuneQ	Male	Dec. 1957	Non-executive	<div><div>• Professor, Kyunghee Univ. (Vice President)</div><div>• Director/Chairman of Korea Academic Society of Taxation</div></div>	Chairman of the Audit Committee	Mar. 18, 2017 - 2020 General Shareholders' Meeting
	Youn, Hai-Su	Male	Feb. 1952	Non-executive	<div><div>• President, Seoul University of Foreign Studies</div><div>• Chairman of the Hae-Kwang Academy</div><div>• Foundation Committee Member of the Presidential 21st Century Committee</div></div>		Mar. 19, 2016 - 2019 General Shareholders' Meeting
	Lee, Eun-Kyung	Female	May 1963	Non-executive	<div><div>• Managing Director of Finance and Management, PVH Corp. Korea</div><div>• Director of Finance, Reebok Korea</div></div>		Mar. 19, 2016 - 2019 General Shareholders' Meeting
	Rho, Joon-Hwa	Male	Jan. 1969	Non-executive	<div><div>• Professor, Dept. of Business Administration, Chungnam University</div><div>• Chair, Accounting Audit Div., Korean Accounting Association</div></div>		Mar. 18, 2017 - 2020 General Shareholders' Meeting

* At the 30th General Meeting of Shareholders (Mar. 17, 2016), Song, Op-Kyo and Lee, JuneQ were reappointed as non-executive directors, and Roh, Joon-Hwa was appointed as executive director.

Key Resolutions

In 2017, KT&G BOD Meeting convened 13 times, where 19 agenda items were voted for and 9 agenda items were reported.

2017 BOD Meeting Resolutions	Reports
<div><div>• 30th (2016) Financial Statements (Consolidated and Separate)</div><div>• 30th (2016) Statement of Appropriations of Retained Earnings</div><div>• 30th (2016) Sales Report</div><div>• Capital increase with consideration for Renzoluc Pte., Ltd. for tobacco business</div><div>• Conversion of investment in Renzoluc Pte., Ltd.</div><div>• Composition of the Non-executive Director Recommendation Committee</div><div>• Amendment of executive retirement payment regulation</div><div>• Establishment of annual remuneration limit of directors</div><div>• Recommendation of the Audit Committee member candidates</div><div>• 30th General Shareholders' Meeting</div></div>	<div><div>• Appointment of the BOD Chairman</div><div>• Appointment of subcommittee chairman and members</div><div>• Decision of compensation for executive directors</div><div>• Amendment of non-executive director remuneration and activity expense</div><div>• Amendment of the Namdaemun Hotel lease agreement</div><div>• Extension of KT&G Shared Growth Loan Fund</div><div>• Introduction of production facilities</div><div>• Budget plans for 2018</div><div>• Plan for evaluating the BOD activities in 2017</div></div> <div><div>• Operating status of Internal Accounting Control System</div><div>• Result of evaluation of Internal Accounting Control System</div><div>• 1Q 2017 Closing of Account</div><div>• 1H 2017 Closing of Account</div><div>• 3Q 2017 Closing of Account</div><div>• Report on information protection masterplan</div><div>• Progress report on plans for FOREX Hedge</div><div>• Review of mid- to long-term business plans of subsidiaries</div><div>• Mid to long-term management strategy and business plans for 2018</div></div>





Subcommittees (as of December 2017)

At KT&G, there are four standing subcommittees - Strategy Committee, Investment & Development Committee, Evaluation Committee, and Audit Committee – and non-standing subcommittees including Independent Non-Executive Director Candidates Recommendation Committee and CEO Candidates Recommendation Committee. Please refer to our Business Report for more details on the committee activities in 2017.

Subcommittees

Board of Directors				
	Strategy Committee	Investment & Development Committee	Audit Committee	Evaluation Committee
Purpose of Establishment	Review of corporate management strategies	Management of investment/ social contribution/risk and other obligations under Commercial Law	Review of finance/accounting feasibility and evaluation of internal control system	Performance evaluation/ remuneration
Composition	3 non-executive directors, 2 executive directors	3 non-executive directors, 2 executive directors	3 non-executive directors	4 non-executive directors
Name	Non-executive directors: Choi, Kyung-Won, Song, Op-Kyo, Lee, JuneQ Executive directors: Baek, Bok-In, Kim, Heung-Ryul	Non-executive directors: Youn, Hai-Su, Rho, Joon-Hwa, Lee, Eun-Kyung Executive directors: Baek, Bok-In, Kim, Heung-Ryul	Non-executive directors: Lee, JuneQ, Lee, Eun-Kyung, Rho, Joon-Hwa	Non-executive directors: Song, Op-Kyo, Choi, Kyung-Won, Lee, JuneQ, Youn, Hai-Su

Audit System for Transparent Management

We operate the Audit Committee to strengthen the independence and roles of our internal audit body and ensure transparency and reliability of our financial information while supervising and supporting the management.

Audit Committee

The Audit Committee is held at least once a quarter to make sure that the company fulfills its responsibilities and obligations to the stakeholders by auditing the legality of executives and directors and reviewing the financial health and accuracy of financial reporting.

1. Composition of Audit Committee (as of December 2017)

As of the end of reporting period, the Audit Committee consists of 3 non-executive directors (Lee, JuneQ, Lee, Eun-Kyung, Rho, Joon-Hwa). Lee, JuneQ was appointed as the Audit Committee Chairman at the 6th BOD meeting in 2017.

2. Audit Committee Activities in 2017

The Audit Committee was held 10 times in total in 2017 and major agendas included resolving internal accounting control system and monitoring system, approving the audit report, and reviewing major items of the general shareholders’ meeting.

Audit Committee Resolutions in 2017

Date	Agenda Items	Resolution	Remarks (Attendance)
Jan. 17, 2017	Review #1: 30th (2016) Financial Statements (Consolidated and Separate)	Resolved (Submitted to the BOD)	Non-executive: 2
	Review #2: 30th (2016) Statement of Appropriation of Retained Earnings	Resolved (Submitted to the BOD)	
	Review #3: 30th (2016) Sales Report	Resolved (Submitted to the BOD)	
	Report #1: Operating status of Internal Accounting Control System	Received	
	Resolution #1: (Proposal) Assessment for Operating status of Internal Accounting Control System	Resolved	
	Resolution #2: (Proposal) Audit Committee Review on Internal Accounting Control System	Resolved	
	Report #2: Internal Audit Results for 4Q, 2016	Received	
	Report #3: Audit plan for FY 2017	Received	
	Resolution #3: 2016 Ethical Management Audit Evaluation	Resolved	
	Resolution #1: Review of 30th General Meeting of Shareholders Agenda	Resolved	
Feb. 28, 2017	Resolution #2: 2016 Audit Report	Resolved	Non-executive: 2
	Report #1: Settlement of accounts for 1Q, 2017 (31st fiscal year)	Received	
Apr. 26, 2017	Resolution #1: KT&G Internal Control and Improvement Consulting Plan	Received	Non-executive: 3
	Report #2: Internal Audit Results for 1Q, 2017	Received	
	Report #3: Progress report on monitoring of inspection (audit)	Resolved	
Jun. 7, 2017	Report #1: KT&G Internal Control and Improvement Consulting Mid-term Report	Received	Non-executive: 3
Jul. 14, 2017	Report #1: Progress report for Internal Control project	Received	Non-executive: 3
Jul. 26, 2017	Report #2: Improvement of KT&G Independent Auditor Appointment Evaluation Index	Received	Non-executive: 3
	Report #1: Settlement of accounts for 2Q, 2017 (31st fiscal year)	Received	
Aug. 21, 2017	Report #2: Internal audit results for 2Q, 2017	Received	Non-executive: 3
	Report #1: Progress report for Internal Control project	Received	
Sep. 28, 2017	Report #1: Overseas Company Analysis Report	Received	Non-executive: 3
Oct. 13, 2017	Discussion #1: Results of audit on Indonesian subsidiary	Discussion	Non-executive: 3
	Report #1: Settlement of accounts for 3Q, 2017 (31st fiscal year)	Received	
	Report #2: Results of audit on Indonesian subsidiary	Received	
	Report #3: Results of internal audit on operating performances for 3Q, 2017	Received	
	Report #4: Progress report on monitoring of inspection (audit)	Received	
	Discussion #1: Pending issues	Discussion	

* Refer to the Business Report for the activities of the Audit Committee.

Evaluation of the BOD Activities

The Evaluation Committee consisting of non-executive directors under the BOD conducts annual management performance evaluation to ensure proper compensation for executive directors.

Evaluation Committee

The Evaluation Committee decides the evaluation criteria of the presidential candidates, their contract terms including business goals, and resolves the remuneration of executive directors and retirement allowance. In addition, the committee reviews and adjusts the quantitative and non-quantitative performance indicators and deliberates the remuneration and retirement allowance of the CEO and executive directors.

1. Composition of the Evaluation Committee (as of December 2017)

The Evaluation Committee consists of 4 non-executive directors (Song, Op-Kyo, Choi, Kyung-Won, Lee, JuneQ, Youn, Hai-Su). Song, Op-Kyo was appointed as the chairman at the 6th BOD Meeting.

2. Evaluation Committee Activities in 2017

The Evaluation Committee was held once in 2017 and they decided the CEO's short and long-term business goals and performance evaluation of the previous year.



Evaluation Committee Resolutions in 2017

Date	Agenda Items	Resolution	Members' Vote			
			Song, Op-Kyo	Choi, Kyung-Won	Lee, JuneQ	Youn, Hai-Su
Jan. 19, 2016	Resolution #1: Establishment of the CEO's short-term management goals in 2017	Resolved	Approved	Approved	Approved	Approved
	Resolution #2: Adjustment of the CEO's long-term management goals for 2017 and 2018	Resolved	Approved	Approved	Approved	Approved
	Resolution #3: Evaluation on the CEO's short-term management performance in 2016	Resolved	Approved	Approved	Approved	Approved
	Resolution #4: Evaluation on the CEO's long-term management performance in 2016	Resolved	Approved	Approved	Approved	Approved

BOD Member Remuneration Regulations & Payment Status in 2017

The remuneration of the BOD members is appropriated on the basis of the following criteria.

BOD Member Remuneration Criteria

Remuneration criteria for registered directors (excl. non-executive directors, Audit Committee members)		
Earned income	Base salary	One-twelfth of annual salary is paid each month under the Executive Director Remuneration Policy.
	Bonus	Bonuses are paid depending on the resolution of the Evaluation Committee, and are based on quantitative indicators (sales, operating profits, domestic market share) and non-quantitative indicators (new growth engine value creation, group infrastructure innovation, ethical management foundation). Bonuses can be paid up to 255% of the base salary amount.
	Stock option income	N/A
	Other earned income	Includes benefits such as medical check-up expenses for spouses.
Retirement income		N/A
Other income		N/A

Remuneration criteria for non-executive directors and Audit Committee members (excl. Audit Committee members)		
Earned income	Base salary	Directors are paid based on their annual activities in accordance with the Non-executive Director Remuneration and Reimbursement Policy.
	Bonus	N/A
	Stock option income	N/A
	Other earned income	N/A
Retirement income		N/A
Other income		In accordance with the Non-executive Director Remuneration and Reimbursement Policy, directors are paid for their information collection and business activities each quarter up to 20% of their annual remuneration amount.

Independence of Directors

To ensure the independence and professionalism of our non-executive directors, we operate the Non-executive Director Recommendation Committee which is composed of at least half of non-executive directors for full compliance with the best practices of legal and corporate governance. In addition, we select the candidates through a headhunting firm to maintain the independence in our nomination process. The committee ensures transparent and fair recommendation process through qualification review on the candidates. Furthermore, the candidates are announced 2-weeks prior to the General Shareholders' Meeting to make sure that our shareholders can make informed decisions on their vote.

Professionalism and Expertise of Directors

The company pays the training and self-development expenses of our directors to help them acquire knowledge and skills needed to perform their duties as members of the committee and BOD. In addition, we provide non-executive directors with educational opportunities and information about our business operations while organizing seminars. We also hold review meetings focusing on our long-term view and key strategies.

Protection of Shareholders' Rights

In accordance with Article 542-7 of the Commercial Law and Article 12 of its Enforcement Ordinance, we amended our Articles of Incorporation and introduced a cumulative voting system on March 23, 2001 at the General Shareholders' Meeting. As a result, shareholders holding at least 1% of the total shares with voting rights were given the right to appoint directors and those who intend to exercise the right must notify the company in writing at least 6 weeks prior to the date of the General Shareholders' Meeting (for a regular general meeting, the date of the Genera Shareholders' Meeting of the previous year).

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Separate Statements of Financial Position

As of December 31, 2017 and 2016 (In millions of won)

	2017		2016	
Assets				
Property, plant and equipment	₩	1,267,825	₩	1,117,268
Intangible assets		27,335		28,928
Investment property		325,423		335,196
Investments in associates and joint ventures		51,930		58,230
Investments in subsidiaries		1,208,228		1,154,925
Available-for-sale financial assets		454,051		364,305
Long-term deposits in MSA Escrow Fund		510,223		503,592
Long-term prepaid expenses		4,583		5,398
Other financial assets		6,340		-
Long-term trade and other receivables		80,535		68,017
Total non-current assets		3,936,373		3,635,859
Inventories		872,085		914,702
Current available-for-sale financial assets		-		1,500
Current other financial assets		1,530,000		1,620,000
Prepaid tobacco excise and other taxes		255,822		439,413
Trade and other receivables		951,435		1,140,598
Advance payments		20,259		22,272
Prepaid expenses		4,164		5,733
Cash and cash equivalents		1,104,825		688,735
Total current assets		4,738,590		4,832,953
Total assets	₩	8,674,963	₩	8,468,812
Equity				
Ordinary shares		954,959		954,959
Other capital surplus		3,582		3,582
Treasury shares		-328,157		-328,157
Gain on reissuance of treasury shares		513,776		513,776
Reserves		5,009,301		4,366,268
Retained earnings		990,096		1,068,469
Total equity		7,143,557		6,578,897
Liabilities				
Long-term trade and other payables	₩	21,655	₩	6,848
Long-term advance receipts		582		319
Provision for doubtful debts		3,086		-
Net defined benefit liability		19,084		47,121
Deferred income tax liabilities		35,969		73,328
Total non-current liabilities		80,376		127,616
Short-term borrowings		1,959		3,851
Trade and other payables		386,587		436,270
Advance receipts		1,801		972
Income tax payable		145,929		174,192
Tobacco excise and other taxes payable		914,754		1,147,014
Total current liabilities		1,451,030		1,762,299
Total liabilities		1,531,406		1,889,915
Total equity and liabilities	₩	8,674,963	₩	8,468,812

Separate Statements of Comprehensive Income

For the years ended December 31, 2017 and 2016

(In millions of won)

		2017		2016
Sales:				
Manufacture of tobacco	₩	2,672,324	₩	2,670,350
Real estate		190,003		184,734
Exports of leaf tobacco and others		137,761		113,136
		3,000,088		2,968,175
Cost of sales:				
Manufacture of tobacco		-883,887		-861,301
Real estate		-123,051		-118,427
Exports of leaf tobacco and others		-91,625		-68,391
		-1,098,563		-1,048,119
Gross profit		1,901,525		1,920,056
Selling, general and administrative expenses		-656,678		-614,979
Operating profit		1,244,847		1,305,077
Other income		118,401		126,578
Other expenses		-241,886		-91,848
Finance income		137,000		69,493
Finance costs		-19,465		-8,936
Net finance income		117,535		60,557
Profit before income tax		1,238,897		1,400,364
Income tax expense		-264,001		-313,017
Profit for the period	₩	974,896	₩	1,087,347
Other comprehensive income (loss):				
Items that will not be reclassified to profit or loss				
Remeasurements of net defined benefit liability, net of tax	₩	15,200	₩	-18,878
Items that are or may be reclassified subsequently to profit or loss				
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		29,118		14,199
Other comprehensive income for the period, net of tax	₩	44,318	₩	-4,679
Total comprehensive income for the period		1,019,214		1,082,668
Earnings per share in won and U.S. dollars:				
Basic and diluted	₩	7,721	₩	8,618

Separate Statements of Changes in Equity

For the year ended December 31, 2017

(In millions of won)

	Ordinary shares	Other capital surplus	Treasury shares	Gain on sales of treasury shares	Reserves	Retained earnings	Total equity
Balance at January 1, 2017	₩ 954,959	3,582	-328,157	513,776	4,366,268	1,068,469	6,578,897
Total comprehensive income for the period:							
Profit for the year	-	-	-	-	-	974,896	974,896
Other comprehensive income (loss):							
Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	15,200	15,200
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	29,118	-	29,118
Total other comprehensive income (loss)	-	-	-	-	29,118	15,200	44,318
Total comprehensive income for the year	-	-	-	-	29,118	990,096	1,019,214
Transactions with owners, recorded directly in equity:							
Dividends	-	-	-	-	-	-454,554	-454,554
Transfer from reserve for research and human resource development	-	-	-	-	-10,000	10,000	-
Transfer to unconditional reserve	-	-	-	-	613,915	-623,915	-
Total transactions with owners	-	-	-	-	613,915	-1,068,469	-454,554
Balance at December 31, 2017	₩ 954,959	3,582	-328,157	513,776	5,009,301	990,096	7,143,557
Balance at January 1, 2016	₩ 954,959	3,582	-337,062	494,648	3,784,467	995,886	5,896,480
Total comprehensive income for the year:							
Profit for the period	-	-	-	-	-	1,087,347	1,087,347
Other comprehensive loss:							
Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	-18,878	-18,878
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	14,199	-	14,199
Total other comprehensive loss	-	-	-	-	14,199	-18,878	-4,679
Total comprehensive income for the year	-	-	-	-	14,199	1,068,469	1,082,668
Transactions with owners, recorded directly in equity:							
Dividends	-	-	-	-	-	-428,284	-428,284
In-kind donation of treasury shares	-	-	8,905	19,128	-	-	28,033
Transfer from reserve for research and human resource development	-	-	-	-	-10,000	10,000	-
Transfer to unconditional reserve	-	-	-	-	577,602	-577,602	-
Total transactions with owners	-	-	8,905	19,128	567,602	-995,886	-400,251
Balance at December 31, 2016	₩ 954,959	3,582	-328,157	513,776	4,366,268	1,068,469	6,578,897

Separate Statements of Cash Flows

For the years ended December 31, 2017 and 2016

(In millions of won)

		2017	2016
Cash flows from operating activities			
Cash generated from operations	₩	1,441,666	1,694,203
Income tax paid		-339,724	-342,058
Net cash provided by (used in) operating activities		1,101,942	1,352,145
Cash flows from investing activities			
Interest received		44,984	34,270
Dividends received		90,252	18,395
Proceeds from sale of property, plant and equipment		4,288	15,360
Proceeds from sale of intangible assets		1,350	476
Proceeds from sale of non-current assets held for sale		-	5,800
Proceeds from investments in associates and joint ventures		7,319	13,095
Disposition of Investments in Subsidiaries		17,724	-
Proceeds from sale of available-for-sale financial assets		22,600	33,988
Collection of loans		13,245	13,167
Withdrawal of guarantee deposits		17,371	12,083
Acquisition of property, plant and equipment		-247,395	-118,665
Acquisition of intangible assets		-2,000	-6,910
Acquisition of investments in associates and joint ventures		-1,000	-19,000
Acquisition of investments in subsidiaries		-97,202	-3,065
Acquisition of available-for-sale financial assets		-89,613	-31,000
Increase in loan		-9,809	-
Payments of guarantee deposits		-19,519	-18,509
Payments of long-term deposits in MSA Escrow Fund		-72,040	-89,663
Increase in other financial assets, net		83,660	-540,000
Net cash provided by investing activities		-235,785	-680,178
Cash flows from financing activities			
Dividends paid		-454,554	-428,284
Increase in deposits received		-4,710	-3,704
Decrease in deposits received		9,515	4,199
Net cash provided by (used in) financing activities		-449,749	-427,789
Effect of exchange rate fluctuation on cash held		-318	181
Net increase in cash and cash equivalents		416,090	244,359
Cash and cash equivalents at January 1		688,735	444,376
Cash and cash equivalents at December 31	₩	1,104,825	688,735

Management’s Discussion & Analysis

1. Principle

The MD&A (Management’s Discussion & Analysis) was prepared to easily compare financial position and operating performance in 2017 with those of the previous year in accordance with the Korean International Financial Reporting Standards (K-IFRS). It should be construed in comparison to the financial statements approved at the general shareholders’ meeting on March 16, 2018 after being audited by the independent auditors. All amount was expressed in Korean won. In this section, KT&G does not include consolidated subsidiaries.

2. Operating Performance

Sales

Our sales in 2017 increased 1.1% from the previous year to KRW 3 trillion.

Sales breakdown (KRW in billions)				
Classification	2017	2016	Change	% change
Sales	3,000.1	2,968.2	31.9	1.07
Domestic	1,793.8	1,839.4	-45.6	-2.48
Export	878.5	830.9	47.6	5.73
Others (real estate, etc.)	327.8	297.9	29.9	10.04

Profit

Cost of sales in 2017 accounted for 36.6% of total sales, an increase of 1.3%p from the previous year’s 35.3%. Gross profit fell by 1.0% year-on-year to KRW 1.90 trillion. Operating profit decreased 4.6% to KRW 1.24 trillion, which was attributable to the decrease of gross profit and increase of S&A expenses including commissions. Net profit was KRW 974.9 billion, down 10.3% year-on-year, due to the decrease of operating profit and increase of asset impairment loss.

Summarized income statements (KRW in billions)				
Classification	2017	2016	Change	% change
Sales	3,000.1	2,968.2	31.9	1.1
Gross profit	1,901.5	1,920.0	-18.5	-1.0
Sales and administrative expenses	656.7	614.9	41.8	6.8
Ratio of S&A expenses	21.9%	20.7%	-	-1.2%p
Operating profit	1,244.8	1,305.1	-60.3	-4.6
Operating margin	41.5%	44.0%	-	-2.5%p
Net profit before tax	1,238.9	1,400.4	-161.5	-11.5
Net profit	974.9	1,087.3	-112.4	-10.3

Sales and administrative expenses

Sales and administrative expenses increased KRW 41.7 billion from the previous year to KRW 656.7 billion in 2017 due to the increase of commissions and provision for bad debt despite decreased wage and advertising costs. Wage, advertising costs, and commissions accounted for 35.4%, 15.9%, and 14.4%, respectively. Wage and advertising costs fell by 0.4% and 5.7% year-on-year to KRW 232.6 billion and KRW 104.7 billion, respectively. Commissions were KRW 94.5 billion, up 18.6% from the previous year.

Breakdown of sales and administrative expenses (KRW in billions)

Classification	2017	2016	Change	% change
Wage	232.6	233.6	-1.0	-0.4
Retirement and dismissal benefits	24.1	23.7	0.4	1.7
Welfare benefits	42.7	34.4	8.3	24.1
Advertising costs	104.7	111.0	-6.3	-5.7
Commissions	94.5	79.7	14.8	18.6
Depreciation costs	33.4	32.0	1.4	4.4
Other expenses	124.7	100.6	24.1	24.0
Total	656.7	615.0	41.7	

Financial Position

Assets

Total assets at the end of 2017 grew 2.4% from the previous year to KRW 8.68 trillion. Current assets decreased 2.0% to KRW 4.74 trillion. Cash and cash equivalents soared 60.4%, while prepaid tobacco excise and other taxes and trade receivables decreased 41.8% and 16.6%, respectively. Non-current assets rose by 8.3% year-on-year to KRW 3.94 trillion due to the increases of 13.5%, 24.6%, and 4.6% in tangible assets, available-for-sale financial assets, and investments in affiliates, respectively, despite the decreases of 2.9% and 10.8% in investment property and investments in associates, respectively.

Liabilities

Total liabilities in 2017 were KRW 1.53 trillion, down 19.0% from the previous year. Current liabilities decreased 17.7% to KRW 1.45 trillion due to the decreases of 11.4% and 20.3% in trade and other payables and tobacco excise and other taxes payable, respectively. Deferred income tax liabilities and defined benefit liability decreased 50.9% and 59.5%, respectively, which affected 37.0% decrease of non-current liabilities to KRW 80.4 billion in 2017.

Summarized financial position (KRW in billions)

Classification	2017	2016	Change	% change
Total assets	8,675.0	8,468.8	206.2	2.4
Current assets	4,738.6	4,833.0	-94.4	-2.0
Cash and cash equivalents	1,104.8	688.7	416.1	60.4
Trade receivables	951.4	931.1	20.3	2.2
Others	2,682.4	3,213.2	-530.8	-16.5
Non-current assets	3,936.4	3,635.9	300.5	8.3
Total liabilities	1,531.4	1,889.9	-358.5	-19.0
Current liabilities	1,451.0	1,762.3	-311.3	-17.7
Non-current liabilities	80.4	127.6	-47.2	-37.0
Total equity	7,143.6	6,578.9	564.7	8.6
Debt-to-equity (%)	21.4	28.7	-	-7.3%p
ROA (%)	11.2	12.8	-	-1.6%p
ROE (%)	13.6	16.5	-	-2.9%p

Cash Flows

Cash and cash equivalents at the end of 2017 soared 60.4% from the previous year to KRW 1.10 trillion. Cash flows from operating activities fell by 18.5% year-on-year to KRW 1.10 trillion due mainly to the decreases of KRW 112.5 billion in net profit and tobacco excise payables. Cash flows from investing activities improved 65.3% from the previous year to minus KRW 235.8 billion due to the decrease of investments in short-term financial instrument. Cash flows from financing activities were minus KRW 449.7 billion due mainly to dividend payment.

Summarized cash flows (KRW in billions)

Classification	2017	2016	Change	% change
Cash flows from operating activities	1,101.9	1,352.1	-250.2	-18.5
Cash flows from investing activities	-235.8	-680.2	444.4	65.3
Cash flows from financing activities	-449.7	-428.3	-21.4	-5.0
Cash and cash equivalents at the beginning of year	688.7	444.4	244.3	55.0
Cash and cash equivalents at the end of year	1,104.8	688.7	416.1	60.4

Dividend

Dividend per share was KRW 4,000 in 2017 and a total of KRW 505.1 billion will be paid.

Dividend payment

Classification	Unit	2017	2016
Net profit	KRW in billions	974.9	1,087.3
Total dividends		505.1	454.6
Dividend per share	KRW	4,000	3,600

ESG Performance

1. Environment

Classification		Unit	2015	2016	2017
Raw material	Purchase	KRW in millions	298,350	324,910	312,329
	Consumption	Ton	39,373	43,272	43,362
Water consumption		Ton	413,044	384,605	464,573
Energy consumption ¹		TJ	1,927.68	1,893.15	-
GHG emissions		tCO2	96,884.48	94,828.92	-
Waste discharge		Ton	2,333	2,368	2,960

¹ Data on energy consumption and GHG emissions in 2017 will be released in May 2018 by the Ministry of Environment.

2. Society

Classification		Unit	2015	2016	2017
Employees	No. of employees		4,194	4,193	4,183
	Recruitment of minorities		139	137	133
Employment and retirement	Employment	Persons	148	68	101
	Retirement		222	50	127
Childbirth and childcare leave	No. of childbirth leave users		123	103	113
	No. of childcare leave users		26	47	77
Labor practice		%	89.3	88.3	90
Training	Annual training costs per employee	KRW in thousands	1,206	949	1,070
	Annual training hours per employee	Hours	65.7	104.6	117.0
Performance evaluation		%	89.5	90.1	88.4
Human rights		Persons	3,907	4,034	3,933
Social contribution		KRW in billions	80.8	72.8	113.9
Customer information protection		Cases	0	0	0
Ethical management		Cases	28	18	15
R&D	R&D expenses	KRW in millions	12,569	12,249	16,081
	No. of IP rights (cumulative)	Cases	3,180	3,296	3,309
Safety	Industrial accident rate	%	0.07%	0.05%	0.02%
	Accident frequency rate	%	0.3548	0.2366	0.1178
	Total working hours	Hours	8,455,104	8,453,088	8,419,392
	Loss days	Days	424	291	272
	Rate of loss days	%	0.005	0.0034	0.0032

¹ Regular employees excluding executives and acting executives

3. Governance

Classification		Unit	2015	2016	2017
BOD	No. of the BOD meetings	Times	18	21	13
	Attendance rate of non-executive directors	%	93.7	97.7	92.2
Governance evaluation level (by CGS)		-	A+	A+	A
Remuneration of directors		KRW in millions	3,972	2,179	3,766

Diagnosis and Analysis of ESG Performances

1. Principles

The diagnosis and analysis of ESG performances was prepared to share KT&G’s performances in the fields of environment, society, and governance with both the management and stakeholders including shareholders and institutional investors. We used the following criteria for the diagnosis and analysis.

GRI (Global Reporting Initiatives) Guideline

GRI Guideline provides principles for reporting strategies, activities, performances, and plans with regard to economic, environmental, and social responsibility of a company. It helps stakeholders understand sustainability activities and performances based on aspects and indicators.

<Integrated Reporting> Framework of IIRC

This principle offers a framework how a company’s corporate governance, business model, strategy, and outlook are connected with operating performances. It requires an integrated reporting of all critical financial and non-financial factors which affect a company’s long-term value creation ability beyond conventional financial reporting.

UNGC (United Nations Global Compact) 10 Principles

This guideline consists of 10 principles in terms of human rights, labor, environment, and anti-corruption which should be complied for the improvement of sustainable development, ethics, and environment in the global society when a company operates businesses.

ISO 26000

This ISO 26000 is a global standard to check the compliance of corporate social responsibility. It consists of seven principles of environment, human rights, labor, corporate governance, fair business practice, consumer issue, and engagement in local communities, serving as a yardstick for CSR evaluation.

2. Environment

Raw materials

Leaf tobacco is core material for KT&G’s products. Procured leaf tobacco goes through a process to separate stems and leaves. The next processes are producing and treating leaf tobacco and byproducts and then reshaping materials for the manufacturing of cigarettes.

Purchase and consumption of raw materials

Classification	Unit	2015	2016	2017
Purchas of raw materials (leaf tobacco, tobacco sheet, and byproducts)	KRW in millions	298,350	324.910	312,329
Consumption of raw materials	Ton	39,373	43,272	43,362

Water resource

Water consumption is calculated on the basis of water charges at Sintanjin, Eyeongju, Gwangju, and Cheonan plants. We endeavor to reduce the emission of effluent with the principle of making wastewater discharge with little influence on ecosystem around worksites a rule.

Water consumption

Classification	Unit	2015	2016	2017
Water supply	Ton	322,459	289,115	365,873
Underground water		90,585	95,490	98,700
Total		413,044	384,605	464,573

Energy consumption and GHG emissions

In order to respond to tightening regulations on energy use and GHG emissions due to climate change and global warming, KT&G is proactive in increasing energy efficiency and reducing GHG emissions. Energy sources used at four plants are classified into fuel (LNG) and electricity.

Energy consumption and GHG emissions

Classification		2014	2015	2016 ¹
Energy (TJ)	Fuel (LNG)	664.70	720.43	571.13
	Electricity	1,308.17	1,207.25	1,322.02
	Total	1,972.87	1,927.68	1,893.15
GHG (tCO ₂)	Direct emission (Scope 1)	37,600.55	38,251.29	30,621.32
	Indirect emission (Scope 2)	63,534.67	58,633.19	64,207.60
	Total	101,135.22	96,884.48	94,828.92

¹ We presented data for 2016 because energy consumption and GHG emissions data for 2017 will be released in May 2018 by the Ministry of Environment after publishing this report.

Waste

We strive to reduce waste emissions from business activities. As part of this, consumption of raw materials has been decreased by developing and applying technologies that reduce byproducts in the manufacturing process. We also increase the recycling rate of byproducts by securing technologies to reuse raw materials separated in the process.

Waste discharge

Classification	Unit	2015	2016	2017
Waste discharge	Kg	2,332,789	2,367,998	2,959,844

3. Society

Employees

As of 2017, there are a total of 4,183 employees working for KT&G (4,062 regular and 121 non-regular workers).

Employment of minorities

Classification	Unit	2015	2016	2017
Employment of the disabled	Persons	139	137	133

Employment and retirement

100 new employees were recruited in 2017, which was an increase of 47% from the previous year. KT&G's recruitment process does not discriminate against nationality, gender or religion and our employment policy ensures equal treatment of all our employees.

Employment and retirement

Classification	Unit	2015	2016	2017
No. of new recruits	Persons	148	68	101
No. of retirees		222	50	127

Childbirth and childcare leave

KT&G is committed to mitigating employees' burdens on childbirth and childcare. To this end, we operate the one-year maternity leave system, childbirth support system to celebrate their childbirth, supports for school expenses, and childcare leave program. Particularly, the number of paternity leave users increased 200% compared with the previous year on the back of active promotion.

Childbirth and childcare leave

Classification	Unit	2015	2016	2017
No. of childbirth leave users (male)	Persons	101	89	97
No. of childbirth leave users (female)		22	14	16
Rate of return to work after childbirth leave	%	99	100	100
No. of childcare leave users (male)	Persons	5	22	42
No. of childcare leave users (female)		21	25	35
Rate of return to work after childcare leave	%	96	98	100
Turnover rate within 12 months after return to work		4	2	0

Labor practice

The freedom of association stipulated in the ILO Convention and the domestic labor law is respected at KT&G. And the company strives to build a desirable labor-management culture based on trust and respect. As part of that, the Labor-Management Council is held every quarter to discuss a variety of agendas including wage negotiation, welfare benefit, HR system, and safety at workplace.

Unionization status

Classification	Unit	2015	2016	2017
Employees who are eligible to join the labor union	Persons	3,929	4,023	3,981
Unionization rate	%	89.3	88.3	90.0

Employee training

Employees are critical assets and the base of competitiveness at KT&G. The company make a concerted effort to create better working conditions and provide them with systematic training programs aimed at supporting career development. In 2017, the annual average training expenses and hours per employee increased 13% and 12% from the previous year.

Employee training

Classification	Unit	2015	2016	2017
No. of participants (cumulative)	Persons	21,680	22,636	22,138
Annual average training expenses per capita	KRW in thousands	1,206	949	1,070
Annual average training hours per capita	Hours	65.7	104.6	117.0

Performance evaluation

Employee evaluation is fairly conducted in accordance with the HR management rule. The company evaluates employees in two categories – performance and capability – and accumulated evaluation results are reflected to their promotion and incentives.

Performance evaluation results¹

Classification	Unit	2015	2016	2017
No. of employees eligible for performance evaluation	Persons	3,753	3,778	3,699
Rate of performance evaluatees	%	96.9	95.4	95.3

¹ Regular employees excluding executives and acting executives

Human rights protection

KT&G continuously monitors potential risks related to human rights at all worksite at home and abroad. In addition, to preemptively prevent disgraceful incidents and cases within the company, all employees are encouraged to obligatorily complete sexual harassment prevention programs.

Sexual harassment prevention program

Classification	Unit	2015	2016	2017
No. of trainings conducted	Times	1	1	1
No. of employees who completed the trainings	Persons	3,907	4,034	3,933

Social contribution

In order to fulfill the role and responsibility as a corporate citizen, KT&G conducts social contribution activities based on core values of "hope", "creativity", and "mutual growth". We have also established a mid to long-term social contribution plan aimed at contributing to solving social issues beyond just short-term and temporary volunteer services. As part of this, a total of 330 billion will be invested in helping young adults start businesses and expanding the infrastructure of culture industry including Sangsang Madang Busan from 2015 to 2018.

Social contribution activities

Classification	Unit	2015	2016	2017
Social responsibility activities ¹	KRW in billions	28.9	16.9	17.4
Culture & art activities ²		20.1	20.6	81.3
Scholarship and welfare foundation		11.8	15.3	15.2
Donation to scholarship foundation		20.0	20.0	0
Total investments in social contribution		80.8	72.8	113.9
Ratio of social contribution investments compared with sales	%	2.9	2.5	3.8

¹ Social contribution activities such as Sangsang Fund, sponsorships, Sangsang Univ., etc.

² Cultural contribution activities centered on Sangsang Madang

Customer information protection

KT&G complies with personal information regulations guided by the Act on Promotion of Information and Communications Network Utilization and Information Protection, etc. and personal information protection guidelines of the Ministry of the Interior and Safety. Since the setup of personal information handling principles in September 2015, we have disclosed how we use personal information and what we act to protect it. Company-wide efforts to protect personal information have resulted in zero leakage since 2015.

Leakage of customer information

Classification	Unit	2015	2016	2017
No. of customer information leakages	Cases	0	0	0

Ethical management

Since stipulating the Charter of Ethics and Code of Ethics in 2013, KT&G has been conducting diverse activities such as monitoring of ethical risks, regular diagnosis, and inspection on unethical cases and countermeasures by operating an exclusive organization responsible for ethical management. If any unethical behavior is reported or found, strict inspections are carried out and then stringent measures of dismissal, suspension, and wage cut are taken.

Disciplinary actions

Classification	Unit	2015	2016	2017
Dismissal	Cases	0	1	4
Suspension		6	6	5
Wage cut		4	5	1
Warning, etc.		18	6	5
Total		28	18	15

Supply chain

KT&G's principal is to pursue fair trade with our suppliers to contribute towards the formation of a healthy industrial ecosystem and improve sustainability in the supply chain. We implement diverse activities for the growth and development of our suppliers.

For example, we make early payments to our suppliers for the costs of goods delivered just before the national holidays. This is to help alleviate their capital shortages as suppliers experience a temporary bottleneck of capital outflows during the national holidays.

We also purchase the entire crop of leaf tobacco produced from domestic farms even though their prices are usually two to four times higher than that of leaf tobacco produced overseas.

Early payment of purchasing costs

Classification	Unit	2015	2016	2017
Early payment of purchasing costs	KRW in billions	41.4	49.8	46.7
Purchase of domestic lead tobacco	KRW in billion	87.2	88.4	79.7

R&D

The company has been devoting itself to developing core and basic technologies for enhancing product competitiveness, launching new products, and improving the quality of existing products. R&D investments had slightly decreased in 2014 due to the completion of technology development for cigarette flavor capsules and plant construction, while the scope and volume of R&D have maintained over a certain level every year.

R&D status

Classification	Unit	2015	2016	2017
R&D projects	Items	41	45	63
Patents	Items	98	106	156

4. Corporate governance

BOD composition

KT&G's BOD is composed of eight directors, six (75%) of whom are non-executive directors. The percentage satisfies the recommendations of the KCGS's Corporate Governance Code (which requires that the number of non-executive directors in the BOD should be the majority of the total number of directors) and is higher than the average of large companies in Korea (which is 50.2% according to data released by the Fair Trade Commission in December 2016 about the corporate governance structures of major companies in Korea). Moreover, KT&G stipulates that there should be a seperate CEO and BOD Chairman in order to create favorable conditions where directors can freely express their opinions.

Compliance with recommendations of Corporate Governance Code

Recommendations	Adoption	Remark
Introduction of the Charter of Corporate Governance	O	-
BOD composition (majority of non-executive directors)	O	2 executive directors and 6 non-executive directors
Separation of the CEO and BOD Chairman, or appointment of a senior non-executive directors	O	Separation of the CEO and BOD Chairman
Disclosure on BOD activities, attendance rate, and agreement on major agendas	O	-
Establishment of regulations about the roles and operational process of the BOD and subcommittees	O	-
Evaluation on the BOD activities	O	-

BOD operation

In 2017, the BOD was held 13 times and the attendance rate of non-executive directors was 92.2%, a decrease of 5.5%p from the previous year.

BOD operation status

Classification	Unit	2015	2016	2017
No. of the BOD meetings	Times	18	21	13
Attendance rate of non-executive directors	%	93.7	97.7	92.2

Evaluation on corporate governance

KT&G has received excellent ratings in the area of Corporate Governance in the ESG (Environment, Social, Governance) evaluations conducted by KCGS for six consecutive years from 2011.

Evaluation on corporate governance

Classification	2015	2016	2017
Corporate governance evaluation level	A+	A+	A

Performance evaluation and remuneration

The remuneration of the BOD is set up through performance evaluation every year. It uses quantitative indices consisting of sales, operating profit, domestic M/S, etc. and qualitative indices in terms of value creation of new growth engines, infrastructure innovation of the Group, and solidifying the foundation for transparent and ethical management. Remuneration limit is decided at the general shareholders’ meeting and payment is fairly conducted in accordance with regulations. Individual remuneration over KRW 500 million is disclosed on the business report according to the revised law since 2014.

Payment of the BOD remuneration

Classification	Unit	2015	2016	2017
Total amount of remuneration	KRW in millions	3,972	2,179	3,766

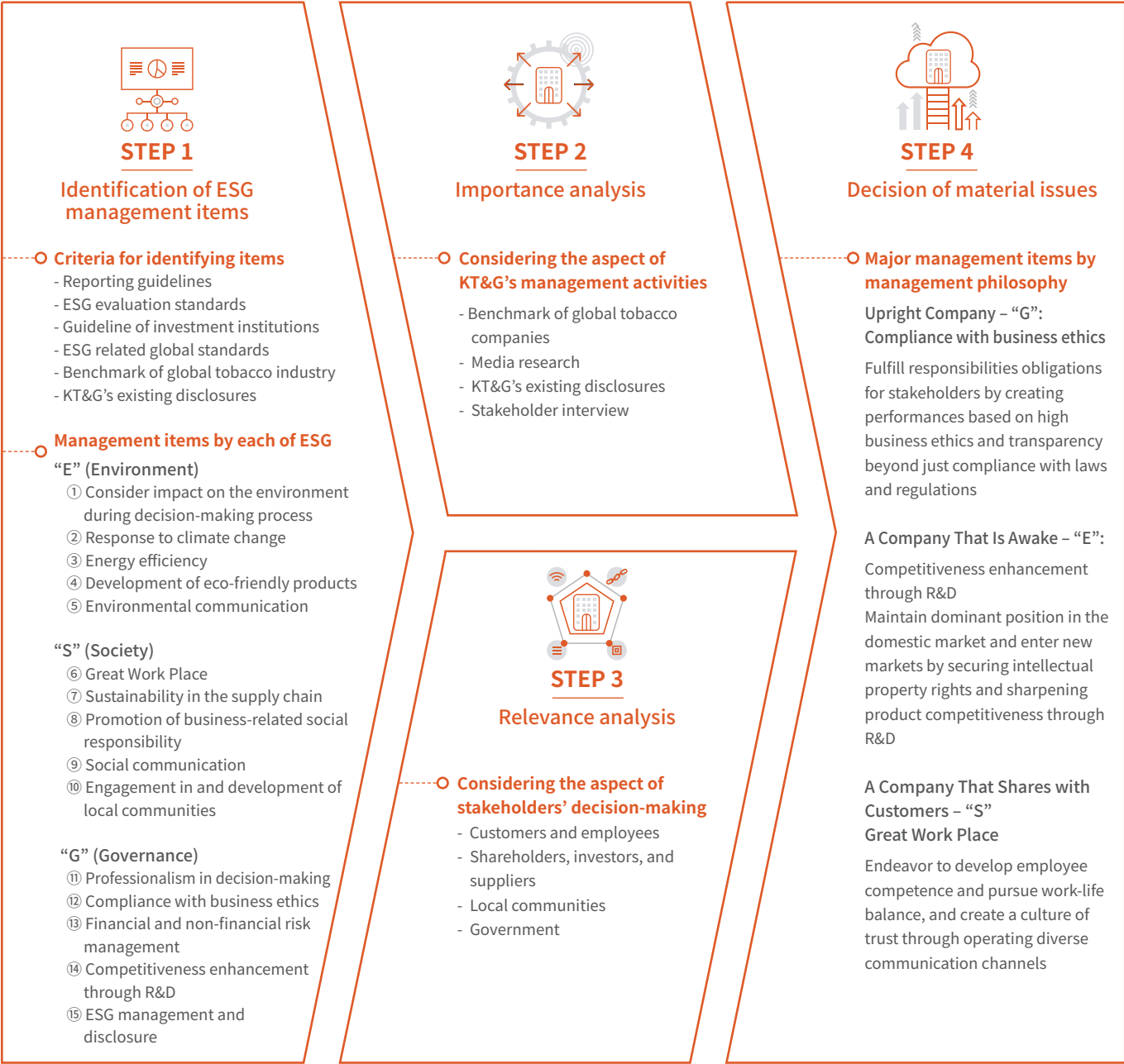
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2017 Materiality Analysis

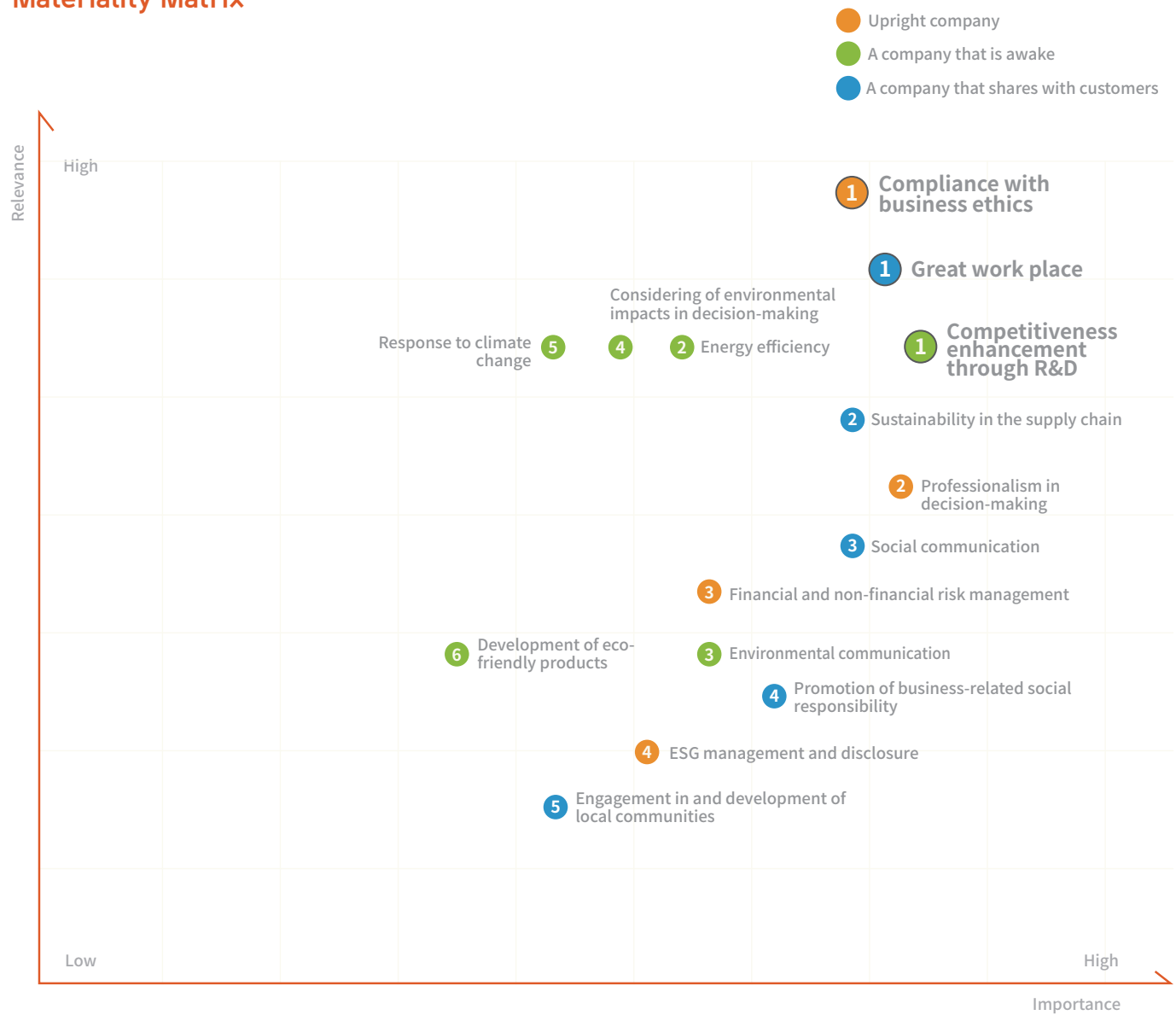
KT&G prepared this report by reflecting the interests of stakeholders as well as corporate value creation ability which affects the evaluation of financial capital provider. With the aim of identifying environment, society, and governance issues related to our businesses, we analyzed the ESG disclosure guidelines, internal and external ESG evaluation items, investment criteria of institutional investors, international CSR initiatives, and disclosures of the company and the industry, through which 15 issues – five issues from each side of environment, society, and governance – were drawn up. Material topics were selected on the basis of the magnitude about impacts on our value creation process and importance and relevance were used as yardsticks for the judgement of magnitude.

Materiality Analysis Process



The identified ESG issues were reported by matching with our management principles of "Upright Company", "A Company That Is Awake", and "A Company That Shares with Customers". As a result of materiality analysis, "Compliance with Business Ethics", "Competitiveness Enhancement through R&D", and "Great Work Place" were selected as the most material issues in the aspects of respective management principles in this report. KT&G will continue to reflect critical ESG issues in our management activities in a timely manner by analyzing the trends at home and abroad.

Materiality Matrix



1. General Standard Disclosures			Report page	note
A. Strategy and Analysis				
G4-1	Core	A general strategic view of the organization's sustainability, in order to provide context for subsequent, more detailed reporting against other sections of the Guidelines	4-5	
G4-2		A description of key impacts, risks, and opportunities	14-19	
B. Organizational Profile				
G4-3	Core	Name of the organization	2, 6	
G4-4	Core	Primary brands, products, and services	10-11	
G4-5	Core	Location of the organization's headquarters	2	
G4-6	Core	The number of countries where the organization operates, and names of countries where either the organization has significant operations or that are specifically relevant to the sustainability topics covered in the report	10-11	
G4-7	Core	Nature of ownership and legal form	6, 13	
G4-8	Core	Markets served (including geographic breakdown, sectors served, and types of customers and beneficiaries)	10, 14-19	
G4-9	Core	Scale of the organization	8-12	
G4-10	Core	Total number of employees by employment contract, gender, region, work scope of non-permanent employees, significant changes in number of employees	64, 67	
G4-11	Core	Percentage of total employees covered by collective bargaining agreements	64, 67	
G4-12	Core	The organization's supply chain	8-9, 42-43, 70	
G4-13	Core	Significant changes during the reporting period regarding the organization's size, structure, ownership or supply chain	4-5, 14-19, 50	
G4-14	Core	Reporting whether and how the precautionary approach or principle is addressed by the organization	22-25, 34-35, 69	
G4-15	Core	Externally developed economic, environmental and social charters, or other initiatives to which the organization subscribes or which it endorses	78	
G4-16	Core	Memberships of association and national or international advocacy organizations	79	
C. Identified Material Aspects and Boundaries				
G4-17	Core	Entities included in the organization's consolidated financial statements or equivalent documents	11	
G4-18	Core	Process for defining the report content and the Aspect Boundaries and how they are implemented	73-74	
G4-19	Core	All the material Aspects identified in the process for defining report content	74	
G4-20	Core	Report on whether the Aspect is material within the organization	73	
G4-21	Core	Report on whether the Aspect is material outside of the organization	73	
G4-22	Core	Effect of any restatements of information provided in previous reports, and the reasons for such restatements	8-9, 66	
G4-23	Core	Significant changes in the Aspect Boundaries and the Aspect in post-reporting period	2	Integrated reporting
D. Stakeholder Engagement				
G4-24	Core	List of stakeholder groups engaged by the organization	28-29	
G4-25	Core	Basis for identification and selection of stakeholders with whom to engage	28-29	
G4-26	Core	The organization's approach to stakeholder engagement	29, 73	
G4-27	Core	Key topics and concerns that have been raised through stakeholder engagement and how the organization has responded to those key topic and concerns	28-29, 73	
E. Report Profile				
G4-28	Core	Reporting period for information provided	2	
G4-29	Core	Date of most recent previous report	2	
G4-30	Core	Reporting cycle	2	
G4-31	Core	Contact point for questions regarding the report for its contents	2	
G4-32	Core	Report on 'in accordance' option the organization has chosen, the GRI Content Index for the chosen option, the reference to the External Assurance Report, if the report has been externally assured	2, 75-77, 80-81	
G4-33	Core	Report on the organization's policy and current practice with regard to seeking external assurance for the report, the relationship between the organization and the assurance providers, and whether the highest governance body or senior executives are involved in seeking assurance for the organization's sustainability report	2, 80-81	
F. Governance				
G4-34	Core	The governance structure of the organization, including committees of the highest governance body	52	
G4-35		The process for delegating authority for economic, environmental and social topics from the highest governance body to senior executives and other employees	52-55	
G4-36		(1) Report on whether the organization has appointed an executive-level position or positions with responsibility for economic, environmental and social topics, and whether post holders report directly to the highest governance body (2) System that enable responsible executives directly report to governance organization	52-55	
G4-37		Processes for consultation between stakeholders and the highest governance body on economic, environmental and social topics. If consultation is delegated, describe to whom and any feedback processes to the highest governance body	52-55	
G4-38		Composition of the highest governance body and its committees	50-55	
G4-39		Report on whether the Chair of the highest governance body is also an executive officer	50	
G4-40		Report on the nomination and selection processes for the highest governance body and its committees and the criteria used for nominating and selecting highest governance body members	52, 55	
G4-41		Report on processes for the highest governance body to ensure conflicts of interest are avoided and managed	55	
G4-43		The measures taken to develop and enhance the highest governance body's collective knowledge of economic, environmental and social topics	55	
G4-44		(1) The processes for evaluation of the highest governance body's performance with respect to governance of economic, environmental and social topics (2) Actions taken in response to evaluation of the highest governance body's performance with respect to governance of economic, environmental and social topics, including, as a minimum, changes in membership and organizational practice	53-54	
G4-45		(1) The highest governance body's role in the identification and management of economic, environmental and social impacts, risks, and opportunities (2) Report whether stakeholder consultation is used to support the highest governance body's identification and management of economic, environmental and social impacts, risks, and opportunities	34-35	
G4-46		The highest governance body's role in reviewing the effectiveness of the organization's risk management processes for economic, environmental and social topics	34-35	
G4-47		The frequency of the highest governance body's review of economic, environmental and social impacts, risks, and opportunities	34-35	
G4-51		(1) The remuneration policies for the highest governance body and senior executives for the below types of remuneration (2) How performance criteria in the remuneration policy relate to the highest governance body's and senior executives' economic, environmental and social objectives	54-55	
G. Ethics and Integrity				
G4-56	Core	The Organization's values, principles, standards and norms of behavior such as codes of conduct and codes of ethics	22, 25	KT&G's internet home page
G4-57		Internal and external mechanisms for seeking advice on ethical and lawful behavior, and matters related to organizational integrity, such as advice lines	23-24	
G4-58		Internal and external mechanisms for seeking advice on unethical and unlawful behavior, and matters related to organizational integrity, such as escalation through line management, whistleblowing mechanisms or hotlines		

GRI Content Index

2. Specific Standard Disclosures		Report page	note
A. Disclosures on Management Approach			
G4-DMA	(1) Why the Aspect is material. Report the impacts that make this Aspect material	22, 30, 38	
	(2) How the organization manages the material Aspect or its impacts		
	(3) The evaluation of the management approach		
B. Performance Indices by Aspects			
Economic			
Economic Performance			
G4-EC1	Direct economic value generated and distributed	8-9, 61-63	
G4-EC2	Financial implications and other risks and opportunities for the organization's activities due to climate change	36-37, 66	
Market Presence			
G4-EC5	Ratios of standard entry level wage by gender compared to local minimum wage at significant locations of operation	39	
G4-EC6	Proportion of senior management hired from the local community at significant locations of operation	10	
Indirect Economic Impacts			
G4-EC7	Development and impact of infrastructure investment and services supported	8-9, 44-49	
G4-EC8	Significant indirect economic impacts, including the extent of impacts	8-9, 44-49	
Procurement Practices			
G4-EC9	Proportion of spending on local suppliers at significant locations of operation	42, 70	
Environmental			
Material			
G4-EN1	Materials used by weight or volume	65-66	
G4-EN2	Percentage of materials used that are recycled input materials	37	
Energy			
G4-EN3	Energy consumption within the organization	64, 66	
G4-EN4	Energy consumption outside of the organization	64	
G4-EN6	Reduction of energy consumption	36-37	
G4-EN7	Reductions in energy requirements of products and services	n/a	
Water			
G4-EN8	Total water withdrawal by source	66	
Biodiversity			
G4-EN11	Operational sites owned, leased, managed in, or adjacent to, protected areas and areas of high biodiversity value outside protected areas	n/a	
G4-EN12	Significant impacts of activities, products, and services on biodiversity in protected areas and areas of high biodiversity value outside protected areas	n/a	
G4-EN13	Habitats protected or restored	n/a	
G4-EN14	Total number of IUCN red list species and national conservation list species with habitats in areas affected by operations by level of extinction risk	n/a	
Emission			
G4-EN15	Direct greenhouse gas (GHG) emissions	64, 66	
G4-EN16	Indirect greenhouse gas (GHG) emissions	64, 66	
G4-EN19	Reduction of greenhouse gas (GHG) emissions intensity	37	
Effluents and Wastes			
G4-EN23	Total weight of waste by type and disposal method	66	
G4-EN24	Total number and volume of significant spills	n/a	
G4-EN25	Weight of transformed, imported, exported, or treated waste deemed hazardous under the terms of the Basel Convention Annex I, II, III and VIII, and percentage of transported waste shipped internationally	n/a	
G4-EN26	Identity, size, protected status, and biodiversity value of water bodies related habitats significantly affected by the organization's discharge of water and runoff	n/a	
Products and Services			
G4-EN27	Extent of impact mitigation of environmental impacts of products and services	37	
G4-EN28	Percentage of products sold and their packaging materials that are reclaimed by category	37	
Compliance			
G4-EN29	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with environmental laws and regulations	n/a	
Environmental Grievance Mechanisms			
G4-EN34	Number of grievances about environmental impacts filed, addressed, and resolved through formal grievance mechanisms	n/a	
Social			
Labor Practices and Decent Work			
Employment			
G4-LA1	Total number and rates of new employee hires and employee turnover by age group, gender and region	64, 67	
G4-LA2	Benefits provided to full-time employees that are not provided to temporary or part-time employees, by significant locations of operation	40	
G4-LA3	Return to work and retention rates after parental leave, by gender	64, 67	
Occupational Health and Safety			
G4-LA6	Type of injury and rates of injury, occupational diseases, lost days, and absenteeism, and total number of work-related fatalities, by region and gender	64	
Training and Education			
G4-LA9	Average hours of training per year per employee by gender, and by employee category	64, 68	
G4-LA10	Programs for skills management and lifelong learning that support the continued employability of employees and assist them in managing career endings	39	
Diversity and Equal Opportunity			
G4-LA12	Composition of governance bodies and breakdown of employees	64, 67	
Equal Remuneration for Women and Men			
G4-LA13	Ratio of basic salary and remuneration of women to men by employee category, by significant locations of operation	39	

GRI Content Index

2. Specific Standard Disclosures		Report page	note
Social			
Human Rights			
Investment			
G4-HR2	Total number of employee training on human rights policies or procedures concerning aspects of human rights that are relevant to operations, including the percentage of employees trained	64, 68	
Child Labor			
G4-HR5	Operations and suppliers identified as having significant risk for incidents of child labor, and measures taken to contribute to the effective abolition of child labor	78	
Forced or Compulsory Labor			
G4-HR6	Operations and suppliers identified as having significant risk for incidents or forced or compulsory labor, and measures to contribute to the elimination of all forms of forced or compulsory labor	78	
Indigenous Rights			
G4-HR8	Total number of incidents of violations involving rights of indigenous peoples and actions take	n/a	
Society			
Local Communities			
G4-SO2	Operations with significant actual and potential negative impacts on local communities	44~49	
Anti-corruption			
G4-SO4	Communication and training on anti-corruption policies and procedures	26	
G4-SO5	Confirmed incidents of corruption and actions taken	69	
Public Policy			
G4-SO6	Total value of political contributions by country and recipient/beneficiary	n/a	
Anti-competitive Behavior			
G4-SO7	Total number of legal actions for anti-competitive behavior, anti-trust, and monopoly practices and their outcomes	n/a	
Compliance			
G4-SO8	Monetary value of significant fines and total number of non-monetary sanctions for non-compliance with laws and regulations	n/a	
Product Responsibility			
Customer Health and Safety			
G4-PR2	Total number of incidents of non-compliance with regulations and voluntary codes concerning the health and safety impacts of products and services during their life cycle, by type of outcomes	n/a	
Product and Service Labeling			
G4-PR3	Type of product and service information required by the organization's procedures for product and service information and labeling, and percentage of significant product and service categories subject to such information requirements	14~15	
G4-PR4	Total number of non-compliance with regulations and voluntary codes concerning product and service information and labeling, by type of outcomes	n/a	
G4-PR5	Results of surveys measuring customer satisfaction	79	
Marketing Communications			
G4-PR6	Sale of banned or disputes products	n/a	
G4-PR7	Total number of incidents of non-compliance with regulations and voluntary codes concerning marketing communications, including advertising, promotion, and sponsorship, by type of outcomes	n/a	
Customer Privacy			
G4-PR8	Total number of substantiated complaints regarding breaches of customer privacy and losses of customer data	n/a	
Compliance			
G4-PR9	Monetary value of significant fines for non-compliance with laws and regulations concerning the provision and use of products and services	n/a	

UN Global Compact

Classification	10 Principles	Page
Human Rights	1. Companies shall support and respect protection of internationally proclaimed human rights.	66~67, 70
	2. Companies shall make sure that they are not complicit in human rights abuses.	66~67, 70
Labor	3. Companies shall uphold the freedom of association and the effective recognition of the right to collective bargaining	30~31, 69
	4. Companies shall uphold the elimination of all forms of forced and compulsory labor	26
	5. Companies shall uphold the effective abolition of child labor.	26
Environment	6. Companies shall uphold the elimination of discrimination in employment and occupation.	27, 41~42, 69
	7. Companies shall support a precautionary approach to environmental challenges.	38~39
	8. Companies shall undertake initiatives to promote environmental responsibility.	38~39, 67~68
Anti-corruption	9. Companies shall encourage development and diffusion of environmentally friendly technologies.	39
	10. Companies shall work against corruption in all its forms, including extortion and bribery.	24~27

Awards and Association Memberships

Association Memberships

Institution	Year joined	Purpose of establishment
Korea International Trade Association	1989	A trade promotion service agency that proposes trade deregulation to the government and informs the government of financial difficulties and supports the trade cooperation in the private sector and the building of trade infrastructure. Supporting small and medium-sized trading companies through the trade support team, the translation/interpretation center, the trade incubator, assistance with overseas transactions, and provision of trade funds.
Korean Mecenat Association	1994	Bridging businesses that support arts, culture and cultural organizations by being continuously involved in creative activities so that the economy and culture can grow by complementing each other.
Korea Tobacco Association	1998	A purely civilian organization consisting of four major cigarette makers. Ensuring that the society understands the cigarette industry fairly and objectively by collecting and disseminating information about cigarettes. Promoting intra-industry cooperation based on fairness and contributing to the sound development of the domestic cigarette industry and the national economy by appropriately coping with the social atmosphere surrounding the cigarette industry.
Korea Fair Competition Federation	1999	Serving as a bridge between the government and the industry by helping the private sector better understand the fair trade system, promoting autonomous fair competition and making suggestions to the government regarding fair trade policies.
Korea Trade-Investment Promotion Agency	2001	A government-invested agency founded to contribute to the development of the national economy by promoting trade, supporting investments between local and overseas corporations and promoting industrial and technological cooperation.

2016~2017 Awards

Award	Awarded by	Details	Year
USD 8 Million Export Tower	Korea International Trade Association	Recognized for export performance for the year	2017
2017 Korea’s Top 100 Brand	Brand Stock	ESSE ranked 50th in all sectors and 1st in the tobacco sector.	
2017 Volunteer Service of Merit Citation (Gyeongbuk HQ)	Gyeongsangbuk-do	Recognized for excellence in social contribution activities for local communities	
Collar Badge of Korean Red Cross Member of Merit	Korean Red Cross	Recognized for excellence in social contribution activities for local communities in 2016	
Excellent Volunteer Service Institution Award	Daegu Social Service Network	Selected as an excellent institution in volunteer service	
Grand Prize at the Social Contribution Festival of Gwangju and Jeonnam	Gwangju Metropolitan City	Contributed to developing local communities and spreading the culture of sharing	
2017 Volunteer Service Award Certificate	Mayor of Jeonju City	Contributed to developing local communities through social contribution activities	
Appreciation Plaque for Startup Program Operation	Gyeongnam Creative Economy Innovation Center	Operated diverse programs to support startups in 2017	
Citation for Social Contribution for Local Communities	Gwangju Metropolitan City	Dedicated to improving local welfare	
Certification on 2017 K-BPI (Korea Brand Power Index)	Korea Management Association Consulting	Ranked top in the brand power survey (ESSE)	
Best Brand in the 2017 NBCI (National Brand Competitiveness Index)	Korea Productivity Center	Ranked top in the brand competitiveness survey (ESSE)	2016
President Prize for the Labor-Management Culture of Merit	Ministry of Employment and Labor	Promoted mutual growth and cooperation between the labor and management	
Prime Minister Prize at the Nationwide Volunteer Service Festival	Ministry of the Interior and Safety	Recognized for excellence in volunteer service	
USD 7 Million Export Tower	Korea International Trade Association	Recognized for export performance for the year	
Certification on Leisure-friendly Company	Ministry of Culture, Sports and Tourism	Provided leisure-friendly working environment	
Certification on Excellent Company in Supporting Culture and Art	Ministry of Culture, Sports and Tourism	Highly recognized for contributing to the development of culture through the Sangsang Madang	
Appreciation Plaque for Work-Life Balance	Ministry of Employment and Labor	Contributed to the culture of work-life balance	
Best Brand in the 2016 NBCI (National Brand Competitiveness Index)	Korea Productivity Center	Ranked top in the brand power survey (ESSE)	
Grand Prize in the 2016 NCSI (National Customer Satisfaction Index)	Korea Productivity Center	Ranked top in the customer satisfaction in the tobacco sector	2016
Certification on 2016 K-BPI (Korea Brand Power Index)	Korea Management Association Consulting	Ranked top in the brand power survey (ESSE)	

Independent Assurance Report

To the Management of KT&G Corporation

We were commissioned to carry out the assurance engagement of the 2017 KT&G Report (herein ‘the Report’). The Company’s management is responsible for all contents within the Report, while our responsibility is to perform a limited assurance engagement and to express a conclusion on the work performed.

Scope of Assurance

The Company is responsible for collecting and indicating information within the Report. The Company is also responsible for ensuring no critical mistake due to fraud or misconduct by designing, operating, and maintaining internal control system with respect to the organization of the Report. Our responsibility is to perform assurance of partial data (“selected data”) within the Report at the limited level. Selected data are as follow:

- Input and output data of the VALUE CREATION MODEL sector and qualitative statements on the data
- Quantitative data of the GLOBAL NETWORK sector and qualitative statements on the data
- Quantitative data of the BUSINESS REVIEW sector and qualitative statements on the data
- ESG Performance and Diagnosis and Analysis of ESG Performances within FINANCIAL & NON-FINANCIAL STATEMENTS

We have no responsibility for different purposes, persons, or organizations with respect to the results of limited assurance on selected data within the Report. Accordingly, any conclusion on the Report made by the third party should be the responsibility of the third party. We conducted our engagement based on the International Standard on Assurance Engagements (ISAE) 3000¹⁾ issued by the International Auditing and Assurance Standards Board.

In addition, we verified the following matters to perform assurance on whether the Report was prepared in accordance with the GRI G4 Guideline which is recognized as an international guideline for corporate sustainability or not.

Stakeholder Inclusivity

- Whether the Company understands stakeholders and responds to their reasonable expectations and interests or not

Sustainability Context

- Whether the Company reports performances based on the vast sustainability context during the reporting period or not

Materiality and Completeness

- Whether the Company has significant influences on stakeholders’ decision-making and discloses information on economic, environmental, and social topics generated through business activities at the sufficient level or not

¹⁾ International Standard on Assurance Engagement (Revised): Assurance Engagements other than Audits or Reviews of Historical Financial Information

Independent Assurance Report

Work Performed

Considering the possibility of critical mistakes, we planned and performed activities to collect information and statements necessary for providing sufficient evidences that can underpin assurance results.

Assurance process includes the followings.

1. Interview with staff in charge of collecting selected data and ensuring accuracy
2. Review of the adequacy of selected data within the Report including the fact that limitation and assumption of selected data was appropriately indicated
3. Identification of online systems used for collecting selected data and data sample collected through the systems
4. Identification of evidentiary materials of data sample equivalent to those of business sites

Limitation of the Assurance

We performed works for limited assurance on the Report. The procedures necessary for limited assurance are different from reasonable assurance in the aspects of assurance works, features, and period, and the scope of assurance is also narrower. Therefore, the level of assurance which can be acquired from limited assurance work is considerably lower than that of reasonable assurance, thus we do not present reasonable assurance statement.

The scope of our assurance work was limited to reporting period.

We did not perform assurance on the Company’s financial performances and details of financial statements contained the Report.

The Company’s management is responsible for preventing and identifying fraud, mistake, and violence of laws and regulations. Our work should not be used for disclosing any material false statements, fraud, mistakes, or violations which may exist.

Conclusion

Based on the procedures performed and collected information, nothing has come to our attention to indicate that the Report is not presented fairly in accordance with the GRI G4 Guideline.

There was no event or prohibited service provided except for assurance work with respect to the provision of this engagement. We also complied with the IFAC (International Federation of Accountants Code of Ethics).

March 2018

Deloitte Anjin LLC

CEO **Lee Jung-hee**

This KT&G Report is a translation of the original Korean KT&G Report. This translation is for information purposes only and no rights can be derived from its content. In the case of any discrepancies between the English and the Korean version, the Korean original will prevail.



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