KT&G CORPORATION

Interim Financial Statements
Third quarter of the 32nd Fiscal Year From
January 1, 2018 to September 30, 2018

ATTACHMENT: INDEPENDENT AUDITORS' REPORT

KT&G CORPORATION

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Third quarter of the 32nd Fiscal Year
From January 1, 2018, to September 30, 2018

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From July 1, 2018, to September 30, 2018

Deloitte Anjin LLC.

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Review Report on Interim Financial Statements

To the Shareholders and Board of Directors of KT&G CORPORATION

Reviewed financial statements

We have reviewed the accompanying condensed interim financial statements of KT&G Corporation (the "Company"). The financial statements consist of the statement of financial position as of September 30, 2018, the related statements of income and comprehensive income, for the three months and nine months ended September 30, 2018 and the related statements of changes in equity and cash flows for the nine months ended September 30, 2018 all expressed in Korean won, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

The Company's management is responsible for the preparation and fair presentation of the accompanying financial statements in accordance with Korean International Financial Reporting Standards ("K-IFRS") and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express a conclusion on the accompanying financial statements based on our reviews.

We conducted our reviews in accordance with standards for review of interim financial statements in the Republic of Korea. A review is limited primarily to inquiries of Company personnel and analytical procedures applied to financial data, and this provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Deloitte.

Review results

Based on our reviews and review results, nothing has come to our attention that causes us to believe that the accompanying financial statements are not presented fairly, in all material respects, in accordance with Korean International Financial Reporting Standards 1034, 'Interim Financial Reporting'.

Other matters

The Company's comparative condensed statements of comprehensive income for the three-month and nine-month period ended September 30, 2017, comparative condensed statements of cash flows and comparative condensed statements of changes in equity for the quarters then ended were reviewed by KPMG Samjung Accounting Corporation, whose review report dated November 14, 2017, stated that no unfairly presented item was found in these financial statements, in all material respects, in terms of the K-IFRS No. 1034 'Interim Financial Reporting'.

The statement of financial position as of December 31, 2017, the statement of comprehensive income, the statement of changes in equity and the statement of cash flows (not included in this review) were audited in accordance with the Korean Auditing Standards by the KPMG Samjung Accounting Corporation, which expressed its unqualified opinion on the audit report dated February 28, 2018. The accompanying statement of financial position as of December 31, 2017, presented for comparative purposes, does not differ from the above audited statements of financial position with respect to materiality.

10, Gukjegeumyung-ro, Yeongdeungpo-gu, Seoul

Lee Jung Hee, CEO of Anjin Deloitte LLC

Deloitte Anjin LLC

November 14, 2018

This report is effective as of the review report date (November 14, 2018). Certain subsequent events or circumstances, which may occur between the review report date and the time of reading this report, could have a material impact on the accompanying condensed financial statements and notes thereto. Accordingly, the readers of the review report should understand that the above review report has not been updated to reflect the impact of such subsequent events or circumstances, if any.

Accompanying Interim Financial Statements

KT&G CORPORATION

Third quarter of the 32nd Fiscal Year
From January 1, 2018, to September 30, 2018

Third quarter of the 31st Fiscal Year
From January 1, 2017, to September 30, 2017

"The Interim financial statements attached have been prepared by our company."
CEO of KT&G Corporation, Baek Bok In

Address of headquarters: (Road name address) 71, Beotkkot-gil, Daedeok-gu, Daejeon
(Telephone) 080-931-0399

Condensed Interim Statements of Financial Position

Third quarter of the 32nd Fiscal Year As of September 30, 2018

Full year of the 31st Fiscal Year As of December 31, 2017

KT&G CORPORATION Korean won

Accounts	Notes	As of September 30, 2018	As of December 31, 2017
Assets			
Current assets			
Cash and cash equivalents	4,34,37,38	445,714,802,673	1,104,824,809,222
Current other financial assets	4,34,38	220,000,000,000	1,530,000,000,000
Current fair value through profit or loss	5,34,38	2,104,492,588,220	-
Financial derivative	21,34	27,089,617	-
Accrued tobacco excise and other taxes		178,037,751,845	255,821,995,393
Trade and other receivables	6,33,34,38	897,750,937,398	951,435,036,855
Inventories	7	852,590,879,356	872,084,980,486
Advance payments		24,708,718,011	20,259,419,135
Prepaid expenses		7,694,454,716	4,163,466,088
Refund and assets		421,874,000	-
Total current assets		4,731,439,095,836	4,738,589,707,179
Non-current assets			
Other long-term financial assets	4,16,34,38	6,937,220,000	6,340,300,000
Long-term deposits in MSA Escrow Fund	8,34,38	593,472,827,285	510,223,375,080
Available-for-sale financial assets	9,34,38	-	454,051,493,361
Fair value through other comprehensive income or loss	9,34,38	258,292,640,200	-
Fair value through profit or loss	5,34,38	220,211,334,030	-
Investments in associates and joint ventures	10	58,930,010,000	51,930,010,000
Investments in subsidiaries	11	1,211,797,973,493	1,208,227,973,493
Property, plant and equipment	12,16	1,203,964,548,892	1,267,824,790,396
Intangible assets	13	31,068,209,533	27,235,455,547
Investment property	14,16	574,410,426,479	325,422,834,006
Long-term trade and other receivables	6,33	118,381,243,137	80,534,875,600
Long-term advance payments		9,339,756,930	-
Long-term prepaid expenses		7,187,875,611	4,582,421,362
Total non-current assets		4,293,994,065,590	3,936,373,528,845
Non-current assets held of sale	15	4,246,922,005	-
Total assets		9,029,680,083,431	8,674,963,236,024
Liabilities and equity			
Liabilities			
Current liabilities			
Short-term borrowings	17,34	1,418,128,175	1,958,661,660
Trade and other payables	18,33,34	400,259,908,803	386,586,874,355

Accounts	Notes	As of September 30, 2018	As of December 31, 2017
Advance receipts		87,693,032,001	1,801,036,938
Income tax payable		169,118,507,042	145,928,809,669
Tobacco excise and other taxes payable		1,001,947,377,934	914,754,090,453
Refund liabilities and provisions	20	3,430,070,125	-
Derivative liabilities	21,34	2,186,311,632	-
Total current liabilities		1,666,053,335,712	1,451,029,473,075
Non-current liabilities			
Long-term trade and other receipts	17,33	32,787,310,099	21,655,355,805
Long-term advance receipts		652,284,454	581,716,864
Net defined benefit liability	19,33	40,693,400,530	19,084,241,508
Deferred income tax liabilities	38	5,551,977,533	35,969,370,768
Refund liabilities (non-current)	20	2,094,980,169	3,086,128,572
Total non-current liabilities		81,779,952,785	80,376,813,517
Total liabilities		1,747,833,288,497	1,531,406,286,592
Equity			
Ordinary shares	22	954,959,485,000	954,959,485,000
Other capital surplus	22	3,582,160,908	3,582,160,908
Treasury shares	23	(328,157,286,128)	(328,157,286,128)
Gain on sale of treasury shares	23	513,775,933,891	513,775,933,891
Reserve	24	5,450,003,494,801	5,009,300,640,505
Retained earnings	25,38	687,683,006,462	990,096,015,256
Total equity		7,281,846,794,934	7,143,556,949,432
Total equity and liabilities		9,029,680,083,431	8,674,963,236,024

"The accompanying notes are a part of the condensed Interim financial statements."

Condensed Interim Statements of Comprehensive Income

From January 1, 2018, to September 30, 2018

From January 1, 2017, to September 30, 2017

KT&G CORPORATION | Korean won

Accounts	Notes	2018		2017	
		Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Sales	26,33	663,865,225,134	1,941,697,172,504	789,494,946,622	2,316,742,226,417
Manufacture of tobacco		589,159,074,989	1,787,229,378,712	713,325,893,757	2,069,488,913,960
Real estate	27	54,418,808,367	92,767,866,479	41,152,474,692	140,003,509,589
Exports of leaf tobacco and others		20,287,341,778	61,699,927,313	35,016,578,173	107,249,802,868
Cost of sales	28	(239,448,450,107)	(715,584,475,950)	(283,393,520,574)	(835,484,794,885)
Manufacture of tobacco		(206,630,831,422)	(639,060,122,543)	(234,840,211,761)	(675,776,856,029)
Real estate		(17,798,108,038)	(28,019,137,835)	(25,023,937,791)	(88,811,908,007)
Exports of leaf tobacco and others		(15,019,510,647)	(48,505,215,572)	(23,529,371,022)	(70,896,030,849)
Gross profit		424,416,775,027	1,226,112,696,554	506,101,426,048	1,481,257,431,532
Selling, general and administrative expenses	28	(149,095,843,155)	(461,768,244,079)	(167,624,822,152)	(479,800,050,833)
Operating profit	28	275,320,931,872	764,344,452,475	338,476,603,896	1,001,457,380,699
Other income	29,33	16,822,068,394	86,099,038,602	20,876,392,362	34,558,274,221
Other expenses	29,33	(20,203,021,114)	(26,667,976,836)	(12,604,438,324)	(92,205,140,039)
Finance income	30,34	26,286,048,057	138,468,785,678	14,110,055,370	117,633,046,631
Finance costs	30,34	(9,118,481,460)	(4,093,384,318)	(3,738,538,606)	(18,905,630,925)
Net finance income		17,167,566,597	134,375,401,360	10,371,516,764	98,727,415,706
Profit before income tax		289,107,545,749	958,150,915,601	357,120,074,698	1,042,537,930,587
Income tax expense	31	(77,967,030,615)	(237,461,321,102)	(87,649,135,444)	(256,466,270,605)
Profit for the period		211,140,515,134	720,689,594,499	269,470,939,254	786,071,659,982
Other comprehensive income (loss) after income tax:					

Accounts	Notes	2018		2017	
		Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Items that will not be reclassified to profit or loss					
Actuarial gains and losses		(317,473,188)	(1,541,946,056)	40,684,215	(357,819,438)
Gain or loss on valuation of fair value through other comprehensive income or loss		6,499,664,173	(7,419,167,632)	-	-
Gain or loss on disposal of fair value through other comprehensive income or loss		-	(147,755,932)		
Others 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		-	-	1,651,008,413	29,619,042,384
Other comprehensive income after income tax		6,182,190,985	(9,108,869,620)	1,691,692,628	29,261,222,946
Total comprehensive income for the period		217,322,706,119	711,580,724,879	271,162,631,882	815,332,882,928
Earning per sale:					
Basic and diluted	32	1,672	5,708	2,134	6,226

“The accompanying notes are a part of the condensed Interim financial statements.”

Condensed Interim Statements of Changes in Equity

From January 1, 2018, to September 30, 2018

From January 1, 2017, to September 30, 2017

KT&G CORPORATION — Korean won

Accounts	Ordinary shares	Other capital surplus	Treasury shares	Gain on sales of treasury shares	Reserve	Retained earnings	Total
Balance at January 1, 2017	954,959,485,000	3,582,160,908	(328,157,286,128)	513,775,933,891	4,366,268,230,007	1,068,469,079,666	6,578,897,603,344
Total comprehensive income (loss) for the period:							
Profit for the period	-	-	-	-	-	786,071,659,982	786,071,659,982
Other comprehensive income (loss) for the period							
- Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	(357,819,438)	(357,819,438)
- Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	29,619,042,384	-	29,619,042,384
Sum of other comprehensive income (loss) for the period	-	-	-	-	29,619,042,384	(357,819,438)	29,261,222,946
Other comprehensive income (loss) for the period	-	-	-	-	29,619,042,384	785,713,840,544	815,332,882,928
Transactions with owners, recorded directly in equity:							
Dividends	-	-	-	-	-	(454,554,457,200)	(454,554,457,200)
Transfer from reserve for research and human resource development	-	-	-	-	(10,000,000,000)	10,000,000,000	-
Transfer to unconditional reserve	-	-	-	-	623,914,622,466	(623,914,622,466)	-
Total transactions with owners of the parent company	-	-	-	-	613,914,622,466	(1,068,469,079,666)	(454,554,457,200)
Balance at September 30, 2017	954,959,485,000	3,582,160,908	(328,157,286,128)	513,775,933,891	5,009,801,894,857	785,713,840,544	6,939,676,029,072
Balance at January 1, 2018	954,959,485,000	3,582,160,908	(328,157,286,128)	513,775,933,891	5,009,300,640,505	990,096,015,256	7,143,556,949,432
Effects of change in accounting policy	-	-	-	-	(36,765,729,396)	(31,464,641,981)	(68,230,371,377)
Balance at January 1, 2018 (basic after revision)	954,959,485,000	3,582,160,908	(328,157,286,128)	513,775,933,891	4,972,534,911,109	958,631,373,275	7,075,326,578,055
Total comprehensive income (loss):							
Profit for the period	-	-	-	-	-	720,689,594,499	720,689,594,499
Other comprehensive income (loss) for the period							
- Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	(1,541,946,056)	(1,541,946,056)
- Other comprehensive profit (loss)-valuation profit and loss of fair value of financial asset	-	-	-	-	(7,419,167,632)	-	(7,419,167,632)
- Other comprehensive income-fair value gain or loss disposal of financial assets	-	-	-	-	(147,755,932)	-	(147,755,932)
Sum of other comprehensive income (loss) for the period	-	-	-	-	(7,566,923,564)	(1,541,946,056)	(9,108,869,620)
Total comprehensive profit (loss) for the period	-	-	-	-	(7,566,923,564)	719,147,648,443	711,580,724,879
Transactions with owners, recorded directly as equity:							
Dividends	-	-	-	-	-	(505,060,508,000)	(505,060,508,000)
Transfer from reserve for research and human resource development	-	-	-	-	(10,000,000,000)	10,000,000,000	-
Transfer to unconditional reserve	-	-	-	-	495,035,507,256	(495,035,507,256)	-
Total transactions with owners of the parent company	-	-	-	-	485,035,507,256	(990,096,015,256)	(505,060,508,000)
Balance at September 30, 2018	954,959,485,000	3,582,160,908	(328,157,286,128)	513,775,933,891	5,450,003,494,801	687,683,006,462	7,281,846,794,934

“The accompanying notes are a part of the condensed Interim financial statements.”

Condensed Interim Statements of Cash Flows

From January 1, 2018, to September 30, 2018
From January 1, 2017, to September 30, 2017

KT&G CORPORATION Korean won

Accounts	Notes	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Cash flows from operating activities			
Cash generated from operations	37	1,051,632,627,611	1,040,313,217,249
Income tax paid		(215,313,514,072)	(266,240,696,877)
Net cash provided by operating activities		836,319,113,539	774,072,520,372
Cash flows from investing activities			
Interest received		6,913,332,756	33,598,287,670
Dividends received		75,301,152,596	82,599,468,642
Proceeds from sale of property, plant and equipment		30,027,357,528	3,052,099,275
Proceeds from sale of intangible assets		350,864,000	1,350,486,000
Disposal of fair value through other comprehensive income or loss		1,152,600,000	-
Disposal of investment in associated company		5,024,535,939	7,318,754,972
Disposal of investment in subsidiary		-	17,723,668,000
Disposal of fair value through profit or loss		31,553,772,081	-
Disposal of available-for-sale financial assets		-	3,462,129,718
Collection of loans		12,535,885,945	10,388,528,849
Withdrawal of guarantee deposits		2,132,407,005	15,439,976,753
Acquisition of property, plant and equipment		(261,278,572,324)	(172,481,158,073)
Acquisition of intangible assets		(4,241,441,273)	(1,742,024,974)
Acquisition associated company		(12,000,000,000)	(1,000,000,000)
Acquisition subsidiary		(3,570,000,000)	(97,201,843,321)
Acquisition of available-for-sale financial assets		-	(52,946,212,000)
Acquisition of fair value through profit or loss		(61,500,000,000)	-
Payments of guarantee deposits		(4,857,243,070)	(17,049,002,053)
Payments of long-term deposits in MSA Escrow Fund		(52,771,183,882)	(57,337,914,030)
Increase (decrease) in other financial assets, net		(756,540,652,882)	353,659,700,000
Net cash provided by (used in) investing activities		(991,767,185,581)	128,834,945,428
Cash flows from financing activities			
Payment of dividends		(505,060,508,000)	(454,554,457,200)
Decrease in deposits received		(4,029,154,500)	(2,190,422,610)
Increase in deposits received		7,118,185,054	8,193,120,110
Net cash used in financing activities	37	(501,971,477,446)	(448,551,759,700)
Effect of exchange rate fluctuation on cash held		(1,690,457,061)	270,405,125
Net increase in cash and cash equivalents		(659,110,006,549)	454,626,111,225
Cash and cash equivalents at January 1		1,104,824,809,222	688,735,175,839
Cash and cash equivalents at September 30		445,714,802,673	1,143,361,287,064

“The accompanying notes are a part of the condensed Interim financial statements.”

Notes

From January 1, 2018, to September 30, 2018

From January 1, 2017, to September 30, 2017

KT&G CORPORATION

1. ORGANIZATION AND DESCRIPTION OF BUSINESS:

KT&G Corporation (the "Company"), which is engaged in manufacturing and selling tobaccos in order to secure financing and to promote and develop, through efficient management, the monopoly business of red ginseng and tobacco. As of September 30, 2018, the Company has three manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 123 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The headquarters of the Company is located at 71, Beotkkot-gil, Daedeok-gu, Daejeon.

On April 1, 1989, the Company changed its name to Korea Tobacco and Ginseng Corporation pursuant to the Korea Tobacco and Ginseng Corporation Act. Also, pursuant to the Act on Management Reform and Privatization of Public Enterprises, proclaimed and established on April 1, 1987, as Korea Monopoly Corporation, a wholly owned enterprise of the Korean government, pursuant to the Korea Monopoly Corporation Act, and enforced on October 1, 1997, the Company was excluded from the application of the Act for the Management of Government Invested Enterprises. Accordingly, the Company became an entity existing and operating under the Commercial Act of Korea. Pursuant to the Korean government's privatization program and management reorganization plan, on December 28, 1998, the shareholders approved a plan to split the Company into two companies by setting up a subsidiary for its red ginseng business segment effective January 1, 1999. The separation was accomplished by the Company's contribution of the assets and liabilities in the red ginseng business segment into a wholly owned subsidiary, Korea Ginseng Corporation. On December 27, 2002, the Company changed its name again to KT&G Corporation from Korea Tobacco and Ginseng Corporation.

The Korean government sold 28,650,000 shares of the Company to the public during 1999 and the Company listed its shares on the Korea Exchange on October 8, 1999. On October 17, 2002, and October 31, 2001, the Company listed 35,816,658 and 45,400,000 Global Depositary Receipts ("GDR") (each GDR representing the right to receive one-half share of an ordinary share of the Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program. Also, on June 25, 2009, the listing market of the Company's GDR was changed from the BdL market to the Euro MTF in the Luxembourg Stock Exchange.

The ownership of the issued ordinary shares for Company as of September 30, 2018, is held as follows:

Item	Number of shares	Percentage of ownership
National Pension Service	13,191 374	9.61%
Industrial Bank of Korea	9,510 485	6.93%
Employee Share Ownership Association	2,785,803	2.03%
Treasury shares	11,027,370	8.03%
Others	100,777,465	73.40%
Total	137,292,497	100.00%

2. BASIS OF PREPARATION:

(1) Statement of Compliance

The Company has prepared its Interim financial statements in accordance with Korean International Financial Reporting Standards ("K-IFRS"). Our Interim financial statements are Interim financial statements prepared in accordance with K-IFRS No. 1034, Interim Financial Reporting.

These financial statements are separate financial statements prepared in accordance with K-IFRS No. 1027, Separate Financial Statements presented by a parent, an investor in an associate or a venture in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

The separate financial statements were authorized for issue by the Board of Directors on November 8, 2018.

(2) Basis of Measurement

The Interim financial statements have been prepared on the historical cost basis, except for the following material items in the statements of financial position:

- Derivatives measured at fair value
- Available-for-sale financial assets measured at fair value
- Liabilities for defined benefit plans recognized at the net of the total present value of defined benefit obligations less the fair value of plan assets

(3) Functional and Presentation Currency

These Interim financial statements are presented in Korean won, which is the Company's functional currency and the currency of the primary economic environment in which the Company operates.

(4) Use of Estimates and Judgments

The preparation of the Interim financial statements in conformity with K-IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the magnitude of assets, liabilities, income and expenses. Actual results may differ from these estimates if estimates and assumptions that are based on the management's best judgment at the end of the Interim reporting period differ from the actual environment.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Management's assessment of the application of, and estimates of, the Company's accounting policies used in the Interim financial statements is based on the same accounting policies and assumptions used in the annual financial statements for that year ended December 31.

3. SIGNIFICANT ACCOUNTING POLICIES:

The Company adopts the same accounting policies applied in the preparation of the annual financial statements for the year ended December 31, 2017, except for the application of the first-time amendment standards.

- K-IFRS No. 1102 'Share-Based Payments' (Amendments)

The amendments include the following as key contents: 1) the accounting for the effects of vesting conditions and non-vesting conditions in measuring the fair value of cash-settled share-based payment transactions shall address the same approach as that applied to the accounting for equity-settled share-based payment transactions; 2) when an entity makes equity-settled share-based payments to its employees, net of income tax withholdings without net settlement characteristics, then the gross payment amounts shall be classified as the equity settled if classified as such; and 3) if the terms of the cash-settled share-based payment transaction are changed to equity settled, the existing liabilities are eliminated while new measurements are recognized, at the fair value of the equity instruments granted, at the date of the modification. The difference between the carrying amount of the eliminated amount of liabilities and the recognized amount of the equity is immediately recognized in profit or loss. There is no material impact on the Company's financial statements.

- K-IFRS No. 1040 'Investment property' (amended)

The amendment clarifies that a real estate shall be reclassified as investment property if the real estate is supported by the observable evidence that a change in use has occurred based on the assessment of whether the real estate meets or fails to meet the definition of the investment property. The amendments also clarify that the circumstances that are not listed in K-IFRS No. 1040 can be the evidence of changes in use as well and change of use is possible for a real estate under construction, that is, the change in use is not limited to the finished or completed asset. The amendments do not have a material impact on the Company's financial statements.

- The Interpretation No. 2122 'Advance Payment or Receipt of Considerations in Foreign Currency' (enacted)
The interpretation explains how to determine the transaction date for the applicable exchange rate when the related assets, costs or revenues (or a portion thereof) are initially recognized by eliminating non-monetary assets or non-monetary liabilities (e.g., non-refundable deposits or deferred revenue) arising from advanced payment or receipt of a consideration in foreign currency.

The interpretation stipulates that the transaction date is the first day of recognizing the non-monetary assets or non-monetary liabilities, either as an advanced payment or receipt of the consideration that is made. The Interpretation also stipulates that the transaction date for each advanced payment or receipt must be determined separately if the payment or receipt is made several times.

The Company has already accounted for the foreign currency advanced payment or receipt of the considerations in a manner consistent with the Interpretation. Accordingly, the Interpretation has no impact on the financial statements of the Company.

- K-IFRS No. 1109 'Financial Instruments' (enacted)
The Company applied the amendments to K-IFRS No. 1109 and the related amendments to other standards for the first time from the current quarter on January 1, 2018, as the date of initial application. K-IFRS No. 1109 introduced new rules for 1) classification and measurement of financial assets and financial liabilities, 2) impairment of financial assets and 3) hedge accounting.

The Company has adopted a method that does not restate the prior period when applying it for the first time and did not reclassify the comparative financial statements, accordingly.

The main provisions of the new regulations are as follows, and the effect on our financial statements is explained in Note 38.

(1) Classification and measurement of financial instruments

All financial assets included in the scope of K-IFRS No. 1109 are subsequently measured at amortized cost or fair value based on the business model for the management of financial assets and the nature of the contractual cash flows.

- Debt instruments that are held under a business model with the aim to receive contractual cash flows and have contractual cash flows that consist of principal and interest on principal balance alone are subsequently measured at their amortized cost (financial assets at amortized cost).

- Debt instruments that are held under a business model with the aim of both the receipt and sale of the contractual cash flows and have contractual cash flows that consist of principal and interest on principal balance alone are subsequently recognized at their fair value (financial assets at fair value through other comprehensive income).

- All other debt instruments and equity instruments other than the above specified are subsequently measured at fair value and are recognized in profit or loss (financial assets at fair value through profit or loss).

Notwithstanding the foregoing, the Company may make the following irrevocable choice or designation at the time of initial recognition of a financial asset:

- For the investment in equity instruments that are not short-term trading items and that are not contingent consideration recognized by the acquirer in a business combination applying K-IFRS No. 1103, the Company may elect to present subsequent changes in its fair value in other comprehensive income.

- When accounting discrepancies can be eliminated or significantly reduced if designated as items at fair value through profit or loss, debt instruments that meet the requirements of financial assets measured at amortized cost or financial assets measured at fair value through other comprehensive income can be designated as items at fair value through profit or loss.

Of the debt instruments that meet the requirements of financial assets measured at amortized cost or financial assets measured at fair value through other comprehensive income in the current period, there is no debt instrument designated as items at fair value through profit or loss.

If the debt instrument measured at fair value through other comprehensive income (or loss) is removed, the cumulative gain or loss recognized in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment. On the other hand, for equity instruments designated as items at fair value through other comprehensive income (or loss), cumulative gains or losses previously recognized in other comprehensive income are not subsequently reclassified to profit or loss. The debt instruments measured at amortized cost or at fair value through other comprehensive income (or loss) subsequently are subject to the impairment provisions.

Management has reviewed and assessed the financial assets held by the Company based on the facts and circumstances that existed at the date of initial application and determined that there will be the following impacts with respect to the classification and measurement of the Company's financial assets as a result of the initial application of K-IFRS No. 1109:

- Among the debt instruments classified as available-for-sale financial assets in accordance with K-IFRS No. 1039, the debt instruments that are held under a business model with the aim of both the receipt and sale of the contractual cash flows and have contractual cash flows that consist of principal and interest on principal balance alone are classified as financial assets at fair value through other comprehensive income (loss). Changes in the fair value of these debt instruments are recognized as accumulated gain or loss (unrealized) until they are eliminated or reclassified.

- Investments in equity instruments classified as available-for-sale financial assets in accordance with K-IFRS No. 1039 and measured at fair value at the end of each reporting period (neither short-term trading nor contingent consideration arising from a business combination) are designated as items at fair value through other comprehensive income (or loss). Changes in the fair value of these equity instruments are continuously recognized as accumulated gain or loss (unrealized).

Among the held-to-maturity investments that are measured at amortized cost or financial assets that are classified as loans and receivables in accordance with K-IFRS No. 1039, debt instruments that are held under a business model with the aim to receive contractual cash flows and have contractual cash flows that consist of principal and interest on principal balance alone are subsequently measured at their amortized cost after K-IFRS No. 1109.

- Financial assets that are classified as financial assets at fair value through profit or loss in accordance with K-IFRS No. 1039 are also measured in the statement of income as items at fair value through profit or loss under K-IFRS No. 1109.

Other reclassifications of financial assets do not affect the Company's financial position, profit or loss, other comprehensive income or total comprehensive income.

(2) Impairment of financial assets

The Company accounts for the expected credit loss and changes in financial assets at the end of the reporting date, to reflect changes in the credit risk of the financial assets that may occur after the date of the initial recognition, in accordance with the expected credit loss model under the K-IFRS No. 1109 unlike K-IFRS No. 1039 with respect to the impairment of financial assets. That is, it does not necessarily mean that a credit event should occur before you recognize credit losses.

The Company recognizes the expected credit loss for the following as a loss reserve: i) debt instruments that are subsequently measured at amortized cost or at fair value through other comprehensive income (or loss); ii) lease receivables; iii) contract assets; and, iv) loan agreements and financial guarantee contracts subject to the impairment provisions of K-IFRS No. 1109. In particular, if the credit risk of a financial instrument increases significantly after initial recognition, or if credit is impaired when the financial asset is acquired, the loss provision is measured at the amount equal to the lifetime-expected credit loss over the period. In addition, K-IFRS No. 1109 provides a simplified method of measuring the allowance for losses on trade receivables, contract assets and lease receivables under certain circumstances. The Company applies the simplified method for trade receivables and contract assets.

In accordance with K-IFRS No. 1109, management of the Company determined the credit risk at the date of initial recognition of the financial instruments and reviewed and assessed impairment losses on financial assets, contractual assets and financial guarantee contracts held by the Company at the date of initial application using reasonable and supportive information that is available without undue cost or effort in comparison to the credit risk of the first application date (January 1, 2018).

(3) Classification and measurement of financial instruments

One of the major changes related to the classification and measurement of financial liabilities as a result of the adoption of K-IFRS No. 1109 is the way of accounting for the change in the fair value of the financial liabilities designated as 'items at fair value through profit or loss' attributable to the change in the issuer's credit risk. Except where accounting inconsistency in profit or loss is caused or enlarged when the effect of the change in the credit risk of the financial liabilities designated as items at fair value through profit or loss is recognized in other comprehensive income (or loss), changes in fair value attributable to changes in credit risk of related financial liabilities are recognized in other comprehensive income. Changes in fair value attributable to changes in credit risk of related financial liabilities are not subsequently reclassified to profit or loss, but are replaced with retained earnings when the financial liabilities are eliminated. In accordance with K-IFRS No. 1039, all the amount of changes in fair value of financial liabilities designated as financial liabilities at fair value through profit or loss has been presented in profit or loss.

Except for the above, the adoption of K-IFRS No. 1109 has no significant impact on the classification and measurement of the Company's financial liabilities.

(4) General hedge accounting

The new general hedge accounting model maintains three types of hedge accounting. However, more flexibility is being introduced in the types of transactions eligible for hedge accounting with the expansion in risk factors of non-financial items and the types of hedging instruments that are appropriate for hedge accounting. In addition, the related regulations on appraisal of hedging effectiveness were generally revised and replaced by the "economic relationship" principle between the hedged items and the hedging instrument. Retrospective assessment of the hedging effectiveness is no longer required. Additional disclosure requirements have been introduced regarding the Company's risk management activities.
In accordance with the transitional provisions of K-IFRS No. 1109 for hedge accounting, the Company adopted the hedge accounting provisions of K-IFRS No. 1109 prospectively from January 1, 2018, but the Company does not have any transaction subject to the hedge accounting as of the end of the quarter.

- K-IFRS No. 1115 'Revenue from contracts with customers' (enacted)
The Company applied K-IFRS No. 1115, 'Revenue from contracts with customers' for the first time in the current quarter reporting and adopted a retrospective application, according to the transitional provisions of K-IFRS No. 1115, to recognize the cumulative effect of the initial application of the K-IFRS on January 1, 2018, the date of initial application. In addition, the Company applied K-IFRS No. 1115 retroactively only to those contracts that had not been completed on the date of initial application, but did not apply the retroactive restatement for any contract changes made prior to the first application date using a practical simplified approach.

Accordingly, the comparative financial statements have not been reclassified in line with the transitional provisions of K-IFRS No. 1115 and the cumulative effects of the first application are retroactively applied to January 1, 2018, to be recognized in retained earnings. Details of the accounting policies and the financial impact of adopting the K-IFRS No. 1115 are explained in Note 38.

- 2014-2016 Annual Improvements to K-IFRS
These annual improvements include certain amendments to K-IFRS No. 1101 'First-time adoption of Korean International Financial Reporting Standards' and K-IFRS No. 1028 'Investments in associates and joint ventures.' In accordance with K-IFRS No. 1028, it is clarified that a venture capital investment organization or a similar entity may individually select each of the associates and joint ventures as items at fair value through profit or loss, and such a choice must be made when initially recognizing an investment in a joint venture or an associate. In addition, when a company, which is not an investment company, applies the equity method to its associate or joint venture, which is an investment company, it is allowed to apply the same fair value measurement for the associates as the investment company applied to its subsidiaries. It is also clarified that the choice can be made on the individual basis for each individual associate as the investment company.

Since the Company does not adopt K-IFRS to date and is not a venture capital investment organization, the amendment does not have any effect on the financial statements.

The significant accounting policies applied by the Company for the preparation of Interim financial statements in accordance with K-IFRS are as follows.

(1) Investments in Subsidiaries and Associates
The Company's Interim financial statements are separate financial statements in accordance with K-IFRS No. 1027. The Company applied the cost method to investments in subsidiaries and associates in accordance with K-IFRS No. 1027. Dividends from subsidiaries and associates are recognized in profit or loss when the right to receive the dividend is established.

(2) Property, Plant and Equipment

All property, plant and equipment are stated at historical cost less depreciation and accumulated impairment loss. Historical cost includes expenditures directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the statement of comprehensive income during the separate financial period in which they are incurred.

Property, plant and equipment, except for land and other tangible fixed assets, are depreciated on a straight-line basis over the following estimated useful lives for the amount of the acquisition cost of assets less residual value:

Type	Useful life (years)
Buildings	10-60
Structures	10-40
Machinery	10-12
Vehicles	4
Tools	4
Furniture and fixtures	4
Other property, plant and equipment	5

(*) Other property, plant and equipment are not depreciated except for lil Flagship Store.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized in other income and expense in the statements of comprehensive income.

(3) Borrowing Costs

The Company capitalizes borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Other borrowing costs are recognized in expense as incurred. A qualifying asset is an asset that requires a substantial period of time to get ready for its intended use or sale. Financial assets and inventories that are manufactured or otherwise produced over a short period of time are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets.

To the extent that the Company borrows funds specifically for the purpose of obtaining a qualifying asset, the Company determines the amount of borrowing costs eligible for capitalization as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings. To the extent that the Company borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the Company determines the amount of borrowing costs eligible for capitalization by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Company that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that the Company capitalizes during a period does not exceed the amount of borrowing costs incurred during that period.

(4) Government Grants

Government grants are not recognized, unless there is reasonable assurance that the Company will comply with the grant's conditions and that the grant will be received.

Government grants that are intended to compensate the Company for expenses incurred are recognized in profit or loss in the statements of comprehensive income over the periods in which the Company recognizes the related costs as expenses.

(5) Intangible Assets

Intangible assets are measured initially at cost and, subsequently, are carried at cost less accumulated amortization and accumulated impairment losses. Intangible assets consist of industrial property rights, facility usage rights and intangible assets under development. Intangible assets are amortized on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. The residual value of intangible assets is assumed to be zero. However, as there are no foreseeable limits to the periods over which some of the industrial property rights and facility usage rights are expected to be available for use, these intangible assets are regarded as having indefinite useful lives and not amortized.

Type	Useful life (years)
Industrial property rights	Between 10 and 20 years or indefinite
Facility usage rights	Indefinite
Intangible assets	Indefinite

Amortization periods and amortization methods for intangible assets with finite useful lives are reviewed at the end of each reporting period. The useful lives of intangible assets that are not being amortized are r eviewed for each reporting period to determine whether events and circumstances continue to support ind efinite useful life assessment for those assets. The change is accounted for as a change in an accounting e stimate.

(6) Investment Property

Property held for the purpose of earning rentals or benefiting from capital appreciation is classified as investment property. Investment property is initially measured at its cost. Transaction costs are included in the initial measurement. Subsequently, investment property is carried at depreciated cost less any accumulated impairment losses.

Subsequent costs are recognized in the carrying amount of investment property at cost or, if appropriate, as separate items if it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing are recognized in profit or loss as incurred.

Investment property, except for land, is depreciated on a straight-line basis over 10-60 years as estimated useful lives.

Depreciation methods, useful lives and residual values of investment property are reviewed at the end of each reporting period and adjusted, if appropriate. The change is accounted for as a change in an accounting estimate.

(7) Non-Current Assets Held for Sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale, rather than through continuing use, are classified as held for sale. In order to be classified as held for sale, an asset (or a disposal group) must be available for immediate sale in its present condition and its sale must be highly probable. The assets or disposal groups that are classified as non-current assets held for sale are measured at the lower of their carrying amount or fair value less cost to sell. The Company recognizes an impairment loss for any initial or subsequent write-down of an asset (or a disposal group) to fair value less costs to sell and a gain for any subsequent increase in fair value less costs to sell up to the cumulative impairment loss previously recognized in accordance with K-IFRS No. 1036 Impairment of Assets. However, deferred income tax assets, assets generated from employees' salaries, and financial assets covered by K-IFRS No. 1039 Financial Instruments: Recognition and Measurement are measured according to the relevant criteria sheet.

A non-current asset that is classified as held for sale or part of a disposal group classified as held for sale is not depreciated (or amortized).

(8) Inventories

Inventories are measured at the lower of cost or net realizable value. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

The method of determining the unit cost for each inventory classified by the Company is as follows:

Type	Method
Finished goods, work in progress and byproducts, products	Total averaging method
Processed leaf tobacco and purchased leaf tobacco in raw materials	Total averaging method
Raw materials (excluding processed leaf tobacco and purchased leaf tobacco) and supplies	Moving-average method
Buildings under construction, completed buildings, sites for allotting-out construction and goods in transit	Individual method

When inventories are sold, the carrying amount of those inventories is recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down or valuation loss of inventories to net realizable value and all losses of inventories are recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, is recognized as a reduction in the amount of inventories and recognized as an expense in the period in which the reversal occurs.

(9) Impairment of Non-Financial Assets

The carrying amounts of the Company's non-financial assets, other than inventories, deferred tax assets, assets arising from employee benefits and non-current assets held for sale, are reviewed at the end of the reporting period to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, irrespective of whether there is any indication of impairment, are tested for impairment annually by comparing their recoverable amount to their carrying amount.

The Company estimates the recoverable amount of an individual asset. If it is impossible to measure the individual recoverable amount of an asset, then the Company estimates the recoverable amount of a cash-generating unit ("CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use or its fair value less costs to sell. The value in use is estimated by applying a pretax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU for which estimated future cash flows have not been adjusted, to the estimated future cash flows expected to be generated by the asset or CGU.

(10) Financial Assets

- Classification:

Effective January 1, 2018, the Company shall classify the financial assets in the following measurement categories:

- Financial assets measured at fair value (recognizing changes in fair value in other comprehensive income (loss) or profit or loss)
- Financial assets measured at amortized cost

Financial assets are categorized based on business models for management and contractual cash flow specialization. Gains or losses on financial assets measured at fair value are recognized in profit or loss or other comprehensive income. Investments in debt instruments are recognized in profit or loss or other comprehensive income depending on the business model in which the asset is held. The Company reclassifies debt instruments only when we change the business model that manages financial assets. Investments in equity instruments other than short-term investments are subject to irrevocable election to specify that subsequent fair value changes will be presented in other comprehensive income at initial recognition. Otherwise (if not specified), changes in the fair value of investments in the equity instruments are recognized in profit or loss.

- Measurement

The Company measures financial assets at their fair value at initial recognition and the transaction costs directly related to the acquisition of the financial asset or the issuance of the financial liability are added to the fair value when it is not a financial asset measured at fair value through profit or loss. The transaction costs of financial asset measured at fair value through profit or loss are recognized in profit or loss. A hybrid contract that includes an embedded derivative considers the entire hybrid contract when determining whether contractual cash flows consist solely of principal and interest.

① Debt instrument

Subsequent measurement of financial assets is based on the contractual cash flow characteristics of the financial asset and the business model for managing the financial asset. The Company shall classify debt products into the following three categories:

(a) Amortized cost

The financial assets that are held under a business model with the aim to receive contractual cash flows and have contractual cash flows that consist of principal and interest on principal balance alone are measured at amortized cost. The gain or loss on a financial asset measured at amortized cost, which is not subject to hedge accounting, is recognized in profit or loss when the financial asset is derecognized or impaired. Interest income from financial assets recognized under the effective interest method is included in financial income.

(b) Financial assets at fair value through other comprehensive income
Financial assets held under a business model that achieves the objective through both receipt of contractual cash flows and sale of financial assets and whose contractual cash flows consist of only principal and interest payments are measured at fair value through other comprehensive income (or loss). Except for impairment losses (reversals), interest income and foreign exchange gains and losses, the gain or loss on the financial asset measured at fair value through other comprehensive income (or loss) is recognized in other comprehensive income. When a financial asset is derecognized, the cumulative gain or loss previously recognized is reclassified from equity to profit or loss. Interest income from financial assets recognized under the effective interest method is included in financial income. Foreign exchange gains and losses are recognized in other income or expense, and the impairment loss is recognized as other expense.

(c) Financial assets at fair value through profit or loss
Debt instruments, except for the financial assets measured at amortized cost or measured at fair value through other comprehensive income, are measured at fair value through profit or loss. Gains or losses on the debt instruments at fair value through profit or loss that are not subject to hedge accounting are recognized in profit or loss and are presented as financial income or financial expense in the statement of income during the period.

② Equity instruments
The Company subsequently measures the investments in all equity instruments at fair value. For equity instruments for which changes in fair value are elected to be presented in other comprehensive income, the amounts recognized in other comprehensive income are not reclassified to profit or loss even when equity instruments are eliminated. Dividend income on these equity instruments is recognized in profit or loss as financial income when the Company's right to receive dividends is established.

- Impairment
The Company assesses expected credit losses on debt instruments measured at amortized cost or fair value through other comprehensive income (loss), based on forward-looking information. The manner of impairment is determined when the credit risk increases significantly. However, for trade receivables, the Company applies the simplified method of recognizing expected credit losses for the whole period from the date of initial recognition of the receivables.

(11) Financial liabilities

- All financial liabilities are subsequently classified as measured at amortized cost except for the following.

- Such liabilities, including financial liabilities at fair value measurement through profit or loss and derivative liabilities, are subsequently measured at fair value
- Financial liabilities arising when the transfer of a financial asset does not meet the elimination conditions or when a continuing involvement approach is applied
- Financial guarantee contracts are measured at fair value at initial recognition and subsequently the issuer of such contracts subsequently measures the contract at the greater of the following
- Allowance for losses estimated based in expected credit losses
- The amount recognized as a deduction from accumulated profit recognized in accordance with K-IFRS No. 1115 at initial recognition
- Commitment to lend at an interest rate lower than the market interest rate; after initial recognition, the issuer of such an arrangement will subsequently measure the arrangement at the greater of the following.
- Allowance for losses estimated based on expected credit losses
- The amount recognized as a deduction from accumulated profit recognized in accordance with K-IFRS No. 1115 at initial recognition
- The contingent consideration recognized by the acquirer in a business combination under K-IFRS No. 1103; such contingent consideration is subsequently measured at fair value through profit or loss

(12) Derivatives

Derivatives are initially measured at fair value at the date of contract and subsequently measured at fair value at the end of each financial year. Unrealized gains or losses arising from changes in the fair value of derivatives are recognized in profit or loss.

(13) Cash and Cash Equivalents

Cash and cash equivalents comprise cash balances and call deposits with maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Company in the management of its short-term commitments. Equity investments are excluded from cash equivalents, unless they are, in substance, cash equivalents, for example in the case of preferred shares when they have a short maturity with a specified redemption date.

(14) Employee Benefits

① Short-term employee benefits
Short-term employee benefits are employee benefits that are due to be settled within 12 months after the end of the period in which the employees render the related service. When an employee has rendered service to the Company during an accounting period, the Company recognizes the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

② Other long-term employee benefits
Other long-term employee benefits that are not to be paid within 12 months after the end of the reporting period for which the employees have provided relevant services are discounted to their present value based on the future benefits received in exchange for services rendered during the current and prior periods.

Changes in remeasurement are recognized in profit or loss in the period in which they arise.

③ Retirement benefits: defined contribution plans

When an employee has rendered service to the Company during a period, the Company recognizes the contribution payable to a defined contribution plan in exchange for that service as a liability (accrued expense) after deducting any contribution already paid. When an employee has rendered service to the Company during a period, the Company recognizes the contribution payable to a defined contribution plan in exchange for that service as a liability (accrued expense) after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the end of the reporting period, the Company recognizes that excess as an asset (prepaid expense) to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

④ Retirement benefits: defined benefit plans

The calculation of defined benefit obligations is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a potential asset for the Company, the recognized asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in other comprehensive income. The Company determines the net interest expense (income) on the net defined benefit liability (asset) for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in profit or loss. The Company recognizes gains and losses on the settlement of a defined benefit plan when the settlement occurs.

⑤ Termination benefits

Termination benefits are expensed at the earlier of when the Company can no longer withdraw the offer of those benefits and when the Company recognizes costs for a restructuring.

(15) Refund Liabilities and provisions
Refund liabilities and provisions are recognized when the Company has a present obligation (legal or constructive obligation) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The risks and uncertainties that inevitably surround many events and circumstances are taken into account in reaching the best estimate of a provision. Where the effect of the time value of money is material, refund liabilities and provisions are determined at the present value of the expected future cash flows.

Where some or all of the expenditures required to settle a provision are expected to be reimbursed by another party, the reimbursement shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset.

Refund liabilities and provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimates. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision is reversed.

(16) Equity Capital
Ordinary shares are classified as equity. Incremental costs directly attributable to the issuance of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects.

When the Company repurchases its share capital, the amount of the consideration paid is recognized as a deduction from equity and classified as treasury shares. The profits or losses from the purchase, disposal, reissue or retirement of treasury shares are not recognized as current profit or loss.

(17) Revenue Recognition
The Company’s revenue categories consist of revenue from goods sold, services and other income.

① Sales of goods
Revenue from sales of goods is measured at the fair value of the consideration received or receivable. Revenue from the sales of goods is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably.

The Company accepts returns from contracts to supply customers, so the income it receives may vary. The Company estimates a variable amount using an expected value method through which it anticipates a better consideration to which it is entitled, and recognizes the revenue, when the due date has passed, with the variable amount included in the transaction price only to the extent that it is highly possible that it will not return a significant portion of the cumulative revenue it has already recognized. Of the consideration received or receivable, amounts that the Company does not anticipate will be entitled to are recognized as a refund liability.

② Provision of services
The profits from the provision of services are recognized according to the progress when the revenue and progress can be measured reliably, the economic benefits can be introduced and the costs incurred for completing the transaction can be reliably measured. However, if the performance of the service provision transaction cannot be reliably estimated, only the amount within the recoverable costs recognized is recognized as a profit.

③ Construction of residential real estates
The Company constructs and sells residential real estates under long-term contracts with customers. These contracts are concluded before the construction of residential real estate commences. Under the terms of the agreement, the transfer of real estate to other customers is contractually restricted, and the Company has the right to make payments that are enforceable for the services already performed. Therefore, revenues from residential real estate are recognized on the cost basis (i.e., proportionate to the costs incurred for the operations performed to date against the estimated costs) over the period. Management believes that the use of the input method is an appropriate measure under K-IFRS No. 1115 for measuring the progress to completion of the performance obligation.

The Company has the right to charge the clients for the construction of residential real estate as a result of the milestones associated with a series of work. When a specific milestone is reached, the customer sends out a related work statement signed by a third-party evaluator and issues an invoice related to the milestone consideration. Contract assets that are recognized for all previously performed operations are reclassified to receivables at the time the customer is charged. If the amount of the milestone payments exceeds the revenue recognized up to that date under the cost-based input method, the Company recognizes the difference as a contractual liability. The Company believes that there is no significant financial component in the construction contracts with customers because the time difference between the revenue recognition based on the cost-based input method and the milestone payment is always less than one year.

The Company pays sales commissions to brokers in connection with the conclusion of residential real estate sales contracts. The Company capitalizes the incremental costs when the incremental costs are expected to be recovered and amortizes the costs over the period of time for which the residential real estate is transferred to the customer.

④ Real estate lease
Rental income from investment properties is recognized on a straight-line basis over the period of the lease.

(18) Finance Income and Finance Costs

Finance income comprises interest income and dividend income from investment in financial assets. Interest income is recognized as it accrues in profit or loss, using the effective interest method. Dividend income is recognized in profit or loss on the date that the Company's right to receive payment is established.

Finance costs are interest expense on unwinding of the discount on trade and other payables which is recognized in profit or loss using the effective interest method.

(19) Income Taxes

Income tax expense comprises current and deferred taxes. Current tax and deferred tax are recognized in profit or loss, except to the extent that they relate to a business combination, or items recognized directly in equity or in other comprehensive income

① Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the end of the reporting period and any adjustment to tax payable in respect of previous years. The taxable profit is different from the accounting profit for the year since the taxable profit is calculated excluding the temporary differences, which will be taxable or deductible in determining taxable profit (tax loss) of future periods, and non-taxable or non-deductible items from the accounting profit.

② Deferred tax

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. The Company recognizes a deferred tax asset for all deductible temporary differences to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

The carrying amount of a deferred tax asset is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Company expects at the end of the reporting period to recover or settle the carrying amount of its assets and liabilities.

Deferred income tax assets and liabilities are measured using the average tax rate that is expected to apply to the taxable income for the period in which the asset is realized or the liability is settled based on tax legislation enacted or substantively enacted at the end of the reporting period. Deferred tax assets and liabilities are measured at the tax rates that are expected to be recovered or settled based on the carrying amount of the related assets and liabilities at the end of the reporting period.

Deferred tax assets and liabilities are offset only if there is a legally enforceable right to offset the related current tax liabilities and assets, they relate to income taxes levied by the same tax authority and they intend to settle current tax liabilities and assets on a net basis.

(20) Foreign Currencies

Transactions in foreign currencies are translated to the respective functional currencies of the Company at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency using the reporting date's exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date the fair value was determined.

Foreign currency differences arising on retranslation are recognized in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation, or qualifying cash flow hedges that are recognized in other comprehensive income. Non-monetary items that are measured in terms of a historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(21) EPS

The Company presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted-average number of ordinary shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted-average number of ordinary shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares.

(22) Operating Segment

An operating segment is a component of the Company that engages in business activities from which it may earn revenues or incur expenses, including revenues and expenses that relate to transactions with any of the Company's other components. All operating segments' operating results are reviewed regularly by the Company's chief executive officer to make decisions about resources to be allocated to a segment and assess its performance, and for which discrete financial information is available. Operating segment disclosures are included in the separate (or consolidated) financial statements in accordance with K-IFRS No. 1108 Operating Segments.

(23) Greenhouse Gases Emission Right

The Company accounts for greenhouse gases emission right and the relevant liability as below pursuant to the Act on Allocation and Trading of Greenhouse Gas Emission that became effective in 2015.

① Greenhouse Gases Emission Right

Greenhouse Gases Emission Right consists of emission allowances that are allocated from the government free of charge or purchased from the market. The cost includes any directly attributable costs incurred during the normal course of business.

Emission rights held for the purpose of performing the obligation are classified as intangible assets and are initially measured at cost and after initial recognition are carried at cost less accumulated impairment losses. Emission rights held for short-swing profits are classified as current assets and are measured at fair value with any changes in fair value recognized as profit or loss in the respective reporting period. Emission rights held for the purpose of performing the obligation are classified as intangible assets and are initially measured at cost and after initial recognition are carried at cost less accumulated impairment losses. Emission rights held for short-swing profits are classified as current assets and are measured at fair value with any changes in fair value recognized as profit or loss in the respective reporting period.

The Company derecognizes an emission right asset when the emission allowance is unusable, disposed or submitted to government in which the future economic benefits are no longer expected to be probable.

② Emission liability

Emission liability is a present obligation of submitting emission rights to the government with regard to emission of greenhouse gas. Emission liability is recognized when it is probable that outflows of resources will be required to settle the obligation and the costs required to perform the obligation are reliably estimable. Emission liability is an amount of estimated obligations for emission rights to be submitted to the government for the performing period. The emission liability is measured based on the expected quantity of emission for the performing period in excess of emission allowance in possession and the unit price for such emission rights in the market at the end of the reporting period.

(24) Separate Financial Statements' Liquidity Arrangement

The Company has changed liquidity presentation order of its separate statements of financial position to provide reliable and purposeful information. The financial statements for the prior period have been presented in the order of liquidity to facilitate comparison with the separate financial statements of the current period. Such reclassifications do not affect the reported net income or net asset value.

(25) New Standards and Interpretations Not Yet Adopted

The following standards and interpretations have been enacted, but are not effective for the fiscal years beginning after January 1, 2018; however, earlier application is permitted, but the Company has not early adopted the following new standards and interpretations in preparing these separate financial statements.

- K-IFRS No. 1116 'Lease' (enacted)

K-IFRS No. 1116 'Lease' established on May 22, 2017, is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted. It replaces existing lease standards, including K-IFRS No. 1017 'Lease,' K-IFRS No. 2104 'Determining whether a commitment includes a lease,' K-IFRS No. 2015 'Operating lease: incentive' and K-IFRS No. 2027 'Assessment of the substance of the transaction, including lease in legal form'.

At the time of contract, the Company determines whether the contract is a lease or whether the contract includes a lease, and identifies whether the contract is a lease or whether the contract includes a lease, in accordance with this standard at the date of initial application. However, the Company may not rejudge all contracts by applying the simplified method for contracts before the first application date.

The lessee and the lessor must account for each lease element in the lease contract separately from the non-lease element (called "non-lease element") in the lease contract or the contract including lease. The lessee must recognize a lease asset representing the right to use an underlying asset and a lease liability representing an obligation to pay the lease payments. However, short-term leases (leases with lease period less than 12 months) and small leases are subject to the exemption provisions of the standard. In addition, the lessee can use the simplified method as a method of accounting for each lease element and related non-lease element as one lease element instead of separating the non-lease element from the lease element.

The lessee can apply either the retrospective application for the past reporting period or retrospective application to recognize the cumulative effect of the initial application at the date of initial application, in accordance with K-IFRS No. 1008 'Accounting Policies, Changes in Accounting Estimates and Errors.' The Company has not selected between the two methods.

In order to assess the financial impact of the initial adoption of K-IFRS No. 1116, the Company is conducting a preliminary analysis for evaluating its potential effects on 2018 separate financial statements based on the current situation and available information as of September 30, 2018, but it is difficult in practice to provide reasonable estimates of financial impact until the Company completes this analysis.

4. CASH AND CASH EQUIVALENTS AND OTHER FINANCIAL ASSETS:

(1) Cash and cash equivalents as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Cash on hand	294	705
Demand deposits	284,644	104,120
Specific money in trust	160,777	1,000,000
Total	445,715	1,104,825

(2) Current other financial assets as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won				
Type	As of September 30, 2018		As of December 31, 2017	
	Current	Non-current	Current	Non-current
Certificates of deposit	150,000	6,937	100,000	6,340
Money trust	70,000	-	1,400,000	-
Certificates of deposit	-	-	30,000	-
Total	220,000	6,937	1,530,000	6,340

(3) Financial assets restricted in use as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won			
Type		As of September 30, 2018	As of December 31, 2017
Other financial assets	Real estate development performance guarantee	6,340	6,340
	Deposits received	597	-
Total		6,937	6,340

5. FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT OR LOSS:

As explained in Note 3, the Company applied K-IFRS No. 1109 'Financial Instruments,' from the beginning of the year. Please refer to Note 38 for the effect of these accounting policies and changes on financial asset classification and financial statements.

(1) Financial assets at fair value through profit or loss

In millions of Korean won				
Type	As of September 30, 2018		As of December 31, 2017	
	Current	Non-current	Current	Non-current
Money trust	2,104,493	-	1,320,000	-
Real estate beneficiary securities	-	220,211	-	184,169
Total	2,104,493	220,211	1,320,000	184,169

(*) The above financial assets were classified as other financial assets and available-for-sale financial assets at the end of the previous fiscal year, respectively. The figures above do not include the effect of changes in retained earnings caused by changes in accounting policies.

(2) Amounts recognized in profit or loss

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Gain or loss on valuation of fair value through profit or loss(*)	(8,891)	5,267	-	-
Gain or loss on disposal of fair value through profit or loss(*)	18,970	45,859	-	-
Total	10,079	51,126	-	

(*) Include profit or loss of money trust recognized in cash and cash equivalents

6. TRADE AND OTHER RECEIVABLES:

(1) Trade and other receivables as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won				
Type	As of September 30, 2018		As of December 31, 2017	
	Current	Non-current	Current	Non-current
Trade receivables	821,562	47,284	861,725	-
Loans of employees	15,180	26,832	17,048	35,931
Loans	9,927	9,424	7,982	21,978
Other receivables	18,802	13,334	26,467	5,789
Guarantee deposits	25,815	21,238	27,852	16,837
Accrued income	6,465	269	10,361	-
Total	897,751	118,381	951,435	80,535

(2) Trade and other receivables and allowance for doubtful accounts as of September 30, 2018, and December 31, 2017, are as follows:

In millions of Korean won				
Type	As of September 30, 2018		As of December 31, 2017	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	971,332	184,656	996,982	91,913
Allowance				
Trade receivables	(65,788)	(36,159)	(32,129)	-
Loans	(5,517)	(16,952)	-	(11,378)
Other receivables	(69)	(10,978)	(11,346)	-
Accrued income	(207)	(2,186)	(2,072)	-
Total allowance	(73,581)	(66,275)	(45,547)	(11,378)
Net trade and other receivables	897,751	118,381	951,435	80,535

(3) Changes in allowance for trade and other receivables for third quarter, 2018 and 2017 are as follows

In millions of Korean won		
Type	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Beginning balance	56,925	71,765
Changes in accounting policies	86,149	-
Impairment loss	4,034	5,923
Reversal of impairment loss	(1,936)	(2,486)
Elimination	(5,316)	-
Ending balance	139,856	75,202

Impairment loss (reversal of impairment loss) on trade and other receivables is included as part of selling, general and administrative expenses and other expense (income) in the separate statements of comprehensive income.

(4) Other receivables measured at amortized cost using the effective interest method as of September 30.

In millions of Korean won						
Type	As of September 30, 2018			As of December 31, 2017		
	Effective interest rate	Current	Non-current	Effective interest rate	Current	Non-current
Employee loan	1.49–5.68%	15,180	26,832	2.45–5.68%	17,048	35,931
Guarantee deposits	1.49–5.68%	25,815	21,238	1.49–3.52%	27,852	16,837
Total		40,995	48,070		44,900	52,768

7. INVENTORIES:

(1) Inventories as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won						
Type	As of September 30, 2018			As of December 31, 2017		
	Cost	Valuation allowance	Carrying amount	Cost	Valuation allowance	Carrying amount
Goods	28,783	(1,070)	27,713	981	-	981
Finished goods	87,525	(772)	86,753	57,801	(833)	56,968
Work in progress	12,647	-	12,647	18,759	-	18,759
Raw materials	665,059	-	665,059	716,034	-	716,034
Supplies	23,985	-	23,985	23,176	-	23,176
Byproducts	6,590	-	6,590	5,591	-	5,591
Buildings under construction	3,200	-	3,200	-	-	-
Completed buildings	2,954	-	2,954	-	-	-
Sites for lotting-out construction	10,402	-	10,402	-	-	-
Goods in transit	13,288	-	13,288	50,576	-	50,576
Total	854,433	(1,842)	852,591	872,918	(833)	872,085

(2) The amount of loss on valuation and disposals of inventories recognized as an expense for third quarter, 2018 and 2017 were as follows:

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Cost of sales:				
Loss on valuation of inventories	300	1,009	497	838
Loss on disposal of inventories	290	2,108	244	1,598
Other expense:				
Loss on disposal of inventories	(3)	48	26	71
Total	587	3,165	767	2,507

8. LONG-TERM DEPOSITS IN MASTER SETTLEMENT AGREEMENT("MSA") ESCROW FUND:

Long-term deposits in MSA Escrow Fund as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Demand deposits	19,878	1,921
T-Note	573,595	508,302
Total	593,473	510,223

As discussed in Note 36 to the separate financial statements, long-term deposits in MSA Escrow Fund are deposited to the U.S. government related to the export of tobacco to the United States. For the quarters ended September 30, 2018 and 2017, ₩52,771 million and ₩57,338 million, respectively, were paid into long-term deposits in MSA Escrow Fund.

9. FINANCIAL ASSETS AT FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME:

(1) Financial assets at fair value through other comprehensive income as of September 30, 2018, and December 31, 2017 are summarized as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Listed equity instruments		
– Oscotech, Inc	13,966	8,686
– Shinhan Financial Group Co., Ltd.	180,376	198,013
- Rexahn Pharmaceuticals, Inc.	1,266	1,382
– U&I Corporation	13,963	12,079
Subtotal	209,571	220,160
Unlisted equity instruments (*)	48,722	233,891
Total	258,293	454,051

(*) In the prior year, the Company classified unlisted equity instruments as available-for-sale financial assets for the purpose of holding them in the long run. The figures did not include the effect of changes in assets caused by changes in accounting policies. Of the unlisted equity instruments classified as available-for-sale financial instruments, ₩ 184,169 million were reclassified to fair value through profit or loss in accordance with the application of K-IFRS No. 1109.

(2) Changes in other comprehensive income (loss)-financial assets measured at fair value for the nine months ended September 30, 2018 and 2017, are as follows:

In millions of Korean won		
Type	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Beginning balance	454,051	365,805
Changes in accounting policies	(184,169)	-
Acquisition	-	52,946
Net change in fair value	(10,589)	21,922
Disposal and account substitution	(1,000)	(5,515)
Ending balance	258,293	435,158
Statement of financial position:		
Current	-	-
Non-current	258,293	435,158
Total	258,293	435,158

10. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES:

Investments in associates as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won						
Company	Location	Principal operation	As of September 30, 2018		As of December 31, 2017	
			Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Cosmo Tobacco Co. LTD	Mongolia	Manufacturing and selling tobaccos	40.00%	-	40.00%	-
Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	20.24%	1,830	20.24%	1,830
JR REIT V Co., Ltd.	Korea	Renting real estate	34.63%	5,600	34.63%	5,600
JR REIT VIII Co., Ltd.	Korea	Renting real estate	21.74%	10,000	21.74%	10,000
LSK Global Pharma Services Co., Ltd.	Korea	Researching and developing medicine	23.15%	-	23.15%	-
JR REIT X Co., Ltd.	Korea	Renting real estate	28.79%	9,500	28.79%	9,500
JR REIT XIII Co., Ltd.	Korea	Renting real estate	-	-	27.03%	5,000
KB Gimpo Logistics CR REIT Co., Ltd.(*1)	Korea	Renting real estate	12.00%	3,000	12.00%	3,000
KORAMCO Private REIT 50 Fund(*2)	Korea	Renting real estate	84.21%	16,000	84.21%	16,000
Yong In Jung Sim Co., Ltd.	Korea	Renting real estate	22.22%	1,000	22.22%	1,000
Starfield Suwon Co. Ltd.	Korea	Renting real estate	50.00%	12,000	-	-
Total				58,930		51,930

(*1) 76% of the equity holders of the collective investment company are restricted in accordance with the Capital Market and Financial Investment Business Act. In determining the important financial policies and operating policies, the Company owns a 12% stake, the Company has classified the shares as joint venture.
(*2) As the investor agreements require the consent of all investors in determining important financial policies and operating policies, the Company classifies these shares as joint venture.
(*3) The Company had made investment of ₩ 12,000 million in Starfield Suwon Co. Ltd. during the current term.

11. INVESTMENTS IN SUBSIDIARIES:

Investments in subsidiaries as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won						
Subsidiary	Location	Principal operation	As of September 30, 2018		As of December 31, 2017	
			Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00%	716,148	100.00%	716,148
Yungjin Pharm. Co., Ltd.	Korea	Manufacturing and selling pharmaceutical	52.45%	73,299	52.45%	73,299
Tae-a Industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00%	15,698	100.00%	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	Manufacturing and selling tobaccos	99.99%	12,741	99.99%	12,741
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf tobaccos	99.99%	2,891	99.99%	2,891
KT&G Pars	Iran	Manufacturing and selling tobaccos	99.99%	-	99.99%	-
KT&G Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00%	110,297	100.00%	110,297
KT&G USA Corporation	USA	Manufacturing and selling tobaccos	100.00%	4,913	100.00%	4,913
Cosmocos Co., Ltd.	Korea	Manufacturing and selling cosmetics	98.56%	56,581	98.56%	56,581
Renzoluc Pte., Ltd.(*)	Singapore	Holding Company	100.00%	148,834	100.00%	148,834
KGC Yebon Corporation	Korea	Manufacturing and selling medical herbs	100.00%	49,828	100.00%	49,828
PT KT&G Indonesia	Indonesia	Manufacturing and selling tobaccos	99.99%	1,240	99.99%	1,240
SangSang Stay, Inc.	Korea	Hotel	100.00%	14,261	100.00%	14,261
KT&G Global Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00%	1,497	100.00%	1,497
Gwacheon SangSang P.F.V.	Korea	Renting real estate	51.00%	3,570	-	-
Total				1,211,798		1,208,228

(*1) The Company's percentage of ownership, shown above, excludes redeemable convertible preferred shares. As of September 30, 2018, the Company's percentage of ownership would be 88.6%, if preferred shares are included.

(*2) The Company had made investment of ₩3,570 million on Gwacheon SangSang P.F.V. during the current period.

12. PROPERTY, PLANT AND EQUIPMENT:

(1) Details of property, plant and equipment as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won						
Type	As of September 30, 2018			As of December 31, 2017		
	Cost	Accumulated depreciation	Carrying amount	Cost	Accumulated depreciation	Carrying amount
Land	497,440	-	497,440	549,343	-	549,343
Buildings	724,552	(375,155)	349,397	713,395	(356,312)	357,083
Structures	45,773	(34,066)	11,707	45,867	(32,937)	12,930
Machinery	983,467	(800,397)	183,070	986,214	(798,513)	187,701
Vehicles	1,530	(1,164)	366	1,791	(1,379)	412
Tools	36,256	(31,645)	4,611	34,827	(30,080)	4,747
Furniture and fixtures	144,454	(110,437)	34,017	134,394	(97,545)	36,849
Other property, plant and equipment	2,374	(11)	2,363	1,594	-	1,594
Construction in progress	120,994	-	120,994	117,166	-	117,166
Total	2,556,840	(1,352,875)	1,203,965	2,584,591	(1,316,766)	1,267,825

(2) Changes in property, plant and equipment as of September 30, 2018 and 2017, are as follows

A. For the nine months ended September 30, 2018

In millions of Korean won							
Type	Beginning balance	Acquisition	Disposal	Depreciation and damaged	Transfer	Others	Ending balance
Land	549,343	43,186	(323)	(91)	77,915	(172,590)	497,440
Buildings	357,083	30,279	(196)	(18,736)	7,722	(26,755)	349,397
Structures	12,930	136	(10)	(1,541)	84	108	11,707
Machinery	187,701	17,471	(2,961)	(28,309)	9,257	(89)	183,070
Vehicles	412	84	-	(130)	-	-	366
Tools	4,747	1,462	(141)	(1,829)	372	-	4,611
Furniture and fixtures	36,849	9,366	(2)	(13,352)	976	180	34,017
Other property, plant and equipment	1,594	-	-	(11)	-	780	2,363
Construction in progress	117,166	175,946	(13)	(3,594)	(96,326)	(72,185)	120,994
Total	1,267,825	277,930	(3,646)	(67,593)	-	(270,551)	1,203,965

B. For the nine months ended September 30, 2017

In millions of Korean won							
Type	Beginning balance	Acquisition	Disposal	Depreciation	Transfer	Others	Ending balance
Land	426,463	4	(245)	-	87,989	(248)	513,963
Buildings	353,952	1,780	(78)	(19,124)	26,298	(562)	362,266
Structures	14,480	285	(47)	(1,512)	125	(3)	13,328
Machinery	207,199	3,079	(1882)	(32,867)	12,870	-	188,399
Vehicles	360	215	-	(127)	-	-	448
Tools	5,355	921	(28)	(1,819)	451	-	4,880
Furniture and fixtures	42,306	7,918	(44)	(13,859)	221	-	36,542
Other property, plant and equipment	1,681	13	-	-	-	-	1,694
Construction in progress	65,472	157,607	-	-	(127,954)	-	95,125
Total	1,117,268	171,822	(2,324)	(69,308)	-	(813)	1,216,645

13. Intangible assets:

(1) Details of intangible assets as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won						
Type	As of September 30, 2018			As of December 31, 2017		
	Cost	Accumulated amortization	Carrying amount	Cost	Accumulated amortization	Carrying amount
Industrial property rights	7,037	(3,655)	3,382	8,696	(5,597)	3,099
Facility usage rights	26,494	-	26,494	23,845	(23)	23,822
Intangible assets under development	1,192	-	1,192	314	-	314
Total	34,723	(3,655)	31,068	32,855	(5,620)	27,235

(2) Changes in intangible assets for the nine months ended September 30, 2018 and 2017, are as follows:

A. For the nine months ended September 30, 2018

In millions of Korean won						
Type	Beginning balance	Acquisition	Disposal	Transfer	Amortization	Ending balance
Industrial property rights	3,099	-	(6)	335	(46)	3,382
Facility usage rights	23,822	3,029	(357)	-	-	26,494
Intangible assets under development	314	1,213	-	(335)	-	1,192
Total	27,235	4,242	(363)	-	(46)	31,068

B. For the nine months ended September 30, 2017

In millions of Korean won						
Type	Beginning balance	Acquisition	Disposal	Transfer	Amortization	Ending balance
Industrial property rights	2,162	226	-	700	(28)	3,060
Facility usage rights	23,206	1,290	(918)	-	-	23,578
Intangible assets under development	3,560	226	(2,958)	(700)	-	128
Total	28,928	1,742	(3,876)	-	(28)	26,766

(3) Research and development expenditures recognized as expenses for the nine months ended September 30, 2018 and 2017 were as follows:

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Cost of sales	23	79	85	134
Selling, general and administrative expenses	4,213	10,978	3,943	10,673
Total	4,236	11,057	4,028	10,807

14. INVESTMENT PROPERTY:

(1) Details of investment property as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won						
Type	As of September 30, 2018			As of December 31, 2017		
	Cost	Accumulated depreciation	Carrying amount	Cost	Accumulated depreciation	Carrying amount
Land	286,687	-	286,687	125,011	-	125,011
Buildings	304,454	(86,414)	218,040	280,302	(79,890)	200,412
Construction in progress	69,683	-	69,683	-	-	-
Total	660,824	(86,414)	574,410	405,313	(79,890)	325,423

(2) Changes in investment property for the nine months ended September 30, 2018 and 2017, are as follows

In millions of Korean won							
Type	Nine months ended September 30, 2018				Nine months ended September 30, 2017		
	Land	Buildings	Construction - in - progress	Total	Land	Buildings	Total
Beginning balance	125,011	200,412	-	325,423	124,763	210,433	335,196
Depreciation	-	(8,148)	-	(8,148)	-	(8,042)	(8,042)
Transfer from property, plant and equipment	161,676	25,776	74,051	261,503	248	565	813
Ending balance	286,687	218,040	69,683	574,410	125,011	202,956	327,967

(3) Details of profit or loss recognized related to the investment property for the nine months ended September 30, 2018 and 2017, are summarized as follows

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Rental income	7,855	35,220	11,773	33,741
Direct operating expense	(2,813)	(8,148)	(2,666)	(8,042)
Total	5,042	27,072	9,107	25,699

(4) The carrying amount and the fair value of investment property as of September 30, 2018, and December 31, 2017, were as follows:

In millions of Korean won				
Type	As of September 30, 2018		As of December 31, 2017	
	Fair value	Carrying amount	Fair value	Carrying amount
Land	815,977	286,687	744,481	125,011
Buildings	311,996	218,040	291,122	200,412
Construction-in-progress	69,683	69,683	-	-
Total	1,197,656	574,410	1,035,603	325,423

The fair value of investment property was determined based on the yield capitalization method by external, independent values. The fair value measurement for all of the investment properties has been categorized as Level 3 fair value based on the inputs to the valuation techniques used.

15. NON-CURRENT ASSETS TO BE SOLD:

Changes in Non-current assets to be sold for the nine months ended September 30, 2018 and 2017, are as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of September 30, 2017
Balance at January 1	-	-
Substitution in tangible assets	4,247	-
Balance at September 30	4,247	-

The Company had made a land agreement with Starfield Suwon Co., Ltd., which is a related party, and received a down payment of ₩16,020 million of the total ₩160,200 million.

16. PLEDGED ASSETS:

Assets pledged as collateral as of September 30, 2018, and December 31, 2017, are summarized as follows:

(1) As of September 30, 2018

In millions of Korean won					
Type	Carrying amount	Type	Received amount	Collateralized amount	Secured party
Investment property	257,763	Leasehold deposits received	14,392	15,605	MetLife Insurance Korea Co., Ltd. and others
Other financial assets	6,340	Performance guarantee	-	6,340	Korea Land and Housing Corporation
Other financial assets	597	Leasehold deposits received	597	597	Samsung Fire & Marine Insurance Co., LTD.
Property, plant and equipment	23,709	Right to collateral security/ right to lease on a deposit basis	3,081	3,493	Labor Welfare Corporation and others
Total	288,409		18,070	26,035	

(2) As of December 31, 2017

In millions of Korean won					
Type	Carrying amount	Type	Received amount	Collateralized amount	Secured party
Investment property	148,810	Leasehold deposits received	12,982	13,889	MetLife Insurance Korea Co., Ltd. and others
Other financial assets	6,340	Performance guarantee	-	6,340	Korea Land and Housing Corporation
Property, plant and equipment	24,601	Right to collateral security/ right to lease on a deposit basis	3,104	3,493	Labor Welfare Corporation and others
Total	179,751		16,086	23,722	

17. SHORT-TERM BORROWINGS:

The Company provides payment guarantees to financial institutions in accordance with consumer financing arrangements in connection with retail receivables, receives the related receivables immediately from financial institutions in exchange for the guarantees provided and recognizes it as short-term borrowings. Short-term borrowings as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won			
Customer credit contracts:	Annual interest rate	As of September 30, 2018	As of December 31, 2017
Nonghyup Bank	5.95%	1,136	1,660
KEB Hana Card Co., Ltd.	Three-month CD rate+2.5%	282	299
Total		1,418	1,959

18. TRADE AND OTHER PAYABLES:

Trade and other payables as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won				
Type	As of September 30, 2018		As of December 31, 2017	
	Current	Non-current	Current	Non-current
Leasehold deposits received	23,592	12,133	23,189	9,565
Trade payables	27,756	-	34,293	-
Withholdings	5,358	-	4,336	-
Withholdings value-added tax	179,941	-	148,065	-
Accrued expenses	124,247	13,163	129,083	12,090
Other payables	39,366	7,491	47,621	-
Total	400,260	32,787	386,587	21,655

19. RETIREMENT BENEFITS PLAN:

(1) Details of profit or loss recognized related to retirement benefits for the nine months ended September 30, 2018 and 2017, were as follows:

In millions of Korean won				
Type	2018		3rd quarter, 2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Defined benefit plans:				
Current service cost	6,438	19,320	6,674	20,022
Net interest on net defined benefit liability	121	364	236	707
	6,559	19,684	6,910	20,729
Defined contribution plans:				
Contributions recognized as expense	1,531	4,830	1,945	5,294
Other long-term employee benefits:				
Current service cost	697	1,805	-	-
Early retirement:				
Termination benefits	201	2,729	-	15
Total	8,988	29,048	8,855	26,038

(2) Net defined benefit liability as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Present value of defined benefit obligations	297,852	283,055
Fair value of plan assets	(257,159)	(263,971)
Total	40,693	19,084

20. REFUND LIABILITIES AND PROVISIONS:

(1) Refund liabilities and provisions as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won				
Type	As of September 30, 2018		As of December 31, 2017	
	Current	Non-current	Current	Non-current
Refund liabilities	1,890	2,048	-	3,086
Provisions	1,540	-	-	-
Restoration liability	-	47	-	-
Total	3,430	2,095	-	3,086

(2) Changes in refund liabilities and provisions as of September 30, 2018 and 2017, are as follows:

In millions of Korean won								
Type	Nine months ended September 30, 2018				Nine months ended September 30, 2017			
	Beginning	Increase	Decrease	Ending	Beginning	Increase	Decrease	Ending
Refund liabilities	3,086	2,436	1,584	3,938	-	-	-	-
Provisions	-	3,551	2,011	1,540	-	-	-	-
Restoration liability	-	47	-	-	-	-	-	-
Total	3,086	6,034	3,595	5,525	-	-	-	-

21. DERIVATIVES:

(1) Details of derivatives as of September 30, 2018, and December 31, 2017, were as follows:

In millions of Korean won				
Type	As of September 30, 2018		As of December 31, 2017	
	Current	Non-current	Current	Non-current
Currency forward:				
Derivative assets	27	-	-	-
Derivative liabilities	(2,186)	-	-	-
Total	(2,159)	-	-	-

(2) Changes in derivatives for the nine months ended September 30, 2018 and 2017 were as follows:

In millions of Korean won		
Type	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Beginning balance	-	-
Valuation gain	27	-
Valuation loss	(2,186)	-
Ending balance	(2,159)	-

22. SHARE CAPITAL:

(1) Details of share capital as of September 30, 2018, and December 31, 2017, were as follows:

Type	As of September 30, 2018	As of December 31, 2017
Authorized	800,000,000 shares	800,000,000 shares
Par value in Korean won	₩5,000	₩5,000
Issued	137,292,497 shares	137,292,497 shares
Ordinary shares	954,959 million	954,959 million

The Company has 53,699,400 shares of treasury shares reacquired and retired in prior years. Accordingly, as of December 31, 2017, the Company's ordinary share differs from the aggregate par value of issued shares by ₩268,497 million.

(2) There was no change in the number of shares issued as of September 30, 2018 and 2017.

(3) There was no change in other capital surplus as of September 30, 2018 and 2017.

23. TREASURY SHARES:

(1) Treasury shares as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won				
Type	As of September 30, 2018		As of December 31, 2017	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Treasury shares	11,027,370 shares	328,157	11,027,370 shares	328,157

(2) There was no change in gain on sale of treasury shares in the third quarter, 2018 and 2017.

24. RESERVES:

(1) Reserves as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Other comprehensive income (loss)	(46,144)	(1,812)
Legal reserve	602,937	602,937
Voluntary reserve	4,893,211	4,408,176
Total	5,450,004	5,009,301

(2) Other comprehensive income (loss) as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Accumulated other comprehensive income (loss) before taxes	(63,647)	(2,499)
Tax effect	17,503	687
Accumulated other comprehensive income (loss) after taxes	(46,144)	(1,812)

(3) The Korean Commercial Act requires the Company to appropriate a legal reserve in an amount equal to at least 10% of cash dividends for each accounting period until the reserve equals 50% of stated capital. The legal reserve may be used to reduce a deficit or may be transferred to ordinary shares in connection with a free issue of shares.

(4) Voluntary reserve as of September 30, 2018, and December 31, 2017, is summarized as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Reserve for business rationalization	12,851	12,851
Reserve for research and human resource development	-	10,000
Reserve for business expansion	698,881	698,881
Unconditional reserve	4,181,479	3,686,444
Total	4,893,211	4,408,176

① Reserve for business rationalization
Until December 10, 2002, under the Restriction of Special Taxation Act, investment tax credits were allowed for certain investments. The Company was, however, required to appropriate from retained earnings the amount of tax benefits received and transfer such amount into a reserve for business rationalization. Effective December 11, 2002, the Company was no longer required to establish a reserve for business rationalization despite tax benefits received for certain investments, and consequently, the existing balance is now regarded as a voluntary reserve.

② Reserve for research and human resource development
According to the Restriction of Special Taxation Act, certain taxable deductions are required to be transferred from retained earnings to reserve for research and human resource development. This reserve may be used for each purpose and their remaining amounts could be reclassified as a voluntary reserve.

③ Reserve for business expansion and other reserves
The Company appropriated reserves without specific purposes. Those reserves can be used for other purposes upon a resolution at the general meeting of shareholders.

25. RETAINED EARNINGS:

Changes in retained earnings for the nine months ended September 30, 2018 and 2017, are as follows

In millions of Korean won		
Type	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Beginning balance	990,096	1,068,469
Changes in accounting policies	(31,465)	-
Dividends	(505,061)	(454,554)
Transfer from reserve for research and human resource development	10,000	10,000
Transfer to unconditional reserve	(495,036)	(623,915)
Profit for the period	720,690	786,072
Remeasurements of net defined benefit liability, net of tax	(1,540)	(358)
Ending balance	687,684	785,714

26. SALES:

The Company creates revenues by transferring goods and services over a period of time or at any of the following major business lines: The classification of major business segments is consistent with the reporting segment's revenue disclosure information in accordance with K-IFRS No. 1108.

In millions of Korean won						
Type			2018		2017	
			Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Revenue recognized at one point in time:						
Manufacturing and selling tobaccos	Korea	Wholesalers and retailers	446,541	1,223,948	455,292	1,245,909
		Special sales (duty free)	49,219	153,334	51,918	152,039
	Export	Wholesalers and retailers	92,354	406,691	206,115	671,540
Manufacture and sale of semifinished tobacco products	Export	Subsidiaries	16,676	50,490	19,019	47,351
Manufacture and sale of tobacco raw materials	Korea	Direct sales	1,833	4,112	13,264	42,104
	Export	Direct sales	1,424	6,057	2,335	8,246
Others	Korea	Direct sales	202	601	233	371
Subtotal			608,249	1,845,233	748,176	2,167,560
Revenue recognized over time:						
Toll processing revenue	Korea	Direct sales	152	441	167	9,179
Logistics sales	Export	Wholesalers and retailers	1,045	3,255	-	-
Sale and lease of real estate	Korea	Sale	39,656	50,640	27,243	99,164
	Korea	Lease	14,763	42,128	13,909	40,839
Subtotal			55,616	96,464	41,319	149,182
Total			663,865	1,941,697	789,495	2,316,742

27. REVENUE FROM REAL ESTATE SALES:

(1) Details of the sale contract under construction as of September 30, 2018, are as follows

In millions of Korean won			
Projects	Period	Presale amount	Contract amount
Suwon Hwaseo Park Purgio	2018. 02–2021.08	1,213,201	1,231,201
Daegu Central Xi(*)		4,498	823
Total		1,217,699	1,214,024

(*) Although all the sales contract had been finalized by the end of the previous fiscal year, the resale of some cancelled agreements are under progress.

(2) Changes in balance of contract amount for the nine months ended September 30, 2018 and 2017, are as follows:

In millions of Korean won		
Type	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Beginning balance of contracts	-	133,491
Increase	1,214,024	1,725
Revenue recognized(*)	(55,138)	(99,164)
Ending balance of contracts	1,158,886	36,052

(*) From the revenue recognized by the sales of contract, ₩4,498 million worth contract that had been cancelled during the current term had been deducted from the recognized revenue.

(3) Details of accumulative presale cost of sale contract under construction as of September 30, 2018, are as follows

In millions of Korean won				
Projects	Progress rate	Accumulative pre-sale revenue	Accumulative pre-sale cost	Pending Work(*)
Suwon Hwaseo ParkPurgio	4.5%	54,315	(22,825)	-

(*) Pending work had been recorded as trade receivables in the financial statement.

(4) Estimated total contract revenue and total contract cost as of September 30, 2018, did not change. Estimated total contract revenue and total contract costs of ongoing construction contracts are based on the situation occurring until September 30, 2018. It may change in future periods.

28. OPERATING PROFIT:

(1) Details of expenses classified by nature incurred for the nine months ended September 30, 2018 and 2017, are as follows

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Changes in inventories	8,051	19,494	51,566	158,461
Raw materials and consumables purchased	154,766	481,827	187,459	482,799
Salaries	86,940	265,290	96,200	263,480
Retirement and termination benefits	8,291	27,243	8,855	26,023
Depreciation	23,758	72,056	25,661	77,350
Amortization	16	46	13	28
Employee welfare	12,900	34,266	11,996	34,025
Advertising	24,791	71,636	27,119	75,592
Commissions	31,898	92,193	31,444	90,913
Other expenses	37,134	113,302	10,705	106,614
Total	388,545	1,177,353	451,018	1,315,285

(2) Details in selling, general and administrative expenses for the nine months ended September 30, 2018 and 2017, are as follows:

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Salaries	58,309	178,626	64,395	177,031
Retirement benefits	5,776	19,193	6,153	18,201
Employee welfare	8,992	24,393	8,634	24,266
Travel	2,309	6,849	2,570	6,428
Communications	731	2,219	786	2,283
Utilities	2,367	7,260	2,397	6,635
Taxes and dues	1,696	17,728	1,167	16,332
Supplies	541	1,458	406	1,335
Rent	3,855	10,583	3,336	9,534
Depreciation	8,059	24,418	8,264	25,006
Amortization	16	46	13	28
Repairs and maintenance	1,010	2,608	1,302	2,998
Vehicles	1,050	3,038	1,026	3,032
Commissions	23,048	61,351	23,635	66,903
Freight and custody	2,621	7,902	7,456	21,298
Conferences	791	2,425	732	2,354
Advertising	24,766	71,546	27,092	75,486
Training	975	3,055	897	2,506
Normal research and development	4,213	10,978	3,943	10,673
Impairment loss on trade receivables	(2,585)	4,034	2,894	5,916
Insurances	82	591	89	348
Prizes and rewards	474	1,467	438	1,207
Total	149,096	461,768	167,625	479,800

29. OTHER INCOME AND EXPENSES:

(1) Details of other income for the nine months ended September 30, 2018 and 2017, are as follows:

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Foreign currency transaction gain	3,893	8,307	1,182	6,577
Foreign currency translation gain	-	37,920	14,253	7,755
Reversal of impairment loss on other receivables	-	1,936	474	2,486
Gain on sale of property, plant and equipment	5,953	6,504	479	4,641
Gain on sale of intangible assets	-	-	-	595
Gain on valuation of fair value derivatives	2,959	27	-	-
Gain from trading of derivatives	-	2,434	-	-
Gain on sale of investments in associates	25	25	19	19
Others	3,992	28,947	4,469	12,485
Total	16,822	86,100	20,876	34,558

(2) Details of other expenses for the nine months ended September 30, 2018 and 2017, are as follows

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Foreign currency transaction loss	791	2,534	7,830	37,791
Foreign currency translation loss	15,313	4,129	-	31,883
Impairment loss on other receivables	217	-	7	7
Loss on valuation of fair value derivatives	-	2,186	-	-
Loss from trading of derivatives	2,802	5,996	-	-
Donations	1,060	4,125	1,966	5,004
Loss on disposals of investments in associates and joint ventures	-	-	-	8,945
Loss on disposals of property, plant and equipment	20	208	185	320
Impairment loss on property, plant and equipment	-	3,685	-	-
Loss on disposals of intangible assets	-	12	2,574	3,121
Others	-	3,794	42	5,134
Total	20,203	26,669	12,604	92,205

30. NET FINANCE INCOME:

(1) Details of net finance income for the nine months ended September 30, 2018 and 2017, are as follows:

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Finance income:				
Interest income	2,809	7,840	9,052	28,023
Interest income under the effective interest rate method	342	1,096	362	1,441
Dividend income	4,164	75,259	4,156	82,549
Interest income on long-term deposits in MSA Escrow Fund	-	-	540	4,606
Gain on valuation of financial assets at fair value through profit or loss	-	8,414	-	-
Gain on sale of financial assets measured at fair value through profit or loss	18,971	45,860	-	-
Gain on sale of available-for-sale financial assets	-	-	-	1,014
Finance income	26,286	138,469	14,110	117,633
Finance costs:				
Interest expense	(226)	(945)	(211)	(739)
Loss on valuation of financial assets at fair value through profit or loss	(8,891)	(3,147)	-	-
Loss on disposal of financial assets at fair value through profit or loss	(1)	(1)	-	-
Impairment loss on available-for-sale financial assets	-	-	(3,528)	(18,167)
Finance costs	(9,118)	(4,093)	(3,739)	(18,906)
Net finance income	17,168	134,376	10,371	98,727

(2) Details of interest income included in finance income for the nine months ended September 30, 2018 and 2017, were as follows:

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Nine months ended September 30	Nine months ended September 30
Deposits	611	1,458	9,002	26,479
Financial assets at fair value through profit or loss	-	-	-	7
Trade and other receivables	526	1,784	412	2,978
Long-term deposits in MSA Escrow Fund	2,014	5,694	-	-
Total	3,151	8,936	9,414	29,464

(3) Details of interest income included in finance income for the nine months ended September 30, 2018 and 2017, were as follows:

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Trade and other payables	226	945	211	739

31. INCOME TAX EXPENSE:

Income tax expense is calculated by adjusting the following items in the current income tax expense: adjustments recognized in the current and prior periods for the previous period's income tax, deferred income tax expense due to the occurrence and termination of temporary differences and income tax expense related to items recognized as other than profit or loss.
The average effective tax rates for the current and prior periods are 24.78% and 24.60%, respectively.

32. EPS:

Changes in EPS for the nine months ended September 30, 2018 and 2017, are as follows

Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Profit for the period (in millions of Korean won)	211,141	720,690	269,471	786,072
Weighted-average number of ordinary shares outstanding	126,265,127	126,265,127	126,265,127	126,265,127
Basic and diluted EPS in Korean won	1,672	5,708	2,134	6,226

The weighted-average number of ordinary shares outstanding is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time-weighted factor.

33. TRANSACTIONS AND BALANCES WITH RELATED PARTIES:

(1) Details of parent and subsidiary relationships and related companies as of September 30, 2018, and December 31, 2017, were as follows:

Type	Company	Note	Location	Percentage of ownership					
				As of September 30, 2018			As of December 31, 2017		
				Parent	Subsidiary	Total	Parent	Subsidiary	Total
Subsidiary	Korea Ginseng Corporation		Korea	100.00%	-	100.00%	100.00%	-	100.00%
	Yungjin Pharm. Co., Ltd.		Korea	52.45%	-	52.45%	52.45%	-	52.45%
	Tae-a Industry Co., Ltd.		Korea	100.00%	-	100.00%	100.00%	-	100.00%
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		Turkey	99.99%	-	99.99%	99.99%	-	99.99%
	Korea Tabacos do Brasil Ltda.		Brazil	99.99%	-	99.99%	99.99%	-	99.99%
	KT&G Pars		Iran	99.99%	-	99.99%	99.99%	-	99.99%
	KT&G Rus L.L.C.		Russia	100.00%	-	100.00%	100.00%	-	100.00%
	KT&G USA Corporation		USA	100.00%	-	100.00%	100.00%	-	100.00%
	Cosmocos Co., Ltd.		Korea	98.56%	-	98.56%	98.56%	-	98.56%
	Renzoluc Pte., Ltd.	(*1)	Singapore	100.00%	-	100.00%	100.00%	-	100.00%
	KGC Yebon Corporation		Korea	100.00%	-	100.00%	100.00%	-	100.00%
	PT KT&G Indonesia		Indonesia	99.99%	-	99.99%	99.99%	-	99.99%
	K&I HK Co., Ltd.		Hong Kong	-	100.00%	100.00%	-	100.00%	100.00%
	K&I China Co., Ltd.		China	-	100.00%	100.00%	-	100.00%	100.00%
	SangSang Stay, Inc.		Korea	100.00%	-	100.00%	100.00%	-	100.00%
	KT&G Global Rus L.L.C.		Russia	100.00%	-	100.00%	100.00%	-	100.00%
	KGC Life & Gin Co., Ltd.		Korea	-	100.00%	100.00%	-	100.00%	100.00%
	Jilin Hanzheng Ginseng Co., Ltd.		China	-	100.00%	100.00%	-	100.00%	100.00%
	Cheong Kwan Jang Taiwan Corporation		Taiwan	-	100.00%	100.00%	-	100.00%	100.00%
	Korean Red Ginseng Corp., Inc.		USA	-	100.00%	100.00%	-	100.00%	100.00%
	Korea Ginseng (China) Corp.		China	-	100.00%	100.00%	-	100.00%	100.00%
	Korea Ginseng Corporation Japan		Japan	-	100.00%	100.00%	-	100.00%	100.00%
	PT CKJ INDONESIA	(*2)	Indonesia	-	99.88%	99.88%	-	99.88%	99.88%
	PT Trisakti Purwosari Makmur		Indonesia	-	99.99%	99.99%	-	99.99%	99.99%
	PT Mandiri Maha Mulia		Indonesia	-	99.98%	99.98%	-	99.98%	99.98%
	PT Sentosa Ababi Purwosari		Indonesia	-	100.00%	100.00%	-	100.00%	100.00%
	PT Purindo Ilufa		Indonesia	-	100.00%	100.00%	-	100.00%	100.00%
	PT Nusantara Indah Makmur		Indonesia	-	100.00%	100.00%	-	100.00%	100.00%
	Gwacheon Sangsang PFV	(*3)	Korea	51.00%	-	51.00%	-	-	-
Investments in associates and joint ventures	Cosmo Tobacco Co LTD		Mongolia	40.00%	-	40.00%	40.00%	-	40.00%
	Lite Pharm Tech, Inc.		Korea	20.24%	-	20.24%	20.24%	-	20.24%
	JR REIT V Co., Ltd.		Korea	34.63%	-	34.63%	34.63%	-	34.63%
	JR REIT VIII Co., Ltd.		Korea	21.74%	-	21.74%	21.74%	-	21.74%
	LSK Global Pharma Services Co., Ltd.		Korea	23.15%	-	23.15%	23.15%	-	23.15%
	JR REIT X Co., Ltd.		Korea	28.79%	-	28.79%	28.79%	-	28.79%
	JR REIT XIII Co., Ltd.	(*4)	Korea	27.03%	-	27.03%	27.03%	-	27.03%
	KB Gimpo Logistics CR REIT Co., Ltd.		Korea	12.00%	-	12.00%	12.00%	-	12.00%
	KORAMCO Private REIT 50 Fund		Korea	84.21%	-	84.21%	84.21%	-	84.21%

Type	Company	Note	Location	Percentage of ownership					
				As of September 30, 2018			As of December 31, 2017		
				Parent	Subsidiary	Total	Parent	Subsidiary	Total
	Yong In Jung Sim Co., Ltd.		Korea	22.22%	-	22.22%	22.22%	-	22.22%
	Starfield Suwon	(*5)	Korea	50.00%	-	50.00%	-	-	-

(*1)The percentage of ownership, shown above, excludes preferred shares. As of September 30, 2018, the Company's percentage of ownership would be 88.6%, if preferred shares are included.
(*2)PT CKJ INDONESIA has been liquidated in the middle of the current half-year and excluded from the scope of related parties as of September 30, 2018.
(*3) The Company had made investment on 51.00% share of Gwacheon SangSang PFV.
(*4) JR REIT XIII Co., Ltd. had been eliminated from the related companies as of the end of current term, as the liquidation process had been completed during the current term.
(*5) The Company had made investment on 50.00% share of Starfield Suwon

(2) Significant transactions that occurred in the normal course of business with related companies as of September 30, 2018 and 2017, are summarized as follows:

① Sales and other revenues

In millions of Korean won					
Type	Company	2018		2017	
		Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Subsidiary	Korea Ginseng Corporation	1,276	5,025	1,925	5,615
	Yungjin Pharm. Co., Ltd.	47	135	36	122
	Tae-a Industry Co., Ltd.	3	11	4	8
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	2,098	3,373	1,944	6,037
	KT&G Pars	465	465	1,499	2,101
	KT&G Rus L.L.C.	8,850	29,646	7,433	19,073
	KGC Life & Gin Co., Ltd.	22	86	27	92
	KT&G USA Corporation	16,197	40,855	20,071	72,512
	Cosmocos Co., Ltd.	18	56	26	80
	Renzoluc Pte., Ltd.	-	-	-	763
	KGC Yebon Corporation	6	18	6	18
	PT KT&G Indonesia	240	731	320	798
	PT Trisakti Puwosari Makmur	3	3	-	-
	PT Mandiri Maha Mulia	2,540	6,868	4,240	10,491
	Korea Tabacos do Brazil Ltda	-	2	-	-
	SangSang Stay, Inc.	1,511	4,567	1,644	4,936
	PT Pruindo llufa	14	14	-	-
Investments in associates and joint ventures	KVG REIT 1 Co., Ltd.	-	-	2,171	2,546
	JR REIT V Co., Ltd.	-	34	-	495
	JR REIT VIII Co., Ltd.	133	133	-	457
	JR REIT X Co., Ltd.	-	289	-	252
	KB Gimpo Logistics CR REIT Co., Ltd.	37	82	248	248
	KORAMCO Private REIT 50 Fund	496	716	108	108
Total		33,956	93,109	41,702	126,752

Other than above mentioned, the Company had made tangible asset sales of ₩4,247 million to KT&G RUS L.L.C., and ₩2,700 million to PT Mandiri Maha Mulia, and had made tangible asset purchase of ₩521 million from PT Sentosa Ababi Purwosari, ₩50 million from KGC Yebon Corporation.

② Purchases and other expense

In millions of Korean won				
Company	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Korea Ginseng Corporation	319	937	395	2,063
Yungjin Pharm. Co., Ltd.	4	13	26	33
Tae-a Industry Co., Ltd.	3,279	10,446	3,603	10,401
KT&G Rus L.L.C.	-	-	86	421
KGC Life & Gin Co., Ltd.	-	3	-	183
Cosmocos Co., Ltd.	378	677	34	95
KGC Yebon Corporation	53	160	-	-
K&I China Co., Ltd.	-	-	-	23
SangSang Stay	2,995	2,995	-	-
Total	7,028	15,231	4,144	13,219

(3) Account balances with related companies as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won					
Type	Company	As of September 30, 2018		As of December 31, 2017	
		Receivables	Payables	Receivables	Payables
Subsidiary	Korea Ginseng Corporation	17	2,111	343	2,075
	Yungjin Pharm. Co., Ltd.	5	32	66	30
	Tae-a Industry Co., Ltd.	-	1,029	4	-
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. (*)	39,159	-	37,029	-
	Korea Tabacos do Brasil Ltda.	-	-	103	-
	KT&G Pars (*)	44,700	-	43,791	-
	KT&G Rus L.L.C. (*)	81,894	-	53,810	-
	KT&G USA Corporation	27,887	278	38,696	-
	Cosmocos Co., Ltd.	3	20	29	16
	PT KT&G Indonesia (*)	28,566	-	27,380	-
	KGC Life & Gin Co., Ltd.	4	-	14	120
	PT Trisakti Purwosari Makmur	-	-	313	-
	PT Sentosa Ababi Purwosari	324	-	162	-
	PT Mandiri Maha Mulia	15,914	-	13,279	-
	KGC Yebon Corporation	-	-	3	-
	SangSang Stay, Inc.	-	-	3	-
Investments in associates	LSK Global Pharma Services Co., Ltd.	450	-	1,500	-
	JR REIT V Co., Ltd.	-	-	242	-
	JR REIT VIII Co., Ltd.	-	-	212	-
	JR REIT XIII Co., Ltd.	-	-	145	-
	KB Gimpo Logistics CR REIT Co., Ltd.	136	-	60	-
	KORAMCO Private REIT 50 Fund	697	-	-	-
Total		239,756	3,470	217,184	2,241

(*) Above receivables are the gross amounts before ₩73,578 million and ₩38,176 million of allowance for doubtful accounts as of September 30, 2018, and December 31, 2017, respectively.

(4) Details of financial transactions with related parties as of September 30, 2018, and December 31, 2017, were as follows:

In millions of Korean won						
Type	Company	As of September 30, 2018		As of December 31, 2017		
		Capital increase	Loans collection	Capital increase	Loans increase	Loans collection
Subsidiary	Yungjin Pharm. Co., Ltd.	-	-	6,944	-	-
	Cosmocos Co., Ltd.	-	-	5,544	-	-
	Renzoluc Pte., Ltd.	-	-	144,691	-	47,489
	Gwachwon SangSang PFV	3,570	-	-	-	-
Investments in associates and joint ventures	LSK Global Pharma Services Co., Ltd.	-	1,050	-	2,054	554
	Yong In Jung Sim Co., Ltd.	-	-	1,000	-	-
	Starfield Suwon	12,000	-	-	-	-
	JR REIT XIII Co., Ltd.	(5,025)	-	-	-	-
	KVG REIT 1 Co., Ltd.	-	-	(7,319)	-	-
Total		10,545	1,050	150,860	2,054	48,043

(5) As of September 30, the Company is providing payment guarantees in order to open an import credit for imports and customs clearance of KT&G US corporations, and we are obliged to observe the executed part of the guarantee amount (refer to 36.(5))

The Company had made a land contract with the related party, Starfield Suwon and had received a down payment of ₩16,020 million from the total ₩160,200 million. The ownership of this land will be transited upon the payment of the balance, which will be on the date of the commencement of the construction work (expected to be at year 2020). (Refer to Note 15, 36.(14))

(6) Details of key management personnel compensation for the nine months ended September 30, 2018 and 2017, are summarized as follows:

In millions of Korean won				
Type	2018		2017	
	Three months ended September 30	Nine months ended September 30	Three months ended September 30	Nine months ended September 30
Short-term employee benefits	4,713	14,710	4,695	14,354
Retirement benefits	352	1,114	156	1,235
Total	5,065	15,824	4,851	15,589

34. RISK MANAGEMENT AND FAIR VALUE OF FINANCIAL INSTRUMENTS:

(1) Market risk

Market risk is the risk that changes in market prices – such as foreign exchange rates, interest rates and equity prices – will affect the Company's income or the value of its financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

① Currency risk

The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates arising from the export and import of tobacco. The Company's management has measured the currency risk internally and regularly, and has entered into foreign currency forward contracts to hedge foreign currency risk, if necessary.

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of September 30, 2018, and December 31, 2017, were as follows:

In millions of Korean won				
Type	As of September 30, 2018		As of December 31, 2017	
	Monetary foreign currency assets	Monetary foreign currency liabilities	Monetary foreign currency assets	Monetary foreign currency assets
USD	1,225,370	7,052	1,039,421	30,912
IDR	1,493	-	1,581	-
EUR	32,468	14,308	33,424	3,580
Others	51,601	17	27,991	-
Total	1,310,932	21,377	1,102,417	34,492

For the nine months ended September 30, 2018 and 2017, the effects of a 10% weakening or strengthening of functional currency against foreign currencies on profit or loss were as follows:

In millions of Korean won				
Type	For the nine months ended September 30, 2018		For the nine months ended September 30, 2017	
	10% increase	10% decrease	10% increase	10% decrease
Increase (decrease) in net income before tax	128,956	(128,956)	115,528	(115,528)

② Equity price risk

The Company has exposure to equity price risk, which arises from listed available-for-sale equity instruments. The Company's management has monitored the proportion of equity instruments in its investment portfolio based on market indices. Material investments within the portfolio are managed on an individual basis, and all buy and sell decisions are approved by the Company's management.

For the nine months ended September 30, 2018 and 2017, the effects of a 5% fluctuation in the price index of stocks on comprehensive income were as follows:

In millions of Korean won				
Type	Nine months ended September 30, 2018		Nine months ended September 30, 2017	
	5% increase	5% decrease	5% increase	5% decrease
Increase (decrease) in comprehensive income before tax	7,883	(7,883)	8,907	(8,907)

③ Interest rate risk
The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. As of March 31, 2018, there is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation, considering the amounts of interest bearing liabilities.

(2) Credit risk
The Company has exposure to the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Company has transacted with customers with high credit ratings to manage credit risk, and has implemented and operated policies and procedures for credit enhancements of the financial assets. Counterparty credit risk is managed by evaluating its credit rating and limiting the aggregate amount and duration of exposure before sales commence, and the Company has been provided collateral and guarantees. The credit ratings of all counterparties and the level of collateral and guarantees are reviewed regularly. Analysis of financial assets past due has been reported Interim and appropriate measures have been taken to secure the Company's assets.

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of September 30, 2018, and December 31, 2017, is as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Cash and cash equivalents (excluding cash on hand)(*)	284,644	1,104,120
Other financial assets	226,937	1,536,340
Financial assets at fair value through profit or loss(*)	2,485,481	-
Trade and other receivables	1,016,132	1,031,970
Long-term deposits in MSA Escrow Fund	593,473	510,223
Derivatives	27	-
Total	4,606,694	4,182,653

(*) Money trust amounting as of September 30, 2018, is included in the financial assets at fair value through profit or loss.

(3) Liquidity risk

The Company has exposure to the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Company's management has established short-term and long-term financial management plans to manage the liquidity risk and analyzed cash outflows occurred and cash outflows budgeted so as to match the maturity structure of financial assets and financial liabilities. The Company's management determines whether or not the financial liabilities are repayable with the operating cash flows and cash inflows from financial assets.

The contractual maturity analysis with a residual contractual maturity of financial liabilities as of September 30, 2018, and December 31, 2017, is as follows:

In millions of Korean won						
Type	Carrying amount	Contractual cash flow	Residual contractual maturity			
			Within 3 months	Between 3 months and 1 year	Between 1 year and 5 years	More than 5 years
As of September 30, 2018:						
Short-term borrowings	1,418	1,418	1,418	-	-	-
Trade and other payables	247,748	249,229	191,577	23,856	33,796	-
Derivative liabilities	2,186	2,186	2,186	-	-	-
Total	251,352	252,833	195,181	23,856	33,796	-
As of December 31, 2017:						
Short-term borrowings	1,959	1,959	1,959	-	-	-
Trade and other payables	243,751	244,566	210,997	23,405	9,879	285
Total	245,710	246,525	212,956	23,405	9,879	285

The above financial liabilities are presented at the nominal value of undiscounted future cash flows as of the earliest period at which the Company can be required to pay.

(4) The carrying amounts of each category of financial assets and liabilities as of September 30, 2018, and December 31, 2017, are summarized as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Financial assets:		
Available-for-sale financial assets	-	454,051
Financial assets at fair value through profit or loss(*)	2,485,481	-
Financial assets at fair value through other comprehensive income	258,293	-
Derivatives	27	-
Financial assets measured at amortized cost		
–Cash and cash equivalents	284,938	1,104,825
–Other financial assets	226,937	1,536,340
–Trade and other receivables	1,016,132	1,031,970
–Long-term deposits in MSA Escrow Fund	593,473	510,223
Subtotal	2,121,480	4,183,358
Total financial assets	4,865,281	4,637,409
Financial liabilities:		
Derivative liabilities	2,186	-
Financial liabilities measured at amortized cost		
–Short-term borrowings	1,418	1,959
–Trade and other payables	247,748	243,751
Subtotal	249,166	245,710
Total Financial liabilities	251,352	245,710

(*) Money trust amounting to ₩ 160,777 million as of September 30, 2018, is included in the financial assets at fair value through profit or loss.

(5) The fair value measurements classified by fair value hierarchy as of September 30, 2018, and December 31, 2017, were as follows:

In millions of Korean won				
Type	Carrying amount	Fair value		
		Level I	Level II	Level III
As of September 30, 2018:				
Financial assets at fair value through profit or loss(*)	2,485,481	-	2,265,269	220,211
Financial assets at fair value through other comprehensive income	258,293	209,571	-	48,722
Derivative assets	27	-	27	-
Derivative liabilities	2,186	-	2,186	-
Total	2,745,987	209,571	2,267,482	268,933
As of December 31, 2017:				
Available-for-sale financial assets	404,329	220,160	-	184,169

(*) Money trust amount as of September 30, 2018, is included in the financial assets at fair value through profit or loss.

There is no transfer between fair value hierarchy levels of recurring fair value measurements during this half-year and the previous year.

The available-for-sale equity instruments in real estate trust fund have been measured using the adjusted net asset method, discounted cash flow and option-pricing model and categorized under Level 3 fair value based on the inputs to the valuation techniques used. Changes in fair value classified as Level 3 as of September 30, 2018, and December 31, 2017, are as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Beginning balance(*)	233,891	132,956
Acquisitions	61,500	70,946
Disposal	(26,888)	(22,798)
Net change in fair value	430	3,065
Ending balance	268,933	184,169

(*) Available-for-sale financial assets, measured using the cost method, in the financial statements as of December 31, 2017, are classified as financial assets at fair value through other comprehensive income in the financial statements as of September 30, 2018, with the amount of ₩ 49,722 million included.

(6) Details of finance income (costs) by categories for the nine months ended September 30, 2018 and 2017, are as follows:

① For the nine months ended September 30, 2018

In millions of Korean won						
Type	Financial assets at fair value through profit or loss	Financial assets at fair value through other comprehensive income	Derivatives assets (liabilities)	Financial assets measured at amortized cost	Financial liabilities measured at amortized cost	Total
Profit or loss:						
Interest income	-	-	-	8,936	-	8,936
Dividend income	-	16,004	-	-	-	16,004
Unrealized net changes in fair value	5,267	-	(2,159)	-	-	3,108
Gain on sale	45,860	-	(3,561)	-	-	42,299
Interest expense	-	-	-	-	(945)	(945)
Impairment loss	-	-	-	(2,098)	-	(2,098)
Total	51,127	16,004	(5,720)	6,838	(945)	67,304
Other comprehensive income before tax						
Net change in fair value	-	(10,590)	-	-	-	(10,590)
Reclassification by disposal	-	153	-	-	-	153
Total	-	(10,437)	-	-	-	(10,437)

② For the nine months ended September 30, 2017

In millions of Korean won				
Type	Available-for-sale financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:				
Interest income	7	29,457	-	29,464
Dividend income	12,744	-	-	12,744
Interest income on long-term deposits in MSA Escrow Fund	-	4,606	-	4,606
Gain on sale and conversion	1,014	-	-	1,014
Interest expense	-	-	(739)	(739)
Impairment loss	(18,167)	(3,437)	-	(21,604)
Total	(4,402)	30,625	(739)	25,484
Other comprehensive income before tax:				
Net change in fair value	21,922	-	-	21,922
Reclassification adjustments on sale	(1,014)	-	-	(1,014)
Reclassification adjustments on impairment	18,167	-	-	18,167
Total	39,075	-	-	39,075

35. CAPITAL MANAGEMENT:

The Company’s policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The board of directors seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position.

The Company monitors capital using equity and net debt by deducting cash and cash equivalents and current financial instruments from borrowings. The Company applied the same capital management strategy that was applied in the previous year. The Company's capital structure as of September 30, 2018, and December 31, 2017, is as follows:

In millions of Korean won		
Type	As of September 30, 2018	As of December 31, 2017
Debt (borrowings)	1,418	1,959
Less: Cash and cash equivalents	(445,715)	(1,104,825)
Less: Current other financial assets and financial assets at fair value through other comprehensive income	(2,324,493)	(1,530,000)
Net debt (asset)	(2,768,790)	(2,632,866)
Equity	7,281,847	7,143,557

36. CONTINGENT LIABILITIES AND COMMITMENTS:

(1) Payment of long-term deposits (MSA Escrow Fund)
Each year, the Company deposits a proportion of sales of tobacco products in the United States in accordance with the MSA (Tobacco Master Settlement Agreement) under the Escrow Statute of the U.S. government. The MSA Escrow Funds is maintained to pay the medical expenses of tobacco purchasers who have suffered health effects as a result of smoking. The unused portion of this fund will be refunded to the Company 25 years from the date of each annual funding. The Company recorded as long-term deposits the amounts paid into the MSA Escrow Funds of state governments in the United States against potential litigation and damages related to the export of tobacco to the United States.

(2) As of September 30, 2018, the Group has a total of three cases of pending litigations under progress and the litigation value is ₩53,954 million. The effect upon the financial statements of the Group resulting in the results of the litigations cannot be reasonably predicted.

(3) The Company has entered into letter of credit (“L/C”) agreements with financial institutions such as KEB Hana Bank (limit: USD 177,000 thousand) as of September 30, 2018.

(4) As of September 30, 2018, the Company’s trade receivables from the export of cigarettes are insured against non-payment up to USD 34,800 thousand by short-term export insurances with the Korea Trade Insurance Corporation

(5) The Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD 36,000 thousand and USD 20,000 thousand by KEB Hana Bank and Westchester Fire Insurance Company, respectively.

Details of guarantees exercised as of September 30, 2018, are summarized as follows

In thousands of USD, THB	
Type	Exercised amount
Customs bond and L/C opening of KT&G USA Corporation	USD 13,000
Performance guarantee for export of tobacco sheet to Thailand Tobacco Monopoly	THB 2,832

(6) As of September 30, 2018, the Company has been provided with guarantees of USD 6,364 thousand from TRAVELERS CASUALTY AND SURETY COMPANY OF AMERICA for the execution of escrow deposits.

(7) On March 17, 2011, the Company signed the memorandum of understanding on global investment partnership with National Pension Service to jointly invest in foreign assets with a limit of ₩800,000 million.

(8) With relation to the acquisition of KT&G Life Sciences Corporation, the Company entered into a contract with a former owner of the acquiree, Gwak, Tae-Hwan ("Individual Shareholder"). Details of the contract are as follows:

Type	Details
Restriction of disposal	Individual Shareholder shall not be permitted to dispose of its shares, in whole or in part, within one year after KT&G Life Sciences Corporation is listed.
Right of first refusal held by the Company	Individual Shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless it has offered them first to the Company.
Tag-along right held by Individual Shareholder	If the Company proposes to enter into a transaction or a series of related transactions with a third-party purchaser to dispose of its shares, then Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Company.

(9) As of September 30, 2018, the Company is insured by performance bond insurance up to ₩3,613 million with the Seoul Guarantee Insurance.

(10) As of September 30, 2018, the Company recognizes other financial assets of ₩6,340 million deposited in Nonghyup Bank and restricted in use in order to provide a performance guarantee for the commercial district development project in Sejong-si.

(11) As of September 30, 2018, the Company has entered into an agreement with KEB Hana Bank and others for USD 153,700 thousand related to derivative financial instruments.

(12) As of September 30, 2018, in connection with the sale of the building, the Company has entered into a housing sale guarantee contract with the Housing Guarantee Corporation for housing construction amounting to ₩889,040 million.

(13) As of September 30, 2018, the Company had established Starfield Suwon under 50:50 ratio with Shinsaegae Property(Joint Investment Party). The disposal of such share is limited for five years from the approval for use of the multi-shopping mall.

(14) As of September 30, 2018, the Group had made a land contract with Starfield Suwon, the ownership of the land will be transited upon the payment of balance.

37. CASH FLOWS:

(1) Details of cash generated from operations for the six months ended September 30, 2018 and 2017, were as follows:

In millions of Korean won		
Type	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Profit for the period	720,690	786,072
Adjustments for:		
Income tax expense	237,461	256,466
Finance costs	4,093	18,906
Finance income	(138,469)	(117,633)
Depreciation	72,056	77,350
Amortization	46	28
Employee welfare	1,805	-
Retirement and termination benefits	27,237	26,023
Foreign currency translation loss	4,129	31,883
Impairment loss on trade and other receivables	4,034	3,437
Loss on valuation of inventories	1,009	838
Loss on disposals of property, plant and equipment	208	320
Impairment loss on property, plant and equipment	3,685	-
Loss on disposals of intangible assets	12	3,121
Loss on disposals of investments in associates and joint ventures	-	8,945
Other income	(27)	-
Other expenses	8,278	7,345
Foreign currency translation gain	(37,920)	(7,755)
Reversal of impairment loss on trade and other receivables	(1,936)	-
Gain on sale of property, plant and equipment	(6,504)	(4,641)
Gain on sale of intangible assets	-	(595)
Gain on sale of investments in associates and joint ventures	(25)	(19)
Subtotal	899,862	1,090,091
Changes in working capital:		
Trade and other receivables	(77,710)	(185,063)
Advance payments	(4,449)	(21,769)
Long-term advance payments	(9,340)	-
Prepaid expenses	(5,229)	4,347
Prepaid tobacco excise and other taxes	77,784	86,087
Inventories	22,591	153,557
Trade and other payables	(961)	(40,557)
Increase (decrease) in net income before tax	68,980	(478)
Tobacco excise and other taxes payable	87,194	(37,180)
Payment of retirement and termination benefits	(8,077)	(8,722)

In millions of Korean won		
Type	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Refund liabilities	988	-
Cash generated from operations	1,051,633	1,040,313

(2) Details of material transactions without cash inflow and outflow as of September 30, 2018 and 2017, are as follows:

In millions of Korean won		
Type	Nine months ended September 30, 2018	Nine months ended September 30, 2017
Transfer of earnings to accrued dividends	505,061	-
Increase (decrease) in accrued expenses related to payment of retirement and termination benefits	(323)	(2,430)
Other long-term employee benefits	1,805	-
Increase (decrease) in other payables related to acquisition of property, plant and equipment acquisition	16,651	(659)
Substituting of the construction in progress to the original account	96,326	-
Transfer of tangible assets to available-for-sale non-current asset	4,247	-
Increase (decrease) of receivables related to disposal of tangible and non-current assets to be sold	4,065	(3,593)
Increase (decrease) in investments in subsidiaries as a result of investment conversion of subsidiaries loan	-	47,489
Transfer of available-for-sale financial assets to loan	-	2,054
Increase (decrease) in advance for tangible assets and available-for-sale non-current assets	16,020	-

(3) Changes in liabilities due to financial activities

Changes in liabilities due to financial activities for the nine months ended September 30, 2018 and 2017 are as follows:

① For the Nine Months Ended September 30, 2018

In millions of Korean won				
Type	Beginning balance	Cash flows from financing activities	Others	Ending balance
Leasehold deposits received	32,754	3,089	(118)	35,725

② For the Nine Months Ended September 30, 2017

In millions of Korean won				
Type	Beginning balance	Cash flows from financing activities	Others	Ending balance
Leasehold deposits received	28,266	6,003	(440)	33,829

(4) The Company has presented net inflows and outflows of some financial assets at fair value through profit and loss for which the transactions occur frequently with large amounts and expire soon.

38. CHANGES IN ACCOUNTING POLICIES:

38.1 K-IFRS No. 1109 ‘ Financial Instruments’ (enacted)

(1) Classification and measurement of financial instruments

Details of changes in retained earnings due to the classification and measurement of financial instruments are as follows:

In millions of Korean won	
Adjustments	Amounts
Retained earnings at the beginning of the period - K-IFRS No. 1039	990,096
Reclassified loans and receivables to financial assets at fair value through profit or loss	(14,514)
Reclassified available-for-sale securities to financial assets at fair value through profit or loss	3,895
Reclassified available-for-sale securities to financial assets at fair value through other comprehensive income	32,870
Long-term deposits in MSA Escrow Fund measured at amortized cost	8,115
Increase in loss allowance on trade and other receivables	(86,149)
Decrease in deferred income tax due to adjustment of retained earnings at the beginning of the period	27,683
Adjustment of total retained earnings due to adoption of K-IFRS No. 1109	(28,100)
Retained earnings at the beginning of the period - K-IFRS No. 1109	961,996

Management has evaluated the business model applied to the financial assets held as of January 1, 2018, the initial application date of K-IFRS No. 1109, and classified the financial assets in accordance with K-IFRS No. 1109. The effect of this reclassification is as follows:

In millions of Korean won							
Financial assets as of January 1, 2018	Financial assets at fair value through profit or loss	Financial assets at fair value through other comprehensive income (loss) (available-for-sale financial assets as of December 31, 2017)	Financial assets measured at amortized cost (Loans and receivables as of December 31, 2017)				Total
			Trade and other receivables	Long-term deposits in MSA Escrow Fund	Other financial assets	Cash and cash equivalents	
Carrying amount at the beginning of the period-K-IFRS No. 1039	-	454,051	1,031,970	510,223	1,536,340	1,104,825	4,637,409
Reclassified loans and receivables to financial assets at fair value through profit or loss	1,314,296	-	(6,548)	-	(1,320,000)	(2,262)	(14,514)
Reclassified available-for-sale securities to financial assets at fair value through profit or loss	184,169	(184,169)	-	-	-	-	-
Long-term deposits in MSA Escrow Fund measured at amortized cost	-	-	1,971	9,402	-	-	11,373
Carrying amount at the beginning of the period-K-IFRS No. 1109	1,498,465	269,882	1,027,393	519,625	216,340	1,102,563	4,634,268

①Reclassified loans and receivables to financial assets at fair value through profit or loss

Of the cash equivalents and other financial assets as of January 1, 2018, money trust of ₩1,320,000 million, which was not composed of principal and interest on principal balance, has been reclassified to financial assets at fair value through profit or loss.

The difference of ₩14,514 million between the amortized cost of the money trust and the fair value as of January 1, 2018, has been reclassified to retained earnings. During the current period, ₩14,514 million, including changes in fair value related to these financial assets, has been recognized in profit.

② Reclassified available-for-sale financial assets to financial assets at fair value through profit or loss

Of the available-for-sale financial assets as of January 1, 2018, the investments in real estate investment funds of ₩184,169 million has been reclassified as financial assets at fair value through profit or loss. The financial assets do not meet the conditions that the contractual cash flows are measured at amortized cost because they do not represent only principal payments. Accumulated other comprehensive income of ₩3,895 million as of January 1, 2018, has been reclassified to retained earnings. During the current period, ₩6,096 million, including changes in fair value related to these financial assets, has been recognized in profit in the current period.

③ Reclassified available-for-sale financial assets to financial assets at fair value through other comprehensive income (or loss)

The changes in the fair value of equity instruments that were not for trading purposes and were previously classified as available-for-sale financial assets have been reclassified to financial assets at fair value through other comprehensive income and presented in other comprehensive income. Accordingly, ₩269,882 million has been reclassified to financial assets at fair value through other comprehensive income (loss). The related accumulated other comprehensive income of ₩32,870 million as of January 1, 2018, shall not be reclassified to profit or loss even if the financial asset is disposed of.

④ Long-term deposits in MSA Escrow Fund measured at amortized cost

The long-term deposits amounting to ₩510,223 million as of January 1, 2018, have been reclassified to financial assets at fair value through profit or loss. The financial assets should be measured at amortized cost because the assets have the cash flow that consists of the principal and interest on the principal balance alone under the contract having the aim to receive the cash flow. Long-term deposits of ₩9,402 million and retained earnings of ₩8,115 million have been increased, respectively, as of January 1, 2018. Interest income related to the long-term deposits amounting to ₩5,694 million was recognized during the period.

The effect of these changes on the Company's capital is as follows:

In millions of Korean won		
Type	Changes in accumulated other comprehensive income	Changes in retained earnings
Carrying amount at the beginning of the period- K-IFRS No. 1039	(1,812)	990,096
Reclassified loans and receivables to financial assets at fair value through profit or loss	-	(14,514)
Reclassified available-for-sale securities to financial assets at fair value through profit or loss	(3,895)	3,895
Reclassified available-for-sale securities to financial assets at fair value through other comprehensive income	(32,870)	32,870
Measured the long-term deposits in MSA Escrow Fund at the amortized cost	-	8,115
Increase in loss allowance on trade and other receivables (*)	-	(86,148)
Decrease in deferred income tax due to adjustment of retained earnings at the beginning of the period	-	27,682
Total	(36,765)	(28,100)
Carrying amount at the beginning of the period- K-IFRS No. 1109	(38,577)	961,996

(*) For the related notes on loss allowance, refer to (2) Impairment of the financial assets in the below.

The reclassification of financial assets as of January 1, 2018 (the initial application date), due to adoption of K-IFRS No. 1109 is as follows:

In millions of Korean won					
Type	Measurement categories		Carrying amount		
	K-IFRS No. 1039	K-IFRS No. 1109	K-IFRS No. 1039	K-IFRS No. 1109	Difference
Cash and cash equivalents	Amortized cost	Amortized cost	1,104,825	1,102,563	(2,262)
Other financial assets	Amortized cost	Amortized cost	1,536,340	216,340	(1,320,000)
Other financial assets	Amortized cost	fair value through profit or loss	-	1,314,296	1,314,296
Long-term deposits in MSA Escrow Fund	Financial assets at fair value through profit or loss	Amortized cost	510,223	519,625	9,402
Available-for-sale financial assets	Available-for-sale financial assets	Available-for-sale financial assets	454,051	269,882	(184,169)
Available-for-sale financial assets	Available-for-sale financial assets	fair value through profit or loss	-	184,169	184,169
Trade and other receivables	Amortized cost	Amortized cost	1,031,970	1,027,393	(4,577)

(2) Impairment of financial assets

The Company has the following two types of financial assets subject to the new expected credit loss model in K-IFRS No. 1109:

· Trade receivables from sales of inventories
· Debt instrument measured at amortized cost

The Company changed the policy on recognition of impairment loss as a result of the adoption of K-IFRS No. 1109. Please refer to the table in the above (1) for the effect on the beginning balance of the retained earnings for the period.

38.2 Application of the K-IFRS No. 1115 'Revenue from contracts with customers'

As noted in Note 3, the Company has adopted K-IFRS No. 1115 from the beginning of the period. The financial statements of the prior period presented here for the comparison purpose have not been restated in accordance with the transitional provisions. The effect of adoption of the K-IFRS on the condensed interim financial statements is as follows.

(1) Adjustments reflected as of January 1, 2018 (the initial application date), in the statement of financial position are as follows:

In millions of Korean won			
Type	As of December 31, 2017 Before adjustments	Adjustments	As of January 01, 2018 After adjustments
Current assets	4,738,590	-	4,738,590
Non-current assets	3,936,373	-	3,936,373
Assets	8,674,963	-	8,674,963
Current liabilities	1,451,029	4,641	1,455,670
Non-current liabilities	80,377	(1,276)	79,101
Liabilities	1,531,406	3,365	1,534,771
Equity	7,143,557	(3,365)	7,140,192

The Company provides services to pay for logistics, insurance and card fees on behalf of customers for certain contracts signed with customers. Logistics costs, etc., are recognized as a deduction of revenue as they are payable to customers in accordance with K-IFRS No. 1115.
As a result of such changes in the standards, the Company recognized the payables amounting to ₩4,641 million additionally and reduced the retained earnings by ₩3,365 million.

(2) The items in the financial statements that are affected by the prechange standards in the period of the initial application of K-IFRS No. 1115 are as follows:

In millions of Korean won			
Type	Amounts reported	Adjustments	If K-IFRS No. 1115 has not been applied
Sales	1,941,697	14,882	1,956,579
Cost of sales	715,584	(3,255)	712,329
Selling, general and administrative expenses	457,735	(11,627)	446.108
Income taxes	237,461	-	237,461
Profit for the period	720,690	-	720,690
Total comprehensive income for the period:	711,581	-	711,581

(3) The cash flows from adoption of K-IFRS No. 1115 are the same as cash flows under previous standards.