KT&G CORPORATION

Interim Financial Statements

(Unaudited)

March 31, 2010 and 2009

(With Independent Accountants' Review Report Thereon)

Contents

KPMG SAMJONG

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Independent Accountants' Review Report

Based on a report originally issued in Korean

The Board of Directors and Shareholders
KT&G Corporation:

We have reviewed the accompanying statement of financial position of KT&G Corporation (the "Company") as of March 31, 2010, and the related statements of comprehensive income, changes in equity and cash flows for the three-month periods ended March 31, 2010 and 2009. Management is responsible for the preparation and fair presentation of these consolidated financial statements. Our responsibility is to issue a report on these financial statements based on our reviews.

We conducted our reviews in accordance with the Review Standards for Semi-Annual Financial Statements established by the Securities and Futures Commission of the Republic of Korea. These Standards require that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review consists principally of inquiries of company personnel and analytical procedures applied to financial data and, thus, provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our reviews, nothing has come to our attention that causes us to believe that the financial statements referred to above are not presented fairly, in all material respects, in accordance with Korean International Financial Reporting Standards.

The statement of financial position of the Company as of December 31, 2009, the related statements of comprehensive income, changes in equity and cash flows for the year then ended, which are not accompanying this report were audited by us and our report thereon, dated February 11, 2010, expressed an unqualified opinion. The accompanying statement of financial position of the Company as of December 31, 2009, presented for comparative purposes, is not different from that audited by us in all material respects.

The accompanying financial statements as of and for the three-month period ended March 31, 2010 have been translated into United States dollars solely for the convenience of the reader. We have reviewed the translation and, in our opinion, the financial statements expressed in Korean Won have been translated into dollars on the basis set forth in note 4 to the financial statements.

The following matters may be helpful to the readers in their understanding of the financial statements:

As discussed in note 29 to the financial statements, the Company and the Korean government are defendants in lawsuits claiming damages of ₩ 584 million for the effects of smoking. The final outcome of these lawsuits cannot be predicted. Accordingly, no provisions have been made in accompanying financial statements.

KPMG Samjong Accounting Corp.

KPMG Samjong Accounting Corp.
Seoul, Korea
May 10, 2010

This report is effective as of May 10, 2010, the review report date. 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 financial statements and notes thereto. Accordingly, the readers of the review report should understand that there is a possibility that the above review report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

KT&G CORPORATION
Statements of Financial Position
(Unaudited)

As of March 31, 2010 and December 31, 2009

In millions of Won and thousands of U.S. dollars	*Note*	2010 Korean Won	2010 U.S. dollars (note 4)	2009 Korean Won
Assets				
Property, plant and equipment	*5*	₩ 1,189,711	$ 1,052,097	₩ 1,210,426
Intangible assets	*6*	45,209	39,979	45,041
Investment property	*7*	101,022	89,337	101,900
Investments in associates	*8*	2,830	2,503	2,830
Investments in subsidiaries	*9*	720,330	637,009	720,330
Available-for-sale financial assets	*10, 27*	518,055	458,132	441,843
Long-term deposits in MSA Escrow Fund	*11, 27, 28*	116,482	103,009	118,121
Long-term prepaid expenses		4,898	4,330	4,927
Long-term trade and other receivables	*12, 27*	89,874	79,479	106,567
Total non-current assets		2,788,411	2,465,875	2,751,985
Inventories	*13*	1,049,995	928,542	1,054,321
Trade and other receivables	*12, 26, 27*	492,788	435,787	505,731
Prepaid tobacco excise and other taxes		228,004	201,631	169,440
Advance payments		34,869	30,836	10,776
Prepaid expenses		5,411	4,784	1,395
Current available-for-sale financial assets	*10, 27*	1,910	1,689	1,957
Cash and cash equivalents	*14, 27*	114,145	100,942	268,954
		1,927,122	1,704,211	2,012,574
Assets held for sale	*29*	23,246	20,557	23,246
Total current assets		1,950,368	1,724,768	2,035,820
Total assets		₩ 4,738,779	$ 4,190,643	₩ 4,787,805

See accompanying notes to financial statements.

KT&G CORPORATION
Statements of Financial Position (continued)
(Unaudited)

As of March 31, 2010 and December 31, 2009

In millions of Won and thousands of U.S. dollars	*Note*	2010 Korean Won	2010 U.S. dollars (note 4)	2009 Korean Won
Equity				
Ordinary shares	*15*	₩ 954,959	$ 844,499	₩ 954,959
Other capital surplus	*15*	2,632	2,327	2,632
Treasury shares	*16*	(226,945)	(200,694)	(226,945)
Gain on reissuance of treasury shares		468,274	414,109	468,274
Reserve	*17*	2,354,861	2,082,474	2,074,108
Retained earnings	*18*	185,421	163,973	579,963
Total equity	*27*	3,739,202	3,306,688	3,852,991
Liabilities				
Long-term trade and other payables	*20, 27*	22,799	20,162	24,042
Long-term advance receipts		416	367	535
Defined benefit liabilities	*21*	14,474	12,800	18,295
Deferred income tax liabilities	*24*	147,537	130,471	122,372
Total non-current liabilities		185,226	163,800	165,244
Short-term borrowings	*19, 27*	10,043	8,881	19,338
Trade and other payables	*20, 26, 27*	327,801	289,885	277,616
Advance receipts	*29*	45,586	40,313	22,528
Income taxes payable	*24*	39,644	35,058	100,038
Tobacco excise and other taxes payable		391,277	346,018	350,050
Total current liabilities		814,351	720,155	769,570
Total liabilities		999,577	883,955	934,814
Total equity and liabilities		₩ 4,738,779	$ 4,190,643	₩ 4,787,805

See accompanying notes to financial statements.

KT&G CORPORATION
Statements of Comprehensive Income
(Unaudited)

For the three-month periods ended March 31, 2010 and 2009

In millions of Won and thousands of U.S. dollars, except earnings per share	*Note*		2010 Korean Won		2010 U.S. dollars (note 4)		2009 Korean Won
Sales:	*26*						
Manufacture of tobacco		₩	500,235	$	442,373	₩	563,343
Real estate			33,080		29,254		103,964
Exports of leaf tobacco and others			7,040		6,226		8,351
			540,355		477,853		675,658
Cost of sales:	*22, 26*						
Manufacture of tobacco			(189,306)		(167,409)		(206,681)
Real estate			(19,749)		(17,464)		(67,693)
Exports of leaf tobacco and others			(3,692)		(3,266)		(3,472)
			(212,747)		(188,139)		(277,846)
Gross profit			327,608		289,714		397,812
Other income	*22*		10,742		9,499		46,208
Selling expenses	*22*		(85,611)		(75,708)		(87,574)
General and administrative expenses	*22*		(43,781)		(38,717)		(50,744)
Other expense	*22*		(18,463)		(16,328)		(9,991)
Profit from operations			190,495		168,460		295,711
Finance income	*23*		36,455		32,239		33,615
Finance costs	*23*		(53)		(47)		(1,886)
Net finance income	*23*		36,402		32,192		31,729
Profit before income taxes			226,897		200,652		327,440
Income tax expense	*24*		(47,544)		(42,045)		(70,894)
Profit for the period		₩	179,353	$	158,607	₩	256,546
Other comprehensive income:							
Available-for-sale financial assets, net of tax	*10*		59,399		52,529		51,347
Actuarial gains (losses), net of tax	*21*		3,615		3,197		1,020
Other comprehensive income (expense) for the period, net of tax			63,014		55,726		52,367
Total comprehensive income for the period		₩	242,367	$	214,333	₩	308,913
Earnings per share in Won:							
Basic and Diluted	*25*	₩	1,410	$	1.25	₩	1,993

See accompanying notes to financial statements.

KT&G CORPORATION
Statements of Changes in Equity
(Unaudited)

For the three-month period ended March 31, 2010

In millions of Won		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
Balance at January 1, 2010	₩	954,959	2,632	(226,945)	468,274	2,074,108	579,963	3,852,991
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	179,353	179,353
Other comprehensive income:								
Available-for-sale financial assets, net of tax		-	-	-	-	59,399	-	59,399
Actuarial gains, net of tax		-	-	-	-	-	3,615	3,615
Total other comprehensive income		-	-	-	-	59,399	3,615	63,014
Total comprehensive income for the period		-	-	-	-	59,399	182,968	242,367
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(356,156)	(356,156)
Transfer from reserve for research and human resource development		-	-	-	-	(15,000)	15,000	-
Transfer from reserve for loss on reissuance of treasury shares		-	-	-	-	(26,646)	26,646	-
Transfer to reserve for research and human resource development		-	-	-	-	60,000	(60,000)	-
Transfer to unconditional reserve		-	-	-	-	203,000	(203,000)	-
Total transactions with owners		-	-	-	-	221,354	(577,510)	(356,156)
Balance at March 31, 2010	₩	954,959	2,632	(226,945)	468,274	2,354,861	185,421	3,739,202

See accompanying notes to financial statements.

KT&G CORPORATION
Statements of Changes in Equity (continued)
(Unaudited)

For the three-month period ended March 31, 2010

In thousands of U.S. dollars		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
Balance at January 1, 2010	$	844,499	2,327	(200,694)	414,109	1,834,195	512,879	3,407,315
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	158,607	158,607
Other comprehensive income:								
Available-for-sale financial assets, net of tax		-	-	-	-	52,529	-	52,529
Actuarial gains, net of tax		-	-	-	-	-	3,197	3,197
Total other comprehensive income		-	-	-	-	52,529	3,197	55,726
Total comprehensive income for the period		-	-	-	-	52,529	161,804	214,333
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(314,960)	(314,960)
Transfer from reserve for research and human resource development		-	-	-	-	(13,265)	13,265	-
Transfer from reserve for loss on reissuance of treasury shares		-	-	-	-	(23,564)	23,564	-
Transfer to reserve for research and human resource development		-	-	-	-	53,060	(53,060)	-
Transfer to unconditional reserve		-	-	-	-	179,519	(179,519)	-
Total transactions with owners		-	-	-	-	195,750	(510,710)	(314,960)
Balance at March 31, 2010	$	844,499	2,327	(200,694)	414,109	2,082,474	163,973	3,306,688

See accompanying notes to financial statements.

KT&G CORPORATION

Statements of Changes in Equity (continued)

(Unaudited)

For the three-month period ended March 31, 2009

In millions of Won		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
Balance at January 1, 2009	₩	954,959	337	(226,945)	468,274	1,821,348	436,453	3,454,426
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	256,546	256,546
Other comprehensive income:								
Available-for-sale financial assets, net of tax		-	-	-	-	51,347	-	51,347
Actuarial losses, net of tax		-	-	-	-	-	1,020	1,020
Total other comprehensive income		-	-	-	-	51,347	1,020	52,367
Total comprehensive income for the period		-	-	-	-	51,347	257,566	308,913
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(360,357)	(360,357)
Transfer to unconditional reserve		-	-	-	-	169,000	(169,000)	-
Transfer from reserve for research and human resource development		-	-	-	-	(15,000)	15,000	-
Expiration of employee share options		-	2,295	-	-	(2,295)	-	-
Total transactions with owners		-	2,295	-	-	151,705	(514,357)	(360,357)
Balance at March 31, 2009	₩	954,959	2,632	(226,945)	468,274	2,024,400	179,662	3,402,982

See accompanying notes to financial statements.

KT&G CORPORATION
Statements of Cash Flows
(Unaudited)

For the three-month periods ended March 31, 2010 and 2009

In millions of Won and thousands of U.S. dollars	*Note*		2010 Korean Won		2010 U.S. dollars (note 4)		2009 Korean Won
Cash flows from operating activities							
Cash generated from operations	30	₩	200,954	$	177,708	₩	229,983
Income tax paid			(39,760)		(35,161)		(64,443)
Net cash from operating activities			161,194		142,547		165,540
Cash flows from investing activities							
Decrease in other financial assets			-		-		1,000
Interest received			4,158		3,677		2,703
Dividends received			30,000		26,530		-
Proceeds from sale of available-for-sale financial assets			967		855		4
Collection of loans			18,717		16,552		4,733
Proceeds from sale of property, plant and equipment			8,406		7,433		3,288
Proceeds from sale of intangible assets			538		476		62
Withdrawal of guarantee deposits			5,825		5,151		3,495
Proceeds from sale of other investment assets			12		11		7
Purchases of available-for-sale financial assets			(623)		(551)		(8,540)
Increase in loans			(2,688)		(2,377)		(4,200)
Purchases of investments in associates			-		-		(500)
Purchases of investments in subsidiaries			-		-		(5,524)
Payments of guarantee deposits			(7,641)		(6,757)		(6,522)
Payments of long-term deposits in MSA Escrow Fund			(1,732)		(1,532)		(4,434)
Purchases of property, plant and equipment			(13,528)		(11,964)		(12,427)
Acquisition of intangible assets			(853)		(754)		(918)
Acquisition of investment property			-		-		(48)
Settlement of financial derivatives			-		-		(4,410)
Net cash used in investing activities			41,558		36,750		(32,231)
Cash flows from financing activities							
Interest paid			(5)		(4)		(3)
Dividends paid			(356,156)		(314,960)		-
Increase in deposits received			452		399		331
Decrease in deposits received			(1,819)		(1,605)		(967)
Net cash used in financing activities			(357,528)		(316,170)		(639)
Net increase (decrease) in cash and cash equivalents			(154,776)		(136,873)		132,670
Cash and cash equivalents at Beginning of period			268,954		237,844		88,352
Effect of exchange rate fluctuation on cash held			(33)		(29)		13
Cash and cash equivalents at end of period		₩	114,145	$	100,942	₩	221,035

See accompanying notes to financial statements.

March 31, 2010 and 2009

1 Organization and Description of Business

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

As of March 31, 2010, the Company has four manufacturing plants, including the Shin Tan Jin plant, and 14 local headquarters and 168 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Chunahn printing plant for the manufacturing of packaging, and has its head office in Pyeongchon-dong, Daedeok-gu, Daejeon.

Pursuant to the Korean Government's privatization program and management reorganization plan, on December 28, 1998, the shareholders approved a plan to separate 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 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 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 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 Company's issued ordinary share at March 31, 2010 is held as follows:

Shareholder	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee Share Ownership Association	5,271,558	3.84%
Treasury shares	10,093,697	7.35%
Others	112,416,757	81.88%
	137,292,497	100.00%

2 Basis of Preparation

(a) Statement of Compliance

The financial statements have been prepared in accordance with Korean International Financial Reporting Standards ("K-IFRS"), as prescribed in the Act on External Audit of Corporations. K-IFRS is effective from the fiscal year beginning on or after January 1, 2011 and the Company early-adopted K-IFRS from 2009.

These financial statements are separate financial statements which are those presented by a parent or an investor in an associate, 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 investee in accordance with K-IFRS No.1027 *Consolidated and Separate Financial Statements*.

The financial statements have been prepared in accordance with K-IFRS No.1034 *Interim Financial Reporting*.

(b) Basis of Measurement

The financial statements have been prepared under the historical cost basis except as described in the accounting policy below on financial instruments and share-based payments.

(c) Use of Estimates and Judgments

The preparation of the financial statements in conformity with K-IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

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.

Information about critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements is included in the following notes:

- Classification of investment property – note 3 (g).

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year is included in the following notes:

- Measurement of defined benefit obligations – note 21
- Provisions and contingencies – note 28.

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies

(a) Investments in Subsidiaries and Associates in the Separate Financial Statement

These financial statements are separate financial statements which are those presented by a parent or an investor in an associate in accordance with K-IFRS No.1027, 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 Company accounts for investments in subsidiaries and associates at cost. The Company measures an investment in Korea Ginseng Corporation at the deemed cost which is previous GAAP carrying amount at the date of transition in accordance with K-IFRS No.1101 *First-time Adoption of Korean International Financial Reporting Standards*. Dividends on investments in subsidiaries and associates are recognized in profit or loss when the Company's right to receive payment is established.

(d) Foreign Currencies

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

Foreign currency transactions are initially recorded using the spot exchange rate between the functional currency and the foreign currency at the date of the transaction. At the end of each reporting period, foreign currency monetary items are translated using the closing rate. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements are recognized in profit or loss in the period in which they arise. When gains or losses on non-monetary items are recognized in other comprehensive income, exchange components of that gains or losses are recognized in other comprehensive income. Conversely, when gains or losses on non-monetary items are recognized in profit or loss, exchange components of that gains or losses are recognized in profit or loss.

(e) Property, Plant and Equipment

Property, plant and equipment are measured initially at cost and after initial recognition, are carried at cost less accumulated depreciation and accumulated impairment losses. The cost of property, plant and equipment includes expenditure arising directly from the construction or acquisition of the asset, any costs directly attributable to bringing the asset to the location and condition necessary for them to be capable of operating in the manner intended by management and the initial estimate of the costs of dismantling and removing the item and restoring the site on which they are located.

Subsequent costs are recognized in the carrying amount of property, plant and equipment 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.

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

Property, plant and equipment, except for land and other tangible fixed assets, are depreciated on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives were as follows:

	Useful lives (years)
Buildings and structures	10 ~ 60
Machinery and vehicles	4 ~ 12
Tools, furniture and fixtures	4

Each part of property, plant and equipment with a cost that is significant in relation to the total cost are depreciated separately.

Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate. The change is accounted for as a change in an accounting estimate.

(f) Intangible Assets

Intangible assets are measured initially at cost and after initial recognition, are carried at cost less accumulated amortization and accumulated impairment losses. Intangible assets consist of industrial property rights, rights to facility usage and other intangible assets. 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 rights to facility usage and some of industrial property right are expected to be available for use, these intangible assets are regarded as having indefinite useful lives and not amortized.

The estimated useful lives were as follows:

	Useful lives (years)
Industrial property rights	10 ~ 20 or indefinite
Rights to facility usage	indefinite
Other intangible assets	15

The amortization period and the amortization method for intangible assets with a finite useful life are reviewed at each financial year-end. The useful lives of intangible assets that is not being amortized are reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for those assets. If it is appropriate to change, such a change is accounted for as a change in an accounting estimate.

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

(g) Investment Property

Properties held to earn rentals or for capital appreciation are classified as investment properties. Investment properties are measured initially at its cost including transaction costs and after initial recognition, are carried at cost less accumulated depreciation and 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 properties, except for land, are depreciated on a straight-line basis over 10 ~ 60 years, the estimated useful lives. Depreciation methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate. The change is accounted for as a change in an accounting estimate.

(h) Inventories

Inventories are measured at the lower of cost and 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 cost of inventories is determined by the weighted-average method for finished goods, by-products, work-in-progress and tobacco leaf in raw materials, by the moving-average method for raw materials and supplies; and by the specific identification method for all other inventories.

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 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 recognized as an expense in the period in which the reversal occurs.

Tobacco leaf inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognized industry practice. The estimated amounts of inventories in current assets which are not expected to be realized within 12 months are ₩357,601 million and ₩362,594 million, respectively, as of March 31, 2010 and December 31, 2009.

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

(i) Non-Derivative Financial Assets

The Company classifies a non-derivative financial asset into the following four categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables or available-for-sale financial assets, relating to recognition and measurement of financial assets. The Company recognizes financial assets in the statement of financial position when the Company becomes a party to the contractual provisions of the financial asset. The Company derecognizes financial assets from the statement of financial position when the contractual rights to the cash flows from the financial asset expire or the Company transfers the contractual rights to receive the cash flows on the financial asset in a transaction in which all the risks and rewards of ownership of the financial asset are substantially transferred. If the Company retains substantially all the risks and rewards of ownership of the transferred financial assets, the Company continues to recognize the transferred financial asset and recognizes financial liabilities for the consideration received.

Non-derivative financial assets comprise investments in equity and debt securities, long-term deposits in MSA Escrow Fund, trade and other receivables and cash and cash equivalents. When non-derivative financial assets are recognized initially, the Company measures it at its fair value plus, in the case of financial assets not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset.

Financial Assets at Fair Value through Profit or Loss
Financial assets are classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition transaction costs are recognized in profit or loss when incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

Held-to-maturity Investments
Non-derivative financial assets with fixed or determinable payments and fixed maturity that the Company has the positive intention and ability to hold to maturity are classified as held-to-maturity investments. After initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method.

Loans and Receivables
Loans and receivables are trade receivables, loans and other receivables with fixed or determinable payments that are not quoted in an active market. After initial recognition, loans and receivables are measured at amortized cost using the effective interest method except for short-term receivables of which the effect of discounting is immaterial.

Available-for-sale Financial Assets
Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables. Subsequent to initial recognition, they are measured at fair value and changes therein are recognized directly in other comprehensive income, except for impairment losses and foreign exchange gains and losses on monetary available-for-sale financial asset. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost. When the financial asset is derecognized or impairment losses is recognized, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss. Dividends on an available-for-sale equity instrument are recognized in profit or loss when the Company’s right to receive payment is established

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

(i) Non-Derivative Financial Assets (continued)

Cash and Cash Equivalents
Cash and cash equivalents comprise cash on hand, demand deposits and short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date. Bank overdrafts are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

(j) Non-Derivative Financial liabilities

The Company classifies non-derivative financial liabilities into financial liabilities at fair value through profit or loss or other financial liabilities in accordance with the substance of the contractual arrangement and the definitions of financial liabilities. The Company recognizes financial liabilities in the statement of financial position when the Company becomes a party to the contractual provisions of the financial liability and removes financial liabilities from the statement of financial position when the financial liability is extinguished.

Non-derivative financial liabilities comprise borrowings and trade and other payables. When non-derivative financial liabilities are recognized initially, the Company measures it at its fair value minus, in the case of financial liabilities not at fair value through profit or loss, transaction costs that are directly attributable to the issue of the financial liability.

Financial Liabilities at Fair Value through Profit or Loss
Financial liabilities are classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition transaction costs are recognized in profit or loss when incurred. Financial liabilities at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

Other Financial Liabilities
Other financial liabilities are those non-derivative financial liabilities that are not classified as financial liabilities at fair value through profit or loss. After initial recognition, other financial liabilities are measured at amortized cost using the effective interest method except for short-term liabilities of which the effect of discounting is immaterial.

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

(k) Derivative Financial Instruments

Derivatives are recognized initially at fair value. Attributable transaction costs are recognized in profit or loss when incurred.

A hedge of the exposure to changes in fair value of a recognized asset or liability or an unrecognized firm commitment that is attributable to a particular risk is accounted for as a fair value hedge. A hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction is accounted for cash flow hedge.

At the inception of the hedge, the Company formally designates the hedging relationship and the Company's risk management objective and strategy for undertaking the hedge and documents identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Company will assess the hedging instrument's effectiveness. The Company assesses the hedge effectiveness on an ongoing basis throughout the financial reporting periods for which the hedge was designated.

Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

Fair value hedges
The gain or loss from remeasuring the hedging instrument designated as a fair value hedge at fair value and the gain or loss on the hedged item attributable to the hedged risk is recognized in profit or loss.

Cash flow hedges
The portion of the gain or loss on the hedging instrument designated as a cash value hedge that is determined to be an effective hedge is recognized in other comprehensive income and the ineffective portion of the gain or loss on the hedging instrument is recognized in profit or loss. The associated gains or losses that were recognized in other comprehensive income is reclassified from equity to profit or loss in the same period or periods during which the hedged forecast transaction affects profit or loss. If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, the associated gains and losses that were recognized in other comprehensive income are removed and included in the initial cost or other carrying amount of the asset or liability.

If the hedging instrument expires or is sold, terminated or exercised or the hedge no longer meets the criteria for hedge accounting or the Company revokes the designation, the hedge accounting is discontinued prospectively. The cumulative gain or loss on the hedging instrument that has been recognized in other comprehensive income is reclassified from equity to profit or loss when the forecast transaction occurs. If the transaction is no longer expected to occur, the cumulative gain or loss that had been recognized in other comprehensive income is immediately reclassified from equity to profit or loss.

Changes in the fair value of derivatives that are not designated as hedging instrument or do not meet the criteria for hedge accounting are recognized immediately in profit or loss.

As of March 31, 2010, the Company does not have derivative financial instruments.

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

(l) Non-current Assets Held for Sale

The Company classifies a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use, and measures it at the lower of its carrying amount and fair value less costs to sell.

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

The Company recognizes an impairment loss for write-down of the asset (or disposal group) to fair value less costs to sell and a gain for increase in fair value less costs to sell of an asset, but not in excess of the cumulative impairment loss that has been recognized previously in accordance with K-IFRS No.1036 *Impairment of Assets*.

(m) Revenue Recognition

The Company's revenue categories consist of goods sold, services and other income.

Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale 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. Tobacco excise and other taxes deducted from revenue for the three-month periods ended March 31, 2010 and 2009 were ₩750,231 million and ₩887,274 million, respectively.

Revenue from the building lotting-out construction contracts is recognized upon delivery when the significant risks and rewards of ownership of the goods are transferred to the buyer.

Revenue associated with the transaction involving the rendering of services is recognized by reference to the stage of completion of the transaction at the end of the reporting period when the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company, the stage of completion of the transaction at the end of the reporting period can be measured reliably and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably. When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue is recognized only to the extent of the expenses recognized that are recoverable.

Revenue arising from the use by others of the Company assets yielding interest, royalties and dividends is recognized when it is probable that the economic benefits associated with the transaction will flow to the Company and the amount of the revenue can be measured reliably.

In addition, interest is recognized using the effective interest method, royalties are recognized on an accrual basis in accordance with the substance of the relevant agreement and dividends are recognized when the shareholder's right to receive is established.

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

(n) Impairment of Non-financial Assets

The Company assesses at the end of each reporting period whether there is any indication that an asset may be impaired except for inventories, deferred tax assets, assets arising from employee benefits and non-current assets (or disposal groups) classified as held for sale. If any such indication exists, the Company estimates the recoverable amount of the asset. Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, irrespective of whether there is any indication that it may be impaired. If there is any indication that an asset may be impaired, recoverable amount is estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, the Company determines the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

The recoverable amount is measured as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. If the recoverable amount of an asset or cash-generating unit is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. That reduction is recognized in profit or loss.

(o) Impairment of Financial Assets

The Company assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired, except a financial asset at fair value through profit or loss. A financial asset or group of financial assets is considered to be impaired if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset. For specific financial assets such as trade receivables, if the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, it collectively assesses them for impairment. The objective evidence that the group of loans and receivables is impaired includes an increased number of delayed payments and an adverse change in national or local economic conditions that correlate with defaults on the assets in the group.

The amount of the impairment loss on financial assets carried at amortized cost is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognized in profit or loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. The reversal does not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal is recognized in profit or loss.

The amount of the impairment loss on financial assets carried at cost is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

(o) Impairment of Financial Instruments (continued)

When a decline in the fair value of an available-for-sale financial asset has been recognized in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment even though the financial asset has not been derecognized. Impairment losses recognized in profit or loss for an investment in an equity instrument classified as available for sale are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in profit or loss.

(p) Income Taxes

Income tax expense comprises current tax expense and deferred tax expense. Current and deferred taxes are recognized as an expense included in profit or loss for the period, except to the extent that the tax arises from a transaction which is recognized in other comprehensive income or directly in equity.

Current tax expense is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period. Current tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and liabilities are recognized for temporary differences which are differences between the carrying amount of an asset or liability in the statement of financial position and its tax base, the carryforward of unused tax losses and unused tax credits. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates that have been enacted or substantively enacted by the end of the reporting period.

The Company recognizes a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries and associates, except to the extent that the parent or investor is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future.

The Company recognizes a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries and associates, to the extent that, and only 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. The Company reduces the carrying amount of a deferred tax asset 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 these deferred tax assets to be utilised. Such reduction is reversed to the extent that it becomes probable that sufficient taxable profit will be available.

Income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

(q) Dividends

The dividends declared to holders of equity instruments after the reporting period are not recognized as a liability at the end of the reporting period.

(r) Equity Capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the equity transaction are recognized as a deduction from equity, net of any tax effects.

If the Company reacquires its own equity instruments, those instruments ("treasury shares") are presented as a deduction from total equity. The gain or loss on the purchase, sale, issue or cancellation of treasury shares is not recognized in profit or loss but recognized directly in equity.

(s) Provisions, Contingent Assets and Contingent Liabilities

Provisions are recognized when the Company has a present 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 amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. 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, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

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

Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate. 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.

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

(t) Employee Benefits

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.

The Company recognizes the expected cost of profit-sharing and bonus payments if the Company has a present legal or constructive obligation to make such payments as a result of past events; and a reliable estimate of the obligation can be made.

Retirement Benefits: Defined Contribution Plans
With regard to the defined contribution plan, 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.

Retirement Benefits: Defined Benefit Plans
The Company classifies retirement benefits plans other than defined contribution plans as defined benefit plans. The defined benefit liabilities are calculated at the present value of the defined benefit obligations less the fair value of the plan assets at the end of the reporting period.

In determining the present value of its defined benefit obligations and the related current service cost, the Company uses the projected unit credit method.

With regard to actuarial gains and losses which arise from application of actuarial assumptions, the Company recognizes all actuarial gains and losses in other comprehensive income. Actuarial gains and losses recognized in other comprehensive income are recognized immediately in retained earnings and are not reclassified to profit or loss in a subsequent period.

(u) Share-based Payment

For equity-settled share-based payment transactions, the Company measures the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the Company cannot estimate reliably the fair value of the goods or services received, the Company measures their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted.

For cash-settled share-based payment transactions, the Company measures the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the Company remeasures the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognized in profit or loss for the period.

March 31, 2010 and 2009

3 Basis of Presenting Financial Statements and Summary of Significant Accounting Policies (continued)

(u) Share-based Payment (continued)

For share-based payment transactions in which the terms of the arrangement provide either the Company or the counterparty with the choice of whether the Company settles the transaction in cash or by issuing equity instruments, the Company accounts for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the Company has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.

(v) Earning per Share

The Company presents basic and diluted earnings per share data for its ordinary shares. Basic earnings per share are calculated by dividing the profit or loss for the period attributable to owners of the Company by the weighted-average number of shares outstanding during the period.

Diluted earnings per share are determined by adjusting the profit or loss for the period attributable to owners of the Company and the weighted-average number of shares outstanding for the effects of all dilutive potential shares, which comprise employee share options.

4 Basis of Translating Financial Statements

The financial statements are expressed in Korean Won and have been translated into U.S. dollars at the rate of ₩1,130.80 to $1, the basic exchange rate on March 31, 2010, solely for the convenience of the reader. This translation should not be construed as a representation that any or all of the amounts shown could be converted into United States dollars at this or any other rate.

5 Property, Plant and Equipment

(a) Changes in property, plant and equipment for the three-month period ended March 31, 2010 were as follows:

In millions of Won		Land, buildings and structures	Machinery and vehicles	Tools, furniture, fixtures and other	Construction-in-progress	Total
Cost:						
Balance at January 1, 2010	₩	1,022,347	835,754	232,769	45,447	2,136,317
Additions		38	559	2,456	10,475	13,528
Disposals		(163)	(19,856)	(6,740)	(66)	(26,825)
Other		-	101	493	(1,027)	(433)
Balance at March 31, 2010	₩	1,022,222	816,558	228,978	54,829	2,122,587
Accumulated depreciation and impairment:						
Balance at January 1, 2010	₩	(229,226)	(523,569)	(173,096)	-	(925,891)
Disposals		78	18,050	5,295	-	23,423
Depreciation		(6,938)	(15,434)	(8,036)	-	(30,408)
Balance at March 31, 2010	₩	(236,086)	(520,953)	(175,837)	-	(932,876)
Carrying amount:						
Balance at January 1, 2010	₩	793,121	312,185	59,673	45,447	1,210,426
Balance at March 31, 2010	₩	786,136	295,605	53,141	54,829	1,189,711

Other changes for the three-month period ended March 31, 2010 include the carrying amount of construction-in-progress transferred to operating expenditures amounting to ₩433 million.

For the three-month period ended March 31, 2009, the Company purchased and disposed of property, plant and equipment amounting to ₩12,427 million and ₩1,662 million, respectively.

March 31, 2010 and 2009

5 Property, Plant and Equipment (continued)

(b) Changes in property, plant and equipment for the year ended December 31, 2009 were as follows:

In millions of Won		Land, buildings and structures	Machinery and vehicles	Tools, furniture, fixtures and other	Construction-in-progress	Total
Cost:						
Balance at January 1, 2009	₩	1,022,851	837,278	212,724	41,380	2,114,233
Additions		12,100	13,349	17,464	53,487	96,400
Disposals		(13,579)	(17,402)	(2,242)	-	(33,223)
Other		975	2,529	4,823	(49,420)	(41,093)
Balance at December 31, 2009	₩	1,022,347	835,754	232,769	45,447	2,136,317
Accumulated depreciation and impairment:						
Balance at January 1, 2009	₩	(206,967)	(492,017)	(139,713)	-	(838,697)
Disposals		2,918	14,756	2,151	-	19,825
Depreciation		(25,177)	(61,811)	(35,535)	-	(122,523)
Other		-	15,503	1	-	15,504
Balance at December 31, 2009	₩	(229,226)	(523,569)	(173,096)	-	(925,891)
Carrying amount:						
Balance at January 1, 2009	₩	815,884	345,261	73,011	41,380	1,275,536
Balance at December 31, 2009	₩	793,121	312,185	59,673	45,447	1,210,426

Other changes for the year ended December 31, 2009 include the carrying amount of machinery, furniture and fixtures provided as an investment in kind in KT&G Pars amounting to ₩2,343 million and the amount transferred to non-current asset held for sale amounting to ₩23,246 million.

6 Intangible Assets

(a) Changes in intangible assets for the three-month period ended March 31, 2010 were as follows:

In millions of Won		Industrial property rights	Rights to facility usage	Other intangible assets	Intangible assets under development	Total
Cost:						
Balance at January 1, 2010	₩	6,175	15,316	658	29,419	51,568
Additions		-	-	-	853	853
Disposals		(105)	(386)	-	(171)	(662)
Others		239	-	-	(239)	-
Balance at March 31, 2010	₩	6,309	14,930	658	29,862	51,759
Accumulated amortization and impairment:						
Balance at January 1, 2010	₩	(5,233)	-	(647)	(647)	(6,527)
Amortization		(12)	-	(11)	-	(23)
Balance at March 31, 2010	₩	(5,245)	-	(658)	(647)	(6,550)
Carrying amount:						
Balance at January 1, 2010	₩	942	15,316	11	28,772	45,041
Balance at March 31, 2010	₩	1,064	14,930	-	29,215	45,209

The Company purchased and disposed intangible assets amounting to ₩918 million and ₩62 million for the three-month period ended March 31, 2009.

(b) Changes in intangible assets for the year ended December 31, 2009 were as follows:

In millions of Won		Industrial property rights	Rights to facility usage	Other intangible assets	Intangible assets under development	Total
Cost:						
Balance at January 1, 2009	₩	6,133	14,616	658	25,456	46,863
Additions		42	764	-	3,963	4,769
Disposals		-	(64)	-	-	(64)
Balance at December 31, 2009	₩	6,175	15,316	658	29,419	51,568
Accumulated amortization and impairment:						
Balance at January 1, 2009	₩	(5,028)	-	(575)	-	(5,603)
Amortization		(205)	-	(72)	-	(277)
Impairment		-	-	-	(647)	(647)
Balance at December 31, 2009	₩	(5,233)	-	(647)	(647)	(6,527)
Carrying amount:						
Balance at January 1, 2009	₩	1,105	14,616	83	25,456	41,260
Balance at December 31, 2009	₩	942	15,316	11	28,772	45,041

The Company recognized ₩647 million of impairment loss on the intangible assets under development due to the relinquishment of the industrial property rights for the year ended December 31, 2009.

6 Intangible Assets (continued)

(c) Expenditures not capitalized for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Cost of sales	₩	61	29
Selling expenses		25	48
General and administrative expenses		1,644	2,215
	₩	1,730	2,292

7 Investment Property

(a) Changes in investment property for the three-month period ended March 31, 2010 were as follows:

In millions of Won		Land	Buildings	Total
Cost:				
Balance at January 1, 2010	₩	13,919	117,010	130,929
Subsequent expenditure		-	-	-
Balance at March 31, 2010	₩	13,919	117,010	130,929
Accumulated depreciation and impairment:				
Balance at January 1, 2010	₩	-	(29,029)	(29,029)
Depreciation		-	(878)	(878)
Balance at March 31, 2010	₩	-	(29,907)	(29,907)
Carrying amount:				
Balance at January 1, 2010	₩	13,919	87,981	101,900
Balance at March 31, 2010	₩	13,919	87,103	101,022

(b) Changes in investment property for the year ended December 31, 2009 were as follows:

In millions of Won		Land	Buildings	Total
Cost:				
Balance at January 1, 2009	₩	13,919	116,687	130,606
Subsequent expenditure		-	323	323
Balance at December 31, 2009	₩	13,919	117,010	130,929
Accumulated depreciation and impairment:				
Balance at January 1, 2009	₩	-	(25,531)	(25,531)
Depreciation		-	(3,498)	(3,498)
Balance at December 31, 2009	₩	-	(29,029)	(29,029)
Carrying amount:				
Balance at January 1, 2009	₩	13,919	91,156	105,075
Balance at December 31, 2009	₩	13,919	87,981	101,900

7 Investment Property (continued)

(c) The amounts recognized in profit or loss from investment property for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Rental income	₩	4,370	4,404
Direct operating expense		(878)	(872)
	₩	3,492	3,532

(d) The carrying amount and the fair value of investment property as of March 31, 2010 and December 31, 2009 were as follows:

		March 31 2010		December 31 2009	
In millions of Won		Fair value	Carrying amount	Fair value	Carrying amount
Land	₩	204,383	13,919	204,383	13,919
Buildings		109,235	87,103	109,235	87,981
	₩	313,618	101,022	313,618	101,900

8 Investments in Associates

Investments in associates as of March 31, 2010 and December 31, 2009 are summarized as follows:

In millions of Won, except percentage of ownership			March 31 2010			December 31 2009		
Associate	Location	Principal operation	Percentage of ownership		Carrying amount	Percentage of ownership		Carrying amount
Cosmo Tabacco Co., Ltd.	Mongolia	Manufacturing and selling tobacco	40.00%	₩	-	40.00%	₩	-
Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	25.34%		1,830	29.46%		1,830
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00%		1,000	20.00%		1,000
				₩	2,830		₩	2,830

The Company recognized ₩2,947 million of impairment loss on the investment in Cosmo Tabacco Co., Ltd. for the year ended December 31, 2009 and this impairment loss is recognized as finance costs in the statements of comprehensive income.

9 Investments in Subsidiaries

Investments in subsidiaries as of March 31, 2010 and December 31, 2009 are summarized as follows:

In millions of Won, except percentage of ownership			March 31 2010		December 31 2009	
Associate	Location	Principal operation	Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00%	₩ 559,882	100.00%	₩ 559,882
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceutical	55.50%	50,691	55.50%	50,691
Tae-a Industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00%	14,198	100.00%	14,198
KT&G Tutun MamulleriSanayi ve Ticaret A.S. (*1)	Turkey	Manufacturing and selling tobacco	99.99%	54,049	99.99%	54,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf tobacco	99.90%	394	99.90%	394
KT&G Pars (*2)	Iran	Manufacturing and selling tobacco	99.99%	5,733	99.99%	5,733
KT&G Rus L.L.C. (*3)	Russia	Manufacturing and selling tobacco	100.00%	34,483	100.00%	34,483
KT&G Bio Corp. (*4)	Korea	Manufacturing and selling pharmaceutical	100.00%	900	100.00%	900
				₩ 720,330		₩ 720,330

(*1) KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. increased paid-in capital by way of shareholder allocation and the Company's investments in subsidiaries increased by ₩19,044 million for the year ended December 31, 2009.

(*2) KT&G Pars increased paid-in capital by way of investment in kind and the Company's investments in subsidiaries increased by ₩4,037 million for the year ended December 31, 2009.

(*3) KT&G Rus L.L.C. increased paid-in capital by way of shareholder allocation and the Company's investments in subsidiaries increased by ₩33,681 million for the year ended December 31, 2009.

(*4) The Company established KT&G Bio Corp. and the Company's investments in subsidiaries increased by ₩900 million for the year ended December 31, 2009.

The Company measures its investment in Korea Ginseng Corporation at the deemed cost which is the previous K-GAAP carrying amount at the date of transition in accordance with K-IFRS No.1101.

10 Available-for-sale Financial Assets

(a) Changes in available-for-sale financial assets for the three-month period ended March 31, 2010 and the year ended December 31, 2009 were as follows:

In millions of Won		2010	2009
Balance at beginning of period	₩	443,800	304,105
Acquisitions		623	11,222
Net changes in fair value before tax		76,152	129,558
Disposals		(610)	(1,085)
Balance at end of period	₩	519,965	443,800
Current	₩	1,910	1,957
Non-current		518,055	441,843
	₩	519,965	443,800

(b) Available-for-sale financial assets as of March 31, 2010 and December 31, 2009 are summarized as follows:

In millions of Won		March 31 2010	December 31 2009
Available-for-sale debt instruments:			
- Government and municipal bonds	₩	1,954	2,001
- Corporate bonds		2,000	2,000
Total available-for-sale debt instruments		3,954	4,001
Available-for-sale equity instruments:			
Listed			
- Yonhap Television News (YTN)		40,350	38,967
- Crystal Genomics Co., Ltd.		1,615	1,748
- Oscotech, Inc.		1,241	780
- Shinhan Financial Group Co., Ltd.		178,171	173,161
- Rexahn Pharmaceuticals, Inc.		11,254	4,878
- Celltrion, Inc.		258,662	195,462
- Genematrix, Inc.		-	708
		491,293	415,704
Unlisted			
- Dream Hub PFV Co., Ltd.		15,975	15,975
- Migami, Inc.		3,988	3,365
- Other unlisted available-for-sale equity instruments		4,755	4,755
		24,718	24,095
Total available-for-sale equity instruments		516,011	439,799
Total available-for-sale financial assets	₩	519,965	443,800

10 Available-for-sale Financial Assets (continued)

The fair value of listed available-for-sale equity instruments is principally based on quoted prices in an active market.

The fair value of Dream Hub PFV Co., Ltd. that does not have market price in an active market is established by the independent rating agency using a valuation method. The fair value of Dream Hub PFV Co., Ltd. is established on the basis of the value per share determined by using discounted cash flow model and net asset valuation model and estimation of probability distribution of the value per share.

The other unlisted available-for-sale equity instruments that do not have market price in an active market and whose fair value cannot be reliably measured and available-for-sale debt instruments whose fair value is similar to their carrying amount, are measured at cost.

11 Long-term Deposits in MSA Escrow Fund

(a) Long-term deposits in MSA Escrow Fund as of March 31, 2010 and December 31, 2009 are summarized as follows:

In millions of Won		March 31 2010	December 31 2009
MMF	₩	6,452	4,874
T-Bill		55,524	57,287
T-Note		54,506	55,960
	₩	116,482	118,121

(b) As discussed in notes 27 to financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2010 and 2009 are ₩1,732 million and ₩4,434 million, respectively.

(c) Investment income on long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2010 and 2009 are ₩352 million and ₩3 million, respectively.

(d) Long-term deposits in MSA Escrow Fund are measured at quoted prices in an active market.

12 Trade and Other Receivables

(a) Trade and other receivables as of March 31, 2010 and December 31, 2009 are summarized as follows:

		March 31 2010		December 31 2009	
In millions of Won		Current	Non-current	Current	Non-current
Loans to employees	₩	24,010	52,053	23,985	68,067
Loans		11,873	3,363	9,870	5,861
Other receivables		52,010	-	53,775	-
Guarantee deposits		-	34,458	-	32,639
Accrued income		619	-	981	-
Trade receivables		404,276	-	417,120	-
	₩	492,788	89,874	505,731	106,567

(b) Trade and other receivables as of March 31, 2010 and December 31, 2009 have been reported in the statements of financial position net of allowances as follows:

		March 31 2010		December 31 2009	
In millions of Won		Current	Non-current	Current	Non-current
Gross trade and other receivables	₩	497,919	89,874	511,138	106,567
Allowance account:					
- Other receivables		(1,875)	-	(2,161)	-
- Trade receivables		(3,256)	-	(3,246)	-
		(5,131)	-	(5,407)	-
Net trade and other receivables	₩	492,788	89,874	505,731	106,567

(c) Changes in the allowance account for the three-month period ended March 31, 2010 and the year ended December 31, 2009 were as follows:

In millions of Won		2010	2009
Balance at Beginning of period	₩	5,407	4,867
Impairment loss		10	540
Write-off		(286)	-
Balance at end of period	₩	5,131	5,407

Impairment loss on trade and other receivables is included as part of other expense and income in the statements of comprehensive income.

(d) The age schedule of trade and other receivables which were past due but not impaired as of March 31, 2010 and December 31, 2009 is as follows:

In millions of Won		March 31 2010	December 31 2009
Within 1 month	₩	42,253	58,419
Between 1 and 2 months		44,950	71,366
Beyond 2 months		93,427	15,243
	₩	180,630	145,028

12 Trade and Other Receivables (continued)

There is no significant concentration of credit risk with respect to trade receivables as the Company has a large number widely dispersed of customers, except for export trade receivables, and the Company holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

(e) Details of trade and other receivables that are measured at amortized cost as of March 31, 2010 and December 31, 2009 were as follows:

				March 31 2010				December 31 2009
In millions of Won	Effective interest rate		Current	Non-current	Effective interest rate		Current	Non-current
Loans to employees	3.00~5.68%	₩	24,010	52,053	3.00~5.68%	₩	23,985	68,067
Guarantee deposits	3.00~5.68%		-	34,458	3.00~5.68%		-	32,639
		₩	24,010	86,511		₩	23,985	100,706

There is no material difference between the carrying amount and their fair value except the above trade and other receivables, due to the short-term duration of the majority of trade and other receivables.

13 Inventories

(a) Inventories as of March 31, 2010 and December 31, 2009 are summarized as follows:

In millions of Won		March 31 2010	December 31 2009
Finished goods, net of loss on the write-down of inventories	₩	114,882	86,318
Work-in-progress		12,770	12,633
Raw materials		797,647	858,373
Supplies		23,945	23,895
By-products		5,843	5,547
Completed buildings		34,945	53,816
Goods-in-transit		59,963	13,739
	₩	1,049,995	1,054,321

(b) The amount of inventories recognized as an expense for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Cost of sales:			
- Loss on the write-down of inventories	₩	39	-
- Reversal of loss on the write-down of inventories		-	(194)
Other expense:			
- Loss on retirement of inventories		997	412
	₩	1,036	218

14 Cash and Cash Equivalents

Cash and cash equivalents as of March 31, 2010 and December 31, 2009 are summarized as follows:

In millions of Won		March 31 2010	December 31 2009
Cash on hand	₩	5,515	6,681
Demand deposits		63,630	62,273
Short-term investment assets		45,000	200,000
	₩	114,145	268,954

Cash equivalents mainly include short-term deposits with an original maturity of three months or less. The carrying amount of cash and cash equivalents approximates their fair value.

15 Share Capital

(a) Details of share capital as of March 31, 2010 and December 31, 2009 were as follows:

In Won, except number of shares		March 31 2010	December 31 2009
Number of ordinary shares:			
- Authorized		800,000,000	800,000,000
- Issued		137,292,497	137,292,497
- Outstanding		127,198,800	127,198,800
Par value	₩	5,000	5,000

The Company has, thus far, reacquired and retired 53,699,400 shares of treasury share. Accordingly, as of March 31, 2010, the Company's ordinary share differs from the aggregate par value of issued shares by ₩268,497 million.

(b) Changes in the number of shares for the three-month period ended March 31, 2010 and the year ended December 31, 2009 were as follows:

	2010			2009		
Number of shares	Ordinary share	Treasury share	Total	Ordinary share	Treasury share	Total
Beginning of period	137,292,497	(10,093,697)	127,198,800	138,792,497	(10,093,697)	128,698,800
Reacquisition of treasury shares	-	-	-	-	(1,500,000)	(1,500,000)
Retirement of treasury shares	-	-	-	(1,500,000)	1,500,000	-
End of period	137,292,497	(10,093,697)	127,198,800	137,292,497	(10,093,697)	127,198,800

15 Share Capital (continued)

(c) Changes in the other capital surplus for the three-month period ended March 31, 2010 and the year ended December 31, 2009 were as follows:

In millions of Won		2010	2009
Balance at beginning of period	₩	2,632	337
Expiration of employee share options		-	2,295
Balance at end of period	₩	2,632	2,632

The employee share options were settled in cash and terminated for the year ended December 31, 2009. Consequently, the employee share option reserve was reclassified to the other capital surplus.

16 Treasury Share

Changes in the treasury shares for the three-month period ended March 31, 2010 and the year ended December 31, 2009 were as follows:

	2010			2009		
In millions of Won, except number of shares	Number of share		Carrying amount	Number of share		Carrying amount
Balance at beginning of period	10,093,697	₩	226,945	10,093,697	₩	226,945
Reacquisition of treasury shares	-		-	1,500,000		103,999
Retirement of treasury shares	-		-	(1,500,000)		(103,999)
Balance at end of period	10,093,697	₩	226,945	10,093,697	₩	226,945

17 Reserves

(a) Details of reserves as of March 31, 2010 and December 31, 2009 were as follows:

In millions of Won		March 31 2010	December 31 2009
Available-for-sale financial assets reserve	₩	188,192	128,793
Legal reserve		602,937	602,937
Voluntary reserve		1,563,732	1,342,378
	₩	2,354,861	2,074,108

(b) Available-for-sale financial assets reserve as of March 31, 2010 and December 31, 2009 are summarized as follows:

In millions of Won		March 31 2010	December 31 2009
Available-for-sale financial assets reserve before tax	₩	241,272	165,119
Tax effect		(53,080)	(36,326)
	₩	188,192	128,793

17 Reserves (continued)

(c) Legal Reserve

The Korean Commercial Code 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 share in connection with a free issue of shares.

(d) Details of voluntary reserve as of March 31, 2010 and December 31, 2009 were as follows:

In millions of Won		March 31 2010	December 31 2009
Reserve for business rationalization	₩	12,851	12,851
Reserve for research and human resource development		60,000	15,000
Reserve for loss on reissuance of treasury shares		-	26,646
Reserve for business expansion		698,881	698,881
Unconditional reserve		792,000	589,000
	₩	1,563,732	1,342,378

Reserve for Business Rationalization
Until December 10, 2002 under the Special Tax Treatment Control Law, 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.

Reserve for Business Expansion
Reserve for business expansion was a legal reserve under the Korea Tobacco and Ginseng Corporation Act, which was abrogated on September 1, 1997, consequently, the existing balance has been regarded as a voluntary reserve since then.

Other Reserves
Reserves for research and human resource development and loss on reissuance of treasury shares were appropriated in order to utilize certain tax deduction benefits through the early recognition of future expenditures. These reserves are restored to retained earnings in accordance with the relevant tax laws. Such reserves are taken back into taxable income in the year of restoration. Reserves without specific purposes are restored to retained earnings by a resolution at a general meeting of shareholders.

18 Retained Earnings

Changes in retained earnings for the three-month period ended March 31, 2010 and the year ended December 31, 2009 were as follows:

In millions of Won		2010	2009
Balance at beginning of period	₩	579,963	436,453
Transfer from reserve for research and human resource development		15,000	15,000
Transfer from Reserve for loss on reissuance of treasury shares		26,646	-
Transfer to reserve for research and human resource development		(60,000)	-
Transfer to unconditional reserve		(203,000)	(169,000)
Dividends		(356,156)	(360,357)
Profit for the period		179,353	744,942
Actuarial gains, net of tax		3,615	16,924
Retirement of treasury shares		-	(103,999)
Balance at end of period	₩	185,421	579,963

19 Short-term Borrowings

Short-term borrowings as of March 31, 2010 and December 31, 2009 are summarized as follows:

In millions of Won		March 31 2010	December 31 2009
Customer credit contracts	₩	10,043	19,338

The Company has entered into a customer credit contract with the National Agricultural Cooperative Federation ("NACF") and other financial institutions, the financial institutions pay past-due trade receivables for customers and the Company has provided guarantees to the financial institutions for customers. The amount paid by the financial institutions is recognized as short-term borrowings on the statements of financial position.

20 Trade and Other Payables

(a) Trade and other payables as of March 31, 2010 and December 31, 2009 are summarized as follows:

		March 31 2010		December 31 2009	
In millions of Won		Current	Non-current	Current	Non-current
Leasehold deposits received	₩	-	22,799	-	24,042
Trade payables		65,165	-	35,019	-
Withholdings		4,500	-	3,504	-
Withholdings taxes		109,303	-	121,217	-
Accrued expenses		66,100	-	87,024	-
Other payables		82,733	-	30,852	-
	₩	327,801	22,799	277,616	24,042

20 Trade and Other Payables (continued)

(b) Details of trade and other payables that are measured at amortized cost as of March 31, 2010 and December 31, 2009 were as follows:

	March 31 2010		December 31 2009	
In millions of Won	Effective interest rate	Amortized cost	Effective interest rate	Amortized cost
Leasehold deposits received	3.00~5.68% ₩	22,799	3.00~5.68% ₩	24,042

There is no material difference between the carrying amount and their fair value except the above trade and other payables, due to the short-term duration of the majority of trade and other payables.

21 Retirement Benefits Plan

The Company operates both defined benefit and defined contribution plans. According to these plans, the Company pays retirement benefits calculated under the plan's benefit formula at the time employees leave the Company. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method.

(a) The components of retirement benefit costs for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Defined benefit costs:			
Current service costs	₩	6,724	8,169
Interest costs		1,744	1,387
Expected returns on plan assets		(1,609)	(1,353)
		6,859	8,203
Defined contribution costs:			
Contributions recognized as expense		1,856	-
	₩	8,715	8,203

21 Retirement Benefits Plan (continued)

(b) Changes in defined benefit liabilities for the three-month period ended March 31, 2010 and the year ended December 31, 2009 were as follows:

In millions of Won		2010	2009
Balance at beginning of period	₩	18,295	48,336
Retirement benefit costs		6,859	32,535
Actuarial losses (gains) before tax		(4,634)	(21,698)
Payments into plan assets		-	(29,127)
Payments, including the amount transferred to the defined contribution plan		(6,046)	(11,751)
Balance at end of period	₩	14,474	18,295
Statements of financial position:			
- Present value of retirement benefit obligations	₩	122,498	129,813
- Fair value of plan assets		(108,024)	(111,518)
Defined benefit liabilities	₩	14,474	18,295

The Company recognized contributions payable amounting to ₩1,749 million and ₩74 million as accrued expenses in the statements of financial position as of March 31, 2010 and December 31, 2009, respectively.

(c) Changes in defined benefit obligations for the three-month period ended March 31, 2010 and the year ended December 31, 2009 were as follows:

In millions of Won		March 31 2010	December 31 2009
Balance at beginning of period	₩	129,813	133,459
Current service costs		6,724	32,676
Interest costs		1,744	5,550
Actuarial losses before tax		(4,209)	(20,937)
Payments, including the amount transferred to the defined contribution plan		(11,574)	(20,656)
Gains on the settlement of the plan		-	(279)
Balance at end of period	₩	122,498	129,813

Some of employees have transferred from the defined benefit plan to the defined contribution plan. The Company recognized ₩279 million of the gains on the settlement of defined benefit plan in profit or loss for the year ended December 31, 2009.

21 Retirement Benefits Plan (continued)

(d) Changes in plan assets for the three-month period ended March 31, 2010 and the year ended December 31, 2009 were as follows:

In millions of Won		March 31 2010	December 31 2009
Balance at beginning of period	₩	111,518	85,123
Expected return on plan assets		1,609	5,412
Actuarial gains before tax		425	761
Payments into plan assets		-	29,127
Payments, including the amount transferred to the defined contribution plan		(5,528)	(8,905)
Balance at end of period	₩	108,024	111,518

Actual returns on plan assets for the three-month periods ended March 31, 2010 and 2009 are ₩2,034 million and ₩2,661 million, respectively.

Expected rates of return are determined taking into account the current level of expected returns on risk-free investments, the historical level of risk premium associated with other invested assets, and the expectations for future returns on such assets.

(e) The amount of actuarial gains (losses) for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Actuarial gains (losses) before tax	₩	4,634	1,308
Tax effect		(1,019)	(288)
	₩	3,615	1,020

(f) The components of plan assets as of March 31, 2010 and December 31, 2009 were as follows:

In millions of Won		March 31 2010	December 31 2009
Cash and cash equivalent	₩	8,948	-
Short-term trading financial assets		51,767	105,630
Available-for-sale financial assets		47,309	5,888
	₩	108,024	111,518

As of March 31, 2010 and December 31, 2009, short-term trading financial assets include severance insurance of ₩64 million and ₩63 million, respectively which continue to be covered by the existing retirement benefits plan.

21 Retirement Benefits Plan (continued)

(g) The principal actuarial assumptions as of March 31, 2010 and December 31, 2009 were as follows:

	March 31 2010	December 31 2009
Rate of salary increases	5.00%	5.00%
Expected rate of return on plan assets	6.00%	6.00%
Discount rate	5.80%	5.80%

For the purpose of calculating present value of the defined benefit obligations, the Company used the discount rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds consistent with the currency and estimated term of the defined benefit obligations.

(h) Sensitivities in respect of the key assumptions used to measure the defined benefit plan were as follows:

In millions of Won		1 percentage point increase	1 percentage point decrease
Rate of salary increases:			
- Increase (decrease) in defined benefit obligations	₩	10,760	(9,482)
- Increase (decrease) in retirement benefit costs before tax		686	(601)
Discount rate:			
- Increase (decrease) in defined benefit obligations		(10,021)	11,614
- Increase (decrease) in retirement benefit costs before tax		(297)	339
Expected rate of return on plan assets:			
- Increase (decrease) in retirement benefit costs before tax		(268)	268

The effect on defined benefit obligations is as of March 31, 2010. The effect on retirement benefit costs before tax is for the three-month period ended March 31, 2010.

22 Profit from Operations

(a) Employee benefit costs for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Salaries	₩	64,040	77,564
Retirement benefit costs		8,715	8,203
Employee welfare		5,565	6,119
	₩	78,320	91,886

22 Profit from Operations (continued)

(b) Depreciation and amortization for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Depreciation	₩	31,286	31,089
Amortization		23	138
	₩	31,309	31,227

(c) Details of other income for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Foreign currency transaction gain	₩	2,444	12,843
Foreign currency translation gain		599	23,466
Gain on sale of property, plant and equipment		5,202	5,312
Gain on sale of intangible assets		1	-
Others		2,496	4,587
	₩	10,742	46,208

(d) Details of selling expenses for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Salaries	₩	32,344	35,146
Retirement benefit costs		2,766	3,112
Employee welfare		2,868	3,054
Travel		712	929
Communications		410	420
Utilities		1,661	1,268
Taxes and dues		3,231	3,500
Supplies		281	324
Rent		2,467	1,072
Depreciation		7,539	8,760
Amortization		-	38
Repairs and maintenance		1,241	212
Vehicles		1,520	1,521
Insurance		11	27
Commissions		5,912	5,805
Freight and custody		7,156	7,465
Conferences		548	544
Advertising		14,431	14,092
Training		269	228
Prizes and rewards		219	9
Normal research and development		25	48
	₩	85,611	87,574

22 Profit from Operations (continued)

(e) Details of general and administrative expenses for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Salaries	₩	7,448	11,732
Retirement benefit costs		3,752	2,472
Employee welfare		129	991
Travel		378	331
Communications		462	604
Utilities		682	611
Taxes and dues		350	52
Supplies		529	478
Rent		355	1,668
Depreciation		3,071	3,235
Amortization		23	95
Repairs and maintenance		106	215
Vehicles		300	342
Insurance		212	215
Commissions		6,801	7,859
Freight and custody		213	236
Conferences		397	389
Advertising		15,789	15,934
Training		953	843
Prizes and rewards		187	227
Normal research and development		1,644	2,215
	₩	43,781	50,744

(f) Details of other expenses for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Foreign currency transaction loss	₩	3,500	3,510
Foreign currency translation loss		11,029	21
Impairment loss on trade and other receivables		10	40
Donations		2,578	2,004
Loss on sale of property, plant and equipment		198	1,993
Loss on sale of intangible assets		125	-
Others		1,023	2,423
	₩	18,463	9,991

23 Net Finance Costs

(a) Details of net finance costs (income) for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Finance costs:			
- Interest costs	₩	53	175
- Loss on transaction of financial derivatives		-	1,711
		53	1,886
Finance income:			
- Interest income		(3,892)	(3,396)
- Dividend income		(31,855)	(30,216)
- Investment income on long-term deposits in MSA Escrow Fund		(352)	(3)
- Gain on sale of available-for-sale financial assets		(356)	-
		(36,455)	(33,615)
Net finance costs (income)	₩	(36,402)	(31,729)

(b) Details of interest costs for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Trade and other payables	₩	48	172
Others		5	3
	₩	53	175

(c) Details of interest income for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Deposits	₩	3,126	2,300
Available-for-sale financial assets		20	106
Trade and other receivables		746	990
	₩	3,892	3,396

(d) Details of finance income recognized in other comprehensive income for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Gain on valuation available-for-sale financial assets, before tax	₩	76,152	65,829
Tax effect		(16,753)	(14,482)
Gain on valuation available-for-sale financial assets, net of tax	₩	59,399	51,347

24 Income Taxes

(a) The Company was subject to income taxes on taxable income at the following normal tax rates.

Taxable income		Tax rate			
Prior to 2008	Thereafter	2008	2009	2010 & 2011	Thereafter
Up to ₩100 million	Up to ₩200 million	12.1%	12.1%	11.0%	11.0%
Over ₩100 million	Over ₩200 million	27.5%	24.2%	24.2%	22.0%

In December 2008, the Korean Government reduced the corporate income tax rate (including resident tax) and increased the tax base from ₩100 million to ₩200 million beginning in 2008. Effective January 1, 2008, the income tax rate for those having their taxable income less than ₩200 million was reduced from 14.3 % to 12.1%. In December 2009, the Korean government postponed the reduction of the corporate income tax rate from 24.2% to 22% until 2012.

(b) The components of income tax expense (benefit) for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Current income tax expense	₩	40,151	60,146
Adjustments recognized in the period for current tax of prior periods		-	(251)
Changes in temporary difference		25,165	25,769
Total income tax expense		65,316	85,664
Tax expense (benefit) recognized outside profit or loss		(17,772)	(14,770)
Income tax expense	₩	47,544	70,894

(c) Current and deferred tax expense that were recognized outside profit or loss for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Current	₩	-	-
Deferred:			
- Net changes in fair value of available-for-sale financial assets		(16,753)	(14,482)
- Actuarial gains (losses)		(1,019)	(288)
		(17,772)	(14,770)
Tax expense (benefit) recognized outside profit or loss	₩	(17,772)	(14,770)

The Company recognized deferred tax expense related to other comprehensive income in other comprehensive income.

24 Income Taxes (continued)

(d) The income tax expense calculated by applying statutory tax rates to the Company's profit before tax for the period differs from the actual tax expense in the statement of comprehensive income for the three-month periods ended March 31, 2010 and 2009 for the following reasons:

In millions of Won, except tax rate information		2010	2009
Profit before tax	₩	226,897	327,440
Normal tax rate		24.2%	24.2%
Expense for income taxes at normal tax rate		54,903	79,234
Adjustment:			
- Tax effects of permanent differences		612	249
- Non-inclusion of proceeds-dividend earned		(7,394)	(7,275)
- Investment tax credits		(576)	(1,133)
- Additional income taxes for prior period		(1)	(181)
Income tax expense	₩	47,544	70,894
Effective tax rate		21.0%	21.7%

(e) Deferred tax expense (benefit) relating to the origination and reversal of temporary differences for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Deferred tax liabilities at end of period	₩	147,537	107,460
Deferred tax liabilities at beginning of period		122,372	81,691
Deferred tax expense (benefit)	₩	25,165	25,769

(f) Deferred tax assets and liabilities are measured using the tax rate to be applied for the period in which temporary differences are expected to be realized.

(g) The net deferred tax liabilities are reflected in the statements of financial position after offsetting assets and liabilities where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred income taxes relate to the same fiscal authority.

24 Income Taxes (continued)

(h) Changes in deferred tax assets and liabilities for the three-month period ended March 31, 2010 were as follows:

In millions of Won		Balance at beginning of period	Credited to profit (charged to loss)	Charged to other comprehensive income	Balance at end of period
Available-for-sale financial assets	₩	9,449	-	-	9,449
Accrued expense		20,411	(7,533)	-	12,878
Donations in excess of tax limit		89	(89)	-	-
Retirement benefit costs		(1,894)	1,422	(1,019)	(1,491)
Depreciation		4,169	(90)	-	4,079
Investments in subsidiaries		(95,884)	-	-	(95,884)
Foreign currency translations		3,841	(1,317)	-	2,524
Treasury shares		(8,565)	-	-	(8,565)
Unrealized gain on valuation of available-for-sale financial assets		(36,326)	(1)	(16,753)	(53,080)
Voluntary reserve		(13,200)	-	-	(13,200)
Provision for advanced depreciation		(4,722)	-	-	(4,722)
Others		260	215	-	475
	₩	(122,372)	(7,393)	(17,772)	(147,537)

(i) Changes in deferred tax assets and liabilities for the year ended December 31, 2009 were as follows:

In millions of Won		Balance at beginning of period	Credited to profit (charged to loss)	Charged to other comprehensive income	Balance at end of period
Available-for-sale financial assets	₩	8,800	649	-	9,449
Accrued expense		20,101	310	-	20,411
Sales		7,157	(7,157)	-	-
Donations in excess of tax limit		8,606	(8,517)	-	89
Retirement benefit costs		4,986	(2,106)	(4,774)	(1,894)
Depreciation		1,978	2,191	-	4,169
Investments in subsidiaries		(95,884)	-	-	(95,884)
Foreign currency translations		(6,130)	9,971	-	3,841
Treasury shares		(8,565)	-	-	(8,565)
Unrealized gain on valuation of available-for-sale financial assets		(7,823)	-	(28,503)	(36,326)
Voluntary reserve		(10,078)	(3,122)	-	(13,200)
Provision for advanced depreciation		(4,722)	-	-	(4,722)
Others		(117)	377	-	260
	₩	(81,691)	(7,404)	(33,277)	(122,372)

24 Income Taxes (continued)

(j) The income taxes payable and income taxes refund before offsetting as of March 31, 2010 and December 31, 2009 were as follows:

In millions of Won		March 31 2010	December 31 2009
Income taxes payable	₩	40,152	221,139
Income taxes refund		(508)	(121,101)
	₩	39,644	100,038

25 Earnings per Share

Basic and diluted earnings per share for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won, except share information		2010	2009
Profit for the period	₩	179,353	256,546
Weighted-average number of ordinary shares outstanding		127,198,800	128,698,800
Basic and diluted earnings per share in Won	₩	**1,410**	**1,993**

26 Transactions and Balances with Related Companies

(a) Details of parent and subsidiary relationships as of March 31, 2010 and December 31, 2009 were as follows:

			Percentage of ownership					
			March 31 2010			December 31 2009		
Subsidiary	Location	Next most senior parent	Parent	Sub-sidiary	Total	Parent	Sub-sidiary	Total
Korea Ginseng Corporation	Korea	The Company	100.00%	-	100.00%	100.00%	-	100.00%
Yungjin Pharm. Ind. Co., Ltd.	Korea	The Company	55.50%	-	55.50%	55.50%	-	55.50%
Tae-a Industry Co., Ltd.	Korea	The Company	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	The Company	99.99%	-	99.99%	99.99%	-	99.99%
Korea Tabacos do Brasil Ltda.	Brazil	The Company	99.90%	-	99.90%	99.90%	-	99.90%
KT&G Pars	Iran	The Company	99.99%	-	99.99%	99.99%	-	99.99%
KT&G Rus L.L.C.	Russia	The Company	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Bio Corp.	Korea	The Company	100.00%	-	100.00%	100.00%	-	100.00%
Korea Ginseng HK, Ltd.	Hong Kong	Korea Ginseng Corporation	-	99.99%	99.99%	-	99.99%	99.99%
KGC Sales Co., Ltd.	Korea	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
Cheong Kwan Jang Taiwan Corporation	Taiwan	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
Korea Red Ginseng Corporation	United States	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
Korea Ginseng (China) Corp.	China	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%

26 Transactions and Balances with Related Companies (continued)

(b) Significant transactions which occurred in the normal course of business with related companies for the three-month periods ended March 31, 2010 and 2009 are summarized as follows:

In millions of Won

Relationship	Related Company		2010	2009
Revenue from sales and other income:				
Subsidiary	Korea Ginseng Corporation	₩	1,286	3,971
	Yungjin Pharm. Ind. Co., Ltd.		48	8
	Tae-a Industry Co., Ltd.		3	-
	KGC Sales Co., Ltd.		7	-
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		997	213
	KT&G Pars		1,067	1,440
	KT&G Rus L.L.C.		43	42
		₩	3,451	5,674
Purchases and other expenses:				
Subsidiary	Korea Ginseng Corporation	₩	449	352
	Yungjin Pharm. Ind. Co., Ltd.		-	10
	Tae-a Industry Co., Ltd.		2,874	3,624
	Korea Tabacos do Brasil Ltda.		-	48
		₩	3,323	4,034

The Company recognized dividends from Korea Ginseng Corporation amounting to ₩30,000 million and ₩30,000 million as finance income for the three-month periods ended March 31, 2010 and 2009, respectively.

(c) Account balances with related companies as of March 31, 2010 and December 31, 2009 were as follows:

In millions of Won

Relationship	Related Company		March 31 2010	December 31 2009
Receivables:				
Subsidiary	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	₩	13,570	13,437
	KT&G Pars		19,113	18,883
	KT&G Rus L.L.C.		26,083	5,487
		₩	58,766	37,807
Payables:				
Subsidiary	Korea Ginseng Corporation	₩	2,311	2,238

26 Transactions and Balances with Related Companies (continued)

(d) Details of guarantees provided for related companies as of March 31, 2010 and December 31, 2009 were as follows:

In thousands of Euro			March 31 2010		December 31 2009	
Relationship	Type of guarantee	Guarantee recipient	Limit	Exercise	Limit	Exercise
Subsidiary	Guarantee on foreign currency letter of credit opened	KT&G Rus L.L.C.	€ 7,267	-	€ 7,267	-

(e) Details of key management personnel compensation for the three-month periods ended March 31, 2010 and 2009 are summarized as follows:

In millions of Won		2010	2009
Short-term employee benefits	₩	1,957	389
Post-employment benefits		1,371	1,532
	₩	3,328	1,921

27 Risk Management

(a) Overview

The Company has exposure to the following risks from its use of financial instruments:

- credit risk
- liquidity risk
- currency risk
- interest rate risk
- other market price risk.

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk and the Company's management of capital including quantitative disclosures.

(b) Risk Management Framework

The purpose of managing financial risks is to identify the potential risk factors that may affect the Company's financial performance, and minimize, eliminate and avoid it to the extent that is acceptable. One of the principal responsibilities of the treasury department is to manage the financial risks arising from the Company's underlying operations. The treasury department monitors and manages the financial risk arising from the Company's underlying operations in accordance with the risk management policies and procedures authorized by the board of directors. Also, the treasury department provides an internal report analyzing the nature and exposure level on financial risks to Risk Management Committee of the Company. The Risk Management Committee prepares the overall strategy for financial risk management, and evaluates the effectiveness of the financial risk management. In addition, the internal auditor consistently observes the compliance of the risk management policy and procedure, and reviews the risk exposure limit of the Company. The Company holds derivative financial instruments to hedge its specific financial risks such as currency risk.

27 Risk Management (continued)

(c) Management of Financial Risks

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 collaterals and guarantees. The credit ratings of all counterparties and the level of collaterals and guarantees are reviewed regularly. Analysis of financial assets past due has been reported quarterly 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 March 31, 2010 and December 31, 2009 is as follows:

In millions of Won		March 31 2010	December 31 2009
Available-for-sale financial assets	₩	519,965	443,800
Long-term deposits in MSA Escrow Fund		116,482	118,121
Trade and other receivables		582,662	612,298
Cash and cash equivalents		114,145	268,954

Export trade receivables to overseas clients, including Alokozay International Limited are ₩235,405 million and ₩229,096 million, and equal to 58.2% and 54.9% of the aggregate trade receivables, respectively, as of March 31, 2010 and December 31, 2009. The Company's trade receivables mentioned above were insured against non-payment up to USD36,200 thousand and USD36,200 thousand by export guarantee insurance with the Korea Export Insurance Corporation, respectively, as of March 31, 2010 and December 31, 2009. The Company has no significant concentrations of customer credit risk except for the above export trade receivables; on the other hand, there are a large number of widely dispersed customers with trade and other receivables.

The Company has made deposits on cash, cash equivalents and long-term deposits in NACF and several financial institutions with high credit ratings, thus the credit risks from theses financial institutions are very limited.

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 plan 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 the financial liabilities are repayable with the operating cash flows and cash inflows from financial assets. The Company entered into an overdraft agreement with the NACF to manage the temporary liquidity risk.

27 Risk Management (continued)

(c) Management of Financial Risks (continued)

The maturity analysis with a residual contractual maturity of financial liabilities as of March 31, 2010 and December 31, 2009 is as follows:

				Residual contractual maturity			
In millions of Won		Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
As of March 31, 2010:							
Derivative financial liabilities	₩	-	-	-	-	-	-
Non-derivative financial liabilities		246,840	247,281	176,526	63,086	5,669	2,000
	₩	246,840	247,281	176,526	63,086	5,669	2,000
As of December 31, 2009:							
Derivative financial liabilities	₩	-	-	-	-	-	-
Non-derivative financial liabilities		196,275	196,838	92,772	93,707	8,359	2,000
	₩	196,275	196,838	92,772	93,707	8,359	2,000

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.

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 option contract to hedge foreign currency risk in case of need.

27 Risk Management (continued)

(c) Management of Financial Risks (continued)

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of March 31, 2010 and December 31, 2009 were as follows:

		March 31 2010		December 31 2009	
In millions of Won		USD	EUR	USD	EUR
Assets:					
Cash and cash equivalents	₩	5,171	659	3,887	44
Trade and other receivables		258,893	9,898	258,943	8,390
Long-term deposits in MSA Escrow Fund		116,482	-	118,121	-
	₩	380,546	10,557	380,951	8,434
Liabilities:					
Trade and other payables	₩	23,653	4,414	3,624	4,045

As of March 31, 2010 and December 31, 2009, the effects of 10% strengthening or weakening of functional currency against foreign currencies other than functional currency on profit before tax were as follows:

		March 31 2010		December 31 2009	
In millions of Won		10% strengthening	10% weakening	10% strengthening	10% weakening
USD	₩	35,689	(35,689)	37,733	(37,733)
EUR		614	(614)	439	(439)
	₩	36,303	(36,303)	38,172	(38,172)

The above sensitivity analysis was applied to monetary assets and liabilities denominated in foreign currencies other than the functional currency at the end of the reporting period.

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, 2010, 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.

Other market price 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 prices. Other market price risk arises from available-for-sale equity instruments held for investments. The Company's management has monitored the mix of debt and 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.

27 Risk Management (continued)

(c) Management of Financial Risks (continued)

As of March 31, 2010 and December 31, 2009, the effects of 5% fluctuation of the price index of stocks on other comprehensive income were as follows:

		March 31 2010		December 31 2009	
In millions of Won		5% Increase	5% Decrease	5% Increase	5% Decrease
Other comprehensive income before tax	₩	27,870	(27,870)	25,536	(25,536)
Tax effect		(6,131)	6,131	(5,618)	5,618
	₩	21,739	(21,739)	19,918	(19,918)

(d) Management of Capital Risk

The fundamental goal of capital management is the maximization of shareholders' value by means of the stable dividend policy and the retirement of treasury shares. The capital structure of the Company consists of equity and net debt deducting cash and cash equivalents and current financial instruments from borrowings. The Company applied the same financial risk management strategy that was applied in the previous period.

As of March 31, 2010 and December 31, 2009, the Company defines net debt and equity as follows:

In millions of Won		March 31 2010	December 31 2009
Net debt:			
Debts (Short-term borrowings)	₩	10,043	19,338
Less:			
- Cash and cash equivalents		(114,145)	(268,954)
- Current available-for-sale financial assets		(1,910)	(1,957)
	₩	(106,012)	(251,573)
Equity	₩	3,739,202	3,852,991

March 31, 2010 and 2009

27 Risk Management (continued)

(e) Fair Value of Financial Instruments

The carrying amount and the fair value of financial instruments as of March 31, 2010 and December 31, 2009 are summarized as follows:

		March 31 2010		December 31 2009	
In millions of Won		Carrying amount	Fair value	Carrying amount	Fair value
Assets:					
Financial assets measured at fair value					
- Available-for-sale financial assets	₩	519,965	519,965	443,800	443,800
- Long-term deposits in MSA Escrow Fund		116,482	116,482	118,121	118,121
- Cash and cash equivalents		114,145	114,145	268,954	268,954
	₩	750,592	750,592	830,875	830,875
Financial assets measured at amortized cost					
- Trade and other receivables	₩	582,662	582,662	612,298	612,298
	₩	1,333,254	1,333,254	1,443,173	1,443,173
Liabilities:					
Financial liabilities measured at fair value	₩	-	-	-	-
Financial liabilities measured at amortized cost					
- Trade and other payables	₩	(236,797)	(236,797)	(176,937)	(176,937)
- Short-term borrowings		(10,043)	(10,043)	(19,338)	(19,338)
	₩	(246,840)	(246,840)	(196,275)	(196,275)
	₩	(246,840)	(246,840)	(196,275)	(196,275)

March 31, 2010 and 2009

27 Risk Management (continued)

(e) Fair Value of Financial Instruments (continued)

The fair value hierarchy
The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The level of fair value hierarchy is as follows:

- Level Ⅰ The quoted prices in active markets for identical assets or liabilities
- Level Ⅱ The inputs that are observable for the asset or liability, either directly or indirectly
- Level Ⅲ The inputs for the asset or liability that are not based on observable market data

The fair value measurements classified by fair value hierarchy as of March 31, 2010 and December 31, 2009 were as follows:

In millions of Won		Level Ⅰ	Level Ⅱ	Level Ⅲ	Total
As of March 31, 2010:					
Financial assets					
- Available-for-sale financial assets	₩	481,993	13,254	24,718	519,965
- Long-term deposits in MSA Escrow Fund		116,482	-	-	116,482
- Cash and cash equivalents		114,145	-	-	114,145
	₩	712,620	13,254	24,718	750,592
As of December 31, 2009:					
Financial assets					
- Available-for-sale financial assets	₩	412,827	6,878	24,095	443,800
- Long-term deposits in MSA Escrow Fund		118,121	-	-	118,121
- Cash and cash equivalents		268,954	-	-	268,954
	₩	799,902	6,878	24,095	830,875

As Genematrix, Inc. was listed on KOSDAQ in the year ended December 31, 2009, available-for-sale equity instruments in Genematrix, Inc. was transferred from Level Ⅲ to Level Ⅰ.

28 Contingent Liabilities and Financial Commitments

(a) The Company deposited some proportion of sales in accordance with Tobacco Master Settlement Agreement ("MSA") under the Escrow Statute of the United States Government, related to the export of tobacco to the United States. 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 that the fund was established. 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 into the United States.

(b) As of March 31, 2010, tobacco lawsuits claiming damages of ₩584 million were filed against the Company and the Korean government. The plaintiffs have asserted that the Company and the Korean government did not perform their obligations to notify smokers of the potential health hazards of smoking. Additionally, the Company is involved in 4 lawsuits and claims for alleged damages totalling ₩3,800 million as a dependent as of March 31, 2010. The amount of the liability the Company may ultimately have with respect to the litigation cannot be reasonably estimated as of March 31, 2010.

(c) As of March 31, 2010, the Company has entered into Letter of Credit Agreements with Korea Exchange Bank and other banks with a limit set at USD48,000 thousand.

(d) As of March 31, 2010, the Company's trade receivables from the export of cigarettes were insured against non-payment up to USD36,200 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

(e) As of March 31, 2010, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD70,000 thousand by Korea Exchange Bank and others.

(f) As of March 31, 2010, the Company and 28 other companies, which form the Samsung Corporation-National Pension Service Joint Consortium, were guaranteed ₩240,000 million by Seoul Guarantee Insurance Co., Ltd. in relation to the Yongsan International Commercial Development Project.

(g) The Company has provided KT&G Rus L.L.C. with payment guarantee on foreign currency letter of credit opened in relation with acquisition of tobacco manufacturing machinery up to EUR7,267 thousand to Korea Exchange Bank as of March 31, 2010.

29 Non-current Assets Held for Sale

The Company entered into a contract to sell the land located in Yongsan and Eulji-ro, Seoul for the year ended December 31, 2009. The Company recognized non-current assets held for sale at the lowers of its carrying amount and fair value less costs to sell. Non-current assets held for sale as of March 31, 2010 and December 31, 2009 were as follows:

In millions of Won		March 31 2010	December 31 2009
The land located in Yongsan, Seoul	₩	2,521	2,521
The land located in Eulji-ro, Seoul		20,725	20,725
	₩	23,246	23,246

March 31, 2010 and 2009

30 Cash Flows from Operating Activities

Details of cash generated from operations for the three-month periods ended March 31, 2010 and 2009 were as follows:

In millions of Won		2010	2009
Profit for the periods	₩	179,353	256,546
Adjustments for:			
- Income tax expense		47,544	70,894
- Finance costs		53	1,886
- Finance income		(36,455)	(33,615)
- Depreciation		31,286	31,089
- Amortization		23	138
- Retirement benefit costs		8,715	8,203
- Foreign currency translations loss		11,029	21
- Loss on the write-down of inventories		39	-
- Impairment loss on trade and other receivables		10	40
- Loss on sale of property, plant and equipment		198	1,993
- Loss on sale of intangible assets		125	-
- Other expense		1,430	412
- Reversal of loss on the write-down of inventories		-	(194)
- Foreign currency translations gain		(599)	(23,466)
- Gain on sale of property, plant and equipment		(5,202)	(5,312)
- Gain on sale of intangible assets		(1)	-
		237,548	308,635
Changes in working capital:			
- Trade and other receivables		455	(8,553)
- Advance payments		(24,093)	(929)
- Prepaid expenses		(4,024)	(5,993)
- Prepaid tobacco excise and other taxes		(58,564)	(16,574)
- Inventories		3,291	17,772
- Trade and other payables		(11,717)	(11,901)
- Advance receipts		23,057	(55,679)
- Tobacco excise and other taxes payable		41,228	10,834
- Payment of retirement benefits		(6,227)	(7,629)
Cash generated from operations	₩	200,954	229,983

31 Date of Authorization for Issue

The financial statements were authorized for issue on April 21, 2010, at the Board of Directors Meeting.