

# **KT&G Corporation**

**Interim Separate Financial Statements**  
**March 31, 2014 and 2013**

**KT&G Corporation**  
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**March 31, 2014 and 2013**

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## **Report on Review of Interim Financial Statements**

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

### ***Reviewed Financial Statements***

We have reviewed the accompanying interim separate financial statements of KT&G Corporation. These financial statements consist of separate statement of financial position of KT&G Corporation (the "Company") as of March 31, 2014, and the related separate statements of comprehensive income, statements of changes in equity and cash flows for the three-month periods ended March 31, 2014 and 2013, and a summary of significant accounting policies and other explanatory notes, expressed in Korean won.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these separate financial statements in accordance with the International Financial Reporting Standards as adopted by the Republic of Korea ('Korean IFRS') 1034, *Interim Financial Reporting*, and for such internal control as management determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to issue a report on these interim separate financial statements based on our reviews.

We conducted our reviews in accordance with the quarterly and semi-annual review standards established by the Securities and Futures Commission of the Republic of Korea. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the Republic of Korea and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

**Conclusion**

Based on our reviews, nothing has come to our attention that causes us to believe the accompanying interim separate financial statements do not present fairly, in all material respects, in accordance with the Korean IFRS 1034, *Interim Financial Reporting*.

**Other Matters**

We have audited the separate statement of financial position of KT&G Corporation as of December 31, 2013, and the related separate statements of comprehensive income, changes in equity and cash flows for the year then ended, in accordance with auditing standards generally accepted in the Republic of Korea. We expressed an unqualified opinion on those financial statements in our audit report dated February 12, 2014. These financial statements are not included in this review report. The separate statement of financial position as of December 31, 2013, presented herein for comparative purposes, is consistent, in all material respects, with the above audited statement of financial position as of December 31, 2013.

The accompanying interim separate financial statements as of and for the three-month period ended March 31, 2014, have been translated into US dollars solely for the convenience of the reader and have been translated on the basis set forth in Note 33 to the interim separate financial statements.

Review standards and their application in practice vary among countries. The procedures and practices used in the Republic of Korea to review such financial statements may differ from those generally accepted and applied in other countries. Accordingly, this report is for use by those who are informed about Korean review standards and their application in practice.

The image shows a handwritten signature in black ink. The signature reads "Samil pricewaterhouseCoopers". The word "Samil" is written in a cursive script, while "pricewaterhouseCoopers" is written in a more formal, slightly stylized font. The signature is positioned in the center of the page, below the main body of text.

Seoul, Korea  
May 14, 2014

The report is effective as of May 14, 2014, 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 separate interim 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**  
**Interim Separate Statements of Financial Position**  
**March 31, 2014 and December 31, 2013**

<i>(in millions of Korean won and thousands of U.S. dollars)</i>	Notes	March 31, 2014 Korean won	March 31, 2014 U.S. dollars (Note 33)	December 31, 2013 Korean won
<b>Assets</b>				
<b>Non-current assets</b>				
Property, plant and equipment	9	₩ 1,178,452	\$ 1,102,593	₩ 1,182,763
Intangible assets	10	21,321	19,949	21,191
Investment property	11,13	144,518	135,215	146,034
Investments in associates	14	60,225	56,348	60,225
Investments in subsidiaries	14	1,169,691	1,094,397	1,166,478
Available-for-sale financial assets	4,5,6	305,452	285,789	296,391
Long-term deposits in MSA Escrow Fund	4,5,8,31	238,028	222,706	219,760
Long-term prepaid expenses		4,747	4,442	4,798
Long-term trade and other receivables	4,5,7,32	131,164	122,721	134,498
		<u>3,253,598</u>	<u>3,044,160</u>	<u>3,232,138</u>
<b>Current assets</b>				
Inventories	15	908,671	850,178	939,744
Other financial assets	4,5,16	540,000	505,240	660,000
Prepaid tobacco excise and other taxes		237,200	221,931	262,770
Trade and other receivables	4,5,7,13,32	762,941	713,830	721,468
Advance payments		15,122	14,148	16,472
Prepaid expenses		3,552	3,324	3,879
Cash and cash equivalents	4,5,16	516,927	483,652	245,838
		<u>2,984,413</u>	<u>2,792,303</u>	<u>2,850,171</u>
<b>Assets held for sale</b>	12	<u>3</u>	<u>3</u>	<u>3</u>
<b>Total assets</b>		<u>₩ 6,238,014</u>	<u>\$ 5,836,466</u>	<u>₩ 6,082,312</u>
<b>Equity</b>				
Capital stock	1,17	₩ 954,959	\$ 893,488	₩ 954,959
Other capital surplus	17	3,583	3,352	3,583
Treasury shares	18	(339,059)	(317,233)	(339,059)
Gain on reissuance of treasury shares	18	492,032	460,369	492,032
Reserve	19	3,522,488	3,295,741	3,411,099
Retained earnings	20	189,553	177,351	509,820
<b>Total equity</b>		<u>4,823,556</u>	<u>4,513,058</u>	<u>5,032,434</u>
<b>Liabilities</b>				
<b>Non-current liabilities</b>				
Long-term trade and other payables	4,5,21,32	28,180	26,366	28,269
Long-term advance receipts		3,311	3,097	3,676
Net defined benefit liability	23	67,964	63,589	60,273
Deferred income tax liabilities		60,427	56,537	53,823
		<u>159,882</u>	<u>149,589</u>	<u>146,041</u>
<b>Current liabilities</b>				
Borrowings	4,5,22	4,606	4,310	4,920
Trade and other payables	4,5,21,32	765,120	715,869	402,389
Advance receipts		14,706	13,758	17,230
Income taxes payable		138,960	130,015	136,285
Tobacco excise and other taxes payable		331,184	309,865	343,013
		<u>1,254,576</u>	<u>1,173,817</u>	<u>903,837</u>
<b>Total liabilities</b>		<u>1,414,458</u>	<u>1,323,406</u>	<u>1,049,878</u>
<b>Total liabilities and equity</b>		<u>₩ 6,238,014</u>	<u>\$ 5,836,464</u>	<u>₩ 6,082,312</u>

The accompanying notes are an integral part of these interim separate financial statements.  
The US dollar figures are provided for information purposes only and do not form part of the separate financial statements. Refer to Note 33.

**KT&G Corporation**  
**Interim Separate Statements of Comprehensive Income**  
**Three-Month Periods Ended March 31, 2014 and 2013**

(in millions of Korean won and thousands of U.S. dollars, except per share amounts)	Notes	Period Ended March 31		
		2014 Korean won	2014 U.S. dollars (Note 33)	2013 Korean won
<b>Sales</b>				
Manufacture of tobacco		₩ 576,931	\$ 539,793	₩ 548,776
Real estate		38,452	35,977	18,504
Exports of leaf tobacco and others		15,752	14,738	13,379
	31,32	<u>631,135</u>	<u>590,508</u>	<u>580,659</u>
<b>Cost of sales</b>				
Manufacture of tobacco		(215,979)	(202,075)	(190,910)
Real estate		(22,334)	(20,896)	(7,206)
Exports of leaf tobacco and others		(9,460)	(8,851)	(8,180)
	15,25,32	<u>(247,773)</u>	<u>(231,822)</u>	<u>(206,296)</u>
<b>Gross profit</b>		<u>383,362</u>	<u>358,686</u>	<u>374,363</u>
Selling and administrative expenses	24,25	(155,817)	(145,787)	(149,287)
<b>Operating income</b>	24	<u>227,545</u>	<u>212,899</u>	<u>225,076</u>
Other income	24,32	17,403	16,283	34,876
Other expenses	24,32	(7,934)	(7,424)	(3,968)
<b>Net other income</b>		<u>9,469</u>	<u>8,859</u>	<u>30,908</u>
Finance income	26	13,200	12,350	13,586
Finance cost	26	(300)	(281)	(12,212)
<b>Net finance income</b>		<u>12,900</u>	<u>12,069</u>	<u>1,374</u>
<b>Profit before income tax</b>		<u>249,914</u>	<u>233,827</u>	<u>257,358</u>
Income tax expense	27	(62,378)	(58,363)	(64,581)
<b>Profit for the period</b>		<u>₩ 187,536</u>	<u>\$ 175,464</u>	<u>₩ 192,777</u>
<b>Other comprehensive income(loss), net of tax</b>				
Items that will not be reclassified to profit or loss:				
Remeasurements of the net defined benefit liability		₩ (406)	\$ (379)	₩ (148)
Items that will be reclassified subsequently to profit or loss:				
Change in value of available-for-sale financial assets		6,868	6,425	8,851
<b>Other comprehensive income for the period, net of tax</b>		<u>6,462</u>	<u>6,046</u>	<u>8,703</u>
<b>Total comprehensive income for the period</b>		<u>193,998</u>	<u>181,510</u>	<u>201,480</u>
<b>Earnings per share attributable to the equity holders of the Company during the period (in won)</b>				
Basic and diluted earnings per share	28	<u>₩ 1,490</u>	<u>\$ 1.00</u>	<u>₩ 1,531</u>

The accompanying notes are an integral part of these interim separate financial statements.  
The US dollar figures are provided for information purposes only and do not form part of the separate financial statements. Refer to Note 33.

**KT&G Corporation**  
**Interim Separate Statements of Changes in Equity**  
**Three-Month Periods Ended March 31, 2014 and 2013**

<i>(in millions of Korean won)</i>	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
₩ 954,959	₩ 3,583	₩	₩ (339,059)	₩ 492,032	₩ 3,039,035	₩ 752,766	₩ 4,903,316
<b>Balance at January 1, 2013</b>							
<b>Total comprehensive Income</b>							
Profit for the period	-	-	-	-	-	192,777	192,777
Other comprehensive income	-	-	-	-	8,851	-	8,851
Change in value of available-for-sale financial assets	-	-	-	-	-	(148)	(148)
Remeasurements of the net defined benefit liability	-	-	-	-	8,851	-	8,851
<b>Total other comprehensive Income (loss)</b>							
	-	-	-	-	8,851	(148)	8,703
<b>Total comprehensive Income</b>							
	-	-	-	-	8,851	192,629	201,480
<b>Transactions with equity holders of the Company</b>							
Cash dividends	-	-	-	-	-	-	-
Other reserve	-	-	-	-	317,000	(402,876)	(402,876)
Transfer from reserve for research and human resources development	-	-	-	-	-	(317,000)	-
<b>Total transactions with equity holders of the Company</b>							
	-	-	-	-	30,000	(30,000)	-
<b>Total comprehensive Income</b>							
	-	-	-	-	347,000	(749,876)	(402,876)
<b>Balance at March 31, 2013</b>	₩ 954,959	₩ 3,583	₩ (339,059)	₩ 492,032	₩ 3,394,886	₩ 195,519	₩ 4,701,920
<b>Balance at January 1, 2014</b>							
<b>Total comprehensive Income</b>							
Profit for the period	-	-	-	-	3,411,099	509,820	5,032,434
Other comprehensive income	-	-	-	-	-	187,536	187,536
Change in value of available-for-sale financial assets	-	-	-	-	6,868	-	6,868
Remeasurements of the net defined benefit liability	-	-	-	-	-	(406)	(406)
<b>Total other comprehensive Income (loss)</b>							
	-	-	-	-	6,868	(406)	6,462
<b>Total comprehensive Income</b>							
	-	-	-	-	6,868	187,130	193,998
<b>Transactions with equity holders of the Company</b>							
Cash dividends	-	-	-	-	-	(402,876)	(402,876)
Transfer from reserve for research and human resources development	-	-	-	-	(47,479)	47,479	-
Other reserve	-	-	-	-	152,000	(152,000)	-
<b>Total transactions with equity holders of the Company</b>							
	-	-	-	-	104,521	(507,397)	(402,876)
<b>Balance at March 31, 2014</b>	₩ 954,959	₩ 3,583	₩ (339,059)	₩ 492,032	₩ 3,522,488	₩ 189,553	₩ 4,823,556

The accompanying notes are an integral part of these interim separate financial statements.

**KT&G Corporation**  
**Interim Separate Statements of Changes in Equity**  
**Three-Month Periods Ended March 31, 2014 and 2013**

	<i>(in thousands of U.S. dollars) (Note 33)</i>						
	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
	\$	\$	\$	\$	\$	\$	\$
Balance at January 1, 2014	893,488	3,352	(317,233)	460,359	3,191,522	477,003	4,708,491
Total comprehensive income	-	-	-	-	-	175,464	175,464
Profit for the period	-	-	-	-	-	-	-
Other comprehensive income(loss)	-	-	-	-	6,425	(379)	6,425
Change in value of available-for-sale financial assets	-	-	-	-	-	(379)	(379)
Remeasurements of the net defined benefit liability	-	-	-	-	6,425	-	6,425
Total other comprehensive income (loss)	-	-	-	-	6,425	(379)	6,046
Total comprehensive income	-	-	-	-	6,425	175,085	181,510
Transactions with equity holders of the Company	-	-	-	-	-	(376,943)	(376,943)
Cash dividends	-	-	-	-	-	-	-
Transfer from reserve for research and human resources development	-	-	-	-	(44,422)	44,422	-
Other reserve	-	-	-	-	142,216	(142,216)	-
Total transactions with equity holders of the Company	-	-	-	-	97,794	(474,737)	(376,943)
Balance at March 31, 2014	893,488	3,352	(317,233)	460,359	3,289,741	177,351	4,513,058

The accompanying notes are an integral part of these interim separate financial statements.  
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**KT&G Corporation**  
**Interim Separate Statements of Cash Flows**  
**Three-Month Periods Ended March 31, 2014 and 2013**

(in millions of Korean won and thousands of U.S. dollars)	Notes	Period Ended March 31		
		2014 Korean won	2014 U.S. dollars (Note 33)	2013 Korean won
<b>Cash flows from operating activities</b>				
Cash generated from operations	30	₩ 232,858	\$ 217,869	₩ 445,574
Income tax paid		(55,163)	(51,612)	(1,390)
<b>Net cash generated from operating activities</b>		<u>177,695</u>	<u>166,257</u>	<u>444,184</u>
<b>Cash flows from investing activities</b>				
Interest received		7,421	6,943	8,452
Investment income received from long-term deposits in MSA Escrow Fund		484	453	400
Dividends received		3,709	3,470	3,591
Proceeds from sale of property, plant and equipment		938	877	904
Proceeds from sale of intangible assets		-	-	1
Proceeds from sale of assets held for sale		-	-	725
Decrease in loans		2,649	2,479	2,252
Decrease in guarantee deposits		4,306	4,029	4,702
Acquisition of property, plant and equipment		(19,746)	(18,475)	(15,379)
Acquisition of intangible assets		(148)	(138)	-
Acquisition of investment property		(77)	(72)	(1,422)
Acquisition of investments in subsidiaries		(3,213)	(3,006)	(3,746)
Increase in loans		-	-	(9,656)
Increase in guarantee deposits		(7,143)	(6,683)	(5,456)
Increase in long-term deposits in MSA Escrow Fund		(15,552)	(14,551)	(9,977)
Decrease in other financial assets		120,000	112,275	390,000
<b>Net cash provided by investing activities</b>		<u>93,628</u>	<u>87,601</u>	<u>365,391</u>
<b>Cash flows from financing activities</b>				
Dividends paid	29	-	-	(402,876)
Increase in deposits received		730	683	1,378
Decrease in deposits received		(872)	(816)	(1,872)
<b>Net cash used in financing activities</b>		<u>(142)</u>	<u>(133)</u>	<u>(403,370)</u>
<b>Net increase in cash and cash equivalents</b>		271,181	253,725	406,205
<b>Cash and cash equivalents at the beginning of period</b>		245,838	230,013	266,720
<b>Exchange losses(gains) on cash and cash equivalents</b>		(92)	(86)	15
<b>Cash and cash equivalents at the end of period</b>		<u>₩ 516,927</u>	<u>\$ 483,652</u>	<u>₩ 672,940</u>

The accompanying notes are an integral part of these interim separate financial statements.

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**KT&G Corporation**  
**Notes to Interim Separate Financial Statements**  
**March 31, 2014 and 2013, and December 31, 2013**

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**1. General Information**

General information about KT&G Corporation (the "Company") is as follows.

The Company, which is engaged in manufacturing and selling tobaccos, 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 shares 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, 2014, the Company has two manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 133 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Company is located 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 an ordinary share of the Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program. Also, on June 25, 2009, the market of the Company's GDR was changed from the BdL Market to the Euro MTF in the Luxembourg Stock Exchange.

**KT&G Corporation**  
**Notes to Interim Separate Financial Statements**  
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The ownership of the Company's issued ordinary shares as of March 31, 2014, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee share ownership association	2,748,736	2.00%
Others	113,639,579	82.77%
	125,898,800	91.70%
Treasury shares	11,393,697	8.30%
	137,292,497	100.00%

## 2. Significant Accounting Policies

The principal accounting policies applied in the preparation of these separate financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

### 2.1 Basis of Preparation

These separate interim financial statements as of and for the three-month period ended March 31, 2014, has been prepared in accordance with Korean IFRS 1034, *Interim financial reporting*. The principles used in the preparation of these financial statements are based on Korean IFRS and interpretations effective as of March 31, 2014, or early adopted.

#### (a) New and amended standards adopted by the Company

The Company newly applied the following amended and enacted standards for the annual period beginning on January 1, 2014:

##### - Amendment to Korean IFRS 1032, *Financial Instruments: Presentation*

Amendment to Korean IFRS 1032, *Financial Instruments: Presentation*, provides that the right to offset must not be contingent on a future event and must be legally enforceable in all of circumstances; and if an entity can settle amounts in a manner such that outcome is, in effect, equivalent to net settlement, the entity will meet the net settlement criterion. There is no material impact of the application of this amendment on the financial statements.

##### - Amendment to Korean IFRS 1039, *Financial Instruments: Recognition and Measurement*

Amendment to Korean IFRS 1039, *Financial Instruments: Recognition and Measurement*, allows the continuation of hedge accounting for a derivative that has been designated as a hedging instrument in a circumstance in which that derivative is novated to a central counterparty (CCP) as a consequence of laws or regulations. There is no material impact of the application of this amendment on the financial statements.

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- Enactment of Korean IFRS 2121, *Levies*

Korean IFRS 2121, *Levies*, are applied to a liability to pay a levy imposed by a government in accordance with the legislation. The interpretation requires that the liability to pay a levy is recognized when the activity that triggers the payment of the levy occurs, as identified by the legislation (the obligating event). There is no material impact of the application of this amendment on the financial statements as of and for the three-month periods ended March 31, 2014, however, the amendment is expected to have a material impact in future interim periods.

*(b) New standards and interpretations not yet adopted*

Since there are no significant new standards, amendments and interpretations issued but not yet adopted by the Company, the related notes are not disclosed for the three-month period ended March 31, 2014.

## **2.2 Subsidiaries and Associates**

These separate financial statements are prepared and presented in accordance with Korean IFRS 1027. The Company applied the cost method to investments in subsidiaries and associates in accordance with K-IFRS 1027. The carrying amount of investment in Korea Ginseng Corporation under previous Korean Generally Accepted Accounting Principles on the date of transition to K-IFRS is considered to be the deemed cost of investments in subsidiaries on the date of transition. Dividends from a subsidiary or associate are recognized in profit or loss when the right to receive the dividend is established.

## **2.3 Segment Reporting**

Operating segments are reported in the consolidated financial statements in accordance with Korean IFRS 1108, *Operating Segments*.

## **2.4 Foreign Currency Translation**

*(a) Functional and presentation currency*

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The financial statements are presented in Korean won, which is the Company's functional and presentation currency.

*(b) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in profit or loss.

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Exchange differences arising on non-monetary financial assets and liabilities such as equity instruments at fair value through profit or loss and available-for-sale equity instruments are recognized in profit or loss and included in other comprehensive income, respectively, as part of the fair value gain or loss.

**2.5 Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less.

**2.6 Financial Instruments**

*(a) Classification and measurement*

The Company classifies its financial assets in the following categories: financial assets at fair value through profit or loss, available-for-sale financial assets, loans and receivables, and held-to-maturity financial assets. Regular purchases and sales of financial assets are recognized on trade date.

At initial recognition, financial assets are measured at fair value plus, in the case of financial assets not carried at fair value through profit or loss, transaction costs. Transaction costs of financial assets carried at fair value through profit or loss are expensed in the statement of income. After the initial recognition, available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables, and held-to-maturity investments are subsequently carried at amortized cost using the effective interest rate method.

Changes in fair value of financial assets at fair value through profit or loss are recognized in profit or loss and changes in fair value of available-for-sale financial assets are recognized in other comprehensive income. When the available-for-sale financial assets are sold or impaired, the fair value adjustments recorded in equity are reclassified into profit or loss.

*(b) Impairment*

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or a group of financial assets that can be reliably estimated.

Impairment of loans and receivables is presented as a deduction in an allowance account. Impairment of other financial assets is directly deducted from their carrying amount. The Company writes off financial assets when the assets are determined to be no longer recoverable.

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The objective evidence that a financial asset is impaired includes significant financial difficulty of the issuer or obligor; a delinquency in interest or principal payments; or the disappearance of an active market for that financial asset because of financial difficulties.

*(c) Derecognition*

If the Company transfers a financial asset and the transfer does not result in derecognition because the Company has retained substantially of all risks and rewards of ownership of the transferred asset due to a recourse in the event the debtor defaults, the Company continues to recognize the transferred asset in its entirety and recognizes a financial liability for the consideration received. The related financial liability is classified as 'borrowings' in the statement of financial position.

**2.7 Trade Receivables**

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets. Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less allowance for doubtful accounts.

**2.8 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 merchandise, 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 and 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 ₩304,786 million and ₩316,168 million as of March 31, 2014 and December 31, 2013, respectively.

**2.9 Non-current Assets (or disposal group) Held for Sale**

Non-current assets (or disposal group) are classified as assets held for sale when their carrying

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amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell.

## **2.10 Property, Plant and Equipment**

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

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

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between their cost and their residual values over their estimated useful lives, as follows:

Buildings	10 - 60 years
Structures	10 - 40 years
Machinery	10 - 12 years
Vehicle	4 years
Tools and equipment	4 years
Supplies	4 years

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

## **2.11 Borrowing Costs**

Borrowing costs incurred in the acquisition or construction of a qualifying asset are capitalized in the period when it is prepared for its intended use, and investment income earned on the temporary investment of borrowings made specifically for the purpose obtaining a qualifying asset is deducted from the borrowing costs eligible for capitalization during the period. Other borrowing costs are recognized as expenses for the period in which they are incurred.

## **2.12 Government Grants**

Government grants are recognized at their fair values when there is reasonable assurance that the grant will be received and the Company will comply with the conditions attaching to it. Government

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grants related to assets are presented by deducting the grants in arriving at the carrying amount of the assets, and grants related to income are deferred and presented by deducting the related expenses for the purpose of the government grants.

**2.13 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, facility usage rights 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 facility usage rights and some of the industrial property rights are expected to be available for use, these intangible assets are regarded as having indefinite useful lives and not amortized.

The estimated useful lives are as follows:

Industrial property rights	10 - 20 years or indefinite
Facility usage rights	Indefinite
Other intangible assets	4 years

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

**2.14 Investment Property**

Property held to earn rentals or for capital appreciation or both is classified as investment property. Investment property is measured initially at its cost. After recognition as an asset, investment property is carried at cost less accumulated depreciation and impairment losses. Investment property, except for land, is depreciated using the straight-line method over their useful lives from 10 to 60 years.

**2.15 Impairment of Non-financial Assets**

Goodwill or intangible assets with indefinite useful lives are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Non-financial assets, other than goodwill, that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.



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**2.16 Financial Liabilities**

*(a) Classification and measurement*

Financial liabilities at fair value through profit or loss are financial instruments held for trading. Financial liabilities are classified in this category if incurred principally for the purpose of repurchasing them in the near term. Derivatives that are not designated as hedges or bifurcated from financial instruments containing embedded derivatives are also categorized as held-for-trading.

The Company classifies non-derivative financial liabilities, except for financial liabilities at fair value through profit or loss, financial guarantee contracts and financial liabilities that arise when a transfer of financial assets does not qualify for derecognition, as financial liabilities carried at amortized cost and presented as 'trade payables', 'borrowings', and 'other financial liabilities' in the statement of financial position.

Preferred shares that provide for a mandatory redemption at a particular date are classified as liabilities. Interest expenses on these preferred shares calculated using the effective interest method are recognized in the statement of income as 'finance costs', together with interest expenses recognized on other financial liabilities.

*(b) Derecognition*

Financial liabilities are removed from the statement of financial position when it is extinguished, for example, when the obligation specified in the contract is discharged, cancelled or expired or when the terms of an existing financial liability are substantially modified.

**2.17 Financial Guarantee Contracts**

Financial guarantees contracts provided by the Company are initially measured at fair value on the date the guarantee was given. Subsequent to initial recognition, the Company's liabilities under such guarantees are measured at the higher of the amounts below and recognized as 'other financial liabilities':

- the amount determined in accordance with Korean IFRS 1037, *Provisions, Contingent Liabilities and Contingent Assets*; or
- the initial amount, less accumulated amortization recognized in accordance with Korean IFRS 1018, *Revenue*.

**2.18 Trade Payables**

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

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**2.19 Borrowings**

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of comprehensive income over the period of the borrowings using the effective interest method. The Company recognizes borrowings as current assets unless it has an unconditional right to delay the settlement of the borrowing.

**2.20 Compound Financial Instruments**

Compound financial instruments are convertible bonds that can be converted into equity instruments at the option of the holder. The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially on the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

**2.21 Provisions**

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation and the increase in the provision due to passage of time is recognized as interest expense.

**2.22 Income Tax Expense**

Interim period income tax expense is accrued based on the best estimate of the weighted average annual income tax rate expected for the full financial year, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

**2.23 Employee Benefits**

*(a) Defined benefit liability*

The Company operates various pension schemes. The schemes are generally funded through payments to insurance companies or trustee-administered funds, determined by periodic actuarial calculations. The Company has both defined benefit and defined contribution plans.

A defined contribution plan is a pension plan under which the Company pays fixed contributions into a separate entity. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. For defined contribution plans, the Company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Company has no further payment obligations once the

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contributions have been paid. The contributions are recognized as employee benefit expense when they are due. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in the future payments is available.

A defined benefit plan is a pension plan that is not a defined contribution plan. Typically defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognized in the statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognized past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Past-service costs are recognized immediately in income, while costs are amortized over the vesting period.

*(b) Termination benefits*

Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits when it is demonstrably committed to a termination when the entity has a detailed formal plan to terminate the employment of current employees without possibility of withdrawal and in the case of an offer made to encourage voluntary redundancy.

**2.24 Share Capital**

Where the Parent Company purchases its own equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued. Where such ordinary shares are subsequently reissued, any consideration received is included in equity attributable to the Company's equity holders.

**2.25 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

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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 months ended March 31, 2014 and 2013, were ₩ 770,158 million and ₩ 823,013 million, respectively.

Revenue from the construction of real estate includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognized in profit or loss in proportion to the stage of completion of the contract. The stage of completion is assessed by reference to surveys of work performed. Meanwhile, profits from an apartment house for self-installment sales is recognized on percentage-of-completion method according to Q&A of Korea Accounting Institute, called 2011-I-KQA. This accounting standard is effective upon Korean Corporation Financial Reporting Standards of Laws on External Audit of Corporation (Article 13, Section 1, Paragraph 1).

Revenue from 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 from the use by others of the Company's 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 shareholders' right to receive the dividend is established.

## **2.26 Lease**

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of income on a straight-line basis over the period of the lease.

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**2.27 Dividend Distribution**

A dividend liability is recognized in the financial statements when the dividends are approved by the shareholders.

**3. Critical Accounting Estimates and Assumptions**

The Company makes estimates and assumptions concerning the future. The estimates and assumptions are continuously evaluated with consideration to factors such as events reasonably predictable in the foreseeable future within the present circumstance according to historical experience. The resulting accounting estimates will, by definition, seldom equal the related actual results.

Significant accounting estimates and assumptions made in preparing interim financial statements are the same those made in preparing the prior financial statements, except for the estimating method used in deriving income tax expenses.

**4. Financial Risk Management**

**4.1 Financial Risk Factors**

The Company's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance.

Risk management is carried out by a central treasury department (Company treasury) under policies approved by the board of directors. The Company treasury identifies, evaluates and hedges financial risks in close co-operation with the Company's operating units. The board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity. The company applied the same financial risk management strategy that was applied in the previous period.

*(a) Market Risk*

i) Foreign exchange 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 contracts to hedge foreign currency risk in case of need.

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The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of March 31, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)	March 31, 2014				December 31, 2013			
	USD	EUR	RUB	THB and Others	USD	EUR	RUB	THB and Others
<b>Assets</b>								
Cash and cash equivalents	₩ 16,209	₩ 1,683	₩ -	₩ -	₩ 10,926	₩ 27	₩ -	₩ -
Trade and other receivables	484,837	28,745	57	52,397	439,194	27,932	1,873	47,073
Long-term deposits	238,028	-	-	-	219,760	-	-	-
	₩ 739,074	₩ 30,428	₩ 57	₩ 52,397	₩ 669,880	₩ 27,959	₩ 1,873	₩ 47,073
<b>Liabilities</b>								
Trade and other payables	₩ 16,732	₩ 10,748	₩ -	₩ -	₩ 30,655	₩ 10,993	₩ -	₩ -

As of March 31, 2014 and December 31, 2013, the effects of a 10% strengthening or weakening of functional currency against the US dollar other than functional currency on profit before tax are as follows:

(in millions of Korean won)	March 31, 2014		December 31, 2013	
	10% strengthening	10% weakening	10% strengthening	10% weakening
US dollar	₩ 72,234	₩ (72,234)	₩ 63,923	(63,923)

ii) 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.

As of March 31, 2014 and December 31, 2013, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income (change in value of available-for-sale financial assets) are as follows:

(in millions of Korean won)	March 31, 2014		December 31, 2013	
	5% increase	5% decrease	5% increase	5% decrease
Other comprehensive income before tax	₩ 5,391	₩ (5,391)	₩ 6,811	₩ (6,811)
Tax effect	(1,305)	1,305	(1,648)	1,648
Other comprehensive income after tax	₩ 4,086	₩ (4,086)	₩ 5,163	₩ (5,163)

iii) 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. There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation as of March 31, 2014.

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*(b) Credit Risk*

The Company is exposed to credit risk which arises from counterparty's non-performance of 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 with collateral and guarantees. The credit ratings of all counterparties and the level of collateral and guarantees are reviewed regularly. Analysis of financial assets past due has been reported quarterly and appropriate measures have been taken to secure the Company's assets.

The carrying amounts of financial assets are maximum exposure to credit risk. The maximum exposure to credit risk as of March 31, 2014 and December 31, 2013, is as follows:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Available-for-sale financial assets	₩ 2,500	₩ 2,500
Long-term deposits in MSA Escrow Fund	238,028	219,760
Trade and other receivables	894,105	855,966
Other financial assets	540,000	660,000
Cash and cash equivalents	516,927	245,838
Financial guarantee contracts	152,263	152,263

*(c) Liquidity Risk*

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

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The maturity analysis of the residual contractual maturity of financial liabilities as of March 31, 2014 and December 31, 2013, is as follows:

	March 31, 2014					
	Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
Trade and other payables	₩ 676,110	₩ 677,280	₩ 647,930	₩ -	₩ 29,350	₩ -
Short-term borrowings	4,606	4,606	4,606	-	-	-
Financial guarantee contracts <sup>1</sup>	-	152,263	-	-	152,263	-

	December 31, 2013					
	Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
Trade and other payables	₩ 307,074	₩ 308,297	₩ 278,805	₩ -	₩ 29,492	₩ -
Short-term borrowings	4,920	4,920	4,920	-	-	-
Financial guarantee contracts <sup>1</sup>	-	152,263	-	-	152,263	-

<sup>1</sup> The maximum guaranteed amount of financial guarantee contracts (Note 31)

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

#### 4.2 Capital Management

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, 2014 and December 31, 2013, the Company defines net debt and equity attributable to owners as follows:

(in millions of Korean won)	March 31, 2014	December 31, 2013
Total borrowings	₩ 4,606	₩ 4,920
Less:		
Cash and cash equivalents	(516,927)	(245,838)
Other financial assets, current	(540,000)	(660,000)
Net debt(Net asset)	(1,052,321)	(900,918)
Equity attributable to owners	₩ 4,823,556	₩ 5,032,435



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**4.3 Fair Value Estimation**

There are no significant changes in business and economic circumstances which impact the fair value of financial assets and liabilities of the Company for the three-month period ended March 31, 2014.

*(a) Fair Value by Financial Instruments*

Book value and fair value by financial instruments consists of the following:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
	<b>Book value</b>	<b>Fair value</b>	<b>Book value</b>	<b>Fair value</b>
<b>Financial assets</b>				
Available-for-sale assets <sup>1</sup>	₩ 288,858	₩ 288,858	₩ 279,797	₩ 279,797
Long-term deposits	238,028	238,028	219,760	219,760
Long-term trade and other receivables	131,164	131,164	134,498	134,498
Other financial assets	540,000	540,000	660,000	660,000
Trade and other receivables	762,941	762,941	721,468	721,468
Cash and cash equivalents	516,927	516,927	245,838	245,838
	<u>₩ 2,477,918</u>	<u>₩ 2,477,918</u>	<u>₩ 2,261,361</u>	<u>₩ 2,261,361</u>
<b>Financial liabilities</b>				
Long-term trade and other payables	₩ 28,180	₩ 28,180	₩ 28,269	₩ 28,269
Short-term borrowings	4,606	4,606	4,920	4,920
Trade and other payables	647,930	647,930	278,805	278,805
	<u>₩ 680,716</u>	<u>₩ 680,716</u>	<u>₩ 311,994</u>	<u>₩ 311,994</u>

<sup>1</sup> Equity securities that do not have a quoted market price in active market and whose fair value cannot be reliably measured are recorded at cost and excluded from fair value disclosures.

*(b) Financial Instruments Measured at Cost*

Details of financial instruments measured at cost consist of the following:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Available-for-sale assets		
MASTERN 2 REIT	₩ 10,000	₩ 10,000
U&I Corporation	3,000	3,000
SJ BIOMED Inc.	1,000	1,000
Others	2,594	2,594
	<u>₩ 16,594</u>	<u>₩ 16,594</u>

MASTERN 2 REIT and others are non-listed equity investments and are measured using cost method as their fair value cannot be reliably estimated.

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*(c) Fair Value Hierarchy*

Assets measured at fair value or for which the fair value is disclosed are categorized within the fair value hierarchy, and the defined levels are as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

Fair value hierarchy classifications of the financial assets and financial liabilities that are measured at fair value or its fair value is disclosed as of March 31, 2014, are as follows:

<i>(in millions of Korean won)</i>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Recurring fair value measurements				
Available-for-sale financial assets	₩ 225,996	₩ 62,862	₩ -	₩ 288,858
Disclosed fair value				
Investment property	-	-	461,378	461,378

The fair value of financial instruments traded in active markets is based on quoted market prices at the statement of financial position date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, an entity in the same industry, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Company is the current bid price. These instruments are included in Level 1. Instruments included in Level 1 consist primarily of KOSPI and KOSDAQ equity investments classified as trading securities or available for sale.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the statement of financial position date, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

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*(d) Valuation Technique and the Inputs*

Valuation techniques and inputs used in the recurring, non-recurring fair value measurements and disclosed fair values categorized within Level 2 and Level 3 of the fair value hierarchy as of March 31, 2014, are as follows:

<i>(in millions of Korean won)</i>	<b>Fair value</b>	<b>level</b>	<b>Valuation techniques</b>
Available-for-sale financial assets			
Real estate investment trusts	₩ 62,862	2	Market approach
Unlisted stock	-	3	Details <sup>1</sup>
Investment property			
Investment property	461,378	3	Yield capitalization method and other method

<sup>1</sup> Unlisted stocks are shares in Dream Hub PFV Co., Ltd., which was established for the development of Yongsan Station area. The Company recognized 100% of the acquisition cost as of 31 December, 2013 as impairment loss due to financial difficulties of this investee.

**5. Financial Instruments by Category**

Categorizations of financial assets as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>			
	<b>Loans and receivables</b>	<b>Assets classified as available-for-sale</b>	<b>Total</b>	
Available-for-sale financial assets, non- current	₩ -	₩ 305,452	₩	305,452
Long-term deposits in MSA Escrow Fund	238,028	-		238,028
Long-term trade and other receivables	131,164	-		131,164
Other financial assets, current	540,000	-		540,000
Trade and other receivables	762,941	-		762,941
Cash and cash equivalents	516,927	-		516,927
	<u>₩ 2,189,060</u>	<u>₩ 305,452</u>	<u>₩</u>	<u>2,494,512</u>

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(in millions of Korean won)

	December 31, 2013		
	Loans and receivables	Assets classified as available-for-sale	Total
Available-for-sale financial assets, non- current	₩ -	₩ 296,391	₩ 296,391
Long-term deposits in MSA Escrow Fund	219,760	-	219,760
Long-term trade and other receivables	134,498	-	134,498
Other financial assets, current	660,000	-	660,000
Trade and other receivables	721,468	-	721,468
Cash and cash equivalents	245,838	-	245,838
	₩ 1,981,564	₩ 296,391	₩ 2,277,955

Categorizations of financial liabilities as of March 31, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

	March 31, 2014		
	Other financial liabilities at amortized cost	Other financial liabilities	Total
Long-term trade and other payables	₩ 28,180	₩ -	₩ 28,180
Short-term borrowings	-	4,606	4,606
Trade and other payables	647,930	-	647,930
	₩ 676,110	₩ 4,606	₩ 680,716

(in millions of Korean won)

	December 31, 2013		
	Other financial liabilities at amortized cost	Other financial liabilities	Total
Long-term trade and other payables	₩ 28,269	₩ -	₩ 28,269
Short-term borrowings	-	4,920	4,920
Trade and other payables	278,805	-	278,805
	₩ 307,074	₩ 4,920	₩ 311,994

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Income and loss of financial instruments by category for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014	2013
Available-for-sale financial assets		
Gain on valuation (Other comprehensive income)	₩ 6,868	₩ 8,851
Interest income	12	7
Dividend income	3,709	3,591
Impairment loss	-	(12,000)
Cash and cash equivalents		
Interest income	7,212	7,440
Gain(Loss) on foreign currency translation	(92)	15
Gain on foreign currency transaction	248	224
Trade and other receivables		
Interest income	1,969	2,202
Gain on foreign currency translation	11,429	20,903
Gain on foreign currency transaction	1,540	1,638
Other financial liabilities at amortized cost		
Interest costs	(300)	(212)
Loss on foreign currency translation	(49)	(184)
Loss on foreign currency transaction	(366)	(883)

**6. Available-for-sale Financial Assets**

The changes in available-for-sale financial assets for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014	2013
Beginning	₩ 296,391	₩ 264,544
Additions	-	-
Gain on valuation	9,061	8,890
Net gains transferred from equity	-	2,787
Impairment loss	-	(12,000)
Disposal	-	-
Ending	305,452	264,221
Less: current portion	-	(1,000)
<b>Non-current portion</b>	<b>₩ 305,452</b>	<b>₩ 263,221</b>

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Available-for-sale financial assets as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
Available-for-sale debt instruments:				
Corporate bonds	₩	2,500	₩	2,500
Total available-for-sale debt instruments		2,500		2,500
Available-for-sale equity instruments:				
Listed				
Yonhap Television News(YTN)		29,204		23,380
Oscotech, Inc.		1,022		916
Shinhan Financial Group Co., Ltd.		188,393		189,595
Rexahn Pharmaceuticals, Inc.		7,377		3,440
		225,996		217,331
Unlisted		76,956		76,560
		76,956		76,560
Total available-for-sale equity instruments		302,952		293,891
<b>Total available-for-sale financial assets</b>	<b>₩</b>	<b>305,452</b>	<b>₩</b>	<b>296,391</b>

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

The other unlisted available-for-sale equity instruments that do not have a 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.

**7. Trade and Other Receivables**

Trade and other receivables as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
	<b>Current</b>	<b>Non-current</b>	<b>Current</b>	<b>Non-current</b>
Loans to employees	₩ 9,351	₩ 26,737	₩ 8,680	₩ 29,884
Loans	9,446	55,696	2,205	58,609
Other receivables	71,628	9,545	82,129	9,567
Guarantee deposits	-	39,185	-	36,437
Accrued income	6,676	-	5,495	-
Trade receivables	665,839	-	622,958	-
	₩ 762,940	₩ 131,163	₩ 721,467	₩ 134,497

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Trade and other receivables as of March 31, 2014 and December 31, 2013, reported in the separate statements of financial position, net of allowances, are as follows:

(in millions of Korean won)	March 31, 2014		December 31, 2013	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 820,954	₩ 139,713	₩ 780,542	₩ 140,779
Allowance account				
- Other receivables	(7,767)	-	(7,711)	-
- Trade receivables	(45,377)	-	(44,395)	-
- Accrued income	(2,070)	-	(2,044)	-
- Loans to subsidiaries	(2,800)	(8,550)	(4,925)	(6,282)
	(58,014)	(8,550)	(59,075)	(6,282)
Net amount	₩ 762,940	₩ 131,163	₩ 721,467	₩ 134,497

Changes in the allowance account for the three-month periods ended March 31, 2014 and 2013, are as follows:

(in millions of Korean won)	2014	2013
Beginning	₩ 65,357	₩ 19,714
Impairment loss	1,207	-
Reversal of impairment loss	-	(1)
Ending	₩ 66,564	₩ 19,713

The aging schedule of trade and other receivables as of March 31, 2014 and December 31, 2013, is as follows:

(in millions of Korean won)	March 31, 2014	December 31, 2013
Not past due	₩ 402,541	₩ 404,941
Past due but not impaired		
Within 1 month	44,423	37,487
Between 1 and 2 months	34,434	20,590
Beyond 2 months	23,030	20,148
Beyond 3 months	206,788	184,187
	₩ 711,216	₩ 667,353

There is no significant concentration of credit risk with respect to trade and other receivables since trade and other receivables, excluding export trade receivables, are widely dispersed amongst a number of customers. The Company holds bank guarantees, other guarantees and credit insurance in respect of some of the past due debtor balances.

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Details of trade and other receivables that are measured at amortized cost using effective interest rate method as of March 31, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)	March 31, 2014			December 31, 2013		
	Effective interest rate(%)	Current	Non- current	Effective interest rate(%)	Current	Non- current
Loans to employees	3.00~5.68	₩ 9,351	₩ 26,737	3.00~5.68	₩ 8,680	₩ 29,884
Other receivables	3.79	8,072	7,777	3.79	7,997	7,705
Guarantee deposits	3.00~5.68	-	39,185	3.00~5.68	-	36,437
		<u>₩ 17,423</u>	<u>₩ 73,699</u>		<u>₩ 16,677</u>	<u>₩ 74,026</u>

*Transferred trade receivables*

The Company has sold its trade receivables through trade receivable factoring agreements with National Agricultural Cooperative Federation and other financial institutions in relation with the collecting sales payments with tobacco card. In case the customers default, the Company has an obligation to pay the related amount to the bank. As a result, this transaction treated as a transaction with recourse, has been accounted for as collateralized borrowings. The borrowings recognized in relation to the said transaction as of March 31, 2014 and December 31, 2013, are ₩ 4,606 million and ₩ 4,920 million, respectively (Note 13 and 22).

**8. Long-term Deposits**

Long-term deposits as of March 31, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)	March 31, 2014	December 31, 2013
MMF	₩ 753	₩ 15,080
T-Note	237,275	204,680
	<u>₩ 238,028</u>	<u>₩ 219,760</u>

As discussed in Note 31 to the separate 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, 2014 and 2013, are ₩ 15,552 million and ₩ 9,977 million, respectively.

Long-term deposits are operated as a way of buying T-Note or MMF. Investment income on long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2014 and 2013, are ₩ 298 million and ₩ 346 million, respectively.



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**9. Property, Plant and Equipment**

Changes in property, plant and equipment for the three-month periods ended March 31, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 410,853	₩ -	₩ 410,853
Buildings	671,767	(274,581)	397,186
Structures	43,180	(26,245)	16,935
Machinery	948,144	(717,893)	230,251
Vehicles	2,488	(2,143)	345
Tools	34,166	(31,379)	2,787
Furniture and fixture	156,985	(125,169)	31,816
Others	1,162	-	1,162
Construction-in-progress	87,117	-	87,117
	₩ 2,355,862	₩ (1,177,410)	₩ 1,178,452

(in millions of Korean won)

	2013		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 403,000	₩ -	₩ 403,000
Buildings	645,609	(249,451)	396,158
Structures	41,000	(24,471)	16,529
Machinery	921,943	(665,494)	256,449
Vehicles	2,648	(2,134)	514
Tools	32,573	(30,053)	2,520
Furniture and fixture	162,997	(128,785)	34,212
Others	1,115	-	1,115
Construction-in-progress	43,397	-	43,397
	₩ 2,254,282	₩ (1,100,388)	₩ 1,153,894

(in millions of Korean won)	2014						
	Opening net book value	Additions	Disposal	Depreciation	Transfer	Other changes <sup>1</sup>	Net book amount
Land	₩ 410,763	₩ -	₩ (24)	₩ -	₩ 103	₩ 11	₩ 410,853
Buildings	400,314	98	-	(6,401)	3,099	76	397,186
Structures	16,973	114	-	(500)	348	-	16,935
Machinery	234,926	673	-	(12,900)	7,552	-	230,251
Vehicles	362	36	-	(53)	-	-	345
Tools	3,135	73	(86)	(335)	-	-	2,787
Furniture and fixture	34,524	1,416	(2)	(4,202)	80	-	31,816
Others	1,162	-	-	-	-	-	1,162
Construction-in-progress	80,604	17,695	-	-	(11,182)	-	87,117

<sup>1</sup> Other changes represent the reclassified amount from investment property to property, plant equipment.

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(in millions of Korean won)	2013						
	Opening net book value	Additions	Disposal	Depreciation	Transfer	Other changes <sup>2</sup>	Net book amount
Land	₩ 397,900	₩ -	₩ (147)	₩ -	₩ 4,814	₩ 433	₩ 403,000
Buildings	394,889	133	(6)	(6,228)	4,429	2,941	396,158
Structures	16,716	10	(1)	(467)	234	37	16,529
Machinery	261,847	3,282	(108)	(16,086)	7,514	-	256,449
Vehicles	529	52	-	(67)	-	-	514
Tools	2,733	241	(165)	(289)	-	-	2,520
Furniture and fixture	36,807	1,270	(72)	(4,480)	687	-	34,212
Others	1,115	-	-	-	-	-	1,115
Construction-in-progress	50,684	10,391	-	-	(17,678)	-	43,397

<sup>2</sup> Other changes represent the reclassified amount from investment property to property, plant equipment.

## 10. Intangible Assets

Changes in intangible assets for the three-month periods ended March 31, 2014 and 2013, are as follows:

(in millions of Korean won)	2014			
	Industrial property rights	Facility usage rights	Intangible assets under development	Total
<b>At January 1, 2014</b>	₩ 1,625	₩ 17,357	₩ 2,209	₩ 21,191
Additions	-	-	148	148
Disposals	-	(3)	-	(3)
Amortization	(15)	-	-	(15)
Acquisition cost	6,973	17,356	2,357	26,686
Accumulated amortization and impairment cost	(5,363)	(2)	-	(5,365)
<b>Net book amount</b>	<b>₩ 1,610</b>	<b>₩ 17,354</b>	<b>₩ 2,357</b>	<b>₩ 21,321</b>

  

(in millions of Korean won)	2013			
	Industrial property rights	Facility usage rights	Intangible assets under development	Total
<b>At January 1, 2013</b>	₩ 1,632	₩ 16,585	₩ 1,720	₩ 19,937
Additions	-	-	-	-
Disposals	-	(1)	-	(1)
Amortization	(15)	-	-	(15)
Transfer-in(out)	53	-	(53)	-
Other changes	-	-	(2)	(2)
Acquisition cost	7,163	16,584	1,665	25,412
Accumulated amortization and impairment cost	(5,493)	-	-	(5,493)
<b>Net book amount</b>	<b>₩ 1,670</b>	<b>₩ 16,584</b>	<b>₩ 1,665</b>	<b>₩ 19,919</b>

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Research and development expenses for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>		<b>2013</b>	
Cost of goods sold	₩	161	₩	363
Selling and administrative expenses		3,966		1,949
	₩	4,127	₩	2,312

**11. Investment Property**

Changes in investment property for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>		
	<b>Land</b>	<b>Building</b>	<b>Total</b>
Beginning net book value	₩ 22,246	₩ 123,788	₩ 146,034
Additions	-	77	77
Other changes	(10)	(76)	(86)
Depreciation	-	(1,507)	(1,507)
Acquisition cost	22,236	169,979	192,215
Accumulated depreciation and impairment cost	-	(47,697)	(47,697)
Net book amount	₩ 22,236	₩ 122,282	₩ 144,518

  

<i>(in millions of Korean won)</i>	<b>2013</b>		
	<b>Land</b>	<b>Building</b>	<b>Total</b>
Beginning net book value	₩ 22,121	₩ 131,786	₩ 153,907
Additions	559	863	1,422
Other changes	(434)	(2,977)	(3,411)
Depreciation	-	(1,503)	(1,503)
Acquisition cost	22,246	169,891	192,137
Accumulated depreciation and impairment cost	-	(41,722)	(41,722)
Net book amount	₩ 22,246	₩ 128,169	₩ 150,415

The amounts recognized in profit or loss from investment property for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>		<b>2013</b>	
Rental income	₩	8,616	₩	8,612
Direct operating expense		(1,507)		(1,503)
	₩	7,109	₩	7,109

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Fair values and book values of investment property as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
	<b>Fair value</b>	<b>Book value</b>	<b>Fair value</b>	<b>Book value</b>
Land	₩ 281,106	₩ 22,236	₩ 281,311	₩ 22,246
Building	180,272	122,282	180,361	123,788
	<u>₩ 461,378</u>	<u>₩ 144,518</u>	<u>₩ 461,672</u>	<u>₩ 146,034</u>

**12. Non-current Assets Held for Sale**

The Company recognizes non-current assets held for sale as the lower of net fair value and book value. The entire amount of non-current assets held for sale is attributable to land, and there are no changes in non-current assets held for sale for the three-month period ended March 31, 2014.

**13. Pledged Assets**

The following assets are pledged as collateral for the Company's long-term and short-term borrowings and others as of March 31, 2014:

<i>(in millions of Korean won)</i>					
<b>Asset</b>	<b>Book amount</b>	<b>Reason</b>	<b>Borrowings</b>	<b>Collateralized amount</b>	<b>Lender /Leaseholder</b>
Investment property	₩ 73,680	Leasehold deposits received	₩ 9,294	₩ 9,397	Metlife Insurance Korea Co., Ltd. and 28 others
Trade receivables	4,606	Short-term borrowings	4,606	4,606	National Agricultural Cooperative Federation and 1 other

The following assets are pledged as collateral for the Company's long-term and short-term borrowings and others as of December 31, 2013:

<i>(in millions of Korean won)</i>					
<b>Asset</b>	<b>Book amount</b>	<b>Reason</b>	<b>Borrowings</b>	<b>Collateralized amount</b>	<b>Lender /Leaseholder</b>
Investment property	₩ 74,555	Leasehold deposits received	₩ 9,020	₩ 9,123	Metlife Insurance Korea Co., Ltd. and 26 others
Trade receivables	4,920	Short-term borrowings	4,920	4,920	National Agricultural Cooperative Federation and 1 other

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**14. Investments in Associates and Subsidiaries**

Investments in associates and subsidiaries as of March 31, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

(in millions of Korean won)			March 31, 2014		December 31, 2013	
	Location	Principal operation	Interest (%)	Carrying Amount	Interest (%)	Carrying Amount
Associates						
Lite Pharm Tech, Inc	Korea	Manufacturing Medical supplies	25.34	₩ 1,830	25.34	₩ 1,830
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	13,995	49.02	13,995
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	7,300	29.67	7,300
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	7,000	22.06	7,000
JR REIT V Co., Ltd.	Korea	Selling and renting of real estate	34.63	5,600	34.63	5,600
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	10,000	21.74	10,000
LSK Global Pharma Services Co., Ltd.	Korea	Research and developing new drug	23.15	-	23.15	-
JR REIT X Co., Ltd.	Korea	Selling and renting of real estate	28.78	9,500	28.78	9,500
JR REIT XIII Co., Ltd.		Selling and renting of real estate	27.03	5,000	27.03	5,000
				60,225	60,225	
Subsidiaries						
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00	599,023	100.00	599,023
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceuticals	53.00	66,355	53.00	66,355
Tae-a Industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00	15,698	100.00	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	Manufacturing and selling tobaccos	99.99	54,049	99.99	54,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf Tobaccos	99.90	535	99.90	535
KT&G Pars	Iran	Manufacturing and selling tobaccos	99.99	-	99.99	-
KT&G Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00	110,297	100.00	110,297
KGC Life & Gin Co., Ltd.	Korea	Selling ginseng	100.00	44,100	100.00	44,100
Global Trading, Inc.	USA	Selling tobaccos	100.00	4,913	100.00	4,913
Jilin Hanzheng Ginseng Co., Ltd.	China	Manufacturing and selling ginseng	100.00	47,675	100.00	47,675
Somang Cosmetics Co., Ltd. <sup>1</sup>	Korea	Manufacturing and selling cosmetics	60.00	60,721	60.00	60,721
Renzoluc Pte., Ltd. <sup>2</sup>	Singapore	Manufacturing and selling tobaccos	100.00	66,356	100.00	66,356
KT&G Life Science <sup>3</sup>	Korea	Medical researching and developing	73.94	31,232	73.94	31,232
Yebon Nongwon Agriculture Co., Ltd.	Korea	Corporate agriculture	90.00	90	90.00	90
KGC Yebon	Korea	Manufacturing and selling medicinal herbs	100.00	43,927	100.00	43,927
K-Q HongKong I,Limited <sup>4</sup>	Hong Kong	Manufacturing and selling ginseng	100.00	17,761	100.00	17,761
PT KT&G Indonesia	Indonesia	Manufacturing and selling tobaccos	99.98	6,949	99.96	3,746
K&I HK Co., Ltd	Hong Kong	Selling cosmetics	100.00	10	-	-
				1,169,691	1,166,478	
				₩ 1,229,916	₩ 1,226,703	

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<sup>1</sup> The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of March 31, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

<sup>2</sup> The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of March 31, 2014, the Company's percentage of ownership would be 68.91% if convertible preferred shares are included.

<sup>3</sup> The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of March 31, 2014, the Company's percentage of ownership would be 59.48% if convertible preferred shares are included.

<sup>4</sup> The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of March 31, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

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Changes in investments in associates and subsidiaries for the three-month periods ended March 31, 2014 and 2013, are as follows:

(in millions of Korean won)

	2014			
	Beginning balance	Acquisition	Disposals	Ending balance
<b>Associates</b>				
Lite Pharm Tech, Inc	₩ 1,830	₩ -	₩ -	₩ 1,830
JR CR-REIT IV Co., Ltd.	13,995	-	-	13,995
KVG REIT 1 Co., Ltd.	7,300	-	-	7,300
KOCREF REIT 17 Co., Ltd.	7,000	-	-	7,000
JR REIT V Co., Ltd.	5,600	-	-	5,600
JR REIT VIII Co., Ltd.	10,000	-	-	10,000
LSK Global Pharma Services Co., Ltd.	-	-	-	-
JR REIT X Co., Ltd.	9,500	-	-	9,500
JR REIT XIII Co., Ltd.	5,000	-	-	5,000
	<u>60,225</u>	<u>-</u>	<u>-</u>	<u>60,225</u>
<b>Subsidiaries</b>				
Korea Ginseng Corporation	599,023	-	-	599,023
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	66,355
Tae-a Industry Co., Ltd.	15,698	-	-	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	54,049
Korea Tabacos do Brasil Ltda.	535	-	-	535
KT&G Pars	-	-	-	-
KT&G Rus L.L.C.	110,297	-	-	110,297
KGC Life & Gin Co., Ltd.	44,100	-	-	44,100
Global Trading, Inc.	4,913	-	-	4,913
Jilin Hanzheng Ginseng Co., Ltd.	47,675	-	-	47,675
Somang Cosmetics Co., Ltd.	60,721	-	-	60,721
Renzoluc Pte., Ltd.	66,356	-	-	66,356
KT&G Life Science	31,232	-	-	31,232
Yebon Nongwon Agriculture Co., Ltd.	90	-	-	90
KGC Yebon	43,927	-	-	43,927
K-Q HongKong I, Limited	17,761	-	-	17,761
PT KT&G Indonesia	3,746	3,202	-	6,948
K&I HK Co., Ltd	-	11	-	11
	<u>1,166,478</u>	<u>3,213</u>	<u>-</u>	<u>1,169,691</u>
	<u>₩ 1,226,703</u>	<u>₩ 3,213</u>	<u>₩ -</u>	<u>₩ 1,229,916</u>

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(in millions of Korean won)

	2013			
	Beginning balance	Acquisition	Disposals	Ending balance
<b>Associates</b>				
Cosmo Tabacco Co., Ltd.	₩ -	₩ -	₩ -	₩ -
Lite Pharm Tech, Inc.	1,830	-	-	1,830
Korean Carbon Finance, Inc.	1,000	-	-	1,000
JR CR-REIT IV Co., Ltd.	13,995	-	-	13,995
KVG REIT 1 Co., Ltd.	7,300	-	-	7,300
KOCREF REIT 17 Co., Ltd.	7,000	-	-	7,000
JR REIT V Co., Ltd.	5,600	-	-	5,600
JR REIT VIII Co., Ltd.	10,000	-	-	10,000
LSK Global Pharma Services Co., Ltd.	1,500	-	-	1,500
JR REIT X Co., Ltd.	9,500	-	-	9,500
	<u>57,725</u>	<u>-</u>	<u>-</u>	<u>57,725</u>
<b>Subsidiaries</b>				
Korea Ginseng Corporation	599,023	-	-	599,023
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	66,355
Tae-a Industry Co., Ltd.	15,698	-	-	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	54,049
Korea Tabacos do Brasil Ltda.	535	-	-	535
KT&G Pars	-	-	-	-
KT&G Rus L.L.C.	110,297	-	-	110,297
KGC Life & Gin Co., Ltd	52,900	-	-	52,900
KT&G Bio Corp.	-	-	-	-
Global Trading, Inc.	4,913	-	-	4,913
Jilin Hanzheng Ginseng Co., Ltd.	31,333	-	-	31,333
Somang Cosmetics Co., Ltd.	60,721	-	-	60,721
Renzoluc Pte., Ltd.	89,756	-	-	89,756
KT&G Life Science	31,232	-	-	31,232
Yebon Nongwon Agriculture Co., Ltd.	90	-	-	90
KGC Yebon	43,927	-	-	43,927
K-Q Hong Kong I, Limited	17,761	-	-	17,761
PT KT&G Indonesia	-	3,746	-	3,746
	<u>1,178,590</u>	<u>3,746</u>	<u>-</u>	<u>1,182,336</u>
	₩ 1,236,315	₩ 3,746	₩ -	₩ 1,240,061



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### 15. Inventories

Inventories as of March 31, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)	March 31, 2014			December 31, 2013		
	Acquisition Cost	Allowance	Book amount	Acquisition Cost	Allowance	Book amount
Finished goods	₩ 99,286	₩ (1,408)	₩ 97,878	₩ 107,950	₩ (2,135)	₩ 105,815
Work in progress	15,148	-	15,148	11,889	-	11,889
Raw materials	700,423	-	700,423	704,494	-	704,494
Supplies	24,464	-	24,464	24,500	-	24,500
By-products	7,341	-	7,341	6,512	-	6,512
Unfinished housing	823	-	823	79,262	-	79,262
Lots	5,207	-	5,207	840	-	840
Goods-in-transit	57,387	-	57,387	6,432	-	6,432
	<u>₩ 910,079</u>	<u>₩ (1,408)</u>	<u>₩ 908,671</u>	<u>₩ 941,879</u>	<u>₩ (2,135)</u>	<u>₩ 939,744</u>

The costs related inventories for the three-month periods ended March 31, 2014 and 2013, are as follows:

(in millions of Korean won)	2014	2013
Cost of sales		
Loss(gain) on inventory valuation (Reversal)	₩ (727)	₩ 83
Loss on retirement of inventories	1,084	696
Other expenses		
Loss on retirement of inventories	121	54
	<u>₩ 478</u>	<u>₩ 833</u>

### 16. Cash and Cash Equivalents

Cash and cash equivalents as of March 31, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)	March 31, 2014	December 31, 2013
Cash on hand	₩ 3,310	₩ 3,147
Demand deposits	83,618	82,691
Short-term investment assets	430,000	160,000
	<u>₩ 516,928</u>	<u>₩ 245,838</u>

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Other financial assets as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
Short-term financial assets				
Time deposits	₩	30,000	₩	20,000
Money trust		480,000		620,000
Certificates of deposit		30,000		20,000
	₩	540,000	₩	660,000

**17. Equity and Share Premium**

Details of share capital as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in Korean won, except number of shares)</i>	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
Number of ordinary shares				
Authorized		800,000,000		800,000,000
Issued		137,292,497		137,292,497
Par value per share	₩	5,000	₩	5,000
Ordinary shares	₩	954,959,485,000	₩	954,959,485,000

The Company has reacquired and retired 53,699,400 shares of treasury shares. Accordingly, as of March 31, 2014, the Company's ordinary shares differ from the aggregate par value of issued shares by ₩ 268,497 million.

Changes in the number of shares for the three-month period ended March 31, 2014 and the year ended December 31, 2013, are as follows:

	<b>2014</b>			<b>2013</b>		
	<b>Ordinary shares</b>	<b>Treasury shares</b>	<b>Total</b>	<b>Ordinary shares</b>	<b>Treasury shares</b>	<b>Total</b>
Number of shares	137,292,497	(11,393,697)	125,898,800	137,292,497	(11,393,697)	125,898,800

There are no changes in the other capital surplus for the three-month period ended March 31, 2014 and the year ended December 31, 2013.

**18. Treasury Shares**

There is no change in the treasury shares for the three-month period ended March 31, 2014 and the year ended December 31, 2013. Details of the number of treasury shares and carrying amount are as follows:

<i>(in millions of Korean Won, except number of shares)</i>	<b>2014</b>		<b>2013</b>	
	<b>Number of shares</b>	<b>Carrying amount</b>	<b>Number of shares</b>	<b>Carrying amount</b>
Issuance of treasury shares	11,393,697	₩ 339,059	11,393,697	₩ 339,059

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There is no change in gain on reissuance of the treasury shares for the three-month period ended March 31, 2014 and the year ended December 31, 2013. The book values are as follows:

<i>(in millions of Korean won)</i>		<b>2014</b>		<b>2013</b>
Gain on reissuance of treasury shares	₩	492,032	₩	492,032

**19. Reserves**

Details of reserves as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>		<b>March 31, 2014</b>		<b>December 31, 2013</b>
Available-for-sale financial assets reserve	₩	1,298	₩	(5,570)
Legal reserve		602,936		602,937
Voluntary reserve		2,918,254		2,813,732
	₩	<u>3,522,488</u>	₩	<u>3,411,099</u>

Available-for-sale financial assets reserve as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>		<b>March 31, 2014</b>		<b>December 31, 2013</b>
Available-for-sale financial assets reserve before tax	₩	1,712	₩	(7,348)
Tax effect		(414)		1,778
Available-for-sale financial assets reserve after tax	₩	<u>1,298</u>	₩	<u>(5,570)</u>

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 shares in connection with a free issue of shares.

Details of the Company's voluntary reserve as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>		<b>March 31, 2014</b>		<b>December 31, 2013</b>
Reserve for business rationalization <sup>1</sup>	₩	12,851	₩	12,851
Reserve for research and human resource development <sup>2</sup>		42,522		90,000
Reserve for business expansion <sup>3</sup>		698,881		698,881
Other reserve <sup>3</sup>		2,164,000		2,012,000
	₩	<u>2,918,254</u>	₩	<u>2,813,732</u>

<sup>1</sup>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

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investments and, consequently, the existing balance is now regarded as a voluntary reserve.

<sup>2</sup>*Reserve for research and human resource development*

Reserve for research and human resource development was appropriated in order to utilize certain tax deduction benefits through the early recognition of future expenditures. This reserve is restored to retained earnings in accordance with the relevant tax laws. Such reserves are taken back into taxable income in the year of restoration.

<sup>3</sup>*Reserve for Business Expansion and other reserve*

Reserves without specific purposes are restored to retained earnings and can be used for other purposes afterwards upon a resolution at a general meeting of shareholders.

**20. Retained Earnings**

Changes in retained earnings for the three-month period ended March 31, 2014 and the year ended December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>		<b>2013</b>	
Beginning	₩	509,820	₩	752,766
Bring from reserve for research and human resource development		47,478		-
Transfer from other reserve		(152,000)		(317,000)
Transfer from reserve for research and human resource development		-		(30,000)
Dividends		(402,876)		(402,876)
Profit for the period		187,536		501,315
Remeasurements of the net defined benefit liability (after tax)		(405)		5,615
Ending	₩	189,553	₩	509,820

**21. Trade and Other Payables**

Trade and other payables as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
	<b>Current</b>	<b>Non-current</b>	<b>Current</b>	<b>Non-current</b>
Leasehold deposits received	₩ -	₩ 27,496	₩ -	₩ 27,585
Accounts payable	60,991	-	60,436	-
Withholdings	7,492	-	3,823	-
Value added tax withheld	109,698	-	119,761	-
Accrued expenses	96,607	-	123,419	-
Other payables	87,456	684	94,950	684
Dividends payable	402,876	-	-	-
	₩ 765,120	₩ 28,180	₩ 402,389	₩ 28,269

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**22. Borrowings**

Details of borrowings as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>Current</b>		
Bank borrowings	₩ 4,606	₩ 4,920

Details of bank borrowings as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>		<b>Latest maturity date</b>	<b>Annual interest rate (%) March 31, 2014</b>	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Korean won	National Agricultural Cooperative Federation	Short-term borrowings	7.15%	₩ 3,803	₩ 4,061
Korean won	Korea Exchange Bank	Short-term borrowings	CD(91) + 2.5%	803	859
				<u>₩ 4,606</u>	<u>₩ 4,920</u>

**23. Net Defined Benefit Liability**

The amounts recognized on the statements of income for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>	<b>2013</b>
Defined benefit plans :		
Current service cost	₩ 7,017	₩ 7,244
Interest expenses	2,082	1,715
Expected return on plan assets	(1,507)	(1,169)
Effect of past service cost or settlement	462	-
	<u>8,054</u>	<u>7,790</u>
Defined contribution plans :		
Contributions recognized as current expense	771	644
Total	<u>₩ 8,825</u>	<u>₩ 8,434</u>

Out of total expenses, ₩2,741 million (2013: ₩2,800 million) and ₩6,084 million (2013: ₩5,634 million) are included in 'cost of sales' and 'selling and administrative expenses', respectively.

Net defined benefit liability recognized on the statements of financial position as of March 31, 2014 and December 31, 2013, are as follows:

<i>(In millions of Korean won)</i>	<b>March 31, 2014</b>	<b>December 31, 2013</b>
Present value of defined benefit liability	₩ 230,398	₩ 227,259
Fair value of plan assets	(162,434)	(166,986)
Liability in the statement of financial position	<u>₩ 67,964</u>	<u>₩ 60,273</u>

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**24. Operating Income and Other Income**

Material items of operating income and expense

Operating income is calculated as gross profit net of selling and administrative expenses and other income and expenses were excluded.

Employee benefit costs for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014	2013
Salaries	₩ 83,311	₩ 77,824
Retirement benefits	8,825	8,434
Termination benefits	269	-
Employee welfare	8,268	8,210
	<u>₩ 100,673</u>	<u>₩ 94,468</u>

Selling and administrative expenses for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014	2013
Salaries	₩ 56,885	₩ 52,397
Retirement benefits	6,353	5,634
Employee welfare	5,763	5,756
Travel	985	969
Communications	958	893
Utilities	2,663	2,817
Taxes and dues	3,314	4,303
Supplies	450	448
Rent	3,300	3,253
Depreciation	7,853	8,016
Amortization	15	15
Repairs and maintenance	592	454
Vehicles	1,822	2,141
Insurance	92	138
Commissions	17,351	16,076
Freight and custody	6,523	5,227
Conferences	730	837
Advertising	33,930	36,717
Training	770	891
Prizes and rewards	520	357
Normal research and development	3,966	1,949
Bad debts expense	982	(1)
	<u>₩ 155,817</u>	<u>₩ 149,287</u>

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Details of other income for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>	<b>2013</b>
Foreign currency transaction gain	₩ 2,286	₩ 2,233
Foreign currency translation gain	11,533	22,878
Gain on sale of property, plant and equipment	733	5,500
Miscellaneous revenues	2,851	4,265
	<u>₩ 17,403</u>	<u>₩ 34,876</u>

Details of other expenses for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>	<b>2013</b>
Foreign currency transaction loss	₩ 864	₩ 1,254
Foreign currency translation loss	245	2,145
Other bad debt expenses	225	-
Donations	440	145
Loss on sale of property, plant and equipment	23	136
Loss on sale of intangible assets	2	-
Miscellaneous expenses	6,135	288
	<u>₩ 7,934</u>	<u>₩ 3,968</u>

**25. Expenses by Nature**

Expenses by nature for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>	<b>2013</b>
Changes in inventories	₩ 31,073	₩ (33,485)
Raw materials and consumables purchased	175,587	197,205
Salary and wage	83,311	77,824
Retirement and termination benefits	9,094	8,434
Depreciation	25,898	29,120
Amortization	15	15
Employee benefits	8,268	8,210
Advertising costs	33,955	36,732
Service fees	23,155	21,697
Other expenses	13,233	9,831
Total cost of sales and administrative expenses <sup>1</sup>	<u>₩ 403,589</u>	<u>₩ 355,583</u>

<sup>1</sup> The amount represents the sum of cost of sales and selling and administrative expenses in the separate statements of comprehensive income.

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**26. Finance Income and Costs**

Finance income and costs for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>	<b>2013</b>
<b>Finance cost</b>		
Interest costs	₩ (300)	₩ (212)
Impairment loss on available-for-sale financial assets	-	(12,000)
	<u>(300)</u>	<u>(12,212)</u>
<b>Finance income</b>		
Interest income	9,193	9,649
Dividend income	3,709	3,591
Investment income on long-term deposits in MSA Escrow Fund	298	346
	<u>13,200</u>	<u>13,586</u>
<b>Net financial income</b>	<u>₩ 12,900</u>	<u>₩ 1,374</u>

Details of interest costs for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>	<b>2013</b>
Trade and other payables	₩ (300)	₩ (212)

Details of interest income for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>	<b>2013</b>
Deposits	₩ 7,212	₩ 7,440
Available-for-sale financial assets	12	7
Trade and other receivables	1,969	2,202
	<u>₩ 9,193</u>	<u>₩ 9,649</u>

**27. Income Tax**

Income tax expense was calculated based on the best weighted average annual corporate tax rate for the entire fiscal period. Estimated average annual tax rate of the year ending December 31, 2014, is 25.0%. (The estimated tax rate for the three-month period ended March 31, 2013, was 25.1%).

**28. Earnings per Share**

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year excluding ordinary shares purchased by the Company and held as treasury shares (Note 19).



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Basic earnings per ordinary share for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in Korean won, except number of shares)</i>	<b>2014</b>	<b>2013</b>
Profit for the period	₩ 187,536 million	₩ 192,777 million
Weighted-average number of ordinary shares outstanding	125,898,800	125,898,800
Basic earnings per share in won	₩ 1,490	₩ 1,531

**29. Dividends**

Dividend distribution to the Company's shareholders amounting to ₩ 402,876 million for the year ended December 31, 2013, is not yet paid as of March 31, 2014. The amount is recognized as dividend payable.

**30. Cash Generated from Operations**

Cash generated from operations for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>2014</b>	<b>2013</b>
<b>Profit</b>	₩ 187,536	₩ 192,777
Adjustments for:		
Income tax expense	62,378	64,581
Finance cost	300	12,212
Finance income	(13,200)	(13,586)
Depreciation	25,898	29,120
Amortization	15	15
Retirement and termination benefits	8,054	7,791
Foreign currency translation loss	245	2,145
Impairment loss on trade and other receivables	1,207	-
Loss on inventory valuation	-	83
Loss on sale of property, plant and equipment	23	136
Loss on sale of intangible assets	2	-
Other expenses	1,205	753
Foreign currency translation gain	(11,533)	(22,879)
Reversal of impairment loss on trade and other receivables	-	(1)
Reversal of impairment loss on inventory valuation	(726)	-
Gain on sale of property, plant and equipment	(733)	(5,500)
	<u>260,671</u>	<u>267,647</u>
<b>Changes in working capital</b>		
Increase in trade and other receivables	(29,607)	(38,395)
Decrease (increase) in advance payments	15,315	(1,721)
Decrease in prepaid expenses	779	1,121
Decrease (increase) in prepaid tobacco excise and other taxes	25,570	(70,003)
Decrease (increase) in inventories	30,595	(34,318)
Increase (decrease) in trade and other payables	(54,602)	15,079
Increase (decrease) in advance receipts	(3,136)	14,672
Increase (decrease) in tobacco excise and other taxes payable	(11,829)	291,854
Payment of retirement benefits	(898)	(362)
<b>Cash generated from operations</b>	<u>₩ 232,858</u>	<u>₩ 445,574</u>

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Significant non-cash transactions for the three-month period ended March 31, 2014, are as follows:

<i>(in millions of Korean won)</i>		<b>2014</b>
Transfer to dividend payable in retained earnings	₩	402,876
Reclassification of construction-in-progress to property, plant and equipment		11,182

### **31. Contingencies and Commitments**

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

As of March 31, 2014, the Company is involved in a lawsuit as a plaintiff claiming damages in relation to development of Yongsan area with other companies. The aggregate litigation amount for this case amounts to ₩ 240,000 million, and the litigation amount attributable to the Company is ₩ 5,136 million.

As of March 31, 2014, tobacco lawsuits claiming damages of ₩ 584 million are filed against the Company and the Korean government. The amount of the liability with respect to the litigation cannot be reasonably estimated as of March 31, 2014. Additionally, as of March 31, 2014, the Company is involved in ten lawsuits as a defendant for alleged damages totaling ₩ 3,026 million.

After the report date, National Health Insurance Service filed a lawsuit seeking ₩ 53,742 million in damages against the Company and other tobacco companies on April 14, 2014.

As of March 31, 2014, the Company has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 57,000 thousand.

As of March 31, 2014, the Company's trade receivables from the export of cigarettes are insured against non-payment up to USD 11,697 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of March 31, 2014, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries and also for an opening of L/C up to USD 40,000 thousand by Korea Exchange Bank and others. In addition, the Company provides Customs Bond with limits in the aggregate of USD 8,900 thousand to Korea Exchange Bank, regarding an opening of L/C for import and customs with relation to a subsidiary located in U.S.A (Global Trading Inc.). The Company also provides Performance Bond with limits in the aggregate of THB 4,302 thousand in relation to an opening of L/C for export of tobacco sheet for Thailand Tobacco Monopoly, and payment guarantee with limits in the aggregate of IDR 63,287,756 thousand in relation to purchase

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of certificate stamp of tobacco of Trisakti Purwosari, as of March 31, 2014.

As of March 31, 2014, the Company and 28 other companies are guaranteed ₩ 240,000 million by Seoul Guarantee Insurance Co., Ltd. related to the Yongsan International Commercial Development Project. Seoul Guarantee Insurance Co., Ltd. can request amounts for recourse to the Company and 28 other companies based on their ownership rate, if Seoul Guarantee Insurance Co., Ltd. paid the insurance proceeds to KORAIL. As KORAIL requested the corresponding payment to Seoul Guarantee Insurance Co., Ltd. during the reporting period, the Company paid the maximum amount ₩ 5,136 million on July 31, 2013 and recognized the amount as the prior period expenses.

On March 17, 2011, the Company signed the memorandum of understanding (MOU) on global investment partnership with National Pension Service to jointly invest in foreign assets with a limit of ₩ 800,000 million. Following this MOU, the Company entered into a joint investment agreement with Q Capital Partners Co., Ltd., which is a general partner of private equity fund, on November 11, 2011.

In relation to the acquisition of Somang Cosmetics Co., Ltd., the Company entered into a contract with a former owner of the acquiree, Kang Seok-Chang ("the Individual Shareholder"). Details of the contract are as follows:

1) Conditional put option granted to the Individual Shareholder

The Company shall be required to purchase the Individual Shareholder's shares, in whole or in part, at the agreed price if the following conditions are met:

- Somang Cosmetics Co., Ltd. satisfies all the listing requirements.
- Notwithstanding the written request of Individual Shareholder, Somang Cosmetics Co., Ltd. is not able to undertake the necessary procedures for listing, due to the Company's objection, within three years after the Company acquired Somang Cosmetics Co., Ltd.

2) Right of first refusal held by the Company

The individual shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless Individual Shareholder has offered them first to the Company.

3) Tag-along right held by The Individual Shareholder

In the event that the Company proposes to enter into a transaction or a series of related transactions with a third party purchaser to dispose of 50% or more of its shares, then the Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Company.

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In relation to the acquisition of KT&G Life Science (formerly Mazence, Inc.), the Company entered into a contract with a former owner of the acquiree, Gwak Tae-Hwan ("Individual Shareholder"). Details of the contract are as follows:

1) Restriction of disposal

Individual shareholder shall not be permitted to dispose of its shares, in whole or in part, within one year after KT&G Life Science is listed.

2) Right of first refusal held by the Company

The Individual shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless the Individual shareholder has offered them first to the Company.

3) Tag-along right held by the Individual Shareholder

In the event that the Company proposes to enter into a transaction or a series of related transactions with a third party purchaser to dispose of its shares, then the Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Company.

Upon the resolution of the Board of Directors on January 23, 2013, the Parent Company guarantees the principal and the related interest that buyers of Andong Central Xi Apartment have borrowed from the National Agricultural Cooperative Federation, as of March 31, 2014. The amount of guarantee is ₩152,263 million and the guarantee will expire on June 30, 2015.

As of March 31, 2014, the Company is insured against non-payment to customs duty up to ₩5,000 million by tax bond insurance with the Seoul Guarantee Insurance.

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### 32. Related Party Transactions

The subsidiaries and parent companies of subsidiaries as of March 31, 2014 and December 31, 2013, are as follows:

Subsidiaries	Location	Immediate parent companies	Percentage of ownership (%)					
			March 31, 2014			December 31, 2013		
			Parent companies	Subsidiaries	Total	Parent companies	Subsidiaries	Total
Korea Ginseng Corporation	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
Yungjin Pharm. Co., Ltd.	Korea	KT&G	53.00	-	53.00	53.00	-	53.00
Tae-a industry Co., Ltd.	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	KT&G	99.99	-	99.99	99.99	-	99.99
Korea Tabacos do Brasil Ltda.	Brazil	KT&G	99.90	-	99.90	99.90	-	99.90
KT&G Pars	Iran	KT&G	99.99	-	99.99	99.99	-	99.99
KT&G Rus L.L.C.	Russia	KT&G	100.00	-	100.00	100.00	-	100.00
KGC Life & Gin Co., Ltd	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
Global Trading, Inc.	USA	KT&G	100.00	-	100.00	100.00	-	100.00
Jilin Hanzheng Ginseng Co., Ltd.	China	KT&G	100.00	-	100.00	100.00	-	100.00
Somang Cosmetics Co., Ltd. <sup>1</sup>	Korea	KT&G	60.00	-	60.00	60.00	-	60.00
Renzoluc Pte., Ltd. <sup>2</sup>	Singapore	KT&G	100.00	-	100.00	100.00	-	100.00
PT Trisakti Purwosari Makmur	Indonesia	Renzoluc Pte., Ltd.	-	60.17	60.17	-	60.17	60.17
PT Mandiri Maha mulia	Indonesia	Renzoluc Pte., Ltd.	-	66.47	66.47	-	66.47	66.47
PT Sentosa Ababi Purwosari	Indonesia	PT Trisakti Purwosari Makmur	-	99.24	99.24	-	99.24	99.24
PT Purindo Ilufa	Indonesia	PT Trisakti Purwosari Makmur	-	100.00	100.00	-	100.00	100.00
KT&G Life Science <sup>3</sup>	Korea	KT&G	73.94	-	73.94	73.94	-	73.94
Yebon Nongwon Agriculture Co., Ltd	Korea	KT&G	90.00	-	90.00	90.00	-	90.00
KGC Yebon	Korea	KT&G	100.00	-	100.00	100.00	-	100.00
K-Q HongKong I, Limited <sup>4</sup>	HongKong	KT&G	100.00	-	100.00	100.00	-	100.00
PT KT&G Indonesia	Indonesia	KT&G	99.96	-	99.96	99.96	-	99.96
Cheong Kwan Jang Taiwan Corporation	Taiwan	Korea Ginseng Corporation	-	100.00	100.00	-	100.00	100.00
Korean Red Ginseng Corp., Inc.	USA	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
Korea Ginseng Corporation Japan	Japan	Korea Ginseng Corporation	-	100.00	100.00	-	100.00	100.00
PT CKJ INDONESIA	Indonesia	Korea Ginseng Corporation	-	99.98	99.98	-	99.98	99.98
K&I HK Co., Ltd <sup>5</sup>	Hong Kong	KT&G	100.00	-	100.00	-	-	-

<sup>1</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of March 31, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

<sup>2</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of March 31, 2014, the Company's percentage of ownership would be 68.91% if convertible preferred shares are included.

<sup>3</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred

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shares. As of March 31, 2014, the Company's percentage of ownership would be 59.48% if convertible preferred shares are included.

<sup>4</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of March 31, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

<sup>5</sup> During the three-month period ended March 31, 2014, K&I HK Co., Ltd. Has been included as a subsidiary.

Transactions with related parties for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>	2014	2013
<b>Sales and other income</b>		
Korea Ginseng Corporation	₩ 1,614	₩ 2,360
Yungjin Pharm. Co., Ltd.	85	68
Tae-a industry Co., Ltd.	6	5
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	801	2,040
KT&G Pars	564	1,034
KT&G Rus L.L.C.	3,126	5,082
KGC Life & Gin Co., Ltd	167	393
Global Trading, Inc.	15,975	13,148
Jilin Hanzheng Ginseng Co., Ltd.	-	5
Renzoluc Pte., Ltd.	991	1,173
KT&G Life Science	16	37
PT Trisakti Purwosari Makmur	37	43
Somang Cosmetics Co., Ltd.	58	-
PT KT&G Indonesia	160	33
KGC Yebon	6	6
PT Mandiri Maha mulia	2,339	-
	<u>25,945</u>	<u>25,427</u>
<b>Purchases and other expenses</b>		
Korea Ginseng Corporation	332	268
Yungjin Pharm. Co., Ltd.	1	1
Tae-a industry Co., Ltd.	4,111	3,797
KGC Life & Gin Co., Ltd	239	262
Somang Cosmetics Co., Ltd.	50	34
Korea Ginseng (China) Corp.	233	-
	<u>₩ 4,966</u>	<u>₩ 4,362</u>

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Details of related party receivables and payables as of March 31, 2014 and December 31, are as follows:

<i>(in millions of Korean won)</i>	<b>March 31, 2014</b>		<b>December 31, 2013</b>	
<b>Receivables from related parties</b>				
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	₩	31,706	₩	31,845
KT&G Pars <sup>1</sup>		41,132		40,149
KT&G Rus L.L.C.		22,032		26,691
Global Trading, Inc.		2,714		2,697
Renzoluc Pte., Ltd.		52,256		46,989
PT Mandiri Maha mulia		4,913		3,655
Somang Cosmetics Co., Ltd.		15		21
PT Trisakti Purwosari Makmur		230		192
Korea Ginseng Corporation		598		8
PT KT&G Indonesia		7,915		7,615
KGC Life & Gin Co., Ltd.		107		116
Yungjin Pharm. Co., Ltd.		17		-
Korea Tabacos do Brasil Ltda.		94		94
		<u>163,729</u>		<u>160,072</u>
<b>Payables to related parties</b>				
Korea Ginseng Corporation		1,817		1,817
Somang Cosmetics Co., Ltd.		19		37
Tae-a industry Co., Ltd.		1,542		810
Yungjin Pharm. Co., Ltd.		413		413
KGC Life & Gin Co., Ltd.		123		115
KT&G Life Science		813		813
	₩	<u>4,727</u>	₩	<u>4,005</u>

<sup>1</sup> Above receivables are the gross amounts before ₩ 24,210 million of allowance for doubtful accounts.

Fund transactions with related parties for the three-month period ended March 31, 2014, are as follows:

<i>(in millions of Korean won)</i>		<b>Loan transactions</b>		<b>Equity contributions</b>
		<b>Loans</b>	<b>Repayments</b>	<b>in cash</b>
Subsidiaries	PT KT&G Indonesia	₩ -	₩ -	₩ 3,202
	K&I HK Co., Ltd.	-	-	11

Fund transactions with related parties for the three-month period ended March 31, 2013, are as follows:

<i>(in millions of Korean won)</i>		<b>Loan transactions</b>		<b>Equity contributions</b>
		<b>Loans</b>	<b>Repayments</b>	<b>in cash</b>
Subsidiaries	Renzoluc Pte., Ltd.	₩ 2,239	₩ -	₩ -
	PT KT&G Indonesia	7,418	-	3,746

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The compensation paid or payable to key management for employee services for the three-month periods ended March 31, 2014 and 2013, consists of:

<i>(in millions of Korean won)</i>	<b>2014</b>		<b>2013</b>	
Short-term employee benefits	₩	3,308	₩	3,428
Retirement benefits		667		420
	₩	<u>3,975</u>	₩	<u>3,848</u>

**33. 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 ₩ 1068.80 to US\$1, the basic exchange rate on March 31, 2014, posted by Seoul Money Brokerage Services, 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 U.S. dollars at this or any other rate.