

KT&G Corporation and Subsidiaries

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

KT&G Corporation and Subsidiaries

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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 consolidated financial statements of KT&G Corporation. These financial statements consist of consolidated statement of financial position of KT&G Corporation (the "Parent Company") and its subsidiaries (collectively referred to "the Group") as of March 31, 2014, and the related consolidated 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 consolidated 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 consolidated 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 consolidated 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 consolidated statement of financial position of KT&G Corporation as of December 31, 2013, and the related consolidated 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 consolidated 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 consolidated 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 34 to the interim consolidated 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.

A handwritten signature in black ink that reads "Samil pricewaterhousecoopers". The signature is written in a cursive, flowing style.

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 consolidated 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 and Subsidiaries
Interim Consolidated Statements of Financial Position
March 31, 2014 and 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 34)	March 31, 2013 Korean won
Assets				
Non-current assets				
Property, plant and equipment	10, 14	₩ 1,613,323	\$ 1,509,472	₩ 1,622,289
Intangible assets	11	230,137	215,323	232,630
Investment property	12, 14	172,424	161,325	173,975
Investments in associates	5, 15	58,465	54,701	58,076
Available-for-sale financial assets	6, 7	305,651	285,976	296,601
Other financial assets	6, 17	1,755	1,642	1,740
Long-term deposits in MSA Escrow Fund	6, 9, 32	238,028	222,706	219,760
Long-term advance payments	32	140,104	131,085	140,692
Long-term prepaid expenses		5,696	5,330	5,966
Long-term trade and other receivables	6, 8	108,463	101,481	108,898
Deferred income tax assets	28	23,674	22,150	25,731
		<u>2,897,720</u>	<u>2,711,191</u>	<u>2,886,358</u>
Current assets				
Inventories	16	1,814,382	1,697,588	1,893,853
Available-for-sale financial assets	6, 7	2,600	2,433	-
Other financial assets	6, 17	568,876	532,256	684,132
Prepaid tobacco excise and other taxes		237,199	221,930	262,769
Trade and other receivables	6, 8	890,042	832,749	915,618
Advance payments	32	102,000	95,434	65,007
Prepaid expenses		23,666	22,142	19,135
Cash and cash equivalents	6, 17	624,998	584,766	347,933
		<u>4,263,763</u>	<u>3,989,298</u>	<u>4,188,447</u>
Assets held for sale	5, 13	<u>3</u>	<u>3</u>	<u>153</u>
Total assets		<u>₩ 7,161,486</u>	<u>\$ 6,700,492</u>	<u>₩ 7,074,958</u>
Equity				
Capital stock	1, 18	₩ 954,959	\$ 893,488	₩ 954,959
Other capital surplus		(4,572)	(4,278)	(4,572)
Treasury shares	19	(339,059)	(317,233)	(339,059)
Gain on reissuance of treasury shares	19	492,032	460,359	492,032
Reserve	20	3,473,168	3,249,596	3,368,835
Retained earnings	21	486,919	455,576	802,755
Equity attributable to equity holders of the Company		<u>5,063,447</u>	<u>4,737,508</u>	<u>5,274,950</u>
Non-controlling interests		<u>87,673</u>	<u>82,029</u>	<u>90,531</u>
Total equity		<u>5,151,120</u>	<u>4,819,537</u>	<u>5,365,481</u>
Liabilities				
Non-current liabilities				
Long-term borrowings	6, 23	119,604	111,905	117,639
Long-term trade and other payables	6, 22	30,958	28,965	29,597
Long-term advance receipts		18,602	17,403	18,837
Defined benefit liability	24	122,926	115,013	111,137
Provisions for other liabilities and charges		2,739	2,562	2,981
Deferred income tax liabilities	28	258,509	241,869	247,043
		<u>553,338</u>	<u>517,717</u>	<u>527,234</u>
Current liabilities				
Borrowings	6, 23	48,331	45,220	96,240
Current portion of long-term borrowings	6, 23	4,629	4,331	4,424
Trade and other payables	6, 22	886,299	829,247	542,908
Advance receipts		23,269	21,771	28,077
Income taxes payable	28	161,494	151,099	156,277
Tobacco excise and other taxes payable		333,006	311,570	354,317
		<u>1,457,028</u>	<u>1,363,238</u>	<u>1,182,243</u>
Total liabilities		<u>2,010,366</u>	<u>1,880,955</u>	<u>1,709,477</u>
Total liabilities and equity		<u>₩ 7,161,486</u>	<u>\$ 6,700,492</u>	<u>₩ 7,074,958</u>

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

The US dollar figures are provided for information purposes only and do not form part of the consolidated financial statements. Refer to Note 34.

KT&G Corporation and Subsidiaries
Interim Consolidated 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 34)	2013 Korean won
Sales	5	₩ 983,666	\$ 901,634	₩ 896,038
Cost of sales	16,26	(434,197)	(406,247)	(376,745)
Gross profit		529,469	495,387	519,293
Selling and administrative expenses	25,26	(269,324)	(251,988)	(270,467)
Operating income		260,145	243,399	248,826
Other income	25	23,282	21,783	45,207
Other expenses	25	(25,083)	(23,468)	(10,494)
Net other income(expenses)		(1,801)	(1,685)	34,713
Finance income	27	13,252	12,399	13,035
Finance expense	27	(2,695)	(2,521)	(15,195)
Net Finance income		10,557	9,878	(2,160)
Income from jointly controlled entities and associates	15	735	688	411
Expense from jointly controlled entities and associates	15	-	-	(993)
Profit before income tax		269,636	252,280	280,797
Income tax expense	28	(81,444)	(76,202)	(82,448)
Profit for the period		₩ 188,192	\$ 176,078	₩ 198,349
Other comprehensive income(loss), net of tax				
Items that will not be reclassified to profit or loss:				
Remeasurements of the net defined benefit liability	24	₩ (499)	₩ (467)	₩ (181)
Items that will be reclassified subsequently to profit or loss:				
Change in value of available-for-sale financial assets	7	6,868	6,425	8,852
Loss(gain) on currency translation of foreign operations		(6,045)	(5,655)	6,447
Other comprehensive income (loss) for the period, net of tax		324	303	15,118
Total comprehensive income for the period		₩ 188,516	\$ 176,381	₩ 213,467
Profit for the period attributable to:				
Equity holders of the Parent Company		₩ 192,057	\$ 179,694	₩ 203,099
Non-controlling interests		(3,865)	(3,616)	(4,750)
		₩ 188,192	\$ 176,078	₩ 198,349
Total comprehensive income for the period attributable to:				
Equity holders of the Parent Company		₩ 191,374	\$ 179,055	₩ 218,219
Non-controlling interests		(2,858)	(2,674)	(4,752)
		₩ 188,516	\$ 176,381	₩ 213,467
Earnings per share attributable to the equity holders of the Parent Company during the period (in won)				
Basic and diluted earnings per share	29	₩ 1,525	\$ -	₩ 1,613

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

Notes	Attributable to equity holders of the Parent Company							Total Equity
	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total	
	₩	₩	₩	₩	₩	₩	₩	₩
Balance at January 1, 2013	954,959	(4,573)	(339,059)	492,032	3,011,110	976,425	5,000,894	5,194,418
Total comprehensive income								
Profit for the period	-	-	-	-	-	203,099	203,099	198,349
Change in value of available-for-sale financial assets	-	-	-	-	8,851	-	8,851	8,851
Gain on currency translation of foreign operations	-	-	-	-	6,447	-	6,447	6,447
Remeasurements of the net defined benefit liability	-	-	-	-	-	(178)	(178)	(180)
Total comprehensive income (loss)	-	-	-	-	15,298	202,921	218,219	213,467
Transactions with equity holders of the Company								
Cash dividends	-	-	-	-	-	(402,876)	(402,876)	(402,876)
Other reserve	-	-	-	-	317,000	(317,000)	-	-
Reserve for research and human resource development	-	-	-	-	30,000	(30,000)	-	-
Changes in investments in subsidiaries	-	-	-	-	-	-	-	-
Total transactions with equity holders of the Company	-	-	-	-	347,000	(749,876)	(402,876)	(401,836)
Balance at March 31, 2013	954,959	(4,573)	(339,059)	492,032	3,373,408	429,470	4,906,237	5,006,047
	₩	₩	₩	₩	₩	₩	₩	₩
Balance at January 1, 2014	954,959	(4,572)	(339,059)	492,032	3,368,835	802,755	5,274,950	5,365,481
Total comprehensive income								
Profit for the period	-	-	-	-	-	192,057	192,057	188,192
Change in value of available-for-sale financial assets	-	-	-	-	6,868	-	6,868	6,868
Loss on currency translation of foreign operations	-	-	-	-	(7,056)	-	(7,056)	(6,045)
Remeasurements of the net defined benefit liability	-	-	-	-	-	(495)	(495)	(499)
Total comprehensive income (loss)	-	-	-	-	(188)	191,562	191,374	189,516
Transactions with equity holders of the Parent Company								
Cash dividends	-	-	-	-	-	(402,876)	(402,876)	(402,876)
Reserve for research and human resource development	-	-	-	-	(47,478)	47,478	-	-
Other reserve	-	-	-	-	152,000	(152,000)	-	-
Total transactions with equity holders of the Company	-	-	-	-	104,522	(507,398)	(402,876)	(402,876)
Balance at March 31, 2014	954,959	(4,572)	(339,059)	492,032	3,473,168	488,919	5,063,447	5,151,120
	₩	₩	₩	₩	₩	₩	₩	₩

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

KT&G Corporation and Subsidiaries
Interim Consolidated Statements of Changes in Equity
Three-Month Period Ended March 31, 2014

Notes	Attributable to equity holders of the Parent Company								Total Equity
	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total	Non-controlling Interests	
	\$ 893,488	\$ (4,278)	\$ (317,233)	\$ 460,359	\$ 3,151,979	\$ 751,081	\$ 4,935,396	\$ 84,703	\$ 5,020,099
Balance at January 1, 2014									
Total comprehensive income									
Profit for the period	-	-	-	-	-	179,694	179,694	(3,616)	176,078
Change in value of available-for-sale financial assets	-	-	-	-	6,425	-	6,425	-	6,425
Loss on currency translation of foreign operations	-	-	-	-	(6,601)	-	(6,601)	946	(5,655)
Remeasurements of the net defined benefit liability	-	-	-	-	-	(463)	(463)	(4)	(467)
Total comprehensive income (loss)	-	-	-	-	(178)	179,231	179,055	(2,674)	176,381
Transactions with equity holders of the Parent Company									
Cash dividends	-	-	-	-	-	(376,943)	(376,943)	-	(376,943)
Reserve for research and human resource development	-	-	-	-	(44,423)	44,423	-	-	-
Other reserve	-	-	-	-	142,218	(142,218)	-	-	-
Total transactions with equity holders of the Company	-	-	-	-	97,793	(474,738)	(376,943)	-	(376,943)
Balance at March 31, 2014	\$ 893,488	\$ (4,278)	\$ (317,233)	\$ 460,359	\$ 3,249,598	\$ 455,576	\$ 4,737,598	\$ 82,029	\$ 4,819,537

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KT&G Corporation and Subsidiaries
Interim Consolidated 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	2014 Korean won	2014 U.S. dollars (Note 34)	2013 Korean won
Cash flows from operating activities				
Cash generated from operations	31	₩ 323,269	\$ 302,460	₩ 492,768
Income tax paid		(64,118)	(59,991)	(2,606)
Net cash generated from operating activities		<u>259,151</u>	<u>242,469</u>	<u>490,162</u>
Cash flows from investing activities				
Interest received		8,960	8,384	10,316
Investment income received from long-term deposits in MSA Escrow Fund		484	453	400
Dividends received		3,442	3,220	3,591
Proceeds from sale of property, plant and equipment		1,366	1,278	1,058
Proceeds from sale of intangible assets		130	122	46
Proceeds from sale of non-current asset held for sale		-	-	725
Proceeds from sale of available-for-sale financial assets		2,810	2,629	-
Decrease in loans		2,666	2,495	2,354
Decrease in guarantee deposits		6,352	5,944	6,712
Acquisition of property, plant and equipment		(31,942)	(29,886)	(26,973)
Acquisition of intangible assets		(405)	(379)	(922)
Acquisition of investment property		(77)	(72)	(1,422)
Acquisition of available-for-sale financial assets		(2,600)	(2,433)	-
Increase in loans		-	-	(183)
Increase in guarantee deposits		(8,785)	(8,220)	(9,413)
Increase in long-term deposits in MSA Escrow Fund		(15,552)	(14,551)	(9,977)
Decrease in other financial assets		115,364	107,938	385,676
Net cash provided by investing activities		<u>82,213</u>	<u>76,922</u>	<u>361,988</u>
Cash flows from financing activities				
Interest paid		(3,183)	(2,979)	(3,214)
Dividends paid		-	-	(402,876)
Proceeds from borrowings		55,889	52,291	41,810
Increase in deposits received		1,672	1,565	1,370
Repayments of borrowings		(117,684)	(110,109)	(66,331)
Decrease in deposits received		(863)	(807)	(1,892)
Net cash used in financing activities		<u>(64,169)</u>	<u>(60,039)</u>	<u>(431,133)</u>
Net increase in cash and cash equivalents		277,195	259,352	421,017
Cash and cash equivalents at the beginning of period		347,933	325,536	372,260
Exchange losses on cash and cash equivalents		(130)	(122)	62
Cash and cash equivalents at the end of period		<u>₩ 624,998</u>	<u>\$ 584,766</u>	<u>₩ 793,339</u>

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

The US dollar figures are provided for information purposes only and do not form part of the interim consolidated financial statements. Refer to Note 34.

KT&G Corporation and Subsidiaries

Notes to Interim Consolidated Financial Statements

March 31, 2014 and 2013, and December 31, 2013

1. General Information

General information about KT&G Corporation (the "Parent Company") and its subsidiaries (collectively referred to "the Group") in accordance with Korean IFRS 1027, *Consolidated and Separate Financial Statements*, is as follows.

The Parent 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 Parent 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 Parent Company was excluded from the application of the Act for the Management of Government Invested Enterprises. Accordingly, the Parent Company became an entity existing and operating under the Commercial Code of Korea. The Korean government sold 28,650,000 shares of the Parent Company to the public during 1999 and the Parent Company listed its shares on the Korea Exchange (formerly the Korea Stock Exchange) on October 8, 1999. On December 27, 2002, the Parent Company changed its name again to KT&G Corporation from Korea Tobacco and Ginseng Corporation.

As of March 31, 2014, the Parent 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 Parent 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 Parent 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 Parent 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 Parent 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 Parent 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 Parent Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program. Also, on June 25, 2009, the market of the Parent Company's GDR was changed from the BdL Market to the Euro MTF in the Luxembourg Stock Exchange.

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

The ownership of the Parent 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%

The Parent Company's consolidated subsidiaries as of March 31, 2014, are as follows:

Immediate Parent	Subsidiaries	Location	Percentage of ownership (%)
			2014
KT&G Corporation	Korea Ginseng Corporation	Korea	100.00
	Yungjin Pharm. Ind. Co., Ltd.	Korea	53.00
	Tae-a Industry Co., Ltd.	Korea	100.00
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	99.99
	Korea Tabacos do Brasil Ltda.	Brazil	99.90
	KT&G Pars	Iran	99.99
	KT&G Rus L.L.C.	Russia	100.00
	KGC Life & Gin Co., Ltd	Korea	100.00
	Global Trading, Inc.	USA	100.00
	Jilin Hanzheng Ginseng Co., Ltd.	China	100.00
	Somang Cosmetics Co., Ltd. ¹	Korea	60.00
	Renzoluc Pte., Ltd. ²	Singapore	100.00
	KT&G Life Science ³	Korea	73.94
	Yebon Nongwon Agriculture Co., Ltd	Korea	90.00
	KGC Yebon	Korea	100.00
	K-Q HongKong I, Limited ⁴	Hong Kong	100.00
	PT KT&G Indonesia	Indonesia	99.98
	K&I HK Co., Ltd	Hong Kong	100.00
	PT Trisakti Purwosari Makmur	Indonesia	60.17
	PT Mandiri Maha Mulia	Indonesia	66.47
PT Trisakti Purwosari Makmur	PT Sentosa Ababi Purwosari	Indonesia	99.24
	PT Purindo Ilufa	Indonesia	100.00
Korea Ginseng Corporation	Cheong Kwan Jang Taiwan Corporation	Taiwan	100.00
	Korean Red Ginseng Corp., Inc.	USA	100.00
	Korea Ginseng (China) Corp.	China	100.00
	Korea Ginseng Corporation Japan	Japan	100.00
	PT CKJ INDONESIA	Indonesia	99.88

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

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

³ The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of March 31, 2014, the Group's percentage of ownership would be 59.48% if convertible

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

preferred shares are included.

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

Summarized financial information of subsidiaries as of March 31, 2014, is as follows:

(In millions of Korean won)

Subsidiaries	Total assets	Total liabilities	Revenue	Profit (loss)	Total comprehensive income(loss)
Korea Ginseng Corporation	₩ 1,392,130	₩ 123,215	₩ 206,580	₩ 23,526	₩ 23,453
Yungjin Pharm. Ind. Co., Ltd.	164,893	63,909	40,107	(1,453)	(1,461)
Tae-a industry Co., Ltd.	13,464	3,491	4,111	265	262
KT&G Tutun Mamulleri Sanayive Ticaret A.S.	40,288	34,159	2,757	(1,329)	(1,456)
Korea Tabacos do Brasil Ltda.	1,099	11	-	-	-
KT&G Pars	19,562	42,510	-	(1,350)	(1,350)
KT&G Rus L.L.C.	116,494	24,148	1,159	(2,147)	(9,439)
KGC Life & Gin Co., Ltd	30,962	5,893	10,350	(2,160)	(2,163)
Global Trading, Inc.	37,358	27,215	57,387	1,632	1,742
Jilin Hanzheng Ginseng Co., Ltd.	80,051	43,500	-	(1,211)	(1,582)
Somang Cosmetics Co., Ltd.	66,876	69,345	20,652	(3,598)	(3,598)
Renzoluc Pte., Ltd.	102,716	52,215	-	(129)	510
KT&G Life science	32,601	15,957	58	(1,833)	(1,833)
Yebon Nongwon Agriculture Co., Ltd	98	-	-	(1)	(1)
KGC Yebon	41,660	877	927	(289)	(297)
PT Trisakti Purwosari Makmur	100,128	73,785	9,050	(1,727)	505
Cheong Kwan Jang Taiwan Corporation	14,248	16,617	4,779	110	129
Korean Red Ginseng Corp., Inc.	7,854	4,827	2,489	(190)	(149)
Korea Ginseng (China) Corp.	49,734	39,861	8,196	(333)	(433)
Korea Ginseng Corporation Japan	4,195	3,320	1,863	75	102
K-Q HongKong I,Limited	36,796	-	-	(404)	66
PT CKJ INDONESIA	2,618	2,220	899	29	60
PT KT&G Indonesia	8,962	9,856	1,661	(1,685)	(1,932)
PT Mandiri Maha Mulia	10,257	5,609	1,669	388	751
K&I HK Co., Ltd	11	-	-	-	-

There has been no change in consolidation scope for the three month period ended 31 March, 2014.

2. Significant Accounting Policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years

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presented, unless otherwise stated.

2.1 Basis of Preparation

These consolidated 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 Group

The Group 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.

- 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 enactment on the financial statements as of and for the three-month periods ended March 31, 2014, however, the enactment 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 Group as of March 31, 2014, the related notes for the financial statements as of and for the three-month period ended March 31, 2014 are not disclosed.

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2.2 Consolidation

Significant accounting policy and estimating method applied in preparing interim financial statements agree with those applied in preparing prior period consolidated financial statements, except for the changes in the application of amended and enacted standards described in Note 2.1(1) and policies and methods described below.

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Company has control. The Company controls the corresponding investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Consolidation of a subsidiary begins from the date the Company obtains control of a subsidiary and ceases when the Company loses control of the subsidiary.

The Group applies the acquisition method to account for business combinations. The consideration transferred is measured at the fair values of the assets transferred, and identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are initially measured at their fair values at the acquisition date. The Group recognizes any non-controlling interest in the acquiree on an acquisition-by-acquisition basis in the event of liquidation, either at fair value or at the non-controlling interest's proportionate share of the recognized amounts of acquiree's identifiable net assets. All other non-controlling interests are measured at their acquisition-date fair values, unless another measurement basis is required by IFRSs. Acquisition-related costs are expensed as incurred.

Goodwill is recognized as the excess of the aggregate of the consideration transferred, the amount of any non-controlling interest in the acquiree, and the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree over the identifiable net assets acquired. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss.

Balances of receivables and payables, income and expenses and unrealized gains on transactions between the Group subsidiaries are eliminated. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Associates

Associates are all entities over which the Group has significant influence, and investments in associates are initially recognized at acquisition cost using the equity method. Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. If there is any objective evidence that the investment in the associate is impaired, the Group recognizes the difference between the recoverable amount of the associate and its book value as impairment loss.

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(c) Joint Arrangements

A joint arrangement of which two or more parties have joint control is classified as either a joint operation or a joint venture. A joint operator has rights to the assets, and obligations for the liabilities, relating to the joint operation and recognizes the assets, liabilities, revenues and expenses relating to its interest in a joint operation. A joint venturer has rights to the net assets relating to the joint venture and accounts for that investment using the equity method.

2.3 Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker (Note 5). The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the steering committee that makes strategic decisions. Operating segments for the consolidation reporting consist of tobacco, ginseng, real estate and others.

2.4 Foreign Currency Translation

(a) Functional and presentation currency

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

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

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2.6 Financial Instruments

(a) Classification and Measurement

The Group 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.

For hybrid (combined) instruments, the Group is unable to measure an embedded derivative separately from its host contract and therefore, the entire hybrid (combined) contract is classified as at fair value through profit or loss. The financial assets designated as at fair value through profit or loss by the Group are foreign convertible bonds and securitized derivatives.

Regular purchases and sales of financial assets are recognized on the 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 Group 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 Group writes off financial assets when the assets are determined to be no longer recoverable.

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 Group transfers a financial asset and the transfer does not result in derecognition because the Group has retained substantially of all risks and rewards of ownership of the transferred asset

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due to a recourse in the event the debtor defaults, the Group 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 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.

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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 Group 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	4 - 40 years
Machinery	2 - 20 years
Vehicle	4 - 5 years
Tools and equipment	4 - 5 years
Supplies	4 - 5 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

General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization. All other borrowing costs are recognized in profit or loss in 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 Group will comply with the conditions attaching to it. Government 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

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expenses for the purpose of the government grants.

2.13 Intangible Assets

(a) Goodwill

Goodwill is measured as explained in Note 2.2(1) and goodwill arises on the acquisition of subsidiaries, associates and business are included in intangible assets. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the CGUs, or group of CGUs, that is expected to benefit from the synergies of the combination. Goodwill is monitored at the operating segment level.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of goodwill is compared to the recoverable amount, which is the higher of value in use and the fair value less costs to sell. Any impairment is recognized immediately as an expense and is not subsequently reversed.

(b) Other 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 - 15 years or indefinite

Amortization periods and amortization methods for intangible assets with finite useful lives are reviewed at the end of each reporting period. The useful lives of intangible assets that are not being amortized are 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

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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.

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

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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 IFRS1018, *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.

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 Group 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.

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2.23 Employee Benefits

(a) Defined benefit liability

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

A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group 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 Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis.

The Group has no further payment obligations once the 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 Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group 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.

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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 Group'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 Group has transferred to the buyer the significant risks and rewards of ownership of the goods, the Group 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 Group and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the three-month periods ended March 31, 2014 and 2013, were ₩ 795,800 million and ₩ 849,084 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 Group, 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 Group'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 Group and the amount of the revenue can be measured reliably.

In addition, interest is recognized using the effective interest method, royalties are recognized on

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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.

2.27 Dividend Distribution

Dividend distribution to the Parent Company's shareholders is recognized as a liability in the financial statements in the period in which the dividends are approved by the Parent Company's shareholders.

3. Critical Accounting Estimates and Assumptions

The Group 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 consolidated financial statements, except for the estimating method used in deriving income tax expenses, agree with those made in preparing the prior period consolidated financial statements.

4. Financial Risk Management

4.1 Financial Risk Factors

The Group'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 Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

The Group uses derivative financial instruments to hedge certain risk exposures. Risk management is carried out by a central treasury department (Group treasury) under policies approved by the board of directors. The Group treasury identifies, evaluates and hedges financial risks in close co-operation with the Group'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.

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(a) Market risk

i) Foreign exchange risk

The Group 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 Group'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. 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:

<i>(in millions of Korean won)</i>	March 31, 2014			December 31, 2013		
	USD	EUR	JPY and Others	USD	EUR	JPY and Others
Assets						
Cash and cash equivalents	₩ 22,106	₩ 1,691	₩ 8	₩ 17,191	₩ 30	₩ 468
Trade and other receivables	484,311	1,615	4,359	365,453	1,605	2,479
Long-term deposits	238,028	-	-	219,760	-	-
	<u>₩ 744,445</u>	<u>₩ 3,306</u>	<u>₩ 4,367</u>	<u>₩ 602,404</u>	<u>₩ 1,635</u>	<u>₩ 2,947</u>
Liabilities						
Trade and other payables	₩ 63,718	₩ 14,506	₩ 190	₩ 56,514	₩ 11,564	₩ 1,030
Short-term borrowings	8,618	-	-	1,386	-	-
	<u>₩ 72,336</u>	<u>₩ 14,506</u>	<u>₩ 190</u>	<u>₩ 57,900</u>	<u>₩ 11,564</u>	<u>₩ 1,030</u>

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:

<i>(in millions of Korean won)</i>	March 31, 2014		December 31, 2013	
	10% strengthening	10% weakening	10% strengthening	10% weakening
US dollar	₩ 67,211	₩ (67,211)	₩ 54,450	₩ (54,450)

ii) Price risk

The Group 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 Group'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 Group'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 are as follows:

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	<i>(in millions of Korean won)</i>		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
Tax effect		(1,305)		1,305		(1,648)
Other comprehensive income after tax	₩	4,086	₩	(4,086)	₩	5,163

iii) Interest rate risk

The Group 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 Group's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. As of March 31, 2014 and December 31, 2013, the amount of borrowings issued at variable rates is ₩ 47,418 million and ₩ 58,564 million, respectively. There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation.

(b) Credit Risk

The Group 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 Group 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 Group'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>	March 31, 2014	December 31, 2013
Available-for-sale financial assets	₩ 5,291	₩ 2,702
Long-term deposits in MSA Escrow Fund	238,028	219,760
Trade and other receivables	998,505	1,024,516
Other financial assets	570,631	685,872
Cash and cash equivalents	624,998	347,933
Financial guarantee contracts	152,263	152,263

(c) Liquidity Risk

The Group has exposure to the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Group'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 Group'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 with a residual contractual maturity of financial liabilities as of March 31, 2014 and December 31, 2013, is as follows:

<i>(in millions of Korean won)</i>	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	₩ 778,197	₩ 779,419	₩ 728,614	₩ 18,946	₩ 31,859	₩ -
Short-term borrowings	48,331	48,811	33,050	15,761	-	-
Long-term borrowings	119,604	127,877	129	388	20,396	106,964
Current portion of long-term borrowings	4,629	4,751	163	4,588	-	-
Financial guarantee contracts ¹	-	152,263	-	-	152,263	-

<i>(in millions of Korean won)</i>	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	₩ 427,466	₩ 428,700	₩ 379,796	₩ 18,441	₩ 30,463	₩ -
Short-term borrowings	96,240	97,472	38,820	58,652	-	-
Long-term borrowings	117,639	126,283	60	256	67,461	58,506
Current portion of long-term borrowings	4,424	4,514	87	4,427	-	-
Financial guarantee contracts ¹	-	152,263	-	-	152,263	-

¹ The maximum guaranteed amount of financial guarantee contracts (Note 32)

The above financial liabilities are presented at the nominal value of undiscounted future cash flows as of the earliest period at which the Group 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 Group consists of equity and net debt deducting cash and cash equivalents, and current financial instruments from borrowings. The Group applied the same financial risk management strategy that was applied in the previous period.

As of March 31, 2014 and December 31, 2013, the Group defines net debt and equity attributable to owners of the Parent as follows:

<i>(in millions of Korean won)</i>	March 31, 2014	December 31, 2013
Total borrowings	₩ 172,565	₩ 218,303
Less:		
Cash and cash equivalents	(624,998)	(347,933)
Other financial assets, current	(568,876)	(684,132)
Available-for-sale financial assets, current	(2,600)	-
Net debt(asset)	(1,023,909)	(813,762)
Equity attributable to owners of the parent	₩ 5,151,120	₩ 5,365,481

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4.3 Fair Value Estimation

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

(a) Fair Value of Financial Instruments by Category

Carrying amount and fair value of financial instruments by category as of March 31, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

	March 31, 2014		December 31, 2013	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets				
Available-for-sale financial assets, non-current ¹	₩ 288,858	₩ 288,858	₩ 279,797	₩ 279,797
Other financial assets, non-current	1,755	1,755	1,740	1,740
Long-term deposit	238,028	238,028	219,760	219,760
Long-term trade and other receivables	108,463	108,463	108,898	108,898
Other financial assets, current	568,876	568,876	684,132	684,132
Trade and other receivables	890,042	890,042	915,618	915,618
Cash and cash equivalents	624,998	624,998	347,933	347,933
	₩ 2,721,020	₩ 2,721,020	₩ 2,557,878	₩ 2,557,878
Financial liabilities				
Long-term borrowings	₩ 119,604	₩ 119,604	₩ 117,639	₩ 117,639
Long-term trade and other payables	30,637	30,637	29,254	29,254
Short-term borrowings	48,331	48,331	96,240	96,240
Current portion of long-term borrowings	4,629	4,629	4,424	4,424
Trade and other payables	747,744	747,744	398,212	398,212
	₩ 950,945	₩ 950,945	₩ 645,769	₩ 645,769

¹ Equity instruments that do not have a quoted price in an active market are measured at cost because their fair value cannot be measured reliably and excluded from the fair value disclosures.

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(b) Financial Instruments Measured at Cost

Details of financial instruments measured at cost as of March 31, 2014 and December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2014		December 31, 2013	
Available-for-sale financial assets				
MASTERN REIT 2 Co., Ltd.	₩	10,000	₩	10,000
U&i Corp.		3,000		3,000
SJ BIOMED Inc.		1,000		1,000
Others		5,393		2,804
	₩	<u>19,393</u>	₩	<u>16,804</u>

MASTERN 2 REIT and others are unlisted equity instruments and measured at cost because their fair value cannot be measured reliably.

(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>	Level 1	Level 2	Level 3	Total
Recurring fair value measurements				
Available-for-sale financial assets	₩ 225,996	₩ 62,862	₩ -	₩ 288,858
Disclosed fair value				
Investment property	-	-	493,768	493,768

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 Group 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.

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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.

(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>	Fair Value	Level	Valuation Technique
Available-for-sale assets			
Real Estate Investment Trust	₩ 62,862	2	Market approach
Unlisted	-	3	(*1)
Investment property			
Investment property	493,768	3	Yield capitalization method and other method

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

5. Operating Segments

The Group's reportable segments and details are as follows:

Operating segment	Principal operation
Tobacco	Manufacturing and selling tobaccos
Ginseng	Manufacturing and selling red ginseng
Real estate	Selling and renting real estate
Others	Manufacturing and selling pharmaceuticals, cosmetics and others

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Segment information on revenue and profit from operations for the three-month periods ended March 31, 2014 and 2013, is as follows:

	2014						
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
(in millions of Korean won)							
Total segment sales	₩ 653,664	₩ 224,501	₩ 38,631	₩ 89,031	₩ 1,005,827	₩ (42,161)	₩ 963,666
Less: Inter-segment sales	21,158	12,089	1,225	7,689	42,161	(42,161)	-
External sales	₩ 632,506	₩ 212,412	₩ 37,406	₩ 81,342	₩ 963,666	₩ -	₩ 963,666
Profit from operations	210,222	35,627	10,340	3,309	259,498	646	260,144

	2013						
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
(in millions of Korean won)							
Total segment sales	₩ 617,504	₩ 218,987	₩ 18,678	₩ 85,295	₩ 940,464	₩ (44,427)	₩ 896,037
Less: Inter-segment sales	16,641	14,676	2,050	11,060	44,427	(44,427)	-
External sales	₩ 600,863	₩ 204,311	₩ 16,628	₩ 74,235	₩ 896,037	₩ -	₩ 896,037
Profit(loss) from operations	211,458	35,723	5,336	(3,951)	248,566	260	248,826

Segment information on assets and liabilities as of March 31, 2014 and December 31, 2013, is as follows:

	March 31, 2014						
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
(in millions of Korean won)							
Assets							
Segment assets	₩ 3,518,635	₩ 1,467,534	₩ 120,059	₩ 344,236	₩ 5,450,464	₩ (234,308)	₩ 5,216,156
Equity accounted investments	-	-	56,889	1,576	58,465	-	58,465
Assets held for sale	3	-	-	-	3	-	3
	₩ 3,518,638	₩ 1,467,534	₩ 176,948	₩ 345,812	₩ 5,508,932	₩ (234,308)	₩ 5,274,624
Unallocated assets							1,886,862
Total assets							<u>₩ 7,161,486</u>
Liabilities							
Segment liabilities	₩ 919,479	₩ 160,550	₩ -	₩ 63,445	₩ 1,143,474	₩ (154,953)	₩ 988,521
Unallocated liabilities							1,021,845
Total liabilities							<u>₩ 2,010,366</u>

	December 31, 2013						
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
(in millions of Korean won)							
Assets							
Segment assets	₩ 3,571,643	₩ 1,518,023	₩ 122,852	₩ 342,760	₩ 5,555,278	₩ (233,917)	₩ 5,321,361
Equity accounted investments	-	-	56,600	1,476	58,076	-	58,076
Assets held for sale	3	150	-	-	153	-	153
	₩ 3,571,646	₩ 1,518,173	₩ 179,452	₩ 344,236	₩ 5,613,507	₩ (233,917)	₩ 5,379,590
Unallocated assets							1,695,368
Total assets							<u>₩ 7,074,958</u>
Liabilities							
Segment liabilities	₩ 985,942	₩ 167,277	₩ -	₩ 63,414	₩ 1,216,633	₩ (154,259)	₩ 1,062,374
Unallocated liabilities							647,103
Total liabilities							<u>₩ 1,709,477</u>

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The major customers who contribute 10% or more of the Group's total revenues for the three-month periods ended March 31, 2014 and 2013, are as follows:

<i>(in millions of Korean won)</i>		2014		2013	
Segment	Major customer				
Tobacco	Alokozay International Limited	₩	100,743	₩	64,125

6. 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>		March 31, 2014			
		Loans and receivables	Assets classified as available-for-sale	Total	
Financial assets as available-for-sale, non-current	₩	-	₩ 305,651	₩	305,651
Other financial assets, non-current		1,755	-		1,755
Long-term deposits		238,028	-		238,028
Long-term trade and other receivables		108,463	-		108,463
Financial assets as available-for-sale, current		-	2,600		2,600
Other financial assets, current		568,876	-		568,876
Trade and other receivables		890,042	-		890,042
Cash and cash equivalents		624,998	-		624,998
	₩	<u>2,432,162</u>	₩ <u>308,251</u>	₩	<u>2,740,413</u>

<i>(in millions of Korean won)</i>		December 31, 2013			
		Loans and receivables	Assets classified as available-for-sale	Total	
Financial assets as available-for-sale, non-current	₩	-	₩ 296,601	₩	296,601
Other financial assets, non-current		1,740	-		1,740
Long-term deposits		219,760	-		219,760
Long-term trade and other receivables		108,898	-		108,898
Financial assets as available-for-sale, current		-	-		-
Other financial assets, current		684,132	-		684,132
Trade and other receivables		915,618	-		915,618
Cash and cash equivalents		347,933	-		347,933
	₩	<u>2,278,081</u>	₩ <u>296,601</u>	₩	<u>2,574,682</u>

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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 Borrowings	₩ 119,604	₩ -	₩ 119,604
Long-term trade and other payables	30,637	-	30,637
Short-term Borrowings	29,627	18,704	48,331
Current portion of long-term borrowings	4,629	-	4,629
Trade and other payables	747,744	-	747,744
	<u>₩ 932,241</u>	<u>₩ 18,704</u>	<u>₩ 950,945</u>

(in millions of Korean won)

	December 31, 2013		
	Other financial liabilities at amortized cost	Other financial liabilities	Total
Long-term Borrowings	₩ 117,639	₩ -	₩ 117,639
Long-term trade and other payables	29,254	-	29,254
Short-term Borrowings	75,748	20,492	96,240
Current portion of long-term borrowings	4,424	-	4,424
Trade and other payables	398,212	-	398,212
	<u>₩ 625,277</u>	<u>₩ 20,492</u>	<u>₩ 645,769</u>

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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	24	7
Dividend income	3,097	3,326
Impairment	-	(12,000)
Cash and cash equivalents		
Interest income	7,628	7,668
Gain on foreign currency translation	24	48
Gain on foreign currency transaction	211	183
Trade and other receivables		
Interest income	2,206	1,688
Gain on foreign currency translation	6,249	22,778
Gain on foreign currency transaction	952	3,172
Other financial liabilities at amortized cost		
Interest costs	(2,457)	(2,951)
Gain on foreign currency translation	1,399	2,397
Loss on foreign currency transaction	(333)	(1,288)
Financial assets at fair value through profit or loss		
Loss on transactions	(14)	-
Loss on valuation (profit or loss)	-	(10)
Other financial liabilities		
Interest costs	(224)	(234)

7. 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	₩ 296,601	₩ 264,884
Additions	2,600	-
Gain on valuation (before tax)	9,060	8,890
Net gains transfer from equity	-	2,787
Impairment	-	(12,000)
Disposal	(10)	-
Ending	308,251	264,561
Less: current portion	(2,600)	(1,000)
Non-current portion	₩ 305,651	₩ 263,561

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

<i>(in millions of Korean won)</i>	March 31, 2014		December 31, 2013	
Available-for-sale debt instruments:				
Government and municipal bonds	₩	161	₩	162
Corporate bonds		5,130		2,540
Total available-for-sale debt instruments		5,291		2,702
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		76,964		76,568
Total available-for-sale equity instruments		302,960		293,899
Total available-for-sale financial assets	₩	308,251	₩	296,601

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.

8. 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>	March 31, 2014		December 31, 2013	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 9,359	₩ 26,808	₩ 8,688	₩ 29,957
Loans	559	5,537	562	5,508
Other receivables	73,636	8,071	96,426	7,705
Guarantee deposits	-	68,047	-	65,728
Accrued income	4,044	-	4,276	-
Trade receivables	802,444	-	805,666	-
	<u>₩ 890,042</u>	<u>₩ 108,463</u>	<u>₩ 915,618</u>	<u>₩ 108,898</u>

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Trade and other receivables as of March 31, 2014 and December 31, 2013, reported in the consolidated 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	₩ 942,758	₩ 108,463	₩ 967,456	₩ 108,898
Allowance account				
Loans	(199)	-	(210)	-
Other receivables	(2,281)	-	(2,303)	-
Trade receivables	(50,236)	-	(49,325)	-
	(52,716)	-	(51,838)	-
Net amount	₩ 890,042	₩ 108,463	₩ 915,618	₩ 108,898

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	₩ 51,838	₩ 28,728
Impairment	979	374
Reversal of impairment	(12)	(1)
Write-off	(93)	(251)
Net exchange difference	4	-
Ending	₩ 52,716	₩ 28,850

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	₩ 436,164	₩ 510,821
Past due but not impaired		
Within 1 month	69,185	56,442
Between 1 and 2 months	61,267	26,073
Beyond 2 months	279,388	255,138
	409,840	337,653
Impaired	6,676	6,517
	₩ 852,680	₩ 854,991

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 Group 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	₩ 9,357	₩ 26,808	3.00~5.68	₩ 8,681	₩ 29,884
Loans	1.7~ 7.29	-	5,069	1.7~ 7.29	-	5,032
Other receivables	3.79	8,072	7,777	3.79	7,997	7,705
Guarantee deposits	1.7~ 8.47	-	65,264	1.7~ 8.47	-	62,845
		<u>₩17,429</u>	<u>₩ 104,918</u>		<u>₩ 16,678</u>	<u>₩ 105,466</u>

Transferred trade receivables

The Group discounted 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 and sales of red ginseng.

In case the customers default, the Group 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 ₩ 18,704 million and ₩ 20,492 million, respectively (Note 14 and 23).

9. 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 32 to the consolidated 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.

Investment income on long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2014 and 2013, is ₩ 298 million and ₩ 346 million, respectively.

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10. 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	₩ 528,757	₩ -	₩ 528,757
Buildings	870,615	(342,907)	527,708
Structures	65,495	(36,668)	28,827
Machinery	1,187,304	(848,245)	339,059
Vehicles	14,061	(10,668)	3,393
Tools	57,139	(49,322)	7,817
Furniture and fixture	227,363	(172,452)	54,911
Others	1,304	-	1,304
Construction-in-progress	121,547	-	121,547
	<u>₩ 3,073,585</u>	<u>₩ (1,460,262)</u>	<u>₩ 1,613,323</u>

(in millions of Korean won)	2013		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 523,324	₩ -	₩ 523,324
Buildings	858,896	(308,958)	549,938
Structures	64,093	(34,425)	29,668
Machinery	1,160,393	(785,867)	374,526
Vehicles	14,873	(10,940)	3,933
Tools	53,770	(45,220)	8,550
Furniture and fixture	233,365	(171,633)	61,732
Others	1,266	-	1,266
Construction-in-progress	71,919	-	71,919
	<u>₩ 2,981,899</u>	<u>₩ (1,357,043)</u>	<u>₩ 1,624,856</u>

(in millions of Korean won)	2014							
	Opening net book value	Additions	Disposal	Transfer	Depreciation	Exchange difference	Other changes ¹	Net book amount
Land	₩ 528,983	₩ -	₩ (24)	₩ 104	₩ -	₩ (316)	₩ 10	₩ 528,757
Buildings	535,055	130	-	3,126	(7,942)	(2,738)	77	527,708
Structures	29,299	119	-	348	(812)	(127)	-	28,827
Machinery	348,643	1,859	(316)	8,290	(18,714)	(703)	-	339,059
Vehicles	3,392	141	115	58	(296)	(17)	-	3,393
Tools	8,710	178	(86)	-	(978)	(7)	-	7,817
Furniture and fixture	60,254	2,471	(897)	280	(6,975)	(222)	-	54,911
Others	1,304	-	-	-	-	-	-	1,304
Construction-in-progress	106,649	27,064	-	(12,206)	-	40	-	121,547
	<u>₩1,622,289</u>	<u>₩ 31,962</u>	<u>₩ (1,208)</u>	<u>₩ -</u>	<u>₩ (35,717)</u>	<u>₩ (4,090)</u>	<u>₩ 87</u>	<u>₩1,613,323</u>

¹ 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	Transfer	Depreciation	Exchange difference	Other changes ¹	Net book amount
Land	₩ 518,056	₩ 59	₩ (147)	₩ 4,815	₩ -	₩ 108	₩ 433	₩ 523,324
Buildings	528,715	21,099	(6)	4,429	(8,909)	1,669	2,941	549,938
Structures	26,999	3,094	(1)	234	(805)	110	37	29,668
Machinery	372,565	6,951	(110)	15,846	(21,754)	1,028	-	374,526
Vehicles	2,950	173	(4)	-	(336)	1,150	-	3,933
Tools	8,856	742	(165)	58	(1,126)	185	-	8,550
Furniture and fixture	65,856	2,177	(155)	1,259	(7,406)	1	-	61,732
Others	1,266	-	-	-	-	-	-	1,266
Construction-in-progress	106,173	(8,213)	-	(26,641)	-	600	-	71,919
	<u>₩1,631,436</u>	<u>₩ 26,082</u>	<u>₩ (588)</u>	<u>₩ -</u>	<u>₩ (40,336)</u>	<u>₩ 4,851</u>	<u>₩ 3,411</u>	<u>₩1,624,856</u>

¹ Other changes represent the reclassified amount from investment property to property, plant equipment.

11. 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						Total
	Goodwill	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development		
At January 1, 2014	₩ 83,370	₩ 31,733	₩ 25,757	₩ 89,285	₩ 2,485	₩ 232,630	
Additions	-	56	104	50	197	407	
Disposals	-	(7)	(2)	(91)	-	(100)	
Transfer-in(out)	-	44	-	-	(44)	-	
Amortization	-	(676)	-	(2,560)	-	(3,236)	
Impairment	-	(19)	-	-	-	(19)	
Exchange differences	624	(212)	-	43	-	455	
Acquisition cost	83,994	46,176	26,881	116,738	4,978	278,767	
Accumulated depreciation and impairment cost	-	(15,257)	(1,022)	(30,011)	(2,340)	(48,630)	
Net book amount	<u>₩ 83,994</u>	<u>₩ 30,919</u>	<u>₩ 25,859</u>	<u>₩ 86,727</u>	<u>₩ 2,638</u>	<u>₩ 230,137</u>	

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(in millions of Korean won)	2013					Total
	Goodwill	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development	
At January 1, 2013	₩ 84,100	₩ 34,086	₩ 26,042	₩ 98,337	₩ 4,228	₩ 246,793
Additions	-	36	-	794	92	922
Disposals	-	-	(33)	-	(13)	(46)
Transfer-in(out)	-	215	-	-	(215)	-
Amortization	-	(740)	-	(2,459)	-	(3,199)
Exchange differences	1,897	(15)	-	83	(3)	1,962
Acquisition cost	85,997	45,535	26,041	116,883	4,490	278,946
Accumulated depreciation and impairment cost	-	(11,953)	(32)	(20,128)	(401)	(32,514)
Net book amount	₩ 85,997	₩ 33,582	₩ 26,009	₩ 96,755	₩ 4,089	₩ 246,432

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

(in millions of Korean won)	2014	2013
Cost of goods sold	₩ 486	₩ 613
Selling and administrative expenses	8,338	5,706
	₩ 8,824	₩ 6,319

Exchange gain of ₩ 624 million arising from the translation of goodwill of PT Trisakti Purwosari Makmur, one of subsidiaries, is accounted for as an addition from goodwill and gain on currency translation of foreign operations.

12. Investment Property

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

(in millions of Korean won)	2014		
	Land	Building	Total
Beginning net book value	₩ 48,303	₩ 125,672	₩ 173,975
Additions	-	77	77
Transfers to Property, Plant and Equipment	(10)	(77)	(87)
Depreciation	-	(1,541)	(1,541)
Acquisition cost	48,293	177,144	225,437
Accumulated depreciation and impairment cost	-	(53,013)	(53,013)
Net book amount	₩ 48,293	₩ 124,131	₩ 172,424

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(in millions of Korean won)

	2013		
	Land	Building	Total
Beginning net book value	₩ 48,177	₩ 133,809	₩ 181,986
Additions	559	863	1,422
Transfers to Property, Plant and Equipment	(433)	(2,978)	(3,411)
Depreciation	-	(1,538)	(1,538)
Acquisition cost	48,303	177,671	225,974
Accumulated depreciation and impairment cost	-	(47,515)	(47,515)
Net book amount	₩ 48,303	₩ 130,156	₩ 178,459

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

(in millions of Korean won)

	2014	2013
Rental income	₩ 8,728	₩ 8,726
Direct operating expense	(1,541)	(1,537)
	₩ 7,187	₩ 7,189

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

(in millions of Korean won)

	March 31, 2014		December 31, 2013	
	Fair value	Book value	Fair value	Book value
Land	₩ 308,294	₩ 48,293	₩ 309,207	₩ 48,303
Building	185,474	124,131	186,426	125,672
	₩ 493,768	₩ 172,424	₩ 495,633	₩ 173,975

13. Non-current Assets Held for Sale

The Group accounts for the smaller amount the fair value and book value of assets held for sale as Non-current Assets Held for sale. Changes in non-current assets held for sale for the three-month period ended March 31, 2014, are as follows:

(in millions of Korean won)

	2014		
	Land	Others	Total
At January 1, 2014			
Acquisition cost	₩ 3	₩ 150	₩ 153
Accumulated depreciation	-	-	-
Net book amount	₩ 3	₩ 150	₩ 153
Changes			
Disposals	₩ -	₩ (150)	₩ (150)
At March 31, 2014			
Acquisition cost	₩ 3	₩ -	₩ 3
Accumulated depreciation	-	-	-
Net book amount	₩ 3	₩ -	₩ 3

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14. Pledged Assets

The following assets are pledged as collaterals for the Group's borrowings and others as of March 31, 2014:

(in millions of Korean won)

Asset	Book amount	Reason	Borrowings	Collateralized amount	Lender /Leaseholder
Investment Property	₩ 73,680	Leasehold deposits received	₩ 9,294	₩ 9,397	Metlife Insurance Co., Ltd. and 28 others
		Short-term borrowings	9,500		
Property, plant and equipment /investment property	72,299	Current portion of long-term borrowings	4,571	59,984	Hana Bank and 2 others & Small & medium Business Coporation
		Long-term borrowings	3,097		
	1,069	ACH pledged	-	1,069	Bank of Oklahoma
Property, plant and equipment	29,324	Investment subsidy	-	660	Chung ju Si
	17,707	Long-term/ short-term borrowings	7,500	14,400	
		Purchasing fund	8,724	3,240	Hana Bank
Short-term financial instruments	600			660	
	700	Short-term borrowings	1,500	110	
Other financial assets	1,410	Performance bond	-	1,410	HAITAI BEVERAGE CO.,LTD. and LG HOUSEHOLD & HEALTH CARE LTD
Trade receivables	14,098	Short-term borrowings	14,098	14,098	Citibank Korea Inc. and 1 other financial institution
Total	₩ 210,887		₩ 58,284	₩ 105,028	

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The following assets were pledged as collateral for the Group's borrowings and others as of December 31, 2013:

(in millions of Korean won)

Asset	Book amount	Reason	Borrowings	Collateralized amount	Lender /Leaseholder
Investment Property	₩ 74,555	Leasehold deposits received	₩ 9,020	₩ 9,123	Metlife Insurance Co., Ltd. and 26 others
		Short-term borrowings	13,000		
Property, plant and equipment /investment property	72,326	Current portion of long-term borrowings	4,366	59,984	Hana Bank and 2 others & Small & medium Business Coporation
		Long-term borrowings	3,387		
	1,055	ACH pledged	-	1,055	Bank of Oklahoma
Property, plant and equipment	29,464	Investment subsidy	-	660	Chung ju Si
		Long-term/ short-term borrowings	7,500	14,400	
	17,771		6,914	3,240	
		Purchasing fund			Hana Bank
	600			660	
Short-term financial instruments	700	Short-term borrowings	1,500	110	
Trade receivables	20,492	Short-term borrowings	20,492	20,492	Citibank Korea Inc. and 2 others
Total	₩ 216,963		₩ 66,179	₩ 109,724	

15. Investments in Associates

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

(in millions of Korean won)

Associates	Location	Principal operation	March 31, 2014		December 31, 2013	
			Interest (%)	Carrying Amount	Interest (%)	Carrying Amount
Lite Pharm Tech, Inc	Korea	Manufacturing Medical supplies	25.34	₩ 1,576	25.34	₩ 1,476
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	13,062	49.02	12,953
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	6,833	29.67	7,047
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	6,842	22.06	6,745
JR REIT V Co., Ltd.	Korea	Selling and renting of real estate	34.63	5,698	34.63	5,573
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	10,087	21.74	9,948
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	9,367	28.78	9,334
JR REIT XV Co., Ltd.	Korea	Selling and renting of real estate	27.03	5,000	27.03	5,000
Total				₩ 58,465		₩ 58,076

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

(in millions of Korean won)	2014				
	Beginning balance	Acquisition	Share of profit(loss)	Other changes	Ending balance
Associates					
Lite Pharm Tech, Inc	₩ 1,476	₩ -	₩ 100	₩ -	₩ 1,576
JR CR-REIT IV Co., Ltd.	12,953	-	109	-	13,062
KVG REIT 1 Co., Ltd.	7,047	-	132	(346)	6,833
KOCREF REIT 17 Co., Ltd.	6,745	-	97	-	6,842
JR REIT V Co., Ltd.	5,573	-	125	-	5,698
JR REIT VIII Co., Ltd.	9,948	-	139	-	10,087
JR REIT X Co., Ltd.	9,334	-	33	-	9,367
JR REIT XV Co., Ltd.	5,000	-	-	-	5,000
	<u>₩ 58,076</u>	<u>₩ -</u>	<u>₩ 735</u>	<u>₩ (346)</u>	<u>₩ 58,465</u>

(in millions of Korean won)	2013				
	Beginning balance	Acquisition	Share of profit(loss)	Other changes	Ending balance
Associates					
Lite Pharm Tech, Inc	₩ 857	₩ -	₩ (104)	₩ -	₩ 753
Korean Carbon Finance, Inc.	932	-	(149)	-	783
JR CR-REIT IV Co., Ltd.	13,570	-	126	-	13,696
KVG REIT 1 Co., Ltd.	7,160	-	89	(265)	6,984
KOCREF REIT 17 Co., Ltd.	6,827	-	54	-	6,881
JR REIT V Co., Ltd.	5,581	-	88	-	5,669
JR REIT VIII Co., Ltd.	10,008	-	56	-	10,064
LSK Global Pharma Services Co., Ltd.	1,343	-	(729)	-	614
JR REIT X Co., Ltd.	9,500	-	(13)	-	9,487
	<u>₩ 55,778</u>	<u>₩ -</u>	<u>₩ (582)</u>	<u>₩ (265)</u>	<u>₩ 54,931</u>

Summary of the associates' financial information as of March 31, 2014 and December 31, 2013, is as follows:

(in millions of Korean won)	March 31, 2014			
	Assets	Liabilities	Revenues	Profit/(loss)
Lite Pharm Tech, Inc.	₩ 7,060	₩ 842	₩ 2,464	₩ 756
JR CR-REIT IV Co., Ltd.	63,173	34,656	889	223
KVG REIT 1 Co., Ltd.	51,089	28,064	1,446	420
KOCREF REIT 17 Co., Ltd.	66,984	35,971	1,272	442
JR REIT V Co., Ltd.	31,641	15,187	589	361
JR REIT VIII Co., Ltd.	109,612	63,321	1,892	533
LSK Global Pharma Services Co., Ltd.	2,226	4,983	2,409	(180)
JR REIT X Co., Ltd.	88,706	56,179	1,021	36

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<i>(in millions of Korean won)</i>	December 31, 2013			
	Assets	Liabilities	Revenues	Profit/(loss)
Lite Pharm Tech, Inc.	₩ 6,581	₩ 756	₩ 8,969	₩ 3,208
JR CR-REIT IV Co., Ltd.	62,917	34,622	3,449	957
KVG REIT 1 Co., Ltd.	51,770	28,021	5,680	1,453
KOCREF REIT 17 Co., Ltd.	66,527	35,956	5,776	1,685
JR REIT V Co., Ltd.	31,253	15,160	2,319	1,235
JR REIT VIII Co., Ltd.	108,936	63,286	6,547	2,255
LSK Global Pharma Services Co., Ltd.	2,815	4,694	10,006	(710)
JR REIT X Co., Ltd.	88,590	56,179	2,001	916

16. Inventories

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

<i>(in millions of Korean won)</i>	March 31, 2014			December 31, 2013		
	Acquisition cost	Allowance	Book amount	Acquisition cost	Allowance	Book amount
Merchandise	₩ 13,038	₩ (448)	₩ 12,590	₩ 10,585	₩ (354)	₩ 10,231
Finished goods	466,786	(2,276)	464,510	427,403	(3,402)	424,001
Work in progress	426,186	(72)	426,114	529,683	(151)	529,532
Raw materials	813,095	(1,321)	811,774	809,545	(1,331)	808,214
Supplies	26,716	-	26,716	26,901	-	26,901
By-products	8,731	-	8,731	7,793	-	7,793
Unfinished housing	823	-	823	840	-	840
Lots	5,207	-	5,207	6,432	-	6,432
Goods-in-transit	57,917	-	57,917	79,909	-	79,909
	<u>₩ 1,818,499</u>	<u>₩ (4,117)</u>	<u>₩ 1,814,382</u>	<u>₩ 1,899,091</u>	<u>₩ (5,238)</u>	<u>₩ 1,893,853</u>

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

<i>(in millions of Korean won)</i>	2014	2013
Cost of sales		
Loss(profit) on inventory valuation (Reversal)	₩ (1,056)	₩ 561
Loss on retirement of inventories	1,543	696
Other expenses		
Loss on retirement of inventories	120	248
	<u>₩ 607</u>	<u>₩ 1,505</u>

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17. Cash and Cash Equivalents

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

<i>(in millions of Korean won)</i>	March 31, 2014	December 31, 2013
Cash on hand	₩ 11,479	₩ 5,107
Demand deposits	171,677	174,700
Short-term investment assets	441,842	168,126
	<u>₩ 624,998</u>	<u>₩ 347,933</u>

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

<i>(in millions of Korean won)</i>	March 31, 2014	December 31, 2013
Long-term financial assets		
Time deposits	₩ 1,553	₩ 1,553
Deposit in current account	12	12
Money trust	190	175
	<u>₩ 1,755</u>	<u>₩ 1,740</u>
Short-term Financial assets		
Time deposits	₩ 52,807	₩ 38,077
Money trust	485,000	625,000
Certificate of deposit	31,069	21,055
	<u>568,876</u>	<u>684,132</u>
	<u>₩ 570,631</u>	<u>₩ 685,872</u>

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

<i>(in millions of Korean won)</i>	Description	March 31, 2014	December 31, 2013
Cash and cash equivalents	Specific research purpose and others	₩ 189	₩ 703
Other financial assets	Pledge for borrowings	3,179	1,755
Long-term other financial assets	Deposits	12	12
Long-term other financial assets	Pledge	-	1,410
		<u>₩ 3,380</u>	<u>₩ 3,880</u>

18. 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>	March 31, 2014	December 31, 2013
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 Parent Company has reacquired and retired 53,699,400 shares of treasury shares. Accordingly, as of March 31, 2014, the Parent Company's ordinary shares differ from the

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aggregate par value of issued shares by ₩ 268,497 million.

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

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

19. Treasury Shares

There is no change in the treasury shares of the Group 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>	2014		2013	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Issuance of Treasury shares	11,393,697	₩ 339,059	11,393,697	₩ 339,059

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

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

20. Reserves

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

<i>(in millions of Korean won)</i>	March 31, 2014	December 31, 2013
Available-for-sale financial assets reserve	₩ 1,297	₩ (5,570)
Exchange differences on translating foreign operations	(49,528)	(42,472)
Legal reserve	603,145	603,145
Voluntary reserve	2,918,254	2,813,732
	<u>₩ 3,473,168</u>	<u>₩ 3,368,835</u>

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

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<i>(in millions of Korean won)</i>	March 31, 2014	December 31, 2013
Available-for-sale financial assets reserve before tax	₩ 1,711	₩ (7,348)
Tax effect	(414)	1,778
Available-for-sale financial assets reserve after tax	₩ 1,297	₩ (5,570)

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>	March 31, 2014	December 31, 2013
Reserve for business rationalization ¹	₩ 12,851	₩ 12,851
Reserve for research and human resource development ²	42,522	90,000
Reserve for business expansion ³	698,881	698,881
Other reserve ³	2,164,000	2,012,000
	₩ 2,918,254	₩ 2,813,732

Reserve for Business Rationalization

Until December 10, 2002, under the Special Tax Treatment Control Law, investment tax credits were allowed for certain investments. The Group 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 Group was no longer required to establish a reserve for business rationalization despite tax benefits received for certain investments and, consequently, the existing balance is now regarded as a voluntary reserve.

Reserve for 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.

Reserve for Business Expansion and other reserve

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

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21. 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>	2014		2013	
Beginning	₩	802,755	₩	976,425
Bring from reserve for research and human resource development		47,478		-
Accumulation of other reserve		(152,000)		(317,000)
Legal reserves		-		(208)
Transfer from reserve for research and human resource development		-		(30,000)
Dividends		(402,876)		(402,876)
Profit for the period		188,192		559,304
Less: non-controlling interests		3,865		11,363
Remeasurements of the net defined benefit liability (after tax)		(499)		5,604
Less: non-controlling interests		4		143
Ending	₩	<u>486,919</u>	₩	<u>802,755</u>

22. 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>	March 31, 2014		December 31, 2013	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	₩ 26,401	₩ -	₩ 25,480
Accounts payable	84,833	-	83,073	-
Withholdings	138,555	321	144,696	343
Accrued expenses	126,873	-	169,971	-
Other payables	133,162	4,236	145,168	3,774
Dividends payable	402,876	-	-	-
	<u>₩ 886,299</u>	<u>₩ 30,958</u>	<u>₩ 542,908</u>	<u>₩ 29,597</u>

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23. Borrowings

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

(in millions of Korean won)

	March 31, 2014		December 31, 2013	
Current				
Bank borrowings ¹	₩	48,331	₩	88,593
Other borrowings		-		7,647
Bank borrowings (Current portion of long-term borrowings)		4,540		4,305
Other borrowings (Current portion of long-term borrowings)		89		119
	₩	52,960	₩	100,664
Non-current				
Bank borrowings	₩	19,989	₩	20,279
Convertible bonds		9,315		8,546
Convertible redeemable preference shares		73,327		72,056
Redeemable preference shares		16,973		16,758
		119,604		117,639
	₩	172,564	₩	218,303

¹ Out of the above borrowings, ₩18,704 million and ₩20,492million as of March 31, 2014 and December 31, 2013, respectively, are related to trade receivable factoring contract. In case the customers default, the Company has an obligation to pay the related amounts to the bank. As a result, this transaction, treated as a transaction with recourse, has been accounted for as a collateralized borrowing (Note 8). In addition, bank borrowings are collateralized with the Group's property, plant and equipment (Note 14).

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

(in millions of Korean won)

Currency	Creditor	Latest maturity date	Annual interest rate(%) March 31, 2014	March 31, 2014	December 31, 2013
Korean won	National Agricultural Cooperative Federation, Korea Exchange Bank, Shinhan Bank and Korea Development Bank	Short-term Borrowings	4.87	₩ 10,161	₩ 46,720
Korean won	Citibank	Short-term Borrowings	CD(91)+1.15	14,043	15,572
Korean won	Hana Bank	Short-term Borrowings	3.4~4.56	24,127	26,300
Korean won	National Agricultural Cooperative Federation	2016.07.20	1.50	720	720
Korean won	National Agricultural Cooperative Federation	2017.06.22	1.50	1,257	1,257
Korean won	National Agricultural Cooperative Federation	2018.07.02	1.50	10,002	10,002
Korean won	Hana Bank	2017.03.31	3.19	688	744
Korean won	Korea Development Bank	2014.11.07	4.33	4,000	4,000
Korean won	Korea Development Bank	2018.06.09	3.69	262	262
Korean won	Hana Bank	2017.09.06	4.58	2,600	2,600
Korean won	Hana Bank	2016.05.15	4.15	5,000	5,000
				₩ 72,860	₩ 113,177

Convertible Bond

The Group issued 9.5% convertible bonds at a par value of ₩12,410 million on December 14, 2011. The bonds will mature four years from the issue date and become convertible into shares at the rate of ₩1,199 per share.

The fair value of the liability component, included in non-current borrowings, was calculated using the market interest rate for an equivalent non-convertible bond. The residual amount, representing the value of the equity conversion option, is included in shareholders' equity in other reserves, net of income taxes.

Convertible Redeemable Preference Shares

The Group issued convertible redeemable preference shares at ₩18,000 million on November 19, 2011. The convertible instrument will mature ten years from the issue date. The instrument can be converted into 1,090,909 ordinary shares at any time, and automatically converts upon maturity. If KT&G Life Sciences will be not listed by the end of 2015, recourse is available.

The Group issued convertible redeemable preferred shares at ₩26,000 million on January 9, 2012.

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The convertible instrument will mature five years from the issue date. The instrument can be converted into 94,079 ordinary shares at any time before maturity, and automatically converts upon maturity. If Somang Cosmetics Co., Ltd. will be not listed by the end of 2016, recourse is available.

The Group issued convertible redeemable preferred shares at ₩ 35,216 million on September 14, 2012. The convertible instrument will mature ten years from the date of establishment of QCP 2011 Corporate Partnership Private Equity Fund. The instrument can be converted into 6,978,948 ordinary shares at any time after five years from its issuance. If this SPC will not be liquidated and apportioned in ten years, recourse is available.

Redeemable Preference Shares

The Group issued redeemable preference shares at ₩ 17,761 million during 2012. Recourse will be available ten years from the date of establishment of QCP 2011 Corporate Partnership Private Equity Fund. If this SPC will not be liquidated and apportioned in ten years, recourse is available.

24. 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>	2014	2013
Defined benefit plans :		
Current service cost	₩ 10,614	₩ 10,714
Interest cost	2,823	2,303
Expected return on plan assets	(1,838)	(1,439)
Past service cost and gains and loss on settlement	463	-
	<u>12,062</u>	<u>11,578</u>
Defined contribution plans :		
Contributions recognized as current expense	804	707
Total	<u>₩ 12,866</u>	<u>₩ 12,285</u>

Termination benefits for the three-month period ended March 31, 2014, were ₩ 269 million. Out of total expenses, ₩ 4,327 million (2013: ₩ 8,773 million) and ₩8,539 million (2013: ₩ 8,296 million) were 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:

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<i>(In millions of Korean won)</i>	March 31, 2014	December 31, 2013
Present value of funded defined benefit liability	₩ 297,143	₩ 291,246
Present value of unfunded defined benefit liability	24,715	24,347
Fair value of plan assets	(198,932)	(204,456)
Liability in the statement of financial position	₩ 122,926	₩ 111,137

Plan assets as of March 31, 2014, include amounts from the previous pension plan which consist of retirement insurance of ₩ 2,129 million and contributions to the National Pension Fund of ₩ 181 million.

25. 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	₩ 125,830	₩ 121,169
Retirement benefits	12,866	12,285
Termination benefits	269	490
Employee welfare	13,843	13,765
	₩ 152,808	₩ 147,709

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	₩ 83,200	₩ 79,576
Retirement and termination benefits	8,711	8,624
Employee welfare	9,623	9,498
Travel	2,461	2,373
Communications	1,418	1,381
Utilities	2,839	3,045
Taxes and dues	4,050	5,290
Supplies	812	835
Rent	6,833	6,648
Depreciation	11,301	11,829
Amortization	3,236	3,199
Repairs and maintenance	771	727
Vehicles	2,433	2,789
Insurance	410	453
Commissions	52,099	49,585
Freight and custody	11,386	10,634

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Conferences	962	1,073
Advertising	55,400	64,842
Training	1,325	1,390
Prizes and rewards	557	416
Cooperation	180	198
Normal research and development	8,338	5,705
Bad debts expense	979	357
	<u>₩ 269,324</u>	<u>₩ 270,467</u>

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>	2014	2013
Foreign currency transaction gain	₩ 2,962	₩ 4,961
Foreign currency translation gain	16,104	29,057
Reversal of allowance for doubtful accounts	12	-
Gain on disposal of property, plant and equipment	943	5,593
Gain on disposal of intangible assets	54	-
Miscellaneous revenues	3,207	5,596
	<u>₩ 23,282</u>	<u>₩ 45,207</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>	2014	2013
Foreign currency transaction loss	₩ 2,132	₩ 2,894
Foreign currency translation loss	8,432	3,834
Other bad debt expenses	-	17
Donations	6,291	423
Loss on disposal of property, plant and equipment	1,020	157
Loss on disposal of intangible assets	17	-
Impairment loss on intangible assets	19	-
Miscellaneous expenses	7,172	3,169
	<u>₩ 25,083</u>	<u>₩ 10,494</u>

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26. 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>	2014	2013
Changes in inventories	₩ 79,471	₩ 5,292
Raw materials and consumables purchased	238,502	266,415
Salary and wage	125,830	121,659
Retirement and termination benefits	12,866	12,285
Depreciation charges	37,258	41,874
Amortization charges	3,236	3,199
Employee benefits	13,843	13,765
Advertising costs	55,425	64,858
Service fees	60,559	56,025
Other expenses	76,532	61,839
Total cost of sales and administrative expenses ¹	₩ 703,522	₩ 647,211

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

27. 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>	2014	2013
Finance costs		
Interest costs	₩ (2,681)	₩ (3,185)
Impairment loss of available-for-sale financial assets	-	(12,000)
Loss on valuation of derivative instruments	(14)	(10)
	₩ (2,695)	₩ (15,195)
Financial income		
Interest income	₩ 9,858	₩ 9,363
Dividend income	3,096	3,326
Investment income on long-term deposits in MSA Escrow Fund	298	346
	13,252	13,035
Net finance income	₩ 10,557	₩ (2,160)

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>	2014	2013
Borrowings	₩ (1,084)	₩ (1,405)
Trade and other payables	(1,011)	(1,457)
Others	(586)	(323)
	₩ (2,681)	₩ (3,185)

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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>	2014	2013
Deposits	₩ 7,628	₩ 7,668
Available-for-sale financial assets	24	7
Trade and other receivables	2,206	1,688
	<u>₩ 9,858</u>	<u>₩ 9,363</u>

28. 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 30.2%. (The estimated tax rate for the three-month period ended March 31, 2013, was 29.4%).

29. 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).

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

	2014	2013
<i>(in Korean won, except number of shares)</i>		
Profit for the period	₩ 192,057 million	₩ 203,099 million
Weighted-average number of ordinary shares outstanding	125,898,800	125,898,800
Basic and diluted earnings per share (in won)	<u>₩ 1,525</u>	<u>₩ 1,613</u>

30. 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.

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31. 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>	2014		2013	
Profit	₩	188,192	₩	198,349
Adjustments for				
Income tax expense		81,445		82,448
Finance costs		2,695		15,195
Finance income		(13,252)		(13,035)
Depreciation		37,258		41,874
Amortization		3,236		3,199
Retirement and termination benefits		12,053		11,578
Foreign currency translations loss		8,432		3,834
Loss(gain) on valuation of inventories (Reversal)		(1,056)		561
Bad debt expenses on trade and other receivables		979		374
Loss on sale of property, plant and equipment		1,020		157
Loss on sale of intangible assets		17		-
Impairment loss on intangible assets		19		-
Other expenses		1,787		4,342
Share of gain of associates		(736)		(411)
Share of loss of associates		-		993
Foreign currency translations gain		(16,104)		(29,057)
Gain on sale of property, plant and equipment		(943)		(5,593)
Gain on sale of intangible assets		(54)		-
Reversal of allowance for doubtful accounts		(12)		-
		<u>304,976</u>		<u>314,808</u>
Changes in working capital:				
Decrease(increase) in trade and other receivables		54,788		(21,035)
Increase in advance payments		(23,848)		(46,698)
Increase in prepaid expenses		(3,748)		(5,597)
Decrease(increase) in prepaid tobacco excise and other taxes		25,568		(69,857)
Decrease(increase) in inventories		77,561		(2,555)
Increase(decrease) in trade and other payables		(84,320)		28,038
Increase(decrease) in advance receipts		(5,354)		15,725
Increase(decrease) in tobacco excise and other taxes payable		(20,710)		281,500
Payment of retirement benefits		(1,644)		(1,561)
Cash generated from operations	₩	<u>323,269</u>	₩	<u>492,768</u>

Non-cash transactions

<i>(in millions of Korean won)</i>	2014	
Reclassification of retained earnings to dividends payable	₩	402,876

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32. Contingencies and Commitments

Each year, the Group 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 Group 25 years from the date of each annual funding. The Group 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 Group is involved in a lawsuit as a plaintiff claiming damages in relation to the development of Yongsan area with other companies. The aggregate litigation amount for this case amounts to ₩ 240,000 million, and the litigation amount of the Group is ₩ 5,136 million. Additionally, as of March 31, 2014, the Group is involved in four lawsuits as a plaintiff for alleged damages totaling ₩ 5,989 million.

As of March 31, 2014, tobacco lawsuits claiming damages of ₩ 584 million are filed against the Group 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 Group is involved in 16 lawsuits as a defendant for alleged damages totaling ₩ 4,131 million.

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

As of March 31, 2014, the Group has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 61,500 thousand.

As of March 31, 2014, the Group'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 Group 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 Group 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 Group 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 of certificate stamp of tobacco of Trisakti Purwosari, as of March 31, 2014.

The Group has maintained a contract with the farmers who grow six-year old green ginseng for purchase volume guarantees and recorded contractual amounts paid to the farmers as advance payments in the amount of ₩ 221,752 million (non-current: ₩ 138,642 million (December 31, 2013:

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₩ 138,699 million) ; current: ₩ 83,110 million (December 31, 2013: ₩ 42,998 million) as of March 31, 2014.

As of March 31, 2014, the Group has an accounts receivable loan agreement with a limit of ₩ 64,055 million with Hana Bank and other financial institutions.

As of March 31, 2014, the Group has a trade bill loan agreement with a limit of ₩ 10,000 million with Korea Exchange Bank and other financial institutions.

As of March 31, 2014, the Group has a loan agreement with a limit of ₩ 185,765 million with Shinhan Bank and other financial institutions.

As of March 31, 2014, the Group has provided two blank notes, 13 notes amounting to ₩ 14,200 million and five blank checks to Resolution and Finance Corporation and others as collateral for its borrowings and trade agreements. As of March 31, 2014, the Group lost one blank note, one blank check and five notes amounting to ₩ 4,300 million, and expects to proceed a judgment of nullification.

As of March 31, 2014, the Group 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 Group paid the maximum amount ₩ 5,136 million on July 31, 2013 and recognized the amount as prior period expenses.

On March 17, 2011, the Group 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 Group 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.

Relative to the acquisition of Somang Cosmetics Co., Ltd., the Parent 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 Parent Company shall be required to purchase 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 the Individual Shareholder, Somang Cosmetics Co., Ltd. is not able to undertake the necessary procedures for listing, due to the Parent Company's objection, within three years after the Parent Company acquires Somang Cosmetics Co., Ltd.

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2) Right of first refusal held by the Parent 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 Parent Company.

3) Tag-along right held by Individual Shareholder

In the event that the Parent 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 Parent Company.

In relation to the acquisition of Mazence, Inc., the Parent 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

The Individual shareholder shall not be permitted to dispose of its shares, in whole or in part, within one year after Mazence, Inc. is listed.

2) Right of first refusal held by the Parent 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 Parent Company.

3) Tag-along right held by the Individual Shareholder

In the event that the Parent 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 Parent 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 Parent Company is insured against non-payment to customs duty up to ₩ 5,000 million by tax bond insurance with the Seoul Guarantee Insurance, and the Group is insured by performance bond insurance up to ₩ 2,168 million with the Seoul Guarantee Insurance.

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The Group sold its property, plant and equipment and intangible assets relating to the drink business of Iksan factory to HAITAI Beverage Co., Ltd. and LG Household & Health Care Ltd., as approved by the Board of Directors on October 16, 2013. In connection, the Group entered into an agreement to refrain from engaging in a business such as beverage manufacture or pharmacy distribution, that could result in a competition with the buyer for three years from the transaction date.

33. Related Party Transactions

The Group has no significant transactions and receivables, liabilities with related parties, for the three-month period ended March 31, 2014.

There is no guarantee being provided by related parties as of March 31, 2014

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

<i>(in millions of Korean won)</i>	2014		2013	
Short-term employee benefits	₩	5,373	₩	6,917
Retirement benefits		1,024		639
	₩	<u>6,397</u>	₩	<u>7,556</u>

34. 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.