

# **KT&G Corporation and Subsidiaries**

**Consolidated Financial Statements**

**December 31, 2013 and 2012**

**KT&G Corporation and Subsidiaries**  
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**December 31, 2013 and 2012**

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## **Report of Independent Auditors**

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

We have audited the accompanying consolidated statements of financial position of KT&G Corporation and its subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, expressed in Korean won. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Republic of Korea. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements, referred to above, present fairly, in all material respects, the financial position of KT&G Corporation and its subsidiaries as of December 31, 2013 and 2012, and their financial performance and cash flows for the years then ended, in accordance with International Financial Reporting Standards as adopted by the Republic of Korea ("Korean IFRS").

The accompanying consolidated financial statements as of and for the year ended December 31, 2013, 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 consolidated financial statements.

Auditing standards and their application in practice vary among countries. The procedures and practices used in the Republic of Korea to audit 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 auditing standards and their application in practice.

Seoul, Korea  
February 12, 2014

*Samil pricewaterhouse Coopers*

This report is effective as of February 12, 2014, the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying consolidated financial statements and notes thereto. Accordingly, the readers of the audit report should understand that there is a possibility that the above audit report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

**KT&G Corporation and Subsidiaries**  
**Consolidated Statements of Financial Position**  
**December 31, 2013 and 2012**

(in millions of Korean won  
and thousands of U.S. dollars)

	Notes	December 31, 2013 Korean won	December 31, 2013 U.S. dollars (Note 34)	December 31, 2012 Korean won
<b>Assets</b>				
<b>Non-current assets</b>				
Property, plant and equipment	10,14	₩ 1,622,289	\$ 1,537,277	₩ 1,631,436
Intangible assets	11	232,630	220,440	246,793
Investment property	12,14	173,975	164,858	181,986
Investments in associates	5,15	58,076	55,032	55,777
Available-for-sale financial assets	6,7	296,601	281,058	263,884
Other financial assets	6,17	1,740	1,648	275
Long-term deposits in MSA Escrow Fund	6,9,32	219,760	208,245	168,667
Long-term advance payments	32	140,692	133,320	144,649
Long-term prepaid expenses		5,966	5,653	5,416
Long-term trade and other receivables	6,8	108,898	103,192	121,784
Deferred income tax assets	28	25,731	24,383	17,491
		<u>2,886,358</u>	<u>2,735,106</u>	<u>2,838,158</u>
<b>Current assets</b>				
Inventories	16	1,893,853	1,794,611	1,706,796
Available-for-sale financial assets	6,7	-	-	1,000
Other financial assets	6,17	684,132	648,281	649,186
Prepaid tobacco excise and other taxes		262,770	249,000	257,183
Trade and other receivables	6,8	915,618	867,638	883,778
Advance payments	32	65,007	61,600	66,315
Prepaid expenses		19,134	18,132	20,523
Cash and cash equivalents	6,17	347,933	329,701	372,260
		<u>4,188,447</u>	<u>3,968,963</u>	<u>3,957,041</u>
<b>Assets held for sale</b>	5,13	<u>153</u>	<u>145</u>	<u>762</u>
<b>Total assets</b>		<u>₩ 7,074,958</u>	<u>\$ 6,704,214</u>	<u>₩ 6,795,961</u>
<b>Equity</b>				
Capital stock	1,18	₩ 954,959	\$ 904,918	₩ 954,959
Other capital surplus	18	(4,573)	(4,333)	-4,573
Treasury shares	19	(339,059)	(321,291)	(339,059)
Gain on reissuance of treasury shares	19	492,032	466,249	492,032
Reserve	20	3,368,835	3,192,299	3,011,110
Retained earnings	21	802,755	760,690	976,425
<b>Equity attributable to equity holders of the Company</b>		<u>5,274,949</u>	<u>4,998,532</u>	<u>5,090,894</u>
<b>Non-controlling interests</b>		<u>90,531</u>	<u>85,787</u>	<u>103,524</u>
<b>Total equity</b>		<u>5,365,480</u>	<u>5,084,319</u>	<u>5,194,418</u>
<b>Liabilities</b>				
<b>Non-current liabilities</b>				
Long-term borrowings	6,23	117,639	111,475	109,599
Long-term trade and other payables	6,22	29,597	28,046	25,407
Long-term advance receipts		18,836	17,849	20,239
Defined benefit liability	24	111,137	105,313	107,644
Provisions for other liabilities and charges		2,981	2,824	3,329
Deferred income tax liabilities	28	247,043	234,098	237,605
		<u>527,233</u>	<u>499,605</u>	<u>503,823</u>
<b>Current liabilities</b>				
Borrowings	6,23	96,240	91,196	91,868
Current portion of long-term borrowings	6,23	4,424	4,192	2,912
Trade and other payables	6,22	542,908	514,458	410,216
Advance receipts		28,079	26,607	30,875
Income taxes payable	28	156,277	148,087	148,925
Tobacco excise and other taxes payable		354,317	335,750	412,924
		<u>1,182,245</u>	<u>1,120,290</u>	<u>1,097,720</u>
<b>Total liabilities</b>		<u>1,709,478</u>	<u>1,619,895</u>	<u>1,601,543</u>
<b>Total liabilities and equity</b>		<u>₩ 7,074,958</u>	<u>\$ 6,704,214</u>	<u>₩ 6,795,961</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**  
**Consolidated Statements of Comprehensive Income**  
**Years Ended December 31, 2013 and 2012**

	Notes	2013 Korean won	2013 U.S. dollars (Note 34)	2012 Korean won
(in millions of Korean won and thousands of U.S. dollars, except per share amounts)				
Sales		₩ 3,821,696	\$ 3,621,431	₩ 3,984,662
Cost of sales	26	(1,688,644)	(1,600,155)	(1,740,809)
Gross profit		2,133,052	2,021,276	2,243,853
Selling and administrative expenses	25,26	(1,119,703)	(1,061,028)	(1,207,922)
Operating income		1,013,349	960,248	1,035,931
Other income	25	71,238	67,505	75,101
Other expenses	25	(219,906)	(208,382)	(123,103)
Net other income(expenses)		(148,668)	(140,877)	(48,002)
Finance income	27	42,468	40,243	43,000
Finance expense	27	(26,792)	(25,388)	(10,503)
Net Finance income		15,676	14,855	32,497
Income from jointly controlled entities and associates	15	3,225	3,054	2,222
Expense from jointly controlled entities and associates	15	(1,662)	(1,574)	(239)
Profit before income tax		881,920	835,706	1,022,409
Income tax expense	28	(322,616)	(305,710)	(297,291)
Profit for the year		₩ 559,304	\$ 529,996	₩ 725,118
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	₩ 5,604	₩ 5,310	₩ (18,579)
Items that will be reclassified subsequently to profit or loss:				
Change in value of available-for-sale financial assets	7	25,065	23,751	1,220
Loss on currency translation of foreign operations		(17,892)	(16,955)	(12,422)
Other comprehensive income				
Other comprehensive income (loss) for the year, net of tax		12,777	12,106	(29,781)
Total comprehensive income for the year		₩ 572,081	\$ 542,102	₩ 695,337
Profit for the year attributable to:				
Equity holders of the Parent Company		₩ 570,667	\$ 540,763	₩ 738,037
Non-controlling interests		(11,362)	(10,768)	(12,919)
		₩ 559,305	\$ 529,995	₩ 725,118
Total comprehensive income for the year attributable to:				
Equity holders of the Parent Company		₩ 586,934	\$ 556,175	₩ 708,412
Non-controlling interests		(14,852)	(14,074)	(13,075)
		₩ 572,082	\$ 542,101	₩ 695,337
Earnings per share attributable to the equity holders of the Parent Company during the year (in won)				
Basic and diluted earnings per share	29	₩ 4,533	\$ 4.30	₩ 5,869

The accompanying notes are an integral part of these interim consolidated financial statements.  
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**KT&G Corporation and Subsidiaries**  
**Consolidated Statements of Changes in Equity**  
**Years Ended December 31, 2013 and 2012**

Notes	Attributable to equity holders of the Parent Company							Non-controlling Interests	Total Equity
	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total		
	₩	₩	₩	₩	₩	₩	₩	₩	₩
Balance at January 1, 2012	954,959	5,333	(343,522)	485,922	2,663,313	1,022,126	4,788,131	96,946	4,885,077
Comprehensive income									
Profit for the year	-	-	-	-	-	738,037	738,037	(12,919)	725,118
Change in value of available-for-sale financial assets	-	-	-	-	1,220	-	1,220	-	1,220
Loss on currency translation of foreign operations	-	-	-	-	(12,423)	-	(12,423)	-	(12,423)
Remeasurements of the net defined benefit liability	-	-	-	-	-	(18,423)	(18,423)	(156)	(18,579)
Total comprehensive income (loss)	-	-	-	-	(11,203)	719,614	708,411	(13,075)	695,336
Transactions with equity holders of the Company									
Cash dividends	-	-	-	-	-	(402,396)	(402,396)	-	(402,396)
Other reserve	-	-	-	-	359,000	(359,000)	-	-	-
Disposition of treasury shares	-	-	4,463	6,110	-	-	10,573	-	10,573
Convertible bond — equity component	-	-	-	-	-	-	-	5,390	5,390
Changes in investments in subsidiaries	-	(9,906)	-	-	-	-	(9,906)	9,894	(72)
Others	-	-	-	-	-	(3,918)	-	4,428	510
Total transactions with equity holders of the Company	-	(9,906)	4,463	6,110	359,000	(765,314)	(401,729)	19,652	(385,895)
Balance at December 31, 2012	954,959	(4,573)	(339,059)	492,032	3,011,110	976,426	5,094,813	103,523	5,194,418
Balance at January 1, 2013	954,959	(4,573)	(339,059)	492,032	3,011,110	976,425	5,090,894	103,524	5,194,418
Comprehensive income									
Profit for the year	-	-	-	-	-	570,667	570,667	(11,363)	559,304
Change in value of available-for-sale financial assets	-	-	-	-	25,065	-	25,065	-	25,065
Loss on currency translation of foreign operations	-	-	-	-	(14,548)	-	(14,548)	(3,345)	(17,893)
Remeasurements of the net defined benefit liability	-	-	-	-	-	5,747	5,747	(144)	5,603
Total comprehensive income (loss)	-	-	-	-	10,517	576,414	586,931	(14,852)	572,079
Transactions with equity holders of the Parent Company									
Cash dividends	-	-	-	-	-	(402,876)	(402,876)	-	(402,876)
Acquisition of investments in subsidiaries	-	-	-	-	-	(317,000)	-	1,859	1,859
Other reserve	-	-	-	-	317,000	(208)	-	-	-
Legal reserve	-	-	-	-	208	(30,000)	-	-	-
Reserve for research and human resource development	-	-	-	-	30,000	(750,084)	-	-	-
Total transactions with equity holders of the Company	-	-	-	-	347,208	(750,084)	(402,876)	1,859	(401,017)
Balance at December 31, 2013	954,959	(4,573)	(339,059)	492,032	3,368,835	802,765	5,274,949	90,531	5,365,480

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

**KT&G Corporation and Subsidiaries**  
**Consolidated Statements of Changes in Equity**  
**Year Ended December 31, 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	Non-controlling Interests	
	\$	\$	\$	\$	\$	\$	\$	\$	\$
<b>Balance at January 1, 2013</b>	904,918	(4,333)	(321,291)	466,249	2,853,321	925,258	4,824,122	98,099	4,922,221
<b>Comprehensive Income</b>									
Profit for the year	-	-	-	-	-	540,764	540,764	(10,768)	529,996
Change in value of available-for-sale financial assets	-	-	-	-	23,751	-	23,751	-	23,751
Loss on currency translation of foreign operations	-	-	-	-	(13,785)	-	(13,785)	(3,170)	(16,955)
Remeasurements of the net defined benefit liability	-	-	-	-	-	5,446	5,446	(135)	5,311
<b>Total comprehensive Income</b>	-	-	-	-	9,965	546,210	556,176	(14,073)	542,103
<b>Transactions with equity holders of the Parent Company</b>									
Cash dividends	-	-	-	-	-	(381,765)	(381,765)	-	(381,765)
Acquisition of investments in subsidiaries	-	-	-	-	(1)	-	(1)	1,761	1,760
Other reserve	-	-	-	-	300,389	(300,389)	-	-	-
Legal reserve	-	-	-	-	197	(197)	-	-	-
Reserve for research and human resource development	-	-	-	-	28,428	(28,428)	-	-	-
<b>Total transactions with equity holders of the Company</b>	-	-	-	-	329,013	(710,779)	(381,766)	1,761	(380,005)
<b>Balance at December 31, 2013</b>	904,918	(4,333)	(321,291)	466,249	3,192,300	760,689	4,998,532	85,787	5,084,319

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**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2013 and 2012**

(in millions of Korean won  
and thousands of U.S. dollars)

	Notes	2013 Korean won	2013 U.S. dollars (Note 34)	2012 Korean won
<b>Cash flows from operating activities</b>				
Cash generated from operations	31	₩ 906,834	\$ 859,314	₩ 1,026,914
Income tax paid		(323,454)	(306,504)	(304,076)
<b>Net cash generated from operating activities</b>		<b>583,380</b>	<b>552,810</b>	<b>722,838</b>
<b>Cash flows from investing activities</b>				
Interest received		38,489	36,472	40,709
Investment income received from long-term deposits in MSA Escrow Fund		845	801	407
Dividends received		10,213	9,678	8,903
Proceeds from sale of property, plant and equipment		15,173	14,378	35,783
Proceeds from sale of intangible assets		7,277	6,896	830
Proceeds from sale of non-current asset held for sale		7,601	7,203	-
Proceeds from sale of available-for-sale financial assets		-	-	4,133
Proceeds from sale of jointly controlled entities and associates		612	580	-
Decrease in loans		13,070	12,385	21,612
Decrease in guarantee deposits		24,894	23,590	66,973
Decrease in derivative instruments		244	231	-
Acquisition of property, plant and equipment		(162,603)	(154,082)	(263,443)
Acquisition of intangible assets		(4,015)	(3,805)	(6,207)
Acquisition of investment property		(1,736)	(1,645)	(51)
Acquisition of jointly controlled entities and associates		(5,000)	(4,738)	(21,000)
Acquisition of available-for-sale financial assets		(13,781)	(13,058)	(16,500)
Increase in loans		(24,663)	(23,371)	(37,669)
Increase in guarantee deposits		(25,575)	(24,235)	(61,605)
Increase in long-term deposits in MSA Escrow Fund		(56,067)	(53,129)	(34,096)
Increase in other financial assets		(42,731)	(40,493)	(636,804)
<b>Net cash used in investing activities</b>		<b>(217,753)</b>	<b>(206,342)</b>	<b>(898,025)</b>
<b>Cash flows from financing activities</b>				
Interest paid		(3,747)	(3,551)	(11,557)
Issuance of common stock		2,097	1,988	-
Dividends paid		(402,876)	(381,765)	(402,396)
Proceeds from borrowings		222,033	210,398	289,022
Increase in deposits received		4,529	4,291	5,903
Repayments of borrowings		(207,945)	(197,048)	(146,422)
Decrease in deposits received		(4,030)	(3,819)	(5,227)
Disposition of treasury shares		-	-	12,525
<b>Net cash used in financing activities</b>		<b>(389,939)</b>	<b>(369,506)</b>	<b>(258,152)</b>
<b>Net decrease in cash and cash equivalents</b>		<b>(24,312)</b>	<b>(23,038)</b>	<b>(433,339)</b>
<b>Cash and cash equivalents at the beginning of year</b>		<b>372,260</b>	<b>352,752</b>	<b>807,731</b>
<b>Exchange losses on cash and cash equivalents</b>		<b>(15)</b>	<b>(12)</b>	<b>(2,132)</b>
<b>Cash and cash equivalents at the end of year</b>		<b>₩ 347,933</b>	<b>\$ 329,702</b>	<b>₩ 372,260</b>

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**

## **Notes to Consolidated Financial Statements**

### **December 31, 2013 and 2012**

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#### **1. General Information**

General information about KT&G Corporation (the "Parent Company") and its subsidiaries (collectively referred to "the Group") 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 December 31, 2013, the Parent Company has two manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 135 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**  
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The ownership of the Parent Company's issued ordinary shares as of December 31, 2013, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee share ownership association	2,802,737	2.04%
Others	113,585,578	82.73%
	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 December 31, 2013, are as follows:

Immediate Parent	Subsidiaries	Location	Percentage of ownership (%)
			2013
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
	KG 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. <sup>1</sup>	Korea	60.00
	Renzoluc Pte., Ltd. <sup>2</sup>	Singapore	100.00
	KT&G Life Science <sup>3</sup>	Korea	73.94
	Yebon Nongwon Agriculture Co., Ltd	Korea	90.00
	KGC Yebon	Korea	100.00
	K-Q HongKong I,Limited <sup>4</sup>	Hong Kong	100.00
	PT KT&G Indonesia	Indonesia	99.96
Renzoluc Pte., Ltd.	PT Trisakti Purwosari Makmur	Indonesia	60.17
	PT Mandiri Maha mulia	Indonesia	66.47
	PT Sentosa Ababi Purwosari	Indonesia	99.24
PT Trisakti Purwosari Makmur	PT Purindo Ilufa	Indonesia	100.00
	Cheong Kwan Jang Taiwan Corporation	Taiwan	100.00
Korea Ginseng Corporation	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

<sup>1</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Group's percentage of ownership would be 50.00% if convertible preferred shares are included.

<sup>2</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Group's percentage of ownership would be 68.91% if convertible preferred shares are included.

<sup>3</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Group's percentage of ownership would be 59.48% if convertible preferred shares are included.

**KT&G Corporation and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**December 31, 2013 and 2012**

<sup>4</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of December 31, 2013, the Group's percentage of ownership would be 50.00% if convertible preferred shares are included.

Summarized financial information of subsidiaries as of December 31, 2013, is as follows:

*(In millions of Korean won)*

<b>Subsidiaries</b>	<b>Total assets</b>	<b>Total liabilities</b>	<b>Revenue</b>	<b>Profit (loss)</b>	<b>Total comprehensive income(loss)</b>
Korea Ginseng Corporation	1,415,039	169,577	784,799	89,292	89,220
Yungjin Pharm. Ind. Co., Ltd.	169,334	66,889	156,623	11,742	11,377
Tae-a industry Co., Ltd.	13,213	3,502	14,185	180	264
KT&G Tutun Mamulleri Sanayive Ticaret A.S.	45,323	37,738	17,669	(11,528)	(13,477)
Korea Tabacos do Brasil Ltda.	1,099	11	-	-	-
KT&G Pars	19,098	40,696	4,328	(37,896)	(21,726)
KT&G Rus L.L.C.	149,250	47,465	49,751	6,950	(2,742)
KG Life & Gin Co., Ltd	32,924	5,692	35,775	(19,801)	(19,533)
Global Trading, Inc.	33,052	24,384	226,562	2,038	1,864
Jilin Hanzheng Ginseng Co., Ltd.	81,469	43,335	-	(4,694)	(4,200)
Somang Cosmetics Co., Ltd.	66,051	64,923	78,782	(21,856)	(21,791)
Renzoluc Pte., Ltd.	97,271	47,281	-	796	30
KT&G Life science	34,205	15,728	83	(6,072)	(6,065)
Yebon Nongwon Agriculture Co., Ltd	99	-	-	(1)	(1)
KGC Yebon	42,042	963	3,352	(1,356)	(1,354)
PT Trisakti Purwosari Makmur	94,896	69,059	39,604	(8,614)	(16,432)
Cheong Kwan Jang Taiwan Corporation	16,869	19,366	16,954	(2,632)	(2,521)
Korean Red Ginseng Corp., Inc.	8,574	5,397	11,854	131	(6)
Korea Ginseng (China) Corp.	50,962	40,655	40,069	632	741
Korea Ginseng Corporation Japan	6,027	5,253	9,320	(922)	(1,211)
K-Q HongKong I,Limited	36,730	-	-	2,949	2,334
PT CKJ INDONESIA	3,393	3,055	6,023	(360)	(475)
PT KT&G Indonesia	5,912	8,076	1,806	(6,220)	(5,910)
PT Mandiri Maha Mulia	7,754	3,858	1,274	(959)	(1,647)

During the year ended December 31, 2013, there has been no change in consolidation scope, except for PT KT&G Indonesia and PT Mandiri Naha mulia which were included in the consolidation.

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## **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 presented, unless otherwise stated.

### **2.1 Basis of Preparation**

The Group maintains its accounting records in Korean won and prepares statutory financial statements in the Korean language (Hangul) in accordance with the International Financial Reporting Standards as adopted by the Republic of Korea ("Korean IFRS"). The accompanying consolidated financial statements have been condensed, restructured and translated into English from the Korean language financial statements.

Certain information attached to the Korean language financial statements, but not required for a fair presentation of the Group's financial position, financial performance or cash flows, is not presented in the accompanying consolidated financial statements.

The preparation of the consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Group's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 3.

#### **2.1.1 Changes in Accounting Policy and Disclosures**

##### *(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, 2013:

- Amendment to Korean IFRS 1001, *Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income*

The amendment requires entities to group items presented in other comprehensive income based on whether they are potentially reclassifiable to profit or loss subsequently. The Group applies the amendment retroactively and there is no impact of the application of this amendment on its total comprehensive income or loss.

- Amendment to Korean IFRS 1019, *Employee Benefits*

The amendment requires entities to immediately recognize all actuarial gains and losses incurred in other comprehensive income or loss. All past service costs incurred are immediately recognized in accordance with the change of the plan, and the previous separate calculation of the interest cost and the expected returns on plan assets has been revised to calculate net interest expense (income) by applying the discount rate used in the defined benefit obligation measurement in the net defined benefit liabilities (assets). There is no material impact of the application of this amendment on the consolidated financial statements.

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#### **- Korean IFRS 1110, *Consolidated Financial Statements***

Korean IFRS 1110, *Consolidated Financial Statements*, introduces a single control concept and provides a specific guidance for the control. The adoption of this standard does not have an impact on consolidation scope in the consolidated financial statements.

#### **- Korean IFRS 1111, *Joint Arrangements***

Korean IFRS 1111, *Joint Arrangements*, reflects the substance of joint arrangements and focuses on the rights and obligations of the parties to the joint arrangements rather than on the legal forms of the arrangements. Joint arrangements are classified into joint operations or joint ventures. The adoption of this standard does not have an impact on the consolidated financial statements.

#### **- Korean IFRS 1112, *Disclosures of Interests in Other Entities***

Korean IFRS 1112, *Disclosure of Interests in Other Entities*, provides disclosure requirements for all types of equity investments in other entities including subsidiaries, associates, joint ventures and unconsolidated structured entities.

#### **- Korean IFRS 1027, *Separate Financial Statements***

Korean IFRS 1027, *Separate Financial Statements*, contains accounting treatments and requirements for investments in subsidiaries, associates and joint ventures relating only to separate financial statements of the Controlling Company.

#### **- Korean IFRS 1113, *Fair Value Measurement***

Korean IFRS 1113, *Fair Value Measurement*, provides a precise definition of fair value, and a single source of fair value measurement and disclosure requirements for use across K-IFRS. The Group has applied this standard prospectively according to the transitional provisions of K-IFRS 1113 and there is no material impact of the application of this standard on the consolidated financial statements.

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

New standards, amendments and interpretations issued but not effective for the financial year beginning January 1, 2013, and not early adopted by the Group are as follows:

#### **- Amendment to Korean IFRS 1110, *Consolidated Financial Statements***

Amendment to Korean IFRS 1110, *Consolidated Financial Statements*, provides that, if a parent company qualifies as an investment entity, it is required to measure its investments in subsidiaries at fair value through profit and loss instead of consolidating these subsidiaries in its consolidated financial statements. The amendment does not apply for a parent of an investment entity if the parent itself is not an investment entity. This amendment is effective for annual periods beginning on or after January 1, 2014, with early adoption permitted. The Group expects that the application of this amendment would not have a material impact on its consolidated financial statements.

#### **- 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. This amendment is effective for annual periods beginning on or after January 1, 2014, and the Group is assessing the

# **KT&G Corporation and Subsidiaries**

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impact of application of this amendment on its consolidated 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. This amendment is effective for annual periods beginning on or after January 1, 2014, with early adoption permitted. The Group is assessing the impact of application of this amendment on its consolidated financial statements.

#### **- Enactment of IFRIC interpretations 2121, *Levies***

IFRIC interpretations 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). This interpretation is effective for annual periods beginning on or after January 1, 2014, with early adoption permitted. The Group expects that the application of this interpretation would not have a material impact on its consolidated financial statements.

## **2.2 Consolidation**

The Group has prepared the consolidated financial statements in accordance with Korean IFRS 1110, *Consolidated Financial Statements*.

### **(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.

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#### *(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.

#### *(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 Controlling 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 all risks and rewards of ownership of the transferred asset 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

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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 ₩ 316,168 million and ₩ 347,489 million as of December 31, 2013 and 2012, 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.

#### **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

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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 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.

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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 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.

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#### *(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 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 Current and Deferred Income Tax**

The tax expense for the period consists of current and deferred tax. Tax is recognized on the profit for the period in the statement of income, except to the extent that it relates to items recognized in

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other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively. The tax expense is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period.

Deferred tax is recognized for temporary differences arising between the tax bases of assets and liabilities and their carrying amounts as expected tax consequences at the recovery or settlement of the carrying amounts of the assets and liabilities. However, deferred tax assets and liabilities are not recognized if they arise from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences can be utilized.

Deferred tax liability is recognized for taxable temporary differences associated with investments in subsidiaries, associates, and interests in joint ventures, except to the extent that the Group is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. In addition, deferred tax asset is recognized for deductible temporary differences arising from such investments to the extent that it is probable the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

#### **2.23 Employee Benefits**

##### *(a) Defined benefit liability*

Group companies operate 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

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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.

## **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 years ended December 31, 2013 and 2012, were ₩ 3,658,313 million and ₩ 3,662,085 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.

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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 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.

#### **2.28 Approval of Issuance of the Financial Statements**

The issuance of the December 31, 2013 financial statements of the Company was approved by the Board of Directors on January 16, 2014, which is subject to change with approval at the annual shareholder's meeting.

### **3. Critical Accounting Estimates and Assumptions**

The management makes judgments, estimates and assumptions that affects the application of accounting policies and the amounts of reported assets and liabilities and profits and costs in the preparation of the financial statements. Estimations 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.

#### *(a) Estimated impairment of goodwill*

The Group tests annually whether goodwill has suffered any impairment. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. (Note 11).

#### *(b) Income taxes*

The Group is operating in numerous countries and the income generated from these operations is subject to income taxes based on tax laws and interpretations of tax authorities in numerous jurisdictions. There are many transactions and calculations for which the ultimate tax determination is uncertain (Note 28).

#### *(c) Fair value of financial instruments*

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Group uses its judgment to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.



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*(d) Net defined benefit liability*

The present value of net defined benefit liability depends on a number of factors that are determined on an actuarial basis using a number of assumptions including the discount rate (Note 24).

**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 Company 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.

*(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 December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>			<b>2012</b>		
	<b>USD</b>	<b>EUR</b>	<b>JPY</b>	<b>USD</b>	<b>EUR</b>	<b>JPY</b>
<b>Assets</b>						
Cash and cash equivalents	₩ 17,191	₩ 30	₩ 468	₩ 19,284	₩ 5	₩ 9
Trade and other receivables	365,453	1,605	2,479	493,243	3,256	6,410
Long-term deposits	219,760	-	-	168,667	-	-
	<u>₩ 602,404</u>	<u>₩ 1,635</u>	<u>₩ 2,947</u>	<u>₩ 681,194</u>	<u>₩ 3,261</u>	<u>₩ 6,419</u>
<b>Liabilities</b>						
Trade and other payables	₩ 56,514	₩ 11,564	₩ 1,030	₩ 16,544	₩ 3,153	₩ 2,129
Short-term borrowings	1,386	-	-	1,406	-	-
	<u>₩ 57,900</u>	<u>₩ 11,564</u>	<u>₩ 1,030</u>	<u>₩ 17,950</u>	<u>₩ 3,153</u>	<u>₩ 2,129</u>

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As of December 31, 2013 and 2012, the effects of a 10% strengthening or weakening of functional currency against the US dollar other than functional currency on profit before tax were as follows:

(in millions of Korean won)	2013		2012	
	10% strengthening	10% weakening	10% strengthening	10% weakening
US dollar	₩ 54,450	₩ (54,450)	₩ 66,324	₩ (66,324)

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 December 31, 2013 and 2012, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income are as follows:

(in millions of Korean won)	2013		2012	
	5% increase	5% decrease	5% increase	5% decrease
Other comprehensive income before tax	₩ 6,811	₩ (6,811)	₩ 5,266	₩ (5,266)
Tax effect	(1,648)	1,648	(1,274)	1,274
Other comprehensive income after tax	₩ 5,163	₩ (5,163)	₩ 3,992	₩ (3,992)

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 December 31, 2013 and 2012, the amount of borrowings issued at variable rates is ₩ 58,564 million and ₩ 53,459 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.

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The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of December 31, 2013 and 2012, is as follows:

<i>(in millions of Korean won)</i>	2013	2012
Available-for-sale financial assets	₩ 2,702	₩ 2,832
Long-term deposits in MSA Escrow Fund	219,760	168,667
Trade and other receivables	1,024,516	1,005,563
Other financial assets	685,872	649,461
Cash and cash equivalents	347,933	372,260
Financial guarantee contracts	152,263	-
	<u>₩ 2,433,046</u>	<u>₩ 2,198,783</u>

**(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. The Group entered into an overdraft agreement with the National Agricultural Cooperative Federation to manage the temporary liquidity risk.

The maturity analysis with a residual contractual maturity of financial liabilities as of December 31, 2013 and 2012, is as follows:

<i>(in millions of Korean won)</i>	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	-	152,263	-	-	152,263	-

  

<i>(in millions of Korean won)</i>	2012					
	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	₩ 298,381	₩ 299,629	₩ 254,604	₩ 9,266	₩ 35,759	₩ -
Short-term borrowings	91,868	93,964	25,687	68,277	-	-
Long-term borrowings	109,599	119,785	144	410	41,984	77,247
Current portion of long-term borrowings	2,912	3,126	159	2,967	-	-

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.

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**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 December 31, 2013 and 2012, the Group defines net debt and equity attributable to owners of the Parent as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
Total borrowings	₩	218,303	₩	204,379
Less:				
-Cash and cash equivalents		(347,933)		(372,260)
-Other financial assets		(684,132)		(649,186)
-Available-for-sale financial assets		-		(1,000)
Net debt(asset)		(813,762)		(818,067)
Equity attributable to owners of the parent	₩	<u>5,365,481</u>	₩	<u>5,194,419</u>

**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 during 2013.

**4.3.1 Fair Value of Financial Instruments by Category**

Carrying amount and fair value of financial instruments by category as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
	<b>Carrying amount</b>	<b>Fair value</b>	<b>Carrying amount</b>	<b>Fair value</b>
Financial assets				
Available-for-sale financial assets, non-current <sup>1</sup>	₩ 279,797	₩ 279,797	₩ 247,950	₩ 247,950
Other financial assets, non-current	1,740	1,740	275	275
Long-term deposit	219,760	219,760	168,667	168,667
Long-term trade and other receivables	108,898	108,898	121,784	121,784
Other financial assets, current	684,132	684,132	649,186	649,186
Trade and other receivables	915,618	915,618	883,778	883,778
Cash and cash equivalents	347,933	347,933	372,260	372,260
	<u>₩ 2,557,878</u>	<u>₩ 2,557,878</u>	<u>₩ 2,443,900</u>	<u>₩ 2,443,900</u>
Financial liabilities				
Long-term borrowings	₩ 117,639	₩ 117,639	₩ 109,599	₩ 109,599
Long-term trade and other payables	29,254	29,254	24,979	24,979
Short-term borrowings	96,240	96,240	91,868	91,868
Current portion of long-term borrowings	4,424	4,424	2,912	2,912
Trade and other payables	398,212	398,212	273,402	273,402
	<u>₩ 645,769</u>	<u>₩ 645,769</u>	<u>₩ 502,760</u>	<u>₩ 502,760</u>

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<sup>1</sup> 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.

#### 4.3.2 Financial Instruments Measured at Cost

Details of financial instruments measured at cost as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
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		2,804		2,934
	₩	16,804	₩	16,934

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

#### 4.3.3 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 December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale financial assets	₩ 217,331	₩ 62,466	₩ -	₩ 279,797
Investment property	-	-	495,633	495,633
Total assets	₩ 217,331	₩ 62,466	₩ 495,633	₩ 775,430

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.

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

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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 interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- 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.

#### 4.3.4 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 December 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	Fair Value		Level	Valuation Technique
Available-for-sale assets				
Real Estate Investment Trust	₩	62,466	2	Market approach
Unlisted		-	-	(*1)
Investment property				Yield capitalization method and other method
Investment property		495,633	3	

<sup>1</sup>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 carrying amount as impairment loss for this period due to financial difficulties of this investee (Note 7).

## 5. Operating Segments

(1) 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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(2) Segment information on revenue and profit from operations for the years ended December 31, 2013 and 2012, follows:

(in millions of Korean won)	2013						Consolidated
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	
Total segment sales	₩ 2,693,582	₩ 867,287	₩ 109,931	₩ 338,642	₩ 4,009,442	₩ (187,746)	₩ 3,821,696
Less: Inter-segment sales	70,698	69,747	8,145	39,156	187,746	(187,746)	-
External sales	2,622,884	797,540	101,786	299,486	3,821,696	-	3,821,696
Profit(loss) from operations	866,271	120,148	30,808	(15,096)	1,002,131	11,218	1,013,349

  

(in millions of Korean won)	2012						Consolidated
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	
Total segment sales	₩ 2,839,860	₩ 899,726	₩ 44,247	₩ 395,466	₩ 4,179,299	₩ (194,638)	₩ 3,984,661
Less: Inter-segment sales	61,101	71,483	7,856	54,198	194,638	(194,638)	-
External sales	2,778,759	828,243	36,391	341,268	3,984,661	-	3,984,661
Profit(loss) from operations	942,026	112,488	9,250	(6,633)	1,057,131	(21,201)	1,035,930

(3) Segment information on assets and liabilities as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013						Consolidated
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	
<b>Assets</b>							
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
<b>Total assets</b>							<b>₩ 7,074,958</b>
<b>Liabilities</b>							
Segment liabilities	985,942	167,277	-	63,414	1,216,633	(154,259)	₩ 1,062,374
Unallocated liabilities							647,103
<b>Total liabilities</b>							<b>₩ 1,709,477</b>

  

(in millions of Korean won)	2012						Consolidated
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	
<b>Assets</b>							
Segment assets	₩ 3,630,713	₩ 1,375,619	₩ 135,368	₩ 362,884	₩ 5,504,584	₩ (349,720)	₩ 5,154,864
Equity accounted investments	-	-	52,647	3,130	55,777	-	55,777
Assets held for sale	762	-	-	-	762	-	762
	3,631,475	1,375,619	188,015	366,014	5,561,123	(349,720)	5,211,403
Unallocated assets							1,584,558
<b>Total assets</b>							<b>₩ 6,795,961</b>
<b>Liabilities</b>							
Segment liabilities	910,420	147,244	-	70,560	1,128,224	(142,569)	₩ 985,655
Unallocated liabilities							615,887
<b>Total liabilities</b>							<b>₩ 1,601,542</b>

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- (4) The major customers who contribute 10% or more of the Group's total revenues for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>		<b>2013</b>		<b>2012</b>	
Segment	Major customer				
Tobacco	Alokozay International Limited	₩	321,083	₩	577,985

**6. Financial Instruments by Category**

Categorizations of financial assets as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>		<b>2013</b>				
		<b>Loans and receivables</b>	<b>Assets at fair value through profit or loss</b>	<b>Derivative financial instruments</b>	<b>Assets classified as available-for-sale</b>	<b>Total</b>
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>₩</u>	<u>₩</u>	<u>₩ 296,601</u>	<u>₩ 2,574,682</u>

  

<i>(in millions of Korean won)</i>		<b>2012</b>				
		<b>Loans and receivables</b>	<b>Assets at fair value through profit or loss</b>	<b>Derivative financial instruments</b>	<b>Assets classified as available-for-sale</b>	<b>Total</b>
Financial assets as available-for-sale, non-current	₩	-	₩	-	₩ 263,884	₩ 263,884
Other financial assets, non-current		275	-	-	-	275
Long-term deposits		168,667	-	-	-	168,667
Long-term trade and other receivables		121,784	-	-	-	121,784
Financial assets as available-for-sale, current		-	-	-	1,000	1,000
Other financial assets, current		649,186	-	-	-	649,186
Trade and other receivables		883,778	-	-	-	883,778
Cash and cash equivalents		372,260	-	-	-	372,260
		<u>₩ 2,195,950</u>	<u>₩</u>	<u>₩</u>	<u>₩ 264,884</u>	<u>₩ 2,460,834</u>



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Categorizations of financial liabilities as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013				
	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total
Borrowings, non-current	₩ -	₩ -	₩ 117,639	₩ -	₩ 117,639
Long-term trade and other payables	-	-	29,254	-	29,254
Borrowings, current	-	-	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>₩ -</u>	<u>₩ -</u>	<u>₩ 625,277</u>	<u>₩ 20,492</u>	<u>₩ 645,769</u>

  

(in millions of Korean won)	2012				
	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total
Borrowings, non-current	₩ -	₩ -	₩ 109,599	₩ -	₩ 109,599
Long-term trade and other payables	-	-	24,979	-	24,979
Borrowings, current	-	-	75,097	16,771	91,868
Current portion of long-term borrowings	-	-	2,912	-	2,912
Trade and other payables	-	-	273,402	-	273,402
	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 485,989</u>	<u>₩ 16,771</u>	<u>₩ 502,760</u>

Income and loss of financial instruments by category for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013	2012
Available-for-sale financial assets		
Gain on valuation (Other comprehensive income(loss))	₩ 25,065	₩ 1,220
Gain(Loss) on disposal (Profit or loss)	-	(287)
Interest income	290	229
Dividend income	6,562	6,366
Impairment	(15,000)	-
Cash and cash equivalents		
Interest income	27,663	30,551
Gain(Loss) on foreign currency translation	199	(170)
Foreign currency transaction gain (loss)	(87)	(1,878)
Trade and other receivables		
Interest income	6,954	5,836
Gain(Loss) on foreign currency translation	6,435	(50,226)
Foreign currency transaction gain (loss)	8,806	(10,253)
Financial assets at fair value through profit or loss		
Gain or loss on valuation (profit or loss)	-	-
Gain or loss on disposition (profit or loss)	244	-
Other financial liabilities at		

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amortized cost		
Interest costs	(10,892)	(9,101)
Gain(Loss) on foreign currency translation	(58,478)	5,479
Foreign currency transaction loss	(11,752)	(4,624)
Other financial liabilities		
Interest costs	(900)	(1,115)

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

The changes in available-for-sale financial assets as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
At January 1	₩ 264,884	₩ 248,403
Additions	13,781	16,500
Disposals	(130)	(1,628)
Gain(loss) on valuation (before tax)	30,280	1,609
Transfer to others	2,787	-
Impairment losses	(15,000)	-
Net exchange difference	(1)	-
At December 31	296,601	264,884
Less: current portion	-	(1,000)
<b>Non-current portion</b>	<b>₩ 296,601</b>	<b>₩ 263,884</b>

Available-for-sale financial assets as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Available-for-sale debt instruments:		
Government and municipal bonds	₩ 162	₩ 292
Corporate bonds	2,540	2,540
Total available-for-sale debt instruments	2,702	2,832
Available-for-sale equity instruments:		
Listed		
Yonhap Television News(YTN)	23,380	29,580
Oscotech, Inc.	916	869
Shinhan Financial Group Co., Ltd.	189,595	155,725
Rexahn Pharmaceuticals, Inc.	3,440	2,122
	217,331	188,296
Unlisted		
Dream Hub PFV Co., Ltd. <sup>1</sup>	-	12,213
Others	76,568	61,543
	76,568	73,756
Total available-for-sale equity instruments	293,899	262,052
<b>Total available-for-sale financial assets</b>	<b>₩ 296,601</b>	<b>₩ 264,884</b>

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<sup>1</sup>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 carrying amount as impairment loss for this period due to financial difficulties of this investee.

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 December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013		2012	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 8,688	₩ 29,957	₩ 7,196	₩ 22,491
Loans	562	5,508	661	6,928
Other receivables	96,426	7,705	84,559	27,529
Guarantee deposits	-	65,728	-	64,836
Accrued income	4,276	-	7,006	-
Trade receivables	805,666	-	784,356	-
	<u>₩ 915,618</u>	<u>₩ 108,898</u>	<u>₩ 883,778</u>	<u>₩ 121,784</u>

Trade and other receivables as of December 31, 2013 and 2012, reported in the consolidated statements of financial position, net of allowances, are as follows:

(in millions of Korean won)	2013		2012	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 967,456	₩ 108,898	₩ 912,506	₩ 121,784
Allowance account				
- Loans	(210)	-	(199)	-
- Other receivables	(2,303)	-	(2,304)	-
- Trade receivables	(49,325)	-	(26,225)	-
	<u>(51,838)</u>	<u>-</u>	<u>(28,728)</u>	<u>-</u>
Net amount	<u>₩ 915,618</u>	<u>₩ 108,898</u>	<u>₩ 883,778</u>	<u>₩ 121,784</u>

Changes in the allowance account for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013	2012
Beginning	₩ 28,728	₩ 16,381
Impairment	23,786	15,801
Write-off	(666)	(3,450)
Net exchange difference	(10)	(4)
Ending	<u>₩ 51,838</u>	<u>₩ 28,728</u>

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The aging schedule of trade and other receivables as of December 31, 2013 and 2012, is as follows:

<i>(in millions of Korean won)</i>		2013	2012
Not past due	₩	510,821	₩ 470,756
Past due but not impaired			
Within 1 month		56,442	74,054
Between 1 and 2 months		26,073	51,070
Beyond 2 months		255,138	208,673
		337,653	333,797
Impaired		6,517	6,028
	₩	854,991	₩ 810,581

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.

Details of trade and other receivables that are measured at amortized cost as of December 31, 2013, and 2012, are as follows:

<i>(Number of shares)</i>	Effective interest rate	2013		Effective interest rate	2012	
		Current	Non-current		Current	Non-current
Loans to employees	3.00~5.68%	₩ 8,681	₩ 29,884	3.00~5.68%	₩ 7,192	₩ 22,486
Loans	1.7%~ 7.29%	-	5,032	1.7%~3.29%	-	4,650
Other receivables	3.79%	7,997	7,705	3.79%	8,300	16,601
Guarantee deposits	1.7%~ 8.47%	-	62,845	1.7%~8.47%	-	62,400
		₩ 16,678	₩ 105,466		₩ 15,492	₩ 106,137

*Transferred trade receivables*

The Group discounted its trade receivables through trade receivable factoring agreements with National Agricultural Cooperative Federation, Citi Bank Korea 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 Company has an obligation to pay the related amount to the bank. As a result, this transaction treated as a transaction with recourse, has been accounted for as collateralized borrowings. The borrowings recognized in relation to the said transaction as of December 31, 2013 and 2012, are ₩ 20,492 million and ₩ 16,771 million, respectively (Note 23).

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**9. Long-term Deposits**

Long-term deposits as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
	₩		₩	
MMF		15,080		10,496
T-note		204,680		158,170
	₩	<u>219,760</u>	₩	<u>168,666</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 years ended December 31, 2013 and 2012, are ₩56,067 million and ₩34,906 million, respectively.

Investment income on long-term deposits in MSA Escrow Fund for the years ended December 31, 2013 and 2012, is ₩756 million and ₩18 million, respectively.

**10. Property, Plant and Equipment**

Changes in property, plant and equipment for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		
	<b>Acquisition Cost</b>	<b>Accumulated depreciation and impairment cost</b>	<b>Net book value</b>
Land	₩ 528,983	₩ -	₩ 528,983
Buildings	870,117	(335,062)	535,055
Structures	65,234	(35,935)	29,299
Machinery	1,179,721	(831,078)	348,643
Vehicles	13,662	(10,270)	3,392
Tools	57,074	(48,364)	8,710
Furniture and fixture	247,223	(186,969)	60,254
Others	1,304	-	1,304
Construction-in-progress	106,649	-	106,649
	<u>₩ 3,069,967</u>	<u>₩ (1,447,678)</u>	<u>₩ 1,622,289</u>

  

<i>(in millions of Korean won)</i>	<b>2012</b>		
	<b>Acquisition Cost</b>	<b>Accumulated depreciation and impairment cost</b>	<b>Net book value</b>
Land	₩ 518,056	₩ -	₩ 518,056
Buildings	828,448	(299,733)	528,715
Structures	60,616	(33,617)	26,999
Machinery	1,139,624	(767,059)	372,565
Vehicles	10,962	(8,012)	2,950
Tools	53,223	(44,367)	8,856
Furniture and fixture	248,433	(182,577)	65,856
Others	1,266	-	1,266
Construction-in-progress	106,173	-	106,173
	<u>₩ 2,966,801</u>	<u>₩ (1,335,365)</u>	<u>₩ 1,631,436</u>

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(in millions of Korean won)	2013							
	Opening net book value	Additions	Disposal	Depreciation	Exchange difference	Transfer	Other changes <sup>1</sup>	Net book amount
Land	₩ 518,056	₩ 240	₩ (2,385)	₩ -	₩ (719)	₩ 13,630	₩ 161	₩ 528,983
Buildings	528,715	25,240	(3,441)	(38,374)	(7,248)	27,323	2,840	535,055
Structures	26,999	4,730	(345)	(3,407)	(234)	1,337	219	29,299
Machinery	372,565	28,867	(3,185)	(80,423)	(9,313)	40,132	-	348,643
Vehicles	2,950	1,043	(38)	(1,292)	537	192	-	3,392
Tools	8,856	4,780	(378)	(5,263)	602	113	-	8,710
Furniture and fixture	65,856	21,076	(1,382)	(29,416)	(167)	4,287	-	60,254
Others <sup>1</sup>	1,266	35	(10)	-	-	13	-	1,304
Construction-in-progress	106,173	86,626	(10)	-	1,037	(87,177)	-	106,649
	<u>₩ 1,631,436</u>	<u>₩ 172,637</u>	<u>₩ (11,174)</u>	<u>₩ (158,175)</u>	<u>₩ (15,505)</u>	<u>₩ (150)</u>	<u>₩ 3,220</u>	<u>₩ 1,622,289</u>

<sup>1</sup> Other changes include ₩ 523 million of reclassification from property, plant and equipment to held-for-sale non-current assets and ₩ 3,743 million of reclassification from investment property to property, plant equipment.

(in millions of Korean won)	2012							
	Opening net book value	Additions	Disposal	Depreciation	Exchange difference	Transfer	Other changes <sup>1</sup>	Net book amount
Land	₩ 460,487	₩ 16,978	₩ (27,930)	₩ -	₩ 272	₩ 74,741	₩ (6,492)	₩ 518,056
Buildings	532,066	13,804	(7,691)	(36,297)	(1,432)	30,951	(2,686)	528,715
Structures	30,072	853	(336)	(3,344)	(33)	(142)	(71)	26,999
Machinery	365,040	27,521	(2,105)	(82,769)	(751)	65,674	(45)	372,565
Vehicles	3,547	567	(168)	(1,271)	(166)	441	-	2,950
Tools	9,871	3,771	(11)	(4,900)	(28)	153	-	8,856
Furniture and fixture	66,299	31,489	(1,044)	(30,723)	(1,305)	1,140	-	65,856
Others <sup>1</sup>	1,219	10	-	-	-	37	-	1,266
Construction-in-progress	115,745	168,450	(160)	-	533	(178,395)	-	106,173
	<u>₩ 1,584,346</u>	<u>₩ 263,443</u>	<u>₩ (39,445)</u>	<u>₩ (159,304)</u>	<u>₩ (2,910)</u>	<u>₩ (5,400)</u>	<u>₩ (9,294)</u>	<u>₩ 1,631,436</u>

<sup>1</sup> Other changes represent the reclassified amount from property, plant and equipment to held-for-sale non-current assets.

## 11. Intangible Assets

Changes in intangible assets for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013					
	Goodwill	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development	Total
At January 1, 2013	₩ 84,100	₩ 34,086	₩ 26,042	₩ 98,337	₩ 4,228	₩ 246,793
Additions	-	352	773	1,963	927	4,015
Disposals	-	(7)	(33)	(305)	(16)	(361)
Transfer-in(out)	-	659	-	53	(712)	-
Amortization	-	(3,005)	-	(10,312)	310	(13,007)

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Exchange differences	-	(344)	(1,022)	(8)	(1,939)	(3,313)
Other changes	(730)	(8)	(3)	(443)	(313)	(1,497)
Acquisition cost	83,370	46,260	26,779	116,927	4,825	278,161
Accumulated depreciation and impairment cost	-	(14,527)	(1,022)	(27,642)	(2,340)	(45,531)
<b>Net book amount</b>	<b>₩ 83,370</b>	<b>₩ 31,733</b>	<b>₩ 25,757</b>	<b>₩ 89,285</b>	<b>₩ 2,485</b>	<b>₩ 232,630</b>

(in millions of Korean won)	2012					
	Goodwill	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development	Total
<b>At January 1, 2012</b>	₩ 87,902	₩ 23,454	₩ 24,387	₩ 106,641	₩ 16,234	₩ 258,618
Additions	-	1,041	1,658	2,122	-	4,821
Disposals	-	(70)	(1)	(134)	(721)	(926)
Transfer-in(out)	-	12,271	(1)	490	(12,270)	490
Amortization	-	(2,942)	-	(9,856)	-	(12,798)
Impairment / reversal	-	(15)	-	-	(43)	(58)
Exchange differences	(3,802)	347	(1)	(926)	(358)	(4,740)
Other changes	-	-	-	-	1,386	1,386
Acquisition cost	84,100	45,113	26,042	115,745	4,629	275,629
Accumulated depreciation and impairment cost	-	(11,027)	-	(17,408)	(401)	(28,836)
<b>Net book amount</b>	<b>₩ 84,100</b>	<b>₩ 34,086</b>	<b>₩ 26,042</b>	<b>₩ 98,337</b>	<b>₩ 4,228</b>	<b>₩ 246,793</b>

Research and development expenses for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013	2012
Cost of goods sold	₩ 1,245	₩ 1,133
Selling and administrative expenses	32,044	37,106
Cost of goods sold	<u>33,289</u>	<u>38,239</u>

Exchange loss of ₩ 730 million arising from the translation of goodwill of PT Trisakti Purwosari Makmur, one of subsidiaries, is accounted for as a deduction from goodwill and loss on currency translation of foreign operations.

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**Impairment Tests for Goodwill**

Goodwill is monitored by the management at the operating segment level. The following is a summary of goodwill allocation for each operating segment as of December 31, 2013 and 2012:

<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
Somang Costmetic Co., Ltd.	₩	32,131	₩	32,131
Renzoluc Pte., Ltd		48,809		49,539
KT&G Life Science Corporation		2,430		2,430
	₩	83,370	₩	84,100

The recoverable amounts of all CGUs have been determined based on value-in-use calculations, and the key assumptions used for value-in-use calculations in 2013 are as follows:

<i>(in millions of Korean won)</i>	<b>Somang Costmetic Co., Ltd.</b>	<b>Renzoluc Pte., Ltd</b>
Gross margin	8.1%	8.3%
Perpetual growth rate	2.0%	2.0%
Discount rate (weighted average cost of capital)	8.7%	13.9%

The impairment test suggests that the carrying value of cash generating units does not exceed the recoverable amount. As of December 31, 2013, the recoverable amount of the Somang Cosmetic Co., Ltd. exceeded its carrying value by ₩ 23,965 million. Nevertheless, there is a possibility that reasonable changes in key assumptions may offset the excess amount. Decrease in perpetual growth rate to 0.5% would offset the excess amount. In addition, the recoverable amount of the Renzoluc Pte., Ltd exceeded its carrying value by ₩ 9,200 million. Nevertheless, there is a possibility that reasonable changes in key assumptions may offset the excess amount. Decrease in perpetual growth rate to 1% would offset the excess amount.

**12. Investment Property**

Changes in investment property for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		
	<b>Land</b>	<b>Building</b>	<b>Total</b>
Beginning net book value	₩ 48,177	₩ 133,809	₩ 181,986
Additions	559	1,178	1,737
Depreciation	-	(6,155)	(6,155)
Other changes <sup>1</sup>	(433)	(3,160)	(3,593)
Acquisition cost	48,303	177,189	225,492
Accumulated depreciation and impairment cost	-	(51,517)	(51,517)
Net book amount	₩ 48,303	₩ 125,672	₩ 173,975

<sup>1</sup> Other changes represent transfer to property, plant and equipment



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	2012		
	Land	Building	Total
Beginning net book value	₩ 45,314	₩ 143,037	₩ 188,351
Additions	-	51	51
Depreciation	-	(6,282)	(6,282)
Other changes <sup>1</sup>	2,863	(2,997)	(134)
Acquisition cost	48,177	179,787	227,964
Accumulated depreciation and impairment cost	-	(45,978)	(45,978)
Net book amount	₩ 48,177	₩ 133,809	₩ 181,986

<sup>1</sup> Other changes represent transfer to held-for-sale non-current assets.

The amounts recognized in profit or loss from investment property for the years ended December 31, 2013 and 2012, are as follows:

	2013		2012	
	₩		₩	
Rental income	₩	33,304	₩	33,032
Direct operating expense		(6,154)		(7,394)
	₩	27,150	₩	25,638

Fair values and book values of investment property as of December 31, 2013 and 2012, are as follows:

	2013		2012	
	Fair value	Book value	Fair value	Book value
Land	₩ 309,207	₩ 48,303	₩ 312,735	₩ 48,177
Building	186,426	125,672	190,214	133,809
	₩ 495,633	₩ 173,975	₩ 502,949	₩ 181,986

### 13. Non-current Assets Held for Sale

Changes in non-current assets held for sale for the year ended December 31, 2013, are as follows:

	2013				
	Land	Buildings	Structures	Others	Total
(in millions of Korean won)					
<b>At January 1, 2013</b>					
Acquisition cost	₩ 625	₩ 215	₩ 64	₩ -	₩ 904
Accumulated depreciation	-	(96)	(46)	-	(142)
Net book amount	₩ 625	₩ 119	₩ 18	₩ -	₩ 762
<b>Changes</b>					
Transfer from property, plant and equipment	₩ 422	₩ 101	₩ -	₩ -	₩ 523
Transfer from advanced payment	-	-	-	150	150
Disposals	(1,044)	(220)	(18)	-	(1,282)
	₩ (622)	₩ (119)	₩ (18)	₩ 150	₩ (609)

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<b>At 2013</b>						
Acquisition cost	₩	3	₩	-	₩	150
Accumulated depreciation		-		-		-
Net book amount	₩	3	₩	-	₩	150
						₩ 153

**14. Pledged Assets**

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

(in millions of Korean won)

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

The following assets were pledged as collateral for the Group's borrowings and others as of December 31, 2012:

(in millions of Korean won)

Asset	Book amount		Borrowings	Collateralized amount	Lender /Leaseholder
Property, plant and equipment /investment property	₩ 76,674	Short-term borrowings	₩ 15,000		Hana Bank and 3 others
		Current portion of long-term borrowings	412	₩ 64,147	Korea Development Bank
		Long-term borrowings	10,034		
Investment Property	80,783	Leasehold deposits received	8,169	8,502	Metlife Insurance Co., Ltd. and 24 others
Property, plant and equipment	1,071	ACH pledged	-	1,071	Bank of Oklahoma
Trade	16,771	Short-term	16,771	16,771	Citibank Korea Inc.

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receivables		borrowings	
<b>Total</b>	<u>₩ 175,299</u>	<u>₩ 50,386</u>	<u>₩ 90,491</u>

**15. Investments in Associates**

Investments in associates as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

Associates	Location	Principal operation	2013		2012	
			Interest (%)	Carrying Amount	Interest (%)	Carrying Amount
Cosmo Tobacco Co., Ltd.	Mongolia	Manufacturing and selling tobaccos	40.00	₩ -	40.00	₩ -
Lite Pharm Tech, Inc	Korea	Manufacturing and Medical supplies	25.34	1,476	25.34	856
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00	-	20.00	932
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	12,953	49.02	13,570
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	7,047	29.67	7,160
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	6,745	22.06	6,827
JR REIT V Co., Ltd.	Korea	Selling and renting of real estate	34.63	5,573	34.63	5,581
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	9,948	21.74	10,008
LSK Global Pharma Services Co., Ltd	Korea	Research and developing new drug	23.15	-	23.15	1,343
JR REIT X Co., Ltd.	Korea	Selling and renting of real estate	28.78	9,334	28.78	9,500
JR REIT 15 Co., Ltd.	Korea	Selling and renting of real estate	27.03	5,000	-	-
<b>Total</b>				<u>₩ 58,076</u>		<u>₩ 55,777</u>

Changes in investments in associates and subsidiaries for the years ended December 31, 2013 and 2012, are as follows:

(in millions of Korean won)	2013				
	Beginning balance	Acquisition	Share of profit(loss)	Other changes	Ending balance
<b>Associates</b>					
Lite Pharm Tech, Inc	₩ 856	₩ -	₩ 620	₩ -	₩ 1,476
Korean Carbon Finance, Inc.	931	-	(319)	(612)	-
JR CR-REIT IV Co., Ltd.	13,571	-	466	(1,084)	12,953
KVG REIT 1 Co., Ltd.	7,160	-	422	(535)	7,047
KOCREF REIT 17 Co., Ltd.	6,827	-	374	(456)	6,745
JR REIT V Co., Ltd.	5,581	-	478	(486)	5,573
JR REIT VIII Co., Ltd.	10,008	-	558	(618)	9,948
LSK Global Pharma Services Co., Ltd	1,343	-	(1,343)	-	-
JR REIT X Co., Ltd.	9,500	-	305	(471)	9,334
JR REIT 15 Co., Ltd.	-	5,000	-	-	5,000
	<u>₩ 55,777</u>	<u>₩ 5,000</u>	<u>₩ 1,561</u>	<u>₩ (4,262)</u>	<u>₩ 58,076</u>

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(in millions of Korean won)	2012				
	Beginning balance	Acquisition	Share of profit(loss)	Other changes	Ending balance
<b>Associates</b>					
Lite Pharm Tech, Inc	₩ 637	₩ -	₩ 219	₩ -	₩ 856
Korean Carbon Finance, Inc.	1,013	-	(81)		932
JR CR-REIT IV Co., Ltd.	13,819	-	768	(1,017)	13,570
KVG REIT 1 Co., Ltd.	7,354	-	333	(527)	7,160
KOCREF REIT 17 Co., Ltd.	6,872	-	186	(231)	6,827
JR REIT V Co., Ltd.	5,635	-	367	(421)	5,581
JR REIT VIII Co., Ltd.	-	10,000	349	(341)	10,008
LSK Global Pharma Services Co., Ltd	-	1,500	(157)	-	1,343
JR REIT X Co., Ltd.	-	9,500	-	-	9,500
	<u>₩ 35,330</u>	<u>₩ 21,000</u>	<u>₩ 1,984</u>	<u>₩ (2,537)</u>	<u>₩ 55,777</u>

Summary of the associates' financial information as of December 31, 2013 and 2012, follows:

(in millions of Korean won)	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

(in millions of Korean won)	2012			
	Assets	Liabilities	Revenues	Profit/(loss)
Lite Pharm Tech, Inc.	₩ 3,832	₩ 452	₩ 4,239	₩ 1,192
Korean Carbon Finance, Inc.	4,739	84	741	(397)
JR CR-REIT IV Co., Ltd.	66,139	36,591	5,309	1,566
KVG REIT 1 Co., Ltd.	52,144	28,014	5,583	1,078
KOCREF REIT 17 Co., Ltd.	66,738	35,792	5,193	865
JR REIT V Co., Ltd.	31,327	15,211	2,230	1,009
JR REIT VIII Co., Ltd.	109,750	63,714	4,822	1,984
LSK Global Pharma Services Co., Ltd.	3,807	2,108	7,738	(680)

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**16. Inventories**

Inventories as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>			<b>2012</b>		
	Acquisition	Allowance	Book amount	Acquisition	Allowance	Book amount
Merchandise	₩ 10,585	₩ (354)	₩ 10,231	₩ 8,074	₩ (521)	₩ 7,553
Finished goods	427,403	(3,402)	424,001	348,664	(1,738)	346,926
Work in progress	529,683	(151)	529,532	452,730	(3,107)	449,623
Raw materials	809,545	(1,331)	808,214	821,905	(3,093)	818,812
Supplies	26,901	-	26,901	25,633	-	25,633
By-products	7,793	-	7,793	6,076	-	6,076
Unfinished housing	840	-	840	227	-	227
Lots	6,432	-	6,432	6,551	-	6,551
Goods-in-transit	79,909	-	79,909	45,395	-	45,395
	<u>₩ 1,899,091</u>	<u>₩ (5,238)</u>	<u>₩ 1,893,853</u>	<u>₩ 1,715,255</u>	<u>₩ (8,459)</u>	<u>₩ 1,706,796</u>

The cost related inventories for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Cost of sales		
- Loss on inventory valuation	₩ 2,878	₩ 1,481
- Loss on retirement of inventories	3,227	3,392
Other expenses		
- Loss on retirement of inventories	952	3,313
	<u>₩ 7,057</u>	<u>₩ 8,186</u>

**17. Cash and Cash Equivalents**

Cash and cash equivalents as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Cash on hand	₩ 5,107	₩ 4,292
Demand deposits	174,700	177,743
Short-term investment assets	168,126	190,225
	<u>₩ 347,933</u>	<u>₩ 372,260</u>

Other financial assets as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Long-term financial assets		
Time deposits	₩ 1,553	₩ 143
Deposit in current account	12	17

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Money trust	175	115
	<u>1,740</u>	<u>275</u>
Short-term Financial assets		
Time deposits	38,077	187,115
Money trust	625,000	271,000
Certificate of deposit	21,055	191,071
	<u>684,132</u>	<u>649,186</u>
	<u>₩ 685,872</u>	<u>₩ 649,461</u>

Restricted financial assets as of December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	Description	2013	2012
Cash and cash equivalents	Specific research purpose	₩ 703	₩ 1,357
Other financial assets	Pledge	1,755	1,771
Long-term other financial assets	Deposits	12	17
Long-term other financial assets	Pledge	1,410	-
		<u>₩ 3,880</u>	<u>₩ 3,145</u>

## 18. Equity and Share Premium

Details of share capital as of December 31, 2013, and 2012, are as follows:

<i>(in Korean won, except number of shares)</i>	2013	2012
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 treasury shares. Accordingly, as of December 31, 2012, the Parent Company's ordinary shares differ from the aggregate par value of issued shares by ₩ 268,497 million.

Changes in the number of shares for the years ended December 31, 2013 and 2012, are as follows:

<i>(Number of shares)</i>	2013			2012		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning	137,292,497	(11,393,697)	125,898,800	137,292,497	(11,543,697)	125,748,800
Issuance of treasury shares	-	-	-	-	150,000	150,000
Ending	<u>137,292,497</u>	<u>(11,393,697)</u>	<u>125,898,800</u>	<u>137,292,497</u>	<u>(11,393,697)</u>	<u>125,898,800</u>

## 19. Treasury Shares

Changes in the treasury shares for the years ended December 31, 2013 and 2012, are as follows:

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*(in millions of Korean won)*

	<b>2013</b>		<b>2012</b>	
	<b>Number of shares</b>	<b>Carrying amount</b>	<b>Number of shares</b>	<b>Carrying amount</b>
Beginning	11,393,697	₩ 339,059	11,543,697	₩ 343,522
Issuance of treasury shares	-	-	(150,000)	(4,463)
Ending	<u>11,393,697</u>	<u>₩ 339,059</u>	<u>11,393,697</u>	<u>₩ 339,059</u>

Changes in gain on reissuance of treasury shares for the years ended December 31, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	<b>2013</b>	<b>2012</b>
Beginning	₩ 492,032	₩ 485,922
Gain on reissuance of treasury shares before tax	-	8,061
Less: Income tax effect	-	(1,951)
Gain on reissuance of treasury shares, net of tax	-	6,110
Ending	<u>₩ 492,032</u>	<u>₩ 492,032</u>

## **20. Reserves**

Details of reserves as of December 31, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	<b>2013</b>	<b>2012</b>
Available-for-sale financial assets reserve	₩ (5,570)	₩ (30,635)
Exchange differences on translating foreign operations	(42,472)	(27,925)
Legal reserve	603,145	602,937
Voluntary reserve	2,813,732	2,466,732
	<u>₩ 3,368,835</u>	<u>₩ 3,011,109</u>

Available-for-sale financial assets reserve as of December 31, 2013 and 2012, are summarized as follows:

*(in millions of Korean won)*

	<b>2013</b>	<b>2012</b>
Available-for-sale financial assets reserve before tax	₩ (7,348)	₩ (40,415)
Tax effect	1,778	9,780
Available-for-sale financial assets reserve after tax	<u>₩ (5,570)</u>	<u>₩ (30,635)</u>

The Korean Commercial Code requires the Parent 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 Group's voluntary reserve as of December 31, 2013 and 2012, are as follows:

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<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
Reserve for business rationalization <sup>1</sup>	₩	12,851	₩	12,851
Reserve for research and human resource development <sup>2</sup>		90,000		60,000
Reserve for business expansion <sup>3</sup>		698,881		698,881
Other reserve <sup>3</sup>		2,012,000		1,695,000
	₩	<u>2,813,732</u>	₩	<u>2,466,732</u>

<sup>1</sup>*Reserve for Business Rationalization*

Until December 10, 2002 under the Special Tax Treatment Control Law, investment tax credits were allowed for certain investments. The 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.

<sup>2</sup>*Reserve for Research and Human Resource Development*

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

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

Reserves without specific purposes are restored to retained earnings by a resolution at a general meeting of shareholders.

**21. Retained Earnings**

Changes in retained earnings for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
Beginning	₩	976,425	₩	1,022,126
Transfer from other reserve		(317,000)		(359,000)
Legal reserves		(208)		-
Research and development reserves		(30,000)		-
Dividends		(402,876)		(402,396)
Profit for the period		559,304		725,118
- Less: non-controlling interests		11,363		12,920
Actuarial losses, net of tax		5,604		(18,579)
- Less: non-controlling interests		143		155
Others		-		(3,919)
Ending	₩	<u>802,755</u>	₩	<u>976,425</u>

**22. Trade and Other Payables**

Trade and other payables as of December 31, 2013 and 2012, are as follows:



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(in millions of Korean won)

	2013		2012	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	₩ 25,480	₩ -	₩ 24,979
Trade payables	83,073	-	48,190	-
Withholdings	144,696	343	136,814	428
Accrued expenses	169,971	-	144,901	-
Other payables	145,168	3,774	80,311	-
	<u>₩ 542,908</u>	<u>₩ 29,597</u>	<u>₩ 410,216</u>	<u>₩ 25,407</u>

### 23. Borrowings

Details of borrowings as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013	2012
<b>Current</b>		
Bank borrowings <sup>1</sup>	₩ 88,593	₩ 84,221
Other borrowings	7,647	7,647
Bank borrowings(Current portion of long-term borrowings)	4,305	293
Other borrowings (Current portion of long-term borrowings)	119	2,619
	<u>100,664</u>	<u>94,780</u>
<b>Non-current</b>		
Bank borrowings	20,279	11,932
Other borrowings	-	119
Convertible bonds	8,546	11,110
Convertible redeemable preference shares	72,056	69,429
Redeemable preference shares	16,758	17,009
	<u>117,639</u>	<u>109,599</u>
	<u>₩ 218,303</u>	<u>₩ 204,379</u>

<sup>1</sup> Out of the above borrowings, ₩ 20,492 million and ₩ 16,771 million as of December 31, 2013 and 2012, 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).

Details of bank borrowings as of December 31, 2013 and 2012, are as follows:

(in millions of Korean won)

Currency	Creditor	Latest maturity date	Annual interest rate(%) 2013	2013	2012
Korean won	National Agricultural Cooperative Federation, other	Short-term Borrowings	4.85	₩ 46,720	₩ 26,823
Korean won	Citibank	Short-term Borrowings	CD(91)+1.15	15,572	14,230
Korean won	Hana Bank	Short-term Borrowings	3.4~5.64	26,300	43,239
Korean won	National Agricultural Cooperative Federation	2016. 07. 20	1.50	720	756
Korean won	National Agricultural Cooperative Federation	2017. 06. 21	1.50	1,257	1,260
Korean won	National Agricultural Cooperative Federation	2017. 07. 02	1.50	10,002	-

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Korean won	Hana Bank	2017. 03. 31	3.56	744	966
Korean won	Korea Development Bank	2014. 11. 07	4.80	4,000	8,000
Korean won	Korea Development Bank	2018. 06. 09	3.77	262	291
Korean won	Hana Bank	2017. 09. 06	4.58	2,600	881
Korean won	Hana Bank	2013. 05. 15	4.15	5,000	-
				<u>₩ 113,177</u>	<u>₩ 96,446</u>

**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. 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.

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**24. Defined Benefit Liability**

The amounts recognized on the statements of income for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
Defined benefit plans :		
Current service cost	₩ 49,070	₩ 37,850
Interest expenses	9,220	9,130
Expected return on plan assets	(5,755)	(6,511)
Past service cost and gains and loss on settlement	(487)	(30)
	<u>52,048</u>	<u>40,439</u>
Defined contribution plans :		
Pension costs	2,448	2,222
Total	<u>₩ 54,496</u>	<u>₩ 42,661</u>

Termination benefits for the year ended December 31, 2013, were ₩1,839 million (2012: ₩1,194 million). Out of total expenses, ₩22,693 million (2012: ₩14,742 million) and ₩31,749 million (2012: ₩27,919 million) were included in 'cost of sales' and 'selling and administrative expenses', respectively.

The movements in the defined benefit liability for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Present value of funded defined benefit liability	₩ 291,246	₩ 286,420
Present value of unfunded defined benefit liability	24,347	1,909
Fair value of plan assets	(204,456)	(180,685)
Liability in the statement of financial position	<u>₩ 111,137</u>	<u>₩ 107,644</u>

The movements in the defined benefit obligation for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	2013	2012
Beginning balance	₩ 288,304	₩ 233,377
Current service cost	49,070	37,850
Interest cost	9,220	9,130
Past service cost	(550)	(116)
Gains on settlement	63	86
Actuarial (gains)/losses (before tax)	(5,706)	24,138
Payments, including the amount transferred to the defined contribution plan	(23,456)	(14,672)
Changes in accrued expenses	-	(16)
Net exchange difference	(1,352)	(1,448)
Ending balance	<u>₩ 315,593</u>	<u>₩ 288,329</u>

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The movements in the fair value of plan assets for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Beginning balance	₩ 180,685	₩ 150,295
Expected return on plan assets	5,755	6,511
Actuarial gains/(losses) (before tax)	317	(186)
Payment into plan assets	32,940	32,797
Payments, including the amount transferred to the defined contribution plan	(14,766)	(8,173)
Changes in accrued expenses	(475)	(536)
Net exchange difference	-	(23)
Ending balance	<u>₩ 204,456</u>	<u>₩ 180,685</u>

Actual return on plan assets for the years ended December 31, 2013 and 2012, are ₩6,324 million and ₩5,591 million, respectively.

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

Actuarial gains and losses recognized as other comprehensive income for the years ended December 31, 2013 and 2012, are as follows:

<i>(In millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Actuarial gains (losses) before income tax	₩ 6,101	₩ (24,324)
Income tax effects	(497)	5,745
Actuarial gains (losses) after income tax	<u>₩ 5,604</u>	<u>₩ (18,579)</u>

The components of plan assets as of December 31, 2013, are as follows:

<i>(In millions of Korean won)</i>	<b>2013</b>
Cash and cash equivalents	₩ 3,824
Debt instruments	24,443
Time deposit (1 year)	57,441
Others	118,748
	<u>₩ 204,456</u>

The principal actuarial assumptions as of December 31, 2013 and 2012, are as follows:

	<b>2013</b>	<b>2012</b>
Rate of salary increases	2.56%~5.35%	3.09%~5.57%
Discount rate	3.30%~3.78%	3.27%~3.37%

Sensitivities in respect of the key assumptions used to measure the defined benefit plan are as

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follows:

<i>( In millions of Korean won)</i>		<b>1% Increase</b>		<b>1% Decrease</b>
Rate of salary increases:				
Increase(decrease) in defined benefit obligations	₩	32,774	₩	(24,652)
Increase(decrease) in retirement benefits before tax		4,563		(3,406)
Discount rate:				
Increase(decrease) in defined benefit obligations		20,572		(19,619)
Increase(decrease) in retirement benefits before tax		2,331		(2,168)

**25. Operating Income and Other Income**

(1) 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.

(2) Employee benefit costs for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>		<b>2013</b>		<b>2012</b>
Salaries	₩	499,477	₩	504,853
Retirement benefits		54,496		42,661
Termination benefits		1,839		1,194
Employee welfare		65,259		61,044
	₩	<u>621,071</u>	₩	<u>609,752</u>

(3) Selling and administrative expenses for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>		<b>2013</b>		<b>2012</b>
Salaries	₩	324,372	₩	325,164
Retirement benefits		32,776		28,683
Employee welfare		45,251		41,935
Travel		11,939		13,420
Communications		5,481		5,816
Utilities		9,032		9,157
Taxes and dues		18,305		18,439
Supplies		3,298		3,953
Rent		27,290		30,640
Depreciation		47,165		48,189
Amortization		13,007		12,798
Repairs and maintenance		6,532		11,445
Vehicles		11,492		12,151
Insurance		1,638		2,215
Commissions		193,459		216,607
Freight and custody		39,939		46,503
Conferences		4,186		4,796
Advertising		259,490		310,967
Training		6,331		7,966
Prizes and rewards		1,984		2,745

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Cooperation	919	1,497
Normal research and development	32,044	37,106
Bad debts expense	23,773	15,730
	<u>₩ 1,119,703</u>	<u>₩ 1,207,922</u>

(4) Details of other income for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Foreign currency transaction gain	₩ 21,767	₩ 16,540
Foreign currency translation gain	8,130	5,646
Gain on sale of property, plant and equipment	19,117	34,337
Gain on sale of intangible assets	6,957	359
Miscellaneous revenues	15,267	18,219
	<u>₩ 71,238</u>	<u>₩ 75,101</u>

(5) Details of other expenses for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Foreign currency transaction loss	₩ 24,801	₩ 33,295
Foreign currency translation loss	59,974	50,563
Impairment loss on other receivables	13	71
Donations	10,812	23,249
Loss on sale of property, plant and equipment	2,721	7,749
Impairment loss on property, plant and equipment	-	201
Loss on sale of intangible assets	40	456
Impairment loss on intangible assets	3,313	58
Loss on retirement of inventories	-	3,313
Miscellaneous expenses <sup>1</sup>	118,232	4,148
	<u>₩ 219,906</u>	<u>₩ 123,103</u>

<sup>1</sup> ₩ 103,468 million of miscellaneous expenses is recognized in relation to tax investigation of the Parent Company which was implemented for the year ended December 31, 2013.

## 26. Expenses by Nature

Expenses by nature for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Changes in inventories	₩ (187,057)	₩ (134,497)
Raw materials and consumables purchased	1,661,000	1,653,653
Salary and wage	499,477	504,853
Retirement and termination benefits	56,335	43,855
Depreciation charges	164,330	165,586
Amortization charges	13,007	12,798
Employee benefits	65,259	61,044
Advertising costs	259,670	311,140
Service fees	221,393	255,059
Other expenses	54,932	75,240
Total cost of sales, selling and administrative expenses and other expenses	<u>₩ 2,808,346</u>	<u>₩ 2,948,731</u>

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**27. Finance Income and Costs**

Finance income and costs for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
<b>Finance costs</b>		
Interest costs	₩ (11,792)	₩ (10,216)
Loss on sale of available-for-sale financial assets	-	(287)
Impairment loss on available-for-sale financial assets	(15,000)	-
	<u>(26,792)</u>	<u>(10,503)</u>
<b>Financial income</b>		
Interest income	34,906	36,616
Dividend income	6,562	6,366
Investment income on long-term deposits in MSA	756	18
Escrow Fund	244	-
Gain on transaction of derivative instruments	<u>42,468</u>	<u>43,000</u>
<b>Net finance income</b>	<u>₩ 15,676</u>	<u>₩ 32,497</u>

Details of interest costs for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Borrowings	₩ (4,769)	₩ (4,828)
Trade and other payables	(4,765)	(1,203)
Others	(2,258)	(4,185)
	<u>₩ (11,792)</u>	<u>₩ (10,216)</u>

Details of interest income for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Deposits	₩ 27,663	₩ 30,551
Available-for-sale financial assets	290	229
Trade and other receivables	6,953	5,836
	<u>₩ 34,906</u>	<u>₩ 36,616</u>

**28. Income Tax**

Income tax expense for the years ended December 31, 2013 and 2012, consists of:

<i>(In millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
<b>Current tax expense:</b>		
Current tax on profits for the year	₩ 283,144	₩ 283,093
Adjustments in respect of prior years	46,694	2,416
Total current tax	<u>329,838</u>	<u>285,509</u>
<b>Deferred tax:</b>		
Origination and reversal of temporary differences	(7,222)	11,782
Total income tax expense	<u>₩ 322,616</u>	<u>₩ 297,291</u>

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Reconciliation of net income before tax and income expense for the years ended December 31, 2013 and 2012, follows:

*(In millions of Korean won)*

	<b>2013</b>		<b>2012</b>	
Profit before tax	₩	881,920	₩	1,022,409
Income tax based on statutory rate	₩	206,646	₩	271,331
Tax effects of:				
Incomes not taxable for tax purposes		(51)		(317)
Expenses not deductible for tax purposes		30,749		6,443
Tax credit		(4,062)		(4,082)
Adjustment in respect of prior years		46,585		2,416
Non-deduction of dividend income		(696)		(233)
Profit of subsidiaries		20,808		24,722
Others		22,637		(2,989)
Income tax expense	₩	322,616	₩	297,291

The tax (charged) / credited directly to other comprehensive income and equity as of and for the years ended December 31, 2013 and 2012, is as follows:

*(In millions of Korean won)*

	<b>2013</b>			<b>2012</b>		
	<b>Before tax</b>	<b>Tax (charge) credit</b>	<b>After tax</b>	<b>Before tax</b>	<b>Tax (charge) credit</b>	<b>After tax</b>
The tax (charge) / credit relating to components of other comprehensive income:						
Fair value gains(losses) from available-for-sale financial assets	₩ 33,067	₩ (8,002)	₩ 25,065	₩ 1,610	₩ (390)	₩ 1,220
Actuarial gains(losses) on retirement benefit obligations	6,101	(497)	5,604	(24,324)	5,745	(18,579)
Gains(Losses) on foreign operation	(321)	78	(243)	(1,517)	367	(1,150)
	<u>38,847</u>	<u>(8,421)</u>	<u>30,426</u>	<u>(24,231)</u>	<u>5,722</u>	<u>(18,509)</u>
The income tax (charged) / credited directly to equity:						
Gains (Losses) on disposal of treasury shares	-	-	-	8,061	(1,951)	6,110
	<u>₩ 38,847</u>	<u>₩ (8,421)</u>	<u>₩ 30,426</u>	<u>₩ (16,170)</u>	<u>₩ 3,771</u>	<u>₩ (12,399)</u>



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The analysis of deferred tax assets and deferred tax liabilities as of December 31, 2013 and 2012, is as follows:

<i>(In millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Deferred tax assets		
Deferred tax asset to be recovered after more than 12 months	₩ 124,653	₩ 100,212
Deferred tax asset to be recovered within 12 months	53,469	39,172
	<u>178,122</u>	<u>139,384</u>
Deferred tax liabilities		
Deferred tax liability to be recovered after more than 12 months	(399,422)	(358,054)
Deferred tax liability to be recovered within 12 months	(12)	(1,443)
	<u>(399,434)</u>	<u>(359,497)</u>
Deferred tax assets (liabilities), net	<u>₩ (221,312)</u>	<u>₩ (220,113)</u>

The gross movement on the deferred income tax account for the years ended December 31, 2013 and 2012, is as follows:

<i>(In millions of Korean won)</i>	<b>2013</b>	<b>2012</b>
Beginning balance	₩ (220,113)	₩ (212,102)
Tax charged to the statement of income	7,222	(13,733)
Tax charge / (credit) relating to components of other comprehensive income	(8,421)	5,722
Ending balance	<u>₩ (221,312)</u>	<u>₩ (220,113)</u>

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The movements in deferred income tax assets and liabilities during the year, without taking into consideration the offsetting of balances within the same tax jurisdiction, are as follows:

<i>(In millions of Korean won)</i>										
	January 1, 2013	Beginning adjustment	Credited to profit (Charged to loss)	Charged to other comprehensive income	Charged or credited directly to equity	December 31, 2013				
<b>Deferred tax assets</b>										
Available-for-sale financial assets	₩ 11,117	₩ -	₩ 3,630	₩ -	₩ -	₩ 14,747				
Accrued expense	26,973	-	(551)	-	-	26,422				
Defined benefit liabilities	8,980	15	1,834	(497)	-	10,332				
Depreciation	8,842	(508)	4,074	-	-	12,408				
Long-term advances from customers	3,713	-	(87)	-	-	3,626				
Specific sales	5,449	-	(467)	-	-	4,982				
Change in value of available-for-sale financial assets	9,779	-	-	(8,002)	-	1,777				
Allowance for doubtful accounts	4,441	20	11,166	-	-	15,627				
Foreign currency losses	-	-	-	-	-	-				
	<u>₩ 79,294</u>	<u>₩ (473)</u>	<u>₩ 19,599</u>	<u>₩ (8,499)</u>	<u>₩ -</u>	<u>₩ 89,921</u>				
<b>Deferred tax liabilities</b>										
Investment in subsidiaries	₩ (240,702)	₩ -	₩ (22,923)	₩ -	₩ -	₩ (263,625)				
Treasury stock	(8,808)	-	-	-	-	(8,808)				
Cost of specific sales	(2,610)	-	248	-	-	(2,362)				
Reserve	(22,199)	(82)	4,592	-	-	(17,689)				
Provision for advanced depreciation	(14,493)	-	-	-	-	(14,493)				
Others	(10,595)	(270)	6,531	78	-	(4,256)				
	<u>₩ (299,407)</u>	<u>₩ (352)</u>	<u>₩ (11,552)</u>	<u>₩ 78</u>	<u>₩ -</u>	<u>₩ (311,233)</u>				

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<i>(In millions of Korean won)</i>	January 1, 2012	Beginning adjustment	Credited to profit (Charged to loss)	Charged to other comprehensive income	Charged or credited directly to equity	December 31, 2012
<b>Deferred tax assets</b>						
Available-for-sale financial assets	₩ 11,812	₩ (697)	₩ 2	₩ -	₩ -	₩ 11,117
Accrued expense	25,325	-	1,648	-	-	26,973
Defined benefit liabilities	2,917	148	170	5,745	-	8,980
Depreciation	6,065	-	2,777	-	-	8,842
Long-term advances from customers	3,133	-	580	-	-	3,713
Specific sales	5,398	-	51	-	-	5,449
Change in value of available-for-sale financial assets	10,169	-	-	(390)	-	9,779
Allowance for doubtful accounts	-	1,856	2,585	-	-	4,441
Foreign currency gains and losses	91	-	(91)	-	-	-
	<u>₩ 64,910</u>	<u>₩ 1,307</u>	<u>₩ 7,722</u>	<u>₩ 5,355</u>	<u>₩ -</u>	<u>₩ 79,294</u>
<b>Deferred tax liabilities</b>						
Investment in subsidiaries	₩ (216,677)	₩ 697	₩ (24,722)	₩ -	₩ -	₩ (240,702)
Treasury stock	(8,924)	-	116	-	-	(8,808)
Cost of specific sales	(2,532)	-	(78)	-	-	(2,610)
Reserve	(21,868)	-	(331)	-	-	(22,199)
Provision for advanced depreciation	(5,194)	-	(9,299)	-	-	(14,493)
Others	(21,817)	(1,856)	12,711	367	-	(10,595)
	<u>₩ (277,012)</u>	<u>₩ (1,159)</u>	<u>₩ (21,603)</u>	<u>₩ 367</u>	<u>₩ -</u>	<u>₩ (299,407)</u>

Unrecognized temporary differences related to interests in subsidiary as deferred tax liabilities as of December 31, 2013 is ₩12,940 million.

Details of unused losses and others are as follows:

<i>(in millions of Korean won)</i>	Amount	Remark
Unused losses	100,939	
Unused tax credits	1,821	

The maturity of unused losses and tax credits are as follows:

<i>(in millions of Korean won)</i>	Within 3 years	Over 5 years ~ within 8 years	Over 5 years ~ within 8 years	Over 8 years
Unused losses	₩ -	₩ -	₩ 20,584	₩ 80,355
Unused tax credits	777	1,044	-	-

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**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 years ended December 31, 2013 and 2012, is as follows:

	2013	2012
<i>(in Korean won, except number of shares)</i>		
Profit for the period	₩ 570,667 million	₩ 738,037 million
Weighted-average number of ordinary shares outstanding	125,898,800	125,756,587
<b>Basic and diluted earnings per share in won</b>	<b>₩ 4,533</b>	<b>₩ 5,869</b>

**30. Dividends**

Dividend distribution to the Company's shareholders amounted to ₩ 402,876 million for the year ended December 31, 2012, was paid in March 2013. A dividend in respect of the year ended December 31, 2013, of ₩ 3,200 per share, amounting to a total dividend of ₩ 402,876 million, is to be proposed at the annual general meeting on March 7, 2014. These financial statements do not reflect this dividend payable.

**31. Cash Generated from Operations**

(1) Cash generated from operations for the years ended December 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013	2012
<b>Profit</b>	₩ 559,304	₩ 725,118
<b>Adjustments for</b>		
Income tax expense	322,616	297,291
Finance costs	26,792	10,503
Finance income	(42,468)	(43,000)
Depreciation	164,330	165,586
Amortization	13,007	12,798
Retirement and termination benefits	47,046	40,600
Foreign currency translations loss	59,974	50,563
Loss on the write-down of inventories	2,878	1,481
Impairment loss on trade and other receivables	23,786	15,801
Loss on sale of property, plant and equipment	2,721	7,749
Loss on sale of intangible assets	41	456
Impairment loss on intangible assets	3,313	-
Other expense	88,147	3,783
Share of gain of associates	(3,223)	(2,222)
Share of loss of associates	1,662	239
Foreign currency translations gain	(8,130)	(5,646)
Gain on sale of property, plant and equipment	(19,117)	(34,337)
Gain on sale of intangible assets	(6,957)	(359)
	<b>1,235,722</b>	<b>1,246,404</b>

**Changes in working capital:**

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Trade and other receivables	(68,474)	(147,370)
Advance payments	20,986	(8,413)
Prepaid expenses	2,639	2,582
Prepaid tobacco excise and other taxes	(8,208)	(55,649)
Inventories	(222,818)	(162,565)
Trade and other payables	37,680	75,162
Advance receipts	630	23,681
Tobacco excise and other taxes payable	(50,090)	92,000
Payment of retirement benefits	(41,233)	(38,918)
<b>Cash generated from operations</b>	<b>₩ 906,834</b>	<b>₩ 1,026,914</b>

(2) Non-cash transactions

	<b>2013</b>	<b>2012</b>
<i>(in millions of Korean won)</i>		
Reclassification of construction in progress to property, plant and equipment	87,027	190,248
Reclassification of property, plant and equipment to non-current assets held for sale	523	23,935
Reclassification of investment property to property, plant and equipment	3,743	-

**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 December 31, 2013, tobacco lawsuits claiming damages of ₩ 584 million are filed against the Group and the Korean government. The amount of the liability the Group may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of December 31, 2013. Additionally, as of December 31, 2013, the Group is involved in eleven lawsuits as a defendant for alleged damages totaling ₩ 2,159 million. The amount of the liability the Group may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of December 31, 2013.

As of December 31, 2013, the Group has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 66,000 thousand.

As of December 31, 2013, the Group's trade receivables from the export of cigarettes are insured against non-payment up to USD 39,207 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of December 31, 2013, the Group has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries and for an opening of L/C for import and customs with relation to a subsidiary located in U.S.A(Global Trading Inc.) for 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, regarding an opening of L/C for import and customs for a subsidiary located in U.S.A (Global Trading Inc.).The Group also provides Bid Bond

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with limits in the aggregate of THB 6,907 thousand in relation to an opening of L/C for export of tobacco sheet for Thailand Tobacco Monopoly as of December 31, 2013.

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 ₩ 181,697 million (non-current: ₩ 138,699 million (2012: ₩ 182,594 million) ; current: ₩ 42,998 million (2012: ₩ 58,259 million)) as of December 31, 2013.

As of December 31, 2013, the Group has an accounts receivable loan agreement with a limit of ₩ 64,000 million with Hana Bank and other financial institutions.

As of December 31, 2013, 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 December 31, 2013, the Group has a loan agreement with a limit of ₩ 182,748 million with Shinhan Bank and other financial institutions.

As of December 31, 2013, 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 December 31, 2013, 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 December 31, 2013, 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 current 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.

#### **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.

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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 December 31, 2013. The amount of guarantee is ₩152,263 million and the guarantee will expire on June 30, 2015.

**33. Related Party Transactions**

The Group has no significant transactions and receivables, liabilities with related parties, for the year ended December 31, 2013.

The guarantee being provided by related parties as of December 31, 2013 and 2012, are as follows:

*(in millions of Korean won)*

Guarantor	Guarantee for	Purpose	2013		2012	
			Limit	Guarantee amount	Limit	Guarantee amount
Kang Seok-chang	Somang Cosmetics Co., Ltd.	Application funds	₩ -	₩ -	₩ 2,591	₩ 2,893

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The compensation paid or payable to key management for employee services for the years ended December 31, 2013 and 2012, consists of:

	2013	2012
<i>(in millions of Korean won)</i>		
Short-term employee benefits	₩ 27,457	₩ 27,738
Retirement benefits	3,063	3,549
	<u>₩ 30,520</u>	<u>₩ 31,287</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 ₩ 1055.30 to US\$1, the basic exchange rate on December 31, 2013, 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.