KT&G Corporation and Subsidiaries

Consolidated Financial Statements
December 31, 2012

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December 31, 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 (the "Company") and its subsidiaries (collectively the "Group") as of December 31, 2012, and the related consolidated statements of comprehensive income, changes in equity and cash flows for the year 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 audit. The consolidated financial statements of the Group as of and for the year ended December 31, 2011, presented herein for comparative purposes, were audited by other auditors whose report dated February 16, 2012, expressed an unqualified opinion on those statements. The consolidated financial statements as of Dec 31, 2011, with unqualified opinion by KPMG Samjong Accounting Corporation do not reflect adjustments due to the change of accounting policy, stated in Note 2.1.1. However, the comparable consolidated financial statements on appendix reflect these adjustments.

We conducted our audit 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 audit provides 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, 2012, and their financial performance and cash flows for the year then ended, in accordance with International Financial Reporting Standards as adopted by the Republic of Korea ("Korean IFRS").

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Seoul 140-702, Korea (Yongsan P.O Box 266, 140-600), www.samil.com

The accompanying consolidated financial statements as of and for the years ended December 31, 2012 and 2011, 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.

Samil PricewaterhouseCoopers

Seoul, Korea
February 5, 2013

This report is effective as of February 5, 2013, 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, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars)	Notes	December 31, 2012 Korean won	December 31, 2012 U.S. dollars (Note 34)	December 31, 2011 Korean won
Assets				
Non-current assets				
Property, plant and equipment	10,14	₩ 1,631,436	$ 1,523,141	₩ 1,584,346
Intangible assets	11	246,793	230,411	258,618
Investment property	12,14	181,986	169,905	188,351
Investments in associates	5,15	55,777	52,075	35,330
Available-for-sale financial assets	6,7	263,884	246,367	247,359
Other financial assets	6,17	275	256	1,427
Long-term deposits in MSA Escrow Fund	6,9,32	168,667	157,471	147,290
Long-term advance payments	32	144,649	135,047	142,880
Long-term prepaid expenses		5,416	5,056	5,775
Long-term trade and other receivables	6,8	121,784	113,700	134,115
Deferred income tax assets	28	17,491	16,330	15,487
		2,838,158	2,649,759	2,760,978
Current assets				
Inventories	16	1,706,796	1,593,498	1,572,299
Available-for-sale financial assets	6,7	1,000	934	1,044
Other financial assets	6,17	649,186	606,093	11,089
Prepaid tobacco excise and other taxes		257,183	240,111	201,911
Trade and other receivables	6,8	883,778	825,113	833,310
Advance payments	32	66,315	61,913	64,342
Prepaid expenses		20,523	19,160	20,516
Cash and cash equivalents	6,17	372,260	347,550	807,731
		3,957,041	3,694,372	3,512,242
Assets held for sale	5,13	762	711	3,196
Total assets		₩ 6,795,961	$ 6,344,842	₩ 6,276,416
Equity				
Capital stock	1,18	₩ 954,959	$ 891,569	₩ 954,959
Other capital surplus	18	(4,573)	(4,269)	5,333
Treasury shares	19	(339,059)	(316,552)	(343,522)
Gain on reissuance of treasury shares	19	492,032	459,371	485,922
Reserve	20	3,011,110	2,811,230	2,663,313
Retained earnings	21	976,425	911,610	1,022,126
Equity attributable to equity holders of the Company		5,090,894	4,752,959	4,788,131
Non-controlling interests		103,524	96,652	96,946
Total equity		5,194,418	4,849,611	4,885,077
Liabilities				
Non-current liabilities				
Long-term borrowings	6,23	109,599	102,324	37,847
Long-term trade and other payables	6,22	25,407	23,721	26,031
Long-term advance receipts		20,239	18,895	14,072
Defined benefit liability	24	107,644	100,498	83,082
Provisions for other liabilities and charges		3,329	3,108	3,509
Deferred income tax liabilities	28	237,605	221,832	227,589
		503,823	470,378	392,130
Current liabilities				
Borrowings	6,23	91,868	85,770	82,836
Current portion of long-term borrowings	6,23	2,912	2,718	3,126
Trade and other payables	6,22	410,216	382,986	422,734
Advance receipts		30,875	28,826	12,628
Income taxes payable	28	148,925	139,039	164,579
Tobacco excise and other taxes payable		412,924	385,514	313,306
		1,097,720	1,024,853	999,209
Total liabilities		1,601,543	1,495,231	1,391,339
Total liabilities and equity		₩ 6,795,961	$ 6,344,842	₩ 6,276,416

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, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars, except per share amounts)	Notes	2012 Korean won	2012 U.S. dollars (Note 34)	2011 Korean won
Sales		₩ 3,984,662	$ 3,720,159	₩ 3,722,966
Cost of sales	26	(1,740,809)	(1,625,254)	(1,607,591)
Gross profit		2,243,853	2,094,905	2,115,375
Selling and administrative expenses	25,26	(1,207,922)	(1,127,740)	(1,025,034)
Operating income		1,035,931	967,165	1,090,341
Other income	25	75,101	70,116	118,899
Other expenses	25,26	(123,103)	(114,932)	(88,611)
Net other income		(48,003)	(44,816)	30,287
Finance income	27	43,000	40,146	47,339
Finance expense	27	(10,503)	(9,806)	(8,221)
Net Finance income		32,497	30,340	39,118
Income from jointly controlled entities and associates	15	2,223	2,075	1,326
Expense from jointly controlled entities and associates	15	(239)	(223)	(8)
Profit before income tax		1,022,409	954,541	1,161,064
Income tax expense	28	(297,291)	(277,557)	(344,135)
Profit for the year		₩ 725,118	$ 676,984	₩ 816,929
Other comprehensive income				
Change in value of available-for-sale financial assets	7	₩ 1,220	$ 1,139	₩ (49,889)
Gain(Loss) on currency translation of foreign operations		(12,423)	(11,598)	(10,026)
Actuarial gain(loss) on defined benefit liability	24	(18,579)	(17,346)	(19,449)
Other comprehensive income (loss) for the year, net of tax		(29,781)	(27,805)	(79,364)
Total comprehensive income for the year		₩ 695,337	$ 649,179	₩ 737,565
Profit for the year attributable to:				
Equity holders of the Parent Company		₩ 738,037	$ 689,046	₩ 816,058
Non-controlling interests		(12,919)	(12,062)	871
		₩ 725,118	$ 676,984	₩ 816,929
Total comprehensive income for the year attributable to:				
Equity holders of the Parent Company		₩ 708,412	$ 661,386	₩ 737,799
Non-controlling interests		(13,075)	(12,207)	(234)
		₩ 695,337	$ 649,179	₩ 737,565
Earnings per share attributable to the equity holders of the Parent Company during the year (in won)				
Basic and diluted earnings per share	29	₩ 5,869	$ 5.48	₩ 6,451

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, 2012 and 2011

(in millions of Korean won)

	Notes	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total	Non-controlling Interests	Total Equity
		Attributable to equity holders of the Parent Company								
Balance at January 1, 2011		₩ 954,959	₩ 5,333	₩ (216,827)	₩ 482,129	₩ 2,179,227	₩ 1,151,359	₩ 4,556,180	₩ 42,130	₩ 4,598,310
Comprehensive income										
Profit for the year		-	-	-	-	-	816,058	816,058	871	816,929
Change in value of available-for-sale financial assets		-	-	-	-	(49,889)	-	(49,889)	-	(49,889)
Gain(Loss) on currency translation of foreign operations		-	-	-	-	(10,025)	-	(10,025)	-	(10,025)
Actuarial gain(loss) on defined benefit liability		-	-	-	-	-	(18,345)	(18,345)	(1,104)	(19,449)
Total comprehensive income (loss)		-	-	-	-	(59,914)	797,713	737,799	(233)	737,566
Transactions with equity holders of the Company										
Cash dividends		-	-	-	-	-	(382,946)	(382,946)	-	(382,946)
Other reserve		-	-	-	-	544,000	(544,000)	-	-	-
Disposition of treasury shares		-	-	2,976	3,793	-	-	6,769	-	6,769
Acquisition of treasury shares		-	-	(129,671)	-	-	-	(129,671)	-	(129,671)
Acquisition of investments in subsidiaries		-	-	-	-	-	-	-	55,049	55,049
Total transactions with equity holders of the Company		-	-	(126,695)	3,793	544,000	(926,946)	(505,848)	55,049	(450,799)
Balance at December 31, 2011		₩ 954,959	₩ 5,333	₩ (343,522)	₩ 485,922	₩ 2,663,313	₩ 1,022,126	₩ 4,788,131	₩ 96,946	₩ 4,885,077
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
Gain(Loss) on currency translation of foreign operations		-	-	-	-	(12,423)	-	(12,423)	-	(12,423)
Actuarial gain(loss) on 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 Parent 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
Change in subsidiaries interest		-	(9,906)	-	-	-	-	(9,906)	9,834	(72)
Other transactions		-	-	-	-	-	(3,919)	(3,919)	4,429	510
Total transactions with equity holders of the Company		-	(9,906)	4,463	6,110	359,000	(765,315)	(405,648)	19,653	(385,995)
Balance at December 31, 2012		₩ 954,959	₩ (4,573)	₩ (339,059)	₩ 492,032	₩ 3,011,110	₩ 976,425	₩ 5,090,894	₩ 103,524	₩ 5,194,418

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, 2012

(in thousands of U.S. dollars) (Note 34)	Notes	Attributable to equity holders of the Parent Company: Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total	Non-controlling Interests	Total Equity
Balance at January 1, 2012		$ 891,569	$ 4,979	$ (320,719)	$ 453,666	$ 2,486,521	$ 954,277	$ 4,470,293	$ 90,512	$ 4,560,805
Comprehensive income										
Profit for the year		-	-	-	-	-	689,046	689,046	(12,062)	676,984
Change in value of available-for-sale financial assets		-	-	-	-	1,139	-	1,139	-	1,139
Gain(Loss) on currency translation of foreign operations		-	-	-	-	(11,598)	-	(11,598)	-	(11,598)
Actuarial gain(loss) on defined benefit liability		-	-	-	-	-	(17,201)	(17,201)	(145)	(17,346)
Total comprehensive income (loss)		-	-	-	-	(10,459)	671,845	661,386	(12,207)	649,179
Transactions with equity holders of the Parent Company										
Cash dividends		-	-	-	-	-	(375,685)	(375,685)	-	(375,685)
Other reserve		-	-	-	-	335,168	(335,169)	(1)	-	(1)
Disposition of treasury shares		-	-	4,167	5,705	-	-	9,872	-	9,872
Convertible bond – equity component		-	-	-	-	-	-	-	5,032	5,032
Change in subsidiaries interest		-	(9,248)	-	-	-	-	(9,248)	9,180	(68)
Other transactions		-	-	-	-	-	(3,658)	(3,658)	4,135	477
Total transactions with equity holders of the Company		-	(9,248)	4,167	5,705	335,168	(714,512)	(378,720)	18,347	(360,373)
Balance at December 31, 2012		$ 891,569	$ (4,269)	$ (316,552)	$ 459,371	$ 2,811,230	$ 911,610	$ 4,752,959	$ 96,652	$ 4,849,611

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, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars)	Notes	2012 Korean won	2012 U.S. dollars (Note 34)	2011 Korean won
Cash flows from operating activities				
Cash generated from operations	31	₩ 1,026,914	$ 958,747	₩ 1,111,648
Income tax paid		(304,076)	(283,892)	(354,794)
Net cash generated from operating activities		722,838	674,855	756,854
Cash flows from investing activities				
Interest received		40,709	38,007	33,210
Investment income received from long-term deposits in MSA Escrow Fund		407	380	10,582
Dividends received		8,903	8,312	7,116
Proceeds from sale of property, plant and equipment		35,783	33,408	32,716
Proceeds from sale of intangible assets		830	775	25,473
Proceeds from sale of non-current asset held for sale		-	-	977
Proceeds from sale of available-for-sale financial assets		4,133	3,858	2,570
Proceeds from sale of investments in subsidiaries		-	-	113
Decrease in loans		21,612	20,177	21,972
Decrease in guarantee deposits		66,973	62,527	36,916
Acquisition of property, plant and equipment		(263,443)	(245,955)	(288,529)
Acquisition of intangible assets		(6,207)	(5,795)	(18,202)
Acquisition of investment property		(51)	(48)	(2,136)
Acquisition of jointly controlled entities and associates		(21,000)	(19,606)	(16,595)
Acquisition of investments in subsidiaries		-	-	(194,539)
Acquisition of available-for-sale financial assets		(16,500)	(15,405)	(22,316)
Increase in loans		(37,669)	(35,168)	(7,412)
Increase in guarantee deposits		(61,605)	(57,516)	(42,452)
Increase in long-term deposits in MSA Escrow Fund		(34,096)	(31,833)	(15,150)
Decrease(Increase) in other financial assets		(636,804)	(594,533)	7,069
Net cash used in investing activities		(898,025)	(838,415)	(428,617)
Cash flows from financing activities				
Interest paid		(11,557)	(10,790)	(3,563)
Dividends paid		(402,396)	(375,685)	(382,946)
Proceeds from borrowings		289,022	269,837	56,844
Increase in deposits received		5,903	5,511	10,135
Repayments of borrowings		(146,422)	(136,703)	(52,777)
Decrease in deposits received		(5,227)	(4,880)	(6,550)
Issuance of common stock		-	-	10
Disposition of treasury shares		12,525	11,694	7,980
Acquisition of treasury shares		-	-	(129,671)
Net cash used in financing activities		(258,152)	(241,016)	(500,538)
Net decrease in cash and cash equivalents		(433,339)	(404,576)	(172,301)
Cash and cash equivalents at the beginning of year		807,731	754,114	981,314
Exchange gains/(losses) on cash and cash equivalents		(2,132)	(1,988)	(1,282)
Cash and cash equivalents at the end of year		₩ 372,260	$ 347,550	₩ 807,731

The accompanying notes are an integral part of these interim consolidated financial statements.
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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, 2012, 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.

The ownership of the Parent Company's issued ordinary shares as of December 31, 2012, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee share ownership association	2,706,848	1.97%
Others	113,681,467	82.80%
	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, 2012, are as follows:

Immediate Parent	Subsidiaries	Location	Percentage of ownership (%) 2012
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.[1]	Korea	60.00
	Renzoluc Pte., Ltd[2].	Singapore	100.00
	KT&G Life Science[3]	Korea	73.94
	Yebon Nongwon Agriculture Co., Ltd	Korea	90.00
	KGC Yebon	Korea	100.00
	K-Q HongKong I,Limited[4]	Hong Kong	100.00
Renzoluc Pte., Ltd.	PT Trisakti Purwosari Makmur	Indonesia	60.17
PT Trisakti Purwosari Makmur	PT Sentosa Ababi Purwosari	Indonesia	99.24
	PT Purindo Ilufa	Indonesia	100.00
Korea Ginseng Corporation	Cheong Kwan Jang Taiwan Corporation	Taiwan	100.00
	Korean Red Ginseng Corp., Inc.	USA	100.00
	Korea Ginseng (China) Corp.	China	100.00
	Korea Ginseng Corporation Japan	Japan	100.00
	PT CKJ INDONESIA	Indonesia	99.88

[1] The Parent Company's percentage of ownership includes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership excludes convertible preferred shares, is 50.00%.

[2] The Parent Company's percentage of ownership includes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership excludes convertible preferred shares, is 68.91%.

[3] The Parent Company's percentage of ownership includes convertible preferred shares. As of December 31, 2012, the Company's percentage of ownership excludes convertible preferred shares, is 59.48%.

[4] The Parent Company's percentage of ownership includes convertible preferred shares. As of

December 31, 2012, the Company's percentage of ownership excludes convertible preferred shares, is 50.00%.

Summarized financial information of subsidiaries as of December 31, 2012, is as follows:

(In millions of Korean won)

Subsidiaries	Total assets	Total liabilities	Revenue	Profit (loss)	Total comprehensive income
Korea Ginseng Corporation	1,283,286	127,045	831,902	99,725	99,576
Yungjin Pharm. Ind. Co., Ltd.	161,951	70,882	137,688	1,794	1,189
Tae-a industry Co., Ltd.	14,868	3,418	16,221	355	278
KT&G Tutun Mamulleri Sanayive Ticaret A.S.	52,323	31,262	16,949	(5,697)	(5,613)
Korea Tabacos do Brasil Ltda.	1,099	11	-	-	-
KT&G Pars	43,136	43,008	20,749	(1,655)	(2,139)
KT&G Rus L.L.C.	142,108	37,580	44,363	(1,857)	(3,703)
KG Life & Gin Co., Ltd	21,441	12,494	57,008	(30,583)	(30,670)
Global Trading, Inc.	32,868	26,064	168,614	(7)	(529)
Jilin Hanzheng Ginseng Co., Ltd.	66,565	40,573	-	(3,637)	(5,265)
Somang Cosmetics Co., Ltd.	91,241	67,826	126,526	549	815
Renzoluc Pte., Ltd.	109,658	59,697	-	618	(2,236)
KT&G Life science	38,598	14,091	13	(6,170)	(6,083)
Yebon Nongwon Agriculture Co., Ltd	101	-	-	1	1
KGC Yebon	44,333	1,899	-	(1,267)	(1,267)
PT Trisakti Purwosari Makmur	133,652	91,383	51,422	(9,076)	(12,478)
Cheong Kwan Jang Taiwan Corporation	21,700	21,677	18,778	(1,775)	(1,777)
Korean Red Ginseng Corp., Inc.	6,587	3,404	10,319	86	(154)
Korea Ginseng (China) Corp.	43,714	34,149	33,780	(6,583)	(7,150)
Korea Ginseng Corporation Japan	5,536	3,551	6,315	(5,973)	(6,654)
K-Q HongKong I,Limited	34,396	-	-	398	(1,126)
PT CKJ INDONESIA	3,095	2,282	1,041	(40)	(67)

During the year ended December 31, 2012, there has been no change in consolidation scope, except KGC Yebon, K-Q HongKong I,Limited and PT CKJ INDONESIA being included in the consolidation,while Rosee Cosmetics and KT&G Bio were liquidated.

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 periods 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 Group's financial statements for the annual period beginning on January 1, 2011, have been prepared in accordance with Korean IFRS. These are the standards, subsequent amendments and related interpretations issued by the International Accounting Standards Board ("IASB") that have been adopted by the Republic of Korea.

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 changed its accounting policy to present the operating income after deducting cost of sales, and selling and administrative expenses from revenue, in accordance with the amendment of Korean IFRS 1001, *Presentation of Financial Statements.*

The Group applies the accounting policy retroactively in accordance with the amended standards and the comparative consolidated statement of the comprehensive income is restated by reflecting adjustments resulting from the retrospective application. As a result of the changes in the accounting policy, other income and expenses of ₩75,101 million and ₩123,103 million, respectively, for the year ended December 31, 2012 (2011: ₩118,899 million and ₩88,611 million, respectively), which include gain or loss on disposal of property, plant and equipment, gain on valuation of available-for-sale securities and gain or loss on disposal of investments in associates and others, classified as operating income under the previous standard, were excluded from operating income. Consequently, operating income for the years ended December 31, 2012 and 2011, increased by ₩48,002 million and decreased by ₩30,288 million, respectively, as compared to the amounts under the previous standard. However, there is no material impact on net income and earnings per share for the years ended December 31, 2012 and 2011.

(b) New standards and interpretations not yet adopted

New standards, amendments and interpretations issued but not effective for the financial year beginning January 1, 2012, and not early adopted by the Group are as follows:

- Amendment of Korean IFRS 1001, *Presentation of Financial Statements*

Korean-IFRS 1001, *Presentation of Financial Statements*, was amended to require other comprehensive income items to be presented into two groups on the basis of whether they are potentially reclassifiable to profit or loss subsequently. This is effective for annual periods beginning on or after July 1, 2012, with early adoption permitted. The Group expects that the application of this amendment would not have a material impact on its consolidated financial statements.

- Amendments to Korean IFRS 1019, *Employee Benefits*

According to the amendments to Korean IFRS 1019, *Employee Benefits*, the use of a 'corridor' approach is no longer permitted, and therefore all actuarial gains and losses incurred are immediately recognized in other comprehensive income. All past service costs incurred from changes in pension plan are immediately recognized, and expected returns on interest costs and plan assets that used to be separately calculated are now changed to calculating net interest expense (income) by applying discount rate used in measuring defined benefit obligation in net defined benefit liabilities (assets). This amendment will be effective for annual periods beginning on or after January 1, 2013, and the Group is assessing the impact of application of the amended Korean IFRS 1019 on its consolidated financial statements as of the report date.

- Enactment of Korean IFRS 1113, *Fair Value Measurement*

Korean IFRS 1113, *Fair value measurement*, aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across Korean IFRSs. Korean IFRS 1113 does not extend the use of fair value accounting but provides guidance on how it should be applied where its use is already required or permitted by other standards within the Korean IFRSs. This amendment will be effective for annual periods beginning on or after January 1, 2013, and the Group expects that the application of this enactment would not have a material impact on its consolidated financial statements.

- Enactment of Korean IFRS 1110, *Consolidated Financial Statements*

Korean IFRS 1110, Consolidated Financial Statements, builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included in the consolidated financial statements of the Parent Company. An investor controls an 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. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. This amendment will be effective for annual periods beginning on or after January 1, 2013, and the Group is reviewing the impact of the amended Korean IFRS 1110.

- Enactment of Korean IFRS 1111, *Joint Arrangements*

Korean IFRS 1111, Joint Arrangements, aims to reflect the substance of joint arrangements by focusing on the contractual rights and obligations that each party to the arrangement has rather than its legal form. Joint arrangements are classified as either joint operations or joint ventures. A joint operation is when joint operators have rights to the assets and obligations for the liabilities, and account for the assets, liabilities, revenues and expenses, while parties to the joint venture have rights to the net assets of the arrangement and account for their interest in the joint venture using the equity method. This amendment will be effective for annual periods beginning on or after January 1, 2013, and the Group is reviewing the impact of the amended Korean IFRS 1111..

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

Korean IFRS 1112, Disclosures of Interests in Other Entities, provides the disclosure requirements for all forms of interests in other entities, including a subsidiary, a joint arrangement, an associate, a consolidated structured entity and an unconsolidated structured entity. This amendment will be effective for annual periods beginning on or after January 1, 2013, and the Group is reviewing the impact of the amended Korean IFRS 1112.

2.2 Consolidation

The Group has prepared the consolidated financial statements in accordance with Korean-IFRS1027, *Consolidated and Separate Financial Statements.*

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Parent Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Parent Company controls another entity. The Group also assesses existence of control where it does not have more than 50% of the voting power but is able to govern the financial and operating policies by virtue of de-facto control. De-facto control may arise in circumstances where the size of the Group's voting rights relative to the size and dispersion of holdings of other shareholders give the Group the power to govern the financial and operating policies and others.

Subsidiaries are fully consolidated from the date on which control is transferred to the Parent Company. They are de-consolidated from the date that control ceases.

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is measured as the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Company. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognizes any non-controlling interest in the acquiree on an acquisition- by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognized amounts of acquiree's identifiable net assets.

Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date and the resulting gain or loss is recognized in profit or loss.

Any contingent consideration to be transferred by the Group is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with Korean-IFRS1039, either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred and the fair value of non-controlling interest over the net identifiable assets acquired and liabilities assumed. 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.

Intercompany transactions, balances, income and expenses on transactions between Group companies are eliminated. Unrealized losses are also eliminated after recognizing impairment of transferred assets. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(b) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting. Under the equity method, the investment is initially recognized at cost, and the carrying amount is increased or decreased to recognize the investor's share of the profit or loss of the investee after the date of acquisition. The Group's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognized in other comprehensive income is reclassified to profit or loss where appropriate.

The Group's share of post-acquisition profit or loss is recognized in the statement of comprehensive income, and its share of post-acquisition movements in other comprehensive income is recognized in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognizes the amount as 'impairment loss on investment in an associate' in the statement of comprehensive income.

Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group. Dilution gains and losses arising in investments in associates are recognized in the statement of comprehensive income.

(c) Joint ventures

A joint venture is a contractual arrangement whereby two or more parties (venturers) exercise joint control. As with associates, investments in jointly controlled entities are accounted for using the equity method of accounting and are initially recognized at cost. The Group's investment in jointly controlled entities includes goodwill identified on acquisition, net of accumulated impairment loss. The Group does not recognize its share of profits or losses from the joint venture that result from the Group's purchase of assets from the joint venture until it re-sells the assets to an independent party. However, a loss on the transaction is recognized immediately if the loss provides evidence of a reduction in the net realizable value of current assets, or an impairment loss.

(d) Changes in ownership interests in subsidiaries without change of control

Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions; that is, as transactions with the owners in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

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.

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 entity operates ("the functional currency"). The consolidated financial statements are presented in Korean won, which is the controlling entity'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 the statement of comprehensive income, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the statement of comprehensive income within 'financial income or expenses'. All other foreign exchange gains and losses are presented in the statement of comprehensive income within 'other gains and losses, net'.

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analyzed between translation differences resulting from changes in the amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortized cost are recognized in profit or loss, and other changes in carrying amount are recognized in other comprehensive income.

(c) Translation to presentation currency

The results and financial position of all Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing rate at the end of the reporting period;
- income and expenses for each statement of comprehensive income are translated at average exchange rates; and
- all resulting exchange differences are recognized in other comprehensive income.

Exchange differences arising from the translation of borrowings designated for hedging the investment and other currency instruments are recognized in other comprehensive income. When foreign operations are wholly or partially sold, exchange differences recognized in equity are transferred to profit or loss in the statement of comprehensive income. When the Company ceases to control the subsidiary, exchange differences that were recorded in equity are recognized in the statement of comprehensive income as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

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.

2.6 Financial Assets

2.6.1 Classification

The Group classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, available-for-sale, and held-to-maturity. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

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

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives or embedded derivatives are also categorized as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. The Group's loans and receivables comprise 'cash and cash equivalents', 'trade and other receivables', and 'other financial assets' in the statement of financial position.

(c) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of them within 12 months after the end of the reporting period.

(d) Financial liabilities carried at amortized cost

The Group classifies non-derivative financial liabilities, except for financial liabilities at fair value through profit or loss, financial guarantee contracts and financial assets that arise when a transfer of financial liabilities at fair value through profit or loss, financial guarantee contracts and financial assets does not qualify for derecognition, as financial liabilities carried at amortized cost. In case when a transfer of a financial asset does not qualify for derecognition, the transferred asset is continuously recognized as asset and the consideration received is recognized as financial liabilities. Financial liabilities carried at amortized cost are included in non-current liabilities, except for liabilities with maturities within 12 months after the end of the reporting period, which are classified as current liabilities.

2.6.2 Recognition and Measurement

Regular purchases and sales of financial assets are recognized on the trade date. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the statement of comprehensive income. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are subsequently carried at amortized cost using the effective interest rate method.

Gains or losses arising from changes in the fair value of the financial assets carried at fair value through profit or loss are presented in the statement of comprehensive income within 'other gains and losses, net' in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognized in the statement of comprehensive income as part of 'other income' when the Group's right to receive dividend payments is established.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the statement of comprehensive income as 'financial gains and losses, net'.

Interest on available-for-sale and held-to-maturity securities calculated using the effective interest method is recognized in the statement of comprehensive income as part of 'financial income'. Dividends on available-for-sale equity instruments are recognized in the statement of comprehensive income as part of 'financial income' when the Group's right to receive dividend payments is established.

2.6.3 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously.

2.7 Impairment of Financial Assets

(a) Assets carried at amortized cost

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.

The criteria that the Group uses to determine that there is objective evidence of an impairment loss include:

- Significant financial difficulty of the issuer or obligor;
- Delinquency in interest or principal payments for more than three months;
- For economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- It becomes probable that the borrower will enter bankruptcy or other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties; or
- Observable data suggesting that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, even though the decrease cannot be identified with respect to individual financial assets in the portfolio, such as:
    (i) adverse changes in the payment status of borrowers in the portfolio;
    (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

Impairment loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted using the initial effective interest rate. The carrying amount of the asset is reduced by the impairment loss amount and the amount of the loss is recognized in the statement of comprehensive income. In practice, the Group may measure impairment loss based on the fair value of financial asset using an observable market price.

If, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (for example, an improvement in debtor's credit rating), the reversal of the previously recognized impairment loss is recognized in the statement of comprehensive income.

(b) Assets classified as available-for-sale

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. For debt securities, the Group uses the criteria refer to in (a) above. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost, for example decrease in fair value of the investments by more than 30% from its cost for more than six months, is also evidence that the asset is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in profit or loss – is removed from equity and recognized in the statement of comprehensive income. Impairment losses recognized in the consolidated statement of comprehensive income on equity instruments are not reversed through the statement of comprehensive income. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the statement of comprehensive income.

2.8 Trade Receivables

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

2.9 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 ₩ 347,489 million and ₩ 385,459 million as of December 31, 2012 and 2011, respectively.

2.10 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.

2.11 Property, Plant and Equipment

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

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

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

Buildings	10 - 60 years
Structures	4 - 40 years
Machinery	2 - 20 years
Vehicle	4 - 5 years
Tools and equipment	4 - 5 years
Supplies	4 - 5 years

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

2.12 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.

2.13 Government Grants

Grants from a government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Group will comply with all attached conditions.

Government grants relating to property, plant and equipment are presented as a deduction of related assets and are credited to depreciation over the expected lives of the related assets.

Government grants relating to costs are deferred and recognized in the statement of comprehensive income over the period necessary to match them with the costs that they are intended to compensate.

2.14 Intangible Assets

(a) Goodwill

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

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

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

(b) Other intangible assets

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

The estimated useful lives are as follows:

Industrial property rights	10 - 20 years or indefinite
Facility usage rights	Indefinite
Other intangible assets	4 - 15 years or indefinite

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

2.15 Investment Property

Investment property is held to earn rentals or for capital appreciation or both. Investment property also includes property that is being constructed or developed for future use as investment property. Investment property is measured initially at its cost including transaction costs incurred in acquiring the asset. After recognition as an asset, investment property is carried at cost less accumulated depreciation and impairment losses.

Subsequent costs are include in the asset's carrying amount or recognized as a separate asset, 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 held for investment is not depreciated. Investment property, except for land, is depreciated using straight-line method over their useful lives from ten to 60 years.

The depreciation method, the residual value and the useful life of an asset are reviewed at the end of each financial year and, if management judges that previous estimates should be adjusted, the change is accounted for as a change in an accounting estimate.

2.16 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. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets, other than goodwill, that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.17 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.

2.18 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. Preference shares, which are mandatorily redeemable on a specific date, are classified as liabilities. The dividends on these preference shares are recognized in the statement of comprehensive income as 'finance expense'.

2.19 Compound Financial Instruments

Compound financial instruments issued by the Group comprise convertible notes that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

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 at 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.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition except on conversion or expiry.

2.20 Provisions

Provisions are recognized when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

2.21 Current and Deferred Income Tax

The tax expense for the period comprises current and deferred tax. Tax is recognized in the statement of comprehensive income, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity.
The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position date in the countries where the Group operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. 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 income tax is determined using tax rates and laws that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income 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.

2.22 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 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.

2.23 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.

2.24 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, 2012 and 2011, were ₩ 3,662,085 million and ₩ 3,462,687 million, respectively.

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

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

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

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

2.25 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.

2.26 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.

2.27 Approval of Issuance of the Financial Statements

The issuance of the December 31, 2012 financial statements of the Company was approved by the Board of Directors on January 17, 2013.

3. Critical Accounting Estimates and Judgments

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 in accordance with the accounting policy stated in Note 2.16. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates

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(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. The Group recorded, based on its best estimate, current taxes and deferred taxes that the Group will be liable in the future for the operating results as of the financial year end. However, the final tax outcome in the future may be different from the amounts that were initially recorded. Such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

(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.

(d) Defined benefit liability

The present value of the defined benefit liability depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of the defined benefit liability. The Group determines the appropriate discount rate at the end of each year. This is the interest rate that is used to determine the present value of estimated future cash outflows expected to be required to settle the defined benefit liability. In determining the appropriate discount rate, the Group considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the pension benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Other key assumptions for defined benefit liability are based in part on current market conditions. Additional information is disclosed in 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 Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance.

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, 2012 and 2011, are as follows:

(in millions of Korean won)	2012			2011		
	USD	EUR	JPY	USD	EUR	JPY
Assets						
Cash and cash equivalents	W 19,284	W 5	W 9	W 26,121	W 68	W 1,471
Trade and other receivables	493,243	3,256	6,410	431,592	17,078	3,560
Long-term deposits	168,667	-	-	147,290	-	-
	W 681,194	W 3,261	W 6,419	W 605,003	W 17,146	W 5,031
Liabilities						
Trade and other payables	W 16,544	W 3,153	W 2,129	W 41,997	W 4,491	W 54,559
Short-term borrowings	1,406	-	-	-	-	-
	W 17,950	W 3,153	W 2,129	W 41,997	W 4,491	W 54,559

As of December 31, 2012 and 2011, 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)	2012		2011	
	10% strengthening	**10% weakening**	**10% strengthening**	**10% weakening**
US dollar	W 66,324	W (66,324)	W 56,301	W (56,301)

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, 2012 and 2011, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income are as follows:

(in millions of Korean won)	2012		2011	
	5% increase	5% decrease	5% increase	5% decrease
Other comprehensive income before tax	₩ 5,266	₩ (5,266)	₩ 8,464	₩ (8,464)
Tax effect	(1,274)	1,274	(2,048)	2,048
Other comprehensive income after tax	₩ 3,992	₩ (3,992)	₩ 6,416	₩ (6,416)

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, 2012 and 2011, the amount of borrowings issued at variable rates is ₩ 53,459 million and ₩ 27,840 million, respectively. There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation.

(b) Credit Risk

The Group has transacted with customers with high credit ratings to manage credit risk, and has implemented and operated policies and procedures for credit enhancements of the financial assets. Counterparty credit risk is managed by evaluating its credit rating and limiting the aggregate amount and duration of exposure before sales commence, and the Group has been provided with collateral and guarantees. The credit ratings of all counterparties and the level of collateral and guarantees are reviewed regularly. Analysis of financial assets past due has been reported quarterly and appropriate measures have been taken to secure the Group's assets.

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of December 31, 2012 and 2011, is as follows:

(in millions of Korean won)	2012	2011
Available-for-sale financial assets	₩ 2,832	₩ 2,376
Long-term deposits in MSA Escrow Fund	168,667	147,290
Trade and other receivables	1,005,563	967,425
Other financial assets	649,461	12,516
Cash and cash equivalents	372,260	807,731
	₩ 2,198,783	₩ 1,937,338

(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, 2012 and 2011, is as follows:

	2012					
(in millions of Korean won)	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	W 298,381	W 299,629	W 254,604	W 9,266	W 35,759	W -
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	-	-

	2011					
(in millions of Korean won)	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	W 311,421	W 312,555	W 95,050	W 208,109	W 7,338	W 2,058
Short-term borrowings	82,836	82,998	50,354	32,644	-	-
Long-term borrowings	37,847	45,568	175	542	44,550	301
Current portion of long-term borrowings	3,126	3,166	1,243	1,923	-	-

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

4.2 Capital Management

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

As of December 31, 2012 and 2011, the Group defines net debt and equity attributable to owners of the Parent as follows:

(in millions of Korean won)	2012	2011
Total borrowings	₩ 204,379	₩ 123,809
Less:		
-Cash and cash equivalents	(372,260)	(807,731)
-Other financial assets	(649,186)	(11,089)
-Available-for-sale financial assets	(1,000)	(1,044)
Net debt(asset)	(818,067)	(696,055)
Equity attributable to owners of the parent	₩ 5,194,419	₩ 4,788,130

4.3 Fair Value Estimation

The table below analyzes financial instruments carried at fair value, by valuation method. The different levels have been defined 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, as 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).

The following table presents the Group's financial assets and financial liabilities that are measured at fair value as of December 31, 2012:

(in millions of Korean won)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Available-for-sale financial assets	₩ 188,297	₩ 47,440	₩ 12,213	₩ 247,950
Total assets	₩ 188,297	₩ 47,440	₩ 12,213	₩ 247,950

The following table presents the Group's assets and liabilities that are measured at fair value as of December 31, 2011:

(in millions of Korean won)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Available-for-sale financial assets	₩ 187,311	₩ 42,604	₩ 12,009	₩ 241,924
Total assets	₩ 187,311	₩ 42,604	₩ 12,009	₩ 241,924

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 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.

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

(2) Segment information on revenue and profit from operations for the years ended December 31, 2012 and 2011, follows:

	2012						
(in millions of Korean won)	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Total segment sales	W 2,839,860	W 899,726	W44,247	W 395,466	W 4,179,299	W (194,638)	W 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

	2011						
(in millions of Korean won)	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Total segment sales	W 2,624,430	W 1,025,181	W 250,579	W 41,814	W 3,942,004	W (219,037)	W 3,722,967
Less: Inter-segment sales	78,893	92,321	42,931	4,892	219,037	(219,037)	-
External sales	2,545,537	932,860	207,648	36,922	3,722,967	-	3,722,967
Profit(loss) from operations	886,467	197,764	7,095	13,186	1,104,512	(14,171)	1,090,341

(3) Segment information on assets and liabilities as of December 31, 2012 and 2011, are as follows:

	2012						
(in millions of Korean won)	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Assets							
Segment assets	W 3,630,713	W 1,375,619	W 135,368	W 362,884	W 5,504,584	W (349,720)	W 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
Total assets							6,795,961
Liabilities							
Segment liabilities	910,420	147,244	-	70,560	1,128,224	(142,569)	985,655
Unallocated liabilities							615,887
Total liabilities							1,601,542

(in millions of Korean won)	2011						
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Assets							
Segment assets	₩ 3,332,975	₩ 1,128,405	₩ 154,456	₩ 382,278	₩ 4,998,114	₩ (121,801)	₩ 4,876,313
Equity accounted investments	-	-	33,681	1,649	35,330	-	35,330
Assets held for sale	3,196	-	-	-	3,196	-	3,196
	3,336,171	1,128,405	188,137	383,927	5,036,640	(121,801)	4,914,839
Unallocated assets							1,361,577
Total assets							6,276,416
Liabilities							
Segment liabilities	766,856	136,388	-	71,461	974,705	(124,565)	850,140
Unallocated liabilities							541,198
Total liabilities							1,391,338

(4) The major customers who contribute 10% or more of the Group's total revenues for the years ended December 31, 2012 and 2011, are as follows:

Segment	Major customer	2012	2011
Tobacco	Alokozay International Limited	₩ 577,985	₩ 522,531

6. Financial Instruments by Category

Categorizations of financial assets as of December 31, 2012 and 2011, are as follows:

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

	2011				
(in millions of Korean won)	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for-sale	Total
Cash and cash equivalents	W 807,731	W -	W -	W -	W 807,731
Financial assets as available-for-sale, current	-	-	-	1,044	1,044
Trade and other receivables, current	833,310	-	-	-	833,310
Other financial assets, current	11,089	-	-	-	11,089
Long-term deposits	147,290	-	-	-	147,290
Financial assets as available-for-sale, non-current	-	-	-	247,359	247,359
Long-term Trade and other receivables	134,115	-	-	-	134,115
Other financial assets, non-current	1,427	-	-	-	1,427
	W 1,934,962	W -	W -	W 248,403	W 2,183,365

Categorizations of financial liabilities as of December 31, 2012 and 2011, are as follows:

	2012				
(in millions of Korean won)	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total
Borrowings, current	W -	W -	W 91,868	W -	W 91,868
Current portion of long-term borrowings	-	-	2,912	-	2,912
Borrowings, non-current	-	-	109,599	-	109,599
Trade and other payables, current	-	-	273,402	-	273,402
Trade and other payables, non-current	-	-	24,979	-	24,979
	W -	W -	W 502,760	W -	W 502,760

	2011				
(in millions of Korean won)	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total
Borrowings, current	W -	W -	W 82,836	W -	W 82,836
Current portion of long-term borrowings	-	-	3,126	-	3,126
Borrowings, non-current	-	-	37,847	-	37,847
Trade and other payables, current	-	-	285,390	-	285,390
Trade and other payables, non-current	-	-	26,031	-	26,031
	W -	W -	W 435,230	W -	W 435,230

Income and loss of financial instruments by category for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		2012		2011
Available-for-sale financial assets				
Gain(Loss) on valuation (Other comprehensive income(loss))	₩	1,220	₩	(49,889)
Gain(Loss) on disposal (Profit or loss)		(287)		643
Interest income		229		69
Dividend income		6,366		5,248
Impairment		-		-
Cash and cash equivalents				
Interest income		30,551		32,632
Gain(Loss) on foreign currency translation		(170)		3,271
Foreign currency transaction gain (loss)		(1,878)		6,970
Trade and other receivables				
Interest income		5,836		2,089
Gain(Loss) on foreign currency translation		(50,226)		7,896
Foreign currency transaction gain (loss)		(10,253)		60
Other financial liabilities at amortized cost				
Interest costs		(10,216)		(4,233)
Gain(Loss) on foreign currency translation		5,479		93
Foreign currency transaction gain (loss)		(4,624)		(3,494)

7. Available-for-sale Financial Assets

The changes in available-for-sale financial assets as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		2012		2011
At January 1	₩	248,403	₩	315,177
Additions		16,500		22,316
Disposals		(1,628)		(1,927)
Net gains(losses) transfer to equity		1,609		(65,145)
Transfer to others		-		(18,033)
Impairment losses		-		(3,988)
Net exchange difference		-		3
At December 31		264,884		248,403
Less: current portion		(1,000)		(1,044)
Non-current portion	₩	263,884	₩	247,359

Available-for-sale financial assets as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Available-for-sale debt instruments:		
Government and municipal bonds	₩ 292	₩ 336
Corporate bonds	2,540	2,040
Total available-for-sale debt instruments	2,832	2,376
Available-for-sale equity instruments:		
Listed		
Yonhap Television News(YTN)	29,580	23,130
Oscotech, Inc.	869	2,049
Shinhan Financial Group Co., Ltd.	155,725	159,332
Rexahn Pharmaceuticals, Inc.	2,122	2,801
	188,296	187,312
Unlisted		
Dream Hub PFV Co., Ltd.	12,213	12,009
Others	61,543	46,706
	73,756	58,715
Total available-for-sale equity instruments	262,052	246,027
Total available-for-sale financial assets	₩ 264,884	₩ 248,403

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

The fair value of Dream Hub PFV Co., Ltd. which does not have a market price in an active market is measured at the value per share determined by the net asset valuation model.

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, 2012 and 2011, are as follows:

(in millions of Korean won)	2012		2011	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 7,196	₩ 22,491	₩ 13,424	₩ 32,441
Loans	661	6,928	1,917	8,540
Other receivables	84,559	27,529	62,910	22,281
Guarantee deposits	-	64,836	-	70,853
Accrued income	7,006	-	1,962	-
Trade receivables	784,356	-	753,097	-
	₩ 883,778	₩ 121,784	₩ 833,310	₩ 134,115

Trade and other receivables as of December 31, 2012 and 2011, reported in the consolidated statements of financial position, net of allowances, are as follows:

(in millions of Korean won)	2012		2011	
	Current	**Non-current**	**Current**	**Non-current**
Gross trade and other receivables	₩ 912,506	₩ 121,784	₩ 849,691	₩ 134,115
Allowance account				
- Loans	(199)	-	(199)	-
- Other receivables	(2,304)	-	(2,235)	-
-Trade receivables	(26,225)	-	(13,947)	-
	(28,728)	-	(16,381)	-
Net amount	₩ 883,778	₩ 121,784	₩ 833,310	₩ 134,115

Changes in the allowance account for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Beginning	₩ 16,381	₩ 8,809
Acquisition of subsidiary	-	6,904
Impairment	15,801	1,893
Reversal of impairment	-	(169)
Write-off	(3,450)	(1,045)
Net exchange difference	(4)	(11)
Ending	₩ 28,728	₩ 16,381

The aging schedule of trade and other receivables as of December 31, 2012 and 2011, is as follows:

(in millions of Korean won)	2012	2011
Not past due	₩ 470,756	₩ 534,899
Past due but not impaired		
Within 1 month	74,054	59,256
Between 1 and 2 months	51,070	58,873
Beyond 2 months	205,402	100,069
	330,526	218,198
Impaired	9,299	13,947
	₩ 810,581	₩ 767,044

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, 2012, and 2011, are as follows:

(Number of shares)	2012			2011		
	Effective interest rate	Current	Non-current	Effective interest rate	Current	Non-current
Loans to employees	3.00~5.68%	₩ 7,192	₩ 22,486	3.00~5.68%	₩ 13,422	₩ 32,427
Loans	1.7%~3.29%	-	4,650	3.13~7.29%	1,521	4,673
Other receivables	3.79%	8,300	16,601	3.79%	7,997	22,281
Guarantee deposits	1.7%~8.47%	-	62,400	2.50~7.29%	-	67,661
		₩ 15,492	₩ 106,137		₩ 22,940	₩ 127,042

Transferred trade receivables

The Group discounted its trade receivables through trade receivable factoring agreements with National Agricultural Cooperative Federation and other financial institutions in relation with the collecting sales payments with tobacco card.

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, 2012 and 2011, are ₩ 5,477 million and ₩ 6,975 million, respectively (Note 23).

9. Long-term Deposits

Long-term deposits of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
MMF	₩ 10,496	₩ 147,290
T-note	158,170	-
	₩ 168,666	₩ 147,290

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, 2012 and 2011, are ₩34,906 million and ₩15,150 million, respectively.

Investment income on long-term deposits in MSA Escrow Fund for the years ended December 31, 2012 and 2011, is ₩18 million and ₩6,658 million, respectively.

10. Property, Plant and Equipment

Changes in property, plant and equipment for the years ended December 31, 2012 and 2011, are as follows:

	2012		
(in millions of Korean won)	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
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
	₩ 2,966,801	₩ (1,335,365)	₩ 1,631,436

(in millions of Korean won)	2011 Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 460,487	₩ -	₩ 460,487
Buildings	825,388	(293,322)	532,066
Structures	65,022	(34,950)	30,072
Machinery	1,058,014	(692,974)	365,040
Vehicles	12,184	(8,637)	3,547
Tools	49,759	(39,888)	9,871
Furniture and fixture	233,286	(166,987)	66,299
Others	1,219	-	1,219
Construction-in-progress	115,745	-	115,745
	₩ 2,821,104	₩ (1,236,758)	₩ 1,584,346

(in millions of Korean won)	2012 Opening net book value	Additions	Disposal	Depreciation	Exchange difference	Transfer	Net book amount
Land	₩ 460,487	₩ 16,978	₩ (27,930)	₩ -	₩ 272	₩ 68,249	₩ 518,056
Buildings	532,066	13,804	(7,691)	(36,297)	(1,432)	28,265	528,715
Structures	30,072	853	(336)	(3,344)	(33)	(213)	26,999
Machinery	365,040	27,521	(2,105)	(82,769)	(751)	65,629	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	1,219	10	-	-	-	37	1,266
Construction-in-progress	115,745	168,450	(160)	-	533	(178,395)	106,173
	₩1,584,346	₩263,443	₩ (39,445)	₩ (159,304)	₩ (2,910)	₩ (14,694)	₩1,631,436

(in millions of Korean)	2011 Opening net book value	Additions	Acquisition of subsidiary	Disposal	Depreciation	Exchange difference	Transfer	Net book amount
Land	₩ 436,950	₩ 975	₩ 150	₩ (10,826)	₩ -	₩ (595)	₩ 33,833	₩ 460,487
Buildings	496,353	45,495	8,732	(1,727)	(32,086)	(4,671)	19,970	532,066
Structures	32,047	686	347	(265)	(3,346)	(102)	705	30,072
Machinery	381,380	12,208	11,889	(1,897)	(75,561)	(3,848)	40,869	365,040
Vehicles	1,789	1,201	1,478	(179)	(933)	(3)	194	3,547
Tools	12,166	2,606	150	(121)	(5,296)	(28)	394	9,871
Furniture and fixture	60,015	28,833	4,254	(724)	(30,650)	28	4,543	66,299
Others	749	-	-	(11)	-	-	481	1,219
Construction-in-progress	89,389	196,525	4,673	(102)	-	705	(175,445)	115,745
	₩1,510,838	₩ 288,529	₩ 31,673	₩ (15,852)	₩ (147,872)	₩ (8,514)	₩ (74,456)	₩1,584,346

11. Intangible Assets

Changes in intangible assets for the years ended December 31, 2012 and 2011, are as follows:

	2012					
(in millions of Korean won)	**Goodwill**	**Industrial property rights**	**Facility usage rights**	**Other intangible assets**	**Intangible assets under development**	**Total**
At January 1, 2012	₩ 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)
Net book amount	₩ 84,100	₩ 34,086	₩ 26,042	₩ 98,337	₩ 4,228	₩ 246,793

	2011					
(in millions of Korean won)	**Goodwill**	**Industrial property rights**	**Facility usage rights**	**Other intangible assets**	**Intangible assets under development**	**Total**
At January 1, 2011	₩ -	₩ 2,049	₩ 24,189	₩ 4,194	₩ 32,713	₩ 63,145
Additions	-	447	4,537	11,623	-	16,607
Disposals	-	(199)	(4,371)	(80)	(14,454)	(19,104)
Acquisition of subsidiary	87,902	20,952	33	94,857	12,728	216,472
Transfer-in(out)	-	276	-	-	(276)	-
Amortization	-	(78)	-	(4,416)	-	(4,494)
Impairment / reversal	-	-	-	-	(15,914)	(15,914)
Exchange differences	-	7	(1)	463	(158)	311
Other changes	-	-	-	-	1,595	1,595
Acquisition cost	87,902	33,060	24,387	122,670	32,795	300,814
Accumulated depreciation and impairment cost	-	(9,606)	-	(16,029)	(16,561)	(42,196)
Net book amount	₩ 87,902	₩ 23,454	₩ 24,387	₩ 106,641	₩ 16,234	₩ 258,618

Research and development expenses for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Cost of goods sold	₩ 1,133	₩ 1,459
Selling and administrative expenses	37,106	29,359
Cost of goods sold	38,239	30,818

Exchange loss of ₩3,802 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(other comprehensive income).

12. Investment Property

Changes in investment property for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012		
	Land	Building	Total
Beginning net book value	₩ 45,314	₩ 143,037	₩ 188,351
Additions	-	51	51
Transfers	2,863	(2,997)	(134)
Depreciation	-	(6,282)	(6,282)
Acquisition cost	48,177	179,787	227,964
Accumulated depreciation	-	(45,978)	(45,978)
Net book amount	₩ 48,177	₩ 133,809	₩ 181,986

(in millions of Korean won)	2011		
	Land	Building	Total
Beginning net book value	₩ 36,550	₩ 84,933	₩ 121,483
Additions	-	2,136	2,136
Transfer to property, plant and equipment	(268)	(291)	(559)
Transfer from property, plant and equipment	9,032	61,272	70,304
Depreciation	-	(5,013)	(5,013)
Acquisition cost	45,314	184,834	230,148
Accumulated depreciation	-	(41,797)	(41,797)
Net book amount	₩ 45,314	₩ 143,037	₩ 188,351

The amounts recognized in profit or loss from investment property for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Rental income	₩ 33,032	₩ 21,243
Direct operating expense	(7,394)	(5,013)
	₩ 25,638	₩ 16,230

Fair values and book values of investment property as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012		2011	
	Fair value	Book value	Fair value	Book value
Land	₩ 312,735	₩ 48,177	₩ 313,922	₩ 45,314
Building	190,214	133,809	198,204	143,037
	₩ 502,949	₩ 181,986	₩ 512,126	₩ 188,351

13. Non-current Assets Held for Sale and Discontinued Operations

The Group entered into sales contracts with Kim Jae Chil and two others on Nam Woolsan Cosmo Tower's land on January 6, 2012, building and others and with HT&D Co., Ltd. to sell the Gyeonggi branch's land, building and others on February 23, 2012.

Also, the Group has sales contracts on Gwangju, Samcheok, Yangyang, Hwasun branch's land, buildings and others with the city governments of Gwangju and Samcheok, Chuncheon District Court and Hansol Techno Co., Ltd, respectively. on January 11, 2012

Changes in non-current assets held for sale for the year ended December 31, 2012, are as follows:

(in millions of Korean won)	2012				
	Land	Buildings	Structures	Machinery	Total
At January 1, 2012					
Acquisition cost	₩ 2,273	₩ 1,429	₩ 197	₩ -	₩ 3,899
Accumulated depreciation	-	(553)	(150)	-	(703)
Net book amount	₩ 2,273	₩ 876	₩ 47	₩ -	₩ 3,196
Changes					
Transfer from property, plant and equipment	₩ 6,491	₩ 2,686	₩ 71	₩ 45	₩ 9,293
Transfer from Investment property	562	4,288	14	-	4,864
Disposals	(8,701)	(7,731)	(114)	(45)	(16,591)
	₩ (1,648)	₩ (757)	₩ (29)	₩ -	₩ (2,434)
At 2012					
Acquisition cost	₩ 625	₩ 215	₩ 64	₩ -	₩ 904
Accumulated depreciation	-	(96)	(46)	-	(142)
Net book amount	₩ 625	₩ 119	₩ 18	₩ -	₩ 762

14. Pledged Assets

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	₩ 64,147	Hana Bank and 3 others
		Current portion of long-term borrowings	412		
		Long-term borrowings	10,034		Korea Development Bank
Investment Property	80,783	Leasehold deposits received	8,169	8,502	Metlife Insurance Co., Ltd. and 29 others
Property, plant and equipment	1,071	ACH pleaged	-	1,071	Bank of Oklahoma
Trade receivables	11,294	Short-term borrowings	11,294	11,294	Citibank Korea Inc.
Total	₩ 169,822		₩ 44,909	₩ 85,014	

The following assets were pledged as collateral for the Group's borrowings and others as of December 31, 2011:

(in millions of Korean won)

Asset	Book amount		Borrowings	Collateralized amount	Lender /Leaseholder
Property, plant and equipment		Short-term borrowings	₩ 21,906		
Investment Property	₩ 82,776	Current portion of Long-term borrowings	549	₩ 94,946	Hana Bank and 5 others
Investment Property		Long-term borrowings	9,821		
Investment Property	89,705	Leasehold deposits received	6,576	7,469	Metlife Insurance Korea Co.,Ltd. and 27 others
Total	₩ 172,481		₩ 38,852	₩ 102,415	

15. Investments in Associates

Investments in associates as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)

Associates	Location	Principal operation	2012 Interest (%)	2012 Carrying Amount	2011 Interest (%)	2011 Carrying Amount
Cosmo Tabacco Co., Ltd.	Mongolia	Manufacturing and selling tobaccos	40.00	₩ -	40.00	₩ -
Lite Pharm Tech, Inc	Korea	Manufacturing and Medical supplies	25.34	857	25.34	637
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00	932	20.00	1,013
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	13,570	49.02	13,819

KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	7,160	29.67	7,354
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	6,827	22.06	6,872
JR REIT V Co., Ltd.	China	Selling and renting of real estate	34.63	5,581	34.63	5,635
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	10,008	-	-
LSK Global Pharma Services Co., Ltd	Korea	Research and developing new drug	23.15	1,343	-	-
JR REIT X Co., Ltd.	Korea	Selling and renting of real estate	28.78	9,500	-	-
Total				₩ 55,778		₩ 35,330

Changes in investments in associates and subsidiaries for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012				
	Beginning balance	**Acquisition**	**Share of profit(loss)**	**Other changes**	**Ending balance**
Associates					
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
	₩ 35,330	₩ 21,000	₩ 1,984	₩ (2,537)	₩ 55,777

(in millions of Korean won)	2011				
	Beginning balance	**Acquisition**	**Share of profit(loss)**	**Other changes**	**Ending balance**
Lite Pharm Tech, Inc	₩ 645	₩ -	₩ (8)	₩ -	₩ 637
Korean Carbon Finance, Inc.	952	-	61	-	1,013
JR CR-REIT IV Co., Ltd.	-	3,995	625	9,199	13,819
KVG REIT 1 Co., Ltd.	-	-	284	7,070	7,354
KOCREF REIT 17 Co., Ltd.	-	7,000	81	(209)	6,872
JR REIT V Co., Ltd.	-	5,600	274	(239)	5,635
	₩ 1,597	₩ 16,595	₩ 1,317	₩ 15,821	₩ 35,330

[1] The Group reclassified ₩17,300 million of available-for-sale financial assets to investments in associates during the year ended December 31, 2011.

Summary of the associates' financial information as of December 31, 2012 and 2011, follows:

(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)

(in millions of Korean won)	2011			
	Assets	Liabilities	Revenues	Profit/(loss)
Lite Pharm Tech, Inc.	₩ 4,041	₩ 1,527	₩ 1,549	₩ (32)
Korean Carbon Finance, Inc.	5,158	97	1,143	303
JR CR-REIT IV Co., Ltd.	65,722	35,658	6,758	1,583
KVG REIT 1 Co., Ltd.	52,829	28,045	5,540	993
KOCREF REIT 17 Co., Ltd.	65,749	34,600	128	441
JR REIT V Co., Ltd.	31,480	15,208	540	831

16. Inventories

Inventories as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012			2011		
	Acquisition	Allowance	Book amount	Acquisition	Allowance	Book amount
Merchandise	₩ 8,074	₩ (521)	₩ 7,553	₩ 5,678	₩ (881)	₩ 4,797
Finished goods	348,664	(1,738)	346,926	307,308	(1,782)	305,526
Work in progress	452,730	(3,107)	449,623	328,087	(3,647)	324,440
Raw materials	821,905	(3,093)	818,812	874,359	(2,974)	871,385
Supplies	25,633	-	25,633	26,158	-	26,158
By-products	6,076	-	6,076	6,738	-	6,738
Unfinished housing	227	-	227	-	-	-
Lots	6,551	-	6,551	-	-	-
Goods-in-transit	45,395	-	45,395	33,255	-	33,255
	₩ 1,715,255	₩ (8,459)	₩ 1,706,796	₩ 1,581,583	₩ (9,284)	₩ 1,572,299

The cost related inventories for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Cost of sales		
-Loss(profit) on inventory valuation	₩ 1,481	₩ 574
- Loss on retirement of inventories	3,392	-
Other expenses		
- Loss on retirement of inventories	3,313	7,270
	₩ 8,186	₩ 7,844

17. Cash and Cash Equivalents

Cash and cash equivalents as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Cash on hand	₩ 4,292	₩ 4,554
Demand deposits	177,743	213,845
Short-term investment assets	190,225	589,332
	₩ 372,260	₩ 807,731

Other financial assets as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Long-term Financial assets		
Time deposits	₩ 143	₩ 1,285
Deposit in current account	17	6
Money trust	115	136
	275	1,427
Short-term Financial assets		
Time deposits	187,115	3,442
Money trust	271,000	-
Certificate of deposit	191,071	7,647
	649,186	11,089
	₩ 649,461	₩ 12,516

Restricted financial assets as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	Description	2012	2011
Cash and cash equivalents	Specific research purpose	₩ 1,357	₩ -
Other financial assets	Pledge	1,771	9,677
Long-term other financial assets	Deposits	17	34
		₩ 3,145	₩ 9,711

18. Equity and Share Premium

Details of share capital as of December 31, 2012, and 2011, are as follows:

(in Korean won, except number of shares)	2012	2011
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, 2012 and 2011, are as follows:

(Number of shares)	2012			2011		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning	137,292,497	(11,543,697)	125,748,800	137,292,497	(9,643,697)	127,648,800
Acquisition of treasury shares	-	-	-	-	(2,000,000)	(2,000,000)
Issuance of treasury shares	-	150,000	150,000	-	100,000	100,000
Ending	137,292,497	(11,393,697)	125,898,800	137,292,497	(11,543,697)	125,748,800

19. Treasury Shares

Changes in the treasury shares for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012		2011	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Beginning	11,543,697	₩ 343,522	9,643,697	₩ 216,827
Acquisition of treasury shares	-	-	2,000,000	129,671
Issuance of treasury shares	(150,000)	(4,463)	(100,000)	(2,976)
Ending	11,393,697	₩ 339,059	11,543,697	₩ 343,522

Changes in gain on reissuance of treasury shares for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		**2012**		**2011**
Beginning	₩	485,922	₩	482,129
Gain on reissuance of treasury shares before tax		8,061		5,004
Less: tax at 24.2%		(1,951)		(1,211)
Gain on reissuance of treasury shares, net of tax		6,110		3,793
Ending	₩	492,032	₩	485,922

20. Reserves

Details of reserves as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		**2012**		**2011**
Available-for-sale financial assets reserve	₩	(30,635)	₩	(31,855)
Exchange differences on translating foreign operations		(27,925)		(15,501)
Legal reserve		602,937		602,937
Voluntary reserve		2,466,732		2,107,732
	₩	3,011,109	₩	2,663,313

Available-for-sale financial assets reserve as of December 31, 2012 and 2011, are summarized as follows:

(in millions of Korean won)		**2012**		**2011**
Available-for-sale financial assets reserve before tax	₩	(40,415)	₩	(42,025)
Tax effect		9,780		10,170
	₩	(30,635)	₩	(31,855)

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, 2012 and 2011, are as follows:

(in millions of Korean won)		**2012**		**2011**
Reserve for business rationalization	₩	12,851	₩	12,851
Reserve for research and human resource development		60,000		60,000
Reserve for business expansion		698,881		698,881
Other reserve		1,695,000		1,336,000
	₩	2,466,732	₩	2,107,732

Reserve for Business Rationalization

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

Reserve for Research and Human Resource Development

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

Reserve for Business Expansion and other reserve

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

21. Retained Earnings

Changes in retained earnings for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		2012		2011
Beginning	₩	1,022,126	₩	1,151,359
Transfer from other reserve		(359,000)		(544,000)
Dividends		(402,396)		(382,946)
Profit for the period		725,118		816,929
- Less: non-controlling interests		12,920		(871)
Actuarial losses, net of tax		(18,579)		(19,449)
- Less: non-controlling interests		155		1,104
Others		(3,919)		-
Ending	₩	976,425	₩	1,022,126

22. Accounts Payable and Other Finance Liabilities

Accounts payable and other finance liabilities as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012		2011	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	₩ 24,979	₩ 154	₩ 25,069
Accounts payable	48,190	-	81,938	-
Withholdings	136,814	428	137,344	644
Accrued expenses	144,901	-	131,775	-
Other payables	80,311	-	71,523	318
	₩ 410,216	₩ 25,407	₩ 422,734	₩ 26,031

23. Borrowings

Details of borrowings as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Current		
Bank borrowings[1]	₩ 84,221	₩ 75,021
Other borrowings	7,647	7,815
Bank borrowings(Current portion of long-term borrowings)	293	549
Other borrowings (Current portion of long-term borrowings)	2,619	1,619
Convertible bonds	-	958
	94,780	85,962
Non-current		
Bank borrowings	11,932	10,220
Other borrowings	119	2,738
Convertible bonds	11,110	12,577
Convertible redeemable preference shares	69,429	12,312
Redeemable preference shares	17,009	-
	109,599	37,847
	₩ 204,379	₩ 123,809

Out of the above borrowings, ₩ 5,477 million and ₩ 6,975 million as of December 31, 2012 and 2011, 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, 2012 and 2011, are as follows:

(in millions of Korean won)

Currency	Creditor	Latest maturity date	Annual interest rate(%) 2012	2012	2011
Korean won	National Agricultural Cooperative Federation, other	Short-term Borrowings	3.65	₩ 26,823	₩ 6,351
Korean won	Citibank	Short-term Borrowings	CD(91)+1.25	14,230	28,829
Korean won	Hana Bank	Short-term Borrowings	1.75~5.32	43,239	36,109
Foreign currency	BCA	Short-term Borrowings	-	-	4,235
Korean won	National Agricultural Cooperative Federation	2016. 07. 20	1.50	756	756
Korean won	National Agricultural Cooperative Federation	2017. 06. 21	1.50	1,260	-
Korean won	Hana Bank	2017. 03. 31	3.04	966	1,036
Korean won	Korea Development Bank	2014. 11. 07	4.45	8,000	8,474
Korean won	Korea Development Bank	2018. 06. 09	3.09	291	-
Korean won	Hana Bank	2017. 03. 31	4.58	881	-
				₩ 96,446	₩ 85,790

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.

24. Defined Benefit Liability

The amounts recognized on the statements of income for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		**2012**		**2011**
Defined benefit plans :				
Current service cost	₩	37,850	₩	32,401
Interest expenses		9,130		8,029
Past service cost		(116)		
Expected return on plan assets		(6,511)		(5,850)
Gains on settlement		86		489
		40,439		35,069
Defined contribution plans :				
Pension costs		2,222		1,194
Total	₩	42,661	₩	36,263

Termination benefits for the year ended December 31, 2012, were ₩1,194 million. Out of total expenses, ₩14,742 million (2011: ₩13,699 million) and ₩27,919 million (2011: ₩22,564 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, 2012 and 2011, are as follows:

(In millions of Korean won)		**2012**		**2011**
Present value of funded defined benefit liability	₩	286,420	₩	232,940
Present value of unfunded defined benefit liability		1,909		437
Fair value of plan assets		(180,685)		(150,295)
Liability in the statement of financial position	₩	107,644	₩	83,082

The movements in the defined benefit obligation for the years ended December 31, 2012 and 2011, are as follows:

(In millions of Korean won)		**2012**		**2011**
Beginning balance	₩	233,377	₩	176,811
Business combination		-		8,330
Current service cost		37,850		32,401
Interest cost		9,130		8,029
Past service cost		(116)		-
Gains on settlement		86		489
Actuarial (gains)/losses (before tax)		24,138		24,648
Payments, including the amount transferred to the defined contribution plan		(14,672)		(17,516)
Changes in accrued expenses		(16)		188
Net exchange difference		(1,448)		(3)
Ending balance	₩	288,329	₩	233,377

The movements in the fair value of plan assets for the years ended December 31, 2012 and 2011, are as follows:

(In millions of Korean won)		**2012**		**2011**
Beginning balance	₩	150,295	₩	128,487
Business combination		-		2,642
Expected return on plan assets		6,511		5,850
Actuarial gains/(losses) (before tax)		(186)		(259)
Payment into plan assets		32,797		22,929
Payments, including the amount transferred to the defined contribution plan		(8,173)		(9,591)
Changes in accrued expenses		(536)		237
Net exchange difference		(23)		-
Ending balance	₩	180,685	₩	150,295

Actual return on plan assets for the years ended December 31, 2012 and 2011, 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, 2012 and 2011, are as follows:

(In millions of Korean won)		**2012**		**2011**
Actuarial gains (losses) before income tax	₩	(24,324)	₩	(24,907)
Income tax effects		5,745		5,458
Actuarial gains (losses) after income tax	₩	(18,579)	₩	(19,449)

The components of plan assets as of December 31, 2012 and 2011, are as follows:

(In millions of Korean won)		**2012**		**2011**
Short-term trading financial assets	₩	105,130	₩	86,346
Available-for-sale financial assets		69,316		57,814
Others		6,239		6,135
	₩	180,685	₩	150,295

The principal actuarial assumptions as of December 31, 2012 and 2011, are as follows:

	2012	**2011**
Rate of salary increases	3.09%~5.57%	3.34%~8.00%
Discount rate	3.27~3.37	3.80~8.25
Expected return on plan assets	3.30~4.30	3.20~6.00

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

(In millions of Korean won)	1% Increase	1% Decrease
Rate of salary increases:		
Increase(decrease) in defined benefit obligations	₩ 28,661	₩ (25,154)
Increase(decrease) in retirement benefits before tax	4,857	(4,457)
Discount rate:		
Increase(decrease) in defined benefit obligations	(26,689)	31,239
Increase(decrease) in retirement benefits before tax	(2,525)	2,619
Expected rate of return on plan assets:		
Increase(decrease) in retirement benefits before tax	(1,547)	1,374

Adjustments for the differences between initial assumptions and actual figures as of December 31, 2012 and 2011, 2010, 2009, 2008 and January 1, 2008, are as follows:

(In millions of Korean won)	December 31, 2012	December 31, 2011	December 31, 2010	December 31, 2009	December 31, 2008	January 1, 2008
Present value of defined benefit liability	₩ 288,329	₩ 233,377	₩ 177,109	₩ 163,462	₩ 39,598	₩ 18,448
Fair value of plan assets	(180,685)	(150,295)	(128,490)	(127,576)	(16,356)	(11,442)
Deficit (Surplus) in the funded plans	107,644	83,082	48,619	35,886	23,242	7,006
Experience adjustments on plan liabilities	(10,724)	(5,256)	5,147	5,730	729	-
Experience adjustments on plan assets	(160)	(289)	(607)	(842)	116	-

25. Classification of Operating 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, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Salaries	₩ 504,853	₩ 463,684
Retirement benefits	42,661	36,263
Termination benefits	1,194	3,573
Employee welfare	61,044	52,644
	₩ 609,752	₩ 556,164

(3) Depreciation and amortization for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		2012		2011
Depreciation	₩	165,586	₩	152,885
Amortization		12,798		4,494
	₩	178,384	₩	157,379

(4) Selling and administrative expenses for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		2012		2011
Salaries	₩	325,164	₩	293,993
Retirement benefits		28,683		25,330
Employee welfare		41,935		35,628
Travel		13,420		12,285
Communications		5,816		5,275
Utilities		9,157		7,518
Taxes and dues		18,439		16,104
Supplies		3,953		4,106
Rent		30,640		27,769
Depreciation		48,189		44,769
Amortization		12,798		4,284
Repairs and maintenance		11,445		8,866
Vehicles		12,151		10,561
Insurance		2,215		2,053
Commissions		216,607		169,756
Freight and custody		46,503		43,589
Conferences		4,796		3,026
Advertising		310,967		266,075
Training		7,966		7,999
Prizes and rewards		2,745		3,733
Cooperation		1,497		1,420
Normal research and development		37,106		29,358
Bad debts expense		15,730		1,537
	₩	1,207,922	₩	1,025,034

(5) Details of other income for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		2012		2011
Foreign currency transaction gain	₩	16,540	₩	35,746
Foreign currency translation gain		5,646		17,966
Gain on sale of investments in subsidiaries		-		1,139
Gain on sale of property, plant and equipment		34,337		45,852
Gain on sale of intangible assets		359		7,016
Miscellaneous revenues		18,219		11,180
	₩	75,101	₩	118,899

(6) Details of other expenses for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		2012		2011
Foreign currency transaction loss	₩	33,295	₩	32,210
Foreign currency translation loss		50,563		6,706

Impairment loss on other receivables		71		187
Donations		23,249		18,531
Loss on sale of property, plant and equipment		7,749		3,493
Impairment loss on property, plant and equipment		201		-
Loss on sale of intangible assets		456		647
Impairment loss on intangible assets		58		15,914
Loss on retirement of inventories		3,313		7,270
Miscellaneous expenses		4,148		3,653
	₩	123,103	₩	88,611

26. Expenses by Nature

Expenses by nature for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		2012		2011
Changes in inventories	₩	(134,497)	₩	(75,265)
Raw materials and consumables purchased		1,653,653		1,300,819
Salary and wage		504,853		463,684
Retirement and termination benefits		43,855		39,836
Depreciation charges		165,586		152,885
Amortization charges		12,798		4,494
Employee benefits		61,044		52,644
Advertising costs		311,140		266,430
Service fees		255,059		202,386
Other expenses		198,344		313,323
Total cost of sales, selling and administrative expenses and other expenses	₩	3,071,835	₩	2,721,236

27. Financial Income and Costs

Financial income and costs for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		2012		2011
Financial cost				
Interest costs	₩	(10,216)	₩	(4,233)
Loss on sale of available-for-sale financial assets		(287)		-
Impairment loss on available-for-sale financial assets		-		(3,988)
		(10,503)		(8,221)
Financial income				
Interest income		36,616		34,790
Dividend income		6,366		5,248
Investment income on long-term deposits in MSA Escrow Fund		18		6,658
Gain on sale of available-for-sale financial assets		-		643
		43,000		47,339
Net financial income	₩	32,497	₩	39,118

Details of interest costs for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011

Borrowings	₩	(4,828)	₩	(3,306)
Trade and other payables		(1,203)		(927)
Others		(4,185)		-
	₩	(10,216)	₩	(4,233)

Details of interest income for the years ended December 31, 2012 and 2011, are as follows:

(in millions of Korean won)		2012		2011
Deposits	₩	30,551	₩	32,632
Available-for-sale financial assets		229		69
Trade and other receivables		5,836		2,089
	₩	36,616	₩	34,790

28. Income Tax

Income tax expense for the years ended December 31, 2012 and 2011, consists of:

(In millions of Korean won)		2012		2011
Current tax expense:				
Current tax on profits for the year	₩	283,093	₩	291,009
Adjustments in respect of prior years		2,416		4,018
Total current tax		285,509		295,027
Deferred tax:				
Origination and reversal of temporary differences		8,011		29,624
Total income tax expense	₩	293,520	₩	324,651
Current tax charged / (credited) directly to equity		3,771		19,484
Income tax expense	₩	297,291	₩	344,135

Reconciliation of net income before tax and income expense for the years ended December 31, 2012 and 2011, follows:

(In millions of Korean won)		2012		2011
Profit before tax	₩	1,022,409	₩	1,161,064
Income tax based on statutory rate	₩	271,331		280,951
Tax effects of:				
Incomes not deductible for tax purposes		(317)		-
Expenses not deductible for tax purposes		6,443		9,233
Tax credit		(4,082)		(3,339)
Adjustment in respect of prior years		2,416		3,927
Re-measurement of deferred tax expense – change in the Korean tax rate		-		28,161
Non-deduction of dividend income		(233)		-
Profit of subsidiaries		24,722		25,955
Others		(2,989)		(753)
Income tax expense	₩	297,291	₩	344,135

The tax (charged) / credited directly to other comprehensive income and equity as of and for the years ended December 31, 2012 and 2011, is as follows:

(In millions of Korean won)	2012			2011		
	Before tax	Tax (charge) credit	After tax	Before tax	Tax (charge) credit	After tax
The tax (charge) / credit relating to components of other comprehensive income:						
Fair value gains(losses) from available-for-sale financial assets	₩ 1,610	₩ (390)	₩ 1,220	₩ (65,145)	₩ 15,256	₩ (49,889)
Actuarial gains(losses) on retirement benefit obligations	(24,324)	5,745	(18,579)	(24,907)	5,458	(19,449)
Gains(Losses) on foreign operation	(1,517)	367	(1,150)	79	(19)	60
	(24,231)	5,722	(18,509)	(89,973)	20,695	(69,278)
The income tax (charged) / credited directly to equity:						
Gains (Losses) on disposal of treasury shares	8,061	(1,951)	6,110	5,004	(1,211)	3,793
	₩ (16,170)	₩ 3,771	₩ (12,399)	₩ (84,969)	₩ 19,484	₩ (65,485)

The analysis of deferred tax assets and deferred tax liabilities as of December 31, 2012 and 2011, is as follows:

(In millions of Korean won)	2012	2011
Deferred tax assets		
Deferred tax asset to be recovered after more than 12 months	₩ 100,212	₩ 76,914
Deferred tax asset to be recovered within 12 months	39,172	30,814
	139,384	107,728
Deferred tax liabilities		
Deferred tax liability to be recovered after more than 12 months	(358,054)	(317,298)
Deferred tax liability to be recovered within 12 months	(1,443)	(2,532)
	(359,497)	(319,830)
Deferred tax assets (liabilities), net	₩ (220,113)	₩ (212,102)

The gross movement on the deferred income tax account for the years ended December 31, 2012 and 2011, is as follows:

(In millions of Korean won)	2012	2011
Beginning balance	₩ (212,102)	₩ (156,436)
Acquisition of subsidiary(business combination)	-	(26,042)
Tax charged to the statement of income	(13,733)	(44,861)
Tax charge / (credit) relating to components of other	5,722	15,237

comprehensive income		
Ending balance	₩ (220,113)	₩ (212,102)

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:

(In millions of Korean won)	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
Deferred tax assets						
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)	-	-	-
	₩ 64,910	₩ 1,307	₩ 7,722	₩ 5,355	₩ -	₩ 79,294
Deferred tax liabilities						
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)
	₩ (277,012)	₩ (1,159)	₩ (21,603)	₩ 367	₩ -	₩ (299,407)

(In millions of Korean won)	January 1, 2011	Beginning adjustment	Credited to profit(Charged to loss)	Charged to other comprehensive income	Charged or credited directly to equity	Change in tax rate	December 31, 2011
Deferred tax assets							
Available-for-sale financial assets	₩ 9,861	₩ -	₩ 877	₩ -	₩ -	₩ 1,074	₩ 11,812
Accrued expense	20,708	138	2,562	-	-	1,917	25,325
Defined benefit liabilities	966	204	1,503	-	-	244	2,917
Depreciation	5,329	(481)	854	-	-	363	6,065
Long-term advances from customers	2,292	103	738	-	-	-	3,133
Specific sales	3,905	-	1,493	-	-	-	5,398
Foreign currency gains and losses	1,313	86	(1,308)	-	-	-	91
	₩ 44,374	₩ 50	₩ 6,719	₩ -	₩ -	₩ 3,598	₩ 54,741
Deferred tax liabilities							
Investment in subsidiaries	₩ (172,123)	₩ -	₩ (15,268)	₩ -	₩ -	(29,286)	₩ (216,677)
Treasury stock	(8,183)	-	70	-	-	(811)	(8,924)
Cost of specific sales	(1,692)	-	(840)	-	-	-	(2,532)
Change in value of available-for-sale financial assets	(5,087)	-	-	15,256	-	-	10,169
Reserve	(9,190)	(361)	(10,997)	-	-	(1,320)	(21,868)
Provision for advanced depreciation	(4,722)	-	-	-	-	(472)	(5,194)
Others	187	(25,731)	3,616	(19)	130	-	(21,817)
	₩ (200,810)	₩ (26,092)	₩ (23,419)	₩ 15,237	₩ 130	₩ (31,889)	₩ (266,843)

As of December 31, 2012 and 2011, the aggregate amounts of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognized were ₩ 1,003 million and ₩ 15,953 million, respectively.

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, 2012 and 2011, is as follows:

(in Korean won, except number of shares)	2012	2011
Profit for the period	₩ 738,037 million	₩ 816,058 million
Weighted-average number of ordinary shares outstanding	125,756,587	126,505,112
Basic and diluted earnings per share in won	₩ 5,869	₩ 6,451

30. Dividends

Dividend distribution to the Company's shareholders amounted to ₩ 402,396 million for the year ended December 31, 2011, was paid in March 2012. A dividend in respect of the year ended December 31, 2012, of ₩ 3,200 per share, amounting to a total dividend of ₩ 402,876 million, is to be proposed at the annual general meeting on February 28, 2013. 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, 2012 and 2011, are as follows:

(in millions of Korean won)	2012	2011
Profit	₩ 725,118	₩ 816,929
Adjustments for		
Income tax expense	297,291	344,135
Finance costs	10,503	8,221
Finance income	(43,000)	(47,339)
Depreciation	165,586	152,885
Amortization	12,798	4,494
Retirement and termination benefits	40,600	39,836
Foreign currency translations loss	50,563	6,706
Loss on the write-down of inventories	1,481	574
Impairment loss on trade and other receivables	15,801	1,893
Loss on sale of property, plant and equipment	7,749	3,493
Loss on sale of intangible assets	456	647
Impairment loss on intangible assets	-	15,914
Other expense	3,783	7,270
Share of gain of associates	(2,222)	(1,325)
Share of loss of associates	239	8
Foreign currency translations gain	(5,646)	(17,966)
Reversal of impairment loss on trade and other receivables	-	(169)
Gain on sale of property, plant and equipment	(34,337)	(45,852)
Gain on sale of intangible assets	(359)	(7,016)
Gain on sale of investment in subsidiaries	-	(1,139)
	1,246,404	1,282,199

	2012	2011
Changes in working capital:		
Trade and other receivables	(147,370)	(134,692)
Advance payments	(8,413)	(25,893)
Prepaid expenses	2,582	(2,603)
Prepaid tobacco excise and other taxes	(55,649)	(21,179)
Inventories	(162,565)	15,212
Trade and other payables	75,162	40,760
Advance receipts	23,681	6,410
Tobacco excise and other taxes payable	92,000	(11,167)
Payment of retirement benefits	(38,918)	(37,399)
Cash generated from operations	₩ 1,026,914	₩ 1,111,648

(2) Non-cash transactions

(in millions of Korean won)	2012
Reclassification of property, plant and equipment to non-current assets held for sale	₩ 9,293
Reclassification of property, plant and equipment to investment property	4,910
Reclassification of investment property to non-current assets held for sale	4,864

32. Contingencies

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, 2012, 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, 2012. Additionally, as of December 31, 2012, the Group is involved in fifteen lawsuits as a defendant for alleged damages totaling ₩ 3,652 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, 2012.

As of December 31, 2012, the Group has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 60,700 thousand.

As of December 31, 2012, the Group's trade receivables from the export of cigarettes are insured against non-payment up to USD 12,200 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of December 31, 2012, 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.

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 ₩ 188,687 million (non-current: ₩ 139,291 million; current: ₩ 49,396 million) as of December 31, 2012.
As of December 31, 2012, the Group has an accounts receivable loan agreement with a limit of ₩ 105,000 million with Hana Bank and other financial institutions.

As of December 31, 2012, 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, 2012, the Group has a loan agreement with a limit of ₩ 86,310 million with Shinhan Bank and other financial institutions.

As of December 31, 2012, 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, 2012, 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.

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.

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.

33. Related Party Transactions

The Group has no significant transactions and receivables, liabilities with related parties, for the year ended December 31, 2012.

The guarantee provided by related parties as of December 31, 2012 and 2011, are as follows:

(in millions of Korean won)

Guarantor	Guarantee for	Purpose	2012		2011	
			Limit	Guarantee amount	Limit	Guarantee amount
Kang Seok-chang	Somang Cosmetics Co., Ltd.	Application funds	₩ 2,591	₩ 2,893	₩ 21,175	₩ 16,748

The compensation paid or payable to key management for employee services for the years ended December 31, 2012 and 2011, consists of:

(in millions of Korean won)	2012	2011
Short-term employee benefits	₩ 27,738	₩ 21,658
Retirement benefits	3,549	2,227
	₩ 31,287	₩ 23,885

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 ₩ 1,071.1 to US$1, the basic exchange rate on December 31, 2012, 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.