

KT&G Corporation

**Interim Separate Financial Statements
September 30, 2012**

	Page(s)
Report on Review of Interim Financial Statements.....	1 - 3
Interim Separate Financial Statements	
Interim Separate Statements of Financial Position	4
Interim Separate Statements of Comprehensive Income	5 - 6
Interim Separate Statement of Changes in Equity	7 - 8
Interim Separate Statements of Cash Flows	9
Notes to Interim Separate Financial Statements.....	10 - 53



Report on Review of Interim Financial Statements

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

Reviewed Financial Statements

We have reviewed the accompanying interim separate financial statements of KT&G Corporation. These financial statements consist of separate statement of financial position of KT&G Corporation (the Company) as of September 30, 2012, and the related separate statements of comprehensive income for the three-month and nine-month periods ended September 30, 2012, and statements of changes in equity and cash flows for the nine-month period ended September 30, 2012, and a summary of significant accounting policies and other explanatory notes, expressed in Korean won.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these separate financial statements in accordance with the International Financial Reporting Standards as adopted by the Republic of Korea ("Korean IFRS") 34, *Interim Financial Reporting*, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe the accompanying interim separate financial statements do not present fairly, in all material respects, in accordance with the Korean IFRS 34, *Interim Financial Reporting*.

Other Matters

The interim separate statement of comprehensive income for the three-month and nine-month periods ended September 30, 2011, and statements of changes in equity and cash flows for the nine-month period ended September 30, 2011, presented herein for comparative purposes, were reviewed by other auditors whose report dated November 11, 2011, expressed that nothing has come to their attention that caused them to believe those statements do not present fairly, in all material respects, the financial performance and cash flows of KT&G Corporation for the three-month and nine-month periods ended September 30, 2011, in accordance with Korean IFRS.

The separate statement of financial position as of December 31, 2011, and the separate statements of comprehensive income, changes in equity and cash flows for the year ended December 31, 2011, were audited by other auditors whose report dated February 16, 2012, expressed an unqualified opinion on those statements in accordance with the Korean IFRS. The separate statement of financial position as of December 31, 2011, presented herein for comparative purposes, is consistent in all material respects, with the above audited statement of financial position as of December 31, 2011.

The accompanying interim separate financial statements as of and for the three-month and nine-month periods ended September 30, 2012, have been translated into US dollars solely for the convenience of the reader and have been translated on the basis set forth in Note 33 to the interim separate financial statements.

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

Samil price waterhouse Coopers

Seoul, Korea

November 13, 2012

This report is effective as of November 13, 2012, the review report date. Certain subsequent events or circumstances, which may occur between the review report date and the time of reading this report, could have a material impact on the accompanying interim separate financial statements and notes thereto. Accordingly, the readers of the review report should understand that there is a possibility that the above review report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

KT&G Corporation
Interim Separate Statements of Financial Position
September 30, 2012 and December 31, 2011

<i>(in millions of Korean won and thousands of U.S. dollars)</i>	Notes	September 30, 2012 Korean won	September 30, 2012 U.S. dollars (Note 33)	December 31, 2011 Korean won
Assets				
Non-current assets				
Property, plant and equipment	9	₩ 1,155,684	\$ 1,033,152	₩ 1,163,361
Intangible assets	10	19,265	17,222	18,972
Investment property	11,13	155,623	139,123	165,053
Investments in associates	14	48,225	43,112	36,725
Investments in subsidiaries	14	1,166,086	1,042,451	1,054,767
Available-for-sale financial assets	4,5,6	266,099	237,886	247,018
Long-term deposits in MSA Escrow Fund	4,5,8,31	166,281	148,651	147,290
Long-term prepaid expenses		4,311	3,855	4,084
Long-term trade and other receivables	4,5,7,32	163,816	146,447	199,031
		<u>3,145,390</u>	<u>2,811,899</u>	<u>3,036,301</u>
Current assets				
Inventories	15	798,959	714,249	904,112
Available-for-sale financial assets	4,5,6	1,044	933	1,044
Other financial assets	4,5,16	730,000	652,601	-
Prepaid tobacco excise and other taxes		159,083	142,216	198,222
Trade and other receivables	4,5,7,32	889,991	795,630	625,756
Advance payments		45,402	40,588	9,358
Prepaid expenses		3,432	3,067	402
Cash and cash equivalents	4,5,16	344,599	308,063	639,097
		<u>2,972,510</u>	<u>2,657,347</u>	<u>2,377,991</u>
Assets held for sale	12	<u>8,049</u>	<u>7,196</u>	<u>3,196</u>
Total assets		<u>₩ 6,125,949</u>	<u>\$ 5,476,442</u>	<u>₩ 5,417,488</u>
Equity				
Capital stock	1,17	₩ 954,959	\$ 853,710	₩ 954,959
Other Capital surplus	17	3,582	3,202	3,582
Treasury shares	18	(343,522)	(307,100)	(343,522)
Gain on reissuance of treasury shares	18	485,922	434,402	485,922
Reserve	19	3,039,955	2,717,641	2,678,814
Retained earnings	20	633,637	566,456	763,738
Total equity		<u>4,774,533</u>	<u>4,268,311</u>	<u>4,543,493</u>
Liabilities				
Non-current liabilities				
Long-term trade and other payables	4,5,21,32	28,001	25,033	26,628
Long-term advance receipts		5,433	4,857	12,375
Defined benefit liability	23	64,997	58,106	47,640
Deferred income tax liabilities		84,312	75,372	82,923
		<u>182,743</u>	<u>163,368</u>	<u>169,566</u>
Current liabilities				
Borrowings	4,5,22	6,523	5,831	6,975
Trade and other payables	4,5,21,32	302,366	270,307	248,976
Advance receipts		10,174	9,095	3,935
Income taxes payable		146,753	131,194	138,846
Tobacco excise and other taxes payable		702,857	628,336	305,697
		<u>1,168,673</u>	<u>1,044,763</u>	<u>704,429</u>
Total liabilities		<u>1,351,416</u>	<u>1,208,131</u>	<u>873,995</u>
Total liabilities and equity		<u>₩ 6,125,949</u>	<u>\$ 5,476,442</u>	<u>₩ 5,417,488</u>

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

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

KT&G Corporation
Interim Separate Statements of Comprehensive Income
Nine-Month Periods Ended September 30, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars, except per share amounts)	Notes	Period Ended September 30		
		2012	2012	2011
		Korean won	U.S. dollars (Note 33)	Korean won
Sales				
Manufacture of tobacco		₩ 1,899,226	\$ 1,697,860	₩ 1,768,626
Real estate		31,190	27,883	21,708
Exports of leaf tobacco and others		50,974	45,569	41,897
	31,32	<u>1,981,390</u>	<u>1,771,312</u>	<u>1,832,231</u>
Cost of sales				
Manufacture of tobacco		(686,748)	(613,935)	(669,304)
Real estate		(4,617)	(4,128)	(3,387)
Exports of leaf tobacco and others		(35,393)	(31,640)	(29,012)
	15,32	<u>(726,758)</u>	<u>(649,703)</u>	<u>(701,703)</u>
Gross profit		<u>1,254,632</u>	<u>1,121,609</u>	<u>1,130,528</u>
Other income	24,32	57,928	51,786	57,819
Selling and administrative expenses	24,25	(472,539)	(422,438)	(440,402)
Other expenses	24,25,32	<u>(37,312)</u>	<u>(33,356)</u>	<u>(28,132)</u>
Operating income	24	<u>802,709</u>	<u>717,601</u>	<u>719,813</u>
Finance income	26	32,968	29,473	86,301
Finance expense	26	<u>(698)</u>	<u>(624)</u>	<u>(4,712)</u>
Net finance income		<u>32,270</u>	<u>28,849</u>	<u>81,589</u>
Profit before income tax		834,979	746,450	801,402
Income tax expense	27	<u>(203,823)</u>	<u>(182,212)</u>	<u>(182,698)</u>
Profit for the period		<u>₩ 631,156</u>	<u>\$ 564,238</u>	<u>₩ 618,704</u>
Other comprehensive income				
Change in value of available-for-sale financial assets		₩ 2,140	\$ 1,913	₩ (35,433)
Actuarial gain(loss) on defined benefit liability		139	124	99
Other comprehensive income (loss) for the period, net of tax		<u>2,279</u>	<u>2,037</u>	<u>(35,334)</u>
Total comprehensive income for the period		<u>₩ 633,435</u>	<u>\$ 566,275</u>	<u>₩ 583,370</u>
Earnings per share attributable to the equity holders of the Company during the period (in won)				
Basic and diluted earnings per share	28	<u>₩ 5,019</u>	<u>\$ 4.49</u>	<u>₩ 4,880</u>

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

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

KT&G Corporation
Interim Separate Statements of Comprehensive Income
Three-Month Periods Ended September 30, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars, except per share amounts)	Notes	Period Ended September 30		
		2012	2012	2011
		Korean won	U.S. dollars (Note 33)	Korean won
Sales				
Manufacture of tobacco		₩ 695,892	\$ 622,110	₩ 649,878
Real estate		10,780	9,637	8,415
Exports of leaf tobacco and others		21,538	19,254	13,276
	31,32	<u>728,210</u>	<u>651,001</u>	<u>671,569</u>
Cost of sales				
Manufacture of tobacco		(246,730)	(220,571)	(249,451)
Real estate		(1,536)	(1,374)	(1,188)
Exports of leaf tobacco and others		(14,710)	(13,148)	(8,630)
	15,32	<u>(262,976)</u>	<u>(235,093)</u>	<u>(259,269)</u>
Gross profit		<u>465,234</u>	<u>415,908</u>	<u>412,300</u>
Other income	24,25,32	36,967	33,048	60,733
Selling and administrative expenses	24,25	(166,990)	(149,285)	(156,825)
Other expenses	24,25,32	<u>(28,853)</u>	<u>(25,794)</u>	<u>(12,848)</u>
Operating income	24	<u>306,358</u>	<u>273,877</u>	<u>303,360</u>
Finance income	26	10,222	9,138	15,055
Finance expense	26	<u>(220)</u>	<u>(197)</u>	<u>(370)</u>
Net finance income		<u>10,002</u>	<u>8,941</u>	<u>14,685</u>
Profit before income tax		<u>316,360</u>	<u>282,818</u>	<u>318,045</u>
Income tax expense	27	<u>(77,084)</u>	<u>(68,911)</u>	<u>(77,527)</u>
Profit for the period		<u>₩ 239,276</u>	<u>\$ 213,907</u>	<u>₩ 240,518</u>
Other comprehensive income				
Change in value of available-for-sale financial assets		₩ (4,027)	\$ (3,600)	₩ (21,931)
Actuarial gain(loss) on defined benefit liability		112	100	36
Other comprehensive income (loss) for the period, net of tax		<u>(3,915)</u>	<u>(3,500)</u>	<u>(21,895)</u>
Total comprehensive income for the period		<u>₩ 235,361</u>	<u>\$ 210,407</u>	<u>₩ 218,623</u>
Earnings per share attributable to the equity holders of the Company during the period (in won)				
Basic and diluted earnings per share	28	<u>₩ 1,903</u>	<u>\$ 1.70</u>	<u>₩ 1,914</u>

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

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KT&G Corporation

Interim Separate Statements of Changes in Equity Nine-Month Periods Ended September 30, 2012 and 2011

<i>(in millions of Korean won)</i>	Notes	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
		₩	₩	₩	₩	₩	₩	₩
Balance at January 1, 2011		954,959	3,582	(216,827)	482,129	2,184,703	929,140	4,337,686
Comprehensive Income								
Profit for the period		-	-	-	-	-	618,705	618,705
Other comprehensive income(loss)		-	-	-	-	(35,432)	-	(35,432)
Change in value of available-for-sale financial assets		-	-	-	-	-	99	99
Actuarial gain(loss) on defined benefit liability		-	-	-	-	(35,432)	99	(35,333)
Total other comprehensive income (loss)		-	-	-	-	(35,432)	99	(35,333)
Total comprehensive income (loss)		-	-	-	-	(35,432)	618,804	583,372
Transactions with equity holders of the Company								
Cash dividends		-	-	-	-	-	(382,946)	(382,946)
Acquisition of treasury shares		-	-	(129,672)	-	-	-	(129,672)
Other reserve		-	-	-	-	544,000	(544,000)	-
Total transactions with equity holders of the Company		-	-	(129,672)	-	544,000	(926,946)	(512,618)
Balance at September 30, 2011		₩ 954,959	₩ 3,582	₩ (346,499)	₩ 482,129	₩ 2,693,271	₩ 620,998	₩ 4,408,440
Balance at January 1, 2012		₩ 954,959	₩ 3,582	₩ (343,522)	₩ 485,922	₩ 2,678,814	₩ 763,738	₩ 4,543,493
Comprehensive Income								
Profit for the period		-	-	-	-	-	631,157	631,157
Other comprehensive income(loss)		-	-	-	-	2,141	-	2,141
Change in value of available-for-sale financial assets		-	-	-	-	-	138	138
Actuarial gain(loss) on defined benefit liability		-	-	-	-	2,141	138	2,279
Total other comprehensive income (loss)		-	-	-	-	2,141	631,295	633,436
Total comprehensive income (loss)		-	-	-	-	2,141	631,295	633,436
Transactions with equity holders of the Company								
Cash dividends		-	-	-	-	-	(402,396)	(402,396)
Other reserve		-	-	-	-	359,000	(359,000)	-
Total transactions with equity holders of the Company		-	-	-	-	359,000	(761,396)	(402,396)
Balance at September 30, 2012		₩ 954,959	₩ 3,582	₩ (343,522)	₩ 485,922	₩ 3,039,955	₩ 633,637	₩ 4,774,533

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

KT&G Corporation

Interim Separate Statements of Changes in Equity Nine-Month Periods Ended September 30, 2012

	Notes	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
		\$	\$	\$	\$	\$	\$	\$
Balance at January 1, 2012		853,710	3,202	(307,100)	434,402	2,394,791	682,762	4,061,767
Comprehensive Income								
Profit for the period		-	-	-	-	-	564,238	564,238
Other comprehensive income(loss)								
Change in value of available-for-sale financial assets		-	-	-	-	1,914	-	1,914
Actuarial gain(loss) on defined benefit liability		-	-	-	-	-	124	124
Total other comprehensive income (loss)		-	-	-	-	1,914	124	2,038
Total comprehensive income (loss)		-	-	-	-	1,914	564,362	566,276
Transactions with equity holders of the Company								
Cash dividends		-	-	-	-	-	(359,732)	(359,732)
Other reserve		-	-	-	-	320,937	(320,937)	-
Total transactions with equity holders of the Company		-	-	-	-	320,937	(680,669)	(359,732)
Balance at September 30, 2012		853,710	3,202	(307,100)	434,402	2,717,642	566,455	4,268,311

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

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KT&G Corporation
Interim Separate Statements of Cash Flows
Nine-Month Periods Ended September 30, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars)	Notes	Period Ended September 30		
		2012 Korean won	2012 U.S. dollars (Note 33)	2011 Korean won
Cash flows from operating activities				
Cash generated from operations	30	₩ 1,187,478	\$ 1,061,575	₩ 848,612
Income tax paid		(195,255)	(174,553)	(289,122)
Net cash generated from operating activities		<u>992,223</u>	<u>887,022</u>	<u>559,490</u>
Cash flows from investing activities				
Interest received		18,987	16,974	21,312
Investment income received from long-term deposits in MSA Escrow Fund		407	364	10,582
Dividends received		6,282	5,616	55,057
Proceeds from sale of property, plant and equipment		20,768	18,566	14,042
Proceeds from sale of intangible assets		401	358	3,754
Proceeds from sale of assets held for sale		15,100	13,499	0
Proceeds from sale of available-for-sale financial assets		233	208	2,570
Proceeds from sale of investments in subsidiaries		900	805	873
Decrease in loans		22,267	19,905	12,077
Decrease in guarantee deposits		43,625	39,000	26,989
Proceeds from sale of other investment assets		0	0	66
Acquisition of property, plant and equipment		(112,777)	(100,819)	(111,208)
Acquisition of intangible assets		(1,046)	(935)	(3,755)
Acquisition of investment property		(51)	(46)	(2,109)
Acquisition of investments in associates		(11,500)	(10,281)	(12,600)
Acquisition of investments in subsidiaries		(73,078)	(65,330)	(85,468)
Acquisition of available-for-sale financial assets		(16,500)	(14,750)	(12,220)
Increase in loans		-	-	(10,207)
Increase in guarantee deposits		(45,595)	(40,761)	(33,808)
Increase in long-term deposits in MSA Escrow Fund		(24,369)	(21,785)	(10,954)
Increase in other financial assets		(730,000)	(652,601)	-
Net cash used in investing activities		<u>(885,946)</u>	<u>(792,013)</u>	<u>(135,007)</u>
Cash flows from financing activities				
Dividends paid	29	(402,396)	(359,732)	(382,946)
Acquisition of treasury shares		-	-	(129,671)
Increase in deposits received		5,540	4,953	8,574
Decrease in deposits received		(3,876)	(3,465)	(5,616)
Net cash used in financing activities		<u>(400,732)</u>	<u>(358,244)</u>	<u>(509,659)</u>
Net decrease in cash and cash equivalents		(294,455)	(263,235)	(85,176)
Cash and cash equivalents at the beginning of period		639,097	571,337	828,951
Exchange gains/(losses) on cash and cash equivalents		<u>(43)</u>	<u>(39)</u>	<u>6,835</u>
Cash and cash equivalents at the end of period		<u>₩ 344,599</u>	<u>\$ 308,063</u>	<u>₩ 750,610</u>

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

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KT&G Corporation

Notes to Interim Separate Financial Statements

September 30, 2012 and 2011, and December 31, 2011

1. General Information

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

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

As of September 30, 2012, the 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 Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Company is located in Pyeongchon-dong, Daedeok-gu, Daejeon.

Pursuant to the Korean government's privatization program and management reorganization plan, on December 28, 1998, the shareholders approved a plan to separate the Company into two companies by setting up a subsidiary for its red ginseng business segment effective January 1, 1999. The separation was accomplished by the Company's contribution of the assets and liabilities in the red ginseng business segment into a wholly owned subsidiary, Korea Ginseng Corporation.

On October 17, 2002 and October 31, 2001, the Company listed 35,816,658 and 45,400,000 Global Depositary Receipts ("GDR") (each GDR representing the right to receive one-half share of an ordinary share of the Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program. Also, on June 25, 2009, the market of the Company's GDR was changed from the BdL Market to the Euro MTF in the Luxembourg Stock Exchange.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

The ownership of the Company's issued ordinary shares as of September 30, 2012, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.92%
Employee share ownership association	2,841,222	2.07%
Others	113,397,093	82.60%
	125,748,800	91.60%
Treasury shares	11,543,697	8.41%
	137,292,497	100.00%

2. Significant Accounting Policies

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

2.1 Basis of Preparation

The financial statements for the nine-month period ended September 30, 2012, have been prepared in accordance Korean IFRS 1034, '*Interim Financial Reporting*'. These financial statements have been prepared in accordance with the Korean IFRS standards and interpretations issued and effective or issued and early adopted at the reporting date.

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

- Amendments to Korean-IFRS1019, *Employ benefits*

According to the amendment, the corridor approach to actuarial gains and losses no longer applies. Accordingly, all actuarial gains and losses are immediately recognized as other comprehensive income. This amendment will be effective for the Company as of January 1, 2013. The Company expects that the application of this amendment would not have material impact on its financial statements.

- Enactment of Korean-IFRS1113, *Fair value measurement*

Korean-IFRS1113, *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-IFRS1101 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 Korean-IFRSs. This amendment will be effective for the Company as of January 1, 2013, and the Company expects that it would not have a material impact on the Company.

- Amendments to Korean-IFRS1001, *Presentation of financial statements*

Korean-IFRS1001, *Presentation of financial statements*, suggests the entity to separate and represent operating income, which is generated by profit subtracted from cost of sales and selling and administrative expenses, in statements of comprehensive income. Also, the entity may classify operating income by adding other income and expenses that reflect business performances, then disclose it with a title of 'Adjusted operating income' in notes. This amendment will be effective for the Company as of December 31, 2012, and will be applied from the first fiscal year ended after an

KT&G Corporation

Notes to Interim Separate Financial Statements

September 30, 2012 and 2011, and December 31, 2011

effective date (early adaption is allowed). The Company expects that the application of this amendment would not have any impact on current net income but on the Company's operating income.

In addition, Korean-IFRS1001, *Presentation of financial statements*, has been amended as to separate items of other comprehensive income by a fact whether they would be reclassified as current income in future, then to represent them into two groups. This amendment will be effective for the Company from a fiscal year beginning after July 1, 2012 and early adoption is allowed. The Company expects that the application of this amendment would not have a material impact on its consolidated financial statements.

2.2 Subsidiaries and associates

These separate financial statements are prepared and presented in accordance with K-IFRS No. 1027. The Company applied the cost method to investments in subsidiaries and associates in accordance with K-IFRS No. 1027. The carrying amount of investment in Korea Ginseng Corporation under previous Korean Generally Accepted Accounting Principles on the date of transition to K-IFRS is considered to be the deemed cost of investments in subsidiaries on the date of transition. Dividends from a subsidiary or associate are recognized in profit or loss when the right to receive the dividend is established.

2.3 Segment Reporting

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

2.4 Foreign Currency Translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The financial statements are presented in Korean won, which is the 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 income statement, 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 income statement within 'financial income or expenses'. All other foreign exchange gains and losses are presented in the income statement 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.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognized in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available-for-sale, are included in other comprehensive income.

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 Company 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 Company's loans and receivables comprise 'cash and cash equivalents', 'trade and other receivables', and 'other financial assets' in the statement of financial position.

(c) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company intends and is able to hold to maturity and are classified as 'other financial assets' in the statements of financial position. If the Company were to sell other than an insignificant amounts of held-to-maturity investments, the whole category would be tainted and reclassified as available-for-sale. Held-to-maturity investments are included in non-current assets, except for those with maturities of less than 12 months after the end of the reporting period, which are classified as current assets.

(d) 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.

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

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

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 income statement. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Company 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 income statement 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 income statement as part of 'other income' when the Company'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 income statement as 'other gains and losses, net'.

Interest on available-for-sale and held-to-maturity securities calculated using the effective interest method is recognized in the income statement as part of 'other income'. Dividends on available-for-sale equity instruments are recognized in the income statement as part of 'other income' when the Company'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 Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or a group of financial assets that can be reliably estimated.

The criteria that the Company 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.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

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 income statement. In practice, the Company 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 income statement.

(b) Assets classified as available-for-sale

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. For debt securities, the Company 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 income statement. Impairment losses recognized in the separate income statement on equity instruments are not reversed through the income statement. 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 income statement.

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.

KT&G Corporation

Notes to Interim Separate Financial Statements

September 30, 2012 and 2011, and December 31, 2011

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 ₩ 301,721 million and ₩ 385,459 million as of September 30, 2012 and December 31, 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 Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

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

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

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

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.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

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 Company 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 income statement over the period necessary to match them with the costs that they are intended to compensate.

2.14 Intangible Assets

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

The estimated useful lives are as follows:

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

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

2.15 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 Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the income statement 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.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

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 income statement over the period of the borrowings using the effective interest method. The Company recognizes borrowings as current assets unless it has an unconditional right to delay the settlement of the borrowing. Preference shares, which are mandatorily redeemable on a specific date, are classified as liabilities. The dividends on these preference shares are recognized in the income statement as 'finance expense'.

2.19 Compound Financial Instruments

Compound financial instruments issued by the Company 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 Company 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.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

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 income statement, 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 Company 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 separate 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 Company 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

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

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

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Company has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense when they are due. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in the future payments is available.

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

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

(b) Termination benefits

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

2.23 Share Capital

Ordinary shares and preferred shares that are not mandatorily redeemable are classified as equity.

Where the 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 Company's revenue categories consist of goods sold, services and other income. Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the nine-month periods ended September 30, 2012 and 2011, were ₩ 2,689,392 million and ₩ 2,545,098 million, respectively.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

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.

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

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

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

2.25 Dividend Distribution

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

3. Critical Accounting Estimates and Judgments

The Board of Directors of the company 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 interim 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.

Critical accounting estimates and assumptions in the preparation of the interim financial statements are all the same as estimates and assumptions applied for previous financial statements, except for an estimation approach that were used to decide Income Tax expenses.

4. Financial Risk Management

4.1 Financial Risk Factors

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

Risk management is carried out by a central treasury department (Company treasury) under policies approved by the board of directors. The Company treasury identifies, evaluates and

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

hedges financial risks in close co-operation with the Company's operating units. The board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity.

(a) Market Risk

i) Foreign exchange risk

The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates arising from the export and import of tobacco. The Company's management has measured the currency risk internally and regularly, and has entered into foreign currency option contracts to hedge foreign currency risk in case of need.

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of September 30, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012				December 31, 2011			
	USD	EUR	RUB	THB(IDR)	USD	EUR	RUB	THB
Assets								
Cash and cash equivalents	₩ 19,110	₩ 14	₩ -	₩ -	₩ 24,198	₩ 37	₩ -	₩ -
Trade and other receivables	561,996	23,291	1,538	1,523	419,781	17,078	10,389	60
Long-term deposits	166,281	-	-	-	147,290	-	-	-
	₩ 747,387	₩ 23,305	₩ 1,538	₩ 1,523	₩ 591,269	₩ 17,115	₩ 10,389	₩ 60
Liabilities								
Trade and other payables	₩ 5,417	₩ 3,600	₩ -	₩ -	₩ 3,194	₩ 4,281	₩ -	₩ -
	₩ 5,417	₩ 3,600	₩ -	₩ -	₩ 3,194	₩ 4,281	₩ -	₩ -

As of September 30, 2012 and December 31, 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:

<i>(in millions of Korean won)</i>	September 30, 2012		December 31, 2011	
	10% strengthening	10% weakening	10% strengthening	10% weakening
US dollar	₩ 74,197	₩ (74,197)	₩ 58,808	₩ (58,808)

ii) Price risk

The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Other market price risk arises from available-for-sale equity instruments held for investments. The Company's management has monitored the mix of debt and equity instruments in its investment portfolio based on market indices. Material investments within the portfolio are managed on an individual basis and all buy and sell decisions are approved by the Company's management.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

As of September 30, 2012 and December 31, 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)	September 30, 2012		December 31, 2011	
	5% increase	5% decrease	5% increase	5% decrease
Other comprehensive income before tax	₩ 6,089	₩ (6,089)	₩ 8,464	₩ (8,464)
Tax effect	(1,474)	1,474	(2,048)	2,048
Other comprehensive income after tax	₩ 4,615	₩ (4,615)	₩ 6,416	₩ (6,416)

iii) Interest rate risk

The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation.

(b) Credit Risk

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

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of September 30, 2012 and December 31, 2011, is as follows:

(in millions of Korean won)	September 30, 2012	December 31, 2011
Available-for-sale financial assets	₩ 3,544	₩ 2,044
Long-term deposits in MSA Escrow Fund	166,281	147,290
Trade and other receivables	1,053,807	824,787
Other financial assets	730,000	-
Cash and cash equivalents	344,599	639,097

(c) Liquidity Risk

The Company has exposure to the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Company's management has established short-term and long-term financial management plans to manage the liquidity risk, and analyzed cash outflows occurred and cash outflows budgeted, so as to match the maturity structure of financial assets and financial liabilities. The Company's management determines whether or not the financial liabilities are repayable with the operating cash flows and cash inflows from financial assets. The Company 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 September 30, 2012 and December 31, 2011, is as follows:

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

		September 30, 2012					
<i>(in millions of Korean won)</i>		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	₩	183,894	₩ 185,293	₩ 155,892	₩ -	₩ 29,401	₩ -
Short-term borrowings		6,523	6,523	6,523	-	-	-

		December 31, 2011					
<i>(in millions of Korean won)</i>		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	₩	157,151	₩ 158,259	₩ 58,309	₩ 89,361	₩ 8,531	₩ 2,058
Short-term borrowings		6,975	6,975	6,975	-	-	-

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

4.2 Capital Management

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

As of September 30, 2012 and December 31, 2011, the Company defines net debt and equity attributable to owners of the Parent as follows:

<i>(in millions of Korean won)</i>	September 30, 2012	December 31, 2011
Total borrowings	₩ 6,523	₩ 6,975
Less:		
-Cash and cash equivalents	(344,599)	(639,097)
-Other financial assets, current	(730,000)	-
-Available-for-sale financial assets, current	(1,044)	(1,044)
Net debt(Net asset)	(1,069,120)	(633,166)
Equity attributable to owners of the parent	₩ 4,774,533	₩ 4,543,493

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 Company's financial assets and financial liabilities that are measured at fair value as of September 30, 2012:

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

<i>(in millions of Korean won)</i>	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale financial assets	₩ 189,842	₩ 47,654	₩ 12,009	₩ 249,505

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

<i>(In millions of Korean won)</i>	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale financial 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 Company is the current bid price. These instruments are included in Level 1. Instruments included in Level 1 consist primarily of KOSPI and KOSDAQ equity investments classified as trading securities or available for sale.

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

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

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- The fair value of 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. Financial Instruments by Category

Categorizations of financial assets as of September 30, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 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	₩ 344,599	₩ -	₩ -	₩ -	₩ 344,599
Financial assets as available-for-sale, current	-	-	-	1,044	1,044
Trade and other receivables, current	889,991	-	-	-	889,991

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

Other financial assets, current	730,000	-	-	-	730,000
Long-term deposits	166,281	-	-	-	166,281
Financial assets as available-for-sale, non-current	-	-	-	266,099	266,099
Long-term Trade and other receivables	163,816	-	-	-	163,816
	<u>₩ 2,294,687</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 267,143</u>	<u>₩ 2,561,830</u>

December 31, 2011

<i>(in millions of Korean won)</i>	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	₩ 639,097	₩ -	₩ -	₩ -	₩ 639,097
Financial assets as available-for-sale, current	-	-	-	1,044	1,044
Trade and other receivables, current	625,756	-	-	-	625,756
Long-term deposits	147,290	-	-	-	147,290
Financial assets as available-for-sale, non-current	-	-	-	247,018	247,018
Long-term Trade and other receivables	199,031	-	-	-	199,031
	<u>₩ 1,611,174</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 248,062</u>	<u>₩ 1,859,236</u>

Categorizations of financial liabilities as of September 30, 2012 and December 31, 2011, are as follows:

September 30, 2012

<i>(in millions of Korean won)</i>	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total
Borrowings, current	₩ -	₩ -	₩ 6,523	₩ -	₩ 6,523
Trade and other payables, current	-	-	302,366	-	302,366
Trade and other payables, non-current	-	-	28,001	-	28,001
	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 336,890</u>	<u>₩ -</u>	<u>₩ 336,890</u>

December 31, 2011

<i>(in millions of Korean won)</i>	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total
Borrowings, current	₩ -	₩ -	₩ 6,975	₩ -	₩ 6,975
Trade and other payables, current	-	-	248,976	-	248,976
Trade and other payables, non-current	-	-	26,628	-	26,628
	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 282,579</u>	<u>₩ -</u>	<u>₩ 282,579</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

Income and loss of financial instruments by category for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

(in millions of Korean won)	2012		2011	
	Three months	Nine months	Three months	Nine months
Available-for-sale financial assets				
Gain(Loss) on valuation (Other comprehensive income(loss))	₩ (4,027)	₩ 2,140	₩ (21,931)	₩ (35,433)
Gain(Loss) on disposal (Profit or loss)	-	(9)	-	643
Interest income	12	30	5	64
Dividend income	843	6,282	449	55,056
Impairment	-	-	-	(3,988)
Cash and cash equivalents				
Interest income	6,921	18,890	7,122	20,137
Gain(Loss) on foreign currency translation	25	(43)	6,915	6,835
Foreign currency transaction gain (loss)	(510)	(779)	900	378
Trade and other receivables				
Interest income	2,443	7,678	977	1,827
Gain(Loss) on foreign currency translation	(19,401)	(17,073)	46,641	28,968
Foreign currency transaction gain(loss)	(2,221)	(2,246)	(4,226)	(10,845)
Other financial liabilities at amortized cost				
Interest costs	(220)	(689)	(370)	(724)
Gain(Loss) on foreign currency translation	33	12	(353)	(329)
Foreign currency transaction gain (loss)	718	257	(552)	688

6. Available-for-sale Financial Assets

The changes in available-for-sale financial assets as of September 30, 2012 and 2011, are as follows:

(in millions of Korean won)	September 30, 2012	September 30, 2011
At January 1	₩ 248,062	₩ 314,937
Additions	16,500	12,220
Disposals	(243)	(1,927)
Net gains(losses) transfer to equity	2,824	(45,428)
Transfer to others	-	(17,300)
Impairment losses	-	(3,988)
At September 30	267,143	258,514
Less: current portion	(1,044)	-
Non-current portion	₩ 266,099	₩ 258,514

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

Available-for-sale financial assets as of September 30, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012		December 31, 2011	
Available-for-sale debt instruments:				
Government and municipal bonds	₩	44	₩	44
Corporate bonds		3,500		2,000
Total available-for-sale debt instruments		<u>3,544</u>		<u>2,044</u>
Available-for-sale equity instruments:				
Listed				
Yonhap Television News(YTN)		33,017		23,130
Oscotech, Inc.		1,062		2,049
Shinhan Financial Group Co., Ltd.		152,117		159,332
Rexahn Pharmaceuticals, Inc.		3,646		2,801
		<u>189,842</u>		<u>187,312</u>
Unlisted				
Dream Hub PFV Co., Ltd.		12,009		12,009
Others		61,748		46,697
		<u>73,757</u>		<u>58,706</u>
Total available-for-sale equity instruments		<u>263,599</u>		<u>246,018</u>
Total available-for-sale financial assets	₩	<u>267,143</u>	₩	<u>248,062</u>

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.

7. Trade and Other Receivables

Trade and other receivables as of September 30, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012		December 31, 2011	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 8,950	₩ 23,649	₩ 13,421	₩ 32,339
Loans	12,592	79,756	7,123	108,461
Other receivables	73,546	22,912	60,457	22,281
Guarantee deposits	-	37,499	-	35,950
Accrued income	9,581	-	4,051	-
Trade receivables	785,322	-	540,704	-
	<u>₩ 889,991</u>	<u>₩ 163,816</u>	<u>₩ 625,756</u>	<u>₩ 199,031</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

Trade and other receivables as of September 30, 2012 and December 31, 2011, reported in the separate statements of financial position, net of allowances, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012		December 31, 2011	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 895,346	₩ 163,816	₩ 631,121	₩ 199,031
Allowance account				
-Other receivables	(2,083)	-	(2,083)	-
-Trade receivables	(3,272)	-	(3,282)	-
	<u>(5,355)</u>	<u>-</u>	<u>(5,365)</u>	<u>-</u>
Net amount	<u>₩ 889,991</u>	<u>₩ 163,816</u>	<u>₩ 625,756</u>	<u>₩ 199,031</u>

Changes in the allowance account for the nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012	September 30, 2011
Beginning	₩ 5,365	₩ 5,184
Impairment	-	180
Reversal of impairment	(10)	-
Write-off	-	-
Ending	<u>₩ 5,355</u>	<u>₩ 5,364</u>

The aging schedule of trade and other receivables as of September 30, 2012 and December 31, 2011, is as follows:

<i>(in millions of Korean won)</i>	September 30, 2012	December 31, 2011
Not past due	₩ 496,681	₩ 406,483
Past due but not impaired		
Within 1 month	42,403	26,792
Between 1 and 2 months	33,759	36,245
Beyond 2 months	212,469	71,184
	<u>288,631</u>	<u>134,221</u>
Impaired	3,272	3,282
	<u>₩ 788,594</u>	<u>₩ 543,986</u>

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

Details of trade and other receivables that are measured at amortized cost as of September 30, 2012, and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	Effective interest rate(%)	September 30, 2012		Effective interest rate(%)	December 31, 2011	
		Current	Non-current		Current	Non-current
Loans to employees	3.00~5.68	₩ 8,950	₩ 23,649	3.00~5.68	₩ 13,421	₩ 32,339
Other receivables	3.79	-	22,912	3.79	7,997	22,281
Guarantee deposits	3.00~5.68	-	37,499	3.00~5.68	-	35,950
		<u>₩ 8,950</u>	<u>₩ 84,060</u>		<u>₩ 21,418</u>	<u>₩ 90,570</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

8. Long-term Deposits

Long-term deposits of September 30, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012		December 31, 2011	
MMF	₩	1,027	₩	147,290
T-note		165,254		—
	₩	166,281	₩	147,290

As discussed in Note 31 to the separate financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the three-month periods ended September 30, 2012 and 2011, are ₩24,369 million and ₩10,954 million, respectively.

Investment income on long-term deposits in MSA Escrow Fund for the nine-month periods ended September 30, 2012 and 2011, are ₩88 million and ₩8,574 million, respectively.

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

9. Property, Plant and Equipment

Changes in property, plant and equipment for the nine-month periods ended September 30, 2012 and 2011, are as follows:

		September 30, 2012		
<i>(in millions of Korean won)</i>	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value	
Land	₩ 401,686	₩ —	₩	401,686
Buildings	623,878	(239,260)		384,618
Structures	40,508	(23,785)		16,723
Machinery	872,721	(637,203)		235,518
Vehicles	2,584	(2,078)		506
Tools	32,174	(29,677)		2,497
Furniture and fixture	182,276	(148,900)		33,376
Others	1,104	—		1,104
Construction-in-progress	79,656	—		79,656
	₩ 2,236,587	₩ (1,080,903)	₩	1,155,684

		September 30, 2011		
<i>(in millions of Korean won)</i>	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value	
Land	₩ 404,502	₩ —	₩	404,502
Buildings	615,996	(238,138)		377,858
Structures	45,152	(26,090)		19,062
Machinery	823,624	(579,551)		244,073
Vehicles	3,855	(3,113)		742
Tools	31,211	(28,769)		2,442
Furniture and fixture	166,423	(130,336)		36,087
Others	803	—		803
Construction-in-progress	100,206	—		100,206
	₩ 2,191,772	₩ (1,005,997)	₩	1,185,775

KT&G Corporation

Notes to Interim Separate Financial Statements

September 30, 2012 and 2011, and December 31, 2011

September 30, 2012						
<i>(in millions of Korean won)</i>	Opening net book value	Additions	Disposal	Transfer ¹	Depreciation charge	Net book amount
Land	₩ 397,775	₩ 3,312	₩ (5,373)	₩ 5,972	₩ -	₩401,686
Buildings	411,217	4,781	(6,553)	(4,175)	(20,652)	384,618
Structures	19,038	115	(272)	(447)	(1,711)	16,723
Machinery	254,484	9,044	(662)	18,237	(45,585)	235,518
Vehicles	703	154	(121)	-	(230)	506
Tools	2,620	874	(8)	153	(1,142)	2,497
Furniture and fixture	36,363	10,775	(123)	449	(14,088)	33,376
Others	1,078	-	-	26	-	1,104
Construction-in-progress	40,084	83,722	-	(44,150)	-	79,656
	<u>₩ 1,163,362</u>	<u>₩ 112,777</u>	<u>₩ (13,112)</u>	<u>₩(23,935)</u>	<u>₩ (83,408)</u>	<u>₩1,155,684</u>

September 30, 2011						
<i>(in millions of Korean won)</i>	Opening net book value	Additions	Disposal	Transfer ¹	Depreciation charge	Net book amount
Land	₩ 379,002	₩ 188	₩ (5,769)	₩ 31,081	₩ -	₩ 404,502
Buildings	385,189	886	(724)	9,179	(16,672)	377,858
Structures	20,485	195	(99)	105	(1,624)	19,062
Machinery	280,371	2,161	(1,371)	7,183	(44,271)	244,073
Vehicles	592	214	-	167	(231)	742
Tools	3,992	129	-	-	(1,679)	2,442
Furniture and fixture	43,413	8,517	(1)	1,375	(17,217)	36,087
Others	607	-	(10)	206	-	803
Construction-in-progress	82,475	98,918	-	(81,187)	-	100,206
	<u>₩ 1,196,126</u>	<u>₩ 111,208</u>	<u>₩ (7,974)</u>	<u>₩ (31,891)</u>	<u>₩ (81,694)</u>	<u>₩ 1,185,775</u>

¹ Transfers for the nine-month period ended September 30, 2012, were transferred to assets held for sale.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

10. Intangible Assets

Changes in intangible assets for the nine-month periods ended September 30, 2012 and 2011, are as follows:

(in millions of Korean won)	September 30, 2012				
	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development	Total
At January 1, 2012	₩ 1,323	₩ 15,946	₩ -	₩ 1,703	₩ 18,972
Additions	-	309	-	737	1,046
Transfer-in(out)	120	-	-	(120)	-
Disposals	(70)	(1)	-	(667)	(738)
Amortization	(15)	-	-	-	(15)
Impairment / reversal	-	-	-	-	-
Other Changes	-	-	-	-	-
Acquisition Cost	₩ 6,828	₩ 16,254	₩ -	₩ 1,653	₩ 24,735
Accumulated depreciation and impairment cost	(5,470)	-	-	-	(5,470)
Net book amount	₩ 1,358	₩ 16,254	₩ -	₩ 1,653	₩ 19,265

(in millions of Korean won)	September 30, 2011				
	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development	Total
At January 1, 2012	₩ 1,079	₩ 16,514	₩ 1	₩ 30,970	₩ 48,564
Additions	-	2,757	-	998	3,755
Transfer-in(out)	92	-	-	(92)	-
Disposals	-	(3,325)	(1)	-	(3,626)
Amortization	(25)	-	-	-	(25)
Impairment / reversal	-	-	-	-	-
Other Changes	-	-	-	-	-
Acquisition Cost	₩ 6,358	₩ 15,946	₩ 4,073	₩ 32,523	₩ 58,900
Accumulated depreciation and impairment cost	(5,212)	-	(4,073)	(647)	(9,932)
Net book amount	₩ 1,146	₩ 15,946	₩ -	₩ 31,876	₩ 48,968

Research and development expenses for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

(in millions of Korean won)	September 30, 2012		September 30, 2011	
	Three months	Nine months	Three months	Nine months
Cost of goods sold	₩ 49	₩ 232	₩ 40	₩ 125
Selling and administrative expenses	5,595	11,279	3,328	9,108
	₩ 5,644	₩ 11,511	₩ 3,368	₩ 9,233

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

11. Investment Property

Changes in investment property for the nine-month periods ended September 30, 2012 and 2011, are as follows:

(in millions of Korean won)

	September 30, 2012		
	Land	Building	Total
Beginning net book value	₩ 22,683	₩ 142,370	₩ 165,053
Subsequent expenditure	-	51	51
Transfers	(563)	(4,301)	(4,864)
Depreciation	-	(4,617)	(4,617)
Acquisition cost	₩ 22,120	₩ 172,801	₩ 194,921
Accumulated depreciation	-	(39,298)	(39,298)
Net book amount	₩ 22,120	₩ 133,503	₩ 155,623

(in millions of Korean won)

	September 30, 2011		
	Land	Building	Total
Beginning net book value	₩ 13,919	₩ 84,224	₩ 98,143
Subsequent expenditure	-	2,109	2,109
Transfers	1,213	25,968	27,181
Depreciation	-	(3,387)	(3,387)
Acquisition cost	₩ 15,132	₩ 144,563	₩ 159,695
Accumulated depreciation	-	(35,649)	(35,649)
Net book amount	₩ 15,132	₩ 108,914	₩ 124,046

The amounts recognized in profit or loss from investment property for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

	September 30, 2012		September 30, 2011	
	Three months	Nine months	Three months	Nine months
Rental income	₩ 8,663	₩ 24,174	₩ 5,897	₩ 15,055
Direct operating expense	(1,537)	(4,617)	(1,188)	(3,387)
	₩ 7,126	₩ 19,557	₩ 4,709	₩ 11,668

Fair values and book values of investment property as of September 30, 2012 and December 31, 2011, are as follows:

	September 30, 2012		December 31, 2011	
	Fair value	Book value	Fair value	Book value
Land	₩ 326,866	₩ 22,120	₩ 313,922	₩ 22,683
Building	206,453	133,503	198,204	142,370
	₩ 533,319	₩ 155,623	₩ 512,126	₩ 165,053

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

The Company entered into a sales contract with HT&D Co., Ltd. to sell the Gyeonggi branch's land, building and others. The Company received partial payment amounting to ₩1,500 million out of total amount ₩17,820 million during the nine-month period ended September 30, 2012, and has agreed to receive in installments the balance of ₩16,320 million during the current period.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

Also, the Company has sales contracts on Gwangju, Samcheok, Yangyang and Hawsun branch's land, buildings and others with the city governments of Gwangju and Samcheok, authority and Hansol Techno Co., Ltd, respectively. And the Company invested in Korea Ginseng Corporation and KGC Yebon by company's contribution providing land, buildings and others of the plants in Wonju and Chungju, respectively.

Changes in non-current assets held for sale for the nine-month period ended September 30, 2012, are as follows:

(in millions of Korean won)	September 30, 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	₩ 8,773	₩ 13,646	₩ 1,471	₩ 45	₩ 23,935
Transfer from Investment property	563	4,301	-	-	4,864
Disposals	(4,752)	(17,737)	(1,411)	(45)	(23,945)
	₩ 4,584	₩ 210	₩ 60	₩ -	₩ 4,854
At September 30, 2012					
Acquisition cost	₩ 6,857	₩ 3,652	₩ 490	₩ -	₩ 10,999
Accumulated depreciation	-	(2,566)	(383)	-	(2,949)
Net book amount	₩ 6,857	₩ 1,086	₩ 107	₩ -	₩ 8,050

13. Pledged Assets

The following assets were pledged as collateral for the Company's borrowings and others as of September 30, 2012:

(in millions of Korean won)					
Asset	Book amount		Borrowings	Collateralized amount	Lender /Leaseholder
Investment Property	₩ 143,217	Leasehold deposits received	₩ 7,663	₩ 7,979	Metlife Insurance Korea Co.,Ltd. and 29 others

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

(in millions of Korean won)					
Asset	Book amount		Borrowings	Collateralized amount	Lender /Leaseholder
Investment Property	₩ 89,705	Leasehold deposits received	₩ 6,576	₩ 7,469	Metlife Insurance Korea Co.,Ltd. and 27 others

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

14. Investments in Associates and Subsidiaries

Investments in associates and subsidiaries as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)

(in millions of Korean won)

	Location	Principal operation	September 30,2012		December 31,2011	
			Interest (%)	Carrying Amount	Interest (%)	Carrying Amount
Associates						
Cosmo Tobacco Co., Ltd.	Mongolia	Manufacturing and selling tobaccos	40.00	₩ -	40.00	₩ -
Lite Pharm Tech, Inc	Korea	Manufacturing and Medical supplies	25.34	1,830	25.34	1,830
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00	1,000	20.00	1,000
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	13,995	49.02	13,995
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	7,300	29.67	7,300
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	7,000	22.06	7,000
JR REIT V Co., Ltd.	China	Selling and renting of real estate	34.63	5,600	34.63	5,600
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	10,000	-	-
LSK Global Pharma Services Co., Ltd	Korea	Research and developing new drug	23.15	1,500	-	-
				48,225		36,725
Subsidiaries						
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00	599,023	100.00	559,882
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceuticals	53.00	66,355	53.00	66,355
Tae-a industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00	15,698	100.00	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	Manufacturing and selling tobaccos	99.99	54,049	99.99	54,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf Tobaccos	99.90	535	99.90	394
KT&G Pars	Iran	Manufacturing and selling tobaccos	99.99	5,733	99.99	5,733
KT&G Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00	110,297	100.00	110,297
KG Life & Gin Co., Ltd	Korea	Selling ginseng	100.00	52,900	100.00	31,500
KT&G Bio Corp.	Korea	Manufacturing and selling pharmaceuticals	-	-	100.00	900
Global Trading, Inc.	USA	Selling tobaccos	100.00	4,913	100.00	4,913
Jilin Hanzheng Ginseng Co., Ltd.	China	Manufacturing and selling ginseng	100.00	31,333	100.00	23,247
Somang Cosmetics Co., Ltd. ¹	Korea	Manufacturing and selling cosmetics	60.00	60,721	60.00	60,721
Renzoluc Pte., Ltd. ²	Singapore	Manufacturing and selling tobaccos	72.67	89,756	100.00	89,756
KT&G Life science ³	Korea	Medical researching and developing	59.48	31,232	59.48	31,232
Yebon Nongwon Agriculture Co., Ltd	Korea	Corporate agriculture	90.00	90	90.00	90
KGC Yebon	Korea	Corporate agriculture	100.00	30,000	-	-
K-Q HongKong I,Limited ⁴	Hong Kong	Manufacturing and selling ginseng	50.00	13,451	-	-
				1,166,086		1,054,767
				₩ 1,214,311		₩ 1,091,492

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

¹ The Company's percentage of ownership includes convertible preferred shares. As of September 30, 2012, the Company's percentage of ownership excluding convertible preferred shares, is 60.00%.

² The Company's percentage of ownership includes convertible preferred shares. As of September 30, 2012, the Company's percentage of ownership excluding convertible preferred shares, is 100.00%.

³ The Company's percentage of ownership includes convertible preferred shares. As of September 30, 2012, the Company's percentage of ownership excluding convertible preferred shares, is 73.94%.

⁴ The Company's percentage of ownership includes convertible preferred shares. As of September 30, 2012, the Company's percentage of ownership excluding convertible preferred shares, is 100.00%.

Changes in investments in associates and subsidiaries for the nine-month periods ended September 30, 2012 and 2011, are as follows:

(in millions of Korean won)	September 30, 2012				
	Beginning balance	Acquisition	Disposals	Other changes	Ending balance
Associates					
Cosmo Tabacco Co., Ltd.	₩ -	₩ -	₩ -	₩ -	₩ -
Lite Pharm Tech, Inc	1,830	-	-	-	1,830
Korean Carbon Finance, Inc.	1,000	-	-	-	1,000
JR CR-REIT IV Co., Ltd.	13,995	-	-	-	13,995
KVG REIT 1 Co., Ltd.	7,300	-	-	-	7,300
KOCREF REIT 17 Co., Ltd.	7,000	-	-	-	7,000
JR REIT V Co., Ltd.	5,600	-	-	-	5,600
JR REIT VIII Co., Ltd.	-	10,000	-	-	10,000
LSK Global Pharma Services Co., Ltd	-	1,500	-	-	1,500
	<u>36,725</u>	<u>11,500</u>	<u>-</u>	<u>-</u>	<u>48,225</u>
Subsidiaries					
Korea Ginseng Corporation ¹	559,882	39,141	-	-	599,023
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	66,355
Tae-a industry Co., Ltd.	15,698	-	-	-	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	394	141	-	-	535
KT&G Pars	5,733	-	-	-	5,733
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KG Life & Gin Co., Ltd	31,500	21,400	-	-	52,900
KT&G Bio Corp.	900	-	(900)	-	-
Global Trading, Inc.	4,913	-	-	-	4,913
Jilin Hanzheng Ginseng Co., Ltd.	23,247	8,086	-	-	31,333
Somang Cosmetics Co., Ltd.	60,721	-	-	-	60,721
Renzoluc Pte., Ltd.	89,756	-	-	-	89,756
KT&G Life science	31,232	-	-	-	31,232
Yebon Nongwon	90	-	-	-	90
Agriculture Co., Ltd	-	-	-	-	-
KGC Yebon	-	30,000	-	-	30,000
K-Q HongKong I,Limited	-	13,451	-	-	13,451
	<u>1,054,767</u>	<u>112,219</u>	<u>(900)</u>	<u>-</u>	<u>1,166,086</u>
	₩ 1,091,492	₩ 123,719	₩ (900)	₩ -	₩ 1,214,311

KT&G Corporation

Notes to Interim Separate Financial Statements

September 30, 2012 and 2011, and December 31, 2011

¹ The amount of acquisition during the nine-month period ended September 30, 2012, represents the Company's investment in kind(Note12).

(in millions of Korean won)	September 30, 2011				
	Beginning balance	Acquisition	Share of profit(loss)	Other changes ¹	Ending balance
Associates					
Cosmo Tobacco Co., Ltd.	₩ -	₩ -	₩ -	₩ -	₩ -
Lite Pharm Tech, Inc	1,830	-	-	-	1,830
Korean Carbon Finance, Inc.	1,000	-	-	-	1,000
JR CR-REIT IV Co., Ltd.	-	-	-	10,000	10,000
KVG REIT 1 Co., Ltd.	-	-	-	7,300	7,300
KOCREF REIT 17 Co., Ltd.	-	7,000	-	-	7,000
JR REIT V Co., Ltd.	-	5,600	-	-	5,600
	<u>2,830</u>	<u>12,600</u>	<u>-</u>	<u>17,300</u>	<u>32,730</u>
Subsidiaries					
Korea Ginseng Corporation	559,882	-	-	-	559,882
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	66,355
Tae-a Industry Co., Ltd.	14,198	1,500	-	-	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	394	-	-	-	394
KT&G Pars	5,733	-	-	-	5,733
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KG Life & Gin Co., Ltd	22,500	-	-	-	22,500
KT&G Bio Corp.	900	-	-	-	900
Global Trading, Inc.	4,913	-	-	-	4,913
Purpleland Development Co., Ltd.	900	-	(900)	-	-
Jilin Hanzheng Ginseng Co., Ltd.	-	23,247	-	-	23,247
Somang Cosmetics Co., Ltd.	-	60,721	-	-	60,721
	<u>840,121</u>	<u>85,468</u>	<u>(900)</u>	<u>-</u>	<u>924,689</u>
	<u>₩ 842,951</u>	<u>₩ 98,068</u>	<u>₩ (900)</u>	<u>₩ 17,300</u>	<u>₩ 957,419</u>

¹ The Company reclassified ₩17,300 million of available-for-sale financial assets to investments in associates during the nine-month period ended September 30, 2011.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

15. Inventories

Inventories as of September 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	September 30, 2012			December 31, 2011		
	Acquisition	Allowance	Book amount	Acquisition	Allowance	Book amount
Finished goods	₩ 75,878	₩ (697)	₩ 75,181	₩ 74,115	₩ (472)	₩ 73,643
Work in progress	14,810	-	14,810	15,373	-	15,373
Raw materials	648,513	-	648,513	752,335	-	752,335
Supplies	22,881	-	22,881	23,340	-	23,340
By-products	5,146	-	5,146	6,362	-	6,362
Goods-in-transit	32,428	-	32,428	33,059	-	33,059
	₩ 799,656	₩ (697)	₩ 798,959	₩ 904,584	₩ (472)	₩ 904,112

The cost related inventories for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

(in millions of Korean won)	September 30, 2012		September 30, 2011	
	Three months	Nine months	Three months	Nine months
Cost of sales				
-Loss(profit) on inventory valuation	₩ (187)	₩ 225	₩ 300	₩ 329
Other expenses				
-Loss on retirement of inventories	1,046	2,367	449	2,361
	₩ 859	₩ 2,592	₩ 749	₩ 2,690

16. Cash and Cash Equivalents

Cash and cash equivalents as of September 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	September 30, 2012	December 31, 2011
Cash on hand	₩ 4,729	₩ 4,298
Demand deposits	99,870	84,799
Short-term investment assets	240,000	550,000
	₩ 344,599	₩ 639,097

Other financial assets as of September 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	September 30, 2012	December 31, 2011
Short-term financial assets		
Time deposits	₩ 80,000	-
Money trust	440,000	-
Certificate of deposit	210,000	-
	₩ 730,000	₩ -

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

17. Equity and Share Premium

Details of share capital as of September 30, 2012, and December 31, 2011, are as follows:

<i>(in Korean won, except number of shares)</i>	September 30, 2012	December 31, 2011
Number of ordinary shares		
-Authorized	800,000,000	800,000,000
-Issued	137,292,497	137,292,497
Par value	₩ 5,000	₩ 5,000
Ordinary shares	₩ 954,959,485,000	₩ 954,959,485,000

The Company has reacquired and retired 53,699,400 shares of treasury shares. Accordingly, as of September 30, 2012, the Company's ordinary shares differ from the aggregate par value of issued shares by ₩ 268,497 million.

Changes in the number of shares for the nine-month period ended September 30, 2012 and the year ended December 31, 2011, are as follows:

<i>(Number of shares)</i>	September 30, 2012			December 31, 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	-	-	-	-	100,000	100,000
Ending	<u>137,292,497</u>	<u>(11,543,697)</u>	<u>125,748,800</u>	<u>137,292,497</u>	<u>(11,543,697)</u>	<u>125,748,800</u>

No changes in the other capital surplus for the nine-month period ended September 30, 2012 and the year ended December 31, 2011.

18. Treasury Shares

Changes in the treasury shares for the nine-month period ended September 30, 2012 and the year ended December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012		December 31, 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	-	-	(100,000)	(2,976)
Ending	<u>11,543,697</u>	<u>₩ 343,522</u>	<u>11,543,697</u>	<u>₩ 343,522</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

Changes in gain on reissuance of treasury shares for the nine-month period ended September 30, 2012 and the year ended December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012	December 31, 2011
Beginning	₩ 485,922	₩ 482,129
Gain on reissuance of treasury shares before tax	-	5,004
Less: tax at 24.2%	-	(1,211)
Gain on reissuance of treasury shares, net of tax	-	3,793
Ending	<u>₩ 485,922</u>	<u>₩ 485,922</u>

19. Reserves

Details of reserves as of September 30, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012	December 31, 2011
Available-for-sale financial assets reserve	₩ (29,714)	₩ (31,855)
Legal reserve	602,937	602,937
Voluntary reserve	2,466,732	2,107,732
	<u>₩ 3,039,955</u>	<u>₩ 2,678,814</u>

Available-for-sale financial assets reserve as of September 30, 2012 and December 31, 2011, are summarized as follows:

<i>(in millions of Korean won)</i>	September 30, 2012	December 31, 2011
Available-for-sale financial assets reserve before tax	₩ (39,201)	₩ (42,025)
Tax effect	9,487	10,170
Available-for-sale financial assets reserve after tax	<u>₩ (29,714)</u>	<u>₩ (31,855)</u>

The Korean Commercial Code requires the Company to appropriate a legal reserve in an amount equal to at least 10% of cash dividends for each accounting period until the reserve equals 50% of stated capital. The legal reserve may be used to reduce a deficit or may be transferred to ordinary shares in connection with a free issue of shares.

Details of the Company's voluntary reserve as of September 30, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012	December 31, 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
	<u>₩ 2,466,732</u>	<u>₩ 2,107,732</u>

Reserve for Business Rationalization

Until December 10, 2002, under the Special Tax Treatment Control Law, investment tax credits were allowed for certain investments. The Company was, however, required to appropriate from retained earnings, the amount of tax benefits received, and transfer such amount into a reserve

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

for business rationalization. Effective December 11, 2002, the Company was no longer required to establish a reserve for business rationalization despite tax benefits received for certain investments and, consequently, the existing balance is now regarded as a voluntary reserve.

Reserve for 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.

20. Retained Earnings

Changes in retained earnings for the nine-month period ended September 30, 2012 and the year ended December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012		December 31, 2011	
Beginning	₩	763,738	₩	929,140
Transfer from other reserve		(359,000)		(544,000)
Dividends		(402,396)		(382,946)
Profit for the period		631,157		775,937
Actuarial losses, net of tax		138		(14,393)
Ending	₩	<u>633,637</u>	₩	<u>763,738</u>

21. Accounts Payable and Other Finance Liabilities

Accounts payable and other finance liabilities as of September 30, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012		December 31, 2011	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	₩ 28,001	₩ -	₩ 26,628
Accounts payable	33,579	-	20,588	-
Withholdings	5,956	-	4,206	-
Value added tax withheld	140,517	-	114,247	-
Accrued expenses	97,323	-	92,386	-
Other payables	24,991	-	17,549	-
	<u>₩ 302,366</u>	<u>₩ 28,001</u>	<u>₩ 248,976</u>	<u>₩ 26,628</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

Accounts payable and other finance liabilities carried at amortized cost using the effective interest rate method as of September 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	September 30, 2012			December 31, 2011		
	Effective interest rate(%)	Current	Non-current	Effective interest rate(%)	Current	Non-current
Leasehold deposits received	3.00~5.68	₩ -	₩ 28,001	3.00~5.68	₩ -	₩ 26,628

22. Borrowings

Details of borrowings as of September 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	September 30, 2012		December 31, 2011	
Current				
Bank borrowings	₩	6,523	₩	6,975
	₩	6,523	₩	6,975

Details of bank borrowings as of September 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)			Annual interest rate(%)	September 30, 2012	December 31, 2011
	Creditor	Latest maturity date	September 30, 2012		
Korean won	Kookmin Bank, other	Short-term Borrowings	-	₩ -	₩ 1,507
Korean won	National Agricultural Cooperative Federation	Short-term Borrowings	8.06	5,417	5,468
Korean won	Korea Exchange Bank	Short-term Borrowings	CD(91) + 2.5%	1,106	-
				₩ 6,523	₩ 6,975

23. Defined Benefit Liability

The amounts recognized on the statements of income for the nine-month periods ended September 30, 2012 and 2011, are as follows:

(in millions of Korean won)	September 30, 2012	September 30, 2011
Defined benefit plans :		
Current service cost	₩ 18,942	₩ 17,199
Interest expenses	5,045	4,572
Expected return on plan assets	(3,787)	(3,355)
	20,200	18,416
Defined contribution plans :		
Pension costs	1,340	894
Total	₩ 21,540	₩ 19,310

Retirement benefits for the nine-month period ended September 30, 2012, were ₩1,194million. Out of total expenses, ₩7,546 million (2011: ₩6,904 million) and ₩15,188 million (2011:

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

₩14,979 million) were included in 'cost of sales' and 'selling and administrative expenses', respectively.

Defined benefit liability recognized on the statements of financial position as of September 30, 2012 and December 31, 2011, is as follows:

<i>(in millions of Korean won)</i>	September 30, 2012	December 31, 2011
Present value of defined benefit liability:	₩ 184,031	₩ 168,419
Fair value of plan assets	(119,034)	(120,779)
Liability on the statement of financial position	<u>₩ 64,997</u>	<u>₩ 47,640</u>

24. Classification of Operating Income

(1) Material items of operating income and expense

Operating income is calculated as gross profit net of distribution costs, selling and administrative expenses, and other income and expenses.

(2) Employee benefit costs for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Salaries	₩ 89,436	₩ 239,922	₩ 85,574	₩ 232,816
Retirement benefits	7,243	21,540	6,484	19,310
Termination benefits	-	1,194	2,550	2,574
Employee welfare	10,466	30,082	9,334	24,680
	<u>₩ 107,145</u>	<u>₩ 292,738</u>	<u>₩ 103,942</u>	<u>₩ 279,380</u>

(3) Depreciation and amortization for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Depreciation	₩ 29,320	₩ 88,025	₩ 29,384	₩ 85,081
Amortization	5	15	5	25
	<u>₩ 29,325</u>	<u>₩ 88,040</u>	<u>₩ 29,389</u>	<u>₩ 85,106</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

(4) Details of other income for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Foreign currency transaction gain	₩ 944	₩ 4,505	₩ 3,763	₩ 5,872
Foreign currency translation gain	-	67	53,203	36,555
Reversal of impairment loss on trade and other receivables	5	11	-	-
Gain on sale of property, plant and equipment	32,091	41,172	1,287	7,912
Gain on sale of intangible assets	-	-	-	605
Others	3,927	12,173	2,480	6,875
	<u>₩ 36,967</u>	<u>₩ 57,928</u>	<u>₩ 60,733</u>	<u>₩ 57,819</u>

(5) Selling and administrative expenses three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Salaries	₩ 58,841	₩ 159,048	₩ 56,037	₩ 152,504
Retirement benefits	4,784	14,220	4,208	12,542
Termination benefits	-	968	2,413	2,437
Employee welfare	7,224	21,013	6,724	17,243
Travel	1,766	5,202	1,694	4,816
Communications	910	2,769	912	2,817
Utilities	1,997	6,612	1,715	5,557
Taxes and dues	3,938	10,752	3,420	10,608
Supplies	475	1,601	583	1,601
Rent	3,791	10,883	3,807	10,057
Depreciation	8,153	25,206	9,277	25,545
Amortization	5	15	5	25
Repairs and maintenance	2,639	6,432	2,199	5,747
Vehicles	2,477	7,151	2,337	6,577
Insurance	115	366	196	522
Commissions	17,577	50,306	12,729	45,304
Freight and custody	6,152	17,264	6,183	19,823
Conferences	969	2,822	671	2,082
Advertising	37,747	113,675	35,503	99,721
Training	1,140	3,425	1,313	3,592
Prizes and rewards	695	1,530	1,572	2,174
Normal research and development	5,595	11,279	3,327	9,108
	<u>₩ 166,990</u>	<u>₩ 472,539</u>	<u>₩ 156,825</u>	<u>₩ 440,402</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

(6) Details of other expenses for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Foreign currency transaction loss	₩ 2,956	₩ 7,272	₩ 7,640	₩ 15,651
Foreign currency translation loss	19,344	17,172	-	1,081
Impairment loss on trade and other receivables	-	-	128	180
Donations	2,069	5,478	3,157	5,481
Loss of investments in subsidiaries	-	-	27	27
Loss on sale of property, plant and equipment	2,831	3,221	1,361	1,844
Loss on sale of intangible assets	-	337	3	177
Others	1,653	3,832	532	3,691
	<u>₩ 28,853</u>	<u>₩ 37,312</u>	<u>₩ 12,848</u>	<u>₩ 28,132</u>

25. Expenses by Nature

Expenses by nature for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Changes in inventories	₩ 35,820	₩ 105,153	₩ 70,126	₩ 126,384
Raw materials and consumables used	169,870	496,286	151,486	455,747
Salary and wage	89,436	239,922	85,574	232,816
Retirement and termination benefits	7,243	22,734	9,033	21,884
Depreciation charges	29,320	88,025	25,997	81,694
Amortization charges	5	15	5	25
Employee benefits	10,466	30,082	9,334	24,680
Advertising costs	37,770	113,774	35,545	99,852
Service fees	23,243	67,381	17,813	60,281
Other expenses	55,646	73,236	24,029	66,875
Total cost of sales, distribution costs and administrative expenses	<u>₩ 458,819</u>	<u>₩ 1,236,608</u>	<u>₩ 428,942</u>	<u>₩ 1,170,238</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

26. Financial Income and Costs

Financial income and costs for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Financial cost				
Interest costs	₩ (220)	₩ (689)	₩ (370)	₩ (724)
Loss on sale of available-for-sale financial assets	-	(9)	-	-
Impairment loss on available-for-sale financial assets	-	-	-	(3,988)
	<u>(220)</u>	<u>(698)</u>	<u>(370)</u>	<u>(4,712)</u>
Financial income				
Interest income	9,376	26,598	8,104	22,028
Dividend income	843	6,282	449	55,056
Investment income on long-term deposits in MSA Escrow Fund	3	88	6,502	8,574
Gain on sale of available-for-sale financial assets	-	-	-	643
	<u>10,222</u>	<u>32,968</u>	<u>15,055</u>	<u>86,301</u>
Net financial income	<u>₩ 10,002</u>	<u>₩ 32,270</u>	<u>₩ 14,685</u>	<u>₩ 81,589</u>

Details of interest costs for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Trade and other payables	₩ (220)	₩ (689)	₩ (370)	₩ (724)

Details of interest income for the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Deposits	₩ 6,921	₩ 18,890	₩ 7,122	₩ 20,137
Available-for-sale financial assets	12	30	5	64
Trade and other receivables	2,443	7,678	977	1,827
	<u>₩ 9,376</u>	<u>₩ 26,598</u>	<u>₩ 8,104</u>	<u>₩ 22,028</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

27. Income Tax

Income tax expense was calculated based on the weighted average annual tax rate of corporate for the entire fiscal period. Estimated average annual tax rate of September 30, 2012, is 24.4%. The estimated tax rate for the nine-month period ended September 30, 2011, was 22.8%. The increase in corporate income tax rate is due to 2% increase in tax rate. The increase in corporate tax rate has been applied from January 1, 2012.

28. Earnings per Share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year excluding ordinary shares purchased by the Company and held as treasury shares (Note 18).

Basic earnings per ordinary share for the three-month and nine-month periods ended September 30, 2012 and 2011, is as follows:

	2012		2011	
	Three months	Nine months	Three months	Nine months
<i>(in Korean won, except number of shares)</i>				
Profit for the period	₩ 239,276 million	₩ 631,157 million	₩ 240,518 million	₩ 618,705 million
Weighted-average number of ordinary shares outstanding	125,748,800	125,748,800	125,666,441	126,787,459
Basic and diluted earnings per share in won	₩ 1,903	₩ 5,019	₩ 1,914	₩ 4,880

29. Dividends

The dividends paid in 2012 were ₩ 402,396 million.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

30. Cash Generated from Operations

- (1) Cash generated from operations for the nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012	September 30, 2011
Profit	₩ 631,157	₩ 618,705
Adjustments for:		
Income tax expense	203,823	182,698
Finance costs	698	4,712
Finance income	(32,968)	(86,301)
Depreciation	88,025	85,081
Amortization	15	25
Retirement and termination benefits	20,199	21,884
Foreign currency translations loss	17,172	1,081
Loss on the write-down of inventories	225	329
Impairment loss on trade and other receivables	-	180
Loss on sale of property, plant and equipment	3,221	1,844
Loss on sale of intangible assets	337	177
Loss on sale of investments in subsidiaries	-	27
Other expense	-	2,361
Foreign currency translations gain	(67)	(36,555)
Reversal of impairment loss on trade and other receivables	(11)	-
Gain on sale of property, plant and equipment	(41,172)	(7,912)
Gain on sale of intangible assets	-	(605)
	<u>890,654</u>	<u>787,731</u>
Changes in working capital		
Trade and other receivables	(266,981)	(97,128)
Advance payments	(36,043)	(37,495)
Prepaid expenses	(1,747)	(1,011)
Prepaid tobacco excise and other taxes	39,139	(2,221)
Inventories	104,928	119,450
Trade and other payables	53,402	37,749
Advance receipts	9,625	(1,240)
Tobacco excise and other taxes payable	397,160	47,426
Payment of retirement benefits	(2,659)	(4,649)
Cash generated from operations	<u>₩ 1,187,478</u>	<u>₩ 848,612</u>

- (2) Non-cash transactions

<i>(in millions of Korean won)</i>	September 30, 2012
Transfer to retained earnings in voluntary reserves	₩ 359,000
Reclassification of construction-in-progress to property, plant and equipment	44,150
Reclassification of property, plant and equipment to non-current assets held for sale	28,799

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

31. Contingencies

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

As of September 30, 2012, tobacco lawsuits claiming damages of ₩ 584 million are filed against the Company and the Korean government. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of September 30, 2012.

As of September 30, 2012, the Company has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 45,000 thousand.

As of September 30, 2012, the Company's trade receivables from the export of cigarettes are insured against non-payment up to USD 17,100 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of September 30, 2012, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD 70,000 thousand by Korea Exchange Bank and others.

As of September 30, 2012, the Company and 28 other companies are guaranteed ₩ 240,000 million by Seoul Guarantee Insurance Co., Ltd. related to the Yongsan International Commercial Development Project.

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

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

1) Conditional put option granted to the Individual Shareholder

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

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

2) Right of first refusal held by the Company

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

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

3) Tag-along right held by The Individual Shareholder

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

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

1) Restriction of disposal

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

2) Right of first refusal held by the Company

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

3) Tag-along right held by the Individual Shareholder

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

The Company provides Customs Bond with limits in the aggregate of USD 3,900 thousand to Korea Exchange Bank, regarding an opening of L/C for import and customs with relation to an Subsidiary located in U.S.A (Global Trading Inc.).

32. Related Party Transactions

The subsidiaries and parent companies of subsidiaries as of September 30, 2012, and December 31, 2011, are as follows:

Subsidiaries	Location	Immediate parent companies	Percentage of ownership (%)			
			September 30, 2012		December 31, 2011	
			Parent companies	Subsidiaries	Parent companies	Subsidiaries
Korea Ginseng Corporation	Korea	KT&G	100.00	-	100.00	-
Yungjin Pharm. Ind. Co., Ltd.	Korea	KT&G	53.00	-	53.00	-
Tae-a Industry Co., Ltd.	Korea	KT&G	100.00	-	100.00	-
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	KT&G	99.99	-	99.99	-
Korea Tabacos do Brasil Ltda.	Brazil	KT&G	99.90	-	99.90	-
KT&G Pars	Iran	KT&G	99.99	-	99.99	-
KT&G Rus L.L.C.	Russia	KT&G	100.00	-	100.00	-
KGC Life & Gin Co., Ltd	Korea	KT&G	100.00	-	100.00	-

KT&G Corporation

Notes to Interim Separate Financial Statements

September 30, 2012 and 2011, and December 31, 2011

KT&G Bio Corp.	Korea	KT&G	100.00	-	100.00	-
Global Trading, Inc.	USA	KT&G	100.00	-	100.00	-
Jilin Hanzheng Ginseng Co., Ltd.	China	KT&G	100.00	-	100.00	-
Somang Cosmetics Co., Ltd. ¹	Korea	KT&G	60.00	-	60.00	-
Renzoluc Pte., Ltd. ²	Singapore	KT&G	100.00	-	100.00	-
PT Trisakti Purwosari Makmur	Indonesia	Renzoluc Pte., Ltd.	-	58.88	-	51.00
PT Sentosa Ababi Purwosari	Indonesia	PT Trisakti Purwosari Makmur	-	99.24	-	99.24
PT Purindo Ilufa	Indonesia	PT Trisakti Purwosari Makmur	-	100.00	-	100.00
KT&G Life science ³	Korea	KT&G	73.94	-	73.94	-
Yebon Nongwon Agriculture Co., Ltd	Korea	KT&G	90.00	-	90.00	-
KGC Yebon ⁵	Korea	KT&G	100.00	-	-	-
K-Q HongKong I, Limited ^{4,6}	HongKong	KT&G	100.00	-	-	-
Cheong Kwan Jang Taiwan Corporation	Taiwan	Korea Ginseng Corporation	-	100.00	-	100.00
Korean Red Ginseng Corp., Inc.	USA	Korea Ginseng Corporation	-	100.00	-	100.00
Korea Ginseng (China) Corp.	China	Korea Ginseng Corporation	-	100.00	-	100.00
Korea Ginseng Corporation Japan	Japan	Korea Ginseng Corporation	-	100.00	-	100.00

¹ The Company's percentage of ownership excludes convertible preference shares. As of September 30, 2012, the Company's percentage of ownership including convertible preference shares is 50.00%.

² The Company's percentage of ownership excludes convertible preference shares. As of September 30, 2012, the Company's percentage of ownership including convertible preference shares is 37.68%.

³ The Company's percentage of ownership excludes convertible preference shares. As of September 30, 2012, the Company's percentage of ownership including convertible preference shares is 59.48%.

⁴ The Company's percentage of ownership excludes convertible preference shares. As of September 30, 2012, the Company's percentage of ownership including convertible preference shares is 50.00%.

⁵ During the nine-month period ended September 30, 2012, KGC Yebon was included as a subsidiary.

⁶ During the nine-month period ended September 30, 2012, K-Q HongKong I, Limited was included as a subsidiary.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

Transactions with related parties for the the three-month and nine-month periods ended September 30, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Sales and other income				
Korea Ginseng Corporation	₩ 3,341	₩ 6,545	₩ 1,389	₩ 3,785
Yungjin Pharm. Ind. Co., Ltd.	81	165	105	253
Tae-a industry Co., Ltd.	-	-	3	7
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	1,725	8,469	1,243	5,024
KT&G Pars	2,818	6,941	1,906	5,846
KT&G Rus L.L.C.	10,166	19,956	2,455	14,954
KGC Life & Gin Co., Ltd	600	1,153	218	565
Global Trading, Inc.	11,416	30,469	8,590	24,957
Purpleland Development Co., Ltd.	-	-	-	7
Jilin Hanzheng Ginseng Co., Ltd.	84	252	-	-
KT&G Life science	12	25	-	-
	<u>30,243</u>	<u>73,975</u>	<u>15,909</u>	<u>55,398</u>
Purchases and other expenses				
Korea Ginseng Corporation	622	1,425	1,283	1,930
Yungjin Pharm. Ind. Co., Ltd.	11	23	8	17
Tae-a industry Co., Ltd.	4,006	12,553	4,574	11,885
KGC Life & Gin Co., Ltd	299	613	303	312
Somang Cosmetics Co., Ltd.	54	112	119	119
	<u>₩ 4,992</u>	<u>₩ 14,726</u>	<u>₩ 6,287</u>	<u>₩ 14,263</u>

The Company has received dividends from subsidiaries. During the nine-month period ended September 30, 2012, there were no dividends received from Korea Ginseng Corp.

Dividends received in the nine-month period ended September 30, 2011, amounted to ₩50,000 million. These dividends were recognized as financial income.

KT&G Corporation
Notes to Interim Separate Financial Statements
September 30, 2012 and 2011, and December 31, 2011

Details of related party receivables and liabilities as of September 30, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	September 30, 2012		December 31, 2011	
Receivables from related parties				
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	₩	27,920	₩	23,084
KT&G Pars		36,656		30,499
KT&G Rus L.L.C.		27,678		41,031
Global Trading, Inc.		16,342		14,574
Renzoluc Pte., Ltd.		63,295		64,045
Jilin Hanzheng Ginseng Co., Ltd.		9,087		9,084
Somang Cosmetics Co., Ltd.		1		2
	₩	180,979	₩	182,319
Payables to related parties				
Korea Ginseng Corporation	₩	3,793	₩	2,414
KGC Life & Gin Co., Ltd		446		192
KT&G Life science		813		-
	₩	5,052	₩	2,606

The compensation paid or payable to key management for employee services for the three-month and nine-month periods ended September 30, 2012 and 2011, consists of:

<i>(in millions of Korean won)</i>	2012		2011	
	Three months	Nine months	Three months	Nine months
Short-term employee benefits	₩ 4,023	₩ 11,885	₩ 3,481	₩ 10,454
Retirement benefits	383	2,043	279	886
	₩ 4,406	₩ 13,928	₩ 3,760	₩ 11,340

33. Basis of Translating Financial Statements

The financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩ 1,118.6 to US\$1, the basic exchange rate on September 30, 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.