

KT&G Corporation

Interim Separate Financial Statements
March 31, 2013 and 2012

KT&G Corporation
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March 31, 2013 and 2012

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Report on Review of Interim Financial Statements

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

Reviewed Financial Statements

We have reviewed the accompanying interim separate financial statements of KT&G Corporation. These financial statements consist of separate statement of financial position of KT&G Corporation (the "Company") as of March 31, 2013, and the related separate statements of comprehensive income, changes in equity and cash flows for the three-month periods ended March 31, 2013 and 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') 1034, Interim Financial Reporting, and for such internal control as management determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

Conclusion

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

Other Matters

We have audited the separate statement of financial position of KT&G Corporation as of December 31, 2012, and the related separate statements of comprehensive income, changes in equity and cash flows for the year then ended, in accordance with auditing standards generally accepted in the Republic of Korea. We expressed an unqualified opinion on those financial statements in our audit report dated February 5, 2013. These financial statements are not included in this review report. The separate statement of financial position as of December 31, 2012, presented herein for comparative purposes, is consistent, in all material respects, with the above audited statement of financial position as of December 31, 2012.

The accompanying interim separate financial statements as of and for the three-month period ended March 31, 2013, have been translated into US dollars solely for the convenience of the reader and have been translated on the basis set forth in Note 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 pricewaterhouseCoopers

Seoul, Korea
May 14, 2013

The report is effective as of May 14, 2013, the review report date. Certain subsequent events or circumstances, which may occur between the review report date and the time of reading this report, could have a material impact on the accompanying separate interim financial statements and notes thereto. Accordingly, the readers of the review report should understand that there is a possibility that the above review report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

KT&G Corporation
Interim Separate Statements of Financial Position
March 31, 2013 and December 31, 2012

<i>(in millions of Korean won and thousands of U.S. dollars)</i>	Notes	March 31, 2013 Korean won	March 31, 2013 U.S. dollars (Note 33)	December 31, 2012 Korean won
Assets				
Non-current assets				
Property, plant and equipment	9	₩ 1,153,894	\$ 1,037,581	₩ 1,163,220
Intangible assets	10	19,919	17,911	19,937
Investment property	11,13	150,415	135,253	153,907
Investments in associates	14	57,725	51,906	57,725
Investments in subsidiaries	14	1,182,336	1,063,156	1,178,590
Available-for-sale financial assets	4,5,6	263,221	236,688	263,544
Long-term deposits in MSA Escrow Fund	4,5,8,31	185,380	166,693	168,666
Long-term prepaid expenses		4,102	3,688	4,163
Long-term trade and other receivables	4,5,7,32	145,895	131,189	146,174
		<u>3,162,887</u>	<u>2,844,065</u>	<u>3,155,926</u>
Current assets				
Inventories	15	906,318	814,961	872,833
Available-for-sale financial assets	4,5,6	1,000	900	1,000
Other financial assets	4,5,16	230,000	206,816	620,000
Prepaid tobacco excise and other taxes		324,565	291,849	254,562
Trade and other receivables	4,5,7,32	788,187	708,738	726,397
Advance payments		14,559	13,091	13,964
Prepaid expenses		5,022	4,516	5,758
Cash and cash equivalents	4,5,16	672,940	605,107	266,720
		<u>2,942,591</u>	<u>2,645,978</u>	<u>2,761,234</u>
Assets held for sale	12	<u>177</u>	<u>159</u>	<u>762</u>
Total assets		<u>₩ 6,105,655</u>	<u>\$ 5,490,202</u>	<u>₩ 5,917,922</u>
Equity				
Capital stock	1,17	₩ 954,959	\$ 858,699	₩ 954,959
Other capital surplus	17	3,583	3,221	3,583
Treasury shares	18	(339,059)	(304,881)	(339,059)
Gain on reissuance of treasury shares	18	492,032	442,435	492,032
Reserve	19	3,394,886	3,052,680	3,039,034
Retained earnings	20	195,518	175,810	752,766
Total equity		<u>4,701,919</u>	<u>4,227,964</u>	<u>4,903,315</u>
Liabilities				
Non-current liabilities				
Long-term trade and other payables	4,5,21,32	26,939	24,224	27,325
Long-term advance receipts		4,535	4,078	4,953
Defined benefit liability	23	73,836	66,393	66,211
Deferred income tax liabilities		85,388	76,781	80,948
		<u>190,698</u>	<u>171,476</u>	<u>179,437</u>
Current liabilities				
Borrowings	4,5,22	5,445	4,896	5,477
Trade and other payables	4,5,21,32	280,985	252,662	266,844
Advance receipts		36,014	32,382	25,639
Income taxes payable		199,357	179,262	137,828
Tobacco excise and other taxes payable		691,237	621,560	399,383
		<u>1,213,038</u>	<u>1,090,762</u>	<u>835,171</u>
Total liabilities		<u>1,403,736</u>	<u>1,262,238</u>	<u>1,014,608</u>
Total liabilities and equity		<u>₩ 6,105,655</u>	<u>\$ 5,490,202</u>	<u>₩ 5,917,922</u>

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

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

KT&G Corporation
Interim Separate Statements of Comprehensive Income
Three-Month Periods Ended March 31, 2013 and 2012

(in millions of Korean won and thousands of U.S. dollars, except per share amounts)	Notes	2013	2013	2012
		Korean won	U.S. dollars (Note 33)	Korean won
Sales				
Manufacture of tobacco		₩ 548,776	\$ 493,459	₩ 563,653
Real estate		18,504	16,639	9,556
Exports of leaf tobacco and others		13,379	12,030	10,157
	31,32	<u>580,659</u>	<u>522,128</u>	<u>583,366</u>
Cost of sales				
Manufacture of tobacco		(190,910)	(171,666)	(207,664)
Real estate		(7,206)	(6,480)	(1,540)
Exports of leaf tobacco and others		(8,180)	(7,356)	(7,116)
	15,32	<u>(206,296)</u>	<u>(185,502)</u>	<u>(216,320)</u>
Gross profit		<u>374,363</u>	<u>336,626</u>	<u>367,046</u>
Selling and administrative expenses	24,25	(149,287)	(134,239)	(144,583)
Operating income	24	<u>225,076</u>	<u>202,387</u>	<u>222,463</u>
Other income	24,32	34,876	31,361	7,948
Other expenses	24,25,32	(3,968)	(3,568)	(11,370)
Net other income and expenses		<u>30,908</u>	<u>27,793</u>	<u>(3,422)</u>
Finance income	26	13,586	12,217	13,587
Finance expense	26	(12,212)	(10,981)	(221)
Net finance income		<u>1,374</u>	<u>1,236</u>	<u>13,366</u>
Profit before income tax		<u>257,358</u>	<u>231,416</u>	<u>232,407</u>
Income tax expense	27	(64,581)	(58,072)	(56,219)
Profit for the period		<u>₩ 192,777</u>	<u>\$ 173,344</u>	<u>₩ 176,188</u>
Other comprehensive income(loss), net of tax				
Items that will not be reclassified to profit or loss:				
Actuarial gains (losses) on defined benefit liability		(148)	(133)	(82)
Items that will be reclassified subsequently to profit or loss:				
Change in value of available-for-sale financial assets		₩ 8,851	\$ 7,959	₩ 20,325
Other comprehensive income for the period, net of tax		<u>8,703</u>	<u>7,826</u>	<u>20,243</u>
Total comprehensive income for the period		<u>₩ 201,480</u>	<u>\$ 181,170</u>	<u>₩ 196,431</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>₩ 1,531</u>	<u>\$ 1.38</u>	<u>₩ 1,401</u>

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

KT&G Corporation

Interim Separate Statements of Changes in Equity Three-Month Periods Ended March 31, 2013 and 2012

(in millions of Korean won)

	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
Balance at January 1, 2012	₩ 954,959	₩ 3,583	₩ (343,522)	₩ 485,922	₩ 2,678,814	₩ 763,738	₩ 4,543,494
Comprehensive Income							
Profit for the period	-	-	-	-	-	176,188	176,188
Other comprehensive income(loss)							
Change in value of available-for-sale financial assets	-	-	-	-	20,326	-	20,326
Actuarial gains (losses) on defined benefit liability	-	-	-	-	-	(82)	(82)
Total other comprehensive income (loss)	-	-	-	-	20,326	(82)	20,244
Total comprehensive income (loss)	-	-	-	-	20,326	176,106	196,432
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 March 31, 2012	₩ 954,959	₩ 3,583	₩ (343,522)	₩ 485,922	₩ 3,038,140	₩ 178,448	₩ 4,337,530
Balance at January 1, 2013	₩ 954,959	₩ 3,583	₩ (339,059)	₩ 492,032	₩ 3,039,034	₩ 752,766	₩ 4,903,315
Comprehensive Income							
Profit for the period	-	-	-	-	-	192,777	192,777
Other comprehensive income(loss)							
Change in value of available-for-sale financial assets	-	-	-	-	8,852	-	8,852
Actuarial gains (losses) on defined benefit liability	-	-	-	-	-	(149)	(149)
Total other comprehensive income (loss)	-	-	-	-	8,852	(149)	8,703
Total comprehensive income (loss)	-	-	-	-	8,852	192,628	201,480
Transactions with equity holders of the Company							
Cash dividends	-	-	-	-	-	(402,876)	(402,876)
Other reserve	-	-	-	-	317,000	(317,000)	-
Transfer from reserve for research and human resources development	-	-	-	-	30,000	(30,000)	-
Total transactions with equity holders of the Company	-	-	-	-	347,000	(749,876)	(402,876)
Balance at March 31, 2013	₩ 954,959	₩ 3,583	₩ (339,059)	₩ 492,032	₩ 3,394,886	₩ 195,518	₩ 4,701,919

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

KT&G Corporation
Interim Separate Statements of Changes in Equity
Three-Month Periods Ended March 31, 2013 and 2012

	Notes	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
		\$	\$	\$	\$	\$	\$	\$
Balance at January 1, 2013		858,699	3,221	(304,881)	442,435	2,732,698	676,887	4,409,059
Comprehensive Income								
Profit for the period		-	-	-	-	-	173,345	173,345
Other comprehensive income		-	-	-	-	7,959	-	7,959
Change in value of available-for-sale financial assets		-	-	-	-	-	(133)	(133)
Actuarial gains (losses) on defined benefit liability		-	-	-	-	7,959	(133)	7,826
Total other comprehensive income (loss)		-	-	-	-	7,959	173,212	181,171
Total comprehensive income		-	-	-	-	7,959	-	-
Transactions with equity holders of the Company								
Cash dividends		-	-	-	-	-	(362,266)	(362,266)
Other reserve		-	-	-	-	285,046	(285,046)	-
Transfer from reserve for research and human resources development		-	-	-	-	26,977	(26,977)	-
Total transactions with equity holders of the Company		-	-	-	-	312,023	(674,289)	(362,266)
Balance at March 31, 2013		858,699	3,221	(304,881)	442,435	3,052,680	175,810	4,227,964

The accompanying notes are an integral part of these interim separate financial statements.
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KT&G Corporation
Interim Separate Statements of Cash Flows
Three-Month Periods Ended March 31, 2013 and 2012

(in millions of Korean won and thousands of U.S. dollars)	Notes	2013		2012	
		Korean won	U.S. dollars (Note 33)	Korean won	
Cash flows from operating activities					
Cash generated from operations	30	₩ 445,574	\$ 400,660	₩ 518,577	
Income tax paid		(1,390)	(1,250)	(1,385)	
Net cash generated from operating activities		<u>444,184</u>	<u>399,410</u>	<u>517,192</u>	
Cash flows from investing activities					
Interest received		8,452	7,600	6,503	
Investment income received from long-term deposits in MSA Escrow Fund		400	360	70	
Dividends received		3,591	3,229	3,677	
Proceeds from sale of property, plant and equipment		904	813	2,976	
Proceeds from sale of intangible assets		1	1	400	
Proceeds from sale of assets held for sale		725	652	-	
Proceeds from sale of available-for-sale financial assets		-	-	233	
Decrease in loans		2,252	2,025	5,418	
Decrease in guarantee deposits		4,702	4,228	5,806	
Acquisition of property, plant and equipment		(15,379)	(13,829)	(19,937)	
Acquisition of intangible assets		-	-	(125)	
Acquisition of investment property		(1,422)	(1,278)	-	
Acquisition of investments in associates		-	-	(11,500)	
Acquisition of investments in subsidiaries		(3,746)	(3,369)	(13,000)	
Acquisition of available-for-sale financial assets		-	-	(1,500)	
Increase in loans		(9,656)	(8,683)	-	
Increase in guarantee deposits		(5,456)	(4,906)	(5,361)	
Increase in long-term deposits in MSA Escrow Fund		(9,977)	(8,971)	(5,578)	
Increase (Decrease) in other financial assets		390,000	350,688	(110,000)	
Net cash provided by (used in) investing activities		<u>365,391</u>	<u>328,560</u>	<u>(141,918)</u>	
Cash flows from financing activities					
Dividends paid	29	(402,876)	(362,266)	(402,396)	
Increase in deposits received		1,378	1,239	4,276	
Decrease in deposits received		(1,872)	(1,684)	(968)	
Net cash used in financing activities		<u>(403,370)</u>	<u>(362,711)</u>	<u>(399,088)</u>	
Net Increase(Decrease) in cash and cash equivalents		406,205	365,259	(23,814)	
Cash and cash equivalents at the beginning of period		266,720	239,835	639,097	
Exchange gains on cash and cash equivalents		15	13	113	
Cash and cash equivalents at the end of period		<u>₩ 672,940</u>	<u>\$ 605,107</u>	<u>₩ 615,396</u>	

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

KT&G Corporation
Notes to Separate Financial Statements
March 31, 2013 and 2012, and December 31, 2012

1. General Information

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

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

As of March 31, 2013, 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
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March 31, 2013 and 2012, and December 31, 2012

The ownership of the Company's issued ordinary shares as of March 31, 2013, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee share ownership association	2,622,646	1.91%
Others	113,765,669	82.86%
	125,898,800	91.70%
Treasury shares	11,393,697	8.30%
	137,292,497	100.00%

2. Significant Accounting Policies

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

2.1 Basis of Preparation

This condensed separate interim financial information as of and for the three-month periods ended March 31, 2013, has been prepared in accordance with Korean IFRS 1034, Interim financial reporting. The principles used in the preparation of these financial statements are based on Korean IFRS and interpretations effective as of March 31, 2013.

(a) New and amended standards adopted by the Company

The Company newly applied the following amended and enacted standards for the annual period beginning on January 1, 2013:

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

According to the amendment to Korean IFRS 1001, *Presentation of Financial Statements*, the amendment requires the entities to group items presented in other comprehensive income based on whether they are potentially reclassified to profit or loss subsequently. The Company applies the amendment retroactively and the comparative consolidated statement of the comprehensive income is restated by reflecting adjustments resulting from the retrospective application. There is no material impact on its total comprehensive income due to the retrospective application of changes in these accounting policies.

- Amendments to Korean IFRS 1019, *Employee Benefits*

According to the amendments to Korean IFRS 1019, *Employee Benefits*, the use of a 'corridor' approach is no longer permitted, and therefore all actuarial gains and losses incurred are immediately recognized in other comprehensive income. All past service costs incurred from changes in pension plan are immediately recognized, and expected returns on interest costs and plan assets that used to be separately calculated are now changed to calculating net interest expense (income) by applying discount rate used in measuring defined benefit liability in net defined benefit liabilities (assets). The Company applies amended Korean IFRS 1019 retrospectively.

In addition, according to Korean IFRS 1019, termination benefits are paid when an employee's employment is terminated by the Company's decision before the normal retirement date, or when an employee accepts voluntary redundancy in exchange for certain benefits. The Company

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recognizes a liability and expense for termination benefits at the earlier of the following dates: (a) when the Company can no longer withdraw the offer of those benefits and (b) when the Company recognizes costs for a restructuring that is within the scope of Korean IFRS 1037 and involves the payment of termination benefits. In the case of voluntary redundancy, the measurement of termination benefits is based on the number of employees expected to accept the offer. Where the benefits fall due more than 12 months after the reporting period, they are discounted to its present value. This amendment does not have a material impact on its financial statements.

- Enactment of Korean IFRS 1111, *Joint Arrangements*

Korean IFRS 1111, *Joint Arrangements*, aims to reflect the substance of joint arrangements by focusing on the contractual rights and obligations that each party to the arrangement has rather than its legal form. Joint arrangements are classified as either joint operations or joint ventures. A joint operation is when joint operators have rights to the assets and obligations for the liabilities, and account for the assets, liabilities, revenues and expenses, while parties to the joint venture have rights to the net assets of the arrangement and account for their interest in the joint venture using the equity method. There are no changes in accounting treatment due to adoption of Korean IFRS 1111 of the Company.

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

Korean IFRS 1112, *Disclosure of Interests in Other Entities*, provides disclosure requirements for all types of equity investments in other entities including subsidiaries, associates, joint ventures and unconsolidated structured entities. Disclosure impact resulting from the application of this standard was not reflected on these interim financial statements.

- Amendments to Korean IFRS 1027, *Separate Financial Statements*

Korean IFRS 1027, which is amended in accordance with enactment of Korean IFRS 1110, is to prescribe the accounting for investments in subsidiaries, associates and joint ventures of the Parent Company in the separate financial statements.

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

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

(b) New standards and interpretations not yet adopted

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

- Amendments to Korean IFRS 1032, *Financial Instruments: Presentation*

According to the amendments to Korean IFRS 1032, *Financial Instruments: Presentation*, a right to offset financial instruments does not depend on future events but should be legally enforceable in every circumstance. Also, standards for settling the payment net would be satisfied in case it is available to settle the amount by the same method as net settlement. This amendment will be effective for annual periods beginning on or after January 1, 2014, and an early adoption is permitted. The Company expects that the application of this amendment would not have a material impact on the separate financial statements.

KT&G Corporation
Notes to Separate Financial Statements
March 31, 2013 and 2012, and December 31, 2012

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 separate 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 statement of comprehensive income, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

All other foreign exchange gains and losses are presented in the statement of comprehensive income within 'other gains and losses, net'.

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

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

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2.6 Financial 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 and liabilities at fair value through profit or loss

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

(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 'trade and other payables' in the statement of financial position.

(c) Available-for-sale financial assets

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

(d) Financial liabilities carried at amortized cost

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

2.6.2 Recognition and Measurement

Regular purchases and sales of financial assets are recognized on the trade date. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the statement of comprehensive income. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the 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.

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

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Interest on available-for-sale and held-to-maturity securities calculated using the effective interest method is recognized in the statement of comprehensive income as part of 'finance income'. Dividends on available-for-sale equity instruments are recognized in the statement of comprehensive income as part of 'finance 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.

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

(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-

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

2.8 Trade Receivables

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

2.9 Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

The cost of inventories is determined by the weighted-average method for merchandise, finished goods, by-products, work-in-progress and tobacco leaf in raw materials, by the moving-average method for raw materials and supplies; and by the specific identification method for all other inventories.

When inventories are sold, the carrying amount of those inventories is recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories are recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, is recognized as a reduction in the amount of inventories and recognized as an expense in the period in which the reversal occurs.

Tobacco leaf inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognized industry practice. The estimated amounts of inventories in current assets which are not expected to be realized within 12 months are ₩ 316,508 million and ₩ 347,489 million as of March 31, 2013 and December 31, 2012, 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 the 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

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flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

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

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

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

2.12 Borrowing Costs

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

2.13 Government Grants

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

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

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.

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 some of the facility usage rights, industrial property rights, and other intangible assets 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

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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 statement of comprehensive income during the financial period in which they are incurred.

Land held for investment is not depreciated. Investment property, except for land, is depreciated using straight-line method over their useful lives from ten to 60 years.

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

2.16 Impairment of Non-financial Assets

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

2.17 Trade Payables

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

2.18 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of comprehensive income over the period of the borrowings using the effective interest method. The 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 statement of comprehensive

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income as 'finance expense'.

2.19 Compound Financial Instruments

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.

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

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

2.22 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 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

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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 three-month periods ended March 31, 2013 and 2012, were ₩ 823,013 million and ₩ 803,947 million, respectively.

Revenue from the construction of real estate includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognized in profit or loss in proportion to the stage of completion of the contract. The stage of completion is assessed by reference to surveys of work performed.

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

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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 Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. 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 estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Income taxes

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

(b) Fair value of financial instruments

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

(c) Provisions

As described in Note 2.20, the Company recognizes provisions for estimated returns as of the reporting date. The amounts are estimated based on historical data.

(d) Defined benefit liability

The present value of the defined benefit liability depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of the defined benefit liability. The Company determines the appropriate discount rate at the end of each year. This is the interest rate that is used to determine the present value of estimated future cash outflows expected to be required to settle the defined benefit liability. In determining the appropriate discount rate, the Company considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the pension benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Other key assumptions for defined benefit liability are based

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in part on current market conditions. Additional information is disclosed in Note 23.

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

(a) Market Risk

i) Foreign exchange risk

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

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of March 31, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013					December 31, 2012				
	USD	EUR	RUB	IDR		USD	EUR	RUB	THB	
Assets										
Cash and cash equivalents	₩ 9,890	₩ 1,764	₩ -	₩ -	₩ -	₩ 10,695	₩ 1	₩ -	₩ -	-
Trade and other receivables	483,268	23,847	-	60,952		497,705	23,059	2,156		290
Long-term deposits	185,380	-	-	-		168,667	-	-		-
	<u>₩ 678,538</u>	<u>₩ 25,611</u>	<u>₩ -</u>	<u>₩ 60,952</u>		<u>₩ 677,067</u>	<u>₩ 23,060</u>	<u>₩ 2,156</u>	<u>₩</u>	<u>290</u>
Liabilities										
Trade and other payables	₩ 8,206	₩ 3,258	₩ -	₩ -	₩ -	₩ 3,047	₩ 1,896	₩ -	₩ -	-

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

<i>(in millions of Korean won)</i>	March 31, 2013		December 31, 2012	
	10% strengthening	10% weakening	10% strengthening	10% weakening
US dollar	₩ 67,033	(67,033)	₩ 67,402	(67,402)

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ii) Price risk

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

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

<i>(in millions of Korean won)</i>	March 31, 2013		December 31, 2012	
	5% increase	5% decrease	5% increase	5% decrease
Other comprehensive income before tax	₩ 2,862	₩ (2,862)	₩ 5,266	₩ (5,266)
Tax effect	(630)	630	(1,274)	1,274
Other comprehensive income after tax	<u>₩ 2,232</u>	<u>₩ (2,232)</u>	<u>₩ 3,992</u>	<u>₩ (3,992)</u>

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

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

<i>(in millions of Korean won)</i>	March 31, 2013	December 31, 2012
Available-for-sale financial assets	₩ 2,500	₩ 2,500
Long-term deposits in MSA Escrow Fund	185,380	168,667
Trade and other receivables	934,083	872,572
Other financial assets	230,000	620,000
Cash and cash equivalents	672,940	266,720

(c) Liquidity Risk

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

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

(in millions of Korean won)	March 31, 2013					
	Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
Trade and other payables	₩ 181,026	₩ 182,162	₩ 154,087	₩ -	₩ 28,075	₩ -
Short-term borrowings	5,445	5,445	5,445	-	-	-

(in millions of Korean won)	December 31, 2012					
	Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
Trade and other payables	₩ 172,634	₩ 173,878	₩ 145,309	₩ -	₩ 28,569	₩ -
Short-term borrowings	5,477	5,477	5,477	-	-	-

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

4.2 Capital Management

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

As of March 31, 2013 and December 31, 2012, the Company defines net debt and equity attributable to owners of the Parent as follows:

(in millions of Korean won)	March 31, 2013	December 31, 2012
Total borrowings	₩ 5,445	₩ 5,477
Less:		
-Cash and cash equivalents	(672,940)	(266,720)
-Other financial assets, current	(230,000)	(620,000)
-Available-for-sale financial assets, current	(1,000)	(1,000)
Net debt(Net asset)	(898,495)	(882,243)
Equity attributable to owners of the parent	₩ 4,701,919	₩ 4,903,315

4.3 Fair Value Estimation

There are no significant changes in business and economic environment which impact the fair value of financial assets and liabilities of the Company for the three-month period ended March 31, 2013.

4.3.1 Fair Value by Financial Instruments

Fair value by financial instruments consists of the following:

(in millions of Korean won)	March 31, 2013		December 31, 2012	
	Book value	Fair value	Book value	Fair value
Financial assets				
Available-for-sale assets (non-current) ¹	₩ 247,627	₩ 247,627	₩ 247,950	₩ 247,950
Long-term deposits	185,380	185,380	168,667	168,667

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Long-term trade and other receivables	145,895	145,895	146,174	146,174
Other financial assets	230,000	230,000	620,000	620,000
Trade and other receivables	788,187	788,187	726,397	726,397
Cash and cash equivalents	672,940	672,940	266,720	266,720
	<u>₩ 2,270,029</u>	<u>₩ 2,270,029</u>	<u>₩ 2,175,908</u>	<u>₩ 2,175,908</u>
Financial liabilities				
Long-term trade and other payables	₩ 26,939	₩ 26,939	₩ 27,325	₩ 27,325
Short-term borrowings	5,445	5,445	5,477	5,477
Trade and other payables	154,087	154,087	145,309	145,309
	<u>₩ 186,471</u>	<u>₩ 186,471</u>	<u>₩ 178,111</u>	<u>₩ 178,111</u>

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

4.3.2 Financial Instruments Measured at Cost

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

<i>(in millions of Korean won)</i>	March 31, 2013	December 31, 2012
Available-for-sale assets		
MASTERN 2 REIT equity	₩ 10,000	₩ 10,000
U&I Corporation equity	3,000	3,000
SJ Biomed equity	1,000	1,000
Others	2,594	2,594
	<u>₩ 16,594</u>	<u>₩ 16,594</u>

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

4.3.3 Fair Value Hierarchy

Financial instruments that are measured or disclosed at fair value are classified by a fair value hierarchy. The different levels for the fair value hierarchy 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 March 31, 2013:

<i>(in millions of Korean won)</i>	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale financial assets	197,023	47,604	3,000	247,627

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

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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.

4.3.4 Valuation Technique and Inputs

The Company uses the following valuation technique and inputs for repetitive fair value measures, non-repetitive fair value measures and disclosed fair value, which are classified as level 2 and 3 in the fair value hierarchy as of March 31, 2013:

(in millions of Korean won)

		Fair Value	Level	Valuation Technique
Available-for-sale assets				
Real Estate Investment Trust	₩	47,604	2	Market approach
Unlisted		3,000	3	(*1)

¹Unlisted stocks are shares in Dream Hub PFV Co., Ltd. which was established for the development of the Yongsan Station area. The Company recognized 80% of the carrying amount as impairment loss for this interim period due to financial difficulties of this investee(Note 6).

5. Financial Instruments by Category

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

<i>(in millions of Korean won)</i>	March 31, 2013					Total
	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for-sale		
Financial assets as available-for-sale, non-current	₩ -	₩ -	₩ -	₩ 263,221	₩	263,221
Long-term deposits	185,380	-	-	-		185,380
Long-term trade and other receivables	145,895	-	-	-		145,895
Financial assets as available-for-sale, current	-	-	-	1,000		1,000
Other financial assets,	230,000	-	-	-		230,000

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current					
Trade and other receivables, current	788,187	-	-	-	788,187
Cash and cash equivalents	672,940	-	-	-	672,940
	<u>₩ 2,022,402</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 264,221</u>	<u>₩ 2,286,623</u>

December 31, 2012

<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
Financial assets as available-for-sale, non-current	₩ -	₩ -	₩ -	₩ 263,544	₩ 263,544
Long-term deposits	168,667	-	-	-	168,667
Long-term trade and other receivables	146,174	-	-	-	146,174
Financial assets as available-for-sale, current	-	-	-	1,000	1,000
Other financial assets, current	620,000	-	-	-	620,000
Trade and other receivables, current	726,397	-	-	-	726,397
Cash and cash equivalents	266,720	-	-	-	266,720
	<u>₩ 1,927,958</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 264,544</u>	<u>₩ 2,192,502</u>

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

March 31, 2013

<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
Long-term trade and other payables	₩ -	₩ -	₩ 26,939	₩ -	₩ 26,939
Short-term borrowings	-	-	5,445	-	5,445
Trade and other payables	-	-	154,087	-	154,087
	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 186,471</u>	<u>₩ -</u>	<u>₩ 186,471</u>

December 31, 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
Long-term trade and other payables	₩ -	₩ -	₩ 27,325	₩ -	₩ 27,325
Short-term borrowings	-	-	5,477	-	5,477
Trade and other payables	-	-	145,309	-	145,309
	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 178,111</u>	<u>₩ -</u>	<u>₩ 178,111</u>

Income and loss of financial instruments by category for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Available-for-sale financial assets		
Gain(Loss) on valuation (Other comprehensive income)	₩ 8,851	₩ 20,325
Loss on disposal (Profit or loss)	-	(9)
Interest income	7	5
Dividend income	3,591	3,677
Impairment	(12,000)	-
Cash and cash equivalents		

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Interest income	7,440	6,971
Gain on foreign currency translation	15	113
Foreign currency transaction gain (loss)	224	(529)
Trade and other receivables		
Interest income	2,202	2,864
Gain(Loss) on foreign currency translation	20,903	(4,530)
Foreign currency transaction gain(loss)	1,638	(1,422)
Other financial liabilities at amortized cost		
Interest costs	(212)	(212)
Gain(Loss) on foreign currency translation	(184)	(94)
Foreign currency transaction gain (loss)	(883)	518

6. Available-for-sale Financial Assets

The changes in available-for-sale financial assets for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
At January 1	₩ 264,544	₩ 248,062
Additions	-	1,500
Gain on valuation	8,890	26,814
Net gains transfer from equity	2,787	-
Impairment losses	(12,000)	-
Disposal	-	(242)
At March 31	264,221	276,134
Less: current portion	(1,000)	(1,044)
Non-current portion	₩ 263,221	₩ 275,090

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

<i>(in millions of Korean won)</i>	March 31, 2013	December 31, 2012
Available-for-sale debt instruments:		
Corporate bonds	₩ 2,500	₩ 2,500
Total available-for-sale debt instruments	2,500	2,500
Available-for-sale equity instruments:		
Listed ¹		
Yonhap Television News(YTN)	31,760	29,581
Oscotech, Inc.	1,122	869
Shinhan Financial Group Co., Ltd.	161,938	155,725
Rexahn Pharmaceuticals, Inc.	2,203	2,122
	197,023	188,297
Unlisted ^{2,3}	64,698	73,747
Total available-for-sale equity instruments	261,721	262,044
Total available-for-sale financial assets	₩ 264,221	₩ 264,544

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¹The fair value of listed available-for-sale equity instruments is principally based on quoted prices in an active market.

²For the three-month period ended March 31, 2013, the Company recognizes impairment loss on unlisted available-for-sale equity instruments of ₩ 12,000 million for Dream Hub PFV Co., Ltd.

³The other unlisted available-for-sale equity instruments that do not have a market price in an active market and whose fair value cannot be reliably measured and available-for-sale debt instruments whose fair value is similar to their carrying amount, are measured at cost.

7. Trade and Other Receivables

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

(in millions of Korean won)	March 31, 2013		December 31, 2012	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 12,124	₩ 15,265	₩ 7,186	₩ 22,408
Loans	8,977	77,186	6,453	71,216
Other receivables	67,478	15,270	82,335	15,128
Guarantee deposits	-	38,174	-	37,422
Accrued income	9,032	-	8,291	-
Trade receivables	690,577	-	622,131	-
	<u>₩ 788,188</u>	<u>₩ 145,895</u>	<u>₩ 726,396</u>	<u>₩ 146,174</u>

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

(in millions of Korean won)	March 31, 2013		December 31, 2012	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 807,901	₩ 145,895	₩ 746,110	₩ 146,174
Allowance account				
- Other receivables	(2,083)	-	(2,083)	-
- Trade receivables	(17,630)	-	(17,631)	-
	<u>(19,713)</u>	<u>-</u>	<u>(19,714)</u>	<u>-</u>
Net amount	<u>₩ 788,188</u>	<u>₩ 145,895</u>	<u>₩ 726,396</u>	<u>₩ 146,174</u>

Changes in the allowance account for the three-month periods ended March 31, 2013 and 2012, are as follows:

(in millions of Korean won)	March 31, 2013	March 31, 2012
Beginning	₩ 19,714	₩ 5,365
Impairment	-	-
Reversal of impairment	(1)	(2)
Write-off	-	-
Ending	<u>₩ 19,713</u>	<u>₩ 5,363</u>

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

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<i>(in millions of Korean won)</i>	March 31, 2013	December 31, 2012
Not past due	₩ 396,649	₩ 413,203
Past due but not impaired		
Within 1 month	32,755	46,417
Between 1 and 2 months	43,168	34,941
Beyond 2 months	34,892	25,114
	110,815	106,472
Impaired	200,743	120,087
	₩ 708,207	₩ 639,762

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 March 31, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013			December 31, 2012		
	Effective interest rate(%)	Current	Non-current	Effective interest rate(%)	Current	Non-current
Loans to employees	3.00~5.68	₩ 12,124	₩ 15,265	3.00~5.68	₩ 7,186	₩ 22,408
Other receivables	3.79	4,654	15,270	3.79	8,300	15,128
Guarantee deposits	3.00~5.68	-	38,174	3.00~5.68	-	37,422
		₩ 16,778	₩ 68,709		₩ 15,486	₩ 74,958

Transferred trade receivables

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

In case the customers default, the Company has an obligation to pay the related amount to the bank. As a result, this transaction, treated as a transaction with recourse, has been accounted for as collateralized borrowings. The borrowings recognized in relation to the said transaction as of March 31, 2013 and December 31, 2012, are ₩ 5,445 million and ₩ 5,477 million, respectively (Note 22).

8. Long-term Deposits

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

<i>(in millions of Korean won)</i>	March 31, 2013	December 31, 2012
MMF	₩ 2,240	₩ 10,496
T-Bill	183,140	158,170
	₩ 185,380	₩ 168,666

As discussed in Note 31 to the separate financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2013 and 2012, are ₩ 9,977 million and ₩ 5,437 million, respectively.

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Investment income on long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2013 and 2012, are ₩346 million and ₩70 million, respectively.

In addition, the Company measured fair value of long-term deposits using market price traded in active market.

9. Property, Plant and Equipment

Changes in property, plant and equipment for the three-month periods ended March 31, 2013 and 2012, are as follows:

(in millions of Korean won)	March 31, 2013		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 403,000	₩ -	₩ 403,000
Buildings	645,609	(249,451)	396,158
Structures	41,000	(24,471)	16,529
Machinery	921,943	(665,494)	256,449
Vehicles	2,648	(2,134)	514
Tools	32,573	(30,053)	2,520
Furniture and fixture	162,997	(128,785)	34,212
Others	1,115	-	1,115
Construction-in-progress	43,397	-	43,397
	₩ 2,254,282	₩ (1,100,388)	₩ 1,153,894

(in millions of Korean won)	March 31, 2012		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 397,682	₩ -	₩ 397,682
Buildings	655,382	(250,704)	404,678
Structures	45,726	(26,784)	18,942
Machinery	851,176	(606,977)	244,199
Vehicles	3,932	(3,240)	692
Tools	31,796	(29,538)	2,258
Furniture and fixture	176,006	(139,959)	36,047
Others	1,078	-	1,078
Construction-in-progress	42,283	-	42,283
	₩ 2,205,061	₩ (1,057,202)	₩ 1,147,859

(in millions of Korean won)	March 31, 2013						
	Opening net book value	Additions	Disposal	Depreciation	Transfer	Other changes ¹	Net book amount
Land	₩ 397,900	₩ -	₩ (147)	₩ -	₩ 4,814	₩ 433	₩ 403,000
Buildings	394,889	133	(6)	(6,228)	4,429	2,941	396,158
Structures	16,716	10	(1)	(467)	234	37	16,529
Machinery	261,847	3,282	(108)	(16,086)	7,514	-	256,449
Vehicles	529	52	-	(67)	-	-	514
Tools	2,733	241	(165)	(289)	-	-	2,520
Furniture and fixture	36,807	1,270	(72)	(4,480)	687	-	34,212
Others	1,115	-	-	-	-	-	1,115
Construction-in-progress	50,684	10,391	-	-	(17,678)	-	43,397

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

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(in millions of Korean won)	March 31, 2012						
	Opening net book value	Additions	Disposal	Depreciation	Transfer	Other changes ²	Net book amount
Land	₩ 397,775	₩ 457	₩ (181)	₩ -	₩ 5,304	₩ (5,673)	₩ 397,682
Buildings	411,217	1,015	(1,269)	(7,023)	868	(130)	404,678
Structures	19,038	-	(179)	(580)	704	(41)	18,942
Machinery	254,484	1,114	-	(15,012)	3,658	(45)	244,199
Vehicles	703	76	-	(87)	-	-	692
Tools	2,620	12	-	(374)	-	-	2,258
Furniture and fixture	36,362	4,530	-	(4,845)	-	-	36,047
Others	1,078	-	-	-	-	-	1,078
Construction-in-progress	40,084	12,733	-	-	(10,534)	-	42,283

² Other changes include ₩ 10,753 million of reclassification from property, plant and equipment to held-for-sale non-current assets and ₩ 4,864 million of reclassification from investment property to property, plant and equipment.

10. Intangible Assets

Changes in intangible assets for the three-month periods ended March 31, 2013 and 2012, are as follows:

(in millions of Korean won)	March 31, 2013			
	Industrial property rights	Facility usage rights	Intangible assets under development	Total
At January 1, 2013	₩ 1,632	₩ 16,585	₩ 1,720	₩ 19,937
Additions	-	-	-	-
Disposals	-	(1)	-	(1)
Amortization	(15)	-	-	(15)
Transfer-in(out)	53	-	(53)	-
Other changes	-	-	(2)	(2)
Acquisition cost	7,163	16,584	1,665	25,412
Accumulated amortization and impairment cost	(5,493)	-	-	(5,493)
Net book amount	₩ 1,670	₩ 6,584	₩ 1,665	₩ 19,919

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<i>(in millions of Korean won)</i>	March 31, 2012			
	Industrial property rights	Facility usage rights	Intangible assets under development	Total
At January 1, 2012	₩ 1,323	₩ 15,946	₩ 1,703	₩ 18,972
Additions	-	2	123	125
Disposals	(70)	-	(667)	(737)
Amortization	(5)	-	-	(5)
Transfer-in(out)	30	-	(30)	-
Other changes	-	-	-	-
Acquisition cost	6,738	15,948	1,129	23,815
Accumulated amortization and impairment cost	(5,460)	-	-	(5,460)
Net book amount	₩ 1,278	₩ 15,948	₩ 1,129	₩ 18,355

Research and development expenses for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Cost of goods sold	₩ 363	₩ 73
Selling and administrative expenses	1,949	3,186
	₩ 2,312	₩ 3,259

11. Investment Property

Changes in investment property for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013		
	Land	Building	Total
Beginning net book value	₩ 22,121	₩ 131,786	₩ 153,907
Subsequent expenditure	559	863	1,422
Transfers	(434)	(2,977)	(3,411)
Depreciation	-	(1,503)	(1,503)
Acquisition cost	22,246	169,891	192,137
Accumulated depreciation and impairment cost	-	(41,722)	(41,722)
Net book amount	₩ 22,246	₩ 128,169	₩ 150,415

<i>(in millions of Korean won)</i>	March 31, 2012		
	Land	Building	Total
Beginning net book value	₩ 22,683	₩ 142,370	₩ 165,053
Subsequent expenditure	-	-	-
Transfers	(563)	(4,301)	(4,864)
Depreciation	-	(1,540)	(1,540)
Acquisition cost	22,120	172,750	194,870
Accumulated depreciation and impairment cost	-	(36,221)	(36,221)
Net book amount	₩ 22,120	₩ 136,529	₩ 158,649

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The amounts recognized in profit or loss from investment property for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Rental income	₩ 8,612	₩ 7,173
Direct operating expense	(1,503)	(1,540)
	<u>₩ 7,109</u>	<u>₩ 5,633</u>

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

<i>(in millions of Korean won)</i>	March 31, 2013		December 31, 2012	
	Fair value	Book value	Fair value	Book value
Land	₩ 281,292	₩ 22,246	₩ 284,993	₩ 22,120
Building	180,349	128,169	186,671	131,787
	<u>₩ 461,641</u>	<u>₩ 150,415</u>	<u>₩ 471,664</u>	<u>₩ 153,907</u>

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

The Company recognizes non-current assets held for sale as the lower of net fair value and book value.

Changes in non-current assets held for sale as of March 31, 2013, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013			
	Land	Buildings	Structures	Total
At January 1, 2013				
Acquisition cost	₩ 625	₩ 215	₩ 64	₩ 904
Accumulated depreciation	-	(96)	(46)	(142)
Net book amount	<u>₩ 625</u>	<u>₩ 119</u>	<u>₩ 18</u>	<u>₩ 762</u>
Changes				
Transfer from property, plant and equipment	₩ -	₩ -	₩ -	₩ -
Transfer from Investment property	-	-	-	-
Disposals	(521)	(60)	(4)	(585)
	<u>₩ (521)</u>	<u>₩ (60)</u>	<u>₩ (4)</u>	<u>₩ (585)</u>
At March 31, 2013				
Acquisition cost	₩ 104	₩ 112	₩ 36	₩ 252
Accumulated depreciation	-	(53)	(22)	(75)
Net book amount	<u>₩ 104</u>	<u>₩ 59</u>	<u>₩ 14</u>	<u>₩ 177</u>

13. Pledged Assets

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

<i>(in millions of Korean won)</i>	Asset	Book amount	Borrowings	Collateralized amount	Lender /Leaseholder
	Investment property	₩ 76,418	Leasehold deposits received ₩ 7,500	₩ 7,833	Metlife Insurance Korea Co., Ltd. and 22 others

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

(in millions of Korean won)

Asset	Book amount		Borrowings		Collateralized amount	Lender /Leaseholder
Investment property	₩ 80,783	Leasehold deposits received	₩ 8,169		₩ 8,502	Metlife Insurance Korea Co., Ltd. and 24 others

14. Investments in Associates and Subsidiaries

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

(in millions of Korean won)

	Location	Principal operation	March 31, 2013		December 31, 2012	
			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.	Korea	Selling and renting of real estate	34.63	5,600	34.63	5,600
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	10,000	21.74	10,000
LSK Global Pharma Services Co., Ltd.	Korea	Research and developing new drug	23.15	1,500	23.15	1,500
JR REIT X Co., Ltd.	Korea	Selling and renting of real estate	28.79	9,500	28.79	9,500
				57,725	57,725	
Subsidiaries						
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00	599,023	100.00	599,023
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceuticals	53.00	66,355	53.00	66,355
Tae-a Industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00	15,698	100.00	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	Manufacturing and selling tobaccos	99.99	54,049	99.99	54,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf Tobaccos	99.90	535	99.90	535
KT&G Pars	Iran	Manufacturing and selling tobaccos	99.99	-	99.99	-
KT&G Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00	110,297	100.00	110,297
KG Life & Gin Co., Ltd.	Korea	Selling ginseng	100.00	52,900	100.00	52,900
KT&G Bio Corp.	Korea	Manufacturing and selling pharmaceuticals	-	-	-	-
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	31,333

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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	100.00	89,756	100.00	89,756
KT&G Life Science ³	Korea	Medical researching and developing	73.94	31,232	73.94	31,232
Yebon Nongwon Agriculture Co., Ltd.	Korea	Corporate agriculture	90.00	90	90.00	90
KGC Yebon	Korea	Corporate agriculture	100.00	43,927	100.00	43,927
K-Q HongKong I, Limited ⁴	Hong Kong	Manufacturing and selling ginseng	100.00	17,761	100.00	17,761
PT KT&G Indonesia	Indonesia	Manufacturing and selling tobaccos	99.96	3,746	-	-
				<u>1,182,336</u>		<u>1,178,590</u>
				<u>₩ 1,240,061</u>		<u>₩ 1,236,315</u>

¹ The Company's percentage of ownership excludes convertible preferred shares. As of March 31, 2013, the Company's percentage of ownership, including convertible preferred shares, is 50.00%.

² The Company's percentage of ownership excludes convertible preferred shares. As of March 31, 2013, the Company's percentage of ownership, including convertible preferred shares, is 68.91%.

³ The Company's percentage of ownership excludes convertible preferred shares. As of March 31, 2013, the Company's percentage of ownership, including convertible preferred shares, is 59.48%.

⁴ The Company's percentage of ownership excludes convertible preferred shares. As of March 31, 2013, the Company's percentage of ownership, including convertible preferred shares, is 50.00%.

Changes in investments in associates and subsidiaries for the three-month periods ended March 31, 2013 and 2012, are as follows:

(in millions of Korean won)	March 31, 2013					
	Beginning balance	Acquisition	Disposals	Other changes	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.	13,995	-	-	-	-	13,995
KVG REIT 1 Co., Ltd.	7,300	-	-	-	-	7,300
KOCREF REIT 17 Co., Ltd.	7,000	-	-	-	-	7,000
JR REIT V Co., Ltd.	5,600	-	-	-	-	5,600
JR REIT VIII Co., Ltd.	10,000	-	-	-	-	10,000
LSK Global Pharma Services Co., Ltd	1,500	-	-	-	-	1,500
JR REIT X Co., Ltd.	9,500	-	-	-	-	9,500
	<u>57,725</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>57,725</u>
Subsidiaries						
Korea Ginseng Corporation	599,023	-	-	-	-	599,023
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	-	66,355
Tae-a Industry Co., Ltd.	15,698	-	-	-	-	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	535	-	-	-	-	535
KT&G Pars	-	-	-	-	-	-
KT&G Rus L.L.C.	110,297	-	-	-	-	110,297
KG Life & Gin Co., Ltd	52,900	-	-	-	-	52,900
KT&G Bio Corp.	-	-	-	-	-	-
Global Trading, Inc.	4,913	-	-	-	-	4,913

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Jilin Hanzheng Ginseng Co., Ltd.	31,333	-	-	-	31,333
Somang Cosmetics Co., Ltd.	60,721	-	-	-	60,721
Renzoluc Pte., Ltd.	89,756	-	-	-	89,756
KT&G Life Science	31,232	-	-	-	31,232
Yebon Nongwon Agriculture Co., Ltd	90	-	-	-	90
KGC Yebon	43,927	-	-	-	43,927
K-Q HongKong I,Limited	17,761	-	-	-	17,761
PT KT&G Indonesia	-	3,746	-	-	3,746
	<u>1,178,590</u>	<u>3,746</u>	<u>-</u>	<u>-</u>	<u>1,182,336</u>
	<u>₩ 1,236,315</u>	<u>₩ 3,746</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 1,240,061</u>

(in millions of Korean won)	March 31, 2012				
	Beginning balance	Acquisition	Disposals	Other changes	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.	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	₩ -	₩ -	₩ -	₩ 559,882
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	-	-	-	394
KT&G Pars	5,733	-	-	-	5,733
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KG Life & Gin Co., Ltd	31,500	-	-	-	31,500
KT&G Bio Corp.	900	-	-	-	900
Global Trading, Inc.	4,913	-	-	-	4,913
Jilin Hanzheng Ginseng Co., Ltd.	23,247	-	-	-	23,247
Somang Cosmetics Co., Ltd.	60,721	-	-	-	60,721
Renzoluc Pte., Ltd.	89,756	-	-	-	89,756
KT&G Life Science	31,232	-	-	-	31,232
Yebon Nongwon Agriculture Co., Ltd	90	-	-	-	90
KGC Yebon	-	13,000	-	-	13,000
	<u>1,054,767</u>	<u>13,000</u>	<u>-</u>	<u>-</u>	<u>1,067,767</u>
	<u>₩ 1,091,492</u>	<u>₩ 24,500</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 1,115,992</u>

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15. Inventories

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

(in millions of Korean won)	March 31, 2013			December 31, 2012		
	Acquisition	Allowance	Book amount	Acquisition	Allowance	Book amount
Finished goods	₩ 110,178	₩ (657)	₩ 109,521	₩ 83,809	₩ (574)	₩ 83,235
Work in progress	14,717	-	14,717	15,207	-	15,207
Raw materials	708,034	-	708,034	694,871	-	694,871
Supplies	23,268	-	23,268	22,877	-	22,877
By-products	6,414	-	6,414	5,034	-	5,034
Unfinished housing	567	-	567	227	-	227
Lots	7,704	-	7,704	6,551	-	6,551
Goods-in-transit	36,093	-	36,093	44,831	-	44,831
	<u>₩ 906,975</u>	<u>₩ (657)</u>	<u>₩ 906,318</u>	<u>₩ 873,407</u>	<u>₩ (574)</u>	<u>₩ 872,833</u>

The cost related inventories for the three-month periods ended March 31, 2013 and 2012, are as follows:

(in millions of Korean won)	March 31, 2013		March 31, 2012	
Cost of sales				
-Loss on inventory valuation	₩	83	₩	143
-Loss on retirement of inventories		696		-
Other expenses				
-Loss on retirement of inventories		54		576
	<u>₩</u>	<u>833</u>	<u>₩</u>	<u>719</u>

16. Cash and Cash Equivalents

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

(in millions of Korean won)	March 31, 2013		December 31, 2012	
Cash on hand	₩	3,655	₩	3,405
Demand deposits		89,285		93,315
Short-term investment assets		580,000		170,000
	<u>₩</u>	<u>672,940</u>	<u>₩</u>	<u>266,720</u>

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

(in millions of Korean won)	March 31, 2013		December 31, 2012	
Short-term financial assets				
Time deposits	₩	140,000	₩	170,000
Money trust		60,000		260,000
Certificates of deposit		30,000		190,000
	<u>₩</u>	<u>230,000</u>	<u>₩</u>	<u>620,000</u>

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17. Equity and Share Premium

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

<i>(in Korean won, except number of shares)</i>	March 31, 2013	December 31, 2012
Number of ordinary shares		
-Authorized	800,000,000	800,000,000
-Issued	137,292,497	137,292,497
Par value per share	₩ 5,000	₩ 5,000
Ordinary shares	₩ 954,959,485,000	₩ 954,959,485,000

The Company has reacquired and retired 53,699,400 shares of treasury shares. Accordingly, as of March 31, 2013, the Company's ordinary shares differ from the aggregate par value of issued shares by ₩ 268,497 million.

Changes in the number of shares for the three-month period ended March 31, 2013 and the year ended December 31, 2012, are as follows:

<i>(Number of shares)</i>	March 31, 2013			December 31, 2012		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning	137,292,497	(11,393,697)	125,898,800	137,292,497	(11,543,697)	125,748,800
Issuance of treasury shares	-	-	-	-	150,000	150,000
Ending	<u>137,292,497</u>	<u>(11,393,697)</u>	<u>125,898,800</u>	<u>137,292,497</u>	<u>(11,393,697)</u>	<u>125,898,800</u>

There are no changes in the other capital surplus for the three-month period ended March 31, 2013 and the year ended December 31, 2012.

18. Treasury Shares

Changes in the treasury shares for the three-month periods ended March 31, 2013 and the year ended December 31, 2012, are as follows:

<i>(in millions of Korean won, except number of shares)</i>	March 31, 2013		December 31, 2012	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Beginning	11,393,697	₩ 339,059	11,543,697	₩ 343,522
Issuance of treasury shares	-	-	(150,000)	(4,463)
Ending	<u>11,393,697</u>	<u>₩ 339,059</u>	<u>11,393,697</u>	<u>₩ 339,059</u>

Changes in gain on reissuance of treasury shares for the three-month period ended March 31, 2013 and the year ended December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	December 31, 2012
Beginning	₩ 492,032	₩ 485,922
Gain on reissuance of treasury shares before tax	-	8,061
Less: tax at 24.2%	-	(1,951)
Gain on reissuance of treasury shares, net of tax	-	6,110
Ending	<u>₩ 492,032</u>	<u>₩ 492,032</u>

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19. Reserves

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

<i>(in millions of Korean won)</i>	March 31, 2013	December 31, 2012
Available-for-sale financial assets reserve	₩ (21,783)	₩ (30,635)
Legal reserve	602,937	602,937
Voluntary reserve	2,813,732	2,466,732
	<u>₩ 3,394,886</u>	<u>₩ 3,039,034</u>

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

<i>(in millions of Korean won)</i>	March 31, 2013	December 31, 2012
Available-for-sale financial assets reserve before tax	₩ (28,738)	₩ (40,415)
Tax effect	6,955	9,780
Available-for-sale financial assets reserve after tax	<u>₩ (21,783)</u>	<u>₩ (30,635)</u>

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

Details of the Company's voluntary reserve as of March 31, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	December 31, 2012
Reserve for business rationalization ¹	₩ 12,851	₩ 12,851
Reserve for research and human resource development ²	90,000	60,000
Reserve for business expansion ³	698,881	698,881
Other reserve ³	2,012,000	1,695,000
	<u>₩ 2,813,732</u>	<u>₩ 2,466,732</u>

¹*Reserve for Business Rationalization*

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

²*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.

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³Reserve 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 three-month period ended March 31, 2013 and the year ended December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013		December 31, 2012	
Beginning	₩	752,766	₩	763,738
Transfer from other reserve		(317,000)		(359,000)
Transfer from Reserve for research and human resource development		(30,000)		-
Dividends		(402,876)		(402,396)
Profit for the period		192,777		768,438
Actuarial losses, net of tax		(148)		(18,014)
Ending	₩	195,519	₩	752,766

21. Accounts Payable and Other Finance Liabilities

Accounts payable and other finance liabilities as of March 31, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013		December 31, 2012	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	₩ 26,939	₩ -	₩ 27,325
Accounts payable	52,385	-	19,037	-
Withholdings	7,657	-	5,540	-
Value added tax withheld	119,241	-	115,995	-
Accrued expenses	77,412	-	105,071	-
Other payables	24,290	-	21,201	-
	₩ 280,985	₩ 26,939	₩ 266,844	₩ 27,325

Accounts payable and other finance liabilities carried at amortized cost using the effective interest rate method as of March 31, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013			December 31, 2012		
	Effective interest rate	Current	Non-current	Effective interest rate	Current	Non-current
Leasehold deposits received	3.00~5.68%	₩ -	₩ 26,939	3.00~5.68%	₩ -	₩ 27,325

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22. Borrowings

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

<i>(in millions of Korean won)</i>	March 31, 2013		December 31, 2012	
Current				
Bank borrowings	₩	5,445	₩	5,477

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

<i>(in millions of Korean won)</i>			Latest maturity date	Annual interest rate(%) March 31, 2013	March 31, 2013	December 31, 2012
Korean won	National Agricultural Cooperative Federation		Short-term Borrowings	7.35	₩ 4,526	₩ 4,575
Korean won	Korea Exchange Bank		Short-term Borrowings	CD(91) + 2.5%	919	902
					<u>₩ 5,445</u>	<u>₩ 5,477</u>

23. Defined Benefit Liability

The amounts recognized on the statements of income for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013		March 31, 2012	
Defined benefit plans :				
Current service cost	₩	7,244	₩	6,314
Interest expenses		1,715		1,682
Expected return on plan assets		(1,169)		(1,263)
		<u>7,790</u>		<u>6,733</u>
Defined contribution plans :				
Pension costs		644		533
Total	₩	<u>8,434</u>	₩	<u>7,266</u>

Out of total expenses, ₩2,800 million (2012: ₩2,503 million) and ₩5,634 million (2012: ₩4,763 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 March 31, 2013 and December 31, 2012, are as follows:

<i>(In millions of Korean won)</i>	March 31, 2013		December 31, 2012	
Present value of defined benefit liability	₩	216,955	₩	213,387
Fair value of plan assets		(143,119)		(147,176)
Liability in the statement of financial position	₩	<u>73,836</u>	₩	<u>66,211</u>

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24. Classification of Operating Income

(1) Material items of operating income and expense

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

(2) Employee benefit costs for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Salaries	₩ 77,824	₩ 74,750
Retirement benefits	8,434	7,266
Termination benefits	-	1,194
Employee welfare	8,210	7,385
	<u>₩ 94,468</u>	<u>₩ 90,595</u>

(3) Depreciation and amortization for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Depreciation	₩ 29,120	₩ 29,461
Amortization	15	5
	<u>₩ 29,135</u>	<u>₩ 29,466</u>

(4) Details of other income for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Foreign currency transaction gain	₩ 2,233	₩ 987
Foreign currency translation gain	22,878	1,096
Gain on sale of property, plant and equipment	5,500	1,359
Others	4,265	4,506
	<u>₩ 34,876</u>	<u>₩ 7,948</u>

(5) Selling and administrative expenses for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Salaries	₩ 52,397	₩ 49,992
Retirement benefits	5,634	4,763
Termination benefits	-	968
Employee welfare	5,756	5,021
Travel	969	1,580
Communications	893	913
Utilities	2,817	2,639
Taxes and dues	4,303	3,612
Supplies	448	595
Rent	3,253	3,565
Depreciation	8,016	8,495
Amortization	15	5
Repairs and maintenance	454	1,367
Vehicles	2,141	2,346

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Insurance	138	219
Commissions	16,076	15,344
Freight and custody	5,227	4,376
Conferences	837	924
Advertising	36,717	33,260
Training	891	981
Prizes and rewards	357	433
Normal research and development	1,949	3,186
Bad debts expense	(1)	(2)
	<u>₩ 149,287</u>	<u>₩ 144,582</u>

(6) Details of other expenses for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Foreign currency transaction loss	₩ 1,254	₩ 2,420
Foreign currency translation loss	2,145	5,606
Donations	145	2,426
Loss on sale of property, plant and equipment	136	13
Loss on sale of intangible assets	-	337
Others	288	568
	<u>₩ 3,968</u>	<u>₩ 11,370</u>

25. Expenses by Nature

Expenses by nature for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Changes in inventories	₩ (33,485)	₩ 26,849
Raw materials and consumables purchased	197,205	156,081
Salary and wage	77,824	74,750
Retirement and termination benefits	8,434	8,460
Depreciation charges	29,120	29,461
Amortization charges	15	5
Employee benefits	8,210	7,385
Advertising costs	36,732	33,287
Service fees	21,697	21,138
Other expenses	13,799	14,857
Total cost of sales, selling and administrative expenses and other expenses	<u>₩ 359,551</u>	<u>₩ 372,273</u>

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26. Finance Income and Costs

Financial income and costs for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Finance cost		
Interest costs	₩ (212)	₩ (212)
Loss on sale of available-for-sale financial assets	-	(9)
Impairment loss on available-for-sale financial assets	(12,000)	-
	<u>(12,212)</u>	<u>(221)</u>
Finance income		
Interest income	9,649	9,840
Dividend income	3,591	3,677
Investment income on long-term deposits in MSA Escrow Fund	346	70
	<u>13,586</u>	<u>13,587</u>
Net finance income	<u>₩ 1,374</u>	<u>₩ 13,366</u>

Details of interest costs for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Trade and other payables	₩ (212)	₩ (212)

Details of interest income for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Deposits	₩ 7,440	₩ 6,971
Available-for-sale financial assets	7	5
Trade and other receivables	2,202	2,864
	<u>₩ 9,649</u>	<u>₩ 9,840</u>

27. Income Tax

Income tax expense was calculated based on the best weighted average annual corporate tax rate for the entire fiscal period. Estimated average annual tax rate of the year ending December 31, 2013, is 25.1%. The estimated tax rate for the three-month period ended March 31, 2012, was 24.2%.

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28. Earnings per Share

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

Basic earnings per ordinary share for the three-month periods ended March 31, 2013 and 2012, is as follows:

	March 31, 2013	March 31, 2012
<i>(in Korean won, except number of shares)</i>		
Profit for the period	₩ 192,777 million	₩ 176,188 million
Weighted-average number of ordinary shares outstanding	125,898,800	125,748,800
Basic and diluted earnings per share in won	₩ 1,531	₩ 1,401

29. Dividends

The dividends paid in 2013 were ₩ 402,876 million.

30. Cash Generated from Operations

(1) Cash generated from operations for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013	March 31, 2012
Profit	₩ 192,777	₩ 176,188
Adjustments for:		
Income tax expense	64,581	56,218
Finance costs	12,212	221
Finance income	(13,586)	(13,587)
Depreciation	29,120	29,461
Amortization	15	5
Retirement and termination benefits	7,791	8,460
Foreign currency translations loss	2,145	5,605
Loss on the write-down of inventories	83	143
Loss on sale of property, plant and equipment	136	13
Loss on sale of intangible assets	-	337
Other expense	753	-
Foreign currency translations gain	(22,879)	(1,096)
Reversal of impairment loss on trade and other receivables	(1)	(2)
Gain on sale of property, plant and equipment	(5,500)	(1,359)
	267,647	260,607
Changes in working capital		
Trade and other receivables	(38,395)	(68,845)
Advance payments	(1,721)	(1,765)
Prepaid expenses	1,121	(1,215)
Prepaid tobacco excise and other taxes	(70,003)	(20,377)
Inventories	(34,318)	26,706
Trade and other payables	15,079	2,861
Advance receipts	14,672	19,050

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Tobacco excise and other taxes payable	291,854	304,274
Payment of retirement benefits	(362)	(2,719)
Cash generated from operations	₩ 445,574	₩ 518,577

(2) Non-cash transactions

(in millions of Korean won)

March 31, 2013

Transfer to voluntary reserves in retained earnings	347,000
Reclassification of construction-in-progress to property, plant and equipment	17,678

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 March 31, 2013, 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 March 31, 2013. Additionally, as of March 31, 2013, the Company is involved in four lawsuits as a defendant for alleged damages totaling ₩ 523 million. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of March 31, 2013.

As of March 31, 2013, the Company has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 57,000 thousand.

As of March 31, 2013, the Company's trade receivables from the export of cigarettes are insured against non-payment up to USD 12,200 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of March 31, 2013, the Group has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries and for an opening of L/C for import and customs with relation to a subsidiary located in U.S.A(Global Trading Inc.) for up to USD 40,000 thousand by Korea Exchange Bank and others.

In addition, the Company provides Customs Bond with limits in the aggregate of USD 11,400 thousand to Korea Exchange Bank, regarding an opening of L/C for import and customs for a subsidiary located in U.S.A (Global Trading Inc.).

As of March 31, 2013, 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, on November 11, 2011.

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

1) Conditional put option granted to the Individual Shareholder

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

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

2) Right of first refusal held by the Company

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

3) Tag-along right held by the Individual Shareholder

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

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

1) Restriction of disposal

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

2) Right of first refusal held by the Company

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

3) Tag-along right held by the Individual Shareholder

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

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

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32. Related Party Transactions

The subsidiaries and parent companies of subsidiaries as of March 31, 2013 and December 31, 2012, are as follows:

Subsidiaries	Location	Immediate parent companies	Percentage of ownership (%)			
			March 31, 2013		December 31, 2012	
			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	-
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.	-	60.17	-	60.17
PT Mandiri Mahamulia	Indonesia	Renzoluc Pte., Ltd.	-	66.47	-	-
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	Korea	KT&G	100.00	-	100.00	-
K-Q HongKong I, Limited ⁴	HongKong	KT&G	100.00	-	100.00	-
PT KT&G Indonesia ⁵	Indonesia	KT&G	99.96	-	-	-
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
PT CKJ INDONESIA	Indonesia	Korea Ginseng Corporation	-	99.88	-	99.88

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¹ The Company's percentage of ownership excludes convertible preferred shares. As of March 31, 2013, the Company's percentage of ownership, including convertible preferred shares, is 50.00%.

² The Company's percentage of ownership excludes convertible preferred shares. As of March 31, 2013, the Company's percentage of ownership, including convertible preferred shares, is 68.91%.

³ The Company's percentage of ownership excludes convertible preferred shares. As of March 31, 2013, the Company's percentage of ownership, including convertible preferred shares, is 59.48%.

⁴ The Company's percentage of ownership excludes convertible preferred shares. As of March 31, 2013, the Company's percentage of ownership, including convertible preferred shares, is 50.00%.

⁵ During the three-month period ended March 31, 2013, PT KT&G Indonesia was included as a subsidiary.

Transactions with related parties for the three-month periods ended March 31, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013		March 31, 2012	
Sales and other income				
Korea Ginseng Corporation	₩	2,360	₩	1,573
Yungjin Pharm. Ind. Co., Ltd.		68		37
Tae-a industry Co., Ltd.		5		-
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		2,040		1,024
KT&G Pars		1,034		1,884
KT&G Rus L.L.C.		5,082		3,944
KGC Life & Gin Co., Ltd		393		272
Global Trading, Inc.		13,148		9,077
Jilin Hanzheng Ginseng Co., Ltd.		5		83
Somang Cosmetics Co., Ltd.		-		6
KT&G Life Science		37		-
Renzoluc Pte., Ltd.		1,173		1,325
PT Trisakti Purwosari Makmur		43		-
PT KT&G Indonesia		33		-
KGC Yebon		6		-
	₩	25,427	₩	19,225
Purchases and other expenses				
Korea Ginseng Corporation	₩	268	₩	235
Yungjin Pharm. Ind. Co., Ltd.		1		3
Tae-a industry Co., Ltd.		3,797		4,472
KGC Life & Gin Co., Ltd		262		248
Somang Cosmetics Co., Ltd.		34		18
	₩	4,362	₩	4,976

The Company has received dividends from subsidiaries. For the three-month periods ended March 31, 2013 and 2012, there are no dividends received from Korea Ginseng Corp.

In addition, the Company has decided to invest in Korea Ginseng Corporation and KGC Yebon by contributing property, plant and equipment amounting to ₩13,497 million and ₩1,145 million, respectively. As a result, the Company recognizes gain on disposal of ₩25,644 million and ₩12,782 million, respectively.

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Details of related party receivables and liabilities as of March 31, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2013		December 31, 2012	
Receivables from related parties				
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	₩	28,699	₩	27,203
KT&G Pars		38,279		36,004
KT&G Rus L.L.C.		28,616		27,135
Global Trading, Inc.		18,023		17,274
Renzoluc Pte., Ltd.		60,952		59,404
Somang Cosmetics Co., Ltd.		30		29
KGC Life & Gin Co., Ltd		105		-
Korea Ginseng Corporation		703		-
Yungjin Pharm. Ind. Co., Ltd.		15		-
PT Trisakti Purwosari Makmur		46		599
PT KT&G Indonesia		7,539		-
	₩	183,007	₩	167,648
Payables to related parties				
Korea Ginseng Corporation	₩	1,854	₩	1,828
Yungjin Pharm. Ind. Co., Ltd.		413		413
KGC Life & Gin Co., Ltd		241		212
KT&G Life Science		813		813
Tae-a industry Co., Ltd.		1,238		1,325
Somang Cosmetics Co., Ltd.		19		-
	₩	4,578	₩	4,591

The compensation paid or payable to key management for employee services for the three-month periods ended March 31, 2013 and 2012, consists of:

<i>(in millions of Korean won)</i>	March 31, 2013		March 31, 2012	
Short-term employee benefits	₩	3,428	₩	3,890
Retirement benefits		420		582
	₩	3,848	₩	4,472

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 ₩ 1,112.1 to US\$1, the basic exchange rate on March 31, 2013, posted by Seoul Money Brokerage Services, solely for the convenience of the reader. This translation should not be construed as a representation that any or all of the amounts shown could be converted into U.S. dollars at this or any other rate.