

KT&G CORPORATION

Separate Interim Financial Statements

March 31, 2017 and 2016

(Unaudited)

(With Independent Auditors' Review Report Thereon)

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Independent Auditors' Review Report

Based on a report originally issued in Korean

The Board of Directors and Shareholders
KT&G Corporation:

Reviewed financial statements

We have reviewed the accompanying separate interim financial statements of KT&G Corporation (the "Company"), expressed in Korean won, which comprise the separate interim statement of financial position as of March 31, 2017, and the separate interim statements of comprehensive income, changes in equity and cash flows for the three-month periods ended March 31, 2017 and 2016, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility

Management is responsible for the preparation and fair presentation of these separate interim financial statements in accordance with Korean International Financial Reporting Standards ("K-IFRS") No.1034 *Interim Financial Reporting*, and for such internal control as management determines is necessary to enable the preparation of separate interim financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' review responsibility

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

We conducted our reviews in accordance with the Review Standards for Quarterly and Semi-annual Financial Statements established by the Securities and Futures Commission of the Republic of Korea. A review of separate interim financial statements 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 Korean Standards on Auditing 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 that the accompanying separate interim financial statements referred to above are not prepared, in all material respects, in accordance with K-IFRS No.1034 *Interim Financial Reporting*.

The accompanying separate interim financial statements as of March 31, 2017 and for the three-month period ended March 31, 2017 have been translated into United States dollars solely for the convenience of the reader and such translation does not comply with K-IFRS. We have reviewed the translation and nothing came to our attention that causes us to believe that the separate interim financial statements expressed in Korean won have not been translated into dollars on the basis set forth in note 4 to the separate interim financial statements.

Other matters

The procedures and practices utilized in the Republic of Korea to review such separate interim financial statements may differ from those generally accepted and applied in other countries.

The separate statement of financial position of the Company as of December 31, 2016, and the related separate statements of comprehensive income, changes in equity and cash flows for the year then ended, which are not accompanying this report, were audited by us in accordance with Korean Standards on Auditing and our report thereon, dated February 24, 2017, expressed an unqualified opinion. The accompanying separate statement of financial position of the Company as of December 31, 2016, presented for comparative purposes, is consistent, in all material respects, with the audited separate financial statements from which it has been derived.

KPMG Samjong Accounting Corp.
Seoul, Korea
May 15, 2017

This report is effective as of May 15, 2017, 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 the above review report has not been updated to reflect the impact of such subsequent events or circumstances, if any.

KT&G CORPORATION
Separate Interim Statements of Financial Position
(Unaudited)

As of March 31, 2017 and December 31, 2016

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	March 31, 2017 Korean won	March 31, 2017 U.S. dollars (note 4)	December 31, 2016 Korean won
Assets				
Property, plant and equipment	5	₩ 1,169,655	\$ 1,047,984	₩ 1,117,268
Intangible assets	6	28,101	25,178	28,928
Investment property	7,16	332,871	298,245	335,196
Investments in associates and joint ventures	8	58,230	52,173	58,230
Investments in subsidiaries	9	1,225,459	1,097,983	1,154,925
Available-for-sale financial assets	10,31	370,930	332,345	364,305
Long-term deposits in MSA Escrow Fund	11,31,33	485,907	435,361	503,592
Long-term prepaid expenses		5,062	4,535	5,398
Other financial assets	14,31	66,340	59,439	-
Long-term trade and other receivables	12,24,30,31	62,777	56,247	68,017
Total non-current assets		3,805,332	3,409,490	3,635,859
Inventories	13	867,372	777,145	914,702
Current available-for-sale financial assets	10,31	-	-	1,500
Current other financial assets	14,31,32	810,000	725,741	1,620,000
Prepaid tobacco excise and other taxes		438,463	392,853	439,413
Trade and other receivables	12,24,30,31	1,235,847	1,107,290	1,140,598
Advance payments		15,524	13,909	22,272
Prepaid expenses		4,603	4,125	5,733
Cash and cash equivalents	14,31,32	948,746	850,055	688,735
Total current assets		4,320,555	3,871,118	4,832,953
Total assets		₩ 8,125,887	\$ 7,280,608	₩ 8,468,812

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Financial Position, Continued

(Unaudited)

As of March 31, 2017 and December 31, 2016

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	March 31, 2017 Korean won	March 31, 2017 U.S. dollars (note 4)	December 31, 2016 Korean won
Equity				
Ordinary shares	1,17	₩ 954,959	\$ 855,622	₩ 954,959
Other capital surplus	17	3,582	3,210	3,582
Treasury shares	18	(328,157)	(294,021)	(328,157)
Gain on reissuance of treasury shares	18	513,776	460,331	513,776
Reserves	19	4,985,205	4,466,629	4,366,268
Retained earnings	20	252,720	226,431	1,068,469
Total equity		6,382,085	5,718,202	6,578,897
Liabilities				
Long-term trade and other payables	16,21,30,31	10,351	9,275	6,848
Long-term advance receipts		460	412	319
Net defined benefit liability	23	54,444	48,780	47,121
Deferred income tax liabilities		82,905	74,281	73,328
Total non-current liabilities		148,160	132,748	127,616
Short-term borrowings	22,31,32	3,353	3,004	3,851
Trade and other payables	21,30,31	941,209	843,302	436,270
Advance receipts		1,434	1,285	972
Income tax payable		51,628	46,257	174,192
Tobacco excise and other taxes payable		598,018	535,810	1,147,014
Total current liabilities		1,595,642	1,429,658	1,762,299
Total liabilities		1,743,802	1,562,406	1,889,915
Total equity and liabilities		₩ 8,125,887	\$ 7,280,608	₩ 8,468,812

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION
 Separate Interim Statements of Comprehensive Income
 (Unaudited)

For the three-month periods ended March 31, 2017 and 2016

<i>In millions of won and thousands of U.S. dollars, except earnings per share</i>	<i>Note</i>	2017 Korean won	2017 U.S. dollars (note 4)	2016 Korean won
Sales:	24,30,33			
Manufacture of tobacco		₩ 662,754	\$ 593,812	₩ 656,276
Real estate		33,332	29,865	19,957
Exports of leaf tobacco and others		29,904	26,793	24,999
		725,990	650,470	701,232
Cost of sales:	24,25,30			
Manufacture of tobacco		(221,717)	(198,653)	(212,726)
Real estate		(19,166)	(17,173)	(8,124)
Exports of leaf tobacco and others		(18,799)	(16,843)	(14,295)
		(259,682)	(232,669)	(235,145)
Gross profit		466,308	417,801	466,087
Selling, general and administrative expenses	25,30	(146,420)	(131,189)	(138,733)
Operating profit		319,888	286,612	327,354
Other income	26,30	9,659	8,654	18,590
Other expenses	26,30	(101,705)	(91,125)	(30,421)
Finance income	27,31	88,049	78,890	18,656
Finance costs	27,31	(305)	(273)	(174)
Net finance income	27	87,744	78,617	18,482
Profit before income tax		315,586	282,758	334,005
Income tax expense	28	(62,427)	(55,933)	(80,236)
Profit for the period		₩ 253,159	\$ 226,825	₩ 253,769
Other comprehensive income (loss):				
Items that will not be reclassified to profit or loss				
Remeasurements of net defined benefit liability, net of tax		₩ (439)	\$ (393)	₩ (65)
Items that are or may be reclassified subsequently to profit or loss				
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		5,022	4,499	4,335
Other comprehensive income for the period, net of tax		4,583	4,106	4,270
Total comprehensive income for the period		₩ 257,742	\$ 230,931	₩ 258,039
Earnings per share in won and U.S. dollars:				
Basic and diluted	29	₩ 2,005	\$ 1.80	₩ 2,012

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Changes in Equity

(Unaudited)

For the three-month period ended March 31, 2017

<i>In millions of won</i>		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
Balance at January 1, 2017	₩	954,959	3,582	(328,157)	513,776	4,366,268	1,068,469	6,578,897
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	253,159	253,159
Other comprehensive income (loss):								
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	(439)	(439)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	5,022	-	5,022
Total other comprehensive income (loss)		-	-	-	-	5,022	(439)	4,583
Total comprehensive income for the period		-	-	-	-	5,022	252,720	257,742
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(454,554)	(454,554)
Transfer from reserve for research and human resource development		-	-	-	-	(10,000)	10,000	-
Transfer to unconditional reserve		-	-	-	-	623,915	(623,915)	-
Total transactions with owners		-	-	-	-	613,915	(1,068,469)	(454,554)
Balance at March 31, 2017	₩	954,959	3,582	(328,157)	513,776	4,985,205	252,720	6,382,085

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Changes in Equity, Continued

(Unaudited)

For the three-month period ended March 31, 2017

In thousands of U.S. dollars (note 4)

	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
Balance at January 1, 2017	\$ 855,622	3,210	(294,021)	460,331	3,912,076	957,324	5,894,542
Total comprehensive income for the period:							
Profit for the period	-	-	-	-	-	226,825	226,825
Other comprehensive income (loss):							
Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	(393)	(393)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	4,499	-	4,499
Total other comprehensive income (loss)	-	-	-	-	4,499	(393)	4,106
Total comprehensive income for the period	-	-	-	-	4,499	226,432	230,931
Transactions with owners, recorded directly in equity:							
Dividends	-	-	-	-	-	(407,271)	(407,271)
Transfer from reserve for research and human resource development	-	-	-	-	(8,960)	8,960	-
Transfer to unconditional reserve	-	-	-	-	559,014	(559,014)	-
Total transactions with owners	-	-	-	-	550,054	(957,325)	(407,271)
Balance at March 31, 2017	\$ 855,622	3,210	(294,021)	460,331	4,466,629	226,431	5,718,202

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION

Separate Interim Statements of Changes in Equity, Continued

(Unaudited)

For the three-month period ended March 31, 2016

<i>In millions of won</i>		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserves	Retained earnings	Total equity
Balance at January 1, 2016	₩	954,959	3,582	(337,062)	494,648	3,784,467	995,886	5,896,480
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	253,769	253,769
Other comprehensive loss:								
Remeasurements of net defined benefit liability, net of tax		-	-	-	-	-	(65)	(65)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		-	-	-	-	4,335	-	4,335
Total other comprehensive loss		-	-	-	-	4,335	(65)	4,270
Total comprehensive income for the period		-	-	-	-	4,335	253,704	258,039
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(428,284)	(428,284)
Donation of treasury shares		-	-	5,290	10,544	-	-	15,834
Transfer from reserve for research and human resource development		-	-	-	-	(10,000)	10,000	-
Transfer to unconditional reserve		-	-	-	-	577,603	(577,603)	-
Total transactions with owners		-	-	5,290	10,544	567,603	(995,887)	(412,450)
Balance at March 31, 2016	₩	954,959	3,582	(331,772)	505,192	4,356,405	253,703	5,742,069

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION
 Separate Interim Statements of Cash Flows
 (Unaudited)

For the three-month periods ended March 31, 2017 and 2016

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2017 Korean won	2017 U.S. dollars (note 4)	2016 Korean won
Cash flows from operating activities				
Cash generated from operations	34	₩ (253,468)	\$ (227,102)	₩ 174,014
Income tax paid		(75,269)	(67,438)	(86,735)
Net cash provided by (used in) operating activities		(328,737)	(294,540)	87,279
Cash flows from investing activities				
Interest received	34	13,902	12,456	10,403
Investment income received				
from long-term deposits in MSA Escrow Fund		46	41	614
Dividends received		2,454	2,199	2,550
Proceeds from sale of property, plant and equipment		8	7	163
Proceeds from sale of intangible assets		1,350	1,210	-
Proceeds from investments in associates and joint ventures		-	-	13,095
Proceeds from investments in subsidiaries		17,724	15,880	-
Collection of loans		3,520	3,154	2,521
Withdrawal of guarantee deposits		8,095	7,254	6,397
Acquisition of property, plant and equipment		(76,631)	(68,659)	(20,514)
Acquisition of intangible assets		(96)	(86)	(121)
Acquisition of investments in subsidiaries		(97,202)	(87,091)	-
Payments of guarantee deposits		(11,660)	(10,448)	(12,796)
Payments of long-term deposits in MSA Escrow Fund		(19,709)	(17,659)	(21,793)
Decrease in current other financial assets		743,660	666,302	130,000
Net cash provided by investing activities		585,461	524,560	110,519
Cash flows from financing activities				
Increase in deposits received	34	4,138	3,708	568
Decrease in deposits received		(489)	(438)	(1,440)
Net cash provided by (used in) financing activities		3,649	3,270	(872)
Effect of exchange rate fluctuation on cash held		(362)	(326)	(357)
Net increase in cash and cash equivalents		260,011	232,964	196,569
Cash and cash equivalents at January 1		688,735	617,091	444,376
Cash and cash equivalents at March 31		₩ 948,746	\$ 850,055	₩ 640,945

See accompanying notes to the separate interim financial statements.

KT&G CORPORATION
Notes to the Separate Interim Financial Statements
(Unaudited)

For the three-month periods ended March 31, 2017 and 2016

1. Organization and Description of Business

KT&G Corporation (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 Act 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 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, 2017, the Company has three manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 123 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 at 71, Beotkkot-gil, 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 split 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.

The ownership of the Company's issued ordinary shares as of March 31, 2017 is held as follows:

Shareholder	Number of shares	Percentage of ownership
National Pension Service	11,958,664	8.71%
Industrial Bank of Korea	9,510,485	6.93%
Employee Share Ownership Association	2,917,885	2.13%
Treasury shares	11,027,370	8.03%
Others	101,878,093	74.20%
	137,292,497	100.00%

KT&G CORPORATION
Notes to the Separate Interim Financial Statements
(Unaudited)

For the three-month periods ended March 31, 2017 and 2016

2. Basis of Preparation

(a) Statement of Compliance

The separate interim financial statements have been prepared in accordance with Korean International Financial Reporting Standards ("K-IFRS") as prescribed in *the Act on External Audits of Corporations*.

These separate interim financial statements were prepared in accordance with K-IFRS No. 1034 *Interim Financial Reporting* as part of the period covered by the Company's K-IFRS annual separate financial statements.

These interim financial statements are separate interim financial statements prepared in accordance with K-IFRS No.1027 *Separate Financial Statements* presented by a parent, an investor in an associate or a venture in a jointly controlled entity, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the reported results and net assets of the investees.

The separate interim financial statements were authorized for issue by the Board of Directors on April 27, 2017.

(b) Basis of Measurement

The separate interim financial statements have been prepared on the historical cost basis, except for the following material items in the separate interim statements of financial position:

- Available-for-sale financial assets measured at fair value
- Liabilities for defined benefit plans recognized at the net of the total present value of defined benefit obligations less the fair value of plan assets

(c) Functional and Presentation Currency

These separate interim financial statements are presented in Korean won, which is the Company's functional currency and the currency of the primary economic environment in which the Company operates.

(d) Use of Estimates and Judgments

The preparation of the separate interim financial statements in conformity with K-IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

In preparing these separate interim financial statements, the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the financial statements as of and for the year ended December 31, 2016.

KT&G CORPORATION
Notes to the Separate Interim Financial Statements
(Unaudited)

For the three-month periods ended March 31, 2017 and 2016

3. Significant Accounting Policies

The significant accounting policies applied by the Company in preparation of its separate interim financial statements are included below. The accounting policies set out below have been applied consistently to all periods presented in these separate interim financial statements.

(a) Subsidiaries, Associates and Joint Ventures in the Separate Financial Statements

These separate interim financial statements are prepared and presented in accordance with K-IFRS No.1027. The Company applied the cost method to investments in subsidiaries, associates and joint ventures in accordance with K-IFRS No. 1027. Dividends from a subsidiaries, associates and joint ventures are recognized in profit or loss when the right to receive the dividend is established.

(b) Property, Plant and Equipment

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

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

Property, plant and equipment, except for land and other tangible fixed assets, are depreciated on a straight-line basis over estimated useful lives that appropriately reflect the pattern in which the asset’s future economic benefits are expected to be consumed.

The estimated useful lives of the Company’s assets are as follows:

	Useful lives (years)		Useful lives (years)
Buildings	10 ~ 60	Vehicles	4
Structures	10 ~ 40	Tools	4
Machinery	10 ~ 12	Furniture and fixtures	4

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 in other income and expense in the statement of comprehensive income.

KT&G CORPORATION
Notes to the Separate Interim Financial Statements
(Unaudited)

For the three-month periods ended March 31, 2017 and 2016

3. Significant Accounting Policies, Continued

(c) Borrowing Costs

The Company capitalizes borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Other borrowing costs are recognized in expense as incurred. A qualifying asset is an asset that requires a substantial period of time to get ready for its intended use or sale. Financial assets and inventories that are manufactured or otherwise produced over a short period of time are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets.

To the extent that the Company borrows funds specifically for the purpose of obtaining a qualifying asset, the Company determines the amount of borrowing costs eligible for capitalization as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings. The Company immediately recognizes other borrowing costs as an expense. To the extent that the Company borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the Company determines the amount of borrowing costs eligible for capitalization by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Company that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that the Company capitalizes during a period does not exceed the amount of borrowing costs incurred during that period.

(d) Government Grants

Government grants are not recognized unless there is reasonable assurance that the Company will comply with the grant's conditions and that the grant will be received. Government grants which are intended to compensate the Company for expenses incurred are recognized as other income in profit or loss over the periods in which the Company recognizes the related costs as expenses.

(e) Intangible Assets

Intangible assets are measured initially at cost and, subsequently, are carried at cost less accumulated amortization and accumulated impairment losses. Intangible assets consist of industrial property rights, facility usage rights and intangible assets under development. 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 industrial property rights and facility usage rights are expected to be available for use, these intangible assets are regarded as having indefinite useful lives and not amortized.

The estimated useful lives are as follows:

	Useful lives (years)
Industrial property rights	10 ~ 20 or indefinite
Facility usage rights	indefinite

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

KT&G CORPORATION
Notes to the Separate Interim Financial Statements
(Unaudited)

For the three-month periods ended March 31, 2017 and 2016

3. Significant Accounting Policies, Continued

(f) Investment Property

Property held for the purpose of earning rentals or benefiting from capital appreciation is classified as investment property. Investment property is initially measured at its cost. Transaction costs are included in the initial measurement. Subsequently, investment property is carried at depreciated cost less any accumulated impairment losses.

Subsequent costs are recognized in the carrying amount of investment property at cost or, if appropriate, as separate items if 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. The costs of the day-to-day servicing are recognized in profit or loss as incurred.

Investment property except for land, are depreciated on a straight-line basis over 10 ~ 60 years as estimated useful lives.

Depreciation methods, useful lives and residual values are reviewed at the end of each reporting period and adjusted, if appropriate. The change is accounted for as a change in an accounting estimate.

(g) Non-current Assets Held for Sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. In order to be classified as held for sale, the asset (or disposal group) must be available for immediate sale in its present condition and its sale must be highly probable. The assets or disposal group that are classified as non-current assets held for sale are measured at the lower of their carrying amount and fair value less cost to sell.

The Company recognizes an impairment loss for any initial or subsequent write-down of an asset (or disposal group) to fair value less costs to sell, and a gain for any subsequent increase in fair value less costs to sell, up to the cumulative impairment loss previously recognized in accordance with K-IFRS No. 1036 *Impairment of Assets*.

A non-current asset that is classified as held for sale or part of a disposal group classified as held for sale is not depreciated (or amortized).

(h) 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 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.

KT&G CORPORATION
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(Unaudited)

For the three-month periods ended March 31, 2017 and 2016

3. Significant Accounting Policies, Continued

(h) Inventories, Continued

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 consumed within 12 months are ₩312,122 million and ₩314,457 million, respectively, as of March 31, 2017 and December 31, 2016.

(i) Impairment of Non-financial Assets

The carrying amounts of the Company's non-financial assets, other than inventories, deferred tax assets, assets arising from employee benefits and non-current assets held for sale, are reviewed at the end of the reporting period to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, irrespective of whether there is any indication of impairment, are tested for impairment annually by comparing their recoverable amount to their carrying amount.

The Company estimates the recoverable amount of an individual asset. If it is impossible to measure the individual recoverable amount of an asset, then the Company estimates the recoverable amount of cash-generating unit ("CGU"). A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. The value in use is estimated by applying a pre-tax discount rate that reflect current market assessments of the time value of money and the risks specific to the asset or CGU for which estimated future cash flows have not been adjusted, to the estimated future cash flows expected to be generated by the asset or CGU.

An impairment loss is recognized if the carrying amount of an asset or a CGU exceeds its recoverable amount. Impairment losses are recognized in profit or loss.

(j) Non-derivative Financial Assets

The Company recognizes and measures non-derivative financial assets by the following four categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets. The Company recognizes financial assets in the statement of financial position when the Company becomes a party to the contractual provisions of the instrument.

Upon initial recognition, non-derivative financial assets are measured at their fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the asset's acquisition or issuance.

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3. Significant Accounting Policies, Continued

(j) Non-derivative Financial Assets, Continued

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

A financial asset is classified as financial assets are classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition, transaction costs are recognized in profit or loss when incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

(ii) Held-to-maturity investments

A non-derivative financial asset with a fixed or determinable payment and fixed maturity, for which the Company has the positive intention and ability to hold to maturity, are classified as held-to-maturity investments. Subsequent to initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method.

(iii) Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method except for loans and receivables of which the effect of discounting is immaterial.

(iv) Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables. Subsequent to initial recognition, they are measured at fair value, which changes in fair value, net of any tax effect, recorded in other comprehensive income in equity. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments are measured at cost.

(v) De-recognition of financial assets

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

If the Company retains substantially all the risks and rewards of ownership of the transferred financial assets, the Company continues to recognize the transferred financial assets and recognizes financial liabilities for the consideration received.

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3. Significant Accounting Policies, Continued

(j) Non-derivative Financial Assets, Continued

- (vi) Offsetting between financial assets and financial liabilities

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

(k) Derivative Financial Instruments

Derivatives are initially recognized at fair value. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are recognized immediately in profit or loss.

Embedded derivatives are separated from the host contract and accounted for separately only if the following criteria have been met:

- the economic characteristics and risks of the embedded derivative are not closely related to those of the host contract
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative and
- the hybrid instrument is not measured at fair value with changes in fair value recognized in profit or loss.

Changes in the fair value of separable embedded derivatives are recognized immediately in profit or loss.

(l) Impairment of Financial Assets

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably. However, losses expected as a result of future events, regardless of likelihood, are not recognized.

If financial assets have objective evidence that they are impaired, impairment losses should be measured and recognized.

- (i) Financial assets measured at amortized cost

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of its estimated future cash flows discounted at the asset's original effective interest rate. If it is not practicable to obtain the instrument's estimated future cash flows, impairment losses would be measured by using prices from any observable current market transactions. The Company can recognize impairment losses directly or establish a provision to cover impairment losses. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed either directly or by adjusting an allowance account.

KT&G CORPORATION
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(Unaudited)

For the three-month periods ended March 31, 2017 and 2016

3. Significant Accounting Policies, Continued

(l) Impairment of Financial Assets, Continued

- (ii) Financial assets carried at cost

If there is objective evidence that an impairment loss has occurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

- (iii) Available-for-sale financial assets

When a decline in the fair value of an available-for-sale financial asset has been recognized in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in other comprehensive income is reclassified from other comprehensive income to profit or loss as a reclassification adjustment even though the financial asset has not been derecognized. Impairment losses recognized in profit or loss for an investment in an equity instrument classified as available-for-sale are not reversed through profit or loss. 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, with the amount of the reversal recognized in profit or loss. For an investment in an equity security, objective evidence of impairment includes a significant or prolonged decline in its fair value below its cost. The Company considers a decline of 20% to be significant and a period of nine months to be prolonged.

(m) Cash and Cash Equivalents

Cash and cash equivalents comprise cash balances and call deposits with maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Company in the management of its short-term commitments. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares when it has a short maturity with a specified redemption date.

(n) Non-derivative Financial Liabilities

The Company classifies non-derivative financial liabilities into financial liabilities at fair value through profit or loss, financial guarantee liabilities and other financial liabilities in accordance with the substance of the contractual arrangement and the definitions of financial liabilities. The Company recognizes financial liabilities in the statement of financial position when the Company becomes a party to the contractual provisions of the financial liability.

- (i) Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading or designated as such upon initial recognition. Subsequent to initial recognition, financial liabilities at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss. Upon initial recognition, transaction costs that are directly attributable to the acquisition are recognized in profit or loss as incurred.

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For the three-month periods ended March 31, 2017 and 2016

3. Significant Accounting Policies, Continued

(n) Non-derivative Financial Liabilities, Continued

(ii) Financial guarantee liabilities

Financial guarantee liability is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified term of a debt instrument. Upon initial recognition, financial guarantee liabilities are measured at their fair value plus, transaction costs that are directly attributable to the acquisition or issue of the financial guarantee liability.

After initial recognition, an issuer of such a contract measures it at the higher of the amount determined in accordance with K-IFRS No. 1037 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognized less, when appropriate, cumulative amortisation recognized in accordance with K-IFRS No. 1018 *Revenue*.

(iii) Other financial liabilities

Non-derivative financial liabilities other than financial liabilities at fair value through profit or loss or financial guarantee liabilities are classified as other financial liabilities. At the date of initial recognition, other financial liabilities are measured at fair value minus transaction costs that are directly attributable to the acquisition. Subsequent to initial recognition, other financial liabilities are measured at amortized cost using the effective interest method.

The Company derecognizes a financial liability from the statement of financial position when it is extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

(o) Employee Benefits

(i) Short-term employee benefits

Short-term employee benefits are employee benefits that are due to be settled within 12 months after the end of the period in which the employees render the related service. When an employee has rendered service to the Company during an accounting period, the Company recognizes the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

(ii) Retirement benefits: defined contribution plans

When an employee has rendered service to the Company during a period, the Company recognizes the contribution payable to a defined contribution plan in exchange for that service as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the end of the reporting period, the Company recognizes that excess as an asset (prepaid expense) to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

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For the three-month periods ended March 31, 2017 and 2016

3. Significant Accounting Policies, Continued

(o) Employee Benefits, Continued

(iii) Retirement benefits: defined benefit plans

The calculation of defined benefit obligations is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a potential asset for the Company, the recognized asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in other comprehensive income. The Company determines the net interest expense (income) on the net defined benefit liability (asset) for the year by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in profit or loss. The Company recognizes gains and losses on the settlement of a defined benefit plan when the settlement occurs.

(iv) Termination benefits

Termination benefits are expensed at the earlier of when the Company can no longer withdraw the offer of those benefits and when the Company recognizes costs for a restructuring. If benefits are not expected to be settled wholly within 12 months of the end of the reporting period, then they are discounted.

(p) Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The risks and uncertainties that inevitably surround many events and circumstances are taken into account in reaching the best estimate of a provision. Where the effect of the time value of money is material, provisions are determined at the present value of the expected future cash flows.

Where some or all of the expenditures required to settle a provision are expected to be reimbursed by another party, the reimbursement shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset.

Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimates. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision is reversed.

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3. Significant Accounting Policies, Continued

(q) Equity Capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issuance of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects.

When the Company repurchases its share capital, the amount of the consideration paid is recognized as a deduction from equity and classified as treasury shares. The profits or losses from the purchase, disposal, reissue, or retirement of treasury shares are not recognized as current profit or loss. If the Company acquires and retains treasury shares, the consideration paid or received is directly recognized in equity.

(r) Revenue Recognition

The Company's revenue categories consist of goods sold, services and other income.

Revenue from sales 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, 2017 and 2016 were ₩ 1,376,736 million and ₩1,421,610 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 completions is assessed by reference to surveys of work performed. Meanwhile, profits from an apartment house for self-installment sales is recognized on percentage-of-completion method according to Q&A of Korea Accounting Institute, called namely 2011-I-KQA. This accounting treatment is valid only under the K-IFRS as stated in subclause1 of clause 1, Article 13 of *the Act on External Audit of Stock companies*.

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

Rental income from investment property, net of lease incentives granted, is recognized in profit or loss on a straight-line basis over the term of the lease.

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3. Significant Accounting Policies, Continued

(s) Finance Income and Finance Costs

Finance income comprises interest income on funds invested (including available-for-sale financial assets), dividend income and investment income on long-term deposits in MSA Escrow Fund. Interest income is recognized as it accrues in profit or loss, using the effective interest method. Dividend income is recognized in profit or loss on the date that the Company's right to receive payment is established.

Finance costs is interest expense on unwinding of the discount on trade and other payables which is recognized in profit or loss using the effective interest method.

(t) Income Taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

(i) Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the end of the reporting period and any adjustment to tax payable in respect of previous years. The taxable profit is different from the accounting profit for the year since the taxable profit is calculated excluding the temporary differences, which will be taxable or deductible in determining taxable profit (tax loss) of future periods, and non-taxable or non-deductible items from the accounting profit.

(ii) Deferred tax

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. The Company recognizes a deferred tax asset for all deductible temporary differences to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

The carrying amount of a deferred tax asset is reviewed at the end of each reporting period and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Company expects, at the end of the reporting period to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset only if there is a legally enforceable right to offset the related current tax liabilities and assets, and they relate to income taxes levied by the same tax authority and they intend to settle current tax liabilities and assets on a net basis

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3. Significant Accounting Policies, Continued

(u) Foreign Currencies

Transactions in foreign currencies are translated to the respective functional currencies of the Company at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency using the reporting date's exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

Foreign currency differences arising on retranslation are recognized in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation, or qualifying cash flow hedges, which are recognized in other comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(v) Earnings per Share

The Company presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares.

(w) Operating Segment

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Company's other components. All operating segments' operating results are reviewed regularly by the Company's chief executive officer to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

Operating segment disclosures are included in the consolidated financial statements in accordance with K-IFRS No. 1108 *Operating Segments*.

(X) New Standards and Interpretations Not Yet Adopted

The following new standards are issued and earlier application is permitted; however, the Company has not early adopted the following new standards and interpretations in preparing these separate interim financial statements.

K-IFRS No. 1109 *Financial Instruments*

K-IFRS No. 1109 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

It replaces the existing guidance in K-IFRS No. 1039 *Financial Instruments: Recognition and Measurement*. K-IFRS No. 1109 includes revised guidance on the classification and measurement of financial instruments, a new expected credit loss model for calculating impairment on financial assets, and new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from K-IFRS No. 1039.

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3. Significant Accounting Policies, Continued

(X) New Standards and Interpretations Not Yet Adopted, Continued

K-IFRS No. 1115 *Revenue from Contracts with Customers*

K-IFRS No. 1115 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. It replaces existing revenue recognition guidance, including K-IFRS No. 1018 *Revenue*, K-IFRS No. 1011 *Construction Contracts*, K-IFRS No. 2031 *Revenue—Barter Transactions Involving Advertising Services*, K-IFRS No. 2113 *Customer Loyalty Programmes*, K-IFRS No. 2115 *Agreements for the Construction of Real Estate* and K-IFRS No. 2118 *Transfers of Assets from Customers*. K-IFRS No. 1115 establishes a comprehensive framework for determining whether, how much and when revenue is recognized.

The Company currently plans to apply K-IFRS No. 1109 and K-IFRS No. 1115 initially on January 1, 2018. The actual impact of adopting those new standards will be dependent on the financial instruments that the Company holds and economic conditions at that time as well as accounting elections and judgements that it will make in the future. The Company is assessing the potential impact on its separate financial statements resulting from the application of those new standards and expects to disclose additional quantitative information in the separate financial statements for the year ended December 31, 2017.

4. Basis of Translating Financial Statements

The separate interim financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩1,116.10 to \$1, the basic exchange rate on March 31, 2017 posted by Seoul Money Brokerage Services, solely for the convenience of the reader. This translation does not comply with K-IFRS and 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.

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5. Property, Plant and Equipment

- (a) Details of property, plant and equipment as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>	March 31 2017			December 31 2016		
	Cost	Accumulated depreciation	Carrying amount	Cost	Accumulated depreciation	Carrying amount
Land	₩ 426,215	-	426,215	426,463	-	426,463
Buildings	691,112	(341,447)	349,665	689,658	(335,706)	353,952
Structures	45,622	(31,491)	14,131	45,467	(30,987)	14,480
Machinery	1,027,677	(827,499)	200,178	1,023,827	(816,628)	207,199
Vehicles	2,433	(1,963)	470	2,293	(1,933)	360
Tools	39,356	(34,618)	4,738	39,406	(34,051)	5,355
Furniture and fixtures	169,544	(128,969)	40,575	166,700	(124,394)	42,306
Others	1,681	-	1,681	1,681	-	1,681
Construction-in-progress	132,002	-	132,002	65,472	-	65,472
	₩ 2,535,642	(1,365,987)	1,169,655	2,460,967	(1,343,699)	1,117,268

- (b) Changes in property, plant and equipment for the three-month period ended March 31, 2017 were as follows:

<i>In millions of won</i>	January 1 2017	Acquisition	Disposal	Depreciation	Transfer of construction- in-progress	Transfer to investment property	March 31 2017
Land	₩ 426,463	-	-	-	-	(248)	426,215
Buildings	353,952	399	-	(6,371)	1,825	(140)	349,665
Structures	14,480	172	-	(507)	(12)	(2)	14,131
Machinery	207,199	1,293	-	(10,874)	2,560	-	200,178
Vehicles	360	148	-	(38)	-	-	470
Tools	5,355	31	(28)	(620)	-	-	4,738
Furniture and fixtures	42,306	2,969	-	(4,700)	-	-	40,575
Others	1,681	-	-	-	-	-	1,681
Construction-in-progress	65,472	70,903	-	-	(4,373)	-	132,002
	₩ 1,117,268	75,915	(28)	(23,110)	-	(390)	1,169,655

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5. Property, Plant and Equipment, Continued

(c) Changes in property, plant and equipment for the year ended December 31, 2016 were as follows:

<i>In millions of won</i>	January 1 2016	Acquisition	Disposal	Depreciation	Transfer of construction- in-progress	Other changes	December 31 2016
Land	₩ 467,590	184	(1,685)	-	62,071	(101,697)	426,463
Buildings	385,418	691	(1,336)	(26,772)	101,183	(105,232)	353,952
Structures	15,901	718	(11)	(2,147)	345	(326)	14,480
Machinery	215,984	1,871	(1,349)	(48,013)	38,706	-	207,199
Vehicles	356	339	(165)	(171)	1	-	360
Tools	5,554	1,431	(56)	(2,397)	823	-	5,355
Furniture and fixtures	33,509	24,676	(5,031)	(16,697)	5,849	-	42,306
Others	1,366	9	-	-	306	-	1,681
Construction-in-progress	183,954	90,838	-	-	(209,284)	(36)	65,472
	₩ 1,309,632	120,757	(9,633)	(96,197)	-	(207,291)	1,117,268

For the year ended December 31, 2016, the Company received ₩289 million of government grant related with acquisition of buildings and furniture and fixtures.

For the year ended December 31, 2016, land, buildings and structures with a carrying amount of ₩207,255 million were transferred to investment property and construction-in-progress with a carrying amount of ₩36 million were transferred to intangible assets.

6. Intangible Assets

(a) Details of intangible assets as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>		March 31 2017			December 31 2016		
		Cost	Accumulated amortization	Carrying amount	Cost	Accumulated amortization	Carrying amount
Industrial property rights	₩	7,797	(5,563)	2,234	7,718	(5,556)	2,162
Facility usage rights		24,015	(1,708)	22,307	24,914	(1,708)	23,206
Intangible assets under development		3,560	-	3,560	3,560	-	3,560
	₩	35,372	(7,271)	28,101	36,192	(7,264)	28,928

(b) Changes in intangible assets for the three-month period ended March 31, 2017 were as follows:

<i>In millions of won</i>	January 1 2017	Acquisition	Disposal	Amortization	March 31 2017
Industrial property rights	₩ 2,162	79	-	(7)	2,234
Facility usage rights	23,206	17	(916)	-	22,307
Intangible assets under development	3,560	-	-	-	3,560
	₩ 28,928	96	(916)	(7)	28,101

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6. Intangible Assets, Continued

(c) Changes in intangible assets for the year ended December 31, 2016 were as follows:

<i>In millions of won</i>		January 1 2016	Acquisition	Disposal	Transfer from property, plant and equipment	Amortization	December 31 2016
Industrial property rights	₩	1,462	721	-	-	(21)	2,162
Facility usage rights		17,472	6,189	(491)	36	-	23,206
Intangible assets under development		3,560	-	-	-	-	3,560
	₩	22,494	6,910	(491)	36	(21)	28,928

(d) Expenditures not capitalized for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>		2017	2016
Cost of sales	₩	18	136
Selling, general and administrative expenses		2,489	1,826
	₩	2,507	1,962

7. Investment Property

(a) Details of investment property as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>		March 31 2017			December 31 2016		
		Cost	Accumulated depreciation	Carrying amount	Cost	Accumulated depreciation	Carrying amount
Land	₩	125,011	-	125,011	124,763	-	124,763
Buildings		279,760	(71,900)	207,860	279,520	(69,087)	210,433
	₩	404,771	(71,900)	332,871	404,283	(69,087)	335,196

(b) Changes in investment property for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>In millions of won</i>		2017			2016		
		Land	Buildings	Total	Land	Buildings	Total
Beginning balance	₩	124,763	210,433	335,196	23,066	113,735	136,801
Depreciation		-	(2,715)	(2,715)	-	(8,860)	(8,860)
Transfer from property, plant and equipment		248	142	390	101,697	105,558	207,255
Ending balance	₩	125,011	207,860	332,871	124,763	210,433	335,196

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7. Investment Property, Continued

- (c) The amounts recognized in profit or loss from investment property for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>		2017	2016
Rental income	₩	10,852	8,907
Direct operating expense		(2,715)	(1,523)
	₩	8,137	7,384

- (d) The carrying amount and the fair value of investment property as of March 31, 2017 and December 31, 2016 were as follows:

<i>In millions of won</i>		March 31 2017		December 31 2016	
		Fair value	Carrying amount	Fair value	Carrying amount
Land	₩	587,391	125,011	532,420	124,763
Buildings		251,099	207,860	227,030	210,433
	₩	838,490	332,871	759,450	335,196

The fair value of investment property was determined based on the yield capitalization method by external, independent valuers. The fair value measurement for all of the investment properties has been categorized as a level 3 fair value based on the inputs to the valuation techniques used.

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8. Investments in Associates and Joint Ventures

Investments in associates and joint ventures as of March 31, 2017 and December 31, 2016 are summarized as follows:

In millions of won

Company	Location	Principal operation	March 31 2017		December 31 2016	
			Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	20.24%	₩ 1,830	20.24%	₩ 1,830
KVG REIT 1 Co., Ltd.	Korea	Renting real estate	29.67%	7,300	29.67%	7,300
JR REIT V Co., Ltd.	Korea	Renting real estate	34.63%	5,600	34.63%	5,600
JR REIT VIII Co., Ltd.	Korea	Renting real estate	21.74%	10,000	21.74%	10,000
LSK Global Pharma Services Co., Ltd.	Korea	Researching and developing medicine	23.15%	-	23.15%	-
JR REIT X Co., Ltd.	Korea	Renting real estate	28.79%	9,500	28.79%	9,500
JR REIT XIII Co., Ltd.	Korea	Renting real estate	27.03%	5,000	27.03%	5,000
KB Gimpo Logistics CR REIT Co., Ltd. ^(*)	Korea	Renting real estate	12.00%	3,000	12.00%	3,000
KORAMCO Private REIT 50 Fund ^(**)	Korea	Renting real estate	84.21%	16,000	84.21%	16,000
				₩ 58,230		₩ 58,230

(*) KB Gimpo Logistics CR REIT Co., Ltd is classified as a joint venture since decisions about the significant financial and operating policy of the investee cannot be made without unanimous consent of the parties, holding 12% shares each, as the voting power of 76% shares held by the collective investment business entity is not entitled to have an impact on a resolution of the investee by the *Financial Investment Services and Capital Markets Act*.

(**) KORAMCO Private REIT 50 Fund is classified as a joint venture since decisions about the significant financial and operating policy of the investee cannot be made without unanimous consent of the parties that control the arrangement collectively.

In 2016, the Company made an investment of ₩3,000 million and ₩16,000 million in KB Gimpo Logistics CR REIT Co., Ltd and KORAMCO Private REIT 50 Fund, respectively.

In 2016, the Company recognized ₩6,095 million of gain on sale of investments in associates and joint ventures as KOCREF REIT 17 Co., Ltd. was liquidated.

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9. Investments in Subsidiaries

Investments in subsidiaries as of March 31, 2017 and December 31, 2016 are summarized as follows:

In millions of won

Company	Location	Principal operation	March 31 2017		December 31 2016	
			Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00%	₩ 716,148	100.00%	₩ 716,148
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceutical	52.45%	73,299	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%	30,049	99.99%	30,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf tobaccos	99.99%	2,891	99.99%	2,891
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
KGC Life & Gin Co., Ltd.	Korea	Selling ginseng door-to-door	-	-	-	-
KT&G USA Corporation	USA	Selling tobaccos	100.00%	4,913	100.00%	4,913
Cosmococ Co., Ltd.	Korea	Manufacturing and selling cosmetics	98.56%	103,637	98.49%	98,093
Renzoluc Pte., Ltd. (*)	Singapore	Manufacturing and selling tobaccos	100.00%	97,202	100.00%	-
KT&G Life Sciences Corporation	Korea	Researching and developing medicine	-	-	34.03%	15,852
KGC Yebon Corporation	Korea	Manufacturing and selling medical herbs	100.00%	49,828	100.00%	49,828
K-Q HongKong I, Limited	HongKong	Manufacturing and selling ginseng	-	-	100.00%	17,761
PT KT&G Indonesia	Indonesia	Manufacturing and selling tobaccos	99.99%	-	99.99%	-
K&I HK Co., Ltd.	HongKong	Selling cosmetics	-	-	100.00%	11
K&I China Co., Ltd.	China	Selling cosmetics	-	-	100.00%	5,532
SangSang Stay, Inc.	Korea	Hotel	100.00%	20,000	100.00%	20,000
KT&G Global Rus L.L.C.	Russia	Selling tobaccos	100.00%	1,497	100.00%	1,497
				₩1,225,459		₩1,154,925

(*) The Company's percentage of ownership, shown above, excludes redeemable convertible preferred shares. As of March 31, 2017, the Company's percentage of ownership would be 85.5%, if preferred shares are included.

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9. Investments in Subsidiaries, Continued

For the three-month period ended March 31, 2017, the Company acquired ₩97,202 million of additional shares of Renzoluc Pte., Ltd.

For the three-month period ended March 31, 2017, the Company made a capital contribution in-kind to Cosmococ Co., Ltd. by transferring its interest in K&I HK Co., Ltd. and K&I China Co., Ltd., increasing its ownership from 98.49% to 98.56%. The Company measured the additional interest in Cosmococ Co., Ltd. at the carrying amount of its investment in K&I HK Co., Ltd. and K&I China Co., Ltd., considering the transaction did not have a discernible effect on the Company's economics.

KT&G Life Sciences Corporation, a subsidiary of the Company was merged into Yungjin Pharm. Ind. Co., Ltd. as of January 13, 2017. For the three-month period ended March 31, 2017, the Company recognized ₩8,908 million of loss on disposal of investments in subsidiaries to recognize the difference between consideration transferred for fair value of Yungjin Pharm. Ind. Co., Ltd.'s shares and book value of interests in KT&G Life Sciences Corporation.

For the three-month period ended March 31, 2017, the Company recognized ₩37 million of loss on disposal of investments in subsidiaries as K-Q HongKong I, Limited was liquidated.

For the year ended December 31, 2016, the Company acquired ₩27,417 million of additional shares of Cosmococ Co., Ltd. as a result of the conversion of its redeemable convertible preferred shares, increasing its ownership from 97.73% to 98.49%.

For the year ended December 31, 2016, redeemable convertible preferred shares of KT&G Life Sciences Corporation were converted and the Company acquired ₩1,565 million of additional shares of the investee, decreasing its ownership interest to 34.03% from 73.94%. As of January 13, 2017, KT&G Life Sciences Corporation was merged into Yungjin Pharm. Ind. Co., Ltd.

For the year ended December 31, 2016, the Company made a capital contribution in-kind of its interest in KGC Life & Gin Co., Ltd. to Korea Ginseng Corporation and measured the additional interest in Korea Ginseng Corporation at the carrying amount of its investment in KGC Life & Gin Co., Ltd., considering the transaction did not have a discernible effect on the Company's economics.

For the year ended December 31, 2016, the Company established KT&G Global Rus L.L.C.

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10. Available-for-sale Financial Assets

- (a) Changes in available-for-sale financial assets for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>In millions of won</i>	2017	2016
Beginning balance	₩ 365,805	340,149
Acquisitions	-	31,000
Net changes in fair value	7,179	28,643
Disposals or reclassification	(2,054)	(33,987)
Ending balance	₩ 370,930	365,805
Statement of financial position:		
Current	₩ -	1,500
Non-current	370,930	364,305
	₩ 370,930	365,805

For the three-month period ended March 31, 2017, the Company reclassified ₩2,054 million of investment in the debt security of LSK Global Pharma Services Co., Ltd., whose maturity has been expired, to loans. The Company recognized ₩554 million of gain on sale of available-for-sale financial assets difference between the fair value and the carrying amount of the investment.

For the year ended December 31, 2016, the Company recognized ₩13,988 million of gain on sale of available-for-sale financial assets upon liquidation of Mastern 2 REIT Co., Ltd.

For the year ended December 31, 2016, the Company recognized ₩4,077 million of impairment loss on its investment in an equity instrument of Rexahn Pharmaceuticals, Inc. as there was a significant and prolonged decline in the fair value below its cost.

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10. Available-for-sale Financial Assets, Continued

(b) Available-for-sale financial assets as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>	March 31 2017	December 31 2016
Available-for-sale debt instruments:		
Corporate bonds	₩ -	1,500
Available-for-sale equity instruments:		
Listed		
– Oscotech, Inc.	3,226	3,775
– Shinhan Financial Group Co., Ltd.	186,789	181,378
– Rexahn Pharmaceuticals, Inc.	3,638	1,081
– U&I Corporation	12,127	14,060
	205,780	200,294
Unlisted	165,150	164,011
Total available-for-sale equity instruments	370,930	364,305
Total available-for-sale financial assets	₩ 370,930	365,805

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

As of March 31, 2017 and December 31, 2016, ₩31,055 million and ₩32,555 million of available-for-sale financial assets that do not have a market price in an active market and whose fair value cannot be reliably measured or is similar to their carrying amount are measured at cost, respectively.

11. Long-term Deposits in MSA Escrow Fund

Long-term deposits in MSA Escrow Fund as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>	March 31 2017	December 31 2016
Demand deposits	₩ 6,871	-
MMF	-	56,069
Treasury bill	-	21,559
Treasury note	479,036	425,964
	₩ 485,907	503,592

As discussed in note 33 to the separate interim 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. For the three-month periods ended March 31, 2017 and 2016, ₩19,709 million and ₩21,793 million were paid into long-term deposits in MSA Escrow Fund, respectively.

Long-term deposits in MSA Escrow Fund are invested in demand deposits of financial institutions or government and public bonds. Investment income on long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2017 and 2016 are ₩2,043 million and ₩2,032 million, respectively.

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12. Trade and Other Receivables

(a) Trade and other receivables as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>		March 31 2017		December 31 2016	
		Current	Non-current	Current	Non-current
Loans to employees	₩	16,641	35,789	16,687	38,853
Loans		49,973	5,501	55,644	4,230
Other receivables		180,879	4,095	104,677	4,568
Guarantee deposits		28,455	17,392	22,121	20,366
Accrued income		7,210	-	10,384	-
Trade receivables		952,689	-	931,085	-
	₩	1,235,847	62,777	1,140,598	68,017

(b) Trade and other receivables as of March 31, 2017 and December 31, 2016 have been reported in the separate statements of financial position net of allowances as follows:

<i>In millions of won</i>		March 31 2017		December 31 2016	
		Current	Non-current	Current	Non-current
Gross trade and other receivables	₩	1,296,037	73,514	1,200,737	79,643
Allowance:					
Loans		(24,518)	(10,737)	(24,194)	(11,626)
Other receivables		(11,038)	-	(11,459)	-
Accrued income		(2,155)	-	(2,333)	-
Trade receivables		(22,479)	-	(22,153)	-
		(60,190)	(10,737)	(60,139)	(11,626)
Net trade and other receivables	₩	1,235,847	62,777	1,140,598	68,017

(c) Changes in the allowance account for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>In millions of won</i>		2017	2016
Beginning balance	₩	71,765	46,186
Impairment loss		750	27,331
Reversal of impairment loss		(1,588)	(1,752)
Ending balance	₩	70,927	71,765

Impairment loss (reversal of impairment loss) on trade and other receivables is included as part of selling, general and administrative expenses and other expense (income) in the separate statements of comprehensive income.

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12. Trade and Other Receivables, Continued

- (d) The aging schedule of trade and other receivables which were past due but not impaired as of March 31, 2017 and December 31, 2016 is as follows:

<i>In millions of won</i>		March 31 2017	December 31 2016
Within 1 month	₩	39,604	43,957
Between 1 and 2 months		47,672	52,048
Beyond 2 months		220,250	257,877
	₩	307,526	353,882

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 pledged assets and guarantees in respect of some of the past due debtor balances.

- (e) Details of trade and other receivables that are measured at amortized cost as of March 31, 2017 and December 31, 2016 were as follows:

<i>In millions of won</i>			March 31 2017				December 31 2016	
	Effective interest rate		Current	Non-current	Effective interest rate		Current	Non-current
Loans to employees	1.89~5.68%	₩	16,641	35,789	1.89~5.68%	₩	16,687	38,853
Guarantee deposits	1.78~5.68%		28,455	17,392	1.78~5.68%		22,121	20,366
		₩	45,096	53,181		₩	38,808	59,219

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13. Inventories

(a) Inventories as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>	March 31 2017	December 31 2016
Finished goods, net of loss on write-down of inventories	₩ 71,813	69,414
Work-in-progress	17,541	17,167
Raw materials	705,625	724,281
Supplies	27,885	28,429
By-products	6,998	6,041
Buildings under construction	808	699
Sites for lotting-out construction	11,411	12,985
Goods-in-transit	25,291	55,686
	₩ 867,372	914,702

(b) The amount of inventories recognized as an expense for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>	2017	2016
Cost of sales:		
Loss on valuation of inventories	₩ 11	19
Loss on retirement of inventories	759	304
Other expense:		
Loss on retirement of inventories	33	2
	₩ 803	325

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14. Cash and Cash Equivalents and Other Financial Assets

(a) Cash and cash equivalents as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>		March 31 2017	December 31 2016
Cash on hand	₩	1,020	1,095
Demand deposits		107,726	77,640
Short-term investment assets		840,000	610,000
	₩	948,746	688,735

(b) Other financial assets as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>		March 31 2017		December 31 2016	
		Current	Non-current	Current	Non-current
Time deposits	₩	100,000	6,340	100,000	-
Money trust		700,000	30,000	1,480,000	-
Certificates of deposit		10,000	30,000	40,000	-
	₩	810,000	66,340	1,620,000	-

In 2015, the Company acquired redeemable convertible preference shares of Cosmococ Co., Ltd. and recognized embedded derivatives as other financial assets separately from the host contract. The Company exercised those conversion options and recognized ₩311 million of gain on conversion of redeemable convertible preferred shares for the year ended December 31, 2016.

(c) Financial assets restricted in use as of March 31, 2017 were as follows:

<i>In millions of won</i>		March 31 2017
Other financial assets	₩	6,340

15. Non-current Assets Held for Sale

Changes in non-current assets held for sale for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>In millions of won</i>		2017	2016
Beginning balance	₩	-	1,542
Transfer from property, plant and equipment		-	-
Disposal		-	(1,542)
Ending balance	₩	-	-

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16. Pledged Assets

(a) Investment property pledged as collateral as of March 31, 2017 was as follows:

In millions of won

Asset	Carrying amount	Type	Received amount	Collateralized amount	Secured party
Investment property	₩ 68,477	Leasehold deposits received	₩ 9,337	9,579	MetLife Insurance Korea Co., Ltd. and others
Other financial assets	6,340	Performance guarantee	-	6,340	Korea Land and Housing Corporation

(b) Investment property pledged as collateral as of December 31, 2016 was as follows:

In millions of won

Asset	Carrying amount	Type	Received amount	Collateralized amount	Leaseholder
Investment property	₩ 68,810	Leasehold deposits received	₩ 9,241	9,467	MetLife Insurance Korea Co., Ltd. and others

17. Share Capital and Other Capital Surplus

(a) Details of share capital as of March 31, 2017 and December 31, 2016 were as follows:

	March 31 2017	December 31 2016
Number of ordinary shares:		
Authorized	800,000,000	800,000,000
Issued	137,292,497	137,292,497
Outstanding	126,265,127	126,265,127
Par value in won	₩ 5,000	5,000

The Company has 53,699,400 shares of treasury shares reacquired and retired in prior years. Accordingly, as of March 31, 2017, the Company's ordinary share differs from the aggregate par value of issued shares by ₩268,497 million.

(b) Changes in the number of shares for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>Number of share</i>	2017			2016		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning balance	137,292,497	(11,027,370)	126,265,127	137,292,497	(11,326,605)	125,965,892
Donation of treasury shares	-	-	-	-	299,235	299,235
Ending balance	137,292,497	(11,027,370)	126,265,127	137,292,497	(11,027,370)	126,265,127

(c) There was no change in other capital surplus for the three-month period ended March 31, 2017 and the year ended December 31, 2016.

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18. Treasury Shares and Gain on Reissuance of Treasury shares

- (a) Changes in treasury shares for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>In millions of won, except number of shares</i>	2017		2016	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Beginning balance	11,027,370	₩ 328,157	11,326,605	₩ 337,062
Donation of treasury shares	-	-	(299,235)	(8,905)
Ending balance	11,027,370	₩ 328,157	11,027,370	₩ 328,157

- (b) Changes in gain on reissuance of treasury shares for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>In millions of won</i>	2017	2016
Beginning balance	₩ 513,776	494,648
Donation of treasury shares, net of tax	-	19,128
Ending balance	₩ 513,776	513,776

19. Reserves

- (a) Details of reserves as of March 31, 2017 and December 31, 2016 were as follows:

<i>In millions of won</i>	March 31 2017	December 31 2016
Available-for-sale financial assets - net change in fair value	₩ (25,907)	(30,929)
Legal reserve	602,937	602,937
Voluntary reserve	4,408,175	3,794,260
	₩ 4,985,205	4,366,268

- (b) Available-for-sale financial assets - net change in fair value as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>	March 31 2017	December 31 2016
Available-for-sale financial assets - net change in fair value before tax	₩ (34,179)	(40,804)
Tax effect	8,272	9,875
	₩ (25,907)	(30,929)

- (c) Legal Reserve

The Korean Commercial Act 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.

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19. Reserves, Continued

(d) Details of voluntary reserve as of March 31, 2017 and December 31, 2016 were as follows:

<i>In millions of won</i>	March 31 2017	December 31 2016
Reserve for business rationalization	₩ 12,851	12,851
Reserve for research and human resource development	10,000	20,000
Reserve for business expansion	698,881	698,881
Unconditional reserve	3,686,443	3,062,528
	₩ 4,408,175	3,794,260

Reserve for business rationalization

Until December 10, 2002 under *the Restriction of Special Taxation Act*, 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.

Reserve for research and human resource development

According to *the Restriction of Special Taxation Act*, certain taxable deductions are required to be transferred from retained earnings to reserve for research and human resource development. This reserve may be used for each purpose and their remaining amounts could be reclassified as a voluntary reserve.

Reserve for business expansion and other reserves

The Company appropriated reserves without specific purposes. Those reserves can be used for other purposes upon a resolution at a general meeting of shareholders.

20. Retained Earnings

Changes in retained earnings for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>In millions of won</i>	2017	2016
Beginning balance	₩ 1,068,469	995,886
Dividends	(454,554)	(428,284)
Transfer from reserve for research and human resource development	10,000	10,000
Transfer to unconditional reserve	(623,915)	(577,602)
Profit for the period	253,159	1,087,347
Remeasurements of net defined benefit liability, net of tax	(439)	(18,878)
Ending balance	₩ 252,720	1,068,469

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21. Trade and Other Payables

Trade and other payables as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>	March 31 2017		December 31 2016	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ 21,469	10,351	21,418	6,848
Trade payables	66,145	-	67,961	-
Withholdings	4,734	-	3,802	-
Withholdings value added tax	175,456	-	186,347	-
Accrued expenses	85,671	-	123,401	-
Other payables	133,180	-	33,341	-
Dividend payables	454,554	-	-	-
	₩ 941,209	10,351	436,270	6,848

22. Short-term Borrowings

Short-term borrowings as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>	Annual interest rate	March 31 2017	December 31 2016
Customer credit contracts:			
Nonghyup Bank	5.92%	₩ 2,780	3,179
KEB Hana Card Co., Ltd.	3M CD rate+2.5%	573	672
		₩ 3,353	3,851

The Company has entered into a customer credit contract with the Nonghyup Bank and KEB Hana Card Co., Ltd. The financial institutions pay trade receivables for customers and the Company has provided guarantees to the financial institutions for customers.

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23. Retirement Benefits Plan

- (a) The components of retirement benefits for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>	2017	2016
Defined benefit plans:		
Current service cost	₩ 6,674	6,225
Net interest on net defined benefit liability	236	232
	<u>6,910</u>	<u>6,457</u>
Defined contribution plans:		
Contributions recognized as expense	2,218	1,678
	<u>₩ 9,128</u>	<u>8,135</u>

- (b) Net defined benefit liability as of March 31, 2017 and December 31, 2016 is summarized as follows:

<i>In millions of won</i>	March 31 2017	December 31 2016
Present value of defined benefit obligations	₩ 281,496	278,612
Fair value of plan assets	(227,052)	(231,491)
Net defined benefit liability	<u>₩ 54,444</u>	<u>47,121</u>

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24. Revenue from Real Estate Sales

- (a) Details of agreements for real estate sales under construction as of March 31, 2017 were as follows:

<i>In millions of won</i>	Construction period		Total revenue estimated	Total revenue contracted
Daegu Station Central-Xi	Dec. 2014 ~ Oct. 2017	₩	343,958	342,130

- (b) Changes in the balance of contract amount for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>In millions of won</i>		2017	2016
Beginning balance	₩	133,491	246,340
Other changes		(95)	23,700
Revenue recognized		(19,860)	(136,549)
Ending balance	₩	113,536	133,491

- (c) Recognized profits and related balances for agreements under construction as of March 31, 2017 were as follows:

<i>In millions of won</i>	Stage of completion		Aggregate revenue recognized	Aggregate expenses recognized	Due from customers for contract work
Daegu Station Central-Xi	66.81 %	₩	228,594	182,408	35,307

Due from customers for contract work is recognized as trade and other receivables in the separate interim financial statements.

- (d) The effect of changes in the estimates of total revenue and total costs for three-month period ended March 31, 2017 was as follows:

<i>In millions of won</i>		Changes in total revenue	Changes in total costs	Effect on profit before income tax	Effect on future profit before income tax	Changes in due from customers for contract work
Daegu Station Central-Xi	₩	-	406	(270)	(136)	-

The total revenue and the total costs are estimated based on the information and circumstances available at the end of the reporting period and actual results may differ from these estimates.

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25. Result from Operating Activities

- (a) Details of expenses classified by nature for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>		2017	2016
Changes in inventories	₩	47,330	22,172
Raw materials and consumables purchased		150,182	158,499
Salaries		85,843	80,949
Retirement and termination benefits		9,128	8,135
Depreciation		25,825	26,069
Amortization		7	5
Employee welfare		10,558	10,479
Advertising		22,434	23,892
Commissions		29,053	26,042
Other expenses		25,742	17,635
	₩	406,102	373,877

- (b) Details of selling, general and administrative expenses for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>		2017	2016
Salaries	₩	58,379	54,731
Retirement and termination benefits		6,288	5,588
Employee welfare		7,488	7,555
Travel		1,621	896
Communications		731	845
Utilities		2,488	2,522
Taxes and dues		1,538	1,105
Supplies		458	431
Rent		3,304	3,062
Depreciation		8,328	8,020
Amortization		7	5
Repairs and maintenance		275	735
Vehicles		996	967
Commissions		21,159	18,703
Freight and custody		5,949	6,007
Conferences		838	715
Advertising		22,412	23,876
Training		688	827
Normal research and development		2,489	1,826
Reversal of impairment loss on trade receivables		326	(3)
Others		658	320
	₩	146,420	138,733

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26. Other Income and Expenses

(a) Details of other income for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>		2017	2016
Foreign currency transaction gain	₩	2,701	7,296
Foreign currency translation gain		1,062	2,222
Reversal of impairment loss on other receivables		1,588	-
Gain on sale of property, plant and equipment		66	9
Gain on sale of intangible assets		595	-
Gain on sale of investments in associates and joint ventures		-	6,095
Others		3,647	2,968
	₩	9,659	18,590

(b) Details of other expenses for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>		2017	2016
Foreign currency transaction loss	₩	14,124	4,746
Foreign currency translation loss		76,479	21,993
Impairment loss on other receivables		424	585
Loss on disposal of investments in subsidiaries		8,945	-
Loss on sale of intangible assets		162	-
Donations		1,367	1,819
Others		204	1,278
	₩	101,705	30,421

27. Net Finance Income

(a) Details of net finance income for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>		2017	2016
Finance income:			
Interest income	₩	11,574	9,750
Dividend income		73,878	6,563
Investment income on long-term deposits in MSA Escrow Fund		2,043	2,032
Gain on sale of available-for-sale financial assets		554	-
Gain on conversion of redeemable convertible preferred shares		-	311
		88,049	18,656
Finance costs:			
Interest expenses		(305)	(174)
Net finance income	₩	87,744	18,482

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27. Net Finance Income, Continued

(b) Details of interest income for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>		2017	2016
Deposits	₩	9,657	7,553
Available-for-sale financial assets		7	7
Trade and other receivables		1,910	2,190
	₩	11,574	9,750

(c) Details of interest expenses for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>		2017	2016
Trade and other payables	₩	305	174

28. Income Tax

Income tax expense comprises as current tax expense adjusted for current adjustments for prior periods, deferred tax expense (income) by origination and reversal of deferred tax assets (liabilities), and income tax recognized in other comprehensive income. The average effective tax rate was 19.78% and 24.02% for the three-month periods ended March 31, 2017 and 2016, respectively.

29. Earnings per Share

Basic and diluted earnings per share for the three-month periods ended March 31, 2017 and 2016 were as follows:

		2017	2016
Profit for the period in millions of won	₩	253,159	253,769
Weighted-average number of ordinary shares outstanding		126,265,127	126,124,134
Basic and diluted earnings per share in won	₩	2,005	2,012

The weighted-average number of ordinary shares outstanding is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time-weighting factor.

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30. Transactions and Balances with Related Companies

- (a) Details of parent and subsidiary relationships and related companies as of March 31, 2017 and December 31, 2016 were as follows:

Subsidiary	Location	Percentage of ownership					
		March 31 2017			December 31 2016		
		Parent	Subsidiary	Total	Parent	Subsidiary	Total
Investments in subsidiaries							
Korea Ginseng Corporation	Korea	100.00%	-	100.00%	100.00%	-	100.00%
Yungjin Pharm. Ind. Co., Ltd. ^{(*)1}	Korea	52.45%	-	52.45%	53.00%	-	53.00%
Tae-a Industry Co., Ltd.	Korea	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	99.99%	-	99.99%	99.99%	-	99.99%
Korea Tabacos do Brasil Ltda.	Brazil	99.99%	-	99.99%	99.99%	-	99.99%
KT&G Pars	Iran	99.99%	-	99.99%	99.99%	-	99.99%
KT&G Rus L.L.C.	Russia	100.00%	-	100.00%	100.00%	-	100.00%
KT&G USA Corporation	USA	100.00%	-	100.00%	100.00%	-	100.00%
Cosmococ Co., Ltd. ^(*)2,3)	Korea	98.56%	-	98.56%	98.49%	-	98.49%
Renzoluc Pte., Ltd. ^(*)4)	Singapore	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Life Sciences Corporation ^(*)1,5)	Korea	-	-	-	34.03%	-	34.03%
KGC Yebon Corporation	Korea	100.00%	-	100.00%	100.00%	-	100.00%
K-Q HongKong I, Limited ^(*)6)	HongKong	-	-	-	100.00%	-	100.00%
PT KT&G Indonesia	Indonesia	99.99%	-	99.99%	99.99%	-	99.99%
K&I HK Co., Ltd. ^(*)3)	HongKong	-	100.00%	100.00%	100.00%	-	100.00%
K&I China Co., Ltd. ^(*)3)	China	-	100.00%	100.00%	100.00%	-	100.00%
SangSang Stay, Inc.	Korea	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Global Rus L.L.C. ^(*)7)	Russia	100.00%	-	100.00%	100.00%	-	100.00%
KGC Life & Gin Co., Ltd. ^(*)8)	Korea	-	100.00%	100.00%	-	100.00%	100.00%
Jilin Hanzheng Ginseng Co., Ltd.	China	-	100.00%	100.00%	-	100.00%	100.00%
Cheong Kwan Jang Taiwan Corporation	Taiwan	-	100.00%	100.00%	-	100.00%	100.00%
Korean Red Ginseng Corp., Inc.	USA	-	100.00%	100.00%	-	100.00%	100.00%
Korea Ginseng (China) Corp.	China	-	100.00%	100.00%	-	100.00%	100.00%
Korea Ginseng Corporation Japan	Japan	-	100.00%	100.00%	-	100.00%	100.00%
PT CKJ INDONESIA	Indonesia	-	99.88%	99.88%	-	99.88%	99.88%
PT Trisakti Purwosari Makmur	Indonesia	-	99.99%	99.99%	-	60.17%	60.17%
PT Mandiri Maha Mulia	Indonesia	-	99.98%	99.98%	-	66.47%	66.47%
PT Sentosa Ababi Purwosari	Indonesia	-	100.00%	100.00%	-	99.80%	99.80%
PT Purindo Ilufa	Indonesia	-	100.00%	100.00%	-	100.00%	100.00%
Investments in associates and joint ventures							
Lite Pharm Tech, Inc.	Korea	20.24%	-	20.24%	20.24%	-	20.24%
KVG REIT 1 Co., Ltd.	Korea	29.67%	-	29.67%	29.67%	-	29.67%
JR REIT V Co., Ltd.	Korea	34.63%	-	34.63%	34.63%	-	34.63%
JR REIT VIII Co., Ltd.	Korea	21.74%	-	21.74%	21.74%	-	21.74%
LSK Global Pharma Services Co., Ltd.	Korea	23.15%	-	23.15%	23.15%	-	23.15%
JR REIT X Co., Ltd.	Korea	28.79%	-	28.79%	28.79%	-	28.79%
JR REIT XIII Co., Ltd.	Korea	27.03%	-	27.03%	27.03%	-	27.03%
KB Gimpo Logistics CR REIT Co., Ltd.	Korea	12.00%	-	12.00%	12.00%	-	12.00%
KORAMCO Private REIT 50 Fund	Korea	84.21%	-	84.21%	84.21%	-	84.21%

^{(*)1} KT&G Life Sciences Corporation was merged into Yungjin Pharm. Ind. Co., Ltd. as of January 13, 2017.

^{(*)2} The ownership interest in Cosmococ Co., Ltd. has increased to 98.49% from 97.73% as a result of the conversion of redeemable convertible preferred shares in 2016.

^{(*)3} For the three-month period ended March 31, 2017, the Company made a capital contribution in-kind to Cosmococ Co., Ltd. by transferring its interest in K&I HK Co., Ltd. and K&I China Co., Ltd., increasing its ownership from 98.49% to 98.56%.

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30. Transactions and Balances with Related Companies, Continued

- (*4) The percentage of ownership, shown above, excludes preferred shares. As of March 31, 2017, the Company's percentage of ownership would be 85.5%, if preferred shares are included.
- (*5) The ownership interest in KT&G Life Sciences Corporation has decreased to 34.03% from 73.94% as a result of the conversion of redeemable convertible preferred shares in 2016.
- (*6) For the three-month period ended March 31, 2017, K-Q HongKong I, Limited was liquidated.
- (*7) The Company established KT&G Global Rus L.L.C in 2016.
- (*8) The Company made a capital contribution in-kind of its entire interest in KGC Life & Gin Co., Ltd. to Korea Ginseng Corporation in 2016.

- (b) Significant transactions which occurred in the normal course of business with related companies for the three-month periods ended March 31, 2017 and 2016 are summarized as follows:

<i>In millions of won</i>	2017		2016	
	Sales and other income	Purchase and other expenses	Sales and other income	Purchase and other expenses
Investments in subsidiaries				
Korea Ginseng Corporation	₩ 1,785	1,407	2,021	1,184
Yungjin Pharm. Ind. Co., Ltd.	42	2	84	3
Tae-a Industry Co., Ltd.	3	3,271	3	3,803
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	1,106	-	58	-
KT&G Pars	-	-	2	-
KT&G Rus L.L.C.	3,206	-	8,671	-
KGC Life & Gin Co., Ltd.	30	149	104	202
KT&G USA Corporation	24,884	-	34,164	-
Cosmococ Co., Ltd.	23	20	21	378
Renzoluc Pte., Ltd.	475	-	1,052	-
KT&G Life Sciences Corporation	-	-	6	-
KGC Yebon Corporation	5	260	88	260
PT KT&G Indonesia	241	-	502	-
K&I China Co., Ltd.	-	40	-	16
PT Trisakti Purwosari Makmur	-	-	72	-
PT Mandiri Maha Mulia	2,668	-	833	-
SangSang Stay, Inc.	1,555	-	100	-
	₩ 36,023	5,149	47,781	5,846

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30. Transactions and Balances with Related Companies, Continued

(c) Account balances with related companies as of March 31, 2017 and December 31, 2016 were as follows:

<i>In millions of won</i>	March 31 2017		December 31 2016	
	Receivables	Payables	Receivables	Payables
Investments in subsidiaries				
Korea Ginseng Corporation	₩ 150	3,288	37	2,071
Yungjin Pharm. Ind. Co., Ltd.	14	30	13	30
Tae-a Industry Co., Ltd.	-	1,193	-	-
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	33,838	-	38,159	-
Korea Tabacos do Brasil Ltda.	101	-	101	-
KT&G Pars ^(*)	40,530	-	43,385	-
KT&G Rus L.L.C. ^(*)	47,197	-	58,652	-
KT&G USA Corporation	22,138	-	19,015	-
Cosmococ Co., Ltd.	-	27	-	27
Renzoluc Pte., Ltd.	47,932	-	50,923	-
KT&G Life Sciences Corporation	-	-	-	1
PT KT&G Indonesia	28,446	-	31,185	-
K&I China Co., Ltd.	284	-	1,074	-
SangSang Stay, Inc.	558	-	552	-
KGC Life & Gin Co., Ltd.	-	116	-	115
PT Trisakti Purwosari Makmur	326	-	353	-
PT Mandiri Maha Mulia	11,150	-	11,050	-
Investments in associates and joint ventures				
LSK Global Pharma Services Co., Ltd.	1,854	-	1,508	-
	₩ 234,518	4,654	256,007	2,244

^(*) Above receivables are the gross amounts before ₩49,121 million and ₩49,965 million of allowance for doubtful accounts as of March 31, 2017 and December 31, 2016, respectively.

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30. Transactions and Balances with Related Companies, Continued

- (d) Details of financial transactions with related parties for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>In millions of won</i>	2017		2016
	Capital Increase	Loans Increase	Loans Collection
Investments in subsidiaries			Capital Increase
Korea Ginseng Corporation	-	-	44,100
Yungjin Pharm. Ind. Co., Ltd.	6,944	-	-
Cosmococ Co., Ltd.	5,544	-	27,417
Renzoluc Pte., Ltd.	97,202	-	-
KT&G Life Sciences Corporation	-	-	1,564
KT&G Global Rus L.L.C.	-	-	1,497
Investments in associates and joint ventures			
LSK Global Pharma Services Co., Ltd.	-	2,054	200

KT&G Life Sciences Corporation was merged into Yungjin Pharm. Ind. Co., Ltd. as of January 13, 2017.

For the three-month period ended March 31, 2017, the Company acquired ₩97,202 million of additional shares of Renzoluc Pte., Ltd.

For the three-month period ended March 31, 2017, the Company acquired ₩5,544 million of additional interest in Cosmococ Co., Ltd. through a capital contribution in-kind of its interest in K&I HK Co., Ltd. and K&I China Co., Ltd.

During the year ended December 31, 2016, the Company acquired ₩44,100 million of additional shares of Korea Ginseng Corporation through a capital contribution in-kind of its entire investment in KGC Life & Gin Co., Ltd.

During the year ended December 31, 2016, the Company acquired ₩27,417 million of additional shares of Cosmococ Co., Ltd. as a result of the conversion of its redeemable convertible preferred shares, increasing its ownership from 97.73% to 98.49%.

- (e) Details of key management personnel compensation for the three-month periods ended March 31, 2017 and 2016 are summarized as follows:

<i>In millions of won</i>	2017	2016
Short-term employee benefits	₩ 5,246	3,745
Retirement benefits	541	534
	₩ 5,787	4,279

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31. Risk Management and Fair Value of Financial Instruments

(a) Overview

The Company has exposure to the following risks from its use of financial instruments:

- Market risk
- Credit risk
- Liquidity risk

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk including quantitative disclosures.

(b) Risk Management Framework

The purpose of managing financial risks is to identify the potential risk factors that may affect the Company's financial performance, and minimize, eliminate and avoid it to the extent that is acceptable. One of the principal responsibilities of the treasury department is to manage the financial risks arising from the Company's underlying operations. The treasury department monitors and manages the financial risk arising from the Company's underlying operations in accordance with the risk management policies and procedures authorized by the board of directors. Also, the treasury department provides an internal report analyzing the nature and exposure level of financial risks to Risk Management Committee of the Company. The Risk Management Committee prepares the overall strategy for financial risk management, and evaluates the effectiveness of the financial risk management strategy. In addition, the Company's audit committee consistently observes the compliance of the risk management policy and procedure, and reviews the risk exposure limit of the Company. The Company applied the same financial risk management strategy that was applied in the previous period.

(c) Management of Financial Risks

(i) Market risk

Market risk is the risk that changes in market prices – such as foreign exchange rates, interest rates and equity prices – will affect the Company's income or the value of its financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

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31. Risk Management and Fair Value of Financial Instruments, Continued

(c) Management of Financial Risks, Continued

Currency 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 forward contracts to hedge foreign currency risk, if necessary.

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of March 31, 2017 and December 31, 2016 were as follows:

<i>In millions of won</i>	March 31 2017		December 31 2016	
	Assets	Liabilities	Assets	Liabilities
USD	₩ 1,079,375	24,192	1,085,906	52,680
IDR	48,558	-	51,593	-
EUR	28,948	1,708	29,630	3,023
Others	12,302	-	11,213	-
	₩ 1,169,183	25,900	1,178,342	55,703

As of March 31, 2017 and December 31, 2016, the effects of a 10% weakening or strengthening of functional currency against foreign currencies on profit before tax were as follows:

<i>In millions of won</i>	March 31 2017		December 31 2016	
	10% weakening	10% strengthening	10% weakening	10% strengthening
Increase (decrease) in profit before tax	₩ 114,328	(114,328)	112,264	(112,264)

Equity price risk

The Company has exposure to equity price risk, which arises from listed available-for-sale equity instruments. The Company's management has monitored the proportion of 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, 2017 and December 31, 2016, the effects of a 5% fluctuation in the price index of stocks on comprehensive income before tax were as follows:

<i>In millions of won</i>	March 31 2017		December 31 2016	
	5% increase	5% decrease	5% increase	5% decrease
Comprehensive income before tax	₩ 7,254	(7,254)	5,162	(5,162)

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31. Risk Management and Fair Value of Financial Instruments, Continued

(c) Management of Financial Risks, Continued

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. As of March 31, 2017, there is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation, considering the amounts of interest bearing liabilities.

(ii) Credit risk

The Company has exposure to the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an 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 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, 2017 and December 31, 2016 is as follows:

<i>In millions of won</i>	March 31 2017	December 31 2016
Available-for-sale debt instruments	₩ -	1,500
Long-term deposits in MSA Escrow Fund	485,907	503,592
Trade and other receivables	1,298,624	1,208,615
Other financial assets	876,340	1,620,000
Cash and cash equivalents (excluding cash on hand)	947,726	687,640
Financial guarantee contracts	191,048	153,145
	₩ 3,799,645	4,174,492

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31. Risk Management and Fair Value of Financial Instruments, Continued

(c) Management of Financial Risks, Continued

(iii) Liquidity risk

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

The contractual maturity analysis with a residual contractual maturity of financial liabilities as of March 31, 2017 and December 31, 2016 is as follows:

<i>In millions of won</i>	Carrying amount	Contractual cash flow	Residual contractual maturity			
			Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	
As of March 31, 2017:						
Trade and other payables	₩ 771,370	771,963	739,550	21,584	10,829	
Short-term borrowings	3,353	3,353	3,353	-	-	
Financial guarantee contracts	-	191,048	-	191,048	-	
	₩ 774,723	966,364	742,903	212,632	10,829	
As of December 31, 2016:						
Trade and other payables	₩ 252,969	253,467	224,703	21,584	7,180	
Short-term borrowings	3,851	3,851	3,851	-	-	
Financial guarantee contracts	-	153,145	-	153,145	-	
	₩ 256,820	410,463	228,554	174,729	7,180	

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.

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31. Risk Management and Fair Value of Financial Instruments, Continued

(d) Fair Value of Financial Instruments

The carrying amounts of each category of financial assets and liabilities as of March 31, 2017 and December 31, 2016 are summarized as follows:

<i>In millions of won</i>		March 31 2017	December 31 2016
Financial assets:			
Available-for-sale financial assets	₩	370,930	365,805
Loans and receivables			
–Trade and other receivables		1,298,624	1,208,615
–Long-term deposits in MSA Escrow Fund		485,907	503,592
–Other financial assets		876,340	1,620,000
–Cash and cash equivalents		948,746	688,735
		3,609,617	4,020,942
	₩	3,980,547	4,386,747
Financial liabilities:			
Financial liabilities measured at amortized cost			
–Trade and other payables	₩	771,370	252,969
–Short-term borrowings		3,353	3,851
	₩	774,723	256,820

The fair value measurements classified by fair value hierarchy as of March 31, 2017 and December 31, 2016 were as follows:

<i>In millions of won</i>		Carrying amount	Level I	Level II	Fair value Level III
As of March 31, 2017:					
Available-for-sale financial assets	₩	339,875	205,780	-	134,095
As of December 31, 2016:					
Available-for-sale financial assets	₩	333,250	200,294	-	132,956

There is no transfer between fair value hierarchy levels of recurring fair value measurements for the three-month period ended March 31, 2017 and the year ended December 31, 2016.

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31. Risk Management and Fair Value of Financial Instruments, Continued

(d) Fair Value of Financial Instruments, Continued

The fair value measurements for available-for-sale equity instruments in real estate trust fund has been measured using the adjusted net asset method, DCF and option pricing model and categorized as a level 3 fair value based on the inputs to the valuation techniques used. Changes in fair value classified as level 3 for the three-month period ended March 31, 2017 and the year ended December 31, 2016 were as follows:

<i>In millions of won</i>		2017	2016
Beginning balance	₩	132,956	127,084
Acquisition		-	16,000
Exercise of conversion options		-	(11,976)
Changes in fair value		1,139	1,848
Ending balance	₩	134,095	132,956

(e) Finance Income (Costs)

(i) Details of finance income (costs) by categories for the three-month period ended March 31, 2017 were as follows:

<i>In millions of won</i>		Available -for-sale Financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:					
Interest income	₩	7	11,567	-	11,574
Dividend income		7,803	-	-	7,803
Investment income on long-term deposits in MSA Escrow Fund		-	2,043	-	2,043
Gain on sale		554	-	-	554
Interest expense		-	-	(305)	(305)
	₩	8,364	13,610	(305)	21,669
Other comprehensive income before tax					
Net change in fair value	₩	7,179	-	-	7,179
Reclassification adjustments on sale		(554)	-	-	(554)
	₩	6,625	-	-	6,625

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31. Risk Management and Fair Value of Financial Instruments, Continued

(e) Finance Income (Costs), Continued

(ii) Details of finance income (costs) by categories for the three-month period ended March 31, 2016 were as follows:

<i>In millions of won</i>	Available -for-sale Financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:				
Interest income	₩ 7	9,743	-	9,750
Dividend income	6,197	-	-	6,197
Investment income on long-term deposits in MSA Escrow Fund	-	2,032	-	2,032
Gain on conversion of redeemable convertible preferred shares	-	311	-	311
Interest expense	-	-	(174)	(174)
	₩ 6,204	12,086	(174)	18,116
Other comprehensive loss before tax				
Net change in fair value	₩ 5,720	-	-	5,720

32. Capital Management

The Company's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The board of directors seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position.

The Company monitors capital using equity and net debt deducting cash and cash equivalents and current financial instruments from borrowings. The Company applied the same capital management strategy that was applied in the previous year.

As of March 31, 2017 and December 31, 2016, the Company's capital structure was as follows:

<i>In millions of won</i>	March 31 2017	December 31 2016
Debt (borrowings)	₩ 3,353	3,851
Less:		
Cash and cash equivalents	(948,746)	(688,735)
Current other financial assets	(810,000)	(1,620,000)
Net debt (asset)	(1,755,393)	(2,304,884)
Equity	₩ 6,382,085	6,578,897

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33. Contingent Liabilities and Commitments

- (a) 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.
- (b) As of March 31, 2017, a lawsuit by National Health Insurance Service claiming damages of ₩53,742 million has been filed against the Company. Additionally, as of March 31, 2017, the Company is involved in five lawsuits as a plaintiff for alleged damages totalling ₩14,190 million and two lawsuits as a defendant for alleged damages totalling ₩1,799 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, 2017.
- (c) As of March 31, 2017, the Company has entered into letter of credit agreements with KEB Hana Bank and other bank with limits in the aggregate of USD 57,000 thousand.
- (d) As of March 31, 2017, the Company’s trade receivables from the export of cigarettes are insured against non-payment up to USD 22,413 thousand by short-term export insurances with the Korea Trade Insurance Corporation.
- (e) The Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD 40,000 thousand by KEB Hana Bank. Details of guarantees exercised as of March 31, 2017, are summarized as follows:

<i>In thousands of USD, THB and millions of IDR</i>		<i>Exercised amount</i>
Customs bond and L/C opening of KT&G USA Corporation	USD	15,217
Performance guarantee for export of tobacco sheet to Thailand Tobacco Monopoly	THB	7,588
Payment guarantee for purchase of certificate stamp of PT Mandiri Maha Mulia, etc.	IDR	204,670

- (f) 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.

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33. Contingent Liabilities and Commitments, Continued

- (g) With relation to the acquisition of KT&G Life Sciences Corporation, 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:

Description	Details
Restriction of disposal	Individual Shareholder shall not be permitted to dispose of its shares, in whole or in part, within one year after KT&G Life Sciences Corporation is listed.
Right of first refusal held by the Company	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.
Tag-along right held by 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 Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Company.

- (h) As of March 31, 2017, the Company has provided guarantees up to ~~₩~~225,600 million with an exercised amount of ~~₩~~159,207 million for the buyers of apartments in respect of their borrowings from Shinhan Bank.
- (i) As of March 31, 2017, the Company is insured by performance bond insurance up to ~~₩~~3,826 million with the Seoul Guarantee Insurance.
- (j) As of March 31, 2017, the Company recognizes other financial assets of ~~₩~~6,340 million deposited in Nonghyup bank and restricted in use in order to provide a performance guarantee for the commercial district development project in Sejong-si.

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34. Cash Flows

- (a) Details of cash generated from operations for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>	2017	2016
Profit for the period	₩ 253,159	253,769
Adjustments for:		
Income tax expense	62,427	80,236
Finance costs	305	174
Finance income	(88,049)	(18,657)
Depreciation	25,825	26,069
Amortization	7	5
Retirement and termination benefits	9,128	8,135
Foreign currency translation loss	76,479	21,993
Impairment loss on trade and other receivables	750	585
Loss on valuation on inventories	11	19
Loss on sale of intangible assets	162	-
Loss on disposal of investments in subsidiaries	8,945	-
Other expenses	791	19,506
Foreign currency translation gain	(1,062)	(2,222)
Reversal of impairment loss on trade and other receivables	(1,588)	(3)
Gain on sale of property, plant and equipment	(66)	(9)
Gain on sale of intangible assets	(595)	-
Gain on sale of investments in associates and joint ventures	-	(6,095)
	346,629	383,505
Changes in working capital:		
Trade and other receivables	(55,673)	(45,085)
Advance payments	6,748	6,512
Prepaid expenses	2,037	914
Prepaid tobacco excise and other taxes	950	3,362
Inventories	46,528	21,846
Trade and other payables	(46,924)	(65,718)
Advance receipts	205	(8,502)
Tobacco excise and other taxes payable	(548,997)	(120,071)
Payment of retirement and termination benefits	(4,971)	(2,749)
Cash generated from operations	₩ (253,468)	174,014

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34. Cash Flows, Continued

- (b) Details of material transactions without cash inflow and outflow for the three-month periods ended March 31, 2017 and 2016 were as follows:

<i>In millions of won</i>	2017	2016
Transfer of retained earnings to dividend payable	₩ 454,554	428,284
Donation of treasury shares	-	19,200
Acquisition of investments in subsidiaries		
resulting from the conversion of redeemable convertible preferred shares	-	27,415
Increase (decrease) in accrued expenses		
related to payment of retirement and termination benefits	(2,587)	(407)
Increase (decrease) in other payables		
related to acquisition of property, plant and equipment	(716)	(122)
Increase (decrease) in other receivables		
related to disposal of property, plant and equipment	85	-
Reclassification of available-for-sale to loans	2,054	150

- (c) The Company presented cash flows arising from short-term financial instruments on a net basis.