KT&G CORPORATION

Non-Consolidated Financial Statements

(Unaudited)

September 30, 2008 and 2007

(With Independent Accountants' Review Report Thereon)

KT&G CORPORATION

Non-Consolidated Financial Statements

(Unaudited)

September 30, 2008 and 2007

Table of Contents

Independent Accountants' Review Report

Based on a report originally issued in Korean

The Board of Directors and Stockholders
KT&G Corporation:

We have reviewed the accompanying non-consolidated balance sheet of KT&G Corporation (the "Company") as of September 30, 2008, and the related non-consolidated statements of income for the three-month and nine-month periods ended September 30, 2008 and 2007, changes in equity and cash flows for the nine-month periods ended September 30, 2008 and 2007. These non-consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these non-consolidated financial statements based on our reviews.

We conducted our reviews in accordance with the Review Standards for Semi-annual Financial Statements established by the Securities and Futures Commission of the Republic of Korea. These standards require that we plan and perform the review to obtain moderate assurance as to whether the financial statements are free of material misstatement. A review consists principally of inquiries of company personnel and analytical procedures applied to financial data and, thus, provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Based on our reviews, nothing has come to our attention that causes us to believe that the financial statements referred to above are not presented fairly, in all material respects, in accordance with accounting principles generally accepted in the Republic of Korea.

The non-consolidated balance sheet of the Company as of December 31, 2007, and the related non-consolidated statements of income, appropriation of retained earnings, changes in equity and cash flows for the year then ended, which are not accompanying this report, were audited by us and our report thereon, dated January 24, 2008, expressed an unqualified opinion on those statements. Except for the adoption of changes in Statements of Korea Accounting Standards ("SKAS") No. 15 (*Investments in Associates*), the accompanying non-consolidated balance sheet of the Company as of December 31, 2007, presented for comparative purposes, is not different from that audited by us in all material respects.

The accompanying non-consolidated financial statements as of and for the nine-month period ended September 30, 2008 have been translated into United States dollars solely for the convenience of the reader. We have reviewed the translation and, in our opinion, the non-consolidated financial statements expressed in Korean Won have been translated into dollars on the basis set forth in note 3 to the non-consolidated financial statements.

The following matters may be helpful to the readers in their understanding of the non-consolidated financial statements:

As discussed in note 2(a) to the non-consolidated financial statements, accounting principles and review standards and their application in practice vary among countries. The accompanying non-consolidated financial statements are not intended to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries other than the Republic of Korea. In addition, the procedures and practices utilized in the Republic of Korea to review such financial statements may differ from those generally accepted and applied in other countries. Accordingly, this report and the accompanying non-consolidated financial statements are for use by those knowledgeable in Korean accounting principles and reviewing standards and their application in practice.

As discussed in note 20 to the non-consolidated financial statements, the Company and the Korean government are defendants in lawsuits claiming damages of ₩759 million for the effects of smoking. The final outcome of these lawsuits cannot be predicted. Accordingly, no provisions have been made in the accompanying non-consolidated financial statements.

As discussed in note 30 to the non-consolidated financial statements, the Company changed accounting policy on equity method accounted investments in conformity with Statement of Korea Accounting Standard “SKAS” No. 15 (*Investment In Associates)* revised February 22, 2008 which required, when accounting on equity method accounted investments, that net assets of non-consolidated financial statements agree with those of consolidated financial statements.

These changes resulted in a decrease in loss on valuation of equity method investments of ₩9 million, equity method investment securities of ₩16 million and unrealized gain on valuation of equity method investments of ₩2,596 million and an increase in capital surplus of ₩2,532 million and unappropriated retained earnings of ₩48 million, respectively. The Company restated prior period’s financial statements in conformity with these changes in accounting policy.

Seoul, Korea
October 7, 2008

This report is effective as of October 7, 2008, 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 non-consolidated financial statements and notes thereto. Accordingly, the readers of the review report should understand that there is a possibility that the above review report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

KT&G CORPORATION

Non-Consolidated Balance Sheets

(Unaudited)

As of September 30, 2008 and December 31, 2007

In millions of Won and thousands of US dollars	Note		2008 Korean Won		2008 U.S. dollars (note 3)		2007 Korean Won
Assets							
Cash and cash equivalents	16	₩	96,080	$	80,896	₩	115,126
Short-term financial instruments			1,000		842		1,000
Trade accounts receivable, net of allowance for doubtful accounts of ₩21,447 in 2008 and ₩8,723 in 2007	8,16		377,294		317,668		294,895
Inventories	4,12		949,608		799,535		979,513
Current deferred tax assets	22		5,496		4,627		16,026
Other current assets	5		148,255		124,825		60,585
Total current assets			1,577,733		1,328,393		1,467,145
Available-for-sale securities	6		336,303		283,155		257,089
Equity method investment securities	7, 30		685,334		577,026		626,668
Property, plant and equipment, net	9,10,12		1,396,276		1,175,613		1,408,958
Intangible assets	11		1,301		1,095		1,719
Long-term loans to employees	8		92,306		77,718		95,939
Guarantee deposits paid			33,319		28,054		30,520
Guarantee deposits for membership			22,139		18,641		21,197
Long-term deposits in Escrow Fund	16,20		100,384		84,520		66,633
Other non-current assets	13		3,982		3,354		1,933
Total non-current assets			2,671,344		2,249,176		2,510,656
Total assets		₩	4,249,077	$	3,577,569	₩	3,977,801

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION

Non-Consolidated Balance Sheets, Continued

(Unaudited)

As of September 30, 2008 and December 31, 2007

In millions of Won and thousands of US dollars, except share data	Note	2008 Korean Won	2008 U.S. dollars (note 3)	2007 Korean Won
Liabilities				
Trade accounts payable	8,16	₩ 33,707	$ 28,380	₩ 9,590
Value added tax payable		146,013	122,938	128,866
Accrued expenses		30,034	25,288	12,320
Other payables		96,678	81,399	95,432
Income taxes payable		80,054	67,403	183,482
Tobacco excise and other taxes payable		168,784	142,110	181,734
Other current liabilities	14	19,087	16,071	11,299
Total current liabilities		574,357	483,589	622,723
Retirement and severance benefits	15, 28	93,418	78,655	64,360
Guarantee deposits received	8	24,802	20,882	26,861
Deferred income tax liabilities	22	152,348	128,271	121,854
Total non-current liabilities		270,568	227,808	213,075
Total liabilities		844,925	711,397	835,798
Equity				
Common stock of ₩5,000 par value Authorized – 800,000,000 shares Issued – 140,742,497 shares in 2008 and 143,442,497 shares in 2007 Outstanding – 129,705,326 shares in 2008 and 130,839,907 shares in 2007	1	954,959	804,041	954,959
Capital surplus	30	471,144	396,686	466,769
Capital adjustments	17	(306,751)	(258,273)	(414,947)
Accumulated other comprehensive income	6,7,18, 29,30	52,446	44,158	1,593
Retained earnings	19,30	2,232,354	1,879,560	2,133,629
Total equity		3,404,152	2,866,172	3,142,003
Total liabilities and equity		₩ 4,249,077	$ 3,577,569	₩ 3,977,801

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION

Non-Consolidated Statements of Income

(Unaudited)

For the nine-month periods ended September 30, 2008 and 2007

In millions of Won and thousands of US dollars, except earnings per share	Note		2008 Korean Won		2008 U.S. dollars (note 3)		2007 Korean Won
Sales							
Tobacco	8	₩	1,835,688	$	1,545,582	₩	1,749,705
Lotting-out	21		37,100		31,237		8,888
Other	8		46,992		39,566		36,847
			1,919,780		1,616,385		1,795,440
Cost of sales	8,21,25,26		742,764		625,380		741,284
Gross profit			1,177,016		991,005		1,054,156
Selling, general and administrative expenses	8,25,26,27		476,256		400,989		425,516
Operating income			700,760		590,016		628,640
Other income (expense):							
Interest income			15,555		13,097		27,425
Interest expense			(453)		(381)		(96)
Other bad debt expense			(448)		(377)		(153)
Gain (loss) on foreign currency transactions, net			14,047		11,827		(649)
Gain (loss) on foreign currency translation, net			46,128		38,838		(1,742)
Gain (loss) on sale of available-for-sale securities, net			84		71		(724)
Gain on sale of property, plant and equipment, net			10,645		8,963		6,313
Provision for Tobacco Production Stabilization Fund			-		-		(13,570)
Gain on valuation of equity method investments	7,30		116,392		97,998		101,414
Loss on valuation of equity method investments	7,30		(5,557)		(4,679)		(22,025)
Gain (loss) on valuation of derivative instruments	31		(4,246)		(3,575)		69
Donations	26		(20,414)		(17,188)		(10,320)
Other, net			344		287		3,192
Other income			172,077		144,881		89,134
Income before income taxes			872,837		734,897		717,774
Income taxes	22		223,896		188,512		191,583
Net income		₩	648,941	$	546,385	₩	526,191
Earnings per share							
Basic earnings per share	23	₩	4,970	$	4	₩	3,968

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION

Non-Consolidated Statements of Income

(Unaudited)

For the three-month periods ended September 30, 2008 and 2007

In millions of Won and thousands of US dollars, except earnings per share	Note		2008 Korean Won		2008 U.S. dollars (note 3)		2007 Korean Won
Sales							
Tobacco	8	₩	627,912	$	528,679	₩	618,170
Lotting-out	21		14,620		12,310		2,904
Other	8		15,571		13,110		13,295
			658,103		554,099		634,369
Cost of sales	8,21,25,26		256,046		215,581		253,419
Gross profit			402,057		338,518		380,950
Selling, general and administrative expenses	8,25,26,27		171,651		144,524		147,870
Operating income			230,406		193,994		233,080
Other income (expense):							
Interest income			5,377		4,527		9,101
Interest expense			-		-		(79)
Other bad debt expense			(188)		(158)		(174)
Gain (loss) on foreign currency transactions, net			8,259		6,954		(407)
Gain (loss) on foreign currency translation, net			30,049		25,300		(1,240)
Gain (loss) on sale of available-for-sale securities			84		71		(296)
Gain on sale of property, plant and equipment, net			5,782		4,868		1,382
Provision for Tobacco Production Stabilization Fund			-		-		(4,634)
Gain on valuation of equity method investments	7,30		39,352		33,133		35,633
Loss on valuation of equity method investments	7,30		(3,269)		(2,752)		(4,610)
Loss on valuation of derivative instruments	31		(2,155)		(1,814)		-
Donations	26		(2,276)		(1,916)		(3,515)
Other, net			(1,682)		(1,417)		3,155
Other income			79,333		66,796		34,316
Income before income taxes			309,739		260,790		267,396
Income taxes	22		80,920		68,132		68,942
Net income		₩	228,819	$	192,658	₩	198,454
Earnings per share							
Basic earnings per share	23	₩	1,754	$	1	₩	1,500

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION

Non-Consolidated Statements of Changes in Equity

(Unaudited)

For the nine-month periods ended September 30, 2008 and 2007

In millions of Won		Korean Won					
		Capital stock	Capital surplus	Capital adjust-ments	Accumu-lated other compre-hensive income	Retained earnings	Total equity
Balance at January 1, 2007	₩	954,959	335,414	(321,904)	15,784	2,061,520	3,045,773
Cumulative effect of change in accounting policy		-	2,532	-	(2,596)	26	(38)
Balance at January 1, 2007, restated		954,959	337,946	(321,904)	13,188	2,061,546	3,045,735
Dividends		-	-	-	-	(319,712)	(319,712)
Net income		-	-	-	-	526,191	526,191
Increase in unrealized gain on valuation of available-for-sale securities		-	-	-	7,841	-	7,841
Decrease in unrealized gain on valuation of equity method investments		-	-	-	(4)	-	(4)
Increase in unrealized loss on valuation of equity method investments		-	-	-	186	-	186
Reacquisition of treasury stock		-	-	(269,410)	-	-	(269,410)
Retirement of treasury stock		-	-	269,410	-	(269,410)	-
Compensation by treasury stock		-	99,465	74,390	-	-	173,855
Balance at September 30, 2007	₩	954,959	437,411	(247,514)	21,211	1,998,615	3,164,682

In millions of Won and thousands of US dollars		Korean Won						U.S. dollars (note 3)
		Capital stock	Capital surplus	Capital adjust-ments	Accumu-lated other compre-hensive income	Retained earnings	Total equity	Total equity
Balance at January 1, 2008	₩	954,959	464,237	(414,947)	4,189	2,133,591	3,142,029	2,645,474
Cumulative effect of change in accounting policy		-	2,532	-	(2,596)	38	(26)	(22)
Balance at January 1, 2008, restated		954,959	466,769	(414,947)	1,593	2,133,629	3,142,003	2,645,452
Dividends		-	-	-	-	(340,449)	(340,449)	(286,646)
Net income		-	-	-	-	648,941	648,941	546,385
Increase in unrealized gain on valuation of available-for-sale securities		-	-	-	43,436	-	43,436	36,572
Increase in unrealized gain on valuation of equity method investments		-	-	-	6,778	-	6,778	5,707
Decrease in unrealized loss on valuation of equity method investments		-	-	-	639	-	639	538
Unearned stock compensation				4,941	-	-	4,941	4,159
Reacquisition of treasury stock		-	-	(108,889)	-	-	(108,889)	(91,681)
Retirement of treasury stock		-	-	209,767	-	(209,767)	-	-
Compensation by treasury stock		-	4,375	2,377	-	-	6,752	5,686
Balance at September 30, 2008	₩	954,959	471,144	(306,751)	52,446	2,232,354	3,404,152	2,866,172

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION
Non-Consolidated Statements of Cash Flows
(Unaudited)

For the nine-month periods ended September 30, 2008 and 2007

In millions of Won and thousands of US dollars	2008 Korean Won	2008 U.S. dollars (note 3)	2007 Korean Won
Cash flows from operating activities			
Net income	₩ 648,941	$ 546,385	₩ 526,191
Adjustments for:			
Depreciation and amortization	101,487	85,448	100,649
Loss (gain) on valuation of inventories, net	(13,821)	(11,637)	(2,716)
Bad debt expense	13,173	11,091	3,002
Gain on valuation of equity method investments, net	(110,835)	(93,319)	(79,389)
Loss (gain) on foreign currency translation, net	(46,060)	(38,781)	1,738
Provision for retirement and severance benefits	43,431	36,567	24,003
Gain on sale of property, plant and equipment, net	(10,645)	(8,963)	(6,313)
Amortization of present value discounts	-	-	(9,761)
Provision for Tobacco Production Stabilization Fund	-	-	13,570
Others, net	4,613	3,884	3,149
	(18,657)	(15,710)	47,932
Change in assets and liabilities			
Trade accounts receivable	(68,690)	(57,834)	(79,633)
Other receivables	(8,056)	(6,783)	(16,443)
Accrued income	(285)	(240)	(3,008)
Advance payments	(65,005)	(54,732)	(62,626)
Prepaid expenses	(13,726)	(11,557)	(17,293)
Inventories	47,148	39,697	163,628
Trade accounts payable	23,322	19,636	16,914
Other payables	1,246	1,049	12,220
Advance receipts	3,392	2,856	5,480
Withholdings	273	230	(1,252)
Value added tax withholdings	17,146	14,436	19584
Accrued expenses	23,695	19,950	9,757
Tobacco excise tax and dues payable	(12,950)	(10,903)	550,298
Income taxes payable	(103,427)	(87,082)	28,681
Deferred income taxes	22,476	18,924	6,985
Deposit for severance benefits trust	(1,611)	(1,356)	220
Gain on dividend of equity method investments	60,000	50,518	20,000
Payments of retirement and severance benefits	(5,390)	(4,538)	(11,164)
Others, net	(123)	(102)	(585)
Net cash provided by operating activities	₩ 549,719	$ 462,844	₩ 1,215,886

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION

Non-Consolidated Statements of Cash Flows, Continued

(Unaudited)

For the nine-month periods ended September 30, 2008 and 2007

In millions of Won and thousands of US dollars		2008 Korean Won		2008 U.S. dollars (note 3)		2007 Korean Won
Cash flows from investing activities						
Proceeds from sale of available-for-sale securities	₩	328	$	276	₩	626
Decrease (increase) in long-term loans to employees, net		3,633		3,059		(6,172)
Decrease in guarantee deposits paid, net		(2,799)		(2,357)		(1,060)
Proceeds from sale of property, plant & equipment		17,553		14,780		15,470
Purchases of available-for-sale securities		(20,527)		(17,283)		(219,481)
Increase in long-term deposit in Escrow Fund		(13,394)		(11,277)		(17,500)
Purchases of property, plant & equipment		(99,168)		(83,497)		(148,316)
Other, net		(2,993)		(2,520)		(1,068)
Net cash used in investing activities		(117,367)		(98,819)		(377,501)
Cash flows from financing activities						
Increase in guarantee deposits received, net		(2,060)		(1,734)		(3,482)
Payment of dividends		(340,449)		(286,646)		(319,712)
Reissuance of treasury stock		-		-		201,900
Reacquisition of treasury stock		(108,889)		(91,681)		(269,410)
Net cash used in financing activities		(451,398)		(380,061)		(390,704)
Net increase (decrease) in cash and cash equivalents		(19,046)		(16,036)		447,681
Cash and cash equivalents at beginning of period		115,126		96,932		165,924
Cash and cash equivalents at end of period	₩	96,080	$	80,896	₩	613,605

See accompanying notes to non-consolidated financial statements.

1 Organization and Description of Business

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

As of September 30, 2008, the Company has four manufacturing plants, including the Shin Tan Jin plant, and 14 local headquarters and 168 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Chunahn printing plant for the manufacturing of packaging.

Pursuant to the Korean government's privatization program and management reorganization plan, on December 28, 1998, the stockholders approved a plan to separate the Company into two companies by setting up a subsidiary for its red ginseng business segment effective January 1, 1999. The separation was accomplished by the Company's contribution of the assets and liabilities in the red ginseng business segment into a wholly-owned subsidiary, the 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 common stock of the Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program.

The ownership of the Company's issued common stock at September 30, 2008 is held as follows:

Stockholder	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.76%
Employee Stock Ownership Association	7,590,405	5.39%
Treasury stock	11,037,171	7.84%
Others	112,604,436	80.01%
	140,742,497	100.00%

The Company has, thus far, reacquired and retired 50,249,400 shares of treasury stock. Accordingly, as of September 30, 2008, the Company's common stock differs from the aggregate par value of issued shares by ₩251,247 million.

2 Summary of Significant Accounting Policies and Basis of Presenting Financial Statements

(a) Basis of Presenting Financial Statements

The Company maintains its accounting records in Korean Won and prepares statutory non-consolidated financial statements in the Korean language in conformity with accounting principles generally accepted in the Republic of Korea. Certain accounting principles applied by the Company that conform with financial accounting standards and accounting principles in the Republic of Korea may not conform with generally accepted accounting principles in other countries. Accordingly, these financial statements are intended solely for use by only those who are informed about Korean accounting principles and practices. The accompanying non-consolidated financial statements have been condensed, restructured and translated into English from the Korean language non-consolidated financial statements.

Certain information included in the Korean language non-consolidated financial statements, but not required for a fair presentation of the Company's financial position, results of operations or cash flows, is not presented in the accompanying non-consolidated financial statements.

Except for the adoption of the changed accounting policy as discussed in note 30, the Company applies accounting policies consistent with the non-consolidated financial statements of the prior year.

(b) Cash Equivalents

The Company considers short-term deposits with maturities of three months or less on acquisition date to be cash equivalents.

(c) Short-term Deposits

Short-term deposits, (including money market deposit accounts (MMDAs), time deposits, and installment savings deposits), are held for short-term cash management purposes, maturing within one year.

(d) Allowance for Doubtful Accounts

Allowance for doubtful accounts is estimated based on an analysis of individual accounts and past experience of collection and presented as a deduction from trade receivables.

(e) Inventories

Inventories are stated at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated selling cost. The cost of inventories is determined by the weighted-average method for finished goods, by-products and work-in-progress; using the moving-average method for raw materials and supplies; and using the specific identification method for goods-in-transit. Also, the cost of construction-in-progress and land involved in pre-contracted sales are determined by the specific identification method. Amounts of inventory written down to net realizable value due to losses occurring in the normal course of business are recognized as cost of goods sold and are deducted as an allowance from the carrying value of inventories. The Company recognized loss and reversal of loss on valuation of inventories amounting to ₩4,618 million and ₩18,439 million, respectively, for the nine-month period ended September 30, 2008. Also, the estimated amounts of inventories in current assets, which will not be realized in a year or less, are ₩155,972 million and ₩319,217 million, respectively, as of September 30, 2008 and December 31, 2007.

2 Summary of Significant Accounting Policies and Basis of Presenting Financial Statements, Continued

(f) Investment in Securities (excluding investments in associates, subsidiaries and joint ventures)

Classification
Upon acquisition, the Company classifies debt and equity securities (excluding investments in subsidiaries, associates and joint ventures) into the following categories: held-to-maturity, available-for-sale or trading securities. This classification is reassessed at each balance sheet date.

Investments in debt securities where the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity. Securities that are acquired principally for the purpose of selling in the short term are classified as trading securities. Investments not classified as either held-to-maturity or trading securities are classified as available-for-sale securities.

Initial recognition
Investments in securities (excluding investments in subsidiaries, associates and joint ventures) are initially recognized at cost.

Subsequent measurement and income recognition
Trading securities are subsequently carried at fair value. Gains and losses arising from changes in the fair value of trading securities are included in the income statement in the period in which they arise. Available-for-sale securities are subsequently carried at fair value. Gains and losses arising from changes in the fair value of available-for-sale securities are recognized as accumulated other comprehensive income, net of tax, directly in equity. Investments in available-for-sale securities that do not have readily determinable fair values are recognized at cost less impairment, if any. Held-to-maturity investments are carried at amortized cost with interest income and expense recognized in the income statement using the effective interest method.

Fair value information
The fair value of marketable securities is determined using quoted market prices as of the period end. Non-marketable debt securities are fair valued by discounting cash flows using the prevailing market rates for debt with a similar credit risk and remaining maturity. Credit risk is determined using the Company's credit rating as announced by accredited credit rating agencies in Korea. The fair value of investments in money market funds is determined by investment management companies.

Presentation
Trading securities are presented as current assets. Available-for-sale securities, which mature within one year from the balance sheet date or where the likelihood of disposal within one year from the balance sheet date is probable, are presented as current assets. Held-to-maturity securities, which mature within one year from the balance sheet date, are presented as current assets. All other available-for-sale securities and held-to-maturity securities are presented as long-term investments.

Impairment
The Company reviews investments in securities whenever events or changes in circumstances indicate that the carrying amount of the investments may not be recoverable. Impairment losses are recognized when the reasonably estimated recoverable amounts are less than the carrying amount and it is not obviously evidenced that impairment is unnecessary.

2 Summary of Significant Accounting Policies and Basis of Presenting Financial Statements, Continued

(g) Investment Securities under the Equity Method of Accounting

Associates are entities of which the Company and its subsidiaries have the ability to significantly influence the financial and operating policies. It is presumed to have significant influence if the Company holds directly or indirectly 20 percent or more of the voting power unless it can be clearly demonstrated that this is not the case. Subsidiaries are entities controlled by the Company.

Investments in associates and subsidiaries are accounted for using the equity method of accounting and are initially recognized at cost.

The Company's investments in associates and subsidiaries include goodwill identified on acquisition (net of any accumulated impairment loss). Goodwill is calculated as the excess of the acquisition cost of an investment in an associate or subsidiary over the Company's share of the fair value of the identifiable net assets acquired. Goodwill is amortized using the straight-line method over its estimated useful life. Amortization of goodwill is recorded together with equity income (losses).

When events or circumstances indicate that the carrying value of goodwill may not be recoverable, the Company reviews goodwill for impairment and records any impairment loss immediately in the statement of income.

The Company's share of its post-acquisition profits or losses in investments in associates and subsidiaries is recognized in the income statement, and its share of post-acquisition movements in equity is recognized in equity. The cumulative post-acquisition movements are adjusted against the carrying amount of each investment. Changes in the carrying amount of an investment resulting from dividends by an associate or subsidiary are recognized when the associate or subsidiary declares the dividend. When the Company's share of losses in an associate or subsidiary equals or exceeds its interest in the associate or subsidiary, including preferred stock or other long term loans and receivables issued by the associate or subsidiary, the Company does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate or subsidiary. Unrealized gains on transactions between the Company and its associates or subsidiaries are eliminated to the extent of the Company's interest in each associate or subsidiary.

When applying the equity method of accounting to a subsidiary, except when the Company's share of losses in subsidiary equals or exceeds its interest in subsidiary, net income and net assets of non-consolidated financial statements must agree with those of consolidated financial statements.

2 Summary of Significant Accounting Policies and Basis of Presenting Financial Statements, Continued

(h) Property, Plant and Equipment

Property, plant and equipment are stated at cost, except in the case of revaluations made in accordance with the Asset Revaluation Law which allowed for asset revaluation prior to the Law being revoked. Assets acquired through investment in kind or donation, are recorded at their fair value upon acquisition. For assets acquired in exchange for a non-monetary asset, the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.

Significant additions or improvements extending useful lives of assets are capitalized. However, normal maintenance and repairs are charged to expense as incurred.

Depreciation is computed by using the straight-line method over estimated useful lives of the respective assets as follows:

	Useful lives (years)
Buildings	10 to 60
Structures	10 to 40
Machinery and equipment	10 to 12
Vehicles and other transportation equipment	4
Tools	4
Furniture and fixtures	4

The Company recognizes as an expense interest cost and other financial charges on borrowings associated with the manufacture, purchase, or construction of property, plant and equipment in the period in which they are incurred.

The Company reviews property, plant and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss would be recognized when the expected estimated undiscounted future net cash flows from the use of the asset and its eventual disposal are less than its carrying amount.

(i) Intangible Assets

An intangible asset is an asset where: (1) it is probable that future economic benefits that are attributable to the asset will flow into the entity and (2) the cost of the asset can be measured reliably.

Intangible assets are stated at cost less accumulated amortization and impairment losses, if any. Impairment losses are determined as the amount required to reduce the carrying amount of an intangible asset to its recoverable amount.

The criteria for determining whether an incurred cost qualifies as an intangible asset and the periods of amortization for each classification of intangible asset are described below.

2 Summary of Significant Accounting Policies and Basis of Presenting Financial Statements, Continued

(i) Intangible Assets, Continued

(i) Research and Development Costs

To assess whether an internally generated intangible asset meets the criteria for recognition, the Company classifies the expense generation process into a research phase and a development phase. All costs incurred during the research phase are expensed as incurred. Costs incurred during the development phase are recognized as assets only if the following criteria are met for recognition in SKAS No. 3, *Intangible Assets*: (1) Completion of the intangible asset is technically feasible so that it will be available for use or sale; (2) the Company has the intention and ability to complete the intangible asset and use or sell it; (3) there is evidence that the intangible asset will generate probable future economic benefit; (4) the Company has adequate technical, financial and other resources to complete the development of the intangible asset and the intangible asset will be available; and (5) the expenditures attributable to the intangible asset during its development can be reliably determined. If the costs incurred fail to satisfy these criteria, they are recorded as expenses as incurred.

(ii) Other Intangible Assets

Other intangible assets, which consist of industrial property rights, franchise rights and software, are amortized using the straight-line method over 5~15 years.

(j) Retirement and Severance Benefits

Employees who have been with the Company for more than one year are entitled to lump-sum payments based on current salary rates and length of service when they leave the Company. The Company's estimated liability under the plan which would be payable if all employees left on the balance sheet date is accrued in the accompanying non-consolidated balance sheets. A portion of the liability is covered by an employees' severance benefits trust where the employees have a vested interest in the deposit with the insurance company in trust. The deposit for severance benefits held in trust is, therefore, reflected in the accompanying non-consolidated balance sheets as a reduction of the liability for retirement and severance benefits.

(k) Foreign Currency Translation

Monetary assets and liabilities denominated in foreign currencies are translated into Korean Won at the balance sheet date, with the resulting gains or losses recognized in current results of operations. Monetary assets and liabilities denominated in foreign currencies are translated into Korean Won at ₩1,187.7 to USD1, the rate of exchange on September 30, 2008 that is permitted by the Financial Accounting Standards. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated into Korean Won at the foreign exchange rate on the date of the transaction.

Foreign currency assets and liabilities of foreign-based operations and companies accounted for using the equity method are translated at current rate of exchange at the balance sheet date while profit and loss items in the statement of income are translated at average rate and capital account at historical rate. Translation gains and losses arising from collective translation of the foreign currency financial statements of foreign-based operations are recorded net as accumulated other comprehensive income. These gains and losses are subsequently recognized as income in the year the foreign operations or the companies are liquidated or sold.

2 Summary of Significant Accounting Policies and Basis of Presenting Financial Statements, Continued

(l) Revenue Recognition

The Company's revenue categories consist of tobacco products sold, construction contracts and other income.

Tobacco products sold
Revenue from the sale of tobacco products is measured at the fair value of the consideration received or receivable, net of returns and allowances, trade discounts and volume rebates. Revenue is recognized when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods.

Lotting-out construction contracts
As soon as the outcome of a lotting-out construction contract can be estimated reliably, contract revenue and expenses are recognized in the statement of income in proportion to the percentage of completion and sales in lots of the contact. Lotting-out revenue 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.

The percentage of completion is assessed by reference to costs incurred for work performed to date to the estimated total contract costs. When the outcome of a construction contract cannot be estimated reliably, revenue is recognized only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognized immediately in the statement of income.

Revenue from other than the above is recognized when the Company's revenue-earning activities have been substantially completed, the amount of revenue can be measured reliably, and it is probable that the economic benefits associated with the transaction will flow to the Company.

(m) Income Taxes

Income tax on the income or loss for the year comprises current and deferred tax. Income tax is recognized in the statement of income except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted.

Deferred tax is provided using the asset and liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable income will be available against which the unused tax losses and credits can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred tax assets and liabilities are classified as current or non-current based on the classification of the related asset or liability for financial reporting or the expected reversal date of the temporary difference for those with no related asset or liability such as loss carryforwards and tax credit carryforwards. The deferred tax amounts are presented as a net current asset or liability and a net non-current asset or liability.

Deferred taxes are recognized on the temporary differences related to unrealized gains and losses on investment securities that are reported as a separate component of capital adjustments.

2 Summary of Significant Accounting Policies and Basis of Presenting Financial Statements, Continued

(n) Provisions, Contingent Assets and Contingent Liabilities

Provisions are recognized when all of the following are met: (1) an entity has a present obligation as a result of a past event, (2) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and (3) a reliable estimate can be made of the amount of the obligation. Where the effect of the time value of money is material, a provision is recorded at the present value of the expenditures expected to be required to settle the obligation.

Where the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement is recognized as a separate asset when, and only when, it is virtually certain that reimbursement will be received if the Company settles the obligation. The expense relating to a provision is presented net of the amount recognized for a reimbursement.

(o) Earnings Per Share

Earnings per common share are calculated by dividing net income by the weighted-average number of shares of common stock outstanding during each period.

(p) Share-based Payments

The Company has granted shares or share options to its employees and other parties. For equity-settled share-based payment transactions, the Company measures the goods or services received, and the corresponding increase in equity as a capital adjustment at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the Company measures their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted. If the fair value of the equity instruments cannot be estimated reliably at the measurement date, the Company measures them at their intrinsic value and recognizes the goods or services received based on the number of equity instruments that ultimately vest. For cash-settled share-based payment transactions, the Company measures the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the Company remeasures the fair value of the liability at each reporting date and at the date of settlement, with changes in fair value recognized in profit or loss for the period.

(q) Derivatives

The Company holds derivative financial instruments to hedge its foreign currency and interest rate risk exposures. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, and a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.

Derivatives are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Attributable transaction costs are recognized in profit or loss when incurred.

Hedge accounting
Where a derivative, which meets certain criteria, is used for hedging the exposure to changes in the fair value of a recognized asset, liability or firm commitment, it is designated as a fair value hedge. Where a derivative, which meets certain criteria, is used for hedging the exposure to the variability of the future cash flows of a forecasted transaction it is designated as a cash flow hedge.

2 Summary of Significant Accounting Policies and Basis of Presenting Financial Statements, Continued

(q) Derivatives, Continued

The Company documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Company also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting the changes in fair values or cash flows of hedged items.

Fair value hedge
Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the statement of income, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

Cash flow hedge
The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in equity. The gain or loss relating to any ineffective portion is recognized immediately in the statement of income. Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at the time remains in equity and is recognized when the forecast transaction is ultimately recognized in the statement of income. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the statement of income.

Derivatives that do not qualify for hedge accounting
Changes in the fair value of derivative instruments that are not designated as fair value or cash flow hedges are recognized immediately in the statement of income.

Separable embedded derivatives
Changes in the fair value of separable embedded derivatives are recognized immediately in the statement of income.

(r) Use of Estimates

The preparation of non-consolidated financial statements in accordance with accounting principles generally accepted in the Republic of Korea requires management to make estimates and assumptions that affect the amounts reported in the non-consolidated financial statements and related notes to non-consolidated financial statements. Actual results could differ from those estimates.

3 Basis of Translating Financial Statements

The non-consolidated financial statements are expressed in Korean Won and have been translated into U.S. dollars at the rate of ₩1,187.7 to US$1, the basic exchange rate on September 30, 2008, solely for the convenience of the reader. This translation should not be construed as a representation that any or all of the amounts shown could be converted into United States dollars at this or any other rate.

4 Inventories

Inventories as of September 30, 2008 and December 31, 2007 are summarized as follows:

In millions of Won		**September 30, 2008**	**December 31, 2007**
Finished goods, net of allowance for valuation losses	₩	98,799	80,680
Work-in-progress		12,708	10,100
Raw materials, net of allowance for valuation losses		697,843	792,561
Supplies		21,461	21,507
By-products		2,867	2,641
Completed buildings		85,940	52,150
Sites for building lotting-out construction (note 10)		14,519	13,204
Goods-in-transit		15,471	6,670
	₩	949,608	979,513

5 Other Current Assets

Other current assets as of September 30, 2008 and December 31, 2007 are summarized as follows:

In millions of Won		**September 30, 2008**	**December 31, 2007**
Accrued income	₩	522	237
Other receivables, net of allowance for doubtful accounts of ₩5,101 in 2008 and ₩4,652 in 2007 (note 16)		41,236	33,564
Prepaid expenses		20,733	7,006
Short-term loans to employees (note 8)		19,442	19,442
Advance payments (note 8)		65,249	244
Available-for-sale securities (note 6)		1,073	92
	₩	148,255	60,585

6 Available-for-sale Securities

Available-for-sale securities as of September 30, 2008 and December 31, 2007 are summarized as follows:

(a) Equity securities (non-current)

In millions of Won, except owned shares and percentage of ownership	Number of shares	Percentage of ownership		Acquisition cost	Fair value	Book value September 30, 2008	Book value December 31, 2007
Marketable securities:							
Yonhap Television News (YTN)	8,380,000	19.95%	₩	5,102	39,805	39,805	28,366
Crystal Genomics Co., Ltd.	172,187	1.67%		3,022	1,715	1,715	1,791
Oscotech, Inc.	230,770	3.51%		2,250	1,027	1,027	1,396
Shinhan Financial Group	3,500,000	0.88%		205,532	146,650	146,650	187,250
REXAHN Pharmaceuticals, Inc.(*1)	4,642,858	8.28%		5,158	7,114	7,114	-
Celltrion, Inc.(*2)	13,030,810	12.23%		21,245	108,807	108,807	-
				242,309	305,118	305,118	218,803
Non-marketable securities:							
Celltrion, Inc.(*2)	-	-		-	-	-	21,245
Nexgen Biotechnologies, Inc. (*3)	1,000,000	11.84%		2,150	-	-	-
Cosmo Tobacco Co., Ltd. (*3)	480,000	40.00%		2,540	-	-	-
Innodis, Inc.	110,000	19.64%		55	55	55	55
REXAHN Pharmaceuticals, Inc.(*1)	-	-		-	-	-	5,158
Lifenza, Inc. (*3)	29,047	13.01%		1,600	-	-	-
Korea Islet Transplantation Institute, Inc. (*4)	110,500	48.25%		2,000	2,000	2,000	2,000
KT&G Mongolia LLC (*5)	-	-		-	-	-	201
Korea Tabacos do Brasil Ltda. (*4)	(*6)	99.90%		394	394	394	394
Genematrix, Inc.	300,000	10.14%		1,500	1,500	1,500	1,500
Litepharmtech, Inc. (*4)	77,667	29.46%		1,830	1,830	1,830	1,830
Hurum, Inc.	7,800	9.75%		39	39	39	39
Mazence Co., Ltd. (formerly, MD Bioalpha Co., Ltd.)	197,556	6.86%		733	733	733	733
OCT USA, Inc.	48,780	19.97%		927	927	927	927
Dream Hub PFV Co., Ltd.	3,000,000	1.50%		15,000	15,000	15,000	75
Migami, Inc.	4,286,000	3.77%		2,830	2,830	2,830	-
KT&G Pars (*4)	459,998	99.99%		479	479	479	-
KT&G Rus L.L.C. (*4)	(*6)	99.00%		793	793	793	-
Korea Carbon Finance, Inc. (*4)	100,000	20.00%		500	500	500	-
SJ Biomed Corporation	285,714	16.00%		1,000	1,000	1,000	-
				34,370	28,080	28,080	34,157
Total			₩	276,679	333,198	333,198	252,960

6 Available-for-sale Securities, Continued

(a) Equity securities (non-current), continued

(*1) As REXAHN Pharmaceuticals, Inc. was listed on American Stock Exchange in the period ended September 30, 2008, REXAHN Pharmaceuticals, Inc. is recorded at the reasonably adjusted value of the market price established in American Stock Exchange.
(*2) As Celltrion, Inc. was listed on KOSDAQ in the period ended September 30, 2008, Celltrion, Inc. is recorded at the market price established in KOSDAQ.
(*3) In the prior period, the Company wrote off its investments in Nexgen Biotechnologies, Inc., Lifenza, Inc. and Cosmo Tobacco Co., Ltd. as its decline in value was judged to be other than temporary. Other than the above, non-marketable securities are recorded at cost since fair value is not available or readily determinable.
(*4) Investments in small affiliates are accounted for under the cost method of accounting for investments since the effect of applying the equity method on its financial statements is not material.
(*5) The liquidation process was completed in the period ended September 30, 2008, the Company recorded a ₩80 million gain on sale of available-for-sale securities.
(*6) Stock certificates are not issued.

(b) Debt securities

In millions of Won	Interest rate per annum		Acquisition cost	Fair value	Book value September 30, 2008	Book value December 31, 2007
Current assets:						
Government and municipal bonds	2.5 ~ 4.0%	₩	73	73	73	92
Oscotech, Inc.	10.0%		1,000	1,000	1,000	-
			1,073	1,073	1,073	92
Non-current assets:						
Government and municipal bonds	2.5%		2,105	2,105	2,105	2,129
Oscotech, Inc.	-		-	-	-	1,000
Litepharmtech, Inc.	8.0%		1,000	1,000	1,000	1,000
			3,105	3,105	3,105	4,129
		₩	4,178	4,178	4,178	4,221

(c) Changes in unrealized gains

Changes in unrealized gains of valuation of available-for-sale securities for the nine-month period ended September 30, 2008 are summarized as follows:

In millions of Won		Amount including tax effect	Tax effect	Amount, net of tax effect
Beginning balance	₩	2,897	(797)	2,100
Changes in unrealized gain		59,912	(16,476)	43,436
Ending balance	₩	62,809	(17,273)	45,536

7 Equity Method Investment Securities

(a) Investments in companies accounted for using the equity method as of September 30, 2008 were as follows:

In millions of Won, except percentage of ownership

Company	Percentage of ownership		Cost	Market value or net assets	Balance at September 30, 2008
Listed					
Yungjin Pharm. Ind. Co., Ltd. (*1)	55.50%	₩	50,691	72,877	22,692
Unlisted					
Korea Ginseng Corporation	100.00%		214,929	617,777	617,777
Tae-a Industry Co., Ltd.	100.00%		14,198	6,914	8,205
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. (*1)	99.99%		33,670	36,858	36,660
		₩	313,488	734,426	685,334

(*1) The Company used unreviewed financial statements of Yungjin Pharm. Ind. Co., Ltd., Tae-a Industry Co., Ltd. and KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. when applying the equity method of accounting.

Investments in companies accounted for using the equity method as of December 31, 2007 were as follows:

In millions of Won, except percentage of ownership

Company	Percentage of ownership		Cost	Market value or net assets	Balance at December 31, 2007
Listed					
Yungjin Pharm. Ind. Co., Ltd. (*1)	55.50%	₩	50,691	97,169	23,941
Unlisted					
Korea Ginseng Corporation	100.00%		214,929	559,883	559,883
Tae-a Industry Co., Ltd.	100.00%		14,198	6,229	9,174
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. (*1,2)	99.99%		33,670	33,670	33,670
		₩	313,488	696,951	626,668

(*1) The Company used unaudited financial statements of Yungjin Pharm. Ind. Co., Ltd. and KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. when applying the equity method of accounting. In the subsequent period, the Company adjusted the difference between the unaudited and audited results. Historically, the differences have been immaterial.

(*2) The Company reclassified its investment in KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. as an equity method accounted investment since the effect of applying the equity method was material due to an additional acquisition of shares in the investee given rise to by an increase in its paid-in capital in the year ended December 31, 2007.

7 Equity Method Investment Securities, Continued

(b) Details of the difference between the acquisition cost and the Company's share of the investees' identifiable net assets arisen in the nine-month period ended September 30, 2008 and the year ended December 31, 2007 were as follows:

In millions of Won		2008 Beginning balance	2008 Amortized amount	2008 Ending balance
Yungjin Pharm. Ind. Co., Ltd.	₩	897	(672)	225
Tae-a Industry Co., Ltd.		3,109	(1,555)	1,554
	₩	4,006	(2,227)	1,779

In millions of Won		2007 Beginning balance	2007 Amortized amount	Ending balance
Yungjin Pharm. Ind. Co., Ltd.	₩	1,793	(896)	897
Tae-a Industry Co., Ltd.		5,183	(2,074)	3,109
	₩	6,976	(2,970)	4,006

(c) Details of unrealized gains from intercompany transactions for the nine-month period ended September 30, 2008 and the year ended December 31, 2007 are summarized as follows:

In millions of Won		2008 Beginning balance	2008 Increase	2008 Realized amount	2008 Ending balance
Yungjin Pharm. Ind. Co., Ltd.	₩	2,017	-	(18)	1,999
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		-	198	-	198
Tae-a Industry Co., Ltd.		164	263	(164)	263
	₩	2,181	461	(182)	2,460

In millions of Won		Beginning balance	2007 Increase	2007 Realized amount	2007 Ending balance
Yungjin Pharm. Ind. Co., Ltd.	₩	876	1,157	(16)	2,017
Tae-a Industry Co., Ltd.		123	41	-	164
	₩	999	1,198	(16)	2,181

7 Equity Method Investment Securities, Continued

(d) Changes in the beginning and ending balances of investments in companies accounted for using the equity method for the nine-month period ended September 30, 2008 and the year ended December 31, 2007 were as follows:

In millions of Won, except percentage of ownership

Company	Percentage of ownership		2008 Balance at January 1, 2008	Net income (loss)	Accumlated other Compre-hensive income	Other decrease (*1)	Balance at September 30, 2008
Korea Ginseng Corporation	100.00%	₩	559,883	116,392	1,502	(60,000)	617,777
Yungjin Pharm. Ind. Co., Ltd	55.50%		23,941	(1,249)	-	-	22,692
Tae-a Industry Co., Ltd.	100.00%		9,174	(969)	-	-	8,205
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	99.99%		33,670	(3,339)	6,329	-	36,660
		₩	626,668	110,835	7,831	(60,000)	685,334

(*1) The amount was cash dividends.

In millions of Won, except percentage of ownership

Company	Percentage of ownership		2007 Balance at January 1, 2007	Net income (loss)	Accumlated other Compre-hensive income	Other decrease (*1)	Balance at December 31, 2007
Korea Ginseng Corporation	100.00%	₩	451,545	128,302	36	(20,000)	559,883
Yungjin Pharm. Ind. Co., Ltd (*3).	55.50%		27,871	(23,633)	-	19,703	23,941
Tae-a Industry Co., Ltd.	100.00%		10,528	(1,354)	-	-	9,174
KT&G USA, Inc (*2)	-		903	-	-	(903)	-
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	99.99%		-	-	-	33,670	33,670
		₩	490,847	103,315	36	32,470	626,668

(*1) The amount consists of ₩20,000 million cash dividends, ₩53,373 million paid-in capital increase and ₩903 million reclassification.

(*2) In the first quarter of 2007, the Company reclassified its investment in KT&G USA, Inc. as available-for-sale securities since KT&G USA, Inc. was in the process of liquidation. The liquidation process was completed in the year ended December 31, 2007, and the Company recorded a gain on sale of available-for-sale securities of ₩724 million.

(*3) Youngjin Pharm. Ind. Co., Ltd. amended its financial statements as of and for the year ended December 31, 2006 due to adjustments for the accounting error for the fiscal year 2006 and prior periods by which accumulated deficit increased by ₩20,959 million. However, as the effect of the adjustments on the financial statements was judged to be not material, a loss of ₩11,940 million has been charged to current results for the year ended December 31, 2007.

7 Equity Method Investment Securities, Continued

(e) Summarized financial information of equity method investment securities, which represents 100% of the entities' balances as of September 30, 2008 was as follows:

In millions of Won		Total assets	Total liabilities	Sales	Net income (loss)
Korea Ginseng Corporation	₩	688,974	71,197	464,531	116,392
Yungjin Pharm. Ind. Co., Ltd.		104,667	60,585	80,004	(3,065)
Tae-a Industry Co., Ltd.		11,691	4,777	11,387	685
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		63,578	26,720	1,132	(3,141)

Summarized financial information of equity method investment securities, which represents 100% of the entities' balances as of December 31, 2007 was as follows:

In millions of Won		Total assets	Total liabilities	Sales	Net income (loss)
Korea Ginseng Corporation	₩	631,874	71,991	521,123	128,302
Yungjin Pharm. Ind. Co., Ltd.		106,912	61,759	109,422	(16,575)
Tae-a Industry Co., Ltd.		10,298	4,069	13,419	767
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		37,973	4,303	-	(1,608)

8 Transactions and Balances with Related Companies

(a) The Company's subsidiaries as of September 30, 2008 were as follows:

Controlled subsidiary(*)			
Subsidiary owned by the Company	**Ownership (%)**	**Entity owned by the subsidiary**	**Ownership (%)**
Korea Ginseng Corporation	100.00%	KGC Sales Co., Ltd.	100.00%
Yungjin Pharm. Ind. Co., Ltd.	55.50%	Yungjin Distribution Co., Ltd.	100.00%
Tae-a Industry Co., Ltd.	100.00%		
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	99.99%		
Cosmo Tabacco Co., Ltd.	40.00%		
Korea Tabacos do Brasil Ltda.	99.90%		
Korea Islet Transplantation Institute, Inc.	48.25%		
Korea Ginseng HK, Ltd.	100.00%		
KT&G Pars	99.99%		
KT&G Rus L.L.C.	99.00%		

(*) Controlled subsidiaries represent majority-owned entities by either the Company or a controlled subsidiary and other entities where the Company or its controlled subsidiary owns more than 30% of total outstanding common stock and is the largest shareholder.

8 Transactions and Balances with Related Companies, Continued

(b) Significant transactions and account balances which occurred in the normal course of business with related companies for the three-month and nine-month periods ended September 30, 2008 and 2007 and as of September 30, 2008 and December 31, 2007 are summarized as follows:

(i) Revenue from sales and others

		Nine-month periods ended September 30					
		2008			2007		
In millions of Won		Sales	Other income	Total	Sales	Other income	Total
Korea Ginseng Corporation	₩	9,935	697	10,632	1,047	10,303	11,350
Yungjin Pharm. Ind. Co., Ltd.		25	6	31	65	1	66
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		2,500	-	2,500	79	293	372
KT&G USA, Inc.		-	-	-	1,694	-	1,694
KT&G Mongolia LLC		-	-	-	1,148	-	1,148
KT&G Pars		555	-	555	-	-	-
	₩	13,015	703	13,718	4,033	10,597	14,630

		Three-month periods ended September 30					
		2008			2007		
In millions of Won		Sales	Other income	Total	Sales	Other income	Total
Korea Ginseng Corporation	₩	3,567	101	3,668	247	3,529	3,776
Yungjin Pharm. Ind. Co., Ltd.		8	3	11	26	-	26
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		693	-	693	-	293	293
KT&G Mongolia LLC		-	-	-	468	-	468
KT&G Pars		269	-	269	-	-	-
	₩	4,537	104	4,641	741	3,822	4,563

8 Transactions and Balances with Related Companies, Continued

(ii) Purchases and other expenses

		Nine-month periods ended September 30					
		2008			2007		
In millions of Won		Purchases	Other expenses	Total	Purchases	Other expenses	Total
Korea Ginseng Corporation	₩	-	1,943	1,943	1,662	-	1,662
Yungjin Pharm. Ind. Co., Ltd.		-	5	5	-	94	94
Tae-a Industry Co., Ltd.		11,387	-	11,387	9,632	-	9,632
Korea Tabacos do Brasil Ltda.		-	129	129	-	106	106
	₩	11,387	2,077	13,464	11,294	200	11,494

		Three-month periods ended September 30					
		2008			2007		
In millions of Won		Purchases	Other expenses	Total	Purchases	Other expenses	Total
Korea Ginseng Corporation	₩	-	870	870	732	-	732
Yungjin Pharm. Ind. Co., Ltd.		-	3	3	-	49	49
Tae-a Industry Co., Ltd.		3,501	-	3,501	3,136	-	3,136
Korea Tabacos do Brasil Ltda.		-	54	54	-	58	58
	₩	3,501	927	4,428	3,868	107	3,975

(iii) Due from affiliates

		September 30, 2008			December 31, 2007		
In millions of Won		Trade accounts receivable	Other	Total	Trade accounts receivable	Other	Total
Korea Ginseng Corporation	₩	-	1,086	1,086	-	-	-
KT&G Tutun MamulleriSanayi ve Ticaret A.S.		1,262	19,044	20,306	1,127	-	1,127
KT&G Mongolia LLC		-	-	-	316	238	554
KT&G Pars		586	2,937	3,523	-	-	-
	₩	1,848	23,067	24,915	1,443	238	1,681

8 Transactions and Balances with Related Companies, Continued

(iv) Due to affiliates

In millions of Won		September 30, 2008			December 31, 2007		
		Trade accounts payable	Other	Total	Trade accounts payable	Other	Total
Korea Ginseng Corporation	₩	-	2,733	2,733	270	2,379	2,649
Tae-a Industry Co., Ltd.		1,375	-	1,375	-	-	-
	₩	1,375	2,733	4,108	270	2,379	2,649

(c) Due from stockholders, directors and employees as of September 30, 2008 and December 31, 2007 are summarized as follows:

In millions of Won		September 30, 2008	December 31, 2007
Loans for employee housing and education	₩	51,552	31,713
Loans to Employee Stock Ownership Association		10,340	37,664
Other		49,856	46,004
	₩	111,748	115,381

(d) Key management personnel compensation in total and for each of the following categories for the nine-month period ended September 30, 2008 are summarized as follows:

In millions of Won		Amount
Short-term payroll	₩	7,372
Post-retirement pay		10,729
	₩	18,101

9 Property, Plant and Equipment

Property, plant and equipment at September 30, 2008 and December 31, 2007 are summarized as follows:

In millions of Won		September 30, 2008	December 31, 2007
Property, plant and equipment at cost	₩	2,283,550	2,224,880
Accumulated depreciation		(886,804)	(815,881)
Accumulated impairment losses		(470)	(41)
Property, plant and equipment, net	₩	1,396,276	1,408,958

(a) Changes in property, plant and equipment for the nine-month period ended September 30, 2008 were as follows:

In millions of Won		January 1, 2008	Acquisition	Disposal	Depreciation	Others (*1)	September 30, 2008
Land	₩	403,344	1,031	(2,364)	-	17,085	419,096
Buildings		470,731	6,970	(3,113)	(16,456)	16,853	474,985
Structures		23,340	580	(145)	(1,556)	789	23,008
Machinery and equipment		342,473	6,487	(984)	(50,542)	43,239	340,673
Vehicles and other transportation equipment		2,836	560	(10)	(1,366)	-	2,020
Tools		11,640	512	(11)	(3,569)	192	8,764
Furniture and fixtures		75,328	13,974	(281)	(27,446)	1,619	63,194
Construction-in-progress (*2)		78,663	69,054	-	-	(83,784)	63,933
Other tangible fixed assets		603	-	-	-	-	603
	₩	1,408,958	99,168	(6,908)	(100,935)	(4,007)	1,396,276

(*1) Other changes in property, plant and equipment, except those transferred from construction-in-progress, for the nine-month period ended September 30, 2008 were as follows:

In millions of Won		Amount
Transferred to site for building lotting-out construction	₩	(3,422)
Loss on impairment of property, plant and equipment		(429)
Transferred to intangible assets (note 11)		(156)
	₩	(4,007)

(*2) Construction-in-progress as of September 30, 2008 included investment on development of new medicines amounting to ₩25,115 million.

9 Property, Plant and Equipment, Continued

(b) Changes in property, plant and equipment for the year ended December 31, 2007 were as follows:

In millions of Won		January 1, 2007	Acquisition	Disposal	Depreciation	Others (*1)	December 31, 2007
Land	₩	353,865	21,961	(13,592)	-	41,110	403,344
Buildings		460,511	6,088	(4,415)	(21,570)	30,117	470,731
Structures		23,194	1,076	(263)	(1,971)	1,304	23,340
Machinery and equipment		332,553	7,220	(2,479)	(67,408)	72,587	342,473
Vehicles and other transportation equipment		5,322	546	(225)	(2,883)	76	2,836
Tools		10,010	2,106	(27)	(4,497)	4,048	11,640
Furniture and fixtures		75,235	32,493	(127)	(36,443)	4,170	75,328
Construction-in-progress (*2)		83,002	149,333	-	-	(153,672)	78,663
Other tangible fixed assets		464	139	-	-	-	603
	₩	1,344,156	220,962	(21,128)	(134,772)	(260)	1,408,958

(*1) Other changes in property, plant and equipment, except those transferred from construction-in-progress, for the year ended December 31, 2007 were as follows:

In millions of Won		Amount
Transferred to vehicles and other transportation equipment	₩	30
Transferred to intangible assets		(290)
	₩	(260)

(*2) Construction-in-progress as of December 31, 2007 included investment on development of new medicines amounting to ₩ 21,320 million.

10 Officially Declared Value of Land

The officially declared value of land at September 30, 2008 and December 31, 2008, as announced by the Minister of Construction and Transportation, were as follows:

		September 30, 2008		December 31, 2007	
In millions of Won		**Book value**	**Declared value**	**Book value**	**Declared value**
Land	₩	419,096	1,408,352	403,344	1,304,163
Sites for building lotting-out construction		14,519	50,555	13,204	40,356

The officially declared value, which is used for government purposes, is not intended to represent fair value.

11 Intangible Assets

(a) Changes in intangible assets for the nine-month period ended September 30, 2008 were as follows:

In millions of Won		**Industrial property rights**	**Other intangible assets**	**Total**
Beginning balance	₩	1,520	199	1,719
Increases		156	-	156
Amortization		(480)	(72)	(552)
Other		-	(22)	(22)
Net balance at end of period	₩	1,196	105	1,301

(b) Changes in intangible assets for the year ended December 31, 2007 were as follows:

In millions of Won		**Industrial property rights**	**Other intangible assets**	**Total**
Beginning balance	₩	1,809	297	2,106
Increases		345	-	345
Amortization		(634)	(98)	(732)
Net balance at end of period	₩	1,520	199	1,719

12 Insurance

Buildings, structures, machinery and inventories were insured against fire damage up to ₩900,286 million as of September 30, 2008 with Dongbu Insurance Co., Ltd. In addition, the Company carries comprehensive automobile insurance, unemployment insurance and workers' accident compensation insurance.

13 Other Non-current Assets

Other non-current assets as of September 30, 2008 and December 31, 2007 are summarized as follows:

In millions of Won		September 30, 2008	December 31, 2007
Long-term loans to affiliates (note 8)	₩	2,546	238
Long-term other receivables, net of allowance for doubtful accounts of ₩10 in 2008 and 2007		1,017	1,018
Other investments assets		419	677
	₩	3,982	1,933

14 Other Current Liabilities

Other current liabilities as of September 30, 2008 and December 31, 2007 are summarized as follows:

In millions of Won		September 30, 2008	December 31, 2007
Withholdings	₩	6,517	6,244
Advance receipts		8,102	4,709
Current portion of financial derivative liabilities (note 31)		4,246	25
Unearned income		222	321
	₩	19,087	11,299

15 Retirement and Severance Benefits

Changes in the retirement and severance benefits for the nine-month period ended September 30, 2008 and the year ended December 31, 2007 are summarized as follows:

In millions of Won		September 30, 2008	December 31, 2007
Estimated retirement and severance benefits accrual at beginning of period	₩	182,345	173,332
Provision for retirement and severance benefits		43,431	31,014
Transferred to unearned stock compensation		(4,941)	-
Payments (*)		(7,820)	(22,001)
Estimated retirement and severance benefits accrual at end of period		213,015	182,345
Deposit for severance benefits trust		(119,597)	(117,985)
Net balance at end of period	₩	93,418	64,360

15 Retirement and Severance Benefits, Continued

The Company maintains an employees' severance benefit trust arrangement with Samsung Life Insurance Co., Ltd. and other. Under this arrangement, the Company has made a deposit in the amount equal to 56.1% and 64.7% of the reserve balances of retirement and severance benefits as of September 30, 2008 and December 31, 2007, respectively. This deposit is to be used to make the required payments to the retirees and accounted for as a reduction of the reserve balance.

(*) Compensations paid by treasury stock amounting to ₩2,430 million for the nine-month period ended September 30, 2008 were included.

16 Assets and Liabilities Denominated in Foreign Currencies

Details of assets and liabilities denominated in foreign currencies as of September 30, 2008 and December 31, 2007 were as follows:

In millions of Won, In thousands of US dollars and Euro		Foreign currency September 30, 2008	Foreign currency December 31, 2007		Korean Won equivalent September 30, 2008	Korean Won equivalent December 31, 2007
Assets:						
Cash and cash equivalents	USD	2,920	9,107	₩	3,469	8,544
Trade accounts receivable	USD	200,070	159,875		237,623	149,995
	EUR	1,083	816		1,849	1,127
Other receivables	USD	259	259		307	243
Long-term deposits in Escrow Fund	USD	84,519	71,022		100,384	66,633
Total	USD	287,768	240,263		341,783	225,415
	EUR	1,083	816		1,849	1,127
				₩	343,632	226,542
Liabilities:						
Trade accounts payable	USD	2,515	692	₩	2,988	649
	EUR	3,849	2,530		6,570	3,495
Other payables	GBP	225	-		481	-
				₩	10,039	4,144

17 Capital Adjustments

Capital adjustments as of September 30, 2008 and December 31, 2007 are summarized as follows:

In millions of Won		September 30, 2008	December 31, 2007
Treasury stock	₩	(311,692)	(414,947)
Unearned stock compensation		4,941	-
	₩	(306,751)	(414,947)

18 Accumulated Other Comprehensive Income

Accumulated comprehensive income as of September 30, 2008 and December 31, 2007 are summarized as follows:

In millions of Won		**September 30, 2008**	**December 31, 2007**
Unrealized gain on valuation of available-for-sale securities (note 6)	₩	45,536	2,100
Unrealized gain on valuation of equity method investments (note 7)		6,910	132
Unrealized loss on valuation of equity method investments (note 7)		-	(639)
	₩	52,446	1,593

19 Retained Earnings

Retained earnings as of September 30, 2008 and December 31, 2007 are summarized as follows:

In millions of Won		**September 30, 2008**	**December 31, 2007**
Legal reserve	₩	602,937	602,937
Reserve for business expansion		698,881	698,881
Reserve for business rationalization		12,851	12,851
Reserve for research and human resource development		30,000	45,000
Reserve for loss on reissuance of treasury stock		26,646	26,646
Other appropriations		420,000	350,000
Unappropriated retained earnings at end of period		441,039	397,314
	₩	2,232,354	2,133,629

(a) Legal Reserve

The Korean Commercial Code requires the Company to appropriate as legal reserve 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 it may be transferred to common stock in connection with a free issue of shares.

(b) Reserve for Business Expansion

Reserve for business expansion was a legal reserve under the old Korea Tobacco and Ginseng Corporation Act, which was abrogated on September 1, 1997; consequently, the existing balance has been regarded as a voluntary reserve since then.

(c) Reserve for Business Rationalization

Under the Special Tax Treatment Control Law, investment tax credit is allowed for certain investments. The Company was, however, required to appropriate from retained earnings the amount of tax benefits obtained and transfer such amount into a reserve for business rationalization.

Effective December 11, 2002, the Company is 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.

19 Retained Earnings, Continued

(d) Other Reserves

Reserves for research and human resource development and loss on reissuance of treasury stock were appropriated in order to utilize certain tax deduction benefits through the early recognition of future expenditures. These reserves are restored to retained earnings in accordance with the relevant tax laws. Such reserves are taken back into taxable income in the year of restoration. Reserves without specific purposes are restored to retained earnings by a resolution at a general meeting of stockholders.

20 Commitments and Contingencies

The Company recorded as a long-term deposit the amounts paid into the Escrow Fund of State governments in the United States against potential litigation and damages relative to the tobacco exportation into the United States. The Escrow Fund would be refunded, if the Company did not indemnify the State governments for damages for a specified number of years on the ground that the Company did not sell cigarettes illegally. As of September 30, 2008 and December 31, 2007, the Company made deposits of ₩100,384 million and ₩66,633 million, respectively which were included as long-term deposits in Escrow Funds in the accompanying non-consolidated balance sheets.

As of September 30, 2008, tobacco lawsuits claiming damages of ₩759 million were filed against the Company and the Korean government. The plaintiffs have asserted that the Company and the Korean government did not perform their obligation to notify smokers of the potential health hazards of smoking. Additionally, the Company is involved in 9 lawsuits and claims for alleged damages totalling ₩5,269 million as of September 30, 2008. The amount of the liability the Company may ultimately have with respect to the litigation cannot be reasonably estimated as of September 30, 2008.

As of September 30, 2008, the Company has provided to the National Agricultural Cooperative Federation (“NACF”) and another bank guarantees totaling ₩11,993 million for the customers who made a financing agreement with these lenders.

The Company has entered into Letter of Credit agreements with the NACF and other banks with a limit set at USD128,500 thousand.

As of September 30, 2008, the Company’s trade accounts receivable from the export of cigarettes was insured against nonpayment up to USD34,900 thousand by an export guaranty insurance with the Korea Export Insurance Corporation.

As of September 30, 2008, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD90,000 thousand by Korea Exchange Bank and other.

The Company and 28 other companies, which form the Samsung Corporation-National Pension Service Joint Consortium, were guaranteed ₩240,000 million by Seoul Guarantee Insurance Co. in relation to the Yongsan International Commercial Development Project.

The Company entered into an overdraft agreement with a limit of ₩10,000 million with the NACF as of September 30, 2008.

21 Building Lotting-out Construction Contracts

(a) Building lotting-out construction contracts as of September 30, 2008 are summarized as follows:

	Builder	Construction period	Location
Apartment buildings in Jeonju	SK Engineering & Construction Co., Ltd.	2006 ~ 2009	Jeonju
Apartment buildings in Daejeon	Kyeryong Construction Industrial Co., Ltd.	2008 ~ 2009	Daejeon

(b) Details of installment sales as of September 30, 2008 are summarized as follows:

In millions of Won		Expected contract amount	Confirmed contract amount	Recognized revenue: Prior to 2008	Recognized revenue: Nine-month period ended September 30, 2008	Unrecognized revenue
Apartment buildings in Jeonju	₩	284,995	80,927	20,275	32,989	231,731
Apartment buildings in Daejeon		44,047	20,719	-	4,111	39,936
	₩	329,042	101,646	20,275	37,100	271,667

(c) Cost of installment sales of housing units as of September 30, 2008 are summarized as follows:

In millions of Won		Prior to 2008	Nine-month period ended September 30, 2008	Aggregate amount
Apartment buildings in Jeonju	₩	13,726	22,370	36,096
Apartment buildings in Daejeon		-	2,841	2,841
	₩	13,726	25,211	38,937

22 Income Taxes

(a) The Company is subject to income taxes on taxable income at the following normal tax rates:

Taxable income	Tax rate
Up to ₩100 million	14.3%
Over ₩100 million	27.5%

The components of income tax expense for the three-month and nine-month periods ended September 30, 2008 and 2007 are summarized as follows:

		2008		2007	
In millions of Won		**Three months**	**Nine months**	**Three months**	**Nine months**
Current income tax expense	₩	66,118	201,421	106,370	222,372
Deferred income tax expense		31,198	41,024	137	9,895
Income tax expense charged directly to stockholders' equity		(16,396)	(18,549)	(37,565)	(40,684)
Income tax charge	₩	80,920	223,896	68,942	191,583

(b) The Charge for income taxes calculated by applying statutory tax rates differs from the actual charge for the three-month and nine-month periods ended September 30, 2008 and 2007 for the following reasons:

		2008		2007	
In millions of Won		**Three months**	**Nine months**	**Three months**	**Nine months**
Charge for income taxes at normal tax rates	₩	85,176	240,021	73,531	197,378
Tax effects of permanent differences		2,130	(11,949)	642	(3,426)
Tax credit		(1,693)	(5,001)	(755)	(3,282)
Changes in valuation allowances for deferred income tax assets (liabilities) arisen from equity in income of affiliates		(4,693)	1,058	(4,476)	874
Additional income taxes for prior period (Refund of prior year's income taxes)		-	(233)	-	39
Actual charge for income taxes	₩	80,920	223,896	68,942	191,583

(c) The effective tax rates, after adjustments for certain differences between amounts reported for financial accounting and income tax purposes, were approximately 25.65% and 26.69% for the nine-month periods ended September 30, 2008 and 2007.

(d) The Company did not recognize a deferred tax liability in the amount of ₩53,408 million and ₩ 58,200 million arising from the taxable temporary differences associated with affiliates as of September 30, 2008 and December 31, 2007, respectively, since non-taxable dividend income is excluded from equity in income of affiliates in the calculation of deferred tax liabilities.

22 Income Taxes, Continued

(e) The Company did not recognize a deferred tax asset in the amount of ₩30,805 million and ₩31,749 million arising from the taxable temporary differences associated with affiliates as of September 30, 2008 and December 31, 2007, respectively, since there is a remote possibility that the Company will dispose of its investments in affiliates in the foreseeable future.

(f) Deferred tax assets and liabilities that were directly charged or credited to accumulated other comprehensive income as of September 30, 2008 and 2007 were as follows:

In millions of Won		2008	2007
Gain on reissuance of treasury stock	₩	(1,659)	(37,728)
Unrealized gain on valuation of available-for-sale securities		(16,476)	(2,975)
Unrealized gain on valuation of equity method investments		(171)	2
Unrealized loss on valuation of equity method investments		(243)	17
	₩	(18,549)	(40,684)

(g) Under SKAS No. 16, *Income Taxes*, the deferred tax amounts should be presented as a net current asset or liability and a net non-current asset or liability. In addition, the Company is required to disclose aggregate deferred tax assets (liabilities). As of September 30, 2008, details of aggregate deferred tax assets (liabilities) were as follows:

In millions of Won		**Temporary differences at September 30, 2008**	**Deferred tax assets (liabilities)**	
			Current	**Non-current**
Assets:				
Provision for retirement and severance benefits	₩	145,904	-	40,124
Loss on valuation of inventories		770	212	-
Depreciation		11,904	-	3,274
Bad debts		21,697	5,966	-
Impairment losses on property, plant and equipment		2,536	-	697
Contributions		42,617	4,500	7,220
Other		39,534	7,631	3,240
		264,962	18,309	54,555
Liabilities:				
Accrued income		(469)	(128)	-
Deposit for severance benefits trust		(119,599)	-	(32,887)
Reserve for research and human resources development		(18,750)	-	(5,156)
Equity method investment securities		(496,495)	-	(132,811)
Reserve for losses on reissuance of treasury stock		(26,646)	-	(7,328)
Available-for-sale securities		(62,810)	-	(17,273)
Treasury stock		(38,930)	-	(10,706)
Gain on foreign currency translation		(46,128)	(12,685)	-
Other		(11,749)	-	(742)
		(821,576)	(12,813)	(206,903)
Net deferred tax asset (liability)	₩	(556,614)	5,496	(152,348)

23 Earnings Per Share

(a) Basic earnings per share

Basic earnings per share for the nine-month periods ended September 30, 2008 and 2007 were as follows:

In Won		2008	2007
Net income	₩	648,940,843,471	526,190,938,163
Weighted-average number of shares outstanding		130,558,756	132,594,933
Basic earnings per share	₩	4,970	3,968

Basic earnings per share for the three-month periods ended September 30, 2008 and 2007 were as follows:

In Won		2008	2007
Net income	₩	228,818,630,209	198,454,412,863
Weighted-average number of shares outstanding		130,470,228	132,306,331
Basic earnings per share	₩	1,754	1,500

(b) Potential dilutive securities which are not included in the calculation of diluted earnings per share for the nine-month period ended September 30, 2008 are summarized as follows:

Type	Par value in Korean Won	Maturity date	Issuable number of shares
Retirement and severance benefits (share-based payment)	₩ 5,000	December 31, 2008 ~ March 31, 2009	107,663

24 Non-cash Investing and Financing Activities

Significant non-cash investing and financing activities for the nine-month periods ended September 30, 2008 and 2007 are summarized as follows:

In millions of Won		2008	2007
Retirement of treasury stock	₩	209,767	269,410
Compensation through treasury stock		5,982	2,999
Severance pay by treasury stock		2,430	6,336

25 Added Value

The components of manufacturing costs and selling, general and administrative expenses which are necessary in calculating added value for the three-month and nine-month periods ended September 30, 2008 and 2007 are as follows:

		2008		2007	
In millions of Won		Three months	Nine months	Three months	Nine months
Wages and salaries	₩	84,900	238,586	73,320	225,313
Provision for severance benefits		19,290	43,431	11,042	24,002
Employee welfare		8,937	30,941	6,981	20,521
Rent		4,323	11,947	3,417	9,670
Depreciation		32,859	100,935	33,304	100,102
Taxes and dues		10,556	19,788	7,594	17,010

26 Employee Welfare and Contributions to Society

For employee welfare, the Company maintains a refectory, an infirmary, athletic facilities, a scholarship fund, workmen's accident compensation insurance, unemployment insurance and medical insurance. The amounts of welfare spent for the nine-month periods ended September 30, 2008 and 2007 were estimated at ₩30,941 million and ₩20,521 million, respectively.

The Company donated ₩20,414 million and ₩10,320 million to KT&G Social Welfare Foundation and others for the nine-month periods ended September 30, 2008 and 2007, respectively.

27 Selling, General and Administrative Expenses

The details of selling, general and administrative expenses for the three-month and nine-month periods ended September 30, 2008 and 2007 were as follows:

		2008		2007	
In millions of Won		**Three months**	**Nine months**	**Three months**	**Nine months**
Salaries	₩	51,563	144,973	43,201	133,429
Provision for severance benefits		10,673	29,161	6,007	15,385
Welfare		4,126	16,645	3,701	11,206
Travel		1,249	4,467	1,641	4,287
Communications		1,049	3,257	1,005	3,121
Utilities		1,467	4,510	1,470	4,365
Taxes and dues		9,795	17,720	6,768	14,953
Supplies		1,556	3,281	509	1,714
Uniforms		57	57	-	34
Rent		2,401	6,292	1,504	4,053
Depreciation		12,995	39,952	13,512	40,511
Amortization		173	538	178	533
Repairs and maintenance		2,188	4,333	1,183	3,455
Vehicles		2,345	6,276	1,878	5,276
Insurance		178	525	132	433
Commissions		14,214	43,340	13,890	43,012
Transportation and warehousing		7,314	18,792	6,033	19,086
Entertainment		97	356	142	421
Conferences		836	2,138	640	1,958
Advertising		34,531	96,417	34,996	96,361
Training		2,382	5,476	2,154	6,198
Prizes and rewards		454	4,625	334	1,391
Cooperation		87	409	141	489
Normal research and development		3,779	9,653	3,924	10,586
Sample		4	5	1	1
Bad debts		6,065	12,725	2,837	2,849
Miscellaneous		73	333	89	409
	₩	171,651	476,256	147,870	425,516

28 Share Based Payment

(a) Employees who have been with the Company for more than one year are entitled to severance payment which is based on employees' performance. Eligible employees may choose to receive the Company's shares for their severance payment. The details of the Company's stock compensation plan as of September 30, 2008 were as follows:

	Optional share-based payment
Type	Severance payment based on performance by share grant
Grant date, number of shares granted	March 1, 2007: 19,503 shares January 1, 2008: 1,350 shares March 1, 2008: 82,867 shares March 15, 2008: 2,870 shares April 1, 2008: 1,073 shares
Vesting condition	Service condition: 1~3 years Non-market, performance condition: long-term evaluation results based on quantified and non-quantified indices

The number of shares that may be granted is subject to the level of performance and service period.

(b) Share-based payment expense for the nine-month period ended September 30, 2008 is summarized as follows:

In millions of Won

Share-based payment expense (recognized) (Retirement and severance payment)	₩	10,729
Remaining expense to be recognized in the future years		4,051

29 Comprehensive Income

Comprehensive income for the periods ended September 30, 2008 and 2007 was as follows:

In millions of Won		**2008**	**2007**
Net income	₩	648,941	526,191
Change in fair value of available-for-sale securities, net of tax effect of ₩16,476 in 2008 and ₩2,975 in 2007		43,436	7,841
Increase in unrealized gain on valuation of equity method investments, net of tax effect of ₩171 in 2008 and ₩(2) in 2007		6,778	(4)
Decrease in unrealized loss on valuation of equity method investments, net of tax effect of ₩243 in 2008 and ₩(17) in 2007		639	186
Comprehensive income	₩	699,794	534,214

30 Change in Accounting Policy

The Company changed accounting policy on equity method accounted investments in conformity with Statement of Korea Accounting Standard (SKAS) No. 15 *Investment In Associates* revised February 22, 2008 which guided, when accounting on equity method accounted investments, to concord net assets of non-consolidated financial statements with those of consolidated financial statements.

These changes resulted in a decrease in loss on valuation of equity method investments of ₩9 million, equity method investment securities of ₩16 million and unrealized gain on valuation of equity method investments of ₩2,596 million and an increase in capital surplus of ₩2,532 million and unappropriated retained earnings of ₩48 million, respectively. The Company restated the prior period's financial statements in conformance with these changes in accounting policy.

Financial positions of prior three years after adjusting retroactively for the cumulative effect are summarized as follows:

In millions of Won,
except earning per share in Won

Account	2007		2006		2005	
	Before	After	Before	After	Before	After
Loss on valuation of equity method investments	₩ 24,999	24,986	5,882	5,869	3,195	3,182
Net Income	661,193	661,206	649,678	649,691	515,925	515,938
Earnings per share	4,992	4,992	4,608	4,609	3,497	3,497
Equity method investment securities	626,693	626,668	490,885	490,847	421,317	421,266
Capital surplus	464,237	466,769	335,413	336,252	300,043	300,882
Unrealized gain on valuation of equity method investments	2,728	132	750	(153)	1,180	277
Unappropriated (undisposed) retained earnings (deficit)	397,276	397,314	(204,796)	(204,770)	404,737	404,750

31 Derivative Instruments

(a) The Company entered into foreign currency forward and foreign currency option contracts to hedge foreign currency risk of accounts receivable. Details of the contracts as of September 30, 2008 were as follows:

In Won and thousands of US dollars

Derivative Instrument	Contractor	Contract position	Exchange rate	Contract date	Expiration date	Contract amount
Currency option	Korea Exchange Bank	Call Option Sell	₩ 988	March 11, 2008	October 29, 2008~	USD 12,000
		Put Option Buy			March 27, 2009	USD 6,000
	Citibank, N.A.,Seoul	Call Option Sell	₩ 989	March 12, 2008	October 29, 2008~	USD 10,000
		Put Option Buy			February 25, 2009	USD 5,000

(b) Details of gain and loss on valuation of derivative instruments for the three-month and nine-month periods ended September 30, 2008 and 2007 are as follows:

In millions of Won		2008		2007	
In millions of Won		Three months	Nine months	Three months	Nine months
Currency forward	₩	-	-	-	69
Currency option		(2,155)	(4,246)	-	-
	₩	(2,155)	(4,246)	-	69