



KT&G CORPORATION

## Non-Consolidated Financial Statements

(Unaudited)

**September 30, 2009 and 2008**

(With Independent Accountants' Review Report)

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## Independent Accountants' Review Report

The Board of Directors and Shareholders  
KT&G Corporation:

We have reviewed the accompanying non-consolidated financial statements of KT&G Corporation (the "Company"), which comprise the non-consolidated statements of financial position as of September 30, 2009 and December 31, 2008, and the non-consolidated statements of comprehensive income for the three- and nine-month periods and changes in equity and cash flows for the nine-month periods all of which ended September 30, 2009 and 2008.

### Management's responsibility

Management is responsible for the preparation and fair presentation of these non-consolidated financial statements in accordance with Korean International Financial Reporting Standards.

### Our responsibility

Our responsibility is to express an opinion on these non-consolidated financial statements based on our reviews.

### Scope of Review

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.

### Review Conclusion

Based on our reviews, nothing has come to our attention that causes us to believe that the non-consolidated financial statements referred to above are not presented fairly, in all material respects, in accordance with Korean International Financial Reporting Standards.

The accompanying non-consolidated financial statements as of and for the three- and nine-month period ended September 30, 2009 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 27 to the non-consolidated financial statements, the Company and the Korean government are defendants in lawsuits claiming damages of ₩584 million for the effects of smoking. The final outcome of these lawsuits cannot be predicted.

As discussed in notes 2 and 29 to the non-consolidated financial statements, the Company has early-adopted Korean International Financial Reporting Standards as prescribed in the Act on External Audit of Corporation from 2009. Accordingly, the prior period non-consolidated financial statements presented for comparative purposes have been restated in accordance with Korean International Financial Reporting Standards No.1101 *First-time Adoption of Korean International Financial Reporting Standards*.

KPMG Samjong Accounting Corp.  
Seoul, Korea  
November 14, 2009

This report is effective as of November 14, 2009, 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 Statements of Financial Position  
(Unaudited)

**As of September 30, 2009 and December 31, 2008**

<i>In millions of Won and thousands of U.S. dollars</i>	<i>Note</i>	September 30 2009 Korean Won	September 30 2009 U.S. dollars (note 3)	December 31 2008 Korean Won
<b>Assets</b>				
<b>Non-current assets</b>				
Property, plant and equipment	4	₩ 1,213,236	\$ 1,020,641	₩ 1,275,536
Intangible assets	5	43,804	36,850	41,260
Investment property	6	102,778	86,462	105,075
Investments in associates	7	4,830	4,063	7,277
Investments in subsidiaries	8	707,764	595,410	662,668
Available-for-sale financial assets	9, 26	465,352	391,480	301,956
Long-term deposits in MSA Escrow Fund	10, 26, 27	117,010	98,436	110,261
Long-term prepaid expenses		4,954	4,167	5,342
Long-term trade and other receivables	11, 26	118,147	99,391	122,122
<b>Total non-current assets</b>		<b>2,777,875</b>	<b>2,336,900</b>	<b>2,631,497</b>
<b>Current assets</b>				
Inventories	12	1,046,921	880,728	1,147,096
Trade and other receivables	11, 26	622,840	523,968	517,644
Prepaid tobacco excise and other taxes		158,751	133,550	201,774
Advance payments		45,002	37,858	21,297
Prepaid expenses		7,034	5,918	2,575
Current available-for-sale financial assets	9, 26	3,060	2,574	2,149
Other financial assets	26	-	-	1,000
Cash and cash equivalents	13, 26	208,894	175,733	88,352
		2,092,502	1,760,329	1,981,887
Non-current asset held for sale		23,246	19,556	-
<b>Total current assets</b>		<b>2,115,748</b>	<b>1,779,885</b>	<b>1,981,887</b>
<b>Total assets</b>		<b>₩ 4,893,623</b>	<b>\$ 4,116,785</b>	<b>₩ 4,613,384</b>

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION

Non-Consolidated Statements of Financial Position (Continued)

(Unaudited)

As of September 30, 2009 and December 31, 2008

<i>In millions of Won and thousands of U.S. dollars</i>	<i>Note</i>	September 30 2009 Korean Won	September 30 2009 U.S. dollars (note 3)	December 31 2008 Korean Won
<b>Equity</b>				
Capital and reserves				
Ordinary shares	14	₩ 954,959	\$ 803,365	₩ 954,959
Other capital surplus	14	2,632	2,214	337
Treasury shares	15	(262,498)	(220,827)	(226,945)
Gain on reissuance of treasury shares	15	468,274	393,938	468,274
Reserve	16	2,094,441	1,761,960	1,821,348
Retained earnings	17	530,019	445,882	436,453
<b>Total equity</b>		<b>3,787,827</b>	<b>3,186,532</b>	<b>3,454,426</b>
<b>Liabilities</b>				
Non-current liabilities				
Long-term trade and other payables	18, 26	24,102	20,276	24,323
Long-term advance receipts		492	412	622
Defined benefit liabilities	20	60,860	51,198	48,337
Deferred income tax liabilities	23	107,692	90,596	81,691
<b>Total non-current liabilities</b>		<b>193,146</b>	<b>162,482</b>	<b>154,973</b>
Current liabilities				
Short-term borrowings	19, 26	13,752	11,569	13,344
Trade and other payables	18, 26	360,544	303,309	392,963
Advance receipts		33,847	28,474	71,296
Other financial liabilities	26	-	-	2,699
Income taxes payable	23	68,874	57,941	153,486
Tobacco excise and other taxes payable		435,633	366,478	370,197
<b>Total current liabilities</b>		<b>912,650</b>	<b>767,771</b>	<b>1,003,985</b>
<b>Total liabilities</b>		<b>1,105,796</b>	<b>930,253</b>	<b>1,158,958</b>
<b>Total equity and liabilities</b>		<b>₩ 4,893,623</b>	<b>\$ 4,116,785</b>	<b>₩ 4,613,384</b>

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION  
 Non-Consolidated Statements of Comprehensive Income  
 (Unaudited)

**For the nine-month periods ended September 30, 2009 and 2008**

<i>In millions of Won and thousands of U.S. dollars, except earnings per share</i>	<i>Note</i>	2009 Korean Won	2009 U.S. dollars (note 3)	2008 Korean Won
<b>Sales:</b>	25			
Manufacture of tobacco		₩ 1,889,724	\$ 1,589,740	₩ 1,835,688
Real estate		145,720	122,588	16,104
Exports of leaf tobacco and others		31,298	26,329	31,031
		2,066,742	1,738,657	1,882,823
<b>Cost of sales:</b>	21, 25			
Manufacture of tobacco		(716,646)	(602,882)	(687,436)
Real estate		(90,572)	(76,194)	(2,557)
Exports of leaf tobacco and others		(18,996)	(15,980)	(20,977)
		(826,214)	(695,056)	(710,970)
<b>Gross profit</b>		1,240,528	1,043,601	1,171,853
Other income	21	38,138	32,084	83,076
Selling, general and administrative expenses	21	(442,371)	(372,147)	(451,379)
Employee welfare fund		-	-	(15,000)
Other expense	21	(80,867)	(68,030)	(19,090)
<b>Profit from operations</b>	25	755,428	635,508	769,460
Finance income	22	38,255	32,182	74,997
Finance costs	22	(5,636)	(4,742)	(6,905)
<b>Net finance income</b>	22	32,619	27,440	68,092
<b>Profit before income taxes</b>		788,047	662,948	837,552
Income tax expense	23	(180,958)	(152,232)	(211,401)
<b>Profit for the period</b>		₩ 607,089	\$ 510,716	₩ 626,151
<b>Other comprehensive income:</b>				
Available-for-sale financial assets, net of tax	9	121,388	102,120	43,436
Actuarial gains (losses), net of tax	20	834	701	(23,284)
<b>Other comprehensive income (expense) for the period, net of tax</b>		122,222	102,821	20,152
<b>Total comprehensive income for the period</b>		₩ 729,311	\$ 613,537	₩ 646,303
<b>Earnings per share in Won:</b>				
Basic and Diluted	24	₩ 4,718	\$ 3.97	₩ 4,796

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION

Non-Consolidated Statements of Comprehensive Income (Continued)

(Unaudited)

**For the three-month periods ended September 30, 2009 and 2008**

*In millions of Won  
and thousands of U.S. dollars,  
except earnings per share*

	Note	2009 Korean Won	2009 U.S. dollars (note 3)	2008 Korean Won
<b>Sales:</b>	25			
Manufacture of tobacco		₩ 671,912	\$ 565,249	₩ 627,912
Real estate		24,282	20,427	5,171
Exports of leaf tobacco and others		9,768	8,217	10,427
		705,962	593,893	643,510
<b>Cost of sales:</b>	21, 25			
Manufacture of tobacco		(262,224)	(220,598)	(237,600)
Real estate		(13,689)	(11,516)	(852)
Exports of leaf tobacco and others		(8,576)	(7,214)	(5,471)
		(284,489)	(239,328)	(243,923)
<b>Gross profit</b>		421,473	354,565	399,587
Other income	21	3,060	2,574	48,768
Selling, general and administrative expenses	21	(156,927)	(132,016)	(161,590)
Employee welfare fund		-	-	-
Other expense	21	(50,551)	(42,526)	(7,584)
<b>Profit from operations</b>	25	217,055	182,597	279,181
Finance income	22	3,138	2,641	4,157
Finance costs	22	(160)	(135)	(3,486)
<b>Net finance income (costs)</b>	22	2,978	2,506	671
<b>Profit before income taxes</b>		220,033	185,103	279,852
Income tax expense	23	(52,577)	(44,230)	(76,433)
<b>Profit for the period</b>		₩ 167,456	\$ 140,873	₩ 203,419
<b>Other comprehensive income:</b>				
Available-for-sale financial assets, net of tax	9	36,278	30,519	42,755
Actuarial losses, net of tax	20	(222)	(187)	(7,761)
<b>Other comprehensive income (expense) for the period, net of tax</b>		36,056	30,332	34,994
<b>Total comprehensive income for the period</b>		₩ 203,512	\$ 171,205	₩ 238,413
<b>Earnings per share in Won:</b>				
Basic and diluted	24	₩ 1,302	\$ 1.100	₩ 1,559

See accompanying notes to non-consolidated financial statements.



KT&G CORPORATION

Non-Consolidated Statements of Changes in Equity

(Unaudited)

For the nine-month period ended September 30, 2009

<i>In millions of Won</i>		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
<b>Balance at January 1, 2009</b>	₩	954,959	337	(226,945)	468,274	1,821,348	436,453	3,454,426
<b>Total comprehensive income for the period:</b>								
Profit for the period		-	-	-	-	-	607,089	607,089
Other comprehensive income:								
Available-for-sale financial assets, net of tax		-	-	-	-	121,388	-	121,388
Actuarial gains, net of tax		-	-	-	-	-	834	834
<b>Total other comprehensive income</b>		-	-	-	-	121,388	834	122,222
<b>Total comprehensive income for the period</b>		-	-	-	-	121,388	607,923	729,311
<b>Transactions with owners, recorded directly in equity:</b>								
Dividends		-	-	-	-	-	(360,357)	(360,357)
Reacquisition of treasury shares		-	-	(35,553)	-	-	-	(35,553)
Transfer to unconditional reserve		-	-	-	-	169,000	(169,000)	-
Transfer from reserve for research and human resource development		-	-	-	-	(15,000)	15,000	-
Expiration of employee share options		-	2,295	-	-	(2,295)	-	-
<b>Total transactions with owners</b>		-	2,295	(35,553)	-	151,705	(514,357)	(395,910)
<b>Balance at September 30, 2009</b>	₩	954,959	2,632	(262,498)	468,274	2,094,441	530,019	3,787,827

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION

Non-Consolidated Statements of Changes in Equity (Continued)

(Unaudited)

For the nine-month period ended September 30, 2009

<i>In thousands of U.S. dollars</i>	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
<b>Balance at January 1, 2009</b>	\$ 803,365	283	(190,918)	393,938	1,532,218	367,170	2,906,056
<b>Total comprehensive income for the period:</b>							
Profit for the period	-	-	-	-	-	510,716	510,716
Other comprehensive income:							
Available-for-sale financial assets, net of tax	-	-	-	-	102,120	-	102,120
Actuarial gains, net of tax	-	-	-	-	-	701	701
<b>Total other comprehensive income</b>	-	-	-	-	102,120	701	102,821
<b>Total comprehensive income for the period</b>	-	-	-	-	102,120	511,417	613,537
<b>Transactions with owners, recorded directly in equity:</b>							
Dividends	-	-	-	-	-	(303,152)	(303,152)
Reacquisition of treasury shares	-	-	(29,909)	-	-	-	(29,909)
Transfer to unconditional reserve	-	-	-	-	142,172	(142,172)	-
Transfer from reserve for research and human resource development	-	-	-	-	(12,619)	12,619	-
Expiration of employee share options	-	1,931	-	-	(1,931)	-	-
<b>Total transactions with owners</b>	-	1,931	(29,909)	-	127,622	(432,705)	(333,061)
<b>Balance at September 30, 2009</b>	\$ 803,365	2,214	(220,827)	393,938	1,761,960	445,882	3,186,532

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION

Non-Consolidated Statements of Changes in Equity (Continued)

(Unaudited)

For the nine-month period ended September 30, 2008

<i>In millions of Won</i>		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
<b>Balance at January 1, 2008</b>	₩	954,959	337	(414,947)	463,900	1,738,415	393,213	3,135,877
<b>Total comprehensive income for the period:</b>								
Profit for the period		-	-	-	-	-	626,151	626,151
Other comprehensive income:								
Available-for-sale financial assets, net of tax		-	-	-	-	43,436	-	43,436
Actuarial losses, net of tax		-	-	-	-	-	(23,284)	(23,284)
<b>Total other comprehensive income</b>		-	-	-	-	43,436	(23,284)	20,152
<b>Total comprehensive income for the period</b>		-	-	-	-	43,436	602,867	646,303
<b>Transactions with owners, recorded directly in equity:</b>								
Dividends		-	-	-	-	-	(340,449)	(340,449)
Reacquisition of treasury shares		-	-	(108,889)	-	-	-	(108,889)
Retirement of treasury shares		-	-	209,767	-	-	(209,767)	-
Share-based payment transaction		-	-	-	-	4,941	-	4,941
Employee benefits by treasury shares		-	-	2,378	4,374	-	-	6,752
Transfer to unconditional reserve		-	-	-	-	70,000	(70,000)	-
Transfer from reserve for research and human resource development		-	-	-	-	(15,000)	15,000	-
<b>Total transactions with owners</b>		-	-	103,256	4,374	59,941	(605,216)	(437,645)
<b>Balance at September 30, 2008</b>	₩	954,959	337	(311,691)	468,274	1,841,792	390,864	3,344,535

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, 2009 and 2008**

<i>In millions of Won and thousands of U.S. dollars</i>	<i>Note</i>	2009 Korean Won	2009 U.S. dollars (note 3)	2008 Korean Won
<b>Cash flows from operating activities</b>				
Profit for the period		₩ 607,089	\$ 510,716	₩ 626,151
Adjustments for:				
Income tax expense	23	180,958	152,232	211,401
Finance costs	22	5,636	4,742	6,905
Finance income	22	(38,255)	(32,182)	(74,997)
Depreciation	4, 6	92,380	77,715	98,138
Amortization	5	247	208	552
Retirement benefit costs	20	24,611	20,563	25,868
Foreign currency translations loss	21	21,376	17,982	795
Loss on the write-down of inventories	12	3,184	2,679	4,618
Impairment loss				
on trade and other receivables	11	17	14	371
Loss on sale of property, plant and equipment	21	5,017	4,221	2,499
Impairment loss				
on property, plant and equipment		-	-	429
Impairment loss on intangible assets		646	544	-
Other expense	12	1,967	1,655	1,080
Reversal of loss				
on the write-down of inventories	12	(222)	(186)	(18,439)
Foreign currency translations gain	21	(133)	(112)	(46,923)
Gain on sale of property, plant and equipment	21	(6,074)	(5,110)	(13,145)
Reversal of impairment loss				
on trade and other receivables		(18)	(15)	-
		898,426	755,666	825,303
<b>Changes in working capital:</b>				
Trade and other receivables		(116,319)	(97,854)	(40,391)
Advance payments		(43,096)	(36,255)	(65,005)
Prepaid expenses		(4,178)	(3,515)	(13,294)
Prepaid tobacco excise and other taxes		43,023	36,193	(92,348)
Inventories		95,246	80,126	20,880
Trade and other payables		(31,897)	(26,834)	67,203
Advance receipts		(37,450)	(31,505)	3,250
Tobacco excise and other taxes payable		65,436	55,048	79,398
Payment of retirement benefits	20	(11,018)	(9,129)	(2,440)
<b>Cash generated from operations</b>		858,173	721,941	782,556
Income tax paid		(274,043)	(230,540)	(305,134)
<b>Net cash from operating activities</b>		584,130	491,401	477,422

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, 2009 and 2008

<i>In millions of Won and thousands of U.S. dollars</i>	<i>Note</i>	2009 Korean Won	2009 U.S. dollars (note 3)	2008 Korean Won		
<b>Cash flows from investing activities</b>						
Decrease in other financial assets		1,000	841	-		
Interest received		6,144	5,168	11,455		
Dividends received		30,215	25,419	63,458		
Proceeds from sale of available-for-sale financial assets		45	38	46		
Proceeds from subsidiaries		-	-	282		
Collection of loans		17,230	14,495	20,314		
Proceeds from sale of property, plant and equipment		8,830	7,428	17,554		
Proceeds from sale of intangible assets		64	54	-		
Withdrawal of guarantee deposits		9,820	8,261	7,610		
Proceeds from sale of other investment assets		7	6	258		
Purchases of available-for-sale financial assets		(8,727)	(7,342)	(18,756)		
Increase in loans		(13,143)	(11,056)	(18,988)		
Purchases of investments in associates		(500)	(421)	(500)		
Purchases of investments in subsidiaries		(21,668)	(18,228)	(1,272)		
Payments for guarantee deposits		(10,969)	(9,228)	(10,409)		
Payments long-term deposits in MSA Escrow Fund		(14,271)	(12,005)	(13,394)		
Purchases of property, plant and equipment		(62,516)	(52,592)	(99,169)		
Acquisition of intangible assets		(3,501)	(2,945)	(943)		
Acquisition of investment property		(323)	(272)	-		
Settlement of financial derivatives		(4,410)	(3,710)	(2,091)		
<b>Net cash used in investing activities</b>		<b>(66,673)</b>	<b>(56,089)</b>	<b>(44,545)</b>		
<b>Cash flows from financing activities</b>						
Interest paid		(576)	(485)	(593)		
Increase in deposits received		2,007	1,688	3,112		
Decrease in deposits received		(2,345)	(1,972)	(5,172)		
Reacquisition of treasury shares		(35,553)	(29,909)	(108,889)		
Payments of dividends		(360,357)	(303,152)	(340,449)		
<b>Net cash used in financing activities</b>		<b>(396,824)</b>	<b>(333,830)</b>	<b>(451,991)</b>		
<b>Net increase in cash and cash equivalents</b>		<b>120,633</b>	<b>101,482</b>	<b>(19,114)</b>		
Cash and cash equivalents at beginning of period		88,352	74,326	115,126		
Effect of exchange rate fluctuation on cash held		(91)	(75)	68		
<b>Cash and cash equivalents at end of period</b>	<b>₩</b>	<b>208,894</b>	<b>\$</b>	<b>175,733</b>	<b>₩</b>	<b>96,080</b>

See accompanying notes to non-consolidated financial statements.

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
(Unaudited)

September 30, 2009 and 2008

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 share on the Korea Exchange (formerly, the Korea Stock Exchange) on October 8, 1999. On December 27, 2002, the Company changed its name again to KT&G Corporation from Korea Tobacco and Ginseng Corporation.

As of September 30, 2009, 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, and has its head office in Pyeongchon-dong, Daedeok-gu, Daejeon.

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

On October 17, 2002 and October 31, 2001, the Company listed 35,816,658 and 45,400,000 Global Depository Receipts ("GDR") (each GDR representing the right to receive one-half share of 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 share at September 30, 2009 is held as follows:

<i>Shareholder</i>	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.85%
Employee Share Ownership Association	6,378,879	4.60%
Treasury shares	10,613,297	7.65%
Others	112,289,836	80.90%
	138,792,497	100.00%

The Company has, thus far, reacquired and retired 52,199,400 shares of treasury stock. Accordingly, as of September 30, 2009, the Company's value of ordinary shares differs from the aggregate par value of issued shares by ₩260,997 million.

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
(Unaudited)

September 30, 2009 and 2008

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

**(a) Basis of Preparation**

The non-consolidated financial statements have been prepared in accordance with Korean International Financial Reporting Standards ("K-IFRS"), as prescribed in the Act on External Audit of Corporations. K-IFRS is effective from the fiscal year beginning on or after January 1, 2011 and the Company early-adopted K-IFRS from 2009.

These non-consolidated financial statements are separate financial statements which are those presented by a parent or an investor in an associate, in which the investments are accounted for on the basis of the direct equity interest rather than on the basis of the period results and net assets of the investee in accordance with K-IFRS No.1027 *Consolidated and Separate Financial Statements*.

The non-consolidated financial statements have been prepared in accordance with K-IFRS No.1034 *Interim Financial Reporting*, and are the Company's first interim non-consolidated financial statements for part of the period covered by its first K-IFRS financial statements, with a transition date of January 1, 2008. The prior period non-consolidated financial statements presented for comparative purposes have been restated in accordance with the accounting policies described below. Also, these accounting policies are consistently applied in the non-consolidated statement of financial position as of January 1, 2008 which is not accompanying this report. The effect of the transition from the Generally Accepted Accounting Principles in the Republic of Korea to K-IFRS, affecting the Company's reported financial position, financial performance and cash flows is described in note 29 to non-consolidated financial statements.

The interim non-consolidated financial statements provide less information as compared with annual non-consolidated financial statements in accordance with K-IFRS No.1034. The accounting policies applied in the interim non-consolidated financial statements is consistent with those which will be applied in the first K-IFRS non-consolidated financial statements for the year to December 31, 2009.

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, changes in equity or cash flows, is not presented in the accompanying non-consolidated financial statements.

**(b) Basis of Measurement**

The non-consolidated financial statements have been prepared under the historical cost convention except as described in the accounting policy below on financial instruments.

**(c) Investments in Subsidiaries and Associates in the Separate Financial Statement**

These non-consolidated financial statements are separate financial statements which are those presented by a parent or an investor in an associate in accordance with K-IFRS No.1027, 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 Company accounts for investments in subsidiaries and associates at cost. The Company measures an investment in Korea Ginseng Corporation at the deemed cost which is previous GAAP carrying amount at the date of transition in accordance with K-IFRS No.1101 *First-time Adoption of Korean International Financial Reporting Standards*. Dividends on investments in subsidiaries and associates are recognized in profit or loss when the Company's right to receive payment is established.

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
(Unaudited)

September 30, 2009 and 2008

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

**(d) Foreign Currencies**

These non-consolidated financial statements are presented in Korean Won, which is the Company's functional currency that is the currency of the primary economic environment in which the Company operates.

Foreign currency transactions are initially recorded using the spot exchange rate between the functional currency and the foreign currency at the date of the transaction. At the end of each reporting period, foreign currency monetary items are translated using the closing rate. 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. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements are recognized in profit or loss in the period in which they arise.

**(e) Property, Plant and Equipment**

Property, plant and equipment are measured initially at cost and after initial recognition, are carried at cost less accumulated depreciation and accumulated impairment losses. The cost of property, plant and equipment includes expenditure arising directly from the construction or acquisition of the asset, any costs directly attributable to bringing the asset to the location and condition necessary for them to be capable of operating in the manner intended by management and the initial estimate of the costs of dismantling and removing the item and restoring the site on which they are located.

Subsequent costs are recognized in the carrying amount of property, plant and equipment 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 those parts that are replaced is derecognized. The costs of the day-to-day servicing are recognized in profit or loss as incurred.

Property, plant and equipment, except for land and other tangible fixed assets, are depreciated on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives are as follows:

	Useful lives (years)
Buildings and structures	10 ~ 60
Machinery and vehicles	4 ~ 12
Tools, furniture and fixtures	4

Depreciation methods, useful lives and residual values are reviewed at each financial year-end. If it is appropriate to change, such a change is accounted for as a change in an accounting estimate.



KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
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September 30, 2009 and 2008

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

**(f) Intangible Assets**

Intangible assets are measured initially at cost and after initial recognition, are carried at cost less any accumulated amortization and accumulated impairment losses. Intangible assets consist of industrial property rights, rights to facility usage, other intangible assets 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. Rights to facility usage and some of industrial property right which are deemed to have an indefinite useful life are not amortized, and are subject to an impairment test.

The estimated useful lives are as follows:

	<u>Useful lives (years)</u>
Industrial property rights	5 ~ 10 or indefinite
Rights to facility usage	indefinite
Other intangible assets	15

The amortization period and the amortization method for intangible assets with a finite useful life are reviewed at each financial year-end. The useful lives of intangible assets that is not being amortized are reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If it is appropriate to change, such a change is accounted for as a change in an accounting estimate.

**(g) Investment Property**

Properties held to earn rent or as capital investments are classified as investment properties. Investment properties are measured initially at its cost including transaction costs and after initial recognition, are carried at cost less accumulated depreciation and 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 those parts that are replaced is derecognized. The costs of the day-to-day servicing are recognized in profit or loss as incurred.

Investment properties, except for land, are depreciated on a straight-line basis over 10 ~ 60 years, the estimated useful lives. Depreciation methods, useful lives and residual values are reviewed at each financial year-end. If it is appropriate to change, such a change is accounted for as a change in an accounting estimate.

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
(Unaudited)

September 30, 2009 and 2008

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

**(h) Inventories**

Inventories are stated 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.

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 recognized as an expense in the period in which the reversal occurs.

Tobacco leaf inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognized industry practice. The estimated amounts of inventories in current assets which are not expected to be realized within 12 months are ₩268,654 million and ₩304,969 million, respectively, as of September 30, 2009 and December 31, 2008.

**(i) Financial Instruments**

The Company recognizes a financial asset or a financial liability in the non-consolidated statement of financial position when the Company becomes a party to the contractual provisions of the instrument and removes a financial asset or a financial liability from the statement of financial position when it is extinguished.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire or when all the risks and rewards of ownership of the financial asset are substantially transferred. If the Company retains substantially all the risks and rewards of ownership of the transferred financial asset, the Company continues to recognize the transferred financial asset and recognizes a financial liability for the consideration received.

**(i) Non-Derivative Financial Instruments**

Non-derivative financial instruments comprise investments in equity and debt securities, long-term deposits in MSA Escrow Fund, trade and other receivables, cash and cash equivalents, borrowings, and trade and other payables. When non-derivative financial instruments are recognized initially, the Company measures it at its fair value plus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

*A Financial Asset or Financial Liability at Fair Value through Profit or Loss*

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's documented risk management or investment strategy. Upon initial recognition transaction costs are recognized in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
(Unaudited)

September 30, 2009 and 2008

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

**(i) Financial Instruments, Continued**

*Held-to-maturity Investments*

If the Company has the positive intent and ability to hold debt securities to maturity, then they are classified as held-to-maturity. Held-to-maturity investments are measured at amortized cost using the effective interest method, less any impairment losses.

*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 loans and receivables, held-to-maturity investments or financial assets at fair value through profit or loss. Subsequent to initial recognition, they are measured at fair value and changes therein are recognized directly in other comprehensive income, except for impairment losses and foreign exchange gains and losses on monetary available-for-sale financial asset. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are measured at cost. When the financial asset is derecognized or impairment losses is recognized, the cumulative gain or loss previously recognized in other comprehensive income is reclassified from equity to profit or loss. Dividends on an available-for-sale equity instrument are recognized in profit or loss when the Company's right to receive payment is established

*Cash and Cash Equivalents*

Cash and cash equivalents comprise cash on hand, demand deposits and short-term, highly liquid investments. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are included as a component of cash and cash equivalents for the purpose of the non-consolidated statement of cash flows.

*Loans and Receivables*

Loans and receivables are trade receivables, loans and other receivables with fixed or determinable payments that are not quoted in an active market. After initial recognition, loans and receivables are measured at amortized cost using the effective interest method except for short-term receivables of which the effect of discounting is immaterial.

**(ii) Derivative Financial Instruments**

Derivatives are recognized initially at fair value. Attributable transaction costs are recognized in profit or loss when incurred.

A hedge of the exposure to changes in fair value of a recognized asset or liability or an unrecognized firm commitment that is attributable to a particular risk is accounted for as a fair value hedge. A hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction is accounted for cash flow hedge.

At the inception of the hedge, the Company formally designates the hedging relationship and the Company's risk management objective and strategy for undertaking the hedge and documents identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the Company will assess the hedging instrument's effectiveness. The Company assesses the hedge effectiveness on an ongoing basis throughout the financial reporting periods for which the hedge was designated.

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
(Unaudited)

September 30, 2009 and 2008

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

**(i) Financial Instruments, Continued**

Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

*Fair value hedges*

The gain or loss from remeasuring the hedging instrument designated as a fair value hedge at fair value and the gain or loss on the hedged item attributable to the hedged risk is recognized in profit or loss.

*Cash flow hedges*

The portion of the gain or loss on the hedging instrument designated as a cash value hedge that is determined to be an effective hedge is recognized in other comprehensive income and the ineffective portion of the gain or loss on the hedging instrument is recognized in profit or loss. The associated gains or losses that were recognized in other comprehensive income is reclassified from equity to profit or loss in the same period or periods during which the hedged forecast transaction affects profit or loss. If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, the associated gains and losses that were recognized in other comprehensive income are removed and included in the initial cost or other carrying amount of the asset or liability.

If the hedging instrument expires or is sold, terminated or exercised or the hedge no longer meets the criteria for hedge accounting or the Company revokes the designation, the hedge accounting is discontinued prospectively. The cumulative gain or loss on the hedging instrument that has been recognized in other comprehensive income is reclassified from equity to profit or loss when the forecast transaction occurs. If the transaction is no longer expected to occur, the cumulative gain or loss that had been recognized in other comprehensive income is immediately reclassified from equity to profit or loss.

Changes in the fair value of derivatives that are not designated as hedging instrument or do not meet the criteria for hedge accounting are recognized immediately in profit or loss.

**(j) Non-current Assets Held for Sale**

The Company classifies a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use, and measures it at the lower of its carrying amount and fair value less costs to sell.

**(k) Revenue Recognition**

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

Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the nine-month periods ended September 30, 2009 and 2008 were ₩2,933,340 million and ₩3,025,860 million, respectively.

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
(Unaudited)

**September 30, 2009 and 2008**

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

**(k) Revenue Recognition, Continued**

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

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

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

**(l) Impairment of Non-financial Assets**

The Company assesses at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the Company estimates the recoverable amount of the asset. Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment annually, irrespective of whether there is any indication that it may be impaired. If there is any indication that an asset may be impaired, recoverable amount is estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, the Company determines the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).

The recoverable amount is measured as the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use. If the recoverable amount of an asset or cash-generating unit is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. That reduction is recognized in profit or loss.

**(m) Impairment of Financial Assets**

The Company assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired, except a financial asset at fair value through profit or loss. A financial asset or group of financial assets is considered to be impaired if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset. The Company first assesses whether objective evidence of impairment exists individually for loans and receivables that are individually significant. If no objective evidence of impairment exists for an individually assessed loans and receivables, the Company includes the asset in a group of loans and receivables with similar credit risk characteristics and collectively assesses them for impairment. Future cash flows in a group of loans and receivables that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group.

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
(Unaudited)

September 30, 2009 and 2008

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

**(m) Impairment of Financial Instruments, Continued**

The amount of the impairment loss on financial assets carried at amortized cost is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognized in profit or loss. 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. The reversal does not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal is recognized in profit or loss.

The amount of the impairment loss on financial assets carried at cost 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.

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 equity 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.

**(n) Income Taxes**

Income tax expense comprises current tax expense and deferred tax expense. Current and deferred taxes are recognized as an expense included in profit or loss for the period, except to the extent that the tax arises from a transaction which is recognized in other comprehensive income or directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be paid to or recovered from the taxation authorities, using the tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax assets and liabilities are recognized for temporary differences which are differences between the carrying amount of an asset or liability in the non-consolidated statement of financial position and its tax base, the carryforward of unused tax losses and unused tax credits. 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 that have been enacted or substantively enacted by the end of the reporting period. When the tax rates or tax laws are changed or the recoverability of deferred tax assets are reassessed, the resulting deferred tax is recognized in profit or loss, except to the extent that it relates to items previously recognized outside profit or loss. Income tax expense is recognized in each interim period based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

The Company recognizes a deferred tax liability for all taxable temporary differences associated with investments in subsidiaries and associates, except to the extent that the parent or investor is able to control the timing of the reversal of the temporary difference; and it is probable that the temporary difference will not reverse in the foreseeable future.

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
(Unaudited)

September 30, 2009 and 2008

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

**(n) Income Taxes, Continued**

The Company recognizes a deferred tax asset for all deductible temporary differences arising from investments in subsidiaries and associates, to the extent that, and only 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.

**(o) Dividends**

The dividends declared to holders of equity instruments after the reporting period are not recognized as a liability at the end of the reporting period.

**(p) Equity Capital**

Ordinary shares are classified as equity. The transaction costs of an equity transaction are accounted for as a deduction from equity net of any related income tax benefit to the extent they are incremental costs directly attributable to the equity transaction.

If the Company reacquires its own equity instruments, those instruments ("treasury shares") are presented as a deduction from total equity. The transaction costs of an equity transaction are accounted for as a deduction from equity net of any related income tax benefit to the extent they are incremental costs directly attributable to the equity transaction. The gain or loss on the purchase, sale, issue or cancellation of treasury shares is not recognized in profit or loss but recognized directly in equity.

**(q) Provisions, Contingent Assets and Contingent Liabilities**

Provisions are recognized when the Company has a present obligation (legal or constructive) 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 amount recognized as a provision is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. 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, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

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

**(r) Employee Benefits**

*Short-term employee benefits*

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.

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
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**September 30, 2009 and 2008**

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

**(r) Employee Benefits, Continued**

*Retirement benefits*

The Company operates both defined benefit and defined contribution plans.

The defined benefit liabilities are calculated the present value of the defined benefit obligations less the fair value of the plan assets at the end of the reporting period.

In determining the present value of its defined benefit obligations and the related current service cost, the Company uses the projected unit credit method and attributes benefit to periods of service on a straight-line basis under the plan's benefit formula.

Actuarial gains and losses may result from increases or decreases in either the present value of a defined benefit obligation or the fair value of any related plan assets. The Company recognizes all actuarial gains and losses in other comprehensive income. Actuarial gains and losses recognized in other comprehensive income are recognized immediately in retained earnings and are not reclassified to profit or loss in a subsequent period.

With regard to the defined contribution plan, 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.

**(s) Share-based Payment**

For equity-settled share-based payment transactions, the Company measures the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the Company 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.

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 the end of each reporting period and at the date of settlement, with any changes in fair value recognized in profit or loss for the period.

For share-based payment transactions in which the terms of the arrangement provide either the Company or the counterparty with the choice of whether the Company settles the transaction in cash or by issuing equity instruments, the Company accounts for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the Company has incurred a liability to settle in cash, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.



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September 30, 2009 and 2008

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

**(t) Use of Estimates and Judgments**

The preparation of non-consolidated financial statements in conformity with K-IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. These include estimates about carrying amount of property, plant and equipment, financial instruments, defined benefit obligations and deferred tax assets and liabilities. Actual results may differ from these 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 ₩1,188.70 to \$1, the basic exchange rate on September 30, 2009, 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 Property, Plant and Equipment**

(a) Changes in property, plant and equipment for the nine-month period ended September 30, 2009 were as follows:

<i>In millions of Won</i>	Land, buildings and structures	Machinery and vehicles	Tools, furniture, fixtures and other	Construction- in-progress	Total
<b>Cost:</b>					
<b>Balance at January 1, 2009</b>	₩ 1,022,851	837,278	212,724	41,380	2,114,233
Additions	10,877	6,502	11,137	34,000	62,516
Disposals	(9,904)	(12,691)	(2,136)	-	(24,731)
Other	975	(7,015)	3,899	(38,953)	(41,094)
<b>Balance at September 30, 2009</b>	₩ 1,024,799	824,074	225,624	36,427	2,110,924
<b>Accumulated depreciation and impairment:</b>					
<b>Balance at January 1, 2009</b>	₩ (206,967)	(492,017)	(139,713)	-	(838,697)
Disposals	2,412	10,739	2,113	-	15,264
Depreciation	(17,384)	(45,311)	(27,065)	-	(89,760)
Other	-	15,504	1	-	15,505
<b>Balance at September 30, 2009</b>	₩ (221,939)	(511,085)	(164,664)	-	(897,688)
<b>Carrying amount:</b>					
<b>Balance at January 1, 2009</b>	₩ 815,884	345,261	73,011	41,380	1,275,536
<b>Balance at September 30, 2009</b>	₩ 802,860	312,989	60,960	36,427	1,213,236

Other changes for the nine-month period ended September 30, 2009 include the carrying amount of machinery, furniture and fixtures provided as an investment in kind in KT&G Pars amounting to ₩2,343 million and the amount transferred to non-current asset held for sale amounting to ₩23,246 million.

The Company purchased and disposed of property, plant and equipment amounting to ₩99,169 million and ₩6,909 million for the nine-month period ended September 30, 2008, respectively.

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4 Property, Plant and Equipment, Continued

(b) Changes in property, plant and equipment for the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>		Land, buildings and structures	Machinery and vehicles	Tools, furniture, fixtures and other	Construction- in-progress	Total
<b>Cost:</b>						
<b>Balance at January 1, 2008</b>	₩	979,361	812,718	227,020	57,893	2,076,992
Additions		10,802	11,748	21,463	92,714	136,727
Disposals		(7,817)	(44,528)	(40,801)	-	(93,146)
Other		40,505	57,340	5,042	(109,227)	(6,340)
<b>Balance at December 31, 2008</b>	₩	1,022,851	837,278	212,724	41,380	2,114,233
<b>Accumulated depreciation and impairment:</b>						
<b>Balance at January 1, 2008</b>	₩	(187,195)	(467,409)	(139,449)	-	(794,053)
Disposals		2,132	40,003	40,335	-	82,470
Impairment		-	(429)	-	-	(429)
Depreciation		(21,904)	(64,354)	(40,599)	-	(126,857)
Other		-	172	-	-	172
<b>Balance at December 31, 2008</b>	₩	(206,967)	(492,017)	(139,713)	-	(838,697)
<b>Carrying amount:</b>						
<b>Balance at January 1, 2008</b>	₩	792,166	345,309	87,571	57,893	1,282,939
<b>Balance at December 31, 2008</b>	₩	815,884	345,261	73,011	41,380	1,275,536

Other changes for the year ended December 31, 2008 include the amount transferred to inventories and intangible assets amounting to ₩5,970 million and ₩198 million, respectively.

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5 Intangible Assets

(a) Changes in intangible assets for the nine-month period ended September 30, 2009 were as follows:

<i>In millions of Won</i>		Industrial property rights	Rights to facility usage	Other intangible assets	Intangible assets under development	Total
<b>Cost:</b>						
<b>Balance at January 1, 2009</b>	₩	6,133	14,616	658	25,456	46,863
Additions		43	-	-	3,458	3,501
Disposals		-	(64)	-	-	(64)
<b>Balance at September 30, 2009</b>	₩	6,176	14,552	658	28,914	50,300
<b>Accumulated amortization and impairment:</b>						
<b>Balance at January 1, 2009</b>	₩	(5,028)	-	(575)	-	(5,603)
Impairment		-	-	-	(646)	(646)
Amortization		(191)	-	(56)	-	(247)
<b>Balance at September 30, 2009</b>	₩	(5,219)	-	(631)	(646)	(6,496)
<b>Carrying amount:</b>						
<b>Balance at January 1, 2009</b>	₩	1,105	14,616	83	25,456	41,260
<b>Balance at September 30, 2009</b>	₩	957	14,552	27	28,268	43,804

The Company purchased intangible assets amounting to ₩943 million for the nine-month period ended September 30, 2008.

(b) Changes in intangible assets for the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>		Industrial property rights	Rights to facility usage	Other intangible assets	Intangible assets under development	Total
<b>Cost:</b>						
<b>Balance at January 1, 2008</b>	₩	5,935	14,246	681	21,319	42,181
Additions		-	370	-	4,137	4,507
Disposals		-	-	(23)	-	(23)
Other		198	-	-	-	198
<b>Balance at December 31, 2008</b>	₩	6,133	14,616	658	25,456	46,863
<b>Accumulated amortization and impairment:</b>						
<b>Balance at January 1, 2008</b>	₩	(4,415)	-	(482)	-	(4,897)
Amortization		(613)	-	(93)	-	(706)
<b>Balance at December 31, 2008</b>	₩	(5,028)	-	(575)	-	(5,603)
<b>Carrying amount:</b>						
<b>Balance at January 1, 2008</b>	₩	1,520	14,246	199	21,319	37,284
<b>Balance at December 31, 2008</b>	₩	1,105	14,616	83	25,456	41,260

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5 Intangible Assets, Continued

- (c) Expenditures not capitalized for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Cost of sales	₩ 46	111	46	132
Selling, general and administrative expenses	3,557	8,955	3,779	9,655
	₩ 3,603	9,066	3,825	9,787

6 Investment Property

- (a) Changes in investment property for the nine-month period ended September 30, 2009 were as follows:

<i>In millions of Won</i>		Land	Buildings	Total
<b>Cost:</b>				
<b>Balance at January 1, 2009</b>	₩	13,919	116,687	130,606
Subsequent expenditure		-	323	323
<b>Balance at September 30, 2009</b>	₩	13,919	117,010	130,929
<b>Accumulated depreciation and impairment:</b>				
<b>Balance at January 1, 2009</b>	₩	-	(25,531)	(25,531)
Depreciation		-	(2,620)	(2,620)
<b>Balance at September 30, 2009</b>	₩	-	(28,151)	(28,151)
<b>Carrying amount:</b>				
<b>Balance at January 1, 2009</b>	₩	13,919	91,156	105,075
<b>Balance at September 30, 2009</b>	₩	13,919	88,859	102,778

- (b) Changes in investment property for the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>		Land	Buildings	Total
<b>Cost:</b>				
<b>Balance at January 1, 2008</b>	₩	13,919	116,465	130,384
Subsequent expenditure		-	222	222
<b>Balance at December 31, 2008</b>	₩	13,919	116,687	130,606
<b>Accumulated depreciation and impairment:</b>				
<b>Balance at January 1, 2008</b>	₩	-	(22,122)	(22,122)
Depreciation		-	(3,409)	(3,409)
<b>Balance at December 31, 2008</b>	₩	-	(25,531)	(25,531)
<b>Carrying amount:</b>				
<b>Balance at January 1, 2008</b>	₩	13,919	94,343	108,262
<b>Balance at December 31, 2008</b>	₩	13,919	91,156	105,075

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6 Investment Property, Continued

- (c) The amounts recognized in profit or loss from investment property for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Rental income	₩ 4,163	12,672	4,017	12,304
Direct operating expense	(856)	(2,620)	(832)	(2,557)
	₩ 3,307	10,052	3,185	9,747

- (d) The fair value of investment property cannot be reliably measured. The officially declared value of land as of September 30, 2009 and December 31, 2008, as announced by the Ministry of Land, Transport and Maritime Affairs, were ₩110,949 million and ₩111,763 million, respectively. The officially declared value, which is used for government purposes, is not intended to represent fair value.

7 Investments in Associates

Investments in associates as of September 30, 2009 and December 31, 2008 are summarized as follows:

<i>In millions of Won, except percentage of ownership</i>	Associate	Location	Principal operation	September 30 2009		December 31 2008	
				Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
	Cosmo Tabacco Co., Ltd.	Mongolia	Manufacturing and selling tobacco	40.00%	₩ -	40.00%	₩ 2,947
	Korea Islet Transplantation, Inc.	Korea	Research and development medicine	48.25%	2,000	48.25%	2,000
	Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	29.46%	1,830	29.46%	1,830
	Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00%	1,000	20.00%	500
					₩ 4,830		₩ 7,277

In 2009, the Company recognized ₩2,947 million of impairment loss on the investment in Cosmo Tabacco Co., Ltd. and this impairment loss is recognized as finance costs in the non-consolidated statements of comprehensive income.

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8 Investments in Subsidiaries

Investments in subsidiaries as of September 30, 2009 and December 31, 2008 are summarized as follows:

In millions of Won,  
except percentage of ownership

Subsidiary	Location	Principal operation	September 30 2009		December 31 2008	
			Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00%	₩ 559,882	100.00%	₩ 559,882
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceutical	55.50%	50,691	55.50%	50,691
Tae-a Industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00%	14,198	100.00%	14,198
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. <sup>(*)1</sup>	Turkey	Manufacturing and selling tobacco	99.99%	54,049	99.99%	35,005
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf tobacco	99.90%	394	99.90%	394
KT&G Pars <sup>(*)2</sup>	Iran	Manufacturing and selling tobacco	99.99%	5,733	99.99%	1,696
KT&G Rus L.L.C. <sup>(*)3</sup>	Russia	Manufacturing and selling tobacco	100.00%	21,917	100.00%	802
KT&G Bio Corp. <sup>(*)4</sup>	Korea	Manufacturing and selling pharmaceutical	100.00%	900	100.00%	-
				₩ 707,764		₩ 662,668

(\*)1 In 2009, KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. increased paid-in capital by way of shareholder allocation and the Company's investments in subsidiaries increased by ₩19,044 million.

(\*)2 In 2008, the Company established KT&G Pars by way of investment in cash. In addition, in 2009, KT&G Pars increased paid-in capital by way of investment in kind and the Company's investments in subsidiaries increased by ₩4,037 million.

(\*)3 In 2008, the Company established KT&G Rus L.L.C. In addition, KT&G Rus L.L.C. increased paid-in capital by way of shareholder allocation and the Company's investments in subsidiaries increased by ₩21,115 million in 2009.

(\*)4 In 2009, the Company established KT&G Bio Corp. and the Company's investments in subsidiaries increased by ₩900 million.

The Company measures its investment in Korea Ginseng Corporation at the deemed cost which is the previous K-GAAP carrying amount at the date of transition in accordance with K-IFRS No.1101.

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9 Available-for-sale Financial Assets

- (a) Changes in available-for-sale financial assets for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
<b>Balance at beginning of period</b>	₩ 304,105	252,755
Acquisitions	8,727	18,931
Net changes in fair value before tax	155,625	32,664
Disposals	(45)	(245)
<b>Balance at end of period</b>	₩ 468,412	304,105
Current	₩ 3,060	2,149
Non-current	465,352	301,956
	₩ 468,412	304,105

The fair value of available-for-sale assets is principally based on quoted prices in an active market with the exception of the unlisted available-for-sale equity instruments that do not have that market price in an active market and whose fair value cannot be reliably measured and available-for-sale debt instruments whose fair value is similar to their carrying amount, which are measured at cost.

- (b) Available-for-sale financial assets as of September 30, 2009 and December 31, 2008 are summarized as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
<b>Available-for-sale debt instruments:</b>		
- Government and municipal bonds	₩ 2,104	2,150
- Corporate bonds	2,000	2,000
<b>Total available-for-sale debt instruments</b>	4,104	4,150
<b>Available-for-sale equity instruments:</b>		
<b>Listed</b>		
- Yonhap Television News (YTN)	42,570	37,249
- Crystal Genomics Co., Ltd.	1,980	1,722
- Oscotech, Inc.	1,511	748
- Shinhan Financial Group Co., Ltd.	188,393	103,950
- Rexhan Pharmaceuticals, Inc.	5,604	5,196
- Celltrion, Inc.	201,978	129,005
	442,036	277,870
<b>Unlisted</b>		
- Dream Hub PFV Co., Ltd.	15,000	15,000
- Migami, Inc.	3,017	2,831
- Genematrix, Inc.	1,500	1,500
- Other unlisted available-for-sale equity instruments	2,755	2,754
	22,272	22,085
<b>Total available-for-sale equity instruments</b>	464,308	299,955
<b>Total available-for-sale financial assets</b>	₩ 468,412	304,105

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10 Long-term Deposits in MSA Escrow Fund

- (a) Changes in long-term deposits in MSA Escrow Fund for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>		September 30 2009	December 31 2008
<b>Balance at beginning of period</b>	₩	110,261	66,633
Foreign currency translations		(7,522)	25,733
Payments		14,271	17,895
<b>Balance at end of period</b>	₩	117,010	110,261

There is no material difference between the carrying amount and their fair value of long-term deposits in MSA Escrow Fund, due to the short-term duration and the floating interest rate.

- (b) Interest income on long-term deposits in MSA Escrow Fund for the nine-month periods ended September 30, 2009 and 2008 are ₩767 million and ₩1,080 million, respectively.

11 Trade and Other Receivables

- (a) Trade and other receivables as of September 30, 2009 and December 31, 2008 are summarized as follows:

<i>In millions of Won</i>		September 30 2009		December 31 2008	
		Current	Non-current	Current	Non-current
Loans to employees	₩	27,911	68,424	27,994	78,437
Loans to subsidiaries		-	15,596	-	10,630
Other investment assets		-	412	-	419
Other receivables		51,141	561	51,813	561
Guarantee deposits		-	33,154	-	32,075
Accrued income		1,232	-	287	-
Trade receivables		542,556	-	437,550	-
	₩	622,840	118,147	517,644	122,122

- (b) Trade and other receivables as of September 30, 2009 and December 31, 2008 have been reported in the non-consolidated statements of financial position net of allowances as follows:

<i>In millions of Won</i>		September 30 2009		December 31 2008	
		Current	Non-current	Current	Non-current
Gross trade and other receivables	₩	627,706	118,147	522,511	122,122
Allowance account:					
- Other receivables		(1,618)	-	(1,636)	-
- Trade receivables		(3,248)	-	(3,231)	-
		(4,866)	-	(4,867)	-
<b>Net trade and other receivables</b>	₩	622,840	118,147	517,644	122,122



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11 Trade and Other Receivables, Continued

- (c) Changes in the allowance account for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
<b>Balance at beginning of period</b>	₩ 4,867	4,314
Impairment loss	17	553
Reversal of impairment loss	(18)	-
<b>Balance at end of period</b>	₩ 4,866	4,867

Impairment loss on trade and other receivables and reversal of impairment loss on trade and other receivables are included as part of other expense and income in the non-consolidated statements of comprehensive income.

- (d) The age schedule of trade and other receivables which were past due but not impaired as of September 30, 2009 and December 31, 2008 is as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
Within 1 month	₩ 45,671	57,002
Between 1 and 2 months	34,829	60,654
Beyond 2 months	56,183	43,580
	₩ 136,683	161,236

There is no significant concentration of credit risk with respect to trade receivables as the Company has a large number widely dispersed of customers, except for export trade receivables, and the Company holds bank guarantees, other guarantees and credit insurance 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 September 30, 2009 and December 31, 2008 are as follows:

<i>In millions of Won</i>	September 30 2009			December 31 2008		
	Effective interest rate	Current	Non-current	Effective interest rate	Current	Non-current
Loans to employees	3.00~5.68%	₩ 27,911	68,424	5.38~5.68%	₩ 27,994	78,437
Guarantee deposits	3.00~5.68%	-	33,154	5.38~5.68%	-	32,075
		₩ 27,911	101,578		₩ 27,994	110,512

There is no material difference between the carrying amount and their fair value except the above trade and other receivables, due to the short-term duration of the majority of trade and other receivables.

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**12 Inventories**

(a) Inventories as of September 30, 2009 and December 31, 2008 were summarized as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
Finished goods, net of loss on the write-down of inventories	₩ 79,664	78,473
Work-in-progress	14,322	10,039
Raw materials	770,092	822,964
Supplies	24,817	22,978
By-products	4,525	3,242
Completed buildings	105,210	-
Buildings under construction	20,472	182,059
Sites for building lotting-out construction	3,103	17,613
Goods-in-transit	24,716	9,728
	₩ 1,046,921	1,147,096

(b) The amount of inventories recognized as an expense for the nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009	2008
Cost of sales:		
- Loss on the write-down of inventories	₩ 3,184	4,618
- Reversal of loss on the write-down of inventories	(222)	(18,439)
Other expense	1,967	1,080
	₩ 4,929	(12,741)

**13 Cash and Cash Equivalents**

Cash and cash equivalents as of September 30, 2009 and December 31, 2008 were summarized as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
Cash on hand	₩ 9,378	5,941
Demand deposits	79,516	72,411
Short-term investment assets	120,000	10,000
	₩ 208,894	88,352

Cash equivalents mainly include short-term deposits with an original maturity of three months or less. The carrying amount of cash and cash equivalents approximates their fair value.

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**14 Paid-in Capital**

(a) Details of paid-in capital as of September 30, 2009 and December 31, 2008 are as follows:

<i>In Won, except number of shares</i>	September 30 2009	December 31 2008
Number of ordinary shares:		
- Authorized	800,000,000	800,000,000
- Issued	138,792,497	138,792,497
- Outstanding	128,179,200	128,698,800
Par value	₩ 5,000	5,000

The Company has, thus far, reacquired and retired 52,199,400 shares of treasury share. Accordingly, as of September 30, 2009, the Company's ordinary share differs from the aggregate par value of issued shares by ₩260,997 million.

(b) Changes in the number of shares for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>Number of shares</i>	September 30 2009			December 31 2008		
	Ordinary share	Treasury share	Total	Ordinary share	Treasury share	Total
<b>Beginning of period</b>	138,792,497	(10,093,697)	128,698,800	143,442,497	(12,602,590)	130,839,907
Reacquisition	-	(519,600)	(519,600)	-	(2,254,082)	(2,254,082)
Employee benefits	-	-	-	-	112,975	112,975
Retirement	-	-	-	(4,650,000)	4,650,000	-
<b>End of period</b>	138,792,497	(10,613,297)	128,179,200	138,792,497	(10,093,697)	128,698,800

(c) Changes in the other capital surplus for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
<b>Balance at beginning of period</b>	₩ 337	337
Expiration of employee share options	2,295	-
<b>Balance at end of period</b>	₩ 2,632	337

In 2009, employee share options were settled in cash and terminated. Consequently, the employee share option reserve was reclassified to the other capital surplus.

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15 Treasury Share

- (a) Changes in the treasury shares for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>In millions of Won, except number of shares</i>	September 30 2009		December 31 2008	
	Number of share	Carrying amount	Number of share	Carrying amount
<b>Balance at beginning of period</b>	10,093,697	226,945	12,602,590	414,947
Reacquisition of treasury shares	519,600	35,553	2,254,082	194,128
Employee benefits by treasury shares	-	-	(112,975)	(2,377)
Retirement of treasury shares	-	-	(4,650,000)	(379,753)
<b>Balance at end of period</b>	<b>10,613,297</b>	<b>262,498</b>	<b>10,093,697</b>	<b>226,945</b>

- (b) Changes in gain on reissuance of treasury shares for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
<b>Balance at beginning of period</b>	₩ 468,274	463,900
Gain on reissuance of treasury shares before tax	-	6,033
Less: Tax at 27.5%	-	(1,659)
Gain on reissuance of treasury shares, net of tax	-	4,374
<b>Balance at end of period</b>	<b>₩ 468,274</b>	<b>468,274</b>

16 Reserve

- (a) Details of reserves as of September 30, 2009 and December 31, 2008 are as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
Available-for-sale financial assets reserve	₩ 149,126	27,737
Employee share option reserve	-	2,295
Legal reserve	602,937	602,938
Voluntary reserve	1,342,378	1,188,378
	<b>₩ 2,094,441</b>	<b>1,821,348</b>

- (b) Legal Reserve

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

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**16 Reserve, Continued**

(c) Details of voluntary reserve as of September 30, 2009 and December 31, 2008 are as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
Reserve for business rationalization	₩ 12,851	12,851
Reserve for research and human resource development	15,000	30,000
Reserve for loss on reissuance of treasury shares	26,646	26,646
Reserve for business expansion	698,881	698,881
Unconditional reserve	589,000	420,000
	₩ 1,342,378	1,188,378

*Reserve for Business Rationalization*

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

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

*Reserve for Business Expansion*

Reserve for business expansion was a legal reserve under the 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.

*Other Reserves*

Reserves for research and human resource development and loss on reissuance of treasury shares 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 shareholders.

**17 Retained Earnings**

Changes in retained earnings for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
<b>Balance at beginning of period</b>	₩ 436,453	393,213
Transfer from reserve for research and human resource development	15,000	15,000
Transfer to unconditional reserve	(169,000)	(70,000)
Dividends	(360,357)	(340,449)
Profit for the period	607,089	849,487
Actuarial gains (losses), net of tax	834	(31,045)
Retirement of treasury shares	-	(379,753)
<b>Balance at end of period</b>	₩ 530,019	436,453

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18 Trade and Other Payables

(a) Trade and other payables as of September 30, 2009 and December 31, 2008 are summarized as follows:

<i>In millions of Won</i>	September 30 2009		December 31 2008	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	24,102	-	24,323
Trade payables	17,942	-	27,543	-
Withholdings	4,965	-	8,632	-
Withholdings taxes	147,843	-	125,184	-
Accrued expenses	76,811	-	91,829	-
Other payables	112,983	-	139,775	-
	₩ 360,544	24,102	392,963	24,323

(b) Details of trade and other payables that are measured at amortized cost as of September 30, 2009 and December 31, 2008 are as follows:

<i>In millions of Won</i>	September 30 2009		December 31 2008	
	Effective interest rate	Amortized cost	Effective interest rate	Amortized cost
Leasehold deposits received	3.00~5.68%	₩ 24,102	5.38~5.68%	₩ 24,323

There is no material difference between the carrying amount and their fair value except the above trade and other payables, due to the short-term duration of the majority of trade and other payables.

19 Short-term Borrowings

Short-term borrowings as of September 30, 2009 and December 31, 2008 are summarized as follows:

<i>In millions of Won</i>	Annual interest rate	September 30 2009	December 31 2008
Customer credit contracts	8.00~8.50%	₩ 13,752	13,344

As of September 30, 2009, the Company has entered into customer credit contract with the National Agricultural Cooperative Federation ("NACF") and other financial institutions, the financial institutions pay past-due trade receivables for customers and the Company has provided guarantees to the financial institutions for customers. The amount paid by the financial institutions is recognized as short-term borrowings on the non-consolidated statements of financial position.

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20 Defined Benefits Plan

The Company operates both defined benefit and defined contribution plans. According to these plans, the Company pays retirement benefits calculated under the plan's benefit formula at the time employees leave the Company. The defined benefit obligations are calculated annually by independent actuaries using the projected unit credit method.

- (a) The components of retirement benefit costs for the three- and nine-month periods ended September 30, 2009 and 2008 were as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
<b>Defined benefit costs:</b>				
Current service costs	₩ 8,002	24,340	10,161	25,157
Interest costs	1,388	4,163	1,645	4,936
Expected returns on plan assets	(1,353)	(4,059)	(1,408)	(4,225)
	₩ 8,037	24,444	10,398	25,868
<b>Defined contribution costs:</b>				
Contributions recognized as expense	167	167	-	-
	₩ 8,204	24,611	10,398	25,868

- (b) Changes in defined benefit liabilities for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
<b>Balance at beginning of period</b>	₩ 48,337	47,005
Retirement benefit costs	24,444	23,322
Actuarial losses (gains) before tax	(1,069)	39,802
Payments	(10,852)	(61,792)
<b>Balance at end of period</b>	₩ 60,860	48,337
<b>Non-consolidated statements of financial position:</b>		
- Present value of retirement benefit obligations	₩ 145,261	133,460
- Fair value of plan assets	(84,401)	(85,123)
<b>Defined benefit liabilities</b>	₩ 60,860	48,337

- (c) Changes in defined benefit obligations for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
<b>Balance at beginning of period</b>	₩ 133,460	164,991
Current service costs	24,340	22,374
Interest costs	4,163	6,582
Actuarial losses before tax	-	40,564
Payments	(16,702)	(101,051)
<b>Balance at end of period</b>	₩ 145,261	133,460

For the purpose of calculating present value of the defined benefit obligations, the Company used the market yields at the end of the reporting period on government and municipal bonds consistent with the currency and estimated term of the defined benefit obligations.

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20 Defined Benefits Plan, Continued

- (d) Changes in plan assets for the nine-month period ended September 30, 2009 and the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>		September 30 2009	December 31 2008
<b>Balance at beginning of period</b>	₩	85,123	117,986
Expected return on plan assets		4,059	5,634
Actuarial gains before tax		1,069	762
Payments		(5,850)	(39,259)
<b>Balance at end of period</b>	₩	84,401	85,123

Actual returns on plan assets for the nine-month periods ended September 30, 2009 and 2008 are ₩5,128 million and ₩4,561 million, respectively.

Expected rates of return are determined taking into account the current level of expected returns on risk-free investments, the historical level of risk premium associated with other invested assets, and the expectations for future returns on such assets.

- (e) The amount of actuarial gains (losses) for the three- and nine-month periods ended September 30, 2009 and 2008 were as follows:

<i>In millions of Won</i>		2009		2008	
		Three-month	Nine-month	Three-month	Nine-month
Actuarial gains (losses) before tax	₩	(285)	1,069	(9,950)	(29,851)
Tax effect		63	(235)	2,189	6,567
	₩	(222)	834	(7,761)	(23,284)

- (f) The components of plan assets as of September 30, 2009 and December 31, 2008 are as follows:

<i>In millions of Won</i>		September 30 2009	December 31 2008
Short-term trading financial assets	₩	45,409	49,737
Available-for-sale financial assets		38,992	35,386
	₩	84,401	85,123

As of September 30, 2009 and December 31, 2008, short-term trading financial assets include severance insurance of ₩190 million and ₩164 million which continue to be covered by the existing retirement benefits plan.

- (g) The principal actuarial assumptions as of September 30, 2009 and December 31, 2008 are as follows:

<i>In millions of Won</i>		September 30 2009	December 31 2008
Discount rate		4.25%	4.25%
Expected rate of return on plan assets		6.50%	6.25%
Rate of increase in salaries		5.00%	5.00%



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20 Defined Benefits Plan, Continued

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

<i>In millions of Won</i>		1 percentage point increase	1 percentage point decrease
<b>Rate of increase in salaries:</b>			
- Increase (decrease) in defined benefit obligations	₩	11,800	(10,625)
- Increase (decrease) in retirement benefit costs before tax		2,514	(2,193)
<b>Discount rate:</b>			
- Increase (decrease) in defined benefit obligations		(11,314)	12,890
- Increase (decrease) in retirement benefit costs before tax		(1,214)	1,396
<b>Expected rate of return on plan assets:</b>			
- Increase (decrease) in retirement benefit costs before tax		(624)	624

The effect on retirement benefit costs before tax is for 2009. The effect on defined benefit obligations is as of December 31, 2008.

21 Profit from Operations

(a) Employee benefit costs for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>		2009		2008	
		Three-month	Nine-month	Three-month	Nine-month
Salaries	₩	71,279	229,388	85,298	239,779
Retirement benefit costs		8,204	24,611	10,398	25,868
Employee welfare		9,712	24,412	8,969	31,003
	₩	89,195	278,411	104,665	296,650

(b) Depreciation and amortization for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>		2009		2008	
		Three-month	Nine-month	Three-month	Nine-month
Depreciation	₩	30,499	92,380	31,927	98,138
Amortization		51	247	178	552
	₩	30,550	92,627	32,105	98,690

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21 Profit from Operations, Continued

(c) Details of other income for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Foreign currency transaction gain	₩ 1,514	24,678	9,684	18,489
Foreign currency translation gain	-	133	30,560	46,923
Reversal of impairment loss				
on trade and other receivables	25	18	-	-
Gain on sale of property, plant and equipment	231	6,074	7,323	13,145
Others	1,290	7,235	1,201	4,519
	₩ 3,060	38,138	48,768	83,076

(d) Details of selling, general and administrative expenses for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Salaries	₩ 46,719	142,500	51,845	145,819
Retirement benefit costs	5,587	16,759	7,042	18,265
Employee welfare	6,591	16,197	4,159	16,707
Travel	1,400	4,150	1,249	4,467
Communications	1,018	3,086	1,049	3,257
Utilities	1,720	4,908	1,467	4,509
Taxes and dues	4,291	12,623	9,795	17,720
Supplies	725	2,672	1,613	3,338
Rent	2,677	7,807	2,554	6,626
Depreciation	11,458	34,939	12,162	37,453
Amortization	51	241	172	538
Repairs and maintenance	1,612	3,816	2,188	4,333
Vehicles	2,183	6,066	2,345	6,276
Insurance	140	435	178	525
Commissions	15,410	43,679	14,214	43,340
Freight and custody	4,819	17,570	7,314	18,792
Conferences	1,003	2,911	836	2,138
Advertising	43,969	107,682	34,793	97,520
Training	1,604	4,519	2,382	5,476
Prizes and rewards	393	856	454	4,625
Normal research and development	3,557	8,955	3,779	9,655
	₩ 156,927	442,371	161,590	451,379

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**21 Profit from Operations, Continued**

(e) Details of other expenses for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Foreign currency transaction loss	₩ 18,211	24,446	1,425	4,442
Foreign currency translation loss	12,892	21,376	510	795
Impairment loss on trade and other receivables	-	17	250	371
Donations	15,097	22,893	2,276	5,414
Loss on sale of property, plant and equipment	2,509	5,017	1,541	2,499
Impairment loss on property, plant and equipment	-	-	429	429
Impairment loss on intangible asstes	646	646	-	-
Others	1,196	6,472	1,153	5,140
	₩ 50,551	80,867	7,584	19,090

**22 Net Finance Costs**

(a) Details of net finance costs (income) for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
<b>Finance cost:</b>				
- Interest costs	₩ 160	978	28	593
- Loss on sale of available-for-sale financial assets	-	-	-	-
- Impairment loss on investments in subsidiary	-	2,947	-	-
- Loss on transaction of financial derivatives	-	1,711	1,304	2,067
- Loss on valuation of financial derivatives	-	-	2,154	4,245
	160	5,636	3,486	6,905
<b>Finance income:</b>				
- Interest income	(3,138)	(8,040)	(4,073)	(11,455)
- Dividend income	-	(30,215)	-	(63,458)
- Gain on sale of available-for-sale financial assets	-	-	(4)	(4)
- Gain on sale of investments in subsidiaries	-	-	(80)	(80)
	(3,138)	(38,255)	(4,157)	(74,997)
<b>Net finance costs (income)</b>	₩ (2,978)	(32,619)	(671)	(68,092)

(b) Details of interest costs for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Related financial liabilities:				
- Short-term borrowings	₩ 27	561	-	449
- Trade and other payables	129	401	28	140
- Others	4	16	-	4
	₩ 160	978	28	593

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22 Net Finance Costs, Continued

- (c) Details of interest income for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Related financial assets:				
- Deposits	₩ 1,320	4,206	3,010	8,296
- Available-for-sale financial assets	13	136	5	15
- Trade and other receivables	1,041	2,931	776	2,064
- Long-term deposits in MSA Escrow Fund	764	767	282	1,080
	₩ 3,138	8,040	4,073	11,455

23 Income Taxes

- (a) The Company was subject to income taxes on taxable income at the following normal tax rates.

Taxable income		Tax rate			
Prior to 2008	Thereafter	Prior to 2008	2008	2009	Thereafter
Up to ₩100 million	Up to ₩200 million	14.3%	12.1%	12.1%	11.0%
Over ₩100 million	Over ₩200 million	27.5%	27.5%	24.2%	22.0%

In December 2008, the Korean government reduced the corporate income tax rate (including resident tax) and increased the tax base from ₩100 million to ₩200 million beginning in 2008. Effective January 1, 2008, the income tax rate for those having their taxable income less than ₩200 million was reduced from 14.3% to 12.1%.

- (b) The components of income tax expense (benefit) for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Current income tax expense	₩ 58,386	189,681	66,117	201,706
Adjustments recognized in the period for current tax of prior periods	-	(251)	-	(287)
Changes in temporary difference	4,361	26,001	24,144	21,550
Total income tax expense	62,747	215,431	90,261	222,969
Credited (charged) directly to equity	(10,170)	(34,473)	(13,828)	(11,568)
<b>Income tax expense</b>	₩ 52,577	180,958	76,433	211,401

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23 Income Taxes, Continued

- (c) Current and deferred tax expense that were directly charged or credited to equity for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
<b>Current:</b>				
- Gain on reissuance of treasury shares	₩	-	-	(1,659)
<b>Deferred:</b>				
- Net changes in fair value of available-for-sale financial assets		(10,233)	(16,017)	(16,476)
- Actuarial gains (losses)		63	2,189	6,567
		(10,170)	(13,828)	(9,909)
<b>Credited (charged) directly to equity</b>	₩	(10,170)	(13,828)	(11,568)

- (d) The income tax expense calculated by applying statutory tax rates to the Company's profit before tax for the period differs from the actual tax expense in the non-consolidated statement of comprehensive income for the three- and nine-month periods ended September 30, 2009 and 2008 for the following reasons:

<i>In millions of Won, except tax rate information</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Profit before tax	₩	220,033	279,852	837,552
Normal tax rate		24.2%	27.5%	27.5%
Expense for income taxes at normal tax rate		53,242	76,956	230,317
Adjustment:				
- Tax effects of permanent differences		661	671	2,217
- Non-inclusion of proceeds-dividend earned		-	498	(15,899)
- Investment tax credits		(1,326)	(1,692)	(5,001)
- Additional income taxes for prior period		-	-	(233)
<b>Income tax expense</b>	₩	52,577	76,433	211,401
<b>Effective tax rate</b>		23.9%	27.3%	25.2%

- (e) Deferred tax expense (benefit) relating to the origination and reversal of temporary differences for the three- and nine-month periods ended September 30, 2009 and 2008 are as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Deferred tax liabilities at end of period	₩	(107,692)	(113,336)	(113,336)
Deferred tax liabilities at beginning of period		(103,331)	(89,192)	(91,786)
<b>Deferred tax expense (benefit)</b>	₩	4,361	24,144	21,550

- (f) Deferred tax assets and liabilities are measured using the tax rate to be applied for the period in which temporary differences are expected to be realized.

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23 Income Taxes, Continued

- (g) The net deferred tax liabilities are reflected in the non-consolidated statements of financial position after offsetting assets and liabilities where there is a legally enforceable right to offset current tax assets and liabilities and where the deferred income taxes relate to the same fiscal authority.
- (h) Changes in deferred tax assets and liabilities for the nine-month period ended September 30, 2009 were as follows:

<i>In millions of Won</i>	Balance at beginning of period	Credited to profit (charged to loss)	Charged to equity	Balance at end of period
Available-for-sale financial assets	₩ 8,800	649	-	9,449
Accrued expense	20,101	(2,448)	-	17,653
Sales	7,157	(5,324)	-	1,833
Donations in excess of tax limit	8,606	(7,714)	-	892
Retirement benefit costs	4,986	3,165	(235)	7,916
Depreciation	1,978	44	-	2,022
Investments in subsidiaries	(95,884)	-	-	(95,884)
Foreign currency translations	(6,130)	11,271	-	5,141
Treasury shares	(8,565)	-	-	(8,565)
Unrealized gain on valuation of available-for-sale financial assets	(7,823)	-	(34,238)	(42,061)
Voluntary reserve	(10,078)	7,558	-	(2,520)
Provision for advanced depreciation	(4,722)	-	-	(4,722)
Others	(117)	1,271	-	1,154
	₩ (81,691)	8,472	(34,473)	(107,692)

- (i) Changes in deferred tax assets and liabilities for the year ended December 31, 2008 were as follows:

<i>In millions of Won</i>	Balance at beginning of period	Credited to profit (charged to loss)	Credited (charged) to equity	Effect of changes in the tax rate	Balance at end of period
Available-for-sale financial assets	₩ 11,000	-	-	(2,200)	8,800
Accrued expense	22,966	(124)	-	(2,741)	20,101
Sales	1,801	6,332	-	(976)	7,157
Donations in excess of tax limit	18,467	(8,687)	-	(1,174)	8,606
Retirement benefit costs	(4,621)	2,098	8,756	(1,247)	4,986
Depreciation	3,859	(1,387)	-	(494)	1,978
Investments in subsidiaries	(120,350)	-	-	24,466	(95,884)
Foreign currency translations	-	(6,966)	-	836	(6,130)
Treasury shares	(10,781)	75	-	2,141	(8,565)
Unrealized gain on valuation of available-for-sale financial assets	(797)	(1,956)	(7,026)	1,956	(7,823)
Voluntary reserve	(15,578)	4,126	-	1,374	(10,078)
Provision for advanced depreciation	(5,903)	-	-	1,181	(4,722)
Others	8,151	(8,195)	-	(73)	(117)
	₩ (91,786)	(14,684)	1,730	23,049	(81,691)

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23 Income Taxes, Continued

(j) The income taxes payable and income taxes refund before offsetting as of September 30, 2009 and December 31, 2008 are as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
Income taxes payable	₩ 189,681	275,315
Income taxes refund	(120,807)	(121,829)
	₩ 68,874	153,486

24 Earnings per Share

Basic and diluted earnings per share for the three- and nine-month periods ended September 30, 2009 and 2008 were as follows:

<i>In millions of Won, except share information</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Profit for the period	₩ 167,456	607,089	203,419	626,151
Weighted-average number of ordinary shares outstanding	128,614,765	128,670,481	130,470,228	130,558,756
<b>Basic and diluted earnings per share in Won</b>	₩ 1,302	4,718	1,559	4,796

25 Transactions and Balances with Related Companies

(a) Details of parent and subsidiary relationships as of September 30, 2009 and December 31, 2008 were as follows:

Subsidiary	Location	Next most senior parent	Percentage of ownership					
			September 30 2009			December 31 2008		
			Parent	Sub- sidiary	Total	Parent	Sub- sidiary	Total
Korea Ginseng Corporation	Korea	The Company	100.00%	-	100.00%	100.00%	-	100.00%
Yungjin Pharm. Ind. Co., Ltd.	Korea	The Company	55.50%	-	55.50%	55.50%	-	55.50%
Tae-a Industry Co., Ltd.	Korea	The Company	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	The Company	99.99%	-	99.99%	99.99%	-	99.99%
Korea Tabacos do Brasil Ltda.	Brazil	The Company	99.90%	-	99.90%	99.90%	-	99.90%
KT&G Pars	Iran	The Company	99.99%	-	99.99%	99.99%	-	99.99%
KT&G Rus L.L.C.	Russia	The Company	100.00%	-	100.00%	100.00%	-	100.00%
KT&G Bio Corp.	Korea	The Company	100.00%	-	100.00%	-	-	-
Korea Ginseng HK, Ltd.	Hong Kong	Korea Ginseng Corporation	-	99.99%	99.99%	-	99.99%	99.99%
KGC Sales Co., Ltd.	Korea	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
Cheong Kwan Jang Taiwan Corporation	Taiwan	Korea Ginseng Corporation	-	100.00%	100.00%	-	-	-
Korea Red Ginseng Corporation	United States	Korea Ginseng Corporation	-	100.00%	100.00%	-	-	-

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25 Transactions and Balances with Related Companies, Continued

- (b) Significant transactions which occurred in the normal course of business with related companies for the three- and nine-month periods ended September 30, 2009 and 2008 are summarized as follows:

*In millions of Won*

Relationship	Related Company	2009		2008	
		Three-month	Nine-month	Three-month	Nine-month
<b>Revenue from sales and other income:</b>					
Subsidiary	Korea Ginseng Corporation	₩ 3,163	10,020	3,668	10,632
	Yungjin Pharm. Ind. Co., Ltd.	121	138	11	31
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	1,265	5,155	693	2,500
	KT&G Pars	996	4,882	269	555
	KT&G Rus L.L.C.	-	168	-	-
		₩ 5,545	20,363	4,641	13,718
<b>Purchases and other expenses:</b>					
Subsidiary	Korea Ginseng Corporation	₩ 1,249	1,857	870	1,943
	Yungjin Pharm. Ind. Co., Ltd.	19	41	3	5
	Tae-a Industry Co., Ltd.	2,513	9,915	3,501	11,387
	Korea Tabacos do Brasil Ltda.	53	151	54	129
		₩ 3,834	11,964	4,428	13,464

The Company recognized dividends from Korea Ginseng Corporation amounting to ₩30,000 million and ₩60,000 million as finance income for the nine-month periods ended September 30, 2009 and 2008, respectively.

- (c) Account balances with related companies as of September 30, 2009 and December 31, 2008 were as follows:

*In millions of Won*

Relationship	Related Company	September 30 2009	December 31 2008
<b>Receivables:</b>			
Subsidiary	Korea Ginseng Corporation	₩ 960	3,184
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	10,890	25,441
	KT&G Pars	17,316	7,204
	KT&G Rus L.L.C.	261	347
		₩ 29,427	36,176
<b>Payables:</b>			
Subsidiary	Korea Ginseng Corporation	₩ 2,238	2,595

The Company has provided Yungjin Pharm. Ind. Co., Ltd. with a guarantee for the payment of taxes amounting to ₩3,600 million as of September 30, 2009.



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**25 Transactions and Balances with Related Companies, Continued**

- (d) Details of key management personnel compensation for the three- and nine-month periods ended September 30, 2009 and 2008 are summarized as follows:

<i>In millions of Won</i>	2009		2008	
	Three-month	Nine-month	Three-month	Nine-month
Short-term employee benefits	₩ 2,138	5,187	3,064	7,372
Post-employment benefits	1,615	4,762	1,652	10,729
	₩ 3,753	9,949	4,716	18,101

**26 Risk Management**

**(a) Management of Capital Risk**

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

As of September 30, 2009 and December 31, 2008, the Company defines net debt and equity as follows:

<i>In millions of Won</i>	September 30 2009	December 31 2008
<b>Net debt:</b>		
Debts (Short-term borrowings)	₩ 13,752	13,344
Less:		
- Cash and cash equivalents	(208,894)	(88,352)
- Current other financial assets	-	(1,000)
- Current available-for-sale financial assets	(3,060)	(2,149)
	₩ (198,202)	(78,157)
<b>Equity</b>	₩ 3,787,827	3,454,426

**(b) Management of Financial Risks**

The Company is exposed to risks such as currency risk, liquidity risk, credit risk, interest rate risk and market price risk. 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 Group'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 on 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. In addition, the internal auditor consistently observes the compliance of the risk management policy and procedure, and reviews the risk exposure limit of the Company. The Company holds derivative financial instruments to hedge its specific financial risks such as currency risk.

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26 Risk Management, Continued

*Currency Risk*

The Company is exposed to foreign currency risk arising from the export and import of tobacco. The Company's primary exposure is to the US dollar and Euro. The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of September 30, 2009 and December 31, 2008 are as follows:

<i>In millions of Won</i>		September 30 2009		December 31 2008	
		Assets	Liabilities	Assets	Liabilities
USD	₩	371,846	1,927	392,697	335
EUR		6,681	1,707	1,408	7,282
	₩	378,527	3,634	394,105	7,617

The Company measures currency risk of changes in foreign exchange rates regularly. As of September 30, 2009 and December 31, 2008, the effect of 10% strengthening or weakening of functional currency against foreign currencies other than functional currency on profit before tax are as follows:

<i>In millions of Won</i>		September 30 2009		December 31 2008	
		10% strengthening	10% weakening	10% strengthening	10% weakening
USD	₩	36,992	(36,992)	39,236	(39,236)
EUR		497	(497)	(587)	587
	₩	37,489	(37,489)	38,649	(38,649)

The above sensitivity analysis was applied to monetary assets and liabilities denominated in foreign currencies other than the functional currency at the end of the reporting period.

The Company entered into foreign currency option contracts to hedge foreign currency risk of accounts receivable related to the export of tobacco. Details of the contracts as of December 31, 2008 were as follows:

<i>In Won and in thousands of U.S. dollars</i>	Contracts outstanding	Exchange rate
Call Option Sell	\$ 6,000	₩ 988
	4,000	989
Put Option Buy	3,000	988
	2,000	989

The above foreign currency option contracts were not designated as hedging instruments, and were settled in the nine-month period ended September 30, 2009. Related gains and losses are charged to the non-consolidated statement of comprehensive income as finance charge.

*Liquidity risk*

The Company has established short-term and long-term financial management plan 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 the financial liabilities are repayable with the operating cash flows and cash inflows from financial assets. The Company entered into an overdraft agreement with the NACF to manage the temporary liquidity risk.

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26 Risk Management, Continued

The maturity analysis with a residual contractual maturity of financial liabilities as of September 30, 2009 and December 31, 2008 is as follows:

<i>In millions of Won</i>		Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years	Total
<b>September 30, 2009:</b>						
Derivative financial liabilities	₩	-	-	-	-	-
Non-derivative financial liabilities		75,510	163,830	4,764	2,000	246,104
	₩	75,510	163,830	4,764	2,000	246,104
<b>December 31, 2008:</b>						
Derivative financial liabilities	₩	2,699	-	-	-	2,699
Non-derivative financial liabilities		85,252	204,135	6,057	2,000	297,444
	₩	87,951	204,135	6,057	2,000	300,143

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.

*Credit Risk*

The Company has transacted with customers with high credit ratings to manage credit risk, and has implemented and operated policies and procedures for credit enhancements of the financial assets. Counterparty credit risk is managed by evaluating its credit rating and limiting the aggregate amount and duration of exposure before sales commence, and the Company has been provided collaterals and guarantees. The credit ratings of all counterparties and the level of collaterals 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.

Export trade receivables to overseas clients, including Alokozay International Limited are ₩222,564 million and ₩266,592 million, and equal to 41.0% and 60.9% of the aggregate trade receivables, respectively, as of September 30, 2009 and December 31, 2008. The Company's trade receivables mentioned above were insured against non-payment up to USD36,200 thousand by export guarantee insurance with the Korea Export Insurance Corporation as of September 30, 2009. The Company has no significant concentrations of customer credit risk except for the above export trade receivables; on the other hand, there are a large number of widely dispersed customers with trade and other receivables.

The Company has made deposits on cash, cash equivalent and long-term in NACF and several financial institutions with high credit ratings, thus the credit risks from these financial institutions are very limited.

*Interest rate risk*

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.

*Market price risk*

The Company is exposed to market price risk on available-for-sale equity investments, but the quantum of such risk is not material.

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26 Risk Management, Continued

(c) Fair Value of Financial Instruments

The carrying amount and the fair value of financial instruments as of September 30, 2009 and December 31, 2008 are summarized as follows.

<i>In millions of Won</i>	September 30 2009		December 31 2008	
	Carrying amount	Fair value	Carrying amount	Fair value
<b>Financial Assets:</b>				
Available-for-sale financial assets	₩ 468,412	468,412	304,105	304,105
Long-term deposits in MSA Escrow Fund	117,010	117,010	110,261	110,261
Trade and other receivables	740,987	740,987	639,766	639,766
Other financial assets	-	-	1,000	1,000
Cash and cash equivalents	208,894	208,894	88,352	88,352
	₩ 1,535,303	1,535,303	1,143,484	1,143,484
<b>Financial Liabilities:</b>				
Trade and other payables	₩ (231,838)	(231,838)	(283,470)	(283,470)
Short-term borrowings	(13,752)	(13,752)	(13,344)	(13,344)
Derivative financial instruments	-	-	(2,699)	(2,699)
	₩ (245,590)	(245,590)	(299,513)	(299,513)

27 Contingent Liabilities and Financial Commitments

- (a) The Company deposited some proportion of sales in accordance with Tobacco Master Settlement Agreement ("MSA") under the Escrow Statute of the United States government, related to the export of tobacco to the United States. The MSA Escrow Funds is 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 that the fund was established. 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 September 30, 2009, tobacco lawsuits claiming damages of ₩584 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 obligations to notify smokers of the potential health hazards of smoking. Additionally, the Company is involved in 5 lawsuits and claims for alleged damages totalling ₩3,880 million as a dependent as of September 30, 2009. The amount of the liability the Company may ultimately have with respect to the litigation cannot be reasonably estimated as of September 30, 2009.
- (c) As of September 30, 2009, the Company has entered into Letter of Credit Agreements with the NACF and other banks with a limit set at USD54,000 thousand.
- (d) As of September 30, 2009, the Company's trade receivables from the export of cigarettes were insured against non-payment up to USD36,200 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

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**27 Contingent Liabilities and Financial Commitments, Continued**

- (e) As of September 30, 2009, 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 others.
- (f) As of September 30, 2009, 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., Ltd. in relation to the Yongsan International Commercial Development Project.
- (g) The Company entered into an overdraft agreement with a limit of ₩150,000 million with the NACF as of September 30, 2009.
- (h) The Company has provided Yungjin Pharm. Ind. Co., Ltd. with a guarantee for the payment of taxes amounting to ₩3,600 million.

**28 Non-current Asset Held for Sale**

Decided upon the board of director meeting, the Company determined to dispose the land for the purpose of improving its financial structure and investments in property. The Company entered into a contract to sell the land for the nine-month period ended September 30, 2009. In respect of the above transaction, the Company recognized non-current asset held for sale amounting to ₩23,246 million at the lowers of its carrying amount and fair value less costs to sell.

**29 Transition to Korean International Financial Reporting Standards**

Prior to 2009, the Company prepared its financial statements under Generally Accepted Accounting Principles in the Republic of Korea ("K-GAAP"). From January 1, 2009, the Company is required to prepare its non-consolidated financial statements in accordance with K-IFRS. As the 2009 financial statements include comparatives for 2008, the Company's date of transition to K-IFRS in accordance with K-IFRS No.1101 on first time adoption of K-IFRS, is January 1, 2008, and the 2008 comparatives are restated to K-IFRS.

The effect of the transition from K-GAAP to K-IFRS, affecting the Company's reported financial position, financial performance and cash flows, is as follows:

- (a) K-IFRS No.1101 permits those companies adopting K-IFRS for the first time certain exemptions from the full requirements of K-IFRS in the transition period. The Company has taken the following key exemptions:
  - (i) Business combinations prior to the date of transition are not restated.
  - (ii) The Company measures investments in a subsidiary, Korea Ginseng Corporation, at the date of transition to K-IFRS at carrying amounts using a K-GAAP as deemed cost at that date.
  - (iii) The Company capitalizes borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset after the date of transition to K-IFRS.

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September 30, 2009 and 2008

**29 Transition to Korean International Financial Reporting Standards, Continued**

(b) The main adjustments in changing to K-IFRS are as follows and the tables of reconciliation are cross-referenced to the notes below where relevant:

(1) Reclassification of Investment Property and Intangible Asset under Development

In accordance with K-GAAP, property held to earn rentals or for capital appreciation or both were classified and accounted for as property, plant and equipment. In accordance with K-IFRS, it is reclassified as investment property. In addition, development costs of new medicines classified as construction-in-progress of property, plant and equipment in accordance with K-GAAP, are reclassified as intangible assets under development in accordance with K-IFRS.

(2) Reclassification of Guarantee Deposits Paid and Guarantee Deposits for Membership

In accordance with K-GAAP, guarantee deposits paid and guarantee deposits for membership recognized as other non-current assets are recorded in intangible assets as rights to facility usage with indefinite useful lives and prepaid expenses, respectively. Prepaid expenses attribute expenses to periods of service.

(3) Revenue Recognition Criteria

In accordance with K-GAAP, revenue from building lotting-out construction contracts is accounted for by the percentage of completion method. In accordance with K-IFRS, it is recognized when the significant risks and rewards of ownership are transferred to a third party.

(4) Investments in Associates and Subsidiaries

In accordance with K-GAAP, investments in associates such as Cosmo Tabacco Co., Ltd., Korea Islet Transplantation Institute, Inc. and Lite Pharm Tech, Inc. were accounted for under the cost method since the effect of applying the equity method on its financial statements is immaterial. In accordance with K-IFRS, these are reclassified as the investments in associates accounted for under the cost method of accounting.

In accordance with K-GAAP, investments in subsidiaries such as Korea Ginseng Corporation, Youngjin Pharm. Ind. Co., Ltd. and KT&G Tutun Mamulleri Sanayi ve Ticaret A.S were accounted for using the equity method of accounting. In accordance with K-IFRS, these are reclassified as the investments in subsidiaries, and are accounted for under the cost method of accounting.

In addition, in the preparation of the opening K-IFRS statement of financial position on the date of transition to K-IFRS, the Company measures its investment in Korea Ginseng Corporation at the deemed cost which is previous GAAP carrying amount at the date of transition in accordance with K-IFRS No.1101.

(5) Retirement Benefit Obligations

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. In accordance with K-GAAP, the Company's estimated liability under the plan which would be payable if all employees left on the end of reporting date is accrued in the statement of financial position. In accordance with K-IFRS, the Company uses the projected unit credit method by way of an actuarial valuation method to determine the present value of its defined benefit obligations.

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**29 Transition to Korean International Financial Reporting Standards, Continued**

(6) Employee Benefits: Accumulating Compensated Absence and Bonus

According to the K-IFRS, the Company recognizes the expected cost of short-term employee benefits in the form of compensated absence as a liability, when employees render service that increases their entitlement to future compensated absences. Also, the Company recognizes its legal or constructive obligation under a profit-sharing or bonus plan as a liability when employees render service.

(7) Derecognition of Financial Assets and Financial Liabilities

With regard to trade receivables with customer credit contracts, trade receivables were derecognized at the point of the collection from lenders in accordance with K-GAAP. However, in accordance with K-IFRS, trade receivables with customer credit contracts were derecognized at the point of the collection from borrowers. In addition, in accordance with K-GAAP, tobacco excise and other taxes payable were reflected in the statement of financial position after offsetting by prepaid tobacco excise and other taxes. However, in accordance with K-IFRS, they are reflected in the statement of financial position the aggregate amount in total rather than offset.

(8) Impairment and Uncollectibility of Financial Assets

In accordance with K-GAAP, allowances for the receivables were influenced by tax requirements and practice. However, in accordance with K-IFRS, the Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant.

(9) Financial Instrument Carried at Amortized Cost

In accordance with K-GAAP, a financial instrument such as loans and receivables was recognized in nominal terms. However, in accordance with K-IFRS, when a financial instrument is recognized initially, it is measured at its fair value. After initial recognition, a financial instrument is measured at amortized cost using the effective interest method.

(10) Review of Depreciation Period or Depreciation Method

The Company reviewed the depreciation method and the useful life of the asset to reflect the pattern and period in which the asset's future economic benefits are expected to be consumed by the Company.

(11) The Effect of Income Tax

In accordance with K-GAAP, it is required that deferred tax assets and liabilities be classified as current or non-current. However, K-IFRS does not specify whether the Company should distinguish current and non-current portions of deferred tax assets and liabilities. In addition, the tax effects of the above adjustments arising from differences between K-GAAP and K-IFRS have been reflected in the financial statements.

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29 Transition to Korean International Financial Reporting Standards, Continued

(c) Reconciliation of equity in accordance with K-GAAP to Equity in accordance with K-IFRS

(i) The effect of the change to K-IFRS on the non-consolidated statement of financial position at January 1, 2008 is as follows:

<i>In millions of Won Notes</i>	K-GAAP	Re- classification (1)(2)	Revenue recognition criteria (3)	Investments (4)	Retirement benefit obligations (5)	Employee benefits (6)	Derecognition of financial instruments (7)	Other Changes (8)(9)(10)(11)	K-IFRS
<b>Assets</b>	₩ 3,977,800	(942)	12,623	36,058	(2,091)	3,741	179,331	(6,954)	4,199,566
<b>Equity</b>	₩ 3,142,003	(942)	(6,549)	36,058	15,262	(73,069)	-	23,114	3,135,877
<b>Liabilities</b>	835,797	-	19,172	-	(17,353)	76,810	179,331	(30,068)	1,063,689
<b>Equity and liabilities</b>	₩ 3,977,800	(942)	12,623	36,058	(2,091)	3,741	179,331	(6,954)	4,199,566

(ii) The effect of the change to K-IFRS on the non-consolidated statement of financial position at December 31, 2008 is as follows:

<i>In millions of Won Notes</i>	K-GAAP	Re- classification (1)(2)	Revenue recognition criteria (3)	Investments (4)	Retirement benefit obligations (5)	Employee benefits (6)	Derecognition of financial instruments (7)	Other Changes (8)(9)(10)(11)	K-IFRS
<b>Assets</b>	₩ 4,382,573	(1,007)	37,474	(42,563)	2,302	3,890	215,118	15,597	4,613,384
<b>Equity</b>	₩ 3,539,831	(1,007)	(29,574)	(42,563)	(7,518)	(74,659)	-	69,916	3,454,426
<b>Liabilities</b>	842,742	-	67,048	-	9,820	78,549	215,118	(54,319)	1,158,958
<b>Equity and liabilities</b>	₩ 4,382,573	(1,007)	37,474	(42,563)	2,302	3,890	215,118	15,597	4,613,384

(iii) The effect of the change to K-IFRS on equity at September 30, 2008 is as follows:

<i>In millions of Won Notes</i>	K-GAAP	Re- classification (1)(2)	Revenue recognition criteria (3)	Investments (4)	Retirement benefit obligations (5)	Employee benefits (6)	Derecognition of financial instruments (7)	Other Changes (8)(9)(10)(11)	K-IFRS
<b>Equity</b>	₩ 3,404,152	(990)	(18,438)	(22,197)	4,980	(74,261)	-	51,289	3,344,535



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29 Transition to Korean International Financial Reporting Standards, Continued

(d) Reconciliation of total comprehensive income in accordance with K-GAAP to total comprehensive income in accordance with K-IFRS

(i) The effect of the change to K-IFRS on the non-consolidated statement of comprehensive income for the year ended December 31, 2008 is as follows:

<i>In millions of Won, except earnings per share</i>	K-GAAP	Re- classification (1)(2)	Revenue recognition criteria (3)	Investments (4)	Retirement benefit obligations (5)	Employee benefits (6)	Other Changes (8)(9)(10)(11)	K-IFRS
Notes								
<b>Sales</b>	₩ 2,644,656	-	(71,975)	-	-	-	461	2,573,142
Cost of sales	(1,023,034)	(3,409)	48,950	-	8,889	(462)	3,748	(965,318)
<b>Gross profit</b>	1,621,622	(3,409)	(23,025)	-	8,889	(462)	4,209	1,607,824
Other income	108,361	-	-	-	-	-	-	108,361
Selling, general and administrative expenses	(634,754)	3,343	-	-	15,147	(1,128)	(626)	(618,018)
Contribution to employee welfare foundation	(15,000)	-	-	-	-	-	-	(15,000)
Other expense	(48,685)	-	-	-	-	-	11,937	(36,748)
<b>Profit from operations</b>	1,031,544	(66)	(23,025)	-	24,036	(1,590)	15,520	1,046,419
Net finance income (costs)	15,053	-	-	60,000	(7,016)	-	263	68,300
Share of the profit or loss of associates	134,706	-	-	(134,706)	-	-	-	-
<b>Profit before tax</b>	1,181,303	(66)	(23,025)	(74,706)	17,020	(1,590)	15,783	1,114,719
Income tax expense	(287,013)	-	-	-	-	-	21,780	(265,233)
<b>Profit for the period</b>	₩ 894,290	(66)	(23,025)	(74,706)	17,020	(1,590)	37,563	849,486
Other comprehensive income, net of tax	29,066	-	-	(3,429)	(31,045)	-	-	(5,408)
<b>Total comprehensive income for the period</b>	₩ 923,356	(66)	(23,025)	(78,135)	(14,025)	(1,590)	37,563	844,078
<b>Basic and diluted earnings per share in Won</b>	₩ 6,872							6,527

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29 Transition to Korean International Financial Reporting Standards, Continued

(d) Reconciliation of total comprehensive income in accordance with K-GAAP to total comprehensive income in accordance with K-IFRS, continued

(ii) The effect of the change to K-IFRS on the non-consolidated statement of comprehensive income for the nine-month period ended September 30, 2008 is as follows:

<i>In millions of Won, except earnings per share Notes</i>	K-GAAP	Re- classification (1)(2)	Revenue recognition criteria (3)	Investments (4)	Retirement benefit obligations (5)	Employee benefits (6)	Other Changes (8)(9)(10)(11)	K-IFRS
<b>Sales</b>	₩ 1,919,781	-	(37,100)	-	-	-	142	1,882,823
Cost of sales	(742,764)	(2,557)	25,211	-	6,667	(347)	2,820	(710,970)
<b>Gross profit</b>	1,177,017	(2,557)	(11,889)	-	6,667	(347)	2,962	1,171,853
Other income	83,076	-	-	-	-	-	-	83,076
Selling, general and administrative expenses	(463,531)	2,507	-	-	10,895	(846)	(404)	(451,379)
Contribution to employee welfare foundation	(15,000)	-	-	-	-	-	-	(15,000)
Other expense	(31,892)	-	-	-	-	-	12,802	(19,090)
<b>Profit from operations</b>	749,670	(50)	(11,889)	-	17,562	(1,193)	15,360	769,460
Net finance income (costs)	12,332	-	-	60,000	(4,561)	-	321	68,092
Share of the profit or loss of associates	110,835	-	-	(110,835)	-	-	-	-
<b>Profit before tax</b>	872,837	(50)	(11,889)	(50,835)	13,001	(1,193)	15,681	837,552
Income tax expense	(223,896)	-	-	-	-	-	12,495	(211,401)
<b>Profit for the period</b>	₩ 648,941	(50)	(11,889)	(50,835)	13,001	(1,193)	28,176	626,151
Other comprehensive income, net of tax	50,853	-	-	(7,417)	(23,284)	-	-	20,152
<b>Total comprehensive income for the period</b>	₩ 699,794	(50)	(11,889)	(58,252)	(10,283)	(1,193)	28,176	646,303
<b>Basic and diluted earnings per share in Won</b>	₩ 4,970							4,796

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29 Transition to Korean International Financial Reporting Standards, Continued

(d) Reconciliation of total comprehensive income in accordance with K-GAAP to total comprehensive income in accordance with K-IFRS, continued

(iii) The effect of the change to K-IFRS on the non-consolidated statement of comprehensive income for the three-month period ended September 30, 2008 is as follows:

<i>In millions of Won, except earnings per share Notes</i>	K-GAAP	Re- classification (1)(2)	Revenue recognition criteria (3)	Investments (4)	Retirement benefit obligations (5)	Employee benefits (6)	Other Changes (8)(9)(10)(11)	K-IFRS
<b>Sales</b>	₩ 658,103	-	(14,620)	-	-	-	27	643,510
Cost of sales	(256,046)	(852)	9,933	-	2,222	(116)	936	(243,923)
<b>Gross profit</b>	402,057	(852)	(4,687)	-	2,222	(116)	963	399,587
Other income	48,767	-	-	-	-	-	1	48,768
Selling, general and administrative expenses	(165,586)	835	-	-	3,631	(282)	(188)	(161,590)
Contribution to employee welfare foundation	-	-	-	-	-	-	-	-
Other expense	(13,585)	-	-	-	-	-	6,001	(7,584)
<b>Profit from operations</b>	271,653	(17)	(4,687)	-	5,853	(398)	6,777	279,181
Net finance income (costs)	2,003	-	-	-	(1,524)	-	192	671
Share of the profit or loss of associates	36,083	-	-	(36,083)	-	-	-	-
<b>Profit before tax</b>	309,739	(17)	(4,687)	(36,083)	4,329	(398)	6,969	279,852
Income tax expense	(80,920)	-	-	-	-	-	4,487	(76,433)
<b>Profit for the period</b>	₩ 228,819	(17)	(4,687)	(36,083)	4,329	(398)	11,456	203,419
Other comprehensive income, net of tax	46,720	-	-	(3,965)	(7,761)	-	-	34,994
<b>Total comprehensive income for the period</b>	₩ 275,539	(17)	(4,687)	(40,048)	(3,432)	(398)	11,456	238,413
<b>Basic and diluted earnings per share in Won</b>	₩ 1,714							1,559

KT&G CORPORATION  
Notes to Non-Consolidated Financial Statements  
(Unaudited)

**September 30, 2009 and 2008**

**29 Transition to Korean International Financial Reporting Standards, Continued**

- (e) Explanation of material adjustments to the non-consolidated statement of cash flows

Interest paid, interest received and dividends received were classified as operating cash flows in accordance with K-GAAP. But, in accordance with K-IFRS, interest paid are reclassified as financing cash flows, and interest received and dividends received are reclassified as investing cash flows. The effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is presented separately from cash flows from operating, investing and financing activities.

Bank overdrafts which form an integral part of the Company's cash management are included as a component of cash and cash equivalents rather than financing cash flows.