



KT&G CORPORATION

Interim Financial Statements

(Unaudited)

March 31, 2011 and 2010

(With Independent Auditors' Review Report Thereon)

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Independent Auditors' Review Report

Based on a report originally issued in Korean

The Board of Directors and Shareholders
KT&G Corporation:

Introduction

We have reviewed the accompanying interim financial statements of KT&G Corporation (the "Company"), which comprise the statement of financial position as of March 31, 2011 and the statements of comprehensive income, changes in equity and cash flows for the three-month periods ended March 31, 2011 and 2010, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Korean International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Review Responsibility

Our responsibility is to express a conclusion on these financial statements based on our reviews. We conducted our reviews in accordance with the Review Standards for Quarterly and Semiannual Financial Statements established by the Securities and Futures Commission of the Republic of Korea. A review consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with auditing standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

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

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

As discussed in note 28 to the 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. Accordingly, no provisions have been made in the accompanying financial statements.

Other Considerations

The statement of financial position of the Company as of December 31, 2010, the related statements of comprehensive income, changes in equity and cash flows for the year then ended, which are not accompanying this report were audited by us and our report thereon, dated February 22, 2011, expressed an unqualified opinion. The accompanying statement of financial position of the Company as of December 31, 2010, presented for comparative purposes, is not different from that audited by us in all material respects.

The accompanying financial statements as of and for the three-month period ended March 31, 2011 have been translated into United States dollars solely for the convenience of the reader. We have reviewed the translation and, nothing has come to our attention to suggest that the financial statements expressed in Korean won have not been translated into dollars on the basis set forth in note 4 to the financial statements.

KPMG Samjong Accounting Corp.

KPMG Samjong Accounting Corp.
Seoul, Korea
May 13, 2011

This report is effective as of May 13, 2011, 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 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
Statements of Financial Position

As of March 31, 2011 and 2010

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2011 Korean won	2011 U.S. dollars (note 4)	2010 Korean won
Assets				
Property, plant and equipment	5	₩ 1,160,764	\$ 1,048,378	₩ 1,196,126
Intangible assets	6	45,760	41,329	48,564
Investment property	7	123,265	111,331	98,143
Investments in associates	8	32,730	29,561	2,830
Investments in subsidiaries	9	840,121	758,780	840,121
Available-for-sale financial assets	10,27	275,137	248,498	313,937
Long-term deposits in MSA Escrow Fund	11,27,28	130,967	118,287	132,414
Long-term prepaid expenses		4,453	4,021	4,401
Long-term trade and other receivables	12,27	106,705	96,374	84,595
Total non-current assets		2,719,902	2,456,559	2,721,131
Inventories	13	977,390	882,759	990,333
Trade and other receivables	12,26,27	577,677	521,746	527,827
Prepaid tobacco excise and other taxes		222,771	201,203	177,043
Advance payments		7,812	7,055	5,783
Prepaid expenses		1,355	1,224	1,707
Current available-for-sale financial assets	10,27	1,000	903	1,000
Cash and cash equivalents	14,27	891,228	804,938	828,951
		2,679,233	2,419,828	2,532,644
Assets held for sale	5,29	5,711	5,158	-
Total current assets		2,684,944	2,424,986	2,532,644
Total assets		₩ 5,404,846	\$ 4,881,545	₩ 5,253,775

See accompanying notes to the financial statements.

KT&G CORPORATION
Statements of Financial Position (Continued)

As of March 31, 2011 and 2010

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2011 Korean won	2011 U.S. dollars (note 4)	2010 Korean won
Equity				
Ordinary shares	1, 15	₩ 954,959	\$ 862,500	₩ 954,959
Other capital surplus	15	3,582	3,235	3,582
Treasury shares	16	(216,827)	(195,834)	(216,827)
Gain on reissuance of treasury shares	16	482,129	435,448	482,129
Reserve	17	2,715,045	2,452,172	2,184,703
Retained earnings	18	201,413	181,912	929,140
Total equity	27	4,140,301	3,739,433	4,337,686
Liabilities				
Long-term trade and other payables	7, 20, 27	24,746	22,350	22,902
Long-term advance receipts		782	708	515
Defined benefit liabilities	21	34,182	30,872	28,774
Deferred income tax liabilities	24	94,513	85,362	93,310
Total non-current liabilities		154,223	139,292	145,501
Short-term borrowings	19, 27	7,883	7,120	8,618
Trade and other payables	20, 26, 27	731,990	661,118	238,587
Advance receipts		7,382	6,667	7,712
Income taxes payable	24	41,302	37,303	190,815
Tobacco excise and other taxes payable		321,765	290,612	324,856
Total current liabilities		1,110,322	1,002,820	770,588
Total liabilities		1,264,545	1,142,112	916,089
Total equity and liabilities		₩ 5,404,846	\$ 4,881,545	₩ 5,253,775

See accompanying notes to the financial statements.

KT&G CORPORATION
Statements of Comprehensive Income

For the three-month periods ended March 31, 2011 and 2010

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

	Note	2011 Korean won	2011 U.S. dollars (note 4)	2010 Korean won
Sales:	26			
Manufacture of tobacco		₩ 518,891	\$ 468,651	₩ 500,235
Real estate		6,145	5,550	33,080
Exports of leaf tobacco and others		11,996	10,835	7,040
		537,032	485,036	540,355
Cost of sales:	26			
Manufacture of tobacco		(191,923)	(173,340)	(189,306)
Real estate		(1,047)	(946)	(19,749)
Exports of leaf tobacco and others		(8,293)	(7,490)	(3,692)
		(201,263)	(181,776)	(212,747)
Gross profit		335,769	303,260	327,608
Other income	22	9,211	8,320	10,742
Selling expenses	22	(88,577)	(80,001)	(85,611)
General and administrative expenses	22	(49,948)	(45,112)	(43,781)
Other expense	22	(17,147)	(15,487)	(18,463)
Profit from operations		189,308	170,980	190,495
Finance income	23	61,229	55,301	36,455
Finance costs	23	(4,006)	(3,618)	(53)
Net finance income	23	57,223	51,683	36,402
Profit before income taxes		246,531	222,663	226,897
Income tax expense	24	(47,320)	(42,739)	(47,544)
Profit for the period		₩ 199,211	\$ 179,924	₩ 179,353
Other comprehensive income:				
Available-for-sale financial assets, net of tax	10,23,24	₩ (13,659)	\$ (12,336)	₩ 59,399
Actuarial gains, net of tax	21,24	9	7	3,615
Other comprehensive income (expense) for the period, net of tax		(13,650)	(12,329)	63,014
Total comprehensive income for the period		₩ 185,561	\$ 167,595	₩ 242,367
Earnings per share in won and U.S. dollars:				
Basic and diluted	25	₩ 1,561	\$ 1.41	₩ 1,410

See accompanying notes to the financial statements.

KT&G CORPORATION
Statements of Changes in Equity

For the three-month period ended March 31, 2011

<i>In millions of won</i>		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
Balance at January 1, 2011	₩	954,959	3,582	(216,827)	482,129	2,184,703	929,140	4,337,686
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	199,211	199,211
Other comprehensive income:								
Available-for-sale financial assets, net of tax		-	-	-	-	(13,658)	-	(13,658)
Actuarial gains, net of tax		-	-	-	-	-	8	8
Total other comprehensive income (expense)		-	-	-	-	(13,658)	8	(13,650)
Total comprehensive income (expense) for the period		-	-	-	-	(13,658)	199,219	185,561
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(382,946)	(382,946)
Transfer to unconditional reserve		-	-	-	-	544,000	(544,000)	-
Total transactions with owners		-	-	-	-	544,000	(926,946)	(382,946)
Balance at March 31, 2011	₩	954,959	3,582	(216,827)	482,129	2,715,045	201,413	4,140,301

See accompanying notes to the financial statements.

KT&G CORPORATION

Statements of Changes in Equity (Continued)

For the three-month period ended March 31, 2011

In thousands of U.S. dollars

	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
Balance at January 1, 2011	\$ 862,500	3,235	(195,834)	435,448	1,973,178	839,180	3,917,707
Total comprehensive income for the period:							
Profit for the period	-	-	-	-	-	179,924	179,924
Other comprehensive income:							
Available-for-sale financial assets, net of tax	-	-	-	-	(12,336)	-	(12,336)
Actuarial gains, net of tax	-	-	-	-	-	7	7
Total other comprehensive income (expense)	-	-	-	-	(12,336)	7	(12,329)
Total comprehensive income (expense) for the period	-	-	-	-	(12,336)	179,931	167,595
Transactions with owners, recorded directly in equity:							
Dividends	-	-	-	-	-	(345,869)	(345,869)
Transfer to unconditional reserve	-	-	-	-	491,330	(491,330)	-
Total transactions with owners	-	-	-	-	491,330	(837,199)	(345,869)
Balance at March 31, 2011	\$ 862,500	3,235	(195,834)	435,448	2,452,172	181,912	3,739,433

See accompanying notes to the financial statements.

KT&G CORPORATION
Statements of Changes in Equity (Continued)

For the three-month period ended March 31, 2010

<i>In millions of won</i>		Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Total equity
Balance at January 1, 2010	₩	954,959	2,632	(226,945)	468,274	2,074,108	579,963	3,852,991
Total comprehensive income for the period:								
Profit for the period		-	-	-	-	-	179,353	179,353
Other comprehensive income:								
Available-for-sale financial assets, net of tax		-	-	-	-	59,399	-	59,399
Actuarial gains, net of tax		-	-	-	-	-	3,615	3,615
Total other comprehensive income		-	-	-	-	59,399	3,615	63,014
Total comprehensive income for the period		-	-	-	-	59,399	182,968	242,367
Transactions with owners, recorded directly in equity:								
Dividends		-	-	-	-	-	(356,157)	(356,157)
Transfer from reserve for research and human resource development		-	-	-	-	(15,000)	15,000	-
Transfer from reserve for loss on reissuance of treasury shares		-	-	-	-	(26,646)	26,646	-
Transfer to reserve for research and human resource development		-	-	-	-	60,000	(60,000)	-
Transfer to unconditional reserve		-	-	-	-	203,000	(203,000)	-
Total transactions with owners		-	-	-	-	221,354	(577,511)	(356,157)
Balance at March 31, 2010	₩	954,959	2,632	(226,945)	468,274	2,354,861	185,420	3,739,201

See accompanying notes to the financial statements.

KT&G CORPORATION
Statements of Cash Flows

For the three-month periods ended March 31, 2011 and 2010

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2011 Korean won	2011 U.S. dollars (note 4)	2010 Korean won
Cash flows from operating activities				
Cash generated from operations	30	₩ 172,328	\$ 155,641	₩ 200,954
Income tax paid		(83,252)	(75,191)	(39,760)
Net cash from operating activities		89,076	80,450	161,194
Cash flows from investing activities				
Interest received		6,863	6,198	4,158
Investment income received				
from long-term deposits in MSA Escrow Fund		904	817	-
Dividends received		200	180	30,000
Proceeds from sale of available-for-sale financial assets		-	-	967
Collection of loans		4,441	4,011	18,717
Proceeds from sale of property, plant and equipment		6,413	5,792	8,406
Proceeds from sale of intangible assets		3,442	3,109	538
Withdrawal of guarantee deposits		18,688	16,878	5,825
Proceeds from sale of other investment assets		9	9	12
Purchases of available-for-sale financial assets		-	-	(623)
Increase in loans		(9,915)	(8,955)	(2,688)
Acquisition of investments in associates		(12,600)	(11,380)	-
Payments of guarantee deposits		(21,253)	(19,195)	(7,641)
Payments of long-term deposits in MSA Escrow Fund		(2,859)	(2,582)	(1,732)
Acquisition of property, plant and equipment		(21,679)	(19,580)	(13,528)
Acquisition of intangible assets		(170)	(153)	(853)
Acquisition of investment property		(1,221)	(1,103)	-
Acquisition of other investment assets		(19)	(17)	-
Net cash provided by (used in) investing activities		(28,756)	(25,971)	41,558
Cash flows from financing activities				
Interest paid		-	-	(5)
Increase in deposits received		5,486	4,955	452
Decrease in deposits received		(3,368)	(3,042)	(1,818)
Dividends paid		-	-	(356,157)
Net cash provided by (used in) financing activities		2,118	1,913	(357,528)
Net increase in cash and cash equivalents				
Cash and cash equivalents at beginning of period		828,951	748,691	268,954
Effect of exchange rate fluctuation on cash held		(161)	(145)	(33)
Cash and cash equivalents at end of period		₩ 891,228	\$ 804,938	₩ 114,145

See accompanying notes to the financial statements.

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

1. Organization and Description of Business

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

As of March 31, 2011, the Company has four manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 139 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Company is located in Pyeongchon-dong, Daedeok-gu, Daejeon.

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

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

The ownership of the Company's issued ordinary shares as of March 31, 2011 is held as follows:

*In millions of won,
except number of shares and percentage of ownership*

Shareholder	Number of shares	Percentage of ownership	Amount
Industrial Bank of Korea	9,510,485	6.93%	47,552
Employee Share Ownership Association	3,846,472	2.80%	19,232
Treasury shares	9,643,697	7.02%	48,219
Others	114,291,843	83.25%	571,459
Retirement of treasury share	-	-	268,497
	137,292,497	100.00%	954,959

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

2. Basis of Preparation

(a) Statement of Compliance

The 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 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 reported results and net assets of the investee in accordance with K-IFRS No.1027 *Consolidated and Separate Financial Statements*.

These financial statements have been prepared in accordance with K-IFRS No.1034 *Interim Financial Reporting*.

(b) Basis of Measurement

The financial statements have been prepared under the historical cost basis except as described in the accounting policy below on financial instruments and inventories valued at net realizable value.

(c) Use of Estimates and Judgments

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

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

Information about critical judgements in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements is included in the following notes:

- Classification of investment property – Note 7.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year is included in the following notes:

- Measurement of defined benefit obligations – Note 21
- Provisions and contingencies – Note 28.

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies

(a) Investments in Subsidiaries and Associates in the Separate Financial Statements

These 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 the 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.

(b) Foreign Currencies

These 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. When gains or losses on non-monetary items are recognized in other comprehensive income, exchange components of those gains or losses are recognized in other comprehensive income. Conversely, when gains or losses on non-monetary items are recognized in profit or loss, exchange components of those gains or losses are recognized in profit or loss.

(c) 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 the replaced part is derecognized. The costs of the day-to-day servicing are recognized in profit or loss as incurred.

KT&G CORPORATION
Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies (Continued)

(c) Property, Plant and Equipment (Continued)

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 were as follows:

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

Each part of property, plant and equipment with a cost that is significant in relation to the total cost are depreciated separately.

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

(d) Intangible Assets

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

The estimated useful lives were as follows:

	Useful lives (years)
Industrial property rights	10 ~ 20 or indefinite
Rights to facility usage	indefinite
Other intangible assets	4

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 are not being amortized are reviewed each period to determine whether events and circumstances continue to support an indefinite useful life assessment for those assets. If it is appropriate to change, such a change is accounted for as a change in an accounting estimate.

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies (Continued)

(e) Investment Property

Properties held to earn rentals or for capital appreciation 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 the replaced part 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 and adjusted if appropriate. The change is accounted for as a change in an accounting estimate.

(f) Inventories

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

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

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

Tobacco leaf inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognized industry practice. The estimated amounts of inventories in current assets which are not expected to be realized within 12 months are ₩386,228 million and ₩403,082 million as of March 31, 2011 and December 31, 2010, respectively.

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies (Continued)

(g) Non-derivative Financial Assets

The Company classifies a non-derivative financial asset into the following four categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables or available-for-sale financial assets, relating to recognition and measurement of financial assets. The Company recognizes financial assets in the statement of financial position when the Company becomes a party to the contractual provisions of the financial asset. The Company derecognizes financial assets from the statement of financial position when the contractual rights to the cash flows from the financial asset expire or the Company transfers the contractual rights to receive the cash flows on the financial asset in a transaction in which 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 assets, the Company continues to recognize the transferred financial asset and recognizes financial liabilities for the consideration received.

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

Financial Assets at Fair Value through Profit or Loss

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

Held-to-maturity Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity that the Company has the positive intention and ability to hold to maturity are classified as held-to-maturity investments. After initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method.

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.

Available-for-sale Financial Assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables. Subsequent to initial recognition, they are measured at fair value 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 assets. 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.

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies (Continued)

(g) Non-derivative Financial Assets (Continued)

Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand, demand deposits and short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date. Bank overdrafts are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

(h) Non-derivative Financial Liabilities

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

Non-derivative financial liabilities comprise borrowings and trade and other payables. When non-derivative financial liabilities are recognized initially, the Company measures it at its fair value minus, in the case of financial liabilities not at fair value through profit or loss, transaction costs that are directly attributable to the issue of the financial liability.

Financial Liabilities at Fair Value through Profit or Loss

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

Other Financial Liabilities

Other financial liabilities are those non-derivative financial liabilities that are not classified as financial liabilities at fair value through profit or loss. After initial recognition, other financial liabilities are measured at amortized cost using the effective interest method except for short-term liabilities of which the effect of discounting is immaterial.

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies (Continued)

(i) 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.

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

The Company recognizes an impairment loss for write-down of the asset (or disposal group) to fair value less costs to sell and a gain for increase in fair value less costs to sell of an asset, but not in excess of the cumulative impairment loss that has been recognized previously in accordance with K-IFRS No.1036 *Impairment of Assets*.

(j) Revenue Recognition

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

Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the three-month periods ended March 31, 2011 and 2010 were ₩738,065 million and ₩750,231 million, respectively.

Revenue from the building lotting-out construction contracts is recognized upon delivery when the significant risks and rewards of ownership of the goods are transferred to the buyer.

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 shareholders' right to receive is established.

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies (Continued)

(k) 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 except for inventories, deferred tax assets, assets arising from employee benefits and non-current assets (or disposal groups) classified as held for sale. 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.

(l) 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. For specific financial assets such as trade receivables, if the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, it collectively assesses them for impairment. The objective evidence that the group of loans and receivables is impaired includes an increased number of delayed payments and an adverse change in national or local economic conditions that correlate with defaults on the assets in the group.

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.

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies (Continued)

(l) Impairment of Financial Assets (Continued)

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.

(m) 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 expense is the amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for a period. Current tax liabilities (assets) for the current and prior periods are measured at the amount expected to be paid to (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 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.

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.

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.

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

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.

KT&G CORPORATION
Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies (Continued)

(n) 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.

(o) Equity Capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the equity transaction are recognized as a deduction from equity, net of any tax effects.

If the Company reacquires its own equity instruments, those instruments ("treasury shares") are presented as a deduction from total equity. 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.

(p) Provisions, Contingent Assets and Contingent Liabilities

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

The 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, and only when, it is virtually certain that reimbursement will be received if the Company settles the obligation. The reimbursement is treated as a separate asset.

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

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies (Continued)

(q) Employee Benefits

Short-term Employee Benefits

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

The Company recognizes the expected cost of profit-sharing and bonus payments if the Company has a present legal or constructive obligation to make such payments as a result of past events; and a reliable estimate of the obligation can be made.

Retirement Benefits: Defined Contribution Plans

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.

Retirement Benefits: Defined Benefit Plans

The Company classifies retirement benefits plans other than defined contribution plans as defined benefit plans. The defined benefit liabilities are calculated at 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.

With regard to actuarial gains and losses which arise from application of actuarial assumptions, 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.

Termination benefits

The Company recognizes termination benefits as a liability and an expense when, and only when, the Company is demonstrably committed to terminating the employment of an employee or group of employees before the normal retirement date or providing termination benefits as a result of an offer made in order to encourage voluntary redundancy.

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

3. Significant Accounting Policies (Continued)

(r) Earnings per Share

The Company presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss for the period attributable to owners of the Company by the weighted-average number of shares outstanding during the period.

Diluted EPS is determined by adjusting the profit or loss for the period attributable to owners of the Company and the weighted-average number of shares outstanding for the effects of all dilutive potential shares, which comprise employee share options.

(s) Operating Segments

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

(t) New Standards and Interpretations Not Yet Adopted

The new and amended standards and interpretations that have been issued but are not yet effective as of March 31, 2011 have not been applied in preparing the financial statements. None of these is expected to have a significant effect on the financial statement of the Company, except for K-IFRS No. 1109 *Financial Instruments*. The extent of the impact of adopting this standard on the financial statements has not been determined.

4. Basis of Translating Financial Statements

The financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩1,107.20 to \$1, the basic exchange rate on March 31, 2011 posted by Seoul Money Brokerage Services, solely for the convenience of the reader. This translation should not be construed as a representation that any or all of the amounts shown could be converted into U.S. dollars at this or any other rate.

KT&G CORPORATION
Notes to the Financial Statements

March 31, 2011 and 2010

5. Property, Plant and Equipment

(a) Changes in property, plant and equipment for the three-month period ended March 31, 2011 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
Cost:						
Balance at January 1, 2011	₩	1,037,073	828,046	188,894	82,475	2,136,488
Additions		257	289	2,451	18,682	21,679
Disposals		(1,926)	(5,311)	(556)	-	(7,793)
Others		10,433	1,615	437	(48,507)	(36,022)
Balance at March 31, 2011	₩	1,045,837	824,639	191,226	52,650	2,114,352
Accumulated depreciation and impairment:						
Balance at January 1, 2011	₩	(252,397)	(547,083)	(140,882)	-	(940,362)
Disposals		484	5,292	546	-	6,322
Depreciation		(3,607)	(14,662)	(6,643)	-	(24,912)
Others		4,609	755	-	-	5,364
Balance at March 31, 2011	₩	(250,911)	(555,698)	(146,979)	-	(953,588)
Carrying amount:						
Balance at January 1, 2011	₩	784,676	280,963	48,012	82,475	1,196,126
Balance at March 31, 2011	₩	794,926	268,941	44,247	52,650	1,160,764

Other changes for the three-month period ended March 31, 2011 include assets with a carrying amount of ₩25,506 million transferred to investment property, those of ₩5,711 million transferred to assets held for sale and those of ₩559 million transferred from investment property.

For the three-month period ended March 31, 2010, the Company purchased and disposed of property, plant and equipment amounting to ₩13,528 million and ₩3,402 million, respectively.

KT&G CORPORATION
Notes to the Financial Statements

March 31, 2011 and 2010

5. Property, Plant and Equipment (Continued)

(b) Changes in property, plant and equipment for the year ended December 31, 2010 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
Cost:						
Balance at January 1, 2010	₩	1,022,347	835,754	232,769	45,447	2,136,317
Additions		4,593	10,500	18,205	91,180	124,478
Disposals		(6,493)	(44,178)	(63,456)	(123)	(114,250)
Others		16,626	25,970	1,376	(54,029)	(10,057)
Balance at December 31, 2010	₩	1,037,073	828,046	188,894	82,475	2,136,488
Accumulated depreciation and impairment:						
Balance at January 1, 2010	₩	(229,226)	(523,569)	(173,096)	-	(925,891)
Disposals		1,936	36,525	61,866	-	100,327
Depreciation		(25,004)	(60,039)	(29,652)	-	(114,695)
Others		(103)	-	-	-	(103)
Balance at December 31, 2010	₩	(252,397)	(547,083)	(140,882)	-	(940,362)
Carrying amount:						
Balance at January 1, 2010	₩	793,121	312,185	59,673	45,447	1,210,426
Balance at December 31, 2010	₩	784,676	280,963	48,012	82,475	1,196,126

Other changes for the year ended December 31, 2010 include assets with a carrying amount of ₩957 million transferred to operating expenditures, those of ₩9,449 million transferred to inventories (sites for lotting-out construction) and those of ₩247 million transferred from investment property.

KT&G CORPORATION
Notes to the Financial Statements

March 31, 2011 and 2010

6. Intangible Assets

(a) Changes in intangible assets for the three-month period ended March 31, 2011 were as follows:

<i>In millions of won</i>		Industrial property rights	Rights to facility usage	Other intangible assets	Intangible assets under development	Total
Cost:						
Balance at January 1, 2011	₩	6,266	16,514	4,074	31,617	58,471
Additions		-	-	-	170	170
Disposals		-	(2,962)	-	-	(2,962)
Others		52	-	-	(52)	-
Balance at March 31, 2011	₩	6,318	13,552	4,074	31,735	55,679
Accumulated amortization and impairment:						
Balance at January 1, 2011	₩	(5,187)	-	(4,073)	(647)	(9,907)
Amortization		(12)	-	-	-	(12)
Balance at March 31, 2011	₩	(5,199)	-	(4,073)	(647)	(9,919)
Carrying amount:						
Balance at January 1, 2011	₩	1,079	16,514	1	30,970	48,564
Balance at March 31, 2011	₩	1,119	13,552	1	31,088	45,760

For the three-month period ended March 31, 2010, the Company purchased and disposed of intangible assets amounting to ₩853 million and ₩662 million, respectively.

KT&G CORPORATION
Notes to the Financial Statements

March 31, 2011 and 2010

6. Intangible Assets (Continued)

(b) Changes in intangible assets for the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		Industrial property rights	Rights to facility usage	Other intangible assets	Intangible assets under development	Total
Cost:						
Balance at January 1, 2010	₩	6,175	15,316	658	29,419	51,568
Additions		3	1,711	3,416	2,657	7,787
Disposals		(200)	(513)	-	(171)	(884)
Others		288	-	-	(288)	-
Balance at December 31, 2010	₩	6,266	16,514	4,074	31,617	58,471
Accumulated amortization and impairment:						
Balance at January 1, 2010	₩	(5,233)	-	(647)	(647)	(6,527)
Disposals		94	-	-	-	94
Amortization		(48)	-	(11)	-	(59)
Impairment		-	-	(3,415)	-	(3,415)
Balance at December 31, 2010	₩	(5,187)	-	(4,073)	(647)	(9,907)
Carrying amount:						
Balance at January 1, 2010	₩	942	15,316	11	28,772	45,041
Balance at December 31, 2010	₩	1,079	16,514	1	30,970	48,564

The Company recognized ₩3,415 million of impairment loss on the intangible assets relating to the acquisition of the sales network in the United States for the year ended December 31, 2010.

(c) Expenditures not capitalized for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Cost of sales	₩	43	61
Selling expenses		48	25
General and administrative expenses		2,552	1,644
	₩	2,643	1,730

KT&G CORPORATION
Notes to the Financial Statements

March 31, 2011 and 2010

7. Investment Property

(a) Changes in investment property for the three-month period ended March 31, 2011 were as follows:

<i>In millions of won</i>		Land	Buildings	Total
Cost:				
Balance at January 1, 2011	₩	13,919	116,660	130,579
Subsequent expenditure		-	1,221	1,221
Transfer to property, plant and equipment		(268)	(463)	(731)
Transfer from property, plant and equipment		1,481	24,025	25,506
Balance at March 31, 2011	₩	15,132	141,443	156,575
Accumulated depreciation and impairment:				
Balance at January 1, 2011	₩	-	(32,436)	(32,436)
Depreciation		-	(1,047)	(1,047)
Transfer to property, plant and equipment		-	173	173
Balance at March 31, 2011	₩	-	(33,310)	(33,310)
Carrying amount:				
Balance at January 1, 2011	₩	13,919	84,224	98,143
Balance at March 31, 2011	₩	15,132	108,133	123,265

(b) Changes in investment property for the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		Land	Buildings	Total
Cost:				
Balance at January 1, 2010	₩	13,919	117,010	130,929
Transfer to property, plant and equipment		-	(350)	(350)
Balance at December 31, 2010	₩	13,919	116,660	130,579
Accumulated depreciation and impairment:				
Balance at January 1, 2010	₩	-	(29,029)	(29,029)
Depreciation		-	(3,510)	(3,510)
Transfer to property, plant and equipment		-	103	103
Balance at December 31, 2010	₩	-	(32,436)	(32,436)
Carrying amount:				
Balance at January 1, 2010	₩	13,919	87,981	101,900
Balance at December 31, 2010	₩	13,919	84,224	98,143

KT&G CORPORATION
Notes to the Financial Statements

March 31, 2011 and 2010

7. Investment Property (Continued)

- (c) The amounts recognized in profit or loss from investment property for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Rental income	₩	4,323	4,370
Direct operating expense		(1,047)	(878)
	₩	3,276	3,492

- (d) The carrying amount and the fair value of investment property as of March 31, 2011 and December 31, 2010 were as follows:

<i>In millions of won</i>		March 31 2011		December 31 2010	
		Fair value	Carrying amount	Fair value	Carrying amount
Land	₩	205,864	15,132	204,383	13,919
Buildings		134,307	108,133	109,235	84,224
	₩	340,171	123,265	313,618	98,143

- (e) Investment property pledged as collateral as of March 31, 2011 was as follows:

<i>In millions of won</i>					
Asset	Carrying amount	Type	Received amount	Collateralized amount	Leaseholder
Investment property	₩ 56,873	Leasehold deposits received	₩ 4,787	5,826	Samsung Engineering Co., Ltd. and 23 others

- (f) Investment property pledged as collateral as of December 31, 2010 was as follows:

<i>In millions of won</i>					
Asset	Carrying amount	Type	Received amount	Collateralized amount	Leaseholder
Investment property	₩ 32,722	Leasehold deposits received	₩ 2,583	3,429	Korea Life Insurance Co., Ltd. and 18 others

KT&G CORPORATION

Notes to the Financial Statements

March 31, 2011 and 2010

8. Investments in Associates

Investments in associates as of March 31, 2011 and December 31, 2010 are summarized as follows:

*In millions of won,
except percentage of ownership*

Associate	Location	Principal operation	March 31 2011		December 31 2010	
			Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Cosmo Tabacco Co., Ltd.	Mongolia	Manufacturing and selling tobaccos	40.00%	₩ -	40.00%	₩ -
Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	25.34%	1,830	25.34%	1,830
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00%	1,000	20.00%	1,000
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	32.68%	10,000	-	-
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67%	7,300	-	-
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06%	7,000	-	-
JR REIT V Co., Ltd.	Korea	Selling and renting of real estate	34.63%	5,600	-	-
				₩ 32,730	₩	2,830

The Company reclassified ₩17,300 million of available-for-sale financial assets to investments in associates for the three-month period ended March 31, 2011.

The Company recognized ₩2,947 million of impairment loss on the investment in Cosmo Tabacco Co., Ltd. prior to the beginning of the previous period.

9. Investments in Subsidiaries

Investments in subsidiaries as of March 31, 2011 and December 31, 2010 are summarized as follows:

*In millions of won,
except percentage of ownership*

Subsidiary	Location	Principal operation	March 31 2011		December 31 2010	
			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	53.00%	66,355	53.00%	66,355
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.	Turkey	Manufacturing and selling tobaccos	99.99%	54,049	99.99%	54,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf tobaccos	99.90%	394	99.90%	394
KT&G Pars	Iran	Manufacturing and selling tobaccos	99.99%	5,733	99.99%	5,733
KT&G Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00%	110,297	100.00%	110,297
KGC Life & Gin Co., Ltd. (formerly, KGC Sales Co., Ltd.)	Korea	Selling ginseng door-to-door	100.00%	22,500	100.00%	22,500
KT&G Bio Corp.	Korea	Manufacturing and selling pharmaceutical	100.00%	900	100.00%	900
Global Trading, Inc. Purpleland	USA	Selling tobaccos	100.00%	4,913	100.00%	4,913
Development Co., Ltd.	Korea	Selling and renting of real estate	100.00%	900	100.00%	900
				₩840,121	₩	840,121

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10. Available-for-sale Financial Assets

- (a) Changes in available-for-sale financial assets for the three-month period ended March 31, 2011 and the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		2011	2010
Balance at beginning of period	₩	314,937	443,800
Acquisitions		-	39,923
Net changes in fair value before tax		(17,512)	(141,998)
Transfer to investments in associates		(17,300)	-
Impairment		(3,988)	-
Disposals		-	(26,788)
Balance at end of period	₩	276,137	314,937
Statements of financial position:			
- Current	₩	1,000	1,000
- Non-current		275,137	313,937
	₩	276,137	314,937

The Company recognized ₩3,988 million of impairment loss on the available-for-sale equity instruments of Migami, Inc. for the three-month period ended March 31, 2011.

- (b) Available-for-sale financial assets as of March 31, 2011 and December 31, 2010 are summarized as follows:

<i>In millions of won</i>		March 31 2011	December 31 2010
Available-for-sale debt instruments:			
- Government and municipal bonds	₩	44	44
- Corporate bonds		3,000	20,300
Total available-for-sale debt instruments		3,044	20,344
Available-for-sale equity instruments:			
Listed			
- Yonhap Television News (YTN)		24,721	30,839
- Oscotech, Inc.		1,468	1,022
- Shinhan Financial Group Co., Ltd.		199,816	212,042
- Rexahn Pharmaceuticals, Inc.		8,350	8,152
		234,355	252,055
Unlisted			
- Dream Hub PFV Co., Ltd.		12,732	12,732
- Migami, Inc.		-	3,988
- Other unlisted available-for-sale equity instruments		26,006	25,818
		38,738	42,538
Total available-for-sale equity instruments		273,093	294,593
Total available-for-sale financial assets	₩	276,137	314,937

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10. Available-for-sale Financial Assets (Continued)

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

The fair value of Dream Hub PFV Co., Ltd. which does not have a market price in an active market is measured at the value per share determined by the net asset valuation model.

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

11. Long-term Deposits in MSA Escrow Fund

- (a) Long-term deposits in MSA Escrow Fund as of March 31, 2011 and December 31, 2010 are summarized as follows:

<i>In millions of won</i>		March 31 2011	December 31 2010
MMF	₩	74,937	74,167
T-Note		56,030	58,247
	₩	130,967	132,414

- (b) As discussed in note 28 to the financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2011 and 2010 are ₩2,859 million and ₩1,732 million, respectively.
- (c) Investment income on long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2011 and 2010 are ₩302 million and ₩352 million, respectively.
- (d) Long-term deposits in MSA Escrow Fund are measured at quoted prices in an active market.

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12. Trade and Other Receivables

(a) Trade and other receivables as of March 31, 2011 and December 31, 2010 are summarized as follows:

<i>In millions of won</i>	March 31 2011		December 31 2010	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 19,272	38,616	19,287	42,972
Loans	-	31,419	14,942	7,374
Other receivables	105,664	-	70,822	-
Guarantee deposits	-	36,670	-	34,249
Accrued income	3,609	-	2,989	-
Trade receivables	449,132	-	419,787	-
	₩ 577,677	106,705	527,827	84,595

(b) Trade and other receivables as of March 31, 2011 and December 31, 2010 have been reported in the statements of financial position net of allowances as follows:

<i>In millions of won</i>	March 31 2011		December 31 2010	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 582,913	106,705	533,011	84,595
Allowance account:				
- Other receivables	(1,961)	-	(1,917)	-
- Trade receivables	(3,275)	-	(3,267)	-
	(5,236)	-	(5,184)	-
Net trade and other receivables	₩ 577,677	106,705	527,827	84,595

(c) Changes in the allowance account for the three-month period ended March 31, 2011 and the year ended December 31, 2010 were as follows:

<i>In millions of won</i>	2011	2010
Balance at beginning of period	₩ 5,184	5,407
Impairment loss	52	63
Write-off	-	(286)
Balance at end of period	₩ 5,236	5,184

Impairment loss on trade and other receivables is included as part of other expense in the statements of comprehensive income.

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March 31, 2011 and 2010

12. Trade and Other Receivables (Continued)

- (d) The aging schedule of trade and other receivables which were past due but not impaired as of March 31, 2011 and December 31, 2010 is as follows:

<i>In millions of won</i>		March 31 2011	December 31 2010
Within 1 month	₩	54,071	46,679
Between 1 and 2 months		51,874	64,212
Beyond 2 months		80,647	7,226
	₩	186,592	118,117

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

- (e) Details of trade and other receivables that are measured at amortized cost as of March 31, 2011 and December 31, 2010 were as follows:

<i>In millions of won</i>	March 31 2011			December 31 2010		
	Effective interest rate	Current	Non-current	Effective interest rate	Current	Non-current
Loans to employees	3.00~5.68%	₩ 19,272	38,616	3.00~5.68%	₩ 19,287	42,972
Guarantee deposits	3.00~5.68%	-	36,670	3.00~5.68%	-	34,249
		₩ 19,272	75,286		₩ 19,287	77,221

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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March 31, 2011 and 2010

13. Inventories

(a) Inventories as of March 31, 2011 and December 31, 2010 are summarized as follows:

<i>In millions of won</i>		March 31 2011	December 31 2010
Finished goods, net of loss on the write-down of inventories	₩	104,361	70,770
Work-in-progress		12,210	14,401
Raw materials		786,283	843,286
Supplies		23,889	23,400
By-products		6,965	7,467
Buildings under construction		1,034	381
Sites for lotting-out construction		9,449	9,449
Goods-in-transit		33,199	21,179
	₩	977,390	990,333

(b) The amounts of inventories recognized as an expense for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Cost of sales:			
- Loss on the write-down of inventories	₩	62	39
Other expense:			
- Loss on retirement of inventories ^{aa}		384	997
	₩	446	1,036

14. Cash and Cash Equivalents

Cash and cash equivalents as of March 31, 2011 and December 31, 2010 are summarized as follows:

<i>In millions of won</i>		March 31 2011	December 31 2010
Cash on hand	₩	5,404	4,956
Demand deposits		110,824	53,995
Short-term investment assets		775,000	770,000
	₩	891,228	828,951

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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March 31, 2011 and 2010

15. Share Capital

(a) Details of share capital as of March 31, 2011 and December 31, 2010 were as follows:

<i>In won, except number of shares</i>	March 31 2011	December 31 2010
Number of ordinary shares:		
- Authorized	800,000,000	800,000,000
- Issued	137,292,497	137,292,497
- Outstanding	127,648,800	127,648,800
Par value	₩ 5,000	5,000

The Company has, thus far, reacquired and retired 53,699,400 shares of treasury share. Accordingly, as of March 31, 2011, the Company's ordinary share differs from the aggregate par value of issued shares by ₩268,497 million.

(b) Changes in the number of shares for the three-month period ended March 31, 2011 and the year ended December 31, 2010 were as follows:

<i>Number of shares</i>	2011			2010		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning of period	137,292,497	(9,643,697)	127,648,800	137,292,497	(10,093,697)	127,198,800
Disposal of treasury shares	-	-	-	-	450,000	450,000
End of period	137,292,497	(9,643,697)	127,648,800	137,292,497	(9,643,697)	127,648,800

(c) Changes in the other capital surplus for the three-month period ended March 31, 2011 and the year ended December 31, 2010 were as follows:

<i>In millions of won</i>	2011	2010
Balance at beginning of period	₩ 3,582	2,632
Acquisition of KGC Life & Gin Co., Ltd.	-	(3,434)
Transfer of the sports department	-	4,384
Balance at end of period	₩ 3,582	3,582

In 2010, the Company acquired all the shares of KGC Life & Gin Co., Ltd. for ₩4,934 million from Korea Ginseng Corporation, which is a subsidiary of the Company. The Company recognized investments in subsidiaries at the carrying amount of ₩1,500 million in the financial statements of Korea Ginseng Corporation. Accordingly, the Company recognized a decrease in other capital surplus amounting to ₩3,434 million.

In 2010, the Company disposed of its sports department for ₩8,565 million to Korea Ginseng Corporation, which is a subsidiary of the Company. The Company recognized the difference of ₩4,384 million between the net disposal proceeds and the carrying amount of the sports department as an increase in other capital surplus.

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16. Treasury Shares

- (a) Changes in the treasury shares for the three-month period ended March 31, 2011 and the year ended December 31, 2010 were as follows:

<i>In millions of won, except number of shares</i>	2011		2010	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Balance at beginning of period	9,643,697	₩ 216,827	10,093,697	₩ 226,945
Disposal of treasury shares	-	-	(450,000)	(10,118)
Balance at end of period	9,643,697	₩ 216,827	9,643,697	₩ 216,827

- (b) Changes in gain on reissuance of treasury shares for the three-month period ended March 31, 2011 and the year ended December 31, 2010 were as follows:

<i>In millions of won</i>	2011	2010
Balance at beginning of period	₩ 482,129	468,274
Gain on reissuance of treasury shares before tax	-	18,278
Less: tax at 24.2%	-	(4,423)
Gain of reissuance of treasury shares, net of tax	-	13,855
Balance at end of period	₩ 482,129	482,129

17. Reserves

- (a) Details of reserves as of March 31, 2011 and December 31, 2010 were as follows:

<i>In millions of won</i>	March 31 2011	December 31 2010
Available-for-sale financial assets reserve	₩ 4,376	18,034
Legal reserve	602,937	602,937
Voluntary reserve	2,107,732	1,563,732
	₩ 2,715,045	2,184,703

- (b) Available-for-sale financial assets reserve as of March 31, 2011 and December 31, 2010 are summarized as follows:

<i>In millions of won</i>	March 31 2011	December 31 2010
Available-for-sale financial assets reserve before tax	₩ 5,610	23,120
Tax effect	(1,234)	(5,086)
	₩ 4,376	18,034

- (c) 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 shares in connection with a free issue of shares.

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March 31, 2011 and 2010

17. Reserves (Continued)

(d) Details of voluntary reserve as of March 31, 2011 and December 31, 2010 were as follows:

<i>In millions of won</i>	March 31 2011	December 31 2010
Reserve for business rationalization	₩ 12,851	12,851
Reserve for research and human resource development	60,000	60,000
Reserve for business expansion	698,881	698,881
Unconditional reserve	1,336,000	792,000
	₩ 2,107,732	1,563,732

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

Reserve for research and human resource development was appropriated in order to utilize certain tax deduction benefits through the early recognition of future expenditures. This reserve is restored to retained earnings in accordance with the relevant tax laws. Such reserve is 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.

18. Retained Earnings

Changes in retained earnings for the three-month period ended March 31, 2011 and the year ended December 31, 2010 were as follows:

<i>In millions of won</i>	2011	2010
Balance at beginning of period	₩ 929,140	579,963
Transfer from reserve for research and human resource development	-	15,000
Transfer from reserve for loss on reissuance of treasury shares	-	26,646
Transfer to reserve for research and human resource development	-	(60,000)
Transfer to unconditional reserve	(544,000)	(203,000)
Dividends	(382,946)	(356,157)
Profit for the period	199,211	931,127
Actuarial gains (losses), net of tax	8	(4,439)
Balance at end of period	₩ 201,413	929,140

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19. Short-term Borrowings

Short-term borrowings as of March 31, 2011 and December 31, 2010 are summarized as follows:

<i>In millions of won</i>		March 31 2011	December 31 2010
Customer credit contracts	₩	7,883	8,618

The Company has entered into a 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 in the statements of financial position.

20. Trade and Other Payables

(a) Trade and other payables as of March 31, 2011 and December 31, 2010 are summarized as follows:

<i>In millions of won</i>		March 31 2011		December 31 2010	
		Current	Non-current	Current	Non-current
Leasehold deposits received	₩	-	24,746	-	22,902
Trade payables		48,275	-	21,669	-
Withholdings		4,708	-	2,725	-
Withholdings taxes		104,815	-	114,727	-
Accrued expenses		68,880	-	86,548	-
Other payables		122,366	-	12,918	-
Dividends payable		382,946	-	-	-
	₩	731,990	24,746	238,587	22,902

(b) Details of trade and other payables that are measured at amortized cost as of March 31, 2011 and December 31, 2010 were as follows:

<i>In millions of won</i>		March 31 2011		December 31 2010	
		Effective interest rate	Amortized cost	Effective interest rate	Amortized cost
Leasehold deposits received		3.00~5.68%	₩ 24,746	3.00~5.68%	₩ 22,902

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.

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21. Retirement 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 benefits for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Defined benefit costs:			
- Current service costs	₩	5,733	6,724
- Interest costs		1,524	1,744
- Expected returns on plan assets		(1,118)	(1,609)
	₩	6,139	6,859
Defined contribution costs:			
- Contributions recognized as expense	₩	344	327
	₩	6,483	7,186

The Company recognized contributions payable amounting to ₩75 million and ₩83 million as trade and other payables (accrued expenses) in the statements of financial position as of March 31, 2011 and December 31, 2010, respectively.

The Company recognized termination benefits amounting to ₩1,529 million as an expense for the three-month period ended March 31, 2010. The Company recognized trade and other payables (accrued expenses) amounting to ₩1,695 in the statement of financial position as of December 31, 2010.

- (b) Changes in defined benefit liabilities for the three-month period ended March 31, 2011 and the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		2011	2010
Balance at beginning of period	₩	28,774	18,295
Retirement benefits		6,139	27,725
Actuarial losses (gains) before tax		(10)	5,692
Payments into plan assets		-	(10,758)
Transfer of the sports department		-	(451)
Payments, including the amount transferred to the defined contribution plan		(1,105)	(11,258)
Changes in accrued expenses		384	(471)
Balance at end of period	₩	34,182	28,774
Statements of financial position:			
- Present value of retirement benefit obligations	₩	137,631	133,114
- Fair value of plan assets		(103,449)	(104,340)
Defined benefit liabilities	₩	34,182	28,774

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March 31, 2011 and 2010

21. Retirement Benefits Plan (Continued)

- (c) Changes in defined benefit obligations for the three-month period ended March 31, 2011 and the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		2011	2010
Balance at beginning of period	₩	133,114	129,813
Current service costs		5,733	26,895
Interest costs		1,524	6,978
Losses on the settlement of the plan		-	286
Actuarial losses before tax		-	5,033
Transfer of the sports department		-	(599)
Payments, including the amount transferred to the defined contribution plan		(3,936)	(33,798)
Changes in accrued expenses		1,196	(1,494)
Balance at end of period	₩	137,631	133,114

Some of employees have transferred from the defined benefit plan to the defined contribution plan. The Company recognized ₩286 million of the losses on the settlement of the defined benefit plan in profit or loss for the year ended December 31, 2010.

- (d) Changes in plan assets for the three-month period ended March 31, 2011 and the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		2011	2010
Balance at beginning of period	₩	104,340	111,518
Expected return on plan assets		1,118	6,434
Actuarial gains (losses) before tax		10	(659)
Payments into plan assets		-	10,758
Transfer of the sports department		-	(148)
Payments, including the amount transferred to the defined contribution plan		(2,831)	(22,540)
Changes in accrued expenses		812	(1,023)
Balance at end of period	₩	103,449	104,340

Actual returns on plan assets for the three-month periods ended March 31, 2011 and 2010 are ₩1,128 million and ₩2,034 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 for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Actuarial gains before tax	₩	10	4,634
Tax effect		(1)	(1,019)
	₩	9	3,615

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21. Retirement Benefits Plan (Continued)

(f) The components of plan assets as of March 31, 2011 and December 31, 2010 were as follows:

<i>In millions of won</i>	March 31 2011	December 31 2010
Cash and cash equivalents	₩ 6	17,532
Short-term trading financial assets	68,346	58,942
Available-for-sale financial assets	35,097	27,866
	₩ 103,449	104,340

As of March 31, 2011 and December 31, 2010, short-term trading financial assets include severance insurance of ₩66 million and ₩65 million, respectively, which continues to be covered by the existing retirement benefits plan.

(g) The principal actuarial assumptions as of March 31, 2011 and December 31, 2010 were as follows:

<i>In millions of won</i>	March 31 2011	December 31 2010
Rate of salary increases	5.00%	5.00%
Discount rate	4.70%	4.70%
Expected rate of return on plan assets	4.40%	4.40%

For the purpose of calculating present value of the defined benefit obligations, the Company used the discount rate determined by reference to market yields at the end of the reporting period on high quality corporate bonds consistent with the currency and estimated term of the defined benefit obligations.

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

<i>In millions of won</i>	1 percentage point increase	1 percentage point decrease
Rate of salary increases:		
- Increase (decrease) in defined benefit obligations	₩ 13,373	(11,755)
- Increase (decrease) in retirement benefits before tax	759	(663)
Discount rate:		
- Increase (decrease) in defined benefit obligations	(12,444)	14,494
- Increase (decrease) in retirement benefits before tax	(358)	400
Expected rate of return on plan assets:		
- Increase (decrease) in retirement benefits before tax	(254)	254

The effect on defined benefit obligations is as of March 31, 2011. The effect on retirement benefits before tax is for the three-month period ended March 31, 2011.

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22. Profit from Operations

(a) Employee benefit costs for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Salaries	₩	75,690	64,040
Retirement benefits		6,483	7,186
Termination benefits		-	1,529
Employee welfare		7,178	5,565
	₩	89,351	78,320

(b) Depreciation and amortization for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Depreciation	₩	25,959	31,286
Amortization		12	23
	₩	25,971	31,309

(c) Details of other income for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Foreign currency transaction gain	₩	580	2,444
Foreign currency translation gain		402	599
Gain on sale of property, plant and equipment		5,043	5,202
Gain on sale of intangible assets		605	1
Others		2,581	2,496
	₩	9,211	10,742

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22. Profit from Operations (Continued)

(d) Details of selling expenses for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Salaries	₩	35,892	32,344
Retirement and termination benefits		2,917	2,766
Employee welfare		3,789	2,868
Travel		875	712
Communications		423	410
Utilities		1,717	1,661
Taxes and dues		3,006	3,231
Supplies		276	281
Rent		3,028	2,467
Depreciation		4,322	7,539
Repairs and maintenance		899	1,241
Vehicles		1,696	1,520
Insurance		27	11
Commissions		7,234	5,912
Freight and custody		5,480	7,156
Conferences		350	548
Advertising		16,271	14,431
Training		289	269
Prizes and rewards		38	219
Normal research and development		48	25
	₩	88,577	85,611

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March 31, 2011 and 2010

22. Profit from Operations (Continued)

- (e) Details of general and administrative expenses for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Salaries	₩	13,748	7,448
Retirement and termination benefits		1,296	3,752
Employee welfare		1,167	129
Travel		517	378
Communications		538	462
Utilities		713	682
Taxes and dues		410	350
Supplies		314	529
Rent		157	355
Depreciation		2,522	3,071
Amortization		12	23
Repairs and maintenance		516	106
Vehicles		357	300
Insurance		189	212
Commissions		9,215	6,801
Freight and custody		297	213
Conferences		341	397
Advertising		14,199	15,789
Training		818	953
Prizes and rewards		70	187
Normal research and development		2,552	1,644
	₩	49,948	43,781

- (f) Details of other expenses for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Foreign currency transaction loss	₩	2,024	3,500
Foreign currency translation loss		11,075	11,029
Impairment loss on trade and other receivables		52	10
Donations		2,155	2,578
Loss on sale of property, plant and equipment		101	198
Loss on sale of intangible assets		125	125
Others		1,615	1,023
	₩	17,147	18,463

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23. Net Finance Costs (Income)

- (a) Details of net finance costs (income) for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Finance cost:			
- Interest costs	₩	18	53
- Impairment loss on available-for-sale financial assets		3,988	-
		4,006	53
Finance income:			
- Interest income		(7,595)	(3,892)
- Dividend income		(53,332)	(31,855)
- Investment income on long-term deposits in MSA Escrow Fund		(302)	(352)
- Gain on sale of available-for-sale financial assets		-	(356)
		(61,229)	(36,455)
Net finance costs (income)	₩	(57,223)	(36,402)

- (b) Details of interest costs for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Related financial liabilities:			
- Trade and other payables		18	48
- Others		-	5
	₩	18	53

- (c) Details of interest income for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Related financial assets:			
- Deposits	₩	7,127	3,126
- Available-for-sale financial assets		12	20
- Trade and other receivables		456	746
	₩	7,595	3,892

- (d) Details of finance income (costs) recognized in other comprehensive income for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>	2011			2010		
	Before tax	Tax effect	Net of tax	Before tax	Tax effect	Net of tax
Gains (losses) on available-for-sale financial assets:						
Net change in fair value	₩ (17,512)	3,853	(13,659)	₩ 76,509	(16,832)	59,677
Less: reclassified to profit or loss	-	-	-	(357)	79	(278)
	₩ (17,512)	3,853	(13,659)	₩ 76,152	(16,753)	59,399

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24. Income Taxes

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

Taxable income			Tax rate
2009 and thereafter	2009	2010 & 2011	Thereafter
Up to ₩200 million	12.1%	11.0%	11.0%
Over ₩200 million	24.2%	24.2%	22.0%

In December 2009, the Korean government postponed the reduction of the corporate income tax rate (including resident tax) from 24.2% to 22%, until 2012.

- (b) The components of income tax expense (benefit) for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Current income tax expense	₩	42,321	40,151
Adjustments recognized in the period for current tax of prior periods		(56)	-
Changes in temporary difference		1,203	25,165
Total income tax expense		43,468	65,316
Tax expense (benefit) recognized outside profit or loss		3,852	(17,772)
Income tax expense	₩	47,320	47,544

- (c) Current and deferred tax expense that were recognized outside profit or loss for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Current:			
- Actuarial gains		(1)	(1,019)
Deferred:			
- Net changes in fair value of available-for-sale financial assets		3,853	(16,753)
Tax expense (benefit) recognized outside profit or loss	₩	3,852	(17,772)

The Company recognized tax expense related to actuarial gains and gains (losses) on valuation of available-for-sale assets in other comprehensive income.

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March 31, 2011 and 2010

24. Income Taxes (Continued)

- (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 statements of comprehensive income for the three-month periods ended March 31, 2011 and 2010 for the following reasons:

*In millions of won
except tax rate information*

		2011	2010
Profit before tax	₩	246,531	226,897
Normal tax rate		24.2%	24.2%
Expense for income taxes at normal tax rate	₩	59,654	54,903
Adjustment:			
- Tax effects of permanent differences		509	612
- Non-inclusion of proceeds-dividend earned		(12,326)	(7,394)
- Investment tax credits		(335)	(576)
- Additional tax return for prior period		(182)	(1)
Income tax expense	₩	47,320	47,544
Effective tax rate		19.2%	21.0%

- (e) Deferred tax expense relating to the origination and reversal of temporary differences for the three-month periods ended March 31, 2011 and 2010 were as follows:

In millions of won

		2011	2010
Deferred tax liabilities at end of year	₩	(94,513)	(147,537)
Deferred tax liabilities at beginning of year		(93,310)	(122,372)
Deferred tax expense	₩	1,203	25,165

- (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.
- (g) The net deferred tax liabilities are reflected in the 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.

KT&G CORPORATION
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March 31, 2011 and 2010

24. Income Taxes (Continued)

(h) Changes in deferred tax assets and liabilities for the three-month period ended March 31, 2011 were as follows:

<i>In millions of won</i>		Balance at beginning of period	Credited to profit (charged to loss)	Charged to other comprehensive income	Balance at end of period
Available-for-sale financial assets	₩	9,861	878	-	10,739
Accrued expense		17,863	(4,602)	-	13,261
Defined benefit liabilities		179	10	-	189
Depreciation		3,895	41	-	3,936
Investments in subsidiaries		(95,884)	-	-	(95,884)
Foreign currency translations		1,220	(1,220)	-	-
Treasury shares		(8,183)	-	-	(8,183)
Unrealized gain on valuation of available-for-sale financial assets		(5,087)	-	3,853	(1,234)
Voluntary reserve		(13,200)	-	-	(13,200)
Provision for advanced depreciation		(4,722)	-	-	(4,722)
Others		748	(163)	-	585
	₩	(93,310)	(5,056)	3,853	(94,513)

(i) Changes in deferred tax assets and liabilities for the year ended December 31, 2010 were as follows:

<i>In millions of won</i>		Balance at beginning of period	Credited to profit (charged to loss)	Charged to other comprehensive income	Balance at end of period
Available-for-sale financial assets	₩	9,449	412	-	9,861
Accrued expense		20,411	(2,548)	-	17,863
Donations in excess of tax limit		89	(89)	-	-
Defined benefit liabilities		(1,894)	2,073	-	179
Depreciation		4,169	(274)	-	3,895
Investments in subsidiaries		(95,884)	-	-	(95,884)
Foreign currency translations		3,841	(2,621)	-	1,220
Treasury shares		(8,565)	382	-	(8,183)
Unrealized gain on valuation of available-for-sale financial assets		(36,326)	-	31,239	(5,087)
Voluntary reserve		(13,200)	-	-	(13,200)
Provision for advanced depreciation		(4,722)	-	-	(4,722)
Others		260	488	-	748
	₩	(122,372)	(2,177)	31,239	(93,310)

(j) The income taxes payable and income taxes refund before offsetting as of March 31, 2011 and December 31, 2010 were as follows:

<i>In millions of won</i>		March 31 2011	December 31 2010
Income taxes payable	₩	42,321	291,736
Income taxes refund		(1,019)	(100,921)
	₩	41,302	190,815

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25. Earnings per Share

Basic and diluted earnings per share for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won, except share information</i>		2011	2010
Profit for the period	₩	199,211	179,353
Weighted-average number of ordinary shares outstanding		127,648,800	127,198,800
Basic and diluted earnings per share in won	₩	1,561	1,410

26. Transactions and Balances with Related Companies

(a) Details of parent and subsidiary relationships as of March 31, 2011 and December 31, 2010 were as follows:

Subsidiary	Location	Next most senior parent	Percentage of ownership					
			March 31 2011			December 31 2010		
			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	53.00%	-	53.00%	53.00%	-	53.00%
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%	100.00%	-	100.00%
KGC Life & Gin Co., Ltd.	Korea	The Company	100.00%	-	100.00%	100.00%	-	100.00%
Global Trading, Inc. Purpleland Development Co., Ltd.	USA	The Company	100.00%	-	100.00%	100.00%	-	100.00%
Korea Ginseng HK, Ltd.	Korea	The Company	100.00%	-	100.00%	100.00%	-	100.00%
Cheong Kwan Jang Taiwan Corporation	Hong Kong	Korea Ginseng Corporation	-	99.99%	99.99%	-	99.99%	99.99%
Korean Red Ginseng Corp., Inc.	Taiwan	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
Korea Ginseng (China) Corp.	USA	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%
	China	Korea Ginseng Corporation	-	100.00%	100.00%	-	100.00%	100.00%

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26. Transactions and Balances with Related Companies (Continued)

- (b) Significant transactions which occurred in the normal course of business with related companies for the three-month periods ended March 31, 2011 and 2010 are summarized as follows:

In millions of won

Relationship	Related Company		2011	2010
Revenue from sales and other income:				
Subsidiary	Korea Ginseng Corporation	₩	1,074	1,286
	Yungjin Pharm. Ind. Co., Ltd.		72	48
	Tae-a Industry Co., Ltd.		2	3
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		1,476	997
	KT&G Pars		2,373	1,067
	KT&G Rus L.L.C.		4,469	43
	KGC Life & Gin Co., Ltd.		170	7
	Global Trading, Inc.		8,268	-
	Purpleland Development Co., Ltd.		7	-
		₩	17,911	3,451
Purchases and other expenses:				
Subsidiary	Korea Ginseng Corporation	₩	413	449
	Yungjin Pharm. Ind. Co., Ltd.		3	-
	Tae-a Industry Co., Ltd.		3,438	2,874
		₩	3,854	3,323

The Company recognized dividends from Korea Ginseng Corporation amounting to ₩50,000 million and ₩30,000 million as finance income for the three-month periods ended March 31, 2011 and 2010, respectively.

- (c) Account balances with related companies as of March 31, 2011 and December 31, 2010 were as follows:

In millions of won

Relationship	Related Company		March 31 2011	December 31 2010
Receivables:				
Subsidiary	Korea Ginseng Corporation	₩	50,000	-
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		18,750	17,642
	KT&G Pars		24,236	22,114
	KT&G Rus L.L.C.		22,281	8,159
	KGC Life & Gin Co., Ltd.		19	-
	Global Trading, Inc.		14,507	11,248
		₩	129,793	59,163
Payables:				
Subsidiary	Korea Ginseng Corporation	₩	2,456	2,289
	Tae-a Industry Co., Ltd.		1,373	-
		₩	3,829	2,289

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March 31, 2011 and 2010

26. Transactions and Balances with Related Companies (Continued)

(d) Details of guarantees provided for related companies as of March 31, 2011 and December 31, 2010 were as follows:

<i>In thousands of euro</i>			March 31		December 31	
Relationship	Type of guarantee	Guarantee recipient	Limit	Exercise	Limit	Exercise
Subsidiary	Guarantee on foreign currency letter of credit opened	KT&G Rus L.L.C.	€ 2,063	2,063	€ 2,063	2,063

(e) Details of key management personnel compensation for the three-month periods ended March 31, 2011 and 2010 are summarized as follows:

<i>In millions of won</i>		2011	2010
Short-term employee benefits	₩	3,680	1,957
Post-employment benefits		298	177
	₩	3,978	2,134

27. Risk Management

(a) Overview

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

- credit risk
- liquidity risk
- currency risk
- interest rate risk
- other market price risk.

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

(b) Risk Management Framework

The purpose of managing financial risks is to identify the potential risk factors that may affect the Company's financial performance, and minimize, eliminate and avoid it to the extent that is acceptable. One of the principal responsibilities of the treasury department is to manage the financial risks arising from the Company's underlying operations. The treasury department monitors and manages the financial risk arising from the Company's underlying operations in accordance with the risk management policies and procedures authorized by the board of directors. Also, the treasury department provides an internal report analyzing the nature and exposure level 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 applied the same financial risk management strategy that was applied in the previous period.

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27. Risk Management (Continued)

(c) Management of Financial Risks

Credit Risk

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

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of March 31, 2011 and December 31, 2010 is as follows:

<i>In millions of won</i>		March 31 2011	December 31 2010
Available-for-sale financial assets	₩	276,137	314,937
Long-term deposits in MSA Escrow Fund		130,967	132,414
Trade and other receivables		684,382	612,422
Cash and cash equivalents		891,228	828,951

Export trade receivables to overseas clients, including Alokozay International Limited are ₩259,557 million, ₩235,636 million, and equal to 57.8% and 56.1% of the aggregate trade receivables, respectively, as of March 31, 2011 and December 31, 2010. The Company's trade receivables mentioned above were insured against non-payment up to USD 42,525 thousand and USD 38,525 thousand by export guarantee insurance with the Korea Export Insurance Corporation, respectively, as of March 31, 2011 and December 31, 2010. The Company has no significant concentration of customer credit risk since trade and other receivables, excluding the above export trade receivables, are widely dispersed amongst a large number of customers.

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

Liquidity Risk

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

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27. Risk Management (Continued)

(c) Management of Financial Risks (Continued)

The maturity analysis with a residual contractual maturity of financial liabilities as of March 31, 2011 and December 31, 2010 is as follows:

<i>In millions of won</i>	Carrying amount	Contractual cash flow	Within 3 months	Residual contractual maturity		
				Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
As of March 31, 2011:						
Derivative financial liabilities	₩ -	-	-	-	-	-
Non-derivative financial liabilities	655,096	655,914	585,534	60,253	8,127	2,000
	₩ 655,096	655,914	585,534	60,253	8,127	2,000
As of December 31, 2010:						
Derivative financial liabilities	₩ -	-	-	-	-	-
Non-derivative financial liabilities	152,655	153,199	68,202	75,105	9,892	-
	₩ 152,655	153,199	68,202	75,105	9,892	-

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.

Currency Risk

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

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March 31, 2011 and 2010

27. Risk Management (Continued)

(c) Management of Financial Risks (Continued)

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of March 31, 2011 and December 31, 2010 were as follows:

<i>In millions of won</i>	March 31 2011				December 31 2010	
	USD	EUR	THB	RUB	USD	EUR
Assets:						
Cash and cash equivalents ₩	19,732	4	-	-	6,228	1,227
Trade and other receivables	306,752	12,041	24	9,733	277,055	9,883
Long-term deposits in MSA Escrow Fund	130,967	-	-	-	132,414	-
₩	457,451	12,045	24	9,733	415,697	11,110
Liabilities:						
Trade and other payables ₩	7,934	2,797	-	-	1,448	2,434

As of March 31, 2011 and December 31, 2010, the effects of a 10% strengthening or weakening of functional currency against foreign currencies other than functional currency on profit before tax were as follows:

<i>In millions of won</i>	March 31 2011		December 31 2010	
	10% strengthening	10% weakening	10% strengthening	10% weakening
USD	₩ 44,952	(44,952)	41,425	(41,425)
EUR	925	(925)	868	(868)
THB	2	(2)	-	-
RUB	973	(973)	-	-
₩	46,852	(46,852)	42,293	(42,293)

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.

Interest Rate Risk

The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. As of March 31, 2011, 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.

Other Market Price Risk

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

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March 31, 2011 and 2010

27. Risk Management (Continued)

(c) Management of Financial Risks (Continued)

As of March 31, 2011 and December 31, 2010, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income were as follows:

<i>In millions of won</i>	March 31 2011		December 31 2010	
	5% increase	5% decrease	5% increase	5% decrease
Other comprehensive income before tax	₩ 12,213	(12,213)	13,338	(13,338)
Tax effect	(2,687)	2,687	(2,934)	2,934
Other comprehensive income after tax	₩ 9,526	(9,526)	10,404	(10,404)

(d) 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 capital risk management strategy that was applied in the previous period.

As of March 31, 2011 and December 31, 2010, the Company defines net debt and equity as follows:

<i>In millions of won</i>	March 31 2011	December 31 2010
Net debt:		
Debts (borrowings)	₩ 7,883	8,618
Less:		
- Cash and cash equivalents	(891,228)	(828,951)
- Current available-for-sale financial assets	(1,000)	(1,000)
	₩ (884,345)	(821,333)
Equity	₩ 4,140,301	4,337,686

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March 31, 2011 and 2010

27. Risk Management (Continued)

(e) Fair Value of Financial Instruments

The carrying amount and the fair value of financial instruments as of March 31, 2011 and December 31, 2010 are summarized as follows:

<i>In millions of won</i>	March 31 2011		December 31 2010	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets:				
Financial assets measured at fair value				
- Available-for-sale financial assets	₩ 276,137	276,137	314,937	314,937
- Long-term deposits in MSA Escrow Fund	130,967	130,967	132,414	132,414
- Cash and cash equivalents	891,228	891,228	828,951	828,951
	₩ 1,298,332	1,298,332	1,276,302	1,276,302
Financial assets measured at amortized cost				
- Trade and other receivables	₩ 684,382	684,382	612,422	612,422
	₩ 1,982,714	1,982,714	1,888,724	1,888,724
Liabilities:				
Financial liabilities measured at fair value				
	₩ -	-	-	-
Financial liabilities measured at amortized cost				
- Trade and other payables	₩ (647,213)	(647,213)	(144,037)	(144,037)
- Short-term borrowings	(7,883)	(7,883)	(8,618)	(8,618)
	₩ (655,096)	(655,096)	(152,655)	(152,655)
	₩ (655,096)	(655,096)	(152,655)	(152,655)

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March 31, 2011 and 2010

27. Risk Management (Continued)

(e) Fair Value of Financial Instruments (Continued)

The Fair Value Hierarchy

The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The level of fair value hierarchy is as follows:

-
- Level I The quoted prices in active markets for identical assets or liabilities
 - Level II The inputs that are observable for the asset or liability, either directly or indirectly
 - Level III The inputs for the asset or liability that are not based on observable market data
-

The fair value measurements classified by fair value hierarchy as of March 31, 2011 and December 31, 2010 were as follows:

<i>In millions of won</i>		Level I	Level II	Level III	Total
As of March 31, 2011:					
Financial assets					
- Available-for-sale financial assets	₩	234,400	23,251	18,486	276,137
- Long-term deposits in MSA Escrow Fund		130,967	-	-	130,967
- Cash and cash equivalents		891,228	-	-	891,228
	₩	1,256,595	23,251	18,486	1,298,332
As of December 31, 2010:					
Financial assets					
- Available-for-sale financial assets	₩	252,099	40,363	22,475	314,937
- Long-term deposits in MSA Escrow Fund		132,414	-	-	132,414
- Cash and cash equivalents		828,951	-	-	828,951
	₩	1,213,464	40,363	22,475	1,276,302

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28. Contingent Liabilities and Financial Commitments

- (a) The Company deposited some proportion of sales in accordance with the 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 are maintained to pay the medical expenses of tobacco purchasers who have suffered health effects as a result of smoking. The unused portion of this fund will be refunded to the Company 25 years from the date 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 March 31, 2011, 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, as of March 31, 2011, the Company is involved in three lawsuits as a defendant for alleged damages totalling ₩3,689 million. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of March 31, 2011.
- (c) As of March 31, 2011, the Company has entered into letter of credit agreements with Korea Exchange Bank and other banks with a limit set at USD 48,000 thousand.
- (d) As of March 31, 2011, the Company's trade receivables from the export of cigarettes were insured against non-payment up to USD 42,525 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.
- (e) As of March 31, 2011, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD 70,000 thousand by Korea Exchange Bank and others.
- (f) As of March 31, 2011, 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. related to the Yongsan International Commercial Development Project.
- (g) The Company has provided KT&G Rus L.L.C. with a payment guarantee on a foreign currency letter of credit opened in relation with the acquisition of tobacco manufacturing machinery up to EUR 2,063 thousand to Korea Exchange Bank as of March 31, 2011.
- (h) The Company entered into an overdraft agreement with a limit of ₩10,000 million with the NACF as of March 31, 2011.

29. Non-current Assets Held for Sale

In 2011, parts of a manufacturing facility within Cheongju plant were presented as assets held for sale following the Company's contract to sell them to Cheongju-si. The Company reclassified the assets from property, plant and equipment to non-current assets held for sale, which resulted in an ₩5,711 million increase of non-current assets held for sale, measured at the lower of its carrying amount and fair value less costs to sell.

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30. Cash Flows from Operating Activities

Details of cash generated from operations for the three-month periods ended March 31, 2011 and 2010 were as follows:

<i>In millions of won</i>		2011	2010
Profit for the periods	₩	199,211	179,353
Adjustments for:			
- Income tax expense		47,320	47,544
- Finance costs		4,006	53
- Finance income		(61,229)	(36,455)
- Depreciation		25,959	31,286
- Amortization		12	23
- Retirement and termination benefits		6,483	8,715
- Foreign currency translations loss		11,075	11,029
- Loss on the write-down of inventories		62	39
- Impairment loss on trade and other receivables		52	10
- Loss on sale of property, plant and equipment		101	198
- Loss on sale of intangible assets		125	125
- Other expense		384	1,430
- Foreign currency translations gain		(402)	(599)
- Gain on sale of property, plant and equipment		(5,043)	(5,202)
- Gain on sale of intangible assets		(605)	(1)
	₩	227,511	237,548
Changes in working capital:			
- Trade and other receivables		(17,866)	455
- Advance payments		(2,028)	(24,093)
- Prepaid expenses		482	(4,024)
- Prepaid tobacco excise and other taxes		(45,728)	(58,564)
- Inventories		12,497	3,291
- Trade and other payables		4,035	(11,717)
- Advance receipts		(330)	23,057
- Tobacco excise and other taxes payable		(3,092)	41,228
- Payment of retirement benefits		(3,153)	(6,227)
Cash generated from operations	₩	172,328	200,954

31. Date of Authorization for Issue

The financial statements were authorized for issue on April 20, 2011, at the Board of Directors meeting.