

KT&G CORPORATION AND SUBSIDIARIES

Consolidated Interim Financial Statements

**March 31, 2015**

(Unaudited)

(With Independent Auditors' Review Report Thereon)

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## Independent Auditors' Review Report

Based on a report originally issued in Korean

The Board of Directors and Shareholders  
KT&G Corporation:

### Reviewed Financial Statements

We have reviewed the accompanying consolidated interim financial statements of KT&G Corporation (the "Parent Company") and its subsidiaries (collectively the "Group"), expressed in Korean won, which comprise the consolidated interim statement of financial position as of March 31, 2015, and the consolidated interim statements of comprehensive income, changes in equity and cash flows for the three-month period ended March 31, 2015 and notes to the consolidated interim financial statements.

### Management's Responsibility

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

### Auditors' Review Responsibility

Our responsibility is to issue a report on these consolidated interim 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 of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the Republic of Korea and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### Conclusion

Based on our reviews, nothing has come to our attention that causes us to believe that the accompanying consolidated interim financial statements referred to above are not prepared, in all material respects, in accordance with K-IFRS No.1034.

The accompanying consolidated interim financial statements as of March 31, 2015 and for the three-month period ended March 31, 2015 have been translated into United States dollars solely for the convenience of the reader and such translation does not comply with K-IFRS. We have reviewed the translation and nothing came to our attention that cause us to believe that the consolidated interim financial statements expressed in Korean won have not been translated into dollars on the basis set forth in note 4 to the consolidated interim financial statements.



### **Other matters**

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

The consolidated interim statements of comprehensive income, changes in equity and cash flows for the three-month period ended March 31, 2014 were reviewed by other auditors whose review report thereon dated May 14, 2014, expressed that nothing came to their attention that caused them to believe that the accompanying consolidated interim financial information as of and for the three-month period ended March 31, 2014 was not prepared, in all material respects, in accordance with K-IFRS No.1034.

The consolidated statement of financial position of the Group as of December 31, 2014, and the related consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, which are not accompanying this report, were audited by other auditors, whose report thereon dated February 5, 2015, expressed an unqualified opinion. The accompanying consolidated statement of financial position of the Group as of December 31, 2014 presented for comparative purposes, is not different from that audited by other auditors in all material respects.

*KPMG Samjong Accounting Corp.*

KPMG Samjong Accounting Corp.  
Seoul, Korea  
May 15, 2015

This report is effective as of May 15, 2015, 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 consolidated interim financial statements and notes thereto. Accordingly, the readers of the review report should understand that the above review report has not been updated to reflect the impact of such subsequent events or circumstances, if any.

KT&G CORPORATION AND SUBSIDIARIES  
Consolidated Interim Statements of Financial Position  
(Unaudited)

**As of March 31, 2015 and December 31, 2014**

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2015 Korean won	2015 U.S. dollars (note 4)	2014 Korean won
<b>Assets</b>				
Property, plant and equipment	6,16	₩ 1,762,221	\$ 1,594,770	₩ 1,753,412
Intangible assets	7	152,524	138,030	154,937
Investment property	8,16	169,133	153,061	167,968
Investments in associates	5,9	58,193	52,664	57,903
Available-for-sale financial assets	10,30	321,007	290,504	325,833
Other financial assets	14,16,30	274	248	259
Long-term deposits in MSA Escrow Fund	11,30,32	321,894	291,307	301,808
Long-term advance payments	32	126,552	114,527	127,855
Long-term prepaid expenses		4,743	4,293	4,625
Long-term trade and other receivables	12,29,30	86,913	78,654	86,735
Deferred income tax assets		27,759	25,121	28,725
<b>Total non-current assets</b>		3,031,213	2,743,179	3,010,060
Inventories	13	1,929,836	1,746,458	1,982,503
Current available-for-sale financial assets	10,30	1,000	905	1,000
Current other financial assets	14,16,30,31	317,863	287,659	668,436
Prepaid tobacco excise and other taxes		556,291	503,430	260,773
Trade and other receivables	12,29,30	1,057,067	956,622	989,777
Advance payments	32	103,733	93,876	68,491
Prepaid expenses		20,442	18,500	20,802
Cash and cash equivalents	14,30,31	395,969	358,343	416,394
<b>Total current assets</b>		4,382,201	3,965,793	4,408,176
Non-current assets held for sale	5,15	420	380	426
<b>Total assets</b>		₩ 7,413,834	\$ 6,709,352	₩ 7,418,662

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES  
Consolidated Interim Statements of Financial Position, Continued  
(Unaudited)

**As of March 31, 2015 and December 31, 2014**

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2015 Korean won	2015 U.S. dollars (note 4)	2014 Korean won
<b>Equity</b>				
Ordinary shares	1,17	₩ 954,959	\$ 864,217	₩ 954,959
Other capital surplus	17	(4,573)	(4,138)	(4,573)
Treasury shares	18	(337,062)	(305,033)	(339,059)
Gain on reissuance of treasury shares	18	494,648	447,646	492,032
Reserve	19	3,726,356	3,372,267	3,426,367
Retained earnings	20	673,102	609,142	1,100,876
<b>Equity attributable to owners of the parent</b>		5,507,430	4,984,101	5,630,602
<b>Non-controlling interests</b>		76,910	69,601	77,478
<b>Total equity</b>		5,584,340	5,053,702	5,708,080
<b>Liabilities</b>				
Long-term borrowings	16,22,30,31	123,444	111,714	137,795
Long-term trade and other payables		32,851	29,729	32,244
Long-term advance receipts		13,982	12,654	14,587
Defined benefit liabilities	23	143,127	129,527	132,247
Provision		2,957	2,676	2,871
Deferred income tax liabilities		274,208	248,152	266,282
<b>Total non-current liabilities</b>		590,569	534,452	586,026
Short-term borrowings	16,22,30,31	131,417	118,929	141,861
Current portion of long-term borrowings	16,22,30,31	17,970	16,262	1,218
Trade and other payables	21,29,30	556,431	503,558	503,853
Advance receipts		23,373	21,150	37,533
Income tax payable		98,827	89,437	180,809
Tobacco excise and other taxes payable		410,907	371,862	259,282
<b>Total current liabilities</b>		1,238,925	1,121,198	1,124,556
<b>Total liabilities</b>		1,829,494	1,655,650	1,710,582
<b>Total equity and liabilities</b>		₩ 7,413,834	\$ 6,709,352	₩ 7,418,662

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES  
Consolidated Interim Statements of Comprehensive Income  
(Unaudited)

**For the three-month periods ended March 31, 2015 and 2014**

<i>In millions of won and thousands of U.S. dollars, except earnings per share</i>	<i>Note</i>	2015 Korean won	2015 U.S. dollars (note 4)	2014 Korean won
Sales	5,29,32	₩ 1,136,912	\$ 1,028,880	₩ 963,666
Cost of sales	24,29	(410,256)	(371,272)	(434,197)
<b>Gross profit</b>		726,656	657,608	529,469
Selling, general and administrative expenses	24,29	(298,121)	(269,793)	(269,324)
<b>Operating profit</b>	5	428,535	387,815	260,145
Other income	25	26,292	23,794	23,282
Other expenses	25	(46,870)	(42,417)	(25,083)
Net finance income	26,30	10,782	9,757	10,557
Share of gain of associates	9	821	743	736
Share of loss of associates	9	(169)	(153)	-
<b>Profit before income tax</b>		419,391	379,539	269,637
Income tax expense	27	(110,612)	(100,101)	(81,445)
<b>Profit for the period</b>		₩ 308,779	\$ 279,438	₩ 188,192
<b>Other comprehensive income (loss):</b>				
<b>Items that are or may be reclassified subsequently to profit or loss</b>				
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		₩ (4,492)	\$ (4,065)	₩ 6,868
Exchange differences on translating foreign operations, net of tax		(4,366)	(3,952)	(6,045)
		(8,858)	(8,017)	823
<b>Items that will never be reclassified to profit or loss</b>				
Remeasurements of the defined benefit liability, net of tax		(238)	(215)	(499)
<b>Other comprehensive income (loss) for the period, net of tax</b>		(9,096)	(8,232)	324
<b>Total comprehensive income for the period</b>		₩ 299,683	\$ 271,206	₩ 188,516
<b>Profit attributable to:</b>				
- Owners of the Parent Company		308,923	279,568	192,057
- Non-controlling interests		(144)	(130)	(3,865)
		308,779	279,438	188,192
<b>Total comprehensive income attributable to:</b>				
- Owners of the Parent Company		300,271	271,738	191,374
- Non-controlling interests		(588)	(532)	(2,858)
		299,683	271,206	188,516
<b>Earnings per share in won and U.S. dollars:</b>				
Basic and diluted	28	₩ 2,453	\$ 2.22	₩ 1,525

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES  
Consolidated Interim Statements of Changes in Equity  
(Unaudited)

**For the three-month period ended March 31, 2015**

<i>In millions of won</i>	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non- controlling interests	Total equity
<b>Balance at January 1, 2015</b>	₩ 954,959	(4,573)	(339,059)	492,032	3,426,367	1,100,876	5,630,602	77,478	5,708,080
<b>Total comprehensive income for the period:</b>									
Profit (loss) for the period	-	-	-	-	-	308,923	308,923	(144)	308,779
<b>Other comprehensive income (loss):</b>									
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	(4,492)	-	(4,492)	-	(4,492)
Exchange differences on translating foreign operations, net of tax	-	-	-	-	(3,923)	-	(3,923)	(443)	(4,366)
Remeasurements of the defined benefit liability, net of tax	-	-	-	-	-	(237)	(237)	(1)	(238)
<b>Total other comprehensive loss</b>	-	-	-	-	(8,415)	(237)	(8,652)	(444)	(9,096)
<b>Total comprehensive income (loss) for the period</b>	-	-	-	-	(8,415)	308,686	300,271	(588)	299,683
<b>Transactions with owners, recorded directly in equity:</b>									
Dividends	-	-	-	-	-	(428,056)	(428,056)	-	(428,056)
In-kind donation of treasury shares	-	-	1,997	2,616	-	-	4,613	-	4,613
Transfer from reserve for research and human resource development	-	-	-	-	(12,522)	12,522	-	-	-
Transfer to unconditional reserve	-	-	-	-	320,926	(320,926)	-	-	-
Others	-	-	-	-	-	-	-	20	20
<b>Total transactions with owners</b>	-	-	1,997	2,616	308,404	(736,460)	(423,443)	20	(423,423)
<b>Balance at March 31, 2015</b>	₩ 954,959	(4,573)	(337,062)	494,648	3,726,356	673,102	5,507,430	76,910	5,584,340

See accompanying notes to the consolidated interim financial statements.



KT&G CORPORATION AND SUBSIDIARIES  
Consolidated Interim Statements of Changes in Equity, Continued  
(Unaudited)

**For the three-month period ended March 31, 2015**

*In thousands of U.S. dollars*

	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non- controlling interests	Total equity
<b>Balance at January 1, 2015</b>	₩ 864,217	(4,138)	(306,840)	445,278	3,100,784	996,268	5,095,569	70,115	5,165,684
<b>Total comprehensive income for the period:</b>									
Profit (loss) for the period	-	-	-	-	-	279,568	279,568	(130)	279,438
<b>Other comprehensive income (loss):</b>									
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	(4,065)	-	(4,065)	-	(4,065)
Exchange differences on translating foreign operations, net of tax	-	-	-	-	(3,551)	-	(3,551)	(401)	(3,952)
Remeasurements of the defined benefit liability, net of tax	-	-	-	-	-	(214)	(214)	(1)	(215)
<b>Total other comprehensive loss</b>	-	-	-	-	(7,616)	(214)	(7,830)	(402)	(8,232)
<b>Total comprehensive income (loss) for the period</b>	-	-	-	-	(7,616)	279,354	271,738	(532)	271,206
<b>Transactions with owners, recorded directly in equity:</b>									
Dividends	-	-	-	-	-	(387,381)	(387,381)	-	(387,381)
In-kind donation of treasury shares	-	-	1,807	2,368	-	-	4,175	-	4,175
Transfer from reserve for research and human resource development	-	-	-	-	(11,332)	11,332	-	-	-
Transfer to unconditional reserve	-	-	-	-	290,431	(290,431)	-	-	-
Others	-	-	-	-	-	-	-	18	18
<b>Total transactions with owners</b>	-	-	1,807	2,368	279,099	(666,480)	(383,206)	18	(383,188)
<b>Balance at March 31, 2015</b>	₩ 864,217	(4,138)	(305,033)	447,646	3,372,267	609,142	4,984,101	69,601	5,053,702

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES  
Consolidated Interim Statements of Changes in Equity, Continued  
(Unaudited)

**For the three-month period ended March 31, 2014**

<i>In millions of won</i>	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non- controlling interests	Total equity
<b>Balance at January 1, 2014</b>	₩ 954,959	(4,573)	(339,059)	492,032	3,368,835	802,755	5,274,949	90,531	5,365,480
<b>Total comprehensive income for the period:</b>									
Profit (loss) for the period	-	-	-	-	-	192,057	192,057	(3,865)	188,192
<b>Other comprehensive income (loss):</b>									
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	6,868	-	6,868	-	6,868
Exchange differences on translating foreign operations, net of tax	-	-	-	-	(7,056)	-	(7,056)	1,011	(6,045)
Remeasurements of the defined benefit liability, net of tax	-	-	-	-	-	(495)	(495)	(4)	(499)
<b>Total other comprehensive income (loss)</b>	-	-	-	-	(188)	(495)	(683)	1,007	324
<b>Total comprehensive income (loss) for the period</b>	-	-	-	-	(188)	191,562	191,374	(2,858)	188,516
<b>Transactions with owners, recorded directly in equity:</b>									
Dividends	-	-	-	-	-	(402,876)	(402,876)	-	(402,876)
Transfer from reserve for research and human resource development	-	-	-	-	(47,478)	47,478	-	-	-
Transfer to unconditional reserve	-	-	-	-	152,000	(152,000)	-	-	-
<b>Total transactions with owners</b>	-	-	-	-	104,522	(507,398)	(402,876)	-	(402,876)
<b>Balance at March 31, 2014</b>	₩ 954,959	(4,573)	(339,059)	492,032	3,473,169	486,919	5,063,447	87,673	5,151,120

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES  
Consolidated Interim Statements of Cash Flows  
(Unaudited)

**For the three-month periods ended March 31, 2015 and 2014**

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2015 Korean won	2015 U.S. dollars (note 4)	2014 Korean won
<b>Cash flows from operating activities</b>				
Cash generated from operations	33	₩ 200,848	\$ 181,763	₩ 323,270
Income tax paid		(80,460)	(72,815)	(64,118)
<b>Net cash provided by operating activities</b>		120,388	108,948	259,152
<b>Cash flows from investing activities</b>				
Interest received		12,851	11,630	8,961
Investment income received				
from long-term deposits in MSA Escrow Fund		-	-	484
Dividends received		699	633	3,442
Proceeds from sale of property, plant and equipment		797	721	1,366
Proceeds from sale of intangible assets		348	315	130
Proceeds from sale of non-current assets held for sale		30	27	-
Proceeds from sale of available-for-sale financial assets		-	-	2,810
Collection of loans		2,327	2,105	2,666
Withdrawal of guarantee deposits		9,845	8,910	6,353
Settlement of derivatives, net		7	6	-
Acquisition of property, plant and equipment		(51,984)	(47,045)	(31,942)
Acquisition of intangible assets		(833)	(754)	(405)
Acquisition of investment property		-	-	(77)
Acquisition of available-for-sale financial assets		(1,100)	(995)	(2,600)
Increase in loans		(275)	(248)	-
Payments of guarantee deposits		(13,478)	(12,198)	(8,785)
Payments of long-term deposits in MSA Escrow Fund		(17,087)	(15,463)	(15,552)
Decrease in other financial assets		350,565	317,253	115,364
<b>Net cash provided by investing activities</b>		292,712	264,897	82,215
<b>Cash flows from financing activities</b>				
Interest paid		(3,815)	(3,452)	(3,184)
Dividends paid		(428,056)	(387,381)	-
Proceeds from borrowings		274,907	248,785	55,889
Increase in deposits received		694	628	1,672
Repayment of borrowings		(275,524)	(249,343)	(117,684)
Decrease in deposits received		(1,804)	(1,633)	(863)
<b>Net cash used in financing activities</b>		(433,598)	(392,396)	(64,170)
<b>Effect of exchange rate fluctuation on cash held</b>		73	66	(130)
<b>Net increase (decrease) in cash and cash equivalents</b>		(20,425)	(18,485)	277,067
Cash and cash equivalents at beginning of period		416,394	376,828	347,933
<b>Cash and cash equivalents at end of period</b>		₩ 395,969	\$ 358,343	₩ 625,000

See accompanying notes to the consolidated interim financial statements.

# KT&G CORPORATION AND SUBSIDIARIES

## Notes to the Consolidated Interim Financial Statements

(Unaudited)

**For the three-month periods ended March 31, 2015 and 2014**

### 1. Reporting Entity

#### (a) Description of the Controlling Company

KT&G Corporation (the "Parent 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 Parent 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 Parent Company was excluded from the application of the Act for the Management of Government Invested Enterprises. Accordingly, the Parent Company became an entity existing and operating under the Commercial Act of Korea. The Korean government sold 28,650,000 shares of the Parent Company to the public during 1999 and the Parent Company listed its shares on the Korea Exchange (formerly, the Korea Stock Exchange) on October 8, 1999. On December 27, 2002, the Parent Company changed its name again to KT&G Corporation from Korea Tobacco and Ginseng Corporation.

As of March 31, 2015, the Parent Company has three manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 123 branches for the sale of tobacco throughout the country. Also, the Parent 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 Parent Company is located in 71, Beotkkot-gil, Daedeok-gu, Daejeon.

Pursuant to the Korean government's privatization program and management reorganization plan, on December 28, 1998, the shareholders approved a plan to separate the Parent 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 Parent 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 Parent Company listed 35,816,658 and 45,400,000 Global Depository Receipts ("GDR") (each GDR representing the right to receive one-half share of an ordinary share of the Parent Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program. Also, on June 25, 2009, the market of the Parent Company's GDR was changed from the BdL market to the Euro MTF in the Luxembourg Stock Exchange.

The ownership of the Parent Company's issued ordinary shares as of March 31, 2015 is held as follows:

Shareholder	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee Share Ownership Association	2,353,538	1.71%
Treasury shares	11,326,605	8.25%
Others	114,101,869	83.11%
	137,292,497	100.00%

KT&G CORPORATION AND SUBSIDIARIES  
Notes to the Consolidated Interim Financial Statements  
(Unaudited)

For the three-month periods ended March 31, 2015 and 2014

1. Reporting Entity, Continued

(b) Consolidated Subsidiaries

(i) List of consolidated subsidiaries

Next most senior parent	Subsidiary	Principal operation	Percentage of ownership	Reporting date	Location
The Parent Company	Korea Ginseng Corporation	Manufacturing and selling ginseng	100.00%	Mar. 31	Korea
	Yungjin Pharm. Ind. Co., Ltd.	Manufacturing and selling pharmaceuticals	53.00%	Mar. 31	Korea
	Tae-a Industry Co., Ltd.	Manufacturing tobacco materials	100.00%	Mar. 31	Korea
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Manufacturing and selling tobaccos	99.99%	Mar. 31	Turkey
	Korea Tabacos do Brasil Ltda.	Processing leaf tobaccos	99.90%	Mar. 31	Brazil
	KT&G Pars	Manufacturing and selling tobaccos	99.99%	Mar. 31	Iran
	KT&G Rus L.L.C.	Manufacturing and selling tobaccos	100.00%	Mar. 31	Russia
	KGC Life & Gin Co., Ltd.	Selling ginseng door-to-door	100.00%	Mar. 31	Korea
	Global Trading, Inc.	Selling tobaccos	100.00%	Mar. 31	USA
	Somang Cosmetics Co., Ltd. <sup>(*)</sup>	Manufacturing and selling cosmetics	60.00%	Mar. 31	Korea
	Renzoluc Pte., Ltd. <sup>(*)</sup>	Manufacturing and selling tobaccos	100.00%	Mar. 31	Singapore
	KT&G Life Sciences Corporation <sup>(*)</sup>	Research and development medicine	73.94%	Mar. 31	Korea
	KGC Yebon Corporation	Manufacturing and selling medical herbs	100.00%	Mar. 31	Korea
	K-Q HongKong I, Limited <sup>(*)</sup>	Manufacturing and selling ginseng	100.00%	Mar. 31	Hongkong
	PT KT&G Indonesia	Selling tobaccos	99.99%	Mar. 31	Indonesia
	K&I HK Co., Ltd.	Selling cosmetics	100.00%	Mar. 31	Hongkong
	K&I China Co., Ltd.	Selling cosmetics	100.00%	Mar. 31	China
Renzoluc Pte., Ltd.	PT Trisakti Purwosari Makmur	Manufacturing and selling tobaccos	60.17%	Mar. 31	Indonesia
	PT Mandiri Maha Mulia	Manufacturing and selling tobaccos	66.47%	Mar. 31	Indonesia
PT Trisakti Purwosari Makmur	PT Sentosa Ababi Purwosari	Manufacturing and selling tobaccos	99.24%	Mar. 31	Indonesia
	PT Purindo Ilufa	Manufacturing and selling tobaccos	100.00%	Mar. 31	Indonesia
Korea Ginseng Corporation	Cheong Kwan Jang Taiwan Corporation	Manufacturing and selling ginseng	100.00%	Mar. 31	Taiwan
	Korean Red Ginseng Corp., Inc.	Manufacturing and selling ginseng	100.00%	Mar. 31	USA
	Korea Ginseng (China) Corp.	Manufacturing and selling ginseng	100.00%	Mar. 31	China
	Korea Ginseng Corporation Japan	Manufacturing and selling ginseng	100.00%	Mar. 31	Japan
	PT CKJ INDONESIA	Manufacturing and selling ginseng	99.88%	Mar. 31	Indonesia
	Jilin Hanzheng Ginseng Co., Ltd.	Manufacturing and selling ginseng	100.00%	Mar. 31	China

(\*) The Group's percentage of ownership, shown above, excludes convertible preferred shares. As of March 31, 2015, the Group's percentage of ownership would be 50.00%, 68.91%, 59.48% and 50.00% if convertible preferred shares are included.

KT&G CORPORATION AND SUBSIDIARIES  
Notes to the Consolidated Interim Financial Statements  
(Unaudited)

For the three-month periods ended March 31, 2015 and 2014

**1. Reporting Entity, Continued**

**(b) Consolidated Subsidiaries, Continued**

(ii) Financial information of subsidiaries

*In millions of won*

Subsidiary	Total assets	Total liabilities	Revenue	Net profit (loss)	Total comprehensive income (loss)
Korea Ginseng Corporation	₩ 1,620,366	193,112	238,969	31,433	32,798
Yungjin Pharm. Ind. Co., Ltd.	182,796	80,742	37,521	1,269	1,266
Tae-a Industry Co., Ltd.	14,066	3,644	3,701	207	207
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	47,448	40,845	5,844	168	(565)
Korea Tabacos do Brasil Ltda.	1,099	11	-	-	-
KT&G Pars	29,664	44,264	5,792	4,792	4,790
KT&G Rus L.L.C.	101,989	39,939	8,554	2,504	916
KGC Life & Gin Co., Ltd.	27,344	7,257	10,711	(979)	(978)
Global Trading, Inc.	48,193	30,774	56,664	2,202	2,297
Somang Cosmetics Co., Ltd.	55,427	67,281	19,058	721	721
Renzoluc Pte., Ltd.	99,988	47,359	-	106	382
KT&G Life Sciences Corporation	23,555	17,178	200	(1,446)	(1,446)
KGC Yebon Corporation	49,783	3,752	2,697	(318)	(326)
K-Q HongKong I, Limited	40,074	-	-	591	800
PT KT&G Indonesia	17,966	27,875	3,349	(4,092)	(3,756)
K&I HK Co., Ltd.	417	272	304	6	6
K&I China Co., Ltd.	1,013	723	319	(50)	(48)
PT Trisakti Purwosari Makmur, etc.	83,726	62,267	7,546	(105)	(1,073)
PT Mandiri Maha Mulia	11,657	7,836	2,421	62	(108)
Cheong Kwan Jang Taiwan Corporation	16,695	14,682	4,680	617	650
Korean Red Ginseng Corp., Inc.	9,465	6,309	2,219	(103)	(86)
Korea Ginseng (China) Corp.	77,755	72,234	9,045	(453)	(418)
Korea Ginseng Corporation Japan	4,537	3,835	1,021	(13)	(13)
PT CKJ INDONESIA	1,447	1,452	-	(51)	(52)
Jilin Hanzheng Ginseng Co., Ltd.	72,061	47,740	341	(3,536)	(3,390)

**(c) Change in consolidated group**

For the three-month period ended March 31, 2015, there is no change in consolidated group.

**2. Basis of Preparation**

**(a) Statement of Compliance**

The consolidated interim financial statements have been prepared in accordance with Korean International Financial Reporting Standards ("K-IFRS"). These consolidated interim financial statements were prepared in accordance with K-IFRS No. 1034 *Interim Financial Reporting* as part of the period covered by the Group's K-IFRS annual consolidated financial statements.

The consolidated interim financial statements were authorized for issue by the Board of Directors on April 23, 2015.

# KT&G CORPORATION AND SUBSIDIARIES

## Notes to the Consolidated Interim Financial Statements

(Unaudited)

**For the three-month periods ended March 31, 2015 and 2014**

### **2. Basis of Preparation, Continued**

#### **(b) Basis of Measurement**

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

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

#### **(c) Functional and Presentation Currency**

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

#### **(d) Use of Estimates and Judgments**

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

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

In preparing these consolidated interim financial statements, the significant judgments made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the financial statements as of and for the year ended December 31, 2014.

### **3. Significant Accounting Policies**

#### **(a) Changes in Accounting Policies**

The accounting policies applied in these consolidated interim financial statements are the same as those applied in the Group's consolidated financial statements as of and for the year ended December 31, 2014, except for the adoption of amendments to K-IFRS 1019 *Employee Benefits*.

Amendments to K-IFRS 1019 introduced a practical expedient to accounting for defined benefit plan, when employees or third parties pay contributions if certain criteria are met. According to the amendments, the entity is permitted to recognize those contributions as a reduction of the service cost in the period in which the related service is rendered, instead of forecast future contributions from employees or third parties and attribute them to periods or service as negative benefits.

The Group retrospectively applied the amendments in accordance with the transitional requirements of K-IFRS 1019. The changes in accounting policies are also expected to be reflected in the Group's consolidated financial statements as of and for the year ending December 31, 2015.

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**For the three-month periods ended March 31, 2015 and 2014**

**3. Significant Accounting Policies, Continued**

**(b) Basis of Consolidation**

(i) Non-controlling interests

Non-controlling interests are measured at their proportionate share of the acquiree's identifiable net assets at the acquisition date.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

(ii) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

(iii) Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related non-controlling interests and other components of equity. Any resulting gain or loss is recognized in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

(iv) Interests in equity-accounted investees

Associates are those entities in which the Group has significant influence, but not control or joint control, over the financial and operating policies. A joint venture is an arrangement in which the Group has joint control, whereby the Group has rights to the net assets of the arrangement, rather than rights to its assets and obligations for its liabilities.

Interests in associates and joint venture are accounted for using the equity method. They are recognized initially at cost, which includes transaction costs. Subsequent to initial recognition, the consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of equity-accounted investees, until the date on which significant influence or joint control ceases.

(v) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated. Unrealised gains arising from transactions with equity-accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.



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**3. Significant Accounting Policies, Continued**

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

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

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

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

The estimated useful lives of the Group's assets are as follows:

	Useful lives(years)		Useful lives(years)
Buildings	10 ~ 60	Vehicles	4 ~ 10
Structures	5 ~ 40	Tools	4 ~ 5
Machinery	5 ~ 20	Furniture and fixtures	2 ~ 5

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

**(d) Borrowing Costs**

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

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

# KT&G CORPORATION AND SUBSIDIARIES

## Notes to the Consolidated Interim Financial Statements

(Unaudited)

**For the three-month periods ended March 31, 2015 and 2014**

### **3. Significant Accounting Policies, Continued**

#### **(e) Government Grants**

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

#### **(f) Intangible Assets except for Goodwill**

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

The estimated useful lives were as follows:

	Useful lives (years)
Industrial property rights	5 ~ 20 or indefinite
Facility usage rights	indefinite
Other intangible assets	3 ~ 5 or indefinite

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

#### **(g) Investment Property**

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

Subsequent costs are recognized in the carrying amount of investment property at cost or, if appropriate, as separate items if it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing are recognized in profit or loss as incurred.

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

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

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**3. Significant Accounting Policies, Continued**

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

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

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

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

**(i) 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 ₩323,904 million and ₩272,649 million, respectively, as of March 31, 2015 and December 31, 2014.

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

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

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**For the three-month periods ended March 31, 2015 and 2014**

**3. Significant Accounting Policies, Continued**

**(j) Impairment of Non-financial Assets, Continued**

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

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

**(k) Non-derivative Financial Assets**

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

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

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

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

**(ii) Held-to-maturity investments**

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

**(iii) Loans and receivables**

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

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For the three-month periods ended March 31, 2015 and 2014

**3. Significant Accounting Policies, Continued**

**(k) Non-derivative Financial Assets, Continued**

(iv) Available-for-sale financial assets

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

(v) De-recognition of financial assets

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

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

(vi) Offsetting between financial assets and financial liabilities

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

**(l) Impairment of Financial Assets**

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

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

(i) Financial assets measured at amortized cost

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

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**3. Significant Accounting Policies, Continued**

**(I) Impairment of Financial Assets, Continued**

(ii) Financial assets carried at cost

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

(iii) Available-for-sale financial assets

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

**(m) Cash and Cash Equivalents**

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

**(n) Non-derivative Financial Liabilities**

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

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

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

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**3. Significant Accounting Policies, Continued**

**(n) Non-derivative Financial Liabilities, Continued**

(ii) Financial guarantee liabilities

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

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

(iii) Other financial liabilities

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

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

**(o) Employee Benefits**

(i) Short-term employee benefits

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

(ii) Retirement benefits: defined contribution plans

When an employee has rendered service to the Group during a period, the Group 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 Group recognizes that excess as an asset (prepaid expense) to the extent that the prepayment will lead to a reduction in future payments or a cash refund.



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**For the three-month periods ended March 31, 2015 and 2014**

**3. Significant Accounting Policies, Continued**

**(o) Employee Benefits, Continued**

(ii) Retirement benefits: defined benefit plans

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

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

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

(iv) Termination benefits

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

**(p) Provisions**

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

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

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

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



# KT&G CORPORATION AND SUBSIDIARIES

## Notes to the Consolidated Interim Financial Statements

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**For the three-month periods ended March 31, 2015 and 2014**

### **3. Significant Accounting Policies, Continued**

#### **(q) Equity Capital**

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

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

#### **(r) Revenue Recognition**

The Group'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 Group has transferred to the buyer the significant risks and rewards of ownership of the goods, the Group 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 Group 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, 2015 and 2014 were ₩970,671 million and ₩795,800 million, respectively.

Revenue from the construction of real estate includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments, to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue is recognized in profit or loss in proportion to the stage of completion of the contract. The stage of completions is assessed by reference to surveys of work performed. Meanwhile, profits from an apartment house for self-installment sales is recognized on percentage-of-completion method according to Q&A of Korea Accounting Institute, called 2011-I-KQA. This accounting standard is effective upon Korean Corporation Financial Reporting Standards of Laws on External Audit of Corporation (Article 13, Section 1, Paragraph 1)

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

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

# KT&G CORPORATION AND SUBSIDIARIES

## Notes to the Consolidated Interim Financial Statements

(Unaudited)

**For the three-month periods ended March 31, 2015 and 2014**

### **3. Significant Accounting Policies, Continued**

#### **(s) Finance Income and Finance Costs**

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

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

#### **(t) Income Taxes**

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

##### **(i) Current tax**

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

##### **(ii) Deferred tax**

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

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

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

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

# KT&G CORPORATION AND SUBSIDIARIES

## Notes to the Consolidated Interim Financial Statements

(Unaudited)

**For the three-month periods ended March 31, 2015 and 2014**

### **3. Significant Accounting Policies, Continued**

#### **(u) Foreign Currencies**

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

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

#### **(v) Earnings per Share**

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

### **4. Basis of Translating Financial Statements**

The consolidated interim financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩1,105.00 to \$1, the basic exchange rate on March 31, 2015 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.

### **5. Operating Segments**

(a) The Group's operating segments are summarized as follows:

<u>Operating segments</u>	<u>Principal operation</u>
Tobacco	Manufacturing and selling tobaccos
Ginseng	Manufacturing and selling red ginseng
Real estate	Selling and renting real estate
Others	Manufacturing and selling pharmaceuticals, cosmetics and others

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5. Operating Segments, Continued

- (b) Segment information on sales and operating profit for the three-month period ended March 31, 2015 was as follows:

<i>In millions of won</i>		Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
<b>Sales:</b>								
Total segment sales	₩	797,218	256,546	52,088	84,904	1,190,756	(53,844)	1,136,912
Less: Inter-segment sales		26,333	14,576	1,745	11,190	53,844	(53,844)	-
<b>External sales</b>	₩	<b>770,885</b>	<b>241,970</b>	<b>50,343</b>	<b>73,714</b>	<b>1,136,912</b>	<b>-</b>	<b>1,136,912</b>
<b>Segment profit (loss):</b>								
Operating profit	₩	379,088	45,325	7,092	3,740	435,245	(6,710)	428,535

- (c) Segment information on sales and operating profit for the three-month period ended March 31, 2014 was as follows:

<i>In millions of won</i>		Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
<b>Sales:</b>								
Total segment sales	₩	653,664	224,501	38,631	89,031	1,005,827	(42,161)	963,666
Less: Inter-segment sales		21,158	12,089	1,225	7,689	42,161	(42,161)	-
<b>External sales</b>	₩	<b>632,506</b>	<b>212,412</b>	<b>37,406</b>	<b>81,342</b>	<b>963,666</b>	<b>-</b>	<b>963,666</b>
<b>Segment profit (loss):</b>								
Operating profit	₩	210,222	35,627	10,340	3,310	259,499	646	260,145

- (d) Segment information on assets and liabilities as of March 31, 2015 was as follows:

<i>In millions of won</i>		Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
<b>Assets:</b>								
Segment assets	₩	4,001,689	1,666,574	142,811	340,143	6,151,217	(282,157)	5,869,060
Investments in associates		-	-	56,301	1,892	58,193	-	58,193
Non-current assets held for sale		420	-	-	-	420	-	420
		4,002,109	1,666,574	199,112	342,035	6,209,830	(282,157)	5,927,673
Unallocated assets								1,486,161
<b>Total assets</b>	₩							<b>7,413,834</b>
<b>Liabilities:</b>								
Segment liabilities	₩	1,067,302	188,385	-	73,243	1,328,930	(172,502)	1,156,428
Unallocated liabilities								673,066
<b>Total liabilities</b>	₩							<b>1,829,494</b>

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**For the three-month periods ended March 31, 2015 and 2014**

**5. Operating Segments, Continued**

(e) Segment information on assets and liabilities as of December 31, 2014 was as follows:

<i>In millions of won</i>	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
<b>Assets:</b>							
Segment assets	₩ 3,620,656	1,682,186	141,938	347,494	5,792,274	(278,945)	5,513,329
Investments in associates	-	-	55,842	2,061	57,903	-	57,903
Non-current assets held for sale	426	-	-	-	426	-	426
	3,621,082	1,682,186	197,780	349,555	5,850,603	(278,945)	5,571,658
Unallocated assets							1,847,004
<b>Total assets</b>	₩						7,418,662
<b>Liabilities:</b>							
Segment liabilities	₩ 867,391	184,385	-	77,175	1,128,951	(173,338)	955,613
Unallocated liabilities							754,969
<b>Total liabilities</b>	₩						1,710,582

(f) Revenues from major customers which amount to more than 10 percent of the details of the Group's consolidated total revenues for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>	2015	2014
Alokozay International Limited	97,210	100,743

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**For the three-month periods ended March 31, 2015 and 2014**

**6. Property, Plant and Equipment**

- (a) Details of property, plant and equipment as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		2015			2014		
		Cost	Accumulated depreciation and impairment	Carrying amount	Cost	Accumulated depreciation and impairment	Carrying amount
Land	₩	578,639	-	578,639	574,429	-	574,429
Buildings		878,926	(364,712)	514,214	878,145	(357,630)	520,515
Structures		68,941	(37,632)	31,309	66,192	(37,624)	28,568
Machinery		1,229,121	(884,568)	344,553	1,224,507	(875,701)	348,806
Vehicles		13,037	(10,284)	2,753	13,383	(10,533)	2,850
Tools		60,258	(50,824)	9,434	59,753	(50,097)	9,656
Furniture and fixtures		233,468	(181,915)	51,553	230,065	(176,229)	53,836
Others		1,454	-	1,454	1,454	-	1,454
Construction-in-progress		228,312	-	228,312	213,298	-	213,298
	₩	3,292,156	(1,529,935)	1,762,221	3,261,226	(1,507,814)	1,753,412

- (b) Changes in property, plant and equipment for the three-month period ended March 31, 2015 were as follows:

<i>In millions of won</i>		January 1 2015	Acquisition	Disposal	Depreciation	Transfer of construction -in-progress	Transfer to investment property	Net exchange difference	March 31 2015
Land	₩	574,429	14	(39)	-	5,293	(830)	(228)	578,639
Buildings		520,515	34	(61)	(8,192)	5,481	(1,874)	(1,689)	514,214
Structures		28,568	195	(45)	(835)	3,473	(28)	(19)	31,309
Machinery		348,806	1,105	(339)	(18,405)	14,626	-	(1,240)	344,553
Vehicles		2,850	252	(37)	(262)	30	-	(80)	2,753
Tools		9,656	816	-	(1,040)	-	-	2	9,434
Furniture and fixtures		53,836	4,442	(36)	(6,747)	79	-	(21)	51,553
Others		1,454	-	-	-	-	-	-	1,454
Construction-in-progress		213,298	43,981	-	-	(28,982)	-	15	228,312
	₩	1,753,412	50,839	(557)	(35,481)	-	(2,732)	(3,260)	1,762,221

- (c) Changes in property, plant and equipment for the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		January 1 2014	Acquisition	Disposal	Depreciation	Transfer of construction -in-progress	Net exchange difference	Others	December 31 2014
Land	₩	528,983	1,643	(716)	-	75,028	(1,650)	(28,859)	574,429
Buildings		535,055	3,201	(1,132)	(32,481)	30,313	(14,518)	77	520,515
Structures		29,299	2,264	(75)	(3,281)	826	(465)	-	28,568
Machinery		348,643	10,476	(2,258)	(73,891)	70,553	(4,717)	-	348,806
Vehicles		3,392	439	(61)	(1,023)	208	(105)	-	2,850
Tools		8,710	4,037	(86)	(3,993)	1,015	(27)	-	9,656
Furniture and fixtures		60,254	20,651	(3,088)	(28,580)	4,799	(200)	-	53,836
Others		1,304	150	-	-	-	-	-	1,454
Construction-in-progress		106,649	293,893	(58)	-	(182,742)	(206)	(4,238)	213,298
	₩	1,622,289	336,754	(7,474)	(143,249)	-	(21,888)	(33,020)	1,753,412

For the year ended December 31, 2014, land and construction-in-progress with a carrying amount of ₩32,682 million was transferred to inventories.

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7. Intangible Assets

(a) Details of intangible assets as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		2015			2014		
		Cost	Accumulated amortization and impairment	Carrying amount	Cost	Accumulated amortization and impairment	Carrying amount
Goodwill	₩	87,151	(54,900)	32,251	87,061	(54,900)	32,161
Industrial property rights		46,050	(29,253)	16,797	46,622	(29,622)	17,000
Facility usage rights		27,069	(3,680)	23,389	27,262	(3,712)	23,550
Other intangible assets		116,586	(39,858)	76,728	116,532	(37,446)	79,086
Intangible assets under development		5,699	(2,340)	3,359	5,480	(2,340)	3,140
	₩	282,555	(130,031)	152,524	282,957	(128,020)	154,937

(b) Changes in intangible assets for the three-month period ended March 31, 2015 were as follows:

<i>In millions of won</i>		January 1 2015	Acquisition	Disposal	Transfer of Intangible assets under development	Amortization	Net exchange difference	March 31 2015
Goodwill	₩	32,161	-	-	-	-	90	32,251
Industrial property rights		17,000	538	(413)	5	(332)	(1)	16,797
Facility usage rights		23,550	-	(161)	-	-	-	23,389
Other intangible assets		79,086	71	-	-	(2,417)	(12)	76,728
Intangible assets under development		3,140	224	-	(5)	-	-	3,359
	₩	154,937	833	(574)	-	(2,749)	77	152,524

(c) Changes in intangible assets for the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		January 1 2014	Acquisition	Disposal	Transfer of Intangible assets under development	Amortization	Impairment	Net exchange difference	December 31 2014
Goodwill	₩	83,370	-	-	-	-	(54,900)	3,691	32,161
Industrial property rights		31,733	397	(6)	326	(2,652)	(12,654)	(144)	17,000
Facility usage rights		25,757	455	(4)	-	-	(2,658)	-	23,550
Other intangible assets		89,285	261	(177)	-	(9,979)	(433)	129	79,086
Intangible assets under development		2,485	981	-	(326)	-	-	-	3,140
	₩	232,630	2,094	(187)	-	(12,631)	(70,645)	3,676	154,937

(d) Expenditures not capitalized for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
Cost of sales	₩	207	486
Selling, general and administrative expenses		7,885	8,338
	₩	8,092	8,824

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**8. Investment Property**

(a) Details of investment property as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		2015			2014		
		Cost	Accumulated depreciation and impairment	Carrying amount	Cost	Accumulated depreciation and impairment	Carrying amount
Land	₩	49,123	-	49,123	48,293	-	48,293
Buildings		179,884	(59,874)	120,010	177,315	(57,640)	119,675
	₩	229,007	(59,874)	169,133	225,608	(57,640)	167,968

(b) Changes in investment property for the three-month period ended March 31, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		2015			2014		
		Land	Buildings	Total	Land	Buildings	Total
Balance at beginning of period	₩	48,293	119,675	167,968	48,303	125,672	173,975
Acquisition		-	-	-	-	248	248
Depreciation		-	(1,567)	(1,567)	-	(6,168)	(6,168)
Transfer from (to) property, plant and equipment		830	1,902	2,732	(10)	(77)	(87)
Balance at end of period	₩	49,123	120,010	169,133	48,293	119,675	167,968

(c) The amounts recognized in profit or loss from investment property for the three-month periods ended March 13, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
Rental income	₩	9,304	8,728
Direct operating expense		(1,625)	(1,541)
	₩	7,679	7,187

(d) The carrying amount and the fair value of investment property as of March 31, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>		2015		2014	
		Fair value	Carrying amount	Fair value	Carrying amount
Land	₩	312,670	49,123	309,002	48,293
Buildings		192,501	120,010	186,337	119,675
	₩	505,171	169,133	495,339	167,968



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9. Investments in Associates

(a) Investments in associates as of March 31, 2015 and December 31, 2014 are summarized as follows:

*In millions of won, except percentage of ownership*

Associate	Location	Principal operation	2015		2014	
			Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	27.97%	₩ 1,892	25.34%	₩ 2,061
JR CR-REIT IV Co., Ltd.	Korea	Renting of real estate	49.02%	13,089	49.02%	12,900
KVG REIT 1 Co., Ltd.	Korea	Renting of real estate	29.67%	6,621	29.67%	6,848
KOCREF REIT 17 Co., Ltd.	Korea	Renting of real estate	22.06%	6,737	22.06%	6,619
JR REIT V Co., Ltd.	Korea	Renting of real estate	34.63%	5,656	34.63%	5,524
JR REIT VIII Co., Ltd.	Korea	Renting of real estate	21.74%	10,027	21.74%	9,858
LSK Global Pharma Services Co., Ltd.	Korea	Research and development medicine	23.15%	-	23.15%	-
JR REIT X Co., Ltd.	Korea	Renting of real estate	28.79%	9,132	28.79%	9,114
JR REIT XIII Co., Ltd.	Korea	Renting of real estate	27.03%	5,039	27.03%	4,979
				₩ 58,193		₩ 57,903

(b) Financial information of associates, which represents 100% of the entities' balances as of and for the three-month period ended March 31, 2015 are summarized as follows:

*In millions of won*

Associate	Total assets	Total liabilities	Revenue	Total comprehensive income
Lite Pharm Tech, Inc.	₩ 8,736	1,971	2,268	802
JR CR-REIT IV Co., Ltd.	63,753	35,182	1,187	385
KVG REIT 1 Co., Ltd.	50,361	28,044	1,472	425
KOCREF REIT 17 Co., Ltd.	66,922	36,381	1,515	537
JR REIT V Co., Ltd.	31,525	15,189	613	384
JR REIT VIII Co., Ltd.	109,200	63,079	1,187	517
LSK Global Pharma Services Co., Ltd.	5,490	6,300	4,901	1,423
JR REIT X Co., Ltd.	87,817	56,097	1,077	75
JR REIT XIII Co., Ltd.	47,210	28,569	1,798	246

(c) Financial information of associates, which represents 100% of the entities' balances as of and for the year ended December 31, 2014 are summarized as follows:

*In millions of won*

Associate	Total assets	Total liabilities	Revenue	Total comprehensive income
Lite Pharm Tech, Inc.	₩ 9,028	894	9,795	2,734
JR CR-REIT IV Co., Ltd.	63,325	35,139	3,540	196
KVG REIT 1 Co., Ltd.	51,094	28,016	5,784	1,661
KOCREF REIT 17 Co., Ltd.	66,270	36,266	5,457	1,820
JR REIT V Co., Ltd.	31,127	15,175	2,412	1,494
JR REIT VIII Co., Ltd.	108,441	63,097	7,619	3,093
LSK Global Pharma Services Co., Ltd.	5,322	6,007	13,988	1,892
JR REIT X Co., Ltd.	87,739	56,095	4,223	130
JR REIT XIII Co., Ltd.	46,965	28,543	2,911	921

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**9. Investments in Associates, Continued**

(d) Changes in investments in associates for the three-month period ended March 31, 2015 were as follows:

*In millions of won*

Associate	January 1 2015	Share of gain (loss)	Dividends	March 31 2015
Lite Pharm Tech, Inc.	₩ 2,061	(169)	-	1,892
JR CR-REIT IV Co., Ltd.	12,900	189	-	13,089
KVG REIT 1 Co., Ltd.	6,848	135	(362)	6,621
KOCREF REIT 17 Co., Ltd.	6,619	118	-	6,737
JR REIT V Co., Ltd.	5,524	132	-	5,656
JR REIT VIII Co., Ltd.	9,858	169	-	10,027
LSK Global Pharma Services Co., Ltd.	-	-	-	-
JR REIT X Co., Ltd.	9,114	18	-	9,132
JR REIT XIII Co., Ltd.	4,979	60	-	5,039
	₩ 57,903	652	(362)	58,193

(e) Changes in investments in associates for the year ended December 31, 2014 were as follows:

*In millions of won*

Associate	January 1 2014	Share of gain	Dividends	December 31 2014
Lite Pharm Tech, Inc.	₩ 1,476	585	-	2,061
JR CR-REIT IV Co., Ltd.	12,953	27	(80)	12,900
KVG REIT 1 Co., Ltd.	7,047	511	(710)	6,848
KOCREF REIT 17 Co., Ltd.	6,745	387	(513)	6,619
JR REIT V Co., Ltd.	5,573	735	(784)	5,524
JR REIT VIII Co., Ltd.	9,948	669	(759)	9,858
LSK Global Pharma Services Co., Ltd.	-	-	-	-
JR REIT X Co., Ltd.	9,334	79	(299)	9,114
JR REIT XIII Co., Ltd.	5,000	253	(274)	4,979
	₩ 58,076	3,246	(3,419)	57,903

**10. Available-for-sale Financial Assets**

(a) Changes in available-for-sale financial assets for the three-month period ended March 31, 2015 and the year ended December 31, 2014 were as follows:

*In millions of won*

	2015	2014
<b>Balance at beginning of period</b>	₩ 326,833	296,601
Acquisitions	1,100	56,392
Net changes in fair value	(5,926)	(11,655)
Disposals	-	(14,505)
<b>Balance at end of period</b>	₩ 322,007	326,833
<b>Statements of financial position:</b>		
Current	₩ 1,000	1,000
Non-current	321,007	325,833
	₩ 322,007	326,833

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**10. Available-for-sale Financial Assets, Continued**

(b) Available-for-sale financial assets as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	2015	2014
<b>Available-for-sale debt instruments:</b>		
Government and municipal bonds	₩ 96	96
Corporate bonds	2,500	2,500
<b>Total available-for-sale debt instruments</b>	<b>2,596</b>	<b>2,596</b>
<b>Available-for-sale equity instruments:</b>		
Listed		
– YTN Co., Ltd.	24,134	22,291
– Oscotech, Inc.	1,505	1,030
– Shinhan Financial Group Co., Ltd.	168,150	178,171
– Rexahn Pharmaceuticals, Inc.	5,155	4,917
	198,944	206,409
Unlisted	120,467	117,828
<b>Total available-for-sale equity instruments</b>	<b>319,411</b>	<b>324,237</b>
<b>Total available-for-sale financial assets</b>	<b>₩ 322,007</b>	<b>326,833</b>

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

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**

Long-term deposits in MSA Escrow Fund as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	2015	2014
MMF	₩ 37,181	19,269
Treasury note	284,713	282,539
	<b>₩ 321,894</b>	<b>301,808</b>

As discussed in note 32 to the consolidated interim financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2015 and 2014 are ₩17,087 million and ₩15,552 million, respectively.

Investment income on long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2015 and 2014 are ₩1,051 million and ₩298 million, respectively.

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**12. Trade and Other Receivables**

(a) Trade and other receivables as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>	2015		2014	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 7,335	17,208	7,816	20,221
Loans	645	3,665	645	3,707
Other receivables	100,019	320	77,067	276
Guarantee deposits	-	65,720	-	62,531
Accrued income	1,431	-	5,595	-
Trade receivables	947,637	-	898,654	-
	₩ 1,057,067	86,913	989,777	86,735

(b) Trade and other receivables as of March 31, 2015 and December 31, 2014 have been reported in the consolidated statements of financial position net of allowances as follows:

<i>In millions of won</i>	2015		2014	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 1,096,742	86,913	1,029,436	86,735
Allowance:				
Loans	(197)	-	(197)	-
Other receivables	(2,296)	-	(2,286)	-
Trade receivables	(37,182)	-	(37,176)	-
	(39,675)	-	(39,659)	-
Net trade and other receivables	₩ 1,057,067	86,913	989,777	86,735

(c) Changes in the allowance account for the three-month period ended March 31, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>	2015	2014
<b>Balance at beginning of period</b>	₩ 39,659	51,838
Impairment loss	20	-
Reversal of impairment loss	(3)	(8,155)
Write-off	(1)	(4,024)
<b>Balance at end of period</b>	₩ 39,675	39,659

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

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**12. Trade and Other Receivables, Continued**

- (d) The aging schedule of trade and other receivables which were past due but not impaired as of March 31, 2015 and December 31, 2014 is as follows:

<i>In millions of won</i>		2015	2014
Within 1 month	₩	64,820	80,369
Between 1 and 2 months		64,622	42,870
Beyond 2 months		259,601	239,153
	₩	389,043	362,392

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

- (e) Details of trade and other receivables that are measured at amortized cost as of March 31, 2015 and December 31, 2014 were as follows:

<i>In millions of won, except percentage of interest rate</i>	2015				2014		
	Effective interest rate	Current	Non-current	Effective interest rate	Current	Non-current	
Loans to employees	3.00~5.68%	₩ 7,335	17,208	3.00~5.68%	₩ 7,816	20,221	
Loans	1.70~7.29%	-	3,633	1.70~7.29%	-	3,665	
Other receivables	3.79%	8,072	-	3.79%	8,300	-	
Guarantee deposits	1.70~8.47%	-	63,446	1.70~8.47%	-	60,123	
		₩ 15,407	84,287		₩ 16,116	84,009	

**13. Inventories**

- (a) Inventories as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		2015	2014
Merchandise, net of loss on the write-down of inventories	₩	2,705	12,271
Finished goods, net of loss on the write-down of inventories		598,770	503,761
Work-in-progress, net of loss on the write-down of inventories		418,153	545,090
Raw materials, net of loss on the write-down of inventories		810,697	797,696
Supplies		26,984	26,936
By-products		9,320	8,646
Buildings under construction		711	1,185
Sites for lotting-out construction		31,362	31,179
Goods-in-transit		31,134	55,739
	₩	1,929,836	1,982,503

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**13. Inventories, Continued**

- (b) The amount of inventories recognized as an expense for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
Cost of sales:			
Loss on (reversal of) the write-down of inventories	₩	(304)	(1,056)
Loss on retirement of inventories		1,313	1,543
Other expense:			
Loss on retirement of inventories		642	120
	₩	1,651	607

**14. Cash and Cash Equivalents**

- (a) Cash and cash equivalents as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		2015	2014
Cash on hand	₩	2,988	11,854
Demand deposits		211,984	157,138
Short-term investment assets		180,997	247,402
	₩	395,969	416,394

- (b) Other financial assets as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		2015		2014	
		Current	Non-current	Current	Non-current
Time deposits	₩	22,537	11	35,337	11
Certificates of deposit		11,326	-	31,099	-
Money trust		284,000	251	602,000	236
Security deposits for checking accounts		-	12	-	12
	₩	317,863	274	668,436	259

- (c) Financial assets restricted in use as of March 31, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>		2015	2014	
Long-term other financial assets	Security deposits for checking accounts	₩	12	12
Other financial assets	Pledge for borrowings		3,436	3,209
Cash and cash equivalents	Specific research purpose and others		2,922	527
		₩	6,370	3,748

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15. Non-current Assets Held for Sale

Changes in non-current assets held for sale for the three-month period ended March 31, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		2015	2014
<b>Balance at beginning of period</b>	₩	426	153
Transfer from property, plant and equipment		-	426
Disposal		(6)	(153)
<b>Balance at end of period</b>	₩	420	426

16. Pledged Assets

(a) The followings assets were pledged as collateral for borrowings as of March 31, 2015.

<i>In millions of won</i>		Carrying amount	Type	Received amount	Collateralized amount	Holder
Investment property	₩	73,011	Leasehold deposits received	₩ 8,981	10,787	Metlife Insurance Korea Co., Ltd., etc.
Property, plant and equipment and investment property		70,034	Short-term borrowings	17,500	65,294	Hana Bank, etc.
			Long-term borrowings	8,677		
Property, plant and equipment		1,262	ACH pledged	-	1,262	Bank of Oklahoma
		29,182	Investment subsidy	-	660	Chungju-si
			Short-term borrowings	621	3,000	Hana Bank
		17,581	Long-term borrowings	5,000	5,000	
			Purchasing fund	6,885	7,392	
Other financial assets		600	Purchasing fund	600	660	
		100	Short-term borrowings	1,500	110	
		1,410	Contract fulfilment	-	1,410	HAITAI Beverage Co., Ltd., etc.
	₩	193,180		₩ 49,764	95,575	

(b) The followings assets were pledged as collateral for borrowings as of December 31, 2014.

<i>In millions of won</i>		Carrying amount	Type	Received amount	Collateralized amount	Holder
Investment property	₩	71,677	Leasehold deposits received	₩ 7,901	8,683	Metlife Insurance Korea Co., Ltd., etc.
Property, plant and equipment and investment property		71,061	Short-term borrowings	12,000	49,694	Hana Bank, etc.
			Long-term borrowings	7,094		
Property, plant and equipment		1,099	ACH pledged	-	1,099	Bank of Oklahoma
		28,882	Investment subsidy	-	660	Chungju-si
			Short-term borrowings	1,554	3,000	Hana Bank
		17,613	Long-term borrowings	5,000	5,000	
			Purchasing fund	7,823	7,392	
Other financial assets		600	Purchasing fund	600	660	
		100	Short-term borrowings	1,500	110	
		1,410	Contract fulfilment	-	1,410	HAITAI Beverage Co., Ltd., etc.
	₩	192,442		₩ 43,472	77,708	

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**17. Share Capital**

(a) Details of share capital as of March 31, 2015 and December 31, 2014 were as follows:

<i>In won, except number of shares</i>	2015	2014
Number of ordinary shares:		
Authorized	800,000,000	800,000,000
Issued	137,292,497	137,292,497
Outstanding	125,965,892	125,898,800
Par value	₩ 5,000	5,000

The Parent Company has, thus far, reacquired and retired 53,699,400 shares of treasury share. Accordingly, as of March 31, 2015, the Parent 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, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>	2015			2014		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
<b>Beginning of period</b>	137,292,497	(11,393,697)	125,898,800	137,292,497	(11,393,697)	125,898,800
In-kind donation of treasury shares	-	67,092	67,092	-	-	-
<b>End of period</b>	137,292,497	(11,326,605)	125,965,892	137,292,497	(11,393,697)	125,898,800

(c) There was no change in other capital surplus for the three-month period ended March 31, 2015 and the year ended December 31, 2014.

**18. Treasury Shares**

(a) Changes in the treasury shares for the three-month period ended March 31, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won, except number of shares</i>	2015		2014	
	Number of shares	Carrying amount	Number of shares	Carrying amount
<b>Beginning of period</b>	11,393,697	₩ 339,059	11,393,697	₩ 339,059
In-kind donation of treasury shares	(67,092)	(1,997)	-	-
<b>Balance at end of period</b>	11,326,605	₩ 337,062	11,393,697	₩ 339,059

(b) Changes in gain on reissuance of treasury shares for the three-month period ended March 31, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>	2015	2014
<b>Balance at beginning of period</b>	₩ 492,032	492,032
In-kind donation of treasury shares, net of tax	2,616	-
<b>Balance at end of period</b>	₩ 494,648	492,032



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**19. Reserves**

(a) Details of reserves as of March 31, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>		2015	2014
Available-for-sale financial assets - net change in fair value	₩	(18,794)	(14,303)
Foreign operations - foreign currency translation differences		(84,653)	(80,729)
Legal reserve		603,145	603,145
Voluntary reserve		3,226,658	2,918,254
	₩	3,726,356	3,426,367

(b) Available-for-sale financial assets - net change in fair value as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		2015	2014
Available-for-sale financial assets - net change in fair value before tax	₩	(24,795)	(18,869)
Tax effect		6,001	4,566
	₩	(18,794)	(14,303)

(c) Legal Reserve

*The Korean Commercial Act* requires the Parent 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.

(d) Details of voluntary reserve as of March 31, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>		2015	2014
Reserve for business rationalization	₩	12,851	12,851
Reserve for research and human resource development		30,000	42,522
Reserve for business expansion		698,881	698,881
Unconditional reserve		2,484,926	2,164,000
	₩	3,226,658	2,918,254

*Reserve for Business Rationalization*

Until December 10, 2002 under *the Special Tax Treatment Control Act*, investment tax credits were allowed for certain investments. The Parent 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 Parent Company was no longer required to establish a reserve for business rationalization despite tax benefits received for certain investments and, consequently, the existing balance is now regarded as a voluntary reserve.

*Reserve for Research and Human Resource Development*

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

*Reserve for Business Expansion and Other Reserves*

Reserves without specific purposes are restored to retained earnings by the Parent Company. Those reserves can be used for other purposes afterwards upon a resolution at a general meeting of shareholders.

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**20. Retained Earnings**

Changes in retained earnings for the three-month period ended March 31, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		2015	2014
<b>Balance at beginning of period</b>	₩	1,100,876	802,755
Dividends		(428,056)	(402,876)
Transfer from reserve for research and human resource development		12,522	47,478
Transfer to unconditional reserve		(320,926)	(152,000)
Profit for the period		308,779	813,801
- Less: non-controlling interests		144	11,805
Remeasurements of the defined benefit liability, net of tax		(238)	(21,654)
- Less: non-controlling interests		1	1,567
<b>Balance at end of period</b>	₩	673,102	1,100,876

Dividend distribution to the Parent Company's shareholders amounting to ₩428,056 million for the year ended December 31, 2014 was paid during the three-month period ended March 31, 2015.

**21. Trade and Other Payables**

Trade and other payables as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		2015		2014	
		Current	Non-current	Current	Non-current
Leasehold deposits received	₩	-	27,203	-	27,007
Trade payables		73,867	-	95,936	-
Withholdings		149,362	236	158,480	258
Accrued expenses		133,863	-	156,231	-
Other payables		199,339	5,412	93,206	4,979
	₩	556,431	32,851	503,853	32,244

**22. Borrowings**

(a) Borrowings as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>					2015	2014
	Lender	Maturity	Annual interest rate			
Borrowings	Nonghyup Bank, etc.	Short term	5.85%, etc.	₩	53,123	87,231
	Hana Bank	Short term	3.63%~4.71%		28,056	28,420
	Korea Exchange Bank	Short term	3M Libor+1.45%		32,610	-
	Nonghyup Bank	Jun.2019	1.50%		23,852	23,852
	Hana Bank	Sep.2017	2.39%~4.20%		7,806	8,096
	Kookmin Bank	Sep.2023	3.39%~3.80%		5,668	3,794
	The Korea Development Bank	Jun.2018	3.36%		204	204
Customer credit contracts <sup>(*)</sup>	Nonghyup Bank, etc.	Short term	6.64%, etc.		17,628	26,210
				₩	168,947	177,807
Statements of financial position:						
- Current				₩	132,634	143,079
- Non-current					36,313	34,728
				₩	168,947	177,807

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## 22. Borrowings, Continued

(\*) The Group has entered into a customer credit contract with Nonghyup Bank, etc. The financial institutions pay past-due trade receivables for customers and the Group has provided guarantees to the financial institutions for customers.

As discussed in note 16 to the consolidated financial statements, the Group provided collateral for above borrowings as of March 31, 2015.

(b) Convertible bond and other liabilities as of March 31, 2015 are summarized as follows:

<i>Description</i>		<i>Details</i>
Convertible bond <sup>(*)</sup>	PT Trisakti Purwosari Makmur	Issue date: Dec.2011 Par value: ₩12,410 million Issued value: ₩12,410 million Carrying amount: ₩8,356 million Interest rate: 9.5% The bonds will mature four years from the issue date and become convertible into shares at the rate of ₩1,199 per share.
Convertible redeemable preferred stock	KT&G Life Sciences Corporation	Issue date: Nov.2011 Issued value: ₩18,000 million Carrying amount: ₩16,753 million The convertible instrument will mature ten years from the issue date. The instrument can be converted into 1,090,909 ordinary shares at any time, and automatically converts upon maturity. If KT&G Life Sciences Corporation will be not listed by the end of 2015, recourse is available.
	Somang Cosmetics Co., Ltd. <sup>(*)</sup>	Issue date: Jan.2012 Issued value: ₩26,000 million Carrying amount: ₩26,561 million The convertible instrument will mature five years from the issue date. The instrument can be converted into 94,079 ordinary shares at any time before maturity, and automatically converts upon maturity. If Somang Cosmetics Co., Ltd. will be not listed by January 9, 2016, recourse is available.
	Renzoluc Pte, Ltd.	Issue date: Sep.2012 Issued value: ₩35,216 million Carrying amount: ₩34,666 million The convertible instrument will mature ten years from the date of establishment of QCP 2011 Corporate Partnership Private Equity Fund (the "PEF"). The instrument can be converted into 6,978,948 ordinary shares at any time after five years from the issue date. If the PEF will not be liquidated and apportioned in ten years, recourse is available.
Redeemable preferred stock	K-Q HongKong I, Limited	Issue date: Aug.2012, Oct.2012, Dec.2012 Issued value: ₩17,761 million Carrying amount: ₩17,547 million The convertible instrument will mature ten years from the date of establishment of the PEF. If the PEF will not be liquidated and apportioned in ten years, recourse is available.

(\*1) The fair value of the liability component was calculated using the market interest rate for an equivalent non-convertible bond. The residual amount, representing the value of the equity conversion option, is included in equity.

(\*2) The Group recognized the equity conversion option in equity according to Q&A of Financial Supervisory Service. This accounting standard is effective upon Korean Corporation Financial Reporting Standards of Laws on External Audit of Corporation (Article 13, Section 1, Paragraph 1)

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**23. Retirement Benefits Plan**

- (a) The components of retirement benefits for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
<b>Defined benefit costs:</b>			
Current service costs	₩	11,014	10,614
Interest costs		2,079	2,823
Expected returns on plan assets		(1,241)	(1,838)
Loss on the settlement of the plan		-	463
		11,852	12,062
<b>Defined contribution costs:</b>			
Contributions recognized as expense		1,412	804
	₩	13,264	12,866

The Group recognized termination benefits amounting to ₩6,729 million and ₩269 million as an expense for the three-month periods ended March 31, 2015 and 2014, respectively.

- (b) Defined benefit liabilities as of March 31, 2015 and December 31, 2014 are summarized as follows:

<i>In millions of won</i>		2015	2014
Present value of retirement benefit obligations	₩	365,675	364,717
Fair value of plan assets		(222,548)	(232,470)
	₩	143,127	132,247

**24. Result from Operating Activities**

- (a) Details of expenses classified by nature for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
Changes in inventories	₩	52,668	79,471
Raw materials used and merchandise purchased		227,966	238,502
Salaries		137,604	125,830
Retirement and termination benefits		19,993	12,866
Depreciation		37,048	37,258
Amortization		2,749	3,236
Employee welfare		30,275	13,843
Advertising		57,058	55,425
Commissions		69,682	60,559
Other expenses		73,334	76,532
	₩	708,377	703,522

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**24. Result from Operating Activities, Continued**

- (b) Details of selling, general and administrative expenses for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
Salaries	₩	92,806	83,200
Retirement and termination benefits		13,880	8,711
Employee welfare		21,011	9,623
Travel		2,417	2,461
Communications		1,334	1,418
Utilities		3,036	2,839
Taxes and dues		2,444	4,050
Supplies		828	812
Rent		6,093	6,833
Depreciation		10,876	11,301
Amortization		2,702	3,236
Repairs and maintenance		784	771
Vehicles		1,605	2,433
Insurance		499	410
Commissions		57,602	52,099
Freight and custody		12,242	11,386
Conferences		828	962
Advertising		57,031	55,400
Training		1,480	1,325
Prizes and rewards		553	557
Cooperation		177	180
Normal research and development		7,885	8,338
Impairment loss on trade receivables		8	979
	₩	298,121	269,324

**25. Other Income and Expenses**

- (a) Details of other income for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
Foreign currency transaction gain	₩	4,243	2,962
Foreign currency translation gain		10,668	16,104
Reversal of impairment loss on other receivables		3	12
Gain on sale of property, plant and equipment		809	943
Gain on sale of intangible assets		86	54
Others		10,483	3,207
	₩	26,292	23,282

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**25. Other Income and Expenses, Continued**

(b) Details of other expenses for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
Foreign currency transaction loss	₩	3,207	2,132
Foreign currency translation loss		11,611	8,432
Impairment loss on other receivables		12	-
Donations		26,897	6,291
Loss on sale of property, plant and equipment		448	1,020
Loss on sale of intangible assets		3	17
Impairment loss on intangible assets		-	19
Others		4,692	7,172
	₩	46,870	25,083

**26. Net Finance Income**

(a) Details of net finance income for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
<b>Finance cost:</b>			
Interest costs	₩	(3,320)	(2,681)
Loss on transactions of derivative instruments		-	(14)
		(3,320)	(2,695)
<b>Finance income:</b>			
Interest income		8,815	9,858
Dividend income		4,229	3,096
Investment income on long-term deposits in MSA Escrow Fund		1,051	298
Gain on transactions of derivative instruments		7	-
		14,102	13,252
<b>Net finance income</b>	₩	10,782	10,557

(b) Details of interest costs for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
Borrowings	₩	1,566	1,084
Trade and other payables		630	1,011
Others		1,124	586
	₩	3,320	2,681

(c) Details of interest income for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
Deposits	₩	7,958	7,628
Available-for-sale financial assets		12	24
Trade and other receivables		845	2,206
	₩	8,815	9,858

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**27. Income Tax**

- (a) Income tax expense comprises as current tax expense adjusted for current adjustments for prior periods, deferred tax expense (income) by origination and reversal of deferred tax assets (liabilities), and income tax recognized in other comprehensive income. The average effective tax rate was 26.37% and 30.21% for the three-month periods ended March 31, 2015 and 2014, respectively.
- (b) Deferred tax assets have been recognized to the extent the Group has determined it is probable that future profits will be available against which the Group can utilize the related benefit.

**28. Earnings per Share**

Basic and diluted earnings per share for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won, except share information</i>		2015	2014
Profit for the period	₩	308,923	192,057
Weighted-average number of ordinary shares outstanding		125,949,492	125,898,800
<b>Basic and diluted earnings per share in won</b>	₩	2,453	1,525

**29. Transactions and Balances with Related Companies**

- (a) The Group has no significant transactions, receivables and liabilities with related parties, as of and for the three-month period ended March 31, 2015.
- (b) There is no guarantee being provided by related parties as of March 31, 2015.
- (c) Details of key management personnel compensation for the three-month periods ended March 31, 2015 and 2014 are summarized as follows:

<i>In millions of won</i>		2015	2014
Short-term employee benefits	₩	7,485	5,373
Retirement benefits		1,286	1,024
	₩	8,771	6,397

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**30. Risk Management and Fair Value of Financial Instruments**

(a) Overview

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

- Market risk
- Credit risk
- Liquidity risk

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

(b) Risk Management Framework

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

(c) Management of Financial Risks

(i) Market risk

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

*Currency Risk*

The Group 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 Group's management has measured the currency risk internally and regularly, and has entered into foreign currency option contracts to hedge foreign currency risk in case of need.

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of March 31, 2015 and December 31, 2014 were as follows:

<i>In millions of won</i>		2015		2014	
		Assets	Liabilities	Assets	Liabilities
USD	₩	872,351	202,570	837,834	180,646
EUR		25,163	5,194	24,735	10,443
Others		7,872	307	10,878	2,036
	₩	905,386	208,071	873,447	193,125



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**30. Risk Management and Fair Value of Financial Instruments, Continued**

As of March 31, 2015 and December 31, 2014, the effects of a 10% strengthening or weakening of functional currency against foreign currencies on profit before tax were as follows:

<i>In millions of won</i>		2015		2014	
		10% strengthening	10% weakening	10% strengthening	10% weakening
Increase (decrease) in profit before tax	₩	69,731	(69,731)	68,032	(68,032)

*Equity price risk*

The Group 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 Group'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 Group's management.

As of March 31, 2015 and December 31, 2014, 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>		2015		2014	
		5% increase	5% decrease	5% increase	5% decrease
Comprehensive income before tax	₩	3,026	(3,026)	4,302	(4,302)

*Interest Rate Risk*

The Group 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 Group'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, 2015, there is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation, considering the amounts of interest bearing liabilities.

(ii) Credit Risk

The Group 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 Group 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 Group 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 Group's assets.

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of March 31, 2015 and December 31, 2014 is as follows:

<i>In millions of won</i>		2015	2014
Available-for-sale debt instruments	₩	2,596	2,596
Long-term deposits in MSA Escrow Fund		321,894	301,808
Trade and other receivables		1,143,980	1,076,512
Other financial assets		318,137	668,695
Cash and cash equivalents (excluding cash on hand)		392,981	404,540
Financial guarantee contract		49,459	150,063
	₩	2,229,047	2,604,214

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**30. Risk Management and Fair Value of Financial Instruments, Continued**

(iii) Liquidity Risk

The Group has exposure to the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. The Group'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 Group's management determines whether or not the financial liabilities are repayable with the operating cash flows and cash inflows from financial assets.

The maturity analysis with a residual contractual maturity of financial liabilities as of March 31, 2015 and December 31, 2014 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	
<b>As of March 31, 2015:</b>							
Trade and other payables	₩ 439,684	441,221	343,317	56,134	37,892	3,878	
Long-term borrowings	123,444	127,656	727	1,655	18,848	106,426	
Current portion of long-term borrowings	17,970	17,994	300	17,694	-	-	
Short-term borrowings	131,417	133,074	75,135	57,939	-	-	
Financial guarantee contract	-	49,459	49,459	-	-	-	
	₩ 712,515	769,404	468,938	133,422	56,740	110,304	
<b>As of December 31, 2014:</b>							
Trade and other payables	₩ 377,359	379,047	328,406	17,414	33,227	-	
Long-term borrowings	137,795	144,266	720	2,171	33,953	107,422	
Current portion of long-term borrowings	1,218	1,248	302	946	-	-	
Short-term borrowings	141,861	143,438	115,604	27,834	-	-	
Financial guarantee contract	-	150,063	-	150,063	-	-	
	₩ 658,233	818,062	445,032	198,428	67,180	107,422	

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

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

(d) Fair value of financial instruments

The carrying amount of each category of financial assets and liabilities as of March 31, 2015 and December 31, 2014 are as follows:

<i>In millions of won</i>		2015	2014
<b>Financial assets:</b>			
Available-for-sale financial assets	₩	322,007	326,833
Loans and receivables:			
- Trade and other receivables		1,143,980	1,076,512
- Other financial assets		318,137	668,695
- Long-term deposits in MSA Escrow Fund		321,894	301,808
- Cash and cash equivalents		395,969	416,394
		2,179,980	2,463,409
<b>Total financial assets</b>	₩	2,501,987	2,790,242
<b>Financial liabilities:</b>			
Financial liabilities measured at amortized cost:			
- Trade and other payables	₩	439,684	377,359
- Long-term borrowings		123,444	137,795
- Current portion of long-term borrowings		17,970	1,218
- Short-term borrowings		131,417	141,861
<b>Total financial liabilities</b>	₩	712,515	658,233

Details of fair value of financial instruments as of March 31, 2015 and December 31, 2014 were as follows

<i>In millions of won</i>	Carrying amount	Level I	Level II	Level III
<b>As of March 31, 2015:</b>				
<b>Financial assets</b>				
- Available-for-sale financial assets	₩ 292,309	198,944	-	93,365
<b>As of December 31, 2014:</b>				
<b>Financial assets</b>				
- Available-for-sale financial assets	₩ 297,135	206,409	-	90,726

There is no transfer between fair value hierarchy levels of recurring fair value measurements for the three-month period ended March 31, 2015 and the year ended December 31, 2014.

Fair value of available-for-sale equity instruments in real estate trust fund is categorized into level 3 in a fair value hierarchy based on the inputs used in the valuation techniques. Changes in fair value classified as level 3 for the three-month period ended March 31, 2015 and the year ended December 31, 2014 were as follows:

<i>In millions of won</i>		2015	2014
<b>Balance at beginning of period</b>	₩	90,726	62,467
Acquisition		1,100	38,992
Disposal		-	(14,411)
Changes in fair value		1,539	3,678
<b>Balance at end of period</b>	₩	93,365	90,726

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**30. Risk Management and Fair Value of Financial Instruments, Continued**

(e) Finance income (costs)

(i) Details of finance income (costs) by categories for the three-month period ended March 31, 2015 were as follows:

<i>In millions of won</i>	Financial assets at fair value through profit or loss	Available -for-sale financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
<b>Profit or loss:</b>					
- Interest income	₩ -	12	8,803	-	8,815
- Dividend income	-	4,229	-	-	4,229
- Investment income on long-term deposits in MSA Escrow Fund	-	-	1,051	-	1,051
- Gain on transactions of derivative instruments	7	-	-	-	7
- Interest expense	-	-	-	(3,320)	(3,320)
	₩ 7	4,241	9,854	(3,320)	10,782
<b>Comprehensive income before tax</b>					
- Net change in fair value	₩ -	(5,926)	-	-	(5,926)

(ii) Details of finance income (costs) by categories for the three-month period ended March 31, 2014 were as follows:

<i>In millions of won</i>	Financial assets at fair value through profit or loss	Available -for-sale financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
<b>Profit or loss:</b>					
- Interest income	₩ -	24	9,834	-	9,858
- Dividend income	-	3,096	-	-	3,096
- Investment income on long-term deposits in MSA Escrow Fund	-	-	298	-	298
- Interest expense	-	-	-	(2,681)	(2,681)
- Loss on transactions of derivative instruments	(14)	-	-	-	(14)
	₩ (14)	3,120	10,132	(2,681)	10,557
<b>Comprehensive income before tax</b>					
- Net change in fair value	₩ -	9,060	-	-	9,060

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**31. Capital Management**

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

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

As of March 31, 2015 and December 31, 2014, the Group's capital structure was as follows:

<i>In millions of won</i>	2015	2014
<b>Net debt:</b>		
Debt (borrowings)	₩ 272,831	280,874
Less:		
- Cash and cash equivalents	(395,969)	(416,394)
- Current other financial assets	(317,863)	(668,436)
	(441,001)	(803,956)
<b>Equity</b>	₩ 5,584,340	5,708,081

**32. Contingent Liabilities and Commitments**

- (a) Each year the Group deposits a proportion of sales of tobacco products in the United States in accordance with the Tobacco Master Settlement Agreement ("MSA") under the Escrow Statute of the United States government. The MSA Escrow Funds are maintained to pay the medical expenses of tobacco purchasers who have suffered health effects as a result of smoking. The unused portion of this fund will be refunded to the Group 25 years from the date of each annual funding. The Group 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, 2015, the tobacco lawsuits claiming damages of ₩100 million and a lawsuit by National Health Insurance Service claiming damages of ₩53,742 million are filed against the Group. Additionally, as of March 31, 2015, the Group is involved in eight lawsuits as a plaintiff for alleged damages totalling ₩9,412 million and 11 lawsuits as a defendant for alleged damages totalling ₩4,024 million. The amount of the liability the Group may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of March 31, 2015.
- (c) As of March 31, 2015, the Group has entered into letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 63,500 thousand.

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**32. Contingent Liabilities and Commitments, Continued**

- (d) As of March 31, 2015, the Group's trade receivables from the export of cigarettes are insured against non-payment up to USD 15,500 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.
- (e) The Group has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD 40,000 thousand by Korea Exchange Bank. Details of guarantees exercised as of March 31, 2015, are summarized as follows:

<i>In thousands of USD, THB and millions of IDR</i>		<i>Exercised amount</i>
Customs bond and L/C opening of Global Trading, Inc.	USD	13,387
Performance guarantee for export of tobacco sheet to Thailand Tobacco Monopoly	THB	16,098
Payment guarantee for purchase of certificate stamp of PT Mandiri Maha Mulia	IDR	89,328

- (f) The Group has maintained a contract with the farmers who grow six-year old green ginseng for purchase volume guarantees and recorded contractual amounts paid to the farmers as advance payments in the amount of ₩207,537 million and ₩170,524 million as of March 31, 2015 and December 31, 2014, respectively.
- (g) As of March 31, 2015, the Group has an accounts receivable loan agreement with a limit of ₩104,000 million with Hana Bank and other financial institutions.
- (h) As of March 31, 2015, the Group has a trade bill loan agreement with a limit of ₩10,000 million with Korea Exchange Bank and other financial institutions.
- (i) As of March 31, 2015, the Group has a loan agreement with a limit of ₩173,254 million with Shinhan Bank and other financial institutions.
- (j) As of March 31, 2015, the Group has provided one blank note, 5 notes amounting to ₩4,000 million and two blank checks to Nara Credit and other financial institutions. Besides, As of March 31, 2015, the Group lost seven blank notes and one blank check and expects to proceed a judgment of nullification.
- (k) On March 17, 2011, the Group signed the memorandum of understanding ("MOU") on global investment partnership with National Pension Service to jointly invest in foreign assets with a limit of ₩800,000 million.

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**32. Contingent Liabilities and Commitments, Continued**

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

Description	Details
Right of first refusal held by the Parent Company	Individual Shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless Individual Shareholder has offered them first to the Parent Company.
Tag-along right held by Individual Shareholder	In the event that the Parent Company proposes to enter into a transaction or a series of related transactions with a third party purchaser to dispose of 50% or more of its shares, then Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Parent Company.

- (m) With relation to the acquisition of KT&G Life Sciences Corporation, the Parent Company entered into a contract with a former owner of the acquiree, Gwak, Tae-Hwan ("Individual Shareholder"). Details of the contract are as follows:

Description	Details
Restriction of disposal	Individual Shareholder shall not be permitted to dispose of its shares, in whole or in part, within one year after KT&G Life Sciences Corporation is listed.
Right of first refusal held by the Parent Company	Individual Shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless Individual Shareholder has offered them first to the Parent Company.
Tag-along right held by Individual Shareholder	In the event that the Parent Company proposes to enter into a transaction or a series of related transactions with a third party purchaser to dispose of its shares, then Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Parent Company.

- (n) As of March 31, 2015, the Parent Company has provided a guarantee of ₩49,459 million to Andong Nonghyup for the principal and the related interest that buyers of Andong Central Xi Apartment have borrowed from. The guarantee will expire on June 30, 2015.
- (o) As of March 31, 2015, the Group is insured by performance bond insurance up to ₩2,440 million with the Seoul Guarantee Insurance.
- (p) The Group sold its property, plant and equipment and intangible assets relating to the drink business of Iksan factory to HAITAI Beverage Co., Ltd. and LG Household & Health Care Co., Ltd., as approved by the Board of Directors on October 16, 2013. In connection, the Group entered into an agreement to refrain from engaging in a business such as beverage manufacture or pharmacy distribution, that could result in a competition with the buyer for three years from the transaction date

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**33. Cash Flows from Operating Activities**

- (a) Details of cash generated from operations for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
<b>Profit for the periods</b>	₩	308,779	188,192
<b>Adjustments for:</b>			
- Income tax expense		110,612	81,445
- Finance costs		3,320	2,695
- Finance income		(14,102)	(13,252)
- Depreciation		37,048	37,258
- Amortization		2,749	3,236
- Retirement and termination benefits		19,993	12,053
- Foreign currency translations loss		11,611	8,432
- Impairment loss on trade and other receivables		20	979
- Reversal of the write-down of inventories		(304)	(1,056)
- Loss on sale of property, plant and equipment		448	1,020
- Loss on sale of intangible assets		3	17
- Impairment loss on intangible assets		-	19
- Other expense		7,240	1,787
- Share of gain of associates		(821)	(736)
- Share of loss of associates		169	-
- Foreign currency translations gain		(10,668)	(16,104)
- Reversal of impairment loss on trade and other receivables		(3)	(12)
- Gain on sale of property, plant and equipment		(809)	(943)
- Gain on sale of intangible assets		(86)	(54)
		475,199	304,976
<b>Changes in working capital:</b>			
- Trade and other receivables		(78,520)	54,789
- Advance payments		(33,810)	(23,848)
- Prepaid expenses		(781)	(3,748)
- Prepaid tobacco excise and other taxes		(295,564)	25,568
- Inventories		48,515	77,561
- Trade and other payables		(42,292)	(84,320)
- Advance receipts		(14,353)	(5,354)
- Tobacco excise and other taxes payable		151,982	(20,710)
- Payment of retirement and termination benefits		(9,528)	(1,644)
<b>Cash generated from operations</b>	₩	200,848	323,270

- (b) Details of material transactions without cash inflow and outflow for the three-month periods ended March 31, 2015 and 2014 were as follows:

<i>In millions of won</i>		2015	2014
Transfer of retained earnings to dividend payable	₩	-	402,876
Increase of other payables related with acquisition of construction-in-progress		1,145	-
Decrease of advance receipts related with disposal of land		(97)	-