15th March 2024

Reconsideration of ISS Proxy Voting Recommendations for KT&G Corp.'s Upcoming Annual General Shareholder Meeting

Dear Shareholders,

As you are aware, KT&G Corp.'s ("KT&G") Annual General Meeting ("AGM") will be held 28th March2024.

We note that Institutional Shareholder Services ("ISS") published their proxy voting recommendations on 14th March 2024, recommending that shareholders align their position with dissident shareholders Industrial Bank of Korea ("IBK") and Flashlight Capital ("FCP") who have engaged in an activist campaign against the Company at this AGM.

Specifically, ISS has recommended shareholders vote against the Board-endorsed nominees, Mr. Bang Kyung Man ("Mr. Bang") as an Inside Director/CEO nominee (Agenda Item 3.1) and Mr. Lim Min Kyu ("Mr. Lim") as an Outside Director (Agenda Item 3.2), as well as Mr. Kwak Sang Wook ("Mr. Kwak") as an Outside Director to serve as an Audit Committee member (Agenda Item 4). In their place, ISS has urged its clients to support dissident nominee Mr. Son Dong-hwan ("Mr. Son") as an Outside Director (Agenda Item 3.3).

ISS has based these above recommendations on their belief that the Company has a *"poor track record of capital allocation, continuing operational problems, and governance concerns"* and that *"the addition of an independent director nominated by shareholders appears to be a necessary step towards restoring shareholder trust"*.

Additionally, ISS has recommended only in favour of the dissident candidate on the basis that the election of directors at this year's AGM will be subject to cumulative voting as there is three candidates vying for two available seats on the Board.

The Board strongly disagrees with ISS' analysis and is gravely concerned with the proxy advisory firm aligning itself with the dissident's assertions. A significant part of ISS' analysis is based on unverified data produced by FCP, which we believe leads the final vote recommendations by ISS to be fundamentally flawed. For a comprehensive response to some of the business case and financial performance arguments made by ISS, please refer to the Appendix attached to this letter.

We understand that investors take their right to vote at AGMs seriously, and we recognize that you will consider a range of matters and inputs when making your final voting decisions. In this letter, the Board would like to highlight our concerns with ISS' analysis as well as our experience in engaging with the proxy advisory firm. We provide this additional information to ensure that our shareholders are able to make their voting decisions on a fully informed basis.

Concerns of ISS supporting only one candidate in cumulative voting

It should be noted that ISS is opposing the election of CEO nominee Mr. Bang.

Whilst we respect that ISS may prefer to support the dissident candidate, we are perplexed that they have failed to support at least one of the Board-endorsed candidates, particularly the CEO nominee.

Typically, for the Korean market, *"ISS generally will not recommend against the election of a CEO, managing director, executive chairman, or founder whose removal from the board would be expected to have a material negative impact on shareholder value"*.

Given the election of directors is subject to cumulative voting, ISS' recommendation could lead to the situation where Mr. Bang is not elected to the Board and appointed to CEO. Consequently, ISS is effectively disregarding its own policies on CEO removal.

The Board strongly opposes ISS' recommendation against the CEO nominee as this could potentially leave, as ISS describes KT&G, one of *"the largest tobacco companies in the world"* leaderless.

Absence of rationale for opposing Mr. Kwak's appointment to the Audit Committee

It should be noted that ISS has recommended against Mr. Kwak as a newly appointed Outside Director who will serve as a member of the Audit Committee.

Given that Mr. Kwak is being appointed both as a member of the Board and Audit Committee, his election is not subject to the cumulative voting system discussed above. This is evident through Mr. Kwak's appointment being separate into Agenda Item 4 – compared to the three-way contest under Agenda Items 3.

Nevertheless, ISS has made this negative recommendation without an explicit rationale to why shareholders should not support Mr. Kwak's appointment.

We believe this shows a lack of understanding by ISS regarding the cumulative voting system and a potential strong bias in favour of dissidents and against the Company as a whole. It appears that ISS is taking an overtly 'zealous' approach in their support for the dissidents.

Concerns over "independence" of dissident nominee

IBK has proposed Mr. Son in the capacity of an Outside Director (i.e. an Independent Non-Executive Director). We note that IBK is a state-owned bank in South Korea and is KT&G's largest shareholder – holding approximately 7.1% of the Company's issued share capital.

Whilst we respect the quality of Mr. Son's experience and expertise, it is questionable that he can truly be considered independent given IBK significant shareholding (which we note is above ISS' 5% threshold for classifying a director or director representative nominee as independent).

Furthermore, we would like to draw shareholders' attention to page 3 of IBK's supplementary documentation to their shareholder proposal (titled "KT&G Re-rating Story Begins with Largest Shareholder IBK") which was released publicly on 12th March 2024. In IBK's own words and rationale for their activist action, they state that the "problem" with KT&G is that *"unlike large companies having owner families, companies with no distinct controlling shareholders such as KT&G can funnel management power to the CEO"*.

We believe the above statement, in IBK's own words, is a strong indication of their perspectives on corporate governance and their intentions for Mr. Son – which do not align with international best practices for governance. We believe the appointment of Mr. Son in his capacity as a nominee of IBK would be a retrograde step backwards in our corporate governance and not in the best interests of all shareholders.

Optics of ISS engagement with activists

The Board is deeply troubled by the sequence of events that have led up to the publication of ISS' Proxy Research Report and the interplay between themselves and FCP. We would like to draw our shareholders' attention to this as we believe the optics of the events of FCP's public disclosures and release of the report is unorthodox behaviour.

Below is the timeline of events as known from the Company's side:

- 28th February 2024:
  - The Company released its Convocation Notice, well in advance of its minimum legal requirement to ensure all stakeholders had sufficient time to assess the meeting materials.
- 11th March 2024:
  - The Company engaged with members of ISS' Korea Research Team and Special Situations Team. At this meeting, representatives from the Special Situations Team asked questions regarding the data provided to them by FCP on the profitability of the export business. The Company notified the ISS representatives that they had not seen or received any presentation materials from FCP and thus could not verify the accuracy of the data in the meeting – but indicated that it appeared incorrect.
  - Following the meeting, KT&G requested if ISS could share the data and/or presentation so the source of the data and its accuracy could be verified, and the correct information provided. KT&G did not receive a response from ISS.
- 13th March 2024:
  - FCP held a webinar for investors in the US at approximately 10pm Korean Standard Time ("KST"), where their presentation material was made public.
  - At this time, KT&G obtained a copy of the presentation materials and was able to review – noting significant inaccuracies and misinformation.
- 14th March 2024:
  - At approximately 12:29pm KST, the Company sent an email notifying ISS that there were sufficient material errors and misinformation in the materials and that the Company was working towards making a public response to this.
  - At 2:00pm KST, FCP held a Korean language webinar for domestic investors.
  - At 4:00pm KST, FCP held a English language webinar for APAC investors.
  - At 7:02pm KST, ISS published their ISS Proxy Research Report as well as their Special Situations Report. Both analyses referred substantially to the FCP data and presentation materials.

It is important to note, whilst making comments that they engaged with both parties, ISS has failed to include their typical engagement notes within this report which summarizes the dates of such meetings and a high-level summary of the discussion points.

Whilst we understand dissident shareholders will try to effectively use key cut-off dates and release of public materials to their advantage, to minimise the window of opportunity for a response or "fact check", it is highly suspicious and concerning of the release of ISS analysis when:

I. They were notified of potential misinformation in the materials and also were unable to verify some of the information themselves (as evident in their questions at the Company's engagement meeting); and
II. The quick release of their "detailed" analysis, wholly reliant on the dissident's presentation, following the short release of FCP's public materials.

Clarification of FCP data

As noted above, a line of query from ISS during our engagement with them centred on the profitability of our export business. Given this is a significant component of FCP's presentation and "headline grabbing" statement, we believe it is appropriate we address this in our response letter here.

FCP has erroneously claimed that KT&G's global tobacco and NGP business recorded a deficit of 125 billion won from 2020 to 2022. However, this assertion is entirely incorrect. During the same period, the Company achieved a cumulative operating profit of 550 billion won. FCP's irresponsible claims regarding financial performance lack any effort to verify accurate information from the Company. KT&G firmly believes that such assertions undermine shareholder value rather than to improve it.

in billion won		2020	2021	2022	Total
FCP (incorrect)	Cig Export	61	(70)	(59)	(68)
	HNB Export	(3)	(30)	(24)	(57)
	①Total	58	(100)	(83)	**(125)**
②KT&G (correct)		231	131	188	**550**
Gap (②-①)		173	231	271	**675**

Conclusion

As demonstrated above, the Board has severe concerns about the analysis and recommendations made by ISS given their overreliance on FCP's argument while disregarding the Company's perspective continually. We do not believe the appointment of the dissident candidate over the Board-endorsed candidates is in the best interests of all shareholders.

As such, we request that you support the Board-endorsed candidates over the dissident candidate at the 2024 AGM.

We highly value your support and trust in our Company and look forward to continuing our partnership for mutual success. Please do not hesitate to reach out if you have any questions or would like to discuss the matter further.

Sincerely,

Kyoung Sin(Kate) Park

Head of Investor Relations Office

KT&G Corporation

APPENDIX

Company's response to ISS criticism of KT&G's performance

1) Regarding Market Reaction to Shareholder Return Policy Announcement

The ISS report failed to accurately capture the comprehensive measures undertaken by our company to enhance shareholder value throughout the preceding year, despite these efforts being transparently disclosed to the public. In alignment with our commitment to exemplary corporate governance and shareholder engagement, we proactively sought feedback from our investor base and implemented strategic adjustments in response. These adjustments encompassed refinements to our medium-to-long-term investment strategy, capital allocation framework, and shareholder remuneration policy, including the strategic cancellation of treasury shares. These measures have been met with favourable market reception.

Notably, the market's positive response was reflected in our share price trajectory, which escalated from KRW 83,100 on August 2, 2023—the eve of our interim dividend announcement—to KRW 92,400 by November 15, 2023, following the unveiling of our refined shareholder return strategy. This price appreciation underscores the efficacy of our corporate governance practices and our financial acumen in delivering value to our shareholders.

<Actual Evaluations from the Institution>

Institution	Analyst Report
CLSA ('23.11.13)	◦ Evolving capital efficiency Better than expected new capital management policy ◦ Price Target : KRW 118,000 → 125,000 (7,000↑)
Goldman Sachs ('23.11.13)	◦ Reaffirms focus on enhancing shareholder returns with announced new treasury cancellation plans ◦ Price Target : KRW 82,000 → 94,000 (12,000↑)

2) Regarding ISS' argument that the Company's improved TSR was beneficiary of the government's Value-up Program

It is important to recognize the sensitivity of TSR calculations to the chosen timeframe, especially the importance of selecting dates unrelated to specific events for an unbiased analysis. Contrary to the assertions in the ISS report, which uncritically adopts FCP's claims that our Company's TSR lags behind that of our industry peers and the KOSPI Index, the report inaccurately attributes the share price increase from January 17^{th} until the notice of convocation solely to the government's Value-up Program announcement. This interpretation misrepresents the facts.

KT&G should not be considered a primary beneficiary of the Value-up Program, as we are not categorized among low Price-to-Book Ratio (PBR) companies that the program aims to target.

This distinction is clearly evidenced by the comparative analysis of share price performance during the same period among companies directly influenced by the program, where KT&G does not exhibit the same levels of price appreciation attributed to the program's effect.

<Share Price Trends After the Announcement of the Value-up Program>

Company Name	January 17th	February 28th	Increase (%)
Samsung Life	61,100	102,900	68.4%
Hyundai Motor	181,800	248,000	36.4%
Hana Financial Group	41,300	55,600	34.6%
Kia	87,900	117,700	33.9%
Samsung C&T	117,000	155,700	33.1%
LG	72,200	94,700	31.2%
SK	153,000	193,600	26.5%
KB Financial Group	49,800	62,300	25.1%
KT&G	84,500	92,000	**8.9%**

Further, an analytical reassessment of our TSR over 1,2,3,5, and 10-year intervals, using January 17th as a baseline— despite the methodological concerns—demonstrates that our performance is not inferior to that of our competitors or the KOSPI index. This analysis refutes ISS's claims and underscores our strategic financial management's effectiveness in generating shareholder value independent of external factors such as the Value-Up Program.

<Annualized TSR (Peer Comparison, as of 2024.1.17) >

Year	KT&G	Peer Median	Result
1-year	-0.9%	-1.5%	Over
2-year	10.5%	0.2%	Over
3-year	7.6%	11.5%	Under
5-year	1.4%	7.0%	Under
10-year	6.9%	6.4%	Over

※ Peer Median: PMI, British American Tobacco, Altria, Imperial Brands and Japan Tobacco

<Annualized TSR (Comparison to KOSPI Index, as of 2024.1.17)>

Year	KT&G	KOSPI	Result
1-year	-0.9%	2.4%	Under
2-year	10.5%	-7.9%	Over
3-year	7.6%	-7.0%	Over
5-year	1.4%	3.1%	Under
10-year	6.9%	2.5%	Over

3) ISS' arguments regarding the Company's Performance

3-1) ISS' lack of Understanding in the KT&G's Business:

- KT&G has traditionally operated within the domestic market. However, recognizing the limitations and saturation of the local market, we are in the important stage of strategically expanding our business footprint into international markets. Amidst these strategic shifts and operational adjustments, our Company has identified three core growth businesses: Global Conventional Cigarette ("CC"), NGP, and Health Functional Foods. Compared to the operating profit in 2021, the operating profit of these core businesses in 2023 increased by 18.9%, with the global cigarette business, which includes both CC and NGP, experiencing a 55.6% growth in operating profit.

3-2) Regarding the Company's CC Products:

- **Domestic Tobacco Business Sustainability:** In the face of a decade-long tobacco price freeze in Korea, which take up approximately 60-70% of the operating profit on a consolidated basis, coupled with the global inflationary pressures escalating raw material costs, profitability challenges have intensified. To mitigate these impacts, KT&G is proactively enhancing the proportion of our premium-priced new products and optimizing pricing strategies in the duty-free segment to defend our profitability margins effectively.
- **Aggressive International Market Penetration:** To transcend the constraints of the domestic market, KT&G is aggressively pursuing the expansion of our tobacco product line in international markets. With the overall market size contracting by -1 to 2% annually from 2019 to 2022, and the CAGR for global tobacco companies' sales volumes during this period was -4%, KT&G has defied this downward trend, achieving a 7% growth in our global sales volume. Therefore, it is essential to recognize that KT&G's business maturity and strategic positioning diverge significantly from those of the industry peers highlighted by ISS. As we align with the expanding demand, capital investments in infrastructure and technological advancements become imperative to sustain and accelerate our growth trajectory.

3-3) Regarding the Company's NGP:

- **Revenue Composition and Strategic Pre-emptive Actions:** The revenue from our NGP business comprises both sticks and devices. The observed decline in overseas NGP revenue for 2023 can be attributed to the base effect of our strategic decision in 2022 to proactively expand the global supply of devices in anticipation of semiconductor global supply chain challenges.
- **Accelerated Market Penetration and Revenue Growth:** Despite the decline in device sales, the NGP segment has witnessed a significant increase in stick sales volume and revenue share, contributing to a notable improvement in profitability. The profitability of our overseas NGP operations soared by 44.9% in 2023 compared to the previous year, with a remarkable CAGR of 157.8% over the last three years. These figures counter the argument that the profitability from our NGP export agreement with PMI is low.
- In response to the analysis presented by ISS, which reflects the claim from FCP that KT&G's NGP are not sold in PMI stores in Japan, the Company's NGP product, 'lil,' enjoys extensive distribution, being available in 98% of all convenience stores across Japan, totaling approximately 55,000 locations.

3-4) Regarding the Performance Targets

- ISS has critiqued the Company's failure to meet performance targets, overlooking the strategic restructuring of our business model. To enhance cost competitiveness, we have transitioned the production of our cigarette exports to overseas subsidiaries, furthering our strategy for business localization. This shift has resulted in a decrease in standalone revenue figures; however, it has significantly bolstered our consolidated revenue, demonstrating the strategic success of our restructuring efforts.

4) Regarding ISS' argument that the Company's Working Capital is Excessive

- ISS's assertion that KT&G maintains an excessive working capital of KRW 1 trillion disregards the unique regulatory and operational complexities of the domestic tobacco market. A substantial portion of the required working capital is allocated for tax payments, making comparisons of adequacy with differently regulated competitors inappropriate. Specifically:

1. The Korean market necessitates a tax payment of KRW 3,323.4 per pack at the time of product dispatch from the factory, requiring approximately KRW 600 billion monthly for tax payments.
2. Operational needs, including labor costs, expenses, sales, and material costs, demand an additional KRW 200 billion in working capital.
3. Quarterly payments for VAT and corporate taxes amount to around KRW 300 billion, necessitating an average of KRW 100 billion in cash monthly.
4. Monthly operational expenses for KT&G's overseas tobacco subsidiaries and affiliates like KGC require approximately KRW 200 billion, further substantiating the working capital levels.

5) **Regarding Capital Allocation**

- Despite ISS's continued criticism regarding our real estate investments, we announced a divestment plan for underperforming properties in November 2023. Additionally, ISS overlooked our efforts and plans to enhance our financial structure. Aligning with market feedback for optimizing our financial framework, we issued KRW 0.3 trillion in corporate bonds dedicated to facility financing. This move increased our debt-to-equity ratio to 37%, with a strategic plan to target a 41% debt-to-equity ratio in the mid to long term, reflecting our proactive capital management strategy. Contrary to ISS's claims of excessive net cash holdings, our strategy to expand shareholder returns while leveraging debt led to a 44% reduction in net cash year-over-year. By the end of 2024, we aim to transition to a net debt position, illustrating our balanced approach to leveraging and financial health, contrary to ISS's assessment.

6) **Regarding ISS' Rationale**

- ISS has raised concerns regarding the independence of certain board members due to past affiliations with entities holding mutual shares. Specifically, concerns were mentioned about connections with Shinhan Financial Group, which had divested all its holdings in KT&G, as confirmed by the Company's 2016 shareholder registry. Consequently, there is no mutual shareholding between KT&G and Shinhan Financial Group, and furthermore, Mr. Kim Myung-chul, who retired from Shinhan Financial Group in 2011 and has served as an independent director at KT&G since 2020, unequivocally maintains his independence, dispelling any concerns regarding his impartiality.

  Additionally, the critique regarding the CEO appointment process being rushed, without any substantiating evidence, is unfounded. The entire CEO selection process was conducted with utmost transparency and diligence over a two-month period, reflecting the board's commitment and effort. Therefore, we respectfully disagree with the assertion that the appointment process's duration was insufficient.

7) **Regarding the CEO Candidate Bang Kyung-man**

- As explained in (3), evaluating the Company performance shall be aligned with its business environment and strategy. While ISS claims that candidate Kyung-man Bang is responsible for poor performance, it is worth noting that since the candidate joined the Board, the operating profit of three core business has grown by 18.9%, and the stock price has risen by 13.4%. This outstanding performance stands in contrast to the 11.8% decline in the KOSPI index during the same period.

8) **Treasury Shares and Expense Issues Surrounding the Company Independent Director**

- For inquiries related to the cancellation of treasury shares and the expenses of independent directors, we have disclosed, "KT&G Statement on Material Posted by IBK" on March 13th, 2023 available at the following link:Investor Relations > Disclosure | Notice | KT&G (ktng.com). We encourage reviewing these documents for a detailed understanding of the facts surrounding these issues.