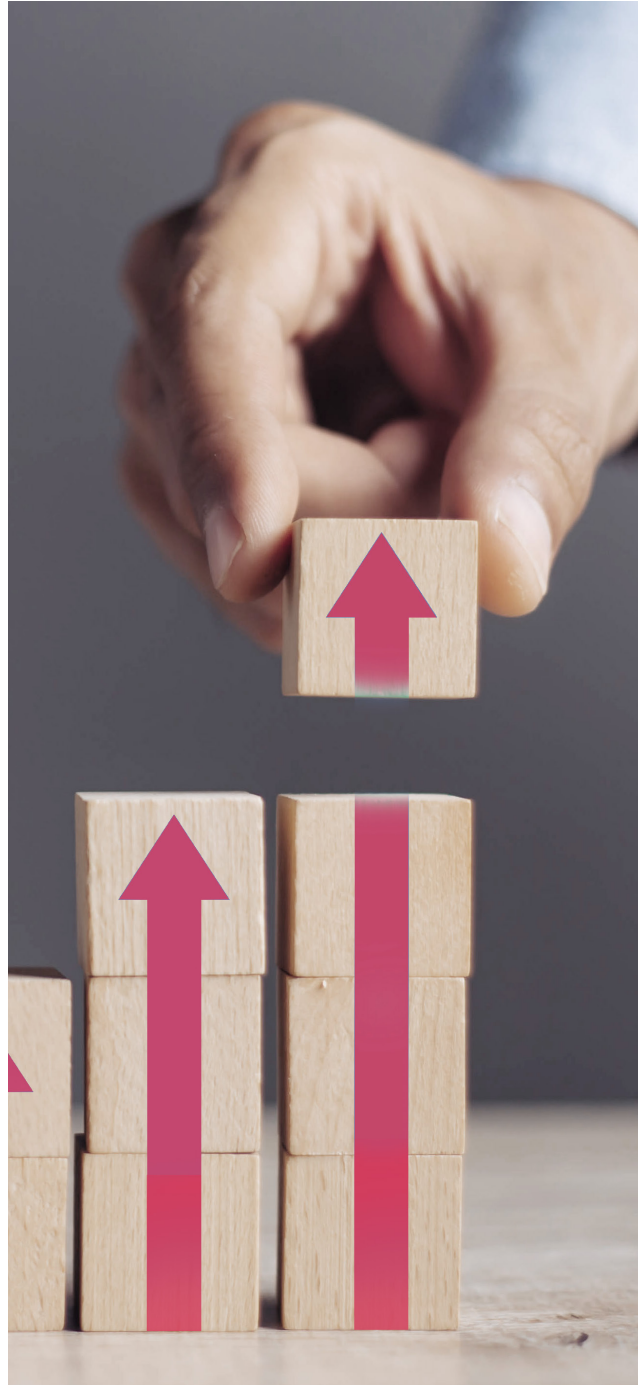


SUSTAINABILITY IN THE SUPPLY CHAIN



Enhancing the Sustainability of Supply Chain

Improving sustainability in the supply chain

Code of conduct for partners

KT&G has established a code of conduct for partners to spread a culture of fulfilling social and environmental responsibilities and reducing related risks in the supply chain. The code of conduct for partners serves as a guideline to reflect on their social and environmental responsibility in the process of partner selection and comprehensive evaluation. It serves to evaluate ESG management items and partner's ability to fulfill contracts and request improvement on insufficient matters, thereby gradually improving the supply chain's sustainability.

[Code of conduct for partners](#)



Special Terms and Conditions for the ethical practice of partners

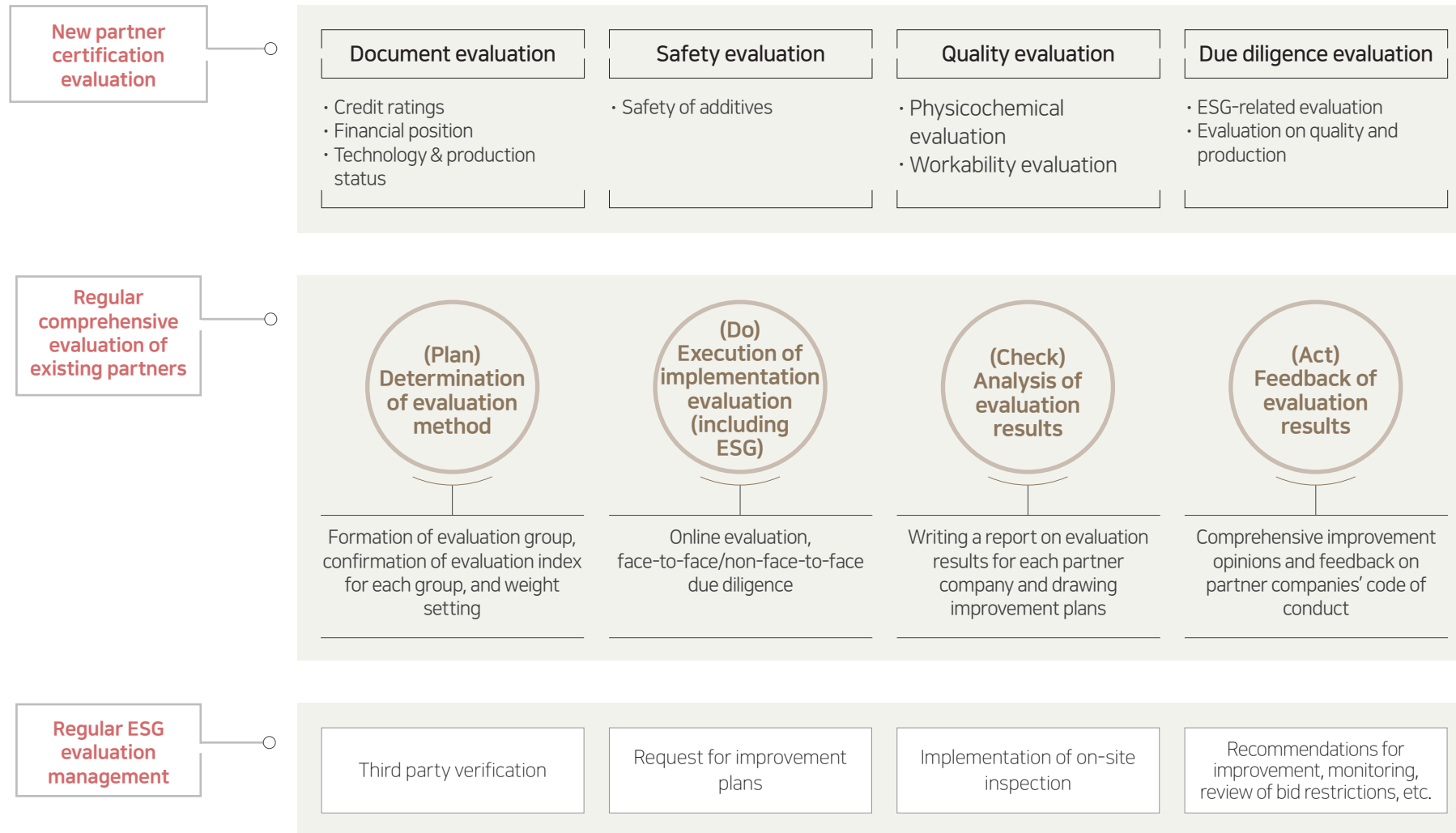
In order to enhance the ethical management in the supply chain and minimize internal and external risks, KT&G has established the 'purchase regulations.' The 'KT&G Special Terms and Conditions for Ethical Practices' are mandatory when signing a contract with partners to motivate them to participate in ethical management.

Three Clauses in the purchasing regulations for the ethical practice of partners (Articles 24-26)

1. We shall maintain business relationships with partners that comply with laws and regulations on ethics, human rights, labor, environmental safety, and occupational health.
2. We shall comply with the Fair Trade Act, the Subcontracting Act, and the Win-Win Cooperation Act for fair procurement.
3. We shall comply with the "Four Guidelines for Win-win Cooperation between Large/Small and Medium Enterprises" presented by the Fair Trade Commission

Supply chain assessment process

Partner evaluation and management aim to strengthen the competitiveness of the overall supply with secured purchasing objectivity and improve the partner's capabilities to fulfill contracts. The SQ Supply Quality Assessment is utilized for discovering and selecting new partners, and regular comprehensive evaluation is conducted to our existing partners to maintain sustainable cooperative relationships with existing partners based on regular comprehensive evaluations. ESG evaluation is included in both credential evaluation and comprehensive evaluation of the supply chain to minimize risks.



Credential evaluation of new partners

In selecting new partners, KT&G conducts a credential evaluation (SQ) that includes human rights, labor conditions, environment, and business management capabilities. The duration of the certification is three years, and 83 companies have been certified since 2011 after screening 85 companies. Upon the findings that a partner is ineligible for the terms and conditions for the credentials during the screening process, we notify the partner of the details and reason for disqualification while the partner takes improvement measures for re-screening. At the request of re-screening of a partner that completely compensated for the reasons for disqualification, we grant credentials after a pre-screening process. 40% of the evaluation items for credential evaluation of partners are ESG-related, and our evaluation team consisting of employees with related work experience or certifications conducts a site inspection.

New partner certification evaluation items

Item	Definition	Evaluation question
Human rights and working conditions	Human rights	Evaluation of control systems that respect human rights and ensure fair working conditions
	Working conditions	
	Safety & health	
	Grievance handling	
Environment	Pollution prevention	Evaluation of environmental control systems such as identification and reduction of pollution sources and efficient use of resources
	Resource recycling	
	Chemical substance	
Ethics	Corporate ethics	Evaluation of the control system to prevent corruption, such as bribery and conflicts of interest
	Pre-/post-management	
Business management	Human resources	Evaluation of overall management system for sustainability
	Supply chain management	
	Product & service	
	Local communities	

Regular comprehensive evaluation of existing partners

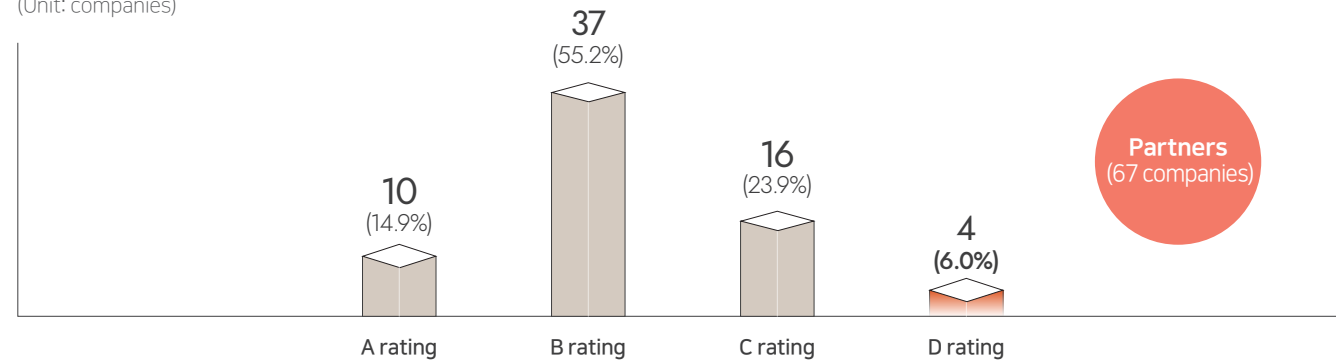
The regular comprehensive evaluation of existing partners comprises 6 indicators, including finance, ESG, quality control, delivery quality, degree of cooperation, and international certifications. In 2020, we conducted a comprehensive evaluation of 67 companies who accounted for around 97.2% of our total purchasing amount, and requested four non-conforming partners (grade D) to submit improvement plans. They submitted improvement plans in July 2021, and KT&G has scheduled to conduct on-site inspections in October.

Evaluation scope and target

Evaluation group	Evaluation index	Target
I	Finance / ESG / quality control / delivery quality	Manufacturing partners that require quality control as important (filter plug, tip paper, etc.)
II	Finance / ESG / delivery quality / cooperation	Over KRW 100 million worth purchasing
III	Finance / delivery quality / cooperation	Less than KRW 100 million worth purchasing
IV	Finance / delivery quality / cooperation / international certification	Overseas partners

Comprehensive evaluation result in 2020

(Unit: companies)

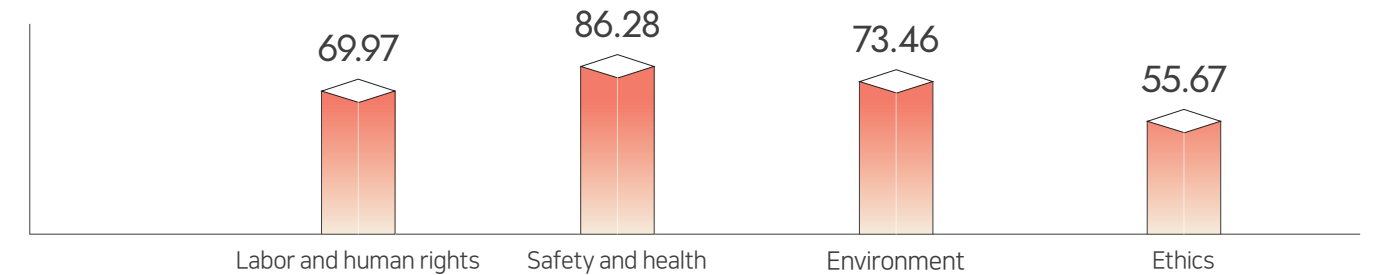


Regular ESG evaluation of existing partners

Regular ESG evaluation is conducted for 53 partners (Groups I and II members who supply at least KRW 100 million, respectively, and account for over 95% of our total purchasing amount). It is commissioned to a third party to minimize legal risks and ensure the professionalism of the evaluation process and the objectivity of the results. The evaluation is classified into five indicators and comprises online self-evaluation and on-site inspections. It consists of 87 items related to labor and human rights, safety and health, environment, ethics, and management system. ESG evaluation results are reflected in the comprehensive evaluation of the partners.

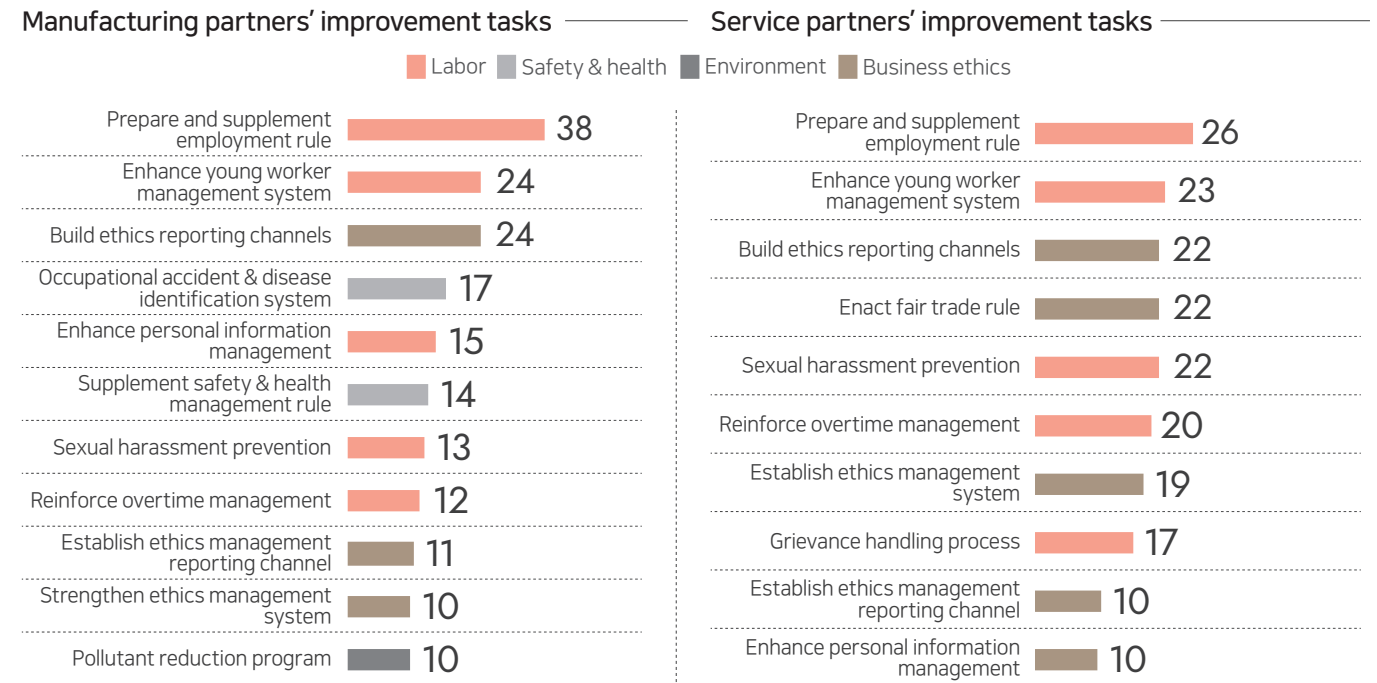
Result of regular ESG evaluation

The result of partners' ESG evaluation conducted in the first half of 2021 presented average 68.66 points (19.51 points of standard deviation). The highest was 100 points and the lowest was 23.70 points. Safety and health sector marked 86.28 points, proving excellent performances, while ethics sector was judged that improvement was most needed with 55.67 points.



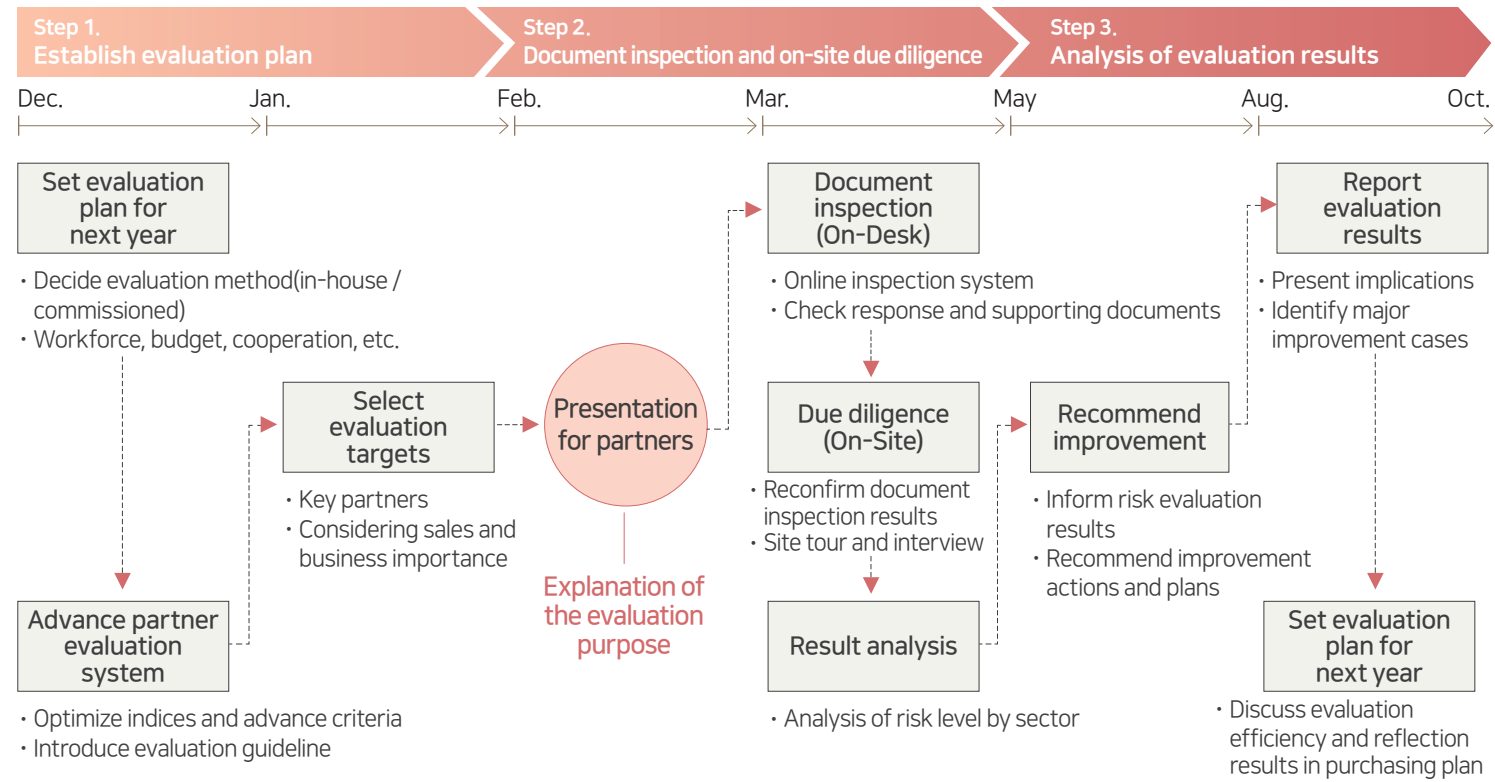
Improvement tasks

As a result of the ESG evaluation, both manufacturing and service partners are required to establish and supplement policies including employment rule. As for manufacturing partners, improvement tasks were derived for industrial accident management and establishment of safety and health regulations in the safety area.



Regularizing the Evaluation Process of Partners

KT&G identified potential risks that were not derived from the evaluation indicators from the written and on-site inspections conducted for ESG evaluation of partners. Notably, in the future, KT&G aims to regularize ESG evaluation of partners and continue monitoring potential risks to identify risk factors likely to violate the law in advance.



ESG training for partners

With the goal of maintaining sustainable management of partners, in 2020, we invited the CEOs of major materials (filter plugs, tip papers, and flexible wrapping paper) partners to support ESG training. In 2021, each of our partners will hold an in-depth workshop to derive actionable environmental indicators.



ECO-Cargo program

With the increased demands for low-carbon green growth and transition to eco-friendly supply chains, KT&G has launched the ECO-Cargo program (ECO mileage, ECO change) to strengthen ESG management capabilities in the transportation sector.

ECO mileage

With the intention to reduce carbon emissions and fuel use by adopting the eco-friendly economic driving strategy, KT&G has been implementing the ECO mileage program since April 2021 for five partners that have signed transportation contracts with us. Ninety vehicles are participating in practicing eco-friendly economic driving and based on quarterly performance, and the top 10 vehicles will be compensated for preferential transportation section. As of June, the average driver's score was 97.6, showing an increase of 83 points from the initial stage, contributing greatly to improving driving habits and reducing truck carbon emissions.

ECO change

The ECO Change is established to achieve eco-friendly and win-win management with our partners by replacing aged cargo vehicles. It applies to ten-year-old vehicles with a transaction record of more than seven years with KT&G. If the partner makes a final decision on whether to replace their selected vehicle by September and submits the proof of replacement with a new vehicle, KT&G will pay 5 million won per vehicle. In case a selected partner decides not to replace their vehicles, the chances are passed on in the order of preliminary candidates. KT&G plans to practice green logistics through the ECO change program actively.

Shared Growth in the Supply Chain

Supply chain management

Funding the supply chain

We operate various funding systems for our partners facing financial difficulties, including leaf tobacco farmers. Our partners of material manufacturers are paid 100% in cash within the given business day of the following month, and it is strongly recommended that primary partners pay cash to secondary partners by the 25th of the following month. In 2020, we supported our partners by early execution of about KRW 27.2 billion before the holidays. In addition, KT&G strives to relieve the burden on our partners by raising the purchase contract amount when the partner experiences an increased burden compared to the contracted time due to cost fluctuation factors, i.e., an increase in raw material prices.