

PRIORITY AREA

Supply Chain Partnership

2019 CASE STUDY

Supplier Quality Evaluation including ESG

KT&G considers environment, social, and governance (ESG) factors such as human rights, labor condition, environment, and ethics when selecting new suppliers. So, we conduct the Supplier Quality (SQ) Evaluation including ESG-related items on main suppliers who wish to have trade relations. In particular, to assess the work environment respecting human rights of labors, we check their policy and programs for each item. More specific evaluation items include prohibition of forced and child labors, working hours and overtime payment, basic wages, collective bargaining, and health and safety activities. The portion of ESG-related items in the SQ Evaluation is 40%, and the evaluation team composed of experienced employees engaged in the relevant field or those who have relevant certificates perform evaluation by visiting the suppliers.

Items for Supplier ESG Evaluation

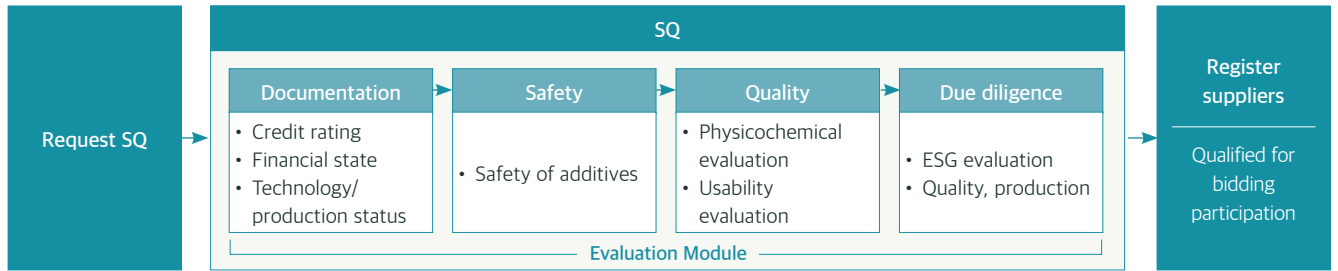
Evaluation Items		Definition	Questionnaires
Human rights and labor conditions	Human rights	Evaluation of the control system that respects human rights and provide fair labor conditions	<ul style="list-style-type: none"> • Relevant policies • Relevant programs
	Labor conditions		
	Safety & Health		
	Grievance treatment		
Environment	Pollution prevention	Evaluation of the environmental control system that identifies/reduces pollution sources and uses resources efficiently	
	Resources use		
	Chemical substances		
Ethics	Business ethics	Evaluation of the control system for prohibiting corruptions such as bribery and inflict of interests	
	Pre-/Post-management		
Business management	Human resources	Evaluation of the overall business management system for sustainable management	
	Supply chain management		
	Products & services		
	Local community		

1. Supply Chain Evaluation

Materials Supplier Qualification System

KT&G runs the Materials Supplier Qualification System to fairly select new suppliers and secure stable supply by establishing cooperative relationship with the existing suppliers. The qualification period is 3 years, and we reevaluate suppliers after 3 years to verify their competence and encourage them to take corrective actions. Since 2011, a total of 75 suppliers were evaluated, and 74 of them were qualified. When the suppliers are not qualified, we provide them reasons and give them time to take corrective actions until the requalification process. Only those who had completely corrected any deficiencies can receive qualifications. Through this qualification system, suppliers can check their production and R&D capacities, and KT&G can create the value of shared growth with stable partners. In the overseas operation, we prioritize tobacco leaf suppliers who comply with requirements of the Sustainable Tobacco Programme (STP) for selection.

Certification Process



Infrastructure for Suppliers' Social/Environmental Responsibility

KT&G developed the Supplier Code of Conduct to transfer its culture of social/environmental responsibility and reduce relevant risks of suppliers. The supplier code is used as a guideline for suppliers to self-check social/environmental responsibility during the supplier selection and comprehensive evaluation processes. In the future, we plan to conduct due diligence to check if suppliers comply with the Supplier Code of Conduct. We will endeavor to improve sustainability in the supply chain by requiring suppliers to correct deficiencies in social, environmental, and governance checklist, as well as their capacities for fulfilling contracts.

NTM Suppliers

Category	Unit	2017	2018	2019
No. of suppliers	Domestic EA	69	71	69
	Overseas EA	9	9	12
	Total EA	78	80	81
Purchase amount	Domestic KRW 100M	3,364	4,258	4,122
	Overseas KRW 100M	237	293	440
	Total KRW 100M	3,601	4,551	4,562

2. Win-Win Growth in Supply Chain

Supply Chain Management

KT&G sources tobacco leaves, filters, and packaging from supply chain. The suppliers in the supply chain are divided into tobacco material suppliers and non-tobacco material (NTM*) suppliers. When signing a contract, suppliers need to sign the Charter of Ethics to enhance the ethical standard of supply chain.

*NTM: Non-tobacco materials such as filters and packaging materials

Tobacco Material Suppliers

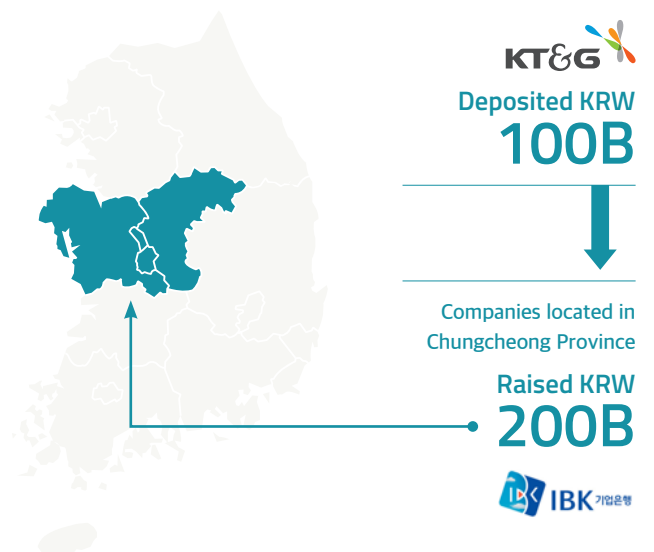
Category	Unit	2017	2018	2019
No. of suppliers	Domestic Persons	3,365	3,144	2,880
	Overseas EA	16	17	19
Purchase amount	Domestic* KRW 100M	951	947	1,175
	Overseas KRW 100M	2,172	1,881	1,713
	Total KRW 100M	3,123	2,828	2,888

*Domestic purchase amount includes the amount purchased from KT&G's subsidiary, Tae-A Industrial (RTL manufacturer)

Low-interest Loan Assistance

In order to facilitate the local economy and job creation in Chungcheong Province where the head office is located, KT&G signed a memorandum of understanding (MOU) with Industrial Bank of Korea (IBK) to provide low-interest loans to local businesses.

Low-Income Loan Assistance Process



Financial Assistance

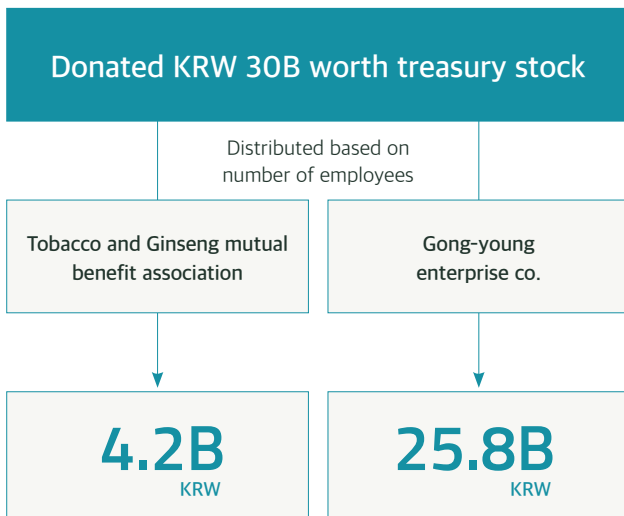
KT&G operates various financial assistance programs for farmers or other suppliers.

We settle invoices by cash payment within 5 business days of the next month, and we also encourage our primary suppliers to pay secondary suppliers by 25th of the next month. In 2019, we aided suppliers by providing KRW 45.9 billion of early payment. In addition, we endeavor to relief suppliers' financial burden by increasing purchase order amount when they suffer from changes in product costs such as raw materials.

Welfare Supports to Cooperative Small Enterprises

In 2019, we donated treasury stock and performed Win-Win Growth activities for the Tobacco and Ginseng mutual benefit association and Gong-young enterprise co., operating partners of our main business.

Cooperative Small Enterprises Supports



3. Shared Value Creation

Purchase of Tobacco Leaves from Farms

Since 2001, the manufacturing monopoly of tobacco companies has been prohibited and obligation to purchase tobacco materials from domestic suppliers has been discontinued. However, KT&G purchases entire amount of tobacco leaves from domestic suppliers. The annual amount is about 10,000 tons which is equivalent to KRW 80 billion to 90 billion, and this is contributing to domestic farmers to cultivate tobacco stably.

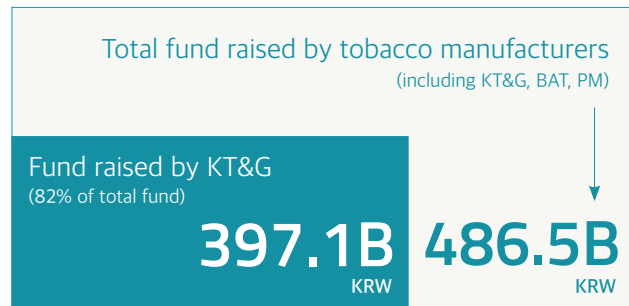
2019 Purchase



Supporting Stability of Tobacco Production

KT&G contributes to fundraising of the 'Tobacco Production Stabilizing Foundation' to enhance productivity and economic/social status of farmers. One of KT&G's directors is nominated as a director of the foundation to engage in fund operation. Therefore, we are helping the stabilizing of the domestic tobacco production.

Fundraising Performance (2002 - 2019 Cumulative)



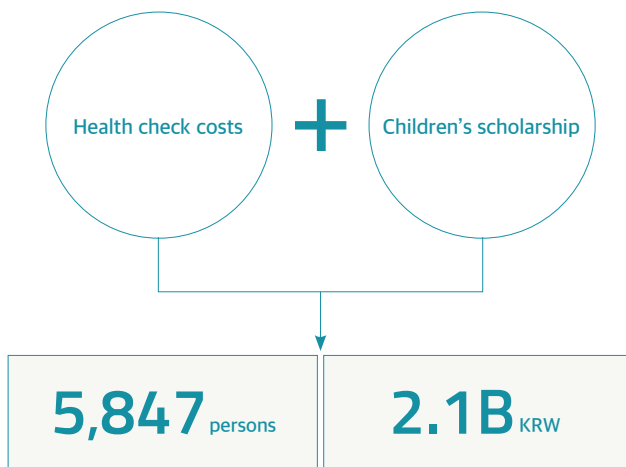
Promoting Two-way Communication with Tobacco Farms

KT&G identifies and improves issues found through the two-way communication with tobacco farms. In 2018 and 2019, we purchased tobacco materials from farms to relieve their issues of insufficient storage space for tobacco. In 2020, we resolved lack of workforce in tobacco farms by enhancing production efficiency of the hand-packaging process. Moreover, we are implementing profit increase for farmers and reduction of packaging materials.

Activities for Supporting Shared Growth of Tobacco Farms

KT&G performs various assistances to enhance life quality of tobacco farms. We pay 30% of payment earlier between April and May to reduce their financial burden. The rest will be paid from September to December after the tobacco leaves harvest. In addition, we provide costs for health check and scholarship for farmers' children to enhance welfare of the tobacco farmers. Along with the financial support, we help tobacco farms through employees' volunteering in harvesting tobacco leaves.

Financial Assistance to Tobacco Farms



Health check assistance and children's scholarship



Tobacco leaf harvest volunteering

Assisting Extra Income of Tobacco Farms

KT&G operates the Haearin Project of assisting cultivation and harvest of peppers for tobacco farms as a means to create extra income using the existing farmlands and technologies. In 2019, we signed a contract with 20 farmers and helped sales of KRW 158 million worth dried peppers. We plan to continue the extra income creation projects to diversify income sources of tobacco farms.

Extra Income Sales Support (Haearin Project) in 2019

Farmers 20 persons	Amount of dried red pepper purchased 10,488 kg	Purchase amount 158M KRW
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4. Supplier Communication

KT&G runs the KT&G Advanced Procurement System (KAPS) which is an information sharing system with suppliers in order to enhance transparency and efficiency in the purchase process.

Supplier Communication through KAPS

Category	Details
Approach to purchase contract process	<ul style="list-style-type: none"> Access the overall purchase process (bidding, contracting and purchase order, product examination and service, payment request, and stock management)
Communication	<ul style="list-style-type: none"> Send notices through the message board of KAPS Report any unethical actions of KT&G employees through the whistleblowing channel, Sinnungo
Transfer of Ethics Management	<ul style="list-style-type: none"> Share the 'KT&G Ethical Management Directions' Encourage execution of the 'KT&G Ethical Practice Special Clause' when signing contracts Post the 'KT&G Purchasing Principles'