

KT&G Corporation

Interim Separate Financial Statements

March 31, 2012

KT&G Corporation
Index
March 31, 2012

	Page(s)
Report on Review of Interim Financial Statements	1 - 3
Interim Separate Financial Statements	
Interim Separate Statements of Financial Position	4
Interim Separate Statements of Comprehensive Income	5
Interim Separate Statement of Changes in Equity.....	6 - 7
Interim Separate Statements of Cash Flows	8
Notes to Interim Separate Financial Statements	9 - 51



Report on Review of Interim Financial Statements

To the Board of Directors and Shareholders of
KT&G Corporation

Reviewed Financial Statements

We have reviewed the accompanying interim separate financial statements of KT&G Corporation. These financial statements consist of separate statement of financial position of KT&G Corporation (the Company) as of March 31, 2012, and the related separate statements of comprehensive income, changes in equity and cash flows for the three-month period ended March 31, 2012, and a summary of significant accounting policies and other explanatory notes, expressed in Korean won.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these separate financial statements in accordance with the International Financial Reporting Standards as adopted by the Republic of Korea ("Korean IFRS") 34, *Interim Financial Reporting*, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to issue a report on these separate financial statements based on our review.

We conducted our review in accordance with the quarterly review standards 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 review, nothing has come to our attention that causes us to believe the accompanying interim separate financial statements do not present fairly, in all material respects, in accordance with the Korean IFRS 34, *Interim Financial Reporting*.

Other Matters

The interim separate statement of comprehensive income, changes in equity and cash flows for the three-month period ended March 31, 2011, presented herein for comparative purposes, were reviewed by other auditors whose report dated May 13, 2011, expressed that nothing has come to their attention that caused them to believe those statements do not present fairly, in all material respects, the financial performance and cash flows of KT&G Corporation for the three-month period ended March 31, 2011, in accordance with Korean IFRS.

The separate statement of financial position as of December 31, 2011, and the separate statement of comprehensive income and changes in equity and cash flows for the year ended December 31, 2011, were audited by other auditors whose report dated February 16, 2012, expressed an unqualified opinion on those statements in accordance with the Korean IFRS. The separate statement of financial position as of December 31, 2011, presented herein for comparative purposes, has no exceptions in all material respects.

The accompanying interim separate financial statements as of and for the three-month period ended March 31, 2012, have been translated into US dollars solely for the convenience of the reader and have been translated on the basis set forth in Note 34 to the interim separate financial statements.

Review standards and their application in practice vary among countries. The procedures and practices used in the Republic of Korea to review such financial statements may differ from those generally accepted and applied in other countries. Accordingly, this report is for use by those who are informed about Korean review standards and their application in practice.

Samil pricewaterhouseCoopers

Seoul, Korea

May 14, 2012

This report is effective as of May 14, 2012, 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 interim separate financial statements and notes thereto. Accordingly, the readers of the review report should understand that there is a possibility that the above review report may have to be revised to reflect the impact of such subsequent events or circumstances, if

KT&G Corporation
Interim Separate Statements of Financial Position
March 31, 2012 and December 31, 2011

(in millions of Korean won
and thousands of U.S. dollars)

	Notes	March 31, 2012 Korean won	March 31, 2012 U.S. dollars (Note 34)	December 31, 2011 Korean won
Assets				
Non-current assets				
Property, plant and equipment	10	₩ 1,147,859	\$ 1,008,840	₩ 1,163,361
Intangible assets	11	18,355	16,132	18,972
Investment property	12,14	158,649	139,435	165,053
Investments in associates	15	48,225	42,384	36,725
Investments in subsidiaries	15	1,067,767	938,450	1,054,767
Available-for-sale financial assets	4,6,7	275,090	241,774	247,018
Long-term deposits in MSA Escrow Fund	4,6,9,32	150,768	132,508	147,290
Long-term prepaid expenses		4,223	3,712	4,084
Long-term trade and other receivables	4,6,8,33	166,711	146,520	199,031
		<u>3,037,647</u>	<u>2,669,755</u>	<u>3,036,301</u>
Current assets				
Inventories	16	877,263	771,017	904,112
Available-for-sale financial assets	4,6,7	1,044	918	1,044
Other financial assets	4,6,17	110,000	96,678	0
Prepaid tobacco excise and other taxes		218,600	192,124	198,222
Trade and other receivables	4,6,8,33	709,820	623,853	S 198,222
Advance payments		11,123	9,776	9,358
Prepaid expenses		1,478	1,299	402
Cash and cash equivalents	4,6,17	615,396	540,865	639,097
		<u>2,544,724</u>	<u>2,236,530</u>	<u>1,752,235</u>
Assets held for sale	13,14	<u>13,949</u>	<u>12,259</u>	<u>3,196</u>
Total assets		<u>₩ 5,596,320</u>	<u>\$ 4,918,544</u>	<u>₩ 4,791,732</u>
Equity				
Capital stock	1,18	₩ 954,959	\$ 839,303	₩ 954,959
Other Capital surplus	18	3,582	3,148	3,582
Treasury shares	19	(343,522)	(301,918)	(343,522)
Gain on reissuance of treasury shares	19	485,922	427,071	485,922
Reserve	20	3,058,140	2,687,767	2,678,814
Retained earnings	21	178,448	156,836	763,738
Total equity		<u>4,337,529</u>	<u>3,812,207</u>	<u>4,543,493</u>
Liabilities				
Non-current liabilities				
Long-term trade and other payables	4,6,22,33	29,518	25,943	26,628
Long-term advance receipts		6,180	5,432	12,375
Defined benefit liability	24	53,489	47,011	47,640
Deferred income tax liabilities		94,171	82,765	82,923
		<u>183,358</u>	<u>161,151</u>	<u>169,566</u>
Current liabilities				
Borrowings	4,6,23	6,146	5,402	6,975
Trade and other payables	4,6,22,33	251,920	221,410	248,976
Advance receipts		18,501	16,260	3,935
Income taxes payable		188,895	166,018	138,846
Tobacco excise and other taxes payable		609,971	536,096	305,697
		<u>1,075,433</u>	<u>945,186</u>	<u>704,429</u>
Total liabilities		<u>1,258,791</u>	<u>1,106,337</u>	<u>873,995</u>
Total liabilities and equity		<u>₩ 5,596,320</u>	<u>\$ 4,918,544</u>	<u>₩ 5,417,488</u>

The accompanying notes are an integral part of these separate financial statements.

The US dollar figures are provided for information purposes only and do not form part of the interim separate financial statements. Refer to Note 34.

KT&G Corporation
Interim Separate Statements of Comprehensive Income
Three-Month Periods Ended March 31, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars, except per share amounts)	Notes	Period Ended March 31		
		2012 Korean won	2012 U.S. dollars (Note 34)	2011 Korean won
Sales				
Manufacture of tobacco		₩ 563,653	\$ 495,389	₩ 518,891
Real estate		9,556	8,398	6,145
Exports of leaf tobacco and others		10,157	8,927	11,996
	32,33	<u>583,366</u>	<u>512,714</u>	<u>537,032</u>
Cost of sales				
Manufacture of tobacco		(207,664)	(182,514)	(191,923)
Real estate		(1,540)	(1,354)	(1,047)
Exports of leaf tobacco and others		(7,116)	(6,254)	(8,293)
	16,33	<u>(216,320)</u>	<u>(190,122)</u>	<u>(201,263)</u>
Gross profit		<u>367,046</u>	<u>322,592</u>	<u>335,769</u>
Other income	25,26,33	7,950	6,987	9,211
Selling and administrative expenses	25,26	(144,585)	(127,074)	(138,525)
Other expenses	25,26,33	<u>(11,370)</u>	<u>(9,993)</u>	<u>(17,147)</u>
Operating income	25	<u>219,041</u>	<u>192,512</u>	<u>189,308</u>
Finance income	27	13,587	11,942	61,229
Finance expense	27	<u>(221)</u>	<u>(194)</u>	<u>(4,006)</u>
Net finance income		<u>13,366</u>	<u>11,748</u>	<u>57,223</u>
Profit before income tax		232,407	204,260	246,531
Income tax expense	28	<u>(56,219)</u>	<u>(49,410)</u>	<u>(47,320)</u>
Profit for the period		<u>₩ 176,188</u>	<u>\$ 154,850</u>	<u>₩ 199,211</u>
Other comprehensive income				
Change in value of available-for-sale financial assets		₩ 20,326	\$ 17,864	₩ (13,658)
Actuarial gain(loss) on defined benefit liability		<u>(82)</u>	<u>(72)</u>	<u>8</u>
Other comprehensive income (loss) for the period, net of tax		<u>20,244</u>	<u>17,792</u>	<u>(13,650)</u>
Total comprehensive income for the period		<u>₩ 196,432</u>	<u>\$ 172,642</u>	<u>₩ 185,561</u>
Earnings per share attributable to the equity holders of the Company during the period (in won)				
Basic and diluted earnings per share	29	<u>₩ 1,401</u>	<u>\$ 1.23</u>	<u>₩ 1,561</u>

The accompanying notes are an integral part of these separate financial statements.

The US dollar figures are provided for information purposes only and do not form part of the interim separate financial statements. Refer to Note 34.

KT&G Corporation
Interim Separate Statements of Changes in Equity
Three-Month Periods Ended March 31, 2012 and 2011

(in millions of Korean won)

	Notes	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
Balance at January 1, 2011		₩ 954,959	₩ 3,582	₩ (216,827)	₩ 482,129	₩ 2,184,703	₩ 929,140	₩ 4,337,686
Comprehensive income								
Profit for the period		-	-	-	-	-	199,211	199,211
Other comprehensive income(loss)								
Change in value of available-for-sale financial assets		-	-	-	-	(13,658)	-	(13,658)
Actuarial gain(loss) on defined benefit liability		-	-	-	-	-	8	8
Total other comprehensive income (loss)		-	-	-	-	(13,658)	8	(13,650)
Total comprehensive income (loss)		-	-	-	-	(13,658)	199,219	185,561
Transactions with equity holders of the Company								
Cash dividends		-	-	-	-	-	(382,946)	(382,946)
Other reserve		-	-	-	-	544,000	(544,000)	-
Total transactions with equity holders of the Company		-	-	-	-	544,000	(926,946)	(382,946)
Balance at March 31, 2011		₩ 954,959	₩ 3,582	₩ (216,827)	₩ 482,129	₩ 2,715,045	₩ 201,413	₩ 4,140,301
Balance at January 1, 2012		₩ 954,959	₩ 3,582	₩ (343,522)	₩ 485,922	₩ 2,678,814	₩ 763,738	₩ 4,543,493
Comprehensive income								
Profit for the period		-	-	-	-	-	176,188	176,188
Other comprehensive income(loss)								
Change in value of available-for-sale financial assets		-	-	-	-	20,326	-	20,326
Actuarial gain(loss) on defined benefit liability		-	-	-	-	-	(82)	(82)
Total other comprehensive income (loss)		-	-	-	-	20,326	(82)	20,244
Total comprehensive income (loss)		-	-	-	-	20,326	176,106	196,432
Transactions with equity holders of the Company								
Cash dividends		-	-	-	-	-	(402,396)	(402,396)
Other reserve		-	-	-	-	359,000	(359,000)	-
Total transactions with equity holders of the Company		-	-	-	-	359,000	(761,396)	(402,396)
Balance at March 31, 2012		₩ 954,959	₩ 3,582	₩ (343,522)	₩ 485,922	₩ 3,058,140	₩ 178,448	₩ 4,337,529

The accompanying notes are an integral part of these separate financial statements.

KT&G Corporation
Interim Separate Statements of Changes in Equity
Three-Month Periods Ended March 31, 2012

(in thousands of U.S. dollars) (Note 34)

	Notes	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total Equity
Balance at January 1, 2012		\$ 839,303	\$ 3,148	\$ (301,918)	\$ 427,071	\$ 2,354,381	\$ 671,241	\$ 3,993,226
Comprehensive income								
Profit for the period		-	-	-	-	-	154,850	154,850
Other comprehensive income(loss)								
Change in value of available-for-sale financial assets		-	-	-	-	17,865	-	17,865
Actuarial gain(loss) on defined benefit liability		-	-	-	-	-	(72)	(72)
Total other comprehensive income (loss)		-	-	-	-	17,865	(72)	17,793
Total comprehensive income (loss)		-	-	-	-	17,865	154,778	172,643
Transactions with equity holders of the Company								
Cash dividends		-	-	-	-	-	(353,662)	(353,662)
Other reserve		-	-	-	-	315,521	(315,521)	-
Total transactions with equity holders of the Company		-	-	-	-	315,521	(669,183)	(353,662)
Balance at March 31, 2012		\$ 839,303	\$ 3,148	\$ (301,918)	\$ 427,071	\$ 2,687,767	\$ 156,836	\$ 3,812,207

The accompanying notes are an integral part of these separate financial statements.
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KT&G Corporation
Interim Separate Statements of Cash Flows
Three-Month Periods Ended March 31, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars)	Notes	Period Ended March 31		
		2012 Korean won	2012 U.S. dollars (Note 34)	2011 Korean won
Cash flows from operating activities				
Cash generated from operations	31	₩ 518,577	\$ 455,772	₩ 172,328
Income tax paid		(1,385)	(1,218)	(83,252)
Net cash generated from operating activities		<u>517,192</u>	<u>454,554</u>	<u>89,076</u>
Cash flows from investing activities				
Interest received		6,501	5,714	6,863
Investment income received from long-term deposits in MSA Escrow Fund		70	62	904
Dividends received		3,677	3,232	200
Proceeds from sale of property, plant and equipment		2,976	2,616	6,413
Proceeds from sale of intangible assets		400	352	3,442
Proceeds from sale of available-for-sale financial assets		233	205	-
Decrease in loans		5,418	4,762	4,450
Decrease in guarantee deposits		5,807	5,103	18,688
Acquisition of property, plant and equipment		(19,936)	(17,522)	(21,679)
Acquisition of intangible assets		(125)	(110)	(170)
Acquisition of investment property		-	-	(1,221)
Acquisition of investments in associates		(11,500)	(10,107)	(12,600)
Acquisition of investments in subsidiaries		(13,000)	(11,426)	-
Acquisition of available-for-sale financial assets		(1,500)	(1,318)	-
Increase in loans		-	-	(9,934)
Increase in guarantee deposits		(5,361)	(4,712)	(21,253)
Increase in long-term deposits in MSA Escrow Fund		(5,578)	(4,903)	(2,859)
Increase in other financial assets		(110,000)	(96,678)	-
Net cash used in investing activities		<u>(141,918)</u>	<u>(124,730)</u>	<u>(28,756)</u>
Cash flows from financing activities				
Dividends paid	30	(402,396)	(353,661)	-
Increase in deposits received		4,276	3,758	5,486
Decrease in deposits received		(968)	(851)	(3,368)
Net cash used in financing activities		<u>(399,088)</u>	<u>(350,754)</u>	<u>2,118</u>
Net increase(decrease) in cash and cash equivalents		(23,814)	(20,930)	62,438
Cash and cash equivalents at the beginning of period		639,097	561,696	828,951
Exchange gains/(losses) on cash and cash equivalents		<u>113</u>	<u>100</u>	<u>(161)</u>
Cash and cash equivalents at the end of period		<u>₩ 615,396</u>	<u>\$ 540,865</u>	<u>₩ 891,228</u>

The accompanying notes are an integral part of these separate financial statements.

The US dollar figures are provided for information purposes only and do not form part of the interim separate financial statements. Refer to Note 34.

KT&G Corporation

Notes to Interim Separate Financial Statements

March 31, 2012 and 2011, and December 31, 2011

1. General Information

General information about KT&G Corporation (the “Company”) is as follows.

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

As of March 31, 2012, the Company has four manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 139 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Company is located in Pyeongchondong, Daedeok-gu, Daejeon.

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

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

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

The ownership of the Company's issued ordinary shares as of March 31, 2012, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee share ownership association	3,105,042	2.26%
Others	113,133,273	82.40%
	125,748,800	91.59%
Treasury shares	11,543,697	8.41%
	137,292,497	100.00%

2. Significant Accounting Policies

The principal accounting policies applied in the preparation of these separate financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

2.1 Basis of Preparation

The interim financial statements for the three-month period ended March 31, 2012, have been prepared in accordance Korean IFRS 1034, '*Interim Financial Reporting*'. These interim financial statements have been prepared in accordance with the Korean IFRS standards and interpretations issued and effective or issued and early adopted at the reporting date. The Korean IFRS standards and interpretations that will be applicable at December 31, 2011, including those that will be applicable on an optional basis, are not known with certainty at the time of preparing these interim financial statements.

New standards, amendments and interpretations issued but not effective for the financial year beginning January 1, 2012, and not early adopted by the Company are as follows:

- Amendments to Korean-IFRS1019, *Employ benefits*

According to the amendment, the corridor approach to actuarial gains and losses no longer applies. Accordingly, all actuarial gains and losses are immediately recognized as other comprehensive income. This amendment will be effective for the Company as of January 1, 2013. The Company expects that the application of this amendment would not have material impact on its financial statements.

- Enactment of Korean-IFRS1113, *Fair value measurement*

Korean-IFRS1113, *Fair value measurement*, aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across Korean-IFRSs. Korean-IFRS1101 does not extend the use of fair value accounting but provides guidance on how it should be applied where its use is already required or permitted by other standards within Korean-IFRSs. This amendment will be effective for the Company as of January 1, 2013, and the Company expects that it would not have a material impact on the Company.

2.2 Subsidiaries and associates

These separate financial statements are prepared and presented in accordance with K-IFRS No. 1027. The Company applied the cost method to investments in subsidiaries and associates in accordance with K-IFRS No.1027. The carrying amount of investment in Korea Ginseng

KT&G Corporation

Notes to Interim Separate Financial Statements

March 31, 2012 and 2011, and December 31, 2011

Corporation under previous Korean Generally Accepted Accounting Principles on the date of transition to K-IFRS is considered to be the deemed cost of investments in subsidiaries on the date of transition. Dividends from a subsidiary or associate are recognized in profit or loss when the right to receive the dividend is established.

2.3 Segment Reporting

Operating segments are reported in the consolidated financial statements in accordance with Korean-IFRS 1108, *Operating Segments*.

2.4 Foreign Currency Translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The financial statements are presented in Korean won, which is the controlling entity's functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the income statement within 'financial income or expenses'. All other foreign exchange gains and losses are presented in the income statement within 'other gains and losses, net'.

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analyzed between translation differences resulting from changes in the amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortized cost are recognized in profit or loss, and other changes in carrying amount are recognized in other comprehensive income.

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognized in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available-for-sale, are included in other comprehensive income.

2.5 Cash and Cash Equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less.

2.6 Financial Assets

2.6.1 Classification

The Company classifies its financial assets in the following categories: at fair value through profit or

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

loss, loans and receivables, available-for-sale, and held-to-maturity. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives or embedded derivatives are also categorized as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. The Company's loans and receivables comprise 'cash and cash equivalents', 'trade and other receivables', and 'other financial assets' in the statement of financial position.

(c) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company intends and is able to hold to maturity and are classified as 'other financial assets' in the statements of financial position. If the Company were to sell other than an insignificant amounts of held-to-maturity investments, the whole category would be tainted and reclassified as available-for-sale. Held-to-maturity investments are included in non-current assets, except for those with maturities of less than 12 months after the end of the reporting period, which are classified as current assets.

(d) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months after the end of the reporting period.

2.6.2 Recognition and Measurement

Regular purchases and sales of financial assets are recognized on the trade date. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are subsequently carried at amortized cost using the effective interest rate method.

Gains or losses arising from changes in the fair value of the financial assets carried at fair value through profit or loss are presented in the income statement within 'other gains and losses, net' in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognized in the income statement as part of 'other income' when the Company's right to receive dividend payments is established.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the income statement as 'other gains and losses, net'.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

Interest on available-for-sale and held-to-maturity securities calculated using the effective interest method is recognized in the income statement as part of 'other income'. Dividends on available-for-sale equity instruments are recognized in the income statement as part of 'other income' when the Company's right to receive dividend payments is established.

2.6.3 Offsetting financial instruments

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

2.7 Impairment of Financial Assets

(a) Assets carried at amortized cost

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or a group of financial assets that can be reliably estimated.

The criteria that the Company uses to determine that there is objective evidence of an impairment loss include:

- Significant financial difficulty of the issuer or obligor;
- Delinquency in interest or principal payments for more than three months;
- For economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- It becomes probable that the borrower will enter bankruptcy or other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties; or
- Observable data suggesting that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, even though the decrease cannot be identified with respect to individual financial assets in the portfolio, such as:
 - (i) Adverse changes in the payment status of borrowers in the portfolio;
 - (ii) National or local economic conditions that correlate with defaults on the assets in the portfolio.

Impairment loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted using the initial effective interest rate. The carrying amount of the asset is reduced by the impairment loss amount and the amount of the loss is recognized in the income statement. In practice, the Company may measure impairment loss based on the fair value of financial asset using an observable market price.

If, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (for example, an improvement in debtor's credit rating), the reversal of the previously recognized impairment loss is recognized in the income statement.

(b) Assets classified as available-for-sale

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. For debt securities, the Company uses the criteria refer to in (a) above. In the case of equity investments classified as available-for-

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

sale, a significant or prolonged decline in the fair value of the security below its cost, for example decrease in fair value of the investments by more than 30% from its cost for more than six months, is also evidence that the asset is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in profit or loss – is removed from equity and recognized in the income statement. Impairment losses recognized in the separate income statement on equity instruments are not reversed through the income statement. 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 through the income statement.

2.8 Trade Receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets. Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less allowance for doubtful accounts.

2.9 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 merchandise, 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 ₩ 357,113 million and ₩ 385,459 million as of March 31, 2012 and December 31, 2011, respectively.

2.10 Non-current Assets (or disposal group) Held for Sale

Non-current assets (or disposal group) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell.

2.11 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

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

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 Company 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 income statement during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between their cost and their residual values over their estimated useful lives, as follows:

Buildings	10 - 60 years
Structures	10 - 40 years
Machinery	10 - 12 years
Vehicle	4 years
Tools and equipment	4 years
Supplies	4 years

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 within 'other gains and losses, net' in the income statement.

2.12 Borrowing Costs

General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization. All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

2.13 Government Grants

Grants from a government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the Company will comply with all attached conditions.

Government grants relating to property, plant and equipment are presented as a deduction of related assets and are credited to depreciation over the expected lives of the related assets.

Government grants relating to costs are deferred and recognized in the income statement over the period necessary to match them with the costs that they are intended to compensate.

2.14 Intangible Assets

Intangible assets are measured initially at cost and after initial recognition, are carried at cost less accumulated amortization and accumulated impairment losses. Intangible assets consist of industrial property rights, facility usage rights and other intangible assets. Intangible assets are amortized on a straight-line basis over the estimated useful lives of intangible assets from the date that they are available for use. The residual value of intangible assets is assumed to be zero. However, as there are no foreseeable limits to the periods over which facility usage rights and some of the industrial property rights are expected to be available for use, these intangible assets

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

are regarded as having indefinite useful lives and not amortized.

The estimated useful lives are as follows:

Industrial property rights	10 - 20 years or indefinite
Facility usage rights	Indefinite
Other intangible assets	4 years

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.

2.15 Investment Property

Investment property is held to earn rentals or for capital appreciation or both. Investment property also includes property that is being constructed or developed for future use as investment property. Investment property is measured initially at its cost including transaction costs incurred in acquiring the asset. After recognition as an asset, investment property is carried at cost less accumulated depreciation and impairment losses.

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

Land held for investment is not depreciated. Investment property, except for land, is depreciated using straight-line method over their useful lives from ten to 60 years.

The depreciation method, the residual value and the useful life of an asset are reviewed at the end of each financial year and, if management judges that previous estimates should be adjusted, the change is accounted for as a change in an accounting estimate.

2.16 Impairment of Non-financial Assets

Goodwill or intangible assets with indefinite useful lives are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets, other than goodwill, that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date.

2.17 Trade Payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

2.18 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method. The Company recognizes borrowings as current assets unless it has an unconditional right to delay the settlement of the borrowing. Preference shares, which are mandatorily redeemable on a specific date, are classified as liabilities. The dividends on these preference shares are recognized in the income statement as 'finance expense'.

2.19 Compound Financial Instruments

Compound financial instruments issued by the Company comprise convertible notes that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially at the difference between the fair value of the compound financial instrument as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition except on conversion or expiry.

2.20 Provisions

Provisions are recognized when: the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

2.21 Current and Deferred Income Tax

The tax expense for the period comprises current and deferred tax. Tax is recognized in the income statement, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position date in the countries where the Company operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the separate financial statements. However, deferred tax assets and liabilities are not recognized if they arise from initial

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes assets and liabilities relate to income taxes levied by the same taxation authority on either the same taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

2.22 Employee Benefits

(a) Defined benefit liability

The Company operates various pension schemes. The schemes are generally funded through payments to insurance companies or trustee-administered funds, determined by periodic actuarial calculations. The Company has both defined benefit and defined contribution plans.

A defined contribution plan is a pension plan under which the Company pays fixed contributions into a separate entity. The Company has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. For defined contribution plans, the Company pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Company has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense when they are due. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in the future payments is available.

A defined benefit plan is a pension plan that is not a defined contribution plan. Typically defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognized in the statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognized past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Past-service costs are recognized immediately in income, while costs are amortized over the vesting period.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

(b) Termination benefits

Termination benefits are payable when employment is terminated by the Company before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Company recognizes termination benefits when it is demonstrably committed to a termination when the entity has a detailed formal plan to terminate the employment of current employees without possibility of withdrawal and in the case of an offer made to encourage voluntary redundancy.

2.23 Share Capital

Ordinary shares and preferred shares that are not mandatorily redeemable are classified as equity.

Where the Company purchases its own equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued. Where such ordinary shares are subsequently reissued, any consideration received is included in equity attributable to the Company's equity holders.

2.24 Revenue Recognition

The Company's revenue categories consist of goods sold, services and other income. Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the three-month periods ended March 31, 2012 and 2011, were ₩ 803,947 million and ₩ 738,065 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 completion is assessed by reference to surveys of work performed.

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 Company, the stage of completion of the transaction at the end of the reporting period can be measured reliably and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably. When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue is recognized only to the extent of the expenses recognized that are recoverable.

Revenue from the use by others of the Company's assets yielding interest, royalties and dividends is recognized when it is probable that the economic benefits associated with the transaction will flow to the Company and the amount of the revenue can be measured reliably.

In addition, interest is recognized using the effective interest method, royalties are recognized on an accrual basis in accordance with the substance of the relevant agreement and dividends are

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

recognized when the shareholders' right to receive the dividend is established.

2.25 Dividend Distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

3. Critical Accounting Estimates and Judgments

The Company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. Estimations and assumptions are continuously evaluated with consideration to factors such as events reasonably predictable in the foreseeable future within the present circumstance according to historical experience. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Income taxes

The Company is operating in numerous countries and the income generated from these operations is subject to income taxes based on tax laws and interpretations of tax authorities in numerous jurisdictions. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Company recorded, based on its best estimate, current taxes and deferred taxes that the Company will be liable in the future for the operating results as of the financial year end. However, the final tax outcome in the future may be different from the amounts that were initially recorded. Such differences will impact the current and deferred income tax assets and liabilities in the period in which such determination is made.

(b) Fair value of financial instruments

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company uses its judgment to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.

(c) Provisions

As described in Note 2.20, the Company recognizes provisions for warranties and repairs and estimated returns as of the reporting date. The amounts are estimated based on historical data.

(d) Defined benefit liability

The present value of the defined benefit liability depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will impact the carrying amount of the defined benefit liability. The Company determines the appropriate discount rate at the end of each year. This is the interest rate that is used to determine the present value of estimated future cash outflows expected to be required to settle the defined benefit liability. In determining the appropriate discount rate, the Company considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the pension benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Other key assumptions for defined benefit liability are based in part on current market conditions. Additional information is disclosed in Note 24.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

4. Financial Risk Management

4.1 Financial Risk Factors

The Company's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk and liquidity risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. The Company uses derivative financial instruments to hedge certain risk exposures.

Risk management is carried out by a central treasury department (Company treasury) under policies approved by the board of directors. The Company treasury identifies, evaluates and hedges financial risks in close co-operation with the Company's operating units. The board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity.

(a) Market Risk

i) Foreign exchange risk

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

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of March 31, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012				December 31, 2011			
	USD	EUR	RUB	THB	USD	EUR	RUB	THB
Assets								
Cash and cash equivalents	₩ 14,093	₩ 1,058	₩ -	₩ -	₩ 24,198	₩ 37	₩ -	₩ -
Trade and other receivables	471,316	19,365	10,057	-	419,781	17,078	10,389	60
Long-term deposits	150,768	-	-	-	147,290	-	-	-
	<u>₩ 636,177</u>	<u>₩ 20,423</u>	<u>₩ 10,057</u>	<u>₩ -</u>	<u>₩ 591,269</u>	<u>₩ 17,115</u>	<u>₩ 10,389</u>	<u>₩ 60</u>
Liabilities								
Trade and other payables	₩ 2,887	₩ 5,302	₩ -	₩ -	₩ 3,194	₩ 4,281	₩ -	₩ -
	<u>₩ 2,887</u>	<u>₩ 5,302</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 3,194</u>	<u>₩ 4,281</u>	<u>₩ -</u>	<u>₩ -</u>

As of March 31, 2012 and December 31, 2011, the effects of a 10% strengthening or weakening of functional currency against the US dollar other than functional currency on profit before tax were as follows:

<i>(in millions of Korean won)</i>	March 31, 2012		December 31, 2011	
	10% strengthening	10% weakening	10% strengthening	10% weakening
US dollar	₩ 63,329	₩ (63,329)	₩ 58,808	₩ (58,808)

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

ii) Price risk

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

As of March 31, 2012 and December 31, 2011, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income are as follows:

	March 31, 2012		December 31, 2011	
	5% increase	5% decrease	5% increase	5% decrease
Other comprehensive income before tax	₩ 7,907	₩ (7,907)	₩ 8,464	₩ (8,464)
Tax effect	(1,740)	1,740	(2,048)	2,048
Other comprehensive income after tax	₩ 6,167	₩ (6,167)	₩ 6,416	₩ (6,416)

iii) Interest rate risk

The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation.

(b) Credit Risk

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

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of March 31, 2012 and December 31, 2011, is as follows:

	March 31, 2012	December 31, 2011
Available-for-sale financial assets	₩ 3,544	₩ 2,044
Long-term deposits in MSA Escrow Fund	150,768	147,290
Trade and other receivables	876,531	824,787
Other financial assets	110,000	-
Cash and cash equivalents	615,396	639,097

(c) Liquidity Risk

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

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

The maturity analysis with a residual contractual maturity of financial liabilities as of March 31, 2012 and December 31, 2011, is as follows:

		March 31, 2012					
<i>(in millions of Korean won)</i>		Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
Trade and other payables	₩	161,872	₩ 161,872	₩ 132,372	₩ 221	₩ 29,279	₩ -
Short-term borrowings		6,146	6,146	6,146	-	-	-

		December 31, 2011					
<i>(in millions of Korean won)</i>		Carrying amount	Contractual cash flow	Within 3 months	Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years
Trade and other payables	₩	157,151	₩ 158,259	₩ 58,309	₩ 89,361	₩ 8,531	₩ 2,058
Short-term borrowings		6,975	6,975	6,975	-	-	-

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

4.2 Capital Management

The fundamental goal of capital management is the maximization of shareholders' value by means of the stable dividend policy and the retirement of treasury shares. The capital structure of the Company consists of equity and net debt deducting cash and cash equivalents and current financial instruments from borrowings. The Company applied the same financial risk management strategy that was applied in the previous period.

As of March 31, 2012 and December 31, 2011, the Company defines net debt and equity attributable to owners of the Parent as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	December 31, 2011
Total borrowings	₩ 6,146	₩ 6,975
Less:		
-Cash and cash equivalents	(615,396)	(639,097)
-Other financial assets	(110,000)	-
-Available-for-sale financial assets	(1,044)	(1,044)
Net debt(Net asset)	(720,294)	(633,166)
Equity attributable to owners of the parent	₩ 4,337,529	₩ 4,543,493

4.3 Fair Value Estimation

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly(that is, as prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

The following table presents the Company's financial assets and financial liabilities that are measured at fair value as of March 31, 2012.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

<i>(In millions of Korean won)</i>	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale financial assets	₩ 214,095	₩ 42,392	₩ 12,009	₩ 268,496
Long-term deposits	150,768	-	-	150,768
Total assets	<u>₩ 364,863</u>	<u>₩ 42,392</u>	<u>₩ 12,009</u>	<u>₩ 419,264</u>

The following table presents the Company's assets and liabilities that are measured at fair value as of December 31, 2011.

<i>(In millions of Korean won)</i>	Level 1	Level 2	Level 3	Total
Assets				
Available-for-sale financial assets	₩ 187,311	₩ 42,604	₩ 12,009	₩ 241,924
Long-term deposits	147,290	-	-	147,290
Total assets	<u>₩ 334,601</u>	<u>₩ 42,604</u>	<u>₩ 12,009</u>	<u>₩ 389,214</u>

The fair value of financial instruments traded in active markets is based on quoted market prices at the statement of financial position date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, an entity in the same industry, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Company is the current bid price. These instruments are included in Level 1. Instruments included in Level 1 consist primarily of KOSPI, KOSDAQ equity investments classified as trading securities or available for sale.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- The fair value of forward foreign exchange contracts is determined using forward exchange rates at the statement of financial position date, with the resulting value discounted back to present value.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

5. Operating Segments

The major customer who contribute 10% or more of the Company's total revenues for the three-month periods ended March 31, 2012 and 2011, is as follows:

Segment	Major customer	March 31, 2012	March 31, 2011
Tobacco	Alokozay International Limited	₩ 92,202	₩ 98,783

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

6. Financial Instruments by Category

Categorizations of financial assets as of March 31, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012				
	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for-sale	Total
Cash and cash equivalents	₩ 615,396	₩ -	₩ -	₩ -	₩ 615,396
Financial assets as available-for-sale, current	-	-	-	1,044	1,044
Trade and other receivables, current	709,820	-	-	-	709,820
Other financial assets, current	110,000	-	-	-	110,000
Long-term deposits	150,768	-	-	-	150,768
Financial assets as available-for-sale, non-current	-	-	-	275,090	275,090
Long-term Trade and other receivables	166,711	-	-	-	166,711
	<u>₩ 1,752,695</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 276,134</u>	<u>₩ 2,028,829</u>

<i>(in millions of Korean won)</i>	December 31, 2011				
	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for-sale	Total
Cash and cash equivalents	₩ 639,097	₩ -	₩ -	₩ -	₩ 639,097
Financial assets as available-for-sale, current	-	-	-	1,044	1,044
Trade and other receivables, current	625,756	-	-	-	625,756
Long-term deposits	147,290	-	-	-	147,290
Financial assets as available-for-sale, non-current	-	-	-	247,018	247,018
Long-term Trade and other receivables	199,031	-	-	-	199,031
	<u>₩ 1,611,174</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 248,062</u>	<u>₩ 1,859,236</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

Categorizations of financial liabilities as of March 31, 2012 and December 31, 2011, are as follows:

		March 31, 2012				
(in millions of Korean won)	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total	
Borrowings, current	₩ -	₩ -	₩ 6,146	₩ -	₩ 6,146	
Trade and other payables, current	-	-	132,354	-	132,354	
Trade and other payables, non-current			29,518	-	29,518	
	₩ -	₩ -	₩ 168,018	₩ -	₩ 168,018	
		December 31, 2011				
(in millions of Korean won)	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total	
Borrowings, current	₩ -	₩ -	₩ 6,975	₩ -	₩ 6,975	
Trade and other payables, current	-	-	130,523	-	130,523	
Trade and other payables, non-current			26,628	-	26,628	
	₩ -	₩ -	₩ 164,126	₩ -	₩ 164,126	

Income and loss of financial instruments by category for the three-month periods ended March 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	March 31, 2011
Available-for-sale financial assets		
Gain(Loss) on valuation (Other comprehensive income(loss))	₩ 20,325	₩ (13,659)
Gain(Loss) on disposal(Profit or loss)	(9)	-
Gain(Loss) on disposal (Reclassification) ¹	-	-
Interest income	5	12
Dividend income	3,677	53,332
Impairment	-	(3,988)
Cash and cash equivalents		
Interest income	6,971	7,127
Gain(Loss) on foreign currency translation	113	(161)
Foreign currency transaction gain (loss)	(529)	17
Trade and other receivables		
Interest income	2,864	456
Gain(Loss) on foreign currency translation	(4,530)	(10,582)
Foreign currency transaction gain (loss)	(1,422)	(1,532)
Other financial liabilities at amortized cost		
Interest costs	(212)	(18)
Gain(Loss) on foreign currency translation	(94)	69
Foreign currency transaction gain (loss)	518	72

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

7. Available-for-sale Financial Assets

The changes in available-for-sale financial assets as of March 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	March 31, 2011
At January 1	₩ 248,062	₩ 314,973
Additions	1,500	-
Disposals	(242)	-
Net gains(losses) transfer to equity	26,814	(17,512)
Transfer to others	-	(17,300)
Impairment losses	-	(3,988)
At March 31	276,134	276,137
Less: current portion	(1,044)	(1,000)
Non-current portion	₩ 275,090	₩ 275,137

Available-for-sale financial assets as of March 31, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	December 31, 2011
Available-for-sale debt instruments:		
Government and municipal bonds	₩ 44	₩ 44
Corporate bonds	3,500	2,000
Total available-for-sale debt instruments	3,544	2,044
Available-for-sale equity instruments:		
Listed		
Yonhap Television News(YTN)	33,185	23,129
Oscotech, Inc.	1,690	2,049
Shinhan Financial Group Co., Ltd.	175,366	159,332
Rexahn Pharmaceuticals, Inc.	3,854	2,801
	214,095	187,311
Unlisted		
Dream Hub PFV Co., Ltd.	12,009	12,009
Others	46,486	46,698
	58,495	58,707
Total available-for-sale equity instruments	272,590	246,018
Total available-for-sale financial assets	₩ 276,134	₩ 248,062

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

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

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

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

8. Trade and Other Receivables

Trade and other receivables as of March 31, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012		December 31, 2011	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 10,330	₩ 30,088	₩ 13,424	₩ 32,339
Loans	25,590	78,036	7,123	108,461
Other receivables	57,076	22,489	60,457	22,281
Guarantee deposits	-	36,098	-	35,950
Accrued income	6,541	-	4,051	-
Trade receivables	610,283	-	540,704	-
	<u>₩ 709,820</u>	<u>₩ 166,711</u>	<u>₩ 625,756</u>	<u>₩ 199,031</u>

Trade and other receivables as of March 31, 2012 and December 31, 2011, have been reported in the separate statements of financial position, net of allowances, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012		December 31, 2011	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 715,183	₩ 166,711	₩ 631,121	₩ 199,031
Allowance account				
-Other receivables	(2,083)	-	(2,083)	-
-Trade receivables	(3,280)	-	(3,282)	-
	<u>(5,363)</u>	<u>-</u>	<u>(5,365)</u>	<u>-</u>
Net amount	<u>₩ 709,820</u>	<u>₩ 166,711</u>	<u>₩ 625,756</u>	<u>₩ 199,031</u>

Changes in the allowance account for the three-month periods ended March 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	March 31, 2012
Beginning	₩ 5,365	₩ 5,184
Impairment	-	52
Reversal of impairment	(2)	-
Write-off	-	-
Ending	<u>₩ 5,363</u>	<u>₩ 5,236</u>

The aging schedule of trade and other receivables as of March 31, 2012 and December 31, 2011, is as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	December 31, 2011
Not past due	₩ 396,135	₩ 406,483
Past due but not impaired		
Within 1 month	81,815	26,792
Between 1 and 2 months	33,946	36,245
Beyond 2 months	98,387	71,184
	<u>214,148</u>	<u>134,221</u>
Impaired	3,280	3,282
	<u>₩ 613,563</u>	<u>₩ 543,986</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

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

Details of trade and other receivables that are measured at amortized cost as of March 31, 2012, and December 31, 2011, are as follows:

(Number of shares)	March 31, 2012			December 31, 2011		
	Effective interest rate(%)	Current	Non-current	Effective interest rate(%)	Current	Non-current
Loans to employees	3.00~5.68	₩ 10,330	₩ 30,088	3.00~5.68	₩ 13,421	₩ 32,339
Other receivables	3.79	-	22,489	3.79	7,997	22,281
Guarantee deposits	3.00~5.68	-	36,098	3.00~5.68	-	35,950
		<u>₩ 10,330</u>	<u>₩ 88,675</u>		<u>₩ 21,418</u>	<u>₩ 90,570</u>

9. Long-term Deposits

Long-term deposits of March 31, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	March 31, 2012	December 31, 2011
MMF	₩ 150,768	₩ 147,290

As discussed in Note 32 to the separate 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, 2012 and 2011, are ₩5,437 million and ₩2,859 million, respectively.

Investment income on long-term deposits in MSA Escrow Fund for the three-month periods ended March 31, 2012 and 2011, are ₩70 million and ₩302 million, respectively.

Long-term deposits in MSA Escrow Fund are measured at quoted prices in an active market.

10. Property, Plant and Equipment

Changes in property, plant and equipment for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)	March 31, 2012		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 397,682	₩ -	₩ 397,682
Buildings	655,382	(250,704)	404,678
Structures	45,726	(26,784)	18,942
Machinery	851,176	(606,977)	244,199
Vehicles	3,932	(3,240)	692
Tools	31,796	(29,538)	2,258
Furniture and fixture	176,006	(139,959)	36,047
Others	1,078	-	1,078
Construction-in-progress	42,283	-	42,283
	<u>₩ 2,205,061</u>	<u>₩ (1,057,202)</u>	<u>₩ 1,147,859</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

(in millions of Korean won)	March 31, 2011		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 391,649	₩ -	₩ 391,649
Buildings	609,150	(225,699)	383,451
Structures	45,038	(25,212)	19,826
Machinery	820,530	(552,132)	268,398
Vehicles	4,109	(3,566)	543
Tools	31,118	(27,696)	3,422
Furniture and fixture	159,348	(119,283)	40,065
Others	760	-	760
Construction-in-progress	52,650	-	52,650
	₩ 2,114,352	₩ (953,588)	₩ 1,160,764

(in millions of Korean won)	March 31, 2012					
	Opening net book value	Additions	Disposal	Transfer ¹	Depreciation charge	Net book amount
Land	₩ 397,775	₩ 457	₩ (181)	₩ (369)	₩ -	₩ 397,682
Buildings	411,217	1,015	(1,269)	738	(7,023)	404,678
Structures	19,038	-	(179)	663	(580)	18,942
Machinery	254,484	1,114	-	3,613	(15,012)	244,199
Vehicles	703	76	-	-	(87)	692
Tools	2,620	12	-	-	(374)	2,258
Furniture and fixture	36,362	4,530	-	-	(4,845)	36,047
Others	1,078	-	-	-	-	1,078
Construction-in-progress	40,084	12,733	-	(10,534)	-	42,283
	₩ 1,163,361	₩ 19,937	₩ (1,629)	₩ (5,889)	₩ (27,921)	₩ 1,147,859

(in thousands of Korean won)	March 31, 2011					
	Opening net book value	Additions	Disposal	Transfer	Depreciation	Net book amount
Land	₩ 379,002	₩ 18	₩ (1,174)	₩ 13,803	₩ -	₩ 391,649
Buildings	385,189	211	(197)	1,331	(3,083)	383,451
Structures	20,485	28	(71)	(92)	(524)	19,826
Machinery	280,371	265	(20)	2,370	(14,588)	268,398
Vehicles	592	24	1	-	(74)	543
Tools	3,992	17	1	-	(588)	3,422
Furniture and fixture	43,413	2,434	(1)	274	(6,055)	40,065
Others	607	0	(10)	163	-	760
Construction-in-progress	82,475	18,682	-	(48,507)	-	52,650
Total	₩ 1,196,126	₩ 21,679	₩ (1,471)	₩ (30,658)	₩ (24,912)	₩ 1,160,764

¹ Transfers for the three-month period ended March 31, 2012, include assets with a carrying amount of ₩10,753 million transferred from investment property, while ₩4,864 million were transferred to assets held for sale.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

11. Intangible Assets

Changes in intangible assets for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)	March 31, 2012					Total
	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development		
At January 1, 2012	₩ 1,323	₩ 15,946	₩ -	₩ 1,703	₩	18,972
Additions	-	2	-	123		125
Transfer-in (out)	30	-	-	(30)		-
Disposals	(70)	-	-	(667)		(737)
Amortization	(5)	-	-	-		(5)
Impairment / reversal	-	-	-	-		-
Other changes	-	-	-	0		-
Acquisition Cost	6,738	15,948	-	1,129		23,815
Accumulated depreciation and impairment cost	(5,460)	-	-	-		(5,460)
Net book amount	<u>₩ 1,278</u>	<u>₩ 15,948</u>	<u>₩ -</u>	<u>₩ 1,129</u>	<u>₩</u>	<u>18,355</u>

(in millions of Korean won)	March 31, 2011					Total
	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development		
At January 1, 2011	₩ 1,079	₩ 16,514	₩ 1	₩ 30,970	₩	48,564
Additions	-	-	-	170		170
Transfer-in (out)	52	-	-	(52)		-
Disposals	-	- 2,962	-	-		(2,962)
Amortization	(12)	-	-	-		(12)
Impairment / reversal	-	-	-	-		-
Other changes	-	-	-	-		-
Acquisition Cost	6,318	13,552	4,074	31,735		55,679
Accumulated depreciation and impairment cost	(5,199)	-	- 4,073	- 647		(9,919)
Net book amount	<u>₩ 1,119</u>	<u>₩ 13,552</u>	<u>₩ 1</u>	<u>₩ 31,088</u>	<u>₩</u>	<u>45,760</u>

Research and development expenses for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)	March 31, 2012	March 31, 2011
Cost of goods sold	₩ 73	₩ 43
Selling and administrative expenses	3,186	2,600
	<u>₩ 3,259</u>	<u>₩ 2,643</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

12. Investment Property

Changes in investment property for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)

	March 31, 2012		
	Land	Building	Total
Beginning net book value	₩ 22,683	₩ 142,370	₩ 165,053
Transfer to property, plant and equipment	(563)	(4,301)	(4,864)
Depreciation	-	(1,540)	(1,540)
Acquisition cost	₩ 22,120	₩ 172,750	₩ 194,870
Accumulated depreciation	-	(36,221)	(36,221)
Net book amount	₩ 22,120	₩ 136,529	₩ 158,649

(in millions of Korean won)

	March 31, 2011		
	Land	Building	Total
Beginning net book value	₩ 13,919	₩ 84,224	₩ 98,143
Transfer to property, plant and equipment	1,213	23,735	24,948
Transfer from property, plant and equipment	-	1,221	1,221
Depreciation	-	(1,047)	(1,047)
Acquisition cost	₩ 15,132	₩ 141,443	₩ 156,575
Accumulated depreciation	-	(33,310)	(33,310)
Net book amount	₩ 15,132	₩ 108,133	₩ 123,265

The amounts recognized in profit or loss from investment property for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)

	March 31, 2012	March 31, 2011
Rental income	₩ 7,173	₩ 4,323
Direct operating expense	(1,540)	(1,047)
	₩ 5,633	₩ 3,276

Fair values and book values of investment property as of March 31, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)

	March 31, 2012		December 31, 2011	
	Fair value	Book value	Fair value	Book value
Land	₩ 326,866	₩ 22,120	₩ 289,422	₩ 22,683
Building	206,452	136,529	196,258	142,370
	₩ 533,318	₩ 158,649	₩ 485,680	₩ 165,053

13. Non-current Assets Held for Sale and Discontinued Operations

The Company entered into a sales contract with HT&D Co., Ltd. to sell the Gyeonggi branch's land, building and others. The Company received partial payment amounting to ₩1,500 million out of total amount ₩17,820 million during the three-month period ended March 31, 2012, and has agreed to receive in installments the balance of ₩16,320 million after the current period.

Also, the Company has an agreement with Mr. Jae-chil Kim and two others for sale of Namulsan Tower's land, building and others. In related to this contract, the Company recognizes non-current

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

assets held for sale as the lower of net fair value and book value.

Changes in non-current assets held for sale for the three-month period ended March 31, 2012, are as follows:

(in millions of Korean won)	March 31, 2012				
	Land	Buildings	Structures	Machinery	Total
At January 1, 2012					
Acquisition cost	₩ 2,273	₩ 1,429	₩ 197	₩ -	₩ 3,899
Accumulated depreciation	-	(553)	(150)	-	(703)
Net book amount	₩ 2,273	₩ 876	₩ 47	₩ -	₩ 3,196
Changes					
Transfer from property, plant and equipment	₩ 6,235	₩ 4,418	₩ 55	₩ 45	₩ 10,753
	₩ 6,235	₩ 4,418	₩ 55	₩ 45	₩ 10,753
At March 31, 2012					
Acquisition cost	₩ 8,508	₩ 8,500	₩ 407	₩ 196	₩ 17,611
Accumulated depreciation	-	(3,206)	(305)	(151)	(3,662)
Net book amount	₩ 8,508	₩ 5,294	₩ 102	₩ 45	₩ 13,949

14. Pledged Assets

The following assets were pledged as collateral for the Company's borrowings and others as of March 31, 2012:

(in millions of Korean won)					
Asset	Amount		Received Amount	Collateralized amount	Lender /Leaseholder
Investment Property	₩ 149,696	Leasehold deposits received	₩ 7,652	₩ 7,969	Metlife Insurance Korea Co.,Ltd. and 27 others
Non-current Assets Held for Sale	4,850		755	1,063	Hyundai Motor Company Co., Ltd and 5 others.
	₩ 154,546		₩ 8,407	₩ 9,032	

The following assets were pledged as collateral for the Company's borrowings and others as of December 31, 2011:

(in millions of Korean won)					
Asset	Amount		Received Amount	Collateralized amount	Lender /Leaseholder
Investment Property	₩ 89,705	Leasehold deposits received	₩ 6,576	₩ 7,469	Metlife Insurance Korea Co.,Ltd. and 27 others

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

15. Investments in Associates and subsidiaries

Investments in associates and subsidiaries as of March 31, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)

(in millions of Korean won)

	Location	Principal operation	March 31,2012		December 31,2011	
			Interest (%)	Carrying Amount	Interest (%)	Carrying Amount
Associates						
Cosmo Tabacco Co., Ltd.	Mongolia	Manufacturing and selling tobaccos	40.00	₩ -	40.00	₩ -
Lite Pharm Tech, Inc	Korea	Manufacturing and Medical supplies	25.34	1,830	25.34	1,830
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00	1,000	20.00	1,000
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	13,995	49.02	13,995
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	7,300	29.67	7,300
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	7,000	22.06	7,000
JR REIT V Co., Ltd.	China	Selling and renting of real estate	34.63	5,600	34.63	5,600
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	10,000	-	-
LSK Global Pharma Services Co., Ltd	Korea	Research and developing new drug	23.15	1,500	-	-
				48,225		36,725
Subsidiaries						
Korea Ginseng Corporation	Korea	Manufacturing and selling ginseng	100.00	559,882	100.00	559,882
Yungjin Pharm. Ind. Co., Ltd.	Korea	Manufacturing and selling pharmaceuticals	53.00	66,355	53.00	66,355
Tae-a industry Co., Ltd.	Korea	Manufacturing tobacco materials	100.00	15,698	100.00	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	Manufacturing and selling tobaccos	99.99	54,049	99.99	54,049
Korea Tabacos do Brasil Ltda.	Brazil	Processing leaf tobaccos	99.90	394	99.90	394
KT&G Pars	Iran	Manufacturing and selling tobaccos	99.99	5,733	99.99	5,733
KT&G Rus L.L.C.	Russia	Manufacturing and selling tobaccos	100.00	110,297	100.00	110,297
KG Life & Gin Co., Ltd	Korea	Selling ginseng	100.00	31,500	100.00	31,500
KT&G Bio Corp.	Korea	Manufacturing and selling pharmaceuticals	100.00	900	100.00	900
Global Trading, Inc.	USA	Selling tobaccos	100.00	4,913	100.00	4,913
Jilin Hanzheng Ginseng Co., Ltd.	China	Manufacturing and selling ginseng	100.00	23,247	100.00	23,247
Somang Cosmetics Co., Ltd. ¹	Korea	Manufacturing and selling cosmetics	50.00	60,721	60.00	60,721
Renzoluc Pte., Ltd.	Singapore	Manufacturing and selling tobaccos	100.00	89,756	100.00	89,756
KT&G Life science ¹	Korea	Medical researching and developing	59.48	31,232	59.48	31,232
Yebon Nongwon	Korea	Corporate agriculture	90.00	90	90.00	90
KGC Yebon	Korea	Corporate agriculture	100.00	13,000	-	-
				1,067,767		1,054,767
				₩ 1,115,992		₩ 1,091,492

KT&G Corporation

Notes to Interim Separate Financial Statements

March 31, 2012 and 2011, and December 31, 2011

¹ The Company's percentage of ownership includes convertible preferred shares. As of March 31, 2012, the Company's percentage of ownership excludes convertible preferred shares, is 60.00% and 73.94%, respectively.

Changes in investments in associates and subsidiaries for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)	March 31, 2012				
	Beginning balance	Acquisition	Share of profit(loss)	Other changes	Ending balance
Associates					
Cosmo Tobacco Co., Ltd.	₩ -	₩ -	₩ -	₩ -	₩ -
Lite Pharm Tech, Inc	1,830	-	-	-	1,830
Korean Carbon Finance, Inc.	1,000	-	-	-	1,000
JR CR-REIT IV Co., Ltd.	13,995	-	-	-	13,995
KVG REIT 1 Co., Ltd.	7,300	-	-	-	7,300
KOCREF REIT 17 Co., Ltd.	7,000	-	-	-	7,000
JR REIT V Co., Ltd.	5,600	-	-	-	5,600
JR REIT VIII Co., Ltd.	-	10,000	-	-	10,000
LSK Global Pharma Services Co., Ltd	-	1,500	-	-	1,500
	<u>36,725</u>	<u>11,500</u>	<u>-</u>	<u>-</u>	<u>48,225</u>
Subsidiaries					
Korea Ginseng Corporation	559,882	-	-	-	559,882
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	66,355
Tae-a industry Co., Ltd.	15,698	-	-	-	15,698
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	394	-	-	-	394
KT&G Pars	5,733	-	-	-	5,733
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KG Life & Gin Co., Ltd	31,500	-	-	-	31,500
KT&G Bio Corp.	900	-	-	-	900
Global Trading, Inc.	4,913	-	-	-	4,913
Jilin Hanzheng Ginseng Co., Ltd.	23,247	-	-	-	23,247
Somang Cosmetics Co., Ltd.	60,721	-	-	-	60,721
Renzoluc Pte., Ltd.	89,756	-	-	-	89,756
KT&G Life science	31,232	-	-	-	31,232
Yebon Nongwon	90	-	-	-	90
KGC Yebon	-	13,000	-	-	13,000
	<u>1,054,767</u>	<u>13,000</u>	<u>-</u>	<u>-</u>	<u>1,067,767</u>
	<u>₩ 1,091,492</u>	<u>₩ 24,500</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 1,115,992</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

(in millions of Korean won)	March 31, 2011				
	Beginning balance	Acquisition	Share of profit(loss)	Other changes	Ending balance
Associates					
Cosmo Tobacco Co., Ltd.	₩ -	₩ -	₩ -	₩ -	₩ -
Lite Pharm Tech, Inc	1,830	-	-	-	1,830
Korean Carbon Finance, Inc.	1,000	-	-	-	1,000
JR CR-REIT IV Co., Ltd.	-	-	-	10,000	10,000
KVG REIT 1 Co., Ltd.	-	-	-	7,300	7,300
KOCREF REIT 17 Co., Ltd.	-	7,000	-	-	7,000
JR REIT V Co., Ltd.	-	5,600	-	-	5,600
	<u>2,830</u>	<u>12,600</u>	<u>-</u>	<u>17,300</u>	<u>32,730</u>
Subsidiaries					
Korea Ginseng Corporation	559,882	-	-	-	559,882
Yungjin Pharm. Ind. Co., Ltd.	66,355	-	-	-	66,355
Tae-a industry Co., Ltd.	14,198	-	-	-	14,198
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	54,049	-	-	-	54,049
Korea Tabacos do Brasil Ltda.	394	-	-	-	394
KT&G Pars	5,733	-	-	-	5,733
KT&G Rus L.L.C.	110,297	-	-	-	110,297
KG Life & Gin Co., Ltd	22,500	-	-	-	22,500
KT&G Bio Corp.	900	-	-	-	900
Global Trading, Inc.	4,913	-	-	-	4,913
Purpleland Development Co., Ltd.	900	-	-	-	900
	<u>840,121</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>840,121</u>
	<u>₩ 842,951</u>	<u>₩ 12,600</u>	<u>₩ -</u>	<u>₩ 17,300</u>	<u>₩ 872,851</u>

¹ The Company reclassified ₩17,300 million of available-for-sale financial assets to equity-method investments during the three-month period ended March 31, 2011.

16. Inventories

Inventories as of March 31, 2012 and December 31, 2011, are as follows:

(In millions of Korean won)	March 31, 2012			December 31, 2011		
	Acquisition	Allowance	Book amount	Acquisition	Allowance	Book amount
Finished goods	₩ 96,257	₩ (614)	₩ 95,643	₩ 74,115	₩ (472)	₩ 73,643
Work in progress	17,612	-	17,612	15,373	-	15,373
Raw materials	716,813	-	716,813	752,335	-	752,335
Supplies	23,006	-	23,006	23,340	-	23,340
By-products	6,025	-	6,025	6,362	-	6,362
Goods-in-transit	18,164	-	18,164	33,059	-	33,059
	<u>₩ 877,877</u>	<u>₩ (614)</u>	<u>₩ 877,263</u>	<u>₩ 904,584</u>	<u>₩ (472)</u>	<u>₩ 904,112</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

The cost related inventories for the three-month periods ended March 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	March 31, 2011
Cost of sales		
-Loss(profit) on inventory valuation	₩ 143	₩ 62
Other expenses		
- Loss on retirement of inventories	576	384
	<u>₩ 719</u>	<u>₩ 446</u>

17. Cash and Cash Equivalents

Cash and cash equivalents as of March 31, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	December 31, 2011
Cash on hand	₩ 4,837	₩ 4,298
Demand deposits	90,559	84,799
Short-term investment assets	520,000	550,000
	<u>₩ 615,396</u>	<u>₩ 639,097</u>

Other financial assets as of March 31, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	December 31, 2011
Short-term financial assets		
Time deposits	₩ 10,000	₩ -
Money trust	50,000	-
Certificate of deposit	50,000	-
	<u>₩ 110,000</u>	<u>₩ -</u>

18. Equity and Share Premium

Details of share capital as of March 31, 2012, and December 31, 2011, are as follows:

<i>(in Korean won, except number of shares)</i>	March 31, 2012	December 31, 2011
Number of ordinary shares		
-Authorized	800,000,000	800,000,000
-Issued	137,292,497	137,292,497
Par value	₩ 5,000	₩ 5,000
Ordinary shares	₩ 954,959,485,000	₩ 954,959,485,000

The Company has reacquired and retired 53,699,400 shares of treasury shares. Accordingly, as of March 31, 2012, the Company's ordinary shares differ from the aggregate par value of issued shares by ₩ 268,497 million.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

Changes in the number of shares for the three-month period ended March 31, 2012 and the year ended December 31, 2011, are as follows:

(Number of shares)	March 31, 2012			December 31, 2011		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning	137,292,497	(11,543,697)	125,748,800	137,292,497	(9,643,697)	127,648,800
Acquisition of treasury shares	-	-	-	-	(2,000,000)	(2,000,000)
Issuance of treasury shares	-	-	-	-	100,000	100,000
Ending	<u>137,292,497</u>	<u>(11,543,697)</u>	<u>125,748,800</u>	<u>137,292,497</u>	<u>(11,543,697)</u>	<u>125,748,800</u>

No changes in the other capital surplus for the three-month period ended March 31, 2012 and the year ended December 31, 2011.

19. Treasury Shares

Changes in the treasury shares for the three-month period ended March 31, 2012 and the year ended December 31, 2011, are as follows:

(in millions of Korean won)	March 31, 2012		December 31, 2011	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Beginning	11,543,697	₩ 343,522	9,643,697	₩ 216,827
Acquisition of treasury shares	-	-	2,000,000	129,671
Issuance of treasury shares	-	-	(100,000)	(2,976)
Ending	<u>11,543,697</u>	<u>₩ 343,522</u>	<u>11,543,697</u>	<u>₩ 343,522</u>

Changes in gain on reissuance of treasury shares for the three-month period ended March 31, 2012 and the year ended December 31, 2011, are as follows:

(in millions of Korean won)	March 31, 2012	December 31, 2011
Beginning	₩ 485,922	₩ 482,129
Gain on reissuance of treasury shares before tax	-	5,004
Less: tax at 24.2%	-	(1,211)
Gain on reissuance of treasury shares, net of tax	-	3,793
Ending	<u>₩ 485,922</u>	<u>₩ 485,922</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

20. Reserves

Details of reserves as of March 31, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	December 31, 2011
Available-for-sale financial assets reserve	₩ (11,529)	₩ (31,855)
Legal reserve	602,937	602,937
Voluntary reserve	2,466,732	2,107,732
	<u>₩ 3,058,140</u>	<u>₩ 2,678,814</u>

Available-for-sale financial assets reserve as of March 31, 2012 and December 31, 2011, are summarized as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	December 31, 2011
Available-for-sale financial assets reserve before tax	₩ (15,210)	₩ (42,025)
Tax effect	3,681	10,170
	<u>₩ (11,529)</u>	<u>₩ (31,855)</u>

The Korean Commercial Code requires the Company to appropriate a legal reserve in an amount equal to at least 10% of cash dividends for each accounting period until the reserve equals 50% of stated capital. The legal reserve may be used to reduce a deficit or may be transferred to ordinary shares in connection with a free issue of shares.

Details of the Company's voluntary reserve as of March 31, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	December 31, 2011
Reserve for business rationalization	₩ 12,851	₩ 12,851
Reserve for research and human resource development	60,000	60,000
Reserve for business expansion	698,881	698,881
Other reserve	1,695,000	1,336,000
	<u>₩ 2,466,732</u>	<u>₩ 2,107,732</u>

Reserve for Business Rationalization

Until December 10, 2002, under the Special Tax Treatment Control Law, investment tax credits were allowed for certain investments. The Company was, however, required to appropriate from retained earnings, the amount of tax benefits received, and transfer such amount into a reserve for business rationalization. Effective December 11, 2002, the Company was no longer required to establish a reserve for business rationalization despite tax benefits received for certain investments and, consequently, the existing balance is now regarded as a voluntary reserve.

Reserve for 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.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

Reserve for Business Expansion and other reserve

Reserves without specific purposes are restored to retained earnings by a resolution at a general meeting of shareholders.

21. Retained Earnings

Changes in retained earnings for the three-month period ended March 31, 2012 and the year ended December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012		December 31, 2011	
Beginning	₩	763,738	₩	929,140
Transfer from other reserve		(359,000)		(544,000)
Dividends		(402,396)		(382,946)
Profit for the period		176,188		775,937
Actuarial losses, net of tax		(82)		(14,393)
Ending	₩	<u>178,448</u>	₩	<u>763,738</u>

22. Accounts Payable and Other Finance Liabilities

Accounts payable and other finance liabilities as of March 31, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012		December 31, 2011	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	₩ 29,518	₩ -	₩ 26,628
Accounts payable	43,171	-	20,588	-
Withholdings	6,882	-	4,206	-
Value added tax withheld	112,684	-	114,247	-
Accrued expenses	69,961	-	92,386	-
Other payable	19,222	-	17,549	-
	<u>₩ 251,920</u>	<u>₩ 29,518</u>	<u>₩ 248,976</u>	<u>₩ 26,628</u>

Accounts payable and other finance liabilities carried at amortized cost using the effective interest rate method as of March 31, 2012 and December 31, 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012			December 31, 2011		
	Effective interest rate(%)	Current	Non-current	Effective interest rate(%)	Current	Non-current
Leasehold deposits received	3.00~5.68	₩ -	₩ 29,518	3.00~5.68	₩ -	₩ 26,628

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

23. Borrowings

Details of borrowings as of March 31, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)

	March 31, 2012		December 31, 2011	
Current				
Bank borrowings	₩	6,146	₩	6,975
	₩	6,146	₩	6,975

Details of bank borrowings as of March 31, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)

	Creditor	Latest maturity date	Annual interest rate(%) March 31, 2012	March 31, 2012	December 31, 2011
Korean won	Kookmin Bank, other	Short-term Borrowings	3M CD rate+2.50	₩ 58	₩ 1,507
Korean won	National Agricultural Cooperative Federation	Short-term Borrowings	8.06	5,160	5,468
Korean won	Korea Exchange Bank	Short-term Borrowings	3M CD rate+2.50	928	-
				₩ 6,146	₩ 6,975

24. Defined Benefit Liability

The amounts recognized on the statements of income for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)

	March 31, 2012	March 31, 2011
Defined benefit plans :		
Current service cost	₩ 6,314	₩ 5,733
Interest expenses	1,682	1,524
Expected return on plan assets	(1,263)	(1,118)
	6,733	6,139
Defined contribution plans :		
Pension costs	533	344
Total	₩ 7,266	₩ 6,483

Out of total expenses, ₩2,503 million (2011: ₩2,270 million) and ₩4,763 million (2011: ₩4,213 million) were included in 'cost of sales' and 'selling and administrative expenses', respectively.

Defined benefit liability recognized on the statements of financial position as of March 31, 2012 and December 31, 2011, is as follows:

(in millions of Korean won)

	March 31, 2012	March 31, 2011
Present value of defined benefit liability:	₩ 173,041	₩ 168,419
Fair value of plan assets	(119,552)	(120,779)
Liability on the statement of financial position	₩ 53,489	₩ 47,640

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

25. Classification of Operating Income

(1) Material items of operating income and expense

Operating income is calculated as gross profit net of distribution costs, selling and administrative expenses, and other income and expenses.

(2) Employee benefit costs for the three-month periods ended March 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	March 31, 2011
Salaries	₩ 74,750	₩ 75,690
Retirement benefits	7,266	6,483
Termination benefits	1,194	-
Employee welfare	7,385	7,178
	<u>₩ 90,595</u>	<u>₩ 89,351</u>

(3) Depreciation and amortization for the three-month periods ended March 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	March 31, 2011
Depreciation	₩ 29,461	₩ 25,959
Amortization	5	12
	<u>₩ 29,466</u>	<u>₩ 25,971</u>

(4) Details of other income for the three-month periods ended March 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	March 31, 2011
Foreign currency transaction gain	₩ 987	₩ 580
Foreign currency translation gain	1,096	402
Reversal of impairment loss on trade and other receivables	2	-
Gain on sale of property, plant and equipment	1,359	5,043
Gain on sale of intangible assets	-	605
Others	4,506	2,581
	<u>₩ 7,950</u>	<u>₩ 9,211</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

(5) Selling and administrative expenses for the three-month periods ended March 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	March 31, 2011
Salaries	₩ 49,992	₩ 49,640
Retirement benefits	4,763	4,213
Termination benefits	968	-
Employee welfare	5,021	4,956
Travel	1,580	1,392
Communications	913	961
Utilities	2,639	2,430
Taxes and dues	3,612	3,416
Supplies	595	590
Rent	3,565	3,185
Depreciation	8,495	6,844
Amortization	5	12
Repairs and maintenance	1,367	1,415
Vehicles	2,346	2,053
Insurance	219	216
Commissions	15,344	16,450
Freight and custody	4,376	5,777
Conferences	924	691
Advertising	33,260	30,470
Training	981	1,107
Prizes and rewards	433	108
Normal research and development	3,186	2,600
	<u>₩ 144,584</u>	<u>₩ 138,526</u>

(6) Details of other expenses for the three-month periods ended March 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	March 31, 2011
Foreign currency transaction loss	₩ 2,420	₩ 2,024
Foreign currency translation loss	5,606	11,075
Impairment loss on trade and other receivables	-	52
Donations	2,426	2,155
Loss on sale of property, plant and equipment	13	101
Loss on sale of intangible assets	337	125
Others	568	1,615
	<u>₩ 11,370</u>	<u>₩ 17,147</u>

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

26. Expenses by Nature

Expenses by nature for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)

	March 31, 2012	March 31, 2011
Changes in inventories	₩ 26,849	₩ 12,943
Raw materials and consumables used	156,081	133,227
Salary and wage	74,750	75,690
Retirement and termination benefits	8,460	6,483
Depreciation charges	29,461	25,959
Amortization charges	5	12
Employee benefits	7,385	7,178
Advertising costs	33,287	30,503
Service fees	21,138	21,271
Other expenses	14,859	43,669
Total cost of sales, distribution costs and administrative expenses	₩ 372,275	₩ 356,935

27. Financial Income and Costs

Financial income and costs for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)

	March 31, 2012	March 31, 2011
Financial cost		
Interest costs	₩ (212)	₩ (18)
Loss on sale of available-for-sale financial assets	(9)	-
Impairment loss on available-for-sale financial assets	-	(3,988)
	(221)	(4,006)
Financial income		
Interest income	9,840	7,595
Dividend income	3,677	53,332
Investment income on long-term deposits in MSA Escrow Fund	70	302
Gain on sale of available-for-sale financial assets	-	-
	13,587	61,229
Net financial income	₩ 13,366	₩ 57,223

Details of interest costs for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)

	March 31, 2012	March 31, 2011
Trade and other payables	₩ (212)	₩ 18
	₩ (212)	₩ 18

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

Details of interest income for the three-month periods ended March 31, 2012 and 2011, are as follows:

(in millions of Korean won)

	March 31, 2012	March 31, 2011
Deposits	₩ 6,971	₩ 7,127
Available-for-sale financial assets	5	12
Trade and other receivables	2,864	456
	<u>₩ 9,840</u>	<u>₩ 7,595</u>

28. Income Tax

Income tax expense was calculated based on the best weighted average annual tax rate of corporate for the entire fiscal period. Estimated average annual tax rate of the year ending December 31, 2012, is 24.2%. The estimated tax rate for the three-month period ended March 31, 2011, was 19.2%. The increase in corporate income tax rate is due to 2% increase in tax rate. The increase in corporate tax rate has been applied from January 1, 2012.

29. Earnings per Share

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year excluding ordinary shares purchased by the Company and held as treasury shares (Note 19).

Basic earnings per ordinary share for the three-month periods ended March 31, 2012 and 2011, is as follows:

	March 31, 2012	March 31, 2011
Profit for the year	₩ 176,188 million	₩ 199,211 million
Weighted-average number of ordinary shares outstanding	125,748,800	127,648,800
Basic and diluted earnings per share in won	<u>₩ 1,401</u>	<u>₩ 1,561</u>

30. Dividends

The dividends paid in 2012 were ₩402,396 million.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

31. Cash Generated from Operations

- (1) Cash generated from operations for the three-month periods ended March 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	March 31, 2012	March 31, 2011
Profit	₩ 176,188	₩ 199,211
Adjustments for:		
Income tax expense	56,218	47,320
Finance costs	221	4,006
Finance income	(13,587)	(61,229)
Depreciation	29,461	25,959
Amortization	5	12
Retirement and termination benefits	8,460	6,483
Foreign currency translations loss	5,605	11,075
Loss on the write-down of inventories	143	62
Impairment loss on trade and other receivables	-	52
Loss on sale of property, plant and equipment	13	101
Loss on sale of intangible assets	337	125
Other expense	-	384
Foreign currency translations gain	(1,096)	(402)
Reversal of impairment loss on trade and other receivables	(2)	-
Gain on sale of property, plant and equipment	(1,359)	(5,043)
Gain on sale of intangible assets	-	(605)
	<u>260,607</u>	<u>227,511</u>
Changes in working capital:		
Trade and other receivables	(68,845)	(17,866)
Advance payments	(1,765)	(2,028)
Prepaid expenses	(1,215)	482
Prepaid tobacco excise and other taxes	(20,377)	(45,728)
Inventories	26,706	12,497
Trade and other payables	2,861	4,035
Advance receipts	19,050	(330)
Tobacco excise and other taxes payable	304,274	(3,092)
Payment of retirement benefits	(2,719)	(3,153)
Cash generated from operations	<u>₩ 518,577</u>	<u>₩ 172,328</u>

- (2) Non-cash transactions

<i>(in millions of Korean won)</i>	March 31, 2012
Transfer to retained earnings in voluntary reserves	₩ 359,000
Reclassification of property, plant and equipment to non-current assets held for sale	10,753
Reclassification of construction-in-progress to property, plant and equipment	10,534

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

32. Contingencies

Each year, the Company 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 Company 25 years from the date of each annual funding. The Company recorded as long-term deposits the amounts paid into the MSA Escrow Funds of state governments in the United States against potential litigation and damages related to the export of tobacco into the United States.

As of March 31, 2012, tobacco lawsuits claiming damages of ₩ 584 million are filed against the Company and the Korean government. The amount of the liability the Company may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of March 31, 2012.

As of March 31, 2012, the Company has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 45,000 thousand.

As of March 31, 2012, the Company's trade receivables from the export of cigarettes are insured against non-payment up to USD 36,300 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of March 31, 2012, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD 70,000 thousand by Korea Exchange Bank and others.

As of March 31, 2012, the Company and 28 other companies are guaranteed ₩ 240,000 million by Seoul Guarantee Insurance Co., Ltd. related to the Yongsan International Commercial Development Project.

On March 17, 2011, the Company 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. Following this MOU, the Company entered into a joint investment agreement with Q Capital Partners Co., Ltd. which is a general partner of private equity fund as of November 11, 2011.

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

1) Conditional put option granted to Individual Shareholder

The Company shall be required to purchase Individual Shareholder's shares, in whole or in part, at the agreed price if the following conditions are met:

- Somang Cosmetics Co., Ltd. satisfies all the listing requirements.
- Notwithstanding the written request of Individual Shareholder, Somang Cosmetics Co., Ltd. is not able to undertake the necessary procedures for listing, due to the Company's objection, within three years after the Company acquired Somang Cosmetics Co., Ltd.

2) Right of first refusal held by the 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 Company.

3) Tag-along right held by Individual Shareholder

In the event that the Company proposes to enter into a transaction or a series of related

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

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 Company.

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

1) 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 Science is listed.

2) Right of first refusal held by the 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 Company.

3) Tag-along right held by Individual Shareholder

In the event that the 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 Company.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

33. Related Parties

The subsidiaries and parent companies of subsidiaries as of March 31, 2012, are as follows:

Subsidiaries	Location	Immediate parent companies	Percentage of ownership (%)			
			March 31, 2012		December 31, 2011	
			Parent companies	Subsidiaries	Parent companies	Subsidiaries
Korea Ginseng Corporation	Korea	KT&G	100.00	-	100.00	-
Yungjin Pharm. Ind. Co., Ltd.	Korea	KT&G	53.00	-	53.00	-
Tae-a industry Co., Ltd.	Korea	KT&G	100.00	-	100.00	-
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	KT&G	99.99	-	99.99	-
Korea Tabacos do Brasil Ltda.	Brazil	KT&G	99.90	-	99.90	-
KT&G Pars	Iran	KT&G	99.99	-	99.99	-
KT&G Rus L.L.C.	Russia	KT&G	100.00	-	100.00	-
KG Life & Gin Co., Ltd	Korea	KT&G	100.00	-	100.00	-
KT&G Bio Corp.	Korea	KT&G	100.00	-	100.00	-
Global Trading, Inc.	USA	KT&G	100.00	-	100.00	-
Jilin Hanzheng Ginseng Co., Ltd.	China	KT&G	100.00	-	100.00	-
Somang Cosmetics Co., Ltd. ¹	Korea	KT&G	50.00	-	60.00	-
Rosee Cosmetics Co., Ltd.	Korea	Somang Cosmetics Co., Ltd.	-	100.00	-	100.00
Renzoluc Pte., Ltd.	Singapore	KT&G	100.00	-	100.00	-
PT Trisakti Purwosari Makmur	Indonesia	Renzoluc Pte., Ltd.	-	51.00	-	51.00
PT Sentosa Ababi Purwosari	Indonesia	PT Trisakti Purwosari Makmur	-	99.24	-	99.24
PT Purindo Ilufa	Indonesia	PT Trisakti Purwosari Makmur	-	100.00	-	100.00
KT&G Life science ¹	Korea	KT&G	59.48	-	59.48	-
Yebon Nongwon	Korea	KT&G	90.00	-	90.00	-
KGC Yebon ²	Korea	KT&G	100.00	-	-	-
Cheong Kwan Jang Taiwan Corporation	Taiwan	Korea Ginseng Corporation	-	100.00	-	100.00
Korean Red Ginseng Corp., Inc.	USA	Korea Ginseng Corporation	-	100.00	-	100.00
Korea Ginseng (China) Corp.	China	Korea Ginseng Corporation	-	100.00	-	100.00
Korea Ginseng Corporation Japan	Japan	Korea Ginseng Corporation	-	100.00	-	100.00

¹ The Company's percentage of ownership includes convertible preference shares. As of March 31, 2012, the Company's percentage of ownership excluding convertible preference shares, is 60.00% and 73.94%, respectively.

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

² During the three-month period ended March 31, 2012, there has been no change in consolidation scope, except for KGC Yebon being included in the consolidation.

Transactions with related parties for the three-month periods ended March 31, 2012 and 2011, are as follows:

<i>(In millions of Korean won)</i>	March 31, 2012		March 31, 2011	
Sales and other income				
Korea Ginseng Corporation	₩	1,573	₩	1,074
Yungjin Pharm. Ind. Co., Ltd.		37		72
Tae-a industry Co., Ltd.		-		2
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		1,024		1,476
KT&G Pars		1,884		2,373
KT&G Rus L.L.C.		3,944		4,469
KGC Life & Gin Co., Ltd		272		170
Global Trading, Inc.		9,077		8,268
Purpleland Development Co., Ltd.		-		7
Jilin Hanzheng Ginseng Co., Ltd.		83		-
Somang Cosmetics Co., Ltd.		6		-
	₩	17,900	₩	17,911
Purchases and other expenses				
Korea Ginseng Corporation	₩	235	₩	413
Yungjin Pharm. Ind. Co., Ltd.		3		3
Tae-a industry Co., Ltd.		4,472		3,438
KGC Life & Gin Co., Ltd		248		-
Somang Cosmetics Co., Ltd.		18		-
	₩	4,976	₩	3,854

The Company has received dividends from subsidiaries. During the three-month period ended March 31, 2012, there were no dividends received from Korea Ginseng Corp.

Dividends received in the three-month period ended March 31, 2011, amounted to ₩50,000 million. These dividends were recognized as financial income.

Details of related party receivables and liabilities as of March 31, 2012 and December 31, 2011, are as follows:

<i>(In millions of Korean won)</i>	March 31, 2012		December 31, 2011	
Receivables from related parties				
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	₩	23,224	₩	23,084
KT&G Pars		32,689		30,499
KT&G Rus L.L.C.		28,275		41,031
Global Trading, Inc.		13,950		14,574
Renzoluc Pte., Ltd.		64,476		64,045
Jilin Hanzheng Ginseng Co., Ltd.		9,059		9,084
Somang Cosmetics Co., Ltd.		2		2
	₩	171,675	₩	182,319
Payables to related parties				
Korea Ginseng Corporation	₩	2,702	₩	2,414
KGC Life & Gin Co., Ltd		23		192
	₩	2,725	₩	2,606

KT&G Corporation
Notes to Interim Separate Financial Statements
March 31, 2012 and 2011, and December 31, 2011

The compensation paid or payable to key management for employee services for the three-month periods ended March 31, 2012 and 2011, consists of:

(in millions of Korean won)

	March 31, 2012	March 31, 2011
Short-term employee benefits	₩ 3,890	₩ 3,680
Retirement benefits	582	298
	<u>₩ 4,472</u>	<u>₩ 3,978</u>

34. Basis of Translating Financial Statements

The financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩ 1,137.80 to \$1, the basic exchange rate on March 31, 2012, 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.