

**KT&G Corporation and Subsidiaries**  
**Interim Consolidated Financial Statements**  
**June 30, 2013 and 2012**

**KT&G Corporation and Subsidiaries**  
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**June 30, 2013 and 2012**

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## Report on Review Interim Financial Statements

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

### ***Reviewed Financial Statements***

We have reviewed the accompanying interim consolidated financial statements KT&G Corporation and its subsidiaries (collectively the "Group"). These financial statements consist of the statement of financial position of the Group as of June 30, 2013, and the related consolidated statements of comprehensive income for the three-month and six-month periods ended June 30, 2013 and 2012, and statements of changes in equity and cash flows for the six-month periods ended June 30, 2013 and 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 consolidated financial statements in accordance with the International Financial Reporting Standards as adopted by the Republic of Korea ("Korean IFRS") 1034, *Interim Financial Reporting*, and for such internal controls as management determines are 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 interim consolidated financial statements based on our reviews.

We conducted our reviews in accordance with the quarterly and semi-annual 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 reviews, nothing has come to our attention that causes us to believe the accompanying interim consolidated financial statements do not present fairly, in all material respects, in accordance with the Korean IFRS 1034, *Interim Financial Reporting*.

### **Other Matters**

We have audited the consolidated statement of financial position of KT&G Corporation as of December 31, 2012, and the related consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, in accordance with auditing standards generally accepted in the Republic of Korea. We expressed an unqualified opinion on those financial statements in our audit report dated February 5, 2013. These financial statements are not included in this review report. The consolidated statement of financial position as of December 31, 2012, presented herein for comparative purposes, is consistent, in all material respects, with the above audited consolidated statement of financial position as of December 31, 2012.

The accompanying interim consolidated financial statements as of and for the three-month and six-month periods ended June 30, 2013, have been translated into US dollars solely for the convenience of the reader and have been translated on the basis set forth in Note 35 to the interim consolidated 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.

*Samuel PricewaterhouseCoopers*

Seoul, Korea

August 9, 2013

This report is effective as of August 9, 2013, 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 consolidated 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 any.

**KT&G Corporation and Subsidiaries**  
**Interim Consolidated Statements of Financial Position**  
**June 30, 2013 and December 31, 2012**

<i>(in millions of Korean won and thousands of U.S. dollars)</i>	<b>Notes</b>	<b>June 30, 2013</b> Korean won	<b>June 30, 2013</b> U.S. dollars (Note 35)	<b>December 31, 2012</b> Korean won
<b>Assets</b>				
<b>Non-current assets</b>				
Property, plant and equipment	10,14	₩ 1,626,174	\$ 1,414,433	₩ 1,631,436
Intangible assets	11	246,673	214,554	246,793
Investment property	12,14	176,947	153,907	181,986
Investments in associates	5,15	54,221	47,161	55,778
Available-for-sale financial assets	4,6,7	242,214	210,676	263,884
Other financial assets	6,17	300	261	275
Long-term deposits in MSA Escrow Fund	4,6,9,33	207,862	180,796	168,667
Long-term advance payments	33	154,782	134,628	144,649
Long-term prepaid expenses		6,429	5,592	5,416
Long-term trade and other receivables	4,6,8	117,329	102,052	121,784
Deferred income tax assets		19,522	16,980	17,490
		<u>2,852,453</u>	<u>2,481,040</u>	<u>2,838,158</u>
<b>Current assets</b>				
Inventories	16	1,647,465	1,432,952	1,706,796
Available-for-sale financial assets	6,7	1,000	870	1,000
Other financial assets	4,6,17	230,010	200,061	649,186
Derivatives assets	4,6	52	45	-
Prepaid tobacco excise and other taxes		255,132	221,912	257,183
Trade and other receivables	4,6,8	922,796	802,640	883,778
Advance payments	33	135,455	117,817	66,315
Prepaid expenses		26,704	23,227	20,523
Cash and cash equivalents	4,6,17	991,429	862,337	372,261
		<u>4,210,043</u>	<u>3,661,861</u>	<u>3,957,041</u>
<b>Assets held for sale</b>	5,13	520	452	762
<b>Total assets</b>		<u>₩ 7,063,016</u>	<u>\$ 6,143,353</u>	<u>₩ 6,795,961</u>
<b>Equity</b>				
Capital stock	1,18	₩ 954,959	\$ 830,616	₩ 954,959
Other capital surplus		(4,573)	(3,977)	(4,573)
Treasury shares	19	(339,059)	(294,911)	(339,059)
Gain on reissuance of treasury shares	19	492,032	427,966	492,032
Reserve	20	3,359,776	2,922,306	3,011,110
Retained earnings	21	625,345	543,920	976,425
<b>Equity attributable to equity holders of the Parent Company</b>		<u>5,088,480</u>	<u>4,425,920</u>	<u>5,090,894</u>
<b>Non-controlling interests</b>		<u>98,543</u>	<u>85,712</u>	<u>103,524</u>
<b>Total equity</b>		<u>5,187,023</u>	<u>4,511,632</u>	<u>5,194,418</u>
<b>Liabilities</b>				
<b>Non-current liabilities</b>				
Long-term borrowings	4,6,23	120,346	104,676	109,599
Long-term trade and other payables	4,6,22	27,511	23,929	25,407
Long-term advance receipts		17,743	15,433	20,239
Defined benefit liability	24	132,866	115,565	107,644
Provisions for other liabilities and charges		3,130	2,723	3,329
Deferred income tax liabilities		237,210	206,319	237,605
		<u>538,806</u>	<u>468,645</u>	<u>503,823</u>
<b>Current liabilities</b>				
Borrowings	4,6,23	64,398	56,013	91,868
Current portion of long-term borrowings	4,6,23	2,897	2,520	2,912
Trade and other payables	4,6,22	457,924	398,299	410,216
Advance receipts		29,763	25,888	30,875
Income taxes payable		150,774	131,142	148,925
Tobacco excise and other taxes payable		631,431	549,214	412,924
		<u>1,337,187</u>	<u>1,163,076</u>	<u>1,097,720</u>
<b>Total liabilities</b>		<u>1,875,993</u>	<u>1,631,721</u>	<u>1,601,543</u>
<b>Total liabilities and equity</b>		<u>₩ 7,063,016</u>	<u>\$ 6,143,353</u>	<u>₩ 6,795,961</u>

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

The US dollar figures are provided for information purposes only and do not form part of the interim consolidated financial statements. Refer to Note 35.

**KT&G Corporation and Subsidiaries**  
**Interim Consolidated Statements of Comprehensive Income**  
**Three-Month Periods Ended June 30, 2013 and 2012**

(in millions of Korean won and thousands of U.S. dollars, except per share amounts)	Notes	Period Ended June 30		
		2013 Korean won	2013 U.S. dollars (Note 35)	2012 Korean won
<b>Sales</b>	5	₩ 914,520	\$ 795,442	₩ 1,005,441
<b>Cost of sales</b>	27	(401,057)	(348,836)	(441,642)
<b>Gross profit</b>		513,463	446,606	563,799
Selling and administrative expenses	25,27	(264,759)	(230,285)	(292,129)
<b>Operating income</b>		248,704	216,321	271,670
Other income	26	35,884	31,212	24,360
Other expenses	26	(21,714)	(18,887)	(9,154)
<b>Net other income</b>		14,170	12,325	15,206
Finance income	28	8,632	7,508	8,716
Finance cost	28	(5,925)	(5,153)	(1,489)
<b>Net Finance income</b>		2,707	2,355	7,227
Income from jointly controlled entities and associates	15	670	583	459
Expense from jointly controlled entities and associates	15	(105)	(92)	(283)
<b>Profit before income tax</b>		266,146	231,492	294,279
Income tax expense	29	(73,468)	(63,902)	(83,738)
<b>Profit for the period</b>		₩ 192,678	\$ 167,590	₩ 210,541
<b>Other comprehensive income(loss), net of tax</b>				
<b>Items that will not be reclassified to profit or loss:</b>				
Remeasurements of the net defined benefit liability	24	1,214	1,056	81
<b>Items that will be reclassified subsequently to profit or loss:</b>				
Change in value of available-for-sale financial assets	7	₩ (13,907)	\$ (12,096)	₩ (14,158)
Gain on currency translation of foreign operations		980	853	(10,685)
<b>Other comprehensive income for the period, net of tax</b>		(11,713)	(10,187)	(24,762)
<b>Total comprehensive income for the period</b>		₩ 180,965	\$ 157,403	₩ 185,779
<b>Profit for the period attributable to:</b>				
Equity holders of the Parent Company		₩ 195,135	\$ 169,727	₩ 214,380
Non-controlling interests		(2,457)	(2,137)	(3,840)
<b>Total comprehensive income for the period attributable to:</b>		₩ 192,678	\$ 167,590	₩ 210,540
Equity holders of the Parent Company		₩ 182,243	\$ 158,515	₩ 189,615
Non-controlling interests		(1,278)	(1,112)	(3,836)
<b>Earnings per share attributable to the equity holders of the Parent Company during the period (in won)</b>				
Basic and diluted earnings per share	30	₩ 1,550	\$ 1	₩ 1,705

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**KT&G Corporation and Subsidiaries**  
**Interim Consolidated Statements of Comprehensive Income**  
**Six-Month Periods Ended June 30, 2013 and 2012**

(in millions of Korean won and thousands of U.S. dollars, except per share amounts)	Notes	Period Ended June 30		
		2013 Korean won	2013 U.S. dollars (Note 35)	2012 Korean won
<b>Sales</b>	5	₩ 1,810,557	\$ 1,574,809	₩ 1,967,002
<b>Cost of sales</b>	27	(777,801)	(676,525)	(871,678)
<b>Gross profit</b>		1,032,756	898,284	1,095,324
Selling and administrative expenses	25,27	(535,226)	(465,536)	(557,710)
<b>Operating income</b>		497,530	432,748	537,614
Other income	26	81,091	70,532	37,385
Other expenses	26	(32,208)	(28,014)	(30,005)
<b>Net other income</b>		48,883	42,518	7,380
Finance income	28	21,529	18,725	21,488
Finance cost	28	(20,982)	(18,250)	(5,427)
<b>Net Finance income</b>		547	475	16,061
Income from jointly controlled entities and associates	15	1,081	944	1,746
Expense from jointly controlled entities and associates	15	(1,098)	(955)	(448)
<b>Profit before income tax</b>		546,943	475,730	562,353
Income tax expense	29	(155,916)	(135,617)	(165,557)
<b>Profit for the period</b>		₩ 391,027	\$ 340,113	₩ 396,796
<b>Other comprehensive income(loss), net of tax</b>				
<b>Items that will not be reclassified to profit or loss:</b>				
Remeasurements of the net defined benefit liability	24	1,032	899	(97)
<b>Items that will be reclassified subsequently to profit or loss:</b>				
Change in value of available-for-sale financial assets	7	₩ (5,056)	\$ (4,397)	₩ 6,167
Gain on currency translation of foreign operations		7,428	6,460	(3,518)
<b>Other comprehensive income for the period, net of tax</b>		3,404	2,962	2,552
<b>Total comprehensive income for the period</b>		₩ 394,431	\$ 343,075	₩ 399,348
<b>Profit for the period attributable to:</b>				
Equity holders of the Parent Company		₩ 398,234	\$ 346,381	₩ 405,201
Non-controlling interests		(7,207)	(6,268)	(8,406)
		₩ 391,027	\$ 340,113	₩ 396,795
<b>Total comprehensive income for the period attributable to:</b>				
Equity holders of the Parent Company		₩ 400,462	\$ 348,320	₩ 407,752
Non-controlling interests		(6,031)	(5,245)	(8,405)
		₩ 394,431	\$ 343,075	₩ 399,347
<b>Earnings per share attributable to the equity holders of the Parent Company during the period (in won)</b>				
Basic and diluted earnings per share	30	₩ 3,163	\$ 3	₩ 3,222

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**KT&G Corporation and Subsidiaries**  
**Interim Consolidated Statements of Changes in Equity**  
**Six-Month Periods Ended June 30, 2013 and 2012**

	Attributable to equity holders of the Parent Company								
	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total	Non-controlling Interests	Total Equity
<i>(in millions of Korean won)</i>									
<b>Balance at January 1, 2012</b>	₩ 954,959	₩ 5,333	₩ (343,522)	₩ 485,922	₩ 2,663,313	₩ 1,022,126	₩ 4,788,131	₩ 96,947	₩ 4,885,078
<b>Comprehensive income</b>									
Profit for the period	-	-	-	-	-	405,201	405,201	(8,406)	396,795
Change in value of available-for-sale financial assets	-	-	-	-	6,167	-	6,167	-	6,167
Loss on currency translation of foreign operations	-	-	-	-	(3,518)	-	(3,518)	-	(3,518)
Remeasurements of the net defined benefit liability	-	-	-	-	-	(98)	(98)	1	(97)
<b>Total comprehensive income (loss)</b>	-	-	-	-	2,649	405,103	407,752	(8,405)	399,347
<b>Transactions with equity holders of the Parent Company</b>									
Cash dividends	-	-	-	-	-	(402,396)	(402,396)	-	(402,396)
Other reserve	-	-	-	-	359,000	(359,000)	-	-	-
Convertible bond – equity component	-	-	-	-	-	-	-	5,390	5,390
Others	-	-	-	-	-	(3,328)	(3,328)	4,429	1,101
<b>Total transactions with equity holders of the Parent Company</b>	-	-	-	-	359,000	(764,724)	(405,724)	9,819	(395,905)
<b>Balance at June 30, 2012</b>	₩ 954,959	₩ 5,333	₩ (343,522)	₩ 485,922	₩ 3,024,962	₩ 662,505	₩ 4,790,159	₩ 98,361	₩ 4,888,520
<b>Balance at January 1, 2013</b>	₩ 954,959	₩ (4,573)	₩ (339,059)	₩ 492,032	₩ 3,011,110	₩ 976,425	₩ 5,090,894	₩ 103,524	₩ 5,194,418
<b>Comprehensive income</b>									
Profit for the period	-	-	-	-	-	398,234	398,234	(7,207)	391,027
Change in value of available-for-sale financial assets	-	-	-	-	(5,056)	-	(5,055)	-	(5,056)
Gain on currency translation of foreign operations	-	-	-	-	6,722	-	6,722	706	7,428
Remeasurements of the net defined benefit liability	-	-	-	-	-	562	562	470	1,032
<b>Total comprehensive income (loss)</b>	-	-	-	-	1,666	398,796	400,463	(6,031)	394,431
<b>Transactions with equity holders of the Parent Company</b>									
Cash dividends	-	-	-	-	-	(402,876)	(402,876)	-	(402,876)
Other reserve	-	-	-	-	317,000	(317,000)	-	-	-
Transfer from reserve for research and human resource development	-	-	-	-	30,000	(30,000)	-	-	-
Acquisition of investments in subsidiaries	-	-	-	-	-	-	-	1,050	1,050
<b>Total transactions with equity holders of the Parent Company</b>	-	-	-	-	347,000	(749,876)	(402,876)	1,050	(401,826)
<b>Balance at June 30, 2013</b>	₩ 954,959	₩ (4,573)	₩ (339,059)	₩ 492,032	₩ 3,359,776	₩ 625,345	₩ 5,088,481	₩ 98,543	₩ 5,187,023

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



**KT&G Corporation and Subsidiaries**  
**Interim Consolidated Statements of Changes in Equity**  
**Six-Month Periods Ended June 30, 2013 and 2012**

Attributable to equity holders of the Parent Company

(in thousands of U.S. dollars) (Note 35)

	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total	Non-controlling Interests	Total Equity
<b>Balance at January 1, 2013</b>	\$ 830,616	\$ (3,977)	\$ (294,911)	\$ 427,966	\$ 2,619,039	\$ 849,286	\$ 4,428,019	\$ 90,044	\$ 4,518,063
<b>Comprehensive income</b>									
Profit for the period	-	-	-	-	-	346,381	346,381	(6,268)	340,113
Change in value of available-for-sale financial assets	-	-	-	-	(4,397)	-	(4,397)	-	(4,397)
Gain on currency translation of foreign operations	-	-	-	-	5,846	-	5,846	614	6,460
Remeasurements of the net defined benefit liability	-	-	-	-	-	490	490	409	899
<b>Total comprehensive income (loss)</b>	-	-	-	-	1,449	346,871	348,320	(5,245)	343,075
<b>Transactions with equity holders of the Parent Company</b>									
Cash dividends	-	-	-	-	-	(350,419)	(350,419)	-	(350,419)
Other reserve	-	-	-	-	275,724	(275,724)	-	-	-
Transfer from reserve for research and human resource development	-	-	-	-	26,094	(26,094)	-	-	-
Acquisition of investments in subsidiaries	-	-	-	-	-	-	-	913	913
<b>Total transactions with equity holders of the Parent Company</b>	-	-	-	-	301,818	(652,237)	(350,419)	913	(349,506)
<b>Balance at June 30, 2013</b>	\$ 830,616	\$ (3,977)	\$ (294,911)	\$ 427,966	\$ 2,922,306	\$ 543,920	\$ 4,425,920	\$ 85,712	\$ 4,511,632

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**KT&G Corporation and Subsidiaries**  
**Interim Consolidated Statements of Cash Flows**  
**Six-Month Periods Ended June 30, 2013 and 2012**

(in millions of Korean won and thousands of U.S. dollars)	Notes	Period Ended June 30		
		2013 Korean won	2013 U.S. dollars (Note 35)	2012 Korean won
<b>Cash flows from operating activities</b>				
Cash generated from operations	32	₩ 866,614	\$ 753,774	₩ 985,865
Income tax paid		(154,120)	(134,052)	(168,287)
<b>Net cash generated from operating activities</b>		<u>712,494</u>	<u>619,722</u>	<u>817,578</u>
<b>Cash flows from investing activities</b>				
Interest received		16,555	14,400	19,001
Investment income received from long-term deposits in MSA Escrow Fund		400	348	407
Dividends received		6,206	5,398	5,440
Proceeds from sale of property, plant and equipment		5,286	4,598	19,601
Proceeds from sale of intangible assets		334	290	781
Proceeds from sale of non-current asset held for sale		6,182	5,377	
Proceeds from sale of available-for-sale financial assets		-	-	233
Decrease in loans		6,011	5,228	13,355
Decrease in guarantee deposits		13,270	11,542	49,106
Acquisition of property, plant and equipment		(72,682)	(63,218)	(97,488)
Acquisition of intangible assets		(2,693)	(2,342)	(2,880)
Acquisition of investment property		(1,421)	(1,236)	-
Acquisition of jointly controlled entities and associates		-	-	(11,500)
Acquisition of available-for-sale financial assets		-	-	(11,500)
Increase in loans		(20,015)	(17,409)	(1,167)
Increase in guarantee deposits		(14,873)	(12,936)	(45,626)
Increase in long-term deposits in MSA Escrow Fund		(26,123)	(22,721)	1
Increase (Decrease) in other financial assets		419,413	364,802	(521,741)
<b>Net cash provided by (used in) investing activities</b>		<u>335,850</u>	<u>292,121</u>	<u>(583,977)</u>
<b>Cash flows from financing activities</b>				
Interest paid		(323)	(281)	(7,491)
Dividends paid		(402,876)	(350,419)	(402,396)
Proceeds from borrowings		60,585	52,696	137,184
Increase in deposits received		2,733	2,377	5,157
Repayments of borrowings		(86,479)	(75,219)	(113,198)
Decrease in deposits received		(2,919)	(2,539)	(3,241)
<b>Net cash used in financing activities</b>		<u>(429,279)</u>	<u>(373,385)</u>	<u>(383,985)</u>
<b>Net increase (decrease) in cash and cash equivalents</b>		619,065	538,458	(150,384)
<b>Cash and cash equivalents at the beginning of period</b>		372,260	323,789	807,731
<b>Exchange gains on cash and cash equivalents</b>		104	90	(163)
<b>Cash and cash equivalents at the end of period</b>		<u>₩ 991,429</u>	<u>\$ 862,337</u>	<u>₩ 657,184</u>

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# **KT&G Corporation and Subsidiaries**

## **Notes to Interim Consolidated Financial Statements**

### **June 30, 2013 and 2012, and December 31, 2012**

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#### **1. General Information**

General information about KT&G Corporation (the “Parent Company”) and its subsidiaries (collectively referred to “the Group”) is as follows.

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

As of June 30, 2013, the Parent Company has two manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 135 branches for the sale of tobacco throughout the country. Also, the Parent Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Parent Company is located in Pyeongchon-dong, Daedeok-gu, Daejeon.

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

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

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The ownership of the Parent Company's issued ordinary shares as of June 30, 2013, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee share ownership association	2,622,646	2.17%
Others	113,765,669	82.86%
	125,898,800	91.70%
Treasury shares	11,393,697	8.30%
	137,292,497	100.00%

The Parent Company's consolidated subsidiaries as of June 30, 2013, are as follows:

Immediate Parent	Subsidiaries	Location	Percentage of ownership (%) June 30, 2013
KT&G Corporation	Korea Ginseng Corporation	Korea	100.00
	Yungjin Pharm. Ind. Co., Ltd.	Korea	53.00
	Tae-a Industry Co., Ltd.	Korea	100.00
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Turkey	99.99
	Korea Tabacos do Brasil Ltda.	Brazil	99.90
	KT&G Pars	Iran	99.99
	KT&G Rus L.L.C.	Russia	100.00
	KG Life & Gin Co., Ltd	Korea	100.00
	Global Trading, Inc.	USA	100.00
	Jilin Hanzheng Ginseng Co., Ltd.	China	100.00
	Somang Cosmetics Co., Ltd. <sup>1</sup>	Korea	60.00
	Renzoluc Pte., Ltd. <sup>2</sup>	Singapore	100.00
	KT&G Life Science <sup>3</sup>	Korea	73.94
	Yebon Nongwon Agriculture Co., Ltd	Korea	90.00
	KGC Yebon	Korea	100.00
	K-Q HongKong I,Limited <sup>4</sup>	Hong Kong	100.00
	Renzoluc Pte., Ltd.	PT KT&G Indonesia	Indonesia
PT Trisakti Purwosari Makmur		Indonesia	60.17
PT Trisakti Purwosari Makmur	PT Mandiri Maha Mulia	Indonesia	66.47
	PT Sentosa Ababi Purwosari	Indonesia	99.24
Korea Ginseng Corporation	PT Purindo Ilufa	Indonesia	100.00
	Cheong Kwan Jang Taiwan Corporation	Taiwan	100.00
	Korean Red Ginseng Corp., Inc.	USA	100.00
	Korea Ginseng (China) Corp.	China	100.00
	Korea Ginseng Corporation Japan	Japan	100.00
	PT CKJ INDONESIA	Indonesia	99.88

<sup>1</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2013, the Group's percentage of ownership would be 50.00% if convertible preferred shares are included.

<sup>2</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2013, the Group's percentage of ownership would be 68.91% if convertible preferred shares are included.

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<sup>3</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2013, the Group's percentage of ownership would be 59.48% if convertible preferred shares are included.

<sup>4</sup> The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2013, the Group's percentage of ownership would be 50.00% if convertible preferred shares are included.

Summarized financial information of subsidiaries as of June 30, 2013, and for the six-month period ended June 30, 2013, is as follows:

*(In millions of Korean won)*

Subsidiaries	Total assets	Total liabilities	Revenue	Profit (loss)	Total comprehensive income(loss)
Korea Ginseng Corporation	₩ 1,317,257	₩ 110,328	₩ 382,902	₩ 50,691	₩ 50,688
Yungjin Pharm. Ind. Co., Ltd.	173,847	76,237	80,296	5,540	6,541
Tae-a industry Co., Ltd.	15,290	3,407	7,402	437	434
KT&G Tutun Mamulleri Sanayive Ticaret A.S.	53,211	37,737	7,323	(5,719)	(5,587)
Korea Tabacos do Brasil Ltda.	1,099	11	-	-	-
KT&G Pars	42,441	42,270	5,564	43	43
KT&G Rus L.L.C.	151,112	44,823	12,306	2,540	1,762
KG Life & Gin Co., Ltd.	29,057	6,783	20,901	(8,571)	(8,568)
Global Trading, Inc.	35,352	27,935	104,528	110	614
Jilin Hanzheng Ginseng Co., Ltd.	71,502	45,582	-	(2,245)	(72)
Somang Cosmetics Co., Ltd.	77,598	68,078	42,010	(13,399)	(13,399)
Renzoluc Pte., Ltd.	114,686	60,889	-	163	3,836
KT&G Life science	36,439	14,729	83	(2,832)	(2,832)
Yebon Nongwon Agriculture Co., Ltd.	98	-	-	(3)	(3)
KGC Yebon	42,471	829	761	(799)	(791)
PT Trisakti Purwosari Makmur	126,390	87,992	21,600	(5,541)	(3,871)
Cheong Kwan Jang Taiwan Corporation	18,554	20,319	8,062	(1,736)	(1,788)
Korean Red Ginseng Corp., Inc.	8,639	5,405	5,152	(175)	52
Korea Ginseng (China) Corp.	40,192	31,102	14,834	(1,254)	(475)
Korea Ginseng Corporation Japan	4,008	2,826	1,350	(667)	(802)
K-Q HongKong I,Limited	38,404	-	-	1,424	4,008
PT CKJ INDONESIA	3,086	2,351	2,095	(109)	(77)
PT KT&G Indonesia	10,827	8,020	132	(1,078)	(939)
PT Mandiri Maha Mulia	5,325	2,504	14	(309)	(188)

For the six-month period ended June 30, 2013, there has been no change in consolidation scope, except for PT KT&G INDONESIA and PT Mandiri Maha Mulia which were included in the consolidation.

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## 2. Significant Accounting Policies

The principal accounting policies applied in the preparation of these consolidated 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

This condensed consolidated interim financial information as of and for the three-month and six-month periods ended June 30, 2013, has been prepared in accordance with Korean IFRS 1034, Interim financial reporting. The principles used in the preparation of these financial statements are based on Korean IFRS and interpretations effective as of June 30, 2013, or early adopted.

#### (a) *New and amended standards adopted by the Group*

The Group newly applied the following amended and enacted standards for the annual period beginning on January 1, 2013:

- Amendment to Korean IFRS 1001, *Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income*

The amendment requires the entities to group items presented in other comprehensive income based on whether they are potentially reclassified to profit or loss subsequently. The Group applies the amendment retroactively. There is no material impact on its total comprehensive income due to the retrospective application of changes in these accounting policies.

- Amendments to Korean IFRS 1019, *Employee Benefits*

The amendment requires all actuarial gains and losses incurred to be recognized immediately in other comprehensive income. In addition, all past service costs incurred from changes in pension plan are immediately recognized, and expected returns on interest costs and plan assets that used to be separately calculated are now changed to calculating net interest expense (income) by applying discount rate used in measuring defined benefit liability in net defined benefit liabilities (assets). There is no material impact on the consolidated financial statements due to application of the amendment.

- Enactment of Korean IFRS 1110, *Consolidated Financial Statements*

Korean IFRS 1110 explains the principle of control which is the basis for determining which entities are consolidated in the consolidated financial statements. There are no changes in consolidation scope of the Group due to adoption of Korean IFRS 1110.

- Enactment of Korean IFRS 1111, *Joint Arrangements*

Korean IFRS 1111, *Joint Arrangements*, aims to reflect the substance of joint arrangements by focusing on the contractual rights and obligations that each party to the arrangement has rather than its legal form. Joint arrangements are classified as either joint operations or joint ventures. There are no changes in accounting treatment due to adoption of Korean IFRS 1111 of the Group.

- Enactment of Korean IFRS 1112, *Disclosures of Interests in Other Entities*

Korean IFRS 1112, *Disclosure of Interests in Other Entities*, provides disclosure requirements for all types of equity investments in other entities including subsidiaries, associates, joint ventures and unconsolidated structured entities.

- Enactment of Korean IFRS 1027, *Separate Financial Statements*

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Korean IFRS 1027 prescribes the accounting for investments in subsidiaries, associates and joint ventures of the Parent Company in the separate financial statements.

- Enactment of Korean IFRS 1113, *Fair Value Measurement*

Korean IFRS 1113, *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. This enactment is prospectively applied for annual periods beginning on or after January 1, 2013, and does not have any material impact on its consolidated financial statements.

## 2.2 Consolidation

Significant accounting policies and methods adopted in the preparation of the interim consolidated financial statements are consistent with the accounting policies and method adopted for the annual financial statements for the year ended December 31, 2012, except as changes due to the application of amendment and enactments of standards described in Note 2.1(a) and described below.

### (a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases. The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is measured as the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Group.

The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Group recognizes any non-controlling interest in the acquiree on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognized amounts of acquiree's identifiable net assets.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred and the fair value of non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss. Intercompany transactions, balances, income and expenses on transactions between the Group companies are eliminated. Unrealized losses are also eliminated after recognizing impairment of transferred assets.

### (b) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting. Under the equity method, the investment is initially recognized at cost, and the carrying amount is increased or decreased to recognize the investor's share of the profit or loss of the investee after the date of acquisition. The Group's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

The Group's share of post-acquisition profit or loss is recognized in the statement of comprehensive income, and its share of post-acquisition movements in other comprehensive

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income is recognized in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group. Dilution gains and losses arising in investments in associates are recognized in the statement of comprehensive income.

#### *(c) Joint ventures*

A joint venture is a contractual arrangement whereby two or more parties (co-venturers) exercise joint control. As with associates, investments in jointly controlled entities are accounted for using the equity method of accounting and are initially recognized at cost. The Group's investment in jointly controlled entities includes goodwill identified on acquisition, net of accumulated impairment loss.

#### *(d) Transactions with non-controlling interest*

Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions; that is, as transactions with the owners in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

## **2.3 Segment Reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker (Note 5). The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the steering committee that makes strategic decisions. Operating segments for the consolidation reporting consist of tobacco, ginseng, real estate and others.

## **2.4 Foreign Currency Translation**

#### *(a) Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated 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 statement of comprehensive income, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

Foreign exchange gains and losses are presented in the statement of comprehensive income within 'other income and expenses'.



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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.

#### *(c) Translation to presentation currency*

The results and financial position of all Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing rate at the end of the reporting period;
- income and expenses for each statement of comprehensive income are translated at average exchange rates; and
- all resulting exchange differences are recognized in other comprehensive income.

Exchange differences arising from the translation of borrowings designated for hedging the investment and other currency instruments are recognized in other comprehensive income. When foreign operations are wholly or partially sold, exchange differences recognized in equity are transferred to profit or loss in the statement of comprehensive income. When the Group ceases to control the subsidiary, exchange differences that were recorded in equity are recognized in the statement of comprehensive income as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

## **2.5 Cash and Cash Equivalents**

Cash and cash equivalents include cash on 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 Instruments**

### 2.6.1 Classification

The Group classifies its financial instruments in the following categories: financial assets and liabilities at fair value through profit or loss, loans and receivables, available-for-sale financial assets, held-to-maturity financial assets and financial liabilities carried at amortized cost. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial instruments at initial recognition.

#### *(a) Financial assets and liabilities at fair value through profit or loss*

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

#### *(b) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that

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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 Group's loans and receivables comprise 'cash and cash equivalents' and 'trade and other receivables' in the statement of financial position.

#### *(c) 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 them within 12 months after the end of the reporting period.

#### *(d) Financial liabilities carried at amortized cost*

The Group classifies non-derivative financial liabilities, except for financial liabilities at fair value through profit or loss, financial guarantee contracts and financial assets that arise when a transfer of financial liabilities at fair value through profit or loss, financial guarantee contracts and financial assets does not qualify for derecognition, as financial liabilities carried at amortized cost. In case when a transfer of a financial asset does not qualify for derecognition, the transferred asset is continuously recognized as asset and the consideration received is recognized as financial liabilities. Financial liabilities carried at amortized cost are included in non-current liabilities, except for liabilities with maturities within 12 months after the end of the reporting period, which are classified as current liabilities.

### **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 statement of comprehensive income. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Group 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.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the statement of comprehensive income as 'finance income and cost'.

Interest on available-for-sale and held-to-maturity securities calculated using the effective interest method is recognized in the statement of comprehensive income as part of 'finance income'. Dividends on available-for-sale equity instruments are recognized in the statement of comprehensive income as part of 'finance income' when the Group'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 Group 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

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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 Group 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 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 statement of comprehensive income. In practice, the Group 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 statement of comprehensive income.

#### *(b) Assets classified as available-for-sale*

The Group 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 Group uses the criteria refer to in (a) above. In the case of equity investments classified as available-for-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 statement of comprehensive income. Impairment losses recognized in the consolidated statement of comprehensive income on equity instruments are not reversed through the statement of comprehensive income. 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 statement of comprehensive income.

## **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

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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 ₩ 294,457 million and ₩ 347,489 million as of June 30, 2013 and December 31, 2012, 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 the 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 accumulated depreciation. Historical cost includes expenditures directly attribute to the acquisition of the items.

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

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	4 - 40 years
Machinery	2 - 20 years
Vehicle	4 - 5 years
Tools and equipment	4 - 5 years
Supplies	4 - 5 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

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recognized within 'other income and expenses in the statement of comprehensive income.

#### 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 Group will comply with all attached conditions.

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

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.

#### 2.14 Intangible Assets

##### *(a) Goodwill*

Goodwill is measured as explained in Note 2.2(a) and goodwill arises on the acquisition of subsidiaries, associates and business are included in intangible assets. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of the CGUs, or group of CGUs, that is expected to benefit from the synergies of the combination. Goodwill is monitored at the operating segment level.

##### *(b) Other 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 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 - 15 years or indefinite

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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 estimates.

#### **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 Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

Land held for investment is not depreciated. Investment property, except for land, is depreciated using straight-line method over their useful lives from 10 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.

#### **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 statement of comprehensive income over the period of the borrowings using the effective interest method. The Group recognizes borrowings as current assets unless it has an unconditional right to delay the settlement of the borrowing. Preferred shares, which are mandatorily redeemable on a specific date, are classified as liabilities. The dividends on these preferred shares are recognized in the statement of comprehensive income as 'finance cost'.

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#### **2.19 Compound Financial Instruments**

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 Group 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 statement of comprehensive income, 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.

Interim period income tax expense is accrued based on the best estimate of the weighted average annual income tax rate expected for the full financial year, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period. 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 consolidated financial statements. However, deferred tax assets and liabilities are not recognized if they arise from initial 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 Group 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.

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#### **2.22 Employee Benefits**

##### *(a) Defined benefit liability*

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

A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group 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 Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group 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 liability 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 liability is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit liability 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.

##### *(b) Termination benefits*

Termination benefits are payable when employment is terminated by the Group before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group 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 Parent 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 Group'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 Group's equity holders.

#### **2.24 Revenue Recognition**

The Group's revenue categories consist of goods sold, services and other income.

Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue



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from the sale of goods is recognized when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods, the Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Group and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the six-month periods ended June 30, 2013 and 2012, were ₩ 1,756,718 million and ₩ 1,715,665 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 Group, the stage of completion of the transaction at the end of the reporting period can be measured reliably and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably. When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue is recognized only to the extent of the expenses recognized that are recoverable.

Revenue from the use by others of the Group'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 Group 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 recognized when the shareholders' right to receive the dividend is established.

#### **2.25 Dividend Distribution**

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

### **3. Critical Accounting Estimates and Assumptions**

The management makes judgments, estimates and assumptions that affects the application of accounting policies and the amounts of reported assets and liabilities and profits and costs in the preparation of the financial statements. 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 resulting accounting estimates will, by definition, seldom equal the related actual results.

#### *(a) Estimated impairment of goodwill*

The Group tests annually whether goodwill has suffered any impairment in accordance with the accounting policy stated in Note 2.16. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates.

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#### *(b) Income taxes*

The Group 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 Group recorded, based on its best estimate, current taxes and deferred taxes that the Group 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.

#### *(c) 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 Group 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.

#### *(d) Provisions*

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

#### *(e) 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 Group 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 Group 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.

## **4. Financial Risk Management**

### **4.1 Financial Risk Factors**

The Group'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 Group's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Group's financial performance.

Risk management is carried out by a central treasury department (Group treasury) under policies approved by the board of directors. The Group treasury identifies, evaluates and hedges financial risks in close co-operation with the Group'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. The Group applied the same financial risk management strategy that was applied in the previous period.

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(a) Market risk

i) Foreign exchange risk

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

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of June 30, 2013 and December 31, 2012, are as follows:

(in millions of Korean won)	June 30, 2013			December 31, 2012		
	USD	EUR	JPY	USD	EUR	JPY
<b>Assets</b>						
Cash and cash equivalents	₩ 17,712	₩ 14	₩ 705	₩ 19,284	₩ 5	₩ 9
Trade and other receivables	413,098	-	5,686	493,243	3,256	6,410
Long-term deposits	207,862	-	-	168,667	-	-
	<u>₩ 638,672</u>	<u>₩ 14</u>	<u>₩ 6,391</u>	<u>₩ 681,194</u>	<u>₩ 3,261</u>	<u>₩ 6,419</u>
<b>Liabilities</b>						
Trade and other payables	₩ 16,203	₩ 8,661	₩ 2,079	₩ 16,544	₩ 3,153	₩ 2,129
Short-term borrowings	1,567	-	-	1,406	-	-
	<u>₩ 17,770</u>	<u>₩ 8,661</u>	<u>₩ 2,079</u>	<u>₩ 17,950</u>	<u>₩ 3,153</u>	<u>₩ 2,129</u>

As of June 30, 2013 and December 31, 2012, 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:

(in millions of Korean won)	June 30, 2013		December 31, 2012	
	10% strengthening	10% weakening	10% strengthening	10% weakening
US dollar	₩ 62,090	₩ (62,090)	₩ 66,324	₩ (66,324)

ii) Price risk

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

As of June 30, 2013 and December 31, 2012, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income(change in value of available-for-sale financial assets) are as follows:

(in millions of Korean won)	June 30, 2013		December 31, 2012	
	5% increase	5% decrease	5% increase	5% decrease
Other comprehensive income before tax	₩ 5,073	₩ (5,073)	₩ 5,266	₩ (5,266)
Tax effect	(1,228)	1,228	(1,274)	1,274
Other comprehensive income after tax	<u>₩ 3,845</u>	<u>₩ (3,845)</u>	<u>₩ 3,992</u>	<u>₩ (3,992)</u>

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iii) Interest rate risk

The Group has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. As of June 30, 2013 and December 31, 2012, the amount of borrowings issued at variable rates is ₩ 66,107 million and ₩ 53,459 million, respectively. There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation.

(b) Credit Risk

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

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of June 30, 2013 and December 31, 2012, is as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Available-for-sale financial assets	₩	2,832	₩	2,832
Long-term deposits in MSA Escrow Fund		207,862		168,667
Trade and other receivables		1,040,125		1,005,563
Other financial assets		230,310		649,461
Cash and cash equivalents		991,429		372,260
	₩	<u>2,472,558</u>	₩	<u>2,198,783</u>

(c) Liquidity Risk

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

The maturity analysis on the residual contractual maturity of financial liabilities as of June 30, 2013 and December 31, 2012, is as follows:

	<b>June 30, 2013</b>					
	<b>Carrying amount</b>	<b>Contractual cash flow</b>	<b>Within 3 months</b>	<b>Between 3 months and 1 year</b>	<b>Between 1 and 5 years</b>	<b>Beyond 5 years</b>
Trade and other payables	₩ 328,337	₩ 329,693	₩ 296,768	₩ 4,443	₩ 26,902	₩ 1,580
Short-term borrowings	64,398	65,448	25,999	39,449	-	-
Long-term borrowings	120,346	125,785	177	527	71,426	53,655
Current portion of long-term borrowings	2,897	3,006	193	2,813	-	-

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	December 31, 2012						
	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	₩ 298,381	₩ 299,629	₩ 254,604	₩ 9,266	₩ 35,759	₩	-
Short-term borrowings	91,868	93,964	25,687	68,277	-		-
Long-term borrowings	109,599	119,785	144	410	41,984		77,247
Current portion of long-term borrowings	2,912	3,126	159	2,967	-		-

The above financial liabilities are presented at the nominal value of undiscounted future cash flows as of the earliest period at which the Group can be required to pay. In addition, derivative financial instruments held for sale will be settled within three months after the end of reporting period. These derivative financial instruments are not included in the table above. Undiscounted aggregate cash inflows and outflows are ₩1,944 million and ₩ 1,892 million, respectively, as of June 30, 2013.

#### 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 Group consists of equity and net debt deducting cash and cash equivalents, and current financial instruments from borrowings. The Group applied the same financial risk management strategy that was applied in the previous period.

As of June 30, 2013 and December 31, 2012, the Group defines net debt and equity attributable to owners of the Parent as follows:

(in millions of Korean won)	June 30, 2013	December 31, 2012
Total borrowings	₩ 187,641	₩ 204,379
Less:		
-Cash and cash equivalents	(991,429)	(372,260)
-Other financial assets, current	(230,010)	(649,186)
-Available-for-sale financial assets, current	(1,000)	(1,000)
Net debt(asset)	(1,034,798)	(818,067)
Equity attributable to owners of the parent	₩ 5,187,024	₩ 5,194,419

#### 4.3 Fair Value Estimation

There are no significant changes in business and economic environment which impact the fair value of financial assets and liabilities of the Group for the six-month period ended June 30, 2013.

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**4.3.1 Fair Value by Financial Instruments**

Book value and fair value by financial instruments consists of the following:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
	<b>Book value</b>	<b>Fair value</b>	<b>Book value</b>	<b>Fair value</b>
<b>Financial assets</b>				
Available-for-sale assets, non-current <sup>1</sup>	₩ 226,280	₩ 226,280	₩ 247,950	₩ 247,950
Other financial assets, non-current	300	300	275	275
Long-term deposits	207,862	207,862	168,667	168,667
Long-term trade and other receivables	117,329	117,329	121,784	121,784
Other financial assets, current	230,010	230,010	649,186	649,186
Trade and other receivables	922,796	922,796	883,778	883,778
Cash and cash equivalents	991,429	991,429	372,260	372,260
Derivative assets, current	52	52	-	-
	<u>₩ 2,696,058</u>	<u>₩ 2,696,058</u>	<u>₩ 2,443,900</u>	<u>₩ 2,443,900</u>
<b>Financial liabilities</b>				
Long-term borrowings	₩ 120,346	₩ 120,346	₩ 109,599	₩ 109,599
Long-term trade and other payables	27,125	27,125	24,979	24,979
Short-term borrowings	64,398	64,398	91,868	91,868
Current portion of long-term borrowings	2,897	2,897	2,912	2,912
Trade and other payables	301,212	301,212	273,402	273,402
	<u>₩ 515,978</u>	<u>₩ 515,978</u>	<u>₩ 502,760</u>	<u>₩ 502,760</u>

<sup>1</sup> Equity securities that do not have a quoted market price in active market and whose fair value cannot be reliably measured are recorded at cost and excluded from fair value disclosures.

**4.3.2 Financial Instruments Measured at Cost**

Details of financial instruments measured at cost consist of the following:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>	<b>December 31, 2012</b>
<b>Available-for-sale assets</b>		
MASTERN 2 REIT equity	₩ 10,000	₩ 10,000
U&I Corporation equity	3,000	3,000
SJ Biomed equity	1,000	1,000
Others	2,934	2,934
	<u>₩ 16,934</u>	<u>₩ 16,934</u>

MASTERN 2 REIT equity and others are non-listed equity investments and are measured using cost method as their fair value cannot be reliably estimated.

**4.3.3 Fair Value Hierarchy**

Financial instruments that are measured or disclosed at fair value are classified by a fair value hierarchy. The different levels for the fair value hierarchy 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,

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unobservable inputs) (Level 3).

The following table presents the Group's financial assets and financial liabilities that are measured at fair value as of June 30, 2013:

<i>(in millions of Korean won)</i>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
Available-for-sale financial assets	₩ 177,756	₩ 48,524	₩ -	₩ 226,280
Derivative assets	-	52	-	52

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 Group is the current bid price. These instruments are included in Level 1. Instruments included in Level 1 consist primarily of KOSPI and 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.

**4.3.4 Valuation Technique and Inputs**

The Group uses the following valuation technique and inputs for repetitive fair value measures, non-repetitive fair value measures and disclosed fair value, which are classified as level 2 and 3 in the fair value hierarchy as of June 30, 2013:

<i>(in millions of Korean won)</i>	<b>Fair Value</b>	<b>Level</b>	<b>Valuation Technique</b>
Available-for-sale assets			
Real Estate Investment Trust	₩ 48,524	2	Market approach
Unlisted	-	-	(*1)
Derivative assets			
Foreign Exchange Forward Contracts	52	2	Market approach

<sup>1</sup>Unlisted stocks are shares in Dream Hub PFV Co., Ltd., which was established for the development of Yongsan Station area. The Group recognized 100% of the carrying amount as impairment loss for this interim period due to financial difficulties of this investee (Note 7).

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**5. Operating Segments**

(1) The Group's reportable segments and details are as follows:

Operating segment	Principal operation
Tobacco	Manufacturing and selling tobaccos
Ginseng	Manufacturing and selling red ginseng
Real estate	Selling and renting real estate
Others	Manufacturing and selling pharmaceuticals, cosmetics and others

(2) Segment information on revenue and profit from operations for the six-month periods ended June 30, 2013 and 2012, is as follows:

<i>(in millions of Korean won)</i>	2013						
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Total segment sales	₩ 1,270,314	₩ 413,860	₩ 38,623	₩ 176,472	₩ 1,899,269	₩ (88,712)	₩ 1,810,557
Less: Inter-segment sales	35,734	28,202	4,083	20,693	88,712	(88,712)	-
External sales	1,234,580	385,658	34,540	155,779	1,810,557	-	1,810,557
Profit (loss) from operations	427,811	63,434	11,414	(5,370)	497,289	241	497,530

<i>(in millions of Korean won)</i>	2012						
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Total segment sales	₩ 1,336,311	₩ 501,888	₩ 20,705	₩ 193,824	₩ 2,052,728	₩ (85,726)	₩ 1,967,002
Less: Inter-segment sales	27,309	27,683	3,911	26,823	85,726	(85,726)	-
External sales	1,309,002	474,205	16,794	167,001	1,967,002	-	1,967,002
Profit (loss) from operations	472,828	87,764	6,376	(10,264)	556,704	(19,090)	537,614

(3) Segment information on assets and liabilities as of June 30, 2013 and December 31, 2012, is as follows:

<i>(in millions of Korean won)</i>	June 30, 2013						
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
<b>Assets</b>							
Segment assets	₩ 3,611,698	₩ 1,333,619	₩ 131,965	₩ 370,035	₩ 5,447,317	₩ (247,234)	₩ 5,200,083
Equity accounted investments	-	-	51,926	2,296	54,222	-	54,222
Assets held for sale, non-current	520	-	-	-	520	-	520
	3,612,218	1,333,619	183,891	372,331	5,502,059	(247,234)	5,254,825
Unallocated assets							1,808,191
<b>Total assets</b>							<b>₩ 7,063,016</b>
<b>Liabilities</b>							
Segment liabilities	₩ 1,220,429	₩ 147,696	₩ -	₩ 63,422	₩ 1,431,547	₩ (148,147)	₩ 1,283,400
Unallocated liabilities							592,592
<b>Total liabilities</b>							<b>₩ 1,875,992</b>



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	December 31, 2012						
	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
<b>Assets</b>							
Segment assets	₩ 3,630,713	₩ 1,375,619	₩ 135,368	₩ 362,884	₩ 5,504,584	₩ (349,720)	₩ 5,154,864
Equity accounted investments	-	-	52,647	3,130	55,777	-	55,777
Assets held for sale, non-current	762	-	-	-	762	-	762
	3,631,475	1,375,619	188,015	366,014	5,561,123	(349,720)	5,211,403
Unallocated assets							1,584,558
<b>Total assets</b>							<b>₩ 6,795,961</b>
<b>Liabilities</b>							
Segment liabilities	₩ 910,420	₩ 147,244	₩ -	₩ 70,560	₩ 1,128,224	₩ (142,569)	₩ 985,655
Unallocated liabilities							615,887
<b>Total liabilities</b>							<b>₩ 1,601,542</b>

(4) The major customer who contributes 10% or more of the Group's total revenues for the six-months periods ended June 30, 2013 and 2012, is as follows:

Segment	Major customer	2013	2012
Tobacco	Alokozay International Limited	₩ 130,330	₩ 191,157

**6. Financial Instruments by Category**

Categorizations of financial assets as of June 30, 2013 and December 31, 2012, are as follows:

	June 30, 2013				
(in millions of Korean won)	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for-sale	Total
Financial assets as available-for-sale, non-current	₩ -	₩ -	₩ -	₩ 242,214	₩ 242,214
Other financial assets, non-current	300	-	-	-	300
Long-term deposits	207,862	-	-	-	207,862
Long-term trade and other receivables	117,329	-	-	-	117,329
Financial assets as available-for-sale, current	-	-	-	1,000	1,000
Other financial assets, current	230,010	-	-	-	230,010
Derivative assets, current	-	52	-	-	52
Trade and other receivables, current	922,796	-	-	-	922,796
Cash and cash equivalents	991,429	-	-	-	991,429
	<u>₩ 2,469,726</u>	<u>₩ 52</u>	<u>₩ -</u>	<u>₩ 243,214</u>	<u>₩ 2,712,992</u>

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<i>(in millions of Korean won)</i>	December 31, 2012				
	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for-sale	Total
Financial assets as available-for-sale, non-current	₩ -	₩ -	₩ -	₩ 263,884	₩ 263,884
Other financial assets, non-current	275	-	-	-	275
Long-term deposits	168,667	-	-	-	168,667
Long-term trade and other receivables	121,784	-	-	-	121,784
Financial assets as available-for-sale, current	-	-	-	1,000	1,000
Other financial assets, current	649,186	-	-	-	649,186
Trade and other receivables, current	883,778	-	-	-	883,778
Cash and cash equivalents	372,260	-	-	-	372,260
	<u>₩ 2,195,950</u>	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 264,884</u>	<u>₩ 2,460,834</u>

Categorizations of financial liabilities as of June 30, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	June 30, 2013				Total
	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	
Long-term Borrowings	-	-	₩ 120,346	-	₩ 120,346
Long-term trade and other payables	-	-	27,125	-	27,125
Short-term borrowings	-	-	64,398	-	64,398
Current portion of long-term borrowings	-	-	2,897	-	2,897
Trade and other payables, current	-	-	301,212	-	301,212
	<u>-</u>	<u>-</u>	<u>₩ 515,978</u>	<u>-</u>	<u>₩ 515,978</u>

<i>(in millions of Korean won)</i>	December 31, 2012				Total
	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	
Long-term Borrowings	₩ -	₩ -	₩ 109,599	₩ -	₩ 109,599
Long-term trade and other payables	-	-	24,979	-	24,979
Short-term borrowings	-	-	91,868	-	91,868
Current portion of long-term borrowings	-	-	2,912	-	2,912
Trade and other payables, current	-	-	273,402	-	273,402
	<u>₩ -</u>	<u>₩ -</u>	<u>₩ 502,760</u>	<u>₩ -</u>	<u>₩ 502,760</u>

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Income and loss of financial instruments by category for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
	Three months	Six months	Three months	Six months
Available-for-sale financial assets				
Gain (loss) on valuation (other comprehensive income)	₩ (13,907)	₩ (5,056)	₩ (14,158)	₩ 6,167
Loss on disposal	-	-	-	(9)
Interest income	8	15	12	17
Dividend income	1,340	4,666	1,061	4,476
Impairment loss	(3,000)	(15,000)	-	-
Cash and cash equivalents				
Interest income	5,367	13,035	1,635	8,865
Gain (loss) on foreign currency translation	72	120	(203)	(88)
Foreign currency transaction gain (loss)	591	774	198	(367)
Trade and other receivables				
Interest income	1,713	3,401	5,994	8,045
Gain(Loss) on foreign currency translation	24,207	46,986	5,677	(2,684)
Foreign currency transaction gain	5,563	8,735	3,200	1,866
Financial assets at fair value through profit or loss				
Gain on valuation (profit or loss)	62	52	-	-
Gain on disposal (profit or loss)	142	142	-	-
Other financial liabilities at amortized cost				
Interest costs	(2,925)	(5,982)	(1,489)	(5,418)
Gain (loss) on foreign currency translation	(4,784)	(2,387)	1,423	1,982
Foreign currency transaction loss	(5,445)	(6,733)	(2,525)	(2,117)

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

The changes in available-for-sale financial assets for the six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
At January 1	₩	264,884	₩	248,403
Additions		-		11,500
Gain(loss) on valuation (before tax)		(9,457)		8,136
Net gains reclassified from equity		2,787		-
Impairment		(15,000)		-
Disposal		-		(243)
At June 30		243,214		267,796
Less: current portion		(1,000)		(1,044)
<b>Non-current portion</b>	₩	<b>242,214</b>	₩	<b>266,752</b>

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Available-for-sale financial assets as of June 30, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Available-for-sale debt instruments:				
Government and municipal bonds	₩	292	₩	292
Corporate bonds		2,540		2,540
Total available-for-sale debt instruments		<u>2,832</u>		<u>2,832</u>
Available-for-sale equity instruments:				
Listed <sup>1</sup>				
Yonhap Television News(YTN)		22,961		29,580
Oscotech, Inc.		847		869
Shinhan Financial Group Co., Ltd.		150,715		155,725
Rexahn Pharmaceuticals, Inc.		3,233		2,122
		<u>177,756</u>		<u>188,296</u>
Unlisted <sup>2,3</sup>		62,626		73,756
Total available-for-sale equity instruments		<u>240,382</u>		<u>262,052</u>
<b>Total available-for-sale financial assets</b>	<b>₩</b>	<b><u>243,214</u></b>	<b>₩</b>	<b><u>264,884</u></b>

<sup>1</sup>The fair value of listed available-for-sale equity instruments is principally based on quoted prices in an active market.

<sup>2</sup>For the six-month period ended June 30, 2013, the Group recognizes impairment loss on unlisted available-for-sale equity instruments of ₩ 15,000 million for Dream Hub PFV Co., Ltd.

<sup>3</sup>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.

**8. Trade and Other Receivables**

Trade and other receivables as of June 30, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
	<b>Current</b>	<b>Non-current</b>	<b>Current</b>	<b>Non-current</b>
Loans to employees	₩ 14,288	₩ 29,704	₩ 7,196	₩ 22,491
Loans	563	5,575	661	6,928
Other receivables	74,432	15,413	84,559	27,529
Guarantee deposits	-	66,637	-	64,836
Accrued income	4,898	-	7,006	-
Trade receivables	828,615	-	784,356	-
	<u>₩ 922,796</u>	<u>₩ 117,329</u>	<u>₩ 883,778</u>	<u>₩ 121,784</u>

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Trade and other receivables as of June 30, 2013 and December 31, 2012, reported in the consolidated statements of financial position, net of allowances, are as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
	<b>Current</b>	<b>Non-current</b>	<b>Current</b>	<b>Non-current</b>
Gross trade and other receivables	₩ 951,460	₩ 117,329	₩ 912,506	₩ 121,784
Allowance account				
- Loans	(214)	-	(199)	-
- Other receivables	(2,306)	-	(2,304)	-
- Trade receivables	(26,144)	-	(26,225)	-
	(28,664)	-	(28,728)	-
Net amount	₩ 922,796	₩ 117,329	₩ 883,778	₩ 121,784

Changes in the allowance account for the six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
Beginning	₩	28,728	₩	16,381
Impairment loss		260		41
Reversal of impairment		(73)		-
Write-off		(251)		(93)
Ending	₩	28,664	₩	16,329

The aging schedule of trade and other receivables as of June 30, 2013 and December 31, 2012, is as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Not past due	₩	453,980	₩	470,756
Past due but not impaired				
Within 1 month		25,589		74,054
Between 1 and 2 months		34,819		51,070
Beyond 2 months		93,085		88,586
Beyond 3 months		247,288		126,115
	₩	854,761	₩	810,581

There is no significant concentration of credit risk with respect to trade and other receivables since trade and other receivables, excluding export trade receivables, are widely dispersed amongst a number of customers. The Group holds 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 using effective interest rate method, as of June 30, 2013, and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>Effective interest rate</b>	<b>June 30, 2013</b>		<b>December 31, 2012</b>		
		<b>Current</b>	<b>Non-current</b>	<b>Current</b>	<b>Non-current</b>	
Loans to employees	3.00~5.68%	₩ 14,286	₩ 29,702	3.00~5.68%	₩ 7,192	₩ 22,486
Loans	1.7%~7.29%	-	4,719	1.7~3.29%	-	4,650
Other receivables	3.79%	-	17,568	3.79%	8,300	16,601
Guarantee deposits	1.7%~8.47%	-	63,589	1.7%~8.47%	-	62,400
		₩ 14,286	₩ 115,578	₩ 15,492	₩ 106,137	

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*Transferred trade receivables*

The Group discounted its trade receivables through trade receivable factoring agreements with National Agricultural Cooperative Federation and other financial institutions in relation with the collecting sales receipts with tobacco cards. In case the customers default, the Group has an obligation to pay the related amount to the bank. As a result, this transaction, treated as a transaction with recourse, has been accounted for as collateralized borrowings. The borrowings recognized in relation to the said transaction as of June 30, 2013 and December 31, 2012, are ₩ 4,789 million and ₩ 5,477 million, respectively (Note 23).

**9. Long-term Deposits**

Long-term deposits as of June 30, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
MMF	₩	18,670	₩	10,496
T-note		189,192		158,170
	₩	<u>207,862</u>	₩	<u>168,666</u>

As discussed in Note 33 to the interim consolidated 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 six-month periods ended June 30, 2013 and 2012, are ₩ 26,123 million and ₩ 16,552 million, respectively.

Investment income on long-term deposits in MSA Escrow Fund for the six-month periods ended June 30, 2013 and 2012, is ₩ 218 million and ₩ 85 million, respectively.

In addition, the Group measured fair value of long-term deposits using market price traded in active market.

**10. Property, Plant and Equipment**

Changes in property, plant and equipment for the six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>					
	<b>Acquisition Cost</b>		<b>Accumulated depreciation and impairment cost</b>		<b>Net book value</b>	
Land	₩	531,159	₩	-	₩	531,159
Buildings		866,520		(317,775)		548,745
Structures		65,357		(35,065)		30,292
Machinery		1,165,931		(805,688)		360,243
Vehicles		15,146		(11,303)		3,843
Tools		55,105		(46,387)		8,718
Furniture and fixture		237,060		(174,648)		62,412
Others		1,270		-		1,270
Construction-in-progress		79,492		-		79,492
	₩	<u>3,017,040</u>	₩	<u>(1,390,866)</u>	₩	<u>1,626,174</u>

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	2012		
	Acquisition Cost	Accumulated depreciation and impairment cost	Net book value
Land	₩ 474,816	₩ -	₩ 474,816
Buildings	820,017	(307,221)	512,796
Structures	65,057	(36,026)	29,031
Machinery	1,073,954	(730,870)	343,084
Vehicles	12,071	(8,958)	3,113
Tools	50,130	(42,146)	7,984
Furniture and fixture	245,802	(179,594)	66,208
Others	1,229	-	1,229
Construction-in-progress	143,375	-	143,375
	<u>₩ 2,886,451</u>	<u>₩ (1,304,815)</u>	<u>₩ 1,581,636</u>

(in millions of Korean won)	2013							
	Opening net book value	Additions	Disposal	Transfer	Depreciation	Exchange difference	Other changes <sup>1</sup>	Net book amount
Land	₩ 518,056	₩ 135	₩ (798)	₩ 13,780	₩ -	₩ (28)	₩ 14	₩ 531,159
Buildings	528,715	23,097	(92)	11,228	(17,842)	825	2,814	548,745
Structures	26,999	3,566	(36)	1,240	(1,648)	134	37	30,292
Machinery	372,565	13,200	(3,711)	20,382	(43,990)	1,797	-	360,243
Vehicles	2,950	213	(2)	90	(688)	1,280	-	3,843
Tools	8,856	2,090	(165)	58	(2,306)	185	-	8,718
Furniture and fixture	65,856	6,573	(383)	4,965	(14,717)	118	-	62,412
Others	1,266	-	(9)	13	-	-	-	1,270
Construction-in-progress	106,173	25,574	-	(51,756)	-	(499)	-	79,492
	<u>₩ 1,631,436</u>	<u>₩ 74,448</u>	<u>₩ (5,196)</u>	<u>₩ -</u>	<u>₩ (81,191)</u>	<u>₩ 3,812</u>	<u>₩ 2,865</u>	<u>₩ 1,626,174</u>

<sup>1</sup> Other changes include ₩ 3,385 million of reclassification from investment property to property, plant and equipment and ₩ 520 million of reclassification from property, plant and equipment to held-for-sale non-current assets.

(in millions of Korean won)	2012							
	Opening net book value	Additions	Disposal	Transfer	Depreciation	Exchange difference	Other changes <sup>1</sup>	Net book amount
Land	₩ 460,487	₩ 5,510	₩ (5,266)	₩ 20,426	₩ -	₩ (42)	₩ (6,299)	₩ 474,816
Buildings	532,066	3,226	(6,362)	3,692	(18,804)	(773)	(249)	512,796
Structures	30,072	360	(277)	746	(1,759)	(53)	(58)	29,031
Machinery	365,040	5,245	(58)	12,740	(39,515)	(323)	(45)	343,084
Vehicles	3,547	285	(47)	22	(655)	(39)	-	3,113
Tools	9,871	815	(186)	-	(2,492)	(24)	-	7,984
Furniture and fixture	66,299	15,648	(604)	524	(15,466)	(193)	-	66,208
Others	1,219	10	-	-	-	-	-	1,229
Construction-in-progress	115,745	66,389	(603)	(38,150)	-	(6)	-	143,375
	<u>₩ 1,584,346</u>	<u>₩ 97,488</u>	<u>₩ (13,403)</u>	<u>₩ -</u>	<u>₩ (78,691)</u>	<u>₩ (1,453)</u>	<u>₩ (6,651)</u>	<u>₩ 1,581,636</u>

<sup>1</sup> Other changes represent the reclassified amount from property, plant and equipment to held-for-sale non-current assets.

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**11. Intangible Assets**

Changes in intangible assets for the six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013					Total
	Goodwill	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development	
<b>At January 1, 2013</b>	₩ 84,100	₩ 34,086	₩ 26,042	₩ 98,337	₩ 4,228	₩ 246,793
Additions	-	129	773	1,332	463	2,697
Disposals	-	(4)	(33)	(324)	(13)	(374)
Transfer	-	285	-	-	(285)	-
Amortization	-	(1,505)	-	(4,914)	-	(6,419)
Exchange differences	3,636	2	-	341	(3)	3,976
Acquisition cost	87,736	45,696	26,814	117,205	4,791	282,242
Accumulated amortization and impairment cost	-	(12,703)	(32)	(22,433)	(401)	(35,569)
<b>Net book amount</b>	<b>₩ 87,736</b>	<b>₩ 32,993</b>	<b>₩ 26,782</b>	<b>₩ 94,772</b>	<b>₩ 4,390</b>	<b>₩ 246,673</b>

<i>(in millions of Korean won)</i>	2012					Total
	Goodwill	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development	
<b>At January 1, 2012</b>	₩ 87,902	₩ 23,454	₩ 24,387	₩106,641	₩ 16,234	₩ 258,618
Additions	-	172	1,319	725	664	2,880
Disposals	-	(861)	-	(116)	(13,395)	(14,372)
Transfer	-	68	-	-	(68)	-
Amortization	-	(1,451)	-	(4,932)	-	(6,383)
Exchange differences	23	13,174	(1)	(174)	339	13,361
Other changes	87,925	34,556	25,705	102,144	3,774	254,104
Acquisition cost	87,925	44,281	25,705	114,419	4,201	276,531
Accumulated amortization and impairment cost	-	(9,725)	-	(12,275)	(427)	(22,427)
<b>Net book amount</b>	<b>₩ 87,925</b>	<b>₩ 34,556</b>	<b>₩ 25,105</b>	<b>₩102,144</b>	<b>₩ 3,774</b>	<b>₩ 254,104</b>

Research and development expenses for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
	Three months	Six months	Three months	Six months
Cost of goods sold	₩ 1,564	₩ 2,177	₩ 284	₩ 574
Selling and administrative expenses	8,050	13,756	7,782	15,655
	<b>₩ 9,614</b>	<b>₩ 15,933</b>	<b>₩ 8,066</b>	<b>₩ 16,229</b>

Exchange loss of ₩167 million arising from the translation of goodwill of PT Trisakti Purwosari Makmur, one of subsidiaries, is accounted for as a deduction from goodwill and loss on currency translation of foreign operations (other comprehensive income).



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**12. Investment Property**

Changes in investment property for the six-month periods ended June 30, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	<b>2013</b>		
	<b>Land</b>	<b>Building</b>	<b>Total</b>
Beginning net book value	₩ 48,177	₩ 133,809	₩ 181,986
Additions	559	862	1,421
Transfer to property, plant and equipment	(433)	(2,952)	(3,385)
Depreciation	-	(3,075)	(3,075)
Acquisition cost	48,303	177,082	225,385
Accumulated depreciation and impairment cost	-	(48,438)	(48,438)
Net book amount	<u>₩ 48,303</u>	<u>₩ 128,644</u>	<u>₩ 176,947</u>

*(in millions of Korean won)*

	<b>2012</b>		
	<b>Land</b>	<b>Building</b>	<b>Total</b>
Beginning net book value	₩ 45,314	₩ 143,037	₩ 188,351
Transfer to held-for-sale non-current assets	(563)	(4,301)	(4,864)
Depreciation	-	(3,101)	(3,101)
Acquisition cost	44,751	177,980	222,731
Accumulated depreciation and impairment cost	-	(42,345)	(42,345)
Net book amount	<u>₩ 44,751</u>	<u>₩ 135,635</u>	<u>₩ 180,386</u>

The amounts recognized in profit or loss from investment property for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	<b>2013</b>		<b>2012</b>	
	<b>Three month</b>	<b>Six month</b>	<b>Three month</b>	<b>Six month</b>
Rental income	₩ 8,022	₩ 16,748	₩ 8,375	₩ 15,580
Direct operating expense	(1,538)	(3,075)	(1,550)	(3,101)
	<u>₩ 6,484</u>	<u>₩ 13,673</u>	<u>₩ 6,825</u>	<u>₩ 12,479</u>

Fair values and book values of investment property as of June 30, 2013 and December 31, 2012, are as follows:

*(in millions of Korean won)*

	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
	<b>Fair value</b>	<b>Book value</b>	<b>Fair value</b>	<b>Book value</b>
Land	₩ 309,188	₩ 48,303	₩ 312,735	₩ 48,177
Building	186,415	128,644	190,214	133,809
	<u>₩ 495,603</u>	<u>₩ 176,947</u>	<u>₩ 502,949</u>	<u>₩ 181,986</u>

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**13. Non-current Assets Held for Sale**

The Group recognizes non-current assets held for sale as the lower of net fair value and book value.

Changes in non-current assets held for sale for the six-month periods ended June 30, 2013, are as follows:

<i>(in millions of Korean won)</i>	<b>Land</b>	<b>Buildings</b>	<b>Structures</b>	<b>Total</b>
<b>At January 1, 2013</b>				
Acquisition cost	₩ 625	₩ 215	₩ 64	₩ 904
Accumulated depreciation	-	(96)	(46)	(142)
Net book amount	<u>₩ 625</u>	<u>₩ 119</u>	<u>₩ 18</u>	<u>₩ 762</u>
<b>Changes</b>				
Transfer from property, plant and equipment	419	101	-	520
Disposals	(625)	(119)	(18)	(762)
	<u>₩ (206)</u>	<u>₩ (18)</u>	<u>₩ (18)</u>	<u>₩ (242)</u>
<b>At June 30, 2013</b>				
Acquisition cost	₩ 419	₩ 203	₩ 54	₩ 676
Accumulated depreciation	-	(102)	(54)	(156)
Net book amount	<u>₩ 419</u>	<u>₩ 101</u>	<u>₩ -</u>	<u>₩ 520</u>

**14. Pledged Assets**

The following assets were pledged as collateral for the Group's long-term and short-term borrowings as of June 30, 2013:

<i>(in millions of Korean won)</i>	<b>Asset</b>	<b>Book amount</b>	<b>Details</b>	<b>Borrowings</b>	<b>Collateralized amount</b>	<b>Lender /Leaseholder</b>
	Property, plant and equipment /investment property	₩ 95,115	Short-term borrowings	₩ 10,392		
			Current portion of long-term borrowings	397	₩ 74,384	Hana Bank, 2 others and Small & medium Business Coporation
			Long-term borrowings	25,350		
	Investment property	75,488	Leasehold deposits received	7,074	7,385	Metlife Insurance Co. of Korea, Ltd. and 21 others
	Property, plant and equipment	1,150	ACH pledged	-	1,150	Bank of Oklahoma
	Short-term financial instruments	700	Short-term borrowings	4,010	700	Hana Bank
	Trade receivables	13,253	Short-term borrowings	13,253	13,253	Citibank Korea Inc.
		57	Short-term borrowings	57	57	Korean Exchange Bank
<b>Total</b>		<u>₩ 185,763</u>		<u>₩ 60,533</u>	<u>₩ 96,929</u>	

The following assets were pledged as collateral for the Group's long-term and short-term borrowings as of December 31, 2012:

<i>(in millions of Korean won)</i>	<b>Asset</b>	<b>Book amount</b>	<b>Details</b>	<b>Borrowings</b>	<b>Collateralized amount</b>	<b>Lender /Leaseholder</b>
	Property, plant and equipment /investment	₩ 76,674	Short-term borrowings	₩ 15,000		
			Current portion of long-term borrowings	412	₩ 64,147	Hana Bank, 3 others and Small & medium Business

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property		Long-term borrowings	10,034		Coporation
Investment Property	80,783	Leasehold deposits received	8,169	8,502	Metlife Insurance Co., Ltd. and 24others
Property, plant and equipment	1,071	ACH pledged	-	1,071	Bank of Oklahoma
Trade receivables	11,294	Short-term borrowings	11,294	11,294	Citibank Korea Inc.
<b>Total</b>	<u>₩ 169,822</u>		<u>₩ 44,909</u>	<u>₩ 85,014</u>	

**15. Investments in Associates**

Investments in associates as of June 30, 2013 and December 31, 2012, are as follows:

(in millions of Korean won)

Associates	Location	Principal operation	June 30, 2013		December 31, 2012	
			Interest (%)	Carrying Amount	Interest (%)	Carrying Amount
Cosmo Tabacco Co., Ltd.	Mongolia	Manufacturing and selling tobaccos	40.00	₩ -	40.00	₩ -
Lite Pharm Tech, Inc	Korea	Manufacturing Medical supplies	25.34	990	25.34	857
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00	769	20.00	932
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	13,217	49.02	13,570
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	7,093	29.67	7,160
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	6,780	22.06	6,827
JR REIT V Co., Ltd.	Korea	Selling and renting of real estate	34.63	5,566	34.63	5,581
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	9,997	21.74	10,008
LSK Global Pharma Services Co., Ltd	Korea	Research and developing new drug	23.15	536	23.15	1,343
JR REIT X Co., Ltd.	Korea	Selling and renting of real estate	28.79	9,273	28.79	9,500
<b>Total</b>				<u>₩ 54,221</u>		<u>₩ 55,778</u>

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Changes in investments in associates for the six-month periods ended June 30, 2013 and 2012, are as follows:

(in millions of Korean won)

	2013				
	Beginning balance	Acquisition	Share of profit(loss)	Other changes	Ending balance
<b>Associates</b>					
Lite Pharm Tech, Inc	₩ 857	₩ -	₩ 134	₩ -	₩ 991
Korean Carbon Finance, Inc.	932	-	(162)	-	770
JR CR-REIT IV Co., Ltd.	13,570	-	140	(494)	13,216
KVG REIT 1 Co., Ltd.	7,160	-	198	(265)	7,093
KOCREF REIT 17 Co., Ltd.	6,827	-	160	(207)	6,780
JR REIT V Co., Ltd.	5,581	-	182	(197)	5,566
JR REIT VIII Co., Ltd.	10,008	-	268	(279)	9,997
LSK Global Pharma Services Co., Ltd	1,343	-	(807)	-	536
JR REIT X Co., Ltd.	9,500	-	(130)	(98)	9,272
	₩ 55,778	₩ -	₩ (17)	₩ (1,540)	₩ 54,221

(in millions of Korean won)

	2012				
	Beginning balance	Acquisition	Share of profit(loss)	Other changes	Ending balance
<b>Associates</b>					
Lite Pharm Tech, Inc	₩ 637	₩ -	₩ 49	₩ -	₩ 686
Korean Carbon Finance, Inc.	1,013	-	(53)	-	960
JR CR-REIT IV Co., Ltd.	13,819	-	1,294	(490)	14,623
KVG REIT 1 Co., Ltd.	7,354	-	169	(262)	7,261
KOCREF REIT 17 Co., Ltd.	6,872	-	46	-	6,918
JR REIT V Co., Ltd.	5,635	-	188	(211)	5,612
JR REIT VIII Co., Ltd.	-	10,000	(342)	-	9,658
LSK Global Pharma Services Co., Ltd	-	1,500	(53)	-	1,447
	₩ 35,330	₩ 11,500	₩ 1,298	₩ (963)	₩ 47,165

Summary of the associates' financial information as of and for the six-month period ended June 30, 2013, and as of and for the year ended December 31, 2012, is as follows:

(in millions of Korean won)

	June 30, 2013			
	Assets	Liabilities	Revenues	Profit/(loss)
Lite Pharm Tech, Inc.	₩ 4,614	₩ 705	₩ 3,882	₩ 1,292
Korean Carbon Finance, Inc.	3,921	75	144	(295)
JR CR-REIT IV Co., Ltd.	64,069	35,236	1,852	289
KVG REIT 1 Co., Ltd.	52,001	28,097	2,841	658
KOCREF REIT 17 Co., Ltd.	67,090	36,360	2,818	716
JR REIT V Co., Ltd.	31,272	15,197	1,151	523
JR REIT VIII Co., Ltd.	109,356	63,370	3,203	1,007
LSK Global Pharma Services Co., Ltd.	2,262	4,048	4,555	(618)
JR REIT X Co., Ltd.	75,418	43,221	882	(694)

(in millions of Korean won)

	December 31, 2012			
	Assets	Liabilities	Revenues	Profit/(loss)
Lite Pharm Tech, Inc.	₩ 3,832	₩ 452	₩ 4,239	₩ 1,192
Korean Carbon Finance, Inc.	4,739	84	741	(397)
JR CR-REIT IV Co., Ltd.	66,139	36,591	5,309	1,566

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KVG REIT 1 Co., Ltd.	52,144	28,014	5,583	1,078
KOCREF REIT 17 Co., Ltd.	66,738	35,792	5,193	865
JR REIT V Co., Ltd.	31,327	15,211	2,230	1,009
JR REIT VIII Co., Ltd.	109,750	63,714	4,822	1,984
LSK Global Pharma Services Co., Ltd.	3,807	2,108	7,738	(680)

**16. Inventories**

Inventories as of June 30, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	June 30, 2013			December 31, 2012		
	Acquisition Cost	Allowance	Book amount	Acquisition Cost	Allowance	Book amount
Merchandise	₩ 10,282	₩ (563)	₩ 9,719	₩ 8,074	₩ (521)	₩ 7,553
Finished goods	416,026	(2,347)	413,679	348,664	(1,738)	346,926
Work in progress	321,952	(19)	321,933	452,730	(3,107)	449,623
Raw materials	820,518	(1,696)	818,822	821,905	(3,093)	818,812
Supplies	27,031	-	27,031	25,633	-	25,633
By-products	6,950	-	6,950	6,076	-	6,076
Unfinished housing	387	-	387	227	-	227
Lots	8,026	-	8,026	6,551	-	6,551
Goods-in-transit	40,918	-	40,918	45,395	-	45,395
	<u>₩ 1,652,090</u>	<u>₩ (4,625)</u>	<u>₩ 1,647,465</u>	<u>₩ 1,715,255</u>	<u>₩ (8,459)</u>	<u>₩ 1,706,796</u>

The cost related inventories for the six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	2013		2012	
	Three months	Six months	Three months	Six months
Cost of sales				
- Loss on inventory valuation	₩ 529	₩ 1,090	₩ 1,904	₩ 1,553
- Loss on retirement of inventories	1,121	1,817	-	-
Other expenses				
- Loss on retirement of inventories	333	581	698	2,321
	<u>₩ 1,983</u>	<u>₩ 3,488</u>	<u>₩ 2,602</u>	<u>₩ 3,874</u>

**17. Cash and Cash Equivalents**

Cash and cash equivalents as of June 30, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	June 30, 2013	December 31, 2012
Cash on hand	₩ 11,677	₩ 4,292
Demand deposits	158,837	177,743
Short-term investment assets	820,915	190,225
	<u>₩ 991,429</u>	<u>₩ 372,260</u>

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Other financial assets as of June 30, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Long-term Financial assets				
Time deposits	₩	288	₩	143
Deposit in current account		12		17
Money trust		-		115
		<u>300</u>		<u>275</u>
Short-term Financial assets				
Time deposits		116,860		187,115
Money trust		67,000		271,000
Certificates of deposit		41,150		191,071
Repurchase agreements		5,000		-
		<u>230,010</u>		<u>649,186</u>
	₩	<u>230,310</u>	₩	<u>649,461</u>

Restricted financial assets as of June 30, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>Description</b>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Cash and cash equivalents	Specific research purpose	₩	201	₩	1,357
Other financial assets	Pledge and others		2,088		1,771
Long-term other financial assets	Deposits		<u>12</u>		<u>17</u>
		₩	<u>2,301</u>	₩	<u>3,145</u>

**18. Equity and Share Premium**

Details of share capital as of June 30, 2013 and December 31, 2012, are as follows:

<i>(in Korean won, except number of shares)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Number of ordinary shares				
-Authorized		800,000,000		800,000,000
-Issued		137,292,497		137,292,497
Par value per share	₩	5,000	₩	5,000
Ordinary shares	₩	954,959,485,000	₩	954,959,485,000

The Parent Company has reacquired and retired 53,699,400 treasury shares. Accordingly, as of June 30, 2013, the Parent Company's ordinary shares differ from the aggregate par value of issued shares by ₩ 268,497 million.

Changes in the number of shares for the six-month period ended June 30, 2013 and the year ended December 31, 2012, are as follows:

<i>(Number of shares)</i>	<b>June 30, 2013</b>			<b>December 31, 2012</b>		
	<b>Ordinary shares</b>	<b>Treasury shares</b>	<b>Total</b>	<b>Ordinary shares</b>	<b>Treasury shares</b>	<b>Total</b>
Beginning	137,292,497	(11,393,697)	125,898,800	137,292,497	(11,543,697)	125,748,800
Issuance of treasury shares	-	-	-	-	150,000	150,000
Ending	<u>137,292,497</u>	<u>(11,393,697)</u>	<u>125,898,800</u>	<u>137,292,497</u>	<u>(11,393,697)</u>	<u>125,898,800</u>

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**19. Treasury Shares**

Changes in the treasury shares for the six-month period ended June 30, 2013 and the year ended December 31, 2012, are as follows:

<i>(in millions of Korean won, except number of shares)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
	<b>Number of shares</b>	<b>Carrying amount</b>	<b>Number of shares</b>	<b>Carrying amount</b>
Beginning	11,393,697	₩ 339,059	11,543,697	₩ 343,522
Issuance of treasury shares	-	-	(150,000)	(4,463)
Ending	<u>11,393,697</u>	<u>₩ 339,059</u>	<u>11,393,697</u>	<u>₩ 339,059</u>

Changes in gain on reissuance of treasury shares for the six-month period ended June 30, 2013 and the year ended December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Beginning	₩	492,032	₩	485,922
Gain on reissuance of treasury shares before tax		-		8,061
Less: tax at 24.2%		-		(1,951)
Gain on reissuance of treasury shares, net of tax		-		6,110
Ending	<u>₩</u>	<u>492,032</u>	<u>₩</u>	<u>492,032</u>

**20. Reserves**

Details of reserves as of June 30, 2013 and December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Available-for-sale financial assets reserve	₩	(35,690)	₩	(30,635)
Exchange differences on translating foreign operations		(21,203)		(27,925)
Legal reserve		602,937		602,937
Voluntary reserve		2,813,732		2,466,732
	<u>₩</u>	<u>3,359,776</u>	<u>₩</u>	<u>3,011,109</u>

Available-for-sale financial assets reserve as of June 30, 2013 and December 31, 2012, are summarized as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Available-for-sale financial assets reserve before tax	₩	(47,084)	₩	(40,415)
Tax effect		11,394		9,780
Available-for-sale financial assets reserve after tax	<u>₩</u>	<u>(35,690)</u>	<u>₩</u>	<u>(30,635)</u>

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

Details of the Group's voluntary reserve as of June 30, 2013 and December 31, 2012, are as

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follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Reserve for business rationalization <sup>1</sup>	₩	12,851	₩	12,851
Reserve for research and human resource development <sup>2</sup>		90,000		60,000
Reserve for business expansion <sup>3</sup>		698,881		698,881
Other reserve <sup>3</sup>		2,012,000		1,695,000
	₩	<u>2,813,732</u>	₩	<u>2,466,732</u>

<sup>1</sup>*Reserve for Business Rationalization*

Until December 10, 2002 under the Special Tax Treatment Control Law, investment tax credits were allowed for certain investments. The Group 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 Group 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.

<sup>2</sup>*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.

<sup>3</sup>*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 six-month period ended June 30, 2013 and for the year ended December 31, 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Beginning	₩	976,425	₩	1,022,126
Transfer from other reserve		(317,000)		(359,000)
Transfer from Reserve for research and human resources development		(30,000)		-
Dividends		(402,876)		(402,396)
Profit for the period		391,027		725,118
- Less: non-controlling interests		7,206		12,920
Remeasurements of the net defined benefit liability, net of tax		1,033		(18,579)
- Less: non-controlling interests		(470)		155
Others		-		(3,919)
Ending	₩	<u>625,345</u>	₩	<u>976,425</u>



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**22. Trade and Other Payables**

Trade and other payables as of June 30, 2013 and December 31, 2012, are as follows:

(in millions of Korean won)

	June 30, 2013		December 31, 2012	
	Current	Non-current	Current	Non-current
Leasehold deposits received	₩ -	₩ 24,734	₩ -	₩ 24,979
Accounts payable	79,379	-	48,190	-
Withholdings	13,338	386	15,855	428
Value added tax withheld	143,375	-	120,959	-
Accrued expenses	143,407	-	144,901	-
Other payables	78,425	2,391	80,311	-
	<u>₩ 457,924</u>	<u>₩ 27,511</u>	<u>₩ 410,216</u>	<u>₩ 25,407</u>

Trade and other payables carried at amortized cost using the effective interest rate method as of June 30, 2013 and December 31, 2012, are as follows:

(in millions of Korean won)

	June 30, 2013			December 31, 2012		
	Effective interest rate	Current	Non-current	Effective interest rate	Current	Non-current
Leasehold deposits received	3.00~5.68%	₩ -	₩ 24,734	3.00~5.68%	₩ -	₩ 24,979

**23. Borrowings**

Details of borrowings as of June 30, 2013 and December 31, 2012, are as follows:

(in millions of Korean won)

	June 30, 2013	December 31, 2012
<b>Current</b>		
Bank borrowings <sup>1</sup>	₩ 56,751	₩ 84,221
Other borrowings	7,647	7,647
Bank borrowings(current portion of long-term borrowings)	279	293
Other borrowings (current portion of long-term borrowings)	2,618	2,619
	<u>67,295</u>	<u>94,780</u>
<b>Non-current</b>		
Bank borrowings	17,699	11,932
Other borrowings	60	119
Convertible bonds	11,580	11,110
Convertible redeemable preference shares	72,750	69,429
Redeemable preference shares	18,257	17,009
	<u>120,346</u>	<u>109,599</u>
	<u>₩ 187,641</u>	<u>₩ 204,379</u>

<sup>1</sup>Bank borrowings above are collateralized with the Group's property, plant and equipment (Note 14).

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Details of bank borrowings as of June 30, 2013 and December 31, 2012, are as follows:

(in millions of Korean won)

Currency	Creditor	Latest maturity date	Annual interest rate (%) June 30, 2013	June 30, 2013	December 31, 2012
Korean won	National Agricultural Cooperative Federation, other	Short-term Borrowings	4.56% and others	₩ 13,346	₩ 26,823
Korean won	Citibank	Short-term Borrowings	CD(91day)+1.25% and others	15,890	14,230
Korean won	Hana Bank	Short-term Borrowings	3.44% ~ 4.98%	27,515	43,239
Korean won	National Agricultural Cooperative Federation	2016. 07. 20	1.50%	756	756
Korean won	National Agricultural Cooperative Federation	2017. 06. 21	1.50%	1,260	1,260
Korean won	Hana Bank	2017. 03. 31	2.84%	911	966
Korean won	Korea Development Bank	2014. 11. 07	4.45%	8,000	8,000
Korean won	Korea Development Bank	2018. 06. 09	3.79%	291	291
Korean won	Hana Bank	2017. 09. 06	4.58%	1,760	881
Korean won	Hana Bank	2016.05.15	4.07%	5,000	-
				₩ 74,729	₩ 96,446

**Convertible Bond**

The Group issued 9.5% convertible bonds at a par value of ₩12,410 million on December 14, 2011. The bonds will mature four years from the issue date and become convertible into shares at the rate of ₩1,199 per share.

The fair value of the liability component, included in non-current borrowings, was calculated using the market interest rate for an equivalent non-convertible bond. The residual amount, representing the value of the equity conversion option, is included in shareholders' equity in other reserves, net of income taxes.

**Convertible Redeemable Preference Shares**

The Group issued convertible redeemable preference shares at ₩18,000 million on November 19, 2011. The convertible instrument will mature ten years from the issue date. The instrument can be converted into 1,090,909 ordinary shares at any time before maturity, and automatically converts upon maturity. If KT&G Life Sciences will be not listed by the end of 2015, recourse is available.

The Group issued convertible redeemable preference shares at ₩26,000 million on January 9, 2012. The convertible instrument will mature five years from the issue date. The instrument can be converted into 94,079 ordinary shares at any time before maturity, and automatically converts upon maturity. If Somang Cosmetics Co., Ltd. will be not listed by the end of 2016, recourse is available.

The Group issued convertible redeemable preference shares at ₩35,216 million on September 14, 2012. The convertible instrument will mature ten years from the date of establishment of QCP 2011 Corporate Partnership Private Equity Fund. The instrument can be converted into 6,978,948 ordinary shares at any time before maturity, after five years from its issuance. If this SPC will not be liquidated and apportioned in ten years, recourse is available.

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**Redeemable Preference Shares**

The Group issued redeemable preference shares at ₩17,761 million during 2012. Recourse will be available ten years from the date of establishment of QCP 2011 Corporate Partnership Private Equity Fund. If this SPC will not be liquidated and apportioned in ten years, recourse is available.

**24. Net Defined Benefit Liability**

The amounts recognized on the statements of income for the six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
Defined benefit plans :				
Current service cost	₩	21,690	₩	18,930
Interest expenses		4,608		4,504
Expected return on plan assets		(2,879)		(3,250)
		<u>23,419</u>		<u>20,184</u>
Defined contribution plans :				
Pension costs		1,132		692
Total	₩	<u>24,551</u>	₩	<u>20,876</u>

Retirement benefits for the six-month period ended June 30, 2013, were ₩1,228 million. Out of total expenses, ₩8,011 million (2012: ₩7,037 million) and ₩16,540 million (2012: ₩13,839 million) were included in 'cost of sales' and 'selling and administrative expenses', respectively.

The movements in the net defined benefit liability as of June 30, 2013 and December 31, 2012, are as follows:

<i>(In millions of Korean won)</i>	<b>June 30, 2013</b>		<b>December 31, 2012</b>	
Present value of defined benefit liability	₩	306,532	₩	288,329
Fair value of plan assets		<u>(173,666)</u>		<u>(180,685)</u>
Liability in the statement of financial position	₩	<u>132,866</u>	₩	<u>107,644</u>

As of June 30, 2013, severance benefit insurance and contributions to the National Pension Plan amounting to ₩ 2,539 million and ₩ 226 million, respectively, are included in plan assets.

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**25. Classification of Operating Income**

(1) Material items of operating income and expense

Operating income is calculated as gross profit net of selling and administrative expenses and other income and expenses were excluded.

(2) Employee benefit costs for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	2013		2012	
	Three months	Six months	Three months	Six months
Salaries	₩ 122,643	₩ 243,812	₩ 117,593	₩ 232,681
Retirement benefits	12,266	24,551	10,074	20,876
Termination benefits	1,168	1,658	-	1,194
Employee welfare	17,479	31,244	17,112	28,939
	<u>₩ 153,556</u>	<u>₩ 301,265</u>	<u>₩ 144,779</u>	<u>₩ 283,690</u>

(3) Depreciation and amortization for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	2013		2012	
	Three months	Six months	Three months	Six months
Depreciation	₩ 42,392	₩ 84,266	₩ 41,063	₩ 81,792
Amortization	3,220	6,419	3,792	6,383
	<u>₩ 45,612</u>	<u>₩ 90,685</u>	<u>₩ 44,855</u>	<u>₩ 88,175</u>

(4) Selling and administrative expenses for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	2013		2012	
	Three months	Six months	Three months	Six months
Salaries	₩ 79,830	₩ 159,406	₩ 74,976	₩ 149,750
Retirement and termination benefits	8,992	17,617	6,761	14,807
Employee welfare	12,208	21,706	11,924	19,738
Travel	3,309	5,681	3,557	6,759
Communications	1,368	2,749	1,489	2,975
Utilities	1,878	4,923	2,109	4,941
Taxes and dues	3,952	9,242	3,925	8,542
Supplies	786	1,622	982	2,006
Rent	7,057	13,705	8,078	15,380
Depreciation	11,740	23,570	12,304	24,454
Amortization	3,220	6,419	3,833	6,383
Repairs and maintenance	1,972	2,698	2,806	4,400
Vehicles	2,910	5,699	3,110	6,120
Insurance	408	860	502	1,301
Commissions	47,582	97,166	55,001	106,999
Freight and custody	8,467	19,101	11,715	20,878

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Conferences	1,016	2,089	1,473	2,369
Advertising	57,842	122,684	76,659	138,327
Training	1,658	3,048	2,399	4,248
Prizes and rewards	488	904	464	922
Cooperation	214	412	321	715
Normal research and development	8,050	13,755	7,782	15,655
Bad debts expense	(188)	170	(41)	41
	<u>₩ 264,759</u>	<u>₩ 535,226</u>	<u>₩ 292,129</u>	<u>₩ 557,710</u>

**26. Other Income and Other Expenses**

Details of other income for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	2013		2012	
	Three months	Six months	Three months	Six months
Foreign currency transaction gain	₩ 8,037	₩ 12,997	₩ 5,091	₩ 11,251
Foreign currency translation gain	20,659	49,717	6,896	7,111
Gain on sale of property, plant and equipment	5,302	10,895	7,854	9,605
Gain on sale of intangible assets	-	-	49	360
Others	1,886	7,482	4,470	9,058
	<u>₩ 35,884</u>	<u>₩ 81,091</u>	<u>₩ 24,360</u>	<u>₩ 37,385</u>

Details of other expenses for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	2013		2012	
	Three months	Six months	Three months	Six months
Foreign currency transaction loss	₩ 7,329	₩ 10,222	₩ 4,218	₩ 11,869
Foreign currency translation loss	1,164	4,997	-	7,902
Impairment loss on other receivables	-	16	-	-
Donations	6,530	6,953	1,890	4,514
Loss on sale of property, plant and equipment	1,800	1,958	656	691
Loss on sale of intangible assets	41	41	23	403
Others	4,850	8,020	2,367	4,626
	<u>₩ 21,714</u>	<u>₩ 32,208</u>	<u>₩ 9,154</u>	<u>₩ 30,005</u>

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**27. Expenses by Nature**

Expenses by nature for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
	<b>Three months</b>	<b>Six months</b>	<b>Three months</b>	<b>Six months</b>
Changes in inventories	₩ 54,040	₩ 59,332	₩ 99,318	₩ 191,007
Raw materials and consumables purchased	291,231	557,646	254,552	494,395
Salary and wage	123,811	245,470	117,593	233,875
Retirement benefits	12,266	24,551	10,074	20,876
Depreciation charges	42,392	84,266	41,063	81,792
Amortization charges	3,220	6,419	3,792	6,383
Employee benefits	17,479	31,244	17,112	28,939
Advertising costs	57,902	122,760	77,501	138,106
Service fees	54,326	110,351	67,001	125,161
Other expenses	14,103	86,436	45,765	108,854
Total cost of sales, and selling and administrative expenses	₩ 665,816	₩ 1,313,027	₩ 733,771	₩ 1,429,388

**28. Finance Income and Cost**

Finance income and cost for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
	<b>Three months</b>	<b>Six months</b>	<b>Three months</b>	<b>Six months</b>
<b>Finance income</b>				
Interest income	₩ 7,088	₩ 16,451	₩ 7,641	₩ 16,927
Dividend income	1,340	4,666	1,060	4,476
Gain on valuation of derivatives	62	52	-	-
Gain on transaction of derivatives	142	142	-	-
Investment income on long-term deposits in MSA Escrow Fund	-	218	15	85
Gain on sale of available-for-sale financial assets	-	-	-	-
	8,632	21,529	8,716	21,488
<b>Finance cost</b>				
Interest cost	(2,925)	(5,982)	(1,489)	(5,418)
Loss on sale of available-for-sale financial assets	-	-	-	(9)
Impairment loss on available-for-sale financial assets	(3,000)	(15,000)	-	-
	(5,925)	(20,982)	(1,489)	(5,427)
<b>Net financial income</b>	₩ 2,707	₩ 547	₩ 7,227	₩ 16,061

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Details of interest costs for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	2013		2012	
	Three months	Six months	Three months	Six months
Borrowings	₩ (928)	₩ (2,333)	₩ (538)	₩ (2,852)
Trade and other payables	(1,097)	(2,554)	(26)	(468)
Others	(900)	(1,095)	(925)	(2,098)
	<u>₩ (2,925)</u>	<u>₩ (5,982)</u>	<u>₩ (1,489)</u>	<u>₩ (5,418)</u>

Details of interest income for the three-month and six-month periods ended June 30, 2013 and 2012, are as follows:

*(in millions of Korean won)*

	2013		2012	
	Three months	Six months	Three months	Six months
Deposits	₩ 5,367	₩ 13,035	₩ 1,635	₩ 8,865
Available-for-sale financial assets	8	15	12	17
Trade and other receivables	1,713	3,401	5,994	8,045
	<u>₩ 7,088</u>	<u>₩ 16,451</u>	<u>₩ 7,641</u>	<u>₩ 16,927</u>

## 29. Income Tax

Income tax expense was calculated based on the best weighted average annual corporate tax rate for the entire fiscal period. Estimated average annual tax rate of the year ending December 31, 2013, is 28.5%. The estimated tax rate for the six-month period ended June 30, 2012, was 29.4%.

## 30. Earnings per Share

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

Basic earnings per ordinary share for the three-month and six-month periods ended June 30, 2013 and 2012, is as follows:

*(in Korean won, except number of shares)*

	2013		2012	
	Three months	Six months	Three months	Six months
Profit for the period attributable to owner of the parent	₩ 195,135 million	₩ 398,234 million	₩ 214,380 million	₩ 405,201 million
Weighted-average number of ordinary shares outstanding	125,898,800	125,898,800	125,748,800	125,748,800
<b>Basic and diluted earnings per share in won</b>	<u>₩ 1,550</u>	<u>₩ 3,163</u>	<u>₩ 1,705</u>	<u>₩ 3,222</u>

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**31. Dividends**

Dividend distribution to the Parent Company's shareholders amounted to ₩ 402,876 million for the year ended December 31, 2012, was paid in March 2013.

**32. Cash Generated from Operations**

Cash generated from operations for the six-month periods ended June 30, 2013 and 2012, are as follows:

<i>(in millions of Korean won)</i>	<b>2013</b>		<b>2012</b>	
<b>Profit</b>	₩	391,027	₩	396,795
<b>Adjustments for</b>				
Income tax expense		155,916		165,558
Finance cost		20,982		5,428
Finance income		(21,529)		(21,489)
Depreciation		84,266		81,792
Amortization		6,419		6,383
Retirement and termination benefits		23,457		20,336
Foreign currency translations loss		4,998		7,902
Loss on inventory valuation		1,090		1,553
Impairment loss on trade and other receivables		186		41
Loss on sale of property, plant and equipment		1,958		691
Loss on sale of intangible assets		41		403
Other expense		6,024		1
Share of gain of associates		(1,082)		(1,746)
Share of loss of associates		1,098		448
Foreign currency translations gain		(49,717)		(7,111)
Gain on sale of property, plant and equipment		(10,895)		(9,605)
Gain on sale of intangible assets		-		(359)
		614,239		647,021
<b>Changes in working capital:</b>				
Decrease (increase) in trade and other receivables		10,751		(126,233)
Increase in advance payments		(79,264)		(138,842)
Increase in prepaid expenses		(4,028)		(3,189)
Decrease in prepaid tobacco excise and other taxes		2,160		43,498
Decrease in Inventories		63,763		172,811
Increase trade and other payables		40,578		51,518
Increase (decrease) in advance receipts		(2,760)		19,128
Increase in tobacco excise and other taxes payable		224,403		323,942
Payment of retirement benefits		(3,229)		(3,788)
<b>Cash generated from operations</b>	<b>₩</b>	<b>866,613</b>	<b>₩</b>	<b>985,866</b>

Non-cash transactions

<i>(in millions of Korean won)</i>	<b>June 30, 2013</b>	
Transfer to voluntary reserves in retained earnings	₩	347,000



# KT&G Corporation and Subsidiaries

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#### 33. Contingencies and Commitments

Each year, the Group deposits a proportion of sales of tobacco products in the United States in accordance with the Tobacco Master Settlement Agreement (MSA) under the Escrow Statute of the United States government. The MSA Escrow Funds are maintained to pay the medical expenses of tobacco purchasers who have suffered health effects as a result of smoking. The unused portion of this fund will be refunded to the Group 25 years from the date of each annual funding. The Group recorded as long-term deposits the amounts paid into the MSA Escrow Funds of state governments in the United States against potential litigation and damages related to the export of tobacco into the United States.

As of June 30, 2013, tobacco lawsuits claiming damages of ₩ 584 million are filed against the Group and the Korean government. The amount of the liability the Group may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of June 30, 2013.

Additionally, as of June 30, 2013, the Group is involved in seven lawsuits as a defendant for alleged damages totaling ₩ 1,834 million. The amount of the liability the Group may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of June 30, 2013.

As of June 30, 2013, the Group has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 61,500 thousand.

As of June 30, 2013, the Group's trade receivables from the export of cigarettes are insured against non-payment up to USD 16,200 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of June 30, 2013, the Group has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries and for an opening of L/C for import and customs with relation to a subsidiary located in U.S.A(Global Trading Inc.) for up to USD 40,000 thousand by Korea Exchange Bank and others. In addition, the Group provides Customs Bond with limits in the aggregate of USD 11,400 thousand, regarding an opening of L/C for import and customs for a subsidiary located in U.S.A (Global Trading Inc.).

The Group has maintained a contract with the farmers who grow six-year old green ginseng for purchase volume guarantees and recorded contractual amounts paid to the farmers as advance payments in the amount of ₩ 151,966 million, classified as non-current, and ₩ 92,835 million, classified as current, (2012: non-current: ₩ 139,291 million; current: ₩ 49,396 million) as of June 30, 2013, respectively.

As of June 30, 2013, the Group has an accounts receivable loan agreement with a limit of ₩ 64,000 million with Hana Bank and other financial institutions.

As of June 30, 2013, the Group has a trade bill loan agreement with a limit of ₩ 10,000 million with Korea Exchange Bank and other financial institutions.

As of June 30, 2013, the Group has a loan agreement with a limit of ₩ 89,101 million with Shinhan Bank and other financial institutions.

As of June 30, 2013, the Group has provided two blank notes, 13 notes amounting to ₩ 14,200 million and five blank checks to Resolution and Finance Corporation and others as collateral for its borrowings and trade agreements. As of June 30, 2013, the Group lost one blank note, one blank check and five notes amounting to ₩ 4,300 million, and expects to proceed a judgment of nullification.

As of June 30, 2013, the Group and 28 other companies are guaranteed ₩ 240,000 million by Seoul Guarantee Insurance Co., Ltd. related to the Yongsan International Commercial

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Development Project. Seoul Guarantee Insurance Co., Ltd. can request amounts for recourse to the Company and 28 other companies based on their ownership rate, if Seoul Guarantee Insurance Co., Ltd. paid the insurance proceeds to KORAIL. As KORAIL requested the corresponding payment to Seoul Guarantee Insurance Co., Ltd. during the reporting period, the Group recognizes 50% of the maximum liability charged to the Group amounting to ₩ 2,568 million as a liability by considering the expected future losses.

On March 17, 2011, the Group signed the memorandum of understanding (MOU) on global investment partnership with the National Pension Service to jointly invest in foreign assets with a limit of ₩ 800,000 million. Following this MOU, the Group entered into a joint investment agreement with Q Capital Partners Co., Ltd., which is a general partner of private equity fund, on November 11, 2011.

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

#### 1) Conditional put option granted to the Individual Shareholder

The Parent 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 the Individual Shareholder, Somang Cosmetics Co., Ltd. is not able to undertake the necessary procedures for listing, due to the Parent Company's objection, within three years after the Parent Company acquires Somang Cosmetics Co., Ltd.

#### 2) Right of first refusal held by the Parent Company

The Individual shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless the Individual Shareholder has offered them first to the Parent Company.

#### 3) Tag-along right held by the Individual Shareholder

In the event that the Parent Company proposes to enter into a transaction or a series of related transactions with a third party purchaser to dispose of 50% or more of its shares, then the Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Parent Company.

In relation to the acquisition of Mazence, Inc., the Parent Company entered into a contract with a former owner of the acquiree, Gwak Tae-Hwan ("Individual Shareholder"). Details of the contract are as follows:

#### 1) Restriction of disposal

The Individual shareholder shall not be permitted to dispose of its shares, in whole or in part, within one year after Mazence, Inc. is listed.

#### 2) Right of first refusal held by the Parent Company

The Individual shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless the Individual Shareholder has offered them first to the Parent Company.

#### 3) Tag-along right held by the Individual Shareholder

In the event that the Parent Company proposes to enter into a transaction or a series of related transactions with a third party purchaser to dispose of its shares, then the Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than

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those applicable to the Parent Company.

Upon the resolution of the Board of Directors on January 23, 2013, the Parent Company guarantees the principal and the related interest that buyers of Andong Central Xi Apartment have borrowed from the National Agricultural Cooperative Federation, as of June 30, 2013. The amount of guarantee is ₩152,263 million and the guarantee will expire on June 30, 2015.

**34. Related Party Transactions**

The Group has no significant transactions and receivables and liabilities with related parties for the six-month period ended June 30, 2013.

The guarantee provided by related parties as of June 30, 2013 and December 31, 2012, are as follows:

*(in millions of Korean won)*

Guarantor	Guarantee for	Purpose	June 30, 2013		December 31, 2012	
			Limit	Guarantee amount	Limit	Guarantee amount
Kang Seok-chang	Somang Cosmetics Co., Ltd.	Application funds	₩ 2,500	₩ 2,500	₩ 2,591	₩ 2,893

The compensation paid or payable to key management for employee services for the three-month and six-month periods ended June 30, 2013 and 2012, consists of:

*(in millions of Korean won)*

	2013		2012	
	Three months	Six months	Three months	Six months
Short-term employee benefits	₩ 6,853	₩ 13,771	₩ 6,726	₩ 12,721
Retirement benefits	646	1,285	867	2,018
	₩ 7,499	₩ 15,056	₩ 7,593	₩ 14,739

**35. 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 ₩ 1,149.7 to US\$1, the basic exchange rate on June 30, 2013, 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.