KT&G Corporation and Subsidiaries

Interim Consolidated Financial Statements

June 30, 2012

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RESPECTED TRUSTED PROFESSIONAL SAMIL

Report on Review of Interim Financial Statements

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

Reviewed Financial Statements

We have reviewed the accompanying interim consolidated financial statements of KT&G Corporation and its subsidiaries. These financial statements consist of consolidated statement of financial position of KT&G Corporation and its subsidiaries (collectively the Group) as of June 30, 2012, and the related consolidated statements of comprehensive income for the three-month and six-month periods ended June 30, 2012, and statements of changes in equity and cash flows for the six-month period ended June 30, 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") 34, *Interim Financial Reporting*, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

We conducted our review in accordance with the quarterly review standards established by the Securities and Futures Commission of the Republic of Korea. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the Republic of Korea and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

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

Other Matters

The interim consolidated statement of comprehensive income for the three-month and six-month periods ended June 30, 2011, and statements of changes in equity and cash flows for the six-month period ended June 30, 2011, presented herein for comparative purposes, were reviewed by other auditors whose report dated August 12, 2011, expressed that nothing has come to their attention that caused them to believe those statements do not present fairly, in all material respects, the financial performance and cash flows of KT&G Corporation and its subsidiaries for the three-month and six-month periods ended June 30, 2011, in accordance with Korean IFRS.

The consolidated statement of financial position as of December 31, 2011, and the consolidated statements of comprehensive income, changes in equity and cash flows for the year ended December 31, 2011, were audited by other auditors whose report dated February 16, 2012, expressed an unqualified opinion on those statements in accordance with the Korean IFRS. The consolidated statement of financial position as of December 31, 2011, presented herein for comparative purposes, is consistent in all material respects, with the above audited statement of financial position as of December 31, 2011.

The accompanying interim consolidated financial statements as of and for the three-month and six-month periods ended June 30, 2012, have been translated into US dollars solely for the convenience of the reader and have been translated on the basis set forth in Note 34 to the interim 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.

Samil PricewaterhouseCoopers

Seoul, Korea

August 13, 2012

This report is effective as of August 13, 2012, the review report date. Certain subsequent events or circumstances, which may occur between the review report date and the time of reading this report, could have a material impact on the accompanying interim 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, 2012 and December 31, 2011

(in millions of Korean won and thousands of U.S. dollars)	Notes	June 30, 2012 Korean won	June 30, 2012 U.S. dollars (Note 34)	December 31, 2011 Korean won
Assets				
Non-current assets				
Property, plant and equipment	10,14	₩ 1,581,637	$ 1,370,807	₩ 1,584,346
Intangible assets	11	254,104	220,232	258,618
Investment property	12,14	180,386	156,341	188,351
Investments in associates	5,15	47,164	40,877	35,330
Available-for-sale financial assets	6,7	266,752	231,194	247,359
Other financial assets	6,17	20,245	17,546	1,427
Long-term deposits in MSA Escrow Fund	6,9,32	163,633	141,821	147,290
Long-term advance payments	32	190,788	165,356	142,880
Long-term prepaid expenses		5,998	5,198	5,775
Long-term trade and other receivables	6,8	123,020	106,622	134,115
Deferred income tax assets	28	19,853	17,207	15,487
		2,853,580	2,473,201	2,760,978
Current assets				
Inventories	16	1,381,292	1,197,168	1,572,299
Available-for-sale financial assets	6,7	1,044	905	1,044
Other financial assets	6,17	525,153	455,151	11,089
Prepaid tobacco excise and other taxes		160,331	138,959	201,911
Trade and other receivables	6,8	935,873	811,123	833,310
Advance payments	32	155,609	134,867	64,342
Prepaid expenses		23,266	20,165	20,516
Cash and cash equivalents	6,17	640,630	555,234	807,731
		3,823,198	3,313,572	3,512,242
Assets held for sale	5,13	9,802	8,495	3,196
Total assets		₩ 6,686,580	$ 5,795,268	₩ 6,276,416
Equity				
Capital stock	1,18	₩ 954,959	$ 827,665	₩ 954,959
Other capital surplus	18	5,333	4,622	5,333
Treasury shares	19	(343,522)	(297,731)	(343,522)
Gain on reissuance of treasury shares	19	485,922	421,149	485,922
Reserve	20	3,024,962	2,621,738	2,663,313
Retained earnings	21	662,505	574,194	1,022,126
Equity attributable to equity holders of the Company		4,790,159	4,151,637	4,788,131
Non-controlling interests		98,360	85,249	96,946
Total equity		4,888,519	4,236,886	4,885,077
Liabilities				
Non-current liabilities				
Long-term borrowings	6,23	60,475	52,414	37,847
Long-term trade and other payables	6,22	26,125	22,643	26,031
Long-term advance receipts		18,685	16,194	14,072
Defined benefit liability	24	99,782	86,481	83,082
Provisions for other liabilities and charges		3,390	2,938	3,509
Deferred income tax liabilities	28	240,852	208,747	227,589
		449,309	389,417	392,130
Current liabilities				
Borrowings	6,23	80,434	69,712	82,836
Current portion of long-term borrowings	6,23	2,052	1,778	3,126
Trade and other payables	6,22	459,604	398,340	422,734
Advance receipts		27,815	24,107	12,628
Income taxes payable	28	153,544	133,077	164,579
Tobacco excise and other taxes payable		625,303	541,951	313,306
		1,348,752	1,168,965	999,209
Total liabilities		1,798,061	1,558,382	1,391,339
Total liabilities and equity		₩ 6,686,580	$ 5,795,268	₩ 6,276,416

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 34.

KT&G Corporation and Subsidiaries
Interim Consolidated Statements of Comprehensive Income
Six-Month Periods Ended June 30, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars, except per share amounts)	Notes		2012 Korean won		2012 U.S. dollars (Note 34)		2011 Korean won
			Period Ended June 30				
Sales		₩	1,967,003	$	1,704,804	₩	1,723,040
Cost of sales	26		(871,678)		(755,485)		(727,228)
Gross profit			1,095,325		949,319		995,812
Other income	25		38,180		33,090		22,499
Selling and administrative expenses	25,26		(557,669)		(483,333)		(442,804)
Other expenses	25,26		(30,841)		(26,730)		(44,693)
Operating income			544,994		472,346		530,814
Finance income	27		21,489		18,624		23,253
Finance expense	27		(5,428)		(4,704)		(5,823)
Net Finance income			16,061		13,920		17,430
Income from jointly controlled entities and associates	15		1,746		1,513		717
Expense from jointly controlled entities and associates	15		(448)		(389)		(55)
Profit before income tax			562,353		487,390		548,906
Income tax expense	28		(165,558)		(143,488)		(150,502)
Profit for the period		₩	396,795	$	343,902	₩	398,404
Other comprehensive income							
Change in value of available-for-sale financial assets	7	₩	6,167	$	5,345	₩	(13,502)
Gain(Loss) on currency translation of foreign operations			(3,518)		(3,049)		(12)
Actuarial gain(loss) on defined benefit liability	24		(97)		(84)		(86)
Other comprehensive income (loss) for the period, net of tax			2,552		2,212		(13,600)
Total comprehensive income for the period		₩	399,347	$	346,114	₩	384,804
Profit for the period attributable to:							
Equity holders of the Parent Company		₩	405,201	$	351,188	₩	397,445
Non-controlling interests			(8,406)		(7,286)		959
		₩	396,795	$	343,902	₩	398,404
Total comprehensive income for the period attributable to:							
Equity holders of the Parent Company		₩	407,752	$	353,399	₩	383,854
Non-controlling interests			(8,405)		(7,285)		950
		₩	399,347	$	346,114	₩	384,804
Earnings per share attributable to the equity holders of the Parent Company during the period (in won)							
Basic and diluted earnings per share	29	₩	3,222	$	2.79	₩	3,121

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KT&G Corporation and Subsidiaries
Interim Consolidated Statements of Comprehensive Income
Three-Month Periods Ended June 30, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars, except per share amounts)	Notes		Period Ended June 30 2012 Korean won		2012 U.S. dollars (Note 34)		2011 Korean won
Sales		₩	1,005,441	$	871,417	₩	898,596
Cost of sales	26		(441,642)		(382,772)		(380,428)
Gross profit			563,799		488,645		518,168
Other income	25		25,038		21,701		10,357
Selling and administrative expenses	25,26		(292,170)		(253,224)		(224,964)
Other expenses	25,26		(9,791)		(8,486)		(22,142)
Operating income			286,876		248,636		281,419
Finance income	27		8,717		7,555		10,764
Finance expense	27		(1,489)		(1,291)		(1,157)
Net Finance income			7,228		6,264		9,607
Income from jointly controlled entities and associates	15		459		398		525
Expense from jointly controlled entities and associates	15		(283)		(245)		-
Profit before income tax			294,280		255,053		291,551
Income tax expense	28		(83,739)		(72,577)		(76,260)
Profit for the period		₩	210,541	$	182,476	₩	215,291
Other comprehensive income							
Change in value of available-for-sale financial assets	7	₩	(14,158)	$	(12,271)	₩	157
Gain(Loss) on currency translation of foreign operations			(10,685)		(9,260)		(2,646)
Actuarial gain(loss) on defined benefit liability	24		81		70		(23)
Other comprehensive income (loss) for the period, net of tax			(24,762)		(21,461)		(2,512)
Total comprehensive income for the period		₩	185,779	$	161,015	₩	212,779
Profit for the period attributable to:							
Equity holders of the Parent Company		₩	214,381	$	185,804	₩	215,047
Non-controlling interests			(3,840)		(3,328)		244
		₩	210,541	$	182,476	₩	215,291
Total comprehensive income for the period attributable to:							
Equity holders of the Parent Company		₩	189,615	$	164,340	₩	212,539
Non-controlling interests			(3,836)		(3,325)		240
		₩	185,779	$	161,015	₩	212,779
Earnings per share attributable to the equity holders of the Parent Company during the period (in won)							
Basic and diluted earnings per share	29	₩	1,705	$	1.48	₩	1,692

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KT&G Corporation and Subsidiaries
Interim Consolidated Statements of Changes in Equity
Six-Month Periods Ended June 30, 2012 and 2011

(in millions of Korean won)	Notes	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total	Non-controlling Interests	Total Equity
		Attributable to equity holders of the Parent Company								
Balance at January 1, 2011		₩ 954,959	₩ 5,333	₩ (216,827)	₩ 482,129	₩ 2,179,227	₩ 1,151,358	₩ 4,556,179	₩ 42,130	₩ 4,598,309
Comprehensive income										
Profit for the period		-	-	-	-	-	397,445	397,445	959	398,404
Change in value of available-for-sale financial assets		-	-	-	-	(13,502)	-	(13,502)	-	(13,502)
Gain(Loss) on currency translation of foreign operations		-	-	-	-	(12)	-	(12)	-	(12)
Actuarial gain(loss) on defined benefit liability		-	-	-	-	-	(78)	(78)	(8)	(86)
Total comprehensive income (loss)		-	-	-	-	(13,514)	397,367	383,853	951	384,804
Transactions with equity holders of the Company										
Cash dividends		-	-	-	-	-	(382,946)	(382,946)	-	(382,946)
Acquisition of treasury shares		-	-	(105,002)	-	-	-	(105,002)	-	(105,002)
Other reserve		-	-	-	-	544,000	(544,000)	-	-	-
Total transactions with equity holders of the Company		-	-	(105,002)	-	544,000	(926,946)	(487,948)	-	(487,948)
Balance at June 30, 2011		₩ 954,959	₩ 5,333	₩ (321,829)	₩ 482,129	₩ 2,709,713	₩ 621,779	₩ 4,452,084	₩ 43,081	₩ 4,495,165
Balance at January 1, 2012		₩ 954,959	₩ 5,333	₩ (343,522)	₩ 485,922	₩ 2,663,313	₩ 1,022,126	₩ 4,788,131	₩ 96,946	₩ 4,885,077
Comprehensive income										
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
Gain(Loss) on currency translation of foreign operations		-	-	-	-	(3,518)	-	(3,518)	-	(3,518)
Actuarial gain(loss) on defined benefit liability		-	-	-	-	-	(98)	(98)	1	(97)
Total comprehensive income (loss)		-	-	-	-	2,649	405,103	407,752	(8,405)	399,347
Transactions with equity holders of the Parent Company										
Cash dividends		-	-	-	-	-	(402,396)	(402,396)	-	(402,396)
Other reserve		-	-	-	-	359,000	(359,000)	-	-	-
Convertible bond – equity component		-	-	-	-	-	-	-	5,390	5,390
Other transactions							(3,328)	(3,328)	4,429	1,101
Total transactions with equity holders of the Company		-	-	-	-	359,000	(764,724)	(405,724)	9,819	(395,905)
Balance at June 30, 2012		₩ 954,959	₩ 5,333	₩ (343,522)	₩ 485,922	₩ 3,024,962	₩ 662,505	₩ 4,790,159	₩ 98,360	₩ 4,888,519

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, 2012

(in thousands of U.S. dollars) (Note 34)	Notes	Capital stock	Other Capital Surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained Earnings	Total	Non-controlling Interests	Total Equity
		Attributable to equity holders of the Parent Company								
Balance at January 1, 2012		$ 827,665	$ 4,622	$ (297,731)	$ 421,149	$ 2,308,297	$ 885,878	$ 4,149,880	$ 84,024	$ 4,233,904
Comprehensive income										
Profit for the period		-	-	-	-	-	351,188	351,188	(7,286)	343,902
Change in value of available-for-sale financial assets		-	-	-	-	5,345	-	5,345	-	5,345
Gain(Loss) on currency translation of foreign operations		-	-	-	-	(3,049)	-	(3,049)	-	(3,049)
Actuarial gain(loss) on defined benefit liability		-	-	-	-	-	(85)	(85)	1	(84)
Total comprehensive income (loss)		-	-	-	-	2,296	351,103	353,399	(7,285)	346,114
Transactions with equity holders of the Parent Company										
Cash dividends		-	-	-	-	-	(348,758)	(348,758)	-	(348,758)
Other reserve		-	-	-	-	311,145	(311,145)	-	-	-
Convertible bond – equity component		-	-	-	-	-	-	-	4,672	4,672
Other transactions		-	-	-	-	-	(2,884)	(2,884)	3,838	954
Total transactions with equity holders of the Company		-	-	-	-	311,145	(662,787)	(351,642)	8,510	(343,132)
Balance at June 30, 2012		$ 827,665	$ 4,622	$ (297,731)	$ 421,149	$ 2,621,738	$ 574,194	$ 4,151,637	$ 85,249	$ 4,236,886

The accompanying notes are an integral part of these interim consolidated financial statements.
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KT&G Corporation and Subsidiaries
Interim Consolidated Statements of Cash Flows
Six-Month Periods Ended June 30, 2012 and 2011

(in millions of Korean won and thousands of U.S. dollars)	Notes	2012 Korean won	Period Ended June 30 2012 U.S. dollars (Note 34)	2011 Korean won
Cash flows from operating activities				
Cash generated from operations	31	₩ 985,865	$ 854,451	₩ 727,273
Income tax paid		(168,287)	(145,856)	(229,091)
Net cash generated from operating activities		817,578	708,595	498,182
Cash flows from investing activities				
Interest received		19,001	16,469	16,257
Investment income received from long-term deposits in MSA Escrow Fund		407	353	904
Dividends received		5,440	4,714	4,607
Proceeds from sale of property, plant and equipment		19,601	16,988	12,676
Proceeds from sale of intangible assets		781	677	3,953
Proceeds from sale of available-for-sale financial assets		233	202	2,570
Decrease in loans		13,355	11,575	9,869
Decrease in guarantee deposits		49,106	42,560	25,212
Acquisition of property, plant and equipment		(97,488)	(84,493)	(138,526)
Acquisition of intangible assets		(2,880)	(2,496)	(12,915)
Acquisition of investment property		-	-	(1,232)
Acquisition of jointly controlled entities and associates		(11,500)	(9,967)	(12,600)
Acquisition of available-for-sale financial assets		(11,500)	(9,967)	(10,000)
Increase in loans		(1,167)	(1,011)	(845)
Increase in guarantee deposits		(45,626)	(39,544)	(39,985)
Increase in long-term deposits in MSA Escrow Fund		(16,552)	(14,346)	(7,544)
Increase(Decrease) in other financial assets		(521,741)	(452,193)	6,520
Net cash used in investing activities		(600,530)	(520,479)	(141,079)
Cash flows from financing activities				
Interest paid		(7,491)	(6,494)	(1,334)
Dividends paid		(402,396)	(348,758)	(382,946)
Proceeds from long-term borrowings		96,845	83,936	-
Proceeds from short-term borrowings		40,338	34,961	14,485
Increase in deposits received		5,157	4,470	7,346
Repayments of long-term borrowings		(69,375)	(60,127)	(254)
Repayments of short-term borrowings		(43,823)	(37,982)	(19,985)
Decrease in deposits received		(3,241)	(2,809)	(4,124)
Acquisition of treasury shares		-	-	(105,002)
Net cash used in financing activities		(383,986)	(332,803)	(491,814)
Net decrease in cash and cash equivalents		(166,938)	(144,687)	(134,711)
Cash and cash equivalents at the beginning of period		807,731	700,062	981,314
Exchange gains/(losses) on cash and cash equivalents		(163)	(141)	811
Cash and cash equivalents at the end of period		₩ 640,630	$ 555,234	₩ 847,414

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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, 2012, the Parent Company has four manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 139 branches for the sale of tobacco throughout the country. Also, the 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.

The ownership of the Parent Company's issued ordinary shares as of June 30, 2012, is held as follows:

Shareholders	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.93%
Employee share ownership association	2,983,684	2.17%
Others	113,254,631	82.49%
	125,748,800	91.59%
Treasury shares	11,543,697	8.41%
	137,292,497	100.00%

The Parent Company's consolidated subsidiaries as of June 30, 2012, are as follows:

Next most senior parent	Subsidiaries	Location	Percentage of ownership (%) June 30, 2012
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.[1]	Korea	50.00
	Renzoluc Pte., Ltd.	Singapore	100.00
	KT&G Life science[2]	Korea	59.48
	Yebon Nongwon	Korea	90.00
	KGC Yebon	Korea	100.00
Renzoluc Pte., Ltd.	PT Trisakti Purwosari Makmur	Indonesia	51.00
PT Trisakti Purwosari Makmur	PT Sentosa Ababi Purwosari	Indonesia	99.24
	PT Purindo Ilufa	Indonesia	100.00
Korea Ginseng Corporation	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

[1] The Parent Company's percentage of ownership includes convertible preferred shares. As of June 30, 2012, the Company's percentage of ownership excludes convertible preferred shares, is 60.00%.

[2] The Parent Company's percentage of ownership includes convertible preferred shares. As of June 30, 2012, the Company's percentage of ownership excludes convertible preferred shares, is 73.94%.

Summarized financial information of subsidiaries as of June 30, 2012 and for the six-month period ended June 30, 2012, is as follows:

(In millions of Korean won)

Subsidiaries	Total assets	Total liabilities	Revenue	Profit or loss	Total comprehensive income
Korea Ginseng Corporation	1,226,915	134,029	469,683	75,488	75,362
Yungjin Pharm. Ind. Co., Ltd.	155,737	67,940	60,935	(2,083)	(2,082)
Tae-a industry Co., Ltd.	14,714	3,184	8,547	359	358
KT&G Tutun Mamulleri Sanayive Ticaret A.S.	58,209	31,542	4,846	(1,328)	(8)
Korea Tabacos do Brasil Ltda.	1,099	11	-	-	-
KT&G Pars	38,089	37,684	9,905	(1,380)	(1,861)
KT&G Rus L.L.C.	140,364	37,368	17,629	(2,092)	(5,235)
KG Life & Gin Co., Ltd	37,050	11,027	31,403	(13,594)	(13,593)
Global Trading, Inc.	29,064	21,637	73,738	90	94
Jilin Hanzheng Ginseng Co., Ltd.	45,625	15,714	-	(1,225)	(1,346)
Somang Cosmetics Co., Ltd.	89,435	67,233	59,825	(398)	(398)
Renzoluc Pte., Ltd.	81,639	64,304	-	343	354
KT&G Life science	41,036	14,137	6	(3,691)	(3,691)
Yebon Nongwon	99	-	-	(1)	(1)
KGC Yebon	12,876	102	-	(157)	(157)
PT Trisakti Purwosari Makmur	122,368	107,396	28,963	(4,141)	(4,620)
Cheong Kwan Jang Taiwan Corporation	26,309	26,157	8,229	(1,666)	(1,648)
Korean Red Ginseng Corp., Inc.	10,150	6,713	4,520	99	101
Korea Ginseng (China) Corp.	52,307	44,102	19,126	(1,670)	(1,692)
Korea Ginseng Corporation Japan	7,796	3,157	2,191	(3,761)	(3,999)

During the six-month period ended June 30, 2012, there has been no change in consolidation scope, except KGC Yebon being included in the consolidation,while Rosee Cosmetics, and KT&G Bio were liquidated.

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

The interim consolidated financial statements for the six-month period ended June 30, 2012, have been prepared in accordance Korean IFRS 1034, '*Interim Financial Reporting*'. These interim consolidated financial statements have been prepared in accordance with the Korean IFRS standards and interpretations issued and effective or issued and early adopted at the reporting date.

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

- Amendments to Korean-IFRS1019, *Employ benefits*

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

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

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

2.2 Consolidation

The Group has prepared the consolidated financial statements in accordance with Korean-IFRS1027, *Consolidated and Separate Financial Statements.*

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Company 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 Company controls another entity. The Group also assesses existence of control where it does not have more than 50% of the voting power but is able to govern the financial and operating policies by virtue of de-facto control. De-facto control may arise in circumstances where the size of the Group's voting rights relative to the size and dispersion of holdings of other shareholders give the Group the power to govern the financial and operating policies and others.

Subsidiaries are fully consolidated from the date on which control is transferred to the Company. 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 Company. 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.

Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date and the resulting gain or loss is recognized in profit or loss.

Any contingent consideration to be transferred by the Group is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with Korean-IFRS1039, either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

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 Group companies are eliminated. Unrealized losses are also eliminated after recognizing impairment of transferred assets. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(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.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognized in other comprehensive income is reclassified to profit or loss where appropriate.

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

The Group determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Group calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying value and recognizes the amount as 'impairment loss on investment in an associate' in the income statement.

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 income statement.

(c) Joint ventures

A joint venture is a contractual arrangement whereby two or more parties (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. The Group does not recognize its share of profits or losses from the joint venture that result from the Group's purchase of assets from the joint venture until it re-sells the assets to an independent party. However, a loss on the transaction is recognized immediately if the loss provides evidence of a reduction in the net realizable value of current assets, or an impairment loss.

(d) Changes in ownership interests in subsidiaries without change of control

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.

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 income statement, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

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

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analyzed between translation differences resulting from changes in the amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortized cost are recognized in profit or loss, and other changes in carrying amount are recognized in other comprehensive income.
Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognized in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available-for-sale, are included in other comprehensive income.

(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 income statement 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 income statement. When the Company ceases to control the subsidiary, exchange differences that were recorded in equity are recognized in the income statement 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 in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less.

2.6 Financial Assets

2.6.1 Classification

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

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

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

(b) Loans and receivables

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

(c) Held-to-maturity investments

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

(d) Available-for-sale financial assets

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

2.6.2 Recognition and Measurement

Regular purchases and sales of financial assets are recognized on the trade date. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the 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.

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

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

Interest on available-for-sale and held-to-maturity securities calculated using the effective interest method is recognized in the income statement as part of 'other income'. Dividends on available-for-sale equity instruments are recognized in the income statement as part of 'other income' when the 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 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 more than three months;
- For economic or legal reasons relating to the borrower's financial difficulty, granting to the

borrower a concession that the lender would not otherwise consider;
- It becomes probable that the borrower will enter bankruptcy or other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties; or
- Observable data suggesting that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, even though the decrease cannot be identified with respect to individual financial assets in the portfolio, such as:
  (i) adverse changes in the payment status of borrowers in the portfolio;
  (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

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

(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 income statement. Impairment losses recognized in the consolidated income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the income statement.

2.8 Trade Receivables

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

2.9 Inventories

Inventories are measured at the lower of cost and net realizable value. The cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

The cost of inventories is determined by the weighted-average method for merchandise, finished goods, by-products, work-in-progress and tobacco leaf in raw materials, by the moving-average method for raw materials and supplies; and by the specific identification method for all other inventories.

When inventories are sold, the carrying amount of those inventories is recognized as an expense in the period in which the related revenue is recognized. The amount of any write-down of inventories to net realizable value and all losses of inventories are recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realizable value, is recognized as a reduction in the amount of inventories and recognized as an expense in the period in which the reversal occurs.

Tobacco leaf inventories which have an operating cycle that exceeds 12 months are classified as current assets, consistent with recognized industry practice. The estimated amounts of inventories in current assets which are not expected to be realized within 12 months are ₩ 332,949 million and ₩ 385,459 million as of June 30, 2012 and December 31, 2011, respectively.

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

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

2.11 Property, Plant and Equipment

All property, plant and equipment are stated at historical cost less depreciation and accumulated impairment loss. Historical cost includes expenditures directly attribute to the acquisition of the 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 income statement during the financial period in which they are incurred.

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

Buildings	10 - 60 years
Structures	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 recognized within 'other gains and losses, net' in the income statement.

2.12 Borrowing Costs

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

2.13 Government Grants

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

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

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

2.14 Intangible Assets

(a) Goodwill

Goodwill is measured as explained in Note 2.2(1) 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.
Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of goodwill is compared to the recoverable amount, which is the higher of value in use and the fair value less costs to sell. Any impairment is recognized immediately as an expense and is not subsequently reversed.

(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

Amortization periods and amortization methods for intangible assets with finite useful lives are reviewed at the end of each reporting period. The useful lives of intangible assets that are not being amortized are reviewed at the end of each reporting period to determine whether events and circumstances continue to support indefinite useful life assessment for those assets. The change is accounted for as a change in an accounting.

2.15 Investment Property

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

Subsequent costs are include in the asset's carrying amount or recognized as a separate asset, only when it is probable that future economic benefits associated with the item will flow to the 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 income statement during the financial period in which they are incurred.

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

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

2.16 Impairment of Non-financial Assets

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

2.17 Trade Payables

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

2.18 Borrowings

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

2.19 Compound Financial Instruments

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

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

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

2.20 Provisions

Provisions are recognized when: the 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 income statement, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position date in the countries where the Group operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities. Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the 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.

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 obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognized past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

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

(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 Company's equity holders until the shares are cancelled or reissued. Where such ordinary shares are subsequently reissued, any consideration received is included in equity attributable to the Company's equity holders.

2.24 Revenue Recognition

The 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 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, 2012 and 2011, were ₩ 1,715,665 million and ₩ 1,621,464 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 Judgments

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

(a) 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.

(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 warranties and repairs and 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 Company determines the appropriate discount rate at the end of each year. This is the interest rate that is used to determine the present value of estimated future cash outflows expected to be required to settle the defined benefit liability. In determining the appropriate discount rate, the Company considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the pension benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Other key assumptions for defined benefit liability are based in part on current market conditions. Additional information is disclosed in Note 24.

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 Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. The Company uses derivative financial instruments to hedge certain risk exposures.
Risk management is carried out by a central treasury department (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.

(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, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012			December 31, 2011		
	USD	EUR	JPY	USD	EUR	JPY
Assets						
Cash and cash equivalents	W 27,962	W 19	W 3,555	W 26,121	W 68	W 1,471
Trade and other receivables	539,692	20,510	3,970	431,592	17,078	3,560
Long-term deposits	163,633	-	-	147,290	-	-
	W 731,287	W 20,529	W 7,525	W 605,003	W 17,146	W 5,031
Liabilities						
Trade and other payables	W 60,482	W 6,241	W 580	W 41,997	W 4,491	W 54,559
Short-term borrowings	1,515	-	-	-	-	-
	W 61,997	W 6,241	W 580	W 41,997	W 4,491	W 54,559

As of June 30, 2012 and December 31, 2011, the effects of a 10% strengthening or weakening of functional currency against the US dollar other than functional currency on profit before tax were as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
	10% strengthening	**10% weakening**	**10% strengthening**	**10% weakening**
US dollar	W 66,929	W (66,929)	W 56,301	W (56,301)

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

(in millions of Korean won)	**June 30, 2012**		**December 31, 2011**	
	5% increase	**5% decrease**	**5% increase**	**5% decrease**
Other comprehensive income before tax	₩ 7,775	₩ (7,775)	₩ 8,464	₩ (8,464)
Tax effect	(1,710)	1,710	(2,048)	2,048
Other comprehensive income after tax	₩ 6,065	₩ (6,065)	₩ 6,416	₩ (6,416)

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, 2012 and December 31, 2011, the amount of borrowings issued at variable rates is ₩ 39,087 million and ₩ 27,840 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 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, 2012 and December 31, 2011, is as follows:

(in millions of Korean won)	**June 30, 2012**	**December 31, 2011**
Available-for-sale financial assets	₩ 267,796	₩ 248,402
Long-term deposits in MSA Escrow Fund	163,633	147,290
Trade and other receivables	1,058,893	967,425
Other financial assets	545,398	12,516
Cash and cash equivalents	640,629	807,731
	₩ 2,676,349	₩ 2,183,364

(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 Group entered into an overdraft agreement with the National Agricultural Cooperative Federation to manage the temporary liquidity risk.

The maturity analysis with a residual contractual maturity of financial liabilities as of June 30, 2012 and December 31, 2011, is as follows:

	June 30, 2012					
(in millions of Korean won)	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	W 323,201	W 323,201	W 209,613	W 79,053	W 34,535	W -
Short-term borrowings	80,434	81,336	67,607	13,729	-	-
Long-term borrowings	60,475	69,189	124	386	68,319	360
Current portion of long-term borrowings	2,052	2,090	1,688	402	-	-

	December 31, 2011					
(in millions of Korean won)	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	W 311,421	W 312,555	W 95,050	W 208,109	W 7,338	W 2,058
Short-term borrowings	82,836	82,998	50,354	32,644	-	-
Long-term borrowings	37,847	45,568	175	542	44,550	301
Current portion of long-term borrowings	3,126	3,166	1,243	1,923	-	-

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.

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

(in millions of Korean won)	June 30, 2012	December 31, 2011
Total borrowings	₩ 142,960	₩ 123,809
Less:		
-Cash and cash equivalents	(640,629)	(807,731)
-Other financial assets	(525,153)	(11,089)
-Available-for-sale financial assets	(1,044)	(1,044)
Net debt	(1,023,866)	(696,055)
Equity attributable to owners of the parent	₩ 4,888,519	₩ 4,885,077

4.3 Fair Value Estimation

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

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly(that is, as prices) or indirectly (that is, derived from prices) (Level 2).

- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3).

The following table presents the Group's financial assets and financial liabilities that are measured at fair value as of June 30, 2012:

(in millions of Korean won)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Available-for-sale financial assets	₩ 195,322	₩ 52,486	₩ 12,009	₩ 259,817
Total assets	₩ 195,322	₩ 52,486	₩ 12,009	₩ 259,817

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

(in millions of Korean won)	**Level 1**	**Level 2**	**Level 3**	**Total**
Assets				
Available-for-sale financial assets	₩ 187,311	₩ 42,604	₩ 12,009	₩ 241,924
Total assets	₩ 187,311	₩ 42,604	₩ 12,009	₩ 241,924

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.

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, 2012 and 2011, follows:

	June 30, 2012						
(in millions of Korean won)	**Tobacco**	**Ginseng**	**Real estate**	**Others**	**Segment total**	**Elimination**	**Consolidated**
Total segment sales	W 1,336,311	W 501,888	W 20,705	W 193,824	W 2,052,728	W (85,727)	W 1,967,001
Less: Inter-segment sales	27,309	27,683	3,911	26,824	85,727	(85,727)	-
External sales	1,309,002	474,205	16,794	167,000	1,967,001	-	1,967,001
Profit from operations	473,977	89,517	12,185	(7,290)	568,389	(23,394)	544,995

	June 30, 2011						
(in millions of Korean won)	**Tobacco**	**Ginseng**	**Real estate**	**Others**	**Segment total**	**Elimination**	**Consolidated**
Total segment sales	W 1,208,958	W 517,298	W 13,523	W 85,416	W 1,825,195	W (102,155)	W 1,723,040
Less: Inter-segment sales	23,452	57,134	2,399	19,170	102,155	(102,155)	-
External sales	1,185,506	460,164	11,124	66,246	1,723,040	-	1,723,040
Profit from operations	407,082	122,603	2,206	10,999	542,890	(12,075)	530,815

(3) Segment information on assets and liabilities as of June 30, 2012 and 2011, are as follows:

	June 30, 2012						
(in millions of Korean won)	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Assets							
Segment assets	W 3,429,228	W1,157,749	W 136,491	W 339,550	W 5,063,018	W (186,328)	W 4,876,690
Equity accounted investments	-	-	44,073	3,092	47,165	-	47,165
Assets held for sale	9,802	-	-	-	9,802	-	9,802
	W 3,439,030	W 1,157,749	W 181,564	W 342,642	W 5,119,985	W (186,328)	W 4,933,657
Unallocated assets							1,752,922
Total assets							W 6,686,579
Liabilities							
Segment liabilities	W 1,142,921	W 172,518	-	W 62,939	W 1,378,378	W (143,524)	W 1,234,854
Unallocated liabilities							563,206
Total liabilities							W 1,798,060

	December 31, 2011						
(in millions of Korean won)	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Assets							
Segment assets	W 3,332,975	W 1,128,405	W 154,456	W 382,278	W 4,998,114	W (121,801)	W 4,876,313
Equity accounted investments	-	-	33,681	1,649	35,330	-	35,330
Assets held for sale	3,196	-	-	-	3,196	-	3,196
	W 3,336,171	W 1,128,405	W 188,137	W 383,927	W 5,036,640	W (121,801)	W 4,914,839
Unallocated assets							1,361,577
Total assets							W 6,276,416
Liabilities							
Segment liabilities	W 766,856	W 136,388	-	W 71,461	W 974,705	W (124,565)	₩ 850,140
Unallocated liabilities							541,198
Total liabilities							W 1,391,338

(4) The major customers who contribute 10% or more of the Group's total revenues for the six-month periods ended June 30, 2012 and 2011, are as follows:

Segment	Major customer	**June 30, 2012**	**June 30, 2011**
Tobacco	Alokozay International Limited	₩ 191,157	₩ 205,500

6. Financial Instruments by Category

Categorizations of financial assets as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012				
	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for-sale	Total
Cash and cash equivalents	W 640,629	W -	W -	W -	W 640,629
Financial assets as available-for-sale, current	-	-	-	1,044	1,044
Trade and other receivables, current	935,873	-	-	-	935,873
Other financial assets, current	525,153	-	-	-	525,153
Long-term deposits	163,633	-	-	-	163,633
Financial assets as available-for-sale, non-current	-	-	-	266,752	266,752
Long-term Trade and other receivables	123,020	-	-	-	123,020
Other financial assets, non-current	20,245	-	-	-	20,245
	W 2,408,553	W -	W -	W 267,796	W 2,676,349

(in millions of Korean won)	December 31, 2011				
	Loans and receivables	Assets at fair value through profit or loss	Derivative financial instruments	Assets classified as available-for-sale	Total
Cash and cash equivalents	W807,731	W -	W -	W -	W 807,731
Financial assets as available-for-sale, current	-	-	-	1,044	1,044
Trade and other receivables, current	833,310	-	-	-	833,310
Other financial assets, current	11,089	-	-	-	11,089
Long-term deposits	147,290	-	-	-	147,290
Financial assets as available-for-sale, non-current	-	-	-	247,359	247,359
Long-term Trade and other receivables	134,115	-	-	-	134,115
Other financial assets, non-current	1,427	-	-	-	1,427
	W1,934,962	W -	W -	W 248,403	W 2,183,365

Categorizations of financial liabilities as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012				
	Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total
Borrowings, current	W -	W -	W 80,434	W -	W 80,434
Borrowings, non-current	-	-	60,475	-	60,475
Current portion of long-term borrowings	-	-	2,052	-	2,052
Trade and other payables, current	-	-	459,604	-	459,604
Trade and other payables, non-current	-	-	26,125	-	26,125
	W -	W -	W 628,690	W -	W 628,690

(in millions of Korean won)	December 31, 2011 Liabilities at fair value through profit or loss	Derivative financial instruments	Other financial liabilities at amortized cost	Other financial liabilities	Total
Borrowings, current	W -	W -	W 82,836	W -	W 82,836
Borrowings, non-current	-	-	37,847	-	37,847
Current portion of long-term borrowings	-	-	3,126	-	3,126
Trade and other payables, current	-	-	422,734	-	422,734
Trade and other payables, non-current	-	-	26,031	-	26,031
	W -	W -	W 572,574	W -	W 572,574

Income and loss of financial instruments by category for the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	2012 Three months	2012 Six months	2011 Three months	2011 Six months
Available-for-sale financial assets				
Gain(Loss) on valuation (Other comprehensive income(loss))	W (14,158)	W 6,167	W 157	W (13,502)
Gain(Loss) on disposal (Profit or loss)	-	(9)	643	643
Interest income	12	17	46	59
Dividend income	1,061	4,476	667	3,999
Impairment	-	-	3,988	-
Cash and cash equivalents				
Interest income	1,635	8,865	7,203	15,525
Gain(Loss) on foreign currency translation	(203)	(88)	(425)	(81)
Foreign currency transaction gain (loss)	198	(367)	(433)	(428)
Trade and other receivables				
Interest income	5,994	8,045	435	955
Gain(Loss) on foreign currency translation	5,677	(2,684)	(7,415)	(19,040)
Foreign currency transaction gain (loss)	3,200	1,866	(6,031)	(8,234)
Other financial liabilities at amortized cost				
Interest costs	(1,489)	(5,418)	(1,157)	(1,835)
Gain(Loss) on foreign currency translation	1,423	1,982	973	631
Foreign currency transaction gain (loss)	(2,525)	(2,117)	1,085	496

7. Available-for-sale Financial Assets

The changes in available-for-sale financial assets as of June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	June 30, 2012		June 30, 2011	
At January 1	₩	248,403	₩	315,177
Additions		11,500		10,000
Disposals		(243)		(1,927)
Net gains(losses) transfer to equity		8,136		(17,311)
Transfer to others		-		(17,300)
Impairment losses		-		(3,988)
At June 30		267,796		284,651
Less: current portion		(1,044)		-
Non-current portion	₩	266,752	₩	284,651

Available-for-sale financial assets as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
Available-for-sale debt instruments:				
Government and municipal bonds	₩	336	₩	336
Corporate bonds		3,540		2,040
Total available-for-sale debt instruments		3,876		2,376
Available-for-sale equity instruments:				
Listed				
Yonhap Television News(YTN)		32,388		23,130
Oscotech, Inc.		1,442		2,049
Shinhan Financial Group Co., Ltd.		159,132		159,332
Rexahn Pharmaceuticals, Inc.		2,359		2,801
		195,321		187,312
Unlisted				
Dream Hub PFV Co., Ltd.		12,009		12,009
Others		56,589		46,706
		68,598		58,715
Total available-for-sale equity instruments		263,919		246,027
Total available-for-sale financial assets	₩	267,795	₩	248,403

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

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

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

8. Trade and Other Receivables

Trade and other receivables as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 9,303	₩ 26,625	₩ 13,424	₩ 32,441
Loans	575	7,867	1,917	8,540
Other receivables	63,615	22,699	62,910	22,281
Guarantee deposits	-	65,829	-	70,853
Accrued income	3,892	-	1,962	-
Trade receivables	858,488	-	753,097	-
	₩ 935,873	₩ 123,020	₩ 833,310	₩ 134,115

Trade and other receivables as of June 30, 2012 and December 31, 2011, reported in the consolidated statements of financial position, net of allowances, are as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 952,202	₩ 123,020	₩ 849,691	₩ 134,115
Allowance account				
-Loans	(199)	-	(199)	-
-Other receivables	(2,235)	-	(2,235)	-
-Trade receivables	(13,895)	-	(13,947)	-
	(16,329)	-	(16,381)	-
Net amount	₩ 935,873	₩ 123,020	₩ 833,310	₩ 134,115

Changes in the allowance account for the six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	June 30, 2012	June 30, 2011
Beginning	₩ 16,381	₩ 8,809
Impairment	836	250
Reversal of impairment	(795)	(15)
Write-off	(93)	(709)
Net exchange difference	-	(10)
Ending	₩ 16,329	₩ 8,325

The aging schedule of trade and other receivables as of June 30, 2012 and December 31, 2011, is as follows:

(in millions of Korean won)	**June 30, 2012**	**December 31, 2011**
Not past due	₩ 490,464	₩ 534,899
Past due but not impaired		
Within 1 month	60,609	59,256
Between 1 and 2 months	43,300	58,873
Beyond 2 months	262,923	100,069
	366,832	218,198
Impaired	15,087	13,947
	₩ 872,383	₩ 767,044

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 as of June 30, 2012, and December 31, 2011, are as follows:

(Number of shares)	June 30, 2012			December 31, 2011		
	Effective interest rate	Current	Non-current	Effective interest rate	Current	Non-current
Loans to employees	1.70~7.29%	₩ 9,297	₩ 26,625	3.00~5.68%	₩ 13,422	₩ 32,427
Loans	1.70~7.29%	-	5,622	3.13~7.29%	1,521	4,673
Other receivables	3.79%	-	22,699	3.79%	7,997	22,281
Guarantee deposits	1.70~8.47%	-	63,325	2.50~7.29%	-	67,661
		₩ 9,297	₩118,271		₩ 22,940	₩ 127,042

9. Long-term Deposits

Long-term deposits of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	**June 30, 2012**	**December 31, 2011**
MMF	₩ 163,633	₩ 147,290

As discussed in Note 32 to the separate financial statements, long-term deposits in MSA Escrow Fund are deposited to the United States government related to the export of tobacco to the United States. The payments of long-term deposits in MSA Escrow Fund for the six-month periods ended June 30, 2012 and 2011, are ₩16,552 million and ₩7,544 million, respectively.

Investment income on long-term deposits in MSA Escrow Fund for the six-month periods ended June 30, 2012 and 2011, are ₩85 million and ₩2,072 million, respectively.

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

10. Property, Plant and Equipment

Changes in property, plant and equipment for the six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	June 30, 2012 Acquisition Cost	June 30, 2012 Accumulated depreciation and impairment cost	June 30, 2012 Net book value
Land	W 474,816	W -	W 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
	W 2,886,451	W (1,304,815)	W 1,581,636

(in millions of Korean won)	June 30, 2011 Acquisition Cost	June 30, 2011 Accumulated depreciation and impairment cost	June 30, 2011 Net book value
Land	W 456,297	W -	W 456,297
Buildings	769,906	(273,956)	495,950
Structures	63,419	(32,699)	30,720
Machinery	996,935	(643,373)	353,562
Vehicles	8,032	(6,038)	1,994
Tools	46,045	(36,200)	9,845
Furniture and fixture	200,694	(147,615)	53,079
Others	944	-	944
Construction-in-progress	136,011	-	136,011
	W 2,678,283	W (1,139,881)	W 1,538,402

(in millions of Korean won)	June 30, 2012 Opening net book value	Additions	Disposal	Depreciation	Exchange difference	Transfer[1]	Net book amount
Land	₩ 460,487	₩ 5,510	₩ (5,266)	₩ -	₩ (42)	₩ 14,127	₩ 474,816
Buildings	532,066	3,226	(6,362)	(18,804)	(773)	3,443	512,796
Structures	30,072	360	(277)	(1,759)	(53)	688	29,031
Machinery	365,040	5,245	(58)	(39,515)	(323)	12,695	343,084
Vehicles	3,547	285	(47)	(655)	(39)	22	3,113
Tools	9,871	815	(186)	(2,492)	(24)	-	7,984
Furniture and fixture	66,299	15,648	(604)	(15,466)	(193)	524	66,208
Others	1,219	10	-	-	-	-	1,229
Construction-in-progress	115,745	66,389	(603)	-	(6)	(38,150)	143,375
	₩ 1,584,346	₩ 97,488	₩ (13,403)	₩ (78,691)	₩ (1,453)	₩ (6,651)	₩ 1,581,636

(in millions of Korean won)	June 30, 2011						
	Opening net book value	Additions	Disposal	Depreciation	Exchange differences	Transfer[1]	Net book amount
Land	₩ 436,950	₩ 415	₩ (5,641)	₩ -	₩ (67)	₩ 24,640	₩ 456,297
Buildings	496,353	1,111	(590)	(14,057)	(80)	13,213	495,950
Structures	32,047	135	(95)	(1,603)	78	158	30,720
Machinery	381,380	2,152	(258)	(37,007)	(1,004)	8,299	353,562
Vehicles	1,789	452	-	(436)	(5)	194	1,994
Tools	12,166	397	-	(2,689)	(29)	-	9,845
Furniture and fixture	60,015	8,278	(65)	(15,444)	(57)	352	53,079
Others	749	-	(10)	-	-	205	944
Construction-in-progress	89,389	125,586	-	-	(12)	(78,952)	136,011
	₩ 1,510,838	₩ 138,526	₩ (6,659)	₩ (71,236)	₩ (1,176)	₩ (31,891)	₩ 1,538,402

[1] Transfers for the six-month period ended June 30, 2012, were transferred to assets held for sale.

11. Intangible Assets

Changes in intangible assets for the six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	June 30, 2012					
	Goodwill	Industrial property rights	Facility usage rights	Other intangible assets	Intangible assets under development	Total
At January 1, 2012	W 87,902	W 23,454	W 24,387	W 106,641	W 16,234	W 258,618
Exchange differences	23	13,174	(1)	(174)	339	13,361
Additions	-	172	1,319	725	664	2,880
Acquisition of subsidiary	-	-	-	-	-	-
Transfer-in (out)	-	68	-	-	(68)	-
Disposals	-	(861)	-	(116)	(13,395)	(14,372)
Amortization	-	(1,451)	-	(4,932)	-	(6,383)
Impairment / reversal	-	-	-	-	-	-
Other Changes	-	-	-	-	-	-
Acquisition Cost	87,925	44,281	25,705	114,419	4,201	276,531
Accumulated depreciation and impairment cost	-	(9,725)	-	(12,275)	(427)	(22,427)
Net book amount	W 87,925	W 34,556	W 25,705	W 102,144	W 3,774	W 254,104

(in millions of Korean won)	June 30, 2011				
	Industrial property rights	**Facility usage rights**	**Other intangible assets**	**Intangible assets under development**	**Total**
At January 1, 2011	W 2,049	W 24,189	W 4,194	W 32,713	W 63,145
Exchange differences	-	(1)	(79)	-	(80)
Additions	353	2,719	8,812	1,031	12,915
Acquisition of subsidiary	-	-	-	-	-
Transfer-in (out)	92	-	-	- 92	-
Disposals	(16)	(3,322)	(1)	-	(3,339)
Amortization	(31)	-	(910)	-	(941)
Impairment / reversal	-	-	-	-	-
Other Changes	-	-	-	-	-
Acquisition Cost	10,372	23,585	24,461	34,299	92,717
Accumulated depreciation and impairment cost	(7,925)	-	(12,445)	(647)	(21,017)
Net book amount	W 2,447	W 23,585	W 12,016	W 34,299	W 92,717

Research and development expenses for the six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	**June 30, 2012**		**June 30, 2011**	
	Three months	**Six months**	**Three months**	**Six months**
Cost of goods sold	₩ 284	₩ 574	₩ 247	₩ 419
Selling and administrative expenses	7,782	15,665	6,192	11,360
	₩ 8,066	₩ 16,229	₩ 6,439	₩ 11,779

Exchange loss of ₩23 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 translation of overseas operations.

12. Investment Property

Changes in investment property for the six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	June 30, 2012		
	Land	**Building**	**Total**
Beginning net book value	W 45,314	W 143,037	W 188,351
Transfers[1]	(563)	(4,301)	(4,864)
Depreciation	-	(3,101)	(3,101)
Acquisition cost	W 44,751	W 177,980	W 222,731
Accumulated depreciation	-	(42,345)	(42,345)
Net book amount	W 44,751	W 135,635	W 180,386

(in millions of Korean won)	June 30, 2011		
	Land	Building	Total
Beginning net book value	₩ 36,550	₩ 84,933	₩ 121,483
Additions	-	1,232	1,232
Transfer to property, plant and equipment	(268)	(291)	(559)
Transfer from property, plant and equipment	1,481	26,258	27,739
Depreciation	-	(2,220)	(2,220)
Acquisition cost	₩ 37,763	₩ 148,916	₩ 186,679
Accumulated depreciation	-	(39,004)	(39,004)
Net book amount	₩ 37,763	₩ 109,912	₩ 147,675

[1] Transfers for the six-month period ended June 30, 2012, represent assets held for sale transferred.

The amounts recognized in profit or loss from investment property for the six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	June 30, 2012		June 30, 2011	
	Three-month	Six-month	Three-month	Six-month
Rental income	₩ 8,375	₩ 15,580	₩ 4,870	₩ 9,223
Direct operating expense	(1,550)	(3,101)	(1,162)	(2,220)
	₩ 6,825	₩ 12,479	₩ 3,708	₩ 7,003

Fair values and book values of investment property as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
	Fair value	Book value	Fair value	Book value
Land	₩ 309,483	₩ 44,752	₩ 313,922	₩ 45,314
Building	188,613	135,634	198,204	143,037
	₩ 498,096	₩ 180,386	₩ 512,126	₩ 188,351

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

The Group entered into a sales contract with HT&D Co., Ltd. to sell the Gyeonggi branch's land, building and others. The Group received partial payment amounting to ₩1,500 million out of total amount ₩17,820 million during the six-month period ended June 30, 2012, and has agreed to receive in installments the balance of ₩16,320 millon after the current period.

Also, the Group has an agreement with Mr. Jae-chil Kim and two others for sale of Namulsan Tower's land, building and others and has sales contracts on Gwangju branch and Samcheok branch's land, buildings and others with the city governments of Gwangju and Samcheok, respectively.

Changes in non-current assets held for sale for the six-month period ended June 30, 2012, are as follows:

(in millions of Korean won)	June 30, 2012				
	Land	**Buildings**	**Structures**	**Machinery**	**Total**
At January 1, 2012					
Acquisition cost	W 2,273	W 1,429	W 197	W -	W 3,899
Accumulated depreciation	-	(553)	(150)	-	(703)
Net book amount	W 2,273	W 876	W 47	W -	W 3,196
Changes					
Transfer from property, plant and equipment	W 6,298	W 235	W 73	W 45	W 6,651
Transfer from investment property	563	4,301	-	-	4,864
Disposals	(562)	(4,288)	(14)	(45)	(4,909)
	W 6,299	W 248	W 59	W -	W 6,606
At June 30, 2012					
Acquisition cost	W 8,572	W 1,910	W 421	W -	W 10,903
Accumulated depreciation	-	(786)	(315)	-	(1,101)
Net book amount	W 8,572	W 1,124	W 106	W -	W 9,802

14. Pledged Assets

The following assets were pledged as collateral for the Group's borrowings and others as of June 30, 2012:

(in millions of Korean won)

Asset	**Book amount**		**Borrowings**	**Collateralized amount**	**Lender /Leaseholder**
Property, plant and equipment Investment Property	W 104,973	Short-term borrowings	W 51,786	W 90,301	Hana Bank and 4 others
		Long-term borrowings	9,380		
Investment Property	143,917	Leasehold deposits received	7,729	8,045	Metlife Insurance Korea Co.,Ltd. and 29 others
Total	W 248,890		W 68,895	W 198,346	

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

(in millions of Korean won)

Asset	Book amount		Borrowings	Collateralized amount	Lender /Leaseholder
Property, plant and equipment		Short-term borrowings	W 21,906		
Investment Property	W 82,776	Current portion of Long-term borrowings	549	W 94,946	Hana Bank and 5 others
Investment Property		Long-term borrowings	9,821		
Investment Property	89,705	Leasehold deposits received	6,576	7,469	Metlife Insurance Korea Co.,Ltd. and 27 others
Total	W 172,481		W 38,852	W 102,415	

15. Investments in Associates

Investments in associates as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)

Associates	Location	Principal operation	June 30,2012		December 31,2011	
			Interest (%)	Carrying Amount	Interest (%)	Carrying Amount
Cosmo Tabacco Co., Ltd.	Mongolia	Manufacturing and selling tobaccos	40.00	W -	40.00	W -
Lite Pharm Tech, Inc	Korea	Manufacturing and Medical supplies	25.34	686	25.34	637
Korean Carbon Finance, Inc.	Korea	Emissions trading	20.00	960	20.00	1,013
JR CR-REIT IV Co., Ltd.	Korea	Selling and renting of real estate	49.02	14,623	49.02	13,819
KVG REIT 1 Co., Ltd.	Korea	Selling and renting of real estate	29.67	7,262	29.67	7,354
KOCREF REIT 17 Co., Ltd.	Korea	Selling and renting of real estate	22.06	6,918	22.06	6,872
JR REIT V Co., Ltd.	China	Selling and renting of real estate	34.63	5,611	34.63	5,635
JR REIT VIII Co., Ltd.	Korea	Selling and renting of real estate	21.74	9,658	-	-
LSK Global Pharma Services Co., Ltd	Korea	Research and developing new drug	23.15	1,447	-	-
Total				W 47,165		W 35,330

Changes in investments in associates and subsidiaries for the six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	June 30, 2012				
	Beginning balance	Acquisition	Disposals	Other changes	Ending balance
Associates					
Lite Pharm Tech, Inc	W 637	W -	W 49	W -	W 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)	7,262
KOCREF REIT 17 Co., Ltd.	6,872	-	46	-	6,918
JR REIT V Co., Ltd.	5,635	-	188	(211)	5,611
JR REIT VIII Co., Ltd.	-	10,000	(342)	-	9,658
LSK Global Pharma Services Co., Ltd	-	1,500	(53)	-	1,447
	W 35,330	W 11,500	W 1,298	W (963)	W 47,165

(in millions of Korean won)	June 30, 2011				
	Beginning balance	Acquisition	Share of profit(loss)	Other changes	Ending balance
Lite Pharm Tech, Inc	W 645	W -	W (22)	W -	W 623
Korean Carbon Finance, Inc.	952	-	(33)	-	919
JR CR-REIT IV Co., Ltd.	-	-	338	9,601	9,939
KVG REIT 1 Co., Ltd.	-	-	104	7,300	7,404
KOCREF REIT 17 Co., Ltd.	-	7,000	186	(209)	6,977
JR REIT V Co., Ltd.	-	5,600	88	-	5,688
	W 1,597	W 12,600	W 661	W 16,692	W 31,550

[1] The Group reclassified ₩17,300 million of available-for-sale financial assets to investments in associates during the six-month period ended June 30, 2011.

The Group's share in the results of its associates, and its aggregated assets (including goodwill) and liabilities as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012			
	Assets	Liabilities	Revenues	Profit/(loss)
Lite Pharm Tech, Inc.	W 4,176	W 1,470	W 1,908	W 517
Korean Carbon Finance, Inc.	4,837	39	158	(253)
JR CR-REIT IV Co., Ltd.	65,552	35,720	2,630	773
KVG REIT 1 Co., Ltd.	52,545	28,072	2,788	544
KOCREF REIT 17 Co., Ltd.	67,153	35,798	2,190	209
JR REIT V Co., Ltd.	31,436	15,231	1,106	516
JR REIT VIII Co., Ltd.	101,058	53,484	962	(48)
LSK Global Pharma Services Co., Ltd.	3,996	1,825	3,615	(230)
	W 330,753	W 171,639	W 15,357	W 2,028

(in millions of Korean won)	December 31, 2011			
	Assets	Liabilities	Revenues	Profit/(loss)
Lite Pharm Tech, Inc.	W 4,041	W 1,527	W 1,549	W (32)
Korean Carbon Finance, Inc.	5,158	97	1,143	303
JR CR-REIT IV Co., Ltd.	65,722	35,658	6,758	1,583
KVG REIT 1 Co., Ltd.	52,829	28,045	5,540	993
KOCREF REIT 17 Co., Ltd.	65,749	34,600	128	441
JR REIT V Co., Ltd.	31,480	15,208	540	831
	W 224,979	W 115,135	W 15,658	W 4,119

16. Inventories

Inventories as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012			December 31, 2011		
	Acquisition	Allowance	Book amount	Acquisition	Allowance	Book amount
Merchandise	W 7,866	W (958)	W 6,908	W 5,678	W (881)	W 4,797
Finished goods	334,315	(2,214)	332,101	307,308	(1,782)	305,526
Work in progress	175,978	(3,122)	172,856	328,087	(3,647)	324,440
Raw materials	823,783	(3,000)	820,783	874,359	(2,974)	871,385
Supplies	25,653	-	25,653	26,158	-	26,158
By-products	6,305	-	6,305	6,738	-	6,738
Goods-in-transit	16,686	-	16,686	33,255	-	33,255
	W 1,390,586	W (9,294)	W 1,381,292	W 1,581,583	W (9,284)	W 1,572,299

The cost related inventories for the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	June 30, 2012		June 30, 2011	
	Three months	Six months	Three months	Six months
Cost of sales				
-Loss(profit) on inventory valuation	W 1,904	W 1,553	W (590)	W (1)
Other expenses				
- Loss on retirement of inventories	698	2,321	2,663	3,351
	W 2,602	W 3,874	W 2,073	W 3,350

17. Cash and Cash Equivalents

Cash and cash equivalents as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
Cash on hand	W	7,701	W	4,554
Demand deposits		262,781		213,845
Short-term investment assets		370,147		589,332
	W	640,629	W	807,731

Other financial assets as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
Long-term Financial assets				
Time deposits	W	20,111	W	1,285
Deposit in current account		6		6
Money trust		128		136
		20,245		1,427
Short-term Financial assets				
Time deposits		81,153		3,442
Money trust		294,000		-
Certificate of deposit		150,000		7,647
		525,153		11,089
	W	545,398	W	12,516

Restricted financial assets as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	Description	June 30, 2012		December 31, 2011	
Cash and cash equivalents	Specific research purpose	W	80	W	-
Other financial assets	Pledge		8,347		9,677
Long-term other financial assets	Deposits		17		34
		W	8,444	W	9,711

18. Equity and Share Premium

Details of share capital as of June 30, 2012, and December 31, 2011, are as follows:

(in Korean won, except number of shares)	June 30, 2012		December 31, 2011	
Number of ordinary shares				
-Authorized		800,000,000		800,000,000
-Issued		137,292,497		137,292,497
Par value	₩	5,000	₩	5,000
Ordinary shares	₩	954,959,485,000	₩	954,959,485,000

The Parent Company has reacquired and retired 53,699,400 treasury shares. Accordingly, as of June 30, 2012, 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, 2012 and the year ended December 31, 2011, are as follows:

(Number of shares)	June 30, 2012			December 31, 2011		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning	137,292,497	(11,543,697)	125,748,800	137,292,497	(9,643,697)	127,648,800
Acquisition of treasury shares	-	-	-	-	(2,000,000)	(2,000,000)
Issuance of treasury shares	-	-	-	-	100,000	100,000
Ending	137,292,497	(11,543,697)	125,748,800	137,292,497	(11,543,697)	125,748,800

19. Treasury Shares

Changes in the treasury shares for the six-month period ended June 30, 2012 and the year ended December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Beginning	11,543,697	₩ 343,522	9,643,697	₩ 216,827
Acquisition of treasury shares	-	-	2,000,000	129,671
Issuance of treasury shares	-	-	(100,000)	(2,976)
Ending	11,543,697	₩ 343,522	11,543,697	₩ 343,522

Changes in gain on reissuance of treasury shares for the six-month period ended June 30, 2012 and the year ended December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012	December 31, 2011
Beginning	₩ 485,922	₩ 482,129
Gain on reissuance of treasury shares before tax	-	5,004
Less: tax at 24.2%	-	(1,211)
Gain on reissuance of treasury shares, net of tax	-	3,793
Ending	₩ 485,922	₩ 485,922

20. Reserves

Details of reserves as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
Available-for-sale financial assets reserve	₩	(25,688)	₩	(31,855)
Exchange differences on translating foreign operations		(19,019)		(15,501)
Legal reserve		602,937		602,937
Voluntary reserve		2,466,732		2,107,732
	₩	3,024,962	₩	2,663,313

Available-for-sale financial assets reserve as of June 30, 2012 and December 31, 2011, are summarized as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
Available-for-sale financial assets reserve before tax	₩	(33,889)	₩	(42,025)
Tax effect		8,201		10,170
	₩	(25,688)	₩	(31,855)

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, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
Reserve for business rationalization	₩	12,851	₩	12,851
Reserve for research and human resource development		60,000		60,000
Reserve for business expansion		698,881		698,881
Other reserve		1,695,000		1,336,000
	₩	2,466,732	₩	2,107,732

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.

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.

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, 2012 and the year ended December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012	December 31, 2011
Beginning	₩ 1,022,126	₩ 1,151,359
Transfer from other reserve	(359,000)	(544,000)
Dividends	(402,396)	(382,946)
Profit for the period	396,794	816,929
- Less: non-controlling interests	8,406	(871)
Actuarial losses, net of tax	(98)	(19,449)
- Less: non-controlling interests	1	1,104
Others	(3,328)	-
Ending	₩ 662,505	₩ 1,022,126

22. Accounts Payable and Other Finance Liabilities

Accounts payable and other finance liabilities as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012		December 31, 2011	
	Current	Non-current	Current	Non-current
Leasehold deposits received	W -	W 25,850	W 154	W 25,069
Accounts payable	91,221	-	81,938	-
Withholdings	162,528	-	137,344	644
Accrued expenses	135,931	-	131,775	-
Other payable	69,924	275	71,523	318
	W 459,604	W 26,125	W 422,734	W 26,031

Accounts payable and other finance liabilities carried at amortized cost using the effective interest rate method as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)	June 30, 2012			December 31, 2011		
	Effective interest rate(%)	Current	Non-current	Effective interest rate(%)	Current	Non-current
Leasehold deposits received	3.00~5.68	W -	W 25,850	3.00~5.68	W -	W 25,069

23. Borrowings

Details of borrowings as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)

	June 30, 2012		December 31, 2011	
Current				
Bank borrowings	W	66,749	W	75,021
Other borrowings		13,684		7,815
Bank borrowings(Current portion of long-term borrowings)		433		549
Other borrowings (Current portion of long-term borrowings)		1,619		1,619
Convertible bonds		-		958
		82,485		85,962
Non-current				
Bank borrowings		11,218		10,220
Other borrowings		2,678		2,738
Convertible bonds		12,220		12,577
Redeemable preference shares		34,359		12,312
		60,475		37,847
	W	142,960	W	123,809

Bank borrowings are collateralized with the Group's property, plant and equipment (Note 14).

Details of bank borrowings as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)

Currency	Creditor	Latest maturity date	Annual interest rate(%) June 30, 2012	June 30, 2012	December 31, 2011
Korean won	Kookmin Bank, other	Short-term Borrowings	4.62	W 3,052	W 6,351
Korean won	Citibank	Short-term Borrowings	CD(91)+1.25	27,553	28,829
Foreign currency	Citibank	Short-term Borrowings	12	4,155	-
Korean won	Hana Bank, other	Short-term Borrowings	4.13 ~ 6.1	31,982	35,606
Foreign currency	BCA, other	Short-term Borrowings	12.00	8	4,235
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	-
Korean won	Hana Bank	2013. 03. 15	2.00	210	503
Korean won	Hana Bank	2017. 03. 31	3.80	1,133	1,036
Korean won	Korea Development Bank	2014. 11. 07	5.44	8,000	8,474
Korean won	Korea Development Bank	2018. 06. 09	3.70	291	-
				W 78,400	W 85,790

Convertible Bond

The Company issued 9.5% convertible bonds at a par value of W12,410 million on December 14, 2011. The bonds will mature four years from the issue date and become convertible into shares at the rate of W1,199 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.

Redeemable preference shares

- instrument over the life: 10 year from the date of issue
- ordinary shares conversion option: In instrument over the life can be converted 1,090,909 ordinary shares at any time, and automatically converts over the maturity.
- recourse option: if KT&G Life Sciences will be not listed by the end of 2015, recourse is available.
- instrument over the life: 5 year from the date of issue
- ordinary shares conversion option: In instrument over the life can be converted 94,079 ordinary shares at any time, and automatically converts over the maturity.
- recourse option: if Somang Cosmetics Co., Ltd. will be not listed by the end of 2016, recourse is available.

24. Defined Benefit Liability

The amounts recognized on the statements of income for the six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	June 30, 2012	June 30, 2011
Defined benefit plans :		
Current service cost	₩ 18,930	₩ 15,863
Interest expenses	4,504	3,970
Expected return on plan assets	(3,250)	(2,902)
	20,184	16,931
Defined contribution plans :		
Pension costs	692	571
Total	₩ 20,876	₩ 17,502

Termination benefits for the six-month period ended June 30, 2012, were ₩1,194 million. Out of total expenses, ₩7,037 million (2011: ₩6,521million) and ₩13,839 million (2011: ₩10,981 million) were included in 'cost of sales' and 'selling and administrative expenses', respectively.

Defined benefit liability recognized on the statements of financial position as of June 30, 2012 and December 31, 2011, is as follows:

(in millions of Korean won)	June 30, 2012	December 31, 2011
Present value of defined benefit liability:	₩ 248,373	₩ 233,377
Fair value of plan assets	(148,591)	(150,295)
Liability on the statement of financial position	₩ 99,782	₩ 83,082

25. Classification of Operating Income

(1) Material items of operating income and expense

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

(2) Employee benefit costs for the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	2012 Three months	2012 Six months	2011 Three months	2011 Six months
Salaries	W 117,593	W 232,681	W 104,916	W 209,930
Retirement benefits	10,074	20,876	8,694	17,502
Termination benefits	-	1,194	24	24
Employee welfare	17,112	28,939	11,518	22,722
	W 144,779	W 283,690	W 125,152	W 250,178

(3) Depreciation and amortization for the the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	2012 Three months	2012 Six months	2011 Three months	2011 Six months
Depreciation	W 41,063	W 81,792	W 38,759	W 73,456
Amortization	3,792	6,383	542	941
	W 44,855	W 88,175	W 39,301	W 74,397

(4) Details of other income for the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	2012 Three months	2012 Six months	2011 Three months	2011 Six months
Foreign currency transaction gain	₩ 5,091	₩ 11,251	₩ 4,317	₩ 6,193
Foreign currency translation gain	6,896	7,111	1,796	3,313
Reversal of impairment loss on trade and other receivables	678	795	15	15
Gain on sale of investments in subsidiaries	-	-	1,139	1,139
Gain on sale of property, plant and equipment	7,854	9,605	1,486	6,715
Gain on sale of intangible assets	49	360	-	789
Others	4,470	9,058	1,604	4,335
	₩ 25,038	₩ 38,180	₩ 10,357	₩ 22,499

(5) Selling and administrative expenses for the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	2012 Three months	2012 Six months	2011 Three months	2011 Six months
Salaries	₩ 74,976	₩ 149,750	₩ 65,326	₩ 132,027
Retirement and termination benefits	6,761	14,807	5,478	11,005
Employee welfare	11,924	19,738	7,500	14,928
Travel	3,557	6,759	3,024	5,384
Communications	1,489	2,975	1,331	2,576
Utilities	2,109	4,941	1,497	3,987
Taxes and dues	3,925	8,542	4,520	8,566
Supplies	982	2,006	884	1,758
Rent	8,078	15,380	6,149	12,231
Depreciation	12,304	24,454	11,784	20,912
Amortization	3,833	6,383	505	850
Repairs and maintenance	2,806	4,400	2,332	3,940
Vehicles	3,110	6,120	2,599	4,913
Insurance	502	1,301	506	1,075
Commissions	55,001	106,999	38,900	77,116
Freight and custody	11,715	20,878	10,800	19,457
Conferences	1,794	3,084	1,160	2,424
Advertising	76,659	138,327	52,233	104,126
Training	2,399	4,248	1,705	3,412
Prizes and rewards	464	922	539	757
Normal research and development	7,782	15,655	6,192	11,360
	₩ 292,170	₩ 557,669	₩ 224,964	₩ 442,804

(6) Details of other expenses for the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	2012 Three months	2012 Six months	2011 Three months	2011 Six months
Foreign currency transaction loss	₩ 4,218	₩ 11,869	₩ 11,115	₩ 15,777
Foreign currency translation loss	-	7,902	7,245	20,385
Impairment loss on trade and other receivables	637	836	118	250
Donations	1,890	4,514	238	2,581
Loss on sale of property, plant and equipment	656	691	597	698
Loss on sale of intangible assets	23	403	50	175
Loss on retirement of inventories	-	-	2,663	3,351
Others	2,366	4,626	116	1,476
	₩ 9,791	₩ 30,841	₩ 22,142	₩ 44,693

26. Expenses by Nature

Expenses by nature for the the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	2012 Three months	2012 Six months	2011 Three months	2011 Six months
Changes in inventories	W 99,318	W 191,007	W (65,713)	W 16,424
Raw materials and consumables used	254,552	494,395	317,059	361,937
Salary and wage	117,593	233,875	104,940	209,954
Retirement and termination benefits	10,074	20,876	8,694	17,502
Depreciation charges	41,063	81,792	38,759	73,456
Amortization charges	3,792	6,383	542	941
Employee benefits	17,112	28,939	11,519	22,722
Advertising costs	77,501	138,106	16,618	37,515
Service fees	67,001	125,161	22,851	45,829
Other expenses	55,597	139,655	172,265	428,445
Total cost of sales, distribution costs and administrative expenses	W 743,603	W1,460,189	W 627,534	W1,214,725

27. Financial Income and Costs

Financial income and costs for the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	2012 Three months	2012 Six months	2011 Three months	2011 Six months
Financial cost				
Interest costs	W (1,489)	W (5,418)	W (1,157)	W (1,835)
Loss on sale of available-for-sale financial assets	-	(9)	-	-
Impairment loss on available-for-sale financial assets	-	-	-	(3,988)
	(1,489)	(5,427)	(1,157)	(5,823)
Financial income				
Interest income	7,641	16,927	7,684	16,539
Dividend income	1,060	4,476	667	3,998
Investment income on long-term deposits in MSA Escrow Fund	15	85	1,770	2,072
Gain on sale of available-for-sale financial assets	-	-	643	643
	8,716	21,488	10,764	23,252
Net financial income	W 7,227	W 16,061	W 9,607	W 17,429

Details of interest costs for the the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

	2012		**2011**	
(in millions of Korean won)	**Three months**	**Six months**	**Three months**	**Six months**
Borrowings	W (538)	W (2,852)	W (672)	W (1,332)
Trade and other payables	(26)	(468)	(336)	(354)
Others	(925)	(2,098)	(149)	(149)
	W (1,489)	W (5,418)	W (1,157)	W (1,835)

Details of interest income for the the three-month and six-month periods ended June 30, 2012 and 2011, are as follows:

	2012		**2011**	
(in millions of Korean won)	**Three months**	**Six months**	**Three months**	**Six months**
Deposits	W 1,635	W 8,865	W 7,203	W 15,525
Available-for-sale financial assets	12	17	46	59
Trade and other receivables	5,994	8,045	435	955
	W 7,641	W 16,927	W 7,684	W 16,539

28. Income Tax

Income tax expense was calculated based on the weighted average annual tax rate of corporate for the entire fiscal period. Estimated average annual tax rate of the year ended December 31, 2012, is 29.4%. The estimated tax rate for the three-month period ended June 30, 2011, was 28.8%. The increase in corporate income tax rate is due to 2% increase of tax rate. The increase in corporate tax rate has been applied from January 1, 2012.

29. Earnings per Share

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

Basic earnings per ordinary share for the three-month and six-month periods ended June 30, 2012 and 2011, is as follows:

	2012		**2011**	
(in millions of Korean won)	**Three months**	**Six months**	**Three months**	**Six months**
Profit for the year	W 214,380million	W 405,201million	W 215,047million	W 397,445million
Weighted-average number of ordinary shares outstanding	125,748,800	125,748,800	127,068,919	127,357,258
Basic and diluted earnings per share in won	W 1,705	W 3,222	W 1,692	W 3,121

30. Dividends

The dividends paid in 2012 and 2011 were ₩402,396 million and ₩382,946 million, respectively.

31. Cash Generated from Operations

(1) Cash generated from operations for the three-month periods ended June 30, 2012 and 2011, are as follows:

(in millions of Korean won)	June 30, 2012	June 30, 2011
Profit	W 396,795	W 398,404
Adjustments for:		
Income tax expense	165,558	150,502
Finance costs	5,428	5,823
Finance income	(21,489)	(23,253)
Depreciation	81,792	73,456
Amortization	6,383	941
Retirement and termination benefits	20,336	17,526
Foreign currency translations loss	7,902	20,385
Loss on the write-down of inventories	1,553	28
Impairment loss on trade and other receivables	836	250
Loss on sale of property, plant and equipment	691	698
Loss on sale of intangible assets	403	175
Other expense	1	3,369
Share of gain of associates	(1,746)	(716)
Share of loss of associates	448	55
Foreign currency translations gain	(7,111)	(3,313)
Reversal of impairment loss on trade and other receivables	(795)	(15)
Gain on sale of property, plant and equipment	(9,605)	(6,715)
Gain on sale of intangible assets	(359)	(789)
Other income	-	(1,168)
	647,021	635,643
Changes in working capital:		
Trade and other receivables	(126,233)	(61,140)
Advance payments	(138,842)	(130,684)
Prepaid expenses	(3,189)	(746)
Prepaid tobacco excise and other taxes	43,498	3,709
Inventories	172,811	174,315
Trade and other payables	51,518	51,311
Advance receipts	19,128	15,314
Tobacco excise and other taxes payable	323,942	45,205
Payment of retirement benefits	(3,788)	(5,654)
Cash generated from operations	W 985,866	W 727,273

(2) Non-cash transactions

(in millions of Korean won)	June 30, 2012
Reclassification of property, plant and equipment to non-current assets held for sale	W 11,516
Reclassification of investment property to property, plant and equipment	4,864
Reclassification of construction-in-progress to property, plant and equipment	38,150

32. Contingencies

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, 2012, 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, 2012.

As of June 30, 2012, the Group has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 47,500 thousand.

As of June 30, 2012, the Group's trade receivables from the export of cigarettes are insured against non-payment up to USD 16,300 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of June 30, 2012, the Group has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries for up to USD 70,000 thousand by Korea Exchange Bank and others.

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 ₩ 282,082 million (non-current: ₩ 184,927 million; current: ₩ 97,155 million) as of June 30, 2012.

As of June 30, 2012, the Group has an accounts receivable loan agreement with a limit of ₩ 85,000 million with Hana Bank and other financial institutions.

As of June 30, 2012, 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, 2012, the Group has a loan agreement with a limit of ₩ 92,003 million with Shinhan Bank and other financial institutions.

As of June 30, 2012, 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, 2012, the Group and 28 other companies are guaranteed ₩ 240,000 million by Seoul Guarantee Insurance Co., Ltd. related to the Yongsan International Commercial Development Project.

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

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 ("Individual Shareholder"). Details of the contract are as follows:

1) Conditional put option granted to 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 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 acquired Somang Cosmetics Co., Ltd.

2) Right of first refusal held by the Parent Company

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

3) Tag-along right held by 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 Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Parent Company.

With 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

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

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

3) Tag-along right held by 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 Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Parent Company.

As of June 30, 2012, the Group has letter of credit agreements with Korea Exchange Bank with limits in the aggregate of USD 2,500 thousand.

33. Related Party Transactions

The Group has no significant transactions and receivables, liabilities with related parties, for the three-month period ended June 30, 2012.

The guarantee provided by related parties as of June 30, 2012 and December 31, 2011, are as follows:

(in millions of Korean won)

Guarantor	Guarantee for	Purpose	June 30, 2012		December 31, 2011	
			Limitation	Exercise amount	Limitation	Exercise amount
Kang Seok-chang	Somang Cosmetics Co., Ltd.	Application funds	₩ 13,591	₩ 12,237	₩ 21,175	₩ 16,748

The compensation paid or payable to key management for employee services for the the three-month and six-month periods ended June 30, 2012 and 2011, consists of:

	2012		2011	
(in millions of Korean won)	Three months	Six months	Three months	Six months
Short-term employee benefits	₩ 6,726	₩ 12,721	₩ 4,258	₩ 8,852
Retirement benefits	867	2,018	434	859
	₩ 7,593	₩ 14,739	₩ 4,692	₩ 9,711

34. Basis of Translating Financial Statements

The financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩ 1,153.80 to US$1, the basic exchange rate on June 30, 2012, posted by Seoul Money Brokerage Services, solely for the convenience of the reader. This translation should not be construed as a representation that any or all of the amounts shown could be converted into U.S. dollars at this or any other rate.