

KT&G Corporation

Interim Separate Financial Statements
June 30, 2014 and 2013

KT&G Corporation
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June 30, 2014 and 2013

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Report on Review of Interim Financial Statements

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

Reviewed Financial Statements

We have reviewed the accompanying interim separate financial statements of KT&G Corporation. These financial statements consist of the separate statement of financial position KT&G Corporation (the Company) as of June 30, 2014, and the related separate statements of comprehensive income for the three-month and six-month periods ended June 30, 2014 and 2013, and the statements of changes in equity and cash flows for the six-month periods ended June 30, 2014 and 2013, and a summary of significant accounting policies and other explanatory notes, expressed in Korean won.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these separate financial statements in accordance with the International Financial Reporting Standards as adopted by the Republic of Korea ('Korean IFRS') 1034, *Interim Financial Reporting*, and for such internal control as management determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

Conclusion

Based on our reviews, nothing has come to our attention that causes us to believe the accompanying interim separate financial statements do not present fairly, in all material respects, in accordance with the Korean IFRS 1034, *Interim Financial Reporting*.

Other Matters

We have audited the separate statement of financial position of KT&G Corporation as of December 31, 2013, and the related separate statements of comprehensive income, changes in equity and cash flows for the year then ended, in accordance with auditing standards generally accepted in the Republic of Korea. We expressed an unqualified opinion on those financial statements in our audit report dated February 12, 2014. These financial statements are not included in this review report. The separate statement of financial position as of December 31, 2013, presented herein for comparative purposes, is consistent, in all material respects, with the above audited statement of financial position as of December 31, 2013.

The accompanying interim separate financial statements as of and for the six-month period ended June 30, 2014, have been translated into US dollars solely for the convenience of the reader and have been translated on the basis set forth in Note 34 to the interim separate financial statements.

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



Seoul, Korea
August 11, 2014

The report is effective as of August 11, 2014, 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 separate interim 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
Interim Separate Statements of Financial Position
June 30, 2014 and December 31, 2013

| <i>(in millions of Korean won and thousands of U.S. dollars)</i> | Notes | June 30, 2014 Korean won | June 30, 2014 U.S. dollars (Note 34) | December 31, 2013 Korean won |
|--|--------------|------------------------------------|---|--|
| Assets | | | | |
| Non-current assets | | | | |
| Property, plant and equipment | 9 | ₩ 1,177,141 | \$ 1,160,430 | ₩ 1,182,763 |
| Intangible assets | 10 | 22,018 | 21,705 | 21,191 |
| Investment property | 11,13 | 143,011 | 140,981 | 146,034 |
| Investments in associates | 14 | 60,225 | 59,370 | 60,225 |
| Investments in subsidiaries | 14 | 1,175,593 | 1,158,904 | 1,166,478 |
| Available-for-sale financial assets | 4,5,6 | 320,873 | 316,318 | 296,391 |
| Long-term deposits in MSA Escrow Fund | 4,5,8,31 | 245,198 | 241,718 | 219,760 |
| Long-term prepaid expenses | | 4,655 | 4,590 | 4,798 |
| Long-term trade and other receivables | 4,5,7,32 | 122,695 | 120,953 | 134,498 |
| | | <u>3,271,409</u> | <u>3,224,969</u> | <u>3,232,138</u> |
| Current assets | | | | |
| Inventories | 15 | 864,531 | 852,258 | 939,744 |
| Other financial assets | 4,5,16 | 610,000 | 601,341 | 660,000 |
| Prepaid tobacco excise and other taxes | | 252,977 | 249,386 | 262,770 |
| Trade and other receivables | 4,5,7,32 | 766,203 | 755,326 | 721,468 |
| Advance payments | | 39,561 | 38,999 | 16,472 |
| Prepaid expenses | | 2,999 | 2,956 | 3,879 |
| Cash and cash equivalents | 4,5,16 | 227,762 | 224,529 | 245,838 |
| | | <u>2,764,033</u> | <u>2,724,795</u> | <u>2,850,171</u> |
| Assets held for sale | 12 | <u>3</u> | <u>3</u> | <u>3</u> |
| Total assets | | <u>₩ 6,035,445</u> | <u>\$ 5,949,767</u> | <u>₩ 6,082,312</u> |
| Equity | | | | |
| Capital stock | 1,17 | ₩ 954,959 | \$ 941,403 | ₩ 954,959 |
| Other capital surplus | 17 | 3,582 | 3,531 | 3,582 |
| Treasury shares | 18 | (339,059) | (334,245) | (339,059) |
| Gain on reissuance of treasury shares | 18 | 492,032 | 485,047 | 492,032 |
| Reserve | 19 | 3,519,928 | 3,469,960 | 3,411,099 |
| Retained earnings | 20 | 364,867 | 359,687 | 509,820 |
| Total equity | | <u>4,996,309</u> | <u>4,925,383</u> | <u>5,032,433</u> |
| Liabilities | | | | |
| Non-current liabilities | | | | |
| Long-term trade and other payables | 4,5,21,32 | 27,082 | 26,698 | 28,269 |
| Long-term advance receipts | | 2,990 | 2,947 | 3,676 |
| Net defined benefit liability | 23 | 75,303 | 74,234 | 60,273 |
| Deferred income tax liabilities | | 50,186 | 49,473 | 53,823 |
| | | <u>155,561</u> | <u>153,352</u> | <u>146,041</u> |
| Current liabilities | | | | |
| Borrowings | 4,5,22 | 4,425 | 4,363 | 4,920 |
| Trade and other payables | 4,5,21,32 | 358,529 | 353,440 | 402,389 |
| Advance receipts | | 3,868 | 3,812 | 17,231 |
| Income taxes payable | | 120,822 | 119,107 | 136,285 |
| Tobacco excise and other taxes payable | | 395,931 | 390,310 | 343,013 |
| | | <u>883,575</u> | <u>871,032</u> | <u>903,838</u> |
| Total liabilities | | <u>1,039,136</u> | <u>1,024,384</u> | <u>1,049,879</u> |
| Total liabilities and equity | | <u>₩ 6,035,445</u> | <u>\$ 5,949,767</u> | <u>₩ 6,082,312</u> |

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

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

KT&G Corporation
Interim Separate Statements of Comprehensive Income
Three-Month Periods Ended June 30, 2014 and 2013

| | Notes | Period Ended June 30 | | |
|--|----------|----------------------|-----------------------------------|--------------------|
| | | 2014 Korean won | 2014 U.S. dollars (Note 34) | 2013 Korean won |
| <i>(in millions of Korean won and thousands of U.S. dollars, except per share amounts)</i> | | | | |
| Sales | | | | |
| Manufacture of tobacco | | ₩ 606,917 | \$ 598,301 | ₩ 564,977 |
| Real estate | | 42,810 | 42,203 | 19,793 |
| Exports of leaf tobacco and others | | 21,614 | 21,307 | 16,523 |
| | 31,32 | <u>671,341</u> | <u>661,811</u> | <u>601,293</u> |
| Cost of sales | | | | |
| Manufacture of tobacco | | (217,401) | (214,315) | (203,038) |
| Real estate | | (26,338) | (25,964) | (8,757) |
| Exports of leaf tobacco and others | | (14,879) | (14,667) | (10,313) |
| | 15,25,32 | <u>(258,618)</u> | <u>(254,946)</u> | <u>(222,108)</u> |
| Gross profit | | | | |
| Selling and administrative expenses | 24,25 | (154,278) | (152,088) | (151,639) |
| | | <u>258,445</u> | <u>254,777</u> | <u>227,546</u> |
| Operating income | | | | |
| Other income | 24,32 | 7,372 | 7,268 | 33,782 |
| Other expenses | 24,32 | (46,979) | (46,312) | (6,134) |
| Net other income | | | | |
| | | <u>(39,607)</u> | <u>(39,044)</u> | <u>27,648</u> |
| Finance income | 26 | 11,631 | 11,466 | 9,686 |
| Finance cost | 26 | (178) | (175) | (3,301) |
| Net finance income | | | | |
| | | <u>11,453</u> | <u>11,291</u> | <u>6,385</u> |
| Profit before income tax | | | | |
| Income tax expense | 27 | (54,883) | (54,104) | (63,321) |
| Profit for the period | | | | |
| | | <u>₩ 175,408</u> | <u>\$ 172,920</u> | <u>₩ 198,258</u> |
| Other comprehensive loss, net of tax | | | | |
| Items that will not be reclassified to profit or loss: | | | | |
| Remeasurements of the net defined benefit liability | | ₩ (97) | \$ (94) | ₩ 177 |
| Items that will be reclassified subsequently to profit or loss: | | | | |
| Change in value of available-for-sale financial assets | | (2,561) | (2,524) | (13,907) |
| Other comprehensive loss for the period, net of tax | | | | |
| | | <u>(2,658)</u> | <u>(2,618)</u> | <u>(13,730)</u> |
| Total comprehensive income for the period | | | | |
| | | <u>172,750</u> | <u>170,302</u> | <u>184,528</u> |
| Earnings per share attributable to the equity holders of the Company during the period (in won) | | | | |
| Basic and diluted earnings per share | 28 | ₩ 1,393 | \$ 1.00 | ₩ 1,575 |

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

KT&G Corporation
Interim Separate Statements of Comprehensive Income
Six-Month Periods Ended June 30, 2014 and 2013

| | Notes | Period Ended June 30 | | |
|--|----------|----------------------|-----------------------------------|--------------------|
| | | 2014 Korean won | 2014 U.S. dollars (Note 34) | 2013 Korean won |
| <i>(in millions of Korean won and thousands of U.S. dollars, except per share amounts)</i> | | | | |
| Sales | | | | |
| Manufacture of tobacco | | ₩ 1,183,847 | \$ 1,167,042 | ₩ 1,113,753 |
| Real estate | | 81,262 | 80,109 | 38,297 |
| Exports of leaf tobacco and others | | 37,366 | 36,835 | 29,902 |
| | 31,32 | <u>1,302,475</u> | <u>1,283,986</u> | <u>1,181,952</u> |
| Cost of sales | | | | |
| Manufacture of tobacco | | (433,379) | (427,227) | (393,949) |
| Real estate | | (48,671) | (47,980) | (15,962) |
| Exports of leaf tobacco and others | | (24,339) | (23,993) | (18,494) |
| | 15,25,32 | <u>(506,389)</u> | <u>(499,200)</u> | <u>(428,405)</u> |
| Gross profit | | | | |
| Selling and administrative expenses | 24,25 | (310,096) | (305,694) | (300,926) |
| | | <u>485,990</u> | <u>479,092</u> | <u>452,621</u> |
| Operating income | | | | |
| Other income | 24,32 | 13,614 | 13,421 | 68,115 |
| Other expenses | 24,32 | (43,751) | (43,130) | (9,559) |
| Net other income | | | | |
| | | <u>(30,137)</u> | <u>(29,709)</u> | <u>58,556</u> |
| Finance income | 26 | 24,831 | 24,477 | 23,145 |
| Finance cost | 26 | (478) | (471) | (15,386) |
| Net finance income | | | | |
| | | <u>24,353</u> | <u>24,006</u> | <u>7,759</u> |
| Profit before income tax | | | | |
| Income tax expense | 27 | (117,261) | (115,596) | (127,903) |
| Profit for the period | | | | |
| | | <u>₩ 362,945</u> | <u>\$ 357,793</u> | <u>₩ 391,033</u> |
| Other comprehensive income, net of tax | | | | |
| Items that will not be reclassified to profit or loss: | | | | |
| Remeasurements of the net defined benefit liability | | ₩ (501) | \$ (494) | ₩ 29 |
| Items that will be reclassified subsequently to profit or loss: | | | | |
| Change in value of available-for-sale financial assets | | 4,308 | 4,245 | (5,055) |
| Other comprehensive income for the period, net of tax | | | | |
| | | <u>3,807</u> | <u>3,751</u> | <u>(5,026)</u> |
| Total comprehensive income for the period | | | | |
| | | <u>366,752</u> | <u>361,544</u> | <u>386,007</u> |
| Earnings per share attributable to the equity holders of the Company during the period (in won) | | | | |
| Basic and diluted earnings per share | 28 | ₩ 2,883 | \$ 3.00 | ₩ 3,106 |

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

KT&G Corporation
Interim Separate Statements of Changes in Equity
Six-Month Periods Ended June 30, 2014 and 2013

(in millions of Korean won)

| | Capital stock | Other Capital Surplus | Treasury shares | Gain on reissuance of treasury shares | Reserve | Retained Earnings | Total Equity |
|--|---------------|--------------------------|--------------------|--|-------------|----------------------|-----------------|
| Balance at January 1, 2013 | ₩ 954,959 | ₩ 3,582 | ₩ (339,059) | ₩ 492,032 | ₩ 3,039,034 | ₩ 752,766 | ₩ 4,903,314 |
| Total comprehensive income | | | | | | | |
| Profit for the period | - | - | - | - | - | 391,033 | 391,033 |
| Other comprehensive income | | | | | | | |
| Change in value of available-for-sale financial assets | - | - | - | - | (5,055) | - | (5,055) |
| Remeasurements of the net defined benefit liability | - | - | - | - | - | 29 | 29 |
| Total other comprehensive income (loss) | - | - | - | - | (5,055) | 29 | (5,026) |
| Total comprehensive income | - | - | - | - | (5,055) | 391,062 | 386,007 |
| Transactions with equity holders of the Company | | | | | | | |
| Cash dividends | - | - | - | - | - | (402,876) | (402,876) |
| Other reserve | - | - | - | - | 317,000 | (317,000) | - |
| Transfer from reserve for research and human resources development | - | - | - | - | 30,000 | (30,000) | - |
| Total transactions with equity holders of the Company | - | - | - | - | 347,000 | (749,876) | (402,876) |
| Balance at June 30, 2013 | ₩ 954,959 | ₩ 3,582 | ₩ (339,059) | ₩ 492,032 | ₩ 3,380,979 | ₩ 393,952 | ₩ 4,886,445 |
| Balance at January 1, 2014 | ₩ 954,959 | ₩ 3,582 | ₩ (339,059) | ₩ 492,032 | ₩ 3,411,099 | ₩ 509,820 | ₩ 5,032,433 |
| Total comprehensive income | | | | | | | |
| Profit for the period | - | - | - | - | - | 362,945 | 362,945 |
| Other comprehensive income | | | | | | | |
| Change in value of available-for-sale financial assets | - | - | - | - | 4,308 | - | 4,308 |
| Remeasurements of the net defined benefit liability | - | - | - | - | - | (501) | (501) |
| Total other comprehensive income (loss) | - | - | - | - | 4,308 | (501) | 3,807 |
| Total comprehensive income | - | - | - | - | 4,308 | 362,444 | 366,752 |
| Transactions with equity holders of the Company | | | | | | | |
| Cash dividends | - | - | - | - | - | (402,876) | (402,876) |
| Transfer from reserve for research and human resources development | - | - | - | - | (47,479) | 47,479 | - |
| Other reserve | - | - | - | - | 152,000 | (152,000) | - |
| Total transactions with equity holders of the Company | - | - | - | - | 104,521 | (507,397) | (402,876) |
| Balance at June 30, 2014 | ₩ 954,959 | ₩ 3,582 | ₩ (339,059) | ₩ 492,032 | ₩ 3,519,928 | ₩ 364,867 | ₩ 4,996,309 |

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

KT&G Corporation
Interim Separate Statements of Changes in Equity
Six-Month Periods Ended June 30, 2014 and 2013

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

| | Capital stock | Other Capital Surplus | Treasury shares | Gain on reissuance of treasury shares | Reserve | Retained Earnings | Total Equity |
|---|---------------|--------------------------|--------------------|--|--------------|----------------------|-----------------|
| Balance at January 1, 2014 | \$ 941,403 | \$ 3,531 | \$ (334,245) | \$ 485,047 | \$ 3,362,677 | \$ 502,583 | \$ 4,960,996 |
| Total comprehensive income | | | | | | | |
| Profit for the period | - | - | - | - | - | 357,793 | 357,793 |
| Other comprehensive income(loss) | | | | | | | |
| Change in value of available-for-sale financial assets | - | - | - | - | 4,245 | - | 4,245 |
| Remeasurements of the net defined benefit liability | - | - | - | - | - | (494) | (494) |
| Total other comprehensive income (loss) | - | - | - | - | 4,245 | (494) | 3,751 |
| Total comprehensive income | - | - | - | - | 4,245 | 357,299 | 361,544 |
| Transactions with equity holders of the Company | | | | | | | |
| Cash dividends | - | - | - | - | - | (397,157) | (397,157) |
| Transfer from reserve for research and human resources development | - | - | - | - | (46,804) | 46,804 | - |
| Other reserve | - | - | - | - | 149,842 | (149,842) | - |
| Total transactions with equity holders of the Company | - | - | - | - | 103,038 | (500,195) | (397,157) |
| Balance at June 30, 2014 | \$ 941,403 | \$ 3,531 | \$ (334,245) | \$ 485,047 | \$ 3,469,960 | \$ 359,687 | \$ 4,925,383 |

The accompanying notes are an integral part of these interim separate financial statements.
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KT&G Corporation
Interim Separate Statements of Cash Flows
Six-Month Periods Ended June 30, 2014 and 2013

| (in millions of Korean won and thousands of U.S. dollars) | Notes | Period Ended June 30 | | |
|--|-------|----------------------|-----------------------------------|--------------------|
| | | 2014 Korean won | 2014 U.S. dollars (Note 34) | 2013 Korean won |
| Cash flows from operating activities | | | | |
| Cash generated from operations | 30 | ₩ 551,038 | \$ 543,215 | ₩ 763,067 |
| Income tax paid | | (137,578) | (135,625) | (141,701) |
| Net cash generated from operating activities | | <u>413,460</u> | <u>407,590</u> | <u>621,366</u> |
| Cash flows from investing activities | | | | |
| Interest received | | 16,702 | 16,465 | 16,289 |
| Investment income received from long-term deposits in MSA Escrow Fund | | 636 | 627 | 400 |
| Dividends received | | 7,165 | 7,063 | 6,206 |
| Proceeds from sale of property, plant and equipment | | 1,076 | 1,061 | 5,365 |
| Proceeds from sale of intangible assets | | - | - | 1 |
| Proceeds from sale of assets held for sale | | - | - | 6,182 |
| Decrease in loans | | 6,287 | 6,198 | 7,005 |
| Decrease in guarantee deposits | | 11,226 | 11,067 | 10,102 |
| Decrease in other financial assets | | 50,000 | 49,290 | 425,000 |
| Acquisition of property, plant and equipment | | (48,997) | (48,302) | (51,851) |
| Acquisition of intangible assets | | (858) | (846) | (1,072) |
| Acquisition of investment property | | (77) | (76) | (1,422) |
| Acquisition of investments in subsidiaries | | (3,213) | (3,167) | (25,746) |
| Acquisition of available-for-sale financial assets | | (18,800) | (18,533) | - |
| Increase in loans | | - | - | (32,262) |
| Increase in guarantee deposits | | (13,781) | (13,585) | (10,128) |
| Increase in long-term deposits in MSA Escrow Fund | | (35,413) | (34,911) | (26,123) |
| Net cash provided by(used in) investing activities | | <u>(28,047)</u> | <u>(27,649)</u> | <u>327,946</u> |
| Cash flows from financing activities | | | | |
| Dividends paid | 29 | (402,876) | (397,157) | (402,876) |
| Increase in deposits received | | 1,170 | 1,154 | 2,556 |
| Decrease in deposits received | | (1,742) | (1,717) | (2,896) |
| Net cash used in financing activities | | <u>(403,448)</u> | <u>(397,720)</u> | <u>(403,216)</u> |
| Net increase(decrease) in cash and cash equivalents | | (18,035) | (17,779) | 546,096 |
| Cash and cash equivalents at the beginning of period | | 245,838 | 242,348 | 266,720 |
| Exchange losses on cash and cash equivalents | | (41) | (40) | (3) |
| Cash and cash equivalents at the end of period | | <u>₩ 227,762</u> | <u>\$ 224,529</u> | <u>₩ 812,813</u> |

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

KT&G Corporation

Notes to Interim Separate Financial Statements

June 30, 2014 and 2013, and December 31, 2013

1. General Information

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

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

As of June 30, 2014, the Company has two manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 133 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Company is located in Pyeongchondong, Daedeok-gu, Daejeon.

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

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

KT&G Corporation

Notes to Interim Separate Financial Statements

June 30, 2014 and 2013, and December 31, 2013

The ownership of the Company's issued ordinary shares as of June 30, 2014, is held as follows:

| Shareholders | Number of shares | Percentage of ownership |
|--------------------------------------|------------------|-------------------------|
| Industrial Bank of Korea | 9,510,485 | 6.93% |
| Employee share ownership association | 2,668,309 | 1.94% |
| Others | 113,720,006 | 82.83% |
| | <hr/> | <hr/> |
| | 125,898,800 | 91.70% |
| Treasury shares | 11,393,697 | 8.30% |
| | <hr/> | <hr/> |
| | 137,292,497 | 100.00% |

2. Significant Accounting Policies

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

2.1 Basis of Preparation

These separate interim financial statements as of and for the six-month period ended June 30, 2014, has been prepared in accordance with Korean IFRS 1034, *Interim financial reporting*. The principles used in the preparation of these financial statements are based on Korean IFRS and interpretations effective as of June 30, 2014, or early adopted.

(a) New and amended standards adopted by the Company

The Company newly applied the following amended and enacted standards for the annual period beginning on January 1, 2014:

- Amendment to Korean IFRS 1032, *Financial Instruments: Presentation*

Amendment to Korean IFRS 1032, *Financial Instruments: Presentation*, provides that the right to offset must not be contingent on a future event and must be legally enforceable in all of circumstances; and if an entity can settle amounts in a manner such that outcome is, in effect, equivalent to net settlement, the entity will meet the net settlement criterion. There is no significant impact of the application of this amendment on the financial statements.

- Amendment to Korean IFRS 1039, *Financial Instruments: Recognition and Measurement*

Amendment to Korean IFRS 1039, *Financial Instruments: Recognition and Measurement*, allows the continuation of hedge accounting for a derivative that has been designated as a hedging instrument in a circumstance in which that derivative is novated to a central counterparty (CCP) as a consequence of laws or regulations. There is no significant impact of the application of this amendment on the financial statements.

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- Enactment of Korean IFRS 2121, *Levies*

Korean IFRS 2121, *Levies*, are applied to a liability to pay a levy imposed by a government in accordance with the legislation. The interpretation requires that the liability to pay a levy is recognized when the activity that triggers the payment of the levy occurs, as identified by the legislation (the obligating event). There is no significant impact of the application of this amendment on the financial statements as of and for the six-month periods ended June 30, 2014.

2.2 Subsidiaries and Associates

These separate financial statements are prepared and presented in accordance with Korean IFRS 1027. The Company applied the cost method to investments in subsidiaries and associates in accordance with K-IFRS 1027. The carrying amount of investment in Korea Ginseng Corporation under previous Korean Generally Accepted Accounting Principles on the date of transition to K-IFRS is considered to be the deemed cost of investments in subsidiaries on the date of transition. Dividends from a subsidiary or associate are recognized in profit or loss when the right to receive the dividend is established.

2.3 Segment Reporting

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

2.4 Foreign Currency Translation

(a) Functional and presentation currency

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

Exchange differences arising on non-monetary financial assets and liabilities such as equity instruments at fair value through profit or loss and available-for-sale equity instruments are recognized in profit or loss and included in other comprehensive income, respectively, as part of the fair value gain or loss.

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2.5 Cash and Cash Equivalents

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

2.6 Financial Instruments

(a) Classification and measurement

The Company classifies its financial assets in the following categories: financial assets at fair value through profit or loss, available-for-sale financial assets, loans and receivables, and held-to-maturity financial assets. Regular purchases and sales of financial assets are recognized on trade date.

At initial recognition, financial assets are measured at fair value plus, in the case of financial assets not carried at fair value through profit or loss, transaction costs. Transaction costs of financial assets carried at fair value through profit or loss are expensed in the statement of income. After the initial recognition, available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables, and held-to-maturity investments are subsequently carried at amortized cost using the effective interest rate method.

Changes in fair value of financial assets at fair value through profit or loss are recognized in profit or loss and changes in fair value of available-for-sale financial assets are recognized in other comprehensive income. When the available-for-sale financial assets are sold or impaired, the fair value adjustments recorded in equity are reclassified into profit or loss.

(b) Impairment

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

Impairment of loans and receivables is presented as a deduction in an allowance account. Impairment of other financial assets is directly deducted from their carrying amount. The Company writes off financial assets when the assets are determined to be no longer recoverable.

The objective evidence that a financial asset is impaired includes significant financial difficulty of the issuer or obligor; a delinquency in interest or principal payments; or the disappearance of an active market for that financial asset because of financial difficulties.

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(c) Derecognition

If the Company transfers a financial asset and the transfer does not result in derecognition because the Company has retained substantially of all risks and rewards of ownership of the transferred asset due to a recourse in the event the debtor defaults, the Company continues to recognize the transferred asset in its entirety and recognizes a financial liability for the consideration received. The related financial liability is classified as 'borrowings' in the statement of financial position.

2.7 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.

2.8 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 ₩279,427 million and ₩316,168 million as of June 30, 2014 and December 31, 2013, respectively.

2.9 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.

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

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

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

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within 'other income and expenses, net' in the statement of comprehensive income.

2.11 Borrowing Costs

Borrowing costs incurred in the acquisition or construction of a qualifying asset are capitalized in the period when it is prepared for its intended use, and investment income earned on the temporary investment of borrowings made specifically for the purpose obtaining a qualifying asset is deducted from the borrowing costs eligible for capitalization during the period. Other borrowing costs are recognized as expenses for the period in which they are incurred.

2.12 Government Grants

Government grants are recognized at their fair values when there is reasonable assurance that the grant will be received and the Company will comply with the conditions attaching to it. Government grants related to assets are presented by deducting the grants in arriving at the carrying amount of the assets, and grants related to income are deferred and presented by deducting the related expenses for the purpose of the government grants.

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2.13 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 years |

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

2.14 Investment Property

Property held to earn rentals or for capital appreciation or both is classified as investment property. Investment property is measured initially at its cost. After recognition as an asset, investment property is carried at cost less accumulated depreciation and impairment losses. Investment property, except for land, is depreciated using the straight-line method over their useful lives from 10 to 60 years.

2.15 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. Non-financial assets, other than goodwill, that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

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2.16 Financial Liabilities

(a) Classification and measurement

Financial liabilities at fair value through profit or loss are financial instruments held for trading. Financial liabilities are classified in this category if incurred principally for the purpose of repurchasing them in the near term. Derivatives that are not designated as hedges or bifurcated from financial instruments containing embedded derivatives are also categorized as held-for-trading.

The Company classifies non-derivative financial liabilities, except for financial liabilities at fair value through profit or loss, financial guarantee contracts and financial liabilities that arise when a transfer of financial assets does not qualify for derecognition, as financial liabilities carried at amortized cost and presented as 'trade payables', 'borrowings', and 'other financial liabilities' in the statement of financial position.

Preferred shares that provide for a mandatory redemption at a particular date are classified as liabilities. Interest expenses on these preferred shares calculated using the effective interest method are recognized in the statement of income as 'finance costs', together with interest expenses recognized on other financial liabilities.

(b) Derecognition

Financial liabilities are removed from the statement of financial position when it is extinguished, for example, when the obligation specified in the contract is discharged, cancelled or expired or when the terms of an existing financial liability are substantially modified.

2.17 Financial Guarantee Contracts

Financial guarantees contracts provided by the Company are initially measured at fair value on the date the guarantee was given. Subsequent to initial recognition, the Company's liabilities under such guarantees are measured at the higher of the amounts below and recognized as 'other financial liabilities':

- the amount determined in accordance with Korean IFRS 1037, *Provisions, Contingent Liabilities and Contingent Assets*; or
- the initial amount, less accumulated amortization recognized in accordance with Korean IFRS 1018, *Revenue*.

2.18 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.

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2.19 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statement of comprehensive income over the period of the borrowings using the effective interest method. The Company recognizes borrowings as current assets unless it has an unconditional right to delay the settlement of the borrowing.

2.20 Compound Financial Instruments

Compound financial instruments are convertible bonds that can be converted into equity instruments at the option of the holder. 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 on 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.

2.21 Provisions

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation and the increase in the provision due to passage of time is recognized as interest expense.

2.22 Income Tax Expense

Interim period income tax expense is accrued based on the best estimate of the weighted average annual income tax rate expected for the full financial year, that is, the estimated average annual effective income tax rate applied to the pre-tax income of the interim period.

2.23 Employee Benefits

(a) Defined benefit liability

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

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

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

2.24 Share Capital

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.

2.25 Revenue Recognition

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

Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods, the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods

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sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the six months ended June 30, 2014 and 2013, were ₩1,652,016 million and ₩1,678,429 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. Meanwhile, profits from an apartment house for self-installment sales is recognized on percentage-of-completion method according to Q&A of Korea Accounting Institute, called 2011-I-KQA. This accounting standard is effective upon Korean Corporation Financial Reporting Standards of Laws on External Audit of Corporation (Article 13, Section 1, Paragraph 1).

Revenue from rendering of services is recognized by reference to the stage of completion of the transaction at the end of the reporting period when the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Company, the stage of completion of the transaction at the end of the reporting period can be measured reliably and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably. When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue is recognized only to the extent of the expenses recognized that are recoverable.

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

In addition, interest is recognized using the effective interest method, royalties are recognized on an accrual basis in accordance with the substance of the relevant agreement and dividends are recognized when the shareholders' right to receive the dividend is established.

2.26 Lease

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the statement of income on a straight-line basis over the period of the lease.

2.27 Dividend Distribution

A dividend liability is recognized in the financial statements when the dividends are approved by the shareholders.

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3. Critical Accounting Estimates and Assumptions

The Company makes estimates and assumptions concerning the future. The estimates and assumptions are continuously evaluated with consideration to factors such as events reasonably predictable in the foreseeable future within the present circumstance according to historical experience. The resulting accounting estimates will, by definition, seldom equal the related actual results.

Significant accounting estimates and assumptions made in preparing interim financial statements are the same those made in preparing the prior financial statements, except for the estimating method used in deriving income tax expenses.

4. Financial Risk Management

4.1 Financial Risk Factors

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

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

(a) Market Risk

i) Foreign exchange risk

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

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The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | | | December 31, 2013 | | | |
|------------------------------------|----------------------|-----------------|----------------|-----------------------|--------------------------|-----------------|----------------|-----------------------|
| | USD | EUR | RUB | THB and Others | USD | EUR | RUB | THB and Others |
| Assets | | | | | | | | |
| Cash and cash equivalents | ₩ 14,354 | ₩ 2 | ₩ - | ₩ - | ₩ 10,926 | ₩ 27 | ₩ - | ₩ - |
| Trade and other receivables | 460,853 | 27,766 | 1,166 | 46,186 | 439,194 | 27,932 | 1,873 | 47,073 |
| Long-term deposits | 245,198 | - | - | - | 219,760 | - | - | - |
| | <u>₩ 720,405</u> | <u>₩ 27,768</u> | <u>₩ 1,166</u> | <u>₩ 46,186</u> | <u>₩ 669,880</u> | <u>₩ 27,959</u> | <u>₩ 1,873</u> | <u>₩ 47,073</u> |
| Liabilities | | | | | | | | |
| Trade and other payables | ₩ 4,045 | ₩ 9,334 | ₩ - | ₩ - | ₩ 30,655 | ₩ 10,993 | ₩ - | ₩ - |

As of June 30, 2014 and December 31, 2013, the effects of a 10% strengthening or weakening of functional currency against the US dollar other than functional currency on profit before tax are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|------------------------------------|--------------------------|----------------------|--------------------------|----------------------|
| | 10% strengthening | 10% weakening | 10% strengthening | 10% weakening |
| US dollar | ₩ 71,636 | ₩ (71,636) | ₩ 63,923 | ₩ (63,923) |

ii) Price risk

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

As of June 30, 2014 and December 31, 2013, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income (change in value of available-for-sale financial assets) are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|---------------------------------------|----------------------|--------------------|--------------------------|--------------------|
| | 5% increase | 5% decrease | 5% increase | 5% decrease |
| Other comprehensive income before tax | ₩ 7,598 | ₩ (7,598) | ₩ 6,811 | ₩ (6,811) |
| Tax effect | (1,839) | 1,839 | (1,648) | 1,648 |
| Other comprehensive income after tax | <u>₩ 5,759</u> | <u>₩ (5,759)</u> | <u>₩ 5,163</u> | <u>₩ (5,163)</u> |

iii) Interest rate risk

The Company has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. There is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation as of June 30, 2014.

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(b) Credit Risk

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

The carrying amounts of financial assets are maximum exposure to credit risk. The maximum exposure to credit risk as of June 30, 2014 and December 31, 2013, is as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|---------------------------------------|----------------------|---------|--------------------------|---------|
| Available-for-sale financial assets | ₩ | 2,500 | ₩ | 2,500 |
| Long-term deposits in MSA Escrow Fund | | 245,198 | | 219,760 |
| Trade and other receivables | | 888,897 | | 855,966 |
| Other financial assets | | 610,000 | | 660,000 |
| Cash and cash equivalents | | 227,762 | | 245,838 |
| Financial guarantee contracts | | 152,263 | | 152,263 |

(c) Liquidity Risk

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

The maturity analysis of the residual contractual maturity of financial liabilities as of June 30, 2014 and December 31, 2013, is as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | | | | |
|--|------------------------|------------------------------|------------------------|------------------------------------|------------------------------|-----------------------|
| | 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 | ₩ 253,810 | ₩ 254,963 | ₩ 226,727 | ₩ - | ₩ 28,236 | ₩ - |
| Short-term borrowings | 4,425 | 4,425 | 4,425 | - | - | - |
| Financial guarantee contracts ¹ | - | 152,263 | - | - | 152,263 | - |

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(in millions of Korean won)

| | December 31, 2013 | | | | | | |
|--|-------------------|-----------------------|-----------------|-----------------------------|-----------------------|----------------|---|
| | 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 | ₩ 307,074 | ₩ 308,297 | ₩ 278,805 | ₩ - | ₩ 29,492 | ₩ - | - |
| Short-term borrowings | 4,920 | 4,920 | 4,920 | - | - | - | - |
| Financial guarantee contracts ¹ | - | 152,263 | - | - | 152,263 | - | - |

¹ The maximum guaranteed amount of financial guarantee contracts (Note 31)

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

4.2 Capital Management

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

As of June 30, 2014 and December 31, 2013, the Company defines net debt and equity attributable to owners as follows:

(in millions of Korean won)

| | June 30, 2014 | December 31, 2013 |
|---------------------------------|--------------------|--------------------|
| Total borrowings | ₩ 4,425 | ₩ 4,920 |
| Less: | | |
| Cash and cash equivalents | (227,762) | (245,838) |
| Other financial assets, current | (610,000) | (660,000) |
| Net debt(Net asset) | <u>(833,337)</u> | <u>(900,918)</u> |
| Equity attributable to owners | <u>₩ 4,996,309</u> | <u>₩ 5,032,435</u> |

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4.3 Fair Value Estimation

There are no significant changes in business and economic circumstances which impact the fair value of financial assets and liabilities of the Company for the six-month period ended June 30, 2014.

(a) Fair Value by Financial Instruments

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

(in millions of Korean won)

| | June 30, 2014 | | December 31, 2013 | |
|--|--------------------|--------------------|--------------------|--------------------|
| | Book value | Fair value | Book value | Fair value |
| Financial assets | | | | |
| Available-for-sale assets ¹ | ₩ 301,279 | ₩ 301,279 | ₩ 279,797 | ₩ 279,797 |
| Long-term deposits | 245,198 | 245,198 | 219,760 | 219,760 |
| Long-term trade and other receivables | 122,695 | 122,695 | 134,498 | 134,498 |
| Other financial assets | 610,000 | 610,000 | 660,000 | 660,000 |
| Trade and other receivables | 766,203 | 766,203 | 721,468 | 721,468 |
| Cash and cash equivalents | 227,762 | 227,762 | 245,838 | 245,838 |
| | <u>₩ 2,273,137</u> | <u>₩ 2,273,137</u> | <u>₩ 2,261,361</u> | <u>₩ 2,261,361</u> |
| Financial liabilities | | | | |
| Long-term trade and other payables | ₩ 27,082 | ₩ 27,082 | ₩ 28,269 | ₩ 28,269 |
| Short-term borrowings | 4,425 | 4,425 | 4,920 | 4,920 |
| Trade and other payables | 226,727 | 226,727 | 278,805 | 278,805 |
| | <u>₩ 258,234</u> | <u>₩ 258,234</u> | <u>₩ 311,994</u> | <u>₩ 311,994</u> |

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

(b) Financial Instruments Measured at Cost

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

(in millions of Korean won)

| | June 30, 2014 | December 31, 2013 |
|---------------------------|-----------------|-------------------|
| Available-for-sale assets | | |
| MASTERN 2 REIT | ₩ 10,000 | ₩ 10,000 |
| U&I Corporation | 3,000 | 3,000 |
| SJ BIOMED Inc. | 1,000 | 1,000 |
| Ktoto Co.,Ltd | 3,000 | - |
| Others | 2,594 | 2,594 |
| | <u>₩ 19,594</u> | <u>₩ 16,594</u> |

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

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(c) Fair Value Hierarchy

Assets measured at fair value or for which the fair value is disclosed are categorized within the fair value hierarchy, and the defined levels are 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, 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).

Fair value hierarchy classifications of the financial assets and financial liabilities that are measured at fair value or its fair value is disclosed as of June 30, 2014, are as follows:

| <i>(in millions of Korean won)</i> | Level 1 | Level 2 | Level 3 | Total |
|-------------------------------------|----------------|----------------|----------------|--------------|
| Recurring fair value measurements | | | | |
| Available-for-sale financial assets | ₩ 219,262 | ₩ 82,017 | ₩ - | ₩ 301,279 |
| Disclosed fair value | | | | |
| Investment property | - | - | 461,378 | 461,378 |

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

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(d) Valuation Technique and the Inputs

Valuation techniques and inputs used in the recurring, non-recurring fair value measurements and disclosed fair values categorized within Level 2 and Level 3 of the fair value hierarchy as of June 30, 2014, are as follows:

| <i>(in millions of Korean won)</i> | Fair value | level | Valuation techniques |
|-------------------------------------|-------------------|--------------|--|
| Available-for-sale financial assets | | | |
| Real estate investment trusts | ₩ 82,017 | 2 | Market approach |
| Investment property | | | |
| Investment property | 461,378 | 3 | Yield capitalization method and other method |

5. Financial Instruments by Category

Categorizations of financial assets as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | |
|---|------------------------------|--|--------------------|
| | Loans and receivables | Assets classified as available-for-sale | Total |
| Available-for-sale financial assets, non- current | ₩ - | ₩ 320,873 | ₩ 320,873 |
| Long-term deposits in MSA Escrow Fund | 245,198 | - | 245,198 |
| Long-term trade and other receivables | 122,695 | - | 122,695 |
| Other financial assets, current | 610,000 | - | 610,000 |
| Trade and other receivables | 766,203 | - | 766,203 |
| Cash and cash equivalents | 227,762 | - | 227,762 |
| | <u>₩ 1,971,858</u> | <u>₩ 320,873</u> | <u>₩ 2,292,731</u> |

| <i>(in millions of Korean won)</i> | December 31, 2013 | | |
|---|------------------------------|--|--------------------|
| | Loans and receivables | Assets classified as available-for-sale | Total |
| Available-for-sale financial assets, non- current | ₩ - | ₩ 296,391 | ₩ 296,391 |
| Long-term deposits in MSA Escrow Fund | 219,760 | - | 219,760 |
| Long-term trade and other receivables | 134,498 | - | 134,498 |
| Other financial assets, current | 660,000 | - | 660,000 |
| Trade and other receivables | 721,468 | - | 721,468 |
| Cash and cash equivalents | 245,838 | - | 245,838 |
| | <u>₩ 1,981,564</u> | <u>₩ 296,391</u> | <u>₩ 2,277,955</u> |

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Categorizations of financial liabilities as of June 30, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

| | June 30, 2014 | | | | | |
|------------------------------------|---|---------|-----------------------------|-------|-------|---------|
| | Other financial liabilities at amortized cost | | Other financial liabilities | | Total | |
| Long-term trade and other payables | ₩ | 27,082 | ₩ | - | ₩ | 27,082 |
| Short-term borrowings | | - | | 4,425 | | 4,425 |
| Trade and other payables | | 226,727 | | - | | 226,727 |
| | ₩ | 253,809 | ₩ | 4,425 | ₩ | 258,234 |

(in millions of Korean won)

| | December 31, 2013 | | | | | |
|------------------------------------|---|---------|-----------------------------|-------|-------|---------|
| | Other financial liabilities at amortized cost | | Other financial liabilities | | Total | |
| Long-term trade and other payables | ₩ | 28,269 | ₩ | - | ₩ | 28,269 |
| Short-term borrowings | | - | | 4,920 | | 4,920 |
| Trade and other payables | | 278,805 | | - | | 278,805 |
| | ₩ | 307,074 | ₩ | 4,920 | ₩ | 311,994 |

Income and loss of financial instruments by category for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|--|--------------|------------|--------------|------------|
| | Three months | Six months | Three months | Six months |
| Available-for-sale financial assets | | | | |
| Gain(Loss) on valuation (Other comprehensive income) | ₩ (2,561) | ₩ 4,307 | ₩ (13,907) | ₩ (5,056) |
| Interest income | 13 | 25 | 8 | 15 |
| Dividend income | 3,456 | 7,165 | 2,615 | 6,206 |
| Impairment loss | - | - | (3,000) | (15,000) |
| Cash and cash equivalents | | | | |
| Interest income | 5,626 | 12,838 | 4,597 | 12,037 |
| Gain(Loss) on foreign currency translation | 51 | (41) | (19) | (4) |
| Gain(Loss) on foreign currency transaction | (791) | (543) | 599 | 823 |
| Trade and other receivables | | | | |
| Interest income | 2,509 | 4,478 | 2,467 | 4,669 |
| Gain(Loss) on foreign currency translation | (39,675) | (28,246) | 19,489 | 40,392 |
| Gain(Loss) on foreign currency transaction | (4,098) | (2,558) | 4,366 | 6,004 |
| Other financial liabilities at amortized cost | | | | |
| Interest costs | (178) | (478) | (301) | (386) |
| Gain(Loss) on foreign currency translation | 223 | 174 | (148) | (332) |
| Gain(Loss) on foreign currency transaction | 1,125 | 759 | (802) | (1,685) |

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6. Available-for-sale Financial Assets

The changes in available-for-sale financial assets for the six-month periods ended June 30, 2014 and 2013, are as follows:

| <i>(in millions of Korean won)</i> | 2014 | | 2013 | |
|------------------------------------|-------------|-----------------------|-------------|-----------------------|
| Beginning | ₩ | 296,391 | ₩ | 264,544 |
| Additions | | 18,800 | | - |
| Gain on valuation | | 5,682 | | (9,457) |
| Net gains transferred from equity | | - | | 2,787 |
| Impairment loss | | - | | (15,000) |
| Disposal | | - | | - |
| Ending | | <u>320,873</u> | | <u>242,874</u> |
| Less: current portion | | - | | (1,000) |
| Non-current portion | ₩ | <u>320,873</u> | ₩ | <u>241,874</u> |

Available-for-sale financial assets as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|--|----------------------|-----------------------|--------------------------|-----------------------|
| Available-for-sale debt instruments: | | | | |
| Corporate bonds | ₩ | 2,500 | ₩ | 2,500 |
| Total available-for-sale debt instruments | | <u>2,500</u> | | <u>2,500</u> |
| Available-for-sale equity instruments: | | | | |
| Listed | | | | |
| Yonhap Television News(YTN) | | 24,931 | | 23,380 |
| Oscotech, Inc. | | 900 | | 916 |
| Shinhan Financial Group Co., Ltd. | | 187,791 | | 189,595 |
| Rexahn Pharmaceuticals, Inc. | | 5,640 | | 3,440 |
| | | <u>219,262</u> | | <u>217,331</u> |
| Unlisted | | 99,111 | | 76,560 |
| | | <u>99,111</u> | | <u>76,560</u> |
| Total available-for-sale equity instruments | | <u>318,373</u> | | <u>293,891</u> |
| Total available-for-sale financial assets | ₩ | <u>320,873</u> | ₩ | <u>296,391</u> |

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

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.

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7. Trade and Other Receivables

Trade and other receivables as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|------------------------------------|----------------------|--------------------|--------------------------|--------------------|
| | Current | Non-current | Current | Non-current |
| Loans to employees | ₩ 8,593 | ₩ 24,011 | ₩ 8,680 | ₩ 29,884 |
| Loans | 8,970 | 50,308 | 2,205 | 58,609 |
| Other receivables | 68,939 | 9,528 | 82,129 | 9,567 |
| Guarantee deposits | - | 38,847 | - | 36,437 |
| Accrued income | 4,183 | - | 5,495 | - |
| Trade receivables | 675,518 | - | 622,958 | - |
| | <u>₩ 766,203</u> | <u>₩ 122,694</u> | <u>₩ 721,467</u> | <u>₩ 134,497</u> |

Trade and other receivables as of June 30, 2014 and December 31, 2013, reported in the separate statements of financial position, net of allowances, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|------------------------------------|----------------------|--------------------|--------------------------|--------------------|
| | Current | Non-current | Current | Non-current |
| Gross trade and other receivables | ₩ 822,569 | ₩ 131,032 | ₩ 780,542 | ₩ 140,779 |
| Allowance account | | | | |
| - Other receivables | (7,446) | - | (7,711) | - |
| - Trade receivables | (44,521) | - | (44,395) | - |
| - Accrued income | (1,964) | - | (2,044) | - |
| - Loans to subsidiaries | (2,435) | (8,338) | (4,925) | (6,282) |
| | <u>(56,366)</u> | <u>(8,338)</u> | <u>(59,075)</u> | <u>(6,282)</u> |
| Net amount | <u>₩ 766,203</u> | <u>₩ 122,694</u> | <u>₩ 721,467</u> | <u>₩ 134,497</u> |

Changes in the allowance account for the six-month periods ended June 30, 2014 and 2013, are as follows:

| <i>(in millions of Korean won)</i> | 2014 | | 2013 | |
|------------------------------------|-------------|---------------|-------------|---------------|
| Beginning | ₩ | 65,357 | ₩ | 19,714 |
| Impairment loss | | 126 | | - |
| Reversal of impairment loss | | (779) | | (2) |
| Ending | <u>₩</u> | <u>64,704</u> | <u>₩</u> | <u>19,712</u> |

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The aging schedule of trade and other receivables as of June 30, 2014 and December 31, 2013, is as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|------------------------------------|----------------------|---------|--------------------------|---------|
| Not past due | ₩ | 414,729 | ₩ | 404,941 |
| Past due but not impaired | | | | |
| Within 1 month | | 29,654 | | 37,487 |
| Between 1 and 2 months | | 21,927 | | 20,590 |
| Between 2 and 3 months | | 26,402 | | 20,148 |
| Beyond 3 months | | 227,327 | | 184,187 |
| | ₩ | 720,039 | ₩ | 667,353 |

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

Details of trade and other receivables that are measured at amortized cost using effective interest rate method as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | | December 31, 2013 | | |
|------------------------------------|-----------------------------------|----------------|--------------------|-----------------------------------|----------------|--------------------|
| | Effective interest rate(%) | Current | Non-current | Effective interest rate(%) | Current | Non-current |
| Loans to employees | 3.00~5.68 | ₩ 8,592 | ₩ 24,011 | 3.00~5.68 | ₩ 8,680 | ₩ 29,884 |
| Other receivables | 3.79 | - | 7,850 | 3.79 | 7,997 | 7,705 |
| Guarantee deposits | 3.00~5.68 | - | 38,847 | 3.00~5.68 | - | 36,437 |
| | | ₩ 8,592 | ₩ 70,708 | | ₩ 16,677 | ₩ 74,026 |

Transferred trade receivables

The Company has sold its trade receivables through trade receivable factoring agreements with National Agricultural Cooperative Federation and other financial institutions in relation with the collecting sales payments with tobacco card. In case the customers default, the Company has an obligation to pay the related amount to the bank. As a result, this transaction treated as a transaction with recourse, has been accounted for as collateralized borrowings. The borrowings recognized in relation to the said transaction as of June 30, 2014 and December 31, 2013, are ₩4,425 million and ₩4,920 million, respectively (Note 13 and 22).

8. Long-term Deposits

Long-term deposits as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|------------------------------------|----------------------|---------|--------------------------|---------|
| MMF | ₩ | 20,048 | ₩ | 15,080 |
| T-Note | | 225,150 | | 204,680 |
| | ₩ | 245,198 | ₩ | 219,760 |

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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, 2014 and 2013, are ₩ 35,413 million and ₩ 26,123 million, respectively.

Long-term deposits are operated as a way of buying T-Note or MMF. Investment income on long-term deposits in MSA Escrow Fund for the six-month periods ended June 30, 2014 and 2013, are ₩ 325 million and ₩ 218 million, respectively.

9. Property, Plant and Equipment

Changes in property, plant and equipment for the six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | |
|--------------------------|-------------------------|---|-----------------------|
| | Acquisition Cost | Accumulated depreciation and impairment cost | Net book value |
| Land | ₩ 410,890 | ₩ - | ₩ 410,890 |
| Buildings | 685,734 | (281,124) | 404,610 |
| Structures | 44,385 | (26,769) | 17,616 |
| Machinery | 945,271 | (730,445) | 214,826 |
| Vehicles | 2,541 | (2,192) | 349 |
| Tools | 35,374 | (31,682) | 3,692 |
| Furniture and fixture | 151,160 | (117,231) | 33,929 |
| Others | 1,312 | - | 1,312 |
| Construction-in-progress | 89,917 | - | 89,917 |
| | <u>₩ 2,366,584</u> | <u>₩ (1,189,443)</u> | <u>₩ 1,177,141</u> |

(in millions of Korean won)

| | 2013 | | |
|--------------------------|-------------------------|---|-----------------------|
| | Acquisition Cost | Accumulated depreciation and impairment cost | Net book value |
| Land | ₩ 410,912 | ₩ - | ₩ 410,912 |
| Buildings | 651,414 | (255,534) | 395,880 |
| Structures | 41,452 | (24,797) | 16,655 |
| Machinery | 922,245 | (680,167) | 242,078 |
| Vehicles | 2,619 | (2,162) | 457 |
| Tools | 33,656 | (30,392) | 3,264 |
| Furniture and fixture | 167,018 | (133,116) | 33,902 |
| Others | 1,127 | - | 1,127 |
| Construction-in-progress | 56,061 | - | 56,061 |
| | <u>₩ 2,286,504</u> | <u>₩ (1,126,168)</u> | <u>₩ 1,160,336</u> |

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| | | 2014 | | | | | | |
|------------------------------------|-------------------------------|------------------|-----------------|---------------------|-----------------|----------------------------------|------------------------|--|
| <i>(in millions of Korean won)</i> | Opening net book value | Additions | Disposal | Depreciation | Transfer | Other changes¹ | Net book amount | |
| Land | ₩ 410,763 | ₩ - | ₩ (30) | ₩ - | ₩ 147 | ₩ 10 | ₩ 410,890 | |
| Buildings | 400,314 | 11,316 | - | (12,950) | 5,854 | 76 | 404,610 | |
| Structures | 16,973 | 1,320 | - | (1,025) | 348 | - | 17,616 | |
| Machinery | 234,926 | 2,321 | (1) | (25,651) | 9,188 | (5,957) | 214,826 | |
| Vehicles | 362 | 89 | - | (102) | - | - | 349 | |
| Tools | 3,135 | 425 | (86) | (708) | 926 | - | 3,692 | |
| Furniture and fixture | 34,524 | 4,805 | (4) | (8,504) | 3,108 | - | 33,929 | |
| Others | 1,162 | 150 | - | - | - | - | 1,312 | |
| Construction-in-progress | 80,604 | 28,936 | (52) | - | (19,571) | - | 89,917 | |

¹ Land and buildings in other changes represent the reclassified amount from investment property to property, plant and equipment. Machinery in other changes represent the decrease due to KGC Yebon's investment in kind.

| | | 2013 | | | | | | |
|------------------------------------|-------------------------------|------------------|-----------------|---------------------|-----------------|----------------------------------|------------------------|--|
| <i>(in millions of Korean won)</i> | Opening net book value | Additions | Disposal | Depreciation | Transfer | Other changes² | Net book amount | |
| Land | ₩ 397,900 | ₩ 16 | ₩ (798) | ₩ - | ₩ 13,780 | ₩ 14 | ₩ 410,912 | |
| Buildings | 394,889 | 1,414 | (86) | (12,519) | 9,368 | 2,814 | 395,880 | |
| Structures | 16,716 | 247 | (1) | (946) | 602 | 37 | 16,655 | |
| Machinery | 261,847 | 4,534 | (1,806) | (32,976) | 10,479 | - | 242,078 | |
| Vehicles | 529 | 63 | - | (135) | - | - | 457 | |
| Tools | 2,733 | 1,324 | (165) | (628) | - | - | 3,264 | |
| Furniture and fixture | 36,807 | 3,862 | (72) | (8,837) | 2,142 | - | 33,902 | |
| Others | 1,115 | - | - | - | 12 | - | 1,127 | |
| Construction-in-progress | 50,684 | 41,760 | - | - | (36,383) | - | 56,061 | |

² Other changes represent the reclassified amount of ₩520 million from investment property to assets held for sale and the amount of ₩ 3,385 million from investment property to property, plant and equipment.

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10. Intangible Assets

Changes in intangible assets for the six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | | |
|--|-----------------------------------|------------------------------|--|-----------------|
| | Industrial property rights | Facility usage rights | Intangible assets under development | Total |
| At January 1, 2014 | ₩ 1,625 | ₩ 17,357 | ₩ 2,209 | ₩ 21,191 |
| Additions | - | 340 | 518 | 858 |
| Disposals | - | (2) | - | (2) |
| Amortization | (29) | - | - | (29) |
| Acquisition cost | 6,973 | 17,696 | 2,727 | 27,396 |
| Accumulated amortization and impairment cost | (5,377) | (1) | - | (5,378) |
| Net book amount | ₩ 1,596 | ₩ 17,695 | ₩ 2,727 | ₩ 22,018 |

(in millions of Korean won)

| | 2013 | | | |
|--|-----------------------------------|------------------------------|--|-----------------|
| | Industrial property rights | Facility usage rights | Intangible assets under development | Total |
| At January 1, 2013 | ₩ 1,632 | ₩ 16,585 | ₩ 1,720 | ₩ 19,937 |
| Additions | - | 773 | 299 | 1,072 |
| Disposals | - | (1) | - | (1) |
| Amortization | (30) | - | - | (30) |
| Transfer-in(out) | 53 | - | (53) | - |
| Other changes | - | - | (3) | (3) |
| Acquisition cost | 7,163 | 17,357 | 1,963 | 26,483 |
| Accumulated amortization and impairment cost | (5,508) | - | - | (5,508) |
| Net book amount | ₩ 1,655 | ₩ 17,357 | ₩ 1,963 | ₩ 20,975 |

Research and development expenses for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|-------------------------------------|---------------------|-------------------|---------------------|-------------------|
| | Three months | Six months | Three months | Six months |
| Cost of goods sold | ₩ 142 | ₩ 303 | ₩ 78 | ₩ 145 |
| Selling and administrative expenses | 3,434 | 7,400 | 3,460 | 5,409 |
| | ₩ 3,576 | ₩ 7,703 | ₩ 3,538 | ₩ 5,554 |

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11. Investment Property

Changes in investment property for the six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | |
|--|----------|-----------|-----------|
| | Land | Building | Total |
| Beginning net book value | ₩ 22,246 | ₩ 123,788 | ₩ 146,034 |
| Additions | - | 77 | 77 |
| Other changes ¹ | (10) | (76) | (86) |
| Depreciation | - | (3,014) | (3,014) |
| Acquisition cost | 22,236 | 169,979 | 192,215 |
| Accumulated depreciation and impairment cost | - | (49,204) | (49,204) |
| Net book amount | ₩ 22,236 | ₩ 120,775 | ₩ 143,011 |

¹ The amount of other changes is the transfer from investment property to property, plant and equipment.

(in millions of Korean won)

| | 2013 | | |
|--|----------|-----------|-----------|
| | Land | Building | Total |
| Beginning net book value | ₩ 22,121 | ₩ 131,786 | ₩ 153,907 |
| Additions | 559 | 863 | 1,422 |
| Other changes ² | (433) | (2,952) | (3,385) |
| Depreciation | - | (3,006) | (3,006) |
| Acquisition cost | 22,247 | 169,916 | 192,163 |
| Accumulated depreciation and impairment cost | - | (43,225) | (43,225) |
| Net book amount | ₩ 22,247 | ₩ 126,691 | ₩ 148,938 |

² The amount of other changes is the transfer from investment property to property, plant and equipment.

The amounts recognized in profit or loss from investment property for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|--------------------------|--------------|------------|--------------|------------|
| | Three months | Six months | Three months | Six months |
| Rental income | ₩ 8,039 | ₩ 16,655 | ₩ 7,904 | ₩ 16,516 |
| Direct operating expense | (1,507) | (3,014) | (1,503) | (3,006) |
| | ₩ 6,532 | ₩ 13,641 | ₩ 6,401 | ₩ 13,510 |

Fair values and book values of investment property as of June 30, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

| | June 30, 2014 | | December 31, 2013 | |
|----------|---------------|------------|-------------------|------------|
| | Fair value | Book value | Fair value | Book value |
| Land | ₩ 281,106 | ₩ 22,236 | ₩ 281,311 | ₩ 22,246 |
| Building | 180,272 | 120,775 | 180,361 | 123,788 |
| | ₩ 461,378 | ₩ 143,011 | ₩ 461,672 | ₩ 146,034 |

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12. Non-current Assets Held for Sale

The Company recognizes non-current assets held for sale as the lower of net fair value and book value. The entire amount of non-current assets held for sale is attributable to land, and there are no changes in non-current assets held for sale for the six-month period ended June 30, 2014.

13. Pledged Assets

The following assets are pledged as collateral for the Company's long-term and short-term borrowings and others as of June 30, 2014:

(in millions of Korean won)

| Asset | Book amount | Reason | Borrowings | Collateralized amount | Lender /Leaseholder |
|---------------------|--------------------|-----------------------------|-------------------|------------------------------|--|
| Investment property | ₩ 72,726 | Leasehold deposits received | ₩ 9,346 | ₩ 9,458 | Metlife Insurance Korea Co., Ltd. and 28 others |
| Trade receivables | 4,425 | Short-term borrowings | 4,425 | 4,425 | National Agricultural Cooperative Federation and 1 other |

The following assets are pledged as collateral for the Company's long-term and short-term borrowings and others as of December 31, 2013:

(in millions of Korean won)

| Asset | Book amount | Reason | Borrowings | Collateralized amount | Lender /Leaseholder |
|---------------------|--------------------|-----------------------------|-------------------|------------------------------|--|
| Investment property | ₩ 74,555 | Leasehold deposits received | ₩ 9,020 | ₩ 9,123 | Metlife Insurance Korea Co., Ltd. and 26 others |
| Trade receivables | 4,920 | Short-term borrowings | 4,920 | 4,920 | National Agricultural Cooperative Federation and 1 other |

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14. Investments in Associates and Subsidiaries

Investments in associates and subsidiaries as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | | | June 30, 2014 | | December 31, 2013 | |
|---|-----------------|---|----------------------|------------------------|--------------------------|------------------------|
| | Location | Principal operation | Interest (%) | Carrying Amount | Interest (%) | Carrying Amount |
| Associates | | | | | | |
| Lite Pharm Tech, Inc | Korea | Manufacturing Medical supplies | 25.34 | ₩ 1,830 | 25.34 | ₩ 1,830 |
| JR CR-REIT IV Co., Ltd. | Korea | Selling and renting of real estate | 49.02 | 13,995 | 49.02 | 13,995 |
| KVG REIT 1 Co., Ltd. | Korea | Selling and renting of real estate | 29.67 | 7,300 | 29.67 | 7,300 |
| KOCREF REIT 17 Co., Ltd. | Korea | Selling and renting of real estate | 22.06 | 7,000 | 22.06 | 7,000 |
| JR REIT V Co., Ltd. | Korea | Selling and renting of real estate | 34.63 | 5,600 | 34.63 | 5,600 |
| JR REIT VIII Co., Ltd. | Korea | Selling and renting of real estate | 21.74 | 10,000 | 21.74 | 10,000 |
| LSK Global Pharma Services Co., Ltd. | Korea | Research and developing new drug | 23.15 | - | 23.15 | - |
| JR REIT X Co., Ltd. | Korea | Selling and renting of real estate | 28.78 | 9,500 | 28.78 | 9,500 |
| JR REIT XIII Co., Ltd. | | Selling and renting of real estate | 27.03 | 5,000 | 27.03 | 5,000 |
| | | | | <u>60,225</u> | | <u>60,225</u> |
| Subsidiaries | | | | | | |
| Korea Ginseng Corporation | Korea | Manufacturing and selling ginseng | 100.00 | 599,023 | 100.00 | 599,023 |
| Yungjin Pharm. Ind. Co., Ltd. | Korea | Manufacturing and selling pharmaceuticals | 53.00 | 66,355 | 53.00 | 66,355 |
| Tae-a Industry Co., Ltd. | Korea | Manufacturing tobacco materials | 100.00 | 15,698 | 100.00 | 15,698 |
| KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. | Turkey | Manufacturing and selling tobaccos | 99.99 | 54,049 | 99.99 | 54,049 |
| Korea Tabacos do Brasil Ltda. | Brazil | Processing leaf Tobaccos | 99.90 | 535 | 99.90 | 535 |
| KT&G Pars | Iran | Manufacturing and selling tobaccos | 99.99 | - | 99.99 | - |
| KT&G Rus L.L.C. | Russia | Manufacturing and selling tobaccos | 100.00 | 110,297 | 100.00 | 110,297 |
| KGC Life & Gin Co., Ltd. | Korea | Selling ginseng | 100.00 | 44,100 | 100.00 | 44,100 |
| Global Trading, Inc. | USA | Selling tobaccos | 100.00 | 4,913 | 100.00 | 4,913 |
| Jilin Hanzheng Ginseng Co., Ltd. | China | Manufacturing and selling ginseng | 100.00 | 47,675 | 100.00 | 47,675 |
| Somang Cosmetics Co., Ltd. ¹ | Korea | Manufacturing and selling cosmetics | 60.00 | 60,721 | 60.00 | 60,721 |
| Renzoluc Pte., Ltd. ² | Singapore | Manufacturing and selling tobaccos | 100.00 | 66,356 | 100.00 | 66,356 |
| KT&G Life Science ³ | Korea | Medical researching and developing | 73.94 | 31,232 | 73.94 | 31,232 |
| Yebon Nongwon Agriculture Co., Ltd. | Korea | Corporate agriculture | 90.00 | 90 | 90.00 | 90 |
| KGC Yebon | Korea | Manufacturing and selling medicinal herbs | 100.00 | 49,828 | 100.00 | 43,927 |
| K-Q HongKong I, Limited ⁴ | Hong Kong | Manufacturing and selling ginseng | 100.00 | 17,761 | 100.00 | 17,761 |
| PT KT&G Indonesia | Indonesia | Manufacturing and selling tobaccos | 99.98 | 6,949 | 99.96 | 3,746 |
| K&I HK Co., Ltd | Hong Kong | Selling cosmetics | 100.00 | 11 | - | - |
| | | | | <u>1,175,593</u> | | <u>1,166,478</u> |
| | | | | <u>₩ 1,235,818</u> | | <u>₩ 1,226,703</u> |

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¹ The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

² The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2014, the Company's percentage of ownership would be 68.91% if convertible preferred shares are included.

³ The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2014, the Company's percentage of ownership would be 59.48% if convertible preferred shares are included.

⁴ The Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

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Changes in investments in associates and subsidiaries for the six-month periods ended June 30, 2014 and 2013, are as follows:

| <i>(in millions of Korean won)</i> | 2014 | | | | |
|---|--------------------|----------------|------------|------------|--------------------|
| | Beginning balance | Acquisition | Disposals | Others | Ending balance |
| Associates | | | | | |
| Lite Pharm Tech, Inc | ₩ 1,830 | ₩ - | ₩ - | ₩ - | ₩ 1,830 |
| JR CR-REIT IV Co., Ltd. | 13,995 | - | - | - | 13,995 |
| KVG REIT 1 Co., Ltd. | 7,300 | - | - | - | 7,300 |
| KOCREF REIT 17 Co., Ltd. | 7,000 | - | - | - | 7,000 |
| JR REIT V Co., Ltd. | 5,600 | - | - | - | 5,600 |
| JR REIT VIII Co., Ltd. | 10,000 | - | - | - | 10,000 |
| LSK Global Pharma Services Co., Ltd. | - | - | - | - | - |
| JR REIT X Co., Ltd. | 9,500 | - | - | - | 9,500 |
| JR REIT XIII Co., Ltd. | 5,000 | - | - | - | 5,000 |
| | <u>60,225</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>60,225</u> |
| Subsidiaries | | | | | |
| Korea Ginseng Corporation | 599,023 | - | - | - | 599,023 |
| Yungjin Pharm. Ind. Co., Ltd. | 66,355 | - | - | - | 66,355 |
| Tae-a Industry Co., Ltd. | 15,698 | - | - | - | 15,698 |
| KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. | 54,049 | - | - | - | 54,049 |
| Korea Tabacos do Brasil Ltda. | 535 | - | - | - | 535 |
| KT&G Pars | - | - | - | - | - |
| KT&G Rus L.L.C. | 110,297 | - | - | - | 110,297 |
| KGC Life & Gin Co., Ltd. | 44,100 | - | - | - | 44,100 |
| Global Trading, Inc. | 4,913 | - | - | - | 4,913 |
| Jilin Hanzheng Ginseng Co., Ltd. | 47,675 | - | - | - | 47,675 |
| Somang Cosmetics Co., Ltd. | 60,721 | - | - | - | 60,721 |
| Renzoluc Pte., Ltd. | 66,356 | - | - | - | 66,356 |
| KT&G Life Science | 31,232 | - | - | - | 31,232 |
| Yebon Nongwon Agriculture Co., Ltd. | 90 | - | - | - | 90 |
| KGC Yebon ¹ | 43,927 | 5,902 | - | - | 49,829 |
| K-Q HongKong I,Limited | 17,761 | - | - | - | 17,761 |
| PT KT&G Indonesia | 3,746 | 3,202 | - | - | 6,948 |
| K&I HK Co., Ltd | - | 11 | - | - | 11 |
| | <u>1,166,478</u> | <u>9,115</u> | <u>-</u> | <u>-</u> | <u>1,175,593</u> |
| | <u>₩ 1,226,703</u> | <u>₩ 9,115</u> | <u>₩ -</u> | <u>₩ -</u> | <u>₩ 1,235,818</u> |

¹ The amount of acquisition represents the Company's investment in kind (Note 9).

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(in millions of Korean won)

| | 2013 | | | | |
|---|----------------------|-----------------|------------|------------|--------------------|
| | Beginning balance | Acquisition | Disposals | Others | Ending balance |
| Associates | | | | | |
| Cosmo Tobacco Co., Ltd. | ₩ - | ₩ - | ₩ - | ₩ - | ₩ - |
| Lite Pharm Tech, Inc. | 1,830 | - | - | - | 1,830 |
| Korean Carbon Finance, Inc. | 1,000 | - | - | - | 1,000 |
| JR CR-REIT IV Co., Ltd. | 13,995 | - | - | - | 13,995 |
| KVG REIT 1 Co., Ltd. | 7,300 | - | - | - | 7,300 |
| KOCREF REIT 17 Co., Ltd. | 7,000 | - | - | - | 7,000 |
| JR REIT V Co., Ltd. | 5,600 | - | - | - | 5,600 |
| JR REIT VIII Co., Ltd. | 10,000 | - | - | - | 10,000 |
| LSK Global Pharma Services Co., Ltd. | 1,500 | - | - | - | 1,500 |
| JR REIT X Co., Ltd. | 9,500 | - | - | - | 9,500 |
| | <u>57,725</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>57,725</u> |
| Subsidiaries | | | | | |
| Korea Ginseng Corporation | 599,023 | - | - | - | 599,023 |
| Yungjin Pharm. Ind. Co., Ltd. | 66,355 | - | - | - | 66,355 |
| Tae-a Industry Co., Ltd. | 15,698 | - | - | - | 15,698 |
| KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. | 54,049 | - | - | - | 54,049 |
| Korea Tabacos do Brasil Ltda. | 535 | - | - | - | 535 |
| KT&G Pars | - | - | - | - | - |
| KT&G Rus L.L.C. | 110,297 | - | - | - | 110,297 |
| KGC Life & Gin Co., Ltd | 52,900 | 22,000 | - | - | 74,900 |
| KT&G Bio Corp. | - | - | - | - | - |
| Global Trading, Inc. | 4,913 | - | - | - | 4,913 |
| Jilin Hanzheng Ginseng Co., Ltd. | 31,333 | - | - | - | 31,333 |
| Somang Cosmetics Co., Ltd. | 60,721 | - | - | - | 60,721 |
| Renzoluc Pte., Ltd. | 89,756 | - | - | - | 89,756 |
| KT&G Life Science | 31,232 | - | - | - | 31,232 |
| Yebon Nongwon Agriculture Co., Ltd. | 90 | - | - | - | 90 |
| KGC Yebon | 43,927 | - | - | - | 43,927 |
| K-Q Hong Kong I,Limited | 17,761 | - | - | - | 17,761 |
| PT KT&G Indonesia | - | 3,746 | - | - | 3,746 |
| | <u>1,178,590</u> | <u>25,746</u> | <u>-</u> | <u>-</u> | <u>1,204,336</u> |
| | <u>₩ 1,236,315</u> | <u>₩ 25,746</u> | <u>₩ -</u> | <u>₩ -</u> | <u>₩ 1,262,061</u> |

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15. Inventories

Inventories as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | | December 31, 2013 | | |
|--|---------------------|------------------|------------------|---------------------|------------------|------------------|
| | Acquisition Cost | Allowance | Book amount | Acquisition Cost | Allowance | Book amount |
| Merchandise | ₩ 4 | ₩ - | ₩ 4 | ₩ - | ₩ - | ₩ - |
| Finished goods | 95,142 | (1,235) | 93,907 | 107,950 | (2,135) | 105,815 |
| Work in progress | 12,446 | - | 12,446 | 11,889 | - | 11,889 |
| Raw materials | 701,047 | - | 701,047 | 704,494 | - | 704,494 |
| Supplies | 24,853 | - | 24,853 | 24,500 | - | 24,500 |
| By-products | 7,946 | - | 7,946 | 6,512 | - | 6,512 |
| Unfinished housing | 837 | - | 837 | 840 | - | 840 |
| Lots | 3,800 | - | 3,800 | 6,432 | - | 6,432 |
| Goods-in-transit | 19,691 | - | 19,691 | 79,262 | - | 79,262 |
| | <u>₩ 865,766</u> | <u>₩ (1,235)</u> | <u>₩ 864,531</u> | <u>₩ 941,879</u> | <u>₩ (2,135)</u> | <u>₩ 939,744</u> |

The costs related inventories for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

| <i>(in millions of Korean won)</i> | 2014 | | 2013 | |
|------------------------------------|--------------|----------------|----------------|----------------|
| | Three months | Six months | Three months | Six months |
| Cost of sales | | | | |
| Loss(gain) on inventory valuation | ₩ (173) | ₩ (899) | ₩ 243 | ₩ 326 |
| Loss on retirement of inventories | 490 | 1,574 | 1,121 | 1,817 |
| Other expenses | | | | |
| Loss on retirement of inventories | 280 | 401 | 528 | 582 |
| | <u>₩ 597</u> | <u>₩ 1,076</u> | <u>₩ 1,892</u> | <u>₩ 2,725</u> |

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16. Cash and Cash Equivalents

Cash and cash equivalents as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|------------------------------------|----------------------|----------------|--------------------------|----------------|
| Cash on hand | ₩ | 3,580 | ₩ | 3,147 |
| Demand deposits | | 74,182 | | 82,691 |
| Short-term investment assets | | 150,000 | | 160,000 |
| | ₩ | <u>227,762</u> | ₩ | <u>245,838</u> |

Other financial assets as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|------------------------------------|----------------------|----------------|--------------------------|----------------|
| Short-term financial assets | | | | |
| Time deposits | ₩ | 10,000 | ₩ | 20,000 |
| Money trust | | 570,000 | | 620,000 |
| Certificates of deposit | | 30,000 | | 20,000 |
| | ₩ | <u>610,000</u> | ₩ | <u>660,000</u> |

17. Equity and Share Premium

Details of share capital as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in Korean won, except number of shares)</i> | June 30, 2014 | | December 31, 2013 | |
|---|----------------------|-----------------|--------------------------|-----------------|
| Number of ordinary shares | | | | |
| Authorized | | 800,000,000 | | 800,000,000 |
| Issued | | 137,292,497 | | 137,292,497 |
| Par value per share | ₩ | 5,000 | ₩ | 5,000 |
| Ordinary shares | ₩ | 954,959,485,000 | ₩ | 954,959,485,000 |

The Company has reacquired and retired 53,699,400 shares of treasury shares. Accordingly, as of June 30, 2014, the 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, 2014 and the year ended December 31, 2013, are as follows:

| | 2014 | | | 2013 | | |
|------------------|------------------------|------------------------|--------------|------------------------|------------------------|--------------|
| | Ordinary shares | Treasury shares | Total | Ordinary shares | Treasury shares | Total |
| Number of shares | 137,292,497 | (11,393,697) | 125,898,800 | 137,292,497 | (11,393,697) | 125,898,800 |

There are no changes in the other capital surplus for the six-month period ended June 30, 2014 and the year ended December 31, 2013.

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18. Treasury Shares

There is no change in the treasury shares for the six-month period ended June 30, 2014 and the year ended December 31, 2013. Details of the number of treasury shares and carrying amount are as follows:

| <i>(in millions of Korean Won, except number of shares)</i> | 2014 | | 2013 | |
|---|------------------|-----------------|------------------|-----------------|
| | Number of shares | Carrying amount | Number of shares | Carrying amount |
| Issuance of treasury shares | 11,393,697 | ₩ 339,059 | 11,393,697 | ₩ 339,059 |

There is no change in gain on reissuance of the treasury shares for the six-month period ended June 30, 2014 and the year ended December 31, 2013. The book values are as follows:

| <i>(in millions of Korean won)</i> | 2014 | 2013 |
|---------------------------------------|-----------|-----------|
| Gain on reissuance of treasury shares | ₩ 492,032 | ₩ 492,032 |

19. Reserves

Details of reserves as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | December 31, 2013 |
|---|--------------------|--------------------|
| Available-for-sale financial assets reserve | ₩ (1,263) | ₩ (5,570) |
| Legal reserve | 602,937 | 602,937 |
| Voluntary reserve | 2,918,254 | 2,813,732 |
| | <u>₩ 3,519,928</u> | <u>₩ 3,411,099</u> |

Available-for-sale financial assets reserve as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | December 31, 2013 |
|--|------------------|-------------------|
| Available-for-sale financial assets reserve before tax | ₩ (1,666) | ₩ (7,348) |
| Tax effect | 403 | 1,778 |
| Available-for-sale financial assets reserve after tax | <u>₩ (1,263)</u> | <u>₩ (5,570)</u> |

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

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Details of the Company's voluntary reserve as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|--|----------------------|------------------|--------------------------|------------------|
| Reserve for business rationalization ¹ | ₩ | 12,851 | ₩ | 12,851 |
| Reserve for research and human resource development ² | | 42,522 | | 90,000 |
| Reserve for business expansion ³ | | 698,881 | | 698,881 |
| Other reserve ³ | | 2,164,000 | | 2,012,000 |
| | ₩ | <u>2,918,254</u> | ₩ | <u>2,813,732</u> |

¹*Reserve for Business Rationalization*

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

²*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.

³*Reserve for Business Expansion and other reserve*

Reserves without specific purposes are restored to retained earnings and can be used for other purposes afterwards upon a resolution at a general meeting of shareholders.

20. Retained Earnings

Changes in retained earnings for the six-month period ended June 30, 2014 and the year ended December 31, 2013, are as follows:

| <i>(in millions of Korean won)</i> | 2014 | | 2013 | |
|---|-------------|----------------|-------------|----------------|
| Beginning | ₩ | 509,820 | ₩ | 752,766 |
| Transfer to reserve for research and human resource development | | 47,479 | | - |
| Transfer from other reserve | | (152,000) | | (317,000) |
| Transfer from reserve for research and human resource development | | - | | (30,000) |
| Dividends | | (402,876) | | (402,876) |
| Profit for the period | | 362,945 | | 501,315 |
| Remeasurements of the net defined benefit liability (after tax) | | (501) | | 5,615 |
| Ending | ₩ | <u>364,867</u> | ₩ | <u>509,820</u> |

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21. Trade and Other Payables

Trade and other payables as of June 30, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

| | June 30, 2014 | | December 31, 2013 | |
|-----------------------------|------------------|-----------------|-------------------|-----------------|
| | Current | Non-current | Current | Non-current |
| Leasehold deposits received | ₩ - | ₩ 27,082 | ₩ - | ₩ 27,585 |
| Accounts payable | 49,476 | - | 60,436 | - |
| Withholdings | 4,221 | - | 3,823 | - |
| Value added tax withheld | 127,581 | - | 119,761 | - |
| Accrued expenses | 129,271 | - | 123,419 | - |
| Other payables | 47,980 | - | 94,950 | 684 |
| | <u>₩ 358,529</u> | <u>₩ 27,082</u> | <u>₩ 402,389</u> | <u>₩ 28,269</u> |

22. Borrowings

Details of borrowings as of June 30, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

| | June 30, 2014 | December 31, 2013 |
|-----------------|---------------|-------------------|
| Current | | |
| Bank borrowings | ₩ 4,425 | ₩ 4,920 |

Details of bank borrowings as of June 30, 2014 and December 31, 2013, are as follows:

(in millions of Korean won)

| | Creditor | Latest maturity date | Annual interest rate (%) June 30, 2014 | June 30, 2014 | December 31, 2013 |
|------------|--|-----------------------|---|----------------|-------------------|
| Korean won | National Agricultural Cooperative Federation | Short-term borrowings | 7.15% | ₩ 3,606 | ₩ 4,061 |
| Korean won | Korea Exchange Bank | Short-term borrowings | CD(91) + 2.5% | 819 | 859 |
| | | | | <u>₩ 4,425</u> | <u>₩ 4,920</u> |

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23. Net Defined Benefit Liability

The amounts recognized on the statements of income for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

| <i>(in millions of Korean won)</i> | 2014 | | 2013 | |
|---|---------------------|-------------------|---------------------|-------------------|
| | Three months | Six months | Three months | Six months |
| Defined benefit plans : | | | | |
| Current service cost | ₩ 7,018 | ₩ 14,035 | ₩ 7,245 | ₩ 14,489 |
| Interest expenses | 2,082 | 4,164 | 1,716 | 3,431 |
| Expected return on plan assets | (1,508) | (3,015) | (1,169) | (2,339) |
| Effect of past service cost or settlement | 462 | 924 | - | - |
| | <u>8,054</u> | <u>16,108</u> | <u>7,792</u> | <u>15,581</u> |
| Defined contribution plans : | | | | |
| Contributions recognized as current expense | 459 | 1,230 | 351 | 995 |
| Total | <u>₩ 8,513</u> | <u>₩ 17,338</u> | <u>₩ 8,143</u> | <u>₩ 16,576</u> |

Out of total expenses, ₩5,382 million (2013: ₩5,470 million) and ₩11,955 million (2013: ₩11,106 million) are included in 'cost of sales' and 'selling and administrative expenses', respectively. Termination benefits arising from voluntary resignation for the six-month period ended June 30, 2014, amounts to ₩269 million (2013: ₩1,168 million).

Net defined benefit liability recognized on the statements of financial position as of June 30, 2014 and December 31, 2013, are as follows:

| <i>(In millions of Korean won)</i> | June 30, 2014 | December 31, 2013 |
|--|----------------------|--------------------------|
| Present value of defined benefit liability | ₩ 236,454 | ₩ 227,259 |
| Fair value of plan assets | <u>(161,151)</u> | <u>(166,986)</u> |
| Liability in the statement of financial position | <u>₩ 75,303</u> | <u>₩ 60,273</u> |

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24. Operating Income and Other Income

Material items of operating income and expense

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

Employee benefit costs for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|----------------------|--------------|------------|--------------|------------|
| | Three months | Six months | Three months | Six months |
| Salaries | ₩ 78,216 | ₩ 161,527 | ₩ 79,281 | ₩ 157,105 |
| Retirement benefits | 8,513 | 17,338 | 8,142 | 16,576 |
| Termination benefits | - | 269 | 1,168 | 1,168 |
| Employee welfare | 10,546 | 18,814 | 11,601 | 19,811 |
| | ₩ 97,275 | ₩ 197,948 | ₩ 100,192 | ₩ 194,660 |

Selling and administrative expenses for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|---------------------------------|--------------|------------|--------------|------------|
| | Three months | Six months | Three months | Six months |
| Salaries | ₩ 53,397 | ₩ 110,282 | ₩ 53,058 | ₩ 105,455 |
| Retirement benefits | 5,870 | 12,224 | 6,291 | 11,925 |
| Employee welfare | 7,871 | 13,634 | 8,088 | 13,844 |
| Travel | 1,108 | 2,093 | 1,565 | 2,534 |
| Communications | 850 | 1,808 | 865 | 1,758 |
| Utilities | 1,639 | 4,302 | 1,752 | 4,569 |
| Taxes and dues | 8,258 | 11,572 | 3,191 | 7,494 |
| Supplies | 520 | 970 | 452 | 900 |
| Rent | 3,549 | 6,849 | 3,748 | 7,001 |
| Depreciation | 8,106 | 15,959 | 7,909 | 15,925 |
| Amortization | 14 | 29 | 15 | 30 |
| Repairs and maintenance | 2,332 | 2,924 | 1,627 | 2,081 |
| Vehicles | 1,535 | 3,357 | 2,232 | 4,373 |
| Insurance | 38 | 130 | 26 | 164 |
| Commissions | 19,414 | 36,765 | 17,215 | 33,291 |
| Freight and custody | 6,818 | 13,341 | 4,407 | 9,634 |
| Conferences | 710 | 1,440 | 857 | 1,694 |
| Advertising | 28,266 | 62,196 | 33,337 | 70,054 |
| Training | 1,132 | 1,902 | 1,073 | 1,964 |
| Prizes and rewards | 273 | 793 | 472 | 829 |
| Normal research and development | 3,434 | 7,400 | 3,460 | 5,409 |
| Bad debts expense | (856) | 126 | (1) | (2) |
| | ₩ 154,278 | ₩ 310,096 | ₩ 151,639 | ₩ 300,926 |

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Details of other income for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|--|----------------|-----------------|-----------------|-----------------|
| | Three months | Six months | Three months | Six months |
| Foreign currency transaction gain | ₩ 1,275 | ₩ 3,561 | ₩ 5,960 | ₩ 8,193 |
| Foreign currency translation gain | - | 597 | 19,323 | 41,658 |
| Reversal of impairment loss on other receivables | 1,003 | 779 | - | - |
| Gain on sale of property, plant and equipment | 80 | 813 | 5,955 | 11,455 |
| Miscellaneous revenues | 5,014 | 7,864 | 2,544 | 6,809 |
| | <u>₩ 7,372</u> | <u>₩ 13,614</u> | <u>₩ 33,782</u> | <u>₩ 68,115</u> |

Details of other expenses for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|---|-----------------|-----------------|----------------|----------------|
| | Three months | Six months | Three months | Six months |
| Foreign currency transaction loss | ₩ 5,039 | ₩ 5,903 | ₩ 1,797 | ₩ 3,051 |
| Foreign currency translation loss | 39,401 | 28,710 | - | 1,602 |
| Donations | 1,762 | 2,202 | 1,333 | 1,478 |
| Loss on sale of property, plant and equipment | 58 | 81 | 34 | 170 |
| Loss on sale of intangible assets | - | 2 | - | - |
| Miscellaneous expenses | 718 | 6,853 | 2,970 | 3,258 |
| | <u>₩ 46,978</u> | <u>₩ 43,751</u> | <u>₩ 6,134</u> | <u>₩ 9,559</u> |

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25. Expenses by Nature

Expenses by nature for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|--|--------------|------------|--------------|------------|
| | Three months | Six months | Three months | Six months |
| Changes in inventories | ₩ 44,140 | ₩ 75,213 | ₩ 17,211 | ₩ (16,274) |
| Raw materials used and consumables purchased | 169,088 | 344,675 | 157,359 | 354,564 |
| Salary and wage | 78,216 | 161,527 | 79,281 | 157,105 |
| Retirement and termination benefits | 8,513 | 17,607 | 9,310 | 17,744 |
| Depreciation | 26,056 | 51,954 | 29,927 | 59,047 |
| Amortization | 14 | 29 | 15 | 30 |
| Employee benefits | 10,546 | 18,814 | 11,601 | 19,811 |
| Advertising costs | 28,313 | 62,268 | 33,386 | 70,118 |
| Service fees | 25,213 | 48,368 | 22,726 | 44,423 |
| Other expenses | 22,797 | 36,030 | 12,931 | 22,762 |
| Total cost of sales and administrative expenses ¹ | ₩ 412,896 | ₩ 816,485 | ₩ 373,747 | ₩ 729,330 |

¹ The amount represents the sum of cost of sales and selling and administrative expenses in the separate statements of comprehensive income.

26. Finance Income and Costs

Finance income and costs for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|--|--------------|------------|--------------|------------|
| | Three months | Six months | Three months | Six months |
| Finance income | | | | |
| Interest income | ₩ 8,148 | ₩ 17,341 | ₩ 7,071 | ₩ 16,721 |
| Dividend income | 3,456 | 7,165 | 2,615 | 6,206 |
| Investment income on long-term deposits in MSA Escrow Fund | 27 | 325 | - | 218 |
| | 11,631 | 24,831 | 9,686 | 23,145 |
| Finance cost | | | | |
| Interest costs | (178) | (478) | (301) | (386) |
| Impairment loss on available-for-sale financial assets | - | - | (3,000) | (15,000) |
| | (178) | (478) | (3,301) | (15,386) |
| Net financial income | ₩ 11,453 | ₩ 24,353 | ₩ 6,385 | ₩ 7,759 |

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Details of interest costs for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|--------------------------|--------------|------------|--------------|------------|
| | Three months | Six months | Three months | Six months |
| Trade and other payables | ₩ (178) | ₩ (478) | ₩ (301) | ₩ (386) |

Details of interest income for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|-------------------------------------|----------------|-----------------|----------------|-----------------|
| | Three months | Six months | Three months | Six months |
| Deposits | ₩ 5,626 | ₩ 12,838 | ₩ 4,597 | ₩ 12,037 |
| Available-for-sale financial assets | 13 | 25 | 8 | 15 |
| Trade and other receivables | 2,509 | 4,478 | 2,466 | 4,669 |
| | <u>₩ 8,148</u> | <u>₩ 17,341</u> | <u>₩ 7,071</u> | <u>₩ 16,721</u> |

27. Income Tax

Income tax expense was calculated based on the best weighted average annual corporate tax rate for the entire fiscal period. Estimated average annual tax rate of the year ending December 31, 2014, is 24.4%. (The estimated tax rate for the six-month period ended June 30, 2013, was 24.6%).

28. 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 18).

Basic earnings per ordinary share for the three-month and six-month periods ended June 30, 2014 and 2013, are as follows:

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

| | 2014 | | 2013 | |
|--|----------------|----------------|----------------|----------------|
| | Three months | Six months | Three months | Six months |
| Profit for the period | ₩ 175,410 | ₩ 362,945 | ₩ 198,257 | ₩ 391,034 |
| Weighted-average number of ordinary shares outstanding | 125,898,800 | 125,898,800 | 125,898,800 | 125,898,800 |
| Basic earnings per share (in won) | <u>₩ 1,393</u> | <u>₩ 2,883</u> | <u>₩ 1,575</u> | <u>₩ 3,106</u> |

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29. Dividends

Dividend distribution to the Company's shareholders amounting to ₩ 402,876 million for the year ended December 31, 2013, was made on April, 2014.

30. Cash Generated from Operations

Cash generated from operations for the six-month periods ended June 30, 2014 and 2013, are as follows:

| <i>(in millions of Korean won)</i> | 2014 | | 2013 | |
|--|-------------|----------------|-------------|----------------|
| Profit | ₩ | 362,945 | ₩ | 391,034 |
| Adjustments for: | | | | |
| Income tax expense | | 117,261 | | 127,903 |
| Finance cost | | 478 | | 15,386 |
| Finance income | | (24,831) | | (23,144) |
| Depreciation | | 51,954 | | 59,047 |
| Amortization | | 29 | | 30 |
| Retirement and termination benefits | | 16,108 | | 15,581 |
| Foreign currency translation loss | | 28,710 | | 1,602 |
| Loss on inventory valuation | | - | | 326 |
| Impairment loss on trade and other receivables | | 126 | | - |
| Loss on sale of property, plant and equipment | | 81 | | 170 |
| Loss on sale of intangible assets | | 2 | | - |
| Other expenses | | 1,975 | | 4,969 |
| Foreign currency translation gain | | (597) | | (41,658) |
| Reversal of impairment loss on inventory valuation | | (899) | | - |
| Reversal of impairment loss on trade and other receivables | | (779) | | (2) |
| Gain on sale of property, plant and equipment | | (813) | | (11,455) |
| | | <u>551,750</u> | | <u>539,789</u> |
| Changes in working capital | | | | |
| Increase in trade and other receivables | | (56,353) | | (8,290) |
| Increase in advance payments | | (7,975) | | (25,359) |
| Decrease in prepaid expenses | | 2,409 | | 2,392 |
| Decrease in prepaid tobacco excise and other taxes | | 9,793 | | 2,119 |
| Decrease (increase) in inventories | | 74,138 | | (18,999) |
| Increase (decrease) in trade and other payables | | (59,446) | | 47,005 |
| Increase (decrease) in advance receipts | | (14,457) | | 702 |
| Increase in tobacco excise and other taxes payable | | 52,918 | | 224,602 |
| Payment of retirement benefits | | (1,739) | | (894) |
| Cash generated from operations | <u>₩</u> | <u>551,038</u> | <u>₩</u> | <u>763,067</u> |

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Significant non-cash transactions for the six-month period ended June 30, 2014, are as follows:

| <i>(in millions of Korean won)</i> | 2014 | |
|---|-------------|--------|
| Reclassification of other financial assets to current portion | ₩ | 50,000 |
| Reclassification of construction-in-progress | | 19,571 |

31. Contingencies and Commitments

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

As of June 30, 2014, the Company is involved in a lawsuit as a plaintiff claiming damages in relation to development of Yongsan area with other companies. The aggregate litigation amount for this case amounts to ₩ 240,000 million, and the litigation amount attributable to the Company is ₩ 5,136 million.

As of June 30, 2014, tobacco lawsuits claiming damages of ₩ 100 million are filed against the Company and the Korean government. The amount of the liability with respect to the litigation cannot be reasonably estimated as of June 30, 2014.

Additionally, as of June 30, 2014, the Company is involved in nine lawsuits as a defendant for alleged damages totalling ₩ 56,284 million.

National Health Insurance Service filed a lawsuit seeking ₩ 53,742 million in damages against the Company on April 14, 2014.

As of June 30, 2014, the Company has letter of credit agreements with Korea Exchange Bank and other banks with limits in the aggregate of USD 57,000 thousand.

As of June 30, 2014, the Company's trade receivables from the export of cigarettes are insured against non-payment up to USD 15,400 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

As of June 30, 2014, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries and also for an opening of L/C up to USD 40,000 thousand by Korea Exchange Bank and others. In addition, the Company provides Customs Bond with limits in the aggregate of USD 12,030 thousand to Korea Exchange Bank, regarding an opening of L/C for import and customs with relation to a subsidiary located in U.S.A (Global Trading Inc.). The Company also provides Performance Bond with limits in the aggregate of THB 4,302 thousand in relation to an opening of L/C for export of tobacco sheet for Thailand Tobacco Monopoly, and payment guarantee with limits in the aggregate of IDR 63,287,756 thousand in

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relation to purchase of certificate stamp of tobacco of Trisakti Purwosari, as of June 30, 2014.

As of June 30, 2014, the Company and 28 other companies are guaranteed ₩ 240,000 million by Seoul Guarantee Insurance Co., Ltd. related to the Yongsan International Commercial Development Project. Seoul Guarantee Insurance Co., Ltd. can request amounts for recourse to the Company and 28 other companies based on their ownership rate, if Seoul Guarantee Insurance Co., Ltd. paid the insurance proceeds to KORAIL. As KORAIL requested the corresponding payment to Seoul Guarantee Insurance Co., Ltd. during the reporting period, the Company paid the maximum amount ₩ 5,136 million on July 31, 2013 and recognized the amount as the prior period expenses.

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

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

1) Conditional put option granted to the Individual Shareholder

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

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

2) Right of first refusal held by the Company

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

3) Tag-along right held by The Individual Shareholder

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

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

1) Restriction of disposal

Individual shareholder shall not be permitted to dispose of its shares, in whole or in part, within one year after KT&G Life Science is listed.

2) Right of first refusal held by the Company

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

3) Tag-along right held by the Individual Shareholder

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

Upon the resolution of the Board of Directors on January 23, 2013, the Parent Company guarantees the principal and the related interest that buyers of Andong Central Xi Apartment have borrowed from the National Agricultural Cooperative Federation, as of June 30, 2014. The amount of guarantee is ₩152,263 million and the guarantee will expire on June 30, 2015.

As of June 30, 2014, the Company is insured against non-payment to customs duty up to ₩ 5,000 million by tax bond insurance with the Seoul Guarantee Insurance.

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32. Related Party Transactions

The subsidiaries and parent companies of subsidiaries as of June 30, 2014 and December 31, 2013, are as follows:

| Subsidiaries | Location | Immediate parent companies | Percentage of ownership (%) | | | | | |
|---|-----------|------------------------------|-----------------------------|--------------|--------|-------------------|--------------|--------|
| | | | June 30, 2014 | | | December 31, 2013 | | |
| | | | Parent companies | Subsidiaries | Total | Parent companies | Subsidiaries | Total |
| Korea Ginseng Corporation | Korea | KT&G | 100.00 | - | 100.00 | 100.00 | - | 100.00 |
| Yungjin Pharm. Ind. Co., Ltd. | Korea | KT&G | 53.00 | - | 53.00 | 53.00 | - | 53.00 |
| Tae-a industry Co., Ltd. | Korea | KT&G | 100.00 | - | 100.00 | 100.00 | - | 100.00 |
| KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. | Turkey | KT&G | 99.99 | - | 99.99 | 99.99 | - | 99.99 |
| Korea Tabacos do Brasil Ltda. | Brazil | KT&G | 99.90 | - | 99.90 | 99.90 | - | 99.90 |
| KT&G Pars | Iran | KT&G | 99.99 | - | 99.99 | 99.99 | - | 99.99 |
| KT&G Rus L.L.C. | Russia | KT&G | 100.00 | - | 100.00 | 100.00 | - | 100.00 |
| KGC Life & Gin Co., Ltd | Korea | KT&G | 100.00 | - | 100.00 | 100.00 | - | 100.00 |
| Global Trading, Inc. | USA | KT&G | 100.00 | - | 100.00 | 100.00 | - | 100.00 |
| Jilin Hanzheng Ginseng Co., Ltd. | China | KT&G | 100.00 | - | 100.00 | 100.00 | - | 100.00 |
| Somang Cosmetics Co., Ltd. ¹ | Korea | KT&G | 60.00 | - | 60.00 | 60.00 | - | 60.00 |
| Renzoluc Pte., Ltd. ² | Singapore | KT&G | 100.00 | - | 100.00 | 100.00 | - | 100.00 |
| PT Trisakti Purwosari Makmur | Indonesia | Renzoluc Pte., Ltd. | - | 60.17 | 60.17 | - | 60.17 | 60.17 |
| PT Mandiri Maha mulia | Indonesia | Renzoluc Pte., Ltd. | - | 66.47 | 66.47 | - | 66.47 | 66.47 |
| PT Sentosa Ababi Purwosari | Indonesia | PT Trisakti Purwosari Makmur | - | 99.24 | 99.24 | - | 99.24 | 99.24 |
| PT Purindo Ilufa | Indonesia | PT Trisakti Purwosari Makmur | - | 100.00 | 100.00 | - | 100.00 | 100.00 |
| KT&G Life Science ³ | Korea | KT&G | 73.94 | - | 73.94 | 73.94 | - | 73.94 |
| Yebon Nongwon Agriculture Co., Ltd | Korea | KT&G | 90.00 | - | 90.00 | 90.00 | - | 90.00 |
| KGC Yebon | Korea | KT&G | 100.00 | - | 100.00 | 100.00 | - | 100.00 |
| K-Q HongKong I,Limited ⁴ | HongKong | KT&G | 100.00 | - | 100.00 | 100.00 | - | 100.00 |
| PT KT&G Indonesia | Indonesia | KT&G | 99.98 | - | 99.98 | 99.96 | - | 99.96 |
| Cheong Kwan Jang Taiwan Corporation | Taiwan | Korea Ginseng Corporation | - | 100.00 | 100.00 | - | 100.00 | 100.00 |
| Korean Red Ginseng Corp., Inc. | USA | Korea Ginseng Corporation | - | 100.00 | 100.00 | - | 100.00 | 100.00 |
| Korea Ginseng (China) Corp. | China | Korea Ginseng Corporation | - | 100.00 | 100.00 | - | 100.00 | 100.00 |
| Korea Ginseng Corporation Japan | Japan | Korea Ginseng Corporation | - | 100.00 | 100.00 | - | 100.00 | 100.00 |
| PT CKJ INDONESIA | Indonesia | Korea Ginseng Corporation | - | 99.88 | 99.88 | - | 99.88 | 99.88 |
| K&I HK Co., Ltd ⁵ | Hong Kong | KT&G | 100.00 | - | 100.00 | - | - | - |

¹ The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

² The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2014, the Company's percentage of ownership would be 68.91% if convertible preferred shares are included.

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³ The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2014, the Company's percentage of ownership would be 59.48% if convertible preferred shares are included.

⁴ The Parent Company's percentage of ownership, shown above, excludes convertible preferred shares. As of June 30, 2014, the Company's percentage of ownership would be 50.00% if convertible preferred shares are included.

⁵ During the six-month period ended June 30, 2014, K&I HK Co., Ltd. Has been included as a subsidiary.

Transactions with related parties for the six-month periods ended June 30, 2014 and 2013, are as follows:

(in millions of Korean won)

| | 2014 | | 2013 | |
|---|-----------------|-----------------|-----------------|-----------------|
| | Three months | Six months | Three months | Six months |
| Sales and other income | | | | |
| Korea Ginseng Corporation | ₩ 2,633 | ₩ 4,247 | ₩ 2,322 | ₩ 4,682 |
| Yungjin Pharm. Ind. Co., Ltd. | 82 | 167 | 66 | 134 |
| Tae-a industry Co., Ltd. | 2 | 8 | 3 | 8 |
| KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. | 2,597 | 3,398 | 4,137 | 6,177 |
| KT&G Pars | 669 | 1,233 | 793 | 1,827 |
| KT&G Rus L.L.C. | 10,811 | 13,937 | 4,273 | 9,355 |
| KGC Life & Gin Co., Ltd | 133 | 300 | 387 | 780 |
| Global Trading, Inc. | 16,587 | 32,562 | 15,659 | 28,807 |
| Jilin Hanzheng Ginseng Co., Ltd. | - | - | - | - |
| Somang Cosmetics Co., Ltd. | 59 | 117 | - | - |
| KT&G Life Science | 19 | 35 | 13 | 50 |
| Renzoluc Pte., Ltd. | 1,041 | 2,032 | 1,375 | 2,548 |
| PT Trisakti Purwosari Makmur | - | - | - | 43 |
| PT KT&G Indonesia | 253 | 413 | 169 | 202 |
| KGC Yebon | 104 | 110 | 4 | 10 |
| PT Mandiri Maha mulia | 940 | 3,279 | - | 773 |
| | <u>₩ 35,930</u> | <u>₩ 61,838</u> | <u>₩ 29,201</u> | <u>₩ 55,396</u> |
| Purchases and other expenses | | | | |
| Korea Ginseng Corporation | ₩ 431 | ₩ 763 | ₩ 530 | ₩ 798 |
| Yungjin Pharm. Ind. Co., Ltd. | 4 | 5 | 1 | 2 |
| Tae-a industry Co., Ltd. | 3,755 | 7,866 | 3,605 | 7,402 |
| KGC Life & Gin Co., Ltd | 33 | 272 | 155 | 417 |
| Somang Cosmetics Co., Ltd. | 10 | 60 | 44 | 78 |
| Korea Ginseng (China) Corp. | - | 233 | - | - |
| | <u>₩ 4,233</u> | <u>₩ 9,199</u> | <u>₩ 4,335</u> | <u>₩ 8,697</u> |

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Details of related party receivables and payables as of June 30, 2014 and December 31, 2013 are as follows:

| <i>(in millions of Korean won)</i> | June 30, 2014 | | December 31, 2013 | |
|---|----------------------|----------------|--------------------------|----------------|
| Receivables from related parties | | | | |
| KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. | ₩ | 31,387 | ₩ | 31,845 |
| KT&G Pars ¹ | | 39,497 | | 40,149 |
| KT&G Rus L.L.C. | | 20,737 | | 26,691 |
| Global Trading, Inc. | | 2,587 | | 2,697 |
| Renzoluc Pte., Ltd. | | 46,145 | | 46,989 |
| PT Mandiri Maha mulia | | 4,306 | | 3,655 |
| Somang Cosmetics Co., Ltd. | | 25 | | 21 |
| PT Trisakti Purwosari Makmur | | 2 | | 192 |
| Korea Ginseng Corporation | | 568 | | 8 |
| PT KT&G Indonesia | | 7,730 | | 7,615 |
| KGC Life & Gin Co., Ltd. | | 67 | | 116 |
| Yungjin Pharm. Ind. Co., Ltd. | | 11 | | - |
| Korea Tabacos do Brasil Ltda. | | 94 | | 94 |
| KGC Yebon | | 705 | | - |
| | ₩ | <u>153,861</u> | ₩ | <u>160,072</u> |
| Payables to related parties | | | | |
| Korea Ginseng Corporation | ₩ | 1,800 | ₩ | 1,817 |
| Somang Cosmetics Co., Ltd. | | 62 | | 37 |
| Tae-a industry Co., Ltd. | | 1,228 | | 810 |
| Yungjin Pharm. Ind. Co., Ltd. | | 413 | | 413 |
| KGC Life & Gin Co., Ltd. | | 116 | | 115 |
| KT&G Life Science | | 813 | | 813 |
| | ₩ | <u>4,432</u> | ₩ | <u>4,005</u> |

¹ Above receivables are the gross amounts before ₩ 22,354 million of allowance for doubtful accounts.

Fund transactions with related parties for the six-month period ended June 30, 2014, are as follows:

| <i>(in millions of Korean won)</i> | | Loan transactions | | Equity contributions | | Investment | | | |
|------------------------------------|-------------------|--------------------------|-------------------|-----------------------------|---|-------------------|-------|---|-------|
| | | Loans | Repayments | in cash | | in kind | | | |
| Subsidiaries | PT KT&G Indonesia | ₩ | - | ₩ | - | ₩ | 3,202 | ₩ | - |
| | K&I HK Co., Ltd. | | - | | - | | 11 | | - |
| | KGC Yebon | | | | | | - | | 5,902 |

KT&G Corporation
Notes to Interim Separate Financial Statements
June 30, 2014 and 2013, and December 31, 2013

Fund transactions with related parties for the six-month period ended June 30, 2013, are as follows:

(in millions of Korean won)

| | | <u>Loan transactions</u> | | <u>Equity</u> |
|--------------|--------------------------|--------------------------|-------------------|----------------------|
| | | <u>Loans</u> | <u>Repayments</u> | <u>contributions</u> |
| | | | | <u>in cash</u> |
| Subsidiaries | Renzoluc Pte., Ltd. | ₩ 2,239 | ₩ - | ₩ - |
| | PT KT&G Indonesia | 7,418 | - | 3,746 |
| | KGC Life & Gin Co., Ltd. | 2,600 | 2,600 | 22,000 |

The compensation paid or payable to key management for employee services for the six-month periods ended June 30, 2014 and 2013, consists of:

(in millions of Korean won)

| | <u>2014</u> | | <u>2013</u> | |
|------------------------------|---------------------|-------------------|---------------------|-------------------|
| | <u>Three months</u> | <u>Six months</u> | <u>Three months</u> | <u>Six months</u> |
| Short-term employee benefits | ₩ 4,245 | ₩ 7,553 | ₩ 4,187 | ₩ 7,615 |
| Retirement benefits | 390 | 1,057 | 442 | 862 |
| | <u>₩ 4,635</u> | <u>₩ 8,610</u> | <u>4,629</u> | <u>₩ 8,477</u> |

33. Events After the Reporting Period

(a) Transfer and investment in kind of investments in subsidiary

On July 26, 2014, the Company provided 100% interests of Jilin Hanzheng Co., Ltd., a subsidiary, to Korea Ginseng Corporation as an investment in kind with the approval from the Board of Directors on April 16, 2014, and in exchange, the Company acquired 331,981 shares of Korea Ginseng Corporation.

(b) Transfer and investment in kind of securities

On July 22, 2014, the Company provided 8,380,000 shares of Yonhap Television News(YTN) to Korea Ginseng Corporation as an investment in kind with the approval from the Board of Directors on July 17, 2014, and in exchange, the Company acquired 217,854 shares of Korea Ginseng Corporation.

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 ₩ 1014.40 to US\$1, the basic exchange rate on June 30, 2014, 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.