

KT&G CORPORATION AND SUBSIDIARIES

Consolidated Interim Financial Statements

June 30, 2016 and 2015

(Unaudited)

(With Independent Auditors' Review Report Thereon)

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Independent Auditors' Review Report

Based on a report originally issued in Korean

The Board of Directors and Shareholders
KT&G Corporation:

Reviewed financial statements

We have reviewed the accompanying consolidated interim financial statements of KT&G Corporation (the "Parent Company") and its subsidiaries (collectively the "Group"), expressed in Korean won, which comprise the consolidated interim statement of financial position as of June 30, 2016, the consolidated interim statements of comprehensive income for the three- and six-month periods ended June 30, 2016 and 2015 and the consolidated interim statements of changes in equity and cash flows for the six-month periods ended June 30, 2016 and 2015 and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's responsibility

Management is responsible for the preparation and fair presentation of these consolidated interim financial statements in accordance with Korean International Financial Reporting Standards ("K-IFRS") No.1034 *Interim Financial Reporting*, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' review responsibility

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

We conducted our reviews in accordance with the Review Standards for Quarterly and Semiannual Financial Statements established by the Securities and Futures Commission of the Republic of Korea. A review of interim financial statements 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 Korean Standards on Auditing 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 that the accompanying consolidated interim financial statements referred to above are not prepared, in all material respects, in accordance with K-IFRS No.1034.

The accompanying consolidated interim financial statements as of and for the three- and six-month periods ended June 30, 2016 have been translated into United States dollars solely for the convenience of the reader and such translation does not comply with K-IFRS. We have reviewed the translation and nothing came to our attention that cause us to believe that the consolidated interim financial statements expressed in Korean won have not been translated into dollars on the basis set forth in note 4 to the consolidated interim financial statements.



Other matters

The procedures and practices utilized in the Republic of Korea to review such consolidated interim financial statements may differ from those generally accepted and applied in other countries.

The consolidated statement of financial position of the Group as of December 31, 2015, and the related consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, which are not accompanying this report, were audited by us in accordance with Korean Standards on Auditing and our report thereon, dated February 25, 2016, expressed an unqualified opinion. The accompanying consolidated statement of financial position of the Group as of December 31, 2015 presented for comparative purposes, is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

KPMG Samjong Accounting Corp.

KPMG Samjong Accounting Corp.

Seoul, Korea

August 16, 2016

This report is effective as of August 16, 2016, 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 consolidated interim financial statements and notes thereto. Accordingly, the readers of the review report should understand that the above review report has not been updated to reflect the impact of such subsequent events or circumstances, if any.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Interim Statements of Financial Position
(Unaudited)

As of June 30, 2016 and December 31, 2015

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	June 30 2016 Korean won	June 30 2016 U.S. dollars (note 4)	December 31 2015 Korean won
Assets				
Property, plant and equipment	6,16	₩ 1,668,599	\$ 1,432,643	₩ 1,789,779
Intangible assets	7	107,371	92,188	105,428
Investment property	8,16	284,178	243,993	164,489
Investments in associates	5,9	38,212	32,808	51,521
Available-for-sale financial assets	10,31	355,745	305,439	364,681
Other financial assets	14,16,31	11	10	12
Long-term deposits in MSA Escrow Fund	11,31,33	449,730	386,134	403,966
Long-term advance payments	33	119,159	102,309	107,723
Long-term prepaid expenses		6,401	5,495	7,128
Long-term trade and other receivables	12,31	72,866	62,562	75,071
Deferred income tax assets		34,763	29,847	32,696
Total non-current assets		3,137,035	2,693,428	3,102,494
Inventories	13	1,970,646	1,691,978	2,119,114
Current available-for-sale financial assets	10,31	1,596	1,370	-
Current other financial assets	14,16,31,32	969,754	832,621	1,136,906
Prepaid tobacco excise and other taxes		480,733	412,753	447,771
Trade and other receivables	12,31	1,273,866	1,093,729	1,217,938
Advance payments	33	123,043	105,642	75,710
Prepaid expenses		28,516	24,484	20,519
Cash and cash equivalents	14,31,32	635,423	545,568	546,213
Total current assets		5,483,577	4,708,145	5,564,171
Non-current assets held for sale	5,15	5,150	4,422	6,692
Total assets		₩ 8,625,762	\$ 7,405,995	₩ 8,673,357

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Interim Statements of Financial Position, Continued
(Unaudited)

As of June 30, 2016 and December 31, 2015

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	June 30 2016 Korean won	June 30 2016 U.S. dollars (note 4)	December 31 2015 Korean won
Equity				
Ordinary shares	1,17	₩ 954,959	\$ 819,919	₩ 954,959
Other capital surplus	17	(10,067)	(8,643)	(9,928)
Treasury shares	18	(331,772)	(284,856)	(337,062)
Gain on reissuance of treasury shares	18	505,191	433,753	494,648
Reserve	19	4,277,084	3,672,262	3,704,315
Retained earnings	20	975,221	837,315	1,401,975
Equity attributable to owners of the parent		6,370,616	5,469,750	6,208,907
Non-controlling interests		68,091	58,463	66,592
Total equity		6,438,707	5,528,213	6,275,499
Liabilities				
Long-term borrowings	16,22,31,32	110,986	95,291	102,242
Long-term trade and other payables	16,21,31	10,194	8,752	13,647
Long-term advance receipts		9,890	8,491	10,390
Net defined benefit liability	23	139,495	119,769	120,648
Provision		2,662	2,285	2,765
Deferred income tax liabilities		285,504	245,131	276,472
Total non-current liabilities		558,731	479,719	526,164
Short-term borrowings	16,22,31,32	102,239	87,782	206,373
Current portion of long-term borrowings	16,22,31,32	29,230	25,097	27,659
Trade and other payables	16,21,31	605,503	519,879	606,355
Advance receipts	24	8,707	7,475	28,650
Income tax payable		197,313	169,411	224,836
Tobacco excise and other taxes payable		685,332	588,419	777,821
Total current liabilities		1,628,324	1,398,063	1,871,694
Total liabilities		2,187,055	1,877,782	2,397,858
Total equity and liabilities		₩ 8,625,762	\$ 7,405,995	₩ 8,673,357

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Interim Statements of Comprehensive Income
(Unaudited)

For the six-month periods ended June 30, 2016 and 2015

<i>In millions of won and thousands of U.S. dollars, except earnings per share</i>	<i>Note</i>	2016 Korean won	2016 U.S. dollars (note 4)	2015 Korean won
Sales	5,24,33	₩ 2,179,440	\$ 1,871,245	₩ 2,168,813
Cost of sales	24,25	(863,852)	(741,695)	(860,116)
Gross profit		1,315,588	1,129,550	1,308,697
Selling, general and administrative expenses	25	(576,769)	(495,208)	(577,189)
Operating profit	5	738,819	634,342	731,508
Other income	26	45,034	38,666	60,805
Other expenses	26	(38,750)	(33,270)	(52,114)
Net finance income	27,31	29,215	25,083	30,786
Share of gain of associates	9	1,406	1,207	2,789
Share of loss of associates	9	(113)	(97)	-
Profit before income tax		775,611	665,931	773,774
Income tax expense	28	(205,303)	(176,270)	(204,290)
Profit for the period		₩ 570,308	\$ 489,661	₩ 569,484
Other comprehensive income (loss):				
Items that will never be reclassified to profit or loss				
Remeasurements of net defined benefit liability, net of tax		₩ (203)	\$ (174)	₩ (183)
Items that are or may be reclassified subsequently to profit or loss				
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		(5,564)	(4,777)	(7,219)
Exchange differences on translating foreign operations, net of tax		11,098	9,529	(829)
Other comprehensive income (loss) for the period, net of tax		5,331	4,578	(8,231)
Total comprehensive income for the period		₩ 575,639	\$ 494,239	₩ 561,253
Profit attributable to:				
Owners of the Parent Company		₩ 569,334	\$ 488,825	₩ 570,125
Non-controlling interests		974	836	(641)
		₩ 570,308	\$ 489,661	₩ 569,484
Total comprehensive income attributable to:				
Owners of the Parent Company		₩ 574,299	\$ 493,088	₩ 562,386
Non-controlling interests		1,340	1,151	(1,133)
		₩ 575,639	\$ 494,239	₩ 561,253
Earnings per share in won and U.S. dollars:				
Basic and diluted	29	₩ 4,514	\$ 3.88	₩ 4,526

See accompanying notes to the consolidated interim financial statements

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Interim Statements of Comprehensive Income, Continued
(Unaudited)

For the three-month periods ended June 30, 2016 and 2015

<i>In millions of won and thousands of U.S. dollars, except earnings per share</i>	<i>Note</i>	2016 Korean won	2016 U.S. dollars (note 4)	2015 Korean won
Sales	5,24,33	₩ 1,088,097	\$ 934,229	₩ 1,031,902
Cost of sales	24,25	(439,764)	(377,577)	(449,862)
Gross profit		648,333	556,652	582,040
Selling, general and administrative expenses	25	(302,478)	(259,705)	(273,068)
Operating profit	5	345,855	296,947	308,972
Other income	26	34,359	29,500	34,513
Other expenses	26	(11,150)	(9,572)	(11,243)
Net finance income	27,31	13,193	11,327	20,004
Share of gain of associates	9	802	688	2,137
Profit before income tax		383,059	328,890	354,383
Income tax expense	28	(97,467)	(83,685)	(93,678)
Profit for the period		₩ 285,592	\$ 245,205	₩ 260,705
Other comprehensive income (loss):				
Items that will never be reclassified to profit or loss				
Remeasurements of net defined benefit liability, net of tax		₩ (53)	\$ (46)	₩ 55
Items that are or may be reclassified subsequently to profit or loss				
Unrealized net changes in fair value of available-for-sale financial assets, net of tax		(11,615)	(9,972)	(2,727)
Exchange differences on translating foreign operations, net of tax		4,672	4,012	3,537
Other comprehensive income (loss) for the period, net of tax		(6,996)	(6,006)	865
Total comprehensive income for the period		₩ 278,596	\$ 239,199	₩ 261,570
Profit attributable to:				
Owners of the Parent Company		₩ 284,945	\$ 244,651	₩ 261,202
Non-controlling interests		647	554	(497)
		₩ 285,592	\$ 245,205	₩ 260,705
Total comprehensive income attributable to:				
Owners of the Parent Company		₩ 277,775	\$ 238,495	₩ 262,116
Non-controlling interests		821	704	(546)
		₩ 278,596	\$ 239,199	₩ 261,570
Earnings per share in won and U.S. dollars:				
Basic and diluted	29	₩ 2,259	\$ 1.94	₩ 2,074

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Interim Statements of Changes in Equity
(Unaudited)

For the six-month period ended June 30, 2016

<i>In millions of won</i>	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non- controlling interests	Total equity
Balance at January 1, 2016	₩ 954,959	(9,928)	(337,062)	494,648	3,704,315	1,401,975	6,208,907	66,592	6,275,499
Total comprehensive income for the period:									
Profit for the period	-	-	-	-	-	569,334	569,334	974	570,308
Other comprehensive income (loss):									
Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	(202)	(202)	(1)	(203)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	(5,564)	-	(5,564)	-	(5,564)
Exchange differences on translating foreign operations, net of tax	-	-	-	-	10,731	-	10,731	367	11,098
Total other comprehensive income (loss)	-	-	-	-	5,167	(202)	4,965	366	5,331
Total comprehensive income for the period	-	-	-	-	5,167	569,132	574,299	1,340	575,639
Transactions with owners, recorded directly in equity:									
Dividends	-	-	-	-	-	(428,284)	(428,284)	-	(428,284)
In-kind donation of treasury shares	-	-	5,290	10,543	-	-	15,833	-	15,833
Transfer from reserve for research and human resource development	-	-	-	-	(10,000)	10,000	-	-	-
Transfer to unconditional reserve	-	-	-	-	577,602	(577,602)	-	-	-
Conversion of redeemable convertible preferred shares of subsidiaries	-	(139)	-	-	-	-	(139)	139	-
Others	-	-	-	-	-	-	-	20	20
Total transactions with owners	-	(139)	5,290	10,543	567,602	(995,886)	(412,590)	159	(412,431)
Balance at June 30, 2016	₩ 954,959	(10,067)	(331,772)	505,191	4,277,084	975,221	6,370,616	68,091	6,438,707

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Interim Statements of Changes in Equity, Continued
(Unaudited)

For the six-month period ended June 30, 2016

<i>In thousands of U.S. dollars</i>	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non- controlling interests	Total equity
Balance at January 1, 2016	\$ 819,919	(8,524)	(289,398)	424,700	3,180,488	1,203,722	5,330,907	57,175	5,388,082
Total comprehensive income for the period:									
Profit for the period	-	-	-	-	-	488,825	488,825	836	489,661
Other comprehensive income (loss):									
Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	(173)	(173)	(1)	(174)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	(4,777)	-	(4,777)	-	(4,777)
Exchange differences on translating foreign operations, net of tax	-	-	-	-	9,213	-	9,213	316	9,529
Total other comprehensive income (loss)	-	-	-	-	4,436	(173)	4,263	315	4,578
Total comprehensive income for the period	-	-	-	-	4,436	488,652	493,088	1,151	494,239
Transactions with owners, recorded directly in equity:									
Dividends	-	-	-	-	-	(367,721)	(367,721)	-	(367,721)
In-kind donation of treasury shares	-	-	4,542	9,053	-	-	13,595	-	13,595
Transfer from reserve for research and human resource development	-	-	-	-	(8,586)	8,586	-	-	-
Transfer to unconditional reserve	-	-	-	-	495,924	(495,924)	-	-	-
Conversion of redeemable convertible preferred shares of subsidiaries	-	(119)	-	-	-	-	(119)	119	-
Others	-	-	-	-	-	-	-	18	18
Total transactions with owners	-	(119)	4,542	9,053	487,338	(855,059)	(354,245)	137	(354,108)
Balance at June 30, 2016	\$ 819,919	(8,643)	(284,856)	433,753	3,672,262	837,315	5,469,750	58,463	5,528,213

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Interim Statements of Changes in Equity, Continued
(Unaudited)

For the six-month period ended June 30, 2015

<i>In millions of won</i>	Ordinary shares	Other capital surplus	Treasury shares	Gain on reissuance of treasury shares	Reserve	Retained earnings	Owners of the parent	Non- controlling interests	Total equity
Balance at January 1, 2015	₩ 954,959	(4,573)	(339,059)	492,032	3,426,367	1,100,876	5,630,602	77,478	5,708,080
Total comprehensive income for the period:									
Profit (loss) for the period	-	-	-	-	-	570,125	570,125	(641)	569,484
Other comprehensive income (loss):									
Remeasurements of net defined benefit liability, net of tax	-	-	-	-	-	(169)	(169)	(14)	(183)
Unrealized net changes in fair value of available-for-sale financial assets, net of tax	-	-	-	-	(7,219)	-	(7,219)	-	(7,219)
Exchange differences on translating foreign operations, net of tax	-	-	-	-	(351)	-	(351)	(478)	(829)
Total other comprehensive loss	-	-	-	-	(7,570)	(169)	(7,739)	(492)	(8,231)
Total comprehensive income (loss) for the period	-	-	-	-	(7,570)	569,956	562,386	(1,133)	561,253
Transactions with owners, recorded directly in equity:									
Dividends	-	-	-	-	-	(428,056)	(428,056)	-	(428,056)
In-kind donation of treasury shares	-	-	1,997	2,616	-	-	4,613	-	4,613
Transfer from reserve for research and human resource development	-	-	-	-	(12,522)	12,522	-	-	-
Transfer to unconditional reserve	-	-	-	-	320,926	(320,926)	-	-	-
Extinguishment of equity conversion option	-	(5,482)	-	-	-	-	(5,482)	(5,390)	(10,872)
Others	-	-	-	-	-	-	-	41	41
Total transactions with owners	-	(5,482)	1,997	2,616	308,404	(736,460)	(428,925)	(5,349)	(434,274)
Balance at June 30, 2015	₩ 954,959	(10,055)	(337,062)	494,648	3,727,201	934,372	5,764,063	70,996	5,835,059

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES
Consolidated Interim Statements of Cash Flows
(Unaudited)

For the six-month periods ended June 30, 2016 and 2015

<i>In millions of won and thousands of U.S. dollars</i>	<i>Note</i>	2016 Korean won	2016 U.S. dollars (note 4)	2015 Korean won
Cash flows from operating activities				
Cash generated from operations	34	₩ 742,743	\$ 637,712	₩ 944,870
Income tax paid		(225,151)	(193,313)	(186,152)
Net cash provided by operating activities		517,592	444,399	758,718
Cash flows from investing activities				
	34			
Interest received		20,953	17,990	16,496
Dividends received		11,620	9,977	9,039
Proceeds from sale of property, plant and equipment		5,332	4,578	4,002
Proceeds from sale of intangible assets		1,092	937	1,080
Proceeds from sale of non-current assets held for sale		5,800	4,980	4,630
Proceeds from sale of investments in associates		13,095	11,243	-
Collection of loans		7,558	6,489	5,974
Withdrawal of guarantee deposits		11,935	10,248	17,398
Settlement of derivatives, net		-	-	7
Acquisition of property, plant and equipment		(74,117)	(63,636)	(113,739)
Acquisition of intangible assets		(6,040)	(5,186)	(2,698)
Acquisition of investment property		-	-	(8)
Acquisition of available-for-sale financial assets		-	-	(1,200)
Increase in loans		(171)	(147)	-
Payments of guarantee deposits		(19,138)	(16,432)	(14,358)
Payments of long-term deposits in MSA Escrow Fund		(46,228)	(39,691)	(40,379)
Decrease (increase) in other financial assets, net		167,147	143,511	(130,950)
Net cash provided by (used in) investing activities		98,838	84,861	(244,706)
Cash flows from financing activities				
	34			
Interest paid		(1,506)	(1,293)	(3,821)
Dividends paid		(428,284)	(367,720)	(428,056)
Paid-in capital increase cost		(128)	(110)	-
Proceeds from borrowings		272,834	234,253	359,047
Increase in deposits received		1,223	1,050	1,070
Repayment of borrowings		(370,957)	(318,500)	(411,588)
Decrease in deposits received		(1,941)	(1,667)	(3,136)
Net cash used in financing activities		(528,759)	(453,987)	(486,484)
Effect of exchange rate fluctuation on cash held		1,539	1,322	(6)
Net increase in cash and cash equivalents		89,210	76,595	27,522
Cash and cash equivalents at January 1		546,213	468,973	416,394
Cash and cash equivalents at June 30		₩ 635,423	\$ 545,568	₩ 443,916

See accompanying notes to the consolidated interim financial statements.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Interim Financial Statements

(Unaudited)

For the six-month periods ended June 30, 2016 and 2015

1. Reporting Entity

(a) Description of the Controlling Company

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

As of June 30, 2016, the Parent Company has three manufacturing plants, including the Shintanjin plant, and 14 local headquarters and 123 branches for the sale of tobacco throughout the country. Also, the Parent Company has the Gimcheon plant for fabrication of leaf tobacco and the Cheonan printing plant for the manufacturing of packaging. The head office of the Parent Company is located at 71, Beotkkot-gil, Daedeok-gu, Daejeon.

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

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

The ownership of the Parent Company's issued ordinary shares as of June 30, 2016 is held as follows:

Shareholder	Number of shares	Percentage of ownership
National Pension Service	11,793,134	8.59%
Industrial Bank of Korea	9,510,485	6.93%
Employee Share Ownership Association	2,851,103	2.08%
Treasury shares	11,148,827	8.12%
Others	101,988,948	74.28%
	137,292,497	100.00%

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Interim Financial Statements
(Unaudited)

For the six-month periods ended June 30, 2016 and 2015

1. Reporting Entity, Continued

(b) Consolidated Subsidiaries

(i) List of consolidated subsidiaries

<i>Next most senior parent</i>	Subsidiary	Principal operation	Percentage of ownership	Reporting date	Location
KT&G Corporation	Korea Ginseng Corporation	Manufacturing and selling ginseng	100.00%	Jun. 30	Korea
	Yungjin Pharm. Ind. Co., Ltd.	Manufacturing and selling pharmaceuticals	53.00%	Jun. 30	Korea
	Tae-a Industry Co., Ltd.	Manufacturing tobacco materials	100.00%	Jun. 30	Korea
	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	Manufacturing and selling tobaccos	99.99%	Jun. 30	Turkey
	Korea Tabacos do Brasil Ltda.	Processing leaf tobaccos	99.99%	Jun. 30	Brazil
	KT&G Pars	Manufacturing and selling tobaccos	99.99%	Jun. 30	Iran
	KT&G Rus L.L.C.	Manufacturing and selling tobaccos	100.00%	Jun. 30	Russia
	KGC Life & Gin Co., Ltd.	Selling ginseng door-to-door	100.00%	Jun. 30	Korea
	Global Trading, Inc.	Selling tobaccos	100.00%	Jun. 30	USA
	Somang Cosmetics Co., Ltd.	Manufacturing and selling cosmetics	98.49%	Jun. 30	Korea
	Renzoluc Pte., Ltd. (*)	Manufacturing and selling tobaccos	100.00%	Jun. 30	Singapore
	KT&G Life Sciences Corporation(*)	Research and development medicine	73.94%	Jun. 30	Korea
	KGC Yebon Corporation	Manufacturing and selling medical herbs	100.00%	Jun. 30	Korea
	K-Q HongKong I, Limited(*)	Manufacturing and selling ginseng	100.00%	Jun. 30	Hongkong
	PT KT&G Indonesia	Manufacturing and selling tobaccos	99.99%	Jun. 30	Indonesia
	K&I HK Co., Ltd.	Selling cosmetics	100.00%	Jun. 30	Hongkong
	K&I China Co., Ltd.	Selling cosmetics	100.00%	Jun. 30	China
	SangSang Stay, Inc.	Hotel	100.00%	Jun. 30	Korea
	KT&G Global Rus L.L.C.	Selling tobaccos	100.00%	Jun. 30	Russia
	Renzoluc Pte., Ltd.	PT Trisakti Purwosari Makmur	Manufacturing and selling tobaccos	60.17%	Jun. 30
PT Mandiri Maha Mulia		Manufacturing and selling tobaccos	66.47%	Jun. 30	Indonesia
PT Trisakti Purwosari Makmur	PT Sentosa Ababi Purwosari	Manufacturing and selling tobaccos	99.24%	Jun. 30	Indonesia
	PT Purindo Ilufa	Manufacturing and selling tobaccos	100.00%	Jun. 30	Indonesia
Korea Ginseng Corporation	Cheong Kwan Jang Taiwan Corporation	Manufacturing and selling ginseng	100.00%	Jun. 30	Taiwan
	Korean Red Ginseng Corp., Inc.	Manufacturing and selling ginseng	100.00%	Jun. 30	USA
	Korea Ginseng (China) Corp.	Manufacturing and selling ginseng	100.00%	Jun. 30	China
	Korea Ginseng Corporation Japan	Manufacturing and selling ginseng	100.00%	Jun. 30	Japan
	PT CKJ INDONESIA	Manufacturing and selling ginseng	99.88%	Jun. 30	Indonesia
	Jilin Hanzheng Ginseng Co., Ltd.	Manufacturing and selling ginseng	100.00%	Jun. 30	China

KT&G CORPORATION AND SUBSIDIARIES
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For the six-month periods ended June 30, 2016 and 2015

(b) Consolidated Subsidiaries, Continued

(*) The Group's percentage of ownership, shown above, excludes preferred shares. As of June 30, 2016, the Group's percentage of ownership would be 68.91%, 59.48% and 50.00% if preferred shares are included.

For the six-month period ended June 30, 2016, the Parent Company's ownership interest in Somang Cosmetics Co., Ltd. has increased to 98.49% from 97.73% as a result of the conversion of its redeemable convertible preferred shares.

(ii) Financial information of subsidiaries

In millions of won

Subsidiary		Total assets	Total liabilities	Revenue	Net comprehensive profit (loss)	Total income (loss)
Korea Ginseng Corporation	₩	1,769,491	229,605	549,141	78,568	77,520
Yungjin Pharm. Ind. Co., Ltd.		193,631	90,375	91,042	2,835	2,832
Tae-a Industry Co., Ltd.		15,854	4,236	7,539	850	855
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.		51,368	39,120	6,846	2,337	2,372
Korea Tabacos do Brasil Ltda.		2,615	6	-	-	-
KT&G Pars		29,439	48,197	-	(815)	(815)
KT&G Rus L.L.C.		130,458	65,341	5,098	5,089	12,968
KGC Life & Gin Co., Ltd.		25,506	7,592	25,866	(1,212)	(1,213)
Global Trading, Inc.		46,574	28,063	70,403	(35)	(150)
Somang Cosmetics Co., Ltd.		79,383	16,200	42,949	494	479
Renzoluc Pte., Ltd.		47,980	80,050	-	(1,780)	(2,986)
KT&G Life Sciences Corporation		17,103	18,406	-	(2,223)	(2,223)
KGC Yebon Corporation		49,994	2,766	3,895	214	166
K-Q HongKong I, Limited		42,029	-	-	505	237
PT KT&G Indonesia		14,855	37,294	7,316	(1,080)	(1,929)
K&I HK Co., Ltd.		788	278	1,264	342	336
K&I China Co., Ltd.		4,339	277	330	(639)	(720)
SangSang Stay, Inc.		16,229	1,903	1,507	(5,248)	(5,248)
KT&G Global Rus L.L.C.		1,540	-	-	(2)	42
PT Trisakti Purwosari Makmur, etc.		87,614	67,635	18,589	56	844
PT Mandiri Maha Mulia		18,306	13,423	4,915	969	1,128
Cheong Kwan Jang Taiwan Corporation		13,660	12,814	6,624	(582)	(562)
Korean Red Ginseng Corp., Inc.		10,336	6,577	7,502	206	181
Korea Ginseng (China) Corp.		67,068	48,996	8,782	(4,717)	(4,851)
Korea Ginseng Corporation Japan		3,993	2,508	5,054	358	538
PT CKJ INDONESIA		1,027	1,111	-	-	(3)
Jilin Hanzheng Ginseng Co., Ltd.		118,538	49,278	663	(3,687)	(4,307)

(c) Change in Consolidated Group

For the six-month period ended June 30, 2016, the Parent Company established KT&G Global Rus L.L.C.

KT&G CORPORATION AND SUBSIDIARIES

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For the six-month periods ended June 30, 2016 and 2015

2. Basis of Preparation

(a) Statement of Compliance

The consolidated interim financial statements have been prepared in accordance with Korean International Financial Reporting Standards ("K-IFRS"). These consolidated interim financial statements were prepared in accordance with K-IFRS No. 1034 *Interim Financial Reporting* as part of the period covered by the Group's K-IFRS annual consolidated financial statements.

The consolidated interim financial statements were authorized for issue by the Board of Directors on July 21, 2016.

(b) Basis of Measurement

The consolidated interim financial statements have been prepared on the historical cost basis, except for the following material items in the consolidated interim statements of financial position:

- Derivative financial instruments measured at fair value
- Available-for-sale financial assets measured at fair value
- Liabilities for defined benefit plans recognized at the net of the total present value of defined benefit obligations less the fair value of plan assets

(c) Functional and Presentation Currency

These consolidated interim financial statements are presented in Korean won, which is the Group's functional currency and the currency of the primary economic environment in which the Group operates.

(d) Use of Estimates and Judgments

The preparation of the consolidated interim financial statements in conformity with K-IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

In preparing these consolidated interim financial statements, the significant judgments made by management in applying the Group's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the financial statements as of and for the year ended December 31, 2015.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Interim Financial Statements

(Unaudited)

For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies

The significant accounting policies applied by the Group in preparation of its consolidated interim financial statements are included below. The accounting policies set out below have been applied consistently to all periods presented in these consolidated interim financial statements.

(a) Basis of Consolidation

(i) Non-controlling interests

Non-controlling interests are measured at their proportionate share of the acquiree's identifiable net assets at the acquisition date.

Changes in the Group's interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

(ii) Subsidiaries

Subsidiaries are entities controlled by the Group. The Group controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control commences until the date on which control ceases.

(iii) Loss of control

When the Group loses control over a subsidiary, it derecognises the assets and liabilities of the subsidiary, and any related non-controlling interests and other components of equity. Any resulting gain or loss is recognized in profit or loss. Any interest retained in the former subsidiary is measured at fair value when control is lost.

(iv) Interests in equity-accounted investees

Associates are those entities in which the Group has significant influence, but not control or joint control, over the financial and operating policies. A joint venture is an arrangement in which the Group has joint control, whereby the Group has rights to the net assets of the arrangement, rather than rights to its assets and obligations for its liabilities.

Interests in associates and joint venture are accounted for using the equity method. They are recognized initially at cost, which includes transaction costs. Subsequent to initial recognition, the consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of equity-accounted investees, until the date on which significant influence or joint control ceases.

(v) Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated. Unrealised gains arising from transactions with equity-accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

KT&G CORPORATION AND SUBSIDIARIES
Notes to the Consolidated Interim Financial Statements

(Unaudited)

For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies, Continued

(b) 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 attributable to the acquisition of the items.

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

Property, plant and equipment, except for land and other tangible fixed assets, are depreciated on a straight-line basis over estimated useful lives that appropriately reflect the pattern in which the asset's future economic benefits are expected to be consumed.

The estimated useful lives of the Group's assets are as follows:

	Useful lives(years)		Useful lives(years)
Buildings	10 ~ 60	Vehicles	4 ~ 10
Structures	5 ~ 40	Tools	4 ~ 5
Machinery	5 ~ 20	Furniture and fixtures	2 ~ 5

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 in other income and expense in the statement of comprehensive income.

(c) Borrowing Costs

The Group capitalizes borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. Other borrowing costs are recognized in expense as incurred. A qualifying asset is an asset that requires a substantial period of time to get ready for its intended use or sale. Financial assets and inventories that are manufactured or otherwise produced over a short period of time are not qualifying assets. Assets that are ready for their intended use or sale when acquired are not qualifying assets.

To the extent that the Group borrows funds specifically for the purpose of obtaining a qualifying asset, the Group determines the amount of borrowing costs eligible for capitalization as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings. The Group immediately recognizes other borrowing costs as an expense. To the extent that the Group borrows funds generally and uses them for the purpose of obtaining a qualifying asset, the Group determines the amount of borrowing costs eligible for capitalization by applying a capitalization rate to the expenditures on that asset. The capitalization rate is the weighted average of the borrowing costs applicable to the borrowings of the Group that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs that the Group capitalizes during a period does not exceed the amount of borrowing costs incurred during that period.

KT&G CORPORATION AND SUBSIDIARIES

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For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies, Continued

(d) Government Grants

Government grants are not recognized unless there is reasonable assurance that the Group will comply with the grant's conditions and that the grant will be received. Government grants which are intended to compensate the Group for expenses incurred are recognized as other income in profit or loss over the periods in which the Group recognizes the related costs as expenses.

(e) Intangible Assets except for Goodwill

Intangible assets are measured initially at cost and, subsequently, are carried at cost less accumulated amortization and accumulated impairment losses. Intangible assets consist of industrial property rights, facility usage rights, other intangible assets and intangible assets under development. 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 some of industrial property rights and facility usage 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 were as follows:

	Useful lives (years)
Industrial property rights	5 ~ 20 or indefinite
Facility usage rights	indefinite
Other intangible assets	3 ~ 5 or indefinite

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

(f) Investment Property

Property held for the purpose of earning rentals or benefiting from capital appreciation is classified as investment property. Investment property is initially measured at its cost. Transaction costs are included in the initial measurement. Subsequently, investment property is carried at depreciated cost less any accumulated impairment losses.

Subsequent costs are recognized in the carrying amount of investment property at cost or, if appropriate, as separate items if it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing are recognized in profit or loss as incurred.

Investment property except for land, are depreciated on a straight-line basis over 10 ~ 60 years as estimated useful lives.

Depreciation methods, useful lives and residual values are reviewed at the end of each reporting date and adjusted, if appropriate. The change is accounted for as a change in an accounting estimate.

KT&G CORPORATION AND SUBSIDIARIES

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3. Significant Accounting Policies, Continued

(g) Non-current Assets Held for Sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. In order to be classified as held for sale, the asset (or disposal group) must be available for immediate sale in its present condition and its sale must be highly probable. The assets or disposal group that are classified as non-current assets held for sale are measured at the lower of their carrying amount and fair value less cost to sell.

The Group recognizes an impairment loss for any initial or subsequent write-down of an asset (or disposal group) to fair value less costs to sell, and a gain for any subsequent increase in fair value less costs to sell, up to the cumulative impairment loss previously recognized in accordance with K-IFRS No. 1036 *Impairment of Assets*.

A non-current asset that is classified as held for sale or part of a disposal group classified as held for sale is not depreciated (or amortized).

(h) 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 ₩291,449 million and ₩310,043 million, respectively, as of June 30, 2016 and December 31, 2015.

(i) Impairment of Non-financial Assets

The carrying amounts of the Group's non-financial assets, other than inventories, deferred tax assets, assets arising from employee benefits and non-current assets held for sale, are reviewed at the end of the reporting period to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Goodwill and intangible assets that have indefinite useful lives or that are not yet available for use, irrespective of whether there is any indication of impairment, are tested for impairment annually by comparing their recoverable amount to their carrying amount.

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3. Significant Accounting Policies, Continued

(i) Impairment of Non-financial Assets, Continued

The Group estimates the recoverable amount of an individual asset. If it is impossible to measure the individual recoverable amount of an asset, then the Group estimates the recoverable amount of cash-generating unit ("CGU"). A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. The value in use is estimated by applying a pre-tax discount rate that reflect current market assessments of the time value of money and the risks specific to the asset or CGU for which estimated future cash flows have not been adjusted, to the estimated future cash flows expected to be generated by the asset or CGU.

An impairment loss is recognized if the carrying amount of an asset or a CGU exceeds its recoverable amount. Impairment losses are recognized in profit or loss.

(j) Non-derivative Financial Assets

The Group recognizes and measures non-derivative financial assets by the following four categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets. The Group recognizes financial assets in the statement of financial position when the Group becomes a party to the contractual provisions of the instrument.

Upon initial recognition, non-derivative financial assets are measured at their fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the asset's acquisition or issuance.

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

A financial asset is classified as financial assets are classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Upon initial recognition, transaction costs are recognized in profit or loss when incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

(ii) Held-to-maturity investments

A non-derivative financial asset with a fixed or determinable payment and fixed maturity, for which the Group has the positive intention and ability to hold to maturity, are classified as held-to-maturity investments. Subsequent to initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method.

(iii) Loans and receivables

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest method except for loans and receivables of which the effect of discounting is immaterial.

KT&G CORPORATION AND SUBSIDIARIES
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For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies, Continued

(j) Non-derivative Financial Assets, Continued

(iv) Available-for-sale financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables. Subsequent to initial recognition, they are measured at fair value, which changes in fair value, net of any tax effect, recorded in other comprehensive income in equity. Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments are measured at cost.

(v) De-recognition of financial assets

The Group derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Group is recognized as a separate asset or liability.

If the Group retains substantially all the risks and rewards of ownership of the transferred financial assets, the Group continues to recognize the transferred financial assets and recognizes financial liabilities for the consideration received.

(vi) Offsetting between financial assets and financial liabilities

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

(k) Derivative financial instruments

Derivatives are initially recognized at fair value. Subsequent to initial recognition, derivatives are measured at fair value, and changes in the fair value of derivative financial instruments are recognized immediately in profit or loss.

Embedded derivatives are separated from the host contract and accounted for separately only if the following criteria have been met:

- The economic characteristics and risks of the embedded derivative are not closely related to those of the host contract;
- A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- The hybrid instrument is not measured at fair value with changes in fair value recognized in profit or loss.

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3. Significant Accounting Policies, Continued

(I) Impairment of Financial Assets

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably. However, losses expected as a result of future events, regardless of likelihood, are not recognized.

If financial assets have objective evidence that they are impaired, impairment losses should be measured and recognized.

(i) Financial assets measured at amortized cost

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of its estimated future cash flows discounted at the asset's original effective interest rate. If it is not practicable to obtain the instrument's estimated future cash flows, impairment losses would be measured by using prices from any observable current market transactions. The Group can recognize impairment losses directly or establish a provision to cover impairment losses. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed either directly or by adjusting an allowance account.

(ii) Financial assets carried at cost

If there is objective evidence that an impairment loss has occurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment losses are not reversed.

(iii) Available-for-sale financial assets

When a decline in the fair value of an available-for-sale financial asset has been recognized in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss that had been recognized in other comprehensive income is reclassified from other comprehensive income to profit or loss as a reclassification adjustment even though the financial asset has not been derecognized. Impairment losses recognized in profit or loss for an investment in an equity instrument classified as available-for-sale are not reversed through profit or loss. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in profit or loss. For an investment in an equity security, objective evidence of impairment includes a significant or prolonged decline in its fair value below its cost. The Group considers a decline of 20% to be significant and a period of nine months to be prolonged.

KT&G CORPORATION AND SUBSIDIARIES
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3. Significant Accounting Policies, Continued

(m) Cash and Cash Equivalents

Cash and cash equivalents comprise cash balances and call deposits with maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by the Group in the management of its short-term commitments. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares when it has a short maturity with a specified redemption date.

(n) Non-derivative Financial Liabilities

The Group classifies non-derivative financial liabilities into financial liabilities at fair value through profit or loss, financial guarantee liabilities and other financial liabilities in accordance with the substance of the contractual arrangement and the definitions of financial liabilities. The Group recognizes financial liabilities in the statement of financial position when the Group becomes a party to the contractual provisions of the financial liability.

(i) Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss include financial liabilities held for trading or designated as such upon initial recognition. Subsequent to initial recognition, financial liabilities at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss. Upon initial recognition, transaction costs that are directly attributable to the acquisition are recognized in profit or loss as incurred.

(ii) Financial guarantee liabilities

Financial guarantee liability is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified term of a debt instrument. Upon initial recognition, financial guarantee liabilities are measured at their fair value plus, transaction costs that are directly attributable to the acquisition or issue of the financial guarantee liability.

After initial recognition, an issuer of such a contract measures it at the higher of the amount determined in accordance with K-IFRS No. 1037 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognized less, when appropriate, cumulative amortisation recognized in accordance with K-IFRS No. 1018 *Revenue*.

(iii) Other financial liabilities

Non-derivative financial liabilities other than financial liabilities at fair value through profit or loss or financial guarantee liabilities are classified as other financial liabilities. At the date of initial recognition, other financial liabilities are measured at fair value minus transaction costs that are directly attributable to the acquisition. Subsequent to initial recognition, other financial liabilities are measured at amortized cost using the effective interest method.

The Group derecognizes a financial liability from the statement of financial position when it is extinguished (i.e. when the obligation specified in the contract is discharged, cancelled or expires).

KT&G CORPORATION AND SUBSIDIARIES
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3. Significant Accounting Policies, Continued

(o) Employee Benefits

(i) Short-term employee benefits

Short-term employee benefits are employee benefits that are due to be settled within 12 months after the end of the period in which the employees render the related service. When an employee has rendered service to the Group during an accounting period, the Group recognizes the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

(ii) Retirement benefits: defined contribution plans

When an employee has rendered service to the Group during a period, the Group recognizes the contribution payable to a defined contribution plan in exchange for that service as a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the end of the reporting period, the Group recognizes that excess as an asset (prepaid expense) to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

(iii) Retirement benefits: defined benefit plans

The calculation of defined benefit obligations is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a potential asset for the Group, the recognized asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in other comprehensive income. The Group determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in profit or loss. The Group recognizes gains and losses on the settlement of a defined benefit plan when the settlement occurs.

(iv) Termination benefits

Termination benefits are expensed at the earlier of when the Group can no longer withdraw the offer of those benefits and when the Group recognizes costs for a restructuring. If benefits are not expected to be settled wholly within 12 months of the end of the reporting period, then they are discounted.

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Notes to the Consolidated Interim Financial Statements

(Unaudited)

For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies, Continued

(p) Provisions

Provisions are recognized when the Group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

The risks and uncertainties that inevitably surround many events and circumstances are taken into account in reaching the best estimate of a provision. Where the effect of the time value of money is material, provisions are determined at the present value of the expected future cash flows.

Where some or all of the expenditures required to settle a provision are expected to be reimbursed by another party, the reimbursement shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset.

Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimates. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision is reversed.

(q) Equity Capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issuance of ordinary shares and share options are recognized as a deduction from equity, net of any tax effects.

When the Group repurchases its share capital, the amount of the consideration paid is recognized as a deduction from equity and classified as treasury shares. The profits or losses from the purchase, disposal, reissue, or retirement of treasury shares are not recognized as current profit or loss. If the Group acquires and retains treasury shares, the consideration paid or received is directly recognized in equity.

(r) Revenue Recognition

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

Revenue from sale of goods is measured at the fair value of the consideration received or receivable, net of tobacco excise and other taxes, trade discounts and volume rebates. Revenue from the sale of goods is recognized when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods, the Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold, the amount of revenue can be measured reliably, it is probable that the economic benefits associated with the transaction will flow to the Group and the costs incurred or to be incurred in respect of the transaction can be measured reliably. Tobacco excise and other taxes deducted from revenue for the six-month periods ended June 30, 2016 and 2015 were ₩3,135,929 million and ₩2,129,503 million, respectively.

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(Unaudited)

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3. Significant Accounting Policies, Continued

(r) Revenue Recognition, Continued

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

Rental income from investment property, net of lease incentives granted, is recognized in profit or loss on a straight-line basis over the term of the lease.

(s) Finance Income and Finance Costs

Finance income comprises interest income on funds invested (including available-for-sale financial assets), dividend income and interest income on long-term deposits in MSA Escrow Fund. Interest income is recognized as it accrues in profit or loss, using the effective interest method. Dividend income is recognized in profit or loss on the date that the Group's right to receive payment is established.

Finance costs is interest expense on borrowings and unwinding of the discount on trade and other payables which is recognized in profit or loss using the effective interest method.

(t) Income Taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

(i) Current tax

Current tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the end of the reporting period and any adjustment to tax payable in respect of previous years. The taxable profit is different from the accounting profit for the period since the taxable profit is calculated excluding the temporary differences, which will be taxable or deductible in determining taxable profit (tax loss) of future periods, and non-taxable or non-deductible items from the accounting profit.

KT&G CORPORATION AND SUBSIDIARIES

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3. Significant Accounting Policies, Continued

(t) Income Taxes, Continued

(ii) Deferred tax

The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities. The Group recognizes a deferred tax asset for all deductible temporary differences to the extent that it is probable that the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

The carrying amount of a deferred tax asset is reviewed at the end of each reporting period and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow the benefit of part or all of that deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and deferred tax assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset only if there is a legally enforceable right to offset the related current tax liabilities and assets, and they relate to income taxes levied by the same tax authority and they intend to settle current tax liabilities and assets on a net basis.

(u) Foreign Currencies

(i) Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of the Group at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency using the reporting date's exchange rate. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined.

Foreign currency differences arising on retranslation are recognized in profit or loss, except for differences arising on the retranslation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation, or qualifying cash flow hedges, which are recognized in other comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(ii) Foreign operations

If the presentation currency of the Group is different from a foreign operation's functional currency, the financial statements of the foreign operation are translated into the presentation currency using the following methods:

The assets and liabilities of foreign operations, whose functional currency is not the currency of a hyperinflationary economy, are translated to presentation currency at exchange rates at the reporting date. The income and expenses of foreign operations are translated to functional currency at exchange rates at the dates of the transactions. Foreign currency differences are recognized in other comprehensive income.

KT&G CORPORATION AND SUBSIDIARIES

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(Unaudited)

For the six-month periods ended June 30, 2016 and 2015

3. Significant Accounting Policies, Continued

(u) Foreign Currencies, Continued

Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation is treated as assets and liabilities of the foreign operation. Thus they are expressed in the functional currency of the foreign operation and translated at the closing rate.

When a foreign operation is disposed of, the relevant amount in the translation is transferred to profit or loss as part of the profit or loss on disposal.

Foreign exchange gains or losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely to occur in the foreseeable future and which in substance is considered to form part of the net investment in the foreign operation, are recognized in other comprehensive income in the translation reserve. On the partial disposal of a subsidiary that includes a foreign operation, the entity re-attribute the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the non-controlling interests in that foreign operation. In any other partial disposal of a foreign operation the entity reclassify to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

(v) Earnings per Share

The Group presents basic and diluted earnings per share ("EPS") data for its ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to ordinary shareholders of the Group by the weighted average number of ordinary shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares.

4. Basis of Translating Financial Statements

The consolidated interim financial statements are expressed in Korean won and have been translated into U.S. dollars at the rate of ₩1,164.70 to \$1, the basic exchange rate on June 30, 2016 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.

5. Operating Segments

(a) The Group's operating segments are summarized as follows:

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

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(Unaudited)

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5. Operating Segments, Continued

(b) Segment information on sales and operating profit for the six-month period ended June 30, 2016 was as follows:

<i>In millions of won</i>	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Sales:							
Total segment sales	₩ 1,436,508	576,612	74,707	224,235	2,312,062	(132,622)	2,179,440
Less: Inter-segment sales	77,490	24,224	3,909	26,999	132,622	(132,622)	-
External sales	₩ 1,359,018	552,388	70,798	197,236	2,179,440	-	2,179,440
Segment profit:							
Operating profit	₩ 613,656	97,388	17,192	18,472	746,708	(7,889)	738,819

(c) Segment information on sales and operating profit for the six-month period ended June 30, 2015 was as follows:

<i>In millions of won</i>	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Sales:							
Total segment sales	₩ 1,540,586	490,763	79,740	182,719	2,293,808	(124,995)	2,168,813
Less: Inter-segment sales	63,985	31,936	3,483	25,591	124,995	(124,995)	-
External sales	₩ 1,476,601	458,827	76,257	157,128	2,168,813	-	2,168,813
Segment profit:							
Operating profit	₩ 643,910	74,409	12,401	11,120	741,840	(10,332)	731,508

(d) Segment information on assets and liabilities as of June 30, 2016 was as follows:

<i>In millions of won</i>	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Assets:							
Segment assets	₩ 3,977,250	1,724,014	273,909	267,197	6,242,370	(228,398)	6,013,972
Investments in associates	-	-	35,215	2,997	38,212	-	38,212
Non-current assets held for sale	-	5,150	-	-	5,150	-	5,150
	3,977,250	1,729,164	309,124	270,194	6,285,732	(228,398)	6,057,334
Unallocated assets							2,568,428
Total assets	₩						8,625,762
Liabilities:							
Segment liabilities	₩ 1,360,002	169,274	-	81,470	1,610,746	(175,042)	1,435,704
Unallocated liabilities							751,351
Total liabilities	₩						2,187,055

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For the six-month periods ended June 30, 2016 and 2015

5. Operating Segments, Continued

(e) Segment information on assets and liabilities as of December 31, 2015 was as follows:

<i>In millions of won</i>	Tobacco	Ginseng	Real estate	Others	Segment total	Elimination	Consolidated
Assets:							
Segment assets	₩ 3,990,313	1,831,157	149,522	365,152	6,336,144	(319,032)	6,017,112
Investments in associates	-	-	48,800	2,721	51,521	-	51,521
Non-current assets held for sale	1,542	5,150	-	-	6,692	-	6,692
	3,991,855	1,836,307	198,322	367,873	6,394,357	(319,032)	6,075,325
Unallocated assets							2,598,032
Total assets	₩						8,673,357
Liabilities:							
Segment liabilities	₩ 1,443,132	161,563	-	84,536	1,689,231	(155,384)	1,533,847
Unallocated liabilities							864,011
Total liabilities	₩						2,397,858

(f) Revenues from major customers which amount to more than 10 percent of the details of the Group's consolidated total revenues for the six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016	2015
Alokozay International Limited	₩	242,404	221,082

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6. Property, Plant and Equipment

- (a) Details of property, plant and equipment as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016			December 31 2015		
	Cost	Accumulated depreciation and impairment	Carrying amount	Cost	Accumulated depreciation and impairment	Carrying amount
Land	₩ 588,125	-	588,125	583,481	-	583,481
Buildings	967,670	(406,831)	560,839	963,700	(389,526)	574,174
Structures	71,743	(40,738)	31,005	72,949	(39,770)	33,179
Machinery	1,298,272	(969,393)	328,879	1,278,124	(933,159)	344,965
Vehicles	12,553	(10,424)	2,129	12,907	(10,572)	2,335
Tools	63,656	(53,988)	9,668	63,467	(52,664)	10,803
Furniture and fixtures	248,360	(198,317)	50,043	245,349	(195,912)	49,437
Others	1,798	-	1,798	1,508	-	1,508
Construction-in-progress	96,113	-	96,113	189,897	-	189,897
	₩ 3,348,290	(1,679,691)	1,668,599	3,411,382	(1,621,603)	1,789,779

- (b) Changes in property, plant and equipment for the six-month period ended June 30, 2016 were as follows:

<i>In millions of won</i>	January 1 2016	Acquisition	Disposal	Depreciation	Transfer of construction -in-progress	Net exchange difference and others	June 30 2016
Land	₩ 583,481	101	(955)	-	52,026	(46,528)	588,125
Buildings	574,174	2,031	(1,111)	(18,630)	78,685	(74,310)	560,839
Structures	33,179	501	(754)	(1,720)	147	(348)	31,005
Machinery	344,965	3,369	(70)	(36,716)	16,939	392	328,879
Vehicles	2,335	255	(177)	(425)	82	59	2,129
Tools	10,803	1,300	-	(2,420)	-	(15)	9,668
Furniture and fixtures	49,437	8,079	(346)	(12,006)	5,010	(131)	50,043
Others	1,508	-	-	-	290	-	1,798
Construction-in-progress	189,897	61,875	(3,189)	-	(153,179)	709	96,113
	₩ 1,789,779	77,511	(6,602)	(71,917)	-	(120,172)	1,668,599

For the six-month period ended June 30, 2016, the Group received ₩289 million of government grant related with acquisition of buildings and furniture and fixtures.

For the six-month period ended June 30, 2016, land, buildings and structures with a carrying amount of ₩123,471 million were transferred to investment property and construction-in-progress with a carrying amount of ₩36 million were transferred to intangible assets.

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6. Property, Plant and Equipment, Continued

(c) Changes in property, plant and equipment for the year ended December 31, 2015 were as follows:

<i>In millions of won</i>		January 1 2015	Acquisition	Disposal	Depreciation	Transfer of construction -in-progress	Net exchange difference and others	December 31 2015
Land	₩	574,429	7,271	(823)	-	5,293	(2,689)	583,481
Buildings		520,515	19,685	(398)	(34,617)	76,931	(7,942)	574,174
Structures		28,568	3,722	(86)	(3,455)	4,588	(158)	33,179
Machinery		348,806	29,847	(740)	(74,567)	48,891	(7,272)	344,965
Vehicles		2,850	481	(107)	(982)	156	(63)	2,335
Tools		9,656	5,502	(144)	(4,568)	351	6	10,803
Furniture and fixtures		53,836	22,493	(384)	(26,629)	108	13	49,437
Others		1,454	54	-	-	-	-	1,508
Construction-in-progress		213,298	112,914	-	-	(136,318)	3	189,897
	₩	1,753,412	201,969	(2,682)	(144,818)	-	(18,102)	1,789,779

For the year ended December 31, 2015, land and buildings with a carrying amount of ₩2,732 million were transferred to investment property and land, buildings and structures with a carrying amount of ₩6,692 million were transferred to non-current assets held for sale.

For the year ended December 31, 2015, borrowing costs of ₩82 million were capitalized as part of the cost of machinery and others with the capitalization rate of 3.75%.

7. Intangible Assets

(a) Details of intangible assets as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>		June 30 2016		December 31 2015	
		Cost	Accumulated amortization and impairment	Cost	Accumulated amortization and impairment
Goodwill	₩	87,902	(72,841)	87,902	(72,841)
Industrial property rights		46,337	(31,742)	46,806	(32,015)
Facility usage rights		31,813	(1,754)	28,282	(2,731)
Other intangible assets		114,962	(71,179)	116,349	(70,150)
Intangible assets under development		6,227	(2,354)	6,180	(2,354)
	₩	287,241	(179,870)	285,519	(180,091)

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7. Intangible Assets, Continued

(b) Changes in intangible assets for the six-month period ended June 30, 2016 were as follows:

<i>In millions of won</i>		January 1 2016	Acquisition	Disposal	Amortization	Transfer from property, plant and equipment	Net exchange difference and others	June 30 2016
Goodwill	₩	15,061	-	-	-	-	-	15,061
Industrial property rights		14,791	391	-	(588)	-	1	14,595
Facility usage rights		25,551	5,518	(1,047)	-	36	1	30,059
Other intangible assets		46,199	84	-	(2,404)	-	(96)	43,783
Intangible assets under development		3,826	47	-	-	-	-	3,873
	₩	105,428	6,040	(1,047)	(2,992)	36	(94)	107,371

(c) Changes in intangible assets for the year ended December 31, 2015 were as follows:

<i>In millions of won</i>		January 1 2015	Acquisition	Disposal	Transfer of Intangible assets under development	Amortization	Impairment	Net exchange difference and others	December 31 2015
Goodwill	₩	32,161	-	-	-	-	(17,941)	841	15,061
Industrial property rights		17,000	1,030	(104)	82	(1,330)	(1,575)	(312)	14,791
Facility usage rights		23,550	4,042	(2,041)	-	-	-	-	25,551
Other intangible assets		79,086	221	-	-	(9,429)	(23,694)	15	46,199
Intangible assets under development		3,140	783	-	(82)	-	(14)	(1)	3,826
	₩	154,937	6,076	(2,145)	-	(10,759)	(43,224)	543	105,428

For the year ended December 31, 2015, the Group recognized ₩43,224 million of impairment losses on goodwill, industrial property rights, other intangible assets and intangible assets under development since the carrying amounts exceeded their recoverable amounts.

(d) Expenditures not capitalized for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016		2015	
		Three-month	Six-month	Three-month	Six-month
Cost of sales	₩	220	553	1,500	1,707
Selling, general and administrative expenses		7,365	14,624	7,929	15,814
	₩	7,585	15,177	9,429	17,521

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For the six-month periods ended June 30, 2016 and 2015

8. Investment Property

(a) Details of investment property as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016			December 31 2015		
	Cost	Accumulated depreciation and impairment	Carrying amount	Cost	Accumulated depreciation and impairment	Carrying amount
Land	₩ 95,948	-	95,948	49,123	-	49,123
Buildings	257,317	(69,087)	188,230	179,949	(64,583)	115,366
	₩ 353,265	(69,087)	284,178	229,072	(64,583)	164,489

(b) Changes in investment property for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>	2016			2015		
	Land	Buildings	Total	Land	Buildings	Total
Beginning balance	₩ 49,123	115,366	164,489	48,293	119,675	167,968
Acquisition	-	-	-	-	64	64
Depreciation	-	(3,782)	(3,782)	-	(6,275)	(6,275)
Transfer from property, plant and equipment	46,825	76,646	123,471	830	1,902	2,732
Ending balance	₩ 95,948	188,230	284,178	49,123	115,366	164,489

(c) The amounts recognized in profit or loss from investment property for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Rental income	₩ 8,426	17,580	8,289	17,593
Direct operating expense	(2,224)	(3,839)	(1,680)	(3,305)
	₩ 6,202	13,741	6,609	14,288

(d) The carrying amount and the fair value of investment property as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>	June 30 2016		December 31 2015	
	Fair value	Carrying amount	Fair value	Carrying amount
Land	₩ 560,854	95,948	435,034	49,123
Buildings	232,807	188,230	177,756	115,366
	₩ 793,661	284,178	612,790	164,489

The fair value of investment property was determined based on the yield capitalization method by external, independent valuers. The fair value measurement for all of the investment properties has been categorized as a level 3 fair value based on the inputs to the valuation techniques used.

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9. Investments in Associates

(a) Investments in associates as of June 30, 2016 and December 31, 2015 are summarized as follows:

In millions of won, except percentage of ownership

Associate	Location	Principal operation	June 30 2016		December 31 2015	
			Percentage of ownership	Carrying amount	Percentage of ownership	Carrying amount
Lite Pharm Tech, Inc.	Korea	Manufacturing medical supplies	20.24%	₩ 2,997	20.24%	₩ 2,720
KVG REIT 1 Co., Ltd.	Korea	Renting of real estate	29.67%	6,531	29.67%	6,635
KOCREF REIT 17 Co., Ltd.	Korea	Renting of real estate	-	-	22.06%	13,208
JR REIT V Co., Ltd.	Korea	Renting of real estate	34.63%	5,443	34.63%	5,470
JR REIT VIII Co., Ltd.	Korea	Renting of real estate	21.74%	9,636	21.74%	9,693
LSK Global Pharma Services Co., Ltd.	Korea	Research and development medicine	23.15%	-	23.15%	-
JR REIT X Co., Ltd.	Korea	Renting of real estate	28.79%	8,815	28.79%	8,907
JR REIT XIII Co., Ltd.	Korea	Renting of real estate	27.03%	4,790	27.03%	4,888
				₩ 38,212		₩ 51,521

(b) Financial information of associates, which represents 100% of the entities' balances as of and for the six-month period ended June 30, 2016 are summarized as follows:

In millions of won

Associate		Total assets	Total liabilities	Revenue	Total comprehensive income (loss)
Lite Pharm Tech, Inc.	₩	15,902	1,096	5,082	1,360
KVG REIT 1 Co., Ltd.		50,085	28,073	2,997	851
JR REIT V Co., Ltd.		30,879	15,162	1,286	591
JR REIT VIII Co., Ltd.		107,452	63,127	3,779	1,644
LSK Global Pharma Services Co., Ltd.		4,122	8,108	7,238	(2,495)
JR REIT X Co., Ltd.		86,711	56,093	2,163	380
JR REIT XIII Co., Ltd.		46,547	28,826	851	34

(c) Financial information of associates, which represents 100% of the entities' balances as of and for the year ended December 31, 2015 are summarized as follows:

In millions of won

Associate		Total assets	Total liabilities	Revenue	Total comprehensive income (loss)
Lite Pharm Tech, Inc.	₩	14,638	1,199	9,405	2,255
JR CR-REIT IV Co., Ltd.		-	-	3,235	8,208
KVG REIT 1 Co., Ltd.		50,386	28,023	5,892	1,678
KOCREF REIT 17 Co., Ltd.		72,473	12,601	5,875	32,677
JR REIT V Co., Ltd.		30,967	15,170	2,508	1,555
JR REIT VIII Co., Ltd.		107,646	63,060	7,167	3,007
LSK Global Pharma Services Co., Ltd.		5,078	7,562	15,703	(251)
JR REIT X Co., Ltd.		87,412	56,473	3,962	272
JR REIT XIII Co., Ltd.		47,178	29,097	2,887	777

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9. Investments in Associates, Continued

(d) Changes in investments in associates for the six-month period ended June 30, 2016 were as follows:

In millions of won

Associate	January 1 2016	Disposal	Share of gain (loss)	Dividends	June 30 2016
Lite Pharm Tech, Inc.	₩ 2,720	-	277	-	2,997
KVG REIT 1 Co., Ltd.	6,635	-	263	(367)	6,531
KOCREF REIT 17 Co., Ltd.	13,208	(13,095)	(113)	-	-
JR REIT V Co., Ltd.	5,470	-	317	(344)	5,443
JR REIT VIII Co., Ltd.	9,693	-	357	(414)	9,636
LSK Global Pharma Services Co., Ltd.	-	-	-	-	-
JR REIT X Co., Ltd.	8,907	-	145	(237)	8,815
JR REIT XIII Co., Ltd.	4,888	-	47	(145)	4,790
	₩ 51,521	(13,095)	1,293	(1,507)	38,212

For the six-month period ended June 30, 2016, the Group received ₩13,095 million of dividend related with liquidation of KOCREF REIT 17 Co., Ltd.

(e) Changes in investments in associates for the year ended December 31, 2015 were as follows:

In millions of won

Associate	January 1 2015	Disposal	Share of gain	Dividends	December 31 2015
Lite Pharm Tech, Inc.	₩ 2,061	-	659	-	2,720
JR CR-REIT IV Co., Ltd.	12,900	(13,625)	4,955	(4,230)	-
KVG REIT 1 Co., Ltd.	6,848	-	519	(732)	6,635
KOCREF REIT 17 Co., Ltd.	6,619	-	7,208	(619)	13,208
JR REIT V Co., Ltd.	5,524	-	758	(812)	5,470
JR REIT VIII Co., Ltd.	9,858	-	654	(819)	9,693
LSK Global Pharma Services Co., Ltd.	-	-	-	-	-
JR REIT X Co., Ltd.	9,114	-	126	(333)	8,907
JR REIT XIII Co., Ltd.	4,979	-	258	(349)	4,888
	₩ 57,903	(13,625)	15,137	(7,894)	51,521

(f) Reconciliation of the summarized financial information presented to the carrying amount of the Group's interest in associates as of June 30, 2016 are summarized as follows:

In millions of won, except percent of ownership

Associate	Percentage of ownership	Equity attributable to owners of the parent	Share of net assets	Share of loss not recognized	Carrying amount
Lite Pharm Tech, Inc.	20.24%	₩ 14,806	2,997	-	2,997
KVG REIT 1 Co., Ltd.	29.67%	22,012	6,531	-	6,531
JR REIT V Co., Ltd.	34.63%	15,717	5,443	-	5,443
JR REIT VIII Co., Ltd.	21.74%	44,325	9,636	-	9,636
LSK Global Pharma Services Co., Ltd.	23.15%	(3,986)	(923)	923	-
JR REIT X Co., Ltd.	28.79%	30,618	8,815	-	8,815
JR REIT XIII Co., Ltd.	27.03%	17,721	4,790	-	4,790
		₩			38,212

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9. Investments in Associates, Continued

- (g) Reconciliation of the summarized financial information presented to the carrying amount of the Group's interest in associates as of December 31, 2015 are summarized as follows:

In millions of won, except percent of ownership

Associate	Percentage of ownership	Equity attributable to owners of the parent	Share of net assets	Share of loss not recognized	Carrying amount
Lite Pharm Tech, Inc.	20.24%	₩ 13,439	2,720	-	2,720
KVG REIT 1 Co., Ltd.	29.67%	22,363	6,635	-	6,635
KOCREF REIT 17 Co., Ltd.	22.06%	59,872	13,208	-	13,208
JR REIT V Co., Ltd.	34.63%	15,797	5,470	-	5,470
JR REIT VIII Co., Ltd.	21.74%	44,586	9,693	-	9,693
LSK Global Pharma Services Co., Ltd.	23.15%	(2,484)	(575)	575	-
JR REIT X Co., Ltd.	28.79%	30,939	8,907	-	8,907
JR REIT XIII Co., Ltd.	27.03%	18,081	4,888	-	4,888
		₩			51,521

10. Available-for-sale Financial Assets

- (a) Changes in available-for-sale financial assets for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

In millions of won

		2016	2015
Beginning balance	₩	364,681	326,833
Acquisitions		-	63,190
Net changes in fair value		(7,340)	3,881
Disposals and exercise of convertible right		-	(29,223)
Ending balance	₩	357,341	364,681
Statements of financial position:			
Current	₩	1,596	-
Non-current		355,745	364,681
	₩	357,341	364,681

In 2015, the Group acquired ₩28,990 million of ordinary shares of U&I Corporation by exercising equity conversion options embedded in their convertible bonds and redeemable convertible preferred shares. The Group recognized ₩24,990 million of difference between the fair value of ordinary shares acquired and the carrying amount of bonds and preferred shares converted as gain on sale of available-for-sale financial assets for the year ended December 31, 2015.

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10. Available-for-sale Financial Assets, Continued

(b) Available-for-sale financial assets as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Available-for-sale debt instruments:		
Government and municipal bonds	₩ 96	96
Corporate bonds	1,500	1,500
Total available-for-sale debt instruments	1,596	1,596
Available-for-sale equity instruments:		
Listed		
– YTN Co., Ltd.	23,129	24,428
– Shinhan Financial Group Co., Ltd.	152,317	158,530
– Oscotech, Inc.	5,280	3,696
– Rexahn Pharmaceuticals, Inc.	1,861	2,696
– U&I Corporation	21,549	22,564
	204,136	211,914
Unlisted	151,609	151,171
Total available-for-sale equity instruments	355,745	363,085
Total available-for-sale financial assets	₩ 357,341	364,681

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

As of June 30, 2016 and December 31, 2015, ₩37,659 million of available-for-sale financial assets that do not have a market price in an active market and whose fair value cannot be reliably measured or is similar to their carrying amount are measured at cost.

11. Long-term Deposits in MSA Escrow Fund

Long-term deposits in MSA Escrow Fund as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
MMF	₩ 5,940	43,309
Treasury note	443,790	360,657
	₩ 449,730	403,966

As discussed in note 33 to the consolidated interim 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, 2016 and 2015 are ₩46,228 million and ₩40,379 million, respectively.

Interest income on long-term deposits in MSA Escrow Fund for the six-month periods ended June 30, 2016 and 2015 are ₩4,089 million and ₩1,066 million, respectively.

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12. Trade and Other Receivables

(a) Trade and other receivables as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016		December 31 2015	
	Current	Non-current	Current	Non-current
Loans to employees	₩ 14,470	46,765	15,774	52,275
Loans	2,393	410	2,504	315
Other receivables	113,735	237	127,369	323
Guarantee deposits	38,940	25,454	34,730	22,158
Accrued income	3,199	-	5,943	-
Trade receivables	1,101,129	-	1,031,618	-
	₩ 1,273,866	72,866	1,217,938	75,071

(b) Trade and other receivables as of June 30, 2016 and December 31, 2015 have been reported in the consolidated statements of financial position net of allowances as follows:

<i>In millions of won</i>	June 30 2016		December 31 2015	
	Current	Non-current	Current	Non-current
Gross trade and other receivables	₩ 1,307,377	72,866	1,251,180	75,071
Allowance:				
Loans	(197)	-	(197)	-
Other receivables	(2,294)	-	(2,296)	-
Trade receivables	(31,020)	-	(30,749)	-
	(33,511)	-	(33,242)	-
Net trade and other receivables	₩ 1,273,866	72,866	1,217,938	75,071

(c) Changes in the allowance account for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>	2016	2015
Beginning balance	₩ 33,242	39,659
Impairment loss	821	12
Reversal of impairment loss	(3)	(5,465)
Net exchange difference and others	(549)	(964)
Ending balance	₩ 33,511	33,242

Impairment loss (reversal of impairment loss) on trade receivables is included as part of selling, general and administrative expenses and impairment loss (reversal of impairment loss) on other receivables are included as part of other expense (income) in the consolidated statements of comprehensive income.

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12. Trade and Other Receivables, Continued

- (d) The aging schedule of trade and other receivables which were past due but not impaired as of June 30, 2016 and December 31, 2015 is as follows:

<i>In millions of won</i>		June 30 2016	December 31 2015
Within 1 month	₩	56,135	67,309
Between 1 and 2 months		47,599	64,851
Beyond 2 months		219,124	198,982
	₩	322,858	331,142

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

- (e) Details of trade and other receivables that are measured at amortized cost as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won, except percentage of interest rate</i>		June 30 2016		December 31 2015		
	Effective interest rate	Current	Non-current	Effective interest rate	Current	Non-current
Loans to employees	1.89~5.68%	₩ 14,470	46,765	1.89~5.68%	₩ 15,774	52,275
Loans	2.71~2.89%	1,780	410	2.71%	1,863	315
Guarantee deposits	1.50~5.68%	37,511	23,665	1.52~5.68%	33,787	20,260
		₩ 53,761	70,840		₩ 51,424	72,850

13. Inventories

- (a) Inventories as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>		June 30 2016	December 31 2015
Merchandise, net of loss on the write-down of inventories	₩	5,620	7,677
Finished goods, net of loss on the write-down of inventories		711,690	610,309
Work-in-progress, net of loss on the write-down of inventories		409,046	608,280
Raw materials, net of loss on the write-down of inventories		753,738	770,561
Supplies		29,143	27,367
By-products		8,219	7,051
Buildings under construction		6,196	3,618
Sites for lotting-out construction		20,935	25,815
Goods-in-transit		26,059	58,436
	₩	1,970,646	2,119,114

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13. Inventories, Continued

- (b) The amount of inventories recognized as an expense for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Cost of sales:				
Write-down (reversal of write-down) of inventories	₩ 120	(194)	(587)	(890)
Loss on retirement of inventories	3,530	4,573	2,156	3,470
Other expense:				
Loss on retirement of inventories	792	977	-	641
	₩ 4,442	5,356	1,569	3,221

14. Cash and Cash Equivalents

- (a) Cash and cash equivalents as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Cash on hand	₩ 1,997	2,788
Demand deposits	274,593	161,627
Short-term investment assets	358,833	381,798
	₩ 635,423	546,213

- (b) Other financial assets as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016		December 31 2015	
	Current	Non-current	Current	Non-current
Time deposits	₩ 118,349	-	120,141	-
Certificates of deposit	41,398	-	31,406	-
Money trust	810,007	-	985,359	-
Security deposits for checking accounts	-	11	-	12
	₩ 969,754	11	1,136,906	12

- (c) Financial assets restricted in use as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Long-term other financial assets Security deposits for checking accounts	₩ 11	12
Current other financial assets Pledge for borrowings	1,398	1,406
	₩ 1,409	1,418

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15. Non-current Assets Held for Sale

Changes in non-current assets held for sale for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>		2016	2015
Beginning balance	₩	6,692	426
Transfer from property, plant and equipment		-	6,692
Disposal		(1,542)	(426)
Ending balance	₩	5,150	6,692

16. Pledged Assets

(a) The followings assets were pledged as collateral for borrowings as of June 30, 2016.

<i>In millions of won</i>						
Asset		Carrying amount	Type	Received amount	Collateralized amount	Holder
Investment property	₩	67,013	Leasehold deposits received	₩ 8,975	9,225	Metlife Insurance Korea Co., Ltd., etc.
Property, plant and equipment and investment property		79,978	Short-term borrowings	12,600	48,053	KEB Hana Bank
			Long-term borrowings	14,357	16,947	KEB Hana Bank, etc.
Property, plant and equipment		28,459	Investment subsidy	-	660	Chungju-si
			Short-term borrowings	1,517	4,440	KEB Hana Bank
Other financial assets		1,398	ACH pledged	-	1,398	Bank of Oklahoma
	₩	176,848		₩ 37,449	80,723	

(b) The followings assets were pledged as collateral for borrowings as of December 31, 2015.

<i>In millions of won</i>						
Asset		Carrying amount	Type	Received amount	Collateralized amount	Holder
Investment property	₩	70,769	Leasehold deposits received	₩ 8,975	9,225	Metlife Insurance Korea Co., Ltd., etc.
Property, plant and equipment and investment property		81,465	Short-term borrowings	12,000	48,009	KEB Hana Bank
			Long-term borrowings	14,936	16,991	KEB Hana Bank, etc.
Property, plant and equipment		28,780	Investment subsidy	-	660	Chungju-si
			Short-term borrowings	1,500	4,440	KEB Hana Bank
Other financial assets		1,406	ACH pledged	-	1,406	Bank of Oklahoma
	₩	182,420		₩ 37,411	80,731	

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17. Share Capital and Other Capital Surplus

(a) Details of share capital as of June 30, 2016 and December 31, 2015 were as follows:

<i>In won, except number of shares</i>	June 30 2016	December 31 2015
Number of ordinary shares:		
Authorized	800,000,000	800,000,000
Issued	137,292,497	137,292,497
Outstanding	126,143,670	125,965,892
Par value	₩ 5,000	5,000

The Parent Company has, thus far, reacquired and retired 53,699,400 shares of treasury share. Accordingly, as of June 30, 2016, the Parent Company's ordinary share differs from the aggregate par value of issued shares by ₩268,497 million.

(b) Changes in the number of shares for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>Number of share</i>	2016			2015		
	Ordinary shares	Treasury shares	Total	Ordinary shares	Treasury shares	Total
Beginning balance	137,292,497	(11,326,605)	125,965,892	137,292,497	(11,393,697)	125,898,800
In-kind donation of treasury shares	-	177,778	177,778	-	67,092	67,092
Ending balance	137,292,497	(11,148,827)	126,143,670	137,292,497	(11,326,605)	125,965,892

(c) Changes in other capital surplus for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>	2016	2015
Beginning balance	₩ (9,928)	(4,573)
Extinguishment of equity conversion options	-	(5,483)
Paid-in capital increase of subsidiary	-	128
Conversion of redeemable convertible preferred shares of subsidiaries	(139)	-
Ending balance	₩ (10,067)	(9,928)

For the six-month period ended June 30, 2016, changes in the ownership interest in Somang Cosmetics Co., Ltd. resulting from the conversion of its redeemable convertible preferred shares were recognized in other capital surplus.

For the year ended December 31, 2015, the Group early redeemed the redeemable convertible preferred shares issued by Somang Cosmetics Co., Ltd. With regard to the early redemption, the Group recognized the consideration paid for the repurchase of equity conversion options as other capital surplus.

For the year ended December 31, 2015, changes in the ownership interest in Somang Cosmetics Co., Ltd. resulting from its paid-in capital increase were recognized in other capital surplus.

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18. Treasury Shares

- (a) Changes in the treasury shares for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won, except number of shares</i>	2016		2015	
	Number of shares	Carrying amount	Number of shares	Carrying amount
Beginning balance	11,326,605	₩ 337,062	11,393,697	₩ 339,059
In-kind donation of treasury shares	(177,778)	(5,290)	(67,092)	(1,997)
Ending balance	11,148,827	₩ 331,772	11,326,605	₩ 337,062

- (b) Changes in gain on reissuance of treasury shares for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>	2016	2015
Beginning balance	₩ 494,648	492,032
In-kind donation of treasury shares, net of tax	10,543	2,616
Ending balance	₩ 505,191	494,648

19. Reserves

- (a) Details of reserves as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Available-for-sale financial assets - net change in fair value	₩ (35,942)	(30,378)
Foreign operations - foreign currency translation differences	(84,380)	(95,110)
Legal reserve	603,145	603,145
Voluntary reserve	3,794,261	3,226,658
	₩ 4,277,084	3,704,315

- (b) Available-for-sale financial assets - net change in fair value as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Available-for-sale financial assets - net change in fair value before tax	₩ (47,417)	(40,077)
Tax effect	11,475	9,699
	₩ (35,942)	(30,378)

- (c) Legal Reserve

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

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19. Reserves, Continued

(d) Details of voluntary reserve as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>		June 30 2016	December 31 2015
Reserve for business rationalization	₩	12,851	12,851
Reserve for research and human resource development		20,000	30,000
Reserve for business expansion		698,881	698,881
Unconditional reserve		3,062,529	2,484,926
	₩	3,794,261	3,226,658

Reserve for business rationalization

Until December 10, 2002 under *the Restriction of Special Taxation Act*, investment tax credits were allowed for certain investments. The Parent 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 Parent Company was no longer required to establish a reserve for business rationalization despite tax benefits received for certain investments and, consequently, the existing balance is now regarded as a voluntary reserve.

Reserve for research and human resource development

According to *the Restriction of Special Taxation Act*, certain taxable deductions are required to be transferred from retained earnings to reserve for research and human resource development. This reserve may be used for each purpose and their remaining amounts could be reclassified as a voluntary reserve.

Reserve for business expansion and other reserves

Reserves without specific purposes are restored to retained earnings by the Parent Company. Those reserves 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, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>		2016	2015
Beginning balance	₩	1,401,975	1,100,876
Dividends		(428,284)	(428,056)
Transfer from reserve for research and human resource development		10,000	12,522
Transfer to unconditional reserve		(577,602)	(320,926)
Profit for the periods		570,308	1,032,220
- Less: non-controlling interests		(974)	3,497
Remeasurements of net defined benefit liability, net of tax		(203)	37
- Less: non-controlling interests		1	1,805
Ending balance	₩	975,221	1,401,975

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21. Trade and Other Payables

Trade and other payables as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>		June 30 2016		December 31 2015	
		Current	Non-current	Current	Non-current
Leasehold deposits received	₩	23,466	2,616	19,404	7,030
Trade payables		87,774	-	103,591	-
Withholdings		238,227	129	212,891	171
Accrued expenses		154,984	-	180,172	-
Other payables		101,052	7,449	90,297	6,446
	₩	605,503	10,194	606,355	13,647

22. Borrowings

(a) Short-term borrowings as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	Lender	Annual interest rate	June 30 2016	December 31 2015
Borrowings	Kookmin Bank, etc.	2.12%	₩ 20,000	23,469
	KEB Hana Bank	2.63 ~ 3.27%	14,117	13,500
	KEB Hana Bank	3M LIBOR+1.3%, etc.	38,442	44,252
	The Korea Development Bank	-	-	100,000
	PT Bank Woori Saudara	10.66%	2,213	2,550
Customer credit contracts ^(*)	Nonghyup Bank, etc.	6.09%, etc.	27,467	22,602
			₩ 102,239	206,373

(*) The Group has entered into a customer credit contract with Nonghyup Bank, etc. The financial institutions pay trade receivables on behalf of customers and the Group has provided guarantees to the financial institutions for customers.

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22. Borrowings, Continued

(b) Long-term borrowings as of June 30, 2016 and December 31, 2015 are summarized as follows:

<i>In millions of won</i>	Lender	Maturity	Annual interest rate	June 30 2016	December 31 2015
Borrowings	Nonghyup Bank	Mar.2021	0.00%	₩ 45,908	34,514
	KEB Hana Bank	Sep.2017	1.69 ~ 4.20%	1,357	1,936
	KEB Hana Bank	Sep.2023	2.55 ~ 3.10%	13,000	13,000
Convertible bond				8,850	8,500
Redeemable convertible preferred shares				53,340	53,340
Redeemable preferred shares				17,761	18,611
				₩ 140,216	129,901

Statement of financial position:

Current	₩ 29,230	27,659
Non-current	110,986	102,242
	₩ 140,216	129,901

Details of convertible bond and preferred shares as of June 30, 2016 are summarized as follows:

<i>Description</i>	<i>Issuing company</i>	<i>Details</i>
Convertible bond ^(*)	PT Trisakti Purwosari Makmur	Issue date: Dec.2011 Par value: IDR 100,000 million Issued value: IDR 100,000 million Carrying amount: ₩8,850 million (IDR 100,000 million) Interest rate: 9.5% The bonds will mature four years from the issue date and become convertible into shares at the rate of IDR 9,659 per share.
Redeemable convertible preferred shares	KT&G Life Sciences Corporation	Issue date: Nov.2011 Issued value: ₩18,000 million Carrying amount: ₩18,000 million The convertible instrument will mature ten years from the issue date. The instrument can be converted into 1,090,909 ordinary shares at any time, and automatically converts upon maturity. If KT&G Life Sciences Corporation does not get listed by the end of 2015, recourse is available.
	Renzoluc Pte, Ltd.	Issue date: Sep.2012 Issued value: ₩35,340 million Carrying amount: ₩35,340 million The convertible instrument will mature ten years from the date of establishment of QCP 2011 Corporate Partnership Private Equity Fund (the "PEF"). The instrument can be converted into 6,978,948 ordinary shares at any time after five years from the issue date. Payable on demand from 270 days prior to the expiration of the PEF
Redeemable preferred shares	K-Q HongKong I, Limited	Issue date: Aug.2012, Sep.2012, Dec.2012 Issued value: ₩17,761 million Carrying amount: ₩17,761 million The convertible instrument will mature ten years from the date of establishment of the PEF. Payable on demand from 270 days prior to the expiration of the PEF

(*) The fair value of the liability component was calculated using the market interest rate for an equivalent non-convertible bond. The fair value of the equity component was determined by deducting the fair value of the liability component from the fair value of the compound financial instrument as a whole.

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22. Borrowings, Continued

For the year ended December 31, 2015, the Group early redeemed the redeemable convertible preferred shares issued by Somang Cosmetics Co., Ltd. With regard to the early redemption, the Group recognized ₩11,962 million of gain on debt redemption and ₩(5,483) million of other capital surplus, respectively.

- (c) As discussed in note 16 to the consolidated financial statements, the Group provided collateral for the above borrowings as of June 30, 2016.

23. Retirement Benefits Plan

- (a) The components of retirement benefits for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Defined benefit plans:				
Current service cost	₩ 10,440	20,856	11,035	22,049
Net interest cost	789	1,525	837	1,675
	11,229	22,381	11,872	23,724
Defined contribution plans:				
Contributions recognized as expense	924	2,889	694	2,106
	₩ 12,153	25,270	12,566	25,830

The Group recognized termination benefits amounting to ₩195 million and ₩6,834 million as an expense for the six-month periods ended June 30, 2016 and 2015, respectively.

- (b) Net defined benefit liability as of June 30, 2016 and December 31, 2015 were summarized as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Present value of defined benefit obligations	₩ 380,965	373,590
Fair value of plan assets	(241,470)	(252,942)
	₩ 139,495	120,648

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24. Revenue from Real Estate Sales

(a) Details of agreements for real estate sales under construction as of June 30, 2016 was as follows:

<i>In millions of won</i>	Construction period		Total revenue estimated	Total revenue contracted
Daegu Station Central-Xi	Dec. 2014 ~ Oct. 2017	₩	342,666	318,525

(b) Changes in the balance of contract amounts for the six-month period ended June 30, 2016 was as follows:

<i>In millions of won</i>	2016
Beginning Balance	₩ 246,340
Revenue recognition	(51,413)
Ending Balance	₩ 194,927

(c) Recognized profits and related balance for agreements under construction as of June 30, 2016 is summarized as follows:

<i>In millions of won</i>	Stage of completion		Aggregate revenue recognized	Aggregate expenses recognized	Due to customers for contract work
Daegu Station Central-Xi	38.80%	₩	123,597	96,567	3,830

(d) There was no change in the estimates of total revenue and total costs during the six-month period ended June 30, 2016. The total revenue and the total costs are estimated based on the information and circumstances available at the end of the reporting period and actual results may differ from these estimates.

25. Result from Operating Activities

(a) Details of expenses classified by nature for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Changes in inventories	₩ 68,119	148,468	88,548	141,216
Raw materials and consumables purchased	224,424	467,767	261,771	489,737
Salaries	132,601	258,665	129,592	267,195
Retirement and termination benefits	12,328	25,465	12,670	32,664
Depreciation	37,802	75,699	37,578	74,626
Amortization	1,484	2,992	2,701	5,450
Employee welfare	22,627	42,571	17,402	53,677
Advertising	57,044	108,443	50,571	107,629
Commissions	77,433	156,308	59,464	129,146
Other expenses	108,380	154,243	62,633	135,965
	₩ 742,242	1,440,621	722,930	1,437,305

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25. Result from Operating Activities, Continued

(b) Details of selling, general and administrative expenses for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Salaries	₩ 88,170	171,921	84,954	177,760
Retirement and termination benefits	8,218	16,837	8,482	22,362
Employee welfare	16,943	31,765	12,157	39,167
Travel	3,694	6,117	2,909	5,326
Communications	1,361	2,632	1,315	2,648
Utilities	1,882	4,511	1,859	4,898
Taxes and dues	13,278	15,214	12,581	15,025
Supplies	3,269	4,108	953	1,781
Rent	5,822	11,460	5,962	12,055
Depreciation	10,039	20,128	11,066	21,942
Amortization	1,434	2,894	2,650	5,351
Repairs and maintenance	1,256	2,164	1,449	2,233
Vehicles	1,431	2,780	1,713	3,317
Insurance	545	1,053	469	969
Commissions	62,665	129,449	50,574	108,175
Freight and custody	12,160	24,446	12,448	24,690
Conferences	922	1,369	919	1,748
Advertising	56,979	108,363	50,518	107,548
Training	1,558	2,885	1,397	2,877
Prizes and rewards	599	845	641	1,194
Cooperation	213	383	135	313
Normal research and development	7,365	14,624	7,929	15,814
Impairment loss (reversal of impairment loss) on trade receivables	2,675	821	(12)	(4)
	₩ 302,478	576,769	273,068	577,189

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26. Other Income and Expenses

(a) Details of other income for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016		2015	
		Three-month	Six-month	Three-month	Six-month
Foreign currency transaction gain	₩	4,583	13,849	4,393	8,636
Foreign currency translation gain		14,035	12,201	20,997	31,665
Reversal of impairment loss on other receivables		-	3	-	3
Gain on sale of property, plant and equipment		8,498	8,591	6,312	7,122
Gain on sale of intangible assets		-	50	668	753
Others		7,243	10,340	2,143	12,626
	₩	34,359	45,034	34,513	60,805

(b) Details of other expenses for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016		2015	
		Three-month	Six-month	Three-month	Six-month
Foreign currency transaction loss	₩	5,971	11,754	3,884	7,091
Foreign currency translation loss		-	15,776	3,173	14,783
Impairment loss on other receivables		-	-	-	12
Donations		1,405	3,981	864	21,761
Loss on sale of property, plant and equipment		1,674	1,841	198	646
Loss on sale of intangible assets		5	5	-	3
Impairment loss on intangible assets		-	-	157	157
Others		2,095	5,393	2,967	7,661
	₩	11,150	38,750	11,243	52,114

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27. Net Finance Income

- (a) Details of net finance income for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Finance cost:				
Interest expense	₩ (1,847)	(3,550)	(2,309)	(5,628)
Finance income:				
Interest income	9,260	18,756	6,718	15,532
Dividend income	3,723	9,920	3,619	7,847
Interest income on long-term deposits in MSA Escrow Fund	2,057	4,089	14	1,066
Gain on transactions of derivative instruments	-	-	-	7
Gain on debt redemption	-	-	11,962	11,962
	15,040	32,765	22,313	36,414
Net finance income	₩ 13,193	29,215	20,004	30,786

- (b) Details of interest expense for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Borrowings	₩ 1,026	2,058	941	2,507
Trade and other payables	820	1,490	257	887
Others	1	2	1,111	2,234
	₩ 1,847	3,550	2,309	5,628

- (c) Details of interest income for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Deposits	₩ 8,123	16,769	5,707	13,665
Available-for-sale financial assets	8	15	13	25
Trade and other receivables	1,129	1,972	998	1,842
	₩ 9,260	18,756	6,718	15,532

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28. Income Tax

- (a) Income tax expense was recognized as current tax expense adjusted to current adjustments for prior periods, deferred tax expense (income) by origination and reversal of deferred tax assets (liabilities) and temporary differences, and income tax recognized in other comprehensive income. The average effective tax rate was 26.47% and 26.40% for the six-month periods ended June 30, 2016 and 2015, respectively.
- (b) Deferred tax assets have been recognized to the extent the Group has determined it is probable that future profits will be available against which the Group can utilize the related benefit.

29. Earnings per Share

Basic and diluted earnings per share for the three- and six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won, except share information</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Profit for the period attributable to owners of the parent in millions of won	₩ 284,945	569,334	261,202	570,125
Weighted-average number of ordinary shares outstanding	126,143,670	126,133,902	125,965,892	125,957,737
Basic and diluted earnings per share in won	₩ 2,259	4,514	2,074	4,526

30. Transactions and Balances with Related Companies

- (a) The Group has no significant transactions, receivables and liabilities with related parties, as of and for the six-month period ended June 30, 2016.
- (b) There is no guarantee being provided by related parties as of June 30, 2016.
- (c) Details of key management personnel compensation for the three- and six-month periods ended June 30, 2016 and 2015 are summarized as follows:

<i>In millions of won</i>	2016		2015	
	Three-month	Six-month	Three-month	Six-month
Short-term employee benefits	₩ 5,606	11,161	5,382	12,867
Retirement benefits	454	1,336	744	1,456
	₩ 6,060	12,497	6,126	14,323

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31. Risk Management and Fair Value of Financial Instruments

(a) Overview

The Group has exposure to the following risks from its use of financial instruments:

- Market risk
- Credit risk
- Liquidity risk

This note presents information about the Group's exposure to each of the above risks, the Group's objectives, policies and processes for measuring and managing risk including quantitative disclosures.

(b) Risk Management Framework

The purpose of managing financial risks is to identify the potential risk factors that may affect the Group's financial performance, and minimize, eliminate and avoid it to the extent that is acceptable. One of the principal responsibilities of the treasury department is to manage the financial risks arising from the Group's underlying operations. The treasury department monitors and manages the financial risk arising from the Group's underlying operations in accordance with the risk management policies and procedures authorized by the board of directors. Also, the treasury department provides an internal report analyzing the nature and exposure level of financial risks to Risk Management Committee of the Group. The Risk Management Committee prepares the overall strategy for financial risk management, and evaluates the effectiveness of the financial risk management strategy. In addition, the Parent Company's audit committee consistently observes the compliance of the risk management policy and procedure, and reviews the risk exposure limit of the Group. The Group applied the same financial risk management strategy that was applied in the previous period.

(c) Management of Financial Risks

(i) Market risk

Market risk is the risk that changes in market prices – such as foreign exchange rates, interest rates and equity prices – will affect the Group's income or the value of its financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimizing the return.

Currency risk

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

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31. Risk Management and Fair Value of Financial Instruments, Continued

(c) Management of Financial Risks, Continued

The carrying amounts of monetary assets and liabilities denominated in a currency other than the functional currency as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>		June 30 2016		December 31 2015	
		Assets	Liabilities	Assets	Liabilities
USD	₩	935,345	22,486	797,656	46,905
EUR		741	2,296	541	1,695
Others		4,749	2,843	7,645	21,151
	₩	940,835	27,625	805,842	69,751

As of June 30, 2016 and December 31, 2015, the effects of a 10% weakening or strengthening of functional currency against foreign currencies on profit before tax were as follows:

<i>In millions of won</i>		June 30 2016		December 31 2015	
		10% weakening	10% strengthening	10% weakening	10% strengthening
Increase (decrease) in profit before tax	₩	91,321	(91,321)	73,609	(73,609)

Equity price risk

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

As of June 30, 2016 and December 31, 2015, the effects of a 5% fluctuation of the price index of stocks on other comprehensive income were as follows:

<i>In millions of won</i>		June 30 2016		December 31 2015	
		5% increase	5% decrease	5% increase	5% decrease
Comprehensive income before tax	₩	3,900	(3,900)	1,780	(1,780)

Interest rate risk

The Group has exposure to the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's management has monitored the level of interest rates regularly and has maintained the balance of borrowings at variable rates and fixed rates. As of June 30, 2016, there is no significant effect on cash flows or the fair value of financial liabilities from the interest rate fluctuation, considering the amounts of interest bearing liabilities.

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31. Risk Management and Fair Value of Financial Instruments, Continued

(c) Management of Financial Risks, Continued

(ii) Credit risk

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

The carrying amount of financial assets is maximum exposure to credit risk. The maximum exposure to credit risk as of June 30, 2016 and December 31, 2015 is as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Available-for-sale debt instruments	₩ 1,596	1,596
Long-term deposits in MSA Escrow Fund	449,730	403,966
Trade and other receivables	1,346,732	1,293,009
Other financial assets	969,765	1,136,918
Cash and cash equivalents (excluding cash on hand)	633,425	543,425
Financial guarantee contract	114,855	76,566
	₩ 3,516,103	3,455,480

(iii) Liquidity risk

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

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31. Risk Management and Fair Value of Financial Instruments, Continued

(c) Management of Financial Risks, Continued

The maturity analysis with a residual contractual maturity of financial liabilities as of June 30, 2016 and December 31, 2015 is as follows:

<i>In millions of won</i>	Carrying amount	Contractual cash flow	Within 3 months	Residual contractual maturity			
				Between 3 months and 1 year	Between 1 and 5 years	Beyond 5 years	
As of June 30, 2016:							
Trade and other payables	₩ 377,341	377,848	341,000	27,882	6,244	2,722	
Long-term borrowings	110,986	112,701	94	282	54,165	58,160	
Current portion of long-term borrowings	29,230	29,255	299	28,956	-	-	
Short-term borrowings	102,239	102,371	71,185	31,186	-	-	
Financial guarantee contract	-	114,855	-	-	114,855	-	
	₩ 619,796	737,030	412,578	88,306	175,264	60,882	
As of December 31, 2015:							
Trade and other payables	₩ 406,940	408,593	368,074	27,043	11,042	2,434	
Long-term borrowings	102,242	104,044	98	293	43,557	60,096	
Current portion of long-term borrowings	27,659	27,676	296	27,380	-	-	
Short-term borrowings	206,373	208,593	122,917	85,676	-	-	
Financial guarantee contract	-	76,566	-	-	76,566	-	
	₩ 743,214	825,472	491,385	140,392	131,165	62,530	

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

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31. Risk Management and Fair Value of Financial Instruments, Continued

(d) Fair value of Financial Instruments

The carrying amount of each category of financial assets and liabilities as of June 30, 2016 and December 31, 2015 are as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Financial assets:		
Available-for-sale financial assets	₩ 357,341	364,681
Loans and receivables		
- Long-term deposits in MSA Escrow Fund	449,730	403,966
- Trade and other receivables	1,346,732	1,293,009
- Other financial assets	969,765	1,136,918
- Cash and cash equivalents	635,423	546,213
	3,401,650	3,380,106
	₩ 3,758,991	3,744,787
Financial liabilities:		
Financial liabilities measured at amortized cost		
- Trade and other payables	₩ 377,341	406,940
- Long-term borrowings	110,986	102,242
- Current portion of long-term borrowings	29,230	27,659
- Short-term borrowings	102,239	206,373
	₩ 619,796	743,214

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31. Risk Management and Fair Value of Financial Instruments, Continued

(d) Fair value of Financial Instruments, Continued

The fair value measurements classified by fair value hierarchy as of June 30, 2016 and December 31, 2015 were as follows:

<i>In millions of won</i>	Carrying amount	Fair value		
		Level I	Level II	Level III
As of June 30, 2016:				
Financial assets				
Available-for-sale financial assets	₩ 319,682	204,136	-	115,546
As of December 31, 2015:				
Financial assets				
Available-for-sale financial assets	₩ 327,022	211,914	-	115,108

There is no transfer between fair value hierarchy levels of recurring fair value measurements for the six-month period ended June 30, 2016 and the year ended December 31, 2015.

The fair value measurements for available-for-sale equity instruments in real estate trust fund have been measured using the adjusted net asset method and categorized as a level 3 fair value based on the inputs to the valuation techniques used. Changes in fair value classified as level 3 for the six-month period ended June 30, 2016 and the year ended December 31, 2015 were as follows:

<i>In millions of won</i>		2016	2015
Beginning balance	₩	115,108	90,726
Acquisition		-	22,200
Changes in fair value		438	2,182
Ending balance	₩	115,546	115,108

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31. Risk Management and Fair Value of Financial Instruments, Continued

(e) Finance income (costs)

(i) Details of finance income (costs) by categories for the six-month period ended June 30, 2016 were as follows:

<i>In millions of won</i>	Financial assets at fair value through profit or loss	Available -for-sale financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:					
Interest income	₩ -	15	18,741	-	18,756
Dividend income	-	9,920	-	-	9,920
Interest income on long-term deposits in MSA Escrow Fund	-	-	4,089	-	4,089
Interest expense	-	-	-	(3,550)	(3,550)
	₩ -	9,935	22,830	(3,550)	29,215
Comprehensive income before tax					
Net change in fair value	₩ -	(7,340)	-	-	(7,340)

(ii) Details of finance income (costs) by categories for the six-month period ended June 30, 2015 were as follows:

<i>In millions of won</i>	Financial assets at fair value through profit or loss	Available -for-sale financial assets	Loans and receivables	Financial liabilities measured at amortized cost	Total
Profit or loss:					
Interest income	₩ -	25	15,507	-	15,532
Dividend income	-	7,847	-	-	7,847
Interest income on long-term deposits in MSA Escrow Fund	-	-	1,066	-	1,066
Gain on transactions of derivative instruments	7	-	-	-	7
Gain on debt redemption	-	-	-	11,962	11,962
Interest expense	-	-	-	(5,628)	(5,628)
	₩ 7	7,872	16,573	6,334	30,786
Comprehensive loss before tax					
Net change in fair value	₩ -	(9,524)	-	-	(9,524)

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32. Capital Management

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The board of directors seeks to maintain a balance between the higher returns that might be possible with higher levels of borrowings and the advantages and security afforded by a sound capital position.

The Group monitors capital using net debt deducting cash and cash equivalents and current financial instruments from borrowings and equity. The Group applied the same capital management strategy that was applied in the previous year.

As of June 30, 2016 and December 31, 2015, the Group's capital structure was as follows:

<i>In millions of won</i>	June 30 2016	December 31 2015
Net debt:		
Debt (borrowings)	₩ 242,455	336,274
Less:		
Cash and cash equivalents	(635,423)	(546,213)
Current other financial assets	(969,754)	(1,136,906)
	<u>(1,362,722)</u>	<u>(1,346,845)</u>
Equity	₩ 6,438,707	6,275,499

33. Contingent Liabilities and Commitments

- (a) Each year the Group deposits a proportion of sales of tobacco products in the United States in accordance with the Tobacco Master Settlement Agreement ("MSA") under the Escrow Statute of the United States government. The MSA Escrow Funds are maintained to pay the medical expenses of tobacco purchasers who have suffered health effects as a result of smoking. The unused portion of this fund will be refunded to the Group 25 years from the date of each annual funding. The Group recorded as long-term deposits the amounts paid into the MSA Escrow Funds of State governments in the United States against potential litigation and damages related to the export of tobacco into the United States.
- (b) As of June 30, 2016, a lawsuit by National Health Insurance Service claiming damages of ₩53,742 million is filed against the Group. Additionally, as of June 30, 2016, the Group is involved in fourteen lawsuits as a plaintiff for alleged damages totalling ₩15,904 million and ten lawsuits as a defendant for alleged damages totalling ₩2,286 million. The amount of the liability the Group may ultimately be liable for with respect to the litigation cannot be reasonably estimated as of June 30, 2016.
- (c) As of June 30, 2016, the Group has entered into letter of credit agreements with KEB Hana Bank and other banks with limits in the aggregate of USD 66,100 thousand.
- (d) As of June 30, 2016, the Group's trade receivables from the export of cigarettes are insured against non-payment up to USD 21,100 thousand by an export guarantee insurance with the Korea Export Insurance Corporation.

KT&G CORPORATION AND SUBSIDIARIES

Notes to the Consolidated Interim Financial Statements

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For the six-month periods ended June 30, 2016 and 2015

33. Contingent Liabilities and Commitments, Continued

- (e) The Group has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD 40,000 thousand by KEB Hana Bank. Details of guarantees exercised as of June 30, 2016, are summarized as follows:

<i>In thousands of USD, THB and millions of IDR</i>		<i>Exercised amount</i>
Customs bond and L/C opening of Global Trading, Inc.	USD	14,222
Bidding guarantee for export of tobacco sheet to Taiwan Tobacco and Liquor Corporation	USD	85
Performance guarantee for export of tobacco sheet to Thailand Tobacco Monopoly	THB	8,142
Payment guarantee for purchase of certificate stamp of PT Mandiri Maha Mulia	IDR	137,524

- (f) The Group has maintained a contract with the farmers who grow six-year old green ginseng for purchase volume guarantees and recorded contractual amounts paid to the farmers as advance payments in the amount of ₩191,097 million and ₩151,783 million as of June 30, 2016 and December 31, 2015, respectively.
- (g) As of June 30, 2016, the Group has an accounts receivable loan agreement with a limit of ₩107,000 million with KEB Hana Bank and other financial institutions.
- (h) As of June 30, 2016, the Group has a trade bill loan agreement with a limit of ₩10,000 million with KEB Hana Bank.
- (i) As of June 30, 2016, the Group has a loan agreement with a limit of ₩162,300 million with Shinhan Bank and other financial institutions.
- (j) As of June 30, 2016, the Group has provided one blank note, five notes amounting to ₩4,000 million and two blank checks to Nara Credit and other financial institutions. Besides, As of June 30, 2016, the Group lost seven blank notes and one blank check and expects to proceed a judgment of nullification.
- (k) On March 17, 2011, the Group signed the memorandum of understanding (“MOU”) on global investment partnership with National Pension Service to jointly invest in foreign assets with a limit of ₩800,000 million.
- (l) With relation to the acquisition of KT&G Life Sciences Corporation, the Parent Company entered into a contract with a former owner of the acquiree, Gwak, Tae-Hwan (“Individual Shareholder”). Details of the contract are as follows:

<i>Description</i>	<i>Details</i>
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 Sciences Corporation is listed.
Right of first refusal held by the Parent Company	Individual Shareholder shall not be permitted to make any transfer of its shares, in whole or in part, unless Individual Shareholder has offered them first to the Parent Company.
Tag-along right held by Individual Shareholder	In the event that the Parent Company proposes to enter into a transaction or a series of related transactions with a third party purchaser to dispose of its shares, then Individual Shareholder shall elect to participate in such disposition upon the terms and conditions no less favorable than those applicable to the Parent Company.

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33. Contingent Liabilities and Commitments, Continued

- (m) As of June 30, 2016, the Group has provided guarantees up to ~~₩~~225,600 million with an exercised amount of ~~₩~~114,855 million for the buyers of apartments in respect of their borrowings from Shinhan Bank
- (n) As of June 30, 2016, the Group is insured by performance bond insurance up to ~~₩~~2,389 million with the Seoul Guarantee Insurance.
- (o) The Group sold its property, plant and equipment and intangible assets relating to the drink business of Iksan factory to Haitai Beverage Co., Ltd. and LG Household & Health Care Co., Ltd., as approved by the Board of Directors on October 16, 2013. In connection, the Group entered into an agreement to refrain from engaging in a business such as beverage manufacture or pharmacy distribution, that could result in a competition with the buyers for three years from the transaction date.

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34. Cash Flows from Operating Activities

- (a) Details of cash generated from operations for the six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>		2016	2015
Profit for the period	₩	570,308	569,484
Adjustments for:			
Income tax expense		205,303	204,290
Finance costs		3,550	5,628
Finance income		(32,765)	(36,414)
Depreciation		75,699	74,626
Amortization		2,992	5,450
Retirement and termination benefits		25,465	32,664
Foreign currency translations loss		15,776	14,783
Impairment loss on trade and other receivables		821	12
Reversal of write-down of inventories		(194)	(890)
Loss on sale of property, plant and equipment		1,841	646
Loss on sale of intangible assets		5	3
Impairment loss on intangible assets		-	157
Other expense		5,198	9,826
Share of loss of associates		113	-
Share of gain of associates		(1,406)	(2,789)
Foreign currency translations gain		(12,201)	(31,665)
Reversal of impairment loss on trade and other receivables		(3)	(7)
Gain on sale of property, plant and equipment		(8,591)	(7,122)
Gain on sale of intangible assets		(50)	(753)
		851,861	837,929
Changes in working capital:			
Trade and other receivables		(41,350)	(96,600)
Advance payments		(59,090)	(81,958)
Prepaid expenses		(4,758)	(2,170)
Prepaid tobacco excise and other taxes		(32,964)	(184,799)
Inventories		146,640	137,533
Trade and other payables		4,007	71,091
Advance receipts		(19,961)	(124)
Tobacco excise and other taxes payable		(93,772)	275,379
Payment of retirement and termination benefits		(7,870)	(11,411)
Cash generated from operations	₩	742,743	944,870

KT&G CORPORATION AND SUBSIDIARIES
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For the six-month periods ended June 30, 2016 and 2015

34. Cash Flows from Operating Activities, Continued

- (b) Details of material transactions without cash inflow and outflow for the six-month periods ended June 30, 2016 and 2015 were as follows:

<i>In millions of won</i>	2016	2015
Increase(decrease) in other payables related with acquisition of property, plant and equipment	₩ 3,394	(2,173)
Increase(decrease) in advance receipts related with disposal of property, plant and equipment and non-current assets held for sale	(623)	514
Increase in other receivables related with disposal of property, plant and equipment and non-current assets held for sale	3,139	230
Increase in other receivables related with disposal of property, plant and equipment	-	700

- (c) The Group presented cash flows arising from short-term financial instruments on a net basis.