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For corporate value maximization thru
corporate-wide reform and innovation

KT&G
Mid-to-Long Term **Masterplan**

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Masterplan Executive Summary

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Masterplan Executive Summary

- Since undergoing privatization process from 1998 to 2002 and to this day, KT&G has actively pursued corporate restructuring and management innovation.
- Efforts such as reduction of headcount by 41.3% (3,180 persons) and modernization & rationalization of manufacturing facilities (no. of production plants: 8 → 4, no. of raw material plants: 4 → 2) have reformed the company's high-cost and low-efficiency management structure.
- Prompted by strengthened marketing capacities and enhanced brand power, KT&G recorded 78% growth in sales and 268% growth in operating profits during the past 8 years to emerge as a leading company.

◆ As a result, KT&G has returned a total of 2.14 trillion won to its shareholders during the past 5 years via dividends and share buyback. This translates into an average annual shareholder return of 101%, which is one of the highest levels of return among Korean companies and comparable to global competitors.

◆ KT&G's improved corporate governance and active IR (highlighting shareholder-friendly management, ethical and transparent management, efficient operation and enhanced role of board of directors and consideration of stakeholders etc.) have won recognition from rating institutions from home and abroad as one of the highest evaluated and trusted companies.

※ Selected as Best Company for 3 consecutive years by the Korea Corporate Governance Service (2004 ~ 2006)
※ Received strong rating (7+) from Standard & Poor's (2003 and 2004): Highest rating among Korean companies and comparable to leading global companies

Masterplan Executive Summary

Background and Objective of Masterplan

- KT&G's cigarette business is facing fierce challenges: Demand for cigarettes is declining 1.6% per annum with stricter regulations on smoking and increasing health-conscious trends etc. Global cigarette companies are aggressively engaging in marketing activities.
- More and more large Korean companies are entering the ginseng and health functional food business. Thus, even with rapid growth of the market, competition is becoming more intense in the ginseng business.
- Thus far, KT&G has maintained a relatively high return rate for its shareholders. Recently, however, there has been increasing demand and various expectation from shareholders in terms of increasing shareholder value.
- The above suggests that KT&G should make an all-out effort to increase corporate value through corporate-wide reform and innovation.

- KT&G has achieved remarkable business performance through restructuring and innovation. However, pending issues for the company still remain such as stricter regulative environment, market uncertainties due to intense competition, increasing various demands from shareholders and need to prepare for future risks. Therefore, a new strategy that will continuously upgrade KT&G's corporate value, in terms of **growth, scalability, profitability and sustainability**, is called for.
- Accordingly, KT&G has established a mid-to-long term masterplan, with assistance from Booz Allen and Hamilton, a global strategy consulting firm – an objective and credible plan for maximizing corporate and shareholder values.
- Objective of the mid-to-long term masterplan is summarized as follows: **Strengthening fundamentals → Remarkably increasing economic value of the company in the long-term → Achieving corporate sustainability management, the hallmark of corporate value.**
- The plan will help to establish shareholder trust through sustained and stable enhancement of shareholder value, to provide employees with opportunities for self-development, and to enable the company to fulfill its role as a socially responsible member of society. In other words, KT&G will be reborn **as a company that returns the highest returns to its shareholders, provides the highest satisfaction to its constituents and trusted by society.**

Masterplan Executive Summary

Strategy for Re-establishing Business Portfolio

- KT&G's business portfolio will be re-established to prepare for stagnant growth of the cigarette market, to sustain company growth and to continually create corporate value.
- While focusing on increasing internal capacities and realizing potential value of existing business, the number one strategic objective is to preempt the fast growing health functional food market.
- To prepare for a possible decline in corporate value in the long term due to business risks resulting from market uncertainties and declining domestic demand for cigarettes etc., prudent measures will be considered to identify opportunities for future external growth, based on strengthened internal capabilities and enhanced performance of existing businesses etc.

- **Cigarette business** will focus on its role as **Value Base** for KT&G by regaining domestic market share and achieving qualitative growth in overseas markets.
- **Ginseng business** will actively seize opportunities in the fast-growing health functional food market (growing at an annual average rate of above 15%) to assume its role as **Value Grower** and growth driver of KT&G.

  ※ Size of domestic health functional food market: Currently approximately 4.3 tril. won ⇒ expected to increase to 8 tril. won in 2010
- **Pharmaceutical business** will be the **Value Catalyst** for KT&G through enhancing corporate value by implementing intense restructuring etc. and creating synergy with affiliated companies.

Masterplan Executive Summary

Strategy by Business

- **Domestic cigarette business** will focus on regaining market share as a prerequisite for company subsistence and corporate value enhancement. KT&G will increase investments in rationalization and modernization of facilities to improve product/quality competitiveness, in marketing to regain market share and in R&D to enhance product line taking into consideration somewhat of a sacrifice in profits for the next 2 to 3 years. Such concentrated efforts will help to maintain and strengthen KT&G's strong no.1 position in the domestic cigarette market.
  - KT&G will make an all-out effort to regain its share of the domestic cigarette market to 76% over the coming 5 years, to record 2.1 tril. won in sales and 700 bil. won in operating profit by 2010
- **Overseas cigarettes business** will focus on qualitative growth strategy which is geared toward attaining both profitability and growth, as seen based on the profits achieved so far this year
  - KT&G's exports in 2010 will record 700 bil. won in sales, 200 bil. won in operating profit and over 50 billion sticks in export volume.
- **Ginseng business (health functional food business)** will break away from being solely relying on red ginseng and expand health functional food business capacity, the feasibility of which has already been proven in terms of sales, brand power, distribution and technology, etc. For this, active investments will be made into R&D, marketing and setting up distribution channels.
  - Growth target for KGC by 2010 is 1 tril. won in sales and 260 bil. won in operating profit. Moreover, external growth in health functional food market will be actively considered by utilizing self-financing capability.
- **Pharmaceutical business** will focus on promoting corporate value by re-establishing its business model via rapid and intense restructuring and maximizing synergy with affiliated businesses such as KGC.
  - Yungjin Pharm.'s growth target for 2010 is 230 bil. won in sales and 23 bil. won in operating profit.

◆ To strengthen capacities of existing businesses including subsidiaries, KT&G will invest total 3.6 tril. won over the next 5 years in R&D, marketing and facilities to reach its 2010 growth target of 4.4 tril. won in sales and 1.3 tril. won in operating profit, thereby maximizing the economic value.

※ Real estate: 370 bil. won Sales and 75 bil. won Operating profit included.

Masterplan Executive Summary

Strategy on Efficient Asset Management

- Strategy for maximizing the economic value of KT&G's real estate is as follows: Each **non-operating properties** undergo comparative analysis in term of sale value and development value. They will then be categorized as ① **sell,** ② **develop** or ③ **hold for L/T development to maximize economic value**.
- As for strategy on **other investment assets including investment in bio venture companies etc.**, investments will be reviewed in terms of commercialization potential and attainment of investment objectives etc. They will be then categorized as ① **sell,** ② **hold** or ③ **new investment for creating synergy.**

Strategy on Shareholder Return

< Principle of Shareholder Return >

- First, in spite of possible decrease in profitability for the next 2~3 years, we will generate corporate value that is above shareholder expectation in the long-term and stable basis by **<strengthening company's fundamentals ⇒maximizing economic value>**.
  - In line with this aspect, amount of shareholder return will be determined in connection with the re-investment plan to grow the existing business.
  - Through this, we will realize the company's greatest value, **corporate sustainable management,** and concentrate on enhancing shareholder value and will also consider balancing the interests of major stakeholders, such as constituents & implementing social corporate responsibilities, etc.
- As stipulated in the current laws and regulations in Korea, **amount of the shareholder return** will be implemented within the scope of **profits available for dividend + future free cash flow** without impeding on company's platform for future growth.
  - Profits will be returned to shareholders within the limit of profit available for dividends, pursuant to paragraph 1, Article 462 of the Commercial Act and Articles 189-2, 190, and 192-3 of the Securities Exchange Act.
  - As regards to debt financing and KGC's IPO, they will be pursued as reserve initiatives to prepare for risk on existing business due to intensified competition and for creating drivers of future growth.
- Regarding **shareholder return process,** shareholder return will be executed based on a resolution by BOD in order to maximize and sustain **<Total Shareholder Return (TSR)= dividend yield + % change in share price>** taking into consideration of mutually complementary role of dividend and share buyback to protect all shareholders' interests.

Shareholder Return Strategy

- **Shareholder return plan for 3 years** is as follows: Profits will be retuned to shareholders within the maximum of 2.8 tril. won, including 1.3 trillion won of accumulated profit available for dividend and 1.5 tril. won of estimated free cash flow for the coming 3 years etc., taking into consideration of market conditions and stock price levels.

  - The full amount of 1.3 tril. won of accumulated profit available for dividend will be used for share cancellation. Of the total amount, 160.8 bil. won has been already utilized in the first half of 2006. We plan to repurchase 12 million shares for cancellation in the second half of 2006, and the remaining amount will be executed from 2007.
  - Moreover, free cash flow of 1.5 tril. won for 3 years, excluding investment expenses for enhancement of existing business capacity, will be returned to shareholders via dividends and share buyback/cancellation.

  - For the 3 years, the size of dividend will increase substantially by returning a minimum of 1 tril. won-level. Dividends for 2006 is planned at 2,400 won/share, an increase of more than 40% yoy.
  - As for the remaining profit available for dividend, size and timing of share cancellation will be determined in a flexible manner, in consideration of cash flow to support fair value.

- Cancellation of **currently held treasury shares** is not allowed under the current laws. Therefore, they will be utilized in a manner which minimizes impact on the market and does not affect shareholder interest.

  - Part of treasury shares-company account (6.6 mil. shares) will be utilized for ESOP and the remaining will be considered for issuing EB's etc.
  - Plan on treasury shares-trust account (8.5 mil. shares) will be determined in the future, in consideration of market conditions etc. since treasury shares in the trust account are not allowed to be withdrawn in kind pursuant to the Securities Exchange Act.

KT&G's Effort to Enhance Corporate and Shareholder Values

- Through active execution of the mid-to-long term masterplan, KT&G will maximize economic value of its businesses, promote effective management of its assets, ensure high returns to its shareholders via dividends and share buyback/cancellation, thereby continually promoting shareholder value.

- Moreover, to prepare for uncertainties in business environment, to ensure company's sustenance, and to continually create corporate value, KT&G will continue its effort to secure a future growth engine.

- Systematic and active IR activities will be carried out so that corporate value of KT&G's subsidiaries including KGC will be amply reflected in KT&G's share price. KT&G will actively engage in social contribution activities at 2% level of annual sales through KT&G Social Welfare Foundation and own programs etc., and will make an all-out effort to perform corporate social responsibility and to realize its management philosophy of **companionship**.

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KT&G's Management Philosophy and Vision

- KT&G's Management Philosophy
- 2010 Corporate Vision
- Masterplan Roadmap

Challenge & Vision

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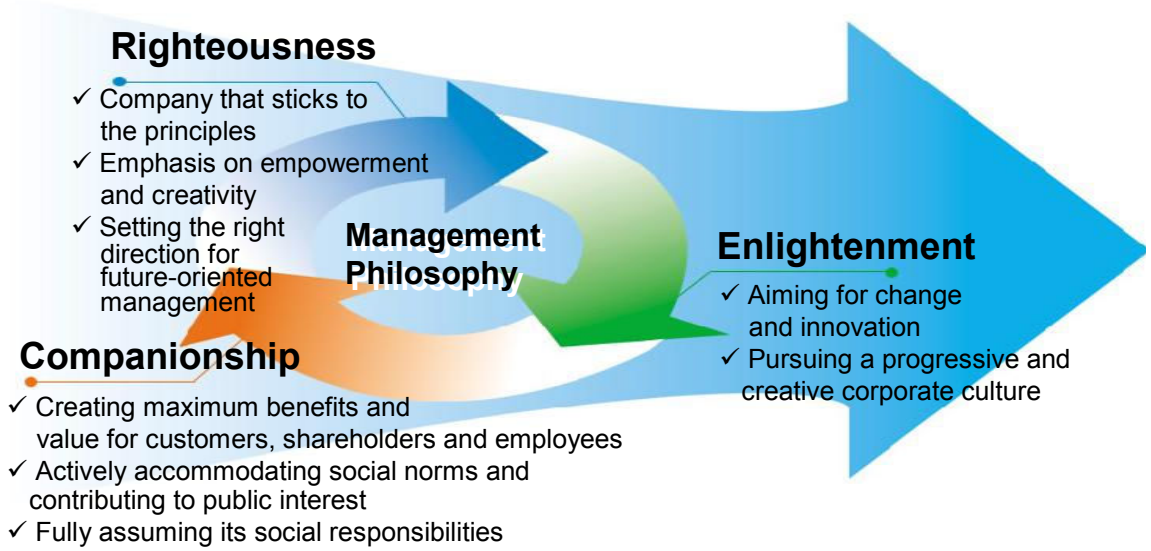
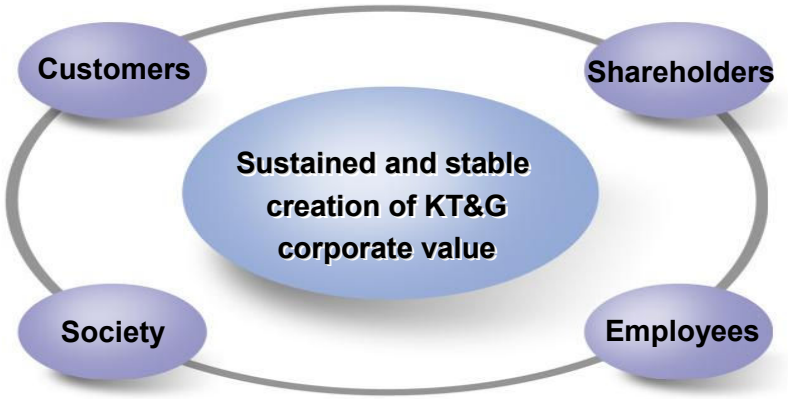
KT&G's Management Philosophy

- KT&G places highest priority on realizing its management philosophy in all its activities. It is recognized as a leading company in Korea in terms of corporate governance, ethical and transparent management, management innovation and social contribution.
- Moreover, KT&G will exert all efforts to practice its management philosophy and achieve corporate sustainability management so that the value created by KT&G's activities shall be fairly distributed and shared among customers, shareholders, employees and the society.
  - Customers: Aiming for customer satisfaction by providing quality products and services and developing new technologies that are more geared toward safety etc.
  - Shareholders: Providing the best long-term and stable gains through maximizing corporate value and sustained growth
  - Employees: Providing dynamic work environment, welfare programs and opportunities for self-development and self-fulfillment, etc.
  - Society: Fulfilling corporate social responsibilities including social welfare activities (home-based social welfare activities, dementia prevention activities, etc.) and support for the culture and arts, etc.





2010 Corporate Vision

- Cigarette business will strengthen its role as **Value Base** for KT&G by investments focused on R&D, brands and marketing etc., will be actively pursued to achieve both quantitative and qualitative growth in the overseas business.
- KGC will be promoted as **Value Grower**, aggressively driving business growth through R&D activities in red ginseng and new materials and M&A activities etc. in the growing health functional food market.
- Pharmaceutical business will perform its function and role as **Value Catalyst** by securing competitiveness through speedy restructuring and synergy creation with affiliates.
- **By 2010, KT&G will establish a balanced business portfolio among cigarette, health functional food and pharmaceutical businesses, to emerge as a leading global company in terms of profitability, growth, stability, and sustainability.**

››› Cigarette Business
- Domestic – Maintaining a strong no. 1 position
- Overseas – Realizing a balance between profit and growth
- Securing the highest capability in R&D and marketing

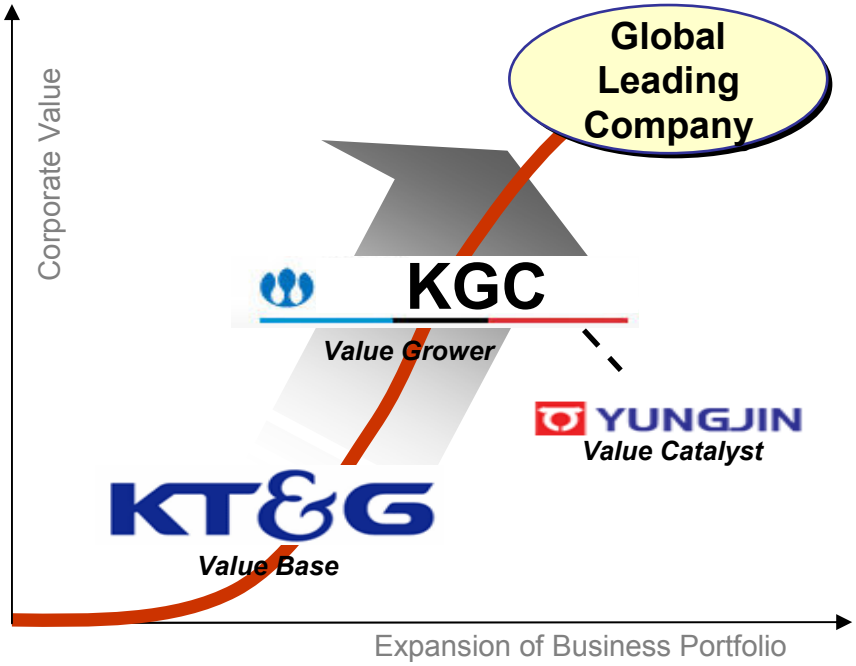
››› Health Functional Food Business
- Strengthening no. 1 position in red ginseng business
- Expanding business portfolio in health functional food market
- Promoting growth as a health functional food company

››› Pharmaceutical Business
- Innovating corporate value based on efficiency
- Realizing high profitability by industry standards by concentrating on generic drug business

Grow as a global cigarette company recording the highest profitability

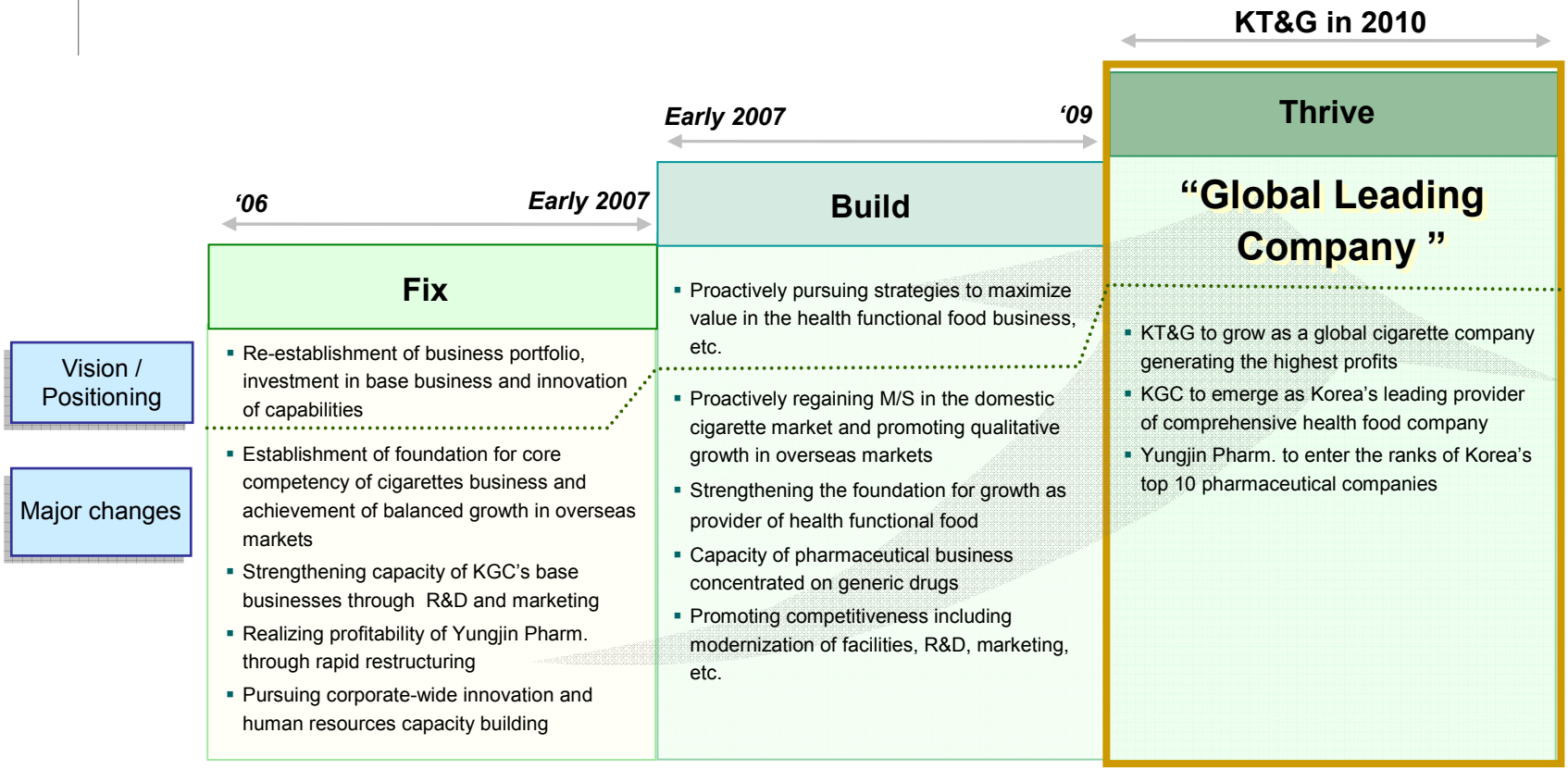
Emerge as a leading company in health functional food business

Join the ranks of Korea's top manufacturer of generic drugs



Masterplan Roadmap

- Mid-to-long term masterplan to strengthen the company's fundamental is comprised of three core strategies: **①Re-establishing business portfolio, ②Maximizing value for each business ③Shareholder return**
- Roadmap leading up to 2010 for achieving KT&G's mid-to long-term masterplan to emerge as a **global leading company** by 2010



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Mid-to-Long Term Strategy On Business Portfolio

- Issues Related to Re-establishment of Business Portfolio
- Strategy for Re-establishing Business Portfolio
- Post Portfolio Re-establishment

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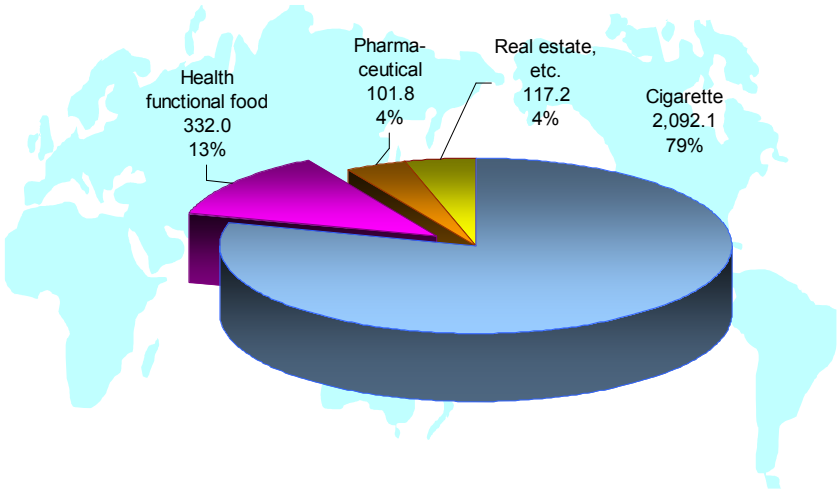
Issues Related to Re-establishment of Business Portfolio

Facing challenges such as stagnant growth of the core cigarette business and intense competition in the health functional food business, measures need to be put in place to ensure growth which is one of the most important corporate values.

››› 2005 Sales Breakdown



Sales in 2005

Stagnant growth/decline of cigarette business

- Due to sophistication of tobacco market such as stricter regulation on smoking and health-conscious trends, demand for cigarette products are stagnating/declining (annual average decreasing rate – 1.6%).
- With intense competition from global competitors, KT&G's dominating position in the market is being challenged. Furthermore, risk on cigarette-related lawsuits is expected to rise.

Intense competition in the health functional food business

- While the business records an average annual growth of over 15%, such dominant position is being threatened due to intensified competition.
  - Increasing number of large Korean companies entering the health functional food market (market size at 4.3 trillion won), with emphasis on ginseng and health food and drink businesses.
- Limitation in the growth of red ginseng business due to supply and demand imbalance of 6-year old red ginseng.

Need for improvement of Yungjin Pharmaceuticals' financial performance

- Deterioration of profitability due to growth-oriented strategy (Operating profit margin: 0.2%)

Lessen concentration in one business & Secure future growth engine

Need to re-establish business portfolio centering on strengthening competitiveness of tobacco business and on promoting heath food business

Strategy for Re-establishing Business Portfolio

In order to continuously create value, KT&G will focus on enhancing economic value of existing business & build prompt capacity to expand in the rapid growing health functional food market for a more balanced business portfolio.

Re-establishment of a more balanced business portfolio

Increasing economic value of existing businesses

Cigarette — Value Base biz

- Regaining domestic M/S and generating stable profit in overseas markets
- Strengthening sales capacity and promoting investments for quality enhancement

Health Food — Value Grower biz

- Preempting opportunities in the fast-growing health functional food market
- Maintaining a leading position in the market by promoting marketing capabilities
- Aggressive investment to secure stable supply of ginseng ingredients

Pharmaceutical — Value Catalyst biz

- Restructuring product lineup to be profit-oriented and pursuing speedy rationalization of assets
- Commercialization of investments in bio companies

Expansion of health functional food business

New ingredients — Products enhancement

- Development of various products using red ginseng
- Identification and commercialization of new ingredients

R&D — Tech lineup

- Increasing R&D and securing human resources for expanding health functional food business
- Increasing in-house R&D capacity and expanding outside networks

M&A — Acquisitions

- Strategic M&As for speedy capacity building and business expansion in the health functional food business

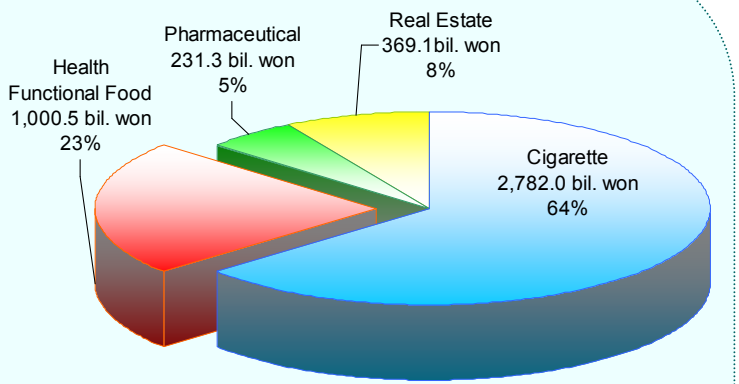
New Business

① Acquiring opportunities that can increase economic value of existing business such as overseas cigarette factories and logistics businesses.
② After accumulating capacity to engage in new businesses, entry strategies will be pursued that can create a synergy.
③ Apply and implement strict standards taking into consideration capital cost and profitability

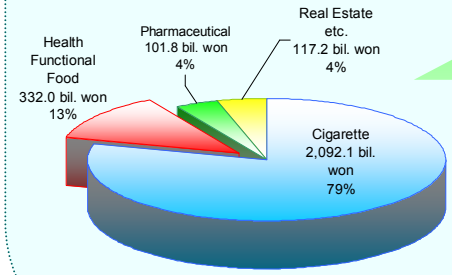
Post Portfolio Re-establishment

Portfolio re-establishment will result in increased sales of health food business from the current 13% to 23%

››› Sales



Total 4,382.9 bil. Won in 2010

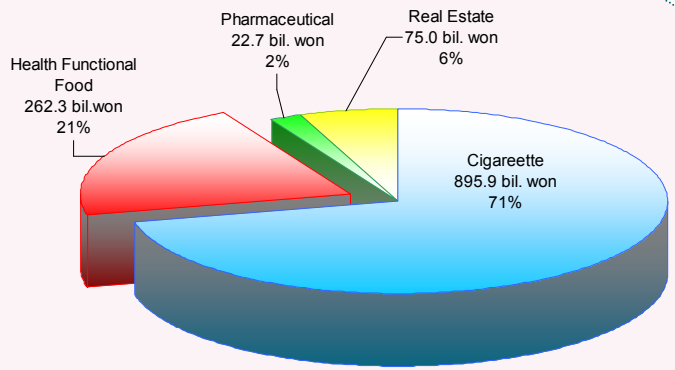


65.8% increase

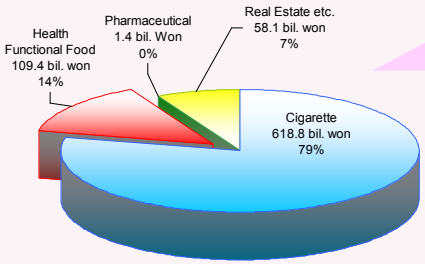
Total 2,643.1 bil. Won in 2005

- To strengthen capacity of existing business, a total of 3.6 tril. won will be invested in R&D, marketing and facilities
- Required funds will come from operational cash flow of each business

››› Operating profit



Total 1,255.9 bil. Won in 2010



59.4% increase

Total 787.7 bil. Won in 2005

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Value Maximization Strategy by Business

- Value Maximization of Cigarette Business
- Value Maximization of Health Functional Food Business
- Value Maximization of Pharmaceutical Business

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Goals & Strategic Initiatives (1)

Value Maximization of Cigarette Business

››› Goals

- Cigarette Business (2010): Sales 3.2 tril. won, Operating profit 970 bil. won
  - -Domestic cigarette market: as core business we expect to achieve M/S of 76% with sales of 2.1 tril. won, operating profit of 700 bil. won, & volume of 60 bil. sticks
  - - Overseas business, KT&G's core strategic business, expected to achieve sales of 700 bil. won, operating profit of 200 bil. won, and sales volume of at least 50 bil. sticks by 2010

※ Real estate business: Sales 370 bil. won, Operating profit 75 bil. won

››› Strategic Initiatives

- Execute pro-active marketing & sales strategy to regain domestic M/S
- Actively increase investments to establish core competence
- Qualitative balance between growth and profitability in overseas business

››› Strategy Details

Re-gaining Domestic M/S	Strengthen Brand Development Capacity	▪ Thru R&D, enhance quality to produce next generation products and develop RRP ▪ Create new demand by taking lead in functional cigarette market
	Establish Strong Brand Portfolio	▪ Strengthen brand differentiation strategy and satisfy market needs ▪ Establish brands to surpass global brands
	Implement Pro-active Marketing	▪ Aggressive investments to defend and increase M/S (focusing on HR & marketing resources) ▪ Promote 'pull marketing' strategy by using image/emotion oriented trend
	Maximize Distribution Leadership	▪ In line with growth of new distribution channel (CVS/super store), expertise by distribution network type ▪ Strengthen PRM by establishing Key Account Management system

Goals & Strategic Initiatives (2)

Value Maximization of Cigarette Business

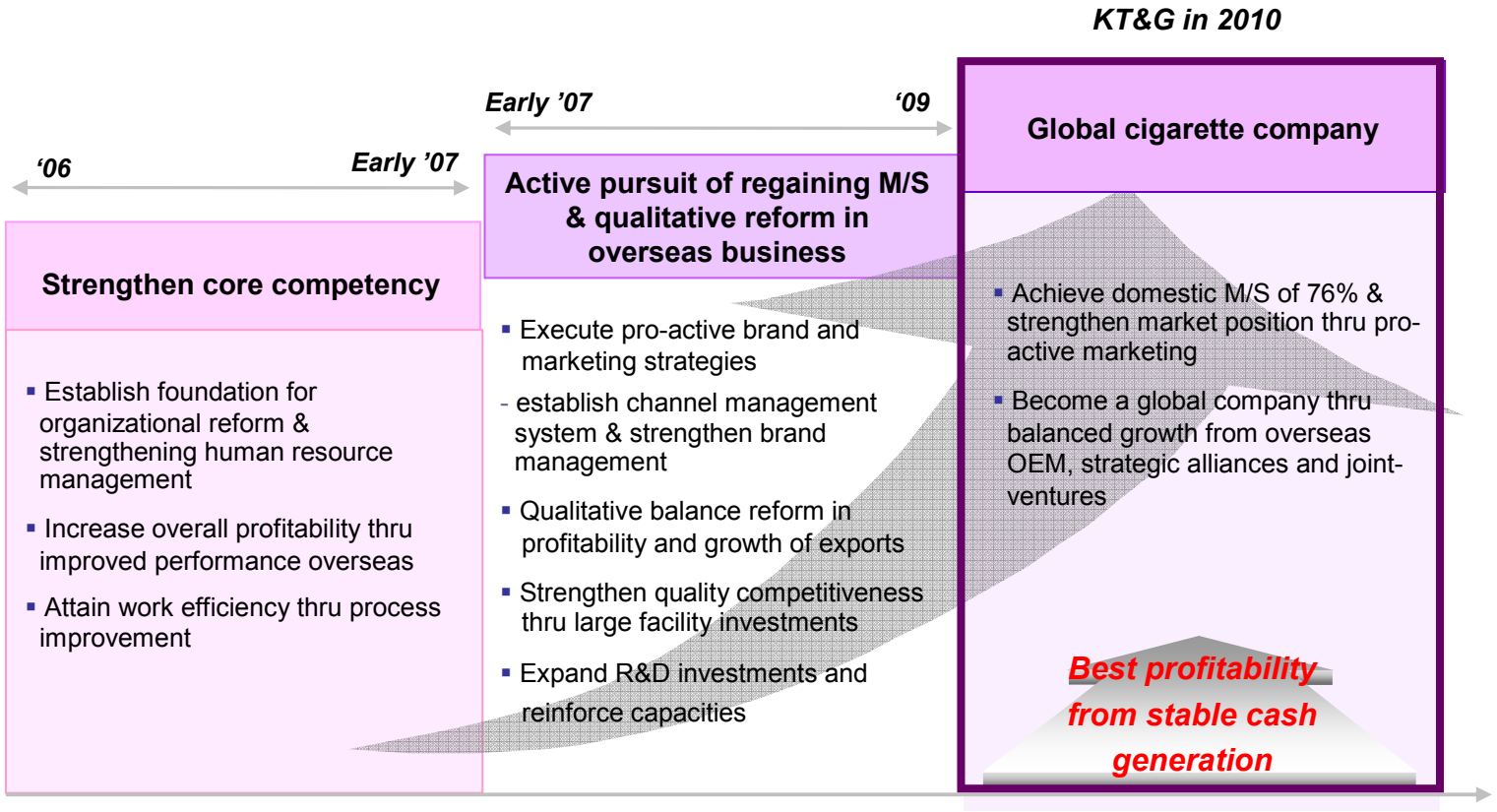
››› Strategy Details

Growth of Balanced Overseas Business	Increase Global Investments		▪ In the short-term, initiate strategic alliances with local companies including OEM ▪ In the mid-to-long term, actively increase overseas investments such as establishment and acquisition of local factories and joint-ventures
	Establish Global Brand Power		▪ Promote ESSE as global strategic brand ▪ Establish brand portfolio according to market characteristics & broaden sales portion of high profitable products
	Systemize Marketing Strategy		▪ Strengthen market analysis functions to effectively execute local marketing strategies ▪ Expand marketing resources to diversify markets
	Establish Local Distribution Channel		▪ Establish strong distribution channel thru strategic alliance with local companies ▪ Strengthen incentive system for importers and wholesalers for effective management
Strengthen Core Capacity	Increase Investments	Marketing Resources	▪ Increase investments to regain domestic M/S and develop overseas markets
		Strengthen R&D	▪ Increase R&D investments to strengthen technological competitiveness and establish global network to strengthen basic technology capacity
		Expand investment in facilities	▪ To strengthen quality competitiveness, increase investment to modernize factories
	Strengthen Competitiveness	Innovate Organizational Structure	▪ Strengthen capacity of key areas/Reorganize & restructure non-key areas
		Expand HR Capacity	▪ Reinforce HR capacity through highly qualified personnel ▪ Establish personnel and compensation system based on performance/capacity
		Process Efficiency	▪ Implement Supply Chain Management (SCM) & outsourcing of delivery unit

KT&G Roadmap

Value Maximization of Cigarette Business

- Executing KT&G's **Value Base** business by regaining domestic M/S and creating stable profits from overseas business



Goals & Strategic Initiatives (1)

Value Maximization of Health Functional Food Business

››› Goals

- Health Food Business (2010): Sales 1 tril. won and Opeating profit 260 bil. won
  - Health functional food business : Sales 660 bil. won, Operating profit 180 bil. won
  - Domestic red ginseng business : Sales 290 bil. won, Operating profit 79 bil. won
  - Overseas red ginseng business : Sales 60 bil. won, Operating profit 6 bil. won

››› Strategic Initiatives

- Active expansion of health functional food business
- Establish platform for overseas red ginseng business and actively penetrate market
- Maintain and strengthen dominant position in domestic red ginseng market

››› Strategy Details

Actively Expand Health Functional Food Business	Strengthen product development of special material products	▪ Focusing on high growth and special purposed products ▪ R&D outsourcing and establish R&D center dedicated to health functional food
	Establish franchise-type multi-purpose stores	▪ In short run, utilize the distribution channels of KGC & Yungjin ▪ Establish “multi-purpose franchise-type” stores focused in major cities after ’08
	Strengthen marketing capacities	▪ Establish a business initiative team including reinforced work force etc. ▪ Strengthen advertising and PR to sustain and expand KGC’s core customer base
	Secure production facility	▪ Until ’08, will be on OEM basis or utilize existing facilities to minimize risks ▪ Will construct new factory after ‘08

Goals & Strategic Initiatives (2)

Value Maximization of Health Functional Food Business

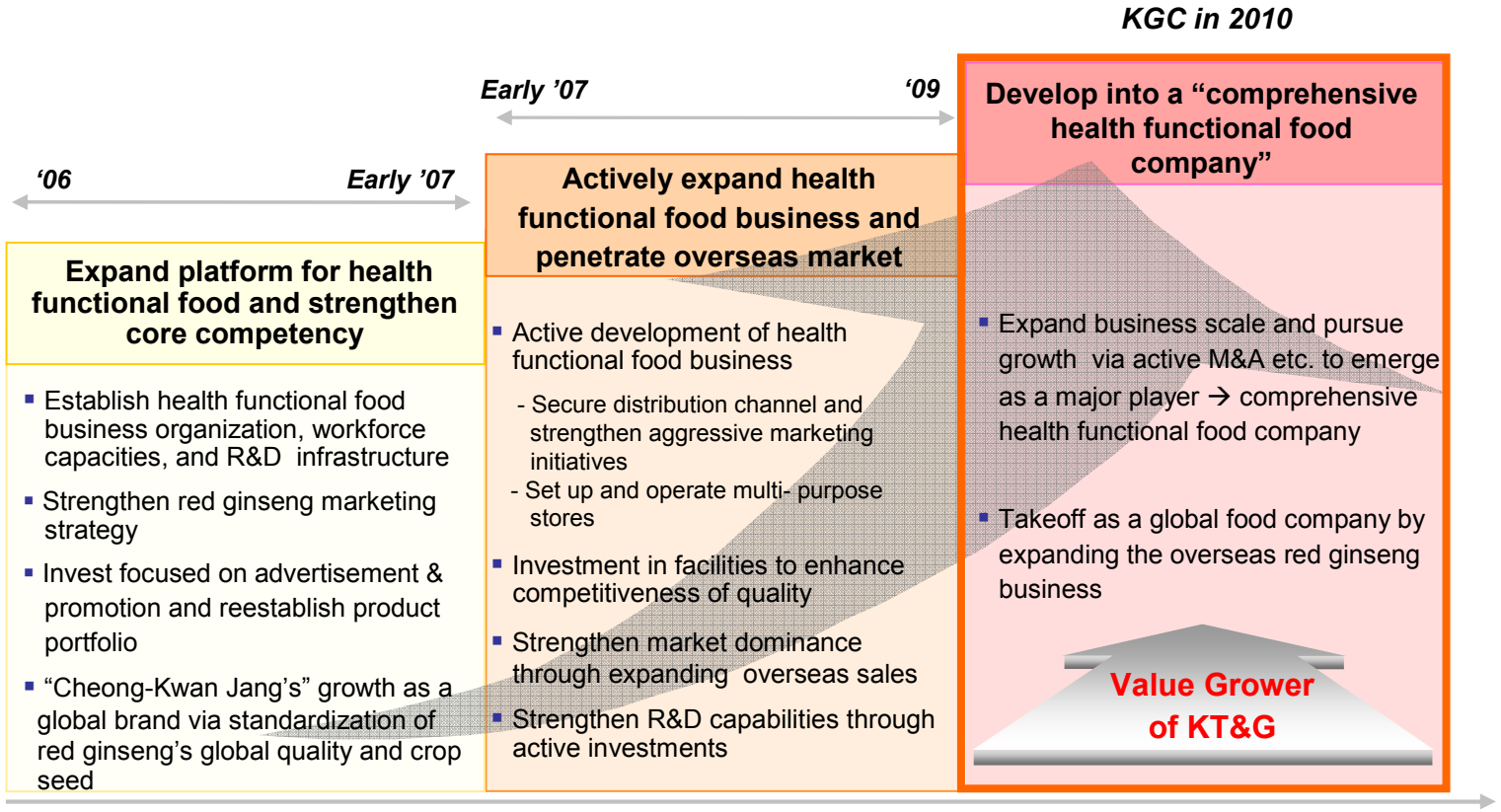
››› Strategy Details

Implement strategy to strengthen leadership position	Adjust product portfolio	▪ Change portfolio to reflect high growth and profitable products ▪ Expand R&D investments for developing highly functional and value-added products
	Manage strategic distribution channel	▪ Strengthen dominance of distribution channel via expanding core channels such as franchises, department stores etc. ▪ Proactive entry and development of new distribution channels such as discount stores & home shopping
	Reform marketing & sales capabilities	▪ Strengthen marketing organization's capabilities and brand management by newly establishing a “brand team” ▪ Implement differentiated strategies by focusing advertising & promotional activities on function and product
	Actively secure supply source	▪ Strengthen technical guidance and actively secure cultivation land ▪ Manage large company-owned farm land: 1 mil. pyeong
Emphasis on establishing a platform to actively enter overseas market	Implement differentiated strategy by market	▪ Implement customized marketing strategy ▪ Establish local distribution channel to reflect market characteristics
	Systemize marketing strategy	▪ Enhance marketing efficiency via precise consumer targeting and market positioning ▪ Expand assistance of marketing activities to enhance awareness of “Cheong-Kwan Jang” in overseas markets
	Reform overseas business capacities	▪ Strengthen sales capacities in each market by establishing strategic points in each region ▪ Establish an overseas strategy team and actively use local/outside professional work force
	Establish production process in China	▪ Production of raw ginseng and product manufacturing & sales to start in China after ’08 (brand localization)

KGC Roadmap

Value Maximization of Health Functional Food Business

- KGC leads KT&G group's growth as a **comprehensive health functional food company**, through active expansion of health functional food business domain and strengthening the market dominant position of the domestic & overseas red ginseng business



Goals & Strategic Initiatives

Value Maximization of Pharmaceutical Business

››› Goals

- Pharmaceutical business (2010): Sales 230 bil. won, Operating profit 23 bil. won

››› Strategy Initiatives

- Business and asset restructuring to maximize economic value
- Raise sales productivity and maximize synergy to enhance competitiveness

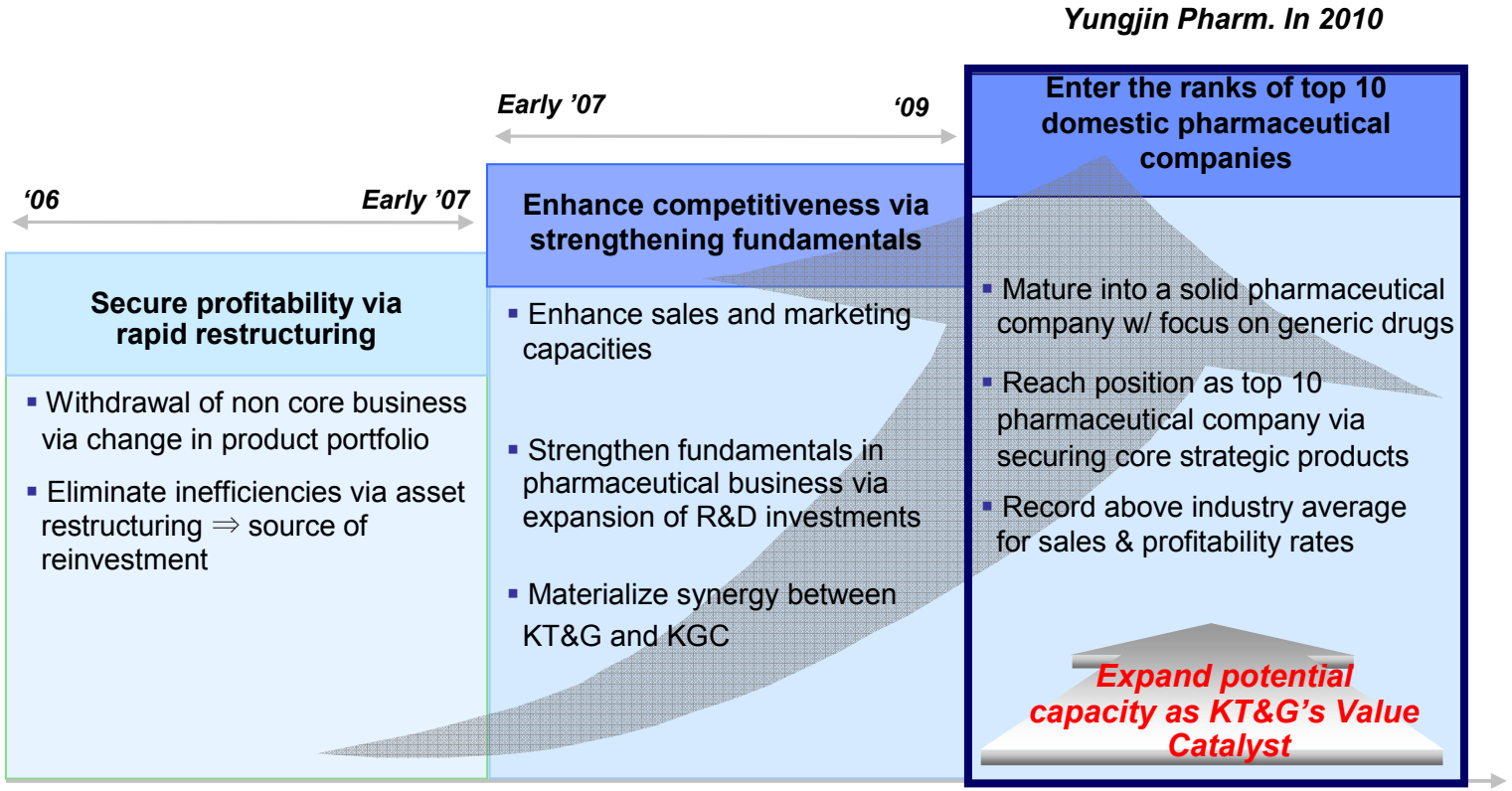
››› Strategy Details

Restructuring	Business Restructuring	▪ Pharmaceutical business : Concentrate on generic business and adjust businesses such as anti-biotics•OTC etc. ▪ Drink business: Withdraw products with annual sales of less than 1 bil. won etc. ▪ Non-drug business: Adjust non core business such as health food & cosmetics
	Asset Restructuring	▪ Efficiency of facility: Nurture into generic drug manufacturing facility and specialize manufacturing facility of Q10 and ingredients etc. ▪ Restructure outdated facilities and equipment
Enhance Competitiveness	Enhance Sales Productivity	▪ Strengthen sales and R&D capacities and rational work force realignment
	Maximize Synergy	▪ Business cooperation w/ KGC, as per Q10, drinks etc., and commercialization of KT&G's bio investments

Yungjin Pharm. Roadmap

Value Maximization of Pharmaceutical Business

- Yungjin Pharm. will establish itself as a top tier pharmaceutical company via rapid restructuring and by strengthening its fundamentals. Furthermore, the company will expand its potential capabilities as KT&G's **Value Catalyst**



For corporate value maximization thru
corporate-wide reform and innovation

KT&G
Mid-to-Long Term **Masterplan**

Challenge & Vision

WWW.KTNG.COM

Value Maximization of Holding Assets and Profit Return Policy

- Efficient Real Estate Management
- Efficient Investment Asset Management
- Shareholder Return
- Social Responsibility
- Stakeholders Return

KT&G

Efficient Real Estate Management

Value Maximization of Holding Assets

Strategic initiation after breaking down idle properties [① Sell ② Develop ③ Hold for L/T development to maximize economic value] through comparable analysis on disposal and develop values

Value Calculation	● Sales value = Estimated market price (Gov't appraisal price / 80%) – Book value ● Development value = Sales – COGS – SG&A (*Book value of land price is included in COGS)

››› Sell

Selection Criteria
- Disposal value > Development value
- No additional profit by development due to poor location

Targeted Asset
- 17 offices totaling 75,387pyeong

Time of Disposal
- Currently bidding to highest price

Disposal Profit
- Estimated profit: around 31 bil. won (Not possible to estimate development profit due to poor location)

››› Develop (Lotting-out)

Selection Criteria
- Development value > Disposal value
- According to internal/external analysis it is possible to secure profits via lotting-out

Targeted Asset
- 6 factories totaling 164,507pyeong

Time of Development
- Between 2006~2008

Development Profit
- Estimated profit: 573.9 bil. won (Disposal value: est. of 312.8 bil. won)

››› Hold for L/T Development

Selection Criteria
- Development value > Disposal value
- Rezoning for re-development etc. and real estate that needs to be settled before hand

Targeted Asset
- Lease: 5 offices totaling 4,601 pyeong

Time of Disposal
- Starting from 2007 by stages

Development Profit
- Estimated profit: 175.0 bil. won (Disposal value: est. 41.7 bil. won)

Total 779.9 bil. won profit realized ← included 'Hold for L/T development'

Efficient Investment Asset Management

Value Maximization of Holding Assets

Maximize value through sales and securing synergy effect from commercialization, taking into consideration of commercialability and whether fulfilled with investment objectives.

Criteria	
	● Possibility of business commercialability considering technology development & market size ● Assets which fulfilled synergy with other investments & original investment objective

Sell

Selection Criteria

- Achievement of investment objectives including securing business license etc.
- Assets in loss of value due to change in business environment

Time of Disposal

- Listed shares: sell immediately
- Non-listed shares: Sell after listing

Target Asset

- Equity stake in 6 companies
- Book value: 15.9 bil. won

Profit

- Estimated profit: 28.3 bil. won
  (est. investment return: around 78%)

Hold (Commercialization)

Selection Criteria

- Bio investment asset to create synergy with affiliate companies
- Assets with possibility of progress in technology development

Target Asset

- Equity stake in 5 companies
- Book value: 26.4 bil. won

Additional Investment

- For continuous technological development investment of 5 bil. won/yr is needed

Investment Profits

- Estimated profit: 170 bil. won + α
- Investment yield: 548% + α

New Investments

Investment Criteria

- New projects with business possibilities
- Commercialization of items completed with technology development

Investment Amount

- Project introduction: avg. 10 bil. won/yr
- Commercialization: avg. 15 bil. won/yr

Shareholder Return - Principles

Basic Principle

- First, in spite of possible decrease in profitability for the next 2~3 years, **strengthening company's fundamentals** ⇒ **maximizing economic value** will realize corporate value that is above shareholder expectation in the long-term and stable basis.
  - In line with this aspect, amount of shareholder return will be determined in connection with the re-investment plan to grow the existing business.
  - Through this, we will realize the company's greatest value, **corporate sustainable management,** and concentrate on enhancing shareholder value, and will also consider balancing the interests of major stakeholders, such as constituents & implementing social corporate responsibilities, etc.
- As stipulated in the current laws and regulations in Korea, **amount of the shareholder return** will be implemented within the scope of **profits available for dividend + future free cash flow** without impeding on company's platform for future growth.
  - Profits will be returned to shareholders within the limit of profit available for dividends, pursuant to paragraph 1, Article 462 of the Commercial Act and Articles 189-2, 190, and 192-3 of the Securities Exchange Act.
  - As regards to debt financing and KGC's IPO, they will be pursued as reserve initiatives to prepare for risk on existing business due to intensified competition and for creating drivers of future growth.
- Regarding **shareholder return process,** shareholder return will be executed based on a resolution by BOD in order to maximize and sustain **Total Shareholder Return (TSR)= dividend yield + % change in share price** taking into consideration of mutually complementary role of dividend and share buyback to protect all shareholders' interests.
  - By utilizing the mutually complementary functions of the dividends & treasury stock policy, we will sustain balance of short and long term shareholder profitability in a flexible and stable manner.

Shareholder Return – Amount and Utilization of Treasury Shares

Amount of shareholder return

Shareholder return within 2.8 tril. won for 3 years

Dividends

- Minimum total of 1 tril. won for 3 years
  - 2006 : Planned for 2,400 won/share (April 2007, dividend payout)
  - From 2007 : Maintain minimum of 2,400 won/share but will be strategically decided considering share price and profit level etc.

Share buyback/cancellation

- Minimum total of 1.3 tril. won for 3 years
  - 1H 2006 : 160.8 bil. Won (previously completed)
  - 2H 2006 : around 12 mil. shares
  - From 2007 : Remaining amount

Additional shareholder return

- share buyback/cancellation will be flexible within the limit of remaining profit available for dividends, considering share price, net income, and cash flow etc.,

Utilization of Treasury Shares

- Currently held treasury shares cannot be cancelled under current law. Therefore, they will be utilized any impact on market and does not affect shareholder value of all investors when utilizing treasury shares
  - Treasury shares-company account (6.6 mil. shares) : Part will be utilized for ESOP and the remaining through issuance of EB etc.
  - Treasury shares-trust account (8.5 mil. shares) : Will be decided in the future pursuant to paragraph 1-3 of Article 189-2 and paragraph 1 and 2 of the Addendum of the SEC's Act since treasury shares in the trust account are not allowed to be withdrawn in kind.

Social Responsibility

››› Basic Principle

- **Together with corporate social responsibility and pursuing companionship principle, we will actively develop socially responsible activities**
- **Concentration on the socially underprivileged and arts/culture & environmental protection etc.**

Amount of Return

Actively pursue returns of around 2% level of annual sales

- '02 ~ '05: donation to average sales ratio was 2.1%
- ('05) 32.5 bil. won → ('08) 56.6 bil. won → ('10) 63 bil. won

KT&G Welfare Foundation

- Continuously concentrate on developing senior citizen welfare related areas
  - Establish and operate retirement welfare home in perpetration for aging society
    ※ 5 retirement welfare homes ⇒ gradual expansion
  - Support specialist training of alzheimer's disease etc.
- Develop children/youth welfare centers
  - Support surgery costs w/ children of rare and incurable disorders etc.

Corporate Social Responsibility

- Focus on the arts & culture area
  - Establish a comprehensive program for the development of the arts & culture area, which is to start full-scale as of '07
  - KT&G and subsidiaries etc. to be separately responsible for a designated area etc. in relations to developing an environmental protection business
- Develop employee volunteer activities
  - Senior volunteers : Former management/employees
  - Junior volunteers : Current management/employees (mandatory)

Stakeholder Return

Seek corporate sustainable management through support, compensation, and providing the highest service possible to all stakeholders including leaf tobacco farmers, employees, customers etc.

- **Supporting leaf tobacco farmers is in line w/ contract and relevant statutes and is done to secure stable supply of domestic leaf and to sustain competitive status in the major domestic market**
  - 2002~2005: Support a total of 82.9 bil. won, 2006~2008: annually 20 bil. won (total of 60 bil. won)
  - Late 2008: Donate 110 bil. won to tobacco production stabilization fund
  - In accordance with the relevant law, donate 15 won/pack monthly to the tobacco production stabilization fund
    - 2002~ June 2006: 169.8 bil won paid (81.5% of total amount paid by tobacco manufacturers)
    - July 2006~ 2008: approx. 80 bil. won is expected to be paid

- **Constituents**
  - Expand opportunities for self development and self fulfillment for constituents
  - Expand incentives, such as ESOP etc., to motivate employees and maximize performances

- **Customers**
  - Enhance customer satisfaction by improving quality & service and product stability etc.