

# SHAPING THE FUTURE

2015 Annual Report



We live in an ever more closely integrated world, a world increasingly shaped by globalization. In order to seize opportunities presented by this global integration, KT&G brings to bear our 117 years of experience and expertise in domestic and international markets to

**SHAPE A SUSTAINABLE FUTURE FOR OUR STAKEHOLDERS AS A 'LEADING GLOBAL COMPANY'.**

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FINANCIAL REVIEW



## CEO MESSAGE

We will achieve our goal of being a ‘Leading global company’ by strengthening our fundamentals so that we can make further advances, and implement greater change and innovation.



*Dear Shareholders,*

I would like to begin by thanking all our shareholders most sincerely for your continued encouragement last year through KT&G’s journey of challenge and innovation.

2015 was another year of difficulties, with greater economic uncertainties in Korea and abroad, hikes in cigarette taxes, and fiercer competition. However, this challenging business environment has made KT&G stronger, and all of us at KT&G worked to maximize corporate and shareholder values. As a result, KT&G made meaningful progress last year.

Our domestic tobacco business accomplished its business goals thanks to distinctive products and innovative brand management. Overseas, we improved the tobacco business by strengthening inventory management and by penetrating new markets with strong growth potential. Our red ginseng business continued its stable sales growth by further improving brand communications and product competitiveness.

2016 is an important year for KT&G as we plan to shape a new future with bigger goals and hope. There will be increased pressures from additional domestic market regulations and continued low growth across the globe. However, everyone at KT&G will aim to make the company stronger in the face of these challenges. To this end, we will concentrate on the following three strategic tasks this year.

**FIRST, WE WILL BUILD ON THE DOMINANT MARKET POSITION OF OUR DOMESTIC TOBACCO, RED GINSENG, AND REAL ESTATE BUSINESSES.**

The target for the domestic tobacco business is to recover a market share of 60% through company-wide commitment and collaboration. In the domestic red ginseng business, we will expand the range of products, including more products for the natural health functional food market, in our efforts to increase growth and profitability. In real estate business, the Group’s major new business area, we will expand investments in profitable real estate ventures, and establish a business structure that can continue to generate value.

**SECOND, WE WILL TARGET OVERSEAS MARKETS,  
TO MAKE KT&G A LEADING GLOBAL COMPANY.**

In overseas tobacco business, we will focus on making inroads into large emerging markets with high growth potential, including Africa and Latin America, while increasing profitability and stability in existing overseas markets. In overseas red ginseng business, we will target greater China by launching more brand products, to expand our range of customers and build foundations for future growth.

**THIRD, WE WILL DEVELOP OUR CORE FUTURE  
COMPETITIVENESS BY MAKING ACTIVE INVESTMENTS  
INTO GROUP BUSINESSES.**

We will build synergy between cosmetics and red ginseng businesses by focusing on raw material R&D, in order to achieve continued growth. In addition, intensive efforts will be made to expand into new markets by developing product competitiveness, strengthening distribution channels at home and abroad, and building a stronger brand power. We will also create momentum for future growth in pharmaceuticals business which will become a new source of revenue for KT&G.



**No.1**

No. 1 tobacco and red ginseng company in Korea,  
and No. 5 globally



**27.8%**

Year-on-year increase in overseas sales  
to reach KRW 681.1 billion



**500+**

Cumulative exports exceed 500 billion sticks  
in september 2015

**Interbrand™**

**25**

25th place in the '2015 Best Korea Brand'  
chosen by Interbrand

**LASTLY, WE WILL TAKE THE LEAD IN SHAPING  
A SUSTAINABLE FUTURE.**

We are building a corporate culture that places great emphasis on transparency, ethics, communications and performance, in our efforts to lay a firm foundation for sustainable growth. This includes a commitment to carrying out creative and distinctive social contribution activities at home and overseas, thus contributing to the sustainable development of local communities around the world.

Throughout our 117 year history, KT&G has succeeded in overcoming challenges by responding quickly and flexibly, and through technological prowess. Our unique strengths and the commitment of everyone at the company will enable us to overcome challenges and to realize our vision of becoming a 'Leading global company'. I thank you for your trust and encouragement you have given us, and I ask for your continued interest in KT&G as we move forward with hope and expectation into 2016.

Thank you.

President & CEO  
**BAEK, BOK-IN**

# FINANCIAL HIGHLIGHTS

## OPERATING RESULTS

(Unit: KRW billion)

|                                     | 2015  | 2014  | 2013  | 2012  | 2011  |
|-------------------------------------|-------|-------|-------|-------|-------|
| Sales                               | 2,822 | 2,743 | 2,511 | 2,638 | 2,491 |
| Cost of Sales                       | 947   | 1,064 | 936   | 982   | 967   |
| Gross Profit                        | 1,875 | 1,679 | 1,575 | 1,656 | 1,524 |
| Selling and Administrative Expenses | 638   | 624   | 651   | 683   | 626   |
| Operating Profit                    | 1,237 | 1,055 | 924   | 973   | 898   |
| Net Profit                          | 988   | 747   | 501   | 768   | 776   |
| Total Assets                        | 7,449 | 6,295 | 6,082 | 5,918 | 5,418 |
| Total Liabilities                   | 1,553 | 953   | 1,050 | 1,015 | 874   |
| Total Shareholders' Equity          | 5,896 | 5,342 | 5,032 | 4,903 | 4,544 |

\* Separate figures basis

## FINANCIAL INDICES

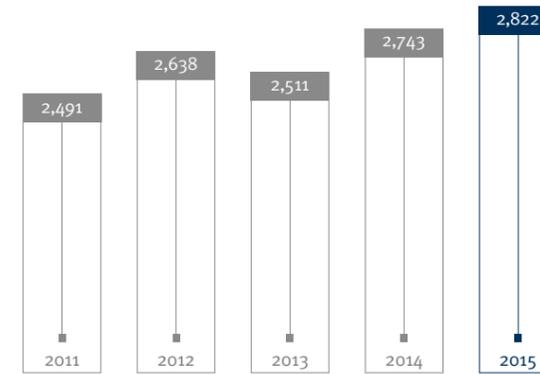
(Unit: %, KRW)

|                             | 2015  | 2014  | 2013  | 2012  | 2011  |
|-----------------------------|-------|-------|-------|-------|-------|
| ROA                         | 13.3  | 11.9  | 8.2   | 13.0  | 14.3  |
| ROE                         | 16.8  | 14.0  | 10.0  | 15.7  | 17.1  |
| Operating Profit Margin     | 43.8  | 38.5  | 36.8  | 36.9  | 36.0  |
| Net Profit Margin           | 35.0  | 27.2  | 20.0  | 29.1  | 31.2  |
| EPS (KRW)                   | 7,843 | 5,934 | 3,982 | 6,111 | 6,134 |
| Payout Ratio                | 43.4  | 57.3  | 80.4  | 52.4  | 51.8  |
| DPS (KRW)                   | 3,400 | 3,400 | 3,200 | 3,200 | 3,200 |
| Liabilities-to-Equity Ratio | 26.3  | 17.8  | 20.9  | 20.7  | 19.2  |

\* Separate figures basis

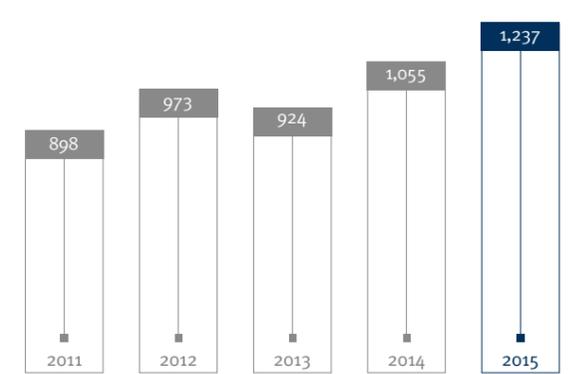
## SALES

(Unit: KRW billion)



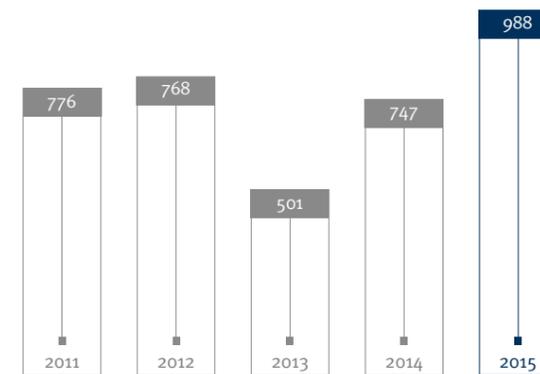
## OPERATING PROFIT

(Unit: KRW billion)



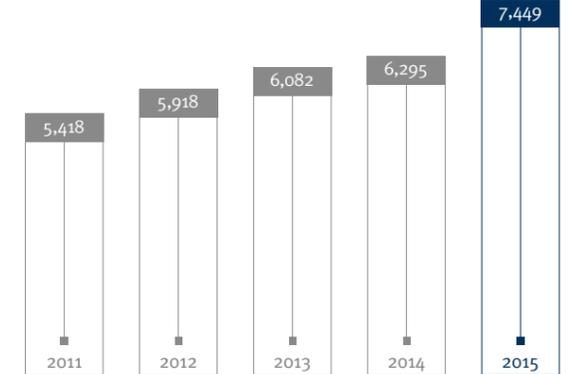
## NET PROFIT

(Unit: KRW billion)



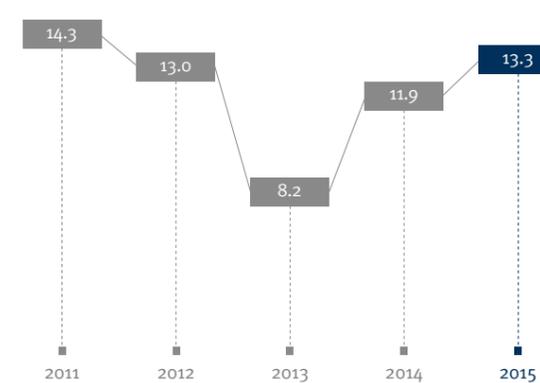
## TOTAL ASSETS

(Unit: KRW billion)



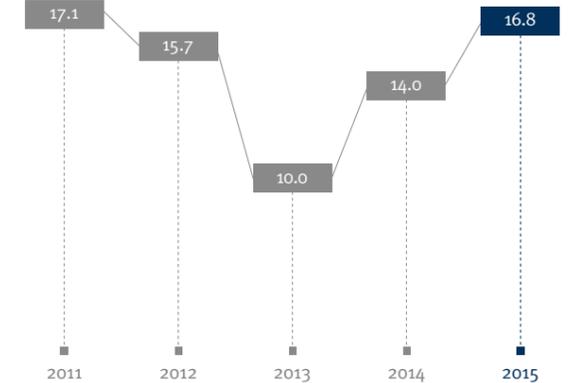
## ROA

(Unit: %)



## ROE

(Unit: %)



## NEWS HIGHLIGHTS



1

### CUMULATIVE EXPORTS EXCEED 500 BILLION STICKS

KT&G's cumulative cigarette exports have surpassed 500 billion sticks, with exports reaching 500.2 billion sticks in September 2015. Total overseas sales reached 532.1 billion sticks, including sales of products made in overseas factories. The cumulative export revenue is USD 5.77 billion. Sales have been led by success from 'ESSE', our high-class super-slim cigarette; cumulative exports of ESSE were 150 billion sticks as of September 2015.

2

### RECEIVED THE GRAND PRIZE AT THE 2015 MECENAT AWARDS

KT&G was honored with the Grand Prize at the 2015 Mecenat Awards, an awards ceremony to recognize companies that have contributed to the development of culture and the arts in Korea, and have given the general public greater access to art. After opening the first Sangsang Madang in Seoul in 2007, KT&G has since established similar spaces in Nonsan and Chuncheon to support creative individuals in the fields of indie music, independent film, visual arts, and



3

### 'BOHEM CIGAR SLIM FIT', THE WORLD'S FIRST SUPER-SLIM CIGARETTE TO CONTAIN CIGAR LEAVES

BOHEM CIGAR slim fit is an super-slim 100mm cigarette made with cigar leaves, the first of its kind in the world. Made with Cuban and South American cigar leaves, BOHEM CIGAR slim fit is low in tar but delivers a rich taste. Once the inside of the filter is crushed during smoking, the taste changes to more refreshing, so that consumers can enjoy two different tastes in one cigarette.

4

### SUBSCRIBING TO THE YOUTH HOPE FUND

The executive management, including the CEO, of KT&G has become a member of the Youth Hope Fund, to support the creation of jobs for young people. The Youth Hope Fund helps young people find jobs, and supports projects that create jobs for them.



5

### 'SANGSANG VILLAGE' TO IMPROVE THE RESIDENTIAL ENVIRONMENT OF PEOPLE ON LOW INCOMES OVERSEAS

KT&G began its 'Sangsang Village' global social contribution project to improve the residential environment of low income people in countries overseas, and to help them become more financially independent. Surabaya in Indonesia was chosen as the first location for the project. Accordingly, 40 new homes, shared bathrooms, and drainage facilities will be built, schools in the region will be remodeled, and local residents will be given education on safety and finance to help them become self-reliant.

6

### 'THE ONE ETIQUETTE', A CIGARETTE WHICH REDUCES ODOR

KT&G released 'THE ONE Etiquette' cigarette, featuring our 'LessTec' technology which uses special cigarette paper to reduce the amount of smoke generated as the cigarette burns, which in turn has less odor. After customer feedbacks, further improvements were made to the blend to enhance the taste and cleanliness of the cigarette.



7

### STRATEGIC PARTNERSHIP WITH DONG-A SOCIO GROUP

KT&G has established a strategic business alliance with Dong-A Socio Holdings and its major affiliates for the beverage, pharmaceuticals, and logistics businesses. The two parties agreed to maximize business synergy by leveraging their flagship brands and distribution networks. They will also expand their global businesses in partnership by improving production and logistics efficiency. This collaboration is a win-win strategy for both companies, and is expected to create opportunities for new growth.

8

### OVERSEAS SALES SURPASS DOMESTIC SALES

KT&G's overseas cigarette sales surpassed domestic cigarette sales for the first time in 2015, with overseas cigarette sales, including both exports and local production, reaching 46.5 billion sticks, while domestic cigarette sales were 40.6 billion sticks. This is the outcome of our active push into emerging markets, especially through ESSE, the world's number one super-slim cigarette. We expect overseas cigarette sales to continue to increase strongly.

# KEY PRODUCTS

## ESSE SERIES

Our world class and most important brand has been a great success with consumers in the 20 years since it was first unveiled in 1996. ESSE continues to hold a strong number one position in sales of super-slim cigarette in Korea and abroad.

# 1996



**ESSE CHANGE** \_ ESSE CHANGE is the world's first super-slim capsule cigarette. It first delivers a smooth, clean flavor, and then a refreshing taste when the inside capsule of the filter is crushed during smoking.



## THIS SERIES

THIS has been popular ever since its release in 1994. It remains a success by offering a great-tasting cigarette of its own, and by reflecting market trends through new product launches.

# 1994



**THIS Africa Rula** \_ THIS Africa Rula is distinctive because it uses an African smoked leaf tobacco for blending, and features a capsule with a unique taste.

# 2003

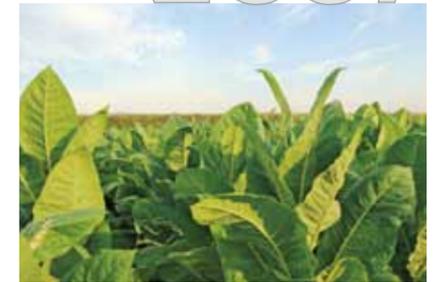


## THE ONE SERIES

Since its launch in 2003, THE ONE series has been a dominant brand in the Korean low-tar cigarette market. Its smooth, clean flavor is the result of an activated oxygen filter with twice-oxygenated filter particles.

**THE ONE Change** \_ This is a new product in which a capsule is added to THE ONE, to create an ultra-low tar capsule cigarette.

# 2007



## BOHEM SERIES

Released in 2007, BOHEM was the first cigarette in Korea to contain cigar leaves. It is a favorite with smokers looking for a taste of the exotic.

**BOHEM Cigar Master** \_ This premium brand is one of the most expensive in Korea. It contains 36% Cuban cigar leaves, and was the first in Korea to use a cigar wrapper. Its unique and distinctive exterior reflects more sophisticated taste, style, and scent.



## RAISON SERIES

RAISON is a highly popular brand among college students appealing to consumers' creative sensibility.

**RAISON French Black** \_ This distinctive new product creates a unique taste by using ripened black tobacco.



# 2002

01.

# OUR COMPANY

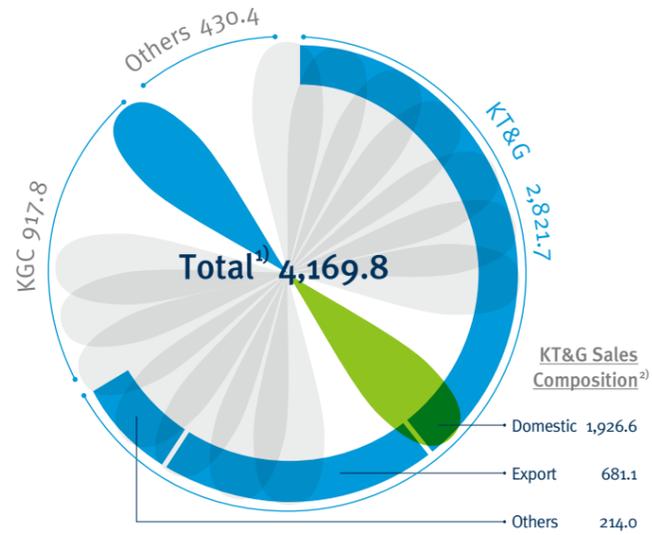
SEEDS OF FUTURE

# No. 1

KT&G IS THE NO. 1 TOBACCO AND RED GINSENG COMPANY IN KOREA. We have led the development of the Korean tobacco and red ginseng industries by taking them in new directions, and pioneering new markets. And now we are sowing the seeds of continued growth by expanding our expertise to include bio-pharmaceuticals, cosmetics and real estate, and by expanding our global presence.

**SALES BY BUSINESS**

(Unit: KRW billion)



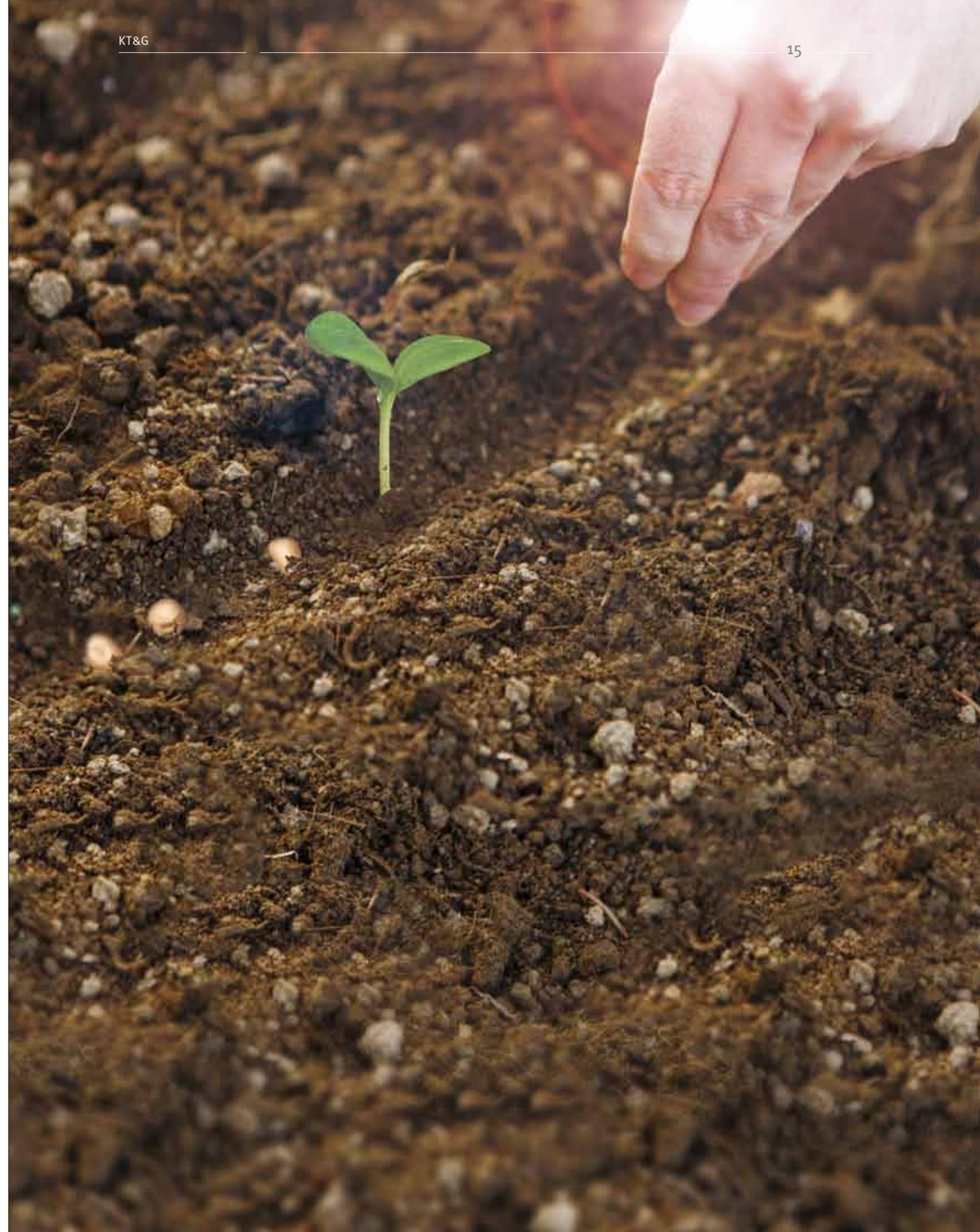
\* As of December 31, 2015

<sup>1)</sup> Consolidated figures basis

<sup>2)</sup> Separate figures basis

**LEADING GLOBAL COMPANY  
WITH STRONG FUNDAMENTALS**

KT&G knows that a prerequisite for a company's healthy growth is to make progress in the right direction, and to be strong in its fundamentals. We therefore have a vision and a corporate philosophy that are right for the Group, and guided by them, we are building a sound governance structure.



# CORPORATE GOVERNANCE

Based on high standards of corporate governance and business ethics, we will do our utmost to maximize shareholder value while enhancing our corporate value, as well.

Establishment



1987

Corporate Governance Assessment by KCGS



A+

No. of Employees



3,886

\* As of December 31, 2015

## COMPOSITION AND ROLES OF THE BOD

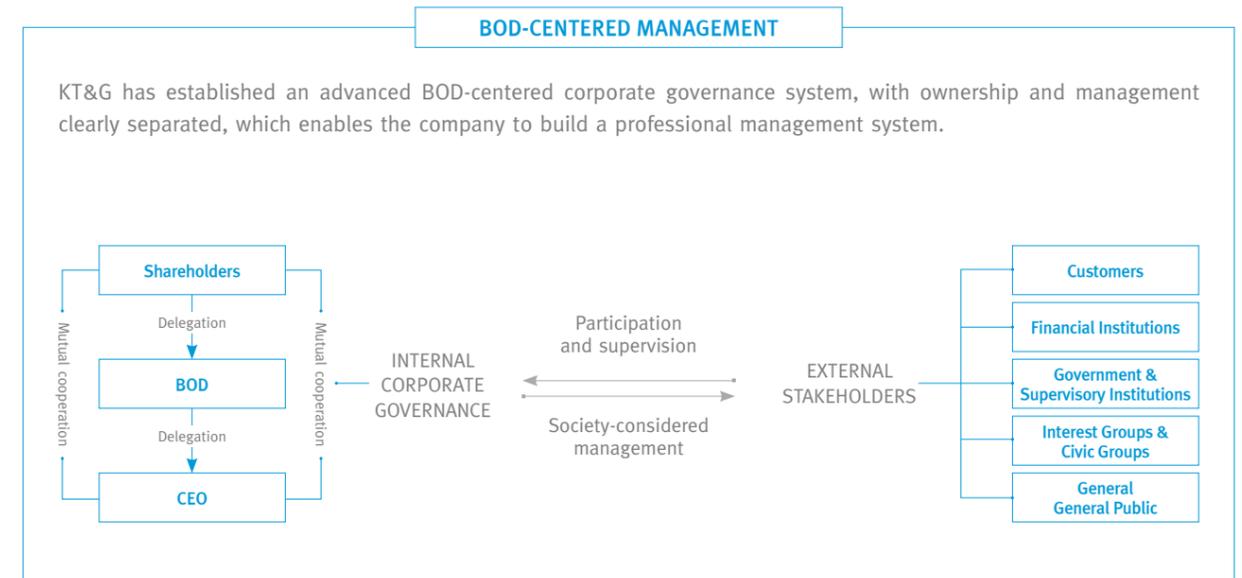
KT&G is well aware of that strong and sound corporate governance is fundamental to achieve continued growth of the company and to improve shareholder and corporate values, which is why we conduct our business in transparent and ethical ways, under the BOD-driven responsibility management system. As of the end of March 2016, KT&G's Board of Directors (BOD) is composed of two executive directors and seven independent nonexecutive directors. The BOD – with expertise, experiences and integrity – is recognized as one of the best in Korea in terms of its proactive functions and operational efficiency.

The BOD is KT&G's top decision-making body. It makes decisions on the company's financial and management issues, as well as on subjects that are authorized to the BOD by legislation and the company's articles of incorporation and

regulations. The independent non-executive directors represent the interests of all shareholders and stakeholders. The BOD and all of its committees undergo detailed evaluations each year, and analyze and report the results of those evaluations in order to continually improve the company's management effectiveness and transparency. There were 18 BOD meetings in 2015.

## INDEPENDENCE OF THE BOD

The percentage of non-executive directors on the KT&G Board is among the highest in Korea. To further ensure the BOD's independence, the role of the Chairman of the BOD is separate from that of the company CEO, and all members of the Audit Committee and the Evaluation Committee are non-executive directors. In addition, an independent specialist search firm is used to ensure transparency in selecting non-executive directors.



The independent specialist search firm selects a pool of candidates, independently from the BOD, and the Independent Non-executive Directors Candidate Recommendation Committee, consisting of three or more non-executive directors, examines the candidates and makes the final recommendations after a strict and impartial screening process.

### COMMITTEES UNDER THE BOD

The individual committees of the BOD are committed to the best possible corporate governance, and the constant strengthening of the BOD's expertise and transparency. In accordance with the Commercial Act, KT&G has established four standing committees: the Strategy Committee, the Investment Growth Committee, the Evaluation Committee, and the Audit Committee. There are also non-standing committees such as the Independent Non-executive Directors Candidate Recommendation Committee and the CEO Candidate Recommendation Committee. The Audit Committee and the Evaluation Committee are the BOD's internal auditors, and are therefore comprised only of independent non-executive directors, to ensure the complete transparency and credibility of the company's financial information, and to properly supervise and support the management.

**Strategy Committee** This committee consists of three independent non-executive directors and two executive directors, and deliberates on company management strategies.

**Investment Growth Committee** With three independent non-executive directors and two executive directors, this committee manages investments, social contributions and risk. It also manages corporate duties required by the Commercial Law, including the setting-up, installation, transfer, and closing of branches, the appointment of proxies and the closing of shareholder lists.

**Audit Committee** This committee consists of four independent non-executive directors, and reviews financial and accounting matters and evaluates internal control systems. The Ethical Management Office has been expanded into the Ethical Management & Audit Division, which reports directly to the Audit Committee. This has further strengthened the Audit Committee's independence and expertise, and has enhanced its internal audit functions.

**Evaluation Committee** This committee consists of four independent non-executive directors, and discusses and evaluates management activities and compensation.

### AWARDS IN CORPORATE GOVERNANCE

- 2003**
  - The Best Corporate Governance among Asian companies by CLSA (Credit Lyonnais Securities Asia)
  - Excellent Corporate Governance in 2003 by KRX (Korea Exchange) and KCGS (Korea Corporate Governance Service)
  - The Best Transparent Company by Economy21
  - Obtained 'Strong' Rating in Corporate Governance Evaluation by S&P
- 2004**
  - The Best Corporate Governance in 2004 by KRX and KCGS
  - Ranked the 4th among Respected Companies by Dong-a Daily Newspaper and IBM BCS Korea
  - Grand Prize at the 5th Audit Award by KLCA (Korea Listed Companies Association) and KICPA (Korean Institute of Certified Public Accountants)
- 2005**
  - The Best Corporate Governance in 2005 by KRX and KCGS
- 2006**
  - The Best Corporate Governance in 2006 by KRX and KCGS
- 2007~2009**
  - Honorary Company in Corporate Governance for three consecutive years by KRX and KCGS
- 2010**
  - The Best Corporate Governance in 2010 by KRX and KCGS
- 2011**
  - The Best Corporate Governance in 2011 by KRX and KCGS
- 2012**
  - A+ in Corporate Governance Assessment by KCGS
- 2013**
  - A+ in Corporate Governance Assessment by KCGS
- 2014**
  - A+ in Corporate Governance Assessment by KCGS
- 2015**
  - A+ in Corporate Governance Assessment by KCGS

### BOARD OF DIRECTORS

#### EXECUTIVE DIRECTORS

##### BAEK, BOK-IN

President & CEO

##### KIM, HEUNG-RYUL

Vice President

#### INDEPENDENT NON-EXECUTIVE DIRECTORS

##### SONG, OP-KYO

- Director, Asia-Pacific Economics Research Institute
- Member of the National Assembly's Constitutional Amendment Advisory Committee
- Chairman of the BOD

##### LEE, JUNE-Q

- Professor, Kyung Hee University
- Board Chairman and President, Korean Academic Society of Taxation

##### CHOI, KYUNG-WON

- Lawyer, Kim & Chang Law Firm
- Minister, Ministry of Justice

##### SON, TAE-GYU

- Professor, Dankook University
- Chairman, Ethics Review and Advisory Committee of the National Assembly

##### YOUN, HAI-SU

- President, Seoul University of Foreign Studies
- Board Chairman, Haegwang Institute

##### KO, SANG-KON

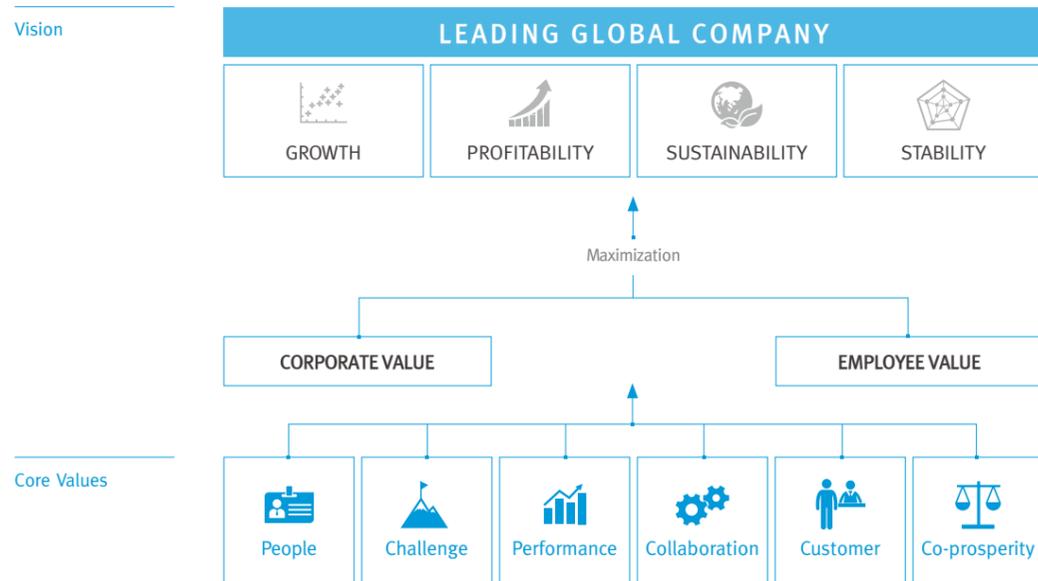
- PR Committee Chairman, Eden Welfare Foundation
- Non-executive Director, Enzychem Lifesciences Corporation

##### LEE, EUN-KYUNG

- CFO & COO, PVH Korea
- Finance Director, Reebok Korea

# VISION & STRATEGY

KT&G will grow into a leading global company and maximize our growth, profitability, stability and sustainability by enhancing corporate and employee values, while maintaining a strong sense of harmony and balance.



**CORPORATE VALUE** \_ KT&G aims to be a leading global company through its business portfolio with high growth potential and profitability. In order to realize the goal, we will strengthen our core businesses, and enhance the competitiveness of new businesses. In the flagship tobacco business, extensive and intensive investment in R&D, branding and marketing will drive quantitative and qualitative growth at home and abroad. Our ginseng business will continue to grow, while pharmaceutical/bio and cosmetics businesses will be catalysts for new growth, and will support a more balanced business structure.

**EMPLOYEE VALUE** \_ In order to create new value, a company must enhance the value of its members. KT&G is well aware of the importance of “employee value”, and we will foster the talents befitting of an era of globalization through systematic human resources management system, based on our human-centered management philosophy. In addition, we will pursue a corporate culture that maximizes the creativity and competency of our people, to realize the goals of every member of the company and the company itself.

## MANAGEMENT PHILOSOPHY

KT&G aims to achieve mutual growth with stakeholders, customers and society as a whole by being an ethical company, a progressive company and a partner company.

**Ethical Company** KT&G will adhere to all the social and ethical requirements placed on it, and its accountability-based management system will ensure that all our businesses are managed in the right way, and future-oriented.

**Progressive Company** KT&G will not pursue change and innovation as a means to achieve the goal, instead, the company pursues a progressive and creative corporate culture which aims at change and innovation.

**Partner Company** KT&G will contribute to the public good and fulfill its social responsibilities, and will do its best to create a sense of fulfillment and value for customers, shareholders and employee.

estate business will contribute to our stable and continued growth as a new growth driver.

**Domestic Tobacco Business** Our strategic target is to return to a domestic market share of 60%, thereby ensuring that the domestic tobacco business continues to generate substantial cash flow for the Group, and expanding our market dominance by releasing distinctive new products.

**Overseas Tobacco Business** We will focus on expanding market share in large new markets, including Africa and Latin America, and improving profitability in overseas markets where we already have a base.

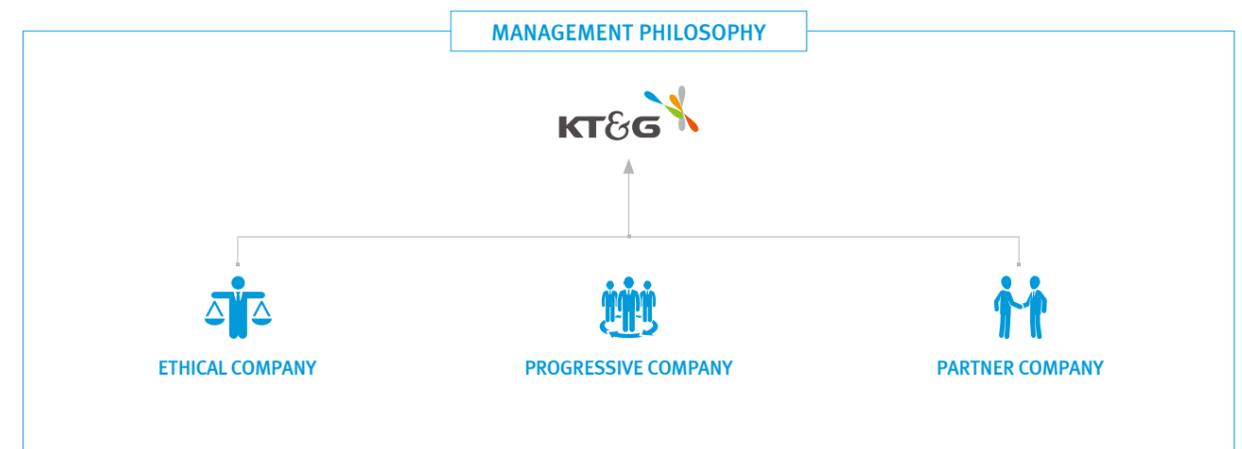
**Red Ginseng Business** In Korea, we will expand the range of products made of red ginseng, while centering our efforts on entering the greater China market to build new profit model overseas.

**Real Estate Business** We will develop real estate business into a key business of the Group by focusing on three strategies – maximize the value of real estate we already own, solidify the foundations for growth, and strengthen the business infrastructure.

**Cosmetics/Pharmaceutical Business** We will build the foundations for mid- to long-term success by improving brand competitiveness and targeting new growth channels for cosmetics business. In pharmaceuticals, we will increase R&D investments, utilize distinctive marketing strategies, and win new global customers, all in efforts to increase growth.

## STRATEGIES

KT&G is building a balanced business portfolio to satisfy its twin objectives of growth potential and profitability in the mid- to long-terms. Tobacco business remains the Group's flagship and generates continuous profits while red ginseng and the new business groups – cosmetics and pharmaceuticals – will strengthen future growth, by generating synergy through shared raw material R&D and other collaborations. The real



# AFFILIATES

## KOREA GINSENG CORPORATION

As Korea's best red ginseng producer, Korea Ginseng Corporation manufactures and sells red ginseng products that uphold the traditions of Korean ginseng, which is the best in the world. Korea Ginseng Corporation's products and technologies have a 117 year history, and their quality is fully recognized by the global market, resulting in exports to around 60 countries worldwide.

- **Business** Manufacture and distribution of red ginseng and red ginseng products
- **Ownership** 100%
- **Sales in 2015** KRW 917.8 billion
- **Major Product** Hongsamjeong (Red ginseng extracts)



## KGC LIFE & GIN

KGC Life & Gin manufactures and distributes products that are made of red ginseng, including health functional foods, beverages, and beauty products. Its total health products are trusted by consumers thanks to Korea Ginseng Corporation's stringent selection of raw materials and quality management system.

- **Business** Distribution of red ginseng products and health functional foods, cosmetics
- **Ownership** 100%
- **Sales in 2015** KRW 52.5 billion
- **Major Product** Donginbi



All affiliates of KT&G operate not just in their own business areas of tobacco, red ginseng, health functional food, cosmetics, and bio/pharmaceuticals, but also generate synergy for the Group by working together.

## SOMANG COSMETICS

Established in 1992, Somang Cosmetics has earned success through its 'Man with Flowers' brand, one of Korea's leading cosmetics brands. Somang Cosmetics is recognized for its high quality products and brand value, which has resulted in being selected as a Super Brand for seven consecutive years and a best cosmetics brand in Korea.

- **Business** Manufacture of cosmetic products
- **Ownership** 97.7%
- **Sales in 2015** KRW 76.0 billion
- **Major Product** Man with Flowers, Danahan



## YUNGJIN PHARMACEUTICAL CO., LTD.

With a history of more than 50 years, Yungjin Pharmaceutical Co., Ltd. is trusted by medical personnel and citizens due to its distinctive pharmaceuticals and diverse health functional foods. It has been leading the Korean pharmaceutical industry, and now focuses its R&D on developing new drugs that contribute to an improved quality of life through the treatment of disease.

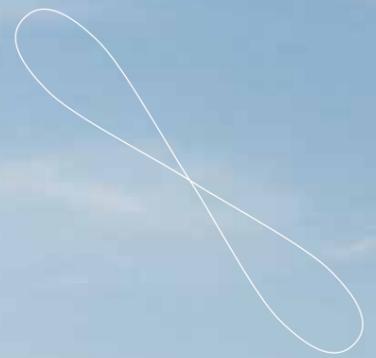
- **Business** Manufacture and distribution of drugs, ingredients, and chemical products
- **Ownership** 53.0%
- **Sales in 2015** KRW 170.2 billion
- **Major Product** Harmonilan Solution



# 01. BUSINESS

02.

## LEADING GROWTH



# 50

Despite a challenging business environment at home and abroad, KT&G continued to grow in 2015, taking further steps towards realizing its vision of becoming a 'Leading global company'. We maintained our undisputed No. 1 position in the domestic market, and expanded our global footprint, exporting MORE THAN 100 BRANDS TO 50 COUNTRIES AROUND THE WORLD.

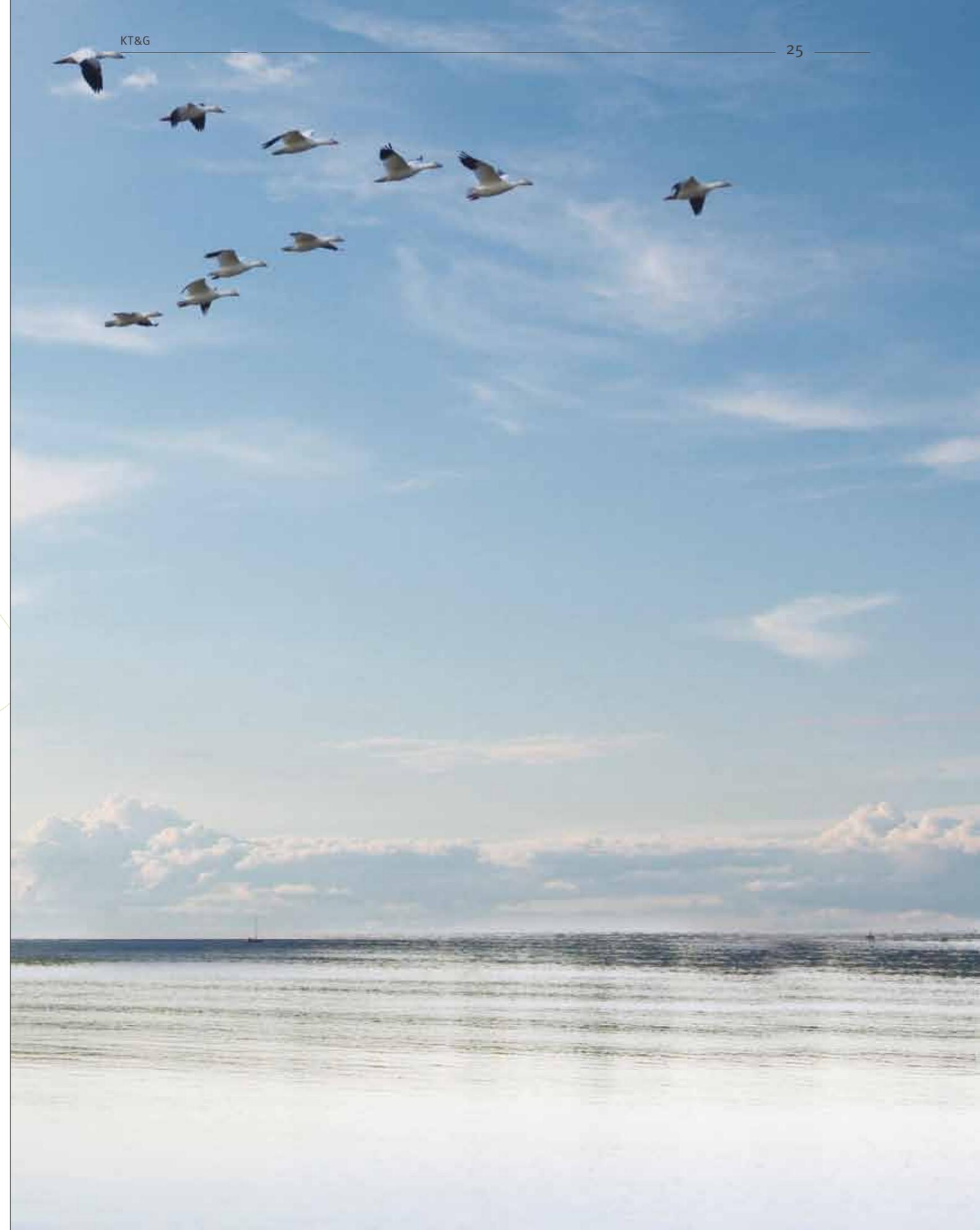
OUR B



\* As of March 2016

### LEADING GLOBAL COMPANY WITH EXTENDED GLOBAL PRESENCE

Our eyes are on global markets. We are expanding our global presence by strengthening our technological prowess, developing localized products, and building a unique brand portfolio. This led to great success in 2015, as overseas sales exceeded domestic sales for the first time. We plan to continue our advance into new markets, including Africa and Latin America.



# DOMESTIC BUSINESS

We boosted our brand competitiveness by releasing distinctive new products that reflect market trends, and responded rapidly to market changes, which enabled us to meet our goals for the year.



## PERFORMANCE IN 2015

Market conditions were more difficult in 2015, with a major increase in cigarette taxes at the beginning of the year, and the resulting aggressive price strategies of competitors. Nevertheless, KT&G was able to record operating profits of KRW 1,237.3 billion by strengthening our brand competitiveness and launching distinctive products that met developing consumer preferences.

Our premium product group particularly saw a good performance, including the renewal of the 'ESSE SOO Masterpiece', a premium brand priced at around KRW 5,000, 'THE ONE Gold Label', and an ultra-high-priced limited edition that is only available in duty-free stores. This showed how KT&G's strategy for its high-price portfolio has been right for the market, and has contributed to increased profitability. The market share of the three types of 'ESSE Change' launched in 2013 rose 1.84%p year-on-year, which was an extremely encouraging accomplishment. Other distinctive new products were successfully established in the market, including 'THIS AFRICA Mola' and 'BOHEM slim fit'.

In order to stabilize market conditions after the cigarette tax hike, KT&G expanded our sales capability and adjusted the zones covered by different parts of the sales division, to make it more market-focused. We also improved our ordering and shipment methods, and increased manufacturing facilities for key products, in an effort to build a system for timely delivery of high-quality products. In addition, we undertook

a technology cooperation project with an overseas facility manufacturer, in order to secure cutting-edge maintenance capabilities which will ensure better continuity.

## CREATING SUSTAINABLE VALUE

A new factory emissions management system was built in 2015, in line with the Korean government's environmental policies. We successfully implemented eleven energy reduction projects to help reduce the amount of greenhouse gases at the national level.

Our low-ignition 'Blue Band' technology, the result of extensive in-house investment by KT&G, has been applied to all our products, as part of our commitment as a socially responsible company. In addition, all our product packaging now has a pictogram on smoking etiquette.

## FUTURE PLANS

We will continue to reflect consumer requirements and market trends by further diversifying our product portfolio. This will enable us to lift our market share back up to our target of 60%. Improving profitability will also help the domestic tobacco business generate cash to support growth at the Group level. To this end, nine HQs, including the Strategy & Planning, Marketing, and Manufacturing HQs, will be integrated into a COO, to boost corporate efficiency.

### DOMESTIC BUSINESS KEY FIGURES

DOMESTIC MARKET SHARE

58.4%

DOMESTIC TOBACCO SALES

1,927 KRW billion



DOMESTIC TOBACCO SALES VOLUME

40.6 Billion sticks

KEY PRODUCTS

ESSE Series, RAISON Series, THE ONE Series, BOHEM Series

# GLOBAL BUSINESS

KT&G achieved notable results and strengthened our position in the global market, through distinctive products, outcomes of our unique technologies, and intensive efforts to pioneer new markets.



## PERFORMANCE IN 2015

In 2015, we exported 39.7 billion sticks, up 10% over the previous year. Sales also grew by 28%, to reach KRW 681.1 billion. This was attributable to increasing sales of major products, including 'ESSE MINI Slim', in our key markets such as the Middle East and Central Asia, helped by improving political and economic conditions in those regions. We also focused on entering new markets, including Asia-Pacific, Latin America, and India, and our exports to those regions therefore increased.

KT&G is a truly global player, selling 50% of its total production volume to some 50 countries around the globe. We are now the fifth-largest tobacco company in the world, but we are not complacent. Instead, based on our never-ending commitment to getting better, we are actively developing products that reflect the different tastes of local consumers around the world, and expanding our local distribution networks. In 2015, overseas sales, including both exports and local production, were 46.5 billion sticks, with our flagship brand 'ESSE' taking the lead. This was a major milestone for the company, with overseas sales exceeding domestic sales.

## FUTURE PLANS

In 2016, we will make inroads into emerging markets with high growth potential, including Africa and Latin America, to ensure that we maintain the growth momentum of our overseas tobacco business. We will also expand brand portfolio by localizing our strategic brands and by launching distinctive new products that can become truly global brands.

KT&G's overseas business organization is being strengthened to support this active market expansion. The Overseas Subsidiary Business Office has been created at Global HQ to provide dedicated support to major overseas subsidiaries, including Russia, the US, and Indonesia. We also plan to improve our global business competitiveness by setting up dedicated sales, marketing and production teams at overseas subsidiaries.

### OVERSEAS SALES BY REGION IN 2015

#### MIDDLE EAST & CENTRAL ASIA

48%

#### RUSSIA & CIS

9%

#### ASIA

25%



#### USA

6%

#### EUROPE, AFRICA, SOUTH AMERICA AND OTHERS

12%

# RED GINSENG BUSINESS

We continue to boost the competitiveness of our red ginseng business as a undisputed leader in Korea, by developing a second brand and expanding into new areas of business such as health functional pet foods.



## KEY COMPETITIVE ADVANTAGE

Red ginseng business is one of major profit sources of KT&G. 'Cheong-Kwan-Jang' brand, in particular, dominates the Korean red ginseng market, earning customer trust through strict quality control, nationwide distribution networks and a strong franchise system.

We produce high-quality red ginseng by purchasing the raw materials through a six-year contract farming system and then systematically managing cultivation. We obtained Hazard Analysis Critical Control Point (HACCP) certification in 2012 by satisfying global standards of food quality and safety.

Based on our outstanding technology and product competitiveness, we have established overseas subsidiaries in China, Taiwan, Japan and the US for the sale of red ginseng products, and continue to advance further into global markets. Our achievements suggest a bright future for overseas sales. In January 2015, 'Cheong-Kwan-Jang Hong Sam Won', a leading red ginseng drink, was offered space at Costco, the largest warehouse distributor of the US. In June, 'Cheong-Kwan-Jang' was chosen as the world's number one brand for retail red ginseng sales by Euromonitor International, a global market survey firm.

## PERFORMANCE IN 2015

Sales substantially rose as a result of increasing new product sales in Korea and targeted marketing activities. Our red ginseng business recorded sales of KRW 917.8 billion in

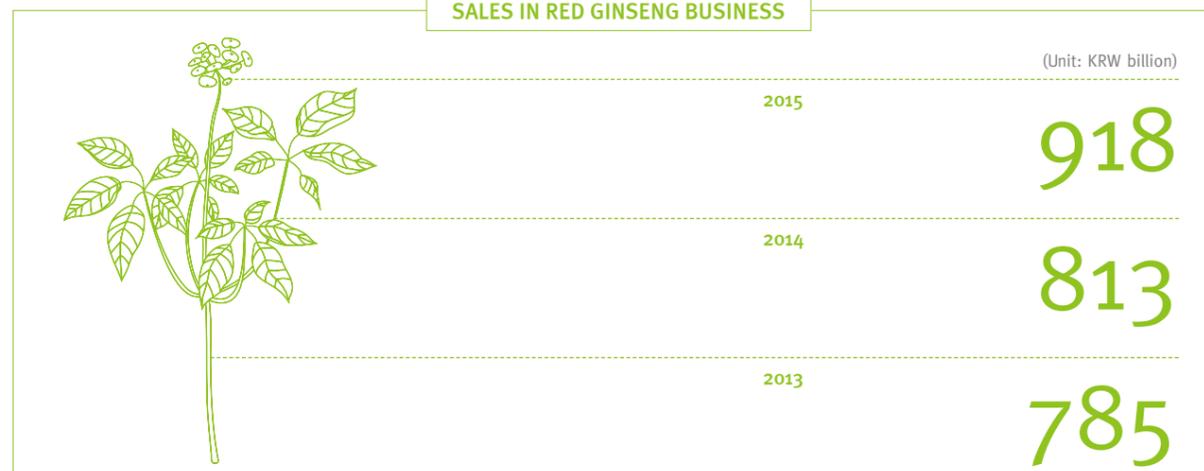
2015, with operating profits of KRW 133.4 billion and a net profit of KRW 69.3 billion, based on separate figures. These represent year-on-year growth of 12.9% and 2.5% in sales and operating profits, respectively. Domestic sales led the overall improvement, up 14.7% over the previous year to reach KRW 836.1 billion.

New products also enjoyed considerable success. 'Cheon Nok Sam', our premium health functional food, sold more than 10,000 sets in only eight months after its release. 'GINIPET', a brand for healthy pet food, achieved sales of more than 10,000 sets in just three months after its launch. The excellent performance by these new products was thanks to top-quality raw materials and product planning that reflects consumer preferences. For 'Cheon Nok Sam', for example, our procurement team went to New Zealand two years before product release to directly import top-quality raw materials such as free-range deer antler velvet. 'GINIPET' combines 95% organic raw materials with six-year Cheong-Kwan-Jang red ginseng to deliver the very best in quality, to satisfy the most demanding customers.

## FUTURE PLANS

In the domestic market, we will increase sales by improving the channel competitiveness of our major brands, and expand the range of health functional products. Overseas, we will create demand by releasing dedicated products in each country that satisfy the unique preferences of local markets, with a particular focus on greater China.

### SALES IN RED GINSENG BUSINESS



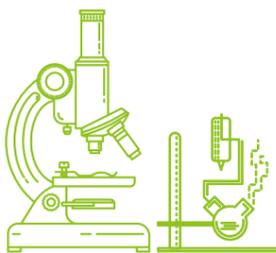
## RESEARCH & DEVELOPMENT

KT&G maintains dominant position in the Korean market and increases global market share by creating distinctive new products through innovative ideas and constant R&D efforts.

### R&D ORGANIZATION

KT&G's R&D HQ is the cradle of our product development, based on world-leading cutting-edge technologies. It consists of the Product Research Center, the Technology Research Center, the Analysis Research Center, and the R&D Planning Office. The Product Research Center works on the development of new products and the improvement of existing lines, based on customer preferences. The Technology Research Center conducts research in core technologies, tobacco cultivation, and research on raw materials, flavorings and aromatic capsules, all in efforts to develop innovative new products. The Analysis Research Center focuses on analysis technologies, component analysis and research, and responses to the technology environment. The R&D Planning Office puts into place our R&D strategies and goals, and manages R&D projects to achieve those goals.

### INTELLECTUAL PROPERTY RIGHTS



3,180

\* As of the end of 2015

### BLUE BAND

Blue Band is a technology independently developed in-house by KT&G, and is used to produce cigarettes with a low ignition propensity (LIP). Our LIP technology is the outcome of three years and KRW 7 billion of investment and development. A special natural material is coated onto the cigarette paper during the manufacturing process, to increase the tendency for a cigarette to go out under certain conditions. KT&G has five independent patents in relation to 'Blue Band'. This technology was first used in three varieties of 'THE ONE' series in 2013, and it is now applied to all products manufactured in our Korean cigarette factories. We also apply it to products exported to countries where cigarettes are mandated to be LIP, including the EU and Australia.

### LESS TEC

This technology uses special cigarette paper so that each cigarette generates less smoke, which in turn reduces odor. It was applied to 'THE ONE Etiquette' released in November 2015, together with a 'scent zone' that reduces the odor of cigarettes on the hand if consumers rub a cigarette pack after smoking, which has made this brand popular.



## QUALITY MANAGEMENT

We inspire trust and generate client satisfaction by setting a new standard for product quality based on our world-leading systematic and independent quality management system.

### COMPETITIVENESS IN QUALITY

KT&G's comprehensive quality management ensures strict quality control at all time. The entire quality process, from raw materials to distribution, has been broken down into 42 separate processes, and each one of these is thoroughly managed.

**Double Verification System** Before finished products are shipped, they are evaluated by specialist professionals, using their trained senses. This is additionally backed up by the use of the latest equipment to review and analyze quality measurement data, so that only standard products are released.

**Taste & Quality Assurance System** This system maintains top quality by carrying out real-time monitoring of the entire process, from the input of raw materials to the finished products. If a problem occurs, the system immediately halts the production line and then restarts it only after the problem is fixed.

**Double Layer Wrapping Technology** This involves wrapping tobacco in a double layer of cigarette paper to provide a dual level of protection against smoke, which in turn helps to reduce tobacco odor on clothes and fingers.

**Aroma Packaging** A micro-capsule containing aroma is mounted on the cigarette packaging – by rubbing this packaging after smoking, an aroma is released to reduce tobacco odors on the smoker's hand.

### DISCLOSURE OF INFORMATION

**Disclosure of Product Information** In August 2011, KT&G became the first tobacco company in the world to adopt the producer 'real name' system, whereby the name of the team head responsible for each packet of cigarettes is printed on the base of the pack. This system encourages our employees to feel more responsible for quality, and raises consumer confidence. It is now applied to all products sold in Korea. We have also established an internal process to continually assess and improve the effectiveness of this system.

**Consumers' Right to Know** We place health warnings on cigarette packages and cigarette advertising in Korea, in accordance with the Tobacco Business Act and the National Health Promotion Act. Our export products are printed with warning messages that comply with the laws of the importing country. We also print warning messages on cigarette packages exported even to countries where there is no such legal requirement, to promote the consumers' right to know. We follow international standards regulating against messages that may be misleading to consumers, and disclose the tar and nicotine contents of our products.



## MARKETING & BRANDING

KT&G has built strong brand value in Korea and a global marketplace, thanks to the implementation of strategic brand management in support of an outstanding product group.



### INCREASING BRAND VALUE

KT&G has maintained its dominant position in the domestic market and has also grown into the world's fifth-largest tobacco company, exporting to some 50 countries across the globe, despite fierce competition and ever-stricter regulations. This has been achieved thanks to KT&G's outstanding technological prowess and unique brand management. Tobacco is an item of personal preference, and brand value is an important factor in customer choice. Brand management therefore determines a tobacco company's success or failure.

As part of brand management, we segmented the management team per brand, and adopted a brand manager system which assigns dedicated personnel to each brand, to enhance product competitiveness and brand awareness. These strategies have enabled the birth of hit brands such as ESSE, RAISON, THE ONE, and BOHEM. Based on distinctive brand images built a long period, we analyze consumer trends by region, age, and gender, and release new products that reflect lifestyle changes and trends, in order to strengthen our brand value.

As well as continually enhancing KT&G's brand value in Korea, we are actively implementing brand management overseas. The licensing of the 'Davidoff' brand from British Imperial Tobacco Group and the release of 'Tonino Lamborghini' has improved KT&G's brand awareness overseas. The products developed through these collaborations earned good reviews from overseas buyers at 'Intertabac', one of the world's largest tobacco industry expos, and the 'World Duty-Free Exhibition'.

KT&G's effective brand management has made the company number one for six consecutive years in the tobacco category of the National Customer Satisfaction Index survey carried out by the Korea Productivity Center. KT&G also moved up two places to take 25th place in the '2015 Best Korea Brand' as chosen by Interbrand, a leading global brand consultancy.

### STAKEHOLDER COMMUNICATION

**Customer Value** KT&G makes extensive efforts to actively reflect customer opinions in our product development and marketing. We operate our customer satisfaction center 24 hours a day, and customer feedback is reflected in our manufacturing processes, so that we can improve product quality. We also collect external opinions through various communications channels, such as an advisory committee consisting of specialists in different areas of the tobacco industry, and our Sinmungo (complaint reporting) system. KT&G will strive to continuously improve our service and product offerings and to exceed our customers' expectations.

**Social Value** KT&G actively fulfills its corporate social responsibilities, in order to establish a smoking environment where the rights of both smokers and non-smokers are protected, and where smokers and non-smokers respect each other. This includes supporting the installation of smoking rooms and smoke control facilities, and the establishment and operation of smoking rooms at airports across the nation. We also supply portable ashtrays and public trash cans, place public advertisements and conduct campaigns to spread an appropriate smoking etiquette, and educate young people on smoking prevention, thereby contributing to a mature civic society and the public interest.





03.

# OUR VALUE



BETTER FUTURE

# 3,886

We know that long-term corporate success is not possible without sustainability. We also know that the enduring strength of our business depends on healthy and vibrant communities. That is why giving back to communities is a core value for KT&G, and every one of 3,886 EMPLOYEES OF KT&G IS COMMITTED TO CREATING A SUSTAINABLE FUTURE FOR ALL OUR STAKEHOLDERS.

## MAJOR CSR ACCOLADES

**Oct. 2007**

Received the Certificate of Merit from Korean Red Cross

**Jun. 2008**

Received the 2008 CSR Grand Prize from Korea Press Forum

**Nov. 2008**

Received the Certificate of Merit from Social Welfare Donation

**Sep. 2009**

Received the Certificate of Merit from Beautiful Fund

**Oct. 2009**

Recognized as one of the best companies by the DJSI

**Nov. 2009**

Received the 2008 CSR Grand Prize from Korea Economy Newspaper

**Dec. 2009**

Received the Certificate of Merit from Seoul Foundation for Arts and Culture

**Nov. 2010**

Received the Art Contribution Award from Korea Mecenat Association

**Dec. 2013**

Listed in the DJSI World Index for Four Consecutive Years

**Nov. 2015**

Received the Presidential Award from Korea Mecenat Association

LEADING GLOBAL COMPANY  
CONTRIBUTING TO  
GLOBAL COMMUNITIES

As a global company, KT&G fulfills our social responsibilities across the global community. We offer diverse support programs in different countries and help those who have lost their livelihoods due to disasters and people in difficult living environments, in order to create better future for all. We are also actively implementing energy reduction policies to counter climate change.

OUR

## ETHICAL VALUE



### ETHICAL MANAGEMENT & AUDIT DIVISION

Reformed to guarantee independence of auditing functions



### AUDIT ON ETHICAL MANAGEMENT

Every year



### COMPLIANCE PROGRAM

Initiated in 2002

### ETHICAL MANAGEMENT

KT&G requires all employees to perform their duties to the highest standards of ethics and transparency. We comply with all relevant laws at home and abroad, and strictly abide by ethical standards, including fair transactions with business partners and the protection of employees' human rights. We have further strengthened our ethical management by reforming the relevant internal organization.

**Code of Ethics** KT&G has established a charter of ethics to enable the company to fulfill its social responsibilities through a detailed code of ethics, backed up by relevant guidelines. The code details employees' responsibilities toward customers, colleagues, the company, business partners, shareholders, and wider society, and sets out requirements to put these into practice. It serves as a guide for the decisions that employees make on a daily basis in their actual work environment.

**Ethical Management Organization** To guarantee the independence and expertise of the audit organization, and to improve internal auditing functions, the previous Ethical Management Office, which reported directly to the CEO, has become the Ethical Management & Audit Division, and reports directly to the Audit Committee. This team shares policies on ethical management, monitors business risks, examines subsidiaries, conducts regular assessments, and investigates and responds to accidents or other safety events. There is an annual audit on ethical management for each division, regional headquarters, and branch.

**Support for Ethical Management** We have diverse ethical training programs in place to make sure that we establish a corporate culture based on ethical management. We also continually update our ethics regulations, programs, and systems. The Group's ethical management guidelines are applied to subsidiaries as well, and we regularly examine ethical management at subsidiaries, and make corrections where necessary.

KT&G is committed to running our business in a way that is ethical, transparent and responsible, thus creates long-term value for stakeholders.



### WIN-WIN PARTNERSHIPS

As a market leader in Korea, KT&G takes the lead in conducting fair trade, and seeks joint growth with business partners. We have set out our basic principles for purchasing in our code of ethics, to ensure fair transactions, and we comply at all times with the guidelines for trading between large companies and SMEs established by the Fair Trade Commission. In addition, internal fair trade compliance guidelines improve employee understanding of the Fair Trade Act.

Since beginning our Compliance Program in 2002, we have designated a compliance officer to ensure compliance with fair trade laws. As a member of the Korea Tobacco Association, we have also joined the Trade-related IPR Protection Association, to help eliminate the illegal distribution of tobacco.

KT&G aims to establish cooperative relations with all our suppliers, through mutual trust and treating them as business partners on an equal footing. We therefore actively look for and support outstanding suppliers, and provide funding to local tobacco farmers. We also offer support for research into improving the quality of locally-produced leaf tobacco, and give practical help to tobacco farmers during their busy season.

# HUMAN RESOURCES VALUE



## HR DEVELOPMENT PHILOSOPHY

'I am C.E.O.' represents the ideal person sought by KT&G. They are people who are committed to constant challenge, striving to perform to the best of their abilities, and committed to achieving win-win partnerships. We have a detailed HR mission to recruit and train the best people, who will take the lead in realizing the company's vision; this in turn improves the skills of all employees. Work roles are assigned based on individual capabilities, and our HR system impartially assesses performance based on outcomes. This system ensures that employees with excellent skills and performance are properly evaluated and compensated.

## PRINCIPLES FOR RECRUITMENT

KT&G recruits talent without prejudice and regardless of gender, academic background, region, or disabilities, pursuant to the Labor Standards Act. We continue to diversify our recruitment schemes and channels, to discover the best talent, while making sure we give full opportunities to women, the disabled, and high school graduates. By continually hiring high school graduates, in particular, we

contribute to solving social problems such as academic inflation and youth unemployment.

## HR DEVELOPMENT PROGRAMS

KT&G makes continuous efforts to strengthen employee competencies through diverse human resources development programs, and also provides active support for employees who are pursuing self-development.

KT&G's HR development program is split into three categories. Firstly, skills-based internal training encourages self-development by requiring an employee to earn at least 10 credits to move up one rank in seniority. Around 300 internal training courses operate per year to help employees earn these credits. Secondly, our training programs help employees develop the basic skills they need for their jobs. These programs cover fields such as marketing, technology, and management support, and there is also a leadership program to foster the leaders who will shape the future of KT&G. Thirdly, our long-term training system develops global talent. It involves selecting employees through internal contests and an internal selection system, and then

Our human resource development is based on the belief that outstanding talent is our number one asset, and the key to the future growth of the company.



supporting them to attend colleges and graduate schools in Korea, E-MBA, and overseas MBA courses.

In order to support employee training, KT&G built the KT&G Business Information Service (BIS) in March 2011. BIS offers web- and smart-phone based video content and thesis search services in economics, business administration, and leadership. The KT&G Innovative Supreme System (KISS), an education management system, helps employees track their education history, manage career development, and share useful information with colleagues.

## PEOPLE OF KT&G

**C**

**CHALLENGE**

KT&G's people are committed to constant challenge, with a passion to support corporate growth and change.

**E**

**EXECUTE**

KT&G's people generate performance through the prompt and efficient execution of the tasks by perceiving issues properly.

**O**

**OPTIMIZE**

KT&G's people communicate and cooperate with all stakeholders, remembering that KT&G is a company of 'us' rather than 'me'.

# ENVIRONMENTAL VALUE



## ENVIRONMENTAL MANAGEMENT STRATEGY

With countries around the world strengthening their environmental regulations, the careful management of environmental standards is becoming an important factor in corporate competitiveness. KT&G's integrated, systematic and pro-active environmental management is our response to this trend, and is helping to enhance our corporate value. We identify environmental factors throughout our business activities, and apply cutting-edge, eco-friendly technologies where needed, rather than merely respond to regulations.

## ENVIRONMENTAL MANAGEMENT SYSTEM

KT&G is expanding environmental management at the corporate-wide level based on its own environmental management system. Given that our businesses have fewer environmental issues than most other manufacturing companies, KT&G's environmental standards can be seen as an exemplar of preemptive environmental management.

KT&G breaks down its environmental management into four categories – eco-friendly factory management, emissions

management, employee environmental awareness, and external communications. Energy saving and environmental issues are monitored around the clock at every factory.

In addition, the Green Management Team has been created to focus on environmental management across the company, improve environmental management at each site, and reduce greenhouse gas emissions. The Team provides regular training on environmental issues to employees, to increase awareness about the environment.

## ENVIRONMENTAL MANAGEMENT ACTIVITIES

KT&G maintains strictly controls over the use of water resources, discharge of waste-water, and generation and release of other wastes, in order to minimize impacts on local communities and the ecosystem, and to make our sites as environmentally friendly as possible. We have installed water-saving facilities, and use recycled industrial or underground water. All water pollutants are kept to levels below legal requirements, and waste-water is treated by specialist outside companies. Waste from our sites is managed by establishing strict waste reduction plans. In 2015, we also established

As a citizen of the global community, we are protecting the environment and working toward making our planet a better place for a sustainable future worth living in.



a new factory emissions management system, to further strengthen our environmental management.

The 'Greenhouse Gas and Energy Target Management System' that went into effect in Korea in 2011 called for most manufacturing business sectors to respond immediately to climate change. Although KT&G is not on the government's list of companies mandated to comply with greenhouse gas and energy target requirements, we are still committed to saving energy, including through energy efficiency projects at our five factories in Korea, and by setting an example in countering climate change.

We implemented eleven energy-saving projects in 2015, to contribute to greenhouse gas reduction. The Gwangju Factory changed how it operates air compressors and air dryers, which resulted in an energy usage reduction of around 116,852 tons of oil equivalent, or 7% of its energy usage. This achievement earned a Minister of Trade, Industry & Energy commendation. Our Yeongju Factory reuses surplus steam from a nearby factory, resulting in an energy bill reduction of more than KRW 500 million per year. The Shintanjin Factory has its own Green Management Division, dedicated to energy saving and the environment.

### ECO-FRIENDLY FACTORY MANAGEMENT

Establishing clean factories through eco-friendly process management

### EMISSIONS MANAGEMENT

Systematically managing air, waste, water polluting materials and greenhouse gases

### EMPLOYEE ENVIRONMENTAL AWARENESS

Improving environmental awareness through training and environmental education

### EXTERNAL COMMUNICATIONS

Improving external environmental communications through detailed environmental performance management

# SOCIAL VALUE



**KRW 80.8 BILLION**  
Expenditures in CSR activities in 2015



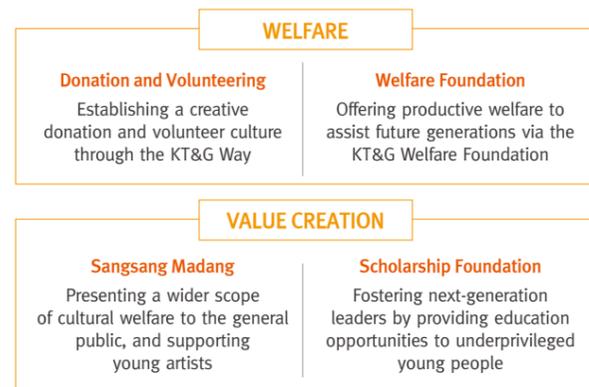
**1.8 MILLION PER YEAR**  
Number of people visiting Sangsang Madang



**1,200**  
Accumulated number of vehicles donated to social welfare institutions

## CSR DIRECTIONS

KT&G is proud to operate the ‘KT&G Way’, a creative and distinctive social contribution program that is based on KT&G’s unique capabilities and characteristics. The KT&G Way is based on ‘Sangsang’ (imagination), and is comprised of five categories – ‘Contributing to the Arts and Culture’, to support and create new culture; ‘Welfare Foundation’, to help the disadvantaged; ‘Scholarship Foundation’, to foster outstanding creative talent; ‘Volunteer Services’, to share our staff’s talents with others; and ‘Social Responsibility Activities’, to reflect the sense of responsibility that we have as a leading company in the tobacco industry.



## CSR HIGHLIGHTS

**Sangsang Fund** Launched in 2011, the Sangsang Fund has come to represent KT&G’s unique donation culture. Employees can participate voluntarily, and all their donations to non-profit organizations or institutions are matched by the company. In 2015, the Sangsang Fund was used to provide scholarships to students from low income families, make donations to Nepal after its devastating earthquake, and deliver winter supplies to people on low incomes.

**Donation Petition System** This system was created to make best use of donations to the Sangsang Fund. Through the donation petition system, donors make a range of choices about donations, including not just the items to be donated, but also the locations and methods. Any employee can make a suggestion on the company’s Intranet, and it is adopted if more than 200 staff members recommend the suggestion by posting a reply. Afterwards, an onsite assessment is carried out to make a final decision on the donation.

**Sangsang Volunteer** This volunteer groups is made up of university students eager to volunteer, and is supported by KT&G in 14 regions throughout Korea. The volunteers independently plan their activities, including helping out by

We are creating a better tomorrow for communities around the world by taking part in social contribution activities at home and abroad.



applying their relevant individual skills, supporting regional festivals, revitalizing traditional markets, and undertaking environmental clean-ups.

**Social Responsibility Activities** KT&G is committed to fulfilling the social responsibilities that come with our business. We have improved smoking rooms in public facilities, and undertaken smoking etiquette campaigns, to promote a culture of mutual respect between smokers and non-smokers. Our ‘Green Narae’ smoking prevention campaign for teenagers is contributing to the improved health of young people. In addition, since 2007, we have provided financial support to a medical institute that researches the causes, diagnosis and treatment of cancer.

**Support for Culture and the Arts** The ‘Sangsang Madang’ program was created to provide the general public with a greater number of opportunities to enjoy the arts and cultural experiences, and to support creative young artists. It has become Korea’s leading multi-purpose art and cultural space, with visitors totaling 1.8 million annually. It currently operates in three areas – Seoul, Nonsan, and Chuncheon. In addition, KT&G has opened the Sangsang Art Hall, a space for performances located in Seoul.

**KT&G Welfare Foundation** The KT&G Welfare Foundation was established in 2003, and carries out social welfare, volunteering, and Internet-based welfare projects. In October 2015, the Foundation delivered 100 vehicles to a social welfare institution – the total number of vehicles provided since 2004 has now reached 1,200. In December 2015, the Foundation supplied medical kits worth around KRW 400 million to people on low incomes through the ‘Happiness Network Welfare Center’, which provides customized welfare services to local communities. The Foundation also funds overseas medical support projects for those in need.

**Scholarship Foundation** The Scholarship Foundation was established in 2008, with an aim to support the education of outstanding students with limited educational opportunities, thus help them grow into future leaders. We choose students receiving ‘Sangsang Scholarship’ every year and, as well as providing financial support, we stay in close contact with them, so that we can offer a scholarship program with real sincerity and long-term benefits.

# FINANCIAL REVIEW

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## MANAGEMENT'S DISCUSSION & ANALYSIS

### 1. INTRODUCTION

KT&G Corporation was established on April 1st, 1987 as a manufacturer and seller of tobacco and tobacco products. The company has grown to be a global enterprise, exporting 100 brands to 50 countries around the world as of the end of 2015. KT&G has subsidiaries including Korea Ginseng Corp., Yungjin Pharmaceutical, KGC Life & Gin, and Somang Cosmetics. The company aims to accomplish balanced growth across a portfolio that has widened from tobacco and ginseng as our flagship businesses at home and abroad, to include bio businesses, and health & beauty.

KT&G's financial statements are reported according to Korean International Financial Reporting Standards (K-IFRS). They thus fulfill the requirements of the Korean government under the standards and guidelines released by the International Accounting Standards Board. KT&G's financial statements for 2015 refer to the period from January 1st to December 31st, 2015, and this Management Discussion & Analysis (MD&A) is based on spate financial statements of the company. It covers not only KT&G's past performance but also a current financial and business evaluation, the economic and industrial outlook, future business performance and business goals. The forecasts in this material are based on internal business environment analyses and market forecasts, including a wide range of uncertainties that are subject to change. These uncertainties could generate a significant difference between the forecasts herein and actual performance. The company therefore does not give any guarantee as to the accuracy and completeness of any forward-looking information herein.

**BUSINESS ENVIRONMENT** In 2015, major global economies improved steadily, thanks to continued recovery in the US and quantitative easing in the Eurozone and Japan. On the downside, however, there was slowing growth in China and a downswing in consumption and investments in emerging markets. The global economy grew by 3.1% in 2015, slightly less than in 2014. The Gross Domestic Product (GDP) growth rate in Korea in 2015 was 2.6%, down from the 3.3% recorded in 2014, mainly due to weakness in consumer activity because

of the concerns caused by the outbreak of Middle East Respiratory Syndrome (MERS) in the first half of the year, and sluggish exports throughout the year because of low oil prices.

Tobacco sales in major economies are falling as a result of increased taxes and stricter regulations. In contrast, sales continue to rise in emerging markets and underdeveloped countries. In Korea, however, demand was down substantially in 2015 due to the first big tax increase on cigarettes in a decade, leading to fiercer price competition and other difficult market conditions.

### 2. OPERATING PERFORMANCE

**SALES** In 2015, KT&G recorded KRW 2,822 billion in sales, up 2.9% year-on-year, despite falling domestic sales, thanks to growth in our overseas business.

The domestic tobacco business was affected by the major tobacco tax increase and aggressive pricing from competitors. KT&G sought to overcome this by improving the competitiveness of its strategic brands, launching distinctive products that reflect consumer preferences, and targeting high-priced products. As a result, sales in our domestic tobacco business in 2015 recorded KRW 1,927 billion.

In our overseas tobacco business, export volumes rose, driven by higher sales of ESSE Mini Slim and other products in our major markets such as the Middle East and Central Asia, helped by some improvements in the political and economic environment in those regions. Sales were also up in new markets such as Asia Pacific, Latin America, and India. Overall exports thus increased 27.8% year-on-year, to reach KRW 681 billion.

In the 'others' category, sales were KRW 214 billion, helped by active marketing, cost reductions, 100% sales at an apartment

#### SALES BY BUSINESS

|                            | 2015         | 2014         | Change (Amount) | Change (%) |
|----------------------------|--------------|--------------|-----------------|------------|
| Domestic Tobacco Business  | 1,927        | 1,967        | (40)            | (2.0)      |
| Overseas Tobacco Business  | 681          | 533          | 148             | 27.8       |
| Others (Real Estate, etc.) | 214          | 243          | (29)            | (11.9)     |
| <b>Total</b>               | <b>2,822</b> | <b>2,743</b> | <b>79</b>       | <b>2.9</b> |

(Unit: KRW billion)

**PROFIT AND LOSS** Total sales rose 2.9% year-on-year, but the cost of sales ratio fell by 5.3%p, from 38.8% in 2014 to 33.5% in 2015. As a result, gross profits increased by 11.7% to reach KRW 1,875 billion. Operating profit increased 17.3% to KRW 1,237 billion, mainly attributable to the increased gross

complex in Daegu, and the completion of our Andong project, despite difficult market conditions in leasing business.

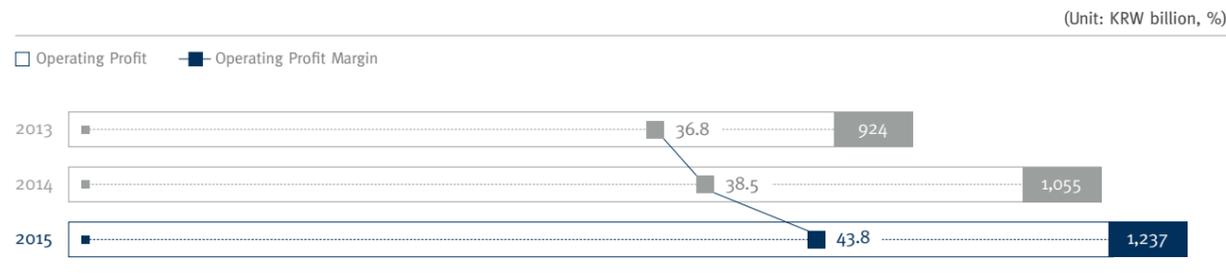
profits, despite SG&A expenses went up 2.2% due to higher retirement and employee benefits. Profit for the year increased by 32.3% year-on-year to KRW 988 billion, thanks to reduced impairment losses.

#### SUMMARIZED STATEMENTS OF INCOME

|                          | 2015  | 2014  | Change (Amount) | Change (%) |
|--------------------------|-------|-------|-----------------|------------|
| Sales                    | 2,822 | 2,743 | 79              | 2.9        |
| Gross Profit             | 1,875 | 1,679 | 196             | 11.7       |
| SG&A Expenses            | 638   | 624   | 14              | 2.2        |
| SG&A Expenses Ratio      | 22.6% | 22.7% |                 | (0.1)%p    |
| Operating Profit         | 1,237 | 1,055 | 182             | 17.3       |
| Operating Profit Margin  | 43.8% | 38.5% |                 | 5.3%p      |
| Profit before Income Tax | 1,319 | 1,045 | 274             | 26.2       |
| Profit for the Year      | 988   | 747   | 241             | 32.3       |

(Unit: KRW billion)

#### OPERATING PROFIT & OPERATING PROFIT MARGIN



Selling, general and administrative (SG&A) expenses went up 2.2% in 2015 to KRW 638 billion, due to increased retirement and employee benefits, despite decrease in advertising expenses and service fees. Salaries, advertising expenses,

and service fees accounted for 36.4%, 18.8%, and 12.2% respectively of SG&A expenses. Salaries rose 0.9% to KRW 232 billion, while advertising expenses and service fees fell by 9.8% and 2.5%, respectively, to KRW 120 billion and KRW 78 billion.

#### BREAKDOWN OF SELLING AND ADMINISTRATION EXPENSES

|                       | 2015       | 2014       | Change (%) | Portion (%)  |
|-----------------------|------------|------------|------------|--------------|
| Salaries              | 232        | 230        | 0.9        | 36.4         |
| Severance Benefits    | 34         | 22         | 54.5       | 5.3          |
| Employee Benefits     | 44         | 29         | 51.7       | 6.9          |
| Advertising           | 120        | 133        | (9.8)      | 18.8         |
| Service Fees          | 78         | 80         | (2.5)      | 12.2         |
| Depreciation Expenses | 33         | 32         | 3.1        | 5.2          |
| Other Expenses        | 97         | 98         | (1.0)      | 15.2         |
| <b>Total</b>          | <b>638</b> | <b>624</b> | <b>2.2</b> | <b>100.0</b> |

(Unit: KRW billion)

### 3. FINANCIAL STATUS

**ASSETS** As at end-2015, KT&G's total assets stood at KRW 7,449 billion, up 18.3% from the previous year-end. Current assets increased by 33.4% to KRW 3,979 billion. While inventory and current available-for-sale financial assets dropped 2.4% and 100%, respectively, other financial assets, prepaid tobacco excise and other taxes, and trade and other receivables grew by 70.6%, 71.7% and 30.3%, respectively. Non-current assets stood at KRW 3,470 billion, up 4.8% year-on-year, mainly attributable to increases in investments in subsidiaries and long-term deposits in MSA Escrow Fund, by 3.9% and 33.8%, respectively, despite decreases in investments in subsidiaries and long-term trade and other receivables, by 23.2% and 34.9%, respectively.

**LIABILITIES** As at end-2015, KT&G's total liabilities stood at KRW 1,553 billion, up 63.0% year-on-year, in which current liabilities were KRW 1,430 billion, up 81.9%. The increase in current liabilities was mainly attributable to increases in trade and other payables, income tax payable, and tobacco excise and other taxes payable of 24.9%, 26.8%, and 206.7%, respectively, despite a 9.4% decrease in short-term borrowings. Non-current liabilities fell 26.3% to KRW 123 billion, mainly attributable to decrease in long-term trade and other payables and net defined benefit liability of 71.2% and 37.3%, respectively.

#### SUMMARIZED STATEMENTS OF FINANCIAL POSITION

|                                   | 2015         | 2014         | Change (Amount) | Change (%)  |
|-----------------------------------|--------------|--------------|-----------------|-------------|
| <b>Total Assets</b>               | <b>7,449</b> | <b>6,295</b> | <b>1,154</b>    | <b>18.3</b> |
| Current Assets                    | 3,979        | 2,983        | 996             | 33.4        |
| Cash and Cash Equivalents         | 444          | 322          | 122             | 37.9        |
| Receivables                       | 819          | 728          | 91              | 12.5        |
| Others                            | 2,716        | 1,933        | 783             | 40.5        |
| Non-current Assets                | 3,470        | 3,312        | 158             | 4.8         |
| <b>Total Liabilities</b>          | <b>1,553</b> | <b>953</b>   | <b>600</b>      | <b>63.0</b> |
| Current Liabilities               | 1,430        | 786          | 644             | 81.9        |
| Non-current Liabilities           | 123          | 167          | (44)            | (26.3)      |
| <b>Total Shareholders' Equity</b> | <b>5,896</b> | <b>5,342</b> | <b>554</b>      | <b>10.4</b> |
| Debt-to-Equity Ratio (%)          | 26.3         | 17.8         |                 | 8.5%p       |
| ROA (%)                           | 13.3         | 11.9         |                 | 1.4%p       |
| ROE (%)                           | 16.8         | 14.0         |                 | 2.8%p       |

(Unit: KRW billion)

#### 4. CASH FLOWS

In 2015, cash and cash equivalents reached KRW 444 billion, up 37.9% year-on-year. Cash flows generated by operating activities rose 75.0% to KRW 1,316 billion. This was due to the increase in profits for the year, and the cash flow effect of tobacco excise and other taxes payable, resulting in cash inflows of KRW 988 billion and KRW 516 billion, respectively. Cash flows

from investing activities were minus KRW 765 billion, a 179.2% increase year-on-year, attributable to additional acquisition of property, plant and equipment, and other financial assets. Cash flows from financial activities were minus KRW 429 billion, with dividends paid being the most significant item.

##### SUMMARIZED STATEMENTS OF CASH FLOWS

|  | (Unit: KRW billion) |       |                 |            |
|--|---------------------|-------|-----------------|------------|
|  | 2015                | 2014  | Change (Amount) | Change (%) |
| Cash Flows from Operating Activities                   | 1,316               | 752   | 564             | 75.0       |
| Cash Flows from Investing Activities                   | (765)               | (274) | (491)           | 179.2      |
| Cash Flows from Financing Activities                   | (429)               | (402) | (27)            | 6.7        |
| Cash and Cash Equivalents at the Beginning of the Year | 322                 | 246   | 76              | 30.9       |
| Cash and Cash Equivalents at the End of the Year       | 444                 | 322   | 122             | 37.9       |

#### 5. DIVIDEND

The dividend per share for 2015 was KRW 3,400, and total dividend costs were KRW 428 billion.

|                          | 2015  | 2014  | 2013  |
|--------------------------|-------|-------|-------|
| Net Income (KRW billion) | 988   | 747   | 501   |
| Dividends (KRW billion)  | 428   | 428   | 403   |
| Dividend per Share (KRW) | 3,400 | 3,400 | 3,200 |

#### 6. 2016 OUTLOOK

The global economy is forecast to continue to grow slowly in 2016 due to interest rate increases in the US and slow growth in China and emerging markets. The Korean economy will likely see growth of no more than 3.0%, because of a continued slowdown in exports and weak domestic demand. The domestic tobacco market will continue to be difficult, with the full launch of new comprehensive regulations, and our non-tobacco business will face challenges as well.

In these times of uncertainties and challenges, KT&G will make intensive efforts to implement diverse growth strategies and improve profitability by responding flexibly to changes in the internal and external business environments. We will

retain our leading positions in the domestic tobacco and red ginseng businesses, while expanding market dominance in real estate business. Furthermore, we will focus on building a truly global KT&G by entering more overseas markets. Our strengths throughout diversified businesses coupled with active investments in new business areas within the Group will enable us to achieve future growth.

KT&G will continue to drive innovation and implement our strategy more effectively, all in our efforts to enhance shareholder value, going beyond your expectations.

## INDEPENDENT AUDITORS' REPORT

### THE BOARD OF DIRECTORS AND SHAREHOLDERS KT&G CORPORATION:

We have audited the accompanying consolidated financial statements of KT&G Corporation (the "Parent Company") and its subsidiaries (collectively the "Group") which comprise the consolidated statement of financial position as of December 31, 2015, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

#### MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Korean International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Korean Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2015 and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Korea International Financial Reporting Standards.

#### OTHER MATTERS

The accompanying statement of financial position of the Group as of December 31, 2014, and the related statements of comprehensive income, changes in equity and cash flows for the year then ended, were audited by other auditors, whose report thereon dated February 5, 2015, expressed an unqualified opinion in accordance with the previous auditing standards generally accepted in the Republic of Korea.

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

The accompanying consolidated financial statements as of and for the year ended December 31, 2015 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 audited the translation and, in our opinion, the consolidated financial statements expressed in Korean won have been translated into dollars on the basis set forth in note 5 to the consolidated financial statements.

*KPMG Samjong Accounting Corp.*

KPMG Samjong Accounting Corp.  
Seoul, Korea  
February 25, 2016

This report is effective as of February 25, 2016, the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying financial statements and notes thereto. Accordingly, the readers of the audit report should understand that the above audit report has not been updated to reflect the impact of such subsequent events or circumstances, if any.

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

KT&G Corporation and Subsidiaries

(In millions of won and thousands of U.S. dollars)

| As of December 31, 2015 and 2014            | 2015<br>Korean won | 2015<br>U.S. dollars | 2014<br>Korean won |
|---|--------------------|----------------------|--------------------|
| <b>Assets</b>                               |                    |                      |                    |
| Property, plant and equipment               | ₩ 1,789,779        | \$ 1,527,115         | ₩ 1,753,412        |
| Intangible assets                           | 105,428            | 89,956               | 154,937            |
| Investment property                         | 164,489            | 140,349              | 167,968            |
| Investments in associates                   | 51,521             | 43,959               | 57,903             |
| Available-for-sale financial assets         | 364,681            | 311,161              | 325,833            |
| Other financial assets                      | 12                 | 10                   | 259                |
| Long-term deposits in MSA Escrow Fund       | 403,966            | 344,681              | 301,808            |
| Long-term advance payments                  | 107,723            | 91,914               | 127,855            |
| Long-term prepaid expenses                  | 7,128              | 6,082                | 4,625              |
| Long-term trade and other receivables       | 75,071             | 64,054               | 86,735             |
| Deferred income tax assets                  | 32,696             | 27,898               | 28,725             |
| <b>Total non-current assets</b>             | <b>3,102,494</b>   | <b>2,647,179</b>     | <b>3,010,060</b>   |
| Inventories                                 | 2,119,114          | 1,808,118            | 1,982,503          |
| Current available-for-sale financial assets | -                  | -                    | 1,000              |
| Current other financial assets              | 1,136,906          | 970,056              | 668,436            |
| Prepaid tobacco excise and other taxes      | 447,771            | 382,057              | 260,773            |
| Trade and other receivables                 | 1,217,938          | 1,039,196            | 989,777            |
| Advance payments                            | 75,710             | 64,599               | 68,491             |
| Prepaid expenses                            | 20,519             | 17,508               | 20,802             |
| Cash and cash equivalents                   | 546,213            | 466,052              | 416,394            |
| <b>Total current assets</b>                 | <b>5,564,171</b>   | <b>4,747,586</b>     | <b>4,408,176</b>   |
| Non-current assets held for sale            | 6,692              | 5,710                | 426                |
| <b>Total assets</b>                         | <b>₩ 8,673,357</b> | <b>\$ 7,400,475</b>  | <b>₩ 7,418,662</b> |

(In millions of won and thousands of U.S. dollars)

| As of December 31, 2015 and 2014                   | 2015<br>Korean won | 2015<br>U.S. dollars | 2014<br>Korean won |
|--|--------------------|----------------------|--------------------|
| <b>Equity</b>                                      |                    |                      |                    |
| Ordinary shares                                    | ₩ 954,959          | \$ 814,812           | ₩ 954,959          |
| Other capital surplus                              | (9,928)            | (8,471)              | (4,573)            |
| Treasury shares                                    | (337,062)          | (287,596)            | (339,059)          |
| Gain on reissuance of treasury shares              | 494,648            | 422,055              | 492,032            |
| Reserve  | 3,704,315          | 3,160,679            | 3,426,367          |
| Retained earnings                                  | 1,401,975          | 1,196,224            | 1,100,876          |
| <b>Equity attributable to owners of the parent</b> | <b>6,208,907</b>   | <b>5,297,703</b>     | <b>5,630,602</b>   |
| <b>Non-controlling interests</b>                   | <b>66,592</b>      | <b>56,819</b>        | <b>77,478</b>      |
| <b>Total equity</b>                                | <b>6,275,499</b>   | <b>5,354,522</b>     | <b>5,708,080</b>   |
| <b>Liabilities</b>                                 |                    |                      |                    |
| Long-term borrowings                               | 102,242            | 87,237               | 137,795            |
| Long-term trade and other payables                 | 13,647             | 11,644               | 32,244             |
| Long-term advance receipts                         | 10,390             | 8,865                | 14,587             |
| Net defined benefit liability                      | 120,648            | 102,942              | 132,247            |
| Provision  | 2,765              | 2,360                | 2,871              |
| Deferred income tax liabilities                    | 276,472            | 235,898              | 266,282            |
| <b>Total non-current liabilities</b>               | <b>526,164</b>     | <b>448,946</b>       | <b>586,026</b>     |
| Short-term borrowings                              | 206,373            | 176,086              | 141,861            |
| Current portion of long-term borrowings            | 27,659             | 23,600               | 1,218              |
| Trade and other payables                           | 606,355            | 517,367              | 503,853            |
| Advance receipts                                   | 28,650             | 24,445               | 37,533             |
| Income tax payable                                 | 224,836            | 191,839              | 180,809            |
| Tobacco excise and other taxes payable             | 777,821            | 663,670              | 259,282            |
| <b>Total current liabilities</b>                   | <b>1,871,694</b>   | <b>1,597,007</b>     | <b>1,124,556</b>   |
| <b>Total liabilities</b>                           | <b>2,397,858</b>   | <b>2,045,953</b>     | <b>1,710,582</b>   |
| <b>Total equity and liabilities</b>                | <b>₩ 8,673,357</b> | <b>\$ 7,400,475</b>  | <b>₩ 7,418,662</b> |

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

KT&G Corporation and Subsidiaries

(In millions of won and thousands of U.S. dollars, except earnings per share)

| For the years ended December 31, 2015 and 2014  | 2015               |                   | 2014             |
|---|--------------------|-------------------|------------------|
|   | Korean won         | U.S. dollars      | Korean won       |
| Sales   | ₩ 4,169,839        | \$ 3,557,883      | ₩ 4,112,855      |
| Cost of sales   | (1,630,601)        | (1,391,298)       | (1,840,819)      |
| <b>Gross profit</b>   | <b>2,539,238</b>   | <b>2,166,585</b>  | <b>2,272,036</b> |
| Selling, general and administrative expenses  | (1,173,334)        | (1,001,138)       | (1,100,174)      |
| <b>Operating profit</b>   | <b>1,365,904</b>   | <b>1,165,447</b>  | <b>1,171,862</b> |
| Other income  | 118,752            | 101,325           | 90,432           |
| Other expenses  | (160,161)          | (136,657)         | (151,767)        |
| Net finance income  | 74,762             | 63,790            | 44,139           |
| Share of gain of associates   | 15,137             | 12,916            | 3,245            |
| <b>Profit before income tax</b>   | <b>1,414,394</b>   | <b>1,206,821</b>  | <b>1,157,911</b> |
| Income tax expense  | (382,174)          | (326,087)         | (344,110)        |
| <b>Profit for the year</b>  | <b>₩ 1,032,220</b> | <b>\$ 880,734</b> | <b>₩ 813,801</b> |
| <b>Other comprehensive income (loss):</b>   |                    |                   |                  |
| <b>Items that are or may be reclassified subsequently to profit or loss</b>             |                    |                   |                  |
| Unrealized net changes in fair value of available-for-sale financial assets, net of tax | ₩ (16,076)         | \$ (13,716)       | ₩ (8,733)        |
| Exchange differences on translating foreign operations, net of tax                      | (14,770)           | (12,602)          | (37,993)         |
| <b>Items that will never be reclassified to profit or loss</b>                          |                    |                   |                  |
| Remeasurements of net defined benefit liability, net of tax                             | 38                 | 31                | (21,655)         |
| <b>Other comprehensive loss for the year, net of tax</b>                                | <b>(30,808)</b>    | <b>(26,287)</b>   | <b>(68,381)</b>  |
| <b>Total comprehensive income for the year</b>  | <b>₩ 1,001,412</b> | <b>\$ 854,447</b> | <b>₩ 745,420</b> |
| <b>Profit attributable to:</b>  |                    |                   |                  |
| Owners of the Parent Company  | ₩ 1,035,717        | \$ 883,718        | ₩ 825,606        |
| Non-controlling interests   | (3,497)            | (2,984)           | (11,805)         |
|   | ₩ 1,032,220        | \$ 880,734        | ₩ 813,801        |
| <b>Total comprehensive income attributable to:</b>                                      |                    |                   |                  |
| Owners of the Parent Company  | ₩ 1,007,103        | \$ 859,303        | ₩ 758,529        |
| Non-controlling interests   | (5,691)            | (4,856)           | (13,109)         |
|   | ₩ 1,001,412        | \$ 854,447        | ₩ 745,420        |
| <b>Earnings per share in won and U.S. dollars:</b>                                      |                    |                   |                  |
| Basic and diluted   | ₩ 8,222            | \$ 7.02           | ₩ 6,558          |

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

KT&G Corporation and Subsidiaries

(In millions of won)

| For the year ended<br>December 31, 2015   | Ordinary<br>shares | Other<br>capital<br>surplus | Treasury<br>shares | Gain on<br>reissuance<br>of treasury<br>shares | Reserve          | Retained<br>earnings | Owners of<br>the parent | Non-<br>controlling<br>interests | Total<br>equity  |
|---|--------------------|-----------------------------|--------------------|--|------------------|----------------------|-------------------------|----------------------------------|------------------|
| <b>Balance at January 1, 2015</b>   | ₩ 954,959          | (4,573)                     | (339,059)          | 492,032  | 3,426,367        | 1,100,876            | 5,630,602               | 77,478                           | 5,708,080        |
| <b>Total comprehensive income for the year:</b>   |                    |                             |                    |  |                  |                      |                         |                                  |                  |
| Profit (loss) for the year  | -                  | -                           | -                  | -  | -                | 1,035,717            | 1,035,717               | (3,497)                          | 1,032,220        |
| <b>Other comprehensive income (loss):</b>   |                    |                             |                    |  |                  |                      |                         |                                  |                  |
| Unrealized net changes in fair value of available-for-sale financial assets, net of tax | -                  | -                           | -                  | -  | (16,076)         | -                    | (16,076)                | -                                | (16,076)         |
| Exchange differences on translating foreign operations, net of tax                      | -                  | -                           | -                  | -  | (14,380)         | -                    | (14,380)                | (390)                            | (14,770)         |
| Remeasurements of net defined benefit liability, net of tax                             | -                  | -                           | -                  | -  | -                | 1,842                | 1,842                   | (1,804)                          | 38               |
| <b>Total other comprehensive income (loss)</b>  | <b>-</b>           | <b>-</b>                    | <b>-</b>           | <b>-</b>                                       | <b>(30,456)</b>  | <b>1,842</b>         | <b>(28,614)</b>         | <b>(2,194)</b>                   | <b>(30,808)</b>  |
| <b>Total comprehensive income (loss) for the year</b>                                   | <b>-</b>           | <b>-</b>                    | <b>-</b>           | <b>-</b>                                       | <b>(30,456)</b>  | <b>1,037,559</b>     | <b>1,007,103</b>        | <b>(5,691)</b>                   | <b>1,001,412</b> |
| <b>Transactions with owners, recorded directly in equity:</b>                           |                    |                             |                    |  |                  |                      |                         |                                  |                  |
| 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  | -                  | (5,483)                     | -                  | -  | -                | -                    | (5,483)                 | (5,390)                          | (10,873)         |
| Paid-in capital increase of subsidiary  | -                  | 128                         | -                  | -  | -                | -                    | 128                     | 117                              | 245              |
| Others  | -                  | -                           | -                  | -  | -                | -                    | -                       | 78                               | 78               |
| <b>Total transactions with owners</b>   | <b>-</b>           | <b>(5,355)</b>              | <b>1,997</b>       | <b>2,616</b>                                   | <b>308,404</b>   | <b>(736,460)</b>     | <b>(428,798)</b>        | <b>(5,195)</b>                   | <b>(433,993)</b> |
| <b>Balance at December 31, 2015</b>   | <b>₩ 954,959</b>   | <b>(9,928)</b>              | <b>(337,062)</b>   | <b>494,648</b>                                 | <b>3,704,315</b> | <b>1,401,975</b>     | <b>6,208,907</b>        | <b>66,592</b>                    | <b>6,275,499</b> |

(In thousands of U.S. dollars)

| For the year ended<br>December 31, 2015   | Ordinary<br>shares | Other<br>capital<br>surplus | Treasury<br>shares | Gain on<br>reissuance<br>of treasury<br>shares | Reserve   | Retained<br>earnings | Owners of<br>the parent | Non-<br>controlling<br>interests | Total<br>equity |
|---|--------------------|-----------------------------|--------------------|--|-----------|----------------------|-------------------------|----------------------------------|-----------------|
| <b>Balance at January 1, 2015</b>   | \$ 814,812         | (3,902)                     | (289,299)          | 419,823  | 2,923,521 | 939,314              | 4,804,269               | 66,107                           | 4,870,376       |
| <b>Total comprehensive income for the year:</b>   |                    |                             |                    |  |           |                      |                         |                                  |                 |
| Profit (loss) for the year  | -                  | -                           | -                  | -  | -         | 883,718              | 883,718                 | (2,984)                          | 880,734         |
| <b>Other comprehensive income (loss):</b>   |                    |                             |                    |  |           |                      |                         |                                  |                 |
| Unrealized net changes in fair value of available-for-sale financial assets, net of tax | -                  | -                           | -                  | -  | (13,716)  | -                    | (13,716)                | -                                | (13,716)        |
| Exchange differences on translating foreign operations, net of tax                      | -                  | -                           | -                  | -  | (12,270)  | -                    | (12,270)                | (332)                            | (12,602)        |
| Remeasurements of net defined benefit liability, net of tax                             | -                  | -                           | -                  | -  | -         | 1,571                | 1,571                   | (1,540)                          | 31              |
| <b>Total other comprehensive income (loss)</b>  | -                  | -                           | -                  | -  | (25,986)  | 1,571                | (24,415)                | (1,872)                          | (26,287)        |
| <b>Total comprehensive income (loss) for the year</b>                                   | -                  | -                           | -                  | -  | (25,986)  | 885,289              | 859,303                 | (4,856)                          | 854,447         |
| <b>Transactions with owners, recorded directly in equity:</b>                           |                    |                             |                    |  |           |                      |                         |                                  |                 |
| Dividends   | -                  | -                           | -                  | -  | -         | (365,235)            | (365,235)               | -                                | (365,235)       |
| In-kind donation of treasury shares   | -                  | -                           | 1,703              | 2,232  | -         | -                    | 3,935                   | -                                | 3,935           |
| Transfer from reserve for research and human resource development                       | -                  | -                           | -                  | -  | (10,684)  | 10,684               | -                       | -                                | -               |
| Transfer to unconditional reserve   | -                  | -                           | -                  | -  | 273,828   | (273,828)            | -                       | -                                | -               |
| Extinguishment of equity conversion option  | -                  | (4,678)                     | -                  | -  | -         | -                    | (4,678)                 | (4,599)                          | (9,277)         |
| Paid-in capital increase of subsidiary  | -                  | 109                         | -                  | -  | -         | -                    | 109                     | 100                              | 209             |
| Others  | -                  | -                           | -                  | -  | -         | -                    | -                       | 67                               | 67              |
| <b>Total transactions with owners</b>   | -                  | (4,569)                     | 1,703              | 2,232  | 263,144   | (628,379)            | (365,869)               | (4,432)                          | (370,301)       |
| <b>Balance at December 31, 2015</b>   | \$ 814,812         | (8,471)                     | (287,596)          | 422,055  | 3,160,679 | 1,196,224            | 5,297,703               | 56,819                           | 5,354,522       |

(In millions of won)

| For the year ended<br>December 31, 2014   | Ordinary<br>shares | Other<br>capital<br>surplus | Treasury<br>shares | Gain on<br>eissuance<br>of treasury<br>shares | Reserve   | Retained<br>earnings | Owners of<br>the parent | Non-<br>controlling<br>interests | Total<br>equity |
|---|--------------------|-----------------------------|--------------------|---|-----------|----------------------|-------------------------|----------------------------------|-----------------|
| <b>Balance at January 1, 2014</b>   | ₩ 954,959          | (4,573)                     | (339,059)          | 492,032                                       | 3,368,835 | 802,755              | 5,274,949               | 90,531                           | 5,365,480       |
| <b>Total comprehensive income for the year:</b>   |                    |                             |                    |   |           |                      |                         |                                  |                 |
| Profit (loss) for the year  | -                  | -                           | -                  | -   | -         | 825,606              | 825,606                 | (11,805)                         | 813,801         |
| <b>Other comprehensive income (loss):</b>   |                    |                             |                    |   |           |                      |                         |                                  |                 |
| Unrealized net changes in fair value of available-for-sale financial assets, net of tax | -                  | -                           | -                  | -   | (8,733)   | -                    | (8,733)                 | -                                | (8,733)         |
| Exchange differences on translating foreign operations, net of tax                      | -                  | -                           | -                  | -   | (38,257)  | -                    | (38,257)                | 264                              | (37,993)        |
| Remeasurements of net defined benefit liability, net of tax                             | -                  | -                           | -                  | -   | -         | (20,087)             | (20,087)                | (1,568)                          | (21,655)        |
| <b>Total other comprehensive loss</b>   | -                  | -                           | -                  | -   | (46,990)  | (20,087)             | (67,077)                | (1,304)                          | (68,381)        |
| <b>Total comprehensive income (loss) for the year</b>                                   | -                  | -                           | -                  | -   | (46,990)  | 805,519              | 758,529                 | (13,109)                         | 745,420         |
| <b>Transactions with owners, recorded directly in equity:</b>                           |                    |                             |                    |   |           |                      |                         |                                  |                 |
| Dividends   | -                  | -                           | -                  | -   | -         | (402,876)            | (402,876)               | -                                | (402,876)       |
| Transfer from reserve for research and human resource development                       | -                  | -                           | -                  | -   | (47,478)  | 47,478               | -                       | -                                | -               |
| Transfer to unconditional reserve   | -                  | -                           | -                  | -   | 152,000   | (152,000)            | -                       | -                                | -               |
| Others  | -                  | -                           | -                  | -   | -         | -                    | -                       | 56                               | 56              |
| <b>Total transactions with owners</b>   | -                  | -                           | -                  | -   | 104,522   | (507,398)            | (402,876)               | 56                               | (402,820)       |
| <b>Balance at December 31, 2014</b>   | ₩ 954,959          | (4,573)                     | (339,059)          | 492,032                                       | 3,426,367 | 1,100,876            | 5,630,602               | 77,478                           | 5,708,080       |

## CONSOLIDATED STATEMENTS OF CASH FLOWS

KT&G Corporation and Subsidiaries

(In millions of won and thousands of U.S. dollars)

| For the years ended December 31, 2015 and 2014                      | 2015<br>Korean won | 2015<br>U.S. dollars | 2014<br>Korean won |
|---|--------------------|----------------------|--------------------|
| <b>Cash flows from operating activities</b>                         |                    |                      |                    |
| Cash generated from operations                                      | ₩ 1,585,600        | \$ 1,352,901         | ₩ 1,059,122        |
| Income tax paid   | (326,365)          | (278,468)            | (293,934)          |
| <b>Net cash provided by operating activities</b>                    | <b>1,259,235</b>   | <b>1,074,433</b>     | <b>765,188</b>     |
| <b>Cash flows from investing activities</b>                         |                    |                      |                    |
| Interest received   | 30,173             | 25,745               | 32,087             |
| Interest income received from long-term deposits in MSA Escrow Fund | 1,486              | 1,268                | 1,346              |
| Dividends received  | 19,196             | 16,379               | 20,259             |
| Proceeds from sale of property, plant and equipment                 | 10,314             | 8,800                | 11,480             |
| Proceeds from sale of intangible assets                             | 2,878              | 2,455                | 218                |
| Proceeds from sale of non-current assets held for sale              | 4,260              | 3,635                | 63                 |
| Proceeds from sale of available-for-sale financial assets           | 233                | 199                  | 14,515             |
| Proceeds from sale of equity accounted investments                  | 13,625             | 11,625               | -                  |
| Collection of loans   | 11,866             | 10,124               | 13,446             |
| Withdrawal of guarantee deposits                                    | 28,425             | 24,253               | 27,392             |
| Settlement of derivatives, net                                      | 4                  | 4                    | -                  |
| Acquisition of property, plant and equipment                        | (210,247)          | (179,392)            | (330,395)          |
| Acquisition of intangible assets                                    | (6,076)            | (5,184)              | (2,094)            |
| Acquisition of investment property                                  | (64)               | (55)                 | (248)              |
| Acquisition of available-for-sale financial assets                  | (34,200)           | (29,181)             | (53,592)           |
| Increase in loans   | (51,336)           | (43,802)             | (360)              |
| Payments of guarantee deposits                                      | (21,437)           | (18,291)             | (24,185)           |
| Payments of long-term deposits in MSA Escrow Fund                   | (78,492)           | (66,973)             | (70,094)           |
| Decrease (increase) in other financial assets, net                  | (468,183)          | (399,473)            | 17,281             |
| <b>Net cash used in investing activities</b>                        | <b>(747,575)</b>   | <b>(637,864)</b>     | <b>(342,881)</b>   |

(In millions of won and thousands of U.S. dollars)

| For the years ended December 31, 2015 and 2014          | 2015<br>Korean won | 2015<br>U.S. dollars | 2014<br>Korean won |
|---|--------------------|----------------------|--------------------|
| <b>Cash flows from financing activities</b>             |                    |                      |                    |
| Interest paid   | ₩ (6,946)          | \$ (5,927)           | ₩ (3,221)          |
| Paid-in capital increase of subsidiary                  | 245                | 209                  | -                  |
| Payments of capital share issue cost                    | (249)              | (213)                | -                  |
| Dividends paid  | (428,056)          | (365,235)            | (402,876)          |
| Proceeds from borrowings                                | 702,040            | 599,010              | 302,078            |
| Increase in deposits received                           | 3,191              | 2,722                | 4,113              |
| Redemption of borrowings                                | (646,030)          | (551,220)            | (251,296)          |
| Decrease in deposits received                           | (5,157)            | (4,400)              | (2,559)            |
| <b>Net cash used in financing activities</b>            | <b>(380,962)</b>   | <b>(325,054)</b>     | <b>(353,761)</b>   |
| <b>Effect of exchange rate fluctuation on cash held</b> | <b>(879)</b>       | <b>(748)</b>         | <b>(85)</b>        |
| <b>Net increase in cash and cash equivalents</b>        | <b>129,819</b>     | <b>110,767</b>       | <b>68,461</b>      |
| Cash and cash equivalents at January 1                  | 416,394            | 355,285              | 347,933            |
| <b>Cash and cash equivalents at December 31</b>         | <b>₩ 546,213</b>   | <b>\$ 466,052</b>    | <b>₩ 416,394</b>   |

## INDEPENDENT AUDITORS' REPORT

### THE BOARD OF DIRECTORS AND SHAREHOLDERS KT&G CORPORATION:

#### REPORT ON THE SEPARATE FINANCIAL STATEMENTS

We have audited the accompanying separate financial statements of KT&G Corporation (the "Company"), expressed in Korean won, which comprise the separate statement of financial position as of December 31, 2015, and the separate statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

#### MANAGEMENT'S RESPONSIBILITY FOR THE SEPARATE FINANCIAL STATEMENTS

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

#### AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these separate financial statements based on our audit. We conducted our audit in accordance with Korean Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the separate financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the separate financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the separate financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the separate financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

#### OPINION

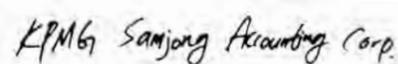
In our opinion, the separate financial statements present fairly, in all material respects, the separate financial position of the Company as at December 31, 2015 and of its separate financial performance and its separate cash flows for the years then ended in accordance with K-IFRS.

#### OTHER MATTERS

The accompanying separate statement of financial position of the Company as of December 31, 2014, and the related separate statements of comprehensive income, changes in equity and cash flows for the year then ended, were audited by other auditors, whose report thereon dated February 5, 2015, expressed an unqualified opinion.

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

The accompanying separate financial statements as of and for the year ended December 31, 2015 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 audited the translation and, in our opinion, the separate financial statements expressed in Korean won have been translated into dollars on the basis set forth in note 5 to the separate financial statements.



KPMG Samjong Accounting Corp.  
Seoul, Korea  
February 25, 2016

This report is effective as of February 25, 2016, the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying separate financial statements and notes thereto. Accordingly, the readers of the audit report should understand that the above audit report has not been updated to reflect the impact of such subsequent events or circumstances, if any.

## SEPARATE STATEMENTS OF FINANCIAL POSITION

KT&G CORPORATION

(In millions of won and thousands of U.S. dollars)

| As of December 31, 2015 and 2014            | 2015<br>Korean won | 2015<br>U.S. dollars | 2014<br>Korean won |
|---|--------------------|----------------------|--------------------|
| <b>Assets</b>                               |                    |                      |                    |
| Property, plant and equipment               | ₩ 1,309,632        | \$ 1,117,433         | ₩ 1,279,660        |
| Intangible assets                           | 22,494             | 19,193               | 19,636             |
| Investment property                         | 136,801            | 116,724              | 140,141            |
| Investments in associates                   | 46,230             | 39,445               | 60,225             |
| Investments in subsidiaries                 | 1,124,446          | 959,425              | 1,081,840          |
| Available-for-sale financial assets         | 340,149            | 290,230              | 303,438            |
| Long-term deposits in MSA Escrow Fund       | 403,966            | 344,681              | 301,808            |
| Long-term prepaid expenses                  | 6,706              | 5,723                | 4,160              |
| Long-term trade and other receivables       | 78,600             | 67,065               | 120,702            |
| <b>Total non-current assets</b>             | <b>3,469,024</b>   | <b>2,959,919</b>     | <b>3,311,610</b>   |
| Inventories                                 | 889,035            | 758,562              | 910,438            |
| Current available-for-sale financial assets | -                  | -                    | 1,000              |
| Other financial assets                      | 1,091,976          | 931,720              | 640,000            |
| Prepaid tobacco excise and other taxes      | 447,771            | 382,057              | 260,773            |
| Trade and other receivables                 | 1,074,862          | 917,118              | 824,948            |
| Advance payments                            | 26,489             | 22,601               | 20,233             |
| Prepaid expenses                            | 4,152              | 3,543                | 3,922              |
| Cash and cash equivalents                   | 444,376            | 379,160              | 321,562            |
| <b>Total current assets</b>                 | <b>3,978,661</b>   | <b>3,394,761</b>     | <b>2,982,876</b>   |
| Not-current assets held for sale            | 1,542              | 1,316                | 426                |
| <b>Total assets</b>                         | <b>₩ 7,449,227</b> | <b>\$ 6,355,996</b>  | <b>₩ 6,294,912</b> |

## SEPARATE STATEMENTS OF COMPREHENSIVE INCOME

KT&G CORPORATION

(In millions of won and thousands of U.S. dollars)

| As of December 31, 2015 and 2014       | 2015<br>Korean won | 2015<br>U.S. dollars | 2014<br>Korean won |
|--|--------------------|----------------------|--------------------|
| <b>Equity</b>                          |                    |                      |                    |
| Ordinary shares                        | ₩ 954,959          | \$ 814,812           | ₩ 954,959          |
| Other capital surplus                  | 3,582              | 3,056                | 3,582              |
| Treasury shares                        | (337,062)          | (287,595)            | (339,059)          |
| Gain on reissuance of treasury shares  | 494,648            | 422,055              | 492,032            |
| Reserves                               | 3,784,467          | 3,229,067            | 3,493,758          |
| Retained earnings                      | 995,886            | 849,733              | 736,460            |
| <b>Total equity</b>                    | <b>5,896,480</b>   | <b>5,031,128</b>     | <b>5,341,732</b>   |
| <b>Liabilities</b>                     |                    |                      |                    |
| Long-term trade and other payables     | 8,147              | 6,951                | 28,310             |
| Long-term advance receipts             | 491                | 419                  | 2,344              |
| Net defined benefit liability          | 42,174             | 35,985               | 67,260             |
| Deferred income tax liabilities        | 72,179             | 61,586               | 69,196             |
| <b>Total non-current liabilities</b>   | <b>122,991</b>     | <b>104,941</b>       | <b>167,110</b>     |
| Short-term borrowings                  | 5,031              | 4,292                | 5,552              |
| Trade and other payables               | 433,824            | 370,157              | 347,240            |
| Advance receipts                       | 26,024             | 22,205               | 26,245             |
| Income tax payable                     | 199,767            | 170,450              | 157,545            |
| Tobacco excise and other taxes payable | 765,110            | 652,823              | 249,488            |
| <b>Total current liabilities</b>       | <b>1,429,756</b>   | <b>1,219,927</b>     | <b>786,070</b>     |
| <b>Total liabilities</b>               | <b>1,552,747</b>   | <b>1,324,868</b>     | <b>953,180</b>     |
| <b>Total equity and liabilities</b>    | <b>₩ 7,449,227</b> | <b>\$ 6,355,996</b>  | <b>₩ 6,294,912</b> |

(In millions of won and thousands of U.S. dollars, except earnings per share)

| For the years ended December 31, 2015 and 2014  | 2015<br>Korean won | 2015<br>U.S. dollars | 2014<br>Korean won |
|---|--------------------|----------------------|--------------------|
| <b>Sales:</b>   |                    |                      |                    |
| Manufacture of tobacco  | ₩ 2,607,650        | \$ 2,224,957         | ₩ 2,499,986        |
| Real estate   | 142,847            | 121,883              | 160,342            |
| Exports of leaf tobacco and others  | 71,175             | 60,729               | 82,233             |
|   | 2,821,672          | 2,407,569            | 2,742,561          |
| <b>Cost of sales:</b>   |                    |                      |                    |
| Manufacture of tobacco  | (813,639)          | (694,231)            | (914,356)          |
| Real estate   | (84,915)           | (72,453)             | (96,076)           |
| Exports of leaf tobacco and others  | (48,091)           | (41,033)             | (53,362)           |
|   | (946,645)          | (807,717)            | (1,063,794)        |
| <b>Gross profit</b>   | <b>1,875,027</b>   | <b>1,599,852</b>     | <b>1,678,767</b>   |
| Selling, general and administrative expenses  | (637,709)          | (544,120)            | (624,212)          |
| <b>Operating profit</b>   | <b>1,237,318</b>   | <b>1,055,732</b>     | <b>1,054,555</b>   |
| Other income  | 104,453            | 89,124               | 71,897             |
| Other expenses  | (103,360)          | (88,191)             | (157,307)          |
| Finance income  | 81,917             | 69,895               | 77,139             |
| Finance costs   | (888)              | (758)                | (830)              |
| Net finance income  | 81,029             | 69,137               | 76,309             |
| <b>Profit before income tax</b>   | <b>1,319,440</b>   | <b>1,125,802</b>     | <b>1,045,454</b>   |
| Income tax expense  | (331,516)          | (282,863)            | (298,400)          |
| <b>Profit for the year</b>  | <b>₩ 987,924</b>   | <b>\$ 842,939</b>    | <b>₩ 747,054</b>   |
| <b>Other comprehensive income (loss):</b>   |                    |                      |                    |
| <b>Items that will not be reclassified to profit or loss</b>                            |                    |                      |                    |
| Remeasurements of net defined benefit liability, net of tax                             | ₩ 7,962            | \$ 6,794             | ₩ (13,016)         |
| <b>Items that are or may be reclassified subsequently to profit or loss</b>             |                    |                      |                    |
| Unrealized net changes in fair value of available-for-sale financial assets, net of tax | (17,695)           | (15,099)             | (21,863)           |
| <b>Other comprehensive loss for the year, net of tax</b>                                | <b>(9,733)</b>     | <b>(8,305)</b>       | <b>(34,879)</b>    |
| <b>Total comprehensive income for the year</b>  | <b>₩ 978,191</b>   | <b>\$ 834,634</b>    | <b>₩ 712,175</b>   |
| <b>Earnings per share in won and U.S. dollars:</b>                                      |                    |                      |                    |
| Basic and diluted   | ₩ 7,843            | \$ 6.69              | ₩ 5,934            |

## SEPARATE STATEMENTS OF CHANGES IN EQUITY

/

KT&G CORPORATION

(In millions of won)

| For the year ended December 31, 2015  | Ordinary shares | Other capital surplus | Treasury shares | Gain on reissuance of treasury shares | Reserves  | Retained earnings | Total equity |
|---|-----------------|-----------------------|-----------------|---------------------------------------|-----------|-------------------|--------------|
| Balance at January 1, 2015  | ₩ 954,959       | 3,582                 | (339,059)       | 492,032                               | 3,493,758 | 736,460           | 5,341,732    |
| <b>Total comprehensive income for the year:</b>   |                 |                       |                 |                                       |           |                   |              |
| Profit for the year   | -               | -                     | -               | -                                     | -         | 987,924           | 987,924      |
| <b>Other comprehensive income (loss):</b>   |                 |                       |                 |                                       |           |                   |              |
| Remeasurements of net defined benefit liability, net of tax                             | -               | -                     | -               | -                                     | -         | 7,962             | 7,962        |
| Unrealized net changes in fair value of available-for-sale financial assets, net of tax | -               | -                     | -               | -                                     | (17,695)  | -                 | (17,695)     |
| <b>Total other comprehensive loss</b>   | -               | -                     | -               | -                                     | (17,695)  | 7,962             | (9,733)      |
| <b>Total comprehensive income for the year</b>  | -               | -                     | -               | -                                     | (17,695)  | 995,886           | 978,191      |
| <b>Transactions with owners, recorded directly in equity:</b>                           |                 |                       |                 |                                       |           |                   |              |
| Dividends   | -               | -                     | -               | -                                     | -         | (428,056)         | (428,056)    |
| In-kind donation of treasury shares   | -               | -                     | 1,997           | 2,616                                 | -         | -                 | 4,613        |
| Transfer from reserve for research and human resource development                       | -               | -                     | -               | -                                     | (12,522)  | 12,522            | -            |
| Transfer to unconditional reserve   | -               | -                     | -               | -                                     | 320,926   | (320,926)         | -            |
| <b>Total transactions with owners</b>   | -               | -                     | 1,997           | 2,616                                 | 308,404   | (736,460)         | (423,443)    |
| Balance at December 31, 2015  | ₩ 954,959       | 3,582                 | (337,062)       | 494,648                               | 3,784,467 | 995,886           | 5,896,480    |

(In thousands of U.S. dollars)

| For the year ended December 31, 2015  | Ordinary shares | Other capital surplus | Treasury shares | Gain on reissuance of treasury shares | Reserves  | Retained earnings | Total equity |
|---|-----------------|-----------------------|-----------------|---------------------------------------|-----------|-------------------|--------------|
| Balance at January 1, 2015  | \$ 814,812      | 3,056                 | (289,299)       | 419,823                               | 2,981,022 | 628,379           | 4,557,793    |
| <b>Total comprehensive income for the year:</b>   |                 |                       |                 |                                       |           |                   |              |
| Profit for the year   | -               | -                     | -               | -                                     | -         | 842,939           | 842,939      |
| <b>Other comprehensive income (loss):</b>   |                 |                       |                 |                                       |           |                   |              |
| Remeasurements of net defined benefit liability, net of tax                             | -               | -                     | -               | -                                     | -         | 6,794             | 6,794        |
| Unrealized net changes in fair value of available-for-sale financial assets, net of tax | -               | -                     | -               | -                                     | (15,099)  | -                 | (15,099)     |
| <b>Total other comprehensive loss</b>   | -               | -                     | -               | -                                     | (15,099)  | 6,794             | (8,305)      |
| <b>Total comprehensive income for the year</b>  | -               | -                     | -               | -                                     | (15,099)  | 849,733           | 834,634      |
| <b>Transactions with owners, recorded directly in equity:</b>                           |                 |                       |                 |                                       |           |                   |              |
| Dividends   | -               | -                     | -               | -                                     | -         | (365,235)         | (365,235)    |
| In-kind donation of treasury shares   | -               | -                     | 1,704           | 2,232                                 | -         | -                 | 3,936        |
| Transfer from reserve for research and human resource development                       | -               | -                     | -               | -                                     | (10,684)  | 10,684            | -            |
| Transfer to unconditional reserve   | -               | -                     | -               | -                                     | 273,828   | (273,828)         | -            |
| <b>Total transactions with owners</b>   | -               | -                     | 1,704           | 2,232                                 | 263,144   | (628,379)         | (361,299)    |
| Balance at December 31, 2015  | \$ 814,812      | 3,056                 | (287,595)       | 422,055                               | 3,229,067 | 849,733           | 5,031,128    |

## SEPARATE STATEMENTS OF CASH FLOWS

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KT&G CORPORATION

(In millions of won)

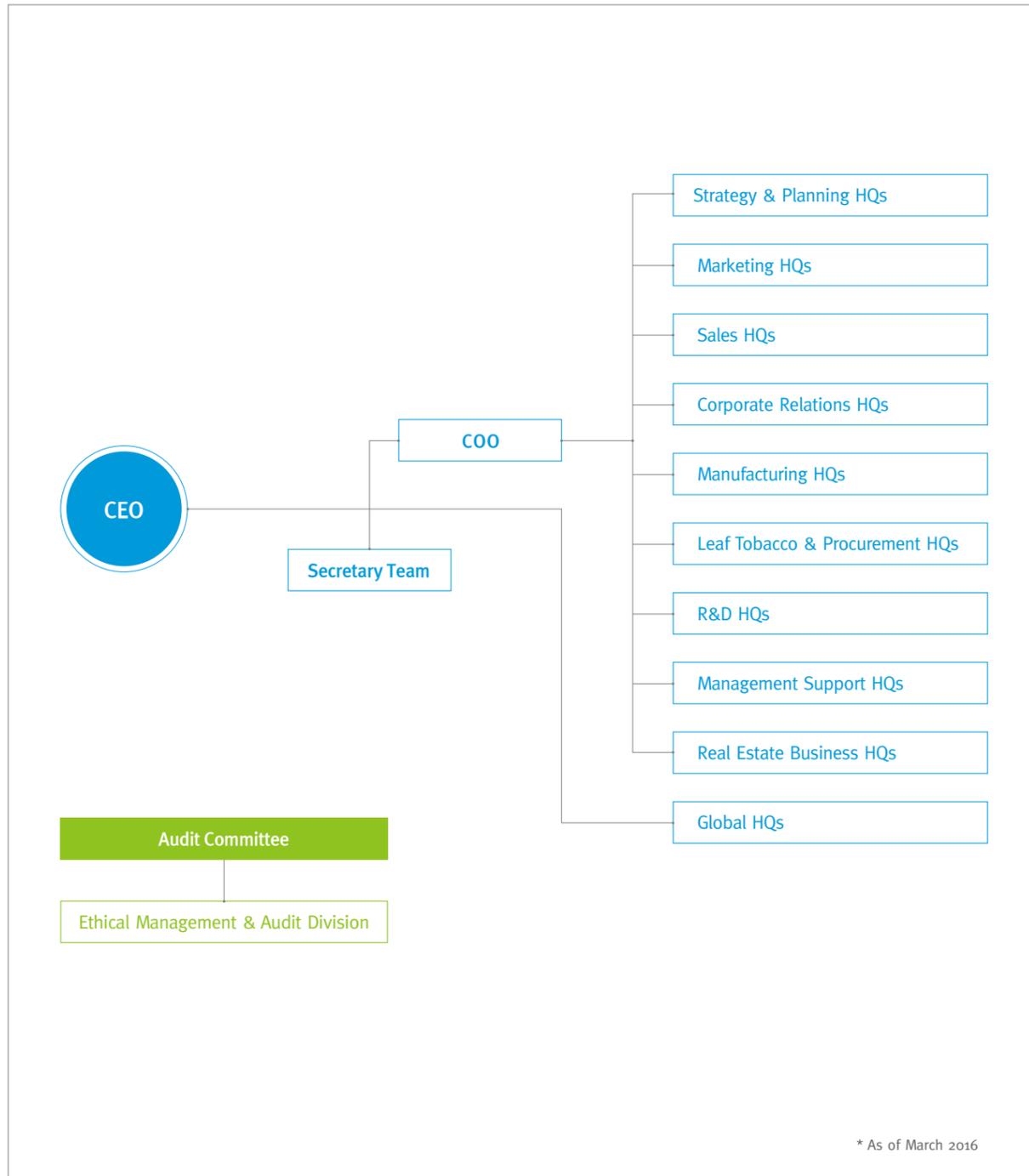
| For the year ended December 31, 2014  | Ordinary<br>shares | Other capital<br>surplus | Treasury<br>shares | Gain on<br>reissuance<br>of treasury<br>shares | Reserves  | Retained<br>earnings | Total<br>equity |
|---|--------------------|--------------------------|--------------------|--|-----------|----------------------|-----------------|
| <b>Balance at January 1, 2014</b>   | ₩ 954,959          | 3,582                    | (339,059)          | 492,032  | 3,411,099 | 509,820              | 5,032,433       |
| <b>Total comprehensive income for the year:</b>   |                    |                          |                    |  |           |                      |                 |
| Profit for the year   | -                  | -                        | -                  | -  | -         | 747,054              | 747,054         |
| <b>Other comprehensive loss:</b>  |                    |                          |                    |  |           |                      |                 |
| Remeasurements of net defined benefit liability, net of tax                             | -                  | -                        | -                  | -  | -         | (13,016)             | (13,016)        |
| Unrealized net changes in fair value of available-for-sale financial assets, net of tax | -                  | -                        | -                  | -  | (21,863)  | -                    | (21,863)        |
| <b>Total other comprehensive loss</b>   | -                  | -                        | -                  | -  | (21,863)  | (13,016)             | (34,879)        |
| <b>Total comprehensive income for the year</b>  | -                  | -                        | -                  | -  | (21,863)  | 734,038              | 712,175         |
| <b>Transactions with owners, recorded directly in equity:</b>                           |                    |                          |                    |  |           |                      |                 |
| Dividends   | -                  | -                        | -                  | -  | -         | (402,876)            | (402,876)       |
| Transfer from reserve for research and human resource development                       | -                  | -                        | -                  | -  | (47,478)  | 47,478               | -               |
| Transfer to unconditional reserve   | -                  | -                        | -                  | -  | 152,000   | (152,000)            | -               |
| <b>Total transactions with owners</b>   | -                  | -                        | -                  | -  | 104,522   | (507,398)            | (402,876)       |
| <b>Balance at December 31, 2014</b>   | ₩ 954,959          | 3,582                    | (339,059)          | 492,032  | 3,493,758 | 736,460              | 5,341,732       |

(In millions of won and thousands of U.S. dollars)

For the years ended December 31, 2015 and 2014

| For the years ended December 31, 2015 and 2014                        | 2015<br>Korean won | 2015<br>U.S. dollars | 2014<br>Korean won |
|---|--------------------|----------------------|--------------------|
| <b>Cash flows from operating activities</b>                           |                    |                      |                    |
| Cash generated from operations  | ₩ 1,600,888        | \$ 1,365,945         | ₩ 1,002,253        |
| Income tax paid   | (284,038)          | (242,353)            | (250,630)          |
| <b>Net cash provided by operating activities</b>                      | <b>1,316,850</b>   | <b>1,123,592</b>     | <b>751,623</b>     |
| <b>Cash flows from investing activities</b>                           |                    |                      |                    |
| Interest received   | 29,374             | 25,063               | 30,139             |
| Investment income received from long-term deposits in MSA Escrow Fund | 1,486              | 1,268                | 1,346              |
| Dividends received  | 20,217             | 17,250               | 20,525             |
| Proceeds from sale of property, plant and equipment                   | 9,563              | 8,159                | 8,787              |
| Proceeds from sale of intangible assets                               | 1,593              | 1,359                | 1                  |
| Proceeds from sale of non-current assets held for sale                | 4,260              | 3,635                | 55                 |
| Proceeds from investments in associates                               | 13,625             | 11,625               | -                  |
| Proceeds from investments in subsidiaries                             | -                  | -                    | 85                 |
| Proceeds from sale of available-for-sale financial assets             | 233                | 199                  | 10,010             |
| Collection of loans   | 11,220             | 9,573                | 13,629             |
| Withdrawal of guarantee deposits                                      | 18,171             | 15,505               | 19,842             |
| Acquisition of property, plant and equipment                          | (138,416)          | (118,102)            | (235,843)          |
| Acquisition of intangible assets                                      | (3,752)            | (3,201)              | (1,164)            |
| Acquisition of investment property                                    | (64)               | (55)                 | (223)              |
| Acquisition of investments in subsidiaries                            | (77,207)           | (65,877)             | (8,101)            |
| Acquisition of available-for-sale financial assets                    | (34,200)           | (29,181)             | (51,992)           |
| Increase in loans   | (59,935)           | (51,139)             | (9,946)            |
| Payments of guarantee deposits  | (16,485)           | (14,065)             | (20,723)           |
| Payments of long-term deposits in MSA Escrow Fund                     | (78,492)           | (66,973)             | (70,094)           |
| Decrease (increase) in other financial assets                         | (440,000)          | (375,427)            | 20,000             |
| Acquisition of redeemable convertible preference shares               | (26,000)           | (22,184)             | -                  |
| <b>Net cash used in investing activities</b>                          | <b>(764,809)</b>   | <b>(652,568)</b>     | <b>(273,667)</b>   |
| <b>Cash flows from financing activities</b>                           |                    |                      |                    |
| Dividends paid  | (428,056)          | (365,235)            | (402,876)          |
| Increase in deposits received   | 3,411              | 2,910                | 3,465              |
| Decrease in deposits received   | (4,605)            | (3,929)              | (2,820)            |
| <b>Net cash used in financing activities</b>                          | <b>(429,250)</b>   | <b>(366,254)</b>     | <b>(402,231)</b>   |
| <b>Effect of exchange rate fluctuation on cash held</b>               | <b>23</b>          | <b>19</b>            | <b>(1)</b>         |
| <b>Net increase in cash and cash equivalents</b>                      | <b>122,814</b>     | <b>104,789</b>       | <b>75,724</b>      |
| Cash and cash equivalents at January 1                                | 321,562            | 274,371              | 245,838            |
| <b>Cash and cash equivalents at December 31</b>                       | <b>₩ 444,376</b>   | <b>\$ 379,160</b>    | <b>₩ 321,562</b>   |

# ORGANIZATION CHART



# GLOBAL NETWORK





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**INQUIRIES**

**INVESTOR RELATIONS DEPARTMENT**

KT&G Tower, 416, Yeongdong-daero,  
Gangnam-gu, Seoul, 135-549, Korea  
Tel: +82-2-3404-4522 Fax: +82-2-3404-4269

**HEAD OFFICE**

**KT&G CORPORATION**

71, Beotkkot-gil, Daedeok-gu,  
Daejeon, 306-712, Korea  
Tel: +82-42-939-5000 Fax: +82-42-939-5001