KT&G Corporation

2008 ANNUAL REPORT

Opening the New Era

KT&G Corporation 2008 ANNUAL REPORT

KT&G IS

BUILDING A LEADING GLOBAL COMPANY THROUGH SUSTAINABLE MANAGEMENT

CONTENTS

RIGHTEOUSNESS

KT&G has been named as an honorary member of hall of fame by Korea Corporate Governance Service's (KCGS) since 2007. The recognitions attest to our dedication to enhancing shareholder value and to transparent management led by an independent board of directors. KT&G fully abides by social norms and faithfully carries out its obligations to society. As a "righteous enterprise," we will pursue autonomy and creativity to fulfill our role as a responsible corporate citizen.

ENLIGHTENMENT

Through ongoing change and innovation, KT&G is enhancing performance and propelling growth to increase corporate value. We have a balanced business portfolio comprising our core tobacco business, red ginseng, and real estate, etc. Our goal is to become a global corporation demonstrating growth, profitability, stability and sustainability.

COMPANIONSHIP

KT&G donates wholeheartedly in social contribution initiatives through the KT&G Social Welfare Foundation and other internal programs. As an "enterprise pursuing companionship," we constantly strive to create new value for customers, shareholders, employees and local communities. We observe social rules and norms and advance public benefit while building win-win relationships with partner companies. At the same time we carry out environmental management activities to protect our planet.

Led by our underlying commitment to management transparency, KT&G will maximize value for stakeholders and contribute to sustainable development as a company promoting righteousness, enlightenment and companionship.

NEW ERA OF GLOBAL BUSINESS

KT&G is emersing as a global leading company through business reformation aiming higher product quality, larger overseas network and stronger marketing capability.

NEW ERA OF MANAGEMENT STANDARD

KT&G's transparent management system, sound corporate governance, and intensive HR management system correspond with the global management standard.

NEW ERA OF CORPORATE SUSTAINABILITY

Environmentally friendly management, social responsibility management, and safety and health oriented management deeply rooted in KT&G make itself as the model company of sustainable management.

NEW ERA OF NUMERICAL EFFECT

KT&G emerges as the globally competitive company in the midst of rough-and-tumble of competition and economic crisis worldwide, through continuous growth in operating revenues and corporate value.

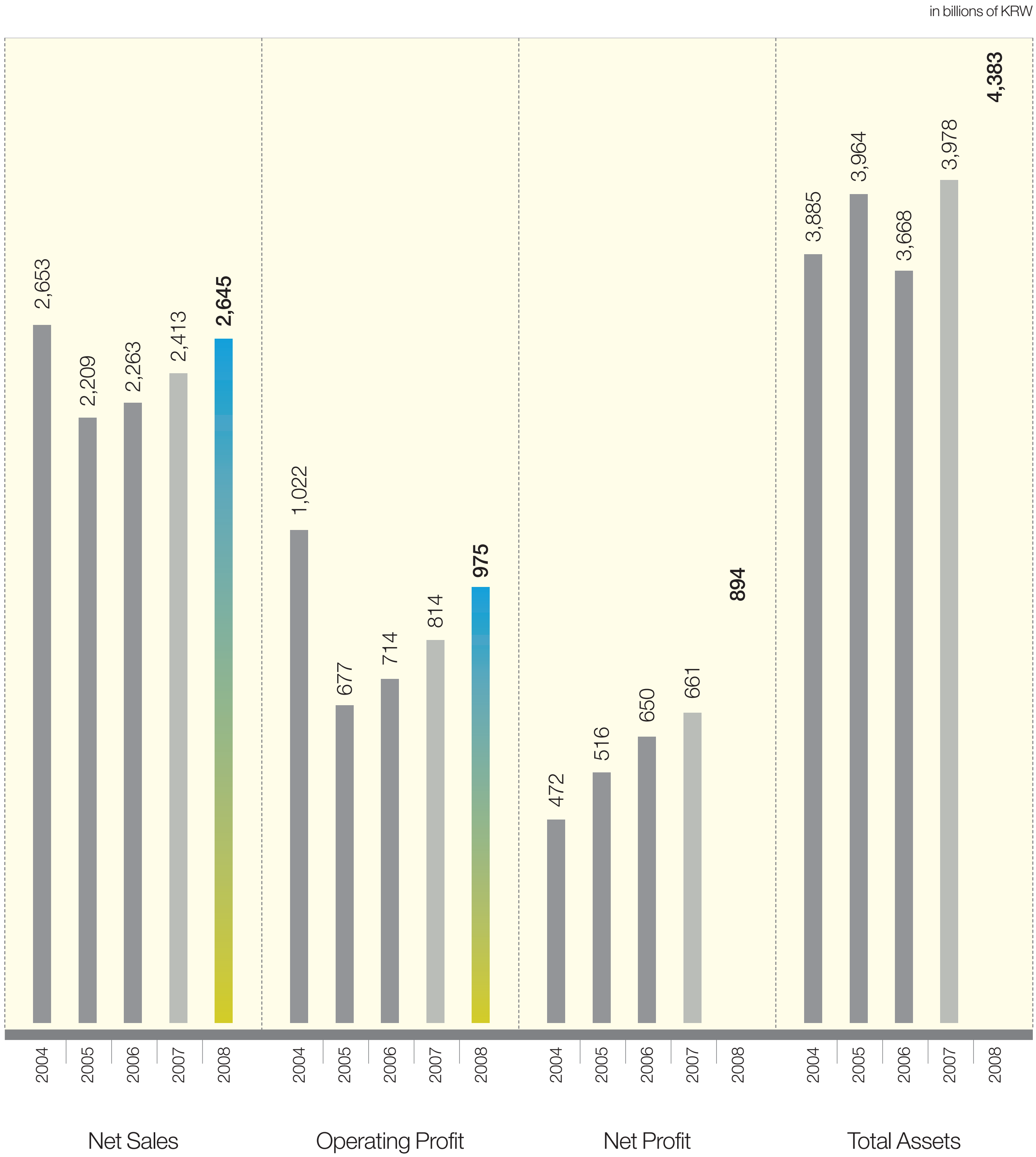
Financial Highlights

in billions of KRW

	2004	2005	2006	2007	2008
Net sales	2,653	2,209	2,263	2,413	2,645
Operating profit	1,022	677	714	814	975
Net profit	472	516	650	661	894
Total assets	3,885	3,964	3,668	3,978	4,383
Total liabilities	671	516	623	836	843
Total shareholders' equity	3,214	3,448	3,046	3,142	3,540

%, KRW

	2004	2005	2006	2007	2008
ROA	12.2	13.0	17.7	17.3	20.4
ROE	15.7	15.0	21.3	21.4	25.3
Operating profit margin	38.5	30.6	31.5	33.8	36.9
EBITDA margin	39.9	35.7	36.9	39.4	41.9
EPS	3,180	3,497	4,608	4,992	6,872
Payout ratio	50.2	48.4	49.2	51.5	40.3
DPS	1,600	1,700	2,479	2,600	2,800
Liabilities-to-equity ratio	20.9	15.0	20.4	26.6	23.8
Net debt-to-equity ratio	0.6	-	-	-	-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4,383
2004
2005
2006
2007
2008
Net Sales
Operating Profit
Net Profit
Total Assets

CEO's Message

All of us at KT&G are ready to face any challenge and will strive to create new value for a better future.

DEAR STAKEHOLDERS,

I am pleased to present KT&G's annual report for fiscal 2008. Looking back over the past year, I am once again grateful to all our stakeholders for your continued support and confidence in KT&G.

Uncertainty loomed over the Korean financial markets and real economy in 2008 as the world grappled with a growing economic crisis. In addition to the economic woes, a declining smoking rate and fierce market competition furthered clouded prospects for our core business of tobacco. Nonetheless, we managed to exceed our business targets and increase corporate value. In the domestic cigarette business, we led the expansion of the ultra low-tar cigarette market and further enhanced profitability by growing the sales of premium brands. In overseas business, we increased profits by strategically fostering mid- to high-end products and made further strides as a global enterprise with the start of production at our plants in Turkey and Iran.

Our ginseng business continued to grow at a fast clip, driven by marketing concentrated on high value-added products and development of new items. We are preparing to build a cutting-edge production facility to support this strong pace of growth.

Regarding the shareholder return stated in our mid/long-term master plan unveiled in 2006, we completed the return plan of a total of KRW 2.3 trillion via dividend and share cancellation. KT&G achieved outstanding results in 2008, growing sales by 10%, operating profit by 20% and net profit by 35%. Moreover, our share price remained stable even though the global financial crisis sent the stock market on a downward spiral. That is an indication of the positive response from our stakeholders regarding our stable profit generation and shareholder-oriented policy.

Our objective for 2009 is to prepare the groundwork for sustainable growth and development by achieving balanced growth both in qualitative and quantitative. In our domestic business, which serves as the center of profit generation and future growth, we will strengthen our market presence with marketing activities emphasizing a youthful image. For our overseas operations, we will nurture brands customized to local needs. Moreover, we will explore new markets while paying close attention to changes in the business environment brought on by foreign exchange fluctuations, etc.

We will establish a management system befitting global standards and build up our presence around the world to realize our vision of creating a premier global enterprise. We will do our best to uphold our promise to shareholders and to society, and deliver hopes and dreams to future generations.

In the ginseng business, we will reinforce our leadership in the domestic market by growing sales of high-end products and pursuing aggressive expansion of distribution channels.

At the same time, we will continue with efforts to enhance value for shareholders and meet our social responsibilities to become one of the admired global companies.

All of us at KT&G are ready to face any challenge and will strive to create new value for a better future. We will establish a management system befitting global standards and build up our presence around the world to realize our vision of creating a premier global enterprise. We will do our best to uphold our promise to shareholders and to society, and deliver hopes and dreams to future generations.

In 2009, we will continue to make every effort to serve the best interest of our stakeholders.

Thank you.

Young-kyoon Kwak
Chairman & CEO

2008 News & Issues

1 ISSUANCE OF SUSTAINABILITY REPORT

KT&G demonstrated its commitment to corporate sustainability management with the publication of its 2007 sustainability report. It was the first sustainability report issued by KT&G and conveyed information on sustainability activities we carried out in 2007. Under the slogan of "EVER - KT&G 2015," the report contained details on 9 strategies and 24 action plans we pursued in the economic, social and environmental domains. KT&G will pursue various activities to produce substantive results and establish sustainability management as an integral part of our corporate culture through ongoing pursuit of evaluation and follow-up measures.

2 COMPLETION OF PLANT IN TURKEY & $ 400 MILLION EXPORT TOWER AWARD

On April 17, KT&G held a ceremony to mark the launch of its plant in Turkey. Attending the event were KT&G executives, the mayor of Izmir and other Turkish government officials, and representatives from the local tobacco industry. Representing KT&G's first direct investment overseas, the plant in Turkey produces cigarettes for local consumption and exports to nearby countries and processes leaf tobacco to be used at our Iran factory. Separately, KT&G received the $400 Million Export Tower Award from the Korean government on December 2. We received the award on three previous occasions - to mark exports of $100 million in 2002, $200 million in 2004, and $300 million in 2006.

3 CLOSURE OF NAMWON LEAF TOBACCO PROCESSING PLANT

KT&G consolidated its tobacco leaf processing plants to rationalize this facet of its operations. As part of this process, our Namwon plant was shut down after operating for 29 years and integrated into our Gimcheon facility. We made the move because of the continued decline in domestic tobacco leaf production and low utilization ratio of the plant. Through the rationalization, we expect to save cost by KRW 2.4 billion a year.

4 SOCIAL CONTRIBUTION AWARD

At the 2008 Korea Social Contribution Awards held at the Seoul Press Center on June 10, KT&G received the grand prize in the public welfare category. Going beyond the concept of returning profits to society, social contribution is recognized as an integral part of doing business and an investment for corporate sustainability. In 2004 and 2005, KT&G also received an award for excellence in social contribution presented by the Korea Economic Daily. The honor was given in recognition of our services to promote the welfare of the elderly.

5 PUBLICATION OF “UNDERSTANDING THE KT&G BUSINESS”

“Understanding the KT&G Business” was published in August, 2008 to help our employees gain a greater understanding of the Company and its operations. It reviews our past achievements and current progress to give employees a clear picture of where the Company is heading. The guidebook provides information on the Company's present conditions and performance, innovation efforts, tobacco litigation, and social contribution. It uses cartoons to convey the information in an interesting and easy manner.

6 RECOGNITION FOR OUTSTANDING CORPORATE GOVERNANCE

KT&G upheld its position as an honorary company in the Korea Corporate Governance Service's (KCGS) hall of fame since 2007. The honor is given to a company that receives the best award of excellence for three consecutive years. KT&G received the best award of excellence from 2004 to 2006. The awards are jointly presented by KCGS and the Korea Exchange.

7 RECOGNITION FOR OUTSTANDING IR

KT&G received the Outstanding IR Company Award presented by the Korea IR Association at the 8th Korea IR Awards in November. Award winners are selected by a committee of experts in their respective fields based on a rigorous evaluation process. KT&G was given the award for its professional and systematic IR activities aimed at enhancing corporate and shareholder value.

KT&G is Broadening the BUSINESS TO GLOBAL

By creating a balanced business portfolio, we will maximize corporate value to emerge as a global enterprise demonstrating growth and stability.

Corporate Vision & Strategy
Business Review


SINESS

Corporate Vision & Strategy

VISION
"Maximize corporate and employee value to emerge as a leading global company"

CORPORATE VISION

KT&G will continue to create new value by enhancing our brand competitiveness and leadership in the domestic tobacco market while cultivating the overseas and ginseng businesses as new growth engines. By creating a balanced business portfolio centered on tobacco and ginseng, we will maximize corporate value to emerge as a global enterprise demonstrating growth and stability.

Creating employee value requires the dedication of each employee and the underlying systems to support individual efforts. KT&G will nurture human resources who can realize their potential in the global marketplace with a people-oriented management approach.

We will build an organizational culture that encourages innovation and maximize creativity based on strong responsible management system.

By maximizing corporate and employee value, KT&G will grow as a leading global enterprise.

BUSINESS STRATEGY

To realize our vision of becoming a global blue-chip company, we will implement a strategy of honing our competitive edge in each of our business areas including our core competencies of tobacco and ginseng.

In our tobacco operations, we will invest further in R&D, brand management and marketing to uphold our leadership status in Korea and expand our overseas presence. We will carry out aggressive marketing and sales activities to regain market share at home while pursuing reform to bolster sales and profits in markets abroad. We plan on making bold investments to sharpen our capabilities and secure a sturdy platform for continued growth.

In order for Korea Ginseng Corp.(KGC) to grow as a leading comprehensive health functional food company, we are conducting various activities through proactive business expansion utilizing R&D capacities into red ginseng and new materials and exploring M&A opportunities, etc. In addition to fostering ginseng as our growth business, we aim to build up a strong global presence in the area of health and functional foods. Leveraging our unrivaled position in the Korean red ginseng market, we are readying the platform for aggressive expansion on the global stage.

KT&G is striving to enhance value in the long-term and steady way. We will prepare for uncertainties in the business environment and develop new growth drivers to ensure continuity and sustained value creation. We will step up IR activities so that the value of Korea Ginseng Corp. and other subsidiaries are fully reflected in our share price. Moreover, we will stay true to our principle of creating an "enterprise pursuing companionship" and meet our responsibilities to society by donating around 2% of annual revenues through KT&G Social Welfare Foundation and other internal programs.

● Maximizing value of tobacco business

Strengthen domestic market leadership

Pursue balanced growth of exports	Reinforce R&D and marketing

Establish a balanced business portfolio

● Maximizing value of health/functional foods business

Expansion of health functional food business

Execute strategy to strengthen leadership position	Build the platform for overseas expansion

Business Review

Backed by ongoing research into products and market trends, we continue to unveil new products while raising the quality of existing products through renewal launches.

Representative Products

• SIMPLE ACE

• VONN

• BOHEM CIGAR NO. 5

• THE ONE 0.1

• SEASONS

• Black Jack - JACK

TOBACCO

Product Portfolio

KT&G offers a diverse product portfolio to keep pace with changing consumer preferences. Backed by ongoing research into products and market trends, we continue to unveil new products while raising the quality of existing products through renewal launches. We recognize that in addition to taste and flavor, the product concept and design play an important role in maximizing customer satisfaction. Bearing that in mind, we provide a wide range of tobacco products offering superior quality as well as distinctive designs and packaging.

New Products

• VONN

VONN represents the bare essence and intrinsic flavor of cigarettes. Delivering refined value, VONN imparts a unique image and strong visual impact with its sporty and masculine logo and appealing logo tab.

• BOHEM CIGAR NO. 5

BOHEM CIGAR NO. 5 is a new addition to the BOHEM CIGAR family. This line blends cigar leaves with regular cigarettes to create a fusion product that reinterprets cigars, an item still unfamiliar to many Korean consumers, to better follow modern trends.

• SIMPLE ACE

The first slim cigarette featuring a sturdy tube filter, SIMPLE ACE is a premium brand combining a deep and rich flavor with a sense of sophistication.

• THE ONE 0.1

We upgraded the design and quality of THE ONE to create THE ONE 0.1. The main symbol is the orange colored ring featured in THE ONE 0.5, but silver was blended into the orange to convey a chic yet soft image.

• Black Jack-BLACK / Black Jack - JACK

Black Jack targets the younger generation seeking a free and active lifestyle. Along with vintage style packaging, it provides a rich and satisfying flavor. The motif was inspired by leather clothing, while the logo design, symbol and color project a sense of unity.

Renewal Launch

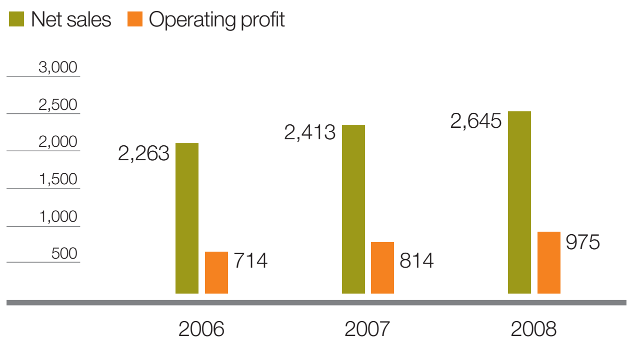
• SEASONS

Retaining the ultra low-tar characteristic and mild taste of its predecessor, the renewed SEASONS presents a clear and consistent brand identity. With the renewal launch, we intend to grow SEASONS into a brand with emotional appeal.

Operation Review

On top of the financial turmoil and economic crisis that swept across the globe, we saw competition become fiercer in the domestic tobacco market in 2008. Over the past year, we concentrated our energy on tackling these hurdles to increase corporate and shareholder value. As a result, our sales and operating income exceeded our targets. Sales grew 9.6% to KRW 2,644.7 billion while operating income rose by 19.8% to KRW 975.3 billion. Our performance in each business segment is explained in detail below.

Operation review (in billions of KRW)



Domestic Sales

To address the diverse purchasing patterns of smokers in Korea and growing penetration by global brands, we implemented various measures to pursue effective and efficient sales activities. We stepped up advertising at key retail outlets for better marketing execution. We also developed a retailer-oriented sales support system and revamped our marketing resource portfolio.

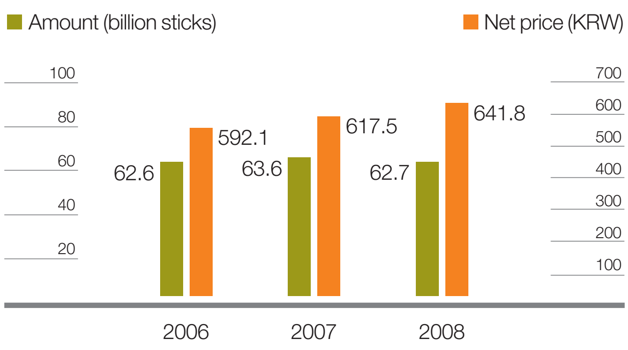
We proceeded to launch new brands to keep pace with market trends. New products unveiled in 2008 include THE ONE 0.1 to seize the domestic ultra low-tar market segment, Black Jack targeting the younger generation, and BOHEM CIGAR NO. 5 to expand the market for cigarettes incorporating cigar leaves. A brand portfolio corresponding to segmented customer needs and rising popularity of high-end brands resulted in greater sales contribution from premium brands and an increase in Net Average Selling Price (Net ASP) per pack. In addition, the renewal of existing products helped raise brand loyalty and corporate image. Moreover, we revamped our organization and redeployed personnel for more efficient operation of each distribution channel and solidified our position through better management of key markets.

Overseas Sales

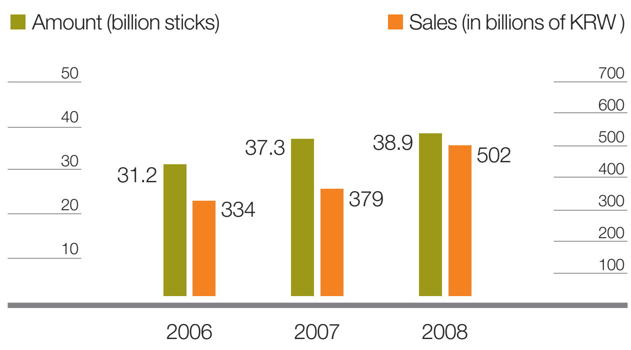
Our overseas sales volume grew 4.4% to 38.9 billion sticks and revenue increased 32.3% to KRW 501.5 billion. Operating income jumped 95.6% to KRW 160.8 billion, largely due to a profit-oriented approach. Besides shipment growth to our main export markets of Russia, the Middle East and Central Asia, we recorded an increase in export price per pack and sales portion of mid/high-priced brands. In particular, there was robust growth in exports of "PINE Premium" launched in late 2007, while ESSE renewal played a major role in lifting the per pack export price.

KT&G has been actively investing in overseas regions showing strong potential. One such investment is our plant in Turkey which processes leaf tobacco and produces super-slim and regular cigarettes. As the world's seventh largest tobacco consumer, Turkey is a promising market and privatization of Tekel, the nation's state-owned cigarette company, presents an opportunity to make greater inroads into the local market. Furthermore, Turkey's entry into the EU would allow us to export products from the plant to EU countries without paying tariffs. Another factor in our decision was the proximity to the Middle East, a major export destination of KT&G.

Domestic sales



Overseas sales



Our localization strategy will help secure price competitiveness through reducing logistics costs and reinforce our global presence. Along with the launch of our Iran plant in 2009, we plan to set up a factory in Russia with the goal of starting production in the second half of 2010.

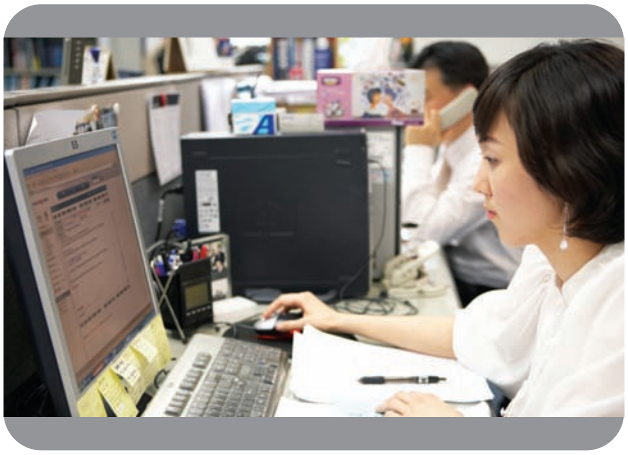
Production & Procurement

Employees' commitment to high quality and low costs, coupled with measures to identify and correct inefficiencies, enhanced factory activities and resulted in cost savings. We expanded our lines for simultaneous production of multiple products to flexibly respond to market changes. Adding to that, we strengthened our manufacturing infrastructure. We will realize more efficient production management and better work processes through utilizing information technology such as our e-production system.

Customer complaints on product flavor and taste decreased significantly thanks to heightened efforts to maintain consistency.

These include improved methods of feeding raw materials, introducing a hygiene quality system, and stepping up SPC (Statistical Process Control) activities. We acquired ISO 9002 and 14000 certification for our production facilities and conducted a thorough investigation on manufacturing processes. We also increased product competitiveness through employees' voluntary suggestions and improvement activities.

The main emphasis related to raw material procurement is obtaining quality leaf tobacco that satisfy the demand of target markets. In response to the reduction in Korea's total cultivation area for leaf tobacco, we secured customized production systems. To rein in raw material costs, we expanded the portion of imported leaves used in manufacturing. KT&G purchases high-grade yet cost-effective leaf tobacco from major tobacco exporting nations.



Net sales

KRW 2,645 billions

HEALTH FUNCTIONAL FOOD

Operation Review

With red ginseng leading the way, our health functional food business is an important growth engine along with our international cigarettes business. Korea Ginseng Corp. (KGC), which runs the health and functional foods business, offers a wide range of products under the Cheong-Kwan-Jang brand, including red ginseng roots, red ginseng products, drinks and gift sets. KGC maximized brand exposure through diverse media including TV advertising, and diversified distribution channels. Special attention was paid to the major channels, namely franchise stores, duty free shops and department stores. Promotional activities targeting different customer groups also continued throughout 2008. Such efforts led to solid results, with sales growing by 19.4% to KRW 622.1 billion and operating income by 22.8% to KRW 199.5 billion.

Cheong-Kwan-Jang ranked first in safety in a domestic survey on health and functional foods. It was also given the honor of Proud Luxury Brand in the wellbeing product-food category by KMAC. For the second consecutive year, KGC received the grand prize for trustworthiness and social contribution at The Company of Korea 2008 Awards jointly sponsored by the Korea Customers' Forum and Joongang Ilbo. These recognitions enhanced our corporate image and brand power and will contribute to expanding our customer base.

Operation review

(in billions of KRW)

2009 Outlook

The wellbeing trend and heightened interest in health prompted by improving quality of life are fueling steady expansion of the health and functional food market. Red ginseng and red ginseng products are gaining greater popularity as a safe, effective and reliable choice amid growing scientific backing and rising awareness.

KGC's strategy for 2009 is to raise the brand profile of Cheong-Kwan-Jang, establish diverse and stable distribution channels, carry out customer-oriented marketing activities, and pursue overseas expansion to promote the Cheong-Kwan-Jang brand in Asian markets such as Hong Kong, China and Japan. While the economic recession is expected to pose a burden, every effort will be made to sustain growth in the health functional food business.

Distribution channel	2008 (%)
Franchise stores	52.1
Dept. stores/Duty-free shops	23.1
Home shopping	11.2
Others	13.6

Health Functional Food

KT&G is Sustaining

OUTSTANDING PERFORMANCE

We revamped our organization and redeployed personnel for more efficient operation of each distribution channel and solidified our position through better management of key markets.


ETENCY

Management's Discussion & Analysis

The information in this section is based on non-consolidated financial statements and generally accepted accounting principles (GAAP) of the Republic of Korea. The information contains certain forward-looking statements regarding the Company's financial conditions, operating performance and business plans. Such forward-looking statements involve known and unknown risks, uncertainties and other factors not within control of the Company, which may cause the actual results or performance of the Company to be materially different from any future results or performance expressly stated or implied in the forward-looking statements.

KT&G does not assume responsibility on the accuracy or completeness of information contained or implied in this section, and statements on the past and future cannot be construed as the Company's promise or claims. The information herein is based on the Company's plans, estimations and projections as well as numerous assumptions regarding the political and economic environment in Korea and other countries in which the Company currently operates or will operate in the future. Such estimations and projections can alter due to the operating environment. Therefore, users of this report should take reasonable care when relying on the information contained herein. Estimations, plans and projections are based on conditions as of the day this report was prepared. KT&G does not bear responsibility of providing additional information on future events. The term "Company" used herein without any other qualifying description refers to "KT&G."

EXECUTIVE SUMMARY

On top of the global financial turmoil and economic woes, Company saw competition intensified in the domestic tobacco market in 2008. During the year, KT&G concentrated its energy on tackling these hurdles to increase corporate and shareholder value. As a result, sales grew by 9.6% to KRW 2,644.7 billion and operating income rose by 19.8% to KRW 975.3 billion. The results are attributable to greater sales contribution from premium brands in the domestic market, growth in our overseas business amid the Korean won's depreciation, cost savings through lowered use of domestic tobacco leaves , and improved performance by our subsidiary, Korea Ginseng Corp.

In the domestic market, we implemented effective and efficient sales activities to appropriately address the diverse purchasing patterns of smokers and penetration by global brands. To counter heightened competitive pressure, we established marketing strategies with better competitiveness, operating systems with more focused on selling point and newly established marketing resource portfolio with much efficiency.

KT&G also continuously improved Net Average Selling Price (Net ASP) through early penetration into the ultra low-tar market segment, a differentiated brand portfolio corresponding to market demands, and a shift in sales mix toward high-end brands. The renewal of core brands helped raise brand loyalty and image. Moreover, we rearranged our organization for more efficient operation of each distribution channel and solidified our position through better management of key markets.

Accordingly, sales volume in 2008 reached 62.7 billion sticks, equivalent to 100.3% of our annual target. In addition, greater sales contribution from premium brands lifted the net ASP by 3.8% to KRW 641.8, resulting in a 2.5% growth in sales to KRW 2,127 billion.

The overseas business has emerged as a major growth driver as we continue to explore opportunities in international markets. In 2008, overseas sales volume grew by 4.4% to 38.9 billion sticks and revenue by 32.3% to KRW 501.5 billion. Along with expanded shipment to growing markets such as Russia, we recorded an increase in the export price per pack and sales portion of mid/high-priced brands under our profit-oriented approach. In particular, exports of the mid-priced "PINE Premium" launched in late 2007 represented astonishing growth to reach 9.2 billion sticks in 2008, while the renewal of ESSE , our leading slim brand, also played a major role in lifting the profitability.

On the production side, we expanded our lines for simultaneous production of multiple products to flexibly respond to market changes. Adding to that, we strengthened our manufacturing infrastructure. We utilized information technology through our e-production system to realize more efficient production management and redesigned work processes.

Related to raw material procurement, we purchased domestic and imported tobacco leaves with the main emphasis on ensuring quality that satisfies the demands of target markets. In response to the reduction in Korea's total cultivation area for tobacco leaf, we expanded the usage of relatively low-priced high-quality tobacco leaves from major overseas exporting countries.

Selected Financial Data

(in billions of KRW)

	2006	2007	2008	% YoY
Net sales	2,263	2,413	2,645	9.6
Gross profit	1,283	1,420	1,622	14.2
Operating income	714	814	975	19.8
Net income	650	661	894	35.3
Total assets	3,668	3,978	4,383	10.2
Total liabilities	623	836	843	0.8
Total shareholders' equity	3,046	3,142	3,540	12.7
Gross margin(%)	56.7	58.9	61.3	2.4%p
Operating margin(%)	31.5	33.8	36.9	3.1%p
Net margin(%)	28.7	27.4	33.8	6.4%p
EPS(won)	4,608	4,992	6,872	37.7
PER(X)	12.3	16.0	11.5	
Stock price(won , year-end)	56,500	79,700	79,100	-0.75

ANALYSIS OF OPERATING RESULTS

Summarized Income Statement

(in billions of KRW)

	2006	2007	2008
Net sales	226.3	241.2	264.5
Operating income	71.4	81.4	97.5
Net income	65.0	66.1	89.4

Notable trends in the operating environment in 2008 were growing health awareness and the subsequent decline in the smoking rate, expansion of smoke-free areas, greater competition with foreign brands, and the global economic downturn. Against this backdrop, KT&G developed and launched diverse brands to meet wide-ranging customer demands. We adopted a marketing strategy of selection and concentration while carrying out management innovation activities including adoption of a market monitoring system.

Company posted net operating revenue of KRW 2,644.7 billion, up 9.6% year on year. Operating income increased by a higher rate, underpinned by both domestic and export sales combined with a shift in sales mix to premium brands. Operating income was KRW 975.3 billion, rising by 19.8%. We also posted a surge in net non-operating income. Consequently, net income recorded KRW 894.3 billion, an increase of 35.3% year-on-year.

OPERATING REVENUES

Domestic Market Share

(%)

	2006	2007	2008
KT&G	71.4	69.2	66.1
BAT	16.8	17.0	17.1
PMI	8.6	9.8	11.9
JTI	3.3	4.0	4.9

As global tobacco companies carried out aggressive marketing to gain market share, competition was very fierce in domestic market. In particular, PMI and JTI expanded their market shares by 2.1%p and 0.9%p, respectively, to 11.8% and 4.9%. However, in domestic market KT&G maintained its market dominance with 66.1% market share. We will continue to deliver differentiated product quality and launch new premium brands to strengthen our market presence and enhance profitability.

KT&G at the Low-tar Segment

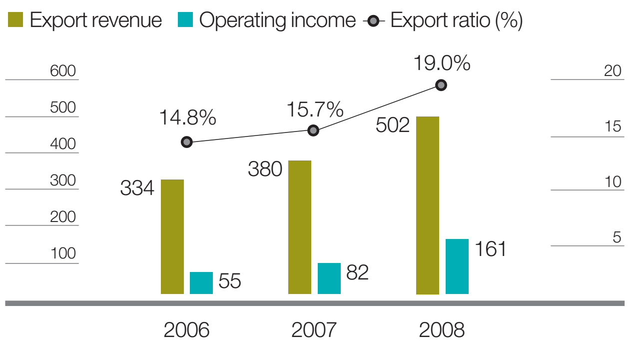
(million sticks, %)

	2006	2007	2008
Korean low-tar market	37,631	42,984	44,613
KT&G's low-tar sales	27,772	31,679	31,809
KT&G's low-tar sales ratio	44.4	49.9	50.7
Premium brand sales	39,862	42,647	42,908
Premium brand sales to total	63.7	67.1	68.4

In 2008, a shift in sales mix toward high-end products led to a higher net average selling price per pack and improvement in operating profitability. The improved net ASP contributed steady and continued revenue growth despite a decline in domestic market share.

Exports

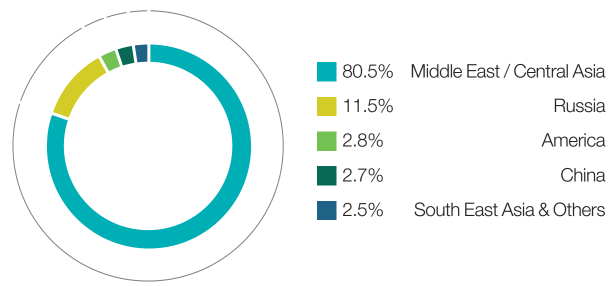
(in billions of KRW, %)



Growth prospects are limited in the domestic market owing to severe competition and slowing demand. To overcome this limitation, Company has been actively pursuing overseas expansion in 2008. We commenced production in the Turkish plant and increased the export portion of mid/high-priced products and the export price per pack. With such efforts, export revenue grew 32.2% to KRW 501.5 billion. As a percentage of total revenue, exports climbed by 3.3%p to 19.0%.

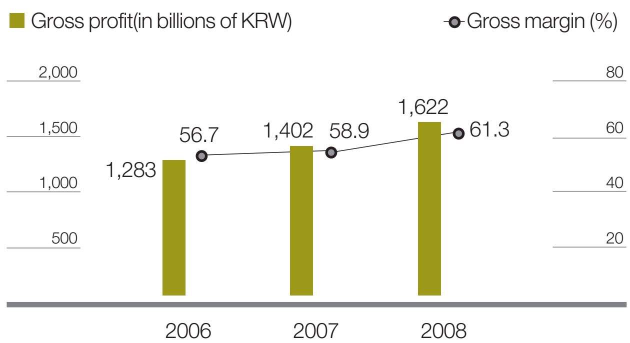
Exports by Region

(Volume)



KT&G currently exports its products to about 40 countries including Russia, CIS, Middle East, , China and Southeast Asia. In 2008, the Middle East/Central Asia and Russia, our main overseas markets, accounted for 92% of total exports. As part of our overseas business strategy, we are strengthening our global presence by promoting brands catering to local market needs and reinforcing local distribution channels.

Gross Profit



Gross profit in 2008 rose by 14.2% to KRW 1,621.6 billion thanks togreater contribution from net ASP increase in domestic business, growth in overseas operations amid the Korean Won's depreciation, and cost savings through lowered use of domestic tobacco leaves. In order to improve manufacturing cost, KT&G maintained efforts to reduce raw material cost and rationalize leaf inventory. The use of domestic tobacco leaves was further reduced to 40% in 2008 from 44% in 2007.

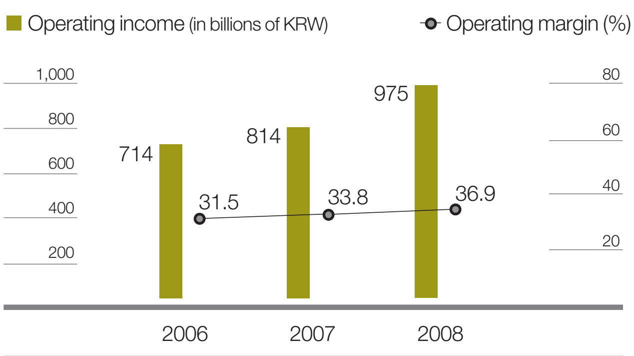
SG&A Expenses Breakdown

(in billions of KRW)

	2006	2007	2008
SG&A expenses	570	606	646
Wages and employee welfare	220	228	247
Advertising	135	137	141
Commissions paid	62	61	63
Depreciation & Amortizaiton	48	55	54
R&D expenses	14	16	15
Others	90	109	125

Selling, general and administrative (SG&A) expenses were KRW 646.3 billion. That represents an increase of 6.7%, which is lower than the sales growth rate of 9.6%. The ratio of SG&A expenses to sales was 24.4%. In 2008, wages and employee welfare as well as advertising expenses rose to some extent, but other major SG&A items were largely unchanged from a year earlier, implying effective control over SG&A expenses.

Operating Income



Higher gross profit and effective control over SG&A expenses provided Company with boosted operating income of KRW 975.3 billion, up 19.8% on 2007. The operating margin improved by 3.1%p to 36.9% amid greater sales contribution from high value-added products, higher net average selling price per pack, and cost savings from rationalization of leaf tobacco procurement.

NON-OPERATING ITEMS

Non Operating Items / Ordinary Income

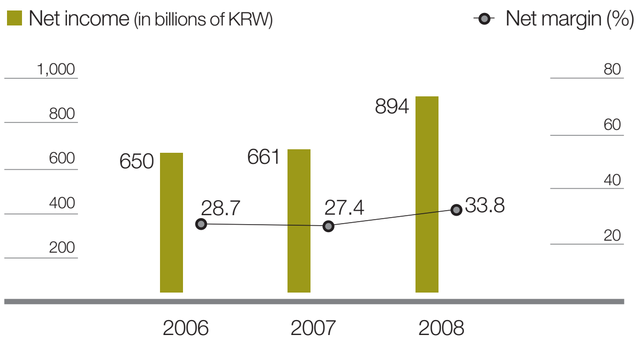
(in billions of KRW)

	2006	2007	2008
Non-operating income	295	201	278
Interest income	40	38	21
Gain on valuation of equity method investments	100	128	145
Gain on foreign currency transaction	2	3	59
Gain on foreign currency translation	-	3	26
Non-operating expense	153	109	72
Donation		25	28
Loss on valuation of equity method investments	6	25	10
Ordinary income	855	907	1,181

Non-operating income grew 38.1% to KRW 278.1 billion. Gain on valuation of equity method investments increased 13.0% year-on-year to the record of KRW 145.0 billion, owing to the wholly-owned subsidiary Korea Ginseng Corp. (KGC). Fueled by the growing market for red ginseng and the launch of new products, KGC's sales soared to a record high of KRW 622.1 billion in 2008. Its operating income and net income reached KRW 289.3 billion and KRW 145.0 billion, respectively. Separately, KT&G posted a surge in gains on foreign currency transactions and translation amid export revenue growth and depreciation of the Korean won. On the other hand, non-operating expenses decreased by KRW 36.6 billion to KRW 72.1 billion due to a substantial decline in loss on valuation of equity method investment. Overall, net non-operating income soared 122% to KRW 206.0 billion.

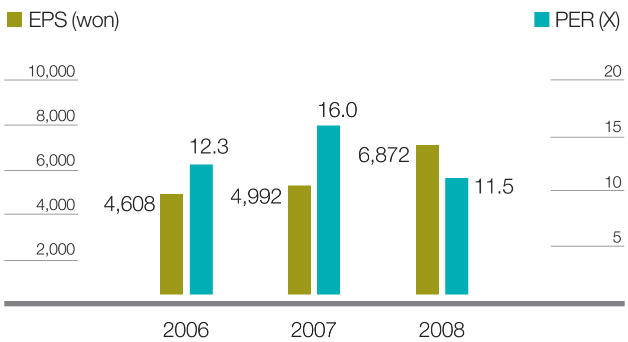
EARNINGS AND DIVIDENDS

Net Income



Income before income taxes rose by 30.2% to reach a new high thanks to net revenue growth, effective cost control and an increase in net non-operating income. The effective tax rate slid 2.8%p from 27.1% in 2007 to 24.3% in 2008, which widened the net margin by 6.4%p to 33.8%. Net income was KRW 894.3 billion, up 35.3% from 2007.

EPS & PER

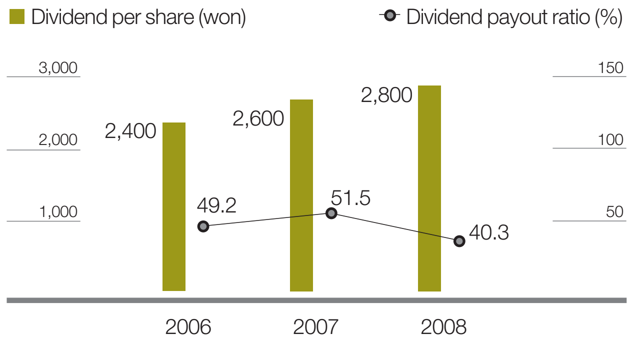


Note) Based on the year-end closing share price

In 2008, as KT&G retired 4.65 million shares, the weighted average number of free floating common shares was 130.1 million as of the year's end. Accordingly, earnings per share (EPS) increased by 37.6%, from KRW 4,992 in 2007 to KRW 6,872 in 2008. Despite the worldwide financial crisis and the plunging stock market from the latter half in 2008, KT&G stock demonstrated a stable movement, with the year-end closing price standing at KRW 79,100, largely unvaried from KRW 79,700 at end-2007. KT&G shares greatly outperformed the KOSPI, which retreated more than 40% in 2008.

The year-end price to earnings ratio in 2008 was 11.5 times, as opposed to 16.0 times in 2007. Further improvement in EPS and the price to earnings ratio are expected in the future.

Dividend per Share & Dividend Yield



Note) Based on the year-end closing share price

With its shareholder-friendly policy, KT&G has continued to pay high dividend. For 2008, we distributed a cash dividend of KRW 2,800 per share. That translates to a dividend yield of 3.54% based on the year-end closing share price of KRW 79,100. In the future, KT&G will continue its best efforts to maximize shareholder value.

ANALYSIS OF FINANCIAL CONDITIONS

Summarized Balance Sheet

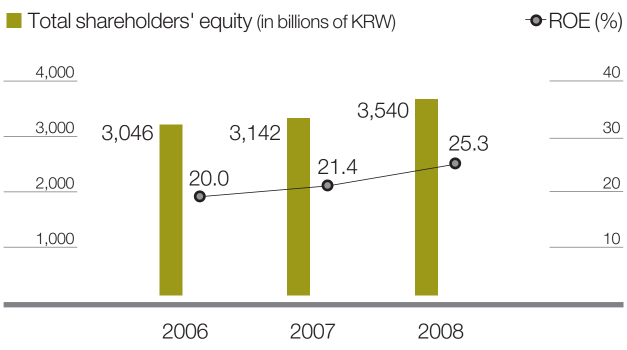
(in billions of KRW)

	2006	2007	2008
Total assets	3,668	3,978	4,383
Total liabilities	623	836	843
Total shareholders' equity	3,046	3,142	3,540

Total assets in 2008 expanded by 10.2% to KRW 4,382.6 billion while liabilities inched up slightly to KRW 842.7 billion. Supported by net income growth and effective asset management, total shareholders' equity increased by 12.7% to KRW 3,539.8 billion.

The debt-to-equity ratio declined from 26.6% in 2007 to 23.8% in 2008, while return on equity and return on assets stood at 25.3% and 20.4%, respectively. With a sound balance sheet and flexible financial strategy, we will continue to generate stable operating cash flows. At the same time, we will bolster asset efficiency and growth potential through effective investment decisions and working capital management.

Shareholder's Equity



Total shareholders' equity amounted to KRW 3,539.8 billion, up by 12.7% year on year, amid net income growth and valuation gain on available-for-sale securities. Our strategy to maximize shareholder value through enhanced profitability and capital efficiency improved return on equity by 3.9%p to 25.3%.

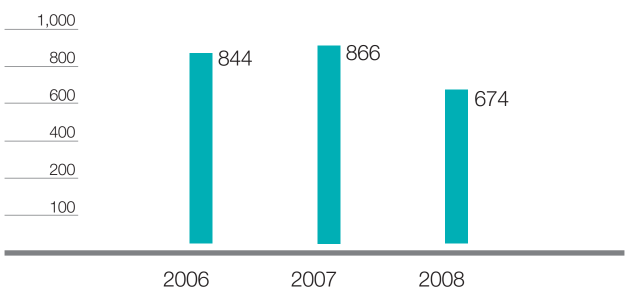
ANALYSIS OF CASH FLOW

Despite significant growth in net income, cash and cash equivalents at the year-end fell to KRW 88.4 billion, down by 23.3% from KRW 115.1 billion at the end of 2007, due to dividend distribution, a heavier working capital burden, investment in tangible assets.

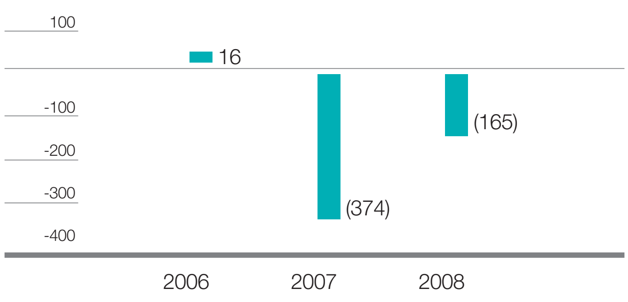
Backed by stable cash flows from operating activities, KT&G is investing in facilities and product development to raise product competitiveness and cultivate future growth engines. At the same time, we have distributed dividends and conducted share buyback and cancellation to increase shareholder value. Going forward, we will do our best to carry out effective business activities based on a policy of selection and concentration and strive to produce consistent cash flows.

Summarized Cash Flow Statement

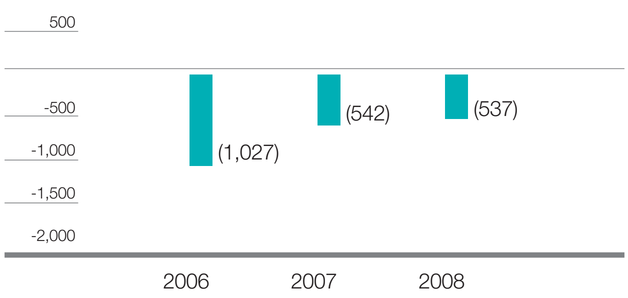
Cash flow from operating activities (in billions of KRW)



Cash flow from investing activities (in billions of KRW)



Cash flow from financing activities (in billions of KRW)



Independent Auditors' Report

The Board of Directors and Stockholders
KT&G Corporation:

We have audited the accompanying non-consolidated balance sheets of KT&G Corporation (the "Company") as of December 31, 2008 and 2007, and the related non-consolidated statements of income, appropriation of retained earnings, changes in equity and cash flows for the years then ended. These non-consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these non-consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Republic of Korea. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the non-consolidated financial statements referred to above present fairly, in all material respects, the financial position of KT&G Corporation as of December 31, 2008 and 2007, and the results of its operations and the appropriation of its retained earnings, the changes in its equity and its cash flows for the years then ended in conformity with accounting principles generally accepted in the Republic of Korea.

The accompanying non-consolidated financial statements as of and for the year ended December 31, 2008 have been translated into United States dollars solely for the convenience of the reader. We have audited the translation and, in our opinion, the non-consolidated financial statements expressed in Korean Won have been translated into dollars on the basis set forth in note 3 to the non-consolidated financial statements.

Without qualifying our opinion, we draw attention to the following:

As discussed in note 2(a) to the non-consolidated financial statements, accounting principles and auditing standards and their application in practice vary among countries. The accompanying non-consolidated financial statements are not intended to present the financial position, results of operations, changes in equity and cash flows in accordance with accounting principles and practices generally accepted in countries other than the Republic of Korea. In addition, the procedures and practices utilized in the Republic of Korea to audit such financial statements may differ from those generally accepted and applied in other countries. Accordingly, this report and the accompanying non-consolidated financial statements are for use by those knowledgeable about Korean accounting principles and auditing standards and their application in practice.

As discussed in note 20 to the non-consolidated financial statements, the Company and the Korean government are defendants in lawsuits claiming damages of ₩ 759 million for the effects of smoking. The final outcome of these lawsuits cannot be predicted. Accordingly, no provisions have been made in the accompanying non-consolidated financial statements

As discussed in note 31 to the non-consolidated financial statements, the Company changed accounting policy on equity method accounted investments in conformity with Statement of Korea Accounting Standard "SKAS" No. 15 Investment In Associates, revised February 22, 2008 which required, when accounting on equity method accounted investments, that net assets of non-consolidated financial statements agree with those of consolidated financial statements.

These changes resulted in a decrease in loss on valuation of equity method investments of ₩ 13 million, equity method investment securities of ₩ 12 million and unrealized gain on valuation of equity method investments of ₩ 2,596 million and an increase in capital surplus of ₩ 2,532 million and unappropriated retained earnings of ₩ 52 million, respectively. The Company restated prior period's financial statements in conformity with these changes in accounting policy.

As discussed in note 35 to the non-consolidated financial statements, all listed companies are required to comply with International Financial Reporting Standards ("K-IFRS") from 2011 and the Company has decided to early-adopt K-IFRS in 2009.

Seoul, Korea
January 23, 2009

KPMG Samjong Accounting Corp.

This report is effective as of January 23, 2009, 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 non-consolidated financial statements and notes thereto. Accordingly, the readers of the audit report should understand that there is a possibility that the above audit report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

Non-Consolidated Balance Sheets

AS OF DECEMBER 31, 2008 AND 2007

Mil. Won, Thou. USD

		2008				2007	
	Note	Korean Won		U.S. dollars (note 3)		Korean Won	
ASSETS							
Cash and cash equivalents	16	₩	88,352	$	70,260	₩	115,126
Short-term financial instruments			1,000		795		1,000
Trade accounts receivable, net of allowance for doubtful accounts of ₩ 20,266 in 2008 and ₩ 8,723 in 2007	8,16		407,171		323,795		294,895
Inventories	4,12		1,075,512		855,278		979,513
Current deferred tax assets	22		9,249		7,355		16,026
Other current assets	5		129,690		103,133		60,585
Total current assets			**1,710,974**		**1,360,616**		**1,467,145**
Available-for-sale securities	6		309,178		245,867		257,089
Equity method investment securities	7,31		705,286		560,864		626,668
Property, plant and equipment, net	9,10,12		1,398,775		1,112,346		1,408,958
Intangible assets	11		1,188		946		1,719
Long-term loans to employees	8		79,948		63,577		95,939
Guarantee deposits paid			33,219		26,415		30,520
Guarantee deposits for membership			22,140		17,606		21,197
Long-term deposits in escrow fund	16,20		110,261		87,683		66,633
Other non-current assets	13		11,604		9,228		1,933
Total non-current assets			**2,671,599**		**2,124,532**		**2,510,656**
Total assets			**4,382,573**		**3,485,148**		**3,977,801**
LIABILITIES							
Trade accounts payable	8,16		27,543		$21,903		9,590
Value added tax payable			125,184		99,550		128,866
Accrued expenses			13,280		10,561		12,320
Other payables			139,775		111,153		95,432
Income taxes payable			153,486		122,056		183,482
Tobacco excise and other taxes payable			168,423		133,935		181,734
Other current liabilities	14		15,581		12,390		11,299
Total current liabilities		**₩**	**643,272**	**$**	**511,548**	**₩**	**622,723**

(Continued)

Mil. Won, Thou. USD

	Note	2008 Korean Won	2008 U.S. dollars (note 3)	2007 Korean Won
Retirement and severance benefits	15,29	₩ 38,517	$ 30,630	₩ 64,360
Guarantee deposits received		824,954	19,844	26,861
Deferred income tax liabilities	22	136,001	108,152	121,854
Total non-current liabilities		**199,472**	**158,626**	**213,075**
Total liabilities		**842,744**	**670,174**	**835,798**
EQUITY				
Common stock of ₩ 5,000 par value				
Authorized - 800,000,000 shares Issued - 138,792,497 shares in 2008 and 143,442,497 shares in 2007				
Outstanding - 128,698,800 shares in 2008 and 130,839,907 shares in 2007	1	954,959	759,411	954,959
Capital surplus	31	471,144	374,667	466,769
Capital adjustments	17	(224,650)	(178,648)	(414,947)
Accumulated other comprehensive income	6,7,18,30,31	30,659	24,381	1,593
Retained earnings	19,31	2,307,717	1,835,163	2,133,629
Total equity		**3,539,829**	**2,814,974**	**3,142,003**
Total equity and liabilities		**₩ 4,382,573**	**$ 3,485,148**	**₩ 3,977,801**

See accompanying notes to non-consolidated financial statements.

Non-Consolidated Statements of Income

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

Mil. Won, Thou. USD, except earnings per share

		2008				2007	
	Note		Korean Won		U.S. dollars (note 3)		Korean Won
SALES							
Tobacco	8	₩	2,514,164	$	1,999,335	₩	2,342,411
Lotting-out	21		71,975		57,237		19,815
Other	8		58,517		46,534		50,463
			2,644,656		2,103,106		2,412,689
Cost of sales	8,21,26,27		1,023,034		813,546		992,449
Gross profit			**1,621,622**		**1,289,560**		**1,420,240**
Selling, general and administrative expenses	26,27,28		646,298		513,954		605,839
Operating income			**975,324**		**775,606**		**814,401**
Other income (expense):							
Interest income			21,152		16,821		38,193
Interest expense			(647)		(515)		(101)
Gain (loss) on foreign currency transactions, net			49,369		39,260		(445)
Gain on foreign currency translation, net			25,332		20,146		2,361
Gain (loss) on sale of available-for-sale securities			84		67		(724)
Gain on sale of property, plant and equipment, net			11,191		8,899		5,489
Provision for Tobacco Production Stabilization Fund			-		-		(35,516)
Gain on valuation of equity method investments	7,31		145,046		115,345		128,302
Loss on valuation of equity method investments	7,31		(10,340)		(8,223)		(24,987)
Loss on valuation of derivative instruments	32		(2,699)		(2,146)		(25)
Gain (loss) on transaction of derivative instruments, net			(6,295)		(5,006)		25
Donations	27		(28,020)		(22,282)		(24,995)
Other, net			1,806		1,435		5,125
Other income			**205,979**		**163,801**		**92,702**
Income before income taxes			**1,181,303**		**939,407**		**907,103**
Income taxes	22		287,013		228,242		245,897
Net income			**894,290**		**711,165**		**661,206**
EARNINGS PER SHARE							
Basic earnings per share	23	₩	6,872	$	5	₩	4,992

See accompanying notes to non-consolidated financial statements.

Non-Consolidated Statements of Appropriation of Retained Earnings

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

Date of Appropriation for 2008: March 13, 2009
Date of Appropriation for 2007: March 14, 2008

Mil. Won, Thou. USD

	2008				2007	
		Korean Won		U.S. dollars (note 3)		Korean Won
UNAPPROPRIATED RETAINED EARNINGS						
Balance at beginning of year	₩	1,865	$	1,483	₩	5,492
Cumulative effect of change in accounting policy		-		-		26
Retirement of treasury stock		(379,753)		(301,990)		(269,410)
Net income		894,290		711,165		661,206
Balance at end of year before appropriation		**516,402**		**410,658**		**397,314**
TRANSFER FROM VOLUNTARY RESERVES						
Reserve for research and manpower development		15,000		11,928		15,000
Unappropriated retained earnings available for appropriation		531,402		422,586		412,314
APPROPRIATION OF RETAINED EARNINGS						
Unconditional reserve		169,000		134,394		70,000
Dividends - 56% on par value at 2,800 Won per share in 2008 and 52% on per value at 2,600 Won per share in 2007 (note 24)		360,357		286,566		340,449
		529,357		420,960		410,449
Unappropriated retained earnings to be carried over to subsequent year	₩	2,045	$	1,626	₩	1,865

See accompanying notes to non-consolidated financial statements.

Non-Consolidated Statements of Changes in Equity

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

Mil. Won

	Korean Won					
	Capital stock	Capital surplus	Capital adjustments	Accumulated other compre-hensive income	Retained earnings	Total equity
Balance at January 1, 2007	**₩ 954,959**	**335,414**	**(321,904)**	**15,784**	**2,061,520**	**3,045,773**
Cumulative effect of change in accounting policy	-	839	-	(903)	26	(38)
Balance at January 1, 2007, restated	**954,959**	**336,253**	**(321,904)**	**14,881**	**2,061,546**	**3,045,735**
Dividends	-	-	-	-	(319,712)	(319,712)
Net income	-	-	-	-	661,206	661,206
Decrease in unrealized gain on valuation of available-for-salesecurities	-	-	-	(13,829)	-	(13,829)
Increase in unrealized gain on valuation of equity method investments	-	1,693	-	285	-	1,978
Decrease in unrealized loss on valuation of equity methodinvestments	-	-	-	256	-	256
Reacquisition of treasury stoc	-	-	(455,035)	-	-	(455,035)
Retirement of treasury stock	-	-	269,411	-	(269,411)	-
Compensation by treasury stock	-	128,823	92,581	-	-	221,404
Balance at December 31, 2007	**₩ 954,959**	**466,769**	**(414,947)**	**1,593**	**2,133,629**	**3,142,003**

Mil. Won, Thou. USD

	Korean Won						U.S. dollars (note 3)
	Capital stock	Capital surplus	Capital adjustments	Accumulated other compre-hensive income	Retained earnings	Total equity	Total equity
Balance at January 1, 2008	**₩ 954,959**	**464,237**	**(414,947)**	**4,189**	**2,133,591**	**3,142,029**	**$ 2,498,631**
Cumulative effect of change inaccounting policy	-	2,532	-	(2,596)	38	(26)	(21)
Balance at January 1, 2008, restated	**954,959**	**466,769**	**(414,947)**	**1,593**	**2,133,629**	**3,142,003**	**2,498,611**
Dividends	-	-	-	-	(340,449)	(340,449)	(270,735)
Net income	-	-	-	-	894,290	894,290	711,165
Increase of unrealized gain on valuation of available-for-sale securities	-	-	-	25,637	-	25,637	20,387
Increase in unrealized gain on valuation of equity method investments	-	-	-	2,790	-	2,790	2,219
Decrease of unrealized loss on valuation of equity method investments	-	-	-	639	-	639	508
Unearned stock compensation	-	-	2,295	-	-	2,295	1,826
Reacquisition of treasury stock	-	-	(194,128)	-	-	(194,128)	(154,376)
Retirement of treasury stock	-	-	379,753	-	(379,753)	-	-
Compensation by treasury stock	-	4,375	2,377	-	-	6,752	5,369
Balance at December 31, 2008	**₩ 954,959**	**471,144**	**(224,650)**	**30,659**	**2,307,717**	**3,539,829**	**$ 2,814,974**

See accompanying notes to non-consolidated financial statements.

Non-Consolidated Statements of Cash Flows

FOR THE YEARS ENDED DECEMBER 31, 2008 AND 2007

Mil. Won, Thou. USD

	2008		2007
	Korean Won	U.S. dollars (note 3)	Korean Won
Cash flows from operating activities			
Net income	₩ 894,290	$ 711,165	₩ 661,206
Adjustments for:			
Depreciation and amortization	134,702	107,119	135,503
Gain on valuation of inventories, net	(14,026)	(11,153)	(4,987)
Loss (gain) on sale of available-for-sale securities	(84)	(67)	724
Bad debt expense	12,491	9,933	6,074
Loss on impairment of available-for-sale securities	-	-	2,150
Gain on valuation of equity method investments, net	(134,706)	(107,122)	(103,315)
Gain on foreign currency translation, net	(25,381)	(20,184)	(2,361)
Provision for retirement and severance benefits	47,071	37,432	31,014
Loss on valuation of derivative investments	2,699	2,146	25
Gain on sale of property, plant and equipment, net	(11,191)	(8,899)	(5,489)
Provision for Tobacco Production Stabilization Fund	-	-	35,516
Amortization of present value discounts	-	-	(11,416)
Others, net	474	377	(664)
	12,049	9,582	82,774
Change in assets and liabilities			
Trade accounts receivable	(124,094)	(98,683)	(35,891)
Other receivables	(40,229)	(31,991)	(9,623)
Advance payments	(21,053)	(16,742)	1,247
Prepaid expenses	2,126	1,691	(3,716)
Inventories	(76,629)	(60,938)	42,014
Trade accounts payable	17,865	14,207	286
Other payables	40,576	32,267	77,559
Advance receipts	(838)	(666)	(2,404)
Withholdings	2,389	1,900	(4,155)
Value added tax withholdings	(3,683)	(2,929)	(11)
Accrued expenses	6,941	5,520	9,940
Tobacco excise tax and dues payable	(13,311)	(10,585)	126,346
Income taxes payable	(29,996)	(23,854)	22,330
Deferred income taxes	₩ 11,755	$ 9,348	₩ 24,540

(Continued)

Mil. Won, Thou. USD

	2008				2007	
	Korean Won		U.S. dollars (note 3)		Korean Won	
Deposit for severance benefits trust	₩	117,822	$	93,695	₩	(22,351)
Gain on dividend of equity method investments		60,000		47,714		20,000
Payments of retirement and severance benefits		(96,681)		(76,883)		(13,754)
Payments to Tobacco Production Stabilization Fund		-		-		(110,000)
Retirement pension plan asset		(84,959)		(67,562)		-
Others, net		(17)		(14)		(670)
Net cash provided by operating activities		**674,323**		**536,242**		**865,667**
Cash flows from investing activities						
Proceeds from sale of available-for-sale securities		530		421		1,750
Decrease in long-term loans to employees, net		7,404		5,889		101,321
Increase in long-term loans to affiliates, net		(10,121)		(8,049)		(34)
Increase in guarantee deposits paid, net		(2,698)		(2,146)		(941)
Proceeds from sale of property, plant & equipment		21,867		17,389		26,617
Purchases of available-for-sale securities		(21,928)		(17,438)		(242,324)
Increase in long-term deposit in Escrow Fund		(17,895)		(14,231)		(20,415)
Purchases of property, plant & equipment		(141,086)		(112,196)		(220,962)
Purchases of equity method investment securities		-		-		(18,009)
Other, net		(685)		(544)		(1,033)
Net cash used in investing activities		**(164,612)**		**(130,905)**		**(374,030)**
Cash flows from financing activities						
Decrease in guarantee deposits received, net		(1,908)		(1,517)		(2,921)
Payment of dividends		(340,449)		(270,735)		(319,712)
Reissuance of treasury stock		-		-		235,233
Reacquisition of treasury stock		(194,128)		(154,376)		(455,035)
Net cash used in financing activities		**(536,485)**		**(426,628)**		**(542,435)**
Net decrease in cash and cash equivalents		**(26,774)**		**(21,291)**		**(50,798)**
Cash and cash equivalents at beginning of year		115,126		91,551		165,924
Cash and cash equivalents at end of year	**₩**	**88,352**	**$**	**$ 70,260**	**₩**	**115,126**

See accompanying notes to non-consolidated financial statements.

Notes to Non-Consolidated Financial Statements

DECEMBER 31, 2008 AND 2007

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

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

As of December 31, 2008, the Company has four manufacturing plants, including the Shin Tan Jin plant, and 14 local headquarters and 168 branches for the sale of tobacco throughout the country. Also, the Company has the Gimcheon plant for fabrication of leaf tobacco and the Chunahn printing plant for the manufacturing of packaging. Pursuant to the Korean government's privatization program and management reorganization plan, on December 28, 1998, the stockholders approved a plan to separate the Company into two companies by setting up a subsidiary for its red ginseng business segment effective January 1, 1999. The separation was accomplished by the Company's contribution of the assets and liabilities in the red ginseng business segment into a wholly-owned subsidiary, the Korea Ginseng Corporation.

On October 17, 2002 and October 31, 2001, the Company listed 35,816,658 and 45,400,000 Global Depositary Receipts ("GDR") (each GDR representing the right to receive one-half share of common stock of the Company), respectively, on the Luxembourg Stock Exchange pursuant to the Korean government's privatization program.

The ownership of the Company's issued common stock at December 31, 2008 is held as follows:

Stockholder	Number of shares	Percentage of ownership
Industrial Bank of Korea	9,510,485	6.85%
Employee Stock Ownership Association	7,236,217	5.21%
Treasury stock	10,093,697	7.27%
Others	111,952,098	80.67%
	138,792,497	100.00%

The Company has, thus far, reacquired and retired 52,199,400 shares of treasury stock. Accordingly, as of December 31, 2008, the Company's common stock differs from the aggregate par value of issued shares by ₩ 260,997 million.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTING FINANCIAL STATEMENTS

(A) BASIS OF PRESENTING FINANCIAL STATEMENTS

The Company maintains its accounting records in Korean Won and prepares statutory non-consolidated financial statements in the Korean language in conformity with accounting principles generally accepted in the Republic of Korea. Certain accounting principles applied by the Company that conform with financial accounting standards and accounting principles in the Republic of Korea may not conform with generally accepted accounting principles in other countries. Accordingly, these financial statements are intended solely for use by only those who are informed about Korean accounting principles and practices. The accompanying non-consolidated financial statements have been condensed, restructured and translated into English from the Korean language non-consolidated financial statements.

Certain information included in the Korean language non-consolidated financial statements, but not required for a fair presentation of the Company's financial position, results of operations, changes in equity or cash flows, is not presented in the accompanying non-consolidated financial statements.

Except for the items explained in note 31 related to accounting changes and the adoption of changes to Statements of Korean Accounting Standards ("SKAS") No. 15 Investments in Associates, No. 16 Income Taxes and Korea Accounting Institute Opinion 06-2 (Deferred Income Taxes on Investments in Subsidiaries, Associates and Interests in Joint Ventures), the Company applied the same accounting policies that were adopted in the previous year's non-consolidated financial statements.

(B) CASH EQUIVALENTS

The Company considers short-term deposits with maturities of three months or less on acquisition date to be cash equivalents.

(C) SHORT-TERM DEPOSITS

Short-term deposits, (including money market deposit accounts (MMDAs), time deposits, and installment savings deposits), are held for short-term cash management purposes, maturing within one year.

(D) ALLOWANCE FOR DOUBTFUL ACCOUNTS

Allowance for doubtful accounts is estimated based on an analysis of individual accounts and past experience of collection and presented as a deduction from trade receivables.

(E) INVENTORIES

Inventories are stated at the lower of cost or net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated selling cost. The cost of inventories is determined by the weighted-average method for finished goods, by-products and work-in-progress; using the moving-average method for raw materials and supplies; and using the specific identification method for goods-in-transit. Also, the cost of construction-in-progress and land involved in pre-contracted sales are determined by the specific identification method. Amounts of inventory written down to net realizable value due to losses occurring in the normal course of business are recognized as cost of goods sold and are deducted as an allowance from the carrying value of inventories. The Company recognized loss and reversal of loss on valuation of inventories amounting to ₩ 4,413 million and ₩ 18,439 million, respectively, for the year ended December 31, 2008. Also, the estimated amounts of inventories in current assets, which will not be realized in a year or less, are ₩ 304,969 million and ₩ 319,217 million, respectively, as of December 31, 2008 and 2007.

(F) INVESTMENT IN SECURITIES (EXCLUDING INVESTMENTS IN ASSOCIATES, SUBSIDIARIES AND JOINT VENTURES)

Classification

Upon acquisition, the Company classifies debt and equity securities (excluding investments in subsidiaries, associates and joint ventures) into the following categories: held-to-maturity, available-for-sale or trading securities. This classification is reassessed at each balance sheet date. Investments in debt securities where the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity. Securities that are acquired principally for the purpose of selling in the short term are classified as trading securities. Investments not classified as either held-to-maturity or trading securities are classified as available-for-sale securities.

Initial recognition

Investments in securities (excluding investments in subsidiaries, associates and joint ventures) are initially recognized at cost.

Subsequent measurement and income recognition

Trading securities are subsequently carried at fair value. Gains and losses arising from changes in the fair value of trading securities are included in the income statement in the period in which they arise. Available-for-sale securities are subsequently carried at fair value. Gains and losses arising from changes in the fair value of available-for-sale securities are recognized as accumulated other comprehensive income, net of tax, directly in equity. Investments in available-for-sale securities that do not have readily determinable fair values are recognized at cost less impairment, if any. Held-to-maturity investments are carried at amortized cost with interest income and expense recognized in the income statement using the effective interest method.

Fair value information

The fair value of marketable securities is determined using quoted market prices as of the period end. Non-marketable debt securities are fair valued by discounting cash flows using the prevailing market rates for debt with a similar credit risk and remaining maturity. Credit risk is determined using the Company's credit rating as announced by accredited credit rating agencies in Korea. The fair value of investments in money market funds is determined by investment management companies.

Presentation

Trading securities are presented as current assets. Available-for-sale securities, which mature within one year from the balance sheet date or where the likelihood of disposal within one year from the balance sheet date is probable, are presented as current assets. Held-to-maturity securities, which mature within one year from the balance sheet date, are presented as current assets. All other available-for-sale securities and held-to-maturity securities are presented as long-term investments.

Impairment

The Company reviews investments in securities whenever events or changes in circumstances indicate that the carrying amount of the investments may not be recoverable. Impairment losses are recognized when the reasonably estimated recoverable amounts are less than the carrying amount and it is not obviously evidenced that impairment is unnecessary.

(G) INVESTMENT SECURITIES UNDER THE EQUITY METHOD OF ACCOUNTING

Associates are entities of which the Company and its subsidiaries have the ability to significantly influence the financial and operating policies. It is presumed to have significant influence if the Company holds directly or indirectly 20 percent or more of the voting power unless it can be clearly demonstrated that this is not the case. Subsidiaries are entities controlled by the Company.

Investments in associates and subsidiaries are accounted for using the equity method of accounting and are initially recognized at cost.

The Company's investments in associates and subsidiaries include goodwill identified on acquisition (net of any accumulated impairment loss). Goodwill is calculated as the excess of the acquisition cost of an investment in an associate or subsidiary over the Company's share of the fair value of the identifiable net assets acquired. Goodwill is amortized using the straight-line method over its estimated useful life. Amortization of goodwill is recorded together with equity income (losses).

When events or circumstances indicate that the carrying value of goodwill may not be recoverable, the Company reviews goodwill for impairment and records any impairment loss immediately in the statement of income.

The Company's share of its post-acquisition profits or losses in investments in associates and subsidiaries is recognized in the income statement, and its share of post-acquisition movements in equity is recognized in equity. The cumulative post-acquisition movements are adjusted against the carrying amount of each investment. Changes in the carrying amount of an investment resulting from dividends by an associate or subsidiary are recognized when the associate or subsidiary declares the dividend. When the Company's share of losses in an associate or subsidiary equals or exceeds its interest in the associate or subsidiary, including preferred stock or other long term loans and receivables issued by the associate or subsidiary, the Company does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate or subsidiary. Unrealized gains on transactions between the Company and its associates or subsidiaries are eliminated to the extent of the Company's interest in each associate or subsidiary.

When applying the equity method of accounting to a subsidiary, except when the Company's share of losses in subsidiary equals or exceeds its interest in subsidiary, net income and net assets of non-consolidated financial statements must agree with those of consolidated financial statements.

(H) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost, except in the case of revaluations made in accordance with the Asset Revaluation Law which allowed for asset revaluation prior to the Law being revoked. Assets acquired through investment in kind or donation, are recorded at their fair value upon acquisition. For assets acquired in exchange for a non-monetary asset, the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.

Significant additions or improvements extending useful lives of assets are capitalized. However, normal maintenance and repairs are charged to expense as incurred.

Depreciation is computed by using the straight-line method over estimated useful lives of the respective assets as follows:

	Useful lives (years)
Buildings	10 to 60
Structures	10 to 40
Machinery and equipment	10 to 12
Vehicles and other transportation equipment	4
Tools	4
Furniture and fixtures	4

The Company recognizes as an expense interest cost and other financial charges on borrowings associated with the manufacture, purchase, or construction of property, plant and equipment in the period in which they are incurred.

The Company reviews property, plant and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An impairment loss would be recognized when the expected estimated undiscounted future net cash flows from the use of the asset and its eventual disposal are less than its carrying amount.

(I) INTANGIBLE ASSETS

An intangible asset is an asset where: (1) it is probable that future economic benefits that are attributable to the asset will flow into the entity and (2) the cost of the asset can be measured reliably. Intangible assets are stated at cost less accumulated amortization and impairment losses, if any. Impairment losses are determined as the amount required to reduce the carrying amount of an intangible asset to its recoverable amount. The criteria for determining whether an incurred cost qualifies as an intangible asset and the periods of amortization for each classification of intangible asset are described below.

Research and Development Costs

To assess whether an internally generated intangible asset meets the criteria for recognition, the Company classifies the expense generation process into a research phase and a development phase. All costs incurred during the research phase are expensed as incurred. Costs incurred during the development phase are recognized as assets only if the following criteria are met for recognition in SKAS No. 3, Intangible Assets: (1) Completion of the intangible asset is technically feasible so that it will be available for use or sale; (2) the Company has the intention and ability to complete the intangible asset and use or sell it; (3) there is evidence that the intangible asset will generate probable future economic benefit; (4) the Company has adequate technical, financial and other resources to complete the development of the intangible asset and the intangible asset will be available; and (5) the expenditures attributable to the intangible asset during its development can be reliably determined. If the costs incurred fail to satisfy these criteria, they are recorded as expenses as incurred.

Other Intangible Assets

Other intangible assets, which consist of industrial property rights, franchise rights and software, are amortized using the straight-line method over 5~15 years.

(J) RETIREMENT AND SEVERANCE BENEFITS

Employees who have been with the Company for more than one year are entitled to lump-sum payments based on current salary rates and length of service when they leave the Company. The Company's estimated liability under the plan which would be payable if all employees left on the balance sheet date is accrued in the accompanying non-consolidated balance sheets. A portion of the liability is covered by an employees' severance benefits trust where the employees have a vested interest in the deposit with the insurance company in trust. The deposit for severance benefits held in trust is, therefore, reflected in the accompanying non-consolidated balance sheets as a reduction of the liability for retirement and severance benefits.

The Company introduced a new pension plan, from 2008. Under the Retirement Benefits Regulation, consideration of service requirements under the new plan begins from the date the new plan is effective; the period of service prior to the effective date of the new plan will continue to be covered by the existing retirement benefits plan.

The Company introduced a defined benefit pension plan, under which each eligible employee receives a fixed amount of pension after retirement. The Company accrued, as a liability for retirement and severance benefits, lump-sum payments payable to employees who are currently in service, assuming that they left the Company as of the balance sheet date. All employees with a minimum of one year of service are eligible to participate and must elect to participate in the plan. Participants accrue estimated benefits based on actuarial assumptions measured on the balance sheet date at the discounted present value.

The combined provision for retirement and severances benefits under the new pension plan and those under the existing retirement benefits plan is recorded as the liability for retirement and severance benefits. Pension plan assets, together with the existing retirement and severance benefit deposit and the deposit previously made to the National Pension Fund under the old National Pension Law, as referred to above, is reflected in the accompanying balance sheets as a reduction of the liability for retirement and severance benefits.

(K) FOREIGN CURRENCY TRANSLATION

Monetary assets and liabilities denominated in foreign currencies are translated into Korean Won at the balance sheet date, with the resulting gains or losses recognized in current results of operations. Monetary assets and liabilities denominated in foreign currencies are translated into Korean Won at ₩ 1,257.5 to USD 1, the rate of exchange on December 31, 2008 that is permitted by the Financial Accounting Standards. Non-monetary assets and liabilities denominated in foreign currencies, which are stated at historical cost, are translated into Korean Won at the foreign exchange rate on the date of the transaction.

Foreign currency assets and liabilities of foreign-based operations and companies accounted for using the equity method are translated at current rate of exchange at the balance sheet date. Foreign currency amounts in the statement of income are translated using an average rate and foreign currency balances in the capital account are translated using the historical rate. Translation gains and losses arising from collective translation of the foreign currency financial statements of foreign-based operations are recorded net as accumulated other comprehensive income. These gains and losses are subsequently recognized as income in the year the foreign operations or the companies are liquidated or sold.

(L) REVENUE RECOGNITION

The Company's revenue categories consist of tobacco products sold, construction contracts and other income.

Tobacco products sold

Revenue from the sale of tobacco products is measured at the fair value of the consideration received or receivable, net of returns and allowances, trade discounts and volume rebates. Revenue is recognized when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, and there is no continuing management involvement with the goods.

Lotting-out construction contracts

As soon as the outcome of a lotting-out construction contract can be estimated reliably, contract revenue and expenses are recognized in the statement of income in proportion to the percentage of completion and sales in lots of the contact. Lotting-out revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments to the extent that it is probable that they will result in revenue and can be measured reliably.

The percentage of completion is assessed by reference to costs incurred for work performed to date to the estimated total contract costs. When the outcome of a construction contract cannot be estimated reliably, revenue is recognized only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognized immediately in the statement of income.
Revenue from other than the above is recognized when the Company's revenue-earning activities have been substantially completed, the amount of revenue can be measured reliably, and it is probable that the economic benefits associated with the transaction will flow to the Company.

(M) INCOME TAXES

Income tax on the income or loss for the year comprises current and deferred tax. Income tax is recognized in the statement of income except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted.

Deferred tax is provided using the asset and liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable income will be available against which the unused tax losses and credits can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Deferred tax assets and liabilities are classified as current or non-current based on the classification of the related asset or liability for financial reporting or the expected reversal date of the temporary difference for those with no related asset or liability such as loss carryforwards and tax credit carryforwards. The deferred tax amounts are presented as a net current asset or liability and a net non-current asset or liability. Deferred taxes are recognized on the temporary differences related to unrealized gains and losses on investment securities that are reported as a separate component of capital adjustments.

(N) PROVISIONS, CONTINGENT ASSETS AND CONTINGENT LIABILITIES

Provisions are recognized when all of the following are met: (1) an entity has a present obligation as a result of a past event, (2) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and (3) a reliable estimate can be made of the amount of the obligation. Where the effect of the time value of money is material, a provision is recorded at the present value of the expenditures expected to be required to settle the obligation.

Where the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement is recognized as a separate asset when, and only when, it is virtually certain that reimbursement will be received if the Company settles the obligation. The expense relating to a provision is presented net of the amount recognized for a reimbursement.

(O) EARNINGS PER SHARE

Earnings per common share are calculated by dividing net income by the weighted-average number of shares of common stock outstanding during each period.

(P) SHARE-BASED PAYMENTS

The Company has granted shares or share options to its employees and other parties. For equity-settled share-based payment transactions, the Company measures the goods or services received, and the corresponding increase in equity as a capital adjustment at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the Company measures their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted. If the fair value of the equity instruments cannot be estimated reliably at the measurement date, the Company measures them at their intrinsic value and recognizes the goods or services received based on the number of equity instruments that ultimately vest. For cash-settled share-based payment transactions, the Company measures the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the Company remeasures the fair value of the liability at each reporting date and at the date of settlement, with changes in fair value recognized in profit or loss for the period.

(Q) DERIVATIVES

The Company holds derivative financial instruments to hedge its foreign currency and interest rate risk exposures. Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, and a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.

Derivatives are initially recognized at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Attributable transaction costs are recognized in profit or loss when incurred.

<u>Hedge accounting</u>

Where a derivative, which meets certain criteria, is used for hedging the exposure to changes in the fair value of a recognized asset, liability or firm commitment, it is designated as a fair value hedge. Where a derivative, which meets certain criteria, is used for hedging the exposure to the variability of the future cash flows of a forecasted transaction it is designated as a cash flow hedge.

The Company documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Company also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting the changes in fair values or cash flows of hedged items.

<u>Fair value hedge</u>

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the statement of income, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

<u>Cash flow hedge</u>

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in equity. The gain or loss relating to any ineffective portion is recognized immediately in the statement of income. Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at the time remains in equity and is recognized when the forecast transaction is ultimately recognized in the statement of income. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the statement of income.

<u>Derivatives that do not qualify for hedge accounting</u>

Changes in the fair value of derivative instruments that are not designated as fair value or cash flow hedges are recognized immediately in the statement of income.

<u>Separable embedded derivatives</u>

Changes in the fair value of separable embedded derivatives are recognized immediately in the statement of income.

(R) USE OF ESTIMATES

The preparation of non-consolidated financial statements in accordance with accounting principles generally accepted in the Republic of Korea requires management to make estimates and assumptions that affect the amounts reported in the non-consolidated financial statements and related notes to non-consolidated financial statements. Actual results could differ from those estimates.

3. BASIS OF TRANSLATING FINANCIAL STATEMENTS

The non-consolidated financial statements are expressed in Korean Won and have been translated into U.S. dollars at the rate of ₩ 1,257.5 to US$1, the basic exchange rate on December 31, 2008, solely for the convenience of the reader. This translation should not be construed as a representation that any or all of the amounts shown could be converted into United States dollars at this or any other rate.

4. INVENTORIES

Inventories as of December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Finished goods, net of allowance for valuation losses	₩	78,473	80,680
Work-in-process		10,039	10,100
Raw materials, net of allowance for valuation losses		816,773	792,561
Supplies		22,978	21,507
By-products		3,241	2,641
Completed buildings		121,552	52,150
Sites for building lotting-out construction (notes 10 and 21)		12,728	13,204
Goods-in-transit		9,728	6,670
	₩	**1,075,512**	**979,513**

5. OTHER CURRENT ASSETS

Other current assets as of December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Accrued income	₩	287	237
Other receivables, net of allowance for doubtful accounts of ₩ 5,605 in 2008 and ₩ 4,652 in 2007 (note 16)		73,048	33,564
Prepaid expenses		4,880	7,006
Short-term loans to employees (note 8)		28,029	19,442
Advance payments (note 8)		21,297	244
Available-for-sale securities (note 6)		2,149	92
	₩	129,690	60,585

6. AVAILABLE-FOR-SALE SECURITIES

Available-for-sale securities as of December 31, 2008 and 2007 are summarized as follows:

(a) Equity securities (non-current)

Mil. Won, except owned shares and percentage of ownership

	Number of shares	Percentage of ownership	Acquisition cost	Fair value	Book value 2008	Book value 2007
Marketable securities:						
Yonhap Television News (YTN)	8,380,000	19.95%	₩ 5,102	37,249	37,249	28,366
Crystal Genomics Co., Ltd.	172,187	1.67%	3,022	1,722	1,722	1,791
Oscotech, Inc.	230,770	3.51%	2,250	748	748	1,396
Shinhan Financial Group	3,500,000	0.88%	205,532	103,950	103,950	187,250
REXAHN Pharmaceuticals, Inc. (*1)	4,642,858	8.28%	5,158	5,196	5,196	-
Celltrion, Inc. (*2)	13,030,810	12.22%	21,245	129,005	129,005	-
			242,309	**277,870**	**277,870**	**218,803**
Non-marketable securities:						
Celltrion, Inc. (*2)	-	-	-	-	-	21,245
Nexgen Biotechnologies, Inc. (*3)	1,000,000	11.84%	2,150	-	-	-
Cosmo Tobacco Co., Ltd. (*3)	480,000	40.00%	2,540	-	-	-
Innodis, Inc.	110,000	19.64%	55	55	55	55
REXAHN Pharmaceuticals, Inc. (*1)	-	-	-	-	-	5,158
Lifenza, Inc. (*3)	29,047	13.01%	1,600	-	-	-
Korea Islet Transplantation Institute, Inc. (*4)	110,500	48.25%	2,000	2,000	2,000	2,000
KT&G Mongolia LLC (*5)	-	-	-	-	-	201
Korea Tabacos do Brasil Ltda. (*4)	(*6)	99.90%	394	394	394	394
Genematrix, Inc.	300,000	10.14%	1,500	1,500	1,500	1,500
Litepharmtech, Inc. (*4)	77,667	29.46%	1,830	1,830	1,830	1,830
Hurum, Inc.	7,800	9.75%	39	39	39	39
Mazence Co., Ltd. (formerly, MD Bioalpha Co., Ltd.)	197,556	6.86%	733	733	733	733
OCT USA, Inc.	48,780	19.97%	927	927	927	927
Dream Hub PFV Co., Ltd.	3,000,000	1.50%	15,000	15,000	15,000	75
Migami, Inc.	4,286,000	3.77%	2,830	2,830	2,830	-
KT&G Pars (*4)	1,577,754	99.99%	1,697	1,697	1,697	-
KT&G Rus L.L.C. (*4)	(*6)	100.00%	802	802	802	-
Korean Carbon Finance Co., Ltd. (*4)	100,000	20.00%	500	500	500	-
SJ Biomed Corporation	285,714	14.39%	1,000	1,000	1,000	-
			35,597	**29,307**	**29,307**	**34,157**
Total			**₩ 277,906**	**307,177**	**307,177**	**52,960**

(*1) As REXAHN Pharmaceuticals, Inc. was listed on New York Stock Exchange in the year ended December 31, 2008, REXAHN Pharmaceuticals, Inc. is recorded at the reasonably adjusted value of the market price established in New York Stock Exchange.

(*2) As Celltrion, Inc. was Listed on KOSDAQ in the year ended December 31, 2008, Celltrion, Inc. is recorded at the market price established in KOSDAQ.

(*3) In the prior period, the Company wrote off its investments in Nexgen Biotechnologies, Inc., Lifenza, Inc. and Cosmo Tobacco Co., Ltd. as its decline in value was judged to be other than temporary. Other than the above, non-marketable securities are recorded at cost since fair value is not available or readily determinable.

(*4) Investments in small affiliates are accounted for under the cost method of accounting for investments since the effect of applying the equity method on its financial statements is not material.

(*5) The liquidation process was completed in the year ended December 31, 2008, the Company recorded a gain of ₩ 80 million on sale of available-for-sale securities.

(*6) Stock certificates are not issued.

(b) Debt securities

Mil. Won

	Interest rate per annum	Acquisition cost	Fair value	Book value 2008	Book value 2007
Current assets:					
Government and municipal bonds	2.5 ~ 4.0%	₩ 149	149	149	92
Oscotech, Inc.	10.0%	1,000	1,000	1,000	-
Litepharmtech, Inc.	8.0%	1,000	1,000	1,000	-
		2,149	**2,149**	**2,149**	**92**
Non-current assets:					
Government and municipal bonds	2.5%	2,001	2,001	2,001	2,129
Oscotech, Inc.	-	-	-	-	1,000
Litepharmtech, Inc.	-	-	-	-	1,000
		2,001	**2,001**	**2,001**	**4,129**
		₩ 4,150	**4,150**	**4,150**	**4,221**

The Company recorded ₩ 20 million of interest income on debt securities for the year ended December 31, 2008.

(c) Changes in unrealized gains

(i) Changes in unrealized gains of valuation of available-for-sale securities for the year ended December 31, 2008 are summarized as follows:

Mil. Won

	Amount including tax effect	Tax effect	Amount, net of tax effect
Beginning balance	₩ 2,897	(797)	2,100
Changes in unrealized gain	32,664	(7,027)	25,637
Ending balance	**₩ 35,561**	**(7,824)**	**27,737**

(ii) Changes in unrealized gains of valuation of available-for-sale securities for the year ended December 31, 2007 are summarized as follows:

Mil. Won

	Amount including tax effect	Tax effect	Amount, net of tax effect
Beginning balance	₩ 21,971	(6,042)	15,929
Changes in unrealized gain	(19,074)	5,245	(13,829)
Ending balance	**₩ 2,897**	**(797)**	**2,100**

7. EQUITY METHOD INVESTMENT SECURITIES

(a) Investments in companies accounted for using the equity method as of December 31, 2008 were as follows:

Mil. Won, except percentage of ownership

Company	Percentage of ownership	Cost	Market value or net assets	Balance at December 31, 2008
LISTED				
Yungjin Pharm. Ind. Co., Ltd. (*1)	55.50%	₩ 50,691	51,211	20,493
UNLISTED				
Korea Ginseng Corporation	100.00%	214,929	646,905	646,905
Tae-a Industry Co., Ltd.	100.00%	14,198	6,808	7,559
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. (*1)	99.99%	33,670	30,533	30,329
		₩ 313,488	**735,457**	**705,286**

(*1) The Company used unaudited financial statements of Yungjin Pharm. Ind. Co., Ltd. and KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. when applying the equity method of accounting.

Investments in companies accounted for using the equity method as of December 31, 2007 were as follows:

Mil. Won, except percentage of ownership

Company	Percentage of ownership	Cost	Market value or net assets	Balance at December 31, 2007
LISTED				
Yungjin Pharm. Ind. Co., Ltd. (*1)	55.50%	₩ 50,691	97,169	23,941
UNLISTED				
Korea Ginseng Corporation	100.00%	214,929	559,883	559,883
Tae-a Industry Co., Ltd.	100.00%	14,198	6,229	9,174
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. (*1,2)	99.99%	33,670	33,670	33,670
		₩ 313,488	**696,951**	**626,668**

(*1) The Company used unaudited financial statements of Yungjin Pharm. Ind. Co., Ltd. and KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. when applying the equity method of accounting. In the subsequent period, the Company adjusted the difference between the unaudited and audited results. Historically, the differences have been immaterial.
(*2) The Company reclassified its investment in KT&G Tutun Mamulleri Sanayi ve Ticaret A.S. as an equity method accounted investment since the effect of applying the equity method was material due to an additional acquisition of shares in the investee given rise to by an increase in its paid-in capital in the year ended December 31, 2007.

(b) Details of the difference between the acquisition cost and the Company's share of the investees' identifiable net assets arisen in the years ended December 31, 2008 and 2007 were as follows:

Mil. Won

	2008		
	Beginning balance	Amortized amount	Ending balance
Yungjin Pharm. Ind. Co., Ltd.	₩ 897	(896)	1
Tae-a Industry Co., Ltd.	3,109	(2,073)	1,036
	₩ 4,006	**(2,969)**	**1,037**

Mil. Won

	2007		
	Beginning balance	Amortized amount	Ending balance
Yungjin Pharm. Ind. Co., Ltd.	₩ 1,793	(896)	897
Tae-a Industry Co., Ltd.	5,183	(2,074)	3,109
	₩ 6,976	**(2,970)**	**4,006**

(c) Details of unrealized gains from intercompany transactions for the years ended December 31, 2008 and 2007 are summarized as follows:

Mil. Won

	2008			
	Beginning balance	Increase	Realized amount	Ending balance
Yungjin Pharm. Ind. Co., Ltd.	₩ 2,017	84	(25)	2,076
Tae-a Industry Co., Ltd.	164	1,626	(1,505)	285
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	-	305	(101)	204
	₩ 2,181	**2,015**	**(1,631)**	**2,565**

Mil. Won

	2007			
	Beginning balance	Increase	Realized amount	Ending balance
Yungjin Pharm. Ind. Co., Ltd.	₩ 876	1,157	(16)	2,017
Tae-a Industry Co., Ltd.	123	41	-	164
	₩ 999	**1,198**	**(16)**	**2,181**

(d) Changes in the begining and ending balances of investments in companies accounted for using the equity method for the years ended December 31, 2008 and 2007 were as follows:

Mil. Won, except percentage of ownership

	2008					
Company	Percentage of ownership	Balance at January 1, 2008	Net income (loss)	Accumlated other comprehensive income	Other decrease(*1)	Balance at December 31, 2008
Korea Ginseng Corporation	100.00%	₩ 559,883	145,046	1,976	(60,000)	646,905
Yungjin Pharm. Ind. Co., Ltd.	55.50%	23,941	(3,448)	-	-	20,493
Tae-a Industry Co., Ltd.	100.00%	9,174	(1,615)	-	-	7,559
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	99.99%	33,670	(5,277)	1,936	-	30,329
		₩ 626,668	**134,706**	**3,912**	**(60,000)**	**705,286**

(*1) The amount was cash dividends.

Mil. Won, except percentage of ownership

	2007					
Company	Percentage of ownership	Balance at January 1, 2007	Net income (loss)	Accumlated other comprehensive income	Other increase (decrease)(*1)	Balance at December 31, 2007
Korea Ginseng Corporation	100.00%	₩ 451,545	128,302	36	(20,000)	559,883
Yungjin Pharm. Ind. Co., Ltd. (*3)	55.50%	27,871	(23,633)	-	19,703	23,941
Tae-a Industry Co., Ltd.	100.00%	10,528	(1,354)	-	-	9,174
KT&G USA, Inc (*2)	-	903	-	-	(903)	-
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	99.99%	-	-		33,670	33,670
		₩ 490,847	**103,315**	**36**	**32,470**	**626,668**

(*1) The amount consists of ₩ 20,000 million cash dividends, ₩ 53,373 million paid-in capital increase and ₩ 903 million reclassification.
(*2) In the first quarter of 2007, the Company reclassified its investment in KT&G USA, Inc. as available-for-sale securities since KT&G USA, Inc. was in the process of liquidation. The liquidation process was completed in the year ended December 31, 2007, and the Company recorded a gain on sale of available-for-sale securities of ₩ 724 million.
(*3) Youngjin Pharm. Ind. Co., Ltd. amended its financial statements as of and for the year ended December 31, 2006 due to adjustments for the accounting error for the fiscal year 2006 and prior periods by which accumulated deficit increased by ₩ 20,959 million. However, as the effect of the adjustments on the financial statements was judged to be not material, a loss of ₩ 11,940 million has been charged to current results for the year ended December 31, 2007.

(e) Summarized financial information of equity-accounted investment securities, which represents 100% of the entities' balances as of December 31, 2008 was as follows:

Mil. Won

Company	Total assets	Total liabilities	Sales	Net income (loss)
Korea Ginseng Corporation	₩ 752,330	105,425	622,066	145,046
Yungjin Pharm. Ind. Co., Ltd.	109,320	68,657	110,868	(6,485)
Tae-a Industry Co., Ltd.	11,107	4,299	15,321	579
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	₩ 56,506	25,973	2,832	(5,073)

Summarized financial information of equity-accounted investment securities, which represents 100% of the entities' balances as of December 31, 2007 was as follows:

Mil. Won

Company	Total assets	Total liabilities	Sales	Net income (loss)
Korea Ginseng Corporation	₩ 631,874	71,991	521,123	128,302
Yungjin Pharm. Ind. Co., Ltd.	106,912	61,759	109,422	(16,575)
Tae-a Industry Co., Ltd.	10,298	4,069	13,419	767
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	₩ 37,973	4,303	-	(1,608)

8. TRANSACTIONS AND BALANCES WITH RELATED COMPANIES

(a) The Company's subsidiaries as of December 31, 2008 were as follows:

		Controlled subsidiary(*)	
Subsidiary owned by the Company	Ownership (%)	Entity owned by the subsidiary	Ownership (%)
Korea Ginseng Corporation	100.00%	KGC Sales Co., Ltd.	100.00%
		Korea Ginseng HK, Ltd.	100.00%
Yungjin Pharm. Ind. Co., Ltd.	55.50%	Yungjin Distribution Co., Ltd.	100.00%
Tae-a Industry Co., Ltd.	100.00%		
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	99.99%		
Cosmo Tabacco Co., Ltd.	40.00%		
Korea Tabacos do Brasil Ltda.	99.90%		
Korea Islet Transplantation Institute, Inc.	48.25%		
KT&G Pars	99.99%		
KT&G Rus L.L.C.	100.00%		

(*) Controlled subsidiaries represent majority-owned entities by either the Company or a controlled subsidiary and other entities where the Company or its controlled subsidiary owns more than 30% of total outstanding common stock and is the largest shareholder.

(b) Significant transactions and account balances which occurred in the normal course of business with related companies as of and for the years ended December 31, 2008 and 2007 are summarized as follows:

(i) Revenue from sales and others

Mil. Won

	2008			2007		
Company	Sales	Other income	Total	Sales	Other income	Total
Korea Ginseng Corporation	₩ 12,176	1,095	13,271	1,440	11,545	12,985
Yungjin Pharm. Ind. Co., Ltd.	163	8	171	202	1	203
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	2,512	682	3,194	1,186	680	1,866
KT&G USA, Inc.	-	-	-	1,694	-	1,694
KT&G Mongolia LLC	-	-	-	1,457	-	1,457
KT&G Pars	556	965	1,521	-	-	-
	₩ 15,407	**2,750**	**18,157**	**5,979**	**12,226**	**18,205**

(ii) Purchases and other expenses

Mil. Won

Company	2008			2007		
	Purchases	Other expenses	Total	Purchases	Other expenses	Total
Korea Ginseng Corporation	₩ -	1,446	1,446	2,223	-	2,223
Yungjin Pharm. Ind. Co., Ltd.	-	121	121	144	-	144
Tae-a Industry Co., Ltd.	15,321	-	15,321	13,419	-	13,419
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	-	-	-	1,092	494	1,586
Korea Tabacos do Brasil Ltda.	-	165	165	-	132	132
	₩ 15,321	**1,732**	**17,053**	**16,878**	**626**	**17,504**

(iii) Due from affiliates

Mil. Won

Company	2008			2007		
	Trade accounts receivable	Other	Total	Trade accounts receivable	Other	Total
Korea Ginseng Corporation	₩ -	3,184	3,184	-	-	-
KT&G Tutun MamulleriSanayi ve Ticaret A.S.	1,313	24,128	25,441	1,127	-	1,127
KT&G Pars	11	7,193	7,204	-	-	-
KT&G Rus L.L.C	-	347	347	-	-	-
KT&G Mongolia LLC	-	-	-	316	238	554
	₩ 1,324	**34,852**	**36,176**	**1,443**	**238**	**1,681**

(iv) Due to affiliates

Mil. Won

Company	2008			2007		
	Trade accounts payable	Other	Total	Trade accounts payable	Other	Total
Korea Ginseng Corporation	₩ -	2,595	2,595	270	2,379	2,649

(c) Due from stockholders, directors and employees as of December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Loans for employee housing and education	₩	30,660	31,713
Loans to Employee Stock Ownership Association		28,388	37,664
Other		48,929	46,004
	₩	**107,977**	**115,381**

(d) Key management personnel compensation in total and for each of the following categories for the years ended December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Short-term payroll	₩	8,698	11,609
Post-retirement pay		9,113	4,081
	₩	**17,811**	**15,690**

9. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Property, plant and equipment at cost	₩	2,266,480	2,224,880
Accumulated depreciation		(867,664)	(815,881)
Accumulated impairment losses		(41)	(41)
Property, plant and equipment, net	**₩**	**1,398,775**	**1,408,958**

(a) Changes in property, plant and equipment for the year ended December 31, 2008 were as follows:

Mil. Won

	January 1, 2008	Acquisition	Disposal	Depreciation	Others (*1)	December 31, 2008
Land	₩ 403,344	1,304	(2,366)	-	16,567	418,849
Buildings	470,731	8,983	(3,175)	(23,159)	22,654	476,034
Structures	23,340	737	(144)	(2,078)	1,284	23,139
Machinery and equipment	342,473	11,173	(4,513)	(66,458)	57,083	339,758
Vehicles and other transportation equipment	2,836	575	(12)	(1,702)	-	1,697
Tools	11,640	612	(11)	(4,757)	3,061	10,545
Furniture and fixtures	75,328	20,851	(455)	(35,842)	1,981	61,863
Construction-in-progress (*2)	78,663	96,851	-	-	(109,227)	66,287
Other tangible fixed assets	603	-	-	-	-	603
	₩ 1,480,958	**141,086**	**(10,676)**	**(133,996)**	**(6,597)**	**1,398,775**

(*1) Other changes in property, plant and equipment, except those transferred from construction-in-progress, for the year ended December 31, 2008 were as follows:

Mil. Won

		Amount
Transferred to site for building lotting-out construction	₩	(5,970)
Loss on impairment of property, plant and equipment		(429)
Transferred to intangible assets (note 11)		(198)
	₩	**(6,597)**

(*2) Construction-in-progress as of December 31, 2008 included investment on development of new medicines amounting to ₩ 25,456 million.

(b) Changes in property, plant and equipment for the year ended December 31, 2007 were as follows:

Mil. Won

	January 1, 2007	Acquisition	Disposal	Depreciation	Others (*1)	December 31, 2007
Land	₩ 353,865	21,961	(13,592)	-	41,110	403,344
Buildings	460,511	6,088	(4,415)	(21,570)	30,117	470,731
Structures	23,194	1,076	(263)	(1,971)	1,304	23,340
Machinery and equipment	332,553	7,220	(2,479)	(67,408)	72,587	342,473
Vehicles and other transportation equipment	5,322	546	(225)	(2,883)	76	2,836
Tools	10,010	2,106	(27)	(4,497)	4,048	11,640
Furniture and fixtures	75,235	32,493	(127)	(36,443)	4,170	75,328
Construction-in-progress (*2)	83,002	149,333	-	-	(153,672)	78,663
Other tangible fixed assets	464	139	-	-	-	603
	₩ 1,344,156	**220,962**	**(21,128)**	**(134,772)**	**(260)**	**1,408,958**

(*1) Other changes in property, plant and equipment except those transferred from construction-in-progress for the year ended December 31, 2007 were as follows:

Mil. Won

		Amount
Transferred to vehicles and other transportation equipment	₩	30
Transferred to intangible assets		(290)
	₩	(260)

(*2) Construction-in-progress as of December 31, 2007 included investment on development of new medicines amounting to ₩ 21,320 million..

10. OFFICIALLY DECLARED VALUE OF LAND

The officially declared value of land at December 31, 2008 and 2007, as announced by the Minister of Construction and Transportation, were as follows:

Mil. Won

	2008			2007	
	Book value		Declared value	Book value	Declared value
Land	₩	418,849	1,408,474	403,344	1,304,163
Sites for building lotting-out construction		12,728	50,555	13,204	40,356
	₩	431,577	1,459,029	416,548	1,344,519

The officially declared value, which is used for government purposes, is not intended to represent fair value.

11. INTANGIBLE ASSETS

(a) Changes in intangible assets for the year ended December 31, 2008 were as follows:

Mil. Won

	Industrial property rights		Other intangible assets	Total
Beginning balance	₩	1,520	199	1,719
Increases		198	-	198
Amortization		(613)	(93)	(706)
Other		-	(23)	(23)
Net balance at end of period	₩	1,105	83	1,188

(b) Changes in intangible assets for the year ended December 31, 2007 were as follows:

Mil. Won

	Industrial property rights		Other intangible assets	Total
Beginning balance	₩	1,809	297	2,106
Increases		345	-	345
Amortization		(634)	(98)	(732)
Net balance at end of period	₩	1,520	199	1,719

12. INSURANCE

Buildings, structures, machinery and equipment and inventories were insured against fire damage up to ₩ 899,418 million as of December 31, 2008 with Dongbu Insurance Co., Ltd. In addition, the Company carries comprehensive automobile insurance, unemployment insurance and workers' accident compensation insurance.

13. OTHER NON-CURRENT ASSETS

Other non-current assets as of December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Long-term loans to affiliates (notes 8 and 16)	₩	10,630	238
Long-term other receivables, net of allowance for doubtful accounts of ₩ 6 in 2008 and ₩ 10 in 2007		555	1,018
Other investments assets		419	677
	₩	**11,604**	**1,933**

14. OTHER CURRENT LIABILITIES

Other current liabilities as of December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Withholdings	₩	8,632	6,244
Advance receipts		3,871	4,709
Current portion of financial derivative liabilities (note 32)		2,699	25
Unearned income		379	321
	₩	**15,581**	**11,299**

15. RETIREMENT AND SEVERANCE BENEFITS

Changes in the retirement and severance benefits for the years ended December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Estimated retirement and severance benefits accrual at beginning of year	**₩**	**182,345**	**173,332**
Provision for retirement and severance benefits		47,071	31,044
Transferred to unearned stock compensation		(2,295)	-
Payments (*1)		(103,481)	(22,001)
Estimated retirement and severance benefits accrual at end of year		123,640	182,345
Retirement pension plan asset (*2)		(84,959)	-
Deposit for severance benefits trust		(164)	(117,985)
Net balance at end of year	**₩**	**38,517**	**64,360**

The Company maintained an employees' severance benefit trust arrangement with Samsung Life Insurance Co., Ltd. and other. Under this arrangement, the Company has made a deposit in the amount equal to 64.7% of the reserve balances of retirement and severance benefits as of December 31, 2007. This deposit was to be used to make the required payments to the retirees and accounted for as a reduction of the reserve balance.

(*1) Compensations paid by treasury stock amounting to ₩ 2,430 million for the year ended December 31, 2008 were included.
(*2) Retirement pension plan asset as of December 31, 2008 was as follows:

Mil. Won

		Amount
Short-term financial instruments	₩	49,573
Available-for-sale securities		35,386
	₩	84,959

16. ASSETS AND LIABILITIES DENOMINATED IN FOREIGN CURRENCIES

Details of assets and liabilities denominated in foreign currencies as of December 31, 2008 and 2007 were as follows:

Mil. Won, Thou. USD and Euro

		Foreign currency		Korean Won equivalent	
		2008	2007	2008	2007
ASSETS:					
Cash and cash equivalents	USD	888	9,107	₩ 1,116	8,544
	EUR	47	-	83	-
Trade accounts receivable	USD	212,002	159,875	266,592	149,995
	EUR	746	816	1,325	1,127
Other receivables	USD	3,259	259	4,098	243
Long-term loans to affiliates	USD	8,453	-	10,630	-
Long-term deposits in escrow fund	USD	87,683	71,022	110,261	66,633
Total	USD	312,285	240,263	392,697	225,415
	EUR	793	816	1,408	1,127
				₩ 394,105	**226,542**
LIABILITIES:					
Trade accounts payable	USD	266	692	₩ 335	649
	EUR	4,100	2,530	7,282	3,495
				₩ 7,617	**4,144**

17. CAPITAL ADJUSTMENTS

Capital adjustments as of December 31, 2008 and 2007 are summarized as follows:

Mil. Won

	2008	2007
Treasury stock	₩ (226,945)	(414,947)
Unearned stock compensation	2,295	-
	₩ (224,650)	**(414,947)**

18. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated other comprehensive income as of December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Unrealized gain on valuation of available-for-sale securities (note 6)	₩	27,737	2,100
Unrealized gain on valuation of equity method investments (note 7)		2,922	132
Unrealized loss on valuation of equity method investments (note 7)		-	(639)
	₩	**30,659**	**1,593**

19. RETAINED EARNINGS

Retained earnings as of December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Legal reserve	₩	602,937	602,937
Reserve for business expansion		698,881	698,881
Reserve for business rationalization		12,851	12,851
Reserve for research and human resource development		30,000	45,000
Reserve for loss on reissuance of treasury stock		26,646	26,646
Other appropriations		420,000	350,000
Unappropriated retained earnings at end of year		516,402	397,314
	₩	**2,307,717**	**2,133,629**

(A) LEGAL RESERVE

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

(B) RESERVE FOR BUSINESS EXPANSION

Reserve for business expansion was a legal reserve under the old Korea Tobacco and Ginseng Corporation Act, which was abrogated on September 1, 1997; consequently, the existing balance has been regarded as a voluntary reserve since then.

(C) RESERVE FOR BUSINESS RATIONALIZATION

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

(D) OTHER RESERVES

Reserves for research and human resource development and loss on reissuance of treasury stock were appropriated in order to utilize certain tax deduction benefits through the early recognition of future expenditures. These reserves are restored to retained earnings in accordance with the relevant tax laws. Such reserves are taken back into taxable income in the year of restoration. Reserves without specific purposes are restored to retained earnings by a resolution at a general meeting of stockholders.

20. COMMITMENTS AND CONTINGENCIES

The Company recorded as a long-term deposit the amounts paid into the escrow funds of State governments in the United States against potential litigation and damages related to the export of tobacco into the United States. The escrow funds will be refunded if the Company did not indemnify the State governments for damages for a specified number of years on the grounds that the Company did not sell cigarettes illegally. As of December 31, 2008 and 2007, the Company made deposits of ₩ 110,261 million and ₩ 66,633 million, respectively which were included as long-term deposits in escrow funds in the accompanying non-consolidated balance sheets.

As of December 31, 2008, tobacco lawsuits claiming damages of ₩ 759 million were filed against the Company and the Korean government. The plaintiffs have asserted that the Company and the Korean government did not perform their obligation to notify smokers of the potential health hazards of smoking. Additionally, the Company is involved in 12 lawsuits and claims for alleged damages totalling ₩ 16,017 million as of December 31, 2008. The amount of the liability the Company may ultimately have with respect to the litigation cannot be reasonably estimated as of December 31, 2008.

As of December 31, 2008, the Company has provided to the National Agricultural Cooperative Federation ("NACF") and another bank guarantees totaling ₩ 13,344 million for the customers who made a financing agreement with these lenders.

As of December 31, 2008, the Company has entered into Letter of Credit agreements with the NACF and other banks with a limit set at USD 104,000 thousand.

As of December 31, 2008, the Company's trade accounts receivable from the export of cigarettes was insured against nonpayment up to USD 34,400 thousand by an export guaranty insurance with the Korea Export Insurance Corporation.

As of December 31, 2008, the Company has been provided with a foreign currency payment guarantee for local dealers in Russia and other countries up to USD 90,000 thousand by Korea Exchange Bank and other.

As of December 31, 2008, the Company and 28 other companies, which form the Samsung Corporation-National Pension Service Joint Consortium, were guaranteed ₩ 240,000 million by Seoul Guarantee Insurance Co. in relation to the Yongsan International Commercial Development Project.

The Company entered into an overdraft agreement with a limit of ₩ 30,000 million with the NACF as of December 31, 2008.

21. BUILDING LOTTING-OUT CONSTRUCTION CONTRACTS

(a) Building lotting-out construction contracts as of December 31, 2008 are summarized as follows:

	Builder	Construction period	Location
Apartment buildings in Jeonju	SK Engineering & Construction Co., Ltd.	2006 ~ 2009	Jeonju
Apartment buildings in Daejeon	Kyeryong Construction Industrial Co., Ltd.	2008 ~ 2009	Daejeon

(b) Details of installment sales as of December 31, 2008 are summarized as follows:

Mil. Won

	Expected contract amount	Confirmed contract cost	Recognized revenue		Unrecognized revenue
			Prior to 2008	2008	
Apartment buildings in Jeonju	₩ 284,995	86,525	20,275	62,311	202,409
Apartment buildings in Daejeon	44,047	25,376	-	9,664	34,383
	₩ 329,042	**111,901**	**20,275**	**71,975**	**236,792**

(c) Cost of installment sales of store units for the years ended December 31, 2008 and 2007 were as follows:

Mil. Won

	Prior to 2008	2008	Aggregate amount
Apartment buildings in Jeonju	₩ 13,726	42,270	55,996
Apartment buildings in Daejeon	-	6,680	6,680
	₩ 13,726	**48,950**	**62,676**

22. INCOME TAXES

(a) The Company is subject to income taxes on taxable income at the following normal tax rates:

Taxable income		Tax rate			
Prior to 2008	Thereafter	Prior to 2008	2008	2009	Thereafter
Up to ₩ 100 million	Up to ₩ 200 million	14.3%	12.1%	12.1%	11.0%
Over ₩ 100 million	Over ₩ 200 million	27.5%	27.5%	24.2%	22.0%

In December 2008, the Korean government reduced the corporate income tax rate (including resident tax) and increased the tax base from ₩ 100 million to ₩ 200 million beginning in 2008. Effective January 1, 2008, the income tax rate for those whose taxable income is less than ₩ 200 million was reduced from 14.3 % to 12.1%.

(b) The components of income tax expense for the years ended December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Current income tax expense	₩	275,258	270,497
Deferred income tax expense		20,924	18,744
Income tax expense charged directly to stockholders' equity		(9,169)	(43,344)
Income tax charge	**₩**	**287,013**	**245,897**

(c) Deferred tax assets and liabilities are measured using the tax rate to be applied for the year in which temporary differences are expected to be realized, and the change in deferred tax assets (liabilities) due to the change in the income tax rate amounting to ₩ 26,901 of which ₩ 261 was recognized directly to equity and ₩ 26,640 was recognized in current income tax expense.

(d) The charge for income taxes calculated by applying statutory tax rates differs from the actual charge for the years ended December 31, 2008 and 2007 for the following reasons:

Mil. Won

		2008	2007
Expense for income taxes at normal tax rates	**₩**	**324,834**	**249,437**
Tax effects of permanent differences		(12,906)	(2,070)
Tax credit		(4,627)	(8,026)
Changes in valuation allowances for deferred income tax assets (liabilities) arisen from equity in income of affiliates		9,744	6,279
Effect from change in tax rate		(29,799)	-
Additional income taxes for prior period (Refund of prior year's income taxes)		(233)	277
Income tax expense	**₩**	**287,013**	**245,897**

(e) The effective tax rates, after adjustments for certain differences between amounts reported for financial accounting and income tax purposes, were approximately 24.3% and 27.1% for the years ended December 31, 2008 and 2007.

(f) The Company did not recognize a deferred tax asset in the amount of ₩ 39,974 million and ₩ 31,749 million arising from the taxable temporary differences associated with affiliates as of December 31, 2008 and 2007, respectively, since there is a remote possibility that the Company will dispose of its investments in affiliates in the foreseeable future.

(g) Deferred tax assets and liabilities that were directly charged or credited to accumulated other comprehensive income as of December 31, 2008 and 2007 were as follows:

Mil. Won

		2008	2007
Gain on reissuance of treasury stock	₩	(1,659)	(48,864)
Unrealized gain on valuation of available-for-sale securities		(7,027)	5,245
Unrealized gain (loss) on valuation of equity method investments		(483)	275
	₩	**(9,169)**	**(43,344)**

(h) Under SKAS No. 16, Income Taxes, the deferred tax amounts should be presented as a net current asset or liability and a net non-current asset or liability. In addition, the Company is required to disclose aggregate deferred tax assets (liabilities). As of December 31, 2008, details of aggregate deferred tax assets (liabilities) were as follows:

Mil. Won

		Temporary differences at December 31, 2008	Deferred tax assets (liabilities)	
			Current	Non-current
ASSETS:				
Provision for retirement and severance benefits	₩	97,968	-	21,553
Loss on valuation of inventories		565	137	-
Depreciation		11,429	-	2,514
Bad debts		20,441	4,946	-
Impairment losses on property, plant and equipment		1,334	-	293
Contributions		35,564	8,606	-
Other		19,058	1,744	2,314
		186,359	**15,433**	**26,674**
LIABILITIES:				
Accrued income		(229)	(54)	-
Deposit for severance benefits trust		(85,126)	-	(18,727)
Reserve for research and human resources development		(15,000)	-	(3,300)
Equity method investment securities		(520,365)	-	(117,701)
Reserve for losses on reissuance of treasury stock		(26,646)	-	(5,862)
Available-for-sale securities		(35,562)	-	(7,823)
Treasury stock		(38,930)	-	(8,565)
Gain on foreign currency translation		(25,332)	(6,130)	-
Other		(7,830)	-	(697)
		(755,020)	**(6,184)**	**(162,675)**
NET DEFERRED TAX ASSET (LIABILITY)	₩	**(568,661)**	**9,249**	**(136,001)**

23. EARNINGS PER SHARE

(a) Basic earnings per share

Basic earnings per share for the years ended December 31, 2008 and 2007 are as follows:

Won

		2008	2007
Net income	₩	894,290,228,258	661,205,876,222
Weighted-average number of shares outstanding		130,140,446	132,442,442
Basic earnings per share	₩	6,872	4,992

(b) Potential dilutive securities which are not included in the calculation of diluted earnings per share for the year ended December 31, 2008 are summarized as follows:

Type	Par value in Korean Won	Maturity date	Issuable number of shares
Retirement and severance benefits (share-based payment)	₩ 5,000	February 28, 2009 and 2010	155,519

24. DIVIDENDS

(a) Details of dividends for the years ended December 31, 2008 and 2007 were as follows:

Mil. Won

		2008	2007
Cash dividends, but not declared	₩	360,357	340,449
Net income		894,290	661,206
Dividends as a percentage of net income		40.30%	51.49%
Par value	₩	643,494	654,710
Dividends as a percentage of par value		56.0%	52.0%

(b) The dividend yield ratios for the years ended December 31, 2008 and 2007 were as follows:

Won

		2008	2007
Dividend per share	₩	2,800	2,600
Market price as of year-end		79,100	79,700
Dividend yield ratio		3.5%	3.3%

25. NON-CASH INVESTING AND FINANCING ACTIVITIES

Significant non-cash investing and financing activities for the years ended December 31, 2008 and 2007 are summarized as follows:

Mil. Won

		2008	2007
Retirement of treasury stock	₩	379,752	269,410
Compensation through treasury stock		5,982	2,999
Severance pay by treasury stock	₩	2,430	8,247

26. ADDED VALUE

The components of manufacturing costs and selling and administrative expenses which are necessary in calculating added value for the years ended December 31, 2008 and 2007 are as follows:

Mil. Won

		2008	2007
Wages and salaries	₩	314,472	306,787
Provision for severance benefits		47,071	31,014
Employee welfare		41,213	43,830
Rent		16,140	13,322
Depreciation		133,996	134,772
Taxes and dues	₩	26,119	22,887

27. EMPLOYEE WELFARE AND CONTRIBUTIONS TO SOCIETY

For employee welfare, the Company maintains a refectory, an infirmary, athletic facilities, a scholarship fund, workmen's accident compensation insurance, unemployment insurance and medical insurance. The amounts of welfare spent for the years ended December 31, 2008 and 2007 were estimated at ₩ 41,213 million and ₩ 43,830 million, respectively.

The Company donated ₩ 28,020 million and ₩ 24,995 million to KT&G Social Welfare Foundation and others for the years ended December 31, 2008 and 2007, respectively.

28. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

The details of selling, general and administrative expenses for the years ended December 31, 2008 and 2007 were as follows:

Mil. Won

		2008	2007
Salaries	₩	190,328	183,268
Provision for severance benefits		33,129	19,883
Welfare		23,788	25,050
Travel		5,986	5,889
Communications		4,326	4,188
Utilities		6,098	6,130
Taxes and dues		23,376	20,178
Supplies		4,307	2,948
Uniforms		62	65
Rent		8,614	5,840
Depreciation		53,656	53,847
Amortization		687	713
Repairs and maintenance		5,322	9,994
Vehicles		8,467	7,098
Insurance		550	561
Commissions		62,972	61,238
Transportation and warehousing		29,465	25,049
Entertainment		358	605
Conferences		3,446	2,634
Advertising		141,148	136,833
Training		7,650	8,111
Prizes and rewards		4,954	1,943
Cooperation		414	700
Normal research and development		15,314	16,402
Sample		5	4
Bad debts		11,543	6,064
Miscellaneous		333	604
	₩	**646,298**	**605,839**

29. SHARE BASED PAYMENT

(a) Executives who have been with the Company for more than one year are entitled to severance payment which is based on executives' performance. Eligible executives may choose to receive the Company's shares for their severance payment. The details of the Company's stock compensation plan as of December 31, 2008 were as follows:

Won

Method of settlement	Optional share-based payment
Type	Severance payment based on performance by share grant
Grant date	1st : March 1, 2007
	2nd: January 1, 2008
	3rd : March 15, 2008
	4th : April 1, 2008
Number of excutives	46
Number of shares granted (*2)	155,519
Vesting condition	Service condition ; 1~3 years
	Non-market performance condition (*1)
Share price at the grant date	₩ 56,534~72,884
Severance payment	₩ 6,953,733,254
	(The average exercise price ; 44,713)
Expiration	0.916~3 years
The risk-free interest rate	4.8%~5.68%
Volatility	0.092~0.148

(*1) Non-market performance condition is measured by long-term evaluation results based on quantified and non-quntified indices.
(*2) The number of shares that may be granted is subject to the level of performance and service period.

(b) Share-based payment expense for the years ended December 31, 2008 and 2007 is summarized as follows:

Mil. Won

		2008	2007
Share-based payment expense (recognized) (Retirement and severance payment)	₩	9,113	1,370
Remaining expense to be recognized in the future years		1,769	4,109

30. COMPREHENSIVE INCOME

Comprehensive income for the years ended December 31, 2008 and 2007 was as follows:

Mil. Won

		2008	2007
Net income	₩	894,290	661,206
Change in fair value of available-for-sale securities, net of tax effect of ₩ (7,027) in 2008 and ₩ 5,245 in 2007		25,637	(13,829)
Increase of unrealized gain on valuation of equity method investments, net of tax effect of ₩ (483) in 2008 and ₩ 285 in 2007		2,790	285
Decrease of unrealized loss on valuation of equity method investments, net of tax effect of nil in 2008 and ₩ (10) in 2007		639	256
Comprehensive income	**₩**	**923,356**	**647,918**

31. CHANGE IN ACCOUNTING POLICY

The Company changed its accounting policy with regard to equity method accounted investments in conformity with Statement of Korea Accounting Standard (SKAS) No. 15 Investment In Associates as revised February 22, 2008. According to the revised policy, when accounting on equity method accounted investments. The company's consolidated net assets should equal the total net assets of all non-consolidated financial statements.

These changes resulted in a decrease in loss on valuation of equity method investments of ₩ 13 million, equity method investment securities of ₩ 12 million and unrealized gain on valuation of equity method investments of ₩ 2,596 million and an increase in capital surplus of ₩ 2,532 million and unappropriated retained earnings of ₩ 52 million, respectively. The Company restated the prior period's financial statements in conformance with these changes in accounting policy.

Financial positions of prior three years after adjusting retroactively for the cumulative effect are summarized as follows:

Mil. Won, except earning per share in Won

		2007		2006		2005	
Account		Before	After	Before	After	Before	After
Loss on valuation of equity method investments	₩	24,999	24,986	5,882	5,869	3,195	3,182
Net Income		661,193	661,206	649,678	649,691	515,925	515,938
Earnings per share		4,992	4,992	4,608	4,609	3,497	3,497
Equity method investment securities		626,693	626,668	490,885	490,847	421,317	421,266
Capital surplus		464,237	466,769	335,413	336,252	300,043	300,882
Unrealized gain on valuation of equity method investments		2,728	132	750	(153)	1,180	277
Unappropriated (undisposed) retained earnings (deficit)	₩	397,276	397,314	(204,796)	(204,770)	404,737	404,750

32. DERIVATIVE INSTRUMENTS

(a) The Company entered into foreign currency forward and foreign currency option contracts to hedge foreign currency risk of accounts receivable. Details of the contracts as of December 31, 2008 were as follows:

Won

Derivative Instrument	Contractor	Contract position	Exchange rate	Contract date	Expiration date	Contract amount
Currency option	Korea Exchange Bank	Call Option Sell	₩ 988	March 11, 2008	January 28, 2009~	USD 6,000
		Put Option Buy			March 27, 2009	USD 3,000
	Citibank, N.A.,Seoul	Call Option Sell	₩ 989	March 12, 2008	January 28, 2009~	USD 4,000
		Put Option Buy			February 25,2009	USD 2,000

(b) Details of gain and loss on valuation of derivative instruments for the years ended December 31, 2008 and 2007 are as follows:

Mil. Won, Thou. USD

		2008	2007
Currency forward	₩	-	(25)
Currency option		(2,699)	-
	₩	**(2,699)**	**(25)**

33. DATE OF AUTHORIZATION FOR ISSUE

The 2008 financial statements were authorized for issue on January 21, 2009, at the Board of Directors Meeting.

34. RESULTS OF OPERATIONS FOR THE LAST INTERIM PERIOD

Mil. Won, except earnings per share

		2008 4th Quarter	2007 4th Quarter
Sales	₩	724,876	617,249
Operating income		274,563	185,761
Net income for the period	₩	245,349	135,015
Earnings per share		1,903	1,023

35. EARLY ADOPTION OF K-IFRS (INTERNATIONAL FINANCING REPORTING STANDARDS)

The Company has decided to early-adopt K-IFRS in 2009, which all listed companies are required to prepared their financial statements in accordance with IFRS from 2011.

(A) PLANNING AND APPLYING K-IFRS

The Financial Supervisory Commission announced roadmap for the adoption of K-IFRS in March 2007. After the announcement, the Company has organized a Task Force Team to conduct internal training and analyze the effects of adopting K-IFRS. In October 2008, the Company has appointed an External Advisor to analyze the main differences between IFRS and K-IFRS as the first-phase preparation. In the second-phase preparation, the Company established responses to for the major differences and decided on the Company's accounting policies. Currently, in the third-phase preparation, the Company is in the process of preparing financial statements based on K-IFRS as of January 1, 2008 (transition date) and January 1, 2009 (adoption date), and for the year ended December 31, 2008.

(B) SUMMARY OF MAIN DIFFERENCE BETWEEN K-GAAP AND K-IFRS

Subject	K-GAAP	K-IFRS
Revenue recognition for construction contracts	Percentage of completion	Revenue recognition at delivery
Valuation on severance and retirement benefit	Estimated payment amount for employees who served more than one year of employment	Based on the Projected Unit Credit Method, provision for severance and retirement benefit is calculated based on actuarial present value and discount rate
Employee benefit - annual leave and bonus payment	Cost is recognized in the period in which obligation for cash payment is determined	Cost is recognized in the period in which the service is received
Offsetting financial asset and liability	Not specific requirement	Financial asset and liability shall be offset when the entity has a legally enforceable right to offset the recognized amount and intends to settle on a net basis
Eliminating financial assets in respect to consumer credit	Elimination occurs when the amount is received from the Financial Institution	Elimination occurs when the amount is collected from the first-debtor
Accounting for membership rights etc.	Membership rights are recognized as other assets	Membership rights are recognized as intangible assets with unlimited useful life
Change in the scope of subsidiaries	Based on the Act on External Audit of Stock Companies, a stock company whose total value of asset is less than KRW 7 billion as of the end of the immediate preceding business year, shall not be considered a subsidiary	If the Parent Company has dominant influence or control over the subsidiary, the Company is deemed to be a subsidiary regardless of the Company size

(c) Effects on the Affiliated Companies

Due to the application of K-IFRS, the following changes affect the scope of subsidiaries.

Subsidiaries under K-GAAP	Subsidiaries under K-IFRS
KT&G Corporation	KT&G Corporation
Korea Ginseng Corporation	Korea Ginseng Corporation
Korea Ginseng HK, Ltd.	Korea Ginseng HK, Ltd.
Yungjin Pharm. Ind. Co., Ltd.	Yungjin Pharm. Ind. Co., Ltd.
Tae-a Industry Co., Ltd.	Tae-a Industry Co., Ltd.
KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.	KT&G Tutun Mamulleri Sanayi ve Ticaret A.S.
	Korea Tabacos do Brasil Ltda.
	KGC Sales Co., Ltd.
	KT&G Pars
	KT&G Rus L.L.C.

(d) Effects on the financial position as of January 1, 2008 (transition date)

Mil. Won

	Total assets	Total liabilities	Shareholder's Equity
K-GAAP	**₩ 3,977,801**	**835,798**	**3,142,003**
Adjustments:			
Revenue recognition for construction contracts	12,623	19,172	(6,549)
Actuarial valuation on severance and retirement benefit	(2,092)	(17,354)	15,262
Employee benefit - annual leave and bonus payment	3,741	76,809	(73,068)
Offsetting financial asset and liability	164,376	164,376	-
Eliminating financial assets in respect to consumer credit	14,955	14,955	-
Bad debts and impairment losses on financial assets	9,072	-	9,072
Accounts for membership rights and etc	(941)	-	(941)
Conversion from securities under equity method to cost method	(458,896)	-	(458,896)
Effect on income tax	(16,026)	(156,319)	140,293
Total adjustments	(273,188)	101,639	(374,827)
K-IFRS	**₩ 3,704,613**	**937,437**	**2,767,176**

(f) Effects on financial position and result of operation as of and for the year ended December 31, 2008(Adoption date)

Mil. Won

		Total assets	Total liabilities	Share-holder's Equity	Net income (loss)
K-GAAP	**₩**	**4,382,573**	**842,744**	**3,539,829**	**894,290**
Adjustments:					
Revenue recognition for construction contracts		37,473	67,047	(29,574)	(23,025)
Actuarial valuation on severance and retirement benefit		2,301	9,820	(7,519)	17,021
Employee benefit - annual leave and bonus payment		3,890	78,549	(74,659)	(1,590)
Offsetting financial asset and liability		201,774	201,774	-	-
Eliminating financial assets in respect to consumer credit		13,344	13,344	-	-
Bad debts and losses on financial assets		21,009	-	21,009	11,937
Accounts for membership rights and etc		(1,007)	-	(1,007)	(66)
Changes in the useful life of tangible assets		3,806	-	3,806	3,806
Amortization cost method for Financial Instrument		31	(9)	40	40
Conversion from securities under equity method to cost		(537,514)	-	(537,514)	(74,705)
Effect on income tax		(9,249)	(154,051)	144,802	(4,732)
Total adjustments		(264,142)	216,474	(480,616)	(71,314)
K-IFRS	**₩**	**4,118,431**	**1,059,218**	**3,059,213**	**822,976**

The effects on the Company's financial position and result of operation mentioned above are prepared based on the separate financial statement and result may change.

Independent Accountants' Review Report on Internal Accounting Control System

To the President of
KT&G Corporation:

We have reviewed the accompanying Report on the Operations of Internal Accounting Control System ("IACS") of KT&G Corporation (the "Company") as of December 31, 2008. The Company's management is responsible for designing and maintaining effective IACS and for its assessment of the effectiveness of IACS. Our responsibility is to review management's assessment and issue a report based on our review. In the accompanying report of management's assessment of IACS, the Company's management stated: "Based on the assessment on the operations of the IACS, the Company's IACS has been effectively designed and is operating as of December 31, 2008, in all material respects, in accordance with the IACS Framework issued by the Internal Accounting Control System Operation Committee."

We conducted our review in accordance with IACS Review Standards, issued by the Korean Institute of Certified Public Accountants. Those Standards require that we plan and perform the review to obtain assurance of a level less than that of an audit as to whether Report on the Operations of Internal Accounting Control System is free of material misstatement. Our review consists principally of obtaining an understanding of the Company's IACS, inquiries of company personnel about the details of the report, and tracing to related documents we considered necessary in the circumstances. We have not performed an audit and, accordingly, we do not express an audit opinion.

A company's IACS is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, however, IACS may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Based on our review, nothing has come to our attention that Report on the Operations of Internal Accounting Control System as of December 31, 2008 is not prepared in all material respects, in accordance with IACS Framework issued by the Internal Accounting Control System Operation Committee. This report applies to the Company's IACS in existence as of December 31, 2008. We did not review the Company's IACS subsequent to December 31, 2008. This report has been prepared for Korean regulatory purposes, pursuant to the External Audit Law, and may not be appropriate for other purposes or for other users.

Seoul, Korea
January 23, 2009

KPMG Samjong Accounting Corp.

Notice to Readers

This report is annexed in relation to the audit of the (non-consolidated) financial statements as of December 31, 2008 and the review of internal accounting control system pursuant to Article 2-3 of the Act on External Audit for Stock Companies of the Republic of Korea.

Report on the Operations of Internal Accounting Control System

To the Board of Directors and Internal Audit Committee of
KT&G Corporation:

I, as the Internal Accounting Control Officer ("IACO") of KT&G Corporation (the "Company"), have assessed the status of the design and operations of the Company's internal accounting control system ("IACS") for the year ended December 31, 2008.

The Company's management including IACO is responsible for the design and operations of its IACS. I, as the IACO, have assessed whether the IACS has been effectively designed and is operating to prevent and detect any error or fraud which may cause any misstatement of the financial statements, for the purpose of establishing the reliability of financial reporting and the preparation of financial statements for external purposes. I, as the IACO, applied the IACS Framework for the assessment of design and operations of the IACS.

Based on the assessment of the operations of the IACS, the Company's IACS has been effectively designed and is operating as of December 31, 2008, in all material respects, in accordance with the IACS Framework issued by the Internal Accounting Control System Operation Committee.

January 23, 2009

Kim, San Kyum, Internal Accounting Control Officer

Kwak, Young Kyoon, Chief Executive Officer

KPMG Samjong Accounting Corp.
10th Floor, Gangnam Finance Center, 737 Yeoksam-dong, Gangnam-gu,
Seoul 135-984, Republic of Korea
Tel. 82-2-2112-0100 Fax. 82-2-2112-0101 www.kr.kpmg.com

Corporate Governance & Organization Chart

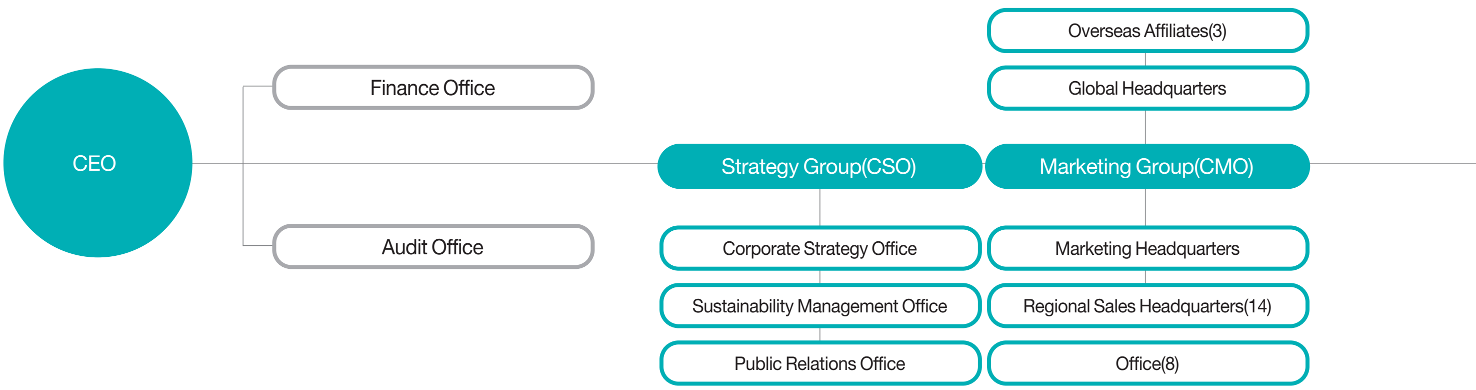
Young-kyoon Kwak
Chairman & CEO

Kwang-youl Lee
Senior Managing Director

Young-jin Min
Senior Managing Director

Chang-woo Lee
Independent
non-executive Director

Kiu-won Kim
Independent
non-executive Director



Kyung-jae Lee
Independent
non-executive Director

Yong-chan An
Independent
non-executive Director

Yoon-jae Lee
Independent
non-executive Director

Jong-hoon Kim
Independent
non-executive Director

Jin-moo Lee
Independent
non-executive Director

Jin-ho Chang
Independent
non-executive Director

Won-yong Kim
Independent
non-executive Director

- Production Group(CPO)
  - Leaf Tobacco&Procurement Headquarters
  - Leaf Tobacco Processing Factory
  - Manufacturing Headquarters
  - Tobacco Manufacturing Plant(4)
  - Printing Plant
- R&D Group(CTO)
  - Central Research Institute
  - R&D Headquarters
- Growth Business Headquarters
- Management Support Headquarters
  - Human Resources Development Institute

Manufacturing & Sales Network, Investor Information

TOBACCO MANUFACTURING
Shintanjin Plant
Wonju Plant
Gwangju Plant
Yeongju Plant

LEAF TOBACCO PROCESSING
Gimcheon Factory

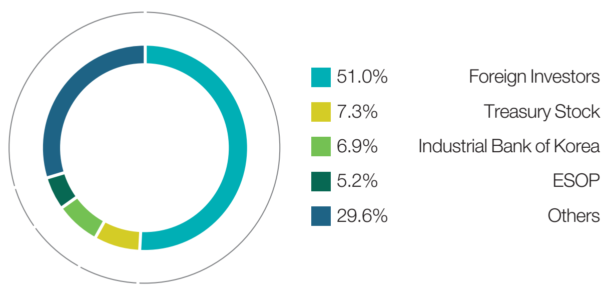
PRINTING PLANT
Cheonan Plant

SALES
Regional Headquarters: 14
Branch Offices: 168

OVERSEAS AFFILATES
KT&G Turkey
KT&G Pars
KT&G Russia

• Capital Stock	KRW 955 billion
• Number of Authorized Shares	800,000,000
• Number of Shares Issued	138,792,497
• Shareholders' Equity	KRW 3,540 billion
	(End of 2008)

Ownership Structure



THIS SECTION AS A FORM OF
BOOK-IN-BOOK IS SPECIALLY PROVIDED TO
DESCRIBE THE COMPANY'S
SOCIAL & ENVIRONMENT ACTIVITIES.

KT&G is Promoting
BALANCED GROWTH

“Open world, happy network”

KT&G is faithfully working to lay the foundation for corporate sustainability management to realize "respect for humanity, preservation of culture and the environment, and construction of a hopeful Korea" by adhering to a philosophy of mutual prosperity, hope and creativity. We regard our contributions to the economy, society and environment as a key part of our operations, in addition to providing high-quality products and services, and generating profits and jobs. Our aim is to become a global company with righteousness, enlightenment, and companionship.

Vision & Strategy for Sustainability
Management Standard
Environmental Standard
Social Standard


NDARD

Vision & Strategy for Sustainability

Vision	BECOME A GLOBAL BLUE-CHIP COMPANY BY CREATING NEW VALUE		
Goal	EVER - KT&G 2015		
	Economy	Society	Environment
Strategic direction	To enhance business competitiveness through value-oriented reform	To enhance win-win relationships by taking on role of corporate citizen	To build an environmentally-friendly company by engaging in green business
Strategic tasks	• Reinforce market competitiveness of main business domain • Bolster innovation leadership activities • Enhance corporate value through diversification	• Maximize customer value • Maximize HR value • Enhance win-win cooperation	• Boost environmental management system • Strengthen readiness to respond to environmental risks • Build eco-friendly corporate culture

KT&G's vision for sustainability management is to become a global blue-chip company by creating new value. EVER - KT&G 2015 is our slogan to achieving our vision.

- **E** Excellent (economy)
- **V** Value-Creating (economy, society, environment)
- **E** Eco-Friendly (environment)
- **R** Responsible (society)

The '**E**' in EVER stands for excellence in our financial performance while the '**V**' represents value-creation for the economy, society and environment. The third '**E**' reflects our commitment to become an eco-friendly firm while the '**R**' signifies our responsibility as a corporate citizen. EVER implies our will to create new value through globalization, diversification, environmental and responsible management to become a global blue-chip company.

Management Standard

We comply with laws and regulations, while our independent BOD comprising mostly outside directors provide a balanced representation of the interest of our shareholders and other stakeholders.

The Ratio of Handicapped Workers

3.40%

Corporate governance

KT&G conducts its business in accordance with the decision-making of the board of directors and under the responsibility of the CEO, and intends to become a global blue-chip company by maximizing corporate value and the values of employees. KT&G complies with relevant laws and regulations, and built a core professional management system centered around the independent board of directors, thereby catering to the interests of stakeholders in a balanced manner.

BOD

The BOD is comprised of 9 non-executive outside directors and 3 executive directors for maximum efficiency and effectiveness. The BOD is the top decision-making body on issues facing the Company as stated in the BOD statutes and regulations as well as KT&G's articles of incorporation.

Nomination of CEO

The CEO Recommendation Committee consisting entirely of outside directors selects a CEO candidate in accordance with the evaluation standards designated by the Outside Board of Directors, and recommends the candidate to the general meeting of shareholders after consultation on contract terms such as management goals, etc. The nominated CEO candidate is appointed at the general shareholders' meeting and signs a management contract with the chairman of the CEO Recommendation Committee. The CEO term is 3 years.

Outside directors

KT&G fully satisfies the 16 criteria of the Code of Best Practice for Corporate Governance set forth by the government. To implement sound corporate governance practices in an active and sustainable manner, KT&G established an outside director system as part of its BOD.

Selection of outside directors: Outside directors are elected to the Board following a strict evaluation of candidates selected by the Independent Non-Executive Board Recommendation Committee and shareholders. A subsequent recommendation and appointment process takes place at the general shareholders' meeting. Candidates are chosen for their social and ethical integrity as well as their expertise in economics, management or finance, etc. to contribute to the Company's growth.

Position of outside directors: The 12 member BOD comprises 9 outside directors and 3 executive directors.

Responsibility of KT&G to outside directors: KT&G must provide outside directors with timely and pertinent information to ensure they have an accurate understanding of company activities. KT&G is also obliged to inform outside directors with a written notice of a BOD meeting and agenda three days prior to the meeting date.

Responsibility of outside directors to KT&G: Outside directors shall attend the six annual regular meetings and extraordinary BOD meetings to review execution of management contracts, investments in other companies, investments in new facilities and other management activities. The outside directors shall comply with the roles, responsibilities, and ethical standards as stated in the KT&G Code of Conduct for Outside Directors.

Independence of outside directors: Outside directors are assured independence regarding BOD resolutions and supervisory activities. They have the right to visit business sites without the presence of high ranking management, and the outside BOD meeting may be convened without the presence of executive management.

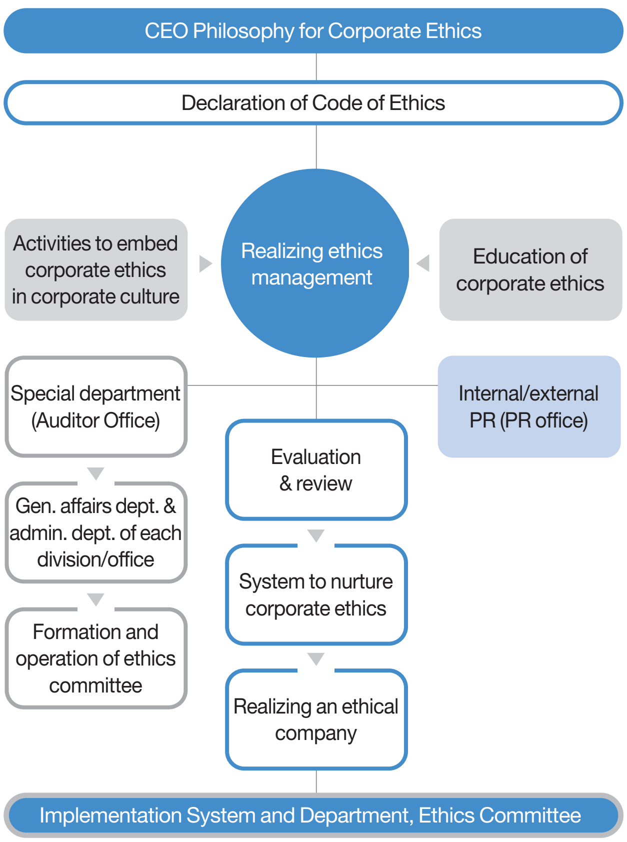
The efforts of top management to improve and operate a voluntary BOD structure, and to readily accept and implement the changed system, led to KT&G's receiving the award of distinction for corporate governance in 2003, and subsequently, the award of excellence for three consecutive years from 2004. In 2007, we were inducted into the hall of fame of the Korea Corporate Governance Service.

ETHICS MANAGEMENT

In 2001, KT&G established a comprehensive system for ethics management to promote fundamental values befitting a global company and endorse a mutually beneficial relationship with stakeholders.

KT&G laid the groundwork for ethics management by formulating the Code of Ethics, Code of Ethics for Directors, and Guidelines on Ethical Conduct in 2001. The ethics management system is based on four components - Code of Conduct, Code of Ethics for Directors, Compliance Program and Customer Service Code. Continuous post-evaluations are led by the Auditor's Office. The Code of Ethics and Guidelines on Ethical Conduct apply to all KT&G employees including irregular workers, and set forth detailed practices with respect to customers, society, environment, market, employees, partner firms and shareholders.

KT&G ETHICS MANAGEMENT STRUCTURE



Strategic ethics management system

New recruits are required to sign a pledge of ethics and honor the Code of Ethics and Guidelines. We also strive to bring greater transparency and accountability across all business domains and to our BOD. As part of these efforts, the BOD adopted the Code of Ethics for Outside Directors by the Korea Listed Companies' Association (KLCA).

Ethics management education

An online ethics management course was created to encourage voluntary participation by employees. The course presents various situations which can occur on the job. The online program was first launched in 2007 for all employees of ranks below level two. New recruits also underwent the course.

System to prevent corruption

Under our strict internal supervisory system, any KT&G employee who engages in irregular activities is subject to punitive measures including pay cut or dismissal. We have established in-house regulations prohibiting the receipt of bribes, gifts, special favors or entertainment, and processes for reporting such irregularities.

Internal control system

KT&G set up an internal control system in January 2006 to satisfy demands for internal accounting requirements and prepare for outside audits. Five internal control elements, namely control environment, risk assessment, control activities, information and communication, and monitoring, are reviewed by working level staff and middle and upper level management to enhance transparency.

Code of Conduct: KT&G will fulfill its social responsibility as a corporate citizen and pursue win-win relationships with stakeholders to become a global blue-chip company. To this end, the Code of Conduct is established as the guiding standard for the conduct and judgments of the Company and its employees.

PARTNERSHIP

KT&G is expanding assistance partner firms in the form of technical support and training to achieve win-win synergy. The production management division provides process evaluations, technical training and support, while the Gwangju Plant distributes manuals on environmental management to enhance partners' competitiveness and eco-capabilities.

In 2002, we declared the KT&G Compliance with Fair Trade Standards and incorporated the Compliance Program (CP) into our corporate culture. This was done by conducting related training and simulation inspections, publishing a CP handbook and revising in-house regulations to reinforce employee awareness of fair practices.

HR MANAGEMENT

Strategic HR development

KT&G supports employee growth and development with a detailed plan that covers value sharing, change and innovation, and learning. The program underscores the importance of nurturing individual abilities in a changing business environment to achieve our vision of becoming a global leader. It is designed to realize corporate goals throughout an employee's career with KT&G by taking into account the Company's strategic direction as well as individual aspirations. In particular, we employ diverse assessment methods to incorporate the program into daily work activities, such as implementing problem solving for each training program and duty/rank. For leadership training, roles and required competencies are clearly defined for each rank to emphasize principles such as ownership, mutual trust, passion and pro-activeness, positive attitude, self-development, autonomy and responsibility.

Employment

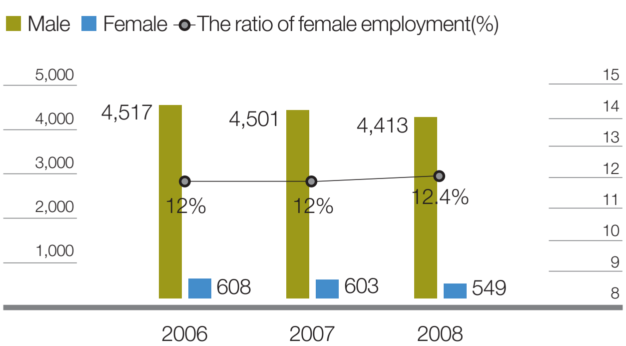
KT&G offers fair recruitment opportunities for all eligible candidates through our open employment system. Local applicants are given priority for sales positions as part of our effort to encourage balanced regional development. Our employment ratios for women and the handicapped surpass legal requirements, while our starting pay for new employees is 2.5 times the minimum legal wage.

Equality

Based on fair evaluation standards, KT&G offers equal opportunities for promotion and bonuses to all employees and teams who possess the necessary abilities and qualities. We conduct regular training on sexual harassment and also provide consulting services to ensure our female employees enjoy a pleasant working atmosphere. Additionally, we are continuing to expand our ratio of disabled workers which is already over the legally required number.

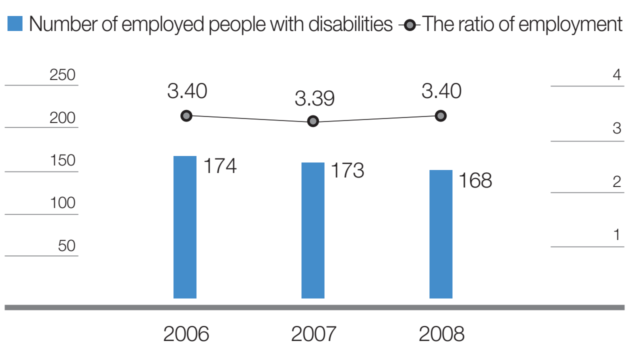
Ratio of Female Workers

Unit: Persons



Handicapped Workers

Unit: %



Employee training

Our training program focuses on value sharing, change and innovation, and extended learning to nurture talents befitting the global business environment. It balances the Company's strategic direction and individual aspirations, and is linked to work activities to maximize impact. Designed to yield maximum results based on the individual's commitment, the program also stresses a healthy work-life balance by emphasizing different themes such as 'leadership,' 'reinforcing key competencies,' and 'personal development.'

Employee Welfare

We have a mid- to long-term welfare vision to improve the quality of life for employees and enhance corporate value. All KT&G employees are eligible to receive a wide selection of benefits including housing loans, congratulatory/condolence money and emergency funds, physical checkups, tuition loans, scholarships, kindergarten tuition, and use of leisure facilities. KT&G also introduced an employee stock ownership plan to promote trust and cooperation between labor and management. The optional welfare system offers employees the choice of diverse benefits to best fit individual needs.

Win-win partnership between labor and management

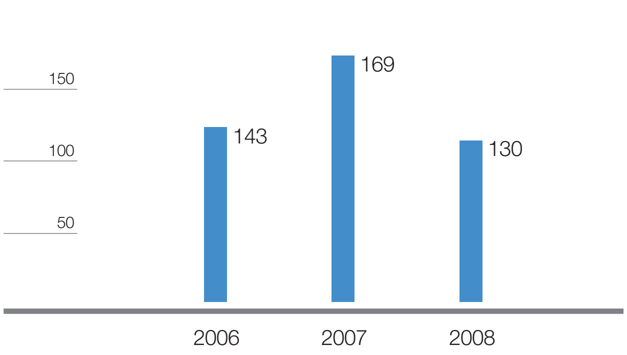
Major labor-management issues are resolved through the labor-management council and collective bargaining. Furthermore, our union shop system which requires all employees of rank level three and below, seasonal employees and delivery staff to join the union has enabled us to realize a labor dispute-free workplace for over ten years. On issues that have a direct impact on employees such as restructuring or mergers, the Company gives advance notice through the collective bargaining process.

Retirement

KT&G complies with the legal retirement age and operates a separate 'Design Your Life' training program to help employees prepare for life after retirement. The program offers courses like financial and retirement planning to prospective retirees.

Training Hours per Employee

Unit: Hours



MID TO LONG-TERM WELFARE DIRECTION

Phase 1	Introduce optional welfare system	Improve employee loan system
Phase 2	Expand support for employee loans	Unify carry-over system
Phase 3	Secure mid- to long-term funds	Introduce new welfare projects

Environmental Standard

Environmental management is an integral part of the KT&G corporate culture.

Annual Environmental Investment

KRW 5,392 millions

ENVIRONMENTAL CARE

Environmental management is an integral part of the KT&G corporate culture. As part of our commitment to sustainability and corporate stewardship, we are striving to establish an eco-friendly system through the operation of green plants, reduction of pollutants, greater environmental awareness among employees, and activities to preserve our natural surroundings. To this end, we have drawn up a mission and strategy for our environmental management organization. The head office oversees the overall system while individual worksites concentrate on eliminating environmental risk factors and implementing green practices in everyday operations.

Performance-based environmental management system

Since 2000, KT&G has deployed environmental staff to the facilities department of the production group for more effective and systematic integration of environmental activities. Moreover, each of our plants has set up an environmental department. Regular workshops for related staff are held to promote information-sharing and a field-oriented approach. The limited number of environmental staff, however, has led to a tendency to focus on immediate, day-to-day issues. KT&G aims to establish and follow a mid- to long-term environmental management plan and encourage greater involvement by each department and business site.

Environmental awareness

Our in-house environmental education program encourages every employee to improve their working environment and share environment-related information. Since 2006, we have organized environmental management workshops on multiple occasions to help on-site teams better respond to related challenges. Additionally, we offer external training and full-fledged support for individuals to take the initiative in reducing our eco-footprint.

Green plant management

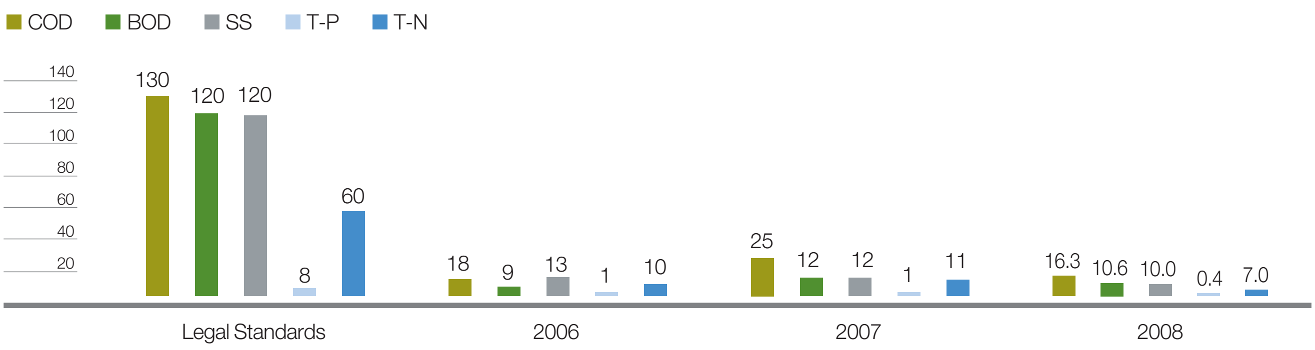
All of KT&G's four cigarette manufacturing plants are ISO14001 certified. The tobacco leaf processing plant is currently undergoing review to acquire certification in 2009. Our independent environmental management system not only ensures compliance with regulations and guidelines, but real-time monitoring of pollutants from each operation site. The headquarters' production management division supervises the system to take immediate action when necessary and contain the fallout from any environmental accident.

Minimizing pollutants

KT&G invests in replacing old facilities and installing low-energy facilities as part of efforts to cut manufacturing costs, reduce energy consumption and minimize pollutants. Each business site has its own environmental management manual and detailed guidelines as part of efforts to promote company-wide improvements. For each stage of the manufacturing process, KT&G has separate standards for water quality, noise/vibrations, hazardous materials, air quality, waste, and soil contamination. This allows us to systematically manage and reduce the pollutants generated by our operations. Our concern extends beyond the production process and we are striving to introduce more earth-friendly raw materials and packaging.

Legal Standards vs. Concentration of KT&G Water Pollutant Emissions

Unit: tons



Environmental investment

To preserve air and water quality, KT&G invests in maintenance/repair works such as replacing or upgrading cleaning machines, dust collectors and air ventilation units. We also make investments in acquiring new facilities. Waste management spending includes payments to outside waste treatment companies and in-house treatment costs like reinforcing compressor sand, repairing warehouses and waste storage units. As seen in the graph, the steady rise in environmental costs reflects the Company's growing awareness and increasing efforts to fulfill our environmental responsibility.

Environmental management system

We operate an environmental management system to ensure effective operations and objective evaluation of our efforts. The system identifies and manages pollutant data to minimize the impact of our operations on our natural surroundings. The headquarters' production management division maintains real-time monitoring over environmental factors and ensures prompt action is taken in the event of any accident.

Environmental communication

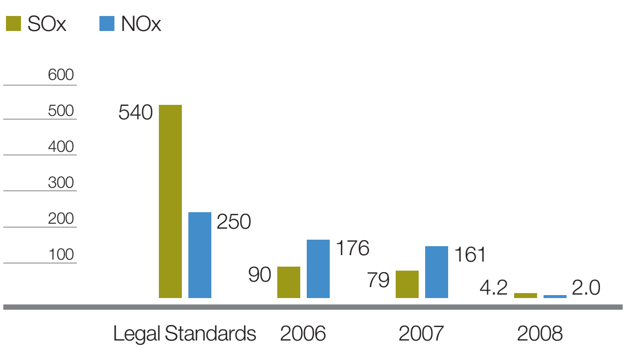
First introduced in 2006, the environmental management workshop has established itself as an important source of information for employees to share and utilize related knowledge to improve their working environment. Going forward, KT&G plans to organize the workshop on an annual basis and create an education system on environmental issues. External training programs will be encouraged and the acquired knowledge will be shared internally.

KT&G is aware of the importance of creating an internal and external network for effective realization of environmental management. To this end, we are taking part in environmental expositions, international environmental technology competitions, environmental campaigns and seminars, in addition to maintaining ties with NGOs and the government. The Shintanjin Tobacco Manufacturing Plant currently runs a Green Email system to share eco-related data with Daejeon City Hall, and operates tours of the plant including its environmental facilities. The company is also actively involved in regional events on environmental education to strengthen relationships with local communities.

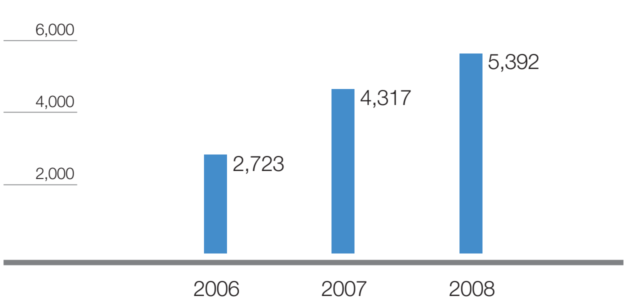
Environmental protection activities

The KT&G Social Welfare Foundation has been involved in replanting trees near Naksan Temple after a devastating forest fire ravaged the area in 2006. Volunteers removed burnt branches and helped plant 10,000 trees. An employee volunteer group took part in cleanup activities for the Taean oil spill in January and February of 2008, when the number of volunteers was dwindling. KT&G will continue to develop and implement various programs to protect local environments and biological diversity.

Legal Standards vs. Concentration of SOx, NOx Emissions Unit: ppm



Annual Environmental Investment in millons of KRW



SAFETY CARE

Employee health and safety

We are working to improve safety awareness and training for employees to keep abreast of changing working environments. We have designated persons in charge of workplace safety in accordance with the Occupational Safety and Health Act. To prevent industrial accidents, we have devised safety health management guidelines and accident-free workplace guidelines. Each business site conducts voluntary safety inspections related to fire risks and other hazards on 'Safety Check Day.' Moreover, each plant has an occupational safety health committee which oversees related activities including training, inspection, and fire control under the safety health management guidelines. Meanwhile, the safety inspection group comprised of the emergency planning team inspects fire facilities and equipment, emergency response measures and training at each related organization on a routine basis.

Training

KT&G is employing diverse routes to relay safety guidelines and related know-how to employees in order to prevent industrial accidents. When accidents do happen, they are included in safety training programs so that employees can learn effective response measures and causes to minimize the fallout in the event of a similar accident in the future.

Industrial accident casebook

In 2007, KT&G published a casebook featuring workplace accidents of the past five years to prevent future incidents and highlight safety awareness among employees. Classified by accident type, the casebook is intended to prevent similar accidents and improve overall productivity. The casebook is constantly revised and amended to provide the most pertinent, up-to-date information.

Category	Training	Details
External Training	Monthly training for safety management personnel	- For in-house personnel in charge of workplace safety - Cultivate specialized know-how, maximize efficiency to prevent accidents through information exchanges
	Training for management supervisors	- For team leaders, division and department heads of plant operations, personnel in charge of workplace safety - Cultivate specialized know-how among supervisors, maximize on-site application of safety health measures
	Entrusted training for safety management	- Safety/industrial accident insurance personnel of each organization - Share information between working-level safety personnel by entrusting on-site training at best practice sites of safety management
Internal Training	Practical training for safety-health personnel	- Conduct safety and health training through tours of on-site facilities, impart techniques and knowhow to relevant personnel
	Incorporation of 3-3 training	- Conduct 3 mins. of safety training before starting work and 3 mins. of clean-up activities after work - Training hours: 20 days/mo. X 6 mins./day = 120 mins. - Gas safety management, how to use fire extinguisher, how to use various safety-related equipment

Social Standard

As a corporate citizen with a global presence that works alongside local communities, KT&G seeks to build trust and repay support to customers and stakeholders through a wide range of corporate social responsibility activities.

SOCIAL CONTRIBUTION

As a corporate citizen with a global presence that works alongside local communities, KT&G seeks to build trust and repay support to customers and stakeholders through a wide range of corporate social responsibility activities. In addition to a youth smoking prevention campaign, KT&G supports various research activities and operates a scholarship foundation. We also extend support to the culture and arts as well as sports. The KT&G Social Welfare Foundation partners with public and private sectors to promote the culture of sharing and volunteering.

Youth smoking prevention

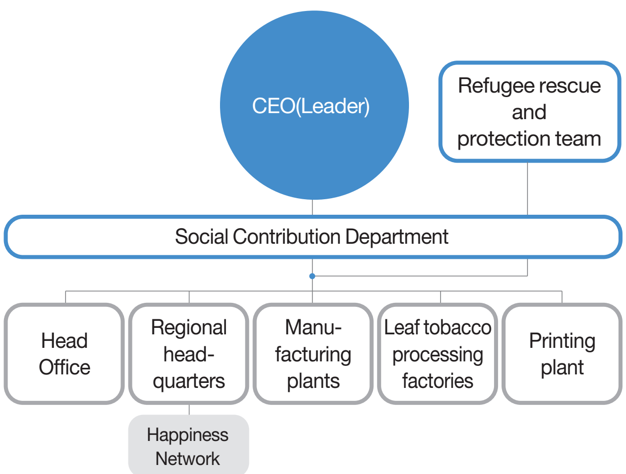
KT&G recognizes teen smoking as a serious social problem and has devised concrete programs to prevent underage consumption of cigarettes. To restrict youth access to cigarettes, we published and distributed 50,000 copies of a guidebook to retailers that provides details on the legal age for buying cigarettes and effective ID checking.

Sales personnel also receive education to provide continued guidance to retailers. Additionally, we are developing a program to educate youths and plan to work with NGOs for its implementation.

Improving the environment for non-smokers

We are searching for public place smoking solutions that balance the interests of smokers and non-smokers. We have installed and provided maintenance works on 15 smoking rooms with ventilation facilities at major public facilities (ie, airports). Our efforts to improve the public smoking environment also include the installation of approximately 5,700 garbage bins at highway rest stops. In compliance with our campaign mission to promote courteousness and consideration when smoking in public places, we produced and distributed 20,000 portable ashtrays and printed smoking etiquette guidelines in major dailies. Other efforts include the 'Contents Festival for a Better Tomorrow' and cards inserted in 2.5 million boxes of Arirang cigarettes. KT&G plans to encourage smoking etiquette using banner ads in internet portal sides and promote a mutually respectful smoking culture by working with local governments and civic groups.

KT&G ETHICS MANAGEMENT STRUCTURE



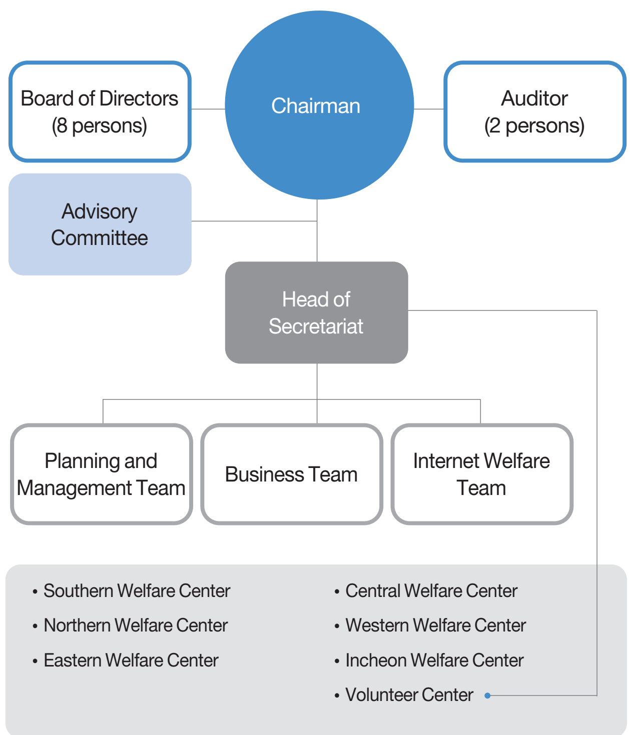
KT&G Social Welfare Foundation

The KT&G Social Welfare Foundation demonstrates a wide range of activities, including Happy Network operations, social welfare projects, and internet welfare programs to extend support to retirees, university students (for overseas volunteering), social welfare centers (vehicle support), the elderly and online welfare projects.

We also join with the Sunny Korea Welfare Foundation to commit to assisting low-income children with heart disease and other serious diseases in Korea, Laos and Inner Mongolia, China. Since 2004, we have been working with the Medical College of Seoul National University to provide medical help in Uzbekistan. The Foundation also sent heating oil to Iraq and Afghanistan, blankets to victims of the Iran earthquake, and antibiotics and other medication to North Korean children.

Employee volunteering

In 2007, each of our business sites voluntarily formed volunteer groups to organize regular visits to social welfare facilities. The employee volunteer groups also have a disaster recovery team to oversee assistance for victims of natural disasters.



KT&G SangSangMaDang

SangSangMaDang is a community designed to provide support for artists and enable the general public to enjoy diverse arts and culture. Its online service includes programs for short films, cartoons, culture and photos to help uncover and foster amateur artists. The offline cross-cultural space offers areas for various stage performances, independent film screenings, art square, gallery, academy and studio.

KT&G Scholarship Foundation

We established the KT&G Scholarship Foundation in 2008 in recognition of the fact that creative and talented people hold the key to national competitiveness in the knowledge-based and borderless 21st century. Key initiatives include tuition fees for foreign students in Korea, scholarships for Korean graduate students in Korea and overseas, and support for research. The KT&G Scholarship Foundation is part of our social commitment to foster the leaders of tomorrow and build a brighter future.

KT&G Sports Club

In addition to managing professional basketball and volleyball teams, the KT&G Sports Club operates table tennis and badminton teams to support promising athletes and promote sports in Korea. The Sports Club is dedicated to building a healthier and cooperative society. As one example, we add to the donations made by key players of the KT&G basketball team in the form of a matching grant to accumulate a certain sum of money per game. The saved donations are delivered to children in need and a social welfare organization in Anyang, where the team is based.

Online welfare programs

The KT&G Social Welfare Foundation operates diverse online programs to raise funds for the heads and guardians of low-income families needing medical treatment. Our aim is to set up a fun and easy donation culture through the 1004 KT&G (www.1004ktng.com) website.

CUSTOMER SATISFACTION

KT&G has set up diverse communication channels for better customer access to information on our business and products. In addition to providing fair and clear information, we follow numerous activities to maximize customer satisfaction.

Disclosure of product information

In accordance to Korean regulations regarding the packaging and advertisement of cigarettes, we include health warnings on our cigarette products sold in Korea. For exports, we place the health warnings on product packages voluntarily when they are not required by relevant countries. In this way, we are guaranteeing the right to know of all of our customers on the health impact of smoking, as well as tar and nicotine levels.

Communication with customers

Our website features a Q&A corner where customers can easily pose questions or ideas related to our products, or access various product information. Customers can also report work-related irregularities, complaints, recommendations or opinions through the ombudsman section.

Improvements in customer service

The CS Center is our main communication channel with customers which also provides real-time monitoring of customer calls. The CS Center writes up weekly and monthly reports which are shared with related departments to deal with customer complaints and improve service quality. Discussions and training sessions are held for problems which arise during the customer consultation process.

No. of reported complaints/recommendations and improvements

	2006	2007	2008
Product claims	1,283	1,051	-
No. of improvements	552	291	-

Customer satisfaction management

We conduct a customer satisfaction index (CSI) survey among adult smokers and dealer satisfaction index (DSI) survey for domestic retailers and salespersons. The results of the surveys which rate product quality, company image (credibility), attitude of salespersons, and sales support are actively reflected on our operations. As a result of our efforts to improve upon shortcomings, KT&G has enjoyed satisfaction levels on par with rivals since 2003.

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