Flash
light
Capital

LOST 15 YEARS: UPDATE

December 2022

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HOW IT STARTED

	After CEO appointment	CEO meeting 2017	CEO meeting 2022	Before the announcement
Stock price (KRW):	137,000 *(July 1, 2016)*	119,500 *(July 28, 2017)*	82,000 *(April 12, 2022)*	81,709 *(avg. Aug 2022)*
Dividend yield[1]:	2.6%	3.3%	6.1%	6.1%

Note 1: Dividend per share announced during the year / stock price
Sources: KRX, Annual Report, Getty Images

SUMMARY

- **Let's step back from quarterly results and see KT&G's history**, only then can we see the root cause of KT&G's underperformance.
- We can share arguments that can be used against our Five Suggestions. **You can check if KT&G uses any of these later.**
- We are not sure if KT&G's BOD is independent from mgt team. **We request a direct meeting with BOD** so that it can come to independent decision. Also, **we request an open debate with KT&G CEO**.
- **We are asking KT&G CEO 10 questions, and we will share them with you.**
- **Our silence can give a wrong signal to mgt team**. The stock price can go down, as it did in the past 7 years.

2022 3Q RESULT (NOV 14)

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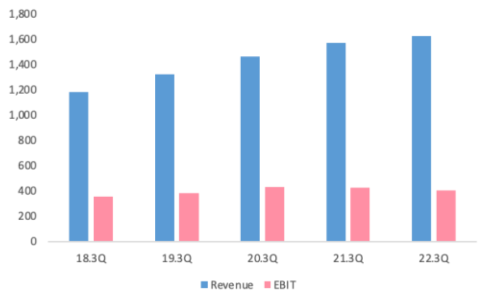
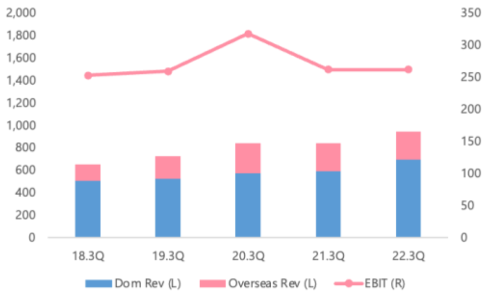
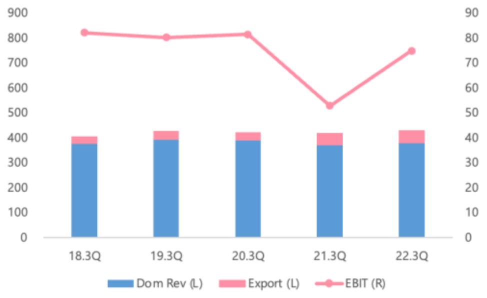
22 3Q Earning (KRW bil)



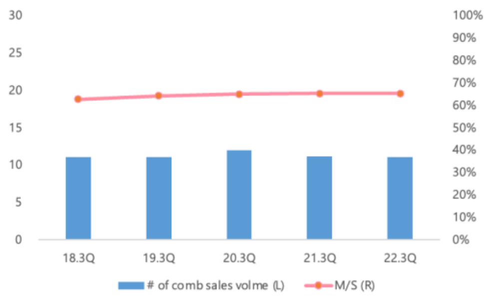
TOB 22 3Q Earning (KRW bil)



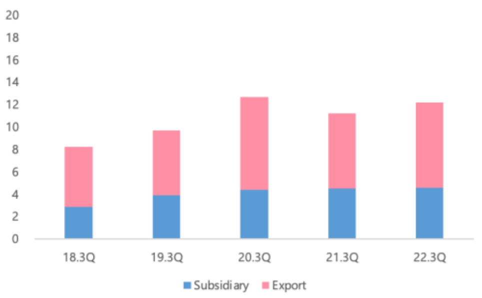
KGC 22 3Q Earning (KRW bil)



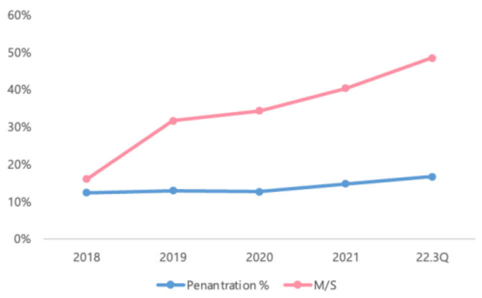
22 3Q Dom comb stick (bil. sticks)



22 3Q Overseas comb stick (bil. sticks)



22 Domestic HNB



Highlights

- Total cash increased from KRW4.2 Tril to 4.6 (2021 EOY to Sep 2022).
- M/S on domestic combustible cigarette was maintained high at 65% in 3Q (vs. 65% in 2Q).
- Domestic HNB M/S increased during 3Q (48.5% 3Q vs. 47% 2Q, 40% end 2021).
- HNB penetration % increased from 14.8% (Dec 2021) to 17% (Sep 2022).
- There is no information on HNB export revenue or profit (KT&G said they cannot disclose due to NDA with PMI).

Source: Annual Report, Company IR

VOICE FROM KOREAN MEDIA

<u>From Local Newspapers</u>

"Flashlight represents "a good activism"

– Korea Economic Daily

"Many think (Flashlight) is different… it is mgt-friendly."

- Bizwatch Korea

"By focusing on "creating shareholder value", (Flashlight) can help eliminate "Korea discount"

- Seoul Economic Daily

<u>Comments From Local Retail Investors</u>

- *"Hope ginseng spin-off happens…"*
- *"quarterly divid + T/S cancel"*
- *"semi-annual divid + T/S cancel"*
- *"quarterly divid + special buyback + T/S cancel*

- Flashlight youtube channel

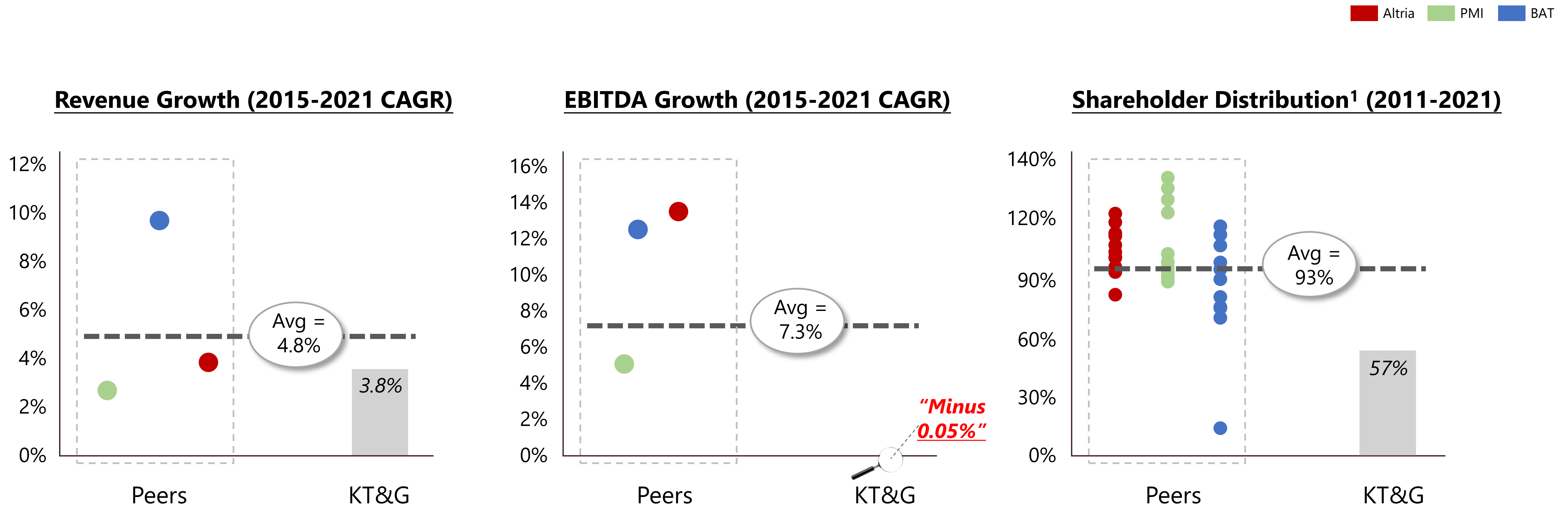
"How is it different from LG spin-off?"
"↲ RE: horizontal spin-off is good"
"↲ RE: in short we get new shares"
"↲ RE:RE: Thanks!"

<u>"Let's do a poll on ginseng spin-off"</u>
<u>"↲ RE: Who would object to horizontal spin-off? Useless poll."</u>

- Comments on Naver.com (Oct 26)

SIGNIFICANT UNDERPERFORMANCE

KT&G significantly underperformed its peers, especially in shareholder distribution.



[1] (Dividend+Share Buyback) / Net Income; between 2011 and 2021

Source: Bloomberg, Annual Report

"NEGATIVE EV"

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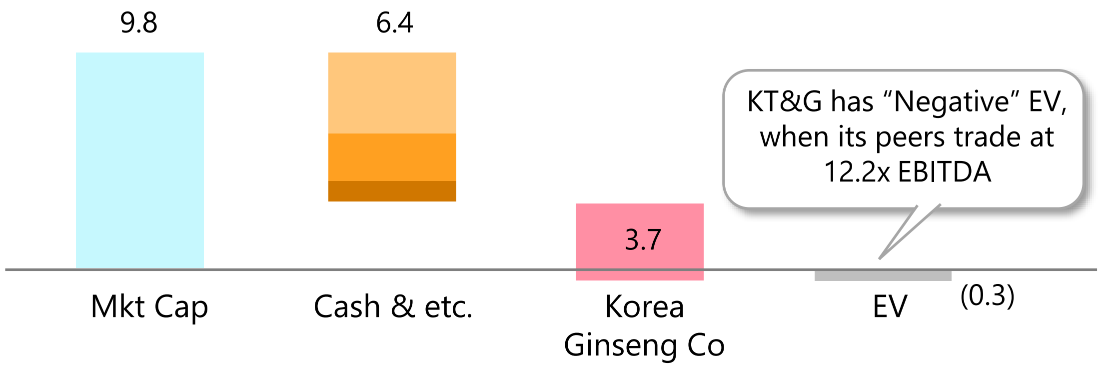
Sum of the Parts Valuation (KRW trillion)[1]

	Revenue	EBITDA	Value
Mkt Cap (exc T/S)			9.8
Net Cash			3.8
Real Estate			2.2
Non-core Subs			0.3
Cash & etc.			6.4
Ginseng Biz	1.4	0.2	3.7
KT&G EV			(0.3)

KT&G's Negative EV (KRW trillion)



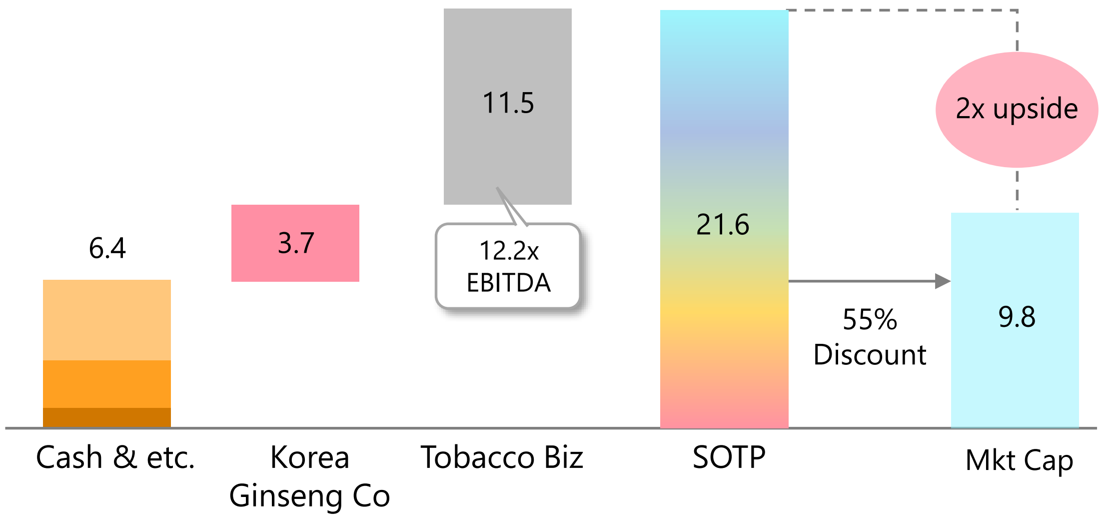
[1] Consolidated net cash of KT&G minus net cash of KGC / Yungjin Pharmaceuticals / Cosmocos, to reflect the plan of KGC spin-off. Appraisal value used for Real Estate value. Non-Core subsidiaries include market value of only one company, Yungjin Pharmaceuticals. Assumed zero value for all other non-core subsidiaries. Korea Ginseng Company valued on 20x EBITDA, a 30% discount to a comparable premium brand food transaction precedent. Tobacco Business valued on 12.2x 2021 EBITDA, median of global peers. Mkt Cap based on stock price as of Avg August, 2022 (excl. T/S).
Source: Annual Report, Bloomberg

MKT CAP SHOULD DOUBLE

Sum of the Parts Valuation (KRW trillion)[1]

	Revenue	EBITDA	Value
Net Cash			3.8
Real Estate			2.2
Non-core Subs			0.3
Cash & etc.			6.4
Ginseng Biz	1.4	0.2	3.7
Tobacco Biz	3.1	0.9	11.5
Total			15.2
SOTP			21.6

SOTP vs. Mkt Cap (KRW trillion)



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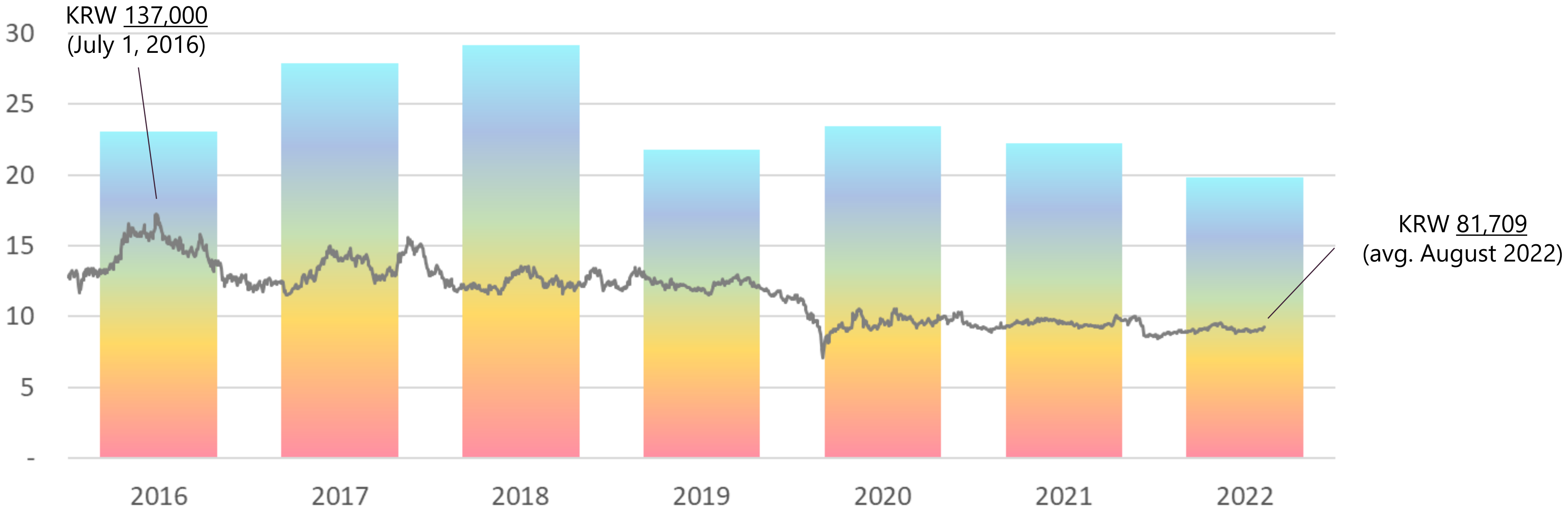
Source: Annual Report, Bloomberg

VALUATION GAP WIDENED SINCE 2016

SOTP and Mkt Cap (KRW trillion)[1]



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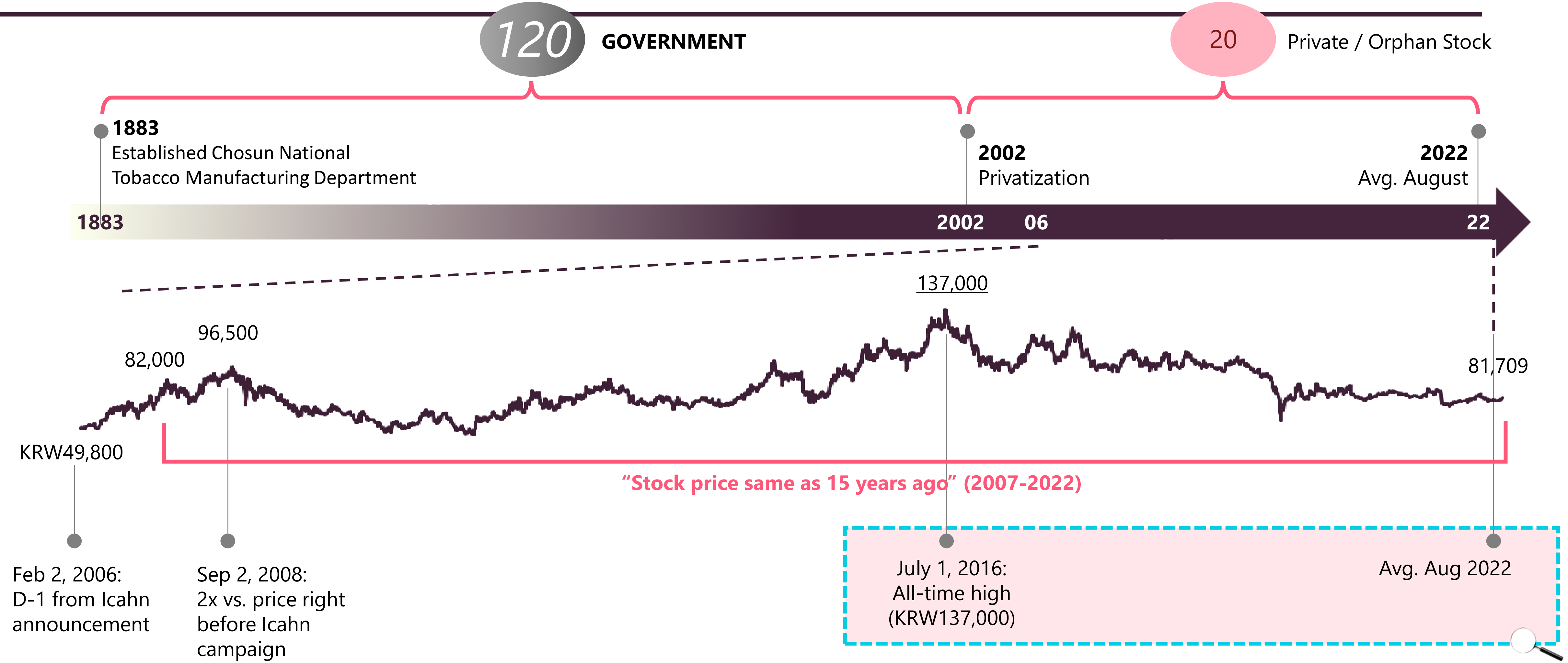
Source: Annual Report, Bloomberg

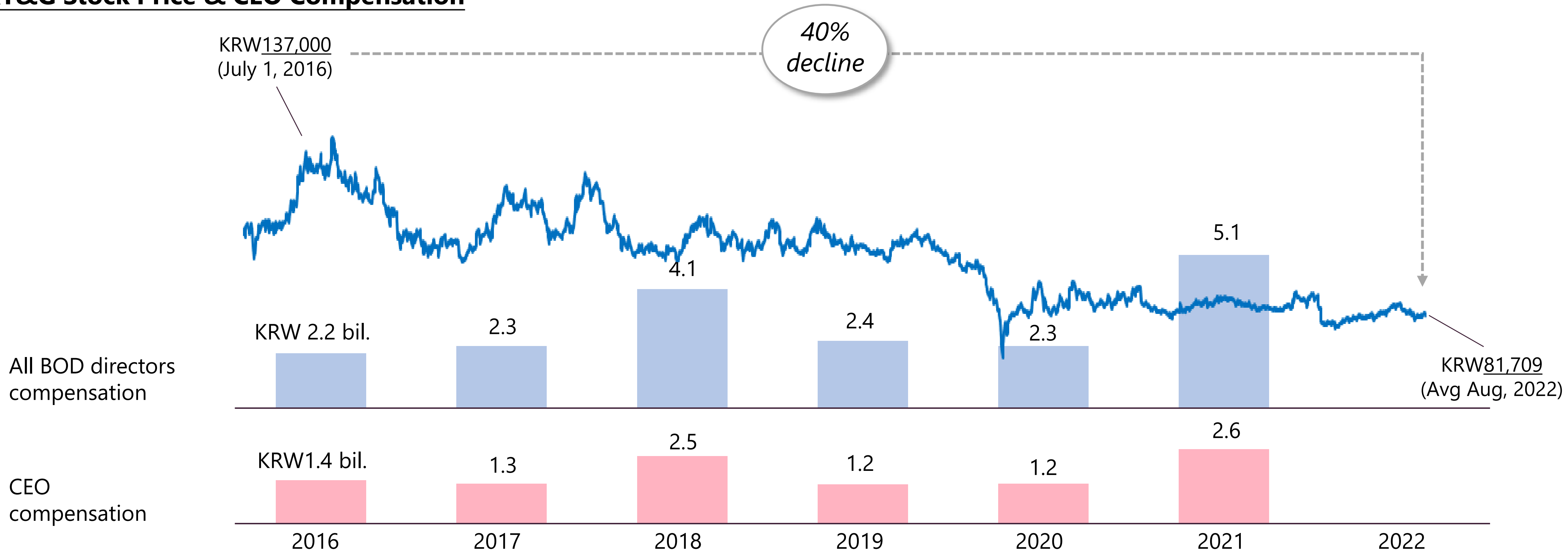
"LOST 15 YEARS"



LONG-TERM VIEW is critical to understand KT&G's current situation

PAST 7 YEARS: SHAREHOLDERS LOST, NOT MANAGEMENT

KT&G Stock Price & CEO Compensation



# of stocks owned by CEO	2016	2017	2018	2019	2020	2021
	3,893 shares	293 shares	293 shares	293 shares	293 shares	293 shares

Source: Annual Report, KRX

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KT&G BOD: DO YOU THINK THEY ARE INDEPENDENT?

Int/External	Name	Terms Until	Background	Shares owned
Internal	Mr. Baek (CEO, since Oct 2015)	Mar 24		293
Internal	Mr. Bang (COO)	Mar 24		-
External	Mr. Koh	Mar 23	Professor	-
External	Mr. Kim	Mar 23	SME	-
External	Mr. Baek	Mar 24	Lawyer	-
External	Mr. Lim	Mar 24	Chaebol (SK)	250
External	Mr. Son	Mar 25	Chaebol (CJ)	-
External	Ms. Lee	Mar 25	Advertisement	-

Less than $20k, less than a typical retail investor in Korea

"Two faces of external directors: Yes Men or a real decision makers"[1]

Annual Report (Mar 2022)
Note 1: The JoongAng Economist: https://jmagazine.joins.com/economist/view/301272

WE HAVE TWO QUESTIONS ON KT&G BOD

#1: CEO Renomination (Mar 2021)

- According to Article of Incorporation, KT&G BOD (a sub-committee that excludes CEO) can nominate new CEO candidates.
- Between Oct 7, 2015 (the date when CEO took office) and Dec 31, 2020, stock price came **down by 24% (vs. KOSPI up +43%).**
- On Jan 26, 2021, CEO Candidate Nomination Committee was formed, and the result was announced on Feb 9, 2021, **in 11 working days.**
- We wonder if BOD had sufficient time to look for and complete the evaluation of other candidates during such short period of time.

#2: CEO Comp Decision (2021)

- According to AOI, KT&G BOD (a sub committee that excludes CEO) can determine CEO compensation.
- Between Oct 7, 2015 (the date when CEO took office) and Dec 31, 2020, stock price came **down by 24% (vs. KOSPI +43%).**
- In 2021, Mr. Baek was awarded KRW2.56 billion ($2.1 million[1]), the largest amount since his appointment in 2015.
- According to KT&G annual report (Mar 2021) **there are a total 12 evaluation criteria including** revenue, new business value creation, group infrastructure renovation, and **"TSR".**
- We do not know how much weight was given to the stock price when BOD decided on the CEO compensation.

Note 1: $1 = KRW1,197.83 as of Feb 27, 2022

OUR INTERACTION WITH MANAGEMENT TEAM

April 22, 2022	Meeting w/ CEO	Initial discussion on our 5 suggestions and request for a presentation to mgt team
May 4, 2022	Meeting w/ COO, CSO	Pre-presentation meetings on the details of 5 suggestions
May 10, 2022	Presentation to CEO, COO, CSO	A 2-hour presentation (the presentation used is available on our web site)
June 6, 2022	Meeting in w/ COO, CSO	Follow-up discussion on 5 suggestions
June 15, 2022	Letter to Company	Asked Company for a meeting with **BOD** (**1st Request**)
June 29, 2022	Response from Company	"It is not appropriate time to make suggestions to BOD."
Oct 26, 2022	Flashlight Cap Announcement, sent a letter **to BOD (2nd Request)**	
Nov 4, 2022	Response from **Mgt Team**	"We reported to BOD on Nov 3… we will faithfully review… we listen to shareholders."
Nov 9, 2022	Announcement through media	"HNB to be 50% of total revenue by 2025. Will consider direct overseas expansion."

We sent our letter to BOD, not mgt team. We also asked for a meeting w/ BOD, but we have not heard a response yet.

FLASHLIGHT'S FIVE SUGGESTIONS

1. Kill Cigarettes, Grow HNB

2. Free Ginseng

3. Exit 9 non-core biz including Real Estate

4. Plan on Excess Cash

5. Governance Reform

Visit our website
(www.FlashlightCap.com)
for more info

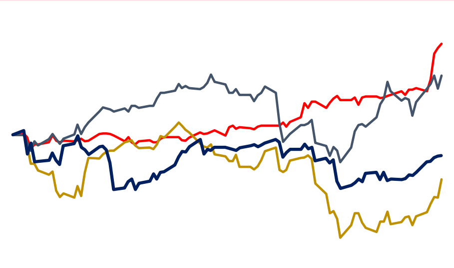
THEY MAY SAY (1/6)

OVERALL

Potential Question

"Some shareholders said we are doing a very good job."

"KT&G stock performed well in 2022. If you pick a certain point of time in the past, KT&G can look like it outperformed Philip Morris! (that look likes below.)"



"KT&G's PER (~10x) is not bad. If stock price doubles, PER of 20x? That's not possible!"

Our Position

- Who are that "some shareholders"? Did you listen to the collective voice of shareholders, or just a few that you like to hear from?

- It is important to have a **Long-term View**. The company's stock price is the same as 15 years ago. Any stocks can pick that magic period it outperforms others.

- PER is not the right metric, as there is over KRW 6 trillion of cashable assets. We should look at EV/EBITDA. If stock price doubles EV/EBITDA will be 12x, in line with peers.

WHY PER DOES NOT WORK HERE

PER

$$\frac{\text{Mkt Cap}^{1}}{\text{Net Income}^{2}} = \frac{\text{KRW13.1 Trn}}{\text{KRW1.2 Trn}} = 11.3\text{x}$$

This may sound comparable, as Altria is trading at 9.4x. (never mind PMI 17x and BAT 14x).

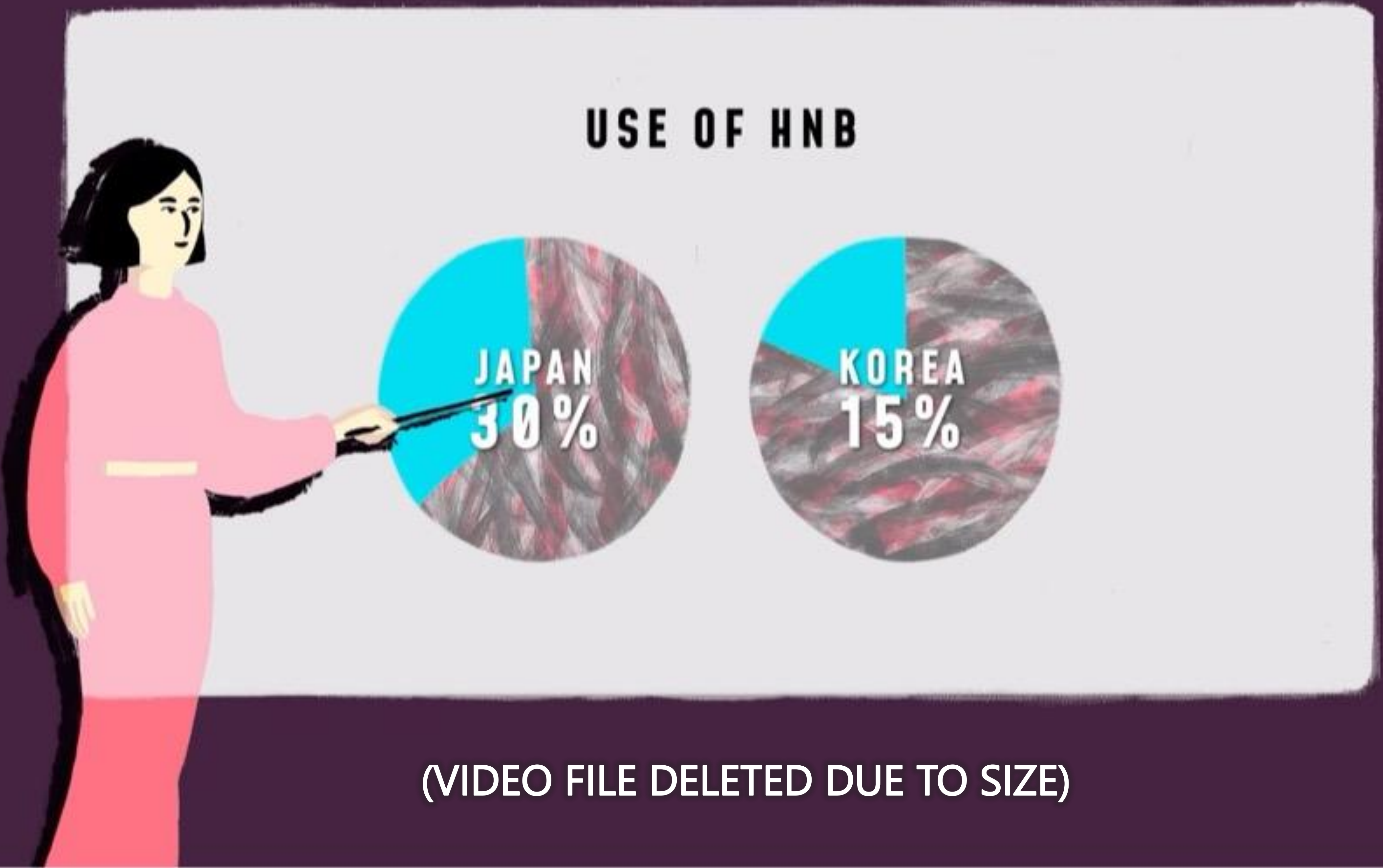
- KRW6.6 (=4.4+2.2, **50% of mkt cap**) is cash & cash-like assets, and investment Real Estate.
- KGC (ginseng) is worth KRW4trillion, so almost all mkt cap can be accounted for by KT&G's non-tobacco assets.
- If we take all these assets out, mkt cap would be KRW2.5 trillion, mostly the same.

EV/EBITDA

$$\frac{\text{EV}}{\text{Tobacco EBITDA}^{3}} = \frac{\text{Mkt Cap}^{4} - \text{cash}^{5,6} - \text{RE inv}^{6} - \text{subsidiaries}^{6}}{0.9} = \frac{11.5 - 3.8 - 2.2 - 0.3 - 3.7}{0.9} = 1.4\text{x}$$

- KT&G is trading at ~1x EV/EBITDA, vs. 12x of peers, despite its being one of Top 30 KOSPI
- It used to trade at "Negative EV" before our announcement

Note 1: Mkt Cap as of Nov 21, 2022, includes Treasure Shares, 12.6% of TSO as of Sep 2022
Note 2: Net Income is as LTM Sep 2022
Note 3: 2021 Full Year
Note 4: Mkt Cap as of Nov 21, 2022, excludes Treasury Shares
Note 5: Net Cash excluding subsidiaries
Note 6: Cash, RE inv, and subsidiaries all as of Dec 2021



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KT&G TALKS ABOUT HNB

(Flashlight’s Video, Oct 26)

(KT&G, lil AIBLE launch, Nov 9)

- We understand that, on Nov 9, during a new HNB launch, KT&G said it would target 50% of total revenue from HNB by 2025 and consider building an independent global distribution capability.[1]
- KT&G is known to have said this announcement is not necessarily related to Flashlight’s request.
- Still, we wait for a) KT&G to officially announce the target, b) **confirmation on whether or not they will renew PMI deal**, and c) share a clear roadmap of how it will achieve the target.
- We also request KT&G disclose the revenue and profit it currently generates from HNB business overseas.
  - ✓ KT&G discloses # of countries it penetrated, but it is NOT disclosing basic financial metrics citing a confidentiality agreement w/ Philip Morris. We find it difficult to understand why Philip Morris would prohibit KT&G from reporting to its shareholders, and why KT&G agreed to hide KPI from its shareholders.

Note 1: https://www.mk.co.kr/news/stock/10523713

JUST WHAT IS HNB EXPORT REVENUE?

HNB Export Revenue

A. KT&G Audit Report (standalone, Mar 2022, Footnote 4) shows a total tobacco export of KRW787 billion.

B. In KT&G 2021 4Q IR report (Feb 10, 2022, Page 8), combustible cigarette export is noted as KRW436 billion.

C. Therefore it seems like the balance (352=787-436) is from HNB export. We understand this figure this KRW352 billion includes both sticks as well as devices.

D. In 2021 KT&G Report (Sustainable See for Tomorrow, Page 11), total NGP (HNB) revenue (both domestic and export) in 2021 is stated as KRW 504 billion.

E. From #C and #D, we can deduce HNB revenue domestically to be KRW152 billion (=504–352). However, KRW152 billion seems too low for HNB domestic revenue. Because that's only 8% of domestic tobacco revenue (KRW1.9 trillion). As HNB has a higher ASP and the revenue includes device (which is much more expensive than sticks), we don't think this does not seem to be the right number.

HNB Export Profitability

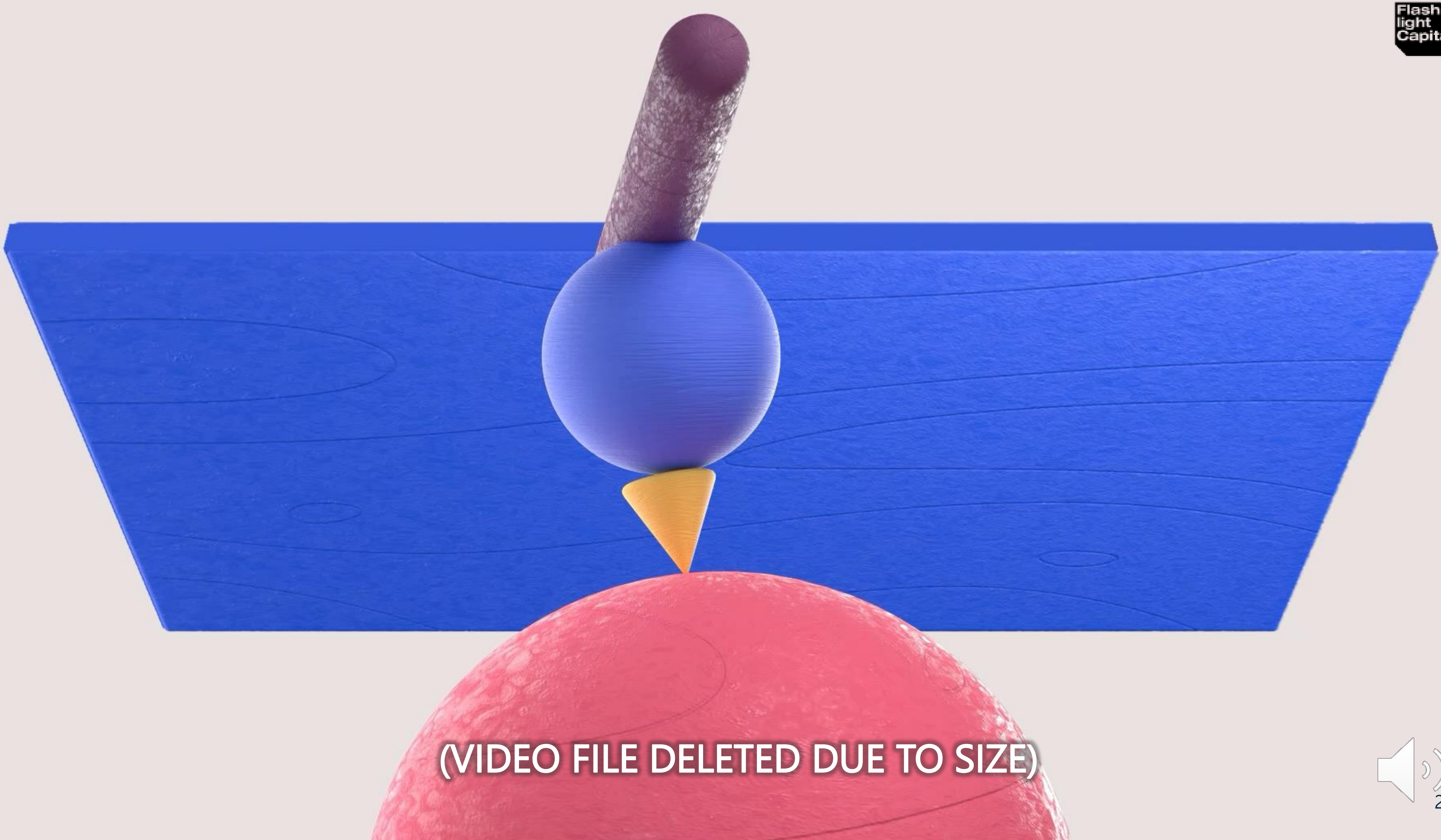
- At least for revenue, we can try to triangulate, but for profit there is no way to tell how (or if) the export business is profitable.
- Revenue and Operating Profit of HNB business, both domestic and export, are true KPI's of KT&G's business.

THEY MAY SAY (2/6)

GINSENG

Flash light Capital

Potential Question	**Our Stance**
“Some shareholders said we don’t need to change anything about our HNB business.”	• Who are that “some shareholders”? Did you listen to the collective voice of shareholders, or just a few that you like to hear from?
“We can’t distribute lil overseas ourselves. How can we do it? We don’t have overseas branches, no talents..”	• KT&G can do it. KT&G has great employees, and KRW 6 trillion.
“Can’t say much about the deal with PMI… because of confidentiality”	• Why would PMI stop KT&G from disclosing the total revenue and profit of total sticks and devices export? What does the KPI have to do with confidentiality?
“We will not tell you whether PMI deal is good or bad.. we will simply renew it next year.”	• Overseas HNB is a very important business to KT&G. Shareholders need to know if there is real economic benefit from the contract, or the Company is using confidentiality as an excuse to extend the contract. **Not disclosing important KPIs should be stopped immediately.**



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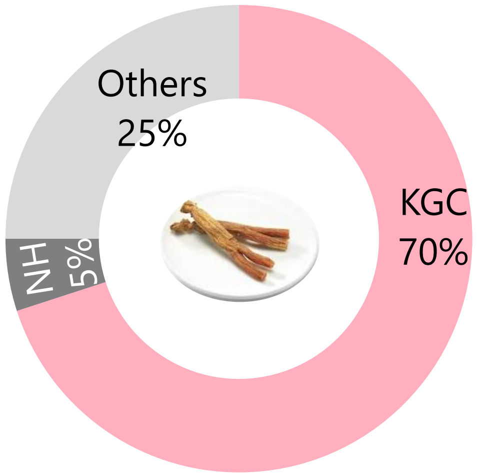
FAST-GROWING W/ GLOBAL POTENTIAL

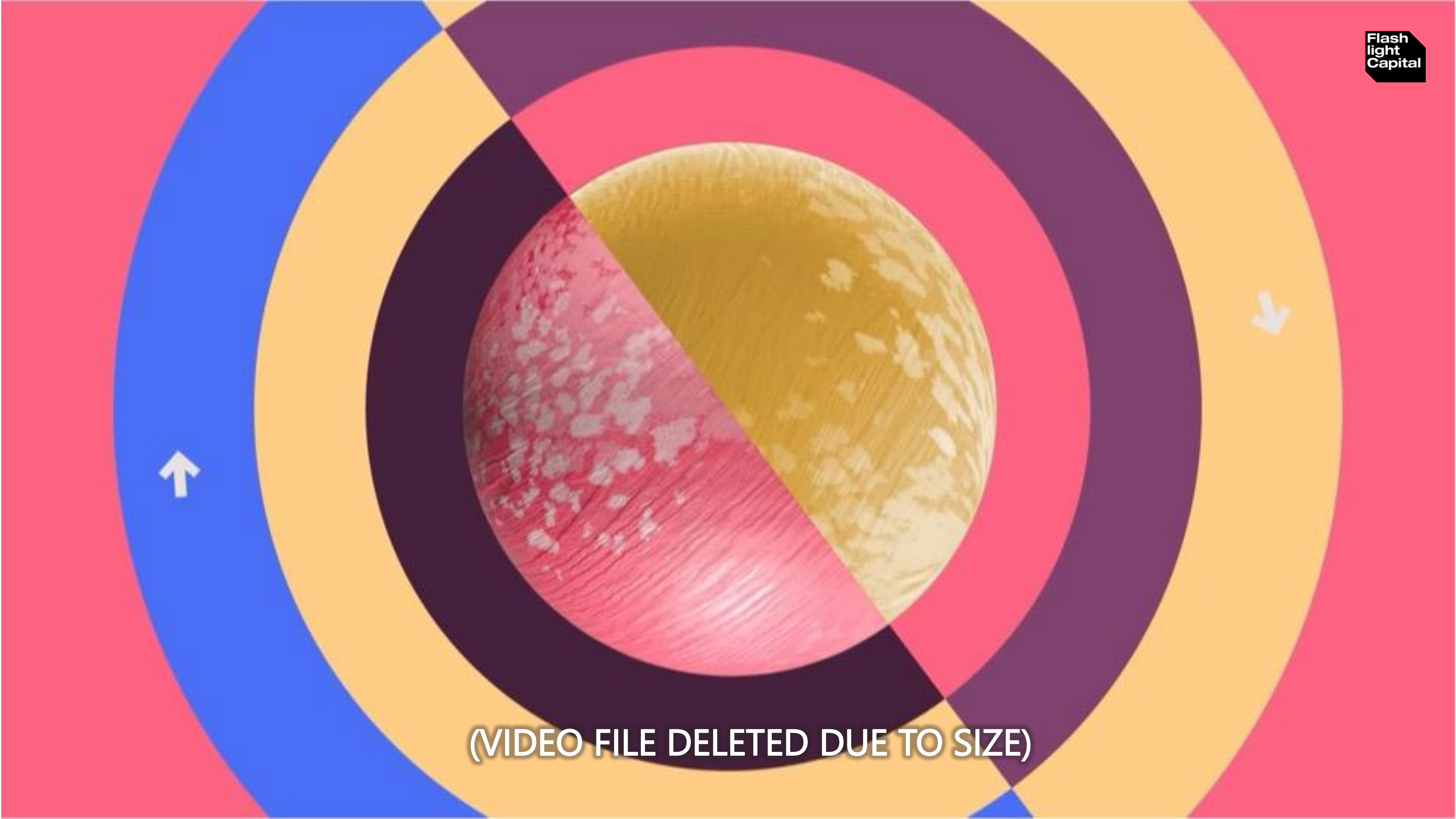
- KGC (KT&G's 100% owned subsidiary) is a strong brand.
  - ✓ Ginseng is a premium health food that accounts for 1/3 of all health nutrients consumed in Korea
  - ✓ KGC enjoys unmatched brand loyalty in Korea due to its history as the authentic ginseng provider, its revenue **growing at 12.3% CAGR from 2014 to 2019**
- Ginseng has huge potential beyond Korea.
  - ✓ Ageing population is the world phenomenon, although Korea is No. 1 in the fastest ageing country.
  - ✓ The global health and wellness food market was $96 billion in 2020 and is projected to grow at a CAGR of 9.2%, reaching $162 billion by 2026
- Despite the potential, KGC is not successful overseas.
  - ✓ Despite huge export potential, **overseas sales accounted for less than 20% of revenue**, mostly in China where only recently escaped a loss.

#1	*World's Fastest Ageing Population (Korea)*
8.8%	*Korea Health Nutrient Industry CAGR (2016-2019)*
9.2%	*Global health & wellness food industry (2020-2026)*
8.9%	*Ginseng Food Volume CAGR in Korea (2009-2020)*
12.3%	*KGC Revenue CAGR (2014-2019)*

Ginseng Market Share



KGC is the world's #1 ginseng brand and producer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SPIN-OFF: HOW IT WILL TAKE PLACE

"Let's do a poll on ginseng spin-off"
"↲ RE: Who would object to horizontal spin-off? Useless poll."
- Comments on Naver.com

How is it different from LG spin-off?"
"↲ RE: horizontal spin-off is good"
"↲ RE: in short we get new shares"
"↲ RE:RE: Thanks! Didn't know that."
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"This is not exactly a great time for IPO…
Wait, this is NOT IPO? *I didn't know…"*

A research analyst

WHY FREE GINSENG

Flash light Capital

Seven reasons why we are proposing ginseng spin-off

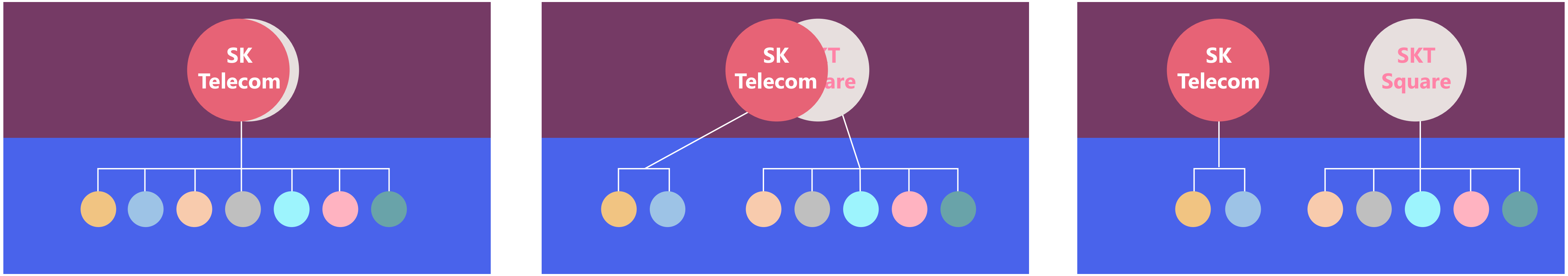
1. A paradox: ginseng (a health food) should not be owned by tobacco;
2. ESG re-rating: Many institutional investors could not invest in ginseng when it was under tobacco company;
3. More scrutiny & more attention as a listed standalone entity;
4. Freedom to Recruit Global Marketing talents: No more parachuting tobacco executives to ginseng;
5. Tobacco and ginseng business have been separate entities for 20 years;
6. We understand spin-off is a non-taxable event for most shareholders; and
7. Multiple precedents with **overwhelming** shareholder approval and successful completion.

One reason why someone may want to oppose the spin-off

1. Management of KT&G may see KGC spin-off as the reduction in their territory.

SPIN-OFFS: SUCCESSFUL PRECEDENTS

SK Telecom (Largest Telco in Korea, Oct 2021)



- In Oct 2021, SK Telecom went through a horizontal spin-off through which SK Telecom was split into two companies with 2 and 5 subsidiaries[1]. It was approved by **99% shareholder approval**.
- In 2020 and 2021, there were several spin-off cases, which got very high shareholder approval rating.
- Horizontal spin-off ('인적분할")'s are regarded as a success, as touted by many local news articles.


서울경제

매일경제

증권

기업 인적분할 봇물 유동성 확보 총력전

박윤예 기자 yespyy@mk.co.kr · 김정환 기자 flame@mk.co.kr
입력 : 2022-12-04 17:42:34 수정 : 2022-12-04 22:51:11

현대百·한화솔루션·OCI…
올해 13곳, 12년만에 최다
위기대비 선제적 구조조정

◆ 기업 인적분할 봇물 ◆
경기 전망이 불안한 가운데 '인적분할'을 택하는 기업들이 금융위기 당시 수준으로 늘고 있다. 인적분할을 활용해 선제적 구조조정을 하거나 성장성 높은 사업을 떼어내 자금 조달에 숨통을 틔워 보려는 의도로 풀이된다. 4일 금융감독원에 따르면 올해 인적분할을 발표한 기업(이사회 결의일 기준)은 총 13곳이다. 2010년(14곳) 이후 12년 만에 가장 많은 수준이다. 2000년대 지주회사 전환을 위한 인적분할이 활발했으나 2010년대 들어 지주사 전환이 줄면서 인적분할도 뜸해지며 지난해엔 3곳에 머물렀다가 올해엔 4배 넘게 늘었다. 특히 채권시장이 얼어붙기 시작한 9월 이후 두 달 새 인적분할을 발표한 기업은 현대백화점·현대그린푸드·한화솔루션·아주산업·AJ네트웍스·OCI·대한제강·이수화학 등 줄잡아 8곳에 이른다.

기업 분할은 인적분할과 물적분할로 나뉜다. 사업분리와 지주사 전환 등의 목적을 위해 이뤄지는 인적분할은 기존 주주가 분할 기업의 주식을 지분율대로 갖게 되지만, 물적분할은 기업이 분할 회

Note 1: Only Only including main subsidiaries (SKT: SK Broadband, SK Telink / SKS: SK Hynix, 11st, One store, ADT caps, Tmap mobility)
Source: Repository of Korea's Corporate Filings

THEY MAY SAY (3/6)

GINSENG

Flash light Capital

Potential Question	Our Stance
"Some shareholders say we should keep KGC as 100% subsidiary."	• Who are that "some shareholders"? Did you listen to the collective voice of shareholders, or just a few that you like to hear from? Why don't we put it on shareholder's vote?
"Why IPO? We don't need more cash.	• It's <u>NOT</u> IPO, but spin-off. existing KT&G shareholders get NewCo shares.
"It is difficult."	• Numerous precedents in Korea had 77%-99% shareholder approval.
"Now is not the right time"	• When is that "Right Time"? It didn't come in the past 20 years.
"KGC will not be properly valued under the uncertain mkt condition."	• KGC is already currently valued in KT&G stock, perhaps at zero. When freed from tobacco, it will be probably be valued at more, not less, than the current value.
"KT&G stock can implode without KGC, as it will become pure tobacco.."	• Really? So pure tobacco players (like Phillip Morris) are valued worse KT&G? **<u>On the contrary</u>**, KGC valuation can go up once it is freed from tobacco/ESG issues.
"KGC already has ginseng expert as CEO. A long time ago he worked at KGC."	• KGC needs "global consumer/marketing expert". Leveraging its great brand as well as talented employees. KGC needs to challenge the world stage and become a global brand.
"KGC can proposer only with CEO Baek's leadership."	• ??!

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Flash light Capital

THEY MAY SAY (4/6)

FOCUS

Flash light Capital

Potential Reaction	Our Position
"Some shareholders think we should continue RE business and other non-core businesses."	• Who are that "some shareholders"? Did you listen to the collective voice of shareholders, or just a few that you like to hear from?
"Actually we did well on Real Estate – we made a lot of money in 2021.	• RE business started to make over $50m profit only from 2018. The past few years was extremely good time for RE developer. We are not sure if KT&G has special capabilities to continue above average performance going forward. It makes little sense for consumer brand specialist to make RE development as growth engine. KT&G should focus on its core business.
"We should do more on M&A."	• KT&G has quite a consistent track record of failure on M&A: - Indonesian tobacco (Trisakti, 2011): We understand KT&G acquired at KRW234 billion, and it had a net loss in 2021. - Cosmetics (Cosmocs) was acquired In 2011 for spent KRW61 billion, had net income of KRW517 million (less than $400k).
"Rea Estate business is what the management team started and is very proud of; we will not let it go."	• Real Estate Asset belongs to KT&G, NOT the management team. Management team should focus all its attention on creating value, not testing new ideas with the company's asset. It should prioritize on the core business that faces a significant opportunity (HNB).

Flash light Capital

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HOW MUCH CASH IS THERE REALLY?

Flash light Capital

KT&G has a total of KRW4.2 trillion cash on a consolidated basis.

Bloomberg

Report Generation Complete

033780 KS Equit | 96) Actions | 97) Export | 98) Set

39) ADJ KT&G Corp IFRS 16 ? Acct Consolidated

1) Key Stats | 2) I/S | 3) B/S | 4) C/F | 5) Ratios | 6) Seg

11) BBG Adj Highlights | 12) BBG GAAP Highlights | 13) Earnings

In Billions of KRW	2021 Y
12 Months Ending	12/31/2021
Market Capitalization	9,478
- Cash & Equivalents	2,564
+ Preferred & Other	48
+ Total Debt	167
Enterprise Value	7,131

Total cash (Bloomberg) =

KRW 2,564 billion

Annual Report (Mar 2022)

	제 35 기
자산	
유동자산	6,255,861,536,474
현금및현금성자산	946,570,845,404
기타유동금융자산	457,056,795,720
유동 당기손익-공정가치 의무 측정 금융자산	965,384,441,544
매출채권 및 기타유동채권	1,012,741,494,275
유동파ㅅ	
재고자ㅅ	
환불자ㅅ	

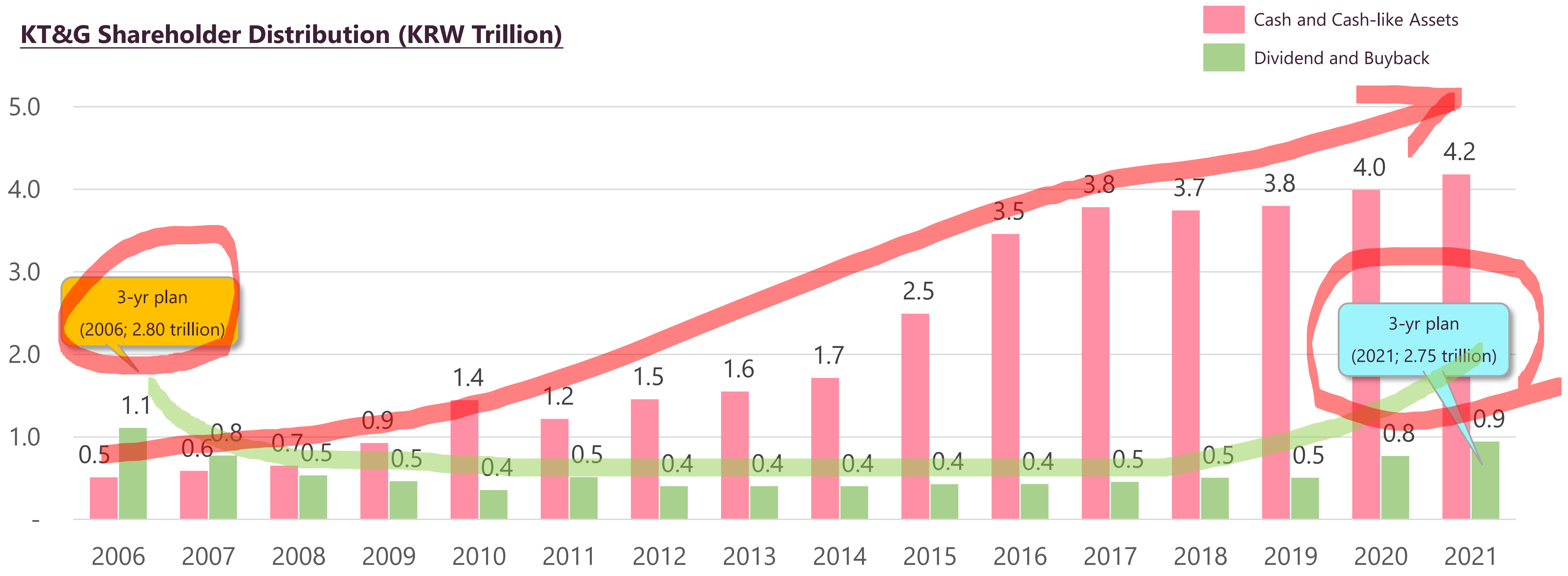
미수담배소비세등	324,920,390,897
단기선급금	98,044,889,263
단기선급비용	53,262,710,533
매각예정자산	20,123,696,708
비유동자산	5,381,409,657,726
기타비유동금융자산	9,001,281,420
장기예치금	1,250,467,510,043
비유동 당기손익-공정가치 의무 측정 금융자산	304,815,651,866
장기매출채권 및 기타비유동채권	94,759,875,704
비유동 기타포괄손익-공정가치 측정 금융자산	228,398,434,797
지분법적용 투자지분	242,991,736,041
유형자산	1,741,041,767,893

	KRW billions
1) Cash and Cash Equivalents	947
2) Current Other Financial Assets	457
3) Current fair market value profit or loss	965
4) Assets held for sale	20
5) Long-term other financial assets	9
6) Long-term deposits in MSA Escrow Fund[1]	1,250
7) Long-term fair value through profit or loss	305
8) Fair value through other comprehensive income or loss	228
Total cash and cash-like in Annual Report	**KRW 4,182 billion**

We encourage you call KT&G and ask if they indeed agree that these are indeed all cash-like assets.

[1] Deposit made under Tobacco Master Settlement Agreement (MSA) under the Escrow Statue of the US state government. The deposit consists of T-Notes, T-bills and demand deposits.

KRW4.2 TRN = 15 YEARS OF STARVATION



Source: Annual Report, Flashlight Analysis

SHAREHOLDER DISTRIBUTION PLAN 2021

Flash light Capital

KT&G's shareholder distribution announcement in 2021 is still not addressing its excess cash.

Recent Announcement in November 2021

- In November 2021, KT&G announced Shareholder Return Plan of KRW0.9 trillion annual dividend/buyback over the next 3 years. This implies 9% of the mkt cap.
- KT&G's EBITDA in 2021 was KRW1.5 trillion; therefore, the recent announcement still assumes total KRW6 trillion of current cash and cash-like assets **will be left untouched.**

Triple Buyback

- Including the value of its subsidiaries and RE investment, KT&G has more than KRW6 trillion of net cashable asset.
- If KRW6 trillion is used in dividend/buyback, **it will triple the planned annual distribution of KRW900 billion**.

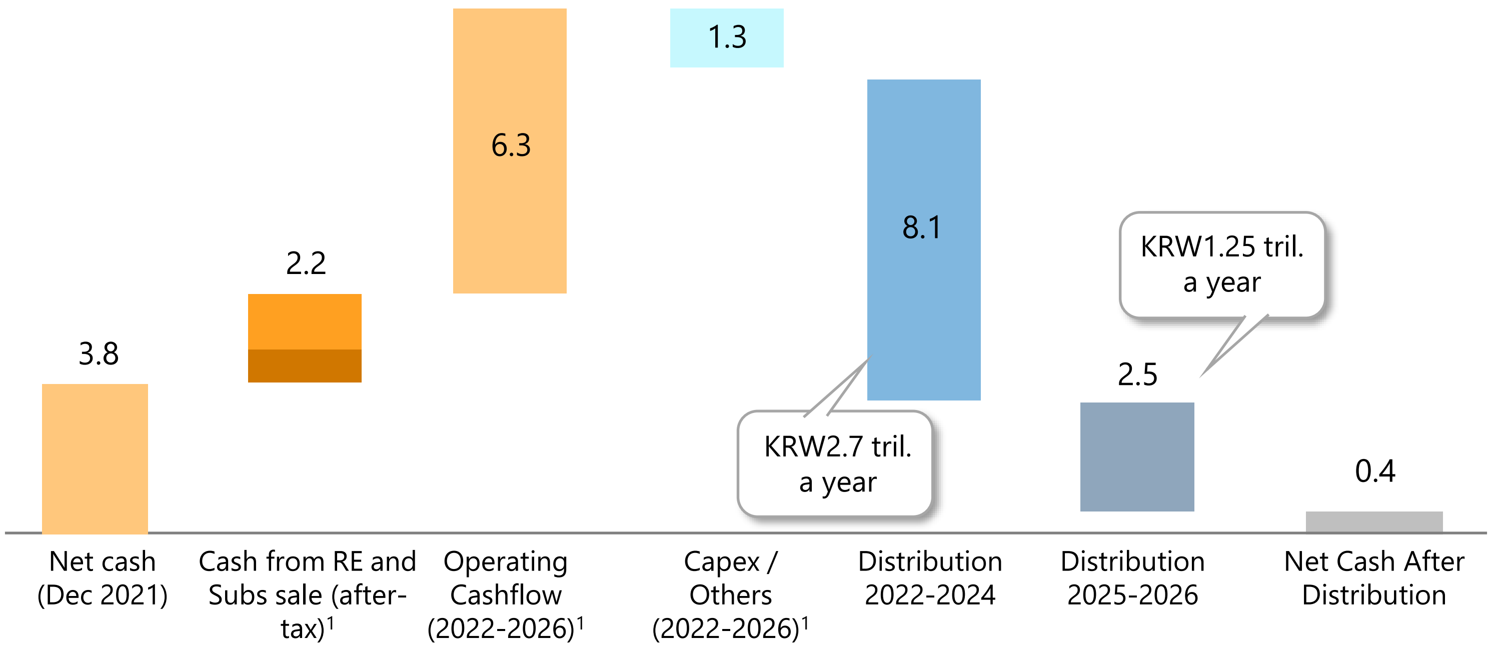
Case Study: 2006

- In 2006, as a response to Icahn's demand, KT&G announced a total KRW2.8 trillion of shareholder distribution for the following 3 years (KRW0.9 trillion a year), a significant increase vs. total dividend in 2005 of KRW0.2 trillion.
- KT&G's Shareholder Return Plan in Nov 2021 (KRW0.9 trillion a year) is **the same level as what the company did 16 years ago.**

KT&G WILL CONTINUE TO STAY NET CASH

After KRW11 trillion of distribution to shareholders, KT&G will still have positive net cash.

Cash Flow for Next 5 Years (KRW Trillions)



- Distribution to shareholders will be funded b the excess cash today, as well as new cashflow strengthened by the growth in HNB.
- Sufficient capex is assumed in the next 5 years (Over KRW200 billion a year, vs. KRW180 billion in the past 5 (2016-2021).
- Even after tripling shareholder distribution, KT&G will stay net cash.
- KT&G is the only one with net cash of global top 5 tobacco companies
  - PMI: net debt of 1.7x EBITDA
  - Altria: net debt of 2.0x EBITDA
  - BAT: net debt of 3.2x EBITDA
  - Imperial Brands: net debt of 2.2x EBITDA
  - JT: net debt of 0.4x EBITDA
  - KT&G NET CASH of KRW4.0 trillion

[1] We assumed corporate tax of 27.5% for asset sale beyond book value. No premium is assumed vs. the current FMV noted in the annual report and stock price. For cash flow 2022-2026, we used projection noted on page 29 and 34. excl. Capex related to investment real estate.
Source: Annual Report, Flashlight Analysis

THEY MAY SAY (5/6)

CASH

Flash light Capital

Potential Reaction	Our Stance
"Some shareholders think we should not change our dividend/buyback policy"	• (Sigh…) Who are that "some shareholders"? Did you listen to the collective voice of shareholders, or just a few that you like to hear from?
"We can't because we need to balance between short-term and long-term shareholders."	• By keeping the cash at banks earning interest rate, what good do you plan to do for long-term shareholders? Besides, who do you mean by long-term shareholders? CEO who has 293 shares since 2017?
"Our 5-6% dividend yield is quite high for a Korean company."	• You are a global Top 5 and should compare with your peers. Your peers have much higher dividend yield, and net debt.
"Everyone loves our distribution plan last year."	• 2021 distribution was after "15 years of starvation". What is your plan on "excess cash"?
"Excessive dividend can hurt KT&G's stability."	• What risk is KT&G trying to protect itself from, with KRW6 trillion of excess cash and more than KRW1 trillion of cash flow a year?
"Triple dividend? That's not sustainable."	• <u>Huddling "excess cash" is not sustainable.</u> KT&G is the only global Top 5 tobacco company with net cash.
*"OK, ok… we will do it some day, but **<u>not now</u>**."*	• 15 years wasn't long enough?
"OK, maybe double, but not triple."	• All excess cash should be distributed unless there is a better way to use it.
"If low interest on cash is the problem, we'll start asset mgt business investing in PE, bonds, etc."	• Why are you so against returning cash to shareholders? Do you think cash is the m asset?


Flash light Capital
(VIDEO FILE DELETED DUE TO SIZE)

THEY MAY SAY (6/6)

GOVERNANCE

Flash light Capital

Potential Reaction	**Our Stance**
"Some shareholders think we should not change anything about our Board of Directors or governance."	• (Sigh…)
"We don't need stock option…"	• Aligned interest is a must, and a critical component of governance. We do not want to see the past 7 years repeated.
"Our BOD members look all fine. We need no new members."	• KT&G can get a lot of help from BOD member with shareholder's perspectives and global business experience.
"Our BOD is the most transparent in Korea. BOD has governance sub-committee, evaluation sub-committee, management sub-committee, ESG sub-committee, audit sub-committee, CEO renomination committee, BOD recruit committee … and KT&G got AA rating from MSCI in 2021. What more can we do?"	• Substance, not form, decides governance. We have concern on the current KT&G's board's independence.

SUMMARY SHEET AVAILABLE ON OUR WEB SITE

Flash light Capital

RESPONSE CHECKLIST

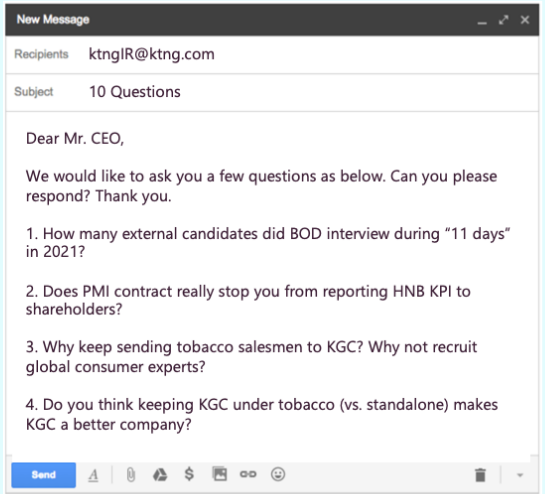
	If KT&G says…	Flashlight would respond…	My Guess	KT&G said
Overall				
A-1	We listened to various opinions of shareholders. Some shareholders said we are doing a very good job.	Who are your "some" shareholders? Do they represent the majority?	✓	
A-2	KT&G stock performed well in 2022. If you carefully pick a certain point in the past, KT&G can look as if it outperformed Philip Morris.	Any stocks can find that magic period, but very few are stuck at the level of 15 years ago.	✓	
A-3	KT&G's PER (~10x) is not bad. If stock price doubles, 20x PER? Impossible!	50% of P is cash! PER (x) EV/EBITDA (o)	✓	
HNB				
B-1	Some shareholders say we don't need to change anything about HNB business.	Who are your "some" shareholders? Do they represent the majority?	✓	
B-2	It's difficult. KT&G can't distribute lil overseas ourselves.	KT&G can do it. It has talented employees and KRW6 trillion.	✓	
B-3	Can't tell you about HNB export profitability, due to confidentiality.	Really?		
B-4	Don't ask if PMI deal is profitable. We will just renew it next year.	Shareholders need to know if it's worth continuing.	✓	
Free Ginseng				
C-1	Some shareholders think we should keep KGC as 100% subsidiary.	Who are your "some" shareholders? **Let Shareholders Vote.**		
C-2	Why IPO? We don't need more cash.	It's spin-off, not IPO.	✓	
C-3	It is difficult.	There are so many successful precedents in Korea.		
C-4	Now is not the right time.	When is that "right time"? Mañana?	✓	
C-5	KGC will not be properly valued under the current mkt condition.	Freed from tobacco, KGC will actually be valued higher.	✓	
C-6	KT&G stock can implode without KGC, as it will become pure tobacco.	Is Philip Morris undervalued vs. KT&G?		
C-7	KGC already has ginseng expert as CEO. A long time ago he worked at KGC.	KGC needs consumer/mkt expert, not ginseng. Leveraging its great brand as well as talented employees. KGC needs to challenge the world stage and become a global brand.	✓	
C-8	KGC can proposer only with CEO Baek's leadership.	Excuse me?	✓	

1

- We have summarized potential responses from KT&G and uploaded on our web site.
- You can use this summary sheet to check how many of these are used by the Company.
- Please visit www.FlashlightCap.com

10 QUESTIONS FOR ASK KT&G

1. How many external candidates did BOD interview during “11 days” in 2021?
2. Does PMI contract really stop you from reporting HNB KPI to shareholders?
3. Why keep sending tobacco salesmen to KGC? Why not recruit global consumer experts?
4. Do you think keeping KGC under tobacco (vs. standalone) makes KGC a better company?
5. In the past few years almost everyone in Korea made money from RE Development. Can KT&G continue above-avg return from Real Estate?
6. Aside from dividend announcement this & last year, what is your plan on “excess cash”?
7. Do you think Philip Morris, Altria, and BAT have net debt because they are reckless?
8. What is your response on Flashlight Capital Partners’s request on Quarterly Dividend?
9. What is the rationale behind not cancelling treasury shares (at least 13% of TSO)?
10. Would you accept the invitation to open debate with Flashlight Capital? It would be very helpful to listen to both sides real-time.


New Message

Recipients ktngIR@ktng.com

Subject 10 Questions

Dear Mr. CEO,

We would like to ask you a few questions as below. Can you please respond? Thank you.

1. How many external candidates did BOD interview during “11 days” in 2021?

2. Does PMI contract really stop you from reporting HNB KPI to shareholders?

3. Why keep sending tobacco salesmen to KGC? Why not recruit global consumer experts?

4. Do you think keeping KGC under tobacco (vs. standalone) makes KGC a better company?

Send

We prepared a draft email draft (and KT&G e-mail address) for you.

Please visit www.FlashlightCap.com

NEXT STEPS

Flashlight's Messages

'Letter to BOD (Oct 26)'

(To Mr. Kim, the Chairman, and 7 members)

"we believe the most effective way is … to meet you in person … we request a meeting…"

"No Response from BOD, but.."

"we will check the proposals and consider carefully"[1]

KT&G, Statement to media (Oct 26)

"We reported to BOD today… we will listen to diverse shareholder opinion"

KT&G, during 3Q IR call (Nov 3)

"Management and BOD will faithfully consider the proposals"

Mgt's Letter to Flashlight (Nov 4)

"We will achieve 50% of revenue from HNB by 2025. Can reconsider expanding overseas directly.[2]

KT&G, at a new product launch (Nov 9)

Our view

We believe it would be prudent of BOD to hear directly from Flashlight and come to its own decision. **BOD should have an independent view** from mgt team, and should hear from Flashlight (the one who proposed the change), not the mgt team.

Who are the **"diverse shareholders"**? "Listening to diverse shareholders" should be a transparent process, not behind the curtain.

We Request

Flashlight - KT&G's BOD meeting

Open Debate between KT&G CEO and Flashlight

Note 1: https://www.hankyung.com/finance/article/202210264229i
Note 2: https://mbnmoney.mbn.co.kr/news/view?news_no=MM1004776148

THREE WAYS TO HELP KT&G

Flash light Capital

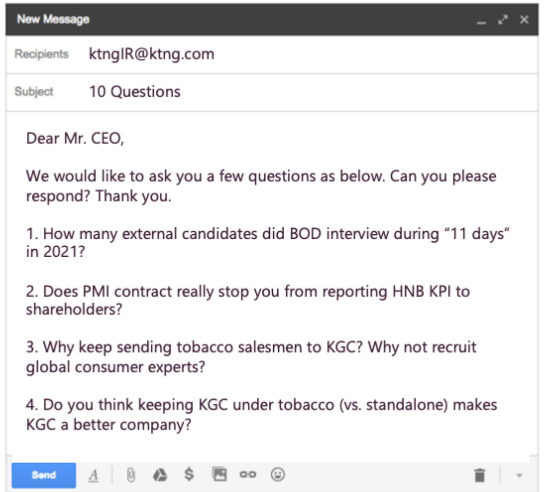
1 Meeting Flashlight

Flashlight – KT& G's BOD meeting

Open Debate between KT& G CEO and Flashlight

After this call, we will send official letters to BOD and CEO and share an update with you.

2 E-mail to CEO



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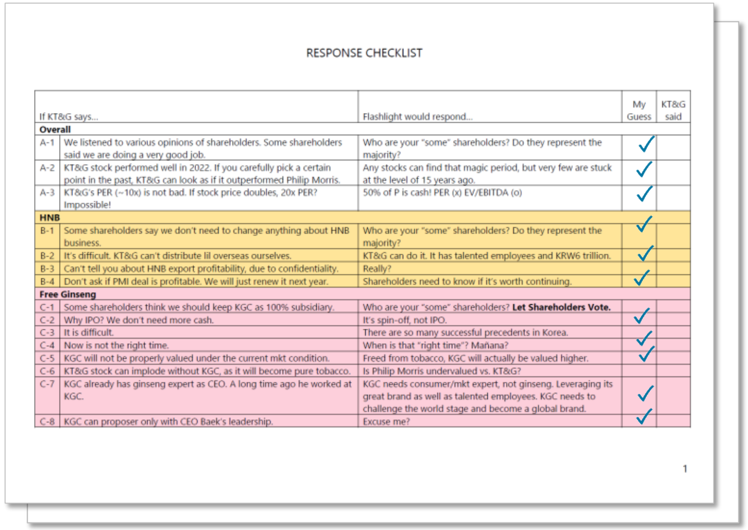
4. Do you think keeping KGC under tobacco (vs. standalone) makes KGC a better company?

Send

We encourage you to send KT&G (email draft available at our web site).

3 Response Checklist



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C-8	KGC can proposer only with CEO Baek's leadership.	Excuse me?	✓	

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You can download the summary file from our web site and monitor if any of these are used by KT&G.

You can find all these materials on www.FlashlightCap.com

Q&A

Please Submit Questions

You can click “Send Anonymously”.

Today's video and more materials at

www.FlashlightCap.com

Flash
light
Capital