



October 26, 2022

Dear Fellow Shareholders,

Flashlight Capital Partners Pte. Ltd (“Flashlight Capital” or “we”) is an Asia-based investment management firm that is focused on improving corporate governance and unlocking long-term value at its portfolio companies. I, Sanghyun Lee, am a Korean native with more than 20 years of experience investing in Korea. Today, Flashlight Capital is writing to you in its capacity as a meaningful shareholder of KT&G Corporation (KRX: 033780) (“KT&G” or the “Company”).

We have been long-term investors in KT&G because we believe in its attractive, well-established businesses that operate in growing, high-potential markets. While we think the Company possesses extremely valuable assets and impressive market share, we believe embracing meaningful environmental, social and governance (“ESG”) improvements and adding fresh perspectives to the Board of Directors (the “Board”) can help KT&G close its significant 50% trading discount and deliver enhanced value to all stakeholders.

In an effort to help catalyze a new, high-growth era for KT&G, over the past six months we have had private discussions with leadership to share our recommendations – including a corporate spin-off of the ginseng business (“KGC”) – that we believe can unlock 100% share price upside over the next 12 months and 5x over the next five years. Today, we want to share with you our analyses and the five-pronged approach that we believe can make KT&G a truly global player.

KT&G’S UNTAPPED POTENTIAL AND POOR GOVERNANCE TRADING DISCOUNT

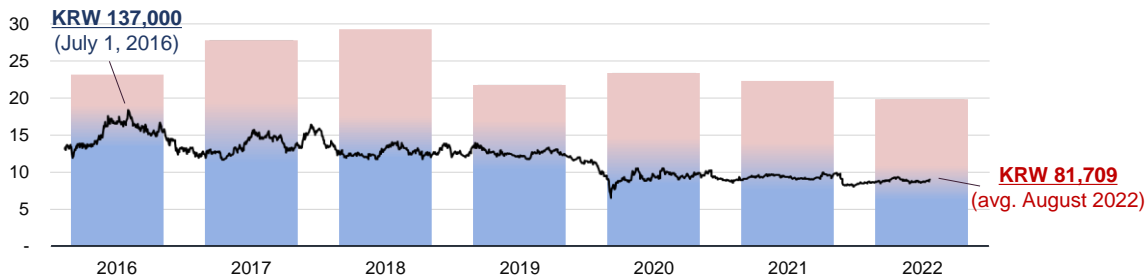
KT&G is a 140-year-old Korean conglomerate with tobacco, ginseng, and miscellaneous business segments which all operate under the same corporate umbrella. It started as a government agency and unlike many chaebols in Korea, has no family owners who control the business. KT&G enjoys unrivaled brand loyalty accumulated over a long period, as well as a strong market share in the tobacco and ginseng industries. Given its exceptional brand power, market position, and track record, we expect KT&G to trade at a premium to its global peers.

However, despite recent share price appreciation and significant cash accumulation, the Company is trading at the same price it was 15 years ago at a steep discount to its peers and the KOSPI index. **Our sum of the parts (“SOTP”) valuation analysis reveals KT&G currently trades at a 50% discount to the intrinsic value of its assets, which we believe is largely attributable to the Company’s poor governance.**¹ Simply put, KT&G is trading at a negative enterprise value (“EV”), which is alarming given KT&G’s position as KOSPI’s 33rd largest company by market capitalization.²

KT&G SOTP Valuation (KRW Trillion)		KT&G EV (KRW Trillion)	
Tobacco Business	11.5	(a) KT&G’s Mkt Cap	9.8
Ginseng Business (KGC)	3.7		
Net Cash	3.8	(b) Net Cash	3.8
Real Estate	2.2	(c) Real Estate	2.2
Non-Core Subsidiaries	0.3	(d) Non-Core Subsidiaries	0.3
<u>Total Value of KT&G</u>	<u>21.6</u>	(e) Ginseng	<u>3.7</u>
KT&G’s Mkt Cap	9.8		
Mkt Cap vs. SOTP	45%	EV (=a-b-c-d-e)	(0.3)

¹ Source: Company filings, Bloomberg. Consolidated net cash of KT&G does not include net cash of KGC, to reflect the plan of KGC spin-off. Company’s own appraisal value used for the value of Real Estate. Non-Core subsidiaries include market value of only Yungjin Pharmaceuticals; assumed zero value for all other non-core subsidiaries. KT&G’s Mkt Cap is based on average August 2022 price, excluding treasury shares. Tobacco Business in SOTP is valued at the average of KT&G’s peers, and KGC is valued at 20x EBITDA, 30% discount to comparable premium brand food transaction precedent.

² As of August 31, 2022.

KT&G Market Capitalization vs. SOTP (KRW Trillion)

We believe that the Company's share price underperformance and widening SOTP gap stems from a deterioration of corporate governance in KT&G's boardroom – namely the Board's lack of alignment with its shareholders – over the past six years. KT&G appears to be run as if it is still a government-owned company with no profit motive, instead of a publicly traded company owned by its shareholders.

Fortunately, KT&G has very bright business prospects. The Company's market share is exceptionally strong in the tobacco and ginseng industries, both of which are growing in dollar terms, with the former going through an exciting technology transformation. In order to overcome KT&G's deep, persistent valuation gap and maximize KT&G's potential, we believe the Company needs a multi-pronged approach to unlock value across its high-quality business segments.

FLASHLIGHT CAPITAL HAS A FIVE-PRONGED APPROACH TO UNLOCK VALUE AT KT&G

Based on our exhaustive due diligence on the Company and its peers, we have developed five core suggestions for KT&G. **We believe taking these steps can unlock 100% share price appreciation over the next 12 months, and 5x over the next five years.**

1. **Expand HNB's Global Reach:** We are calling upon the Company to establish a roadmap that would lead to its Heat-not-Burn ("HNB") products accounting for at least 50% of its total tobacco revenue by 2027. We believe focusing on innovative HNB products such as KT&G's "lil" is key to addressing public health and becoming a leader in reduced-risk-products. The tobacco industry has already seen enormous growth stemming from the rise in alternative tobacco products. Therefore, KT&G must seize this opportunity and focus on globalizing its lil products, which are currently outselling Philip Morris' IQOS in Korea. By doing so, we believe KT&G can triple its tobacco business' EBITDA over the next five years.
2. **Spin-off Ginseng Business:** We believe that separating KGC, the world's number one ginseng brand, from the Company's tobacco business can unlock significant value and business potential for KT&G shareholders. From our perspective, it defies logic that a ginseng business is owned by a tobacco company. While Korean ginseng is very popular throughout Asia, KT&G's KGC business is relatively unknown outside Korea, leaving a huge export opportunity untapped. We believe that there is a large potential for growth in the global ginseng market, given the global ageing population as well as the surge in popularity for healthy foods amongst consumers. By separating the ginseng business from the tobacco business, it is our view that KGC will get its fair valuation from the market and can more than quadruple its EBITDA over the next five years.
3. **Divest Non-Core Assets:** With huge opportunities ahead, we suggest that KT&G's management team focus on the Company's two core businesses: HNB and ginseng. Therefore, we urge the Company to sell its nine non-synergistic and unprofitable businesses, including real estate development, which has no synergies with the core



consumer businesses. We believe that the sale of these non-core businesses could unlock more than KRW2 trillion and allow management to focus its undivided attention on value generating businesses.

4. **Triple Share Buyback Program:** Among the global top five, KT&G is the only tobacco company that holds net cash. With over KRW6 trillion of excess cash (including the proceeds from non-core divestitures), KT&G can triple its share repurchase program, while still holding net cash and aggressively investing for future business growth.
5. **Commit to ESG Improvements Through Actionable Plans:** A tobacco business seeking to survive and thrive in the 21st century needs to be a leader – not a laggard – in ESG matters. On Governance, we believe that installing shareholder-nominated directors on the Board and adopting a stock-based management incentive plan will realign the Company's interests with those of shareholders. On Environment, KT&G can become the world's first tobacco company to achieve 50% of its total sales from HNB products. On Society, the Company can provide tremendous support to over 4,000 ginseng farmers in Korea by building a global ginseng brand.

Based on the discussions we have had with other shareholders, it is clear that investor-driven change is desired by many. We firmly believe that KT&G can produce superior value for all stakeholders, which is why we want to collaborate with leadership on steps that can be taken in the near term to help produce enduring, long-term value for shareholders.

Please visit www.FlashlightCap.com to view our investor presentation, videos detailing our plan to unlock value at KT&G, as well as other important investor materials.

We look forward to working together to help KT&G become a truly global player.

Sincerely,

Sanghyun Lee
Managing Partner
Flashlight Capital Partners

