

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

1. General Information

General information of Lotte Confectionery Co.,Ltd. (the "Parent Company") and its subsidiaries (collectively referred to as the "Company") is as follows:

1.1 Description of the Parent Company

Lotte Confectionery Co., Ltd. (the "Parent Company") was established on March 24, 1967, in the Republic of Korea to manufacture and sell confectionery goods and ice cream. The Parent Company listed its common stock on the Korea Exchange on February 16, 1974, and the capital stock as of December 31, 2012, amounts to ₩ 7,107 million.

The shareholders of the Parent Company and their ownership as of December 31, 2012, are as follows:

Shareholder	Number of shares	Ownership
Lotte Aluminum Co., Ltd.	217,268	15.29%
Shin Kyuk Ho	97,057	6.83%
The Lotte Foundation	123,576	8.69%
Others	969,499	68.21%
	1,407,400	99.02%
Treasury stock	14,000	0.98%
	1,421,400	100.00%

1.2 Consolidated subsidiaries

The Company's consolidated subsidiaries as of December 31, 2012, are as follows:

Subsidiaries	Location	Fiscal Year-end	Percentage of ownership
Lotte India Co., Ltd.	India	Dec. 31	98.37%
Lotte Qingdao Foods Co., Ltd.	China	Dec. 31	100.00%
Lotte Confectionery Holdings B.V.	Netherlands	Dec. 31	51.00%
Chocolaterie Guylian N.V. ¹	Belgium	Dec. 31	99.97%
Chocolaterie Guylian Deutschland ²	Deutschland	Dec. 31	100.00%
Aimee BVBA ²	Belgium	Dec. 31	100.00%
Guylian Asia ²	Hong Kong	Dec. 31	100.00%
Guylian Iberia, LDA ²	Portugal	Dec. 31	100.00%
Guylian UK ²	England	Dec. 31	100.00%
Guylian USA ²	USA	Dec. 31	100.00%
SAS Chocolaterie Guylian France ²	France	Dec. 31	100.00%
Lotte Food Holding Co., Ltd.	Hong Kong	Dec. 31	100.00%
Lotte (China) Investment Co., Ltd. ³	China	Dec. 31	54.80%
Lotte Ice (Shandong) Co., Ltd.	China	Dec. 31	71.38%
Kirin Foods Co., Ltd.	Korea	Dec. 31	100.00%
K.S. SULEMANJI ESMAILJI & SONS(Private) Limited	Pakistan	Dec. 31	69.45%
Kolson Industries(Private) Limited ⁴	Pakistan	Dec. 31	85.00%
Lotte Confectionery (S.E.A) Pte., Ltd.	Singapore	Dec. 31	100.00%
Lotte China Foods Co., Ltd.	China	Dec. 31	53.64%

¹ The shares of Chocolaterie Guylian NV are held by Lotte Confectionery Holdings B.V. and Lotte

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Europe Holdings B.V.

² The shares of Chocolaterie Guylian Deutschland and Aimee BVBA and Guylian Asia and Guylian Iberia, LDA and Guylian UK and Guylian USA and SAS Chocolaterie Guylian France are owned by Chocolaterie Guylian NV.

³ The shares of Lotte (China) Investment Co., Ltd. are held by Lotte Food Holding Co., Ltd.

⁴ The shares of Kolson Industries(Private) Limited are held by K.S. SULEMANJI ESMAILJI & SONS(Private) Limited.

1.3 Summary of the relevant financial information of subsidiaries

The significant financial data of the subsidiaries as of and for the years ended December 31, 2012 and 2011 included in the accompanying consolidated financial statements are summarized as follows:

(in millions of Korean won)

	2012			
Subsidiaries	Asset	Liabilities	Sales	Net Income(loss)
Lotte India Co., Ltd.	100,179	14,291	63,804	491
Lotte Qingdao Foods Co., Ltd.	31,166	3,737	16,824	107
Lotte Confectionery Holdings B.V.	196,224	53,634	127,550	8,458
Lotte Food Holding Co., Ltd.	42,906	30	-	(22,573)
Lotte (China) Investment Co., Ltd.	49,863	88,364	60,936	(34,006)
Lotte Ice (Shandong) Co., Ltd.	11,147	4,480	3,963	(2,708)
Kirin Foods Co., Ltd.	108,027	17,344	81,541	(13,954)
K.S. SULEMANJI ESMAILJI & SONS (Private) Limited	37,274	17,887	63,692	614
Lotte Confectionery (S.E.A) Pte., Ltd.	6,650	866	4,267	(900)
Lotte China Foods Co., Ltd.	100,904	23,391	50,276	(275)

(in millions of Korean won)

	2011			
Subsidiaries	Asset	Liabilities	Sales	Net Income(loss)
Lotte India Co., Ltd.	108,390	13,152	65,560	1,083
Lotte Qingdao Foods Co., Ltd.	32,279	3,263	15,360	(742)
Lotte Confectionery Holdings B.V.	193,525	51,859	119,686	8,137
Lotte Food Holding Co., Ltd.	48,840	33	-	(10,096)
Lotte Ice (Shandong) Co., Ltd.	13,362	3,515	3,765	(1,799)
Kirin Foods Co., Ltd.	126,051	21,294	88,661	(2,720)
K.S. SULEMANJI ESMAILJI & SONS (Private) Limited	45,042	22,947	53,729	(1,886)
Lotte Confectionery (S.E.A) Pte., Ltd.	6,948	154	515	(109)

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

1.4 Changes in the scope of consolidation

An investee newly included and excluded in the scope of consolidation for the year ended December 31, 2012, is as follows:

The following companies are included in the scope of consolidation for the year ended December 31, 2012:

Subsidiaries	Reason
Lotte (China) Investment Co., Ltd.	The company has become a subsidiary due to the parent company's acquisition of 11.3% interest.
Lotte China Foods Co., Ltd.	The company has become a subsidiary due to the Parent Company's ownership of 6.48% interest in Lotte (China) Investment Co., Ltd. which has become a subsidiary during the year.

2. Significant Accounting Policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of Preparation

The Company maintains its accounting records in Korean won and prepares statutory financial statements in the Korean language (Hangul) in accordance with the International Financial Reporting Standards as adopted by the Republic of Korea ("Korean IFRS"). The accompanying consolidated financial statements have been condensed, restructured and translated into English from the Korean language financial statements.

Certain information attached to the Korean language financial statements, but not required for a fair presentation of the Company's financial position, financial performance or cash flows, is not presented in the accompanying consolidated financial statements.

The Company's financial statements for the annual period beginning on January 1, 2011, have been prepared in accordance with Korean IFRS. These are the standards, subsequent amendments and related interpretations issued by the International Accounting Standards Board ("IASB") that have been adopted by the Republic of Korea.

The preparation of the consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note 4.

(a) New and amended standards adopted by the Company

The Company changed its accounting policy to present the operating profit after deducting cost of sales, and selling and administrative expenses from revenue, in accordance with the amendment of Korean IFRS 1001, *Presentation of Financial Statements*.

The Company applies the accounting policy retroactively in accordance with the amended standards and the comparative consolidated statement of the comprehensive income is restated by reflecting adjustments resulting from the retrospective application. As a result of the changes in the accounting policy, other income and expenses of ₩16,370 million and ₩25,065 million,

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

respectively, for the year ended December 31, 2012 (2011: ₩19,409 million and ₩13,389 million, respectively), which include profit or loss on disposal of property, plant and equipment, foreign currency gains or losses related to non-financial assets, and others, classified as operating profit under the previous standard, were excluded from operating profit. Consequently, operating profit for the years ended December 31, 2012 and 2011, was higher by ₩8,695 million and lower by ₩6,019 million, respectively, as compared to the amounts under the previous standard. However, there is no material impact on net income and earnings per share for the years ended December 31, 2012 and 2011.

(b) New standards and interpretations not yet adopted

New standards, amendments and interpretations issued but not effective for the financial year beginning January 1, 2012, and not early adopted by the Company are as follows:

- Amendment of Korean IFRS 1001, *Presentation of Financial Statements*

Korean-IFRS 1001, *Presentation of Financial Statements*, requires other comprehensive income items to be presented into two groups on the basis of whether they are potentially reclassifiable to profit or loss subsequently. This is effective for annual periods beginning on or after July 1, 2012, with early adoption permitted. The Company expects that the application of this amendment would not have a material impact on its consolidated financial statements.

- Amendments to Korean IFRS1019, *Employee Benefits*

According to the amendments to Korean IFRS1019, Employee Benefits, use of a 'corridor' approach is no longer permitted, and therefore all actuarial gains and losses incurred are immediately recognized in other comprehensive income. All past service costs incurred from changes in pension plan are immediately recognized, and expected returns on interest costs and plan assets that used to be separately calculated are now changed to calculating net interest expense(income) by applying discount rate used in measuring defined benefit obligation in net defined benefit liabilities(assets). This amendment will be effective for the Company as of January 1, 2013, and the Company is assessing the impact of application of the amended Korean IFRS1019 on its consolidated financial statements as of the report date.

- Enactment of Korean IFRS1113, *Fair value measurement*

Korean IFRS1113, *Fair value measurement*, aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements for use across Korean IFRSs. Korean IFRS1113 does not extend the use of fair value accounting but provides guidance on how it should be applied where its use is already required or permitted by other standards within the Korean IFRSs. This amendment will be effective for the Company as of January 1, 2013, and the Company expects that it would not have a material impact on its consolidated financial statements as of the report date.

- Enactment of Korean IFRS 1110, *Consolidated Financial Statements*

Korean IFRS 1110, Consolidated Financial Statements, builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included in the consolidated financial statements of the Company. An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. This enactment will be effective for annual periods beginning on or after January 1, 2013, and the Company is assessing the impact of application of the enactment of Korean IFRS1110 on its consolidated financial statements as of the report date.

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

- Enactment of Korean IFRS 1111, *Joint Arrangements*

Korean IFRS 1111, *Joint Arrangements*, aims to reflect the substance of joint arrangements by focusing on the contractual rights and obligations that each party to the arrangement has rather than its legal form. Joint arrangements are classified as either joint operations or joint ventures. A joint operation is when joint operators have rights to the assets and obligations for the liabilities, and account for the assets, liabilities, revenues and expenses, while parties to the joint venture have rights to the net assets of the arrangement and account for their interest in the joint venture using the equity method. This enactment will be effective for annual periods beginning on or after January 1, 2013, and the Company is assessing the impact of application of the enactment of Korean IFRS1111 on its consolidated financial statements as of the report date.

- Enactment of Korean IFRS 1112, *Disclosures of Interests in Other Entities*

Korean IFRS 1112, *Disclosures of Interests in Other Entities*, provides the disclosure requirements for all forms of interests in other entities, including a subsidiary, a joint arrangement, an associate, a consolidated structured entity and an unconsolidated structured entity. This enactment will be effective for annual periods beginning on or after January 1, 2013, and the Company is assessing the impact of application of the enactment of Korean IFRS1112 on its consolidated financial statements as of the report date.

2.2 Consolidation

The Company has prepared the consolidated financial statements in accordance with Korean IFRS1027, *Consolidated and Separate Financial Statements*.

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Company has the power to govern the financial and operating policies generally accompanying a shareholding of more than one-half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Company controls another entity. The Company also assesses existence of control where it does not have more than 50% of the voting power but is able to govern the financial and operating policies by virtue of de-facto control. De-facto control may arise in circumstances where the size of the Company's voting rights relative to the size and dispersion of holdings of other shareholders give the Company the power to govern the financial and operating policies and others.

The Company applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of a subsidiary is measured as the fair values of the assets transferred, the liabilities incurred to the former owners of the acquiree and the equity interests issued by the Company. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The Company recognizes any non-controlling interest in the acquiree on an acquisition- by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognized amounts of acquiree's identifiable net assets.

Acquisition-related costs are expensed as incurred.

If the business combination is achieved in stages, the acquisition date fair value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date and the resulting gain or loss is recognized in profit or loss.

Any contingent consideration to be transferred by the Company is recognized at fair value at the acquisition date. Subsequent changes to the fair value of the contingent consideration that is

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

deemed to be an asset or liability is recognized in accordance with Korean IFRS1039, either in profit or loss or as a change to other comprehensive income. Contingent consideration that is classified as equity is not remeasured, and its subsequent settlement is accounted for within equity.

Goodwill is initially measured as the excess of the aggregate of the consideration transferred and the fair value of non-controlling interest over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss.

Intercompany transactions, balances, income and expenses on transactions between consolidated companies are eliminated. Unrealized losses are also eliminated after recognizing impairment of transferred assets. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Company.

(b) Changes in ownership interests in subsidiaries without change of control

Transactions with non-controlling interests that do not result in loss of control are accounted for as equity transactions; that is, as transactions with the owners in their capacity as owners. The difference between fair value of any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary is recorded in equity. Gains or losses on disposals to non-controlling interests are also recorded in equity.

(c) Disposal of subsidiaries

When the Company ceases to have control any retained interest in the entity is re-measured to its fair value at the date when control is lost, with the change in carrying amount recognized in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognized in other comprehensive income in respect of that entity are accounted for as if the Company had directly disposed of the related assets or liabilities. This may mean that amounts previously recognized in other comprehensive income (except for revaluation surplus) are reclassified to profit or loss (revaluation surplus is reclassified to retained earnings).

(d) Associates

Associates are all entities over which the Parent Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting. Under the equity method, the investment is initially recognized at cost, and the carrying amount is increased or decreased to recognize the investor's share of the profit or loss of the investee after the date of acquisition. The Parent Company's investment in associates includes goodwill identified on acquisition, net of any accumulated impairment loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognized in other comprehensive income is reclassified to profit or loss where appropriate.

The Parent Company's share of post-acquisition profit or loss is recognized in the income statement, and its share of post-acquisition movements in other comprehensive income is recognized in other comprehensive income with a corresponding adjustment to the carrying amount of the investment. When the Parent Company's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Parent Company does not recognize further losses, unless it has incurred legal or constructive obligations or made payments on behalf of the associate.

The Company determines at each reporting date whether there is any objective evidence that the investment in the associate is impaired. If this is the case, the Company calculates the amount of impairment as the difference between the recoverable amount of the associate and its carrying

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

value and recognizes the amount as 'impairment loss on investment in an associate' in the income statement.

Unrealized gains on transactions between the Company and its associates are eliminated to the extent of the Parent Company's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Company. Dilution gains and losses arising in investments in associates are recognized in the income statement.

(e) Joint ventures

A joint venture is a contractual arrangement whereby two or more parties (co-venturers) exercise joint control. Investments in jointly controlled entities, as associates, are accounted for using the equity method of accounting and are initially recognized at cost. The Company's investment in jointly controlled entities, as associates, includes goodwill identified on acquisition, net of accumulated impairment loss. The Company does not recognize its share of profits or losses from the joint venture that result from the Company's purchase of assets from the joint venture until it re-sells the assets to an independent party. However, a loss on the transaction is recognized immediately if the loss provides evidence of a reduction in the net realizable value of current assets, or an impairment loss.

2.3 Segment Reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the steering committee that makes strategic decisions.

2.4 Foreign Currency Translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Korean won, which is the parent company functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement, except when deferred in other comprehensive income as qualifying cash flow hedges and qualifying net investment hedges.

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the statement of comprehensive income within 'financial income or expenses'. All other foreign exchange gains and losses are presented in the statement of comprehensive income within 'other gains and losses, net'.

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analyzed between translation differences resulting from changes in the amortized cost of the security and other changes in the carrying amount of the security. Translation differences related to changes in amortized cost are recognized in profit or loss, and other changes in carrying amount are recognized in other comprehensive income.

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognized in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets, such as equities classified as available-for-sale, are included in other comprehensive income.

(c) Translation to presentation currency

The results and financial position of all Company entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing rate at the end of the reporting period;
- income and expenses for each income statement are translated at average exchange rates; and
- all resulting exchange differences are recognized in other comprehensive income.

Exchange differences arising from the translation of borrowings designated for hedging the investment and other currency instruments are recognized in other comprehensive income. When foreign operations are wholly or partially sold, exchange differences recognized in equity are transferred to profit or loss in the income statement. When the Company ceases to control the subsidiary, exchange differences that were recorded in equity are recognized in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

2.5 Cash and Cash Equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less.

2.6 Financial Assets

2.6.1 Classification

The Company classifies its financial assets in the following categories: at fair value through profit or loss, loans and receivables, available-for-sale, and held-to-maturity. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition.

(a) Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives or embedded derivatives are also categorized as held for trading unless they are designated as hedges. Assets in this category are classified as current assets.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the end of the reporting period. These are classified as non-current assets. The Company's loans and receivables comprise 'cash and cash equivalents', 'trade and other receivables', and 'other financial assets' in the statement of financial position.

(c) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

not classified in any of the other categories. They are included in non-current assets unless the investment matures or management intends to dispose of it within 12 months after the end of the reporting period.

(d) Financial liabilities carried at amortized cost

The Company classifies non-derivative financial liabilities, except for financial liabilities at fair value through profit or loss and financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition. Financial liabilities carried at amortized cost are included in non-current liabilities, except for liabilities with maturities less than 12 months after the end of the reporting period, which are classified as current liabilities.

2.6.2 Recognition and Measurement

Regular purchases and sales of financial assets are recognized on the trade date. Investments are initially recognized at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognized at fair value, and transaction costs are expensed in the income statement. Financial assets are derecognized when the rights to receive cash flows from the investments have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables are subsequently carried at amortized cost using the effective interest rate method.

Gains or losses arising from changes in the fair value of the financial assets carried at fair value through profit or loss are presented in the statement of comprehensive income within 'finance income(costs)' in the period in which they arise. Dividend income from financial assets at fair value through profit or loss is recognized in the income statement as part of 'finance income' when the Company's right to receive dividend payments is established.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the statement of comprehensive income as 'finance income(costs)'.

Interest on available-for-sale and held-to-maturity securities calculated using the effective interest method is recognized in the statement of comprehensive income as part of 'finance income'. Dividends on available-for-sale equity instruments are recognized in the statement of comprehensive income as part of 'finance income' when the Company's right to receive dividend payments is established.

2.6.3 Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously.

2.6.4 Derecognition

Financial assets are derecognized when the contractual rights to receive cash flows from the investments have expired or have been transferred and the Company has substantially transferred all risks and rewards of ownership. If the risk and rewards of ownership of transferred assets have not been substantially transferred, the Company reviews the level of control retained over that asset and the extent of its continuing involvement to determine if transfers do not qualify for derecognition.

Collaterals (trade receivables and other) provided in transactions of discount and factoring of trade receivables do not meet the requirements for asset derecognition if risks and rewards do not substantially transfer in the event the debtor defaults. Financial liabilities recognized in relation to

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

these transactions are included as borrowings in the Company's statement of financial position.

2.6.5 Impairment of Financial Assets

(a) Assets carried at amortized cost

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or a group of financial assets that can be reliably estimated.

The criteria that the Company uses to determine that there is objective evidence of an impairment loss include:

- Significant financial difficulty of the issuer or obligor;
- Delinquency in interest or principal payments.
- For economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- It becomes probable that the borrower will enter bankruptcy or other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties;
- or
- Observable data suggesting that there is a measurable decrease in the estimated future cash flows from a portfolio of financial assets since the initial recognition of those assets, even though the decrease cannot be identified with respect to individual financial assets in the portfolio, such as:
 - (i) adverse changes in the payment status of borrowers in the portfolio;
 - (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

Impairment loss is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted using the initial effective interest rate. The carrying amount of the asset is reduced by the impairment loss amount and the amount of the loss is recognized in the income statement. In practice, the Company may measure impairment loss based on the fair value of financial asset using an observable market price.

If, in a subsequent period, the amount of impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (for example, an improvement in debtor's credit rating), the reversal of the previously recognized impairment loss is recognized in the income statement.

(b) Assets classified as available-for-sale

The Company assesses at the end of each reporting period whether there is objective evidence that a financial asset or a group of financial assets is impaired. For debt securities, the Company uses the criteria refer to in (a) above. In the case of equity investments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost, for example decrease in fair value of the investments significantly or consistently, is also evidence that the asset is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in profit or loss – is removed from equity and recognized in the income statement. Impairment losses recognized in the Company income statement on equity instruments are not reversed through the income statement. If, in a subsequent period, the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in profit or loss, the impairment loss is reversed through the income statement.

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

2.7 Derivative Financial Instruments and Hedging Activities

Derivatives are initially recognized at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The resulting gain or loss is recognized in 'financial income (costs)' according to the nature of transactions.

The effective portion of changes in the fair value of derivatives that are designated and qualified as cash flow hedges is recognized in other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately in the income statement within 'other gains(losses), or 'finance income (costs)'

Any cumulative gain or loss existing in equity at that time remains in equity and is recognized when the forecast transaction is ultimately recognized in the income statement. 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 income statement within 'other gains(losses), or 'finance income (costs)'

2.8 Trade Receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less, they are classified as current assets. If not, they are presented as non-current assets. Trade receivables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less allowance for doubtful accounts.

2.9 Inventories

Inventories are stated at the lower of cost and net realizable value. Cost is determined using the weighted average method, except for the cost of inventories in-transit that is determined using the specific identification method. The cost of finished goods and work in progress consists of the design costs, raw materials, direct labor, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realizable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

2.10 Property, Plant and Equipment

All property, plant and equipment are stated at historical cost less depreciation and accumulated impairment loss. Historical cost includes expenditures directly attribute to the acquisition of the items. In case that revaluation occurred on past financial policy, it was noted as deemed cost at the time of that revaluation.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate the difference between their cost and their residual values over their estimated useful lives, as follows:

Buildings	5 ~ 50 years
Structures	7 ~ 40 years
Machinery	5 ~ 20 years

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Tools, equipment	4 ~ 10 years
Vehicles	4 ~ 10 years
Other	3 ~ 10 years

The assets residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within 'other income(losses), net' in the comprehensive income statement.

2.11 Borrowing Costs

General and specific borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization. All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

2.12 Intangible Assets

(a) Goodwill

Goodwill is measured as explained in Note 2.2(1) and goodwill arises on the acquisition of subsidiaries, associates and business are included in intangible assets. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill impairment reviews are undertaken annually or more frequently if events or changes in circumstances indicate a potential impairment. The carrying value of goodwill is compared to the recoverable amount, which is the higher of value in use and the fair value less costs to sell. Any impairment is recognized immediately as an expense and is not subsequently reversed.

(b) Industrial property rights

Industrial property rights are shown at historical cost. Industrial property rights have a finite useful life and are carried at cost less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of industrial property rights over their estimated useful lives of five to ten years.

(c) Other intangible assets

Other intangible assets such as software that meet the definition of an intangible asset are amortized using the straight-line method over their estimated useful lives of four to ten years when the asset is available for use. Membership rights are regarded as intangible assets with indefinite useful life and not amortized because there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity. All membership rights are tested annually for impairment and stated at cost less accumulated impairment. Impairment losses are not reversed.

2.13 Investment Property

Investment property is held to earn rentals or for capital appreciation or both. Investment property also includes property that is being constructed or developed for future use as investment property. Investment property is measured initially at its cost including transaction costs incurred in acquiring

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

the asset. After recognition as an asset, investment property is carried at cost less accumulated depreciation and impairment losses.

Subsequent costs are include in the asset's carrying amount or recognized as a separate asset, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognized. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred.

Land held for investment is not depreciated. Investment property, except for land, is depreciated using straight-line method over their useful lives from five to 40 years.

The depreciation method, the residual value and the useful life of an asset are reviewed at the end of each financial year and, if management judges that previous estimates should be adjusted, the change is accounted for as a change in an accounting estimate.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized within 'other gains and losses, net' in the income statements.

2.14 Impairment of Non-financial Assets

Goodwill or intangible assets with indefinite useful lives are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets, other than goodwill, that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

2.15 Trade Payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Trade payables are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities. Trade payables are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method.

2.16 Financial Guarantee Contract

Financial guarantee contracts are contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payments when due, in accordance with the terms of a debt instrument.

Financial guarantees are initially recognized in the financial statements at fair value on the date the guarantee was given. Subsequent to initial recognition, the Company's liabilities under such guarantees are measured at the higher of the amounts below. Any increase in the liability relating to guarantees is reported as other financial liabilities.

- Amount calculated in accordance with Korean IFRS 1037, *Provisions, Contingent Liabilities and Contingent Assets*; or
- The initial amount, less accumulated amortization recognized in accordance with Korean IFRS1018, *Revenue*.

2.17 Borrowings

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the income statement over the period of the borrowings using the effective interest method. The Company recognizes borrowings as current assets unless it has an unconditional right to delay the settlement of the borrowing. Terms on liabilities that can be settled by issuance of equity instruments according to the option of contract counterpart do not affect liquidity classification.

2.18 Provisions

Provisions are recognized when: the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognized for future operating losses.

Provisions are measured at the present value of the expenditures that is expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognized as interest expense.

2.19 Current and Deferred Income Tax

The tax expense for the period comprises current and deferred tax. Tax is recognized in the income statement, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity.

The current income tax charge is calculated based on the tax laws enacted or substantively enacted at the statement of financial position date in the countries where the Company operates and generates taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions, where appropriate, based on amounts expected to be paid to the tax authorities.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax assets and liabilities are not recognized if they arise from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit(loss). Deferred income tax is determined using tax rates and laws that have been enacted or substantially enacted by the statement of financial position date and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

Deferred income tax assets are recognized only to the extent that it is probable that the future taxable profit against which the temporary differences can be utilized will be available.

Deferred income tax liabilities are recognized on addible temporary differences arising on investments in subsidiaries and associates, except for the cases where the timing of the reversal of the temporary differences are controlled by the Company and it is probable that the temporary differences will not be reversed in the foreseeable future.

Deferred income tax assets and liabilities are offset, when there is a legally enforceable right to offset current tax assets against current tax liabilities, and when the deferred income tax assets and liabilities relate to income taxes levied by the same taxation authority for the same taxable entity or when there is an intention to settle the balances on a net basis for the different taxable entities.

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

2.20 Employee Benefits

(a) Retirement benefit obligations

A defined benefit plan is a pension plan that is not a defined contribution plan. Typically defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. The liability recognized in the statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets, together with adjustments for unrecognized past-service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension obligation.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to equity in other comprehensive income in the period in which they arise. Past-service costs are recognized immediately in income, while costs are amortized over the vesting period.

(b) Internal labor welfare fund

A few companies in the Company operate internal labor welfare fund. The Company estimates asset amounts to the level that the net asset of internal labor welfare fund is able to decrease future related work force salary.

(c) Other long-term employee benefits

The Company provides other long-term employee benefits to their employees. The entitlement to these benefits is usually conditional on the employee working for more than ten years. The expected costs of these benefits are accrued over the period of employment using the same accounting methodology as used for defined benefit pension plans. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are recognized in the income statement as they occur. These benefits are calculated annually by independent actuaries.

2.21 Share Capital

Ordinary shares that are not mandatorily redeemable are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Where the Company purchases its own equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs is deducted from equity attributable to the Company's equity holders until the shares are cancelled or reissued. Where such ordinary shares are subsequently reissued, any consideration received is included in equity attributable to the Company's equity holders.

2.22 Revenue Recognition

Revenue is measured at the fair value of the consideration received or receivable, and represents amounts receivable for goods and services supplied, stated net of discounts, returns and value added taxes, after elimination of intra-company transactions.

The Company recognizes revenue when the amount of revenue can be reliably measured; when it is probable that future economic benefits will flow to the entity; and when specific criteria have been met for each of the Company's activities, as described below. The Company bases its estimate on historical results, taking into consideration the type of customer, the type of transaction and the specifics of each arrangement.

Lotte Confectionery Co., Ltd. and Subsidiaries

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(a) Sales of goods

Sales of goods are recognized when products are delivered to the purchaser. Delivery does not occur until the products have been shipped to the specified location, the risks of obsolescence and loss have been transferred to the wholesaler, and either the purchaser has accepted the products in accordance with the sales contract or the acceptance provisions have lapsed or the Company has objective evidence that all criteria for acceptance have been satisfied.

(b) Interest income

Interest income is recognized using the effective interest method according to the time passed. When a loan and receivable is impaired, the Company reduces the carrying amount to its recoverable amount and continues unwinding the discount as interest income. Interest income on impaired loan and receivables is recognized using the original effective interest rate.

(c) Dividend income

Dividend income is recognized when the right to receive payment is established.

2.23 Lease

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

The Company leases specific property, plant and equipment agreement. Leases of property, plant and equipment where the Company has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the lease's commencement at the lower of the fair value of the leased property and the present value of the minimum lease payments.

Each lease payment is allocated between the liability and finance charges. The corresponding rental obligations, net of finance charges, are included in 'borrowings'. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset and the lease term.

2.24 Dividend Distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the financial statements in the period in which the dividends are approved by the Company's shareholders.

2.25 Approval of Issuance of the Financial Statements

The consolidated financial statements as of December 31, 2012 of the Company were approved by the Board of Directors on February 1, 2013.

3. Financial Risk Management

3.1 Financial Risk Factors

The Company's activities expose it to a variety of financial risks: market risk, credit risk and liquidity risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. The Company uses derivative financial instruments to hedge certain risk exposures.

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Risk management is carried out by a central treasury department. The Company treasury identifies, evaluates and hedges financial risks in close co-operation with the Company's operating units. The board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity.

(a) Market risk

i) Foreign exchange risk

The Company operates internationally and issue foreign exchange debentures exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar and the Japanese yen. Foreign exchange risk arises from future commercial transactions, recognized assets and liabilities.

Management has set up a policy manage their foreign exchange risk against their functional currency. The Company companies manage their foreign exchange risk arising from future commercial transactions and recognized assets and liabilities cooperate with Company treasury. Foreign exchange risk arises when future commercial transactions or recognized assets or liabilities are denominated in a currency that is not the entity's functional currency.

The Company entity adopted management model for foreign exchange risk to make a boundary of foreign exchange loss.

The Company's financial instruments denominated in major currencies as of December 31, 2012 and 2011, are :

	2012		2011	
	Asset	Liabilities	Assets	Liabilities
<i>(in millions of Korean won)</i>				
USD	12,795	3,718	13,313	14,142
JPY	1,317	309	777	299,419
EUR	-	3,226	-	3,863
CHF	-	2	-	39
GBP	4,086	(1,469)	3,589	1,275
AUD	878	(539)	748	182
CAD	412	(37)	359	9
NZD	229	(58)	313	30
AED	-	-	-	1,155
DKK	-	-	-	105
HKD	-	(18)	-	8
SEK	-	(7)	-	-

As of December 31, 2012 and 2011, if the foreign exchange rate of the Korean won fluctuated by 10% while other variables were fixed, the effects on income before tax would be as follows:

	2012		2011	
	10% increase	10% decrease	10% increase	10% decrease
<i>(in millions of Korean won)</i>				
USD	908	(908)	(83)	83
JPY	101	(101)	(29,864)	29,864

The above sensitivity analysis is done with foreign currency denominated assets and liabilities that are not each entity's functional currency. The changes in exchange rate can have an effect on the sales prices and gross margin ratio of the Company in the future.

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

ii) Cash flow interest rate risk

The Company's cash flow interest rate risk arises from debentures and etc. Short-term borrowings and others that are issued at variable rates expose the Company to the cash flow interest rate.

The Company analyses its interest rate exposure on a dynamic basis. Various scenarios are simulated taking into consideration refinancing, renewal of existing positions, alternative financing and hedging. Based on these scenarios, the Company calculates the impact on profit and loss of a defined interest rate shift. For each simulation, the same interest rate shift is used for all currencies. The scenarios are run only for liabilities that represent the major interest-bearing positions. Based on the simulations performed, the impact on the profit of a 1% shift would be a maximum increase of ₩ 208 million (2011: ₩ 3,069 million) or decrease of ₩ 208 million (2011: ₩ 3,069 million), respectively. The simulation is done on a quarterly basis to verify that the maximum loss potential is within the limit given by the management.

Based on the various scenarios, the Company manages its cash flow interest rate risk by using floating-to-fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates.

(b) Price Risk

The Company's exposed to the price risk of equity securities that are categorized as available-for-sale financial assets. Stocks owned by the Company are trading in the Korea Stock Exchange. The effect on the shareholders' equity from price fluctuations of equity securities as of December 31, 2012, is as follows:

	<u>2012</u>	<u>2011</u>
<i>(in millions of Korean won)</i>		
10% increase	133,238	118,770
10% decrease	(133,238)	(118,770)

(c) Credit Risk

Credit risk is managed on the group basis. Credit risk arises from cash and cash equivalents and deposits with banks and financial institutions, as well as credit exposures to retail customers, including outstanding receivables and committed transactions. The Company trades with business parties whose credit is upper standard to manage credit risks. The entity reviews the limitation of trade by credit and adjusts collateral levels through consistent credit checking to the business parties.

No credit limits were exceeded during the reporting period, and management does not expect any losses from nonperformance by these counterparties.

Details of maximum exposure to credit risk, as of December 31, 2012 and 2011, are as follows:

	<u>2012</u>	<u>2011</u>
<i>(in millions of Korean won)</i>	Carrying amount (maximum exposure)	Carrying amount (maximum exposure)
Cash and cash equivalents ¹	161,970	132,102
Trade and other receivables	252,991	247,449
Other current financial instrument assets	59,001	104,491
	<u>473,962</u>	<u>484,042</u>

¹ The amounts of cash and cash equivalents which exclude cash on hand are different from those in the statement of financial position

Details of financial guarantee provided by the Parent Company are included in Notes 3.1(d) and 25.

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

The Company operates following policies and procedures to take care of credit risks.

(d) Liquidity Risk

Cash flow forecasting is performed by each subsidiary within the Company and gathered by the group finance department. The group finance department monitors rolling forecasts of the Company's liquidity requirements to ensure it has sufficient cash to meet operational needs while maintaining sufficient headroom on its undrawn committed borrowing facilities at all times so that the Company does not breach borrowing limits or covenants (where applicable) on any of its borrowing facilities. Such forecasting takes into consideration the Company's debt financing plans, covenant compliance, compliance with internal statements of financial position ratio targets and, if applicable external regulatory or legal requirements.

The group finance department invests surplus cash in interest bearing current accounts, time deposits, and money market deposits, choosing instruments with appropriate maturities or sufficient liquidity to provide sufficient headroom as determined by the above-mentioned forecasts.

At the reporting date, the Company held cash and cash equivalents of ₩ 179,675 million (2011: ₩ 182,610 million) and other liquid assets of ₩ 58,159 million (2011: ₩ 68,474 million) that are expected to readily generate cash inflows for managing liquidity risk.

The table below analyzes the Company's non-derivatives financial liabilities into relevant maturity groupings based on the remaining period at the reporting date to the contractual maturity date. Cash flow in the table below represents undiscounted amounts. Borrowings include stated interest.

December 31, 2012				
<i>(in millions of Korean won)</i>	Less than 1 year	1 year between 2 years	2 years between 5 years	Over 5 years
Borrowings ¹	33,266	2,939	-	-
Debentures ¹	10,650	109,630	205,703	-
Trade and other payables	214,879	-	-	-
Other financial liabilities	50,909	-	-	-
Financial guarantee contracts	48,735	-	-	-
	358,439	112,569	205,703	-
December 31, 2011				
<i>(in millions of Korean won)</i>	Less than 1 year	1 year between 2 years	2 years between 5 years	Over 5 years
Borrowings ¹	6,838	8,119	6,954	-
Debentures ¹	297,397	4,080	103,060	-
Currency swap contract ²	(36,847)	-	-	-
Currency swap contract ²				
Trade and other payables	6,463	-	-	-
Other financial liabilities	259,904	-	-	-
Financial guarantee contracts	48,605	-	-	-
	58,860	-	-	-
	641,220	12,199	110,014	-

¹ The undiscounted nominal amounts of borrowings incurred by discounts on trade receivables which were unsatisfied to meet the derecognition requirements of financial assets, principal and interest expenses to be

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

paid until maturities.

² Bonds with floating rate in foreign currencies and future expecting cash outflow of currency swaps are estimated with foreign exchange rate and floating rate.

3.2 Capital Management

The purpose of financial management of the Company is to maximize profit of shareholders by keeping sound financial structure. The entity progresses adequate fixing methods of financial structure by monitoring financial ratio every months such as debt ratio and net borrowing ratio to achieve the best financial structure.

Consistent with others in the industry, the Company monitors capital based on of the gearing ratio. This ratio is calculated as net debt divided by total capital. Net debt is calculated as total borrowings less cash and cash equivalents. Total capital is calculated as 'equity' as shown in the consolidated statement of financial position plus net debt.

The gearing ratios and debt-to-equity ratio as of December 31, 2012 and 2011, were as follows:

<i>(in millions of Korean won)</i>	2012	2011
Total borrowings (a)	333,706	406,465
Less: cash and cash equivalents (b)	(179,675)	(182,610)
Net debt (c)=(a)-(b)	154,031	223,855
Total liabilities (d)	1,222,782	1,286,275
Total equity(e)	2,801,605	2,614,990
Total capital (f)=(d)+(e)	4,024,387	3,901,265
Gearing ratio (c/f)	3.8%	5.7%
Debt-to-equity ratio(d/e)	43.6%	49.2%

3.3 Fair Value Estimation

The Company classifies fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in measurements.

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1).
- Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (Level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (Level 3). To determine the fair value, growth rate, discount rate that reflects credit risks and capital expenses are used.

The following table presents the Company's financial assets and financial liabilities that are measured at fair value.

<i>(in millions of Korean won)</i>	December 31, 2012			
	Level 1	Level 2	Level 3	Total
Assets				
Derivative instruments used for hedging purpose	-	-	-	-
Available-for-sale financial assets				
Equity securities	1,332,379	-	337,854	1,670,233
Debt investments	-	-	506	506
Total	1,332,379	-	338,360	1,670,739
Liabilities				
Derivative instruments used for hedging purpose	-	1	-	1
Total	-	1	-	1

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

(in millions of Korean won)	December 31, 2011			
	Level 1	Level 2	Level 3	Total
Assets				
Derivative instruments used for hedging purpose	-	34,650	-	34,650
Available-for-sale financial assets				
Equity securities	1,187,702	-	318,214	1,505,916
Debt investments	-	-	1,912	1,912
Total	<u>1,187,702</u>	<u>34,650</u>	<u>320,126</u>	<u>1,542,478</u>
Liabilities				
Derivative instruments used for hedging purpose	-	42	-	42
Total	<u>-</u>	<u>42</u>	<u>-</u>	<u>42</u>

The fair value of financial instruments traded in active markets is based on quoted market prices at the statement of financial position date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, an entity within the same industry, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Company is the current bid price. These instruments are included in Level 1. Instruments included in Level 1 consist primarily of KOSPI and KOSDAQ equity investments classified as trading securities or available for sale.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximize the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in Level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in Level 3.

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

The following table presents the changes in Level 3 instruments.

(in millions of Korean won)	2012	2011
Beginning balance	320,126	215,852
Increase	-	27,306
Decrease	(3,336)	(5,864)
Increase due to business combination	2,221	-
Gains and losses on valuation	19,349	82,832
Ending balance	<u>338,360</u>	<u>320,126</u>

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

The following table presents available-for-sale financial assets that are valued at historical cost as of December 31, 2012 and 2011:

<i>(in millions of Korean won)</i>	2012	2011
Non-marketable securities	1,240	349
Equity investments	114	114
Total	1,354	463

The above non-marketable securities and equity investments do not have quoted price in the active market. The range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed and therefore these instruments are measured at cost.

4. Critical Accounting Estimates and Judgments

The Company makes estimates and assumptions concerning the future by definition, the resulting accounting estimates will seldom equal the related actual results. Estimations and assumptions are continuously evaluated with consideration to factors such as events reasonably predictable in the foreseeable future within the present circumstance according to historical experience. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(a) Estimated impairment of goodwill

The Company tests annually whether goodwill has suffered any impairment in accordance with the accounting policy stated in Note 2. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates.

(b) Income taxes

The Company is operating in numerous countries and the income generated from these operations is subject to income taxes based on tax laws and interpretations of tax authorities in numerous jurisdictions. There are many transactions and calculations for which the ultimate tax determination is uncertain. The Company recorded, based on its best estimate, current taxes and deferred taxes that the Company will be liable in the future for the operating results as of the financial year-end. However, the final tax outcome in the future may be different from the amounts that were initially recorded. Such differences will affect the current and deferred income tax assets and liabilities in the period in which such determination is made.

(c) Fair value of financial instruments

The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The Company uses its judgment to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period.

(d) Defined benefit liability

The present value of the defined benefit liability depends on a number of factors that are determined on an actuarial basis using a number of assumptions. The assumptions used in determining the net cost (income) for pensions include the discount rate. Any changes in these assumptions will affect the carrying amount of the defined benefit liability. The Company determines the appropriate discount rate at the end of each year. This is the interest rate that is used to determine the present value of estimated future cash outflows expected to be required to settle the defined benefit liability. In determining the appropriate discount rate, the Company

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

considers the interest rates of high-quality corporate bonds that are denominated in the currency in which the pension benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. Other key assumptions for defined benefit liability are based in part on current market conditions.

(e) Provisions

The Company recognizes provisions for warranties estimated returns as of the reporting date. The amounts are estimated based on historical data.

5. Segment Information

The Company's reportable segments and details are as follows:

Segment	Products or services	Major customers
Dried fruits	Snacks, Gums	E-mart, Lotte Mart, Home plus
Frozen confectionery	Frozen confectionery	E-mart, Lotte Mart, Home plus
Others	Health food, Leasing	Lotte Mart, Lotte logistics

(a) The segment information on revenue and operating profit as of December 31, 2012 and 2011, is as follows:

2012					
<i>(in millions of Korean won)</i>	Dried fruits	Frozen confectionery	Others	Shared	Total
Total segment revenue	1,492,878	340,456	80,875	-	1,914,209
Inter-segment revenue	(49,716)	-	-	-	(49,716)
Revenue from external customers	1,443,162	340,456	80,875	-	1,864,493
Operating profit (losses)	68,935	38,527	11,599	(3,666)	115,395
Depreciation and amortization	58,685	13,529	2,356	-	74,570

2011					
<i>(in millions of Korean won)</i>	Dried fruits	Frozen confectionery	Others	Shared	Total
Total segment revenue	1,435,424	341,258	92,562	-	1,869,244
Inter-segment revenue	(15,086)	-	-	-	(15,086)
Revenue from external customers	1,420,338	341,258	92,562	-	1,854,158
Operating profit (losses)	121,894	35,783	16,369	(807)	173,239
Depreciation and amortization	51,774	10,527	7,798	-	70,099

(b) The segment information on assets and liabilities as of December 31, 2012 and 2011, is as follows:

2012					
<i>(in millions of Korean won)</i>	Dried fruits	Frozen confectionery	Others	Shared	Total
Total assets for the segment ¹	1,595,702	485,105	116,594	1,826,986	4,024,387
Acquisition cost of non-current assets ²	1,358,811	218,153	49,648	1,671,051	3,297,663
Total liabilities for the segment ¹	325,966	99,096	23,817	773,903	1,222,782

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

	2011				
<i>(in millions of Korean won)</i>	Dried fruits	Frozen confectionery	Others	Shared	Total
Total assets for the segment ¹	1,538,218	496,480	110,400	1,756,167	3,901,265
Acquisition cost of non-current assets ²	1,337,017	236,486	61,202	1,506,859	3,141,563
Total liabilities for the segment ¹	328,948	107,393	23,244	826,691	1,286,276

¹ Assets and liabilities are measured in a manner consistent with those in the financial statements and allocated based on segment operation.

² Financial instruments and deferred tax assets are excluded in acquisition cost of non-current assets.

(c) Financial information by geographical segments as follows:

<i>(in millions of Korean won)</i>	Sales		Non-current assets¹	
	2012	2011	December 31, 2012	December 31, 2011
<i>Location</i>				
Korea	1,591,795	1,595,544	1,120,675	1,191,880
China	14,136	19,125	93,017	30,714
India	63,052	65,560	78,419	85,658
Europe	127,550	119,686	102,017	43,503
Others	67,960	54,244	24,892	33,060
Total	1,864,493	1,854,159	1,419,020	1,384,815

¹ The total amount of property, plant and equipment, intangible assets, and investment property.

6. Financial Instruments by Category

Categorizations of financial assets and liabilities are as follows:

Financial assets	December 31, 2012		
<i>(in millions of Korean won)</i>	Loans and receivables	Available-for-sale financial assets	Total
Cash and cash equivalents	179,675	-	179,675
Trade and other receivables	252,991	-	252,991
Other current financial assets	57,442	1,559	59,001
Other non-current financial assets	24,544	1,671,922	1,696,466
Total	514,652	1,673,481	2,188,133

Financial liability	December 31, 2012		
<i>(in millions of Korean won)</i>	Derivative instruments used for hedging purpose	Liabilities measured at amortized cost	Total
Trade and other payables	-	214,879	214,879
Other current financial liabilities	1	50,909	50,910
Borrowings	-	34,558	34,558
Debentures	-	299,149	299,149

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Other non-current financial liabilities	-	22,642	22,642
Total	1	622,137	622,138

Financial assets	December 31, 2011			
	Loans and receivables	Derivative instruments used for hedging purpose	Available-for-sale financial assets	Total
<i>(in millions of Korean won)</i>				
Cash and cash equivalents	182,610	-	-	182,610
Trade and other receivables	247,449	-	-	247,449
Other current financial assets	69,690	34,650	151	104,491
Other non-current financial assets	28,924	-	1,508,140	1,537,064
Total	528,673	34,650	1,508,291	2,071,614

Financial liability	December 31, 2011		
	Derivative instruments used for hedging purpose	Liabilities measured at amortized cost	Total
<i>(in millions of Korean won)</i>			
Trade and other payables	-	259,904	259,904
Other current financial liabilities	42	48,605	48,647
Borrowings	-	17,503	17,503
Debentures	-	388,963	388,963
Other non-current financial liabilities	-	22,109	22,109
Total	42	737,084	737,126

Non-current financial assets and financial liabilities, excluding available-for-sale financial assets at fair value (Note 18) and non-current borrowings recorded at fair value, use their book value as fair value. Fair values of current financial assets and financial liabilities are the same as their book values.

Income and loss of financial instruments by category for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Available-for-sale financial assets		
Gain(Loss) on valuation(other comprehensive income)	122,695	(170,769)
Gain(Loss) on disposal(profit or loss)	2,308	402
Gain(Loss) on disposal(profit and loss substitution) ¹	(823)	(254)
Dividend income	25,249	6,536
Loans and receivables		
Interest income	7,610	8,045
Foreign exchange gain	285	1,033
Foreign exchange loss	(591)	(1,029)
Gain on foreign currency transactions	2,584	1,068
Loss on foreign currency transactions	(2,516)	(905)
Bad debts allowance	(5,379)	(1,324)
Other bad debts allowance	-	(163)

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Reversal of allowance for bad debts	-	23
Liabilities at amortized cost		
Interest expense	(17,244)	(21,148)
Foreign exchange gain	61	710
Foreign exchange loss	(242)	(17,923)
Gain on foreign currency transactions	28,271	1,698
Loss on foreign currency transactions	(733)	(3,427)
Derivative instruments used for hedging purpose		
Gain on valuation of derivative	39	17,390
Gain on derivative transactions	708	1,811
Loss on derivative transactions	(28,936)	(275)
Gain(Loss) on valuation of derivative (other comprehensive income)	1,622	3,939

¹ Reclassification to profit/loss represents amounts transferred from components of other comprehensive income.

7. Cash and Cash Equivalents

Cash and cash equivalents are as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Cash	17,705	50,508
Ordinary deposits	68,500	30,538
Time deposits	93,470	101,564
Total	179,675	182,610

8. Available-for-sale Financial Assets

The changes in available-for-sale financial assets are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Beginning balance	1,508,291	1,668,196
Acquisition ¹	3,424	23,624
Disposal	(2,250)	(2,517)
Evaluation	161,493	(181,347)
Net gains/(losses) transfer from equity	(1,086)	(326)
Other increase and decrease ²	-	661
Increase due to business combination ³	2,221	-
Ending balance	1,672,093	1,508,291
Less: non-current portion	(1,671,922)	(1,508,140)
Current portion	171	151

¹ During 2012, Lotte Fresh Delica Co., Ltd., whose equity is recorded as available-for-sale financial assets, merged with Lotte Foods Co., Ltd. on October 1, 2012, as approved by the Board of Directors on July 12, 2012. On October 15, 2012, using the ratio of 0.0130929 share of Lotte Foods Co., Ltd. for one share of Lotte Fresh Delica Co., Ltd., the equivalent number of shares of

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

the former were handed over to the Company.

Therefore, available-for-sale financial assets amounting to ₩ 1,901 million were disposed of and the related gain on valuation of available-for-sale securities was classified as gain for the year.

The acquisition costs of Lotte Foods Co., Ltd.'s shares amount to ₩ 2,533 million, based on the closing price on delivery date.

² The cost is substitution from investment in associates to available-for-sale financial assets was due to the decrease in PT, Lotte Indonesia's shareholding ratio.

³ Shares of Lotte Huabang (Beijing) Beverage Co., Ltd. held by Lotte (China) Investment Co., Ltd., are included as available-for-sale financial assets due to a business combination.

Details of available-for-sale financial assets are as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Current available-for-sale financial assets		
Debt securities	171	151
Non-current available-for-sale financial assets		
Equity securities		
Marketable equity securities	1,332,379	1,187,702
Non-marketable equity securities	339,094	318,563
Equity Investments	114	114
Debt securities	335	1,761
	1,671,922	1,508,140
Total	1,672,093	1,508,291

Details of available-for-sale securities (equity securities) are as follows:

		December 31, 2012				December 31, 2011
<i>(in millions of Korean won)</i>		Number of shares	Percentage of ownership (%)	Acquisition cost	Fair value	Book value
Marketable equity securities						
Lotte Shopping Co., Ltd.		2,474,543	8.52	5,644	932,903	932,903
Lotte Chilsung Co., Ltd. (ordinary stock)		145,237	11.74	21,379	220,034	220,034
Lotte Chilsung Co., Ltd. (preferred stock)		9,660	8.05	176	3,115	3,115
BS financial Company Co. Ltd.		5,536,479	2.86	27,596	73,082	73,082
Lotte Samkang Co., Ltd.		127,677	9.79	3,521	84,011	84,011
Shinhan Financial Company Co., Ltd.		458,111	0.10	3,315	17,798	17,798
Others		-	-	205	1,436	1,436
				61,836	1,332,379	1,332,379
Non-marketable						1,187,702

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

equity securities						
Korea seven co. Ltd.	5,977,672	16.60	37,267	107,712	107,712	95,027
Lotteria Co., Ltd.	65,374	13.59	28,922	73,731	73,731	70,662
Lotte Station B/D. Co.	319,200	8.87	1,596	64,442	64,442	63,284
Lotte Data Communication Co., Ltd.	52,376	6.12	7,616	39,661	39,661	37,528
Lotte Asset Development Co. Ltd	2,177,458	7.19	11,074	10,887	10,887	10,887
Lotte Buyeo Resort Co., Ltd.	1,666,667	11.11	8,333	8,333	8,333	8,333
Lotte Logistics Co., Ltd.	66,308	4.64	4,000	8,455	8,455	7,060
Korea Fuji Film Co., Ltd.	1,250	0.89	41	6,545	6,545	6,190
Lotte.com Co., Ltd.	523,548	11.25	2,500	5,595	5,595	5,596
Lotte Jeju Resort Co., Ltd.	1,000,000	12.50	5,000	5,000	5,000	5,000
Lotte Trading Co., Ltd.	12,187	1.36	4,487	4,157	4,157	4,525
Lotte Fresh Delica Co., Ltd.	-	-	-	-	-	1,804
COSMO investment Management Co., Ltd.	4,668	0.55	1,664	1,202	1,202	1,401
PT, Lotte Indonesia	8,910	7.58	661	989	989	680
Lotte Moolsan Co., Ltd.	12,984	0.02	18	274	274	237
Lotte (China) Management Co., Ltd	-	10.00	891	891	891	-
Lotte Huabang (Beijing) Beverage Co., Ltd	-	5.99	2,221	871	871	-
Others	-	-	349	349	349	349
			<u>116,640</u>	<u>339,094</u>	<u>339,094</u>	<u>318,563</u>
Equity Investments						
Korea Analysis Research Institute and others	-	-	114	114	114	114
Total			<u>178,590</u>	<u>1,671,587</u>	<u>1,671,587</u>	<u>1,506,379</u>

The ₩ 1,086 million (2011: ₩ 326 million) profit was reclassified to income and loss from equity.

The maximum exposed price related to credit risk of debt securities among available-for-sale financial assets is limited to the book value.

There are no assets which are impaired or whose dividends are in arrears among available-for-sale financial assets.

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

9. Trade and Other Receivables

Trade and other receivables are as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Trade receivable	266,072	251,847
Allowance for doubtful accounts	(16,198)	(7,392)
	249,874	244,455
Other accounts receivable	3,117	2,933
Other receivables	-	61
Total	252,991	247,449

The Company transferred trade receivables amounting to ₩ 266 million to a bank in exchange for cash during the year ended December 31, 2012. The transaction is accounted for as a borrowing (Note 18). According to the loan commitments, the Company has the obligation to pay in case of the customers' default.

The aging analysis of these trade receivables is as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Up to 3 months	253,282	242,219
3 to 6 months	8,401	4,965
Over 6 months	4,389	4,663
Total	266,072	251,847

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Receivables not past due	190,172	176,704
Past due but not impaired ¹	67,121	70,854
Impaired ²	8,779	4,289
Total	266,072	251,847

¹Overdue receivables that are not impaired are related to a few consumers who do not have any recent history of bankruptcy.

²The amount of provisions for the receivables separately impaired is ₩ 8,779 million (2011: ₩ 4,289 million). Collection is difficult for separately impaired receivables because those are usually related to business parties suffering unexpected financial problems.

The movements in bad debt allowance for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Beginning balance	7,392	9,275
Bad debts expense	5,379	1,324
Reversed	-	(23)
Transfer out	-	(48)
Written-off	(1,806)	(3,450)
Reversed (written-off)	224	350
Business combination	5,006	-
Exchange differences	3	(36)
Ending balance	16,198	7,392

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

10. Other Financial Assets and Liabilities

Other financial assets and liabilities are as follows:

<i>(in millions of Korean won)</i>		December 31, 2012	December 31, 2011
Current	Short-term financial instruments	58,159	68,474
	Derivative instruments used for hedging purpose	-	34,650
	Available-for-sale financial assets	171	151
	Accrued income	671	1,216
		<u>59,001</u>	<u>104,491</u>
Non-current	Long-term financial instruments	10,388	14,242
	Available-for-sale financial assets	1,671,922	1,508,140
	Loan asset	-	175
	Deposits provided	14,156	14,507
		<u>1,696,466</u>	<u>1,537,064</u>
Total		<u>1,755,467</u>	<u>1,641,555</u>

<i>(in millions of Korean won)</i>		December 31, 2012	December 31, 2011
Current	Accrued expenses	50,909	48,605
	Derivative instruments used for hedging purpose	1	42
		<u>50,910</u>	<u>48,647</u>
Non-current	Non-trade payables	-	46
	Deposits received	22,642	22,063
		<u>22,642</u>	<u>22,109</u>
Total		<u>73,552</u>	<u>70,756</u>

11. Inventories

Inventories are as follows:

<i>(In millions of Korean won)</i>	December 31, 2012	December 31, 2011
Merchandise	21,502	12,887
Finished goods	70,119	72,873
Work-in-process	11,681	10,681
Raw materials	79,657	72,473
Supplies	1,165	411
Work-in-process in transit	10,342	12,196
	<u>194,466</u>	<u>181,521</u>

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Provision for valuation of Inventories	(608)	(276)
Total	193,858	181,245

The cost of inventories recognized as expense and included in 'cost of sales' amounted to ₩ 1,161,013 million (2011: ₩ 1,120,418 million).

12. Associates and Joint ventures

Associates and joint ventures are as of December 31, 2012 and 2011, are as follows:

Investee <i>(in millions of Korean won)</i>	2012		
	Acquisition cost	Net asset value	Book value
Lotte China Foods Co., Ltd.	-	-	-
Lotte Packaging (Beijing) Co., Ltd.	6,576	5,616	5,616
Lotte Europe Holdings B.V	138,250	91,143	91,143
BIBICA CORPORATION	17,610	8,162	13,282
Lotte Vietnam Co., Ltd.	5,475	3,033	4,828
PT Lotte Trade And Distribution	2,739	(1,805)	-
Lotte Taiwan Co., Ltd.	6,672	4,660	7,624
Lotte Confectionery Pilipinas Co	2,643	58	393
Lotte Malaysia Sdn. Bhd	2,837	546	743
Lotte giants	774	5,019	5,019
Lotte (China) Investment Co., Ltd.	-	-	-
LH Foods Co., Ltd.	44,591	47,591	47,591
Lotte Shanghai Foods., Ltd.	11,811	10,364	12,376
Total	239,978	174,387	188,615

Investee <i>(in millions of Korean won)</i>	2011		
	Acquisition cost	Net asset value	Book value
Lotte China Foods Co., Ltd.	40,153	41,903	45,946
Lotte Packaging (Beijing) Co., Ltd.	6,576	6,367	6,367
Lotte Europe Holdings B.V	138,250	98,388	98,388
BIBICA CORPORATION	17,610	9,210	14,331
Lotte Vietnam Co., Ltd.	5,475	3,156	4,951
PT Lotte Trade And Distribution	2,739	(906)	-
Lotte Taiwan Co., Ltd.	6,672	4,365	7,191
Lotte Confectionery Pilipinas Co	2,643	1,200	1,555
Lotte Malaysia Sdn. Bhd	2,837	1,350	1,546
Lotte giants	774	2,218	2,218
Lotte (China) Investment Co., Ltd.	21,968	(12,119)	-
LH Foods Co., Ltd.	44,591	48,660	48,660
Lotte Shanghai Foods., Ltd.	-	-	-
Total	290,288	203,792	231,153

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Changes in investments in associates and joint ventures are as follows:

<i>(in millions of Korean won)</i>	2012								
	Beginning	Acquisition (Disposal)	Valuation Gain/Loss	Capital Adjustment	Actuarial gains and losses	Dividends	Foreign currency translation	Fair value evaluation	Ending
Lotte China Foods Co., Ltd.	45,946	(37,608)	(1,130)	(1,055)	-	-	-	(6,153)	-
Lotte Packaging (Beijing) Co., Ltd.	6,367	-	(395)	(356)	-	-	-	-	5,616
Lotte Europe Holdings B.V	98,388	1,396	(6,106)	(2,535)	-	-	-	-	91,143
BIBICA CORPORATION	14,331	-	(99)	(562)	-	(388)	-	-	13,282
Lotte Vietnam Co., Ltd.	4,951	-	76	(199)	-	-	-	-	4,828
Lotte Taiwan Co., Ltd.	7,191	-	588	(155)	-	-	-	-	7,624
Lotte Confectionery Pilipinas Co.	1,555	-	(1,185)	23	-	-	-	-	393
Lotte Malaysia Sdn. Bhd	1,546	-	(787)	(16)	-	-	-	-	743
Lotte Giants Lotte (China)	2,218	-	2,853	-	(52)	-	-	-	5,019
Investment Co., Ltd.	-	(6,461)	-	-	-	-	-	6,461	-
LH Foods Co., Ltd.	48,660	-	1,834	647	-	-	(3,550)	-	47,591
Lotte Shanghai Foods., Ltd.	-	11,811	587	-	-	-	(22)	-	12,376
Total	231,153	(30,862)	(3,764)	(4,208)	(52)	(388)	(3,572)	308	188,615

<i>(in millions of Korean won)</i>	2011							
	Beginning	Acquisition (Disposal)	Valuation Gain/Loss	Capital Adjustment	Dividends	Transfer	Foreign currency translation	Ending
Lotte China Foods Co., Ltd.	16,501	23,295	200	5,950	-	-	-	45,946
Lotte Packaging (Beijing) Co., Ltd.	6,290	-	(271)	348	-	-	-	6,367
Lotte Europe Holdings B.V	117,991	-	(16,281)	(3,322)	-	-	-	98,388
BIBICA CORPORATION	17,142	-	(1,689)	(802)	(320)	-	-	14,331
Lotte Vietnam Co., Ltd.	5,206	-	(39)	(216)	-	-	-	4,951
PT Lotte Trade And Distribution	821	-	(815)	(6)	-	-	-	-
Lotte Taiwan Co., Ltd.	6,907	-	379	(95)	-	-	-	7,191
PT, Lotte Indonesia	2,732	-	89	6	-	(2,827)	-	-
Lotte Confectionery Pilipinas Co.	2,064	-	(514)	5	-	-	-	1,555
Lotte Malaysia Sdn. Bhd	2,201	-	(619)	(36)	-	-	-	1,546
Lotte Giants Lotte (China)	1,130	-	1,089	-	-	-	-	2,219
Investment Co., Ltd.	11,575	-	(11,062)	(200)	-	-	(313)	-
LH Foods Co., Ltd.	44,988	-	998	1,983	-	-	690	48,659
Total	235,548	23,295	(28,535)	3,615	(320)	(2,827)	377	231,153

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Financial information of investees as of and for the year ended December 31, 2012, is summarized as follows:

<i>(in millions of Korean won)</i>	Location	Percentage of ownership (%)	Total Assets	Total Liabilities	Revenue	Net Income (loss)
Lotte Packaging (Beijing) Co., Ltd.	China	25.00	32,286	9,823	17,866	(852)
Lotte Europe Holdings B.V.	Netherlands	30.08	753,865	450,864	154,889	(14,527)
BIBICA CORPORATION	Vietnam	38.60	31,029	9,887	43,826	(256)
Lotte Vietnam Co., Ltd.	Vietnam	36.84	16,331	8,097	29,020	208
PT Lotte Trade And Distribution	Indonesia	40.00	5,144	9,657	14,435	(2,474)
Lotte Taiwan Co., Ltd.	Taiwan	50.00	15,469	6,150	16,596	390
Lotte Confectionery Pilipinas Co.	Philippines	40.00	2,310	2,165	2,576	(2,057)
Lotte Malaysia Sdn. Bhd	Malaysia	40.00	2,372	1,007	1,358	(1,744)
Lotte Giants.	Korea	30.00	26,322	9,593	44,765	9,502
LH Foods Co., Ltd. ¹	Hongkong	51.00	156,672	52,991	87,572	3,998
Lotte Shanghai Foods., Ltd. ¹	China	10.00	156,630	52,989	87,572	4,005

¹ The 90% and 10% interest in Lotte Shanghai Foods., Ltd. are held by LH Foods Co., Ltd., a joint venture, and Lotte (China) Investment Co., Ltd., a subsidiary, respectively. The financial information of LH Foods Co., Ltd. has been prepared on the consolidated basis.

Fair value of marketable shares held by associates:

<i>(in millions of Korean won except per share)</i>	Shares	Market price per share	Market Price	Book Value
BIBICA CORPORATION	5,953,000	870	5,181	13,282

Unrecognized accumulated loss from discontinue applied equity method:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
PT, Lotte Trade And Distribution	(2,005)	(906)

13. Property, Plant and Equipment

Changes in property, plant and equipment are as follows:

<i>(in millions of Korean won)</i>	2012							
	Land	Buildings	Structures	Machinery	Vehicles	Others	Construction-in-progress	Total
Balance as of January 1, 2012	698,786	247,968	3,074	213,900	1,272	41,882	24,744	1,231,626
Acquisition	242	1,129	15	2,857	348	3,613	58,593	66,797
Transfer	-	(8,561)	300	50,458	803	13,504	(69,286)	(12,782)
Disposals	(1)	(79)	-	(182)	(538)	(2,354)	-	(3,154)

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Depreciation	-	(8,832)	(274)	(43,151)	(737)	(18,790)	-	(71,784)
Business combination	-	5,818	368	21,680	41	2,007	770	30,684
Exchange differences	(2,245)	(6,184)	(37)	(8,810)	40	165	151	(16,920)
Balance as of December 31, 2012	696,782	231,259	3,446	236,752	1,229	40,027	14,972	1,224,467
Acquisition Cost	698,120	417,222	13,602	851,697	7,933	170,915	14,972	2,174,461
Accumulated Depreciation	-	(185,963)	(10,156)	(614,527)	(6,704)	(130,888)	-	(948,238)
Accumulated Impairment Loss	(1,338)	-	-	(418)	-	-	-	(1,756)

2011

<i>(in millions of Korean won)</i>	Land	Buildings	Structures	Machinery	Vehicles	Others	Construction-in-progress	Total
Balance as of January 1, 2011	706,086	244,470	2,912	205,816	1,658	34,446	8,637	1,204,025
Acquisition	1,079	3,043	56	4,845	142	4,154	74,925	88,244
Transfer	994	12,970	15	21,411	723	22,554	(58,592)	75
Disposals	(10,637)	(482)	-	(1,599)	(954)	(356)	-	(14,028)
Depreciation	-	(10,490)	(235)	(37,476)	(948)	(18,199)	-	(67,348)
Disposal of Subsidiary	-	-	-	-	-	(1,974)	-	(1,974)
Impairment	-	-	-	(393)	-	-	-	(393)
Business combination	3,596	4,311	-	26,923	100	1,105	-	36,035
Exchange differences	(2,332)	(5,854)	326	(5,627)	551	152	(226)	(13,010)
Balance as of December 31, 2011	698,786	247,968	3,074	213,900	1,272	41,882	24,744	1,231,626
Acquisition Cost	700,124	421,439	11,947	726,380	6,189	156,186	24,744	2,047,009
Accumulated Depreciation	-	(173,471)	(8,873)	(510,797)	(4,917)	(114,304)	-	(812,362)
Accumulated Impairment Loss	(1,338)	-	-	(1,683)	-	-	-	(3,021)

Depreciation amounting to ₩ 47,515 million (2011: ₩ 39,565 million) has been charged to 'cost of sales', and ₩ 24,269 million (2011: ₩ 27,783 million) to 'selling and administrative expenses'.

Lease expenses recognized for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Lease expenses	7,481	5,900

Details of the future minimum lease payments payable under operating lease agreement as of December 31, 2012 and 2011, are as follows:

<i>(In millions of Korean won)</i>	2012	2011
No later than 1 year	₩ 8,867	₩ 7,482
1 year to 5 years	20,017	15,129
	₩ 28,884	₩ 22,611

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

14. Intangible Assets

Changes in intangible assets for are as follows:

	2012				
<i>(in millions of Korean won)</i>	Industrial property rights	Member-ships	Others	Goodwill	Total
Beginning balance	1,513	1,791	1,064	70,757	75,125
Acquisition	140	89	202	-	431
Transfer	142	2,499	-	-	2,641
Disposal	-	-	-	-	-
Amortization	(789)	-	(135)	-	(924)
Business combination	1,518	-	19	43,869	45,406
Impairment loss	-	-	-	(8,186)	(8,186)
Foreign exchange translation	(4)	-	(79)	(3,622)	(3,705)
Ending balance	<u>2,520</u>	<u>4,379</u>	<u>1,071</u>	<u>102,818</u>	<u>110,788</u>

	2011				
<i>(in millions of Korean won)</i>	Industrial property rights	Member-ships	Others	Goodwill	Total
Beginning balance	1,814	1,786	638	70,309	74,547
Acquisition	111	8	898	-	1,017
Transfer	98	-	170	-	268
Disposal	(1)	(3)	-	-	(4)
Amortization	(506)	-	(424)	-	(930)
Business combination	6	-	-	1,355	1,361
Disposal of Subsidiary	(10)	-	(221)	-	(231)
Foreign exchange translation	1	-	3	(907)	(903)
Ending balance	<u>1,513</u>	<u>1,791</u>	<u>1,064</u>	<u>70,757</u>	<u>75,125</u>

Amortization amounting to ₩ 24 million (2011: ₩ 3 million) is included in the 'cost of sales', ₩ 900 million (2011: ₩ 927 million) in the 'selling and administrative expenses', respectively.

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

15. Impairment Tests for Goodwill

Goodwill is monitored by the management at the operating segment level (cash-generating units or group of cash-generating units). The following is a summary of goodwill allocation for each operating segment:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Chocolaterie Guylian N.V.	65,787	69,404
K.S. SULEMANJI ESMAILJI & SONS (Private) Limited	1,347	1,353
Lotte (China) Investment Co., Ltd.	35,284	-
Lotte China Foods Co., Ltd.	400	-
	102,818	70,757

Goodwill impairment reviews are undertaken annually. Impairment test suggests that, the carrying value of cash generating units does not exceed the recoverable amount except Lotte (China) Investment Co., Ltd. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations use pre-tax cash flow projections based on financial budgets approved by management covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rates stated below. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates. In addition, a constant growth rate assumption is used for perpetual cash flow calculation. The key assumptions used for value-in-use calculations are as follows:

	December 31, 2012		
	Chocolaterie Guylian N.V.	K.S. SULEMANJI ESMAILJI & SONS(Private) Limited	Lotte (China) Investment Co., Ltd.
Gross margin	30.5%	19.5%	42.8%
Sales growth rate ¹	17.0%	5.0%	20.0%
Perpetual growth rate ²	0.0%	0.0%	0.0%
Pretax discount rate ³	10.9%	10.4%	18.9%

	December 31, 2011	
	Chocolaterie Guylian N.V.	K.S. SULEMANJI ESMAILJI & SONS(Private) Limited
Gross margin	30.9%	17.7%
Sales growth rate ¹	11.8%	5.0%
Perpetual growth rate ²	0.0%	0.0%
Pretax discount rate ³	11.6%	10.0%

¹ Sales growth rate is the weighted-average sales growth rate in order to calculate the expected cash flows for five-year period, which is estimated based on the historical results and the expectation of the Company.

² Perpetual growth rate is the expected growth rate after five years.

³ Pretax discount rate is applied to the cash flow projection.

The Company determines the sales growth rate based on its past performances and expectation

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

on future market development. The discount rate used is the pre-tax discount rate that reflects relevant risks.

The impairment charge arose in Lotte (China) Investment Co., Ltd. due to the accumulated loss resulting from early stage investment for business expansion in China. Following this adjustment, the carrying value in cash generating unit exceeded the value in use by ₩ 8,186 million and the corresponding amount is recognized as the other expense in the consolidated statement of comprehensive income. No class of asset other than goodwill was impaired.

16. Investment property

Changes in investment property are as follows:

	2012			
<i>(in millions of Korean won)</i>	Land	Buildings	Structures	Total
Beginning balance	17,683	59,802	579	78,064
Acquisition	-	470	-	470
Transfer	-	9,790	-	9,790
Depreciation	-	(1,818)	(44)	(1,862)
Disposal	-	(789)	-	(789)
Foreign exchange translation	(2,468)	560	-	(1,908)
Ending balance	15,215	68,015	535	83,765
Acquisition cost	15,215	80,041	664	95,920
Accumulated depreciation	-	(12,026)	(129)	(12,155)
	2011			
<i>(in millions of Korean won)</i>	Land	Buildings	Structures	Total
Beginning balance	17,606	61,777	623	80,006
Transfer	-	(248)	-	(248)
Depreciation	-	(1,776)	(44)	(1,820)
Business combination	1,995	-	-	1,995
Foreign exchange translation	(1,918)	49	-	(1,869)
Ending balance	17,683	59,802	579	78,064
Acquisition cost	17,683	63,500	664	81,847
Accumulated depreciation	-	(3,698)	(85)	(3,783)

Depreciation amounting to ₩ 1,827 million (2011: ₩1,799 million) has been charged to 'cost of sales', and ₩35 million (2011: ₩21 million) to 'selling and administrative expenses'.

Fair value of investment property as of December 31, 2012, is ₩ 97,367 million.

Rent income from investment property during the year ended December 31, 2012, is ₩ 9,276 million (2011: ₩ 9,065 million), and operating expenses (including repairs and maintenance) directly related to those investment property is ₩ 2,824 million (2011: ₩ 2,680 million).

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

17. Accounts Payable and Other Liabilities

Accounts payable and other liabilities as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Accounts payable	141,925	169,742
Non-trade payables	72,910	90,116
Other payables	44	46
Total	214,879	259,904

18. Borrowings

Details of borrowings are as follows:

Short-term Borrowings				
<i>(in millions of Korean won)</i>	Bank	Interest rate At 12/31/2012	2012.12.31	2011.12.31
Short-term borrowings	Shinhan Bank	1.52%~6.36%	22,190	715
Current portion of long-term liabilities	Al Falah, others	Kibor+1.4%, others	6,666	1,285
Bank overdraft	Banco BPI, others	EURIBOR+1%, others	2,875	4,509
	Total		31,731	6,509

Long-term Borrowings					
<i>(in millions of Korean won)</i>	Details	Maturity date	Interest rate At 12/31/2012	2012.12.31	2011.12.31
Al Falah	Fund for facilities	2014-06-30	Kibor+1.4%	2,827	9,169
Hana Bank	Operating fund	2013-03-08	8.65%	-	1,825
	Total			2,827	10,994

Debentures					
<i>(in millions of Korean won)</i>	Bank	Maturity date	Interest rate At 12/31/2012	2012.12.31	2011.12.31
54th placed	Mizuho Corporate Bank, Ltd	2012-07-10	3M Euro Yen LIBOR+150b.p	-	148,516
55th placed	Mizuho Corporate Bank, Ltd	2012-12-28	3M Euro Yen TIBOR+100b.p	-	141,090
56th placed	Tong Yang Securities Inc, Others	2014-07-29	4.08%	100,000	100,000
57th placed	KDB Daewoo securities, Others	2015-07-06	3.47%	100,000	-
58th placed	KB securities,	2015-12-27	3.10%	100,000	-

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Others		
	300,000	389,606
Less : discount on debentures	(851)	(643)
Book value(Current debentures)	299,149	388,963
Current maturities		
Current debentures	-	289,606
Current discounts on debentures	-	(248)
Book value(Non-current debentures)	299,149	99,605

Debentures above will be paid on their maturity date. Interest expense is paid every three months.

Book value and fair value of non-current borrowings and debentures are as follows:

(in millions of Korean won)

	December 31, 2012		December 31, 2011	
	Book value	Fair value	Book value	Fair value
Long-term borrowings	2,827	2,827	10,994	10,994
Debentures	299,149	301,862	388,963	390,878
Total	301,976	304,689	399,957	401,872

Changes in borrowings and debentures:

(in millions of Korean won)

	2012		2011	
	Borrowings	Debentures	Borrowings	Debentures
Beginning balance	17,503	388,963	23,673	425,456
Amortization	-	449	-	481
Repayments	(30,164)	(289,598)	(48,200)	(153,679)
Increase	24,865	199,335	17,442	99,542
Exchange differences	(2,376)	-	(1,160)	17,163
Business combination	24,730	-	25,748	-
Total	34,558	299,149	17,503	388,963

19. Defined Benefit Liabilities

Defined benefit liabilities recognized on the statements of financial position are as follows:

(in millions of Korean won)

	December 31, 2012	December 31, 2011
Present value of obligation	59,025	35,995
Fair value of plan assets ¹	(35,556)	(28,347)
Liability in the statement of financial position	16,469	7,648

¹ The fair value of plan assets includes ₩ 48 million in contributions to the National Pension Fund (2011: ₩ 52 million).

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

The amounts recognized in the comprehensive income statements are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Current service cost	16,730	15,416
Interest cost	2,140	2,478
Expected return on plan assets	(1,362)	(1,465)
Curtailment of plan	-	282
Total, included in employee benefit expenses	17,508	16,711

Actuarial gains and losses recognized as other comprehensive income are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Cost of sales	5,962	5,705
Selling and administrative expenses	11,546	11,006
Total	17,508	16,711

Actual return of plan assets was ₩ 1,332 million (2011: ₩ 1,220 million)

Changes in the carrying amount of defined benefit obligations are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Beginning balance	28,347	32,753
Expected return on plan assets	1,362	1,465
Profit from settlements(Curtailment) of plan	-	265
Actuarial gains and losses	(30)	(508)
Employer contribution	10,263	9,592
Benefit paid	(5,106)	(4,494)
Management commission	(98)	-
Transfer from associates	818	-
Curtailment of plan	-	(154)
Settlements of plan	-	(10,576)
Exchange differences	-	4
Ending balance	35,556	28,347

The movements in the fair value of plan assets are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Beginning balance	35,995	43,668
Business combination	-	529
Transfer in	1,030	187
Current service cost	16,730	15,416
Interest income	2,140	2,478
Profit from settlements(Curtailment) of plan	-	547
Actuarial gains and losses	3,806	(479)
Benefit paid	(7,572)	(6,083)
Curtailment of plan	-	(279)
Settlements of plan	-	(19,967)
Exchange differences	(104)	(22)
Ending balance	52,025	35,995

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Actuarial gains and losses recognized as other comprehensive income are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Before income tax effect	(3,837)	(29)
Income tax effect	925	151
After income tax effect	(2,912)	122

As of December 31, 2012, ₩(-)7,913 million (2011: ₩(-)5,001 million) of accumulated actuarial losses are included in other comprehensive income.

The principal actuarial assumptions used are as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Discount rate	3.46%	4.41%
Expected return of plan assets	4.41%	4.90%
Future salary increase	3.31%	2.50%

The sensitivity of the overall pension liability to changes in the weighted principal assumptions as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	
	1% increase	1% decrease
Changes in discount rate		
Changes in defined benefit liabilities	(2,222)	2,448

Plan assets consist of:

<i>(in millions of Korean won)</i>	December 31, 2012		December 31, 2011	
	Amount	Proportion	Amount	Proportion
Time deposits	35,508	99.87%	28,295	99.82%
National pension fund	48	0.13%	52	0.18%
Total	35,556	100.00%	28,347	100.00%

The Company management estimates plan assets to be paid in 2013 to be ₩ 10,000 million.

Adjustments for the differences between initial assumptions and actual figures are as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Present value of defined benefit liability	52,025	35,995
Fair value of plan assets	(35,556)	(28,347)
Deficit of the funded plans	16,469	7,648
Defined benefit liability adjustments	(210)	1,187
Defined benefit asset adjustments	(30)	(243)

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

20. Deferred Income Tax

The analysis of deferred tax assets and deferred tax liabilities is as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Deferred tax assets		
Deferred tax asset to be recovered after more than 12 months	22,680	28,689
Deferred tax asset to be recovered within 12 months	15,789	12,867
Deferred tax liabilities		
Deferred tax liability to be recovered after more than 12 months	(523,418)	(490,003)
Deferred tax liability to be recovered within 12 months	(3,078)	(2,420)
Deferred tax assets(liabilities), net	<u>(488,028)</u>	<u>(450,867)</u>

The gross movements on the deferred income tax account are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Beginning balance	(450,867)	(443,083)
Income statement charge	2,317	(18,776)
Tax charge/(credit) relating to components of other comprehensive income	(39,663)	9,599
Tax charged/(credited) directly to equity	925	151
Acquisition of subsidiary	(380)	889
Exchange differences	(360)	353
Ending balance	<u>(488,028)</u>	<u>(450,867)</u>

Changes in the temporary differences and related deferred tax assets and liabilities are as follows:

	2012						
<i>(in millions of Korean won)</i>	January 1, 2012	Income statement	Other comprehensive income	Retained earnings	Acquisition of subsidiary	Currency translation differences	December 31, 2012
Deferred tax liabilities							
Gain on valuation of available-for-sale	(322,498)	-	(39,145)	-	-	-	(361,643)
Revaluation of land	(94,667)	1,182	-	-	-	195	(93,290)
Advanced depreciation provision	(21,616)	-	-	-	-	-	(21,616)
Depreciation	(12,912)	3,467	-	-	-	-	(9,445)
Retirement deposits	(6,933)	(1,063)	-	-	-	-	(7,996)
Reserve for research and development	(3,388)	(968)	-	-	-	-	(4,356)
Others	(30,445)	1,502	-	-	-	537	(28,406)
	<u>(492,459)</u>	<u>4,120</u>	<u>(39,145)</u>	<u>-</u>	<u>-</u>	<u>732</u>	<u>(526,752)</u>

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Deferred tax assets							
Accrual for retirement and severance benefits	10,372	(2,639)	-	925	-	(29)	8,629
Provision for sales returns	5,288	(37)	-	-	-	-	5,251
Bad debts expense	4,789	(101)	-	-	-	(62)	4,627
Accrued expenses	17	1,993	-	-	-	-	2,011
Accrued expenses(unused annual leave)	369	1,564	-	-	-	(37)	1,896
Leased assets	1,358	(67)	-	-	-	-	1,291
Unused amounts reversed	846	83	-	-	-	(2)	928
Loss on available for sale financial assets	731	-	-	-	-	-	731
Others	17,821	(2,600)	(518)	-	(380)	(963)	13,360
	<u>41,592</u>	<u>(1,803)</u>	<u>(518)</u>	<u>925</u>	<u>(380)</u>	<u>(1,092)</u>	<u>38,724</u>
Total	<u>(450,867)</u>	<u>2,317</u>	<u>(39,663)</u>	<u>925</u>	<u>(380)</u>	<u>(360)</u>	<u>(488,028)</u>

2011

<i>(in millions of Korean won)</i>	January 1, 2011	Income statement	Other comprehensive income	Retained earnings	Acquisition of subsidiary	Currency translation differences	December 31, 2011
Deferred tax liabilities							
Gain on valuation of available-for-sale	(333,148)	-	10,650	-	-	-	(322,498)
Revaluation of land	(86,850)	(5,134)	-	-	(3,185)	502	(94,667)
Advanced depreciation provision	(19,654)	(1,962)	-	-	-	-	(21,616)
Depreciation	(7,405)	(5,507)	-	-	-	-	(12,912)
Retirement deposits	(5,684)	(1,249)	-	-	-	-	(6,933)
Reserve for research and development	(2,339)	(1,049)	-	-	-	-	(3,388)
Others	(23,835)	(2,273)	-	-	(5,153)	816	(30,445)
	<u>(478,915)</u>	<u>(17,174)</u>	<u>10,650</u>	<u>-</u>	<u>(8,338)</u>	<u>1,318</u>	<u>(492,459)</u>
Deferred tax assets							
Accrual for retirement and severance benefits	8,485	1,561	-	151	180	(6)	10,371
Provision for sales returns	5,373	(85)	-	-	-	-	5,288

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Bad debt expense	4,074	733	-	-	-	(18)	4,789
Leased assets	1,758	(400)	-	-	-	-	1,358
Prepaid expense	3,495	(2,236)	-	-	-	-	1,259
Others	12,647	(1,176)	(1,051)	-	9,047	(941)	18,527
	35,832	(1,603)	(1,051)	151	9,227	(965)	41,592
Total	(443,083)	(18,776)	9,599	151	889	353	(450,867)

Temporary differences not recognized as deferred tax assets:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Impairment loss on available-for-sale financial assets	1,625	1,625
Investments in subsidiaries and associates	208,690	226,441
Tax loss	9,880	-
Others	5,306	-

Deductible temporary differences from impairment loss on available-for-sale financial assets, investments in subsidiaries and associates and tax losses have not been recognized as deferred tax assets as it was determined to be not realizable in the near future.

Temporary differences not recognized as deferred tax liabilities

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Investments in subsidiaries and associates	61,235	84,033

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates. Deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Company. It is probable that the temporary difference will not reverse in the foreseeable future.

21. Provisions

Changes in the carrying amount of provisions are as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Beginning balance	23,929	22,852
Increase(decrease)	2,111	1,077
Ending balance	26,040	23,929

Sales return provisions have been accrued for the estimated sales returns determined based on historical experience.

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

22. Capital Stock

Common Stock

The Company is authorized to issue 3 million shares of common stock with a par value of ₩5,000 per share. As of December 31, 2012, 1,421,400 shares of common stock have been issued.

Capital Surplus

(in millions of Korean won)

	December 31, 2012
Additional paid-in capital	1,350
Other additional capital	10,003
	11,353

The Company performed the asset revaluation for its property, plant, and equipment. In relation to the revaluation, over-depreciation on machinery which has been excluded from deductible expenses is recognized as other additional capital.

Treasury Shares

As of December 31, 2012, the Company purchased 14,000 shares of treasury stock for ₩6,248 million in order to stabilize stock market and fulfill listing requirements. The Company intends to sell these treasury shares in the future depending on the market conditions.

23. Accumulated Other Comprehensive Income

Accumulated other comprehensive income consists of:

(in millions of Korean won)

	December 31, 2012	December 31, 2011
Change in value of available-for-sale financial assets	1,132,010	1,010,137
Share of other comprehensive income of associates	(6,699)	1,689
Cash flow hedge	-	(1,622)
Cumulative effect of foreign currency translation	(43,262)	(21,678)
	1,082,049	988,526

Changes in accumulated other comprehensive income for the years ended December 31, 2012 and 2011, are as follows:

	2012			
<i>(in millions of Korean won)</i>	Beginning	Increase (Decrease)¹	Reclassification to profit or loss	Ending
Change in value of available-for-sale financial assets	1,010,137	122,696	(823)	1,132,010
Share of other comprehensive income of associates	1,689	(4,208)	(4,180)	(6,699)
Cash flow hedge	(1,622)	-	1,622	-
Cumulative effect of foreign currency translation	(21,678)	(21,584)	-	(43,262)
	988,526	96,904	(3,381)	1,082,049

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

			2011	
<i>(in millions of Korean won)</i>	Beginning	Increase (Decrease)¹	Reclassification to profit or loss	Ending
Change in value of available-for-sale financial assets	1,181,160	(170,769)	(254)	1,010,137
Share of other comprehensive income of associates	(1,905)	3,615	(21)	1,689
Cash flow hedge	(5,562)	3,690	250	(1,622)
Cumulative effect of foreign currency translation	(6,612)	(15,066)	-	(21,678)
	<u>1,167,081</u>	<u>(178,530)</u>	<u>(25)</u>	<u>988,526</u>

¹ Changes in accumulated other comprehensive income represent net of tax effect amounts.

24. Retained Earnings

Details of retained earnings are as follows:

<i>(in millions of Korean won)</i>	December 31, 2012	December 31, 2011
Legal reserve ¹	3,554	3,554
Discretionary reserve ²	1,531,400	1,470,900
Unappropriated retained earnings	85,184	62,653
Total	<u>1,620,138</u>	<u>1,537,107</u>

¹ The Commercial Code of the Republic of Korea requires the Parent Company to appropriate, as a legal reserve, an amount equal to a minimum of 10% of cash dividends paid, until such reserve equals 50% of its issued capital stock. The reserve is not available for the payment of cash dividends, but may be transferred to capital stock, or used to reduce accumulated deficit, if any, with the ratification of the Parent Company's majority shareholders.

² The Parent Company accounted for reserve for improvement of financial structure as a legal reserve in accordance with the regulations regarding securities issuance and disclosure until 2006. This reserve was not available for dividends, but may be transferred to capital stock, or used to reduce accumulated deficit, if any, with the ratification of the Parent Company's majority shareholders. However, according to the revised regulation as of December 27, 2007, this reserve has been revised to voluntary reserve. According to the special tax treatment control law, the Parent Company has additionally reserved research and development that is deducted by adjustment report when the Parent Company appropriates retained earnings. The reserve reversed by the special tax treatment control law can be distributed as dividend.

25. Commitments and Contingencies

As of December 31, 2012, the Company is a plaintiff in various lawsuits claiming damages totaling ₩ 3,086 million and is a defendant in various lawsuits with damage claims totaling ₩ 43,794 million. The management believes that the ultimate outcome of these legal actions will not have a material effect on the financial position or operations of the Company.

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

The Company has various forms of credit facility commitments with financial institutions, as follows:

(in millions of Korean won, foreign currencies in thousands)

		<u>December 31, 2012</u>		<u>December 31, 2011</u>	
Overdraft	Woori Bank and others		59,078		58,868
Buyer's loan	Hana Bank		140,000		140,000
Purchase card	Industrial Bank of Korea and others		7,000		6,000
Letter of credit	Woori Bank and others	USD	20,000	USD	20,000
	State Bank of India and others		7,271		1,283
Letter of credit (Local)	Korea Exchange Bank		1,500		1,500
Discount of bill	Hana Bank		-		3,000
	Woori Bank		-		2,600
Import L/C issuance	Korea Exchange Bank		-	USD	2,000
Loans for operating funds	Hana Bank and others		7,225		-
Facility loans	Standard Chartered Bank and others		19,546		-
Performance guarantees	Seoul Guarantee Insurance Co. Ltd.		2,010		2,309

Technical assistance agreements of the Company with Wilkes & Associates and others as of December 31, 2012, are as follows:

Contractor	Description	Fee	Expiration
Wilkes & Associates, Inc.	Prime production	1.00% of Net Sales	June 2013
	SPIC ice cream production	1.15% of Net Sales	Oct. 2015
	Cracker and snack production	0.75% of Net Sales	Feb. 2014
PepsiCo, Inc.	Snack (Cheetos) production	3.00% of Net Sales	Dec. 2013
	Snack (Sun chips) production	3.00% of Net Sales	Dec. 2013
	Snack (Doritos) production	1.50% of net Sales	Dec. 2020
The Hershey Company	Ice cream production	1.15~3.00% of Net Sales	June 2013
Miles Willard Technologies	Snack (Tacos) production	1.30% of Net Sales	March 2019

The Company entered into technical assistance and exchange agreement with Lotte Japan Co. for ten years, from April 1, 2004 to March 31, 2014. According to the agreement, the Company has to pay for the use of trademarks and patents and the cost incurred for the current year amounts to ₩ 480 million.

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

26. Selling and Administrative Expenses

Selling and administrative expenses are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Salaries	140,385	142,278
Severance benefits	11,607	10,624
Employee fringe benefits	27,966	26,488
Training Expenses	1,933	1,872
Travel Expenses	3,822	3,369
Vehicles Maintenance Expenses	11,649	11,683
Insurance Premium	1,701	1,924
Taxes and dues	5,604	5,423
Entertainment	742	484
Supplies expenses	3,797	3,938
Publication Expenses	338	330
Communications	2,080	1,981
Water & utilities	3,010	6,481
Repairs and maintenance	3,293	4,970
Rental expense	21,611	20,268
Depreciation	24,304	27,804
Amortization	900	927
Commission expense	160,227	141,911
Advertising expenses	46,072	48,085
Samples Expenses	626	132
Sales commission	30,916	31,429
Sales promotional expense	33,905	22,322
Bad debt expense	5,379	1,324
Reversal of allowance for doubtful accounts	-	(23)
Other	25,550	25,104
	<u>567,417</u>	<u>541,128</u>

27. Other Income

Other income consists of:

<i>(in millions of Korean won)</i>	2012	2011
Foreign exchange gain	1,731	2,242
Gain on foreign currency translation	93	133
Gain on disposal of property, plant and equipment	1,225	2,836
Gain on disposal of intangible assets	3	3
Gain on disposal of investment property	368	-
Gain on disposal of investments subsidiary	-	13,659
Gain on disposal of investments associates	7,061	-
Miscellaneous revenue	12,951	14,195
	<u>23,432</u>	<u>33,068</u>

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

28. Other Expenses

Other expenses consist of:

(in millions of Korean won)

	2012	2011
Foreign exchange loss	1,618	3,636
Loss on foreign currency translation	487	114
Loss on disposal of property, plant and equipment	2,482	227
Impairment loss of property, plant and equipment	-	393
Impairment loss on disposal of intangible assets	8,186	-
Donations	8,060	4,147
Other bad debt expenses	-	163
Loss on disposal of investments associates	1,131	2,145
Miscellaneous expense	4,232	4,709
	26,196	15,534

29. Expenses by Nature

Expenses that are recorded by nature as cost of sales, selling and administrative expenses and other operating expenses consist of:

(in millions of Korean won)

	2012	2011
Changes in inventories of finished goods, merchandises and work in progress	(6,407)	(14,732)
Raw materials and consumables used	545,303	683,233
Purchase of merchandise	298,049	257,021
Employee benefit expenses	238,022	232,057
Advertising expenses	46,072	48,085
Rental expense	36,605	36,598
Commission expense	223,323	201,221
Depreciation	73,646	69,168
Amortization	924	930
Sales commission	30,916	31,429
Sales promotional expense	33,905	22,322
Other expenses	254,935	129,121
	1,775,293	1,696,453

30. Financial Income

Financial income consists of:

(in millions of Korean won)

	2012	2011
Interest income	7,610	8,045
Dividend income	25,249	6,536
Gain on foreign currency transactions	29,124	524
Gain on foreign currency translation	253	1,611
Gain on disposal of available-for-sale	2,308	402

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

financial assets		
Gain on valuation of hedging derivatives	39	17,390
Gain on transactions of hedging derivatives	708	1,811
	<u>65,291</u>	<u>36,319</u>

31. Financial Costs

Financial costs consist of:

<i>(in millions of Korean won)</i>	2012	2011
Interest expenses	17,244	21,148
Loss on foreign currency transactions	1,631	695
Loss on foreign currency translation	346	18,838
Loss on transactions of hedging derivatives	28,936	275
	<u>48,157</u>	<u>40,956</u>

32. Income Tax

Income tax expense consists of:

<i>(in millions of Korean won)</i>	2012	2011
Current tax:		
Current tax on profits for the year	36,041	36,414
Adjustments in respect of prior years	3,319	(18)
Total current tax	<u>39,360</u>	<u>36,396</u>
Deferred tax (Note 20):		
Origination and reversal of temporary differences	(2,317)	10,395
Impact of change in Korean tax rate	-	10,563
Currency translation differences	(817)	(115)
Total deferred tax	<u>(3,134)</u>	<u>20,843</u>
Income tax expense	<u>36,225</u>	<u>57,239</u>

The tax on the Company's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the Company entities as follows:

<i>(in millions of Korean won)</i>	2012	2011
Profit before tax	126,001	157,601
Tax calculated based on applicable tax rate	35,841	49,684
Tax effects of:		
Income not subject to tax	(1,830)	202
Expenses not deductible for tax purposes	91	(462)
Tax credit	(1,079)	(1,633)
Tax refund	2,715	(18)
Additional tax (Refund)	487	(1,097)
Re-measurement of deferred tax – change in the Korean tax rate	-	10,563
Income tax expense	<u>36,225</u>	<u>57,239</u>

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

The income tax (charged)/credited directly to equity is as follows:

	December 31, 2012			December 31, 2011		
	Before tax	Tax (charge) credit	After tax	Before tax	Tax (charge) credit	After tax
(in millions of Korean won)						
Gain(loss) on valuation of available-for-sale financial assets	160,407	(39,145)	121,262	(181,673)	10,650	(171,023)
Cash flow hedge	2,140	(518)	1,622	4,990	(1,051)	3,939
Actuarial gain (loss) on retirement benefit obligations	(3,837)	925	(2,912)	(186)	308	122
	<u>158,710</u>	<u>(38,738)</u>	<u>119,972</u>	<u>(176,869)</u>	<u>9,907</u>	<u>(166,962)</u>

33. Earnings per Share

Basic earnings per share

	2012	2011
(in Korean won)		
Parent interest in net income	91,624,784,247	97,675,688,016
Weighted average number of common stock outstanding ¹	1,407,400	1,407,400
Basic earnings per share	65,102	69,402

¹ Calculation of the weighted average number of common stock outstanding

	Number of Shares	Weighted Average	Weighted Number of Shares
Carryover	1,421,400	366	520,232,400
Treasury stock	(14,000)	366	(5,124,000)
	<u>1,407,400</u>		<u>515,108,400</u>

Weighted average number of common stock: 515,108,400 / 366 = 1,407,400 shares

Diluted earnings per share

As there are no diluted securities outstanding, diluted earnings per share is identical to basic earnings per share.

34. Dividends

Dividends paid by the Parent Company in 2012 and 2011 are ₩ 5,630 million (₩ 4,000 per share). Dividends per share and total dividends are ₩ 4,000 and ₩ 5,630 million, respectively, for 2012. This will be submitted to the shareholders for approval on March 22, 2013. The December 31, 2012 consolidated financial statements do not reflect this dividends payable.

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

35. Related Party Transactions

Related parties as of December 31, 2012, are as follows:

Relationship	Related parties
Ultimate parent company	-
Investors with significant influence	-
Associates	BIBICA CORPORATION, Lotte Packaging(Beijing) Co., Ltd., Lotte Europe Holdings B.V., Lotte Vietnam Co., Ltd., PT, Lotte Trade And Distribution, Lotte Taiwan Co., Ltd., Lotte Confectionery Pilipinas Co., Lotte Malaysia Sdn. Bhd, Lotte Giants Co., Ltd., Lotte Shanghai Foods., Ltd.
Joint ventures	LH Foods Co., Ltd.
Other related parties	Lotte Aluminum Co., Ltd., Hotel Lotte Co., Ltd., Daehong Communications Inc., Lotte Engineering & Construction Co., Ltd., Lotte Midopa Co., Ltd. Lotteria Co., Ltd., Lotte Shopping Co., Ltd, Lotte Data Communication Company, Lotte Trading Co., Ltd., Lotte Logistics Co., Ltd, Lotte.com Inc., Korea Seven Co., Ltd Lotte Station B/D. Co., Lotte Samkang Co., Ltd., Lotte Ham Co., Ltd., Lotte Chilsung Beverage Co., Ltd., Canon Korea Business Solutions Inc., Lotte Card Co., Ltd., PT, Lotte Indonesia, ZAO Lotte Rus, Lotte KF Rus LLC, Lotte Shopping Rus LLC, Lotte (China) Management Co., Ltd., Lotte Huabang (Beijing) Co., Ltd., others

Significant transactions, which occurred in the normal course of business with related companies, and their related balances are as follows:

(in millions of Korean won)	2012		December 31, 2012	
	Sales	Purchases	Receivables	Payables
Associates	11,434	15,860	3,108	5,286
Other related parties	244,844	306,508	31,573	79,263
Total	256,278	322,368	34,681	84,549

(in millions of Korean won)	2011		December 31, 2011	
	Sales	Purchases	Receivables	Payables
Associates	16,772	5,566	4,074	1,494
Other related parties	230,424	290,204	27,374	65,554
Total	247,196	295,770	31,448	67,048

Compensation for key management consists of:

(in millions of Korean won)	2012	2011
Short-term salaries	6,540	6,488
Post-retirement benefits	2,163	1,593
	8,703	8,081

Key management refers to the registered directors and non-registered directors who have the authority and responsibilities for planning, operation and control of the business of the Parent Company.

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

As of December 31, 2012, the Company's provides guarantees to related parties are as follows:

(in thousands of US dollars)

Guarantee beneficiary	Amount of guarantee		Financial institution
Lotte KF Rus LLC	USD	19,500	Korea Exchange Bank
Lotte KF Rus LLC	USD	6,500	Korea Exchange Bank
Lotte KF Rus LLC	USD	19,500	Korea Exchange Bank

36. Business combination

(1) K.S. Sulemanji Esmailji & Sons (Private) Ltd.

The Company participated in paid-in capital increase of K.S. Sulemanji Esmailji & Sons (Private) Ltd. on January 3, 2011, which is located in Pakistan. Consequently, the ownership has become 69.45% and the paid-in capital amount has become ₩ 18,304 million. The Company is expecting to increase its share in this market and reduce cost through economies of scale.

The ₩ 1,311 million amount of goodwill from this acquisition is based on the synergy effect with companies related to K.S. Sulemanji Esmailji & Sons (Private) Ltd. in Pakistan. Those companies are in the same business and are customer-oriented.

The Company anticipates that the goodwill will not be deductible for the purpose of income tax calculation. The assets and liabilities recognized on the acquisition date were estimated at fair values. The amounts paid to K.S. Sulemanji Esmailji & Sons (Private) Ltd. and the amounts of assets and liabilities recognized on the purchase date are as follows:

(In millions of Korean won)

I. Consideration transferred	
Paid-in capital increase(cash)	18,304
II. Recognized amounts of identifiable assets acquired and liabilities assumed	
Cash and cash equivalents	18,908
Trade and other receivables	3,752
Inventories	3,384
Investment property	1,995
Property, plant and equipment	36,035
Intangible assets	50
Other assets	1,950
Trade and other payables	6,559
Borrowings	25,748
Retirement benefit obligations	529
Other liabilities	8,398
Non-controlling interest ¹	371
Total identifiable net assets	24,469
Percentage of ownership	69.45%
Amount of equity in net assets	16,993
III. Non-controlling interest	7,476
IV. Goodwill ²	1,311

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

¹ Non-controlling interest for Kolson Industries (Private) Ltd. which is owned by K.S. Sulemanji Esmailji & Sons (Private) Ltd. on the date of purchase.

² The ₩ 1,311 million of goodwill from the business combination was from synergy effects among inter-businesses that originally existed.

Non-controlling interest was calculated by applying non-controlling interest rate of 30.55%, to the fair value of recognizable net assets.

Sales and losses amounts for K.S. Sulemanji Esmailji & Sons (Private) Ltd. are ₩ 53,729 million and ₩ 1,886 million, respectively, and losses for non-controlling interest are ₩ 610 million for this period.

(2) Lotte (China) Investment Co., Ltd.

The Company participated in the paid-in capital increase of Lotte (China) Investment Co., Ltd. on August 21, 2012 in which the Company held 43.50% equity interest. Consequently, the ownership has become 54.80% and the gross paid-in capital amount has become ₩ 22,601 million. The Company is expecting to increase its share in this market and reduce cost through economies of scale.

The ₩ 43,470 million of goodwill from this acquisition is based on the synergy effect with companies related to Lotte (China) Investment Co., Ltd. in China. Those companies are in the same business and are customer-oriented.

The Company anticipates that the goodwill will not be deductible for the purpose of income tax calculation. The assets and liabilities recognized on the acquisition date were estimated at fair values. The amounts paid to Lotte (China) Investment Co., Ltd. and the amounts of assets and liabilities recognized on the purchase date are as follows

(In millions of Korean won)

I. Consideration transferred	
Paid-in capital increase(cash)	22,601
FV of holding shares of Lotte (China) Investment Co., Ltd. before business combination ¹	6,461
II. Recognized amounts of identifiable assets acquired and liabilities assumed	
Cash and cash equivalents	19,787
Trade and other receivables	6,313
Inventories	1,490
Short-term loans	55
Available for sale financial assets	25,528
Property, plant and equipment	2,636
Intangible assets	18
Other assets	2,612
Trade and other payables	61,314
Short-term borrowings	11,537
Non-trade payables	10,797
Value added tax withheld	346
Reserve for sales return	736
Total identifiable net assets	(26,291)
Percentage of ownership	54.80%
Amount of equity in net assets	(14,407)
III. Non-controlling interest	(11,884)

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

IV. Goodwill ²	43,470
---------------------------	--------

¹ The fair value of the shares representing 43.5% ownership issued as part of the consideration paid for Lotte (China) Investment Co., Ltd. amounting to ₩ 6,461 million was estimated by applying the income approach.

² The ₩ 43,470 million of goodwill from the business combination was from synergy effects among inter-businesses that originally existed.

Non-controlling interest was calculated by applying non-controlling interest rate of, 45.20%, to the fair value of recognizable net assets.

The Company recognized a gain of ₩ 5,854 million as a result of measuring at fair value its 43.5% equity interest in Lotte (China) Investment Co., Ltd. held before the business combination. The gain is included in gains (loss) on disposal of investment assets in associates in the Company's statement of comprehensive income for the year ended December 31, 2012.

The consolidated financial statements have been prepared by the Company as if business combination occurred as of September 30, 2012. Sales and profit or loss of Lotte (China) Investment Co., Ltd. for three months are included in the consolidated statement of comprehensive income.

Had Lotte (China) Investment Co., Ltd. been consolidated from January 1, 2012, the consolidated statement of comprehensive income would have shown sales of ₩ 60,936 million and net loss of ₩ 34,006 million.

(3) Lotte China Foods Co., Ltd.

The 6.48% equity interest in Lotte China Foods Co., Ltd. held indirectly through Lotte (China) Foods Co., Ltd. is included in the controlling interest which is reclassified as a subsidiary during the year. Consequently, the Company obtained control with the acquisition of 53.64% equity interest in Lotte China Foods Co., Ltd.

The Company is expecting an increase of share in this market and reduce cost through economies of scale as a result of the business combination.

The ₩ 400 million of goodwill from this acquisition is based on the synergy effect with companies related to Lotte China Foods Co., Ltd. in China. Those companies are in the same business and are customer-oriented.

The Company anticipates that the goodwill will not be deductible for the purpose of income tax calculation. The assets and liabilities recognized on the date of acquisition were estimated by fair values. The amounts paid to Lotte China Foods Co., Ltd. and the amounts of assets and liabilities recognized on the date of acquisition are as follows:

(In millions of Korean won)

I. Consideration transferred	
FV of direct holding shares of Lotte (China) Foods Co., Ltd. before business combination ¹	37,608
FV of indirect holding shares of Lotte (China) Foods Co., Ltd. through Lotte (China) Investment Co., Ltd. before business combination ²	5,160
II. Recognized amounts of identifiable assets acquired and liabilities assumed	
Cash and cash equivalents	1,048

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Trade receivables	61,884
Inventories	4,752
Available for sale financial assets	3,905
Property, plant and equipment	28,049
Intangible assets	1,518
Other assets	2,203
Trade and other payables	9,863
Short-term borrowings	13,193
Accrued expenses	634
Value added tax withheld	299
Reserve for sales return	380
Total identifiable net assets	78,990
Percentage of ownership	53.64%
Amount of equity in net assets	42,368
III. Non-controlling interest	36,622
IV. Goodwill ³	400

¹The fair value of the shares representing 47.16% interest issued as part of the consideration paid for Lotte China Foods Co., Ltd. amounting to ₩ 37,608 million was estimated by applying the income approach.

²The shares representing 6.48% ownership issued as part of the consideration paid for Lotte China Foods Co., Ltd. was based on the carrying value of the investment in equity securities of Lotte China Investment Co., Ltd. amounting to ₩ 5,160 million.

³The ₩ 400 million goodwill from the business combination was from synergy effects among inter-businesses that originally existed.

Non-controlling interest was calculated applying non-controlling interest rate of 46.36%, to the fair value of recognizable net assets.

The Company recognized a loss of ₩ 1,131 million as a result of measuring at fair value its 47.16% equity interest in Lotte China Foods Co., Ltd. held before the business combination. The loss is included in loss on disposal of investment assets in associates in the Company's statement of comprehensive income for the year ended December 31, 2012.

The consolidated financial statements have been prepared by the Company as if business combination occurred as of September 30, 2012. Sales and profit or loss of Lotte China Foods Co., Ltd. for three months are included in the consolidated statement of comprehensive income.

Had Lotte China Foods Co., Ltd. been consolidated from January 1, 2012, the consolidated statement of comprehensive income would show sales of ₩ 50,276 million and net loss of ₩ 275 million.

37. Transactions with Non-controlling Interests

The Company obtained control over Lotte (China) Investment Co., Ltd. by capital increase with consideration on August 21, 2012. Accordingly, 10% interest of Lotte Qingdao Foods Co., Ltd. and 6.38% of Lotte Ice (Shandong) Co., Ltd. held by Lotte (China) Investment Co., Ltd. were included in the controlling interests. Non-controlling interests amounting to ₩3,341 million were eliminated as a result of the above transactions and ₩1,645 million were recognized as deduction from the equity attributable to the Parent Company's shareholders. Effects on equity attributable to the Parent

Lotte Confectionery Co., Ltd. and Subsidiaries
Notes to Consolidated Financial Statements
December 31, 2012 and 2011

Company's shareholders as the changes in ownership interests in Lotte Qingdao Foods Co., Ltd. and Lotte Ice (Shandong) Co., Ltd. are as follows:

<i>(In millions of Korean won)</i>	Lotte Qingdao Foods Co., Ltd.	Lotte Ice (Shandong) Co., Ltd.	Total
Carrying amount of non-controlling interests acquired	2,815	526	3,341
Consideration paid to non-controlling interests	(5,404)	(939)	(6,343)
Difference	(2,589)	(413)	(3,002)
Excess of consideration paid recognized in parent's equity	(1,419)	(226)	(1,645)
Excess of consideration paid recognized in non-controlling equity	(1,170)	(187)	(1,357)

38. Supplemental Cash Flow Information

Significant transactions not affecting cash flows for the years ended December 31, 2012 and 2011, are as follows:

<i>(in millions of Korean won)</i>	2012	2011
Reclassification of construction in-progress to property, plant and equipment	69,287	58,592
Reclassification to current portion of debentures	-	289,358
Disposal of a subsidiary in return of equity securities	-	11,226
Exchange of available-for-sale securities	631,339	-

39. Events after the Reporting Period

(1) Merger with Kirin Food Co., Ltd.

The Parent Company decided to merge with Kirin Food Co., Ltd. to increase management efficiency through a merger of entities in the similar industry as approved by the Board of Directors on February 27, 2013. The merger date is April 1, 2013, with a merger ratio of 1:0. This merger will be implemented as a small scale merger under the Commercial Code.

(2) Acquisition of additional interest in Lotte (China) Investment Co., Ltd.

Additional acquisition of Lotte (China) Investment Co., Ltd. interest is in progress by Lotte Food Holdings Co., Ltd., which is wholly owned by the Parent Company. As of December 31, 2012, Lotte Food Holdings Co., Ltd. had 54.8% interest in Lotte (China) Investment Co., Ltd. and the percentage of shareholding will be 100% after the acquisition is completed.