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INTERNATIONAL FLAVORS & FRAGRANCES INC
Form 8-K
July 27, 2005

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 8-K

CURRENT REPORT
PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

Date of report (Date of earliest event reported) July 27, 2005

INTERNATIONAL FLAVORS & FRAGRANCES INC.

(Exact Name of Registrant as Specified in Charter)

New York	1-4858	13-1432060
(State or Other Jurisdiction of Incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)
521 West 57th Street, New York, New York		10019
(Address of Principal Executive Offices)		(Zip Code)

Registrant's telephone number, including area code (212) 765-5500

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions (see General Instruction A.2. below):

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 2.02. Results of Operations and Financial Condition

Attached and being furnished hereby as Exhibit 99.1 is a copy of a press release of International Flavors & Fragrances Inc. ("IFF" or "the Company") dated July 27, 2005 reporting IFF's financial results for the second quarter and six months ended June 30, 2005.

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The discussion of the Company's historical results and its commentary regarding expected future results include and, where indicated, exclude the impact of sales and operating results attributable to certain non-core business disposed of in 2004, the impact of certain restructuring and other charges recorded in 2004, as well as the effects of exchange rate fluctuations. Such information is supplemental to information presented in accordance with generally accepted accounting principles (GAAP) and is not intended to represent a presentation in accordance with GAAP. In discussing its historical and expected future results and financial condition, the Company believes it is meaningful for investors to be made aware of and to be assisted in a better understanding of, on a period-to-period comparative basis, the impact of sales and operating results attributable to the business disposed of, the relative impact of the restructuring and other charges, as well as ongoing exchange rate fluctuations on the Company's operating results and financial condition. The Company believes that this additional non-GAAP information provides investors with an overall perspective of the period-to-period performance of the Company's core business. In addition, management internally reviews each of these non-GAAP financial measures to evaluate performance on a comparative period-to-period basis in terms of absolute performance, trends and expected future performance with respect to its core continuing business.

Item 9.01. Financial Statements and Exhibits

(c) Exhibits

- 99.1 Press Release of International Flavors & Fragrances Inc., dated July 27, 2005.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

INTERNATIONAL FLAVORS & FRAGRANCES INC.

Dated: July 27, 2005

By: /s/ Douglas J. Wetmore

Name: Douglas J. Wetmore
Title: Senior Vice President and
Chief Financial Officer

FOR IMMEDIATE RELEASE

IFF REPORTS SECOND QUARTER RESULTS

UPDATES 2005 GUIDANCE

New York, N.Y., July 27, 2005 ... International Flavors & Fragrances Inc. (NYSE: IFF) ("IFF" or "the Company") reported earnings per share for the second quarter 2005 of \$.60 compared to \$.59 in the prior year quarter. The 2004 second quarter results included sales and operating results of the European fruit preparations business which was disposed of in the second half

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of the year; 2004 results also included \$7.7 million (\$5.0 million after tax or \$.06 per share) of restructuring and other charges related primarily to the impairment of the fruit business assets. On an as-adjusted basis, excluding both the sales and operating results of the fruit business and the effects of the charges related to the disposition, 2004 second quarter earnings per share would have been \$.63.

Second quarter 2005 sales totaled \$515.6 million, declining 2% in comparison to the prior year, as reported. Sales for the 2005 quarter benefited from the strengthening of various currencies, particularly the Euro, in relation to the U.S. dollar; had exchange rates remained constant, sales for the quarter would have decreased 4% in comparison to the prior year quarter. Fragrance sales increased 5% while flavor sales decreased 9%; on a local currency basis, fragrance sales grew 2% while flavor sales declined 11%.

Flavor sales in the 2005 quarter were impacted by the disposition, in the second half of 2004, of the Company's European fruit preparations business. On an as-adjusted basis, excluding \$21.6 million in sales attributable to the fruit business from the 2004 second quarter, consolidated sales for the current quarter would have increased 3% in dollars and been flat in local currency; on the same basis, flavor sales would have declined 2% in local currency and been flat in dollars. Flavor sales, most notably in North America and Europe, were also unfavorably impacted by lower selling prices for naturals, mainly vanilla. Also in the quarter, as previously disclosed, the Company experienced a slowdown in flavor sales for products that included a contaminated raw material received from a supplier. As a result of associated production and shipment delays while quarantined raw materials were tested, second quarter sales were negatively impacted by approximately \$5.0 million (1.0% of the quarter's sales).

Fragrance sales were led by fine fragrance which increased 12% in dollars and 9% in local currency; the fine fragrance performance reflected the benefit of a number of new product wins. Chemical sales increased 6% in dollars and 3% in local currency while sales of functional fragrances were flat in dollars and declined 2% in local currency.

"Our focus on technological innovation and superior service is creating positive momentum throughout the Company," said Richard A. Goldstein, Chairman and Chief Executive Officer of IFF. "In addition to new wins during the quarter, IFF also received the fragrance industry's highest award for our unique Sensory Perception(TM) technology. With proprietary technology like this and our focus on operating excellence, I believe IFF will successfully manage through this difficult pricing environment and drive growth for our shareholders. The recent dividend increase and new share repurchase program underscore the confidence we have in our Company and its future."

Sales performance by region for the 2005 second quarter compared to the prior year quarter follows:

- North America flavor sales declined 10% and fragrance sales were flat; in total, regional sales declined 5%. Aroma chemical and functional fragrance sales declined 2% and 3%, respectively, while fine fragrances increased 4%. New fragrance wins drove the fine fragrance performance for the quarter.
- European fragrance sales increased 8% while flavor sales declined 21%; in total, regional sales declined 5%. Reported sales benefited from the strength of the Euro and Pound Sterling; local currency sales declined 9%. Local currency fragrance sales increased 2%; aroma chemical and fine fragrance sales increased 4% and 11%, respectively, while functional fragrances declined 8%. Local currency flavor sales declined 25%, mainly as a result of the disposition of the fruit preparations business. On an

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- as-adjusted basis, excluding sales attributable to this business from the 2004 results, 2005 flavor sales would have increased 4% in dollars and decreased 1% in local currency; this local currency decline was primarily the result of the raw material matter, previously discussed.
- Asia Pacific sales declined 2% as a result of a local currency sales decline of 4%. Fragrance sales decreased 6% in dollars and 8% in local currency. Local currency functional fragrance sales declined 15%, mainly due to weak demand in Singapore, Malaysia, Thailand and Australia. Local currency flavor sales declined 1%, resulting in a 1% increase in reported dollars. For the region, Greater China, Vietnam and Singapore were strongest, with respective local currency flavor sales increases of 11%, 11% and 17%; the flavor growth was offset by weakness in the Philippines, Indonesia and Australia which declined 7%, 9% and 6%, respectively.
 - Latin American sales increased 13% with fragrance and flavor sales increasing 13% and 14%, respectively. For the region, sales growth was strongest in Argentina, Brazil and Mexico which grew 21%, 17% and 15%, respectively. Fragrance sales were strongest in Argentina, Brazil and Mexico, with respective increases of 27%, 15% and 15%. Fragrance sales grew in all categories with increases of 15%, 12% and 14% in fine fragrances, functional fragrances and aroma chemical sales, respectively. Flavor sales were led by respective increases of 18%, 21% and 23% in Mexico, Columbia and Brazil.
 - India reported 16% sales growth in local currency and 17% in dollars. Local currency fragrance sales increased 16% and 18% in dollars, while flavor sales increased 17% in both local currency and dollars. In both flavors and fragrances, the sales performance reflected the benefit of new product introductions.

Net income, as reported for the 2005 quarter was flat with the prior year quarter; excluding the impact of restructuring and other charges from the 2004 quarter, net income declined 8%. The decline in net income was partially due to the disposition of the European fruit business; 2004 results included \$1.9 million in net income attributable to this business. Proceeds from the disposition were used to reduce debt but profits related to the Fruit business were not replaced by interest expense savings. In the quarter, gross profit, as a percentage of sales, was 42.0% compared to 43.6% in the prior year. The gross margin decline was mainly attributable to increased raw material costs and customer resistance to price increases, as well as lower selling prices for naturals, most notably vanilla. Gross margin was also impacted by costs attributable to the raw material matter noted above; in the quarter, the Company expensed approximately \$3.0 million in associated costs, comprised mainly of additional testing costs and the write-off of affected materials. As

previously announced the Company will seek full indemnification from its supplier, the supplier's insurers and, to the extent required, its own insurers with regard to any potential costs and customer claims. Research and Development ("R&D") expenses totaled 8.6% of sales compared to 8.5% in the prior year quarter, consistent with the Company's intended level of R&D spending. Selling, General and Administrative ("SG&A") expenses, as a percentage of sales, increased to 16.1% from 15.9%. SG&A expenses include \$2.1 million of equity compensation expense compared to \$0.8 expense included in the 2004 second quarter results. However, this increase was partially offset by lower accruals under the Company's various incentive plans compared to the 2004 quarter. Interest expense decreased 1% from the prior year. The effective tax rate for the 2005 second quarter was 30.8% compared to 31.2% reported in the prior year quarter; variations in the effective rate are mainly attributable to fluctuations in earnings in the countries in which the Company operates.

For the six-month period ended June 30, 2005, sales totaled \$1,038.6 million, declining 2% in comparison to the prior year period, as reported. Reported sales for 2005 benefited from the strengthening of various currencies,

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particularly the Euro, in relation to the U.S. dollar; had exchange rates remained constant, sales for the six-month period ended June 30, 2005 would have decreased 4% compared to the prior year period. For the 2005 period, fragrance sales increased 4% while flavor sales declined 9%; on a local currency basis, fragrance sales grew 2% while flavor sales declined 11%.

Flavor sales in the 2005 period were impacted by the disposition, in the second half of 2004, of the Company's European fruit preparations business. On an as-adjusted basis, excluding \$46.2 million in sales attributable to the fruit business from the 2004 period, 2005 sales would have increased 1% in dollars and declined 2% in local currency. Flavor sales, most notably in North America and Europe, were also unfavorably impacted by lower selling prices for naturals, mainly vanilla, and by the raw material matter that occurred in the 2005 second quarter, as discussed above.

Sales performance by region for the 2005 six-month period compared to the prior year follows:

- North America fragrance and flavor sales declined 2% and 9%, respectively; in total, regional sales declined 5%. Functional fragrance and fine fragrance sales declined 5% and 1%, respectively, while aroma chemical sales increased 3%. Sales of both fragrances and flavors had a difficult comparative with the first half of 2004 when sales grew 10% and 11%, respectively.
- Europe sales declined 10% in local currency and 5% in dollars. Fragrance sales increased 2% in local currency, resulting in an 8% increase in reported dollar sales. Local currency fine fragrance sales increased 14%, driven mainly by new wins, while functional fragrances declined 7% and aroma chemical sales were flat. Local currency flavor sales declined 25% mainly as a result of the disposition of the fruit preparations business. On an as-adjusted basis, excluding sales attributable to this business from the 2004 results, 2005 flavor sales would have increased 4% in dollars and declined 1% in local currency. Product contamination issues also impacted flavor sales in Europe (discussed above).
- Local currency sales in Asia Pacific decreased 1%, resulting in a 1% increase in reported dollar sales. Fragrance sales decreased 3% in local currency and 2% in reported dollars; local currency flavor sales increased 1% and 3% in reported dollars. For the region, sales growth was strongest in Vietnam and China, with respective local currency increases of 59% and 4%.
- Latin American sales increased 9% in comparison to the prior year. Flavor sales increased 10%, benefiting from increases of 9%, 15% and 26% in Argentina, Brazil and Mexico, respectively. Fragrance sales increased 9% with Argentina, Mexico and Brazil increasing 22%, 7% and 11%, respectively.
- India sales increased 15% in local currency and 16% in reported dollars. This performance was led by a 17% local currency increase in flavor sales with fragrance sales increasing 13% in comparison to the prior year period. In both flavors and fragrances, the sales performance reflected the benefit of new wins.

Net income for the six-month period ended June 30, 2005 decreased 3% in comparison to the prior year, as reported; excluding the impact of restructuring and other charges from the 2004 results, net income declined 7%. The decline in net income was partially due to the disposition of the European fruit business; 2004 results included income approximating \$4.2 million attributable to this business. As noted above, proceeds from the disposition were used to reduce debt but profits related to the Fruit business were not replaced by interest expense savings. Gross profit, as a percentage of sales, was 41.5% compared to 43.1% in the prior year period. The gross margin decline was mainly attributable to increased raw material costs and customer

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resistance to price increases, as well as lower selling prices for naturals, most notably vanilla. Gross margin was also impacted by the \$3.0 million costs attributable to the product contamination matter in the second quarter 2005. R&D expenses totaled 8.6% of sales, consistent with the Company's intended level of R&D spending. SG&A expenses, as a percentage of sales, were 16.1% compared to 16.3% reported in the prior year period. Interest expense decreased 7% from the prior year due to lower average borrowings in 2005 compared to the prior year. The effective tax rate for the six-month period ended June 30, 2005 and 2004 was 31.0% and 31.3%, respectively; variations in the effective rate are mainly attributable to fluctuations in earnings in the countries in which the Company operates.

Outlook for 2005

IFF currently expects 2005 local currency sales to decrease in the low-single digits in comparison to 2004 sales as reported; based on current exchange rates, such local currency performance is expected to result in a low-single digit decrease in reported dollars. For purposes of this comparison, 2004 sales include \$58 million of sales attributable to the European fruit preparations business. Excluding fruit sales from the 2004 comparative, IFF expects 2005 local currency sales to increase in the low-single digits in comparison to 2004; based on current exchange rates, this local currency growth is expected to result in a low-single digit increase in reported dollars.

Gross profit as a percentage of sales is expected to remain at approximately the same levels as reported for the first half of 2005. Margins are expected to remain under pressure due to anticipated increased supply chain costs including the impact of the raw material costs as well as expected delays in fully implementing price increases. The expected margin also contemplates costs associated with the product contamination issue; the Company has included all costs that it is aware of or has incurred as a result of the raw material contamination. As previously announced, the Company will seek full indemnification from its supplier, the supplier's insurers and, to the extent required, its own insurers with regard to any potential claims; there can be no assurance, however, of the final outcome of any claims made, or of the timing or extent of indemnification from the supplier and its insurers. R&D expenses are expected to approximate 9% of sales, consistent with the Company's intended level of R&D spending. R&D spending will increase somewhat as a percentage of sales in comparison to 2004, mainly as a result of the

elimination of the fruit preparations business; relative to other parts of the business, fruit preparations required less R&D as a percentage of sales. In 2005, SG&A expenses, as a percentage of sales, are expected to increase somewhat from 2004 levels, mainly from inclusion of an expected \$11.0 million - \$14.0 million in equity compensation expense in 2005, compared to \$5.0 million of such expense in 2004. In May 2004, the Company began using Restricted Stock Units ("RSU's"), rather than stock options, as an element of the Company's incentive compensation plans for all eligible U.S. - based employees and a majority of eligible overseas employees. Vesting of the RSU's for the Company's senior management is performance and time based; for the remainder of eligible employees, vesting is time based (generally over a three year period). The actual expense will depend upon the value of the Company's stock and the number of RSU's granted. Interest expense is expected to decline 10% - 12% from 2004. The Company expects the effective tax rate in 2005 to approximate 31.0%. This tax rate does not contemplate the effect, if any, that may arise as a result of repatriation from overseas subsidiaries as envisioned under the American Jobs Creation Act of 2004; the Company expects to determine the amounts and sources, if any, of foreign earnings to be repatriated in the second half of 2005.

Based on the foregoing, IFF currently expects earnings per share for 2005 to

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be in the range of \$2.08 to \$2.18 compared to \$2.05 reported in 2004. Excluding restructuring and other charges representing \$.22 per share, 2004 results per share were \$2.27.

About IFF

IFF is a leading creator and manufacturer of flavors and fragrances used in a wide variety of consumer products--from fine fragrances and toiletries, to soaps, detergents and other household products, to beverages and food products. IFF is dedicated to The Pursuit of Excellence in every area of its business, using knowledge, creativity, innovation and technology to continually provide customers with the highest quality products and service and superior consumer understanding.

IFF has sales, manufacturing and creative facilities in 31 countries worldwide. For more information, please visit our Web site at www.iff.com.

Cautionary Statement Under the Private Securities Litigation Reform

Act of 1995

Statements in this report, which are not historical facts or information, are "forward-looking statements" within the meaning of The Private Securities Litigation Reform Act of 1995. Such forward-looking statements are based on management's reasonable current assumptions and expectations. Certain of such forward-looking information may be identified by such terms as OexpectO, ObelieveO, OmayO, "outlook", "guidance" and similar terms or variations thereof. All information concerning future revenues, tax rates or benefits, interest savings, and other future financial results or financial position, constitutes forward-looking information. Such forward-looking statements are based on management's reasonable current assumptions and expectations. Such forward-looking statements involve risks, uncertainties and other factors, which may cause the actual results of the Company to be materially different from any future results expressed or implied by such forward-looking statements, and there can be no assurance that actual results will not differ materially from management's expectations. Such factors include, among others, the following: general economic and business conditions in the Company's markets, including economic, population health and political uncertainties; interest rates; the price, quality and availability of raw materials; the Company's ability to implement its business strategy, including the achievement of anticipated cost savings, profitability and growth targets; the impact of currency fluctuation or devaluation in the Company's principal foreign markets and the success of the Company's hedging

and risk management strategies; the outcome of uncertainties related to litigation; uncertainties related to any potential claims and rights of indemnification or other recovery for customer and consumer reaction to the contamination issue; the impact of possible pension funding obligations and increased pension expense on the Company's cash flow and results of operations; and the effect of legal and regulatory proceedings, as well as restrictions imposed on the Company, its operations or its representatives by foreign governments. The Company intends its forward-looking statements to speak only as of the time of such statements and does not undertake to update or revise them as more information becomes available or to reflect changes in expectations, assumptions or results.

Conference call

There will be a conference call today at 10:00 AM Eastern Time, at which time the Company will discuss operating results for the second quarter 2005, and its current expectations for 2005. The dial in number for U.S.-based participants is 1-888-202-2422; for international participants, the number is

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1-913-981-5592. The pass code for the call is 4993754.

A replay of the conference call will be available from 1:00 PM Eastern Time beginning on Wednesday July 27, 2005 and ending at Midnight on Wednesday, August 10. The dial in number for the replay for U.S.-based listeners is 1-888-203-1112; for international listeners, the number is 1-719-457-0820. The replay pass code will be 4993754.

The call can also be monitored via the World Wide Web at www.iff.com. Real Network's Real Player or Microsoft Media Player is required to access the webcast. They can be downloaded from www.real.com or www.microsoft.com/windows/mediaplayer. A replay of the conference call will be available on the Company's website for twelve months.

Contact

Douglas J. Wetmore
Senior Vice President and Chief
Financial Officer
Phone: 212-708-7145

International Flavors & Fragrances Inc.
Consolidated Income Statement
(Amounts in thousands except per share data)
(Unaudited)

	Quarter Ended June 30		
	As Reported 2004	Adjustments (A)	As-ad 20
Net Sales	\$224,177	\$21,622	\$50
Cost of goods sold	295,716	16,580	27
Gross margin on sales	228,461	5,042	22
Research & development	44,342	612	4
Selling and administrative	83,184	1,654	8
Amortization	3,709	-	
	97,226	2,776	9
Restructuring and other charges	(7,716)	-	(
Interest expense	(6,114)	-	(
Other income (expense), net	(1,305)	-	(
Pretax income	82,091	2,776	7
Income taxes	25,589	865	2
Net income	\$56,502	\$1,911	\$5
Including restructuring and other charges:			

Net income	\$56,502		\$5
Earnings per share - basic	\$0.60		

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Earnings per share - diluted \$0.59

Excluding restructuring and other charges:

Net income	\$61,517	\$5
Results per share - basic	\$0.65	
Results per share - diluted	\$0.65	

(A) Adjustments reflect elimination of sales and operating results of the European fruit preparations business for the period presented. Additional details regarding as-adjusted information are contained in a January 25, 2005 Form 8-K filed with the SEC and are also available via the Company's website.

International Flavors & Fragrances Inc.
Consolidated Income Statement
(Amounts in thousands except per share data)
(Unaudited)

	Six Months Ended June 30,		
	As Reported 2004	Adjustments (A)	As-adjust 2004
Net Sales	\$1,059,192	\$46,238	\$1,012,954
Cost of goods sold	602,502	35,507	566,995
Gross margin on sales	456,690	10,731	445,959
Research & development	88,990	1,239	87,751
Selling and administrative	172,910	3,431	169,479
Amortization	7,408	-	7,408
Restructuring and other charges	187,382	6,061	181,321
Interest expense	(7,716)	-	(7,716)
Other income (expense), net	(12,571)	-	(12,571)
Pretax income	(2,730)	-	(2,730)
Income taxes	164,365	6,061	158,304
Net income	51,505	1,900	49,605
Net income	\$112,860	\$4,161	\$108,699
Including restructuring and other charges:			
Net income	\$112,860		\$108,699
Earnings per share - basic	\$1.20		\$1.08
Earnings per share - diluted	\$1.19		\$1.07
Excluding restructuring and other charges:			
Net income	\$117,875		\$113,860
Results per share - basic	\$1.25		\$1.13
Results per share - diluted	\$1.24		\$1.12

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(A) Adjustments reflect elimination of sales and operating results of the European fruit preparations business for the period presented. Additional details regarding as-adjusted information are contained in a January 25, 2005 Form 8-K filed with the SEC and are also available via the Company's website.

International Flavors & Fragrances Inc.
Consolidated Condensed Balance Sheet
(Amounts in thousands)
(Unaudited)

	December 31, 2004	June 2005
Cash & short-term investments	\$ 32,995	\$ 60
Receivables	358,361	387
Inventories	457,204	432
Other current assets	112,810	103
Total current assets	961,370	983
Property, plant and equipment, net (1,2)	501,334	484
Goodwill and other intangibles, net	789,676	782
Other assets	110,914	117
Total assets	\$2,363,294	\$2,367
Commercial paper/bank borrowings, overdrafts and current portion of long-term debt (3)	\$ 15,957	\$ 614
Other current liabilities	383,565	326
Total current liabilities	399,522	941
Long-term debt (3)	668,969	139
Non-current liabilities	384,316	397
Shareholders' equity	910,487	888
Total liabilities and shareholders' equity	\$2,363,294	\$2,367

Notes:

-
- | | | |
|-----------------------|---------------|--------------|
| 1. Capital spending - | Quarter: | \$22 million |
| | Year-to-date: | \$38 million |
| 2. Depreciation - | Quarter: | \$19 million |
| | Year-to-date: | \$38 million |

3. At December 31, 2004 and June 30, 2005 long-term debt includes unamortized gains and FAS 133 mark to market adjustments of \$23.8 million and \$16.5 million, respectively, on various interest rate swaps the Company has entered into; such gains have been deferred and are being amortized over the remaining term of the underlying debt and the mark to market adjustment is recorded each quarter.

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Average Shares Outstanding (in thousands):

Second quarter:	2004	2005
Basic	94,136	93,876
Diluted	95,330	95,255
Year-to-date:	2004	2005
Basic	94,085	94,100
Diluted	95,228	95,640

Quarter ended June 30, 2005 As Reported

% Change in Sales by Area of Destination	Fragrances	Flavors
North America	-	(10)
Europe - Reported	8	(21)
Europe - Local Currency	2	(25)
Latin America	13	14
Asia Pacific - Reported	(6)	1
Asia Pacific - Local Currency	(8)	(1)
India - Reported	18	17
India - Local Currency	16	17
Total - Reported	5	(9)
Total - Local Currency	2	(11)

Quarter ended June 30, 2005 Compared to 2004 As-Adjusted

Excluding Sales Attributable to European Fruit Preparations Business

% Change in Sales by Area of Destination	Fragrances	Flavors
North America	-	(10)

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Europe - Reported	8	4

Europe - Local Currency	2	(1)
Latin America	13	14
Asia Pacific - Reported	(6)	1

Asia Pacific - Local Currency	(8)	(1)
India - Reported	18	17

India - Local Currency	16	17
Total - Reported	5	-

Total - Local Currency	2	(2)

Six-months ended June 30, 2005 As Reported

% Change in Sales by Area of Destination	Fragrances	Flavors
--	------------	---------

North America	(2)	(9)
Europe - Reported	8	(22)

Europe - Local Currency	2	(25)
Latin America	9	10
Asia Pacific - Reported	(2)	3

Asia Pacific - Local Currency	(3)	1
India - Reported	15	17

India - Local Currency	13	17
Total - Reported	4	(9)

Total - Local Currency	2	(11)

Six-months ended June 30, 2005 Compared to 2004 As-Adjusted

Excluding Sales Attributable to European Fruit Preparations Business

% Change in Sales by Area of Destination	Fragrances	Flavors
--	------------	---------

North America	(2)	(9)
---------------	-----	-----

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Europe - Reported	8	4

Europe - Local Currency	2	(1)
Latin America	9	10
Asia Pacific - Reported	(2)	3

Asia Pacific - Local Currency	(3)	1
India - Reported	15	17

India - Local Currency	13	17
Total - Reported	4	1

Total - Local Currency	2	(2)

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2015

2016

2017

Gravity Interactive, Inc.⁽¹⁾

27{3}

27{3}

33{3}

NeoCyon, Inc.⁽¹⁾

168{9}

140{9}

200{9}

Gravity Games Corporation⁽¹⁾

1{1}

1{1}

1{1}

Gravity Entertainment Corporation

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—

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Total

196

168

234

Note:

(1)The number in { } is the number of employees (who are included in the total number) seconded from us.

None of the employees of Gravity Interactive, NeoCyon or Gravity Games is represented by a labor union or covered by a collective bargaining agreement. Gravity Entertainment does not have any employees because it has no significant operations.

We have entered into a standard annual employment contract with most of our officers, managers and employees. These contracts include a covenant that prohibits the relevant officer, manager or employee from engaging in any activities that compete with our business during, and for six months after, the period of their employment with our company.

Under the severance payment plan that we have established in accordance with the Employee Retirement Benefit Security Act, employees with more than one year of service with us are entitled to receive a lump sum payment upon voluntary or involuntary termination of their employment. The amount of the benefit equals the employee's monthly salary, calculated by averaging the employee's daily salary for the three months prior to the date of the employee's departure, multiplied by the number of continuous years of employment. As of December 31, 2017, we provided Won 208 million (US\$195 thousand) to 173 employees as severance payment, being 100% of our severance liability as of such date.

Pursuant to the Korean National Pension Law, we are required to pay 4.5% of each employee's standard monthly income to the National Pension Corporation. Our employees are also required to pay 4.5% of their standard monthly income to the National Pension Corporation each month. Our employees are entitled to receive an annuity in the event they lose, in whole or in part, their wage earning capability. Our employees can receive pension payments upon making a claim when they reach a certain age or lose all or part of their income due to disability, such as by receiving age pension payments when they reach the age of 60 after being registered for the national pension plan for at least 10 years and disability pension payments when a disease or illness acquired during the time they were registered for the national pension plan leaves a disability even after the disease or illness that originally caused the disability is cured. The total amount of contributions we, including our subsidiaries in Korea, made to the National Pension Corporation in 2016 and 2017 was Won 1,100 million and Won 1,114 million (US\$1,044 thousand), respectively.

ITEM 6.E. SHARE OWNERSHIP

None of our current directors or officers beneficially owns our common shares.

Stock option plan

Under our articles of incorporation, we may grant options for the purchase of our shares to certain qualified directors, officers and employees. Set forth below are the details of our stock option plan as currently contained in our articles of incorporation:

Stock options may be granted to our officers and employees who have contributed or are qualified to contribute to our establishment, management and technical innovation. Notwithstanding the foregoing, no stock options may be granted to any person who is (i) our largest shareholder, (ii) a holder of 10% or more of our shares outstanding, (iii) certain specially related persons of the person set forth in (i) and (ii) above, or (iv) a shareholder who would own 10% or more of our shares upon exercise of options granted under the stock option plan; provided, however, that those who fall under the specially related persons upon becoming one of the officers of the concerned company (including part time officers of the affiliated company) shall be excluded from item (iii) above;

- Stock options may be granted by a special resolution of our shareholders with the aggregate number of shares issuable not to exceed 10% of the total number of our then issued and outstanding common shares;

Upon exercise of stock options, we deliver our common shares or pay in cash the difference between the market price of our shares and the option exercise price;

The number of officers and employees subject to grant of stock options shall not exceed 90% of the currently employed officers and employees, and the stock option granted to an officer or an employee shall not exceed 10% of the total issued and outstanding shares;

Stock options granted under the stock option plan, in case new shares are issued, have a minimum exercise price equal to the higher of (i) the market price of our shares calculated pursuant to the method under the Inheritance and Gift Tax Law and (ii) the par value of our shares, and in other cases, have a minimum exercise price equal to or higher than the market price of our shares calculated pursuant to the method under the Inheritance and Gift Tax Law;

Stock options may be exercisable by a person who is granted a stock option and has served the Company for two or more years from the date of the special resolution of shareholders granting such stock options; provided, that stock options may be exercised by, or on behalf of, a person that dies, retires or resigns due to any cause not attributable to himself/herself before the completion of such two year period;

Stock options can vest after two years from the stock option grant date and can be exercised up to five years from the vesting date; and

Stock options may be cancelled by a resolution of our Board of Directors if (i) the officer or employee who holds the option voluntarily retires after being granted stock options, (ii) the officer or employee who holds the option causes material damage to us by willful misconduct or negligence, (iii) we are unable to deliver our shares or pay the prescribed amount due to bankruptcy or dissolution, or (iv) the occurrence of any cause for cancellation of stock options specified in the stock option agreement.

Each stock option confers the right to the grantee to purchase one share of our common stock at the exercise price. On December 24, 2004, our shareholders approved the implementation of our employee stock option plan and the granting of stock options under this plan to our directors, officers and employees. All the stock options granted on December 24, 2004 have expired. There are no stock options exercisable as of December 31, 2017.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

ITEM 7.A. MAJOR SHAREHOLDERS

The table below sets forth information known to us with respect to the beneficial ownership of our common shares as of April 20, 2018, by each person known to us to own beneficially 5% or more of our common shares based on 6,948,900 common shares outstanding. None of our common shares entitles the holder to any preferential voting rights. Beneficial ownership is determined in accordance with the Exchange Act and the rules and regulations promulgated thereunder and includes the power to direct the voting or the disposition of the securities or to receive the economic benefit of the ownership of the securities.

Name	Number of Shares Beneficially Owned	Percentage Beneficially Owned	%
GungHo Online Entertainment, Inc.	4,121,737	59.3	%

To the best of our knowledge, as of December 31, 2017, approximately 47.1% of our common shares was held in the United States (in the form of ADSs). Also to the best of our knowledge, we had approximately 2,074 beneficial holders of our shares (in the form of ADSs) in the United States as of December 31, 2017. As of the date hereof, our largest shareholder GungHo beneficially owns 59.3% of the voting power of our common shares.

ITEM 7.B. RELATED PARTY TRANSACTIONS

As further disclosed in Note 22 of notes to our consolidated financial statements included elsewhere in this Annual Report, we engage in transactions with our related parties, including our largest shareholder, from time to time, involving the sale of our products to, and the purchase of products and services from, such related parties.

Relationship with GungHo Online Entertainment, Inc.

On April 1, 2008, GungHo acquired 3,640,619 shares of our common stock, which was approximately 52.4% of our total shares. On June 23, 2008 and June 24, 2008, GungHo acquired our ADSs representing 450,554.25 and 30,565.25 shares of the Company, respectively. As of April 20, 2018, GungHo beneficially owns approximately 4,121,737 shares of the Company's common stock, constituting approximately 59.3% of the total issued and outstanding common shares. See ITEM 3.D. "Risk Factors—RISKS RELATING TO OUR COMPANY STRUCTURE—GungHo, the publisher of our games in Japan, our principal market in terms of revenues, is our majority shareholder, which gives them control of our board of directors."

In July 2002, we entered into an agreement with GungHo, formerly known as OnSale, Inc., for the service and distribution of Ragnarok Online in Japan, which was renewed in September 2004, August 2006, September 2009, September 2012, September 2015 and September 2017.

In December 2005, we entered into a software licensing agreement with GungHo for the right to publish and distribute Emil Chronicle Online worldwide, except for Japan, which was renewed in August 2010, August 2011, August 2012, August 2013, August 2014, August 2015 and August 2016. Such agreement expired in August 2017.

In September 2006, we entered into a license and distribution agreement with GungHo for Ragnarok Online II in Japan, under which we received US\$5,000 thousand from GungHo as license fees until the agreement was terminated

in February 2016. We agreed to refund the US\$5,000 thousand in initial payments received from GungHo in four equal payments by the end of December 2017, which repayments were duly made.

In August 2012, we entered into a co-development agreement with GungHo to develop Ragnarok Odyssey Ace for the PlayStation Vita platform, which was amended in January 2013, June 2013 and February 2017.

In May 2010, we entered into a license with GungHo to commercialize the merchandise business using Ragnarok Online game characters within Japan, which was amended in May 2012, May 2014, May 2016 and September 2017.

Mr. Hyun Chul Park, our Chief Executive Officer, Mr. Yoshinori Kitamura, our Chairman of the Board of Directors and Chief Operating Officer, Mr. Kazuki Morishita, our Executive Director, and Mr. Kazuya Sakai, our Executive Director, have been General Manager, Director and Executive General Manager, President and Chief Executive Officer, and Chief

Financial Officer and Director of GungHo, respectively.

ITEM 7.C. INTERESTS OF EXPERTS AND COUNSEL

Not applicable.

ITEM 8. FINANCIAL INFORMATION

ITEM 8.A. CONSOLIDATED STATEMENTS AND OTHER FINANCIAL INFORMATION

FINANCIAL STATEMENTS

All relevant financial statements are included in “ITEM 18. FINANCIAL STATEMENTS.”

LEGAL PROCEEDINGS

As of the date hereof, we are not involved in any lawsuit or other proceeding the outcome of which we believe may, individually or taken as whole, have a material adverse effect on our business, results of operations or financial condition.

DIVIDEND POLICY

Since our inception, we have not declared or paid any dividends on our common shares. Any decision to pay dividends in the future will be subject to a number of factors, including cash requirements for future capital expenditures and investments, and other factors our Board of Directors may deem relevant. We have no intention to pay dividends in the near future. Consequently, we cannot give any assurance that any dividends may be declared and paid in the future. Holders of outstanding common shares on a dividend record date will be entitled, subject to applicable withholding taxes, to the full dividend declared without regard to the date of issuance of the common shares or any subsequent transfer of the common shares. Payment of annual dividends in respect of a particular year, if any, will be made in the following year after approval by our shareholders at the annual general meeting of shareholders or, if (i) an external auditor gives an unqualified opinion to the financial statement and (ii) all members of the audit committee unanimously agree, after approval by the Board of Directors, and payment of interim dividends, if any, will be made in the same year after approval by our Board of Directors, in each case, subject to certain provisions of our articles of incorporation and the Korean Commercial Code. All dividends may be paid in cash, by shares or by other properties (in kind). See ITEM 10.B. “MEMORANDUM AND ARTICLES OF INCORPORATION—Dividends.”

Subject to the terms of the deposit agreement for the ADSs, you will be entitled to receive dividends on common shares represented by ADSs to the same extent as the holders of common shares, less the fees and expenses payable under the deposit agreement in respect of, and any Korean tax applicable to, such dividends. See ITEM 10.E. “TAXATION—KOREAN TAXATION.” The depository will generally convert the Won it receives into U.S. dollars and distribute the U.S. dollar amounts to you. For a description of the U.S. federal income tax consequences of dividends paid to our shareholders, see ITEM 10.E. “TAXATION—MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS.”

ITEM 8.B. SIGNIFICANT CHANGES

We have not experienced any significant changes since the date of our audited consolidated financial statements included in this Annual Report.

ITEM 9. THE OFFER AND LISTING

ITEM 9.A. OFFER AND LISTING DETAILS

Common Stock

Our common shares are not listed on any stock exchange or organized trading market, including in Korea. There is no public market for our common shares, although a small number of our common shares are traded in off market transactions involving private sales primarily in Korea.

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American Depositary Shares

Following our initial public offering on February 8, 2005, the ADSs were issued by The Bank of New York Mellon, formerly known as The Bank of New York, as depositary and were listed on the NASDAQ Stock Market's the NASDAQ Global Market, formerly the NASDAQ National Market, under the symbol "GRVY." The ADSs were transferred to the NASDAQ Capital Market on November 26, 2014 where it continues to trade under the same symbol. On May 11, 2015, we effected a change of our ADS to common shares ratio from four ADSs to one common share (4:1) to one ADS to two common shares (1:2), which had the effect of a 1-for-8 reverse split of our ADSs. As of April 20, 2018, 1,644,102 ADSs representing 822,051 shares of our common stock were outstanding.

The table below provides the high and low trading prices for our ADSs on the NASDAQ Global Market (prior to November 26, 2014) and the NASDAQ Capital Market (from November 26, 2014) for the periods shown. Each ADS represents two shares of common stock. For ease of comparison purposes, the trading prices for our ADSs prior to May 11, 2015 have been retroactively adjusted to reflect the ratio change.

Period	Price	
	High	Low
	(In US\$)	
2012	27.76	8.64
2013	12.16	7.20
2014	10.32	4.08
2015	4.80	3.10
2016	4.80	3.68
First Quarter	3.83	3.00
Second Quarter	5.49	3.08
Third Quarter	5.52	3.65
Fourth Quarter	15.14	4.5
2017	96.44	10.48
First Quarter	39.00	10.48
Second Quarter	22.80	14.55
Third Quarter	35.08	13.18
Fourth Quarter	96.44	28.50
October	66.74	28.50
November	83.82	54.58
December	96.44	72.00
2018 (through April 20, 2018)	106.50	68.11
First Quarter	106.50	68.11
January	98.58	69.31
February	86.87	68.11
March	106.50	81.00
April (through April 20, 2018)	82.90	76.00

ITEM 9.B. PLAN OF DISTRIBUTION

Not applicable.

ITEM 9.C. MARKETS

See ITEM 9.A. "OFFER AND LISTING DETAILS."

ITEM 9.D. SELLING SHAREHOLDERS

Not applicable.

ITEM 9.E. DILUTION

Not applicable.

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ITEM 9.F. EXPENSES OF THE ISSUE

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

ITEM 10.A. SHARE CAPITAL

Not applicable.

ITEM 10.B. MEMORANDUM AND ARTICLES OF INCORPORATION

The section below provides summary information relating to the material terms of our capital stock and our articles of incorporation. It also includes a brief summary of certain provisions of the Korean Commercial Code and related Korean law, all as currently in effect.

General

Our total authorized share capital is 40,000,000 shares, which consists of common shares and convertible preferred dividend shares without voting rights (hereinafter referred to as “preferred shares”) each with a par value of Won 500 per share. Under our articles of incorporation, holders of preferred shares are entitled to dividends of not less than 1% and up to 15% of the par value of such shares, the exact rate to be determined by our Board of Directors at the time of issuance, provided that the holders of preferred shares shall be entitled to receive dividends at a rate not lower than that determined for holders of common shares. Under our articles of incorporation, we may not issue any class of shares which are redeemable.

Under our articles of incorporation, we are authorized to issue up to 2,000,000 preferred shares.

As of the date hereof, 6,948,900 common shares were issued and outstanding. We have not issued any equity securities other than common shares. All of the issued and outstanding shares are fully paid and non assessable and are in registered form. Pursuant to our articles of incorporation, we may issue additional common shares without further shareholder approval. The unissued shares remain authorized until an amendment to our articles of incorporation changes the status of the authorized shares to unauthorized shares.

Objects and Purposes

Under Article 2 of our articles of incorporation, our purpose is to engage in the following businesses: (i) consulting regarding software and development and distribution of software; (ii) software and compact disc development and sale; (iii) development of info-communications related software; (iv) production, development, distribution, sale, and licensing of and consulting regarding digital contents including game software; (v) online network game service; (vi) development of software for application packages; (vii) computer program development and sale; (viii) software import and export; (ix) electronic transactions; (x) character merchandising; (xi) animation; (xii) real estate lease; (xiii) rest area restaurant business; (xiv) media-related business; (xv) printing and publication; (xvi) production and distribution of audio and visual records; and (xvii) all businesses auxiliary to the above.

Director’s Power to Vote in Interested Transactions

Our articles of incorporation prohibit a director of ours from exercising his or her voting right in respect of any interested transactions. The amount of compensation to be provided to our directors is subject to an approval obtained at the general meeting of our shareholders. Our articles of incorporation are silent on the borrowing powers exercisable by directors, and do not prescribe any age limit for directors. Directors are appointed through the general

meeting of shareholders and an affirmative vote of the majority of the shares represented at the meeting and at least one-fourth of the total issued and outstanding shares is require required for a director's appointment.

Dividends

We may pay dividends to our shareholders in proportion to the number of shares owned by each shareholder. The common shares represented by the ADSs have the same dividend rights as our other common shares.

In general, we may declare dividends at the annual general meeting of shareholders which is held within three months after the end of each fiscal year. However, in some cases, we may also declare dividends at a meeting of the Board of Directors, if (i) an external auditor gives an unqualified opinion to our financial statements for such fiscal year and (ii) all members of the audit committee unanimously agree, after approval by the Board of Directors. In addition, we may declare any interim dividends at a meeting of the Board of Directors. All dividends may be paid in cash, by shares or by other properties (in kind). However, a dividend in shares must be distributed at par value, and dividends in shares may not exceed one half of the annual dividends.

Under the Korean Commercial Code, we may pay an annual dividend only out of the excess of our net assets, on a non consolidated basis, over the sum of (i) our stated capital, (ii) the total amount of our capital surplus reserve and earned surplus reserve accumulated up to the end of the relevant dividend period, (iii) the earned surplus reserve to be set aside for the annual dividend period and (iv) unrealized gains (the amount of net assets stated on the balance sheet increased as a result of an evaluation of the assets and liabilities in accordance with IFRS, which is not offset by unrealized losses).

We may not pay an annual dividend unless we have set aside as earned surplus reserve an amount equal to at least 10% of the cash portion of the annual dividend, or unless we have an accumulated earned surplus reserve of not less than one half of our stated capital. We may not use our legal reserves to pay cash dividends but may transfer amounts from our legal reserves to capital stock or use our legal reserves to reduce an accumulated deficit. If our legal reserves exceed 1.5 times our stated capital, the excess legal reserves may be reduced by a majority vote of the shareholders.

In addition to annual dividends, under the Korean Commercial Code and our articles of incorporation, we may pay interim dividends once during each fiscal year in case we earn more retained earnings as of the end of the first half of such year than the retained earnings not disposed of at the time of the general shareholder meeting with respect to the immediately preceding fiscal year. The decision to pay interim dividends shall be made by a resolution of the Board of Directors and is not subject to shareholder approval. Any interim dividends must be paid to the shareholders of record as of June 30 of the relevant fiscal year. We may distribute the interim dividend in cash, in shares or in other form of valuable property (in kind).

The total amount of interim dividends payable in a fiscal year shall not be more than the net assets on the balance sheet of the immediately preceding fiscal year, after deducting (i) our capital in the immediately preceding fiscal year, (ii) the aggregate amount of our capital reserves and earned surplus reserves accumulated up to the immediately preceding fiscal year, (iii) the amount relating to the immediately preceding fiscal term which is confirmed at the annual general meeting of shareholders to be distributed as profit or paid, (iv) the amount of voluntary reserves accumulated up to the immediately preceding fiscal year for special purposes pursuant to our articles of incorporation or a resolution by our shareholders, (v) the amount of earned surplus reserves that should be set aside for the current fiscal year following the interim dividend payment and (vi) unrealized gains (the amount of net assets stated on the balance sheet increased as a result of an evaluation of the assets and liabilities in accordance with IFRS). Furthermore, the rate of interim dividends for non voting preferred shares must be the same as that for our common shares.

We have no obligation to pay any dividend unclaimed for five years from the dividend payment date.

Distribution of free shares

In addition to paying dividends in shares out of our retained or current earnings, we may also distribute to our shareholders an amount transferred from our capital surplus or earned surplus reserve to our stated capital in the form of bonus shares issued free of charge, or free shares. We must distribute such free shares to all our shareholders in proportion to their existing shareholdings. Since our inception, we have not distributed any free shares. We currently have no intention to make such distribution in the near future.

Preemptive rights and issuance of additional shares

We may issue authorized but unissued shares from time to time, unless otherwise provided for in the Korean Commercial Code, on such terms as our Board of Directors may determine. We must offer new shares on uniform terms to all shareholders who have preemptive rights and are listed on our shareholders' register as of the relevant record date.

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We may issue new shares pursuant to a board resolution to persons other than existing shareholders, who in these circumstances will not have preemptive rights, if the new shares are issued:

- through a general public offering, of no more than 50% of the total number of issued and outstanding shares;
- to the members of the employee stock ownership association;
- upon exercise of a stock option in accordance with our articles of incorporation;
- in the form of depositary receipts of no more than 50% of the total number of issued and outstanding shares;
- to induce foreign direct investment necessary for business in accordance with the Foreign Investment Promotion Act of no more than 50% of the total number of issued and outstanding shares;
- to the extent not exceeding 50% of the total number of issued and outstanding shares, to domestic or overseas financial institutions, corporations or individuals for the purpose of raising funds on an emergency basis;
- to certain companies under a joint venture arrangement with us; or
- in a public offering or the new shares are underwritten by underwriters for the purpose of listing such shares on any stock exchange, to the extent not exceeding 50% of the total number of issued and outstanding shares, provided that, if new shares are allocated to persons other than existing shareholders, the company is required to provide notice to shareholders or make a public notice at least two weeks prior to the payment date of the subscription amount for such new shares.

We must give public notice of preemptive rights regarding new shares and their transferability at least two weeks before the relevant record date. We will notify the shareholders who are entitled to subscribe for newly issued shares of the deadline for subscription at least two weeks prior to such deadline. If a shareholder fails to subscribe by the deadline, the shareholder's preemptive rights lapse. Our Board of Directors may determine how to distribute fractional shares or shares for which preemptive rights have not been exercised.

In the case of ADS holders, the depositary will be treated as the shareholder entitled to preemptive rights.

General meeting of shareholders

We hold the annual general meeting of shareholders within three months after the end of each fiscal year. Subject to a board resolution or court approval, we may hold an extraordinary general meeting of shareholders:

- as necessary;
- at the request of shareholders holding an aggregate of 3% or more of our outstanding shares; or
- at the request of our audit committee.

We must give shareholders written notice or electronic document setting out the date, place and agenda of the meeting at least two weeks prior to the general meeting of shareholders. The agenda of the general meeting of shareholders is determined at the meeting of the Board of Directors. In addition, a shareholder holding an aggregate of 3% or more of the outstanding shares may propose an agenda for the general meeting of shareholders. Such proposal should be made in writing at least six weeks prior to the meeting. The Board of Directors may decline such proposal if it is in violation of the relevant laws and regulations or our articles of incorporation. Shareholders not on the shareholders' register as of the record date are not entitled to receive notice of the general meeting of shareholders or attend or vote at the meeting. Holders of preferred shares, unless enfranchised, are not entitled to receive notice of or vote at the general meeting of shareholders.

A shareholder holding an aggregate of 1% or more of the outstanding shares may, prior to the shareholders' meeting, request the court to appoint an inspector to examine the appropriateness of the meeting notice process and voting method.

The chairman of the shareholders' meeting shall be appointed by the Board of Directors, and if the person determined by the Board of Directors cannot serve as chairman, the representative director shall serve as chairman. If the representative director cannot serve as chairman, then the vice president, senior executive director or executive director shall serve as chairman, in that order. If a general meeting of shareholders is proposed by a shareholder or shareholders holding an aggregate of not less than 3% of the outstanding shares, the court may approve such general meeting and may also appoint the chairman of such shareholders' meeting upon request by the requesting parties or at its own discretion.

Our shareholders' meetings are held in Seoul, Korea or other nearby areas as deemed necessary.

Voting rights

Holders of our common shares are entitled to one vote for each common share. However, common shares held by us (i.e., treasury shares) or by any corporate entity in which we have, directly or indirectly, greater than a 10% interest, do not have voting rights. Unless the articles of incorporation explicitly state otherwise, the Korean Commercial Code permits cumulative voting pursuant to which each common share entitles the holder thereof to multiple voting rights equal to the number of directors to be elected at such time. A holder of common shares may exercise all voting rights with respect to his or her shares cumulatively to elect one director. However, our shareholders have decided not to adopt cumulative voting.

Our shareholders may adopt resolutions at a general meeting by an affirmative majority vote of the voting shares present or represented at the meeting, where the affirmative votes also represent at least one third of our total voting shares then issued and outstanding. However, under the Korean Commercial Code and our articles of incorporation, the following matters require approval by the holders of at least two thirds of the voting shares present or represented at the meeting, where the affirmative votes also represent at least one third of our total voting shares then issued and outstanding:

- amending our articles of incorporation;
- removing a director;
- effecting a capital reduction (except any reduction in capital to make up for deficits);
- effecting any dissolution, merger or consolidation with respect to us;
- transferring all or any significant part of our business;
 - acquiring all of the business of any other company or a part of the business of any other company having a material effect on our business (the "material effect" qualifier is applied to the acquisition of both the whole and partial business of any other company);
- issuing new shares at a price below the par value; or
- any other matters for which such resolution is required under relevant laws and regulations.

In general, holders of non-voting shares are not entitled to vote on any resolution or receive notice of any general meeting of shareholders. However, in the case of amendments to our articles of incorporation, any merger or consolidation, capital reductions or in some other cases that affect the rights or interests of the preferred shares, approval of the holders of such class of shares is required. We must obtain the approval, by a resolution, of holders of at least two thirds of the preferred shares present or represented at a class meeting of the holders of such class of shares, where the affirmative votes also represent at least one third of the total issued and outstanding shares of such class. In addition, the Korean Commercial Code provides that a company's articles of incorporation may prescribe conditions for enfranchisement of non-voting shares. For example, if we are unable to pay dividends on preferred shares as provided in our articles of incorporation, the holders of preferred shares may become enfranchised and may be entitled to exercise voting rights until the dividends are paid. The holders of enfranchised preferred shares have the same rights as holders of voting shares to request, receive notice of, attend and vote at a general meeting of shareholders.

Shareholders may exercise their voting rights by proxy. Under our articles of incorporation, the person exercising the proxy does not have to be a shareholder. A person with a proxy must present a document evidencing its power of attorney in order to exercise voting rights.

Holders of ADSs will exercise their voting rights through the ADS depository. Subject to the provisions of the deposit agreement, holders of ADSs will be entitled to instruct the depository how to vote the common shares underlying their ADSs.

Rights of dissenting shareholders

In some limited circumstances, including the transfer of all or any part of our business having a material effect on our business and our merger or consolidation with another company except a small scale merger (as prescribed under Korean law) that leaves us as the surviving company, dissenting shareholders have the right to require us to purchase their shares. To exercise this right, shareholders must submit to us a written notice of their intention to dissent before the applicable general meeting of shareholders. Within 20 days after the relevant resolution is passed, the dissenting shareholders must request us in writing to purchase their shares. We are obligated to purchase the shares of dissenting shareholders within two months after receiving such request. The purchase price for the shares is required to be determined through negotiations between the dissenting shareholders and us. If an agreement is not attained within 30 days since the receipt of the request, we or the shareholder requesting the purchase of shares may request the court to determine the purchase price. Holders of ADSs will not be able to exercise dissenters' rights unless they withdraw the underlying common shares and become our direct shareholders.

Register of shareholders and record dates

Our transfer agent, Hana Bank, maintains the register of our shareholders at its office in Seoul, Korea. It registers transfers of shares on the register of shareholders upon presentation of the share certificates.

The record date for annual dividends is December 31 of each year. For the purpose of determining shareholders entitled to annual dividends, the register of shareholders will be closed for the period from January 1 to January 31 of each year. Further, for the purpose of determining the shareholders entitled to some other rights pertaining to the shares, we may, on at least two weeks' public notice, set a record date and/or close the register of shareholders for not more than three months. The trading of shares and the delivery of share certificates may continue while the register of shareholders is closed.

Annual report

At least one week before the annual general meeting of shareholders, we must make our annual business report, auditor's report and audited consolidated financial statements available for inspection at our principal office and at all of our branch offices. In addition, copies of such reports, financial statements and any resolutions adopted at the general meeting of shareholders will be available to our shareholders. Under the Korean Commercial Code and the Act on External Audit of Stock Companies, we are required to prepare non consolidated and consolidated financial statements. In addition, the non consolidated and consolidated financial statements are required to be approved at our shareholders' meeting. However, the Board of Directors may, without a shareholders' meeting, approve the non consolidated and consolidated financial statements if (i) an external auditor gives an unqualified opinion to the financial statements and (ii) all members of the audit committee unanimously agree.

Transfer of shares

Except for the procedural requirements which obligate a non citizen or non resident of Korea to file a report to the relevant government authority of Korea at the time of acquisition or transfer of the Company's shares, there is no restriction on the transfer or sale of our shares applicable to our shareholders or holders of ADSs under our articles of

incorporation and relevant laws.

Under the Korean Commercial Code, the transfer of shares is effected by delivery of share certificates. However, to assert shareholders' rights against us, the transferee must have his name and address registered on our register of shareholders. For this purpose, a shareholder is required to file his name, address and seal with our transfer agent. A non Korean shareholder may file a specimen signature in place of a seal, unless he is a citizen of a country with a sealing system similar to that of Korea. In addition, a non resident shareholder must appoint an agent authorized to receive notices on his or her behalf in Korea and file a mailing address in Korea. The above requirement does not apply to the holders of ADSs.

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Under current Korean regulations, the KSD, foreign exchange banks, investment traders, investment brokers, collective investment business entities and internationally recognized foreign custodians may act as agents and provide related services for foreign shareholders. Certain foreign exchange controls and securities regulations apply to the transfer of shares by non residents or non Koreans. See ITEM 10.D. "EXCHANGE CONTROLS."

Our transfer agent, Hana Bank, maintains the register of our shareholders at its office located at 72 Gukjegeumyung ro, Yeongdeungpo gu, Seoul, Korea. It registers transfers of shares in the register of shareholders on presentation of the share certificates.

Acquisition of our shares

Within the limitation of distributable profits, we may acquire our own common shares with the prior approval of the general meeting of shareholders (or by a resolution of the Board of Directors) after providing notice or making a public notice to all shareholders of the acquisition of treasury stocks. However, in limited circumstances such as in the case of a merger of our company or an acquisition by us of all of another company's business, or in the case when a shareholder exercises his or her stock option, we may acquire our own common shares without making notice to all shareholders as above.

Under the Korean Commercial Code and our articles of incorporation, our Board of Directors can determine the method by which we dispose of any common shares owned by us. Except in limited circumstances, corporate entities in which we own a 50% or greater equity interest may not acquire our common shares.

Except for the procedural requirements which obligate a non citizen or non resident of Korea to file a report to the relevant government authority of Korea at the time of acquisition or transfer of the Company's shares, there exists no provision which limits the rights to own our shares or exercise voting rights on our shares due to their status as a non resident or non Korean under our articles of incorporation and applicable Korean laws.

Liquidation rights

In the event of our liquidation, after payment of all debts, liquidation expenses and taxes, our remaining assets will be distributed among shareholders in proportion to their shareholdings.

Other provisions

Under our articles of incorporation, there exists no provision (i) which may delay or prevent a change in control of us and that is triggered in the event of a merger, acquisition or corporate restructuring, (ii) which requires disclosure of ownership above a certain threshold or (iii) that governs change in capital that is more stringent than required by the applicable laws in Korea.

We may issue bonds by a resolution of the Board of Directors. Our articles of incorporation permit the issuance of convertible bonds and bonds with warrants, but none have been issued.

ITEM 10.C. MATERIAL CONTRACTS

Since the filing of our annual report on Form 20 F on April 28, 2017, we have not entered into any material contracts other than in the ordinary course of business and otherwise as described in ITEM 4. "INFORMATION ON THE COMPANY" or elsewhere in this Annual Report.

ITEM 10.D. EXCHANGE CONTROLS

General

The Foreign Exchange Transaction Law and the Presidential Decree and regulations under such Law and Decree, or the “Foreign Exchange Transaction Laws,” regulate investment in Korean securities by non residents and issuance of securities outside Korea by Korean companies. Under the Foreign Exchange Transaction Laws, if non residents wish to acquire Korean securities, a report must be filed with the president of a foreign exchange bank or the President of Bank of Korea except for certain cases, provided, however, that under the Financial Investment Services and Capital Markets Act, foreigners cannot acquire equity securities issued by certain designated public interest corporations in excess of a fixed limit, and under the Foreign Investment Promotion Law, foreigners are either not allowed or restricted in making an investment in certain industries.

Under the Foreign Exchange Transaction Laws, (i) the Ministry of Strategy and Finance, or the “MOSF,” may temporarily suspend payment, receipt or the whole or part of transactions to which the Foreign Exchange Transaction Laws apply, or impose an obligation to safe keep, deposit or sell means of payment in or to certain Korean governmental agencies or financial institutions, if the Korean government deems that it is inevitable to take such measures, due to the outbreak of natural calamities, wars, conflict of arms or grave and sudden changes in domestic or foreign economic circumstances or other situations equivalent thereto; and (ii) if the Korean government deems that the international balance of payments and international finance are confronted or are likely to be confronted with serious difficulty or the movement of capital between Korea and abroad brings or is likely to bring on serious obstacles in carrying out currency policies, exchange rate policies and other macroeconomic policies, the MOSF may take measures to require any person who intends to perform capital transactions to obtain permission from the MOSF or a person/entity designated by the public notification of the MOSF or to require any person who performs capital transactions to deposit part of the means of payment acquired in such transactions in certain Korean governmental agencies or financial institutions, in each case subject to certain limitations thereunder.

Filing with the Korean government in connection with the issuance of American Depositary Shares

In order for us to issue common shares represented by ADSs in an amount exceeding US\$30 million, we are required to file a prior report of the issuance with the MOSF through the designated foreign exchange bank. No further Korean governmental approval is necessary for the initial offering and issuance of the ADSs.

Under current Korean laws and regulations, the depository is required to obtain our prior consent for the number of common shares to be deposited in any given proposed deposit which exceeds the difference between (i) the aggregate number of common shares deposited by us for the issuance of ADSs (including deposits in connection with the initial and all subsequent offerings of ADSs and stock dividends or other distributions related to these ADSs), and (ii) the number of common shares on deposit with the depository at the time of such proposed deposit. We have agreed to consent to any deposit so long as the deposit would not violate our articles of incorporation or applicable Korean law, and the total number of our common shares on deposit with the depository would not exceed the sum of the aggregate number of common shares and any number of additional shares for which the depository has received our written consent.

Furthermore, prior to making an investment of 10% or more of the outstanding voting shares of a Korean company, foreign investors are generally required under the Foreign Investment Promotion Law to submit a report to the Chairman of the Korea Trade Investment Promotion Agency, or “KOTRA,” (including the head of the Trade Center, branch office and/or office designated by the Chairman of KOTRA) or the president of the foreign exchange bank (including the head of the branch office designated by the president of the foreign exchange bank). Subsequent sales of such shares by foreign investors will also require a prior report to the Chairman of KOTRA or the president of the foreign exchange bank.

Certificates of the shares must be kept in custody with an eligible custodian

Under Korean law, certificates evidencing shares of Korean companies must be kept in custody with an eligible custodian in Korea, which certificates may in turn be required to be deposited with the KSD if they are designated as being eligible for deposit with the KSD. Only the KSD, foreign exchange banks, investment traders, investment brokers, collective investment business entities and internationally recognized foreign custodians are eligible to act as a custodian of shares for a foreign investor. However, a foreign investor may be exempted from complying with the requirement to have the certificates deposited with the KSD with the approval of the Governor of the Financial Supervisory Service in circumstances where such compliance is made impracticable, including cases where such compliance would contravene the laws of the home country of such foreign investor.

A foreign investor may appoint one or more standing proxies from among the KSD, foreign exchange banks, investment traders, investment brokers, collective investment business entities, internationally recognized foreign

custodians and the Bank of Korea (only when related to a treasury bond, a treasury bill or a monetary stabilization bond which is or will be acquired by a foreign central bank, an international financial organization or a foreign government), and cannot have any other apart from those standing proxies to represent or act on behalf of them in order to exercise rights of acquired shares, or other matters connected thereto. However, a foreign investor may be exempted from complying with these standing proxy rules with the approval of the Governor of the Financial Supervisory Service in circumstances where such compliance is made impracticable, including cases where such compliance would contravene the laws of the home country of such foreign investor.

Restrictions on American Depositary Shares and shares

Once the report to the MOSF is filed in connection with the issuance of ADSs, no further Korean governmental approval is necessary for the sale and purchase of ADSs in the secondary market outside Korea or for the withdrawal of shares underlying ADSs and the delivery inside Korea of shares in connection with such withdrawal. In addition, persons who have acquired shares as a result of the withdrawal of shares underlying the ADSs may exercise their preemptive rights for new shares, participate in free distributions and receive dividends on shares without any further governmental approval.

A foreign investor may receive dividends on the shares and remit the proceeds of the sale of the shares through a foreign currency account and/or a Won account exclusively for stock investments by the foreign investor which are opened at a foreign exchange bank designated by the foreign investor without being subject to any procedural restrictions under the Foreign Exchange Transaction Laws. No approval is required for remittance into Korea and deposit of foreign currency funds in the foreign currency account. Foreign currency funds may be transferred from the foreign currency account at the time required to place a deposit for, or settle the purchase price of, a stock purchase transaction to a Won account opened at a foreign exchange bank. Funds in the foreign currency account may be remitted abroad without any governmental approval.

Dividends on shares are paid in Won. No Korean governmental approval is required for foreign investors to receive dividends on, or the Won proceeds of the sale of, any such shares to be paid, received and retained in Korea. Dividends paid on, and the Won proceeds of the sale of, any such shares held by a non resident of Korea must be deposited in his Won account. Funds in the investor's Won account may be transferred to his foreign currency account or withdrawn for local living expenses up to certain limitations. Funds in the investor's Won account may also be used for future investment in shares or for payment of the subscription price of new shares obtained through the exercise of preemptive right.

Investment brokers and investment traders are allowed to open foreign currency accounts with foreign exchange banks exclusively for accommodating foreign investors' securities investments in Korea. Through such accounts, these investment brokers or investment traders may enter into foreign exchange transactions on a limited basis, such as the conversion of foreign currency funds and Won funds, either as a counterparty to or on behalf of foreign investors, without such investors having to open their own Won and foreign currency accounts with foreign exchange banks.

ITEM 10.E. TAXATION

KOREAN TAXATION

The following is a discussion of material Korean tax consequences to owners of our ADSs and common shares that are non resident individuals or non Korean corporations without a permanent establishment in Korea to which the relevant income is attributable or with which the relevant income is effectively connected. A non resident individual according to Korean tax laws means an individual who does not have an address or a place of residence in Korea for longer than a period of 183 days. A non Korean corporation is a corporation whose headquarters and main office is located overseas and does not have a place of effective management in Korea. The statements regarding Korean tax laws set forth below are based on the laws in force and as interpreted by the Korean taxation authorities as of the date hereof. This discussion is not exhaustive of all possible tax considerations which may apply to a particular investor, and prospective investors are advised to satisfy themselves as to the overall tax consequences of the acquisition, ownership and disposition of our ADSs and common shares, including specifically the tax consequences under Korean law, the laws of the jurisdiction of which they are resident, and any tax treaty between Korea and their country of residence, by consulting their own tax advisors.

Dividends on the shares or American Depositary Shares

Under Korean tax laws, the domestic source dividend income of non-resident individuals and non-Korean corporations means any profits or surpluses that are distributed by domestic companies or distributed in Korea. Therefore, dividends that are distributed to non-resident individuals and non-Korean corporations who own common shares of domestic companies are considered to be domestic source dividend income. The dividends provided to the holder of ADSs are also included in the domestic source dividend income as it is no different from dividends that are paid to a holder of common shares in the domestic companies.

With respect to the taxation of domestic source dividend income of a non resident individual and non Korean corporation, if there is no tax treaty entered into between Korea and the country of tax residence of the non resident individual or non Korean corporation or if the country of tax residence is a tax haven designated by the Commissioner of the National Tax Service of Korea (currently, only Labuan, Malaysia) and has not acquired prior approval of the Commissioner, we will deduct Korean withholding tax from dividends paid to such non resident individual or non Korean corporation (whether in cash or in shares) at a rate of 22% (including local income tax). If you are a resident of a country that has entered into a tax treaty with Korea and you are a beneficial owner of the dividends, you may qualify for an exemption or a reduced rate of Korean withholding tax according to the tax treaty. In this connection, if the party with whom the income has been provided exists as a paper company in order to receive the benefits of the tax treaty and there exists a separate beneficiary owner who is the real owner of the income (hereinafter referred to as the “Beneficiary Owner”) that is provided with income from dividends, tax will be withheld at source by applying the tax rate determined in the tax treaty entered into between Korea and the country of tax residence of the Beneficiary Owner. If the country of tax residence of the Beneficiary Owner and Korea has not entered into a tax treaty or in the case that such country is Labuan, Malaysia, tax will be withheld at source at a tax rate of 22% according to the Korean Corporate Tax Law.

Generally, in order to obtain a reduced rate of withholding tax pursuant to an applicable tax treaty, you must submit to us, prior to the dividend payment date, together with the request form to apply for the reduced rate, such evidence of tax residence as the Korean tax authorities may require in order to establish your entitlement to the benefits of the applicable tax treaty. If you hold ADSs, evidence of tax residence may be submitted to us through the depository. See ITEM 10.E. “TAXATION—KOREAN TAXATION—Tax treaties” below for a discussion on treaty benefits.

In order for the beneficiary of dividends that is a corporation or an individual in Labuan to be qualified for a limited tax rate, the beneficiary must obtain an approval before such dividends are paid by submitting legal evidentiary documents that verify the country of tax residence of the beneficiary to the Commissioner of the National Tax Service of Korea along with a request for prior approval of tax withholding or the beneficiary may submit a request for correction to the responsible director of the tax office within three years of withholding tax at source.

Taxation of capital gains

Under Korean tax laws, capital gains from securities are triggered when a non resident individual or a non Korean corporation transfers his or its securities. Securities subject to taxation include shares and depository receipts issued based on such shares and equity interests and all securities issued by domestic corporations. (However, in the case of bonds, the interests that are accrued during the holding period are taxable as interest income, and therefore, capital gains treatment is not triggered.)

In regards to capital gains tax originating from Korea, if there is no tax treaty entered into between Korea and the country of tax residence of the non resident individual or non Korean corporation or if the country of tax residence is a tax haven designated by the Commissioner of the National Tax Service of Korea (currently, only Labuan, Malaysia) and has not acquired prior approval of the Commissioner, capital gains earned by such non resident individual or non Korean corporation upon the transfer of our common shares or ADSs are subject to Korean withholding tax at the lower of (i) 11% (including local income tax) of the gross proceeds realized and (ii) 22% (including local income tax) of the net realized gains (subject to the production of satisfactory evidence of the acquisition costs and certain direct transaction costs). However, in most cases where a tax treaty is entered into between Korea and the country of tax residence of the non resident individual or non Korean corporation, such non resident individual or non Korean corporation is exempt from Korean income taxation under the applicable Korean tax treaty with his or its country of tax residence. In this regard, if the party to whom the capital gains from securities are provided exists as a paper company in order to receive benefits of a tax treaty and there exists a separate Beneficiary Owner that is provided with income from capital gains, tax will be withheld at source by applying the tax rate determined in the tax treaty entered into between Korea and the country of tax residence of the Beneficiary Owner. If the country of tax residence of the Beneficiary Owner and Korea has not entered into a tax treaty or in the case that such country is Labuan, Malaysia,

tax will be withheld at source at a tax rate (11% of transfer price or 22% of capital gains, whichever is less) according to the Korean Corporate Tax Law. See ITEM 10.E. “TAXATION—KOREAN TAXATION—Tax treaties” below for a discussion on treaty benefits. Even if you do not qualify for any exemption under a tax treaty, you will not be subject to the foregoing withholding tax on capital gains if you qualify for the relevant Korean domestic tax law exemptions discussed in the following paragraphs.

Aside from the benefits provided in the tax treaties, Korean tax law provides provisions on tax exemptions in regards to capital gains from securities when certain requirements are met. With respect to our common shares, you will not be subject to Korean income taxation on capital gains realized upon the transfer of such common shares, (i) if our common shares are listed on either the Market Division of the Korea Exchange or the KOSDAQ Division of the Korea Exchange, (ii) if shares are transferred through stock market, (iii) if you have no permanent establishment in Korea and (iv) if you did not own or have not owned (together with any shares owned by any entity which you have a certain special relationship with and possibly including the shares represented by the ADSs) 25% or more of our total issued and outstanding shares at any time during the calendar year in which the sale occurs and during the five calendar years prior to the calendar year in which the sale occurs.

Under the tax law amendments effective for capital gains recognized or to be recognized from disposition of ADSs on or after January 1, 2008, ADSs are viewed as shares of stock for capital gains tax purposes. Accordingly, capital gains from sale or disposition of ADSs are taxed (if taxable) as if such gains are from sale or disposition of shares of our common stock. It should be noted that (i) capital gains earned by you (regardless of whether you have a permanent establishment in Korea) from a transfer of ADSs outside Korea will generally be exempt from Korean income taxation by virtue of the Special Tax Treatment Control Law of Korea, or the “STTCL,” provided that the issuance of ADSs is deemed to be an overseas issuance under the STTCL, but (ii) in the case where an owner of the underlying shares of stock transfers ADSs after conversion of the underlying shares into ADSs, the exemption under the STTCL described in (i) will not apply. In the case where an owner of the underlying shares of stock transfers the ADSs after conversion of the underlying shares of stock into ADSs, such person is obligated to file corporate income tax returns and pay tax unless a purchaser or a financial investment company with a brokerage license, as applicable, withholds and pays the tax on capital gains derived from transfer of ADSs, as discussed below.

Generally, to obtain the benefit of an exemption from tax pursuant to a tax treaty, you must submit to the purchaser or the securities company, or through the ADS depository, as the case may be, prior to or at the time of payment, such evidence of your tax residence as the Korean tax authorities may require in support of your claim for treaty benefits. However, in order for the beneficiary of capital gains from securities who is a corporation or an individual in Labuan to be qualified for a limited tax rate, the beneficiary must obtain an approval before such capital gains from securities is realized by submitting legal evidentiary documents that verify the country of tax residence of the beneficiary to the Commissioner of the National Tax Service of Korea along with a request for prior approval of tax withholding or the beneficiary may submit a request for correction to the responsible director of the tax office within three years of withholding tax at source. See ITEM 10.E. “TAXATION—KOREAN TAXATION—Tax treaties” for additional explanation on claiming treaty benefits.

Tax treaties

Korea has entered into a number of income tax treaties with other countries (including the United States), which would reduce or exempt Korean withholding tax on dividends on, and capital gains on transfer of, our common shares or ADSs. For example, under the Korea United States income tax treaty, reduced rates of Korean withholding tax of 16.5% or 11.0% (respectively, including local income tax, depending on your shareholding ratio) on dividends and an exemption from Korean withholding tax on capital gains are available to residents of the United States that are beneficial owners of the relevant dividend income or capital gains. However, under Article 17 (Investment or Holding Companies) of the Korea United States income tax treaty, such reduced rates and exemption do not apply if (i) you are a United States corporation, (ii) by reason of any special measures, the tax imposed on you by the United States with respect to such dividends or capital gains is substantially less than the tax generally imposed by the United States on corporate profits, and (iii) 25% or more of your capital is held of record or is otherwise determined, after consultation between competent authorities of the United States and Korea, to be owned directly or indirectly by one or more persons who are not individual residents of the United States. Also, under Article 16 (Capital Gains) of the Korea United States income tax treaty, the exemption on capital gains does not apply if you are an individual, and (a) you maintain a fixed base in Korea for a period or periods aggregating 183 days or more during the taxable year and your ADSs or common shares giving rise to capital gains are effectively connected with such fixed base or (b) you are

present in Korea for a period or periods of 183 days or more during the taxable year.

On the other hand, the International Tax Coordination Law provides that in regard to taxable income, gains, assets, acts or transactions, when the holder and Beneficiary Owner is not the same, the Beneficiary Owner is considered to be the taxpayer who is subject to the applicable tax treaty. If one engages in activities to receive benefits of a tax treaty through having international transactions with a third party indirectly or conducts transactions with more than two parties, such activity is considered to be a direct transaction or a single transaction for which the tax treaty applies. Thus, if a non Korean company or a non resident individual establishes a paper company in a certain country for the purpose of receiving benefits

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of a tax treaty and tries to unreasonably receive dividends and capital gains from securities pursuant to a tax treaty between a certain country and Korea, the tax treaty that is entered into between the country of the residence of the Beneficiary Owner and Korea shall be applied.

In addition, even if a tax treaty provides for either an exemption from or reduction of the applicable income tax, the company or person paying dividends, interest, royalty or consideration for share purchase to an offshore entity established in a tax haven jurisdiction designated by the MOSF, must initially withhold the applicable tax on such income under the applicable tax law. In such case, by submitting documents that verify the country of tax residence of the Beneficiary Owner within three years from deduction of withholding tax to the public office for tax in Korea in order to request for correction, the difference between the amount of tax to which the tax rate of exemption and restriction in the tax treaty that the Beneficiary Owner qualifies for and the amount of tax that was withheld initially shall be refunded. If, however, the National Tax Service of Korea has granted prior approval upon application for an exemption or reduction of tax pursuant to a relevant tax treaty, such withholding requirement will not apply.

You should inquire for yourself whether you are entitled to the benefit of an income tax treaty with Korea. It is the responsibility of the party claiming the benefits of an income tax treaty in respect of dividend payments or capital gains to submit to us, the purchaser or the securities company, as applicable, a certificate as to its tax residence. In the absence of sufficient proof, we, the purchaser or the securities company, as applicable, must withhold tax at the normal rates. Furthermore, in order for you to claim the benefit of a tax rate reduction or tax exemption on certain Korean source income (e.g., dividends or capital gains) under an applicable tax treaty as the beneficial owner of such Korean source income, Korean tax law requires you (or your agent) to submit an application (in the case for reduced withholding tax rate, an “application for entitlement to reduced tax rate”, and in the case for exemption from withholding tax, an “application for tax exemption”) with a certificate of your tax residency issued by the competent authority of your country of tax residence, subject to certain exceptions (together, the “BO application”). For example, a U.S. resident would be required to provide a Form 6166 as a certificate of tax residency with the application for entitlement to reduced tax rate or the application for tax exemption, as the case may be. Subject to certain exceptions, where the relevant income is paid to an overseas investment vehicle that is not the beneficial owner of such income (an “OIV”), a beneficial owner claiming the benefit of an applicable tax treaty with respect to such income must submit its BO application to such OIV, which in turn must submit an OIV report and a schedule of beneficial owners to the withholding agent prior to the payment date of such income. In the case of a tax exemption application, the withholding agent is required to submit such application (together with the applicable OIV report in the event the income will be paid to an OIV) to the relevant district tax office by the ninth day of the month following the date of the payment of such income.

Inheritance tax and gift tax

Korean inheritance tax is imposed upon (i) all assets (wherever located) of the deceased if he or she was domiciled in Korea at the time of his or her death and (ii) all property located in Korea which passes on death (irrespective of the domicile of the deceased). Gift tax is imposed in similar circumstances to the above (based on the donee’s place of domicile in the case of (i) above). The taxes are imposed if the value of the relevant property is above a limit and vary from 10% to 50% at sliding scale rate according to the value of the relevant property and the identity of the parties involved.

Under the Korean inheritance and gift tax laws, shares issued by Korean corporations are deemed located in Korea irrespective of where the share certificates are physically located or by whom they are owned. If the tax authority’s interpretation of treating depositary receipts as the underlying share certificates under the 2004 tax ruling applies in the context of inheritance and gift taxes as well, you may be treated as the owner of the common shares underlying the ADSs.

At present, Korea has not entered into any tax treaty relating to inheritance or gift taxes.

Securities transaction tax

The Securities Transaction Tax Act provides that a securities transaction tax shall be imposed on the transfer of share certificates or shares. The scope of taxable share certificates includes, with respect to share certificates transferred on or after January 1, 2011, rights arising from the acquisition of shares, shares prior to the issuance of share certificates, preemptive rights and subscription securities issued by corporations established under special laws (e.g., Agricultural Cooperatives Act) and depositary receipts (issued by depository of equity securities in a country other than the country of issuance, which describes the rights related to the relevant deposited securities) pursuant to the Financial Investment Services and Capital Markets Act. However, with respect to the transfer of share certificates listed in overseas securities markets that are similar to the Korean securities market, such as the New York Stock Exchange or the NASDAQ Stock Market, or the

transfer of share certificates to an underwriter in order to list such share certificates on foreign stock exchanges, such transfer is not subject to the securities transaction tax. The said Act provides that the types of share certificates that are subject to the securities transaction tax is a share certificate issued by a domestic corporation established according to the Commercial Act or a special act, or the share certificate or depository receipts which are issued by a non Korean corporation that are listed or registered in the securities market. Therefore, if you transfer common shares in a Korean corporation and the common shares are not listed in the securities market overseas, you will be subject to a securities transaction tax at the rate of 0.5%.

In principle, the securities transaction tax, if applicable, must be paid by the transferor of the shares or the rights to subscribe for such shares. When the transfer is effected through a securities settlement company, such settlement company is generally required to withhold and pay the tax to the tax authorities. When such transfer is made through a securities company only, such securities company is required to withhold and pay the tax. Where the transfer is effected by a non resident without a permanent establishment in Korea, other than through a securities settlement company or a securities company, the transferee is required to withhold and pay the securities transaction tax.

MATERIAL U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following summary describes certain material U.S. federal income tax consequences of the purchase, ownership and disposition of our ADSs and common shares as of the date hereof. The discussion set forth below is applicable to U.S. Holders (as defined below) (i) who are residents of the United States for purposes of the current Convention Between the United States of America and the Republic of Korea for the Avoidance of Double Taxation, as amended (the "Tax Convention"), (ii) whose ADSs or common shares are not, for purposes of the Tax Convention, attributable to a permanent establishment in Korea and (iii) who otherwise qualify for the full benefits of the Tax Convention. Except where noted, it deals only with U.S. Holders that hold our ADSs and common shares as capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the "Code"). This section does not discuss the tax consequences to any particular holder, nor any tax considerations that may apply to U.S. Holders subject to special tax rules, such as:

- financial institutions;
- regulated investment companies;
- tax exempt entities;
- grantor trusts;
- certain former citizens or residents of the United States;
- insurance companies;
- brokers, dealers or traders in securities, commodities or currencies;
- persons liable for alternative minimum tax;
- persons (including traders in securities) using a mark to market method of accounting;
- persons that have a "functional currency" other than the U.S. dollar;
- persons that own (or are deemed to own) 10% or more (by vote or value) of our equity;
- persons who hold our common shares or ADSs as a hedge or as part of a straddle with another position, constructive sale, conversion transaction or other integrated transaction;
- entities that are treated as partnerships for U.S. federal income tax purposes.

This discussion is based on the Code, Treasury regulations promulgated thereunder, administrative and judicial interpretations thereof and the Tax Convention, all as in effect and available on the date hereof and all of which are subject to change, possibly with retroactive effect, or to different interpretation. This discussion is for general information only and does not address all of the tax considerations that may be relevant to specific U.S. Holders in light of their particular circumstances or to U.S. Holders subject to special treatment under U.S. federal income tax law. This discussion does not address the 3.8% Medicare contribution tax imposed on certain net investment income, any U.S. state or local or non U.S. tax considerations or any U.S. federal estate, gift or alternative minimum tax considerations. The discussion below is based, in part, upon representations made by the depositary to us and assumes that the deposit agreement, and all related agreements, will be performed in accordance with their terms.

Persons considering the purchase, ownership or disposition of our ADSs or common shares should consult their own tax advisors concerning U.S. federal income tax consequences (including the U.S. federal income tax rules applicable to PFICs discussed below) in light of their particular situation as well as any other tax consequences arising under the laws of any taxing jurisdiction.

As used herein, the term “U.S. Holder” means a beneficial holder of our ADSs or common shares that is for U.S. federal income tax purposes:

- an individual citizen or resident of the United States;
- a corporation (or other entity treated as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust that:
 - is subject to the primary supervision of a court within the United States and the control of one or more United States persons as described in section 7701(a)(30) of the Code; or
 - has a valid election in effect under applicable U.S. Treasury regulations to be treated as a domestic trust.

If an entity or arrangement treated as a partnership for U.S. federal income tax purposes acquires, owns or disposes of our ADSs or common shares, the U.S. federal income tax treatment of a partner in such partnership generally will depend upon the status of the partner and the activities of the partnership. Such a partner or partnership should consult its own tax advisor as to the U.S. federal income tax consequences of acquiring, owning or disposing of our ADSs and common shares.

American Depositary Shares

If you hold our ADSs, for U.S. federal income tax purposes, you generally will be treated as the owner of the underlying common shares that are represented by such ADSs. Accordingly, upon the exchange of ADSs for a U.S. Holder’s proportionate interest in our common shares represented by such ADSs, (i) no gain or loss will be recognized to such U.S. Holder, (ii) such U.S. Holder’s tax basis in such common shares will be the same as its tax basis in such ADSs, and (iii) the holding period in such common shares will include the holding period in such ADSs.

The U.S. Treasury has expressed concern that parties to whom ADSs are released before shares are delivered to the depositary or intermediaries in the chain of ownership between holders and the issuer of the security underlying the ADSs, may be taking actions that are inconsistent with the claiming of foreign tax credits by U.S. Holders of ADSs. These actions would also be inconsistent with the claiming of the reduced rate of tax, described below, applicable to dividends received by certain non-corporate U.S. Holders. Accordingly, the creditability of non-U.S. withholding taxes (if any), and the availability of the reduced tax rate for dividends received by certain non-corporate U.S. Holders, each described below, could be affected by actions taken by such parties or intermediaries. For purposes of the discussion below, we assume that intermediaries in the chain of ownership between the holder of an ADS and us are acting consistently with the claim of U.S. foreign tax credits by U.S. Holders.

Passive Foreign Investment Companies (“PFICs”)

In general, we will be a PFIC for U.S. federal income tax purposes for any taxable year in which:

- at least 75% of our gross income is passive income; or
- on average at least 50% of the value (determined on a quarterly basis) of our assets is attributable to assets that produce or are held for the production of passive income.

For this purpose, passive income generally includes dividends, interest, rents and royalties (other than rents and royalties derived in the active conduct of a trade or business and not derived from a related person), gains from commodities and securities transactions and gains from the disposition of assets that produce or are held for the production of passive income. If we own, directly or indirectly, at least 25% by value of the stock of another corporation, we will be treated, for purposes of the PFIC tests, as owning our proportionate share of the other corporation’s assets and receiving our proportionate share of the other corporation’s income.

Although we believe that we may not have been a PFIC for taxable year 2017, we believe that we were a PFIC for taxable years 2008 through 2016, and we may be a PFIC in future taxable years. The determination of whether we are a PFIC depends on particular facts and circumstances (such as the valuation of our assets, including goodwill and intangible assets) and may also be affected by the application of the PFIC rules, which are subject to differing interpretations. Such determination is also expected to depend, in part, upon (1) the market price of the ADSs and (2) the composition of our income and assets. In light of the foregoing, no assurance can be provided that we are not currently a PFIC or that we will not become a PFIC in any future taxable year. Furthermore, if we are treated as a PFIC, then one or more of our subsidiaries may also be treated as PFICs.

If we are a PFIC for any taxable year during which you hold our ADSs or common shares, we generally will continue to be treated as a PFIC with respect to you in all succeeding taxable years, regardless of whether we continue to meet the tests described above. Because we believe that we were a PFIC for taxable years 2008 through 2016, if you held ADSs or common shares during any of those taxable years, we would continue to be treated as a PFIC with respect to those ADSs or common shares for all succeeding years in which you hold them. Similarly, if you first acquired ADSs or common shares in any year in which we were not a PFIC and we became a PFIC in a subsequent year, we would be treated as a PFIC with respect to those ADSs or common shares for all succeeding years during which you hold them. You may terminate this continued PFIC status by making a “deemed sale election,” as discussed below.

You are urged to consult your own tax advisor concerning the U.S. federal income tax consequences of holding our ADSs or common shares if we are considered a PFIC in any taxable year.

U.S. Federal Income Tax Treatment of a Shareholder

If we are a PFIC for any taxable year during which you hold our ADSs or common shares, absent certain elections (including the mark-to-market election or qualified electing fund election described below), you generally will be subject to adverse tax consequences (regardless of whether we continue to be classified as a PFIC) with respect to (1) any “excess distribution” received with respect to our ADSs or common shares and (2) any gain recognized from a sale or disposition (including a pledge) of such ADSs or common shares. Distributions received in a taxable year that are greater than 125% of the average annual distributions received during the shorter of the three preceding taxable years and your holding period for our ADSs or common shares will be treated as excess distributions. Under these special tax rules:

- the excess distribution or gain will be allocated ratably over your holding period for our ADSs or common shares;
- the amount allocated to the current taxable year, and any taxable year prior to the first taxable year in which we were a PFIC in your holding period will be treated as ordinary income arising in the current taxable year; and
- the amount allocated to each other year during your holding period in which we were classified as a PFIC will be subject to tax at the highest tax rate in effect for that year and applicable to you, and the interest charge generally

applicable to underpayments of tax will be imposed on the resulting tax attributable to each such year.

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In addition, if we are a PFIC in the taxable year in which such dividends are paid or in the preceding taxable year, non corporate U.S. Holders will not be eligible for reduced rates of taxation on any dividends received from us.

If we are a PFIC, the tax liability for amounts allocated to years prior to the year of disposition or excess distribution cannot be offset by any net operating losses, and gains (but not losses) recognized on the transfer of the ADSs or common shares cannot be treated as capital gains, even if the ADSs or common shares are held as capital assets.

If we are classified as a PFIC and then cease to be so classified, a U.S. Holder may make an election (a “deemed sale election”) to be treated for U.S. federal income tax purposes as having sold such U.S. Holder’s ADSs or common shares on the last day of our taxable year during which we were a PFIC. A U.S. Holder that makes a deemed sale election would then cease to be treated as owning stock in a PFIC. However, gain recognized as a result of making the deemed sale election would be subject to the adverse rules described above, and loss would not be recognized.

“Mark-to-market” Election

In certain circumstances, in lieu of being subject to the excess distribution rules discussed above, a shareholder may make an election to include gain on the stock of a PFIC as ordinary income under a mark to market method, provided that such stock is “regularly traded” on a “qualified exchange.” A “qualified exchange” includes a national securities exchange that is registered with the SEC. Generally, a class of stock is considered regularly traded for any calendar year during which such class of stock is traded, other than in de minimis quantities, on at least 15 days during each calendar quarter. Under current law, the mark to market election may be available to U.S. Holders of our ADSs because our ADSs are listed on NASDAQ, which constitutes a qualified exchange as designated in the Code, although there can be no assurance that our ADSs will be “regularly traded” for purposes of the mark to market election. Our common shares are not expected to be listed on a qualified exchange. Accordingly, the mark to market election may not be available for U.S. Holders of our common shares. The remainder of this discussion assumes that the mark to market election will be available for U.S. Holders of our ADSs and will not be available for U.S. Holders of our common shares.

If you make an effective mark to market election, you will be required to include in gross income, as ordinary income, for each taxable year that we are a PFIC an amount equal to the excess of the fair market value of our ADSs that are “marketable stock” at the end of the year over your adjusted tax basis in our ADSs. You will be entitled to deduct, as an ordinary loss in such year an amount equal to the excess of your adjusted tax basis in our ADSs over their fair market value at the end of the year, but only to the extent of the net amount previously included in income as a result of the mark to market election. Your adjusted tax basis in our ADSs will be increased by the amount of any income inclusion and decreased by the amount of any deductions under the mark to market rules. If you make a mark to market election it will be effective for the taxable year for which the election is made and all subsequent taxable years unless our ADSs are no longer regularly traded on a qualified exchange or the IRS consents to the revocation of the election. You are urged to consult your tax advisor about the availability and consequences of the mark to market election, and whether making the election would be advisable in your particular circumstances.

“QEF” Election

Alternatively, in certain cases, a U.S. Holder can avoid the interest charge and the other adverse PFIC tax consequences described above by obtaining certain information from the PFIC and electing to treat the PFIC as a “qualified electing fund” under Section 1295 of the Code. However, we do not anticipate that this option will be available to you because we do not intend to provide the information regarding our income that would be necessary to permit you to make this election.

You should consult your tax advisor regarding the application of the foreign tax credit rules to the QEF and mark-to-market regimes described above in the event we are a PFIC.

You are urged to contact your own tax advisor regarding the determination of whether we are a PFIC and the tax consequences of such status.

U.S. Federal Income Tax Treatment of a Shareholder If We Are Not a PFIC

Distributions

If you are a U.S. Holder of our ADSs or common shares in a taxable year in which we are a PFIC (and any subsequent taxable year), then this section generally will not apply to you.

As described in “Dividend Policy” above, we do not currently anticipate paying any distributions on our ADSs or common shares in the near future. However, to the extent that there are any distributions made with respect to our ADSs or common shares, the gross amount of distributions on our ADSs or common shares (without deduction for any withholding tax, including amounts withheld as Korean withholding taxes) will be taxable as dividends, to the extent paid out of our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. Such income (including withheld taxes) will be includible in your gross income as ordinary income on the day actually or constructively received by you, in the case of our common shares, or by the depository, in the case of our ADSs. Such dividends will not be eligible for the dividends received deduction allowed to corporations under the Code. With respect to non-corporate U.S. Holders, certain dividends received from a “qualified foreign corporation” may be subject to reduced rates of taxation. A qualified foreign corporation includes a foreign corporation (other than a corporation that is a PFIC in the taxable year in which the dividend is paid or the prior year) that is eligible for the benefits of a comprehensive income tax treaty with the United States that the U.S. Treasury Department determines to be satisfactory for these purposes and which includes an exchange of information provision. The U.S. Treasury Department has determined that the current Tax Convention meets these requirements. A foreign corporation (other than a corporation that is a PFIC in the taxable year in which the dividend is paid or the prior year) is also treated as a qualified foreign corporation with respect to dividends paid by that corporation on shares (or ADSs backed by such shares) that are readily tradable on an established securities market in the United States. Our common shares generally will not be considered readily tradable for these purposes. Under the U.S. Treasury Department guidance our ADSs, which are currently listed on NASDAQ, will be considered readily tradable on an established securities market in the United States. There can be no assurance that our ADSs will be considered readily tradable on an established securities market in future years. Non-corporate holders that do not meet a minimum holding period requirement during which they are not protected from the risk of loss or that elect to treat the dividend income as “investment income” pursuant to section 163(d)(4) of the Code will not be eligible for the reduced rates of taxation regardless of our status as a qualified foreign corporation.

For U.S. federal income tax purposes, the amount of any dividend paid in Won, including any Korean or other taxes withheld, will be included in your gross income in an amount equal to the U.S. dollar value of the Won received calculated by reference to the exchange rate in effect on the date the dividend is received by you, in the case of our common shares, or by the depository, in the case of our ADSs, regardless of whether the Won are converted into U.S. dollars. If the Won are converted into U.S. dollars on the date of actual or constructive receipt, your tax basis in those Won should be equal to their U.S. dollar value on that date and, as a result, you generally should not be required to recognize any foreign exchange gain or loss. If the Won received as a dividend are not converted into U.S. dollars on the date of actual or constructive receipt, you will have a basis in the Won equal to their U.S. dollar value on the date of receipt. Any gain or loss realized on a subsequent conversion or other disposition of the Won generally will be treated as ordinary income or loss and generally will be income or loss from sources within the United States for foreign tax credit limitation purposes.

Subject to certain conditions and limitations, Korean withholding taxes on dividends may be treated as foreign taxes eligible for credit against your U.S. federal income tax liability. Instead of claiming a credit, you may, at your election, deduct such otherwise creditable Korean taxes in computing your taxable income, subject to generally applicable limitations under U.S. federal income tax law. For purposes of calculating the foreign tax credit, dividends paid on our ADSs or common shares generally will be treated as income from sources outside the United States and generally will constitute “passive category income.” Further, in certain circumstances, if you:

have held our ADSs or common shares for less than a specified minimum period during which you are not protected from risk of loss; or
are obligated to make payments related to the dividends, you will not be allowed a foreign tax credit for foreign taxes imposed on dividends paid on our ADSs or common shares.

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The rules governing the availability of the foreign tax credit and the limitations on its availability are fact specific and are subject to complex rules. You are urged to consult your tax advisor regarding the availability of the foreign tax credit under your particular circumstances.

To the extent that the gross amount of any distribution on our ADSs or common shares exceeds our current and accumulated earnings and profits, the excess (including the amount of any Korean taxes withheld from the excess) will first be treated as a non-taxable return of (and will reduce, but not below zero) your tax basis in the ADSs or common shares to the extent thereof. Any remaining portion of the distribution will be treated as capital gain (which will be either long-term or short-term capital gain depending upon whether you have held the ADSs or common shares for more than one year). However, we do not expect to maintain calculations of our earnings and profits under U.S. federal income tax principles and, therefore, U.S. Holders should expect to treat the entire amount of any distribution as dividend income. See “—Backup Withholding Tax and Information Reporting Requirements” below.

Taxation of gains from the sale, exchange, or other disposition of our ADSs or common shares

You generally will recognize capital gain or loss for U.S. federal income tax purposes upon the sale, exchange, or other disposition of our ADSs or common shares in an amount equal to the difference, if any, between the amount realized on the sale, exchange, or other disposition (without reduction for any Korean or other non-U.S. tax withheld from such disposition, and determined in the case of sales or exchanges in currencies other than U.S. dollars by reference to the spot exchange rate in effect on the date of the sale or exchange or, if sold or exchanged on an established securities market and you are a cash basis taxpayer or an electing accrual basis taxpayer, the spot exchange rate in effect on the settlement date) and your adjusted tax basis (as determined in U.S. dollars) in the ADSs or common shares. Such capital gain or loss will be long-term capital gain (taxable at a reduced rate for non-corporate U.S. Holders, including individuals) or loss if, on the date of sale, exchange, or other disposition, you have held the ADSs or common shares for more than one year. The deductibility of capital losses is subject to limitations. You should consult with your own tax advisor regarding the availability of a foreign tax credit or deduction in respect of any Korean tax imposed on a sale or other disposition of ADSs or common shares.

Information Reporting Regarding PFICs and Specified Foreign Financial Assets

If we are a PFIC, unless an exception applies, a U.S. Holder would be required to file IRS Form 8621 for each year in which the U.S. Holder owns our ADSs or common shares, including any taxable year in which the U.S. Holder (i) recognizes gain on the direct or indirect disposition of our ADSs or common shares, (ii) receives certain direct or indirect distributions from us, or (iii) makes any of certain reportable elections (including a mark-to-market election). This requirement is in addition to other reporting requirements applicable to ownership in a PFIC. In the event a U.S. Holder does not file such form, the statute of limitations on the assessment and collection of U.S. federal income taxes of such U.S. Holder for the related tax year may be extended.

Owners of “specified foreign financial assets” with an aggregate value in excess of US\$50,000 (and in some cases, a higher threshold) may be required to file an information report with the IRS (on IRS Form 8938) with respect to such assets with their tax returns. “Specified foreign financial assets” include any financial accounts maintained by foreign financial institutions, as well as any of the following, but only if they are held for investment and not held in accounts maintained by financial institutions: (i) stocks and securities issued by non-U.S. persons, (ii) financial instruments and contracts that have non-U.S. issuers or counterparties and (iii) interests in foreign entities. U.S. Holders are urged to consult their tax advisors regarding the application of this disclosure requirement to their ownership of our stock.

If you are a U.S. Holder, you are urged to consult with your own tax advisor regarding the application of the PFIC and specified foreign financial assets information reporting requirements and related statute of limitations tolling provisions with respect to the ADSs or our common shares.

Reportable transactions

Under U.S. Treasury regulations, U.S. Holders that participate in “reportable transactions” (as defined in the Treasury regulations) must attach to their federal income tax returns a disclosure statement on Form 8886. You should consult your own tax advisor as to the possible obligation to file Form 8886 with respect to the sale, exchange or other disposition of any Won received as a dividend from our ADSs or common shares, or as proceeds from the sale of our ADSs or common shares.

Information reporting and backup withholding

In general, information reporting will apply to payments of dividends in respect of our ADSs or common shares and the proceeds from the sale, exchange, or redemption of our ADSs or common shares that are paid to you within the United States (and in certain cases, outside the United States), unless you are an exempt recipient, such as certain corporations. Backup withholding may apply to such payments if you fail to provide a taxpayer identification number or certification of exempt status, or otherwise fail to comply with applicable certification requirements. Any amounts withheld under the backup withholding rules will be allowed as a refund or a credit against your U.S. federal income tax liability, provided the required information is furnished to the IRS. Prospective investors should consult their own tax advisors as to their qualification for exemption from backup withholding and the procedure for establishing an exemption.

ITEM 10.F. DIVIDENDS AND PAYING AGENTS

Not applicable.

ITEM 10.G. STATEMENT BY EXPERTS

Not applicable.

ITEM 10.H. DOCUMENTS ON DISPLAY

We have filed this Annual Report on Form 20 F, including exhibits, with the SEC. As allowed by the SEC, in ITEM 19 of this Annual Report, we incorporate by reference certain information we filed with the SEC. This means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is considered to be part of this Annual Report. You may inspect and copy this Annual Report, including exhibits, and documents that are incorporated by reference in this Annual Report at the Public Reference Room maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1 800 SEC 0330 for further information on the operation of the Public Reference Room. Any filings we make electronically will be available to the public over the Internet at the Web site of the SEC at <http://www.sec.gov>.

ITEM 10.I. SUBSIDIARY INFORMATION

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of our business, we are subject to market risk associated with currency movements on non Won denominated assets and liabilities and license and royalty revenues and interest rate movements.

Foreign currency risk

We conduct our business primarily in Won, which is also our functional and reporting currency. However, we have exposure to some foreign currency exchange rate fluctuations on cash flows from our branch in Taiwan and overseas licensees. The primary foreign currencies to which we are exposed are the NT dollar, the Japanese Yen and the U.S. dollar. Fluctuations in these exchange rates may affect our subscription revenues or revenues from license fees and royalties and result in exchange losses and increased costs in Won terms.

As of December 31, 2017, we had NT dollar denominated accounts receivable of Won 8,355 million, which represented 19.8% of our total consolidated accounts receivable balance, Japanese Yen denominated accounts receivable of Won 713 million, which represented 1.7% of our total consolidated accounts receivable balance, and

U.S. dollar denominated accounts receivable of Won 22,127 million, which represented 52.3% of our total consolidated accounts receivable balance. We also had NT dollar denominated accounts payable of Won 2,512 million, which represented 5.7% of our total consolidated accounts payable balance, U.S. dollar denominated accounts payable of Won 32,209 million, which represented 72.5% of our total consolidated accounts payable balance and Japanese Yen denominated accounts payable of 6 million, which represented 0.01% of our account receivable balance. As these balances all have short maturities, exposure to foreign currency fluctuations on these balances is not significant. For example, a hypothetical 10% appreciation of the Won against the NT dollar, Japanese Yen and the U.S. dollar, in the aggregate, would reduce our cash flows by Won 353 million.

In 2017, Won 112,915 million of our revenue was derived from currencies other than the Won: primarily the NT dollar, Won 76,121 million; the Japanese Yen, Won 9,491 million; the U.S. dollar, Won 7,774 million; the Thai Baht, Won 6,569 million; and the Chinese Yuan, Won 5,301 million. A hypothetical 10% depreciation in the exchange rates of these foreign currencies against the Won in 2017 would have reduced our revenue by Won 10,526 million.

As of April 20, 2018, we had no foreign currency forward contract outstanding. We may in the future enter into hedging transactions in an effort to reduce our exposure to foreign currency exchange risks, but we may not be able to successfully hedge our exposure at all. In addition, our currency exchange losses may be magnified by Korean exchange control regulations that restrict our ability to convert the Won into U.S. dollar, Japanese Yen or Euro under certain emergency circumstances.

Interest rate risk

Our exposure to risk for changes in interest rates relates primarily to our investments in short term financial instruments and other investments. Investments in both fixed rate and floating rate interest earning instruments carry some interest rate risk. The fair value of fixed rate securities may fall due to a rise in interest rates, while floating rate securities may produce less income than expected if interest rates fall. We do not believe that we are subject to any material market risk exposure on our short term financial instruments, as they are readily convertible to cash and have short maturities.

Credit risk

Our cash and cash equivalents and short term financial instruments are placed with several local financial institutions. Three different financial institutions are holding approximately 30.6%, 18.9% and 18.7% respectively of our cash and cash equivalents and short term financial instruments. We face a potential credit risk that the financial institutions may become insolvent and be unable to repay our principal and interest in a timely manner. While the management believes such financial institutions are of a high credit quality, it is difficult for us to predict the financial condition of the Korean or Taiwanese banking sectors and the financial institutions that manage our cash holdings. We may be materially and adversely affected by any widespread failure in the Korean or Taiwanese banking sectors caused by any economic downturn or volatile financial markets in the future.

The above discussion and the estimated amounts generated from the sensitivity analyses referred to above include “forward looking statements,” which assume for analytical purposes that certain market conditions may occur. Accordingly, such forward looking statements should not be considered projections by us of future events or losses.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

ITEM 12.A. DEBT SECURITIES

Not applicable.

ITEM 12.B. WARRANTS AND RIGHTS

Not applicable.

ITEM 12.C. OTHER SECURITIES

Not applicable.

ITEM 12.D. AMERICAN DEPOSITARY SHARES

Fees and Charges Our ADS holders May Have to Pay

The Bank of New York Mellon, the depository of our ADS program, collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs for the purpose of withdrawal or from intermediaries acting for them. The depository collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depository may collect its annual fee for depository services by deductions from cash distributions or by directly billing investors or by charging the book entry system accounts of participants acting for them. The depository may generally refuse to provide fee attracting services until its fees for those services are paid.

Persons depositing or withdrawing shares must pay:
\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)

\$.02 (or less) per ADS

A fee equivalent to the fee that would be payable if securities distributed to you had been shares and the shares had been deposited for issuance of ADSs

\$.02 (or less) per ADS per calendar year

Registration or transfer fees

Expenses of the depository

Taxes and other governmental charges the depository or the custodian has to pay on any ADS or share underlying an ADS, including without limitation stock transfer taxes, stamp duty or withholding taxes

Any charges incurred by the depository or its agents for servicing the deposited securities

Fees and Other Payments Made by the Depository to Us

For:

- Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property
- Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates
- Any cash distribution to ADS registered holders
- Distribution of securities distributed to holders of deposited securities which are distributed by the depository to ADS registered holders
- Depository services
- Transfer and registration of shares on our share register to or from the name of the depository or its agent when you deposit or withdraw shares
- Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)
- Converting foreign currency to U.S. dollars
- As necessary

• As necessary

The Bank of New York Mellon, as depository, has agreed to reimburse the Company for expenses they incur that are related to establishment and maintenance expenses of the ADS program. The depository has agreed to reimburse the Company for its continuing annual stock exchange listing fees. The depository has also agreed to pay the standard out of pocket maintenance costs for the ADRs, which consist of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend checks, electronic filing of U.S. Federal tax information, mailing required tax forms, stationery, postage, facsimile, and telephone calls. It has also agreed to reimburse the Company annually for certain investor relationship programs or special investor relations promotional activities. In certain instances, the depository has agreed to provide additional payments to the Company based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depository will reimburse the Company, but the amount of reimbursement available to the Company is not necessarily tied to the amount of fees the depository collects from investors.

From January 1, 2017 to December 31, 2017, the depositary waived fees for standard costs associated with the administration of the ADRs estimated to total US\$ 45,000.

From January 1, 2018 to the date of this Annual Report, the Company received no reimbursement from the depositary.

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PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not applicable.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not applicable.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2017. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures as of December 31, 2017 were effective to provide reasonable assurance that information required to be disclosed by us in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit the preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Our management has evaluated the effectiveness of our internal control over financial reporting as of December 31, 2017, based upon criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 Framework) and concluded that we maintained effective internal

control over financial reporting as of December 31, 2017.

Attestation Report of the Registered Public Accounting Firm

This Annual Report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting, as we are a non-accelerated filer exempted from section 404(b) of the Sarbanes-Oxley Act.

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Changes in Internal Control over Financial Reporting

Certain of our mobile games and services were provided through servers located overseas and operated by a third party developer and/or licensee. During 2017, we implemented general information technology controls which were operated by third party developers for the adequate preparation of financial statements and effective internal controls. We directly accessed these controls and evaluated their effectiveness as of December 31, 2017, as no Service Organization Controls (“SOC”) report from the third party developers and licensees was available.

Also, in order to facilitate our expected adoption of new revenue recognition accounting standard starting from January 1, 2018, we implemented internal controls for proper evaluation of customer contracts and assessments of impacts to our financial statements. We expect to continue to implement additional internal controls related to the adoption of the new revenue recognition standard during the first half of 2018.

There have been no other changes in our internal control over financial reporting that occurred during the year ended December 31, 2017 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

ITEM 16. RESERVED

ITEM 16.A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Board of Directors has determined that Mr. Jong Gyu Hwang, our outside director, is an “audit committee financial expert,” as such term is defined by the regulations of the SEC issued pursuant to Section 407 of the Sarbanes Oxley Act. Mr. Hwang is an independent director as such term is defined in Rule 10A-3 of the Exchange Act for purposes of the listing standards of NASDAQ that are applicable.

ITEM 16.B. CODE OF ETHICS

Pursuant to the requirements of the Sarbanes Oxley Act, we previously adopted a Code of Ethics applicable to all our employees, including our Chief Executive Officer, Chief Financial Officer and all other directors and executive officers. We have adopted an amended Code of Ethics, applicable to all our directors and officers and employees, which was filed as Exhibit 11.1 to our annual report for the year ended December 31, 2005. The amendment was made to more clearly set forth the principles underlying the Code of Ethics in order to assist our directors, officers and employees in connection with their adherence to the guidelines for ethical behavior described in the Code of Ethics.

ITEM 16.C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The tables below set forth the aggregate fees billed by Samil PricewaterhouseCoopers, the Korean network firm of PricewaterhouseCoopers and our principal accountant for the years ended December 31, 2017 and December 31, 2016, categorized by the types of services provided and a brief description of the nature of such services.

Type of Service	Year Ended December 31,		Nature of Services
	2016	2017	
Audit Fees	₩ 440	₩ 679	Audit service for the Company
Audit Related Fees	—	—	
Tax Fees	—	₩ 15	
All Other Fees	—	—	
Total	₩ 440	₩ 694	

Pre-approval Policies and Procedures of the Audit Committee

Under our audit committee rules and policies, our audit committee or any member thereof, to whom approval authority has been delegated, must approve all audit services performed by our principal accountant after consulting our management.

ITEM 16.D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16.E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

Not applicable.

ITEM 16.F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT

The disclosure related to this Item was previously reported, as that term is defined in Rule 12b-2 under the Exchange Act, in our Form 20-F filed on April 20, 2016, as amended on April 29, 2016.

ITEM 16.G. CORPORATE GOVERNANCE

See ITEM 6.C. "BOARD PRACTICES."

ITEM 16.H. MINE SAFETY DISCLOSURE

Not applicable.

PART III

ITEM 17. FINANCIAL STATEMENTS

We have responded to ITEM 18 in lieu of responding to this item.

ITEM 18. FINANCIAL STATEMENTS

Reference is made to ITEM 19 “EXHIBITS” for a list of all financial statements and related notes filed as part of this Annual Report.

ITEM 19. EXHIBITS

(a) Financial Statements filed as part of this Annual Report

The following financial statements and related notes, together with the reports of an independent registered public accounting firm thereon, are filed as part of this Annual Report:

<u>Index to the Consolidated Financial Statements</u>	Page F-1
<u>Report of Independent Registered Public Accounting Firm on the Consolidated Financial Statements</u>	F-2
<u>Consolidated Statements of Financial Position as of December 31, 2017, December 31, 2016 and January 1, 2016</u>	F-3
<u>Consolidated Statements of Comprehensive Income for the Years Ended December 31, 2017, and 2016</u>	F-4
<u>Consolidated Statements of Changes in Equity for the Years Ended December 31, 2017, and 2016</u>	F-5
<u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2017, and 2016</u>	F-6
<u>Notes to Consolidated Financial Statements</u>	F-7

(b) Exhibits filed as part of this Annual Report

Exhibit

No.	Description
1.1	<u>Articles of Incorporation, amended as of March 27, 2012 (English translation, incorporated by reference to Exhibit 1.1 of our annual report on Form 20 F (file no. 000 51138) filed with the Securities and Exchange Commission on April 27, 2012)</u>
2.1	<u>Form of Stock Certificate of Registrant’s common stock, par value Won 500 per share (incorporated by reference to Exhibit 4.1 of our Registration Statement on Form F 1 (file no. 333 122159) filed with the Securities and Exchange Commission on January 20, 2005)</u>
2.2	<u>Form of Deposit Agreement among Registrant, The Bank of New York Mellon, formerly known as The Bank of New York, as depositary, and all holders and beneficial owners of American Depositary Shares evidenced by American Depositary Receipts, including the form of American depositary receipt (incorporated by reference to Exhibit 1 of our Registration Statement on Form F 6 (file no. 333 122160) filed with the Securities and Exchange Commission on January 20, 2005)</u>

- 4.1 Ragnarok License and Distribution Agreement, dated July 24, 2002, between GungHo Online Entertainment, Inc. (formerly OnSale Japan K.K.) (licensee in Japan) and Registrant (incorporated by reference to Exhibit 10.11 of our Registration Statement on Form F 1 (file no. 333 122159) filed with the Securities and Exchange Commission on January 20, 2005)
- 4.2 Amendment to Ragnarok License and Distribution Agreement, dated September 23, 2004, between GungHo Online Entertainment, Inc. (licensee in Japan) and Registrant (incorporated by reference to Exhibit 10.12 of our Registration Statement on Form F 1 (file no. 333 122159) filed with the Securities and Exchange Commission on January 20, 2005)
- 4.3 2nd Renewal of Ragnarok License and Distribution Agreement dated September 29, 2006 between GungHo Online Entertainment, Inc. (licensee in Japan) and Registrant (incorporated by reference to Exhibit 4.45 of our annual report on Form 20 F (file no. 000 51138) filed with the Securities and Exchange Commission on June 29, 2007)

- 4.4 Amendment to the 2nd Renewal of Ragnarok License and Distribution Agreement dated September 29, 2009 between GungHo Online Entertainment, Inc. (licensee in Japan) and Registrant (incorporated by reference to Exhibit 4.77 of our annual report on Form 20 F (file no. 000 51138) filed with the Securities and Exchange Commission on June 1, 2010)
- 4.5 7th Amendment to the 2nd Renewal of Ragnarok License and Distribution Agreement dated September 29, 2012 between GungHo Online Entertainment, Inc. (licensee in Japan) and Registrant (incorporated by reference to Exhibit 4.44 of our annual report on Form 20 F (file no. 000 51138) filed with the Securities and Exchange Commission on April 26, 2013)
- 4.6 8th Amendment to the 2nd Renewal of Ragnarok License and Distribution Agreement dated September 29, 2015 between GungHo Online Entertainment, Inc. and Registrant (incorporated by reference to Exhibit 4.58 of our annual report on Form 20 F (file no. 000-51138) filed with the Securities and Exchange Commission on April 20, 2016)
- 4.7 Lease Agreement dated January 3, 2013, between National IT Industry Promotion Agency and Registrant (translation in English, incorporated by reference to Exhibit 4.48 of our annual report on Form 20 F (file no. 000 51138) filed with the Securities and Exchange Commission on April 26, 2013)
- 4.8 Amendment to Lease Agreement dated May 1, 2013 between National IT Industry Promotion Agency and Registrant (translation in English) (incorporated by reference to Exhibit 4.44 of our annual report on Form 20 F (file no. 000 51138) filed with the Securities and Exchange Commission on April 30, 2014)
- 4.9 Lease Agreement dated December 31, 2014 between National IT Industry Promotion Agency and Registrant (incorporated by reference to Exhibit 4.51 of our annual report on Form 20-F (file no. 000-51138) filed with the Securities and Exchange Commission on April 27, 2015)
- 4.10 Lease Agreement dated December 31, 2016 between National IT Industry Promotion Agency and Registrant (incorporated by reference to Exhibit 4.10 of our annual report on Form 20 F (file no. 000-51138) filed with the Securities and Exchange Commission on April 28, 2017)
- 8.1* List of Registrant's subsidiaries
- 11.1 Registrant's Code of Ethics (amended, incorporated by reference to Exhibit 11.1 of our annual report on Form 20 F (file no. 000 51138) filed with the Securities and Exchange Commission on June 30, 2006)
- 12.1* CEO Certification Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
- 12.2* CFO Certification Pursuant to Section 302 of the Sarbanes Oxley Act of 2002
- 13.1* CEO Certification Pursuant to Section 906 of the Sarbanes Oxley Act of 2002
- 13.2* CFO Certification Pursuant to Section 906 of the Sarbanes Oxley Act of 2002
- 101.INS* XBRL Instance Document
- 101.SCH* XBRL Taxonomy Extension Schema Document
- 101.CAL* XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF* XBRL Taxonomy Extension Definition Linkbase Document

101.LAB* XBRL Taxonomy Extension Label Linkbase Document

101.PRE* XBRL Taxonomy Extension Presentation Linkbase Document

*Filed herewith

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20 F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

GRAVITY CO., LTD.

By: /s/ Heung Gon Kim
Name: Heung Gon Kim
Title: Chief Financial Officer

Date: April 27, 2018

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Gravity Co., Ltd.

Opinion on the Financial Statements

We have audited the accompanying consolidated statements of financial position of Gravity Co., Ltd. and subsidiaries (the “Company”) as of December 31, 2017, December 31, 2016, January 1, 2016, and the related consolidated statements of comprehensive income, changes in equity, and cash flows for each of the two years in the period ended December 31, 2017, including the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017, December 31, 2016, January 1, 2016, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2017 in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits of these consolidated financial statements in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Samil PricewaterhouseCoopers

Seoul, KOREA
April 27, 2018

We have served as the Company's auditor since 2016.

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GRAVITY CO., LTD.

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

December 31, 2017, December 31, 2016 and January 1, 2016

		December 31,	December 31,	January 1,
	Note	2017	2016	2016
		(In millions of Korean won)		
Assets				
Cash and cash equivalents	5, 6	₩ 39,095	₩ 16,720	₩ 24,909
Short-term financial instruments	6	22,500	22,000	11,500
Accounts receivables, net	6, 7	42,168	11,819	5,289
Other receivables, net	6, 7	698	710	160
Prepaid expenses		3,027	1,213	764
Other current assets	6	1,383	1,131	836
Total current assets		108,871	53,593	43,458
Property and equipment, net	8	946	478	650
Intangible assets	9	1,036	234	392
Deferred tax assets	17	3,036	—	—
Other non-current financial assets	6	1,394	965	954
Other non-current assets	11	600	474	421
Total non-current assets		7,012	2,151	2,417
Total assets		₩ 115,883	₩ 55,744	₩ 45,875
Liabilities				
Accounts payables	6	₩ 44,410	₩ 9,723	₩ 2,535
Deferred revenue		16,100	9,689	4,997
Withholdings		1,439	199	188
Accrued expense	6	1,037	865	947
Income tax payable	17	1,628	208	120
Other current liabilities	6	130	2	18
Total current liabilities		64,744	20,686	8,805
Long-term deferred revenue		6,581	4,096	6,601
Other non-current liabilities	6	560	315	332
Total non-current liabilities		7,141	4,411	6,933
Total liabilities		71,885	25,097	15,738
Equity				
Share capital	12	3,474	3,474	3,474
Capital surplus	12	27,164	27,901	43,627
Other components of equity	12	(40)	(77)	—
Retained earnings (Accumulated deficit)	12	13,962	(94)	(16,477)
Equity attributable to owners of the Parent Company		44,560	31,204	30,624
Non-controlling interest		(562)	(557)	(487)
Total equity		43,998	30,647	30,137
Total liabilities and equity		₩ 115,883	₩ 55,744	₩ 45,875

The accompanying notes are an integral part of these consolidated financial statements.

GRAVITY CO., LTD.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

For the Years Ended December 31, 2017 and 2016

	Note	2017	2016
		(In millions of Korean won except per share data)	
Revenue	21, 22	₩ 141,623	₩ 51,396
Online games—subscription revenue		36,428	23,065
Online games—royalties and license fees		16,244	12,867
Mobile games and applications		82,624	12,041
Character merchandising, animation and other revenue		6,327	3,423
Cost of revenue	13	94,234	29,587
Gross profit		47,389	21,809
Selling, general and administrative expenses	13, 14	(28,012)	(15,977)
Research and development	13	(5,239)	(1,973)
Other income	15	165	44
Other expenses	15	(268)	(69)
Operating profit		14,035	3,834
Finance income	6, 16	1,875	1,666
Finance costs	6, 16	(1,452)	(1,673)
Profit before income tax		14,458	3,827
Income tax expense	17	1,144	3,240
Profit for the year		₩ 13,314	₩ 587
Other comprehensive income (loss)			
Items that may be subsequently reclassified to income or loss			
Foreign currency translation adjustments	12	37	(77)
Total comprehensive income for the year		₩ 13,351	₩ 510
Profit (loss) attributable to:			
Owners of the Parent Company		13,319	657
Non controlling interest		(5)	(70)
Total comprehensive income attributable to:			
Owners of the Parent Company		13,356	580
Non-controlling interest		(5)	(70)
Earnings per share (in Korean won)			
Basic earnings per share	18	₩ 1,917	₩ 95
Diluted earnings per share	18	1,917	95

The accompanying notes are an integral part of these consolidated financial statements.

GRAVITY CO., LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

For the Years Ended December 31, 2016 and 2017

	Attributable to owners of the Parent Company					Non-	
	Share	Capital	Other	Retained	Total	Interest	Controlling Total equity
	Note capital	surplus	components of equity	earnings (Accumulated deficit)			
	(In millions of Korean won)						
Balance at January 1, 2016	₩ 3,474	₩ 43,627	₩ —	₩ (16,477)	₩ 30,624	₩ (487)	₩ 30,137
Total comprehensive income (loss) for the year							
Profit (loss) for the year	—	—	—	657	657	(70)	587
Foreign currency translation adjustments	12	—	(77)	—	(77)	—	(77)
Total comprehensive income (loss) for the year	—	—	(77)	657	580	(70)	510
Transaction with owners, recognized directly in equity							
Disposition of deficit with capital surplus	—	(15,726)	—	15,726	—	—	—
Balance at December 31, 2016	3,474	27,901	(77)	(94)	31,204	(557)	30,647
Balance at January 1, 2017	3,474	27,901	(77)	(94)	31,204	(557)	30,647
Total comprehensive income (loss) for the year							
Profit (loss) for the year	—	—	—	13,319	13,319	(5)	13,314
Foreign currency translation adjustments	12	—	37	—	37	—	37
Total comprehensive income (loss) for the year	—	—	37	13,319	13,356	(5)	13,351
Transaction with owners, recognized directly in equity							
Disposition of deficit with capital surplus	—	(737)	—	737	—	—	—
Balance at December 31, 2017	₩ 3,474	₩ 27,164	₩ (40)	₩ 13,962	₩ 44,560	₩ (562)	₩ 43,998

The accompanying notes are an integral part of these consolidated financial statements.

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GRAVITY CO., LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2017 and 2016

	Note	2017	2016
		(In millions of Korean won)	
Cash flows from operating activities			
Cash generated from operations	19	₩ 28,189	₩ 5,213
Interest received		554	468
Income taxes paid		(2,607)	(3,187)
Net cash inflow from operating activities		26,136	2,494
Cash flows from investing activities			
Proceeds from lease deposits		7	2
Proceeds from short-term loans		3	6
Proceeds from disposal of property and equipment	8	2	3
Increase in short term financial instruments, net		(500)	(10,500)
Payment of lease deposits		(430)	(10)
Purchase of property and equipment	8	(899)	(154)
Purchase of other intangible assets	9	(1,165)	(14)
Net cash outflow in investing activities		(2,982)	(10,667)
Cash flows from financing activities			
Net cash inflow (outflow) in financing activities		—	—
Effect of exchange rate changes on cash and cash equivalents		(779)	(16)
Net increase (decrease) in cash and cash equivalents		22,375	(8,189)
Cash and cash equivalents at beginning of the year		16,720	24,909
Cash and cash equivalents at end of the year		₩ 39,095	₩ 16,720

The accompanying notes are an integral part of these consolidated financial statements.

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GRAVITY CO., LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. General Information

The Parent Company

Gravity Co., Ltd. (the “Parent Company” or “Gravity”) was incorporated on April 4, 2000 to engage in developing and distributing online games and other related businesses principally in the Republic of Korea and other countries in Asia, North and South America, and Europe. Gravity’s principal product, Ragnarok Online, a multiplayer online role playing game, was commercially launched in August 2002. On February 8, 2005, Gravity listed its common shares on NASDAQ in the United States by means of American Depositary Shares (“ADSs”).

Gravity has four subsidiaries. NeoCyon, Inc. and Gravity Games Corporation operate in the Republic of Korea, Gravity Interactive, Inc., operates in the United States and Gravity Entertainment Corporation operates in Japan. Gravity has a local branch in Taiwan.

On April 1, 2008, GungHo Online Entertainment, Inc. became a majority shareholder by acquiring 52.39% of the voting shares from Heartis Inc., the former majority shareholder, and also acquired an additional 6.92% of voting shares on June 23 and June 24, 2008. As of December 31, 2017, GungHo Online Entertainment, Inc. has majority ownership and voting rights (59.31%) over the Gravity.

Consolidated Subsidiaries

The accompanying consolidated financial statements include the accounts of Gravity and the consolidated subsidiaries (collectively referred to as the “Company”). Details of the consolidated subsidiaries as of December 31, 2017, December 31, 2016, and January 1, 2016, are as follows:

Subsidiary	Location	Ownership interest held	by the Gravity	Main business
NeoCyon, Inc.	Korea	96.11	%	Mobile game development and service
Gravity Interactive, Inc	U.S.A.	100.00	%	Online and mobile game services
Gravity Games Corp	Korea	85.50	%	Online game development
Gravity Entertainment Corp	Japan	100.00	%	Animation production, distribution, and game services

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 years presented, unless otherwise stated.

Basis of Preparation

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by International Accounting Standard Board (“IASB”). The Company has adopted IFRS as issued by IASB for the annual period beginning on January 1, 2017. In accordance with IFRS 1 First-time adoption of IFRS, the Company’s transition date to IFRS is January 1, 2016. Prior to the adoption of IFRS, the Company prepared the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (“U.S.GAAP”). These are the Company’s first consolidated financial statements prepared in accordance with IFRSs including IFRS No. 1, First-time adoption of International Financial Reporting Standards. Reconciliations and descriptions of the effect of the transition on the Company’s assets, liabilities, equity, and comprehensive income are provided in Note 4.

The preparation of financial statements requires the use of critical accounting estimates. Management also needs to exercise judgement in applying Gravity’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 3.

Consolidation

The Company has prepared the consolidated financial statements in accordance with IFRS 10 Consolidated Financial Statements.

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Subsidiaries are all entities over which Gravity has control. The Company controls an entity when the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power to direct the activities of the entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Gravity. They are deconsolidated from the date that control ceases.

The acquisition method of accounting is used to account for business combinations by the Company. The consideration transferred is measured at the fair values of the assets transferred, and identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair value at the acquisition date. The Company recognizes any non-controlling interest in the acquired entity on an acquisition-by-acquisition basis either at fair value or at the non-controlling interest's proportionate share of the acquired entity's net identifiable assets. All other non-controlling interests are measured at fair values, unless otherwise required by other standards. Acquisition-related costs are expensed as incurred.

The excess of consideration transferred, amount of any non-controlling interest in the acquired entity and acquisition-date fair value of any previous equity interest in the acquired entity over the fair value of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the business acquired, the difference is recognized directly in the profit or loss as a bargain purchase.

Intercompany transactions, balances and unrealized gains on transactions between consolidated companies are eliminated. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the transferred asset. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by Gravity.

Foreign Currency Translation

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 each entity operates (the "functional currency"). The consolidated financial statements are presented in Korean Won, which is the Parent Company's functional currency.

Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies at year end exchange rates are generally recognized in profit or loss.

Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined. Translation differences on assets and liabilities carried at fair value are reported as part of the fair value gain or loss. For example, translation differences on non-monetary 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 and translation differences on non-monetary assets such as equities classified as available-for-sale financial assets are recognized in other comprehensive income.

Finance Income and Finance Costs

Finance income comprises interest income, unrealized foreign currency gain, and gain on foreign currency transaction. Finance costs comprise unrealized foreign currency loss and loss on foreign currency transaction. The Company presents all foreign exchange gains and losses in finance income and finance costs.

Segment Reporting

Information of each operating segment is reported in a manner consistent with the internal business segment reporting provided to the chief operating decision-maker (Note 21). The chief operating decision-maker is responsible for allocating resources and assessing performance of the operating segments.

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Cash and cash equivalents

Cash and cash equivalents consist of cash held, bank deposits and floating short-term investment assets with an expiration date of less than three months upon acquisition.

Financial Assets

Classification and measurement

The Company classifies its financial assets into the following categories: financial assets at fair value through profit or loss, available-for-sale financial assets, loans and receivables, and held-to-maturity financial assets. Regular way purchases and sales of financial assets are recognized as of the trade date, the date on which the Company commits to purchase or sell the asset.

At initial recognition, the Company measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at fair value through profit or loss are expensed in profit or loss. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. And, loans and receivables and held-to-maturity investments are subsequently carried at amortized cost using the effective interest method.

Gains or losses arising from changes in the fair value of financial assets at fair value through profit or loss are recognized in profit or loss within other income or other expenses. Gains or losses arising from changes in the available-for-sale financial assets are recognized in other comprehensive income, and amounts are reclassified to profit or loss when the associated assets are sold or impaired.

Impairment

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 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.

Impairment of loans and receivables is presented as a deduction in an allowance account, and impairment of other financial assets is directly deducted from their carrying amount. The Company writes off financial assets when the assets are determined to be no longer recoverable.

The Company considers that there is objective evidence of impairment if the debtor has significant financial difficulties of the debtor, or delinquency in interest or principal payments.

Derecognition

If a transfer does not result in derecognition because the Company has retained substantially all the risks and rewards of ownership of the transferred asset, the Company continues to recognize the transferred asset in its entirety and recognizes a financial liability for the consideration received. For the years ended December 31, 2017 and 2016, there were no transfers of financial assets.

Offsetting of financial instruments

Financial assets and liabilities are offset and the net amount reported in the consolidated statements of financial position where 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 assets and settle the liability simultaneously. The legally enforceable right must not be contingent on future events and must be enforceable in the normal course of business and in the event of default, insolvency or bankruptcy of the Company or the counterparty. For the years ended December 31, 2017 and 2016, there were no offsetting of financial instruments.

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Property and equipment

Property and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the assets.

Depreciation of all property and equipment, except for land, is calculated using the straight-line method to allocate their cost or revalued amounts, net of their residual values, over their estimated useful lives as follows:

Computer and equipment	4 years
Furniture and fixtures	4 years
Leasehold improvements	4 years

The assets' depreciation method, residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period.

Intangible assets

Intangible assets, except for goodwill, are initially recognized at its historical cost, and carried at cost less accumulated amortization and accumulated impairment losses.

The Company amortizes intangible assets with a definite useful life using the straight-line method over the following periods:

Software	3 years
Industrial property rights	10 years
License	3 years
Other intangible assets	3 years

Royalties and licenses

The Company entered into a game licensing agreement with number of third parties to gain exclusive rights to the games developed by other companies, 'Licensors'. The contracts with some licensors include initial upfront license fees, and/or minimum guaranteed royalty payments, which are creditable against the amount of running royalty calculated as certain percentage of the Company's revenue. The license fee payments and minimum guaranteed royalty payments are initially recorded as 'License' and 'Other non-current asset', respectively. Running royalty obligation over the guaranteed minimum payment is accrued as incurred and subsequently paid.

The royalty-based obligations are generally expensed to cost of revenue generally at the greater of the contractual rate or a straight-line basis over the term of the contract when the contract includes minimum guaranteed royalty payments. The license payments are generally expensed to cost of revenue generally at a straight-line basis over the term of the contract.

The Company evaluate the expected future realization of these assets using discounted cash flows. If impairment exists, then the assets are written down to fair value less cost of disposal.

Impairment of Non-financial Assets

Goodwill and intangible assets that have an indefinite useful life or not yet available for use, are not subject to amortization and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested 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 of disposal or value in use. Non-financial assets other than goodwill that have been impaired are reviewed for possible reversal of the impairment at the end of each reporting period.

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Financial Liabilities

Classification and measurement

The Company's financial liabilities at fair value through profit or loss are financial instruments held for trading. A financial liability is held for trading if it is incurred principally for the purpose of repurchasing in the near term. A derivative that is not a designated as hedging instruments and an embedded derivative that is separated are also classified as held for trading.

The Company classifies non-derivative financial liabilities, except for financial liabilities at fair value through profit or loss, financial guarantee contracts and financial liabilities that arise when a transfer of financial assets does not qualify for derecognition, as financial liabilities carried at amortized cost and present as 'accounts payables' and 'other liabilities' in the statement of financial position.

Derecognition

Financial liabilities are removed from the statement of financial position when they are extinguished; for example, when the obligation specified in the contract is discharged, cancelled or expired or when the terms of an existing financial liability are substantially modified.

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (where the effect of the time value of money is material). The discount rate used is a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized in profit or loss as borrowing cost.

At the end of each reporting period, the remaining provision balance is reviewed and assessed to determine if the current best estimate is being recognized. If the existence of an obligation to transfer economic benefit is no longer probable, the related provision is reversed during the period.

As of December 31, 2017, 2016 and January 1, 2016, there are no material provision balances on the consolidated statements of financial position.

Current and Deferred Tax

The tax expense for the period consists of current and deferred tax. Current and deferred taxes are recognized in profit or loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In these cases, the tax is also recognized in other comprehensive income or directly in equity, respectively.

The tax expense is measured at the amount expected to be paid to the taxation authorities, using the tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. The Company recognizes current income tax on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is provided in full, 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 income tax is not accounted for if it arises 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 or loss.

Deferred tax assets are recognized only if it is probable that future taxable income will be available to utilize those temporary differences.

The Company recognizes a deferred tax liability all taxable temporary differences associated with investments in subsidiaries, associates, and interests in joint arrangements, except to the extent that the Company is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. In addition, The Company recognizes a deferred tax asset for all deductible temporary differences arising from such investments to the extent that it is probable the temporary difference will reverse in the foreseeable future and taxable profit will be available against which the temporary difference can be utilized.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets and liabilities and when the deferred tax balances relate to the same taxation authority. Current tax assets and tax liabilities are offset where the entity has a legally enforceable right to offset and intends to settle on a net basis.

Employee Benefits

Salaries

During the accounting period, during which employees provide work services to generate the right to annual paid vacation, the Company recognizes the costs and liabilities associated with annual paid vacation.

Defined contribution plan

The Company operates defined contribution plan for certain employees and directors in Korea. Gravity and NeoCyon introduced a defined contribution plan in 2005 and 2011, respectively, and provide an individual account for each participant. The Company pays contribution to publicly or privately administered pension insurance plans on a mandatory or contractual basis. The Company has no further payment obligation once the contribution has been paid. Contributions to defined contribution retirement benefit plans are recognized as an expense when employees have rendered service entitling them to the contributions.

Revenue Recognition

The Company recognizes revenue when it is probable that future economic benefits will flow to the Company and the amount of revenue can be reliably measured. The Company derives revenue principally from online and mobile subscription revenues from Ragnarok Online and Ragnarok Online intellectual property (“IP”)-based games paid by users in Korea, Taiwan and the United States and Canada, and royalties and license fees paid by the licensee of the Company in overseas markets.

Online games—subscription revenue

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Players can access certain games free of charge, but may purchase game points to acquire in-game premium features. Subscription revenue consists of revenues from (i) micro-transactions, and (ii) subscription fees from Internet cafés. Micro-transaction fees for consumable in-game items are deferred when purchased, and then recognized as revenue as they are used in the games while permanent in-game items are recognized ratably as revenues over the estimated life cycle of game users. Prepaid subscription fees from Internet cafés are deferred and recognized as revenue on a monthly basis based on actual hours used.

Online games—royalties and license fees

The Company licenses the right to distribute, promote, and market its local version of games in overseas countries in exchange for an initial upfront license fee and/or guaranteed minimum royalties. The upfront license fee and/or guaranteed minimum royalties are recorded as deferred revenue and recognized ratably over the license period. When the running royalty revenue based on the contractual royalty rate and the actual revenue of the licensee exceeds the ratably recognized guaranteed minimum, the excess is then recognized as revenue and accounts receivable.

Mobile games and applications revenue

Mobile games and applications revenue consists of (i) revenues from micro-transactions that users purchase in cases where the Company directly provides mobile game services to users; (ii) royalties and license fees from licensees to which the Company licenses the right to distribute, promote, and market its local version of mobile games in overseas countries; (iii) royalties and license fees from licensees to which the Company licenses the right to use the original game and intellectual property (“IP”) to develop new games and distribute, promote, and market those newly developed games; (iv) revenues from contract development services provided by the Company to third parties, such as developing games embedded in mobile phones, mobile applications, and sound for mobile phones and appliances; (v) revenues from mobile games operation services for third parties.

Revenues from micro-transactions and royalties and license fees from licensees are recognized in line with those of Online games. Revenues from contract development services are recognized when the services have been rendered and the customers can begin use in accordance with the contractual terms. Revenues from mobile application development service are recognized by measuring progress-to-completion under the percentage-of-completion method. The stage of completion is measured by reference to the costs incurred up to the end of the reporting period as a percentage of total estimated costs for each contract. Revenues from mobile games operation service are based on an agreed percentage of each of the licensors’ revenues based on the licensor’s sales from the mobile games the Company operates on their behalf and recognized on a monthly basis.

Character merchandising, animation and other revenue

Character merchandising, animation and other revenue consists of revenue from sales of console games, game character merchandising, animation and other services, including sales of goods related to mobile phones and website development and operation services for third parties.

Revenue from sales of console games is derived from a specified percentage of the publisher’s sales after deductibles, including payments to the platform holder and others, and recognized on a quarterly basis as they are earned by the publisher. Royalty payments from game character merchandising are recognized on a quarterly basis as they are earned by the licensee. Contract prices for the Company’s services provided to third parties are recognized when the products or services have been delivered or rendered and the customers can begin their use in accordance with the contractual terms.

Research and development expenses

Research and development expenses consist primarily of payroll and other overhead expenses which are all expensed as incurred. Research and development expenses for a game development are capitalized only after the technological feasibility of the game is established. The technological feasibility of the game is not established until substantially all development is complete, which is generally when it is ready for open beta testing.

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Lease

A lease is an agreement, whereby the lessor conveys to the lessee, in return for a payment or series of payments, the right to use an asset for an agreed period of time. Leases in which a significant portion of the risks and rewards of ownership are not transferred to the Company are classified as operating leases. Payments made under operating leases are charged to expenses on a straight-line basis over the period of lease

Earnings per share

Basic earnings per share is calculated by dividing profit attributable to owners of the Parent by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net earnings by the weighted average number of common shares outstanding, increased by common stock equivalents. However, for the years ended December 31, 2017 and 2016, there have been no common stock equivalents outstanding.

Approval of the Financial Statements

The 2017 consolidated financial statements were approved by the Board of Directors on April 27, 2018.

New standards and interpretations not yet adopted by the Company

Certain new accounting standards and interpretations that have been published but are not mandatory for the annual reporting period commencing January 1, 2017 and have not been early adopted by the Company are set out below.

(i) IFRS 15 Revenue from Contracts with Customers

The Company will apply IFRS 15 Revenue from Contracts with Customers issued in May 2014 and amended in September 2015 for annual reporting periods beginning on or after January 1, 2018. Earlier adoption is permitted under IFRS. This standard replaces IAS 18 Revenue, IAS 11 Construction Contracts, SIC Interpretation 31 Revenue-Barter Transactions Involving Advertising Services, IFRIC Interpretation 13 Customer Loyalty Programs, IFRIC Interpretation 15 Agreements for the Construction of Real Estate and IFRIC Interpretation 18 Transfers of assets from customers. The Company must apply IFRS 15 Revenue from Contracts with Customers within annual reporting periods beginning on or after January 1, 2018, and will elect the modified retrospective approach which will recognize the cumulative impact of initially applying the revenue standard as an adjustment to retained earnings as of January 1, 2018, the period of initial application.

In order to prepare for the adoption of IFRS 15, the Company formed a task force consisting of members from the accounting department and other relevant departments, as necessary. Beginning in September 2017, the Company performed a detailed impact analysis of the financial effects of adopting the standard. In addition to the accounting and financial reporting impact, the Company also analyzed the impact of IFRS 15 on their internal controls, based on the Company's revenue structure and processes. IFRS 15 will affect not only accounting methods but also general business practices, including the execution of new contracts and overall business attitude. Therefore, the Company has launched an orientation and training program for both the Company's directors and employees.

As a result of the analysis, the Company identified the following area that is likely to be impacted by the adoption of IFRS 15.

The accounting for royalties and license fees from game licensing contracts. The Company licenses the right to distribute and market its local version of games to overseas licensees ("game licensing contracts") in exchange for an

initial prepaid license fee and/or guaranteed minimum royalty payments. The Company generally provides its licenses with post-contract customer support on its software products, consisting of technical support and occasional unspecified upgrades, or enhancements during the contract term. The Company determined that granting a license is not distinct from other promised services in the contracts, therefore, the promise to grant a license and those other promised services together are considered a single performance obligation. Revenue is recognized over time, from commercial launch date to expiration date of contract under IAS 18 whereas it is recognized from the date when performance obligation is performed for the first time to expiration date of contract under IFRS 15.

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For the year ended December 31, 2017, revenue from licensing contracts was ₩ 20,464 million, which was 14% of total consolidated revenue. Based on the nature of the Company's promise in granting a license as described above, the Company determined that the revenue from licensing contracts shall be recognized on a ratable basis over the license period in accordance with IFRS 15.

In accordance with IAS 18, license fees and royalties paid are recognized in accordance with the substance of the contract, and therefore, are recognized ratably over the license period. When the running royalty revenue based on the contractual royalty rate and the actual revenue of the licensee exceeds the ratably recognized guaranteed minimum, the excess is then recognized as revenue and accounts receivable. Although the accounting framework changes, the accounting treatment under the new standard would not be substantially changed.

The revenue recognition disclosures will significantly expand under the new standard, specifically around the quantitative and qualitative information about reconciliation of contract balances, changes in contract assets and liabilities and disaggregation of revenue. The Company will continue to evaluate these requirements.

(ii) Amendments to IAS 28 Investments in Associates and Joint Ventures

When an investment in an associate or a joint venture is held by, or held indirectly through, an entity that is a venture capital organization, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that investment at fair value through profit or loss in accordance with IFRS 9. The amendments clarify that an entity shall make this election separately for each associate or joint venture at initial recognition of the associate or joint venture. The Company will apply these amendments retrospectively for annual periods beginning on or after January 1, 2018, and early adoption is permitted. The Company does not expect the amendments to have a significant impact on the financial statements.

(iii) IFRIC Interpretation 22 Foreign Currency Transaction and Advance Consideration

According to IFRIC 22, the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the entity shall determine a date of the transaction for each payment or receipt of advance consideration. These enactments will be effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. The Company does not expect the enactments to have a significant impact on the consolidated financial statements upon adoption of the amendments.

(iv) IFRS 16 Leases

IFRS 16 Leases issued in January 2016 is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted. This standard will replace IAS 17 Leases, IFRIC Interpretation 4 Determining whether an Arrangement contains a Lease, SIC Interpretation 15 Operating Leases-Incentives, and SIC Interpretation 27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. The Company will apply the standard for the annual period beginning on or after January 1, 2019.

At inception of a contract, the entity shall assess whether the contract is, or contains, a lease. Also, at the date of initial application, the entity shall assess whether the contract is, or contains, a lease in accordance with the standard. For a contract that is, or contains, a lease, the entity shall account for each lease component within the contract as a lease separately from non-lease components of the contract. A lessee is required to recognize a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments. The lessee may elect not to apply the requirements to short-term lease (a lease term of 12 months or less at the commencement date) and low value assets. The Company is currently evaluating the impact of adoption on the consolidated financial statements upon adoption of the standard.

(v) IFRS 9 Financial Instruments

The new standard for financial instruments issued in July 2014 is effective for annual periods beginning on or after January 1, 2018 with early adoption permitted. This standard will replace IAS 39 Financial Instruments: Recognition and Measurement. The Company will apply the standards for annual periods beginning on or after January 1, 2018. The Company will apply practical expedients permitted by the standard.

IFRS 9 Financial Instruments impacts three main areas including: (a) classification and measurement of financial assets on the basis of the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial assets, (b) a new impairment model for financial instruments based on the expected credit losses, and (c) hedge accounting including expansion of the range of eligible hedging instruments and hedged items that qualify for hedge accounting and a change to the methodology of the hedge effectiveness assessment.

An effective implementation of IFRS 9 requires preparation processes including financial impact assessment, accounting policy establishment, accounting system development and system stabilization. The Company performed an impact assessment to identify potential financial effects of applying IFRS 9. Based on the Company's initial assessment, the Company does not expect the adoption of IFRS 9 to have a significant impact on the consolidated financial statements.

(a) Classification and measurement

As of December 31, 2017, the Company held Won 106,010 million in loans and receivables and Won 44,980 million in financial liabilities, which is measured at amortized cost. The Company expects that the financial assets and liabilities will continue with their respective classification and measurements upon the adoption of IFRS 9.

(b) Impairment

This new impairment model may result in an earlier recognition of credit losses on the Company's financial assets. Based on a preliminary assessment, the application of the new impairment model may not have a significant impact on the Company.

(c) Hedge accounting

The Company does not have any hedge relationship and therefore it may not have any impact on the Company upon the adoption.

(vi) IFRIC Interpretation 23 Uncertainty over Income Tax Treatment

The Interpretation, issued in July 2017, clarifies application of recognition and measurement requirements in IAS 12. The Interpretation specifically addresses the following: (i) whether an entity considers uncertain tax treatments separately, (ii) the assumptions an entity makes about the examination of tax treatments by taxation authorities, (iii) how an entity determines taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates and (iv) how an entity considers changes in facts and circumstances. IFRIC 23 is effective for annual reporting periods beginning on or after January 1, 2019, but certain transition reliefs are available. The Company does not expect a significant impact on its financial statements on applying the interpretation.

3. Critical Accounting Estimates and Assumptions

The preparation of financial statements requires the Company to make estimates and assumptions concerning the future. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The resulting accounting estimates will, by definition, seldom equal the related actual results. 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 discussed below.

Deferred tax assets

In assessing the realizability of deferred tax assets, the Company considers whether it is probable that a portion or all of the deferred tax assets will not be realized. When the Company assessed the realizability of the deferred tax assets, the Company considered its performance, general economic environment, projected future taxable income, periods available to deduct tax loss carryforwards and tax credit carryforwards, etc. The ultimate realization of deferred tax assets is dependent on whether the Company is able to generate future taxable income in specific tax jurisdictions during the periods in which temporary differences are deductible. However, the amount of deferred tax assets may be different if the Company does not realize estimated future taxable income during the carry forward periods as originally expected.

4. Transition to IFRSs

As noted in Note 2, the Company's financial statements are prepared in accordance with the requirements of IFRS on or after January 1, 2016, the date of transition, for IFRS effective as of December 31, 2017. The consolidated statements of financial position as of January 1, 2016 and December 31, 2016 and the consolidated statements of comprehensive income (loss), changes in equity and cash flows for the year ended December 31, 2016, which are comparatively presented, were previously prepared in accordance with previous GAAP ("US GAAP") but were restated in accordance with IFRS 1, First-time adoption of International Financial Reporting Standard.

IFRS 1 First-time of adoption of IFRS—Optional exemptions

In preparing the consolidated financial statements in accordance with the IFRS 1, the Company has applied the mandatory exceptions and certain optional exemptions allowed by IFRS. The Company has applied the mandatory exceptions and certain optional exemptions as set out below:

(1) Business combinations

The Company has elected not to apply IFRS 3, Business Combinations retrospectively to past business combinations that occurred before the date of transition to IFRS.

(2) Cumulative translation differences

Cumulative translation differences for all foreign operations were deemed to be zero at the date of transition to IFRS. The Company had cumulative translation difference of Won 694 million in accumulated other comprehensive income as of January 1, 2016 under US GAAP.

Reconciliations between US GAAP and IFRS

(1) Cost deferral

The Company pays platform processing fees to operate mobile games on third party platforms. These fees are charged for the game users' purchases in cash, and are considered as the incremental cost which can be capitalized. The Company records these costs as prepaid expense and amortizes them to costs of revenue in accordance with the related revenue recognition of the services provided to the game user.

(2)Disposition of deficit with capital surplus

The Parent Company held share holders' meeting and decided to use additional paid in capital to reduce accumulated deficit on March 30, 2017 and March 25, 2016. In accordance with US GAAP, the Company did not reclassify or eliminate a deficit

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in retained earnings as all requisite conditions for a quasi-reorganization were not satisfied. Since there is no such requirement under IFRS, reclassification of accumulated deficit was recorded (Note 12).

(3) Reclassification

The Company reclassified certain accounts according to the IFRS.

Effect of transition to IFRS

(1) Effects of transition to IFRS as of January 1, 2016, date of transition, are as follows:

	Assets	Liabilities	Equity
	(In millions of Korean won)		
US GAAP (previous GAAP)	₩ 45,729	₩ 15,738	₩ 29,991
Cost deferral	146	—	146
IFRS	₩ 45,875	₩ 15,738	₩ 30,137

(2) Effects of transition to IFRS as of December 31, 2016, the end date of the last fiscal year the financial statements were prepared under US GAAP, are as follows:

	Assets	Liabilities	Equity
	(In millions of Korean won)		
US GAAP (previous GAAP)	₩ 55,190	₩ 25,097	₩ 30,093
Cost deferral	554	—	554
IFRS	₩ 55,744	₩ 25,097	₩ 30,647

(3) Effects to net income and comprehensive income for the year ended December 31, 2016, the end date of the last fiscal period the financial statements were prepared under US GAAP, are as follows:

	Net	Comprehensive
	income	income
	(In millions of Korean won)	
US GAAP (previous GAAP)	₩ 179	₩ 102
Cost deferral	408	408
IFRS	₩ 587	₩ 510

5. Cash and Cash equivalents

(1) Cash and cash equivalents as of December 31, 2017, 2016 and January 1, 2016 consist of the following:

	December 31,	December 31,	January 1,
	2017	2016	2016
	(In millions of Korean won)		
Deposits in banks	₩ 24,431	₩ 7,773	₩ 24,044
Money market instruments	14,664	8,947	865
Total	₩ 39,095	₩ 16,720	₩ 24,909

(2) Restricted cash included in cash and cash equivalents as of December 31, 2017, 2016 and January 1, 2016 are as follows:

	December 31,	December 31,	January 1,
	2017	2016	2016
	(In millions of Korean won)		
Credit card deposits	₩ 20	₩	—₩ —

6. Financial instruments

(1) Financial assets and liabilities by category, as of December 31, 2017, 2016 and January 1, 2016 are as follows:

	December 31		January 1,
	2017	2016	2016
Loans and receivable	(In millions of Korean won)		
Cash and cash equivalents	₩ 39,095	₩ 16,720	₩ 24,909
Short-term financial instruments	22,500	22,000	11,500
Accounts receivables	42,168	11,819	5,289
Other receivables	698	710	160
Other current assets	155	157	102
Other non-current financial assets	1,394	965	954
Total	₩ 106,010	₩ 52,371	₩ 42,914
Financial liabilities at amortized cost			
Accounts payables	₩ 44,410	₩ 9,723	₩ 2,535
Accrued expenses	322	250	209
Other current liabilities	107	—	17
Other non-current liabilities	141	—	—
Total	₩ 44,980	₩ 9,973	₩ 2,761

Other current assets include short-term loans and accrued interest. Other non-current financial assets include leasehold deposits, other deposits, and long-term loans. Other non-current liabilities include capital lease payables.

(2) Net Gains or Losses by Category of Financial Instruments

Net gains or losses by each category of financial instruments for the periods ended December 31, 2017 and 2016 are as follows:

	December 31,	
	2017	2016
Loans and receivables	(In millions of Korean won)	
Interest income	₩ 554	₩ 522
Gains on foreign currency transactions	231	759
Financial liabilities at amortized cost		
Losses on foreign currency transactions	(349)	(1,289)

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(3) The carrying amount and fair value of financial instruments as of December 31, 2017, 2016 and January 1, 2016 are as follows:

	December 31, 2017	
	Carrying value	Fair value
	(In millions of Korean won)	
Financial assets		
Cash and cash equivalents	₩ 39,095	₩ 39,095
Short-term deposits not classified as cash equivalents	22,500	22,500
Accounts receivables	42,168	(*)
Other receivables	698	(*)
Other current assets	155	(*)
Other non-current financial assets	1,394	(*)
Total	₩ 106,010	
Financial liabilities		
Accounts payables	₩ 44,410	(*)
Accrued expenses	322	(*)
Other current liabilities	107	(*)
Other non-current liabilities	141	(*)
Total	₩ 44,980	

	December 31, 2016	
	Carrying value	Fair value
	(In millions of Korean won)	
Financial assets		
Cash and cash equivalents	₩ 16,720	₩ 16,720
Short-term deposits not classified as cash equivalents	22,000	22,000
Accounts receivables	11,819	(*)
Other receivables	710	(*)
Other current assets	157	(*)
Other non-current financial assets	965	(*)
Total	₩ 52,371	
Financial liabilities		
Accounts payables	9,723	(*)
Accrued expenses	250	(*)
Total	₩ 9,973	

	January 1, 2016	
	Carrying value	Fair value
	(In millions of Korean won)	
Financial assets		
Cash and cash equivalents	₩ 24,909	₩ 24,909
Short-term deposits not classified as cash equivalents	11,500	11,500
Accounts receivables	5,289	(*)

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Other receivables	160	(*)
Other current assets	102	(*)
Other non-current financial assets	954	(*)
Total	₩ 42,914	
Financial liabilities		
Accounts payables	₩ 2,535	(*)
Accrued expenses	209	(*)
Other current liabilities	17	(*)
Total	₩ 2,761	

(*) As the carrying amount is a reasonable approximation of fair value due to the short maturity of the instrument, it is excluded from fair value disclosure.

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(4) The fair value hierarchy of the Company's financial instruments at fair values as of December 31, 2017, 2016 and January 1, 2016, is as follows:

December 31, 2017				
	Level 1	Level 2	Level 3	Total
(In millions of Korean won)				
Cash and cash equivalents	₩ 24,431	₩ 14,664	₩ —	₩ 39,095
Short-term financial instruments	₩ 11,000	₩ 11,500	₩ —	₩ 22,500

December 31, 2016				
	Level 1	Level 2	Level 3	Total
(In millions of Korean won)				
Cash and cash equivalents	₩ 7,773	₩ 8,947	₩ —	₩ 16,720
Short-term financial instruments	₩ 4,500	₩ 17,500	₩ —	₩ 22,000

January 1, 2016				
	Level 1	Level 2	Level 3	Total
(In millions of Korean won)				
Cash and cash equivalents	₩ 24,044	₩ 865	₩ —	₩ 24,909
Short-term financial instruments	₩ 1,000	₩ 10,500	₩ —	₩ 11,500

Fair value measurements are categorized into Level 1, 2 or 3 as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company can access at the measurement date;

Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and

Level 3 inputs are unobservable inputs for the asset or liability.

The fair value of financial instruments traded in an active market is determined based on the quoted market price as of the end of the reporting period. If the quoted prices are readily and regularly available through exchanges, sellers, brokers, industry groups, rating agencies or regulators and such prices represent actual market transactions that occur regularly between independent parties, they are considered active markets. These products are included in Level 1.

The fair value of financial instruments that are not traded in an active market is determined using valuation techniques. These valuation techniques use as much market observable information as possible and use the least amount of group-specific information. At this time, if all the significant input variables required to measure the fair value of a financial instrument are observable, the instrument is included in Level 2.

If one of more than one significant input variable is not based on observable market information, the financial instrument is included in Level 3.

The valuation techniques used to measure the fair value of a financial instrument include:

- Market price or dealer price of a similar financial instrument
- The fair value of derivative instruments is determined by discounting the amount to present value using the leading exchange rate as of the end of the reporting period

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7. Accounts and Other Receivables

(1) Accounts and other receivables as of December 31, 2017, 2016 and January 1, 2016 are as follows:

	December 31, 2017	December 31, 2016	January 1, 2016
	(In millions of Korean won)		
Accounts receivables			
Non-related party	₩ 41,516	₩ 10,865	₩ 4,191
Related party	775	1,080	1,223
Deduction : Allowance for doubtful receivables	(123)	(126)	(125)
Total	₩ 42,168	₩ 11,819	₩ 5,289

	December 31, 2017	December 31, 2016	January 1, 2016
	(In millions of Korean won)		
Other receivables			
Non-related party	₩ 744	₩ 755	₩ 207
Related party	—	—	—
Deduction : Allowance for doubtful receivables	(46)	(45)	(47)
Total	₩ 698	₩ 710	₩ 160

The above accounts and other receivables are classified as loans and receivables, and are measured at amortized cost.

(2) Aging analysis of accounts and other receivables as of December 31, 2017, 2016 and January 1, 2016 are as follows

	December 31, 2017	December 31, 2016	January 1, 2016
	(In millions of Korean won)		
Accounts receivables			
Receivables not past due	₩ 42,146	₩ 11,797	₩ 5,267
Past due but not impaired	22	22	22
Impaired	123	126	125
Total	₩ 42,291	₩ 11,945	₩ 5,414

December 31, December 31, January 1,

2017 2016 2016