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Company No FC21610

# KUMHO TIRE CO., INC. and Subsidiaries

Consolidated Financial Statements  
December 31, 2006 and 2005

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SAMIL PRICEWATERHOUSECOOPERS

# KUMHO TIRE CO., INC. and Subsidiaries

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December 31, 2006 and 2005

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## Report of Independent Auditors

To the Shareholders and Board of Directors of  
KUMHO TIRE CO, INC

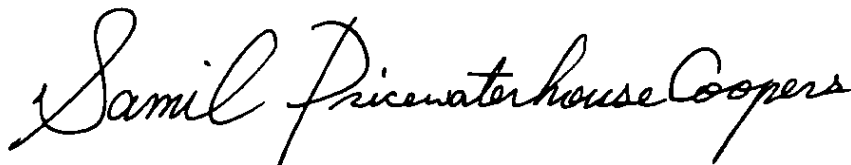
We have audited the accompanying consolidated balance sheets of KUMHO TIRE CO, INC (Controlling Company) and its subsidiaries (collectively the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the year ended December 31, 2006 and 2005, expressed in Korean won. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of certain consolidated subsidiaries, whose assets represent 31.4% (2005: 30.7%) of total consolidated assets as of December 31, 2006, and 37.2% (2005: 36.5%) of total revenues for the year then ended. These financial statements were audited by other auditors whose reports have been furnished us and our opinion, insofar as it relates to the amounts included for these subsidiaries, is based solely on the reports of the other auditors.

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

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of KUMHO TIRE CO, INC and its subsidiaries as of December 31, 2006 and 2005, and the results of its operations, the changes in shareholders' equity and its cash flows for the years then ended in conformity with accounting principles generally accepted in the Republic of Korea.

# Samil PricewaterhouseCoopers

Accounting principles and auditing standards and their application in practice vary among countries. The accompanying financial statements are not intended to present the financial position, results of operations and cash flows in conformity with accounting principles and practices generally accepted in countries and jurisdictions other than the Republic of Korea. In addition, the procedures and practices used in the Republic of Korea to audit such financial statements may differ from those generally accepted and applied in other countries. Accordingly, this report and the accompanying financial statements are for use by those who are informed about Korean accounting principles or auditing standards and their application in practice.



Seoul, Korea  
April 25, 2007

This report is effective as of April 25, 2007, the audit report date. Certain subsequent events or circumstances, which may occur between the audit report date and the time of reading this report, could have a material impact on the accompanying consolidated financial statements and notes thereto. Accordingly, the readers of the audit report should understand that there is a possibility that the above audit report may have to be revised to reflect the impact of such subsequent events or circumstances, if any.

**KUMHO TIRE CO., INC and Subsidiaries**  
**Consolidated Balance Sheets**  
**December 31, 2006 and 2005**

(In millions of Korean won)

	2006	2005
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	₩ 58,538	₩ 319,389
Short-term financial instruments (Note 3)	11,915	92,489
Short-term investment securities (Note 4)	2	9
Trade accounts and notes receivable, net (Notes 6, 14, 20 and 22)	488,293	408,138
Other accounts receivable (Notes 20 and 22)	15,588	7,774
Short-term loans receivable	371	395
Accrued income	484	460
Advance payments	6,441	5,826
Prepaid expenses	19,217	13,806
Derivative instruments (Note 25)	2,406	2,094
Inventories (Notes 7 and 11)	492,325	383,937
Deferred income tax assets (Note 17)	19,136	3,596
Other current assets	41	7
<b>Total current assets</b>	<b>1,114,757</b>	<b>1,237,920</b>
Long-term financial instruments (Note 3)	39	52
Available-for-sale securities (Note 5)	742	-
Equity-method investments (Note 8)	510,272	-
Guarantee deposits	24,599	24,586
Long-term loans receivable	82	131
Long-term prepaid expenses	2,555	5,286
Deferred income tax assets (Note 17)	13,979	5,288
Long-term other investments	-	1
Property, plant and equipment, net (Notes 9, 11 and 12)	1,573,302	1,380,316
Intangible assets, net (Note 10)	185,265	192,978
<b>Total assets</b>	<b>₩ 3,425,592</b>	<b>₩ 2,846,558</b>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities</b>		
Trade accounts payable (Notes 20 and 22)	₩ 215,511	₩ 203,433
Short-term borrowings (Note 11)	720,378	662,007
Current maturities of long-term debts, net (Note 12)	144,562	9,790
Current maturities of debentures, net (Note 12)	199,702	-
Other accounts payable (Notes 20 and 22)	105,499	91,928
Accrued expenses	54,337	44,190
Income tax payable (Note 17)	10,500	22,136
Advances received	6,549	4,374
Withholdings	12,673	11,757
Derivative instruments (Note 25)	6,746	6
Others	453	52
<b>Total current liabilities</b>	<b>1,476,910</b>	<b>1,049,673</b>
Debentures, net (Note 12)	283,953	308,958
Long-term borrowings, net (Note 12)	624,905	361,839
Accrued severance benefits, net (Note 13)	114,734	115,216
Provision for warranty expense	25,405	24,829
Long-term other accounts payable	1,426	1,313
Deferred income tax liabilities (Note 17)	3,753	1
<b>Total liabilities</b>	<b>2,531,086</b>	<b>1,861,829</b>
<b>Commitments and contingencies (Note 14)</b>		
<b>Shareholders' equity (Notes 1 and 15)</b>		
Common stock	350,000	350,000
Capital surplus	413,159	415,090
Retained earnings	116,538	188,885
Capital adjustments	(18,578)	(6,778)
Minority interests in consolidated subsidiaries	33,387	37,532
<b>Total shareholders' equity</b>	<b>894,506</b>	<b>984,729</b>
<b>Total liabilities and shareholders' equity</b>	<b>₩ 3,425,592</b>	<b>₩ 2,846,558</b>

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

# KUMHO TIRE CO., INC. and Subsidiaries

## Consolidated Statements of Operations

Years Ended December 31, 2006 and 2005

(In millions of Korean won, except per share amounts)

	2006	2005
Sales (Notes 22 and 24)	₩ 2,077,642	₩ 1,970,683
Cost of sales (Notes 21 and 23)	1,669,966	1,416,895
Gross profit	407,676	553,788
Selling and administrative expenses (Notes 16 and 23)	385,777	372,599
Operating income	21,899	181,189
<b>Non-operating income</b>		
Interest income	18,619	4,051
Gain on foreign currency transactions	16,282	15,834
Gain on foreign currency translation	13,448	5,409
Gain on disposal of property, plant and equipment	10,070	2,035
Reversal of allowance for doubtful accounts	395	1,117
Income tax refunds	96	-
Gain on derivatives transactions	572	3,424
Gain on valuation of derivatives (Note 25)	1,165	2,094
Others	1,727	1,681
	62,374	35,645
<b>Non-operating expenses</b>		
Interest expense	73,364	51,294
Loss on valuation of equity-method investments	396	-
Loss on foreign currency transactions	10,813	15,464
Loss on foreign currency translation	3,144	1,023
Loss on disposal of short-term investment securities	2	88
Loss on disposal of property, plant and equipment	3,539	4,060
Loss on disposal of account receivables	17,282	13,455
Donations	2,426	2,442
Loss on disposal of inventories	2,032	332
Loss on derivatives transactions	572	1
Loss on valuation of derivatives (Note 25)	6,760	6
Others	268	732
	120,598	88,897
Ordinary income before income(loss) tax expense	(36,325)	127,937
Income tax expense(benefit) (Note 17)	(6,923)	28,579
Income(loss) after income tax	(29,402)	99,358
Minority interests in gain of consolidated subsidiaries, net	(945)	(3,195)
Net income(loss)	₩ (30,347)	₩ 96,163
Basic and diluted ordinary income(loss) per share in Korean won (Note 19)	₩ (434)	₩ 1,427
Basic and diluted earnings(loss) per share in Korean won (Note 19)	₩ (434)	₩ 1,427

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

**KUMHO TIRE CO., INC. and Subsidiaries**  
**Consolidated Statements of Changes in Shareholders' Equity**  
**Years Ended December 31, 2006 and 2005**

*(In millions of Korean won)*

	2006	2005
<b>Common stock</b>		
Balance at the beginning of the year	₩ 350,000	₩ 250,000
Change in common stock	-	100,000
Balance at the end of the year	350,000	350,000
<b>Consolidated capital surplus</b>		
Balance at the beginning of the year	415,090	237,304
Business acquisition	(1,931)	177,786
Balance at the end of the year	413,159	415,090
<b>Consolidated retained earnings</b>		
Balance at the beginning of the year	188,885	120,222
Dividends paid (Note 18)	(42,000)	(27,500)
Net income(loss)	(30,347)	96,163
Balance at the end of the year	116,538	188,885
<b>Consolidated capital adjustments</b>		
Balance at the beginning of the year	(6,778)	(7,703)
Consolidated capital adjustments during the year	(11,800)	925
Balance at the end of the year	(18,578)	(6,778)
<b>Minority interests</b>		
Balance at the beginning of the year	37,532	31,593
Changes during the year	(4,145)	5,939
Balance at the end of the year	33,387	37,532
Total shareholders' equity	₩ 894,506	₩ 984,729

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

**KUMHO TIRE CO., INC. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2006 and 2005**

(In millions of Korean won)

	2006	2005
<b>Cash flows from operating activities</b>		
Net income(loss)	₩ (30,347)	₩ 96,163
Adjustments to reconcile net income(loss) to net cash provided by(used in) operating activities		
Bad debt expense	3,627	1,369
Depreciation	148,235	131,975
Provision for severance benefits	60,313	56,590
Amortization of intangible assets	12,220	12,094
Loss on disposal of property, plant and equipment	3,539	4,060
Loss on foreign currency translation	2,472	1,023
Loss on disposal of inventories	2,032	332
Interest expense (discounted present value)	1,407	13,568
Loss on valuation of equity-method investments	396	-
Loss on valuation of derivatives	6,760	6
Gain on foreign currency translation	(8,938)	(5,409)
Gain on disposal of property, plant and equipment	(10,070)	(2,035)
Reversal of allowance for doubtful accounts	(395)	(2,486)
Gain on valuation of derivatives	(1,165)	(2,094)
Changes in minority interests in gain of consolidated subsidiaries, net	945	3,195
Others	3	92
	<u>221,381</u>	<u>212,280</u>
Changes in operating assets and liabilities		
Increase in trade accounts and notes receivable	(74,462)	(63,919)
Increase in other accounts receivable	(7,414)	(8,248)
Increase in accrued income	-	(399)
Decrease(Increase) in advance payments	(380)	243
Decrease(Increase) in prepaid expenses	(5,622)	(6,651)
Increase in derivative instruments assets	852	-
Increase in inventories	(142,917)	(115,293)
Increase in deferred income tax assets	(24,256)	(4,410)
Increase in trade accounts payable	15,736	68,679
Increase in advances received	2,175	1,206
Increase in withholdings	814	4,860
Increase(Decrease) in other accounts payable	21,343	(40,410)
Increase(Decrease) in accrued expenses	10,003	(14,623)
Increase(Decrease) in income taxes payable	(11,150)	7,324
Decrease in derivative instruments liabilities	(20)	(2,339)
Payment of severance benefits	(56,254)	(50,174)
Deposits for severance benefit insurance	(5,162)	(29,911)
Succession of accrual of severance benefits	127	109
Increase in provision for warranty expense	1,344	2,084
Increase in deferred income tax liabilities	3,855	-
	<u>(271,388)</u>	<u>(251,872)</u>
Net cash provided by(used in) operating activities	<u>(80,354)</u>	<u>56,571</u>



**KUMHO TIRE CO., INC. and Subsidiaries**  
**Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2006 and 2005**

<i>(In millions of Korean won)</i>	2006	2005
<b>Cash flows from investing activities</b>		
Proceeds from short-term financial instruments	₩ 150,992	₩ 187,099
Proceeds from short-term investment securities	33	1,058
Collection of short-term loans receivable	743	370
Proceeds from long-term financial instruments	27	55
Collection of long-term loans receivable	132	122
Decrease in guarantee deposits	5,049	7,625
Decrease in long-term prepaid expenses	2,843	883
Increase in long-term other accounts payable	228	-
Disposal of property, plant and equipment	33,568	20,476
Acquisition of short-term financial instruments	(70,748)	(277,254)
Acquisition of short-term investment securities	(29)	(1,125)
Acquisition of available-for-sale securities	(742)	-
Acquisition of long-term financial instruments	(14)	-
Short-term loans granted	(634)	(405)
Acquisition of equity-method investments	(514,738)	-
Payment of guarantee deposits	(5,010)	(6,364)
Acquisition of property, plant and equipment	(17,445)	(18,958)
Payment of construction-in-progress	(370,586)	(311,941)
Acquisition of intangible assets	(3,608)	(2,035)
Long-term loans granted	(28)	(39)
Increase in long-term prepaid expenses	(274)	(4,672)
Net cash used in investing activities	(790,241)	(405,105)
<b>Cash flows from financing activities</b>		
Proceeds from short-term borrowings	250,332	840,163
Proceeds from long-term debts	438,110	383,117
Issuance of debentures	174,168	308,874
Issuance of common stock	-	277,707
Increase in minority interests in consolidated subsidiaries	-	2,958
Repayment of current maturities of long-term debts	(100)	-
Repayment of short-term borrowings	(185,867)	(732,745)
Repayment of long-term borrowings	(26,952)	(413,173)
Payment of dividends	(39,122)	(27,500)
Net cash provided by financing activities	610,569	639,401
<b>Cash flows from foreign exchange rate fluctuations</b>	(825)	(752)
Net increase in cash and cash equivalents	(260,851)	290,115
<b>Cash and cash equivalents</b>		
Beginning of year	319,389	29,274
End of year	₩ 58,538	₩ 319,389

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

**KUMHO TIRE CO., INC. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**December 31, 2006 and 2005**

**1. The Consolidated Companies**

The accompanying consolidated financial statements include the accounts of KUMHO TIRE CO., INC. and its subsidiaries (the "Company"). General information on the Company is described below.

**The Controlling Company**

KUMHO TIRE CO., INC. (the "Controlling Company") was incorporated on June 30, 2003, under the laws of the Republic of Korea to engage in manufacturing and selling tires. Kumho Industrial Co., Ltd. contributed and transferred its tire business to the Controlling Company on June 30, 2003.

The Controlling Company has its headquarters at Gwangju, operates manufacturing plants in various locations including Gwangju and Gokseong, and has several overseas affiliates and research centers.

The Controlling Company issued and listed 6.8 million shares of common stock (issue amount ₩99,620 million) on February 17, 2005, on the Korea Exchange. The Controlling Company also issued and listed 22.4 million shares of Global Depository Shares, representing 11.2 million shares of common stock (issue amount, US\$160 million), on the London Stock Exchange on February 16, 2005. Further, the Controlling Company issued additional four million shares of Global Depository Shares, representing two million shares of common stock, (issue amount US\$29 million) on March 2, 2005, by the execution of stock purchase option granted to J.P. Morgan Securities Ltd.

The Controlling Company is authorized to issue 200 million shares with a par value per share of ₩5,000. As of December 31, 2006, the Controlling Company has an outstanding capital stock amounting to ₩350,000 million.

**Consolidated Subsidiaries**

Consolidated subsidiaries as of December 31, 2006 and 2005, are as follows:

Consolidated Subsidiaries	Fiscal Year End	Percentage of Ownership(%)		Number of shares	
		2006	2005	2006	2005
Kumho Tire U.S.A.	December 31	100.00	100.00	101,000	101,000
Kumho Tyre U.K.	December 31	100.00	100.00	19,998	19,998
Kumho Tire Europe	December 31	100.00	100.00	2,100	2,100
Kumho Tire Japan	December 31	100.00	100.00	40,000	40,000
Kumho Tire Canada	December 31	100.00	100.00	537	537
Kumho Tyre Australia	December 31	100.00	100.00	100,000	100,000
Kumho Tire HongKong <sup>2</sup>	December 31	100.00	100.00	187,527,677	82,000,000
Nanjing Kumho Tire <sup>2</sup>	December 31	68.80	67.00	1	1
Kumho Tire Tianjin <sup>3</sup>	December 31	100.00	100.00	1	1
Kumho Tire Changchun <sup>3</sup>	December 31	100.00	100.00	1	1
Kumho PFV1 Inc.	December 31	80.00	80.00	3,040,000	3,040,000

**KUMHO TIRE CO., INC. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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<sup>1</sup> No shares are issued

<sup>2</sup> The Company transferred all of its shares in Nanjing Kumho Tire to Kumho Tire HongKong as a contribution in kind in 2006

<sup>3</sup> Kumho Tire HongKong holds 100% shares

Kumho Tire Changchun was established and included in consolidated subsidiaries in 2006

The subsidiaries, which were excluded from the accompanying consolidated financial statements for the year ended December 31, 2006, are as follows

<b>Company</b>	<b>Percentage of Ownership(%)</b>	<b>Fiscal Year End</b>
Kumho Tire China	90 10	December 31
Kumho Tire Vietnam	100 00	December 31

Since the total assets of Kumho Tire China and Kumho Tire Vietnam at establishment are less than ₩ 7,000 million, the subsidiaries are excluded from the consolidated financial statements

Nanjing Kumho Tire, Kumho Tire Tianjin and Kumho Tire Changchun engage in manufacturing and selling tire products and have entered into license and technical assistance agreements with the Controlling Company Kumho Tire HongKong is a holding company Kumho PFV1 Inc engages in managing real estate All other subsidiaries import tire products from the Controlling Company and distribute them to the local markets

**KUMHO TIRE CO., INC. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**December 31, 2006 and 2005**

A summary of significant financial data of the Controlling Company and its subsidiaries, included in the accompanying consolidated financial statements for the years ended December 31, 2006 and 2005, are as follows

*(in millions of Korean won)*

Company	Total Assets	Shareholders' Equity	Sales	Net Income (Loss)
Kumho Tire	₩ 2,409,782	₩ 909,926	₩ 1,813,794	₩ 970
Kumho Tire U.S.A	267,836	(34,587)	415,278	(37,164)
Kumho Tyre U K	35,683	(4,427)	63,811	(4,667)
Kumho Tire Europe	139,463	(12,488)	234,719	(8,804)
Kumho Tire Japan	12,492	424	30,054	6
Kumho Tire Canada	13,214	744	43,331	75
Kumho Tyre Australia	33,136	366	35,304	(705)
Kumho Tire HongKong	206,052	144,121	-	(27,036)
Nanjing Kumho Tire	318,240	97,764	269,335	4,503
Kumho Tire Tianjin	252,828	53,450	31,901	(26,398)
Kumho Tire Changchun	65,347	49,327	-	-
Kumho PFV1 Inc	90,747	15,436	-	(1,893)
Consolidation adjustments	(419,228)	(325,550)	(859,885)	70,766
Total	₩ 3,425,592	₩ 894,506	₩ 2,077,642	₩ (30,347)

As of and for the year ended December 31, 2005

*(in millions of Korean won)*

Company	Total Assets	Shareholders' Equity	Sales	Net Income (Loss)
Kumho Tire	₩ 2,205,897	₩ 966,936	₩ 1,772,456	₩ 98,199
Nanjing Kumho Tire	291,371	102,976	252,725	10,440
Kumho Tire U S A	222,239	1,717	393,627	232
Kumho Tyre U K	40,661	395	73,192	34
Kumho Tire Europe	131,522	(3,448)	228,839	3,418
Kumho Tire Japan	10,468	461	26,608	123
Kumho Tire Canada	16,130	731	50,547	132
Kumho Tyre Australia	10,955	1,097	35,293	326
Kumho Tire HongKong	83,066	83,050	-	(16)
Kumho Tire Tianjin	112,322	84,046	-	-
Kumho PFV1 Inc	71,892	17,328	-	(1,672)
Consolidation adjustments	(349,965)	(270,560)	(860,007)	(15,053)
Total	₩ 2,846,558	₩ 984,729	₩ 1,973,280	₩ 96,163

**KUMHO TIRE CO., INC. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**December 31, 2006 and 2005**

**2. Summary of Significant Accounting Policies**

The significant accounting policies followed by the Controlling Company and its subsidiaries in the preparation of the accompanying consolidated financial statements are summarized below

**Basis of Consolidated Financial Statement Presentation**

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

**Elimination of Investment and Capital Accounts**

The investment account of the Controlling Company is eliminated against the corresponding capital accounts of its consolidated subsidiaries.

The Controlling Company records differences between the investment account and the corresponding capital accounts of subsidiaries as goodwill or negative goodwill. Goodwill is amortized over its economic lives not to exceed 20 years using the straight line method, and the negative goodwill is reversed over the weighted-average useful life of depreciable assets using the straight-line method.

The major changes in goodwill in connection with elimination of investment and capital accounts for the years ended December 31, 2006 and 2005, are set forth in the following table

<i>(in millions of Korean won)</i>	2006	2005
Beginning balance	₩ 70,820	₩ 74,853
Acquisition	-	-
Amortization	(4,029)	(4,033)
Ending balance	₩ 66,791	₩ 70,820

**Elimination of Intercompany Unrealized Profit**

Unrealized profits included in inventories, property, plant and equipment and other assets as the result of intercompany transactions are eliminated based on the average gross profit ratio of the corresponding company. Unrealized profits arising from sales by the consolidated subsidiaries to the Controlling Company or sales between the subsidiaries are fully eliminated and charged to the equity of the Controlling Company to the extent of the Controlling Company's percentage of ownership. The eliminated unrealized profits amounted to ₩50,116 million (2005 ₩55,034 million) for the year ended December 31, 2006.

**KUMHO TIRE CO., INC. and Subsidiaries**  
**Notes to Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**Accounting Estimates**

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect amounts reported therein. Although these estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future, actual results may differ from those estimates

**Application of the Statements of Korean Financial Accounting Standards**

The Korean Accounting Standards Board has published a series of Statements of Korean Financial Accounting Standards (SKFAS), which will gradually replace the existing financial accounting standards established by the Korean Financial Supervisory Commission. As SKFAS Nos. 18 through 20 became applicable to the Company on January 1, 2006, the Company adopted these Standards in its financial statements covering periods beginning January 1, 2006.

The Company adopted early the Interpretations of SKFAS 06-2 '*Accounting treatment of deferred income taxes related to investments in subsidiaries, equity method investees and shares in joint ventures*' in the financial statements for the year ended December 31, 2006.

**Revenue Recognition**

Revenues from the sales of finished goods and merchandise recognized upon delivery when the significant risks and rewards of ownership of the goods are transferred to the buyer.

**Allowance for Doubtful Accounts**

The Company provides an allowance for doubtful accounts, notes and other accounts receivable based on historical collection experience and estimated collectibility of the receivables.

**Investment Securities**

The Company accounts for equity and debt securities under the provision of SKFAS No. 8, *Investments in Securities*. This statement requires investments in equity and debt securities to be classified into three categories: trading, available-for-sale and held-to-maturity.

Securities are initially carried at cost, including incidental expenses, with cost being determined using the gross average method. Debt securities, which the Company has the intent and ability to hold to maturity, are generally carried at cost, adjusted for the amortization of discounts or premiums. Premiums and discounts on debt securities are amortized over the term of the debt using the effective interest rate method. Trading and available-for-sale securities are carried at fair value, except for non-marketable securities classified as available-for-sale securities whose fair value may not be determined, which are carried at cost. Non-marketable debt securities are carried at a value using the present value of future cash flows, discounted at a reasonable interest rate determined considering the credit ratings by independent credit rating agencies.

Unrealized valuation gains or losses on trading securities are charged to current operations, and those resulting from available-for-sale securities are charged to capital adjustments, the accumulated amount of which shall be charged to current operations when the related securities are sold, or when an impairment loss on the securities is recognized. Impairment losses are recognized in the statement of income when the recoverable amounts are less than the acquisition cost of securities or adjusted cost of debt securities after the amortization of discounts or premiums.

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**Equity Method Investments**

Investments in equity securities of companies, over which the Company exercises a control or significant influence, are recorded using the equity method of accounting. Under the equity method, the Company records changes in its proportionate ownership in the book value of the investee in current operations, as capital adjustments or as adjustments to retained earnings, depending on the nature of the underlying change in book value of the investee.

The Company discontinues the equity method of accounting for investments when the Company's share in the accumulated losses of the investees equals the costs of the investments, and until the subsequent cumulative changes in its proportionate net income of the investees equal its cumulative proportionate net losses not recognized during the periods when the equity method was suspended. Differences between the initial purchase price and the Company's initial proportionate ownership in the net book value of the investee are amortized over 20 years using the straight-line method, and the amortization is charged to current operations.

In addition, proportionate share in the difference between fair value of the investee's identifiable assets (liabilities) and book value is amortized according to the investee's accounting for the assets and liabilities.

Unrealized profit included in inventories and property, plant and equipment from transaction between the Company and equity method investees is calculated based on gross margin by product and eliminated considering the percentage of ownership. However, unrealized profit arising from sales by the Company to equity method investees which are its consolidated subsidiaries is fully eliminated. Unrealized profit arising from sales between equity method investees is also eliminated considering the percentage of ownership.

Foreign currency financial statements of equity method investees are translated into Korean won using the exchange rates in effect as of the balance sheet date for assets and liabilities, and annual average exchange rates for income and expenses. Any resulting translation gain or loss is included in the capital adjustments account, a component of shareholders' equity.

In accordance with SKFAS No. 15, *Equity Method*, equity in earnings and losses of the investees are shown in the statement of income as gross amounts. Likewise, positive and negative capital adjustments are shown in the balance sheet in gross amounts.

**Sale or Discount of Receivables**

The Company sells or discounts certain accounts or notes receivable to financial institutions, and accounts for the transactions as sales of the receivables if the control over the receivables is substantially transferred to the buyers. The losses from the sale of the receivables are charged to operations as incurred.

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**Inventories**

The quantities of inventories on hand are verified using the perpetual inventory system, which continuously updates the quantities of the inventories during the period, and by physical count as of the balance sheet date. Inventories are stated at the lower of cost or market, with cost being determined using the weighted-average method for merchandises, finished goods, the moving-average method for raw materials and supplies, and the specific identification method for materials-in-transit and merchandise-in-transit.

If the net realizable value of inventory is less than its cost, a contra inventory account representing the valuation loss, is created to reduce the inventory to its net realizable value. The said valuation loss is recorded as cost of sales. If, however, the circumstances which caused the valuation loss ceased to exist, causing the market value to rise above the carrying amount, the valuation loss is reversed limited to the original carrying amount before valuation. The said reversal is a deduction from cost of sales.

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows:

	<b>Estimated Useful Lives</b>
Buildings	20-40 years
Structures	15-20 years
Machinery and equipment	3-15 years
Vehicles	1-5 years
Tools	4 years
Furniture and fixtures	3-10 years

Routine maintenance and repairs are charged to expense as incurred. Expenditures, which enhance the value or materially extend the useful life of the related assets, are capitalized as additions to property, plant and equipment.

The Company capitalizes interest expense incurred on borrowings used to finance the cost of constructing facilities and equipment.

The Company recognizes an impairment loss when the carrying amount of an asset exceeds its recoverable amount. The impairment loss is recognized in the income statement and is deducted from the acquisition cost of the impaired asset. If there is a subsequent recovery from the impairment, the previous write-down is reversed up to the amount of the original cost. The reversal amount of the previously recognized loss is credited to current operations as a gain.



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**Intangible Assets**

Intangible assets, comprising industrial property rights and goodwill, are recorded at cost and amortized using the straight-line method over the following estimated useful lives

**Estimated Useful Lives**

Industrial property rights	5 years
Others	3-50 years

Research costs are charged to operations as incurred. Costs incurred for new products or technologies, which can be clearly defined and measured and which have probable future economic benefits, are accounted for as development costs and are capitalized. Other development costs are recognized in the period incurred as normal development expenses.

Capitalized development costs are amortized over their economic lives not to exceed 20 years using the straight-line method. If collectible development costs are valued at less than the book value and such difference is material, then the difference should be subtracted directly from the book value and reclassified as collectable development costs. The difference between the book value and the collectible development costs are accounted for as loss on valuation of development costs and expensed in the year incurred.

As of the date of spin-off, the Company has recognized goodwill for the purchase amount exceeding the shares of the purchasing company whose fair values of assets and liabilities are identifiable. Such goodwill is amortized over its economic lives not to exceed 20 years using the straight line method. Goodwill recognized at the date of the acquisition will be valued every year based on its collectability. If collectable amounts are less than its book value and if such difference is material, then the difference is accounted for as loss on valuation of goodwill and expensed in the year incurred.

**Present Value Discount Account**

The Company records incidental expenses arising from syndicated loans as present value discount. Such present value discount is amortized using the effective interest rate method over the due period as interest expenses.

**Premiums and Discounts on Debentures**

The Company accounts for the difference between the face amount and issued amount of debentures as premiums or discounts on debentures after deducting other expenses and commission related to the issuance of debentures as premiums or discounts. Premiums or discounts on debentures are amortized using the effective interest rate method over the term of the debentures and the resulting amortization is recorded as interest expense.

**Foreign Currency Translation**

Monetary assets and liabilities denominated in foreign currencies are translated into Korean won at ₩929.6 US\$1, the exchange rate in effect at December 31, 2006 (₩1,013 US\$1 as of December 31, 2005), and resulting translation gains or losses are recognized in current operations.

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**Translation of Foreign Currency Statements**

Foreign currency denominated financial statements of combined subsidiaries are translated into Korean won using the exchange rates in effect at the balance sheet date for assets and liabilities, and annual average exchange rates for income and expenses. Any resulting translation gain or loss is included in business' equity.

The annual average exchange rate used to translate U.S. dollar denominated income and expenses for the year ended December 31, 2006, is ₩955.5 / US\$1 (2005 ₩1,024.3 / US\$1).

**Accrued Severance Benefits**

Employees and directors with at least one year of service are entitled to receive a lump-sum payment upon termination of their employment with the Controlling Company based on their length of service and rate of pay at the time of termination. Accrued severance benefits represent the amount payable assuming all eligible employees and directors were to terminate their employment as of the balance sheet date.

The Controlling Company has made deposits to the National Pension Fund in accordance with the National Pension Funds Law. The use of the deposit is restricted to the payment of severance benefits. Accordingly, accrued severance benefits in the accompanying consolidated balance sheet are presented net of this deposit.

Accrued severance benefits are funded approximately 53.4% (2005 52.0%) as of December 31, 2006, through a group severance insurance plan and are presented as deduction from accrued severance benefits.

**Impairment Loss**

Assets other than marketable securities, investment securities, restructured receivables and assets with present value discounts are stated at cost. However, declines in fair value arising from obsolescence, physical damage or a sharp decline in the market value are recorded as impairment losses and included in current operations.

**Warranty Reserve**

The Company accrued warranty reserves for the estimated costs of future repairs and recalls, based on the experience and the expectation of future repairs. Estimated costs of product warranties amounting to ₩25,405 million (2005 ₩24,829 million) are charged to operations for the year ended December 31, 2006. Warranty reserve is recorded as long-term liabilities since the warranty expense is to be incurred over several years and its incurrence period cannot be readily and reasonably determined.

**Income Taxes**

The Company recognizes deferred income taxes for anticipated future tax consequences resulting from temporary differences between amounts reported for financial reporting and income tax purposes. Deferred income tax assets and liabilities are computed on such temporary differences by applying enacted statutory tax rates applicable to the years when such differences are expected to be reversed. Deferred income tax assets are recognized to the extent that it is almost certain that such deferred income tax assets will be realized. The total income tax provision includes current tax expenses under applicable tax regulations and the change in the balance of deferred income tax.

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assets and liabilities

In accordance with SKFAS No. 16, *Deferred Income Tax*, which became effective on January 1, 2005, the Company classified deferred tax assets and liabilities into current and non-current, and within each classification, amounts for deferred tax assets and liabilities are offset against each other and presented as net amount. Deferred tax effects applicable to items in the shareholders' equity are directly reflected in the shareholders' equity account.

**Derivative Financial Instruments**

All derivative instruments are accounted for at fair value with the resulting valuation gain or loss recorded as an asset or liability. If the derivative instrument is not designated as a hedging instrument, the gain or loss is recognized in earnings in the period of change. Fair value hedge accounting is applied to a derivative instrument with the purpose of hedging the exposure to changes in the fair value of an asset or a liability or a firm commitment that is attributable to a particular risk.

The gain or loss, both on the hedging derivative instrument and on the hedged item attributable to the hedged risk, is reflected in current operations. Cash flow hedge accounting is applied to a derivative instrument with the purpose of hedging the exposure to variability in expected future cash flows of an asset or a liability or a forecasted transaction that is attributable to a particular risk. The effective portion of the gain or loss on a derivative instrument designated as a cash flow hedge is recorded as a capital adjustment and the ineffective portion is recorded in current operations. The effective portion of the gain or loss recorded as a capital adjustment is reclassified to current operations in the same period during which the hedged forecasted transaction affects earnings.

**3. Restricted Bank Deposits**

Restricted bank deposits as of December 31, 2006 and 2005, consist of the following

<i>(in millions of Korean won)</i>	<b>2006</b>		<b>2005</b>	
Short-term financial instruments	₩	8,750	₩	1,561
Long-term financial instruments		39		25
	₩	8,789	₩	1,586

**4. Short-Term Investment Securities**

All short-term investment securities as of December 31, 2006 and 2005, are in the form of government and public bonds.

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**5. Available-For-Sale Securities**

Available-for-sale securities as of December 31, 2006 and 2005, consist of the following

(in millions of Korean won)	Percentage of Ownership (%)	Acquisition Cost		Book Value <sup>1</sup>		Net Asset Value <sup>2</sup>	
		2006	2005	2006	2005	2006	2005
Rubbertnetwork.com	5.28	₩ 742	₩ -	₩ 742	₩ -	₩ 245	₩ -

<sup>1</sup> Non-marketable equity security whose fair value could not be reliably measured due to the lack of historical information on the future cash flows of investee, is stated at its acquisition cost

<sup>2</sup> Net asset value is stated at the net asset value of the investee based on the most recent financial statement made available to investors

**6. Trade Accounts and Notes Receivable**

Receivables and allowance for doubtful accounts as of December 31, 2006 and 2005, are as follows

(in millions of Korean won)	2006	2005
Trade accounts and notes receivable	₩ 508,476	₩ 426,089
Less : Allowance for doubtful accounts	(20,183)	(17,951)
	<u>₩ 488,293</u>	<u>₩ 408,138</u>

As of December 31, 2006, a portion of trade accounts of the Company are pledged as collateral for short-term borrowings (Note 11)

**7. Inventories**

Inventories as of December 31, 2006 and 2005, are as follows

	2006	2005
Finished goods	₩ 141,777	₩ 111,028
Merchandises	153,161	116,074
Work in process	22,774	15,705
Raw materials	19,046	15,967
Supplies	3,534	3,184
Merchandise-in-transit	91,537	77,023
Materials-in-transit	60,496	44,956
	<u>₩ 492,325</u>	<u>₩ 383,937</u>

As of December 31, 2006, a portion of inventories of the Company are pledged as collateral for short-term borrowings (Note 11)

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**8. Equity-Method Investments**

Details of the equity method investments as of December 31, 2006 and 2005, are as follows

(in millions of Korean won)	Percentage of Ownership (%)	Acquisition Cost		Book Value		Net Asset Value <sup>1</sup>		
		2006.12.31	2006	2005	2006	2005	2006	2005
		Investee						
Kumho Tire China	90 10	₩ 5,854	₩ -	₩ 5,430	₩ -	₩ 5,370	₩ -	
Kumho Tire Vietnam	100 00	4,927	-	4,842	-	4,842	-	
Daewoo Engineering & Construction <sup>2</sup>	5 61	500,000	-	500,000	-	155,608	-	
Total		₩510,781	₩ -	₩ 510,272	₩ -	₩ 165,820	₩ -	

<sup>1</sup> The equity method of accounting is applied based on the affiliates' most recent available financial statements

<sup>2</sup> As of December 31, 2006, the fair value of equity investments in Daewoo Engineering & Construction amounts to ₩ 363,637 million. Since the total ownership including indirect investment through affiliated company is more than 20%, the equity method of accounting was applied on this investee

Details of equity method investments for the year ended December 31, 2006, are as follows

(in millions of Korean won)	Beginning Balance	Acquisition (Disposition)	Valuation Gain or Loss	Increase (Decrease) in Capital Adjustments	Ending Balance
<b>Investee</b>					
Kumho Tire China	₩ -	₩ 5,854	₩ (396)	₩ (28)	₩ 5,430
Kumho Tire Vietnam	-	4,927	-	(85)	4,842
Daewoo Engineering & Construction	-	500,000	-	-	500,000
	<u>₩ -</u>	<u>₩ 510,781</u>	<u>₩ (396)</u>	<u>₩ (113)</u>	<u>₩ 510,272</u>

The accumulated unamortized differences between the purchase price and the underlying proportionate net book value of equity investments are amortized over their economic lives not to exceed 20 years using the straight-line method, along with changes in such amounts for the year ended December 31, 2006, are as follows

(in millions of Korean won)	Beginning Balance	Increase	Amortization	Ending Balance
<b>Investee</b>				
Kumho Tire China	₩ -	₩ -	₩ -	₩ -
Kumho Tire Vietnam	-	-	-	-
Daewoo Engineering & Construction	-	344,392	-	344,392
	<u>₩ -</u>	<u>₩ 344,392</u>	<u>₩ -</u>	<u>₩ 344,392</u>

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For the year ended December 31, 2006, unrealized profit amounting to ₩406 million was eliminated as a result of the valuation of equity method investments

As of and for the years ended December 31, 2006, summaries of financial information of equity-method investees follow

<i>(in millions of Korean won)</i> <b>Investee</b>	<b>2006</b>			
	<b>Assets</b>	<b>Liabilities</b>	<b>Sales</b>	<b>Net Income (Loss)</b>
Kumho Tire China	₩ 69,885	₩ 63,925	₩ 124,924	₩ 10
Kumho Tire Vietnam	4,842	-	-	-
Daewoo Engineering & Construction	6,084,687	3,310,920	5,729,109	438,298
Total	<u>₩ 6,159,414</u>	<u>₩ 3,374,845</u>	<u>₩ 5,854,033</u>	<u>₩ 438,308</u>

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**9. Property, Plant and Equipment**

Changes in property, plant and equipment for the years ended December 31, 2006 and 2005, are as follows

(in millions of Korean won)	2006					
	Land	Buildings	Machinery and equipment	Construction- in-progress	Others	Total
Beginning balances	₩ 155,992	₩ 286,439	₩ 565,290	₩ 244,973	₩ 127,622	₩ 1,380,316
Acquisition	-	524	2,428	370,586	9,037	382,575
Transfer	63,160	60,054	252,415	(424,420)	48,791	-
Disposal	(4,059)	(5,260)	(9,138)	-	(6,955)	(25,412)
Depreciation	-	(9,721)	(93,773)	-	(44,741)	(148,235)
Fluctuation of foreign exchange rate	(168)	(2,344)	(7,622)	(4,670)	(1,138)	(15,942)
Ending balance	₩ 214,925	₩ 329,692	₩ 709,600	₩ 186,469	₩ 132,616	₩ 1,573,302
Accumulated depreciation	₩ -	₩ 33,399	₩ 306,971	₩ -	₩ 127,303	₩ 467,673

(in millions of Korean won)	2005					
	Land	Buildings	Machinery and equipment	Construction- in-progress	Others	Total
Beginning balances	₩ 154,946	₩ 276,802	₩ 610,793	₩ 39,537	₩ 121,253	₩ 1,203,331
Acquisition	-	41	523	311,942	18,393	330,899
Transfer	4,815	22,032	50,650	(106,809)	29,312	-
Disposal	(3,694)	(3,418)	(10,206)	-	(2,483)	(19,801)
Depreciation	-	(8,798)	(85,908)	-	(37,269)	(131,975)
Fluctuation of foreign exchange rate	(75)	(220)	(562)	303	(1,584)	(2,138)
Ending balance	₩ 155,992	₩ 286,439	₩ 565,290	₩ 244,973	₩ 127,622	₩ 1,380,316
Accumulated depreciation	₩ -	₩ 26,333	₩ 216,565	₩ -	₩ 89,846	₩ 332,744

As of December 31, 2006, the value of the Controlling Company's land, as determined by the local government in Korea for property tax assessment purposes, amounts to approximately ₩152,059 million

As of December 31, 2006, a substantial portion of the Company's land, buildings and machinery are pledged as collateral for long-term and short-term debt obligations of up to ₩273,600 million, US\$457 million, JPY2,532 million and RMB403 million in aggregate (Notes 11 and 12) In addition, property, plant and equipment are insured against fire casualty losses for up to ₩2,945,525 million

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The Company capitalizes interest expense incurred on borrowings used to finance the cost of constructing facilities and equipment. Capitalized interest expenses for the year ended December 31, 2006, amounted to ₩5,720 million.

**10. Intangible Assets**

The major changes in intangible assets for the years ended December 31, 2006 and 2005, are as follows

<i>(in millions of Korean won)</i>	2006			
	Goodwill	Industrial Property Rights	Others	Total
Beginning balance	₩ 188,520	₩ 833	₩ 3,625	₩ 192,978
Acquisition	1,129	801	1,678	3,608
Accumulated amortization	(10,755)	(456)	(1,009)	(12,220)
Fluctuation of foreign exchange rates	25	-	874	899
Ending balance	<u>₩ 178,919</u>	<u>₩ 1,178</u>	<u>₩ 5,168</u>	<u>₩ 185,265</u>

<i>(in millions of Korean won)</i>	2005			
	Goodwill	Industrial Property Rights	Others	Total
Beginning balance	₩ 199,279	₩ 1,114	₩ 5,432	₩ 205,825
Acquisition	-	140	1,895	2,035
Accumulated amortization	(10,759)	(421)	(914)	(12,094)
Fluctuation of foreign exchange rates	-	-	(2,788)	(2,788)
Ending balance	<u>₩ 188,520</u>	<u>₩ 833</u>	<u>₩ 3,625</u>	<u>₩ 192,978</u>



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**11. Short-Term Borrowings**

Short-term borrowings as of December 31, 2006 and 2005, consist of the following

(in millions of Korean won)	Annual Interest Rate (%)	2006	2005
	Dec. 31, 2006		
Bank overdrafts	2.45~6.02	₩ 67,812	₩ -
Commercial papers issued	6.06	25,000	150,000
General term-loans	4.18~8.68	244,716	201,305
Usance and others	2.50~5.94	382,850	310,702
		<u>₩ 720,378</u>	<u>₩ 662,007</u>

Short-term borrowings include borrowings denominated in foreign currencies amounting to US\$205 million, EUR20 million, JPY1,081 million and RMB340 as of December 31, 2006 (2005 US\$209 million, EUR16 million, JPY783 million and RMB110)

The Company has bank overdraft agreements with various financial institutions of up to ₩74,200 million. Also a substantial portion of the Company's short-term instruments, trade accounts and notes receivables, inventories, and property, plant and equipment as of December 31, 2006, are pledged as collaterals for the borrowings above (Notes 3, 7 and 9)

**12. Long-Term Borrowings**

Debentures as of December 31, 2006 and 2005, consist of the following

(in millions of Korean won)	Annual Interest Rate (%)	2006	2005
	Dec. 31, 2006		
Non-guaranteed debentures	4.76 ~ 5.53	₩ 485,000	₩ 310,000
Less Discount on debentures		(1,345)	(1,042)
		<u>483,655</u>	<u>308,958</u>
Less Current portion		199,702	-
		<u>₩ 283,953</u>	<u>₩ 308,958</u>

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Long-term borrowings as of December 31, 2006 and 2005, consist of the following

<i>(in millions of Korean won)</i>	Annual Interest Rate (%)		
	Dec. 31, 2006	2006	2005
Won currency loans	5.66~6.18	₩ 331,750	₩ 252,150
Less: Current portion		<u>(135,500)</u>	<u>(100)</u>
		196,250	252,050
Foreign currency loans of			
US\$ 339,553 million, JPY 2,263,959 and RMB 890,000 million			
(2005: US\$ 81,951 million, JPY 2,104,603 and RMB 160,351 million)	2.01~6.86	439,188	121,241
Less: current maturities			
US\$ 49,483 million and JPY 50,694			
(2005: US\$ 9,574 million)		<u>(9,206)</u>	<u>(9,697)</u>
		429,982	111,544
		626,232	363,594
Less: present value discount		<u>(1,327)</u>	<u>(1,755)</u>
		₩ 624,905	₩ 361,839

Current maturities of long-term borrowings as of December 31, 2006, consist of the following

<i>(in millions of Korean won)</i>	2006	2005
Won currency long-term borrowings	₩ 135,500	₩ 100
Foreign currency long-term borrowings of		
US\$ 49,483 million, JPY 50,694 million	9,206	9,697
(2005: US\$ 9,574 million)	<u>144,706</u>	<u>9,797</u>
Less: present value discount	<u>(144)</u>	<u>(7)</u>
	₩ 144,562	₩ 9,790

The annual maturities in aggregate of long-term borrowings outstanding at December 31, 2006, are as follows

<i>(in millions of Korean won)</i>	Year Ending	Debentures	Won Currency Loans	Foreign Currency Loans	Total
2008		₩ 110,000	₩ 25,625	₩ 25,159	₩ 160,784
2009		75,000	91,150	138,975	305,125
Thereafter		100,000	79,475	265,848	445,323
Total		₩ 285,000	₩ 196,250	₩ 429,982	₩ 911,232

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As of December 31, 2006, a substantial portion of the Company's property, plant and equipment are pledged as collateral for the borrowings above (Note 9)

**13. Accrued Severance Benefits**

Changes in accrued severance benefits for the years ended December 31, 2006, and 2005, consist of the following

<i>(in millions of Korean won)</i>	2006	2005
Beginning balance	₩ 248,942	₩ 242,423
Provision for severance benefits	60,313	56,590
Succession of accrued severance benefits	127	109
Actual severance payments	(55,760)	(50,180)
	253,622	248,942
Less Cumulative deposits to National Pension Fund	(3,592)	(4,354)
Severance insurance deposits	(135,296)	(129,372)
Ending balance	₩ 114,734	₩ 115,216

**14. Commitments and Contingencies**

As of December 31, 2006 and 2005, the Controlling Company has provided guarantees amounting to US\$ 372.072 million (equivalent to ₩345,878 million) and US\$ 139.333 million (equivalent to ₩141,444 million), respectively, for the operations of its subsidiaries as follows:

<i>(in thousands of US dollars)</i>	2006	2005
Kumho Tire Japan	US\$ 15,738	US\$ 15,845
Kumho Tire Canada	-	447
Kumho Tyre U.K	-	896
Kumho Tire Tianjin	167,920	122,145
Kumho Tire Changchun	104,000	-
Kumho Tire Australia	18,014	-
Kumho Tire HongKong	66,400	-
	US\$ 372,072	US\$ 139,333

As of December 31, 2006, the Controlling Company has provided guarantees amounting to ₩1,372 million for the borrowings of Tire Net Corporation, one of its suppliers

As of December 31, 2006, the outstanding balance of trade accounts receivable in foreign currency sold at a discount to various financial institutions amounted to ₩326,295 million, which included ₩301,871 million of trade accounts receivable to subsidiaries

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As of December 31, 2006, The Korea Development Bank and other banks have provided the Controlling Company with guarantees in relation to the opening of letters of credit. In addition, the Controlling Company has been provided with performance guarantees by Seoul Guarantee Insurance Company and others.

The Controlling Company has provided Kia Motors Corporation with two promissory notes as collateral in connection with performance guarantees.

As of December 31, 2006, the Controlling Company has technical assistance and license agreements with the Nanjing Kumho Tire Co., Ltd. and Kumho Tire Tianjin Co., Ltd. and other affiliated company.

As of December 31, 2006, the Controlling Company has granted put options to the International Finance Corporation (IFC) and other shareholders of Nanjing Kumho Tire Co., Ltd. (Nanjing Kumho) which give them the right to request the Controlling Company to purchase their shares. Further, the Controlling Company has also agreed with the IFC and others that it should maintain ownership of more than 51% in the investee, Nanjing Kumho, until Nanjing Kumho's loans are fully paid, and that should the said investee suffer financial insolvency resulting in a default, the Controlling Company is required to provide subordinated loans.

The Controlling Company has entered into a contract with Standard Chartered First Bank Korea Ltd. and other creditors of Kumho PFVI Inc. to provide funds by way of increasing capital investment or providing subordinated loans in case Kumho PFVI Inc. suffers financial difficulties.

As of December 31, 2006, the Company is a defendant in several lawsuits filed by customers in relation to product liability. The ultimate outcome of these cases cannot presently be determined. The Company is also insured by Hyundai Marine & Fire Insurance Co., Ltd. and other insurance companies against future claims.

The Controlling Company has entered into an agreement with Korea Kumho Industrial Co., Ltd. which prohibits the Company from selling, transferring, offering as a collateral, or disposing all or part of its shares of Daewoo Engineering & Construction in any other method for three years and one month from December 15, 2006, the purchase date of the shares without the prior consent from Korea Kumho Industrial Co., Ltd.

The Controlling Company also has an agreement with Korea Kumho Industrial Co., Ltd., wherein if Korea Kumho Industrial Co., Ltd. disposes of its shares in Daewoo Engineering & Construction, and loses its majority shareholder position, the Controlling Company may also sell all or part of its shares of Daewoo Engineering & Construction under the same conditions as Korea Kumho Industrial Co., Ltd.

**KUMHO TIRE CO., INC. and Subsidiaries**  
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**15. Retained Earnings**

The Commercial Code of the Republic of Korea requires the Controlling Company to appropriate a portion of retained earnings as a legal reserve in an amount equal to a minimum of 10% of its cash dividends until such reserve equals 50% of its capital stock. The reserve is not available for dividends but may be transferred to capital stock or used to reduce accumulated deficit, if any.

**16. Selling and Administrative Expenses**

Selling and administrative expenses for the years ended December 31, 2006 and 2005, consist of the following.

<i>(in millions of Korean won)</i>	2006	2005
Salaries	₩ 66,647	₩ 58,449
Severance benefits	11,041	9,732
Employee benefits	9,275	8,389
Depreciation	10,580	8,682
Advertising expenses	44,960	50,074
Freight	111,110	122,046
Warranty expense	12,342	9,611
Others	119,822	105,616
Total	₩ 385,777	₩ 372,599

**17. Income Taxes**

Income tax expense for the years ended December 31, 2006 and 2005, consists of the following

<i>(in millions of Korean won)</i>	2006	2005
Current income taxes	₩ 13,555	₩ 32,968
Changes in deferred income tax	(20,478)	(4,389)
Income tax expense	₩ (6,923)	₩ 28,579

Components of deferred income tax assets as of December 31, 2006 and 2005, are as follows

<i>(in millions of Korean won)</i>	2006	2005
Allowance for doubtful accounts	₩ 4,012	₩ 3,346
Accrued severance benefits	11,172	4,300
Provision for warranty expense	995	914
Others	13,183	324
Deferred income tax assets, net	₩ 29,362	₩ 8,884

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As of December 31, 2006, details of ordinary income before income tax expense and income tax expense are as follows.

*(in millions of Korean won)*

Company	2006		
	Ordinary income(loss) before income tax expense	Income tax expense	Deferred income tax
Kumho Tire	₩ 2,102	₩ 1,132	₩ 18,031
Kumho Tire U S A	(31,203)	5,961	(1,844)
Kumho Tyre U.K	(4,632)	35	(3)
Kumho Tire Europe	(8,749)	55	-
Kumho Tire Japan	6	-	-
Kumho Tire Canada	125	50	86
Kumho Tyre Australia	(994)	(289)	469
Kumho Tire HongKong	(1,923)	-	-
Nanjing Kumho Tire	2,955	(1,244)	-
Kumho Tire Tianjin	(26,398)	-	-
Kumho Tire Changchun	-	-	-
Kumho PFV1 Inc	(1,893)	-	-
Consolidation adjustments	34,278	(12,623)	12,623
	₩ (36,326)	₩ (6,923)	₩ 29,362

*(in millions of Korean won)*

Company	2005		
	Ordinary income(loss) before income tax expense	Income tax expense	Deferred income tax
Kumho Tire	₩ 124,098	₩ 25,898	₩ 7,936
Nanjing Kumho Tire	11,738	1,298	-
Kumho Tire U S A	1,124	893	794
Kumho Tyre U K	131	98	(1)
Kumho Tire Europe	3,437	19	-
Kumho Tire Japan	250	127	-
Kumho Tire Canada	225	93	149
Kumho Tyre Australia	478	152	6
Kumho Tire HongKong	(16)	-	-
Kumho PFV1 Inc	(1,672)	-	-
Consolidation adjustments	(11,856)	-	-
	₩ 127,937	₩ 28,578	₩ 8,884

# KUMHO TIRE CO., INC. and Subsidiaries

## Notes to Consolidated Financial Statements

December 31, 2006 and 2005

### 18. Dividend Information

Dividends of the Controlling Company for the years ended December 31, 2006 and 2005, are calculated as follows:

	2006	2005
Number of common shares	70,000,000 shares	70,000,000 shares
Par value	₩ 5,000	₩ 5,000
Dividend ratio	6%	12%
Cash dividends	₩ 21,000,000,000	₩ 42,000,000,000

Dividend payout ratio for the years ended December 31, 2006 and 2005, are follows

	2006	2005
Dividend	₩ 21,000,000,000	₩ 42,000,000,000
Net income <sup>1</sup>	₩ 970,130,370	₩ 98,199,192,962
Dividend payout ratio	2164 7%	42 8%

<sup>1</sup> Controlling Company's net income

### 19. Earnings per Share

Earnings per share are computed by dividing net income by the weighted average number of common shares outstanding during the year. Ordinary income per share is computed by dividing ordinary income allocated to common stock, which is net income allocated to common stocks as adjusted by extraordinary gain or losses, net of related income taxes, by the weighted average number of common shares outstanding during the year.

	2006	2005
(1) Weighted average number of common shares outstanding	70,000,000 shares	67,397,260 shares
(2) Net income(loss) for common shares	₩ (30,347) million	₩ 96,163 million
(3) Basic earnings(loss) per share ((2)/(1))	₩ (434)	₩ 1,427

There are no outstanding dilutive securities as of December 31, 2006 and 2005. Accordingly, basic earnings and ordinary income per share are identical to fully diluted earnings per share.

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**20. Foreign Currency Denominated Assets and Liabilities**

Significant monetary assets or liabilities of the Controlling Company denominated in foreign currencies as of December 31, 2006 and 2005, other than those presented elsewhere in the consolidated financial statements, are as follows

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

	Foreign Currency				Won Equivalent	
	US\$	JPY	EUR	Others <sup>1</sup>		
<b>Assets</b>						
Trade accounts receivable	98,238	134,843	12,528	₩ 9,635	₩	118,554
Other accounts receivable	15,421	-	58	109		15,486
Total 2006	113,659	134,843	12,586	₩ 9,744	₩	134,040
Total 2005	101,096	197,619	8,680	₩ 6,239	₩	120,765
<b>Liabilities</b>						
Trade accounts payable	93,554	-	2	₩ -	₩	87,574
Other accounts payable	1,119	95,500	6	-		1,885
Total 2006	94,673	95,500	8	₩ -	₩	89,459
Total 2005	78,946	3,701	374	₩ 812	₩	81,264

<sup>1</sup> Won equivalent of other foreign currencies

**21. Intercompany Transactions**

Significant intercompany transactions between consolidated companies, which have been eliminated in the accompanying consolidated financial statements, are summarized as follows

<i>(in millions of Korean won)</i>	2006		2005	
Revenues	₩	733,142	₩	791,033
Expenses		120,823		84,000
Receivables		88,038		83,786
Payables		21,661		13,283



**KUMHO TIRE CO., INC. and Subsidiaries**  
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**22. Related Party Transactions**

Significant transactions that occurred in the ordinary course of business with related companies for the years ended December 31, 2006, and 2005, and the related account balances as of December 31, 2006 and 2005, are summarized as follows

*(in millions of Korean won)*

Company	Revenues	Purchases	Receivables	Payables
Controlling company	₩ 835	₩ 123,765	₩ -	₩ 32,615
Equity-method investees	138,503	-	66,855	405
Others	3,398	108,510	1,915	13,559
Total 2006	₩ 142,736	₩ 232,275	₩ 68,770	₩ 46,579
Total 2005	₩ 9,516	₩ 195,529	₩ 8,023	₩ 54,868

Significant management compensation expenses of the Controlling Company for the year ended December 31, 2006, are as follows

*(in millions of Korean won)*

	2006
Short-term salaries	₩ 4,207
Post-retirement benefits	1,123
Total	₩ 5,330

The above compensation expenses include all benefits provided to directors of the board, internal auditors and executives who are responsible for the planning, operations and control of the Company

**23. Value Added Information**

Details of accounts included in the computation of value added for the years ended December 31, 2006 and 2005, are as follows

<i>(in millions of Korean won)</i>	2006			2005
	Selling and Administrative expenses	Cost of sales	Total	Total
Salaries and wages	₩ 66,647	₩ 282,476	₩ 349,123	₩ 322,239
Severance benefits	11,042	49,355	60,397	56,590
Welfare expenses	9,276	43,553	52,829	47,349
Rental charges	15,907	2,207	18,114	15,986
Depreciation	10,580	137,655	148,235	131,976
Taxes and dues	8,447	11,328	19,775	17,959
	₩ 121,899	₩ 526,574	₩ 648,473	₩ 592,099

**KUMHO TIRE CO., INC. and Subsidiaries**  
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**24. Geographical Segment Information**

The Company's sales by geographical segments for the years ended December 31, 2006 and 2005, are as follows

<i>(in millions of Korean won)</i>	2006	2005
Korea	₩ 883,739	₩ 691,764
North America	519,254	502,858
Europe	284,817	311,571
Asia	91,673	151,060
Others	298,159	313,430
Total	<u>₩ 2,077,642</u>	<u>₩ 1,970,683</u>

**25. Derivative Instrument Contracts**

The Company has a foreign currency forward agreement to hedge its foreign currency assets and liabilities. Details of the foreign currency forward agreement as of December 31, 2006, are as follows

<i>(in millions of Korean won, foreign currencies in thousands)</i>	Contract	Valuation gain	Valuation loss
Forward exchange	EUR 149,983	₩ 53	₩ 2,466

The Company entered into derivative instrument contracts including foreign currency forwards and interest rates swaps to hedge the exposure to changes in foreign exchange currency and interest rates

Contracting date	Maturity date	Contract amount	Terms of interest payment	Valuation Gain <sup>1</sup>	Valuation loss <sup>1</sup>
2006 08 28	2009 08 28	₩100,000	Receiving 3M LIBOR+ 0.84%, Payable 5.75%	₩1,112	₩4,294

<sup>1</sup> The Company recognized valuation gain and loss in current operations

**26. Subsequent Events**

On January 4, 2007, the Controlling Company provided guarantees amounting to ₩71,755 million for the borrowings of Kumho Tire HongKong from KDB Asia Limited

On March 21, 2007, Nanjing Kumho Tire acquired 27.5% ownership in Jiuhehuoyun (Shanghai) Youxiangongsi for US\$ 100,000

**KUMHO TIRE CO., INC. and Subsidiaries**  
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**27. Supplemental Cash Flow Information**

Significant transactions not affecting cash flows for the years ended December 31, 2006 and 2005, are as follows

<i>(in millions of Korean won)</i>	2006	2005
Reclassification of current portion of long-term debts	₩ 144,706	₩ 9,797
Reclassification of property, plant and equipment from construction-in-progress	424,420	106,809

**28. Acquisition of business unit**

Kumho Tire Australia, purchased the business of Tyremaster(wholesale) Pty Ltd , the tire selling company on September 29, 2006. The Company recognized goodwill amounting to AUD 1,570 that the difference between the purchase price and the fair value of purchased assets and liabilities.

**29. Reclassification of Prior Year Financial Statements**

Certain accounts in the financial statements as of and for the year ended December 31, 2005, have been reclassified to conform to the December 31, 2006 financial statement presentation. These reclassifications had no effect on previously reported net income or shareholders' equity.