

# **LG Chem, Ltd.**

**Non-Consolidated Financial Statements  
December 31, 2006 and 2005**

**LG Chem, Ltd.**  
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**December 31, 2006 and 2005**

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## Report of Independent Auditors

To the Board of Directors and Shareholders of  
LG Chem, Ltd.

We have audited the accompanying non-consolidated balance sheets of LG Chem, Ltd. (the “Company”) as of December 31, 2006 and 2005, and the related non-consolidated statements of income, appropriations of retained earnings, and cash flows for the years then ended, 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 Ningbo LG Yongxing Chemical Co., Ltd. and certain other subsidiaries, the investments in which are reflected in the accompanying non-consolidated financial statements using the equity method of accounting. The investments in those subsidiaries represent 5.6% of the Company's total assets as of December 31, 2006 (2005: 7.6%), and the equity in their net profits and losses represent 4.8% of the Company's net income before income taxes for the year ended December 31, 2006 (2005: 7.6%). These statements were audited by other auditors whose reports have been furnished to us and our opinion, insofar as it relates to the amounts included for the subsidiaries, is based solely on the reports of the other auditors.

We conducted our audits in conformity 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 other auditors, the non-consolidated financial statements referred to above present fairly, in all material respects, the financial position of LG Chem, Ltd. as of December 31, 2006 and 2005, and the results of its operations, the changes in its retained earnings and its cash flows for the years then ended in conformity with accounting principles generally accepted in the Republic of Korea.

# SAMIL PRICEWATERHOUSECOOPERS

As discussed in Note 27 to the non-consolidated financial statements, the Company merged with LG Daesan Petrochemical Ltd. on January 1, 2006.

Accounting principles and auditing standards and their application in practice vary among countries. The accompanying non-consolidated 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 non-consolidated financial statements are for use by those who are informed about Korean accounting principles or auditing standards and their application in practice.

Seoul, Korea  
March 5, 2007

This report is effective as of March 5, 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 non-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.

**LG Chem, Ltd.**  
**Non-Consolidated Balance Sheets**  
**December 31, 2006 and 2005**

<i>(in millions of Korean won)</i>	<b>2006</b>		<b>2005</b>	
<b>Assets</b>				
<b>Current assets</b>				
Cash and cash equivalents (Note 25)	₩	115,830	₩	189,445
Trade accounts and notes receivable, net (Notes 2, 4, 5, 16, 22 and 25)		818,384		499,382
Other accounts receivable, net (Notes 5 and 25)		121,142		100,059
Accrued income		1,704		55
Advance payments		1,807		3,062
Prepaid expenses		14,130		15,142
Inventories, net (Notes 2 and 6)		869,138		608,850
Deferred income tax assets (Note 19)		127		11,545
Other current assets		6,959		8,756
Total current assets		1,949,221		1,436,296
Long-term financial instruments (Note 3)		60		51
Investment securities (Note 7)		1,718		1,939
Equity-method investments (Notes 8 and 27)		876,622		1,476,532
Long-term trade accounts and notes receivable, net (Note 5)		465		775
Long-term other accounts receivable, net (Note 5)		1,054		1,491
Long-term guarantee deposits		39,344		67,611
Long-term prepaid expenses		20,107		20,470
Other investments		31,893		30,557
Property, plant and equipment, net (Notes 2, 9, 24 and 27)		3,099,022		2,456,822
Intangible assets, net (Notes 2, 10, 24 and 27)		(212,990)		100,855
Total assets	₩	5,806,516	₩	5,593,399

**LG Chem, Ltd.**  
**Non-Consolidated Balance Sheets**  
**December 31, 2006 and 2005**

<i>(in millions of Korean won)</i>	<b>2006</b>	<b>2005</b>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities		
Short-term borrowings (Note 11)	₩ 25,076	₩ 100,224
Current maturities of long-term debts, net (Note 11)	439,932	740,604
Trade accounts and notes payable (Notes 22 and 25)	750,762	596,580
Other accounts payable (Note 25)	516,955	372,834
Withholdings	50,488	39,400
Accrued expenses (Note 13)	42,276	30,452
Income tax payable (Note 19)	44,241	63,609
Other current liabilities	2,925	3,207
Total current liabilities	1,872,655	1,946,910
Long-term debts, net (Note 12)	1,110,683	988,805
Accrued severance benefits, net (Notes 2, 3 and 14)	98,415	80,410
Deferred income tax liabilities (Notes 19 and 27)	95,316	111,020
Derivative instrument transaction credit (Note 16)	3,089	23,814
Other long-term liabilities	9,118	3,915
Total liabilities	3,189,276	3,154,874
Commitments and contingencies (Note 16)		
Shareholders' equity (Note 1)		
Common stock	322,126	322,126
Preferred stock	43,306	43,306
	365,432	365,432
Capital surplus (Note 17)		
Paid-in capital in excess of par value	532,002	532,002
Gain on disposal of treasury stock	841	841
Asset revaluation surplus	206,769	206,769
	739,612	739,612
Retained earnings (Note 17)		
Legal reserve	49,438	40,335
Other reserves	1,221,519	921,393
Unappropriated retained earnings	318,787	400,261
	1,589,744	1,361,989
Capital adjustments		
Gain on valuation of equity-method investments (Note 8)	1,355	36,109
Loss on valuation of equity-method investments (Note 8)	(55,774)	(41,043)
Treasury stock (Note 18)	(23,129)	(23,129)
Loss on valuation of derivative instruments (Note 16)	-	(445)
	(77,548)	(28,508)
Total shareholders' equity	2,617,240	2,438,525
Total liabilities and shareholders' equity	₩ 5,806,516	₩ 5,593,399

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

**LG Chem, Ltd.**  
**Non-Consolidated Statements of Income**  
**Years Ended December 31, 2006 and 2005**

*(in millions of Korean won, except per share amounts)*

	<b>2006</b>	<b>2005</b>
<b>Sales</b> (Notes 22 and 24)	₩ 9,302,341	₩ 7,425,104
<b>Cost of sales</b> (Note 22)	7,965,401	6,107,725
Gross profit	1,336,940	1,317,379
<b>Selling and administrative expenses</b> (Note 22)	1,002,995	895,665
Operating income	333,945	421,714
<b>Non-operating income</b>		
Interest income	8,918	12,193
Foreign exchange gains	62,687	45,795
Gain on foreign currency translation	32,213	13,894
Gain on disposal of short-term investment assets (Note 7)	-	14,960
Gain on disposal of investment securities (Note 7)	-	10,306
Gain on valuation of equity-method investments (Note 8)	133,491	243,751
Gain on disposal of property, plant and equipment	1,945	8,574
Reversal of negative goodwill (Notes 2 and 27)	39,170	-
Reversal of bad debt allowance	63	-
Reversal of compensation expenses associated with stock options (Note 15)	1,042	-
Others	41,916	23,134
	321,445	372,607
<b>Non-operating expenses</b>		
Interest expenses	88,610	94,731
Foreign exchange losses	34,214	24,748
Loss on foreign currency translation	2,572	5,321
Loss on disposal of trade accounts receivable (Note 2)	34,052	22,747
Loss on disposal of investment securities	5	73
Loss on disposal of property, plant and equipment	10,379	35,468
Loss on valuation of equity-method investments (Note 8)	27,471	33,731
Impairment loss on investment securities (Note 7)	361	2,161
Impairment loss on equity-method investments (Note 8)	10,993	-
Impairment loss on intangible assets (Note 10)	2,778	51,434
Impairment loss on property, plant and equipment	-	23,912
Loss on valuation of derivative instruments (Note 16)	3,089	3,080
Donations	6,513	5,950
Others	39,052	23,287
	260,089	326,643
Income before income taxes	395,301	467,678
Income tax expense (Note 19)	76,519	67,420
Net income	₩ 318,782	₩ 400,258
<b>Per share data (in won)</b>		
Earnings per share (Note 20)	₩ 4,392	₩ 5,501
Ordinary income per share (Note 20)	₩ 4,392	₩ 5,501

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

**LG Chem, Ltd.****Non-Consolidated Statements of Appropriations of Retained Earnings****Years Ended December 31, 2006 and 2005****(Date of appropriations: March 16, 2007 and March 9, 2006  
for the years ended December 31, 2006 and 2005)**

<i>(in millions of Korean won)</i>	<b>2006</b>	<b>2005</b>
<b>Retained earnings before appropriations</b>		
Unappropriated retained earnings carried over from prior year	₩ 5	₩ 3
Net income	318,782	400,258
	<u>318,787</u>	<u>400,261</u>
<b>Transfers from other reserves</b>		
Reserve for technology development	63,333	46,667
<b>Appropriation of retained earnings</b>		
Legal reserve	7,291	9,103
Dividend	72,909	91,028
Reserve for technology development	220,120	182,270
Reserve for investment losses	81,791	164,522
	<u>382,111</u>	<u>446,923</u>
<b>Unappropriated retained earnings carried forward to subsequent year</b>	<u>₩ 9</u>	<u>₩ 5</u>

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

**LG Chem, Ltd.**  
**Non-Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2006 and 2005**

<i>(in millions of Korean won)</i>	<b>2006</b>	<b>2005</b>
<b>Cash flows from operating activities</b>		
Net income	₩ 318,782	₩ 400,258
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	532,091	372,092
Provision for severance benefits	66,651	55,853
Gain on foreign currency translation, net	(30,177)	(10,515)
Loss on disposal of trade accounts receivable	34,052	22,747
Impairment loss on investment securities	361	2,161
Impairment loss on equity-method investments	10,993	-
Loss on disposal of property, plant and equipment, net	8,434	26,894
Impairment loss on property, plant and equipment	-	23,912
Impairment loss on intangible asset	2,778	51,434
Gain on disposal of short-term investment assets	-	(14,960)
Loss (gain) on disposal of investment securities, net	5	(10,233)
Gain on valuation of equity-method investments, net	(106,020)	(210,020)
Loss on valuation of derivative instruments	3,089	3,080
Reversal of negative goodwill	(39,170)	-
Reversal of bad debt allowance	(63)	-
Reversal of compensation expenses associated with stock option	(1,042)	-
Others, net	19,782	26,392
	<u>501,764</u>	<u>338,837</u>
Changes in operating assets and liabilities		
Increase in trade accounts and notes receivable	(209,801)	(72,358)
(Increase) decrease in inventories	(71,669)	11,109
Dividend received	46,899	68,415
Increase in other accounts receivable	(10,565)	(16,968)
(Increase) decrease in accrued income	(1,402)	78
Decrease (increase) in advance payments	1,255	(1,390)
Decrease (increase) in prepaid expenses	1,249	(2,531)
Decrease (increase) in deferred income tax assets	11,486	(23,832)
Decrease in other current assets	1,230	232
Decrease in long-term trade accounts and notes receivable	-	454
Increase (decrease) in trade accounts and notes payable	76,137	(168,313)
Increase in other accounts payable	124,662	6,302
Increase in accrued expenses	7,353	8,135
Decrease in income taxes payable	(26,415)	(14,089)
Increase in other current liabilities	9,558	3,865
Increase in long-term accrued expenses	1,994	-
Accrued severance benefits transferred from affiliated company	351	361
Decrease in deferred income tax liabilities	(4,830)	(20,896)
Payment of severance benefits	(64,166)	(49,068)
Others, net	3,838	2,557
	<u>(102,836)</u>	<u>(267,937)</u>
Net cash provided by operating activities	<u>717,710</u>	<u>471,158</u>

**LG Chem, Ltd.**  
**Non-Consolidated Statements of Cash Flows**  
**Years Ended December 31, 2006 and 2005**

(in millions of Korean won)

	2006	2005
<b>Cash flows from investing activities</b>		
Disposal of property, plant and equipment	₩ 6,463	₩ 30,138
(Acquisition) disposal of short-term investment assets, net	(4)	74,513
Disposal (acquisition) of long-term guarantee deposits, net	31,663	(1,035)
Disposal (acquisition) of other investment, net	411	(3,347)
Acquisition of property, plant and equipment	(527,215)	(451,447)
(Acquisition) disposal of investment securities, net	(140)	22,873
Acquisition of equity method securities, net	(64,170)	(72,860)
Acquisition of intangible assets, net	(22,416)	(19,055)
Others, net	(27,970)	(9,203)
Net cash used in investing activities	<u>(603,378)</u>	<u>(429,423)</u>
<b>Cash flows from financing activities</b>		
Repayment of short-term borrowings, net	(100,865)	(81,090)
Repayment of current maturities of long-term debts	(732,158)	(322,266)
Issuance of debentures	419,750	227,344
Payment of dividends	(91,046)	(109,963)
Proceeds from long-term debts, net	138,532	41,635
Acquisition of treasury stock	-	(20,779)
Others, net	(3,667)	(888)
Net cash used in financing activities	<u>(369,454)</u>	<u>(266,007)</u>
<b>Cash flows from merger</b>		
Net decrease in cash and cash equivalents	<u>181,507</u>	<u>-</u>
	(73,615)	(224,272)
<b>Cash and cash equivalents</b>		
Beginning of the year	<u>189,445</u>	<u>413,717</u>
End of the year	<u>₩ 115,830</u>	<u>₩ 189,445</u>

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

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**1. The Company**

The Company was spun off from LG Chem Investment Ltd. (formerly LG Chemical Ltd.) on April 1, 2001, and completed the registration process on April 3, 2001. The Company engages in the business of petrochemicals, industrial materials, and information and electronic materials. The Company has its manufacturing facilities in Yeosu, Cheongju, Ulsan, Naju, Onsan, Iksan, Daesan and Ochang.

The Company merged with LG Daesan Petrochemical Ltd. on January 1, 2006 (Note 27).

As of December 31, 2006, the Company has an outstanding capital stock of ₩365,432 million, including preferred stock of ₩43,306 million. The Company has been listed on the Korea Stock Exchange since April 25, 2001.

The Company is authorized to issue 292 million shares of common stock at ₩5,000 per share. As of December 31, 2006, the Company has issued 64,425,064 common shares and 8,661,251 preferred shares. The holders of preferred stock are not granted the right to vote, but are entitled to receive cash dividend at a rate of one percentage point over that of common stockholders.

**2. Summary of Significant Accounting Policies**

The significant accounting policies followed by the Company in the preparation of its non-consolidated financial statements are summarized below.

**Basis of Financial Statements Presentation**

The Company maintains its accounting records in Korean won and prepares statutory financial statements in the Korean language, in conformity with financial 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 financial statements are intended for use by those who are informed about Korean accounting principles and practices. The accompanying non-consolidated financial statements have been condensed, restructured and translated into English from the Korean language non-consolidated financial statements. Certain information attached to the Korean language financial statements, but not required for a fair presentation of the Company's financial position, results of operations, or cash flows, is not presented in the accompanying non-consolidated financial statements.

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**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. The Company's financial statements have been prepared in accordance with the SKFAS including Nos. 1 through 20 (excluding Nos. 11 and 14). The significant accounting policies adopted for the preparation of the Company's financial statements are identical to those adopted for the financial statements for the year ended December 31, 2005, except for SKFAS Nos. 18 through 20 which became effective for the Company on January 1, 2006 and the Accounting Standards for Business Combinations in relation to the merger with LG Daesan Petrochemical Ltd.

**Merger**

The Company merged with LG Daesan Petrochemical Ltd. on January 1, 2006. According to the Accounting Standards for Business Combination, this merger was regarded as the merger between a parent company and its subsidiary. Therefore, assets and liabilities taken over by the Company were assessed at their book values on the consolidated financial statements (Note 27).

**Accounting Estimates**

The preparation of the non-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.

**Revenue Recognition**

Sales of manufactured products and goods are recognized upon delivery when the significant risks and rewards of ownership of the goods are transferred to the buyer.

**Asset-Backed Securities**

The Company recognizes interest and issuance expenses as losses on disposal of trade accounts receivable and losses on disposal of investments, respectively.

**Allowance for Doubtful Accounts**

The Company provides an allowance for doubtful accounts based on the aggregate estimated realizable value of the receivables.

**Inventories**

Inventories are stated at the lower of cost or market, with cost being determined using the moving-average method, except for materials-in-transit which are stated at actual cost determined using the specific identification method. If the net realizable value of inventory is less than its cost, a contra inventory account representing the valuation loss, is presented 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.

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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**Securities**

In accordance with SKFAS No. 8, *Investments in Securities*, investments in equity securities or debt securities are classified into trading securities, available-for-sale securities and held-to-maturity securities depending on the acquisition and holding purpose. Trading securities are classified as current assets, and available-for-sale securities and held-to-maturity securities are classified as long-term investments, except for those securities that mature or are certain to be disposed of within one year, which are classified as part of current assets.

Securities are initially carried at cost, including incidental expenses, with cost being determined using the moving 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, which are carried at cost. Non-marketable debt securities are carried at a value using the present value of future cash flows, discounted at the reasonable interest rate determined considering the credit ratings provided 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 recorded as a capital adjustment, 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 income statement when the recoverable amounts are less than the acquisition cost of securities or adjusted cost of debt securities for the amortization of discounts or premiums.

**Equity-Method Investments**

In the non-consolidated financial statements of the Company, investments in business entities, over which the Company exercises significant control or influence over the operating and financial policies of such entities, are recorded using the equity method of accounting.

Under the equity method, the original investment is recorded at cost and adjusted by the changes in the Company's 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 the net book value of the investee. Unrealized profit arising from intercompany transactions is eliminated based on the average gross profit ratio of the corresponding company. The Company's proportionate unrealized profit arising from sales between the Company and equity-method investees or sales between equity-method investees is eliminated. However, unrealized profit arising from sales by the Company to its consolidated subsidiaries is fully eliminated.

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**Notes to Non-Consolidated Financial Statements**  
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The Company discontinues the equity method of accounting for investments when the Company's share in the accumulated losses of the investee equals the costs of the investments, and until the subsequent accumulated proportionate net income of the investees equals its cumulative proportionate net losses not recognized during the periods when the equity method was suspended. Even if the book value of the investments, including other investment-type assets such as the preferred shares or long-term debts of the investees becomes zero or negative, the Company still continues to record its share in the net losses of the investees until its proportionate net loss of the investee equals the book value of such assets.

The difference between the Company's initial proportionate ownership in the net fair value and the net book value of the investee, which is the net of the fair value and the net book value of the recognizable assets and liabilities, is amortized according to the investee's accounting policy for the related assets and liabilities.

When the initial purchase price exceeds or is below the Company's initial proportionate ownership in the net fair value of the investee, which is the net of the fair value of the investee's recognizable assets and liabilities, the Company considers the difference as goodwill (negative goodwill) and amortizes it in accordance with the Accounting Standards for Business Combination.

In cases where the investee is the Company's consolidated subsidiary, the difference between change of the Company's proportionate ownership in the net book value of the investee and purchase price, which is paid for the Company's additional acquisition of shares or investee's issuance of new shares, is accounted for capital adjustments.

Accounts and records of the overseas equity method companies are maintained in foreign currencies. The financial statements of the overseas equity-method investees have been translated into Korean won at exchange rates as of the balance sheet date for the balance sheet and annual average exchange rate for income statements. Any resulting translation gain or loss is accounted for as overseas operation translation debit or credit under the capital adjustments, a component of shareholders' equity.

In the application of the equity method of accounting, the overseas investee companies apply the same accounting policies as the Company. For example, the Company made adjustments to the financial statements of overseas investees whose estimated useful lives on their property, plant and equipment are different from those used by the Company. As a result of these adjustments, the Company's equity-method investments as of December 31, 2006, decreased by ₩10,029 million. Also, the gain on valuation of equity-method investments decreased by ₩2,773 million, while the loss on valuation of equity-method investments increased by ₩7,256 million for the year ended December 31, 2006.

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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**Property, Plant and Equipment, and Related Depreciation**

Property, plant and equipment are recorded at cost, except for upward revaluations in accordance with the Korean Asset Revaluation Law. Such revaluations present production facilities and other buildings at their depreciated replacement cost and land at the prevailing market price as of the effective date of revaluation.

Depreciation is computed using the straight-line method over the following estimated useful lives:

	<b>Estimated Useful Lives</b>
Buildings and structures	25 – 50 years
Machinery and equipment	6 – 15 years
Vehicles	6 years
Tools	6 years
Furniture and fixtures	6 years
Others	3 years

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

Routine maintenance and repairs are charged to expense as incurred. Expenditures, which enhance the value or extend the useful lives of the related assets, are capitalized.

The Company assesses the potential impairment of property, plant and equipment when there is evidence that events or changes in circumstances have made the recovery of an asset's carrying value unlikely, and recognizes an impairment loss when the carrying value of an asset exceeds the value of its future economic benefits. The carrying value of the impaired assets is reduced to the estimated realizable value, and an impairment loss is recorded as a reduction in the carrying value of the related asset and charged to current operations. However, the recovery of the impaired assets is recorded in current operations up to the cost of the assets, net of accumulated depreciation before impairment, when the estimated value of the assets exceeds the carrying value after impairment.

**Lease Transactions**

The Company accounts for lease transactions as either operating leases or capital leases, depending on the terms of the underlying lease agreements. Machinery and equipment acquired under financing lease agreements are recorded as property, plant and equipment at cost and depreciated using the declining-balance method over their estimated useful lives. In addition, the aggregate lease payments are recorded as obligations under financing leases, net of accrued interest, as determined by the total lease payments in excess of the cost of the leased machinery and equipment. Accrued interest is amortized over the lease period using the effective interest rate method.

Machinery and equipment acquired under operating lease agreements are not included in property, plant and equipment. Instead, the related lease rentals are charged to expense on a pro-rata basis over the lease term.

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
**December 31, 2006 and 2005**

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**Intangible Assets**

Intangible assets, consisting of intellectual property rights and exclusive facility use rights are stated at cost, net of accumulated amortization. Amortization is computed using the straight-line method over the estimated useful lives ranging from three to 25 years. Research and development costs are charged to current operations when incurred and are included in operating expenses. Costs incurred in developing new products or technologies, which can be clearly defined and measured, and having probable future economic benefits, are capitalized as development costs. Other development costs are charged as normal development expense in the period incurred. For the year ended December 31, 2006, the Company expensed ₩198,198 million (2005: ₩190,348 million) as normal development expense.

Capitalized development costs are amortized over their economic lives not to exceed 20 years using the straight-line method. The Company performs periodic assessments of the recoverability of development costs. Unrecoverable costs are charged to operations in the period that they are first identified.

**Negative Goodwill**

The Company records differences between the investment account and corresponding capital accounts of subsidiaries as a goodwill or negative goodwill in accordance with the Accounting Standards for Business Combination. The negative goodwill is amortized using a straight-line method over weighted average useful lives of assets.

**Revaluation of Receivables**

Receivables, which are modified during the course of court receivership, court mediation or restructuring of customers, are revalued at the present value discounted by an adjusted interest rate. The difference between the book value and the present value is accounted for as bad debt expense.

**Premiums or Discounts on Debentures**

The Company accounts for the difference between the face amount and issued amount of debentures as an addition to or deduction from debentures.

Premiums or discounts on debentures are amortized using the effective interest rate method over the terms of the debentures. The resulting amortization is recorded as interest expense.

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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**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, based on their length of employment and rate of pay at the time of termination. Accrued severance benefits represent the amount of severance benefits which would be payable assuming all eligible employees and directors were to terminate their employment as of the balance sheet date.

Accrued severance benefits are funded at approximately 58.6 % (2005: 59.9 %) as of December 31, 2006 through group severance insurance plans and are presented as a deduction from accrued severance benefits.

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

**Contingent liabilities**

When there is a probability that an outflow of economic benefits will occur due to a present obligation resulting from a past event, and whose amount is reasonably estimable, a corresponding amount of provision is recognized in the financial statements.

**Impairment Loss**

An impairment loss related to assets, other than marketable securities, investment securities, restructured receivables and assets on which present value discounts are applied, are included in income from operations when there are declines in fair value arising from obsolescence, physical damage or the significant decline in market value. A subsequent recovery is recorded as non-operating income up to the original book value.

**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 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 reverse. Deferred tax assets are recognized when it is more likely that such deferred tax assets will be realized. The total income tax provision includes the current tax expense under applicable tax regulations, and the change in the balance of deferred tax assets and liabilities during the year.

Deferred income tax assets (liabilities) for temporary differences are classified into current assets (current liabilities) or investments (non-current liabilities) according to the classification of the assets (liabilities) on balance sheet, to which the temporary differences are related. For temporary differences that are not related to the assets (liabilities) on balance sheet, the deferred income tax assets (liabilities) are classified into current or non-current assets (liabilities) according to the expected reversal date of the temporary differences.

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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**Derivative Financial Instruments**

The Company utilizes derivative instruments to reduce its exposure to fluctuations in interest and foreign currency exchange rates. Derivative financial instruments for trading or hedging purpose are valued at estimated market price with the resulting unrealized gains or losses recognized in the current operations, except for the effective portion of derivative transactions entered into for the purpose of cash-flow hedges, which is recorded as an adjustment to shareholders' equity.

**Foreign Currency Translation**

Monetary assets and liabilities denominated in foreign currencies are translated into Korean won at the exchange rate in effect at the balance sheet date, and resulting translation gains and losses are recognized in current operations. The exchange rate used to translate U.S. dollar denominated monetary assets and liabilities as of December 31, 2006, is ₩929.6: US\$1 (2005: ₩1,013: US\$1).

**3. Restricted Bank Deposits**

As of December 31, 2006, long-term financial instruments of ₩60 million (2005: ₩51 million) are deposited in connection with bank overdraft agreements. The withdrawal of these deposits is restricted.

The withdrawal of group severance insurance deposits is also restricted to employees' severance payments.

**4. Asset-Backed Securitization**

In accordance with the Asset Securitization Law, on December 27, 2004, the Company transferred ₩229,625 million of trade accounts receivable outstanding as of November 30, 2004, to LG Chem 3<sup>rd</sup> Special Purpose Company. Through the asset-backed securitization of trade receivables, the Company acquired beneficiary certificates. The maturity dates of these beneficiary certificates are January 28, 2008 (₩50,000 million), February 28, 2008 (₩50,000 million) and March 28, 2008 (₩60,000 million).

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As of December 31, 2006, 2<sup>nd</sup> beneficiary certificates acquired from the trust companies, amounting to ₩123,761 million (2005: ₩49,760 million), are included in the trade accounts receivable.

The senior tranche securities have priority claims on the principal, interest and operating expenses of the special purpose companies. However, the beneficiary certificates and subordinated notes held by the Company can enforce their claim only after the priority claims will have been satisfied.

The Company has the obligation to collect the trade accounts receivable transferred and pay for the special purpose companies' expenses, such as interest and operating expenses as described above.

As of December 31, 2006, trade accounts receivable transferred to the special purpose companies amounted to ₩283,761 million (2005: ₩209,760 million).

**5. Receivables**

Receivables and allowance for doubtful accounts as of December 31, 2006 and 2005, consist of the following:

<i>(in millions of Korean won)</i>	<b>2006</b>	<b>2005</b>
Trade accounts and notes receivable	₩ 864,339	₩ 546,511
Less: Allowance for doubtful accounts	(45,955)	(47,129)
	<u>₩ 818,384</u>	<u>₩ 499,382</u>
Other accounts receivable	₩ 145,889	₩ 123,520
Less: Allowance for doubtful accounts	(24,719)	(23,419)
Less: Present value discount accounts	(28)	(42)
	<u>₩ 121,142</u>	<u>₩ 100,059</u>
Long-term trade accounts and notes receivable	₩ 550	₩ 926
Less: Allowance for doubtful accounts	(85)	(151)
	<u>₩ 465</u>	<u>₩ 775</u>
Long-term other accounts receivable	₩ 1,188	₩ 1,690
Less: Present value discount accounts	(134)	(199)
	<u>₩ 1,054</u>	<u>₩ 1,491</u>

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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**6. Inventories**

Inventories as of December 31, 2006 and 2005, consist of the following:

<i>(in millions of Korean won)</i>	<b>2006</b>	<b>2005</b>
Merchandise, net of valuation allowance of ₩649 million (2005: ₩561 million)	₩ 47,064	₩ 29,750
Finished products, net of valuation allowance of ₩11,973 million (2005: ₩12,881 million)	375,421	279,431
Work-in-process	104,860	82,377
Raw materials, net of valuation allowance of ₩414 million (2005: ₩315 million)	212,788	149,709
Supplies	30,559	17,914
Materials-in-transit	98,446	49,669
	<u>₩ 869,138</u>	<u>₩ 608,850</u>

As of December 31, 2006, inventories are insured against fire and other casualty losses up to ₩656,075 million (2005: ₩514,020 million).

**LG Chem, Ltd.**  
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**7. Investment Securities**

Non-marketable stocks classified as available-for-sale as of December 31, 2006 and 2005, consist of the following:

<i>(in millions of Korean won)</i>	Percentage of Ownership (%)		Acquisition Cost		Book Value		Fair Value or Net Asset Value <sup>4</sup>	
	2006	2005	2006	2005	2006	2005	2006	2005
<b>Long-term Investment</b>								
N&L Marble	22.73	22.73	₩ 539	₩ 539	₩ -	₩ -	₩ 114	₩ 114
PT. Halim Samara Interutama	12.10	12.10	576	576	576	576	564	564
TECWIN <sup>1</sup>	19.90	19.90	419	279	419	279	2,042	1,550
Chemizen. Com Ltd.	2.62	2.62	300	300	10	10	10	10
LG Mozel Ltd.	9.75	9.75	195	195	195	195	392	377
EICO Properties Pte. Ltd. <sup>2</sup>	9.20	9.20	2,298	2,298	509	870	509	870
LG Environment Strategy Institute	6.00	6.00	9	9	9	9	10	10
LG Lucoat Powder Coatings Ltd. <sup>3</sup>	-	13.30	-	1,036	-	-	-	574
			₩ 4,336	₩ 5,232	₩ 1,718	₩ 1,939	₩ 3,641	₩ 4,069

<sup>1</sup> The Company acquired an additional 27,860 shares of TECWIN for ₩140 million in 2006 without any change in percentage of ownership.

<sup>2</sup> The Company recognized an impairment loss of ₩361 million in 2006.

<sup>3</sup> The Company disposed of all shares of LG Lucoat Powder Coatings Ltd. in 2006.

<sup>4</sup> Net asset values were calculated based on the recent available financial statements of the investees. Impairment losses are recognized in the statement of income in cases where there is an indication that an investment may have been impaired.

The Company disposed of all common stocks of LG Card Co., Ltd. which were acquired through the debt-to-equity swap, resulting to a gain on disposal of ₩10,306 million for the year ended December 31, 2005. And the Company realized gains on disposals of ₩14,960 million from the commercial papers upon their maturity for the year ended December 31, 2005.

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**8. Equity-Method Investments**

Equity-method investments as of December 31, 2006 and 2005, are summarized as follows:

<i>(in millions of Korean won)</i>	Investee <sup>11</sup>	Percentage of		Acquisition Cost		Book Value		Fair Value or Net	
		Ownership (%)						Asset Value	
		2006	2005	2006	2005	2006	2005	2006	2005
	LG Petrochemical Co., Ltd. <sup>1</sup>	40.00	40.00	₩ 153,790	₩ 153,790	₩ 352,579	₩ 338,017	₩ 342,029	₩ 325,493
	Tianjin LG Dagu Chemical Co., Ltd.	75.00	75.00	17,440	17,498	21,465	30,172	21,502	41,256
	Tianjin LG New Building Materials Co., Ltd. <sup>2</sup>	82.80	81.47	20,341	19,894	16,849	16,037	21,609	17,343
	Tianjin LG Window & Door Co., Ltd.	90.00	90.00	13,308	13,308	7,689	7,479	8,955	8,290
	Ningbo LG Yongxing Chemical Co., Ltd. <sup>3</sup>	75.00	75.00	95,237	86,417	112,539	103,608	111,924	107,004
	LG Chemical India Pvt. Ltd.	100.00	100.00	31,466	31,466	40,906	43,441	40,906	44,066
	LG Chemical Hong Kong Ltd.	100.00	100.00	254	254	6,669	6,141	6,120	5,257
	LG Vina Chemical J/V Company	40.00	40.00	1,194	1,194	2,239	2,270	2,549	2,621
	LG Chem America, Inc.	100.00	100.00	9,596	9,596	5,200	5,764	8,388	8,993
	M. Dohmen S.A. <sup>4</sup>	49.00	49.00	43,203	43,203	993	18,306	14,835	18,306
	LG Daesan Petrochemical Ltd. <sup>5</sup>	-	100.00	-	554,634	-	650,565	-	1,113,010
	SEETEC Co., Ltd.	50.00	50.00	36,643	36,643	54,749	44,663	152,280	145,429
	LG Dow Polycarbonate Ltd.	50.00	50.00	36,794	36,794	80,246	71,534	79,287	70,925
	LG Chemical (Guangzhou) Engineering Plastics Co., Ltd.	100.00	100.00	10,486	10,486	11,301	9,249	11,325	10,125
	LG Chem (Nanjing) Information & Electronics Materials Co., Ltd. <sup>6</sup>	73.43	79.01	43,296	41,679	21,370	28,130	35,687	31,323
	LG Chem Trading (Shanghai) Co., Ltd.	100.00	100.00	3,503	3,503	1,653	1,850	1,656	1,687
	LG Chem (China) Investment Co., Ltd. <sup>7</sup>	100.00	100.00	40,340	31,339	40,298	31,757	40,298	31,666
	LG Chem (Taiwan), Ltd.	100.00	100.00	2,291	2,291	1,158	2,113	4,341	3,155
	LG Chem Industrial Materials Inc.	100.00	100.00	17,846	17,846	9,850	11,873	10,229	11,845
	LG Chem Europe Sarl.	100.00	100.00	5,635	5,635	1,441	-	1,441	196
	LG Holdings (HK) Ltd. <sup>8</sup>	18.18	18.18	41,582	30,494	28,682	22,302	25,802	18,904
	Ningbo LG Yongxing Latex Co., Ltd.	75.00	75.00	6,843	6,843	4,748	6,158	4,759	6,209
	Compact Power Inc.	81.00	81.00	4,635	4,635	545	1,120	545	277
	LG Chem (Tianjin) Engineering Plastics Co., Ltd.	90.00	90.00	5,589	5,589	4,639	4,415	5,419	4,675
	LG Chem Display Materials (Beijing) Co., Ltd.	90.00	90.00	6,865	6,865	4,977	6,898	5,526	6,894
	Tianjin LG Bohai Chemical Co., Ltd. <sup>9</sup>	43.89	22.07	38,445	8,185	37,294	8,169	47,377	8,206
	LG Chem Europe GmbH	100.00	100.00	1,927	1,927	933	1,448	1,964	1,840
	LG Chem Brasil, Ltd.	100.00	100.00	258	258	258	258	258	258
	LG Chem Poland Sp. Z.O.O. <sup>10</sup>	100.00	100.00	5,790	2,795	5,352	2,795	5,352	2,795
				₩694,597	₩1,185,061	₩ 876,622	₩1,476,532	₩1,012,363	₩2,048,048

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- <sup>1</sup> As of December 31, 2006, the market value of the shares of LG Petrochemical Co., Ltd. owned by the Company amounted to ₩424,880 million.
- <sup>2</sup> In 2006, the Company acquired additional shares of Tianjin LG New Building Materials Co., Ltd. for ₩447 million. As a result, the Company's percentage of ownership in Tianjin LG New Building Materials Co., Ltd. increased from 81.47% to 82.80%.
- <sup>3</sup> In 2006, the Company acquired additional shares of Ningbo LG Yongxing Chemical Co., Ltd. for ₩8,820 million without any change in its percentage of ownership.
- <sup>4</sup> The Company recognized an impairment loss of ₩10,993 million for the difference between the estimated realizable value and the book value in 2006.
- <sup>5</sup> As the Company merged with LG Daesan Petrochemical Ltd., this investment was eliminated in 2006 (Note 27).
- <sup>6</sup> The Company acquired new shares of LG Chem (Nanjing) Information & Electronics Materials Co., Ltd. for ₩1,617 million in 2006. As a result, the Company's percentage of ownership in LG Chem (Nanjing) Information & Electronics Materials Co., Ltd. decreased from 79.01% to 73.43%.
- <sup>7</sup> In 2006, the Company acquired additional shares of LG Chem (China) Investment Co., Ltd. for ₩9,001 million without any change in its percentage of ownership.
- <sup>8</sup> This investment is classified as an equity-method investment as the combined percentage of ownership of the Company and LG Electronics Inc., a consolidated subsidiary of LG Corp., exceeds 20%. The Company acquired additional shares of LG Holdings (HK) Ltd. for ₩11,088 million without any change in its percentage of ownership.
- <sup>9</sup> The Company acquired additional shares of Tianjin LG Bohai Chemical Co., Ltd. for ₩30,260 million in 2006. As a result, the Company's percentage of ownership in Tianjin LG Bohai Chemical Co., Ltd. increased from 22.07% to 43.89%. Of the acquisition amount, ₩6,274 million was paid to Tianjin LG Dagu Chemical Co., Ltd.
- <sup>10</sup> In 2006, the Company acquired additional shares of LG Chem Poland Sp. Z.O.O. for ₩2,995 million without any change in its percentage of ownership.
- <sup>11</sup> As of December 31, 2006, the Company has control over all the investees, except for M. Dohmen S.A., SEETEC Co., Ltd. and LG Holdings (HK) Ltd.

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Changes in equity-method investments for the years ended December 31, 2006 and 2005, are as follows:

(in millions of Korean won)

Investee	2006						December 31, 2006
	January 1, 2006	Acquisition (Disposal)	Dividends	Valuation Gain (Loss)	Increase (Decrease) in Capital Adjustment		
LG Petrochemical Co., Ltd.	₩ 338,017	₩ -	₩ (18,080)	₩ 74,385	(41,743)	352,579	
Tianjin LG Dagu Chemical Co., Ltd.	30,172	(58)	-	(7,338)	(1,311)	21,465	
Tianjin LG New Building Materials Co., Ltd.	16,037	447	-	1,465	(1,100)	16,849	
Tianjin LG Window & Door Co., Ltd.	7,479	-	-	(762)	972	7,689	
Ningbo LG Yongxing Chemical Co., Ltd.	103,608	8,820	(25,451)	30,129	(4,567)	112,539	
LG Chemical India Pvt. Ltd.	43,441	-	(2,640)	2,324	(2,219)	40,906	
LG Chemical Hong Kong Ltd.	6,141	-	-	993	(465)	6,669	
LG Vina Chemical J/V Company	2,270	-	(728)	925	(228)	2,239	
LG Chem America, Inc.	5,764	-	-	783	(1,347)	5,200	
M. Dohmen S.A. <sup>1</sup>	18,306	-	-	(14,362)	(2,951)	993	
LG Daesan Petrochemical Ltd.	650,565	(650,565)	-	-	-	-	
SEETEC Co., Ltd.	44,663	-	-	10,070	16	54,749	
LG Dow Polycarbonate Ltd.	71,534	-	-	8,705	7	80,246	
LG Chemical (Guangzhou) Engineering Plastics Co., Ltd.	9,249	-	-	2,594	(542)	11,301	
LG Chem (Nanjing) Information & Electronics Materials Co., Ltd.	28,130	1,617	-	(6,362)	(2,015)	21,370	
LG Chem Trading (Shanghai) Co., Ltd.	1,850	-	-	48	(245)	1,653	
LG Chem (China) Investment Co., Ltd.	31,757	9,001	-	17	(477)	40,298	
LG Chem (Taiwan), Ltd.	2,113	-	-	(526)	(429)	1,158	
LG Chem Industrial Materials Inc.	11,873	-	-	(1,067)	(956)	9,850	
LG Chem Europe Sarl <sup>2</sup>	-	-	-	754	687	1,441	
LG Holdings (HK) Ltd.	22,302	11,088	-	(4,172)	(536)	28,682	
Ningbo LG Yongxing Latex Co., Ltd.	6,158	-	-	(968)	(442)	4,748	
Compact Power Inc.	1,120	-	-	287	(862)	545	
LG Chem (Tianjin) Engineering Plastics Co., Ltd.	4,415	-	-	(110)	334	4,639	
LG Chem Display Materials Co., Ltd.	6,898	-	-	(1,672)	(249)	4,977	
Tianjin LG Bohai Chemical Co., Ltd.	8,169	30,260	-	12	(1,147)	37,294	
LG Chem Europe GmbH	1,448	-	-	(560)	45	933	
LG Chem Brasil, Ltd.	258	-	-	-	-	258	
LG Chem Poland Sp. Z.O.O.	2,795	2,995	-	(565)	127	5,352	
	<u>₩1,476,532</u>	<u>₩(586,395)</u>	<u>₩ (46,899)</u>	<u>₩ 95,027</u>	<u>₩ (61,643)</u>	<u>876,622</u>	

<sup>1</sup> The Company recognized an impairment loss of ₩10,993 million for the difference between the estimated realizable value and the book value in 2006.

<sup>2</sup> The Company resumed the equity method of accounting since the investee's net asset value became positive in 2006.

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Investee	2005						December 31, 2005
	January 1, 2005	Acquisition (Disposal)	Dividends	Valuation Gain (Loss)	Increase (Decrease) in Capital Adjustment		
LG Petrochemical Co., Ltd.	₩ 291,131	₩ -	₩ (31,640)	₩ 79,341	₩ (815)	₩ 338,017	
Tianjin LG Dagu Chemical Co., Ltd.	42,110	-	(3,008)	(8,482)	(448)	30,172	
Tianjin LG New Building Materials Co., Ltd.	14,864	-	-	1,172	1	16,037	
Tianjin LG Window & Door Co., Ltd.	8,558	-	-	(1,054)	(25)	7,479	
Ningbo LG Yongxing Chemical Co., Ltd.	94,810	13,070	(27,612)	25,243	(1,903)	103,608	
LG Chemical India Pvt. Ltd.	52,348	-	(5,393)	889	(4,403)	43,441	
LG Chemical Hong Kong Ltd.	5,378	-	-	919	(156)	6,141	
LG Vina Chemical J/V Company	2,140	-	(762)	986	(94)	2,270	
LG Chem America, Inc. <sup>1</sup>	-	-	-	4,156	1,608	5,764	
M. Dohmen S.A.	21,299	-	-	(1,731)	(1,262)	18,306	
Hyundai Petrochemical Co., Ltd. <sup>2</sup>	585,372	(585,372)	-	-	-	-	
LG Daesan Petrochemical Ltd. <sup>2</sup>	-	554,634	-	95,931	-	650,565	
SEETEC Co., Ltd. <sup>2</sup>	-	36,643	-	8,031	(11)	44,663	
Lotte Daesan Petrochemical Ltd. <sup>2</sup>	-	-	-	-	-	-	
LG Dow Polycarbonate Ltd.	46,704	-	-	24,830	-	71,534	
LG Chemical (Guangzhou) Engineering Plastics Co., Ltd.	7,401	-	-	1,881	(33)	9,249	
LG Chem (Nanjing) Information & Electronics Materials Co., Ltd.	41,679	-	-	(9,041)	(4,508)	28,130	
LG Chem Trading (Shanghai) Co., Ltd.	1,723	-	-	139	(12)	1,850	
LG Chem (China) Investment Co., Ltd.	6,253	25,086	-	(197)	615	31,757	
LG Chem (Taiwan), Ltd.	2,291	-	-	(51)	(127)	2,113	
LG Chem Industrial Materials Inc.	17,846	-	-	(3,904)	(2,069)	11,873	
LG Chem Europe Sarl <sup>3</sup>	2,321	-	-	(2,239)	(82)	-	
LG Holdings (HK) Ltd.	30,494	-	-	(4,915)	(3,277)	22,302	
LG Chemical (Hunan) Phosphor.	1,793	(2,027)	-	234	-	-	
Ningbo LG Yongxing Latex Co., Ltd.	3,162	3,681	-	(553)	(132)	6,158	
Compact Power Inc. <sup>4</sup>	454	710	-	-	(44)	1,120	
LG Chem (Tianjin) Engineering Plastics Co., Ltd.	-	5,589	-	(1,225)	51	4,415	
LG Chem Display Materials Co., Ltd.	-	6,865	-	-	33	6,898	
Tianjin LG Bohai Chemical Co., Ltd.	-	8,185	-	-	(16)	8,169	
LG Chem Europe GmbH	-	1,927	-	(340)	(139)	1,448	
LG Chem Brasil, Ltd.	-	258	-	-	-	258	
LG Chem Poland Sp. Z.O.O.	-	2,795	-	-	-	2,795	
	<u>₩ 1,280,131</u>	<u>₩ 72,044</u>	<u>₩ (68,415)</u>	<u>₩ 210,020</u>	<u>₩ (17,248)</u>	<u>₩ 1,476,532</u>	

## LG Chem, Ltd.

### Notes to Non-Consolidated Financial Statements

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- <sup>1</sup> The Company resumed the equity method of accounting since the investee's net asset value became positive in 2005.
- <sup>2</sup> Hyundai Petrochemical Co., Ltd. (HPCL) was acquired by a consortium consisting of the Company and Honam Petrochemical Corp. in 2003. On January 1, 2005, HPCL spun off its petrochemical business to the newly established LG Daesan Petrochemical Ltd (LGPC) and Lotte Daesan Petrochemical Ltd. (LDPC). The remaining businesses of HPCL are maintained by the continuing company, SEETEC Co., Ltd. (formerly Hyundai Petrochemical Co., Ltd.). The spin off resulted to the Company owning 50% of LGPC, LDPC and SEETEC Co., Ltd. The book value of the Company's investment security in HPCL as of January 1, 2005, consists of acquisition costs of investment securities in LGPC, LDPC, and SEETEC, in proportion to the fair values of the three companies. On April 30, 2005, the Company swapped its 50% ownership in LDPC for Honam Petrochemical's 50% ownership in LGPC. The Company did not recognize any gain or loss on disposal of equity-method investments for this transaction. As of December 31, 2006, the Company has 100% ownership of LGPC and 50% ownership of SEETEC Co., Ltd.. The equity method was applied on the investment in LGPC since the spin-off to account for the 100% ownership.
- <sup>3</sup> During the year ended December 31, 2005, the Company discontinued the application of the equity method as the investment's book value was reduced to nil. The accumulated unrecognized loss after the discontinuation amounted to ₩293 million.
- <sup>4</sup> During the year ended December 31, 2005, the Company acquired additional shares and recognized impairment loss.

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The accumulated unamortized differences between the purchase price and the underlying proportionate net book value of equity investments, as well as the changes in such amounts for the years ended December 31, 2006 and 2005, are as follows:

(in millions of Korean won)

Investee	2006				2005			
	Beginning Balance	Increase	Amortization	Ending Balance	Beginning Balance	Increase	Amortization	Ending Balance
LG Petrochemical Co., Ltd.	₩ 16,120	₩ -	₩ 2,608	₩ 13,512	₩ 18,703	₩ -	₩ 2,583	₩ 16,120
Tianjin LG New Building Materials Co., Ltd.	180	-	180	-	212	-	32	180
Hyundai Petrochemical Co., Ltd.	-	-	-	-	(337,487)	337,487 <sup>2</sup>	-	-
LG Daesan Petrochemical Ltd. <sup>1</sup>	(353,752)	353,752	-	-	-	(393,058) <sup>2</sup>	(39,306)	(353,752)
SEETEC Co., Ltd.	(70,619)	-	(3,363)	(67,256)	-	(73,982) <sup>2</sup>	(3,363)	(70,619)
LG Dow Polycarbonate Ltd.	1,586	-	198	1,388	1,784	-	198	1,586
LG Holdings (HK) Ltd.	3,403	-	524	2,879	-	5,235	1,832	3,403
Compact Power Inc.	845	(845)	-	-	-	845	-	845
	<u>₩(402,237)</u>	<u>₩352,907</u>	<u>₩ 147</u>	<u>₩ (49,477)</u>	<u>₩(316,788)</u>	<u>₩(123,473)</u>	<u>₩ (38,024)</u>	<u>₩(402,237)</u>

<sup>1</sup> As the Company merged with LG Daesan Petrochemical Ltd. in 2006, a negative goodwill of ₩353,752 million was recorded in 2006 (Note 27).

<sup>2</sup> As of January 1, 2005, the date of the spin-off of Hyundai Petrochemical Co., Ltd., the differences between the Company's book values for LG Daesan Petrochemical Ltd. and SEETEC Co., Ltd., and the Company's respective proportionate fair value for each company represent their respective negative goodwill.

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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The eliminated unrealized gains incurred from transactions entered into with equity method investees as of December 31, 2006 and 2005, are as follows:

(in millions of Korean won)

Investee	2006		2005	
	Inventory		Inventory	
LG Petrochemical Co., Ltd.	₩	3,814	₩	4,268
Tianjin LG Dagu Chemical Co., Ltd.		68		39
Tianjin LG New Building Materials Co., Ltd.		92		45
Tianjin LG Window & Door Co., Ltd.		45		8
Ningbo LG Yongxing Chemical Co., Ltd.		91		39
LG Chemical Hong Kong Ltd.		755		421
LG Vina Chemical J/V Company		310		198
LG Chem America, Inc.		3,205		3,843
LG Daesan Petrochemical Ltd.		-		159
LG Dow Polycarbonate Ltd.		437		1,002
LG Chemical (Guangzhou) Engineering Plastics Co., Ltd.		30		223
LG Chem (Nanjing) Information & Electronics Materials Co., Ltd.		559		1,070
LG Chem Trading(Shanghai) Co., Ltd.		5		-
LG Chem (China) Investment Co., Ltd.		-		3
LG Chem (Taiwan), Ltd.		3,186		1,221
LG Chem Industrial Materials Inc.		424		17
LG Chem Europe Sarl		-		430
Ningbo LG Yongxing Latex Co., Ltd.		11		24
LG Chem Europe GmbH		1,033		393
LG Chem (Tianjin) Engineering Plastics Co., Ltd.		166		116
	₩	14,231	₩	13,519

Changes in gain (loss) on valuation of investment securities accounted for as capital adjustment for the years ended December 31, 2006 and 2005, are as follows:

(in millions of Korean won)

	2006			2005		
	Gain	Loss	Net	Gain	Loss	Net
Beginning balance	₩ 48,396	₩ (41,079)	₩ 7,317	₩ 48,697	₩ (24,131)	₩ 24,566
Increase	-	(14,779)	(14,779)	2,318	(16,948)	(14,630)
Decrease	46,873	-	46,873	2,619	-	2,619
Ending balance	1,523	(55,858)	(54,335)	48,396	(41,079)	7,317
Tax effect <sup>1</sup>	(168)	84	(84)	(12,287)	36	(12,251)
Net ending balance	₩ 1,355	₩ (55,774)	₩ (54,419)	₩ 36,109	₩ (41,043)	₩ (4,934)

<sup>1</sup> As the Company adopted SKFAS No. 16, *Deferred Income Tax*, the Company recognized deferred income taxes for the temporary differences arising from the capital adjustments, which may be realized in the future (Note 19).

**LG Chem, Ltd.**  
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The summary financial information on the equity-method investees as of and for the years ended December 31, 2006 and 2005, is as follows:

(in millions of Korean won)

Investee	2006			
	Total Assets	Total Liabilities	Sales	Net Income (Loss)
LG Petrochemical Co., Ltd.	₩1,138,511	₩ 283,440	₩2,195,239	₩ 190,883
Tianjin LG Dagu Chemical Co., Ltd.	107,825	79,155	229,277	(9,117)
Tianjin LG New Building Materials Co., Ltd.	44,911	23,302	32,748	1,867
Tianjin LG Window & Door Co., Ltd.	25,588	16,633	23,772	(731)
Ningbo LG Yongxing Chemical Co., Ltd.	371,748	222,516	679,761	40,396
LG Chemical India Pvt. Ltd.	59,268	18,362	108,588	2,613
LG Chemical Hong Kong Ltd.	101,317	95,197	897,188	1,327
LG Vina Chemical J/V Company	11,962	5,589	37,115	2,240
LG Chem America, Inc.	104,516	96,128	357,169	3,921
M. Dohmen S.A.	85,149	54,874	62,050	(3,555)
SEETEC Co., Ltd.	513,380	208,820	362,477	13,694
LG Dow Polycarbonate Ltd.	262,148	103,574	222,168	17,121
LG Chemical (Guangzhou) Engineering Plastics Co., Ltd.	43,137	31,812	68,866	2,392
LG Chem (Nanjing) Information & Electronics Materials Co., Ltd.	158,948	123,261	217,659	(7,076)
LG Chem Trading (Shanghai) Co., Ltd.	1,728	72	7,052	57
LG Chem (China) Investment Co., Ltd.	54,980	14,682	70,037	156
LG Chem (Taiwan), Ltd.	101,928	97,588	209,671	1,863
LG Chem Industrial Materials Inc.	41,159	30,930	31,475	(346)
LG Chem Europe Sarl	1,441	-	10,002	384
LG Holdings (HK) Ltd.	142,007	81	-	(19,852)
Ningbo LG Yongxing Latex Co., Ltd.	47,074	40,729	39,905	(1,306)
Compact Power Inc.	1,044	372	4,064	382
LG Chem (Tianjin) Engineering Plastics Co., Ltd.	21,603	16,183	18,511	(55)
LG Chem Display Materials Co., Ltd.	37,072	31,546	45,265	(1,885)
Tianjin LG Bohai Chemical Co., Ltd.	253,595	167,455	-	-
LG Chem Europe GmbH	22,153	20,189	44,624	79
LG Chem Brasil Ltd.	258	-	505	-
LG Chem Poland Sp. Z.O.O.	26,246	20,893	5	(565)
	<u>₩3,780,696</u>	<u>₩1,803,383</u>	<u>₩5,975,193</u>	<u>₩ 234,887</u>

**LG Chem, Ltd.**  
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(in millions of Korean won)

Investee	2005			
	Total Assets	Total Liabilities	Sales	Net Income (Loss)
LG Petrochemical Co., Ltd.	₩1,039,959	₩ 226,227	₩1,988,923	₩ 192,944
Tianjin LG Dagu Chemical Co.,	137,445	82,437	222,000	(6,312)
Tianjin LG New Building Materials Co., Ltd.	51,399	30,112	25,725	1,754
Tianjin LG Window & Door Co.,	28,208	18,997	19,330	(1,046)
Ningbo LG Yongxing Chemical Co., Ltd.	263,545	120,873	574,657	36,205
LG Chemical India Pvt. Ltd.	69,894	25,828	117,244	1,721
LG Chemical Hong Kong Ltd.	140,271	135,014	867,162	211
LG Vina Chemical J/V Company	12,091	5,539	30,790	2,218
LG Chem America, Inc.	129,051	120,058	328,464	3,262
M. Dohmen S.A.	103,300	65,941	65,536	(1,733)
LG Daesan Petrochemical Ltd.	1,298,694	185,684	1,631,874	15,611
SEETEC Co., Ltd.	503,698	212,841	358,713	6,394
LG Dow Polycarbonate Ltd.	259,550	117,701	316,612	51,284
LG Chemical (Guangzhou) Engineering Plastics Co., Ltd.	37,151	27,026	56,966	1,720
LG Chem (Nanjing) Information & Electronics Materials Co., Ltd.	159,447	119,803	248,728	(6,342)
LG Chem Trading (Shanghai) Co., Ltd.	3,716	2,029	4,824	(123)
LG Chem (China) Investment Co., Ltd.	40,924	9,258	52,233	(194)
LG Chem (Taiwan), Ltd.	73,725	70,570	121,687	1,471
LG Chem Industrial Materials Inc.	45,328	33,483	9,868	(2,692)
LG Chem Europe Sarl	7,605	7,409	14,722	(1,420)
LG Holdings (HK) Ltd.	167,689	63,707	-	(3,877)
Ningbo LG Yongxing Latex Co., Ltd.	39,827	31,548	11,674	(496)
Compact Power Inc.	669	327	2,607	101
LG Chem (Tianjin) Engineering Plastics Co., Ltd.	14,852	9,658	1,237	(1,063)
LG Chem Display Materials Co., Ltd.	18,663	11,003	-	-
Tianjin LG Bohai Chemical Co., Ltd.	87,233	50,050	-	-
LG Chem Europe GmbH	10,316	8,476	9,486	53
LG Chem Brasil Ltd.	258	-	-	-
LG Chem Poland Sp. Z.O.O.	2,795	-	-	-
	<u>₩4,747,303</u>	<u>₩1,791,599</u>	<u>₩ 7,081,062</u>	<u>₩ 289,651</u>

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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**9. Property, Plant and Equipment**

Property, plant and equipment as of December 31, 2006 and 2005, consist of the following:

<i>(in millions of Korean won)</i>	<b>2006</b>		<b>2005</b>	
Buildings	₩	925,972	₩	774,933
Structures		366,588		260,851
Machinery and equipment		3,737,563		3,068,204
Vehicles		26,356		24,087
Tools and furniture		596,301		553,310
Others		12,935		-
		<u>5,665,715</u>		<u>4,681,385</u>
Less: Accumulated depreciation		(3,346,920)		(2,763,241)
Accumulated impairment loss		(19,510)		(23,912)
		<u>2,299,285</u>		<u>1,894,232</u>
Land		430,480		340,755
Construction-in-progress		324,841		179,757
Machinery-in-transit		44,416		42,078
	₩	<u>3,099,022</u>	₩	<u>2,456,822</u>

For the year ended December 31, 2006, capitalized interest expense amounted to ₩2,386 million (2005: ₩4,575 million). As a result of the capitalization of interest expense, for the year ended December 31, 2006, property, plant and equipment increased by ₩20,038 million (2005: ₩18,422 million), and net income increased by ₩1,302 million (2005: ₩3,010 million).

As of December 31, 2006, property, plant and equipment, except for land, are insured against fire and other casualty losses for up to ₩7,467,353 million (2005: ₩6,622,074). In addition, as of December 31, 2006 and 2005, the Company has business interruption insurance policies.

As of December 31, 2006, certain property, plant and equipment have been pledged as collaterals for certain bank loans, for up to a maximum of ₩356,988 million (2005: ₩369,442 million) (Notes 11 and 12).

As of December 31, 2006, the appraised value of the Company's land, as determined by the local governments in Korea for property tax assessment purposes, amounted to approximately ₩662,742 million (2005: ₩525,953 million).

As of December 31, 2006, the Company has a financing lease agreement on certain property, plant and equipment of the methyl tertiary butyl ether factory, which it previously sold. The book values of the said property, plant and equipment total ₩10,924 million as of December 31, 2006, and their total depreciation expense amounts to ₩2,178 million for the year then ended (Note 12).

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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**10. Intangible Assets**

Intangible assets as of December 31, 2006 and 2005, are as follows:

<i>(in millions of Korean won)</i>	<b>2006</b>		<b>2005</b>	
Intellectual property rights	₩	17,761	₩	10,966
Exclusive facility use rights		1,443		169
Development costs, net		66,345		83,392
Others		14,818		6,328
Negative goodwill		(313,357)		-
	₩	<u>(212,990)</u>	₩	<u>100,855</u>

The changes in development costs for the years ended December 31, 2006 and 2005, are as follows:

<i>(in millions of Korean won)</i>	<b>2006</b>		<b>2005</b>	
Beginning balance	₩	83,392	₩	135,865
Increase		<u>10,341</u>		<u>23,795</u>
		93,733		159,660
Less: Amortization		(24,610)		(24,149)
Disposal		-		(685)
Impairment loss		<u>(2,778)</u>		<u>(51,434)</u>
Ending balance	₩	<u>66,345</u>	₩	<u>83,392</u>

For the years ended December 31, 2006 and 2005, expenses which have potential future benefits but were not capitalized as intangible assets due to their uncertainty include:

<i>(in millions of Korean won)</i>	<b>2006</b>		<b>2005</b>	
Employee education expenses	₩	12,519	₩	13,897
Advertising expenses		<u>44,161</u>		<u>35,125</u>
	₩	<u>56,680</u>	₩	<u>49,022</u>

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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**11. Short-Term Borrowings and Current Maturities of Long-Term Debts**

Short-term borrowings and current maturities of long-term debts as of December 31, 2006 and 2005, consist of the following:

*(in millions of Korean won)*

	<b>Annual</b>		<b>2006</b>	<b>2005</b>
	<b>Interest Rate (%)</b>			
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
<b>Short-term borrowings</b>				
General term loans	CD+1.45	CD+1.45	₩ 76	₩ 224
Commercial paper	4.71	3.66~3.68	25,000	100,000
			<u>25,076</u>	<u>100,224</u>
<b>Current maturities of long-term debts</b>				
Debentures, including US\$ 80 million (2005: US\$ 130 million)	3.5~LIBOR+0.95	LIBOR+0.45-5.0	374,368	696,495
Won currency loans	3.0~9.0	3.0~7.0	1,387	195
Foreign currency loans of US\$ 70 million (2005: US\$ 31.245 million)	LIBOR+0.6	LIBOR+0.6-0.92	65,072	46,847
			<u>440,827</u>	<u>743,537</u>
Less: Discount on debentures issued			<u>(895)</u>	<u>(2,933)</u>
			<u>439,932</u>	<u>740,604</u>
			<u>₩ 465,008</u>	<u>₩ 840,828</u>

Certain property, plant and equipment serve as collaterals for the above borrowings as of December 31, 2006 (Note 9).

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
**December 31, 2006 and 2005**

**12. Long-term Debts**

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

*(in millions of Korean won)*

	Reference	2006		2005	
Debentures	(1)	₩	913,798	₩	872,470
Loans	(2)		196,885		116,335
		₩	<u>1,110,683</u>	₩	<u>988,805</u>

(1) Debentures as of December 31, 2006 and 2005, are as follows:

*(In Millions of Korean won)*

	Annual Interest Rate (%)			2006	2005
	2006	2005			
Publicly offered debentures, payable through 2013	3.5~5.02	3.5~5.0	₩	980,000	₩ 1,200,000
Privately offered debentures, payable through 2009	5.02~5.32	CD+0.7		100,000	100,000
Foreign debentures of US\$230 million (2005: US\$275 million, payable through 2009 <sup>1</sup> )	LIBOR+ 0.4-0.95	LIBOR+ 0.45-0.92		<u>213,808</u>	<u>278,575</u>
				1,293,808	1,578,575
Less: Current maturities				(374,368)	(696,495)
Discount on debentures issued				<u>(5,642)</u>	<u>(9,610)</u>
			₩	<u>913,798</u>	₩ <u>872,470</u>

<sup>1</sup> Floating rate notes were issued on March 11, 2005 to mature on March 11, 2008; and on May 25, 2005 to mature on November 25, 2007 and November 25, 2008. Term notes were also issued on June 24, 2004 to mature on June 24, 2007; and on March 23, 2006 to mature on September 23, 2008 and September 23, 2009.

**LG Chem, Ltd.**  
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(2) Loans as of December 31, 2006 and 2005, consist of the following:

(in Millions of Korean won)

	Annual Interest Rate (%)		2006	2005
	2006	2005		
<b>Won currency loans</b>				
Energy fund loans	-	7.0	₩ -	₩ 100
Housing loans	3.0	3.0	3,141	3,247
Company housing				
Movement expense	5.7	5.7	1,754	1,754
Capital lease <sup>1</sup>	9.0	-	14,867	-
			<u>19,762</u>	<u>5,101</u>
Less: Current maturities			<u>(1,387)</u>	<u>(195)</u>
			<u>18,375</u>	<u>4,906</u>
<b>Foreign currency loans</b>				
General term loans of US\$				
262.029 million (2005:				
US\$156.245 million)	LIBOR+0.35-0.6	LIBOR+0.6-1.1	243,582	158,276
Less: Current maturities			<u>(65,072)</u>	<u>(46,847)</u>
			<u>178,510</u>	<u>111,429</u>
			<u>₩ 196,885</u>	<u>₩ 116,335</u>

<sup>1</sup> Capital lease liabilities are liabilities associated with a financing lease of property, plant and equipment of methyl tertiary butyl ether factory after the sale of the property, plant and equipment (Note 9).

Certain property, plant and equipment serve as collaterals for the above borrowings as of December 31, 2006 (Note 9).

The annual maturities of long-term debts, excluding discounts and premiums on debentures, as of December 31, 2006, are as follows:

(in millions of Korean won)

Year	Debentures	Won Currency Loans		Foreign Currency Loans	Total
		Loans	Lease		
2008	₩ 326,904	₩ 1,754	₩ 2,481	₩ 37,184	₩ 368,323
2009	432,536	-	2,481	48,366	483,383
2010	100,000	-	2,481	46,480	148,961
Thereafter	60,000	3,028	10,636	46,480	120,144
Unearned interest	-	-	(4,486)	-	(4,486)
	<u>₩ 919,440</u>	<u>₩ 4,782</u>	<u>₩ 13,593</u>	<u>₩ 178,510</u>	<u>₩ 1,116,325</u>

**LG Chem, Ltd.**  
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**13. Contingent Liabilities**

On February 21, 2007, the Fair Trade Commission of Korea (FTC) announced that it would be imposing fines on ten local petrochemical companies, including the Company, for collusion. Relative to this, the provisional fine imposed by the FTC on the Company amounted to ₩13,100 million, which the Company accrued as of December 31, 2006. The amount may change pending final decision of the FTC.

**14. Accrued Severance Benefits**

Accrued severance benefits as of December 31, 2006 and 2005, are as follows:

<i>(in millions of Korean won)</i>	<b>2006</b>		<b>2005</b>	
Provision for severance benefits	₩	246,543	₩	209,759
Less: Group severance insurance deposits		(144,394)		(125,737)
Contribution to National Pension Plan		(3,734)		(3,612)
Ending balance	₩	98,415	₩	80,410

**LG Chem, Ltd.**  
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**15. Stock Options**

Based on the Commercial Code of Korea, the Company may grant stock options to directors and employees who have contributed or can contribute to the Company's establishment, management, overseas business or technology renovation with the approval of the Board of Directors or shareholders. In 2005, the Company granted stock options pursuant to the resolution of the Board of Directors.

Details of the stock options granted are as follows:

<b>Grant date</b>	<b>Number of Common Shares Granted <sup>1</sup></b>	<b>Grant Method</b>	<b>Exercise Price per share (in Korean won)</b>	<b>Exercise Period</b>
March 25, 2005	221,000	To compensate price difference	₩ 42,530	March 26, 2008 to March 25, 2012

<sup>1</sup> In 2005, stock options for 347,000 shares were forfeited due to the early termination of employment of the grantee employees.

The Company reversed stock compensation expense of ₩1,042 million due to the decline in the stock price of the Company for the year ended December 31, 2006.

**16. Commitments and Contingencies**

As of December 31, 2006, the Company has provided a joint guarantee for obligations existing prior to the spin-off, which were assumed by LG Corp. (formerly LG Chem Investment Ltd.) and LG Household & Health Care Ltd. Also, the Company has provided a joint guarantee for obligations outstanding on January 1, 2005 for Lotte Daesan Petrochemical Ltd. and SEETEC Co., Ltd. In addition, the Company has provided financial guarantee to customers.

As of December 31, 2006 and 2005, the Company has been provided with guarantees from Seoul Guarantee Insurance for the execution of supply contracts.

As of December 31, 2006, the Company has provided one blank promissory note to the Korea National Oil Corporation as a collateral in relation to petroleum import surcharges.

The Company has guaranteed repayments of various obligations of subsidiaries and affiliated companies. The outstanding balances of such guarantees as of December 31, 2006, amounted to ₩118,424 million (2005: ₩204,241 million) (Note 22).

**LG Chem, Ltd.**  
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As of December 31, 2006, the Company is contingently liable for notes receivable from export sales amounting to ₩558,731 million which were discounted through financial institutions in the ordinary course of business. Also, as of December 31, 2006, the Company is contingently liable for trade accounts receivable transferred to the special purpose companies amounting to ₩283,761 million (Note 4).

As of December 31, 2006, the Company has bank overdraft agreements with several banks for up to ₩77,100 million. The Company has also entered into contracts with several financial institutions to open letters of credit for up to ₩88,600 million and US \$ 602 million. The Company has entered into contracts with several financial institutions for discounting notes from export for up to ₩10,000 million and US \$ 740 million, and for other notes up to ₩100,000 million.

As of December 31, 2006, the Company has technical importation contracts with companies like Goodyear Tire & Rubber Company for the production of polymer and rubber products. The Company has also entered into technical contracts for technologies and consultation in relation to the manufacture of certain products.

On January 1, 2005, the Company entered a contract with LG Corp. to use trademarks on the products that the Company manufactures and sells and on the services the Company provides in relation to its business.

As of December 31, 2006, the Company has a long-term purchase contract for certain raw materials and was provided US\$162 thousand as a guarantee for the contract performance. As of December 31, 2005, the Company provided US\$30,833 thousand as a guarantee for the above contract performance. Furthermore as of December 31, 2006, the Company provided US\$45,620 thousand as a guarantee in regard to purchase contract for certain raw materials.

The Company has interest rate swap, currency swap, forward exchange contracts and options for hedging against fluctuations in foreign exchange rates and interest rates. As of December 31, 2006, the Company's outstanding contracts and options include currency swap of US \$ 152 million. As of December 31, 2005, the Company had currency swap of US\$100 million and interest rate swap of ₩100,000 million.

As of December 31, 2006 and 2005, the Company has been named as a defendant and plaintiff in various legal actions. Management believes that these legal actions will not have a material adverse impact on the Company's operations or financial position although the outcome of these legal actions is uncertain.

**LG Chem, Ltd.**  
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**17. Capital Surplus and Retained Earnings**

**Paid-in Capital in Excess of Par Value**

At the time of spin-off, the Company recorded ₩532,002 million as paid-in capital in excess of par value.

**Legal Reserve**

The Korean Commercial Code requires the Company to appropriate an amount equal to a minimum of 10% of its cash dividends as a legal reserve until such reserve equals 50% of its paid-in capital. This reserve is not available for the payment of cash dividends. With the approval of the Board of Directors, it may be transferred to common stock or may be used to reduce accumulated deficit, if any.

**Other Reserve**

Pursuant to the Special Tax Treatment Control Law, the Company is required to appropriate, as a reserve for business rationalization, a portion of retained earnings equal to tax reductions arising from investment and other tax credits. This reserve may be distributed as dividends after reversal.

**18. Treasury Stock**

Changes in treasury stock for the years ended December 31, 2006 and 2005, are as follows:

*(in millions of Korean won)*

	<b>2006</b>			
	<b>Common Stock</b>		<b>Preferred Stock</b>	
	<b>Number of Shares</b>	<b>Amount</b>	<b>Number of Shares</b>	<b>Amount</b>
January 1, 2006	606,881	₩ 23,109	3,657	₩ 20
Increase	1	-	-	-
Decrease	-	-	-	-
December 31, 2006	<u>606,882</u>	<u>₩ 23,109</u>	<u>3,657</u>	<u>₩ 20</u>

*(in millions of Korean won)*

	<b>2005</b>			
	<b>Common Stock</b>		<b>Preferred Stock</b>	
	<b>Number of Shares</b>	<b>Amount</b>	<b>Number of Shares</b>	<b>Amount</b>
January 1, 2005	54,080	₩ 2,383	3,657	₩ 20
Increase	568,000	21,395	-	-
Decrease	(15,199)	(669)	-	-
December 31, 2005	<u>606,881</u>	<u>₩ 23,109</u>	<u>3,657</u>	<u>₩ 20</u>

**LG Chem, Ltd.**  
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**19. Income Taxes**

Income taxes for the years ended December 31, 2006 and 2005, consist of the following:

<i>(in millions of Korean won)</i>	<b>2006</b>	<b>2005</b>
Current income taxes under the tax law	₩ 67,822	₩ 112,132
Income tax directly added to capital surplus <sup>1</sup>	-	15
Changes in deferred income tax assets (liabilities) <sup>2</sup>	8,697	(44,727)
Income taxes	<u>₩ 76,519</u>	<u>₩ 67,420</u>

<sup>1</sup> Income tax resulting from loss on disposal of treasury stock was directly added to capital surplus.

<sup>2</sup> The changes in deferred income tax assets (liabilities) are as follows:

<i>(in millions of Korean won)</i>	<b>Accumulated Temporary Differences</b>		<b>Deferred Income Tax Assets (Liabilities)</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Beginning balance	₩ 361,727	₩ 480,435	₩ (99,475)	₩(132,120)
Ending balance	346,137	361,727	<u>(95,189)</u>	<u>(99,475)</u>
			4,286	32,645
Deferred income taxes added to (deducted from) shareholders' equity <sup>1,2</sup>			11,998	(12,082)
Deferred income taxes due to merger and others			985	-
			<u>₩ (8,697)</u>	<u>₩ 44,727</u>

<sup>1</sup> Deferred income taxes directly added to (deducted from) shareholders' equity as of December 31, 2006, are as follows:

<i>(in millions of Korean won)</i>	<b>Accumulated Temporary Differences</b>		<b>Deferred Income Tax Assets (Liabilities)</b>	
Beginning balance	₩	(43,938)	₩	(12,082)
Ending balance		(306)		<u>(84)</u>
			<u>₩</u>	<u>11,998</u>

**LG Chem, Ltd.**  
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<sup>2</sup> Deferred income taxes directly added to (deducted from) shareholders' equity as of December 31, 2005, are as follows:

<i>(in millions of Korean won)</i>	<b>Accumulated Temporary Differences <sup>1</sup></b>		<b>Deferred Income Tax Assets (Liabilities)</b>	
Gain on valuation of equity-method investments	₩	(44,552)	₩	(12,251)
Loss on valuation of derivative instruments		614		169
	₩	(43,938)	₩	(12,082)

<sup>1</sup> As the Company adopted SKFAS No. 16, *Deferred Income Tax*, in 2005, the Company recognized deferred income taxes for the temporary differences arising from the capital adjustments, which may be realized in the future.

Current income taxes under the tax law for the years ended December 31, 2006 and 2005, are calculated as follows:

<i>(in millions of Korean won)</i>	<b>2006</b>		<b>2005</b>	
Income before income taxes	₩	395,301	₩	467,678
Additions to pretax income		1,077,687		564,210
Deductions from pretax income		(1,136,804)		(584,716)
Taxable income	₩	336,184	₩	447,172

**LG Chem, Ltd.**  
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Changes in temporary differences for the years ended December 31, 2006 and 2005, are as follows:

(in millions of Korean won)

	2006							
	Beginning Balance Before adjustment	Adjustment due to merger, etc. <sup>1</sup>	Beginning Balance After adjustment	Increase	Decrease	Ending Balance	Current	Non-current
Accrued severance benefits	₩ 122,243	₩19,264	₩141,507	₩35,084	₩32,400	₩ 144,191	₩ -	₩ 144,191
Severance insurance plans	(122,243)	(19,264)	(141,507)	(35,084)	(32,400)	(144,191)	-	(144,191)
Allowance for doubtful accounts	67,037	60	67,097	67,200	64,569	69,728	61,283	8,445
Accrued interest income	(2)	(248)	(250)	(1)	(250)	(1)	(1)	-
Research and development costs	(7,932)	-	(7,932)	-	(5,338)	(2,594)	-	(2,594)
Present value discount	69	-	69	-	37	32	32	-
Depreciation	40,326	-	40,326	91,872	19,029	113,169	-	113,169
Gain on valuation of equity-method investments	(411,061)	-	(411,061)	(59,120)	(215,328)	(254,853)	-	(254,853)
Reserves for technology development	(306,666)	-	(306,666)	(90,000)	(63,333)	(333,333)	(76,666)	(256,667)
Others	121,109	3,772	124,881	24,596	62,567	86,910	15,812	71,098
Equity <sup>2</sup>	(6,704)	-	(6,704)	61,642	604	54,334	-	54,334
	(503,824)	3,584	(500,240)	₩96,189	₩(137,443)	(266,608)	460	(267,068)
Gain on valuation of equity-method investments <sup>3</sup>	(179,331)	-	(179,331)			24,889	-	24,889
Equity <sup>3</sup>	37,234	-	37,234			54,640	-	54,640
Total	₩ (361,727)	₩ 3,584	₩(358,143)			₩(346,137)	₩ 460	₩ (346,597)
Deferred income tax assets (liabilities)	₩ (99,475)	₩ 985	₩ (98,490)			₩ (95,189)	₩ 127	₩ (95,316)

<sup>1</sup> This includes adjustments such as temporary differences incurred when assets and liabilities were initially assumed from LG Daesan Petrochemical Ltd., at the time of merger at the beginning of 2006.

<sup>2</sup> As of December 31, 2006, negative goodwill of ₩313,357 million was not recognized as deferred income tax assets, as the Company adopted SKFAS No. 16, *Deferred Income Tax*.

<sup>3</sup> As of December 31, 2006, the accumulated temporary differences that may not be realized in the future were excluded from the calculation of deferred income taxes.

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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	2005					
	Beginning Balance	Increase	Decrease	Ending Balance	Current	Non-current
Accrued severance benefits	₩ 116,503	₩ 32,534	₩ 26,794	₩ 122,243	₩ -	₩ 122,243
Severance insurance plans	(116,503)	(32,534)	(26,794)	(122,243)	-	(122,243)
Allowance for doubtful accounts	60,827	64,917	58,707	67,037	64,524	2,513
Accrued interest income	(399)	(232)	(629)	(2)	(2)	-
Research and development costs	(25,771)	-	(17,839)	(7,932)	-	(7,932)
Present value discount	130	-	61	69	69	-
Depreciation	40,138	10,552	10,364	40,326	-	40,326
Gain on valuation of equity-method investments	(417,984)	(210,020)	(216,943)	(411,061)	-	(411,061)
Gain on foreign currency translation	450	-	450	-	-	-
Reserves for technology development	(263,333)	(90,000)	(46,667)	(306,666)	(46,666)	(260,000)
Others	125,507	93,867	98,265	121,109	24,055	97,054
Equity <sup>1</sup>	(20,754)	17,861	3,811	(6,704)	-	(6,704)
	<u>(501,189)</u>	<u>₩(113,055)</u>	<u>₩(110,420)</u>	<u>(503,824)</u>	<u>41,980</u>	<u>(545,804)</u>
Gain on valuation of equity-method investments <sup>2</sup>	-			(179,331)	-	(179,331)
Equity <sup>2</sup>	<u>(20,754)</u>			<u>37,234</u>	<u>-</u>	<u>37,234</u>
Total	<u>₩(480,435)</u>			<u>₩(361,727)</u>	<u>₩41,980</u>	<u>₩ (403,707)</u>
Deferred income tax assets (liabilities)	<u>₩(132,120)</u>			<u>₩ (99,475)</u>	<u>₩11,545</u>	<u>₩ (111,020)</u>

<sup>1</sup> As the Company adopted SKFAS No. 16, *Deferred Income Tax*, in 2005, the accumulated temporary differences for equity were included in the list of accumulated temporary differences.

<sup>2</sup> As of December 31, 2005, the accumulated temporary differences that may not be realized in the future were excluded from the calculation of deferred income taxes.

The statutory income tax rate, including resident tax surcharges, applicable to the Company for the years ended December 31, 2006 and 2005, was 27.5%. However, as a result of tax reconciliation, tax credits and other items, the effective tax rate of the Company for the year ended December 31, 2006, was 19.4% (2005: 14.4%).

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**Notes to Non-Consolidated Financial Statements**  
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**20. Earnings Per Share**

Basic ordinary income per share and earnings per share for the years December 31, 2006 and 2005, were computed as follows:

*(in millions of Korean won, except per share amounts)*

	<b>2006</b>		<b>2005</b>	
Net income	₩	318,782	₩	400,258
Preferred stock dividends		(9,090)		(11,255)
Preferred stock share of remaining profit available for dividend		(29,371)		(36,839)
Net income and ordinary income available for common stock (A)		280,321		352,164
Weighted average number of shares of outstanding common stock (B) <sup>1</sup>		63,818,183		64,014,536
Basic earnings per share and ordinary income per share (A/B)	₩	4,392	₩	5,501

<sup>1</sup> Excludes treasury stock.

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

**21. Dividends**

Details of dividends for the years ended December 31, 2006 and 2005, are as follows:

	<b>2006</b>		<b>2005</b>	
Shares issued and outstanding (par value per share: ₩5,000)				
Common stock		63,818,182		63,818,183
Preferred stock		8,657,594		8,657,594
Dividend per share (in won)				
Common stock: cash	₩	1,000 (20%)	₩	1,250 (25%)
Preferred stock: cash	₩	1,050 (21%)	₩	1,300 (26%)
Cash dividend amount (in millions)				
Common stock	₩	63,818	₩	79,773
Preferred stock		9,091		11,255
	₩	72,909	₩	91,028

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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**22. Related Party Transactions**

LG Corp. is the Parent of the Company, and issues the consolidated financial statements.

Significant transactions, which 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:

<i>(in millions of Korean won)</i>	<b>Sales</b>	<b>Purchases</b>	<b>Receivables<sup>4</sup></b>	<b>Payables</b>
Controlling company	₩ -	₩ 27,031	₩ 6,386	₩ 653
Subsidiaries <sup>1,2</sup>	1,187,514	1,797,520	34,750	217,799
Equity method investees <sup>1</sup>	46,303	152,937	6,150	18,564
Other related companies <sup>3</sup>	1,229,156	438,071	230,770	95,547
2006 Total	<u>₩2,462,973</u>	<u>₩2,415,559</u>	<u>₩ 278,056</u>	<u>₩ 332,563</u>
2005 Total	<u>₩2,147,383</u>	<u>₩2,233,776</u>	<u>₩ 171,552</u>	<u>₩ 292,121</u>

<sup>1</sup> Please refer to Note 8 for percentage of ownership, acquisition cost, net asset value and book value of the Company's investments to its related parties.

<sup>2</sup> Includes LG Solid Source, LLC, a subsidiary of LG Chem America Inc., and Ningbo Bond International Trade, a subsidiary of Ningbo LG Yongxing Chemical Co., Ltd.

<sup>3</sup> Includes LG Philips LCD Co., Ltd. and LG Electronics Inc.

<sup>4</sup> Allowance for doubtful accounts for the outstanding balance as of December 31, 2006, amounts to ₩2,344 million. Bad debt expense recognized for the year then ended is ₩1,178 million.

Compensation for key management officers for the year ended December 31, 2006, consists of :

*(in millions of Korean won)*

Short-term employee benefits	₩ 19,150
Post-employment benefits	3,221
Other long-term employee benefits	2,459
Reversal of share-based compensation	(1,042)
Total	<u>₩ 23,788</u>

Key management officers include directors and audit committee members having duties and responsibilities over planning, operations and control of the Company's business activities.

**LG Chem, Ltd.**  
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The details of guarantees provided by the Company as of December 31, 2006 and 2005, are as follows:

(in millions of Korean won)

<b>2006</b>			
<b>Guarantee Beneficiary</b>	<b>Amount of Guarantee</b>	<b>Financial Institution</b>	<b>Outstanding Loan Amount</b>
LG Chem (Nanjing) Information & Electronics Materials Co., Ltd.	₩ 23,240	Bank of China	₩ 23,240
	18,592	Woori Bank	18,592
LG Chem Industrial Materials Inc.	23,519	Wachovia Bank	23,519
LG Chem Europe GmbH	3,667	Societe Generale	-
Tianjin LG Bohai Chemical Co., Ltd.	37,184	Export-Import Bank of Korea	18,592
LG Chem Poland Sp.Z.O.O.	12,222	Export-Import Bank of Korea	12,222
	<u>₩ 118,424</u>		<u>₩ 96,165</u>

(in millions of Korean won)

<b>2005</b>			
<b>Guarantee Beneficiary</b>	<b>Amount of Guarantee</b>	<b>Financial Institution</b>	<b>Outstanding Loan Amount</b>
Tianjin LG Dagu Chemical Co., Ltd.	₩ 12,156	Pudong Shanghai Development Bank	₩ 12,156
	18,234	Agricultural Bank of China	18,234
Tianjin LG New Building Materials Co., Ltd.	2,026	Industrial and Commercial Bank of China	1,520
	4,660	Korea Development Bank	4,660
LG Chem (Nanjing) Information & Electronics Materials Co., Ltd.	25,325	Bank of China	25,325
	25,325	Woori Bank	20,260
LG Chem America, Inc.	10,130	Woori Bank	-
LG Chem Industrial Materials Inc.	25,629	Wachovia Bank	25,629
LG Chemical Hong Kong Ltd.	35,455	Bank of America	7,395
LG Chem Europe Sarl	1,195	Credit Agricole	1,378
	3,586	Societe Generale	1,384
Tianjin LG Bohai Chemical Co., Ltd.	40,520	Export-Import Bank of Korea	7,091
	<u>₩ 204,241</u>		<u>₩ 125,032</u>

**LG Chem, Ltd.**  
**Notes to Non-Consolidated Financial Statements**  
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**23. Operating Results for the Final Interim Period**

Operating results for the three-month periods ended December 31, 2006 and 2005, are as follows:

*(in millions of Korean won, except per share amounts)*

	<b>Three-Month Periods Ended December 31</b>	
	<b>2006</b> <b>(unaudited)</b>	<b>2005</b> <b>(unaudited)</b>
Sales	₩ 2,418,201	₩ 1,910,751
Operating income	112,258	102,578
Net income	84,513	111,150
Earnings per share	1,164	1,532

**24. Segment Information**

The Company defines its segments by the nature of its products and services.

(1) Industry Segment Information

<b>Industry</b>	<b>Products or Services</b>	<b>Major Customers</b>
Petrochemicals	PE, PVC, VCM, alcohol, plasticizers, ABS/PS, EPS, MBS, SBL, EP, ethylene, propylene and others	LG Electronics Inc. Daewoo Electronics Co., Ltd. Kia Motors Corp. Youlchon Chemical Co., Ltd. National Plastic Co., Ltd. and others
Industrial Materials	Hi Sash, UBR, wall coverings, living materials, building materials and others	Hyundai Motors Co., Ltd. GM Daewoo Auto & Technology Company Distributors and wholesalers
Information & Electronic Materials	Batteries, Polarizers	LG Electronics Inc. LG Philips LCD Co., Ltd. and others

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Financial information on industry segments for the years ended December 31, 2006 and 2005, are as follows:

<i>(in millions of Korean won)</i>	<b>2006</b>				
	<b>Petrochemicals</b>	<b>Industrial Materials</b>	<b>Information &amp; Electronic Materials</b>	<b>Others</b>	<b>Total</b>
Sales					
External sales	₩ 5,611,535	₩ 2,068,581	₩ 1,605,789	₩ 16,436	₩ 9,302,341
Inter-segment sales	273,275	19,433	4,955	120,171	417,834
	<u>₩ 5,884,810</u>	<u>₩ 2,088,014</u>	<u>₩ 1,610,744</u>	<u>₩ 136,607</u>	<u>₩ 9,720,175</u>
Operating income	<u>₩ 169,889</u>	<u>₩ 118,006</u>	<u>₩ 48,658</u>	<u>₩ (2,608)</u>	<u>₩ 333,945</u>
Property, plant and equipment, and intangible assets <sup>1</sup>	<u>₩ 1,445,328</u>	<u>₩ 455,594</u>	<u>₩ 877,419</u>	<u>₩ 421,048</u>	<u>₩ 3,199,389</u>
Depreciation and amortization	<u>₩ 328,441</u>	<u>₩ 65,852</u>	<u>₩ 133,837</u>	<u>₩ 3,961</u>	<u>₩ 532,091</u>

<sup>1</sup> Excludes negative goodwill, incurred from the merger, which is deducted from intangible assets.

<i>(in millions of Korean won)</i>	<b>2005</b>				
	<b>Chemicals &amp; Polymers</b>	<b>Industrial Materials</b>	<b>Information &amp; Electronic Materials</b>	<b>Others</b>	<b>Total</b>
Sales					
External sales	₩ 4,065,677	₩ 2,078,903	₩ 1,267,973	₩ 12,551	₩ 7,425,104
Inter-segment sales	261,058	7,823	3,413	47,689	319,983
	<u>₩ 4,326,735</u>	<u>₩ 2,086,726</u>	<u>₩ 1,271,386</u>	<u>₩ 60,240</u>	<u>₩ 7,745,087</u>
Operating income	<u>₩ 310,497</u>	<u>₩ 140,264</u>	<u>₩ (24,986)</u>	<u>₩ (4,061)</u>	<u>₩ 421,714</u>
Property, plant and equipment, and intangible assets	<u>₩ 857,017</u>	<u>₩ 441,664</u>	<u>₩ 829,451</u>	<u>₩ 429,545</u>	<u>₩ 2,557,677</u>
Depreciation and amortization	<u>₩ 164,690</u>	<u>₩ 62,961</u>	<u>₩ 139,547</u>	<u>₩ 4,894</u>	<u>₩ 372,092</u>

**LG Chem, Ltd.**  
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(2) Geographical Segment Information

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

*(in millions of Korean won)*

	<b>Domestic<sup>1</sup></b>	<b>China</b>	<b>North America</b>	<b>South America</b>	<b>South-East Asia</b>	<b>Western Europe</b>	<b>Others</b>	<b>Total</b>
2006	<u>₩5,314,756</u>	<u>₩2,198,221</u>	<u>₩374,629</u>	<u>₩102,611</u>	<u>₩266,491</u>	<u>₩291,770</u>	<u>₩753,863</u>	<u>₩9,302,341</u>
2005	<u>₩4,400,623</u>	<u>₩1,650,030</u>	<u>₩374,390</u>	<u>₩69,370</u>	<u>₩146,389</u>	<u>₩219,111</u>	<u>₩565,191</u>	<u>₩7,425,104</u>

<sup>1</sup> Domestic sales include the exports made through local letters of credit.

(3) Discontinued Operations

The Company discontinued or disposed of some businesses, including the POM business, and realized a gain on the disposal of the segment amounting to ₩8,315 million in 2005.

The financial results of the discontinued operations are as follows:

*(in millions of Korean won)*

	<b>2005</b>		<b>2004</b>	
Sales	₩	22,599	₩	37,559
Cost of sales		<u>23,275</u>		<u>34,322</u>
Gross profit (loss)		(676)		3,237
Selling and administrative expenses		<u>1,526</u>		<u>5,757</u>
Operating loss	₩	<u>(2,202)</u>	₩	<u>(2,520)</u>

**LG Chem, Ltd.**  
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**25. Assets and Liabilities Denominated in Foreign Currencies**

Monetary assets and liabilities denominated in foreign currencies are translated into Korean won at the exchange rates in effect at the balance sheet date. Resulting translation gains and losses are recognized in current operations.

As of December 31, 2006 and 2005, monetary assets and liabilities denominated in foreign currencies, excluding items referred to in Notes 11 and 12, consist of the following:

	<b>Foreign Currency (in thousands)</b>				<b>Korean Won (in millions)</b>	
	<b>2006</b>		<b>2005</b>		<b>2006</b>	<b>2005</b>
Cash and cash equivalents	US\$	4,442	US\$	1,864	₩5,520	₩2,920
	EUR	870	EUR	483		
	GBP	146	GBP	197		
	JPY	5,814	JPY	12,688		
Trade accounts and notes receivable	US\$	125,393	US\$	77,828	139,214	97,761
	EUR	4,045	EUR	2,463		
	GBP	11	GBP	44		
	JPY	2,262,079	JPY	1,847,268		
Other accounts receivable	US\$	15,414	US\$	7,313	33,278	12,287
	EUR	199	EUR	53		
	JPY	2,392,503	JPY	-		
Trade accounts and notes payable	US\$	172,814	US\$	78,185	268,976	210,924
	EUR	351	EUR	523		
	JPY	13,797,996	JPY	15,221,656		
Other accounts payable	US\$	51,644	US\$	41,547	59,026	55,968
	EUR	1,091	EUR	974		
	JPY	1,193,161	JPY	1,474,255		

**LG Chem, Ltd.**  
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**26. Supplemental Cash Flow Information**

Major transactions not involving an inflow or outflow of cash and cash equivalents for the years ended December 31, 2006 and 2005, are as follows:

<i>(in millions of Korean won)</i>	<b>2006</b>	<b>2005</b>
Reclassification of construction-in-progress to property, plant and equipment	₩ 282,911	₩ 310,536
Reclassification of machinery-in-transit to machinery and equipment	77,698	92,134
Reclassification of depreciation expenses to development costs	1,857	3,929
Gain on valuation of investment using the equity method of accounting (capital adjustment)	61,642	17,248
Reclassification of long-term debt to current maturities of long-term debts	66,459	48,466
Reclassification of long-term debt to current maturities of debentures	373,368	700,037
Gain on valuation of derivatives (capital adjustment)	613	3,197

**LG Chem, Ltd.**  
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**27. Merger**

Hyundai Petrochemical Co., Ltd. (HPCL) was acquired by a consortium consisting of the Company and Honam Petrochemical Corp. in 2003. On January 1, 2005, HPCL spun off its petrochemical business to the newly established LG Daesan Petrochemical Ltd. (LGPL) and Lotte Daesan Petrochemical Ltd. (LDPL). The spin-off resulted in the Company owning 50% of LGPL, LDPL and SEETEC Co., Ltd. On April 30, 2005, the Company swapped its 50% ownership in LDPL for Honam Petrochemical's 50% ownership in LGPL. Pursuant to the opinion of the Financial Supervisory Services, the acquisition date of LG Daesan Petrochemical Ltd. is deemed to be January 1, 2005, the spin-off date.

As approved by the Board of Directors on October 13, 2005, the Company merged with LG Daesan Polychemicals Co., Ltd. on January 1, 2006. As this merger was considered small scale under the Commercial Code of Korea, the Company did not need the approval of the shareholders. Instead, the Board of Directors approved of the merger on November 16, 2005. The merger was officially announced by the Board of Directors on January 3, 2006.

The major businesses and the CEOs of LG Chem, Ltd. and LG Daesan Petrochemical Ltd. are as follows:

<b>Entity</b>	<b>CEO</b>	<b>Major Business</b>	<b>Relationship</b>
LG Chem, Ltd.	No Ki-ho	Manufacturing, processing and marketing of petrochemical products	Parent Company
LG Daesan Petrochemical Ltd.	Kim Bahn-suk	Manufacturing and marketing of petrochemical products	Subsidiary

Pursuant to the Accounting Standards for Business Combination, this merger was regarded as the merger between a parent company and its subsidiary. Accordingly, assets and liabilities taken over by the Company were assessed at their book values on the consolidated financial statements.

Negative goodwill as of January 1, 2005, the date the Company came to have a significant control over LG Daesan Petrochemical Ltd., amounts to ₩393,058 million, computed as follows:

*(in millions of Korean won)*

Net asset fair value of LG Daesan Petrochemical Ltd.	₩	947,692
Acquisition cost		(554,634)
Negative goodwill	₩	<u>393,058</u>

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Acquisition cost is calculated as follows:

*(in millions of Korean won)*

Acquisition of shares of LGPL due to the spin-off	₩ 272,901
Acquisition of shares of LGPL due to the share swap	281,733
Total	<u>₩ 554,634</u>

Changes in negative goodwill from January 1, 2005 to December 31, 2006, are as follows:

*(in millions of Korean won)*

January 1, 2005 (purchase date) <sup>1</sup>	₩ 393,058
Reversal <sup>1</sup>	<u>(39,306)</u>
December 31, 2005 <sup>1</sup>	<u>₩ 353,752</u>
January 1, 2006 <sup>2</sup>	₩ 353,752
Reversal	(39,170)
Identifiable assets and liabilities after the purchase date	<u>(1,225)</u>
December 31, 2006	<u>₩ 313,357</u>

<sup>1</sup> Difference between the investment and the Company's proportionate ownership in the net asset fair value of LG Daesan Petrochemical Ltd. according to the equity-method application. The reversal amount is recorded as a gain on valuation of equity method investments.

<sup>2</sup> The negative goodwill on January 1, 2006, is computed as follows:

*(in millions of Korean won)*

Net asset value of LG Daesan Petrochemical Ltd. <sup>3</sup>	₩ 1,004,317
Acquisition cost <sup>4</sup>	<u>(650,565)</u>
Negative goodwill	<u>₩ 353,752</u>

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- <sup>3</sup> As of January 1, 2006, the book values of assets and liabilities of LG Daesan Petrochemical Ltd. on the Company's consolidated financial statements are as follows:

*(in millions of Korean won)*

Current assets <sup>5</sup>	₩	534,345
Investments		5,369
Property, plant and equipment		648,357
Intangible assets		<u>1,929</u>
Total assets		<u>1,190,000</u>
Current liabilities <sup>5</sup>		152,530
Long-term liabilities		<u>33,153</u>
Total liabilities		<u>(185,683)</u>
Fair value of net assets	₩	<u>1,004,317</u>

- <sup>4</sup> Acquisition cost is the book value of the investments as of December 31, 2005 (Note 8).
- <sup>5</sup> Balances of assets and liabilities before offsetting of receivables and payables.

From January 1, 2005, goodwill is amortized using a straight-line method over ten years, a weighted average useful life of amortizable assets out of non-monetary assets acquired. As of December 31, 2006, the remaining useful life is eight years.

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The condensed income statements for the year ended December 31, 2005 and condensed balance sheets as of January 1, 2005 and December 31, 2005, of the Company and LG Daesan Petrochemical Ltd., are as follows:

Condensed Balance Sheets as of December 31, 2005

<i>(in millions of Korean won)</i>	LG Chem, Ltd.	LG Daesan Petrochemical Ltd.
Current assets	₩ 1,436,296	₩ 533,824
Investments	1,599,426	5,369
Property, plant and equipment	2,456,822	759,501
Intangible assets	100,855	-
Total assets	<u>₩ 5,593,399</u>	<u>₩ 1,298,694</u>
Current liabilities	₩ 1,946,910	₩ 152,530
Long-term liabilities	1,207,964	33,154
Total liabilities	3,154,874	185,684
Total shareholders' equity	<u>2,438,525</u>	<u>1,113,010</u>
Total liabilities and shareholders' equity	<u>₩ 5,593,399</u>	<u>₩ 1,298,694</u>

Condensed Income Statements for the year ended December 31, 2005

<i>(in millions of Korean won)</i>	LG Chem, Ltd.	LG Daesan Petrochemical Ltd.
Sales	₩ 7,425,104	₩ 1,631,874
Cost of sales	<u>(6,107,725)</u>	<u>(1,485,898)</u>
Gross profit	1,317,379	145,976
Selling and administrative expenses	<u>(895,665)</u>	<u>(102,585)</u>
Operating income	421,714	43,391
Non-operating income and expenses	<u>45,964</u>	<u>(1,887)</u>
Income before income taxes	467,678	41,504
Income tax expense	<u>(67,420)</u>	<u>(25,893)</u>
Net income	<u>₩ 400,258</u>	<u>₩ 15,611</u>

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Condensed Balance Sheets as of January 1, 2005

<i>(in millions of Korean won)</i>	LG Chem, Ltd.	LG Daesan Petrochemical Ltd.
Current assets	₩ 1,656,707	₩ 329,671
Investments	1,419,104	209
Property, plant and equipment	2,453,255	950,808
Intangible assets	150,463	-
Total assets	<u>₩ 5,679,529</u>	<u>₩ 1,280,688</u>
Current liabilities	₩ 1,779,045	₩ 155,527
Long-term liabilities	1,705,342	27,762
Total liabilities	3,484,387	183,289
Total shareholders' equity	<u>2,195,142</u>	<u>1,097,399</u>
Total liabilities and shareholders' equity	<u>₩ 5,679,529</u>	<u>₩ 1,280,688</u>

**28. Approval of Financial Statements**

The December 31, 2006 non-consolidated financial statements were approved on February 23, 2007, by the Board of Directors of the Company.

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

Certain amounts in the December 31, 2005 financial statements were reclassified to conform with the December 31, 2006 financial statement presentation. These reclassifications had no effect on the previously reported net income, shareholders' equity or cash flows.

**Report of Independent Accountants'**  
**Review of Internal Accounting Control System**

To the President of  
LG Chem, Ltd.

We have reviewed the accompanying management's report on the operations of the Internal Accounting Control System ("IACS") of LG Chem, Ltd. (the "Company") as of December 31, 2006. The Company's management is responsible for designing and operating IACS and for its assessment of the effectiveness of IACS. Our responsibility is to review the management's report on the operations of the IACS and issue a report based on our review. The management's report on the operations of the IACS of the Company states that "based on its assessment of the operations of the IACS as of December 31, 2006, the Company's IACS has been designed and is operating effectively as of December 31, 2006, in all material respects, in accordance with the IACS standards established by the Internal Accounting Control System Operations Committee (IACSOC) of the Korea Listed Companies Association."

Our review was conducted in accordance with the IACS review standards established by the Korean Institute of Certified Public Accountants. Those standards require that we plan and perform, in all material respects, the review of management's report on the operations of the IACS to obtain a lower level of assurance than an audit. A review is to obtain an understanding of a company's IACS and consists principally of inquiries of management and, when deemed necessary, a limited inspection of underlying documents, which is substantially less in scope than an audit.

A company's IACS is a system to monitor and operate those policies and procedures designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the Republic of Korea. Because of its inherent limitations, IACS may not prevent or detect a material misstatement of the financial statements. 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.

Based on our review, nothing has come to our attention that causes us to believe that management's report on the operations of the IACS, referred to above, is not presented fairly, in all material respects, in accordance with the IACS standards established by IACSOC.

Our review is based on the Company's IACS as of December 31, 2006, and we did not review management's assessment of its IACS subsequent to December 31, 2006. This report has been prepared pursuant to the Acts on External Audit for Stock Companies in Korea and may not be appropriate for other purposes or for other users.

Samil PricewaterhouseCoopers

March 5, 2007

## **Report on the Operations of the Internal Accounting Control System**

To the Board of Directors and Audit Committee of  
LG Chem, Ltd.

I, as the Internal Accounting Control Officer (“IACO”) of LG Chem, Ltd. (“the Company”), assessed the status of the design and operations of the Company’s internal accounting control system (“IACS”) for the year ended December 31, 2006.

The Company’s management including IACO is responsible for designing and operating IACS. I, as the IACO, assessed whether the IACS has been effectively designed and is operating to prevent and detect any error or fraud which may cause any misstatement of the financial statements, for the purpose of establishing the reliability of financial reporting and the preparation of financial statements for external purposes. I, as the IACO, applied the IACS standard for the assessment of design and operations of the IACS.

Based on the assessment on the operations of the IACS, the Company’s IACS has been effectively designed and is operating as of December 31, 2006, in all material respects, in accordance with the IACS standards.

February 23, 2007

Cho Seok-Je, Internal Accounting Control System Officer

Kim Bahn-Suk, Chief Executive Officer