# Ten Key Value-up Missions Proposed to 22nd National Assembly

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# Will Korea face its own Galapagos moment?


에콰도르령 갈라파고스 제도는 본국에서 서쪽으로 약 926㎞ 떨어진 고립된 섬 무리이다. 사진/ Top Dreamer

# Korea's valuation reflects poor TSR despite many world-class producers

| | 2024 PER(x) | 2023년 PBR(x) | 10-yr TSR** (%) |
|---|---|---|---|
| Korea | 11x | 1.1x | 5% |
| Japan | 16x | 1.6x | 11% |
| Taiwan | 19x | 2.8x | 10% |
| China | 9x | 1.2x | 3% |
| US | 21x | 4.7x | 13% |
| World | 18x | 3.3x | 10% |

*Source: MSCI
** Total shareholder return

# Korea discount is catastrophe comparable to low birth rate issue

**The Impoverishing Korean citizens and the NPS**

Comparing 30 years' result with CAGR of 5% vs 10%

Comparison of the performance after 30 years of compounding return
(From the principal amount of W10mn to an expected amount of W43mn, compared to W175mn)

| | |
|---|---|
| CAGR 5% | W43mn |
| CAGR 7.5% | W88mn |
| CAGR 10% | W175mn |
| CAGR 12.5% | W340mn |

# 1. Adopt board member's fiduciary duty to all shareholders by amending Commercial Code

- According to "G20/OECD Corporate Governance Principle", good governance is when shareholders' rights are well performed and every shareholder, including minority and foreign shareholders, is fairly treated.

- As the governor of the FSS, Lee Bokhyun, commented a few times the Commercial Law reform for fiduciary duty for shareholders is necessary.

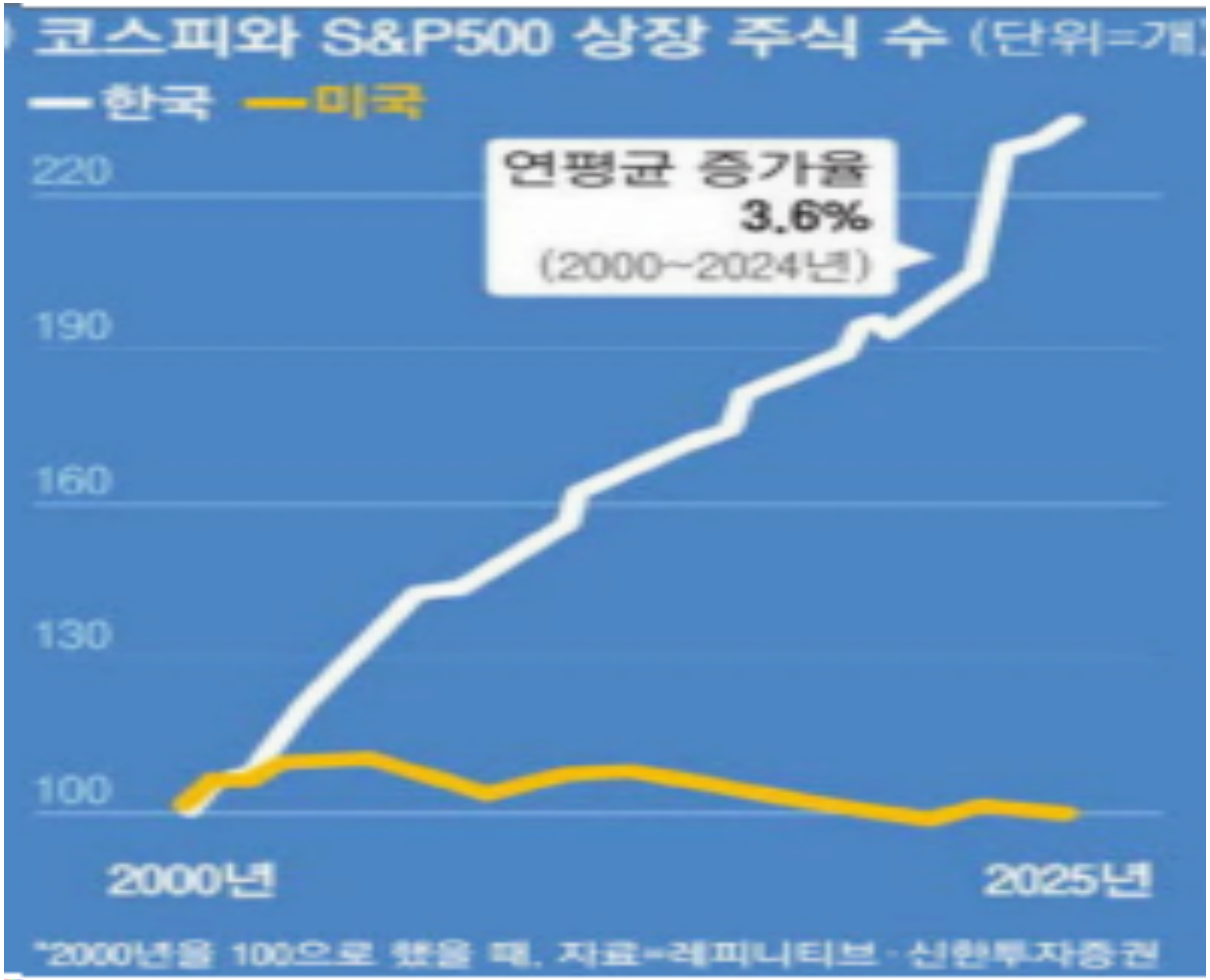
# 2. After detailed value-up template, heads at the financial authorities to encourage listed companies to execute

- Value-up process to be driven by the BoD. The board should review, announce, and execute a detailed action plan after analyzing the cost of equity, return on equity/investment, share price valuation, etc. "Cost of capital" is important.
- The reality is that most board members lack basic accounting and finance knowledge, so the BoD should invite specialists (consultants, investment bankers etc), to help directors equip with basic knowledge and skills to perform their duties.
- This is the first step toward an independent board. We hope the heads, executives, and officers at the FSC, FSS, and KRX visit or get in touch with CEOs and executives of listed companies to check their understanding of the template and encourage its adoption.

# 3. Treasury share cancellation (cancellation of existing shares, future cancellation within 3 months)

- <u>Treasury shares are not a means of defence for control by the controlling families.</u>
- Since treasury shares are purchased with corporate's cash, they cannot be used for control purpose.
- If the treasury shares remain on balance sheet, they serve discount factors.
- <u>We suggest adopting new clause in the Articles of Incorporation to cancel any treasury shares within the first three months after their buybacks.</u> Treasury share in Korea best represents a mismatch between the law and accounting regarding governance and ignorance of global standards.

# Korea saw # of outstanding shares rise 4% pa since 2000




Korea

US

# Most foreigners do not factor in treasury shares in share valuation

- The recent survey by our Forum revealed that 80% of foreign investors do not reflect treasury shares in the market cap or per share value (EPS, DPS etc) calculation if it is not cancelled.

- KRX does not even fully take account the impact of treasury share buyback to adjust market cap.

# 4. Introduce separate taxation and lower rate for dividend income

- Significant problems with applying a maximum 50% tax on dividend income when total financial income exceeds W20 million per annum, even for long–term investors.
- This is a harsh taxation for the middle–aged and the elderly who pursue dividend income in stable cash generating businesses. The controlling shareholders would be subject to the highest tax rate too, therefore discouraging high dividends.
- Hong Kong and Singapore do not have a dividend income tax, and the US adopted separate taxation on dividend income at a 15% rate when holding shares for more than a year. **Adopting separate taxation for dividend income would be rational.**

# 5. Ensure NPS's stewardship code is fully operational and increase allocation to Korean stocks

- Global investors are paying very close attention to the role of NPS in the Value-up Program. This is because GPIF's role in Japan's governance reformation was crucial.

- GPIF is well renowned for following the exact stewardship code, and Japanese institutional investors follow GPIF as the leader symbol in the market.

- FSS has recently announced its plan to disclose the names of local asset management companies that have exercised their voting rights irresponsibly. This move is expected to promote responsible voting practices.

# NPS should have better disclosure regarding voting rights

- <u>We suggest NPS fully disclose internal committees' decisions and their evidence in detail whenever performing their voting rights to their website 2~3 weeks prior to the AGM</u>. Other institutions also need to disclose one week ahead of the AGM when they exercise their voting rights (status quo).

- <u>NPS domestic equity exposure stands at 14% of total assets compared to Japan's GPIF at 25%. This is a clear "adverse home bias" case</u>. With the Value-up initiatives as a catalyst, we hope that NPS will lead the re-rating of the Korean shares by a significant increase in allocation to domestic equities funds.

# 6. Reinforce board's independence

- Global investors are interested in the composition and operation of Korean boards because boards are the core governance bodies.
- They endorse our Forum's joint program with the Ewha Womans University Graduate School of Business Women Outside Directors Program and wish there were more directors' programs in Korea.
- <u>We will launch other program to educate directors.</u>
- <u>As our Forum already announced model Articles of Incorporation in early March, we suggest having a 1-year term for independent directors with annual re-election.</u>
- <u>We also propose one of independent directors to become a chairman of the board. We advise forming the Audit Committee and Compensation Committee only with independent directors and having two people (currently one) for the separate election of the Audit Committee.</u>

# 7. Tax benefit for corporates with consistent dividend increase

- The government is considering providing corporate tax cuts for listed companies that increase dividend payout and actively cancel treasury shares.
- While it is commendable that the government encourages shareholder returns via tax cut, the effect will be reduced if the benefits of corporate tax cuts are not for long-term and expire after a brief period.
- For this purpose, the revision of the Corporate Tax Act is well in need and a comparative analysis of international compatibility is also required.

# 8. Activate a warning system for potential delisting

- Demand that listed companies whose shareholder returns (dividends + treasury share buybacks/cancellations) decrease compared to the previous year are required to disclose the reasons in detail ("Comply or explain").

- <u>In particular, listed companies that have not made efforts to improve shareholder value for a long period of time or whose ROE has continuously deteriorated due to excessive cash and/or surplus retained earnings (ie, overcapitalization) will be ordered to delist after the warning system is activated</u>.

# 9. Evaluate at fair value when listed parent+subsidiary or affiliates merge

- The valuation method using the market price (ie share price) when the parent–subsidiary or afffilates merge have the high possibility of violating general shareholders' rights, as seen from the case of the merger between Cheil Worldwide and Samsung C&T.
- The Samsung C&T merger caused significant damage to minority shareholders, while the controlling shareholder Lee family benefited as a result. ISS and Sustinvest —the proxy advisory firms— were against the merger decision.
- In 2018, Hyundai Motor Group sought to spin off the attractive module AS parts business from Mobis and merge it at a questionable merger ratio with Hyundai Glovis controlled by the Chung family. However, this plan was thwarted as proxy advisory firms Glass Lewis and Sustinvest opposed the move, and one of major shareholders Elliott strongly objected and eventually led to the proposal to fall through.
- In such mergers, it is reasonable to assess the value based on fair value and to place the burden of proving fair value on the corporate itself.

# 10. Adjust inheritance/gift tax

- Chaebol lobbying associations and select local media controlled by chaebol claim that the high inheritance tax rate is one of major reasons for the Korea discount, which in our view is unsubstantiated.
- Until recently Korea's big four financial holding companies' valuations were lower than those by China's big 4 banks controlled by the the Chinese Communist Party.
- Low valuation at KB, Shinhan, Hana, and Woori Financial Group was largely due to government intervention and selfish management (ie, Group Chairman and his executive team) rather than controlling shares (that did not exist).

# Tax calculation based solely on market price leads to wrong idea by families

- While it is true that Korea's inheritance tax rates are excessive, a more significant problem lies in the irrational tax system that calculates inheritance tax solely based on market value. This system favors bad controlling shareholders who intentionally lower share prices of listed entities to reduce their inheritance tax burden. We recommend levying taxes based on the higher value between book value and market value, while simultaneously lowering tax rates to a reasonable level.

- The government can lower tax rates without reducing tax revenue. However, the change requires approval at the National Assembley. Before any further discussion on inheritance and gift tax, controlling shareholders of listed Korean companies should demonstrate clear and tangible efforts to improve corporate governance.