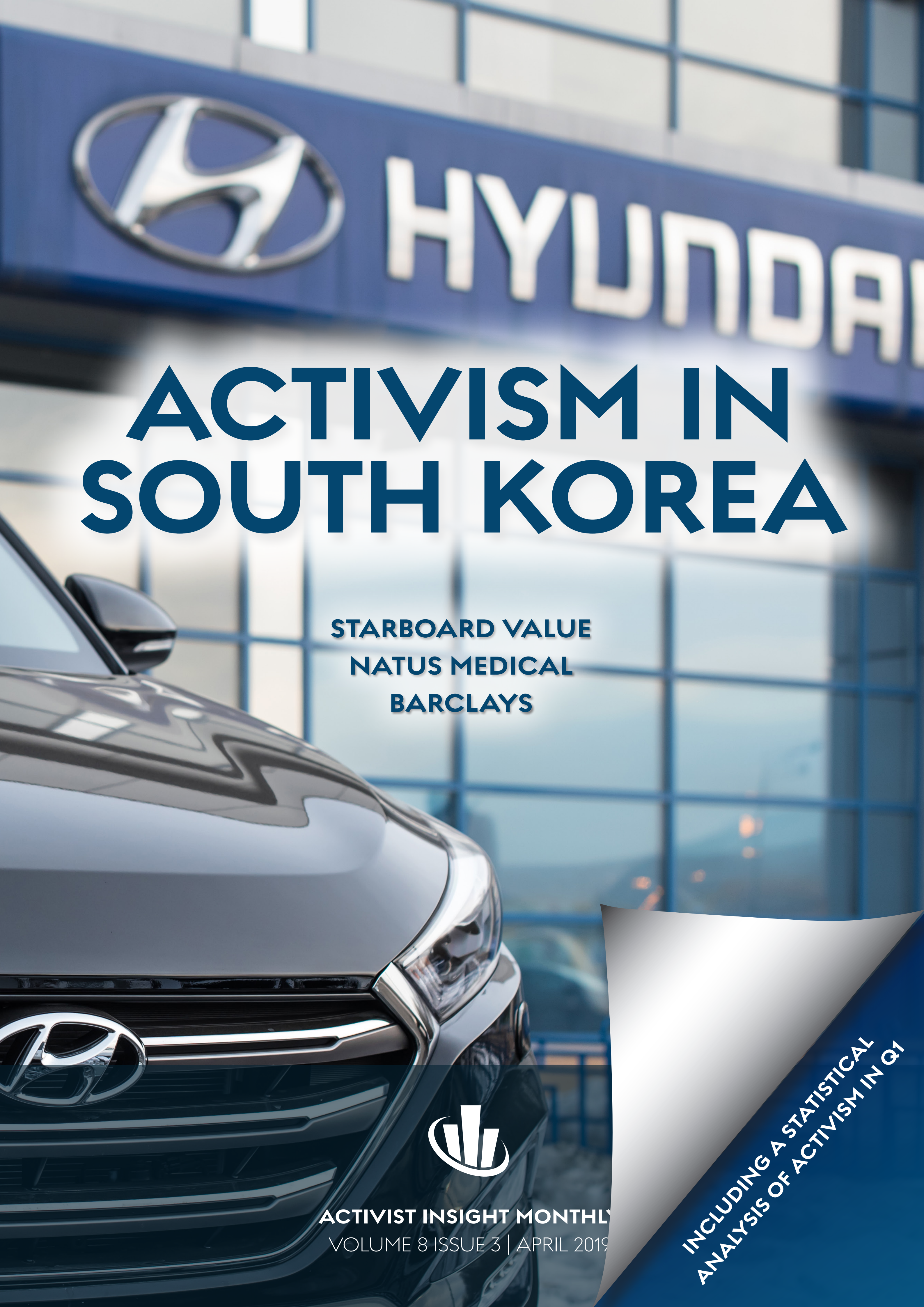

ACTIVISM IN SOUTH KOREA

STARBOARD VALUE
NATUS MEDICAL
BARCLAYS

INCLUDING A STATISTICAL ANALYSIS OF ACTIVISM IN Q1

ACTIVIST INSIGHT MONTHLY
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PLUGGING THE 'KOREA DISCOUNT'

THE ADOPTION OF A STEWARDSHIP CODE IN 2016, A CLAMPDOWN ON CHAEBOLS, AND A GRADUAL SHIFT OF INVESTOR AND POLITICAL SENTIMENT HAVE LED TO AN INCREASE IN SOUTH KOREAN SHAREHOLDER ACTIVISM. AWASH WITH CASH AND DEEPLY UNDERVALUED, KOREAN COMPANIES PRESENT COMPELLING TARGETS FOR ACTIVIST INVESTORS, WRITES IURI STRUTA.

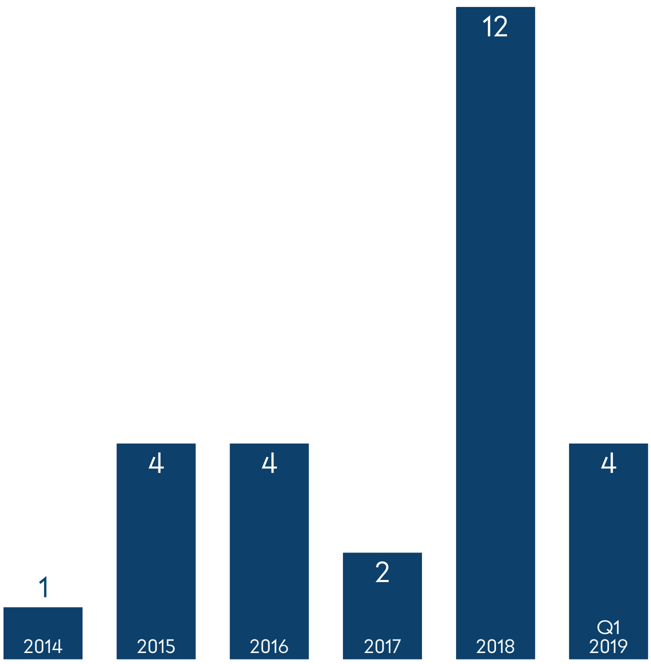
South Korea appears ready to embrace shareholder activism, but **Elliott Management**'s year-defining proxy fight at two Hyundai group companies proved too early for the country's young shareholder reforms.

"Their demands are short-lived and greedy, and they have little future value," Yoon Chang-hyun, a professor at the City University of Seoul, wrote in an opinion piece about Elliott's campaign at South Korea's second-largest chaebol after **Samsung**. The professor's comments reflect a long-held belief in the country that foreign activists are short-term oriented and value destroyers. Indeed, Elliott's proposals for board changes and capital returns to shareholders at flagship companies **Hyundai Motor** and **Hyundai Mobis** gained little traction with shareholders, delivering the activist a painful defeat.

"ACCORDING TO ACTIVIST INSIGHT ONLINE, 12 COMPANIES WERE PUBLICLY TARGETED IN 2018 COMPARED TO A MERE TWO IN 2017."

Hyundai's war with Elliott is set to continue, however, amid an unprecedented rise in shareholder activism. According to *Activist Insight Online*, 12 companies were publicly targeted in 2018 compared to a mere two in 2017. In the first 10 weeks of 2019, four companies have been subjected to public activist demands. Across Asia, 111 companies faced activist shareholders in 2018, with Japan seeing 41% of the action.

SOUTH KOREA TARGETS BY YEAR SINCE 2014



SOUTH KOREA-BASED COMPANIES PUBLICLY SUBJECTED TO ACTIVIST DEMANDS.

SOURCE: ACTIVIST INSIGHT ONLINE

'ENHANCED AWARENESS'

To clamp down on abuse by chaebols (family-owned conglomerates), the Korean government has been encouraging investors to become more active with their holdings. The introduction of the Stewardship Code – a non-binding set of guidelines for investors on how to best exercise their voting rights and responsibilities – by Korea's Financial Services Commission in 2016 and its mid-2018 adoption by the National Pension Service (NPS) has prompted a ripple effect in the domestic asset management industry. Other institutional investors have followed suit, and now 91 entities adhere to it.

"We do feel enhanced awareness of shareholder rights among domestic asset managers including the NPS," Jin Soo Yoon, head of the ESG Service Division at Korea Corporate Governance Service, told *Activist Insight Monthly*. "A growing number of institutional investors hire proxy advisers." The rate of protest votes against management proposals rose from 2.4% in 2016 to 4.6% in 2018, Junbeom Park, a portfolio manager at **KB Asset Management**, a domestic asset manager with $50 billion in assets, noted in an email interview with *Activist Insight Monthly*.

"WE DO FEEL ENHANCED AWARENESS OF SHAREHOLDER RIGHTS AMONG DOMESTIC ASSET MANAGERS."

In February, **Dalton Investments**, a $3.5 billion U.S. investment firm that occasionally engages in activism, wrote a public letter to several Korean constituencies, including the government and the NPS, calling for steps such as lower taxes on dividends, active exercising of shareholder rights, and mandatory electronic voting. James Lim, a research analyst at Dalton who is spearheading the move, told *Activist Insight Monthly* the response from institutional investors and the government was positive but that it was too early to discern the true impact. He expects to meet with some government agencies to speak about the letter.

Korean institutional investors take their lead from the NPS and activists frequently complain that the business interests of large investors are entangled with the firms they invest in. Smaller investors are more independent and have been more outspoken. Lim said a local online retail investing club, with over 100,000 members, initiated a petition for the government to take note of Dalton's recommendations.

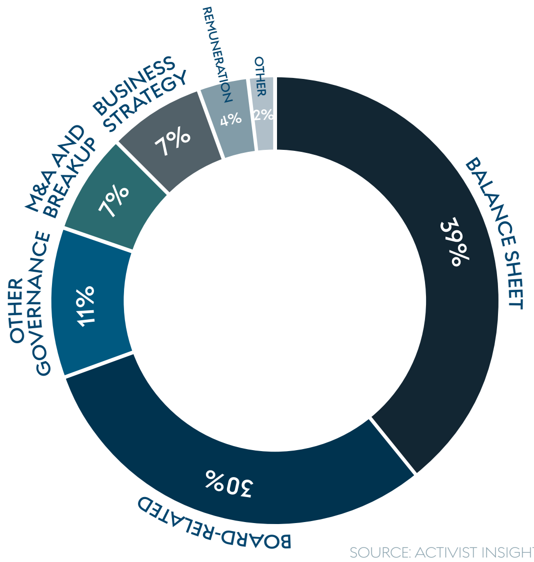
Foreign shareholders are also becoming a force. As of mid-2017, 36.9% of the Korean stock market was owned by foreign entities, up from 32.8% in 2011, according to the Korea Stock Exchange. As the environment becomes more shareholder-friendly and the chaebol structures are gradually dumped, foreigners' holdings could continue getting bigger.

> "IN MANY CASES, WINNING THE SUPPORT OF NPS IS CRUCIAL FOR AN ACTIVIST CAMPAIGN TO BE SUCCESSFUL."

CASH ONLY

Chief among the reasons for the so-called "Korea discount" is poor capital allocation. Korean corporations sit on vast amounts of cash, leading to low returns on equity. It is not rare to see companies trading at net cash levels, something unthinkable in the Western world. Dalton noted in its letter that the Korea Composite Stock Price Index (KOSPI) has returned 25% over the past seven years, despite corporate profits increasing by 80%.

ACTIVIST DEMANDS IN SOUTH KOREA BY TYPE SINCE 2016



SOURCE: ACTIVIST INSIGHT ONLINE

"I don't think many CEOs have a full grasp of the cost of capital," Lim, who believes the Korean stock market trades at a $1 trillion discount, said. "We want the Korean companies to think about economic value added and cost of capital."

As such, activists have been pushing companies to return capital to shareholders. According to *Activist Insight Online*, a third of activist demands were for share repurchases or dividends in 2018, one of the few regions where they outstripped board-related requests such as new directors and board independence. "Buybacks and dividends are pretty much the answer for almost all activist situations in South Korea," David Hurwitz, the founder of SC Fundamental Value, said in an interview with *Activist Insight Monthly*.

HARVEST DAY

Companies are slowly responding to outside pressure. According to Bloomberg, South Korean issuers paid 23% of their net income in dividends last year, the largest amount since 2007.

Hyundai Mobis proposed a dividend of nearly $1 billion for the next three years amid pressure from Elliott. Samsung Electronics, another company targeted by Elliott, increased its payout to shareholders by 20% in 2017 and doubled it in 2018. Lotte Group, the third-largest chaebol, has more than doubled its payout ratio to 30% since it converted to a holding company structure in mid-2017.

HYUNDAI MOBIS INITIATED A DIVIDEND AFTER A DEMAND FROM ELLIOTT MANAGEMENT.

"ONE OF THE THINGS THEY DO THAT'S DEFINITELY DIFFERENT IS A MUCH MORE FRIENDLY OUTREACH TO SEE HOW FAR THEIR NETWORK CAN GET THEM."

"Corporations are changing, recognizing changes in government and investors," Park said, noting that the 70-year-old founder of travel agency Modetour Network proposed meeting with the activist regularly after it bought a near-10% stake in the firm. KB engaged with five companies last year and four responded positively to at least some of its demands, mostly for dividends. "Until now, institutional investors would never meet with the owner," Park said.

Elsewhere, Hurwitz convinced alcoholic drinks manufacturer Muhak to increase its dividend, although he reckons it is still "woefully low," while Dalton launched a campaign for buybacks at Hyundai Home Shopping.

PASSIVE NO MORE

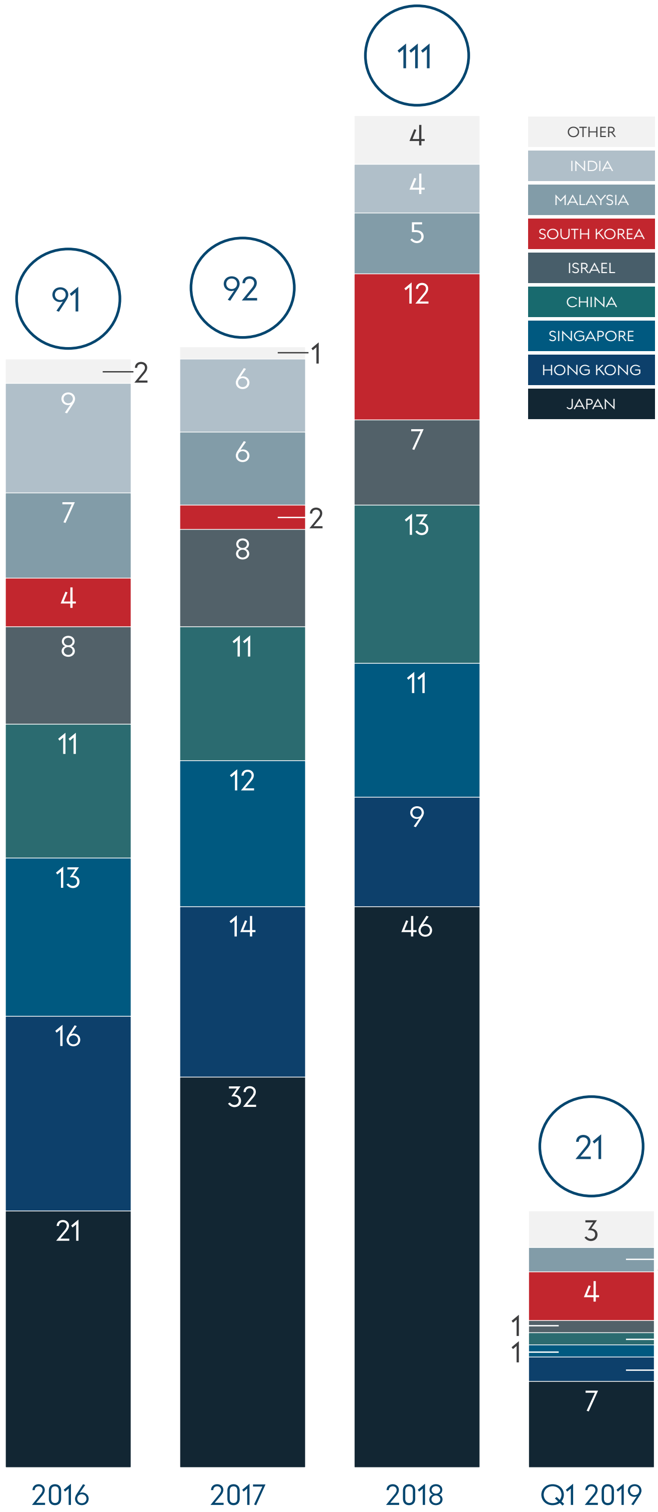
For all this progress, launching more aggressive campaigns such as proxy fights might be too far for Korea's incipient shareholder-friendly reforms.

The role of the NPS, which has $568 billion in assets under management and stakes of at least 5% in all South Korean companies, is hard to overestimate. In many cases, winning the pension fund's support is crucial for an activist campaign to be successful, particularly at chaebols.

Elliott began expressing flexibility in its demands at Hyundai after the pension fund publicly announced its support for management. In 2016, the backing of the NPS was critical for a merger between Samsung C&T and Cheil Industries, a deal opposed by Elliott and many minority shareholders which led to the jailing of Samsung heir Lee Jae-yong and the impeachment of President Park Geun-hye amid accusations of political interference in the NPS' voting decisions.

Expectations of a sudden change in the NPS' behavior despite a recent leadership shakeup seem misplaced. Because it manages the money of all Korean people, the fund is always in the spotlight and its decisions have political implications. In addition, corporate influence on the fund remains high, according to Yoo-Kyung Park, head of APG Asset Management's responsible investment and governance, Asia Pacific. "The NPS is under constant watch from outsiders and they have to be very prudent," Park told *Activist Insight Monthly*.

ASIAN TARGETS BY YEAR SINCE 2016



SOURCE: ACTIVIST INSIGHT ONLINE

"THE NPS IS UNDER CONSTANT WATCH FROM OUTSIDERS AND THEY HAVE TO BE VERY PRUDENT."

In a landmark development, NPS voted against the re-election of Korean Air CEO and controlling shareholder Cho Yang-ho, prompting other shareholders to follow suit and leading to his eventual removal from the board. Cho, 70, unexpectedly died of a chronic illness shortly after his ouster. At Hanjin KAL, the holding company which controls Korean Air, the support of the NPS saved the incumbents' positions despite a consensus the company is poorly-run and a proxy contest led by recently-founded investment firm Korea Corporate Governance Improvement. "Everybody knows that there is no hope, [Hanjin management] is a value destroyer," the APG's Park said. "Hanjin looks like a typical case of mismanagement," Lim agreed.

The government has been attempting to relax the NPS' restrictions to embolden the fund to become more active, although its efforts have met some resistance. The fund is now in the process of expanding its stewardship team and making it more independent, and is also expected to implement the Stewardship Code for its external asset managers. "If materialized, it will trigger a widespread adoption of responsible investing and shareholder activism," Yoon predicts.

KOREAN AIR LINES' CEO WAS VOTED DOWN FROM THE BOARD AFTER THE NPS PUBLICLY OPPOSED HIS RE-ELECTION.

ELLIOTT MANAGEMENT AT HYUNDAI

After marginally losing a vote to block a merger between Samsung C&T and Cheil Industries in July 2015, Elliott Management launched its second campaign in South Korea more than three years later in a more shareholder-friendly environment. The activist's proposals at Hyundai Motor and Hyundai Mobis to appoint new directors and initiate a dividend of $4.3 billion at the former and $2.2 billion at the latter were defeated, however.

In part, Elliott's loss was due to high insider ownership and the NPS publicly siding with Hyundai. Glass Lewis and Institutional Shareholder Services partially backed the resolution to add new directors but did not endorse the dividend.

Many shareholders thought Elliott's dividend proposal was too aggressive. APG's Park said the Dutch pension fund backed Hyundai in the proxy fight "hoping that the new board will better oversee management." If the company fails to manage its cash well going forward, Park believes shareholders will not be so forgiving. KB, which is a top-20 shareholder in Mobis, would support a "proper mix" between the director slates presented by Elliott and Hyundai, but Junbeom Park argued the "logic behind the dividend proposal is lacking."

Elliott is now reportedly looking to the company's restructuring as its next opportunity to push for changes. Hyundai ditched a restructuring plan last year after it became clear there was not enough support, amid opposition from Elliott. With two-thirds of the shares needed to endorse its proposal and half of the shares owned by foreigners, Elliott might get its way.