Asia ex-Japan Equity: Letter to Investors

It was us and we did it! (we think)

Our intervention in South Korea and what it means for investors

Jonathan Pines
Lead Portfolio Manager

Asia ex-Japan Equity
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Federated Hermes Limited

www.hermes-investment.com
For professional investors only

In early 2024, we published a landmark report which outlined the shortcomings in South Korea's corporate governance laws and proposed various solutions.

- South Korea has long had a reputation for poor corporate governance, with controlling shareholders resisting efforts to reduce their power relative to minority shareholders.
- Over time, it became clear to us that an engagement approach centred on asking company directors to treat minority shareholders fairly and optimise the capital structure would fall on deaf ears.
- Our only hope to achieve viable change was to encourage an overhaul of the country's regulations – a tough ask. We embarked on an ambitious campaign amid wider political shifts in the country. It is pleasing to now see the country enact sweeping changes which could have far-reaching implications, with South Korean stocks being among the best performing asset classes this year.

We typically engage with holdings in our portfolio, seeking improvement in key areas such as governance. Nonetheless, even when the management of a company moves in the way we want, it can be hard to claim full credit. There are inevitably other investors pushing for the same changes. Sometimes the company might have fixed the problem on its own. Most of the time, the best an engager can claim after a hard fought campaign to encourage the company to do the right thing is that they "definitely positively contributed to the conversation".

It can be frustrating to not have a sense of complete victory. The satisfaction that comes from knowing that you worked hard to meet an objective, and through your own efforts, have succeeded.

At least when we pick stocks, the market finds us out – one way or another. There is neither purgatory nor 'near heaven'. We either outperform or we don't. Of course, we might get lucky and outperform for the 'wrong reasons' – but that well-trod topic is for another day.

First, Naspers

Take our engagement experience with South African-listed tech investor Naspers.[1] Naspers had a large holding in Chinese tech giant Tencent – the value of which dwarfed its own market capitalisation – hence we invested in Naspers instead of a direct holding in Tencent, when we initially invested a few years ago.

The investment offered us two opportunities to 'win' – from the possible outperformance of Tencent, and from the potential closing of the discount in the market value of Naspers relative to its key holding.

Naspers' initial investment in Tencent many years earlier was far-sighted and visionary (as its management kept reminding us). It was hard to deny.

However, most shareholders were not invested from the beginning, and by retaining a minority interest – via a holding company structure – Naspers was not adding ongoing value to its shareholders.

Instead, by operating such a structure Naspers was detracting value – at least in the opinion of the market. The discount to the value of its holding typically exceeded 50%.

Moreover, Naspers was paying very substantial remuneration to its executives – comparable to the top-dollar packages paid to executives of Tencent itself (the operating company) and the largest US tech firms.

Such a situation was particularly exasperating when you consider that the company was worth more to shareholders dissolved than as a going concern. It made economic sense for Naspers to unbundle or sell its stake in Tencent, allowing investors in Naspers to realise an immediate gain – which exceeded 25% (and was potentially more than double that).

As investors in Naspers, we engaged with the company to try and make this happen. We weren't alone. Other shareholders were pushing for the same thing. Naspers, however, had a controlling shareholder who remained intransigent to change.

We tried our best to convince the company. We held meetings with management and directors. We formally wrote to the board multiple times. We invoked all the shares we represented under our stewardship arm[2] (which exceeded more than 1% of this giant company, vastly more than the direct holding held by our Asia-ex-Japan Equity Strategy) to try to get the board to take us more seriously.

We even eventually – and successfully – gave a presentation to shareholder proxy providers outlining why they should recommend that shareholders not approve the proposed remuneration packages for Naspers' directors.[3]

[1] In this note when we refer to Naspers, we are referring to the group, which includes separately listed Prosus.

[2] EOS is the stewardship arm of Federated Hermes which engages with companies on behalf of institutional investors to drive long-term value and positive societal and environmental outcomes.

[3] To clarify, it was our representation that was effective in that the proxy provider recommended a vote 'against'. However, the vote approving directors' remuneration passed, despite this.

All we got back from the company was vague assurances that shareholders' views were appreciated and that the company was always on the lookout for ways to enhance shareholder value – and that it would eventually add value from its host of relatively-smaller tech acquisitions. This back-and-forth went on for years, despite the fact that the solution to the issue was obvious (the sale or unbundling of its stake in Tencent).

We do not want to be sidetracked (as this is secondary to the main thrust of this letter). However, at this, ESG engagement purists might have argued that our next course of action was clear. We bought a company with poor governance. We engaged in an effort to improve the governance. We failed. Now – the purist might contend – we needed to sell.

In fact, we did (regretfully) sell some of our stake in Naspers out of frustration. Fortunately, we did not sell our entire stake. Had we done so, we would have sold out just before Naspers announced that it would progressively sell its stake in Tencent (and buy back its own stock with the proceeds). Such an outcome was almost exactly what we had been pushing for.

Of course, had we taken the approach of an ESG engagement purist, we would have exited the company at exactly the wrong time.

This episode underlines a key point. Sometimes management does eventually get around to doing the right thing for their own reasons.

In the case of Naspers, we suspect that the reason for the sale had little to do with the extent of the discount, or the protestations of minority shareholders. Its primary concern – led by the controlling shareholder – was what impact the rising tensions between Beijing and Washington might have on its future ability to ultimately realise fair value for Tencent.

The timing of Naspers' announcement in June 2022 coincided with a brutal sell-off in Chinese technology stocks (including Tencent). Between its post-pandemic high in February 2021 and the day of Naspers' announcement, Tencent's share price had fallen more than 50%.[4]

A good barometer of US-China tensions is the US-listed Chinese technology stock index (KraneShares CSI China Internet ETF) which fell more than 70% over the period.[5]

It's far more likely, in our opinion, that Naspers' controlling shareholder was spooked into realising the holding in Tencent by the slump in its share price (from its post-Covid high) as opposed to being persuaded by our protests, and those of other minority shareholders.

Indeed, I am confident that the effort we put into getting our desired outcome had next to nothing to do with us ultimately achieving it. Naspers changed tack because it suited the controlling shareholder to do so.

Which brings us to South Korea.

South Korea – all that glitters

When we first started investing in South Korea for the Asia ex-Japan Strategy about 16 years ago, two things were clear about the country's stock market.

1) Stocks were very cheap – with some domestic companies trading not only below book value per share, but also below net cash value per share.

(We have little doubt that had Benjamin Graham, the father of value investing, seen what was on offer he would have been beside himself with excitement.)

2) Moreover, there were various pricing anomalies within the capital structure of companies. Non-voting stock, for example, traded at discounts to voting stock by as much as 70% or more (compared to a an average of about 2% in the US as discussed in our June 2024 note).

Something was clearly amiss. We were, of course, aware that the country had a reputation for poor corporate governance. Over the course of our 16-year journey, we would discover first hand just how spectacularly poor it was.

During the period we experienced multiple episodes of poor corporate governance that were breathtaking in both their variety and creativity.

- Companies in which we were invested got taken over at huge premiums to market but we didn't get to participate in any control premium (as there is no tag-along right for minority shareholders in South Korea).
- We were forced to sell our stock to controlling shareholders because of 'restructurings' at price-to-earnings multiples below three times (twice).
- A chairman's daughter sold her personal property to the company in which we were invested and that he chaired for an eye-watering price.
- Directors found guilty of embezzlement from the companies they directed were pardoned and made re-eligible to direct the companies they had stolen from.
- Management teams used general company resources to buy back stock on the market, which they didn't cancel (which would have been in the interests of all shareholders) but instead used them to shore-up control by being on-sold to friendly third-parties when crucial votes came up.

When we sought to challenge poor director conduct we were advised by lawyers that there was little we could do as directors owed no duty of care to minority shareholders. On one occasion, we even wrote to a judge overseeing an egregious restructuring being forced upon us by the controlling shareholder, but to no avail. We were further

[4] Source: Bloomberg
[5] Ibid.

advised by our lawyers not to publicly name names because in South Korea, pointing out wrongdoing can be deemed defamatory (even if it's true).

I remember thinking: do South Korean controlling shareholders not realise that while acting badly might result in short-term gains at minority shareholders' expense, over the long run the share price discounts because of poor governance would have a more than opposite impact on their wealth?

Our 'Sixth Sense' moment

And then one day a realisation dawned on me. On that day, a profitable, cash rich company in which we had invested had needlessly decided to cut its dividend payout ratio from a low 20% to a measly 10%.

I was initially irate and perplexed, until a moment of clarity hit me. I remember feeling exactly the same as when I watched M. Night Shyamalan's 1999 blockbuster *The Sixth Sense*. The final scene revealed that Bruce Willis's character, an all-seeing child psychologist, had actually been dead all along.

The plot twist explained everything – the final piece of the puzzle.

The realisation was that, as the majority of South Korea's controlling shareholders have no immediate need to raise capital, they actually prefer a lower stock price, for two reasons:

1) Inheritance taxes are as high as 60% in South Korea, with limited available routes to avoid them.

2) South Korea's Commercial Act allowed controlling shareholders to force out minority shareholders at the market price at a time of their choosing on the basis of a 'restructuring' – and a weak market price provides ongoing opportunities for them to do so.[6] (As majority shareholders already maintained control they could use the Commercial Act to crystalise the lion's share of true value, whenever it suited them – so that they stood to personally benefit).

When the directors of a public company want a lower stock price, all bets are off. Financial markets become a casino. The present value of future cash flows cease to relate directly to stock prices. Stocks become cheap, volatile and news driven. Investor relations personnel become jesters – reduced to being unwitting participants in an elaborate pretence.

"Uninvestable," I can almost hear ESG engagement purists whisper.

An effective engagement

It became clear that an engagement approach centred on asking company directors – who had been appointed by controlling shareholders – to "behave better and treat minority shareholders fairly", and optimise the capital structure would continue to fall on deaf ears.

The incentives to encourage controlling shareholders to continue to act in the same way were simply too powerful. As a result, engagement with South Korean companies would continue to be ineffective.

Our approach needed to focus on encouraging regulatory change – a tough ask, but it was the only hope for achieving an effective outcome.

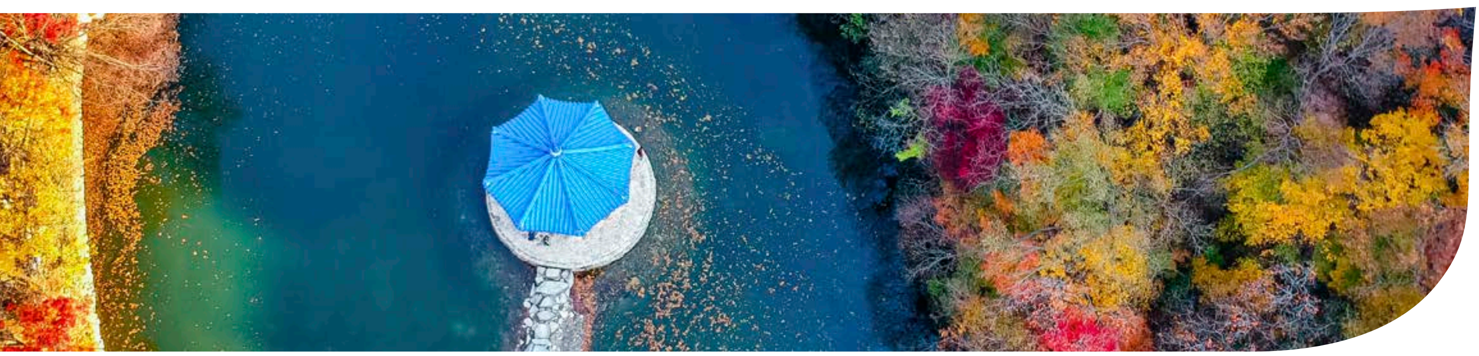
In January 2024, we published our landmark *Letter to Investors* report South Korea – enough is enough which outlined in clear and stark terms the various shortcomings in South Korea's corporate governance laws.

It told the story of our long and painful experience investing in South Korea.

The report also proposed solutions and highlighted what regulatory amendments could solve the so-called 'Korea discount', which sees domestic companies trade at lower price-to-earnings multiples than global peers.

We also announced a new voting policy targeting director malfeasance, including a presumption to vote against all directors in companies trading persistently below book value, save for certain exceptions.

As minority shareholders in South Korean companies – controlled by majority shareholders – we understood that our vote would never be decisive. Instead, the objective of the



[6] The lack of tag-along rights in the event of a change in control means that minority investors can't even hope that an eventual sale of the business will allow them to realise fair value.

letter was to obtain support from other like-minded investors – particularly South Korean individual investors – who, unlike us, have political voting rights.

To be sure, it was an extraordinarily difficult letter to get through our Legal and Compliance teams, which were concerned that we were being too publicly critical of both South Korea's controlling shareholders (present in more than 90% of companies) and the country's legislative framework. We couldn't afford to get a single fact wrong. We embarked on an extensive fact-checking exercise. We consulted South Korean law professors, legal firms, and sell-side analysts to ensure our facts were correct. And once our Legal and Compliance teams were finally satisfied, it was the turn of our Press and Sales teams to weigh in. They were worried about the implications of possible adverse publicity resulting from our criticisms.

Finally, it fell to the intervention of our New York-based Chief Investment Officer to clear the letter for release.

But the delay gave us time to increase the letter's effectiveness. We spoke to colleagues at other firms on the buy-side and advised them of our intention, many of whom voiced support. On LinkedIn, we connected with everyone we could in the South Korean financial services industry – so they would see our letter when we published it. We set up interviews with leading business-oriented television channels.

And then we published.

The reaction

To our considerable relief, the reaction to our letter was almost universally positive. Initially, it was picked up by the traditional media in South Korea.

We understand, however, that it quickly found its way into online investor chat groups. We received multiple requests to do local interviews, and to translate the letter into Korean.

Someone we did not know translated the report and a Korean-language version started circulating widely. The letter was referred to in at least one Korean legal journal. The Korean Corporate Governance Forum honoured us with an award that in previous years had always gone to locals.

The mood had changed. We believe it was driven by rising retail participation. The number of shareholders in South Korea had increased to more than 14 million[7] compared to five million before the pandemic (from a population of 52 million). The rebound in the Japanese stock market on the back of its own corporate governance reforms also helped.

South Korea, it seemed, was finally ready for change.

We continued our campaign. We wrote follow-up papers and held media interviews, seeking to blunt the inevitable counter-arguments from controlling shareholders that the status quo should be preserved.

And argue they did. "We will be drowning in lawsuits... The laws will discourage us from risk taking and entrepreneurship… We will be subject to foreign takeovers... The existing laws are good enough and we already act in the interests of all shareholders."

All easily refutable of course.

Indeed, as the issue rose in prominence, various controlling shareholders did not help their cause by trying to speed up plans to implement 'restructurings' – which benefitted the controlling shareholders at the expense of minority shareholders – in attempts to beat the clock.

We held calls with various people at South Korea's National Pension Service, the country's largest public market investor, which often has to navigate the difficult task of walking the line between protecting shareholders' interest and complying with the desires of politicians.

We even appeared in a sell-side sponsored webinar, presenting to our buy-side peers. Later, we would attend the launch of the Korean Exchange London office (although, we admit, no one, it seemed, knew who we were or about our intense focus on corporate governance).

A timely political earthquake

And then, in an ill-fated move on 3 December 2024, President Yoon Suk Yeok, of the People's Power Party (PPP), declared martial law – a move widely viewed as attempting to avert a domestic political crisis. It would be reversed the next day by a unanimous vote in the National Assembly and led to his impeachment.

It paved the way for a snap presential election.

The PPP had long been viewed as the party more closely aligned with the interests of South Korea's controlling shareholders.

To our delight, Lee Jae Myung, of the Democratic Party of Korea (DPK), emerged as the frontrunner – with a catchphrase promising to take the Kospi to 5000 – and a campaign pledge to end the 'Korea discount'.

(The DPK already controlled the National Assembly.)

As at 1 September, the Kospi was at 3,142[8] compared to about 2,500 at the start of his campaign.

[7] Korea's Corporate Value-Up Program: A New Opportunity for Equity Investors?
[8] Bloomberg as at 31 August 2025.

On 2 June, Lee Jae Myung won the presidential election by a landslide. One month later the Commercial Act was revised to introduce a fiduciary duty for directors, and the revision became law on 22 July 2025.

The PPP embraced the zeitgeist – after previously resisting it – and backed the Commercial Act revision, a rare act of bipartisan support.

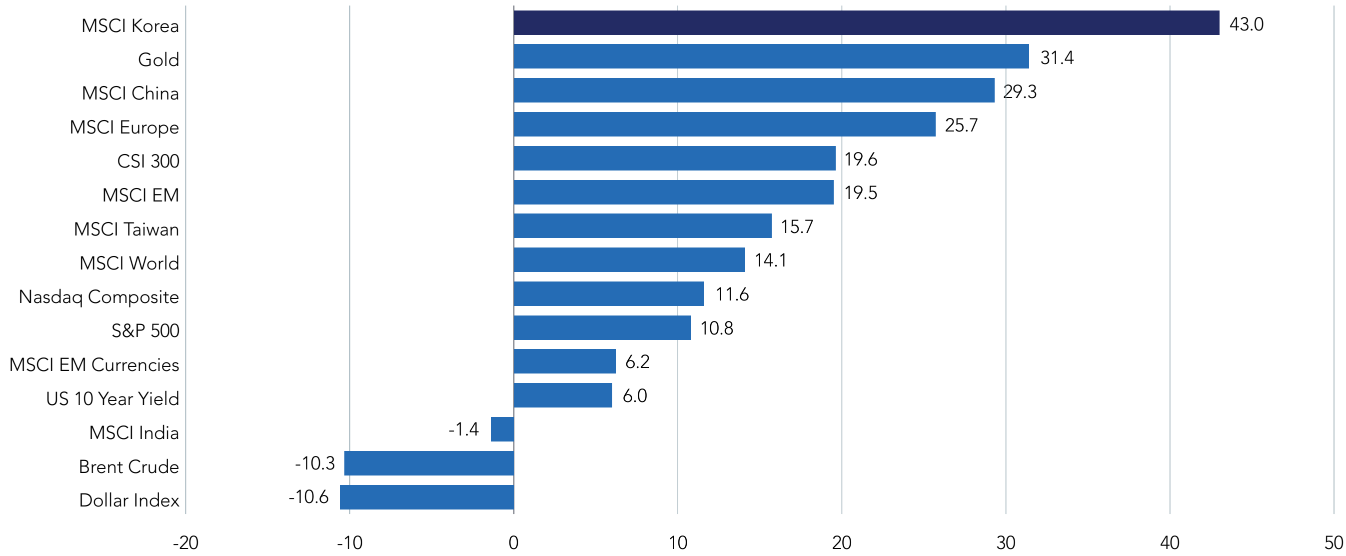
Other changes that we recommended in our letter including: treasury stock cancellation, tax reforms, tag-along rights for minority shareholders in the event of a takeover; and encouraging higher dividends and stock prices through tax policy are all being seriously considered by legislators, we understand.

Before we published our letter we had researched whether there had been any similar initiatives on the buy-side. We saw no evidence of any other buy-side firm (in South Korea or internationally) anywhere near as interested, exercised or active as we have been on this issue. Perhaps understandably, we did not see it either on the sell-side, or within the South Korean legal fraternity.

The South Korean stock market, up 43% on a dollar basis YTD,[9] currently stands among the best performing asset classes in the world this year. To be sure, at this level the market has become more volatile and we believe that South Korean regulators will need to follow through on other proposed reforms in order to maintain the rally's momentum.

Figure 1: South Korea leads the world YTD

Year to date return in US dollars (%)



Source: Bloomberg as at 31 August 2025.

Reflections

We cannot say for sure it was us, of course. It might have been the frustration of the growing number of South Korean investors finally boiling over (especially in light of Japan's outperformance following its own corporate governance reforms[10]). It might have been more attributable to the tireless efforts of another body, the respected Korea Corporate Governance Forum, led by its superb chairman Namuh Rhee. It might have been that this was simply the right time in the country's development for the change to happen.

The timing of the release of our letter might well have been coincidental relative to the events that followed. So we cannot definitively say it was us. All we can claim, as usual, is that we "positively contributed to the conversation".

Of course, dear reader, if you had a superpower akin to the all-seeing boy played by Haley Joel Osment in the movie *The Sixth Sense* and could observe, undetected, our internal team meetings – where we are allowed to be less careful and nuanced about how we describe developments, you might see that our contentions go further.

In those meetings, we know.

It was us and we did it!

Jonathan Pines
Lead Portfolio Manager
Federated Hermes Asia ex-Japan Equity

The opinions expressed this report represent the views of Jonathan Pines, Lead Portfolio Manager, Asia ex-Japan Equity and the Federated Hermes Asia-ex Japan Equity team.

[9] Ibid.

[10] The number of individual South Korean investors is estimated at about 14 million, up from a pre-Covid level of five million. South Korea seeks to unlock property money in 'Kospi 5,000' drive – The Business Times.

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