Emerging Value Capital Management, LLC

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June 2015

Korean Preference Shares Basket

Number of positions in basket:	**15**	**Average dividend yield:**	**1.8%**
Combined market cap (prefs):	**$4B USD**	**Recommendation:**	**BUY**
Combined daily traded value (prefs):	**$7M USD**	**Expected holding period:**	**3 - 5 Years**
Average price discount from common:	**52%**	**Upside:**	**144%**

"Citicorp sent a manual on Korean stocks. Within 5 or 6 hours, twenty stocks selling at 2 or 3x earnings with strong balance sheets were identified … The strategy was to buy the securities of twenty companies … $100 million was quickly put to work."

-- Warren Buffett – 2005 talk to students at Harvard

"When Warren said he'd put 100% of his fund in Korea, maybe he wouldn't quite do that, but pretty much [he would]."

-- Charlie Munger – 2006 Berkshire Hathaway Annual Meeting

Investment Summary:

We recommend investing in a carefully selected basket of 15 Korean preference shares which trade at a 50% - 60% price discount to their respective common stocks. Korean preference shares are a form of equity security and are materially equivalent to Korean common stocks. They are legally entitled to a higher dividend and have a legal claim on company assets, earnings, and cash flows. Their lack of voting rights justifies a small price discount of 10% - 20%, but cannot justify the huge price discounts at which they trade.

Multiple catalysts are already causing this price discount to gradually narrow. These include mean reversion, capital inflows into Korea, rising dividend yields, improved corporate governance and bargain hunting value investors. The average price discount for the 20 largest Korean Preference Shares has already narrowed from 60% to about 40%. Our basket contains the cheaper preference shares which are catching up, yet still trade at an average 52% price discount.

Over the next few years this huge price discount could narrow from 52% to a more reasonable 20% discount. Adding 7% annual Korean market appreciation and a 2% dividend yield could result in upside of 144% over the next 5 years (20% annualized IRR, possibly higher).

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Importantly, the risk of permanent capital loss in this basket approach is minimized since we invest in a diversified basket of 15 cheap, profitable, dividend paying preference shares. Therefore, we view this investment opportunity as compelling from a risk-reward standpoint.

Korean Preference Shares:

South Korea, the world's 15th largest economy, has achieved impressive economic growth and development over the last 50 years. Today, South Korea is a developed, capitalist, democracy. It is home to leading global companies including Samsung, LG, Posco and Hyundai. The Korean stock market is cheap, trading for 10 X earnings and about 1.1 X book value.

Over 100 of the publicly listed companies in South Korea have both common and preference shares. The Preference shares in Korea are very different than preferred stocks in the US and most other countries. They are legally required to pay a higher dividend than the common stocks, have a claim on company assets, cash flows and profits, and are treated fairly whenever corporate events take place.

Most Korean preference shares were originally issued several decades ago when the Korean government pressured chaebols (Korean business conglomerates) to raise equity and de-lever their capital structures. The chaebols wanted the extra equity capital, but they also wanted to retain control of their companies — hence the new non-voting stock shares (preference shares).

When first issued, Korean preference shares traded at only small price discounts to their respective common stocks. Over the years this price discount has fluctuated dramatically. Today, many preference shares in Korea trade at a 50% or higher price discount to their respective common stocks. Since they must pay a higher absolute dividend amount, dividend yields for the preference shares are much higher and usually range between 1% to 3%.

After extensive research, we found that owners of Korean preference shares are almost always treated fairly with owners of Korean common stocks. Further supporting this viewpoint is the fact that many preference shares in the past (and a few today) traded at little or no price discount to their respective common stocks. Clearly, investors in the past viewed Korean preference shares as roughly equivalent to Korean common stocks and they did not think that preference shares in Korea deserved a large price discount.

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While the lack of voting rights of the preference shares is a negative, we do not view it as very significant since, in any case, most Korean companies are controlled by majority shareholders. In addition, Korean authorities have recently taken increased actions to protect the rights of minority shareholders and to improve corporate governance in Korea. These actions are favorable for investors in Korean preference shares since they protect our rights.

	Preferred Tic	Common Price	Preferred Price	Price % of common	Market CAP ($M)	Preferred Dividend Yield	Name	Industry
53	011785 KS	87600	35000	40.0%	2472	4.43%	KUMHO PETRO CHEMICAL CO LTD	Industrial
54	014285 KS	29700	15600	52.5%	134	2.56%	KUMKANG KIND CO LTD	Industrial
55	051915 KS	254000	148000	58.3%	15593	2.74%	LG CHEM LTD	Basic Materials
56	003555 KS	57000	32450	56.9%	9111	3.24%	LG CORP	Consumer, Cyclical
57	066575 KS	63800	27200	42.6%	9672	0.92%	LG ELECTRONICS INC	Industrial
58	108675 KS	154000	69500	45.1%	1279	2.66%	LG HAUSYS LTD	Basic Materials
59	051905 KS	484000	237500	49.1%	7003	1.60%	LG HOUSEHOLD & HEALTH CARE	Consumer, Non-cyclical
60	068875 KS	37700	21750	57.7%	579	0.00%	LG LIFE SCIENCES LTD	Consumer, Non-cyclical
61	005305 KS	1414000	600000	42.4%	1621	0.63%	LOTTE CHILSUNG BEVERAGE CO	Consumer, Non-cyclical
62	003925 KS	873000	360000	41.2%	582	0.29%	NAMYANG DAIRY PRODUCTS CO	Consumer, Non-cyclical
63	005725 KS	78900	32500	41.2%	372	1.69%	NEXEN CORP	Consumer, Cyclical
64	002355 KS	14100	5880	41.7%	1240	1.19%	NEXEN TIRE CORPORATION	Consumer, Cyclical
65	000325 KS	22000	12700	57.7%	269	3.19%	NOROO HOLDINGS CO LTD	Basic Materials
66	090355 KS	7150	5610	78.5%	132	3.65%	NOROO PAINT & COATINGS CO LT	Basic Materials
67	004255 KS	5500	2265	41.2%	187	3.31%	NPC	Industrial

Part of our Korean preference shares tracking system.
Source: Emerging Value Capital Management LLC

At Emerging Value Capital we track all the Korean preference shares and have done extensive research on most of them. We have been profitably investing in Korea for over a decade and view the current opportunity to invest in Korean preference shares as compelling.

Why Invest in a Basket:

While most of our investments are in individual companies, we do occasionally prefer to purchase a basket of related securities. This happens when we are confident that a certain sector or class of securities will, in aggregate, perform very well, but we are less certain about each individual member of the group. We think that Korean preference shares perfectly fit this definition. While not every company in our basket will be a star, we expect that, on average, our basket will perform very over the next few years.

An added benefit of the basket approach is that we are able to adjust our basket of preference shares as prices (and relative discounts) shift. For example, we earned an 80% return on our investment in Hyundai Mobis preference shares when the company announced a tender offer. We were able to take these profits and redeploy them into other preference shares in our basket.

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Portfolio Strategy (Selecting Preference Shares for our Basket):

We track over 100 preference shares in Korea and have invested in a basket of 15 carefully selected preference shares.

When selecting Korean preference shares for our basket, we look for 8 key criteria:

- 50% - 60% price discount between the preference share and common stock.
- Sustainable dividend yield.
- Reasonable trading liquidity (average daily trading volume).
- Good business with competitive advantages.
- A history of profitability and positive free cash flows.
- Strong balance sheet.
- Trustworthy and capable management team.
- Extremely cheap price relative to the intrinsic value of the business.

While clearly not all preference shares in Korea meet these criteria, we have found 15 preference shares that meet our high standards for investment.

Preference Shares in Our Basket:

The following table shows eight out of the fifteen Korean preference shares in our basket. Several of these are analyzed below in more detail. Across all the preference shares in our basket, the average price discount is about 52% and the average dividend yield is 1.8%. We estimate that we are able to buy the businesses in our basket for about one third of their intrinsic business values. The combined market cap and daily trading value for the preference shares in our basket are about $4B USD and $7M USD respectively.

	Company Name	Ticker	Common Price (KRW)	Pref. Price (KRW)	Price Discount	Pref. Div Yield
1	Amorepacific Corp.	KOSE:A090435	419000	206000	50.8%	0.53%
2	Daelim Industrial Co., Ltd.	KOSE:A000215	77700	31000	60.1%	0.32%
3	Doosan Corporation	KOSE:A000155	111000	67400	39.3%	6.36%
4	Kolon Industries, Inc.	KOSE:A120115	66500	28250	57.5%	3.19%
5	LG Household and Health Care, Ltd.	KOSE:A051905	741000	327000	55.9%	1.22%
6	sebang Co., Ltd.	KOSE:A004365	20350	9420	53.7%	1.59%
7	SK Chemicals Co.,Ltd	KOSE:A006125	79100	36250	54.2%	0.83%
8	Lotte Chilsung Beverage Co., Ltd.	KOSE:A005305	2591000	1160000	55.2%	0.42%
	Average:				53.3%	1.81%

8 out of the 15 Preference Shares currently in our basket.
Source: Emerging Value Capital Management

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Lotte Chilsung Beverage Preference Shares (005305 KS)
Lotte Chilsung Beverage, a subsidiary of the Lotte Group, has a 40% share of the Korean beverage market. It sells leading products in all main beverage categories including carbonated soft drinks, coffee, tea, energy drinks, bottled water, beer and whiskey. Its top brands include Chilsung Cider (lemon-lime soft drink), Let's Be (canned coffee), Sunny 10 (sparkling ade), Cheoeum Cheoreom (Soju – alcoholic drink), and Hot Six (energy drink). Lotte Beverage also owns multiple subsidiaries and non-core assets including a 34% stake in Pepsi-Cola Phillipines, real-estate development projects, and a securities portfolio.

Lotte Beverage's competitive advantages include dominant brands, economies of scale, and an extensive distribution network. The Lotte group is in the process of improving corporate governance and simplifying its structure. We therefore expect Lotte Beverage to unlock shareholder value by divesting some of its non-core assets.

The company's alcoholic beverage sales continue to grow rapidly driven by hit products Soju and Soonhari. Lotte Chilsung is responding accordingly and rapidly expanding its production capacity. We buy the preference shares at a 55% price discount to the common shares which means they are effectively trading for less than 6X EV to EBITDA – an unreasonably cheap price for such a high quality growing business.

Amorepacific Corp (090435 KS)
Amorepacific is Korea's leading cosmetics company. It has a 34% market share, multiple leading brands, and a dominant position in all distribution channels (door-to-door, retail, duty-free and online). The company also produces household goods and some food products. The company is growing sales rapidly and will likely become a global top 10 cosmetics producer in a few years.

Amorepacific enjoys excellent economics due to its strong brands and economies of scare in manufacturing, R&D, marketing, and distribution. Beyond its home market in Korea, Amorepacific is actively expanding into foreign markets with a focus on China, France, and the US.

The preferred stock of Amorepacific trades at a 51% price discount to the common stock. By investing in Amorepacific preferred stock we are paying about 12 times free cash flow, a cheap price for an excellent, well managed consumer brands business with significant growth prospects.

Doosan Preference Shares (000155 KS)
Doosan Corp is an industrial conglomerate operating in a number of disparate businesses, including electronic components for cell phones, heavy-duty excavators, machine tools, fast food, and building nuclear power plants. Doosan's management has been working to streamline the conglomerate structure. They are selling non-core

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assets, recapitalizing weak subsidiaries, and improving operational and financial performance. We expect these actions will unlock shareholder value over time.

We estimate Doosan's sum-of-parts value to be about 4B KRW. The preference shares of Doosan trades at a 39% price discount to the common stock. By investing in Doosan through its preference shares we are paying about one third of its intrinsic value. We accept a somewhat lower price discount for Doosan preference shares due to their high 6.4% dividend yield which is in addition to share buybacks by the company.

Sebang Co Preference Shares (004365 KS)

Sebang is a South Korean port operating company specializing in logistics, stevedoring, storage, and trucking services. They operate in major ports in Korea, including Busan, Gwangyang, Masan and Pohang. In addition, they own 38% of Global & Yuasa Battery – South Koreas leading manufacturer of vehicle and industrial batteries. Only a few companies in each port are licensed to perform stevedoring operations, thus limiting competition and providing Sebang with a competitive advantage.

The common stock of Sebang trades for about 8X Normalized earnings of 40B KRW (includes Sebang's portion of Global & Yuasa Battery earnings). While the common stock is cheap, the preference shares of Sebang are extraordinarily cheap. They trade at a 57% price discount to the common stock. By investing in Sebang through its preference shares we are paying 3.5X normalized earnings.

Kolon Industries Preference Shares (120115 KS)

Kolon Industries is a diversified chemicals and materials manufacturer with business lines in industrial materials, chemicals (petroleum resins), films and fashion materials. The company has significant market share in multiple niche markets including petroleum resins, polyester tire cord, airbags, and fashion item materials. Economies of scale, strong customer relationships, and intellectual property provide Kolon with a sustainable competitive advantage. Recent legal settlement with DuPont removes a major overhang from the stock and opens up the US market for all Kolon products.

The common stock of Kolon trades for about 6X EV / EBITDA. While the common stock is cheap, the preference shares of Kolon are extraordinarily cheap. They trade at a 57% price discount to the common stock. By investing in Kolon through its preference shares we are paying just 3 X EV / EBITDA and 4 X P/E. The preference shares should also pay an estimated 3.2% dividend yield starting in 2016.

LG Household & Healthcare Preference Shares (051905 KS)

LG Household & Health Care (LG H&H) manufactures and distributes cosmetics, household & personal goods and Coca-Cola beverages in South Korea. It has a leading market share in all 3 business segments. The company was spun off from LG Chemical

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(now LG Corp) in 2001 and has since been focused on western style brand management and shareholder value creation. LG H&H management is well regarded and shareholder friendly. Over the years the company has allocated capital wisely by investing in its core businesses, repurchasing stocks and completing multiple value creating acquisitions.

We view LG H&H as one of the best businesses in Korea. It enjoys strong consumer brands and significant growth drivers both domestically and internationally. We want to own it, but are unwilling to pay 20 times earnings for its common stock. Luckily, we can buy it at a much cheaper price via its preference shares.

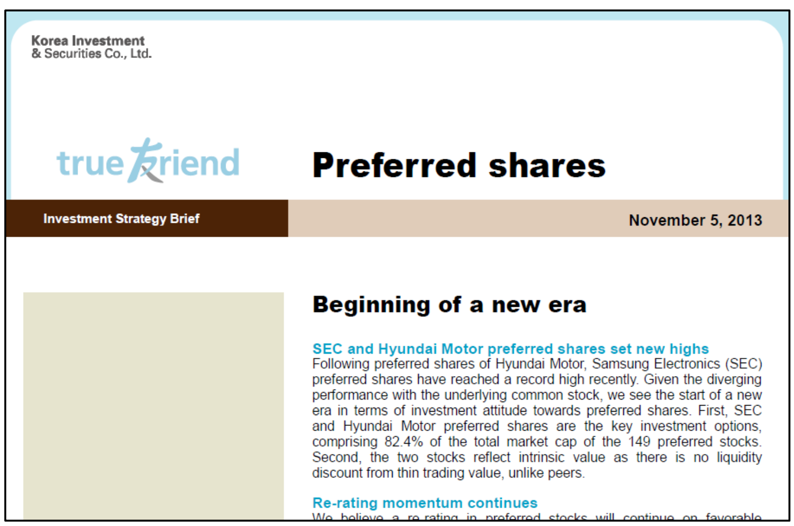
The preference shares of LG H&H trade at a 56% price discount to the common stock. By investing in LG H&H's preference shares we are paying about 10 times free cash flow, a cheap price for an excellent, well managed consumer brands business with significant growth prospects.

Catalysts:

In addition to simple mean reversion, we believe that there are four catalysts that will close the high price discount between Korean common stocks and Korean preference shares over the next few years:

Capital inflow (both local and international):

In past years the price discount between Korean common and Korean preference shares has widened dramatically due, in part, to a negative feedback loop. As the price discount increased and preference shares underperformed, momentum chasing Korean investors fled from them, thus further reducing their price and their liquidity. Reduced prices and reduced liquidity led even more Korean investors to shun preference shares further pushing down prices, and so on and so on. This dynamic was further exacerbated by capital flight due to the 2008 global financial crisis.


Korea Investment & Securities Co., Ltd.

true friend

Preferred shares

Investment Strategy Brief

November 5, 2013

Beginning of a new era

SEC and Hyundai Motor preferred shares set new highs
Following preferred shares of Hyundai Motor, Samsung Electronics (SEC) preferred shares have reached a record high recently. Given the diverging performance with the underlying common stock, we see the start of a new era in terms of investment attitude towards preferred shares. First, SEC and Hyundai Motor preferred shares are the key investment options, comprising 82.4% of the total market cap of the 149 preferred stocks. Second, the two stocks reflect intrinsic value as there is no liquidity discount from thin trading value, unlike peers.

Re-rating momentum continues

This negative feedback loop started to reverse in 2013 as bargain hunting foreign investors (like us) began buying Korean preference shares, thus increasing their price and liquidity and reducing the price discount verses the common stocks. In addition, sell

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side research firms both in Korea and the US recently began publishing about Korean preference shares.

One example is the listing in May 2013 of the Weiss Korea Opportunity closed end fund. This fund raised 100M British Pounds of permanent capital to invest in Korean preference shares. We also know of multiple other international hedge-funds that have invested, or are looking/starting to invest, in this space.

Improved corporate governance and minority shareholder rights:
In recent years, Korean authorities have taken multiple steps to protect the rights of minority shareholders and to improve corporate governance in Korea. These steps are very favorable for preference shareholders since they ensure the protection of our rights.

Corporate governance and transparency in Korea have improved significantly following the revisions to the Commercial Act, imposition of gift taxes on contracts to group affiliates, and aggressive legal action against abusive controlling shareholders. In addition, recent corporate law amendments in Korea now prohibit poison pills, require super majority board approval for related party transactions, and place strict independence and corporate governance burdens on directors.

> true friend **Korea Investment**
> & Securities Co., Ltd.
>
> **Sector Note**
> May 29, 2013
>
> ## Preferred stocks
>
> ### Ugly duckling reborn: Three major changes
>
> **Three meaningful changes**
>
> **1. <u>Emerging as favorable investment target</u>:** Preferred shares are emerging as a favorable investment target. Foreign investors are leading the buying of preferred shares, which was previously limited mostly to value investors due to high dividend yields. But, active investors are rotating out of common shares to preferred shares to generate excess returns.
>
> **2. <u>Improving liquidity</u>:** Limited liquidity has been a major hurdle to investments in preferred shares. With a seven-year de-rating, preferred stock accounted for only 0.9% of Kospi trading value as of Apr, which is relatively low given that preferred shares account for 2.9% of Kospi market cap. But, the preferred share trading value weighting has increased to 2.9-7.1% as investor interest grows and liquidity improves. Given that major shareholders have limited preferred positions, most preferred stakes are marketable securities and we believe the optimal weighting of preferred shares for trading value is 4-5%.
>
> **3. <u>Enhanced corporate transparency fades discounts</u>:** Corporate governance should improve following the recent problems with major shareholders and tighter regulations on business misappropriations. Given taxes on intra-affiliate transactions, bans on business misappropriations from last year and the new electronic voting systems, the power of major shareholders should fade. As we believe preferred shares are mostly discounted due to the lack of voting rights, the improving transparency should reduce the voting rights premiums, narrowing the price gap.

Buybacks and tender offers for preference shares:
A handful of companies in Korea have repurchased some of their preference share. Given the cheapness of the preference shares, this is clearly a strong way to increase shareholder value. While we would like to see more and larger preference share buybacks, we are encouraged that in the past few years Korean companies including Doosan Corp, Samsung F&M, Samsung Electronics, and Hyundai Mobis have repurchased preference share. We expect this trend to accelerate over the next few years.

Rising Dividend Yields:
Korean preference shares are legally required to pay a higher absolute dividend amount than the respective common stocks. Therefore, dividend yields for the preference

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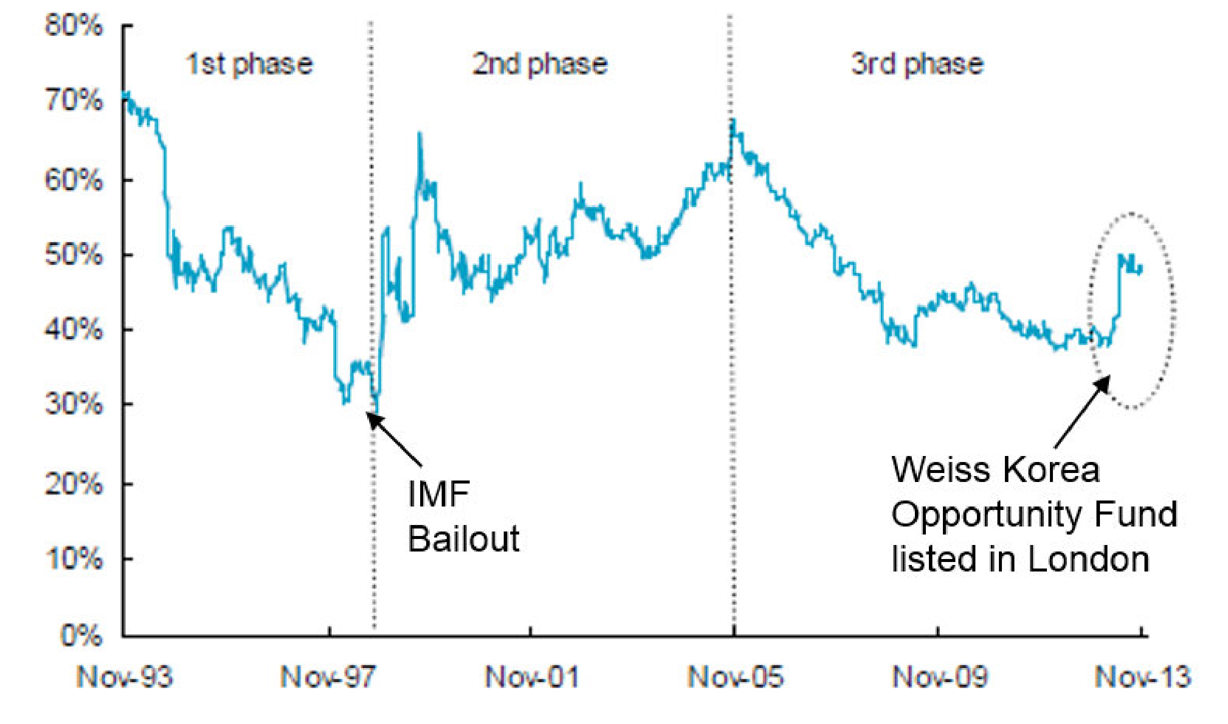
shares are often 2 to 3 times as high and mostly range between 2% to 3%. Many Korean companies have underleveraged balance sheets and could potentially increase their dividend yields even higher. In an investment world hungry for yield, we think this market anomaly (much higher yield on mostly equivalent securities) will continue to attract investors.

Price Discount Is Already Narrowing:

Figure 5. Relative price of top 20 preferred stocks by market cap compared to common stock



Note: The average of (preferred stock prices/common stock prices)
Source: Company data
Korea Investment & Securities Co., Ltd.

The chart above show the price discount history for the 20 largest Korean preference shares. From a recent peak of about 60% price discount (in the financial crisis of 2008), the price discount has narrowed to around 40% today. In past periods the price discount has narrowed to 30% or less.

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Importantly, our basket contains preference shares trading at discounts that are much higher than average. Currently, the average price discount in our basket is around 52% which implies large upside potential as our basket "catches up" with the top 20 preference shares and its price discounts narrow.

Expected Returns:

We make the flowing assumptions for our preference share basket:

- 5-year holding period.
- Average price discount narrows from 52% to 20%.
- Stock market appreciates 7% per year.
- 2% annual dividend yield.
- Conservatively ignore profit from trading between the different preference shares.

These assumptions lead to the following expected returns:

- 67% from price discount narrowing.
- 40% from common stock price appreciation (7% per year for 5 years).
- 10% from dividends (2% X 5 years).
- Total Return = (167% X 140%) + 10% –1.0 = 144% (almost 20% annualized IRR).
- If our thesis plays out in less than 5 years then the annualized IRR could be even higher.

Importantly, the risk of permanent capital loss is minimized since we invest in a diversified portfolio of 15 cheap, dividend paying, preference shares. As such we view this opportunity as compelling from a risk-reward standpoint.

About the Author:

Ori Eyal
Managing Partner
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Ori Eyal is the Founder and Managing Partner of Emerging Value Capital Management (EVCM) with over 14 years of experience in global value investing. EVCM manages a global, long-short, value hedge fund which invests based on Mr. Eyal's global investing framework.

Prior to launching Emerging Value Capital Management in 2008, he worked at Deutsche Bank Asset Management in New-York. At Deutsche Bank, Ori

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was in charge of identifying, researching, analyzing, and executing multiple investments in Korea and around the world, including investments in Korean Preference Shares.

Ori also performed global investment analysis at Deephaven Capital Management and at Aquamarine Fund. He has presented at several prestigious conferences including the Value Investing Congress (California), The Value Investing Seminar (Italy), the Best Ideas Conference (Online), and ValueX (Zurich).

Ori earned an MBA from the University of Chicago Booth School of Business, an MSc in Computer Science from the Open University of Israel and a BSc from the University of Maryland. In addition to investing, economics and emerging markets, his interests include logic games & puzzles, artificial intelligence, strategy, science/physics/astronomy, and the upcoming technological singularity.

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