RBC BlueBay
Asset Management

South Korea: where old meets new

Notes from the road

For Professional Investors Only | Marketing Communication

Emerging Markets
Equity team

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A lot can change in a year. Twelve months prior to this visit, arriving at Seoul Incheon airport meant being subjected to PCR testing that would best be described as 'thorough'. You would then leave, wait to be released later that day from your hotel room by a text message with your Covid results, before embarking on a series of facemask-clad meetings.

This time around, we were through and en route to Seoul city centre in no time, to get ready for a week of face-to-face discussions that really were face-to-face. With tourists also returning to town, it felt like things are back to normal.

> "Demographics was one of the most talked about topics during our trip, as Korea is ageing quickly."

One thing that has not changed is the feeling of vastness that hits you when you head through Seoul's metropolitan area. Travelling around the city and its satellite areas, it's plain to see how a country of nearly 50 million people manages to have half of its population concentrated in what is one of the most populous metropolitan areas in the world. It's easy to lose your bearings on long journeys between districts and satellite cities. The sheer scale is testament to the pull that the capital holds for Korea's young population with its jobs, culture and vibrant nightlife.

We say 'young population', yet demographics was one of the most talked about topics during our trip, as Korea is ageing quickly. With one of the highest life expectancies globally (87 for women and 81 for men[1]), but one of the lowest birth rates (at 0.78, the lowest among all OECD countries[2]), Korea is starting to face what some argue is a demographic crisis. The government is looking at how to reinvigorate Korea's demographics and workforce, including a potential change in retirement age from 60 to 65 to avoid a labour shortage[3], and is trying to incentivise the population to have more children by extending paternity leave, increasing financial support for children and improving childcare services. Speaking to several people living in the city, however, most cite structural trends including couples getting married later, expensive housing and the cost of education as the main impediments to increasing the birth rate.

[1] South Korea demographics 2023 (worldometers.info).
[2] South Korea's world lowest fertility rate drops again | Reuters.
[3] Discussion continues over extending the retirement age - The Korea Times.

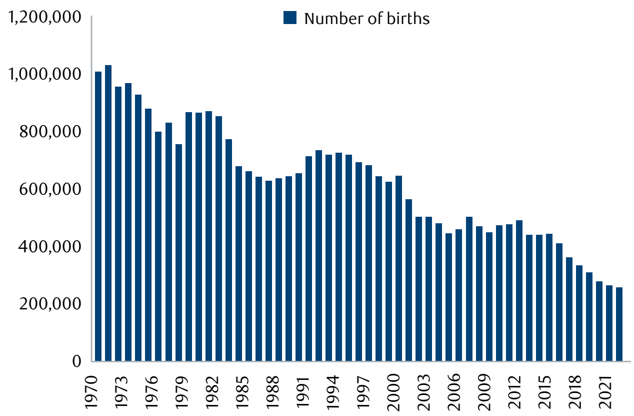
This backdrop can be challenging for Korean companies. While pride in local brands is incredibly high, as we were reminded by Hyundai and Kia's overwhelming presence on the Korean roads, many companies are having to look outside their domestic markets for long-term growth. Despite Korean culture being one of the country's headline exports, including entertainment and cosmetics, growing internationally and sustainably isn't always easy.

We did, though, hear about the opportunities demographic changes can bring. For insurers, a growing elderly population affords the opportunity for new products, including for nursing, and greater health coverage, while fewer children being born can lead to increased spending by parents to protect them. Demand for more specialised products, including areas like wealth management and pet insurance, could also surge in a country with both an aging population and an increasing number of single-person households. For healthcare and technology companies, a relatively large and savvy retirement population also creates ideal conditions for exploring new products and services.

"What we see from the Korean companies we invest in, however, is a real desire to improve corporate governance and shareholder engagement."

We often get asked about the quality and valuation of Korean companies. Korea's potential MSCI graduation from emerging to developed market status has been mooted for some time. As part of the preparations for any potential move, there has been a push by the government and regulators for corporate governance standards and company disclosure to improve. The perception of poor corporate governance and old-school practices have long underpinned the 'Korea discount', which hampers the valuations of Korean businesses irrespective of quality.

Figure 1: Korea's birth rate has sunk to a record low



Source: Korea Statistics Office.

Night time shopping in central Seoul.

What we see from the Korean companies we invest in, however, is a real desire to improve corporate governance and shareholder engagement. Our meetings on this trip provided further evidence of this. As a team, we have seen a noticeable improvement over the last decade in the quality of Korean company meetings. We have also enjoyed growing levels of access to management and board members as companies have become more willing to engage with us, as well as learn from best practice around the world. On this trip, we were able to meet with multiple members of companies' C-suite and senior management teams, many of whom have also travelled to London to meet us in the last 12 months.

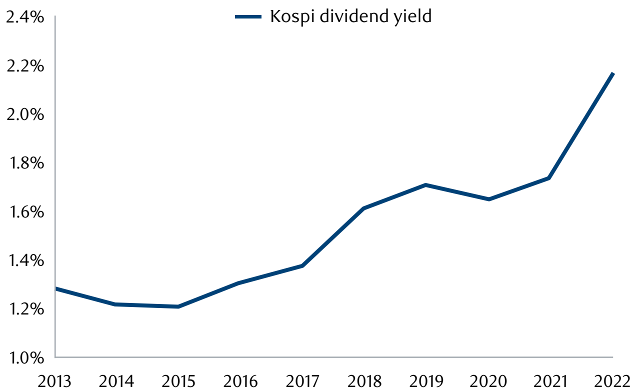
These meetings reinforced our belief that there are strong companies in Korea with durable franchises which are thinking about and acting on the interests of minority shareholders. Irrespective of whether Korea eventually achieves developed market status or not, we believe the efforts to get there will continue to drive an improvement in margins and returns within the country's equity market. We have already seen one example of improving corporate governance in the country through increased dividend payouts, as companies start to focus on minority shareholders' returns.

Robotic capabilities on display at a Korean technology company.

The dynamic city centre of Seoul.

Another structural growth area where we feel Korea has a real competitive advantage is AI. Korea has a heavy tech tilt, and we met various companies with exposure across the AI value chain. Semiconductors are one of Korea's main exports, along with autos and batteries, and AI is acting as a catalyst for memory heavyweights and portions of the tech supply chain after a particularly tough downcycle. The rewards are there for the companies that have been investing in innovation, capacity, talent, and their stakeholder relationships. We met a number of technology companies during our trip, undertaking facility tours, meeting management teams and speaking to companies about how they plan to sustain long-term durable advantages in the technology space.

Figure 2: The Kospi's dividend yield over the past 10 years



Source: CLSA, as at October 2023.

Over the longer term, Korea's shrinking workforce and technological prowess make it a prime candidate for increasing the use of AI and robotics within its domestic workplaces. This can also factor into improving employee benefits, corporate culture and workplace environment; visiting one technology company, as part of the facilities available to employees in their impressive 'smart' HQ, we ordered coffees on an app which were delivered five minutes later to our meeting room by a robot. Overall, we came away feeling confident that the AI 'picks and shovels' in Korea, including companies we own, have positioned themselves well to benefit from this long-term trend.

We also spent time in Busan, Korea's second largest city and the mainstay of the country's south coast. Korea is an export-oriented economy, and Busan is a reminder of Korea's industrial heritage, awash with factories and shipbuilding facilities around its large port. Korea can be something of a paradox for us as EM investors; one of the most developed countries in the world sitting within EM, a technologically-advanced nation with deep-seated industrial roots, and a culture where the modern and the traditional are rarely far apart. Our time in Busan epitomised this. We toured Asia's first vertically integrated container port terminal and spent an afternoon visiting a market-leading computer testing socket and pin equipment company, a technology business whose success has been built on traditional Korean values of humility, hard work, and attention to detail.

The last big talking point was the rise of the Korean retail investor. No-one could say that dynamics in the Korean equity market have been dull recently. The last three years have seen the number of individual domestic equity investors surge to almost a third of the population, rivalling the number of individual homeowners. As long-term institutional investors, this is something of a double-edged sword. On the one hand, we have seen short-term hype propel stocks in certain sectors to extremely stretched valuations for short periods; the EV battery value chain has been the main example in 2023.


Site visit to Busan New Container Terminal, Asia's first vertically integrated container port terminal.

[4] [Friday Focus: The Vertically-Automated Terminal (porttechnology.org).]

As long-term investors, sudden rallies like these that defy fundamentals can cause temporary headaches. The positive for us is that this can also work the other way, creating opportunities when stocks fall out of favour. In addition, in an increasingly polarised political environment in the country, the Korean government will need to act in the best interests of the domestic equity market to keep their supporter base onside.

> **"Reflecting on our trip, we continue to see the potential for long-term global winners to emerge from Korea."**

Reflecting on our trip, we continue to see the potential for long-term global winners to emerge from Korea. While selectivity remains vital in a country where corporate governance standards are still improving, Korea is home to a lot of companies that are positively exposed to the global growth themes that we look to gain exposure to in our portfolio. As such, we think that high hopes remain for the strongest players on the Korean field.

The modern and traditional sit side-by-side in central Seoul.

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