ALTERNATIVES RESEARCH

Private Equity in Korea

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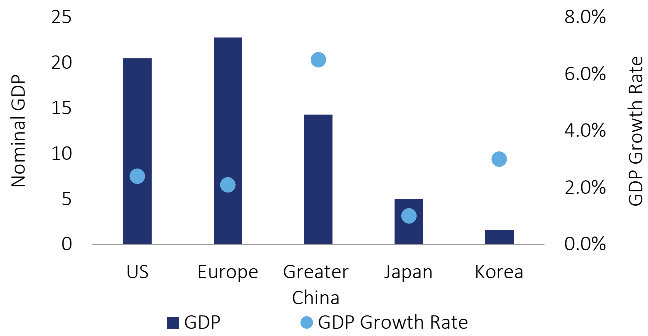
Macroeconomic Environment

Overview

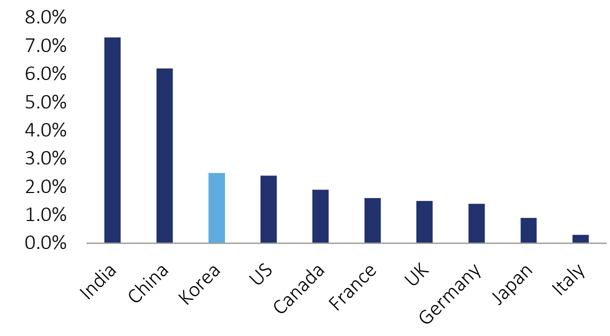
Korea currently stands as the fourth largest economy in Asia and ranks 13th globally with over $1.4 trillion GDP. It is also a member of the OECD and G20, and is widely recognized as a developed country, characterized by its free, well-developed capital market, mature legal system, highly educated workforce as well as advanced infrastructure. In addition, Korea is strategically well-positioned in North Asia between China and Japan, underpinned by a strong GDP growth which is at the higher end of advanced economies. During the past few decades, the Korean economy has been fueled by its export-led manufacturing industry. However, in recent years, the economy has transitioned to be more driven by domestic consumption and technology development. Furthermore, Korea enjoys one of the world's strongest fiscal balances and foreign currency reserves. Its sovereign credit ratings have been upgraded to AA, Aa2 and AA- by S&P, Moody's and Fitch, respectively, representing one of the highest among Asian countries.

Exhibit 1 – Nominal GDP & Real GDP Growth



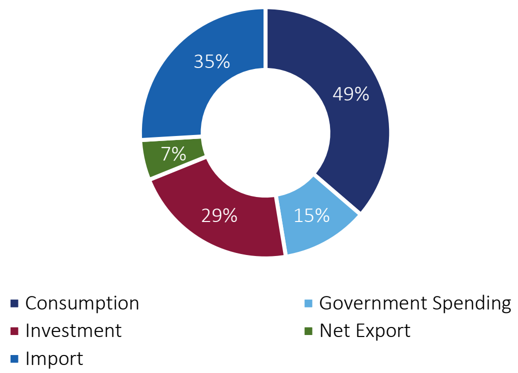
Source: EIU, as of May 2019

Exhibit 2 – Real GDP Growth Forecast (2019 E)



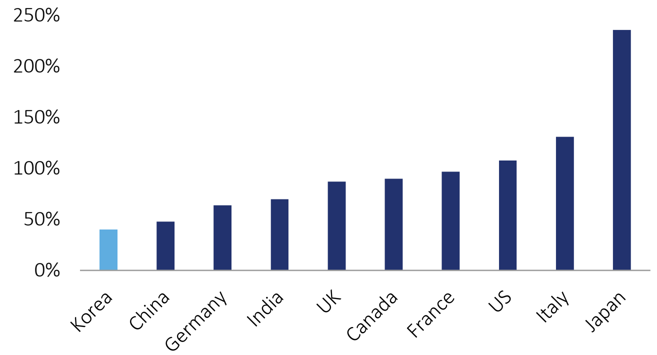
Source: Goldman Sachs, as of December 2018

Exhibit 3 – GDP Composition of Korea (2017)



Source: IMF, as of June 2019

Exhibit 4 – Government Debt to GDP (2017)



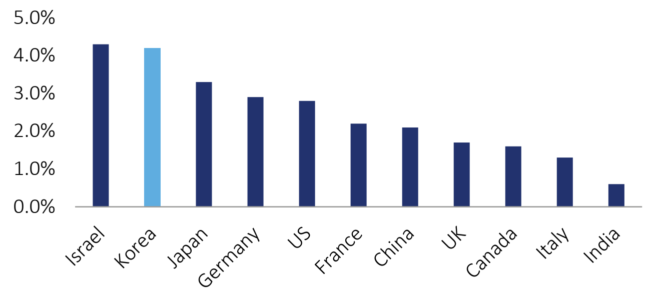
Source: IMF, as of June 2019

Exhibit 5 – Sovereign Credit Rating

	S&P	Moody's	Fitch
US	AA+	Aaa	AAA
Korea	AA	Aa2	AA-
Japan	A+	A1	A+
China	A+	A1	A

Source: Korea International Trade Association

Exhibit 6 – R&D Investment to GDP (2015)

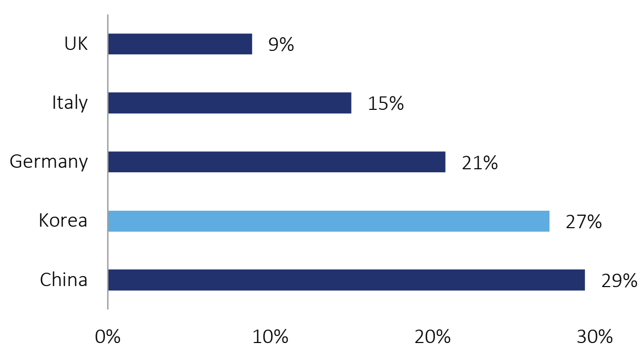


Source: World Bank

Prolonged, Export-Led Manufacturing Economy

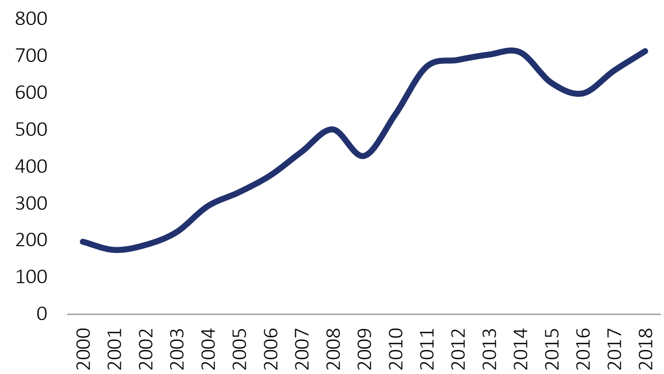
Korea has been recognized globally in key industries such as semiconductors, automobiles, shipbuilding and mobile devices. The country's global strength across these sectors positions Korea to become a global base for the manufacturing and supplying of high value-added, quality machinery and components, with a price competitiveness derived from its advanced R&D and manufacturing process capabilities. As a result, Korean GDP has tripled in the past 20 years driven by the manufacturing and export of goods in the country's core industries with a well-diversified export base. To date, export remains an important economic driver for Korean economy, benefitting from not only the growth in emerging markets especially Greater China and ASEAN, but also the rise of Korean consumer brands in global markets. In 2017, Korea ranked sixth globally in terms of goods and services exported. Nevertheless, Wilshire notices the current US-China trade war and uncertainty of global economy may impair Korea's export in the short term, which can be burdensome to Korean economy.

Exhibit 7 – Manufacturing's Contribution to GDP (2018)



Source: World Bank, as of June 2019

Exhibit 8 – Total Exports of Korea ($Billion)

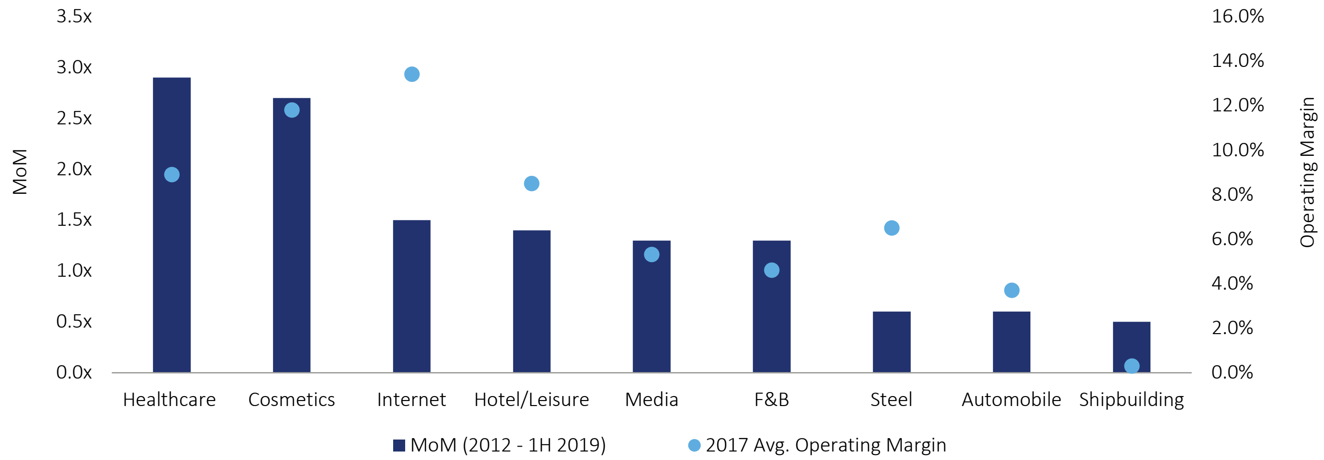


Source: World Bank, as of June 2019

Rising Domestic Consumption-Driven Economy

As the Korean economy matures, the domestic consumption becomes more sophisticated due to a pervasive demand of a higher quality of life. In addition, Korea's GDP per capita exceeded $30,000 in 2018, ranking the fourth amongst all economies in Asia and raising the consumer's purchasing power to a higher level. Resulting from all these factors, the Korean economy has seen a shift from heavy industries to consumer-focused industries, such as healthcare, cosmetics and internet.

Exhibit 9 – Stock Market Return & Operating Margin by Industry



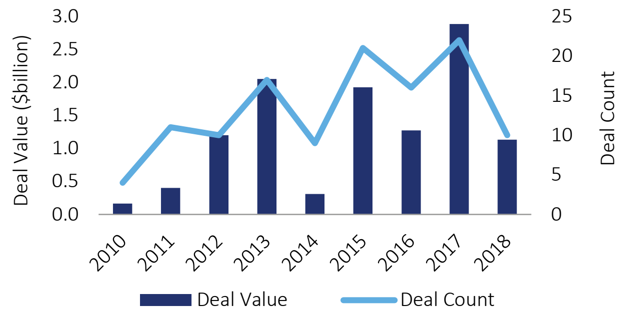
Unique Market Dynamics

Similar to Japan, Korea is characterized by an aging population and family-owned, chaebol conglomerates, which brings in attractive opportunities for private equity investments.

1) Aging Population

In 2017, the number of people aged 65 and above in Korea has surpassed 7.1 million, accounting for 14% of the population, and the median age of Koreans stood at 42 years old. The aging population has led to strong growth in demographic change-related industries. In addition, as aging entrepreneurs approach retirement, their next generations are reluctant to take over the businesses, creating a large amount of small- to mid- family businesses that are seeking full exit through buyout, as it provides confidential and relatively fast exits. In 2018, there were 10 succession deals totalling $1.1 billion in Korea.

Exhibit 10 – Succession Deals in Korea



Source: VIG Partners

2) Chaebol Conglomerates

The Korean economy is dominated by chaebol conglomerates, with the aggregate revenue of top 20 chaebol groups equivalent to approximately 70% of Korea's GDP in 2016. The chaebol conglomerates have a presence in dozens of uncorrelated industries, often directly competing with each other across multiple industries. Organizationally, chaebol business groups exhibit a centralized decision-making and capital allocation process that, while effective in the 1970s and 80s when Korea was heavily underdeveloped, now results in inefficiencies in today's globalized and highly competitive business environment. Due to increased competition both in domestic and export markets, the chaebol groups have had to increasingly focus on core business while disinvesting in non-core assets, leaving plenty of divestiture opportunities to private equity investors.

Exhibit 11 – Number of Affiliate Companies by Sector of Top 5 Korean Chaebol

	Samsung	Hyundai	SK Group	LG	Lotte
Consumer/ Retail	3	0	8	15	31
Chemical/ Energy	1	4	31	3	10
Construction	3	10	6	0	15
Industrial	3	6	9	10	4
IT/Tech	18	4	16	10	4
Finance	17	6	3	3	10
Median/Telecom	2	1	9	9	3
Auto	0	13	1	0	3
Other	15	9	18	19	11
Total	**62**	**53**	**101**	**69**	**91**
Avg. Revenue (KRW in billion)	**4,510**	**3,213**	**1,244**	**1,661**	**814**

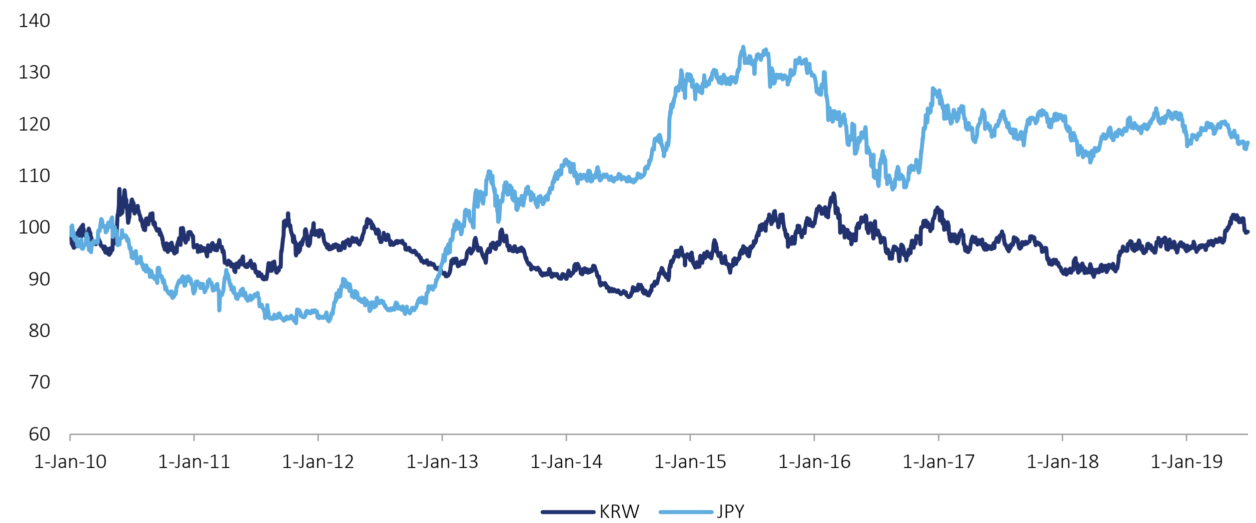
Stable Foreign Exchange Rate

The Korean Won has been largely stable against US dollars for the last decade within the range of KRW/USD 1000-1200. Although it has seen a depreciation since 2018 impacted by the US-China trade war, economists expect the exchange rate will recover slowly and stay stable going forward[1], backed by strong fundamentals such as abundant foreign currency reserves and continuing current account surplus. Korea's foreign exchange reserves hit a record high $405.5 billion in January, while the current account surplus reached $75 billion last year. Additionally, according to the Bank of Korea, the country's credit default swap premium on foreign exchange stabilization bonds with a five-year maturity came down to 32 basis points as of January 31 2019, the lowest level since the financial crisis of 2007-08. This credit default risk has shrunk lower than those of other major economies such as China, Britain and France, and further reinforced the lower volatility and higher stability trends of the Korean currency.

Exhibit 12 – KRW Exchange Rate

Source: Investing.com, as of July 18, 2019

Exhibit 13 – KRW & JPY Exchange Rate Movement



Source: Investing.com, as of June 30, 2019.

Note: Assume both KRW and JPY exchange rate to be 100 at the beginning day for benchmark.

[1] Exchange Rate in Korea, FocusEconomics

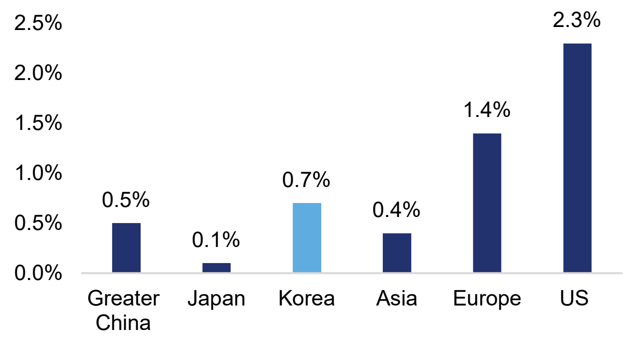
Private Equity Market

Private Equity Environment

The Korean private equity market has developed significantly since 2012, not only due to the greater pressure from the government on Korean corporations to restructure, but also due to the progressive change of public perception towards private equity investments. Rooted from a unique North Asian culture, financial investors such as private equity firms have long operated under a stigma attached to both labor unions and the mainstream public opinion. To date, with the recent success of private equity investments, private equity firms are increasingly regarded as healthy participants in the Korean business and social environment, which dramatically increased the opportunity set.

Nevertheless, Korea's private equity market remains underpenetrated relative to other advanced economies, due in part to the country's limited amount of private equity firms which have both sufficient capital and adequate experience for complex, control buyout investments. Additionally, just as other Asian markets, there is a substantial barrier to entry for foreign private equity investors without local knowledge and networks, despite their increasing interests in the Korean market. As a result, there are still considerable opportunities existing for private equity investors to enter the underpenetrated Korean private equity market and to seek alpha returns by unlocking potential values.

Exhibit 14 – PE Penetration of Nominal GDP (2018)



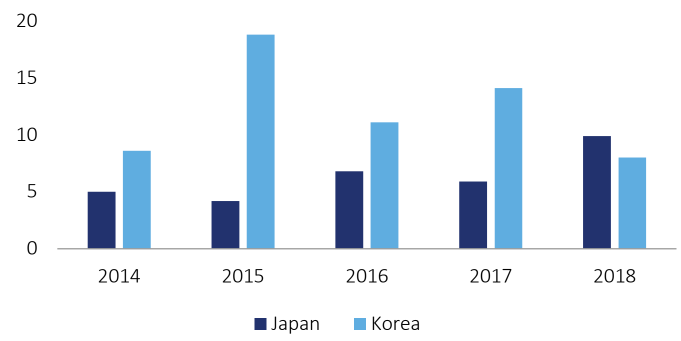
Source: Dealogic, as of May 2019

Fundraising Activity

In 2018, Korea saw a 44% dip in fundraising, from $14.1 billion in 2017 to $8.0 billion in 2018.This was the first time in the past five years that fundraising in Korea had dipped below that of the Japanese private equity market, partially due to the overfunding in the previous year with excessive dry powder.

However, Korean private equity funds stood well ahead in terms of the number of funds in the market, with several large-cap buyout funds currently fundraising for billions on target size, such as Hahn &Co. III and IMM Rose Gold IV.

Exhibit 15 – PE Fundraising in North Asia



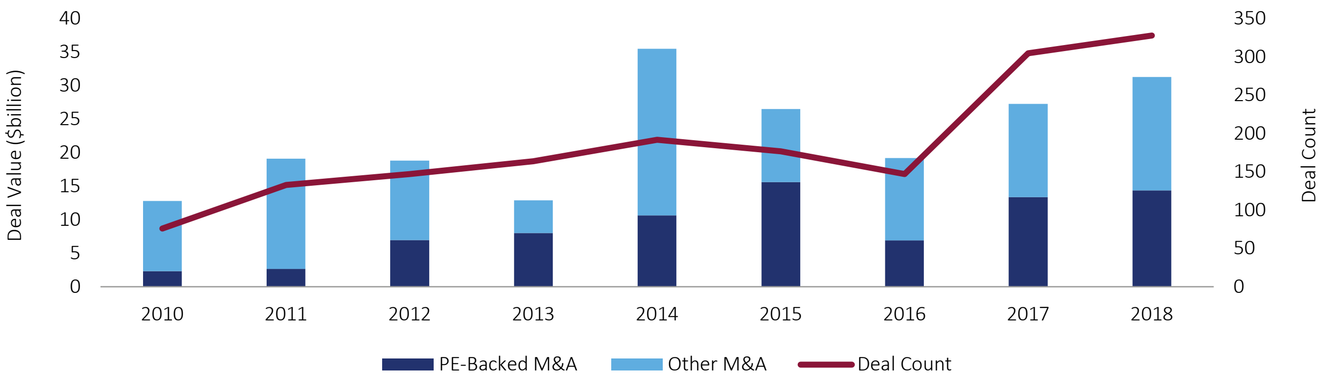
Source: AVCJ North Asia Report, 2019

Investment Activity

M&A Activity

Korea provides a unique set of factors that combine to make the country an attractive market for corporate control investments. M&A activity continues to increase in Korea, reaching $31 billion in total deal value in 2018, with private equity funds accounting for 46% of the M&A transactions. The total number of M&A deals exploded especially at small and mid-sized segments, significantly decreasing the average deal size in 2018.

Exhibit 16 – Korean M&A Market Size Trend



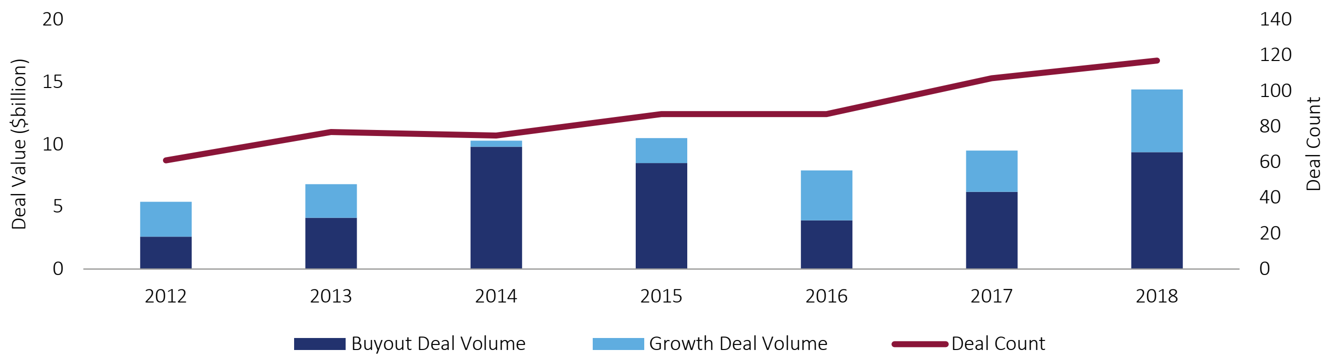
Source: AVCJ, Bain Analysis, as of January 2019

PE Activity

Private equity deal volume in Korea, dominated by buyout transactions, has grown steadily over the past few years. In the lower-middle market, as local firms increasingly open up with private equity investment, private equity firms are well positioned to take advantage of the aging population and succession issues in a huge pool of family-owned businesses to boost M&A transactions. This trend is further driven by the country's taxation and regulations. Korea's inheritance tax is one of the highest globally at 50 percent, and the progressive tax for controlling shareholders is 65 percent, far more than the OECD average of 26 percent. In addition, Korean regulation requires the largest shareholder in a business pre-IPO to remain for up to two years of time post IPO. These dynamics make selling a controlling share compelling as it avoids high inheritance tax and complexities associated with listing. In the large-cap market, private equity firms have also seen a mounting deal flow of chaebol carve-outs driven by the increasingly fierce competitions elaborated previously. According to AVCJ and Bain & Co's research[2], 8 of the 20 largest M&A deals in Korea were corporate carve-outs in 2017, implying a substantial rise from only one out of 20 largest deals in 2012.

In aggregate, the Korean private equity market reaches $14.4 billion in deal value with record-high 117 deals in 2018. Buyout deals and mid-sized deals ($100mn - $1bn) both accounted for around 60% of total private equity deal values, in terms of deal type and deal size, respectively.

Exhibit 17 – Korean private equity Market Size Trend



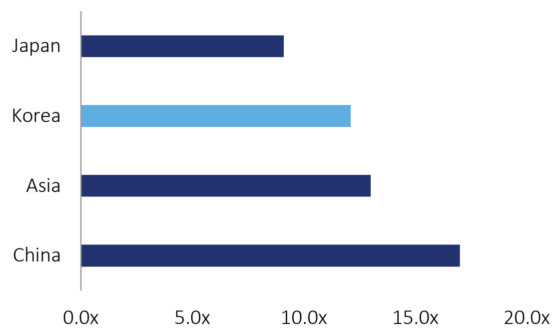
Source: Dealogic, AVCJ, as of January 2019

[2] Source: AVCJ, Bain & Co – Korean M&A/ PE Market Overview

Valuation Trends

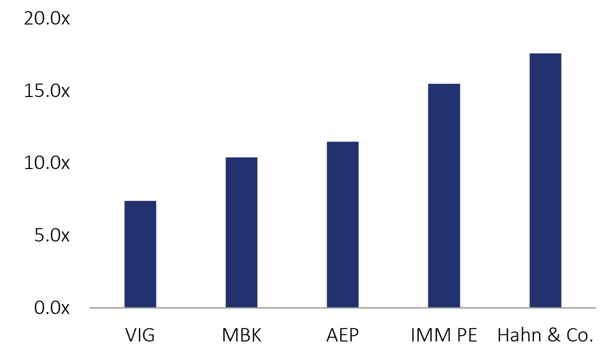
Korea has seen an increase in private market valuation since 2016, trending close to average valuation levels in the whole Asia-Pacific region during the past three years. This increase is mostly driven by the large-end private equity market in Korea with increasingly intensifying competition among global players.

Exhibit 18 – 2016-2018 Median Entry EV/EBITDA Multiple across Asia Markets



Source: Bain & Co. Asia PE Report 2019

Exhibit 19 – 2016-2018 Median Entry EV/EBITDA Multiple across GPs in Korea

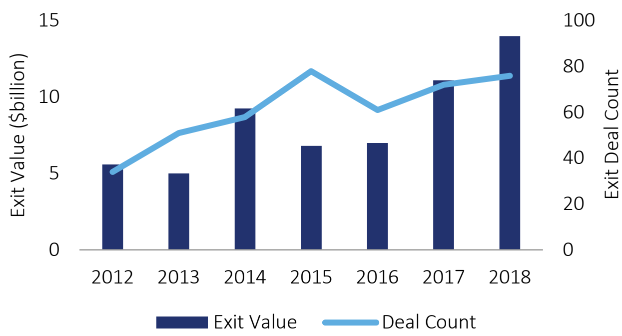


Source: Wilshire Analysis, VIG Partners

Exit Activity

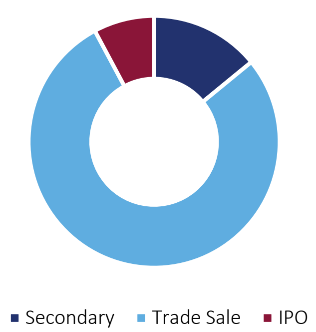
The exit environment in Korea has continued to improve for private equity funds. In addition to domestic investors, Korean private equity firms have seen an influx of Chinese and large global, strategic and financial investors in search of appealing private equity investments, which has in turn created an array of exit opportunities. Trade sales have been the majority of private equity exit type, followed by secondary exits. Additionally, a domestic IPO has become an increasingly viable exit route with the Korea Stock Exchange relaxing listing requirements and encouraging private equity funds to list their portfolio companies. In 2018, Korean private equity exits recorded $14 billion in total exit value, driven by large-cap deals with over $1 billion deal size.

Exhibit 20 – Private Equity Exit in Korea



Source: AVCJ North Asia Report, 2019

Exhibit 21 – Exit Value by Type in 2018



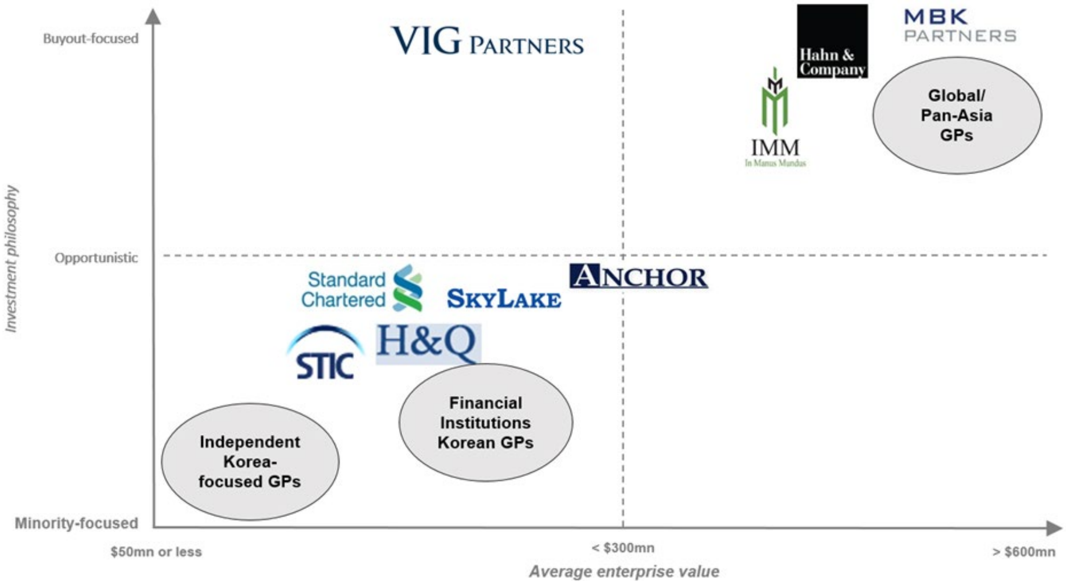
Source: AVCJ North Asia Report, 2019

Competitive Landscape

In Korea, the competition for deals has intensified slightly over the past few years due to the increasing number of new participants both at large cap and lower middle markets. However, despite the growing number of managers, there are a limited number of managers with a dedicated blind pool of capital. Only about a quarter of private equity funds have a blind of pool of capital and the rest operate on a deal-by-deal fund basis. The number of investable managers can be narrowed down even further after considering the quality of the team and the track record of the managers. Wilshire considers there are approximately 10 buyout and/or growth equity managers worth including in the Korean manager pool.

Similar to other developed markets, middle market and lower-middle market are less competitive while the larger-end of the market being relatively more competitive, as it is driven by the intermediation. However, considering the development stage of the private equity market, the large cap market is where experienced and capable investors are clustered. The middle market buyout space enjoys a void of capital as VIG is one of few providers of such capital. The lower-middle market has become increasingly crowded over the past few years due to the exponential growth of the number of spin-out teams, deal-by-deal funds, and the captive capital of domestic financial institutions.

Exhibit 22 – Private Equity Competitive Landscape in Korea



Source: Wilshire analysis, VIG Partners

Opportunity Set

USD Funds

Fund	Size (M)	Fundraising Status	Investment Focus
Affinity Asia Pacific Fund V	6,000	Closed in 2018	Pan-Asia large cap buyout
MBK Partners V	5,000	Raising	North Asia large cap buyout
Hahn & Company III	2,500	Raising	South Korea large cap buyout
IMM RoseGold PEF IV	1,500	Raising	South Korea large cap growth and buyout
Anchor Equity Partners Fund III	TBD	Raising	South Korea mid-market growth and buyout
VIG Partners IV	800	Raising	South Korea mid-market buyout

KRW Funds

Fund	Size (M)	Fundraising Status	Investment Focus
Unison Capital Korea II	KRW 500bn	Raising	South Korea small cap buyout
Glenwood Private Equity II	KRW 500bn	Expected in 2020	South Korea small cap buyout
Crescendo Equity Partners III	KRW 500bn	Expected in 2020	South Korea growth equity
SkyLake New Growth Buyout III	KRW 296bn	Closed in 2017	South Korea growth and buyout

Sources: Preqin, Wilshire analysis, as of 3/13/2019. Based on most up-to-date Preqin net ROI benchmarking for global buyout funds. For calculation, first quartile is equal to 1.0 and fourth quartile is equal to 4.0. Number in parenthesis indicates the number of most relevant funds with accessible performance data used to calculate the average quartile.

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