

Actuarially get a Life, or a Non-Life... around the DMZ!

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Hark! A new financial sub-sector for the Korea Stock Exchange Index (KOSPI)!

Long life or short life... or non-life?

The insurance sector on the bottom half of the Korean peninsula may be guaranteed neither to excite nor to hold the attention of the casual reader, but for operatives more closely involved, things are finally more than perceptibly changing, and roll up the “yo” (traditional Korean mattress rolled out on the floor for sleeping) and the “*ondo*” floors tell a tale! Grimm meets Aesop!

Life insurance comes with a hint of the possible oxymoron on a peninsula that remains to this day in a state of civil war 56 years after the cessation of formal hostilities and the signing of an armistice, a fact regularly attested by drivers and pedestrians on the streets of Seoul. Life insurance companies were traditionally abused by their grateful and rapacious industrialising owners as a cash flow generator and as an oblivious in-house lending proxy for a bank to support capacity expansion, and all related efforts and expenses, in a host of me-too projects. Chaebol could not own banks, but they could own insurance companies. Very much the old Korea.

Many projects and their supporting life insurance companies (around one third of all lifes) imploded in a horrendous asset-liability miss-match in the lead up to and in the backwash from the 1997 currency crisis. Those that did not implode have been carrying the millstone legacy and will continue so to do for years. *Aigoo* – interest rates, credit spreads and currencies moved when they should not have, and much credit became debit... terminally.

Ten years on, resurrected life insurance is belatedly on the move to greater transparency and accountability as it starts listing its shares on the Korea Stock Exchange ahead of the need to comply with tougher international regulatory standards (Risk Based Capital and IFRS)! As such this is to be applauded. The last significant financial sub-sector to come in from the unlisted cold, legacies and all.

As of end September 2009, the Korea Stock Exchange had a capitalisation of W810tr (US\$687.6bn) and financials represented 18.5% of the index, of which banks accounted for 12.96%, non-life insurance companies 2.21% and brokers 3.27%. Hence forward 2-3 years, listed life insurers could be capitalised at around W40tr for a weighting of around 5.5%, more than double the weighting of the listed non-life companies. To give the full index-weighted picture as of end September, Korea was 19.5% in MSCI Asia ex-Japan, and 15.3% in MSCI GEM. Korean life insurance companies could be 1.07% of MSCI Asia ex-Japan, and 0.81% of MSCI GEM! Allocate that to your pipe and smoke it.

How long have we waited for this? The first rumbles of debate were picked up give or take twenty years ago, at the time of some initial deregulation letting in new operatives and foreigners in return for government tax incentives for the incumbents, and IPOs... crocks, gold or otherwise, at the end of the rainbow!

But there were many impediments, crises of one kind or another, minor or major details depending upon who you were or how you looked at those details, and whether you were a participatory policy holder (ie thought you were entitled to a share of any listing as an effective mutual beneficiary) or not. Therein lies the riddle. The companies were/are joint stock companies rather than mutual insurers, but they had sold participatory policies which carry mutual baggage and mutual reward!

Ministry of Finance bureaucrats and regulators, the courts and the politicians were for years tied in a Gordian knot. The Chaebol major shareholders (or owners) of the life companies may have wanted to list, but did not want to surrender the proceeds of the listing to the participatory policy holders. Minority abuse requiring rewriting of rules, if listings were to boost lagging solvency ratios for more business as usual. Needless to say, the moment the companies realised that there was a “mutual” impediment to listing, they offered only non-participatory policies, but it was too late as the participatory policies were out there and in force.

Politics, politics, politics. Ten years of purported distributive socialist government under the Presidencies of Kim Dae-Jung and Roh Moo-Hyun “wrestled” with the situation.

The Alexandrian solution was many years in the making... finally arriving in April 2007 (by which time Roh Moo-Hyun was well into his lame duck period as President with only months to go to the next election). The Financial Supervisory Commission (FSC), the regulator, endorsed listing guidelines and defined policy holders as de facto creditors rather than de facto shareholders; list, up the solvency, and the minorities can go to... but there will be some form of subscription by all listing companies to a W1.5tr to a public fund for 20 years by way of recompense. Heard that one before. Thanks.

Scroll forward two and a half years, and the international institutional investor at the very least is required to sit up and take note; the passive fund manager will have to program in some new stock code numbers and learn some new names, even if the per force more sceptical active stock picker chooses to bide his time.

The first life insurance company out of the IPO traps was TongYang Life (082640.KS) which followed the less than resounding success of the Jinro “soju” IPO from Hite Holdings which had to be repriced.

TongYang, variously ranked 6-8th, listed its shares on the Korea Stock Exchange on 8th October at W17,000/share, priced at the bottom of the indicated range of W17,000-22,000, implying a price to embedded value (EV) multiple of 1.5 times. This was a 50% premium to the listed second tier non-life companies trading at or below 1x unaudited EV (for the technically minded this is not an apple to apple comparison as life EV is all life, and non-life EV is ex casualty so material). On listing day the share opened at W15,700, a drop of 7.6%, and fell a further 9.9% to W14,150 in market hours. As of mid-November it has just dipped below W14,000, 17% below its IPO price. Small life scarcity seems now to imply only a 1.2 multiple to EV... or a 20% premium down from 50% at IPO. A good one to have avoided...?

A total of 20.2 millions shares were offered (10.75m new shares, 10% of the enlarged capital, and 9.27m existing shares, 8.2m from TongYang Capital and 1.07m from the Vogo Fund, a local private equity fund with its own propensity to attract headlines). Post IPO the TongYang Group stake dropped to 49.5%. Institutions were allocated 66% in the IPO, domestic retail 20% and 14% went to the Employee Stock Ownership Programme (ESOP). W340bn was raised. However, it is of particular note that 46% from the 66% institutional allocation was taken by international investors. The retail portion was oversubscribed by 12.6 times, perhaps driven by the strong overseas institutional interest. Foreigners wanted it, the domestic institutions were not so sure and retail (*gemi* – ants) went with the international flow. For now it is a bit of ouch.

Who's up next? Korea Life (no.3), owned by Hanwha (good story behind this one), is in process for mid '10 as is Mirae Asset Life (a tiddler). There are another five potentials; Dongbu Life, Kyobo Life (no. 2 – another good story involving Daewoo International, owned 35% by KAMCO and 11.2% by K-Exim Bank so government, itself up for “privatisation” and all three, owning 39.8% in Kyobo, just behind the Shin family's 40.27% - rumours abound), Green Cross Life, Kumho Life, and the elephantine Samsung Life (no.1).

The top three account for about 60% of sector assets, Samsung is 30%, and the top three are 55% of premium income.

All will want to squeeze out into the market before Samsung Life arrives to kill investor appetite. It could be a busy few years in the flotation department with shuffling investment banking allegiances. And Samsung could just play timing ball, as it has a raft of its own impediments... or it could not. There are reports that as of 16th November, the company has requested proposals from prospective investment banks and securities companies to lead its IPO...!

Epitome and metaphor.

Samsung Life lies at the heart of much that was and is Korea. It was founded in 1957 as DongBang Life Insurance, and employed widows from the Korean War as door-to-door saleswomen selling savings policies offering a slight premium over bank deposits. The founding family got into difficulties, and in 1963, the government arranged sale to the Samsung group. The name was changed in 1989, ahead of market deregulation which opened the market to new entrants, and foreigners. As already mentioned, the sops were a tax exemption and proposed IPOs.

More recently Samsung Life is embedded in the fourth act of the scrappy five act tragi-comedy that was Samsung Motors (SM). SM was the Samsung group's internally combustible and peccadillo attempt to enter the car industry from a wheel-less green field farm yard standing start in 1994 with rebranded Nissans. The first cars appeared in 1998 ...ahem... just months after the currency crisis of late 1997. The virtual bankruptcy of the country killed domestic demand. Come back the Hyundai Pony, the Daewoo Tico and the Kia Pride, all is forgiven! SM failed spectacularly under debt of W2.45tr from 14 financial institutions and spluttered into court protection in June 1999. SM is self-inflicted financial pain; no pleasure there.

Group Chairman Lee Kun-Hee pledged to creditors 3.5m shares, or 17.5%, in Samsung Life. At the time these were claimed to be each worth W700,000 for a notional value of W2.45tr. It was also agreed that Samsung Life would list by the end of 2000. Any shortfall following listing/disposal would be made up by up to a further 500,000 shares from Mr Lee, and anything above and beyond would be guaranteed by 28 Samsung group companies. Done. And minority shareholders in the 28 group companies... By the way, the OTC price in Samsung Life shares was W477,000 prior to the reports of RFPs, but "jumped" to W653,000. Ahhhhh.

But in the absence of the FSC ruling of April 2007 endorsing listing guidelines, at the time no more than a twinkle in the regulator's eye, the previously eagerly anticipated Samsung Life listing unsurprisingly failed to happen by end 2000!

So things slowly moved on. Seoul Guarantee Insurance sold 1.1m of the pledged shares in the OTC market (who picked these up?). Come December 2005, the frustrated creditors filed a law suit with the Seoul Central District Court against Mr Lee and 28 group companies claiming W2.45tr in principal and W2.88tr of deferred interest at a penalty rate of 19% per annum. The court's first ruling took a further two years plus, and was finally delivered on 31st January 2008 in favour of the creditors; sell 2.33m shares, a further 500,000 shares from Mr Lee to cover any shortfall, and any further shortfall to be covered by 28 group companies. The deferred interest rate applicable was slashed from the claimed 19% to 6%. The court thus required an adjusted W2.3tr settlement with future interest accruing at 6%.

Within days in February 2008, Samsung appealed to the Seoul High Court. After due deliberation and 21 months, this court was due to present its final decision on 10th November 2009. It has baulked at the last, and has instead proposed arbitration, the first attempt falling on the same 16th November. Instead of agreeing a settlement, the IPO RFPs were disclosed.... A second attempt at arbitration will happen on 7th December. Discounted closure around the corner? Maybe.

The SM saga, together with ownership of Samsung Life and Everland (unlisted theme park operator and de facto Group parent) is at the heart of any potential restructuring of the Samsung Group, and the aspired generational transfer of control. As of end September 2009, Mr Lee owns 20.8% of Samsung Life (post his earlier pledge of 3.5m shares), after various false name accounts “handed over” their shares. Samsung Everland owns 19.3%, Shinsegae 13.6%, CJCJ 4.8%, the Samsung Foundation of Culture 4.7%, Samsung Life Public Welfare Foundation 4.7%, CJ Corp 3.2% and the ESOP 2.8%.

There is the issue of under-priced OTC warrants into shares of... Samsung Everland issued to Lee Jae-Yong, the crown prince, who now owns 25.1% of Samsung Everland (family stake 51.1%). So what?



The parent of US\$173bn in revenues in 2008 and 20% of Korea’s exports

Source: http://www.forbes.com/2002/03/21/0321feat_6.html

Samsung Group Financial Summary (addition of Group company numbers – not consolidated)

Wbn	1997	1999	2001	2003	2005	2006	2007	2008
Sales	66,571	88,968	125,199	117,520	143,660	151,293	163,490	190,883
EBIT	4,465	7,455	6,500	9,148	10,023	11,354	11,662	10,785
Net	282	3,699	5,517	6,909	9,757	12,329	12,834	11,140

Source; KRX, Samsung Securities

Samsung Electronics Parent Company – not consolidated)

Wbn	1997	1999	2001	2003	2005	2006	2007	2008
Sales	18,465	26,118	32,380	43,582	57,458	58,973	63,176	72,952
EBIT	2,856	4,481	2,295	7,193	8,060	6,934	5,943	4,134
Net	126	3,170	2,947	5,959	7,640	7,926	7,425	5,526

Source; KRX, Samsung Securities

Everland, the unlisted theme park, owns 19.3% of Samsung Life, which owns 7.3% of Samsung Electronics ... add on the 38.4% that Life owns in Samsung Card, the 28.7% that Electronics owns in same Card, and the 25.6% that same Card owns in Everland ... stir gently on the roller coaster and simmer, and any reader will be forgiven for feeling dizzy... but it is the business of life insurance that occupies this submission.

Korea is listed as the 7th largest life insurance market in the world with a high penetration rate. Not bad for a country of 48.6million (World Bank, 2008). But that would suggest a mature market rather than a growing one. Lift the "yo", and it transpires that the historic base of life insurance is actually the sale of savings products, rather than protection policies. These were actuarially Long Term Mutual Savings Banks by another name. Protection product penetration is much lower, but is a growing market with an aging population. Over 15 years, foreign market share exploded from a very low base at the time of the Asian crisis to around 25%, but post-Lehman is fast evaporating – estimated at 14% and falling: there is a flight to domestic quality. Absolute growth in the protection market compounded by recovering market share. Not bad for starters.

The asset side also has a rosy outlook. Institutionalised corporate pensions will be mandatory from end 2010. Current labour law and practices favour a retirement allowance whereby a company pays out in cash at "severance" one month salary equivalent for every year worked, but at the average monthly salary of the last three years worked. Where they have them, companies generally keep these allowances in cash on their balance sheets. That will change. By end 2010, an estimated W50tr of retirement allowance cash will convert to corporate pensions and migrate to institutions joining the W9tr already migrated; and then there will be the annual contributions, maybe as much as W80tr from 2012. No problem gathering assets, they will come. Two down and just one to go!

So, management and their abilities to manage, and to price and manage risk? How many CFO's and members of senior management are internationally qualified actuaries? How many understand EV? Comprehension and qualification may just not reside in great depth. Recall that these companies managed to miss-price their savings policies offering long term fixed rate guaranteed returns which looked good back then, but have been legacy millstones for years, eroding solvency. Legacy issues still have years to run but that in itself could represent an opportunity. But are the inevitable IPO premium expectations to EV justifiable? Management probably has much to prove in entering a listed world...

Actuarially, Meatloaf may neatly sum it up in one of his songs; "Now don't be sad, don't be sad, 'Cause two out of three ain't bad".

So, index impact significant, and market impact significant. Premia to EV? Long life, or short life? Or pair trade with non-life? Or long non-life?

Once the IPOs are out of the way, the dust settles, and tricks are learned, there could be something here for the long term return on EV. We shall see, but whatever, we will all have to take note.

And long life, short life or non-life north of the DMZ?

Life expectancy north of the DMZ at birth is around 63.8 years compared to 78.7 years to the south. That suggests a 15 year premium for South life versus North non-life ...

But life does seem to go on, just, amidst reports of floods, expected food shortages, of stand-in doubles and ever slimmer and more gaunt images of the Dear Leader, Kim Jong-Il. His reported schedule of on-the-spot utterances suggests some recovery in his health, but grave suspicions remain. Missiles are readied, ships loose off, and now there are suggestions in certain quarters that the Dear Leader may have "weaponised" water in two unprovoked water attacks on the south.

On 27th August, the DPRK discharged 7,400 tons of water a second for two hours from one dam – this attack seems to have been dealt with, presumably with the help of river banks, gravity and ultimately the sea, and hushed up. Recon, probing, or skirmish? Just days later there was a second more devastating attack over a weekend involving 40 million tons of water released at 1,500 tons per second from the Hwanggang Dam. The Imjin River rose 2 metres, and six southern campers were lost.

But at an individual level perhaps the state of life and non-life is encapsulated by the highly contrived, but very limited and occasional, family reunions between North and South. There are an estimated 600,000 people in the South with relatives in the North. In late September, 97 South Koreans met 228 members of their North Korean families at the Mt Kungang resort in the DPRK, and a matching 99 North Koreans met with their relatives from the South. This was the 17th round of such reunions but the first for 23 months; the first reunion happened in 1985.

As ever the scenes throughout, but particularly at the end, were harrowing melodrama made for television. Family members permitted to spend a few hours together in contrived situations for the first time in almost 60 years with no interim contact or knowledge, and then it was all over. They will probably never see each other again. Demand is high and capacity is a couple of hundred a time. The lucky few will consider it worth the few hours despite the pain, the unlucky many may never ever get to see their families as everyone is getting older. Things move slowly in North-South relations. What a life.

I bet he drinks Carling Black Label...well Taedonggang Maekju!

There has somewhat unusually been summer movement in the DPRK beer and broadcasting markets. Back around the turn of the century, Ushers, a British brewery, sold a surplus plant to the DPRK for a reported Stg1.5m; the plant was dismantled on site by North Korean technicians, and shipped to the DPRK for reassembly.

It has been producing beer under the brand "*Taedonggang Maekju*", (Taedong River Beer) and in July, the Korean Central News Agency broadcast its first beer commercial claiming the beer was the "pride of Pyongyang" and that it was brewed to international specifications under the ISO 9001 quality standard. No mention of whether it was probably the best lager in the world... or the parts that it may or may not reach!

A number of other commercials promoting inter alia ginseng and quails were also produced. Cha Sung-Su, Chairman of the Central Broadcasting Committee, was apparently responding to instructions from Kim Jong-Il to "produce more interesting and diverse programmes". Cha, 69, is known as being close to Kim Jong-Il, has been a regular companion on trips of inspection, and was the top TV man north of the DMZ, having served on the Central Broadcasting Committee for four decades.

It seems that the beer commercial, on closer viewing by the Dear Leader, did not live up to expectations. He expressed his strong disappointment, stating "they are as degrading as the ones that China had in its earlier reform". Those were presumably the source of Mr Cha's artistic imitation...errr...inspiration...anyway, he will be broadcasting little for now, as he has been sacked. Take a look at the following link to see why - <http://news.bbc.co.uk/2/hi/asia-pacific/8132199.stm>



Satellite image ...of the Taedonggang Maekju malt reprocessing plant

Source: <http://news.bbc.co.uk/2/hi/asia-pacific/8110093.stm>



And the DPRK at the 2010 Soccer World Cup in South Africa!

....rumours abound of an approach made to Sven-Goran Eriksson, former national coach of the England soccer team to accept a coaching position for the DPRK team at the World Cup. His record suggests that he will look at most things both on and off the football pitch, but this seems to have been a pitch too far.

Life for Eriksson would not seem to be on the peninsula.