

KOREA FUND INC
Form N-CSR/A
September 03, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED
MANAGEMENT INVESTMENT COMPANIES
Investment Company Act file number 811-04058

The Korea Fund, Inc.
(Exact name of registrant as specified in charter)

1633 Broadway, New York, NY 10019
(Address of principal executive offices) (Zip code)

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Lawrence G. Altadonna

1633 Broadway,

New York, New York 10019

(Name and address of agent for service)

Registrant's telephone number, including area code: 212-739-3371

Date of fiscal year end: June 30, 2014

Date of reporting period: June 30, 2014

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Item 1. Report to Shareholders

Annual Report

June 30, 2014

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The Korea Fund, Inc. Portfolio Manager's Report

June 30, 2014 (unaudited)

During the fiscal year ended June 2014, the MSCI Korea Index (the Index) gained 10.2% in KRW terms and 24.4% in USD terms. The market movement was a sharp reversal from the first half of calendar 2013, where the Index fell 13.0% in USD terms. Especially during the second calendar quarter of 2013, where the Korean market fell sharply along with many other emerging markets on concerns over the US Federal Reserve's tapering of its quantitative easing (QE) program. However, Korean equities had a relatively fast recovery in the second half of calendar 2013 as the market increasingly recognized Korea's robust financial health. Korea's foreign reserve amounted to 5.1% of GDP whilst its current account surplus also exceeded 6% of GDP in the second half of calendar 2013.

From July 2013 to June 2014, the Korean won appreciated towards the critical export competitive levels of KRW 1,000 against the US dollar and KRW 10 against the Japanese yen. The Korean won reached those levels back in 2005 with little impact to the domestic economy. However, compared to the robust export demand in 2005, the current external environment is more challenging. Some key exporters such as auto companies are particularly at risk as they compete directly with the Japanese auto makers. Whilst the won's strength is partly the result of strong exports, it also reflects the very slow CAPEX investments in Korea. Given Korea's large current account surplus, the upward pressure on its currency is likely to stay in the medium term.

On the policy front, President Park announced her Three year Innovation Plan marking her first anniversary in office in February 2014. Her reform program targets 4% annual GDP growth, 70% overall employment rate and above USD30,000 per capita income in the next three years. Under her plans, public sector companies are urged to restructure and shore up their balance sheets. For private sector growth, the government is introducing policies to support small-to-medium sized enterprises and recognizing the slowdown in domestic consumption in recent years, the government has also been developing plans to boost tourism and support the housing market.

A significant trend we have observed since the end of 2013 is the improvement in the property market. Due to unfavorable housing policies and slower economic growth, Korea's property market has stayed weak in recent years while most other Asian countries saw strong house price appreciation. However, a number of indicators are now pointing towards a recovery. These include rising rents, good affordability, stable supply and the declining inventory of unsold apartments. Housing transaction volume had stayed low for the past 2-3 years, but has noticeably picked up since the fourth quarter of 2013. Meanwhile, the housing price index from Kookmin Bank showed house prices trending upward over the past few months after declining since 2008. The sentiment among potential home buyers has also shown improvement. While we are not yet sure about the strength or speed of the potential recovery, we do feel that the housing cycle has likely passed its trough. Furthermore, government policies towards the housing market have been supportive during the past year. However, if contrary to our expectations, the property market continues to stay weak, there is room for the government to introduce further supportive measures in the areas of taxation and relaxation of mortgage restrictions. Given that real estate accounts for a large portion of household assets, a healthier property market tends to have considerable influence on consumer sentiment through the wealth effect. Historical data shows a high correlation between consumption and house prices. Historical data also shows a high correlation of housing prices to loan growth and a high inverse

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The Korea Fund, Inc. Portfolio Manager's Report

June 30, 2014 (unaudited) (continued)

correlation to the corporate bill default ratio. Hence, the banking sector is also an indirect beneficiary of a stronger property market.

Although Korea's currency has been strong, it has not discouraged tourists from visiting the country. In recent years, we observed strong growth of Asians traveling overseas together with increasing income levels in the region. At the same time, Korean pop culture has gained strong popularity among many Asian countries and has helped make Korea an increasingly popular holiday destination, especially for Chinese tourists. In 2013, the number of Chinese tourists grew by 53% from 2012 to 4.3 million. For the first five months of 2014, the Chinese inbound tourist number grew yet another 57%. As a result, tourist spending has seen strong growth in Korea, benefiting such companies as duty free shops and casino operators. In fact, one of the major duty free shop operators has capitalized on its success in Korea and is expanding to other airports in Asia.

The mobile internet is another area where Korean corporates are finding growth opportunities. One example is a Korean internet company, who had initial success in Japan with its free messenger system on smartphones and is now seeing fast expansion in Spain and South America as global smartphone penetration continues to rise. In the retail space, the growth in online shopping has been strong as it allows consumers to easily compare prices and product features. Some of the traditional consumer companies also find mobile commerce a powerful new channel to broaden their customer base and capture more sales. We expect this migration of consumers to online platforms to continue, as more Koreans start to shop using their smartphones.

Fund's Performance

For the year ended June 30, 2014, the total return of the Korea Fund, Inc. on a NAV basis was 22.84% (net of fees). The Fund underperformed its benchmark MSCI Korea Index by -1.54%.

Performance Attribution Review

From July 2013 to June 2014, our stock picks in the information technology sector contributed the most to the Fund's performance, while our stock picks in the industrials sector and the underweight in consumer staples sector hurt performance.

Outlook

The US Federal Reserve's QE program is expected to end in the second half of 2014. Without QE, capital flows into Asian markets including Korea may weaken or reverse, hence draining liquidity in the stock market. However, even if global monetary conditions were to turn less favorable, we expect the Korean market to be relatively resilient. Currently at 2.5%, Korea's short term interest rates are significantly higher than those in the US, which have stayed near zero since 2009. Compared to many Asian countries, credit growth in Korea has been moderate over the past few years. The corporate sector has not been investing aggressively and as a result their cash flows and balance sheets are generally healthy.

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The housing market has been in the doldrums until late last year and therefore we believe the risk of an asset bubble in Korea is quite low. Simply put, Korea's economy has seen relatively small distortions from QE, compared to some other Asian economies that have grown dependent on rising asset prices and rapid credit growth.

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The Korea Fund, Inc. Portfolio Manager's Report

June 30, 2014 (unaudited) (continued)

Another macro development that may affect the Korean equity market is the slowdown in China's economic growth. Korea's export exposure is well diversified, but China still is the largest export destination. Despite the Chinese government's effort to support growth, the economic slowdown is likely to continue, as it will take time to digest the aggressive fixed asset investments made since 2008. Therefore, sectors that are exposed to China's construction demand, such as steel and petrochemical, are likely to remain under pressure. However, there are some bright spots. Unless the Chinese economy suffers a hard landing, tourism from China will likely see continued strong growth and benefit the related consumer companies in Korea. Also some companies have achieved some success in building their brands within the Chinese consumer market.

In the near term, we believe Korea's corporate earnings are unlikely to offer many positive surprises due to the currency's impact on exporters and lackluster domestic economy. While we do not have a strong view on where the currency will be heading in the next few quarters, we expect the continued recovery in the global economy to eventually benefit Korean exporters. At the same time, the government seems more determined to boost consumption through changes in housing regulations and tax policies. We are hopeful that these measures will have some success in the next few quarters. In terms of valuation, the MSCI Korea's forward PER is 9.4x, slightly above its 10 year average of 9.0x and at an 18% discount to the MSCI Asia ex-Japan index. With an undemanding valuation and with the corporate earnings outlook expected to improve, we hold a positive view on the Korean equity market.

The information contained herein has been obtained from sources believed to be reliable but the investment manager and its affiliates do not warrant the information to be accurate, complete or reliable. The opinions expressed herein are solely those of the Fund's Portfolio Manager and are subject to change at any time and without notice. Past performance is not indicative of future results. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Investors should consider the investment objectives, risks, charges and expenses of any mutual fund carefully before investing. This and other information is contained in the Fund's annual and semiannual reports, proxy statement and other Fund information, which may be obtained by contacting your financial advisor or visiting the Fund's website at www.thekoreafund.com.

This information is unaudited and is intended for informational purposes only. It is presented only to provide information on investment strategies and opportunities. The Fund seeks long-term capital appreciation through investment in securities, primarily equity securities, of Korean companies. Investing in non-U.S. securities entails additional risks, including political and economic risk and the risk of currency fluctuations, as well as lower liquidity. These risks, which can result in greater price volatility, will generally be enhanced in less diversified funds that concentrate investments in a particular geographic region. The Fund is a closed-end exchange traded management investment company. This material is presented only to provide information and is not intended for trading purposes. Closed-end funds, unlike open-end funds, are not continuously offered. After the initial public offering, shares are sold on the open market through a stock exchange, where shares may trade at a premium or a discount. Holdings are subject to change daily.

Table of Contents**The Korea Fund, Inc. Performance & Statistics**

June 30, 2014 (unaudited)

Total Return⁽¹⁾	1 Year	5 Year	10 Year
Market Price	23.93%	12.27%	10.97%
Net Asset Value (NAV ⁽²⁾)	22.84%	13.09%	9.75%
MSCI Korea (Total Return) ⁽³⁾	24.38%	15.00%	12.17%
MSCI Korea (Price Return) ⁽³⁾	23.31%	13.94%	10.87%
MSCI Korea (Custom Benchmark) ⁽³⁾	25.12%	15.05%	12.55%
KOSPI ⁽⁴⁾	21.29%	12.64%	11.27%

Premium (Discount) to NAV:

June 30, 2004 to June 30, 2014

Industry Breakdown (as a % of net assets):**Market Price/NAV:**

Market Price	\$42.72
NAV	\$47.33
Discount to NAV	-9.74%

Ten Largest Holdings (as a % of net assets):

Samsung Electronics Co., Ltd. Manufacturer of electronic parts	18.5%
Hyundai Motor Co. Manufacturer of automobiles	8.9%
SK Hynix, Inc. Manufacturer of memory and non-memory semiconductors	6.9%
Hyundai Development Co. Civil engineering and architecture construction businesses	5.0%
Korea Zinc Co., Ltd. Manufacturer and marketer of non-ferrous metal products	4.8%
Hotel Shilla Co., Ltd. Operates hotels and duty free shops	4.4%
OCI Co., Ltd. Manufacturer of chemical products	4.1%
Hankook Tire Co., Ltd. Holding company for manufacturing and distribution of tires	3.8%
NAVER Corp. Provider of Internet services	3.6%

Shinhan Financial Group Co., Ltd.
Provider of financial products and services

3.3%

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The Korea Fund, Inc. Performance & Statistics

June 30, 2014 (unaudited) (continued)

- (1) **Past performance is no guarantee of future results.** Total return is calculated by determining the percentage change in NAV or market price (as applicable) in the specified period. The calculation assumes that all dividends and distributions, if any, have been reinvested. Total return does not reflect broker commissions or sales charges in connection with the purchase or sale of Fund shares. Total return for a period of more than one year represents the average annual total return.
- Performance at market price will differ from results at NAV. Although market price returns typically reflect investment results over time, during shorter periods returns at market price can also be influenced by factors such as changing views about the Fund, market conditions, supply and demand for the Fund's shares, or changes in the Fund's dividends.
- An investment in the Fund involves risk, including the loss of principal. Total return, market price and NAV will fluctuate with changes in market conditions. This data is provided for information purposes only and is not intended for trading purposes. Closed-end funds, unlike open-end funds, are not continuously offered. There is a one-time public offering and once issued, shares of closed-end funds are traded in the open market through a stock exchange. NAV is equal to total assets less total liabilities divided by the number of shares outstanding. Holdings are subject to change daily.
- (2) See Note 8 in the Notes to Financial Statements.
- (3) Morgan Stanley Capital International (MSCI) Korea Index is a market capitalization-weighted index of equity securities of companies domiciled in Korea. The index is designed to represent the performance of the Korean stock market and excludes certain market segments unavailable to U.S. based investors. The MSCI Korea (Total Return) returns assume reinvestment of dividends (net of foreign withholding taxes) while the MSCI Korea (Price Return) returns do not and, unlike Fund returns, do not reflect any fees or expenses. The MSCI Korea (Custom Benchmark) represents a daily adjustment to the performance calculation of MSCI Korea if the weight of the semiconductor and semiconductor equipment industry is greater than 25%. The remaining industry groups are weighted according to their adjusted market capitalizations as a percentage of the remaining non-capped weight. It is not possible to invest directly in an index. Total return for a period of more than one year represents the average annual return.
- (4) The Korea Composite Stock Price Index (KOSPI) is an unmanaged capitalization-weighted index of all common shares on the Stock Market Division of the Korea Exchange (formerly the Korea Stock Exchange). The KOSPI returns, unlike Fund returns, do not reflect any fees or expenses. It is not possible to invest directly in an index. Total return for a period of more than one year represents the average annual return.

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June 30, 2014

Shares		Value
COMMON STOCK 99.4%		
Aerospace & Defense 2.5%		
303,859	Korea Aerospace Industries Ltd.	\$ 9,371,373
Auto Components 6.7%		
239,540	Hankook Tire Co., Ltd.	14,291,203
39,422	Hyundai Mobis	11,071,386
		25,362,589
Automobiles 12.2%		
149,028	Hyundai Motor Co.	33,787,737
222,271	Kia Motors Corp.	12,435,038
		46,222,775
Banks 7.1%		
175,563	Hana Financial Group, Inc.	6,506,051
224,018	KB Financial Group, Inc.	7,785,046
272,352	Shinhan Financial Group Co., Ltd.	12,565,307
		26,856,404
Chemicals 4.1%		
92,120	OCI Co., Ltd. (c)(d)	15,665,554
Construction & Engineering 5.0%		
598,850	Hyundai Development Co.	19,047,881
Hotels, Restaurants & Leisure 8.5%		
82,960	Grand Korea Leisure Co., Ltd. (c)	3,410,615
183,528	Hotel Shilla Co., Ltd. (c)	16,577,287
332,889	Paradise Co., Ltd. (c)	12,307,275
		32,295,177
Household Durables 3.9%		
114,431	Coway Co., Ltd.	9,577,690
68,555	Hanssem Co., Ltd.	5,269,584
		14,847,274
Insurance 3.5%		
387,550	Korean Reinsurance Co.	4,001,885
21,155	Samsung Fire & Marine Insurance Co., Ltd.	5,384,324
38,250	Samsung Life Insurance Co., Ltd.	3,855,799
		13,242,008
Internet & Catalog Retail 8.1%		
27,160	CJ O Shopping Co., Ltd.	9,807,101

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26,736	Hyundai Home Shopping Network Corp.	3,884,877
602,806	Interpark Corp. (c)	6,492,860
502,761	Interpark INT Corp. (d)	10,358,212
		30,543,050
	Internet Software & Services 3.6%	
16,469	NAVER Corp.	13,569,873
	IT Services 2.5%	
35,234	KCP Co., Ltd. (c)	368,986
54,752	SK C&C Co., Ltd.	9,008,342
		9,377,328

Table of Contents**The Korea Fund, Inc. Schedule of Investments**

June 30, 2014 (continued)

Shares		Value
	Metals & Mining 4.8%	
46,290	Korea Zinc Co., Ltd.	\$ 18,150,840
	Semiconductors & Semiconductor Equipment 25.5%	
53,681	Samsung Electronics Co., Ltd.	70,104,629
544,191	SK Hynix, Inc. (d)	26,130,887
		96,235,516
	Wireless Telecommunication Services 1.4%	
22,340	SK Telecom Co., Ltd.	5,222,075
	Total Common Stock (cost \$228,916,893)	376,009,717

SHORT-TERM INVESTMENTS 8.5%

	Collateral Invested for Securities on Loan (b) 8.5%	
31,927,887	BNY Mellon Overnight Government Fund (cost \$31,927,887)	31,927,887
	Total Investments (cost \$260,844,780) (a) 107.9%	407,937,604
	Liabilities in excess of other assets (7.9)%	(29,791,139)
	Net Assets 100.0%	\$378,146,465

Notes to Schedule of Investments:

- (a) Securities with an aggregate value of \$376,009,717, representing 99.4% of net assets, were valued utilizing modeling tools provided by a third-party vendor. See Note 1(a) and Note 1(b) in the Notes to Financial Statements.
- (b) Purchased with cash collateral received from securities on loan.
- (c) A portion of securities on loan with an aggregate value of \$30,362,648; cash collateral of \$31,927,887 was received with which the Fund invested in the BNY Mellon Overnight Government Fund.
- (d) Non-income producing.
- (e) Fair Value Measurements See Note 1(b) in the Notes to Financial Statements.

	Level 1	Level 2	
	Quoted Prices	Other Significant	
		Observable	
		Inputs	Level 3