S&P Global
Market Intelligence

Dividend Forecasting

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South Korea's Corporate Value-up Program

What is overlooked

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S&P Global Market Intelligence Dividend Forecasting serves top-tier financial institutions with their investment decision-making and risk management through provision of timely data, insights and commentary on dividend forecasts. Powered by a global team of 40 dividend analysts closely maintaining precise forecasts on the size and timing of payments based on bottom-up fundamental research as well as a proprietary advanced analytics model, our dataset incorporates the latest company news and market developments. We pride ourselves in an unmatched coverage that spans over 28,000+ stocks across the globe and our analysts are always available to engage in discussion and address users' queries.

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Key takeaways

South Korea's Corporate Value-up Program aims to replicate the Tokyo Stock Exchange's success in 2023 by incentivizing companies to distribute more dividends. To investors, however, a good dividend is not simply more dividends and KOSPI 200 lags behind Nikkei 225 in various aspects, including the following:

- 88% of Nikkei 225 companies pay dividends more than once in a year (KOSPI 200: 15%).
- 76% of Nikkei 225 companies specify quantified dividend targets (KOSPI 200: 55%).
- 63% of Nikkei 225 companies' dividend guidance as of the third quarter of fiscal year 2022 was spot on (KOSPI 200: N/A).
- 44% of Nikkei 225 companies sustained dividends without cutbacks since fiscal year 2014 (KOSPI 200: 18%).

While pushing for a higher payout ratio is necessary, it will take a multifaceted approach for the Value-up Program to truly enhance the attractiveness of South Korean dividends.

On the brighter side, South Korea's economy is expected to be revitalized in 2024 with many top dividend payers' earnings turning around, making it a favorable year to launch the Value-up Program. Our analysis also showed that KOSPI 200 is better placed than Nikkei 225 in earnings per share (EPS)/dividend per share (DPS), free cash flow (FCF)/DPS and leverage ratios, thus having more room to increase dividends.

South Korea's Corporate Value-up Program

In February 2024, South Korea's Financial Services Commission (FSC) unveiled its game plan for the *Corporate Value-up Program* which aims to elevate the valuation of companies listed in KOSPI and KOSDAQ. The program is designed to tackle the underlying factors that are widely recognized to be contributing to the "Korea discount," with substantial emphasis placed on improving the companies' capital allocation. Inspired by the Tokyo Stock Exchange's (TSE) initiative in 2023, *Action to Implement Management that is Conscious of Cost of Capital and Stock Price*, the FSC aspires to enhance the appeal of the South Korean capital market to investors by encouraging companies to distribute more dividends.

What FSC is missing out: It's not just about larger dividends

When it comes to shareholder returns, in particular dividends for the scope of this report, the Japanese market is a good model that offers many learning points because it is held in high regard for its dividend stability and predictability. TSE's initiative in 2023 to boost companies' dividends played a significant role in propelling the Nikkei 225 index value to its new record high. However, direct replication of pushing for more dividends in South Korea — as the Value-up Program is best interpreted at the current stage — will likely result in a limited level of success because TSE's policy holds a different magnitude of credibility and trust, built upon the good dividend practices implemented by the market that are not yet established in South Korea. In this report, we introduce seven distinct aspects of good dividend practice and analyze where KOSPI 200 stands in comparison with Nikkei 225. This will show that a multifaceted approach needs to be taken to improve South Korean dividends and enhance their appeal in the long term.

Better dividend, better valuation?

To begin with, will improving the dividend practice in South Korea result in raising the stock valuation? Purely from the value investing standpoint, Benjamin Graham propagated that the share value largely depends on the dividends the company is expected to pay, and that the earnings are only important to the extent that they enable the payment of dividends. More practically, dividend payment bolsters investor confidence because it is a manifestation of commitment to shareholder interest and signal to financial health and cash flow generation. A myriad of factors come into play when determining a share price, and better dividend practice will not single-handedly guarantee a better valuation. However, considering that the current dividend practice of the South Korean market lags behind the global standard in various aspects, it is one of the hurdles that need to be overcome to achieve the desired outcome of the Value-up Program.

What makes a desirable dividend practice?

A good dividend practice possesses the three qualities of predictability, consistency and profitability.

Predictability: A company should dissolve as much uncertainty as possible to investors and provide predictability to its future dividends. The market will treat a share more favorably when it has a high level of visibility in the future stream of dividend payouts. We can assess how well a company is doing in providing predictability based on four parameters.

1. **Dividend policy:** A company should outline a clear policy statement that is meaningful to investors in making dividend predictions. As of April 2024, 110 (55%) KOSPI 200 companies have meaningful dividend policies and the remaining have either no policy or not-well-defined ones without quantified targets. For Nikkei 225, 170 (76%) companies have dividend policies with quantified targets.

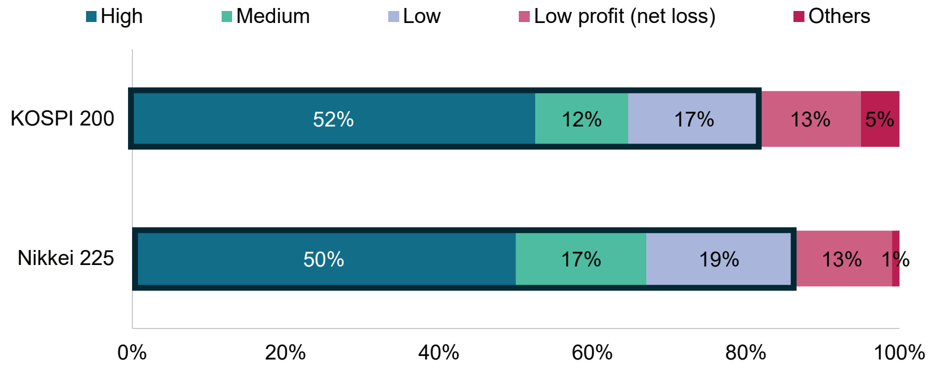
2. **Adherence:** Equally important to having a clear and meaningful policy is a company's adherence to the policy. If a company has a good track record of sticking closely to its policy, investors will have more confidence in predicting future dividends of the company. Based on our own rubrics, KOSPI 200 and Nikkei 225 companies did not vary significantly in terms of their general level of adherence to dividend policies.

   About 52% of dividend-paying companies with quantified policies in KOSPI 200 have a "High" policy adherence level, while 50% of those in Nikkei 225 have also met that level (three-year average). However, a higher proportion (65%) of KOSPI 200 companies falling into the "Low" adherence level category were deviating from their targets in an arbitrary manner, while this propensity was lower (51%) among Nikkei 225 companies because many of them were missing the ratio targets due to their stable/sticky movement in DPS (while the earnings fluctuate).

   Hence, Nikkei 225 is still superior in dividend predictability because a higher percentage (76%) of Nikkei 225 companies have quantified policies compared with KOSPI 200 (55%) to begin with. Even though Nikkei 225 companies may be missing their targets, the DPS is still moving in a predictable way.

KOSPI 200 and Nikkei 225 dividend policy adherence level

Average of latest three fiscal year results available



Data compiled April 10, 2024.

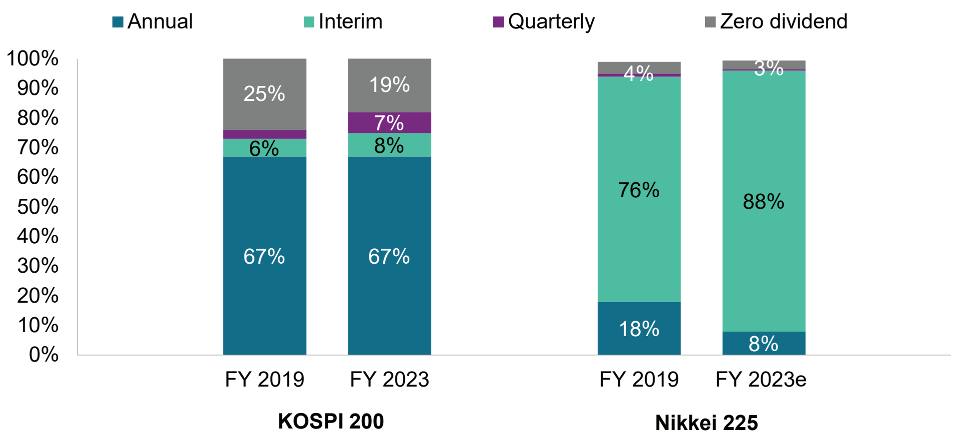
Does not include companies without quantified dividend policies or companies that are nonpayers. High/Medium/Low ranks based on meeting the expectation that a reasonable investor would hold given the knowledge of financial results and dividend policy.

Source: S&P Global Market Intelligence.

3. Frequency: Apart from having various benefits, such as enticing investors seeking regular cash flow, distributing dividends at higher frequencies enhances dividend predictability by providing a check on the company's commitment to consistent payouts. It has been less than a decade since interim and quarterly dividends were first distributed by KOSPI 200 companies, and the adoption rate remains limited at 15% as of fiscal year 2023. On the other hand, almost 90% of Nikkei 225 companies have implemented interim payment schemes for the same period.

KOSPI 200 and Nikkei 225 dividend frequency distribution

FY 2019 and FY 2023



Data compiled April 10, 2024.

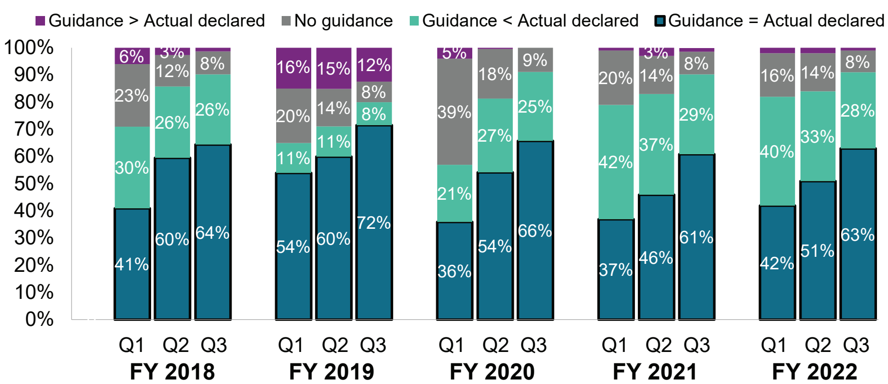
e = estimate.

Estimation used for Nikkei 225 companies that have yet to announce FY 2023 (ended March 2024) final dividends.

Source: S&P Global Market Intelligence.

4. Communication: While KOSPI 200 and Nikkei 225 companies employ various forms of communication on dividend-related matters to provide clarity and transparency regarding future payouts, dividend guidance issued by Nikkei 225 companies is arguably the most effective way in facilitating investors' dividend expectations. Dividend guidance is a company's own estimation for the upcoming dividend amount. It is a unique feature in TSE, issued and updated each quarter based on the prevailing financial and business outlooks for the full fiscal year. Although the guidance is not perfect, it gets more accurate as the fiscal quarter draws closer to the year-end. By the third quarter, the accuracy rate (guidance amount = actual

Nikkei 225 final dividend guidance vs. declared trend



Data compiled Sept. 15, 2023.

Guidance is typically updated every quarter along with quarter results. Each bar represents guidance updated at respective quarter end.

FY 2022 comprises data from companies whose financial years end in August 2022 to March 2023. Same convention applies for the rest of the fiscal years.

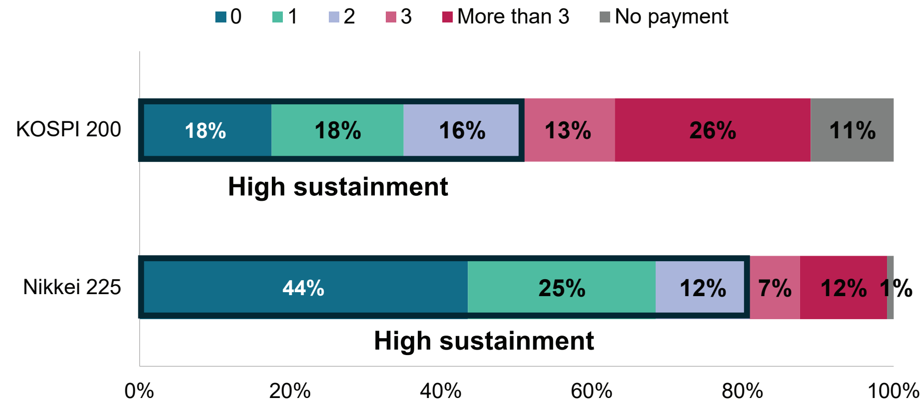
Source: S&P Global Market Intelligence.

dividend amount) averaged about 65% from fiscal year 2018 to fiscal year 2022. The timely provision of specific dividend estimation by Nikkei 225 companies speaks a thousand words, obviating the need for lengthy statements.

Consistency: Any company may devise an ambitious shareholder return plan or boost dividends in the short run, but investors will not necessarily see lasting value in that. Rather, a company has to show consistency underpinned by sustainment and stability, lending credibility and assurance to its long-term dividend commitment in the eyes of investors.

5. **Sustainment:** All businesses are bound to go through downturns and may incur losses at some point. However, avoiding suspensions or, better, having no cutbacks through such difficult times will be highly regarded because it is a sign of commitment to shareholders, prudent cash flow planning and strong financial health. The chart below shows that 98 (44%) Nikkei 225 companies have sustained their dividends (i.e., no cutbacks) since fiscal year 2014, while 35 (18%) KOSPI 200 companies have sustained their dividends for the same period. A dividend cutback in general context sends out a negative signal about the company's outlook, and KOSPI 200 companies shall reconsider the magnitude of the impact when cutting down on dividends.

KOSPI 200 and Nikkei 225 number of dividend cutbacks between FY 2014 and FY 2023



Data compiled April 10, 2024.
Estimation is used for Nikkei 225 companies with fiscal years ended March 31, 2024.
Source: S&P Global Market Intelligence.

6. **Stability:** Sticking closely to one's payout ratio target is one way to keep dividends predictable. Another way to do so is by maintaining a stable dividend trajectory by carefully calculating one's ability to distribute dividends over the medium- to long-term horizon, then growing the dividends in a progressive manner at a consistent pace. A stable payout pattern without close links to underlying performance could create a sense of consistency and predictability, thereby ensuring shareholder trust. The table below shows that the tendency for paying progressive dividends at a consistent pace was higher in Nikkei 225 (23%) than in KOSPI 200 (14%), while the tendency for fluctuating dividends was higher in KOSPI 200 (28%) than in Nikkei 225 (16%), indicating that dividend stability is an area that KOSPI 200 can improve on.

KOSPI 200 and Nikkei 225 dividend trajectory type

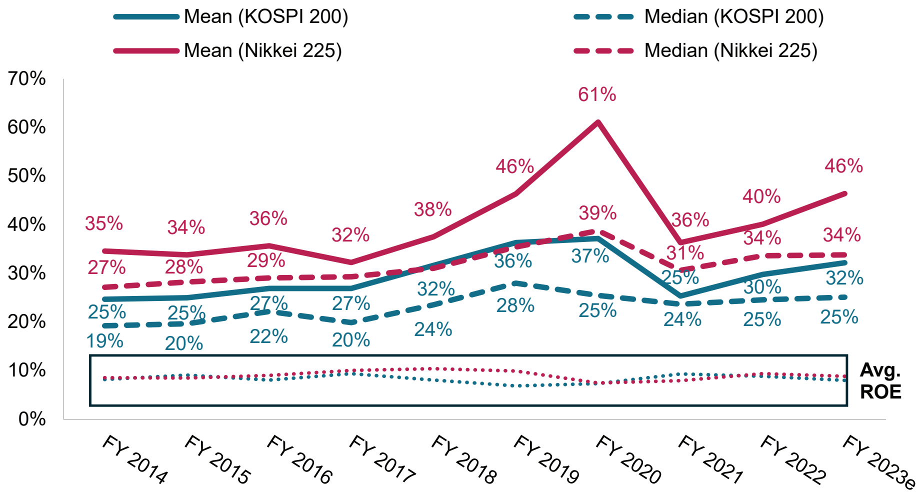
Type	Explanation	Shape	KOSPI 200	Nikkei 225
Progressive (consistent)	Progressive dividend trajectory over years with relatively consistent rate of growth		14%	23%
Progressive (bumpy)	Progressive dividend trajectory over years but at irregular pace of growth		10%	17%
Progressive (weak)	Progressive dividend trajectory over years with occasional spikes/drops		22%	18%
Flat	Flat dividend is maintained for varied periods (at least 3 years) before an increment		14%	15%
Smooth	Upturns and downturns in the dividend trajectory but the movement is smoothened out		12%	10%
Fluctuate	Volatile dividend trajectory with rapid ups and downs		28%	16%
Non-regular payer	Excluded from the count if dividend is not sustained for more than 3 years		46 out of KOSPI 200 (30%)	5 out of Nikkei 225 (2%)

Data compiled April 10, 2024.
Analyst discretion was used for classification of dividend trajectories into best fitting type. 10-year horizon was used for the analysis.
Source: S&P Global Market Intelligence.

Profitability: At the basic level, investors are attracted by dividend yield that can be influenced by the payout ratios controlled by companies. Deciding on the payout ratio, which is about striking the balance between rewarding the shareholders presently and in the future (by reinvesting the capital), is a delicate management decision, and there is no hard rule to dictate which is the ideal level. Regardless, KOSPI 200 companies lag behind most of the developed markets in terms of payout ratio, and it is a major factor making KOSPI less attractive.

7. **Payout ratio:** A quick test often used for justification of high capital retention (i.e., low payout ratio) is return on equity (ROE) because a high ROE may be an indication that the company has good capital utilization, thus generating more shareholder value through reinvestments rather than distributing dividends. The chart below shows that there is no strong distinction in the average ROE levels between KOSPI 200 and Nikkei 225. However, Nikkei's payout ratio is at least 10% higher on average. This implies that KOSPI 200 companies are holding onto earnings without investing or returning them to shareholders.

KOSPI 200 and Nikkei 225 payout ratio average 10-year trend



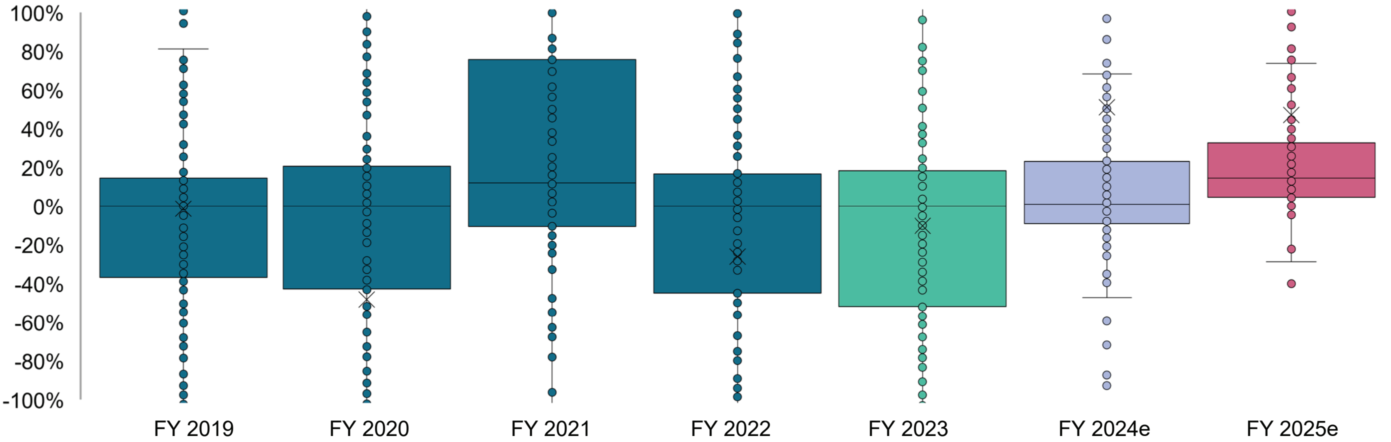
Data compiled April 10, 2024.
Estimation is used for FY 2023 Nikkei 225 companies whose fiscal years ended in March 2024.
Source: S&P Global Market Intelligence.

Assessing dividend dynamics under Corporate Value-up Program

In the previous section, we discussed different aspects of dividend practice that need to be improved, apart from simply pushing the companies for higher dividends. When it comes to paying more dividends, where does KOSPI 200 stand in comparison with Nikkei 225 and how much room do KOSPI 200 companies have to increase and sustain dividends to replicate the success of TSE that they aspire to have, especially when South Korea's FSC is giving more weight on shareholder return than TSE?

Growth potential: While not necessarily all dividends exhibit a close relationship with underlying earnings, earnings are unanimously deemed as the baseline of the cash distribution, exerting a significant influence over the upside/downside of dividends. The earnings growth estimate of KOSPI 200 outlines a positive picture for fiscal year 2024 with an upward trend in average and median EPS consensus. The top dividend-contributing companies are all set to show solid earnings growth too.

KOSPI 200 companies' EPS YOY change distribution



Data compiled April 8, 2024.
Source: S&P Capital IQ Pro.

Top 10 dividend contributors of KOSPI 200

Name	Sector	% in KOSPI 200 FY 2023 dividend	FY 2023 EPS growth	FY 2024 EPS growth (estimated)
Samsung Electronics Co. Ltd.	Technology	24.3%	-78%	165%
Hyundai Motor Co.	Automobiles & parts	6.5%	70%	-2%
Kia Corp.	Automobiles & parts	6.2%	72%	-4%
KB Financial Group Inc.	Banks	3.7%	15%	6%
SK Hynix Inc.	Technology	3.6%	Net loss	Turnaround
Shinhan Financial Group Co. Ltd.	Banks	3.2%	2%	6%
Hana Financial Group Inc.	Banks	3.0%	4%	3%
Woori Financial Group Inc.	Banks	2.3%	-10%	5%
Industrial Bank of Korea	Banks	2.2%	-1%	6%
POSCO Holdings Inc.	Basic resources	2.1%	-39.0%	-10.0%

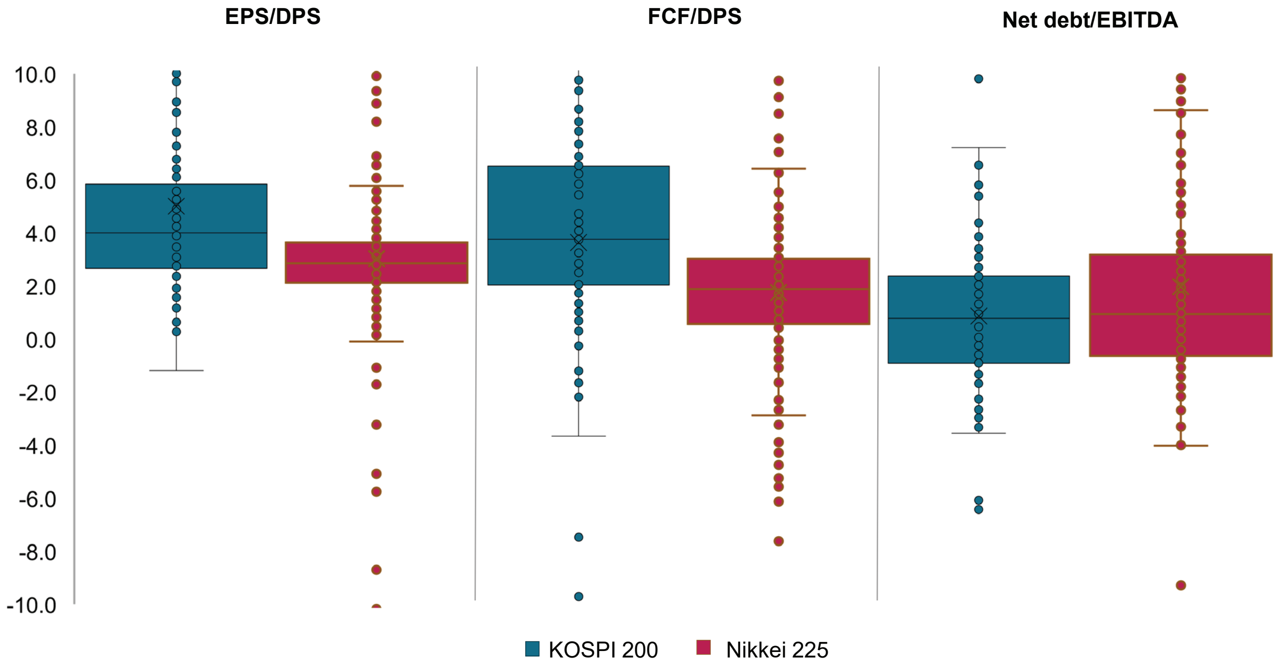
Data compiled April 12, 2024.
For common shares only.
Source: S&P Capital IQ Pro.

The robust earnings growth outlook for KOSPI 200 firms is aligned with the relatively optimistic macroeconomic estimations. South Korea's real GDP is projected to accelerate to 2.3% in 2024 (compared with the European Union's 0.75%, Japan's 0.65% and advanced economies' 1.60%), and the weak South Korean won is likely to boost exports. This echoes the macroenvironment of Japan in 2023 during which real GDP increased to 1.9% from 0.9% in 2022.

Sustainability: The goal of the program is to resolve the long-standing issue of the Korea Discount. Having the fundamentals to sustain progressive dividends is thus as important as having an upside room lifted by the earnings driver. We evaluated the sustainability of dividends based on three main metrics — earnings, FCF and debt level. To successfully support the government's initiative, KOSPI 200's fiscal year 2024 (hereafter "FY+1") should be at least on a par with, if not better than, that of Nikkei 225's sustainability stats post-one year the initiative implementation (hereafter "FY0").

Referring to the chart below that reflects KOSPI 200 companies' response to FSC's announcement in February 2024, KOSPI 200 generally has better dividend sustainability than Nikkei 225. The mean and median of the introduced metrics indicated a superior capacity to sustain dividends, which also implies that the companies have more room to lift dividends further should the FSC call for such actions in the next announcement scheduled in the second quarter of 2024.

KOSPI 200 and Nikkei 225 dividend sustainability comparison

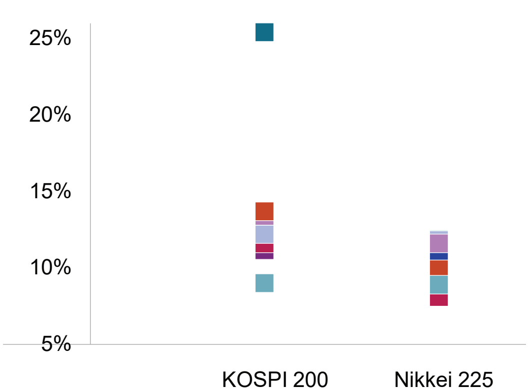


Data compiled April 12, 2024.
Net debt/EBITDA: Of the stocks with DPS forecast, net debt and EBITDA data available, two Nikkei 225 companies (Sumitomo Chemical Co. Ltd. and Dena Co. Ltd.) with EBITDA < 0 in FY0 have been excluded for the analysis. No KOSPI 200 company with EBITDA < 0 in FY+1.
Source: S&P Global Market Intelligence.

Our analysis above shows that the same observation is made in the banking sector, with the spread of expected common equity Tier 1 (CET1) ratio of KOSPI 200 banks standing higher than that of Nikkei 225 banks.

KOSPI 200 and Nikkei 225 banks CET1 ratio

KOSPI 200 FY+1 data vs. Nikkei 225 FY0 data



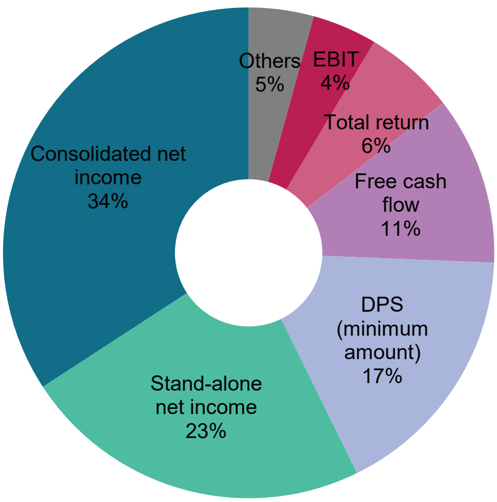
Data compiled April 9, 2024.
Source: S&P Global Market Intelligence.

Visibility: From a long-term perspective, a dividend is more than a sharing of profit with shareholders. It is a signal of the management's confidence in the outlook for a company, as well as a long-term commitment to build trust with shareholders. Therefore, the importance of having a steady dividend policy that gives visibility on future cash distribution cannot be emphasized more in this case when tackling the Korea Discount essentially boils down to enhancing international investors' confidence in KOSPI and KOSDAQ.

We analyzed the nature of the dividend policies of KOSPI 200 and Nikkei 225. As seen in the charts below, 45% of the KOSPI 200 dividend metrics is on ambiguous metrics such as stand-alone earnings, net cash flow, FCF and dividend income from subsidiaries that allow the company to exercise discretionary judgment to decide the pool of distributable cash. A growing number of KOSPI companies are adopting share buybacks/cancellations — yet a short history and a lack of guidance hinder investors from anticipating dividend size.

On the other hand, the majority of Nikkei 225 dividend policies are based on estimable metrics such as consolidated earnings, minimum amount of DPS and earnings before interest and tax (EBIT). A dividend policy set with clarity and visibility of investors in mind allows investors to project dividends in a reliable manner, thereby ensuring shareholder confidence.

KOSPI 200 dividend policy metric distribution

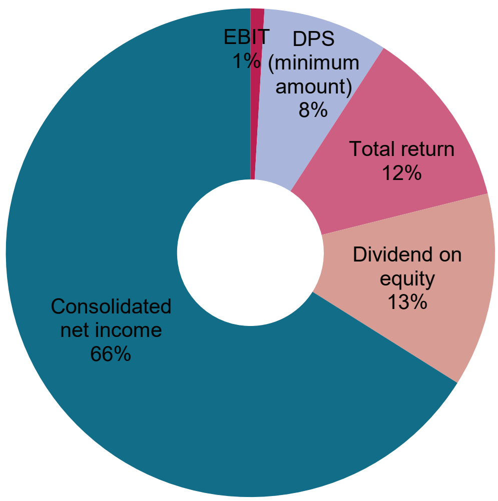


Data compiled April 6, 2024.

For dividend-paying companies only. Multiple count is allowed if more than one parameter is specified in the dividend policy.

Source: S&P Global Market Intelligence.

Nikkei 225 dividend policy metric distribution



Data compiled April 6, 2024.

For dividend-paying companies only. Multiple count is allowed if more than one parameter is specified in the dividend policy.

Source: S&P Global Market Intelligence.

Conclusion

This is not South Korea's first attempt at tackling the Korea Discount. Before the Value-up Program, the government had introduced the Korea Stewardship Code in 2017, which included assertive measures such as identifying companies deemed as not meeting the government and general market's dividend expectations and exercising pressure through the National Pension Fund. This initiative faded with the COVID-19 pandemic. There was also a corporate tax reform in 2014, levying a surcharge on retained cash in excess of a certain fraction of earnings if it is not distributed as dividend payouts, wage increases or investments.

Each policy sparked off positive anticipation in the market, leading to short-lived stock market rallies. However, the fact that the two past policies did not sustain somewhat aligns with our analysis — KOSPI companies are not lacking capacity, but they need to cultivate a corporate culture of putting shareholders first in the market.

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