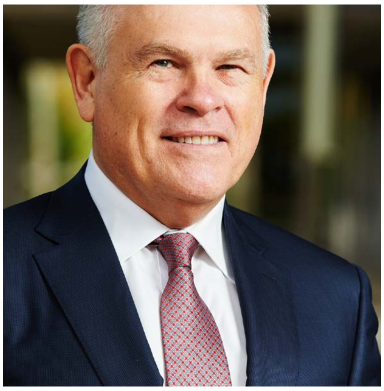
DON'T SHOOT THE MESSENGER: A DEFENCE OF KOREAN LISTED ADRS

Op Ed by Dr Rory Knight



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The recent article in Scoop entitled "*Report cards for companies listed in the US before Coupang deliver an increase in share price of 35.6%: Do you know Coupang?*" (19th February 2021) is a welcome exposition in the build-up to Coupang's IPO, on the Korean firms that have launched listed ADRs in New York. The article celebrates the emergence of the Korean unicorn and highlights the performance of its compatriots on the NYSE and NASDAQ as an indication of how it might be received.

The recent news of the listing of Coupang on the New York Stock Exchange (NYSE) is an exciting development for Korean listed companies. It is a recognition of a Korean unicorn which will have a positive effect on many similar Korean companies. This event is far more significant than just another listing. It is the first listing in the US markets by a Korean listed company since Gravity listed some sixteen years ago. In that period of inactivity the world has endured the Great Financial Crisis, the world pandemic and yet the longest bull run in living memory.

Clearly, Korean listed companies did not take advantage of the markets' decade-long rally by listing in the largest capital market in the world. Korea is a noticeable outlier among the world's major economies in that it is has almost no presence in the US stock-markets. There are 2,396 American Depositary Receipts (ADRs) traded in the United States of which only 10 are Korean from a population of 2,356 listed Korean securities – whichever metric one uses Korean companies are almost absent and easily the least represented. The Scoop article focusses on an important subject and we wish here to respond to a number of aspects covered. There are three areas in the original that need to be clarified; these are measurement issues, misnterpretations and omissions.

Measurement issues

The article firstly compared the pairwise performance of each of the firm's ordinary share listed in Seoul and its ADR counterpart in New York. Secondly, it reported the comparative performance of a portfolio of the ADRs in aggregate to a portfolio of the counterparts of ordinary shares listed in Seoul. There are several measurement

TABLE 1: Korea ADRs currently traded in the US
SOURCE: BNY Mellon

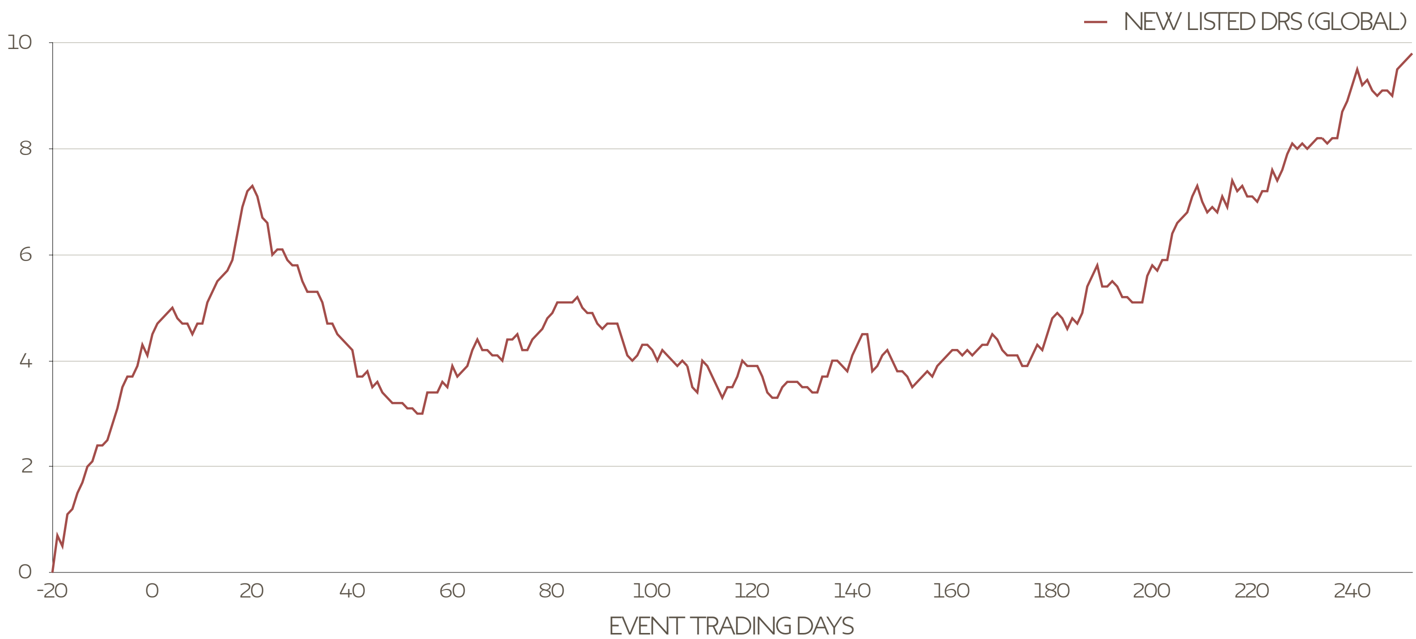
ADR ISSUER	CAPITAL RAISED	ADR VENUE	RATIO ADR:ORD	INDUSTRY	First listed
POSCO	Y	NYSE	4:1	Indust.Metals&Mining	1994
KEP	N	NYSE	2:1	Electricity	1994
SK Telecom	Y	NYSE	9:1	Mobile Telecom.	1996
KT	Y	NYSE	2:1	Fixed Line Telecom.	1999
KB	N	NYSE	1:1	Banks	2001
Shinhan	N	NYSE	1:2	Banks	2003
Woori	N	NYSE	1:3	Banks	2003
Webzen	Y	OTC (Ex NASDAQ)	10:3	Leisure Goods	2003
LG Display	Y	NYSE	2:1	Tech.Hardware&Equip	2004
Gravity	Y	NASDAQ	1:1	Leisure Goods	2005

issues which were not addressed in the analysis.

Firstly, comparing the pairwise percentage performance is not valid as each member of the pair is derived from a different numeraire; ADRs in US dollars and Ordinary shares in Won. The cross-sectional comparisons then compound the problem by comparing different time periods and therefore market conditions. Thus pointing out that Posco's ADRs generated a return of 63.8% over 26 years while over the same period the ordinary shares generated a 225.9% in Won is meaningless without adjusting for currency movements. Furthermore, comparing Posco's 63.8% over a 26 year period, which includes the Asian crisis, to Gravity's 160.1% performance for the last 16 years of a bull market is obviously a mismatch.

Two further adjustments were omitted, risk and dividends. Posco has considerably lower risk as reflected in beta and generates higher dividends than Gravity. The comparison presented is nugatory.

FIGURE 1: Increase in value after ADR launch
SOURCE: Oxford Metrica



Misinterpretations

The article seriously misunderstands ADRs which nullifies much of the analysis. The article highlights that Posco's ADR price on 16 February 2021 of $61.84 (about 68,400 Won) is about one quarter of the domestic stock price (275,500 Won) of the ordinary shares in Seoul. The implication being that there has been a considerable underperformance in the ADR. The article should have pointed out that the ADR price in Won has to be "about a quarter" of the Seoul price because each ADR represents 25% of an ordinary share. The so called ratio of ADR:Ordinary is 4:1. The difference is not remotely unexpected. This adjustment applies across all firms presented in the analysis although the ratio is different for each as shown in table 1.

The translation of one price to the other requires two adjustments. Firstly for the ratio of ADRs to ordinary shares; for example POSCO's ADR price has to be multiplied by 4 as 1 ADR represents 1/4 of a POSCO share in Seoul. Secondly, an adjustment is made for the exchange rate to compare the prices in Won terms. Over time the two-price series will generate the same return adjusted for the change in exchange rates. Many empirical studies provide evidence on the efficiency of markets keeping stock prices and ADRs prices in equilibrium through arbitrage.

Omissions

The most serious omission in the analysis is the reconciliation of the performance of the ADR/Ordinary couplets. Presenting the huge differences such as Posco's ADR performance in dollars of 63.8% and the Ordinary Posco share performance of 225.9% as the flaw in the ADR is to shoot the messenger. The most significant cause of the difference is the change in the price of the Won in dollar terms over the 26 years, absolutely nothing to do with the ADR instrument or the company for that matter. The ADR reflects more than a 30% weakening in the Won...that is the message, the ADR is the innocent messenger, omitting to mention that the article maligns an excellent instrument for Korean firms.

Obviously, any Korean ADR launched before the Asian crisis will reflect a significant currency effect. In fact all offshore investors investing directly in any Korean firm, including those with ADRs, incurred a similar loss, it is independent of the existence of the ADR.

The impact of currencies over such a long period weathering the Asian crisis and enjoying high returns domestically inevitably has a huge effect. The currency impact in the case of Posco is about -100% which is the sum of currency impact on initial capital of -30% and the currency impact on the domestic return on the Posco shares which is -69.2% (-30% of 225.9%). The analysis in the article clearly needs a significant rethink.

In short the ADR has been framed, the real culprit is the weakening Won during the Asian financial crisis. All of this is now ancient history and Korean firms might reflect on the changed circumstances and on the considerable benefits of an international listing.

We wish Coupang well in their endeavours and we hope others will follow suit.

> "The ADR was framed, the real culprit is the weak Won in the Asian financial crisis "

Conclusion

Empirical research has shown that in aggregate the establishment of an ADR programme creates a significant increase in value. Figure 1 reports the impact of the establishment of an ADR for the universe of ADRs. The study isolates the effect of the ADR listing by controlling for market wide factors, timing, risk and currency effects over three decades. The result shows a permanent improvement in value of 10% in the long term. This is a significant reduction in the firm's cost of capital.

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