Private acquisitions in South Korea: market analysis overview

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Q&A guide to private acquisitions market practice in South Korea.

The Q&A gives a high level overview of key issues including current major trends, private M&A activity, structuring and documentation in transactions, governing law and arbitration, and reform and future market trends.

Market overview

1. What are the current major trends in the private M&A market?

Over the past few years, the South Korean M&A market has been active and shown significant growth in terms of size and number of transactions. Many conglomerates underwent restructurings by acquiring new businesses or companies and/or selling businesses or subsidiaries with low profitability or non-core businesses. In addition, private equity deals have increased and diversified, with transactions including buyouts, secondary deals, acquisition of minority shares, and so on. As a result, it is generally expected that a private equity fund will participate as a bidder in most of large- and medium-sized deals.

However, the novel coronavirus 2019 (COVID-19) has adversely affected the South Korean M&A market and contributed to a decrease in the number of new transactions in the first quarter and second quarter of 2020. Conglomerates tend to be more cautious about making new investments, and financial institutions take a more conservative position in acquisition financing. While private equity funds continue to search for opportunities to

expand their portfolio or to enter into exit deals, they are taking a more cautious approach when it comes to new investments.

2. What has been the level of private M&A activity in the previous year?

The South Korean M&A market has enjoyed great success in 2019. It is reported that the total number of M&A transactions in 2019 was the highest ever. The number of domestic M&A transactions has increased partly due to an increase of small- and medium-sized deals led by private equity funds. The number of inbound M&A transactions also increased significantly.

Outbound M&A activity reached its highest level ever in terms of deal volume. Notable transactions in 2019 included the following:

- KCC corporation's acquisition of Momentive for about USD3.1 billion, which is the second largest outbound M&A transaction ever conducted by a South Korean company.
- CJ's acquisition of Schwans's Company for about USD1.6 billion.
- Hanon System's acquisition of Fluid Pressure & Controls business of Magna International for about USD1.1 billion.

Transactions involving financial institutions were also noteworthy in 2019, including:

- MBK Partners-Woori Bank consortium's acquisition of Lotte Card from Lotte Group.
- Shinhan Financial Group's acquisition of Orange Life Insurance from MBK Partners.

In addition, a few insurance companies, including Prudential Life Insurance and KDB Life Insurance, were put up for sale in 2019. These sales are expected to occur during the course of 2020.

Deal structures

3. What are the current trends in the structuring of private M&A transactions?

Share sales are the most prevailing form of M&A transactions in South Korea. Even in a sale of a specific business unit, a share transfer following a spin-off of the business unit is sometimes used instead of a direct transfer of the

unit. For example, SKC agreed with a state-owned Kuwait company to form a joint venture by selling its 45% shares in the South Korean company, which is newly established through a vertical spin-off of its chemical business.

Cash is the most common form of consideration used in M&A transactions in South Korea. Shares are sometimes used as consideration, especially where the parties want the seller to remain involved in the business of the target company after completion of the transaction. For example, KakaoM, a subsidiary of leading IT company Kakao Corporation, acquired production companies and entertainment agent companies to strengthen its content production business, and gave its shares as a part of the consideration to certain sellers who are key directors and officers of the acquired companies.

Although it is still typical for the buyer to pay the purchase price in a lump sum at closing, the buyer more frequently pays a deposit ranging from 5% to 10% of the purchase price at signing of the transaction agreement. The seller normally requests a deposit for deal certainty, especially in auction deals.

Price adjustment mechanisms are not frequently used in the Korean M&A market, because the parties generally prefer to fix the price at signing. A pre-closing adjustment is sometimes used, mainly based on the difference in the net asset value found in the course of the confirmatory due diligence conducted by the buyer in the period between signing and closing (such as a difference caused by errors in financial statements or changes that occurred between the record date of financial statements and signing). However, post-closing adjustment mechanisms including earn-out payments are rare. Examples of post-closing adjustment mechanisms include:

- Price adjustment based on the difference between the net working capital on the record date and at closing, in private equity exit deals.
- Earn-out payments in some venture deals.

4. What are the current trends in the terms and documentation of private M&A transactions?

Warranty and indemnity insurance (W&I insurance) is increasingly considered in M&A transactions, especially when the seller is a private equity fund. W&I insurance is intended to provide coverage for matters not known to the buyer, and therefore does not cover the matters that were actually known by the buyer or disclosed in the definitive transaction agreement or due diligence report. W&I insurance also generally does not provide coverage for consequential damages, civil or criminal fines, secondary tax liabilities, environmental liabilities (from pollution, contamination, and so on), and anti-bribery and anti-corruption liabilities. The premium depends on the limitations to indemnification (such as *de minimis* and caps) as well as the size and characteristics of the transaction.

Anti-sandbagging clauses are sometimes discussed and negotiated in M&A transactions (that is, a clause prohibiting the buyer from claiming indemnification based on an inaccuracy or breach of a representation or warranty that the buyer knew about before closing). Since the South Korean Supreme Court ruled that sandbagging is allowed if the transaction agreement does not include any clause prohibiting sandbagging, sellers tend to incorporate an anti-sandbagging clause into their draft transaction agreement. However, anti-sandbagging clauses are rarely included in the final transaction agreement. Instead, when the seller has bargaining power, anti-sandbagging takes the form

of a clause limiting or excluding indemnification for matters that are publicly available or fairly disclosed during the due diligence process.

5.What are the current trends in how private M&A transactions are conducted?

In 2019, most notable M&A transactions in South Korea were conducted through an auction process led by the seller's financial adviser (adviser). In such auction process, potential bidders are provided with an information memorandum (IM) after signing a non-disclosure agreement with the seller. The IM generally includes details of current and future projections of the target company's financial position and business (sometimes including material legal issues related to them). After reviewing the IM and other relevant materials, potential bidders submit their preliminary non-binding bid proposal to the adviser.

After then, the seller selects and invites some of those potential bidders to participate in the next phase of the auction process, a binding bid submission. Before submitting their binding bid proposal, the selected bidders conduct due diligence reviews controlled by the adviser, which is generally followed by a management presentation session, break out session and written Q&A sessions (typically each bidder submits requests for information and the adviser/target company replies and delivers information and materials). The number of questions or requests per round of Q&A session is sometimes limited for efficiency purposes.

While a seller's due diligence report is increasingly provided to bidders in auction deals where the seller is a private equity fund, this remains rare in South Korea.

Cross-border litigation and arbitration

6. Is it common market practice for a share purchase agreement to provide for a foreign governing law and/or jurisdiction? If so, in what circumstances does this occur and which governing law and/or jurisdiction are common choices?

Although South Korean law does not require a share purchase agreement to be subject to South Korean law and the jurisdiction of South Korean courts, South Korean law and South Korean courts are commonly selected if the target is a South Korean company. In outbound M&A transactions, the governing law and jurisdiction are determined based on the negotiation of the parties.

Regardless of the governing law or jurisdiction, certain South Korean laws such as anti-trust law or capital market law, may be applied depending on the nature of the transaction.

7. Is it market practice for an arbitration provision to be included in private M&A documents? Are arbitration clauses enforceable in your jurisdiction? Do local courts respect the choice of jurisdiction in an arbitration clause?

It is not market practice to include an arbitration provision in M&A documents in South Korea. However, an arbitration provision is sometimes included in a definitive agreement for a cross-border transaction, especially where the parties cannot reach an agreement with respect to jurisdiction.

In principle, arbitration clauses and awards are enforceable in South Korea. To enforce an arbitration award, it is necessary to obtain a South Korean court decision recognising the award. The recognition and enforcement of arbitral awards in South Korea is governed by the Arbitration Act, along with treaties ratified by South Korea, such as the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention). South Korean courts are familiar with the rules and practices of international arbitration and set up internal guidelines to maintain consistency in the recognition and enforcement of arbitral awards. There are only a handful of cases in which a South Korean court refused to recognise or enforce foreign arbitral awards over the past decade.

Recent developments and proposals for reform

8. Have there been any significant recent or proposed legal developments affecting the market that could impact on transactions?

To overcome difficulties caused by COVID-19, the South Korean Government recently convened several Emergency Economic Meetings and Crisis Management Meetings to discuss and implement countermeasures against COVID-19. These include the:

- Establishment of the bond market stabilisation fund.
- Acquisition of corporate bonds through primary collateralised bond obligations.
- Expedited underwriting of corporate bonds.
- Extension of loan maturity or allowance of deferred interest payment to provide liquidity to companies in South Korea.

The South Korean Government also came up with measures to support key industries undergoing economic difficulties, such as the automobile, aviation, shipping, oil refinery and shipbuilding industries. These measures

include the establishment and operation of the KRW40 trillion key industry stabilisation fund to finance key industry companies in need of capital injection.

While the above measures may not be directly related to M&A transactions, they could affect the South Korean M&A market. This is because when providing liquidity to companies, the South Korean Government normally seeks certain covenants from major shareholders that could facilitate M&A activities. Examples of such covenants include agreements to sell assets or business, to improve sales performance, and/or to inject capital.

9. What will be the main factors affecting the market next year, and how do you expect the market to develop?

Although it depends on how long the COVID-19 pandemic lasts, South Korean conglomerates are likely to seek restructuring of their businesses by selling their existing businesses or subsidiaries, and purchasing businesses or companies that can bring growth opportunities.

Private equity funds are expected to continue developing the M&A market as they have done over the past years. Most large private equity funds have been successful in fundraising and have not yet exhausted their funds. They are therefore likely to be key players in the M&A market. In addition, consortiums between conglomerates and private equity funds are expected to be formed in large-sized deals as was the case over the past few years (for example, the KCC corporation-SJL Partners consortium's acquisition of Momentive, the Woori Bank-MBK Partners consortium's acquisition of Lotte Card, and SK and IMM's joint investment in Vin Group).

In the second half of 2020 and 2021, M&A transactions requested by government entities (specifically state-owned creditors) are also expected to affect the market. For example, Doosan Group has recently finalised its restructuring plan and submitted it to state-owned creditors. The plan reportedly includes the sale of its affiliated companies or non-core business units, such as Doosan Solus and Mottrol BG unit. M&A transactions are expected to occur as a result of the government providing liquidity to companies, and the government may play an important role in these M&A transactions (*see Question 8*).

Contributor profiles

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Recent transactions

- Represented Asiana Airline and Kumho in the sale of Asiana Airline.
- Represented Baring Private Equity Asia in the sale of Logen Logistics.
- Represented SK Gas in its sale of shares in SK D&D to Hahn & Company.

Languages. Korean, English

Publications

- *Public Disclosure System related to Corporate Governance, BFL Vol. 97, September 2019* (co-authored).
- *Restrictions on transfer of shares in Shareholders Agreement, BFL Vol. 88, March 2018* (co-authored).
- *Issues Relating to Shareholders Agreement – Mainly From a Drafting Point of View, BFL Vol. 67, September 2014* (co-authored).

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