

Quarterly Country Update: The Korea Fund, Inc.

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As this quarter's country update, we would like to provide an insight into the Korean education industry.

Education market overview

The Korean education market continues to post robust growth despite the recent slowing in consumer spending. According to the Bank of Korea, private education spending for the first half of 2008 reached 15 trillion Korean Won (KRW), an increase of 9.1% year on year. We also continue to see that education spending is rising as a portion of total household expenditure, from 4.9% in 2000 to 6.2% in 2008. This is because children's education is of utmost importance in most Korean households. Increasingly more Korean families are relying on private education for their children.

The Korean education market is divided into two areas: public and private. Public education includes public and private schools whose curricula are authorized by the government. Private education includes the various after-school activities that students participate in order to improve their academic skills. Historically, the private education market revolved around traditional (i.e. offline) institutions (*Hakwon*) or tutoring by private teachers in group study or one-on-one. However, the trend of private education has been changing to utilize diversified sources such as online education in line with the general development of the IT infrastructure in Korea. So far, the government has been trying to impede further expansion of the private education market due to the heavy financial burden that is placed on Korean households. Nevertheless, the private education market has been growing at an annual rate of 9.3%

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Sang Won Kim, a Korean National, joined the RCM in May 2007 as a Portfolio Manager to manage dedicated Korean equity portfolios. Sang Won was previously an Investment Analyst in the Asia ex Japan Equity Research team of Schroder Investment Management before relocating to Hong Kong from Seoul. Prior to joining the Group, he spent two years with Samsung Securities as an Equity Research Analyst covering Korean non-life insurers and securities brokers. Overall, Sang Won has over ten years working experience in researching and analyzing companies in South Korea. He holds an MBA in Finance and Accounting from the Kellogg School of Management of Northwestern University and obtained his Bachelor's degree in Business Administration from Yonsei University.

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Raymond Chan is Chief Investment Officer of RCM Asia Pacific. He has over 18 years of investment experience, with a focus on equity markets in South Korea, Hong Kong, China and Taiwan. Prior to joining RCM, Mr. Chan was an Associate Director with Barclays Global Investors in Hong Kong and Head of the firm's Greater China team, managing single-country and regional portfolios. Mr. Chan holds an M.A. in Finance and Investment from the University of Exeter and a B.A. (Hons) in Economics from the University of Durham, U.K.

from 2000-2007, thanks to parents' enthusiasm for higher scholarly attainments.

When compared to other countries, Koreans tend to show extremely high level of enthusiasm for education. According to The Organisation for Economic and Co-operation and Development (OECD), Korea's education expenditure of 8.2% of GDP is the highest among OECD countries. This means that Koreans unsparingly invest their money on their children's education in response to the brutal competition that exists. Among OECD countries, Korea has the largest expenditure on private education – at 3.2% of GDP. It is followed by the USA and Australia, where the corresponding figures are 2.3% and 1.4% respectively.

Trends in Education business

Online: Among the recent trends of the education business, the most interesting is *the rapid growth of the online education sector*. Many students are changing their way of studying from attending offline institutes to taking online classes. This is partly because of limitation on time and location and in part because of the high quality content that is delivered by famous lecturers who have near-celebrity status. Moreover, the fees are fairly cheap. Between 2003 and 2007, the markets for online educational services for high and middle school education rose by 23% and 39% respectively.

English: Within the traditional - or offline - sector, we believe that *English education* could achieve strong growth under the new administration. New president MB Lee has a strong willingness to improve the quality of English classes in the public education sector. Before he was inaugurated, the new administration's transition committee had released several proposals related to English education. The reason behind the

strongly government support? Demand for high quality English classes has far exceeded the supply in the domestic market. In 2000–2005, the number of students studying abroad has surged from 4,000 to 20,000. Such trends drained capital and talents from Korea and has been perceived to have had a negative influence on the family-oriented culture of Korea. In response, the new government has suggested several proposals including, expanding the numbers of native English speaking teachers in public schools and introducing government-authorized English speaking tests. Therefore, we see the offline market for English education as an area on which we should focus in the near future.

Consolidation: The stock market success of Megastudy Co Ltd, whose share price has increased tenfold since its initial offering in 2004, has attracted massive money into companies within the education sector. Global investors have poured millions of dollars into small, unlisted, education companies. Meanwhile, large non-traditional Korean companies such as KT Corp, SK Telecom, and E-Land have started their own education businesses. We expect that the involvement of corporate and portfolio investors in education will increase as the sector's opportunities and growth are better understood. Also, we expect significant consolidation during the next five years, with the emergence of national chains. Merger & acquisition activity, together with large-scale investments, will make it increasingly difficult for the average mom-and-pop player to compete with its larger peers.

Major new Education Policies

MB Lee administration's basic direction of education policy is "building up capabilities of Korean students through competition". Detailed policies released after inauguration are as follows:

- 1) diversification of high schools,
- 2) expansion of public English classes - and changes to the Korean Scholastic Aptitude Test English exam, and ;
- 3) reduction of Education Ministry functions, while enhancing the autonomy of universities and regional education offices.

The government's major new education policies could revive the high school entrance exam market within the private sector.

Outstanding students who want to enter prestigious universities will likely compete for private schools, leading to the expansion of the middle school entrance exam market.

The government plans to revise the national curriculum by 2010, to allow high schools to offer English classes taught only in English. It also plans to extend the policy to middle and elementary schools.

We therefore expect the new policies will accelerate the growth momentum of the private education sectors - especially in English education.

Attractive investment opportunities worth a close watch

We believe the Korean education industry can offer attractive investment opportunities over the long-term, given the background and outlook that we describe here. However, suitable candidates for investment may not be readily available; reasons include valuation and regulations. In addition, with a survey showing Korean households' belief that education is 'necessity' rather than 'discretionary spending'; we are of the view that the industry can remain less affected by the economic conditions than other sectors. It should therefore be capable of providing decent investment returns regardless of economic cycles. Taking all these factors into consideration, we will continue to closely monitor the education sector, to identify and invest in future

leading companies who can thrive thanks to the various drivers of secular growth.

Thank you.

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* Source: Citi Investment Research, Korean Statistical Information Service

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