

Hanwha Chemical Corporation [009830, KSE]

CENTER FOR GOOD CORPORATE GOVERNANCE

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2008.05.28

Characteristics of Corporate Governance

1. As the intermediary holding company of Hanwha Group, the profits of the company may be sacrificed due to investment in affiliates and internal transactions made by the controlling shareholders for the purpose of dominating the Group
2. The controlling shareholders committed several offenses previously and may usurp the company of business opportunities for the succession of managerial powers
3. Hanwha Group's reluctance to establish a holding company negatively affects the enhancement of corporate transparency and value.
4. The Board of Directors lacks independence required to enhance corporate value and keep the management practices of controlling shareholders in check.

1. Corporate governance overview

The majority shareholder of Hanwha Chemical Corporation ("Hanwha Chemical") is Hanwha Corporation which owns 40.25% of the shares, and the controlling shareholder, Chairman Seung-youn Kim, and the related parties own over 30% of the shares of Hanwha Corporation.

Chairman Seung-youn Kim and his family (the controlling shareholders of the company) dominate the Group by means of investment cascading from Hanwha to Hanwha Chemical and to other affiliates.

There is a very slim possibility of a hostile M&A because the majority shareholder and related parties own over 45% of total equity.

Majority shareholder & related parties	Other domestic shareholders	Foreign shareholders
45.41%	28.72%	25.85%

The Board of Directors of Hanwha Chemical consists of three management officials and three outside directors. Although outside directors account for half of the Board of Directors, their independence is still questionable.

Inside director	Outside director	Number of directors allowed for additional appointment
3 directors	3 directors	6 directors

Due to the high percentage of shares owned by the majority shareholder, the exclusion of the cumulative voting system and the application of the staggered board system, it is not likely that minority shareholders of Hanwha Chemical will be able to elect directors. However, the Audit Committee system of the company may reduce the voting rights of the majority shareholder to 12.12% (outside director), 6.21% (inside director) in relation to the appointment of auditors to which the restrictions on voting rights of the majority shareholder are applied.

Hanwha Chemical belongs to Hanwha Group, the 16th largest conglomerate in terms of the asset size with a total of 40 affiliates as of April 2008. Hanwha Chemical which owns a large portion of equities of several affiliates is the de facto holding company of the Group.

Hanwha Chemical didn't pay dividends from 1998 to 2002 due to net losses. Since 2004, the dividend payout ratio of Hanwha Chemical has been approximately 2.8%.

2. Corporate governance analysis

Possibility that Chairman Seung-youn Kim uses the company as a vehicle to control the Group

The biggest risk underlying the corporate governance of Hanwha Chemical is that Chairman Seung-youn Kim whose interest may not correspond with that of Hanwha Chemical has absolute control over the company as a controlling shareholder.

The controlling shareholder, Seung-youn Kim, holds the risk of making decisions that may conflict with the interest of Hanwha Chemical in order to serve the interest of the Group and himself.

Chairman Seung-youn Kim has acquired or established new businesses to expand the Group business and utilized listed affiliates to provide financial support to the insolvent affiliates. The possibility that Hanwha Chemical plays the role of an intermediary holding company and uses its own assets to support other affiliates of the Group is a risk factor for the company. In fact, Hanwha Chemical was previously penalized by the Korea Fair Trade Commission for entering into unfair internal transactions, violation of the limit on the total investment amount, failure to disclose internal transactions, etc.

Hanwha Chemical participated in the consortium for Hanwha Group's acquisition of the shares of Korea Life Insurance in 2002 and acquired 65,940,000 shares. In 2003, it sold 58,840,000 shares to Hanwha. The series of transactions indicate that

Hanwha Chemical temporarily provided financial support to Hanwha Group which was planning a financing group centered on Hanwha. Moreover, as the call option written on the shares of Korea Life Insurance hasn't been exercised yet, Hanwha Chemical may additionally purchase shares afterwards and sell them to Hanwha when it has sufficient funds.

In 2004, Hanwha Chemical purchased 9 million shares of Korea Independent Energy Corporation held by Hanwha and an additional 6 million shares owned by Hanwha Galleria Co., Ltd. In relation to the purchase, Hanwha Chemical paid KRW 98.1 billion to Hanwha and KRW 69.4 billion to Hanwha Galleria. The payment of KRW 167.5 billion by Hanwha Chemical to Hanwha and Hanwha Galleria for the shares, equivalent to 1,081% of dividends paid by Hanwha Chemical in 2003, was made for the purpose of providing funds to affiliates rather than a result of its business operations.

Such financial support provided according to decisions made at the Group level poses a serious risk to the corporate governance of Hanwha Chemical.

Risk of company assets and business opportunities being usurped to serve the interest of the controlling shareholder(s)

Hanwha Chemical has a high risk in that business opportunities or company assets may be usurped by the controlling shareholder for the succession of the managerial powers and the interest of controlling shareholders.

Hanwha S&C, an IT company established in March 2001, is a family company whose shares are 100% owned by three sons of Chairman Seung-youn Kim. Over 50% of the sales revenues of Hanwha S&C is generated from transactions with the affiliates. Its transactions with Hanwha Chemical generated KRW 16.12 billion in sales (7.21% of Hanwha S&C sales revenue). The transactions between Hanwha Chemical and Hanwha S&C are internal transactions where the family members of the controlling shareholder can easily obtain financial gains from Hanwha Chemical. In particular, as the management and the Board of Directors of Hanwha Chemical cannot make decisions independent of the controlling shareholders, the controlling shareholders can secretly hoard profits of Hanwha Chemical for personal gains through continued transactions, and there is a possibility of further asset outflows from Hanwha Chemical going forward. In fact, the transaction amount between Hanwha Chemical and Hanwha S&C more than doubled from KRW 7,168,900,000 in 2006 to KRW 16.12 billion in 2007.

[Sales of Hanwha S&C to associated companies]

Company Name	Amount/Rate
Hanwha Chemical Coporation	16,121,526
Hanwha Corporation	8,295,858
Hanwha E&C	26,149,546
Other affiliates	50,566,383
Total sales to associated companies	116,940,997
Total sales	223,736,167
Percentage of sales to associated companies	52.27%
Percentage of sales to Hanwha Chemical	7.21%

There has been a recent movement on the part of minority shareholders who put pressure on the affiliates of Hanwha to improve the transaction practices intended to support Hanwha S&C.

The Solidarity for Economic Reform (“SER”), a civic organization, is planning to file a derivative lawsuit on behalf of Hanwha to seek recovery of losses against the directors and to accuse Hanwha Corporation of incurring losses to the company by selling 400,000 shares of Hanwha S&C to Dong-kwan Kim at low prices. Currently, SER has filed for a preliminary injunction in order to access to the company’s shareholder’s list in preparation for the suit on the merits.

Board of Directors without sufficient independence

Another factor that increases the corporate governance risk of Hanwha Chemical in relation to the controlling shareholders and the ownership structure of the Group is the Board of Directors which lacks independence.

The majority of the Board of Directors of Hanwha Chemical comprises outside directors but they are not independent of the controlling shareholders and the management.

Two out of four outside directors are former executive members of Hanwha affiliates. Moreover, the other two went to the same school with Chairman Seung-youn Kim and therefore, it is hard to expect an independent role from them as the outside directors.

It is judged that the Board of Directors of Hanwha Chemical is not able to protect the interest of the entire shareholders from decisions of controlling shareholders or the management who either damage the profits of shareholders or are incapable of raising the corporate value.

Delay in transformation into a holding company structure

Converting Hanwha Group into a holding company structure would have

positive effects on corporate governance as the ownership structure of the whole Group would be simplified and the ownership in subsidiaries would be restricted. As Hanwha Chemical was the de facto holding company of Hanwha Group, the ownership adjustment for the conversion to a holding company wasn't complicated except for its financial affiliates.

But the conversion didn't have many incentives for Chairman Seung-youn Kim in terms of strengthening the power of controlling shareholders because such conversion cost money to adjust the ownership structure and, in particular, Hanwha needed to sell its financial affiliates including Hanwha Securities Co., Ltd., etc. Furthermore, as Hanwha Group has no reason to hasten the conversion to a holding company structure and it is clear that government regulations on large conglomerates including the limit on the total amount of investment will be loosened, it appears that it will delay the conversion for the time being by evading the holding company regulations.

Repeated offenses of Chairman Seung-youn Kim

The repeated offenses of Chairman Seung-youn Kim are also a risk factor that affects corporate governance. Despite the fact that Chairman Seung-youn Kim is not a member of the Board of Directors or the management, his offenses negatively affect Hanwha Chemical as he is the head of Hanwha Group.

During the presidential election in 2002, Chairman Seung-youn Kim was accused of illegally providing political funds in the amount of KRW 1 billion. He was sentenced to a stay of execution at the trial court while the penalty was mitigated into a fine at the appellate court. Moreover, he was investigated by the prosecution on the charges of malfeasance, bribery, etc. under the Act on the Aggravated Punishment, etc. of Specific Economic Crimes but he was not prosecuted due to lack of sufficient material evidence. Recently, he was convicted of lynching in retaliation for an attack on his son and sentenced to one year in prison, three years of stay of execution and 200 hours of community service at the appellate court. Consequently, Chairman Kim resigned from his position as the representative director of Hanwha and Hanwha Engineering & Construction Corp.

3. Measures to improve corporate governance

Appointment of audit committee members who can keep the management practices of controlling shareholders in check

In order to prevent Hanwha Chemical from being sacrificed for the sake of controlling shareholders, which is a risk factor in corporate governance of

Hanwha Chemical, it is required to secure the independence of the Board of Directors.

The outside directors who are former executives of Hanwha Group affiliates shall be replaced with independent persons and the Audit Committee and the Internal Transaction Committee shall consist of independent outside directors.

As the controlling shareholders own 45.41% of the total equity of Hanwha Chemical, however, constituting a completely independent Board of Directors is not possible for the external shareholders, in reality.

Hanwha Chemical needs to appoint auditors who can represent the interest of all shareholders. Under the applicable law, the voting rights of controlling shareholders are limited to 3% with respect to the appointment of an auditor who is also an outside director and therefore, Chairman Seung-youn Kim and other related parties can exercise only 12.12% of the total voting rights. Therefore, the minority shareholders may appoint an auditor and outside director if they form solidarity. However, forming solidarity may be difficult as there are few shareholders who hold more than 5%.

The Audit Committee of Hanwha consists of three outside directors and after the resignation of Yeon-cheon Oh from the position of auditor and outside directorship, Seung-jong Lee was appointed as an auditor (who also serves as the outside director) on April 17, 2008

As the term of office of outside director and auditor, In-Hyeon Jeong, expires during the coming AGM in 2009, seven directors can be additionally appointed according to the Articles of Incorporation which allows the appointment of up to 12 directors. Pursuant to the Articles of Incorporation, the company shall appoint at least three outside directors as the auditors and at least 2/3 of the Committee members shall be the outside directors. Therefore, at least one auditor who is also an outside director shall be newly appointed in case director In-hyeon Jeong is not reelected. Given the ownership structure, it may be hard for the minority shareholders to appoint inside or outside directors but if the minority shareholders form solidarity, they may nominate and appoint auditors who would also be serving as the outside directors.

Upward adjustment of dividend payment

Hanwha Chemical didn't pay dividends until 2002 due to net losses but since then, it has been increasing dividend payout ratios every year. For the past five years, the average payout ratio was 15.7%, lower than the industry average of 16.58%. Its retained earnings in 2007 stood at KRW 212,937 million and the total cash dividend was KRW 40,458 million. The dividend payout ratio may be adjusted

upward in the future.

Exercise of minority shareholders' right to improve corporate governance

Hanwha Chemical satisfies only the minimum requirements for the corporate governance system required by law, and it was previously subject to reprimand or warning for its accounting practices or transparency in information disclosure. It was also subject to disciplinary actions by the Korea Fair Trade Commission in relation to its inappropriate transactions with affiliates.

Minority shareholders are allowed to exercise the rights of minority shareholders by gathering 0.01~3% of equity to hold the management responsible for losses incurred to the company due to misjudgment. The types of minority shareholder rights include the right to bring shareholders' derivative actions, the right to inspect accounting books, the right to make proposals, the right to nominate outside directors, etc. (Refer to the tables below).

Major items relating to corporate governance

Ownership Structure and Voting Rights

(as of Dec. 31, 2007)

(unit: number of shares, %)

		Ownership		Voting Rights		
		Number of Shares	Stake Ratio	Ordinary Items	Restricted by 3% Rule	Total 3%
Controlling Shareholder and Persons with Special Interest	Hanwha Corporation	40,240,590	40.29	40.29	5.82	
	Hanwha E&C	4,870,000	4.88	4.88	5.82	
	Chonan Bukil Academy	231,456	0.23	0.23	0.45	
	Directors	14,368	0.01	0.01	0.03	
	Sub-total	45,356,414	45.41	45.41	12.12	6.21
Other Shareholders	JF Asset Management Limited	7,939,620	7.95	7.95	6.81	7.27
	Sloane Robinson LLP	3,515,380	3.52	3.52	6.83	7.29
	AllianceBernstein L.P.	5,293,290	5.30	5.30	5.82	6.21
	SMALLCAP World Fund, Inc	4,789,310	4.79	4.79	5.82	6.21
	CRMC	3,771,760	3.78	3.78	5.82	6.21
	Foreign	526,312	0.53	0.53	1.02	1.09
	Domestic	28,689,354	28.72	28.72	55.75	59.49
	Sub-total	54,525,026	54.59	54.59	87.88	93.79
Treasury Stocks		-	-	-	-	-
Total		99,881,440	100.00	100.00	100.00	100.00

* General Agendas: With respect to general agendas excluding those subject to restrictions on voting rights by law, the voting rights can be exercised except for non-voting treasury stock

** Individual 3%: With respect to the appointment of an auditor who is also an outside director and the changes to the Articles of Incorporation for the introduction/exclusion of the cumulative voting system (in companies over KRW 2 trillion in total assets), each shareholder holding over 3% of voting stock cannot exercise the voting rights for the stock in excess of 3%.

*** Total 3%: With respect to the appointment of an auditor or an auditor who is also an outside director, the combined voting rights of the majority shareholder and the related parties cannot exceed 3% of voting stock. Besides, a shareholder holding 3% or more of voting stock cannot individually exercise the voting rights in excess of 3%.

Minimum Shareholdings Required for Exercise of Minority Shareholders' Rights

(as of Dec. 31, 2007)

(unit: number of shares, %)

Minimum Number of Shares	Holding for 6 months or more		Holding less than 6 months	
Right to bring shareholders' derivative actions	10,101	0.010%	998,814	1%
Right to claim injunctive relief for directors' illegal activities	25,251	0.025%	998,814	1%
Right to demand dismissal of director/auditor	252,513	0.250%	2,996,443	3%
Right to inspect accounting books	50,503	0.050%	2,996,443	3%
Right to demand appointment of inspector	1,498,222	1.500%	2,996,443	3%
Right to call an extraordinary shareholders' meeting*	1,498,222	1.500%	2,996,443	3%
Shareholder proposal right*	499,407	0.500%	2,996,443	3%
Right to nominate outside directors*	499,407	0.500%	-	-
Right to request cumulative voting*	10,101	1.000%	2,996,443	3%

* based on the shares with voting rights

Board Structure

(as of Apr. 1, 2008)

Position	Name	Year of Election	End of Term	Other Particulars
Rep. Director	Won-Jun Heo	Mar. 2005	2008	
Internal Director	Gi-Jun Hong	Mar. 2007	2010	
Internal Director	Chang-Beom Kim	Mar. 2006	2009	
Sub-total	3			
Outside Director	In-Hyeon Jeong	Mar. 2006	2009	Audit Committee (Former Director of an affiliate)
Outside Director	Seung-Jong Yi	Mar. 2008	2011	Outside Director Nomination Committee
Outside Director	Duk-Geun Oh	Mar. 2008	2011	Audit Committee (Former Director of an affiliate)
Sub-total	3			
Total	6			

* Yeon Cheon Oh, outside director and auditor, resigned on April 17, 2008.

Restrictions by Articles of Incorporation and applicable laws and violations

Contents			
Shareholders' Meeting	Proxy	Allowed	
	Resolution of general agendas	Cumulative voting excluded/ Vote by mail allowed	
	Limitations on voting rights with respect to the appointment of outside directors	A shareholder holding 3% or more of voting stock cannot exercise the rights in excess of 3%.	Securities and Exchange Act
Board of Directors	Number of directors	3~12 directors	Articles of Incorporation
	Number of outside directors	At least 25%	Articles of Incorporation
	Term of office	3 years	Articles of Incorporation
	Method of appointment	Through a resolution at the Shareholders' Meeting	Articles of Incorporation
Internal transaction	Prohibition of interlocking investment /payment guarantee		
	Internal transactions exceeding a certain volume shall be resolved by the Board of Directors and then disclosed.		Fair Trade Act
	Transactions exceeding a certain volume shall be approved by the Board of Directors and reported to the Shareholders' Meeting		Fair Trade Act

Data	Sanctions	Reason	Imposed by
1999.8.5	Warning issuance and submission of a written promise	Inaccurate and insufficient preparation of business reports	Financial Supervisory Committee
2002.3.14	Restriction on issuance of marketable securities for six months	Violation of Financial Accounting Standards for businesses	Securities & Futures Commission
	Assignment of an auditor for two years		
	Recommendation for dismissal of responsible executive officer (1 person)		
	Request for correction		
2001.7.11	Imposition of penalties	Unfair internal transaction (Kyunghyang Daily)	Fair Trade Commission
2000.2.25	Imposition of penalties	Unfair internal transaction (Binggrae, Hanwha Finance)	Fair Trade Commission
2005.1.3	Imposition of penalties	Violation of the limit on the total amount of investment	Fair Trade Commission
2004.2	Imposition of penalties	Failure to disclose internal transaction	Fair Trade Commission

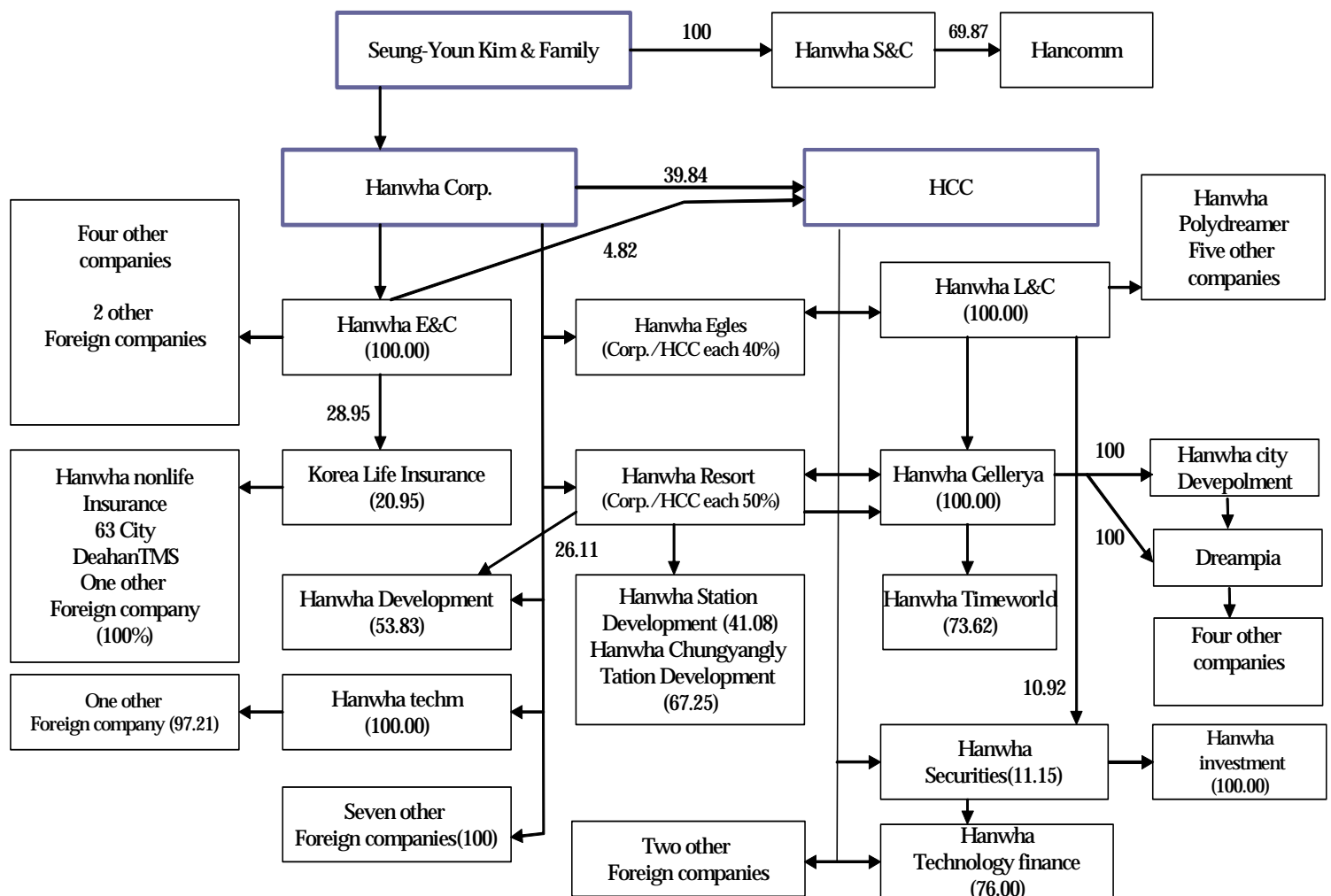
Dividend Price Policies

	(unit: KRW, %)				
	2007	2006	2005	2004	2003
Dividend					
Common Stock	400	350	350	300	150
Preferred Stock	450	400	400	350	200
Dividend Yield Ratio	2.2	2.8	2.9	2.8	1.4
Dividend Payout Ratio	19.0	17.3	10.8	10.1	9.9
EPS	2,127	2,047	3,286	3,004	1,583

Ownership Structure of Hanwha Group

(as of Dec. 31, 2007)

(unit: %)



Relevant Reports

Title	Date
Analysis on the Holding Company System (4) – The Expected Path of Hanwha Group's Transformation	2004-02-02
Hanwha Chemical Continues to Get Involved in the Stock Transactions with its Affiliates	2004-05-27
Hanwha Corporation Transfers its Treasury Stocks to Solidify the Controlling Shareholder's Control	2004-09-01
Hanwha Group Still Haunted By Acquisition of Korea Life Insurance	2004-12-13
The Prosecutors' Investigation On Bidding Process Of Korea Life Insurance Shakes Hanwha	2005-01-31
Hanwha Corporation and Hanwha Construction Being Merged? What Is The True Intention?	2005-11-10
Chairman Seung Yeon Kim Arrested -Any Impact on Hanwha Group?	2007-05-15
Suspicious Transaction of Hanwha S&C by Hanwha Corporation	2007-08-01
Hanwha Group – No Intention to Convert Into A Holding Company Structure	2008-03-24

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