PHARMION CORP
Form 10-Q
May 10, 2005

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2005

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 000-50447

PHARMION CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**84-1521333**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

2525 28th Street, Boulder, Colorado 80304
(Address of principal executive offices)

(720) 564-9100
(Registrant s telephone number)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes þ No o

As of May 4, 2005, there were 31,826,271 shares of the Registrant s Common Stock outstanding.

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PART I
FINANCIAL INFORMATION

Item 1. ***Consolidated Financial Statements***

PHARMION CORPORATION

CONSOLIDATED BALANCE SHEETS
(In thousands, except for share amounts)

	March 31, 2005 (Unaudited)	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	$ 102,026	$ 119,658
Short-term investments	142,447	125,885
Accounts receivable, net of allowances of $2,621 and $2,210, respectively	32,118	35,193
Inventories	4,731	3,688
Other current assets	5,585	4,396
Total current assets	286,907	288,820
Product rights, net	105,432	108,478
Goodwill	14,089	9,426
Property and equipment, net	4,385	4,284
Other assets	223	223
Total assets	$ 411,036	$ 411,231
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 8,735	$ 9,891
Accrued liabilities	44,775	45,563
Total current liabilities	53,510	55,454
Deferred tax liability	3,414	3,606
Other long-term liabilities	149	218
Total liabilities	57,073	59,278
Stockholders equity:		
Common stock, $0.001 par value; 100,000,000 shares authorized and 31,823,082 and 31,780,715 shares issued and outstanding at March 31, 2005 and December 31, 2004, respectively	32	32
Preferred stock, $0.001, 10,000,000 shares authorized, no shares issued and outstanding at March 31, 2005 and December 31, 2004		
Additional paid-in capital	482,650	482,661

Deferred compensation	(453)	(680)
Other comprehensive income	5,560	8,036
Accumulated deficit	(133,826)	(138,096)
Total stockholders equity	353,963	351,953
Total liabilities and stockholders equity	$ 411,036	$ 411,231

The accompanying notes are an integral part of these consolidated financial statements

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PHARMION CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except for share and per share amounts)
(Unaudited)

	Three Months Ended March 31,	
	2005	**2004**
Net sales	$ 51,737	$ 15,721
Operating expenses:		
Cost of sales, including royalties of $10,108 and $4,581 for the three months ended March 31, 2005 and 2004, respectively	13,947	6,309
Clinical, development and regulatory	9,464	6,553
Selling, general and administrative	20,680	10,948
Product rights amortization	2,238	725
Total operating expenses	46,329	24,535
Operating income (loss)	5,408	(8,814)
Interest and other income (expense), net	1,779	(73)
Income (loss) before taxes	7,187	(8,887)
Income tax expense	2,917	922
Net income (loss)	$ 4,270	$ (9,809)
Net income (loss) per common share:		
Basic	$ 0.13	$ (0.40)
Diluted	$ 0.13	$ (0.40)
Weighted average number of common and common equivalent shares used to calculate net income (loss) per common share:		
Basic	31,804,784	24,349,920
Diluted	33,035,855	24,349,920

The accompanying notes are an integral part of these consolidated financial statements

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PHARMION CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2005	**2004**
Operating activities		
Net income (loss)	$ 4,270	$ (9,809)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,848	1,210
Compensation expense related to stock option issuance	55	174
Other	273	
Changes in operating assets and liabilities:		
Accounts receivable, net	2,035	(3,349)
Inventories	(1,296)	623
Other current assets	(1,338)	60
Other long-term assets	(4)	247
Accounts payable	(904)	(1,483)
Accrued liabilities	1,547	2,988
Net cash provided by (used in) operating activities	7,486	(9,339)
Investing activities		
Purchases of property and equipment	(818)	(223)
Acquisition of business, net of cash acquired	(5,204)	(19)
Purchase of available-for-sale investments	(65,227)	(33,253)
Sale and maturity of available-for-sale investments	48,335	
Net cash used in investing activities	(22,914)	(33,495)
Financing activities		
Proceeds from exercise of common stock options	161	6
Payment of debt obligations	(1,048)	(967)
Net cash used in financing activities	(887)	(961)
Effect of exchange rate changes on cash and cash equivalents	(1,317)	(420)
Net decrease in cash and cash equivalents	(17,632)	(44,215)
Cash and cash equivalents at beginning of period	119,658	88,542
Cash and cash equivalents at end of period	$ 102,026	$ 44,327
Noncash items		
Accrual of additional business acquisition consideration	5,166	
Conversion of debt and accrued interest to common stock		14,161

The accompanying notes are an integral part of these consolidated financial statements

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PHARMION CORPORATION

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF BUSINESS

Pharmion Corporation (the Company) was incorporated in Delaware on August 26, 1999 and commenced operations in January 2000. The Company is engaged in the acquisition, development and commercialization of pharmaceutical products for the treatment of oncology and hematology patients. The Company s product acquisition and licensing efforts are focused on both late-stage development products as well as those approved for marketing. In exchange for distribution and marketing rights, the Company generally grants the seller royalties on future sales and, in some cases, up-front and scheduled future cash payments. To date, the Company has acquired the distribution and marketing rights to four products, three of which are approved for marketing and with the fourth being sold on a compassionate use or named patient basis while the Company pursues marketing approval. The Company has established operations in the United States, Europe and Australia. Through a distributor network, the Company can reach the hematology and oncology community in additional countries in the Middle East and Asia.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements of the Company and its subsidiaries have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the SEC pertaining to Form 10-Q. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain disclosures required for complete financial statements are not included herein. These statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s latest audited annual financial statements, which are included in its 2004 Annual Report on Form 10-K, which has been filed with the SEC.

In the opinion of management, the unaudited interim financial statements reflect all adjustments, which include only normal, recurring adjustments necessary to present fairly the Company s financial position at March 31, 2005 and results of operations and cash flows for the three months ended March 31, 2005 and 2004. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the year ending December 31, 2005 or for any other interim period or for any other future year.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of expenses during the reporting period. Actual results could differ from those estimates or assumptions. The significant estimates reflected in these financial statements include estimates of chargebacks from distributors, product returns and rebates, inventory impairment and valuation of stock-based compensation.

Revenue Recognition

The Company sells its products to wholesale distributors and directly to hospitals, clinics and retail pharmacies. Revenue from product sales is recognized when ownership of the product is transferred to the customer, the sales price is fixed and determinable, and collectibility is reasonably assured.

Revenue is reported net of allowances for chargebacks from distributors, product returns, rebates and prompt payment discounts. Significant estimates are required for determining such allowances and are based on historical data, industry information and information from customers. If actual results are different from estimates, the Company will adjust the allowances at the time such differences become apparent.

Certain governmental health insurance providers as well as hospitals and clinics that are members of group purchasing organizations may be entitled to price discounts and rebates on the Company s products used by those organizations and their patients. As such, the Company must estimate the likelihood that products sold to wholesale distributors will ultimately be subject to a rebate or price discount. This estimate is based on historical trends and industry data on the utilization of the Company s products.

Cash and Cash Equivalents

Cash and cash equivalents consist of money market accounts and overnight deposits. The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents. Interest income resulting from cash and cash equivalent holdings was $1.9 million and $.2 million for the three months ended March 31, 2005 and 2004, respectively.

The Company has entered into international standby letters of credit to guarantee both current and future commitments of new foreign office lease agreements. The aggregate amount outstanding under the letters of credit was approximately $1.6 million at March 31, 2005 and is secured by restricted cash held in U.S. cash accounts.

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Short-term Investments

Short-term investments consist of investment grade government agency and corporate debt securities due within one year. Investments with maturities beyond one year are classified as short-term based on their highly liquid nature and because such investments represent the investment of cash that is available for current operations. All investments are classified as available-for-sale and are recorded at market value. Unrealized gains and losses are reflected in other comprehensive income.

Inventories

Inventories consist of raw materials and finished goods and are stated at the lower of cost or market, cost being determined under the first-in, first-out method. The Company periodically reviews inventories and any items considered outdated or obsolete are reduced to their estimated net realizable value. The Company estimates reserves for excess and obsolete inventories based on inventory levels on hand, future purchase commitments, product expiration dates and current and forecasted product demand. If an estimate of future product demand suggests that inventory levels are excessive, then inventories are reduced to their estimated net realizable value.

Long-Lived Assets

Our long-lived assets consist primarily of product rights and property and equipment. In accordance with Statement of Financial Accounting Standards No. 144 (SFAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets, we evaluate our ability to recover the carrying value of long-lived assets used in our business, considering changes in the business environment or other facts and circumstances that suggest their value may be impaired. If this evaluation indicates the carrying value will not be recoverable, based on the undiscounted expected future cash flows estimated to be generated by these assets, we reduce the carrying amount to the estimated fair value.

Goodwill

We completed a business acquisition in 2003 that resulted in the creation of goodwill. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, we do not amortize goodwill. SFAS No. 142 requires us to perform an impairment review of goodwill at least annually. If it is determined that the value of goodwill is impaired, we will record the impairment charge in the statement of operations in the period it is discovered. The process of reviewing for impairment of goodwill is similar to that of long-lived assets in that expected future cash flows are calculated using estimated future events and trends such as sales, cost of sales, operating expenses and income taxes. The actual results of any of these factors could be materially different than what we estimate.

In addition to the goodwill that was created as a result of the 2003 business acquisition, the agreement included contingent payments based on cumulative sales milestones. The final cumulative sales milestone was achieved in the first quarter of 2005 which resulted in an additional $5.1 million being added to goodwill.

Concentration of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk are primarily cash and cash equivalents, short-term investments and accounts receivable. The Company maintains its cash balances in the form of short-term investment grade securities, money market accounts and overnight deposits with financial institutions that management believes are creditworthy. The Company has no financial instruments with off-balance-sheet risk of accounting loss.

The Company s products are sold both to wholesale distributors and directly to hospitals and clinics. Ongoing credit evaluations of customers are performed and collateral is generally not required. The Company maintains a reserve for potential credit losses, and such losses have been within management s expectations. In the three months ended March 31, 2005 and 2004, revenues generated from the Company s three largest customers in the U.S. totaled approximately 46% and 10%, respectively, of consolidated net revenues. Additionally, the three largest U.S. customers each totaled approximately 15% of consolidated net revenues for the period ended March 31, 2005. Revenues generated from international customers were individually less than 5% of consolidated net revenues.

Accounting for Stock-Based Compensation

At March 31, 2005, the Company had two stock option plans. The Company has elected to account for stock-based compensation arrangements using the intrinsic value method under the provisions of Accounting Principles Board Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees and its related interpretations. Under this method, when the exercise price is less than the market price for the underlying stock on the date of grant, a non-cash charge to compensation expense is recorded ratably over the term of the option vesting period in an amount equal to the difference between the value calculated using the exercise price and the fair value. The Company uses the fair value method to account for nonemployee stock-based compensation.

During 2003, options were granted to employees and directors at exercise prices that were less than the estimated fair value of the underlying shares of common stock as of the grant date. In accordance with APB 25, deferred compensation expense is being recognized for the excess of the estimated fair value of the Company s common stock as of the grant date over the exercise price of the options and amortized to expense on a straight-line basis over the vesting periods of the related options, which is generally 4 years.

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Pro forma information regarding net loss is required by SFAS No. 123, Accounting for Stock-Based Compensation, and has been determined as if the Company had accounted for its employee stock options under the fair value method of that statement. The fair value for these options was estimated at the date of grant using the Black-Scholes valuation model.

The effects of applying the fair value method to the results for the three months ended March 31, 2005 and 2004 are (in thousands):

	Three Months Ended March 31,	
	2005	2004
Net income (loss):		
As reported	$ 4,270	$ (9,809)
Plus: stock based compensation recognized under the intrinsic value method	55	174
Less: stock based compensation under fair value method	(1,984)	(526)
Pro forma net income (loss)	$ 2,341	$ (10,161)
Net income (loss) per common share:		
Basic, as reported	$ 0.13	$ (0.40)
Basic, pro forma	$ 0.07	$ (0.42)
Diluted, as reported	$ 0.13	$ (0.40)
Diluted, pro forma	$ 0.07	$ (0.42)

Option valuation models such as the Black-Scholes value method described above require the input of highly subjective assumptions. Because the Company s employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management s opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

The weighted-average fair value per share was $18.18 and $12.16 for stock options granted in the three months ended March 31, 2005 and 2004, respectively. The assumptions used to develop the estimated fair value of the options granted utilizing the Black-Scholes pricing model are:

	Three Months Ended March 31,	
	2005	2004
Risk-free interest rate	3.8%	2.8%
Expected stock price volatility	61%	85%
Expected option term until exercise (years)	4	5
Expected dividend yield	0%	0%

Recently Issued Accounting Standards

On December 16, 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), Share-Based Payment, which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation. SFAS

No. 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their estimated fair values. Pro forma disclosure is no longer an alternative.

SFAS No. 123(R) must be adopted no later than the beginning of the first fiscal year after June 15, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued. We expect to adopt SFAS No. 123(R) on January 1, 2006.

SFAS No. 123(R) permits public companies to adopt its requirements using one of two methods:

A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all rewards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the effective date; or

A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods or (b) prior interim periods of the year of adoption.

We are still evaluating which method we will adopt on January 1, 2006.

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3. NET INCOME (LOSS) PER COMMON SHARE

The Company applies SFAS No. 128, Earnings per Share, which establishes standards for computing and presenting earnings per share. Basic net income (loss) per common share is calculated by dividing net income (loss) applicable to common stockholders by the weighted average number of unrestricted common shares outstanding for the period. Diluted net loss per common share is the same as basic net loss per common share for the three months ended March 31, 2004, since the effects of potentially dilutive securities were antidilutive for that period. Diluted net income per common share is calculated by dividing net income applicable to common stockholders by the weighted average number of common shares outstanding for the period increased to include all additional common shares that would have been outstanding assuming the issuance of potentially dilutive common shares. Potential incremental common shares include shares of common stock issuable upon exercise of stock options, warrants and convertible notes outstanding during the periods presented.

A reconciliation of the weighted average number of shares used to calculate basic and diluted net income (loss) per common share follows:

	Three Months Ended March 31,	
	2005	**2004**
Basic	31,804,784	24,349,920
Effect of dilutive securities:		
Stock options	1,231,071	
Diluted	33,035,855	24,349,920

The total number of potential common shares excluded from diluted earnings per share computation because they were anti-dilutive was 784,967 and 2,035,537 for the three months ended March 31, 2005 and 2004, respectively.

4. LICENSE AGREEMENTS AND PRODUCT RIGHTS

Thalidomide

In 2001, the Company licensed rights relating to the development and commercial use of thalidomide from Celgene Corporation and separately entered into an exclusive supply agreement for thalidomide with Celgene UK Manufacturing II Limited (formerly known as Penn T Limited), or CUK. Under the agreements, as amended in December 2004, the territory licensed from Celgene is for all countries other than the United States, Canada, Mexico, Japan and all provinces of China (except Hong Kong).The Company pays (i) Celgene a royalty/license fee of 8% on the Company s net sales of thalidomide under the terms of the license agreements, and (ii) CUK product supply payments equal to 15.5% of the Company s net sales of thalidomide under the terms of the product supply agreement. The agreements with Celgene and CUK each have a ten-year term running from the date of receipt of the Company s first regulatory approval for thalidomide in the United Kingdom. In October of 2004, Celgene acquired CUK.

In December 2004, the Company amended its thalidomide agreements with Celgene and CUK to reduce the thalidomide product supply payment, expand the Company s licensed territory, and eliminate certain license termination rights held by Celgene. The Company paid Celgene a one-time payment of $80 million in exchange for (i) the reduction in the cost of product supply from 28.0% of net sales to 15.5% of net sales, (ii) the addition of Korea, Hong Kong, and Taiwan to the Company s licensed territory and, (iii) elimination of Celgene s right to terminate the

license agreement in the event the Company has not obtained a marketing authorization approval for thalidomide in the United Kingdom by November 2006. The $80 million payment was capitalized as part of the thalidomide product rights and is being amortized over the remaining period the Company expects to generate significant thalidomide sales, approximately 13 years from December 31, 2004.

The Company has also committed to provide funding to support further clinical development studies of thalidomide sponsored by Celgene. Under these agreements, the Company will pay Celgene $4.7 million for all of 2005 and $2.7 million in each of 2006 and 2007.

Vidaza®

In 2001, the Company licensed worldwide rights to Vidaza (azacitidine) from Pharmacia & Upjohn Company, now part of Pfizer, Inc. Under terms of the license agreement, the Company is responsible for all costs to develop and market Vidaza and the Company pays Pfizer a royalty equal to 20% of Vidaza net sales. No up-front or milestone payments have or will be made to Pfizer. The license has a term extending for the longer of the last to expire of valid patent claims in any given country or ten years from the first commercial sale of the product in a particular country.

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***Refludan*®**

In May 2002, the Company entered into agreements to acquire the exclusive right to market and distribute Refludan in all countries outside the U.S. and Canada. These agreements, as amended in August 2003, transferred all marketing authorizations and product registrations for Refludan in the individual countries within the Company s territories. The Company has paid Schering an aggregate of $10 million to date and is obligated to make three additional fixed payments to Schering, payable in quarterly installments of $1 million through the end of 2005. The value of the total cash payments made and the present value of future payments is $12.2 million, which was capitalized to product rights and is being amortized over the 10 year period during which the Company expects to generate revenue. Additional payments of up to $7.5 million will be due Schering upon achievement of certain milestones. Because such payments are contingent upon future events, they are not reflected in the accompanying financial statements. The Company pays a royalty of 14% of net sales of Refludan until the aggregate royalty payments total $12.0 million measured from January 2004. At that time, the royalty rate will be reduced to 6%.

***Innohep*®**

In June 2002, the Company entered into a 10 year agreement with LEO Pharma A/S for the license of the low molecular weight heparin, Innohep. Under the terms of the agreement, the Company acquired an exclusive right and license to market and distribute Innohep in the United States. On the closing date the Company paid $5 million for the license, which was capitalized as product rights and is being amortized over a 10 year period in which the Company expects to generate significant revenues. In addition, the Company is obligated to pay LEO Pharma royalties at the rate of 30% of net sales on annual net sales of up to $20 million and at the rate of 35% of net sales on annual net sales exceeding $20 million, less in each case the Company s purchase price from LEO Pharma of the units of product sold. Furthermore, the agreement contains a minimum net sales clause that is effective for two consecutive two-year periods. If the company does not achieve these minimum sales levels for two consecutive years, it has the right to pay LEO Pharma additional royalties up to the amount LEO Pharma would have received had the company achieved these net sales levels. If the company opts not to make the additional royalty payment, LEO Pharma has the right to terminate the license agreement. The second of the two-year terms will conclude on December 31, 2006.

The cost value and accumulated amortization associated with Thalidomide, Innohep and Refludan are as follows (in thousands):

	As of March 31, 2005		As of December 31, 2004	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized product rights:				
Thalidomide	$ 96,322	$ (4,174)	$ 97,242	$ (2,509)
Refludan	12,208	(2,549)	12,208	(2,213)
Innohep	5,000	(1,375)	5,000	(1,250)
Total product rights	$ 113,530	$ (8,098)	$ 114,450	$ (5,972)

5. INVENTORIES

Inventories at March 31, 2005 and December 31, 2004 consisted of the following (in thousands):

	March 31, 2005	December 31, 2004
Raw materials	$ 1,377	$ 351
Finished goods	3,354	3,337
Total inventories	$ 4,731	$ 3,688

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6. OTHER COMPREHENSIVE INCOME (LOSS)

Total comprehensive income (loss) for the three months ended March 31, 2005 and 2004 was (in thousands):

	Three Months Ended March 31,	
	2005	2004
Net income (loss)	$ 4,270	$ (9,809)
Other comprehensive income (loss):		
Foreign currency translation	(2,427)	(1,023)
Unrealized loss on available for sale securities	(48)	(169)
Comprehensive income (loss)	$ 1,795	$ (11,001)

The foreign currency translation amounts relate to the operating results of our foreign subsidiaries.

7. INCOME TAXES

Income taxes have been provided for using the liability method in accordance with SFAS No. 109, Accounting for Income Taxes. The provision for income taxes reflects management s estimate of the effective tax rate expected to be applicable for the full fiscal year for each country in which we do business. This estimate is re-evaluated by management each quarter based on the Company s estimated tax expense for the year. Income tax expense for the three months ended March 31, 2005 and 2004 resulted primarily from taxable income generated in certain foreign jurisdictions.

8. GEOGRAPHIC INFORMATION

Domestic and foreign financial information for the three months ended March 31, 2005 and 2004 was (in thousands):

		Three Months Ended March 31,	
		2005	2004
United States	Net sales	$ 28,915	$ 1,657
Foreign entities	Net sales	22,822	14,064
Total	Net sales	$ 51,737	$ 15,721
United States	Operating income (loss)	$ 4,688	$ (7,477)
Foreign entities	Operating income (loss)	720	(1,337)
Total	Operating income (loss)	$ 5,408	$ (8,814)

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the condensed financial statements and the related notes that appear elsewhere in this document.

FORWARD-LOOKING STATEMENTS

All statements, trend analysis and other information contained in this Form 10-Q that are not historical in nature are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, without limitation, discussion relative to markets for our products and trends in revenue, gross margins and anticipated expense levels, as well as other statements including words such as anticipate, believe, plan, estimate, expect and intend and other similar expressions. All statements regarding our expected financial position and operating results, business strategy, financing plans, forecast trends relating to our industry are forward-looking statements. These forward-looking statements are subject to business and economic risks and uncertainties, and our actual results of operations may differ materially from those contained in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those mentioned in the discussion below. As a result, you should not place undue reliance on these forward-looking statements. We undertake nor revise these forward-looking statements to reflect future events or developments.

Overview

We are a global pharmaceutical company focused on acquiring, developing and commercializing innovative products for the treatment of hematology and oncology patients. We have established our own regulatory, development and sales and marketing organizations covering the U.S., Europe and Australia. We have also developed a distributor network to cover the hematology and oncology markets in additional countries throughout Europe, the Middle East and Asia. To date, we have acquired the rights to four products. Thalidomide Pharmion 50mg™ is being sold by us on a compassionate use or named patient basis in Europe and other international markets while we pursue marketing authorization from the European Agency for the Evaluation of Medicinal Products, or EMEA. In May 2004, Vidaza®, was approved for marketing in the U.S. and we commenced sales of the product in July 2004. We have filed for approval to market Vidaza in Europe and Australia and these submissions are under review by the respective regulatory authorities. In addition, we sell Innohep® in the U.S. and Refludan® in Europe and other international markets. With our combination of regulatory, development and commercial capabilities, we intend to continue to build a balanced portfolio of approved and pipeline products targeting the hematology and oncology markets.

Critical Accounting Policies

Revenue Recognition

We sell our products to wholesale distributors and directly to hospitals, clinics, and retail pharmacies. Revenue from product sales is recognized when ownership of the product is transferred to our customer, the sales price is fixed and determinable, and collectibility is reasonably assured. Within the U.S. and certain foreign countries revenue is recognized upon shipment (freight on board shipping point) since title passes and the customers have assumed the risks and rewards of ownership. In certain other foreign countries it is common practice that ownership transfers upon receiving the product and, accordingly, in these circumstances revenue is recognized upon delivery (freight on board destination) when title effectively transfers.

We report revenue net of allowances for distributor chargebacks, product returns, rebates, and prompt-pay discounts. Significant estimates are required in determining such allowances and are based on historical data, industry

information, and information from customers. If actual results are different from our estimates, we adjust the allowances in the period the difference becomes apparent.

Certain governmental health insurance providers as well as hospitals and clinics that are members of group purchasing organizations may be entitled to price discounts and rebates on our products used by those organizations and their patients. When we record sales, we estimate the likelihood that products sold to wholesale distributors will ultimately be subject to a rebate or price discount and book our sales net of estimated discounts. This estimate is based on historical trends and industry data on the utilization of our products.

Inventories

Inventories are stated at the lower of cost or market, cost being determined under the first-in, first-out method. We periodically review inventories and items considered outdated or obsolete are reduced to their estimated net realizable value. We estimate reserves for excess and obsolete inventories based on inventory levels on hand, future purchase commitments, product expiration dates and current and forecasted product demand. If an estimate of future product demand suggests that inventory levels are excessive, then inventories are reduced to their estimated net realizable value.

Long-Lived Assets

Our long-lived assets consist primarily of product rights and property and equipment. In accordance with Statement of Financial Accounting Standards No. 144 (SFAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets, we evaluate our ability to recover the carrying value of long-lived assets used in our business, considering changes in the business environment or

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other facts and circumstances that suggest their value may be impaired. If this evaluation indicates the carrying value will not be recoverable, based on the undiscounted expected future cash flows estimated to be generated by these assets, we reduce the carrying amount to the estimated fair value.

Goodwill

We completed a business acquisition in 2003 that resulted in the creation of goodwill. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, we do not amortize goodwill. SFAS No. 142 requires us to perform an impairment review of goodwill at least annually. If it is determined that the value of goodwill is impaired, we will record the impairment charge in the statement of operations in the period it is discovered. The process of reviewing for impairment of goodwill is similar to that of long-lived assets in that expected future cash flows are calculated using estimated future events and trends such as sales, cost of sales, operating expenses and income taxes. The actual results of any of these factors could be materially different than what we estimate.

Recently Issued Accounting Standards

Accounting for Stock-Based Compensation

On December 16, 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), Share-Based Payment, which is a revision of SFAS No. 123, Accounting for Stock-Based Compensation. SFAS No. 123(R) supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees, and amends SFAS No. 95, Statement of Cash Flows. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

SFAS No. 123(R) must be adopted no later than the beginning of the first fiscal year after June 15, 2005. Early adoption will be permitted in periods in which financial statements have not yet been issued. We expect to adopt SFAS No. 123(R) on January 1, 2006.

SFAS No. 123(R) permits public companies to adopt its requirements using one of two methods:

A modified prospective method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all rewards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the effective date; or

A modified retrospective method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under SFAS 123 for purposes of pro forma disclosures either (a) all prior periods or (b) prior interim periods of the year of adoption.

We are still evaluating which method we will adopt on January 1, 2006.

Results of Operations

Comparison of the Company s Results for the Three Months Ended March 31, 2005 and 2004.

Net sales. Net sales totaled $51.7 million for the three months ended March 31, 2005 as compared to $15.7 million for the three months ended March 31, 2004. Net sales included $28.9 million and $1.7 million in the U.S. and

$22.8 million and $14.0 million in Europe and other countries for the three months ended March 31, 2005 and 2004, respectively. The primary reason for the net sales growth is due to the commercial launch of Vidaza in the U.S. on July 1, 2004, which resulted in net sales of $27.5 million for the three months ended March 31, 2005. The growth has also resulted from an increase in thalidomide sales, which totaled $20.3 million for the three months ended March 31, 2005, as compared to $12.6 million for the quarter ended March 31, 2004. We began selling thalidomide on a compassionate use or named patient basis in France and Belgium in April 2003 following our acquisition of Gophar S.A.S., the parent company of Laphal Développement. In July 2003, we began selling thalidomide on a compassionate use or namedFF"> **Stockholder Communications with the Board of Directors**

The Board of Directors of the Fund has adopted procedures by which Fund stockholders may send communications to the Board. Stockholders may mail written communications to the Board to the attention of the Board of Directors, The Korea Fund, Inc., c/o Thomas J. Fuccillo, Chief Legal Officer (CLO), Allianz Global Investors Fund Management LLC, 1345 Avenue of the Americas, New York, NY 10105. Stockholder communications must (i) be in writing and be signed by the stockholder and (ii) identify the class and number of Shares held by the stockholder. The CLO or his designee is responsible for reviewing properly submitted stockholder communications. The CLO shall either (i) provide a copy of each properly submitted stockholder communication to the Board at its next regularly scheduled Board meeting or (ii) if the CLO determines that the communication requires more immediate attention, forward the communication to the Directors promptly after receipt. The CLO may, in good faith, determine that a stockholder communication should not be provided to the Board because it does not reasonably relate to the Fund or its operations, management, activities, policies, service providers, Board, officers, stockholders or other matters relating to an investment in the Fund or is otherwise routine or ministerial in nature. These procedures do not apply to (i) any communication from an officer or Director of the Fund, (ii) any communication from an employee or agent of the Fund, unless such communication is made solely in such employee s or agent s capacity as a stockholder, or (iii) any stockholder proposal submitted pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the Exchange Act), or any communication made in connection with such a proposal.

In addition, the Chairman of the Board is happy to receive communications directly from any stockholder at julianreid@btopenworld.com.

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Executive and Other Officers of the Fund. The table below provides certain information concerning the executive officers of the Fund and certain other officers who perform similar duties. Officers hold office at the pleasure of the Board and until their successors are appointed and qualified or until their earlier resignation or removal. Officers and employees of the Fund who are principals, officers, members or employees of the Manager, the Sub-Adviser or their affiliates are not compensated by the Fund.

Name, Address* and Date of Birth	Position(s) with the Funds	Length of Time Served	Other Positions
Robert Goldstein 4 Embarcadero Center, San Francisco, CA 94111 2/8/1963	President and Chief Executive Officer	Since April 2007	Managing Director, Chief Operating Officer and General Counsel of RCM Capital Management LLC; Member of RCM s Management Committee; Mr. Goldstein joined RCM in 1996. Prior to joining RCM, Mr. Goldstein was an associate in the New York, London and Prague offices of Weil, Gotshal & Manges where his practice primarily focused on cross-border transactions and general corporate matters.
Brian S. Shlissel 11/14/1964	Treasurer, Principal Financial and Accounting Officer	Since April 2007	Executive Vice President, Director of Fund Administration, Allianz Global Investors Fund Management LLC; President and Chief Executive Officer of 33 funds in the Allianz Global Investors Fund Complex; Treasurer, Principal Financial and Accounting Officer of 45 funds in the Allianz Global Investors Fund Complex. Formerly, Director of 6 funds in the Allianz Global Investors Fund Complex.
Thomas J. Fuccillo 03/22/1968	Vice President, Secretary and Chief Legal Officer	Since April 2007	Senior Vice President, Senior Counsel, Allianz Global Investors of America L.P., Vice President, Secretary and Chief Legal Officer of 78 funds in the Allianz Global Investors Fund Complex; Formerly, Vice President and Associate General Counsel, Neuberger Berman, LLC (1991-2004).
Lawrence G. Altadonna 03/10/1966	Assistant Treasurer	Since April 2007	Senior Vice President, Allianz Global Investors Fund Management LLC; Treasurer, Principal Financial and Accounting Officer of 33 funds in the Allianz Global Investors Fund Complex; Assistant Treasurer of 45 funds in the Allianz Global Investors Fund Complex.

Richard J. Cochran 01/23/1961	Assistant Treasurer		Vice President, Allianz Global Investors Fund Management LLC; Assistant Treasurer of 78 Funds in the Allianz Global Investors Fund Complex; formerly, Tax Manager, Teachers Insurance Annuity Association/College Retirement Equity Fund (TIAA-CREF) (2002-2008).
Youse Guia 680 Newport Center Drive, Suite 250 Newport Beach, CA 92660 09/03/1972	Chief Compliance Officer	Since April 2007	Senior Vice President, Group Compliance Manager, Allianz Global Investors of America L.P.; Chief Compliance Officer of 78 funds in the Allianz Global Investors Fund Complex; Formerly, Vice President, Group Compliance Manager, Allianz Global Investors of America L.P. (2002-2004); Audit Manager, PricewaterhouseCoopers LLP (1996-2002).

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Name, Address* and Date of Birth	Position(s) with the Funds	Length of Time Served	Other Positions
Lagan Srivastava 09/20/1977	Assistant Secretary	Since April 2007	Assistant Secretary of 78 funds in the Allianz Global Investors Fund Complex; formerly, Research Assistant, Dechert LLP (2004-2005); Research Assistant, Swidler Berlin Shereff Friedman LLP (2002-2004).

* Unless otherwise noted, the address of the Fund s officers is c/o Allianz Global Investors Fund Management LLC, 1345 Avenue of the Americas, New York, New York 10105.

Transactions with and Remuneration of Directors and Officers

The Board s remuneration policy is to emphasize commitment to the Fund, involvement in Fund issues and attendance by Directors at Board meetings. Directors receive an annual retainer fee of $15,000, except the Chairman of the Board, who receives an additional $12,000 annual retainer fee. Each Independent Director receives a fee, paid by the Fund, of $3,000 per Directors meeting attended. The Chairman of the Audit and Compliance Committee receives an additional $7,000 annual fee for serving in that capacity. Each Independent Director also receives $3,000 per Audit and Compliance Committee meeting (unless only compliance matters are discussed) and Contracts Committee meeting attended (there is a $3,000 annual maximum remuneration for attendance at Contracts Committee meetings).

In addition, each Independent Director is eligible to receive a per diem fee for a full day of $1,500 or a pro-rated fee for a lesser period as compensation for taking on special assignments at the request of the Board. Such special assignments must be approved in advance by the Governance, Nominating and Remuneration Committee, except that special assignments for which compensation will be less than $5,000 may be approved in advance by the Chairman of the Governance, Nominating and Remuneration Committee. A report regarding compensation for such assignments is provided to the Governance, Nominating and Remuneration Committee at its next regular meeting.

RCM supervises the Fund s investments, pays the compensation and certain expenses of its personnel who serve as officers of the Fund, and receives a management fee for its services. The Fund s other officers are also officers, employees, or stockholders of RCM s affiliates and are paid a salary by those firms. The Fund makes no direct payments to its officers.

The following Compensation Table provides the aggregate compensation received by each Director from the Fund for the fiscal year ended June 30, 2009. For the calendar year ended December 31, 2008, the Directors and nominees received the compensation set forth in the table below for serving as Directors of the Fund and other funds in the same fund complex as the Fund. None of the Directors serves on any other registered investment company in the fund complex advised by RCM and its affiliates. The Fund does not pay retirement benefits to its Directors.

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Compensation Table

Independent Director/Nominee	Aggregate Compensation from the Fund for the Fiscal Year Ended June 30, 2009	Total Compensation from the Fund and Fund Complex* Paid to Directors/Nominees for the Calendar Year Ended December 31, 2008
Ronaldo A. da Frota Nogueira	$ 39,000	$ 42,000
Julian Reid	$ 51,000	$ 54,000
Christopher Russell	$ 39,000	$ 42,000
Richard A. Silver	$ 46,000	$ 49,000
Kesop Yun	$ 39,000	$ 42,000

* The Fund Complex includes only funds advised by RCM and its affiliates.

Required Vote. Election of the nominees for Class III Directors, Messrs. Nogueira and Silver, requires the affirmative vote of the holders of a majority of Shares present in person or by proxy and entitled to vote thereon.

The Directors unanimously recommend that you vote FOR the election of each nominee set forth in the Proposal.

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Question
Should the Fund continue in its current form?

The Board is soliciting the views of stockholders regarding whether the Fund should continue in its current form. The reasons for soliciting the views of stockholders and the reasons that the Board believes that the Fund s operations should continue are set forth below.

In January 2009, the Fund paid a distribution to stockholders of approximately $220.3 million of its long-term and short-term capital gains. The Board of Directors of the Fund decided for compelling reasons set out hereunder to pay the distribution to a stockholder in newly issued Fund shares, unless the stockholder elected to receive cash. The Board also decided to cap the total amount of cash to be distributed by the Fund at 20% of the aggregate dollar amount of the total distribution. As noted in the December 10, 2008 press release announcing the plan for the distribution, one of the primary reasons for going forward with the capped cash election dividend was to avoid the unintended liquidation of the Fund at a time that, due to exceptional market conditions, may not have been advantageous to stockholders (based on the Fund s net asset value at the time, the ongoing viability of the Fund in light of the assets remaining after a cash distribution of capital gains was uncertain). In light of that decision, the Board deemed it appropriate to seek the view of stockholders regarding the future of the Fund. Specifically, the Board decided to solicit the views of stockholders regarding the continuation of the Fund at the 2009 annual stockholder meeting, provided that more normal market conditions had resumed by that time. The purpose of soliciting stockholder views was to give stockholders the opportunity to consider carefully, hopefully in more normal market conditions, if the Fund should continue its operations.

The Board believes that the exceptional market driven circumstances leading to the capped cash election dividend have now subsided and more normal conditions for the Fund have resumed. As of September 2, 2009, the Korean market (as measured by the KOSPI, the Fund s benchmark) is up 104.74% on a total return basis since its low on November 20, 2008, and is up 55.34% since the Fund s December 10, 2008 press release. Therefore, consistent with the December 2008 press release, the Board has determined to solicit the views of stockholders whether the Fund should continue in its current form. For these and the reasons set forth below, the Board of Directors encourages stockholders to express their support for the continuation of the Fund in its current form.

In connection with its consideration of this matter, the Board sought the views of RCM AP as to its long term outlook for the Korean equity market. RCM AP reported to the Board that it was optimistic regarding Korea s economic outlook and that it believed Korean equities were a sound investment for the long term based on RCM AP s belief that:

The Korean economy should recover at a faster pace from current global recession and post higher growth than other developed economies following the stabilization of the global economy in the next several years due to:

solid export growth led by major companies enhanced competitiveness in the global markets, stronger financial position and significant investment in research and development; and

the Korean government s economic expansionary measures (including aggressive stimulus measures, measures for financial industry stabilization and infrastructure investment) supported by a sound fiscal position (i.e., budget surplus).

There will be long term growth in the Korean economy driven by:

continued strong growth of Korean exports as a result of diversified and balanced export destinations and a strong exposure to fast growing economies such as China and other emerging countries;

the structural change of economic development from capital intensive manufacturing toward a service-driven economy, supported by a commitment from the current government to promote deregulation to improve service industries competitiveness; and

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various new business initiatives developed by diverse and leading companies that are transforming themselves with technology and capital accumulated from traditional business areas, including expansion into green technology.

RCM AP also noted that the OECD projects Korea s real GDP growth to be the third highest among OECD members from 2011-2017.

There are several structural growth drivers for the Korean stock market, including that:

Korean household asset composition is expected to shift from real estate, cash and deposits to sophisticated financial investments as Koreans seek higher return investments;

Korea s fast aging population is expected to stimulate further this shift of household assets to the Korean stock market; and

Rapidly expanding corporate pensions are expected to seek higher return assets to secure the longer life expectancy.

The Korean stock market looks attractive in terms of valuation for long term investors because:

traditional discount factors, measured on a price/earnings and price/book basis, known as the Korea discount (including Korean companies heavy use of debt, poor corporate governance, low domestic equity ownership, capital intensive structure, low payout, low focus on delivery of returns to capital, limited management equity ownership and poor minority holder protection) have begun to improve gradually since the Asian crisis in 1997; and

higher earnings visibility and lower profit volatility support a smaller valuation discount.

RCM AP informed the Board that the key risks to their optimistic long-term view on the Korean market are:

the possibility that prolonged global recession may cap sustainable growth of Korean exports;

the higher level of leverage by Korean households may limit consumption growth potential; and

the uncertainty on the future of North Korea and its impact on South Korea from political and economic standpoints.

The Board also requested a report from AGIFM, which provides investor relations, stockholder servicing and marketing services to the Fund, regarding the position of the Fund in the market and possible alternatives for the Fund (including open-ending, share repurchases, tender offers, converting to an interval fund, initiating a managed distribution policy, mergers, liquidation and investment repositioning). AGIFM recommended to the Board that the Fund continue in its current form based on, among other things:

The high trading volume for the Fund;

The high demand for and interest in the Fund;

The market outlook of potential investors in the Fund;

The marketing opportunities for the Fund; and

The costs and benefits of alternatives for the Fund other than continuation in its current form.

The Board of Directors of the Fund, which is composed solely of Independent Directors, unanimously determined to encourage stockholders to express their support for continuation of the Fund in its current form. In determining that the Fund should continue in its current form, the Directors considered, among others, the factors below:

The report of RCM AP regarding the long term outlook for the Korean equity market, including their optimistic view of the long-term market outlook and the potential risks.

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The report of AGIFM regarding the Fund s position in the market and possible alternatives for the Fund, including their recommendation that the Fund continue in its current form.

The Fund s discount, which has ranged from 3.29% to 14.03% since the January 29, 2009 distribution and was 9.32% on August 28, 2009, and the Board s proven willingness to take action to address the Fund s discount as necessary.

The Fund s expense ratio of 1.43% as of June 30, 2009 and the projected expense ratio of 1.30% based on the fiscal year 2010 budget prepared by the Fund s administrator.

The current level of the Fund s net assets. The Fund s net assets on August 31, 2009 were $352,625,443.

That concentration of the Fund s investments, liquidity of the Fund s holdings and relative stability of the Fund s asset base support the closed-end fund structure.

That the Fund permits stockholders to achieve exposure to the Korean markets with the benefit of the expertise of RCM AP.

The Fund s capital gains position. As of August 31, 2009, the Fund s unrealized gains amounted to approximately $101.3 million. The Fund has deferred realized capital losses of approximately $50.2 million and a capital loss carryforward of approximately $32.1 million, which may offset any realized capital gains.

Because the Board is subject to a continuing obligation to make decisions that it believes are in the best interests of the Fund, the Board will take steps to follow the outcome of the polling only if it makes an independent determination that such action would be in the Fund s best interests at the time (although the results of the stockholder polling are non-binding, the outcome would be taken seriously into consideration by the Board as it evaluates the future of the Fund). In other words, the outcome of the polling would constitute one key factor in the total mix of information that the Board would consider in its ongoing evaluation of the future of the Fund. The Board also takes other key factors into account in such evaluations, including the costs and benefits of possible alternatives to continuing the Fund in its current form (*e.g.,* (i) transaction costs, service provider costs, regulatory costs and costs of any stockholder votes associated with implementing a potential alternative, (ii) the effect on the expense ratio, discount, net asset value and market price of the Fund, (iii) the liquidity of Fund shares and (iv) any tax repercussions).

The Board will weigh the outcome of the polling as a factor in its ongoing consideration of the future of the Fund based not only on the difference between the number of shares supporting and opposing continuation of the Fund, but also based on the total number of shares responding to the Question. Respond For if you support continuation of the Fund in its current form. Respond Against if you oppose continuation of the Fund in its current form.

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ADDITIONAL INFORMATION

Manager, Sub-Adviser and Sub-Administrator. RCM, the Manager, is located at Four Embarcadero Center, San Francisco, California 94111. The Manager retains its affiliate, RCM AP, as Sub-Adviser to manage the Fund s investments. RCM AP is located at 21st Floor, Cheung Kong Centre, 2 Queen s Road Central, Hong Kong.

RCM was founded as Rosenberg Capital Management and began managing assets in 1970. RCM is wholly owned by RCM US Holdings LLC (US Holdings). US Holdings is a Delaware limited liability company. RCM AP was formed in 2006 and licensed by the Hong Kong SFC and registered with the SEC in January of 2007. RCM AP is succeeding to all of Allianz Global Investors Hong Kong Limited s equity management business in Hong Kong. RCM AP and RCM are affiliated companies under common control that are part of the same investment platform. RCM and RCM AP are wholly owned indirect subsidiaries of Allianz SE, a publicly traded insurance and financial services company.

AGIFM is the Fund s sub-administrator and has its principal offices at 1345 Avenue of the Americas, New York, New York 10105.

Legal Proceedings

The disclosure below relates to AGIFM, certain of its affiliates and their employees. The events described below occurred prior to the appointment of AGIFM as sub-administrator. The Manager, the Sub-Adviser and AGIFM believe that these matters are not likely to have a material adverse effect on the Fund or their ability to perform their respective investment advisory and administration activities relating to the Fund.

In June and September 2004, AGIFM and certain of its affiliates agreed to settle, without admitting or denying the allegations, claims brought by the SEC, the New Jersey Attorney General and the California Attorney General alleging violations of federal and state securities laws with respect to certain open-end funds for which the Manager serves as investment adviser. Two settlements (with the SEC and New Jersey) related to an alleged market timing arrangement in certain open-end funds sub-advised by an affiliate of AGIFM. In February 2006, the plaintiffs voluntarily dismissed RCM from the consolidated market timing lawsuits. Two settlements (with the SEC and California) related to the alleged use of cash and fund portfolio commissions to finance shelf-space arrangements with broker-dealers for open-end funds. AGIFM and its affiliates agreed to pay a total of $68 million to settle the claims related to market timing and $20.6 million to settle the claims related to shelf-space. In addition to monetary payments, the settling parties agreed to undertake certain corporate governance, compliance and disclosure reforms related to market timing, brokerage commissions, revenue sharing and shelf-space arrangements, and consented to cease and desist orders and censures. None of the settlements alleged that any inappropriate activity took place with respect to the Fund.

Since February 2004, AGIFM and certain of its affiliates and their employees have been named as defendants in eleven lawsuits filed in various jurisdictions, which have been transferred to and consolidated for pre-trial proceedings in a multi-district litigation proceeding in the U.S. District Court for the District of Maryland. The lawsuits generally relate to the same allegations that are the subject of the regulatory proceedings discussed above. The lawsuits seek, on behalf of fund stockholders or the funds themselves, among other things, unspecified compensatory damages plus interest and, in some cases, punitive damages, the rescission of investment advisory contracts, the return of fees paid under those contracts, restitution and waiver of or return of certain sales charges paid by fund stockholders.

The Manager, the Sub-Adviser and AGIFM believe that these matters are not likely to have a material adverse effect on the Fund or on the Manager s, the Sub-Advisers or AGIFM s ability to perform their respective investment advisory or administration services relating to the Fund.

The foregoing speaks only as of the date of this document.

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Other Matters

The Board of Directors does not know of any matters to be brought before the Meeting other than the proposals mentioned in this Proxy Statement. The appointed proxies will vote on any other business that comes before the Meeting or any adjournment or postponement thereof in their discretion.

Miscellaneous

Proxies will be solicited by mail and may be solicited in person or by telephone by officers of the Fund or personnel of AGIFM. The Fund will reimburse banks, brokers, and other persons holding the Fund s shares registered in their names or in the names of their nominees for their expenses incurred in sending proxy material to, and obtaining proxies from, the beneficial owners of such shares.

Solicitation of proxies for the Proposal is being made primarily by the mailing of this Proxy Statement with its enclosures on or about September 22, 2009.

In the event that sufficient votes in favor of the Proposal are not received by October 28, 2009, the persons named as appointed proxies on the enclosed proxy card may propose one or more adjournments of the Meeting to permit further solicitation of proxies. Any such adjournment will require the affirmative vote of a majority of the votes entitled to vote at the Meeting and present thereat in person or by proxy, and will be effective to adjourn the Meeting without further notice to a date not more than 120 days following the Record Date. The persons named as appointed proxies on the enclosed proxy card will vote in favor of such adjournment those proxies that they are entitled to vote in favor of the Proposal. They will vote against any such adjournment those proxies required to be voted against the Proposal. The costs of any such additional solicitation and of any adjourned session will be borne by the Fund.

Stockholder Proposals

Stockholders wishing to submit proposals pursuant to Rule 14a-8 under the Exchange Act for inclusion in the proxy statement for the Fund s 2010 annual meeting of stockholders should send their written proposals to the Secretary of the Fund, c/o Allianz Global Investors Fund Management LLC, at 1345 Avenue of the Americas, New York, New York 10105 by May 25, 2010. The timely submission of a proposal does not guarantee its inclusion.

For nominations of candidates for election as Directors (other than nominations made by or at the recommendation of the Directors) or other business to be properly brought before the annual meeting by a stockholder, the stockholder must comply with the Fund s By-Laws, which, among other things, require that the stockholder must give timely notice thereof in writing to the Secretary of the Fund, the stockholder must be a stockholder of record, and the notice must contain the information about the nomination or other business that is required by the Fund s By-Laws. To be timely, any such notice must be delivered to or mailed by certified mail, return receipt requested, and received at the principal executive offices of the Fund not later than 90 days nor more than 120 days prior to the date of the meeting; provided, however, that if less than 100 days notice or prior public disclosure is given or made to stockholders, any such notice by a stockholder to be timely must be so received not later than the close of business on the 10th day following the earlier of the day on which such notice of the date of the annual or special meeting was given or such public disclosure was made.

The Fund may exercise discretionary voting authority with respect to stockholder proposals for the Meeting that are not included in the Proxy Statement and form of proxy, but that were timely received

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by the Fund. Discretionary voting authority is the ability to vote proxies that stockholders have executed and returned to the Fund on matters not specifically reflected on the form of proxy.

By order of the Board of Directors of the Fund

Thomas J. Fuccillo
Secretary

September 22, 2009

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PROXY CARD

THE KOREA FUND, INC.
THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS
Annual Meeting of Stockholders October 28, 2009

The undersigned hereby appoints Brian Shlissel, Thomas J. Fuccillo and Lawrence G. Altadonna, and each of them, the proxies of the undersigned, with full power of substitution in each of them, to represent the undersigned and to vote all shares of The Korea Fund, Inc. that the undersigned is entitled to vote at the Annual Meeting of Stockholders of The Korea Fund, Inc. to be held at the offices of Allianz Global Investors Fund Management LLC, 1345 Avenue of the Americas (at 54th 55 Streets), 49th Floor, New York, New York 10105, on Wednesday, October 28, 2009 at 9:30 a.m., Eastern time, and at any adjournment or postponement thereof. The undersigned acknowledges receipt of the Notice of Annual Meeting of Stockholders and accompanying Proxy Statement and revokes any proxy previously given with respect to the meeting.

THIS PROXY, IF PROPERLY EXECUTED, WILL BE VOTED IN THE MANNER DIRECTED. IF NO INSTRUCTIONS ARE INDICATED ON A PROPERLY EXECUTED PROXY, THE UNDERSIGNED S VOTE WILL BE CAST FOR THE PROPOSAL. THIS PROXY WILL BE VOTED IN THE DISCRETION OF THE PERSONS NAMED AS PROXIES WITH RESPECT TO ANY OTHER MATTER THAT PROPERLY COMES BEFORE THE MEETING.

A separate section of this Proxy Card has been created to permit the undersigned to express a view as to whether the Fund should continue in existence in its current form (the Question). Although the Question will not be called for a formal vote at the Annual Meeting of Stockholders, the results of the polling on the Question will be announced at the Annual Meeting of Stockholders.

Note: Please sign this proxy exactly as your name or names appear hereon. Each joint owner should sign. Trustees and other fiduciaries should indicate the capacity in which they sign. If a corporation, partnership or other entity, this signature should be that of a duly authorized individual who should state his or her title.

Signature
Date:

Signature (if held jointly)
Date:

Title if a corporation, partnership or other entity

FOLD HERE

YOUR VOTE IS IMPORTANT, NO MATTER HOW MANY SHARES YOU OWN. THE MATTERS WE ARE SUBMITTING FOR YOUR CONSIDERATION ARE SIGNIFICANT TO THE FUND AND TO YOU AS A FUND STOCKHOLDER. PLEASE TAKE THE TIME TO READ THE PROXY STATEMENT AND CAST YOUR VOTE AS DESCRIBED BELOW.

Mail: Simply sign, date, and complete the reverse side of this proxy card and return it in the postage paid envelope provided.

Internet:

	Log on to www.proxyvote.com. Make sure to have the voting instruction card available when you plan to vote your shares and submit your views on the Question.
Phone:	Call 1-800-454-8683 and have the voting instruction card available. Follow the instructions.

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PROXY CARD

THE KOREA FUND, INC.
THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS
Annual Meeting of Stockholders October 28, 2009

TO VOTE, MARK ONE BOX IN BLUE OR BLACK INK. Example: x

PROPOSAL:

1.	Election of Class III Directors	FOR	AGAINST	WITHHOLD
1.a.	Ronaldo A. da Frota Nogueira	o	o	o
1.b.	Richard Silver	o	o	o

QUESTION:	FOR	AGAINST	ABSTAIN
Should the Fund continue in existence in its current form?	o	o	o

Respond For if you support continuation of the Fund in its current form. Respond Against if you oppose continuation of the Fund in its current form.