COMPANY ANALYSIS

[Korea] Shipping

May 26, 2023

HMM

(011200 KS)

Well-positioned to withstand downturns

Trading Buy
(Initiate)

TP: W21,000
Upside: 15.4%

Mirae Asset Securities Co., Ltd.
Jay JH Ryu jay.ryu@miraeasset.com
Chang-min Lee changmin.lee@miraeasset.com

Initiate coverage

Trading Buy rating and TP of W21,000

- Our target price of W21,000 is based on HMM's trough P/B (five-year average low of 0.6x) and our adjusted BPS estimate.
- With our target price implying 15% upside, we present a Trading Buy recommendation on the stock. We believe additional share price weakness should be viewed as a buying opportunity.
- We believe demand is bottoming out. This, together with supply adjustments, could support a stabilization in container freight rate indices.
- We think the stock could rebound quickly if HMM exercises the call provision of its convertible bonds and its largest shareholders sell their stakes.

Investment points

Well-positioned to withstand downturns, given ample cash and lower unit cost

- At end-1Q23, HMM held W13tr in cash and had a debt ratio of 28% (vs. 73% in 2021).
- Even if the industry descends into another price war amid a severe recession, we believe the company will be able to persevere for at least four years on the back of its healthy balance sheet.
- Cost per TEU was US$974 in 2021 and US$1,200 in 2022, down from US$1,304 in 2010.

Container freight rate indices are near record lows

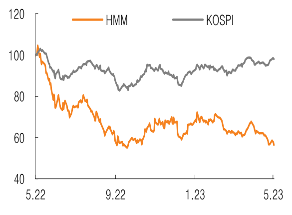
- We expect the container market to remain oversupplied through 2024, given the massive orders placed during the industry's unprecedented boom.
- However, the mismatch between supply and demand has been gradually easing since 2022. As a result, the pace of decline in freight rates has been slowing.
- Notably, a reduction in vessel speeds to meet CO_2 regulations should reduce effective supply by 1.5-2%.
- The Shanghai Containerized Freight Index (SCFI) is close to its all-time low. We believe freight rates are more likely to stabilize than to fall sharply.

Risks

Structural oversupply and potential dilution

- We think the supply/demand balance is unlikely to be restored for some time, given the high orderbook-to-fleet ratio (29%).
- Potentially dilutive shares from convertible bonds are equivalent to around 100% of HMM's current share count. Dilution could reach 40% in 2023 alone.
- Along with freight rate movements, we think the risk of share dilution will be a major share price determinant in the near term.

Key data



Current price (5/25/23, W)	18,200	Market cap (Wbn)	8,901
OP (23F, Wbn)	1,769	Shares outstanding (mn)	489
Consensus OP (23F, Wbn)	2,545	Free float (%)	79.3
EPS growth (23F, %)	-80.2	Foreign ownership (%)	10.8
P/E (23F, x)	4.5	Beta (12M)	1.23
Market P/E (23F, x)	15.2	52-week low (W)	17,800
KOSPI	2,554.69	52-week high (W)	33,750

Share performance

(%)	1M	6M	12M
Absolute	-12.5	-15.9	-43.7
Relative	-14.7	-19.8	-42.3

Earnings and valuation metrics

(Dec.)	2020	2021	2022	2023F	2024F	2025F
Revenue (Wbn)	6,413	13,794	18,583	8,578	9,141	9,986
OP (Wbn)	981	7,378	9,952	1,769	2,311	2,938
OP margin (%)	15.3	53.5	53.6	20.6	25.3	29.4
NP (Wbn)	124	5,337	10,085	1,997	2,700	3,426
EPS (W)	384	13,754	20,623	4,083	5,522	7,007
ROE (%)	8.9	88.6	65.0	9.2	11.4	13.1
P/E (x)	36.3	2.0	0.9	4.5	3.3	2.6
P/B (x)	2.7	1.3	0.5	0.4	0.4	0.3
Div. yield (%)	0.0	2.2	6.1	6.6	6.6	6.6

Notes: Under consolidated K-IFRS; NP is attributable to owners of the parent
Source: Company data, Mirae Asset Securities Research estimates

MIRAE ASSET Securities

I. Valuation and recommendation

Initiate coverage with Trading Buy and TP of W21,000

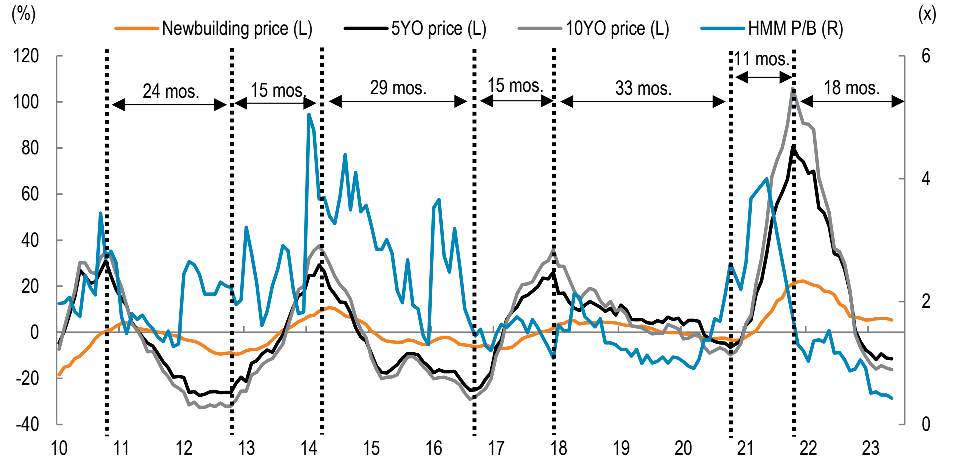
Target P/B of 0.6x represents five-year average low; buy if shares dip further

We initiate our coverage on HMM with a Trading Buy rating and target price of W21,000, which equates to 0.6x our adjusted BPS estimate of W34,000. HMM's P/B multiple contracted to a low of 0.4x in 2020, before re-rating to a high of 2.5x (or 4x pre-conversion).

Since then, however, the stock has retreated to a P/B of 0.4x amid worries about share dilution and peak earnings. We view the current level as a mid-cycle multiple, given that valuation was at its lowest in the early days of the pandemic.

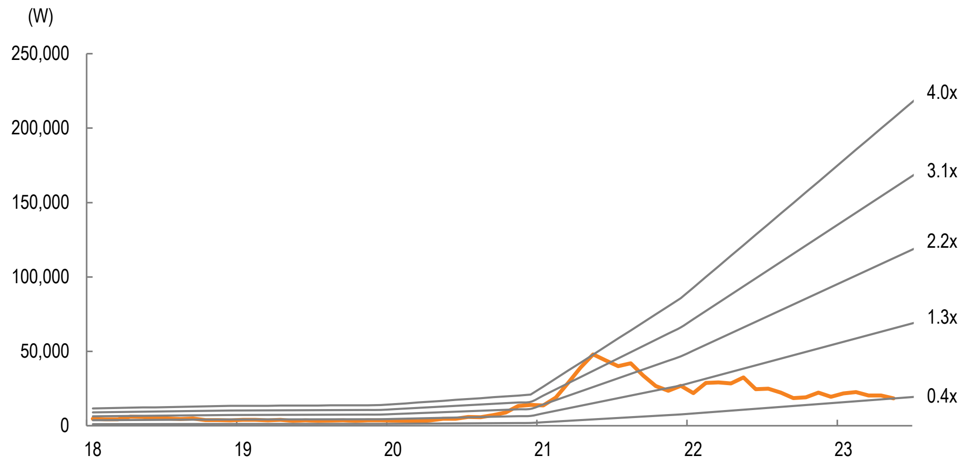
HMM's multiple tends to move in line with the ship price cycle. And while prices have not yet rebounded, the pace of decline has been moderating. We do not expect any further sharp downturns.

Figure 1. HMM's P/B vs. containership prices



Source: Clarksons, Thomson Reuter, Mirae Asset Securities Research

Figure 2. HMM P/B band chart



Source: QuantiWise, Mirae Asset Securities Research

Bond conversion would roughly double share count

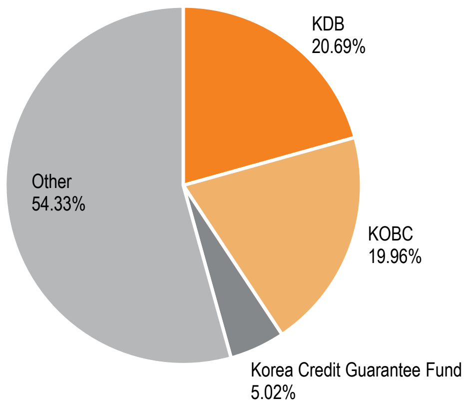
HMM's convertible bonds are likely to have a major impact on its share price in the near term. The company has W2.68tr worth of perpetual convertible bonds and bonds with warrants outstanding (the no. 190 and 191 notes were already converted in 2021), which are evenly held by Korea Development Bank (KDB) and Korea Ocean Business Corporation (KOBC).

The conversion of all of HMM's convertible bonds and exercise of all warrants would increase shares outstanding from 489mn to roughly 1.025bn. Both KDB and KOBC currently have the option to convert the bonds into stock, but appear reluctant to do so because of the risk of share dilution (and resulting uncertainty over whether they would be able to recoup their investments as they prepare to divest their stakes).

HMM's call provision is a key factor to watch. We believe the company will call its no. 192 convertible bonds and no. 193 bonds with warrants on Sep. 25, 2023, as coupon rates are set to rise from October. The company previously exercised its call provision back in 2021, but KDB and KOBC instead chose to convert the bonds, arguing that failing to do so would be an act of negligence, as the conversion price (W5,000 per share) was well below the market price.

HMM's sale process has begun, but the company's convertibles/bonds with warrants are causing unease among potential buyers. We believe related uncertainty will persist until a decision is made on whether the bonds are converted and, if so, what the scale of the conversion will be.

Figure 3. HMM's ownership structure



Source: Company data, Mirae Asset Securities Research

Table 1. HMM perpetual bonds held by KDB and KOBC

	Issue date	Amount (Wbn)	Conversion/ exercise price (W)	No. of convertible/ exercisable shares	Maturity	Coupon	Bondholders	Notes	
No. 192 CB issue	10/25/2018	400	5,000	80,000,000	10/25/48	3%	KDB (50%) KOBC (50%)	Step-up in Oct. 2023	3% (first five years) 6% (sixth year) Additional 0.25% per year (from seventh year) 10% maximum
No. 193 BW issue	10/25/2018	600	5,000	120,000,000	10/25/48	3%		Step-up in Oct. 2023	
No. 194 CB issue	5/24/2019	100	5,000	20,000,000	5/24/49	3%		Step-up in May 2024	
No. 195 CB issue	6/27/2019	200	5,000	40,000,000	6/27/49	3%		Step-up in Jun. 2024	
No. 196 CB issue	10/28/2019	660	5,000	132,000,000	10/28/49	3%		Step-up in Oct. 2024	
No. 197 CB issue	4/23/2020	720	5,000	144,000,000	4/23/50	3%		Step-up in Apr. 2025	
Total		2,680		536,000,000					

Source: Media reports, HMM, Mirae Asset Securities Research

Table 2. Global peer valuation table (US$mn, %, x)

	Company	Ticker	Market cap	Revenue		Operating profit		ROE		P/E		P/B		EV/EBITDA	
				23F	24F	23F	24F	23F	24F	23F	24F	23F	24F	23F	24F
Dry bulk	Pan Ocean	028670 KS	2,812	5,634	5,899	630	696	10.8	11.2	5.0	4.4	0.5	0.5	3.6	2.7
	Korea Line	005880 KS	642	1,644	1,388	306	211	9.7	5.7	3.7	6.7	0.4	0.4	6.7	8.6
	K Line	9107 JP	8,005	8,680	9,338	771	720	6.9	4.0	10.6	13.0	0.5	0.5	5.7	2.4
	Mitsui O.S.K. Lines	9104 JP	10,918	14,610	15,766	1,062	1,203	7.5	7.3	7.5	6.9	0.6	0.5	10.2	9.6
	NYK Line	9101 JP	14,748	21,699	22,077	1,624	1,788	6.8	6.6	8.6	11.2	0.6	0.5	6.7	6.2
	Pacific Basin	2343 HK	2,182	3,717	3,667	604	649	20.2	19.2	3.8	3.7	0.7	0.7	2.8	2.6
	U-Ming Marine	2606 TT	1,959	-	-	-	-	-	-	-	-	-	-	-	-
	Eneti	NETI US	-	207	374	21	120	(1.0)	5.8	-	-	-	-	-	-
	Star Bulk Carriers	SBLK US	2,564	1,333	1,534	655	932	21.0	29.7	4.3	3.1	0.9	0.8	4.5	3.6
	Diana Shipping	DSX US	521	376	455	152	287	10.6	29.5	5.2	2.5	0.7	-	5.5	3.8
	Golden Ocean Group	GOGL NO	2,204	1,070	1,236	528	675	18.3	20.7	6.0	4.1	0.8	0.9	5.2	4.4
	D/S Norden	DNORD DC	2,253	5,492	5,782	357	377	18.4	21.1	6.6	6.0	1.2	1.1	2.7	2.8
Dry bulk avg.			**4,437**	**5,860**	**6,138**	**610**	**696**	**11.7**	**14.6**	**6.1**	**6.2**	**0.7**	**0.6**	**5.4**	**4.7**
Container	COSCO Shipping	601919 CH	32,148	37,228	38,945	3,975	4,333	8.9	8.4	12.8	9.6	0.8	0.8	3.3	2.8
	Orient Overseas	316 HK	16,956	13,054	13,662	2,147	2,155	7.4	10.4	11.6	8.2	1.0	0.8	2.0	1.5
	Wan Hai Lines	2615 TT	7,301	4,994	-	-619	-	-5.6	-	-	-	0.9	-	5.3	-
	Evergreen Marine	2603 TT	13,971	11,118	10,871	610	1,133	2.0	6.1	50.9	12.1	0.8	0.7	1.2	0.8
	Yang Ming Marine	2609 TT	9,326	6,371	-	-184	-	-0.2	-	-	-	0.8	-	-	-
	SFL	SFL US	1,593	1,105	1,038	394	300	14.3	17.8	7.3	5.3	1.0	0.9	6.9	6.7
	Hapag-Lloyd	HLAG GR	45,888	23,231	24,002	1,783	2,056	6.7	3.8	31.0	26.3	1.7	1.6	6.1	5.7
	Maersk	MAERSKB DC	42,153	67,164	70,140	2,212	3,458	1.8	3.1	35.7	16.2	0.5	0.5	3.4	3.0
Container avg.			**21,167**	**20,533**	**26,443**	**1,290**	**2,239**	**4.4**	**8.3**	**24.9**	**13.0**	**0.9**	**0.9**	**4.0**	**3.4**
Tanker	COSCO Shipping Energy	600026 CH	9,390	5,031	5,418	1,852	2,009	17.8	16.3	8.3	7.4	1.4	1.2	6.6	6.4
	China Merchants Energy	601872 CH	9,212	6,165	6,662	1,741	1,909	18.0	16.7	6.3	5.7	1.1	0.9	5.2	5.0
	Great Eastern Shipping	GESCO IN	1,519	730	-	254	-	10.3	-	7.7	-	-	-	4.5	-
	MISC	MISC MK	9,469	3,791	3,817	820	853	5.7	6.1	14.7	13.0	0.8	0.8	8.9	8.5
	Navigator Holdings	NVGS US	1,320	650	671	171	177	8.0	7.0	9.8	8.0	0.7	0.7	5.8	5.6
	Ardmore Shipping	ASC US	734	403	324	166	88	12.6	-	4.7	8.7	0.8	-	4.4	7.0
	Nordic American Tankers	NAT US	1,019	417	525	243	359	28.3	26.6	4.8	3.1	1.3	-	4.4	3.2
	Euronav	EURN US	4,865	1,799	1,753	1,013	1,053	30.4	25.9	5.0	5.3	1.4	1.3	5.1	4.9
	Scorpio Tankers	STNG US	3,705	1,784	1,671	972	783	23.8	15.7	4.6	4.7	0.8	0.7	4.1	4.4
	Golar LNG	GLNG US	3,078	663	680	539	463	7.1	5.0	7.5	9.5	0.7	0.7	6.6	6.8
	DHT Holdings	DHT US	1,751	747	751	460	494	33.3	33.2	4.0	3.7	1.2	1.2	4.2	4.2
	Stolt-Nielsen	SNI NO	2,045	3,729	3,734	711	712	17.1	16.1	3.5	3.4	0.6	0.5	4.3	4.3
	Flex LNG	FLNG NO	2,231	498	487	298	280	18.0	16.5	11.0	12.1	2.0	2.1	10.5	11.0
	Odfjell	ODF NO	1,000	1,659	1,639	386	364	25.9	22.0	3.1	3.2	0.8	0.7	4.1	4.2
	Frontline	FRO NO	4,362	1,734	1,793	1,117	1,270	25.7	27.1	4.4	4.3	1.4	1.9	4.9	4.6
Tanker avg.			**3,713**	**1,987**	**2,138**	**716**	**772**	**18.8**	**18.0**	**6.6**	**6.6**	**1.1**	**1.1**	**5.6**	**5.7**
Total avg.			**9,772**	**9,460**	**11,573**	**872**	**1,236**	**11.7**	**13.6**	**12.5**	**8.6**	**0.9**	**0.9**	**5.0**	**4.6**

Source: Bloomberg, Mirae Asset Securities Research

II. Earnings outlook

1Q23 review: Despite strong bulk earnings, OP plunges 90% YoY

For 1Q23, HMM reported revenue of W2.08tr (-58% YoY). At the container unit, revenue slumped 63% YoY to W1.75tr on weaker volume (-8% YoY to 860,000 TEU) and lower rates (-71% YoY), dragging down overall top line. In contrast, bulk revenue expanded 36% YoY thanks to the strength of the tanker segment (+102% YoY).

As a result of the revenue decline, operating profit plunged to W306.9bn (-90% YoY), and OP margin contracted 49%p YoY to 14.7%. The container unit's operating profit slumped 93% YoY to W229bn, with the plunge in rates eroding margins. The recent fall in oil prices led to some transportation and fuel cost savings, and the chartering of vessels also dropped 8.4% YoY, but this was not enough to stem the decline in profits.

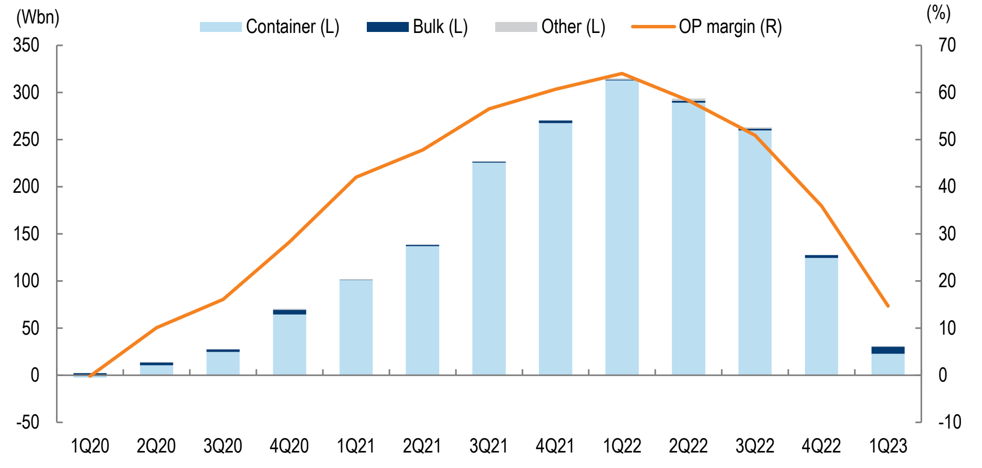
Still, we note that 1Q23 OP margin (14.7%) was fairly strong compared to pre-pandemic levels and was also in line with those of large-sized competitors. We view this as proof of the company's strong cost competitiveness and ability to withstand downturns.

Table 3. 1Q23 review (Wbn, %, %p)

	1Q22	4Q22	1Q23P		Growth	
			Preliminary	Consensus	YoY	QoQ
Revenue	4,919	3,524	2,082	2,610	-57.7	-40.9
OP	3,149	1,265	307	710	-90.3	-75.7
OP margin (%)	64.0	35.9	14.7	27.2	-49.3	-21.2
Pretax profit	3,136	1,487	300	862	-90.4	-79.8
Net profit	3,132	1,415	285	854	-90.9	-79.9

Note: Under consolidated K-IFRS
Source: Company data, Mirae Asset Securities Research

Figure 4. HMM's OP trend



Source: Company data, Mirae Asset Securities Research

2023 outlook: OP to continue to fall sharply after unprecedented boom

HMM's operating profit has been trending downward since peaking in 1Q22. Back in 2021, company-wide OP margin neared 60% thanks to an unprecedented boom in the container shipping segment. But with the pandemic-fueled shipping surge now over and a potential global recession on the horizon, container freight rates have been falling to pre-pandemic levels. As a result, HMM's operating profit—90% of which is derived from the containership business—has taken a beating.

In 2021 and 1H22, even as bulkers and other vessel classes suffered from heightened market volatility, container freight rate indices continued setting new records, mainly due to a shortage of available ships for charter amid increased container trade volumes. However, the SCFI and other indices have since stabilized to pre-pandemic levels due to declining volumes and the subsequent easing of port congestion issues.

We believe that any surge in container freight rates is unlikely in the near term, given: 1) increased deliveries of new vessels (ordered during the industry boom); 2) the easing of supply chain disruptions; and 3) dwindling shipping demand amid recession worries. While bulker earnings could remain robust for some time, persistently low container freight rates will likely continue to weigh on overall profits.

We also do not foresee a near-term recovery in trade volume, given still-elevated US retail inventories. For 2023 as a whole, we forecast HMM's revenue to drop 54% YoY to W8.58tr and operating profit to tumble 82% YoY to W1.77tr (OP margin of 21%). Still, we think that earnings are merely returning to more typical levels (following abnormally high growth in 2020-22) and note that both operating profit and margins are still well above historical levels.

After recovering slightly in April, the SCFI has been hovering around the 1,000p mark in May, averaging 980p so far in 2Q23. While freight rate movements in June should have a significant influence on HMM's quarterly results, we expect 2Q23 operating profit to slightly expand QoQ to W327bn (-89% YoY) on the back of long-term contract wins. Looking ahead to 2H23, we expect the pace of earnings contraction to slow on the arrival of peak-demand season.

Table 4. Quarterly and annual earnings

(Wbn, %)

	1Q22	2Q22	3Q22	4Q22	1Q23P	2Q23F	3Q23F	4Q23F	2022	2023F	2024F
Revenue	4,919	5,034	5,106	3,524	2,082	1,963	2,205	2,328	18,583	8,578	9,141
Container	4,668	4,700	4,747	3,190	1,752	1,753	1,830	1,923	17,305	7,258	7,651
Bulker	209	272	317	297	285	161	330	360	1,095	1,136	1,307
Other	41	62	43	37	45	48	45	45	183	183	322
OP	3,149	2,937	2,601	1,265	307	327	527	608	9,952	1,769	2,311
Container	3,128	2,892	2,597	1,245	229	274	453	523	9,862	1,480	1,986
Bulker	8	20	19	30	74	40	67	86	76	268	300
Other	12	26	-14	-10	4	12	7	-1	14	22	32
Pretax profit	3,136	2,950	2,611	1,487	300	417	635	717	10,184	2,069	2,797
NP (owners of the parent)	3,132	2,933	2,605	1,415	285	406	615	689	10,085	1,996	2,700
OP margin (%)	64	58	51	36	15	17	24	26	54	21	25
Net margin (owners of the parent)	64	58	51	40	14	21	28	30	54	23	30
Freight rate (US$/TEU)	3,698	3,380	2,862	1,620	1,061	1,085	1,116	1,147	2,890	1,102	1,139
Trade volume ('000 TEU)	920	900	920	950	860	829	867	887	3,690	3,443	3,530

Source: Company data, Mirae Asset Securities Research

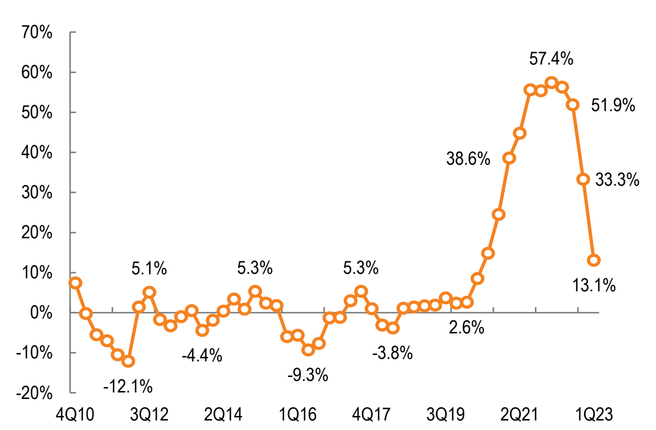
Global peers also suffering from sluggish earnings

Recent earnings trends at peers can provide clues about the earnings outlook for HMM. For 1Q23, the top 10 global container shippers reported an average OP margin of 13.1%. While down sharply from the 2022 peak of over 50%, the current margin is still high by historical standards, suggesting further downside ahead.

In 2021, container shippers delivered exceptionally strong performances, as supply chain disruptions and a shortage of vessels pushed up freight rates. While port congestion issues have mostly been resolved, increased deliveries of new vessels (ordered during the industry boom) should continue to weigh on container shippers' earnings for some time.

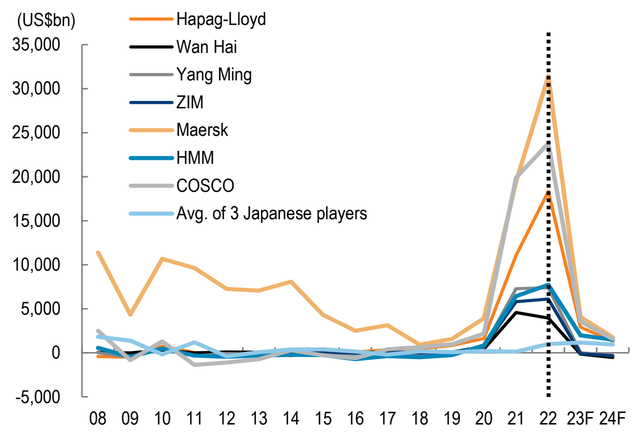
Indeed, Wan Hai Lines, a small/mid-sized Taiwanese carrier, swung to a loss in 1Q23 and is forecast to slip into the red on an annual basis. In addition, large carriers Maersk and Hapag-Lloyd reported steep revenue declines in 1Q23 (-26% and -30% YoY, respectively) and are forecast to suffer sharp drops in full-year operating profit (-87% and -83% YoY, respectively).

Figure 5. Top 10 container shippers: Quarterly avg. OP margin



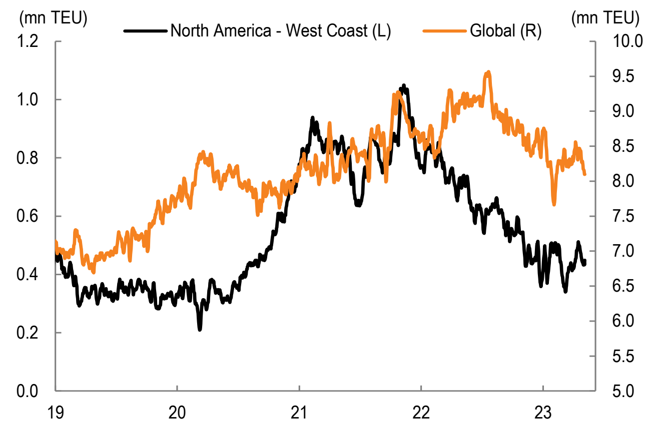
Source: Clarksons, Mirae Asset Securities Research

Figure 6. Major listed container shippers: Annual OP



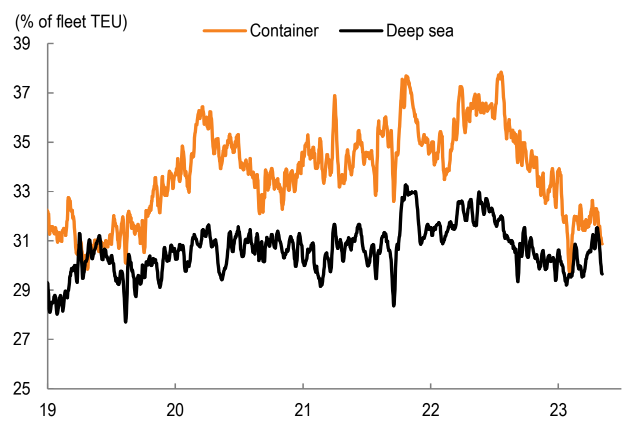
Source: Clarksons, Mirae Asset Securities Research

Figure 7. Port backlogs: Global vs. North America West Coast



Source: Clarksons, Mirae Asset Securities Research

Figure 8. Port backlogs (% of total fleet) by vessel category



Source: Clarksons, Mirae Asset Securities Research

III. Well-positioned to withstand downturns

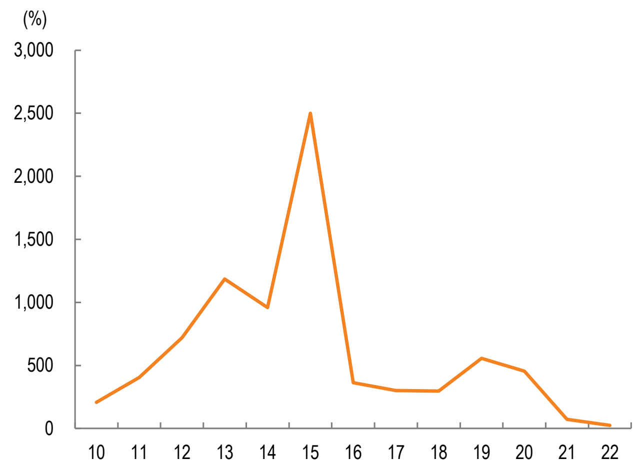
1. Ample cash holdings (W13tr)

As of end-1Q23, HMM held roughly W13tr in cash and cash equivalents and had a debt ratio of just 28% (vs. 73% in 2021). In 2022, the firm's annual net interest expenses narrowed to the W100bn level (from around W200bn-400bn).

During the nearly decade-long slump in the domestic container shipping industry (2011-19), when industry players were locked in a game of chicken, HMM posted cumulative operating losses of W3.84tr. In 2016, when operating losses peaked, the company's operating cash flow deteriorated to -W640bn; on a per-TEU basis, this is equivalent to -W150,000.

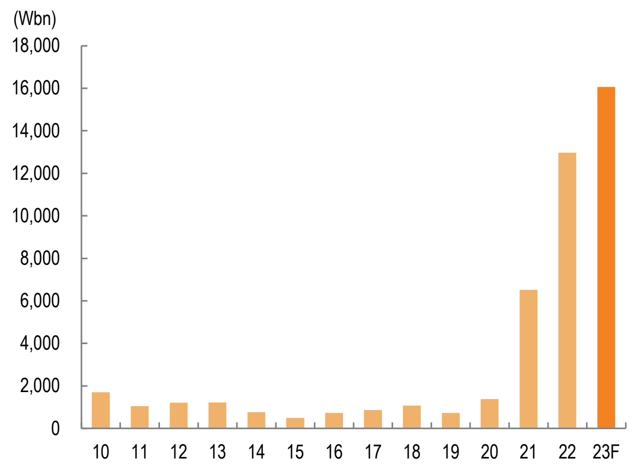
If a severe recession hits, we estimate HMM's annual operating cash flow could deteriorate to -W800bn. But thanks to its healthy balance sheet, we believe the company would be able to withstand these conditions for a long time—at least 10 years assuming no investments and around 48 months (two business cycles) assuming large investments.

Figure 9. HMM's debt-to-equity ratio



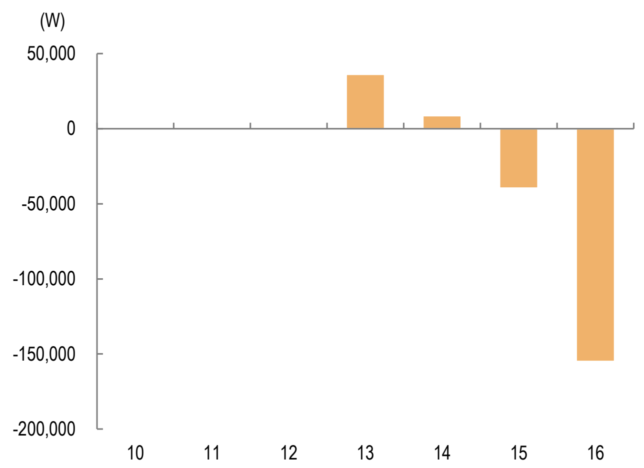
Source: Company data, Mirae Asset Securities Research

Figure 10. HMM's cash/equivalents



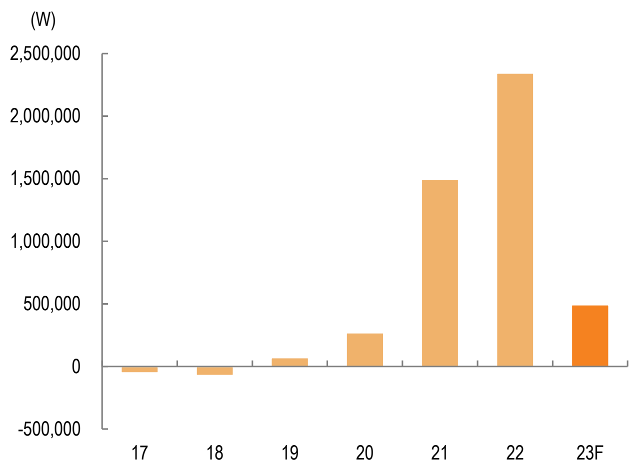
Source: Company data, Mirae Asset Securities Research

Figure 11. HMM's cash flow per TEU (2010-16)



Source: Company data, Mirae Asset Securities Research

Figure 12. HMM's cash flow per TEU (2017-23F)



Source: Company data, Mirae Asset Securities Research

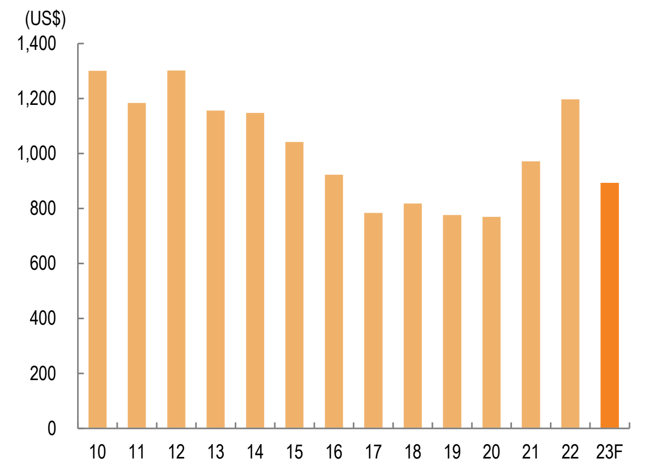
2. Lower unit cost

To achieve economies of scale, HMM has invested aggressively in fleet expansion with a focus on large vessels. We think the resulting drop in cost per TEU has contributed to improved earnings. In 2020, following nine consecutive years of losses, the company swung to an operating profit (OP margin of 16%), supported not only by higher freight rates but also by a drop in unit cost per TEU to US$772 (vs. US$1,305 in 2012).

In 1Q23, as the SCFI fell to around 1,000p, HMM's average freight rate dropped to US$1,061 per TEU, a nearly 70% drop from the 1Q22 level (US$3,698). Despite this, the container unit's OP margin remained resilient at 13% (similar to the level seen in previous up-cycles). Even if freight rates fall further, the company is unlikely to suffer massive losses on the scale seen in 2016 (OP margin of -19%).

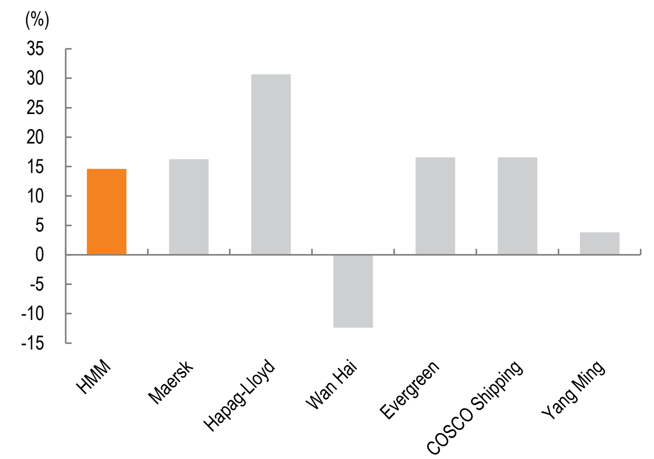
In contrast, some competitors have already recorded losses. As mentioned earlier, Wan Hai Lines swung to a loss in 1Q23 (OP margin of -12.5%) and is forecast to slip into the red on an annual basis. HMM recorded a 1Q23 OP margin of 15%, which, while down significantly from recent highs, is on par with those of Maersk (16%), COSCO Shipping (17%), and Evergreen (16%).

Figure 13. HMM's unit cost per TEU



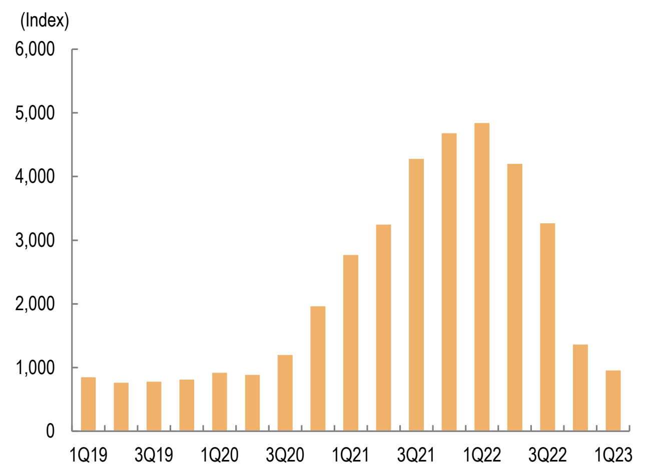
Source: Company data, Mirae Asset Securities Research

Figure 14. Major container shippers: OP margin comparison (1Q23)



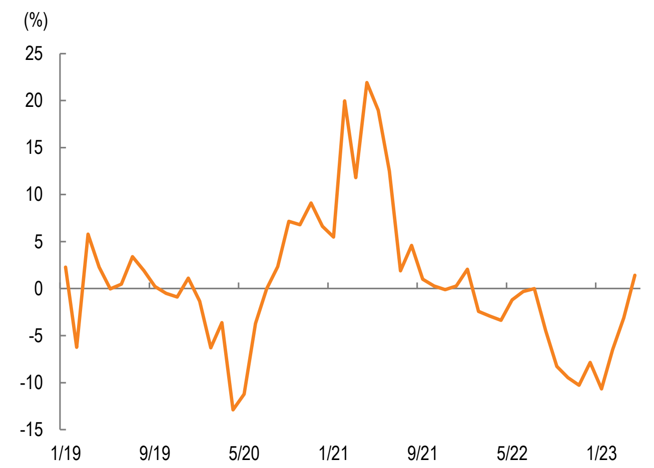
Source: Bloomberg, Mirae Asset Securities Research

Figure 15. SCFI trend



Source: Clarksons, Mirae Asset Securities Research

Figure 16. Container trade volume growth (YoY)



Source: Bloomberg, Mirae Asset Securities Research

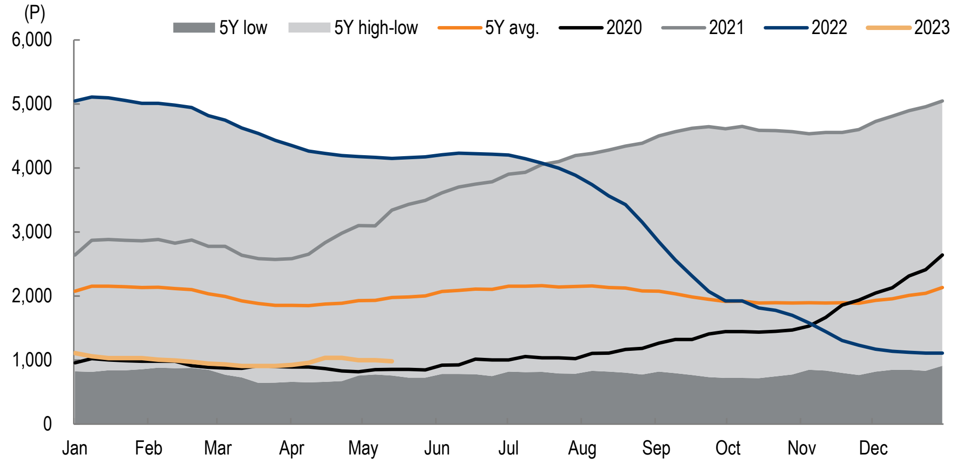
IV. Container market outlook

The party is winding down

Tough market environment taking shape

The container shipping market has been declining since the SCFI peaked at 5,110p in Jan. 2022. From Jul. to Sep. 2022, the index plunged 54%, fueling concerns over container shipping companies' earnings. In the short term, additional downside pressure should ease thanks to carriers' efforts to control supply (e.g., designating vessels for certain routes). But from a long-term perspective, new supply pressures and a delayed demand recovery should create a tough market environment.

Figure 17. SCFI trends



Source: Thomson Reuters, Mirae Asset Securities Research

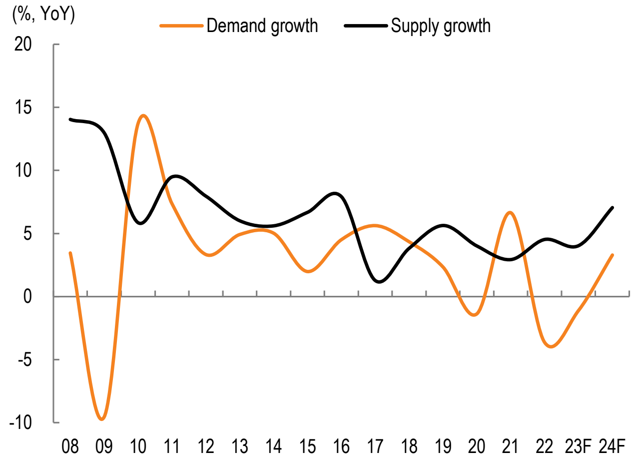
Demand likely to recover, but only to a limited degree

In 2022, container tonne-mile demand decreased 5% YoY. In 2023, despite a low base of comparison arising from lower trade volume in 2022, we see demand slipping 1.3% YoY due to persistently high retail inventories (stemming from high inflation and the economic slowdown).

On a brighter note, China is aiming to fully reopen in 2H23, which may bring some positive momentum to the global economy and help revitalize the Asian market.

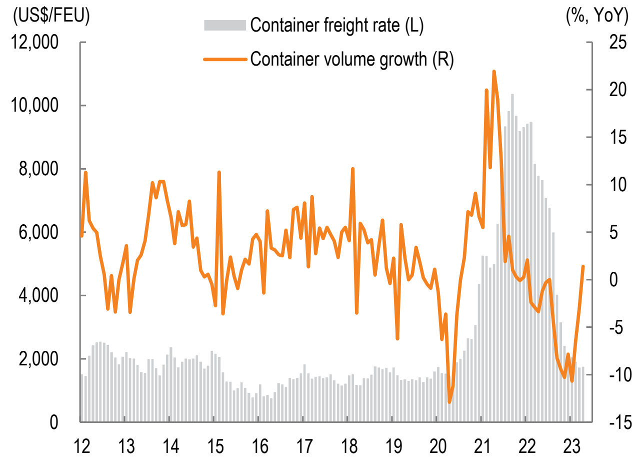
Of note, some are projecting that retail inventories may peak in 3Q23. While this would certainly be positive for the container market, we believe it is still too early to make predictions. In the long term, we believe container shipping demand will hinge on changes in trade patterns, with the trend toward reshoring and the emergence of regional economic blocs amid US-China tensions being a potential risk factor.

Figure 18. Container shipping supply/demand growth



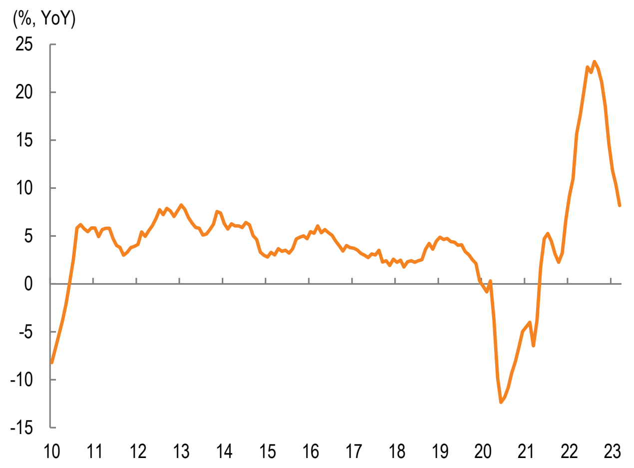
Source: Clarksons, Mirae Asset Securities Research

Figure 19. Global container volume growth and freight rate



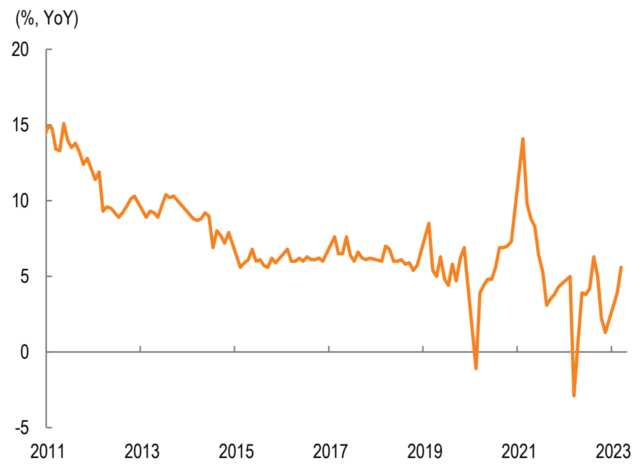
Source: Bloomberg, Mirae Asset Securities Research

Figure 20. US retail inventory growth



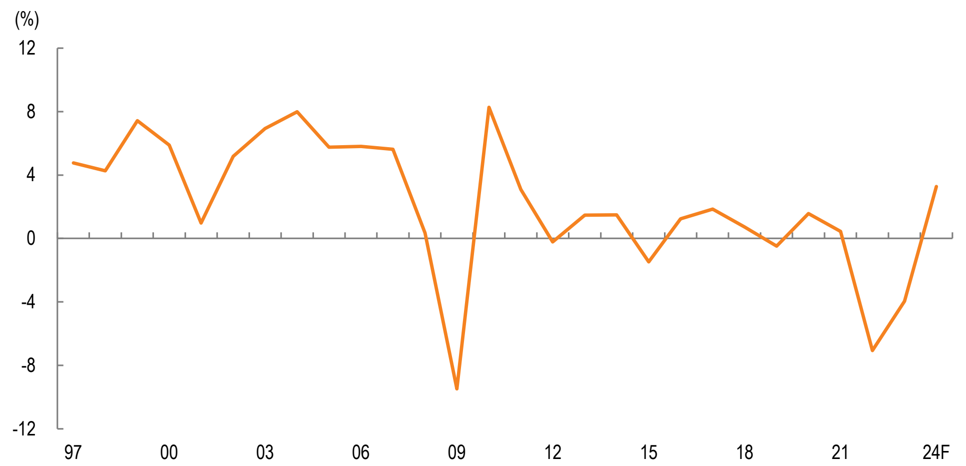
Source: Bloomberg, Mirae Asset Securities Research

Figure 21. China's industrial output growth



Source: Bloomberg, Mirae Asset Securities Research

Figure 22. Container demand growth minus global GDP growth



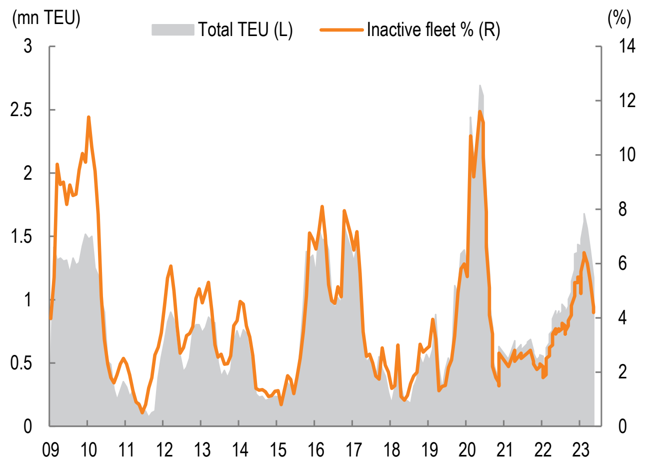
Source: Clarksons, Mirae Asset Securities Research

Supply: Excess fleet capacity and supply control measures

In 2023, we expect global containership capacity (which increased 4% YoY in 2022) to expand 7% YoY, as new deliveries should hit a record high of 2mn TEU. Meanwhile, vessel demolitions have been modest despite the recent market weakness; we do not expect to see a significant pickup in demolitions until 2024.

However, one positive development is the reduction in vessel speeds. In 1Q23, containership speeds decreased more than 3% compared to the 2022 average, with ultra-large containerships (12,000-17,000 TEU) seeing a bigger reduction (-7%). We believe carriers are reducing vessel speeds in response to weakening market conditions and expect this trend to persist. In addition to reducing speeds, carriers are continuing efforts to adjust supply (through service suspensions, route reassignments, and lay-ups), which should also help slow the pace of the market decline.

Figure 23. Inactive fleet trend



Source: Alphaliner, Mirae Asset Securities Research

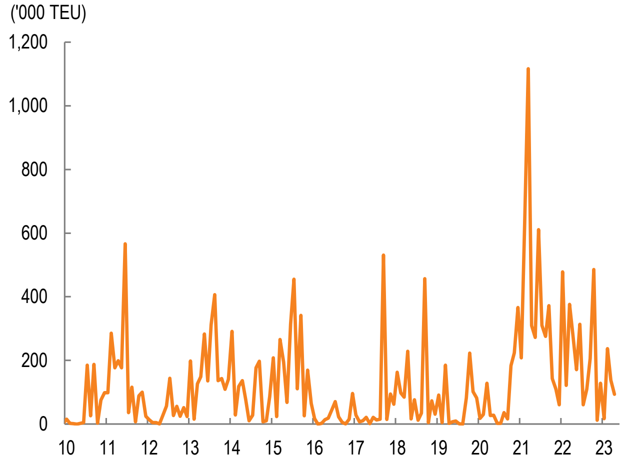
Figure 24. Avg. containership speed

Source: Clarksons, Mirae Asset Securities Research

Figure 25. Orderbook-to-fleet ratio stabilizes after breaking above 30%

Note: Based on 8,000 TEU-or-larger containerships
Source: Clarksons, Mirae Asset Securities Research

Figure 26. New orders decline after reaching 1mn TEU/mo.



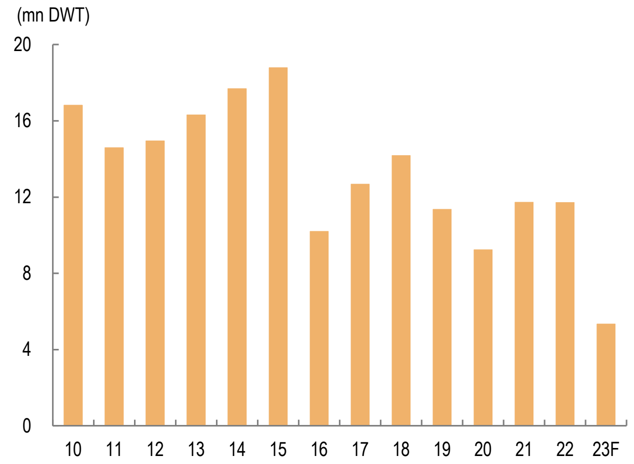
Source: Clarksons, Mirae Asset Securities Research

Market to remain oversupplied in 2024 given large newbuilding orders

The newbuilding order backlog for containerships hit a record 7.6mn TEU in March, which represents 29% of existing shipping capacity (vs. 10% at end-2020). Based on large-sized containerships, the figure represents 38% of existing capacity. The large order backlog suggests that supply pressures will increase over the long term.

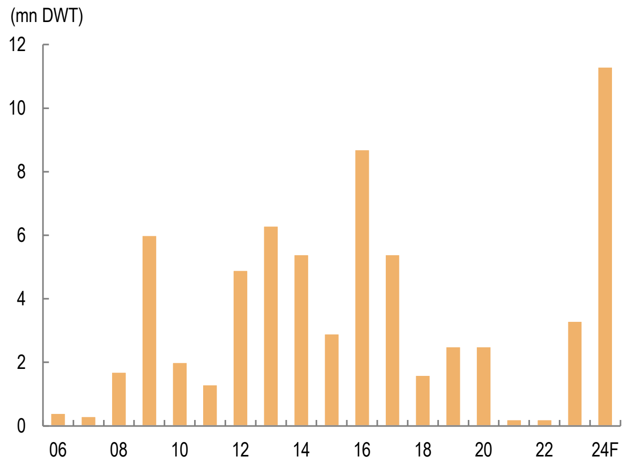
Despite the recent deterioration in market conditions, many container shipping companies and shipowners are in no rush to scrap ships, as they are still making profits. In 2024, we expect container shipping tonnage to grow around 6%, with newbuild deliveries likely to total 2.4mn TEU.

Figure 27. Containership newbuild deliveries



Source: Clarksons, Mirae Asset Securities Research

Figure 28. Containership demolitions



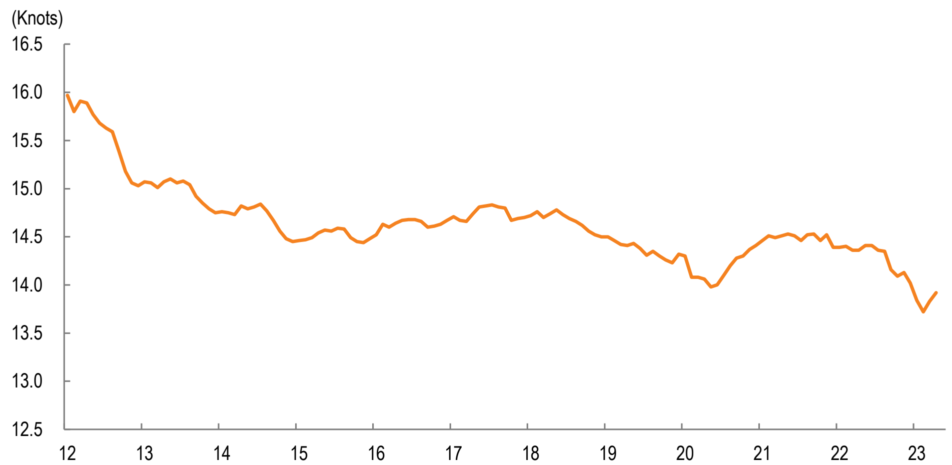
Source: Clarksons, Mirae Asset Securities Research

Environmental regulations to help mitigate supply pressures

To reduce the carbon intensity of shipping, the International Maritime Organization (IMO) has introduced two new measures: the Energy Efficiency Existing Ship Index (EEXI) and the Carbon Intensity Indicator (CII). Accordingly, we have seen an increase in orders for ships that can run on alternative fuels (over 60% of newbuilding orders in 1Q23). Among LNG tankers, vessels that can run on methanol represented 62% of new orders over the past two years.

In the short term, however, we believe slow steaming is the most practical way for shipping companies to comply with tightening carbon regulations. This could help mitigate supply pressures, given that slower speeds can reduce de facto capacity by an average of 1.5-2% per year (according to Clarksons). That said, slow steaming alone will not be enough to offset projected supply growth of over 5%.

Figure 29. Avg. containership speed



Source: Clarksons, Mirae Asset Securities Research

Maersk and MSC to discontinue 2M alliance

Shipping companies form alliances for survival

Similar to the codeshare agreements seen in the aviation industry, shipping companies often form alliances with competitors to share surplus capacity, jointly operate routes, and maximize cost efficiency. Currently, there are three major shipping network alliances—2M, Ocean Alliance, and The Alliance—comprising nine major shippers, which hold a collective market share of over 80% globally. Among large shipping companies, ZIM, Wan Hai Lines, and Pacific International Lines (PIL) operate independently but can still jointly operate routes under individual contracts.

2M—an alliance between MSC and Maersk, the world's largest and second-largest shipping companies—is the largest alliance, with a 32% market share. The Alliance network, which includes HMM, is smaller in size but includes major shipping firms based in Europe and Asia and engages in broader-based cooperation.

Table 5. Maritime alliances: M/S changes

Alliance/ company	Fleet (TEU)			M/S		Notes
	Current	On order	Total	Current fleet	Incl. vessels on order	
MSC	4.6mn	1.73mn	6.33mn	17.4%	18.7%	32.3% if 2M continues
Maersk	4.23mn	376,000	4.6mn	16.0%	13.6%	
Ocean	7.93mn	2.01mn	9.94mn	30.0%	29.4%	
The Alliance	4.84mn	980,000	5.82mn	18.3%	17.2%	
Other	4.8m	2.38mn	7.18mn	18.2%	21.2%	
Total	**26.39mn**	**7.48mn**	**33.87mn**	**100%**	**100%**	

Source: KOBC, Mirae Asset Securities Research

Table 6. Three major shipping alliances

Alliance	Participants	Years in effect	M/S		Routes
			By route	By capacity	
2M	Maersk, MSC	2015-24	North America 24%, Europe 33%	32.3%	North America, Europe, Atlantic
Ocean	CMA CGM, COSCO, Evergreen	2017-27	North America 34%, Europe 36%	29.4%	North America, Europe, Atlantic, Middle East
The Alliance	Hapag-Lloyd, ONE, HMM, Yang Ming	2017-30	North America 27%, Europe 28%	17.2%	North America, Europe, Atlantic, Middle East, Asia

Source: KOBC, Mirae Asset Securities Research

2M alliance to be discontinued

Recently, Maersk announced plans to end its alliance with MSC in 2025. The two companies formed 2M in 2015 to efficiently operate their rapidly expanding fleets, but the partnership appears to have lost traction, with MSC becoming the largest shipping company by tonnage following aggressive fleet expansion and increased solo operations.

Market competition will likely intensify once the 2M alliance dissolves. Unlike Maersk, which has been cautious in expanding capacity, MSC has aggressively placed newbuilding orders and thus will likely gain further market share. The two companies may remain partners even after the alliance comes to an end, but competition is expected to increase at any rate.

While MSC could potentially join another shipping alliance, the firm's large market share means there would likely be anti-trust issues to deal with, and obtaining approval could take a long time. As such, Ocean Alliance's market influence could increase for the time being.

It will be interesting to see how CMA CGM—which was planning to join 2M but ultimately chose Ocean Alliance—responds to 2M's collapse. We would not be surprised to see a new alliance emerge, which could include MSC and/or independent players such as ZIM and Wan Hai Lines.

Table 7. Top 10 global shipping companies (containerships)

Rank	Company	Country	Incorporation	Tonnage (TEU)	M/S (%)	No. of ships (large-sized)	On order (large-sized)	Alliance
1	MSC	Switzerland	1970	4,609,915	17.5	717	124	2M
2	Maersk	Denmark	1904	4,235,425	16.1	705	30	2M
3	CMA CGM	France	1978	3,399,694	12.9	599	77	Ocean Alliance
4	COSCO Shipping	China	1997	2,866,755	10.9	465	46	Ocean Alliance
5	Hapag-Lloyd	Germany	1970	1,796,163	6.8	249	18	The Alliance
6	Evergreen	Taiwan	1968	1,663,177	6.3	209	49	Ocean Alliance
7	ONE	Japan	2017	1,528,921	5.8	204	30	The Alliance
8	HMM	Korea	1976	816,365	3.1	75	17	The Alliance
9	Yang Ming	Taiwan	1972	705,614	2.7	93	-	The Alliance
10	ZIM	Israel	1945	533,823	2	138	43	-

Source: KOBC, Mirae Asset Securities Research

V. Company overview

A leading shipping company

Established in 1976 as Asia Merchant Marine, the firm changed its name to Hyundai Merchant Marine in 1983 and to HMM in 2020. Its main businesses are container shipping and bulk carrier operations (oil tankers and dry bulk carriers).

The company is 20.69% owned by KDB and 19.96% by KOBC. The state-owned KDB has been the firm's largest shareholder since it was separated from the Hyundai Group after suffering liquidity problems in 2016. Under the government's five-year initiative for rebuilding the shipping industry, HMM has emerged as the largest shipping firm in Korea and the eighth largest in the world.

As of 2022, container shipping services accounted for 93% of revenue. The company joined The Alliance in 2019 and has focused on improving its bottom line through frozen cargo and specialty shipping container services.

Table 8. Company history

Year	Notes
1976	Established as Asia Merchant Marine
1983	Changed name to Hyundai Merchant Marine; created the container service division
1995	Listed on the stock market
2005	Split off Hyundai U&I (changed name to Hyundai Movex)
2014	Sold the LNG business
2019	Became a member of The Alliance
2020	Changed name to HMM

Source: Company data, Mirae Asset Securities Research

Businesses

1) Containerships

HMM is the eighth largest container carrier in the world, with a 3.1% market share. In 2019, the firm joined The Alliance, one of the three major shipping alliances. The company plans to cooperate with the network over the next decade (through 2030).

As of 2022, US routes made the largest revenue contribution (43.4%), followed by Europe routes (29.6%), Asia routes (17.3%), and South America routes (9.6%). The firm posted record revenue in 2022, helped in large part by the large revenue mix of US and Europe routes, which have higher average freight rates (US$5,656/FEU for US and US$4,846/FEU for Europe in 2022). That said, in 4Q22, average freight rates plunged to US$1,624/FEU for US routes and US$1,490/FEU for Europe routes. While changes in supply/demand and freight rate volatility are sources of uncertainty, the company is seeking to bolster its resilience by increasing long-term contracts, focusing on highly profitable segments (frozen cargo, etc.), and strengthening customer (cargo owner) management.

2) Bulk carriers

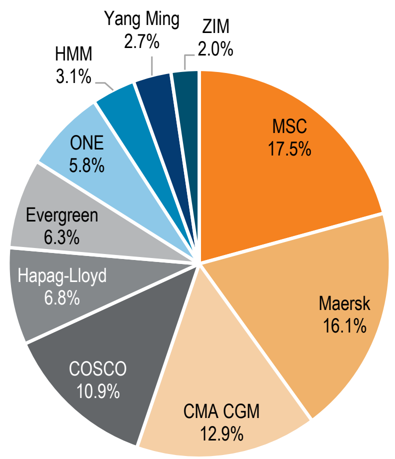
Oil tankers and dry bulk carriers accounted for 73% and 27%, respectively, of the bulk carrier division's revenue in 2022.

1) Oil tankers: Oil tanker earnings improved sharply in 1Q23, as the market environment turned favorable on strong seasonal demand and the fading pandemic impact. Generally speaking, oil tanker market conditions are strongly affected by oil prices, which have grown more volatile since the outbreak of the Russia-Ukraine war.

2) Dry bulk carriers: Demand slipped roughly 2.7% YoY amid rising interest rates in key economies and slowing global growth. Demand uncertainty has increased as a result, and supply volatility has also climbed due to limited order placements. Iron ore and coal market conditions—which are closely linked with the dry bulk market—have recently recovered slightly from their slump and could improve further with China's reopening.

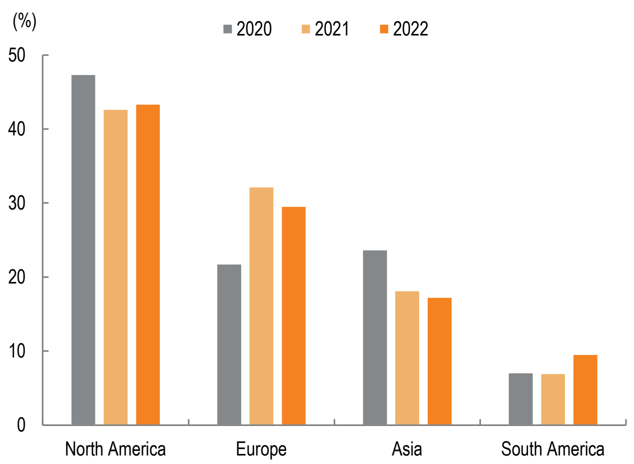
HMM has seen its dry bulk revenue grow steadily since 2018. In 2022, the company announced plans to strengthen its bulk carrier division over the medium to long term, thereby reducing its reliance on containerships (90%). To that end, it plans to invest W15tr in core assets, including carriers and terminals, by 2026. Notably, by 2026, the firm plans to increase the number of wet bulk carriers to 25 (from 10 in 2021) and the number of dry bulk carriers to 30 (from 19 in 2021), including both large and small carriers.

Figure 30. Containership M/S by company



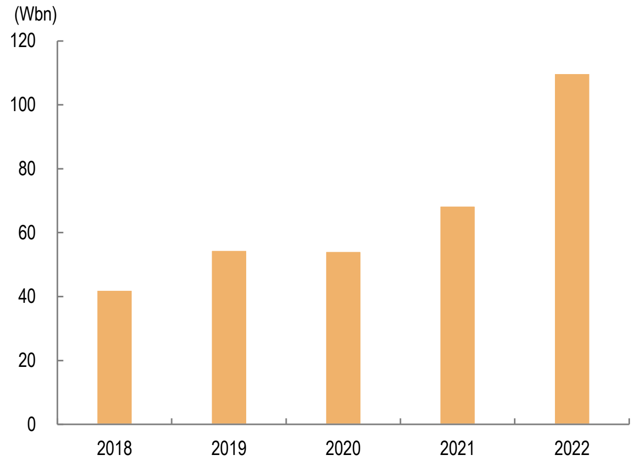
Source: Alphaliner, Ministry of Oceans and Fisheries, Mirae Asset Securities Research

Figure 31. HMM: Containership revenue by route



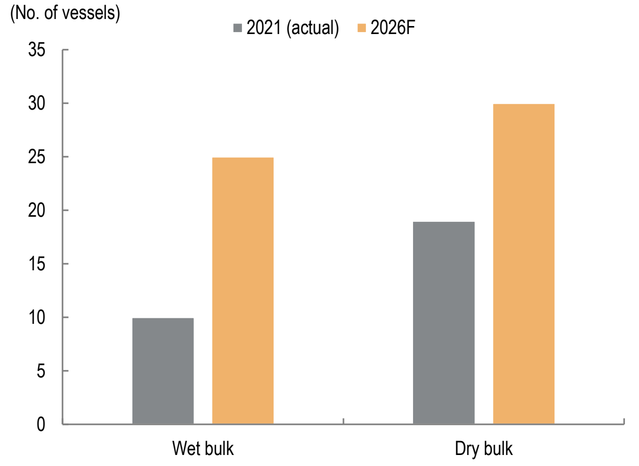
Source: Company data, Mirae Asset Securities Research

Figure 32. HMM: Bulk carrier business revenue



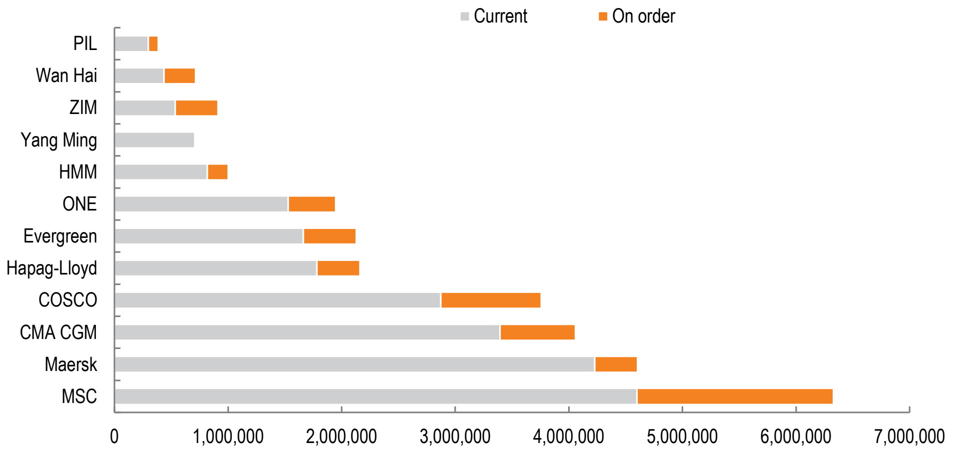
Source: Company data, Mirae Asset Securities Research

Figure 33. HMM: Bulk carrier business expansion plans



Source: Company data, Mirae Asset Securities Research

Figure 34. Shipping capacity of top 12 shipping companies (as of Jan. 2023; TEU)



Source: Alphaliner, Mirae Asset Securities Research

HMM (011200 KS)

Income statement (summarized)

(Wbn)	2022	2023F	2024F	2025F
Revenue	**18,583**	**8,578**	**9,141**	**9,986**
Cost of revenue	**8,137**	**6,414**	**6,409**	**6,588**
GP	**10,446**	**2,164**	**2,732**	**3,398**
SG&A expenses	**494**	**394**	**421**	**460**
OP (adj.)	**9,952**	**1,769**	**2,311**	**2,938**
OP	**9,952**	**1,769**	**2,311**	**2,938**
Non-operating profit	**232**	**300**	**486**	**611**
Net financial income	-111	381	486	610
Net income from associates	-12	0	0	0
Pretax profit	10,184	2,069	2,797	3,549
Income tax	98	73	97	123
Profit from continuing operations	10,085	1,996	2,700	3,425
Profit from discontinued operations	0	0	0	0
NP	**10,085**	**1,996**	**2,700**	**3,425**
Attributable to owners	10,085	1,997	2,700	3,426
Attributable to minority interests	0	-1	-1	-1
Total comprehensive income	**10,655**	**2,613**	**2,700**	**3,425**
Attributable to owners	10,655	2,613	2,700	3,426
Attributable to minority interests	0	0	0	0
EBITDA	10,791	2,584	3,079	3,685
FCF	10,876	1,775	2,911	3,473
EBITDA margin (%)	58.1	30.1	33.7	36.9
OP margin (%)	53.6	20.6	25.3	29.4
Net margin (%)	54.3	23.3	29.5	34.3

Balance sheet (summarized)

(Wbn)	2022	2023F	2024F	2025F
Current assets	**14,280**	**16,558**	**18,815**	**21,627**
Cash & equivalents	4,980	5,001	6,846	9,225
AR & other receivables	943	623	684	753
Inventory	325	215	236	260
Other current assets	8,032	10,719	11,049	11,389
Non-current assets	**11,693**	**11,091**	**11,024**	**11,137**
Investments in associates	439	290	319	350
PP&E	4,123	4,088	3,860	3,794
Intangible assets	44	45	45	45
Total assets	**25,973**	**27,649**	**29,839**	**32,764**
Current liabilities	**2,052**	**1,703**	**1,776**	**1,858**
AP & other payables	608	401	441	485
Short-term financial liabilities	930	962	962	962
Other current liabilities	514	340	373	411
Non-current liabilities	**3,234**	**3,319**	**3,323**	**3,328**
Long-term financial liabilities	3,167	3,275	3,275	3,275
Other non-current liabilities	67	44	48	53
Total liabilities	**5,286**	**5,022**	**5,100**	**5,186**
Equity attributable to owners	**20,686**	**22,625**	**24,739**	**27,579**
Capital stock	2,445	2,445	2,445	2,445
Capital surplus	4,425	4,425	4,425	4,425
Retained earnings	10,543	11,865	13,978	16,818
Minority interests	**2**	**1**	**0**	**-1**
Shareholders' equity	**20,688**	**22,626**	**24,739**	**27,578**

Cash flow statement (summarized)

(Wbn)	2022	2023F	2024F	2025F
Operating cash flow	**11,319**	**2,387**	**3,451**	**4,153**
NP	10,085	1,996	2,700	3,425
Non-cash income/expenses	646	609	377	257
Depreciation	839	814	768	746
Amortization	0	0	0	0
Other	-193	-205	-391	-489
Chg. in working capital	475	-461	-17	-19
Chg. in AR & other receivables	1,044	342	-60	-67
Chg. in inventory	-39	123	-21	-24
Chg. in AP & other payables	-50	267	31	34
Income tax	-44	-74	-97	-123
Cash flow from investing activities	**-4,818**	**-2,433**	**-990**	**-1,155**
Chg. in PP&E	-436	-611	-540	-680
Chg. in intangible assets	-8	-2	0	0
Chg. in financial assets	-4,985	-2,059	-450	-475
Other	611	239	0	0
Cash flow from financing activities	**-3,601**	**-189**	**-587**	**-587**
Chg. in financial liabilities	-1,814	140	0	0
Chg. in equity	0	0	0	0
Dividends	-326	-20	-587	-587
Other	-1,461	-309	0	0
Chg. in cash	**3,255**	**21**	**1,845**	**2,379**
Beginning balance	1,725	4,980	5,001	6,846
Ending balance	4,980	5,001	6,846	9,225

Source: Company data, Mirae Asset Securities Research estimates

Key valuation metrics/ratios

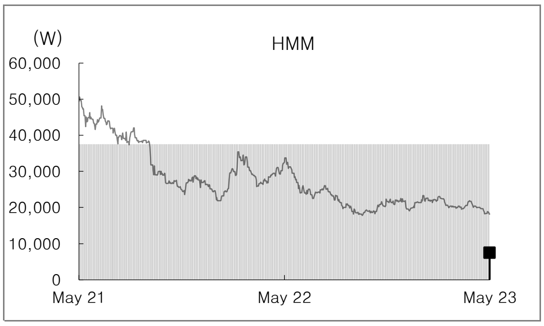
	2022	2023F	2024F	2025F
P/E (x)	0.9	4.5	3.3	2.6
P/CF (x)	0.9	3.4	2.9	2.4
P/B (x)	0.5	0.4	0.4	0.3
EV/EBITDA (x)	0.1	-	-	-
EPS (W)	20,623	4,083	5,522	7,007
CFPS (W)	21,944	5,327	6,292	7,530
BPS (W)	42,300	46,265	50,587	56,393
DPS (W)	1,200	1,200	1,200	1,200
Dividend payout ratio (%)	5.8	29.4	21.7	17.1
Dividend yield (%)	6.1	6.6	6.6	6.6
Revenue growth (%)	34.7	-53.8	6.6	9.2
EBITDA growth (%)	34.4	-76.1	19.2	19.7
OP growth (%)	34.9	-82.2	30.6	27.1
EPS growth (%)	49.9	-80.2	35.3	26.9
AR turnover (x)	13.1	11.1	14.2	14.1
Inventory turnover (x)	64.2	31.8	40.5	40.3
AP turnover (x)	15.6	16.3	19.6	18.3
ROA (%)	46.0	7.4	9.4	10.9
ROE (%)	65.0	9.2	11.4	13.1
ROIC (%)	106.3	17.8	23.6	30.4
Debt-to-equity ratio (%)	25.5	22.2	20.6	18.8
Current ratio (%)	696.0	972.1	1,059.2	1,164.2
Net debt-to-equity ratio (%)	-42.2	-50.2	-54.7	-58.9
Interest coverage ratio (x)	24.5	4.8	6.2	7.9

Appendix 1

Important disclosures and disclaimers

Two-year rating and TP history

Company	Date	Rating	TP (W)
HMM (011200)	05/26/23	Trading Buy	21,000



Stock ratings	
Buy	Expected 12-month performance: +20% or greater
Trading Buy	Expected 12-month performance: +10% to +20%
Hold	Expected 12-month performance: -10% to +10%
Sell	Expected 12-month performance: -10% or worse

Sector ratings	
Overweight	Expected to outperform the market over 12 months
Neutral	Expected to perform in line with the market over 12 months
Underweight	Expected to underperform the market over 12 months

Rating and TP history: Share price (─), TP (▬), Not Rated (■), Buy (▲), Trading Buy (■), Hold (●), Sell (♦)
* Our investment rating is a guide to the expected return of the stock over the next 12 months.
* Outside of the official ratings of Mirae Asset Securities Co., Ltd., analysts may call trading opportunities should technical or short-term material developments arise.
* The TP was determined by the research analyst through valuation methods discussed in this report, in part based on estimates of future earnings.
* TP achievement may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

Ratings distribution and investment banking services

	Buy	Trading Buy	Hold	Sell
Ratings distribution	85.7%	10.7%	2.9%	0.7%
Investment banking services	87.5%	12.5%	0%	0%

* Based on recommendations in the last 12-months (as of March 31, 2023)

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Mirae Asset Securities International Network

Mirae Asset Securities Co., Ltd. (Seoul) One-Asia Equity Sales Team Mirae Asset Center 1 Building 26 Eulji-ro 5-gil, Jung-gu, Seoul 04539 Korea Tel: 82-2-3774-2124	**Mirae Asset Securities (HK) Ltd.** Units 8501, 8507-8508, 85/F International Commerce Centre 1 Austin Road West Kowloon Hong Kong Tel: 852-2845-6332	**Mirae Asset Securities (UK) Ltd.** 41st Floor, Tower 42 25 Old Broad Street, London EC2N 1HQ United Kingdom Tel: 44-20-7982-8000
Mirae Asset Securities (USA) Inc. 810 Seventh Avenue, 37th Floor New York, NY 10019 USA Tel: 1-212-407-1000	**Mirae Asset Wealth Management (USA) Inc.** 555 S. Flower Street, Suite 4410, Los Angeles, California 90071 USA Tel: 1-213-262-3807	**Mirae Asset Wealth Management (Brazil) CCTVM** Rua Funchal, 418, 18th Floor, E-Tower Building Vila Olimpia Sao Paulo - SP 04551-060 Brazil Tel: 55-11-2789-2100
PT. Mirae Asset Sekuritas Indonesia District 8, Treasury Tower Building Lt. 50 Sudirman Central Business District Jl. Jend. Sudirman, Kav. 52-54 Jakarta Selatan 12190 Indonesia Tel: 62-21-5088-7000	**Mirae Asset Securities (Singapore) Pte. Ltd.** 6 Battery Road, #11-01 Singapore 049909 Republic of Singapore Tel: 65-6671-9845	**Mirae Asset Securities (Vietnam) LLC** 7F, Saigon Royal Building 91 Pasteur St. District 1, Ben Nghe Ward, Ho Chi Minh City Vietnam Tel: 84-8-3911-0633 (ext.110)
Mirae Asset Securities Mongolia UTsK LLC #406, Blue Sky Tower, Peace Avenue 17 1 Khoroo, Sukhbaatar District Ulaanbaatar 14240 Mongolia Tel: 976-7011-0806	**Mirae Asset Investment Advisory (Beijing) Co., Ltd** 2401B, 24th Floor, East Tower, Twin Towers B12 Jianguomenwai Avenue, Chaoyang District Beijing 100022 China Tel: 86-10-6567-9699	**Beijing Representative Office** 2401A, 24th Floor, East Tower, Twin Towers B12 Jianguomenwai Avenue, Chaoyang District Beijing 100022 China Tel: 86-10-6567-9699 (ext. 3300)
Shanghai Representative Office 38T31, 38F, Shanghai World Financial Center 100 Century Avenue, Pudong New Area Shanghai 200120 China Tel: 86-21-5013-6392	**Ho Chi Minh Representative Office** 7F, Saigon Royal Building 91 Pasteur St. District 1, Ben Nghe Ward, Ho Chi Minh City Vietnam Tel: 84-8-3910-7715	**Mirae Asset Capital Markets (India) Pvt Ltd** 1st Floor, Tower 4, Equinox Business Park, LBS Marg, Off BKC, Kurla (West), Mumbai - 400 070 India Tel: 91-22-62661300 / 48821300