

Kiwoom Securities

(039490 KS/Buy)

Back at rock bottom

- Weak brokerage commissions partly offset by improving interest income; Proprietary trading losses stabilizing
- Balance sheet less vulnerable to risk of rise in bond yields
- Considering a number of business options that are less capital intensive
- Only brokerage stock to benefit from higher bond yields; Potential introduction of capital gains tax would entail elimination of transaction tax
- Current P/B of 1.5x represents bottom; Maintain Buy and TP of W86,000; Our top pick for securities

Key takeaways from our company visit

Operating earnings: Weak brokerage income partly offset by strong interest income

Kiwoom Securities' market share in terms of brokerage commissions has stalled at around 13%, which we believe is due to: 1) the increase in ETF trades (which are less geared towards retail investors), and 2) the KOSDAQ market correction. Proprietary trading income, the main source of last year's earnings distortion, appears to be stabilizing. Losses from ELS hedging have mostly been cleared and, unlike other brokerages, the firm's small bond position (W170bn) suggests the recent rise in bond yields will have a negligible impact on its financial position. Interest income has been strong, thanks to: 1) the steady increase in customer deposits since earlier this year, and 2) a visible recovery in margin lending. The release of pent-up demand following deregulation (removal of margin lending cap) in early May has also been a contributing factor.

Kiwoom's savings bank became the focus of market concerns after the firm set aside roughly W2bn in loss provisions in CY1Q. However, we do not believe the savings bank's financial position has gotten any worse than it was when Kiwoom first bought the bank. That said, it should be noted that June is the book-closing month for savings banks, and there is a risk that the new management may decide to make an additional, albeit modest, provision. On a positive note, we believe the acquisition has been yielding the intended synergy with the firm's brokerage business.

Kiwoom's profits appear relatively healthy, as opposed to large brokerage firms, which have been hit hard by the poor performance of bond trading (resulting in losses for some firms).

New businesses: Trying to take advantage of existing business platform at low cost

Kiwoom Securities is considering ways it can utilize its existing business platform without spending too heavily and capitalize on its economy of scale (examples include ATS and online financial products). We believe the company will fully move ahead with the introduction of an alternative trading system (ATS), once the enforcement decree of the revised Financial Services and Capital Markets Act (FSCMA) comes into place. There are still some issues that need to be addressed, such as Korea Exchange's response to the change, and securing system suppliers. In the earlier stages, we think Kiwoom will more directly benefit from falling commission rates (due to competition) rather than from ATS margins.

FY (Mar.)	03/11	03/12	03/13P	12/13F	12/14F	12/15F
Net Operating Income (Wbn)	287	336	229	214	318	366
OP (Wbn)	137	168	63	73	126	163
NP (Wbn)	112	128	50	58	99	127
EPS (W)	5,050	5,716	2,329	2,677	4,587	5,886
BPS (W)	31,241	36,407	37,861	40,030	42,986	46,506
P/E (x)	9.3	6.9	26.3	22.9	13.3	10.4
P/B (x)	1.5	1.1	1.6	1.5	1.4	1.3
ROE (%)	16.0	16.9	6.0	6.5	11.9	12.5
Dividend Yield (%)	1.7	2.1	0.7	0.8	1.5	1.8
Stockholder Equity (Wbn)	690	822	861	910	1,007	1,057

Note: All figures are based on consolidated K-IFRS; NP refers to profit attributable to controlling interests; 12/13F figures are based on 9-months due to change in accounting standards

Source: Company data, KDB Daewoo Securities Research estimates

Company Visit Note
June 12, 2013

Daewoo Securities Co., Ltd.

Securities/Insurance

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The firm is also looking into the online insurance business. Although still only at an exploratory stage, we believe Kiwoom is well-positioned for online insurance given its 1.6mn customer base and 30% market share in terms of new account openings. From a demographic perspective, the firm has a customer profile that is relatively young and well-versed in online financial products and services. Such characteristics would fit well with simplified insurance policies.

As witnessed by the success of its mobile trading system (MTS) (30% market share), Kiwoom is now better positioned to generate new sources of income by introducing new services and products to its existing customer base.

Stock is once again at bottom; Our top pick for securities

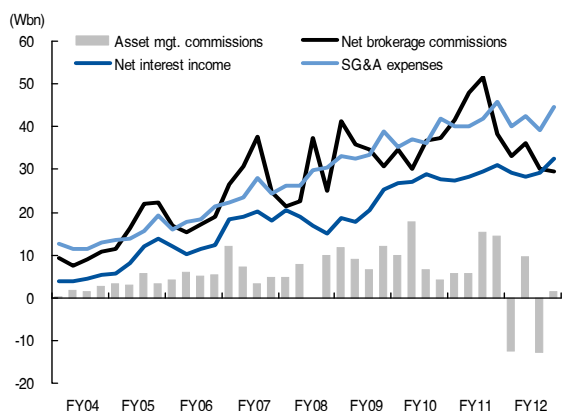
Kiwoom Securities shares are currently down 15% from the previous high of W70,000, and are trading at a P/B of 1.5x, which has historically marked a bottom.

We see several reasons behind the pullback: 1) the firm’s loss provisions from the acquisition of its savings bank, 2) weakening earnings momentum due to an overall decline in trading value, and 3) the potential introduction of a new capital gains tax.

However, we expect the stock will see downside support and bounce back for the following reasons.

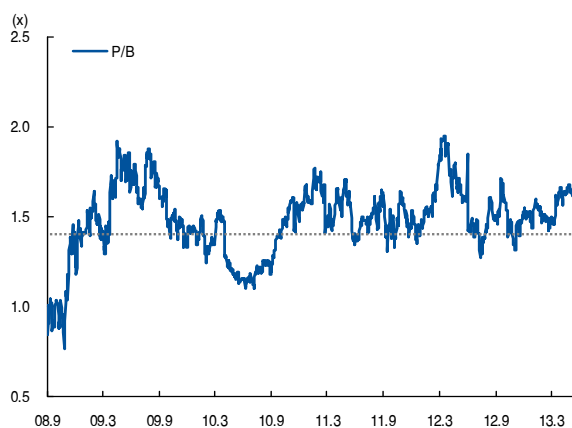
- 1) The savings bank provision risk should dissipate after the closing month of June, and the recent increase in interest income should make up for the weakness in trading value.
- 2) On a relative basis, the firm’s earnings should remain resilient. The company is free from asset quality issues related to the restructuring of large corporations, and the recent rise in bond yields is unlikely to cause any significant losses from bond trading.
- 3) In particular, if bond yields do rise further, this would directly lead to higher trading income from customer deposits, in stark contrast to other brokerages, which would likely suffer due to their high exposure to proprietary bond trading.
- 4) As for the rumored introduction of a capital gains tax, we are not overly concerned, as it will likely be conditioned on the elimination of the transaction tax. The removal of transaction costs (i.e. the 30bp transaction tax), which are equivalent to ten times current commissions, would benefit Kiwoom Securities, given its high mix of heavy traders.
- 5) In addition, we believe low commission rates have made beta plays (i.e., betting on leverage from higher trading value) no longer valid for the brokerage sector. Kiwoom Securities is the only exception here, having a profit structure that is consistent with a traditional beta stock and being the sole industry player that benefits from higher bond yields.

Figure 1. Earnings trends



Source: Company data, KDB Daewoo Securities Research

Figure 2. P/B trends

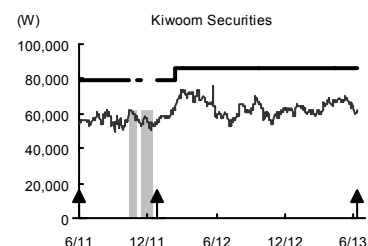


Source: Company data, KDB Daewoo Securities Research

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Sell	Relative performance of -10%		

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