

Internet

News Comment
May 27, 2014

Daewoo Securities Co., Ltd.

[Internet/Game/Entertainment]

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Daum Communications

(035720 KQ/Buy)

Kakao seeks backdoor listing

- Post-merger market cap to reach W4.4tr (Kakao to account for W3.4tr)
- Kakao seems undervalued relative to its global peers
- Appraisal right to be exercised Aug. 27 to Sept. 16; New shares to be listed on Oct. 14
- Maintain Buy with TP of W93,000

KakaoTalk uses its dominant position to build mobile ecosystem

Daum Communications and Kakao announced a merger, creating the new entity Daum Kakao. Kakao shareholders will get 1.56 shares in the merged company for each Kakao share they own, with Daum's and Kakao's stock prices determined at W72,910 (based on recent stock prices) and W113,429 (based on intrinsic value), respectively. As the number of issued shares is 13,560,229 for Daum and 26,996,580 for Kakao, the market cap (based on the merger price) will become W1tr (W72,910 x 13,560,229) for Daum and W3tr (W113,429 x 26,996,580) for Kakao.

Kakao shareholders will receive 43mn new shares (including convertible preferred shares). As such, the value of Daum Kakao can be derived by adding the existing market cap of Daum Communications (13.56mn shares x Daum share price) to the market cap of these new shares (43mn shares x Daum share price). Based on the May 23rd closing price of W78,100, we derive the value of Daum Kakao by summing the market cap of Daum (W1.06tr) and W3.4tr (43mn shares x W78,100).

Meanwhile, the W3.4tr value of Kakao seems lower than those of other global mobile-messaging service/social network service providers. <Figures 4-5> show that Kakao is the most undervalued among its global peers in terms of value per monthly active user and market cap-to-revenue ratio.

A look at user traffic shows that Kakao's mobile messaging service mainly attracts those in their 30s-50s who have high customer loyalty.

Although Daum will acquire Kakao, the largest shareholder of the merged company will be Beom-soo Kim, chairman of Kakao's board and the person with the largest stake in the firm. As such, the combined company is expected to expand aggressively into overseas mobile internet markets.

The merger announcement is boosting expectations for Daum's growth. We see the merger as a positive development for several reasons: 1) Daum should manage to obtain a more dominant position in the mobile internet market, 2) the merger method is favorable to Daum's existing shareholders (no EPS dilution), and 3) Kakao is expected to show earnings momentum in 2015 as new revenue models – including mobile ads, mobile commerce, and financial transaction services – gain traction.

FY (Dec.)	12/11	12/12	12/13	12/14F	12/15F	12/16F
Revenue (Wbn)	421	453	531	583	637	683
OP (Wbn)	117	102	82	78	92	113
OP margin (%)	27.8	22.5	15.4	13.4	14.4	16.5
NP (Wbn)	108	76	66	61	75	94
EPS (W)	8,079	5,656	4,862	4,463	5,507	6,953
ROE (%)	26.9	15.7	12.5	10.8	12.2	13.8
P/E (x)	14.9	16.1	17.3	17.5	14.2	11.2
P/B (x)	3.5	2.4	2.0	1.7	1.6	1.4

Note: All figures are based on consolidated K-IFRS; NP refers to profit attributable to controlling interests

Source: Company data, KDB Daewoo Securities Research estimates

Table 1. Market cap. before and after the merger

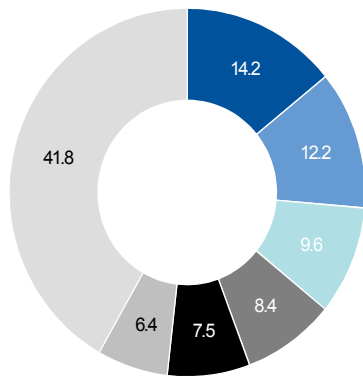
(W, shares, Wbn)

	Daum	Kakao	Notes
Merger method	Acquirer	Acquiree	Daum Communications to merge with Kakao
Base price	72,910	113,429	
Proportion	1.00	1.56	
Issued stocks before the merger (A)	13,560,229	26,996,580	Kakao had 20.5mn common shares and 6.5mn convertible preferred stocks
Stocks to be newly issued (B)	-	43,006,844	Daum Communications to give Kakao 43mn new stocks (33mn common shares + 10.1mn special shares to prepare for the exercising of options)
Market cap.	1,059	3,359	(A) x W78,100 (closing price on May 23) (B) x W78,100 (closing price on May 23)
Market cap. after the merger		4,418	

Source: Company data, KDB Daewoo Securities Research

Figure 1. Shareholding structure of Daum before the merger

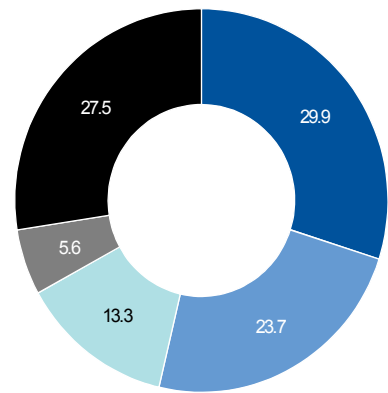
- Jaewoong Lee
- KB Asset Management
- Capital Group Companies
- Templeton Investment
- NPS
- Wellington Management
- Other



Source: Company data, KDB Daewoo Securities Research

Figure 2. Shareholding structure of Kakao before the merger

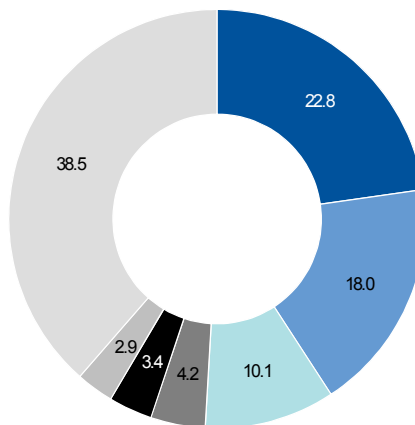
- Beom-soo Kim
- Kcubeholdings
- Maximo Pte. Ltd.
- Werrade Ent.
- Other



Note: Maximo Pte. Ltd. is an investment corporation owned by Tencent; Beom-soo Kim owns a 100% share of Kcubeholdings

Source: Company data, KDB Daewoo Securities Research

Figure 3. Shareholding structure of Daum Kakao after the merger (expected)



- Beom-soo Kim
- Kcubeholdings
- Maximo Pte. Ltd.
- Werrade Ent.
- Jaewoong Lee
- KB Asset Management
- Other

Note: Maximo Pte. Ltd. is an investment corporation owned by Tencent; Beom-soo Kim owns a 100% share of Kcubeholdings

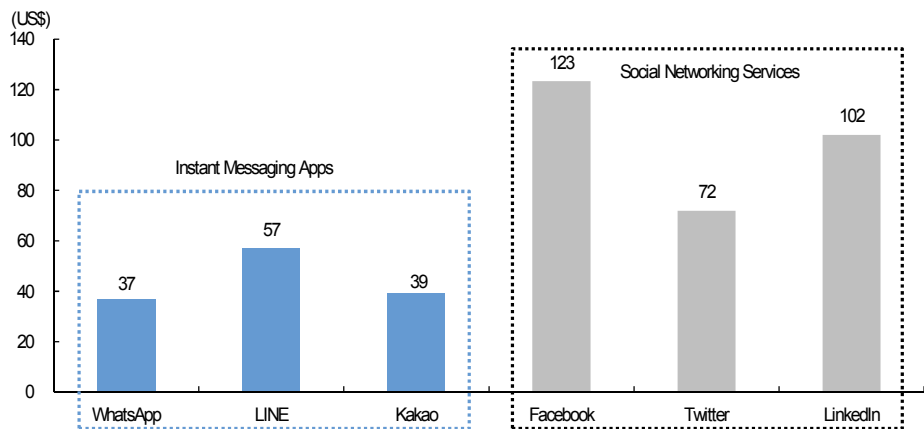
Source: Company data, KDB Daewoo Securities Research

Table 2. Merger schedule

Daum Communications, Kakao	
Resolution by Board of Directors	5/23/2014
Signing of merger agreement	5/23/2014
Closing of shareholders list	7/17/2014
Closing of shareholder register	7/18/2014 - 7/22/2014
Shareholder meeting for spin-off approval	8/27/2014
Exercise of appraisal right	8/27/2014 - 9/16/2014
Date of merger	10/1/2014
Distribution of stock certificates	10/13/2014
Listing of new shares	10/14/2014

Source: Company data, KDB Daewoo Securities Research

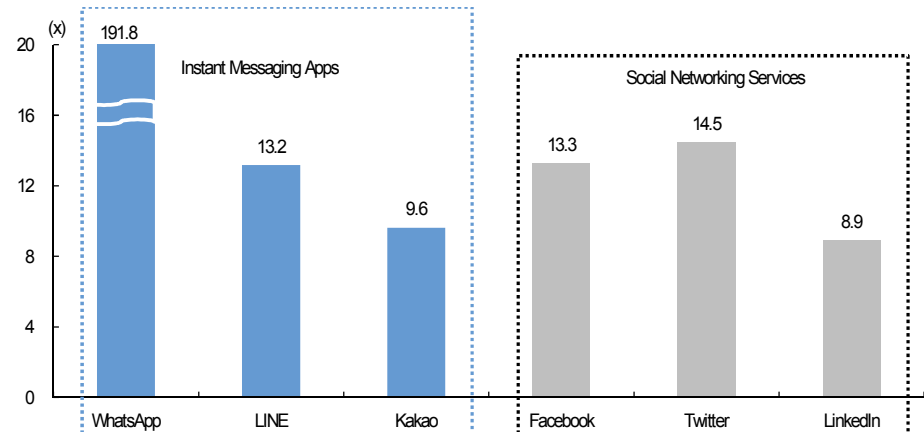
Figure 4. Value per MAU of major social networking services and instant messaging apps



Note: LINE's value assumption: ₩12.9tn, % of MAUs among total subscribers: 50%; Kakao's value assumption: ₩3.36tn, % of MAUs among total subscribers: 60%; LINE and WhatsApp subscription data from May 2014, others based on 1Q14 earnings release

Source: Company data, KDB Daewoo Securities Research

Figure 5. P/S multiples of social networking services and instant messaging apps



Note: LINE and Kakao forecasts based on Daewoo estimates, others based on Bloomberg consensus 14F revenue; LINE discloses earnings on a net basis

Source: Bloomberg, KDB Daewoo Securities Research estimates

Table 3. Earnings forecasts of global internet companies

(US\$m, %)

	Market cap.	Revenue			Operating profit			OP margin			Net profit			NP margin			EPS		
		13	14F	15F	13	14F	15F	13	14F	15F	13	14F	15F	13	14F	15F	13	14F	15F
Naver	23,981	2,113	2,746	3,364	479	787	1,129	22.7	28.7	33.6	1,734	583	835	82.1	21.2	24.8	10.0	18.1	25.7
Daum	1,034	485	558	613	75	76	87	15.4	13.7	14.2	60	61	75	12.4	11.0	12.2	4.0	4.6	5.6
Interpark	680	2,679	3,400	3,801	44	71	95	1.6	2.1	2.5	7	32	38	0.3	0.9	1.0	0.1	0.5	0.6
Google	376,228	59,825	52,367	62,039	13,966	18,686	22,725	23.3	35.7	36.6	12,920	15,162	18,453	21.6	29.0	29.7		26.7	31.6
Yahoo	35,258	4,680	4,499	4,636	577	726	828	12.3	16.1	17.9	1,366	1,381	1,623	29.2	30.7	35.0	1.1	1.6	1.8
Amazon	143,683	74,452	90,789	108,973	745	1,024	2,539	1.0	1.1	2.3	274	491	1,562	0.4	0.5	1.4	0.6	3.4	6.0
Facebook	157,448	7,872	11,850	15,590	2,804	6,089	8,093	35.6	51.4	51.9	1,491	2,904	4,059	18.9	24.5	26.0	0.8	1.4	1.8
Twitter	18,340	665	1,267	2,045	-636	29	176	-95.6	2.3	8.6	-645	-647	-439	-97.1	-51.1	-21.5	-1.8	0.0	0.3
LinkedIn	18,983	1,529	2,126	2,820	48	311	391	3.1	14.6	13.9	27	-49	48	1.8	-2.3	1.7	-0.1	1.6	2.5
Groupon	4,291	2,574	3,208	3,684	76	46	130	2.9	1.4	3.5	-95	-38	52	-3.7	-1.2	1.4	-0.1	0.1	0.3
Yahoo Japan	25,596	3,857	4,929	5,493	1,971	2,113	2,358	51.1	42.9	42.9	1,249	1,305	1,472	32.4	26.5	26.8	0.2	0.2	0.3
Rakuten	16,339	5,321	5,789	6,459	926	1,066	1,293	17.4	18.4	20.0	440	589	742	8.3	10.2	11.5	0.3	0.4	0.6
Baidu	58,739	5,196	7,746	10,713	1,820	1,927	2,770	35.0	24.9	25.9	1,711	1,838	2,589	32.9	23.7	24.2	5.1	5.5	7.7
Sohu	2,287	1,400	1,702	2,070	183	-222	0	13.1	-13.0	0.0	-15	-190	-18	-1.1	-11.1	-0.9	-3.1	-4.1	-0.3
Sina	3,101	665	787	984	23	15	88	3.4	1.9	8.9	45	15	96	6.8	1.8	9.7	0.3	0.7	1.6
Youku	3,403	493	677	937	-111	-51	56	-22.4	-7.5	6.0	-94	-41	40	-19.2	-6.1	4.3	-0.6	-0.1	0.5
Tencent	N/A	9,831	12,673	15,574	2,810	4,287	5,498	28.6	33.8	35.3	2,522	3,628	4,654	25.6	28.6	29.9	N/A	0.4	0.5
Avg.								8.7	15.8	19.1				8.9	8.1	12.8			

Note: Bloomberg consensus based on May 26th closing prices

Source: Bloomberg, KDB Daewoo Securities Research

Table 4. Valuations of global internet companies

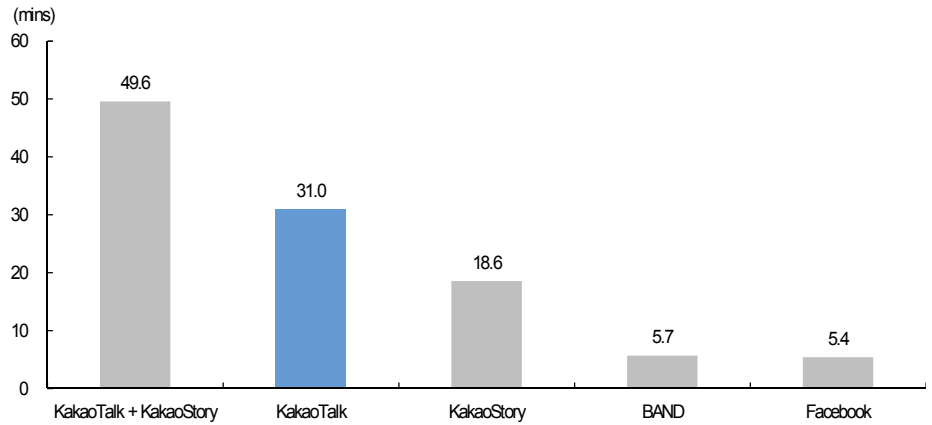
(US\$m, %)

	Market cap.	P/E			P/B			P/S			EV/EBITDA			ROE			ROA		
		13	14F	15F	13	14F	15F	13	14F	15F	13	14F	15F	13	14F	15F	13	14F	15F
Naver	23,981	68.3	40.3	28.3	14.0	11.2	8.2	10.0	8.7	7.1	31.0	25.0	17.9	103.5	33.5	34.6	62.2	19.7	22.7
Daum	1,034	17.9	16.5	13.5	1.9	1.8	1.6	2.0	1.9	1.7	7.0	7.0	6.2	10.5	11.0	12.3	8.4	9.3	10.3
Interpark	680	84.1	20.9	17.7	1.6	1.6	1.5	0.2	0.2	0.2	11.5	10.3	8.5	1.9	8.0	8.6	0.7	3.7	4.4
Google	376,228	N/A	20.7	17.5	N/A	3.1	2.9	N/A	7.2	6.1	17.1	12.3	10.3	15.6	17.9	18.2	12.2	14.4	15.0
Yahoo	35,258	33.0	21.8	19.0	2.7	2.6	2.4	8.8	7.8	7.6	30.7	23.3	21.9	9.5	11.4	12.1	7.8	6.0	6.5
Amazon	143,683	N/A	90.9	52.0	13.9	12.8	10.3	1.8	1.6	1.3	35.1	21.4	16.2	3.2	7.9	15.1	0.9	2.2	3.9
Facebook	157,448	81.8	43.0	33.6	9.4	8.7	6.9	17.0	13.3	10.1	31.3	19.9	15.1	13.4	19.4	21.0	11.2	18.9	20.4
Twitter	18,340	N/A	782.1	121.0	6.1	6.8	7.0	18.2	14.5	9.0	N/A	79.6	36.2	N/A	-6.1	-1.2	N/A	-7.4	-1.6
LinkedIn	18,983	N/A	94.5	61.8	6.9	6.6	6.0	10.9	8.9	6.7	111.2	31.9	21.9	-0.5	3.3	6.0	-0.4	2.8	5.1
Groupon	4,291	N/A	57.2	25.2	5.2	4.2	4.4	1.5	1.3	1.2	30.8	11.0	8.1	-16.2	5.3	14.1	-6.1	2.7	4.5
Yahoo Japan	25,596	21.0	19.8	17.6	4.2	3.6	3.1	6.8	5.2	4.7	N/A	9.6	8.1	21.5	19.2	18.4	15.8	14.3	14.3
Rakuten	16,339	36.9	27.6	22.1	5.4	4.6	3.8	3.0	2.8	2.5	14.5	11.3	9.5	15.9	18.3	19.2	1.6	2.0	2.5
Baidu	58,739	33.4	30.7	21.8	9.1	7.2	5.4	10.5	7.6	5.5	24.1	23.5	16.5	32.1	26.0	28.2	18.2	14.0	16.4
Sohu	2,287	N/A	N/A	N/A	1.8	2.0	2.0	1.6	1.3	1.1	10.6	N/A	13.3	-9.6	-12.6	-2.0	-3.7	-6.4	0.6
Sina	3,101	134.7	68.1	29.7	2.7	2.0	1.9	4.4	3.9	3.2	N/A	43.0	17.0	2.2	2.1	6.6	1.2	1.1	3.8
Youku	3,403	N/A	N/A	40.2	2.4	2.1	2.0	6.6	5.0	3.6	86.2	85.7	19.7	-6.3	-1.5	5.7	-5.4	-2.3	3.9
Tencent	N/A	N/A	166.6	131.1	N/A	49.7	37.5	N/A	N/A	N/A	31.5	N/A	N/A	32.8	32.8	32.1	17.1	18.3	18.7
Avg.		56.8	100.1	40.8	5.8	7.7	6.3	6.9	5.7	4.5	33.8	27.7	15.4	14.3	11.5	14.7	8.8	6.7	8.9

Note: Bloomberg consensus based on May 26th closing prices

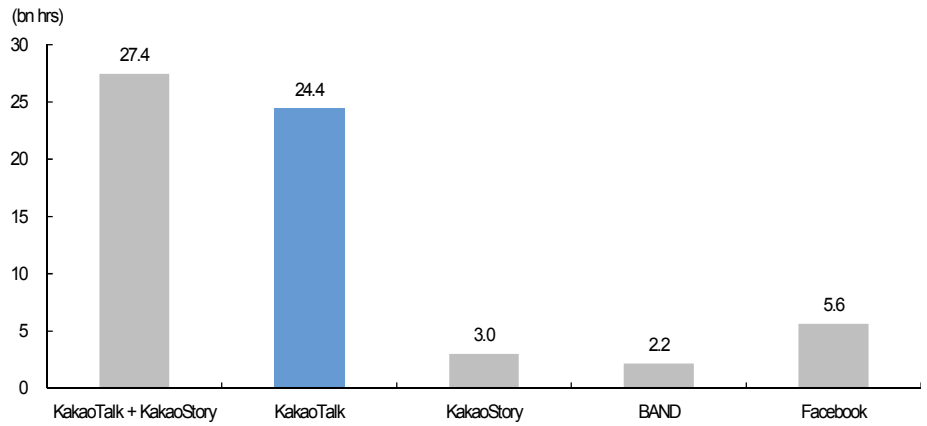
Source: Bloomberg, KDB Daewoo Securities Research

Figure 6. Average daily social networking service/instant messaging app usage



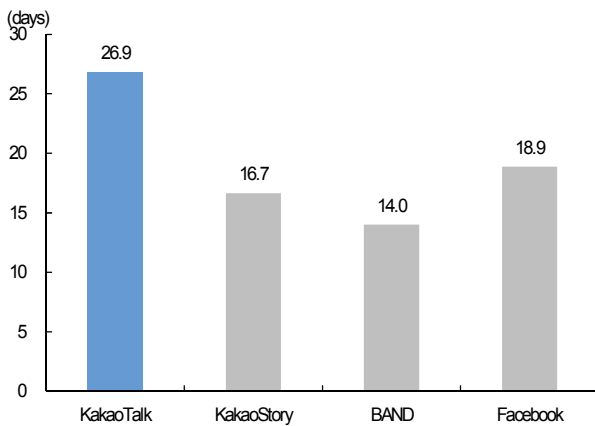
Note: Based on Apr. 2014 data
 Source: Koreanclick, KDB Daewoo Securities Research

Figure 7. Monthly social networking service/instant messaging app usage



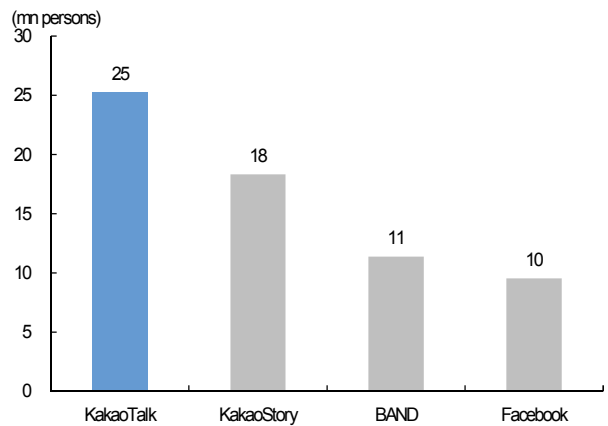
Note: Based on Apr. 2014 data
 Source: Koreanclick, KDB Daewoo Securities Research

Figure 8. Monthly average frequency of usage



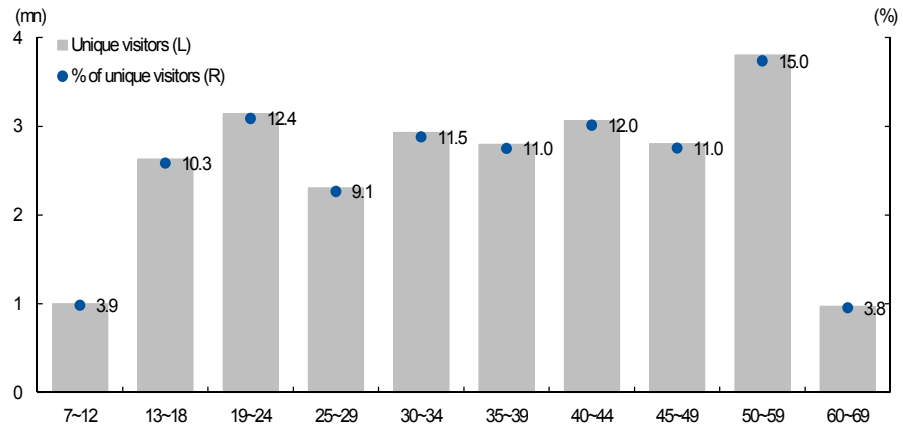
Note: Based on Apr. 2014 data
 Source: Koreanclick, KDB Daewoo Securities Research

Figure 9. Monthly unique visitors



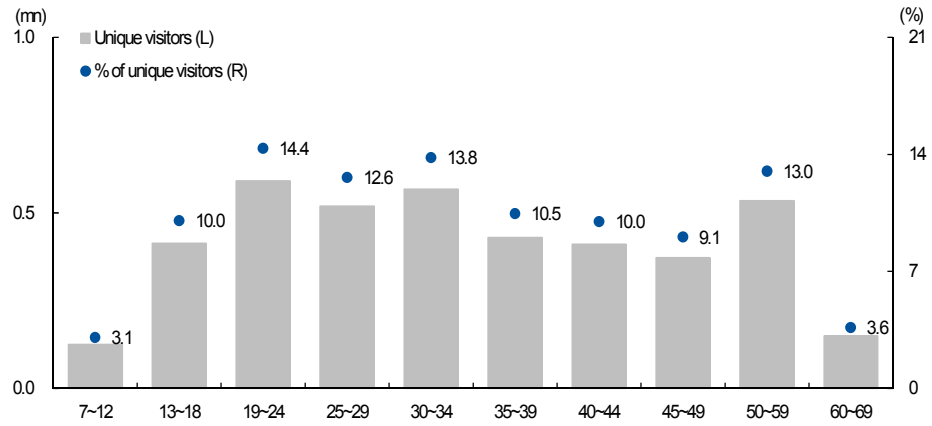
Note: Based on Apr. 2014 data
 Source: Koreanclick, KDB Daewoo Securities Research

Figure 10. User breakdown by age: KakaoTalk



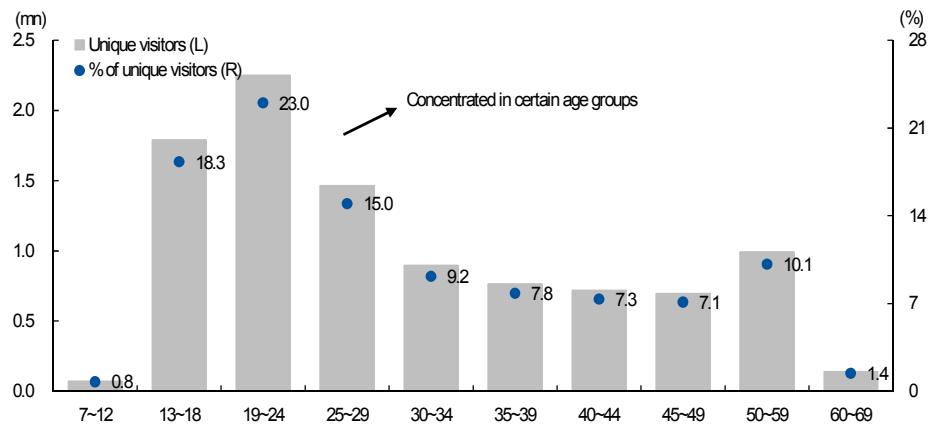
Note: Based on Apr. 2014 data
 Source: Koreanclick, KDB Daewoo Securities Research

Figure 11. User breakdown by age: LINE



Note: Based on Apr. 2014 data
 Source: Koreanclick, KDB Daewoo Securities Research

Figure 12. User breakdown by age: Facebook



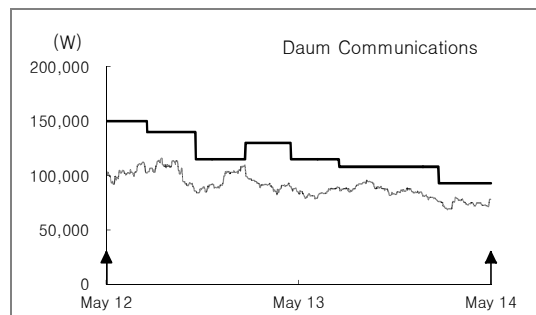
Note: Based on Apr. 2014 data
 Source: Koreanclick, KDB Daewoo Securities Research

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Daum Communications (035720)	02/16/2014	Buy	93,000
	08/11/2013	Buy	108,000
	05/12/2013	Buy	115,000
	02/14/2013	Buy	130,000
	11/12/2012	Buy	115,000
	08/12/2012	Buy	140,000
	05/24/2012	Buy	150,000



Stock Ratings

Buy	: Relative performance of 20% or greater
Trading Buy	: Relative performance of 10% or greater, but with volatility
Hold	: Relative performance of -10% and 10%
Sell	: Relative performance of -10%

Industry Ratings

Overweight	: Fundamentals are favorable or improving
Neutral	: Fundamentals are steady without any material changes
Underweight	: Fundamentals are unfavorable or worsening

Ratings and Target Price History (Share price (—), Target price (—), Not covered (■), Buy (▲), Trading Buy (■), Hold (●), Sell (◆))

* Our investment rating is a guide to the relative return of the stock versus the market over the next 12 months.

* Although it is not part of the official ratings at Daewoo Securities, we may call a trading opportunity in case there is a technical or short-term material development.

* The target price was determined by the research analyst through valuation methods discussed in this report, in part based on the analyst's estimate of future earnings.

* The achievement of the target price may be impeded by risks related to the subject securities and companies, as well as general market and economic conditions.

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