

# Securities

## (Overweight/Maintain)

### KRX holding company conversion back on the table

- The government is seeking to put the KRX holding company bill to a vote
- If the bill is passed during the September plenary session, KRX IPO could take place in 1H17
- Short-term impact: IPO gains; Long-term impact: Increased brokerage income
- Key beneficiaries: 1) Firms with large KRX stakes, 2) large players with a competitive advantage in brokerage, and 3) Kiwoom Securities

### KRX holding company conversion back on the table

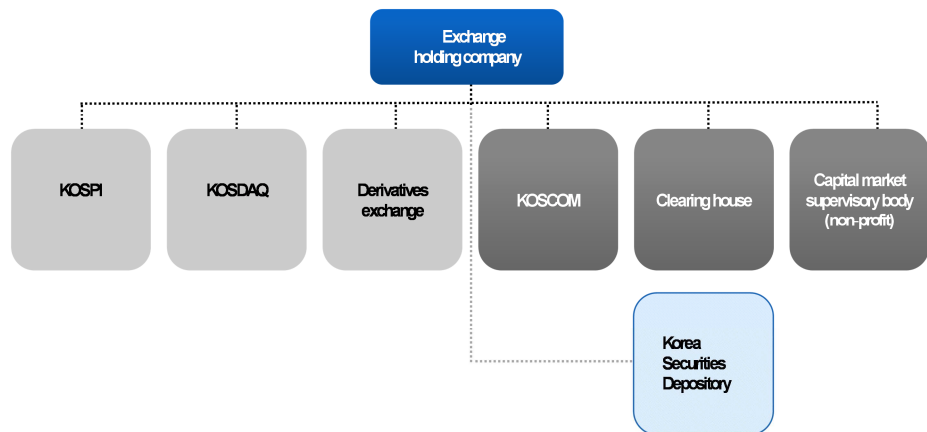
The government is seeking to bring back a bill revising the capital market law that would allow the Korea Exchange (KRX) to convert into a holding company structure.

The bill, which failed to make it to a vote in the National Assembly's previous session, will be resubmitted to the National Policy Committee with the recent opening of the 20<sup>th</sup> Assembly. Under the bill, the KRX would switch to a holding company and spin off the KOSPI, KOSDAQ, and derivatives exchange into subsidiaries.

If the bill is passed during the September plenary session, the holding company conversion is likely to take place in 1H17 and be immediately followed by an IPO.

As part of the IPO, discussions will likely be held regarding shareholders' contribution of a portion of related gains to a public fund.

**Figure 1. Exchange holding company governance structure**



Source: FSC, Mirae Asset Daewoo Research

### Short-term impact: Brokerage firms to enjoy IPO gains

A KRX IPO would enable many brokerage firms to unlock the value of their stakes in the exchange, thereby 1) increasing their book value, 2) boosting their leverage capacity, and 3) removing existing restrictions on stake disposals. Currently, major brokerage firms each own around 3-8% stakes in the KRX.

Given the business nature of stock exchanges, we think the KRX could fetch a high valuation. Foreign exchanges tend to trade at high premiums, especially in Asia. This is because the market tends to assign higher P/B multiples to financial sectors that have low cost of capital (i.e., investors' opportunity costs) as well as low fixed costs, the primary examples being exchanges and asset managers. In particular, exchanges are less exposed to the risks facing most of the financial industry (due to their commission-based, stable profit structure), and have low cost of capital because of their monopolistic positions. And unlike other financial firms, exchanges are not bound by stringent capital requirements and therefore have more financial room to pay dividends. Expense-wise, they are spared from spending money on competition and enjoy near-zero marginal costs (i.e., higher revenue does not lead to higher costs).

A rise in the value of KRX shares will also provide a financial buffer for brokerage firms nearing regulatory leverage limits.

Some brokerage firms have already reached their maximum leverage capacity as a result of strong asset inflows and a surge in ELS issuance. (From 2016, firms with a leverage ratio of over 1,100% are issued a recommendation for management improvement.) Thus, if the value of their KRX stakes appreciates post-IPO, this would free up more room for leverage. Furthermore, the increased value of KRX shares as collateral would also strengthen brokerage firms' position when doing business with other institutions.

### Long-term impact: Cross-border trading could be new income source

Once the KRX is listed, its performance will come under greater public scrutiny. As such, we believe the bourse will make various efforts to strengthen its growth and profits. This could include the exchange trading of ELS, or the listing of foreign ETFs and other securities. The KRX could also potentially use its IPO proceeds or treasury shares to purchase stakes in foreign exchanges.

Many foreign exchanges have already taken steps to introduce regional cross-border trading programs and strengthen alliances through stake acquisitions and M&As. A recent example is the planned merger between the London Stock Exchange Group and Deutsche Boerse announced in March. Following China's launch of the Shanghai-Hong Kong Stock Connect, many exchange operators in Asia have been focusing on cross-border trading to attract capital flows. The Japan Exchange Group, which went public in 2013 after switching to a holding company, has been working with exchange operators in Singapore and Taiwan to introduce cross-trading programs. Following its failed merger with Australia's stock exchange, the Singapore Exchange has also been expanding cross-border trading in the Southeast Asian region.

Being publicly listed makes it easier for exchanges to form strategic alliances and pursue M&As, and encourages them to identify new products and services in order to enhance shareholder value.

Meanwhile, slowing top- and bottom-line growth has made domestically listed companies less appealing to investors. This, along with falling commission rates, has made it challenging for firms to expand the profit margins of their traditional brokerage businesses.

If the KRX lays the foundation for cross-border trading following its IPO, we think this could present a new opportunity for the brokerage industry. For investors, this could significantly reduce the cost of directly investing in foreign stocks (currently, commissions and currency conversions can reach 1.5% of transaction value), while providing a wider selection of investments and strategies (such as long/short ETFs or pair trading of domestic and foreign stocks in the same sector).

### Key beneficiaries: Large firms and Kiwoom Securities

In terms of IPO profit gains, we believe NH Investment & Securities (NH I&S), Hanwha I&S, and Meritz Securities would benefit the most, as they have sharply increased their stakes following their respective mergers. Smaller firms, who own large stakes relative to their equity, should also benefit. That said, actual gains will likely vary depending on how much of the gains will be required to be returned.

From a cross-trading perspective, we believe key beneficiaries would be 1) large firms that have expanded their customer base through M&As and have competitive advantages in the brokerage business, and 2) Kiwoom Securities, which is favorably positioned in the online brokerage segment.

**Table 1. Securities firms' stakes in KRX**

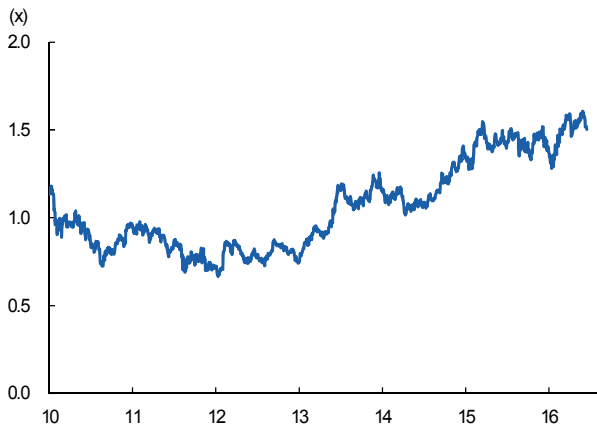
(Wbn, shares, %)

Company	Market cap	Equity capital (as of Dec. 2015)	KRX ownership				Post-IPO value (2.0x P/B)	Post-IPO value relative to equity capital
			No. of shares	Stake	Acquisition value	Book value		
NH I&S	2,686	4,551	1,490,646	7.45	12	212	330	7.2
Meritz Securities	1,552	1,719	1,165,345	5.83	10	166	258	15.0
Hanwha I&S	242	783	1,000,000	5.00	69	142	221	28.3
Yuanta Securities	676	990	691,091	3.46	6	98	153	15.4
Samsung Securities	2,664	3,524	669,845	3.35	10	95	148	4.2
Mirae Asset Daewoo	2,620	4,385	646,107	3.23	2	92	143	3.3
Daishin Securities	783	1,732	644,885	3.22	3	92	143	8.2
Golden Bridge	66	144	624,851	3.12	3	89	138	95.7
Hyundai Securities	1,495	3,302	624,190	3.12	3	89	138	4.2
Eugene I&S	233	614	608,185	3.04	2	87	135	21.9
Shinyoung Securities	807	1,069	602,692	3.01	3	86	133	12.5
Bookook Securities	248	424	595,415	2.98	2	85	132	31.1
Kyobo Securities	336	686	588,444	2.94	2	84	130	19.0
Yuhwa Securities	231	469	584,092	2.92	2	83	129	27.5
Hanyang Securities	100	263	577,846	2.89	5	82	128	48.7
HMC Securities	290	720	574,784	2.87	3	82	127	17.7
SK Securities	345	411	572,668	2.86	2	82	127	30.8
Dongbu Securities	149	685	565,076	2.83	7	81	125	18.3

Note: Stakes are recognized at 1.3x value

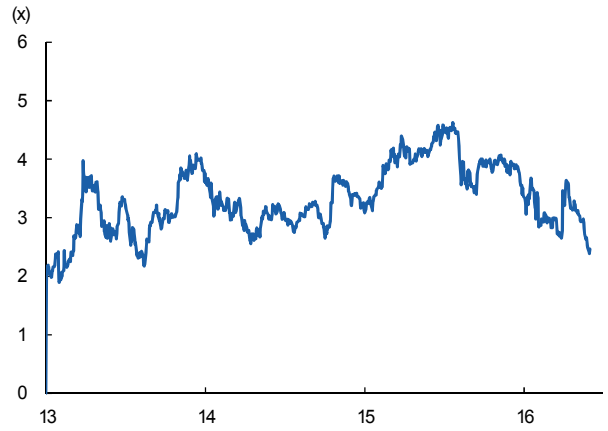
Source: KRX, Mirae Asset Daewoo Research

**Figure 2. CME Group's P/B trend**



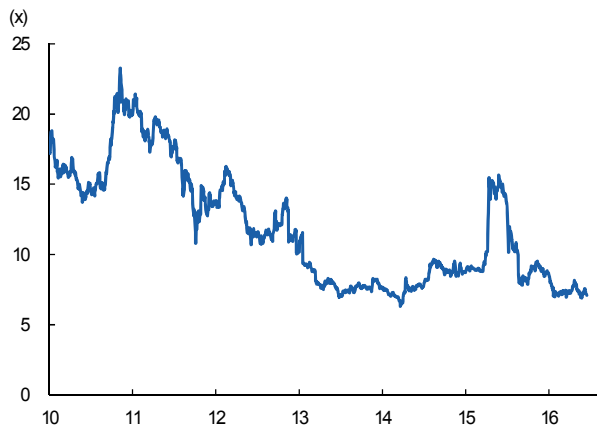
Source: DataStream, Mirae Asset Daewoo Research

**Figure 3. Japan Exchange Group's P/B trend**



Source: DataStream, Mirae Asset Daewoo Research

**Figure 4. Hong Kong Exchanges and Clearing's P/B trend**



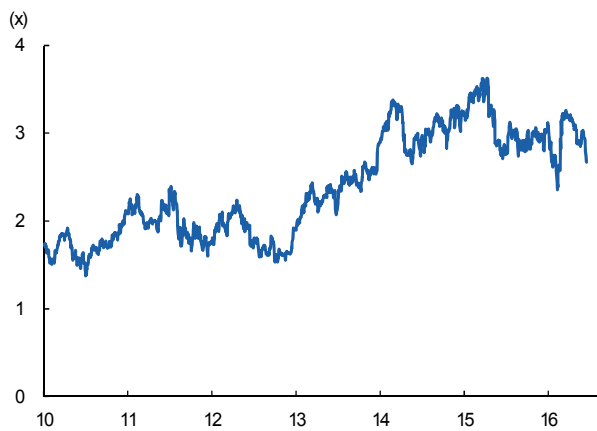
Source: DataStream, Mirae Asset Daewoo Research

**Figure 5. Singapore Exchange's P/B trend**



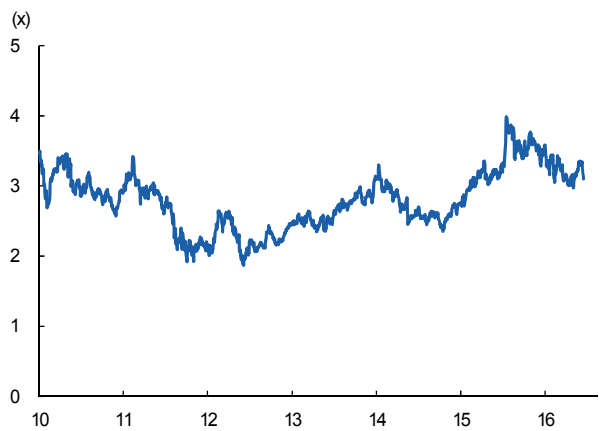
Source: DataStream, Mirae Asset Daewoo Research

**Figure 6. London Stock Exchange Group's P/B trend**



Source: DataStream, Mirae Asset Daewoo Research

**Figure 7. Deutsche Boerse's P/B trend**



Source: DataStream, Mirae Asset Daewoo Research

## APPENDIX 1

### Equity Ratings Distribution

Buy	Trading Buy	Hold	Sell
68.29%	17.56%	14.15%	0.00%

\* Based on recommendations in the last 12-months (as of March 31, 2016)

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