MIRAE ASSET
Building on principles

Lotte Himart
(071840 KS)

Earnings are key

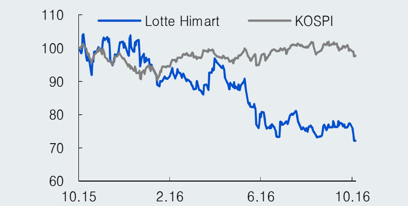
Retail

Results Comment
November 7, 2016

(Maintain)	**Buy**
Target Price (12M, W)	**60,000**
Share Price (11/04/16, W)	42,000
Expected Return	43%

OP (16F, Wbn)	167
Consensus OP (16F, Wbn)	160
EPS Growth (16F, %)	8.3
Market EPS Growth (16F, %)	17.5
P/E (16F, x)	8.6
Market P/E (16F, x)	10.6
KOSPI	1,982.02
Market Cap (Wbn)	992
Shares Outstanding (mn)	24
Free Float (%)	33.6
Foreign Ownership (%)	8.3
Beta (12M)	1.02
52-Week Low	42,000
52-Week High	60,600

(%)	1M	6M	12M
Absolute	-5.2	-24.2	-30.6
Relative	-1.7	-24.4	-28.1



Mirae Asset Daewoo Co., Ltd.

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Enjoying attractive valuation while earnings improve

Lotte Himart's shares have been weak for some time, which we attribute to a series of below-consensus results that damaged investors' confidence in the company's earnings. Despite high expectations for 3Q earnings, share weakness persisted due to already-low investor confidence. However, we believe the stronger-than-expected 3Q results helped dispel investors' concerns.

Still, some worry about the company's long-term growth and profitability. We believe the offline retail channel is unlikely to see robust growth, and it is also true that the low profitability of shop-in-shop channel has pressured overall margins.

However, concerns appear to have been excessively priced in. Moreover, we expect revenue to continue to expand through online channel growth, and shop-in-shop profitability is likely to improve. With earnings improving, we recommend buying shares, which are attractively valued at the moment.

3Q16 review: OP beats consensus

For 3Q16, Lotte Himart reported revenue of W1.12tr (+5.5% YoY), and operating profit of W66.4bn (+18.2% YoY). The latter significantly beat the consensus of W62.7bn. By product category, sales of mobile products were soft, but air conditioner sales surged 50%, driving top-line growth. We estimate the sales mix of the online channel increased to around 5% of total revenue, continuing its robust growth.

Operating profit was driven mainly by mobile products' lower revenue contribution and gross margin improvement resulting from expanded sales of white goods. As for SG&A expenses, labor costs increased more than expected, as bonus payouts of W3bn were recognized and installation costs surged due to higher sales of air conditioners. Commissions and delivery costs continued to increase significantly.

Given solid sales of air conditioners in 3Q, we believe gross margin is unlikely to continue to improve. We forecast high increases in commissions as well as delivery costs, as robust growth of online sales is expected. Nevertheless, we still expect operating profit in 4Q to grow 20.1% YoY to W31.8bn.

Maintain Buy and TP of W60,000

We maintain our Buy rating on Lotte Himart with a target price of W60,000. We forecast earnings to improve through 4Q, which will help the stock continue its uptrend even after a short-term rebound driven by valuation merits. The stock's additional upside potential hinges on the sales trend of the online channel and possible benefits to the company from housing supply expansion.

FY (Dec)	12/13	12/14	12/15	12/16F	12/17F	12/18F
Revenue (Wbn)	3,519	3,754	3,896	4,017	4,238	4,439
OP (Wbn)	185	144	160	167	180	189
OP margin (%)	5.3	3.8	4.1	4.2	4.2	4.3
NP (Wbn)	129	96	107	115	128	139
EPS (W)	5,469	4,085	4,515	4,892	5,430	5,876
ROE (%)	8.4	5.9	6.1	6.3	6.6	6.7
P/E (x)	16.0	16.5	13.1	8.6	7.7	7.1
P/B (x)	1.3	0.9	0.8	0.5	0.5	0.5

Note: All figures are based on consolidated K-IFRS; NP refers to net profit attributable to controlling interests
Source: Company data, Mirae Asset Daewoo Research estimates

Table 1. 3Q16P review **(Wbn, %)**

	3Q15	2Q16	3Q16P			Growth (%)		Diff. (%)
			Preliminary (A)	Mirae Asset Daewoo	Consensus (B)	YoY	QoQ	(A vs. B)
Revenue	1,063	951	**1,121**	1,129	1,131	5.5	18.0	-0.9
Operating profit	56	41	**66**	62	63	18.2	62.7	5.9
OP margin	5.3	4.3	**5.9**	5.5	5.5			
Pretax profit	52	38	**64**	59	58	22.1	67.9	10.1
Net profit	40	29	**46**	44	45	15.7	58.9	2.1

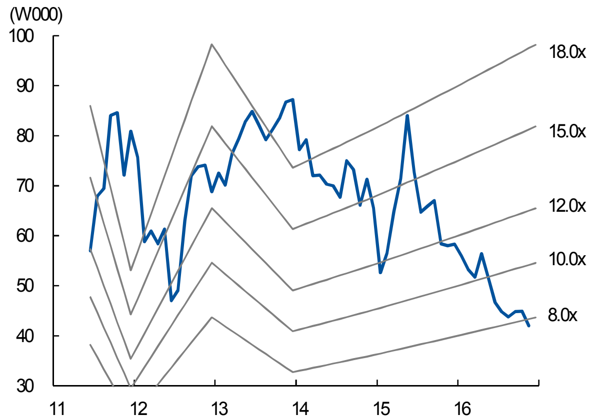
Source: Company data, Bloomberg, Mirae Asset Daewoo Research estimates

Table 2. Quarterly and annual earnings **(Wbn, %)**

	2016				2017F				2015	2016F	2017F	Growth (%)		
	1Q16	2Q16	3Q16P	4Q16F	1Q17F	2Q17F	3Q17F	4Q17F				3Q16	2016F	2017F
Revenue	888	951	1,122	1,057	934	1,016	1,179	1,106	3,896	4,017	4,235	5.5	3.1	5.4
Stand-alone stores	681	751	895	845	703	785	924	865	3,163	3,173	3,278	2.7	0.3	3.3
Shop-in-shops	175	152	168	150	177	156	172	153	647	645	657	1.2	-0.2	1.8
Online	32	47	58	63	54	75	83	88	88	199	300	130.0	125.0	51.0
No. of stores	438	442	448	456	457	460	461	464	440	456	464	2.5	3.6	1.8
Stand-alone stores	332	336	342	349	350	352	353	355	334	349	355	3.0	4.5	1.7
Shop-in-shops	106	106	106	107	107	108	108	109	106	107	109	1.0	0.9	1.9
Revenue per store	2.0	2.2	2.5	2.3	2.0	2.2	2.6	2.4	8.9	8.8	9.1	2.9	-0.5	3.6
Stand-alone stores	2.1	2.2	2.6	2.4	2.0	2.3	2.6	2.4	9.5	9.1	9.2	0.4	-4.0	1.6
Shop-in-shop	1.6	1.4	1.6	1.4	1.7	1.4	1.6	1.4	6.2	6.1	6.1	0.2	-2.1	0.4
Gross profit	215	252	296	250	224	266	304	261	963	1,013	1,056	10.8	5.1	4.2
Operating profit	28	41	66	32	31	45	69	35	160	167	180	18.2	4.3	7.6
Gross margin	24.2	26.5	26.4	23.6	24.0	26.2	25.8	23.6	24.7	25.2	24.9			
OP margin	3.2	4.3	5.9	3.0	3.3	4.5	5.8	3.2	4.1	4.2	4.2			

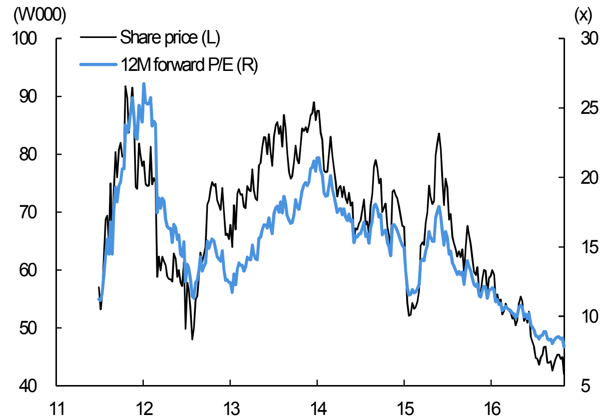
Notes: Stand-alone, shop-in-shop, and online data are estimates
Source: Company data, Mirae Asset Daewoo Research estimates

Figure 1. 12-month forward P/E trend



Source: Mirae Asset Daewoo Research

Figure 2. P/E trend



Source: Mirae Asset Daewoo Research

Lotte Himart (071840 KS/Buy/TP: W60,000)

Comprehensive Income Statement (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Revenue	**3,896**	**4,017**	**4,238**	**4,439**
Cost of Sales	**2,933**	**3,003**	**3,182**	**3,343**
Gross Profit	**963**	**1,014**	**1,056**	**1,096**
SG&A Expenses	**803**	**847**	**876**	**907**
Operating Profit (Adj)	**160**	**167**	**180**	**189**
Operating Profit	**160**	**167**	**180**	**189**
Non-Operating Profit	**-17**	**-11**	**-6**	**0**
Net Financial Income	-18	-12	-6	0
Net Gain from Inv in Associates	0	0	0	0
Pretax Profit	143	156	174	189
Income Tax	37	40	46	50
Profit from Continuing Operations	107	115	128	139
Profit from Discontinued Operations	0	0	0	0
Net Profit	107	115	128	139
Controlling Interests	107	115	128	139
Non-Controlling Interests	0	0	0	0
Total Comprehensive Profit	**105**	**114**	**128**	**137**
Controlling Interests	105	114	128	137
Non-Controlling Interests	0	0	0	0
EBITDA	213	219	231	240
FCF (Free Cash Flow)	89	92	115	124
EBITDA Margin (%)	5.5	5.5	5.5	5.4
Operating Profit Margin (%)	4.1	4.2	4.2	4.3
Net Profit Margin (%)	2.7	2.9	3.0	3.1

Statement of Financial Condition (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Current Assets	**640**	**726**	**843**	**973**
Cash and Cash Equivalents	130	146	243	353
AR & Other Receivables	69	94	102	103
Inventories	416	470	481	499
Other Current Assets	25	16	17	18
Non-Current Assets	**2,265**	**2,272**	**2,283**	**2,292**
Investments in Associates	0	0	0	0
Property, Plant and Equipment	422	418	431	444
Intangible Assets	1,705	1,704	1,699	1,696
Total Assets	**2,905**	**2,998**	**3,126**	**3,265**
Current Liabilities	**638**	**442**	**452**	**464**
AP & Other Payables	280	293	306	318
Short-Term Financial Liabilities	285	70	70	0
Other Current Liabilities	73	79	76	146
Non-Current Liabilities	**484**	**670**	**669**	**670**
Long-Term Financial Liabilities	469	649	649	0
Other Non-Current Liabilities	15	21	20	670
Total Liabilities	**1,122**	**1,112**	**1,121**	**1,134**
Controlling Interests	**1,783**	**1,887**	**2,005**	**2,131**
Capital Stock	118	118	118	118
Capital Surplus	1,056	1,056	1,056	1,056
Retained Earnings	608	714	832	960
Non-Controlling Interests	**0**	**0**	**0**	**0**
Stockholders' Equity	**1,783**	**1,887**	**2,005**	**2,131**

Cash Flows (Summarized)

(Wbn)	12/15	12/16F	12/17F	12/18F
Cash Flows from Op Activities	120	140	175	184
Net Profit	107	115	128	139
Non-Cash Income and Expense	127	114	103	102
Depreciation	49	47	47	48
Amortization	3	5	4	3
Others	75	62	52	51
Chg in Working Capital	-88	-43	-10	-7
Chg in AR & Other Receivables	3	-28	-6	0
Chg in Inventories	-59	-54	-11	-18
Chg in AP & Other Payables	4	4	10	9
Income Tax Paid	**-25**	**-46**	**-46**	**-50**
Cash Flows from Inv Activities	-85	-62	-51	-46
Chg in PP&E	-31	-48	-60	-60
Chg in Intangible Assets	-11	-4	0	0
Chg in Financial Assets	-54	-12	-2	-1
Others	**11**	**2**	**11**	**15**
Cash Flows from Fin Activities	-11	-61	-27	-27
Chg in Financial Liabilities	21	-35	0	0
Chg in Equity	0	0	0	0
Dividends Paid	-8	-10	-10	-10
Others	**-24**	**-16**	**-17**	**-17**
Increase (Decrease) in Cash	25	16	98	110
Beginning Balance	105	130	146	243
Ending Balance	**130**	**146**	**243**	**353**

Forecasts/Valuations (Summarized)

	12/15	12/16F	12/17F	12/18F
P/E (x)	13.1	8.6	7.7	7.1
P/CF (x)	6.0	4.3	4.3	4.1
P/B (x)	0.8	0.5	0.5	0.5
EV/EBITDA (x)	9.5	7.1	6.3	5.6
EPS (W)	4,515	4,892	5,430	5,876
CFPS (W)	9,887	9,708	9,804	10,185
BPS (W)	75,519	79,916	84,916	90,277
DPS (W)	430	430	430	430
Payout ratio (%)	9.5	8.8	7.9	7.3
Dividend Yield (%)	0.7	1.0	1.0	1.0
Revenue Growth (%)	3.8	3.1	5.5	4.7
EBITDA Growth (%)	8.1	2.8	5.5	3.9
Operating Profit Growth (%)	11.1	4.4	7.8	5.0
EPS Growth (%)	10.5	8.3	11.0	8.2
Accounts Receivable Turnover (x)	74.3	65.1	57.8	58.1
Inventory Turnover (x)	10.1	9.1	8.9	9.1
Accounts Payable Turnover (x)	16.0	14.8	14.7	14.8
ROA (%)	3.8	3.9	4.2	4.3
ROE (%)	6.1	6.3	6.6	6.7
ROIC (%)	5.3	5.3	5.6	5.9
Liability to Equity Ratio (%)	63.0	58.9	55.9	53.2
Current Ratio (%)	100.3	164.4	186.4	209.8
Net Debt to Equity Ratio (%)	34.9	30.3	23.6	17.0
Interest Coverage Ratio (x)	6.7	9.3	10.7	11.3

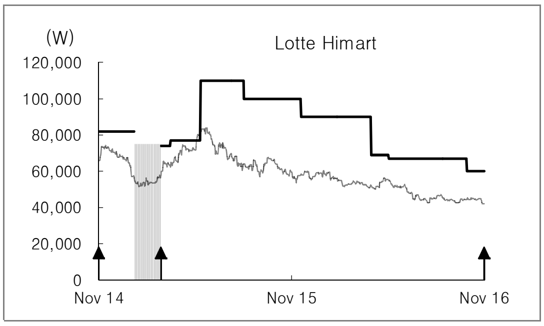
Source: Company data, Mirae Asset Daewoo Research estimates

APPENDIX 1

Important Disclosures & Disclaimers

2-Year Rating and Target Price History

Company (Code)	Date	Rating	Target Price
Lotte Himart(071840)	10/04/2016	Buy	60,000
	05/09/2016	Buy	67,000
	04/06/2016	Buy	69,000
	11/25/2015	Buy	90,000
	08/09/2015	Buy	100,000
	05/19/2015	Buy	110,000
	03/23/2015	Buy	77,000
	03/05/2015	Buy	74,000
		No Coverage	
	08/06/2014	Buy	82,000



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 Mirae Asset Daewoo Co., Ltd., 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.

Equity Ratings Distribution

Buy	Trading Buy	Hold	Sell
69.27%	17.07%	13.66%	0.00%

* Based on recommendations in the last 12-months (as of September 30, 2016)

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